

CARIBBEAN ECONOMICS

Quarterly



Dealing with Debt in the Caribbean



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Regional Overview – Dealing with Debt in the Caribbean

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Introduction

During the COVID-19 pandemic, governments around the world borrowed more. The pandemic generated costs to public health systems to treat those infected with COVID-19 and provide vaccinations to combat its spread. Restrictions on mobility led to economic recessions that contributed to declines in government revenues. Economic recessions caused a rise in unemployment and had other social impacts that required a response in the form of increased government expenditures. Higher spending combined with lower revenues implied that government deficits increased, and governments borrowed to finance those deficits.


Public debt dynamics, in turn, are shaped by many economic variables that are not fully within the control of governments, including economic growth and interest rates.¹ Government policies can influence both of these variables domestically, but other factors beyond a government's control are important as well. COVID-19 is still with us, but the pandemic is not. Economic recovery took hold at a varied pace in 2022 and 2023 in most countries around the world. The recovery helps governments deal with debt through growth of the tax base and, as such, improved ability to service debt. On the other hand, central banks around the world have increased interest rates to address the recent bout of inflation driven by global supply shocks, among other factors.² Higher interest rates make it more expensive to borrow, and as such, higher interest rates increase the financial burden of debt.

As explained in more detail in the next section, the difference between interest rates and economic growth matters greatly for debt dynamics. When interest rates are higher than economic growth rates, there is a natural tendency for debt-to-GDP ratios to increase, which makes it necessary to tighten fiscal policy. When interest rates are lower than economic growth rates, fiscal policy can be more relaxed and still stabilize debt-to-GDP ratios. As stated by Nobel Laureate Paul Krugman in late September 2023 in reference to the situation in the United States:

“...if the real interest rate is lower than the economy's growth rate ($r < g$), debt isn't really a burden because the ratio of debt to gross domestic product tends to fall even if the government is running deficits. Indeed, in a low-rate world, budget deficits may actually be good....But now, suddenly, real interest rates are above most estimates of the economy's long-run growth rate. If this reversal persists, the

¹ Exchange rate movements and fiscal outcomes might also be considered outside of the government's full control.

² See the 2nd Quarter 2023 edition of the Caribbean Economics Quarterly. <https://publications.iadb.org/en/caribbean-economics-quarterly-volume-12-issue-2-global-and-regional-economies-crossroads>



sustainability of high debt will become a major issue for the first time in many years.”³

Many countries in Latin America and especially the Caribbean have struggled with public indebtedness for decades, but some have transitioned to relatively low and stable debt levels by strengthening fiscal institutions and macroeconomic institutions more generally. The 2022 Development in the Americas (DIA) report published by the IDB, *Dealing with Debt: Less Risk for More Growth in Latin America and the Caribbean*, focuses on both public and private debt (Powell and Valencia 2022). As the title suggests, debt in and of itself is not necessarily bad, but prudent management of debt can reduce risks and improve the investment climate, creating the basis for stronger economic growth. For example, Latin American and Caribbean countries that rank in the highest 25 percent of countries in the region in terms of public debt-to-GDP ratios experienced economic growth rates that were less than half of countries with lower ratios (Powell and Valencia 2022, Figure 8.2, panel A).


Unlike the DIA, this focuses only on public debt in the Caribbean.⁴ Many Caribbean countries entered the pandemic with high public debt-to-GDP ratios, and during the pandemic countries that specialized in tourism suffered some of the largest declines in GDP in the world. As explored in detail in previous editions of this report, the Caribbean is the most tourism-dependent region of the world (Mooney and Zegarra 2020). The almost inevitable sharp increases in debt-to-GDP ratios in the region because of the pandemic are now declining across the Caribbean.

Key findings from the analysis of both this Regional Overview and the country sections of this edition of the Caribbean Economics Quarterly are as follows:

- Several channels can influence public debt trajectories—interest rates, inflation, exchange rates, economic growth, primary balances and stock-flow adjustments. All these elements have played a role in the evolution of public debt-to-GDP ratios in Caribbean countries over the last decade, but to varying degrees depending on the specific country circumstances.
- There are examples of large reductions in public debt-to-GDP ratios via a combination of institutional reforms and sustained primary fiscal surpluses (Jamaica) or more recent explosive economic growth (Guyana).
- Debt restructuring has also played an important role in reducing debt ratios in several countries.

³ *New York Times*, September 29, 2023. <https://www.nytimes.com/2023/09/29/opinion/natural-interest-rate-higher.html>

⁴ This Caribbean Economics Quarterly focuses on the six countries of the IDB's Caribbean Country Department: The Bahamas, Barbados, Guyana, Jamaica, Suriname, and Trinidad and Tobago.

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- Governments have a direct influence over primary balances and borrowing, so public debt is referred to in the literature as “weakly” sustainable when primary balances move in tandem with public debt. In other words, governments engage in a fiscal response by raising revenues and/or decreasing expenditures whenever public debt increases, thus reversing the trend. Recent research indicates that Caribbean public debt is “weakly” sustainable.
 - Recent research also indicates that half of Caribbean countries’ public debt-to-GDP levels are above the maximum “safe” debt limits, as calculated in the above-mentioned DIA report.
 - Institutional strengthening of Debt Management Offices (DMOs) can play an important role in reducing risks of debt distress for a given level of indebtedness. The World Bank’s Debt Management Performance Assessment Methodology (DeMPA) provides guidance on the key features of strong DMOs.
 - The attainment of a prudent, or “safe,” level of public debt requires a strong medium-term fiscal framework, often supported by fiscal rules.


Given these global and regional trends, it seems an appropriate moment to reexamine the status of public indebtedness in the Caribbean, with an eye to determining how the recent literature on this topic can inform policies and institutional reforms. Long-term debt, by definition, has long-term implications. Institutional foundations are thus required to ensure long-term economic sustainability while also reducing the risk of short-term economic stress.

A Primer on Debt Dynamics

Public debt is not necessarily bad, so long as it is used to finance initiatives with a positive social impact like high-return infrastructure investments or social programs to cushion the impact of an external economic shock (e.g., the pandemic). However, public debt, just like personal or household debt, needs to be maintained at affordable levels.

Defining affordability for a household can be a bit complex, but there are even more complexities when defining affordability for governments. Income-earning individuals in the household do not work (or live) forever. However, while government administrations come and go through the electoral cycle, the government itself lives on, essentially forever. The government’s income that can be used for paying debt service is mostly in the form of taxes and fees.⁵ Unlike households, governments can pass laws that affect the share of national income that is collected via taxes and fees. Finally, governments are economically large, which means that their use of available

⁵ There can also be income-earned profits of state-owned enterprises (if profitable) and financial investments in savings funds or sovereign wealth funds.



national savings through borrowing can affect how much savings remain available for the private sector. This form of “crowding out” can have impacts on private investment and the long-term rate of economic growth.

One relatively weak way of establishing affordability, therefore, is to ensure that public debt is not on an explosive path. The simplest way to measure this is to examine the debt-to-GDP ratio, understand the determinants of the evolution of that ratio, and assess whether those determinants indicate a stable ratio.⁶ This is a weak criterion because it does not consider potential crowding-out effects mentioned above. It also does not consider potential liquidity risks from the need to roll over short-term debt, or implicit or contingent liabilities that are not accounted for in public debt, such as the liabilities of state-owned enterprises (SOEs), financial sector risks (that could precipitate a government bailout), and pensions. In brief, a stable debt-to-GDP ratio is essential over time, but the level of debt to GDP also matters for reducing risks, as will be discussed in more detail below.

The debt crises of developing countries in the 1980s inspired economists to analyze debt dynamics using a coherent mathematical approach.⁷ In managing the debt the government has direct influence over the so-called primary balance: the difference between revenues and primary expenditures, which are all expenditures except interest expenditures. If the primary balance is zero, then the overall deficit is equal to total interest expenditures. If that deficit is financed by debt (which is usually the case), then the level of debt will grow by the amount of interest expenditures. This is why the interest rate itself is so important to debt dynamics. Finally, the denominator of the debt-to-GDP ratio obviously evolves over time according to economic growth.

This is the basic intuition as to why the difference between the interest rate and economic growth is so important to debt dynamics. The precise mathematics are derived in a variety of sources,⁸ but the simple rule of thumb is that the primary surplus (as a percent of GDP) required to achieve debt sustainability at time t is the difference between the interest rate and growth rates times the stock of debt:

$$(r_t - g_t)d_{t-1},$$

where r is the interest rate, g is the growth rate of GDP, and d is the stock of debt as a percent of GDP.⁹ The interest and growth rates can be in either nominal or real terms, so long as consistency

⁶ Economists such as Bohn (1998) use the term “stationary” to describe this condition. Alternatively, when the ratio is non-stationary, Trehan and Walsh (1988) show that if both the primary balance and the debt ratio are cointegrated (i.e., they move together), this condition is almost met.

⁷ See Smith and Cuddington (1985) for one of the early key contributions.

⁸ See Debrun et al. (2020) for an excellent summary.

⁹ The more precise derivation is $(r-g)/(1+g)*d$. The economic growth rate is usually small, especially if the parameters are in real terms, so the denominator of the precise derivation does not dramatically change the estimated required primary balance.



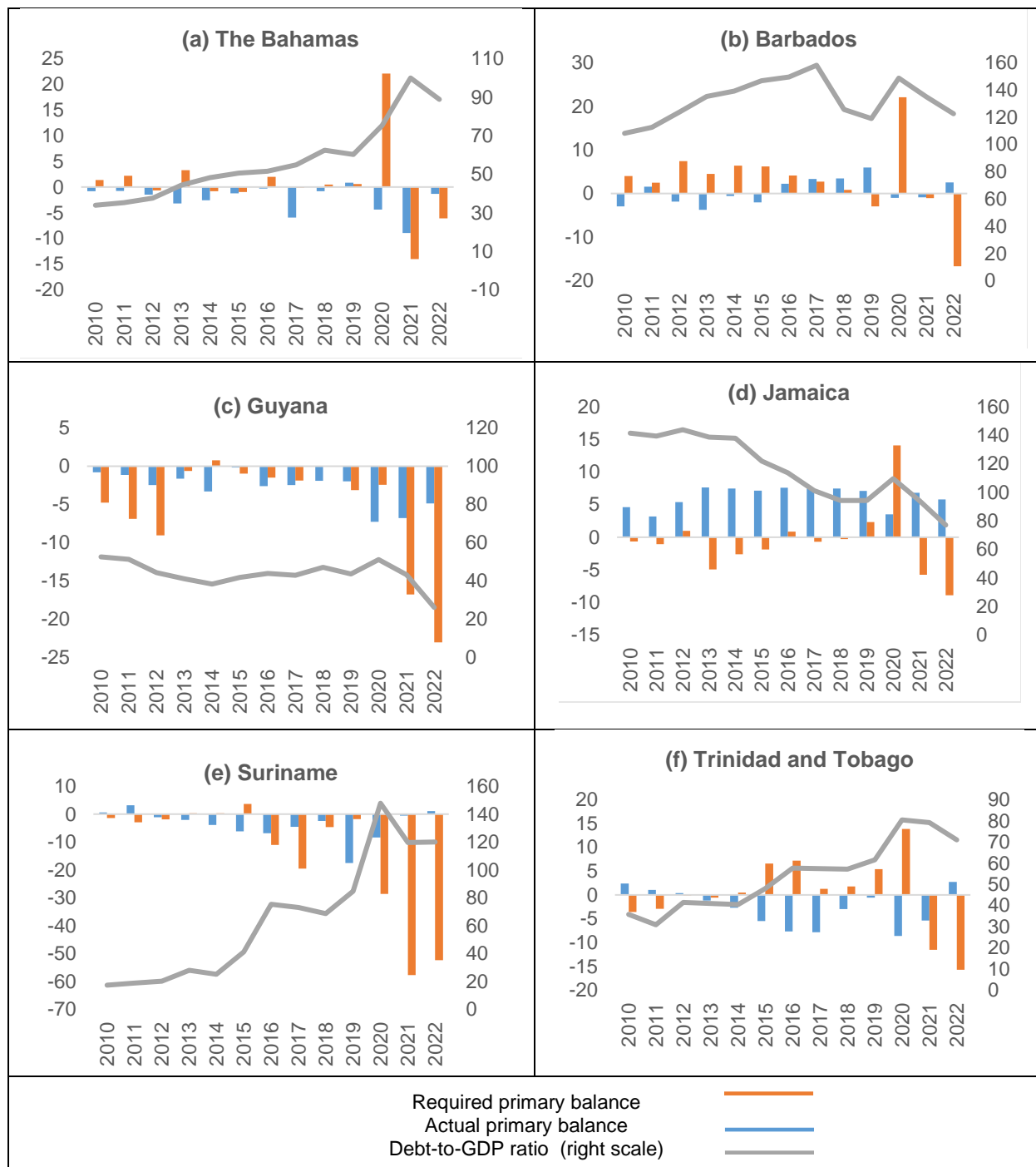
is maintained. So, if the stock of public debt is 100 percent of GDP and the interest–growth differential is 3 percent, then the required primary surplus for stabilizing debt to GDP is 3 percent of GDP. Naturally, as noted in the Krugman quote in the introduction, if the interest–growth differential is negative, then a government can run primary deficits (of a limited nature) and still stabilize the debt-to-GDP ratio. In the mathematics of debt dynamics, the primary balance is considered the “control” variable.

It is important to note that assessments of debt stability are generally forward-looking, so one needs to make assumptions about long-term interest rates and growth. It is also important to note that changes in interest rates affect debt accumulation gradually, as new debt at the new rate replaces old debt at the old contractual rate, unless a significant portion of the old debt is in the form of variable interest rate contracts that automatically adjust to the new interest rate.

Despite the need for a forward-looking analysis, it is illustrative to look at the evolution of the required primary balance over time, the actual recorded primary surplus, and the evolution of debt to GDP. This can be done with nominal variables using the implicit interest rate: the interest bill divided by the previous year’s stock of debt and the nominal GDP growth rate to calculate the required primary balance (Figure 1).



Figure 1. Required and Actual Primary Surpluses and the Evolution of the Debt-to-GDP Ratio, 2001–2022 (Percent of GDP)





Source: Authors' calculations based on the International Monetary Fund's (IMF) World Economic Outlook database. For Trinidad and Tobago, the debt-to-GDP ratio is from public sector debt from historical IMF Article IV Consultation reports.

Note: The implicit interest rate is the difference between the primary general government balance and the overall general government balance (as shares of GDP) divided by the debt-to-GDP ratio. The nominal growth rate is calculated using nominal GDP in local currency terms.

Figure 1 shows how the sharply negative GDP growth of the 2020 COVID-19 recession implies a sharp spike in the required primary balance, as a large negative number for GDP growth is subtracted, resulting in a large positive number added to the interest rate. Also, one sees the strong recovery at the end of the period, combined with a rise in inflation that drives up nominal GDP growth. As a result, the required primary balances become negative, since r is much smaller than g . (Again, think back to the quote from Paul Krugman in the Introduction.)

In panels (a) and (b) of Figure 1, one sees a period of early years when primary balances are either negative or are insufficiently large positive surpluses to meet the primary balance needed to stabilize the debt-to-GDP ratio. As a result, the grey line of debt to GDP drifts upward. Similarly, the high primary surpluses in panel (d) are persistently above the required primary balance, and the debt-to-GDP ratio is drifting downward (see Box 1 and the Jamaica country section for more details). In panel (c), Guyana's oil-fueled economic boom drives the required primary balance into negative territory in recent years. The actual primary balance is also in deficit, as the government invests in infrastructure to support both the hydrocarbon sector and the now rapidly growing non-hydrocarbon sector. But that deficit is still "above" the required level, in absolute value, so the debt-to-GDP ratio declines sharply (see Box 1 and the Guyana country section for more details).

Box 1. Examples of Substantial Reductions in Public-Debt-to-GDP Ratios: Jamaica and Guyana

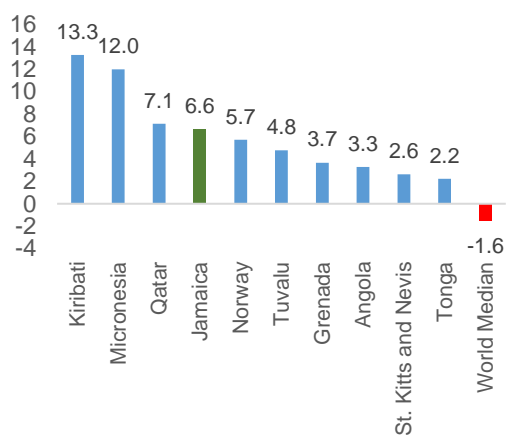
Jamaica: Fiscal Rules and Persistently High Primary Surpluses

Jamaica suffered from macroeconomic volatility and unsustainable debt burdens for decades. Before 2010, debt had risen sharply, and financing costs had soared. A first restructuring of domestic debt in 2010, supported by the International Monetary Fund (IMF), was accompanied by incipient fiscal reforms. But debt levels did not fall, and the debt-to-GDP ratio reached a peak of about 149 percent in FY2012–2013, behind only Japan and Greece at that time (Mooney and Zegarra 2020).

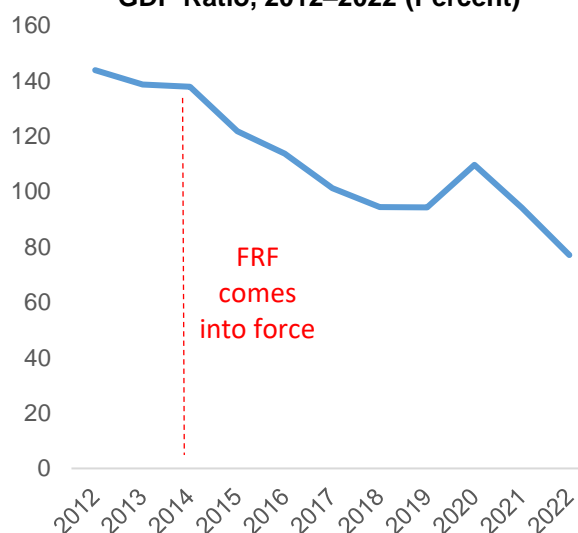
Against the backdrop of another IMF-supported program, in coordination with the IDB, Jamaica's debt ratio declined by about a third after revising and fully implementing a Fiscal Responsibility Framework (FRF) and related reforms in 2014. Jamaica's fiscal effort (a primary fiscal surplus of about 7 percent per year on average from 2015 to 2019) exceeded that of all other Latin American and Caribbean countries, on average, and ranked among the top five countries globally (Box Figure 1.1). Jamaica's FRF includes two rules: a balanced budget rule and a debt rule. In 2014, a floor was set on the overall balance of the covered public sector, with the objective of reducing public debt to 60 percent of GDP, initially targeted for 2026. The FRF also includes a well-designed escape clause and an automatic correction mechanism. Specifically, the FRF's targets were initially designed to be amendable on the grounds of national

security, national emergency, or other exceptional grounds, as determined by the Minister of Finance and Public Service. Key features of the correction mechanism include the stipulation that deviations be recorded, with the expectation that future fiscal adjustments will be made to return the trajectory of fiscal aggregates to a path consistent with public debt targets. Jamaica’s FRF also includes a ceiling for the public wage bill to contain the increase of current expenditures. With persistently high primary surpluses and strong institutional reforms in several areas, the government of Jamaica was able to reduce the debt-to-GDP ratio from over 140 percent to under 80 percent. (Text adapted from Box 2.1 (by Henry Mooney) in Cavallo et al.)

Box Figure 1.1. Top 10 Average Primary Balances in the World, 2015–2022 (Percent)



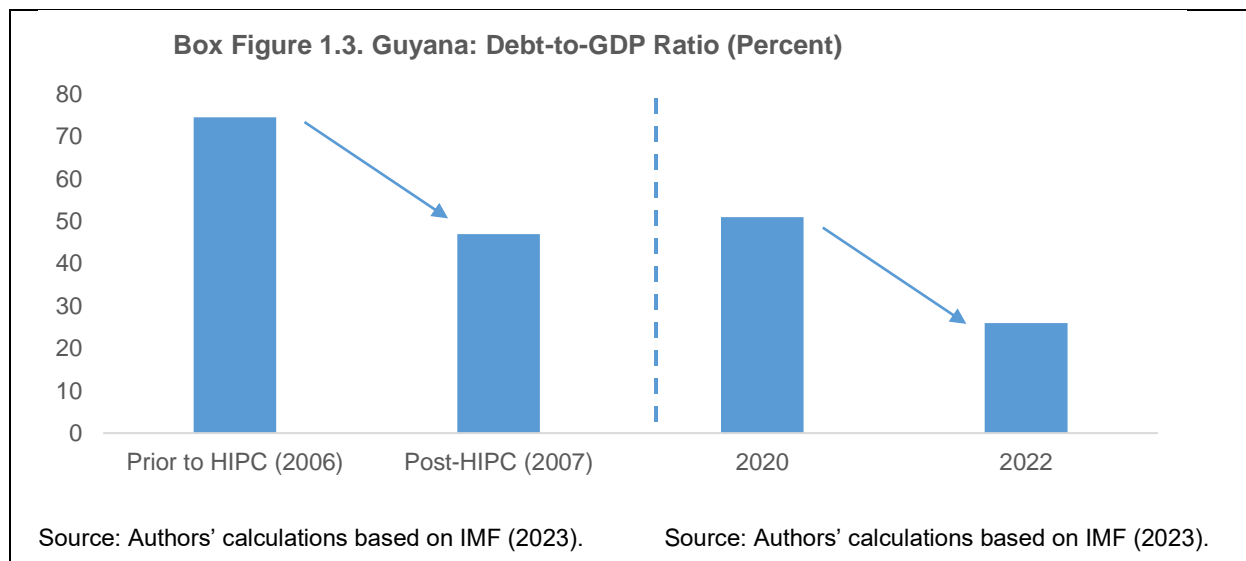
Box Figure 1.2. Jamaica: Debt-to-GDP Ratio, 2012–2022 (Percent)



Source: Authors’ calculations based on IMF (2023).
Note: FRF: Fiscal Responsibility Framework.

Guyana: Debt Relief and “Growing Out of Indebtedness”

Guyana has been experiencing an economic boom driven by the start of large-scale oil production, infrastructure construction, foreign investment, and the resulting multiplier effects on the rest of the economy. GDP growth averaged over 40 percent from 2020–2022. Despite an increase in government borrowing to finance large infrastructure projects, this extraordinary economic growth has led to a sharp decline in the debt-to-GDP ratio (Box Figure 1.4), nearly cutting the ratio in half. This is not the only such experience of a sharp decline in this ratio this century. In the first decade of the century, Guyana entered into the Highly Indebted Poor Country Initiative (HIPC) and received debt relief on the order of almost 30 percent of GDP (Box Figure 1.3).



On the other hand, some panels of Figure 1 also show years when the actual primary balance exceeded the required primary balance (or vice versa), but the debt-to-GDP ratio did not decline (or increase) accordingly. The problem is that this approach abstracts away from a variety of other factors that affect the level of indebtedness, as noted above. Many governments borrow in international markets, with their loans denominated in foreign currency. This implies that exchange rate changes will affect the level of debt in domestic currency, and hence the debt-to-GDP ratio. The sharp depreciation in Suriname is one example (Figure 1, panel e). Some governments over this period assumed the liabilities of SOEs or absorbed liabilities from troubled private sector financial institutions. For example, the bailout and restructuring of CLICO, the largest insurance agent in Trinidad and Tobago, occurred over several years after 2008 (IMF 2014). On the debt-reduction side, several countries engaged in debt restructuring of private creditors' debt over this period, and Guyana benefited from the Highly Indebted Poor Country (HIPC) Initiative between 1999 and 2006. These events led to debt reduction that was not associated with primary surpluses. In addition, governments have sometimes financed their deficits through seigniorage from the central bank, so the deficit does not result in debt accumulation. Over time, the resulting inflation itself can be decomposed from the interest rate effect. For example, in the case of Suriname, nominal GDP growth was driven by inflation in the later years shown in panel (e) of Figure 1. Finally, there are other residual changes in debt stocks that are just not properly accounted for in the data.

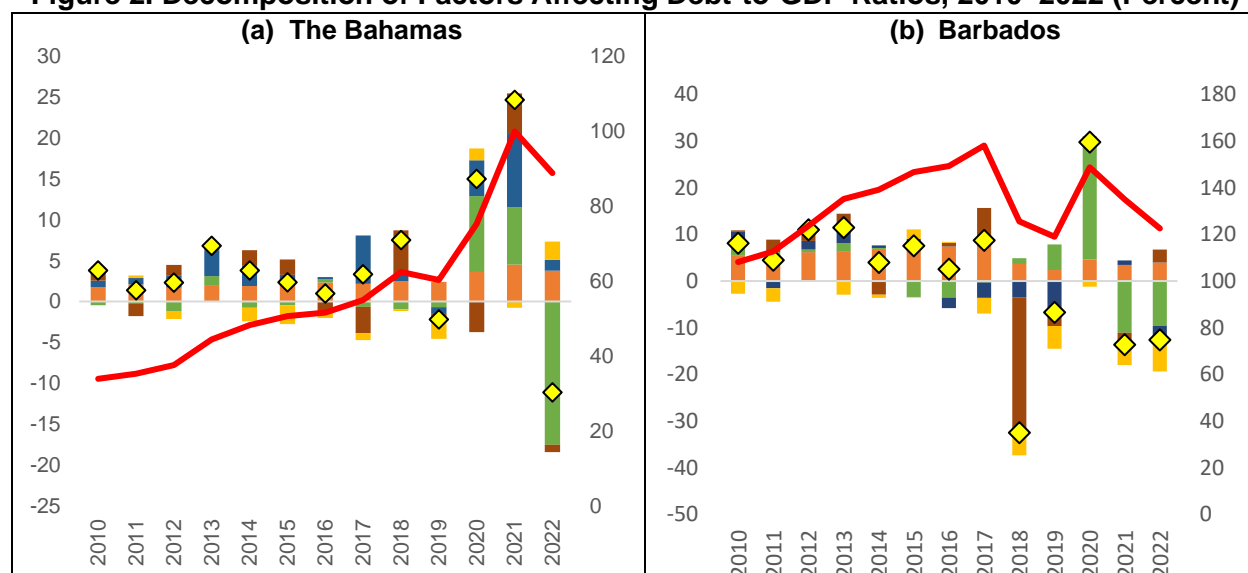
In brief, a mix of fiscal policy decisions, economic drivers, and external factors drive debt dynamics, including weather events that can affect GDP and other factors. Table 1 provides a summary.

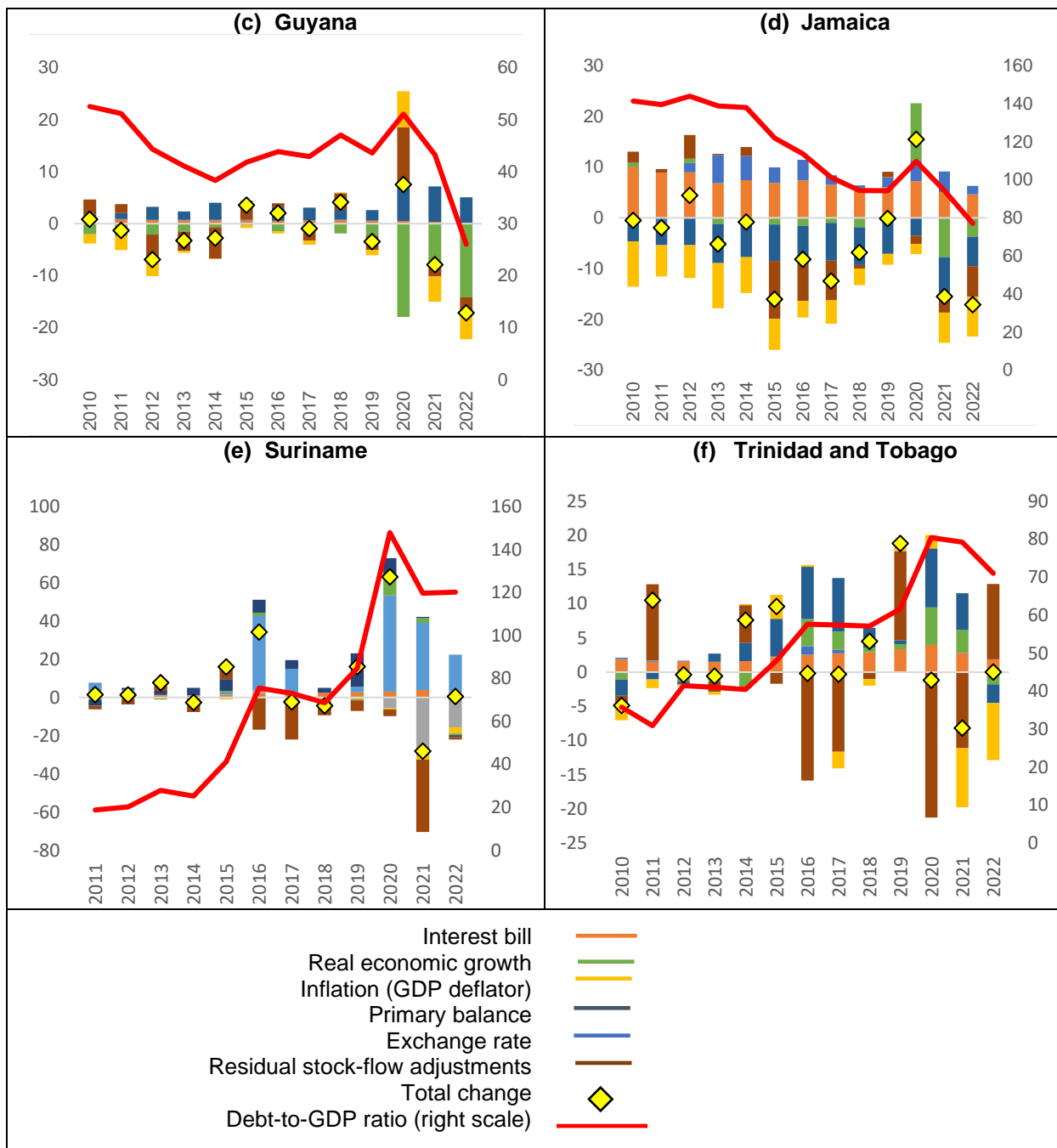
Table 1. Summary of Factors Affecting Debt Dynamics

Debt Accumulation as a Share of GDP	Debt Reduction as a Share of GDP
Recessions	(Positive) GDP growth
Primary fiscal deficits	Primary fiscal surpluses
Contingent liabilities assumed by the central government (e.g., bankruptcies of state-owned enterprises, financial sector bailout)	Debt default/Debt forgiveness and asset sales (e.g., divestment of state-owned enterprises)
Foreign exchange depreciation	Foreign exchange appreciation
Rising interest rate	Falling interest rate
	Seigniorage and/or inflation

The discussion above and Table 1 allow for a more complete decomposition of the historic evolution debt, leaving as a residual those effects from assumed debts (or debt relief) and accounting anomalies (residual stock-flow adjustments) over time (Figure 2, panels a-e). For example, in Figure 1, the role of changes in the exchange rate is not accounted for; however, in panel (d) of Figure 2 for Suriname, one can see the important role of exchange rate depreciation in increasing the debt-to-GDP ratio during several years. Figure 2 also separates out the effects of inflation from real GDP growth, as opposed to the nominal GDP growth used in Figure 1. Each of the country chapters of this report provides a more complete discussion of the historical evolution.

Figure 2. Decomposition of Factors Affecting Debt-to-GDP Ratios, 2010–2022 (Percent)





Source: Authors' calculations based on the International Monetary Fund's (IMF) World Economic Outlook and International Financial Statistics databases; Country Statistical Offices; and the World Bank's International Debt Statistics (<https://www.worldbank.org/en/programs/debt-statistics/ids>). The debt-to-GDP ratio for Trinidad and Tobago is public sector debt from historical IMF Article IV Consultation reports.



Note for Figure 2: Residuals include stock-flow adjustments. Data are presented in a fiscal year format for The Bahamas, Barbados, Jamaica, and Trinidad and Tobago. The fiscal year is mapped to the calendar year as follows: $FY(t-1/t)=CY(t)$, except for Jamaica, where $FY(t/t+1)=C(t)$. Barbados' growth estimates are based on calendar year data until 2017, and The Bahamas and Trinidad and Tobago use real calendar year growth until 2014. External debt decomposition is only available for Guyana, Jamaica, and Trinidad and Tobago.

As mentioned above, debt sustainability necessarily is forward-looking rather than historical. This implies different assumptions about the future evolution of the factors described in Table 1 and calculated in the historical perspective of Figure 2. Various approaches are commonly used, and even if the analysis is forward-looking, historical experience provides a guide for realistic assumptions about the future evolution of key variables such as the rate of real economic growth. For example, even more technically sophisticated approaches deploying econometric models draw on historical or cross-country data to estimate those models.

The IMF revised its debt sustainability framework for market access countries last year (IMF 2022).¹⁰ The revised framework takes a broad-ranging, forward-looking approach that explores short-, medium-, and longer-term risks. Quantitative tools are used to look at probabilistic future scenarios for the evolution of public debt-to-GDP ratios, and stress testing of a baseline projection is deployed to reveal the potential impact of negative shocks on variables such as economic growth, the fiscal policy stance, interest rates, and exchange rates. Clearly, the structure of debt matters for the impact of these stress tests (foreign currency component, variable interest rate versus fixed rate, etc.) For example, in the medium term there could be a sensitivity analysis that shows that certain shocks could increase financing needs substantially in the medium term, or that dependence on natural resource revenues poses a longer-term risk.¹¹

For each timeframe in the IMF framework, quantitative techniques provide a “mechanical signal” that guides a final assessment that admittedly involves expert judgment. It is interesting to note that under the revised framework, the baseline projection of the debt-to-GDP ratio might be rising in the initial years—due for example to an only gradual recovery from an economic downturn or a well-designed increase in public investment—and yet the overall risk assessment will be only “moderate” or even “low.” A key feature of the judgment is the political and economic feasibility of changes to fiscal policy that would be required to confront possible negative shocks in the future. In addition, the overall macroeconomic framework is critical. For example, poorly structured monetary policy can lead to exchange rate instability, with consequent large effects on public debt if much of that debt is denominated in foreign currency.

¹⁰ The IMF uses two Debt Sustainability Frameworks: one for market access countries, and one for low-income countries. Of the Caribbean economies, only Guyana is still assessed using the low-income countries framework.

¹¹ To see a recent application of the revised methodology, see any recent IMF Article IV Consultation report and read the debt sustainability framework annex. For example, see the most recent report for Mexico (IMF 2023a).

Recent Literature on Debt Sustainability

The revisions to the IMF's Debt Sustainability Framework, as well as the IDB's DIA report (Powell and Valencia 2022), build upon a 10-to-15-year period of new research on fiscal and debt sustainability. One line of this literature has explored how to statistically test whether the debt-to-GDP ratio is stable, or "weakly" sustainable, over the long run. This has led to analysis of fiscal response functions to see whether fiscal policy responds in the right direction to stabilize the debt-to-GDP ratio when the level changes (as mentioned above). There has also been literature on the growth effects of the level of indebtedness and on the impact of indebtedness on the effectiveness of fiscal policy to combat recessions. Finally, the role of SOEs is explored in other papers and reports, and this topic is particularly relevant for the Caribbean. Some of the key findings of this diverse literature are summarized here.

Bohn (1998) pioneered econometric techniques to determine the sustainability of public debt, launching a rich literature. Mauro et. al. (2013), using several recursive and iterative techniques, showed that Bohn's methodology could identify periods when fiscal behaviors either contributed to unsustainable ("profligate") or sustainable ("prudent") debt trajectories across an extensive database of advanced and emerging markets over almost 200 years. Additionally, Mauro et. al. showed that structural breaks can be identified to show when fiscal behaviors change. More recently, using methodologies based on Bohn (1998), Hernández and González (2023) and Khadan (2019) found evidence that debt in the Caribbean may be sustainable, if albeit weakly. However, "weakly sustainable" debt is particularly worrisome for a region susceptible to external shocks, including hurricanes and price shocks.

Historically, research on debt sustainability focused on the ability of governments to sustain debt payments, as captured by the required primary balance. However, more recent research has focused on governments' willingness (or political ability) to sustain these primary balances, and on the debt levels that are likely to produce liquidity or solvency crises. In other words, governments cannot raise their debt levels (as a percent of GDP) indefinitely, and they certainly cannot borrow indefinitely to pay existing debt ("borrowing from Peter to pay Paul"). Fiscal space describes the gap between current debt levels and the point at which debt becomes unsustainable. When debt becomes unsustainable, governments may experience fiscal fatigue, and solvency concerns arise. Fiscal fatigue broadly describes the point after which governments are unable or unwilling to raise primary surpluses to keep up with increasing debt levels.¹² When governments experience fiscal fatigue, the risk of default becomes noticeably higher and, eventually, financing costs will either become too onerous or creditors will refuse to extend credit.

Ghosh et al. (2013) sought out empirical evidence to support the theoretical concepts of fiscal fatigue and fiscal space. Using a sample of advanced economies, they found that fiscal response

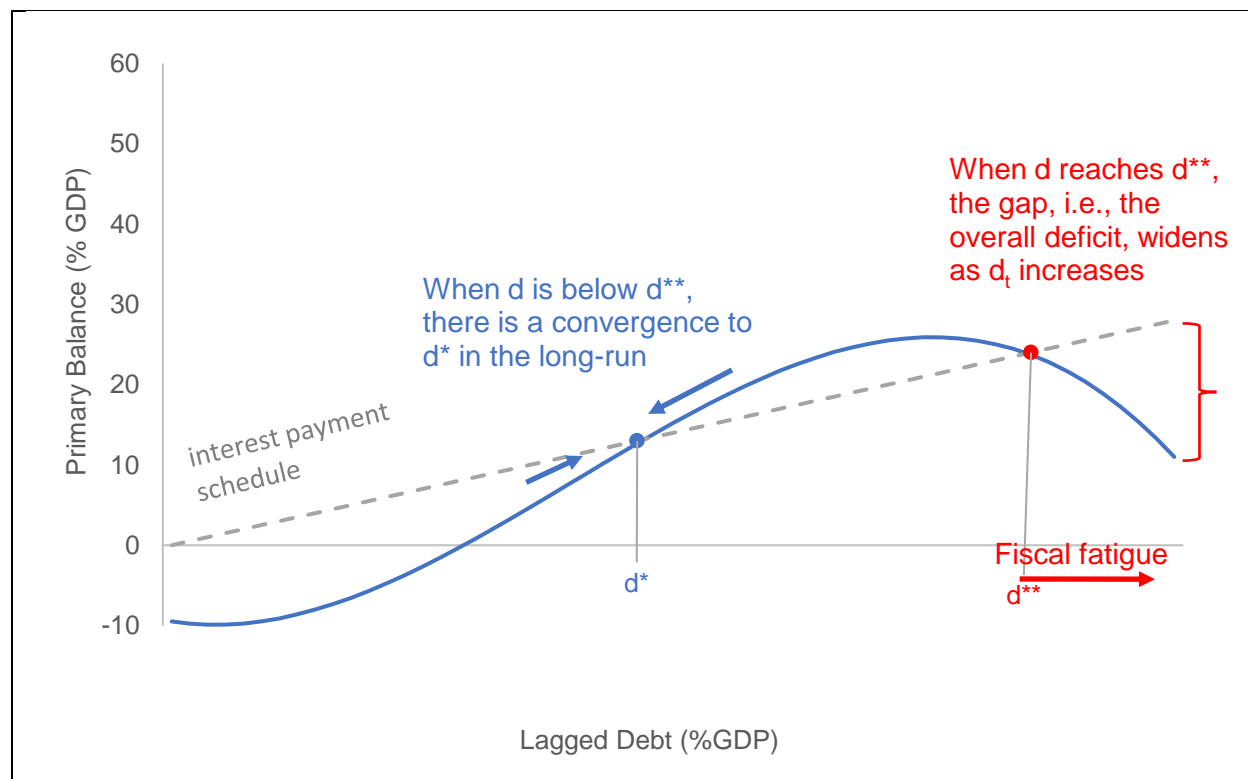
¹² Higher primary balances imply either higher revenues (higher taxes or fees) or lower expenditures. Governments, particularly competitive democracies, face electoral constraints. Khadan (2019) finds evidence that during and before elections, primary balances decline by almost 1 percentage point of GDP in the Caribbean.



functions may follow a cubic form (Figure 3). That is, before a specific debt-to-GDP, d_t^* , governments reduce primary surpluses as their debt-to-GDP ratio grows. After that threshold, governments begin to re-orient their priorities towards debt payments. Primary surpluses (i.e., debt payments) can keep up with increasing debt service costs stemming from a gradual increase in debt burdens. However, for each government, there is an implicit limit to how high primary balances can reach, as governments can only go so far in increasing revenues or decreasing expenditures. This debt limit, d_t^{**} , marks the point after which fiscal fatigue occurs.¹³ When fiscal fatigue occurs, the government is forced to borrow to pay its debts and this gap continues to grow in an unsustainable feedback loop.

Box 2 draws on the historical experience of St. Kitts and Nevis as an example of how multiple factors can interact and lead to a situation of fiscal, or debt, fatigue. In the years leading up to the pandemic, the government was able to enact fiscal reforms that eventually lowered the public debt-to-GDP ratio.

Figure 3. Graphical Explanation of Fiscal Fatigue (Percent of GDP)



¹³ An implicit corollary to the behavior of primary balances between d_t^* and d_t^{**} is cointegration. That is, between d_t^* and d_t^{**} , primary balances and debt levels move together in the same direction. Beyond this range, these variables are no longer cointegrated.



Source: Adapted from Ghosh et al. (2013).

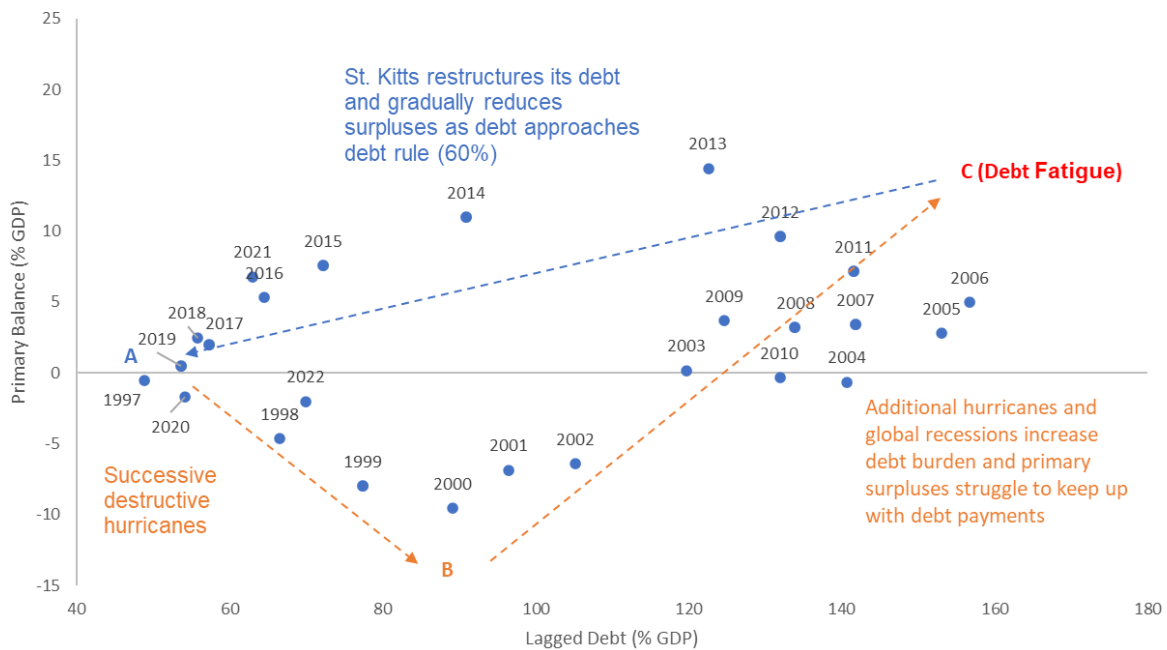
Note: dt refers to the lagged debt-to-GDP at time t . d^* refers to the long-run equilibrium for debt and is the first intersection of the interest payment schedule with the fiscal response function. D^{**} refers to the debt limit, after which fiscal fatigue occurs.

Box 2. Public Debt in St. Kitts and Nevis: A Caribbean Example of Theory and Experience¹

St. Kitts and Nevis is a high-income Caribbean island that has experienced successive exogenous shocks—destructive hurricanes and recessions—since before the start of the 21st century. Following consecutive hurricanes in the late 1990s, particularly Hurricane Georges, which caused an estimated US\$400 million in damage (or 110 percent of then GDP) in 1998, St. Kitts and Nevis saw a sharp increase in its debt. Tourism receipts dropped sharply following the September 11, 2001, attacks in the United States, and advanced economies were broadly in a recession by 2001. By 2003, St. Kitts and Nevis was spending between 3 and 4 percent of its GDP to subsidize its failing state-owned St. Kitts Sugar Manufacturing Corporation (SSMC) sugar company. In 2005, the sugar industry was closed, and the central government assumed direct ownership of both its land (25 percent of the land of St. Kitts) and its debt service (about 20 percent of 2006 GDP). By 2005, St. Kitts and Nevis had a gross public debt-to-GDP of 157 percent (compared to 49 percent in 1996), which ranked among the highest in the world.

In 2009, the debt-to-GDP ratio had dropped sharply to almost 120 percent but was still unsustainably high, as debt service was equivalent to 25 percent of revenues. The global financial crisis that same year made external financing on international capital markets exceptionally challenging. As a result, the government became more reliant on the domestic banking system to roll over its debt. Finally, in 2009, International Monetary Fund (IMF) analyses suggested that interest payments would reach 15 percent (almost double) by 2014. Two years later, the government began a sovereign debt restructuring process, with IMF technical assistance, with the goal of reaching the Eastern Caribbean Currency Union's debt-to-GDP target of 60 percent by 2020. The Paris Club agreed to reschedule debt service at lower interest rates, external private creditors accepted haircuts, and domestic banks accepted a land-for-debt swap. The unexpectedly high revenues from the country's Citizenship by Investment Program also contributed to high primary surpluses in the early 2010s. St. Kitts and Nevis reached its target in 2016, about four years ahead of schedule (Box Figure 2.1).


Box Figure 2.1. Debt Trajectory of St. Kitts and Nevis (Percent of GDP)



¹ Data for this box are from IMF (2023); Université catholique de Louvain, Emergency Events Database (www.emdat.be); and IMF Article IV Consultation reports between 1999 and 2017.

Empirical approaches can be used to estimate the debt limit at which fiscal fatigue becomes a phenomenon. Region-specific research indicates that these debt limits may vary depending on how the economy is structured. For example, the IDB’s DIA report indicates that debt limits as a percent of GDP are 91 percent for tourism-dependent economies, 56 percent for commodity-dependent economies, and 76 percent for diversified economies (Powell and Valencia 2022).¹⁴ Yet, the pernicious effects of debt extend beyond primary surpluses and “fiscal fatigue.” Another conceptual approach to defining “safe” levels of indebtedness is to estimate what level of indebtedness becomes a drag on economic growth. Caner, Grennes, and Kehler-Geib (2010) found that limit to be 77 percent for advanced economies and 64 percent for emerging market economies, costing about 0.02 percentage points of growth annually. It is interesting to note that these levels of indebtedness are broadly consistent with some existing debt-to-GDP targets in fiscal frameworks around the world. For example, the euro zone, the Eastern Caribbean Currency

¹⁴ See Box 5.1 and Figure 5.10 in Powell and Valencia (2023).



Union, Jamaica, and The Bahamas all have fiscal rules that target debt-to-GDP ratios of 60 percent (or 50 percent in the case of The Bahamas).

Debt sustainability is not just a question of timely debt service payments but also one of the efficacy of fiscal policy. Using an innovative dataset of 44 countries, including both advanced and emerging economies, Ilzetzki, Mendoza, and Végh (2013) estimated that fiscal multipliers are 0 when the debt-to-GDP ratio is over 60 percent. Huidrom et al. (2020) found that, under high indebtedness, fiscal multipliers are weakened as households and investors reduce spending in anticipation of future fiscal adjustments, and borrowing costs for both the private sector and the government increase. In other words, during economic downturns (e.g., recessions) or shocks (e.g., pandemics), fiscal stimuli to cushion the economy may be ineffective if governments are highly indebted. Hence, the deleterious effects of high debt, and especially unsustainable debt, can become economy-wide burdens and even a self-fulfilling prophecy.

Recent developments have also raised concerns about the fiscal risks of SOEs in the region. In the Caribbean, stock-flow adjustments can include the assumption of debt from SOEs, and thus can abruptly affect public debt trajectories. Reyes-Tagle et al. (2022) investigated how pervasive a risk SOEs pose to the region. In per capita terms, the Caribbean has the highest concentration of commercial SOEs in Latin America and the Caribbean. This partly reflects the Caribbean's dependence on the public sector to provide services, particularly in cases where profitability may be elusive or difficult. According to Reyes-Tagle et al. (2022), Caribbean countries spend between 5.3 and 8 percent of GDP annually to support these SOEs. Furthermore, fiscal risks from these enterprises have only increased. Using text mining techniques Reyes-Tagle et al (2022) showed that, between 2000 and 2019, mentions of SOEs in the IMF's Article IV Consultation reports increased, particularly for countries such as Barbados, where SOE reform is a key part of reform efforts encouraged by the IMF.

The discussion of SOEs also is a reminder that well-managed SOEs are an income-generating asset rather than a liability, and that a comprehensive balance sheet approach to government financial sustainability would be ideal. However, there are practical complications with calculating government assets, given that a main asset is the government's ability to tax.¹⁵ On the liability side, one area not touched upon here is the sustainability of pension systems. A future edition of Caribbean Economics Quarterly may indeed tackle this topic.

The Crucial Role of Debt Management Institutions

Debt management institutions have been the focus of considerable research, capacity-building, and reform efforts over the past few decades.¹⁶ Particularly since the launch of major multilateral debt forgiveness initiatives in the 1990s (e.g., the HIPC and Multilateral Debt Relief Initiatives), international financial institutions have taken the lead in distilling best practices for debt

¹⁵ See Debrun et al. (2020, Section C) for a discussion.

¹⁶ See Mooney, Prats, and Rosenblatt (2021) for a more detailed discussion of debt management institutions and their implications for debt sustainability in the Caribbean.



management from advanced economies, and in developing sound practice standards to help emerging and developing economies reform.

Debt management institutions are in many ways distinct from the typical concept of public institutions, as they necessarily span many agencies of government—for example, the executive, ministries of finance and line ministries, debt management offices, central banks, and subnational agencies—as well as banks and market participants that are crucial for funding. Similarly, sound debt management practices and institutions involve more than the agencies themselves. They also require adequate legislation, authorizations, mechanisms for information-sharing and competent decision-making, data management and analysis, and the human capital required to undertake related functions.

Ultimately, the main function of a properly structured set of debt management institutions and procedures is to execute the government's financing requirements at the lowest possible cost, given a certain appetite for risk. As costs and risks linked to financing tend to be countervailing forces—that is, higher-risk strategies may offer lower short-term costs—ensuring that policymakers are adequately informed about the nature of this tradeoff is a key responsibility of debt managers (Box 3).

Box 3. Main Risks Associated with Public Debt Management

It is important to understand the many types of risks inherent to public debt portfolios that are crucial for the design of debt management institutions. These include both risks driven by the markets in which debt managers operate (e.g., domestic and external credit and financial markets), as well as risks related to instruments themselves (IMF 2001).

- **Market risk:** This refers to the risks associated with changes in market prices, such as interest rates, exchange rates, commodity prices, and the cost of the government's debt servicing. For both domestic and foreign currency debt, changes in interest rates affect debt servicing costs on new borrowing when fixed-rate debt is refinanced, and on floating-rate debt when rates reset. Hence, short-duration debt (short-term or floating-rate) is usually considered to be more risky than long-term, fixed-rate debt. Debt denominated in or indexed to foreign currencies also adds volatility to debt servicing costs as measured in domestic currency, owing to exchange rate movements. Debt instruments with embedded options can also create additional market and/or rollover risks.

- **Rollover risk:** This refers to the risk that debt will have to be rolled over at an unusually high cost or, in extreme cases, cannot be rolled over at all (e.g., due to a loss of market access). To the extent that rollover risk is limited to the risk that debt might have to be rolled over at higher interest rates, including changes in credit spreads, it may be considered a type of market risk. However, rollover risk is often treated separately because of the inability to roll over debt, and/or because exceptionally large increases in government funding costs can lead to or exacerbate a debt crisis and thereby cause real economic losses (in addition to the purely financial effects of higher interest rates). Managing this risk is particularly important for emerging market countries.

- **Liquidity risk:** There are two types of liquidity risk. One refers to the cost or penalty investors face in trying to exit a position when the number of transactions has markedly decreased or because of the lack

of depth of a particular market. This risk is particularly relevant in cases where debt management includes the management of liquid assets or the use of derivatives contracts. The other form of liquidity risk for a borrower refers to a situation where the volume of liquid assets can diminish quickly in the face of unanticipated cash flow obligations and/or a possible difficulty in raising cash through borrowing in a short period of time.

- **Credit risk:** This refers to the risk of nonperformance by borrowers on loans or other financial assets or by a counterparty on financial contracts. Credit risk is particularly relevant in cases where debt management includes the management of liquid assets. It may also be relevant in the acceptance of bids in auctions of securities issued by the government as well as in relation to contingent liabilities, and in derivative contracts entered into by the debt manager.

- **Settlement risk:** This refers to the potential loss that the government, as a counterparty, could suffer as a result of failure to settle, for whatever reason other than default by another counterparty.

- **Operational risk:** This includes a range of different types of risks, including transaction errors in the various stages of executing and recording transactions; inadequacies or failures in internal controls, or in systems and services; reputational risk; legal risk; security breaches; or natural disasters that affect business continuity.

Sound Structures and Practices for Effective Debt Management

Over time, there have been many attempts by academics, practitioners, and market participants to define and delineate international sound practices for debt management. As might be expected, debt management agencies in larger and more advanced economies tend to be viewed as those with the best-developed institutions and approaches. This is partially because these countries tend to have large domestic capital markets, strong and continuous access to international capital markets, and high levels of institutional capacity. Similarly, these economies tend to have relatively large financing requirements, meaning that their debt managers will transact often and on a very large scale, providing them with considerable experience over time. Many have also been at it for a long time, which has allowed them to develop their approaches in line with market innovations.

An exhaustive discussion of approaches to debt management pursued by different countries is beyond the scope of this Regional Overview. However, there are a few well-regarded sets of principles and recommendations that have been developed by international agencies in order to distill best practices from advanced and other market economies and provide a roadmap for emerging, developing, and lower-capacity countries to strengthen debt management institutions. Perhaps the best known and most widely used are the joint IMF and World Bank Guidelines for Public Debt Management (IMF 2016), which are also the basis for the World Bank's DeMPA (World Bank 2021). The guidelines and the DeMPA were developed to set out key principles and benchmarks to support institutional and capacity development for countries in need.




In this context, the DeMPA focuses on five key institutional pillars for debt management: (1) governance and strategy development; (2) coordination with macroeconomic policies; (3) borrowing and related financing activities; (4) cash flow forecasting and cash balance management; and (5) debt recording and operational risk management. Each of these pillars of sound debt management institutional practices also involves a number of sub-pillars considered crucial to ensure that public debt mandates and portfolios are designed, executed, and managed in a sustainable and cost-efficient way that minimizes fiscal and economic risks to governments. The five key institutional pillars for sound debt management are outlined in greater detail in Table 2.

Table 2. Key Pillars of Sound Debt Management Institutions and Practices

1. Governance and Strategy Development	2. Macroeconomic Policy Coordination	3. Borrowing and Related Financing Activities	4. Cash Flow Forecasting and Cash Balance Management	5. Debt Recording and Operational Risk Management
• Managerial Structure	• Coordination with Fiscal Policy	• Domestic Borrowing	• Cash Flow Forecasting and Cash Balance Management	• Debt Administration and Data Security
• Legal Framework	• Coordination with Monetary Policy	• External Borrowing		• Separation of Duties, Staff Capacity, and Business
• Debt Management Strategy		• Loan Guarantees, On-lending, and Derivatives		• Debt and Debt-related Records
• Debt Reporting and Evaluation				
• Audit Practices				

Source: Based on World Bank (2021).

In brief, it is not only the level of public debt that affects the risk of debt distress. How that debt is selected, approved, assessed, recorded, reported, structured, and managed can also influence the associated risk-reward tradeoffs. International institutions, donor governments, and markets have increasingly focused on debt management capacity and institutions as key factors influencing both the perception of risk and the costs associated with borrowing for emerging markets. Several Latin American and Caribbean countries have successfully improved debt



dynamics and sustainability over the past decade by focusing on improving these institutions and practices, in addition to sound fiscal and economic policies.

Policy Agenda Moving Forward

One central theme discussed in this Regional Overview has been how fiscal policy responds to the level of government indebtedness. One institutional approach to ensuring that there is an appropriate fiscal response over time is to create medium-term fiscal frameworks, anchored in quantitative fiscal targets or rules.¹⁷ Fiscal councils can provide external oversight that further strengthens compliance with these institutional arrangements. Several Caribbean countries have made progress on these institutional reforms, as noted in the country chapters of this report. Ardanez, Ulloa-Suarez, and Valencia (2023) find that compliance with fiscal rules has rewards in terms of lower borrowing costs, among other effects. They also find that the strength of institutions raises the probability of compliance with fiscal rules.

Strengthening fiscal institutions becomes even more important at a time when key variables such as interest rates and economic growth rates turn in an unfavorable direction. Fiscal adjustment to offset these changing circumstances can be accomplished more gradually if there are credible institutional arrangements for managing medium-term fiscal objectives.


Interest rates and economic growth rates are not fully under a government's control, and both are subject to external shocks. However, improved fiscal institutions can lower sovereign risk and thus lower the interest rates required by international markets. In addition, fiscal frameworks that lower debt distress risks improve the investment climate and enhance growth prospects. Productivity-enhancing microeconomic and structural reforms are also important, as noted in previous editions of this report.

Debt distress risks are also reduced via improved management of SOEs to ensure that they are primarily government assets, rather than government liabilities. The preceding section outlined the key pillars of sound debt management institutions that can lower the risks of debt distress for a given level of indebtedness. Proper transparency, monitoring, planning, and structuring of public debt has an important role in reducing risks.

The overall macroeconomic framework also matters. Monetary financing of government deficits can lead to sharp adjustments in the exchange rate that lead to a rise in debt-to-GDP levels when a significant portion of the public debt is denominated in foreign currency. There have been episodes of this phenomenon in the Caribbean in the past.

Finally, climate risks weigh heavily on the Caribbean. One approach to reduce these risks is to target a lower public-debt-to-GDP ratio in the fiscal framework than would be the case in the absence of these risks. Financial reforms and reforms to the international financial architecture can help vulnerable economies deal with their debts. For example, as of July 2023, the IDB was

¹⁷ See Ter-Minassian (2021) for an assessment of fiscal institutions in the Caribbean countries covered in this report.



the first and only multilateral institution to offer Climate Resilient Debt Clauses (CRDC) that allow borrowing states to pause interest payments due to natural disasters.¹⁸ Additionally, several Caribbean states have implemented legislation to integrate such “pause clauses” in future sovereign debt, and Barbados became the first to introduce sovereign debt with pause clauses for pandemics.¹⁹ There are deeper reforms of the international financial architecture in the public debate, such as the Bridgetown Initiative 2.0,²⁰ that aim to provide additional support to small island states.

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¹⁸ The World Bank has unveiled a commitment to eventually introduce CRDCs. See “What Could World Bank Reforms Mean for Climate-Vulnerable Small Island Developing States?”, July 2023, available at <https://www.cgdev.org/blog/what-could-world-bank-reforms-mean-climate-vulnerable-small-island-developing-states>

¹⁹ See M. Jones, 2022, “Barbados Issues World’s First Pandemic-protected Bond,” Reuters, September 21, available at <https://www.reuters.com/world/americas/barbados-issues-worlds-first-pandemic-protected-bond-2022-09-21/>.

²⁰ See Barbados Government Information Services, “Bridgetown Initiative 2.0 Highlights Six Key Action Areas,” April 27, available at <https://gisbarbados.gov.bb/blog/bridgetown-initiative-2-0-highlights-six-key-action-areas/>



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HURRICANE DORIAN
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Assessment of the Effects and Impacts
Caused by **Hurricane Irma**
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COUNTRY SUMMARIES

The Bahamas

José Luis Saboin

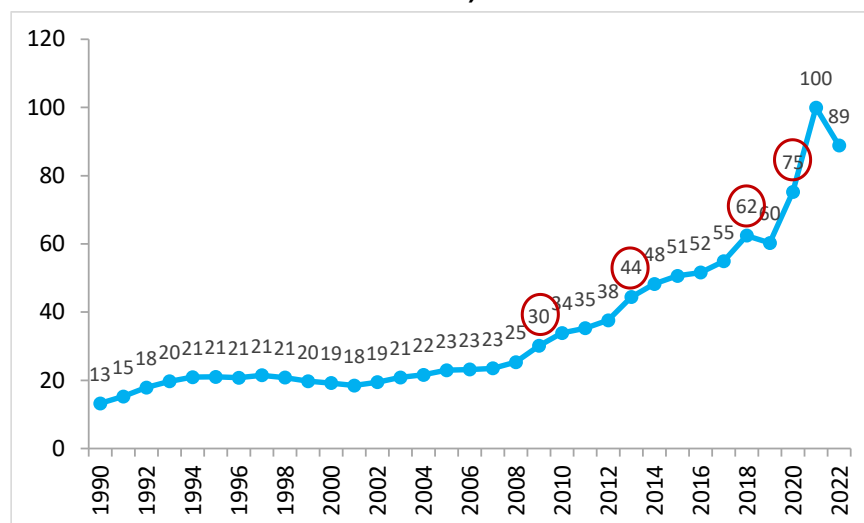
A short history of Bahamian Public Debt

The public-debt-to-GDP ratio of The Bahamas had quite a stable trajectory during the 1990s and early 2000s (Figure 1).²¹ However, in tandem with the global economic crisis of 2009, the ratio started to trend upward, with three additional upward inflection points in 2013, 2018, and 2020. There are many reasons behind this increasing trend over the last decade, the most notable being those associated with two main components that feed into the ratio: GDP growth and the primary balance. In terms of (real) GDP growth, in line with the trend of other high-income Caribbean countries, The Bahamas experienced a deceleration of economic growth from 2009 onward, from 2.5% in the 1990s to around 1% in the 2000s and 2010s. In terms of the primary balance, over the same period, the country ran persistent and increasing fiscal deficits. A key reason for these deficits is the increasing incidence of natural disasters due to climate change. At the same time, revenues underperformed, and current expenditures have been downwardly sticky.²² These persistent deficits significantly increased the country's vulnerability to unexpected shocks, as the COVID-19 pandemic of 2020 demonstrated.

²¹ Unless otherwise indicated, public debt refers to central government gross debt. Yearly data for fiscal numbers and their corresponding ratios are presented as end of fiscal year numbers. The fiscal year runs from July to June.

²² See Frasier (2022) for a detailed review of fiscal performance in The Bahamas, with an emphasis on expenditures.

Figure 1. The Bahamas: Public-Debt-to-GDP Ratio, 1990–2022 (% of GDP)



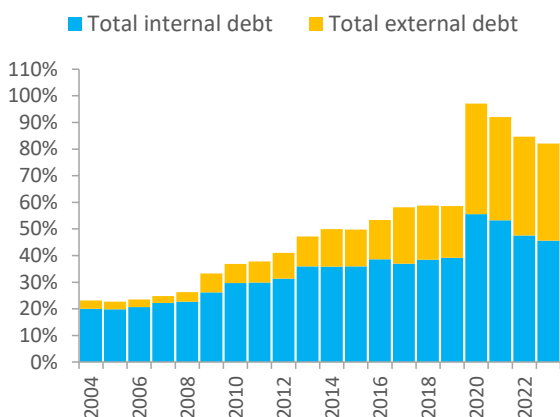
Source: International Monetary Fund, World Economic Outlook database.

Characteristics of Bahamian Public Debt

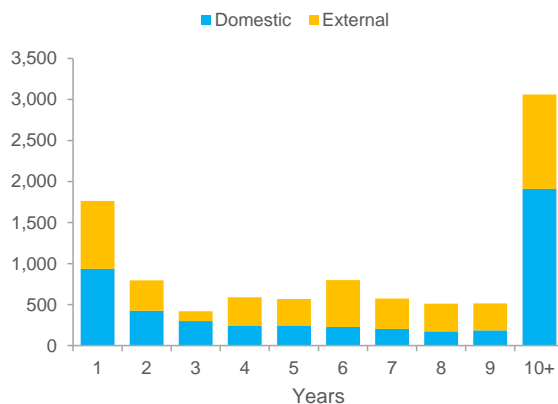
Figure 2 describes the fundamentals of Bahamian public debt. Panel a shows that, over the last 20 years, the external component has increased (from 13.6% of the total in 2004 to 44.4% in 2023). In terms of (remaining) maturity, 18.4% or BSD 1.8 billion of outstanding debt expires within one year; 24.7% matures within 1-3 years; 25% matures within 5-10 years; and the rest matures in 10 years or more (Figure 2, panel b). Looking at external and domestic debt separately, private capital markets and international financial institutions are the main holders of external debt (Figure 2, panel c), whereas the private sector and commercial banks are the main holders of domestic debt (Figure 2, panel d). By instrument, two-thirds of external debt is in the form of securities and the rest is loans (Figure 2, panel e). Domestic debt is mostly in the form of government securities (also two-thirds) followed ordinarily by Treasury bills, loans, and advances (Figure 2, panel f).

Figure 2. The Bahamas: Characteristics of Public Debt

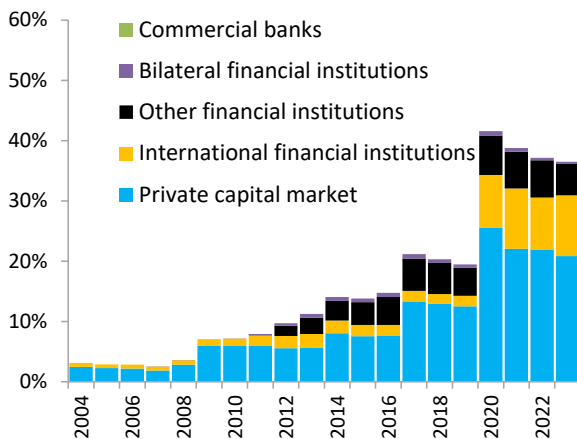
a. Total, by Residence (% of GDP)



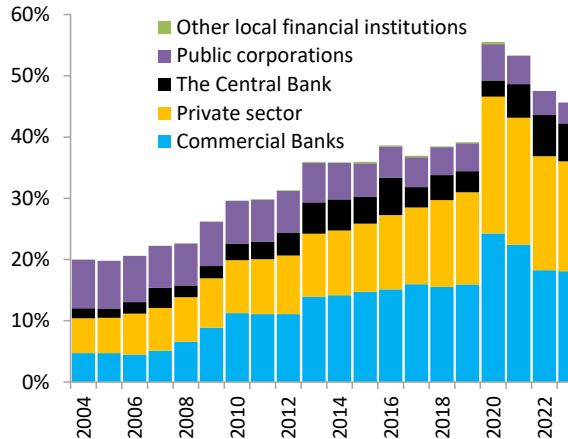
b. Total, by Residency and Maturity (In millions of Bahamian dollars)



c. External, by Sector (% of GDP)

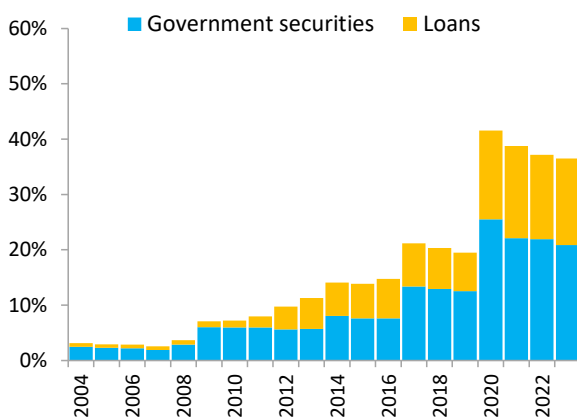


d. Domestic, by Sector (% of GDP)

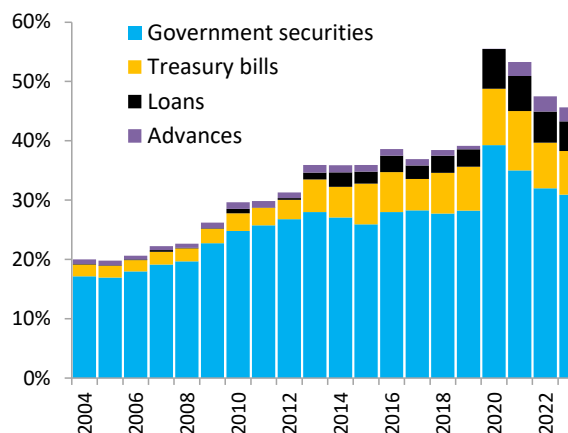


The Bahamas

e. External, by Instrument (% of GDP)



f. Domestic, by Instrument (% of GDP)

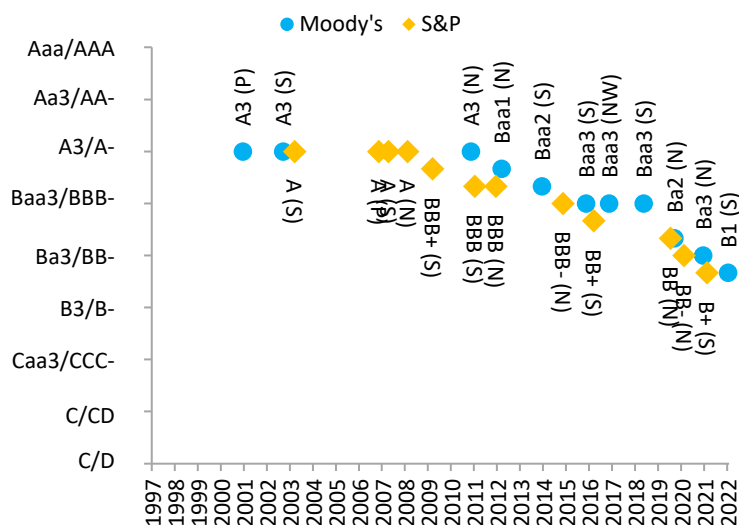


Source: Author's calculations based on several editions of the Central Bank of The Bahamas Quarterly Statistical Digest.

Note: Over the period of study, The Bahamas has maintained an exchange rate peg of US\$1 = 1 BSD.

Together with the change in the macro-fiscal landscape after the global financial crisis, The Bahamas' credit ratings started to fall. Figure 3 shows that, starting in 2009, Standard & Poor's (S&P) downgraded Bahamian credit from the upper to the lower-medium investment grade. Moody's followed suit in 2011. In 2016, S&P assigned a non-investment grade (speculative) rating, while Moody's confirmed the same credit downgrade (from Baa3 to Ba2) in June 2020. In 2021, Moody's continued the downgrade to Ba3, and to B1 in October 2022. S&P followed a similar path from BB to BB- in November 2020 and to B+ in November 2021. S&P recently reaffirmed this rating and gave a stable outlook. Despite the recent improvements on the fiscal landscape, Bahamian credit continues to be considered as speculative by the rating agencies.

Figure 3. Credit Ratings of Bahamian Public Debt, 1987–2022

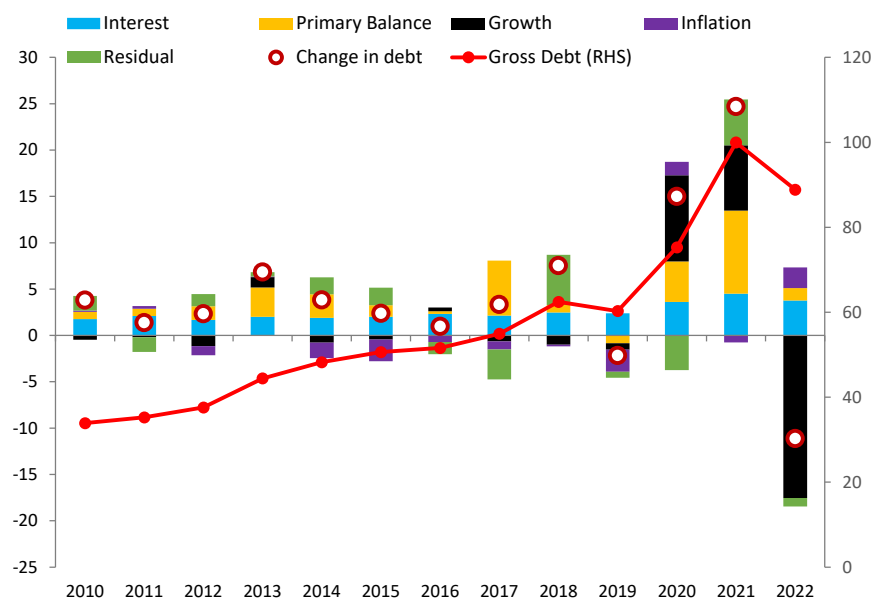


Source: Trading Economics
(<https://tradingeconomics.com/bahamas/rating>).

Evolution of Key Macroeconomic Variables Affecting Bahamian Public Debt

Figure 4 presents the debt decomposition analysis for Bahamian debt. It shows that net debt-increasing flows are large and are composed of two main drivers: (i) the cost of debt (which has added 40 percentage points to the ratio since 2004), followed by (ii) the primary balance (which has added 30 percentage points to the ratio over the same period). The net debt-reducing flows, on the other hand, which are the real growth rate of GDP and the inflation rate, are low (as expected in the case of inflation but not on the case of GDP) and have only reduced the ratio by 11 percentage points during the last 20 years. An explanation on the driving dynamics of each of these components is presented next.

Figure 4. Bahamian Debt Decomposition, 2010–2022 (% of GDP)



Source: Author's calculations based on the International Monetary Fund's World Economic Outlook database and the World Bank's International Debt Statistics .
Notes: Residuals include stock-flow adjustments. Data are presented in fiscal year format. The fiscal year is mapped to the calendar year as follows: $FY(t-1/t)=CY(t)$. Real calendar year growth until 2014.

Primary Balance

Debt decomposition analysis for public debt of The Bahamas shows that the primary balance has been a debt-creating flow, adding around 30 percentage points to the public-debt-to-GDP ratio over the last 20 years (Figures 5 and 6). The primary balance has registered a 2.3% of GDP deficit on average over the period, whereas the required primary surplus hovered around 0.7% of GDP on average. Among the reasons that explain this difference between the actual primary balance from the debt-stabilizing one are (i) subdued economic growth that exacerbates revenue underperformance, (ii) increasing public spending on goods and services and on transfers and subsidies (particularly to state-owned enterprises),²³ (iii) increasing incidence of natural disasters (with four major hurricanes in the last eight years), and (iv) the COVID-19 pandemic.

²³ See Reyes-Tagle et al. (2022) for a detailed analysis of the impact of state-owned enterprises on the fiscal sustainability of Caribbean countries,



Figure 5. The Bahamas: Primary Balance, 2004–2022 (% of GDP)

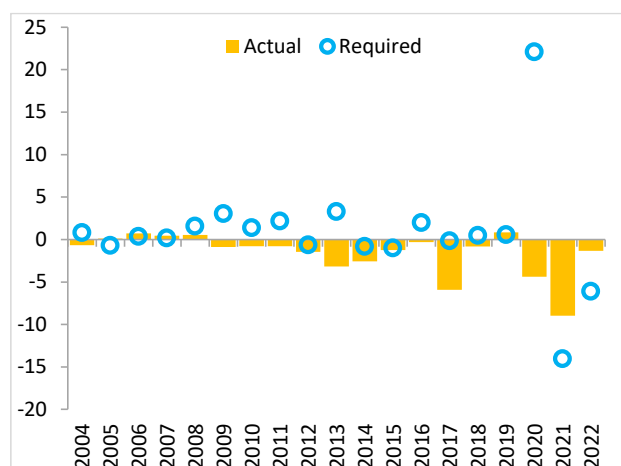
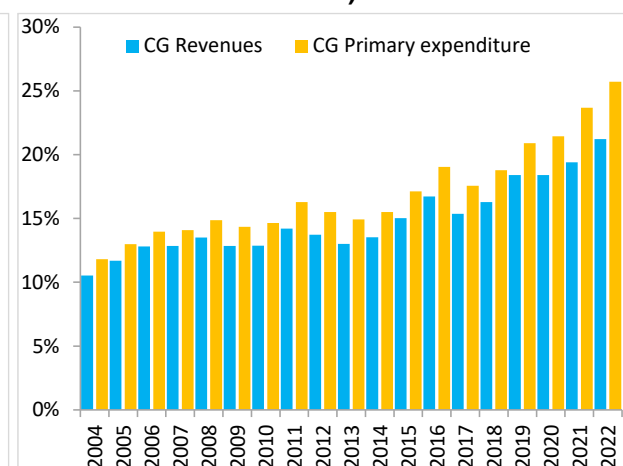


Figure 6. The Bahamas: Central Government Revenues vs. Expenditures, 2004–2022 (% of GDP)



Source: Author's calculations based on the International Monetary Fund's World Economic Outlook database.

Note: The required primary balance is estimated as $(r-g)*d$ and using nominal variables; r is the implicit interest rate measured as the difference between the primary and the overall general government balance (as shares of GDP) divided by debt/GDP; and the nominal growth rate is calculated using GDP in local currency terms.

Interest Rates

The total contribution of the interest rate to increasing the debt-to-GDP ratio is 41 percentage points over the last 20 years (Figures 7 and 8). Although effective interest rates show a downward trend in this period (and, in particular, earlier, during the 1990s), they have started to pick up since 2020. This has coincided with (i) increasing financing needs that have increased risk premia, (ii) the economic downturn due to Hurricane Dorian and the COVID-19 pandemic, and (iii) tighter global financial conditions that followed the pandemic, particularly for external debt. Due to the exchange rate peg, external borrowing is more vulnerable to changes in international financial conditions than to foreign exchange rate movements.



Figure 7. The Bahamas: Implicit Interest Rate, 1991–2021 (%)

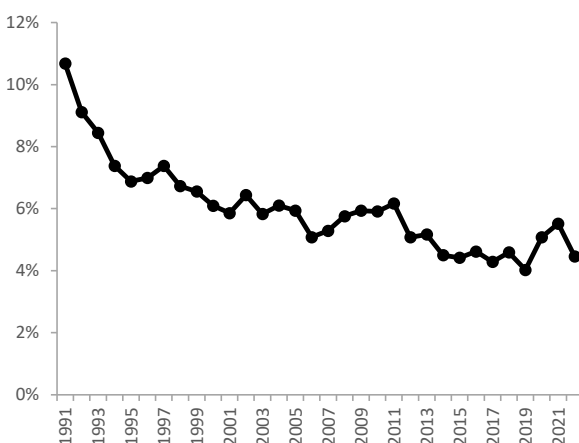
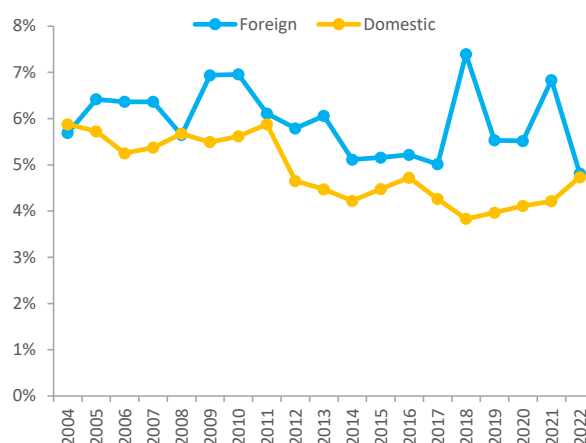


Figure 8. The Bahamas: Implicit Interest Rate Domestic vs. External, 2004–2022 (%)



Source: Author's calculations based on the International Monetary Fund's World Economic Outlook database.

Note: Implicit interest rates are calculated as current period interest payments in the corresponding currency as a % of GDP times the first lag of the debt-to-GDP ratio in the corresponding currency.

Growth and Inflation Rates

Low growth rates in The Bahamas over the last 20 years did little to reduce the debt-to-GDP ratio (Figures 9 and 10). Specifically, the 20-year cumulative effect of the real GDP growth rate on the debt-to-GDP ratio is a reduction of 5 percentage points, in sharp contrast to the 30 percentage points added by persistent primary deficits and the 41 percentage points added by interest rates. Many reasons explain the low growth rates of Bahamian GDP, the most important being vulnerability to natural disasters, increasing debt levels, and structural factors (e.g., human capital, the business environment, and institutions).²⁴ On the other hand, inflation (measured by the GDP deflator) accounts for a cumulative reduction of 6 percentage points. While inflation most often contributes to reductions in the debt-to-GDP ratio, in the case of The Bahamas, this contribution has sometimes been positive, as the GDP deflator has shown deflation in some years.

²⁴ For more details on the growth challenges of The Bahamas, see Melgarejo et al. (2013), Fuentes, Melgarejo, and Mercer-Blackman (2016), Cavallo and Powell (2018), and Schwartz and Beuermann (2021).



Figure 9. The Bahamas: Real GDP, 1991–2021 (Year-over-year % change)

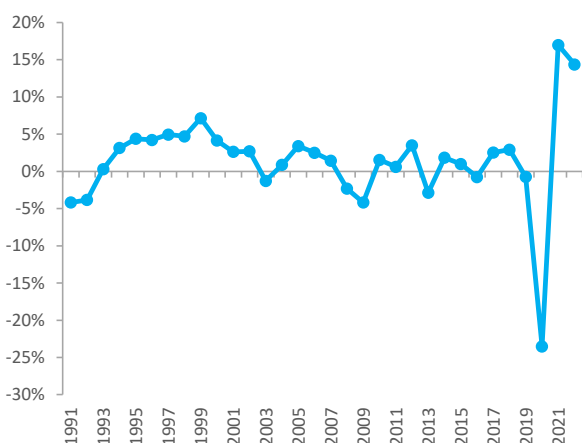
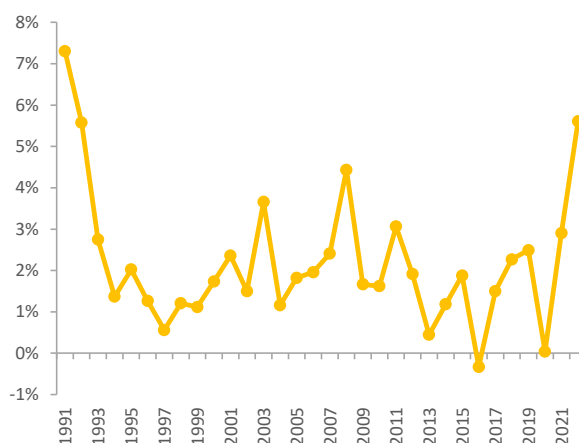


Figure 10. The Bahamas: GDP Deflator, 1991–2021 (Year-over-year % change)



Source: Author's calculations based on the International Monetary Fund's World Economic Outlook database.

Other (Exogenous) Factors

The residual that was shown in Figure 4 is partially explained by exchange rate differences in the small portion of the foreign debt (8.5% in 2023:Q2) that is denominated in currencies other than the U.S. dollar, which is not accounted for in this debt decomposition analysis. Other factors that affect the residual are stock-flow adjustments, as well as other residual changes in debt stocks that are not properly accounted for in the data. However, there are three other key factors affecting the debt stock for The Bahamas, as discussed below.

1. Natural disasters are the main exogenous factors that affect debt dynamics in The Bahamas. Hurricanes Joaquin (2015), Mathew, (2016), Irma (2017), and Dorian (2019) had a cumulative impact on the primary deficit of 7.5% of GDP. Together with the impact of the COVID-19 pandemic, this added almost 13 percentage points to the debt-to-GDP ratio over the last eight years through higher-than-anticipated public expenditures and therefore higher-than-anticipated primary deficits (Table 1).²⁵

²⁵ See Acevedo (2014) for a more detailed analysis of the role of debt in growth and natural disasters. For a more detailed account on the impact of hurricanes in The Bahamas, see ECLAC and IDB (2020a, 2020b, 2020c).

**Table 1. The Bahamas: Central Government Primary Balance (% of GDP)**

	Hurricane Joaquin FY2015/16	Hurricane Mathew FY2016/17	Hurricane Irma FY2017/18	Hurricane Dorian/COVID-19 FY2019/20	COVID-19 FY2020/21
Budget	1.5	0.2	-0.3	1.8	-8.1
Actual	-0.2	-3.2	-0.8	-4.4	-9.0
Difference	1.7	3.4	0.5	6.2	0.9
Cumulative	1.7	5.1	5.6	11.8	12.7

Sources: Budget communications; and past International Monetary Fund Article IV Consultation reports.

Notes: Budget estimates are from the year each budget was approved by the Commonwealth's Parliament. Actual figures are the most updated vintages from current and government budget communications. Calculations are partial estimates because not all the expenditures are fully attributable to the natural disaster of the year in question.

- Contingent liabilities are another key aspect of public debt in The Bahamas (Figures 11 and 12). Total debt of state-owned enterprises (SOEs) and other government agencies reached BSD 1.39 billion or 10.1% of GDP at the end of 2023:Q2, as the pandemic raised financing needs for some of these entities. Around 26.1% of public debt is held by the external sector and only 27.7% is guaranteed by the central government. Adding the total debt from SOEs to central government debt increases the public-debt-to-GDP ratio from 82.1 to 92.3% of GDP. However, since the central government holds debt from these SOEs and some of them also possess central government debt, the consolidated public-debt-to-GDP ratio declines to 87.7% of GDP.

While the debt-to-GDP ratio of SOEs has decreased over the last four years, the share of non-guaranteed debt is still a significant source of risk, particularly when considering that central government assistance to SOEs has increased over the years. Strengthening SOE governance and operational efficiency will be key to mitigate this risk.²⁶

²⁶ For more details, see Reyes-Tagle et al. (2022).

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Figure 11. The Bahamas: State-owned Enterprise Debt, 2004–2022 (% of GDP)

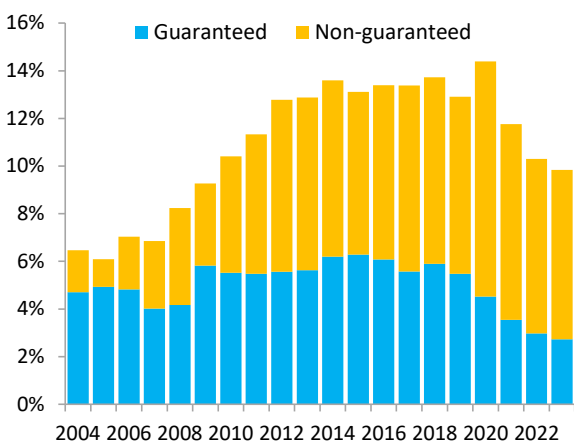
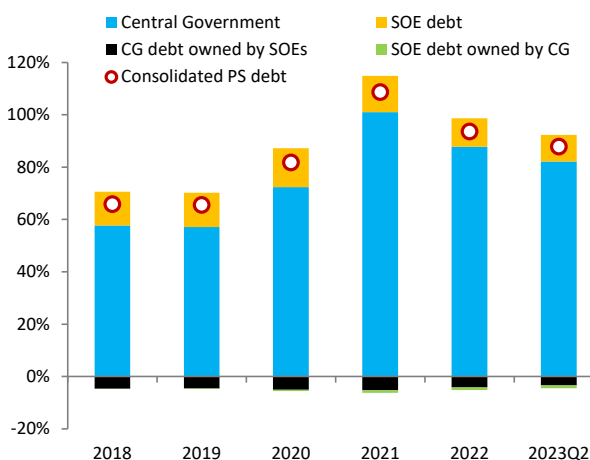


Figure 12. The Bahamas: Consolidated Public Sector Debt, 2018–2023:Q2 (% of GDP)



Source: Author's calculations based on several editions of the Central Bank of The Bahamas' Quarterly Statistical Digest, the Ministry of Finance's Quarterly Statistical Debt Bulletin, and the International Monetary Fund's World Economic Outlook database.

Note: SOE: state-owned enterprise.

- Another source of contingent liabilities is underfunded pension systems. While the non-contributory public pension system of The Bahamas is currently funded by the budget, it is increasing upward, with population aging adding more risk to the trend. Some estimates point to public and private pension systems possibly running out of funds by 2029 (ILO 2017).

Institutional Policy Framework for Debt Management in The Bahamas

A year after Hurricane Irma, in October 2018, the government of The Bahamas took a step forward in its fiscal consolidation efforts and enacted the Fiscal Responsibility Act (FRA). This law lays out the foundations of a homegrown fiscal consolidation program and includes a series of numerical fiscal rules to guide fiscal policymaking. The framework establishes three specific fiscal rules:⁷

- A ceiling on the overall budget deficit set at 0.5% of GDP (which the authorities expected to meet in FY2020/2021).
- A ceiling on the annual growth rate of current expenditures, which should remain lower than long-term nominal GDP growth (once the budget deficit target is met).
- A ceiling on government debt set at no more than 50% of GDP (expected to be met by FY2024/2025).

⁷ The framework also provides a compliance margin of 0.5% of GDP in any given fiscal year, including the transition period, to account for uncertainty in macroeconomic forecasts.



The rules are accompanied by a mandatory annual Fiscal Strategy Report (FSR) that guides the transition path toward these targets. The FRA also contains an escape clause that allows deviations “only when sudden and unexpected events arising from external shocks result in a significant economic downturn, as well as in the case of national security considerations, or natural disasters.” A Fiscal Council was also established in 2019 to help enhance transparency and bolster the credibility of the rule-based policy framework. The Fiscal Council’s mandate is to assess compliance with the law and advise on budgetary matters, including review of the fiscal strategy report, annual budget, mid-year review, pre-election economic and fiscal update, government accounts, and the government’s fiscal adjustment plan when deviations from the FRA targets are required.

During the transition phase, set between 2018 and 2020, temporary targets were established: the overall budget deficit should not exceed 1.8% of GDP in FY2018/2019 and 1% of GDP in FY2019/2020. While the FY2018/2019 overall deficit was in line with the path set in the FSR, Hurricane Dorian in 2019 activated the escape clause and delayed the achievement of the overall deficit target (of 0.5% of GDP) until FY2024/2025 and the debt ceiling target (of 50% of GDP) until FY2028/2029. The COVID-19 pandemic prompted continued use of the escape clause and consequently delayed achievement of the overall deficit and debt-to-GDP targets until FY2024/2025 and FY2030/2031, respectively.

In 2021, the authorities developed two additional key pieces of legislation to support sounder fiscal management: (i) the Public Finance Management Act (PFMA);²⁷ and (ii) the Public Debt Management Act (DMA). The DMA introduces the Medium-Term Debt Management Strategy (MTDS), which marks a key step in the annual budget formulation process and is fully aligned with the foundational macro-fiscal assumptions detailed in the FSRs.

The MTDS directs the government’s borrowing choices aimed at financing its overall fiscal deficit, while adhering to clearly defined cost and risk objectives. It considers attention to prevailing macroeconomic and financial market conditions, the accessibility of funding from diverse creditors, potential vulnerabilities that may affect future borrowing needs, and the costs associated with servicing the debt. It also establishes benchmarks for foreign currency risk, interest rate risk, and refinancing risk.

²⁷ This also changed the Fiscal Responsibility Framework, allowing for more discretion on changing the targets, among other measures.



Current Medium-term Debt Strategy

In December 2022, in accordance with mandatory reporting obligations specified in the DMA, the government published its current MTDS, which covers the period 2023/2024–2025/2026. In conceiving the optimal strategy, the government evaluated the costs and risks of four alternatives that could be followed under the prevailing domestic and external financial market conditions. Such alternatives consider the following actions: managing the proportion of foreign currency debt, changing the tenor of the debt portfolio, and using liability management operations.

The cost and risk analysis of the debt portfolio in the last MTDS highlights the exposure to moderate refinancing risk. This is because the share of debt maturing in one year over total debt has increased to 23.6% and is still around 20% of GDP. At the same time, the average time to maturity of the total stock decreased to 6.9 years due to the reduction in the average time to maturity of the debt in foreign currency from 7 to 6.3 years, while the longer average time to maturity (7.4 years) of the domestic currency debt remained constant.

On interest rate risk, although there have been increases in interest rates partly due to tighter financial conditions and the recent debt accumulation from the two consecutive shocks of Hurricane Dorian and the COVID-19 pandemic (which is reflected in the higher fixed rate of foreign exchange bonds), average time to refixing has been kept at five years over the last two years,²⁸ while the share of total debt subject to change in one year decreased by 2 percentage points to 54.5%.

Regarding foreign currency risk, since most of the foreign currency debt is denominated in U.S. dollars, the exposure of The Bahamas' debt portfolio to foreign exchange rate risk is almost null as long as the Bahamian dollar continues to be pegged to the U.S. dollar. In all, the strengthening of the U.S. dollar relative to other foreign currencies over the last couple of years has had a positive impact on the foreign currency debt of The Bahamas.

Based on the situation described above, four strategies were designed and proposed (Table 3). The first assumed keeping the previous strategy; the second focused on prioritizing issuing domestic currency bonds at larger maturities; the third emphasized reducing refinancing risk and balancing cost using foreign-currency-denominated instruments; and the fourth combined domestic market issuances and the use of external facilities (including concessional/semi-concessional loans and structured credits involving multilateral lenders), together with liability management operations. The strategies were based on the following benchmarks: (i) maintaining external debt at 30% (+/- 5% percentage points) of total debt; (ii) increasing the share of fixed

²⁸ Average time to refixing captures the vulnerability of the debt stock to higher market interest rates at the point at which the interest is reset or fixed rate debt is refinanced.

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interest rate debt (by keeping the average time to refixing greater or equal to five years); and (iii) maintaining an average time to refixing greater or equal to seven years.

The fourth strategy was chosen on the basis of reduced refinancing risk by (i) leveraging domestic sources of financing and (ii) lowering interest rate risk through increased use of fixed-rate instruments and liability management operations, but at the cost of (iii) slightly increasing the share of foreign currency debt. Moreover, after testing the effect of external shocks on each strategy,²⁹ the chosen strategy follows the FRA objectives of lowering the debt burden at the lowest possible cost and a prudent level of risk.

Table 3. The Bahamas: Alternative and Selected Medium-term Debt Strategies

Cost and Risk Indicators	FY2022	As of End-FY2025/2026				Long-term Targets
	Current	S1	S2	S3	S4	
Debt (% GDP)	86.7	70.8	70.8	70.7	70.6	< 50%
Present value debt (% of GDP)	86.3	70.0	69.9	69.9	69.8	
Interest payment (% of GDP)	4.1	3.4	3.4	3.4	3.3	
Weighted average interest rate (%)	4.8	4.7	4.7	4.7	4.6	< 5%
Debt maturing in one year (% of total)	22.2	11.9	11.5	11.5	10.5	
Debt maturing in one year (% of GDP)	19.3	8.5	8.2	8.2	7.4	
Refinancing risk						
Average time to refixing external portfolio (years)	7.0	6.9	6.9	6.9	6.8	
Average time to refixing domestic portfolio (years)	7.1	8.0	8.1	8.1	8.3	
Average time to refixing total portfolio (years)	7.09	7.41	7.45	7.46	7.43	>= 7 years
Average time to refixing (years)	5.9	5.1	5.1	5.1	5.1	>= 5 years
Interest rate risk						
Debt refixing in 1 year (% of total)	43.5	31.0	30.5	30.5	29.4	
Fixed rate debt (% of total)	73.9	79.8	79.8	79.8	80.0	
T-bills (% of total)	8.4	6.6	6.2	6.2	5.3	
FX risk						
Foreign exchange debt as % of total	44.1	42.4	40.7	41.6	44.4	

Source: Ministry of Finance, Medium-Term Debt Management Strategy 2023/2024–2025/2026.

Note: Fixed rate debt includes T-bills. Shaded area denotes best overall result.

²⁹ Simulated by 100 basis point interest rate increases on floating debt instruments and one standard deviation U.S. dollar depreciations to the non-U.S. dollar debt baseline projections.



Recent debt developments (i.e., with data until June 2023) align with the guidelines of the MTDS, particularly showing the expected shifts toward foreign currency loans (although larger than envisioned) and toward a larger share of fixed interest rates for domestic-currency-denominated securities.

Conclusions

External shocks such as hurricanes and the COVID-19 pandemic have resulted in large fiscal deficits, rising financing needs, and higher reliance on external borrowing for The Bahamas. Interest rates are high due to greater risk aversion of investors but also due to monetary policy actions in main global economies to contain increasing inflation. Financing needs for the current fiscal year remain elevated (15.2% of GDP), and although lower than previously, the debt-to-GDP ratio is still high. Accessing global financial markets has become more difficult. Debt sustainability analysis, such as that of the last IMF Article IV Consultation in 2022, predicts a decreasing path for the debt-to-GDP ratio, although analysts assume a more conservative approach than the government on the medium-term fiscal outlook. The government has acted soundly in addressing these issues not only at the operational level through its Debt Management Office and Revenue Enhancing Unit, but also at the institutional level through a series of reforms to improve both the management and governance of public finances, with instruments such as the MTDS.

The fiscal targets for FY2023/2024 and upcoming years seem ambitious. The current budget expectation is that revenues will increase 14% above those in the revised budget for FY2022/2023 (equivalent to 2 additional percentage points of GDP in tax revenue in a single year) and that total expenditures will continue a downward trend (but recurrent expenditure will increase by 0.4% of GDP). This implies a primary fiscal surplus rising from US\$39 million to US\$486 million (3.3% of GDP). In this context, the fiscal goals set for this year should be monitored early in order to react swiftly by adjusting not only the budget goals but also the medium-term fiscal strategy.

Given the efforts that have been made to regain market confidence, the government might benefit from adjusting its fiscal framework towards one more in line with the history and recent structure of the Bahamian economy. In this regard, recent studies of new approaches to and benchmarks for debt sustainability, such as those in the IDB's most recent *Development in the Americas Report* entitled *Dealing with Debt: Less Risk for More Growth in Latin American and the Caribbean*, suggest a new "prudent" public-debt-to-GDP ratio for tourism-oriented economies of 66% (Powell and Valencia 2023). An adjustment of that kind could be complemented with the introduction of an automatic adjustment mechanism like the one implemented in Jamaica (IMF 2022). Moreover, the necessity and the opportunity to build fiscal buffers could not be greater now that the Bahamian economy is in the middle of a tourism boom. In this regard, the reestablishment of the Natural Disaster Fund (which in essence is also a Macroeconomic Stabilization Fund) will not only improve resilience against natural disasters but also help bring down the debt ratio toward



more prudent levels. Last but not least, securing broad support for implementation of the ongoing and upcoming revenue and expenditure measures will be essential to achieving all these goals.

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Barbados

Cloe Ortiz de Mendivil

History of Public Debt

Barbados is one of the most indebted nations in the world and the Caribbean country with the highest debt-to-GDP ratio. However, the government's commitment to restore fiscal sustainability and macroeconomic stability is starting to bear fruit.

The 2008–2009 global financial crisis led to a decade of low growth in Barbados and deepening fiscal and external imbalances. During the 1990s, the debt-to-GDP ratio had been stable and below 60%, but it started rising in the following decade and reached 83% by FY2008/09.³⁰ From then on, debt accumulation accelerated, peaking at 158.1% in FY2017/18 (Figure 1). Investors' confidence deteriorated, the country's credit rating declined by several notches from investment-grade in 2012, access to international markets eventually dried up, and international reserves dropped sharply from US\$850 million in 2007 to US\$220 million in 2017.³¹

In 2018, the newly elected government led by Prime Minister Mia Mottley deemed the fiscal situation unsustainable and devised the Barbados Economic Recovery and Transformation (BERT) Plan to restore macroeconomic stability and return the country to a strong growth path. Supported by a four-year International Monetary Fund (IMF) Extended Fund Facility (EFF) arrangement, the plan envisioned strengthening the external position and improving growth prospects through upfront fiscal consolidation, effective debt restructuring, and structural measures to support growth.³²

In June 2018, only one week after assuming office, the government announced a comprehensive debt restructuring that took the market by surprise.³³ It included both external debt to commercial creditors and domestic debt. Debt targeted for restructuring amounted to 147% of GDP, and only bilateral external debt and debt held by multilaterals was excluded. In October 2018, an agreement with domestic creditors was announced. One year later an agreement with the external creditor committee was reached that included a 26% haircut on the original principal and past due and accrued interest, as well as issuance of a new bond with a 10-year maturity with a five-year grace period and 6.5% interest rate. In December 2019, the debt restructuring process closed

³⁰ The fiscal year in Barbados runs from April 1 to March 31.

³¹ In July 2012, S&P's sovereign credit rating for Barbados decreased from BBB- (investment-grade) to BB+. Moody's followed suit in December 2013, downgrading its rating from Baa3 (investment-grade) to Ba3.

³² The EFF arrangement was considered successful and disbursed a total of about US\$435 million. However, quantitative targets were revised downward several times and some structural benchmarks had to be delayed due to the impact of the COVID-19 pandemic on economic activity and fiscal performance (IMF 2022).

³³ For details on the debt restructuring process see IMF (2020).

Barbados



with full creditor participation, and Standard & Poor's (S&P) upgraded the country's sovereign credit rating to B-. Although the spread with U.S. bonds more than tripled following the debt structuring announcement from 700 to 2,500 basis points, it subsequently dropped to below 500 basis points when the agreement was finalized.

Overall, debt restructuring was successful, as the debt-to-GDP ratio fell to 119.0% by FY2019/20 and new debt instruments had longer maturities and grace periods, and lower interest rates. The estimated reduction in present value of domestic claims was 43% on average and 44% in U.S. dollar-denominated debt.

Barbados was making progress towards debt sustainability but shortly afterward was impacted by the COVID-19 pandemic that started in 2020. International travel came to a halt, which depressed economic activity, and the combination of lower revenues and additional expenses to support the lives and livelihoods of those most affected pressured public finances. The debt-to-GDP ratio rose again to 148.8% in FY2020/21.³⁴ In 2021, the island was hit with ashfall from the eruption of the La Soufriere volcano in neighboring St. Vincent and by Hurricane Elsa, further pressuring the fiscal stance.

Given the nature of the pandemic shock and its impact on delaying important structural reforms, the government decided to update the original BERT Plan in 2022. The government agreed on a new three-year IMF program that is a combination of an EFF and a Resilience and Sustainability Fund (RSF) arrangement.³⁵ Fiscal discipline helped keep deficits at a minimum and the country even reverted to primary fiscal surpluses. As a result, debt has been decreasing, and in FY2022/23 the debt-to-GDP ratio stood at 122.5%, returning to the pre-COVID level. In 2023, Moody's upgraded Barbados' sovereign credit rating to B3, and S&P and Fitch, though they did not change the rating, upgraded the outlook to positive.

Turning to the composition of public debt, prior to debt restructuring the share of external debt was gradually shrinking, going from above 30% of total debt in the early 2000s to below 20% in FY2017/18 (Figure 2). From then on, the proportion of external debt started to rise due to higher liquidity support from international financial institutions, especially during the pandemic. As of FY2022/23, domestic debt accounted for 64.1% of total public debt, with most of it held by the National Insurance Scheme and commercial banks. External debt is mostly held by multilaterals.

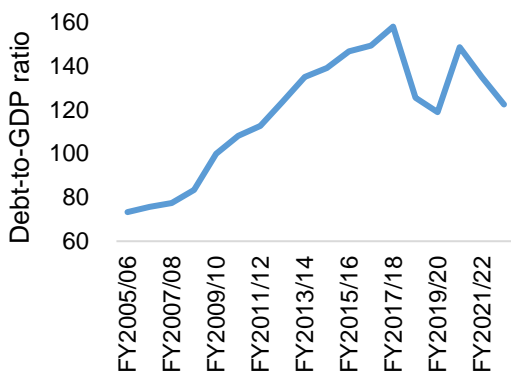
³⁴ Nominal debt increased 4.7% compared to FY2019/20, while GDP dropped 16.3%.

³⁵ The [BERT 2022 Plan](#) can be accessed on the Parliament website. See the [press release](#) stating the agreement between the IMF and the government of Barbados of September 28, 2022.

Barbados

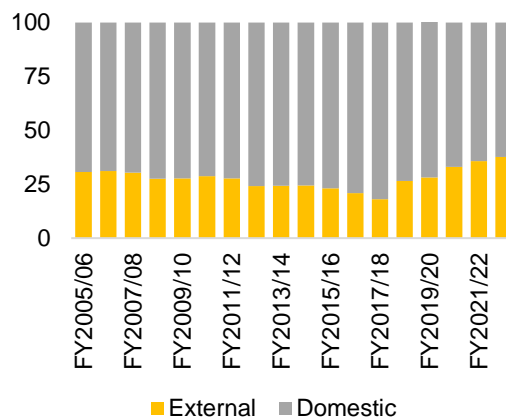


Figure 1. Barbados: Public Debt as a Share of GDP, 2005/06 to 2022/23 (Percent)



Source: IMF (2023).

Figure 2. Barbados: Public Debt Composition, 2005/06 to 2022/23 (Percent)



Sources: IMF (2023); and Central Bank of Barbados.

One of the objectives of the current debt strategy is to further develop the domestic securities market and gradually reduce the level of external debt. To that end, the Barbados Optional Savings Scheme (BOSS) bond was launched in 2020 and the BOSS+ bond in 2022.³⁶ T-bills and domestic bonds with maturities up to 10 years will continue to be offered. Notably, Barbados returned to international capital markets in September 2022 for the first time since the debt restructuring. Under the debt-for-nature conversion deal the government repurchased more expensive public debt, both domestic and external,³⁷ and obtained a blue loan that is covered by a guarantee provided by the IDB (US\$100 million) and the Nature Conservancy (US\$50 million). The savings from the transaction are expected to amount to US\$50 million over a 15-year period and will be channeled towards marine conservation.

In finding innovative ways to create fiscal space for most-needed investment in resilient infrastructure, the government is currently pursuing a new debt-for-climate swap operation with the support of the IDB, European Investment Bank, and Green Climate Fund. The savings from

³⁶ The BOSS program gave civil servants the option to turn part of their wages into a four-year domestic bond with an annual interest rate of 5%. Within 18 months, BDS\$83.8 million were issued. BOSS+ expanded access to the general public with a five-year bond that bears an annual interest rate of 4.5%, with BDS\$200 million being offered. Barbados follows a fixed exchange rate regime where US\$1 = BDS\$2.

³⁷ The government repurchased US\$77.6 million of the 6.5% note due in 2029 (denominated in U.S. dollars) and prepaid the equivalent to US\$72.9 million of the series E 8% bond due in 2043 (denominated in Barbados dollars).



the operation will be used to finance sewage treatment plant upgrades that will in turn increase water supply.

Factors Behind the Evolution of Public Debt

Debt dynamics are affected by fiscal balances, interest rates, and the growth rate of the economy. External factors such as natural disasters can also affect debt accumulation.

Barbados recorded primary fiscal deficits between FY2007/08 and FY2015/16 in all but one fiscal year (Figure 3). During this period, the annual average primary deficit stood at 1.5% of GDP, driven in part by sluggish economic activity. Real GDP shrank by an annual average of 1.7% between 2008 and 2014. Despite some improvement in the two years that followed, with growth rates above 2% and primary surpluses, activity then stalled once again. The lack of economic diversification and high dependency on the tourism sector left Barbados heavily exposed to the economic crisis in source markets. Lower disposable income and uncertainty about potential recovery affected the island's tourism performance.

Given the dire situation of public finances, high fiscal surpluses were needed to stabilize the growing debt. The IMF's EFF program started on a strong footing, and in FY2019/20 the objective of reaching a primary surplus of 6% of GDP was accomplished. However, in March 2020 the COVID-19 pandemic halted economic activity and strained the fiscal stance. Real GDP dropped in 2020 by 13.3%. Economic recovery was expected in 2021, but there were multiple spikes in COVID-19 cases. In addition, in April the ashfall from La Soufriere volcano in St. Vincent impacted the island, and in July the first hurricane in more than 60 years hit. A Category 1 storm, Hurricane Elsa caused damage estimated at around 1% of GDP. Public expenditures increased—COVID-19-related public expenditures were estimated at above 2% of GDP in each of the two first fiscal years of the pandemic and close to 1% in FY2022/23—while revenues dropped sharply. However, thanks to the authorities' commitment to fiscal adjustment, the primary deficit was contained at 1% during these two years. The economic rebound of 9.8% in 2022, driven by the tourism and construction sectors, helped reverse the primary balance deficit, with the balance returning to a surplus of 2.5% of GDP in FY2022/23.

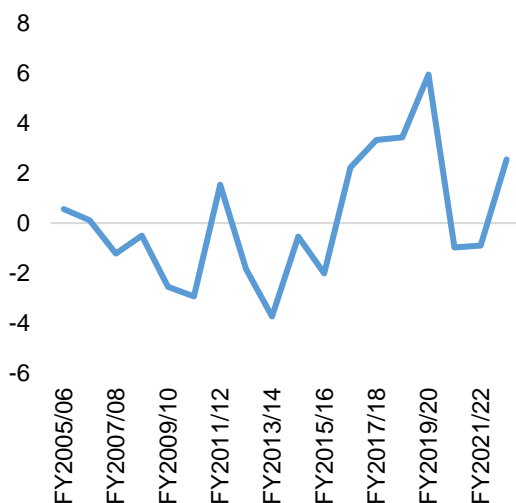
Effective interest rates between 2005 and 2017 for Barbados were around 5%, which were above nominal GDP growth for most of the years and therefore contributed to debt expansion (Figure 4). In 2018, rates decreased by half in part due to debt restructuring and to a higher influx of cheaper financing provided by international financial institutions. The trend of lower rates followed in subsequent years, but recently rates have increased again in line with global developments. Inflation has been on the rise due to higher international prices of energy and food related to supply chain issues during the pandemic and to the war between Russia and Ukraine. In advanced economies, tighter monetary policy has been used to contain the rise of inflation, which in turn has translated into higher global interest rates.

Barbados



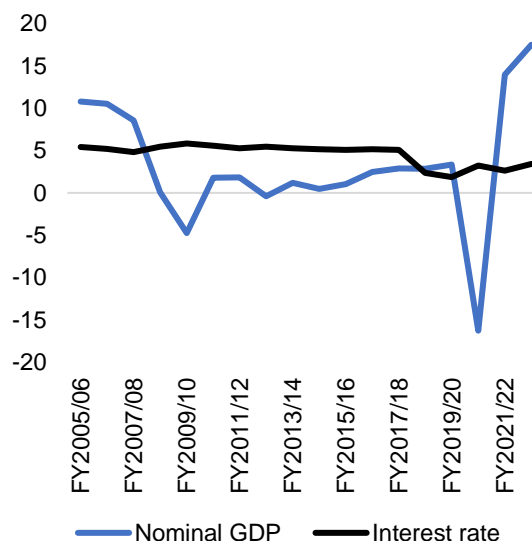
Another factor that has contributed to debt accumulation is the burden that state-owned enterprises (SOEs) represent for the central government. However, one of the core components of the BERT Plan is SOE reform, and the government is working actively in this regard. Grants to public institutions decreased from a peak of 29% of current expenditures in FY2018/19 to 19% in FY2022/23. In addition, authorities are committed to clearing arrears. Arrears on external debt have been resolved and arrears on domestic debt are expected to be cleared by FY2027/28.

Figure 3. Barbados: Primary Fiscal Balance, 2005/06 to 2022/23 (Percent of GDP)



Source: IMF (2023).

Figure 4. Barbados: Nominal GDP Growth and Effective Interest Rate, 2005/06 to 2022/23 (Percent)



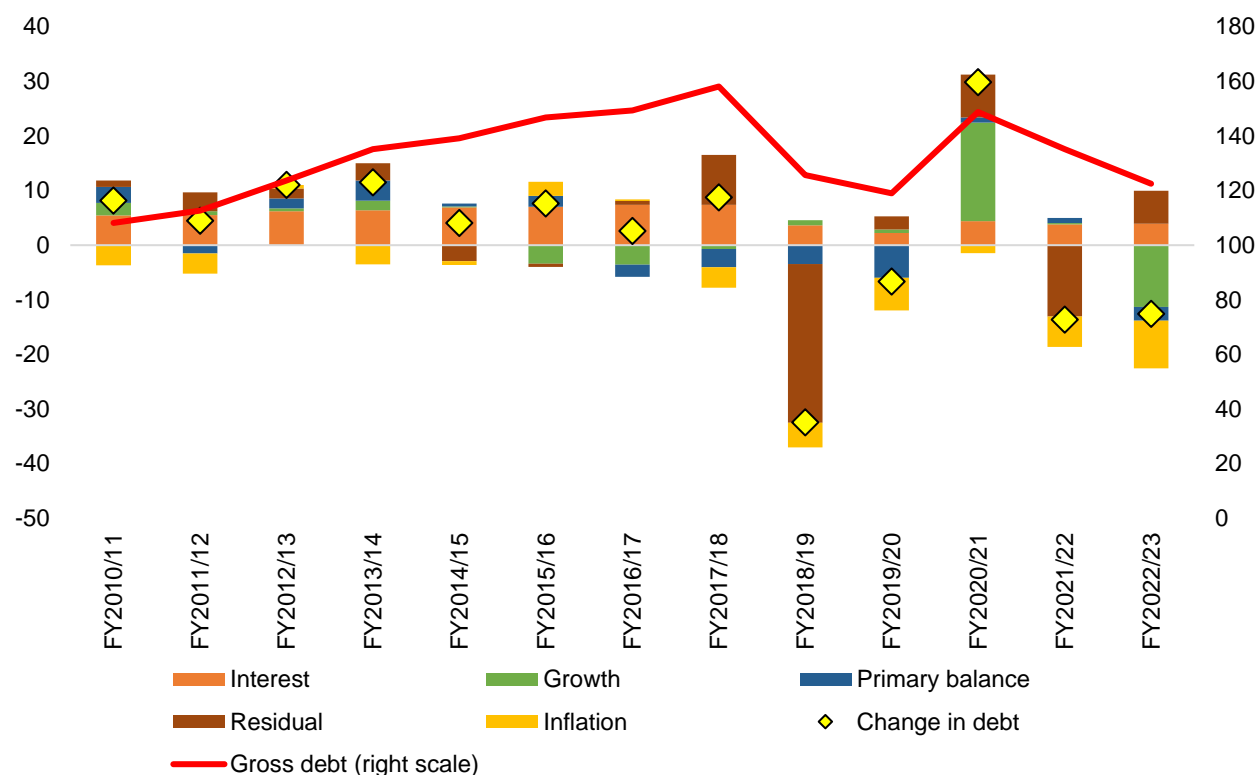
Sources: Author's calculations; and IMF (2023).

The debt decomposition exercise sheds light on the dynamics of debt accumulation (Figure 5). From FY2010/11 to FY2017/18, interest payments were the main culprit behind growing debt-to-GDP ratios. Interest as a share of GDP grew from 5.3% to 7.6% within that period. In addition, primary deficits and sluggish growth also contributed to increases in the debt-to-GDP ratio in most of those years. Inflation, on the other hand, acted as a counterforce. In FY2018/19, the sharp reduction in debt was attributed to the residual, and in fact, is explained by the debt restructuring the country undertook, which included haircuts. Fiscal adjustment and inflation in the next year helped reduce the debt-to-GDP ratio, but the COVID-19 impact increased debt once again, mainly due to the sharp drop in economic growth. The improvement in the last two fiscal years is attributed to deeper inflation and to a recovery in GDP.

Barbados



Figure 5. Barbados: Decomposition of Factors Affecting the Debt-to-GDP Ratio, 2010/11 to 2022/23 (Percent)



Source: Author’s calculations based on the International Monetary Fund’s World Economic Outlook and International Financial Statistics databases; Country Statistical Offices; and the World Bank’s International Debt Statistics.

Institutional Policy Framework for Debt Management

In Barbados, the Minister of Finance, Economic Affairs and Investment is in charge of all matters related to public borrowing, and different pieces of legislation delegate authority to corresponding bodies. Various divisions of the Ministry of Finance, Economic Affairs and Investment and the Central Bank of Barbados have debt management responsibilities. There is a Debt Management Unit within the ministry along with several committees, including a Debt Working Group.

Although Barbados does not have a comprehensive debt law, the government is working towards that goal and currently conducting a review of debt management practices. At present, legislation governing borrowing and debt management includes the Financial Management and Audit Act, Public Finance Management Act of 2019, Local Loans Act, Treasury Bills and Tax Reserve Certificate Act, Savings Bond Act, Special Loans Act, External Loans Act, Guarantee of Loans



(Companies) Act, and the Central Bank of Barbados Act. Within the context of the debt restructuring of 2018–2019, the Debt Holder (Approval of Debt Restructuring) Act 2018, the Debt Holder (Approval of Debt Restructuring) (Amendment) Act 2019, and the Dematerialisation of Government Securities Act were passed. Recently, the Debt (Natural Disaster and Pandemic Deferment of Payment) (Miscellaneous Provisions) Bill, 2023, was passed by the House of Assembly.

In particular, the responsibilities of the Ministry of Finance regarding debt management are governed by the [Public Finance Management Act 2018](#), passed in January 2019. This legislation introduced measures to improve fiscal transparency and accountability and strengthen SOE oversight. It lists three fiscal responsibility principles that need to be followed: (i) achieving and maintaining a prudent level of public debt, (ii) managing fiscal risks in a prudent manner, and (iii) pursuing macroeconomic stability, inclusive growth, and intergenerational equity. The act mandates that a medium-term debt management strategy and borrowing plan consistent with such fiscal responsibilities be presented to Parliament in conjunction with the annual budget. Importantly, to enhance transparency the act establishes the Internal Audit Office.

In both the BERT 2018 and BERT 2022 Plans, enhancing debt management is a priority. The [Medium Term Debt Management Strategy Fiscal Year 2023–2024 to 2025–2026](#) reiterates that the principal objectives for debt management in Barbados are to (i) ensure that the government's financing needs and payment obligations are met on a timely basis, at the lowest possible cost, and within a framework consistent with an acceptable level of risk; (ii) ensure that public debt levels are put on a downward trajectory toward sustainability with a long-term debt-to-GDP target of 60% by FY2035/36; and (iii) further develop domestic market securities.

Noting that Barbados is heavily exposed to the effects of climate change, and that shocks can pose a challenge to public debt management, a new piece of legislation, the [Debt \(Natural Disaster and Pandemic Deferment of Payment\) \(Miscellaneous Provisions\) Bill, 2023](#), was passed by the House of Assembly and is currently pending approval at the Senate. The bill would allow the government to defer payments of principal and interests for two years in the event of a natural disaster or a pandemic that triggers a policy payment under the Caribbean Catastrophe Risk Insurance Facility. This tool would allow for some breathing room at times when fiscal needs unexpectedly rise.

Finally, it is worth noting that even though Barbados does not have a quantitative fiscal rule, in 2021 the government established a procedural fiscal rule to improve fiscal transparency and secure benefits from fiscal consolidation. The rule includes the obligation to prepare an annual fiscal framework that can be monitored and an annual mid-year review report, and to implement corrective responses when deviations occur. An Independent Fiscal Council was established in 2023 to monitor implementation of the fiscal strategy, further strengthening the government's fiscal framework and promoting sound fiscal management to sustain fiscal discipline and macroeconomic stability.



Conclusions

Even though Barbados is one of the most indebted countries in the world, the government is fully committed to returning debt to a sustainable path and promoting reforms to foster economic growth for all. The progress made after tough adjustments were implemented, including debt restructuring, was wiped out by the COVID-19 pandemic shock, but those initial efforts left the country better positioned than others to tackle the crisis. Tailwinds are on the horizon and a strong tourism recovery is finally materializing. This will provide momentum to consolidate the fiscal stance and continue with implementation of the reform agenda. Finally, the government is strongly engaged in improving debt management and in finding innovative ways to create savings that can be channeled towards building resilience within a context of limited fiscal space and expanding needs.

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Guyana

Victor Gauto

History of Public Debt

Guyana's history of public debt has evolved from being vulnerable to unsustainable levels of public debt beginning in the 1990s to the current context of sustainable debt levels and declining debt-to-GDP ratios on the back of booming GDP growth. The unsustainable debt levels of the 1990s significantly burdened public finance. External public debt as a share of GDP was reported to be as high as 607% of GDP in 1993, falling to 218% of GDP in 1996. External debt levels reached US\$2 billion in 1993 (IMF 1998). In 1996, Guyana benefited from significant debt relief by participating in the Highly Indebted Poor Countries (HIPC) Initiative and later the Multilateral Debt Relief Initiative (MDRI), which were both implemented by the International Monetary Fund (IMF) and World Bank. The HIPC Initiative began in 1996 to support low-income countries with unsustainable debt burdens, followed by the MDRI in 2005. In 1999, the IMF announced Guyana had met the requirements to receive US\$410 million in debt relief.³⁸ In 2007, the IDB provided debt relief for US\$470 million.³⁹ Paris club creditors also provided debt relief in the amount of approximately US\$ 930 million between 1996 and 2004.⁴⁰

Total debt relief for Guyana by the early 2000s amounted to US\$2.1 billion, including US\$1.3 billion from the HIPC Initiative and US\$710 million from the MDRI (IMF 2016). These programs contributed to lowering Guyana's debt-to-GDP ratio from 108% in 1998 to 47% in 2007, then averaging 46% over 2007–2020 (Figure 1). After Guyana's oil-driven GDP boom started in 2020, the debt-to-GDP ratio declined further to 26% in 2022. The main sources of debt are domestic debt, which accounts for 58% of total public debt in June 2023. The largest external creditors are the IDB, China, and the Caribbean Development Bank, which account for 20%, 6%, and 4% of total debt, respectively (Figure 2).

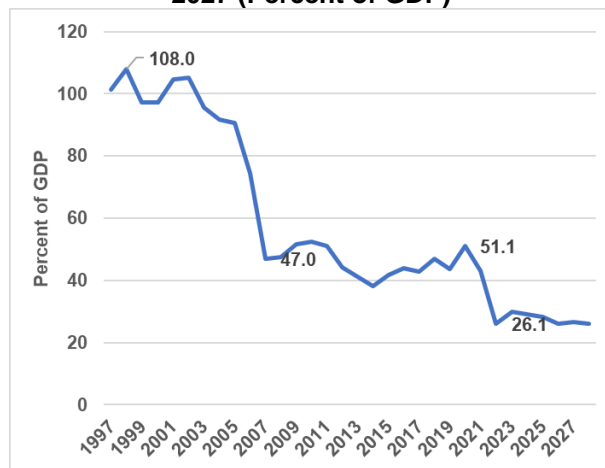
³⁸ IMF, 1999, "Guyana to Receive Over US\$400 Million in Debt Relief," Press Release (April 14), available at www.imf.org/en/News/Articles/2015/09/14/01/49/pr9917

³⁹ IDB, 2007, "IDB Governors Approve \$4.4 Billion in Debt Relief for Bolivia, Guyana, Haiti, Honduras, and Nicaragua," Press Release (March 16), available at www.iadb.org/en/news/idb-governors-approve-44-billion-debt-relief-bolivia-guyana-haiti-honduras-and-nicaragua

⁴⁰ Paris Club, 2004, "The Paris Club Agrees to Reduce Guyana's Debt by US\$95 Million in Net Present Value Terms Under the Enhanced HIPC Initiative," Press Release (January 14), available at https://clubdeparis.org/sites/default/files/node/field_treatment_files_attached/PrGuyana6870.pdf#:~:text=PRESS%20RELEASE%20THE%20PARIS%20CLUB%20AGREES%20TO%20REDUCE,Governments%20a%20reduction%20of%20Guyana's%20stock%20of%20debt

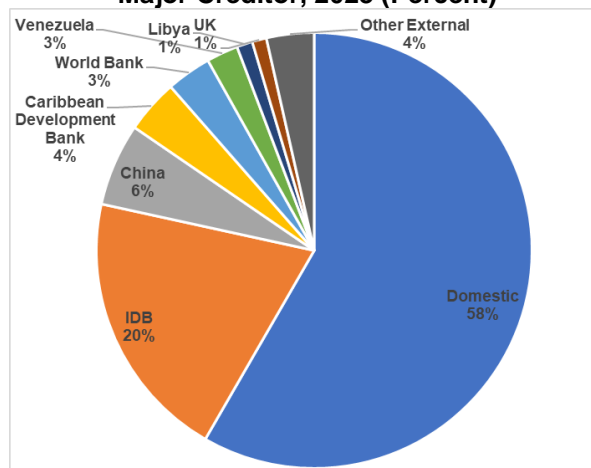


Figure 1. Guyana: Public Sector Debt, 1997–2027 (Percent of GDP)



Sources: Author’s calculations; IMF (2023a) and historical IMF World Economic Outlook databases; and Ministry of Finance (2023).

Figure 2. Guyana: Share of Public Debt by Major Creditor, 2023 (Percent)



Source: Ministry of Finance (2023).

Evolution of Key Macroeconomic Variables Affecting Debt

The composition of Guyana’s public debt changed in 2020, when domestic debt surpassed external debt. As mentioned previously, the country benefited from external debt relief through the early 2000s. Still, in the mid-2010s most of Guyana’s stock of public debt was external debt, which made up more than 70% of total debt. External debt averaged US\$1.3 billion over 2016–2021. Domestic debt increased from an average of US\$450 million in 2016–2019 to US\$1.7 billion in 2020–2022. The main driver of the increase was the government’s securitization for US\$783 million of the central government’s overdraft with the central bank in 2020. The securitization was an important step towards providing a complete picture of the government’s debt. Domestic debt increased after 2020, mainly due to issuance of new Treasury bills (Figure 3).

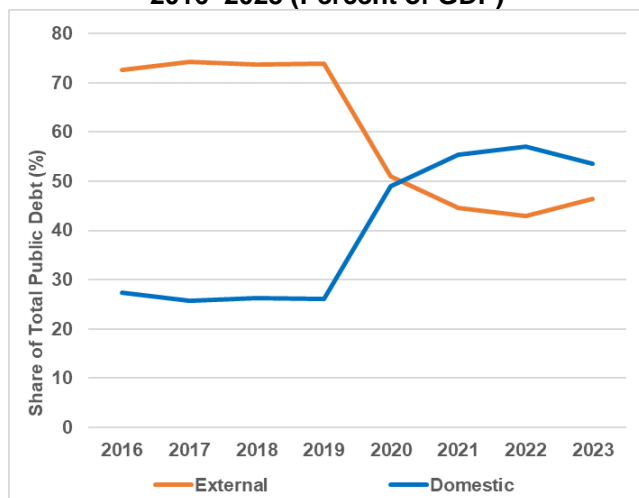
As discussed in the Regional Overview of this report, nominal GDP growth, the implicit interest rate, and the debt-to-GDP ratio can be used to calculate the government’s primary fiscal balance that would maintain the current debt-to-GDP level, or the “required primary balance.” The primary balance is made up all government revenues, less all government expenditures except interest payments, such that the primary balance is higher than the overall fiscal balance. The required primary balance is simply the difference between the implicit interest rate and nominal GDP growth multiplied by the previous year’s debt-to-GDP ratio, as defined in the Regional Overview. The implicit interest rate can be calculated by taking the difference between the primary fiscal balance and the overall fiscal balance, which represents interest payments, and dividing that value by the previous year’s level of total debt to obtain an estimate of the nominal interest rate. Whenever the implicit interest rate is higher than the GDP growth rate, the government should



have a primary surplus to maintain current levels of debt. The difference between the required primary surplus and the actual primary surplus defines the fiscal adjustment that is needed to avoid spiraling debt.

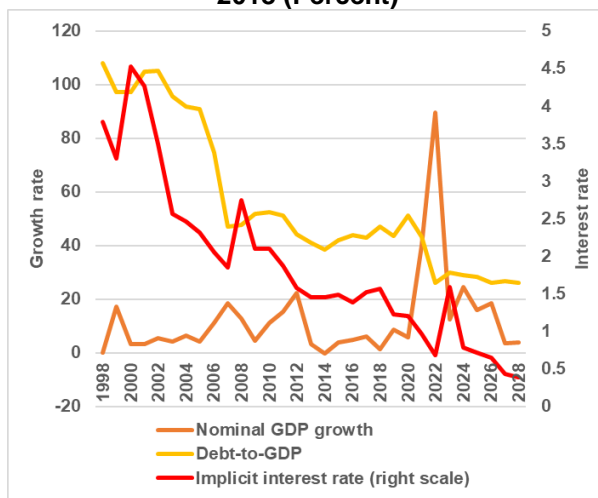
Figure 4 shows recent trends in nominal GDP growth, the implicit interest rate, and the debt-to-GDP ratio. The implicit interest rate declined in the 2000s, suggesting that interest payments significantly decreased when debt relief was provided, dropping from 4.5% in 2000 to less than 1% in 2022. In fact, the average implicit interest rate was 2.2% over 1998–2022, compared to an average nominal GDP growth rate of 12% in the same period. This suggests that in most years, Guyana had a primary deficit and still maintained current levels of debt. Clearly, the implicit interest rate for Guyana is relatively low, which is explained by the country’s historical access to concessional or low interest lending rates from multilateral and bilateral lenders as well as relatively low domestic interest rates. Implicit interest rates could increase with a future fall in the share of concessional debt.⁴¹

Figure 3. Guyana: Domestic vs. External Debt, 2016–2023 (Percent of GDP)



Source: Ministry of Finance, Mid-Year Report and Budget Speeches.

Figure 4. Drivers of the Primary Balance, 1998–2018 (Percent)



Source: IMF (2023b).

These trends, based on Guyana’s relatively low interest rates, are summarized in Figure 5, which compares actual primary balances with estimated “required” primary balances. The figure shows that during several years the required primary balance was a larger deficit than the actual primary deficit, such as from 2010–2012, which favors debt sustainability. If nominal interest rates had

⁴¹ In 2020, Guyana graduated from concessional status at the IDB, such that new loans starting in 2021 are based on Ordinary Capital, not Concessional Ordinary Capital. The interest rate on concessional loans at the IDB is 0.25 percent with a 40-year maturity and grace period. The interest rate on government Treasury bills varied between 1 and 1.54 percent in 2022.

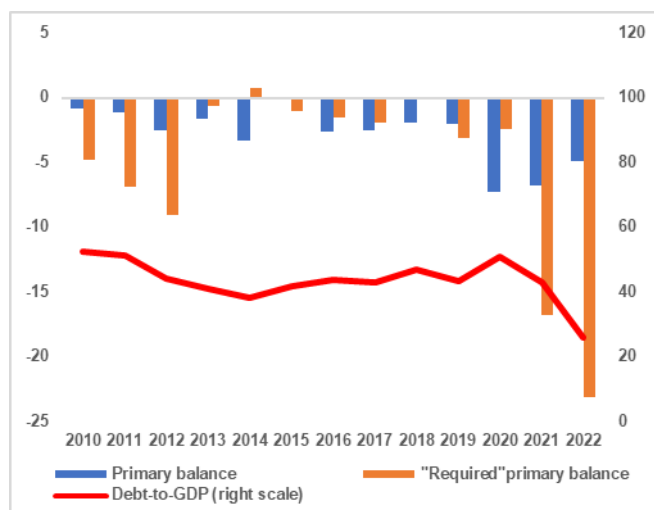


hypothetically been 6 percent, the required primary balance would have been lower than the balances shown in Figure 5. Still, Guyana's average nominal GDP growth before the oil boom was 7.4 percent over 2000–2018, suggesting that the required primary balance would have been a primary deficit in several years, even with hypothetically higher interest rates.

Several factors drive changes to overall levels of debt, as discussed in the Regional Overview. As discussed earlier, Guyana's history of public debt is filled with economic developments, such as the episodes of debt relief, falling interest payments, and the current economic boom. All can be observed in an exercise estimating the contribution of different components to public debt (Figure 6). The exercise identifies drivers of public debt levels to include GDP growth, interest rates, inflation rates, the primary balance, currency depreciation, and a residual that captures any other unidentified factors. The sum of all these factors equals the change in the debt-to-GDP ratio as shown. For example, currency depreciations make it more costly to repay external debt. In Guyana, depreciations were only a factor in 1999, when the currency depreciated by 18%. However, nominal GDP increased by 17% that year, helping to offset the negative impact of the currency depreciation (Figure 6). The debt-to-GDP ratio declined from 108% of GDP in 1998 to 97% of GDP in 1999. GDP growth appears as a major driver of a declining debt-to-GDP ratio in 2020, 2021, and 2022, with declines averaging 13% for those years. Finally, the residual played a significant role in driving declines in the debt-to-GDP ratio in 2006 and 2007, when the levels declined by 16% and 27% of GDP, respectively, as explained by the debt relief programs discussed earlier. Guyana's level of debt fell from US\$1.5 billion in 2005 to US\$1 billion in 2007. The residual also played a role in 2020, contributing to a higher level of debt despite a GDP growth rate of 43.5%, potentially capturing the effect of the securitization of the central government's debt with the central bank explained above.

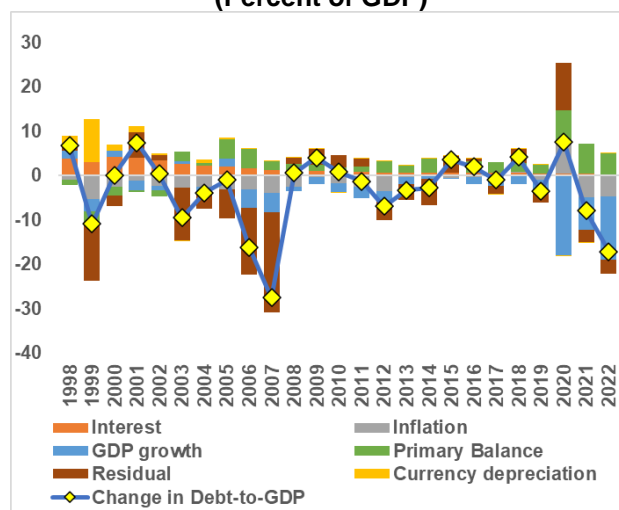


Figure 5. Guyana: Required and Actual Primary Balances, 2010–2022 (Percent of GDP)



Source: Author's calculations based on the International Monetary Fund's World Economic Outlook database.

Figure 6. Guyana: Decomposition of Factors Affecting the Debt-to-GDP Ratio, 1998–2022 (Percent of GDP)



Source: Author's calculations based on the International Monetary Fund's World Economic Outlook database and the World Bank's International Debt Statistics.

Institutional Policy for Fiscal and Debt Management

In recent years, Guyana has introduced several policies to strengthen the fiscal framework and debt management. A significant achievement was the legislation creating the Natural Resource Fund (NRF), which governs the management of government oil revenues, favors transparency, promotes economic development, and allows for saving for future generations. As the volume of oil production continues expanding in Guyana, so will the volume of government oil revenues flowing into the NRF. The NRF is held abroad, which contributes to mitigating risk of exchange rate appreciation, as Guyana's oil revenues do not flow into the economy directly. A framework such as the NRF is particularly valuable for a resource-rich country like Guyana, since it mitigates budget revenue volatility. The NRF sets clear rules on how to make transfers from the NRF to the budget, and the projected amounts are reported in budget documents. For example, the NRF is projected to receive between US\$1.6 billion and US\$2.7 billion in 2023 through 2026, of which between US\$1 billion and US\$1.3 billion is projected to be transferred to the budget (Ministry of Finance, Budget Speech, 2023).

The government has also worked on developing a Medium-Term Expenditure Framework to strengthen planning. Such frameworks address questions regarding what, when, and how the government plans to implement policy. They can articulate policy goals and the budget over a multi-year horizon. This fiscal tool contributes to promoting fiscal discipline and sustainability and helps to focus resources on expenditure priorities. It also identifies risks to the fiscal outlook and considers potential risk mitigation measures.



Finally, the government has established a Public Debt Policy for 2021–2024 that guides its contracting of debt from both domestic and external sources, with the objective of ensuring long-term debt sustainability. One of the risks to public debt Guyana faces is reduced access to concessional or low interest rate lending as a result of the economic boom. Guyana's Public Debt Policy recognizes this risk, which is one of several reasons why country needs to strengthen debt management. The policy states that in 2020 Guyana's average cost of borrowing was an interest rate of 1.5%, a rate that could gradually increase over time.

Conclusions

Guyana has a rich history of managing various levels of debt. Historically, a low-income country, Guyana was able to access programs supporting debt sustainability such as concessional sources of financing and debt relief from both bilateral and multilateral development partners. These events were observable in the empirics discussed in this chapter, where low implicit interest rates drove required primary balances smaller than the actual primary balance for many years. However, Guyana has transitioned into a high-growth economy, which has opened access to finance from multiple sources and reduced access to concessional resources. Under these new conditions, continuing to strengthen transparency, multi-year planning and budgeting, and effective debt management will be fundamental for Guyana to remain on a sustainable development trajectory. This will serve to transform the country's economic boom into higher levels of productivity, better public services, and better employment opportunities across the entire economy.

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Jamaica

Henry Mooney

Overview

Jamaica's recent economic history is extraordinary. There are few countries on earth that have experienced such a reversal of fortune over a comparably short period. After decades of boom-bust cycles, Jamaica achieved a dubious distinction in 2012/13—being crowned the third most indebted country in the world (measured by public debt-to-GDP), behind only Greece and Japan at the time (Mooney, Prats, and Rosenblatt 2021). In the decade since, Jamaica's extraordinary effort and progress with the reform of economic institutions, consolidation of public agencies and state enterprises, and prudent fiscal policies have transformed it into Latin America and the Caribbean's strongest performer with respect to fiscal consolidation and debt reduction (IDB 2022, Box 2.1). With the right support, Jamaica's story sets an example that can be emulated by other countries, assuming policymakers can build a public consensus in support of transformational reforms, and summon the political will to carry them through. This chapter details some of the key pillars of this transformation, with an emphasis on less obvious factors.

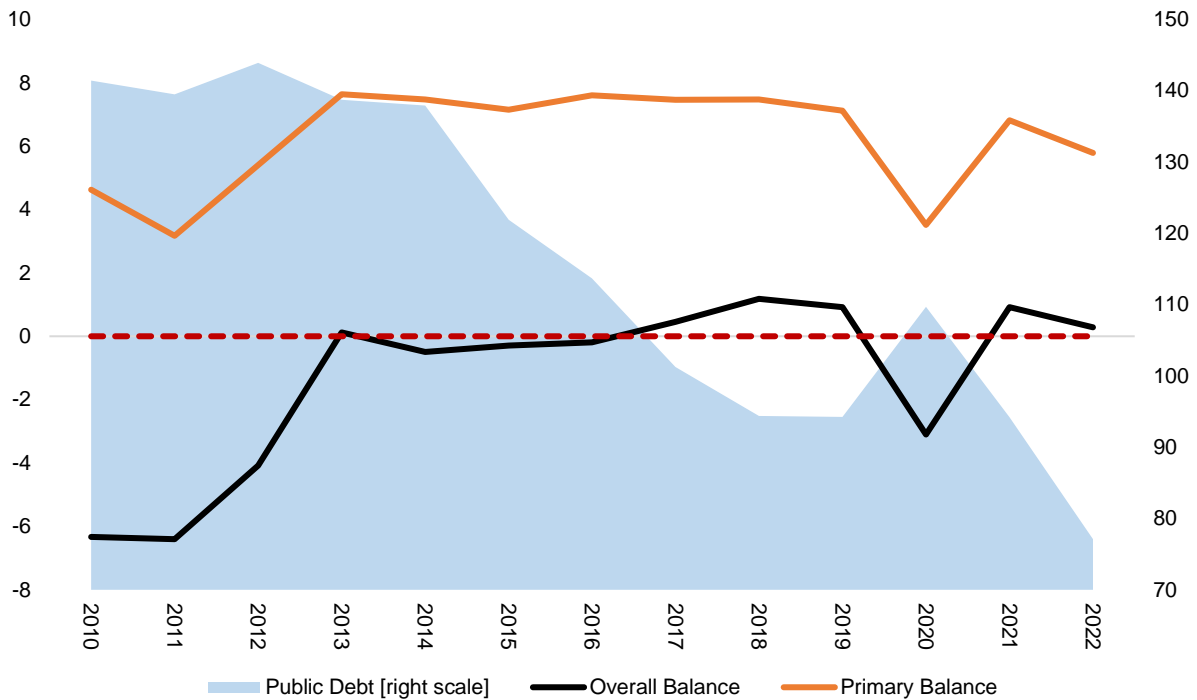
History of Public Debt

Jamaica has long suffered from macroeconomic volatility and unsustainable debt burdens. Before 2010, debt had risen sharply and financing costs had soared. A first restructuring of domestic debt in 2010 was accompanied by several fiscal reforms. But debt levels did not fall, and the debt-to-GDP ratio reached a peak of well over 140 percent in 2012/2013.⁴² Against the backdrop of a subsequent program supported by the International Monetary Fund (IMF), with both financial and technical support from the IDB, Jamaica's debt ratio began to decline precipitously after revising and fully implementing its Fiscal Responsibility Framework (FRF), along with other significant reforms of fiscal policy and the structure of the public sector, as well as of the exchange rate and monetary policy regimes beginning in about 2014. As a result, Jamaica's fiscal effort (primary fiscal surplus of about 7 percent per year on average from 2015 to 2022) has exceeded that of all other Latin American and Caribbean countries, and has been ranked among the top five countries globally. Public debt levels fell to about 77 percent of GDP at end-2022, and are expected to continue falling rapidly over the medium term (Figure 1).

⁴² Based on the definition of public debt that prevailed at the time. This has since been revised to exclude certain categories of obligations.



Figure 1. Jamaica: Evolution of the Public-Debt-to-GDP Ratio, 2010–2022 (Percent)



Sources: IMF (2023); and author's calculations.

Note: Data displayed are based on a revised definition of public debt, excluding central bank debt. The debt level for 2012/2013 discussed in the main text was based on the previously reported definition in place at that time, which was modestly higher.

Fiscal Policy and Institutions: A Key Pillar of Successful Consolidation

As noted, a key driver of Jamaica's improved performance has been the FRF, which includes two rules: a balanced budget rule and a debt rule (IDB 2022, Box 2.1). In 2014, a floor was set on the overall balance of the covered public sector, with the objective of reducing public debt to 60 percent of GDP, initially targeted for 2026. In 2020, this target date was pushed back to 2028 as a result of the shock to growth and public finances brought on by the COVID-19 crisis. The FRF's well-designed escape clause and automatic correction mechanism enabled the government to push back the target date. Specifically, the FRF's targets were designed to be amendable on the grounds of national security, national emergency, or other exceptional circumstances, as determined by the Minister of Finance and Public Service. Key features of the correction mechanism include the stipulation that deviations be recorded, with the expectation that future fiscal adjustments will be made to return the trajectory of fiscal aggregates to a path consistent with public debt targets. Box 1 presents more details on the benefits of the rule in the context of the recent crisis.

Box 1. Jamaica and COVID-19: Benefits of a Sound Fiscal Rule

Jamaica's fiscal performance up to and through the COVID-19 crisis illustrates the benefits of a rule-based regime. The pandemic provided a significant external test of Jamaica's Fiscal Responsibility Framework (FRF). The country's real GDP contracted by about 10 percent in 2020, owing largely to its dependence on tourism. In line with the FRF's built-in flexibility, amendments to the framework were approved in May 2020 to accommodate the pandemic shock, while continuing to adhere to a transparent consolidation path. The Minister of Finance and the Public Service extended the FRF target date to reduce public debt to 60 percent of GDP from 2026 to 2028, as permitted under the framework, allowing the primary fiscal surplus target to be trimmed from 6.5 to 3.5 percent of GDP for FY2020/2021, without compromising credibility. Credit rating agencies and investors have welcomed the government's pre-crisis fiscal efforts guided by the FRF and cited its flexible and fluid operation during the crisis as factors supporting positive ratings and a minimal deterioration of risk premia on sovereign debt, despite the worst single-year GDP contraction in Jamaica's history during 2020.

Source: IDB (2022, Box 2.1).

These and many other reforms have helped not just to improve debt and fiscal outcomes, but also to improve economic stability, resilience, and debt sustainability. Nowhere has this—and the external perception thereof—been more obvious than in the recent upgrades of Jamaica's credit rating by two of the major international credit rating agencies. As noted above, Jamaica's public debt levels had reached unsustainable heights from 2010 to 2013, precipitating two domestic debt operations resulting in rescheduling from private creditors. These two events resulted in Standard and Poor's (S&P) assigning a "selective default" rating to the Jamaican government (Table 1). Since 2013, both S&P and Moody's have been steadily improving their assessments of default risk and debt sustainability for Jamaica, driven by both sustained debt reduction and what they consider to be durable improvements in the economic institutional environment. While Jamaica's ratings are still below investment-grade (considered to be a rating of BBB/Baa3 or above)⁴³, both S&P (to BB- in September 2023) and Moody's (to B1 in October 2023) recently issued higher ratings to Jamaica's sovereign. This coincides with a recent debt issuance milestone—Jamaica's first-ever local currency international bond, issued on November 3, 2023 in the amount of J\$46.6 billion, equivalent to US\$300 million.⁴⁴ The success of this operation points to growing confidence in Jamaica's stability and sustainability as a debt issuer.

⁴³ Bonds with a rating of BBB- (S&P) or Baa3 (Moody's) or better are considered "investment-grade". Bonds with lower ratings are considered "speculative".

⁴⁴ The issuance, which was oversubscribed 1.4 times, consists of Senior Unsecured Notes due in 2030. The operation represents the inaugural Jamaican dollar-linked transaction for the government of Jamaica in international capital markets, and is in line with the objective of reducing foreign exchange risks in the public debt portfolio.



Table 1. Jamaica: Sovereign Credit Ratings from Moody's and S&P, 2010–October 2023

Agency	Rating	Date
Moody's	B1	Oct 18 2023
S&P	BB-	Sep 13 2023
S&P	B+	Oct 04 2021
S&P	B+	Apr 16 2020
Moody's	B2	Dec 11 2019
S&P	B+	Sep 27 2019
S&P	B	Sep 25 2018
Moody's	B3	Jul 20 2018
Moody's	B3	Nov 21 2016
S&P	B	Jun 03 2015
Moody's	Caa2	May 28 2015
S&P	B-	Sep 19 2014
Moody's	Caa3	Feb 12 2014
S&P	CCC+	Mar 07 2013
S&P	CCC+	Mar 06 2013
Moody's	Caa3	Mar 06 2013
S&P	B-	Feb 24 2013
Moody's	B3	Feb 14 2013
S&P	Selective default	Feb 12 2013
S&P	B-	Oct 31 2011
Moody's	B3	Mar 02 2010
S&P	B-	Feb 24 2010
Moody's	Caa1	Jan 22 2010
S&P	Selective default	Jan 14 2010

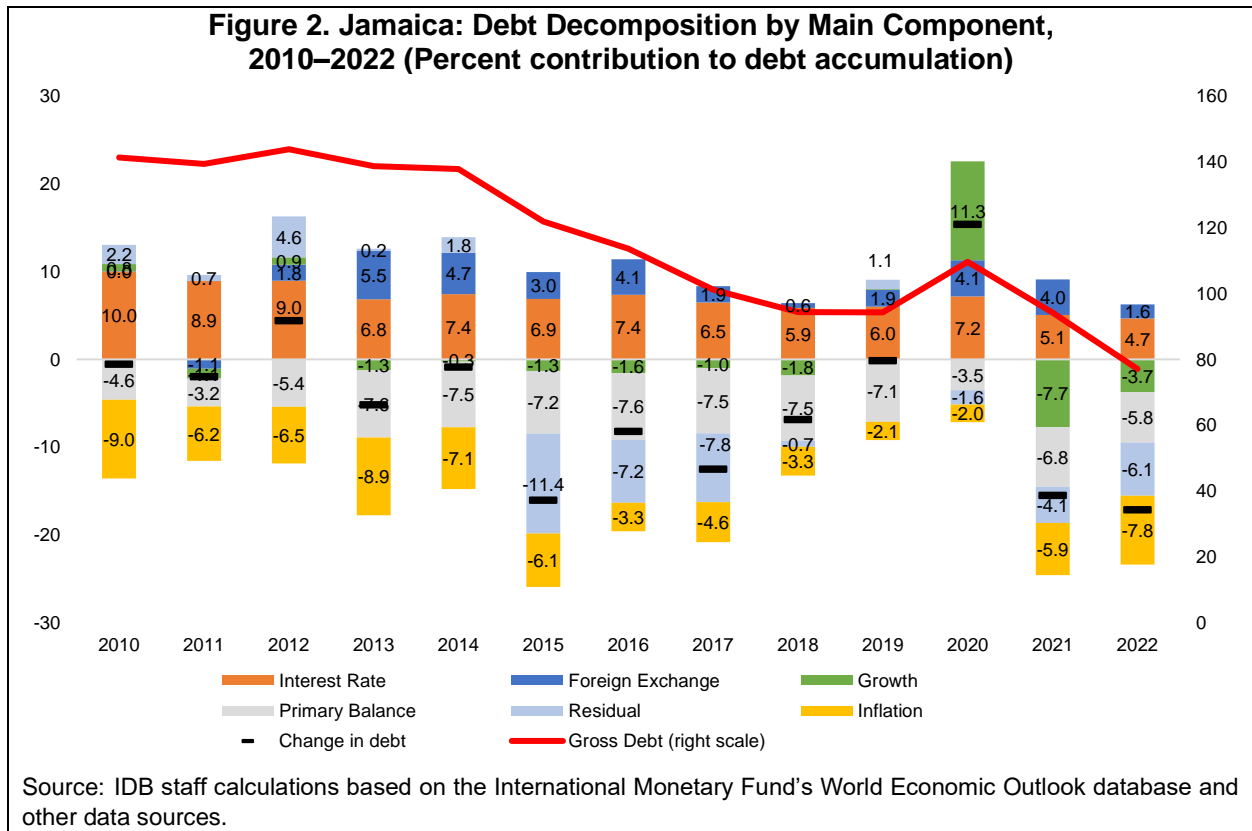
Source: TradingEconomics.com.

Beyond Fiscal Balances: A Debt Decomposition

While fiscal policy has been a key driver of Jamaica's success with debt reduction, many other factors have also played important roles. To better understand some of these forces, it is helpful to turn to a decomposition of public debt and its evolution, focused on the six main constituent variables: fiscal outcomes, GDP growth, inflation, interest rates, changes in the foreign exchange rate, and what is commonly termed the "residual" (which, as explained below, incorporates several important policy-influenced and exogenous developments) (Figure 2). While fiscal issues and their key drivers were discussed at length above, it is worth delving into the other key variables in more detail to understand what else has affected Jamaica's success story.



Figure 2. Jamaica: Debt Decomposition by Main Component, 2010–2022 (Percent contribution to debt accumulation)



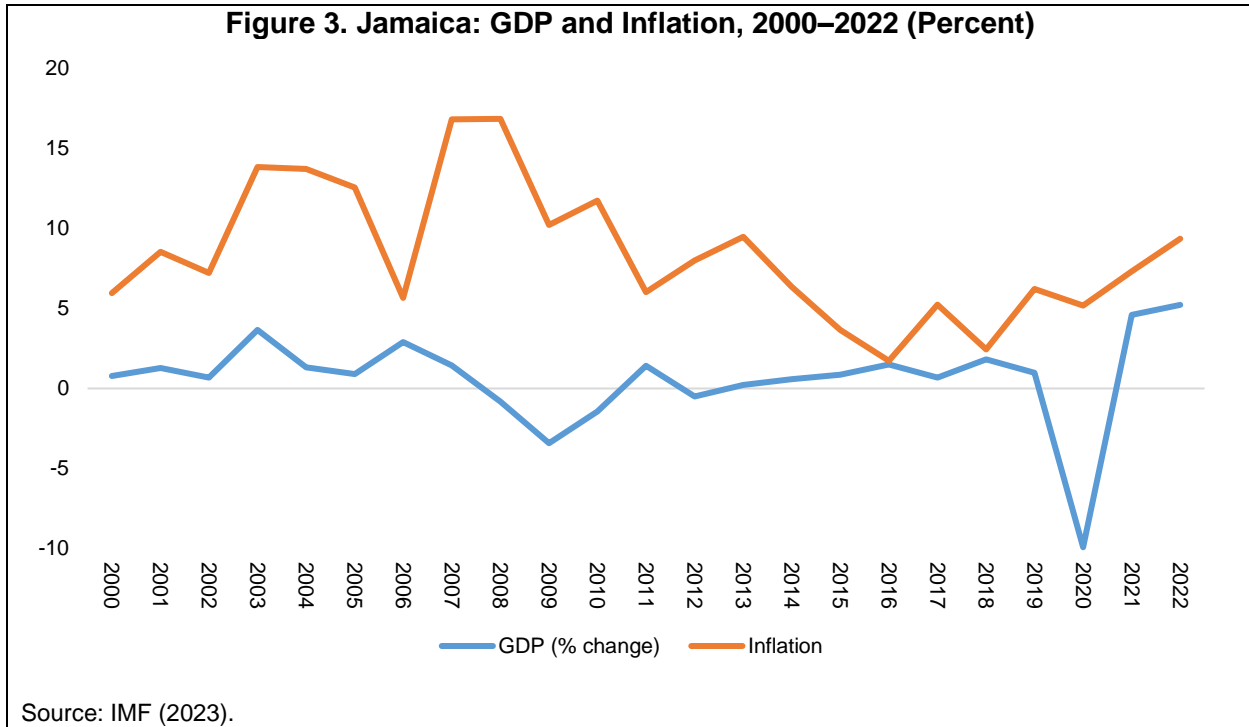
Source: IDB staff calculations based on the International Monetary Fund's World Economic Outlook database and other data sources.

GDP Growth

As noted above, Jamaica has long suffered from economic volatility and relatively low levels of growth. Since 1980, GDP growth has averaged less than 1 percent per year. But the largest shock to growth came in 2020—a decline of about -10 percent driven by COVID-19 and the loss of tourism (Figures 2 and 3). Against this backdrop, IDB research has shown that Jamaica is one of the most tourism-dependent economies in the world (Mooney and Zegarra 2020). Owing to strong policies and a rapid rebound in tourism, real GDP growth was about 4.6 percent in 2021 and 5.2 percent for 2022, resulting in a roughly equivalent improvement in the debt-to-GDP ratio in those two years. Despite this near-term rebound, our debt decomposition shows that since 2010, GDP growth has been only a modest contributor to overall debt reduction, with 2020 and the subsequent rebound in output standing out as a notable outlier.



Figure 3. Jamaica: GDP and Inflation, 2000–2022 (Percent)

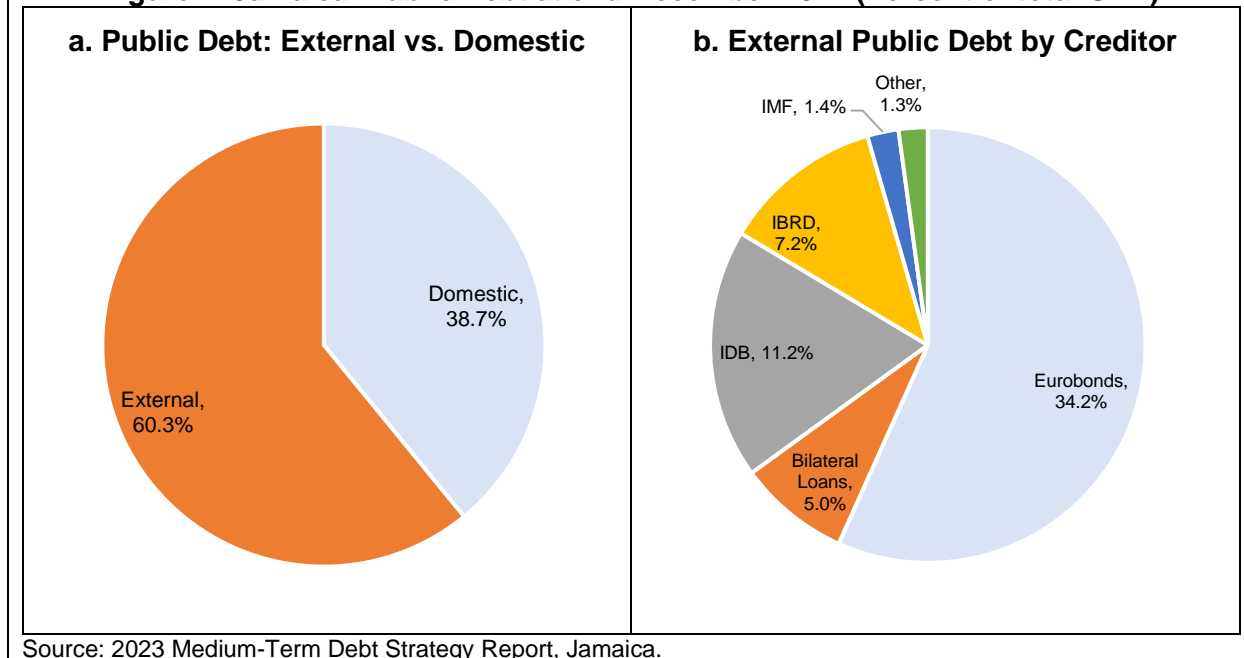


Inflation

The Bank of Jamaica (BOJ) implemented an inflation-targeting regime in 2017, with a target band of between 4 and 6 percent. This helped to ensure that despite manifold external shocks, inflation has not risen to the highs observed in the early 2000s (annualized), anchored in greater policy transparency and credibility. However, as with other countries around the world, recent post-COVID-19 spikes in import prices have stoked inflation, and the BOJ has responded with several rate increases. The BOJ maintained its policy rate—the main policy instrument—at 0.5 percent from August 2019 to September 2021, when it began raising rates to counter rising price pressures. The policy rate was increased to 7 percent in November 2022, as the rate of inflation reached about 10.3 percent (annualized). Against this backdrop, inflation is projected to return to within its target range around the end of 2023 (Figure 3). But inflation actually helps to reduce public debt, as nominal GDP growth (the denominator in the debt ratio) is positively influenced by inflation, while the existing local debt stock remains constant in nominal terms. However, it is important to acknowledge that the improved inflationary environment has had a net positive impact on confidence in the economy and currency, which have helped to limit interest rates and financing costs as well as exchange rate devaluation, supporting faster debt reduction.



Figure 4. Jamaica: Public Debt at end-December 2022 (Percent of total GDP)



Interest Rates (Debt Servicing Costs)

Debt servicing costs, or interest rates on debt, are by definition a factor that contributes to debt accumulation. However, related changes over time can have a significant impact on cumulative outcomes. Countries like Jamaica have a broad spectrum of borrowing instruments, including both external and domestic debt, as well as semi-concessional sources such as official creditors (both bilateral and multilateral). In Jamaica’s case, about 60 percent of debt is external, of which about two-thirds is held by official creditors (Figure 4, panel b). While official credit is characterized by rates that are not generally risk-adjusted (though they can be market-sensitive), Jamaica’s domestic debt and eurobonds do reflect creditor assessments of country risk. As discussed above, improving credit ratings translated into lower risk-adjusted borrowing costs that led not only to lower overall debt levels but also to a striking compression of interest costs by about half between 2010 and 2022 (Figure 3). These factors, along with continued efforts to increase the proportion of domestic debt (e.g., issuance of local currency debt in international markets, described above), should continue to drive faster debt reduction and improved sustainability.

Exchange Rate

Exchange rate stability, supported by the shift to inflation-targeting in 2017, has helped to limit the impact of depreciation of the Jamaican dollar relative to other currencies, particularly the U.S.



dollar. This is important for overall debt levels and their trajectory because of the relatively large proportion of foreign debt in total debt. Relatively low rates of inflation and prudent monetary and fiscal policies have limited the rate of depreciation over the past several years, despite a historic shock to GDP in 2020 and related impacts on the economy. Over time, this factor, along with a transition to more domestic currency debt, should continue to insulate the debt portfolio from exchange rate movements as well.

Residual

In the context of this exercise, the term “residual” refers to two sets of factors, including “other debt-creating flows” and “public residuals.”⁴⁵ Other debt-creating flows refers to factors beyond those listed above that can impact the stock of debt, including the crystallization of contingent liabilities (e.g., the calling of guarantees issued to public enterprises), or asset sales that can be used to reduce debt (e.g., the privatization of public assets). Public residuals refer to any changes in the stock of public debt not explained by all other input components—for example, unforeseen changes in the valuation of assets or liabilities held within the debt portfolio. Taken together, these factors have been hugely consequential in terms of the reduction of public debt in Jamaica since 2015 (Figure 3). In fact, since 2013—the year of the second domestic debt operation—these factors together have made significant contributions to debt reduction during 8 of the past 10 years. In some years, residuals were the most important debt-reducing factor, eclipsing even fiscal consolidation. This stems from a combination of factors, including public sector reforms such as consolidation and divestment of public assets and state enterprises, among others. While true that there are limits to the degree to which these types of successes can be replicated over time—for example, there are only so many public enterprises that can be sold off—the net impact of this kind of reform, when undertaken prudently and sustainably, must be emphasized.

Summary

While the many factors underpinning Jamaica’s decade-long success with debt reduction are too numerous and complex to detail in this short chapter, some of the most important drivers have been discussed above. First, Jamaica’s notable progress with the reform of economic institutions—particularly fiscal and monetary institutions—has been a key driver of reduced borrowing, faster debt repayment, and lower credit risk and borrowing costs. It has also helped to minimize the effects of exchange rate depreciation on the overall debt portfolio. Similarly, efforts to restructure the public sector—including state enterprise reform—have been a key driver of rapid and durable debt consolidation. Importantly, the cumulative impact of these and related reforms on both domestic and external investor confidence has also made borrowing less expensive and created new opportunities for the government of Jamaica, as highlighted by the recent successful local currency external capital markets issuance. These self-reinforcing policies and actions should help support continued debt reduction and a durable exit from the country’s

⁴⁵ See Mooney, Prats, and Rosenblatt (2021) for a deeper discussion.



history of high debt and volatility, as well as serve as an example for others seeking to improve fiscal and debt outcomes.

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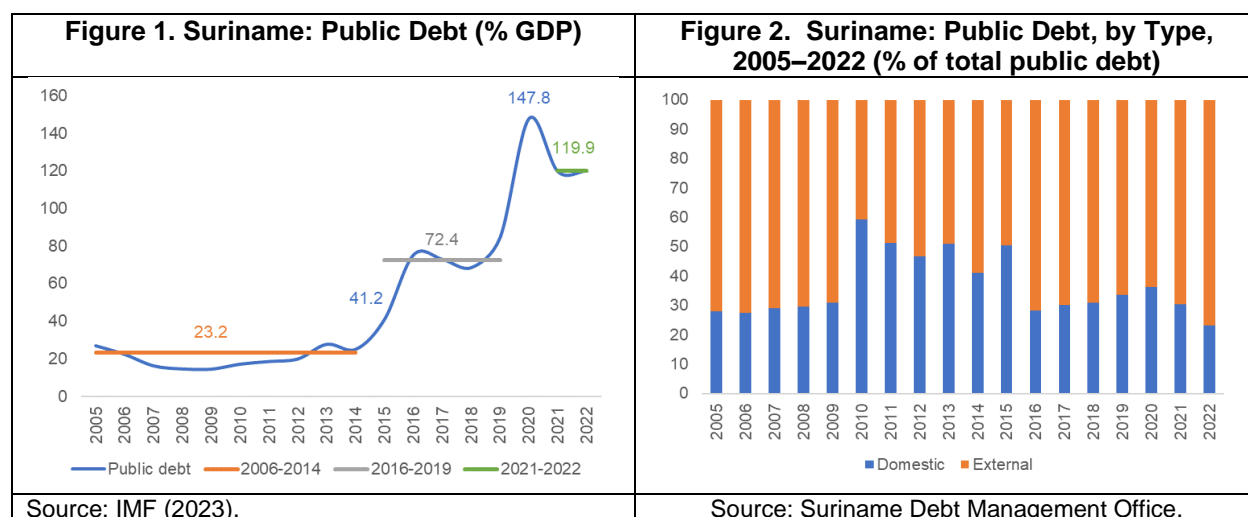


Suriname

Gisele Teixeira Braun

History of Public Debt

Suriname's public debt surged in the aftermath of the COVID-19 pandemic, leading to a sovereign debt crisis. As a result of persistent fiscal deficits, exchange rate devaluations, and a depressed economy, the debt-to-GDP ratio had increased by almost 10 times in less than two decades. During the commodity price boom from 2005 to 2014, the debt-to-GDP ratio averaged 23.2% (Figure 1). However, a combination of an international commodity shock and the closure of alumina production led the ratio to increase dramatically from 25.2% in 2014 to 84.7% in 2019. In addition, the economic recession prompted by the pandemic tipped the country into distress, and the debt-to GDP ratio reached 147.8% of GDP in end-2020. As a result, credit rating agencies downgraded Suriname to default status. As the Government implements its fiscal adjustment and debt is restructured,⁴⁶ the debt-to-GDP ratio decreased about 18 percentage points to around 120% in 2021 and 2022.



External debt has been the main source of public financing in Suriname, despite a temporary predominance of domestic sources from 2010 to 2015. Domestic debt decreased from its peak in 2010, when it represented around 60% of total debt, to around less than one-third at end-2022 (Figure 2). As of the second quarter of 2023, domestic debt was estimated at 21% of GDP (Figure

⁴⁶ Bilateral agreements with all the Paris Club creditors and with India have been completed. The government of Suriname invited the bondholders to swap their 2023 and 2026 notes (US\$912 million, including arrears) for a 10-year bond with a nominal value of US\$660 million. In addition, Suriname will issue notes with payouts linked to government of Suriname royalties from the Block 58 offshore reserve. Suriname expects to reach a deal with China by mid-December 2023.

Suriname

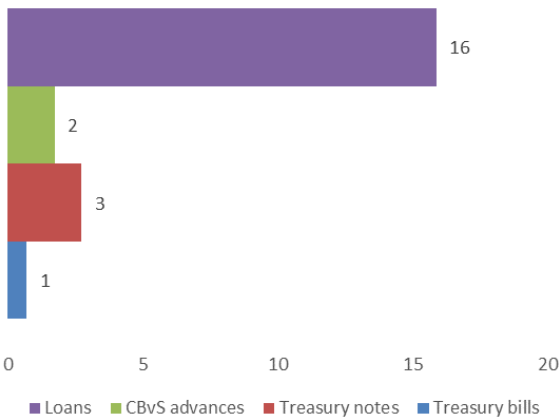


3), denominated in both domestic currency and foreign currencies (U.S. dollar, euro). External debt accounted for about two-thirds of the total in the same period, comprised of medium- and long-term bonds and loans denominated in foreign currency. The largest external creditors are commercial and multilateral, followed by bilateral creditors (Figure 4). As of the second quarter of 2023, Suriname had external debt levels with multilaterals and commercial creditors that were equivalent to 30% of GDP each, while bilateral debt represented 19% of GDP. Among multilaterals, the IDB and the International Monetary Fund (IMF) are the largest creditors (Figure 5).

Suriname

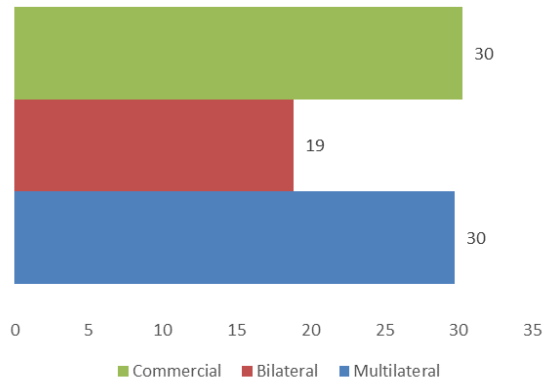


Figure 3. Suriname: Domestic Public Debt, 2023:Q2 (% GDP)



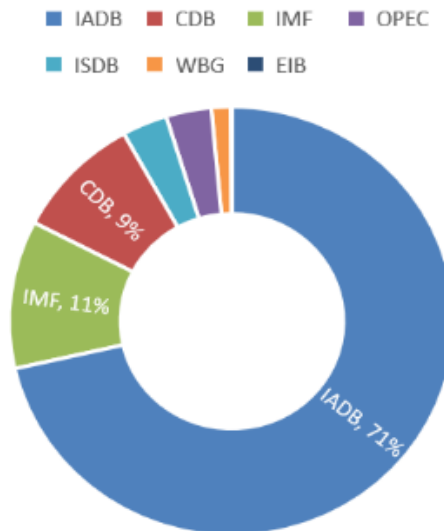
Source: Suriname Debt Management Office.
Note: CBvS: Central Bank of Suriname.

Figure 4. Suriname: External Public Debt, 2023:Q2 (% GDP)



Source: Suriname Debt Management Office.

Figure 5. Suriname: Multilateral Public Debt, 2023:Q2 (% total)



Source: Suriname Debt Management Office.
Note: CDB: Caribbean Development Bank; EIB: European Investment Bank; IADB: Inter-American Development Bank; IMF: International Monetary Fund; ISDB: Islamic Development Bank; OPEC: Organization of the Petroleum Exporting Countries; WBG: World Bank Group.

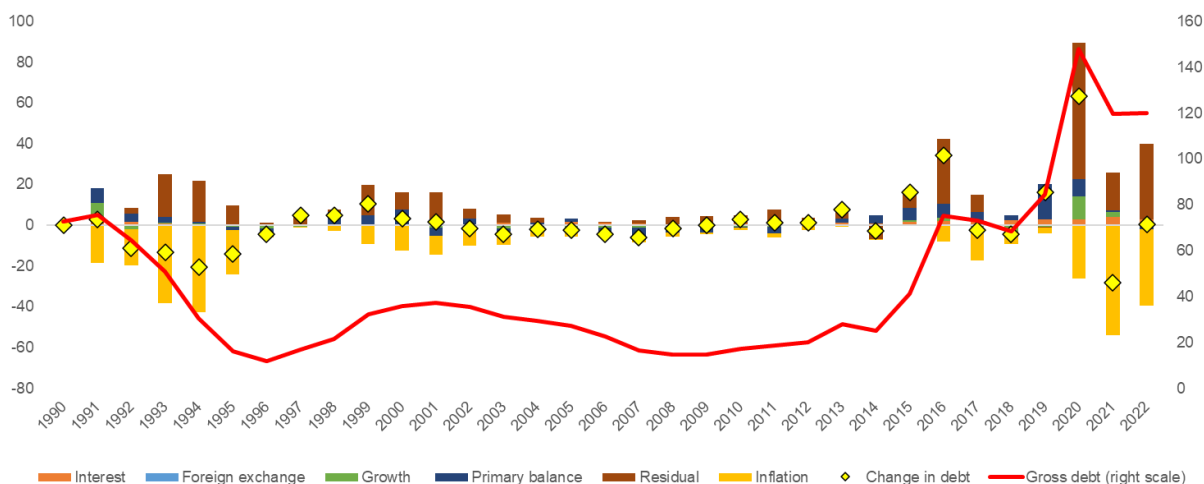


Evolution of Key Macroeconomic Variables Affecting Debt

As discussed in the Regional Overview of this report, public debt dynamics are shaped by economic growth and interest rates, variables that are not fully within the control of governments. However, national policies and measures can partially influence both variables.

Suriname’s primary deficits have been important drivers increasing the debt-to-GDP ratio. The decrease in the ratio in the first half of the 1990s was mostly explained by inflation, while the ratio was relatively stable at below 45 percent in the 2000s. However, persistent primary deficits in the 2010s pushed the ratio to a level above 80% by 2019. As the pandemic shock hit Suriname’s economy in 2020, the government started implementing a structural fiscal reform to return public finances to a sustainable path. The primary surplus of 1.1% of GDP in 2022 resulted from a more prudent fiscal policy, in which the government adopted measures on both revenues and expenditure sides, including the phasing out of untargeted subsidies and a cap on the public wage bill. The inflation also played a role, given that a sizable share of spending was fixed in nominal terms. Large residuals observed in recent years are related to Suriname’s ongoing public debt restructuring process (Figure 6).

Figure 6. Suriname: Decomposition of Factors Affecting the Debt-to-GDP Ratio, 1990–2022 (%)



Source: Author’s calculations based on the International Monetary Fund’s World Economic Outlook and International Financial Statistics databases, and on the World Bank’s International Debt Statistics.

Additionally, the economy has not grown enough to offset the borrowing costs incurred to finance its policies. Suriname’s economic recovery has been sluggish and slower than that of Latin America and the Caribbean (LAC), demonstrating the need for structural reforms not only on the fiscal side, but also in terms of transparency, governance, and anti-corruption to attract more investment. Even though economic activity increased in 2022, after contractions of 15.9% (LAC:



-7%) in 2020 and 3.7% (LAC: 6.9%) in 2021, GDP is still below its pre-pandemic level. While real GDP grew by only 1% (LAC: 3.5%) in 2022, effective interest rate was 3.5% that year.

The lack of accountability for risks arising from climate change can impact the debt level. Since more than 90% of the population and economic activities in Suriname are located along the low-lying coast, the country's infrastructure is at risk of suffering significant impacts from the expected sea level rise and changing precipitation patterns due to climate change.⁴⁷ Integrating resilience in public investment management, in addition to improving its effectiveness, is one of the priorities of the Suriname National Adaptation Plan 2019–2029.⁴⁸ An update to the procurement and public investment framework is required to address these issues, given that there are no line ministries that have integrated climate change resilience guidelines in the design of public infrastructure projects.

Weak monitoring of state-owned enterprises (SOEs) constitutes a fiscal risk that adds pressure to public indebtedness. The SOEs have an important role in social policy, physical infrastructure, government revenues, and general economic activities in Suriname (Reyes-Tagle et al. 2022). The number of SOEs increased from an average of 40 over 2010–2016 to more than 160 in 2020 (La Cruz 2020). However, there are weaknesses in government oversight of SOEs, with only a limited number of companies consistently providing financial information.

Institutional Policy Framework for Debt Management

Even though Suriname's national legislation on the public debt-to-GDP ratio ceiling has evolved over time, the legislation lacks enforceability. First issued in 2002, the national legislation set a public-debt-to-GDP ceiling of 60%, in which the domestic debt-to-GDP ratio would not surpass 15% and the foreign debt-to-GDP ratio would not surpass 45%.⁴⁹ Due to negative growth of nominal GDP and exchange rate devaluation in 2015–2016, the government exceeded the legally established obligation ceilings, without incurring additional obligations, which required the establishment of specific provisions.⁵⁰ Given further negative developments in the fiscal balance during 2019, another amendment defined additional budget deficit limits for subsequent years up to the fifth year at 5% of GDP and, consequently, increased the overall debt-to-GDP ceiling from 60 to 95%.⁵¹ When the new government took office in 2020 and measures were adopted to restore debt sustainability, two additional amendments were approved, setting a transitional phase to


⁴⁷ Republic of Suriname, [Nationally Determined Contribution 2020](#).

⁴⁸ Republic of Suriname, [Suriname National Adaptation Plan 2019-2020](#).

⁴⁹ Republic of Suriname, 2002, [S.B. 2002 No. 27 of 19 March \(State Debt Act\)](#). In 2011, a first amendment ([S.B. 2011 No.5 of 12 January](#)) increased the limit for domestic debt from 15% to at most 25% of GDP, while keeping the ceiling at 60%. In a second amendment ([S.B. 2016 No. 63 of 25 April](#)), the law was modified to comply with international accepted standards for defining and determining public debt.

⁵⁰ Republic of Suriname, 2017, [S.B. No. 10 of 3 February](#). In situations when the debt ceiling is exceeded, the government may only enter into debt commitments to finance a budget deficit up to a limit of 6.5% of nominal GDP.

⁵¹ Republic of Suriname, 2019, [S.B. 2019 No. 134 of 6 November](#).



bring the debt-to GDP level back to 60%,⁵² and further defining the conditions for exceeding the ceiling.⁵³ Nevertheless, enforcement of the law has yet to be achieved.

The government enacted the Savings and Stabilization Fund (SSF) in 2017, but its implementation is pending.⁵⁴ The SSF aims to absorb eventual volatility in fiscal revenues due to commodity-dependency and to generate savings for future generations. However, some of the SSF's design issues are likely to limit its effectiveness. For instance, the accumulation rule could mandate deposits in a context of budget deficits and/or when government debt is rising. Given the country's debt levels, the marginal cost of the additional debt necessary to finance the transfers to the fund could be considerably higher than the returns on the fund's assets. Additionally, the rule for withdrawals has a strong bias towards the accumulation of resources, restricting the fund's use for stabilization purposes (IDB 2021).

In 2019, the Government Accounts Act was approved, strengthening the framework for public financial management. The legislation sets the rules for annual budget preparation, execution, monitoring, and reporting. The act mandates preparation of a fiscal strategy to be submitted to the Council of Ministers by 1 April, while the president must submit the draft budget to the National Assembly no later than the first working day in October of the year preceding the year to which the proposal relates. However, the country often has significant differences between actual and budgeted primary expenditures. Even though the legislation includes the obligation to prepare a medium-term fiscal framework, it has not been fully taken into account in the annual exercises.

The Suriname Economic Oversight Board was established in June 2023 through a Memorandum of Understanding signed by President Chandrikapersad Santokhi with the Suriname Economic Oversight Board (SEOB).⁵⁵ The SEOB is an initiative of the Surinamese Business Community (VSB) and the Surinamese Bankers Association (SBV), in collaboration with the Central Bank of Suriname (CBvS) and the Ministry of Finance and Planning. The SEOB is tasked with advising the government on implementation of the Economic Recovery Plan, which aims to restore debt sustainability. Moreover, the board monitors the achievement of quantitative and qualitative targets set in the IMF's extended arrangement with Suriname for access to funds from the Extended Funding Facility.

Conclusions

The lack of an adequate institutional macro framework has often exacerbated the impact of shocks on Suriname's economy, leading to increases in the debt-to-GDP ratio. A critical element of the fiscal reform program for sustainable fiscal balances involves strengthening the medium-term fiscal framework, which includes amendment of the Government Accounts Act,

⁵² Republic of Suriname, 2020, [S.B. 2020 No. 185 of 30 September](#).

⁵³ Republic of Suriname, 2023, [S.B. 2023 No. 51 of March 16](#).

⁵⁴ Republic of Suriname, 2017, [S.B. 2017 No. 59 of 13 June](#) (*Stabilisatiefonds Suriname*).

⁵⁵ Republic of Suriname, June 2023, [Memorandum of Understanding](#) between the government and private sector.



operationalization of the SSF, and adoption of an additional quantitative fiscal rule. More objective rules for public finance management, including budget preparation, execution, and monitoring, would improve transparency and credibility to enforce application of the National Debt Act, among other things. The SSF, in turn, would be a tool not only to control excessive volatility in the fiscal balance, but also to transfer wealth across generations. Finally, the adoption of an additional fiscal rule on the budget balance would enhance the credibility of the government's efforts to bring public debt back to the authorized ceiling of 60% of GDP. In terms of sequencing, public finance management improvements are necessary both on their merits and to prepare the ground for fiscal rules.

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Trinidad and Tobago

Nirvana Satnarine-Singh and Victor Gauto

History of Public Debt

Like many economies in the world, Trinidad and Tobago's debt-to-GDP ratio reached a record high in 2020 on account of the global health crisis brought on by COVID-19. The public-debt-to-GDP ratio soared to 80.4 percent, increasing by 18.8 percentage points, year-over-year, due to a 12.5 percent decline in nominal GDP and the overall deficit widening by 9 percentage points.⁵⁶ As Trinidad and Tobago's economy is heavily dependent on the energy sector, there was an inverse relationship historically observed prior to 2014⁵⁷ between oil prices and the country's debt-to-GDP ratio because of the significant impact of higher energy prices on government revenue. Windfall revenues therefore provided sufficient financing for government expenditure in boom periods, and the debt-to-GDP ratio fell to 25 percent in 2008, as the total debt stock declined and nominal GDP increased. When oil prices soared between 2008 and 2015, averaging US\$92 per barrel, the debt-to-GDP ratio averaged 35 percent. Similarly, the share of government energy revenues increased from 40 percent in 2000–2007 to 52 percent in 2008–2014 (Figures 1 and 2). Energy prices dropped after 2014, contributing to higher debt-to-GDP ratios that averaged 54 percent over 2015–2019, before the COVID-19 pandemic hit (Figure 1). During periods of high energy prices and accelerated production (2000–2008), the economy's fiscal buffers in terms of international reserves and assets from the country's Heritage and Stabilization Fund also improved, which was a fundamental policy tool to provide support and to finance the fiscal deficits, especially at the time of the pandemic.

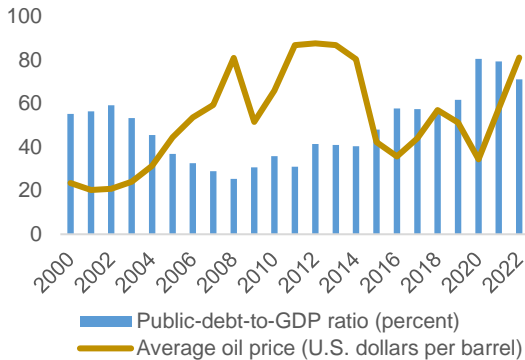
⁵⁶ Public debt data were sourced from the International Monetary Fund's Article IV Consultation reports on Trinidad and Tobago. This is closely aligned with the government's measure of debt defined as "Adjusted General Government Debt," which excludes debt for open-market operations or sterilization purposes.

⁵⁷ Energy sector GDP began declining in 2014, following a period of high levels of production between 2000 and 2013. Energy sector GDP growth averaged -3.9 percent between 2014 and 2022.

Trinidad and Tobago

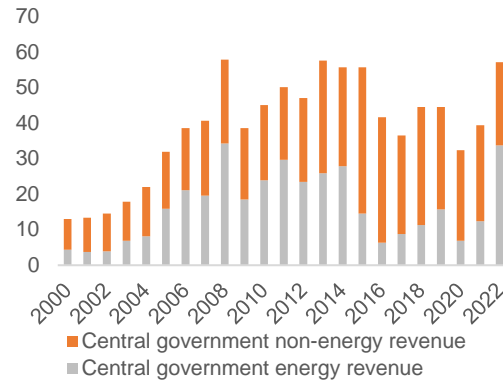


Figure 1. Trinidad and Tobago: Historical Debt-to-GDP Ratio and Debt Composition, 2000–2022



Sources: Central Bank of Trinidad and Tobago; and International Monetary Fund, Article IV Consultations and Commodity Price database.

Figure 2. Trinidad and Tobago: Energy and Non-energy Revenue, 2000–2022 (Billions of Trinidad and Tobago dollars)



Source: Central Bank of Trinidad and Tobago.

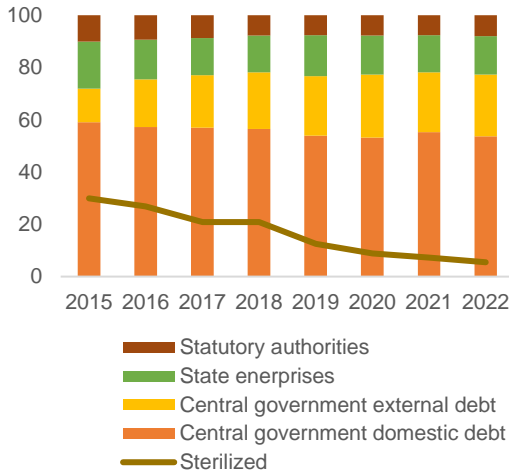
Since the mid-2010s, most outstanding central government debt has been from domestic creditors. From 2015–2022, domestic central government debt accounted for between 52 and 61 percent of general government debt, while external central government debt accounted for only between 13 and 25 percent. Non-self-serviced government guaranteed debt, which includes debt accumulated by state enterprises and statutory authorities, contributed to a substantial share of government debt, accounting for between 21 and 28 percent 2015–2022 from (Figure 3).⁵⁸ At the end of 2022, domestic debt was comprised of notes and bonds (development bonds, Colonial Life Insurance Company (CLICO), Hindu Credit Union Cooperative Society (HCU), and value-added tax bonds), which account for 84 percent of domestic debt, as well as Treasury bills and notes (7 percent of domestic debt) and debt management bills (9 percent of domestic debt).

⁵⁸ Most of this debt is also denominated in local currency.

Trinidad and Tobago

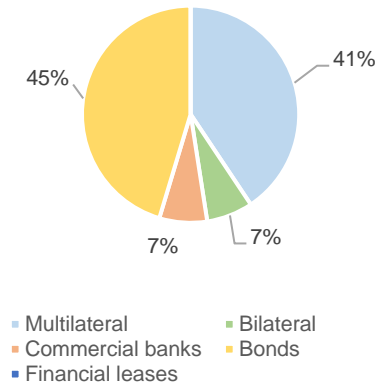


Figure 3. Trinidad and Tobago: Composition of Public Debt, 2015–2022 (Percent)



Source: Central Bank of Trinidad and Tobago.

Figure 4. Trinidad and Tobago: Composition of External Debt in 2022 (Percent)



Source: Central Bank of Trinidad and Tobago.

External debt is made up mostly of international bond issuances. At the end of 2022, international bonds accounted for 45 percent of external debt, and 41 percent of external debt was sourced from multilateral banks. The remaining 14 percent of external debt is owed to commercial banks and bilateral organizations (Figure 4). Trinidad and Tobago is the only investment-grade country in the Caribbean with a credit rating of BBB- from Standard & Poor’s (S&P) (Table 1). In July 2022, S&P upgraded Trinidad and Tobago’s economic outlook from negative to stable. In July 2023, Moody’s upgraded the country’s creditworthiness outlook from stable to positive, citing improved fiscal performance, while S&P reaffirmed the country’s stable outlook. The government issued US\$560 million in seven-year bonds at the rate of 5.95 percent in September 2023 to repay US\$550 million in bonds that mature at the start of 2024. Prior to this, the last bond issuance was in June 2020 for US\$550 million at a rate of 4.5 percent.



Table 1. Trinidad and Tobago: Credit Rating History

Moody's			Standard and Poor's		
Rating	Outlook	Year	Rating	Outlook	Year
Baa1	Stable	2008–2014	A	Stable	2009–2014
Baa2	Negative	2015	A	Negative	2015
Baa3	Negative	2016	A-	Negative	2016
Ba1	Stable	2017–2019	BBB+	Stable	2017
Ba1	Negative	2020	BBB+	Negative	2018
Ba2	Stable	2021–2022	BBB	Stable	2019
Ba2	Positive	2023	BBB-	Stable	2020 and 2022–2023
		-	BBB-	Negative	2021
			BBB-	Stable	2022

Source: Ministry of Finance, Trinidad and Tobago

Trinidad and Tobago's Debt Dynamics

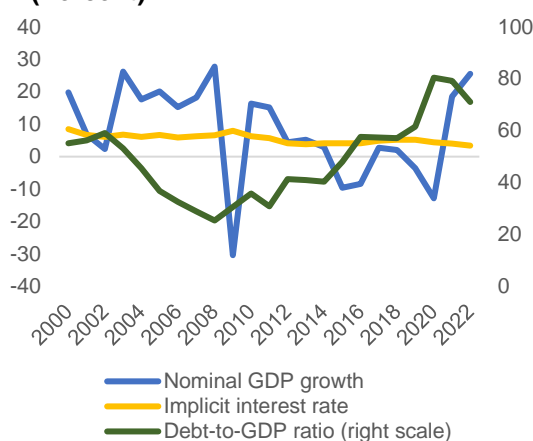
The required primary balance turned negative in 2021 and 2022 as the economy benefited from higher-than-budgeted energy prices and nominal GDP growth. Nominal GDP growth, the implicit interest rate, and the debt-to-GDP ratio were used to calculate the government's primary fiscal balance that would maintain the current debt-to-GDP level, or the "required" primary balance. The difference between the primary balance and the overall balance (in percent of GDP) captures the government's interest payments as a percent of GDP, and a primary deficit implies that revenue is insufficient to cover non-interest expenditure. The implicit interest rate calculated for Trinidad and Tobago fluctuated between 3.4 and 8.5 percent annually between 2000 and 2022 (Figure 5).⁵⁹ The nominal growth rate, however, has been somewhat volatile. When the nominal GDP growth rate is higher than the implicit interest rate, the required primary balance will be negative, suggesting that the government can run a primary deficit and still stabilize the debt-to-GDP level, so long as that deficit is smaller than the required level (see the Regional Overview of this report). This was the case in 2021 as the economy recovered from the COVID-19 pandemic recession, and the primary deficit shrank to levels smaller than the required deficit. In 2022, the primary balance turned positive, and the debt-to-GDP ratio declined further. Similarly, between 2003 and 2008, a period of significant economic growth, nominal GDP growth was higher than the implicit interest rate. Required primary balances were negative, and the government ran primary surpluses, supported by high energy revenues, and there was a sharp reduction in the debt-to-GDP ratio during this period. Between 2014 and 2020 the implicit interest rate was higher than nominal GDP growth, suggesting government expenditures needed to be contained, or revenues increased, to maintain debt-to-GDP levels. During those same years, significant adjustments to the primary balance were required to maintain a sustainable debt level. In keeping with the logic

⁵⁹ Calculated as the difference between the primary and overall balance in percent of GDP over the debt ratio.

Trinidad and Tobago

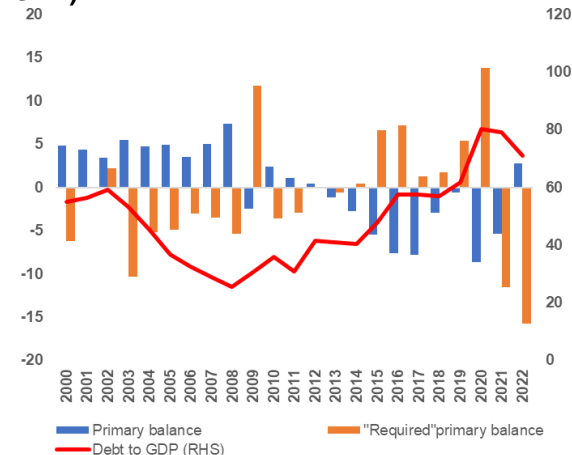
that if interest growth surpasses GDP growth a tightened fiscal position will be required,⁶⁰ the authorities began implementing measures to increase fiscal consolidation even prior to the COVID-19 pandemic in 2020.

Figure 5. Trinidad and Tobago: Drivers of the Required Primary Balance Calculation, 2000–2022 (Percent)



Source: International Monetary Fund, World Economic Outlook database.

Figure 6. Trinidad and Tobago: Required and Actual Primary Balances, 2000–2022 (Percent of GDP)



Source: Authors' calculations based on the International Monetary Fund's World Economic Outlook database.

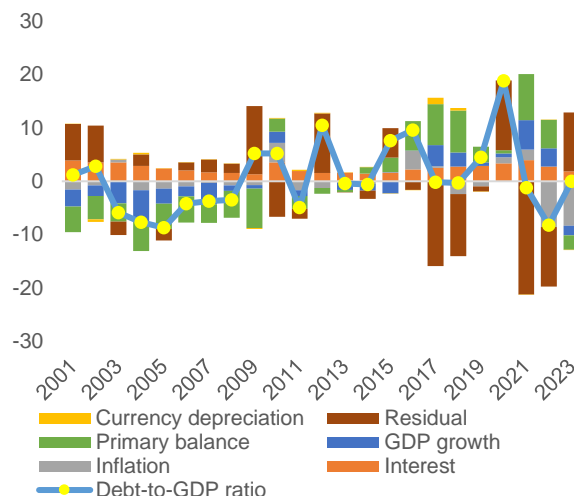
In fact, in comparing the actual primary balance and the calculation here of the required primary balance between 2014 and 2019, the average primary balance was a primary deficit of 4.5 percent of GDP while the average required primary balance was a primary surplus of 3.8 percent of GDP (Figure 6). This suggests that total expenditures excluding interest rate payments should have been 8.3 percent less of GDP than they were (3.8 minus (-4.5)), or that the average fiscal adjustment should have been 8.3 percent of GDP, explaining the increasing levels of debt to GDP over 2014–2019. The opposite trends were observable in 2021 and 2022, when nominal GDP growth rates were much higher than the implicit interest rate. Consequently, in 2021 and 2022 the average required primary balance was a primary deficit of 13.6 percent of GDP, while the actual average primary balance was a primary deficit of 1.3 percent of GDP. That is, expenditures were less than they needed to be to maintain the debt-to-GDP ratio. In fact, this represented a fiscal adjustment of 12 percent of GDP (13.6 minus 1.3) and the debt-to-GDP ratio fell from 80.4 percent in 2020 to 71 percent in 2022.

⁶⁰ Adjustments to curb expenditure have resulted in the initiation of policies that reverse earlier policies initially intended to keep price levels low (subsidies).

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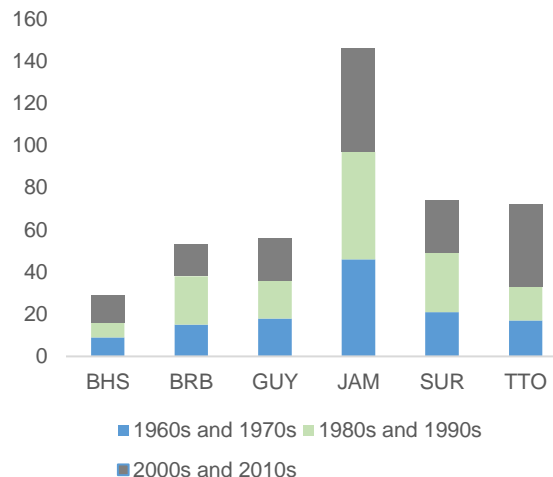


Figure 7. Trinidad and Tobago: Decomposition of Factors Affecting the Debt-to-GDP Ratio, 2001–2022 (Percent)



Source: Authors' calculations based on the International Monetary Fund's World Economic Outlook database and the World Bank's International Debt Statistics.

Figure 8. The Caribbean: Number of State-Owned Enterprises



Source: Reyes-Tagle et al. (2022).

Several factors drive changes to overall levels of debt, as discussed in the Regional Overview of this report. In the debt decomposition exercise, the following drivers of public debt levels are identified: GDP growth, interest rates, inflation rates, the primary balance, currency depreciation, and a “residual” that captures the impact of any other unidentified factors. The sum of all these factors equals the change in the debt to-GDP ratio shown in Figure 7. For example, the primary balance was a key driver of the declining debt-to-GDP ratio between 2002 and 2008, when the ratio declined from 59.1 to 25.4 percent of GDP. During this time, the government averaged a primary surplus of 5 percent of GDP. Nominal GDP growth was also a significant driver of the declining debt-to-GDP ratio before 2008. Interest rates played a small role in contributing to the increase in the debt-to-GDP ratio across the entire period reported. Unexplained factors captured in the residual played a significant role in both directions in several years. In 2017 and 2018, the debt-to-GDP ratio remained stable, despite relatively large primary deficits expected to drive ratios up. During this time, Trinidad and Tobago was recovering from a deep recession in 2016, when real GDP fell by 7.5 percent and continued falling by 4.8 percent in 2017. The large negative residual, which contributed to keeping the debt ratio low, could be the impact of the Heritage and Stabilization Fund (HSF), which contributed to financing fiscal deficits in 2016 and 2017, when the level of public debt was increasing. The same applies to 2021 and 2022, when the HSF contributed to financing the deficit during the pandemic recovery period without increasing levels



of public debt. On the other hand, the large positive residual in 2020, representing an unidentified factor contributing to increase the debt-to-GDP ratio, could be explained by the impact of the pandemic.

The debt path is also exposed to risks due to the number of state-owned enterprises (SOEs) and changing demographics of the country. Several countries in the Caribbean have SOEs that can increase pressures on public finance if they need support from the central government. In Trinidad and Tobago, most SOEs have been created since 2010 (Figure 8). Further, as seen in many countries in the region, the aging population puts pressure on the pension system due to differences between contributions and expenditure benefits.

Fiscal Context of Trinidad and Tobago

The Ministry of Finance is the primary fiscal institution of Trinidad and Tobago and it is responsible for fiscal estimates, budgetary revisions, debt reporting and management, and the HSF. The authorities utilize debt targets based on their short- to medium-term fiscal strategies to set benchmark debt ratios. The soft debt target was set by the government at 65 percent in 2018 but subsequently increased to 75 percent in 2021 to facilitate the Public Sector Investment Program (2021–2025). Budgetary estimates are provided for one fiscal year,⁶¹ with mid-year reviews and adjustments presented in the middle of each year. The Ministry of Finance has a Medium-Term Policy Framework that presents the medium-term outlook over a three-year period at each budget presentation. The framework provides details on the assumptions driving projections, such as the estimated levels of natural gas production, which are used to provide GDP growth forecasts over the next three years, as well as growth estimates for both the energy and non-energy sectors. Other macroeconomic variables that are projected over the medium term include the inflation rate and the fiscal balance. For example, in the Budget Statement 2024, projected economic growth for 2023 is 2.7 percent, with a broadly similar projection expected for 2024 and 2025. The fiscal balance is expected to average a deficit of 3 percent of GDP over 2023–2025.

The HSF serves as a fiscal buffer and a savings fund and is managed by a set of formal rules that regulate deposits and withdrawals from the fund. As reported above, the HSF played a fundamental role in alleviating fiscal pressures from the recession in 2016 and the pandemic-related contraction in 2020. If actual revenue surpasses budgeted revenue, 60 percent of the difference is mandated to be deposited into the fund. In terms of a shortfall in budgeted prices, up to 60 percent of the difference can be withdrawn, but withdrawals cannot surpass 25 percent of the fund. In 2016 and 2017, transfers from the HSF to the budget averaged US\$315 million, or 22 percent of the fiscal deficit, while in 2020 and 2021 the transfers averaged US\$940 million, or 44 percent of the fiscal deficit. The favorable environment of high energy prices in 2022 and 2023 supported depositing higher-than-expected levels of revenue back into the HSF in both years, averaging US\$175 million, signaling the institutional framework's strength. The net asset valuation

⁶¹ The fiscal year runs from October 1 to September 30.

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of the HSF was US\$5.5 billion in June 2023, down from US\$6.5 billion before the start of the pandemic, but up from US\$4.7 billion in September 2022.

Conclusions

The debt-to-GDP ratio of Trinidad and Tobago has been historically dependent on energy price movements, which are inextricably linked to government revenue and hence determine the economy's gross financing needs. The decline in energy prices in 2016 along with slowing levels of energy production have contributed to increasing debt-to-GDP levels, which were exacerbated by the COVID-19 pandemic. Energy prices have contributed to driving fiscal balances, which were consistently fiscal surpluses at the time of high energy prices but declined to fiscal deficits when energy prices fell, resulting in higher levels of debt to GDP. The implicit interest rate was higher than the nominal growth rate, indicating that primary surpluses were necessary to contain growing debt-to-GDP ratios starting in 2014, when actual primary balances were lower than required primary balances. The energy price boom of 2022 strengthened the government's fiscal position to a fiscal surplus that year, which contributed to decreasing the debt-to-GDP ratio from 80.4 percent in 2020 to 71 percent in 2022. There remain risks in the medium term given the volatility of energy prices, but the HSF has been the key policy tool that has supported financing the fiscal balance and contributing to slowing further increases in public debt, as observed in the debt decomposition exercise. Another mitigating factor is that the composition of the country's debt, such that most is denominated in domestic currency, reduces exposure to exchange rate depreciation and global interest rate hikes.

References

Reyes-Tagle, Gerardo, Aldo Musacchio, Carolina Pan, and Yery Park, editors. 2022. *Smoldering Embers: Do State-Owned Enterprises Threaten Fiscal Stability in the Caribbean?* Washington, DC: Inter-American Development Bank.



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