

# Framework for Sustainable Fiscal Policy in the Caribbean

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# Overview of Issues

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

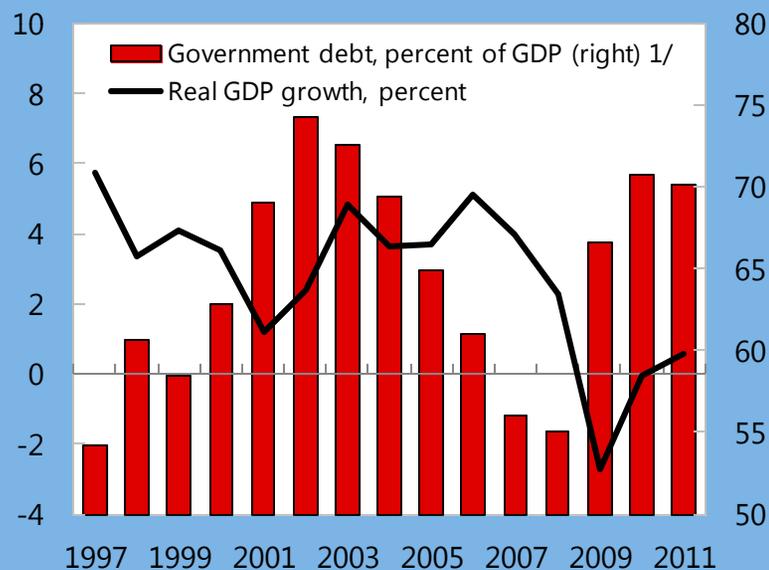
# Main Messages

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

# The global financial crisis worsened the already high debt burdens

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

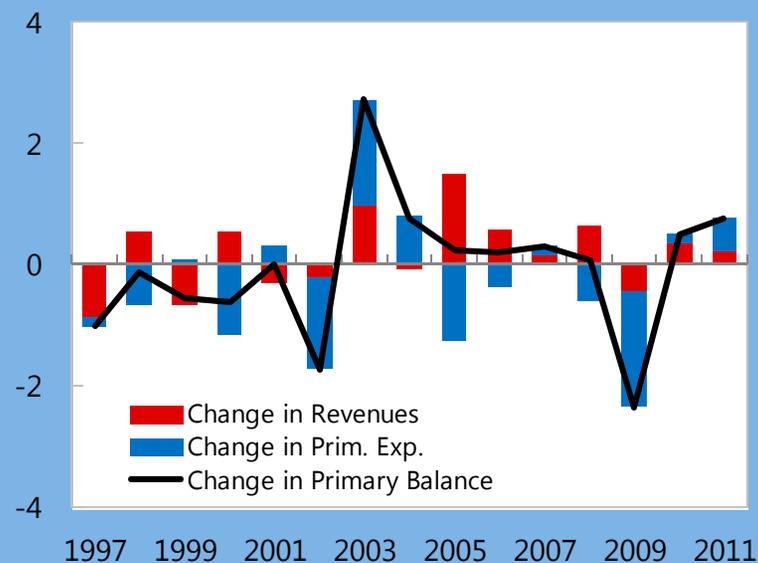
**Real GDP Growth and Government Debt**



Source: IMF staff estimates.

1/ Weighted average.

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

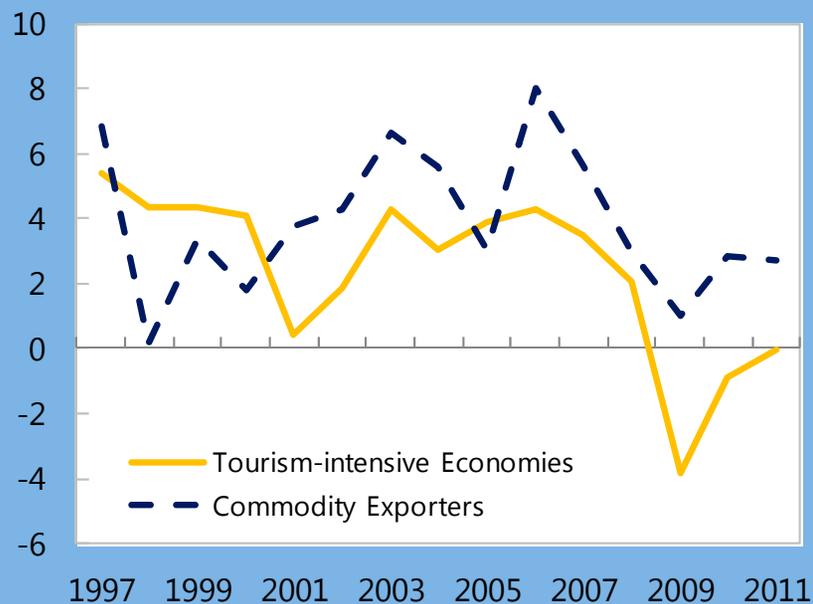


Source: IMF staff estimates.

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

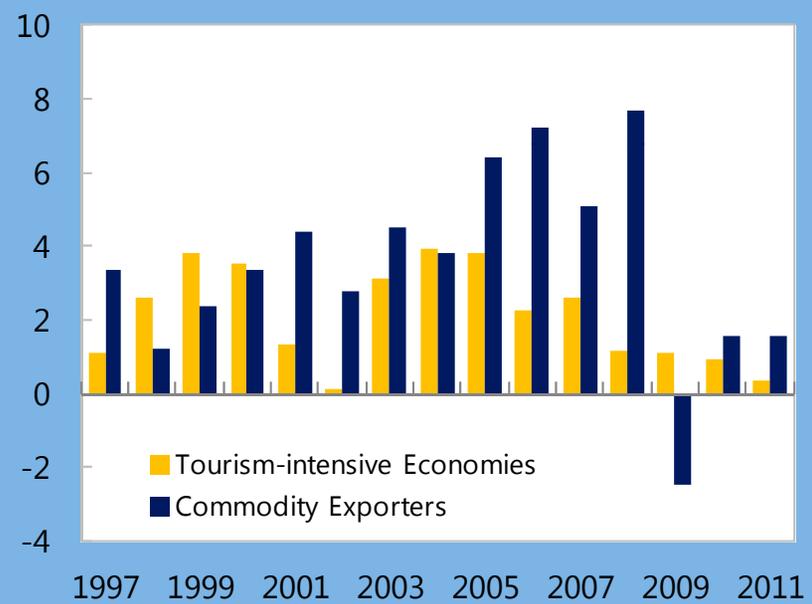
# Tourism intensive economies were hit harder by the crisis than commodity exporters

**Real GDP Growth**  
(percentage change)



Source: IMF staff estimates.

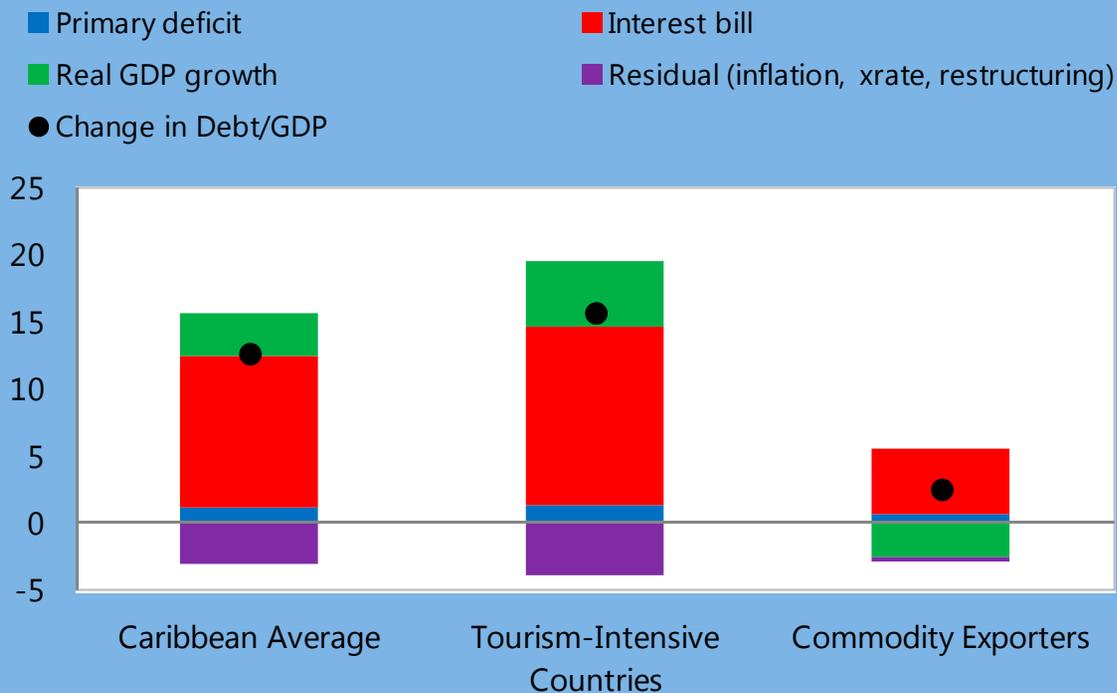
**Primary Balance**  
(weighted average, percent of GDP)



Source: IMF staff estimates.

# High interest bill and slow growth have driven debt accumulation in recent years

**Decomposition of Debt Accumulation, 2008-11**  
(percent of GDP)



Source: IMF staff estimates.

# Fiscal consolidation—lessons from global experience

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

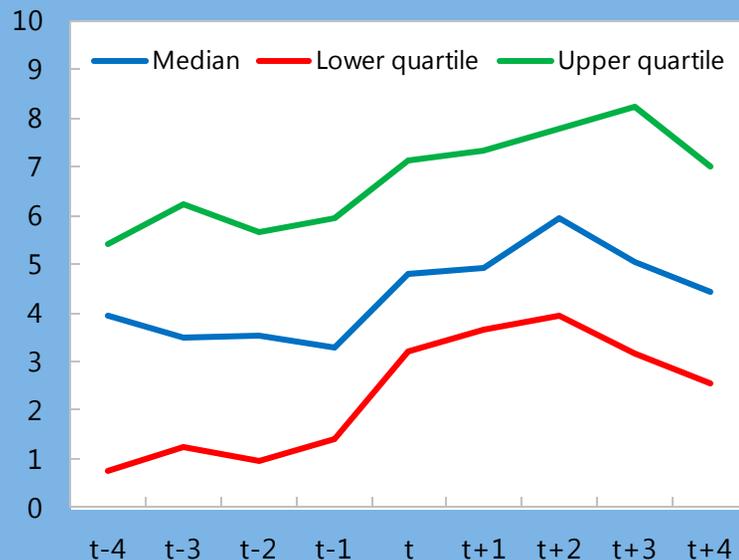
# World experience provides interesting insights for the region

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

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

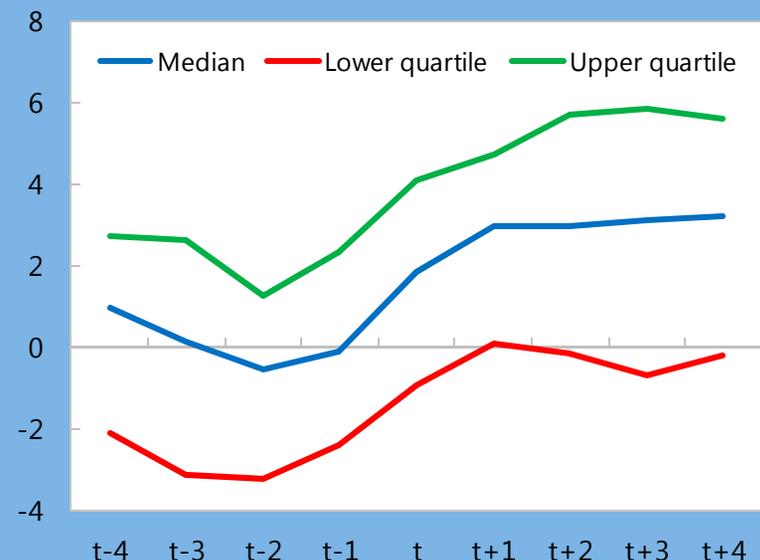
- **Primary balance** started to improve at least 2 years before debt ratios started to decline, and was sustained during the first 5 years
- **Economic growth was sustained during the adjustment.** Growth averaged 5 percent a year during the first 5 years of consolidation

**Real GDP Growth**  
(percentage change)



Source: IMF staff estimates.

**Primary Balance**  
(percent of GDP)

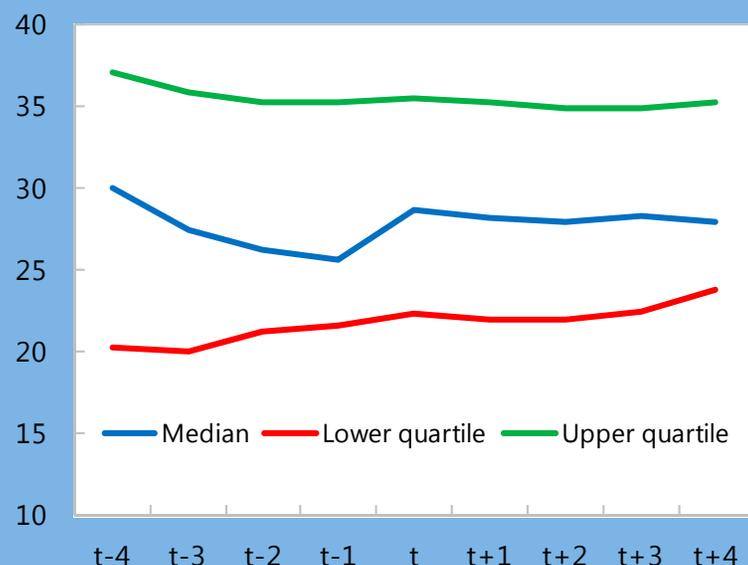


Source: IMF staff estimates.

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

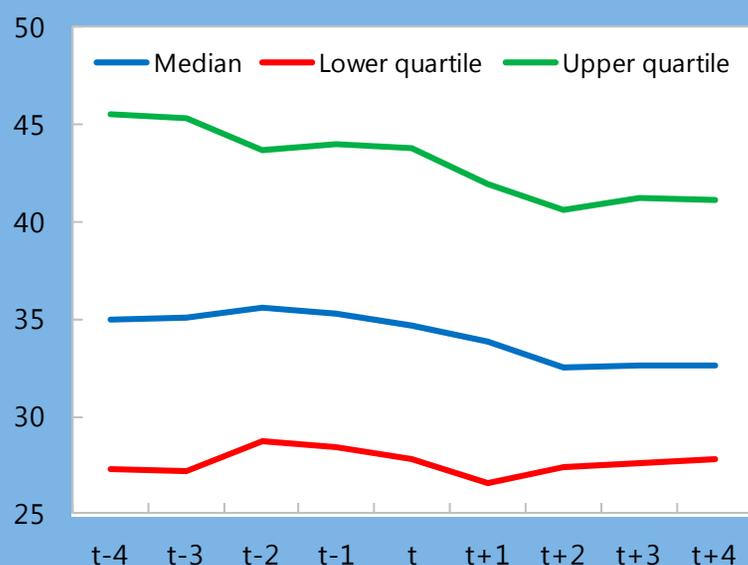
- The revenue effort averaged 3 points of GDP.
- The median decline in government **spending** was 4 points of GDP over a five year period. The reduction came mainly from cuts in **current spending**. **Capital spending** was broadly flat

**Government Revenues**  
(percent of GDP)



Source: IMF staff estimates.

**Government Spending**  
(percent of GDP)



Source: IMF staff estimates.

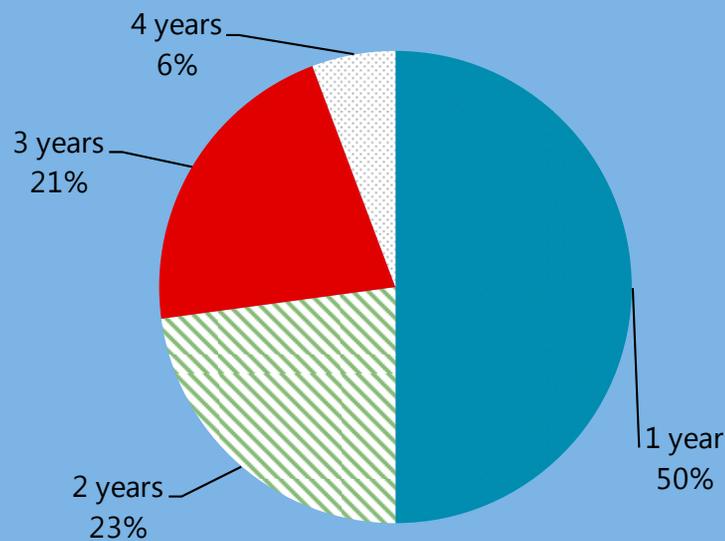
# In the Caribbean, the fiscal consolidation experience has been mixed

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

# The duration of fiscal consolidation has been short lived

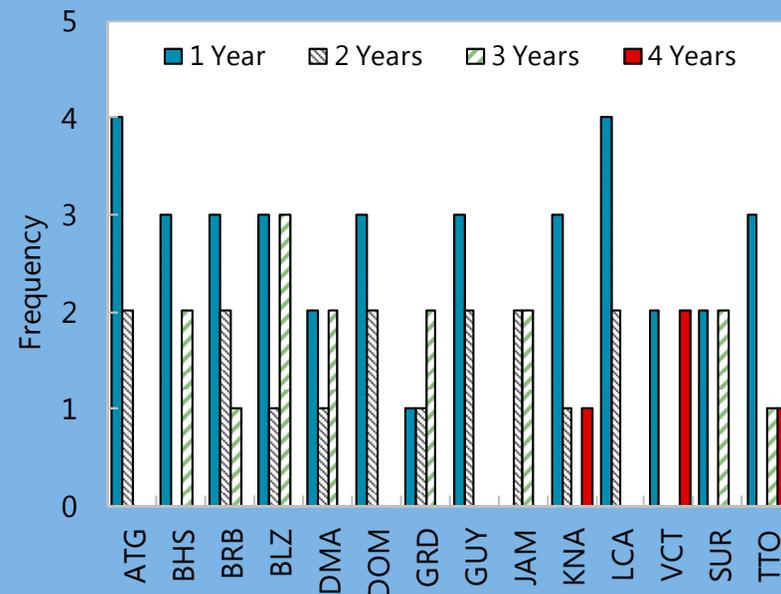
- Attempts at fiscal consolidation in the Caribbean have been infrequent. However, when countries undertook consolidation, they were **successful in about half of the cases** (success is measured as a decline of at least 5 percent in the debt-to-GDP ratio)

Duration of Episodes



Source: IMF staff estimates.

Consolidation Episodes by Duration

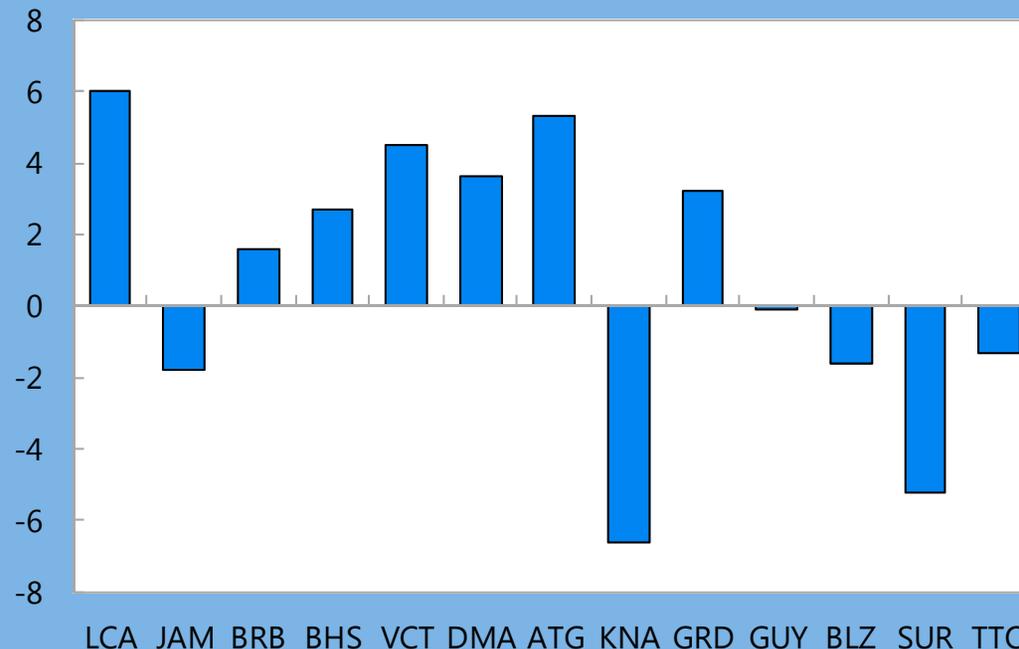


Source: IMF staff estimates.

# The Caribbean faces challenges to stabilize debt

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

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

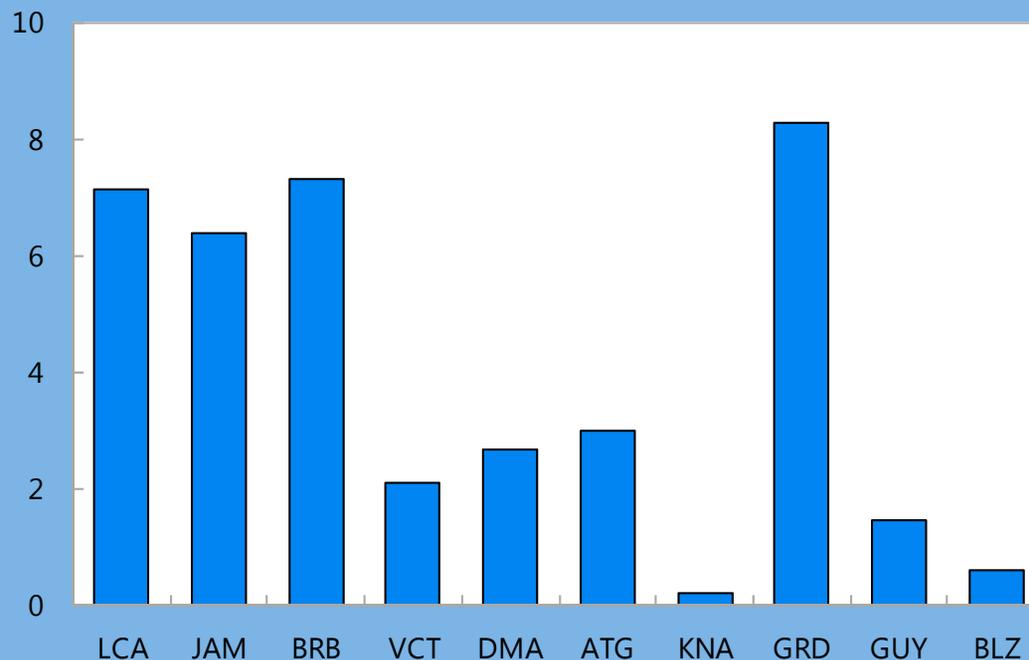


Source: IMF staff estimates.

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

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

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

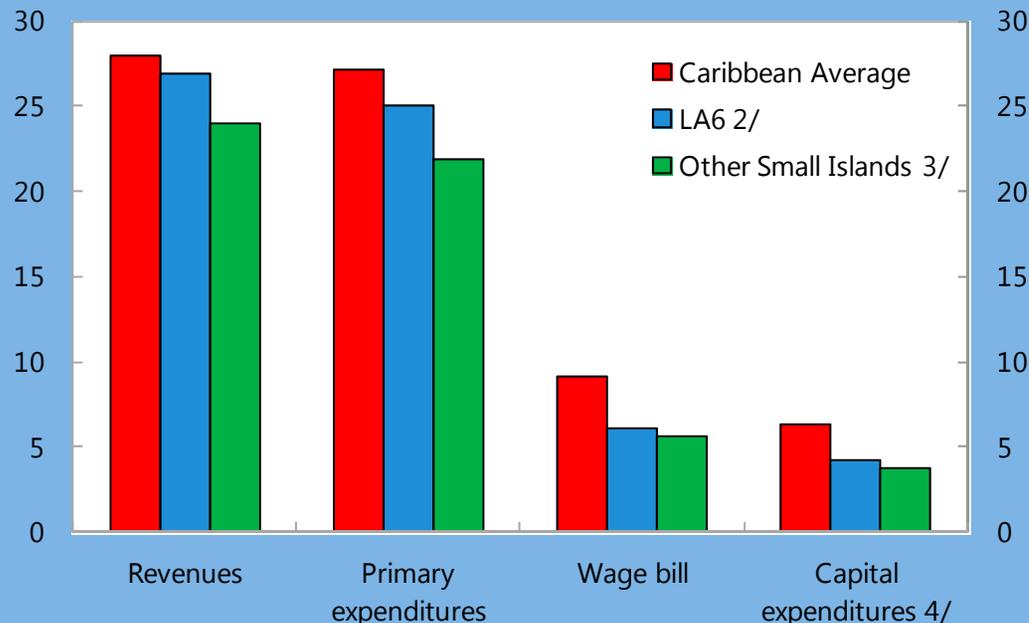


Source: IMF staff estimates.

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

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

**Caribbean Fiscal Indicators 1/**  
(percent of GDP)



Sources: Authorities; and Fund staff estimates and projections.

1/ 2007 to 2011 Averages.

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

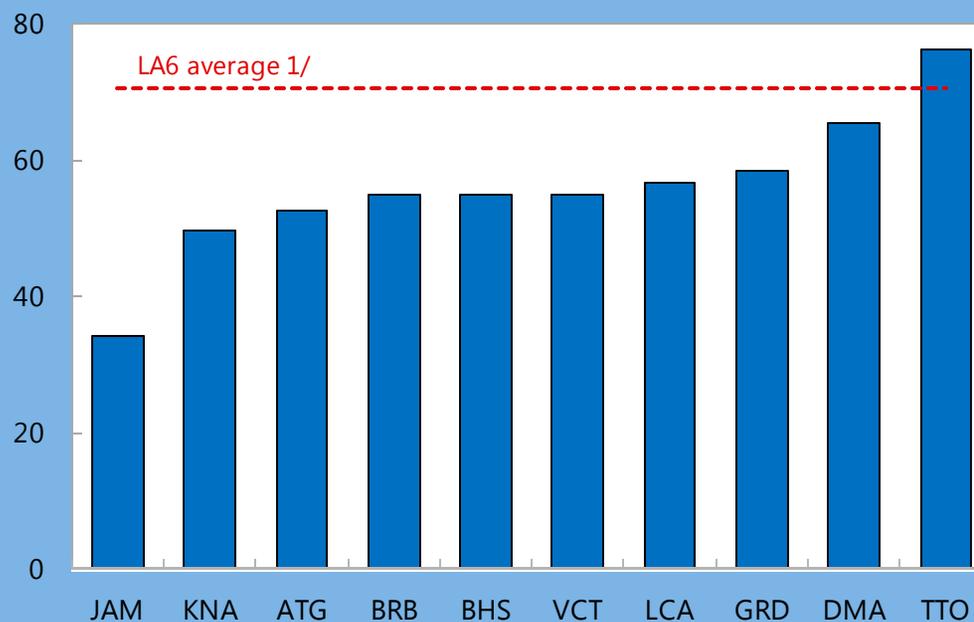
3/ Includes Dominican Republic, Mauritius, and Seychelles.

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

# There is also a need to reduce fiscal rigidities

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

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



Source: IMF staff estimates.

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

# Reorienting fiscal policy—where to go from here?

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

# A comprehensive Package of Reforms is needed

## ❖ Tax policy, focus on:

- **Broadening the tax base** and lowering excessive rates
- Optimizing revenues; **reducing waivers**

## ❖ Spending, focus on:

- Reducing the level of current spending, including through public sector rationalization
- Protecting **well-targeted social safety nets**
- Improving the selection and monitoring of **capital spending**

## ❖ Structural reforms:

- Improve institutional **debt management capacity**
- Contain the growth of **contingent liabilities**

**Thank You**



# Country experiences with fiscal rules

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

# The Chilean experience

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

# Reasons for the Chilean success

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