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Revisiting Fiscal Challenges

September 2017 Caribbean Quarterly Bulletin

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Introduction

The Bahamas, Barbados, Guyana, Jamaica, Trinidad and Tobago and Suriname constitute the countries of the Caribbean Country Department, CCB.

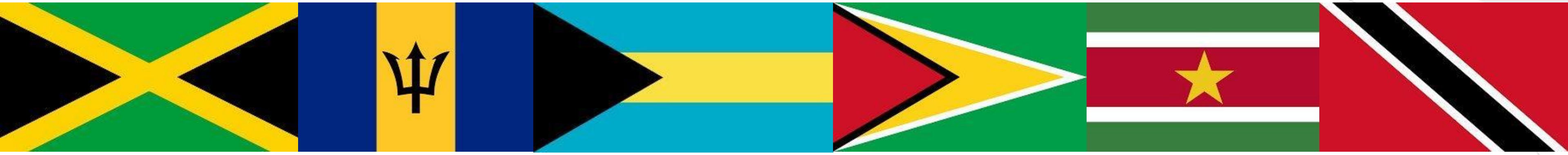
A diverse region…

- Islands (4) but all are small
- Tourism dependent: The Bahamas, Barbados and Jamaica
- Commodity producers: Guyana, Suriname and Trinidad and Tobago
- Middle income and high income

… not so diverse in terms of challenges they face

- **Growth** too low
- **Fiscal** consolidation required
- **Social** challenges

The current Quarterly Bulletin revisits Fiscal

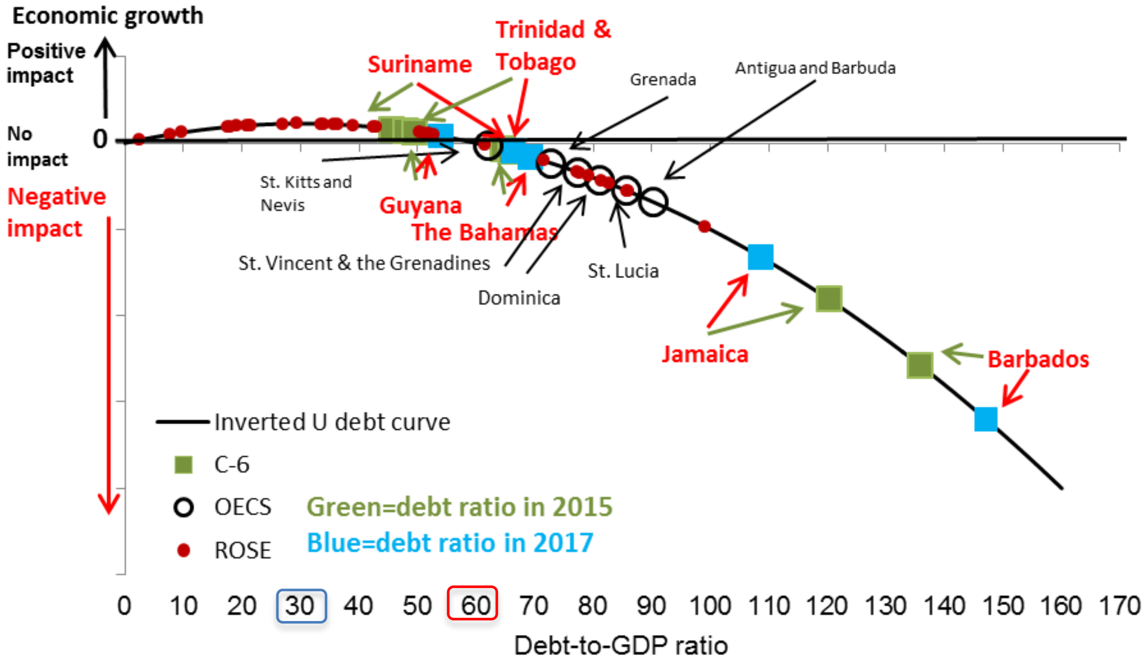


Fiscal Challenges

All Countries of CCB are in some stage of fiscal adjustment.

Debt has become a constraint to economic growth

Debt-to-GDP Ratio and Economic Growth (2015 and 2017)



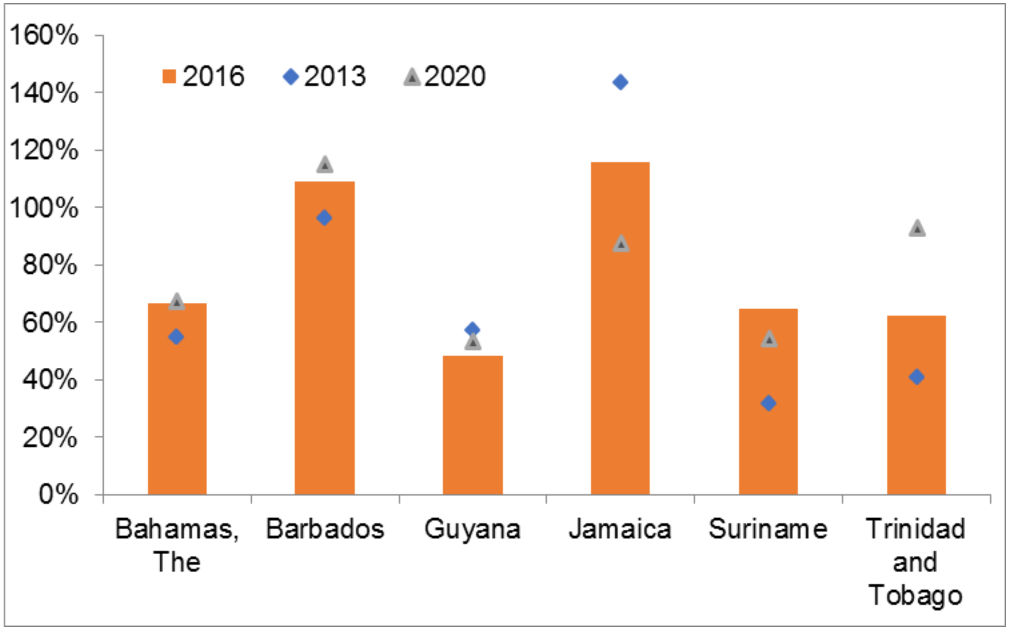
Sources: IDB calculations; and International Monetary Fund, World Economic Outlook (April 2017), based on Kevin Greenidge et al., 2012, "Threshold Effects of Sovereign Debt: Evidence from the Caribbean." IMF Working Paper 12/157

Empirical evidence suggests diminishing returns from increasing debt-to-GDP.

CCB countries are either on or above the threshold where the effect is negative.

Outlook does not suggest change

Debt-to-GDP Ratios (percent)



Sources: IDB calculations; and International Monetary Fund, *World Economic Outlook* (April 2017).

WEO outlook projects similar or increasing levels of debt.

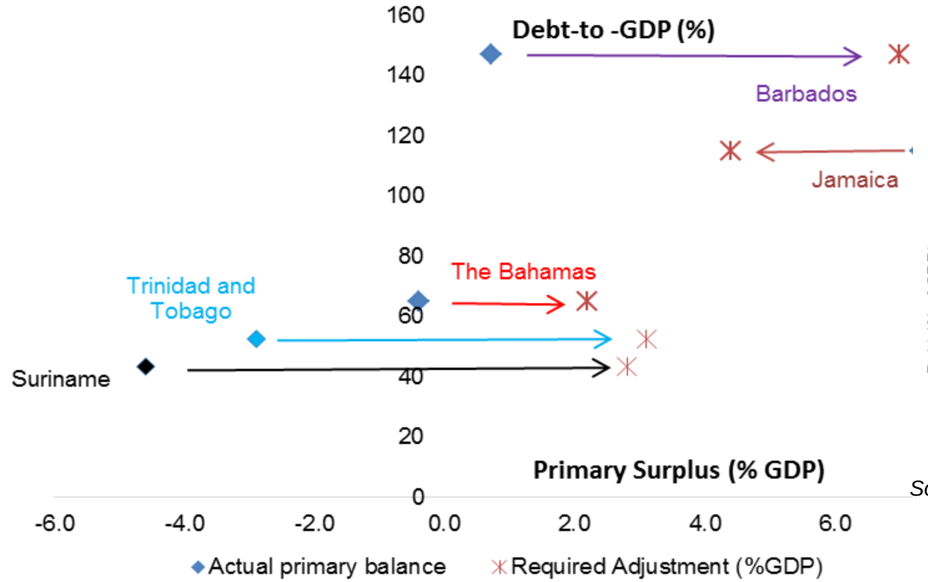
Jamaica is exception as fiscal consolidation was started in 2013.

With low growth, rigid expenditure and already high taxation, debt is prone to increase, even in absence of shocks.

Which implies risks and requires fiscal effort

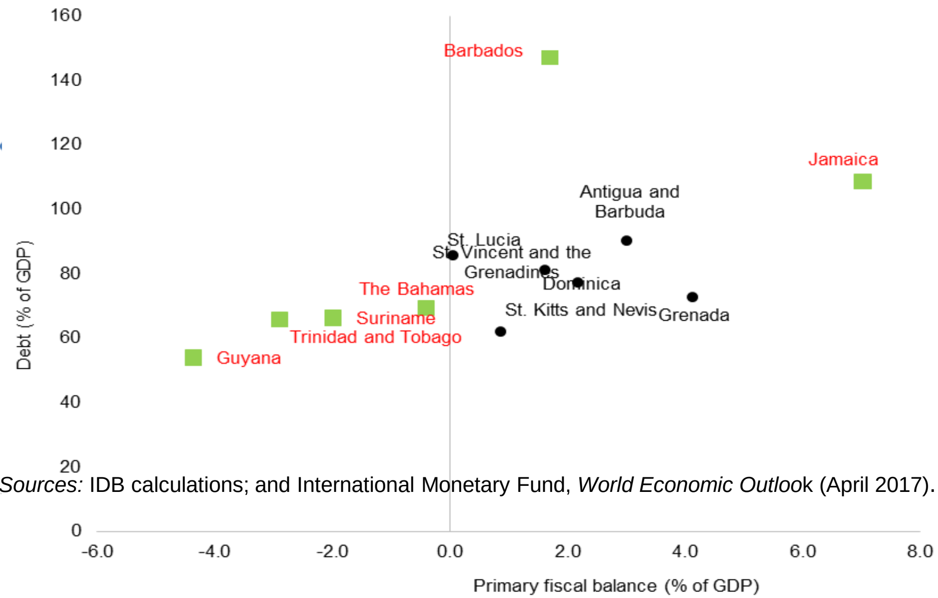
Even keeping debt at current levels requires important effort, meaning there are little buffers to absorb shocks.

Actual (2016) and Required Fiscal Balance (2017) (percent of GDP)



Sources: IDB calculations; and International Monetary Fund, *World Economic Outlook* (April 017).

Fiscal Buffers, 2017 (percent of GDP)



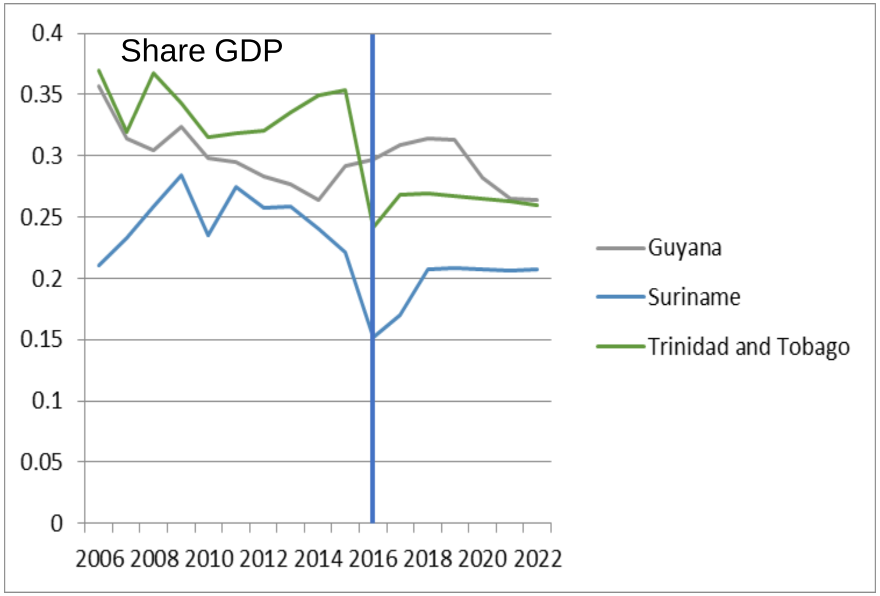
Sources: IDB calculations; and International Monetary Fund, *World Economic Outlook* (April 2017).

Can revenues save fiscal sustainability?

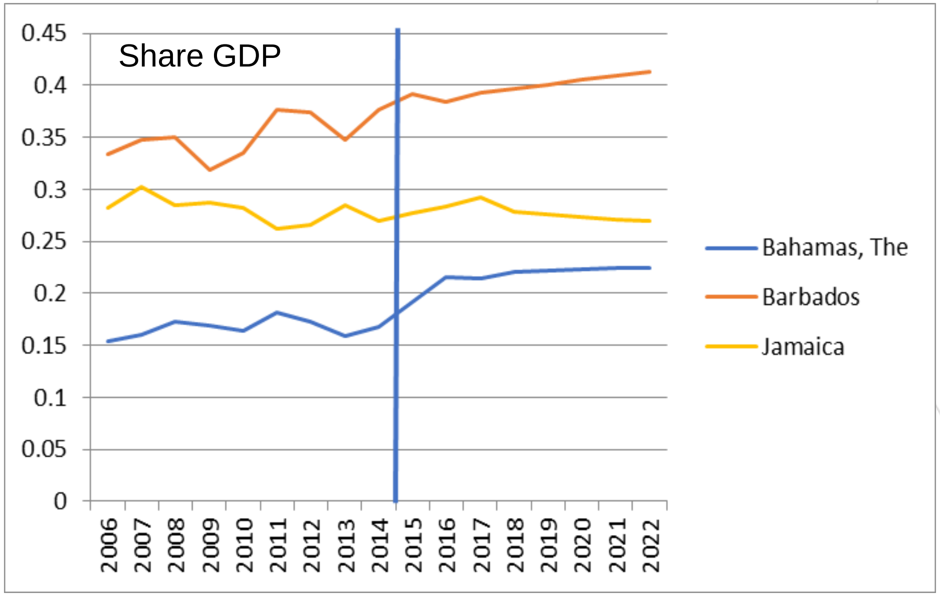
Revenue slump visible in commodity producers

Tourism countries reaching limits of taxation

Commodity Producers: Total Revenue



Tourism Countries: Total Revenue



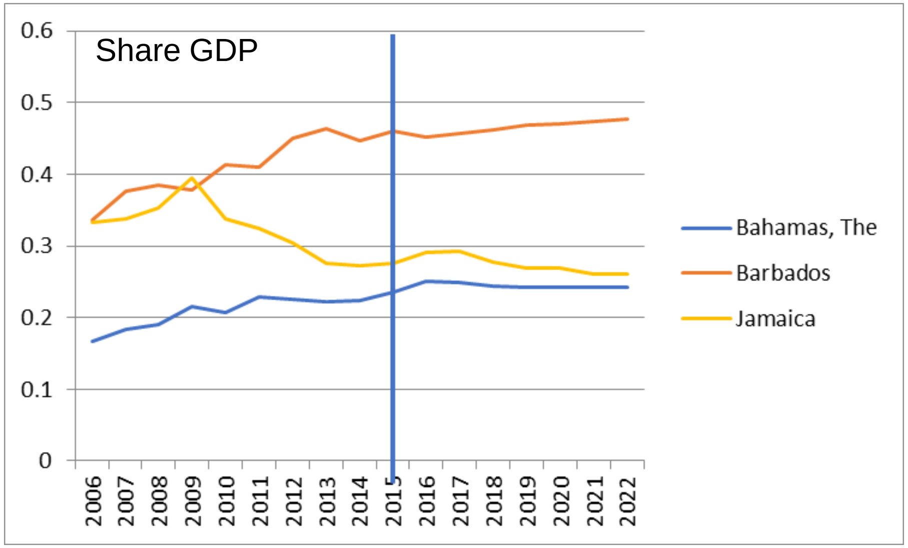
Sources: IDB calculations; and International Monetary Fund, *World Economic Outlook* (April 2017).

Expenditures

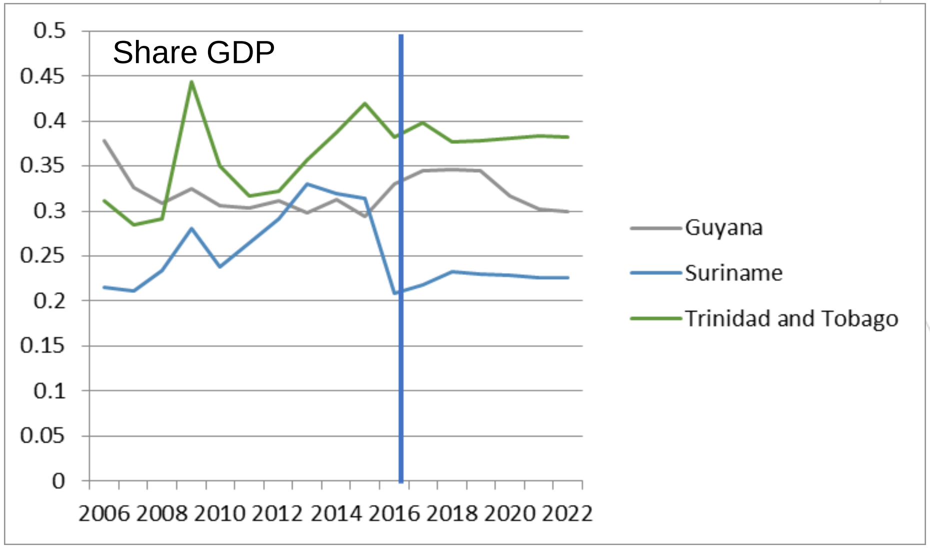
Expenditure growth is driving fiscal imbalances

Expenditure adjustment has not been fast enough

Tourism Countries: Expenditure



Commodity Producers: Expenditure



Sources: IDB calculations; and International Monetary Fund, *World Economic Outlook* (April 2017).

Summary

- Caribbean countries are small, open and highly vulnerable to external shocks.
- Debt levels are high, no relieve in sight without policy adjustment.
- Even keeping current debt levels requires an important effort.
- Buffers (fiscal surpluses or low debt) to accommodate potential shocks are low.
- While improvements on the revenue side are possible, expenditure need to adjust.

Policy Adjustment?

- Current fiscal policy leaves countries exposed.
  - Little buffers
  - Heavy focus on revenue; less on expenditure.
  - Pro-cyclical
- Improvements are possible but require deep reforms (reduce rigid expenditure, building of buffers, fiscal rules, etc.).

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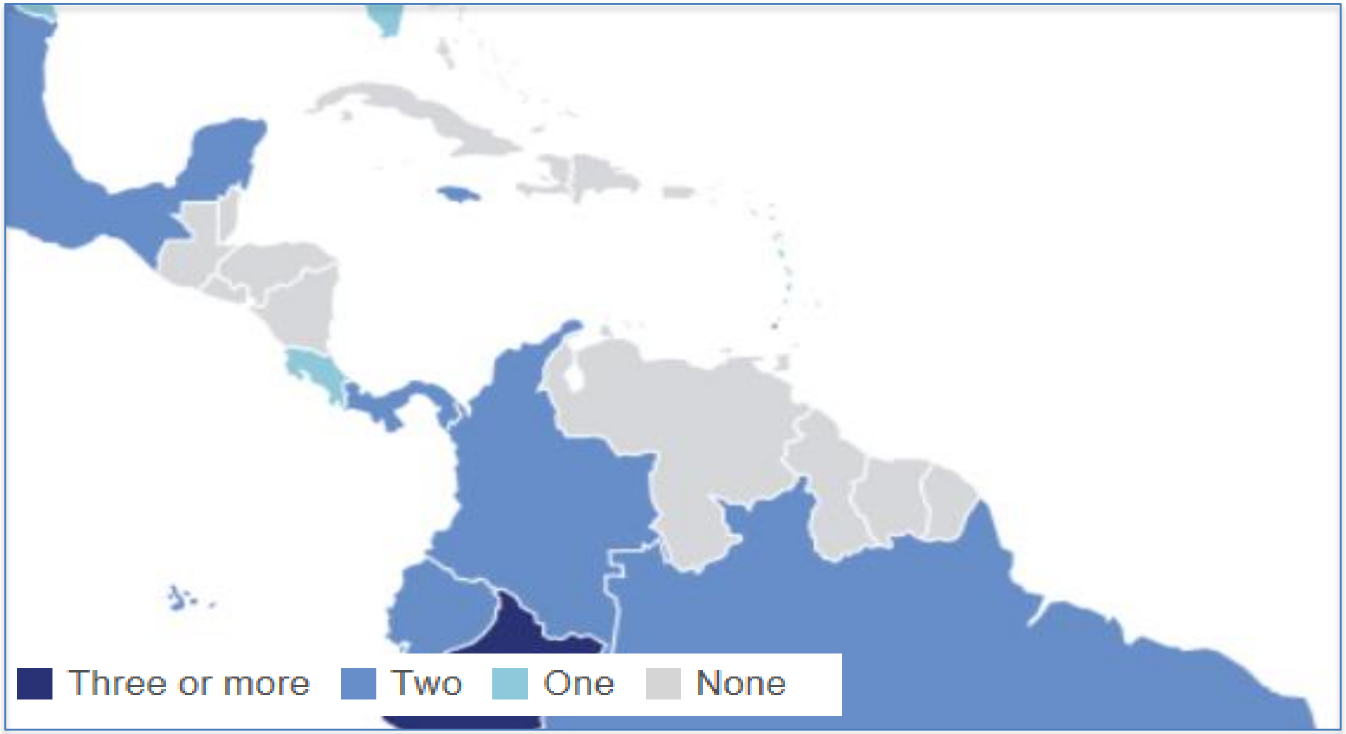
Call for Fiscal Rules?

- Caribbean, together with Central America are behind in Fiscal Rule coverage.

Number and type of fiscal rules (2015)



Source: IMF Data Mapper

Fiscal Rules, advantages

- Flexible in terms of coverage (debt, deficit, expenditure, balances, in combination with sovereign wealth fund)
- Reduce scope for mismanagement
- Reduce pro-cyclicality (spend less in good times and more in bad ones)
- Reduce uncertainty – short and long term

Thank you

Outline:

1. Introduction
2. Fiscal Challenges
   1. Debt
   2. Revenue
   3. Expenditure
3. Conclusion and Policy Discussion