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FINANCING FISCAL DEFICITS The Case of Dominica

By

Karen P. Williams

Research & Information Department
Eastern Caribbean Central Bank
Basseterre, St. Kitts

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ABSTRACT

The macroeconomic effects of government budget deficits are many. An examination of the various methods of financing deficits brings to light the different imbalances that may result; monetising the deficit will show up as inflation, high foreign borrowing results in explosive debt ratios, while too much domestic borrowing will raise interest rates and crowd out the private sector.

Keywords: Deficits, financing, inflation, crowding out.

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Karen P Williams

*Research & Information Department
Eastern Caribbean Central Bank
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A budget deficit, by itself, has no monetary meaning. The important point is out of which resources it is financed." (Holtrop, 1965, in IMF WP/86)

I. INTRODUCTION

The role of the state in economic development has been the focus of intensive study in recent times. From the rescue of market failure to the establishment of institutional conditions under which the market mechanism and private profit incentives can function, the government has an indispensable role. Recently, 'government failure' has been emphasised because of government's overprotection, unnecessary interventions in the market mechanism, bureaucratic rigidity, and corruption. However, particularly at an early stage of economic development, the role of government is crucially important to create the proper infrastructure and provide educational opportunities that enhance the quality of human capital. Therefore throughout the world governments have been undertaking big expenditure projects on various social and economic programs.

To carry out their indispensable involvement, governments of developing countries need financial resources. Tax revenue is the basic source of government revenue and it is not sufficient in many instances to finance the already large and ever-increasing government expenditure. The salient features of the tax system in developing countries do not permit governments to generate sufficient funds required to support large expenditures necessary for economic growth and development.

Therefore, strong demands for expenditures, coupled with political and economic obstacles to taxation, have impelled governments to obtain financing by borrowing either at home or abroad, each source with its own set of consequences. Governments must be cognizant of these consequences and seek to ensure that the most efficient means of financing is used. Furthermore, with the contraction of aid flows and the difficulty associated with sourcing external funding, there is greater need for resources to be generated from domestic sources. This paper aims, therefore, to examine the differential impact of financing a given deficit in alternative ways; it will highlight the experience of Dominica. The argument is structured as follows: section II reviews the role of government and the need for financing; section III examines the various sources and methods of financing, and their impact on the balance of payments (BoP), money supply and the net foreign

assets (NFA) of the banking system, while section IV discusses the case of Dominica. The policy recommendations are made in section V, along with the concluding statement.

II. ROLE OF THE STATE

Private enterprise and capitalist economic development do not exist in a vacuum. They require capable, not passive, government - government that can fashion a sanctuary within which the profit motive and the price mechanism can work. Adam Smith, focussing on the enabling role of government, made the same points two hundred years ago in his book, "The Wealth of Nations". Smith (1776:862) stated that "commerce and manufactures can seldom flourish long in any state which does not enjoy a regular administration of justice, in which people do not feel themselves secure in possession of their property, in which the faith of contracts is not supported by the law." Here, Smith saw the state as providing the prerequisites for the proper functioning of the market. These include basic law and order, the right to property and the enforcement of contracts. Smith (1776:651) also saw government as having "the duty of erecting and maintaining certain public works and certain public institutions." However, he advocated a minimalist state [not across the board], because he saw the state, like the market, as a flawed institution. Smith's proposal was that government should intervene to create an enabling environment for private activity.

Arising from the problems of the great depression, John Maynard Keynes argued that in addition to the conventional role, governments should also attempt to influence the level of effective demand. He, therefore, advocated greater government involvement in the economy, and until the late 1970s, the state was assigned a substantial role in economic development. Structuralist economists, borrowing from the Keynesian theory, felt that left to free market forces, the underdeveloped economies¹ would be marginalised and free markets would result in socially undesirable investments. Thus the state had to provide not only 'public' goods but "also undertake responsibility both for augmenting the economy's investable resources and for establishing a mechanism to transfer those resources into productive investment." (Wade 1990:9)

By the second half of the 1970s, the mainstream thinking of development policy shifted from the prescription of greater government involvement towards the neoclassical view of the appropriate

¹ Underdeveloped Economies - refer to economies with low private savings, dependence on primary exports, declining prices of exports in relation to imports, small internal markets, limited skills and few entrepreneurs adept at large scale organisation (Wade 1990).

role of the market and government. The neoclassicals felt that state intervention in the 1950s and 1960s had resulted in inefficient industries and excessive 'rent-seeking'. Neoclassicals view the engine of development as the efficient allocation of resources, and once the institutional arrangements are in place to generate an efficient allocation of resources, investment can be left to take care of itself. Therefore, government's role should be to ensure that these arrangements, i.e., competitive markets, are in place. In the neoclassical view, the essential economic functions of government are to:

- (a) maintain macroeconomic stability
- (b) provide physical infrastructure
- (c) supply 'public' goods
- (d) contribute to the development of institutions for improving the markets for labour, finance, technology,
- (e) offset or eliminate price distortions that arise in cases of demonstrable market failure
- (f) redistribute income to the poorest in sufficient measure for them to meet basic needs.

Even in recent time (1980s), the neo-liberals have argued that the neoclassical economic principles are still valid, and have favoured the doctrine of *laissez-faire*. Contrary to the dominant economic development policy approach in the 1950s, 1960s and 1970s, which assigned the state a substantial role in developing the economy, and emphasised capital formation as the main engine of growth, neo-liberals, like the neoclassicals, have underlined the efficient allocation of resources as the primary source of growth. They pointed to the importance of 'getting the prices right' and of promoting competitive, relatively undistorted markets. Neo-liberals generally see government as inefficient and corrupt, and believe that it should not take on functions that go beyond its 'appropriate role'. While they would concede that governments may intervene in the event of market failure, they argue that the intervention should be done at the very source of the failure. However, neo-liberals would assert that there are few inherent failures and that existing market imperfections are often due to government-induced policy errors which distort the smooth functioning of the market.

Recent studies of the East Asian growth experience seem to suggest that governments have to play a vital role in initiating the process of development by establishing institutions upon which the market system can operate. The state and market are counterparts and must combine to advance growth and development. As Wah and Jomo K. S. observes², "the strong faith placed on a freely

² Chapter 2 in the State and Economic Development; p 35

functioning market in promoting growth - with almost total denial of a positive role for government - seems misplaced.”

Consequently, there are a number of reasons why governments in developing countries, should adopt the Structuralist approach and play a more active role in economic development. Firstly, markets for the creation of resources needed in industrialisation are either inadequate or nonexistent. Governments, therefore, have to "create" the institutional framework for developing the market for these resources. For instance, institutions within which the price system operates (for example, laws and regulations governing contract or commercial transactions), can and will have to be created by the governments. Secondly, economic development of a country depends upon the performance of economic agents, such as workers and entrepreneurs. However, developing countries, especially in the Eastern Caribbean Central Bank (ECCB) region, lack an adequate supply of entrepreneurs. Those who exist are too risk averse, and it becomes necessary for government to induce them by providing them with a means to reduce risk.

Since independence, governments in the ECCB region became more responsible for the economic development of their respective countries. They developed social and economic infrastructure, established institutions and regulatory framework, which allowed for the operation of the market, and implemented programs to reduce poverty. Some governments also intervened in the economy by establishing price controls systems. In recent years, there has been a policy shift towards the free market economy, but governments continue to be intimately involved in promoting sustainable economic development.

Therefore, to promote economic development, a country needs a government that is strong enough to provide an adequate supply of public goods. They have to build an institutional framework within which the market system can operate with maximum efficiency. This entails establishing laws and regulations that ensure free, fair and effective competition, and open and free trade.

III. ECONOMIC IMPACT OF FINANCING A DEFICIT

The fiscal balance can be defined in a number of ways³; this paper however focuses on the overall balance and assumes that foreign grants are recorded as revenue. Furthermore, the fiscal deficit is defined on an accrual basis, and relates to the central government. Here the fiscal deficit refers to the difference between total revenues and total expenditures. This conventional concept of the fiscal deficit is of primary importance to fiscal analysis because it offers a comprehensive picture of the government's overall financial position and of the resulting impact on monetary conditions, domestic demand and the balance of payments.

Increasing needs and demand for certain services provided by governments may cause public expenditure to grow at a rate faster than the rate of growth of GDP. When the growth in national income is not high enough to provide the growth in public revenue necessary to finance expenditure, governments will resort to borrowing and/or accumulate arrears. This fact has caused many countries to rely on deficit financing of government outlays as a means for achieving government goals. Deficit financing, therefore, becomes fundamental for development and growth. Economic expansion generates a demand for foreign exchange. Particularly in developing countries, borrowing, especially foreign borrowing, is essential for capital accumulation. Many of today's developing countries have a dominant foreign exchange gap, which manifests itself in a chronic balance of payments deficit on the current account. Developing countries continue to need resource inflows, and therefore their indebtedness will rise because of the foreign exchange gap to meet development requirements and to pay interest and amortisation on past borrowing. Foreign borrowing then supplements both the domestic savings and foreign exchange gaps.

Sustainability

The danger in relying on debt emerges when the ratio of public debt to GDP is allowed to rise over time. While there is no generally accepted definition of what constitutes a sustainable fiscal policy, there is broad agreement that government debt becomes unsustainable if the country is unable to service its debt without recourse to relief or rescheduling or the accumulation of arrears. To ensure a sustainable debt position, it is imperative that government spending and GDP grow at least at the same rate.

The level of indebtedness of a country may be evaluated by certain key indicators based on the size and growth rate of the debt-to-GDP ratio, and debt service-to-exports ratio. The critical

³ See appendix I for definitions of the fiscal deficit

levels of these ratios are debt-to-GDP - 50 per cent and debt service-to-exports - 20 to 25 percent. As the experience of many countries has shown, ratios above these thresholds are costly and will eventually become unsustainable. However, it is also true that countries, which in the past have run external payments arrears or sought debt rescheduling have done so with widely differing debt burdens, measured using the standard indicators. Clearly other factors are at work. The chief practical value of indicators is that they signal situations in which debt service difficulties become increasingly likely. The fiscal dimension of the country has to be taken into account since the debt is usually public debt. The ability to service debt depends on whether additional foreign exchange can be earned or saved by the borrower. This depends on the domestic economic policy pursued by the country concerned, and on the ability to export, which depends to a large extent on world economic conditions. Other factors to be considered for sustainability includes fiscal and foreign exchange reserve position, efficiency of foreign exchange market, pace and variability of economic growth, and general thrust and credibility of the country's policies. The risk indicators that could be used are:

- export diversity,
- sensitivity to export shortfalls,
- underlying resource gap,
- aid dependency,
- resource coverage,
- fiscal burden, and
- policy track record.
- susceptibility to shocks

Some writers argue that a deficit that results from high return public investment will be sustainable. However, it should be noted that although spending on public infrastructure often has a very high return, many low-return or no-return projects may also be included in the category of investment. More importantly, even if public investment has a high return, the government must capture the additional returns from the investment if it is to be self-sustaining. Whether the deficit is sustainable depends not only on factors that the fiscal authorities control directly, such as revenue and spending programs, but also on other factors such as the interest rate on the debt and on how fast the economy is growing. Rapid growth will permit the government to run larger deficits. However, sustainability only becomes an issue if large deficits are likely to persist for the foreseeable future.

Financing Methods

Countries finance deficits differently depending on the economic development of the financial system, especially the loan market and the market for government securities. The most important distinction to be drawn in this respect is between borrowing within the country and abroad. A recurring deficit can have adverse consequences if governments resort to large-scale borrowing to close the gap. It may result in:

- (i) an accumulation of domestic debt that will crowd out productive private investment, i.e., resulting in a re-allocation of resources within the country or;
- (ii) an accumulation of external debt that not only adds an additional burden for further generations but it may in the long run deteriorate the credit standing of the country in the international capital market.

Different forms of government financing have varying effects upon the economy. To provide an accurate analysis of the impact of government operations on an economy, it is necessary to evaluate the magnitude, sources and financing of government deficits. While a larger government deficit is usually associated with a lower rate of economic growth, the effects of deficits on growth are likely to depend on the way deficits are financed. In determining how deficits should be financed, the impact of the sources and methods of funding should be analysed.

The annual difference between expenditure and revenue is financed using one or a combination of the following methods:

- (i) borrowing from abroad;
- (ii) borrowing from the central bank, or “monetising” the deficit;
- (iii) borrowing from the rest of the banking system;
- (iv) borrowing from the domestic non-bank sector;
- (v) accumulation of arrears;

• Borrowing from Abroad

Whether a government should borrow abroad is essentially a benefit-cost question. An immediate gain in resources should be balanced against the future real cost of debt service and debt repayment. Ideally, a decision to borrow should be made *deliberately, after careful appraisal of*

benefits and costs. In practice, however, much borrowing is unplanned and undertaken with little or no systematic comparison of benefits and costs.

Foreign financing of fiscal deficits can originate in many different ways. Governments can finance deficits abroad by issuing bonds to nonresidents or by seeking foreign (concessionary or commercial) loans.

The direct cost of external financing involves a stream of future debt service payments. While in the short term, external loans are sources of foreign exchange, over the life of a loan there is a net outflow of foreign exchange. Furthermore, high external debt increases the vulnerability of the fiscal position to developments in the international capital markets such as changes in the exchange rate and world interest rates. Such financing also facilitates the maintenance of an over-valued exchange rate, damaging exports and encouraging imports. An issue of increasing concern has been the fiscal burden of external debt. In many countries with external debt difficulties, scheduled debt service payments absorb a major proportion of government revenues, reducing the government's room to maneuver in terms of fiscal adjustment.

The impact of external financing on the BOP in the long run differs depending on the final use of this financing, i.e., consumption versus investment. Borrowing for consumption purposes may provide budgetary support in the short-term but over the medium-to-long-term this borrowing has to be repaid with interest. In small open economies, the immediate effect of such borrowing is a rise in the net foreign assets of the country, however these funds will not remain in the economy, but be used as payments for imports. This in turn neutralises the impact on the net foreign assets. In general, borrowing for consumption increases purchasing power and leads to an expansion in aggregate demand. The augmented aggregate demand has to be satisfied through imports, thereby necessitating a reduction in the net foreign assets and a consequential widening of the current account gap on the balance of payments. Moreover, when this borrowing is repaid (interest and principal) both the current and capital accounts of the balance of payments are adversely affected.

In the case of borrowing for investment, there is also the resulting rise in the net foreign assets position of the country. However, this growth in NFA is only temporary as it will be lost through payments for imports for the investment, and cause a deterioration of the current account of the BOP. If the investment, on the other hand, generates employment and foreign exchange then this borrowing could not only be self liquidating, but may also support those projects that are not economically viable but important for socio-economic reasons. It is important that external

borrowing be channeled into productive investment, as foreign inflows from the exports of these projects will contribute to an improvement in the current account of the BOP, and will support the outflows on the capital account of the BOP associated with principal repayment.

Theoretically, borrowing abroad causes net international reserves to increase by the amount of the foreign debt and consequently, the money supply will increase by the amount of the increase in the net imputed reserves. The increase in the money supply could be used to lend additional resources to the private sector thereby stimulating economic activity, but depending on the supply response, could also result in rising prices. However, for small open economies the final impact will be the net foreign assets, as the increased aggregate demand is satisfied primarily through imports. A large portion of the increased net international reserves will be lost through leakage for payments on import. As such borrowing for consumption is unsustainable. Additionally, governments in the region borrow for investment projects, and most of the materials have to be imported. Furthermore, consultancy and design fees are generally paid to foreigners. Consequently, projects financed by borrowing from abroad should be productive.

Deficits financed through external borrowing, therefore, need to be assessed in the context of the external debt position of the country, the medium-term balance of payments prospects, the terms under which borrowing takes place, and the uses to which external borrowing may be put.

• *Borrowing from the Central Bank*

Government borrowing from the central bank is equivalent to the creation of money. A growth in money at a rate that exceeds demand at the current price level, creates excess cash balances and eventually drives up the overall price level. Borrowing from the monetary authority, therefore, leads to an increase in deposits and currency by the amount of deficit financing. Under this method governments usually finance deficits by selling securities to or obtaining direct loans from the central bank, causing the domestic component of the monetary base to increase by the amount of the sale.

When the government finances its deficit by selling securities to the central bank, the central bank's holdings of securities increases. When government borrows from the central bank, central bank claims on the government as well as government deposits with the central bank rise; hence, there is no change in net claims on government. But when the government uses the borrowed money to make a payment to the private sector, the stock of reserve money rises, because government's deposits with the central bank are reduced, thus increasing the central bank's net credit to

government. A fiscal deficit financed by borrowing from the central bank thus results in a one-for-one increase in the money. For this reason, financing a deficit by borrowing is equivalent to financing a deficit by issuing currency (frequently referred to as deficit financing by printing money or simply as the monetisation of the deficit).

In the OECS area, the member states can access credit from the Central Bank (ECCB) for development financing. However, the extent to which this is possible is limited by the legal requirement that the ECCB maintain a foreign exchange reserves to demand liabilities ratio of 60.0 per cent. In addition, ECCB holdings of treasury bills of any member may not exceed 10 per cent of that member's recurrent revenue for the current year; ECCB holdings of securities other than treasury bills issued by all members may not exceed 15 per cent of its currency in circulation and other demand liabilities; and the ECCB temporary advances to a member in any financial year may not exceed 5 per cent of that member's average annual recurrent revenue over the three preceding years.⁴ The ECCB has the legal power to influence money and credit but in practice it is limited by the open nature of the economy, the fact that money and credit are not sensitive to modest interest variation and the important role played by multinational banks with access to international financial markets. In the ECCB member countries, borrowing from the Central Bank will impact on the NFA, as the borrowed funds is used to increase imports, and so widening the current account of the BOP.

• *Borrowing from the Rest of the Banking System*

Many governments resort to borrowing from domestic commercial banks because of difficulties associated with borrowing from other domestic sources or from abroad. Borrowing from commercial banks by the government could take the form of loans, including overdrafts, and the sale of securities (treasury bills or bonds). In many developing countries, banks hold securities largely because they are captive buyers required to hold a specific quota of government securities after every new issue. The immediate concern of such borrowing however is the impact on domestic private investment.

Literature suggest that the effects on the money supply of financing deficits through commercial banks depend on the way banks choose to reallocate their asset holdings for this purpose. Banks could finance deficits in three ways:

⁴ ECCB Agreement

- a) increase borrowed reserves from the monetary authority for the purpose of buying government securities;
- b) reduce holdings of excess reserves;
- c) call in private debt in the form of loans made earlier to non-bank public, or reduce credit to the private sector in order to meet government's demand.

In the absence of effective open-market operations, which are a major policy tool in many developed countries, the discount rate and discount window activities become more important in stabilising money and credit aggregates and injecting reserves in the economy. Developing countries have relied heavily on the discount window as a major source of credit to banks. This is tantamount to monetising the deficit. If the central bank extends credit to the banking system solely for the purpose of buying government securities, this would cause the money supply to increase directly by increasing the monetary base by the amount of the loan.

Many banks hold excess reserves in amounts large enough to finance parts of the government securities allotted to them after every new issue. Government borrowing from the commercial banks with excess reserves would not limit credit to the private sector, but result in an addition to the stock of money (money creation) which leads to increased aggregate spending, larger imports and depending on supply and demand conditions, higher prices. Commercial banks would have to increase their foreign liabilities or reduce their foreign assets to meet the demand for credit, hence affecting the capital account of the BOP. Governments in using these funds to pay for imports induce a further reduction in the NFA, and also a widening of the current account balance, unless the borrowing is for a productive investment that will generate a future stream of foreign exchange earnings.

On the other hand, government borrowing from commercial banks without excess reserves displaces loans to other customers or reduces the amount of credit available to the private sector either via an increase in the interest rate or through credit rationing. As, the commercial banks could possibly finance government budget deficits by calling in some loans made earlier to the non-bank public or reducing credit to the private sector. In this situation, there will be no effect on the money supply since lending to the government is made at the cost of private sector's credit. However, this results in the phenomenon referred to as the 'crowding out' of private investment. The precise mechanism by which this crowding out takes place can vary. If public and private investments are close substitutes then the former may directly displace the latter. Alternatively, there may be financial

crowding out as the availability of credit to the private sector to finance investment is rationed or the higher deficit forces up interest rates which, in turn, lowers investment.

Accordingly, undue financing of the deficit by domestic commercial banks can succeed in pushing up interest rates and other price levels, crowding out the private sector and leading to lower investment, and worsening the BOP deficits through changes in the monetary base.

Within the ECCB region, commercial banks are for the most part branches of British and Canadian international banks with access to pooled reserves, and the international financial market through their head office. Additionally, liquidity may be high making it unnecessary to ration credit to the private sector or raise interest rates to make funds available to governments. As such the crowding out effect may be minimal. Moreover, these economies are not at full employment and the increased government spending might just very well stimulate the private sector to invest and spend.

• *Borrowing from the Domestic Non-Bank Sector*

The non-bank public is the third domestic group financing budget deficits. This group includes a combination of firms, individuals, insurance companies, social security schemes, and investment and trust companies. Borrowing from the non-bank public has been mainly in the form of bonds issued by the central government. However, the scope for domestic non-bank financing is usually a function of how far capital markets have developed and whether there is public demand for government bonds. Thus, in developing countries the potential for using this option to finance the deficit is very limited. Consequently, bond financing is hardly used and is often an insignificant source of fiscal finance.

Nevertheless, while the scope for financing a fiscal deficit through the voluntary placement of bonds in the market is limited in developing countries, an alternative exists that is often of greater significance: the sale of bonds to captive buyers referred to as 'financial repression'. Financial repression involves urging private sector agents to buy government securities at below-market yields. Social security institutions and public enterprises are often required by law to invest in government bonds. This captive market for government securities accounts for much of the non-bank domestic source of financing in developing countries.

Non-bank borrowing allows governments to sustain, in the short run, a deficit without increasing the monetary base or depleting international reserves. Because of this, it is often

considered an effective way to avoid both inflation and external crises. Yet, non-bank borrowing carries its own dangers if used too often. First, bond financing of the deficit, while it postpones inflation, may lead to significantly higher inflation in the future if the stock of government debt is not kept in check. Second, like bank borrowing, borrowing from the public directly crowds out the private sector, limiting the availability of resources for investment, particularly during periods of tight liquidity. It also puts upward pressures on domestic interest rates. After all, not only do high interest rates hurt economic growth, but also issuing public debt at such rates adds to the cost of future debt servicing and thus to future fiscal deficits.

Deficits financed by borrowing from the non-bank private sector may have a more limited impact on aggregate demand than direct monetary financing, insofar as there is a compensating reduction in spending by the private sector. The demand effects of deficits financed by debt issuance may, to a limited extent, be offset by increases in private sector savings in anticipation of future taxation to finance debt service. According to the debt neutrality or "Ricardian equivalence" hypothesis, borrowing is no more than deferred taxation. Specifically, for a given government expenditure, a reduction in current taxes would clearly raise the budget deficit and hence borrowing. Under this hypothesis, insofar as the private sector recognises that increased government borrowing today means higher taxes in the future, it increases private savings in order to provide for increases in taxes in the future. The "Ricardian equivalence" stipulates that a shift from tax financing to debt financing would not change total national saving, as the initial reduction in government saving will be fully and exactly offset by an increase in private sector saving. Thus, a tax cut financed by government borrowing does not reduce the tax burden; it only postpones it. The hypothesis states that deficits and taxes are equivalent in their effect on consumption. Notwithstanding, the theoretical attraction of this view, it clearly assumes a degree of rationality on the part of private agents that is most unlikely to exist in practice. For all practical purposes it has to be assumed that the hypothesis is of limited relevance and that financing indeed matters.

In cases where there may be excess demand in the economy, an increase in the purchase of bonds by the public could lead to the absorption of private savings and a reduction in aggregate demand. This may yield positive results with regard to reducing inflationary pressures and the level of imports. However, where there is not much savings in the economy by the private sector, the bond issue could have a deflationary impact on economic activity unless government injects in the economy. Moreover, government borrowing may increase domestic interest rates and reduce private investment; alternatively when interest rates are controlled, private investment may be more directly reduced through credit rationing.

Thus, while non-bank borrowing is likely to have the considerable advantage of being less inflationary than monetary financing, this may well come at the cost of crowding out productive private sector activities. However, opportunities for borrowing at home from non-bank lenders are severely limited in most developing countries as very few persons put their savings in government securities. Besides, time would be required to establish the institutions and practices that make possible wide voluntary purchases of government securities.

Extraordinary Financing (Arrears)

Government expenditure arrears, which indicate delays in government payments to suppliers or creditors, have become an important fiscal issue in many economies. The presence of arrears could lead to an under-estimation of expenditure and correspondingly, of the impact of government operations and the size of the fiscal problem facing a country. Because arrears can be viewed as a form of 'forced financing' to the government, the government's borrowing requirement may also be underestimated, yielding a distorted picture of the sources of credit expansion in an economy.

When fiscal adjustment is less than programmed or there are unprogrammed shortfalls in other sources of financing a buildup of arrears could become a means by which governments reconcile the constraint on domestic bank financing. The accumulation of arrears may also reflect the monetary arrangement or legal requirements that limit government access to central bank credit. Arrears are accumulated as the government effectively finances its deficit through an involuntary expansion of suppliers' credit or forced credits from employees, creditors or other agents in the economy.

Delays in payments on debt service or on goods and services purchased are considered a particularly costly means of financing budgetary commitments. Such arrears are likely to have similar macroeconomic consequences to other forms of public borrowing (domestic or external), as well as jeopardising future financing, government's credibility, and the integrity of the budgetary system. Government's share in total output is limited by the amount the rest of the economy is prepared to release to the government by paying taxes or by extending credit. The buildup of arrears increases the government's absorption of resources above this level. But while it allows government to absorb more of the economy's resources than would otherwise be possible, this initial effect is offset as the rest of the economy responds by raising suppliers' prices or holding back payments for taxes and fees.

Vendors dealing with the government may begin to charge higher prices to make up for refinancing costs, a risk premium, and bribes to speed up the payment process. Similarly, there is also a possibility that creditors will bid up the interest rate charged on loans to the government if they anticipate that the government will not pay back these loans as scheduled. Companies frequently adjust to the emergence of government arrears by incurring arrears on their tax liabilities. Insofar as the vendors not paid by the government in turn retain funds equivalent to the taxes owed to the government, the government in practice is financing its expenditure by forgoing tax revenue. This results in a deterioration of the budget/fiscal system.

The development of a chronic pattern of arrears may influence the costs and prices in the economy. The accumulation of government arrears may have serious impact on the confidence of private enterprises and households in the soundness of government financial operations. Private consumers and investors may anticipate an increase in the tax rate, higher inflation, or a general worsening of the financial situation in the medium-term. Arrears may accumulate throughout the economy as a result of government arrears with severe consequences for the stability of the financial system and prospects for economic growth.

Ultimately, arrears raise the cost of providing government services. Besides, the impact on prices and the balance of payments would be essentially the same whether a deficit is financed by *borrowing from the domestic banking system* or by accumulating domestic arrears to public enterprises and the private sector, which then borrow from the banking system.

* **Other⁵**

One other form of financing worth mentioning here is government leased-to-own liabilities. This method of financing which some governments in the region has been making use of, is referred to as BOOT (build-own-operate-transfer) or BOLT (build-own-lease-transfer). While Dominica has not yet made use of this form of deficit financing, Antigua, Grenada and St. Lucia have made use of it to implement certain aspects of their investment programs. This method involves either a foreign or domestic financier undertaking the construction or establishment of the needed expenditure, leasing it out to the central government for a specified period and at the end of the term transferring ownership to government. During the construction phase, the domestic financier borrows from the local commercial banks or brings in foreign funds to undertake the project. An locally financed

⁵ Other methods of financing not discussed in the paper, but governments might use include running down foreign

project results in either a fall in or an increase in NFA. However, NFA will contract as the domestic financier has to import the necessary materials for the project. If, the construction is being undertaken by an external financier, he brings in foreign exchange, thereby increasing the NFA, but he has to be repaid with foreign exchange in the future. For government, this would have the same impact as borrowing as it would entail a stream of payments and result in an increase in the country's indebtedness. Moreover, these arrangements usually involve commercial rates, which would impact negatively on the debt service burden.

IV. GOVERNMENT FINANCING IN DOMINICA

Macroeconomic Profile

The Commonwealth of Dominica is a small island state in the Eastern Caribbean with an area of 750 square kilometres, and an estimated (mid-1995) population of 72,000. In 1996 per capita income was estimated at US\$3,194. The economy is small, open and relatively undiversified. The openness of the economy is partly manifested in the fact that in 1996 imports of goods was 43.0 per cent of GDP, while exports of goods was 23.0 per cent of GDP.

In keeping with its resource endowments and reflecting historical circumstances, the economy of Dominica has been based on agriculture, although tourism and manufacturing have recently been making contributions to total output and to exports. The economy, therefore, depends on a narrow range of export goods and tourism, and lacks control over prices received, particularly in the case of agricultural commodities. There is significant vulnerability to fluctuations in international demand, prices and currency exchange rates. In addition, it has to cope with the problems of small domestic market, high infrastructure costs and poor transport, notably air access.

Historically, bananas have been the dominant form of productive economic activity and the most important source of foreign exchange earnings. Banana production fell sharply in 1989 due to the passage of hurricane Hugo and in subsequent years did not recover to the pre-1989 levels because of low investments and limited field maintenance due to concerns about the possible elimination of preferential access to the European banana market. American interest and Latin American banana producers have, successfully challenged the current preferential and protected arrangement under which Dominican bananas are exported to the United Kingdom.

Still, efforts to broaden the economic base have had limited success, mainly because of a shortage of arable land, the lack of attractive beaches, the occurrence of natural disasters and poor infrastructure. Moreover, there is an inadequate supply of the technical and managerial skills that are needed for entrepreneurial-led expansion. Government therefore had to play a major role in improving the island's infrastructure, establishing institutions for free trade and developing social programs to improve the performance of economic agents to better enable them to participate in the economic development of the island. Thus, governments over the years have engaged in expenditures geared towards the designing of development plans and programs aimed at social and economic transformation of these islands.

Governor Venner of the ECCB noted in his address to the 1992 'Symposium on Small States,' that, OECS governments would need to

“identify and successfully launch new export agricultural commodities, increase the size and variety of the tourist plant, and diversify the source of visitors, and identify manufacturing industries with products...able to penetrate niche markets.”

This points to substantial involvement of the state in economic development. Furthermore, with the recent changes to the external environment, the country needs to undertake PSIPs of sufficient size in both infrastructure and human resource development, to withstand the impact of changes in the preferential trading agreement for banana and to facilitate the development of services-oriented activities. As such Dominican authorities spend more than current revenue in any particular fiscal year, with deficits being financed by a combination of domestic and external borrowing.

Dominica's economy performed reasonably well over the mid-to-late 1980s with real GDP growth averaging about 7.0 per cent per annum. This was maintained by the economic policies supported by the auspices of a Structural Adjustment Programme (SAP) adopted in 1987 and propelled by increased banana production and favourable exchange rate movements of the Eastern Caribbean dollar vis-a-vis the Pound Sterling. During the period, public sector savings averaged 5.0 per cent of GDP and the external balances showed improvements. The economy suffered a setback in 1989 with the passage of Hurricane Hugo, notwithstanding it recovered rapidly and by 1990 real GDP growth reached 6.0 per cent. In the next four years, real growth was estimated to have slowed down to roughly 2.2 per cent, due in part to the

demise of the banana industry. The public finances strengthened considerably under the SAP, but deteriorated in the years following the 1989 hurricane. Over the last decade there has been a decline in revenue buoyancy and in external grant financing. The reduction in foreign inflows of funds came about because of the recession in traditional donor countries, and the intensification of international competition for aid after the end of the Cold War and the focus on Eastern Europe. During the period 1988 to 1996 the ratio of budgetary deficit to GDP averaged 3.7 per cent, with a high of 8.2 per cent in 1989/90. These deficits led to a build up of debt, both domestic and external.

Table 1 in appendix II shows Dominica central government fiscal operations as a percentage of GDP during period 1988 to 1996. From the table we observe that throughout the period Dominica lacked adequate revenues to fund government expenditures, with resulting deficits in all the years.

Table 2 shows the methods used to finance the deficits over those years. Dominica has basically used three options of the financing available to it, external borrowing, borrowing from the commercial banks and build-up of arrears. There is a limit as mention in section 3 to borrowing from the Central Bank, and Dominica did not make use of the BOOT arrangement or divestment in the period examined.

Financing of Budget Deficits

1988/89-1991/92

During the fiscal years 1988/89 - 1991/92, the overall deficit was largely satisfied by external financing and averaged 2.9 per cent of GDP, with highs of 3.9 per cent and 3.6 per cent in 1990/91 and 1991/92 respectively. However, in 1989/90 financing needs were met primarily by borrowing from the commercial banks.

In the fiscal years (FY) 1990/91 and 1991/92 net external funds to the Government of the Commonwealth of Dominica (GOCD) was \$18.7m and \$20.4m respectively. Most of the funds were sourced from the Caribbean Development Bank (CDB), European Investment Bank (EIB), La Caisse Centrale, and Government of the United Kingdom (UK) with most of the resources being used for multi-sector activities, the development of the agricultural sector and roads and bridges.

Up to 1988/89, GOCD made an attempt to retire domestic debt, and those years prior to the fiscal year 1988/89 were characterised by repayments to the commercial banks and other domestic

agents. However, in the fiscal years 1989/90 and 1990/91 there was substantial borrowing from the domestic commercial banks. Consequently, in FY 1989/90 domestic financing increased to 6.5 per cent of GDP and totaled \$29.2m, from a net repayment position of 2.1 per cent of GDP. This was necessary to finance a huge deficit of \$37.1m, which resulted from a 46.4 per cent rise in capital expenditure. The growth in capital expenditure was associated with rehabilitation efforts needed after the passage of Hurricane Hugo in 1989. Most of the needed capital came from the commercial banks and net borrowing from the commercial banks rose to 3.7 per cent of GDP. This borrowing was facilitated via an increase in loans and advances, and increased holdings of debentures by the banks.

1992/93 - 1995/96

During this period, government revenues remained relatively stable, while growth in expenditures surpassed that of revenues. The ratio of current expenditure to GDP was above 25.0 per cent throughout the period compared with the FYs 1988/89 to 1991/92. Furthermore, following a large wage increase (with retroactive elements) in 1993/94 the overall deficit of the central government increased to 5.0 per cent of GDP from 0.9 per cent in the previous year. Given the weak fiscal performance since 1991/92 and the contraction of foreign flows, the central government began to rely heavily on commercial bank borrowing and the accumulation of arrears to finance its overall deficit. In this period, external financing continued to be used, but there was an increased in domestic commercial bank borrowing. In addition, government accumulated arrears, both domestic and external.

External financing averaged 0.1 per cent of GDP compared with 2.9 per cent of GDP in the previous period. Only in the fiscal year 1994/95 did the ratio of external financing to GDP reached 1.0 per cent. This was associated primarily with disbursements of \$13.3m from Caisse Centrale. This capital inflow was used for the development of the Roseau Cruise Ship Berth and the Roseau Ferry Terminal.

Meanwhile, domestic financing averaged 2.6 per cent of GDP up from 1.3 per cent, with a high of 4.7 per cent in 1994/95. This was attributed to a net increase of \$14.6m in credit from commercial banks, mainly in the form of loans and advances. During that period government also started borrowing from the Social Security Scheme, and in the fiscal year 1994/95 borrowed \$6.8m in the form of loans.

Over the period, 1992/93 - 1995/96 GOCD also accumulated arrears, both external and domestic. Most of these arrears were to the Social Security Scheme for contributions and debenture interest and to regional and international organisations.

Economic Impact

External borrowing led to an increase in external debt from \$120.1 m in 1988 to \$187.70m in 1996. The ratio of external debt to GDP averaged 34.6 per cent during 1988/89 to 1991/92, declining marginally to an average of 33.2 per cent during 1992/93 to 1995/96. The debt service ratio (i.e., debt service to export earnings) declined to 4.1 per cent in 1995/96 from 5.8 per cent in 1988/89. The ratio of debt service to current revenues declined from an average of 8.0 per cent in the first period to an average of 7.5 per cent in the second. The slight improvements in the foregoing indicators hints at the increased use of domestic borrowing, and also masked the accumulation in external arrears that was taking place.

The World Bank in its World Debt Tables defines a severely indebted country as one in which 3 of 4 key ratios are above the critical levels. These ratios and their critical levels are debt to GDP: 50 percent, debt to export of goods and all services: 275 percent, accrued debt service to exports: 20-25 percent, and accrued interest to exports: 20 percent. A moderately indebted country is one in which 3 of the 4 ratios fall in the following ranges: debt to GNP: 30 to 50 per cent, debt to export of goods and all services: 165 to 275 per cent, accrued debt service to exports: 18 to 30 per cent and accrued interest to exports: 12 to 20 percent. The CARICOM Technical Committee on Convergence has established a criterion for debt service level to export of goods and non-factor services of 15 percent. This implies that Dominica's indebtedness is extremely low. However, in relation to the size of the economy, the debt may be large and the debt service burden can threaten its sustainability, keeping in mind that the country is small and open, and very vulnerable to external shocks. Thus, the fiscal dimension of Dominica has to be reviewed by examining the risk factors discussed in section 3, sub-heading "Sustainability." Table 5 in the appendix highlights these risk factors, and it is observed that Dominica is not highly reliant on foreign resources and with current revenue averaging approximately 20 percent of GDP, government should be able to meet its obligations. Therefore the impact of external borrowing has been primarily an addition to the debt burden of the country, and in a further tightening of the cash flow. What are probably needed are improvements in tax administration and efficiency, and reductions in some components of expenditure.

In terms of domestic borrowing, the theory suggests that the money supply will grow resulting in higher prices, if the commercial banks reduce their excess reserves. And the private sector will be crowded out, if liquidity is tight. Thus, in the years of substantial domestic borrowing in Dominica, the money supply grew at higher rates than the average and at higher rates than in previous years. In the three years (1989/90, 1993/94, 1994/95) when domestic borrowing was especially high, the money supply grew by 14.6 per cent, 9.3 per cent and 6.2 per cent respectively. (See table 3 – appendix). Yet, the inflation rate was not substantially higher in those years, and could be related to the discipline imposed by membership in the ECCB. Additionally, being an open economy Dominica's inflation is determined by movements in the prices of its major trading partners.

Despite the expanded use of domestic borrowing to finance the deficit in the FY 1992/93 – 1995/96, there was no notable “crowding out” in any single year. However, the average growth in credit to the private sector did decline to 9.9 per cent in that period from 21.2 per cent in the previous period. This crowding out may however have taken place through a rationing of credit rather than through increased interest rates. During the period interest rates remained relatively stable, even while the liquidity ratio (loans-to-deposit) increased from an average of 74.9 per cent to 85.2 per cent. This could be indicative of the access to pooled reserves that the branches of international banks have at their disposal, making it unnecessary to raise interest rates in an effort to ration credit. Furthermore the economy had a high level of unemployment and as such there is room for private sector investment alongside government spending.

In the period, 1992/93 to 1995/96, domestic interest payments as a percentage of current revenue was significantly larger averaging 8.5 per cent compared with the average of 4.2 per cent in the previous period, 1988/89 to 1991/92. Throughout the eight-year period a rising trend was noticed in terms of interest payments, this coupled with increasing outlays on other categories of expenditure particularly personal emoluments would have had an adverse impact on central government's savings and on the government's investment program. In the second half of the period being reviewed, total interest payments to export earnings, and total interest payments to current revenue ratios rose to averages of 6.0 per cent and 10.3 per cent from averages of 3.6 per cent and 6.2 per cent respectively.

During the period, 1988 to 1996, deficit financing in Dominica resulted in tightening of the cash flow situation, and faster growth in interest payments relative to growth in GDP and growth in current revenues.

V. POLICY GUIDELINES AND CONCLUSION

Examining the size of budget deficits and the various methods of deficit financing in the case of Dominica shows that GOCD has embarked on various borrowing policies to finance large budget deficits. The government has relied on both domestic and foreign financing methods to achieve high levels of public spending.

Domestic financing is composed of financing from the monetary authority, borrowing from banks and borrowing from the non-bank public. Financing from the monetary authority raises the domestic component of the monetary base by the size of the deficit. Money creation also results from borrowing from commercial banks, if the banks were to increase their borrowed reserves or reduce their excess reserves. A fiscal deficit financed by reducing holdings of reserves results in multiple money creation, while increasing borrowed reserves results in a one-for-one increase in the money supply. This results in an increase in aggregate spending through imports and has the potential to cause inflation. For small open economies, the increased purchasing power is expended on imports resulting in a decline in the net foreign assets position, and neutralising the impact of the increase in the money supply. Most investment projects have a relatively high import content, and despite the fact that a project is financed entirely from local sources there will be an outflow of foreign exchange to purchase capital and intermediate goods. In addition, there are likely to be leakages from the economy through the consumption of import from income earned by residents associated with the project. The effect will be a widening of the current account balance of the BoP. Financing from non-bank public is not likely to result in money creation. Like commercial bank financing, it may displace lending to the private sector and impact negatively on investment. In developing countries, opportunities for borrowing from non-bank public are limited due to the lack of an efficient government securities market. Moreover in Dominica, the banking system is fairly liquid and with high unemployment, the expected "crowding out" does not take place

The initial impact of financing from abroad is an increase in international reserves component of the monetary base. The money supply rises initially by the amount of the increase in the international reserves assuming no change in domestic credit. In an open economy, the increased money supply is used to purchase imported goods for consumption, imported materials for investment projects, and also used to pay external agents for consultancy and professional services related to investment projects. This results in a decline in the net foreign assets, which neutralises the impact on the money supply as the imports have to be paid for with foreign exchange. Properly used, borrowed external resources can greatly benefit a developing country and contribute to its growth.

Such borrowing is desirable when it is used to finance investment that is expected to yield an adequate rate of return, particularly if the project earns foreign exchange. Likewise, it is desirable when it is used temporarily to smooth consumption in the face of an uneven aggregate supply since it can provide a level of economic welfare that could not otherwise be attained.

Notwithstanding, the existence of high debt, whether external or domestic, created largely to finance past fiscal deficits, presents policymakers with serious difficulties for the conduct of fiscal and monetary policy. Financing this debt adds to the other pressures for public spending and thus increases the likelihood that a country will continue running large fiscal deficits. A country that does not take measures to reduce its fiscal deficit in order to stabilise the ratio of debt to GDP will almost automatically find itself facing an increasing debt problem.

When borrowing as a means of financing becomes a burden, this points to the need for internal structural measures to correct the fiscal imbalance. Governments should seek, therefore, to address any fiscal imbalances by improving the tax administration and imposing expenditure control measures. This would go a long way in generating a surplus on the recurrent operations which may be used for financing small projects, eliminating arrears, providing counterpart funds, debt servicing and accumulating reserves. If borrowing is necessary, it should be used for productive investments.

Furthermore, with the difficulty associated with obtaining funds from abroad and the constraint on borrowing from the central bank, governments in the ECCB region would need to source financing requirements from other domestic sources (commercial banks and non-bank public). Consequently, it would be necessary for governments in the region to support the development of the regional government securities market which would provide them with greater flexibility in borrowing from the market and should eventually lower their costs of raising debt, both administratively and in terms of direct cost.

If funds are to be procured from external sources then governments should seek to ensure that they are on concessional terms and that they are used efficiently and for investments with high productivity, investments that generate employment and foreign exchange. For this to obtain, countries need to pay greater attention to the management and operation of their PSIP's. PSIPs therefore need to be properly designed, organised and implemented.

Moreover, the ability of a country to expand its debt size depends on the current level of exports, prospects for growth of export earnings and the interest rates. The ECCB member countries

generally depend on two sectors, namely tourism and primary agriculture, for export earnings. To this effect the member countries should intensify their efforts to diversify their economies and increase export earnings which will increase their debt absorptive capacity. Browne in the 1996 ECCB's Annual Report highlighted some factors from Worrell (1991), which may lead to export diversification. These include: (i) increasing productivity to maintain export competitiveness; (ii) national awareness of the importance of the export challenge; (iii) diversion of resources from the non-tradable sector; and (iv) export marketing.

The management of government's financing, therefore, should be concerned not only with cost minimisation but also with ensuring that financing policies are consistent with general economic policy objectives. Governments must seek to ensure that deficits are sustainable, i.e., deficits that requires no more financing than is compatible with sustainable external borrowing, existing targets for inflation and output growth and a sustainable internal debt policy. The policy-maker needs also to be acutely aware of the impact of the various types of financing on various aspects of the domestic economy and on the balance of payment. Finding the right financing for the fiscal deficit is very important, but it should not be confused with finding the solution to the problem. When deficits become high, they must be reduced and not just financed. However, macroeconomic policies need to be framed so that total financial flows - from both domestic and external sources - are consistent with the level of aggregate demand that is compatible with internal and external balance. Financing objectives must, therefore, be consistent with other objectives relating to domestic activity, price stability, and the balance of payments.

Appendix I

Definitions of the Fiscal Deficit

- ◆ For analytical and policy purposes, it is useful to focus on the difference between government revenues and grants and government expenditures including net lending. The *conventional concept of fiscal deficit* does precisely this, defining the fiscal deficit as the difference between total revenues and total expenditures.

$$\begin{array}{l} \text{Conventional} \\ \text{Fiscal deficit} \end{array} = \begin{array}{l} \text{Total revenue} \\ \text{grants} \end{array} - \begin{array}{l} \text{Total expenditures} \\ \text{and net lending} \end{array}$$

Although this concept of the overall deficit is widely used, there is no single or best measure of the fiscal deficit. Alternative concepts of the deficit defined according to different analytical criteria can also be useful, providing additional insights into the impact of a government's fiscal policy stance.

- ◆ The *current fiscal deficit* represents the current revenue minus current expenditure. It provides a measure of government's contribution to national savings. This deficit implies that government is unable to finance its consumption from its own revenue. There are, however, limits to the usefulness of this concept in practical fiscal analysis. The concept hinges on the distinction between capital and current expenditures and revenues. However, the distinction and conventions for classifying expenditures as current or capital are inherently arbitrary.

$$\begin{array}{l} \text{Current} \\ \text{Fiscal deficit} \end{array} = \begin{array}{l} \text{Current} \\ \text{Revenues} \end{array} - \begin{array}{l} \text{Current} \\ \text{Expenditures} \end{array}$$

- ◆ The *primary or non-interest deficit* accurately measures the effects of current discretionary budgetary policy by excluding interest payments from the conventional measure of the deficit. It can be said to provide an indicator of current fiscal effort, since interest payments are predetermined by the size of previous deficits. It indicates how the current fiscal actions of the government affect the government's net debt. It is also important in assessing the sustainability of government deficit.

$$\text{Primary Fiscal deficit} = \text{Conventional fiscal deficit} - \text{Interest payments}$$

- ♦ The *operational deficit* has been devised to take account of the fact that the high interest rates are paid on government debt during times of very high inflation effectively compensate purchasers of government debt for the reduced real value of the debt principal caused by inflation. It is equivalent to the conventional deficit less the inflation-induced portion of interest payments or, equivalently, the primary deficit plus the real component of interest payments. Inflation reduces the real value of the outstanding stock of public debt, although creditors are compensated through higher nominal interest rates. In other words, a part of the government interest payments on its debt is actually amortisation and, if this amount is not removed from the interest payments above the line, the deficit will be overstated. This concept is particularly important in countries with high inflation and large public debt because it measures the extent to which fiscal policy in a given year affects the real stock of public debt.

$$\text{Operational Deficit} = \text{Conventional deficit} - \text{Inflation component of interest payments}$$

$$\text{Operational Deficit} = \text{Primary deficit} + \text{Real component of interest payments}$$

Appendix II

Table 1- Fiscal Operations as % of GDP

YEARS	1988/89	1989/90	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96
Current Revenue	29.5	27.3	26.5	26.9	26.6	26.5	25.8	26.7
Current Expenditure	24.1	23.3	24.5	25.4	26.5	28.6	27.5	26.5
Fiscal Balance, Surplus/(Deficit)	5.4	4.0	2.0	1.6	0.1	-2.2	-1.7	0.2
Capital Revenue + Grants	8.0	5.7	5.4	3.4	3.9	2.0	2.1	1.4
Capital Expenditure	13.5	17.9	10.1	9.7	5.0	4.8	6.4	3.8
Overall Balance; (Deficit)	-0.1	-8.2	-2.7	-4.7	-0.9	-5.0	-6.0	-2.2

Table 2 - Borrowing Requirement as a percentage of GDP

YEARS	88/89	89/90	90/91	91/92	92/93	93/94	94/95	95/96
Borrowing Requirement	0.1	8.2	2.7	4.7	0.9	5.0	6.0	2.2
External	2.2	1.8	3.9	3.6	0.1	-0.9	1.0	0.2
Domestic	-2.1	6.5	-1.1	1.7	0.7	4.4	4.7	0.4
ECCB	0.4	0.9	-0.1	-0.7	-0.5	0.6	-0.2	-0.6
Commercial Banks	-1.5	3.7	4.1	1.8	-0.2	0.7	2.5	0.9
Arrears	0.0	0.0	0.0	0.0	0.2	1.4	0.3	2.8

Source: ECCB

	88/89	89/90	90/91	91/92	92/93	93/94	94/95	95/96
Domestic Interest Payments/Current Revenue	5.2	3.2	3.9	4.6	8.1	8.2	8.9	8.6
Money Supply (% growth)	-3.5	14.6	5.6	-6.5	1.2	9.3	6.2	-6.2
Credit to Private Sector(% growth)	36.5	29.0	12.0	7.3	14.4	6.5	10.4	8.3
Lending rates	9.0-18.2	9.0-18.2	9.0-18.2	9.0-18.2	9-18.9	9-26.0	9-19.1	9-19.1
Liquidity Ratios	62.8	76.3	81.9	78.8	83.4	86.0	85.5	84.0
Inflation Rate	5.2	4.7	2.0	4.4	1.7	0.8	1.4	2.0

4 - External Debt Ratios expressed as percentage of GDP

	88/89	89/90	90/91	91/92	92/93	93/94	94/95	95/96
Debt to GDP	31.95	33.92	34.02	38.41	34.28	32.31	34.56	31.79
Debt Service to Export Earnings	5.81	5.07	4.05	3.65	4.21	4.04	5.23	4.12
Debt Service to Current Revenue	10.12	7.94	7.51	6.48	7.61	6.88	8.97	6.51
External Interest Payments/Current Revenue	-	2.4	2.3	3.1	1.8	1.6	1.7	1.8
Total interest Payments/Export Earnings	3.0	3.6	3.4	4.4	5.5	5.8	6.1	6.6
Total Interest Payments/Current Revenue	5.2	5.6	6.2	7.8	10.0	9.8	10.5	10.3

NEGATIVE RISK FACTOR
Highly concentrated export base
POSITIVE RISK FACTORS
Non-Interest Current Account Surpluses
High Reserve Coverage; 3.5 months
Relatively Low Burden of External Debt on Budget
Relatively Good Track Record on Policies
Low Reliance on Grants
Relatively Large Domestic Tax Base

DISBURSEMENTS (EC\$m)

	88/89	89/90	90/91	91/92	92/93	93/94	94/95	95/96
Total	12.8	16.5	25.7	29.3	8.9	4.1	17.0	9.3
Bilateral	3.0	8.0	8.3	22.0	4.5	2.8	13.3	7.9
Caisse Central	-	8.0	7.5	5.7	2.1	2.8	13.3	6.5
UK	3.0	-	0.8	10.4	2.4	-	-	-
Venezuela	-	-	-	-	-	-	-	-
Exim Bank	-	-	-	5.9	-	-	-	1.4
Multilateral	9.8	8.5	17.4	7.3	4.4	1.4	3.7	1.4
CDB	1.8	3.4	8.2	3.1	0.3	0.2	2.4	1.2
EIB	1.3	1.3	6.4	1.5	2.3	1.0	0.6	-
IDA	3.2	3.0	1.4	1.6	0.7	0.2	0.6	0.2
IFAD	0.9	0.9	1.2	0.8	0.6	-	-	-
IMF	2.6	-	-	-	-	-	-	-
OPEC	-	-	0.4	0.3	0.6	-	0.1	-

PRINCIPAL REPAYMENTS

	88/89	89/90	90/91	91/92	92/93	93/94	94/95	95/96
Total	9.6	7.5	7.1	6.2	8.0	7.7	11.1	7.8
Bilateral	0.3	0.3	1.0	1.6	2.8	2.6	13.3	7.9
Banque Worms	0.2	0.2	0.2	0.1	-	-	-	-
Caisse Central	-	-	0.0	0.0	1.0	1.4	1.8	2.3
UK	-	-	0.7	1.3	1.7	1.1	3.0	-
Venezuela	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.1
Exim Bank	-	-	-	5.9	-	-	-	1.4
Multilateral	9.3	7.1	6.0	4.6	5.1	5.0	5.6	5.1
CDB	1.6	1.4	1.5	1.6	1.7	1.8	1.7	1.6
EIB	-	-	-	0.1	0.1	0.5	0.6	0.6
IDA	-	-	-	-	0.2	0.2	0.2	0.2
IFAD	-	-	0.1	0.4	0.4	0.4	0.5	0.5
IMF	6.9	4.9	3.7	2.2	2.2	1.7	2.3	1.7
OPEC	0.7	0.7	0.7	0.4	0.5	0.5	0.5	0.5

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