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DEBT SUSTAINABILITY IN THE ECCB AREA

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Abstract:

The rate of growth of public sector external debt obligations, and the nature of the debt contracted by the member countries of the Eastern Caribbean Central Bank over the last ten years signals the need for proper debt management policies and the maintenance of sustainable debt levels. Debt sustainability, by definition, refers to a country's ability to service its debt obligations without contributing to fiscal imbalances in the economy. Fiscal imbalances are often manifested in the accumulation of arrears on external debt, and the need to resort to debt rescheduling and other forms of debt relief.

This paper defines the concept of debt sustainability and assesses some of the factors that affect debt sustainability among the member countries of the Eastern Caribbean Central Bank. It outlines the level of external debt outstanding, debt repayments and the debt service arrears of these countries between 1988 and 1998. Further, the paper examines the level of concessional borrowing, interest rate variability and other indicators of debt sustainability and their impact on the macro economic accounts. The paper concludes with recommendations for the development of debt management strategies that will assist these countries in maintaining sustainable debt levels.

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Introduction

The easy availability of external loan funds as a result of the oil boom of the 1970s and the lack of adequate debt management strategies by many low and middle-income countries, lead to one of the most significant crisis in world history. The international debt crisis of the mid 1970s and early 1980s was characterised by the acquisition of massive debt burdens and acute debt servicing problems for many of the developing and less developed countries of the world.

The impact of the debt crisis manifested itself in the rapid deterioration of the fiscal external and monetary accounts of many of the poorer countries of the world. The rate of growth of external debt in these poorer countries during the 1970's and early 1980s became even more serious during the oil crisis and the economic recession of the 1980s came. This precipitating crisis gave impetus to the concept of debt sustainability and the issues related to the maintenance of sustainable debt levels.

This paper is aimed primarily at examining debt sustainability in the Eastern Caribbean Central Bank area. It begins with a brief background of the international debt crisis, its impact on the ECCB member territories and the emerging importance of maintaining sustainable debt levels. This is followed by an examination of the definition and measurement of debt sustainability and the identification of some of the factors that affect sustainability among the member countries of the Eastern Caribbean Central Bank. Section III of the paper analyses the implications of public debt, as a source of external financing, for the other macro economic accounts of a country. Further it takes a snapshot of the nature and level of external debt outstanding, debt service payments and payment arrears of the ECCB member territories between 1988 and 1998. Consequently it examines the level of concessional borrowing, interest rate variability as well as some of the key indicators of debt sustainability. The paper concludes with recommendations for the development of debt management strategies that will assist countries in maintaining sustainable debt levels.

Background

The International Debt Crisis, the HIPC Initiative and the ECCB area

One of the most important causes of the debt crisis was the sharp rise in the price of oil in 1973 to 1974, and again in 1979-1980. Countries grouped as non-oil producing countries, suffered from the deterioration of their terms of trade, perpetuating in balance of payments disequilibrium and fiscal imbalance. Contrary to the popular expectations, countries like Mexico who were expected to benefit greatly from the oil boom experienced large debt build ups as a result of the rising oil prices. Mexico first borrowed heavily to develop oil production and subsequently the promise of oil exports was the main basis for its ability to borrow large amounts in pursuit of high growth strategy.

According to Cline, "if higher oil prices set the stage for heavy debt burdens, the global recession and high interest rates of the 1980s added sufficiently to the burden to precipitate several major debt crises."¹ The harsh economic contractions that the recession created caused international creditors to realise that borrowing countries would not be able to repay since they were also experiencing severe fiscal imbalances. Many initiatives were undertaken in an attempt to restrain the debt burden of these middle and low- income countries. One of such initiatives was the HIPC Initiative developed by the World Bank and IMF, which attempted to address the external debt problems of the heavily indebted poor countries. The primary objective of the initiative was to target overall debt sustainability focusing on the totality of a country's debt.

Despite the support of the IMF and World Bank group and the efforts of the Paris Club and the implementation of stock of debt arrangements and adjustment programmes to help these poorer countries, most of the HIPCs continue to encounter difficulties in meeting their external debt payment obligations. Boote and Thugge² identified six factors that accounted for the difficulties experienced by these territories in controlling their debt problem:

- 1) External shocks such as the deterioration in the terms of trade;

¹ International Debt, William Cline, page 11

² Debt Relief for low-income Countries : The HIPC Initiative, A.Boote and K. Thugge, page 1

- 2) Civil strife;
- 3) Lack of sustained adjustment or implementation of structural reform ;
- 4) Lending policies of many creditors especially the provision of loans on commercial interest rates with short repayment periods;
- 5) Lack of prudent debt management policies by debtor countries, driven in part by excessive optimism by creditors and debtors about the prospects for increasing export earnings to build debt servicing capacity; and
- 6) The lack of careful management of currency composition of external debt.

The international debt crisis and the subsequent world recession also took its toll on the countries of the ECCB area. In the late 1970s and early 1980s most of these islands had not yet gained independence and were therefore dependent to a large extent on the colonial powers to assist in balancing their accounts. The emergence of the debt crisis coincided with the era when most colonies were seeking their independence and as such independence came more quickly. In this context the countries of the ECCB were granted their independence making Britain less obligated to ensure that they were financially viable. Many of the countries depended on loan funds from both multilateral and bilateral agencies, including the United Kingdom, which was termed development aid. However this aid was costly to these newly independent territories since they were required to repay what they borrowed.

In the current arrangement, the eight³ islands in the eastern Caribbean which constitute the ECCB area now operate in a monetary union under a single currency, the Eastern Caribbean (EC)⁴ dollar, which is fixed to the US dollar. The area is served by one Central Bank whose main objective is to maintain the stability of the EC dollar and the integrity of the banking system in order to facilitate the balanced growth and development of the member states.

³ These islands include Anguilla, Antigua and Barbuda, Dominica, Grenada, Montserrat, St.Kitts and Nevis, St.Lucia and St. Vincent and the Grenadines.

⁴ The single currency of these territories which is pegged to the US dollar at a rate of \$1US = \$2.70 EC, ensures a degree of stability to any trading done in US dollars.

With the exception of Anguilla and Montserrat, which are still colonies, all the countries of the ECCB area have similar political and economic backgrounds. They all moved from being dependent territories of Britain through statehood to fully independent territories. In relation to debt contraction and obligations, each stage of development was unique. During the colonial era, these countries had virtually no power to contract debt since their financing needs were met by the colonial power. During the statehood period there was limited power to contract debt and as such their external assistance consisted mainly of grant funding with minimal external and domestic borrowing. The early post independence era on the other hand, was characterised by full power by the authorities to contract debt. Generally there were a large number of grants and loans were concessionary with very low interest rates and repayment periods exceeding twenty years, from multilateral creditors like Caribbean Development Bank, International Bank for Reconstruction and Development and International Development Association. Recently there has been a movement to more commercial type loans from bilateral creditors.

The debt burden of the eastern Caribbean territories is not as chronic as that of the HIPCs. However, the growth in the stock of outstanding external debt in these territories indicates the need to take a closer look at some of the factors which contributed largely to the ability of the HIPC to met their debt service obligations and maintain fiscal balance.

The rate of external debt accumulation of the Eastern Caribbean member territories over the last ten years also signals the need for proper debt management policies and sustainable debt levels. This is because the growth in external debt has implications for the external and fiscal balances of these countries and influences the money supply. Therefore it is important to ensure that the debt burden is maintained at sustainable levels. Assessing debt sustainability requires an examination of a country's total debt that is both its external and its domestic debt. However, the paper focuses on external debt sustainability but will be extended at a later date to incorporate domestic debt sustainability issues.

Section II

Debt sustainability: Definition and Measurement

Debt sustainability generally refers to the ability of a country to service their debt. The concept was originally defined by the HIPIC Initiative as a “position in which their export earnings, capital flows and aid flows would enable them to service their debt without an undue burden.”⁵ However a more recent definition of debt sustainability by Boote and Thugge defines debt sustainability as

“ The situation which exists when a country is expected to be able to meet its current and future external debt service obligations in full, without recourse to debt relief, rescheduling of debts or the accumulation of arrears and without unduly compromising growth.”

Debt sustainability has implications for the creditworthiness of a country. It refers to the ability of countries to service their debt obligations with out adverse impact on their fiscal, external and monetary accounts.

A country’s debt situation becomes chronic and unsustainable when its debt rises above its Gross Domestic Product over time. Sustainability as the timely fulfillment of current and future debt obligations is essentially an issue of solvency. Solvency refers to the ability of a country to generate current account surpluses and increase their international reserves in order to facilitate the impact of external liabilities such as external debt and the present value of foreign investment. If a country has the ability to generate sufficient trade surpluses in the future to repay existing debt, then it meets the solvency criterion.

An asset liability management approach to solvency requires that the country generate future foreign exchange surpluses sufficient to service its external debt, where as the government needs to generate adequate revenues to meet both its external and domestic obligations.

⁵ Debt sustainability and Social Development , page 22

In stock terms, solvency would only be possible if the present value of the country's earning is greater than the present value of its costs. The diagram below shows the Asset Liability Management (ALM) model of the country's external balance sheet. A country's whose external assets are greater than its external liabilities would be considered solvent.

COUNTRY'S EXTERNAL BALANCE SHEET	
EXTERNAL ASSETS	EXTERNAL LIABILITIES
<i>PV of Current Account Surpluses</i>	<i>External Debt</i>
<i>Foreign Reserves</i>	<i>PV of Foreign investment</i>

However although solvency is a necessary condition for sustainability, in itself it is not sufficient to determine sustainability. Sustainability, in contrast to solvency takes into account the willingness of borrowers to pay their debt and the willingness of creditors to lend. Other country specific factors which affect sustainability such as the concentration and variability of exports, the fiscal burden of external debt service, external debt in relation to GDP, the resource gap and the burden of private sector debt must be taken into account in determining whether the country's debt level is sustainable.

Examining debt sustainability therefore seeks to address the issue of the country's long term economic viability given an increasing debt portfolio and the changing characteristics of the debt contracted.

Measuring debt sustainability

There has been much contention on what variables should be used to measure a country's debt sustainability. The key sustainability indicators used by the World Bank and IMF

are the scheduled debt service ratio and the present value of debt to exports of goods and services. Another ratio often used in debt sustainability analysis is the debt service payments to current revenue ratio, which gives an indication of the country's ability to pay its debt obligations.

The key indicators of debt sustainability most widely used are (1) the Net present value of debt to gross domestic product ratio, (2) the debt service to exports of goods and services ratio and (3) the debt to current revenue ratio. Each of these ratios used in debt sustainability analysis examines different aspects of the debt portfolio as it relates to some other macro- economic variables in the economy. In this light, debt sustainability is therefore contingent on a country's ability to manage its debt portfolio based on the fiscal and monetary conditions in the particular country. However, as one writer pointed out, these ratios cannot be used in isolation.

The HIPC Initiative defines sustainable debt levels as those within the range of 200 to 250 per cent for the present value of debt to exports ratio and of 20 to 25 per cent for the debt service to exports ratio. However the HIPCs refer to the heavily indebted poor countries of the world, whose export-generating base is in itself constrained and unsustainable. Generally the critical levels of these ratios often used for developing and less developed countries are that the present value of debt to GDP ratio is 50 per cent and that the debt service payments to exports of goods and services ratio lies between 20 and 25 per cent.⁶

In the context of our study of external debt sustainability, according to Alwyn B. Taylor, the debt burden only becomes a problem when the rate of growth of debt is faster than that of the major macro economic variables, which spur the country's growth and development. In this light the implications of external financing on the country's macro economic accounts becomes important.

⁶ Financing Fiscal Deficits: The case of Dominica, Karen Williams, page 6

Section III

The Implications of External financing on other Macro- economic sector accounts

Ideally whether a government should borrow abroad should “ essentially be a cost – benefit question.” However in practice external borrowing is often unplanned and is therefore dependent to a large extent on the availability of these funds as opposed to a systematic assessment of the costs and benefits associated with borrowing abroad. External borrowing affects the money supply of a country. This impact is channeled through its impact on the external accounts, which in turn is manifested in the net foreign assets of the country.

The implications for the fiscal accounts

Debt is essentially a source of financing the fiscal deficit in many middle income and low- income countries. The current account balance, which refers to the difference between the country’s current revenue and its current expenditure, indicates the Government’s contribution to national savings or its need for acquiring additional financing. A current account deficit implies that government is unable to finance its consumption bill from its own revenue and would need to seek additional funds to help finance its expenditure. In addition, reserves need to be sourced for financing capital expenditure.

According to Richard Goode, strong demands for expenditures, coupled with political and economic obstacles have impelled many governments to obtain financing by borrowing. Essentially a country can borrow either from both domestic sources or from external sources. Domestic borrowing may take the form of issuing domestic bonds and treasury bills or borrowing from the domestic or national economy. The financial impact of domestic financing by the government is often reflected in the interest payments and net lending of the commercial and central bank. In order to accommodate domestic financing however the overall balance on the fiscal accounts must be in surplus.

The economic impact of such financing is often reflected in the crowding out of private sector borrowing, since it reduces the amount of credit available to the private sector. The direct effect of such financing on the macroeconomic accounts would be an increase in the money supply due to a net increase in domestic credit. Domestic financing has virtually no direct impact on international reserves and as such the balance of payments will not be directly affected.

External borrowing on the other hand may take the form of bond issues to non- resident or the contraction of external (concessionary or commercial) loans. In the short run, foreign debt serves as a source for financing the deficit on the fiscal accounts. Thereafter, debt service payments, in the form of interest and principal repayments impacts negatively on the fiscal accounts. This can serve to worsen the fiscal situation of the country if the debt was used primarily for consumption and not investment. Investment may in fact lead to higher income and availability of revenue to finance debt.

The implications of the balance of payments

A country's balance of payments (BOP) is a statement of account of the country's transactions with the rest of the world. Basically an improvement in the current account requires either an increase in a country's output or a reduction in its expenditure. This is reflected in the following identity;

$$\text{GNDI} - A = \text{CAB} \quad (\text{i})$$

Where GNDI is the gross national disposable income, A is the resident's consumption and investment expenditures. The following balance of payments identity purports that any excess of absorption over income, as reflected in a current account deficit, must be financed either by capital inflows or drawdowns on reserves.

$$\text{CAB} = \Delta \text{NFA} + \Delta \text{R} \quad (\text{ii})$$

Where CAB represents the current account balance, NFA the net foreign assets and R the foreign reserves of the country.

External borrowing allows the government to finance itself without displacing borrowing by household and enterprise spending. When a country borrows externally, the initial impact on the balance of payments is a capital inflow of funds into the economy that shows up on the financial and capital account of the BOP. However, the commencement of repayments on the external loan will result in capital outflow in the form of interest payments reflected in the current account of the balance of payments (BOP) and principal repayments on the capital and financial accounts.

The final effect of external debt financing on the balance of payments depends on how the funds are utilised. Borrowing for consumption purposes such as budgetary support may serve to alleviate the fiscal deficit, but the debt must be repaid. Borrowing for consumption increases the purchasing power of the nationals and leads to an expansion in aggregate demand. In satisfying this change in demand, imports of goods and services are likely to increase, adversely affecting the current account of the balance of payment. Consequently, the net reserves position may remain unchanged.

The initial impact of borrowing for investment is similar to borrowing undertaken for consumption. There is a capital inflow on the capital account of the BOP, which represents the loan disbursements of the external debt. In the context of the ECCB area, loan funds are used to import material and sometimes even human capital from outside the country, which has an adverse impact on the capital and financial account. However, borrowing for investment may positively affect the balance of payments. Investment projects may generate foreign inflows through increased exports, which in turn may partially offset the effects of loan repayments.

The implications for the monetary accounts

Increased external borrowing as means of financing the current account deficit also affects the monetary accounts. In terms of the monetary accounts, based on the identity:

$$\Delta MS = \Delta NFA + \Delta DC \quad (iii)$$

Where MS represents the money supply, NFA refers to the Net foreign assets of the country and DC refers to domestic credit. The initial impact of external financing is to generate a capital inflow, which increases the country's net foreign assets, which leads to an increase in the money supply of the country. Theoretically the change in the money supply could be inflationary, if production structures are rigid and do not respond to the growth in the money supply. Given the nature of the economies of the ECCB area,

Given the nature of the economies of the ECCB area the final impact on the monetary account will be on the net foreign assets, since aggregate demand is satisfied primarily by importing from abroad. The increase in the net foreign assets created by external borrowing contributes to the growth in imports, due to the expansion in aggregate demand. Therefore the impact on the money supply would depend on the net increase in the net foreign assets of the country. However for the ECCB member territories, the initial increase in the NFA is therefore only temporary and as such a large portion of the increase in foreign reserves will be lost through outflows from imports. Additionally the terms of most external loans are "tied" in that they stipulate that materials, physical resources and even human resources must be employed from the creditor country or one of its affiliates. This accounts for a larger portion of the leakage in reserves.

The danger in relying on debt as a source of financing however lies in the difficulties which may arise when a country's debt is growing faster than its gross domestic product. The definition of debt sustainability specifically states that countries are expected to meet their external debt payments in full, without recourse to debt relief, debt rescheduling or the accumulation of arrears. In assessing the debt sustainability of the ECCB area, a closer examination of the nature and composition of the outstanding debt of the area needs to be undertaken.

Section IV

Debt Sustainability and Public Debt in the ECCB Area

The issue of debt sustainability becomes relevant to the countries of the ECCB area in the context of their growing need for external financing due to persistent negative overall balance on the fiscal accounts. Grant funding is diminishing and as such countries are becoming increasingly dependent on loans to finance their capital programmes. The fiscal gap has become much larger and over the last ten years, the member countries of the ECCB have been resorting to external financing to close the gap in their fiscal accounts.

This section of the paper therefore takes a brief look at the key debt sustainability indicators and further examines the nature of the debt portfolio of the ECCB area, in the context of our definition of debt sustainability.

The Debt Indicators

The table below shows the key debt ratios used in debt sustainability analysis for the ECCB area between 1988 and 1998. The ratio of debt to GDP for the ECCB area for the past ten years seems to be below the critical level, the closest to 50 per cent being, 46.11 per cent in 1988. This reflects the combined effect of the increasing disbursed outstanding debt and Gross domestic product (See Appendix D) throughout the period. The debt service to export ratios has remained below the critical levels for the entire period under study. However the definition of debt sustainability does not facilitate a conclusion based solely on the debt indicators. In this regard, there is the need for a closer examination of the nature of the debt portfolio of the member territories of the ECCB area requires more attention.

TABLE I

ECCB Area
Debt Sustainability Indicators:
External Debt Ratios

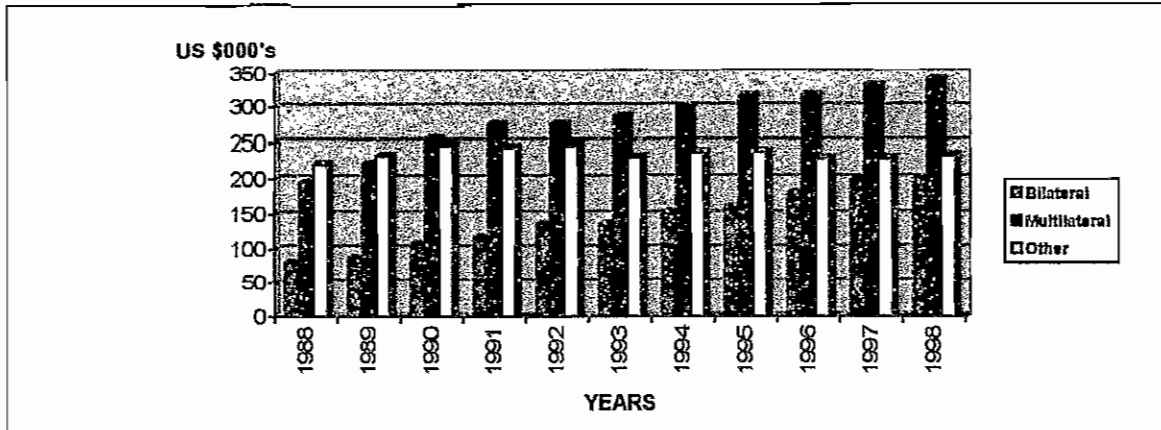
	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
EXTERNAL DEBT RATIOS											
<u>D O D / GDP</u>	46.11	42.65	36.77	36.11	34.59	32.80	32.86	32.13	30.54	31.37	30.10
<u>D O D / EXPORTS OF GOODS & SERVICES</u>	53.82	56.16	55.87	56.63	52.61	50.45	51.74	52.56	52.23	52.66	52.79
<u>D S P / EXPORTS OF GOODS & SERVICES</u>	3.38	3.07	3.38	3.04	3.45	3.57	3.53	4.14	3.77	3.91	3.58
<u>D O D / CURRENT REVENUE</u>	145.12	146.45	150.81	149.77	144.40	137.62	138.61	133.29	124.12	125.86	116.97

The nature of the Debt Outstanding

The outstanding external debt of the heavily indebted poor countries of the world (HIPC) between 1988 and 1993 increased by approximately 30 per cent, while the growth in external debt outstanding for the ECCB area was approximately 31.3 per cent. Between 1993 and 1998, HIPC debt grew further by approximately 7.5 per cent, while the growth rate of the external debt of the ECCB area was almost 19.3 per cent during that same period. Although the growth rate has declined, it still exceeds that of the poorest countries in the world. Although the magnitude of the external debt outstanding of the ECCB territories may seem marginal in comparison with that of the HIPCs. The rate of

growth of the external debt outstanding of ECCB member territories and the increasing level of arrears suggest the need for addressing issues of debt sustainability in the region.

ECCB AREA
EXTERNAL DEBT OUTSTANDING BY CREDITOR
1988-1998



Source: Debt Unit, ECCB

The bar chart above depicts the increasing trend in outstanding external debt over the last decade. During that period, multilateral creditors as opposed to bilateral creditors have dominated the territories borrowing choices. This is in slight contrast with the HIPCs, which between 1988 and 1993 experienced growth in multilateral funding of roughly 50 per cent, compared with the 66.4 per cent in the member territories of the ECCB area.

Along with the growth in outstanding external debt, contingent liabilities have also been increasing. As shown in appendix A between 1988 and 1998, statutory body external debt liabilities grew by approximately 24.8 per cent. In 1998 alone, the external debt outstanding of the statutory bodies contributed 37 per cent to the overall external debt outstanding of the ECCB area.

Although the countries of the ECCB area may not have exorbitant fiscal deficits as that of the HIPCs, the rate of growth of external debt is definitely signaling the need for better debt management and structured control mechanisms to ensure that their debt burdens do not become uncontrollable.

Interest rates and the General terms of External debt contracted

In a study by Enrique Pascal (1997), it was contended that in order to avoid difficulties in the longer term, the productivity of borrowed resources must at least equal the interest charges associated with that debt.

One of the main contributing factors to the debt problems of the HIPC's was the contraction of debt at commercial interest rates. The general terms of the loans contracted is therefore a very important factor in ensuring that a country is able to sustain the servicing of its debt obligations. It essentially affects the magnitude of the debt servicing that countries will have to pay in the future.

Appendix B depicts the average annual terms of the loans contracted by the member countries of the ECCB area. An examination of the external debt revealed that generally the average annual rate of interest ranged was 6 per cent in 1988 but peaked at 10 per cent in 1996, before falling to 6 per cent in 1998. This indicates that generally the member countries of the ECCB area have been borrowing at concessional rates rather than commercial rates. In essence this practice should be encouraged since commercial rates directly imply increased interest payments.

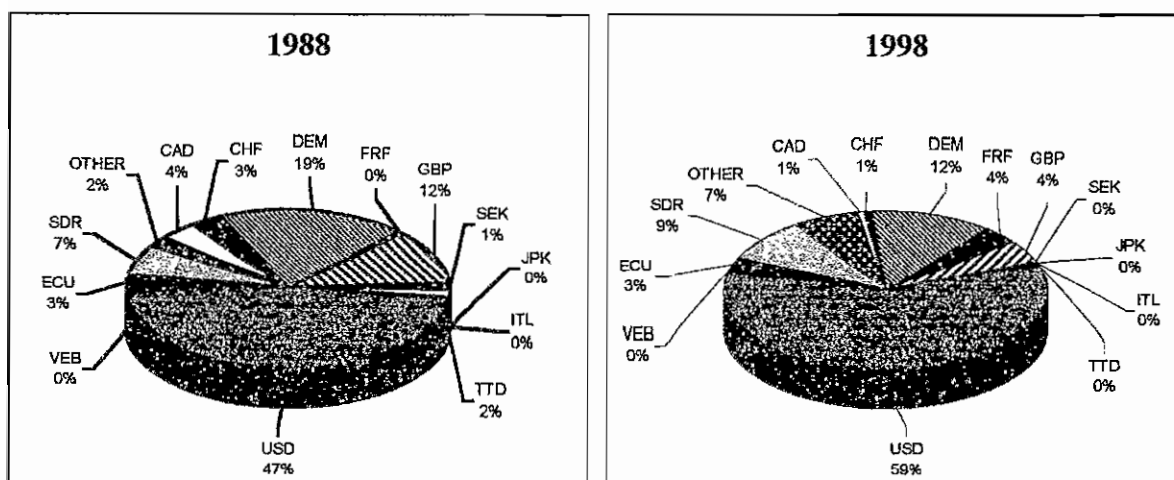
Currency composition of the External Debt

Over the past decade, the countries of the ECCB area have borrowed predominantly in US dollars. However loans denominated in other currencies such as the deutsche mark, Japanese Yen, pound sterling, special drawing rights continue to account for between six and fifteen per cent of the area's total external debt.

The pie charts below shows the percentage of external debt outstanding for the ECCB area denominated in the various currencies in 1988 and 1998. It indicates that debt denominated in US dollars has grown by approximately 12 per cent between 1988 and 1998 while the debt denominated in most of the other currencies are declining. This is a

particularly good debt strategy for the members of the ECCB area, since most of the other more frequently used currencies have exchange rates that far exceed the exchange rate of the EC to the US dollar. Once the Eastern Caribbean Central Bank maintain adequate foreign reserves to the EC dollar, the countries of the ECCB area will find it advantageous to borrow in US dollars or any other currency whose exchange rate is lower than the pegged rate.

ECCB AREA DEBT BY CURRENCY COMPOSITION



Many of the countries have recognised the fiscal and external advantages to be gained from borrowing predominantly in US dollars.

Debt servicing and the accumulation of arrears

The definition of debt sustainability profoundly advocates that when a country is able to service its debt without resorting to the accumulation of arrears, it can be considered as having attained sustainable debt levels. Debt servicing in the ECCB area over the past ten years has remained relatively consistent with an annual average growth rate of 6.9 per cent. Between 1988 and 1998, debt servicing increased by 66.8 per cent, exceeding even the growth in external debt outstanding of 66.0 per cent.

As previously mentioned, the importance of the contribution of statutory bodies to the debt portfolio of the region has also become somewhat significant. Appendix C depicts the total debt service payments of the region by borrower category (statutory bodies and central government). It indicates an 89.3 per cent increase in statutory body debt servicing between 1988 and 1998 and a similar increase in statutory body liabilities during that period. It is therefore necessary to closely monitor the increasing contribution of statutory body debt to the overall debt portfolios of the ECCB area and to ensure that the growth in statutory body debt does not contribute to an unsustainable situation.

Although there has been a substantial increase in debt servicing in the area, the accumulation of arrears and late payments adamantly raises issues of debt sustainability. One of the striking features of debt sustainability is the country's ability to avoid the accumulation of arrears, which can seriously impact on the rate of economic growth and development. The build up of arrears and late payments can also affect the ability of the country to source future funding. Creditors may be hesitant to lend in the future, if countries are unable to meet their current or previous period debt service obligations.

Table II overleaf, shows the arrears and late payments of the ECCB member territories between 1988 and 1998 by borrower and by creditor. It reflected an average annual growth rate of 26.4 per cent in arrears and late payments between 1988 and 1998. This was primarily due to increases in the arrears and late payments by the statutory bodies which increased from EC\$129.0m in 1988 to EC\$680.1m in 1998. Over the last five years alone, more than sixty per cent of the arrears and late payments accumulated was statutory body debt. This points to some elements of unsustainability.

TABLE II

ECCB AREA
ARREARS AND LATE PAYMENTS
1988-1998

	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
Total Arrears	232.3	337.6	580.4	539.9	653.4	715.8	814.1	901.7	896.1	851.6	928.9
By Borrower											
Central Gov't	103.3	133.5	182.7	173.5	192.4	211.2	239.7	245.7	236.1	230.5	248.8
Statutory Bodies	129.0	204.1	297.7	366.4	461.0	504.6	574.4	656.0	660.0	621.1	680.1
By Creditor											
Bilateral	44.6	49.3	52.7	47.8	46.4	48.9	52.2	52.5	56.2	56.0	65.5
Multilateral	11.8	16.0	22.3	25.1	28.0	30.6	33.0	24.4	11.3	10.4	19.0
Other	175.6	272.1	405.5	466.9	578.9	636.4	728.9	824.8	828.3	784.8	844.8

Rescheduling

The definition of debt sustainability advocates that countries must not resort to debt rescheduling or other forms of debt relief if they are to be classified as attaining debt sustainability. During the period 1988 to 1998, all of the ECCB member territories undertook some form of debt relief. In total between 1988 and 1998, there were nine cases of complete debt write-off in the form of debt forgiveness and twenty-eight cases of debt rescheduling. The United Kingdom and the Canadian IDA were the two primary agents responsible for the debt forgiveness received by four of the ECCB member territories.

The Level of concessionality of loans contracted

The level of concessionality of debt will determine to a large extent the degree of effort that will be required to raise the necessary revenue for debt servicing and in turn will also contribute to the magnitude of government expenditure. In the context of sustainability,

the level of concessionality also points out some of the advantages that could be obtained from external financing.

Appendix C shows the level of total concessionality of the debt outstanding of the ECCB area. Over the past ten years the level of concessionality of the debt outstanding of the area has been declining steadily. This clearly indicates that the terms of the loans contracted by the member territories are becoming increasingly commercial.

Maturity periods

A common problem experienced by most of the member countries relates to the scheduling of their repayments to accommodate seasonal fluctuations in their economies. The table below, of the ECCB area shows the expected maturity of debt outstanding for the period 1999 to 2003. The payment maturity of most of the ECCB member territories loans seem to be bunched within the five to ten year period and beyond. Financing arrangements will have to be made to accommodate the large debt service payments that will mature in those periods.

TABLE III

ECCB AREA
Percentage of Debt Payment Maturity
1999-2003

MATURITY PERIODS	1999	2000	2001	2002	2003
LESS THAN 1 YEAR	0.0	0.0	0.0	0.0	0.0
1 - 2 YEARS	0.2	0.0	0.0	0.0	0.0
>2 - 3 YEARS	0.7	0.3	0.0	0.0	0.0
>3 - 4 YEARS	2.2	1.7	0.9	0.0	0.0
>4 - 5 YEARS	1.4	1.4	1.1	0.7	0.0
>5 - 10 YEARS	13.4	12.4	11.3	10.0	8.3
OVER 10 YEARS	82.1	84.2	86.7	89.3	91.7
TOTAL	100.0	100.0	100.0	100.0	100.0

SOURCE: CS-DRMS REPORT 654

Exports of Goods and Services

A critical factor, which requires some consideration in assessing debt sustainability in the ECCB area, is the diversity of exports of goods and services. The export diversity or the extent to which a country relies on a narrow range of products for its export earning is extremely important in determining the stability of the foreign reserves. The high concentration of exports on one or two products will tend to imply more volatility in total export earnings.

The ECCB territories obtain most of their export earnings from two fragile sectors, tourism and primary agriculture. The dominant export from the ECCB area are predominantly agricultural products such as Banana, Sugar cane and Nutmeg, which are susceptible to damage by natural disaster or infectious diseases. Earnings are also highly dependent on international market conditions, resulting in fluctuations in receipts. Given the relatively small size of the countries and the fact that they are extremely vulnerable to external shocks, the level of exports of each individual territory is minimal in most cases. As a result, debt sustainability is critical to the member countries of the ECCB area.

Section V

Comments and Recommendations for the Development of a sustainable debt management strategy for the ECCB area

There is not a strong history of structured debt management in any of the Eastern Caribbean territories. The changing composition of the debt portfolios of these territories calls for a more coordinated approach to debt monitoring and management. However, the pursuance of efficient debt management strategies and the maintenance of sustainable debt levels cannot be done in isolation of the other economic objectives of sound monetary policy and prudent fiscal management.

The analysis of public debt in the ECCB area raises a number of debt sustainability issues. The declining growth rate of external debt outstanding and the relatively favorable debt ratios may imply that there is no urgent need to control or manage the debt portfolios of the ECCB member territories. However, the numbers of cases of debt rescheduling and the debt forgiveness given to the individual territories, as well as the accumulated external debt arrears indicates that there is the need for policy makers to be concerned.

Quite often the countries of the Caribbean do not devise a debt strategy for managing their debt and no formal negotiation of the terms of the loan actually takes place but they simply accept the terms offered in light of the needed financing. Clearly certain criteria should guide the borrowing choices that these countries make. S.Griffith - Jones⁷ in her study on Third World debt identified four guiding principles that should help countries in evaluating a desirable debt management strategy. These can also be used to guide ECCB member territories in the development of their debt strategies.

1. Debt to Exports ratios should not increase excessively:

Exorbitant increases in the debt to export ratios can serve to impact negatively on the balance of payments and the money supply and subsequently can serve to further aggravate the debt burden of the country in the future.

⁷ Third world debt: How sustainable are current strategies and solutions , page 99

2. Reduction or elimination of negative net transfers:

Negative net transfers refer to an outward flow of capital resources from the economy and as such also adversely affects the balance of payments and the money supply. A key principle that should guide these territories in developing desirable debt management strategy is that it should lead to drastic reduction or the elimination of the negative transfers.

3. Debt Servicing should relate to capacity to pay

A country ability to service its debt in the future is one of the key factors, which determines whether its debt level is sustainable. In this light a key concern which Griffith- Jones highlights is the negative effect which debt servicing and outward net transfers have on growth and development. This effect would be more negative when the country's exports are low and more favourable when exports are high. The nature and magnitude of debt contracted by the country in terms of the repayment periods and terms of the loans should therefore relate the country's capacity to pay.

4. Maximum contribution to development

Foreign borrowing must lead to increased productivity and growth, so that debt service on new borrowing can be paid. It is therefore prudent for the resources obtained through debt financing be (a) used in the context of a development plan leading to sustained economic growth and increased welfare of the population and (b) consistent with the macro-economic policies that are likely to lead to relatively small disequilibria.

The governments of the ECCB area therefore need to systematically chart the way forward for controlling the accumulation of foreign debt and managing the nature and composition of their debt portfolio. Often countries do not effectively negotiate the terms of the debt contracted but sometimes accept the terms outlined by the particular creditors.

If the debt situation is to be sustainable, the primary mandate of debt managers and negotiators in these territories should be to develop debt strategies that:

1. Encourage countries to negotiate loan terms with interest rates that are less than commercial rates and fixed. They should avoid borrowing in LIBOR and PIBOR that are relatively high and variable
2. Encourages the continuance of borrowing predominantly in US dollars.
3. Implement limits on the debt contracted, particularly by the statutory bodies, which are contingent liabilities to central government.

Additionally, in light of the fragility and uncertainty surrounding the level of exports of goods and services, consideration must be given to diversifying the export base. There is the need for urgent action by the countries that would lead to or result in the diversification of their economies. Worrell⁸ (1991) enunciates a set of measures, which may lead to export diversification. These include (1) increasing productivity to maintain export diversity; (2) national awareness of the importance of the export challenge; (3) diversion of resources from the non-tradable sector; and (4) export marketing.

Notwithstanding the exogenous factors that affect a country's ability to service its debt, appropriate debt management practices and policies can help countries maintain a sustainable position in regard to external sources of finance. Further, in developing a good debt management strategy, policy makers must be mindful that for debt to be sustainable, a solution to a country's debt problems must be acceptable to creditors as well as borrowers. Additionally, whether or not a country is experiencing a debt crisis, the need for good debt management practices are an integral part of macro-economic policy and good governance.

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Appendix A

ECCB AREA
Disbursed Outstanding Debt by borrower
1988-1998

US \$ 000'S

	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
TOTAL DISBURSED OUTSTANDING DEBT	495.6	541.2	609.3	633.6	655.5	650.9	689.5	713.9	725.5	757.7	776.3
BY BORROWER											
CENTRAL GOVERNMENT	266.0	293.2	333.4	355.4	362.9	369.8	399.4	415.3	430.7	470.2	489.1
STATUTORY BODIES	230.2	293.2	275.5	277.9	279.0	267.1	268.6	298.5	294.8	287.4	287.3
NOTE: PROJECTIONS EXCLUDE ARREARS SOURCE: CS-DRMS REPORTS 727 and 728											

Appendix B

ECCB AREA
Range of Average Annual Terms
1988 - 1998

	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
Interest (%)	2-6	0-4	2-6	0-5	0-5	4-6	0-7	1-8	2-10	2-7	0-6
Maturity (years)	9-47	2-25	5-32	10-27	12-40	3-22	8-21	15-30	6-30	10-23	12-26
Grace Period (years)	3-7	2-8	0.1-10	4-10	0-11	0.3-11	2-6	0.5-9	0.2-10	2-5	0-8
Grant Element (years)	19-71	11-51	19-68	32-74	0-84	8-52	0-39	0-60	0-69	0-53	0-51

Source: CS-DRMS REPORT 725

Note: Interest rates are rounded to the nearest whole number.

Appendix C

ECCB AREA

Concessional Debt as a percentage of Total Debt

1988-1998

YEAR	CONCESSIONAL DEBT AS A % OF TOTAL DEBT
1988	98.7 %
1989	97.6%
1990	95.8 %
1991	89.3 %
1992	81.2 %
1993	78.7 %
1994	77.3 %
1995	76.3 %
1996	75.1 %
1997	75.2 %
1998	74.7 %

SOURCE: CS-DRMS REPORT 355

Appendix D

ECCB AREA

External Financing, Current Account balance, Overall balance, Gross Domestic Product at market prices

1988-1998

In millions of EC\$

YEAR	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998
C/A Balance	133.0	50.2	117.5	99.8	113.3	166.0	111.6	83.99	88.7	50.1	66.4
Overall Balance	(229.7)	(197.4)	(259.8)	(93.5)	(127.1)	(96.3)	(96.8)	(134.7)	(109.1)	(159.9)	NA
GDP at Mkt. Pr	3735.3	4175.2	4517.9	4774.9	5119.4	5312.7	5658.3	5857.6	6181.4	6471.1	NA
External Finance	-	-	-	-		96.3	96.8	134.7	109.1	159.9	NA

Source: ECCB Area Annual Statistical Digest 1999