

Advance Book Information (Coming Soon)

Caribbean Renewal
Tackling Fiscal and Debt Challenges

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Four Decades of Global Large Debt Reduction: Anatomy, Determinants, and Lessons



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Disclaimer

Conclusions of the paper are those of the authors and do not necessarily represent the views of the IMF or IMF policy

Overview of issues

- ❖ The global financial crisis has led to renewed interest in the issue of debt reduction
- ❖ This paper examines global large debt reduction over four decades using a panel data of 160 countries
- ❖ The paper attempts to answer the following questions:
 - How have global large debt reductions occurred in practice
 - What factors determine the probability of a large debt reduction
 - What lessons can we draw for future large debt reductions in the Caribbean

Main messages

- ❖ Global large debt reductions are associated with robust growth, decisive and lasting fiscal consolidation, and favorable external environment
- ❖ The initial level of debt servicing cost appears to play a disciplinary role
- ❖ Fiscal rules are associated with a higher probability of debt reduction because they help secure the gains of fiscal consolidation
- ❖ The results are robust to alternative estimation methodologies and alternative definition of large debt reduction

Main messages---Lessons for the Caribbean

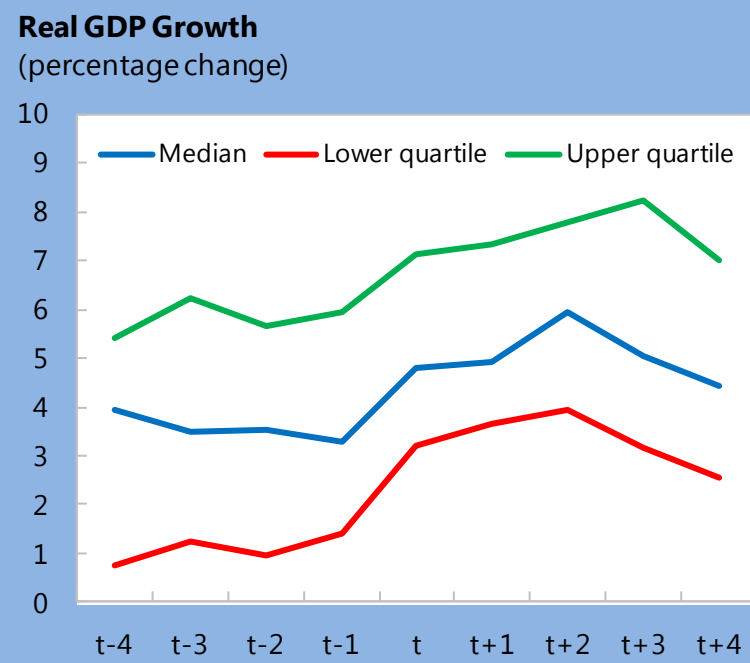
- ❖ Debt levels are high and **fiscal consolidation** and **growth** are needed
- ❖ Reducing public debt require a comprehensive **strategy**
- ❖ Both **revenue** and **expenditure** sides have a role to play
- ❖ **Fiscal rules** are needed to lock in hard won gains
- ❖ **Structural reforms** are required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

Anatomy of global large debt reduction

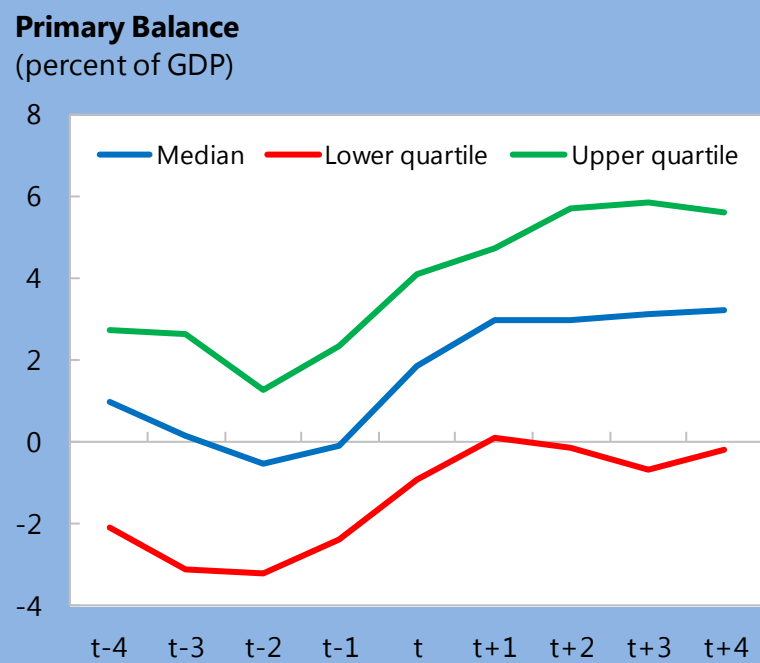
- ❖ We define a large debt reduction as **15 points** of GDP reduction in the debt to GDP ratio.
- ❖ We recorded **206 episodes** of large debt reduction.
- ❖ Over half of global debt reductions were achieved through **fiscal consolidation** and just under half through **debt restructuring**
- ❖ The average duration of large debt reduction is **7 years**
- ❖ In the **consolidation** cases, the median decline in the debt to GDP ratio was 27 percent over a five-year period
- ❖ About a quarter of the episodes were preceded or accompanied by **fiscal rules**

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

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



Source: IMF staff estimates.



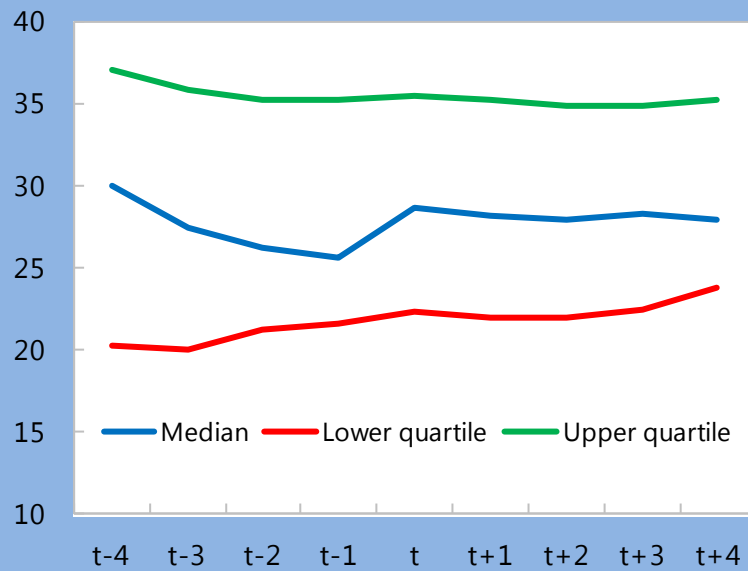
Source: IMF staff estimates.

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

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

Government Revenues

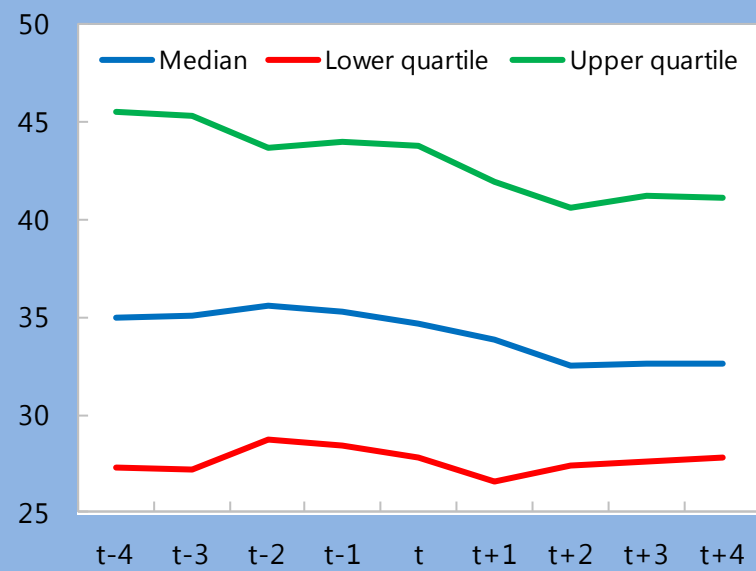
(percent of GDP)



Source: IMF staff estimates.

Government Spending

(percent of GDP)



Source: IMF staff estimates.

Estimating the probability of a large debt reduction

- ❖ We use a dataset spanning 4 decades (1970-2009).
- ❖ The analysis estimate the probability that a large debt reduction will be initiated
- ❖ We use the logit regression approach.
- ❖ The dependent variable is the probability of a large debt reduction
- ❖ It takes a value of 1 if a debt reduction occurred and 0 otherwise
- ❖ If a debt reduction takes place in period t and continues to $t+1$, $t+1$ is treated as missing

Estimating the probability of a large debt reduction

- ❖ We examine the determinant of global large debt reduction using the logit approach.
- ❖ The explanatory variables are measures of fiscal consolidation, macroeconomic variables, fiscal rules, and global economic conditions.
- ❖ The estimation technique uses the conditional fixed effects logit approach
- ❖ We first examine some comparative statistics

Estimating the probability of a large debt reduction

Table 4.1. Comparative Statistics: Determinants of Global Large Debt Reduction

	Large debt reduction		No large debt reduction	
	Mean	Standard deviation	Mean	Standard deviation
Debt reduction	1	0	0	0
Debt	68.5	34.1	60.9	60.69
GDP growth	4.9	4.11	3.72	3.6
Primary balance	1.62	5.3	-0.004	6
Interest cost	3.8	3.1	2.77	2.2
Inflation	6.9	9.4	10.94	14.69
Political risk	65	12.5	66.5	13.6
Fiscal rules	0.26	0.44	0.15	0.36
Expenditure rule	0.11	0.32	0.05	0.21
Balance budget rule	0.25	0.43	0.13	0.33
Debt rule	0.19	0.4	0.11	0.31
Revenue rule	0.04	0.2	0.016	0.13

Source: Authors' calculations.

Estimating the probability of a large debt reduction

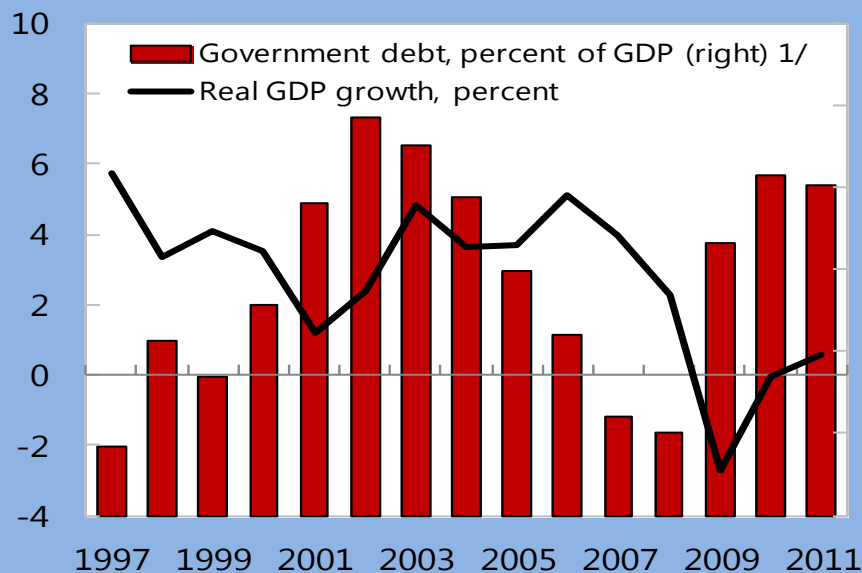
Table 4.2. Determinants of Global Large Debt Reduction

	(1) Fixed effects	(2) Fixed effects	(3) Fixed effects	(4) Fixed effects	(5) Fixed effects
Interest payments	0.4803** (0.2328)	0.2284 (0.1793)	0.5500** (0.2546)	0.6233** (0.2673)	0.2510 (0.1845)
Inflation	-0.0436 (0.0361)	-0.0659* (0.0342)	-0.0442 (0.0350)	-0.0326 (0.0364)	-0.0661* (0.0338)
Global growth	1.2181** (0.6039)	0.9749* (0.5149)	1.3896** (0.6303)	1.4011** (0.6428)	1.0819** (0.5326)
Primary balance	0.1535** (0.0623)	0.1411** (0.0620)	0.1600** (0.0689)	0.1476** (0.0667)	0.1394** (0.0626)
Debt-to-GDP ratio	0.0483*** (0.0179)	0.0558*** (0.0175)	0.0519*** (0.0178)	0.0455*** (0.0173)	0.0560*** (0.0174)
GDP growth	0.1271** (0.0494)	0.1144** (0.0483)	0.1396*** (0.0519)	0.1382*** (0.0521)	0.1166** (0.0483)
Fiscal rules	3.0087*** (1.0787)				
Expenditure rule		1.0147 (0.8789)			
Debt rule			5.3949** (2.0981)		
Balanced budget rule				5.4797*** (1.9784)	
Revenue rule					1.7689 (1.3734)
N	217	217	217	217	217
Log likelihood	-45.9339	-51.8868	-44.0946	-42.6553	-51.6386

What is the current debt situation in the Caribbean?

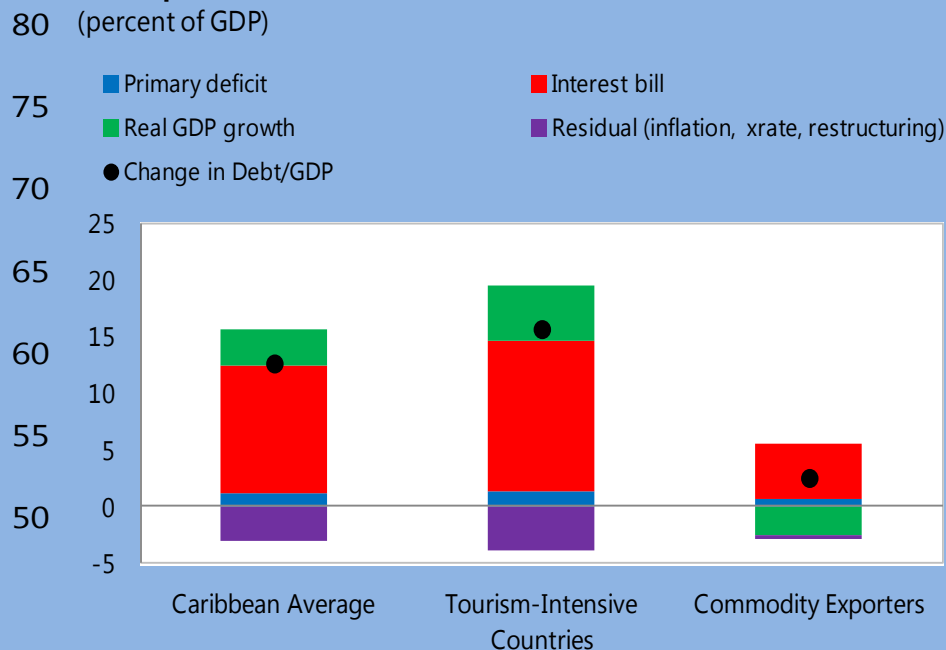
- The global financial crisis worsened the already high debt burdens
- Faster growth, fiscal consolidation and debt relief helped lower debt ratios by about 18 points of GDP between 2001 and 2007
- During 2008-2011, debt rose by about 15 points of GDP

Real GDP Growth and Government Debt



Source: IMF staff estimates.
1/ Weighted average.

Decomposition of Debt Accumulation, 2008-11



Source: IMF staff estimates.

In the Caribbean, the fiscal consolidation experience has been mixed

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

Global large debt reduction: Lessons for the Caribbean

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

Global large debt reduction: Lessons for the Caribbean

- ❖ On fiscal consolidation, our review of country experiences shows that:
- ❖ Easier to build **consensus** for change in difficult times
- ❖ Expenditure based **consolidation** tends to be more successful
- ❖ If adjustment needs are large, a **combination** is needed
- ❖ **Front loaded consolidation** enhances policy credibility
- ❖ **Fiscal rules** are associated with larger and sustained fiscal consolidation effort

Global large debt reduction: Lessons for the Caribbean

A comprehensive package of reforms is needed

❖ **Tax policy, focus on:**

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

❖ **Spending, focus on:**

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

❖ **Structural reforms:**

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

Thank You

