

Saturday December 28, 2013



Fear of debt

T.K.JAYARAMAN

This week we had two reports from International Monetary Fund.

One of them was on Fiji, which was comforting and the other one on a Caribbean country, which was disturbing.

The report on Fiji contains the findings the IMF consultation Mission mounted in November.

The IMF report says the Fiji's current configuration of policies, including accommodative monetary policy as broadly appropriate in view of low inflation. However, as unemployment is high at 9 percent, IMF recommends speeding up of structural reforms. The report welcomes government's efforts to reduce fiscal deficits and keep budget deficits low as debt-to-gross domestic product is below 50 percent.

An alarming report on Barbados

The IMF press release of December 13 on the completion of Article 1V Consultation to Barbados is alarming and portent with lessons for Pacific island countries, which share many commonalities with the Caribbean: proneness to hurricane and cyclones, small size and openness; and dependence on inward remittances and tourism.

The press release says Barbados's ratio of debt has risen to 94 percent, similar to that of Cyprus early this year, which was forced to seek a bail-out from European Union.

The reasons behind rise in debt are all too familiar: weak exports and slowdown in tourism, poor growth and fiscal deficits over the years since world recession in 2009.

The measures suggested are also the familiar ones: tighten the belt. Barbados wage bill is 10.3 percent of GDP in 2012/13, the highest in the region. Together with rising interest payments, there is little room for investment spending.

So, the government has decided to lay off 3,000 public sector workers by March 2014. It will also freeze wages for the staff retained.

More in debt-trap

Besides Barbados, other Caribbean countries too were affected by slowdown in tourism after 2009. Fiscal expansion to get out of recession led to rise in public debt. The region's debt averaged 70 percent of GDP in 2012.

Six Caribbean countries were through the crisis. They defaulted in debt servicing. They include Jamaica, Belize, Dominica and St. Kitts & Nevis.

In March, Grenada defaulted on its dollar bonds in March. Government had to mobilize public opinion and force lenders to write-off of two-thirds of its debt.

Back to Pacific region

We have two serious cases.

Samoa's debt would increase to 65.9 percent of GDP in 2014, following heavy expenditure on tsunami rehabilitation, as against 34 percent six years ago. A debt sustainability analysis by IMF has shifted Samoa's rating from moderate to high risk of debt distress.

In the case of Tonga, the debt is reported to be above 50 percent. Most of it is external debt and it is heavily dominated by loans from China.

Both, whether domestic debt (owed to citizens) or external debt (owed to foreigners) are worrisome.

If governments do not care to put the house in order, they get into what is known as debt trap. The trap emerges this way: governments cut spending; the cuts will further reduce the already low levels of GDP growth; and debt repayment obligations as percent of GDP would bulge; and they would only lead to further fall in growth rate.

Poor growth affects ability to service debt.

If defaults are feared, restructuring will have to be resorted to. If the borrowing has been from international agencies, conditionalities will be severe.

If the debt is from bilateral sources, one can request the lender to postpone payment date or extend grace period. If it could be for an indefinite period, that will be fine. If the loan is forgiven, it will be simply great.

Radio International of New Zealand reported the opposition leader 'Akilisi Pohiva saying that Tonga government leaders made several trips to Beijing to plea for the loan to become a grant. If it becomes a grant, China will expect something from Tonga.

"We are now in a very difficult position to make any choice because failure to pay the loan would give China a chance to make a choice. Whatever China will need Tonga to do - that's what will happen.", Pohiva says.

Pohiva indicates China could ask Tonga to allow it to establish a naval base in the Kingdom.

That request will become an issue of compromising sovereignty