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Debt Sustainability in the Caribbean

BY

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Inter-American Development Bank

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ABSTRACT

This paper examines debt sustainability in the Caribbean region in general giving the emerging market status, and small size of Caribbean economies. Particular emphasis is given to six countries within the region with respect to debt sustainability techniques and policies. The size, scope and effects of sovereign indebtedness is also discussed. Policy options and recommendations for ensuring debt sustainability and reducing indebtedness are examined herein.

I: Introduction

This paper examines the macroeconomic performance of several Caribbean countries, with respect to debt sustainability, and debt reduction and management measures. Six countries are examined within the purview of this paper, as is the region as a whole. While living standards and fiscal performance as a whole vary widely across the region, some fiscal as well as human development trends are prevalent.

Most countries in the Caribbean region enjoy high levels of human development and democratization. Most countries in the Caribbean region rank highly on the Human Development Index in comparison with averages for Latin America and the Caribbean. Moreover, life expectancy and literacy are also high in comparison with both the averages for developing and emerging market economies, and with Latin American and the Caribbean, while enjoying lower inequality statistics. Notwithstanding, emigration rates are among the highest in the world. From 1970-2000, emigration from the ECCU countries included 40-70 % of the skilled labor force (IMF ECCU Article IV, 2005) Additionally economic growth rates have been sluggish for several countries in the region. Growth rates, are only marginally higher than that of Latin America and the Caribbean's average, and less than that of the developing and emerging market economies average. (Sahay, 2005)

The late 1990s saw a stark increase of sovereign debt across the nations in the Caribbean region, which largely tapered-off in the early 2000s. Accordingly, public sector debt to revenue has seen a drop since 2000. The presence of a debt problem arose through accumulated deficits resulting largely from a series of unforeseen external shocks including disaster relief, and a slowdown in the tourism sector in the aftermath of September 11th. In the face of such rising expenditures, revenues have remained stable in most cases, and saw only a slight revenue growth on average.

While sovereign debt has tapered-off in terms of magnitude, sovereign debt has also come to be managed more efficiently and responsibly in several countries across the region for which data is available. Steps have been taken by all countries to attempt to manage their debt. These steps include renegotiation, the development and improvement of primary surpluses, redistribution between foreign currency denominated and domestic currency denominated debt, and the reduction or elimination of relatively risky short-term debt as well as bullet payments. In most cases several of these policies were used together as a package.

Beyond the region at large and the nature of the challenge facing the countries in the region, six countries are investigated in terms of fiscal and debt management performance. These are Antigua and Barbuda, Bahamas, Barbados, Belize, Jamaica, and Trinidad and Tobago. Each of these nations has taken some steps to reduce or manage its sovereign debt, with varying degrees of success.

The paper proceeds as follows. Section II explains the fiscal and macroeconomic performance of the region. Section III analyses the risks and pitfalls associated with risk in emerging markets, and provides a look at how it affects the Caribbean region. Section IV provides a look into the six countries, Antigua and Barbuda, Bahamas, Barbados, Belize, Jamaica, and Trinidad and Tobago. This section also examines what has been done outside of the region in order to manage and reduce sovereign debt. Section V provides some conclusions and policy recommendations.

II: Fiscal and Macroeconomic Performance of the Caribbean:

Sharp contrasts exist across the Caribbean region in terms of income, living standards, and macroeconomic performance. Similarly, sharp contrasts exist in terms vulnerability to exogenous shocks of various types, given range and distribution of sovereign debt in the region.

Economic growth in the region was quite varied in the region during the 2001-2005 period. The average growth for the ECCU for 1990-2003 was less than three percent, while Jamaican GDP growth from 2001-2005 was less than two percent. Aruba experience negative GDP growth during 2001 and 2002, only to recover to a GDP growth of less than 2% in 2003. Conversely, Growth rates in Suriname and Belize were above 4.5% while those in Trinidad and Tobago were above 8%.

While debt in the region has grown to be large and burdensome for many countries in the Caribbean region, where debt exceeds 100% of GDP and features high rates of debt growth, in several countries in the region, debt growth has tapered while debt sustainability indicators show improved signs of sustainability. In Trinidad and Tobago, as well as in the Bahamas, foreign currency denominated debt accounts for less than 30% of all sovereign debt. Moreover, it has decreased as a share of total debt since 2001 in the case of Trinidad and Tobago. In Jamaica and Belize meanwhile, short-term debt has undergone vast reductions since 1998, and now represents less than 10% of external debt in each country. Suriname meanwhile reduced both its sovereign debt and foreign currency denominated debt as a share of total debt.

Since 2001, fiscal performance has improved across the region. On average, fiscal revenues have improved, while Public Sector Debt-to-GDP ratios have decreased. The sharp increases in debt that characterized the 1990s and early 2000s ended in 2001-2002. Suriname moved gradually from generating primary deficits to primary surpluses during the 2001-2005 period.

While some progress has been made in these respects, more needs to be done in order to improve prospects of debt sustainability. Ultimately, debt sustainability means not only the sustainability of the possibility to finance government deficits, but also survivability and insulation in the face of exogenous shocks which may occur.

III: The Perils of Emerging Market Debt in the Caribbean:

In many ways, sovereign debt sustainability in the Caribbean is vulnerable to exogenous shocks. In emerging markets in as a whole, debt is riskier than in large OECD economies. (Alvarado, 2004) This is especially true in small economies, where exogenous factors can have a much larger effect. (Alvarado, 2004) In this sense, the debt profiles and economies of many countries in the Caribbean region are no exception.

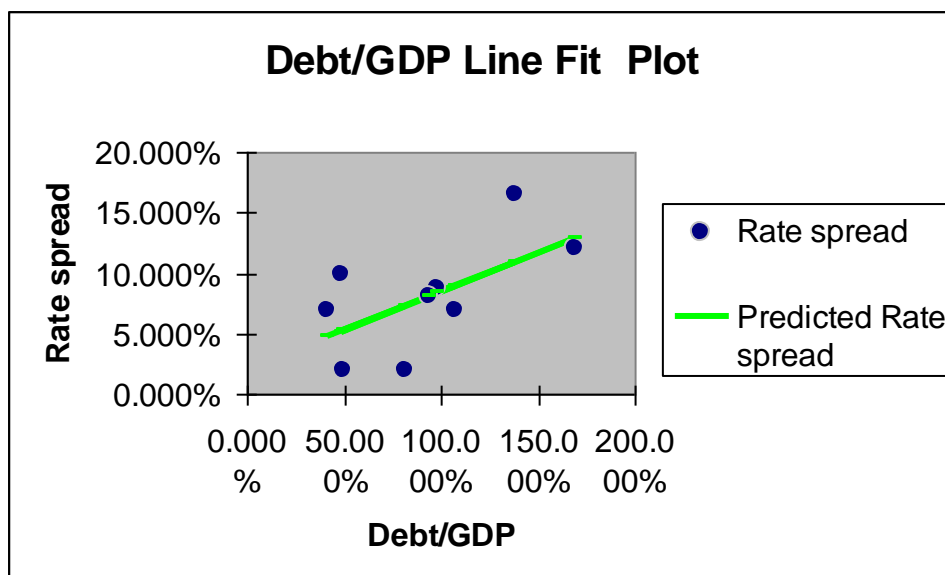
In terms of GDP size, Trinidad and Tobago's GDP for 2005 was approximately \$12.5 Billion, while that of the Bahamas was \$5.2 Billion. These two countries represent some of the largest GDPs in the Caribbean region. By comparison, the 2005 GDP of Chile was \$94 Billion, Mexico's GDP was \$676.5 Billion, and Brazil's was \$ 604.8 Billion. Moreover, there exists a certain vulnerability to exogenous shocks within the region. The average size foreign currency denominated debt, GDP in the six countries examined in detail in this paper was 41.250% in 2005. In comparison, larger emerging markets in the region, the size of the foreign currency denominated debt in Mexico for 2005 was 13.5%, while that Chile was 5.4%. In many larger economies it is more readily possible to have more of the debt denominated in domestic currency, this is more difficult for small emerging market economies. While size of the Bahamas foreign debt relative to GDP, as well as that of Trinidad and Tobago resemble that of Mexico, most other nations in the region have much larger foreign debts. Hence, the threat of foreign currency shocks is appreciably larger.

Additionally, dependency on tourism in many of the region's economies means that income and growth in the Caribbean region can be affected severely by events a world away. The bulk of Caribbean countries depends on tourism for over 25% of their GDP. In the aftermath of September 11th 2001, there was a sharp decline in tourism arrivals for the

2001-2002 winter season. (WSJ) Beyond the possibility of foreign currency shock, and trade shock, lies the possibility of natural disaster. In 2006, Belize underwent a major debt restructuring. According to the Government of Belize, this was a necessary measure due to a precarious fiscal stance brought on by the hurricane relief expenditures.

Debt accumulation can have potentially disastrous implications. In some scenarios, high debt accumulation may adversely affect levels of economic growth chiefly through increases in the cost of finance, which can in turn be caused by increases in risk premia, relating to the level of indebtedness. The ultimate effect would be a decrease in investment. Growth may also be curtailed in the case of a high sovereign debt through the development of a sizeable interest rate spread between the deposit rates and the lending rate in the countries, thereby making the savings in a country increasingly inaccessible to the markets for investment. Indeed, a regression analysis reveals that the Debt-to-GDP ratio is responsible for a sizable portion of the interest rate spread.

SUMMARY OUTPUT					
<i>Regression Statistics</i>			X = DEBT / GDP Y = Rate Spread		
Multiple R	0.601885182				
R Square	0.362265773				
Adjusted R Square	0.282548994				
Standard Error	0.03665646				
Observations	10				
ANOVA					
	<i>DF</i>	<i>SS</i>	<i>MS</i>	<i>F</i>	<i>Significance F</i>
Regression	1	0.006106307	0.006106307	4.5444106	0.065612685
Residual	8	0.010749569	0.001343696		
Total	9	0.016855876			
	<i>Coefficients</i>	<i>Standard Error</i>	<i>t Stat</i>	<i>P-value</i>	<i>Lower 95%</i>
Intercept	0.020848544	0.030235232	0.689544707	0.5099831	-0.04887407
Debt/GDP	0.063750964	0.029905287	2.131762323	0.0656127	-0.005210796



Source: IMF, World Bank, WDI Online

Table 1 and Figure 1 above capture the relationship between a country's indebtedness, and its rate spread. This logically follows since in many ways, interest rate spreads are a measure of fear of volatility and instability on the part of the investors with respect to the lending situation. Ergo, one can expect investors to become increasingly nervous about suffering a loss as indebtedness rises. In the case of rising indebtedness, the risk spread can ultimately increase because of the increased willingness on the part of the investor to be suitably compensated for the risk taken.

A more severe possibility is the threat of currency or interest rate instability, which in the case of a large external debt, can leave a country extremely vulnerable to exogenous shocks, whose onset may ultimately have little to do with the domestic fiscal or financial situation. (ECLAC, 2006) Alvarado et al. (2004) stress the fact that given the climate of risk involved with sovereign debt in emerging markets, there is an elevated level of investor volatility, and hence thresholds of maximum debt tolerance are subject to volatile changes and shocks. In fact, a country under tranquil and sustainable conditions may have an acceptable and sustainable level of sovereign debt, which suddenly becomes unacceptable because fear of defaults may lead to investors asking for higher premia, hence making debt sustainability much more difficult. This may even occur despite the absence of any changes in a country's policies or fiscal stance. (Alvarado et al., 2004)

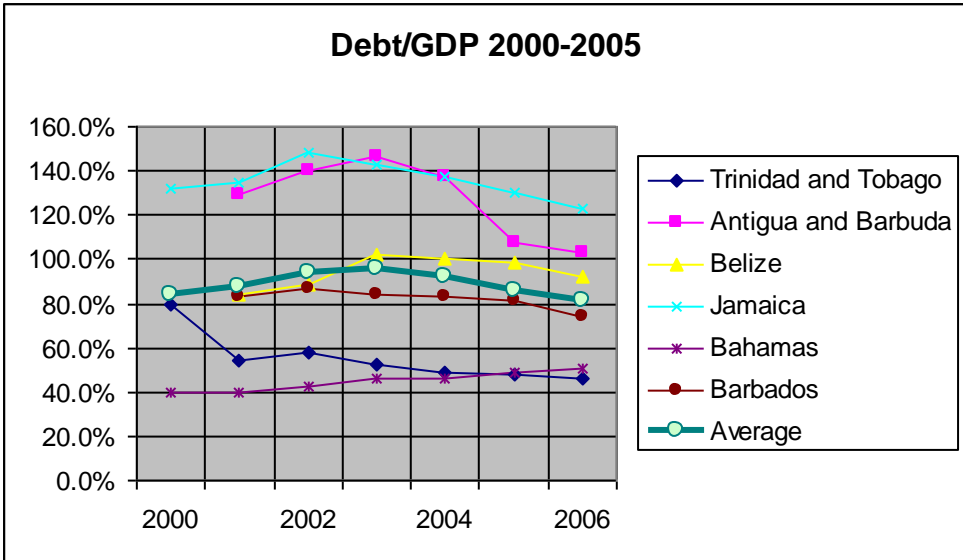
Such may become the case during a contagion outbreak, or market reaction to far away events such as a major market crash half a world away.

Insulation against the possibility of such an event is difficult for small economies, no matter what their fiscal shape. In the Caribbean region, vulnerabilities exist in this sense due to the large existing debt portfolios of many of the region's countries, as well as the size of the proportion of both foreign currency denominated, and relatively risky forms of debt, such as short-term debt, variable interest rate debt, and debt whose terms of maturity are in bullet remuneration.

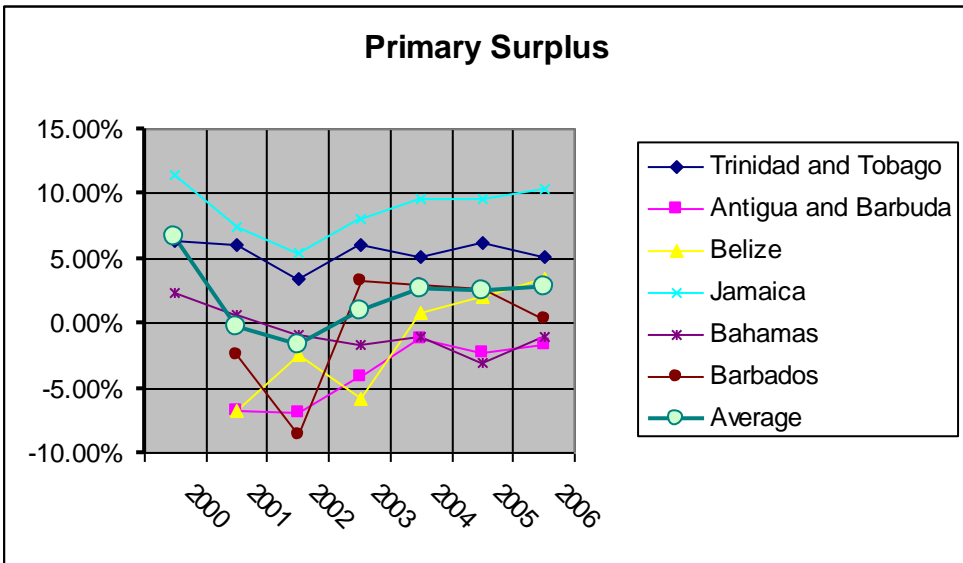
IV: Performance of Six Selected Countries in the Caribbean region:

Six countries in the Caribbean region, Antigua and Barbuda, Bahamas, Barbados, Belize, Jamaica, and Trinidad and Tobago, are studied in more detail in this paper because they represent some of the larger economies in the region. Each of them has also taken steps towards improving debt sustainability worth examining in closer detail.

In these six countries, indebtedness has both declined slightly and converged slightly since 2001, as shown in figure 2. Additionally, the average debt-to-GDP ratio for these countries has decreased continuously since 2003. There has also been an upward trend in the size and existence of primary surpluses since 2002 in these six countries as demonstrated in figure 3, signaling an overall better fiscal health. Taken together, it can be seen that debt sustainability outlooks have improved since 2003.



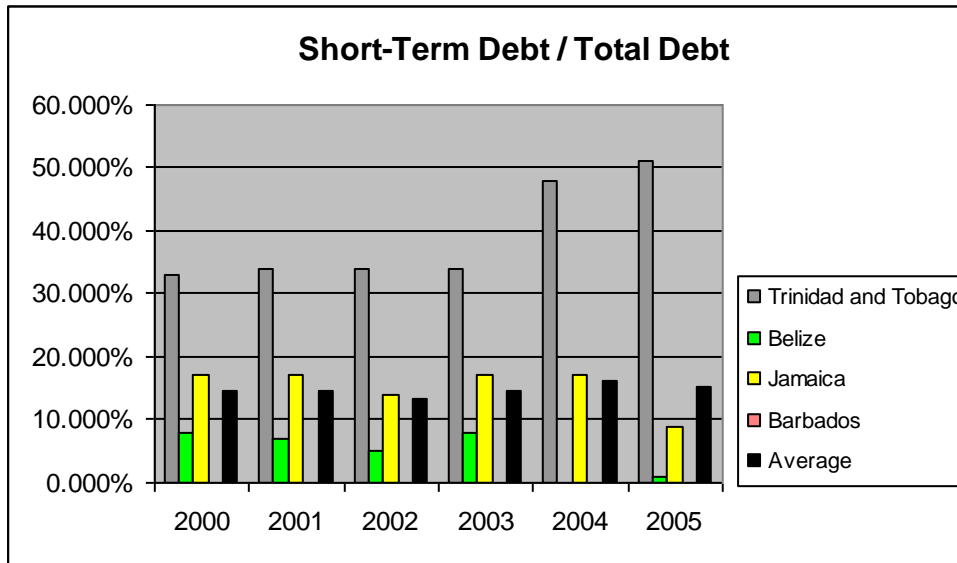
Source: IMF



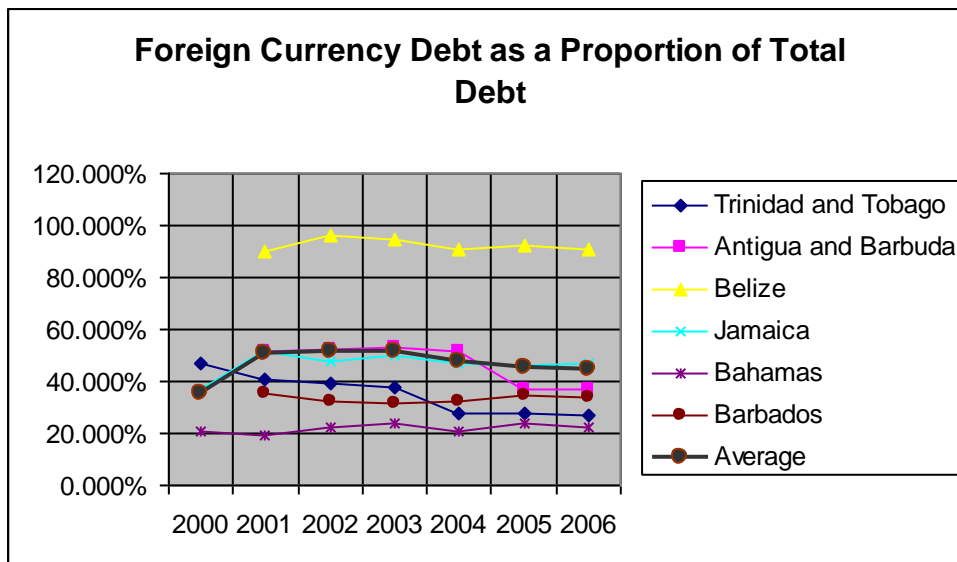
Source: IMF

In terms of risk factors of debt, are the proportions of short-term debt, and the proportions of external debt. As shown in figure 4, short-term debt has remained stable in three of the four countries for which data was available, as well as on average for the countries. Of the six countries, the proportion of short term debt increased only in Trinidad and Tobago. Additionally, both Barbados and Belize managed to reduce their short-term debt proportions to zero. In the case of Barbados, the elimination of its short-term debt was achieved in 1998, and so is not visible in figure 4. In as far as the proportion of foreign currency denominated debt as a proportion of total, the average of the six countries has

remained stable for the 2001-2005 period. Typically, countries in the Caribbean region have between one and two thirds of their sovereign debt denominated in a foreign currency. This foreign currency denominated debt, ultimately consists of a portfolio of foreign currency obligations, distributed amongst multiple convertible foreign currencies. While most of the six countries examined have less than 52% of their total sovereign debt denominated in a foreign currency in any given year during the 2001-2005 period, the foreign currency denominated share of their debt was above 90%.

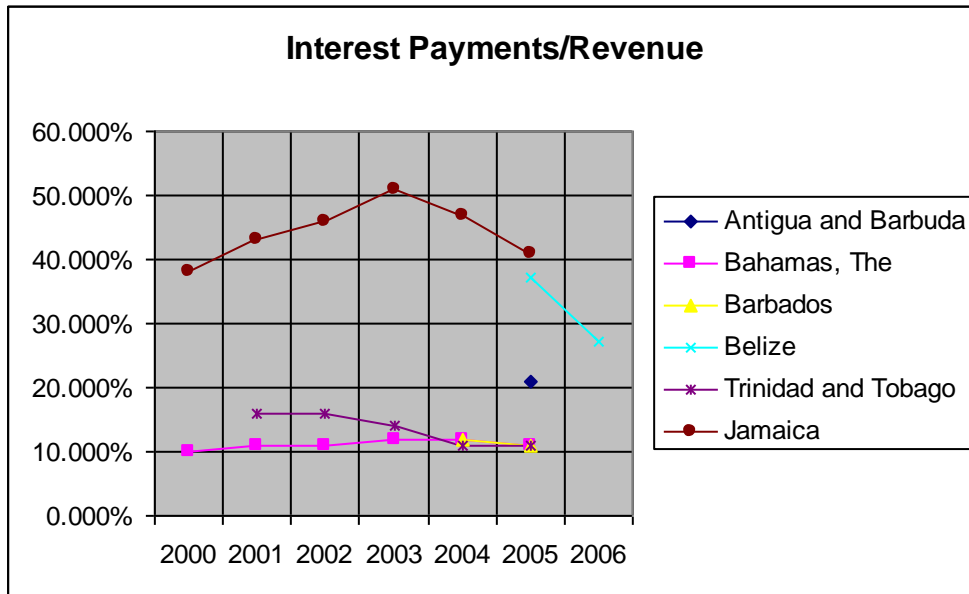


Source: World Bank WDI

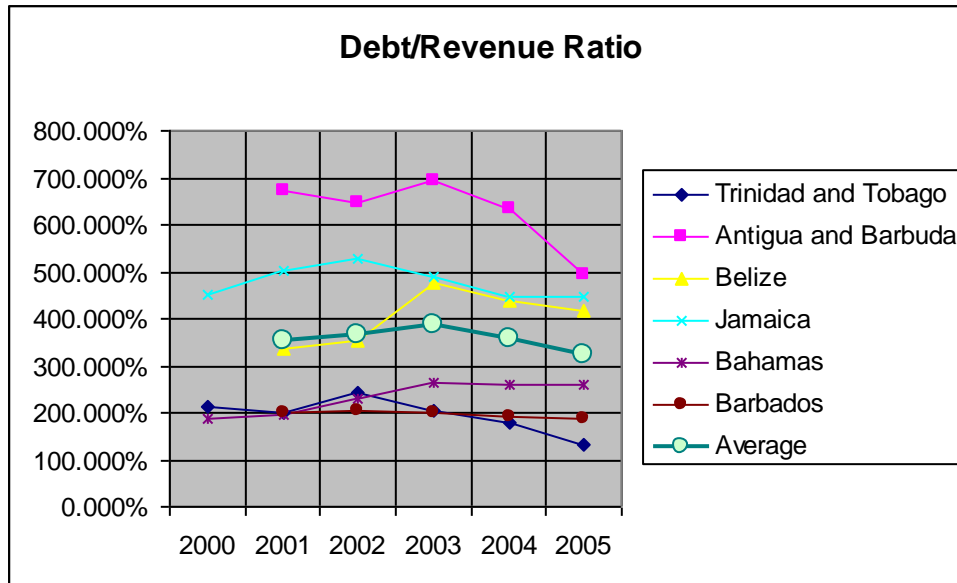


Sources: IMF, IADB

In the short-run, perhaps the most important indicator of sustainability of the existing sovereign debt is the cost of paying the interest on the debt so to maintain it as it is. With this in mind, trends show a shrinking convergence given the limited availability of data in with this indicator. Figure six demonstrates the convergence in interest payments towards approximately 10% of national revenues. Also important to gauging the short and immediate term of debt sustainability in the sovereign debt's size relative to revenues. Clearly, a country with high and stable fiscal revenues can sustain and repay lagers debts, size of the country or economy notwithstanding. A low debt/revenue ratio also signals upward flexibility, not only in terms of debt repayments ability, but also the ability to maintain interest payments, given difficulties with data availability with respect to interest payments. Figure seven demonstrates overall stability of debt with respect to revenue. While the average for the six countries dropped slightly during the 2001-2005 period, this drop can be attributed chiefly to drops in debt levels specifically in two countries; Antigua and Barbuda and Trinidad and Tobago. Beyond this, it can be said that most of the six countries witnessed at least a slight drop in the debt/revenue ratio after 2003.



Sources: World Bank WDI, Government of Belize



Sources: World Bank WDI

Each of these countries has taken active steps in attempts reduce its debt burden. These are a combination of active debt management policies, and the development of primary surpluses. Consequently, some countries have succeeded in making their debt burdens much more sustainable.

Trinidad and Tobago:

Trinidad and Tobago's experience with managing its debt has been characterized by the rapid and effective reduction of its sovereign debt during 2000-2005. This has been achieved largely through debt buybacks, rollover into low-yield 10 year bonds, and reduction of its borrowing requirements. These reductions were made possible largely by seizing on high oil prices, and a robustly performing financial sector during the period, fueled by broad acquisition of assets both domestically and across the region as well as high economic growth rates. The reduction of Trinidad and Tobago's indebtedness, has served to improve its credibility and further fuel its financial market. In many ways Trinidad and Tobago has adequately taken advantage of a favorable Balance of Payments position, (that is, both a favorable Capital Accounts and Current Accounts position) in order to buy back its debt, especially its multilateral debt, as well as roll-over remaining debt on more favorable terms.

Trinidad and Tobago is the only country among the six where short-term debt increased. However, it is also the country with the lowest level of indebtedness and highest growth rates. Additionally, Trinidad and Tobago's share of foreign currency denominated debt is well below average in terms of both the region and the six countries examined herein. In terms of Trinidad and Tobago's primary surplus, it has remained both stable and positive. Moreover, an examination of the trends in Trinidad and Tobago's debt sustainability indicators indicates an eventual elimination of sovereign debt, should the trends continue as they are.

While Trinidad and Tobago is considered a stable country in terms of debt sustainability, debt sustainability in the country is most vulnerable to the threats of both contingent liability shock, and Growth shock, according to the IMF's debt sustainability bound tests.

Jamaica:

Jamaica is characterized by both a very a high level of indebtedness and a high primary surplus. The country's debt-to-GDP ratio is consistently between 130-140%, while the primary surpluses around 10%. Additionally, interest rate payments for Jamaica's sovereign debt amounted to over 40% of Jamaica's revenues during the 2001-2005 period. Additionally, Jamaica's sovereign debt represents a high concentration of short term debt, which stood at 82% of total sovereign debt at the end of 2005. (ECLAC, 2006)

Jamaica has attempted to reduce its debt burden thorough primary surpluses. Also, the country has attempted to lower the risk profile of its sovereign debt by more evenly distributing its sovereign debt. Jamaica's efforts to reduce its indebtedness have unfortunately not been successful. This is chiefly because debt service costs have consistently been around 15% of the GDP, while primary surpluses have hovered around 10%. Jamaica's distributionary efforts however have fared better. While in the early 1990s, Jamaica's sovereign debt was almost exclusively external, foreign currency denominated debt, the proportion of external debt as a share of total debt shrank progressively, reaching parity in 1999, since which time the proportion of domestic debt

has been slightly higher than external debt. In 2005, the proportion of foreign currency denominated debt with relation to its total sovereign debt stood at 43%. Overall, Jamaica's debt sustainability situation has remained stable. Accordingly, Jamaica's rate spread has remained stable since late 2003, while debt-to-GDP ratios have declined slightly over the same period.

According to the IMF's public debt sustainability bounds tests, Jamaica is under much less threat from exogenous shocks than the other countries examined in the Caribbean region. In the event of most types of shock, the tests indicate that indebtedness would merely drop less immediately.

Antigua and Barbuda:

Antigua and Barbuda, while being one of the two most highly indebted countries of the six examined within this paper, it has managed to reduce both its debt level and its level of indebtedness the most. The Antiguan government managed to renegotiate the terms of its high interest domestic debt, which accounted for a third of its total debt stock. Additionally, the country secured a significant debt write-off of bilateral debt from the Italian government. In terms of active debt management, Antigua and Barbuda retired more expensive obligations, replacing them with the issuance of lower-yielding, but short term regional treasury bonds.

Antigua and Barbuda was one of the few countries in the Caribbean region not to adopt an expansionary fiscal stance in the late 1990s. (ECLAC, 2006) Additionally, for Antigua and Barbuda, unpaid contributions and vouchers represent a sizable share of the sovereign debt stock.

According to the IMF's debt sustainability bounds tests, the largest long-term threat to debt sustainability in Antigua and Barbuda is a non-interest current account shock. It is also noteworthy that the effects of a real depreciation shock reverse would themselves in the medium term.

Bahamas:

Bahamas is a country with a high sovereign credibility rating, and a low level of indebtedness. The debt to GDP ratio however, rose steadily throughout the 2001-2005 period. Nonetheless, the sovereign debt of the Bahamas is around 50% of the GDP, as it was at the end of the 2005 period. This is a lower level of indebtedness than the less specified in the convergence criteria in the treaty of Maastricht. The IMF however, considers the reduction of indebtedness a main policy challenge in order to secure macroeconomic stability. A budget proposal was introduced to Parliament in May 2005 to reduce the debt to GDP ratio to 30% within five years. (IMF, 2006)

The domestic sovereign debt is larger than what the data would indicate on the surface because the foreign currency denominated portion of Bahamas' debt during the 2001-2005 period was in fact financed by domestic banks. In terms of active debt management, the Bahamian government seeks to avoid government guarantees of third parties specifically with respect to airports and public utilities.

According to the IMF's debt sustainability bounds tests, debt sustainability in the country is most vulnerable in the event of sustained low GDP growth. In this case however, Bahamas' indebtedness levels would still leave sovereign debt below 70% of GDP, a level comparable to many European countries.

Belize:

In 1998-2002, Belize incurred large deficits which were translated into large debt increases. These were incurred unexpectedly for the purposes of disaster relief, and were exacerbated by refinancing operations which led to a consistent rise in borrowing costs. Ultimately, the situation grew problematic, over 90% of Belize's sovereign debt was owed to foreign creditors, and interest payments exceeded 27% of government revenues. (Houlihan Lokey, 2007) Moreover, Belize's sovereign debt was a high risk debt because of the presence of bullet maturities, which created a significant rollover risk.

In December 2006, Belize restructured its external commercial debt. The Government of Belize made extensive use of Collective Action Clauses (CACs), which ease negotiation with creditors by imposing the terms agreed to by the majority of credit holders on all credit notes. CACs prevent a minority of credit holders holding out for better terms, requiring the debtor to negotiate separately with each individual crediting party, or suing in response to debt restructuring agreements with which they are unsatisfied. Although long written into financial instruments of sovereign debt in the region, CACs had theretofore gone unused.

As a result of Belize's debt restructuring, both short-term debt and bullet maturities were replaced completely, thus making the country's sovereign debt less risky. Indeed, after the restructuring was complete, Belize's S&P rating rose to its highest level since August 2004. Instead Belize issued US dollar denominated bonds to be repaid in semi-annual installments from 2019-2029.

The final result of the debt negotiation was a successful reduction in the cost of servicing Belize's sovereign debt purely through active debt management policies. While the debt-to-GDP ratio has been maintained, interest payments-to-revenue ratios were cut in half, from between 30-35% to 15-20%, as far forward as 2015. Additionally, Belize's sovereign debt became less risky –and thereby cheaper– due to the elimination of both short-term payments, and bullet maturities. Successful debt restructuring notwithstanding, Belize retains quite a high level of risk in that the vast majority of its sovereign debt is foreign currency denominated debt. This fact may come to undermine debt sustainability in the future, particularly in the event of foreign currency shock. While currently Belize's currency is pegged to the dollar, this may change as the Balance of Payments and the level of Belize's reserves changes in the future. Moreover, the IMF identifies various types of possible shocks as sizeable threats for Belize's debt sustainability. Among these threats are low growth, drop in primary balance, contingent liability shock, and any combination of the aforementioned threats acting in unison.

Barbados:

Barbados is highly rated, investment grade debt and has consistently managed to maintain around two-thirds of its total sovereign debt as domestic debt since 1998. (ECLAC, 2006) Moreover, Barbados' domestic debt is largely held in relatively safe long-term instruments. (ECLAC, 2006) It is largely these factor which may be contributing to the country's sovereign debt credibility rating.

Barbados has also managed to reduce its interest payments, maintain a high primary surplus, and avoid short-term sovereign debt obligations. The debt sustainability picture in Barbados is one of the best in the region, given the country's relatively low level of indebtedness relative to its revenue. While Barbados' sovereign debt relative to GDP, was consistently between 80 and 90% from 2001-2005, it took a downward trend starting in 2002 and continuing into the present day (Central Bank of Barbados, 2007). Since 2003, Barbados' borrowing needs have shrunk, and the public sector debt to GDP ratio has also decreased. Moreover, the country has generated a surplus since 2004. (IMF, 2006)

The IMF reports however, that Barbados faces risks due to its already high level of indebtedness, as well as the high prices for oil, which Barbados imports, and on which Barbados' economy largely depends. (IMF, 2006) This in turn, puts Barbados at risk of several types of external shock, which may increase the country's indebtedness level, and from which recovery may become difficult.

Outside of the Caribbean region:

Beyond the Caribbean region, one of the emerging market which was able to successfully reduce its debt was South Africa. Despite some apparent characteristic economic differences between South Africa and most countries in the Caribbean, as well as its larger size as an economy, some of the steps South Africa has taken may hold valuable lessons for reducing sovereign debt.

South Africa's situation in many ways parallels that of Trinidad and Tobago. Fundamentally, South Africa seized an opportunity to act with respect to its debt burden.

This opportunity presented itself in the form of increased value of its currency internationally. As a result, domestic currency denominated bonds are traded overseas, as is South African currency. Stronger currency increased South Africa's hand in attempts to undertake active debt management. South Africa lowered its contingent liabilities from 26.1% of GDP in 1994/95 to 9.8% of GDP in 2005/06. South Africa also improved the quality of domestic currency debt instruments by introducing inflation-linked bonds, while increasing liquidity in its bond markets. (SAG, 2006) Foreign currency denominated debt has declined from 19% of total sovereign debt in 2001/02, to 14.3% in 2007. (Government of South Africa, National Treasury, 2007)

Additionally, South Africa managed to reduce its borrowing requirement from 5.1% of GDP in 1994/95, to a projected 0.3% in 2009/10. According to Government documents, this due to the cheaper cost of financing the operations of state-run enterprises, as well as higher sovereign debt credibility ratings. (Government of South Africa, National Treasury, 2007) Finally, the government improved the efficiency, transparency, and accountability of its state-owned enterprises. (Government of South Africa, National Treasury, 2007)

The South African government reduced its indebtedness through a mix of fiscal measures and active debt management. In terms of fiscal measures, South Africa managed to lower its borrowing requirements by rendering its state-run firms more efficient, while in terms of active debt management, South Africa lowered its contingent liabilities as a percentage of GDP. Furthermore, the South African central bank has accumulated unusually large reserves, having the effect of improving credibility, and flexibility given its flexible exchange rate regime. (IMF, 2007)

Ecuador on the other hand has made progress in reducing its indebtedness levels by improving its fiscal stance. The country managed to reduce its debt to GDP ratio from over 70% in 2001 to 43% in 2005. According to the IMF, the Ecuadorian government has set a final debt to GDP target at 40% as a maximum level of indebtedness. Additionally,

Ecuador has maintained a consistent fiscal surplus of over 4% since 2001, and has reduced its borrowing needs by more than half since 2001. (IMF, 2005)

Ecuador's debt sustainability improvement however, has to do largely with increased oil revenues. The country's non-oil deficit increased from 2003-2005. (IMF, 2005) This, along with increased level of expenditure has lead to an increased shock susceptibility, putting at risk much of the gains made from oil price increases. According to the IMF's 2005 assessment, even slightly lower (but still high) international oil prices may put Ecuador's debt sustainability in peril.

In an effort to reduce risk, the Ecuadorian government has created a plan to create an escrow account specifically for debt management. These funds will be used to retire outstanding short-term high-interest bonds. (IMF, 2005)

The lessons on debt sustainability both inside and outside of the region are more or less clear. To summarize, debt sustainability is most solidly secured in those countries which have relied more heavily on active debt management. While both fiscal policies and active debt management policies vital to securing debt sustainability and reducing indebtedness, reliance on fiscal policies primarily leads to debt which is risky and on unfavorable terms. This increased riskiness will have the further effect of making future debt more expensive due to its credibility rating and inflated rate spread (see figures 1 and 2), which has the potential to become a vicious risky debt cycle if left unchecked.

Conclusions and Policy Recommendations:

Fundamentally, the road to sovereign debt reduction or sustainability has two important avenues which must both be used to one extent or another. First, in order to render debt sustainable, certain fiscal steps should be taken. These are the reduction of borrowing needs and the development or increase of a primary surplus. The country's fiscal stance must be made more conducive to debt sustainability. Fiscal approaches to debt sustainability however, have their inherent limits. Typically, these limits set by a constraining need to maintain fairly constant fiscal expenditures.

As far as the fiscal path is concerned, many successful examples of debt reduction or debt sustainability have managed to improve their fiscal stances by lowering their country's borrowing requirements. Market performance and export fortunes aside, it must be noted that advantageous moments in terms of fiscal, trade or capital balances must be capitalized on in terms of debt management. Advantageous good moments in the market do not by themselves reduce the debt burden, nor ensure sustainability.

With respect to fiscal spending, it must be said that there is a need to maintain fairly constant expenditure, *ceteris paribus*. Fiscal consolidation through spending cuts has two constraints limit the downward flexibility of spending cuts. First, there exists a second political constraint in the sensitivity of the electorate to spending cuts over time, that is, how quickly or how gradually expenditures are cut. Second, there is an absolute maximum acceptable level of expenditure cuts, irrespective of time, beyond which a government may find itself in peril in terms of political sustainability. Moreover, fiscal consolidation measures may have pro-cyclical effects and may ultimately increase volatility risk, particularly in small emerging market economies, where volatility risks are already present, and may ultimately be magnified. To provide a healthy partial alternative, it must be noted that successful examples of improving the country's fiscal stance have relied on measures such as increasing and diversifying exports, as well as improving transparency and efficiency in state-run enterprises both in terms of operation and financing. Overall, improvement of the fiscal stance must be multifaceted and proceed cautiously.

In order to reduce the magnitude of fiscal measures necessary to have an effect on the debt sustainability picture, active debt management must also be undertaken. The most straightforward and successful debt management technique documented within the purview of this paper is debt buyback. This strategy has been successful in Trinidad and Tobago, as well outside of the region in South Africa. Debt buyback is a technique that can be employed in order to take advantage of good moments in time in terms of fiscal, trade, or capital surpluses, as was demonstrated these two cases.

Beyond this, active debt management strategies include principally debt rollover strategies. In order for debt sustainability to be improved, it is important that debt be rolled-over on as beneficial terms as possible, and that as a minimum the terms of debt rollover at least as good as the previous terms. The improvement of rollover terms lowers various types of risk, which in turn improves credibility, which in turn will lead to cheaper future debt, making future rollover operations easier and less expensive. Successful policies have rolled over debt from bullet maturities to stepped maturities, thereby reducing the rollover risk. Other successful policies lead to the issue of maturities with lower yield or longer maturity periods, reducing the default risk. The risk of foreign currency shock can be lowered by replacing foreign currency denominated risk with domestic currency denominated risk. Additionally, foreign currency denominated debt can be spread out in debt issuances denominated in several currencies, rather than to keeping external debt concentrated in a single currency. This may also mitigate the risk foreign currency shock, as the external foreign currency denominated debt does not depend entirely on the relationship between the country's currency, and a single foreign country's currency. The major shortcoming of active debt management is that a certain trade-off exists between one debt management policy and another. That is, in many cases a country will have the opportunity to roll-over debt either into a more advantageous (domestic) currency denomination, or with a more advantageous terms. Achieving both at once will be difficult. With this said, the relative benefits of one active debt policy will have to be weighed against the relative benefits of another.

It must be noted that while debt buybacks can be undertaken primarily by countries that have experienced a balance of payments windfall, other types of active debt management do not require a good moment in the market to seize. Rollover operations can be done in many circumstances. While a windfall may help a country improve the debt rollover terms, there have been examples of active debt management where even the opposite was the case, such as that of Belize.

Overall, it is active debt management which matters most in the effort to secure debt sustainability. While debt reduction and sustainability require both fiscal measures and active debt management in order to be successful, it is the debt management strategies which ensure the greatest flexibility of action, secure future debt, and minimize future risk.

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