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Addressing Unsustainable Debt in **Small Island Developing States**

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Many small island developing states (SIDS) have struggled to address increasing levels of public debt over the past decade. Most small islands are disproportionately exposed to and impacted by external economic shocks because of structural weaknesses, such as limited natural resources, a dependence on one or two exports, lack of economies of scale, distance from markets, heavy dependence on imports, the high unit cost of service provision and a reliance on tourism and remittances for foreign exchange. This is combined with vulnerability to extreme weather conditions, such as hurricanes, which can wipe out entire communities and entail substantial reconstruction costs. These factors, in conjunction with lower levels of overseas development assistance for most SIDS, have left governments excessively reliant on domestic and external credit to meet fiscal deficits and to fund development.

In 2009, 14 SIDS registered public debt to GDP ratios in excess of 60 per cent (the broadly accepted threshold for sustainable levels of public debt). Eight SIDS, mostly in the Caribbean, registered debt to GDP levels of more than 100 per cent: Antigua and Barbuda, Barbados, Grenada, Guinea-Bissau, Guyana, Jamaica, St. Kitts and Nevis, and the Seychelles (UNDP, 2010). Several more are approaching the 100 per cent mark (the Maldives, for example). Debt levels in SIDS also increased markedly in the recent food-fuel-financial crises.

The fiscal burden of this debt is also high. In 2009, the proportion of government revenues devoted to public debt service was 99 per cent in Jamaica, 70 per cent in the Seychelles, 40 per cent in Papua New Guinea and in St. Kitts and Nevis, and 35 per cent in Antigua and Barbuda and in St. Lucia (UNDP, 2010). In several countries, debt service ratios are projected to rise further over the next few years, partly because there have been large increases in the amount of debt owed to commercial creditors (domestic and external). This raises important questions about governments' capacities to devote sufficient resources to poverty reduction and the Millennium Development Goals (MDGs).

Only five SIDS (Comoros, Guinea-Bissau, Guyana, Haiti, and São Tomé and Príncipe) have been considered poor enough or severely indebted enough to benefit from international debt-relief schemes such as the Heavily Indebted Poor Countries (HIPC) Initiative and the Multilateral Debt Relief Initiative (MDRI). The problem of indebtedness in other small island developing states has been largely disregarded by the international policy community.

SIDS have been called on to resolve their indebtedness problems themselves, mainly by cutting public expenditures, raising taxes and seeking debt restructuring with individual creditors on an ad-hoc basis. While cuts in public expenditures may resolve the immediacy of fiscal burdens, they have exacerbated internal inequalities and thus represent a false choice for governments. Some governments, such as those of Jamaica and the Seychelles, have recently restructured portions of their debt, but debt problems persist.

What more can be done? Policy measures are required by both the governments of the affected SIDS and the international community *in parallel*.

Measures for SIDS' governments

Reduce inefficiencies in public expenditures and improve the targeting of scarce public resources towards the neediest and most vulnerable populations.

Policy reforms to broaden and strengthen revenue collection must be informed by a Poverty and Social Impact Analysis (PSIA) to better anticipate impacts on the poor and vulnerable.

Implement measures to tackle trade mispricing and tax avoidance and evasion.

Strengthen institutional debt management capacities and factor in the risks presented by disasters and other economic shocks.

Channel more support towards the development of small businesses and public-private partnerships to help countries move away from public sector-led growth. This will require regulatory and legislative changes, as well as improvements to citizens' access to financial services and a banking/financial system centred on development, not just on profit.

Measures for the international community

Reform of aid allocation criteria to take structural vulnerabilities into account in the allocation of concessional resources.

In some SIDS, the size of the debt overhang is so large that comprehensive debt relief must be ruled in. This will be essential to increase the fiscal space for development spending and should be based on fair burden sharing between creditors.

Options for implementing "debt conversions for climate-change adaptation" should be explored. Such initiatives would help to "recycle" official-sector debt repayments into climate-adaption schemes.

Innovative financial instruments such as "counter-cyclical loans", which reduce the amount of debt service payable on a loan in the event of a major external shock, could be extremely useful to SIDS.

Over the long term, a sovereign debt restructuring mechanism at the international level is required. Such an instrument would help to address sovereign debt crises in a predictable, efficient and fair manner, and would thus also support human development objectives.

Reference:

UNDP (2010). 'Achieving Debt Sustainability and the MDGs in Small Island Developing States', *Discussion Paper*. New York, UNDP. Available online at:<http://www.undp.org/poverty/topics8_debt.shtml>.

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