Centre for International
Governance Innovation

CIGI Papers No. 125 — April 2017

Pathways through the Silent Crisis: Innovations to Resolve Unsustainable Caribbean Public Debt

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Centre for International Governance Innovation

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About the Author

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At CIGI, Cyrus is looking for solutions to small states' debt challenges and exploring the benefits of the blue economy. His research looks into how small countries in the Pacific, the Caribbean and elsewhere can benefit from greater reliance on the use and reuse of locally available resources, including those from maritime environments.

Based in the United Kingdom, Cyrus is currently managing director at Cetaworld Ltd., an independent consulting practice. He was previously director of the Economic Affairs Division at the Commonwealth Secretariat in London, as well as head of the G-20 Secretariat at the National Treasury of South Africa at the time the country held the rotating presidency of the group. Cyrus also served as an executive director of the International Monetary Fund (IMF) in Washington, DC, representing 21 African countries at the IMF Executive Board. Previously, he was an adviser to the executive director of the World Bank Group.

In addition to the blue economy and domestic resource mobilization, his research has previously focused on diaspora finance and innovative financing for development, as well as on migration issues.

Born in Durban, South Africa, Cyrus holds a Ph.D. in economics and an M.Sc., with distinction, in development economics from the University of London, England; a B.Proc. in law and a B.Com. in business economics and private law from the University of South Africa, Pretoria; and a B.A. (Honours) in economics and politics from the University of Oxford.

About the Global Economy Program

Addressing limitations in the ways nations tackle shared economic challenges, the Global Economy Program at CIGI strives to inform and guide policy debates through world-leading research and sustained stakeholder engagement.

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Through its research, collaboration and publications, the Global Economy Program informs decision makers, fosters dialogue and debate on policy-relevant ideas and strengthens multilateral responses to the most pressing international governance issues.

Acronyms and Abbreviations

CDB	Caribbean Development Bank
CIP	Citizenship by Investment Programme
CPIA	Country Policy and Institutional Assessment
DRF	Debt Reduction Facility
DSAs	debt sustainability assessments
ECLAC	Economic Commission for Latin America and the Caribbean
GNI	gross national income
HIPC	Heavily Indebted Poor Countries
IDA	International Development Association
IFI	international financial institution
IMF	International Monetary Fund
LICs	low-income countries
MDRI	Multilateral Debt Relief Initiative
MICs	middle-income countries
ODA	official development assistance
PPG	public and publicly guaranteed
RDVRP	Regional Disaster Vulnerability Reduction Project
SDGs	Sustainable Development Goals
SSA	Sub-Saharan Africa
SSF	Small States Forum
WDI	World Development Indicators
WEO	World Economic Outlook

Executive Summary

Most of the 13 small states in the Caribbean region have been gripped by a silent debt crisis since 2000, experiencing stagnant growth and near-continuous unsustainable levels of public debt. Despite extensive fiscal adjustment, together with a series of debt restructurings, public debt levels remained unsustainable in 10 countries in 2015.

Based on five standardized measures of debt and debt service sustainability used by the International Monetary Fund (IMF) and the World Bank, most Caribbean small states record highly unsustainable levels across all five metrics, and perform far worse than small states in the Pacific and Sub-Saharan Africa (SSA) and among both low-income countries (LICs) and middle-income countries (MICs).

Projections for future debt sustainability are also bleak. By 2020, debt will remain unsustainable in 11 of 13 Caribbean small states. And by 2030, when the United Nations' 2030 Agenda for Sustainable Development has run its course, the majority of the region's small states will face the same predicament — for some, even in the context of having run continuous, large fiscal surpluses. Among small states, the prevalence of unsustainable debt is also becoming a largely Caribbean problem: in 2020, nearly three-quarters of all small states with unsustainable debt levels will be Caribbean countries.

Taken together, these findings make a compelling special case for resolving unsustainable debt in Caribbean small states. In the absence of a new dynamic, there is a real prospect that, in dealing with unsustainable debt, these countries will have lost the first three decades of the twenty-first century, and foregone opportunities for poverty reduction, transformation and growth.

New initiatives and momentum are needed in these countries, to reduce debt to sustainable levels and to establish more supportive international mechanisms to help maintain debt sustainability once it is achieved. Despite enormous complexity, these are achievable goals. But they require a new strategic approach, including much closer collaboration among highly indebted Caribbean small states, international development partners, including multilateral institutions, and, given the heterogeneity of debt, a menu of innovative financing and policy options. Ten options are proposed in this paper, together with some key actions, as a foundation for developing a new approach to resolving unsustainable Caribbean debt.

Introduction

Recent international attention has focused on the escalating debt levels of a growing number of developing countries, with increasing debt driven by declining commodity prices and by rapidly increasing private and multilateral lending. The scale of debt accumulation has recently led to declarations that, for these countries, a new "developing world debt crisis" has emerged (Jubilee Debt Campaign 2016). In this discourse, analysis has almost exclusively focused on LICs, with particular attention to the challenges of African LICs, a majority of which have received debt relief through the Heavily Indebted Poor Countries (HIPC) initiative and Multilateral Debt Relief Initiative (MDRI) since 1996 (United Nations Conference on Trade and Development 2016). But further removed from international attention are the debt challenges of small states, a majority of which are MICs, and where another more trenchant, longer-term and intractable debt crisis has been taking place. Many small states have accumulated large public debts and debt servicing obligations since 2000, and the challenge has been most acute among Caribbean small states. Described by the IMF as a "silent crisis" (IMF 2013a), most small middle-income Caribbean countries have been gripped by unsustainable debt and debt servicing levels during this period.

While debt accumulation and debt servicing do not themselves pose an intrinsic threat to poverty reduction, growth and development, unsustainably high debt and debt servicing levels do, compelling governments to forego social spending and public investment in economic infrastructure, in turn compromising prospects for future growth. Indeed, the relationship between growth and debt is widely posited in the literature as non-linear. Moderate levels of debt are positively associated with growth, with additional resources from debt used *inter alia* to invest in productive capacity (Khan and Kumar 1997; Deshphande 1997; and Elbadawi, Ndulu and Ndung'u 1997) and to manage the impact of unexpected shocks (Bourne 2010). In contrast, a threshold can be reached — beyond which debt becomes unsustainable — when the assumption of additional debt begins to have a negative impact on growth. Additional debt imposes a marginal tax on investment, with an increasing share of gains to output arising from increased investment accruing to creditors as debt repayment (Sachs 1989; Krugman 1989). The IMF and the World Bank and others have developed several commonly used measures of debt and debt service sustainability. The IMF and the World Bank, for example, suggest a public debt ratio above 60 percent of GDP as one measure of unsustainable debt. Similarly, for the Caribbean region, Kevin Greenidge et al. (2012) suggest that at debt levels lower than 30 percent of GDP, increases in the debt-to-GDP ratio are associated with faster growth, while debt levels above 55 percent of GDP are associated with a negative impact on growth.

Most Caribbean small states have crossed — and indeed far exceeded — the thresholds suggested by both Greenidge et al. and the IMF and World Bank. A recent substantive review of Caribbean public sector debt concluded that current debt levels are fiscally unsustainable and detrimental to development prospects in indebted Caribbean countries, and that the region will not be able to achieve rising standards of living in the presence of existing debt service obligations and debt-induced economic vulnerability (Caribbean Development Bank [CDB] 2013).

For these countries, the transformative promise of the 2030 Agenda for Sustainable Development and the Sustainable Development Goals (SDGs) — as an opportunity to break the cycle of high debt, build resilience, invest in infrastructure and achieve higher levels of growth — will remain a chimera, achievable only through a rapid scaling up of new investment in economic and social infrastructure, and will not be reached without a prolonged reduction in public debt to sustainable levels. Finding ways to break through this chimera at an early stage in the pursuit and implementation of Agenda 2030 will be a crucial task for Caribbean small states and the region, and for their development partners.

The paper is structured as follows. Examining the period 2000–2015, the first part applies IMF-World Bank debt and debt service sustainability measures to review and compare the sustainability of debt and debt servicing among 39 Caribbean, Pacific, SSA and other small states for whom data is available; highlights changes in the composition of small states' debt during this period; and identifies steps taken by Caribbean countries to reduce debt, including fiscal adjustment and debt restructuring operations. The second part presents projections for debt sustainability to 2020 and, where projections are available, to 2030.

Both the review of debt sustainability to 2015 and projections to 2030 suggest that the Caribbean region stands out as having by far the most unsustainable levels of debt and debt servicing, with challenges deepening over the period 2000–2015 and likely to deepen further in the future, notwithstanding fiscal efforts and debt restructuring operations to date. Collectively, these findings also suggest that the problem of unsustainable debt in small states will become increasingly concentrated among Caribbean small states.

New initiatives are needed, and a new dynamic required, to shift toward debt sustainability. The third section identifies a menu of 10 options — including new and innovative financing instruments, policy measures and initiatives already taken by Caribbean and other small states, as well as by regional and multilateral financial institutions, all of which can support the reduction of unsustainable levels of public debt in the Caribbean — and suggests some key steps in developing collective country and international momentum for change.

Debt in Caribbean Small States: Unsustainable and Changing

Some 50 states, or more than one-quarter of the world's countries, are considered small states.[1] They are characterized by wide disparities in structure of production, access to global trade markets and access to sources of development finance on affordable terms, as well as by income and geography. Fifteen are high-income countries, 31 are MICs and four are LICs. Small states are largely concentrated in three regions: the Caribbean (13 countries), the Pacific (11) and SSA (13), with other small states located in Europe, South and East Asia, the Middle East and North Africa (see Annex 1).[2]

This section examines the debt and debt servicing challenges of small states using a set of five measures of debt and debt service, all used by the IMF and the World Bank to measure and compare country-level debt and debt service sustainability

1 There are 50 members of the Small States Forum (SSF), an association of small countries with populations less than 1.5 million. The SSF was launched by the Commonwealth and World Bank in 2000, and is convened on an annual basis by the World Bank.

2 See https://datahelpdesk.worldbank.org/knowledgebase/articles/906519-world-bank-country-and-lending-groups.

and debt sustainability assessments (DSAs). Where data is available, these measures and associated thresholds for sustainability of debt and debt service are applied in the context of small states' public debt and, separately, to small states' external debt. Debt sustainability measures comprise: the ratio of the present value debt-to-GDP; the ratio of the present value of debt to exports; and the ratio of the present value of debt to government revenue. Debt service sustainability measures comprise: debt service in percentage of exports; and debt service in percentage of revenue. The IMF-World Bank measures and thresholds are summarized in Annex 2. Applying these metrics to a sample of 39 small states, the analysis shows that most Caribbean countries — and the region as a whole — consistently rank as the most significantly lacking sustainability in debt and debt service.[3]

Public Debt

Ratio of Public Debt to GDP

Among the sample of 39 small states, 16 countries exhibited public debt-to-GDP ratios greater than 60 percent in 2015 (see Table 1), with public debt sustainability challenges both acute and persistent for Caribbean small states. They face disproportionately large public debt burdens in comparison with other small states, and are now among the most highly indebted developing countries in the world. No fewer than 10 of 16 small states with unsustainable levels of public debt in 2015 were Caribbean countries, with three among these — Jamaica, Barbados and Antigua and Barbuda — exhibiting public debt-to-GDP ratios of more than 100 percent.

Unsustainable debt has also been a long-term challenge in the Caribbean region: five Caribbean small states — Antigua and Barbuda, Belize, Dominica, Jamaica and St. Kitts and Nevis — recorded unsustainable debt levels in each year since 2000 (see Annex 3). Collectively, debt levels in the region exceeded the IMF-World

Table 1: Public Debt-to-GDP Ratios — Highly Indebted Small States

	2005	2010	2015
Jamaica	119.3	142.0	124.3
Cabo Verde	85.3	72.4	119.3
Bhutan	84.5	57.5	115.7
Barbados	46.1	70.2	103.0
Antigua and Barbuda	95.0	90.8	102.1
Grenada	87.3	96.9	92.7
Gambia	136.0	69.6	91.6
St. Lucia	60.2	62.4	83.0
São Tomé and Príncipe	284.3	75.3	82.5
Dominica	82.0	66.8	82.4
Belize	95.9	83.2	76.3
St. Vincent and the Grenadines	65.4	65.4	73.6
Maldives	44.9	60.4	72.9
Seychelles	144.1	81.9	68.1
Bahamas	29.3	43.2	65.7
St. Kitts and Nevis	157.9	159.3	65.5

Data source: World Development Indicators (WDI).
Note: Figures shaded in red denote debt-to-GDP ratios in excess of the IMF-World Bank debt sustainability threshold.

Bank debt sustainability threshold throughout the period 2000–2015 (see Figure 1).[4]

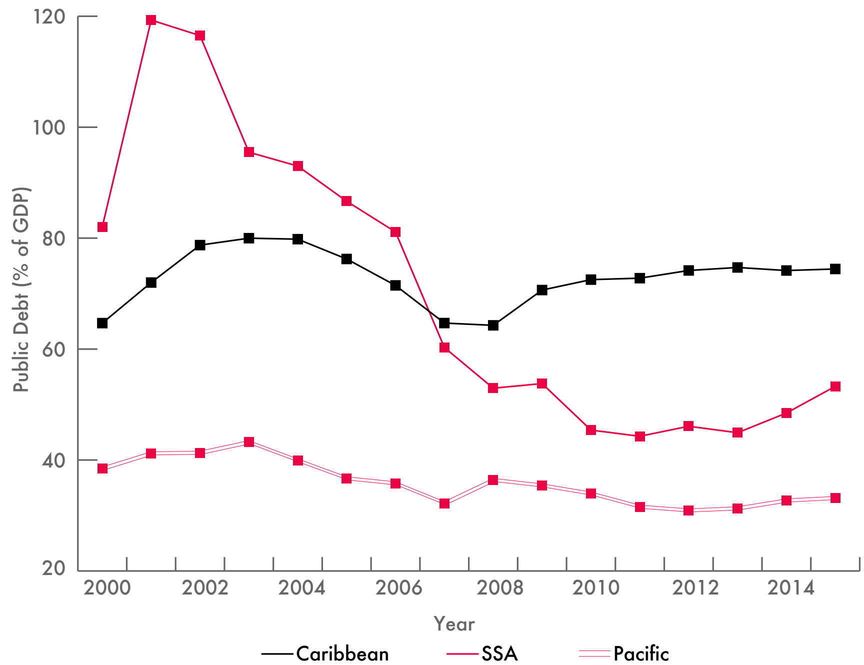
Since 2008, Caribbean states have also consistently carried the highest public debt levels compared with other regions, with these levels increasing and averaging almost 80 percent of GDP by 2014. By contrast, among 13 small states in SSA, public debt levels declined dramatically following their peak of over 120 percent of GDP in 2001, reflecting the impact of the HIPC and MDRI multilateral debt relief initiatives, which benefited four small states in SSA.[5] In 2014, public debt across Caribbean small states was, on average, 160 percent of the average level of small states in SSA. Similarly, since 2000, public

3 This group excludes nine high-income small states in Europe, South and East Asia and the Middle East, as well as three small states for which no data are available from the group of 50 small states. Papua New Guinea, with a population larger than 1.5 million but with economic characteristics closely resembling that of other small states, is included.

4 The sample includes small states in the Caribbean (13), SSA (13) and the Pacific (10) and three other small states (the Maldives, Bhutan and Djibouti).

5 These were Comoros, Gabon, Guinea-Bissau and São Tomé and Príncipe.

Figure 1: Small States — Public Debt (Percentage of GDP), 2000–2014



Data source: WDI.

debt levels in Caribbean small states have been 212 percent of the levels for Pacific small states.

The Caribbean region's public debt challenge has also been compounded by stagnating growth since 2000, exhibiting the lowest rates of real GDP growth since 2000, in comparison with small states in the Pacific and SSA (see Table 2).

Public Debt Service as a Percentage of Government Revenue

Since 2000, debt servicing in several Caribbean countries has also rapidly escalated and become unsustainable, necessitating new borrowing in domestic markets to debt servicing itself, crowding out private sector access to domestic financial markets and reducing fiscal space for counter-cyclical spending. Among seven countries for which data is available, the ratio of public debt servicing to revenue has consistently exceeded 18 percent. In at least five instances, it has exceeded the IMF-World Bank sustainability threshold for this measure of sustainability for countries with weak policy ratings (see Annex 2) and, in most instances, has also exceeded the sustainability threshold (22 percent) for countries with strong policy ratings (see Table 3).

Table 2: Real GDP Growth — Small State Regions

	2000–2008	2009–2012	2013–2016
Caribbean	3.7	0.0	2.1
Pacific	5.0	1.8	2.3
SSA	3.7	3.1	3.7

Data source: IMF (2015b).

External Debt

External Debt Stocks as a Percentage of Gross National Income

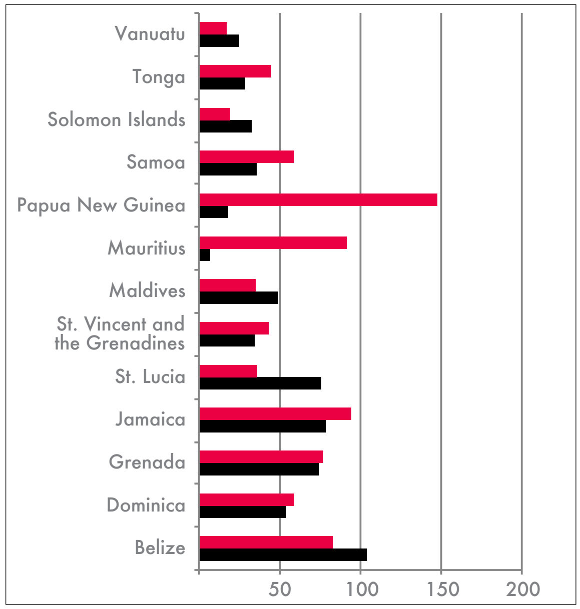
External debt stocks and debt servicing have also increased significantly in several Caribbean and Pacific small states since the global financial crisis, in turn raising solvency and liquidity risks and, for several countries, precipitating high and unsustainable levels of external debt. Between 2008 and 2013, ratios of external debt stock to gross national income (GNI) in six Caribbean countries for which data is available exceeded this measure of IMF-World Bank external debt sustainability for countries with strong policy ratings (a ratio of 50 percent, with Jamaica, Grenada, Dominica

Table 3: Public Debt Service as Percentage of Government Revenue

Country	2011	2012	2013	2014
Belize	36.94	40.35	34.00	22.43
Dominica	12.83	20.00	17.10	21.60
Guyana	8.90	10.3	8.20	7.70
Jamaica	40.74	44.28	32.04	41.56
St. Kitts and Nevis	22.00	57.30	16.00	26.00
St. Lucia	15.72	15.20	11.86	12.35
St. Vincent and the Grenadines	..	23.80	23.60	22.30

Data sources: World Economic Outlook (WEO) data; IMF Article IV Reports.

Figure 2: Small States — External Debt Stocks (Percentage of GNI), 2008 and 2013



Data source: WDI.

and Belize exceeding this threshold) and in three cases exceeded the threshold for countries with weak policy ratings (a lower ratio of 30 percent, with St. Lucia and St. Vincent and the Grenadines exceeding this lower threshold) (see Figure 2).[6]

Between 2000 and 2014, Caribbean external debt levels consistently exceeded those recorded by Pacific small states, LICs and MICs (see Figure 3), with debt levels, on average, more than three times the debt levels of MICs and twice those of LICs and Pacific small states, respectively. Since 2008, following the rapid decline in external debt stocks among SSA small states due to HIPC and MDRI debt relief, Caribbean external debt has exceeded average levels in SSA small states by approximately 47 percent.

External Debt Stocks as a Percentage of Exports

The ratio of external debt stocks, as a percentage of exports of goods, services and primary income, represents a further IMF-World Bank measure of debt vulnerability and solvency risk. Between 2007 and 2012, among 14 small states for which data is available, 10 countries — including six Caribbean small states — experienced increased debt vulnerability based on this measure (see Figure 4). Jamaica, Grenada and Papua New Guinea recorded ratios above the debt sustainability threshold for countries with strong policies (external debt stocks of 200 percent of exports, services and income). In 2012, three other countries — Dominica, Samoa and Tonga — exceeded debt sustainability thresholds applied for countries with medium policies (150 percent), and three others — Belize, Mauritius and Guyana — exceeded the 100 percent threshold established for countries with weak policies. Only four small states — Vanuatu, the Solomon Islands, St. Lucia and the Maldives — achieved external debt levels below the IMF-World Bank's minimum debt sustainability threshold.

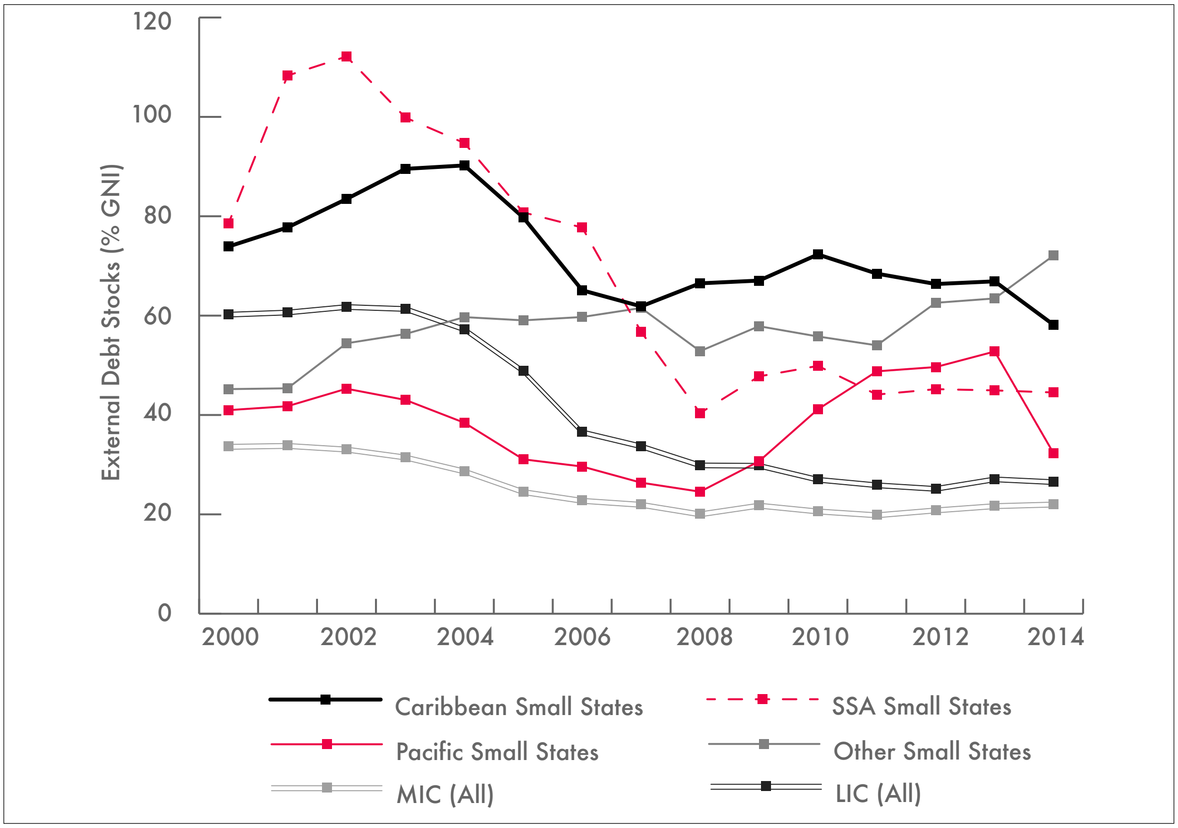
The Caribbean region has again been disproportionately affected, and is the only region in which this measure has increased since 2000. By comparison, both SSA and LIC country groups recorded large declines in external debt vulnerability. Since 2002, countries in the Caribbean region have, on average, consistently exceeded levels recorded by Pacific small states and for the group of all MICs (see Figure 5).

External Debt Service as a Share of Exports

Small states have also experienced significant challenges in servicing external debt. In 2013, among 20 small states for which data is available, seven had external debt service ratios, as a share of exports, of more than 10 percent, including five

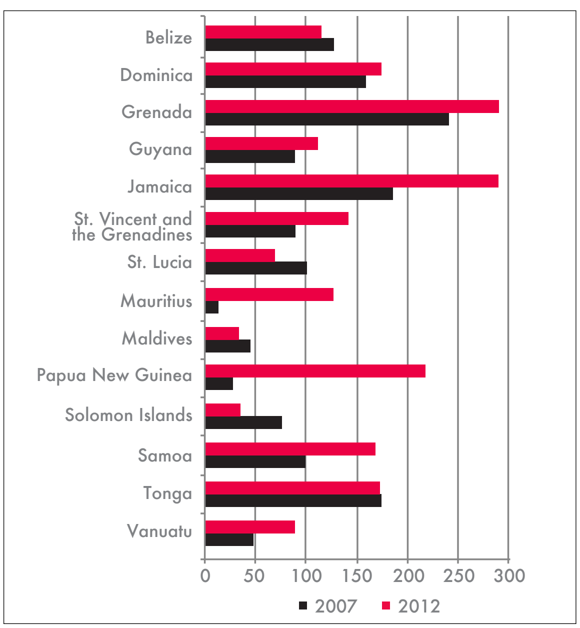
6 Data are for Belize, Dominica, Grenada, Jamaica, St. Lucia and St. Vincent and the Grenadines.

Figure 3: Small States — External Debt Stocks (Percentage of GNI), 2000–2014



Data source: WDI.

Figure 4: External Debt Stocks (Percentage of Exports of Goods, Services and Income), 2007 and 2012

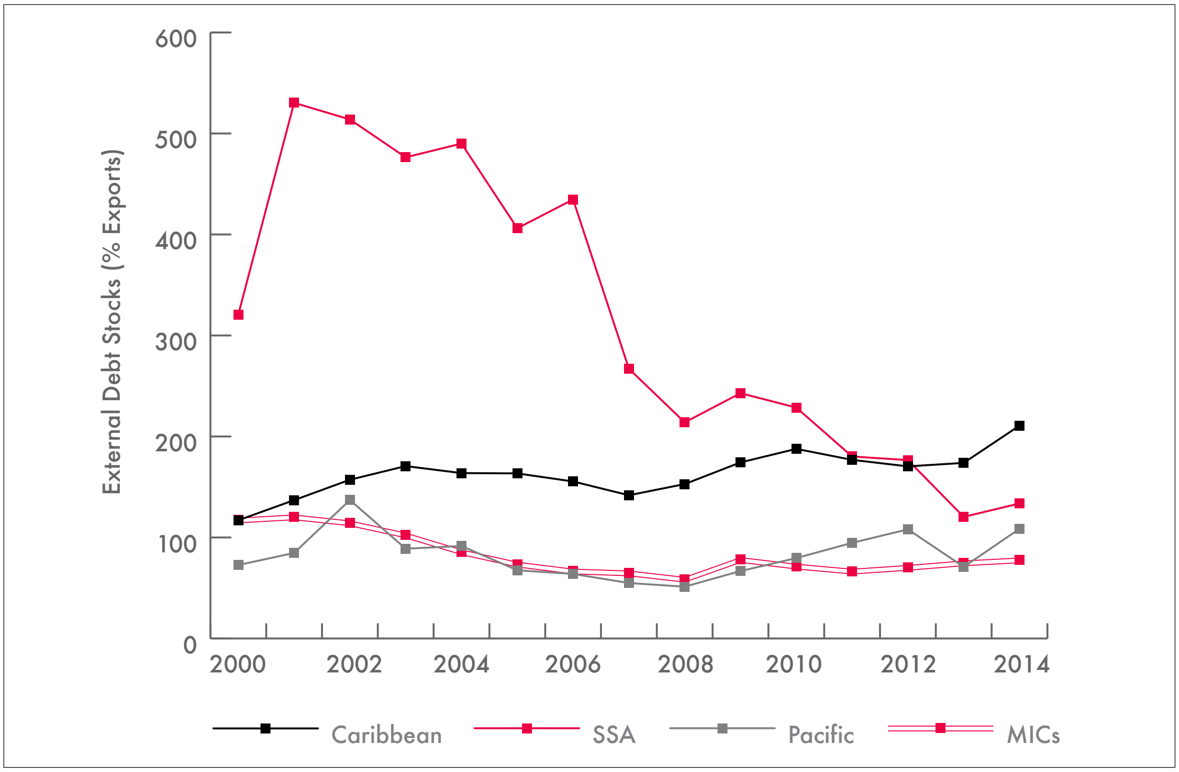


Data source: WDI.

Caribbean small states (see Figure 6). Applying a 15 percent threshold, beyond which the IMF-World Bank Debt Sustainability Framework deems external debt servicing to be unsustainable, most small states maintained sustainable debt service ratios,but three Caribbean small states — Jamaica, Grenada and St. Vincent and the Grenadines — had unsustainable external debt servicing levels.

External debt servicing has been a disproportionately large problem in the Caribbean. The average cost of servicing public and publicly guaranteed (PPG) debt, including debt due to the IMF, as a share of exports, has remained above 10 percent of exports of goods, services and primary income throughout the period from 2000 to 2013 (see Figure 7), contrasting sharply with all other small state regions, as well as with the experience of both MICs and LICs. Since 2000, debt servicing levels have grown among Caribbean small states but have declined among all other small state regions, MICs and LICs,

Figure 5: Small States — External Debt Stocks (Percentage of Exports), 2000–2014



Data source: WDI.

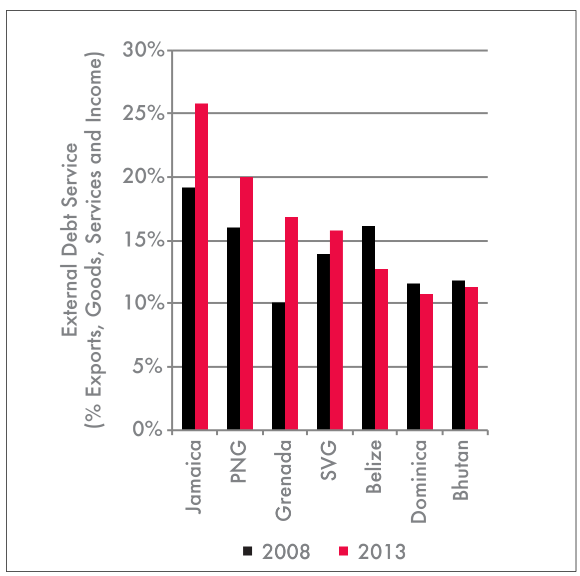
and by 2013 they reached more than double the burden incurred by these country groupings.

The scale of the challenge is also masked by the fact that during the period 2000–2013, 10 Caribbean countries underwent debt restructuring operations, with most occurring in the period 2005–2012, and with most contributing to reducing debt servicing.

A Persistent, Increasingly Caribbean, Challenge

The above trends in public and external debt accumulation and debt servicing since 2000 emphasize that the challenge of small states' debt is largely becoming a Caribbean problem. Understanding the reasons for this can help identify potential responses and solutions to the Caribbean debt overhang.

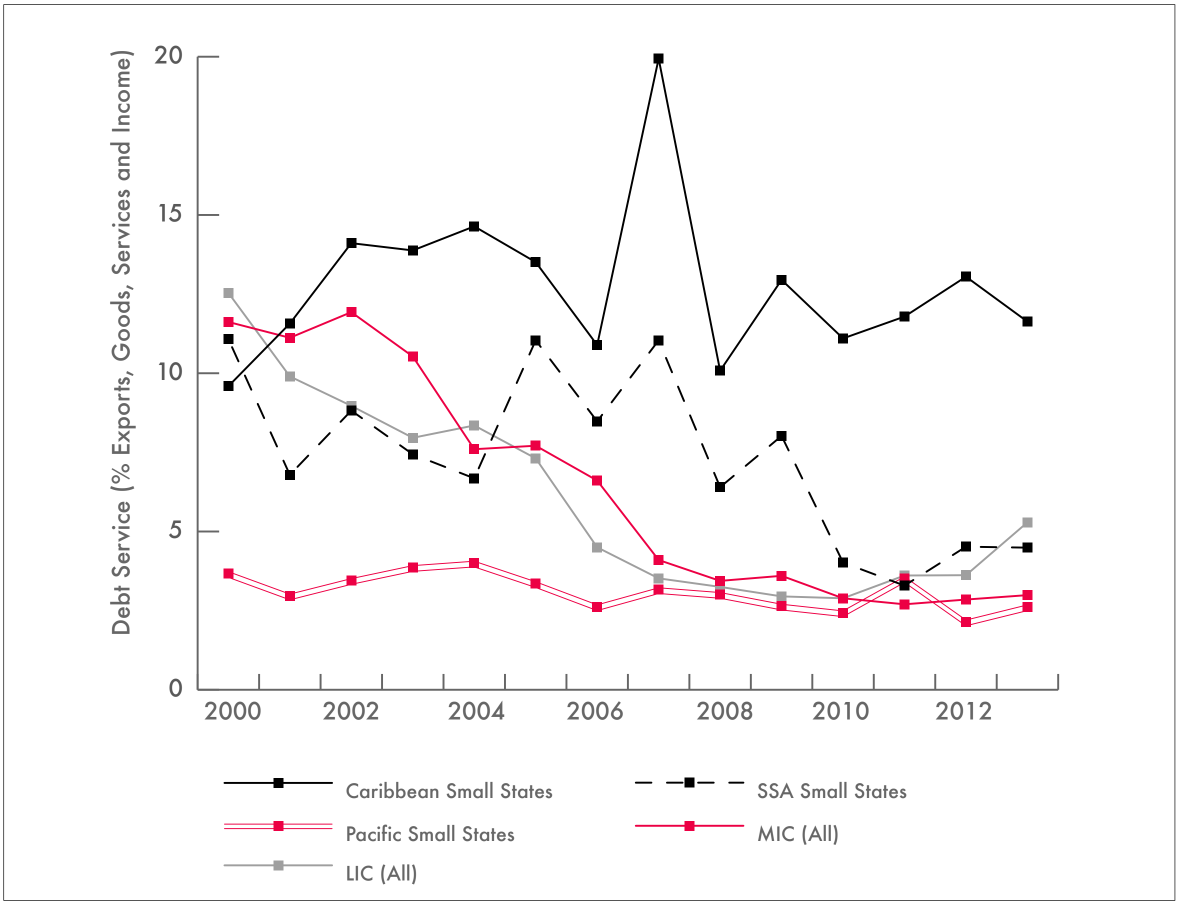
Figure 6: External Debt Service (Percentage of Exports of Goods, Services and Income), 2008 and 2013



Data source: WDI.

Note: PNG = Papua New Guinea; SVG = St. Vincent and the Grenadines.

Figure 7: Debt Service — PPG and IMF Debt (Percentage of Exports, Goods, Services and Income), 2000–2013



Data source: WDI.

Defined as countries with a population of less than 1.5 million, small states suffer from acute vulnerabilities and a lack of resilience due to their size. Diseconomies of scale in the production of goods and services limit diversification and competitiveness, and result in high public spending ratios, compared to larger developing countries. Remoteness and lack of international trade connectivity increase trade costs, further reducing external competitiveness. Small states are also disproportionately prone to the impacts of climate change, weather-related and other natural disasters, and suffer disproportionately large recovery costs when these occur. The collective impact has been enormous, with a recent review of macroeconomic developments in 33 small states — predominantly in the Caribbean, Asia-Pacific and African regions — finding that these factors have contributed to weak growth, higher macroeconomic vulnerability and high debt levels since the 2000s (IMF 2015b).

Since all small states are susceptible to these vulnerabilities, why has the debt overhang in the Caribbean become more stubborn and persistent compared to small states elsewhere? An extensive, region-specific literature suggests that there have been multiple causes of debt accumulation. One set of causes stems from the consequences of debt policy choices, some made early in the millennium, together with the quality of subsequent debt management. These include easy access to both domestic and external resources due to benign inflation and relatively stable political environments, in particular in the early 2000s; public enterprise borrowing and off-balance-sheet spending; the escalating costs of debt servicing; debt revaluations; and the assumption of contingent liabilities by central governments (CDB 2013). A debt disaggregation exercise conducted by the CDB identifies some of the proximate causes of debt, finding that for the seven largest debtor countries in the region, debt accumulation was driven by a combination of fiscal slippage, often due to infrastructure reconstruction following a natural disaster; unfavourable debt dynamics necessitating the assumption of additional debt to service the existing and growing debt overhang; and contingent liabilities assumed by central government. Key lessons include the need for expanded sources of emergency financing to minimize the fiscal impact of natural disasters, strengthened management of countries' debt portfolios and improved contingency risk management.

A second factor has been the changing composition of Caribbean debt. Indeed, in most small states, the composition of debt has changed markedly since 2000. Key influences have included increased access to international capital markets, resulting in an expanding share of external commercial debt in total public debt, and a shift away from access to bilateral and multilateral sources of debt for several small states, brought about by reductions in aid and a hardening of terms in accessing aid and other forms of concessional resources, as aid agencies have shifted away from the provision of grants, to loans. MICs, including several Caribbean small states, have been particularly impacted, precipitating a shift in external debt composition toward commercial debt. Access to both domestic and regional sources of credit has also increased, as small states' domestic financial markets have deepened and as regional financial markets have expanded.

These shifts have presented significant challenges to debt sustainability, in particular among Caribbean small states, by increasing the complexity of public debt management and exposing individual countries to a variety of new risks. With interest rates typically substantially higher than those for multilateral and domestic debt, increased access to external private debt has come at enormous debt servicing cost, exposing many small states to global market volatility, increasing vulnerability to high interest rates and to rollover risk in the event of a sudden cessation of market access. Consequently, the 2008 global crisis severely affected many Caribbean small states that had borrowed in international capital markets in the preceding decade, prompting many countries to refinance newly acquired external debt with domestic borrowing as part of their debt restructuring operations.

There is another set of causes of high and unsustainable debt accumulation in the Caribbean since 2000. While these have often been identified as contributors to Caribbean vulnerability, their impact on debt accumulation may have been underplayed.

First, in comparison with other small states, Caribbean countries have been disproportionately affected by natural disasters, precipitating debt accumulation both for immediate post-disaster response and for longer-term recovery. The region has six of the world's 10 most disaster-prone countries and has experienced over 250 natural disasters in the past 40 years (Rasmussen 2006). Losses from floods and hurricanes have equated almost one percent of GDP per annum since the 1960s, rising over time to 1.3 percent of GDP in the 2000s (IMF 2013a).

Second, and again in comparison with other small states, the region has suffered a disproportionately large impact from the erosion of European Union trade preferences since the early 1990s. The erosion of preferences for banana exports to the European Union alone resulted in a decline in output of between 1.5 to 2 percent and an increase in fiscal deficits of 0.5 percent of GDP among the seven most affected Caribbean small states, while the erosion of sugar preferences is estimated to have had a cumulative decline in Guyana's GDP (Bauer, Cashin and Panth 2008).

Third, the Caribbean region, which has one percent of the world's population, is also considered to be one of the most tourism-dependent regions in the world, attracting three percent of global tourism arrivals and global tourism expenditure (Andrew 2007). Consequently, the region is disproportionately vulnerable to the impact of external shocks on tourism, suffering acute losses in tourism receipts and employment, and the forestalling of a large number of infrastructure projects, following both the terrorist attacks in New York on September 11, 2001, and the 2008 global economic crisis.

Fourth, in contrast to the experience of small states in the Pacific region, which have received large official development assistance (ODA) flows in recent years, allowing debt levels to remain in check for most countries (IMF 2013c), Caribbean small states have experienced a dwindling in traditional donor assistance since the 1990s, with assistance directed increasingly to low-income and post-conflict countries (CDB 2013). This has had a direct consequence for Caribbean small states, driving up debt servicing costs as countries have sought alternate, largely private sources of debt. Relative shifts in concessional funding among small state regions have been stark. For example, the share of concessional debt in total external debt among six Caribbean countries for which data is available declined from 34 percent (66 percent excluding Jamaica) in 1990, to 15 percent (43 percent excluding Jamaica) by 2013. In contrast, the share of concessional debt in total external debt among four Pacific small states for which data is available has increased in the same period, from 75 percent to no less than 80 percent. In the Caribbean region, declining ODA has rapidly increased debt and debt servicing costs. These factors have differentiated Caribbean small states from those in other regions, reducing degrees of freedom in adjusting to external shocks and driving up debt.

Key Caribbean Responses: Prolonged Fiscal Adjustment and Debt Restructuring

Prolonged Fiscal Adjustment

High debt levels, low growth, the escalating costs of servicing both domestic debt and external commercial debt, a hardening of terms for external concessional debt, weak financial markets, limited access to both domestic and external sources of finance, exposure to the economic and financial impacts of natural disasters and limited fiscal space have all forced intensive and prolonged macroeconomic, fiscal and structural adjustment and reforms. In the context of IMF-supported adjustment programs, fiscal adjustment has often centred on containing fiscal expenditure by achieving primary fiscal surpluses large enough to offset negative differences between growing debt and interest, and real exchange rate appreciation and real GDP growth. For many Caribbean small states, it has necessitated running large, continuous annual primary surpluses.

Significant adjustment has been achieved since 2000 (see Table 4). Among 11 highly indebted Caribbean small states, five — Barbados, Belize, Dominica, Jamaica and St. Kitts and Nevis — recorded average primary surpluses over the period 2004–2008. Thereafter, and despite the impact of the 2008 global financial crisis, three countries — Belize, Jamaica and St. Kitts and Nevis — continued to record primary surpluses. Over the period 2004–2015, four Caribbean small states achieved positive average primary balances, and five others recorded modest average primary deficits of between 0.5 percent to 1.7 percent of GDP.

Yet by 2015, and despite over a decade of fiscal adjustment, all 11 countries registered public debt ratios over the 60 percent threshold for debt sustainability. In three cases, public debt-to-GDP ratios increased further, with continuous, high fiscal surpluses proving insufficient to even maintain debt at unsustainable levels. The inability to break the cycle of increasing debt, debt servicing and lack of debt sustainability have been most acute for countries that have successfully achieved average positive primary balances over the period. Jamaica, for example, has run primary surpluses each year since 2004, and has since achieved annual primary surpluses of more than seven percent of GDP on seven occasions.

Debt Restructuring since 2000

Since 2000, eight Caribbean small states have also pursued debt restructuring operations, spanning both domestic and external debt and including Paris Club rescheduling (Dominica, Grenada, Antigua and Barbuda, St. Kitts and Nevis); rescheduling agreements with individual external private creditors (Suriname); a variety of commercial and other debt exchanges; and a debt-for-land swap (St. Kitts and Nevis) (see Table 5). Impacts have varied widely, with debt relief between 10 percent of net present value of debt in Jamaica's debt restructuring in 2010, up to 73 percent in the case of St. Kitts and Nevis (Amo-Yartey and Turner-Jones 2014). However, a reduction in the principal amount of debt was achieved in only a few cases, including the debt exchanges negotiated by Dominica and St. Kitts and Nevis, while Belize, Grenada and Jamaica needed to approach creditors at least twice. Two other countries — Guyana and Haiti — benefited from HIPC and MDRI debt relief.

Table 4: Heavily Indebted Caribbean Small States — Primary Balances and Public Debt Ratios

Country	Average Primary Surpluses (Deficits)				Public Debt-to-GDP (%)
	2004–2008	2008–2012	2012–2015	2004–2015	2015
Antigua and Barbuda	-6.6	-3.4	-1.8	-3.9	102.1
Barbados	1.1	-1.5	-3.4	-1.2	103.0
Belize	2.5	2.6	-0.7	1.5	76.3
Dominica	4.3	-0.3	-1.8	0.7	82.4
Grenada	-1.1	-2.4	-1.3	-1.6	92.7
Guyana	-3.6	-2.1	-3.8	-3.2	48.1
Jamaica	8.8	4.7	7.0	6.8	124.3
St. Kitts and Nevis	2.2	3.4	11.5	5.7	65.5
St. Lucia	-1.7	-1.0	-1.9	-1.5	83.0
St. Vincent and the Grenadines	-1.1	-1.8	-2.2	-1.7	73.6
Bahamas	0.2	-0.6	-1.2	-0.5	65.7

Data source: WEO.
Note: Areas shaded in green indicate average primary surpluses. Areas shaded in red depict public debt-to-GDP ratios above 60 percent representing the IMF-World Bank threshold for debt sustainability.

While aggregate debt levels declined in the short term, the benefits mostly proved short-lived, with the 2008 global economic crisis, in particular, sharply reducing fiscal space, necessitating increased public debt to sustain output and counter the social impacts of the crisis. While debt restructuring provided Caribbean countries interim fiscal space to borrow less and to grow out of their problems, persistently high debt post-restructuring suggests that debt deferral has been insufficient to deal with the Caribbean's debt burden (CDB 2013).

In almost no instance has debt restructuring precipitated either a short- or longer-term shift toward debt sustainability. Among seven non-HIPC Caribbean countries that embarked on restructuring operations in the context of unsustainable public debt levels, all seven maintained unsustainable levels of public debt after restructuring (see Figure 8). For three countries — Antigua and Barbuda, Grenada and St. Vincent and the Grenadines — public debt ratios have increased further in the period since their debt restructuring operations.[7] Debt levels for Belize and Jamaica, while declining modestly, have remained far above the IMF-World Bank sustainability threshold. Individual country experiences have also varied widely, illustrated by the experiences of Antigua and Barbuda, Dominica, Grenada and St. Vincent and the Grenadines.

For example, Antigua and Barbuda's public debt levels have become increasingly unsustainable post restructuring, with public debt-to-GDP levels currently more than 100 percent. Achieving a debt-to-GDP ratio of 60 percent by 2023 will require annual primary surpluses of three percent per year from 2016 throughout the period to 2023. Dominica's public debt declined to near-sustainable levels following its private bilateral

7 Public debt levels in Suriname have also increased since the country's debt restructuring operation in 2008; however, debt levels have remained comfortably below the IMF-World Bank sustainability threshold.

Table 5: Caribbean Debt Restructuring Operations — 2000–Present

Country	Date	Domestic			External			
		Private	Public	Restructuring Details	Private	Bilateral	Multilateral	Restructuring Details
Guyana	2003					✓	✓	HIPC debt relief; MDRI debt relief
Dominica	May 2004	✓			✓	✓		Bilateral rescheduling of Paris Club and non-Paris Club debt, and private debt exchange (domestic and external debt)
Grenada	November 2005; May 2006, 2013	✓		Debt exchange	✓			Commercial debt exchange; Paris Club agreement
Belize	2006, 2013				✓			Commercial debt exchange
St. Vincent and the Grenadines	2006–2008					✓		Italy — bilateral debt relief
Suriname	2008				✓			Individual rescheduling
Haiti	2009					✓	✓	HIPC debt forgiveness; MDRI debt forgiveness
Antigua and Barbuda	2010	✓	✓	Debt exchange	✓	✓		Paris Club rescheduling; non-Paris Club rescheduling
Jamaica	2010, 2013	✓		Debt exchange				
St. Kitts and Nevis	February 2012	✓	✓	Debt exchange; debt-for-land swap		✓		Debt exchange with bondholders and external commercial creditors; agreement with Paris Club

Sources: CDB (2013); Country DSAs, IMF and World Bank; Commonwealth Secretariat (2012).

rescheduling operations and Paris Club relief in 2004, but significant debt accumulation from 2008 effectively erased earlier gains; and the impact of tropical storm Erika in 2015 — the country's worst natural disaster since 1979 — necessitating large rehabilitation and reconstruction expenditure, has recently prompted the government to seek debt relief from bilateral creditors. Several risks to future debt sustainability are largely or completely beyond the government's control, including reductions in grant funding, lower revenues from the country's Economic Citizenship Programme and the occurrence of future natural disasters, with the recent DSA classifying the country as at high risk of debt distress (IMF 2016b).

Public debt remained unsustainable in Grenada, even following restructuring operations in 2005, and progressively increased after the 2008 crisis, peaking in 2013 at almost 108 percent of GDP. Debt levels have subsequently declined, with the country successfully reaching restructuring agreements with creditors representing approximately 64 percent of debt, valued at 34 percent of GDP (IMF 2016c), reducing both external and domestic public debt, generating important cash flow relief and lowering the debt-to-GDP ratio by eight percentage points. Elsewhere, St. Vincent and the Grenadines' renegotiation of bilateral external debt in 2006 temporarily reduced public debt to sustainable levels. But since 2008, total public debt has escalated, rising from 57 to 73 percent of GDP by 2015. Additional debt has been used *inter alia* to fund a new airport and for reconstruction in the aftermath of flooding in 2013 (IMF 2016f). Based on current fiscal adjustment measures, total public debt is expected to peak in 2018 and projected to decline to a still-unsustainable level of 71 percent of GDP by 2030.

Debt restructuring has clearly had a modest impact, and has failed to shift countries with unsustainable debt burdens toward sustainability.

Table 6: Small States — Projected Public Debt to GDP, 2016–2020

Country	2016	2020
Bhutan	122.0	120.3
Maldives	82.8	118.1
Cabo Verde	121.7	114.3
Barbados	105.7	106.6
Jamaica	123.1	93.5
St. Lucia	86.0	89.0
Belize	92.4	88.6
Trinidad and Tobago	62.8	85.9
Dominica	83.1	80.2
São Tomé and Príncipe	91.9	79.5
St. Vincent and the Grenadines	80.3	79.0
Gambia	96.9	74.1
Bahamas	66.9	65.4
Grenada	88.3	64.6
Antigua and Barbuda	95.6	64.1
Guyana	51.9	60.6

Data source: WEO.

Future Projections: High, Unsustainable Debt

Notwithstanding extensive, ongoing macroeconomic adjustment and repeated debt operations since 2000, the IMF's most recent projections indicate that most Caribbean small states will remain at risk of debt distress for several years. Indeed, based on these projections, by 2020 the debt challenges of small states will become a challenge almost exclusively in small Caribbean countries. Of 39 small states,[8] 16 will continue to exhibit unsustainable levels of public debt in 2020, based on the IMF-World Bank threshold for debt sustainability. Among these, no fewer than 11 will be Caribbean small states (see Table 6), comprising the vast majority of the region's 13 small states. Within the region, only Suriname and St. Kitts and Nevis are projected to attain sustainable public debt levels by 2020. By contrast, only three of 14 African small states (Cabo Verde, São Tomé and Príncipe, and the Gambia) will exhibit unsustainable public debt by 2020, while all nine Pacific small states are projected to have comfortably achieved public debt sustainability. Among all other small states, only two — Bhutan and the Maldives — are expected to have unsustainable public debt by 2020.

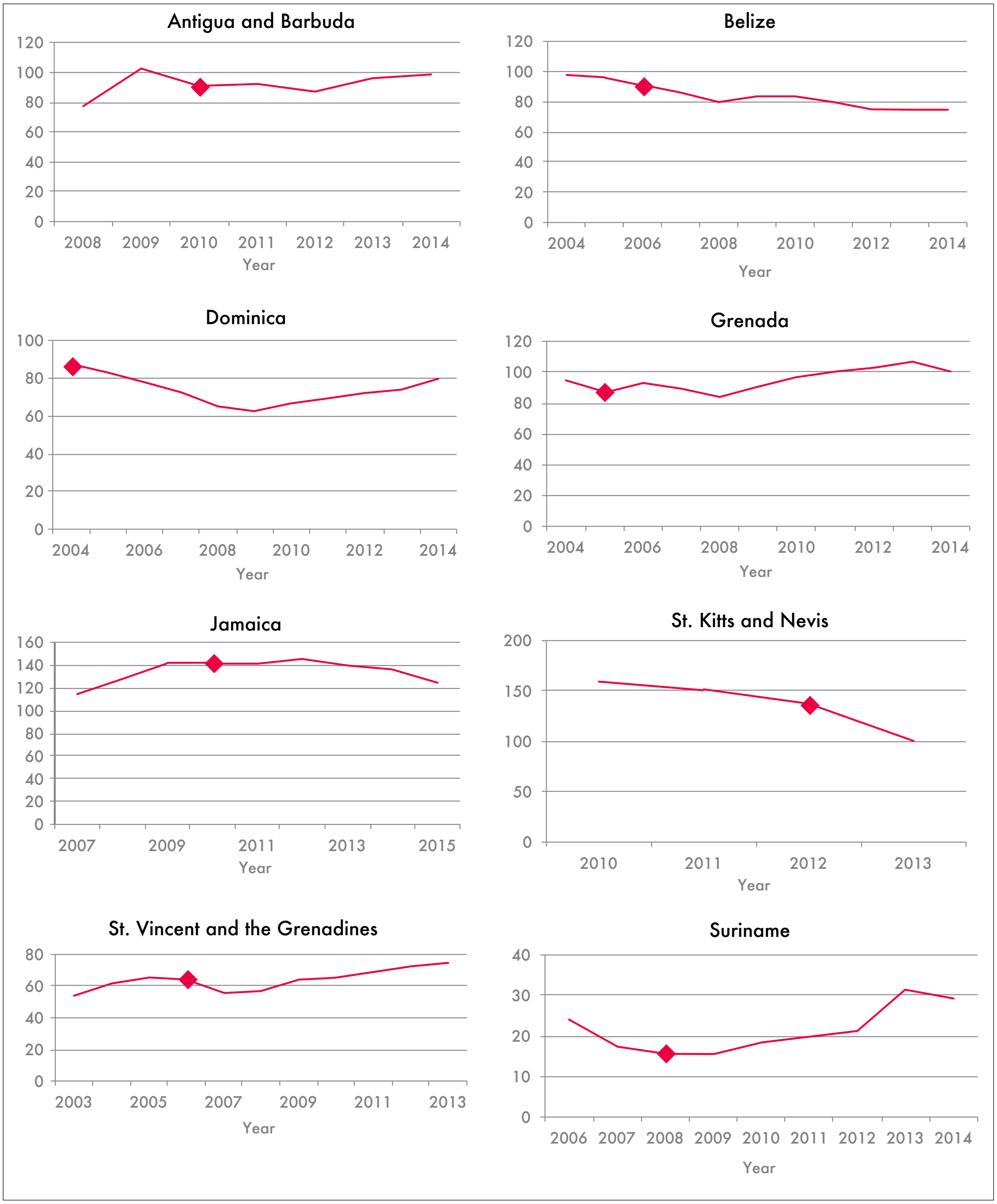
Large Projected Primary Surpluses Ahead

Beyond 2020, Caribbean countries face further, more severe challenges. Current long-term debt projections suggest that in the absence of additional measures, including exceptional fiscal adjustment and foregone expenditure, they will not meet their debt sustainability targets, with several projected to remain with unsustainable levels of public debt throughout the period to 2030, when the 2030 Agenda for Sustainable Development concludes and the SDGs established in 2015 are due to have been achieved.

For example, Jamaica is not expected to achieve a sustainable level of public debt until 2026 and then only by retaining an extraordinarily strong fiscal stance throughout the next decade — a primary surplus of seven percent of GDP will be needed each year until 2026 to achieve this goal

8 For sample composition, see footnote 3.

Figure 8: Public Debt-to-GDP Ratios Before and After Debt Restructuring — Eight Caribbean Small States



Data source: WEO.

Note: Year of debt restructuring operations denoted by red diamond.

(IMF 2016d). Similarly, the most recent DSA for Belize highlights that public debt, which is largely denominated in foreign currency, is vulnerable to exchange rate shocks, and the public debt-to-GDP ratio is highly vulnerable to shocks in growth, interest rates and the primary balance. With a primary surplus of one percent of GDP, it will take approximately 30 years to reduce public debt to sustainable levels, and Belize will need to achieve a primary surplus of 4.5 percent of GDP per annum to achieve debt sustainability by 2030 (IMF 2016a).

St. Lucia will also need to generate progressively larger fiscal surpluses over the period 2016–2030, rising to three percent of GDP by 2030 to achieve its debt-to-GDP target; alternatively — and assuming the country experiences some natural disasters between 2016 and 2030 — it will need to record four successive years of fiscal surplus of 3.33 percent in the short term to achieve the same target by 2030 (IMF 2016e). And Antigua and Barbuda is not projected to achieve public debt sustainability until 2023, and then only in the context of annual fiscal surpluses of three percent, achieved continuously from 2016 to 2023. Even then, debt will remain fragile and highly vulnerable to several types of shocks, including low growth and contingent liabilities (IMF 2015a). In St. Vincent and the Grenadines, based on current fiscal measures, public debt is projected to decline from an expected peak in 2018 to a nevertheless unsustainable level of 71.3 percent in 2030 (IMF 2016f).

These projections, which require the achievement of high primary surpluses, both in absolute terms and compared to countries' baseline fiscal efforts, do not augur well for the Caribbean region. It is unclear whether, despite political will, countries will be able to achieve required primary surpluses of the order projected in recent DSAs: among highly indebted countries, of all sizes but excluding LICs, that achieved large-scale debt reductions over the past 30 years, just over one-half included an element of debt restructuring, suggesting that even with strong political will, adjustment and reform on the scale needed to restore debt sustainability may be infeasible (IMF 2013b), and the magnitude of surpluses required to achieve debt sustainability in Caribbean and other small states appears to be unprecedented, even by the most advanced countries (Commonwealth Secretariat 2015b). Recognition of the sheer scale of the challenge has also prompted calls for a debt relief strategy for MICs, based on the use of resources from the Green Climate Fund, to be used to reduce Caribbean public debt held by multilateral and bilateral lenders (Economic Commission for Latin America and the Caribbean [ECLAC] 2016).

Instead, these projections point to the strong likelihood that in the absence of a new internationally supported initiative to reduce Caribbean public debt, the region will be left behind and, contrary to the intent of the 2030 Agenda for Sustainable Development, will continue to confront unsustainable public debt levels in 2030 — with the very real prospect of having lost three decades of potential growth and opportunity for transformation, while dealing with debt.

Stabilizing and Reducing Caribbean Small States Debt: Toward a New Agenda

A fresh start and new momentum is clearly needed in the Caribbean region to reduce debt levels and debt servicing to sustainable levels. There are three possible pathways. First, a continuation of the status quo, characterized by piecemeal debt restructuring operations conducted periodically by individual highly indebted Caribbean small states and with significant, yet largely uncoordinated, support among development partners. With 11 countries projected to remain with unsustainable public debt levels in 2020 and with the majority expected to record unsustainable debt levels by 2030, notwithstanding achieving continuous extraordinary annual fiscal surpluses throughout the period to 2030, this approach will clearly not achieve a broad-based reduction in public debt levels.

Second, the development and implementation of a fully fledged multilateral fresh-start initiative, similar to the HIPC initiative developed for eligible LICs in the late 1990s. Since its launch in 1996, the initiative has helped more than 30 of the world's poorest LICs to reduce their multilateral debt. By September 2016, debt relief packages had been approved for 36 countries, constituting some US$75 billion in debt service relief. Africa has been the largest beneficiary region, with 30 African countries receiving relief (IMF 2016g). Sustained relief, coupled with an array of multilateral development financing mechanisms and other forms of support, have helped African countries increase social spending, reversing the situation of 20 years ago when debt service exceeded social expenditure. Social expenditures now exceed debt service by a factor of five; however, among HIPC beneficiaries, only five comprised small states, and only two — Guyana and Haiti — are Caribbean countries.

Can a similar arrangement be developed for Caribbean small states? The concept is appealing: they face trenchant structural vulnerabilities and exposure to external shocks of greater magnitude in relation to economic size compared to many HIPC-eligible LICs; the debt problem is increasingly concentrated in the Caribbean region; these countries confront a similar low-growth, high-debt future to that faced by LICs in the late 1990s; and likely costs of debt relief on unsustainable debt would be a small proportion of that for the HIPC initiative. Small states' aggregate debt stock, including unsustainable debt, is estimated to be approximately US$16 billion, or one-tenth of the stock of debt of HIPC-eligible countries (Commonwealth Secretariat 2012). But for several reasons, a similar multilateral relief mechanism for small states may be more difficult and complex to achieve. Unlike HIPC-eligible LICs, the composition of Caribbean small states' debt is far more heterogeneous. It is not concentrated among multilateral creditors, with multilateral debt representing a much smaller share of Caribbean debt, thereby limiting the likely impact of a multilateral initiative alone. Since commercial creditors make up a large proportion of overall Caribbean debt, designing a single cohesive debt relief mechanism will be far more challenging.

Faced with these challenges and with both continuation of the status quo and a HIPC-style multilateral debt initiative for Caribbean small states unlikely to resolve the Caribbean's debt challenges, a third approach — characterized by heterodoxy, innovation, partnership, collective political will and a menu of options — seems more likely to be able to support these countries in achieving debt sustainability and a fresh start.

Resolving Unsustainable Caribbean Debt: Toward a New Agenda

There is enormous yet hitherto largely untapped potential for innovation in dealing with unsustainable Caribbean and other small states' debt. Innovation is emerging through at least four channels: through several proposals from the Commonwealth, a plurilateral association of 54 countries whose membership includes the majority of the world's small states and, in particular, all heavily indebted small states in the Caribbean and Pacific regions (Commonwealth Secretariat 2012; 2015a); from increasing innovation in Caribbean and other small states; through greater innovation among multilateral and regional financial institutions, including the IMF, the World Bank, the CDB and the Inter-American Development Bank; and from several new policy innovations. These can be incorporated into a new debt resolution agenda.

Instrument Innovation

Commonwealth Proposals

Since 2012, several targeted proposals from the Commonwealth have offered opportunities to reduce small states' debt. They accord strong recognition of the vulnerability of small states to exogenous shocks, and emphasize the need to preserve resilience and sustain growth during fiscal adjustment.

Option 1: Multilateral debt swap facility. A first proposal is for a multilateral debt swap facility for small MICs to finance climate change adaptation and mitigation (Commonwealth Secretariat 2015a). Building on successful past practice in the use of debt swaps, it proposes that multilateral debtors write off all or part of their debts, while small states contribute the equivalent value of debt servicing in local currency to a trust fund to finance national climate change initiatives. Eligibility criteria include financial criteria, such as income level and the relative size of multilateral debt, or a criterion measuring environmental vulnerability, such as the World Bank's Environmental Vulnerability Index. Based on 2010 data, the Commonwealth estimates that US$2.4–US$3.2 billion of all Commonwealth small states' multilateral debt could be written off, while annual spending on climate change adaptation and mitigation would increase by US$157.5–US$277.2 million per year. If this option were applied to Caribbean small states, approximately US$1.1 billion of these countries' multilateral debt could be written off. Formally proposed in 2012 (Commonwealth Secretariat 2012), the proposal has been recognized by the United Nations as a promising option to address the twin challenges of unsustainable debt and climate change (Ki-moon and Sharma 2016).

Option 2: Reinstating and reorienting the International Development Association's (IDA's) Commercial Debt Reduction Facility (DRF). This Commonwealth proposal seeks to address the commercial debt challenges of IDA-eligible small states, using the IDA DRF. Established in 1989, the DRF was used to support HIPC-eligible countries to achieve commercial debt buybacks. While there have been no transactions since the mid-1990s, the facility remains available until July 2017. If implemented, the proposal would extinguish US$247 million of these countries' commercial debts at a cost of US$37 million. Using a common advisory team could also help support multiple small states in pursuing this approach. With debt sustainability challenges increasingly concentrated among Caribbean small states, support for this aspect of the proposal could readily be provided by regional financial institutions, or as a collective initiative among heavily indebted Caribbean small states.

Option 3: Opportunities for bilateral debt relief. A third Commonwealth proposal highlights the untapped potential from bilateral debt relief. Noting precedents in 2004 by the United Kingdom, Canada and the Netherlands, through which these countries paid a proportion of the debt servicing of beneficiary countries to the African Development Bank, the World Bank and the IMF, a similar approach could support up to 10 percent of the multilateral debt servicing of eligible Commonwealth countries. Where feasible, similar initiatives could also be developed as collective bilateral arrangements within other plurilateral groupings such as, for example, the Commonwealth and the African, Caribbean and Pacific group of countries. This proposal is particularly amenable to highly indebted Caribbean small states — all are members of the Commonwealth — and a collective initiative could readily identify bilateral Commonwealth (and other) creditors and estimate potential relief based on a range of scenarios.

Innovations by Highly Indebted Caribbean Small States

Caribbean small states have also achieved several successes in reducing the cost of debt, and in debt restructuring, including debt exchanges, debt buybacks, debt swaps and debt relief, including reductions in principal debt, all of which may be readily amenable to emulation among a wider range of countries within the region. For example, since 2002, a regional financing mechanism, the Regional Government Securities Market, has been successfully used to issue medium- and long-dated bonds, as well as shorter-term treasury bills, to secure financing at comparatively low cost. Further scaling up use, deepening the range of available instruments and greater lesson sharing can all help further reduce borrowing costs across the region.

There are also several successful lessons from debt restructuring that can be implemented more widely among small states. For example, Jamaica's 2010 debt exchange emphasized ensuring financial sector stability during restructuring through a specific financial sector support fund to provide liquidity support in the event of negative spillovers from the debt exchange (IMF 2013a). This approach has subsequently been emulated by St. Kitts and Nevis. Similarly, Grenada has recently innovated in using revenues from its Citizenship by Investment Programme (CIP), allocating 40 percent of proceeds from the CIP to a contingency fund for future natural disasters (IMF 2016c). There remains substantial untapped scope to share experience of these innovations, and to find ways to emulate these more widely in future debt restructurings.

Option 4: Embedding deferred debt servicing and other innovations in restructuring agreements. Another recent innovation by Grenada, comprising a new instrument issued to external creditors as part of its debt restructuring, includes a clause allowing the country to elect to defer debt service payments and providing cash flow relief in the event of a qualifying natural disaster — if the loss from an event exceeds US$15 million — with further relief to be considered by its Paris Club creditors. Embedding these debt servicing deferrals and similar innovations can support both policy and macroeconomic stability, helping minimize the financial and fiscal impacts of external shocks and providing policy makers with policy space to manage economic and social recovery after disasters strike. The approach can, and should, be readily emulated by other Caribbean countries. But these approaches still require debtor countries to repay deferred repayments and accrued interest. Consequently, there is scope for these innovations to be further extended, for example, by twinning these with commercial debt reduction (option 2) and other bilateral debt relief (option 3), or by adding these latter options as a further debt relief measure in the event of severe natural disasters.

Option 5: Introducing and expanding the use of debt swaps for conservation and other developmental goals. Other non-Caribbean small states have also successfully innovated, mobilizing private impact investor resources to swap high-interest sovereign debt in exchange for governmental commitments to conservation and climate adaptation and mitigation. For example, in 2016, the Seychelles successfully arranged a US$30 million debt-for-conservation swap, extinguishing public debt in exchange for the government's commitment to enhancing marine conservation and climate adaptation, and establishing a permanent endowment generating sustainable financing for marine conservation and climate adaptation activities. These initiatives have not yet been widely adopted, nor have mechanisms to share knowledge of good practices been developed; therefore, there exists a further untapped opportunity for highly indebted Caribbean small states.

Recent International Financial Institution Innovations

Option 6: Expanding nascent international financial institution (IFI) debt reduction initiatives. Multilateral and regional partners, including the IMF, the World Bank, the IADB and the CDB, have all been active in identifying new and innovative sources of financing to support highly indebted Caribbean countries. Initiatives include, for example, the CDB's support to St. Kitts and Nevis in its 2012 debt exchange, providing a US$12 million partial guarantee for the new discount bonds, enabling a 50 percent reduction in the nominal value of the bond (CDB 2013); the World Bank's use of blended financing to help highly indebted Caribbean and other small states to develop contingency funding to address future natural disasters; the IMF's encouragement to several countries, including St. Kitts and Nevis, to pool accumulated fiscal savings in a contingency fund to address future shocks; and an initiative by the IADB in the aftermath of the global financial crisis to provide liability management support, in the form of an option to convert floating rate obligations to fixed rate obligations.

All have helped curtail debt accumulation and strengthen financial resilience to future shocks. Yet there is much further scope to develop these innovative initiatives, through improved coordination and support among multilateral and regional development partners by developing these facilities and instruments on a region-wide basis, and in transforming these first-generation innovative instruments into a new generation of facilities capable of attracting wider investor participation, including among impact investors.

Option 7: Entrenching debt reduction as an explicit goal in IFI financing initiatives. There is also untapped scope to integrate debt reduction goals more explicitly within existing and emerging innovative financing instruments. For example, Dominica, with a public debt-to-GDP ratio of 83.1 percent in 2016 and a projected debt ratio of 80.2 percent in 2020, currently participates in the World Bank-financed Regional Disaster Vulnerability Reduction Project (RDVRP). The project is an innovative mechanism intended to reduce vulnerability to natural hazards and climate change impacts in Dominica and other countries in the region. But of the US$38 million allocated to the project in Dominica, thus far only US$0.76 million has been disbursed, due to project size, complexity and the need for extensive World Bank staff support because of the low capacity of the country and the weak familiarity with World Bank processes and procedures. (IMF 2016b).

An alternative approach, which can achieve the project objectives while both enhancing domestic institutional capacity and reducing Dominica's external commercial debt, could be for the World Bank to support Dominica in developing a debt swap for disaster vulnerability reduction, utilizing resources from the US$38 million blend facility where feasible, to extinguish high-interest debt in return for government's commitment to establishing and endowing a national disaster reduction facility. This would more explicitly integrate debt reduction objectives in innovative financing initiatives and in blend financing; achieve early repayment of costly debt; help establish national institutional capacity for debt reduction; and develop a domestically managed fund that can serve as a mechanism to attract further resources. Further advantages include developing a template for potential adoption by other highly indebted Caribbean countries participating in the RDVRP.

Policy Innovations for Longer-term Debt Sustainability

Several policy innovations can also help support initiatives designed to reduce unsustainable debt levels among Caribbean and other highly indebted small states in the longer term. Several initiatives proposed by the Commonwealth (Commonwealth Secretariat 2012), seek to emphasize small states' long-term vulnerabilities to shocks and natural disasters, and their access to stable sources of long-term financing for development on affordable terms.

Option 8: Reforming criteria for allocating concessional resources. Aid is allocated by multilateral development banks and several bilateral donors based on two factors: GNI per capita and country performance. The latter is assessed using the World Bank's Country Policy and Institutional Assessment (CPIA) ratings methodology to gauge the quality of a country's present policy and institutional framework — in particular, how conducive country frameworks are to fostering poverty reduction, sustainable growth and the effective use of development assistance. The CPIA ratings are used *inter alia* in the IDA allocation process (World Bank 2011). Including structural vulnerability as a further criterion in determining the allocation of concessional resources, using two objective measures — the Economic Vulnerability Index and the Human Assets Index, both of which are already used by the United Nations in defining the category of "Least Developed Countries" — would better recognize small states' vulnerabilities, look beyond a simplistic income-per-capita filter and provide a plausible, objective benchmark for consideration of eligibility for concessional resources.

There is also further scope to formalize recognition of the long-term vulnerabilities of small states. Since 1985, the World Bank has partially recognized the vulnerability of some small island states to economic shocks and natural disasters, despite having GNI per capita levels well above IDA operational cut-off levels, and has granted partial, or blended, access to 14 small island states. From 2014, these countries were granted access to regular IDA credit terms, offering longer maturities and grace periods, as well as a lower interest rate. But only four Caribbean small states benefit from this exception (Dominica, Grenada, St. Lucia and St. Vincent and the Grenadines), and access remains temporary. Given widespread long-term debt distress in Caribbean small states, two further steps can also be taken: granting all Caribbean small states access to this exceptional window and converting the exceptional dispensation to a permanent one.

Option 9: Developing new counter-cyclical loan facilities for small states. Long-term debt sustainability can also be supported through the development of counter-cyclical loans for use by small states in recognition of their limited ability to recover quickly from exogenous shocks (Commonwealth Secretariat 2012). Already used by the Agence Française de Développement, if developed and implemented at a multilateral level, they can provide for a moratorium on debt servicing for a defined period following a natural disaster, strengthening policy makers' ability to address the immediate shock to output while also helping reduce negotiation costs and saving time. As noted earlier, Grenada has successfully negotiated similar arrangements in recent debt restructuring agreements. However, a standardized facility, developed and implemented by multilateral and regional development banks and modelled on the above principles, could also serve a wider constituency of small states.

Option 10: Establishing a regional debt restructuring unit. There is also substantial untapped potential to formalize collaboration among Caribbean highly indebted small states in sharing information, experience and lessons learned in debt management, restructuring, negotiation processes, strategies and tactics, as well as in successes and challenges in debt innovation. There may also be scope to shift from national toward collective negotiation of selected components of Caribbean small states' debt, *inter alia* including bilateral official debt. Achieving this will require more institutionalized forms of intra-Caribbean collaboration that go beyond informal information sharing, and that proactively identify and secure the critical human resources and institutional capacity needed to address the region's long-term debt challenges. Establishing an institutional mechanism, such as a regional debt restructuring unit, supported by regional and multilateral partners, could offer such an opportunity.

Menu-of-Options Approach: Advantages and Further Challenges

A menu-of-options approach offers several advantages. It emphasizes opportunities for debt resolution through innovation and astute, developmentally focused financial engineering. It introduces a new dynamic to what has otherwise become a stagnant, cyclic discourse, characterized by insistence on enhanced fiscal adjustment, strengthened debt management and structural reform in the quest for ever-elusive growth and even more elusive restoration of debt sustainability. It provides a diversified set of options to help both creditors and highly indebted Caribbean small states to snap a nearly two-decade cycle of low growth, high debt and continuous yet seemingly inadequate adjustment. It offers opportunities for creditor and debtor country priorities to be more clearly identified, allowing for both policy effort and creditor political will to be honed to address specific challenges in and specific components of a country's debt overhang. The approach may also contribute to addressing another challenge these countries face in restoring debt sustainability — that unlike HIPC countries, Caribbean debt is heterogeneous and widely diversified, on a country-by-country basis, across multilateral, bilateral and private creditors and across both domestic and foreign-currency-denominated debt. And it provides renewed opportunity for more effective sharing of country experience in innovations to reduce debt.

The menu-of-options approach also acts in lieu of a single HIPC-style multilateral debt resolution mechanism, instead straddling instruments and policy innovations that target public, private, domestic and external debt. Representing, as it does, a more complex and diffused approach to debt resolution, it will consequently require careful strategic debt and debt management choices and a country-by-country approach, with options selected on the basis of countries' current debt profiles and policy makers' objectives for the composition of and balance among domestic, external, public and private debt. For example, several options within the above menu carry implicit trade-offs. Some can be expected to precipitate a shift in debt composition, for example, multilateral debt swaps and debt swaps for conservation and other developmental goals. Both are likely to increase the relative share of both private and domestic debt, as private creditors finance climate adaptation initiatives and as debtor countries establish trust funds and other long-term budget commitments in support of this goal. Consequently, these may be suitable for countries with relatively low levels of domestic and private debt, but counterproductive for countries with relatively modest multilateral debt and high levels of private debt.

Almost two decades of structural reform, fiscal adjustment and debt restructuring have shown that there is no simple solution, nor any panacea for Caribbean debt resolution. And absent ongoing fiscal and structural reform and strengthened debt management, the menu-of-options approach will not be able to resolve the Caribbean debt overhang. But strategically applied, it can serve to help disaggregate a seemingly hopeless debt overhang, diffusing the task into a less daunting set of challenges.

Key Actions

Developing momentum for action on a concerted multi-country and region-wide basis will also require some key actions and a catalyst. Key steps include targeted further analysis of the scale of debt overhang in highly indebted Caribbean small states; clearer estimates of the required primary balances both to sustain debt at current levels and to achieve region-wide debt sustainability by 2030 among all Caribbean small states; identification of the most useful options for debt innovation on a country-specific basis; estimates of the likely debt relief and restructuring costs associated with each option, also by country; and steps to improve data on debt and debt sustainability levels. A consultative conference on achieving Caribbean public debt sustainability — drawing together Caribbean small states' policy makers; regional, bilateral and multilateral development partners; and international debt experts — could serve as a useful catalyst for this process.

Conclusion

Caribbean small states have experienced unsustainably high levels of public debt for most of the period since 2000, forcing disproportionately large fiscal adjustment and postponing growth, public investment and social expenditure to achieve debt sustainability. Among small states, unsustainable public debt has also increasingly become a Caribbean problem. But extraordinary ongoing fiscal and macroeconomic adjustment alone cannot return debt to sustainable levels. Without a new dynamic, the silent crisis of unsustainable Caribbean debt will prevail throughout much of the period to 2030, and the region will forfeit three decades of opportunity for poverty reduction, higher growth and transformation offered by both the MDG and SDG frameworks and defy the injunction embedded in the 2030 Agenda for Sustainable Development to leave no one behind.

This future is avoidable. Caribbean public debt levels can be systematically reduced to sustainable levels. Doing so requires a new agenda pursued collectively by Caribbean governments and regional, bilateral and multilateral partners, driven by innovation and greater sharing of good practices in debt restructuring, and using a menu-of-options approach that recognizes the complexity and heterogeneous nature of Caribbean small states' debt. Early steps, including a consultative conference to plan for a new pathway out of unsustainable public debt could catalyze this process.

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Annexes

Annex 1: Small States by Region, Income Category, Access to Concessional Resources and HIPC Eligibility

13 Caribbean Small States	High Income	UMIC	LMIC	LIC	IBRD	Blend	IDA	HIPC
Antigua and Barbuda	✓				✓			
Bahamas	✓							
Barbados	✓							
Belize		✓			✓			
Dominica		✓				✓		
Grenada		✓				✓		
Guyana		✓					✓	✓
Jamaica		✓			✓			
St. Kitts and Nevis	✓				✓			
St. Lucia		✓				✓		
St. Vincent and the Grenadines		✓				✓		
Suriname		✓			✓			
Trinidad and Tobago	✓				✓			
Totals	5	8	0	0	6	4	1	1
13 Sub-Saharan African Small States	**High Income**	**UMIC**	**LMIC**	**LIC**	**IBRD**	**Blend**	**IDA**	**HIPC**
Botswana			✓		✓			
Cabo Verde			✓			✓		
Comoros				✓			✓	✓
Equatorial Guinea		✓			✓			
Gabon		✓			✓			✓
Gambia				✓			✓	
Guinea-Bissau				✓			✓	✓
Lesotho				✓			✓	
Mauritius		✓			✓			
Namibia		✓			✓			
São Tomé and Príncipe			✓				✓	✓
Seychelles	✓				✓			
Swaziland			✓		✓			
Totals	1	4	4	4	7	1	5	4
11 Pacific Island Small States	**High Income**	**UMIC**	**LMIC**	**LIC**	**IBRD**	**Blend**	**IDA**	**HIPC**
Fiji		✓			✓			
Kiribati			✓				✓	
Marshall Islands		✓					✓	
Micronesia			✓				✓	
Nauru	✓				✓			
Palau		✓			✓			
Samoa			✓				✓	
Solomon Islands			✓				✓	
Tonga			✓				✓	
Tuvalu		✓					✓	
Vanuatu			✓				✓	

13 Other Small States	High Income	UMIC	LMIC	LIC	IBRD	Blend	IDA	HIPC	Middle East & North Africa	South Asia	East Asia	Europe
Bahrain	✓											
Bhutan			✓				✓			✓		
Brunei Darussalam	✓										✓	
Cyprus	✓											✓
Djibouti			✓				✓		✓			
Estonia	✓											✓
Iceland	✓											✓
Maldives		✓					✓			✓		
Malta	✓											✓
Montenegro		✓			✓							✓
Qatar	✓											
San Marino	✓											✓
Timor-Leste			✓			✓					✓	
Totals	8	2	3	0	1	1	3	0	1	2	2	6

Data source: https://datahelpdesk.worldbank.org/knowledgebase/articles/906519-world-bank-country-and-lending-groups.
Notes: UMIC = upper middle income country; LMIC = lower middle income country; IBRD = International Bank for Reconstruction and Development.

Annex 2: IMF and World Bank Debt Sustainability Thresholds

	Present Value of Debt in Percent of			Debt Service in Percent of	
	Exports	GDP	Revenue	Exports	Revenue
Weak Policy	100	30	200	15	18
Medium Policy	150	40	250	20	20
Strong Policy	200	50	300	25	22

Source: IMF (2016h).

Annex 3: Caribbean Small States – Public Debt to GDP (Percentage), 2005–2015

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Antigua and Barbuda	110.84	122.03	128.17	127.52	122.99	94.99	90.87	79.20	77.27	102.46	90.78	92.43	87.15	95.50	98.24	102.09
Bahamas	24.48	23.59	24.81	26.60	27.60	29.30	29.55	29.98	32.35	38.40	43.24	45.00	48.45	56.27	60.89	65.69
Barbados	39.87	46.19	47.33	47.17	47.65	46.07	48.43	51.42	53.88	63.05	70.22	76.15	84.21	94.74	98.37	103.01
Belize	n/a	82.38	87.64	100.35	97.72	95.89	90.63	85.98	79.75	83.66	83.21	79.39	74.98	75.22	75.33	76.26
Dominica	68.86	98.51	97.88	94.92	86.16	82.01	77.36	71.77	64.36	62.51	66.80	69.72	72.56	74.74	81.12	82.42
Grenada	41.63	44.61	79.09	79.56	94.69	87.31	92.92	89.06	83.91	91.09	96.94	100.69	103.34	106.80	100.83	92.66
Guyana	120.19	129.66	133.75	121.25	118.64	116.08	94.16	59.89	61.65	64.81	65.30	65.16	62.48	56.83	50.85	48.82
Haiti	55.25	49.51	54.28	61.97	49.90	47.16	39.11	34.51	38.01	27.78	17.34	11.81	16.35	21.46	26.50	30.44
Jamaica	91.81	108.01	118.40	123.10	119.94	119.26	117.12	114.48	127.02	141.94	142.04	140.50	145.33	139.68	135.62	124.35
St.Kitts and Nevis	96.80	104.76	119.78	142.64	154.89	157.94	143.78	135.00	131.93	144.25	159.31	151.65	137.40	100.41	80.21	65.46
St. Lucia	39.09	45.70	57.60	54.18	58.40	60.18	56.10	55.40	55.84	59.35	62.38	66.85	73.74	78.58	79.68	82.98
St. Vincent and the Grenadines	58.94	56.52	56.46	53.91	62.02	65.45	64.13	55.52	56.74	63.57	65.45	68.77	72.02	74.69	80.58	73.59
Suriname	38.27	39.83	38.12	33.51	31.57	28.84	23.97	17.38	15.64	15.55	18.47	19.94	21.39	31.43	29.16	43.32

Data source: WDI.
Note: Areas shaded in red depict public debt-to-GDP ratios above 60 percent representing the IMF-World Bank threshold for debt sustainability.

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