GOVERNMENT OF BARBADOS

Fiscal Risk Statement

2024

MARCH 18, 2024

MINISTRY OF FINANCE, ECONOMIC AFFAIRS AND INVESTMENT

Background

Legislative Requirement for Fiscal Risk Reporting

Fiscal risks are factors that may cause fiscal outcomes to deviate from expectations or forecasts[1]. Key macro-fiscal outcomes such as real and nominal gross domestic product (GDP) growth, inflation, interest rates, revenues, expenditure, the fiscal balance and debt to GDP can deviate from projections dependent on both the fiscal impact of the risk and its likelihood of realization. The Government of Barbados acknowledges that fiscal risks can undermine fiscal sustainability. The legislative framework for public financial management in Barbados recognizes that fiscal risks can threaten macro-economic sustainability.

Barbados' PFM Act 2019 requires a Fiscal Risk Statement (FRS). The FRS is one of the main contents of the Fiscal Framework set out in the Third Schedule of the PFM Act 2019 (2(f)). The FRS should include:

(i) contingent liabilities;
(ii) any commitments not included in the fiscal forecasts; and
(iii) all other circumstances which may have a material effect on the fiscal and economic forecasts and which have not already been incorporated into the fiscal forecasts and such fiscal risks shall be quantified where practicable.

The PFM Act 2019 provides a governance framework for fiscal risks.

- Part II – S.5(1)(b), where prudent management of fiscal risks is a principle element of fiscal responsibility;
- Part III – S.11(1)(b), where the Minister responsible for Finance is responsible for, among other things, managing the fiscal performance, fiscal risks and report on the financial position of the Government as a whole
- Part III – S.12(1)(n), where the Director of Finance assists the Minister by monitoring and managing the fiscal risks of the Government
- Part IX – S.94(4), where the Cabinet is required to consider, among other things, the risks, including the fiscal costs to the Government over the long term and present a report prior to establishing a new State-Owned Enterprise (SOE) or Commercial State-Owned Enterprise (CSOE)
- Part IX – S.97(2)(g&h), where the Board of Directors of a SOE or CSOE, is responsible for, among other things, "overseeing the management of the entity including overseeing the management for risks"; and "ensuring the entity has adequate corporate governance arrangements including for the management of risks", respectively

The PFM Act 2019 placed particular emphasis on the state-owned enterprises (SOEs) as a source of fiscal risks. Provisions have been implemented for a more comprehensive assessment of the risk SOEs pose

[1] International Monetary fund. 2016. Analysing and Managing Fiscal Risks Best Practices; IMF Policy Paper; May 4, 2016.

to public finances, with the incorporation of a mandated risk statement to be completed as part of the entities' reporting requirements. The recent update of the Barbados Economic Recovery and Transformation plan[2] (Barbados' short- and medium-term economic strategy) reemphasizes the need for further public finance management reform, inclusive of an extension of fiscal risk analysis beyond those presented by public entities.

A widening of the coverage of fiscal risk analysis has emerged since the pandemic. The COVID-19 pandemic has had a debilitating impact on the domestic economy and fiscal performance. The increasing occurrence of climatic events and the requisite fiscal response to these fiscal risks have also created greater impetus for fiscal risk management. The cumulative impact of both the pandemic and climatic events derailed short term initiatives with further implications for medium term targets such as the reduction in debt to GDP.

The FRS achieves two objectives: legal compliance and fiscal reporting. This first FRS not only complies with the PFM Act 2019 but also presents information on macro-economic risks, contingent liabilities, environmental risks and other fiscal risks. The intent is to achieve greater coverage and comprehensiveness in the identification and quantification of fiscal risks as the Government improves its capacity for fiscal risk management.

Scope of the FRS

This statement has two main priorities. The first is to present the framework for identifying analysing, monitoring and publishing fiscal risks. The FRS uses the Fiscal Risk Assessment Tool (FRAT), a segment of the IMF's fiscal risk toolkit, to deliver an initial assessment of exposure to various sources of fiscal risk. The tool provides a starting point for risk analysis and allows for identification, quantification and prioritization of the fiscal risk exposure. The second is to: identify and quantify short, medium- and long-term indicators that may have an impact on the fiscal outlook. It is expected, that mitigative actions will be undertaken to minimise the impact of these risks on the fiscal performance of government.

[2] Barbados Economic Recovery and Transformation (BERT). 2022

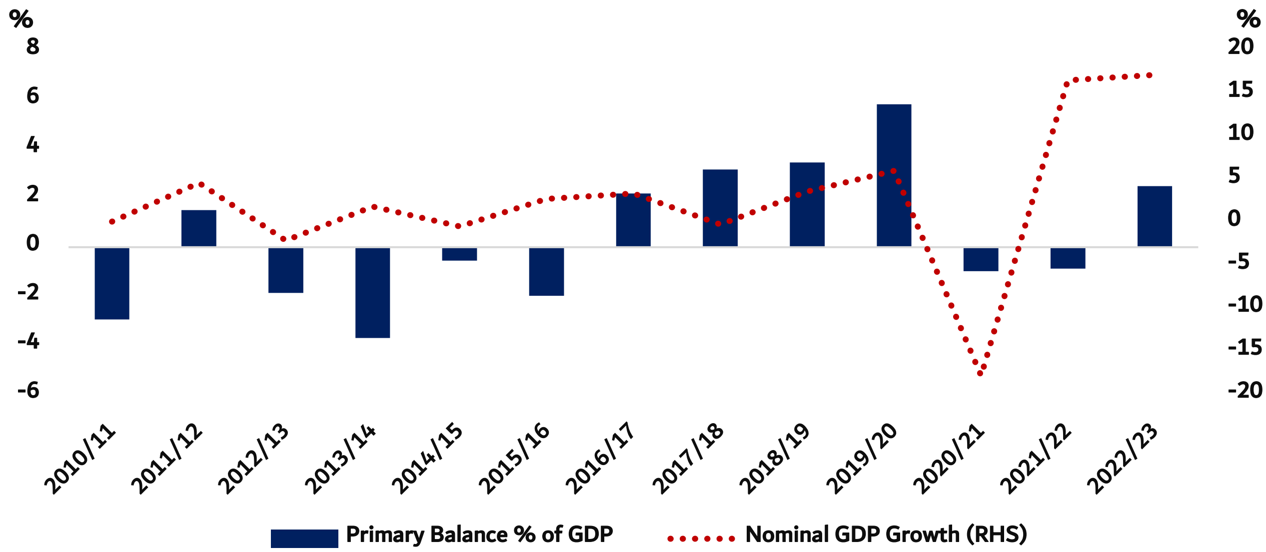
Table 1: Overview of Risks

Type of Risk	Description	Source of Risk
Macroeconomic Risk	Volatility in macroeconomic indicators can cause deviations in fiscal outputs relative to initial forecasts	▪ Reduced economic growth ▪ Increased interest rates
Contingent Liabilities	Possible future claims that a government agrees to settle if some unexpected event occurs. These represent unplanned fiscal costs that if realized can worsen government's short, medium- and long-term fiscal position	▪ Government Guarantees ▪ State Owned Enterprise Financial Performance
Environmental Risk	Realization of external environmental events (climatic, technological or health) that can impair fiscal outcomes due to its inherent uncertainty	▪ Natural Disasters

Macroeconomic Risks

Despite Barbados' strong economic performance following the onset of the COVID-19 pandemic, adverse global developments could potentially impact the country's growth outlook. Barbados recorded two consecutive years of growth in 2022 and 2023 after the onset of the COVID-19 pandemic, primarily driven by increased growth across all sectors. These developments, coupled with the strategic allocation of spending, led to the Government meeting its primary balance targets set under the BERT-2022 IMF-supported programme in FY2022/23 and FY2023/24, with primary surpluses averaging approximately $375 million over the periods. Although, the economy is projected to register continued growth during 2024, several factors could derail the outlook. Slower than expected global economic activity, tighter financial conditions in developed nations such as the US, and heightened geopolitical tensions are likely to dampen growth projections by reducing travel demand. Consequently, these developments could potentially erode the tax base for both direct and indirect taxes, leading to an expansion in the fiscal deficit and a reduction in the primary balance. While international inflationary pressures eased during 2023, potential price hikes resulting from an extended backlog of cargo in the Panama Canal, Red Sea conflicts, and escalation of the Russia-Ukraine War could lead to higher priced goods and services in the public sector. Additionally, increases in interest expenses on foreign variable-rate debt due to monetary policy tightening in lending countries could also worsen the fiscal projections.

Figure 1: GDP and Fiscal Performance



Source: Ministry of Finance, Barbados Statistical Service and Central Bank of Barbados

Macro Fiscal Assumptions

The Parliamentary Draft Estimates of revenue and expenditure for FY2024/25 were prepared in line with the baseline economic assumptions for the financial year and into the medium term. The fiscal projections are mainly underpinned by estimates for economic activity, prices, and debt service costs for both domestic and external debt. Any deviations in the actual performance of these key indicators may result in variations in the forecasted outcomes for revenue and expenditure.

Scenario Analysis

Baseline

In FY2024/25, real GDP growth is expected to be approximately 3.8 percent, primarily influenced by the continued pick-up in tourism activity. The higher inflow of tourists is expected to be driven by increased airlift capacity, intensified marketing of cultural events by the Barbados Tourism Marketing Inc., increased cruise activity and Barbados' hosting of the 2024 Cricket World Cup. The anticipated rise in tourism activity is expected to benefit auxiliary sectors such as manufacturing, wholesale, and retail as well as business & other services. Moreover, construction activity is expected to be buoyed by public sector projects along with several hospitality projects slated for the forecast period. During the period, the economic growth trajectory is anticipated to be the main driver of the revenue and expenditure outturn.

Scenario 1: Positive Outlook

The positive outlook considers a rise in economic activity in FY2024/25, influenced by a 10 percent increase in tourist arrivals over the period compared to the baseline projections. The 10 percent increase in tourism activity causes the growth in nominal GDP to increase from the baseline projection of 7.1 percent to 7.4 percent

(Figure 2). In FY2025/26 the growth rate falls below the baseline, as nominal GDP grows from a higher base. Thereafter, the growth trajectory stabilizes, reverting to baseline nominal GDP growth by FY2026/27. The increase in economic activity leads to a $14 million expansion in revenues within FY2024/25, which improves the FY2024/25 primary balance from the baseline estimate of 4 percent to 4.1 percent. The higher level of tourism activity also results in an improved fiscal outturn over the medium-term (Figure 3).

Scenario 2: Negative Outlook

The negative outlook assumes a 10 percent fall in tourist arrivals in FY2024/25. As a result, the growth in nominal GDP falls below baseline projections by 0.32 percentage points and ends FY2024/25 at 6.7 percent (Figure 2). In FY2025/26 nominal GDP growth exceeds the baseline, driven by the strong economic recovery subsequent to the falloff which then stabilises in the medium term. The subsequent impact on total revenue is shown in Figure 3, with a $14 million drop in revenue in FY2024/25 which moderates in the medium term.

Figure 2: Nominal GDP Growth Trajectory

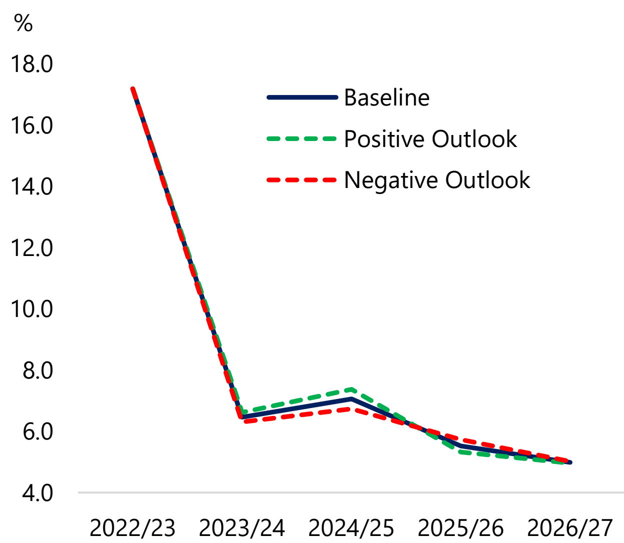
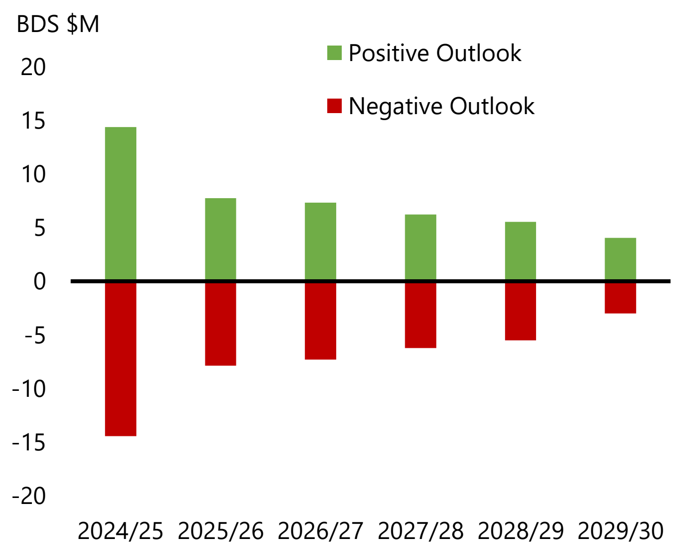


Figure 3: Total Revenue Deviation from Baseline



Source: Ministry of Finance, Barbados Statistical Service and Central Bank of Barbados

Contingent Liabilities

Contingent Liabilities denote possible future claims that a government agrees, or is required to settle if some unexpected event occurs. If these amounts cannot be reasonably estimated they represent potential fiscal costs that if realized, can worsen government's short, medium- and long-term fiscal position. Risks related to contingent liabilities are often presented in the form of government guarantees and in SOE financial performance as these can incur significant costs that are ultimately borne by government through increased subventions.

Government Guarantees

The Government has a small portfolio of guaranteed debt for which the issuing entities can primarily adequately cover their own debt service costs. During 2023/24 Central Government continued to settle one SOE's debt obligations. The outstanding loan amount is small and the loan matures in the next quarter. The exposure to government from guarantees is limited and not considered a significant fiscal risk.

Table 2: Government Guarantees

Organisation	Amount of Loan $BDS M	Balance Outstanding $BDS M	Maturity Date
Barbados Investment and Development Corporation	$31.08	$23.31	1-Oct-29
Caves of Barbados Limited	$33.73	$0.71	1-Jan-24
Caves of Barbados Limited	$26.21	$0.50	1-Jan-24
University of the West Indies	$3.37	$0.97	1-Dec-33
University of the West Indies	$7.00	$0.51	1-Oct-24
University of the West Indies- Mona	$1.54	$0.28	1-Oct-33
University of the West Indies- Mona	$5.50	$1.49	1-Jan-27
Total	$108.44	$27.77	

Source: Ministry of Finance, Debt Unit

There has been an internal commitment of the Government of Barbados to limit guarantees on domestically financed debt. Any request for a guarantee is subject to a comprehensive assessment, including the entity's capacity to repay. In accordance with the Public Finance Management Act any guarantee must be approved, in advance, by Parliament.

Financial Performance of State-Owned Enterprises (SOEs)

Heat Map indicators which detail performance ratios of state-owned entities, suggest that public enterprise liquidity, solvency and profitability point to significant risk to government at least over the current and possibly for the upcoming financial year[3]. Weak revenue growth for most commercial enterprises and a high reliance on government subventions to meet operating expenses have meant consolidated net losses of commercial public enterprises before subventions. A number of SOEs have

[3] The Risk Analysis Framework provides an analysis, at the aggregate level, by specific category and at the individual level, for twenty-eight (28) entities. It comprises two Heat Map Dashboards (**red** - high risk, **yellow** – medium risk, **green** – low risk and grey – no information) and four corresponding 6-panel Risk Analysis Charts

been deemed insolvent as current assets are unable to cover liabilities. Additionally, some commercial entities' revenues have not fully rebounded post peak pandemic. This had led to an accumulation of short-term liabilities that must be settled to avoid an untenable arrears position for the public sector. The financial performance of public enterprise poses potential risk to government as financing shortages necessitate increased transfers these enterprises. This includes the settlement of short- and long-term liabilities.

Table 3: State Owned Enterprise Heat Map

Source: Ministry of Finance, Management Accounting Unit

Types	Ratios	FY 2023-24		FY 2022-23	
		Commercial	Non-Commercial	Commercial	Non-Commercial
Liquidity	Current	1.60	5.98	1.99	2.24
Solvency	Debt to Asset	0.51	0.39	0.47	0.37
	Debt to Equity	1.05	0.65	0.89	0.59
Profitability	Net Profit Margin (%)	7.62	-3.56	-1.08	-1.54
	Return on Equity (%)	5.48	-3.94	-1.13	-2.19
	Operating Profit Margin (%)	-2.43	-82.71	-7.47	-79.09
	Return on Assets (%)	2.68	-2.39	-0.61	-1.38
Financial Performance	Cost Recovery	1.18	1.00	1.07	0.99
	Operating Costs to Revenue	0.91	1.02	0.99	1.01
Government Relationship	Grants to Revenue	0.12	0.81	0.08	0.78

The consolidated net loss of commercial public enterprises before subventions totalled $49.9 million for FY 2023/24, compared to $226.4M for FY 2022/23. Non -commercial entities registered losses of approximately $164.7 million for FY 2023/24 compared to $139.8 million for FY 2022/23.

Overall, liquidity ratios generated for the current financial year, reflect medium and low risks for the commercial and non-commercial SOEs, respectively. However, a number of commercial SOEs, including Barbados Agricultural Development Marketing Inc. (BADMC), Caribbean Broadcasting Corporation (CBC) and Transport Board (TB), registered current ratios less than one, indicating that their liabilities due within one year are greater than the available cash and other liquid resources. Given the traditional reliance on government to settle arrears of the SOEs in times where they have been cash-strapped, there is a high risk that these entities may require unbudgeted subventions during FY2024/25.

The entities' ability to support their operations (grants to revenue ratio) without reliance on government during the period of April to December 2023 was considered adequate for commercial SOEs, while remaining untenable for those that undertake quasi fiscal operations.

Medium Term

Solvency ratios generally indicate whether the entities have sufficient cash flow to meet their long-term liabilities and thus measure the financial health of the entity. At December 2023, Barbados Agricultural Development Management Company (BADMC), Caribbean Aircraft Handling (CAH), CBC, HOPE, BTMI, BPTA, and Transport Board's all had negative debt to equity ratios signalling that these entities were insolvent and capital injections may be required over the medium to long term horizon.

Large long-term liabilities include unfunded pension liabilities which totalled $284.7 million at December 2023 as well as debt obligations not guaranteed by Central Government which total $782.4 million. Barbados National Oil Company Limited (BNOCL), Barbados Port Inc. (BPI), Barbados Tourism Investment Inc. (BTII), Barbados Water Authority (BWA), and Grantley Adams International Airport (GAIA) collectively accounted for 80% of the total debt and demonstrated the ability to service same and thus present no immediate or long-term risks. On the other hand, HOPE and National Petroleum Company (NPC), with reported net losses, represent both current and long-term risks.

Reform Measures of State-Owned Enterprises

As government entered into a second phase of the Barbados Economic Recovery and Transformation (BERT) Program new significance was given to the SOE reform efforts in order to limit fiscal risks by enhancing SOE oversight and accountability, improving performance, and exploring where economies of scale could be achieved to reduce expenditure and reliance on grants from Central Government. In so doing, government in May 2022, engaged a Special Advisor to the Ministry of Finance and a Consultant to evaluate specific SOEs, with QEH, BWA, TB, NHC, BAMC/BADMC/BACT and CBC given priority, given their current financial position and dependency on large subventions, for required changes in their Corporate Governance, Financial Management and Operational Efficiency.

Table 4: Subventions for FY 2023/24

Entity	**Ministry**	**Subvention 2023/24**
Barbados Tourism Marketing Inc.	Ministry of Tourism & International Transport	$2.5M
Queen Elizabeth Hospital	Ministry of Health & Wellness	Did not report for FY 2023-24
National Housing Corporation	Ministry of Housing, Lands & Maintenance	$8.0M
Caribbean Broadcasting Corporation	Ministry of Home Affairs & Information	No subvention reported
Barbados Water Authority	Prime Minister Office	No subvention reported
Barbados Transport Board	Ministry of Transport, Works & Water Resources	24.37M
Barbados Agricultural Management Corporation		$39.1M

Barbados Agricultural Development Management Corporation	Ministry of Agriculture, Food & Nutritional Security	
Barbados Agricultural Credit Trust		

Natural Disasters

Every region in the world is projected to face further increases in climate hazards (medium to high confidence, depending on region and hazard), increasing multiple risks to ecosystems and humans (very high confidence). Hazards and associated risks expected in the near term include an increase in heat-related human mortality and morbidity (high confidence), food-borne, water-borne, and vector-borne diseases (high confidence), and mental health challenges (very high confidence), flooding in coastal and other low-lying cities and regions (high confidence), biodiversity loss in land, freshwater and ocean ecosystems (medium to very high confidence, depending on ecosystem), and a decrease in food production in some regions (high confidence).

Barbados faces a number of climate related risks including hurricanes, non-hurricane related storm surge and coastal inundation, floods, landslides and saline intrusion. Over the year 2023, Barbados was impacted by storms, drought and flooding from various weather systems. Natural disasters weaken the' fiscal forecasts by undermining economic growth and eroding the public revenue base over the short to medium term. Concurrent increases in expenditure for disaster-related provisioning impact debt and fiscal sustainability. Disaster-related delays on capital projects further inhibit avenues for economic growth. The increased frequency of these climatic events exacerbates the size of fiscal adjustment needed to address immediate disaster relief and reconstruction which may span multiple financial years, crowding out other spend due to government's limited fiscal space.

Barbados' Mitigation Strategies to reduce Climate Risks

The government has undertaken a number of mitigation initiatives that are geared towards minimizing the impacts of climate change and its associated fiscal costs. These initiatives are designed to strengthen resilience and adaptation through a comprehensive public investment programme (Roofs to Reefs Programme)[4]. There has been specific focus on building resilience in the areas of water (inclusive of potable water, sewage treatment, storm water management, groundwater enhancement, rainwater, harvesting}, housing transport and road infrastructure resilience, energy, waste and coastal infrastructure and ecosystem services. In addition, Government met all the structural benchmarks under Pillar 2 of the IMF-RSF Programme for 2023 and has included climate budget tagging in its Budget Estimates Process for Fiscal Year 2024/2025.

New and existing measures include natural disaster clauses that allow temporary cessation of debt servicing subsequent to climatic events, that allow for much needed fiscal space. Additionally, the government

[4] *Roofs to Reefs refers to Barbados' National Resilience Plan which outline necessary interventions that seek to minimize the impact of climate change on households and other economic sectors. This includes the upgrade of homes, water borne facilities, the reduction of pollution and greenhouse gas emissions and the protection of ecosystems.*

subscribes to the Caribbean Catastrophe Risk Insurance Facility, which offers parametric insurance in the event of specific climatic events.

Also, with respect to a new, innovative and more easily accessible financial architecture, Barbados has developed the "Bridgetown Initiative 2.0" which is a critical improvement to the financing architecture that represents longer-term reforms for the global financial system to immediately and fully align with climate science. These initiatives are:

(i) reform of the international financial architecture to make debt work for the most vulnerable and to overcome the cost of capital hurdles for climate investment;
(ii) transformation of the international and development finance system;
(iii) a global deal on carbon financing; and
(iv) revolutionize risk management through universal risk surveillance and pre-arranged and trigger-based funds.

Similarly, the GCF has approved the establishment of the Blue Green Bank (BGB) which will provide finance for private and public initiatives for green, affordable, gender-inclusive housing, food security, and low-carbon transport and the primary development sectors. The objective of the BGB will be to build climate resilience, inclusive of adaptation and mitigation efforts in Barbados, the Caribbean and beyond. This will be achieved by pioneering innovative and risk-mitigated financial solutions that will mobilize private sector investments and channel international finance to projects aligned with national priorities.

These are innovative financial instruments that seek to revolutionize the financing architecture to assist SIDS in dealing with the systemic issues of accessing climate finance to cope with the challenges of climate change impacts from an adaptation and mitigation perspective, as well as other associated development issues.

Financial Sector

The most recent Financial Stability Report for Barbados declared the financial system as sound and stable. Given the sustained health of the financial sector and improving fiscal conditions, stresses to the sovereign-bank nexus are expected to be minimal in the near-term. Commercial banks continue to dominate the financial space, with soundness indicators moving in a positive direction. The capital adequacy of banks remains well above the prudential requirement and the sector is equipped with ample liquidity to support economic growth into the medium term. Notably, improved economic conditions have enhanced borrower resilience and resulted in improved credit quality indicators for deposit-taking institutions. Furthermore, the addition of new real time payment services makes it easier and quicker for consumers, corporates and the public sector to complete transactions. The Central Bank and the Financial Services Commission looks to further enhance its regulatory framework through widening its supervisory scope, finalising regulatory guidelines for evaluating and licensing payment service providers and bringing deposit insurance for credit unions into fruition.

Figure 4*: *Banks' Capital Adequacy Ratio

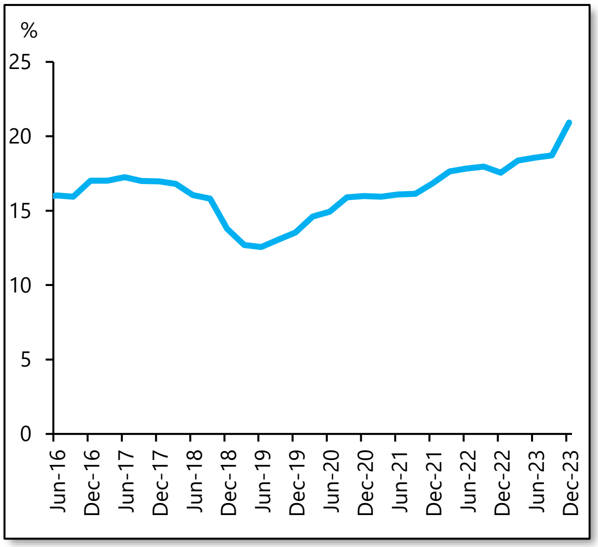
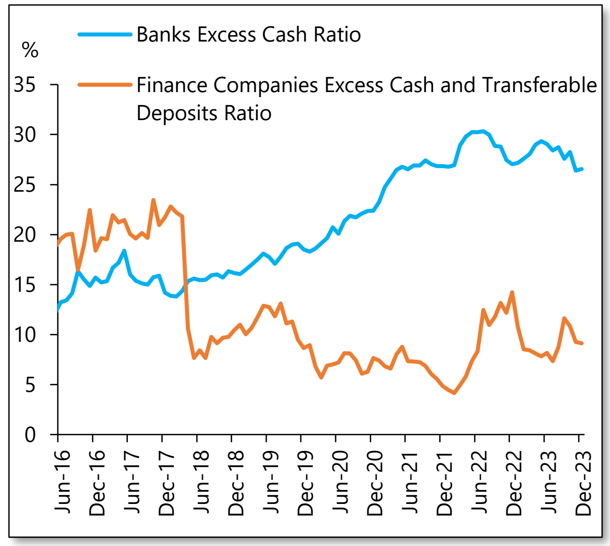


Figure 5*: *Excess Liquidity Ratios



Source: Central Bank of Barbados