GOVERNMENT OF BARBADOS

Fiscal Risk Statement

MARCH 13, 2023

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 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-

[1] International Monetary fund. 2016. Analysing and Managing Fiscal Risks Best Practices; IMF Policy Paper; May 4, 2016.
[2] Barbados Economic Recovery and Transformation (BERT). 2022

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 has 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.

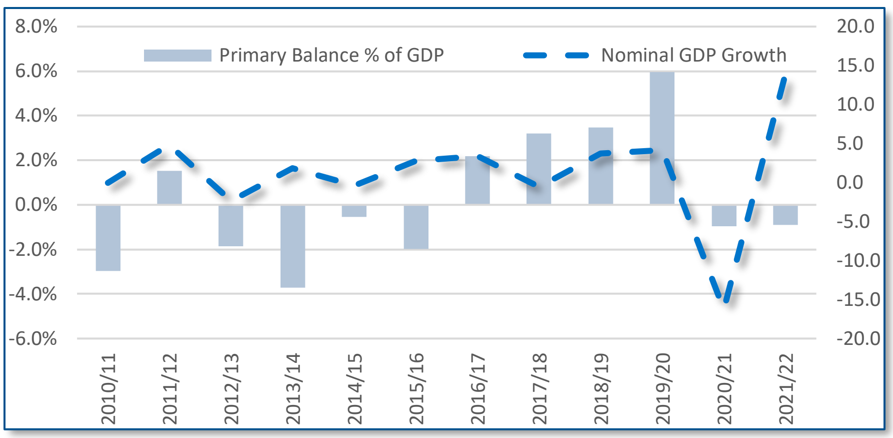
Table 1: Overview of Risks

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

A sharper than expected slowdown in global growth and continued international pressure on prices can negatively impact domestic activity and consequently, tax revenue and interest costs. Concurrently, higher prices make the provision of government services more expensive, worsening the fiscal position. The movement of global output has historically tailored the domestic economic performance for Barbados. The heavy reliance on tourism to bolster growth, and large import dependency has meant global economic shocks directly impair GDP, resulting in reduced tax intake. This is further exacerbated by traditionally procyclical fiscal policy, which widens fiscal deficits as well as financing requirements. During the height of the pandemic, GDP declined by 17 percent, revenues fell by over $400 million, while expenditure expanded by an almost equivalent amount. The falloff in growth and increased borrowing resulted in a recalibration of the debt to GDP target, extending the upper threshold of 60 percent beyond 2023/24 to 2025/26, an additional two years.

Figure 1: GDP and Fiscal Performance



Source: Treasury Department, Central Bank of Barbados

Macro Fiscal Assumptions

The current Parliamentary Draft Estimates of revenue and expenditure have been prepared using baseline economic assumptions for the FY 2023/24 financial year and into the medium term. These include expectations of economic activity, which help inform the revenue intake. It also includes assumptions on price movements which determine the cost of government services and interest rates, which determine debt service costs. Deviations in the actual performance of these key indicators can lead to differences in outcomes for forecasts of revenue and expenditure.

Adjusted Baseline

The Prime Minister, in February 2023, announced the extension of a number of inflation-mitigative measures that were not included in the original baseline. Additionally, in March 2023, wage negotiations were concluded and consensus reached on the terms under which central government and state-owned enterprises would receive salary increases. The budget initiatives announced on March 14th, have also been incorporated into the baseline. Changes to the baseline include:

- An eight-month extension of the reduced VAT on electricity (17.5 to 7.5 percent)
- A six-month extension of the COMPACT initiative which includes specific items deemed as necessary into the VAT free basket.
- 3 percent increase in wages and salaries and allowances for the next two financial years.
- Targeted reduction of tax expenditures by $30 million in FY 2023/24 and $150 million in the medium term.
- The increase in personal income tax allowance for pensioners to $45,000 in income year 2023

Cumulatively this increased total revenue relative to the original baseline by $25 million and has increased expenditure by $52.4 million for FY 2023/24.

A table of the key macro indicators that underpin the Baseline and Adjusted Baseline is included below as well as the expected revenue, expenditure and debt indicators that make up the baseline forecast.

Table 2: Key Economic Indicators

Key Economic Assumptions	FY 2023/24	FY 2024/25	FY 2025/26	FY 2026/27
Real GDP growth	4.1	3.6	3.3	2.8
Nominal GDP growth	7.0	5.9	5.0	5.0
Tourism GDP growth	11.5	7.2	6.8	5.1
CPI (annual %)	5.7	2.0	2.1	2.0
Baseline ($BDS M)				
Total Revenue	3318.7	3577.0	3747.9	3927.3
Tax Revenue	3140.6	3355.1	3515.0	3682.7
Total Expenditure	3498.8	3671.0	3726.2	3877.3
Interest	651.6	636.6	635.7	640.3
Primary Balance	471.5	542.6	657.4	690.3
Adjusted Baseline ($BDS M)				
Total Revenue	3344.2	3612.9	3785.6	3966.9
Tax Revenue	3166.3	3391.2	3552.8	3722.4
Total Expenditure	3551.1	3762.9	3818.4	3970.8
Interest	651.6	687.2	685.0	686.8
Primary Balance	444.6	537.2	652.3	683.0
Primary Balance (% of GDP)	3.5	4.0	4.6	4.6
Debt (% of GDP)	106.7	101.6	96.3	90.8

Source: Ministry of Finance, Central Bank of Barbados

Scenario Analysis

For the 2023/24 financial year, real growth is forecasted at 4.1 percent, predicated on current projections of global output, particularly for economies that form the basis of the main tourism markets. However, continued geopolitical tension between Russia and Ukraine, possible further COVID-19 outbreaks and an overall dampening of demand in response to economies efforts to curb inflation can weaken the current growth forecast globally and domestically. A downward revision of growth precedes a fall-off in tax revenue for the upcoming financial year. Concurrently, tighter than anticipated financial market conditions and the subsequent hikes in international interest rates can inflate debt service costs. Higher than anticipated global prices impact the cost of public goods and services, increasing overall expenditure and financing for the current fiscal year.

Over the medium and long term, real growth is expected to average at 3 percent. This assumes a full recovery of the tourism sector post pandemic, and a requisite pickup in its ancillary sectors including construction which has several hospitality projects earmarked over the forecast horizon. Slower than anticipated global growth initiated by an overtightening of financial market conditions can translate to slower tourism receipts catalysing lower domestic growth. In addition, medium term debt dynamics hinge on growth levels outpacing real interest rate changes. A deterioration of growth below baseline levels, or higher than anticipated interest can hamper debt targets.

Scenario A:1, considers economic activity concomitant with tourist arrivals 10 percent below S(low) or above S(high) baseline projections in FY 2023/24. The subsequent impact on tax revenue is shown in A:2. Nominal GDP growth falls below initial forecasts in the first year following the slower than anticipated performance in tourism, however there is strong recovery the following year before returning to steady state over the medium term.

There is a large adjustment in revenue in FY 2023/24 (ScenarioA:2). Thereafter the impact on revenue tapers into the medium term. The reduction in revenue lends to a strong downward adjustment in discretionary expenditure in order to maintain EFF targeted primary balances and debt trajectory. If there is no adjustment in expenditure, the smaller primary balance has implications for achieving the debt target over the medium term.

Figure 2: Scenario A:1

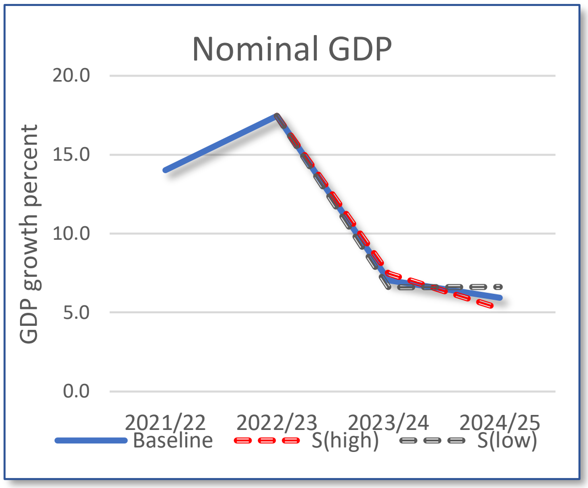
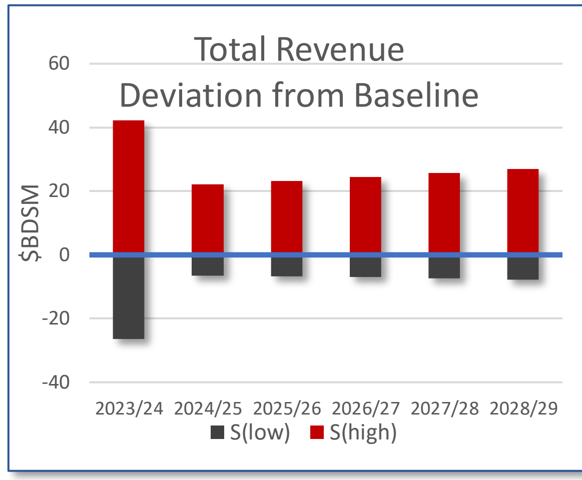


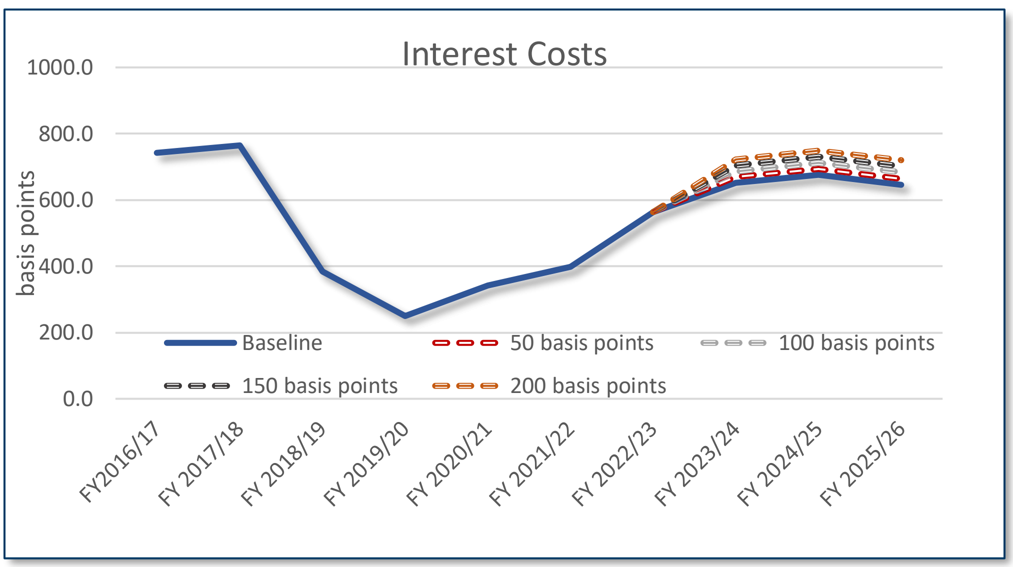
Figure 3: Scenario A:2



Source: Ministry of Finance, Central Bank of Barbados

Scenario B considers the impact that higher than anticipated interest rates have on debt service costs. Increased interest costs expand total expenditure, widening the fiscal deficit, and gross financing needs of government.

Figure 4: Scenario B



Source: Ministry of Finance, Debt Unit

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 adequately cover their own debt service costs. The pandemic severely impaired a number of SOE's ability to generate revenue, leading to the reliance on Central Government to settle one entity's debt obligations. The outstanding amounts for this loan are considered small and the loan is scheduled to mature within the upcoming financial year. The exposure to government from guarantees is limited and not considered a significant fiscal risk.

Table 3:Government Guarantees

Organisation	Amount of Loan $BDS M	Balance Outstanding $BDS M	Maturity Date
Barbados Investment and Development Corporation	$31.08	$27.20	1-Oct-29
Caves of Barbados Limited	$33.73	$3.56	1-Jan-24
Caves of Barbados Limited	$26.21	$2.48	1-Jan-24
University of the West Indies	$3.37	$1.11	1-Dec-33
University of the West Indies	$7.00	$1.03	1-Oct-24
University of the West Indies- Mona	$1.54	$0.31	1-Oct-33
University of the West Indies- Mona	$5.50	$1.95	1-Jan-27
Total	$108.44	$37.63	

Source: Ministry of Finance, Debt Unit

There has been an internal commitment of the government of Barbados to limit guarantees on domestically financed debt. In addition, a review of the ability to pay, is expected to be done on all entities that request guarantees. In addition, any such guarantee must be approved 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 SOE's have 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 4: State Owned Enterprise Heat Map

Types	Ratios	FY 2022-23		FY 2021-22	
		Commercial	Non-Commercial	Commercial	Non-Commercial
Liquidity	Current	1.99	2.24	1.78	2.60
Solvency	Debt to Asset	0.47	0.37	0.47	0.40
	Debt to Equity	0.89	0.59	0.89	0.66
Profitability	Net Profit Margin (%)	-1.08	-1.54	-5.98	-1.40
	Return on Equity (%)	-1.13	-2.19	-5.29	-2.01
	Operating Profit Margin (%)	-7.47	-79.09	-27.02	-82.98
	Return on Assets (%)	-0.60	-1.38	-2.81	-1.21
Financial Performance	Cost Recovery	1.07	0.99	1.02	1.04
	Operating Costs to Revenue	0.99	1.01	1.04	0.99
Government Relationship	Grants to Revenue	0.08	0.78	0.23	0.84

Source: Ministry of Finance, Management Accounting Unit

The consolidated net loss of commercial public enterprises before subventions totalled $402.4 million for FY 2021/22 and was estimated at approximately $270.98 million at the end of December 2022. Non -commercial entities registered losses of approximately $126.7 million and $140.1 million for the same period.

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 SOE's, including Barbados Agricultural Management Corporation (BAMC), 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

[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

SOEs in times where they have been cash-strapped, there is a high risk that these entities may require unbudgeted subventions during FY 2023/24.

The entities' ability to support their operations (grants to revenue ratio) without reliance on government during the period of April to December 2022 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 2022, Barbados Agricultural Development Management Company (BADMC), Caribbean Aircraft Handling (CAH), CBC, HOPE, and TB'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 $258 million at December 2022 as well as debt obligations not guaranteed by Central Government which total $756.8 million. Barbados National Oil Company Limited (BNOCL), Barbados Port Inc (BPI), Barbados Tourism Investment Inc (BTII), National Petroleum Holdings Limited (NPHL) and Grantley Adams International Airport (GAIA) account for 65% of the total debt and demonstrated the ability to service same and thus present no immediate or long-term risks. On the other hand, BAMC, Barbados Water Authority (BWA) 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.

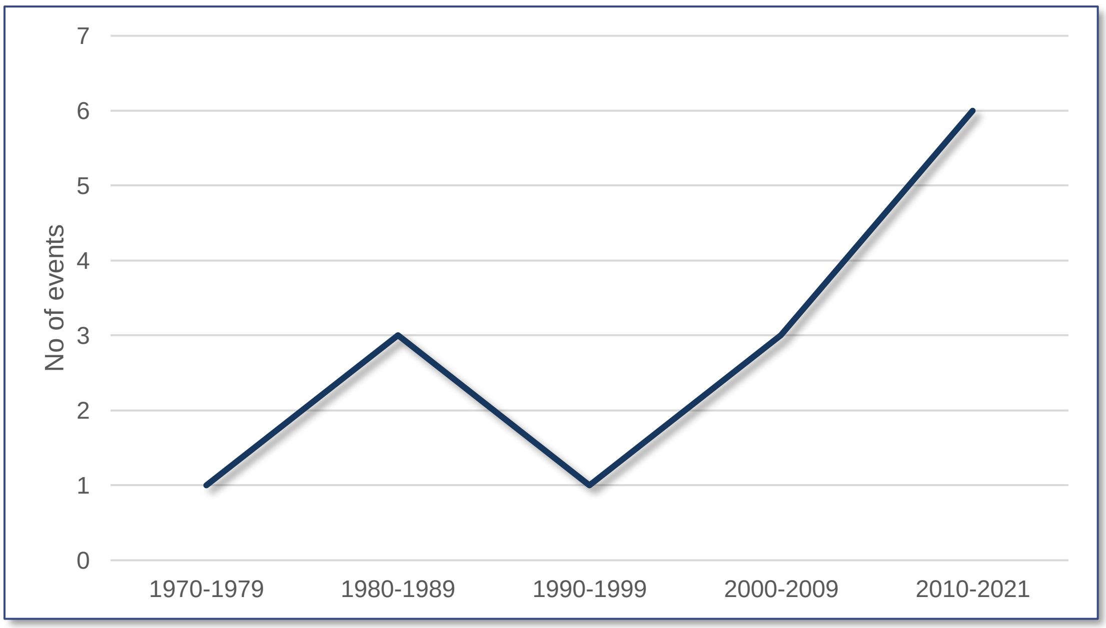
Table 5: Subventions for FY 2022/23

Entity	**Ministry**	**Subvention 2022/23**
Barbados Tourism Marketing Inc.	Ministry of Tourism & International Transport	$8.2M
Queen Elizabeth Hospital	Ministry of Health & Wellness	$188M
National Housing Corporation	Ministry of Housing, Lands & Maintenance	$10.3M
Caribbean Broadcasting Corporation	Ministry of Home Affairs & Information	$10.5M
Barbados Water Authority	Ministry of Transport, Works & Water Resources	$19.6M
Barbados Transport Board	Ministry of Transport, Works & Water Resources	32.8M
Barbados Agricultural Management Corporation	Ministry of Agriculture, Food & Nutritional Security	$32.6M
Barbados Agricultural Development Management Corporation		
Barbados Agricultural Credit Trust		

Natural Disasters

Natural disasters weaken Barbados' 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.

Figure 5: Frequency of Natural Disasters in Barbados

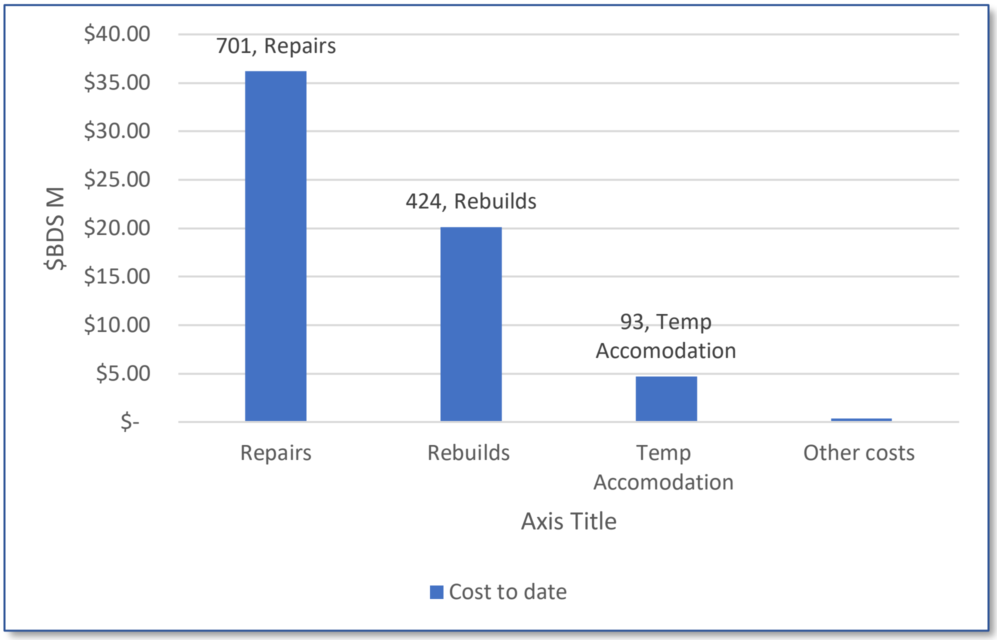


Source: Ministry of Finance, EM-DAT

FY 2021/22 was unprecedented in the number of natural disasters to impact the island within the financial year. These included a tropical storm, a volcanic eruption, and the first hurricane in a century, which caused major destruction and damage, with the latter two curtailing economic recovery during the height of the pandemic. While the true economic cost of these events remains unknown, fiscal spend is estimated at $78 million at the end of March 2023, with additional expenditure expected in the FY 2023/24 financial year.

Direct expenditure by state agencies for Hurricane Elsa for 1218 rebuilding and repair projects accounted for approximately $56.3 million, while costs related to housing persons that were displaced and were awaiting repairs or replaced homes totalled $4.7 million to date. Spending related to housing persons in hurricane shelters, spending on medical supplies, temporary roofing and other related spend is estimated at $.35 million as of February 2023.

Figure 6: Hurricane Elsa; Fiscal Costs



Source: UDC, RDC, NHC, DEM[4]

Mitigation

The government has undertaken a number of mitigative 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)[5].

There has also been consideration in accessibility to affordable financing to fund these mitigative efforts through the Bridgetown Initiative. These financing options are geared toward minimizing government's exposure to climate and disaster related expenses by creating a trust that is financed independently of government, however initialises a pay out when major climatic disasters occur.

New and existing includes natural disaster clauses that allows temporary cessation of debt servicing subsequent to climatic events, that allow for much needed fiscal space. Additionally, the government subscribes to the Caribbean Catastrophe Risk Insurance Facility, which offers parametric insurance in the event of specific climatic events.

[4] *Urban Development Corporation, Rural Development Corporation, National Housing Corporation and Department of Emergency Management*

[5] *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 green house gas emissions and the protection of ecosystems.*

Financial Sector

Analysis of the risks related to banks and other financial institutions drawing CBB/FSC Financial Stability reports, and reporting on key financial ratios. Risk mitigation strategies.

All recent analysis suggests that any near-term risk to the fiscal accounts emanating from the depository institutions system are likely minimal and not systemic. The largest component of deposit-taking institutions remains the commercial bank sector for which all banks are solvent, exceed regulatory benchmarks in terms of capital adequacy, and possess abundant liquidity. In instances where the Central Bank has required improvement in performance for any entity it regulates, monitoring metrics have been developed and guidance provided by regulators on pathways to addressing improvements. Similarly, the Central Bank's sister regulator, the Financial Services Commission, has continued to upgrade its regulations and industry guidance in response to industry needs. In addition, the recent upswing in the economy has resulted improved creditworthiness among consumers and businesses and consequently, in improvements aggregate credit metrics for all banks and finance houses. Credit unions have also indicated modestly improving solvency and credit indicators in the most recent Financial Stability Reports, and the economic rebound in 2022, and growth forecasted for 2023 suggest that their financial prospects will also continue to benefit from the upturn in the country's economic prospects.

Figure 7: Banks' Capital Adequacy Ratio

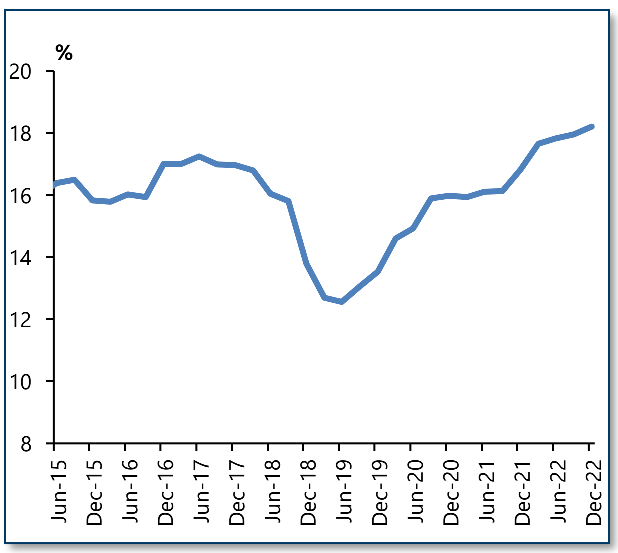
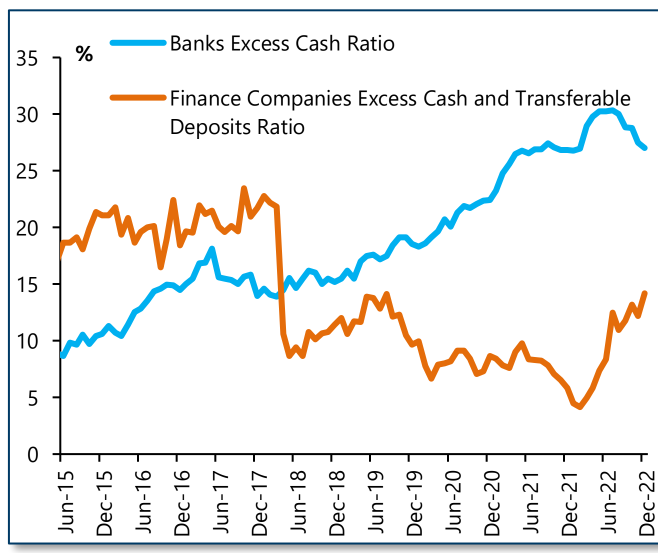


Figure 8: Excess Liquidity Ratios



Source: Central Bank of Barbados