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Does Fiji need a debt ceiling?

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In Fiji, it is budget time again.

The concerns would centre around fiscal deficits, external current account deficits and of course, finally the public debt.

Last two weeks, we discussed current account deficits and budget deficits. So, we appropriately focus this week on public debt.

Interestingly the Australian Treasurer, Mr. Joe Hockey has also initiated a debate on the subject, announcing that there is a need to raise the country's debt limit by 67 percent. The current limit, which is AUS$ 300 billion, was set by the Parliament in June 2012 when Labour party was in power.

The new coalition government, which replaced Labour government this year, wants to raise it to AUS$ 500 billon. The new bill will be considered by Parliament this month.

The ongoing Australian debate is on "Why this new ceiling of half a trillion dollar now?"

The arguments for raising the debt limit are two: (i) by mid December, the present limit of AUS$ 300 billion would be reached; and (ii) as the debt level is expected to go up to hit AUS$ 400 billion in the next four years, it is better to raise the ceiling now rather than later, when the government would have to face the next election.

A history of ceilings

The debt limit is a self imposed one. It is prevalent in four countries: Australia, Canada, Denmark and the US.

The US has no constitutional requirement for a limit on government borrowing. However, the executive and the legislative wings agreed to have a ceiling in 1917. There were disputes, whenever government informed the US legislature of the need for increasing the debt limit. The October 2013 two week shutdown of the US economy is an example.

It was agreed to re-examine the case in mid January 2014. In the meanwhile, the ceiling was increased from US$16.3 trillion by US$305 billion to US$16.7 trillion. The American debt is nearly 106 percent of GDP.

The Pacific region

Solomon Islands has a debt limit since 2005 under the Honiara Club Agreement (HCA), signed by international lenders and the government. Under HCA, assistance is being provided for rescuing the economy from a deep financial crisis. One of the HCA requirements is Debt Management Strategy which has set a limit at SI$150 million (2 percent of GDP). Further, the country cannot borrow from official external lenders until it received a “green light” rating from the World Bank’s International Development.

These restrictions have resulted in total debt (domestic and external) falling to 22 percent of GDP from 60 percent in 2005. Domestic debt is one third of total public debt. Total external debt has also declined to about 25 percent of GDP, from 50 percent of GDP in 2005.

Other major island countries, including Fiji, Samoa, Tonga and Vanuatu have not faced debt crises of the kind which hit Solomon Islands.

As Samoa, Tonga and Vanuatu’s domestic financial sectors are small, domestic borrowing is small. Its external debt is large. All of them are eligible for concessional loan assistance from international lenders at low interest rates. Thus, the debt servicing costs in foreign exchange are low as well.

Samoa’s domestic debt is less than 4 percent of GDP. Its external debt was 48 percent of GDP). Since its external debt was mostly from international lenders with a high grant element, Samoa has no major debt problem.

Vanuatu’s total debt is 21.6 percent of GDP. It is dominated by external debt, which is 13.9 percent. Since Vanuatu’s external debt is mostly concessional loans, debt service costs are low.

The only country with a potential debt crisis is Tonga. Its debt is 43 percent of GDP, dominated by external debt (39 percent of GDP). The March 2013 IMF Article IV Consultation Mission issued a warning that “high external indebtedness remains an important vulnerability since grace periods on the external loans, mostly from China are expiring in 2013/14”.

China extended the grace period of a loan of US$ 60 million, days before its first payment of nearly US$ 7 million was due in late September. It is not known how long this extension of grace period would be. There are other loans due for servicing in 2014.

Tonga’s external debt is dominated by loans from China, creating yet another problem of an excessive exposure to a single foreign currency.

Fiji’s 2014 Budget

It is the most expansionary budget of all. It has a huge lot of “giveaways”. Yet, it has projected a very small deficit of 1.9 percent of GDP. Because of a low budget deficit, there is no problem on the debt front.

Total debt which was estimated at 49.3 percent of GDP for 2013, is expected to decline to 48.3 percent of GDP in 2014.

A conscious effort towards reducing budget deficits is always welcome. Additionally, if external debt stock is reduced and if international reserves (September 2013 reserves: FJ$ 1.8 billion) are increasing each year, debt servicing , which is often in foreign currencies, would not pose any problem.

Current account deficits are sustainable, with steadily rising remittances and tourism earnings. If the tax collection machinery works, tax revenues will be buoyant as well. Domestic debt servicing costs will also be declining over time, reducing both primary and net deficits.

So, the answer to the question is we do not need a debt ceiling, unless the trends are in the opposite direction.