The Impact of dismantling the Petro Caribe Arrangement in the ECCU –

A Case Study Approach

Prepared for the
152nd Board of Directors' Meeting
08 June 2015

EASTERN CARIBBEAN CENTRAL BANK

ST KITTS

Contents

1.0 Introduction

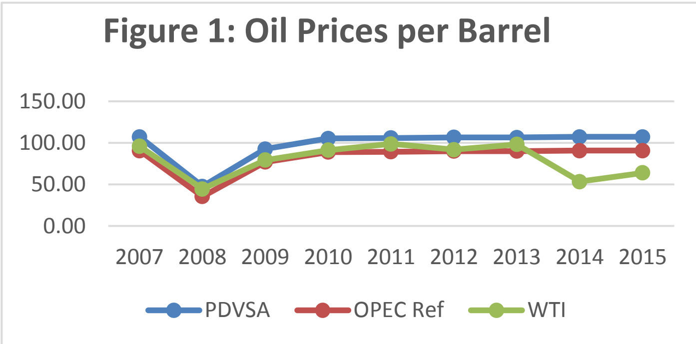
1.1. Overview of Petro Caribe

The Caribbean's political relationship with Venezuela began over forty years ago, but in the recent decade the relationship has been associated with increased dependence on Venezuela for petroleum funding and financing. The Petro Caribe arrangement, a brain child of former President Hugo Chavez, was established in 2005. The main objective was to assist countries in mitigating the impact of rising energy costs. It was intended to be a catalyst for eradicating social inequality and improving the living standards of the nations in the region. Since its establishment, Venezuela has sold over US$28 billion[1] in petroleum to countries in the Caribbean and Central America. The arrangement allows for countries to purchase crude oil and petroleum products from Venezuela at international market prices, pay a portion of their import bill upfront and the balance is financed at very concessional rates between 1.0 and 2.0 per cent over a maximum period of 25 years. Oil under the Petro Caribe arrangement constitutes only 5.0 per cent of Venezuela's oil exports.

In July 2008, at the fifth Petro Caribe Summit, a slight amendment was made to the agreement, which stated that as long as the price of oil from Venezuela costs at least US$100 per barrel, members of the Petro Caribe programme will pay 40 per cent (compared with 50 per cent from the initial agreement) within 90 days and the remaining 60 per cent would be serviced over 25 years at 1.0 per cent. If the price would increase above US$200 per barrel, which is highly unlikely, then members would pay 30 per cent upfront and 70 per cent would be financed.

Since the death of President Hugo Chavez in 2013, there has been speculation about the continuity and sustainability of the arrangement, particularly given the economic and political tumult that the country has been facing. To compound the situation, oil prices have been on a decline (Figure 1) and Petroleos de Venezuela (PDVSA) – the state-owned oil company, has been facing a number of challenges. Consequently, Venezuela has been experiencing

[1] Bloomberg Business News – January 2015



difficulty servicing its external debt obligations, hence pressures to modify the Petro Caribe programme.

In January 2015, after one year of negotiations, the Dominican Republic struck a deal to buy back some of its Petro Caribe debt at a discounted price and negotiations for a similar deal with Jamaica are advancing. The aim of the buy-back is to provide Venezuela with some much needed cash flows to assist its economy in dealing with the recent revenue shortfall. This paper therefore is intended to analyze the effects of the accumulation of Petro Caribe debt on the participating countries of the ECCU and the impact of a dismantling of the Energy Co-operation Agreement. While the current President of Venezuela, Nicolas Maduro has given the assurance of continuity for the Petro Caribe programme, a myriad of economic challenges threaten the economic stability of the country, risking the fulfilment of the late President Chavez's vision of regional energy cooperation.

1.2. The Significance of Petro Caribe to the Region

Since the signing of the agreement, Petro Caribe has become an important part of the energy sector in the participating countries of the ECCU[2]. Not only have they imported fuel and its derivatives from Venezuela, but they have also benefited from a number of social and infrastructural projects, which have been financed by the Petro Caribe funds. Table 1 shows that total imports of fuel from Venezuela to the ECCU territories up to December 2014 ranged from $168.6m in St Vincent and the Grenadines (8.6 per cent of GDP) to $903.4m in Grenada (37.9 per cent of GDP). A fuel storage facility of 30,000 barrels, that can meet the electricity needs of St Vincent and the Grenadines for three months, was recently built in Lowman's Bay,

[2] Participating countries – Antigua and Barbuda, Dominica, Grenada, St Kitts and Nevis and St Vincent and the Grenadines

at a cost of US$31.6m**.** This facility represents Venezuela's commitment to the programme and its investment in the energy security of the region.

Table 1:Petro Caribe Imports, Cost & Outstanding Debt (December 2014)			
Country	Total Volume (US gallons)	Total Cost	Total Outstanding
Antigua and Barbuda	87.64m	EC$796.37m	EC$318.55m
Dominica	26.56m	EC$286.34m	EC$150.35m
Grenada	231.49m	EC$903.35	EC$362.11
St Kitts and Nevis	42.61m	EC$309.0m	EC$123.84
St Vincent and the Grenadines	20.79m	EC$168.59	$EC141.0m

Source: Petro Caribe Companies, Ministries of Finance and Authors' estimates

2.0 The Petro Caribe Agreement

Thirteen Caribbean countries signed the Energy Co-operation Agreement - Petro Caribe with the Bolivarian Republic of Venezuela in June 2005. Based on the Memorandum of Understanding, the agreement is meant for energy security, social and economic development and further integration of the parties involved. Although all six of the ECCU independent countries signed the agreement, to date, five of these territories (Antigua and Barbuda, Dominica, Grenada, St Kitts and Nevis and St Vincent and the Grenadines) have begun importing petroleum products from Venezuela. The analysis will include three of these countries – Antigua and Barbuda, Dominica and Grenada, since data requested from the authorities to conduct this exercise have not been forthcoming.

Antigua and Barbuda

The authorities in Antigua and Barbuda signed on to the agreement in its original form and began receiving oil from Venezuela in 2006. Like the other territories, a company was created to operate and manage the receipt of oil and the related funds. The same bases for the agreement applied to Antigua and Barbuda (Appendix – Table I). The country would pay part of its import bill up front – within 90 days, and the balance would be converted to a long term concessionary loan over a period of at least 17 years, but not exceeding 25 years. In its first year on the programme (December 2006), accumulated debt was about EC$13.6m. From 2007 to 2014, Antigua and Barbuda accumulated debt of EC$38.1m per annum on average under the Petro Caribe arrangement.

Funds from the social aspect of the Petro Caribe arrangement in Antigua and Barbuda are used for the People's Benefit Programme, a utility subsidy and a gas subsidy for Barbuda. The country's Prime Minister announced in December 2014 that Petro Caribe funds will also be used to finance mortgages for a proposed housing project, which will build 2000 houses in 5 years. These houses will be mortgaged at a discounted rate for low income persons over a thirty year period.

Dominica

Apart from the general agreement that all thirteen countries signed unto, the Commonwealth of Dominica signed a more specific arrangement with Venezuela on 06 September 2005. In this arrangement Dominica will be directly supplied with crude oil, refined products and LPG in the amount of 1000 barrels per day annually, as long as the necessary conditions are met. These include Venezuela's ability to supply and decisions that may be taken by the Organization of Petroleum Exporting Countries. Financing under the bilateral agreement would be at an interest rate of 2.0 per cent per annum and allowed a grace period of two years for capital payments. The amount to be financed would be determined under the terms of the original multilateral agreement (Appendix – Table I).

The short term obligation for Dominica involved an upfront payment within 90 days of the bill of lading. The first 30 days would be interest free, while the balance (60 days) would bear a rate of 2.0 per cent. A number of social and infrastructural development programmes have been undertaken by Dominica under the Petro Caribe arrangement. These include the development of roads and the provision of low cost housing to the lower income group of the country. Dominica has also benefited from the construction of a fuel storage and distribution facility at an estimated cost of EC$56.7m, with a capacity of 35,000 barrels of fuel.

Grenada

Grenada's Petro Caribe arrangement started operations in 2007 under the terms of the original agreement signed by the participating countries. Grenada, like Dominica would receive from the government of Venezuela a supply of 1,000 barrels of crude oil daily on an annual basis. Based on the agreement, the cash portion should also be paid within a period of 90 days, with an interest rate of 2.0 per cent applied to the last 60 days. If oil prices rise above US$40 per barrel, a longer period will be given for the serviced portion and interest rates will be at 1.0 per cent per annum.

PDV Grenada receives on average 18,000 barrels of diesel from Venezuela on a monthly basis and sells the fuel to the domestic market. The company pays 50 per cent of the value of its imports in cash upfront or 40 per cent if oil prices are higher than US$100 per barrel. The remainder becomes a long-term loan (25 years) at an annual rate of 1.0 per cent. Of that concessional loan, 35 per cent serves as grant funding to the Central Government for social projects, while the remaining 65 per cent is placed into a trust fund for investments expected to yield returns that will assist in servicing the long-term debt.

3.0 Experiences outside the ECCU

The Venezuelan economy has experienced severe stress from the falling price of oil, as 95.0 per cent of its revenue comes from oil exports. So much so, that the authorities wanted to securitize debt owed under the Petro Caribe oil programme, which is subsidized at a cost of approximately $3.5 billion per annum. The debt of Dominican Republic, Jamaica and Nicaragua together make up 69.0 per cent (about $10 billion) of the total owed under the Petro Caribe initiative. Selling these countries' debt to a Wall Street Investment Bank would assist Venezuela with its current cash flow problems.

3.1. Dominican Republic

Under the Petro Caribe preferential financing energy programme, Dominican Republic accumulated a large amount of debt to Venezuela. The plan was for Venezuela to sell that debt to Goldman Sachs for $1.75 billion and Dominican Republic would in turn issue new bonds and use the proceeds to purchase the debt from Goldman Sachs. After more than a year of negotiations with PDVSA, which concluded on 27 January 2015, Dominican Republic reached a deal, making it the largest debt management transaction in its economic history. The Dominican Republic, through a bond sale, paid off $1.9 billion of its debt to Venezuela. That amount represents a discount of about 52 per cent of the $4.1 billion that was owed to the state-owned Petroleos de Venezuela SA (PDVSA). As a result of this deal, Dominican Republic's public debt was instantly reduced by approximately 3.3 per cent of GDP ($2 billion). Dominican Republic's debt to Venezuela could begin to grow again since Venezuela will continue to ship about 30,000 barrels of oil a day to Dominican Republic.

3.2. Jamaica

Jamaica became the first country to finalize the Petro Caribe agreement and in September 2005, began receiving up to 21,000 barrels a day at significant savings (US$40 per barrel). The Petro Caribe arrangement has become very important to Jamaica, a country that imports more than 90 per cent of its energy demand. Under the programme, Jamaica can import up to 7.0m barrels of oil annually from Venezuela and based on the price of oil, it could get up to 70 per cent of its import bill on credit terms. Any amount outstanding (up to J$27 billion per annum) will be converted to long term debt at very low interest rates and used in local project development. Jamaica owes Venezuela about 26.2 per cent (US$3.8 billion) of the total Petro Caribe debt and together with the Dominican Republic total approximately 50.0 per cent (US$7.1 billion) of that debt, which Venezuela records as receivables. Like the arrangement used for the Dominican Republic, Jamaica's Petro Caribe debt, with a market value of $1.8b, could be sold to Goldman Sachs at a discounted price as low as $1.3 billion. If Jamaica buys back its Petro Caribe debt in a deal like that of the Dominican Republic, its total public sector debt of 130 per cent of GDP could be reduced by 10 percentage points to 120 per cent of

GDP. Jamaica will have to return to the bond market, following sale of $800m of bonds in July 2014.

3.3. To What Extent does the Restructuring by the Dominican Republic and Jamaica has merit for the ECCU?

If the proposal adopted to restructure Dominican Republic debt is utilized to securitize all of Petro Caribe's debt, Venezuela would raise a total of approximately $6 billion and an additional $3.6 billion per annum from a complete cancellation of the programme[3]. The total yield constitutes only about 20 per cent of the $25 billion[4] per annum in new financing that Venezuela needs to foot its import bill. In light of the aforementioned, it is unlikely that the programme will be dismantled.

Notwithstanding the assurances that a sudden dismantling may not occur, the countries of the region need to look at possible outcomes and be proactive in articulating solutions for these eventualities. If the countries of the ECCU should negotiate a deal to buy back some of their debt from Venezuela, it is assumed that the courtesies extended to the Dominican Republic will also be offered to these countries, despite the large variance in debt stock.

4.0 Impact of Petro Caribe on Debt

The accumulated debt stocks of the countries analyzed are not currently recorded in their total public sector debt. In light of this, it became necessary to look at the impact that inclusion of the Petro Caribe debt would have on the debt sustainability of these countries. To do this, a twenty year forecast for the Petro Caribe debt was done for each country, using estimated consumption along with the projected price increases for a barrel of oil. Three benchmarks – the OPEC Reference Basket, the WTI and the PDVSA were used for the forecasting period. From this exercise the financing portion was calculated at 40 per cent of the total cost. Antigua and Barbuda under current policies would have an accumulated Petro Caribe debt stock of EC$1.5 billion in 2030, Grenada would then owe Venezuela EC$1.5b and Dominica

[3] Financial Times – December 2014
[4] Annual estimates of imports by Venezuela – Bank of America

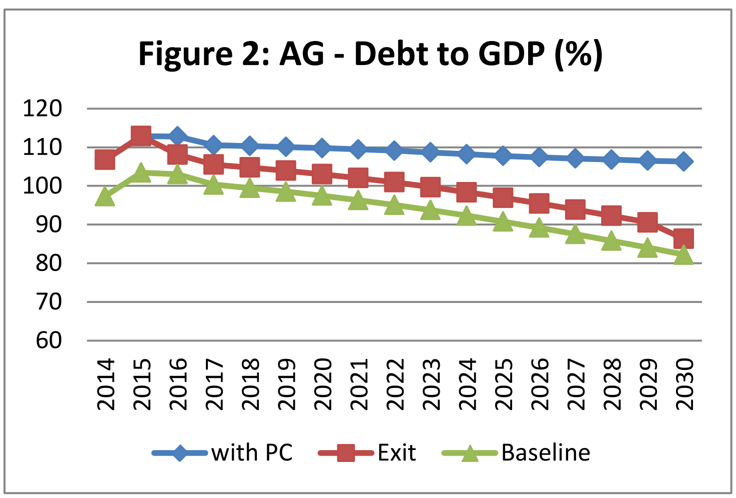
EC$0.5 billion. These amounts were compared with the forecasted debt stock of these countries under a baseline scenario, which were derived from a debt sustainability assessment using projections from the country's financial programming framework. An exit scenario, representing the behaviour of debt if the agreement should be dismantled was also modeled and will be explained in section five.

Table 2: Petro Caribe – Impact on Debt Stock in 2030

	Without Petro Caribe	With Petro Caribe
Antigua and Barbuda	EC$5.8 billion	EC$7.4 billion
Dominica	EC$1.4 billion	EC$1.6 billion
Grenada	EC$3,2 billion	EC$4.4 billion

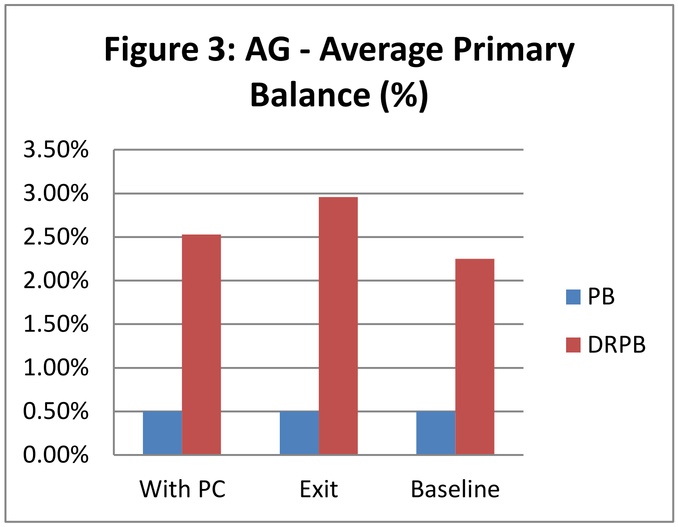
4.1 Antigua and Barbuda

At end December 2014, Antigua and Barbuda's public sector debt-to-GDP ratio stood at 97.4 per cent (see Figure 2). Over the period 2015 to 2030, the debt-to-GDP ratio is expected to average 97.4 per cent under a baseline scenario. By 2030, that ratio is projected to be 82.2 per cent which is above the ECCU's Monetary Council recommended threshold of 60.0 per cent.

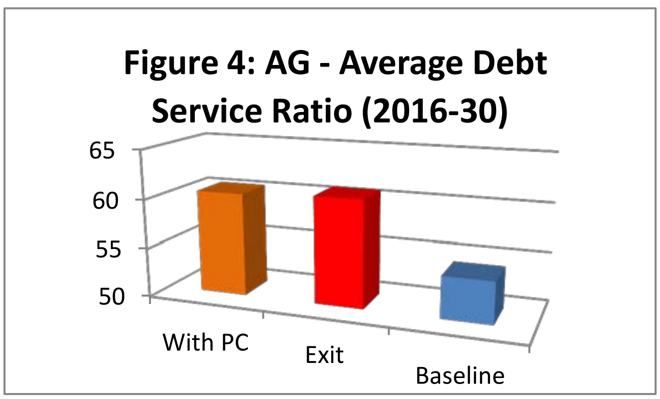


The debt stock in the baseline scenario does not include Antigua and Barbuda's outstanding debt to Petro Caribe. When that obligation is included in the forecast from 2015 onwards, the debt dynamics change. Estimates for public debt in 2015 move from EC$3.8 billion to EC$4.1 billion and from 103.4 per cent of GDP to 112.9 per cent of GDP. By 2030, Antigua and Barbuda will record $7.5 billion compared with EC$5.8 billion without the Petro Caribe debt. The debt to GDP ratio is expected to be 106.3 per cent with the extra debt compared with 82.2 per cent without it.

As at end 2014, Antigua and Barbuda's primary balance as a per cent of GDP was -3.7 per cent. The primary balance-to-GDP is projected to average 0.5 per cent over the period 2016 to 2030. An average primary balance-to-GDP of 2.3 per cent is required to achieve a debt-to-GDP ratio of 60.0 per cent by 2030 (figure 3). When the Petro Caribe debt is included, the primary balance averages close to 0.5 per cent in the period leading to 2030, while the debt reducing primary balance is 2.5 per cent.



Another debt indicator – the debt service ratio was also adversely impacted both by the addition of Petro Caribe debt and by dissolution of the arrangement. That ratio averaged 60.5 per cent with Petro Caribe debt compared with 54.2 per cent in the baseline analysis.



4.2 Commonwealth of Dominica

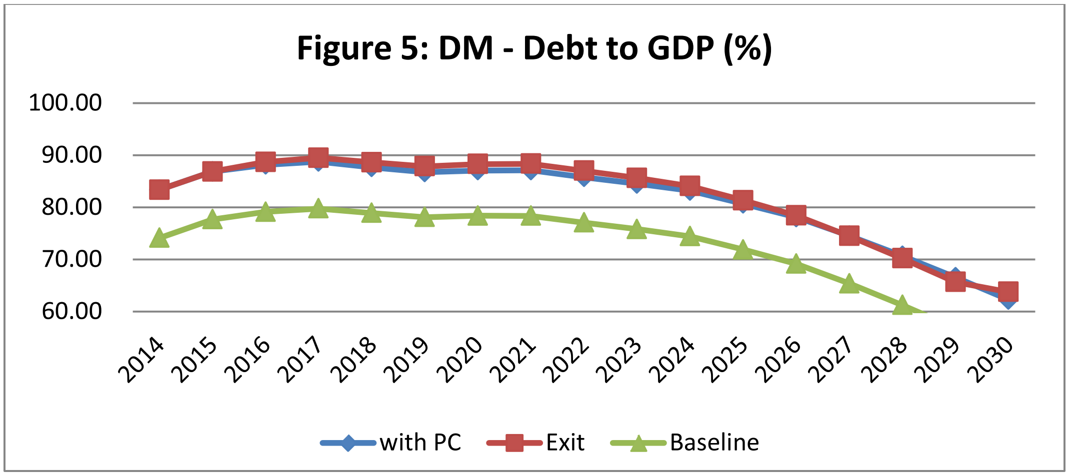


Figure 5: DM - Debt to GDP (%)

Dominica, under a baseline scenario recorded a public sector debt-to-GDP ratio of 74.1 per cent at the end of December 2014 (figure 5). Over the period 2015 to 2030, the debt-to-GDP ratio is projected to average 72.1 per cent under the baseline. By 2030, that ratio is estimated to be 52.1 per cent which is lower than the ECCU's Monetary Council recommended threshold of 60.0 per cent.

Like the other territories the stock of public sector debt recorded for Dominica in the baseline scenario does not include Petro Caribe loans. Including that debt in the forecast impacts the debt and fiscal dynamics. Projections for public debt in 2015 now show a debt to GDP ratio of 86.7 per cent from 77.7 per cent under the baseline. By 2030, Dominica's debt to GDP ratio is estimated to be at 62.3 per cent, slightly above the 60.0 per cent threshold. Dominica's average primary balance is marginally higher than the debt reducing primary balance, an indication that the economy is able to sustain its level of debt.

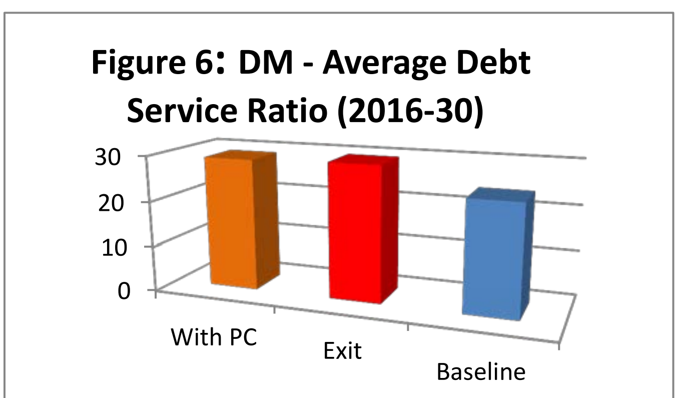


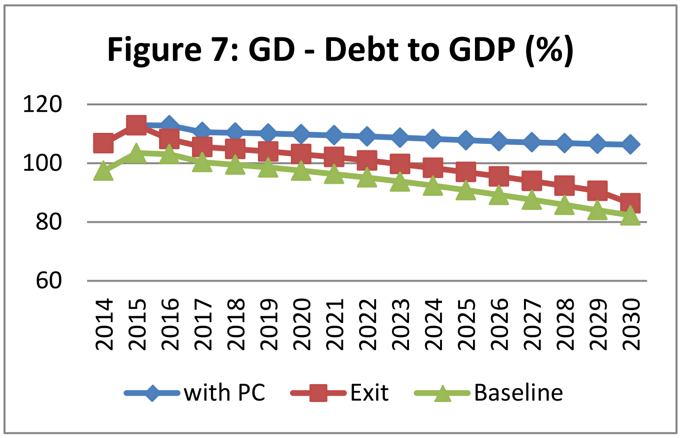
Figure 6: DM - Average Debt Service Ratio (2016-30)

Dominica's debt service ratio was adversely affected in both scenarios. When the Petro Caribe debt was added, the average debt service ratio increased by 4.9 percentage points to 29.0 per cent from a 24.1 per cent average under the baseline scenario.

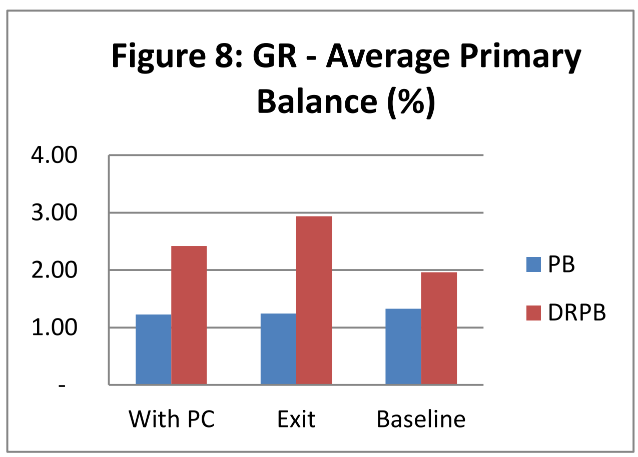
4.3 Grenada

Under a baseline scenario, Grenada recorded a public sector debt-to-GDP ratio of 99.6 per cent at the end of December 2014 (figure 7). Over the period 2015 to 2030, the debt-to-GDP ratio is projected to average 83.2 per cent under the baseline. By 2030, that ratio is estimated to be 71.3 per cent which is a divergence from the recommended threshold of 60.0 per cent.

As anticipated, the stock of public sector debt recorded for Grenada in the baseline scenario does not include Petro Caribe loans. Therefore its inclusion in the forecast impacts the debt and fiscal dynamics. Projections for public debt in 2015 reveal a debt to GDP ratio of 112.1 per cent compared with 95.2 per cent under the baseline. By 2030, Grenada's debt to GDP ratio is estimated to be 97.8 per cent, way above the 60.0 per cent threshold.



As at end of December 2014, Grenada's primary balance as a per cent of GDP was -1.2 per cent. The primary balance-to-GDP is projected to average 1.3 per cent over the period 2016 to 2030. An average primary balance-to-GDP of 2.0 per cent is needed to achieve a debt-to-GDP ratio of 60.0 per cent by 2030 (figure 8). After including the Petro Caribe debt, the primary balance averages 1.2 per cent in the period leading to 2030, while the debt reducing primary balance is 2.4 per cent.



The debt service ratio for Grenada was negatively impacted by both the addition of Petro Caribe debt and dismantling of the arrangement. That ratio averaged 61.7 per cent with Petro Caribe debt compared with 53.8 per cent in the baseline analysis.

5.0 Implications of Exit/Dismantling

Should the Petro Caribe arrangement be dismantled, the impact on countries will vary based on the level of funds being received under the programme and the access to alternative funding. Another factor that will likely influence the impact on a country is the behaviour of oil prices on the international market. There are countries with buffers for such eventualities and these countries may not be impacted as much as those without. The IMF[5] estimated that Antigua and Barbuda, Dominica and Grenada will record larger deficits in the event of dissolution of the Petro Caribe arrangement, as governments may have to finance the social and infrastructural projects previously funded by the programme.

5.1. The Debt Impact

In keeping with the proposal negotiated with the Dominican Republic, it is assumed that any dismantling of the Petro Caribe arrangement will involve a 50 per cent discount on outstanding debt, and additionally a sudden stop in the financing arrangement. Hence for Antigua and Barbuda accumulation of debt to Venezuela will cease and the country will have to buy back its existing debt. At the same time, future imports will require 100 per cent payment up front. Based on forecasts, the amount due to Venezuela by Antigua and Barbuda at the end of 2015 will be EC$339.6m. The forecasts were done under the assumption that a bond will be issued for EC$169.8m (half of the debt), at an interest rate of 7.5 per cent, with a bullet repayment in 2030. As a result of the new borrowing in 2016, the debt to GDP ratio is estimated to be 86.3 per cent by 2030 (figure 2 - Exit), a further divergence from the 60 per cent target. The average primary balance (2016- 2030) remained at 0.5 per cent, but the debt reducing primary balance required increased to 3.0 per cent (Figure 3 – Exit), a feat which has not been achieved by Antigua and Barbuda. The average debt service ratio under the dismantling scenario (Figure 4 - Exit) was 60.9 per cent on average, 6.7 percentage

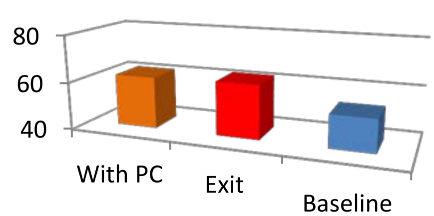
[5] Cheasty A - 2015

points above that of the baseline. Although the debt dynamics also changed with the new discount bond, the alternative scenarios used in the preliminary analysis reveal that Antigua and Barbuda could be slightly better off in terms of its long run debt stock, if the agreement is dismantled.

For Dominica, the Petro Caribe debt stock at the end of 2015 was estimated at $150.4m. The same assumptions as Antigua and Barbuda were used for the dismantling, considering that the countries of the ECCU may collaborate in any negotiations with Venezuela. A 50 per cent discount meant that a bond of $75.2m had to be issued in 2016, at a discount rate of 7.5 per cent and a bullet payment in 2030. Consequently, the debt to GDP ratio was estimated to be 63.8 per cent by 2030 (Figure 5 - Exit), indicating that the 60 per cent target will not be achieved on time, but will be met before 2035. The average debt service ratio under the dismantling was 29.5 per cent (Figure 6 – Exit), about 5.0 percentage points higher than the baseline. While the debt dynamics changed with the new discount bond, the results from the alternative scenarios for Dominica were slightly better than what obtained for Antigua and Barbuda.

Grenada's Petro Caribe debt stock at the end of 2015 was estimated at $423.7m. The same assumptions used for Antigua and Barbuda and Dominica were used for Grenada under the same consideration that the countries would collaborate in any negotiation process. A 50 per cent discount meant that a bond of $212.0m had to be issued in 2016, at a discount rate of 7.5 per cent and a bullet payment in 2030. Consequently, the debt to GDP ratio increased to 84.5 per cent by 2030 (figure 7), an indication that Grenada's convergence to the 60 per cent target will not be done in a timely fashion.

Figure 9: GR - Average Debt Service Ratio (2016-30)



The average debt service ratio under the dismantling was 62.5 per cent (Figure 9 – Exit), about 8.7 percentage points higher than the baseline. The debt dynamics for Grenada also changed with the new discount bond. The preliminary assessment shows that adding the Petro Caribe debt to Grenada's public sector debt results in further unsustainability. However, buying back the debt at a 50 per cent discount puts the country in a better position than totally assuming the debt.

5.2. Fiscal and External Accounts

It is believed that the Petro Caribe agreement has promoted fiscal dependence and has also created the opportunity for its members to increase their level of energy consumption. Amenities that they may not have been able to afford prior to the implementation of the agreement may have become affordable. Dismantling of the arrangement may have severe implications for the fiscal operations of the governments involved.

Grant financing for social projects has for the last two years averaged about 40.0 per cent of total spending in Grenada. This spending cuts across a number of areas including education, housing, infrastructure and employment. A sudden stop in that level of financing could adversely impact these projects and force the government to source additional capital funding for these projects. Doing so will result in a larger debt stock and higher interest payments, which is likely to affect the fiscal balance. This additional borrowing, coupled with the amount required to buy back its existing stock of Petro Caribe debt have the potential to derail the fiscal and economic recovery that the region has been experiencing.

In this current global environment, concessional financing is not as forthcoming and more so borrowing terms are not as favourable as the 1.0 per cent under the Petro Caribe arrangement. Replacing this source of external financing could pose serious challenges for the authorities of these highly indebted countries. Their public sector investment programmes could be compromised, adversely impacting capital expenditure and subsequently growth.

While it may not be difficult to find other sources for imports of fuel, having to pay the full import bill up front is likely to affect the country's external dynamics. This new development will result in larger outflows and create pressure on the financial accounts since the full amount will now have to be paid, either through the commercial banking system or otherwise.

In the case where commodities are exchanged for oil, the balance of payments position is likely to improve as initial exports may increase; but this type of arrangement is not in place with the ECCU member countries. Most members of Petro Caribe spend approximately 10 to 15 per cent of GDP per annum on fuel imports.

5.3 Social Implications

In all the countries signed under the Petro Caribe agreement, a proportion of the financial portion goes into financing of social programmes, since one of the objectives of the Socialist leader – President Hugo Chavez, was to improve the quality of life of the populace of the nations involved. In these tough economic times, these countries have to deal with poverty and unemployment, inter alia. Removing the energy subsidies, particularly in the case of LPG in Barbuda, and cutting back on the other social programmes can be detrimental to the small gains achieved in alleviating poverty and increasing employment in the region. On the other hand, the absence of subsidies is likely to force lower consumption and decrease imports of petroleum products.

In Antigua and Barbuda, funding is used for social programmes – people's benefit programme and a utility and gas subsidy. A stop in the social financing will negatively impact the persons who receive assistance under the benefit programme, unless the government can quickly identify alternative financing. That would create fiscal pressure – transfers and interest payments, but also additional social challenges if the government cannot continue to finance these programmes. The Government of Antigua also intends to use the funds from that programme for the financing of 2000 houses in five years. The beneficiaries are expected to get favourable mortgage loans at 5 per cent with a repayment term of up to 30 years. The feasibility of achieving that feat without the Petro Caribe funding is questionable.

6.0 Conclusion and Recommendations

The future of the Petro Caribe Energy Cooperation Agreement depends largely on developments in the economy of Venezuela and the petroleum industry. The industry contributes close to one third of Venezuela's GDP, nearly half of government revenues and almost all of its export earnings. Recent developments in the international oil industry have posed significant challenges for the economy of Venezuela. Petroleum production is about three-quarters of the amount recorded just over a decade ago. Oil reserves are insufficient to fund its large social expenditure and to adequately service its debt. There have been reports of shortages of important commodities in supermarkets in Venezuela, due to its inability to make payments for imports.

As Venezuela's challenges increase, economies like China and India become more important as exporting oil to these countries make more financial sense than the US$6.7 billion annual cost of Petro Caribe. How will these developments impact shipments to very small importers like the ECCU countries? Venezuela's accounts receivables more than doubled over the last five years and it has received only about 60 per cent of the cost of its petroleum exports in that same period. From a fiscal perspective, Petro Caribe is therefore unsustainable to Venezuela. The fundamental implication for the ECCU and the Caribbean on a whole is that as Venezuela strengthens its relationship with other allies, especially China, the political importance of the ECCU region may be diminished. As Venezuela becomes more financially challenged, it would make more economic sense to hang on to the larger markets, hence diverting supply at the expense of the smaller nations.

In March 2015, the Venezuelan Government convened a meeting with all member states of the Petro Caribe programme. At that meeting member governments were assured that they will continue to benefit from the programme as long as that regime remains in power. Notwithstanding these promises, there are greater undercurrents to contend with. Notably, the agreement greatly favours Venezuela in that it does not include any clause for arbitration or otherwise in the event of a dispute. The Government of Venezuela is the party given all discretion in the arrangement; inter alia, allowing only thirty days for termination of the agreement. It is apparent that a number of political and fundamental factors impinge on the longevity of the Petro Caribe arrangement and the region should therefore be prepared for dissolution of the energy union, despite the reassurance by the Venezuelan authorities.

Although members of Petro Caribe have become used to the debt accumulation arrangements, it is imperative to give consideration to the implications of a possible policy shift in Venezuela, since such would require a revamp of a number of national energy security plans. Preventative action would be much less costly than a sudden unsystematic dissolution of the arrangement. In the ECCU countries, a part of the financed portion is given back to the government as grant funding. That grant funding won't be available if the arrangement is discontinued. Are there contingency plans in place for such an event? This is a fundamental question that authorities need to answer.

Adding the Petro Caribe debt to the countries' total debt, had a significant impact on debt serving, the total debt burden and the fiscal accounts as greater effort is needed to achieve the 60 per cent debt to GDP target by 2030. The forecasts used in this analysis assumed that a 50 per cent discount will be granted, there is no guarantee of that happening. What if the countries are required to pay less or more than 50 per cent? Considering the unsustainability of the debt in these countries, the impact of a dismantling of the arrangement must form part of the wider policy discussion. It may be best for Saint Lucia to consider carefully a proposal for amending the arrangement before the country begins to import from Venezuela, if they choose to go that route.

For a more in-depth analysis of impact of the arrangement, a comprehensive view of the companies that were incorporated in each territory is important. One would need to know the legal and other intricacies of the Petro Caribe companies and their relationship with the government's fiscal, if one exists. Their inputs into the PSIP, the proportion of that funding to the overall development programme, among other issues are imperative to unearth the linkages to other aspects of the economy. Greater value would be added to the whole analysis if there was greater access to data from countries and in some cases more disaggregated information.

This analysis has brought to the fore a number of issues under the Petro Caribe Agreement that need to be discussed and addressed. Inter alia, the following:

Recording and monitoring of the debt: While the PDVs are generally incorporated as limited liability companies, the governments are liable for unpaid claims on their holding of shares with the companies. Therefore, debt owed to the company should be reported to the DMAS to be recorded and included accordingly in any analysis of the countries' debt position. Transparency and accountability must be integral in the operations of these companies.

Prudent Investments: Since this arrangement is not infinite, funds received for investment purposes should be utilized efficiently.

Consider other options for repayment: It may not be possible to issue these large bonds on the RGSM market at the same time. Although the bond option was used in the analysis as a starting point, alternative means of paying off the debt should be examined in the event that these countries are required to do so.

Find alternatives for grant funding: In some cases grants from the PDV fund constitute close to 40 per cent of total social spending; therefore a sudden stop could be disastrous. As a proactive measure, other sources of financing or total revamping of these programmes should be considered.

Appendix

Table I: Long–term Financing under Petro Caribe Arrangement		
Price per Barrel - US$ (F.O.B)	Proportion Financed (%)	Time (Years)
≥ 15	5	15
≥ 20	10	15
≥ 22	15	15
≥ 24	20	15
≥ 30	25	15
≥ 40	30	23
≥ 50	40	23
≥ 100	50	23

Source: Petro Caribe Multilateral Agreement