



# REVIEW OF THE USVI TERRITORIAL ECONOMY 2019



**OFFICE OF MANAGEMENT & BUDGET**

Division of Economic Research

March 24, 2020

# TABLE OF CONTENTS

<b>I. Introduction .....</b>	<b>2</b>
<b>II. Economic Structure and Performance.....</b>	<b>3</b>
Size of the Economy.....	3
Structure of the Economy.....	3
Real Growth Rates.....	5
Income Levels and Growth Rates .....	6
Prices and Inflation .....	6
Employment.....	7
Leading Sectors.....	8
Lagging Sector .....	10
Trade Openness, Balance, and Export Concentration .....	11
Housing and Construction Cost Values .....	12
Banking Sector .....	13
<b>III. Fiscal Performance .....</b>	<b>13</b>
Debt Management and Contingent Liabilities.....	15
Summary and Remaining Policy Challenges.....	16
References.....	17

## I. INTRODUCTION

This report provides an overview of the economic and fiscal conditions in the US Virgin Islands (USVI) as of the end of 2019. The purpose of this document is to inform policymakers, the business and investor community, and the general public as to recent economic developments and trends in the territory.



The territorial economy, in brief, continued to recover in 2019 and is rebounding after years of a secular decline in economic output, high unemployment, per capita income growth, and enduring weak financial and liquidity conditions. In 2019, the economy recorded more tourist arrivals, registered lower unemployment rates, and witnessed a spike in tax revenue that is helping to improve public finances, and realized improvements in the delivery of essential public services. Real economic growth is expected to be positive in 2019.

The recovery process, which started in 2018, is likely to continue into the first quarter of 2020 as up to \$6.08 billion allocated in Federal disaster-related relief continues to be obligated and expended, but may falter in the remaining quarters of the year due to an external shock. As of Dec. 31, 2019, according to the Office of Disaster Recovery, \$1.82 billion out of \$3.98 billion Federally obligated funds were expended, or 45.7%.

The main external economic threat to the territorial economy will be slowing global growth and even recessionary threat posed by the novel coronavirus (COVID-19) pandemic that is dampening international travel and disrupting global supply chains anchored in China and other East Asian countries and threatening to push major economies into recession. In addition to a potential pandemic, continuing trade and immigration policy uncertainties and tensions between major trading economies are likely to have ripple effects on smaller states and dependencies, reducing growth, disposable incomes, the movement of people, and the flow of remittances. Other risks, such as hurricanes and earthquakes are present but not as concerning as a COVID-19 induced recession. Initial long-range forecasts of the 2020 hurricane season point to an average to above-average season (Norwall, 2020). The first quantitative forecast will be available in April. Seismic activity around the Puerto Rican trench, the boundary of the Caribbean plate with the North American plate closest to the USVI, has been on the increase but earthquakes are very difficult to predict.

The main internal threats to the USVI economy are the massive unfunded liabilities of the Government Employee Retirement System (GERS) and the illiquidity of Water and Power Authority (WAPA), a semi-autonomous government-owned electric, water, and sewer utility. The likely consequences of the dire financial situations of these two entities would be a reduction in the benefits paid to retirees after 2023 in the case of GERS and demands for more transfers from the central government in the case of WAPA.

In 2019, the main driver in the economy was government spending. Government spending increased dramatically over the last two years with an influx of Federal disaster assistance. In 2018, government spending was estimated to be 42% of GDP, when for the decade before the hurricanes (2007-2016), the average government share of GDP was 26.36%. Although the official GDP for 2019 has not yet been calculated, the expected 2019 government spending as a share ratio is likely to be in the 30% range.

Despite the many positive strides in 2019, five principal economic challenges for the territory remain:

- (1) improving procurement, grants management, and supervisory absorptive capacity in order to more quickly and effectively spend the Federal disaster-related assistance;
- (2) improving the overall quality and effectiveness of public institutions and services to reduce transaction costs, stimulate economic growth, and promote social development;
- (3) inspiring private sector-led growth by strengthening the business climate and generating new poles of sustainable economic growth, unrelated to government contracting;
- (4) constructing a credible plan to address the pending insolvency of GERS; and
- (5) mitigating climate change effects and strengthening environmental protection and conservation efforts, given the critical link between the ecological patrimony and the mainstay of the economy, tourism.

The report provides information on the structure and performance of the territorial economy, highlighting movements in key macroeconomic variables, developments in the real and financial sectors, fiscal and debt management, and ends with a catalog of remaining economic challenges.

## II. ECONOMIC STRUCTURE AND PERFORMANCE

### Size of the Economy

The USVI economy is small and extremely vulnerable to natural disasters— windstorms, earthquakes, tsunamis— as well as external economic shocks due to the high degree of trade dependence and lack of economic diversification. The most recent Gross Domestic Product (GDP), the market value of all final goods and services produced in a given period, was estimated by the US Bureau of Economic Analysis (BEA) at \$3.984 billion in nominal terms for 2018. Of the five insular US territories, the USVI is the third-ranked economy for 2018. The USVI surpassed the Commonwealth of the Northern Mariana Islands (CNMI) (1.5b) and American Samoa (\$684 m) but was dwarfed by Puerto Rico (\$101 billion), and slightly smaller than Guam (\$5.3 b). All the US insular territories, except for Puerto Rico, are much smaller in terms of GDP than any of the 50 states and the District of Columbia.

GDP estimates for 2019 will not be available until the third quarter of 2020. However, expectations are to have another year of expansion due to ongoing reconstruction activities.

### Structure of the Economy

The USVI economy is mainly service-oriented with a small manufacturing sector and a largely moribund primary sector (agriculture, fisheries, mining, and extraction). Because of the small market size (approximately 96 to 104,000 persons depending on the source of population estimates used), limited natural resources, small landmass, and high cost of energy, little is produced domestically for internal consumption. Most goods are imported for either direct consumption or for resale, making the trade very critical.

Value-added by industry as a percentage of GDP shows that the average contribution for goods-producing industries is 14% and 64.6% for service industries for the period 2015-2017. The contribution of manufacturing to GDP dropped precipitously from approximately \$800 m to \$500 m per year with the closure of Hovensa in 2012 and has not yet recovered. With the commissioning of Limetree Bay Refining, LLC (“Limetree Refinery”) in 2020, the contribution of manufacturing to GDP will most likely increase.

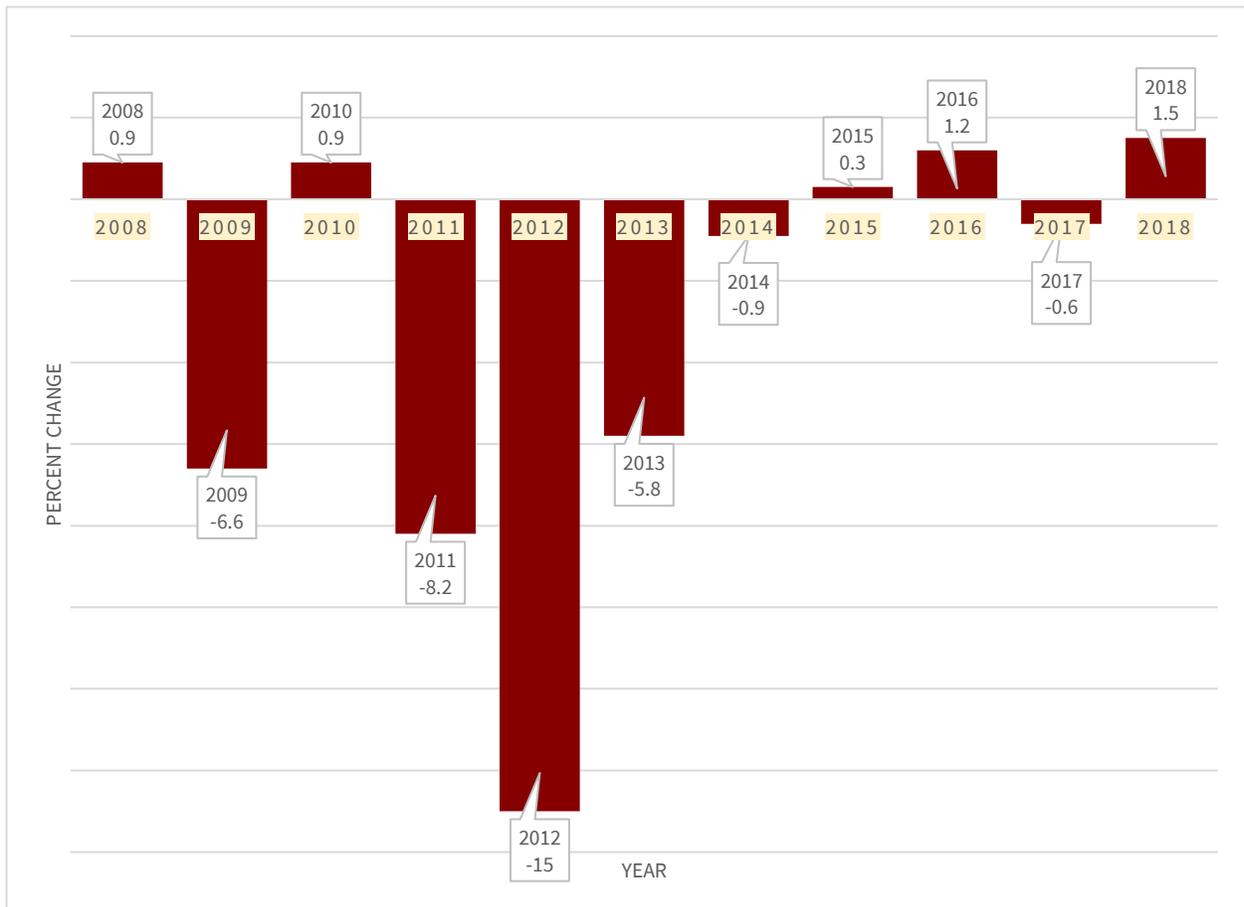
## Real Growth Rates

The real economic growth rate, that is, the growth adjusted for the effects of inflation, for 2018 was 1.5%. The growth in the overall economy was driven by a 38.7% increase in government spending, a 51.4% increase in private fixed investment, and a 1.4 percent increase in consumer spending. Declines in tourist arrivals in 2018 compared to 2017 help explained reduced net exports.

As can be seen in Figure 1, real economic growth has been volatile over the last decade or so. In five of the years, real growth has been positive, and in six years, negative. The coefficient of variation for growth rates (mean divided by variance) is high, calculated to be 1.96. High volatility increases investment uncertainty, contributes to government revenue volatility, which in turn complicates budgeting and heightens the likelihood of fiscal imbalances and the persistence of structural budget deficits.

The expand-contract cycle of economic performance is due to large adverse external shocks—Great Financial Recession of 2008-2009 that reduced the number of visitors; the closing of Hovensa oil refinery in 2012 that reduced the manufacturing working force considerably; and the adverse effects of two major hurricanes in 2017 that caused an estimated \$10.96 billion worth of damages, more than twice the size of GDP. The lack of economic diversification that characterizes the economy also amplifies the ill effects of shocks. The engines of the economy are tourism and government expenditures. Tourism expenditures as a share of GDP averaged 30% annually between 2007 and 2018, and the government as a share of GDP over the same period was 26%, together summing to 56%.

**Figure 1: Real Economic Growth Rates**

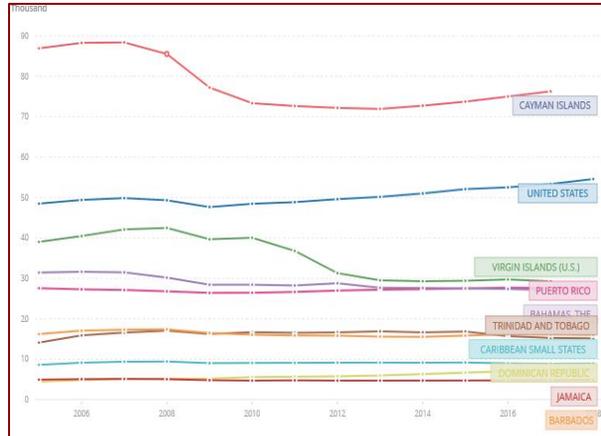


Source: US Dept of Commerce, Bureau of Economic Analysis (USDOC-BEA)

## Income Levels and Growth Rates

Per capita incomes in constant dollars to adjust for the effects of inflation in the territory have shown some improvement in recent years, but overall, since 2013 has been relatively flat and less than the amounts recorded in the mid-2000s. The per capita levels for the territory are far below the figures for the entire US, but the highest among insular territories, and superior to all other sovereign independent Caribbean states, and inferior only to the Cayman Islands, a British dependency that relies on Citizenship and Residency by Investment (CBI), offshoring banking, and tourism. Figure 2 shows the comparison between the USVI and the United States (US), and several neighboring Caribbean states and territories.

**Figure 2: Per Capita GDP in Constant 2010 Dollars**



Source: World Bank (Available at <https://data.worldbank.org/indicator/NY.GDP.PCAP.KD?end=2018&location=US-VI-KY-PR-S3-BS-DO-JM-TT-BB&start=2005&view=chart>)

**Figure 3: Per Capita Real Growth Rates (Constant 2010 Dollars)**



Source: World Bank (Available at <https://data.worldbank.org/indicator/NY.GDP.PCAP.KD.ZG?end=2018&locations=US-VI-KY-PR-S3-BS-DO-JM-TT-BB&start=2005&view=chart>)

As seen in figure 3, per capita growth in constant 2010 dollars has been more volatile for the USVI, reflecting three shocks in the last decade or so, and trended negative, compared to other jurisdictions.

## Prices and Inflation

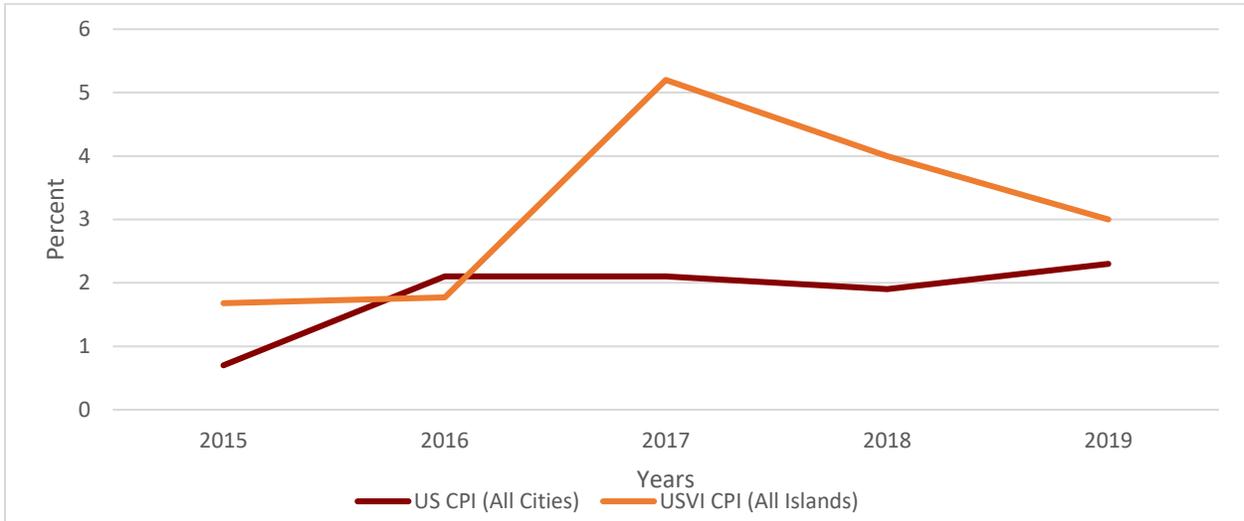
The revised CPI for the USVI follows the US Bureau of Labor Statistics classification system of Goods and Services, which has nine major groups. These are: Food, Alcoholic Beverages, Housing, Apparel, Transportation, Medical Care, Recreation, Education and Communication, and Other Goods and Services and has weights for each island in constructing the all-island index.

The rate of annual inflation, as measured by the Consumer Price Index (CPI) for all three islands in the USVI, rose 3 percent from December 2018 to December 2019. This increase was due mainly to the higher prices for food, up 9.0 percent over the year, as well as higher prices for recreation, up 7.3 percent, and alcoholic beverages, up 5.4 percent. Lower prices were recorded for apparel, down 5.8 percent, as well as negligible decreases for transportation and other goods and services. Of the three main islands in the CPI, St. Thomas showed the largest increase over the year, rising 4.8 percent, followed by St. Croix, up 3.2 percent. St. John showed a very moderate annual increase, up only 0.9 percent, although food prices on St. John showed a large rise, up 13.5 percent.

As displayed in Figure 2, inflation in the USVI exceeds mainland figures consistently, except for one year in the last five. The USVI showed a spike in 2017 and 2018 and is regressing to trend. The underlying factors explaining larger price increases in the territory compared to the mainland are high import dependence in the territory, the high cost of shipping, the high cost of electricity, less competition and more concentration among retail businesses allowing for the greater exercise of market

power. In the immediate period after the hurricanes, prices spiked due to the disruptions in normal shipping and trading arrangements, high demand for certain items, shortages, and exercise of market power.

**Figure 2: Annual Inflation Rates- U.S. vs. USVI**



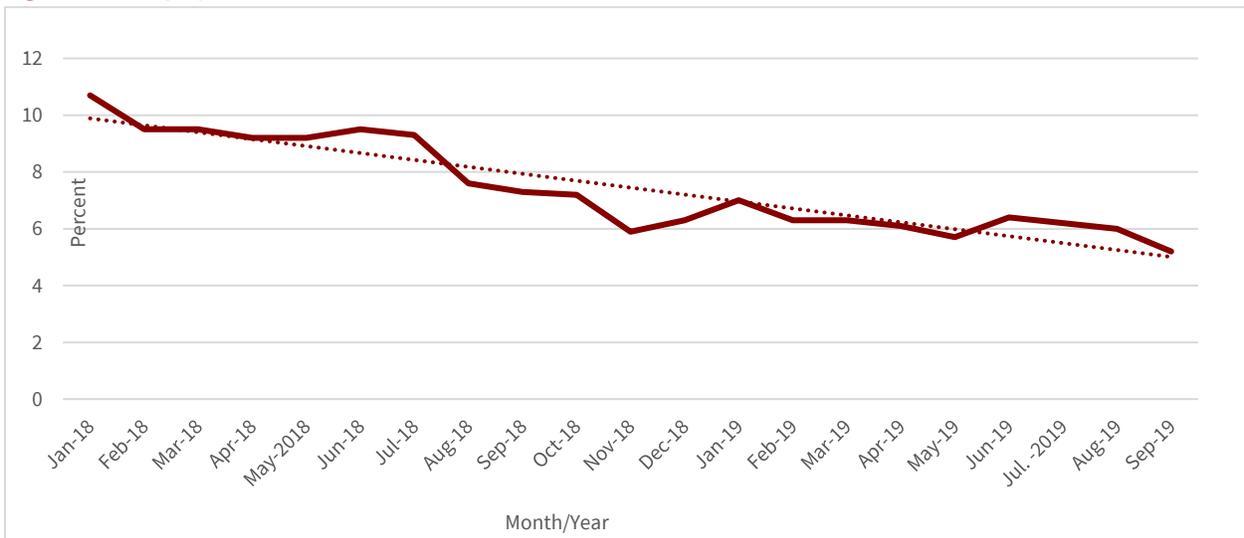
Sources: Bureau of Labor Statistics and DER/OMB

## Employment

As of September 2019, an average of 35,079 persons are employed in non-agricultural payroll positions. Of that number, 10,622 (30%) are in the public sector and 24,457 (70%) in the private sector. Manufacturing or goods-producing jobs, 3,363, (9.5%) are far less than service jobs, 31,717 (90.5%).

Over that last two years, the unemployment rate has plummeted after a spike in initial unemployment claims shortly after the hurricanes (See Figure 3). As of September 2019, the unemployment rate was 5.1 percent. This figure is down from double digits that prevailed after the closure of Hovensa in 2012.

**Figure 3: Unemployment Rate**



Source: VI Dept of Labor

However, the median wage is relatively low (\$33,390 for 2018) compared to the US mainland but higher than many surrounding Caribbean neighbors. The labor force participation rate for the USVI is slightly lower compared to typical labor force participation rates in other jurisdictions, suggesting more discouragement in the population (See Table 1). For example, the labor participation rate was 63.3 % for the US (Dec. 2019), 65.2% for Dominican Republic(June 2019), 65.2% for Jamaica (2019), 60% for Trinidad and Tobago (2019), 40% for Puerto Rico (June 2019), 64% for all of Latin America and the Caribbean (2019) (World Bank and ILO). The female participation rate was even lower than the overall rate, implying that fewer females are engaged in the formal workforce or seeking formal employment.

**Table 1.**

<b>Labor Statistics</b>	<b>USVI (Entire Territory)</b>
<b>Unemployment Rate (Nov. 2019)</b>	5.1%
<b>Labor Force (Nov. 2019) (persons)</b>	42,508
<b>Median Wage (2018)</b>	\$33,390
<b>Overall Labor Force Participation Rate (2019)</b>	59.13%
<b>Female Labor Force Participation Rate (2019)</b>	55.43%
<b>Non-Agricultural Employment (payroll)</b>	35,079

Source: VI Dept. of Labor and ILO

The key private sector employment sector, tourism-related jobs, showed a 39 percent decline from 2017 to 2018, mirroring the ill effects of the storms. Statistics for 2019, which will not be available until the Spring of 2020, are expected to show some recovery as airlift capacity, and hotel room availability continues to increase.

**Table 2.**

<b>Tourism Related Employment</b>			
<b>Category</b>	<b>2018</b>	<b>2017</b>	<b>Percent Change</b>
<b>Hotel and other Lodging</b>	1,559	3,469	-55%
<b>Gift Shops</b>	726	974	-25%
<b>Restaurants and Bars</b>	2,179	2,996	-27%
<b>Airline Transportation</b>	326	402	-18%
<b>Scenic and Sightseeing Transportation</b>	62	115	-46%
<b>TOTAL</b>	4,852	7,956	-39%
<b>Note: 2019 figures will not be available until May 2020; Source: VI Dept. of Labor. The 2019 numbers are expected to show improvement over 2018, with more hotels reopening and airlift capacity being restored.</b>			

Source: VI Dept. of Labor

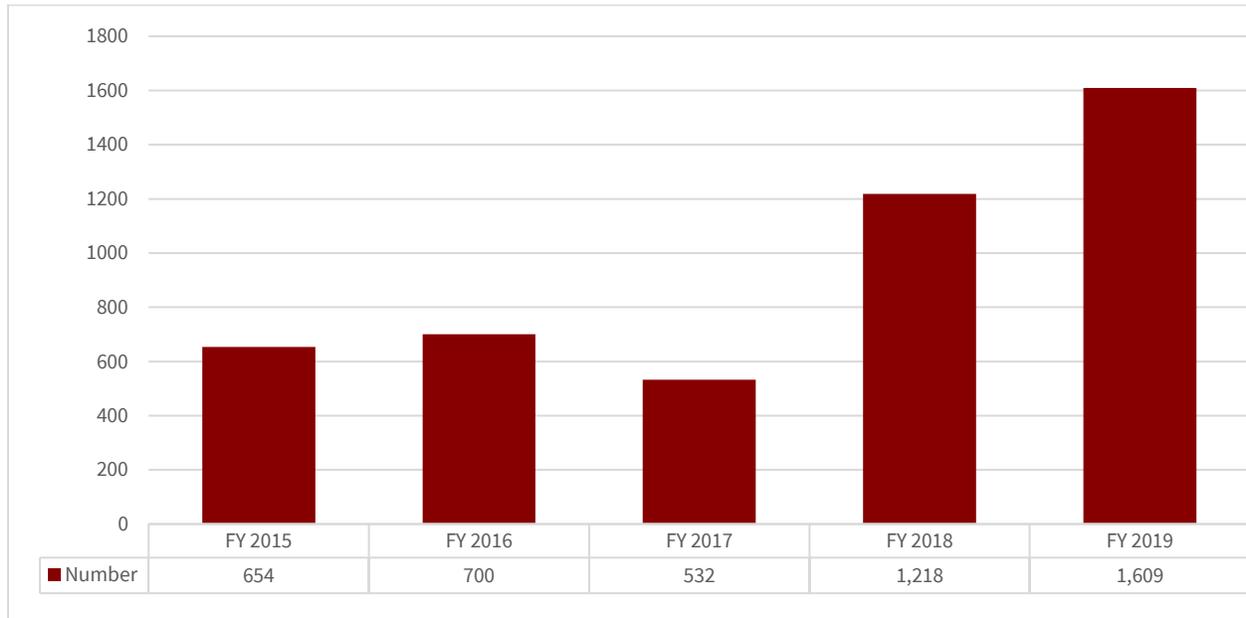
## Leading Sectors

The most dynamic sector of the local economy at present is construction. Most of the job creation is occurring in this sector. Federal disaster assistance is spurring reconstruction, infrastructure repair, and several hazard mitigation activities, resulting in high demand for construction workers.

For 2019, the USVI construction and extraction category of workers numbered 1,780. It constituted 5% of the employment force (VI Dept of Labor). Installation, maintenance, and repair occupations, a closely related occupation category, numbered 1,350, or 3.8% of the workforce (VI Dept of Labor). When these two categories are combined, the territory has approximately 8% of its formal workforce in construction and repair. Given the scale of approved and contemplated Federally financed infrastructure projects, the demand for construction workers is bound to continue to increase in out years.

One of the most reliable indicators of construction sector dynamism is the number of building permits issued. As can be seen, the average number of building pre-hurricane was 677 per year (average for FY15 and FY16) (See Figure 3). In the post-hurricane years (FY18 and FY19), the percentage jumped to 1413. Between FY18 and FY19, permits increased 32%, signaling to continue strong building/rehabilitation activity, after the triple-digit increase in year following the twin hurricanes FY2018 (See Figure 4).

**Figure 4:** Number of Building Permits Issued FY 2015- FY 2019



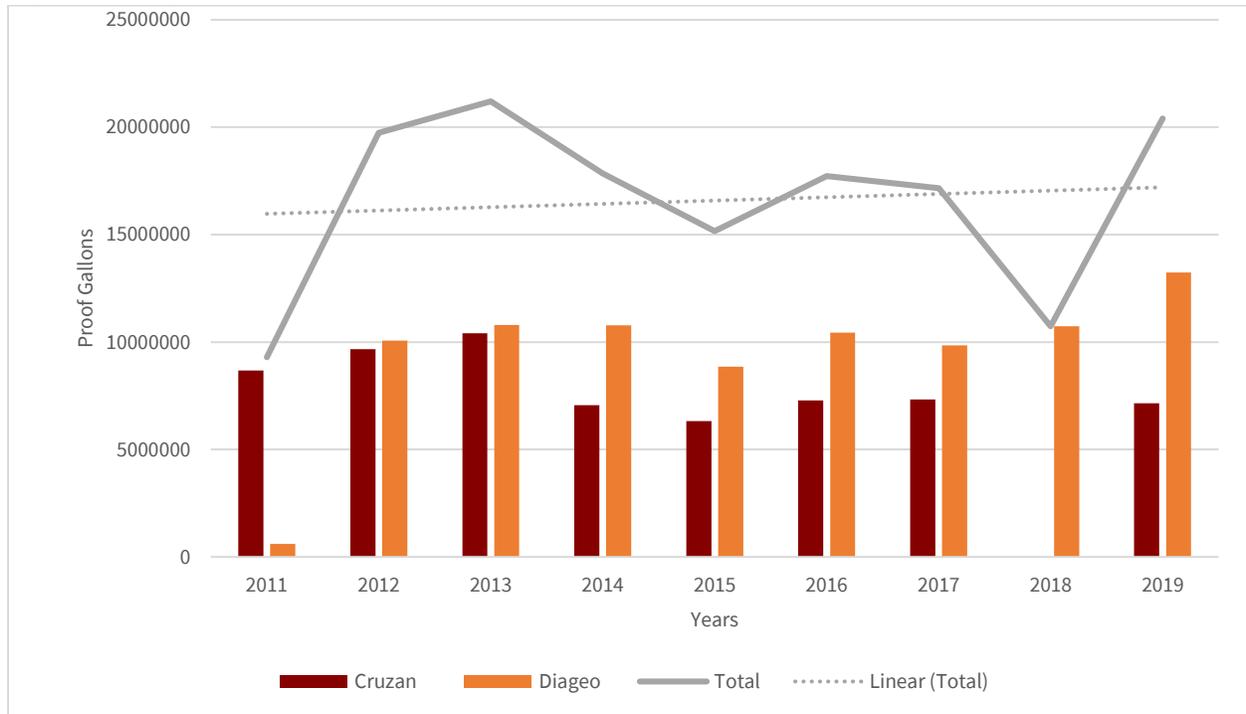
Source: VI Dept. of Planning and Natural Resources

Historically, tourism is the principal private-sector economic activity. Tourism expenditures amount to approximately 30% of GDP and generate, 42% of total exports, and on average, 8,000 direct jobs in an economy with a civilian workforce of 42,000. However, in the aftermath of the devastating twin hurricanes of September 2017, the number of stay-over tourist arrivals declined, and employment in the leisure and hospitality sector plummeted, as several large hotel properties closed for renovations. Tourism-related jobs rose in 2018 and are expected to rise further in 2019 as some hotel properties reopened, and airlift capacity improved. Tourist arrivals were approximate, 1.997 million in 2019, up from 1,937 million in 2018, but still far removed from the pre-hurricane peak of 2.814 million realized in 2014.

After tourism, the most critical sector in the economy is the storing and shipping of petroleum products. Petroleum products account for some 42% of total good exports in 2018. However, this is largely a reexport business and little value is added in the territory. Once the Limetree Refinery is recommissioned in 2020, much more value-added will occur and the value of exports will increase. Then the oil sector will truly have a significant impact on net trade.

After tourism and petroleum, the next most important sector is the production and export of rum. Rum constituted 41% of total exports in 2018. Two major distillers, Cruzan Rum and Diageo, are active. Together, the territory’s average annual production from 2011-2019 has been 16.5 million proof gallons. As can be seen in the following chart, rum production virtually doubled from 2018 to 2019. However, overall, the trend over the last decade has had a slight positive slope (dotted gray line) (Figure 5).

**Figure 5: US Virgin Islands Rum Production**



*Division of Economic Research-OMB*

## Lagging Sector

Agriculture is by far the most moribund and neglected sector in the territory despite apparent fresh produce import substitution possibilities. The territory imported food products valued at \$110.3 million in 2018, with fresh and chilled fruits and vegetables constituting \$4.4 million, or 4% of the total food import bill. The fruits and vegetables category represent an area for possible import substitution. However, statistics on local fruit and vegetable production were unavailable at the time of publication.

Nonetheless, the number of active farmers is estimated to be a few hundred, with most being part-time, with most household income coming from a non-farm source. For the most recent numbers available dating from 2015, the number of licensed farmers were reported to be 157 (104-crop, 30 livestock, 9 mixed, and 4 honeybees) (VI Dept. of Agriculture). The vast majority of farmers, as of 2015, were located on St. Croix, some 78%.

Agriculture continues to suffer from a set of perennial problems that include limited access to irrigation water, technology, land; high cost of imported inputs and energy, constrained access to capital to invest in more technology or more intensive forms of agriculture, poor marketing, and transport infrastructure, and a rapidly aging farmer population. Similarly, commercial fisheries are in decline with fewer landed catches recorded and declining numbers of active registered commercial fishermen over time. As of 2017, there were 235 licensed commercial fishermen. Several of the commercial fisheries are considered overfished, and coral reef health continues to deteriorate marked by increased algae growth, bleaching events, and the spread of coral disease. Since 2001 there has been a moratorium on the issuing of fishing licenses. Since the 1990s, the fisheries sector has been in decline. No mining or logging activities are reported in the territory.

## Trade Openness, Balance, and Export Concentration

A significant feature of the economy is its trade openness, which is measured Exports plus Imports divided by Gross Domestic Product times 100. If the measure exceeds 100, it implies openness or a condition where trade is more important than domestic production. The US Virgin Islands economy has limited domestic production; thereby, it depends heavily on the imports of goods and the export of services (tourism) (See Figure 5 orange line). When openness exists, it means that the economy can take advantage of gains from trade but, at the same time, becomes very sensitive to price volatility, macroeconomic developments, and trade policy changes in its major trading partners and the principal source markets for tourists.

The USVI is an open economy and very susceptible to developments on the US mainland and large regional trading partners, namely Puerto Rico and the Dominican Republic. More than 80 percent of all tourists are from the US mainland, and most goods imported originate either from the US mainland or Puerto Rico. The Dominican Republic is another significant trading partners and serves as a source of food and agricultural imports.

What is noteworthy is that since 2016, the trade deficits have been getting steadily larger (See Figure 6 (maroon bars below zero)). The spikes in 2017 and 2018 can be explained by the need to import a large volume of goods to facilitate the rebuilding process in the aftermath of the hurricanes of 2017. The figures for 2019 are estimated and signify a drop in openness and an improvement in the trade balance. However, the chart indicates that export recovery is desperately needed.

**Figure 6: Trade Indicators**



Source: USDOC-BEA and authors own calculations

In terms of export concentration, the USVI tourist expenditures as a share of total exports of goods and services are very high. According to the World Travel and Tourism Council, the USVI visitor exports accounted for more than 54% of GDP in 2017. The average share of visitor exports as a share of GDP in the entire Caribbean was 19% in 2017. The only countries in the Caribbean that had higher tourism dependence were Barbados, St. Lucia, and Jamaica (WTTC, 2019).

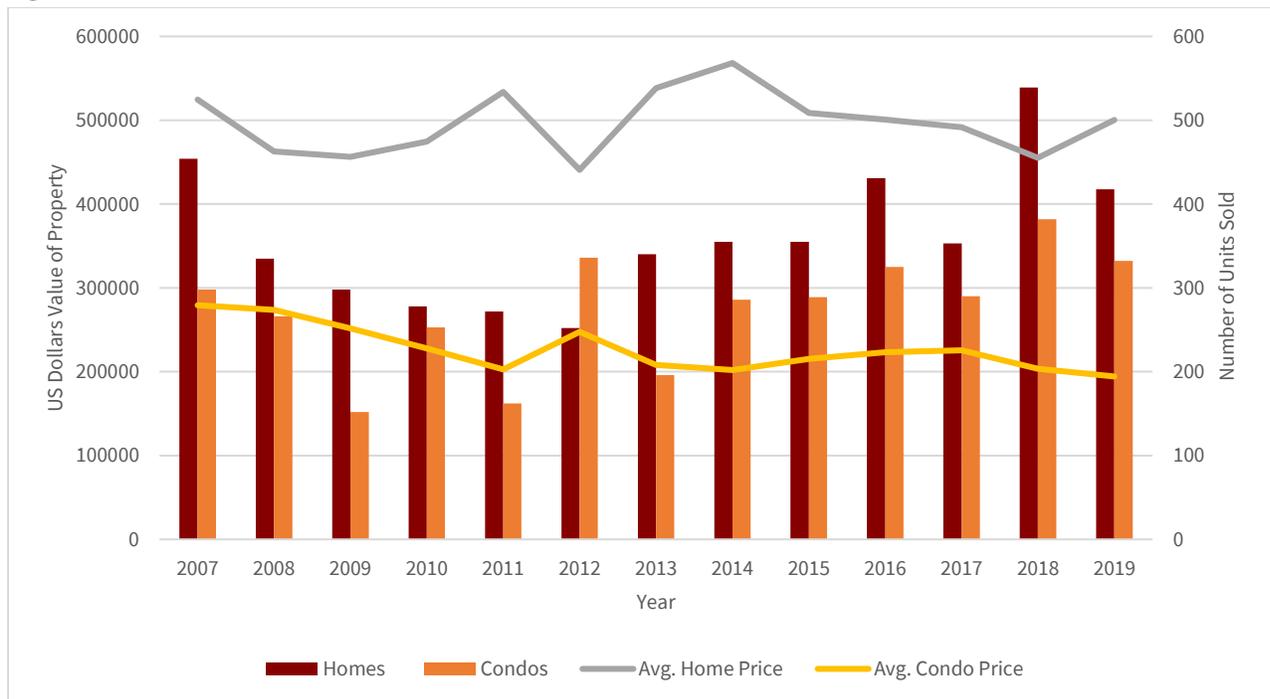
## Housing and Construction Cost Values

Housing values in the territory have tended to hover around the \$500,000 mark for single-family homes and \$230,000 mark for condos over the last decade (See Figure 5). After the twin hurricanes of 2017, the number of houses and condos sold dropped significantly, as did the final sale price. In 2018, the housing market rebounded, with year to year 5% increase in the number of homes sold. However, the year to year average price fell 7.4%. The decline in the average price may have indicated distressed sales. The condo market showed an increase in the number of units sold, 2018 moving up from 290 units in 2017 to 392 units in 2018, an increase of 35%. However, the average value dropped from \$225,480 to \$203,633. Actual 2019 figures are not available until May 2020, but the forecast projections average sale price for homes is \$500,439 and for condos is \$194,332 (See Figure 6).

At a disaggregated level, each district in the territory has distinct market characteristics. St. Thomas tends to be the most active in terms of the number of properties sold, while St. Croix has fewer sales at a lower average house price compared to St. Thomas. St. John tends to have the highest valued transactions but has the fewest transactions.

House construction in the territory tends to be high, with cost per square foot ranging between \$250 to \$400 depending on the quality of masonry construction and location. Average masonry construction in St. Croix being closer to the lower bound and while high-quality masonry construction in St. John, being closer to the higher bound and St. Thomas around \$300-\$302. For the sake of comparison, the most expensive real estate market of the 50 states is Hawaii, where construction of a single detached medium quality home in Honolulu, HA, costs \$296 per sq. ft. and a mid-rise condo is \$413, according to Cummings, a leading observer of construction and housing trends in the US. In the greater Caribbean construction cost per square ranges from a low of \$93 in Puerto Rico to a high of \$600 in the British Virgin Islands according to Global Property Guide<sup>4</sup>.

**Figure 7:** USVI Real Estate Indicators



Division of Economic Research-OMB

## Banking Sector

The financial sector in the US Virgin Islands consists of five commercial banks (Banco Popular, First Bank, Merchants Bank, Bank of St. Croix, and Nova Scotia (soon to be Oriental Bank of Puerto Rico, permit to acquire granted July 2019) and several insurance companies. The financial sector is informationally opaque, which makes it challenging to analyze the structure and performance of the sector. For 2018, the most recent statistics available from the Banking, Insurance, and Financial Regulations of the Lt. Governor's Office, total assets in the banking system summed to \$3.2 billion, total deposits amounted to \$3.1 billion, operating income to \$90.9 million, and operating expenses to \$89.3 million, and net income, \$880,000.

The banking system is highly concentrated, just two banks controlling 76.2% of the assets. Three out of five banks reported net profits in 2018. The majority of lending is for single-family residential mortgages. Conventional mortgage finance constituted 48 percent as a share of total commercial bank lending compared to 20 percent for commercial/industrial loans and 0 percent for agricultural loans. Remaining lending activity is split between real estate development, FHA-VA housing finance, and personal consumer loans (vehicles, purchase of other retail items, and student loans, etc.). Moreover, the banks in 2018, did not originate any Small Business Administration guaranteed loans.

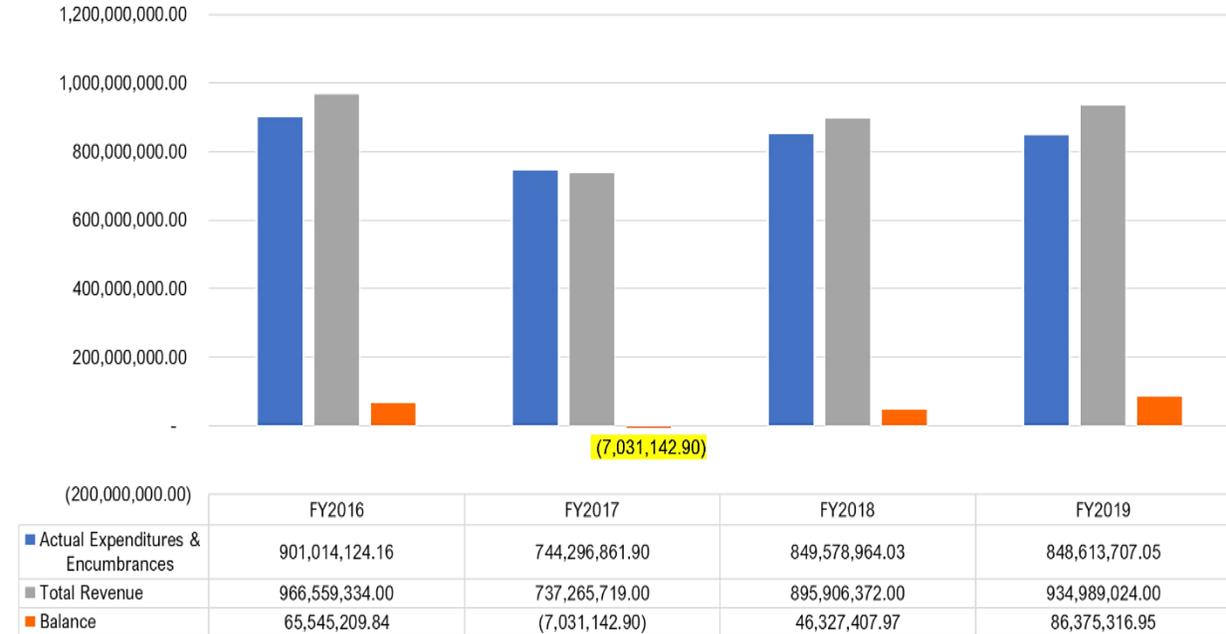
In 2018, the approximate depth of the financial system (private credit to GDP) was 27.4%, which indicates a relatively lower level of financial development. For example, higher-income countries averaged private credit to GDP ratios of 103% (World Bank, 2016). Higher ratios of financial depth are associated with greater long-term growth and poverty reduction because they indicate that more intermediation is occurring. In shallow financial systems, savings and intermediation are suppressed, and access to credit tends to be restricted. Of course, there are limits, countries with extremely high ratios tend to face financial crises due to an excess of risk-taking and poor underwriting policies.

No information is available on the number of loan recipients and the number of savers to determine the degree of access and financial inclusion, nor loan delinquency rates, nor liquidity, nor efficiency. No information on prudential ratios was available on 4 of 5 banks from the FDIC database. No information was provided on the insurance sector to assess whether homeowners are fully insured or underinsured against windstorms, a major risk threat to the territory given the increasing frequency and severity of storms as global warming progresses.

## III. FISCAL PERFORMANCE

The territory has historically faced structural deficits in its budget and has relied heavily on debt financing and Federal transfers. Structural deficits are said to exist when the average level of government expenditures exceed the average level of revenue, even when the economy is at full potential or fully employed. As can be seen in Figure 8, fiscal discipline has improved, but the positive balances are still a small percentage of total expenditures and of GDP. For the last three out of the last four fiscal years, positive balances been recorded for the General Fund. The exception was FY 2017, a year when the impact of the twin hurricanes was felt the most, reducing revenues significantly as many businesses closed and personal and corporate incomes dropped. In that year, revenues fell 23.7 percent while expenditures only fell 17.4 percent. In FY2018 and FY2019, government spending expanded dramatically, enabled by federal disaster assistance programs.

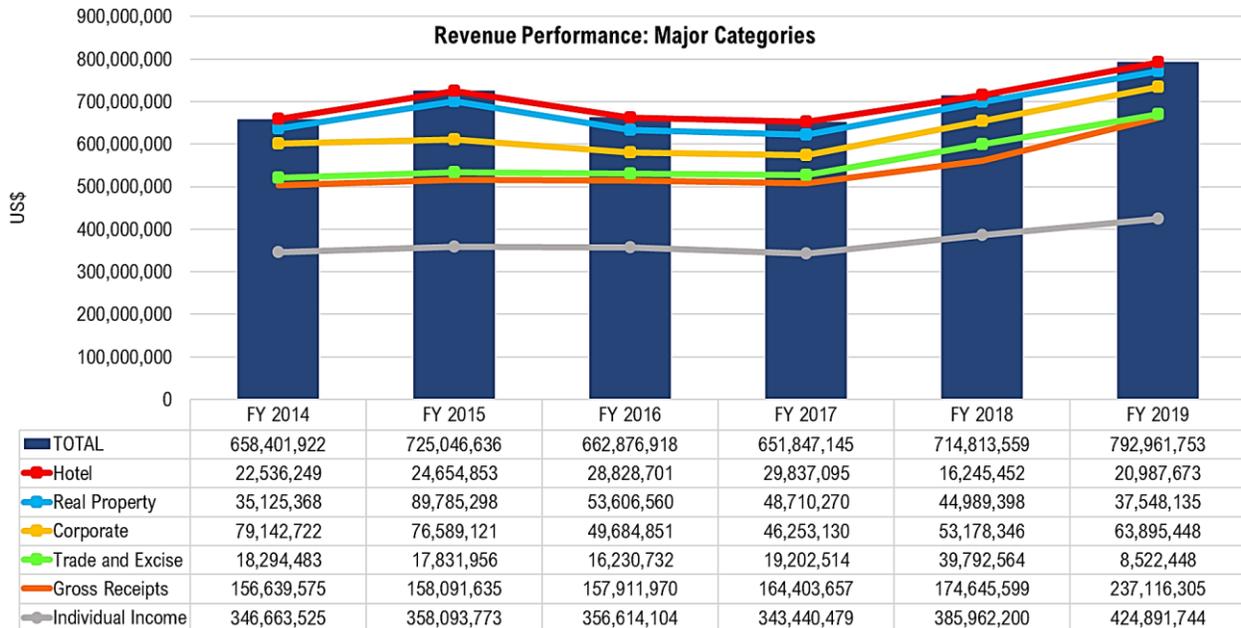
**Figure 8. Expenditures**



Budget Administration Unit-Office of Management and Budget (November 2019)

Concerning revenue generation and collection, revenues fell in FY2017 but recovered strongly in FY2018, and FY2019 (See Figure 9) Total revenues increased from \$714 m to \$792 m between the two fiscal years, an increase of 10.9 percent. The 36% increase in gross receipts contributed the most to the overall improvement in tax capture. However, much of the increase in gross receipts stems from contractors winning large Federally financed disaster-recovery projects and will not continue beyond the medium-term. These are one-off payments paid to the government at the signing of the contract. Therefore, for the positive trend in budget balances to be sustained, more revenue growth must originate organically, either from new local businesses being formed, existing business expanding, or personal incomes of residents rising.

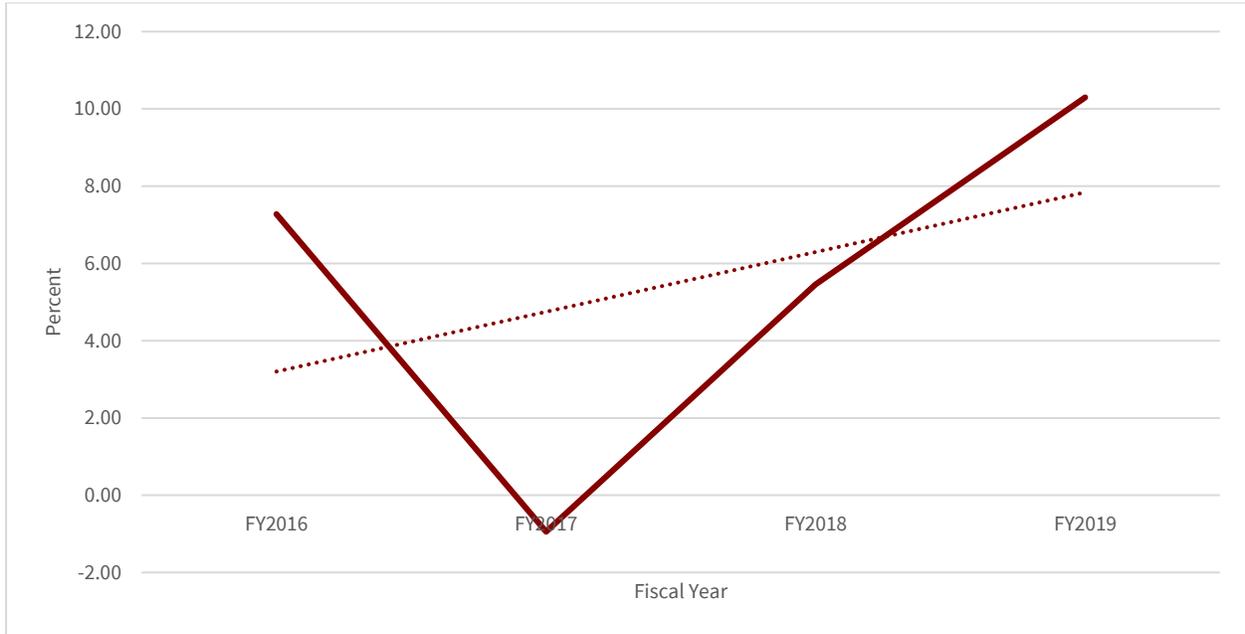
**Figure 9. Revenue Performance**



Revenue Officer-Office of Management Budget (November 2019)

When comparing the fiscal discipline of the territory to nation-wide benchmarks, the territory is improving. However, still, 20 mainland states have total balances at a share of total expenditures that exceed 10% in FY2019 (NASBO, 2018). The average total fiscal balances as a share of total expenditures for the 50 mainland states averaged 6.6% for the period 1979-2019 (NASBO, 2018). The territory just started a rainy-day stabilization fund and deposited \$1,000,000 in FY 2019, or 0.11% of total expenditures (See Figure 10). For the mainland states, the average rainy-day fund balances are much higher and have been in place longer. The average rainy fund balance as a percentage of expenditures for the US mainland is 4.4% (NASBO, 2018).

**Figure 10: Total Balance as Share of Total Expenditures**



Office of Management and Budget. Note Total Balance in FY2019 includes Rainy Day Fund.

## Debt Management and Contingent Liabilities

The outstanding central government bond debt is approximately \$1.9 billion. Since 2017 no new bonds have been issued due to a less than investment bond rating. In January 2018, Moody’s credit rating agency assigned the territory a rating of Caa3 with a negative outlook (Moody’s, 2018). This rating is below investment grade (Aaa-Baa3). It would mean the capital cost of issuing a junk bond would be exorbitant, meaning there is no effective capital market access. The current ratio of bond debt to GDP is 48%, and debt servicing capacity as measured by interest payments to exports and as a share of total government expenditures seem adequate. However, the main fears animating capital market analysts and potential investors are government’s need of much larger fiscal balances and to address two significant contingent liabilities posed by two semi-autonomous government agencies, Government Employee Retirement System (GERS) and Water and Power Authority (WAPA). The most recent periodic review of Moody’s Investor’s Service in September of 2019 noted improvements in the government’s financial and liquidity position and changed the economic outlook from negative to stable but confirmed the Caa3 rating (Moody’s, 2019).

The financial stability of the two aforementioned semi-autonomous agencies has to been restored. First, the assets of GERS are being depleted to make payouts to retirees, and the unfunded liability of \$4.4 billion (GAAP net base as of 2017) exists, which could eventually force a restructuring of the central government debt, after 2023. Therefore, urgent and deliberate measures are needed to develop a credible plan to recapitalize the investment portfolio and make the fund actuarially sound.

Second, WAPA is facing liquidity problems, a high debt load of \$550 million, and exclusion from capital markets. Plans are afoot to transform the utility using federal grant assistance to purchase four new efficient generators, invest in solar and wind farms, create microgrids and harden its distribution system to windstorms by burying a fair portion of power lines and

replacing wooden posts with composite posts in outlying areas. However, when the Public Service Commission refused a base rate hike, the utility had to petition for transfers from the central government in December 2019 to cover operational expenses, given insufficient revenue. If recurrent requests for transfers are made to the central government in the future, it is likely to place an additional strain on central government finances. The most notable achievement of the utility was that it was able to reduce its frequency of service interruptions in the last quarter compared to the period of June to October.

## Summary and Remaining Policy Challenges

The USVI economy performed better in 2018 and 2019, exhibiting positive real economic growth, higher revenues, decreasing unemployment, and improving fiscal balances and liquidity positions for the central government. However, the improvement in economic performance was primarily due to an infusion of Federal disaster relief assistance that is helping rebuild the economy.

Despite the positive achievements and progress on reconstruction, the economy still faces many weaknesses and vulnerabilities that could result in the return of significant deficits and financial distress, namely the pending insolvency of GERS and the mounting liquidity issues at WAPA. To minimize these risks, the quality of financial management and governance has to improve across the public sector, new economic growth needs to be stimulated, tourism products need to be revitalized and differentiated, and credible plans shaped to stabilize GERS and improve the management and financial performance of WAPA.

Externally, a threat of slowing global growth is mounting as more and more major trading economies are being affected by the spread of the novel coronavirus. The two percent lethality of the virus, which is twenty times more so than the flu, the most common viral infection, is triggering containment and mitigation efforts that in turn are disrupting business activities and, in particular, the travel and hospitality sector. The pace of output of many factories in key Far East Asian countries that are anchors in many global value chains has fallen with ripple effects. Social distancing is emerging as the best tactic to slow transmission and as a result conferences and large public gatherings are being cancelled and nonessential travel is not being recommended. Slower growth in output increases the likelihood that major economies that already were experiencing meager growth rates, may slide into recession. During recessions, there is less disposable income and less appetite for leisure travel. The prognosis for the US, the principal tourist source market for the territory, is a revised downward annual growth rate of 1.9% compared to 2.1% before the COVID-19 economic impacts were deemed to be substantial (OECD, 2020).

Internally, the main challenge for the territory is to continue to improve the capacity to manage, disburse, and supervise the execution of programs supported by Federal disaster-relief and mitigation grants.

In closing, the long-term prospects of the economy depend on improving institutional capacity, strengthening the business climate, and reducing vulnerabilities. Currently the economy is marked by limited diversification, high export concentration, high dependence on imported fossil fuels, lack of preparedness to cope with disasters and climate change, and limited access to capital markets and does not use advanced risk management tools such as parametric insurance, catastrophic bonds, contingent lines of credit, well-funded stabilization funds, hedging to cope with its high exposure to external risks..

## References

Bureau of Economic Analysis. News Release- US Virgin Islands GDP. BEA 19-66, Dept. of Commerce, Washington, DC. Office of Management and Budget. 2020. Various databases. Government of the Virgin Islands.

National Association of State Budget Officers, 2018. The Fiscal Survey of States. Washington, DC.

Moody's, 2019. "Moody's Confirms US Virgin Islands' Caa3 issuer rating; Outlook Stable".

Available at [issuer-rating-outlook-stable--PR\\_906060075](#)

\_\_\_\_\_. 2018. "Moody's Assigns a Caa3 Issuer Rating to US Virgin Islands" Available at

[https://www.moodys.com/research/Moodys-assigns-Caa3-Issuer-Rating-to-US-Virgin-Islands-lowers--PR\\_904456105](https://www.moodys.com/research/Moodys-assigns-Caa3-Issuer-Rating-to-US-Virgin-Islands-lowers--PR_904456105)

Norwall. January 3, 2020. "2020 Atlantic Hurricane Season Forecasts and Predictions". Available at

<https://blog.norwall.com/news-and-updates/2020-atlantic-hurricane-season-forecast-and-predictions/>.

Virgin Island Disaster Recovery Office. Government of US VI. Available at <http://www.usviodr.com/>

OECD. March 2020. OECD Economic Outlook Interim Report, Available at <http://www.oecd.org/economic-outlook/>

World Travel and Tourism Council. Travel and Tourism Economic Impact 2018: US Virgin Islands.

Available at

<https://www.wttc.org/economic-impact/country-analysis/country-reports/>

World Bank. Indicators Database. Available at

<https://data.worldbank.org/indicator/NY.GDP.PCAP.KD?end=2018&locations=US-VI-KY-PR-S3-BS-DO-JM-TT-BB&start=2006>