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Caribbean Policy Research Institute

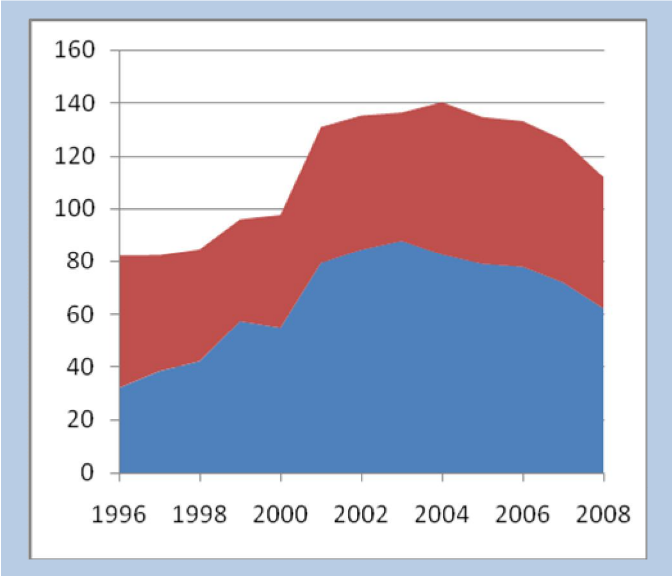
Taking Responsibility

Jamaica's Debt Problem

Background

At the end of September, Jamaica's total public indebtedness stood at just over J$1 trillion, an amount that represents more than three years' worth of government revenue. To service this debt, the government expects to pay J$111 billion in interest this fiscal year, or more than a third of revenue.

Most of this debt was accumulated during the financial crisis between 1996 and 2003 when the debt as a percentage of GDP went from 79 to 141. Almost all of that accumulation can be accounted for by the socialized, aggregated losses of the private banking system, the National Water Commission, and Air Jamaica. Non-debt-related fiscal imbalances were no part of it; in fact, the primary balance (i.e., the fiscal balance with debt service payments omitted) was in surplus for the entire period of debt accumulation.



Since the peak of 141 percent reached in 2003- 2004, the debt to GDP ratio has fallen dramatically to the current level of 114 percent, with the last 14 percentage point improvement occurring this calendar year (see figure). Between January and September, the debt stock actually grew by J$73 billion as interest payments and capital expenditure more than wiped out the primary, recurrent surplus. The big gain was due to the effect of unexpected inflation. Calendar year inflation is running at almost 20 percent, inflating the value of a stagnant GDP volume and thereby diminishing the relative of value of existing domestic debt.

STRATEGIES

The greatest challenge going forward is the effect of the American sub-prime crisis on liquidity in the global market for sovereign debt. It is unlikely that Jamaica will be able to access the sovereign debt market over the next 12 months, so the options for debt management will severely constrained.

The mix of types of debt in the portfolio may be changed in several ways, between multi-lateral and commercial lenders, between fixed and flexible interest rates loans, and between domestic and foreign currency debt. The government is already pursuing the option of increasing multi-lateral borrowing. While cheaper, softer, debt is always preferred to commercial debt, the difficulty here is that multi-lateral institutions such as the World Bank, the International Monetary Fund, and the Inter-American Development Bank provide loans for specified projects or programmes and not for the amortization of existing, maturing debt, which is where Jamaica's needs lie.

The other choices for debt mix do not point in an obvious direction. While fixed-rate debt provides the advantage of reducing the country's exposure to the vagaries of the global capital market, that insurance comes with a price in the form of an interest rate that is usually higher than the average flexible rate over time on a similarly structured instrument. Similarly, while external debt, or debt denominated in or indexed to a foreign currency, can be had at a lower rate of interest, the cost of servicing and amortizing that debt is vulnerable to exchange rate movements. Notwithstanding this observation, shifting the debt mix in favour of external debt provides a good signal to potential investors in that it indicates that the government is taking on more of the currency depreciation risk and therefore has an incentive to maintain price and currency stability.

Even if changes in the debt mix were to yield unambiguous gains to the fiscal accounts and the debt trajectory, because the mix can be changed only at the rate at which existing instruments mature, it would take a long time before such changes had a significant impact on the fiscal accounts and the debt burden. Even with a large debt stock and the global credit squeeze, however, there are actions that can be taken to minimize the impact of debt on the economy.

With the recognition that all of the debt accumulation was due to non-central government liabilities that had to be accommodated on the public purse, the Ministry of Finance should be more vigilant and stringent with the monitoring and management of such contingent liabilities. In this direction, important steps have already been taken with the establishment of deposit insurance and a commitment to privatize the national airline. Those need to be built upon with systematic monitoring of, and contingency planning for, all entities for which central government is the ultimate liability-holder.

With a projected fiscal deficit of J$72 billion this fiscal year, an obvious candidate for a debt management strategy is to slow the rate of debt accumulation by reducing the fiscal deficit. Additional revenue collection can go a far way towards this goal; but this must be set against the recognition that enforcement and collection has been made especially difficult by the current tax code. Low thresholds, obligations differentiated by the identity of the taxpayer rather than by the type of activity, and unenforceable product distinctions, amongst many other examples, all serve to make taxpayers difficult to identify and collect from.

Finally, the dramatic reduction in the debt to GDP level this year, despite a large projected fiscal deficit, provides a clue to debt reduction strategy. The debt to GDP ratio shrank because the denominator (GDP) grew faster than the numerator (debt). This year, it was inflation that caused growth in value without growth in volume of GDP. But the lesson is that economic growth is the best debt-management tool. Growth improves the debt situation in two ways. As GDP grows, the debt to GDP ratio shrinks, reducing the relative burden of the debt and improving the ability to pay. This, in turn, creates a virtuous circle of interest rate reductions and fiscal improvement. Secondly, an expanding economy necessarily generates more tax revenue, which further contributes to deficit reduction and a reduced need for borrowing.

The combination of contingent liability management, tax reform, and growth-focused policies is the best and fastest route to debt reduction – faster, indeed, than actually trying to pay off the debt.