CENTER FOR ECONOMIC AND POLICY RESEARCH

Update on the Jamaican Economy

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Executive Summary

This paper looks at Jamaica's stalled agreement with the International Monetary Fund (IMF), its economic performance over the past year and examines its persistently high debt burden. It finds that an unsustainable debt burden continues to displace needed investments, preventing long-term growth. The stalling of the IMF agreement has prevented disbursements of necessary multilateral financing, slowing the economy's recovery. Together with pro-cyclical macroeconomic policies supported by the IMF, the recovery of the Jamaican economy remains muted.

Although economic growth returned in 2011, a lack of public investment coupled with pro-cyclical macroeconomic policies implemented under the IMF agreement constrained growth. The Jamaican economy grew by 1.5 percent in 2011. This is slow growth by any comparison but is especially weak for a recovery from a recession. The IMF projects the Jamaican economy will not reach its 2007 level until late 2015 while per-capita GDP will remain below its 2007 level in 2017. Accordingly, poverty and unemployment continue to be elevated.

Last year, Jamaica's agreement with the IMF stalled, reportedly over the Jamaican government's paying of back wages owed to public sector employees. The decision by the Jamaican government came after the Industrial Disputes Tribunal and Supreme Court ruled in favor of the public sector employees. Nonetheless, the IMF stopped reviewing the Jamaican economy and has not disbursed any funds since January 2011. The breakdown in relations with the IMF also impacted financing from other multilaterals. The World Bank, Inter-American Development Bank and European Union all curtailed spending in 2011 following the IMF's decision. The cut off in funding made it even more difficult for Jamaica to meet the stringent requirements of the IMF and contributed to the anemic economic recovery.

Jamaica remains one of the most highly indebted countries in the world. Interest payments as a percent of GDP were higher than anywhere else in the world in 2011, including crisis-ravaged Europe. This exceedingly large debt burden has effectively displaced most other public expenditure, debt servicing has taken up nearly 50 percent of total budgeted expenditures over the last four fiscal years while health and education combined have only been around 20 percent. This situation is very problematic for a country of Jamaica's income level, which should be able to invest in infrastructure and human capital, as well as have the financial flexibility to respond to frequent natural disasters and other external shocks.

While the Jamaica Debt Exchange (JDX), an initiative launched in 2010 by the government to restructure its domestic debt, reduced interest payments, we find that it has not gone nearly far enough. Interest payments remain higher than anywhere else in the world and the maturity profile has actually worsened in the past year, with over 50 percent of domestic debt coming due within one to five years. Further, the JDX failed to address the fact that over half of Jamaica's public debt stock is denominated in dollars, making it highly sensitive to changes in the nominal exchange rate. This places the health of public finances at odds with Jamaica's long-term economic interests, which suggest a depreciation of the currency is needed.

Further, we note that if the Jamaican government decides to re-engage with the IMF as they have suggested, any agreement should ensure adequate fiscal space to invest in important areas such as infrastructure, health and education. As long as creditors are prioritized over the country as a whole, Jamaica will remain heavily indebted with persistently low growth.

Introduction

In May of 2011 we examined Jamaica's history of indebtedness, its performance during the global economic slowdown and its agreement with the International Monetary Fund (IMF).[1] Jamaica has been burdened by heavy debt servicing costs due to both the size of its debt and very high interest rates. This exceedingly large debt burden has effectively displaced most other public expenditures, especially public investment in education and infrastructure, which has stagnated over the last 18 years. Such sustained underinvestment poses a severe problem for Jamaica's long-term development prospects, and it has had extremely weak per capita GDP growth over the past two decades, averaging less than 0.7 percent annually.

The paper showed that the Jamaica Debt Exchange (JDX) -- an initiative launched in 2010 by the government to restructure its domestic debt -- did little to solve Jamaica's long-term debt burden. Although the JDX was able to lower average interest rates on domestic debt, there was no reduction of principal and it left nearly half of the debt coming due within one to five years.

We found that pro-cyclical macroeconomic policies, implemented under the auspices of the IMF, damaged Jamaica's recent and current economic prospects. This policy mix risks perpetuating an unsustainable cycle where public spending cuts lead to low growth, exacerbating the public debt burden and eventually leading to further cuts and even lower growth. The IMF agreement put particular emphasis on controlling the wage bill, which can have negative consequences for a developing country that needs to increase spending on vital sectors such as health and education.

Jamaica offers a stark example of the long-term costs that an excessive debt burden can impose on a developing country, especially when the interests of creditors are prioritized over the needs of the country as a whole.

Two years after the IMF approved a $1.27 billion agreement with Jamaica during the depths of the world recession, the Jamaican economy, while showing some signs of improvement, still remains constrained by persistently low growth and an unsustainable debt burden. Despite the JDX, the country still has the highest interest burden on its public debt, as a share of GDP, in the world. Furthermore, while economic growth returned in 2011 following three consecutive years of negative growth rates, the economy remains below its 2008 level of GDP; and unemployment and poverty remain elevated.

The IMF's agreement with Jamaica, which unlocked an additional 1 billion dollars in financing from other multilateral lenders, went off track a year ago, reportedly over the Jamaican government's paying of back wages owed to public sector employees. Reducing the public sector wage bill was a principal component of the IMF's policy recommendations.

[1] Johnston and Montecino (2011).

A new government, led by Prime Minister Portia Simpson Miller, won elections in December and has indicated its intent to negotiate a new IMF agreement. The government has stated its commitment to increasing growth through boosting aggregate demand, following the recommendations of the Planning Institute of Jamaica's Growth-Inducement Strategy; and mitigating the negative social impacts of austerity. Nevertheless, the persistently high interest burden of the public debt, and the possibility of increased austerity with the return to the IMF will likely continue to hold back economic growth and the accompanying improvement in social indicators.

In the first section, this paper will provide an overview of Jamaica's relations with the IMF and the cut-off of disbursements last year. Next we turn to recent economic developments and factors that have contributed to the return of economic growth in 2011. The paper then examines public finances, outlining the government's fiscal policy in the face of persistently high interest payments; and analyzes recent trends in the debt stock following the JDX.

Jamaica and the IMF

When the IMF announced its agreement with Jamaica in early 2010, the economy had already suffered through two years of negative economic growth. Nonetheless, the agreement focused extensively on reducing the overall deficit through pro-cyclical policies, as opposed to stimulating demand through counter-cyclical policies. The Jamaican government has been running primary budget surpluses for the last two decades, yet because of extremely high interest payments on the public debt, the overall fiscal balance has consistently remained in deficit. Despite the Fund's insistence on controlling expenditure, an analysis of budgets from previous years showed that the largest factors causing Jamaican authorities to miss their budget targets were lower-than-projected revenue and higher-than-anticipated interest payments -- not increased spending.[2]

As part of the original IMF agreement, Jamaica imposed a public sector wage freeze. At the time, there were critics who argued that the wage freeze could have a negative impact on the economic recovery. For example, the Planning Institute of Jamaica noted in their report, "Growth Inducement Strategy for Jamaica in the Short and Medium Term," that the wage freeze would result in the "reduction in demand for goods and services, thus leading to a further contraction in output."[3]

In July 2011, following rulings by the Supreme Court and the Industrial Disputes Tribunal, the Jamaican government reached an agreement with public sector unions on the payment of back wages and previously agreed-upon wage increases. IMF reviews, which are the basis for continued disbursements under the loan, had been delayed due to the wage negotiations. Even since the agreement was reached with public sector workers, no further reviews have taken place. There has been no IMF review and no disbursement of IMF funds since January 2011. Overall, only about two-thirds of the $1.27 billion allocated under the IMF agreement has been disbursed. It is worth noting that although the IMF opposed the payment of back wages, the recovery would likely be even weaker in its absence.

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[2] Johnston and Montecino (2011).
[3] PIOJ (2011).

Despite the cut-off of IMF disbursements, Jamaican authorities continued to pursue a tight fiscal policy throughout 2011. Although reduced interest payments due to the JDX created about 5 percent of GDP in extra fiscal space, overall spending stayed nearly constant as compared to 2010 levels. The new Jamaican Prime Minister, Portia Simpson-Miller, acknowledged in her swearing-in ceremony in early 2012 that "in a time of crisis, government must act to stimulate growth."[4] The authorities have outlined a number of programs, including the recently launched Jamaica Emergency Employment Programme (JEEP) to help stimulate demand and decrease unemployment. At the same time however, the government is in negotiations with the IMF to begin a new agreement. The early indications are that the new program will contain many of the contractionary policies required previously. For example, in a press release after an IMF team visited Jamaica in early March, the Fund stresses the need for "a growth-oriented environment" while at the same time noting the need to attain "significantly higher primary fiscal surpluses."[5] Without securing adequate fiscal space to allow for additional public investment and social spending, continued engagement with the IMF and prioritizing deficit reduction is likely to keep Jamaica on a path of low growth and subpar social conditions. Furthermore, the IMF's emphasis on expanding fiscal surpluses could prove to be even more ill-timed, given the downside risks to the global economy that the Fund itself emphasized in its April World Economic Outlook.[6]

IMF Agreement as a Requirement for Other Sources of Funds

In the original IMF agreement, the Fund notes that, "[t]he [Jamaican] authorities anticipate that financial support from the Fund will also help unlock critical financing from other multilateral institutions."[7] This likely was a driving factor for Jamaica's reengagement with the Fund. The importance of the IMF agreement as a means to unlock other funding was made clear by then-Finance Minister Audley Shaw in his presentation of the 2011/2012 budget. Shaw noted the importance of continued engagement with the IMF, but rather than citing the direct economic benefits, Shaw cites the "positive signal" it would send to their international partners, the Inter-American Development Bank (IDB), World Bank, European Union (EU) and Caribbean Development Bank. Shaw notes that all these organizations "use the quarterly reviews as the primary and first conditionality to be met prior to disbursement of loans and grants."[8]

The IMF agreement envisioned $2.4 billion in multilateral financing for Jamaica throughout 2010 and 2011, accounting for over 8 percent of GDP for the two-year period[9]. However, without the IMF reviews, international support for Jamaica was severely curtailed throughout 2011. The World Bank and IDB both blamed funding delays on the part of the Jamaican government and not explicitly on the lack of IMF reviews.

The World Bank, which disbursed $200 million upon the approval of the original IMF loan, delayed a second loan, worth $100 million from January 2011 to September 2011. According to World Bank

4 Jamaica Observer (2012).
5 IMF (2012c).
6 IMF (2012b).
7 IMF (2010a).
8 Shaw (2012).
9 IMF (2010a)

officials, this postponement was because of a delay by the Jamaican parliament in passing debt management legislation.[10]

Support from the IDB, after reaching over $600 million in 2010, was significantly lower in 2011. Over $300 million in loans were approved, but the vast majority of the money has yet to be disbursed. The third tranche from the IDB's Public Financial and Performance Management Program, worth $60 million, was approved in April 2011 but so far none of the funds have been disbursed.[11] Additionally, the third tranche of the IDB's Fiscal Consolidation Program has yet to be approved. According to Bank officials, this delay is because the Jamaican government has yet to pass a tax reform bill.[12] The Jamaican Minister of Finance recently said that the stalled IMF agreement has resulted "in the non-disbursement of multilateral funding, including US$220 million from the Inter-American Development Bank (IDB)."[13]

The EU, which provides direct budget support, stopped disbursing funds altogether after the ceasing of IMF reviews. In September 2011, the EU Ambassador told the Jamaican press, "We have already declared that we have to wait for Jamaica to re-engage with the IMF in order to continue disbursing our own funds," adding, "We have a considerable amount of funding between now and the end of the financial year in the vicinity of US$70 million in grants for the budget, and part of the funds are quite ready to disburse as soon as the IMF issue is settled."[14]

These additional resources would have been very valuable to Jamaica on their own terms, and their delay while the economy remains weak and vulnerable is likely to have further weakened Jamaica's economic growth. The delay of funds, especially the direct budgetary support, also makes it difficult to reach the fiscal targets outlined under the original IMF agreement, making it much more difficult for the program to get back on track.

While the IDB and World Bank are important sources of funding for the Jamaican government, they also hold a significant portion of Jamaica's external debt, accounting for 15.0 percent and 7.7 percent respectively.[15] Repayments and interest paid to the IDB and World Bank partially offset the positive impact of their expenditures in Jamaica. In 2010, 1.2 percent of GDP ($159 million) went to repayments and interest to the two multilaterals.[16] This number is anticipated to rise to $173.7 million in the current fiscal year.[17]

Growth and Employment: Recent Developments

Jamaica's economy has long suffered from low growth and high debt. During the fifteen years prior to the world financial crisis and recession, 1993-2007, real GDP growth averaged just 1.1 percent per year. GDP per capita grew at an average of just 0.4 percent per year during the same period. The debt-to-GDP ratio has been over 100 percent in each year since 2001. At the same time, interest

[10] M. Zipperer, personal communication, March 27, 2012.
[11] IADB (2011).
[12] H. Arzu, personal communication, April 7, 2012.
[13] Brooks (2012).
[14] Gordon (2011).
[15] Ministry of Finance and the Public Service (2011).
[16] IMF (2010d).
[17] IADB (2012), and World Bank (2012).

payments have taken an increasingly larger share of government expenditure, displacing needed investments.

In the last year, Jamaica started to emerge from the recession that began during the global downturn. After shrinking 5.1 percent between 2008-2010, the Jamaican economy grew by 1.5 percent in 2011. This is slow growth by any comparison but is especially weak for a recovery from the recession. The recovery reflects improving external conditions, as well as a less contractionary fiscal stance on the part of the government.

As can be seen in **Table 1**, the agricultural and mining sectors together were responsible for two-thirds of Jamaica's growth in real value added during 2011. The agricultural sector had the largest contribution to growth, with 0.6 percentage points, followed by mining and quarrying, which contributed 0.4 percentage points. Growth in these sectors was supported by a recovery in export demand, with exports of crude materials and mineral fuels growing 33 percent during the year.[18]

TABLE 1
Contributions to Real Growth in Value Added
(Constant 2007 Seasonally-Adjusted J$)

	2006	2007	2008	2009	2010	2011
Total Value Added	**2.9**	**1.4**	**-0.8**	**-3.1**	**-1.4**	**1.5**
Agriculture, Forestry & Fishing	1.0	-0.5	-0.3	0.7	0.0	0.6
Mining & Quarrying	0.0	-0.1	-0.1	-2.1	-0.1	0.4
Manufacturing	-0.2	0.1	0.0	-0.4	-0.3	0.1
Food, Beverages & Tobacco	-0.2	0.1	-0.1	-0.2	0.0	0.1
Other Manufacturing	0.0	0.0	0.0	-0.2	-0.2	0.0
Electricity & Water Supply	0.1	0.0	0.0	0.1	-0.1	0.1
Construction	-0.3	0.4	-0.6	-0.4	-0.1	0.0
Wholesale & Retail Trade	0.4	0.3	-0.1	-0.5	-0.6	0.0
Hotels & Restaurants	0.4	0.0	0.1	0.1	0.2	0.1
Transport, Storage & Communication	0.5	0.2	-0.4	-0.4	-0.2	0.0
Finance & Insurance	0.3	0.5	0.2	0.2	-0.5	-0.1
Real Estate, Renting & Business Activities	0.2	0.3	0.2	-0.1	-0.1	0.1
Producers of Gov. Services	0.0	0.2	0.0	-0.1	0.0	0.0
Other Services	0.3	0.1	0.1	0.0	-0.1	0.0
(-) Financial Intermediation	0.0	0.1	-0.2	0.2	-0.6	-0.2

Source: Statistical Institute of Jamaica and Author's Calculations.

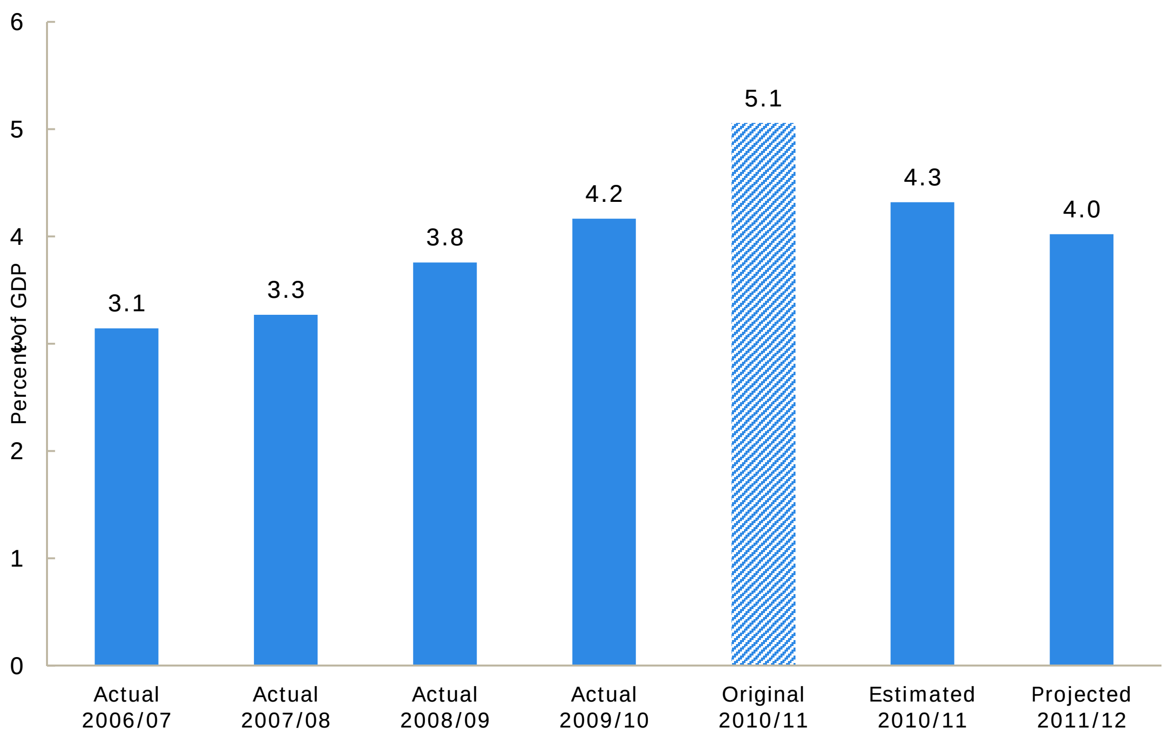
The manufacturing and food, beverages and tobacco sectors also contributed small amounts to growth, both with 0.1 percentage points. The production of government services neither increased nor decreased growth in 2011, as expected given the government's neutral fiscal stance throughout the year. However, it is worth noting that the "producers of government services" category does not capture the full contribution of the public sector to value added since some publicly owned companies are classified under the respective industries in which they operate.[19]

[18] STATINJA (2012c).
[19] According to Jamaica's system of national accounts, publicly owned entities are not classified in the "producers of government services" category if they: "A. Charge prices for their output that are economically significant. B. Are operated and managed in a similar way to a corporation. C. Have a complete set of accounts so that their operating surplus, savings, assets and liabilities can be separately identified and measured." See STATINJA (2012d).

An important factor in the muted recovery is the fall in infrastructure spending, as a percent of GDP, by Jamaica's Public Bodies. The Public Bodies are an important part of the public sector and play a large role in the implementation of infrastructure projects, including the construction and maintenance of public housing, national roads and bridges, as well as water supply and sanitation projects. According to the Ministry of Finance and Public Service, in fiscal year 2011/12 "the Public Bodies spending [was] constrained by the targets under the Stand-By Arrangement with the IMF."[20] As a consequence, infrastructure spending by the Public Bodies was projected to fall as a percent of GDP throughout fiscal year 2011/12 (which runs from April 2011 to March 2012), from 4.3 percent in fiscal year 2010/11 to 4.0 percent.

Despite falling as a percent of GDP, the infrastructure spending by the Public Bodies has a positive impact by contributing to aggregate demand and mobilizing idle resources as Jamaica emerges from recession, as well as boosting the economy's long-term productive capacity. It is worth noting, however, that infrastructure spending during fiscal year 2010/11 was originally budgeted much higher and that total spending in fiscal year 2011/12 could also end up lower than forecast. As can be seen in **Figure 1**, total infrastructure spending in fiscal year 2010/11 was originally budgeted at 5.1 percent of GDP, but was subsequently lowered significantly in order to meet IMF primary balance targets after government revenues came in below what was budgeted.

FIGURE 1
Infrastructure Spending by Public Bodies



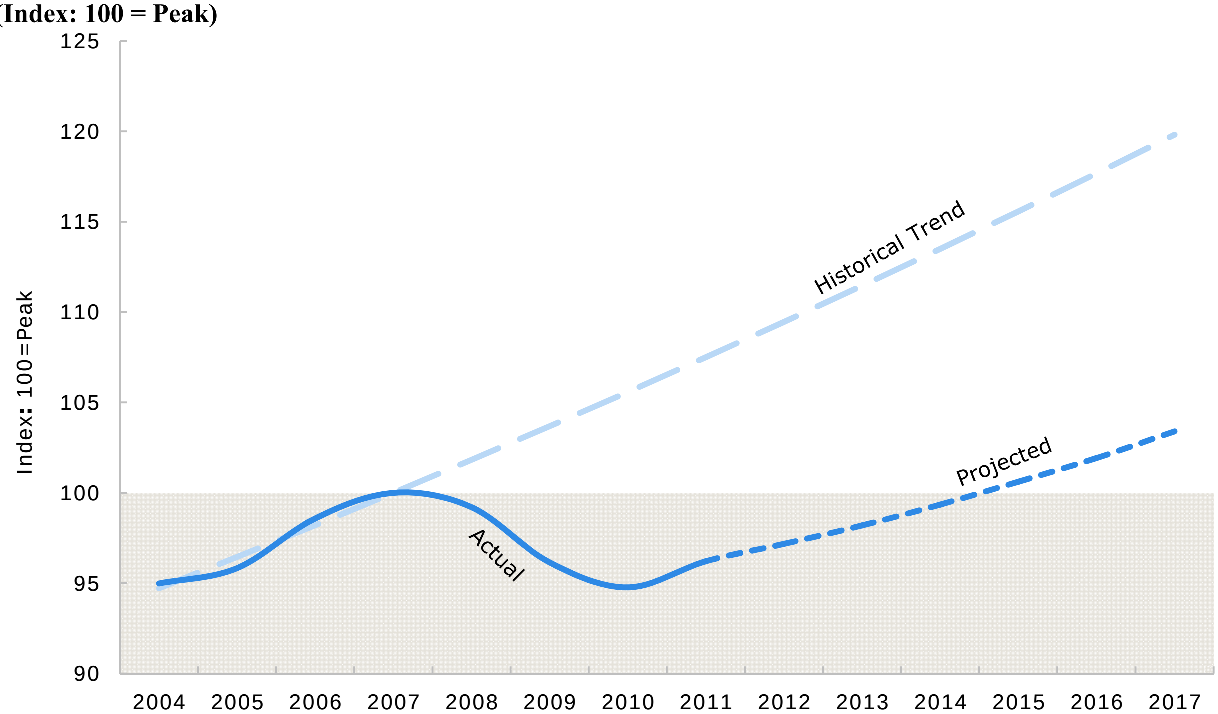
Source: Ministry of Finance and Public Service.
Note: Data refers to the Selected Public Bodies – the 19 largest and considered most important by the Jamaican government.

[20] Ministry of Finance and Public Service (2011).

The maintenance of expansionary monetary policy by the Bank of Jamaica may have contributed to the recovery. In 2011, the Bank of Jamaica lowered the interest rate on its 30-day Open Market Instruments—the main instrument of monetary policy—four consecutive times. The policy rate now stands at 6.25 percent, or 125 basis points below where it stood in 2010. [21]

Although real GDP growth was positive in 2011, the economy remains below its 2007 level. As can be seen in **Figure 2**, IMF projections suggest that Jamaica's GDP will not reach 2007 levels until near the end of 2015. GDP per capita will still be below its 2007 level in 2017.[22] It is worth emphasizing that even though real GDP is projected to regain its pre-recession level in 2015, it would nonetheless remain far below its historical trend by as late as 2017. And this historical trend is one of very low growth for a developing country – just 1.8 percent annually. The current projected growth path thus entails a persistent waste of economic potential and therefore must be regarded as a long-term policy failure.

FIGURE 2
Actual and Projected Real GDP vs. Its Historical Trend
(Index: 100 = Peak)



Source: IMF and Authors' Calculations.

The modest recovery observed during 2011 does not appear robust enough to significantly reduce unemployment. Although in October 2011 unemployment had fallen below its 2010 peak of 13.5 percent, it remained elevated, at 12.8 percent. Employment, which had shown signs of recovery in

[21] BOJ (2012).
[22] IMF (2012).

late 2010, actually fell as a percent of the labor force during 2011.[23] The recently launched Jamaica Emergency Employment Programme (JEEP) aims to stimulate demand and reduce unemployment. While any efforts to improve the employment situation are welcome, it is still far too early to judge the program's impact on employment.

The external position remained weak throughout 2011. Jamaica has registered consistent and large current account deficits since 1995 -- in some years exceeding 15 percent of GDP -- driven by a very large trade deficit. This has translated into sharp increases in Jamaica's net foreign liabilities (for both the public and private sectors), which according to the most recent available data from the IMF, amounted to 134 percent of GDP in 2010 (up from 97 percent in 2005).[24]

Such consistently large current account deficits and increasing foreign liabilities are most likely unsustainable and suggest that the real exchange rate is overvalued. Although the Jamaican dollar has depreciated about 44 percent against the U.S. dollar over the last decade, Jamaica has maintained a large inflation differential relative to the U.S., its most important trading partner. As a result, Jamaica's exchange rate has appreciated significantly in real terms, making its imports artificially cheap while hurting domestic producers by making its exports artificially expensive.

The current account deficit peaked at 20 percent of GDP in 2008 but then improved dramatically throughout the recession. As imports fell and the nominal exchange rate depreciated markedly against the U.S. dollar, the current account deficit decreased to 7 percent of GDP by 2010. However, throughout 2011 the current account deficit widened by around 4 percent of GDP through the third quarter, from 7 percent to 11.2. This was primarily due to the higher price of fuel imports. As a result, Jamaica's official foreign reserves fell throughout the year, though nonetheless stood comfortably at around 20 weeks' worth of imports of goods and services.[25]

Public Finances and Interest Payments

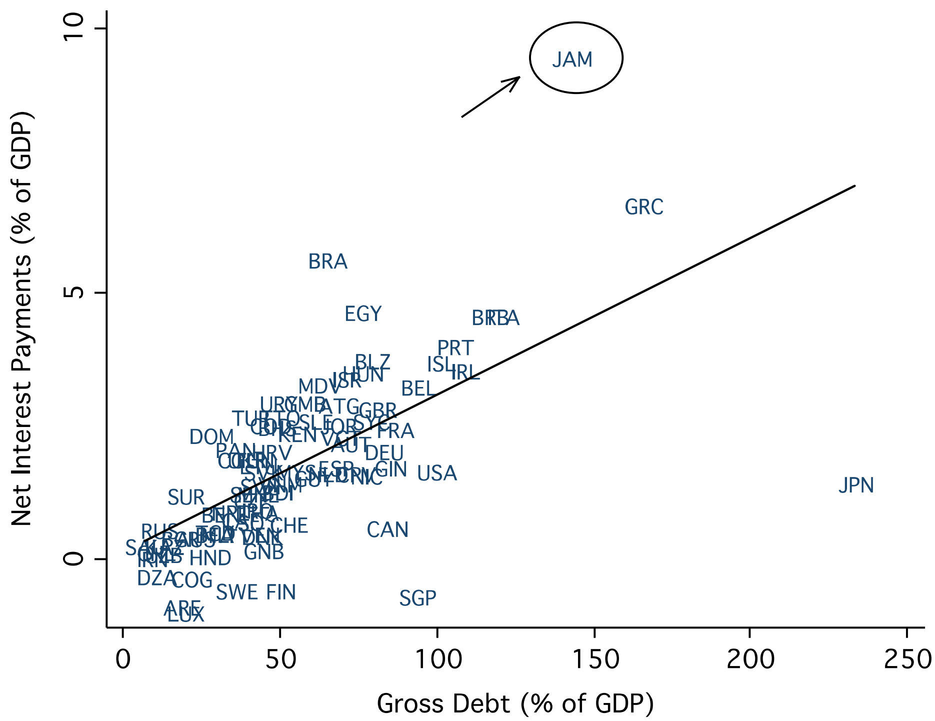
Despite the IMF agreement lapsing in early 2011, the Jamaica government appears to have largely stayed on track with the IMF's contractionary fiscal program, continuing to reduce the overall budget deficit.

Since 2009, the overall fiscal deficit has fallen steadily from 10.6 percent of GDP to below 6 percent in 2011. The key factor behind this improvement was the large decrease in interest payments on Jamaica's public debt following the completion of the JDX in 2010, a debt restructuring initiative that renegotiated the interest and maturity structure of Jamaica's entire domestic debt stock. (The JDX did not include external debt and, notably, did not feature a reduction of principal. See the next section for more detail.) These savings from reduced interest payments have allowed fiscal policy to adopt a more neutral, less contractionary stance without worsening the overall fiscal deficit. Moreover, the extra fiscal space made it easier to accommodate the payment of back wages owed to public sector employees, without increasing the deficit.

[23] Statistical Institute of Jamaica (2012b).
[24] IMF (2012d).
[25] Bank of Jamaica (2012b).

Nevertheless, Jamaica's interest payments remain extremely high, amounting to nearly 10 percent of GDP in 2011, or 2.5 times what was spent on capital programs. The burden of excessively high interest payments will continue to displace public investments, which are needed to restore normal growth and bring down the persistently high levels of poverty and unemployment. As can be seen in **Figure 3**, Jamaica pays far more in interest than any other country for which data is available. This situation is very problematic for a country of Jamaica's income level, which should be able to invest in infrastructure and human capital, as well as have the financial flexibility to respond to frequent natural disasters and other external shocks.

FIGURE 3
Net Interest Payments vs. Gross Government Debt in 2011
(Percent of GDP)



Source: Author's Calculations and IMF WEO.
Note: In some cases fiscal data from the IMF WEO uses the fiscal rather than calendar year. All data shown above represent provisional estimates for 2011.

After increasing in 2010, the primary surplus decreased throughout 2011, from 5.4 percent of GDP to 3.8. The deterioration was primarily due to lower than expected tax revenues and not increased spending. Tax revenues appear to have been negatively impacted by the sluggish pace of recovery at home and in Jamaica's main trading partners. Revenues from taxes on income and production registered large shortfalls throughout FY2011/12 and revenue associated with international trade and tourism were similarly affected.[26] A decrease in the amount of grants received also negatively affected the primary surplus. This was most likely the result of the suspension of budget support from international partners after the IMF agreement was halted.[27]

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[26] Ministry of Finance and the Public Service (2012b).
[27] See later section on IMF and Jamaica relations.

As can be seen in **Table 2**, during 2011, primary expenditure (total expenditure minus interest payments) remained virtually constant as a percent of GDP. This reflects two developments. First, following rulings by the Supreme Court and the Industrial Disputes Tribunal, the government agreed to pay back wages owed to public sector employees (which amounted to 0.4 percent of GDP in 2011). As a result, overall expenditures on wages and salaries only declined by 0.1 percent of GDP in 2011. Second, public investment (capital programs) fell by 0.3 percent of GDP in 2011, with increased spending on government programs offsetting the decline. Given that Jamaican authorities have been running large, consistent primary surpluses, there were resources available to be used to stimulate the economy if such a path had been chosen.

TABLE 2
Central Government Finances (Percent of GDP)

	2006	2007	2008	2009	2010	2011
Revenue & Grants	26.4	26.8	27.3	26.6	27.0	25.3
Tax Revenue	23.1	23.9	23.9	23.7	23.5	22.7
Non-Tax Revenue	1.7	1.6	2.0	1.6	2.1	1.4
Bauxite Levy	0.5	0.6	0.5	0.2	0.0	0.1
Capital Revenue	0.9	0.6	0.2	0.2	0.5	0.7
Grants	0.2	0.1	0.6	1.0	0.8	0.3
Primary Expenditure	18.1	19.7	21.3	22.1	21.6	21.5
Programs	5.9	6.7	7.2	6.6	6.4	6.6
Wages & Salaries	9.5	9.5	10.5	11.4	10.9	10.8
Back Wages Owed	0.0	0.0	0.0	0.0	0.0	0.4
Capital Programs	2.8	3.6	3.6	4.1	4.3	4.0
Interest Payments	12.1	11.4	11.9	15.1	12.3	9.7
Domestic	8.8	8.0	8.4	11.0	8.9	6.4
External	3.3	3.4	3.5	4.1	3.4	3.2
Primary Balance	8.3	7.1	6.0	4.5	5.4	3.8
Overall Balance	-3.8	-4.3	-5.9	-10.6	-6.9	-5.9
Public Debt	118	112	111	125	130	128
Domestic	68.4	63.1	60.6	69.8	68.2	69.3
External	49.6	48.8	50.8	54.7	61.4	58.6
Nominal GDP (J$ billions)	784	885	1,005	1,080	1,173	1,274
Nominal GDP (US$ billions)	11.9	12.9	13.9	12.3	13.4	14.7
Bilateral Exchange Rate (J$/US$)	65.7	68.8	72.6	88	87.1	85.8

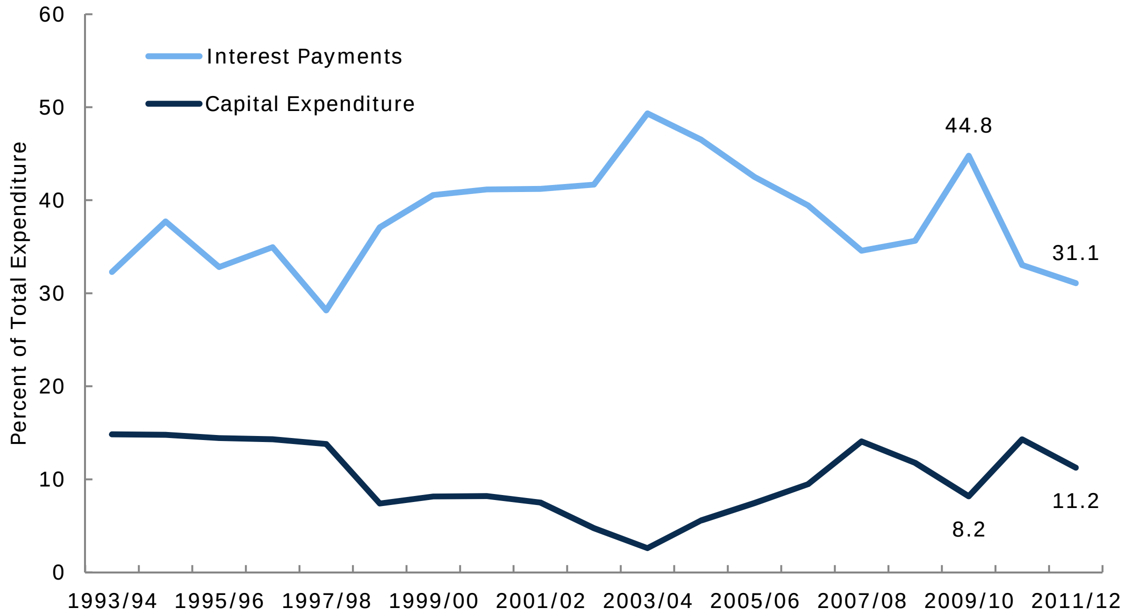
Source: Ministry of Finance, Statistical Institute of Jamaica and Author's Calculations.

As a developing country, Jamaica needs to increase spending on health and education, yet debt servicing (interest payments and amortization) takes up such a huge portion of the budget that social spending is constrained. Total debt servicing has taken up nearly 50 percent of total budgeted expenditures over the last four fiscal years. Health and education combined have only been around 20 percent.[28] This large debt burden has effectively displaced public capital expenditure, which includes investment in education and infrastructure. As can be seen in **Figure 4**, capital expenditure

[28] Ministry of Finance and the Public Service (2008), (2009), (2010), (2011).

has stagnated, and after increasing in fiscal year 2010/11, actually fell this year despite lower interest payments. The Jamaican government has not used this additional fiscal space to increase spending on health, education or capital expenditure, but has rather used it to reduce the fiscal deficit, again despite lower interest payments.

FIGURE 4
Interest Payments Vs. Capital Expenditure (percent of total expenditure)



Source: Jamaica Ministry of Finance.

Although economic growth is slowly returning, fiscal policy remains excessively tight if one considers the last eight years of zero per-capita income growth.

The Jamaica Debt Exchange Revisited

As noted above, the JDX has had a lasting positive influence on the state of public finances. However, the problem is that it was not sufficient; Jamaica's public debt burden remains dangerously high and most likely unsustainable. This is due to (1) the sheer size of Jamaica's debt stock and the limited scope of the JDX, which only sought to restructure domestically held debt and did not seek a reduction of principal; and (2) the very high interest rates on the debt.

The two key objectives of the JDX were to lower Jamaica's interest payments and extend the maturity of its domestic debt stock, both of which were achieved. Prior to the JDX, interest payments had reached a staggering 15 percent of GDP by the end of 2009, and 17 percent of GDP if we refer to the fiscal year instead. By convincing domestic creditors to accept lower interest rates, the Jamaican government was able to lower its interest payments by significant amounts. Following the restructuring, interest payments dropped to 12.3 percent of GDP in 2010. Most importantly, interest rates on domestic debt appear to have stabilized at lower levels throughout 2011, resulting in total interest payments of 9.7 percent of GDP.

However, despite this success, Jamaica pays far more in interest than any other country for which data is available, as was previously shown in **Figure 3**.

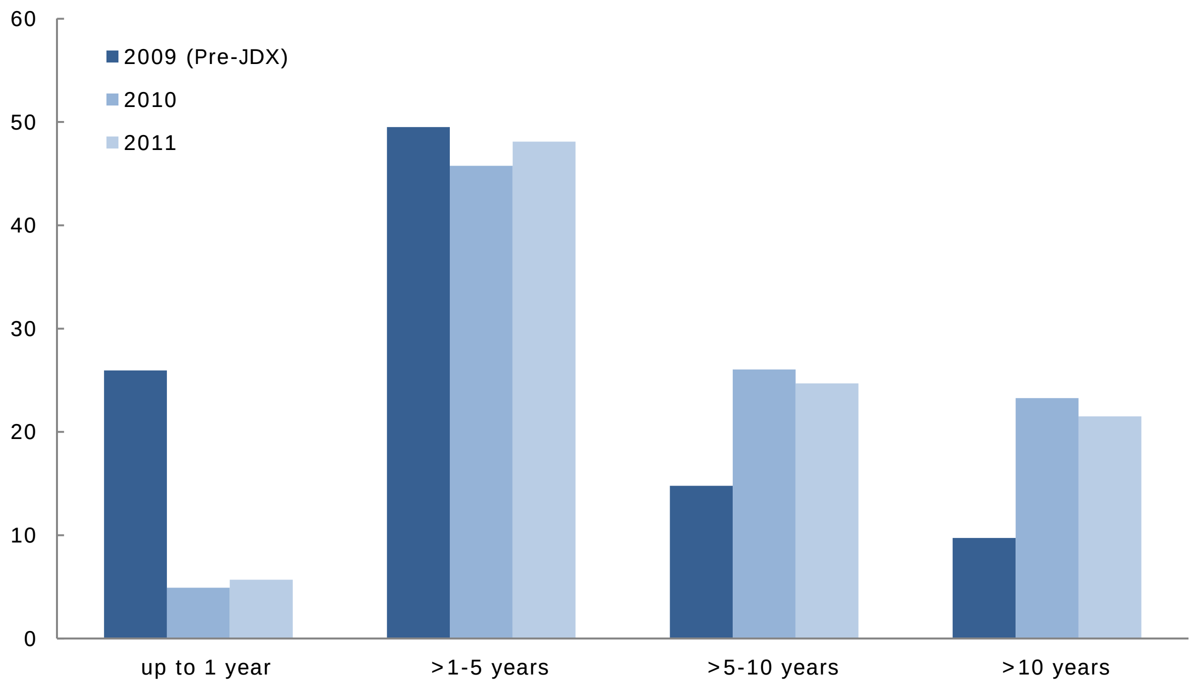
TABLE 3
Interest Rate Composition of the Public Debt Stock (percent of total)

	2007	2008	2009	2010	2011
Domestic Debt					
Variable Rate	62.1	62.0	51.1	40.7	43.4
Fixed Rate	37.9	38.0	48.9	59.3	56.5
Non-Interest Bearing	0.1	0.0	0.0	0.0	0.1
External Debt					
Variable Rate	18.6	17.8	20.5	25.2	27.2
Fixed Rate	81.4	82.2	79.5	74.8	72.8

Source: Jamaica Debt Management Unit.

Moreover, there is no guarantee that interest rates on Jamaica's domestic debt will continue to remain low. As can be seen in **Table 3**, in 2011, 43.4 percent of the domestic debt stock was subject to a variable interest rate, which renders Jamaica's interest burden sensitive to changes in interest rates both in the short and long run. Similarly, the maturity structure of Jamaica's domestic debt has worsened somewhat since 2010. In particular, the share of domestic debt coming due within five years has increased from 50.7 percent at the end of 2010, to nearly 54 percent by the end of 2011. Thus, a large amount of Jamaica's debt stock has not locked in lower rates and the interest burden could increase substantially if the refinancing of the majority of the domestic debt stock maturing within the next five years were to coincide with an increase in interest rates.

FIGURE 5
Maturity Profile of the Domestic Debt Stock (Percent of Total)



Source: Jamaica Debt Management Unit.

Finally, it is regrettable that the JDX also failed to address the high proportion of Jamaica's debt that is denominated in foreign currency, as this continues to represent a serious vulnerability to the health of public finances. With a foreign denominated share of 53 percent, Jamaica's public debt stock is highly sensitive to changes in the nominal exchange rate. Indeed, during the recession, the Jamaican dollar depreciated 27 percent against the U.S. dollar through 2008 and 2009, adding about 12 percentage points to Jamaica's debt-to-GDP ratio (see **Table A1** and **Figure A1** in the Appendix).

The failure to reduce the share of foreign currency debt places the health of public finances at odds with Jamaica's long-term economic interests. On the one hand, Jamaica's large and persistent current account deficits suggest the real exchange rate is overvalued and that a nominal depreciation could therefore contribute to rebalancing the external position while providing a boost to the export and manufacturing sectors. On the other hand, any exchange rate depreciation large enough to have a meaningful effect in these areas would also greatly inflate the value of Jamaica's public debt, creating a perverse incentive to prioritize a stronger Jamaican dollar to the detriment of Jamaica's potential for economic development, as well as the adjustment of its current account deficit.

Conclusion

This paper has argued that Jamaica's economic performance and development prospects have been seriously damaged by an unsustainable debt burden. The Jamaican economy has stagnated for decades. As noted previously, during the 15 years prior to the 2008-2010 recession, Jamaica's real GDP growth averaged just 1.1 percent annually and real per capita growth performed even worse—0.4 percent per year. Although growth resumed in 2011, the current recovery is inadequate, as evidenced by elevated levels of unemployment and poverty. Recent projections by the IMF also suggest that, under the current pace of recovery, the economy will not regain its pre-recession output level until 2015.

The JDX, which provided a modest amount of debt relief, has nonetheless proven inadequate given the magnitude of the problem. The interest burden on Jamaica's debt, despite the JDX, is still the largest in the world for which data is available. As a consequence, public finances remain extremely precarious and capital expenditure on sorely needed infrastructure and social spending will continue to be constrained.

Multilateral institutions, including the IMF, World Bank and IDB, have played a particularly problematic role, supporting contractionary policies intended to maximize the primary surplus and prioritize the service of debt. This amounts to a consistent transfer of output from taxpayers to domestic and foreign creditors, and a serious impediment to the formulation and implementation of a development agenda. It is difficult to envision Jamaica overcoming its current situation of low growth and high debt without concerted multilateral debt relief or a far more ambitious debt restructuring.

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Appendix: Debt Accounting Framework

This Appendix presents a standard debt accounting framework that allows us to decompose the changes in Jamaica's debt-to-GDP ratio. As can be seen in **Table A1** and **Figure A1** below, the change in the debt-to-GDP ratio is decomposed into the effect of real GDP growth and inflation (which reduce the debt-to-GDP ratio by increasing the size of the denominator). The change in debt-to-GDP is also decomposed into the contribution of interest payments, the primary balance, the effect of exchange rate depreciation (which increases the value of debt denominated in foreign currency) and a residual "stock-flow adjustment," which we will discuss below.

As can be seen in **Table A1**, Jamaica's debt-to-GDP ratio increased dramatically during 2009 and 2010 and finally began to decrease again in 2011. The two most important factors underlying these changes were inflation and interest payments. As shown below, Jamaica's high inflation rate exerts strong downward pressure on the debt-to-GDP ratio, subtracting 11.7, 9.9 and 8.3 percentage points in 2009-2011, respectively. Interest payments, on the other hand, are the single largest contributor to increases in the debt-to-GDP ratio, adding 15.1, 12.3 and 9.7 percentage points in 2009-2011, respectively. It is worth noting that interest payments on domestic debt account for the majority of interest expenditure.

Real GDP growth, compared to inflation and interest payments, has played a modest role in explaining changes in debt-to-GDP. Prior to the 2008-2010 recession real GDP growth subtracted 3.3 and 1.7 percentage points from the debt-to-GDP ratio in 2006 and 2007, respectively. However, as the economy sank into recession, this contribution turned positive, adding 0.9, 3.5 and 1.8 percentage points in 2008-2010.

TABLE A1
Debt Accounting Framework
(Percentage points)

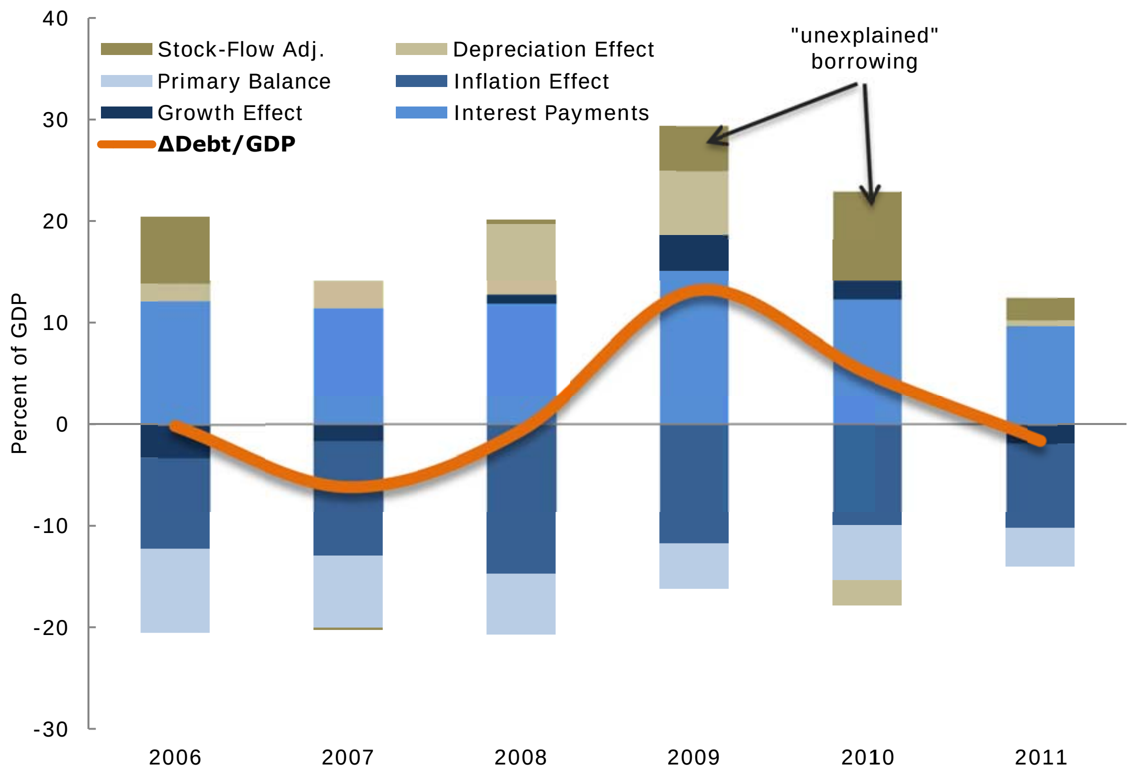
	2006	2007	2008	2009	2010	2011
ΔDebt/GDP	**-0.1**	**-6.2**	**-0.6**	**13.2**	**5.1**	**-1.6**
Real Growth Effect	-3.3	-1.7	0.9	3.5	1.8	-1.9
Inflation Effect	-9.0	-11.3	-14.7	-11.7	-9.9	-8.3
Interest Payments	12.1	11.4	11.9	15.1	12.3	9.7
Domestic	8.8	8.0	8.4	11.0	8.9	6.4
External	3.3	3.4	3.5	4.1	3.4	3.2
Primary Balance	-8.3	-7.1	-6.0	-4.5	-5.4	-3.8
Exchange Rate Depreciation	1.8	2.7	6.9	6.3	-2.5	0.6
Stock-Flow Adjustment	6.6	-0.2	0.4	4.4	8.8	2.2

Source: Author's Calculations.

Because a significant share of Jamaica's public debt is denominated in U.S. dollars, changes in the nominal exchange rate can have large effects on the debt-to-GDP ratio. As can be seen above, the Jamaican dollar depreciated sharply against the U.S. dollar in 2008 and 2009, adding 6.9 and 6.3 percentage points, respectively, to the debt-to-GDP ratio. Since then, the bilateral exchange rate appreciated modestly in 2010 and then remained more or less stable in 2011.

During 2009 and 2010, stock-flow adjustments contributed large amounts to Jamaica's debt-to-GDP ratio. Stock-flow adjustments represent changes in the debt-to-GDP ratio that are not explained by the primary balance or the evolution of relevant macroeconomic factors. In effect, the stock-flow adjustment is what is left over after accounting for all budgeted spending and borrowing. Stock-flow adjustments typically capture off-budget expenditure or, in Jamaica's case, the incurring of contingent liabilities from public bodies—publicly owned companies not formally included in the central government budget.

FIGURE A1
Decomposed Changes in the Debt/GDP Ratio



Source: Authors' Calculations.