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The Multilateral Debt Trap in Jamaica

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Jamaica's economy has long suffered from low growth and high debt. Over the past 20 years, average annual per capita GDP growth has been negative 0.1 percent, the lowest in the Caribbean outside of Haiti. The world recession caused even greater economic hardships in Jamaica, with GDP falling in four of the last five years. Unemployment has increased to 14.2 percent, from less than 10 percent in 2008. The poverty rate has nearly doubled. The gap between rich and poor has gotten larger.

Throughout this time, multilateral development banks, in particular the International Monetary Fund (IMF), World Bank and Inter-American Development Bank (IDB) have played a key role. In early 2010, in an effort to address its unsustainable debt burden, and as a pre-condition for an IMF agreement, Jamaica undertook a debt exchange that sought to lower interest rates and extend maturities but did not provide any haircut (a lowering of the debt principal). The subsequent IMF loan, worth $1.27 billion, unlocked additional funding from the World Bank and IDB, together amounting to well over $2 billion.

As part of the IMF agreement, Jamaica undertook severe austerity measures, freezing wages and cutting spending. Even after the debt exchange, Jamaica was left with the highest debt interest burden in the world; interest payments alone amounted to 11 percent of GDP.[1]

The IMF agreement eventually broke down after a Jamaican court ruled that the government had to distribute back pay to public sector workers, against the wishes of the IMF. Nevertheless, Jamaica has largely continued the austerity measures from the first agreement. After a return to growth –albeit slow- in fiscal year 2011/12, Jamaica slipped back into a recession this past year, after the government cut non-interest expenditure by over 2 percentage points of GDP. Even some within the IMF warned that the fiscal consolidation efforts were going too far and could threaten "the fragile recovery and social cohesion."[2]

Three years after the IMF agreement was signed and the debt exchange completed, Jamaica once again turned to the IMF and undertook a new exchange. Once again, the exchange only affected domestically held debt and did not reduce the principal. Once again, the conditions may prove unsustainable. The IMF is requiring Jamaica to run primary surpluses (revenue minus expenditure, excluding interest costs) of 7.5 percent of

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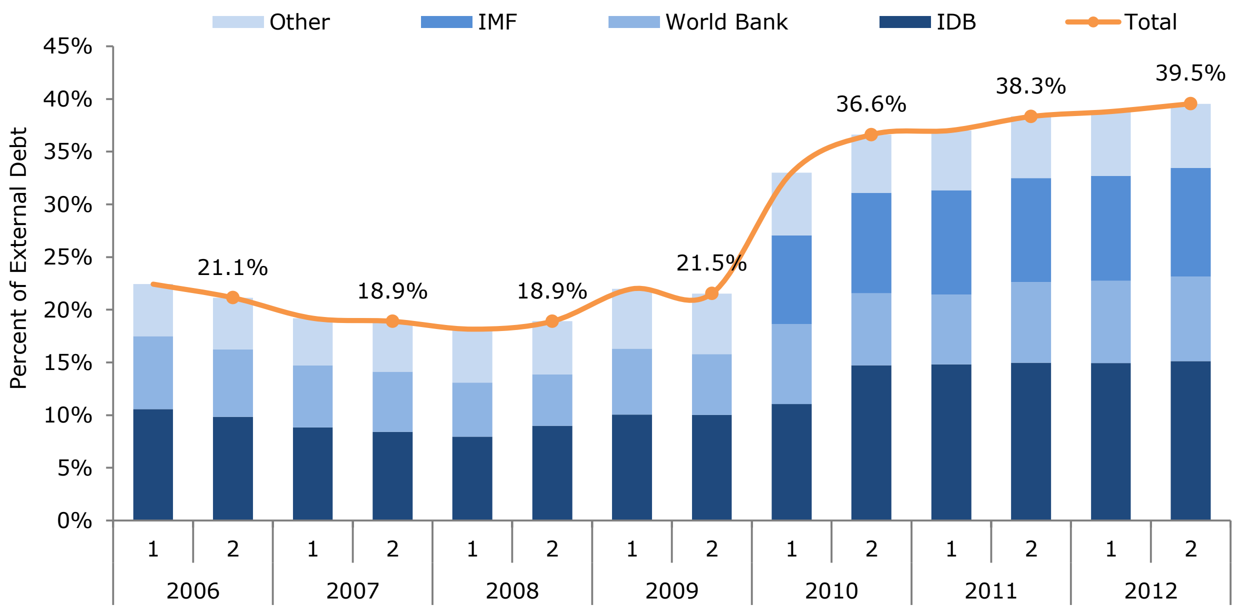
GDP, which according to the latest IMF World Economic Outlook, would mean Jamaica would have the highest primary surplus in the world outside of oil exporting countries in 2013 [Oil-exporting countries that run large primary budget surpluses are doing so because of excess oil revenues, not budget tightening as in the case of Jamaica]. And even after the second debt exchange in three years, Jamaica is projected to have the highest average interest burden in the world over the next six years.[3]

The recently signed IMF agreement, together with funding from the World Bank and IDB, will give Jamaica access to some $2 billion dollars of loans over the next four-plus years. Crippled with devastatingly high debt levels and anemic growth for years, Jamaica is certainly in need of financing. But it is also the case that, after billions of dollars of previous World Bank, IDB and IMF loans, much of its debt is actually owed to the very same institutions that are now offering new loans.

Figure 1 shows the share of external debt owed to multilateral institutions since 2006. As can be seen, while Jamaica has owed these multilaterals large sums for many years, in 2010, after Jamaica signed an IMF agreement, the share of debt owed to multilaterals increased greatly. As of December 2012, Jamaica owed multilateral banks $3.26 billion, accounting for 39.5 percent of its total external debt. This is up from a low of 17.9 percent ($1.12 billion) in September 2008. Loans from multilaterals accounted for 70 percent of the total increase in external debt from 2006 to 2012.[4]

FIGURE 1
Multilateral Share of Total External Debt

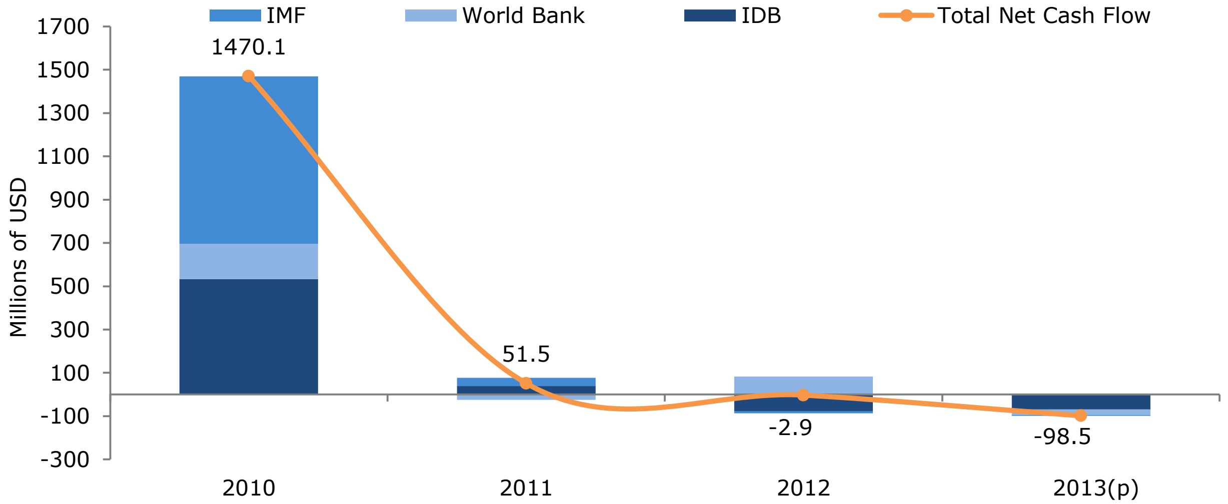


Source: Ministry of Finance and Public Servce: Debt Management Unit. 2013.
Note: Data is reported as end of period totals. 1 and 2 refer to half years, so data corresponding to "2006:1" is from end of June 2006.

Jamaica has twice restructured its debt in just the last three years, extending the maturity and lowering interest rates, but neither time has external debt been affected. Funds from the IMF, World Bank and IDB carry much lower interest rates than private loans and so are not necessarily as damaging, yet debt servicing to these institutions still eats up a large share of Jamaican finances. After the previous IMF agreement went off-track in 2011, financing from other multilaterals was also cut; after considering repayments, net cash flow from multilaterals actually turned negative in

2012 and is projected to be negative again in 2013. Amazingly, Jamaica is actually paying more to the multilaterals than it is getting back this year, even after the approval of the IMF agreement.[5]

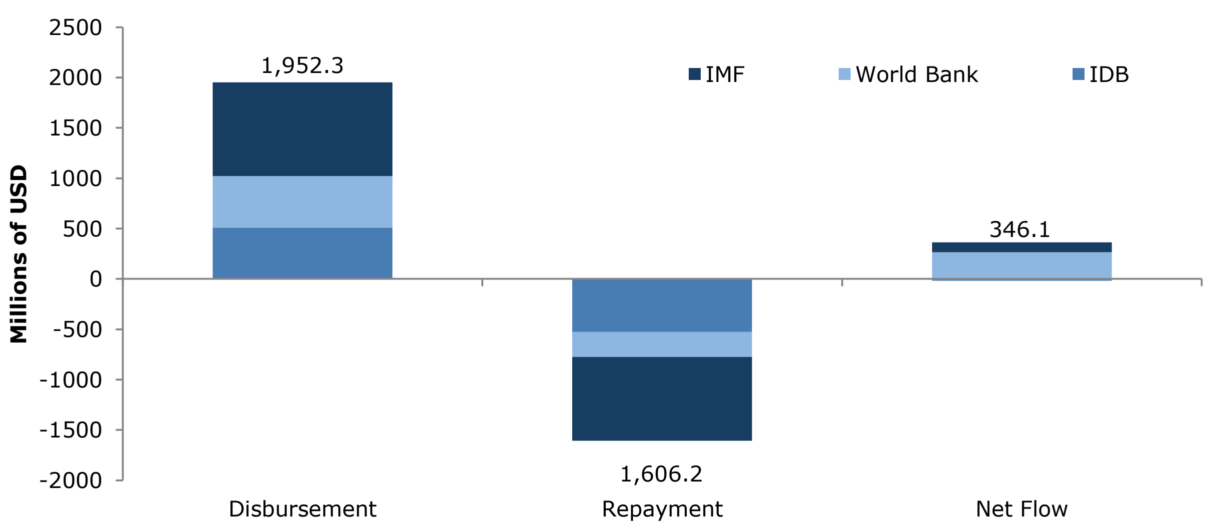
FIGURE 2
Net Flows from Multilaterals, 2010-2013



Source: IMF, 2013

Despite multilaterals offering up another $2 billion in loans over the next four years, the net cash flow to Jamaica will be drastically lower than this due to debt repayments. From 2013-2017 (the last IMF disbursement is projected to be in March 2017), Jamaica is projected to spend $1.6 billion on repayments, resulting in a net cash flow of $346.1 million or 0.4 percent of GDP over the period.[6]

FIGURE 2
Projected Net Flows From Multilaterals, 2013-2017



Source: IMF, 2013. IDB, 2013. World Bank, 2013.

What this shows is that simply by providing debt cancellation to Jamaica, the World Bank, IDB and IMF could leave the country with more available resources than through new loans. As compared to a net cash flow of $350 million, debt cancellation would free up $1.6 billion from 2013-2017, much needed resources for a country which is being forced to drastically cut spending as part of the IMF agreement.

The IMF-backed program aims to achieve a debt/GDP ratio of 126.5 percent by the end of the current program.[7] While debt/GDP ratios can be a misleading target[8], if this is truly the goal, it could be achieved virtually overnight. As mentioned previously, interest on multilateral loans is relatively low, and so while the debt cancellation would only reduce interest payments by a small margin, it would drastically reduce Jamaica's overall debt load. With multilateral debt cancellation, Jamaica's debt/GDP ratio would shrink from 146.9 percent of GDP to 123.4 percent.

This would also have the added benefit of reducing the share of Jamaica's debt that is denominated in dollars. Currently, since such a large portion of the debt is in dollars, as the Jamaican currency depreciates the burden of the debt increases. But Jamaica might have to depreciate its currency in order to have a sustainable current account deficit, thus placing the health of public finances at odds with Jamaica's long-term economic development.

Thus far, efforts to reduce Jamaica's debt, supported by the IMF and other multilaterals, have focused exclusively on domestic debt, so as not to lock Jamaica out of foreign capital markets. At the same time, haircuts on the domestic debt have been ruled out because this would negatively affect local financial institutions. The result is that even after two debt restructurings, Jamaica's debt burden remains unsustainable. The IMF's country representative recently stated that "debt reduction will come from very tight government budgets" because "there is no alternative." But clearly there is. By providing meaningful debt cancellation, as opposed to providing billions in new loans, the multilaterals could make a strong statement that they are serious about Jamaica's development and the needs of its people.

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1 See Johnston, Jake and Juan Montecino. 2011. "Jamaica: Macroeconomic Policy, Debt and the IMF." Washington, DC: Center for Economic and Policy Research. Available at http://www.cepr.net/index.php/publications/reports/jamaica-macroeconomic-policy-debt-and-the-imf and Johnston, Jake and Juan Montecino. 2012. "Update on the Jamaican Economy." Washington, DC: Center for Economic and Policy Research. Available at http://www.cepr.net/index.php/publications/reports/update-on-the-jamaican-economy

2 Johnston, Jake. 2012. "Austerian Dissent." CEPR Blog, Center for Economic and Policy Research. June 18, 2012. Available at http://www.cepr.net/index.php/blogs/cepr-blog/austerian-dissent-jamaica-and-the-imf

3 Johnston, Jake. 2013. "IMF Approves Jamaica Loan – Pain, No Gain." The Americas Blog, Center for Economic and Policy Research. May 23, 2013. Available at http://www.cepr.net/index.php/blogs/the-americas-blog/imf-approves-jamaica-loan-pain-no-gain

4 Ministry of Finance and Public Service: Debt Management Unit. 2013. "External Debt Stock by Creditor (Various Years)." Jamaica: Ministry of Finance and Public Service. Accessed February 2013. http://dmu.mof.gov.jm/default.asp?c=1000&page=1008

5 International Monetary Fund. 2013. "Jamaica: Request for an Extended Arrangement Under the Extended Credit Fund Facility." Washington, DC: International Monetary Fund. May. Available at http://www.imf.org/external/pubs/cat/longres.aspx?sk=40549.0

6 For projected debt service payments to the IMF, see IMF 2013. For projected debt service payments to the World Bank see World Bank. 2013. "Jamaica: Estimated Debt Service Payments – Summary." Accessed January 2013 and June 2013. Available at http://web.worldbank.org/WBSITE/EXTERNAL/COUNTRIES/0,,menuPK:180465~pagePK:169597~piPK:169631~targetSubmitPK:169646~theSitePK:136917,00.html. For projected debt service payments to the IDB, see Inter-American Development Bank. 2013. "Debt Service Projections." Accessed January 2013 and June 2013. Available at http://www.iadb.org/dsprj

7 See IMF, 2013.

8 Baker, Dean. 2013. "We Need Job Creation, Not Talk of Debt-to-GDP Ratios." Debate Club (*U.S. News & World* Report), February 20, 2013. Available at http://www.usnews.com/debate-club/is-the-new-bowles-simpson-plan-a-good-deficit-reduction-proposal/we-need-job-creation-not-talk-of-debt-to-gdp-ratios