Jamaica: Macroeconomic Policy, Debt and the IMF

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Executive Summary

This paper looks at Jamaica's recent history of indebtedness, its experience during the global economic downturn, and examines its current agreement with the International Monetary Fund (IMF). It finds that Jamaica's economic and social progress has suffered considerably from the burden of an unsustainable debt; and that even after the debt restructuring of 2010, this burden remains unsustainable and very damaging. Pro-cyclical macroeconomic policies, implemented under the auspices of the IMF, have also damaged Jamaica's recent and current economic prospects.

As one of the most highly indebted countries in the world, with a gross public debt of 129 percent of GDP in fiscal year 2009/10, Jamaica has been burdened by heavy debt servicing costs due to both the size of its debt and very high interest rates. Over the last five years the government's interest payments have averaged 13 percent of GDP or 49 percent of non-grant government revenue. During fiscal year 2009/10 these were even higher, reaching 17 percent of GDP or 64 percent of non-grant revenue.

This exceedingly large debt burden has effectively crowded out most other public expenditure, especially public investment in education and infrastructure, which have stagnated over the last 18 years and amounted to only about 3 percent of GDP during fiscal year 2009/10. Such sustained underinvestment poses a severe problem for Jamaica's long-term development prospects, as evidenced by its very weak per capita GDP growth over the last two decades, which averaged less than 0.7 percent annually. This was also evidenced by its failure to progress towards the Millennium Development Goals, and by the decline exhibited by social indicators such as coverage rates for the detection and treatment of tuberculosis or primary school enrollment rates.

The paper examines Jamaica's macroeconomic policy during the global economic crisis and notes that the government's response was inadequate and may have made the recession worse. We also outline the details of the current IMF program, which is strongly pro-cyclical and includes measures such as tax increases and large cuts in expenditure. This drive for fiscal tightening at a time when the economy remains weak threatens Jamaica's prospects for recovery and risks exacerbating its public debt problems.

The recent Jamaica Debt Exchange (JDX) -an initiative launched in 2010 by the government to restructure its domestic debt- did little to solve Jamaica's debt burden. Although the JDX was able to lower average interest rates on domestic debt, there was no reduction of principal. The restructuring also left nearly half of the debt coming due within one to five years. This exposes Jamaica to potential problems at the time of refinancing that could easily erase the fiscal gains achieved by the exchange. The end result of the restructuring has still left Jamaica with a crippling, unsustainable debt burden.

We note that the current IMF program places particular emphasis on containing the wage bill. This can have negative consequences for developing countries that need to increase spending on vital sectors such as health and education. Efforts to contain the wage bill have put pressure on Jamaica's already struggling healthcare sector, creating uncertainty surrounding the treatment and payment of healthcare workers. This is especially problematic in light of Jamaica's difficulty in retaining trained and qualified healthcare professionals.

Introduction

The difficulties associated with the world recession and a cripplingly high public debt have forced Jamaica to seek assistance from the International Monetary Fund (IMF) and restructure its entire domestic debt stock (the so-called Jamaica Debt Exchange, or JDX). With support from IMF staff, Jamaica is currently pursuing strongly pro-cyclical fiscal policies in an effort to meet its large debt obligations. As a consequence, the Jamaican economy has failed to recover from its recession, with real GDP growth estimated to have been negative for fiscal year 2010/2011 and unemployment remaining persistently high.

In this context, it is important to stress that Jamaica's large debt buildup is not the result of profligate government spending, and that the recent JDX initiative did little to address Jamaica's long-term fiscal problems. Indeed, Jamaica is a case where IMF policies have focused on the narrow goal of fiscal consolidation, prioritizing the interests of creditors over employment needs as well as the growth and development of the Jamaican economy.

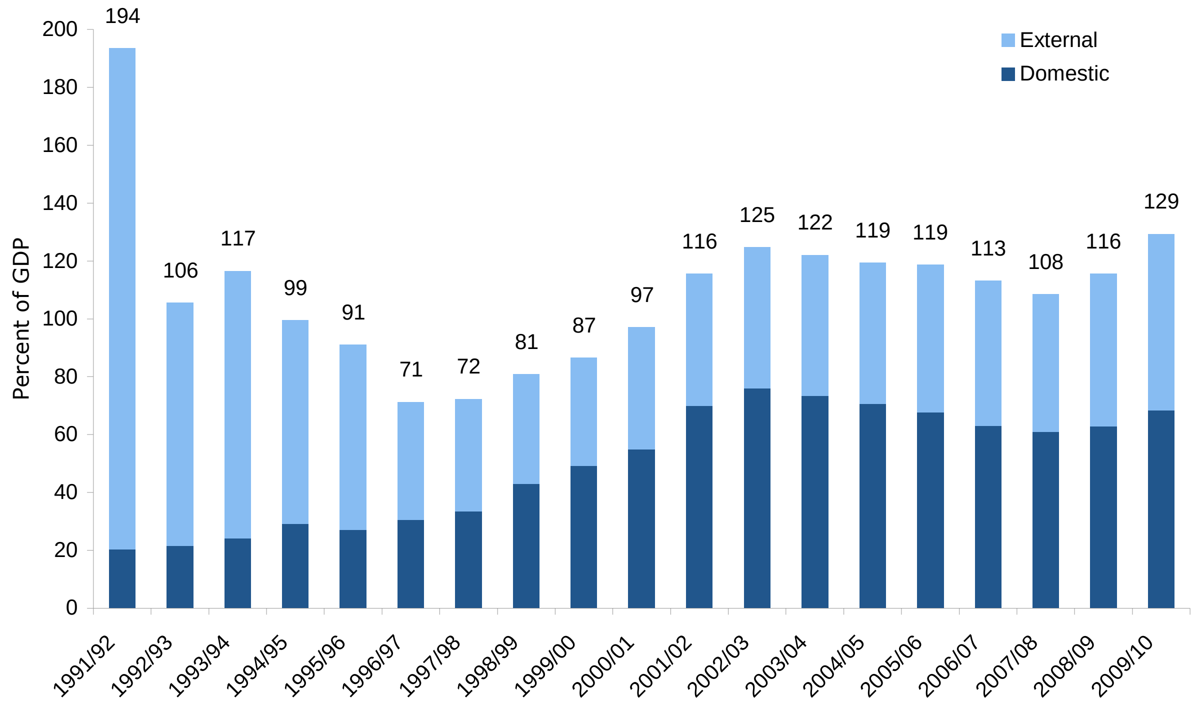
The first section of this paper will assess the buildup and effects of Jamaica's large public debt, as well as the impact of the recent JDX initiative. We then turn to Jamaica's general macroeconomic context and its experience during the global financial crisis and world recession, outlining the administration's policy response and the circumstances leading to the signing of the Stand-By Arrangement with the IMF in 2010. The paper then examines Jamaica's experience with the IMF and outlines the key aspects of the current IMF program.

A History of Indebtedness

Jamaica is one of the most highly indebted countries in the world, with a total public debt of 129.3 percent of GDP at the end of fiscal year 2009/10. As can be seen in **Figure 1**, after decreasing sharply during the early '90s, Jamaica's total debt to GDP ratio began to rise again between 1996/97 and 2002/03, increasing from 71.3 percent to 124.7 percent. The debt to GDP ratio decreased slightly during the following five years but began to grow again with the onset of the current recession.

Even at its current levels, Jamaica's level of debt would be manageable if it were at low interest rates. However, its effective interest rates are very high, leading to extremely high debt servicing costs. Over the last five years the government's interest payments have averaged 13 percent of GDP or 49 percent of non-grant government revenue. These were even higher during fiscal year 2009/10, amounting to 17 percent of GDP or 64 percent of non-grant revenue.

FIGURE 1
Public Debt as a Share of GDP, External and Domestic



Source: The Bank of Jamaica

Jamaica's increasing interest rates and debt burden are partly due to an increase in the share of debt that is domestically financed. Starting in the early 1990s, the composition of Jamaica's debt changed drastically, exhibiting a marked shift from a reliance on external to domestic creditors and, at the same time, from official bilateral and multilateral assistance to private sources of funding. At the beginning of the 1990s, the share of external debt dropped sharply from nearly 90 percent of the total to a low of about 40 percent a decade later. Since then, the share of external debt has increased somewhat, accounting for 47 percent of the total debt stock in fiscal year 2009/10; but it remains far below the levels of two decades earlier.

Although it can be argued that a greater reliance on domestic and private creditors is a positive development -in so far as it encourages the development of the domestic financial system and can enhance the effectiveness of monetary policy, as well as easing the balance of payments problems associated with foreign debt- in Jamaica's case it has translated into much higher effective interest rates on public sector debt. Effective interest rates on debt contracted domestically are significantly higher than on external debt, averaging about 17.9 percent annually over the last decade. In comparison, effective interest rates on external debt only averaged about 7.4 percent annually during the same period.[1] Domestic debt also tends to have much shorter maturities than external debt.

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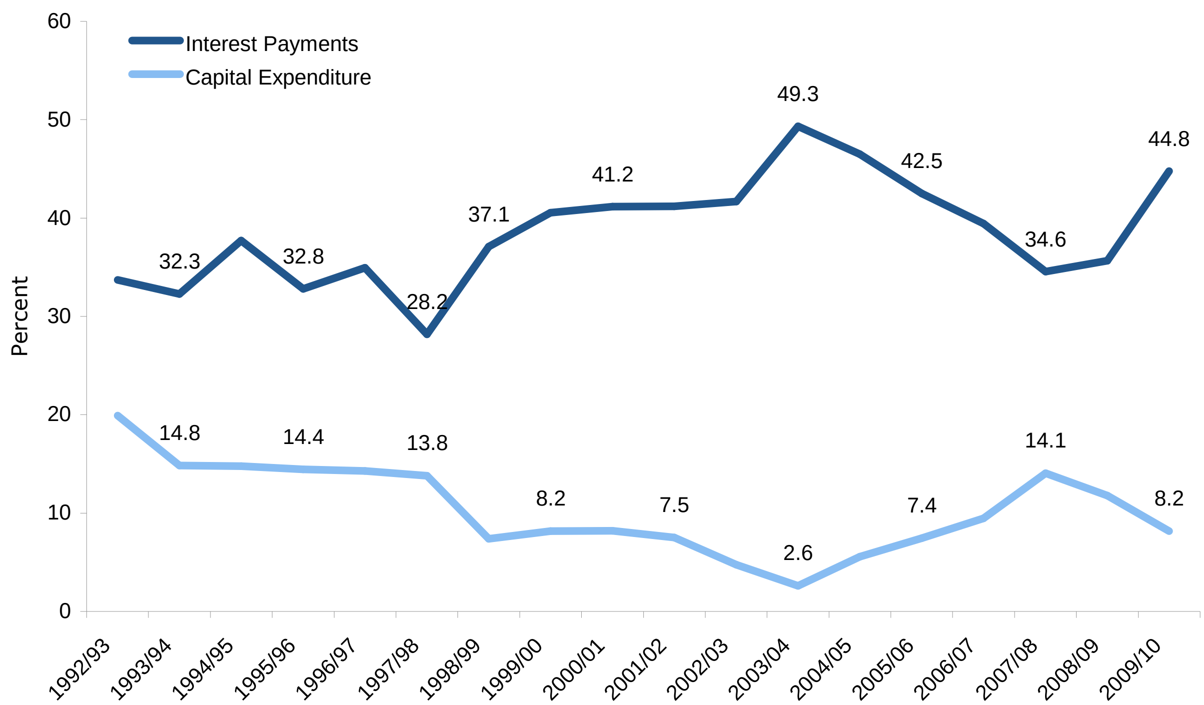
1 Authors' calculations based on data from Jamaica's Debt Management Unit. Effective interest rates are calculated as the implicit rate from the ratio of interest payments to the previous year debt stock.

This exceedingly large debt burden has effectively crowded out most other public expenditure. As **Figure 2** below shows, public capital expenditure, which includes investment in education and infrastructure, has stagnated over the last 18 years and has decreased almost proportionately to increases in interest payments. This chronic lack of public investment in economic and social infrastructure, which during the last fiscal year amounted to just 8.2 percent of total government expenditure or a little more than 3 percent of GDP, is a serious impediment to achieving sustained productivity increases and growth in human capital.[2]

FIGURE 2
Interest Payments and Capital Expenditure, Percent of Total Expenditure



Source: Ministry of Finance and Planning, Debt Management Unit

Jamaica's debt burden also appears to have negatively affected its progress towards the Millennium Development Goals (MDGs). The most glaring example is that of coverage rates for detection and treatment of tuberculosis. According to a recent study by the United Kingdom's Overseas Development Institute, of the 77 countries for which data was available, Jamaica showed the largest decline in coverage, from 79 percent in 1997 to 43 percent in 2006. Jamaica also seems to have regressed with regard to education, having the net enrollment ratio in primary school decline from 97 percent in 1991 to 87 percent in 2006/2007.[3]

2 See King (2010), for a detailed account of Jamaica's declining physical and social infrastructure. King notes that during the 1980s and 1990s "almost every element of the physical economic infrastructure failed to expand at a rate commensurate with the needs of a modern economy."

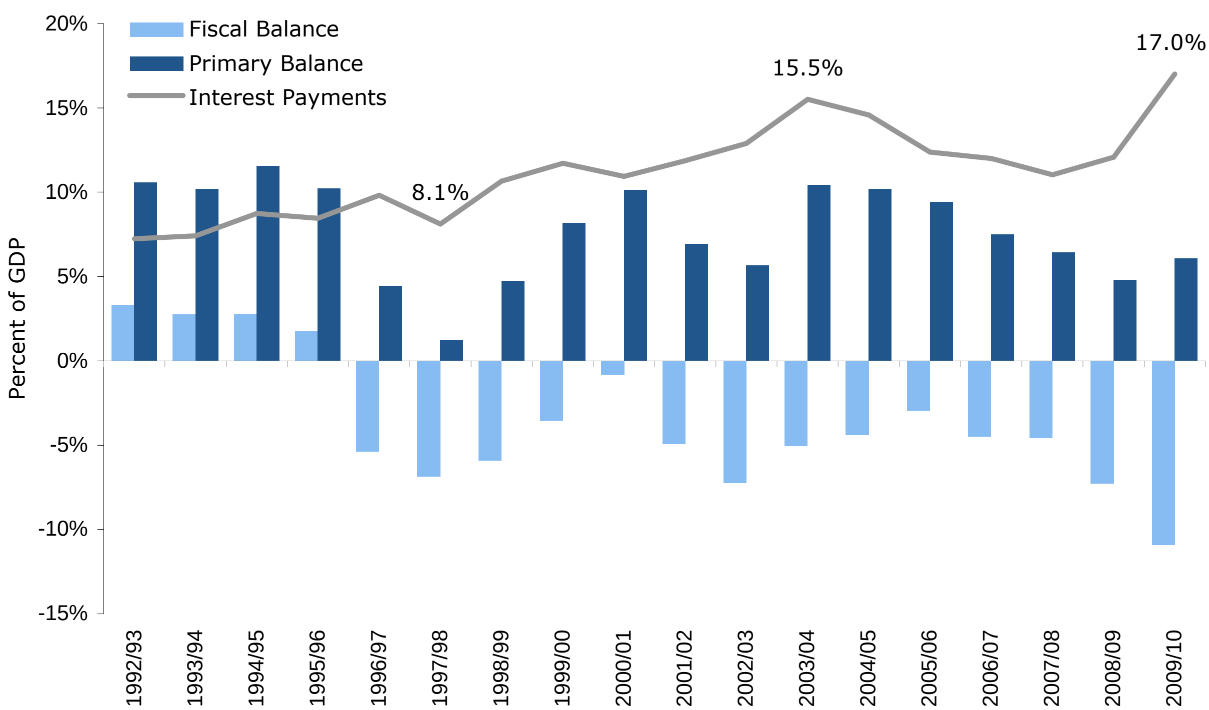
3 Overseas Development Institute (2010). For more information on Jamaica's progress towards the MDGs, see UNDP (2010).

However, it is important to remember that Jamaica's debt problems are not the result of excessive government spending. As can be seen in **Figure 3**, the central government ran sizeable budget surpluses during the early '90s and large primary surpluses in every one of the last 18 years except fiscal year 1997/98. Instead, the near doubling of the public debt that took place between 1996/97 and 2002/03 was the result of government interventions during Jamaica's financial crisis.[4]

Beginning in 1991 with the signing of a Structural Adjustment Package with the IMF, Jamaica undertook a rapid process of financial liberalization. Jamaica proceeded to eliminate and loosen long-standing credit restrictions and interest rate ceilings, resulting in a rapid expansion of the financial sector. However, the establishment of accompanying prudential regulations lagged behind the liberalization process, encouraging reckless behavior by financial institutions that eventually led to widespread bankruptcies by 1994.[5]

The government was forced to intervene through the creation of the Financial Sector Adjustment Company (FINSAC), which managed the breakup, nationalization and merging of troubled financial institutions. The debts assumed by FINSAC, which were eventually transferred to the central government in 2000 and 2001, amounted to over 34 percent of GDP.[6]

FIGURE 3
Overall Balance and Primary Balance, Percent of GDP



Source: Bank of Jamaica

4 King and Richards (2008).
5 King (2010).
6 King and Richards (2008).

The Jamaica Debt Exchange (JDX)

On January 14, 2010 the Jamaican government launched the JDX, a preemptive debt-restructuring scheme intended to make public finances more sustainable and unlock funding from the IMF. Most importantly, the exchange was limited to domestic debt and did not include a reduction of principal. Instead, the objective was to lower the public debt burden by renegotiating its interest rate and maturity structure.[7]

The JDX achieved the participation of all domestic debt holders, allowing the restructuring of the entire domestic debt stock. As a result, its average maturity was lengthened from 5.3 to 8.7 years. Also, the average coupon rate was lowered from 17 percent to 11 percent.[8] This translates into an estimated 3 percent of GDP reduction in annual interest payments during the next three fiscal years.[9]

While the JDX has succeeded in lowering debt-servicing costs in the short-run, the domestic debt's maturity profile will still pose a problem for public finances in the medium-run. As can be seen in **Figure 4**, although the amount of debt maturing within one year was dramatically lowered, from 26 percent of the total domestic debt to 6 percent, the share of debt coming due within one to five years remained virtually unchanged, decreasing slightly from 50 to 46 percent. In other words, the government will still face large amortization costs in the medium-run.

This maturity profile could also pose significant problems for the government in the event that refinancing needs were to coincide with unfavorable external conditions or any number of possible scenarios negatively affecting borrowing costs. With roughly 30.4 percent of GDP worth of domestic debt maturing within one to five years, the fiscal sustainability gains made by the JDX could all too easily be erased at the time of refinancing. Moreover, given the sheer magnitude of the amount coming due, the government could easily encounter difficulties rolling over its maturing debt.

The latest review of the IMF Stand-by Arrangement projects that Jamaica's debt will decrease to 102.8 percent of GDP by fiscal year 2014/15.[10] However, this is assuming that the government continues to run large and continually increasing primary surpluses, averaging 6.3 percent of GDP over the period in question.[11] Under this outlook it will remain difficult for the government to pursue any pro-growth or development-oriented spending measures. Perhaps more threatening, these large and increasing primary surpluses could choke off growth altogether and lead to further fiscal crises.

7 See Hurley et al. (2010) for a detailed account of the mechanics of the JDX. The JDX also succeeded in simplifying the structure of public sector debt instruments. Hurley notes that it "consolidated the government's complex array of 345 domestic debt instruments at different maturities and in different currencies into a much-simplified set of 24 new instruments."

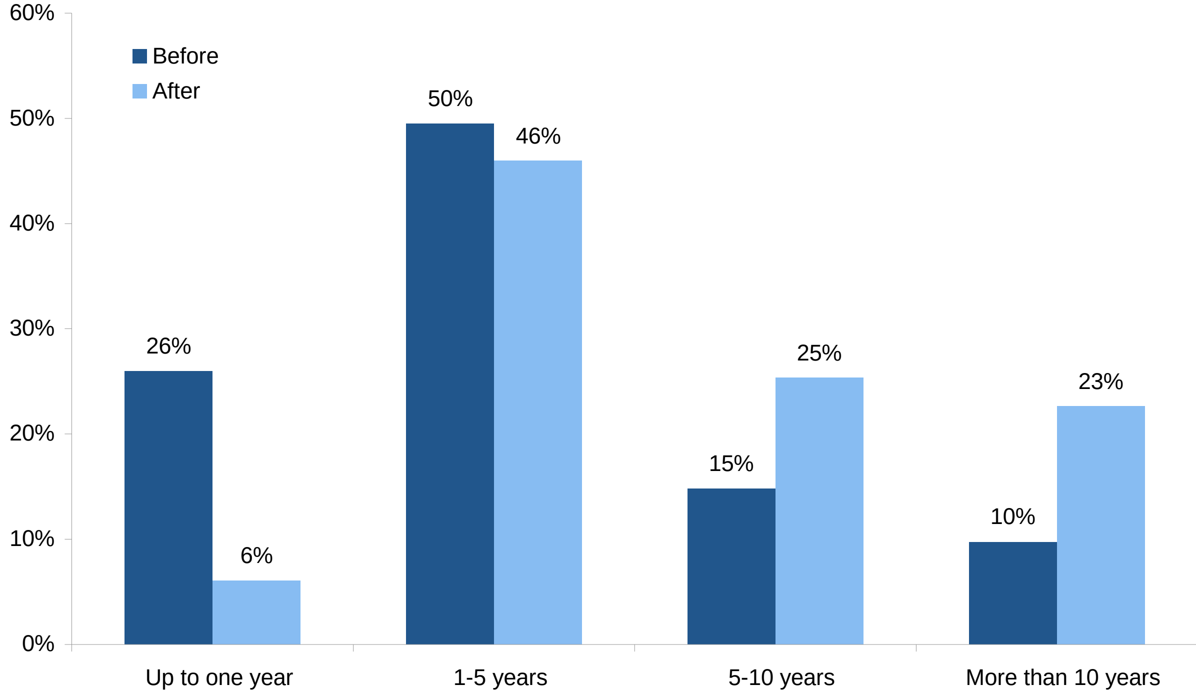
8 Ibid.

9 King and Kiddoe (2010).

10 IMF (2010a).

11 The latest IMF public sector debt sustainability analysis assumes the primary surplus rises to 8.9 percent of GDP by fiscal year 2014/15.

FIGURE 4
Maturity Composition of Domestic Debt, Before and After the JDX (percent of total domestic debt)



Source: Ministry of Finance and Planning, Debt Management Unit

It should also be noted that the contractionary nature of Jamaica's current IMF agreement could itself endanger the sustainability of the government's long-term fiscal outlook. Indeed, the strongly pro-cyclical character of the current fiscal consolidation, which we will describe in detail below, constitutes a significant obstacle to economic recovery, jeopardizing Jamaica's ability to pay off its debt and potentially leading to a self-perpetuating cycle of greater fiscal tightening and low growth. As noted by the most recent economic program of the Planning Institute of Jamaica:

> In the absence of sustained growth, a fiscal consolidation programme will have to be supported by unsustainable cuts in public expenditures or additional revenue enhancement, the limits of which will be quickly reached. Such additional expenditure cuts and/or additional tax or revenue enhancing measures would further compound the pro-cyclicality of the current fiscal consolidation programme.[12]

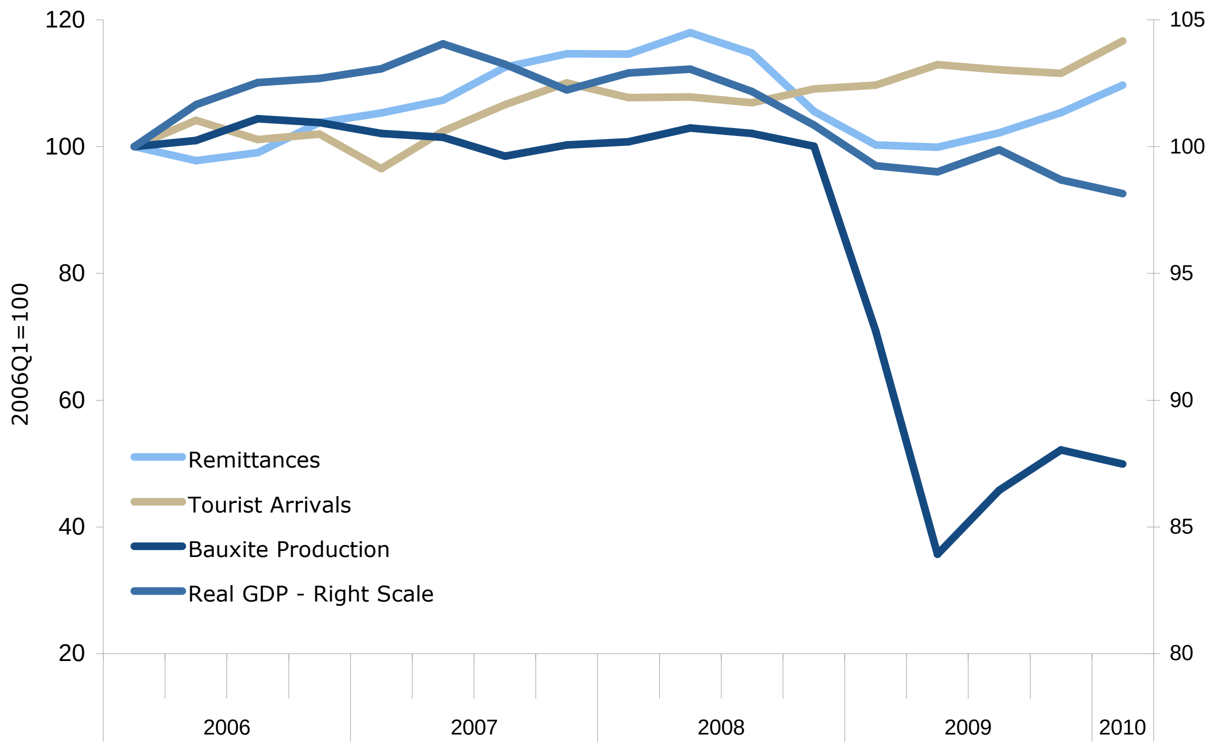
12 Planning Institute of Jamaica (2011).

Jamaican Economy on Uneven Ground Even Before the Recession

As a small open economy, Jamaica is extremely vulnerable to external conditions and as such was negatively affected by the world economic crisis. Even before the onset of the crisis, however, Jamaica had experienced a prolonged period of stagnant growth. For the 20-year period from 1988-2008 average annual real GDP growth was just 1.4 percent, while over the entire period real per capita GDP grew by just 14 percent; this compares to Caribbean country averages of near 3 percent and 54 percent respectively.[13] Subject to external demand shocks, natural disasters and a crippling debt, Jamaica has been unable to lay the foundation for long-term economic growth.

Heading into the recession, Jamaica was already experiencing a significant economic shock from Hurricane Dean, which struck the island late in the summer of 2007. As can be seen in **Figure 5**, GDP began contracting in 2007, despite strong growth in remittances and tourism.

FIGURE 5
Growth: Real GDP and Important Sectors, Seasonally Adjusted Index



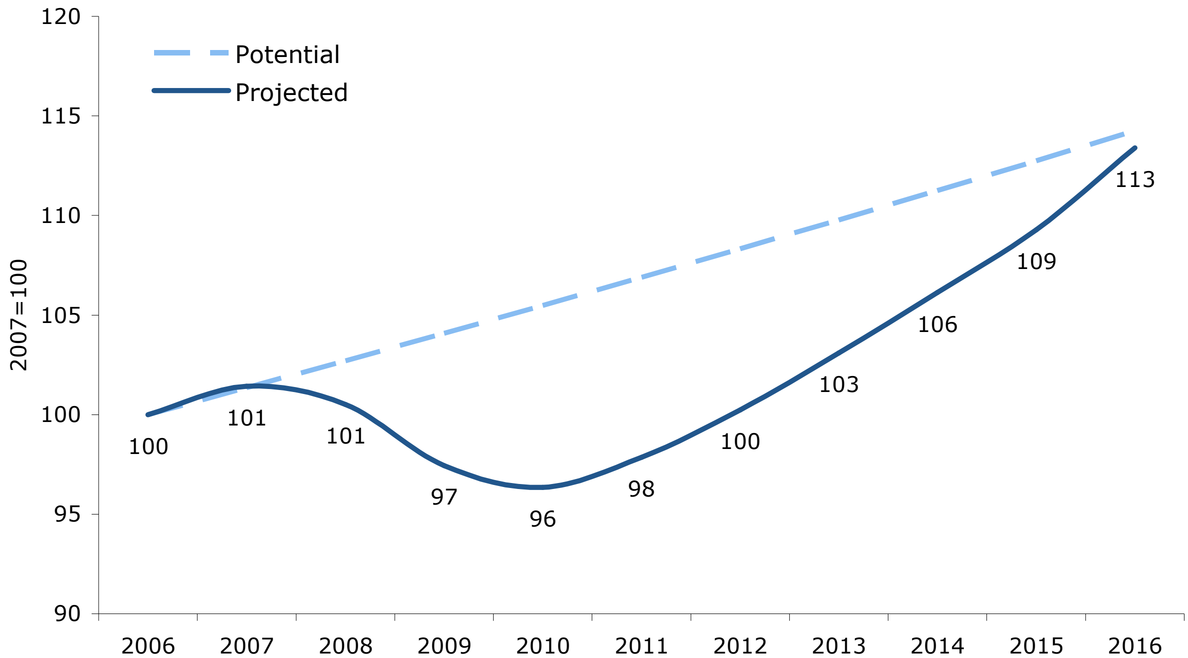
Source: Bank of Jamaica, Statistical Institute of Jamaica, Jamaica Tourist Board and Authors' calculations.

13 IMF (2011).

How did the Global Recession Reach Jamaica?

In the first quarter of 2008, the Bank of Jamaica assessed the impact of a potential recession in the United States on the Jamaican economy. The assessment, however, was based on the assumption that the slowdown in the U.S. would be short-lived and not very deep. As such the authorities revised their growth projections downwards to just a 0.4 percent drop in GDP from an original estimate of 3.0 percent for the fiscal year 2008/2009[14] (Jamaica's fiscal year runs from April-March).

FIGURE 6
Real GDP: Playing Catch Up



Source: IMF World Economic Outlook and Authors' Calculations.
Note: Projected after 2010.
*Trend real GDP was calculated as the annual growth rate of potential real output between 2007 and 1987. Potential output was obtained by applying a Hodrik-Prescott filter using the standard smoothing parameter of 1600.

The slowdown in the United States, and subsequently throughout the world, had a significantly larger impact on Jamaica than the authorities originally believed. As can be seen in **Figure 6**, real GDP is not projected to reach 2007 levels until sometime in 2013, while real per capita GDP won't fully recover until 2014. Remittances, which accounted for over 15 percent of GDP in 2007, declined dramatically beginning in the final quarter of 2008 and throughout 2009. Remittances fell by 11.2 percent, or some $225 million dollars, in 2009 from 2008.[15]

Jamaica was also affected by a slowdown in the tourism sector, although not by as much as other Caribbean countries. Tourism receipts have equaled nearly 15 percent of GDP over the last four years. Total tourist stopovers actually increased in both 2008 and 2009 over previous years, although

14 Bank of Jamaica (2008).
15 Bank of Jamaica (2010a).

the growth was significantly slower than in the years preceding the crisis. However, the increased number of stopovers was counteracted by price reductions, as hotels and resorts attempted to attract tourists, resulting in lower tourism revenue.

Weak external demand also negatively affected exports, especially bauxite and alumina, traditionally the main export products of Jamaica. Although mining accounts for roughly 4 percent of GDP, crude materials made up over 50 percent of exports of goods in 2007 and 2008. Exports of crude materials, which include bauxite and alumina, decreased by 55 percent between 2008 and 2009. Overall, exports of goods decreased by some 38 percent in 2009, although the decrease in imports (47 percent) was even greater, resulting in an improvement of the current account balance.[16]

TABLE 1
External Sector Indicators, millions of US dollars and percent of GDP

	2007	2008	2009	2010
Nominal GDP	12,896	13,527	12,640	13,737
Trade Balance	-4,587.8	-5,666.7	-3,738.3	-3,889
% of GDP	-35.6	-41.9	-29.6	-28.3
Imports of Good	6,893.0	8,162.9	5,057.6	5,226.8
% of GDP	53.5	60.3	40.0	38.0
Exports of Goods	2,305.2	2,496.2	1,319.4	1,337.4
% of GDP	17.9	18.5	10.4	9.7
of which, crude materials	1,387.8	1,336.4	470.4	555.7
% of GDP	10.8	9.9	3.7	4.0
Remittances	1,964.2	2,025.6	1,791.8	n/a
% of GDP	15.1	14.4	15.1	n/a
Current Account Balance	-2,126	-2,482	-1,341	-1,110
% of GDP	-16.5	-17.8	-10.9	-8.1
Tourist Stopovers (millions)	1.70	1.77	1.83	1.92

Source: Bank of Jamaica, Statistical Institute of Jamaica and International Monetary Fund

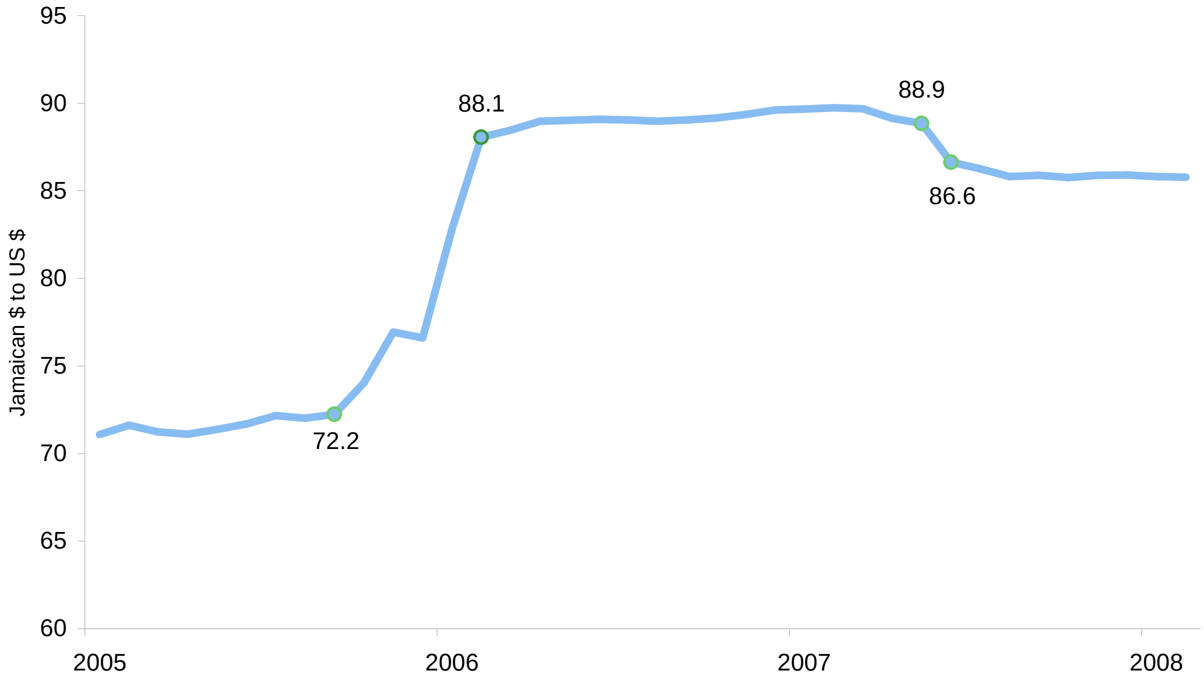
The Collapse of Lehman, and Jamaica's Policy Response

Following the collapse of Lehman Brothers in September 2008, panic spread throughout the world as global credit shrank. Jamaica was not exempt from the panic, as a poor economic outlook and severe debt problems (as discussed previously) put significant pressure on the Jamaican Dollar. As shown in **Figure 7**, from September 2008 to February 2009 the currency depreciated by nearly 20 percent. In response, Jamaican authorities responded by significantly tightening monetary policy to defend the currency and lower inflation. Through this time period the Bank of Jamaica raised the policy rate (180 day Open Market Instrument) by 6.8 percentage points to 21.5 percent and increased the reserve requirements for banks.

The Government of Jamaica also announced a series of stimulus measures in December 2008. The Caribbean Policy Research Institute (CaPRI) has done a detailed analysis of the different measures, their costs, and their effect.[17] The results, however, were not encouraging. CaPRI estimated that the total cost of the stimulus package would be between J$4.6 billion and J$5.3 billion (0.5 percent of

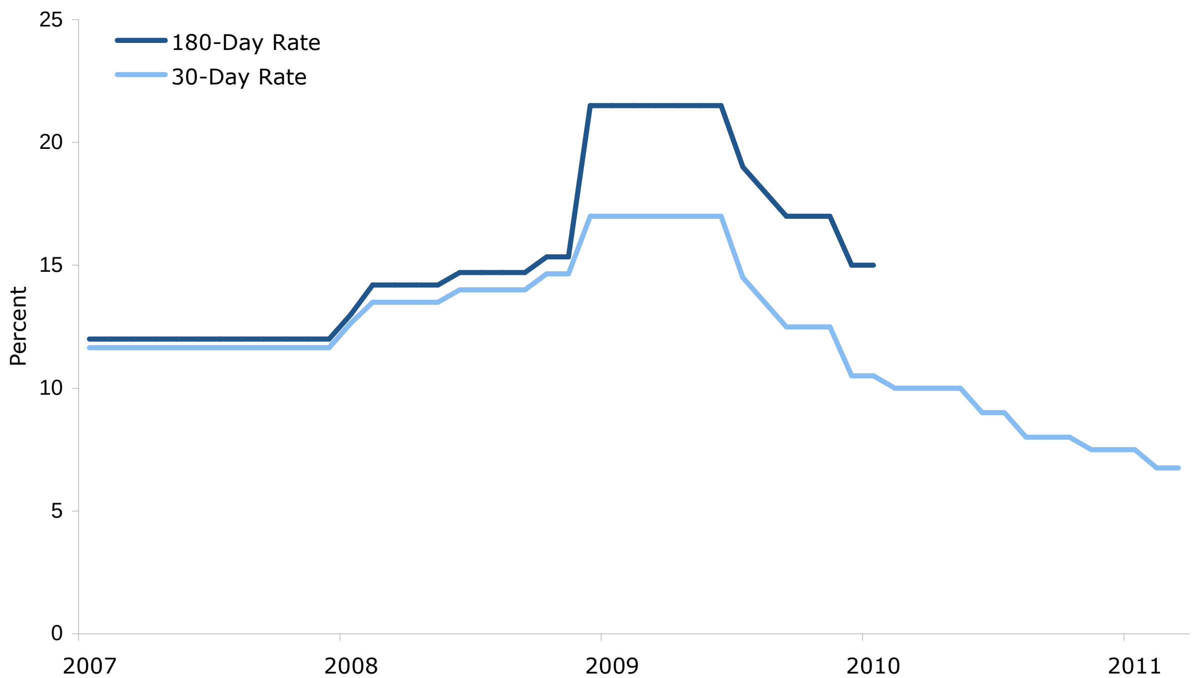
16 Statistical Institute of Jamaica (2010a)
17 Caribbean Policy Research Institute (2009).

FIGURE 7
Nominal Exchange Rate, Monthly Average ($J/$US)



Source: The Bank of Jamaica

FIGURE 8
Bank of Jamaica Monetary Policy Rates, percent



Source: The Bank of Jamaica
Note: The Bank of Jamaica stopped offering the 180-day open-market instruments in January, 2010.

GDP). At roughly half a percentage point of GDP, the government stimulus measures were simply too small to counteract the large shocks to demand. Any positive effects were also counteracted when, in early 2009, it was clear there would be a significant revenue shortfall due to the recession. The government responded with fiscal tightening measures equal to 1.9 percent of GDP.

Jamaica Returns to the IMF

"The authorities have been forced to confront the global crisis by implementing strongly pro-cyclical fiscal and monetary policies in order to address large fiscal and balance of payments financing gaps and declining investor sentiment." - IMF

Jamaica has had a long relationship with the Fund, having near continuous agreements from 1973-1996. In the summer of 2009, in the midst of a severe economic slowdown, Finance Minister Audley Shaw announced Jamaica's intent to secure a new IMF agreement. The 27 month Stand-by-Arrangement worth $1.27 billion was approved by the Executive Board on February 4, 2010 allowing Jamaica to immediately receive the first tranche of financing in the amount of US$640 million.[18] The agreement also unlocked funding from other multilateral organizations, including $450 million from the World Bank and $600 million from the Inter-American Development Bank (IADB).

The current IMF program contains a three-part strategy; primarily "medium-term fiscal consolidation", lowering interest costs and addressing debt overhang problems and reforming the financial sector.[19]

When Shaw announced the return to the IMF, there was considerable consternation on the part of many Jamaicans. As the *Jamaica Gleaner* pointed out when reporting the story, "The nation's relationship with the IMF became tense in the late 1970s and 1980s as a result of strict conditionalities such as a public-sector wage freeze, increase in interest rates and other belt-tightening measures."[20] Yet the current IMF agreement contains many of these exact same provisions.

Fiscal Policy

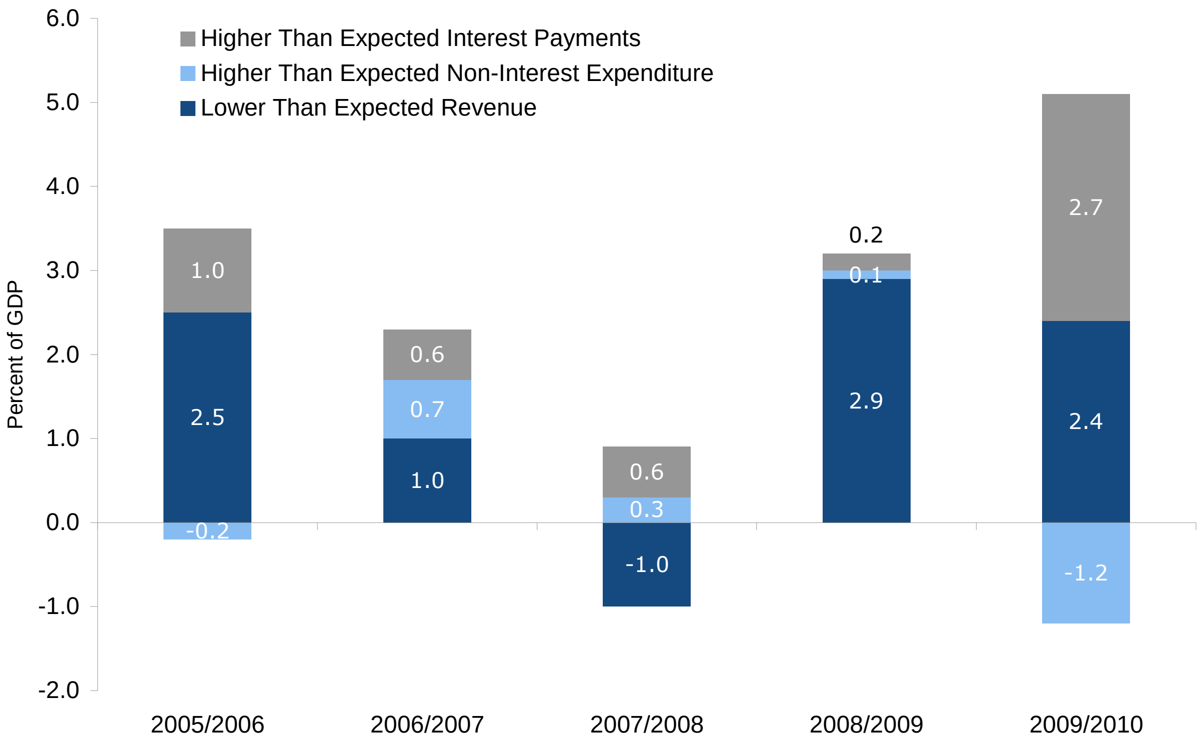
GDP growth the year before the IMF agreement was signed was –1.8 percent, and the outlook for the global economy remained weak. At the time, the IMF projected growth for FY2009/2010 was -3.5. In the context of a severely depressed local and international economy, the IMF program focused on pro-cyclical rather than countercyclical policies. This was especially the case regarding fiscal policy. In the first year of the program, the overall fiscal deficit was programmed to go from 12.7 percent of GDP to 7.5 percent of GDP. Through the entire duration of the IMF program the aim is to reduce the overall fiscal deficit "from 12¾ percent of GDP in FY2009/10 to ½ percent in

18 IMF (2010a).
19 Ibid.
20 See Luton (2009).

FY2013/14"[21]. The main avenue through which the program achieves this "is a tightening of fiscal policy."[22] The tightening includes both increases in taxes and cuts in expenditure. As part of the program's conditionality, the Jamaican parliament had to pass a tax package that increased tax revenue by 2 percent of GDP. The specific package contained an introduction of a new fuel tax, a one percentage point increase in the general consumption tax, and an increase of the tax rate for high income earners.

Although the IMF program puts an emphasis on controlling expenditure as a means to reduce the deficit, a look at recent history suggests that non-interest spending has played only a minor role in increasing the deficit. **Figure 9** shows the amount by which Jamaica missed its deficit targets over the last five years, and what factors led to the higher than budgeted deficits. As can be seen, the main determinant was lower than expected revenues, followed by higher than budgeted interest payments. Excess non-interest spending barely contributed to the deficit, and in some years was even lower than budgeted. Jamaica has averaged primary surpluses of 8 percent of GDP over the last decade.

FIGURE 9
Causes of Fiscal Slippage, percent of GDP



Source: IMF, Ministry of Finance and Author's Calculations

Nevertheless, the IMF program called for reducing expenditure. The Jamaican authorities noted in the Memorandum of Economic and Financial Policies (MEFP) that, "primary spending in

21 The most recent review aims to reach an overall fiscal surplus of 1.2 percent of GDP by FY2013/2014.
22 IMF (2010a).

FY2010/11 will be reduced by 1¼ percent of GDP."[23] In the first review, the IMF notes, "Although not without drawbacks, postponing the execution of capital expenditure will be used as a last resort to accommodate unanticipated revenue shortfalls." The authorities also delayed capital expenditure to offset higher than anticipated expenditures. At the time of the second review, revenues were 0.2 percentage points of GDP lower than expected and expenditures were 0.2 percentage points greater because of "unanticipated spending related to the State of Emergency in Kingston and the purchase of critical medical equipment for the two main public hospitals." The IMF, however, notes that, "they plan to offset this by reducing budgeted capital spending."[24]

In fact, the IMF has shown a reluctance to allow any fiscal easing, even after the negative shock of Tropical Storm Nicole in the fall of 2010, despite GDP growth being revised downwards for FY2010/11 to –0.5 percent, from 0.6 percent in the second review, and storm damages estimated at 1.7 percent of GDP. This may have a particularly negative effect since, as the IMF explains, "Given that Tropical Storm Nicole did not have hurricane-force winds, the government was not eligible for relief under the World Bank-administered Caribbean Catastrophe Risk Insurance Facility (CCRIF). In that context, staff agreed to support the inclusion of an adjustor (with an upward limit of 0.2 percent of GDP) to accommodate expenses related to the storm", while noting the "limited room for flexibility in that area."[25] Despite the damage from the storm equaling 1.7 percent of GDP, Jamaica was only allowed to increase spending by 0.2 percent of GDP. Overall, for FY 2010/11, unbudgeted expenditures totaled 1.4 percent of GDP, but that was entirely offset by tax and revenue measures, including the delaying of more capital expenditure.[26]

Throughout the program particular emphasis is put on containing the wage bill, which can have negative consequences for a developing country that needs to increase spending on sectors such as health and education. As can be seen in **Table 2**, the wage bill was programmed to see just a 2.3 percent nominal increase in FY 2010/11, despite projected inflation of over 11 percent. Although the IMF program allows for a 0.3 percent of GDP increase in targeted social spending, there is also evidence, demonstrated below, that there have been pressures put on the health and education sectors.

The tightened government budget has also negatively affected the tourism sector. After the government's security operations to capture Christopher "Dudus" Coke,[27] tourism, which accounts for some 15 percent of GDP, was negatively affected by the month long pursuit. The Tourist Board planned a $10 million campaign to better the country's image. In September, however, the money

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23 IMF (2010a). In subsequent reviews primary expenditures for FY2009/2010 were revised downwards by 1.1 percentage points and for FY2010/2011 they were revised upwards by 1.1 percentage points. The original IMF program estimated an increase in primary expenditure of 0.2 percentage points in FY 2009/2010, however after the IMF revised these numbers at a later review it is now clear that spending was actually reduced by 1.1 percentage points in FY2009/2010. Further cuts are planned, as primary expenditures are programmed to be reduced by 2.5 percentage points of GDP in FY2011/2012 followed by more modest reductions in the years following.

24 IMF (2010c).

25 IMF (2010d).

26 Ibid.

27 The Jamaican government succumbed to U.S. pressure to extradite Coke in May 2010. The operation to capture Coke involved declaring a state of emergency and deploying hundreds to troops in the Tivoli Gardens area of Kingston, leading to a multiple day shoot-out eventually which resulted in over 70 deaths. Coke was arrested a month later and extradited to the U.S.

designated for the Tourist Board was cut in half "in a bid to meet International Monetary Fund (IMF) stipulations," according to local press reports.[28]

TABLE 2
Selected Economic Indicators (percent of GDP, unless noted otherwise)

	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
Real GDP growth (percent)	-1.7	-2.5	-0.5	1.8	2.0	2.0
Budgetary Revenue and Grants	26.9	27	26.5	26.2	26.3	26.7
Budgetary Expenditure	34.3	37.9	32.9	28.5	26.5	25.6
Of which, Interest	12.3	17	11.1	9.2	7.7	7.1
Wage Bill	10.9	11.4	10.5	10.0	n/a	n/a
Nominal Wage Bill Increase (percent)	29.4	13.3	2.3	5.2	n/a	n/a
Budget Balance	-7.4	-10.9	-6.4	-2.3	-0.2	1.1
Primary Balance	-4.9	-6.1	-4.7	-6.8	-7.5	-8.2
Gross Financing Need	17.6	25.6	13.2	10.6	12.7	11.9
Growth of Real Primary Spending (percent)	10.2	-7.2	3.5	-9.3	-0.8	0
Tourism Receipts (percent)	-2.1	1.2	1.5	11.0	n/a	n/a

Source: IMF, Jamaica: Third Review Under the Stand-By Arrangement—Informational Annex
Note: The original IMF projections had growth in real primary spending negative in each year. At the third review the numbers were revised. The original projections were: 10.2, -2.6, -5.5, -0.8, -1.3, -1.7.

In addition to negative effects on education and tourism that may arise from contractionary fiscal policy, the Government is essentially giving up on stimulating the economy, despite depressed demand and high unemployment (**Figure 10**). As was seen previously, real GDP will not reach it's pre-crisis level until 2013 and with both domestic and external demand still lacking it would be appropriate for the government to step in with counter-cyclical policies. As can be seen in Table 2, real primary spending shrank by 7.2 percent in FY 2009/10 and is projected to be negative or flat in all but one year of the IMF's five-year outlook.[29]

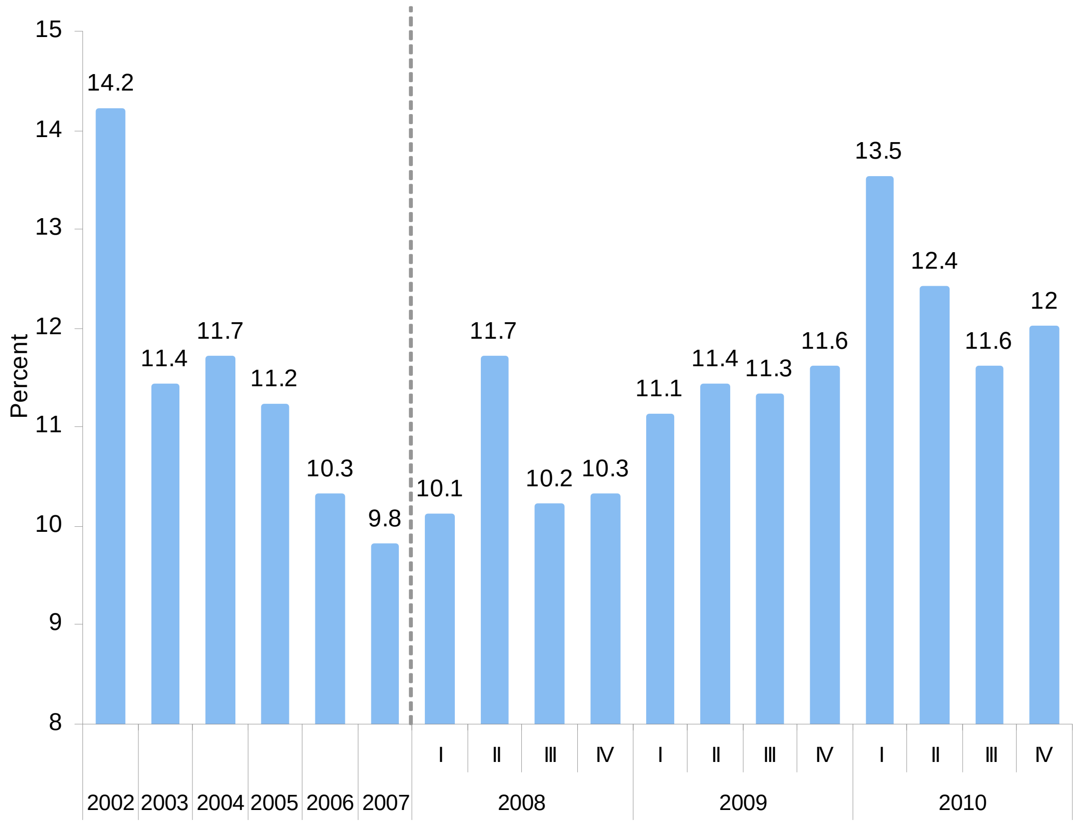
The IADB sums up the trade-off associated with the IMF program:

> While the IMF programme remains broadly on track, it continues to demand high primary fiscal surpluses required to bring down [Jamaica's] high debt ratios. This places a burden on the economy which also limits economic recovery. This poses risks on two fronts: either growth is lower than predicted and hence the debt to GDP ratio does not decline, or there is slippage in the tight fiscal programme. In either case, if markets respond by demanding higher interest rates the debt dynamics will suffer. This tight fiscal situation will continue for several years to come, beyond the expiry date of the current [Stand-By Agreement] SBA, until its debt ratios have fallen substantially.[30]

28 See Silvera (2009).
29 It should be noted that many IMF agreements relied on overly optimistic growth forecasts, which significantly underestimated the impact of the world recession on borrowing countries. See CEPR (2009) for more information on IMF policies during the global recession.
30 IADB (2010).

While the IMF program puts strain on Jamaica's social safety net, the IADB has stepped in to provide $50 million in support of social programs. However, despite the official government poverty rate rising from under 10 percent in 2007 to over 16 percent in 2009,[31] spending levels for health, education and childhood development are all programmed to decrease in real terms from FY2009/10 to FY2010/11. On the other hand, the program allows for slight increases in the conditional-cash-transfer program, "Program for the Advancement Through Health and Education" (PATH) and the School Feeding Program. While the IADB loans aim to protect social spending, they are specifically meant to protect only "non-salary" social spending.[32]

FIGURE 10
Official Unemployment Rate



Source: The Statistical Institute of Jamaica and The Economic Commission for Latin America and the Caribbean.

It is worth emphasizing that Jamaica does not qualify for concessional financing from multilateral lenders under the "small island" clause offered by some and receives very small amounts of official aid.[33] As a consequence Jamaica has relied exclusively on market-based finance for development spending or to fund fiscal deficits. This reliance is especially problematic given the structural

31 Ibid.
32 Ibid.
33 Currently Venezuela, through its PetroCaribe arrangement, is one of the only countries providing Jamaica with concessional financing.

vulnerabilities of the Jamaican economy, undermining the long-term continuity of development programs and exposing social spending to cutbacks in the event of external shocks.

Health, Education and the Public Wage Bill

In 2008, there was a salary agreement between the government and the main public sector union that would have resulted in a 7 percent nominal salary increase for all public sector employees in FY2009/10 after a 15 percent increase in FY2008/09. Facing fiscal pressure, this raise was never implemented. In August of 2010, the Supreme Court ruled that the agreement between the government and public sector employees constituted "a binding contract, and awarded legal costs against the Government. However, the ruling denied the request that interest be paid on outstanding amounts and did not specify the method or timing of payments."[34]

In August 2010, the U.S. National Education Association wrote a letter to U.S. Treasury Secretary Timothy Geithner protesting what they saw as "pressure" from the IMF that "is causing violations of fairly negotiated agreements between Jamaican Teachers Association and the Government of Jamaica."[35] The head of the National Education Trust of Jamaica, Paul Matalo, also warned that the IMF agreement restricted the Government's ability to build new schools.[36] A specific salary agreement with teachers was signed in 2008/2009 and was retroactive to the previous year, but despite this, the second IMF review notes that "the FY2010/11 budget did not accommodate any retroactive payments for teachers."[37]

The health sector has also faced increasing uncertainty because of strikes on the part of health care workers. The workers contend they are owed back wages and are trying to pressure the government to implement a reclassification that would increase wages. The reclassification, which would impact both teachers and healthcare workers, was brought to the Industrial Disputes Tribunal.

At the time of the third review, the IMF noted that, following a ruling of the Industrial Disputes Tribunal, "they [the Government of Jamaica] also decided to pay outstanding allowances due to healthcare workers and teachers and make back payments owed to teachers**.** Such payments amounted to 0.2 percent of GDP."[38] This increase in spending on wages was offset in other areas, as discussed earlier.

The uncertainty surrounding the treatment and payment of healthcare workers is especially problematic considering Jamaica's difficulty retaining trained and qualified healthcare professionals. For instance, as highlighted by a recent World Bank study, between 2002 and 2006 an estimated 1,800 nurses left the Caribbean, compared to 7,800 nurses currently working there. In relation to Jamaica specifically, the authors of the report note that based on a survey of Jamaican nurses who emigrated, some 95 percent did so because of wage concerns.[39]

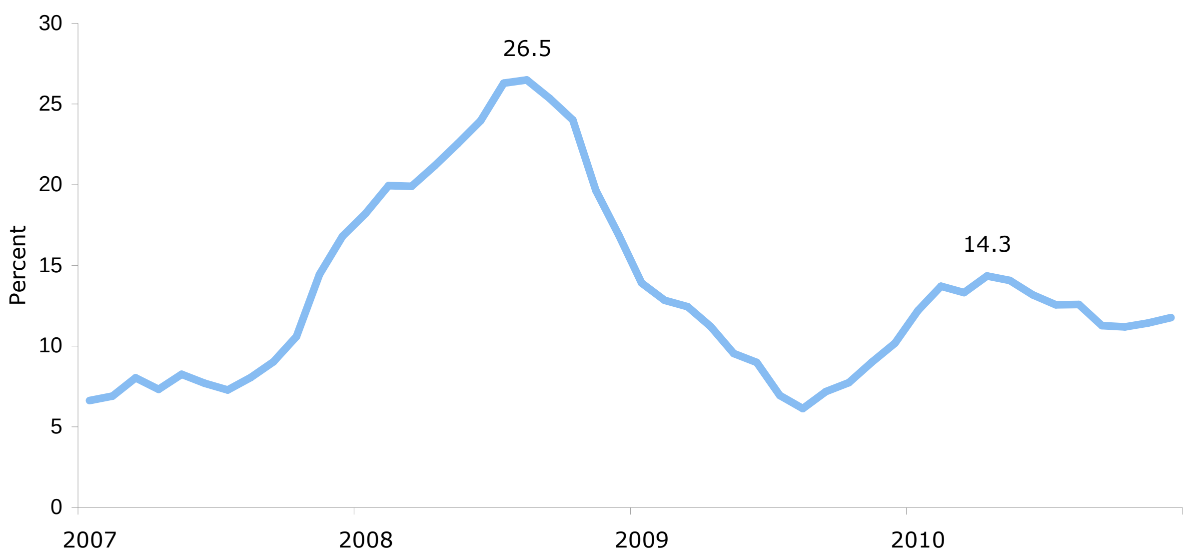
34 IMF (2010c).
35 NEA Letter to U.S. Treasury Secretary Timothy Geithner. <http://www.justforeignpolicy.org/node/671>
36 See Luton (2010).
37 IMF (2010c).
38 IMF (2010d).
39 World Bank (2009).

Monetary Policy

Figure 11 shows year over year growth in the Consumer Price Index. As can be seen, inflation has dropped significantly since 2008. Inflation in FY2009/2010 was slightly higher than originally programmed due to the effects of the tax measures and an increase in bus fares, according to the IMF. During the time of the second program review, unforeseen exchange rate appreciation -driven by the growth of remittance flows- and weak aggregate demand kept inflation low. By the time of the third program review inflation had registered a small up-tick through the end of 2010. However, as noted by Fund staff, this slight increase in the CPI was driven by food and fuel prices, with core inflation continuing to fall throughout the period.

Jamaica's IMF program does not focus extensively on monetary policy. Although the IMF notes that the primary goal of monetary policy is "containing inflation," Fund staff has remained supportive of the authorities' "cautious approach" to monetary loosening.[40] After raising interest rates significantly after the collapse of Lehman Brothers in the fourth quarter of 2008, the Bank of Jamaica has begun slowly lowering the policy interest rates. The 30-day Open Market Instrument has declined from a high of 17 percent to its current rate of 6.75 percent.

FIGURE 11
Consumer Price Index, year-over-year percentage change



Source: IMF International Financial Statistics

Public Sector Structural Reforms

The IMF agreement contains significant reforms to the public sector. As part of the program's conditionality, the Jamaican government had to divest or liquidate Air Jamaica by June 2010. In May,

40 IMF (2010b).

Jamaica handed over control of the airline to Caribbean Air, which is majority owned by the government of Trinidad & Tobago. Fund staff and the Jamaican authorities stressed the need to remove the operating losses of the airline from the government budget. From FY 2007/08 to FY 2009/10 Air Jamaica had an average annual operating balance of –0.93 percent of GDP. Costs associated with the divestment however were expected to reach 1.5 percent of GDP; in addition 1,800 workers were "declared redundant".[41]

Another structural benchmark of the IMF program was an increase of no less than 40 percent for the state-owned Jamaican Urban Transport Company's bus fares and the leasing or selling of factories belonging to the state owned Sugar Company of Jamaica. The government has also agreed to sell Clarendon Alumina Production and its majority holding of the Petrojam oil refinery. By the second review, Jamaica had privatized all of its holdings in the Sugar Company of Jamaica, reaching an agreement with a Chinese firm.[42] The IMF review notes that the Jamaican government has agreed to "sell the three remaining sugar factories and associated farmlands of the Sugar Company of Jamaica (SCJ) Holdings for US$ 9 million." Because the original sale of the Clarendon Alumina Production (CAP) to another Chinese firm fell through, the government's divestment in CAP has been added as a "structural benchmark" in the latest review.

Conclusion

Jamaica offers a stark example of the long-term costs 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. As demonstrated previously, Jamaica's debt burden has seriously constrained government fiscal policy over the last two decades. Public investment in the long-term productivity and development of the Jamaican economy has taken a backseat to debt servicing costs.

The Jamaica Debt Exchange, widely supported by the international community as a success, did little to resolve Jamaica's debt problems or to place the country's public finances on sustainable footing. As shown above, while the JDX succeeded in lowering interest rates on the government's domestic debt, Jamaica's debt burden nevertheless remains unsustainably large. Moreover, the JDX still left nearly half of the domestic debt stock coming due within one to five years. This leaves the country vulnerable to potential difficulties at the time of refinancing, threatening to erase the fiscal gains made by the exchange.

At the same time, Jamaica's agreement with the IMF has included pro-cyclical macroeconomic policies during the current downturn. This unfavorable 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. In the absence of plans to tackle Jamaica's debt problems with a broader concern for the growth and employment needs of the economy, Jamaica's economy will likely continue to stagnate.

41 IMF (2010b).
42 IMF (2010c).

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