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Jamaica's Debt Exchange

A Case Study for Heavily Indebted Middle-Income Countries

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Report written by: Gail Hurley, Poverty Group, Bureau for Development Policy, UNDP New York; Minh H. Pham, Resident Representative, UNDP Jamaica, and; Machel Stewart, Poverty Programme Advisor, UNDP Jamaica

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Cover photo: market in downtown Kingston

Photos: Courtesy of Heves Krausz Nagy

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United Nations Development Programme
Bureau for Development Policy
Poverty Group
304 East 45th Street
New York, NY, 10017
U.S.A.
E-mail: poverty.reduction@undp.org
Website: www.undp.org/poverty

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EXECUTIVE SUMMARY

Jamaica's Debt Exchange:
A Case Study for Heavily Indebted Middle-Income Countries

Executive Summary

Jamaica is a severely indebted middle-income nation. The total public debt burden stood at approximately US$ 13.4 billion or 135 percent of GDP at the end of 2009. 55 percent is owed to domestic creditors and 45 percent to external creditors.

Over the last 10 years, annual debt service costs (principal amortization and interest) have averaged more than 112 percent of government revenues. Domestic debt service has been particularly burdensome: interest rates on some local currency denominated bonds have been as high as 28 percent and over a quarter of domestic sovereign bonds mature in less than 24 months.

High debt – and debt service – levels coupled with limited access to external finance has meant the government has had little fiscal space with which to increase expenditures in public investment and poverty reduction programmes. This has led to slow progress in some areas of the Millennium Development Goals.

The recent economic crisis worsened the government's fiscal position further as revenues from exports, tourism and migrant remittances all declined simultaneously. In 2009, the fiscal burden of the public debt became unsustainable; interest repayments alone reached an unprecedented 65.1 percent of central government tax revenues. This made some form of solution to the country's debt burden not only necessary to sustain human development gains, but also urgent and unavoidable.

This report provides a snapshot of Jamaica's public debt situation, followed by an explanation and assessment of the Government of Jamaica's recent debt exchange initiative; its solution to its immense public debt burden. It examines how far the debt exchange programme – or JDX (Jamaica Debt Exchange) – may contribute to positive development outcomes and whether the initiative will be sufficient to restore debt sustainability to the island. It also explores the strategies used by the Government of Jamaica to secure broad-based buy-in for its exchange operation and asks whether a sovereign insolvency procedure at the international level may have resulted in a more efficient and robust solution to the country's public debt difficulties.

The Jamaica Debt Exchange (JDX) was launched in January 2010 and concluded in February 2010. The initiative aimed to reduce the fiscal burden of *domestic* debt service on the central government by exchanging high-interest, short-maturity debt instruments for lower-interest, longer-maturity coupons, but which still offered domestic investors positive real rates of return. The initiative has not reduced the nominal value of the securities held by domestic investors; rather it has reduced the present value of the returns from the securities. The focus of the debt exchange programme was thus on liquidity rather than solvency. The debt exchange consisted of the entire stock of domestic debt – 345 instruments – which were

consolidated into 24 new instruments. Average interest rates were reduced from 17 to 11 percent; average debt maturities were extended by 2.5 years.

The transaction has significantly reduced the burden of interest repayments on the Government of Jamaica; the initiative will release approximately US$ 527.5 million in interest savings each year in 2010 and 2011, or 3.5% of GDP. The government also managed to secure an unprecedented 99.2 percent investor participation in the debt exchange programme. The United Nations Development Programme (UNDP) played a key role in raising the public debt issue at national level and in securing the advice of an independent attorney who worked through various scenarios with UNDP and the Government of Jamaica, which led ultimately to the design and implementation of the Jamaica Debt Exchange.

The initiative has released substantial extra domestic resources, which in the current economic climate, a middle-income country such as Jamaica would struggle to attract from external sources. Most importantly, the government has committed to increase social expenditures with these funds; as such the real measure of the success of the initiative as a development strategy can only be assessed if and when the government fulfils this pledge.

Jamaica has found an innovative solution to its immediate fiscal constraints. The initiative has not reduced the public debt stock however, and indeed the debt exchange operation unlocked over US$ 2 billion in fresh loans from the multilateral financial institutions and so has indirectly increased the overall debt stock. As a small open economy, the island remains extremely vulnerable to changes in international market conditions and sentiment – as well as to natural disasters – and, as such, remains extremely vulnerable to debt distress. Reforms are now needed to consolidate the benefits of the debt exchange operation. These include: a legislative framework to ensure fiscal discipline; development of a credible medium-term debt strategy and improvement of the national debt management capacity; rationalization of public bodies; equitable tax reform; and a clear and nationally agreed growth strategy that is not debt-dependent.

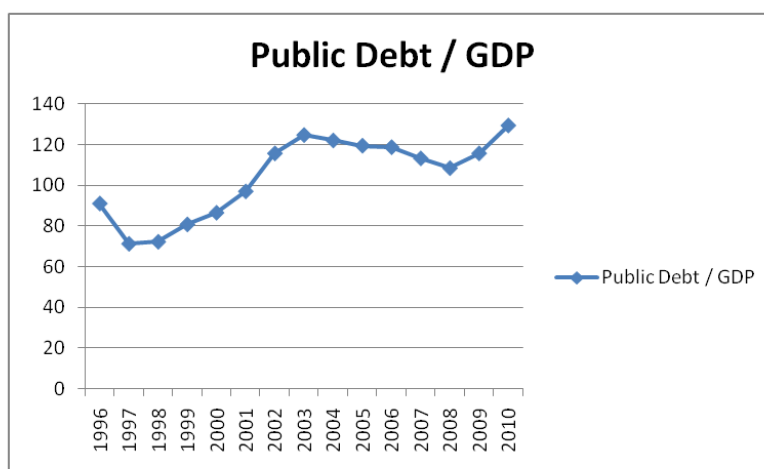
The debt exchange initiative, as executed, was also based on the political feasibility of the solution. The case shows that had the country had recourse to an international insolvency procedure a more robust solution to the country's debt difficulties – based on an objective assessment of the measures needed to restore the country to debt sustainability – may have been found.

> *"Every year for many years, we have been spending more than we earn. Every year, we have to borrow to make up the difference, so, each year, the debt gets bigger and bigger and each year we have to set aside more money to pay the interest on that debt. [...] For the last 10 years, all of the taxes we collect have had to be used to service that debt. So, before we can pay one teacher or nurse or policeman, before we can patch one pothole, before we can put one bottle of medicine in our hospitals or provide one school lunch for a needy child, we have to borrow more money, piling up the debt even further and the cost of servicing that debt even higher."*
>
> (Prime Minister Bruce Golding, 13 January 2010)

1. Jamaica's Debt Burden: A Snapshot

Jamaica is in a critical situation with regard to its public debt. It is the world's fourth- most severely indebted nation. At the end of 2009, the country's public debt-to-GDP ratio had reached 135 percent, a figure projected to climb to 140 percent by the end of 2010. The total public debt burden stands at about US$ 13.4 billion, of which US$7.3 billion (55.5 percent) is owed to domestic creditors and 44.5 percent is owed to external creditors. In per-capita terms, each Jamaican resident's share of the public debt amounts to about US$ 7,920.[1] The debt stock has climbed steadily over the last ten years, however between 2008 and 2009, the debt-to-GDP increased by an astonishing 14 percent.[2]

Figure 1: Jamaica's public debt stock



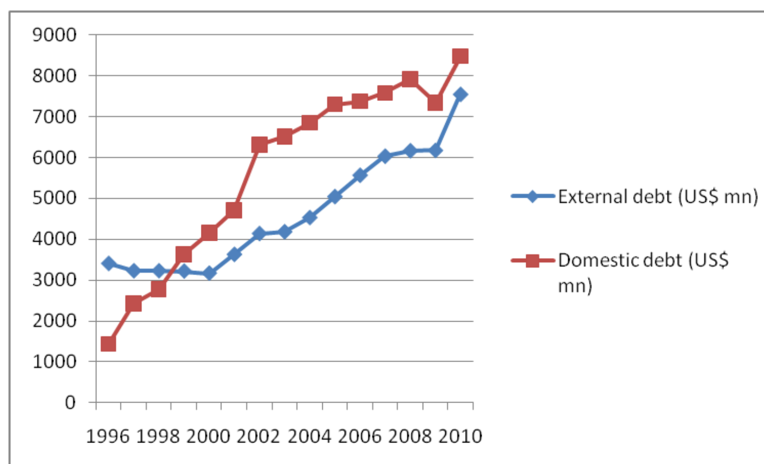
Source: Government of Jamaica, Ministry of Finance and the Public Service, January 2010

[1] All data from the Government of Jamaica, Ministry of Finance and the Public Service, January 2010, Debt Management Unit (DMU). See also Caribbean Policy Research Institute (CaPRI), *Jamaica's Debt*, March 2008

[2] Government of Jamaica, Ministry of Finance and the Public Service, January 2010, Debt Management Unit (DMU)

With regard to the composition of the public debt, the island's *domestic* debt burden is owed principally to domestic merchant banks, commercial banks, insurance companies and pension funds; together, they hold more than 80 percent of government bonds. The island's *external* debt burden is owed chiefly to private external bondholders (US$ 4.25 billion in 2008) and multilateral lenders, such as the Inter-American Development Bank, Caribbean Development Bank and World Bank (US$ 1.32 billion in 2008).[3]

Figure 2: Composition of Jamaica's Public Debt



Source: Government of Jamaica, Ministry of Finance and the Public Service, January 2010

The debt was accumulated largely between 1996 and 2003 and has averaged over 115 percent of GDP over the last 10 years.[4] Servicing this debt has been burdensome. Over the last 10 years, annual debt service costs (principal amortization and interest) have averaged more than 112 percent of total government revenues.[5] As a direct consequence, fewer resources have been available to the government to spend on infrastructure and poverty reduction programmes. Human development in the country has thus been severely affected by the high public debt burden. Also, because the government has been able to meet only interest repayments on the public debt burden, it has been unable to reduce the debt stock.

Domestic debt service has been particularly burdensome, absorbing more than three-quarters of total interest costs; in addition US$ 3.1 billion (J$ 288 billion), or 27 percent of GDP, matures in less than 24 months.[6] Interest rates on local currency-denominated bonds are particularly high and have averaged 19 percent over recent years, with some as high as 28 percent. Average interest rates on US dollar-denominated bonds have stood at about 9 percent.[7] This contrasts with interest rates on bilateral and multilateral loans, which averaged just 3.81 percent in 2008 and 2009.[8]

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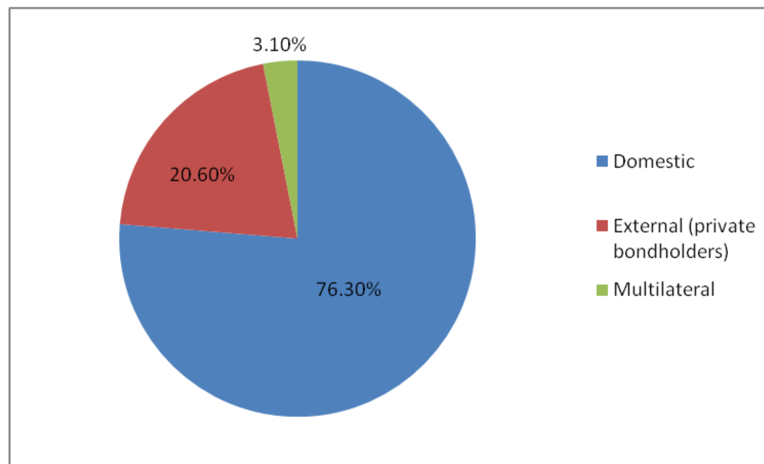
[3] World Bank, Global Development Finance 2010
[4] The Government of Jamaica Ministry of Finance and the Public Service, Debt Management Unit (DMU), January 2010
[5] Address to Parliament by Prime Minister Bruce Golding on the Supplementary Estimates, 30 September 2009
[6] An exchange rate of 1 US$ = 91.35 JM$ has been used throughout this report, current as at end-March 2010
[7] Government of Jamaica, Jamaica's Economic Programme, Investor Presentation, 14 January 2010
[8] Ministry of Finance and the Public Service, Budget Memorandum 2009/10, 23 April 2009, Chapter 5, p. 5

Figure 3: Public debt interest expense breakdown



Source: Government of Jamaica, Ministry of Finance and the Public Service, January 2010

In 2009, the Government of Jamaica's fiscal situation became unsustainable, due in part to the effects of multiple and simultaneous external shocks on the economy caused by the global economic crisis. The government saw its export income halved, tourism revenues decline by 6.5 percent between 2007 and 2008 and migrant remittances decrease all simultaneously.[9] As a result, the fiscal deficit widened to 8.7 percent of GDP.[10]

In 2009, interest repayments on the public debt reached an unprecedented 65.1 percent of government tax revenues.[11] Contending that the government appeared close to debt default, major international ratings agencies such as Standard and Poor's (S&P) and Moody's downgraded the country's domestic and foreign currency bonds on several consecutive occasions. Coupled with depreciation of the Jamaican dollar by 24 percent between September 2008 and January 2010, this considerably increased the cost of borrowing – and the government's debt service costs – at exactly the moment the government saw its revenues decline.

This marked the government's most serious fiscal crisis in recent history and prompted the administration to introduce short-term procyclical fiscal and monetary policies (such as an increase in the General Consumption Tax – GCT – and income and fuel taxes), seek new finance from the multilateral financial institutions – in particular the International Monetary Fund – and to simultaneously propose the Jamaica Debt Exchange.[12] The tax package was intended to generate around US$ 237 million

[9] More than 40,000 people lost their jobs in the bauxite/alumina sector The Gleaner, "Job Losses Hit 40,000," November 2009. For data on tourist numbers, see Jamaica Tourist Board

[10] International Monetary Fund, Jamaica: 2008 Article IV Consultation—Staff Report, June 2008

[11] Address to Parliament by Prime Minister Bruce Golding on the Supplementary Estimates, 30 September 2009

[12] Public anger forced the Government to reconsider certain tax measures to lessen the impact on poor and low-income families. See: National Broadcast on the Revised Tax Measures, by Prime Minister Bruce Golding, 23 December 2009

in extra government revenues however public anger forced it to re-consider certain tax measures to lessen the impact on poor and low-income families.[13] The JDX then became inevitable and was by far the government's most difficult move.

Box 1: Fiscal burden of public debt service

2009 marked the government's most serious fiscal crisis over recent years. Debt service costs amounted to US$ 3.55 billion (J$ 325 billion) out of a total government budget of US$ 6.14 billion (J$ 561 billion). Once the costs of the government administration were deducted, only US$ 864 million (J$ 79 billion) was available to the government to invest in social programmes and improve the island's infrastructure; under such a scenario, meaningful progress towards poverty reduction is impossible.

Fiscal profile of the Government of Jamaica 2009:

Debt service costs:	US$ 3.55 billion / J$ 325 billion
Costs of government administration:	US$ 1.71 billion / J$ 157 billion
Total:	US$ 5.27 billion / J$ 482 billion
Total budget:	US$ 6.14 billion / J$ 561 billion
Available to finance government programmes:	**US$ 864 million / J$ 79 billion**

Rubbish in downtown Kingston. High debt service costs leave the government few resources for essential services such as litter collection.

Photo courtesy of: Heves Krausz Nagy

[13] National Broadcast on the Revised Tax Measures, Presented By Prime Minister, Hon. Bruce Golding, Wednesday, December 23, 2009

Box 2: Jamaica and the MDGs

Jamaica's progress towards the Millennium Development Goals (MDGs) has been significant. It has halved the number of people who live in poverty from 19.9 percent of the population recorded in 1997 to an estimated 9.9 percent in 2007. Jamaica appears on track to achieve MDG1, eradication of extreme poverty and hunger; has achieved Goal 2 of universal primary education; and has made significant progress towards eliminating gender disparity in primary and secondary education. Life expectancy is 73.5 years, and access to health care is universal.

Yet the island also faces considerable social, economic and environmental challenges. Poverty, violence and insecurity persist, and the island is extremely vulnerable to natural disasters and climate change. Crime data show that murders increased from 1,583 in 2007 to 1,680 in 2009. Other major crimes such as larceny, robbery and break-ins also are on an upward trajectory. The island has experienced three hurricanes over recent years: Hurricanes Gilbert in 1988, Ivan in 2004 and Dean in 2007 all extensively damaged agriculture, homes and businesses. The fall in real GDP growth in 2007 – by 1.5 percentage points – can in large part be explained by the destruction caused by Hurricane Dean. The impacts of climate change will further exacerbate these vulnerabilities; more variable rainfall, increased tropical storm activity and a rise in sea levels are all predicted.

At the same time, classified as a middle-income country by the World Bank, and with a per-capita income of US$ 4,870 in 2008, the country has struggled to attract international donor assistance and is not eligible for concessional finance – or debt relief – from major multilateral financial institutions. In 2008 the island's net Official Development Assistance (ODA) position was negative, with repayments amounting to US$ 198.1 million and fresh disbursements to just US$ 180.8 million. This has left the government excessively dependent on domestic and international capital markets for new resources.

The large public debt burden has crowded out expenditures in infrastructure, education, health and other critical public services. Without a solution to the public debt problem, Jamaica would find it extremely difficult to achieve the overall MDGs by 2015.

Sources: Government of Jamaica, Ministry of Foreign Affairs and Trade, Progress Towards the Achievement of the Internationally Agreed Development Goals, including the MDGs, National Report of Jamaica for the ECOSOC Annual Ministerial Review, July 2009; Jamaica Survey of Living Conditions 2008; Jamaica Constabulary Force, Major Crime Statistics Provisional Report, December 2009, and; International Monetary Fund, Jamaica: 2008 Article IV Consultation—Staff Report, June 2008

2. Jamaica's Debt Exchange – JDX – Programme

In January 2010, the Government of Jamaica formally launched the Jamaica Debt Exchange, or JDX, programme. This was the first time that a pre-emptive debt restructuring operation was to take place in the country. In contrast to other recent debt exchange operations – such as Argentina (2001 and 2003), Dominican Republic (2005), Ecuador (1999 – 2000), Ukraine (1998 – 2000), Moldova (2002 and 2004), Pakistan (1999), Russia (1998 – 2000), Ukraine (1998 – 2000) and Uruguay (2003) – the operation targeted domestically held government debt only, and did not include external debt.

Whereas a range of fora and initiatives already exist that aim to address *external* sovereign debt difficulties, policymakers have focused less attention on to how to deal with *domestic* debt difficulties.[14] Yet domestic debt is sizable in many developing countries. Moreover, in the context of the recent global recession – and as external finance dried up – many developing countries turned to domestic financial markets to fund countercyclical fiscal policies. Because domestic debt instruments typically carry higher interest rates and shorter maturities, the fiscal burden of this debt on governments' budgets is also considerable.

Mechanics of the debt exchange operation

The debt exchange was restricted to domestic debt instruments and to domestic resident bondholders only. The reason given by the government was that interest rates on domestic debt instruments were considered excessively high, while on external debt they were not. The interest rate on domestic debt has averaged 19 percent over the last ten years. On external bonds, the interest rate has averaged nine percent and on multilateral loans, just under four percent.[15] Secondly, the government feared that a wider debt restructuring – including external debt – may be much more complex and time consuming.

The JDX covered about US$ 7.6 billion (J$ 700 billion, or 65 percent of GDP, or almost 47 percent of public debt) in Jamaican-dollar fixed- and variable-rate bonds, as well as US dollar denominated bonds. The operation aimed to secure medium-term fiscal savings by exchanging existing high-cost debt with short maturities for new debt instruments with lower interest rates and longer maturities. The Government put forward two explicit goals of the operation:

1. To achieve interest savings of at least 3 percent of GDP in fiscal year 2010/11;
2. To reduce by two-thirds the amount of domestic debt that would mature over the next 36 months.[16]

Investors were offered a par-for-par exchange on old securities for a range of new debt securities. The debt exchange operation did not involve a reduction in the principal amount; each holder of 100 old bonds received 100 new bonds, plus a one-time cash payment of accrued interest. As such, the operation focused on debt service relief (liquidity) rather than debt reduction (solvency).

[14] For example, the Paris Club, London Club, Highly Indebted Poor Countries (HIPC) and Multilateral Debt Relief (MDRI) initiatives, and collective action clauses in sovereign bonds.

[15] Government of Jamaica, Jamaica's Economic Programme, Investor Presentation, 14 January 2010

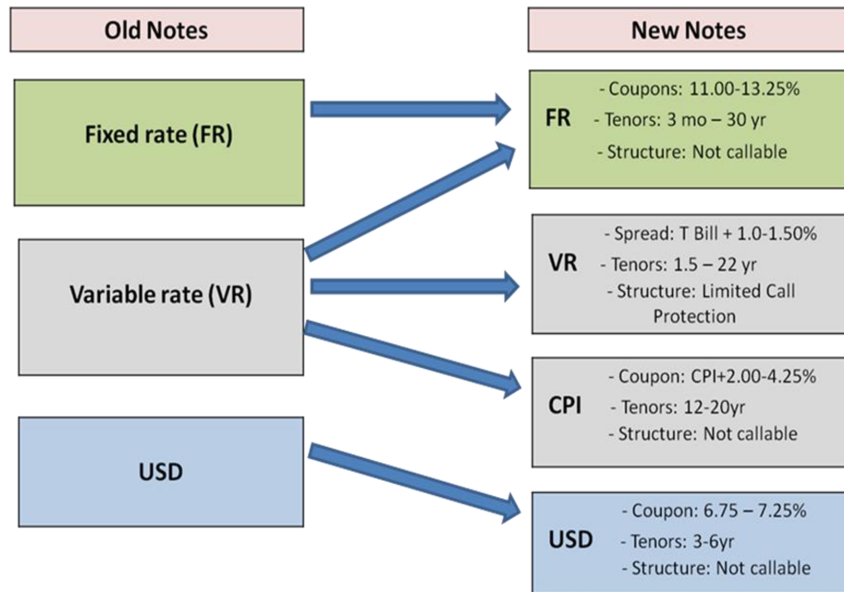
[16] Government of Jamaica, Jamaica's Economic Programme, Investor Presentation, 14 January 2010

The JDX 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. The new debt instruments offered reduced interest rates and longer maturities, but they also encompassed a positive rate of return. Average interest rates were reduced from 17 percent to 11 percent; average maturities were extended from 5.3 to 8.7 years.[17]

For example, the interest rate paid on new Jamaican-dollar fixed-rate bonds now ranges from 11 percent to 13.25 percent (vs. the recent average of around 19 percent). New variable-rate bonds carry an interest rate of Treasury Bill + 1 to 1.5 percent. Consumer Price Inflation (CPI)-indexed bonds offer CPI + 2 to 4.25 percent interest rates. Finally, the yield on new US dollar-denominated fixed-rate bonds ranges from 6.75 percent to 7.25 percent (vs. the recent average of more than 9 percent). Details are summarized in the figure below.

Old fixed-rate bonds were exchanged for new fixed-rate bonds only. Old variable-rate bonds could be exchanged for new variable, fixed or CPI-indexed bonds. Old US dollar bonds could be exchanged for new US dollar bonds only, to avoid increased US dollar exposure.

Figure 4: Allocation Rules



Source: Government of Jamaica, Ministry of Finance and the Public Service, January 2010

[17] Government of Jamaica, Jamaica's Economic Programme, Investor Presentation, 14 January 2010

Institutional and retail investors were required to complete a physical or electronic submission form and deliver this, plus the Note Certificate, to either the Bank of Jamaica (for holders of fewer than 10 certificates) or the Ministry of Finance (for holders of more than 10 certificates).

The debt exchange operation also needed to be carefully designed in order to avoid 'maturity peaks;' it would be of little real benefit to the government to face the same situation five years from now. To do this, the government developed 'cap and staggered maturity rules;' each old bond was assigned to one or more new bond categories as a function of:

1. Structure of the old bond (fixed-rate/variable-rate/US$);
2. Maturity.

The final outcome, critically, is reduced interest payments on domestic debt – from 16.2 percent of GDP in 2010 to 9.7 percent of GDP by fiscal year 2013/14. Debt interest payments will decrease from about 65 cents of every dollar to 45 cents – still high, but a significant reduction nevertheless. This amounts to interest savings of about US$ 527.5 million (J$ 48.2 billion) in 2010 alone.[18]

'Carrot and stick' tactics

After lengthy and tough negotiations with creditors over several months, the government obtained a voluntary – and unprecedented – 99.2 percent investor participation in the debt exchange; this represents a remarkable achievement. The high degree of participation can be attributed to a number of 'carrot and stick' factors which interacted to persuade domestic bondholders to agree to the government's debt swap.

On the 'carrot' side, these included: the sovereign's demonstration of 'willingness to pay' and to conduct the debt restructuring in an orderly and transparent manner; the government's involvement of national financial leaders in negotiations; fresh financial support from the multilateral institutions – and in particular the IMF – which tied the government to a structural fiscal reform programme, and crucially; creation of a 'Financial Sector Support Fund'.

The Financial Sector Support Fund – or FSSF – would be funded via a new US$ 1.27 billion loan from the IMF. It was designed to provide emergency liquidity to deposit-taking institutions, securities dealers and insurance companies should they run into liquidity difficulties as a result of their participation in the debt exchange.[19] Importantly however, it would provide this exceptional assistance *only* to those institutions and entities that had tendered at least 90 percent of eligible assets in the government's debt exchange programme. The FSSF therefore was designed as an incentive mechanism.

[18] For an excellent summary of the Jamaica Debt Exchange Programme, see: Government of Jamaica, Jamaica's Economic Programme, Investor Presentation, 14 January 2010: http://www.mof.gov.jm/downloads/2010/jdx/JDX_Investor_Presentation.pdf
[19] Government of Jamaica's Request to the International Monetary Fund (IMF) for a 27 Month Stand-By Arrangement (SBA) Ending March 2010: Letter of Intent between the Government of Jamaica and the IMF; Jamaica – Memorandum of Economic and Financial Policies

On the ‘stick’ side, most bondholders could not fail to be aware of the government’s desperate fiscal situation, and could not be certain that the government would not be forced to make them a worse offer in the near future – or even default – which would have resulted in more significant net present value reductions to wealth holders. In this context, bondholders had little to lose. It was combined with tough language used by the government which warned investors that it could offer no alternative and would not tolerate investor holdouts.

At the official launch of Jamaica’s Debt Exchange Offer on 14 January 2010, Minister of Finance and Public Service, Audley Shaw warned that the government: *“will not permit some holders to free ride and exploit the willingness of other investors to contribute to the resolution of Jamaica’s economic crisis. This is a matter of basic fairness.”* [20] In a presentation to pension fund managers, trustees and administrators shortly after the JDX was launched, Prime Minister Golding also declared: “I have not come here today to say that there is an alternative, because there is none.” In addition, he warned: *“Bear in mind that the exemption to taxation that applies to pension funds is an executive decision taken by the Minister of Finance, and that exemption will continue to be provided if it is consistent with the levelling of the playing field."*[21]

[20] Government of Jamaica, Jamaica Debt Exchange Offer, Opening Remarks by Hon. Audley Shaw, Minister of Finance and the Public Service, January 14, 2010
[21] The Gleaner, “New pensioners facing 40% cut,” 22 January 2010

Box 3: The Role of UNDP in the Jamaica Debt Exchange

UNDP Jamaica played a central role in the development of the Jamaica Debt Exchange. The country office secured US$ 88,000 via the Poverty Thematic Trust Fund to support the country office's programme of work on the public debt issue. It had increasingly recognized that the issue of public debt could not be separated from that of poverty reduction and human development on the island since the government was forced to spend more on debt service than on serving its people.

UNDP first publicly proposed a strategy for debt management in 2008 when it initially floated the idea of a 'Kingston Club' – modelled on the Paris and London Club forums – to facilitate comprehensive discussions between the government and its domestic creditors. Then in 2009, UNDP again called publicly for an urgent national dialogue on the debt situation to create increased fiscal space for development and pro-poor expenditures. *"There is a need for a national dialogue on the debt situation, with a view to finding workable strategies for its management so that there is more fiscal space for meeting urgent development needs of citizens,"* said UNDP Resident Coordinator, Minh H. Pham in an article to the Gleaner newspaper: *"If Jamaica is to put development at the heart of government interventions, addressing the debt issue will be imperative."*

With the support of the Poverty Thematic Trust Fund, UNDP contracted an independent attorney to advise and work with the Government of Jamaica on the various scenarios available to it – and to explore the pros and cons of each. This critical intervention led directly to the design and implementation of the final Jamaica Debt Exchange (JDX). Through its financial support for an independent advisor to guide the government through difficult decisions, UNDP essentially turned a US$ 88,000 grant into interest savings of approximately US$ 527 million in 2010.

The country office will now work with the government and local civil society organizations to monitor the government's use of the fiscal savings generated via the debt exchange programme to ensure they support key social and development priorities.

Source: The Gleaner, "Why Jamaica needs a 'Kingston Club' - How to break the national debt squeeze," 5 April 2009

3. The Debt Exchange: A Preliminary Evaluation

How successful has the Jamaica Debt Exchange really been? To be considered successful, the programme should diminish the likelihood of subsequent debt crises. It should also improve the government's capacities to invest in human development and poverty reduction on the island. Who have been the winners and the losers of the initiative, and are there useful lessons learned for other severely indebted middle income countries? As such, the scheme may be assessed against a range of social and economic indicators. These include:

1. The extent to which the initiative achieved its stated aims;
2. The impact of the operation on the island's vulnerabilities to future debt crises;
3. The impact of the initiative on positive development outcomes;
4. The winners and losers of the initiative;
5. Useful lessons learned for other severely indebted middle-income countries.

i. Has the initiative achieved its aims?

At a basic level, the debt exchange can be judged against its stated aims, which were to:

1. Achieve interest savings of at least 3 percent of GDP in fiscal year 2010/11;
2. Reduce by two-thirds the amount of domestic debt that would mature over the next 36 months.

The government has announced that interest savings will amount to a total of J$ 42.8 billion, or US$ 527.5 million, in 2010 (see Figure 5). This amounts to 3.5 percent of GDP. Over the next three years, a total of about J$ 80 billion in new bonds will mature, compared to a pre-debt exchange scenario of around J$ 390 billion. Average maturities on fixed-rate local-currency bonds have been extended from 5.1 to 6 years. On variable-rate local-currency bonds, average maturities are now 9.5 years (vs. 5.3 years pre-transaction). Average maturities on US dollar-denominated bonds have been extended from 1.4 to 5 years. Thus the stated aims of the debt exchange operation have been achieved.

Figure 5: Summary Transaction Impact

Type	Eligible amount J$bn	Average coupon before	Average coupon after	Coupon Reduction	Average maturity before (years)	Average maturity after (years)	Interest before J$bn	Interest after J$bn	Savings
Fixed rate	234.9	18.1%	12.4%	5.7%	5.1	6.0	42.5	29.1	13.4
Variable rate	375.9	19.0%	12.1%	6.9%	5.3	9.5	71.6	44.2	27.4
USD	90.6	9.2%	7.0%	2.2%	1.4	4.5	8.3	6.4	2.0
Total	701.4	17.5%	11.4%	6.1%	4.7	7.0	122.5	79.7	42.8

Source: Government of Jamaica, Ministry of Finance and the Public Service, January 2010

ii. The impact of the operation on vulnerabilities to future debt crises

The programme should diminish the likelihood of subsequent debt crises and thus contribute to medium term debt sustainability. The Jamaica Debt Exchange is an example of a pre-emptive (i.e. pre-default) restructuring. Pre-default debt restructurings are typically associated with a lesser amount of debt relief in nominal principal reduction than post-default restructurings.[22] And indeed in this particular case, there was no reduction in the nominal value of investors' securities which indicates that the government's debt exchange programme was principally focused on debt service relief (liquidity) rather than debt reduction (solvency). Thus the impact of the debt exchange operation on the public debt portfolio is not as large as it would have been had it occurred post-default.

Additionally, the JDX helped 'unlock' over US$ 1.27 billion in IMF resources of which US$ 1 billion was used to finance creation of a Financial Sector Support Fund, which was used to incentivize investors to participate in the swap.[23] This, in turn, led the World Bank and Inter-American Development Bank to release more than US$ 1 billion in additional loan resources to the island.[24] Ironically then, the debt exchange programme has contributed to an *increase* in the country's overall public debt stock.

The government has argued that the debt exchange initiative combined with key medium-term fiscal reforms as outlined in the IMF Stand-By Arrangement (such as an increase in taxes; a freeze on public sector wages and reclassification of some workers; enactment of a fiscal responsibility framework; improved debt management capacities and implementation of a central treasury management system) will help put the public debt-to-GDP ratio on a downward trajectory.[25] It aims to reduce the current public debt-to-GDP ratio of 135 percent to 100.5 percent by 2013.[26]

It appears as though the reputational damage – and the real cost – to the government due to the exchange operation has so far been minimal. International ratings agencies such as Standard & Poor's (S & P) and Moody's had downgraded the rating on the island's domestic debt on news that the debt exchange would be launched (S & P downgraded the sovereign from CCC+ to CCC in November 2009 and to SD in January 2010; Moody's downgraded the sovereign from Caa1 to Caa2 in January 2010).[27] The agencies indicated that they viewed the exchange operation as a technical default. Standard & Poor's and Moody's have since quickly raised the credit rating on the country's domestic sovereign bonds to B- and to B3 respectively.[28] This is evidence of the market's renewed confidence – and trust – in the government's abilities to service its debt.

[22] The recent post-default debt restructurings of Ecuador, Russia and Argentina all produced net present value reductions of at least 25 percent. See CaPRI, Achieving Fiscal Sustainability in Jamaica: The JDX and Beyond, April 2010

[23] The IMF loan is scheduled to be reimbursed over the next 27 months at an annual interest rate of 3.87 percent in 2010 and 5.6 percent in 2011 and 2012 therefore the fiscal burden is lower than on domestic debt. See: IMF: Jamaica, Financial Position in the Fund, 28 February 2010

[24] See Inter-American Development Bank and World Bank (Jamaica country pages)

[25] See: Government of Jamaica's Request to the International Monetary Fund (IMF) for a 27 Month Stand-By Arrangement (SBA) Ending March 2010: Letter of Intent between the Government of Jamaica and the IMF; Jamaica – Memorandum of Economic and Financial Policies

[26] International Monetary Fund, Jamaica: 2008 Article IV Consultation—Staff Report, June 2008

[27] The Jamaica Observer, "JDX Success Should Allow JA to Move Away from High Interest Rate Model," 23 February 2010

[28] See: Standard & Poor's, Sovereign Credit Ratings, Jamaica

Nevertheless, the jury remains out on whether the debt exchange programme – combined with structural fiscal reforms – will really be enough to restore medium-term debt sustainability and economic recovery to the island. The debt overhang remains large, and if not carefully managed, could quickly become unmanageable once again. There are concerns that severe fiscal consolidation measures may jeopardize the government's efforts to scale-up investments in the Millennium Development Goals. It will also be vital to ensure that complacency does not set in – in other words, the government and citizens must not dismiss the public debt issue as 'done.' As a small open economy, the island remains extremely vulnerable to external conditions and market sentiment. As such, it remains extremely fragile to future debt difficulties and the need for some form of debt relief – domestic and/or external – in the future cannot yet be entirely ruled out.

iii. The impact of the initiative on positive development outcomes

The success of the Jamaica Debt Exchange may also be assessed against broader social benchmarks, and most importantly, the extent to which it leads directly to positive development outcomes. The initiative has released approximately US$ 527.5 million in interest savings in 2010, so how does the government intend to use the resources freed up via the programme to improve the lives of ordinary citizens?

These extra funds can in principle be redeployed to key development areas such as health and education. The government has pledged to increase social expenditures by 25 percent over the previous fiscal year. In particular it has committed to increase funds for the social safety net programme for poor families (Programme for Advancement through Health and Education, PATH), which aims to achieve better targeting of welfare benefits and to increase human capital by conditioning receipt of cash benefits on participants' meeting certain requirements for children's school attendance and health care visits. Likewise, an expanded School Feeding Programme is being prioritized with the additional savings.

It is also useful to put the amounts released via the initiative into context. The interest savings of approximately US$ 527.5 million this year are almost equivalent to the government's entire national security budget in 2009/10 and represent more than half the entire budgeted expenditure for education, as well as 1.3 times the budgeted expenditure for health (see table overleaf).

Ultimately, the successful redeployment of the interest savings to key development areas will be the crucial measure of how successful the JDX has been as a development strategy. UNDP will continue its work at the country level to monitor and scrutinize the government's key commitments to use these extra resources to increase expenditures in critical social and development areas.

Figure 6: Equivalency between Budgeted Expenditure 2008/09 and Debt Exchange Savings

Budgeted expenditure 2009/10	$J Billions	Ministry allocation as % of 2008/09 national budget	Budget equivalency of debt exchange savings
Ministry of Education	68.2	18.8%	More than half the education budget
Ministry of National Security	39.8	10.9%	Equivalent to the entire national security budget
Ministry of Health	29.7	8.2%	1.3 times the health budget
Ministry of Agriculture and Fisheries	3.1	0.9%	13 times the agriculture and fisheries budget
Ministry of Industry, Investment and Commerce	2.1	0.6%	19 times the industry, investment and commerce budget
Ministry of Labour and Social Security	1.9	0.5%	21 times the labour and social security budget

Source: UNDP Jamaica

iv. The winners and losers of the initiative

All sovereign debt defaults and restructurings involve winners and losers. Given that lower-interest, longer-maturity coupons unambiguously lessen the present value of the returns from a security, value to wealth-holders is diminished. Thus domestic bondholders are clearly the losers from such initiatives. The government clearly tried to offset some of the possible losses which the domestic financial sector may experience as a consequence of the debt exchange via the creation of a Financial Sector Support Fund (also used to incentivise key investors to 'play ball'). It also remains to be seen whether banks which relied heavily on the income streams from government bond investments will pass these losses on to customers in the form of increased bank charges, in which case ordinary citizens will also shoulder some of the banks' losses.

The programme has also attracted criticism from some national pension funds and pension fund trustees. The debt exchange will impact some 60,000 local pensioners whose pension funds had invested heavily in government bonds; their income, it has been estimated, will be reduced 30 to 40 percent as a result of the debt swap.[29] While the Financial Sector Support Fund will assist banks that run into liquidity problems due to the debt exchange, no measures were outlined by the government to compensate pension funds.

On the other hand, considerable extra funds have been released via the debt exchange and it is hoped the government will use these wisely to invest in social programmes and infrastructure development which will benefit all the island's citizens. Locally, the JDX also has been described as a 'concrete expression of the much-talked-about social partnership, shared effort

[29] For example, the JDX will cause the country's National Insurance Fund (NIF) to earn US$13.4 million less than the US$44.8 million in interest that had been expected from Government bonds in 2010/11. The Jamaica Observer, "Jamaica Debt Exchange Affects NIS," 19 March 2009

and sacrifice that is needed to take Jamaica forward.'[30] This is arguably a more subjective measure of the initiative's success, but one that should not be dismissed out of hand. In the past, governments had reduced investments in education, health and other social programmes in response to severe fiscal constraints. Thus, ordinary citizens made large sacrifices in the form of poor public services. The debt exchange operation made it clear that domestic banks – not simply ordinary citizens – also had to make their fair share of sacrifices. Thus the debt exchange programme was important from a symbolic point of view. The government also successfully managed to persuade (many) investors that it was not in their rational self-interest to see the continued economic decline of the island.

For Jamaica to achieve the MDGs by 2015, this will require not only new finance, but also a shared vision and commitment by government, businesses and communities alike. If Jamaica's debt exchange operation has helped generate active public debate – and the evidence suggests it has – over how the island can move forward and the importance of the social contract among government, businesses and citizens, then these are important, and longer-term, secondary effects.

Finally, it should be noted that the initiative has increased the government's fiscal space – at least in the short-term – and therefore it is more able to service its *external* debt without potential difficulties. Thus it could be argued that external bondholders and other creditors such as the multilateral financial institutions are also indirect beneficiaries of the initiative.

v. Lessons learned for other severely indebted middle-income countries

The Jamaica Debt Exchange has resolved an unsustainable fiscal situation in the short-term. Because the government remained committed to debt service payments and an orderly, transparent process which involved local investors throughout, the damage to its reputation – and interest penalties – have been small.

The initiative will release approximately US$ 527.5 million in additional resources each year in 2010 and 2011. In the current economic climate, it would be very difficult for a country such as middle-income Jamaica to find more than US$ 500 million per year via international donor assistance and the international capital markets. As such, it had to look inwards. In this sense, the Jamaica Debt Exchange is an example of rapid and effective domestic resource mobilization. Jamaica has shown that although external finance is crucial to help countries raise expenditures in poverty reduction programmes, innovative solutions to raise revenues can also be found at home.

Nevertheless, the country's public debt situation remains extremely fragile. The debt exchange involved no financial 'haircut' on the nominal value of domestic investors' securities. External debt was excluded from treatment. As such, the debt burden remains extremely large and the economy vulnerable to external market conditions and sentiment, as well as to natural disasters.

The Jamaica Debt Exchange arguably represented a pragmatic and politically feasible solution to an unsustainable debt situation. To many observers, Jamaica's public debt burden was clearly unsustainable and yet the country simply had

[30] The Jamaica Observer, "Jamaica's Debt Exchange: At Last, Breathing Room for Development," by Minh H Pham, 17 January 2010

nowhere to turn for a comprehensive resolution to its debt difficulties. In this context, there are strong arguments that a sovereign insolvency procedure at the international level may have helped the island to resolve its repayment problems in a fair and more efficient manner.[31]

Such a mechanism would examine the entire portfolio of the government's liabilities (external and domestic) in a single procedure, and decide on appropriate measures to be taken with respect to the country's debts on the basis of an independent, objective assessment of the measures needed to restore economic recovery and growth to the island. This may inevitably range from a simple rescheduling to a 'light-dusting' to a fuller financial 'hair-cut' on the nominal value of securities. Importantly, it would also ensure a level playing-field between creditors.

Several other countries in the Caribbean also have critically high public debt stock and debt service ratios.[32] Additionally, many developing countries increased their public debt burdens during the global economic crisis to maintain social expenditures and fund countercyclical fiscal policies. This would suggest that the moment is opportune to reopen policy debates over the importance – and necessity – of a sovereign debt workout mechanism at the international level.

[31] See, for example: IMF, Proposals for a Sovereign Debt Restructuring Mechanism (SDRM), January 2003, and; Erlassjahr.de, International Insolvency/Arbitration, Arguments and Counter-Arguments, January 2002. See also: EURODAD, A Fair and Transparent Arbitration Procedure, 10 Civil Society Principles, December 2009

[32] Such as Grenada, St. Kitts & Nevis and St. Vincent & the Grenadines for example

4. Conclusion

Where does Jamaica go from here? How can the country continue to move forward? The debt exchange, though necessary, is not a sufficient answer for long-term development and, indeed, is just a start. Alone, the JDX is not enough to achieve the sustained rate of economic growth required by the country to seriously reduce poverty and achieve the Millennium Development Goals by 2015. The debt overhang remains large, and if not carefully managed, could quickly become unmanageable once again due to the island's systemic vulnerabilities. It will be vital to ensure that complacency does not set in – in other words, to assist the government and citizens to realize that the public debt issue is not 'done.' Provided that the government uses the resources released via the debt exchange programme for investments in key social and development areas, the initiative can be said to have contributed towards positive development outcomes, at least in the short-term.

Other measures are also needed to prevent a return to the previous situation. Priorities include a legislative framework to ensure fiscal discipline; development of a credible debt strategy and improvement of the national debt management capacity; rationalization of public bodies; implementation of equitable tax reform; and a clear and nationally agreed growth strategy that is not debt-dependent.

The debt exchange has bought the government invaluable breathing space. Arguably however, a more robust resolution to the island's debt problems may have been found had the country had recourse to a sovereign insolvency mechanism at the international level. Under this scenario, the measures needed to restore medium-term debt sustainability and economic growth to the island would have been based on an independent and objective debt sustainability analysis. Such an analysis should also take into account the resources governments need to meet the essential needs of their citizens and the investments they need to make to make progress towards the Millennium Development Goals.

Many countries – developed and developing – increased their debt ratios during the global economic crisis to maintain social expenditures and fund countercyclical fiscal policies. This increases the risks that some may run into repayment difficulties at some stage in the future. This would suggest that the moment is opportune to reopen public policy debates over the usefulness of a sovereign debt workout mechanism at international level.

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