Contribution to the debate on the Economic Strategies being pursued by the Government

Peter Bunting M.P. - Jan. 26, 2010

The Opposition has been careful to avoid public statements which could jeopardize the proposed IMF Agreement, or more specifically, torpedo the chances of success of the Jamaica Debt Exchange Programme (JDX).

The JDX represents not just a paradigm shift in our approach to debt repayment; it is perhaps better described as a 'crossing of the Rubicon'. The point of no return that we have now passed was articulated less than six months ago by the Hon. Prime Minister (on August 11th 2009), while addressing the PSOJ Chairman's Club Forum as follows:

> *"Jamaica has never defaulted on its debt. There is absolutely no chance of Jamaica defaulting on its debt. Not only are we one of the few countries in the world where the first claim on budgetary expenditure of debt service and repayment are guaranteed by an entrenched provision in our constitution but the government of Jamaica – this one and all those that have preceded it – has never flinched in making any and all the necessary adjustment to ensure that we meet our debt obligations."*

My contribution will focus on the Jamaica Debt Exchange Programme (JDX) - a major component of the Government's economic programme and an essential for the reduction of the fiscal deficit. However, it is important to first set this JDX programme in context. In understanding where we are and how we got here, unlike the Minister of Finance, I don't find it particularly useful to look at the ratio of total debt service to government revenues since total debt service includes both principal and interest payments it tends to obscure rather than clarify the picture. To illustrate my point, we can look at the table in the Minister of Finance's presentation, the TDS/TR in 08/09 was 99% and in 09/10 it is 103%. On the face of it these ratios appear similar but it hides the dramatic jump in interest expense, by 30% (proportionate to revenues). The reason for this jump in interest expense is the sharp increase in local interest rates which occurred since September 2007. These interest rates were not inherited from the previous government.

In determining the solvency of any entity, whether government or company, it is helpful to separate interest payments from principal payments. If an entity is solvent and capable of meeting its interest payments and other obligations comfortably, then principal maturities can be refinanced in the ordinary course of business, because the bankers or the capital markets have confidence in the future of the entity. However, if the entity's solvency is in question, then refinancing principal maturities and even working capital becomes a serious problem and ultimately leads to illiquidity and the inability to service your obligations as they fall due.

Mr. Speaker, this is the situation that the entity called the Government of Jamaica found itself in last year. Using the chart from the Government's briefing document, interest as a % of tax revenues moved from 47% in 07/08 to 50% in 08/09 then jumped dramatically to 65% in 09/10. What this means is that the portion of the tax revenues available to provide all services of

Government was cut approximately a third (30%) in the last year alone. The Government couldn't cut its services by that amount so it borrowed more, growing the fiscal deficit from 4.6% of GDP in 07/08 to 7.3% in 08/09 and 10% in 09/10. The deficits are central government deficits rather than overall public sector which would be higher.

The deficit must be financed, so after being on a declining trajectory for four years, the debt/ GDP ratio, a standard measure of an economy's indebtedness, started climbing from 114% in 07/ 08 to near 140% at the present time and this is before the loan disbursements by the multilaterals, so our indebtedness will increase further. [pg34] Towards the end of the 2009 calendar year the market had lost confidence in the Government's ability to meet its obligations as they came due and by early December the debt issues of the Treasury were no longer being subscribed by the market, resulting in the Bank of Jamaica having to provide advances to the Government to meet its December obligations. At that point the Government found itself in a position analogous to corporate bankruptcy.

While it is useful and important to review the path that brought us here, we are now where we are. Continuing with the corporate bankruptcy analogy, the JDX Programme is the sovereign equivalent of a U.S. Chapter 11 bankruptcy which lets a potentially viable entity restructure its debt and operations under court supervision. In our case, the supervisor is the International Monetary Fund and while the JDX addresses the debt restructuring, the remainder of the IMF programme treats with the operations restructuring of government. This is as opposed to the Chapter 7 bankruptcy where the entity is deemed to be terminally ill and therefore the process just focuses on liquidating assets and distributing the proceeds amongst its creditors.

Faced with these two choices, a Chapter 11 bankruptcy - the JDX Programme - is clearly the preferable choice so the issue becomes how to best achieve fairness and equity. Mr. Speaker, the Opposition believes that this is where the programme would have benefitted from consultation with all the key players <u>before</u> rather than after the fact.

In examining the details and consulting with sector players on the impact of the JDX, there are elements of the design, as opposed to the objectives, with which we disagree. These are:

1. There has been insufficient attention paid to evaluating the impact of the JDX on pensioners. One actuary has made the following estimate: "The members from defined contribution plans shall suffer significant falls in their pensions. For example, for a 65 year old, each 1% fall in interest rates should result in a fall in pension of 8%. The expectation is for the yield curve to fall by at least 5%, so a new pensioner has a reduction of 40%" [of the pension payments he was otherwise going to receive.] It appears that persons about to become pensionable from defined contribution plans would be the hardest hit. The Opposition believes that such a case would neither be fair nor equitable and we are calling on the Government to do a comprehensive evaluation of how many such new or upcoming pensioners would be severely affected and to find a way to ameliorate this impact. We also believe that acceptance of the JDX exposes pension fund trustees to potential lawsuits for breaches of duty since they are rushed into a decision

without any prior consultation and without sufficient time for a proper actuarial evaluation of the impact. Therefore the government should consider indemnifying trustees against any lawsuits arising specifically from decisions to participate in the JDX.

2. The JDX while primarily targeting interest cost savings also attempts to improve liquidity by stretching out maturities. If you look on the Summary of the Transaction Impact [pg.31], it is interesting to note that debt with an average maturity of 5.1 years before the transaction is lengthened to 6 years after the JDX, an extension of less than 20% yet debt with average maturity of 1.4 years is lengthened to 4.5 years, an extension of over 200%. And if we drill down further into the specific instruments, we see that an instrument which was scheduled to mature three months after the closing date of the JDX, will now see its owners having to wait four years for full repayment, or an extension of 1500%. Mr. Speaker there seems to be a lack of proportionality which does not square with the objectives of fairness and equity. Perhaps these numbers were arrived at by a technician manipulating a spreadsheet to achieve a targeted goal, but it does not measure the inconvenience and the unreasonableness of asking someone who had planned to receive a sum of money in 3 to 6 months whether for personal use or to deploy it in business, to have to instead wait for four years.

3. A final comment on the objective of "Fair and equitable contribution from all segments of the investing community" and "mechanisms to assure no free riders…" [pg.21]

a. What about the fact that this JDX does not include the global bonds, Jamaican Foreign Currency debt originally issued overseas but which are now held substantially by Jamaican entities and Jamaicans? The holders of these bonds would typically be large foreign institutions, large local institutions, or relatively sophisticated individuals. Pragmatic reasons may have dictated the exclusion of these debt holders but let's not speak about "Fair and equitable contribution from all segments of the investing community" because it is not so. Furthermore, the fact that these US$ instruments appear to get more favoured treatment could create a bias towards these instruments and in future encourage portfolio conversions resulting in pressure on the exchange rate.

b. What about the fact that this does not include persons who own repos (repurchase agreements) backed by GOJ debt rather than owning the debt directly? They are also a part of the investing community. Ironically, the FSC has for years been advocating the shift away from the repo model for securities dealers and instead persuade its clients to buy Government debt outright. Now it is the clients of those dealers who complied with the policy advocacy that are placed at a disadvantage and called on to sacrifice.

Having demonstrated by these three sets of examples that the sacrifice falls unevenly and sometimes inequitably on debt holders, the Government should respect the right of any debt

holder not to participate for their own sincere reasons. Citizens must be entitled to rely on the protection afforded by the constitution.

Conclusion

In closing, I wish to recognize that in every crisis there is opportunity and this one presents a number of opportunities:

1. To reduce the administrative burden on the Debt Management Unit and enhance the efficiency of our debt markets through the immobilization and dematerialization of debt instruments.

2. To condense the plethora of legacy debt instruments to a few dozen.

3. To streamline the other structures and operations of government which are often talked about but that never seem to get done. There is a greater probability that these will now get done under the strict scrutiny of the IMF.

4. To seize the opportunity to forge the other oft talked about goal of a social partnership, to which our local debt holders are now making a tangible commitment and sacrifice, and to stop the finger pointing and get on with the task of building our beloved nation.

Thank you.