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Addressing Debt Overhang:

Experiences from Two Debt Operations in Jamaica

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Abstract[1]

Jamaica entered the world economic downturn in 2008 from a position of ongoing weak economic performance and high, increasing debt levels. As a result, Jamaica's fiscal situation quickly became unsustainable. Starting in 2010, the government made important efforts, including two domestic debt exchanges, to bring its debt trajectory on a sustainable path. This brief assesses the two debt exchanges and explores whether their design was appropriate to address Jamaica's debt sustainability. A major issue in the case of Jamaica is the high exposure of the financial sector to government debt, creating a link between the fiscal situation and financial sector stability. In addition, the composition of Jamaica's debt restricts debt operations to domestic government securities, which comprise around half of total debt. Any attempt to restructure the debt stock through a debt action, such as a haircut, is likely to have a substantial impact on the domestic financial sector, which has a sizeable exposure to sovereign securities. Any losses of the financial sector would likely have negative multiplier effects on GDP growth, employment, and poverty. As such, the brief concludes that the scope of fiscal savings from debt restructuring in the absence of financial sector crisis was always small.

JEL codes: E62, F34, H63, H81
Keywords: Jamaica, IMF, debt overhang, debt restructuring, fiscal consolidation

[1] The opinions expressed in this publication are those of the author and do not necessarily reflect the views of the Inter-American Development Bank, its Board of Directors, or the countries they represent. Corresponding author: jpschmid@iadb.org

1. Introduction

Facing a rapid deterioration of its external and fiscal situation, Jamaica entered a four-year Extended Fund Facility (EFF) with the IMF on 1 May 2013. As a prior action for the EFF, in February 2013 Jamaica performed a par-on-par exchange of Government of Jamaica (GOJ) domestic debt securities, called the National Debt Exchange (NDX). While the face value of the securities was preserved, interest rates on fixed-rate and adjustment margins on variable-rate debt were reduced. In addition, the average maturity was extended and a critical debt repayment equivalent to 8 percent of GDP in February 2013 was avoided (see IMF [2013] for a detailed discussion of the NDX).

The NDX followed a similar exchange in 2010, called the Jamaica Debt Exchange (JDX) which had been a prior condition for the February 2010 Stand-By Arrangement (SBA) with the IMF. The SBA was a 28-month program, but it stalled after three reviews in early 2011 (see IMF [2010] for details on the JDX).

While the debt exchange supported the efforts under the EFF to stabilise the Jamaican economy, the country remained in a vulnerable position given the high level of debt at the beginning of the program (146 percent of GDP as of March 2013). In addition, the macroeconomic framework required a long fiscal consolidation—a primary balance of 7.5 percent of GDP during the program and 7 percent thereafter—leaving little space for adjustments in case of policy slippages or external shocks (Schmid and Malcolm, 2016).

Given the two debt exchanges over a three-year period, the question arose why Jamaica still required such a strong fiscal consolidation. Both the JDX and the NDX were criticised that they did not modify the face value of the securities and still required relatively high primary surpluses for an extended period of time to avoid a renewed debt build-up. In other words, some observers argued that the debt exchanges were not deep enough and did not address the fundamental solvency problem of the country (Johnston and Montecino, 2011; 2012). This brief discusses Jamaica's experience with debt restructurings and draws lessons for the future.

2. Background

Sovereign debt problems are probably as old as sovereign borrowing itself, with the first reported account dating in the fourth century B.C. in Greece (see Sturzenegger and Zetelmeyer [2006] or Das, Papaioannou, and Trebesch [2010] for a history of sovereign defaults). In more recent times, sovereign debt problems have often occurred in waves, including those in the 1970s and the 1990s that also affected Latin American countries. Given the many historical

examples, there is a substantial literature that uses case studies to explore effects of debt restructurings or defaults on the macroeconomy.[2] Even though generalizations can be difficult to draw, as the circumstances leading to the need of a debt operation are the result of unique factors and the developments afterward are often the result of external factors, some stylized facts have emerged (see Das, Papaioannou, and Trebesch [2010] for an overview).

Debt restructurings are often accompanied by recessions, which continue following the settlement.[3] It has been shown that recessions are stronger and last longer for restructurings combined with foreign exchange and/or financial sector crisis. The economic turbulence that leads to the debt problem often also leads to a real devaluation of the exchange rate, which can help in the subsequent recovery (e.g., Russia, Ukraine). Similarly, commodity-exporting countries often benefited from improved terms of trade in the cases with a real devaluation.

Orderly restructurings, in which the debtor country negotiates settlement, are usually less costly for the economy than outright defaults. In both cases, the debtor country is excluded from international debt markets afterward, even though several countries have gained renewed access to external financing after only a short period. However, the cost of the restructuring for the creditors in terms of the haircut applied can also have an impact on the possibility to regain access to external financing (Cruces and Trebesch, 2011). Markets can be accessed again relatively quickly in light restructurings. Finally, debt restructurings create more disruption in countries with a substantial exposure of the domestic banking sector to government debt, with the restructurings often going hand in hand with a financial crisis, as experienced in Russia and Ecuador between 1998 and 2000 (Das, Papaioannou, and Trebesch, 2010).

The Jamaican experience fits neatly into these stylised facts. In addition, the designs of the debt exchanges were aligned with the expected consequences from prior experiences.

3. Jamaica's Experiences with Debt Operations

As a prior action for the EFF, in February 2013, Jamaica performed a par-on-par exchange of GOJ domestic debt securities, called the National Debt Exchange (NDX). While the face value of the securities was preserved, interest rates on fixed-rate and adjustment margins on variable-rate debt were reduced between 1 and 5 percent. The goal of the exchange was to reach cumulative interest savings equivalent to 8.5 percent of GDP by 2020.[4] In addition, maturities

[2] Even though different, I will use restructuring and default interchangeably in this brief.
[3] See e.g., Yeyati and Panizza (2011), who show that debt crises tend to follow output contractions.
[4] The NDX missed the goal by 0.4 percent of GDP. However, major financial institutions agreed to a further cut in their debt holdings to reach the target.

were extended, avoiding the rollover risk from repayments equivalent to 8 percent of GDP in February 2013 (IMF, 2013).

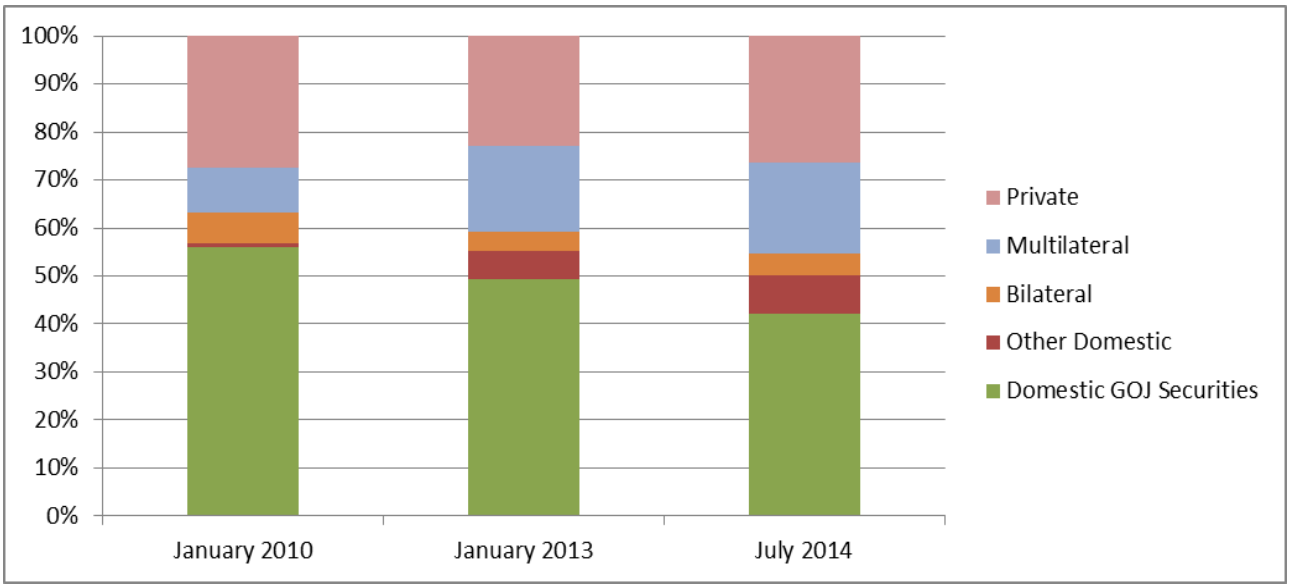
The NDX followed a similar exchange in 2010, called the Jamaica Debt Exchange (JDX), which had been a prior condition for the February 2010 SBA with the IMF (see IMF [2010] for details on the JDX). Neither the JDX nor the NDX modified the face value of the securities and they still required relatively high primary surpluses for an extended period to reduce the actual level of debt.

Given the historically high level of debt as a share of GDP in Jamaica, a debt operation had long been seen as a necessity for Jamaica's medium- and long-term fiscal and debt sustainability. At the same time, Jamaica has always remained committed to honor its debt obligation, including through a constitutional clause.[5] In addition, the last two operations highlighted specific characteristics of Jamaica's debt portfolio that made a deep adjustment through an exchange risky for the financial sector while delivering limited fiscal benefits.

Jamaica's external debt consists of commercial debt (mostly global bonds) and debt to official creditors (bilateral and multilateral). Domestic debt comprises GOJ securities and direct commercial debt. Total public sector debt also includes domestic and external publicly guaranteed debt (Figure 1). In addition, Jamaica participates in the Petrocaribe agreement, the inflows of which are paid into the domestic Petrocaribe Development Fund (PDF). The PDF on-lends to public enterprises and the central government.[6]

[5] Section 119 of the Jamaican Constitution provides for the public debt to be charged on the Consolidated Fund. This clause has been interpreted as de facto forbidding involuntary debt exchanges.
[6] Because of the involvement of the PDF, these obligations are counted as domestic debt under the EFF.

Figure 1: Debt Composition Before JDX, NDX and 14 Months after NDX



Source: MoFPS and own calculations.

In spite of the diverse debt instruments, both debt operations in Jamaica were concentrated in GOJ domestic securities. Both exchanges were done under pressure from a rapidly deteriorating macroeconomic situation and inclusion of external bonds would have been costly and time consuming. In addition, including external commercial debt might not have been successful as Jamaica's sizeable number of global bonds lacks a common action clause (CAC). As the case of Argentina illustrated, the absence of a CAC can lead to holdout creditors that do not want to participate in an exchange, opening the country to lawsuits by distressed debt funds (also known as vulture funds) and cutting it off from international debt markets for many years.[7] Besides the commercial debt, Jamaica's external debt is to official creditors, mainly multilaterals.

Domestically, debt owed to the Petrocaribe Development Fund (which in turn was owed to Venezuela from oil shipments under the Petrocaribe arrangement) comprised the lion's share of domestic debt other than GOJ securities.[8] This left only domestic GOJ securities, which were less than half of public and publicly guaranteed (PPG) debt for a possible debt operation.

The major issue with domestic GOJ securities was that they were widely held by domestic financial institutions. Even though these financial institutions were well capitalised, it was questionable to what extent they would have been able to absorb a value loss on their

[7] See Hornbeck 2013 for a discussion of the Argentina case.
[8] A debt buyback operation between Jamaica and Venezuela amounting to US$3billion, eliminated most of the Petrocaribe debt in July 2015 (see Schmid and Malcolm, 2016).

holdings of GOJ securities, which represented a major part of their assets. This is especially true for securities dealers, which specialise in offering short-term instruments, called repos,[9] backed by GOJ securities. The security dealers hold the government securities while offering guaranteed returns on the repos, exposing the dealer to interest rate and valuation risks. While the duration of the repos (liabilities) are relatively short-term (under one year), the underlying GOJ securities (assets) have maturities of several years. A reflection of the indebtedness of Jamaica was the exposure of its securities dealer sector, which at the time of the NDX held over 20 percent of GDP in GOJ securities, equivalent to over three times capital and 42.5 percent of assets. A second issue was the interconnectedness among financial institutions. While banks would have been better positioned than securities dealers to absorb value losses on GOJ securities, some were linked through conglomerates to each other. Consequently, solvency or liquidity problems of a securities dealer could have triggered runs on associated banks and eventually on the whole banking sector. Finally, other financial institutions also held substantial amounts of GOJ securities, including insurance companies (56.3 percent of assets as of December 2012) and the pension industry (42.47 percent of assets).

Taken together, the debt operations in Jamaica were restricted to domestic GOJ securities and the degree of debt reduction was constrained by the risk to the domestic financial sector. As a result, both the 2010 and 2013 debt operations were par-on-par exchanges of existing domestic instruments for new instruments with longer maturities and lower interest rates. As interest rates were high, especially before the JDX, important NPV reductions could be achieved without a change in the face value of the instruments. JDX reduced average yields from 19 to 12.5 percent and 9 to 7 percent for JM$ and US$ denominated securities, respectively, leading to a net present value reduction of 20 percent (using a 12 percent discount rate). Inflation over the year before the JDX had averaged 10 percent and the BOJ one month repo rate was 10.5 percent, so real interest rates on the new securities were on average still positive, even though much smaller than before the exchange. Total securities equivalent to 65 percent of GDP were treated in this way.

The JDX[10] was the first time the Jamaican government did a debt exchange and the market saw it as a one-time sacrifice. As such, its adverse impact on investor confidence was short-lived. Not only was the government able to return to the domestic markets shortly after the exchange, but yields on newly issued debt decreased further. As a result, the government was able to issue fixed and variable rate instruments only three months after the exchange and

[9] The repos can be thought of as a Certificate of Deposit with a guaranteed return (the investment plus an interest), which are backed by holding of government securities.
[10] See Grigorian, Alleyne, and Guerson (2012) for a detailed analysis of the developments surrounding the JDX.

interest rates declined to historically low levels. However, demand for GOJ securities fell in 2011 as the fourth review of the SBA started to be delayed. The government was still able to issue securities, but the maturities were shorter and comprised a higher share of variable rate instruments. The shorter maturities of these new issuances contributed to the bunching of domestic debt repayment in February 2013, which was one of the reasons for the NDX.

Table 1: Comparison Jamaica Debt Exchange and National Debt Exchange

	JDX	NDX
Amount Treated	JM$680 bln; 65% GDP	J$876 bln; 64% GDP
Participation	99.2%	99%
Pre-Yield	19% JM$; 9% US$	10.1% JM$; 7% US$
Post-yield	12.5% JM$; 7% US$	8.8% JM$; 5.2 US%
Fiscal savings	3.%% GDP per year	8.5% GDP by 2020
Maturity extension	from 4.7 to 8.3 years	from 6.4 to 10.2 years
Access to International Markets	US$400 million 12 month after Exchange	US$800 million 14 month after Exchange

Sources: Gregorian (2012), IMF (2010;2013), and own calculations.

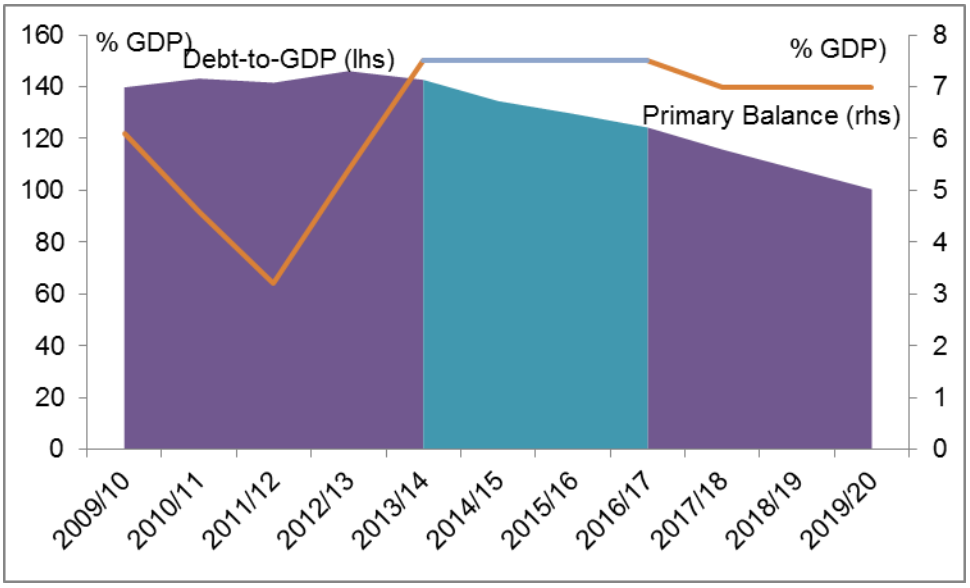
The JDX had not only been seen as a one-time event; there was also the perception that interest rates on these securities had been excessively high in the period before the exchange. As such, the JDX was seen as necessary, even by the holders of the securities. Interest rates started to decline quickly after the exchange, leading to an appreciation of fixed-rate JDX bonds compared to the date of the exchange. However, the same is not true for the NDX. The maturity extension during the JDX had left investors holding GOJ securities with declining yields (for VR debt). In addition, the JM$ had started to depreciate at a fast rate in mid-2012, reducing the return of JD$ denominated securities in US$ terms. February 2013 would have been the first time in three years these investors would have been paid out, but the NDX again extended the maturity of most of the securities. The adverse effect of the NDX on investors was also stronger because the pre-NDX yields were lower than at the time of the JDX, averaging 10.1 percent (12.4 percent for FR and 8.3 percent for VR debt) for JM$ denominated and 7 percent for US$ denominated securities. Conversely to the period following the JDX, interest rates quickly started to increase post-NDX. The benchmark three-month T-Bill rate increased from a low of 5.5 percent just following the NDX to 8.7 percent in March 2014. In addition, the domestic debt market became inactive without any government issuances and virtually no secondary-market trading. In line with the stabilisation of the economy under the EFF and the consistent meeting of program targets, the situation eventually reversed. The benchmark 180-day T-Bill rate declined to below 7 percent by end-2014 and below 6 percent by end-2015. In addition, the

government issued securities equivalent to just below 1 percent of GDP in February 2016, three years after the NDX and coinciding with the first major repayment of domestic securities since 2010.

4. Should the NDX have been More Aggressive?

Given the strong performance under the EFF, the debt exchange did contribute to the stabilisation of the economy. At the same time, to maintain fiscal sustainability Jamaica still required a long and tight fiscal consolidation. In order to reach 100 percent of GDP, the EFF foresaw a primary balance between 7 and 7.5 percent of GDP between FY2013/14 and FY2019/20.[11] In addition, these targets assume relatively optimistic economic developments and the absence of external shocks or policy slippages (Figure 2). Under these circumstances, the debt exchanges did not eliminate the risk of a renewed fiscal crisis in the medium term and the stabilisation might have been faster with a stronger debt adjustment. This section analyses with hindsight whether the debt exchanges could have been more aggressive. While the focus is on the NDX, comparisons to the time of the JDX and to the current situation are also provided.

Figure 2: Debt-to-GDP and Primary Balance, 2009/10 to 2019/20



Source: IMF and own calculations.

[11] Similarly, simulations indicate that Jamaica needs to maintain a 7 percent of GDP primary balance until 2026 to reach the 60 percent debt target established under the fiscal rule.

Figures 3a and 3b show how strong the exposure to GOJ securities was for commercial banks. The value of domestic GOJ securities to total capital was on average 112 percent in December 2012, while individual institutions had exposures as high as over 200 percent. The situation at end-2010 was similar, except that individual institutions had even higher exposures. The risk of holding government debt is also evident in terms of total assets, as government securities at end-2012 made up to one-third of total assets, with the average almost 20 percent.

Figure 3a: Commercial Banks, GOJ Securities as a Share of Capital

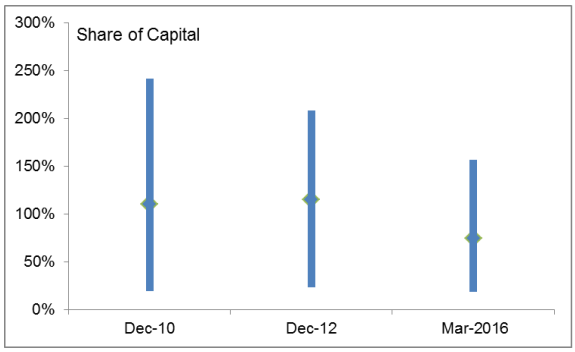
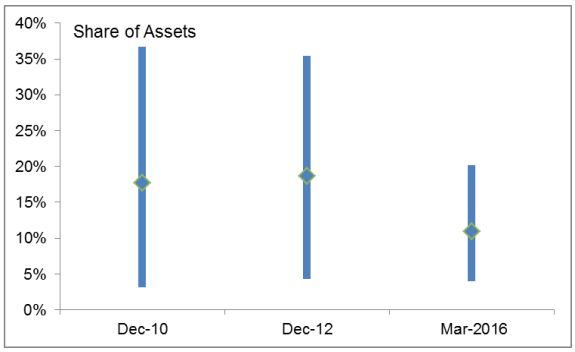


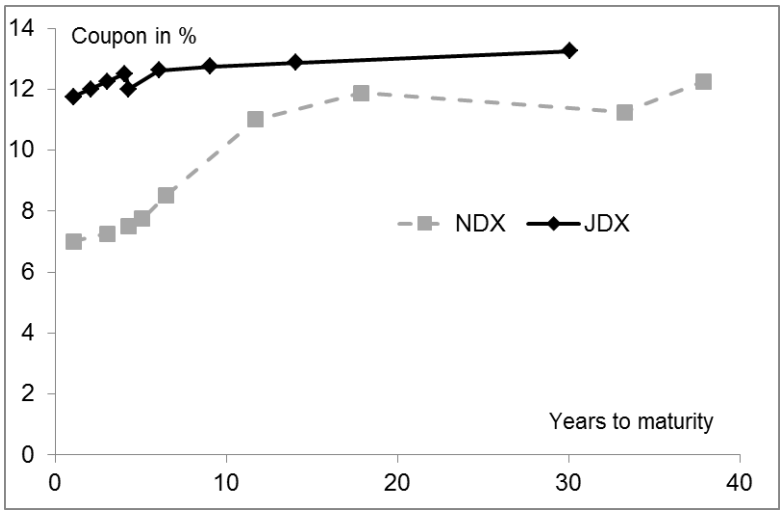
Figure 3b: Commercial Banks, GOJ Securities as a Share of Assets



Source: Bank of Jamaica.

The high exposure of commercial banks to government securities highlights the risk for an exchange that would have reduced the face value of government bonds. However, even reducing interest rates can have negative value on bond pricing, and thus spillover to the financial sector as the value of fixed interest rates bonds is determined by the coupon (interest) it pays compared to the prevalent interest rate level. A bond that pays less interest than the current level will trade at less than the face value (it will trade at a discount), while a bond that pays higher interest rates than current rates will trade at a premium. This characteristic of bonds also restricted the intensity of the debt exchanges, as it placed a limit on how much interest rates could be reduced, as the values of bonds fall when interest rates are decreased. Given the high level of interest rates before the JDX, the interest rate reduction was seen as appropriate, and interest rates decreased even further after the exchange. However, the potential effect of interest rates increases on bond valuations was an important consideration for the NDX. Average inflation for the 10 years preceding the JDX had been 11 percent, resulting in expected positive real interest rates for the new JDX bonds. However, given the yield curve of the NDX bonds, it was possible that real interest rates would be negative for bonds with a tenure below 10 years (Figure 4).

Figure 4: Post-Debt Exchange Yield Curves for JDX and NDX



Source: MOFPS and own calculations.

The combination of the debt portfolio and the holding of GOJ securities by the domestic financial sector had important consequences for the feasibility of debt restructurings in Jamaica. Assume, for example, that the government had radically reduced its debt securities by applying a haircut of 50 percent at the time of the NDX. From the above discussion it is clear that such a haircut would have a severe impact on the domestic financial sector, especially securities dealers, in addition to insurance companies, pensioners, savers, and other holders of GOJ debt. However, even excluding any need to recapitalise financial institutions, the effects would be restricted.[12] Halving the face value of domestic securities would have cut the debt-to-GDP ratio by 33 percent of GDP, reducing debt-to-GDP from around 146 percent to 113 percent. This is a rather high level for a hypothetical example with a haircut that would severely impact the domestic economy.

Conversely, assume the government would have kept the face value of the securities intact but would have reduced the interest rate coupons to have the value of the coupons of the NDX bonds. Compared to the values of the bonds after the NDX, the ones paying half the interest would have lost on average 23 percent in value. The value loss would have varied among different kind of bonds with the biggest losses accruing for the longest dated ones, implying that the losses for creditors would have depended on which ones they hold.

While decreases in the face value and strong decreases in interest coupons both would lead to challenges for the financial sector, the effects of a debt operation on the fiscal situation and the debt trajectory would depend on secondary effects of the exchange rate, GDP growth,

[12] Jamaica bailed out its financial sector in the 1990s at a cost of 40 percent of GDP.

and a potential need to recapitalise systemically important institutions. Figures 5a and 5b compare the baseline debt trajectory to those that would result from a 50-percent reduction in interest rates and face value, respectively. Without any secondary effects and keeping the primary surplus target, Jamaica's debt-to-GDP ratio by March 2020 would have reached 70.6 percent and 89.9 percent for a face value and interest rate reduction, respectively. Conversely, the debt-to-GDP target of 100 percent by 2020 could have been reached with an average primary surplus of 3 percent with a face value reduction of 50 percent and 5.75 percent of GDP with the same reduction in the interest rate, both substantial reductions to the average of 7.25 percent foreseen in the EFF. However, secondary effects on growth, and potentially the exchange rate, could have been expected.

The simulated slowdown in growth under the 50 percent face value reduction would have halved the effect of the debt exchange, with debt-to-GDP reaching 85.4 percent by 2020 instead of the 70.6 percent in the absence of a growth slowdown. Similarly, following the exchange Jamaica could have reached the 100 percent debt target with a primary surplus of 5.5 percent of GDP. A one-time nominal depreciation of 30 percent would also slow down the decline in debt, leaving debt-to-GDP at 81 percent in 2020 or requiring a primary surplus of 6.2 percent of GDP to reach 100 percent by the same date. A combination of the two shocks would bring debt-to-GDP to the same level projected under the EFF.

Figure 5a: Debt Trajectory under Different Debt Operations

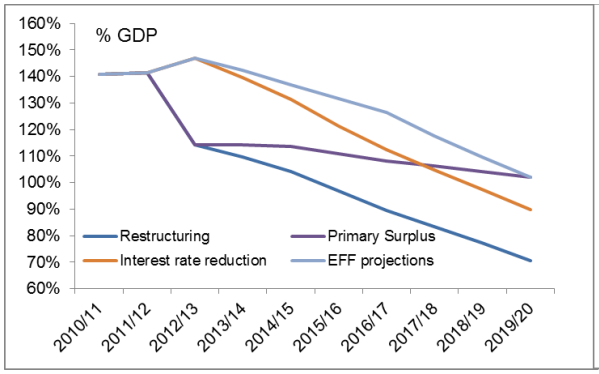
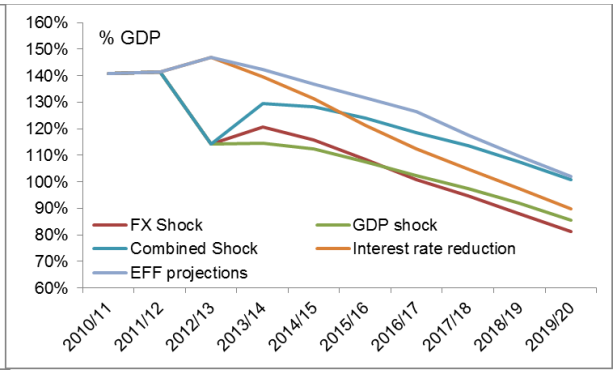


Figure 5b: Debt Trajectory after 50 Percent Face Value Reduction and Shocks



Sources: IMF, MoFPS, BOJ, and own calculations.
Notes: Growth in growth slowdown simulations are -4, -2, -1 percent for 2013/14 forward. The exchange rate adjustment was simulated with a one-time 30 percent depreciation while inflation in the same year was doubled.

The debt simulations highlight the challenge that Jamaica was facing in early 2013. The simulated face value reduction by 50 percent would have cancelled debt equivalent to 30 percent of GDP, which has negative impacts on banks, security dealers, pensioners, and private

savers, among others. As a result, the beneficial impact of the debt reduction would have been, at least partly, reversed by an economic contraction and possible capital flight as savers would have taken capital abroad.

The fallout would have been less severe from a more aggressive reduction in interest rates. However, the simulated interest rates at half of the NDX rate would have reduced the value of GOJ domestic securities by 20 percent, equivalent to 12 percent of GDP. As such, a growth slowdown and exchange rate adjustment could have been expected, resulting in a debt-to-GDP ratio above the 89.9 percent simulated above.

5. Lessons from the Two Debt Exchanges

The JDX and the NDX offer important lessons for other countries in similar situations. With hindsight, it is clear that the JDX should have led to a stronger reduction in debt in NPV terms. Not only did interest rates decrease after the exchange, but the interest payments still posed a high burden on the country and a second debt exchange was required only three years later. Jamaica would probably have been better off if it had done only one, more aggressive, debt exchange. After the JDX, the average interest rate payment on GOJ securities was 11.7 percent. If the interest rates had been reduced to the level to which they were reduced after the NDX, average interest rates would have been 9.3 percent, allowing the program to either reduce debt-to-GDP faster or with lower fiscal adjustment.

Also with hindsight, some of the securities could have taken a stronger discount, especially those denominated in US$. For instance, including interest payment, the value one year after the NDX of the 5 percent US$ 2016 benchmark note increased by 7 percent in real JM$ terms, while a similar JM$ denominated security lost 1 percent despite the higher interest rate of 7 percent. Because of the depreciation of the JM$, holders of US$ securities benefited in relative terms in JM$.

A major reason for the JDX was the over-reliance on short-term debt, as a substantial share of domestic securities matured in the relative short term, forcing the government to rely on the willingness of investors to roll over substantial amounts of debt. While short-term debt has the advantage of carrying lower interest rates, it has the disadvantage that it makes the government vulnerable to fluctuations in market conditions, for instance if the government needs to roll over debt at a time when interest rates increase. However, the JDX addressed bunching only partially as over 20 percent of exchanged debt was still maturing in the three years following the exchange, most of it in the third year, 2013. As such, it did not completely address the bunching but moved it down three years with the perception that a successful SBA program

would have made accessing new funding simple. A better approach might have been to transform short-term debt into debt with different maturities. For instance, securities due in 2010 could have become three securities, maturing in 2013, 2016, and 2019. Avoiding shorter maturities in an exchange is also important as the government might only be able to issue new instruments with shorter maturity following the exchange. As the JDX already resulted in a bunching in 2013, subsequent issuances aggravated the situation.

Other ways to lower the interest burden without putting too much burden on debt holders could have been to create instruments with increasing interest rates.[13] For instance, an instrument could have paid 2 percent interest the first year, 4 percent the second until it reached the desired interest rate. A lower interest rate in the early years of the program would have freed more government resources to retire debt in the early years and would have postponed part of the interest rate burden to a time the stabilisation efforts would have yielded lower overall debt and higher growth. At the same time, the increase in interest rates would have protected the value of the security, especially for investors with a longer investment horizon.

The two debt exchanges also present lessons on the feasibility of another debt exchange in Jamaica. Jamaica has been successful in its fiscal consolidation since the start of the EFF, but a fiscal crisis can never be excluded given the small size of the country and its vulnerability to external economic and natural shocks. Jamaica's financial sector has become much less dependent on domestic GOJ securities.[14] At the same time, the share of domestic GOJ securities had decreased to 43 percent of direct GOJ debt by March 2016 (39 percent for all public and publicly guaranteed debt), reducing the part of debt that could be exchanged and, thus, reducing further the benefits from an exchange. Furthermore, interest rates are currently lower than they were during both exchanges, which would imply that even a JDX/NDX exchange would either not yield many benefits or force interest rates to a level that the value of the securities would be negatively affected. Finally, Jamaica was excluded from the domestic debt market for three years following the NDX. A renewed debt operation could lead to a much longer shutdown, which would imply that any debt exchange would have to be deep to free the government from any dependence on financing from the domestic market. Given these factors together, a renewed debt operation would not yield an attractive risk/reward ratio and has become unlikely.

[13] Note that the FRAN instrument offered under the NDX is similar to this idea as it is an instrument with a face value of 80 that increases to 100 at maturity. Over the whole period, the instrument pays 10 percent of its face value (8-10 percent of original value). However, the FRAN option was optional and take-up was restricted mostly to state enterprises.

[14] The holders of GOJ global bonds that are issued internationally are not known, but anecdotal evidence suggests that a large share is held by domestic creditors.

6. Conclusion

Weak fiscal and economic performance over extended periods of time led to an unsustainable fiscal situation for Jamaica in 2009. The high level of debt and the related interest rate payments were the major problems that Jamaica was facing. Two debt exchanges later, Jamaica still faces challenges. Despite strict adherence to a demanding IMF-supported program, debt-to-GDP in March 2016 is at 125 percent of GDP. In addition, the country has to adhere for the next decade to a macroeconomic framework that requires primary balances of 7 percent of GDP (Schmid and Malcolm, 2016) and the country faces major vulnerabilities. As a result, observers have been wondering whether the past debt operations were adequate or even whether a renewed, stronger debt operation should be considered. This brief outlines the restrictions that debt operations in Jamaica faced because of a relatively small share of debt that could be treated (domestic securities) and the exposure of the domestic financial sector. Under these circumstances, the trade-off between the benefits from a deeper debt adjustment and the negative economic impact were skewed toward a high risk for the domestic economy and restricted benefit from deeper adjustment.

In spite of these restrictions, the Jamaican debt exchanges could have been done differently, possibly with more fiscal benefits to the government. As the need for a second debt operation three years after the first one has shown, the JDX was too weak, not giving enough space to the government under the SBA and hindering a faster reduction of debt. It would have been more beneficial for Jamaica if the JDX had also included the interest reduction and maturity extension of the NDX. In addition, individual instruments could have been exchanged for different types of instruments, for instance, avoid moving to a renewed bunching in 2013.

Finally, the brief indicates that the potential for a renewed debt restructuring is worse today than it was at the time of the JDX and the NDX. Achieving a substantial reduction in debt while avoiding a fallout of the financial sector does not seem feasible. An exchange that focuses on domestic GOJ securities would not have an attractive risk/reward ratio, while Jamaican global bonds lack a common action clause, making a debt restructuring on these instruments difficult, lengthy, and possibly more costly.

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