Public Debt Consolidation: The Jamaica Exception

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Comments

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What Does the Paper Do?
Sustained Debt Reduction *Beyond Crisis*

Two Empirical Regularities

i. "Sharp, **sustained reductions** in public debt **are exceptional**, especially recently."

ii. "But only in rare instances have they succeeded in bringing those higher debt ratios back down **once the emergency passed**."

- Jamaica: 144% of GDP (2012) → 72% (2023)
  - **Sustained** primary fiscal surpluses to reduce debt
    - Modestly favorable *r-g*
    - + more than its fair share of external shocks

Debt to GDP Reductions

Reinhart, Reinhart, and Rogoff (2015)

Orthodox measures:

i. Economic growth (g-r)

ii. Primary surplus → **Jamaica's 144% →72% "old-fashioned way"**

Heterodox measures:

iii. Surprise inflation tax (local currency/not indexed)

iv. Explicit default or restructuring

v. Financial repression

"How" and "Why"

Sustained Debt Reduction *Beyond Crisis*

I. Fiscal rules: Transparent, clear, and flexible budgetary rules within the Fiscal Responsibility Framework (2010; 2014)

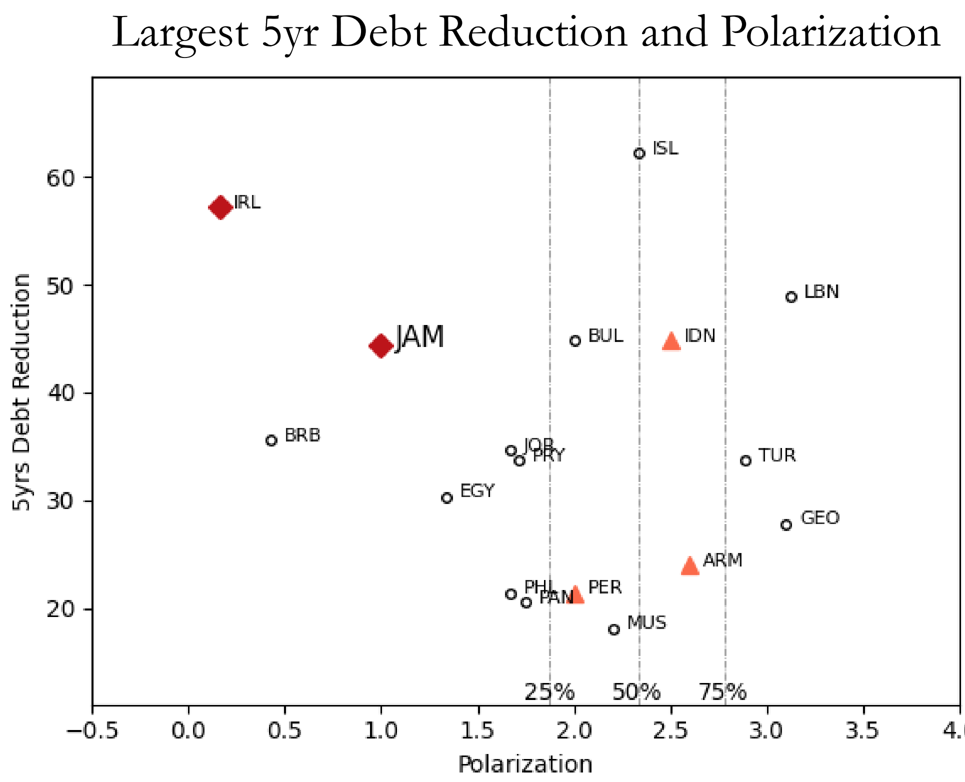
  – Monitoring, Reporting, Independent Verification

II. Ownership: History of Consensus Building → transparency and fairness in burden sharing, dialogue, ownership, and continuity.

  – **Reduced Polarization:** sustain the **benefits beyond the crisis** despite changes in parties.

- Other examples: Ireland (1980s), Barbados (1990s), Iceland (2008)

EMEs Largest 5-Year Debt Reduction and Polarization (Table 1 Sample)



Comments: Case Studies!

- Case studies uncover the intricacies of societal norms, political legacies, shared mental models, and formal rules that shape political, economic, and social interaction crucial for understanding fiscal issues over time + complexity debt management
  - Internal logic, consistency, and timing are highly complex.

- Excellent paper… extremely complete (details, footnotes); very hard to comment

- Comments
  - Fiscal Rules
  - Ownership/ Polarization
  - End with a question for the authors: High Debt World!

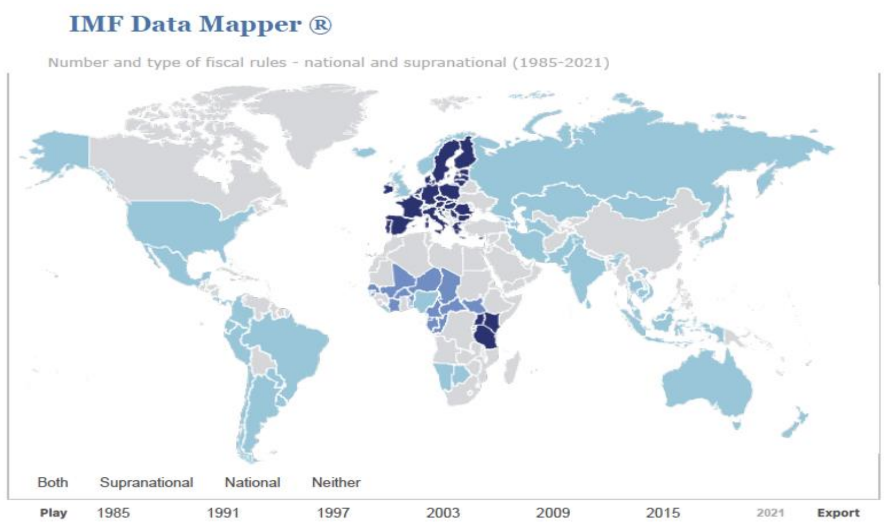
High Public-Debt-to GDP

- Bringing down high public debt-to-GDP ratios
  - Debt Sustainability: default is costly (Alfaro and Kanczuk, 2005; Mendoza and Yue, 2012)
  - Implement countercyclical fiscal policy
  - Fiscal dominance, debt overhang, crowding out ...(Reinhart, Rogoff, 2010)
- But… "When it Rains, it Pours" (Kaminsky, Reinhart, Vegh, 2005)
  - More so in the tropics (Caribbean-hurricanes)! as the paper describes
- Fiscal rules rationales → correct excessive indebtedness
  - Political economy: heterogeneity, "war of attrition" over the distribution of costs, common pool/ externalities that lead to a deficit bias, and interest groups …(Alesina and Passalacqua, 2016)

I. Controlling the Government: Fiscal Rules

"In framing a government which is to be administered by men over men, the great difficulty lies in this: you must first enable the government to control the governed, and in the next place oblige it to control itself." –The Federalist, No. 51

- Only 5 countries in 1985; 100+ countries
  - Different types: Debt, deficit, revenues, expenditures..



Source: https://www.imf.org/external/datamapper/fiscalrules/map/map.htm

I. Controlling the Government: Fiscal Rules
Do Fiscal Rules Improve Welfare?

- Why commitment? Is the government too impatient?
  - Are optimal fiscal rules quantitatively important (welfare)?
    - Broader debate of "Rule versus discretion."

- Alfaro and Kanczuk (2019), we examine the welfare implications of fiscal rules in the context of emerging market's sovereign debt and default.
  - Traditional sovereign debt and default model + time-inconsistent governments' preferences: Quasi-hyperbolic consumption model (Laibson, 1997).
    - $U_t = E_t[u(g_t) + \beta \sum_{t=1}^{\infty} u(g_{t+\tau})]$; $\{1, \beta\delta, \beta\delta^2, \beta\delta^3, \ldots\}$
    - The consequent conflict between today's government and tomorrow generates an incentive to pre-commit to a particular fiscal rule.

I. Controlling the Government: Fiscal Rules

Do Fiscal Rules Improve Welfare? Control the Government?

- Calibrate to Brazilian economy: model can reproduce the Brazilian debt level and default frequency (household impatience calibrated to local interest rates).
  - Optimal fiscal rule: welfare gains relative to the absence of a rule
  - Alternative simpler debt rule (over the more complex optimal rule) can improve welfare (relative to no rule);
    - But not all rules improve welfare (e.g. restrictive deficit rules) → Lessons from Jamaica (other government's envy at IDB event)

- Brazi (large and not an island), yet interesting:

  i. Dilma's impeachment in 2016 was "due" to disobedience of the fiscal rule;

  ii. Congress passed additional fiscal restrictions in December 2016

  iii. Fiscal rule was eliminated during COVID-19

✓ **Is commitment effective?**

II. Controlling the Government: The Spirit of a People

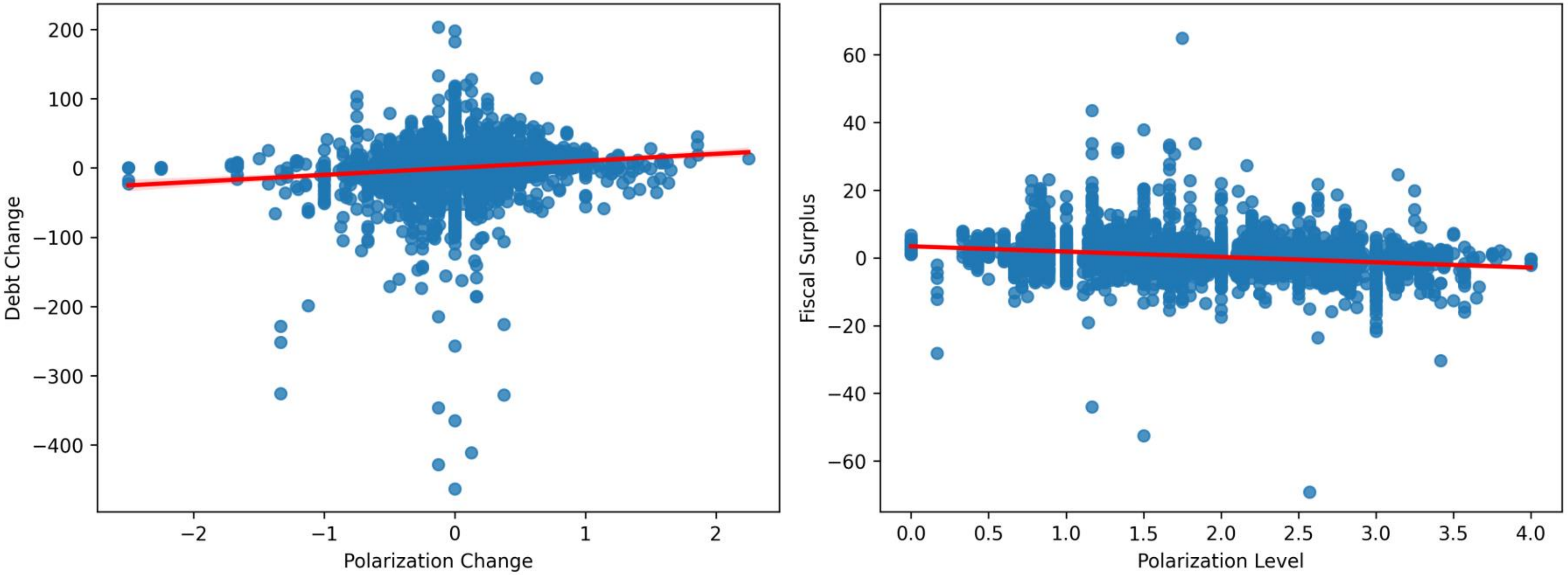
"The spirit of a people, its cultural level, its social structure, the deeds its policy may prepare, all this and more, is written into its fiscal history." –J. Schumpeter "Crisis of the Tax State," 1918

- As the paper shows: complex and reinforcing process that builds on the country's history.
  - Jamaica: ownership (inst./organizations) ←→ transparency ←→ reduced polarization ←→ monitoring fiscal rules
  - Brazil's case had no real buy in (despite the votes); contigency
- But it's not simple: the "Spirit of the people" does not make the country immune to problems/ shocks / changes
  - Costa Rica (we used to be cohesive…but we are not an island)
  - Ireland, Iceland, and Barbados

II. Controlling the Government: The Spirit of a People Polarization

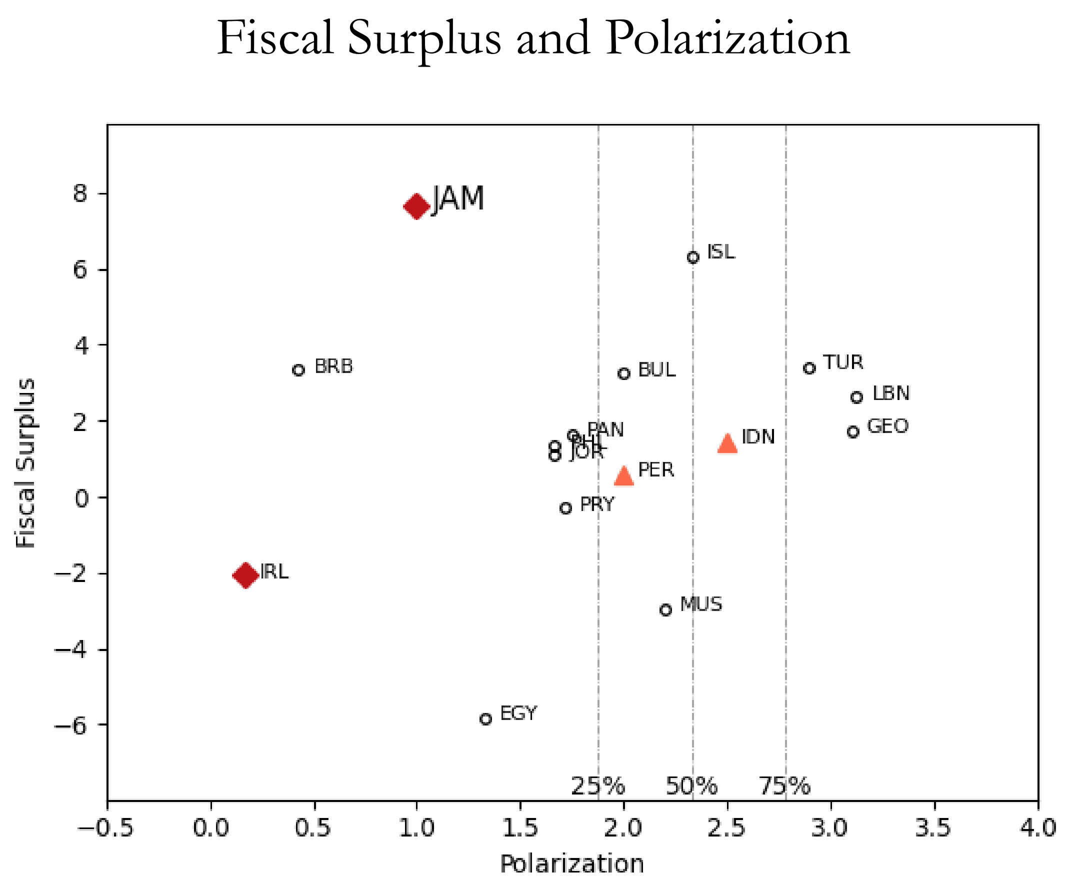
- Literature on polarization and the government's incentives/ability to tax and spend: somewhat mixed
  - Forms of polarization, heterogeneity, conflict of interest, heterogeneity between policymakers and voters, heterogeneity of fiscal preferences across politicians, and heterogeneity of fiscal preferences across social groups or regions, (Eslava, 2011)
    - Polarization can lead to overspending and deficits (Alesina and Tabellini (1990), depend on the type of incumbent (Persson and Svensson, 1989); polarization and disagreement can also lead to smaller government and less spending (Alesina, Baqir, and Easterly, 1999; and Azzimonti, 2011).
- \+ process are complex, non-linear, over many years, as the paper shows

Controlling the Government: Polarization (1980-2019)



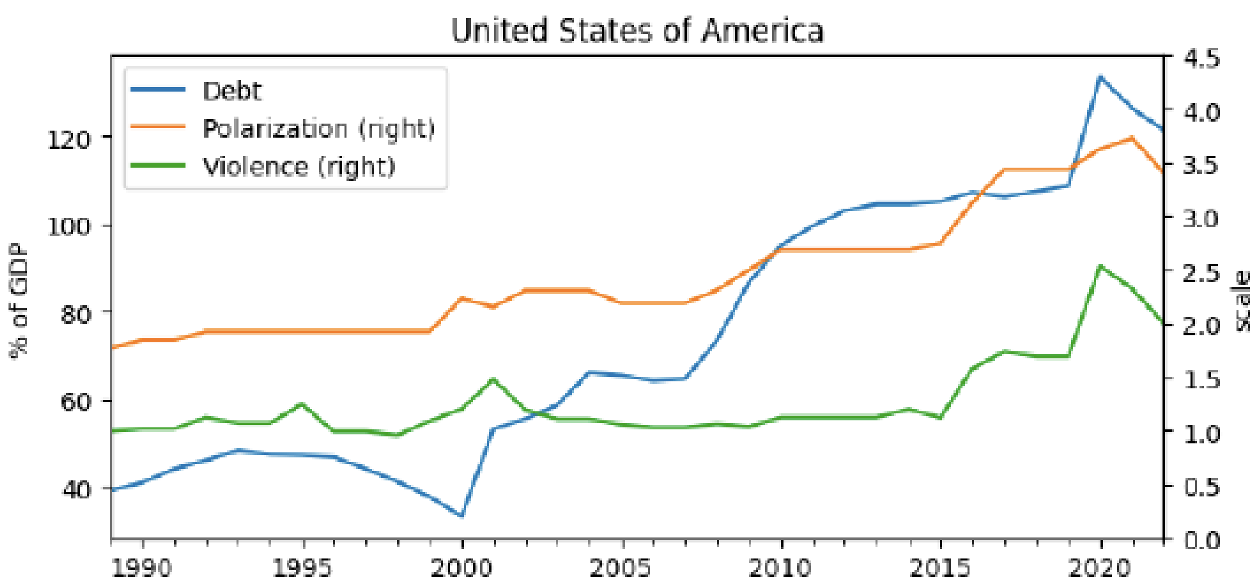
Sample: Non-High income countries, Excludes oil countries; very extreme outliers; IMF, IFS.

EMEs Largest 5-Year Fiscal Surplus and Polarization (Table 1 Sample)



Pessimistic Outlook for the US… Other Countries

- From reading the paper, I also walked away somewhat pessimistically, not only of the outlook for the US
- But also others, as developing countries face increased debt payments in the coming years in a more complex, polarized geopolitical environment.



Sustained Debt Reduction *Beyond Crisis*

International Financial Architecture

- Lessons on how the IMF should handle high-debt countries?
  - Variable that pops up… HIPC=1
    - Arslanalp and Henry (2006): effects not always encouraging

Public debt

The Fiscal and Financial Risks of a High-Debt, Slow-Growth World

Higher long-term real interest rates, lower growth, and higher debt will put pressure on medium-term fiscal trends and financial stability

Tobias Adrian, Vitor Gaspar, Pierre-Olivier Gourinchas

March 28, 2024

Inflation-adjusted interest rates are well above post global financial crisis lows, while medium-term growth remains weak. Persistently higher interest rates raise the cost of servicing debt, adding to fiscal pressures and posing risks to financial stability. Decisive and credible fiscal action that gradually brings global debt levels to more sustainable levels can help mitigate these dynamics.

Public debt sustainability

Debt sustainability depends upon four key ingredients: primary balances, real growth, real interest rates, and debt levels. Higher primary balances—the excess of government revenues over expenditures excluding interest payments—and growth help to achieve debt sustainability, whereas higher interest rates and debt levels make it more challenging.

Conclusions

As always from the authors, a must-read!