Barita INSIGHTS

# Budget FY2021/22

# ‘SERVE’ing a Recovery?

**Jamaica’s Budget in a COVID-19 Environment: Competing Priorities Among Scarce Resources**

Without doubt, Jamaica’s FY2021/22 budget, as presented by Dr. Nigel Clarke, is the outcome of an incredibly difficult task of choosing the top priorities relative to the significant constraints on available fiscal resources, to boost economic recovery. Various macroeconomic studies have pointed to ‘counter-cyclical’ fiscal measures as the appropriate policy response from a government trying to escape the clutch of a vicious economic crisis. But, for Jamaica, which is still highly indebted, it is a delicate calculus to solve for the optimum fiscal spend subject to the constraints of limited resources and also the need to maintain fiscal prudence, which is at the core of macroeconomic stability.

In view of the foregoing, the GOJ’s cautious approach seems warranted, and the ‘Social and Economic Recovery and Vaccine Programme’, or the ‘SERVE Jamaica Programme’, which is the Government’s $60 billion policy response to resuscitate the Jamaican economy is a practical response to generate economic activity as quickly as possible. The SERVE programme represents 11% of non-debt expenditure or 7.2% of the Government’s planned budget of $830.8 billion. The lowering of the debt remains paramount as it increases fiscal space, thereby allowing direct spending on growth inducing initiatives. This document gives our insights on the budget.

# Jamaica:

## Priorities for Recovery: The SERVE Programme

**Key Pillars of Recovery**

- **Vaccination - Financing Procurement, Storage, Distribution and Application of Vaccines to reach herd immunity**
- **Social Spending + Continued delivery of public goods and services**
- Financing Infrastructure
- **Support for Small Businesses**
- **Preservation of Macroeconomic Stability**

The Government of Jamaica has designed a $60 billion Social and Economic Recovery and Vaccine Programme: The **Main** allocations are as follows:

- $10.5 billion in special resources for the Ministry of Health
- $31.1 billion to an infrastructure programme
- $5 billion in targeted financing for businesses
- $1.7 billion for agricultural support
- $1.8 billion to expand wifi and broadband nationally
- $8.1 billion in targeted social support

# Jamaica:

# Theme: From 'Engineered Lockdown' to an 'Engineered Re-start'

## Planning For Recovery

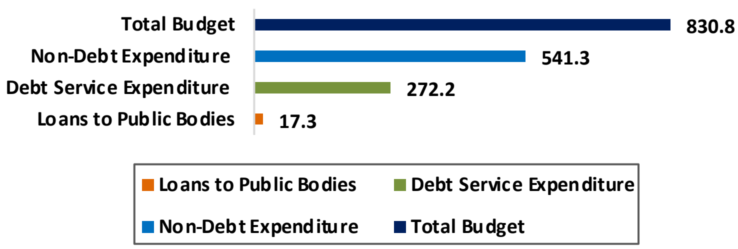
One of the arguments in support of greater fiscal spend to combat this particular crisis, is that COVID-19 is a health crisis, which required an 'engineered' shutdown of economies. Consequently, to revive economies, that is, pursuing an 'engineered re-start', would require as much fiscal or government spending as possible. However, this engineered re-start must balance the key element of economic stability, in particular, fiscal sustainability. For a very long time it seemed an elusive aspiration for Jamaica to achieve all four elements of economic stability at once: external sustainability, fiscal sustainability, price stability and financial stability. Yet, just before the COVID-19 crisis struck, Jamaica had achieved that feat and was heading in the right direction.

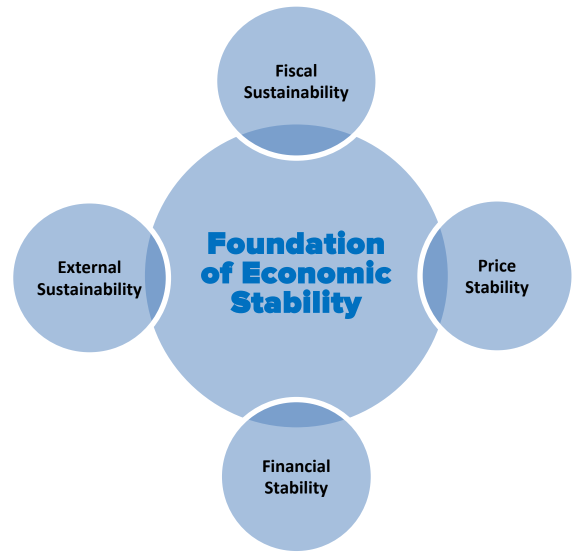
How we treat fiscal policy at this juncture holds critical implications for overall economic stability. With that in mind, the Government of Jamaica (GOJ) is planning to spend $830.8 billion, with 65.2% of that amount going towards non-debt expenditure. This compares favorably to the third supplementary estimates for FY2020/21, in which the total non-debt expenditure represented 61% of total expenditure. The proportion of the budget allocated to debt servicing, 32.8%, is also lower in this new fiscal year relative to fiscal year 2020/21, at 34.6%, an indication that more of the budget will go towards growth inducing spending.

As we have noted in our 2021 Investment Outlook, Jamaica's and other global economies' recovery will ultimately be shaped by their local management of COVID-19. So, it comes as no surprise that a sizeable percentage of the budget is allocated to the vaccination and other COVID-19 related interventions. Secondarily, it is also important that unemployed households receive social support to both prop-up their capacity to consume and also to help mitigate adverse social outcomes such as an increase in opportunistic crimes such as robberies. So, how has the GOJ proposed to address these specific issues?

- **Social Spending** - $16.4 billion or 2.0% of the budget, of which $14.5 billion will fund the PATH Programme; the total spend here doesn't include the additional spend under JSIF and the SERVE Jamaica Programme.

**Central Government Budget (J$Bns)**




- **Capital Expenditure (CAPEX)** - The GOJ is allocating $54.2 billion to capital expenditure, which the Government suggests is a 20% increase relative to the last financial year's provisions. The bulk of the capital spend will form part of the SERVE recovery programme. But, outside of the SERVE programme, the government will be spending approximately $22.7 billion on CAPEX projects that will set the foundation for longer term recovery. Some of those projects we find particularly important are as follows:
  - ✓ **Digital transformation** - $2.3 billion allocation to NIDS
  - ✓ **Agricultural support** - $1.3 billion to agricultural projects, of which $905 million is earmarked to support irrigation of arable lands
  - ✓ **Health infrastructure** - $2.7 billion for redevelopment of Cornwall Regional Hospital
  - ✓ **Education Infrastructure** - $1.2 billion earmarked for the Ministry of Education Youth and Information, of which $800 million will be spent to develop additional classrooms to eliminate the shift system and overcrowding at 17 high and primary schools.

# Jamaica:

# The 'SERVE Recovery Programme': The Critical Issues

**Fiscal Conservatism May be Justified**

The Bank of Jamaica's one-time $33 billion dividend payment to the Government is the only reason the Government is able to fund the SERVE Recovery Programme, while also covering the typical recurring expenditures, inclusive of interest costs, without resorting to additional borrowing. The upshot is that the economic path to recovery is still uncertain and for that reason, it makes sense for the Government to be cautious with its fiscal spend. Our view, however, is that it is within the policy arena, that much more effort and thought are required, especially as it pertains to crime reduction strategies. An opportunity also exists for the government to consider more broadly 'infrastructure'. We will elaborate on this point below:

*a) Will Supply Create Its Own Demand?*

The core of the SERVE Programme, outside of the Vaccination initiatives, is the infrastructure program that is billed at $31.1 billion; of which, $17.7 billion will be used to fund the Southern Coastal Highway Improvement Project (SCHIP); another $8 billion will be used for an assortment of public investment infrastructure projects such as drains, water, wastewater and sewer infrastructure.

These investments could absorb slack in the labour market over the short-term, which is paramount. However, it is not clear that these investments will necessarily translate into improvements in productivity, which ultimately matters most to a sustained recovery into the medium and long-term. Consequently, a clear multi-sectoral strategy on crime, in particular violent crime, is required. Why? Because crime is one of the largest detractors from total factor productivity (TFP) and has been found to be one of the main contributors to the paradox of Jamaica having a high investment rate, yet low economic growth. In other words, it is not clear to us that these investments in transportation infrastructure, necessary as they are, will automatically redound to improved productivity.

**Notwithstanding, the investment implications emerging from these infrastructure projects imply that materials based public equities such as cement and lumber, could get some tailwind. Consumer staples, such as LASD, Wisynco, Derrimon, GK and Seprod could also benefit to the extent that these investments in fact result in significant job creation for Jamaicans.**

*b) Agriculture Requires more creative Imagination and more funding*

Agriculture and GDP share a very close relationship. Typically, quarterly GDP moves in the same direction as agricultural sector output. COVID-19 offers an opportunity for a reset, for a transformational recovery of the sector.

**Notwithstanding the tight fiscal space, it might be worthwhile to consider agriculture within the suite of infrastructure projects, beyond just agricultural roads and productive input relief ($1.7 billion). For example, post-harvest losses remain especially challenging for local farmers, particularly those that produce perishables. Specialized warehouses near to 'farming belt' communities; for example, in St. Elizabeth, could be game changing. This would benefit not only the farmers directly, but also contributing to the minimization of food waste and lowering of the nation's import bill.**

Finally, the issue of crime as it pertains to agriculture, i.e., praedial larceny, is itself an urgent matter that should form a core part of the recovery conversation: praedial larceny remains a major disincentive to systematic private sector investments in agriculture. Now may be the opportune time to prioritise the proper capitalisation of the various public bodies needed to solve this perennial problem.

*How Will this budget be Funded? And what Buffers are there?*

**The GOJ, for the sixth consecutive year, will not impose new taxes. This is part of the 'dividend' of pursuing good policies that prioritise economic stability. This is complemented by the BoJ's dividend mentioned previously.**

**Finally, as part of the Disaster Risk Financing strategy, the GOJ is working with the World Bank to issue a three-year Catastrophe Bond, which would be a first by any Caribbean country. This bond would help Jamaica to manage the economic costs that would arise from a hurricane.**

# Jamaica:

# Good Institutions and Policies Matter

A major strength of the budget presentation, in our view, is the continued dedication to the institutionalization of economic governance. Such measures are critical for long-term economic stability and growth. It is this dedication of sound economic governance that has contributed to Jamaica maintaining its credit rating by S&P, Fitch and Moody's during the economic crisis, while many regional compatriots were downgraded.

The specific policies the GOJ will focus on during the fiscal year include:

1. **Modernization of the Central Bank**
2. **Independent Fiscal Commission**
3. **Public Investment Map**
4. **Open Government Partnership**
5. **Disaster Risk Financing**

Each of these initiatives will have an immediate impact on the quality of policymaking in Jamaica with strict guidelines by which authorities and institutions will have to be guided.

**Our view is that the attention given to these areas of institutional reform are cornerstones for Jamaica's economic reform. Our expectations are that they will enable sustainable economic growth into the future, while ensuring that adequate absorption buffers are built-in for external shocks for which Jamaica, as a small open economy, is susceptible to. The issuance of a three-year Catastrophe Bond ("CAT Bond") which would see Jamaica receiving payouts in the event Jamaica gets hit by a serious hurricane. This represents an important part of building up the macro-resilience of the economy.**

Built into the legislative framework are Medium Term fiscal policies that will enable Jamaica to recover from this pandemic. These include:

1. **Debt to GDP target of 60% to be obtained by March 2028**
2. **Central Government Primary Surplus (PS) of 6.1% of GDP for FY 2021/22, with targeted average of 5.4% over the medium term.**
3. **Operations of the Central Government are projected to generate a Fiscal Surplus (FS) of 0.3% of GDP in FY 2021/22 and be maintained thereafter through to FY 2024/25**

These policy initiatives and targets are critical to establishing the foundations of entrenched economic stability over the long-term.

# Jamaica:

# Concluding Thoughts

## Growth Drivers

As Dr. Clarke noted in his budget speech, "Inclusive of this quarter ending March 31, 2021, where PIOJ expects a 10% contraction in the economy, **we are anticipating at least five consecutive quarters of economic decline**." How we manage the vaccination program and continued social distancing measures will determine whether that expectation is eventually longer or shorter. Considering expectations for growth, its important to note that the main factors that will guide our recovery include the following:

- Policy intervention tools and the degree to which these tools can stimulate growth;
- The severity of the virus, specifically positivity rate, which is linked to the vaccine administration and social distancing;
- The revival of the global economy (particularly the USA) which in turn has implications for our economy.

In addition to the foregoing, the Government will be pursuing a number of reforms and policy changes that we think will also lay an important foundation for a rebound in the local economy. Those include:

- ✓ **Digital Society and Businesses** - Facilitating greater financial support for MSME's to transition to digital;
- ✓ **Modernization of the payment system** - this could be game changing for financial inclusion and financial deepening
- ✓ **Modernization of antiquated legislation** - the 1952 Income Tax Act and the 1944 Customs Act will be updated
- ✓ **Operational Independence of Central Bank** – this is another critical pillar to establishing the credibility of the Central Bank and ultimately that of the inflation targeting framework
- ✓ **Establishment of Independent Fiscal Commission**
- ✓ **Leveraging Capital Markets to manage natural disasters** – through the World Bank, Government's intention to issue a Catastrophe Bond signals Jamaica's growing maturity and creativity in managing macroeconomic and other vulnerabilities.

With interest rates at the 'zero lower bound', monetary policy has very little ammunition in this fight. Fiscal policy is where the action is. And, there is a view that the Government of Jamaica should bring out the 'Fiscal Bazooka'. But, when we consider the current debt levels, our vulnerability to natural disasters and still uncertain pathway to a resolution of this COVID-19 crisis, a prudent fiscal approach, as the GOJ has proposed, might be best. But where they allocate those scare resources and the necessary policies to fully unlock the benefits of the fiscal spend might be more fertile ground for a critique.

It is useful for us to be reminded that Jamaica is a Small Island Developing State that could need to tap the international capital markets if an unfortunate course of event materializes. Consequently, our debt metrics and commitment to fiscal prudence is critical in maintaining our very good access to the international markets. In this regard, we quote from a June 2020 Bank for International Settlements (BIS) paper : " The room for fiscal policy is another important factor. International investors are more sensitive to EMEs' fiscal fundamentals and less tolerant to their debt levels (Reinhart et al (2003)). Higher financing costs and hampered access to external financing in times of financial stress constrain their fiscal response. The current turmoil is no exception".