Unravelling: Issuing Bonds to Pay Salary Arrears to Public Officers
By Laurel Theresa Bain

The financing of the arrears of salaries to public officers by issuing bonds directly to them, and if in need of immediate cash, their subsequent sale of these bonds to financial institutions require examination for the implications to the Government and people of Grenada, public officers, and financial institutions.
The proposed financing of the arrears of short payment salaries increase with bonds could be described as a strategy for compulsory or forced saving and investment by public officers. They will not be receiving cash in hand, but bonds, which will earn a rate of return if these are held to maturity. While savings and investment are good for the economy, such decisions ideally should be the responsibility of the individual after assessing their personal financial situation and the cost and benefit of any financial investment.

Implications for the Government and People of Grenada
The economic and social costs of the impasse over salary arrears between the Government and public officers have not been assessed and quantified; but created a debt, which could have been avoided. With the proposal of issuing bonds to finance the arrears of salary the Government is substituting one kind of debt [arrears of salaries] with another type of debt [bonds]. With this proposal, the net debt position of the Government will remain unchanged. However, the interest charges due on the bonds will accrue on the current account, adding to the Government's operational expenditure.

Ideally, the face value of the issued bonds should include interest that accumulated on the arrears of salaries to public officers. The interest rate of three (3) percent would then be applied to the face value of the bonds. Consequently, the interest accrued on the outstanding salary arrears and the interest that will have to be paid on the issued bonds are additional charges on the public purse. The timely payment of the four (4) percent salary increase could have avoided the accumulation of debt with the accompanying interest cost.

Even, in this present situation, if the arrears of salaries to public officers are financed with revenue or with 'grants', the liability of the Government for the arrears of salaries would be eliminated without the additional interest cost associated with the bonds. In contrast, the debt, now in the form of bonds, would remain outstanding accruing interest until the bonds are redeemed.

The issue of bonds to finance the arrears of salaries due to public officers means that the Government is contracting debt to finance accumulated arrears on current operations. This is not considered prudent fiscal policy. Contracting debt to finance current operations should be used only if alternative cheaper financial resources are not available. This should not be the case in

Grenada. Based on the estimated fiscal position at the end of June 2021, the Government realized a current account surplus of $34.7M. Therefore, the retroactive payment could have been financed with a portion of this surplus from the current operations instead of a new debt created through the issue of bonds. Another possible source of financing is the revenue from the sale of passports which is channeled into the National Transformation Fund. Expenditure on wages and salaries are current or operational expenses and borrowing, through the issue of bonds, to finance such expenses should be a last resort.

This borrowing, that is the bond issue, is taking place in the context of high and increasing public debt and a substantial shrink in national income. Central Government debt has risen from $1.89billion in 2019 to $1.99billion in 2020 and to a further $2.13billion by June 2021. Coupled with the decline in GDP, the debt to GDP ratio of Central Government rose from 59.9 percent in 2019 to 70.4 percent in 2020 and to 71.5 percent by June 2021. With the inclusion of the debt of State-owned Enterprises, the total public debt amounted to $2.63billion or 88.5 percent of GDP at the end of June 2021. Given the deterioration in the debt profile of the country, debt financing for operational expenditure should be a last resort.

Implications for the Public Officers

The proposal to issue bonds directly to public officers will mean that the officers do not have immediate access to cash. If in need of urgent cash before the maturity date, the officers will have to sell the bonds. In the absence of an active bond market, the public officers may need to sell the bond at a steep discount, that is, at an amount much less than the face value of the bond. As such, public officers would receive a sum of cash less than the amount of their salary arrears. The purchasers, most likely the banks and other financial institutions, would be the main beneficiaries, particularly if a high discount rate is applied to the bonds. If this occurs, it would be equivalent to transferring resources from public officers to these financial institutions. There is one caveat. If financial institutions, such as credit unions, with broad-based membership, in which public officers are members, are the purchasers of these bonds, then some of the profits earned on these discounted bonds would be returned to the members as dividends.

If the bonds are held by public officers to maturity, they will receive the full face-value as well as the accrued interest on the bonds. The financial benefits to the public officers would depend on the rate of interest applied to the bonds. The interest rate on the bonds would need to be higher than the rate of inflation with provision for a positive return on the investment after accounting for inflation. This is a global inflationary period. Grenada's inflation is mostly imported. Based on the IMF World Economic Outlook for July 2021, the rate of inflation in the USA, Grenada's main trading partner, is projected at 4 percent in 2021 and 3.2 percent in 2022. The duration of the inflationary period is uncertain, and, in any event, price levels would be higher than in 2021. The real value of money, that is, the amount of goods and services that a quantum of money could buy would be less in the future. For the public officers to receive a

positive return on this savings and investment in bonds, the interest rate on the bonds would need to be higher than the increases in the general prices, as measured by the rate of inflation, with an additional margin for the return on investment. This would need to be compared with returns that can be earned on alternative investment products in Grenada.

The uncertainties of holding government debt must be factored into the decision to hold bonds. Government debt has traditionally been described as sovereign debt. This implied that the debt had minimum risk and it was safe to hold Government debt. This has changed overtime. Government debt has become risky as it has been subjected to debt restructuring involving haircuts or extension in the maturity date of the debt. Sovereign debt is no longer considered safe.

Implication for Financial Institutions

Financial institutions are likely to benefit whether the bonds are repurchased from the public officers or directly from the Government. If the bonds are issued directly to public officers and these are subsequently sold, the financial institutions stand to gain on the difference between the discounted value of the bond and the face value at maturity as well as the accrued interest on the matured bonds. In the case of a financial institution taking up the bonds directly from the Government, it will receive the face value plus the interest at maturity. In either case, it is beneficial for a financial institution with high liquidity to invest in the bonds. In a situation of high liquidity, financial institutions are holding deposits which they would prefer to lend. Interest is paid on deposits and if these are not lent, they are being held at a cost to the financial institutions. It is therefore in the interest of financial institutions with high liquidity to invest these deposits in bonds and earn interest which would partially offset the interest paid on deposits.

In summary, the debt associated with the payment of the four (4) percent salary increase to public officers should not have been created. By issuing bonds to finance the arrears of salary to public officers the Government is substituting one kind of debt [arrears of salaries] with another type of debt [bonds]. The public officers could benefit from the direct issue of bonds if held to maturity and the interest rate on the bonds is higher than the rate of inflation with an additional margin for the return on investment. If officers need cash and they are forced to sell these bonds, public officers will most likely receive less than the face value of the bonds and therefore less than the salary arrears due. Financial institutions with liquidity stand to gain from purchasing the bonds which would be a source of income and possibly capital gain. Rigorous assessments of the implications of policy proposals are important in determining the best options.

Knowledge is power and experience is the greatest teacher

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