Financing the Payment of Pension and Gratuity

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Summary of Proposal

1. The Prime Minister, in the national address, provided information on the cost of the Court ruling on pension and gratuity which is summarized as follows:
   i. The arrears of pension and gratuity to already retired public officers is $465M; and
   ii. The annual cost for new retirees and the ongoing payment for the previously retired officers averages $120M for the next thirty-seven years.

   The $120M is interpreted to mean that the total annual pension and gratuity, inclusive of the approximately $70M that is currently being paid, would average $120M beginning from 2023.

2. The payment of the $465M in arrears of pension and gratuity to the already retired public officers could be through a combination of debt, inflows from the Citizenship by Investment programme and the use of reserves.

3. The proposal is for the debt of $465M to be paid in two tranches, that is, a tranche of $115M in 2022, to be financed from the operational surplus, inflows from the Citizenship by Investment programme and reserves; and a tranche of $350M in 2023 to be financed by debt.

4. The criteria for the receipt of payment could be the date of retirement, commencing with the earliest retirees and those that are ailing and are in urgent need of their cash.

5. The proposal for sourcing the $115M in 2022 is as follows: i. $45M from government current operations, ii. $45M from the National Transformation Fund or the Citizenship by Investment programme, and iii. $25M from the reserves.

6. The Government should settle the other part of the debt liability of $350M of the $465M by either contracting a long-term loan or by issuing bonds or a combination of loans and bonds.

7. A long term highly concessionary loan is the best option. However, few institutions, notable the World Bank, provide long-term concessionary loans. Also, the amount of the loan may be limited and linked to specific projects rather than reduction in debt.

8. The alternative approach to the concessionary loan would be to issue bonds with different dates of maturity. The Government would need to aggressively market the bonds with national, regional, and international financial institutions and entities to achieve attractive interest rates.

9. The annual average expenditure of $120M could be incorporated in government annual current operations.

10. The Estimates of Revenue and Expenditure for 2022 provides the forecast of government operations for 2023 and 2024 which shows an operational surplus of $108.7M in 2023 and $238.3M in 2024; and the overall surplus, after grants, of $56.3M in 2023 and $188M in 2024.

11. The cost of the Court ruling is incorporated in the forecasted Government finances. For 2023 and 2024, there would be an annual pension and gratuity payment of $120M for each year; an annual interest payment of $10.5M on the debt of $350M, based on an interest rate of 3 percent; and an annual contribution to the sinking fund of $5M, which is invested with cumulated interest at 3 percent.

12. The results of the adjustments show that the Government finances would be within budget in 2022; it would tighten in 2023 with a reduced current account surplus and a smaller overall surplus; but recover in 2024.

13. Despite the payment of the $115M in 2022, government finances would remain within the budgeted overall deficit, after grants, of $97.9M, as the deficit is projected at $ 61.1M in the revised budget. This improvement in the Government finances is due primarily to the receipt of the unbudgeted financial inflows.

14. In 2023, the current account or operational surplus, would be reduced from $108.7M excluding the payment of the additional pension and gratuity and interest on the debt, to $56.1M with the inclusion of the additional payment for pension and gratuity and the interest on the debt. The overall surplus after grants would move from $56.3M to $3.7M. The inclusion of the sinking fund contribution results in and overall deficit of $1.3M in 2023.

15. The Government may wish to supplement the financial resources in 2023. To increase the fiscal space, the Government could seek budgetary support which it has successfully negotiated over the years.

16. The fiscal position, with the inclusion of the payment of pension and gratuity and the interest on the debt, recovers in 2024. The forecast shows a current account or operational surplus of $188.7M and an overall surplus (after grants) of $138.4M. The inclusion of the sinking fund contribution reduces the overall surplus to $133.4M.

17. The Court ruling on pension and gratuity must be honored. However, the issue of pension and pension reform would continue to be a national issue. All debates on pension and gratuity should be guided by the Constitution which is the supreme law of the land.

18. The Terms of Reference of the recently established Pension Solution and Strategy Committee should be a public document, and the structure of the Committee should be representative of society.

Financing the Payment of Pension and Gratuity

The Context

In the previous article on 'Payment of Pension and Gratuity', the cost of the Court ruling was not yet publicly released, and the proposal for the payment of pension and gratuity was indicative. The Prime Minister, in the address to the nation on Tuesday 26 April 2022, indicated that the Government would not appeal the Court ruling on pension and gratuity. This was a step in moving the process forward. It must be noted that the public service is a bureaucracy, and information is communicated in written documents to ensure there is clarity among all parties and there are historical records. A serious matter as the decision not to appeal the Court ruling on pension and gratuity by the Government should be documented and maintained in the records of the public service.

The Prime Minister, in the national address, provided information on the cost of the ruling which is summarized as follows:

i. The arrears of pension and gratuity to already retired public officers is $465M; and
ii. The annual cost for new retirees and the ongoing payment for the previously retired officers averages $120M for the next thirty-seven years.

The $120M is interpreted to mean that the total annual pension and gratuity, inclusive of the approximately $70M that is currently being paid, would average $120M beginning from 2023. Importantly, detailed information on the cost of the Court ruling ought to be published, inclusive of the number of officers and the accompanying annual cost. This would result in clarity and hence precision in assessing the liability of the Government, and by extension, the public. Notwithstanding, a debt has been created, and it must be honored. The obligation of the Government to pay the pension and gratuity must be anchored in the economic and social environment in order to mitigate adverse impact and to take advantage of the opportunities provided by such payment.

The Socio-economic Environment

The economy is recovering from the Covid-19 Pandemic, and there is excess capacity that could benefit from the injection of financial resources. In 2021, the level of economic activity, as measured by the Gross Domestic Product [GDP] of 3 billion was less than the $3.3billion in 2019. This indicates that there is still unused capacity in the economy when compared with 2019. Unemployment and poverty are high with youth unemployment of 38.6 percent and poverty at a minimum of 40 percent in 2021. This implies that there are idle human resources that could benefit from the injection of funds in the economy. It is the opportune time to embrace the potentials for economic development in this new economy created by the Covid-19 Pandemic. The injection of $ 465M in the economy within a short period of time has the potential of providing capital to idle human resource and to the excess capital capacity so that private entities could contribute to the transformation of the economy.

Financing the Payment of Pension and Gratuity

The $465M in arrears to retired public officers and the routine payment of the annual average of $120M in pension and gratuity, are unplanned expenditures. Therefore, the Government would need to revise the national budget for 2022 and the fiscal forecast for 2023 and 2024. The Court ruling has increased the **Central Government** debt from $2.1 billion or 64 percent of GDP to $2.6 billion or 78.4 percent of GDP. If the debt is held without a settlement, the debt would increase further due to accrued interest at a high statutory rate of 6 percent per annum.

Payment of the Arrears of $465M in Pension and Gratuity

The payment of the $465M in arrears of pension and gratuity to the already retired public officers could be through a combination of debt, inflows from the Citizenship by Investment Programme and the use of reserves. The proposal is for the debt of $465M to be paid in two tranches, that is, a tranche of $115M in 2022, to be financed from the operational surplus, inflows from the Citizenship by Investment Programme and reserves; and a tranche of $350M in 2023 to be financed by debt. The criteria for the receipt of payment could be the date of retirement, commencing with the earliest retirees and those that are ailing and are in urgent need of their cash. The spread of the payment over two years would allow the Government to prepare for and negotiate the $350M in debt financing. It would also smooth the expenditure over a two-year period. The plan should be to pay the arrears of pension and gratuity within the shortest time. However, the determination of the period over which to smooth the expenditure would be influenced by the absorptive capacity of the economy and the trend in inflation.

The $115M of the $465M to be paid in 2022 could be accommodated in an amended 2022 Budget. In this scenario, the funds have already been budgeted and Parliamentary approval would be required for the revised budget, particularly the additional expenditure for the payment of the arrears of pension and gratuity. The proposal for sourcing the $115M in 2022 is as follows: i. $45M from government current operations, ii. $45M from the National Transformation Fund or the Citizen by Investment programme, and iii. $25M from the reserves.

The proposed financing of $45M from Government current operations is derived from an assessment of Government finances. Based on the fiscal reports for the months of January, February and March from the Ministry of Finance, Government finances were favourable during the first quarter of 2022. The Government received a 'one off payment in the form of dividends' of $17.5M and budgetary support of $81M during the first quarter of 2022. These were unbudgeted financial inflows. Consequently, there was a current account surplus, after grants, of $155.1M in the first quarter of 2022. (See previous article on Government Finances and the Economy). With these developments during the first quarter and with prudent fiscal management, the Government could record a higher current account surplus than the budgeted $60.5M. Inclusive of the budget support in the form of grants, a current account surplus of more than $141.5M could be recorded for 2022. It is unlikely and not recommended that the Government spends the unexpected revenues on its current operations. Therefore, a portion of this surplus could be used to pay the arrears of pension and gratuity to retired public officers. It is in this context that it is proposed that at least $45M of the current account surplus for 2022 be allocated for that extraordinary expenditure of arrears of pension and gratuity.

The proposal to pay $45M from the National Transformation Fund and $25M from reserves, based on the 2022 national budget, is anchored on the premise that the payment of the arrears would lead to increases in consumption and investment in the economy by private entities. Therefore, there could be some element of switching of direct consumption and investment expenditures from the public sector to private entities. The budgeted capital expenditure of $333.5M or 10.2 percent of GDP for 2022 is abnormally high compared with the expenditure of $261.7M or 8 percent of GDP in 2021, and the planned capital spending of $231M or 6.7 percent of GDP in 2023 and $201.8M or 5.5 percent of GDP in 2024.

At the time of the presentation of the national budget in December 2021, the high capital expenditure for 2022 was considered an injection in the economy during the recovery from the Covid-19 Pandemic. With the need to spend $465M in a short period, by transferring financial resources to private entities, the Government would need to re-examine its expenditures. The Government could moderate its capital spending in 2022, to approximately $278M or 9 percent of GDP, thereby releasing financial resources of $55M. The budget made provision for expenditure of $112.4M from the National Transformation Fund and $86M from reserves. In this scenario, financial resources of $30M from the National Transformation Fund and $25M from reserves

which were already included in the budget for 2022 could be diverted to the payment of the arrears of pension and gratuity. The Government could source an additional $15M from the National Transformation Fund, to obtain the $45M [$30M+$15M] from the National Transformation Fund. This would be in keeping with the use of the Fund for contingencies.

The use of reserves is justified as some of these financial resources were accumulated due to the non-payment of pension and gratuity to public officers over the years.

The Government could also determine what combination of operational surplus, inflows from the Citizenship by Investment Programme, and reserves makes the best fit for the payment of the $115M. The impact of the moderation in Government spending on the economy in 2022 would be nullified by the increased spending by private entities following the payment of the $115M in arrears of pension and gratuity. It would also allow for the Government to focus on the proper management of high impact and transformative capital projects. At the same time, the Government would need to establish systems, incentives, and facilities to guide the expenditure from the payment of the arrears of pension and gratuity to achieve the desired outcomes.

The Government should settle the other part of the debt liability of $350M of the $465M by either contracting a long-term loan or by issuing bonds or a combination of loans and bonds. A long term highly concessionary loan is the best option. However, few institutions, notable the World Bank, provide long-term concessionary loans. Also, the amount of the loan may be limited and linked to specific projects rather than reduction in debt. The alternative approach would be to issue bonds with different dates of maturity. In either case, the Government would need to show capacity to repay the debt and the proposals would need to be well developed. For a highly concessionary loan, after an extended grace period, the interest and principal need to be repaid. For financing by bonds, the Government would need to aggressively market the bonds with national, regional, and international financial institutions and entities. The marketing strategy for the issue of the bonds should include evidence to pay interest based on fiscal forecast, and the arrangements for repayment when the bonds need to be redeemed. In both cases, it is recommended that a Sinking Fund be established where a specified amount is deposited annually and invested along with the accumulated interest to contribute to the payment of the debt. This would ensure that this generation contributes to the financing of the fiscal fiasco.

Financing the Annual Expenditure of $120M

In terms of the annual average expenditure of $120M, this would be incorporated in government annual current operations. The Estimates of Revenue and Expenditure for 2022 provides the forecast of government operations for 2023 and 2024. It shows an operational surplus of $108.7M in 2023 and $238.3M in 2024; and the overall surplus, after grants, of $56.3M in 2023 and $188M

in 2024. The following table shows the projected Government finances as presented in the Estimates of Revenue and Expenditure for 2022.

Table 1: Central Government Operation in EC$M

	Actual Provisional 2021	**Approved Estimates 2021**	**Estimates 2022**	**Forward Estimates 2023**	**Forward Estimates 2024**
Total Revenue & Grants	923.0	917.1	897.6	946.3	963.7
Recurrent Revenue	690.4	653.5	722.2	767.8	812.2
Current Expenditure (excluding Principal repayments)	598.6	629.6	661.7	659.1	573.8
Interest Payments	54.5	63.7	63.7	62.2	56.8
Pension and Gratuity	70.5	72.7	75.4	77.9	80.8
Current Account Balance	91.8	23.9	60.5	108.7	238.3
Capital Expenditure	261.7	305.6	333.8	231.0	201.8
Capital Grants	232.6	263.6	175.4	178.6	151.5
Overall Balance (including grants)	62.7	-18.2	-97.9	56.3	188.0

Source: Estimates of Revenue and Expenditure for the year 2022, Produced by the Ministry of Finance.

The need to pay the arrears of pension and gratuity to retired public officers and to pay, on average, $120M annually for pension and gratuity is integrated in the Government finances. Therefore, the budget for 2022 is adjusted and the forecasted expenditure for 2023 and 2024 is revised. The adjustments include i. For 2022, the payment of $115M in arrears to public officers; the reduction in capital spending to $278M; and the sourcing of an additional $15M from the National Transformation Fund. ii. For 2023 and 2024, the annual pension and gratuity payment of $120M for each year; the annual interest payment of $10.5M on the debt of $350M, based on an interest rate of 3 percent; and the annual contribution to the sinking fund of $5M, which is invested with the cumulated interest. To curb the high inflation, central banks are increasing interest rates which would be transmitted to higher cost of borrowing. It is now the time to borrow at relatively low interest rates and gain by investing in the sinking fund during the period of rising interest rates.

The revised forecast of Government fiscal operation is conservative as it does not include revenue gains from the increased economic activity associated with the payment of pension and gratuity; and net revenue gained from the collection of outstanding revenue liabilities to the Government and savings on expenditure from improvement in efficiency and reduced wastage.

The results of the adjustments show that the Government finances would be within budget in 2022; it would tighten in 2023; but recover in 2024. In 2022, government finances would remain within the budgeted overall deficit, after grants, of $97.9 M, as the deficit is projected at $61.1M in the revised budget. This improvement, despite the increased expenditure, is due primarily to the receipt of the unbudgeted financial inflows as the reduction in capital expenditure is offset by the partial payment of the arrears of pension and gratuity. In 2023, the current account or operational surplus, would be reduced from $108.7M excluding the payment of the additional pension and gratuity and interest on the debt, to $56.1M with the inclusion of the additional payment for pension and gratuity and the interest on the debt. The overall surplus after grants would move from $56.3M to $3.7M. The inclusion of the sinking fund contribution results in an overall deficit of $1.3M in 2023. To increase the fiscal space in 2023, the Government could seek budgetary support which it has successfully negotiated over the years.

The fiscal position, with the inclusion of the payment of pension and gratuity and the interest on the debt, recovers in 2024. The forecast shows a current account or operational surplus of $188.7M and an overall surplus (after grants) of $138.4M. The inclusion of the sinking fund contribution reduces the overall surplus to $133.4M. The revised fiscal position is shown in the following table.

Table 2: Central Government Operations in EC$M

	Actual Provisional 2021	Approved Estimates 2021	Estimates 2022	Revised Estimates 2022	Forward Estimates 2023	Forward Estimates 2024
Total Revenue & Grants	923.0	917.1	897.6	993.6	946.3	963.7
Recurrent Revenue	690.4	653.5	722.2	722.2	767.8	812.2
Current Expenditure (excluding Principal repayments)	598.6	629.6	661.7	661.7	711.7	623.5
Interest Payment	54.5	63.7	63.7	63.7	72.7	67.3
Pension and Gratuity	70.5	72.7	75.4	75.4	120	120
Current Account Balance	91.8	23.9	60.5	60.5	56.1	188.7
Current Grants				81.0		
Current Account Balance (After Grants)				141.5		
Extraordinary Expenditure				115.0		
Operational Balance (after extraordinary expenditure)				26.5		
Capital Expenditure	261.7	305.6	333.8	278.0	231.0	201.8
Capital Grants	232.6	263.6	175.4	190.4	178.6	151.5
Overall Balance (including grants)	62.7	-18.2	-97.9	-61.1	3.7	138.4
Sinking Fund contribution	0	0	0	0	5.0	5.0
Overall Balance (including sinking fund contribution)	62.7	-18.2	-97.9	-61.1	-1.3	133.4

Source: Derived from Estimates of Revenue and Expenditure for the year 2022, Produced by the Ministry of Finance.

Implications and Opportunities

With the debt of $350M, the Central Government debt to GDP ratio is 78.6 percent in 2022, comparable to its neighbours where the **Central Government** debt to GDP ratio was 83.7 percent in St Vincent and the Grenadines, 86.2 percent in Saint Lucia and 100.1 percent in Dominica. The payment of the annual pension and gratuity and interest on the debt, beginning from 2023, tightens the fiscal position in 2023, with the Government realizing a small overall surplus. The government finances improve in 2024. As indicated, this revised forecast of Government fiscal operation is conservative as it does not include revenue gains from the increased economic activity associated with the payment of pension and gratuity; and net revenue gained from the collection of outstanding revenue liabilities to the Government and savings on expenditure from improvement in efficiency and reduced wastage.

The increased public debt and cost of Government operations would bring to the forefront the applicability of the Fiscal Responsibility Act which is expected to guide fiscal policy from 2023. The issues related to the current construct of the Fiscal Responsibility Act are documented in the book: Budget Alert: Fiscal Policy Issues in Grenada for 2021.The conclusion in the article is:

> "The opportunity should now be taken by the Government to thoroughly examine the Fiscal Responsibility Act for consistency, transparency, accountability and as a policy instrument to facilitate economic development. These findings should guide the reform of the Fiscal Responsibility Act making it fit for purpose."

The increased debt related to the payment of pension and gratuity should be viewed as an opportunity to guide the expenditure into investment that would transform the economy thereby contributing to sustainable economic growth and higher government revenues. The specific opportunities are outlined in the previous article on the 'Payment of Pension and Gratuity' and is summarized as follows:

> "The opportunity should be taken to pursue policies, provide incentives and establish infrastructure to facilitate the use of the funds for the integration of domestic production and the innovative and creative industries with the tourism industry. The objective is to direct the use of the financial resources provided to households to rebalance the economy from the heavy reliance on tourism by improving the agriculture sector and the development of innovative and creative industries to achieve an integrated economy with greater food security".

Conclusion

The Court ruling on pension and gratuity must be honored. However, the issue of pension and pension reform would continue to be a national issue. All debates on pension and gratuity should be guided by the Constitution which is the supreme law of the land. In this context, the Terms of Reference of the recently established Pension Solution and Strategy Committee should be a public document, and the structure of the Committee should be representative of society.

The payment of pension and gratuity is good for the Government, better for the population and best for the economy.

Knowledge is power and experience is the greatest teacher.

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