

EBS/84/101
Supplement 1

CONFIDENTIAL

June 7, 1984

To: Members of the Executive Board

From: The Secretary

Subject: Jamaica - Staff Report for the 1984 Article IV Consultation
and Request for Stand-By Arrangement

The attached supplement to the staff report for the 1984 Article IV consultation with Jamaica and its request for a stand-by arrangement has been prepared on the basis of additional information. Revised draft decisions relating to the stand-by arrangement and the purchase transaction under the compensatory financing facility appear on page 7.

It is proposed to bring this subject, together with Jamaica's request for a purchase under the compensatory financing facility (EBS/84/102, 5/4/84), to the agenda for discussion on Friday, June 8, 1984.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. Chee Sung Lee (ext. (5)7167).

Att: (1)

INTERNATIONAL MONETARY FUND

JAMAICA

Staff Report for the 1984 Article IV Consultation
and Request for Stand-By Arrangement
Supplementary Information

Prepared by the Western Hemisphere and
Exchange and Trade Relations Departments

(In consultation with the Fiscal, Legal, Research,
and Treasurer's Departments)

Approved by E. Wiesner and W.A. Beveridge

June 6, 1984

I. Introduction

In a letter dated May 31, 1984 (attached) the Governor of the Bank of Jamaica informed the Managing Director of additional fiscal measures which became necessary in light of the expenditure plan contained in the central government budget for 1984/85 and the decision by the United States not to purchase additional bauxite for its strategic stockpile; such a purchase had been contemplated in the program described in EBS/84/101. In his letter, the Governor also reports on the actions taken by the Government of Jamaica to put into effect the measures which were to be implemented prior to Executive Board consideration of Jamaica's request for a stand-by arrangement.

The sections of the paper that follow present revised estimates of the Central Government's operations for 1983/84, modifications to the fiscal program for 1984/85 described in EBS/84/101, and the status of the prior actions. The modifications in the fiscal area do not alter the budget balance contemplated in the program.

II. Central Government Operations

1. Revised 1983/84 estimates

According to the revised estimates, the overall budget deficit for 1983/84 was equivalent to 17.5 percent of GDP, or 2.3 percentage points of GDP higher than had been reported in EBS/84/101 (Table 1).^{1/} The wider deficit reflected shortfalls in domestic revenue collections

^{1/} Including J\$34 million of bauxite levy corresponding to repayment on an advance of the levy in 1982/83.

Jamaica: Table 1. Summary of Central Government Operations

	1983/84			1984/85		
	Original Program	Est. Out- turn ¹ /	Revised Estimate	Original Program ¹ /	Net Changes	Revised Program
(In millions of Jamaica dollars)						
<u>Revenue</u>	<u>1,983</u>	<u>1,860</u>	<u>1,751</u>	<u>2,725</u>	<u>44</u>	<u>2,769</u>
Tax revenue	1,640	1,568	1,501	1,870	-15	1,855
Tax measures 1984/85	--	--	--	206	-1	205
Nontax revenue	146	98	76	98	55	153
Bauxite levy	197	194	174	551	-60	491
Grants (cash)	--	--	--	--	25	25
Grants (in kind)	--	--	--	--	40	40
<u>Expenditure</u>	<u>2,639</u>	<u>2,910</u>	<u>2,958</u>	<u>3,354</u>	<u>44</u>	<u>3,398</u>
Current expenditure	2,136	2,394	2,420	2,789	41	2,830
Wages and salaries	(934)	(967)	(967)	(1,097)	(-36)	(1,061)
Interest	(607)	(780)	(802)	(1,067)	(--)	(1,067)
Subsidies	(--)	(99)	(99)	(85)	(-40)	(45)
Operating and maintenance	(263)	(185)	(189)	(185)	(74)	(259)
Other	(332)	(363)	(363)	(355)	(3)	(358)
Transfers (in kind)	(--)	(--)	(--)	(--)	(40)	(40)
Capital expenditure	503	516	538	565	3	568
<u>Overall balance</u>	<u>-656</u>	<u>-1,050</u>	<u>-1,207</u>	<u>-629</u>	<u>--</u>	<u>-629</u>
(In percent of GDP)						
<u>Revenue</u>	<u>31.0</u>	<u>26.9</u>	<u>25.3</u>	<u>32.8</u>	<u>0.5</u>	<u>33.3</u>
Domestic	27.9	24.1	22.8	26.2	0.5	26.7
Bauxite levy and grants	3.1	2.8	2.5	6.6	--	6.6
<u>Expenditure</u>	<u>41.3</u>	<u>42.1</u>	<u>42.8</u>	<u>40.4</u>	<u>0.5</u>	<u>40.9</u>
Current expenditure	33.4	34.6	35.0	33.6	0.5	34.1
Wages and salaries	(14.6)	(14.0)	(14.0)	(13.2)	(-0.4)	(12.8)
Interest	(9.5)	(11.3)	(11.6)	(12.9)	(--)	(12.9)
Subsidies	(--)	(1.4)	(1.4)	(1.0)	(-0.5)	(0.5)
Operating and maintenance	(4.1)	(2.7)	(2.7)	(2.2)	(0.9)	(3.1)
Other	(5.2)	(5.2)	(5.2)	(4.3)	(--)	(4.3)
Transfers (in kind)	(--)	(--)	(--)	(--)	(0.5)	(0.5)
Capital expenditure	7.9	7.5	7.8	6.8	--	6.8
<u>Overall balance</u>	<u>-10.3</u>	<u>-15.2</u>	<u>-17.5</u>	<u>-7.6</u>	<u>--</u>	<u>-7.6</u>

Source: Ministry of Finance and Planning.

^{1/} As presented in EBS/84/101.

and receipts from the bauxite levy, as well as higher payments for interest and for investment. The larger deficit was financed by domestic bank credit.

2. Summary of the modified 1984/85 program

Compared with the program presented in EBS/84/101, the budget for 1984/85, which was made public on May 24, 1984, included additional expenditures of J\$63 million and projected that revenues would be J\$75 million smaller. The latter reflected reductions in projected income tax receipts of J\$15 million and bauxite levy receipts of J\$60 million.

In order to assure that the budget deficit would not exceed 7.6 percent of GDP, the Jamaican authorities have secured additional cash grants of J\$25 million from foreign sources and have taken additional revenue measures which are projected to yield at least J\$55 million. They have also decided to reduce the expenditure by J\$60 million from the figure presented in the budget. The original and the revised programs for central government operations in 1984/85 are compared in subsections (a) and (b) below and in Table 1.

Since the elaboration of the original program, it also has become known that an additional food grant of J\$40 million will be provided in kind by the United States, to be delivered free of charge to certain groups of the population through a food-stamp program; the effects of this grant are included in Table 1 under both revenue and expenditure.

a. Revenue and grants

The tax package of about J\$200 million has been implemented as agreed, although its composition has been altered to include higher taxes on beer and spirits and lower taxes on the tourist industry, telephone service, and certain licenses. As has been noted, projected revenue from income taxes has been reduced by J\$15 million and from the bauxite levy by J\$60 million. The latter is related to the decision by the United States not to purchase additional bauxite for its strategic stockpile, and the former reflects implementation of the first stage of a tax reform program, originally contemplated for 1985/86, which raises exemptions for low income wage earners.

To help ensure that the overall budget deficit in 1984/85 does not exceed 7.6 percent of GDP, the authorities have decided to take a number of compensatory revenue measures, as reported in the attached letter, and also have obtained additional cash grants of J\$5 million from various donor countries and J\$20 million from the economic support fund (ESF) of the United States. The measures to bolster revenues could yield up to J\$113 million, but the projections in Table 1 assume that these measures will yield J\$55 million in 1984/85, thereby providing some safety margin in the program. The measures include: (1) sales of assets, involving five hotels and publicly-owned land, valued by the authorities at nearly J\$160 million, of which as much as J\$26 million might be received during

1984/85; (2) significant increases, already approved, of a number of court fines (including traffic violations) and the collection of fines recently imposed for violations of the exchange control law, with an estimated yield of up to J\$18 million; (3) user charges and fees are being increased by substantial amounts and could yield up to J\$13 million; (4) the state-owned petroleum company will reduce its investment program in order to repay J\$25 million against an advance received from the government in 1982 for the purchase of the local oil refinery; and (5) proceeds from commodities bartered against bauxite for the U.S. stockpile last year would be brought forward with a potential yield of up to J\$31 million in 1984/85.

b. Expenditures

In addition to the transfer payments corresponding to the J\$40 million of food grant from the United States, the revised program includes an increase of J\$80 million in outlays on goods, services, and transfers, compared with the original program, including a provision of J\$20 million for an exchange rate guarantee to foreign airlines on local ticket sales in 1983 and substantially higher rent payments. These expenditure increases are to be offset by reductions of J\$36 million in planned outlays for wages and salaries, which result from widening the scope of the program to curtail employment from about 6,000 in the central government to about 11,000 throughout the public sector, and reductions of J\$40 million in subsidies, reflecting an accelerated schedule of price increases for imported basic foods and the food aid which will be provided in kind from the United States.

III. Prior Actions

The program described in EBS/84/101 was predicated on a number of specific actions to be taken prior to Executive Board consideration of Jamaica's request for a stand-by arrangement. The prior actions have now been taken except that confirmation is still needed in respect of the refinancing of short-term liabilities to Trinidad and Tobago amounting to some US\$55 million, although it should be added that the Trinidadian authorities had earlier proposed to refinance one half of those liabilities. The outstanding debt with medium-term maturities owing to Trinidad and Tobago (US\$41 million) would be refinanced through the Paris Club arrangement.

In addition to action in regard to the central government budget described above, electricity rates were increased by 54 percent effective May 1. This increase would provide some J\$150 million in incremental revenues during the program period and would be sufficient to bring the financial operations of the electricity company into line with the program objectives. It has also been announced that telephone tariffs will be raised by 50 percent for domestic calls and 100 percent for international calls effective July 1, and that a further 50 percent

increase in domestic rates will take effect next January. These new telephone rates would yield additional resources of J\$70-80 million during the program year.

As regards price subsidies, the prices of 8 out of 12 imported basic food items have been raised by 45 percent to 160 percent. The prices of the remaining four items are to be raised in the next few weeks when new supplies arrive, on the basis of which budget subsidies would be reduced by about half, compared with the original program for 1984/85. In addition, at the end of May the domestic price of brown sugar was raised 36 percent while the prices of other grades of sugar were decontrolled.

An exchange rate regime based on a bi-weekly auction and an adjustable band is now in operation. Following a technical review by the staff in April, the Bank of Jamaica (BOJ) excluded from the auction all payments that fell due before February. These were placed in an arrears scheme, with counterpart deposits in the BOJ by end-May. The staff agrees that this was a necessary step. At the same time, however, the authorities excluded all service payments from the auction pending revalidation by the BOJ, and delayed the entry of bids for the opening of cash letters of credit for three-four weeks, during which time the BOJ sought an undertaking from commercial banks to match any foreign exchange obtained from the auction for letters of credit with exchange from correspondent banks abroad. These actions reduced demand for foreign exchange in the auction, but in the last two weeks bids for current payments have been readmitted. The BOJ for a time also sold lines of credit in the auction and provided an exchange rate guarantee; this has now been discontinued because of the risk that such guarantees might give rise to a multiple currency practice. A forward market was established recently.

After depreciating to J\$4.11 per U.S. dollar in early May, the Jamaica dollar subsequently appreciated and has remained at J\$3.85 per U.S. dollar in the auctions of the last two weeks.

Among the other prior actions, the modifications to the trade and licensing system have been implemented, the bauxite companies have agreed to the new levy regime, a meeting of the Paris Club tentatively has been set for the second half of July, and confirmation has been received on a loan from a private U.K. company. Creditors outside the Paris Club have been approached for refinancing on the same terms as Paris Club members. It is expected that the commercial bank refinancing arrangement will be concluded around mid-June.

IV. Staff Appraisal

The staff supports Jamaica's request for a stand-by arrangement on the basis of the program described in EBS/84/101 as modified by the attached letter.

The recent policy adaptations are consistent with the basic thrust of the original program as set out in EBS/84/101 and appear to provide a certain margin of safety. No modifications are needed in respect of phasing or performance criteria. All domestic prior actions have been implemented. At this time no change in the draft decision is recommended, but an amendment will be necessary in the event that the refinancing of certain short-term liabilities referred to above is not confirmed prior to Executive Board consideration of Jamaica's request for a stand-by arrangement. In such an event the staff would recommend Board approval of the stand-by arrangement in principle only, and would propose a revision in the draft decision related to the stand-by arrangement, which appears on page 30 of EBS/84/101. This in turn would have the further consequence of a revision in the draft decision on page 16 of EBS/84/102 relating to Jamaica's compensatory financing request, which is expected to be considered concurrently with the request for the stand-by arrangement. The revised texts of the two draft decisions are:

Proposed Decisions

Stand-by Arrangement

1. The Government of Jamaica has requested a stand-by arrangement for the period of a year following its effective date for an amount equivalent to SDR 64 million.

2. The Fund approves the stand-by arrangement set forth in EBS/84/101, which shall become effective on the date, but not later than June 20, 1984, on which the Fund finds that satisfactory arrangements have been made for the refinancing of certain short-term liabilities.

3. The Fund waives the limitation in Article V, Section 3 (b)(iii).

Compensatory Financing Facility

1. The Fund has received a request by the Government of Jamaica for a purchase of SDR 72.6 million under the Decision on Compensatory Financing of Export Fluctuations (Executive Board Decision No. 6224-(79/135), adopted August 2, 1979, as amended).

2. The Fund notes the representation of Jamaica and approves the purchase in accordance with the request, as of the date on which the stand-by arrangement set forth in EBS/84/101 becomes effective.

3. The Fund waives the limitation in Article V, Section 3(b)(iii).

Kingston, Jamaica
May 31, 1984

Mr. Jacques de Larosière
Managing Director
International Monetary Fund
700 19th Street, N.W.
Washington, D.C. 20431

Dear Mr. de Larosière:

I refer to the request of the Government of Jamaica for a stand-by arrangement with the International Monetary Fund as set out in the letter of intent of April 29, 1984, and more particularly, to recent discussions with Fund Staff on certain fiscal issues including the implications of the decision by the Government of the U.S.A. to support an alternative programme to the stockpile proposal. The outcome of these conversations has been a requirement for further adjustment measures by Jamaica to maintain the integrity of the programme. I am to advise you that my Authorities have agreed to undertake the action described in subsequent paragraphs.

The overall expenditure of the Budget for Fiscal Year 1984/85, (presented to the legislature by the Prime Minister on May 24, 1984) will be scaled down by J\$60.5 million. The Current Account adjustment will be J\$51.5 million, of which 63 percent relates to Operating and Maintenance expenses and 23 percent to transfers. The Capital Account would be reduced by J\$9.0 million. The details have been forwarded to Fund Staff.

To reinforce the fiscal programme, a number of supplementary financial measures will be implemented at once. Discussions have been initiated with the U.S. Government to ensure that the outstanding food barter arrangement under the 1983 stockpile programme is advanced to Fiscal Year 1984/85. The Government has approved a programme within the policy for privatisation, for accelerating the sale of Government-owned capital assets, including five hotels. The target date for completion is December 1985.

Finally, user charges for a number of services will be increased, including rates applicable in rural areas for irrigation and potable water, fees for Public Passenger Transport franchises, fees for the services provided to the business community by the Standards Bureau, and charges for Registration Plates and Cards for motor vehicles. The resource target of J\$118 million will provide margins against possible slippage in revenue flows.

I attach a report on the current status of the measures to be acted on prior to Board approval. Supporting evidence as needed, is in the hand of Fund Staff.

Yours sincerely,

/s/
H.G. Barber
Governor

Enclosure

Prior Action Measures

This memorandum sets out the actions taken by the Government of Jamaica in regard to the understandings set out in the memorandum to Fund staff dated March 23, 1984 and entitled "Measures to be taken prior to Board approval of the stand by arrangement."

Tax package: Tax measures to yield revenues of J\$204.5 million were approved by the cabinet and announced by the Government over a period terminating with the Budget statement of the Prime Minister on May 24, 1984.

Budget - F.Y. 1984/85: The estimates of expenditure for F.Y. 1984/85 were tabled in the House of Representatives on May 10, 1984 and presented to the legislature by the Prime Minister on May 24, 1984.

Treasury Bill Ceiling: The legislature approved the increase in the limit on Treasury Bills from J\$500 million to J\$750 million on March 27, 1984.

Sugar Sector: The restructuring of the operations of the National Sugar Company was set out in a letter dated May 2, 1984 from the Prime Minister and forwarded to the Fund staff by letter of May 14, 1984. The increase in the Domestic price of sugar was approved by the Government on May 21, 1984 and announced on May 29, 1984.

Electricity Tariffs: The fuel oil subsidy of some J\$100 million a year to the Jamaica Public Service Company was terminated on May 1, 1984. At the same time, electricity tariffs, including the fuel clause, have been adjusted to reflect the incremental costs to the electric utility arising from the removal of the subsidy and the devaluation of the exchange rate. The increase in charges to the consumers averages 54 per-cent.

Telephone Rates: The Jamaica Telephone Company has modified the investment programme for the period through 1985. The Government has approved increases in telephone rates as follows:

- (a) 50 percent increase in rates for domestic calls and 100 percent increase in rates for outgoing overseas calls, effective from July 1, 1984;
- (b) 50 percent increase in rates for outgoing calls effective January 1, 1985.

Food Subsidy and Prices for Basic Commodities: Price adjustments have been implemented for all basic commodities and related end products with the exception of Animal Feed, Baking Flour, Mackerel and Saltfish. The latter four commodities and related end products await the arrival of new supplies at which time the relevant price adjustments will take place.

Exchange System: A Fund mission has evaluated the exchange system and modifications mutually agreed with Fund staff and management, have been implemented.

Trade and Licencing System: The agreed modifications have been implemented.

Bauxite Levy Arrangements: The new levy arrangements have been confirmed by the companies and are in effect.

Refinancing Arrangements Trinidad and Tobago and Venezuela:

In July 1983, the Prime Minister of Jamaica forwarded proposals to the Prime Minister of Trinidad and Tobago seeking a four year repayment of the outstanding debt of US\$96.0 million. Counter proposals were made for payment of US\$48.0 million in the F.Y. 1984/85. These discussions were overtaken by the Fund negotiations and the subsequent decision to approach the Paris Club for debt relief. Jamaica understands that Paris Club guidelines require broadly comparable treatment by Government creditors who are not members of the Paris Club. The Government of Trinidad has been informed of this development and the Paris Club Secretariat has been requested to write the Government of Trinidad to participate in the forthcoming discussions.

In early February 1984, refinancing proposals were put to the Central Bank of Venezuela for the outstanding debt payments of US\$73.0 million. The proposals called for an outlay of US\$30.0 million in 1984/85 and compares with the standby programme assumption of US\$36.5 million which was included in the Foreign Exchange Budget. The Quarterly profiles are however, very different. The Central Bank of Venezuela has accepted the initial proposals. However, the decision to proceed to the Paris Club with the understanding that Non OECD government creditors should also provide broadly comparable treatment, has overtaken these discussions. The Venezuelan Government has been informed of the current status and the Paris Club Secretariat has been asked to invite the Venezuelan Government to participate in the forthcoming discussions.

Austin Blades Credit: The Austin Blades group has confirmed by telex of May 25, 1984, the availability of a medium term loan of US\$30 million, subject to the completion of legal documents.

Commercial Bank Refinancing: The major creditors met on Monday, May 7, 1984 and agreed to conclude the refinancing arrangements given acceptance of the letter of intent for a standby arrangement, by the management of the Fund. The Bank of Nova Scotia (the coordinating bank) has reported that the programme is on track.

Paris Club Refinancing: A formal request for debt relief has been submitted to the Paris Club Secretariat. A meeting is to be arranged by the Secretariat in the second half of the month of July 1984.

Forward Exchange Market: The guidelines for the Forward Exchange Market were implemented on May 28, 1984.

Liquid Asset Ratio: The Cabinet approved the amendment of the Bank of Jamaica Act to raise the ceiling on liquid assets ratio of commercial banks to fifty percent of deposit liabilities. The necessary legislative action is in process.

Bauxite Stockpile: The United States Government has supported an alternative financial programme. The implementations for the fiscal programme F.Y. 1984/85, including appropriate expenditure adjustment measures, have been reported to the Fund.

New Money from Commercial Banks: The proposal for new money of US\$7.5 million was explained to the major creditors at the meeting of May 7, 1984 and accepted. Banque Paribas would associate itself with the proposal on a "best efforts" basis.

H.G. Barber
Governor, Bank of Jamaica

May 30, 1984