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**FOR
AGENDA**

EBS/84/233

CONFIDENTIAL

November 19, 1984

To: Members of the Executive Board

From: The Secretary

Subject: Jamaica - Review Under Stand-By Arrangement and Request
for Waiver of Performance Criteria

Attached for consideration by the Executive Directors is the staff report for a review under the stand-by arrangement for Jamaica and a request for waiver of its performance criteria. A draft decision appears on page 24.

This subject will be brought to the agenda for discussion on a date to be announced.

If Executive Directors have technical or factual questions relating to this paper prior to the Board discussion, they should contact Mr. Hardy (ext. (5)7158).

Att: (1)

INTERNATIONAL MONETARY FUND

JAMAICA

Review under Stand-by Arrangement and Request for Waiver
of Performance Criteria

Prepared by the Western Hemisphere and Exchange
and Trade Relations Departments

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

Approved by E. Wiesner and S. Kanesa-Thanan

November 16, 1984

I. Introduction

On June 8, 1984, the Executive Board approved in principle a 12-month stand-by arrangement for Jamaica (EBS/84/101 and Supplements 1-6) in the amount of SDR 64 million (44 percent of quota), which became effective on June 22, 1984. In their letter of April 25, 1984, the Jamaican authorities indicated that they would complete reviews with the Fund by September 30 and December 31, 1984 on the progress made in implementing the policies affecting demand management and the exchange system. The completion of these reviews is a performance criterion under the program.

A staff mission, consisting of Messrs. Hardy (Head), Escobar, Fajgenbaum, and Gronlie (all WHD), Mr. Nowak (ETR), Ms. Cheasty (EP-WHD), and Ms. McLeod (Secretary-WHD), visited Jamaica during July 26-August 3, 1984 to examine performance under the program during the April-June quarter and assess the prospects for the remaining months of the program, which covers the Jamaican fiscal year from April 1, 1984.

Discussions were held with the Prime Minister, who is also Minister of Finance and Planning, the Governor of the Bank of Jamaica, and other senior officials. Members of the mission also met with representatives of the private sector, including the banking community. Mr. Douglas Shaw, Advisor to the Executive Director for Jamaica, participated in several of the discussions. The mission was assisted by Mr. Chee Sung Lee, the Fund's resident representative in Kingston. Discussions with the Jamaican authorities continued at headquarters in a number of meetings during August, September, October, and November.

Jamaica has made the two purchases totaling SDR 18 million available under the stand-by arrangement prior to completion of the current review, including SDR 3.4 million which was purchased on August 1, 1984

on the basis of observance of performance targets at the end of June (Table 1). On June 26, 1984, Jamaica also purchased SDR 72.6 million under the compensatory financing facility. Jamaica has frequently experienced difficulty in remaining current with the Fund within the past two years and has been overdue on payments for periods ranging from a few days to eight weeks. In recent months delays have been of very brief duration, and Jamaica is at present current with the Fund.

II. Background and the 1984/85 Stand-by Program 1/

Jamaica has suffered from severe internal and external imbalances since the early 1970s, mainly due to a sharp increase in public expenditure, which led to chronically large fiscal deficits, strong inflationary pressures, a prolonged contraction in economic activity, recurring balance of payments crises, and a large buildup of external debt. Since 1973, the Fund has approved several arrangements with Jamaica, the most recent being an extended arrangement for 430 percent of quota in 1981, which was interrupted in 1983 following failures to comply with the program targets.

The program under the current stand-by arrangement calls for a major strengthening of the adjustment effort, based on a tightening of demand management, pursuit of a market-determined exchange rate, and action to liberalize the trade regime together with other measures to encourage export-led growth. It includes large-scale restructuring of external debt and seeks the restoration of Jamaica's creditworthiness through the elimination of arrears and a rebuilding of liquid international reserves to the equivalent of about five weeks of projected 1984/85 imports.

The program provides for a reduction in the central government deficit equivalent to about 10 percentage points of GDP and a substantial cutback in recourse to domestic credit by the selected public entities. The fiscal measures are reinforced by a credit program which limits the expansion of banking system credit to the private sector to 12 percent. On that basis, the current external deficit was projected to decline to 6.4 percent of GDP from 13 percent in 1983/84.^{2/} At the same time, inflation was projected to average nearly 20 percent for the year as a whole due to adjustments in administered prices, the reduction or elimination of subsidies on a wide range of imported foods, and the effects of exchange rate depreciation; economic growth would remain below 1 percent (slightly less than in the previous two years).

1/ A more detailed description of the program and of economic developments in recent years is provided in EBS/84/101, EBS/84/101 Supplement 1, and SM/84/111.

2/ Revised GDP estimates for 1983/84 show that the current account deficit was 12.1 percent of GDP. However, the projected drop to 6.4 percent in 1984/85 remains unchanged, due to a larger depreciation of the Jamaica dollar than had originally been projected.

Table 1. Jamaica: Projection of Fund Position During Period of Stand-by Arrangement: April 1984 - April 1985

	Out- standing Apr. 30 1984	1984			1985	
		May- June	July- Sept.	Oct.- Dec.	Proj. Jan.- Mar.	April
(In millions of SDRs)						
Transactions under tranche policies (net) <u>1/</u>		9.4	-5.5	-4.9	2.8	8.3
Purchases		14.6	3.4	10.0	18.0	18.0
Ordinary resources		(14.6)	(3.4)	(10.0)	(18.0)	(18.0)
Enlarged access resources		(--)	(--)	(--)	(--)	(--)
Repurchases		-5.2	-8.9	-14.9	-15.2	-9.7
Ordinary resources		(-1.3)	(-5.1)	(-6.8)	(-5.1)	(-5.5)
Enlarged access resources		(-3.9)	(-3.9)	(-8.1)	(-10.1)	(-4.2)
Transactions under special facilities (net) <u>2/</u>		68.6	-6.6	-2.6	-2.6	-2.6
Purchases		72.6	--	--	--	--
Repurchases		-4.0	-6.6	-2.6	-2.6	-2.6
Total Fund credit outstanding (end of period)	584.9	662.9	650.8	643.3	643.5	649.2
Under tranche policies <u>1/</u>	536.8	546.2	540.7	535.8	538.6	546.9
Special facili- ties <u>2/</u>	48.1	116.7	110.1	107.5	104.9	102.3
(In per cent of quota)						
Total Fund credit outstanding (end of period)	402.0	455.6	447.3	442.1	442.3	446.2
Under tranche policies <u>1/</u>	368.9	375.4	371.6	368.2	370.2	375.9
Special facili- ties <u>2/</u>	33.1	80.2	75.7	73.9	72.1	70.3

Source: International Monetary Fund.

1/ Ordinary and enlarged access resources.

2/ Compensatory Financing Facility.

In late 1983 and early 1984, the Jamaican authorities adopted a wide range of adjustment measures. In November 1983 the dual exchange rate system was unified, with the rate constrained by an adjustable band and determined in an auction in which the local banks participated. The band was set initially at J\$3.00-J\$3.15 per U.S. dollar. This compared with a rate of J\$1.78 per U.S. dollar in January 1983 when the dual market system was instituted, and a parallel market rate of J\$2.96 per U.S. dollar before unification. A new auction mechanism with wider participation was adopted in March 1984, whereby the rate vis-a-vis the U.S. dollar is set twice a week in auctions conducted by the Bank of Jamaica. Movements in the rate continue to be constrained by a band, which is adjusted if there is persistent excess demand for foreign exchange in the auction. From March 20, 1984, when the broader auction system became operational, to May 3, the band was adjusted on four occasions from J\$3.25-J\$3.55 per U.S. dollar to J\$3.85-J\$4.15 per U.S. dollar. It then remained unchanged until late September, but subsequently was adjusted four times to reach to J\$4.45-J\$4.75 4.60 per U.S. dollar in early November (Chart 1).

In order to reduce the central government budget deficit, tax measures projected to yield about 2.5 percent of GDP were implemented before Board approval of the program, and cuts were made in planned current and capital outlays. A program for reducing the government payroll was initiated, and price adjustments were made to reduce budgetary subsidies on imported basic foods, which had been introduced in November 1983 to offset the impact on prices of the depreciation of the Jamaica dollar.

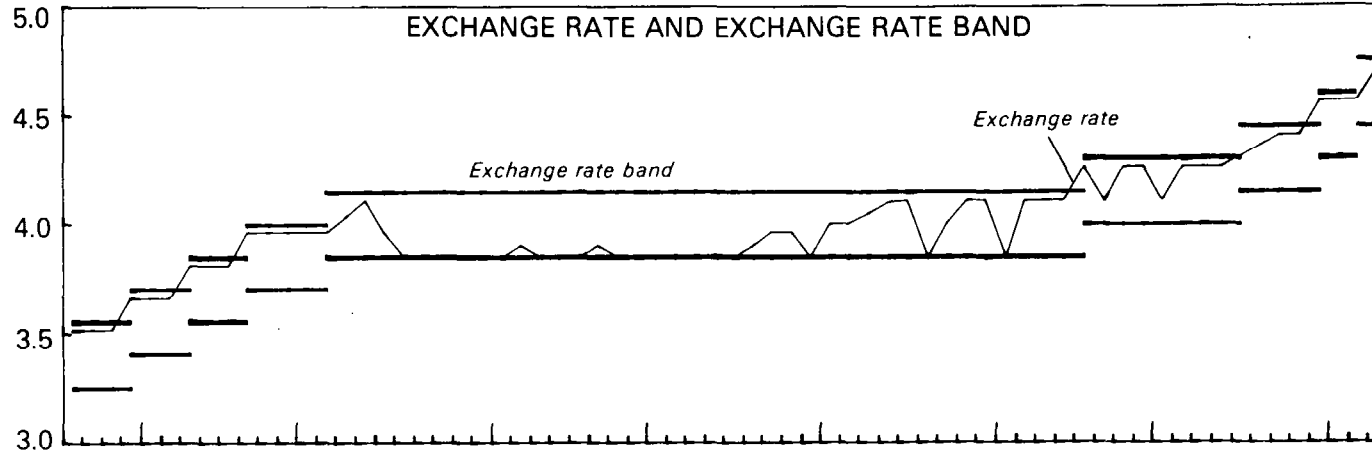
To strengthen the financial position of the rest of the public sector, utility rates and administered prices were raised substantially: electricity rates by 40 percent in January and a further 54 percent on May 1, 1984, water rates by 69 percent in November 1983, gasoline prices by 100 percent on January 1, 1984 (following an increase of 29 percent in June 1983), and domestic and overseas telephone rates by 50 percent and 100 percent, respectively, effective from July 1, 1984.

Credit policies were tightened in February-March 1984 through doubling to 10 percent the commercial banks' cash reserve requirement, an increase in the liquid assets ratio (which allocates credit between the Central Government and the rest of the economy) from 36 to 40 percent for commercial banks and from 10 to 15 percent for certain other financial intermediaries, and by the institution of a temporary deposit scheme designed to sterilize the local currency counterpart of the external payment arrears of the private sector. Selective measures were designed to prevent the restrictive credit policies from unduly constraining the manufacturing and export sectors, and consumer credit was to be reduced in absolute terms. The reactivation of the World Bank financed Export Development Fund (EDF) and the provision of US\$35 million under the IDB Industrial Rehabilitation loan were expected to help support the manufacturing and export sectors. The minimum interest rate on savings deposits was raised by 2 percentage points to 11 percent.

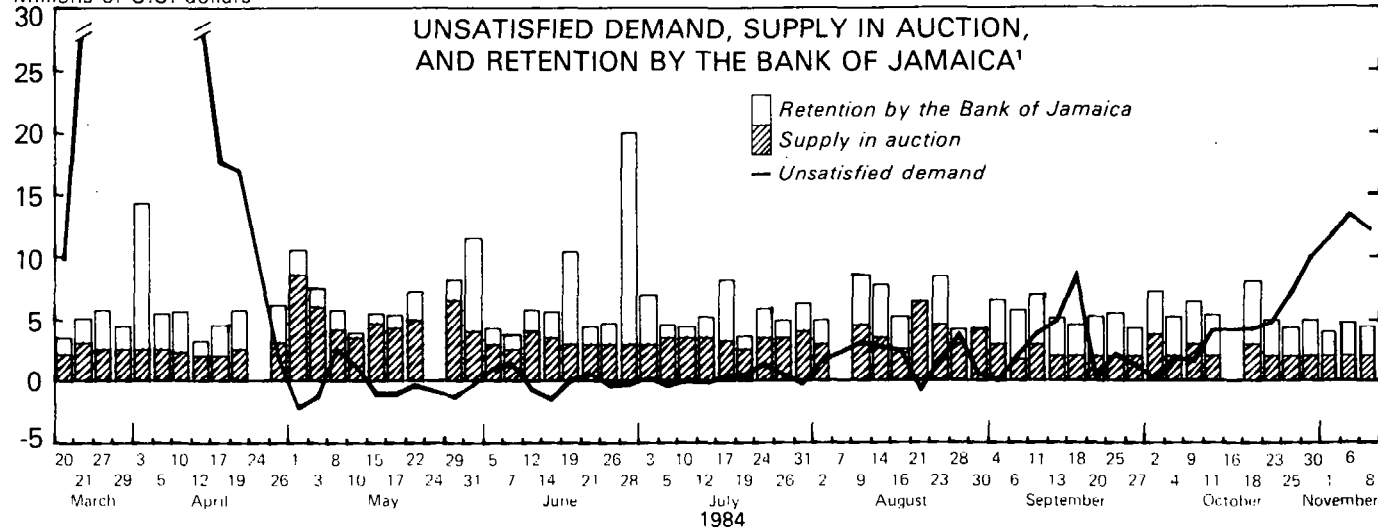
CHART 1
JAMAICA

FOREIGN EXCHANGE AUCTION

Jamaica dollars per U.S. dollars



Millions of U.S. dollars



¹In April, all bids corresponding to imports cleared or service payments due before end February 1984 were removed from the auction and funded by the Bank of Jamaica according to a payment schedule for arrears.

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Quantitative restrictions on external trade were relaxed prior to Board consideration of the arrangement; quotas were lifted on a wide range of imports, leaving about one quarter of total nonoil, nonbauxite sector imports subject to quantitative restrictions or state trading. At the time the arrangement was approved by the Board, debt restructuring was being discussed with the Paris Club and other bilateral creditors, and with commercial banks. Most of this rescheduling has now been completed.

III. Report on Discussions

The discussions with the authorities focused on the progress made in implementing the 1984/85 program and on the adequacy of existing policies for achieving the program objectives. A number of weak areas were identified, and the staff encouraged the authorities to take further action to ensure compliance with the program for the remaining period, and to allow for the required exchange rate flexibility.

1. Output and inflation

The forecast for the growth of nominal GDP in 1984/85 has been raised to 24 percent from 20 percent. Output is now expected to remain flat, compared with a growth of nearly 1 percent envisaged under the program. During April-August consumer prices were more than 30 percent higher than in the corresponding months of the previous year, and inflation for the program year is now expected to be 25 percent rather than 19 percent as previously projected (Table 2).

2. The external sector

a. Balance of payments developments

Earnings from exports and tourism (net) had been projected to increase by about 22 percent in U.S. dollar terms during the program year, including a purchase of 1 million tons of bauxite by the U.S. Government for its strategic stockpile; earnings from exports and tourism are now projected at US\$1,188 million, an increase of only 9 percent, and some US\$112 million below the original projection. Shortly before Board consideration of the program, the Fund had been informed that the strategic stockpile purchase (which had been estimated at US\$30 million) would not take place, but the net foreign exchange impact would be offset by additional external grants from the United States.^{1/} Other domestic exports are now projected to be US\$63 million lower than under the original program (Table 3), reflecting a three-month closure of the Alpart alumina plant because of a labor dispute, a sharp downward revision for exports of sugar and bananas because of lower domestic production, and a slower than expected growth of exports to CARICOM. Nontraditional

^{1/} The Board was notified in EBS/84/101, Supplement 1, that the sale of bauxite for the stockpile would not proceed.

Table 2. Jamaica: Selected Economic Indicators

	1981/82	1982/83	Revised 1983/84	1984/85	
				Program	Revised
(In millions of Jamaican dollars)					
Nominal GDP	5,425.3	6,042.8	7,296.4	8,293.0	9,039.2
(Percentage change)					
Nominal GDP	22.5	11.4	20.7	19.9	23.9
Real GDP	2.2	0.9	1.4	0.8 <u>1/</u>	—
GDP deflator	19.9	10.4	19.0	18.9 <u>1/</u>	23.9
Consumer prices (period average)	9.0	7.1	14.9	19.4	25.0
Exports and tourism receipts <u>2/</u>	-4.1	-12.6	1.9	21.9	8.9
Domestic exports <u>2/</u>	-12.0	-18.8	-3.4	23.4	9.9
Traditional exports	(-14.1)	(-27.0)	(1.2)	(20.9)	(-12.8)
Nontraditional exports	(5.5)	(19.0)	(-16.2)	(31.8)	(25.4)
Tourism receipts (net) <u>2/</u>	30.4	5.6	73.8	19.1	6.9

1/ Percentage changes as in the original program based on estimated data for 1983/84.

2/ Measured in U.S. dollars.

Table 3. Jamaica: Exports, f.o.b.

		Rev.	April-Aug.		1984/85	
	1982/83	1983/84	1983	1984	Orig. Prog.	Rev.
(In million of U.S. dollars)						
<u>Total Exports</u>	<u>734.2</u>	<u>700.1</u>	<u>299.3</u>	<u>340.3</u>	<u>870.3</u>	<u>801.5</u>
<u>Domestic Exports</u>	<u>713.2</u>	<u>689.0</u>	<u>291.2</u>	<u>333.3</u>	<u>850.3</u>	<u>757.5</u>
Bauxite/alumina	472.8	465.5	168.8	220.8	563.1	502.5
Bauxite	(137.2)	(143.1)	(44.3)	(72.2)	(178.9) ^{1/}	(132.0)
Alumina	(335.6)	(322.4)	(124.5)	(148.6)	(384.2)	(370.5)
Sugar	49.7	62.6	38.8	30.2	65.2	55.5
Bananas	4.9	5.4	3.6	1.3	17.0	4.5
Non-traditional	185.8	155.5	80.0	81.0	205.0	195.0
To CARICOM	(80.5)	(67.3)	(38.9)	(23.9)	(75.0)	(60.0)
To other markets	(105.3)	(88.2)	(41.1)	(57.1)	(130.0)	(135.0)
<u>Re-exports</u>	<u>21.0</u>	<u>11.1</u>	<u>8.1</u>	<u>7.0</u>	<u>20.0</u>	<u>44.0</u>
(Volume)						
Bauxite (million metric tons)	3.37	4.22	1.26	2.12	5.11	3.77
Alumina (million metric tons)	1.85	1.80	0.76	0.70	1.97	1.90
Sugar (thousand metric tons)	149.0	166.0	90.8	78.0	165.0	154.0
Bananas (thousand metric tons)	21.0	21.0	10.2	4.4	46.8	17.8
(Unit price: U.S. dollar per metric ton)						
Bauxite	40.7	33.9	35.1	34.1	35.0	35.0
Alumina	181.4	179.1	163.8	212.3	195.0	195.0
Sugar	333.6	377.1	427.3	387.1	395.2	360.4
Bananas	233.3	257.1	352.9	295.4	363.2	252.8
(Value: percentage annual change)						
<u>Domestic Exports</u>	<u>-18.8</u>	<u>-3.4</u>		<u>14.4</u>	<u>23.4</u>	<u>9.9</u>
Bauxite/Alumina	-29.3	-1.5		30.8	21.0	7.9
Bauxite	(-9.9)	(4.3)		(62.9)	(25.0)	(-7.7)
Alumina	(-35.1)	(-3.9)		(19.4)	(19.1)	(14.9)
Sugar	2.3	26.0		-22.1	4.2	-11.3
Bananas	-2.0	10.2		-63.9	214.8	-16.7
Non-traditional	19.0	-16.3		1.3	31.8	25.4
To CARICOM	(11.8)	(-16.4)		(-38.6)	(11.4)	(-10.8)
To other markets	(25.1)	(-16.2)		(38.9)	(47.3)	(53.1)

Source: Bank of Jamaica; and Fund staff estimates and projections.

^{1/} Includes expected strategic stockpile purchase by U.S. Government.

exports to other markets have risen very strongly and are now projected to increase by over 50 percent in 1984/85. Partly offsetting the export shortfall, a sale and lease-back arrangement of aircraft is expected to result in a one-time increase in re-exports of about US\$24 million.

In the period April-August 1984 the number of tourist arrivals was in line with program projections, but the average length of stay and per diem expenditure by tourists were lower than programmed. As a result, net travel receipts for the year as a whole are now expected to be US\$386 million, US\$44 million less than originally projected (Table 4).

Despite the export shortfall, the current account is still expected to remain on target as imports are now projected at US\$1,190 million, some 7 percent (US\$115 million) lower than had been originally projected, and US\$31 million less than the revised outturn for 1983/84. Apart from fuel imports, which are likely to be 6-8 percent lower than last year in volume, the new projection implies about the same import volume as in the previous year and is consistent with the tightening of credit and the depreciation of the Jamaica dollar that have taken place. So far, imports appear to be in line with the revised projections, as during April-August 1984 imports amounted to US\$510 million, which was 4 percent lower than in the corresponding period of 1983.

Overall public capital flows are likely to be on target, as greater than anticipated refinancing would offset shortfalls in other disbursements. At the time the financial program for 1984/85 was approved by the Executive Board, official capital inflows were projected at US\$1,042 million, including a financing gap of US\$274 million, to be closed through refinancing (Table 5). This gap has now been closed as a result of (1) the consolidation in July by Paris Club creditors into medium-term debt of principal and interest payments of US\$93 million falling due in 1984/85 and of arrears outstanding at end-March 1984 of US\$23 million; 1/ (2) the rescheduling in late June of all principal payments falling due to commercial banks between July 1983 and March 1985 amounting to US\$164 million; (3) the rescheduling by Mexico of US\$25 million of arrears and short-term debt, and US\$16 million of payments on medium-term debt falling due in 1984/85; and (4) the rescheduling by Venezuela of US\$97 million of payments, including US\$37 million of previously rescheduled arrears and penalty interest which had been expected to fall due in 1984/85, and some US\$20 million in payments relating to the oil facility; the latter were consolidated into 366-day credits.

In accordance with the terms of the Paris Club agreement, Jamaica is also seeking debt relief from nonparticipating official creditors on comparable terms; if successful, this would yield an additional US\$19 million in debt relief during 1984/85. The total amount of debt relief

1/ A full description of the terms of the Paris Club debt renegotiation is contained in SM/84/203. Jamaica has now concluded the bilateral agreements with all participating countries except Switzerland and the United States.

Table 4. Jamaica: Balance of Payments

	1984/85			Proj.				
	Revised 1983/84	Original Program 1/	Revised Program 2/	1985/86	1986/87	1987/88	1988/89	1989/90
(In millions of U.S. dollars)								
<u>Current account</u>	<u>-271</u>	<u>-133</u>	<u>-131</u>	<u>-115</u>	<u>-100</u>	<u>-71</u>	<u>-79</u>	<u>-69</u>
Exports, f.o.b.	700	870	802	899	1,057	1,236	1,421	1,634
Bauxite	(465)	(563)	(502)	(593)	(713)	(806)	(926)	(1,064)
Other	(235)	(307)	(300) 2/	(306)	(344)	(430)	(495)	(570)
Imports	-1,221	-1,305	-1,190	-1,204	-1,250	-1,388	-1,618	-1,861
Oil	(-405)	(-412)	(-388)	(-400)	(-421)	(-444)	(-463)	(-490)
Other	(-816)	(-893)	(-802)	(-804)	(-829)	(-944)	(-1,155)	(-1,371)
Services/transfers	250	302	257	190	93	81	118	178
Travel (net)	(361)	(430)	(386)	(413)	(450)	(497)	(547)	(601)
Interest, official (net)	(-243)	(-262)	(-272)	(-309)	(-323)	(-337)	(-344)	(-353)
Other	(132)	(134)	(143)	(86)	(-34)	(-79)	(-85)	(-90)
<u>Capital (net)</u>	<u>-189</u>	<u>370</u>	<u>670</u>	<u>83</u>	<u>143</u>	<u>122</u>	<u>139</u>	<u>126</u>
Official	65	339	631	83	143	122	139	126
Inflows	(449)	(768)	(1,040)	(555)	(518)	(478)	(490)	(511)
Outflows	(-384)	(-429)	(-409)	(-472)	(-375)	(-356)	(-351)	(-385)
Domestic commercial banks	-15	14	20	—	—	—	—	—
Other private 3/	-239	17	19	—	—	—	—	—
<u>Overall balance</u>	<u>-460</u>	<u>237</u>	<u>539</u>	<u>-32</u>	<u>43</u>	<u>51</u>	<u>60</u>	<u>57</u>
<u>Financing</u>	<u>460</u>	<u>-237</u>	<u>-539</u>	<u>32</u>	<u>-43</u>	<u>-51</u>	<u>-60</u>	<u>-57</u>
Change in net international reserves	316	-283	-293 4/	-156	-188	-189	-204	-156
Gross reserves	(37)	(-88)	(-98)	(-38)	(-44)	(-25)	(-45)	(-60)
IMF	(39)	(58)	(58)	(-104)	(-130)	(-150)	(-159)	(-96)
Arrears 5/	(190)	(-190)	(-190)	(—)	(—)	(—)	(—)	(—)
Other	(50)	(-63)	(-63)	(-14)	(-14)	(-14)	(—)	(—)
Exceptional financing (net) 6/	144	-228	-246	—	—	—	—	—
Financing gap	—	274 7/	—	188	145	138	144	99
(In percent of GDP) 8/								
Current account deficit	12.1	6.4	6.4 9/	4.6	3.7	2.4	2.4	1.9

Sources: Bank of Jamaica; and Fund staff estimates.

1/ As presented in EBS/84/101.

2/ Includes re-exports of US\$24 million as a result of aircraft sale-lease back arrangement.

3/ Includes net errors and omissions.

4/ The increase in net international reserves is US\$10 million higher than in the original program due to a downward revision of the position at March 31, 1984.

5/ Overdue payments which are treated as reserve liabilities for program purposes.

6/ For details, see Table 5.

7/ Amount of refinancing required under original program.

8/ Calculated on the basis of the average shadow rate, i.e., the rate necessary to keep the real effective exchange rate constant at the 1970 level.

9/ Based on revised GDP.

Table 5. Jamaica: External Financing

(In millions of U.S. dollars)

	1984/85			Proj.		
	Revised 1983/84	Original Program	Revised Est.	1985/86	1986/87	1987/88
<u>Current account</u>	-271	-133	-131	-115	-100	-71
<u>Official capital inflows:</u>						
<u>new funds</u>	336	599	505	555	518	478
<u>Governments</u>	199	322	244	225	192	200
United States	(114)	(195)	(176)	(129)	(87)	(88)
United Kingdom	(6)	(7)	(5)	(...)	(...)	(...)
Canada	(12)	(22)	(7)	(...)	(...)	(...)
West Germany	(4)	(7)	(4)	(...)	(...)	(...)
Netherlands	(3)	(6)	(3)	(...)	(...)	(...)
France	(13)	(12)	(5)	(...)	(...)	(...)
Japan	(4)	(10)	(-)	(...)	(...)	(...)
Italy	(4)	(17)	(8)	(...)	(...)	(...)
India	(-)	(5)	(-)	(...)	(...)	(...)
Venezuela/Mexico	(39)	(41)	(36)	(-)	(-)	(-)
<u>Multilateral</u>	51	116	92	85	85	45
IDB	(16)	(35)	(12)	(35)	(40)	(45)
World Bank	(35)	(81)	(80)	(50)	(45)	(-)
OPEC	(-)	(-)	(-)	(-)	(-)	(-)
<u>Project financing/sup-</u>						
<u>pliers' credits ^{1/}</u>	77	132	129	138	145	160
<u>Other</u>	10	30	40	107	96	73
<u>Commercial banks ^{2/}</u>	(-)	(-)	(-)	(107)	(96)	(73)
<u>bauxite-related bor-</u>						
<u>rowing</u>	(10)	(-)	(-)	(-)	(-)	(-)
<u>Other</u>	(-)	(-)	(10)	(-)	(-)	(-)
<u>Official capital in-</u>						
<u>flows: rescheduling</u>	111	169	535	=	=	=
Mexico	=	=	41	=	=	=
Venezuela	15	73	97	=	=	=
Trinidad and Tobago	96	96	98	=	=	=
Commercial banks	=	=	164	=	=	=
Paris Club creditors	=	=	116	=	=	=
Nonparticipating Paris	=	=	19	=	=	=
Club creditors ^{3/}	=	=	=	=	=	=
<u>Official capital outflows</u>	-384	-429	-409	-472	-375	-356
<u>Private capital movements</u>						
<u>(net)</u>	-254	31	39	=	=	=
<u>Net international reserves</u>						
<u>(increase -)</u>	316	-283	-293	-156	-188	-189
<u>Arrears ^{4/}</u>	190	-190	-190	=	=	=
<u>Other</u>	126	-93	-103	-156	-188	-188
<u>Exceptional financing</u>						
<u>(arrears)</u>	144	-228	-246	=	=	=
Venezuela	=	-73	-77	=	=	=
Paris Club creditors	39	-34	-39	=	=	=
Commercial banks	65	-65	-65	=	=	=
Other ^{5/}	40	-56	-65	=	=	=
<u>Financing gap</u>	=	274 ^{6/}	=	188	145	138

Sources: Bank of Jamaica; and Fund staff estimates.

^{1/} Includes Eximbank.

^{2/} Commercial bank flows beyond 1984/85 based on maintenance of exposure.

^{3/} Debts which Jamaica is seeking to reschedule in accordance with the terms of the Paris Club agreement of July 1984 relating to comparable treatment of creditors. For program purposes, it is assumed that these debts receive Paris Club rescheduling terms.

^{4/} Overdue payments which are treated as reserve liabilities for program purposes.

^{5/} Amounts in 1984/85 represent private sector arrears removed from the auction in May 1984 and made subject to a phased repayment schedule ending March 1985.

^{6/} Identified possible sources of finances included rescheduling of debt due to Paris Club creditors (a total of US\$120 million were eligible), US\$158 million in amortization payments due to the commercial banks (of which US\$65 million fell due in 1983/84), and a new commercial bank loan of US\$8 million.

for 1984/85 is estimated at US\$535 million, some US\$100 million higher than had been projected in the program. However, expected new disbursements from government and multilateral sources have been revised downward by US\$102 million, mainly because of delays in negotiating and utilizing available foreign credits. As a result, the revised net official capital flow projection is still in line with the program target.^{1/}

Following the rescheduling, Jamaica's actual debt service payments in 1984/85 are now projected to total some US\$511 million, equivalent to 34 percent of exports of goods and services (Table 6).

Although overall official capital flows are expected to be as projected for the program period as a whole, the timing of certain disbursements has been delayed. At the time of Board approval of the program, the Fund had received notification that a loan of US\$30 million from the Austen Blades Group had been agreed upon, with disbursement expected in June. Receipt of this loan has been delayed, as has a disbursement of US\$27.5 million under the World Bank's structural adjustment program (SAL III), because of delays in negotiations. As a result, Jamaica incurred new external arrears of US\$44.8 million during the July-September quarter, which was contrary to the program performance criteria. (Jamaica was nominally in compliance with the ceiling on the outstanding stock of public sector arrears for end-September; however, more arrears had been rescheduled than envisaged under the program.) Disbursements of the loan from Austen Blades and from the first tranche of the SAL III are expected to take place during November 1984. On this basis it would be possible to eliminate the new arrears incurred during July-September.

b. Exchange rate policy

Between October 1983 and April 1984, the Jamaica dollar depreciated by 39 percent in real effective terms; this was followed by a real appreciation of 14 percent during May-September, during which period the nominal exchange rate remained around J\$3.85-4.15 per U.S. dollar (Charts 1 and 2). From mid-September to early November, however, much of the real appreciation that had taken place in the preceding four months was reversed, as the Jamaica dollar depreciated again.

Since the adoption of the present foreign exchange auction system on March 20, 1984 the authorities have accorded priority to stabilizing the exchange rate. Pressure on the rate was temporarily eased in the April-June quarter by running down oil inventories. During the April-August period the Bank of Jamaica also failed to purchase (or retain) enough foreign exchange from the auction to meet a bunching of oil payments in August and September, and had to increase its retentions from the biweekly auctions from an average of about US\$2 million per auction in July and August to about US\$3 million per auction starting in September. At the same time, demand in the auction began to pick up,

^{1/} The net foreign assets target of the program is adjustable for any excess in net disbursements over the program target.

Table 6. Jamaica: External Public Debt Operations, 1982/83-1989/90 ^{1/}

	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89	1989/90
(In millions of U.S. dollars)							
External debt (end of period)	3,111	3,667	3,887	4,044	4,150	4,283	4,418
Of which: IMF	(617)	(674)	(594)	(464)	(314)	(155)	(59)
Debt service (before rescheduling) ^{2/}	610	904 ^{3/}	767	743	787	777	748
Principal	365	622	493	447	472	428	402
Interest	245	282	274	296	315	329	346
Debt service (after rescheduling) ^{2/}	274	511	869	836	851	852	834
Principal	91	211	554	504	504	496	466
Interest	183	300	315	332	347	356	368
Net impact of 1984/85							
rescheduling	...	393 ^{4/}	-102	-93	-64	-75	-86
Principal	...	376	-61	-57	-32	-68	-64
Interest	...	-17	-41	-36	-32	-27	-22
Arrears	...	34	--	--	--	--	--
(In percent)							
Memorandum items:							
Debt/GDP	139.4	178.5	156.3	147.8	137.9	129.4	121.3
Net debt/GDP ^{5/}	139.4	173.9	150.3	140.7	130.6	121.4	112.4
Debt service ratio (before rescheduling) ^{6/}	42.7	59.4	47.3	40.5	37.6	32.9	28.0
Debt service ratio (after rescheduling) ^{6/}	19.2	33.6	53.6	45.5	40.7	36.1	31.2
Interest payments ratio (after rescheduling) ^{6/}	12.8	19.7	19.4	18.1	16.6	15.1	13.8

Sources: Bank of Jamaica; and Fund staff estimates.

^{1/} Medium- and long-term public and publicly guaranteed debt, including liabilities of the Bank of Jamaica.

^{2/} Including payments on projected debt.

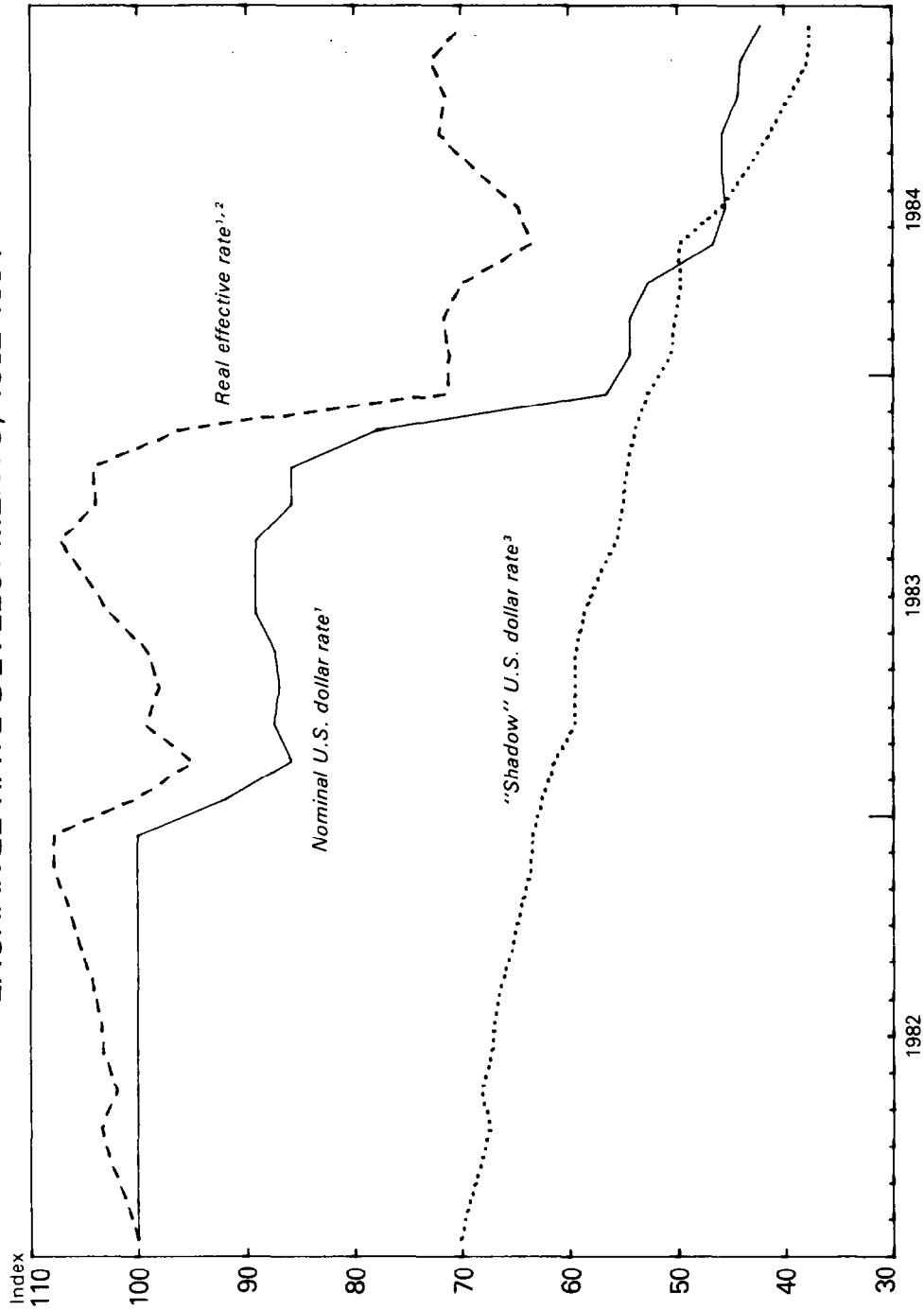
^{3/} Includes repayment of US\$163 million in arrears incurred in 1983/84.

^{4/} Gross relief on medium- and long-term debt in 1984/85 is estimated at US\$433 million; interest on rescheduled amounts in 1984/85 are estimated at US\$40 million. In addition US\$102 million in short-term debt was also rescheduled.

^{5/} Gross debt less liquid foreign exchange reserves.

^{6/} In terms of exports of goods and services.

CHART 2
JAMAICA
EXCHANGE RATE DEVELOPMENTS, 1982-1984



1 January 1982 = 100.
 2 Trade-weighted 1980 average value of partner countries currencies in terms of Jamaica dollars, adjusted for movements in relative consumer prices (increase in index denotes appreciation); incorporates officially sanctioned dual market transactions and, for 1979 and beyond, transactions in the black market.
 3 January 1982 = 70.1. The "shadow" exchange rate is the imputed rate against the U.S. dollar necessary to maintain the real effective exchange rate constant at its 1970 level; adjustments have been made to take account of differential rates of productivity growth between traded goods sectors of Jamaica and its trading partners.



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averaging US\$6.6 million per auction in August and September from about US\$4 million per auction in June and July. Although the pressure on the exchange rate intensified, the Bank of Jamaica, through varying its retentions and restricting bids for foreign exchange for opening cash letters of credit, succeeded for a while in maintaining the band unchanged.

The program understandings governing the operations of the auction market required that bids to buy foreign exchange needed in order to open cash letters of credit be given unrestricted access to the auction, as commercial banks in Jamaica have limited credit facilities with overseas correspondent banks and require importers to provide cash to open letters of credit. The authorities justified the exclusion of such bids on the need to encourage importers to use available foreign lines of credit.

The staff felt that the apparent reluctance of importers to use foreign credit reflected the low cost of borrowing domestically relative to borrowing abroad, when allowance is made for the expected exchange rate depreciation. This pointed to the need for adjustments in the exchange rate, interest rates, and credit policies. As explained below, credit policies were tightened in September-October and the interest rate structure adjusted upward by 2-3 percentage points.

The demand for exchange to open letters of credit was permitted back in the auction again on September 6 and the band was moved to J\$4.00-J\$4.30 per U.S. dollar in the auction of September 18. However, as the pressure on the exchange rate continued, the authorities subsequently introduced further regulations: (1) all bidders for foreign exchange were required to present a certificate indicating that they were current with all tax payments and payroll tax deductions; and (2) exporters of nontraditional goods were required to fully utilize available import credit from the Export Development Fund before being permitted to purchase foreign exchange for imports in the auction.

The authorities justified the tax clearance requirement on the ground that liquidity corresponding to tax arrears was being used to speculate against the Jamaica dollar. The EDF clearance requirement was instituted because they felt that Jamaica could ill afford to leave the foreign exchange holdings of the EDF unused. The staff pointed out that these regulations contravened understandings on the operations of the exchange auction, and noted that the EDF clearance requirement placed exporters at a relative disadvantage. More fundamentally, the staff reiterated the view that appropriate adjustments of interest rates and the exchange rate were needed. The authorities lifted these restrictions on October 19, 1984, but raised questions on the operation of the auction mechanism itself, expressing concern that the system has an inbuilt bias toward exchange depreciation, and seeking an in-depth review of the system in the forthcoming second review of the program (see attached letter). From mid-October to early November the band was adjusted three times to J\$4.45-J\$4.75 per U.S. dollar, and a large excess demand built up on the auctions.

3. Demand management

The demand management policies supporting the program are centered on a reduction of the central government deficit to 7 percent of GDP in 1984/85 from 16.5 percent of GDP in 1983/84 (based on the revised GDP estimate for 1983/84 and projection for 1984/85), a curtailment of the domestic financing requirement of the selected public entities, and a deceleration of credit expansion to the private sector and the rest of the public sector.

a. Central government operations

The central government finances were broadly on target in the first program quarter. Revenue exceeded projections by J\$18 million due to higher than programmed collections of bauxite levy and nontax revenue; expenditure was slightly higher than provided for in the program, but there was a small margin of J\$13 million under the ceiling on the overall deficit (Table 7). Tax revenue fell somewhat short of target even though income tax receipts were boosted by some collections corresponding to the previous year's taxes. Shortfalls were recorded in proceeds from consumption duties, property taxes, and taxes on motor vehicles and the tourist industry, reflecting in part delays in the implementation of certain revenue measures.

Identified expenditure was somewhat lower than projected, including some savings on outlays for personal emoluments. However, there were offsetting unidentified expenditures, which in part reflects debt servicing on behalf of certain enterprises for which reimbursement was not received.

The staff cautioned that further slippages in tax revenue were likely to result from the downward revisions of tourist expenditure, imports (including car imports), and gasoline sales. Moreover, a shortfall in revenue from the bauxite levy is likely to emerge because of lower bauxite exports. The staff therefore urged immediate implementation of the planned increases in fees and charges, and more rapid progress in arranging for sales of government assets (such as certain hotels) as planned under the program. The authorities were confident that any emerging slippages in revenue would be made up, in part because collections would be boosted by the higher than projected rate of inflation. It should be noted, however, that the Jamaican tax system is relatively inelastic with respect to inflation due to the prevalence of specific taxes. As regards the bauxite levy, a payment of J\$32 million was being received in the first quarter that had not been anticipated in the estimates. This corresponded to final adjustments on the previous year's tax obligations of the companies. Since the mission, the authorities have raised a number of fees and charges, including those for motor vehicle licenses, health services, rural water rates and fees paid by market vendors.

Table 7. Jamaica: Summary Central Government Operations, 1984-85 ^{1/}

(In millions of Jamaica dollars)

	1st Quarter		2nd Quarter		Fiscal Year	
	Program	Actual	Program	Prelim.	Program	Revised
Total revenue	535	553	1,123	1,095	2,677	
Tax revenue	440	430	900	897	2,060	
Nontax revenue	5	12	23	25	129	
Bauxite levy	90	111	190	173	423	
Regular	(90)	(90)	(100)	(166)	(423)	
CDF deposits	(--)	(21)	(--)	(7)	(--)	
Cash grants	--	--	--	...	25	
Grants in kind	--	--	10	...	40	
Other	--	--	--	...	--	
Total expenditure	764	769	1,641	1,599	3,374	
Current	664	653	1,400	1,379	2,790	
Personal emoluments	(268)	(259)	(533)	(...)	(1,061)	
Interest	(244)	(241)	(551)	(...)	(1,067)	
Other	(152)	(153)	(316)	(...)	(662)	
Capital and net lending ^{2/}	100	67	231	214	544	
Transfers in kind	--	--	10	...	40	
Unidentified	--	49	--	6	--	
Overall balance	-229	-216	-518	-504	-697	-697
Total financing	229	216	518	504	697	697
Net external	498	330	876	490	1,613	1,356
Net domestic	-269	-114	-358	14	-916	-659
Banking system	(-260)	(-155)	(-369)	(-30)	(-1,062)	(-805)
Other	(-9)	(62)	(11)	(51)	(146)	(146)
CDF deposits (increase -)	(--)	(-21)	(--)	(-7)	(--)	(--)

Sources: Ministry of Finance; and Fund staff estimates and projections.

^{1/} Corresponds to presentation in SM/84/101, Annex II, tables 1 and 2 which constitute the basis for monitoring the program; i.e., not adjusted for deductions from the bauxite levy for repayment of a 1982/83 advance on the levy.

^{2/} Includes loan repayment by the Petroleum Corporation of Jamaica.

Given the questions on future revenue performance and the upward trend in interest rates, the staff urged the authorities to reduce current outlays, such as transfers and subsidies on imported basic foods, to accelerate the planned reduction in staffing, and keep capital spending below program levels. As regards the authorities' plans to reduce the central government payroll by about 6,000 employees during 1984/85 (about 7 percent of total), a large number of vacant positions were suppressed in the April-June quarter and 870 staff reductions were made due to attrition, against a target of 1,500 for the year. The staff wondered whether the program was lagging as the number of redundancies in the first quarter was only 327, against a target for the year of 4,356. The authorities explained that the redundancy part of the manpower program involved substantial administrative preparation and stressed their determination to carry out the plan. By the end of September the government payroll had been reduced by 1,600 through attrition and redundancies, and substantial additional redundancies had been announced, mainly in the Ministries of Agriculture, Health and Construction.

Recently received preliminary data show compliance with program targets for the central government finances for the first half of the fiscal year: the overall deficit amounted to J\$504 million, and was J\$14 million below the ceiling. A substantial shortfall in bauxite levy receipts which occurred during July-September was more than offset by underexpenditure.

While the overall deficit of the Central Government was within the program ceiling in the first and second quarters, the financing of the deficit differed significantly from the projection. Net external financing was J\$386 million less than had been anticipated, mainly as bilateral and some multilateral flows fell short of projection. As a result, net use of domestic credit, in particular banking system credit, exceeded program projections by J\$372 million.

b. Operations of the public entities

The selected public entities in the past have been large net users of domestic bank credit. The program is designed to reduce net use of such credit from J\$155 million in 1983/84 to J\$67 million. The net credit expansion under the program is entirely accounted for by the transfer of a deposit from one of the entities to the Central Government, as the latter assumes the external debt for the construction of the provisional headquarters of the International Seabed Authority. In addition, the selected entities may borrow J\$42 million from domestic nonbank financial institutions in 1984/85.

In the first quarter, net use of domestic credit by the selected entities was below the ceiling by a margin of J\$108 million, mostly reflecting a reduction in inventories by the state petroleum company and a failure to transfer J\$33 million to the Central Government for debt servicing on their behalf, as mentioned above.

For the year as a whole, the staff projected that, in the absence of corrective action, the selected entities would need financing of about J\$40 million in excess of the program projections. The projected overrun reflected the need to rebuild oil inventories and problems in several of the public enterprises. In particular, the National Sugar Company (NSC) and the National Water Commission were expected to require financial support in excess of the provisions under the program, as was the Jamaica Public Service Company (JPSCO) because of plans to increase its investment program. In addition, it was questionable whether the Jamaica Commodities Trading Company (the sole importer of automobiles) would generate sufficient revenue from its motor vehicle sales to cover the planned cross-subsidies for basic foods. Noting that overruns in the financing requirement of the public entities could not be accommodated under the program, the staff also stressed that the authorities would need to monitor closely the adequacy of domestic energy prices in light of adjustments in the exchange rate.

As regards the sugar industry, the authorities had stated in the letter attached to EBS/84/101 that three sugar factories/estates would be closed. However, the plans to close two of these factories have subsequently been rescinded; they will continue to be operated on a private basis by their existing staff, remaining in the ownership of the National Sugar Company but without financial support from it.

Subsequent to the mission's departure, the authorities raised water rates by 69 percent, and indicated that JPSCO's investment outlays will be kept within program levels. The authorities also informed the staff that domestic petroleum prices would not require adjustment up to an exchange rate of J\$4.50 per U.S. dollar.

At the end of the second quarter, the selected public entities' net use of domestic credit was J\$237 million less than had been programmed. This reflected mainly surpluses generated by the state petroleum company (PCJ), the National Insurance Fund (NIF), and the Jamaica Commodities Trading Company (JCTC). The PCJ's position resulted mainly from the rundown of petroleum inventories referred to above. A large portion of the surplus of the NIF is expected to be utilized for financing the Central Government, while the temporary surpluses of the JCTC that represent proceeds from PL480 sales will be transferred to the Central Government, where they would be recorded as foreign financing.

c. Monetary and credit policies

The program contemplates a sharp slowdown in domestic credit expansion, reflected in a large reduction in the net indebtedness of the Central Government to the banking system and a substantial deceleration in the growth of bank credit to the private sector, the selected public entities, and the rest of the public sector. This policy was also intended to exert upward pressure on domestic interest rates so as to curtail private capital outflows (or even induce a reflow).

Developments in the April-June quarter, while differing in certain respects from what had been expected, remained within the program parameters. The differences mainly reflected the expansion of net credit to the rest of the public sector, the institution of a deposit scheme for private external arrears which were removed from the foreign exchange auction and scheduled for payment by the Bank of Jamaica during the program period, and the replenishment of the Export Development Fund (EDF), which had not been specifically included in the program. During the quarter, the net domestic assets of the banking system declined by J\$277 million compared with a projected reduction of J\$318 million. The net domestic assets of the Bank of Jamaica declined by J\$497 million compared with a program target of J\$452 million (Table 8). The reduction in the net domestic assets of the banking system was facilitated by a sharp rundown in the net foreign assets of the commercial banks, and the drawdown of oil inventories which improved the cash position of the state petroleum company. Net banking system credit to the Central Government contracted by only half the programmed amount, as use was made of the margins provided by greater than expected external refinancing of the Bank of Jamaica's medium-term external liabilities, and the sterilization of deposits corresponding to private sector arrears. However, the commercial banks also failed to observe the liquid assets ratio by about 1 percentage point at the end of the first quarter.

The staff stressed that tight credit policies were fundamental to the achievement of the program goals, especially in view of the authorities' desire to stabilize the exchange rate and the reluctance of importers to use foreign credit. It was noted that the tightening of credit in the first quarter mainly reflected the temporary impact of the sterilization of deposits under the arrears scheme; these deposits would be released during the remainder of the year. This would provide the commercial banks with resources to increase credit, which in turn might jeopardize the attainment of the international reserve target, especially if the commercial banks should fail to comply with the liquid assets ratio. During July and August the liquidity of the commercial banks increased, with cash reserves rising to 13 percent of deposits, and in September the authorities raised the cash reserve requirement from 10 to 14 percent of prescribed deposits and the liquid assets ratio from 40 to 44 percent. The effect of the increase in the cash reserve requirement was strengthened by requiring that the ratio be calculated on a daily basis rather than once a week. Bank liquidity was also tightened further in the first half of October as the authorities transferred part of the state petroleum company's deposits from the commercial banks to the Bank of Jamaica.

At the time of the mission, the minimum savings rate was 11 percent, time deposit rates ranged around 15-18 percent, the bank and rediscount rates were 13 and 15 percent, respectively, and commercial bank lending rates were in the range of 20-23 percent. Interest earnings on savings deposits are tax free, and increases in the savings rate are not constrained (it is only subject to a minimum rate). In addition, banks charge fees and commissions, bringing the cost of new borrowing above the 20-23 percent range referred to above. The staff expressed concern

Table 8. Jamaica: Summary Monetary Accounts

	First Quarter		Second Quarter		1984/85	
	Prog.	Actual	Prog.	Prel.	Prog.	Rev.
(Cumulative flows in millions of Jamaica dollars)						
I. Banking System						
Net international reserves	412	401	382	...	1,075	1,088
Net domestic credit	-318	-277	-205	...	-487	-500
Central Government	-322	-157	-435	-33	-1,062	-805
Selected public entities	-38	-122	65	-118	67	67
Other public sector	7	326	14	...	30	440
Private sector	20	14	96	53	250	196
Medium- and long-term foreign liabilities	7	-85	7	-110	199	-221
Arrears counterpart	--	-303	--	-303	--	-262
Valuation adjustment, exchange losses, and other (net)	8	50	48	...	29	85
Liabilities to private sector	139	-57	222	...	633	639
Special deposits	-45	181	-45	...	-45	-51
II. Bank of Jamaica						
Net international reserves 1/	452	496	432	516	1,132	1,172
Net domestic credit	-452	-497	-421	-518	-1,072	-1,112
Central Government	-428	-108	-495	-241	-1,339	-789
Selected public entities	--	-33	52	14	52	52
Other public sector	--	211	--	35	--	225
Net credit to banks	-9	-173	-17	28	-58	-205
Medium- and long-term foreign liabilities	7	-85	7	-110	199	-221
Arrears counterpart	--	-303	--	-303	--	-262
Valuation adjustment, exchange losses, and other (net)	-22	-6	34	59	74	88
Currency in circulation	--	-1	11	-2	60	60
III. Commercial Banks						
Net foreign assets	--	-95	-10	...	-57	-84
Net domestic credit	94	220	176	...	585	612
Central Government	106	-49	60	208	277	-16
Selected public enterprises	-38	-89	13	-132	15	15
Other public sector	7	115	14	...	30	215
Private sector	20	14	96	53	250	196
Claims on Bank of Jamaica	9	211	17	...	58	205
Other (net)	3	17	-11	...	-45	-3
Liabilities to private sector	139	-56	211	...	573	579
Special deposits	-45	181	-45	...	-45	-51

Sources: Bank of Jamaica; and Fund staff estimates.

1/ Valued at J\$4 per U.S. dollar.

that interest rates in Jamaica were still negative in real terms, and that the cost of borrowing domestically was substantially lower than borrowing abroad, when adjusted for the expected depreciation of the Jamaica dollar. Both the staff and the authorities concluded that an upward adjustment of interest rates was necessary to encourage financial savings and to help induce importers to use foreign lines of credit.

Accordingly, in September and October the Bank of Jamaica raised the minimum savings rate by 2 percentage points and the rediscount and bank rates by 3 percentage points. In addition the ceiling on mortgage rates charged by building societies was removed. The treasury bill rate rose by about 1 percentage point in October to 15 percent. The minimum savings rate is now 13 percent, and the bank and rediscount rates are 16 and 18 percent, respectively.

During the second quarter, the net domestic assets of the Bank of Jamaica remained under the program ceilings, despite a considerably lower than programmed reduction in credit to the Central Government. This outcome was facilitated by additional refinancing of external debt of the Bank of Jamaica, and the aforementioned transfer of EDF and other deposits of state enterprises from the commercial banks to the Bank of Jamaica.

d. Wage developments

It was assumed under the program that wage increases would average 15 percent during 1984/85. Comprehensive data on wage developments are not available, and the monitoring of wage settlements by the authorities has remained deficient. The latest wage contract in the bauxite sector provided for increases of 33 percent for the first 14 months, retroactive to February 1984, and 11 percent for the following 15 months, with a one-month "signing bonus". This works out at about 20 percent a year for the nearly two and a half years of the contract. Some recent settlements in the decentralized public sector also seem to have been around 20 percent a year, including awards at the Bank of Jamaica and the international telephone company (JAMINTEL).

IV. Medium-Term Balance of Payments Outlook

The medium-term outlook for the current account of the balance of payments as presented in EBS/84/101 suggested that a real growth rate of 3 percent a year was feasible over the medium term, but that the further adjustment needed in the current account of the balance of payments would leave little scope for increases in per capita disposable incomes at least over the next two to three years. The downward revision in the forecasts for exports and tourism receipts reinforce this relatively somber perspective. The export volume and value for bauxite/alumina for 1985/86 and beyond have not been revised downward significantly, although it should be noted that the export performance of the bauxite industry is now subject to heightened uncertainty in light of the softening of the aluminum market in recent months and the possibility of

further plant closures in Jamaica. The prospects of this sector will be re-examined in the next program review. The medium-term projections for imports have been lowered in line with the lower base and the weaker outlook for exports and tourism receipts.

The projections of net capital flows have been modified to take account of the debt rescheduling and modifications in 1984/85 net official borrowing. Financing gaps of US\$100-US\$190 million a year over the next few years are still to be closed. Assuming they are closed by rescheduling or new loans, the debt service burden is expected to decline to around 28 percent by 1989/90.

V. Program Performance in the First and Second Program Quarter

At the end of both June and September 1984 Jamaica was in compliance with quantitative performance targets under the stand-by arrangement (Table 9). At end-September the level of public sector external arrears was below the ceiling due to rescheduling of arrears in excess of what had been contemplated, and notwithstanding the accumulation of US\$44.8 million of new arrears during the July-September quarter because of delays in the disbursements of two external loans (US\$30 million from Austen Blades and US\$27.5 million from the World Bank SAL III). According to the attached letter from the Jamaican authorities, both loans are expected to be disbursed in November. Thus all the new arrears will be cleared before the end of the year. On this basis a waiver of the performance criterion for external arrears is being sought.

VI. Staff Appraisal

During the past year the Jamaican economy has undergone significant adjustments; important reforms have been made in the exchange and trade system; and the Jamaica dollar has been depreciated substantially, leading to major changes in the structure of relative prices. Fiscal policy, which has been at the core of Jamaica's economic problem, has been strengthened, credit policies have been tightened, and domestic interest rates raised. Nevertheless, attainment of the objectives of the stand-by program for 1984/85 will require continued and determined efforts. The likely shortfall in exports and tourism receipts in particular underscores the need to maintain tight domestic demand policies and to allow the exchange rate to respond freely to market forces.

Except for an accumulation of new arrears because of a temporary delay in the disbursement of external loans, Jamaica observed all the quantitative performance criteria of the program for the first half of the program year. However, the extremely narrow margins in the fiscal area and the possibility of slippages in budgetary revenue and of higher interest costs suggest the need for a further strengthening of fiscal policies. On the revenue side, an acceleration in the process of divesting government properties could provide some margins, and other adjustments may also be needed. On the expenditure side the authorities face a major task in keeping budgetary outlays within the

Table 9. Jamaica: Quantitative Performance Criteria, 1984/85

	1983	1984						1985
	Dec.1/	March 1/	June		Sept.		December	March
			Program	Actual	Program	Actual	Program	Program
(End of period, in millions of U.S. dollars)								
Net international reserves <u>2/</u>	-854	-863	-750	-739.0	-755	-733.9	-670	-570
Public sector external arrears		362	114	113.5	76	74.6 <u>6/</u>	—	—
Net external debt disburse- ments <u>3/</u>		...	279	214.2	377	282.4	399	478
(In millions of U.S. dollars)								
Reduction in private sector external arrears		...	14	14.0	14	14.3	14	14
(End of period, in millions of Jamaica dollars)								
Net domestic assets of the Bank of Jamaica <u>4/</u>	3,952	3,968	3,516	3,470.7	3,546	3,448.8	3,285	2,855
Central government net borrowing requirement <u>5/</u>			229	216.5	518	503.8	710	697
Net banking credit to selected public sector <u>5/</u>			-38	-100.3	65	-118.2	35	67
Net nonbank credit to selected public sector <u>5/</u>			42	-3.9	42	-11.9	42	42

Source: Technical Memorandum of Understanding.

1/ Actual.

2/ Targets adjustable upward for any excess of net external debt disbursements over programmed amounts.

3/ Refers to medium and long term debt. Any excess in net disbursements is to be added to net international reserves. Excludes project loans by multilateral and other official development agencies and trade financing contracted by the private sector with a government guarantee. Figures refer to cumulative change from December 31, 1983.

4/ Ceilings adjustable downward for any excess of net external debt disbursements over programmed amounts.

5/ Cumulative change from March 31, 1984.

6/ Includes U.S.\$44.8 million of new arrears incurred during the July-September quarter.

target given the higher than programmed rate of inflation. This could require further cutbacks in current outlays and involve holding capital spending below the program level. In this context, the program to reduce staffing throughout the Government is particularly important as it will lead to a permanent reduction in expenditure levels: this program should be given maximum emphasis.

The staff welcomes the recent increase in water rates and the assurance that the electric power company's investment spending will be kept within program limits. Nevertheless, a number of uncertainties remain with regard to the operations of the selected public entities during the rest of the program year. The rundown in oil inventories in the first quarter, which eased the pressure on the exchange rate and generated some margins in the credit program, provides only a temporary respite. It is essential that prices of goods and services supplied by the public sector be adjusted promptly to reflect changes in the exchange rate and other cost elements. The adequacy of the domestic prices for petroleum products and the financial performance of the publicly owned sugar sector need particularly close monitoring.

Credit conditions have tightened significantly as a result of the recent increase in the commercial banks' cash reserve requirement. This is exerting upward pressure on interest rates and will help to strengthen the balance of payments. Increases of 2-3 percentage points in controlled interest rates have taken place during the last two months. However, importers and exporters still appear reluctant to use available foreign credits, which would suggest that the level of interest rates in Jamaica remains inadequate, given exchange rate expectations, and that action continues to be required in the area of interest rates.

Continued wage restraint is of critical importance to avoid a wage-price-exchange rate spiral. The staff urges the authorities to make every effort to encourage moderation in wage settlements in the private sector, and to lay the groundwork for a modest settlement for next year's public sector negotiations.

The weakening in Jamaica's medium-term export prospects, the uncertainties surrounding the bauxite/alumina industry, and the difficult external debt situation underscore the importance of continuing the adjustment effort. It is especially important that the exchange rate system be fully responsive to market forces, and the staff would therefore urge the authorities to abstain from any measures which would impede the effective functioning of the auction system. Much has been achieved in the last few months, and it would be unfortunate for this progress to be jeopardized as a result of a preoccupation with achieving a short-term stabilization of the exchange rate through artificial means, with a view to dampening price pressures.

The emergence of new arrears during the September quarter can be ascribed to temporary shortfalls in external loan disbursements. The temporary restrictions that had been imposed on the exchange system in the form of tax and EDF clearance requirements have been removed. The staff therefore supports the authorities' request for a waiver of the relevant performance criteria.

VII. Proposed Decision

The following draft decision is proposed for adoption by the Executive Board:

1. Jamaica has consulted with the Fund in accordance with paragraphs 4 (d) of the stand-by arrangement for Jamaica (EBS/84/101, Sup. 3, June 13, 1984) and paragraph 32 of the letter dated April 25, 1984 from the Prime Minister and Minister of Finance and Planning and the Governor of the Bank of Jamaica, in order to review the progress made in implementing the policies affecting demand management and the exchange system and to reach understandings with the Fund regarding the circumstance in which purchases under the arrangement can be resumed.
2. The letter of October 22, 1984 from the Governor of the Bank of Jamaica shall be annexed to the stand-by arrangement for Jamaica, and the letter of April 25, 1984 and the technical memorandum of understanding annexed thereto shall be read as supplemented by the letter of October 22, 1984.
3. The Fund finds that the first review contemplated in paragraph 4 (d) of the arrangement is completed and that in light of the letter dated October 22, 1984 from the Governor of the bank of Jamaica, no additional understandings are necessary regarding circumstances in which further purchases may be made by Jamaica under the arrangement, notwithstanding the incurrence of new external payment arrears and the temporary imposition of the exchange restrictions referred to in paragraphs 5 and 7 of technical memorandum of understandings annexed to the letter dated April 25, 1984 and in paragraphs 4(c) and (e) of the arrangement.

Jamaica - Fund Relations
(As of October 31, 1984)

I. Membership status

- (a) Date of membership: February 21, 1963.
(b) Status: Article VIII.

(A) Financial Relations

II. General Department

- (a) Quota: SDR 145.5 million

(b) Total Fund holdings of Jamaica dollars:
SDR 782.2 million or 537.6 percent of quota

(c) Fund credit (i.e., Fund holdings of Jamaica dollars
subject to repurchase and charges):

	<u>Millions of SDRs</u>	<u>As Percent of Quota</u>
<u>Total Fund credit</u>	636.6	437.5
Of which: Under tranche policy	538.8	370.3
Credit tranches	34.4	23.6
Extended facility	512.4	338.6
Ordinary resources	(160.0)	(96.4)
Supplementary financing	(186.0)	(127.8)
Enlarged access resources	(166.4)	(114.4)
Under CFF	107.6	74.0

- (d) Reserve tranche position: --

III. Current stand-by or extended arrangement and special facilities

- (a) Current stand-by arrangement:
 (i) Duration: June 22, 1984 to June 21, 1985
 (ii) Amount: SDR 64 million
 (iii) Utilization: SDR 18 million.
 (iv) Undrawn balance: SDR 46 million.
(b) Stand-by and extended arrangements during the last ten years:

<u>Type</u>	<u>Date</u>	<u>Duration</u>	<u>Amount</u>	<u>Utilization</u>	
				<u>(millions of SDRs)</u>	<u>(In percent of then quota)</u>
Stand-by	6/01/73	1 year	26.5	26.5	50.0
Stand-by	8/11/77	2 years	64.0	19.2	25.9
EFF	6/09/78	3 years	200.0		
(augmented)	6/11/79		259.7	155.0	209.5
EFF	4/13/81	3 years	477.7	402.8	362.9

- (c) Special facilities during the last 3 years:

CFF	4/13/81	SDR 37.0 million
CFF	8/25/82	SDR 19.4 million
CFF	6/26/84	SDR 72.6 million

IV. SDR Department

- (a) Net cumulative allocation: SDR 40.61 million
- (b) Holdings: SDR 0.03 million (0.06 percent of net cumulative allocation)

V. Administered Accounts

- (a) Trust Fund loans: —
- (b) SFF Subsidy Accounts: Payments by Fund

August 10, 1982	SDR	4.67	million
September 29, 1983	SDR	3.33	million
July 20, 1984	SDR	3.07	million
Total		SDR	11.07 million

VI. Overdue obligations to Fund:

Jamaica has frequently experienced difficulty in remaining current with the Fund within the past two years and has been overdue on payments for periods ranging from a few days to eight weeks. In recent months delays have been of very brief duration, and Jamaica is at present current with the Fund.

(B) Nonfinancial Relations

VII. Exchange rate arrangement:

In November 1983, Jamaica adopted a unified floating rate within an adjustable exchange rate band. An auction mechanism to determine rates was instituted in December 1983 and modified in March 1984.

VIII. Last Article IV consultation:

January 1984, completed by the Executive Board on June 8, 1984 (Standard 12-month cycle).

IX. Technical Assistance:

- (a) CBD: Two CDB advisors have been assigned to the Bank of Jamaica since April 1983:
 - Mr. R. Moghadam (appointed on April 17, 1983)
 - Mr. T. Tweddle (appointed on April 24, 1983)

X. Resident Representative:

Mr. Chee Sung Lee, since August 1, 1982. Mr. Lee is to be succeeded by Mr. D. Citrin (ASD) with effect from mid-December 1984.

Jamaica--Basic Data

Area and population

Area	4,411 sq. miles (11,424 sq. kilometers)
Population (1983)	2.1 million
Annual rate of population increase (1978-83)	1.2 percent
Unemployment rate (April 1983)	26 percent

GDP (1983)^{1/}

SDR 2,082 million
US\$2,171 million
J\$6,750 million

GDP per capita (1983)

SDR 991

Origin of GDP (1983)

(percent)

Agriculture and fishing	8
Mining	6
Manufacturing	16
Construction	6
Government	19
Other	45

Ratios to GDP (1983)

Exports of goods and nonfactor services	40.3
Imports of goods and nonfactor services	53.1
Central government revenues (fiscal year from April 1)	25.9
Central government expenditures (fiscal year from April 1)	40.5
External public and government-guaranteed debt (fiscal year from April 1)	147.3
Gross national savings	1.5
Gross domestic investment	22.3
Money and quasi-money (end of year)	44.2

Annual percentage changes in selected economic indicators

Rev. Prog.
1981/82 1982/83 1983/84 1984/85

Real GDP per capita	2.0	-1.5	0.6	-1.0
Real GDP	2.2	0.9	1.4	—
GDP at current prices	22.5	11.4	20.7	23.9
Domestic expenditure (at current prices)	19.6	10.0	14.5	
Investment	(51.2)	(3.8)	(18.9)	
Consumption	(13.9)	(11.5)	(13.5)	
GDP deflator	7.0	8.1	14.1	23.9
Consumer prices (period average)	12.0	6.5	11.3	25.0
Money and quasi-money	31.3	26.8	26.3	18.7
Money	(17.4)	(2.3)	(21.3)	(17.0)
Quasi-money	(36.9)	(35.5)	(26.5)	(19.1)
Net domestic bank assets ^{2/}	24.3	33.1	57.6	14.1
Credit to public sector (net)	(...)	(30.6)	(17.3)	-30.8
Credit to private sector	(17.8)	(20.5)	(17.6)	7.2
Central government revenues	24.5	9.9	14.2	43.9
Central government expenditures	16.9	9.7	12.2	15.9
Merchandise exports (f.o.b., in U.S. dollars)	-11.9	-17.4	-4.6	14.5
Merchandise imports (c.i.f., in U.S. dollars)	23.8	-6.5	-9.1	-2.5
Travel receipts (net, in U.S. dollars)	30.5	5.6	13.8	6.9

<u>Central government finances</u>	<u>1981/82</u>	<u>1982/83</u>	<u>1983/84</u>	<u>1984/85</u>
	(millions of Jamaica dollars)			
Revenues	1,482.9	1,629.0	1,860.0	2,677.0
Expenditures	2,364.7	2,594.4	2,910.0	3,374.0
Current account deficit (-)	-238.0	-292.4	-534.0	-113.0
Overall deficit (-)	-881.8	-965.4	-1,050.0	-697.0
External financing (net)	503.7	376.2	370.0	1,356.0
Domestic financing (net) and residual	378.1	589.2	680.0	-659.0
 <u>Balance of payments</u>	 (millions of U.S. dollars)			
Merchandise exports (f.o.b.)	889.1	734.2	700.0	801.5
Merchandise imports (c.i.f.)	-1,487.7	-1,391.6	-1,221.0	-1,190.0
Travel (net)	300.4	317.3	361.0	386.0
Investment income (net)	-225.3	-214.6	-243.0	-272.0
Other services and transfers (net)	85.7	94.2	132.0	143.0
Balance on current and transfer accounts	-437.8	-460.5	-271.0	-131.0
Official capital (net)	427.1	387.4	65.0	631.0
Private capital (net) and errors and omissions	54.3	-73.3	-254.0	19.0
SDR allocation	--	--	--	--
Overall balance	43.6	-146.4	-460.0	539.0
 <u>International reserve position</u>	 (end of period, millions of U.S. dollars)			
Central Bank (gross)	130.7	188.1	60.5	148.5
Central Bank (net)	-539.8	-619.2	-853.1	-570.0

1/ Based on the average shadow exchange rate for the Jamaica dollar.
2/ In relation to the stock of liabilities to the private sector at the beginning of the period.

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

October 22, 1984

Dear Mr. de Larosiere:

At the request of the IMF Review Mission to Jamaica (July 30 - August 3, 1984), I am responding to you on certain issues relating to Balance of Payments management and monetary policy which were raised by the Review Mission in the paper of August 3, 1984, entitled "Preliminary Conclusions of I.M.F. Review Mission July 30 - August 3, 1984." You should be aware that Prime Minister Seaga had extensive discussions with Fund staff led by Mr. S. T. Beza of the Western Hemisphere Department, during the recent Fund/Bank Annual Meetings. You should know also that, on behalf of the Government of Jamaica, I replied in detail by letter of October 2, 1984, to twenty points raised by the I.M.F. Review Mission as follow-up to the paper of August 3 and set out in Fund staff memorandum of August 8, 1984, entitled "Action needed under the Stand-by Program."

Balance of Payments Management

2. The Government of Jamaica is fully committed to the exchange system and mechanism described in paragraphs 5 and 9 of the Letter of Intent dated April 25, 1984, and subsequently modified by mutual agreement of the Fund and Jamaican authorities. This system speedily moved the exchange band in its relationship to the US\$, to J\$3.85 to J\$4.15 and the rate, fluctuating within the Band, appeared to clear the market within the cash and credit parameters of the programme flows. However, in July there was evidence of a build up of inordinate pressure on the exchange as importers moved heavily into cash rather than credit to offset the exchange risk inherent in a system with a bias towards exchange rate depreciation. The authorities moved to restrain demand. The liquid assets ratio and cash reserve ratio of the banking system were increased from 40% to 44% and 10% to 14%, respectively. Bank rate was increased from 13% to 14% with consequential upward movement in deposit and lending rates. The consumer credit ceiling of the banking sector was reduced by an incremental J\$50 million; in aggregate a decline of J\$150 million for the program year on F.Y. 1983/84.

3. However, these actions did not contain the exchange pressure as importers switched to internally generated cash rather than bank credit. The authorities, therefore, took further action as follows: -

- (1) Bids to the foreign exchange auction market to be accompanied by a certificate from the Revenue authorities that the statutory liabilities of the bidder (PAYE payments, company tax obligations, deductions of payroll taxes for N.I.F., N.H.T. and Education tax)

were up to date. This would ensure that importers were not using statutory domestic cash flows to the Government in the effort to bypass the banking system and the related credit constraints.

(2) Companies which normally use the World Bank Export Development Fund must present with the relevant bid document a certificate that full use has been made of the E.D.F. resources. The Jamaican authorities and the World Bank had recently completed agreements which released resources to the E.D.F. with minimum balances of foreign currency, and accordingly activated that fund. These resources are an integral part of the capital flows for the Stand by Programme and the Jamaican authorities are determined that such available flows are appropriately used.

In conversations with Fund staff, the Jamaican Authorities made it clear that the speculation against the Jamaican currency implicit in the inordinate pressure on the exchanges could not be tolerated. It was subsequently concluded that the requirement for the tax and E.D.F. certificates for accessing the auctions system should be removed by October 19, 1984. This action has been taken. Further, the Jamaican authorities could, if it so wished, apply the tax compliance arrangements through the customs system and its relationship to imports of goods.

While committed to the exchange system, the Jamaican authorities are very concerned at the inbuilt bias towards exchange depreciation, the firm expectations which users of the system derive from such bias and the tendency towards speculation against the Jamaican currency. In addition, the current system inhibits the development of a forward exchange market. The authorities, therefore, seek your agreement to an indepth review by Fund and Bank of Jamaica staff of the exchange system at the forthcoming November review discussions with a view to determining what appropriate modifications can be undertaken to improve its operations.

The Fund Review Mission expressed concern at the foreign exchange cash position of the Central Bank particularly in regard to the outstanding liabilities for oil imports and the expected loan inflows from the SAL III World Bank loan and the loan of US\$30 million from Girozentrale und Bank der Osterreichischen Sparkassen of Vienna, Austria. In regard to oil liabilities and as explained in the Central Bank letter of 2nd October, 1984, the Authorities are fully aware of the determination by the Fund's legal department on the refinancing/re-scheduling of trade related credits for less than one year. The Bank of Jamaica has taken the necessary steps to meet such liabilities within the parameters of the stand by programme. To support future oil payments the Bank of Jamaica from October 1984 increased deductions for oil payments from banking flows designated for the auction market, from US\$0.5 million per auction to US\$1.5 million per auction.

7. Fund staff is aware of the reasons for the delay in the disbursement of the World Bank SAL III loan. As to the US\$30 million from Girozentrale of Austria, I quote below the contents of a telex which was received from that bank on October 20, 1984:

"TX. To: Mr. H. Barber, Governor of Bank of Jamaica
Presently in Washington

FROM: Girozentrale Vienna

We refer to conversation with Mr. Heller and by means of this telex, we confirm that our board has in principle approved to arrange the US\$30 million facility through ATC Handelsges. MBH to Bank of Jamaica, subject to satisfactory completion of alumina contract between Bauxite and Alumina Trading Company of Jamaica (BATCO) and ATC Handelsges. MBH

Regards,
Girozentrale Wien
H. Pecina".

This loan is complemented by a trade arrangement for the sale of alumina in 1985 and 1986 and the delay in consummating the transaction was due largely to the technical marketing negotiations including off take arrangements, which had to be put in place. It is expected that such funds will be disbursed by November 15, 1984.

8. The Jamaican authorities have received a commitment for the sale and lease of four Boeing 727-200 advanced aircraft owned by Air Jamaica. The purchase price is US\$25.4 million, gross, of which US\$16.4 million, gross, will be available during the programme year. The necessary waivers under the refinancing arrangements with external commercial banks are being sought by the Bank of Nova Scotia - Toronto. The net flows will augment the foreign currency inflows to the Central Bank and provide domestic currency support to the Airline. Finally, the Paris Club Arrangements were formally established by agreed minute of July 1984. The Jamaican authorities completed by October 19, 1984 the negotiation of implementation agreements with all the participating countries and their agencies, with the exception of the United States and Switzerland. The USA Agreement, which was the subject of preliminary discussions during the Fund/Bank meeting, should be completed within fourteen days. For Non-Paris Club creditors debt relief arrangements have been concluded with the Governments of Trinidad and Tobago, Venezuela and Mexico. Discussions are underway with the Central bank of Libya and the Ministry of Finance of Iraq. Jamaica awaits a response from the Government of Algeria.

Monetary Policy

9. The Government has taken action to further tighten demand management by adjusting liquid assets and cash reserve ratios of the banking system and lowering consumer credit ceilings as described in paragraph 2 above. Other supporting action is the adjustment in banking practice to ensure daily, rather than monthly, observance of cash reserve limits by the banking system; and the introduction in September 1984 by the Bank

of Jamaica of penalty charges to discourage the discontinuing of Government paper. As a result of the impact on the Treasury bill discount rate, from October 16, 1984, the Bank Rate was increased from 14 to 16 percent, the Central Bank Rediscount rate from 16 to 18 percent and Commercial Bank Prime rate was increased from 16 to 18 percent. Also from November 1, 1984, savings deposit minimum interest rate will increase from 12 to 13 percent.

10. The Government fully accepts and will adhere to the commitment on interest rate policy set out at paragraph 16 of the Government's letter of intent of April 25, 1984. In particular, the Jamaican authorities also recognise the use of the interest rate mechanism to counter speculative tendencies which lead to the switching of domestic currency for foreign currency. The steps recently taken to tighten liquidity of and ensure daily observance of cash limits by the banking system provide the conditions within which market forces can adjust interest rate levels using the market determined Treasury bill discount rate as the point of reference.

Performance Criteria - September 30, 1984

11. The document incorporating appropriate data for the September performance criteria is with Fund staff. I understand that it is the Fund's view that the limit on external payment arrears on public sector obligations, was not observed. The programme limit is US\$76 million, and the actual amount achieved is US\$74.6 million. It appears, however, that the constraint that "no new arrears will be incurred in FY 1984/85", is interpreted to exclude from the programme limit any transaction which was not in the original arrears basket. This issue would not have arisen if the programmed disbursement of World Bank SAL III and the US\$30 million loan from Girozentrale of Vienna, had taken place. These loans are valid propositions and the delay in disbursement has been outside the control of the Jamaican authorities - see paragraph 7. Accordingly, the Government of Jamaica requests a waiver from the limits on external payment arrears as described in paragraph 5 of the technical memorandum of understanding annexed to the letter of intent dated April 25, 1984.

Yours sincerely,

/s/

Horace Barber
Governor, Bank of Jamaica