NOT FOR PUBLIC USE

0404

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 90/44

3:00 p.m., March 23, 1990

M. Camdessus, Chairman

Executive Directors	Alternate Executive Directors
	S. Gurumurthi, Temporary
F. Cassell	
C. S. Clark	
	Di W., Temporary
	M. E. Hansen, Temporary
	J. Prader
	J. M. Jones, Temporary
	F. E. R. Alfiler, Temporary
E. V. Feldman	
	G. García, Temporary
	A. Fanna, Temporary
	M. A. Ahmed, Temporary
	I. H. Thorlåksson
	M. J. Mojarrad, Temporary
	B. Goos
J. E. Ismael	
	L. M. Piantini
	J.-F. Cirelli
	D. Saha, Temporary
	M. Al-Jasser
	G. P. J. Hogeweg
	K. Ichikawa, Temporary

C. Brachet, Acting Secretary
T. S. Walter, Assistant

Also Present

IBRD: H. Fazel, Latin America and the Caribbean Regional Office. African Department: C. V. Callender. Exchange and Trade Relations Department: S. Kanesa-Thasan, P. J. Winglee. External Relations Department: R. R. Brauning. Fiscal Affairs Department: J. Diamond, K. Nashashibi. Legal Department: J. K. Oh. Western Hemisphere Department: S. T. Beza, Counsellor and Director; J. Ferrán, Deputy Director; E. Decarli, R. A. Elson, L. Schmitz, R. J. Niebuhr. Personal Assistant to the Managing Director: H. G. O. Simpson. Advisors to Executive Directors: J. O. Aderibigbe, Z. Iqbal, K.-H. Kleine. Assistants to Executive Directors: H. S. Binay, C. Björklund, J. Gold, C. J. Jarvis, M. E. F. Jones, J. C. Westerweel.

1. JAMAICA - STAND-BY ARRANGEMENT, AND EXCHANGE SYSTEM

The Executive Directors considered a staff paper on Jamaica's request for a 14-month stand-by arrangement in an amount equivalent to SDR 82 million (EBS/90/42, 3/6/90; and Cor. 1, 3/13/90).

Mr. Clark made the following statement:

Following an extended period of economic adjustment that was characterized by slow growth, inflationary pressures, and persistent domestic and external imbalances, the Jamaican economy turned around in 1986. Economic growth accelerated significantly, inflation subsided substantially, and important progress was made toward reducing domestic and external imbalances. However, in September 1988 Hurricane Gilbert set the economy back somewhat, and the authorities are still dealing with some of the economic repercussions.

The most recent stand-by arrangement with Jamaica was approved just days after the hurricane struck. The program was substantially modified on the occasion of the first review, and performance criteria for the duration of the program were set during the second review. However, the program became inoperative in the fall of 1989, as a result of delays in correcting the exchange rate and an insufficient tightening of credit conditions. The authorities delayed adjusting the exchange rate, because the weakness in foreign external reserves was initially the result of substantial shortfalls in reinsurance receipts and some shortfalls in capital inflows; these amounts were expected to be realized, but with some delay. Subsequent heavy demand on the foreign exchange auction was interpreted by the authorities as speculative activity against the currency, which the authorities thought could be checked by satisfying the excess demand and by tightening credit conditions.

Despite the authorities' efforts to meet foreign exchange demand on the auction and to tighten credit conditions, the pressure on the exchange rate did not ease. By early October 1989, the exchange rate declined to J$6.0 per U.S. dollar, from J$5.5 per U.S. dollar in July. In light of this development, the authorities tightened monetary policy further and introduced a number of measures, including an increase of 500 basis points in the legal minimum rate for savings deposits. Although these actions diminished considerably the pressures on the exchange rate, they were still not sufficient to arrest the further accumulation of domestic arrears. Consequently, on October 31, 1989, the authorities devalued the currency to J$6.5 per U.S. dollar and suspended the foreign exchange auction. The new exchange rate level more than restored the real effective value of the Jamaica dollar to the June 1988 level, as was required under the stand-by arrangement, in the event that the end-September 1989 net international reserve target was not observed. The decision to suspend the auction was based on the authorities' view that, given the low level of reserves and the prevailing market psychology, the level that would be determined by the auction would not reflect market fundamentals.

These difficulties notwithstanding, there have been encouraging developments during the year. In particular, the fiscal performance of the public sector for the current fiscal year is in line with the program, with substantial overperformance by the central government and the rest of the general government. This is especially notable because of the magnitude of the decline of the deficit--about 9 percent of GDP--and also because it re-establishes the prehurricane deficit reduction track. One important factor underlying this strong performance has been the considerable progress made in divesting government assets, with revenue from divestment nearly twice as much as envisaged by the program.

There were also some positive developments in the external sector. There was a marked improvement of about 3 percent of GDP in the trade balance, despite some deterioration in the terms of trade. Export growth was substantially stronger than projected in the program--over 10 percent above the forecast rate and similar to the prehurricane pace. Imports also grew at a faster rate than was projected in the program, but remained well below the prehurricane pace. The major deterioration in the external sector took place in the service balance and led to a substantial loss of reserves during the year, mainly owing to the shortfall in expected reinsurance receipts.

My authorities are confident that the new policy package will address the problems that surfaced in 1989 and will provide the basis for a continuation of the prehurricane growth strategy. As noted by the staff, the program is an ambitious one and seeks to rapidly correct the major imbalance that developed in the past year. The program intends to further reduce the fiscal deficit, to effect a major improvement in the external accounts, and to substantially reduce inflationary pressures in the economy.

As the various components of the program are thoroughly described in the staff paper, I only wish to draw attention to a number of features. First, a large number of the measures in the program have been designed as prior actions, and have in fact already been enacted: most recently electricity tariffs were increased by an average of 37.6 percent, above the 32.5 percent initially planned for and presented in the staff paper.

Second, the exchange rate was further devalued to J$7 per U.S. dollar on February 1, 1990, and is now substantially below the June 1988 real effective rate. It is not expected that the exchange rate will need further adjustment during the program period. Nonetheless, the program does provide a trigger mechanism for further adjustment, if there is an erosion in competitiveness. Moreover, the authorities intend to review the appropriateness of the level of the exchange rate, if the net international reserves target is not met.

Third, monetary and credit conditions are now considerably tighter than at the time of the third review and should contribute to a rapid reduction in inflationary pressures. Substantial evidence of the tighter credit policy is provided in the staff paper; it is particularly notable that bank credit to the private sector is expected to expand by only 2 percent in the second half of the fiscal year, in comparison with 25 percent growth rate in the first half. In addition to the recently implemented policy measures, the authorities plan to keep monetary conditions under close review and to take further action, if required. Finally, the authorities plan to review their monetary policy instruments, in order to improve the efficiency and effectiveness of monetary management.

Fourth, the more restrictive monetary stance is accompanied by further fiscal retrenchment. This should allow for some easing of credit conditions in the latter part of the fiscal year without losing ground in the battle against inflation. Major adjustments are being made in the government enterprise sector, where some weaknesses were evidenced in the past year. These adjustments which are taking place primarily through price increases, should place the enterprises on a sounder financial footing and contribute to the Government's efforts to minimize the subsidization of the economy. Moreover, the authorities have now indicated that, in order to strengthen the program, the April budget will contain fiscal measures beyond that originally planned.

I would like to comment briefly on Jamaica's debt and its medium-term prospects. On a per capita basis, Jamaica is one of the most highly indebted nations in the world. Nonetheless, as a result of its debt structure, as well as its designation as a lower middle-income country, it has not been able to benefit from any of the recent debt initiatives that have brought much-needed relief to many other highly indebted countries. Moreover, a significant part of Jamaica's debt is not eligible for rescheduling, as it is owed to the multilateral institutions. Nonetheless, Jamaica has continued to service all its external creditors, despite the adjustments this has entailed. In this endeavor, the support of the Fund has been, and continues to be, critical. Over the program period, Jamaica has continued to make net repayments to the Fund, and, by the end of the program period, total Fund exposure will decline to 184 percent of quota. The medium-term projection suggests that the most difficult period has now passed and that, with standard rescheduling agreements, Jamaica's debt-service ratio will decline steadily to a very manageable 19 percent by 1995/96.

Finally, my authorities wish to express their appreciation to the staff and management for their valuable contribution to the development of this program.

Mr. Cassell made the following statement:

The process of adjustment in Jamaica has been a long and uneven one. Since the early 1980s, the authorities have made prodigious efforts, but, unfortunately, these efforts have often been punctuated by slippages and by external shocks that have derailed adjustment programs. The damage recently inflicted by Hurricane Gilbert is only one example of this pattern.

Throughout the period of adjustment, the Fund and the World Bank have provided strong support to Jamaica. The most recent stand-by arrangement, however, which was intended to run for 20 months beginning in September 1988, was finally abandoned in November 1989, in conditions of severe foreign exchange shortage and mounting external payments arrears. The stand-by arrangement request now before us represents a new attempt to get the adjustment process running again.

In assessing the strength of the program, the Board needs to ask two questions. Will the program be sufficient to stabilize the economy in the short term? Does it provide a good basis for a long-term improvement in Jamaica's economy?

The program seems strongest in the area of short-term stabilization. It contains a number of important fiscal measures, most notably the agreed price increases for electricity and for commodities sold by the Jamaica Commodity Trading Company. In the longer term, the effective implementation of a new general consumption tax that increases revenue in real terms will be crucial for a lasting improvement in the fiscal position, which, in turn, is critical for the needed adjustment.

Moreover, the program provides for an essential correction in the exchange rate and commits the authorities to maintain a tight monetary policy. These measures, if followed resolutely by the authorities, should be sufficient to deal with the short-term problems that Jamaica faces.

However, an adequate supply of finance will also be essential to the program. There is a substantial financing gap in the first year, which is expected to be filled by Paris Club and commercial bank rescheduling and donor commitments. My authorities are keenly aware of the need to ensure that financing is adequate and have pledged support accordingly; presumably, a number of other donor countries have done the same. Perhaps the staff could let us know the latest developments in filling the financing gap, including any information on the donors meeting that is under way in Paris.

With respect to the second question--whether the program will be sufficient to bring about a lasting improvement in Jamaica's position--there must be much more uncertainty at present. The staff paper records some important positive developments over the past year: the authorities' privatization program has provided a useful source of revenue, and, at least in some areas, is expected to improve productivity; the switch from general food subsidies to better targeted support for the poor is also welcome, as it marks an important departure from past policies, which, although expensive for the authorities, appear to have had only limited impact on the welfare of the poor; and the prospects for increased flows of private capital from abroad look promising, owing largely to liberalizations in investment procedures.

However, it is clear that major structural problems remain. In particular, the role of the Jamaica Commodity Trading Company remains pervasive, and the prevalence of administered prices in major commodities is a cause for concern. In the longer term, the activities of the Jamaica Commodity Trading Company should be curtailed, and much greater reliance should be placed on the market in the allocation and pricing of commodities. A fundamental reform of monetary policy is also needed to improve its efficiency; in that context, the thoroughgoing review of monetary policy that the authorities are undertaking with the aid of the World Bank is welcome.

There must also be a question mark about exchange rate policy, since the authorities seem to have followed a pattern of adopting a fixed exchange rate without taking the necessary measures to support it. The exchange rate then becomes overvalued, and capital flight ensues before the authorities reluctantly acquiesce in an overdue devaluation. The authorities must now make every effort to break this pattern, since the exchange rate mechanism, if not used properly, could serve as a warning signal for capital flight.

Much will depend on the authorities' ability to adopt sufficiently strong domestic policies. If the exchange rate does become overvalued, the authorities should be prepared to act quickly, rather than allowing capital flight to set in. Although the program stipulates that a real exchange rate appreciation of more than 7 percent will trigger an automatic devaluation, this procedure still carries the risk that substantial capital flight will occur before the rate is adjusted. The staff's comments on this issue, as well as on the authorities' decision not to move back to an auction system in the foreign exchange market, would be appreciated.

Finally, there is Jamaica's debt problem. Jamaica is one of the most heavily indebted countries and, as Mr. Clark reminded us in his opening statement, one that has not been able to benefit from any of the recent debt relief initiatives. Although its debt ratios are projected to decline over the program period, they still remain high, and there are substantial financing gaps over the medium term. Taken together, these developments suggest that this program will not be the final stage in Jamaica's adjustment. It can, however, be a decisive stage, enabling Jamaica to look forward to sustained growth and economic stability. If this is to happen, the authorities must demonstrate both courage and good sense. They have made a good start; I hope that they can continue as they have begun. In that spirit, I support the request for a stand-by arrangement.

Mr. Piantini made the following statement:

Until recently, Jamaica's economy could be said to have made substantial progress in reducing rigidities and financial disequilibria and in diversifying exports: only one year after the onslaught of Hurricane Gilbert, export volume and tourism receipts have increased impressively; GDP growth, although lower than projected, is expected to almost double; and the public sector deficit has fallen sharply by two thirds to 4.4 percent of GDP, despite the enormous task of rebuilding the country faced by the authorities.

Nevertheless, the most recent Fund arrangement became inoperative in September 1989, as most of the performance criteria under the stand-by arrangement approved by the Board in the aftermath of the devastation were not observed. A deterioration in the terms of trade and a drop in the projected amount of foreign assistance and reinsurance receipts contributed to the outcome. The authorities, however, acted appropriately to halt the rapid deterioration in foreign reserves by tightening monetary policy and bringing the real effective value of the Jamaica dollar below its June 1988 level.

Jamaica is again requesting Fund financial assistance for an ambitious economic program designed to reinforce the gains already achieved and to continue the implementation of structural reforms, with a view to fostering sustained economic growth and restoring external viability over the medium term. We are in general agreement with the thrust of the staff appraisal and therefore strongly endorse the proposed decision.

Since the public sector is the main source of financial imbalances, the authorities should be more aggressive in reforming it by taking advantage of the present circumstances to broaden their divestment program, thereby reducing the share of the public sector in the economy. Air Jamaica, for example, is a prime candidate for divestiture. Furthermore, the recent rise in public prices and tariffs is encouraging, insofar as Jamaica's fiscal targets could be met if these prices and tariffs accurately reflected the rate of inflation.

The high level of domestic interest payments calls for a rapid improvement in fiscal performance; nonrecurrent fiscal revenue could be helpful in this respect. On the other hand, the implementation of the General Consumption Tax should be accelerated. The application of this tax, together with the elimination of a wide range of tax exemptions, additional reductions in the highest threshold of taxable income, and the implementation of the second stage of trade reform would rationalize the tax system. On the expenditure side, the necessary increase in capital expenditures should be handled by reducing current outlays while protecting social and maintenance expenditures, rather than by increasing overall spending.

The authorities' commitment to implementing a tight monetary policy is a key element in the plan to reduce inflation and to protect reserves. A decline in net credit to the public sector would be important for lowering interest rates, which should reflect market forces. We concur with the staff that the authorities should rely on open-market operations rather than on credit control measures to reduce liquidity, because the latter cause disintermediation and misallocation of financial resources. We welcome the authorities' intention to request technical assistance from the Fund on this matter.

The authorities' commitment to maintain export competitiveness by setting a more realistic exchange rate is also welcome; however, it should be emphasized that a tight macroeconomic policy supported by wage restraints is needed to stabilize the exchange rate. In this respect, we encourage the authorities to replace the present wage guidelines with more flexible ones that will reflect productivity gains.

The medium-term outlook calls attention to Jamaica's vulnerability to external shocks, emphasizing the need for a well-managed exchange rate policy to preserve stability. Nevertheless, the projections indicate that, if Jamaica were to stick to its program of structural reforms--including economic liberalization and a more aggressive free trade policy--it could develop to its full potential by taking advantage of its geographical situation and access to foreign markets, thus rapidly expanding employment opportunities. Meanwhile, however, the country is in urgent need and deserves financial assistance from the international financial community, especially from the Paris Club, in the form of debt relief and concessional aid to cover its financing gap through 1996.

Although Jamaica has been a prolonged user of Fund resources, it has reduced its outstanding liability substantially, thus demonstrating that it deserves the full support of the Board in its efforts to achieve a better standard of living for its people.

Mr. Goos made the following statement:

It is quite unfortunate that, as the widening of the external current account deficit and the decline in the domestic savings rate to below pre-1989 levels clearly demonstrate, much of the adjustment progress that had been made prior to the arrival of the hurricane was reversed in 1989. Equally disappointing are the strong revival of inflationary pressures, the resurgence of capital flight, and, above all, the re-emergence of substantial external payments arrears. Even worse, all this occurred in a period of much stronger than expected export performance that had seemed to offer an excellent opportunity for further tangible progress in reducing the domestic and external imbalances.

Against this background, I certainly welcome the authorities' embarkation upon what the staff has rightly labeled an ambitious adjustment program. This program, however, must be viewed against the backdrop of a difficult medium-term outlook, characterized in particular by the need for continuous exceptional financing until 1995/96. In this light, the program appears to fall short of one of the fundamental principles of Fund financial assistance, namely, the restoration of balance of payments viability in the medium term. Similar difficulties arise with the assumption that the Fund is expected to remain financially involved in the country for another five years, thereby making Jamaica the longest continuous user of Fund resources.

Those issues of the adjustment strategy pursued by Jamaica remind one of the emphasis that is being placed on the strengthening of preventive actions in the ongoing general discussions of the Fund's arrears policy; I am not sure, however, to what extent Jamaica's strategy is compatible with that emphasis. Still another difficulty arises from the fact that full financing of the program has yet to be secured, although the staff seems to be confident that the necessary financing will be duly forthcoming. I join Mr. Cassell in asking the staff to provide us with the latest assessment of the situation.

As a minimum, all this suggests that there is absolutely no room for program slippages, and that the authorities should aim at a more ambitious course of adjustment in the years ahead than is currently envisaged under the staff's medium-term scenario; an earlier attainment of balance of payments viability, in particular, should be striven for. Furthermore, a more ambitious adjustment course would be advisable as a means of forestalling the potential re-emergence of payments arrears to the Fund--a situation in which Jamaica has found itself in the recent past. This point also serves to remind one of the connection between Jamaica's case and the ongoing arrears discussions.

In specific policy areas, I welcome, first of all, the commendable adjustment measures in the public enterprise sector, the decontrolling of food prices, and the encouraging tightening of monetary policy and interest rates that was implemented toward the end of 1989. At the same time, I feel strongly that the authorities would be well advised to follow closely the staff's recommendations for future actions in fiscal and monetary policy, with one exception: given the urgent need to attain balance of payments viability, the necessary containment of current expenditure should be enacted without delay, rather than be postponed to future years.

In the same vein, I associate myself with the previous speakers in urging the prompt introduction of the proposed consumption tax, which should be designed so as to generate a net increase in budget revenue. As described in Mr. Clark's opening statement, the authorities' intention to strengthen the program through the adoption of additional fiscal measures is welcome; perhaps Mr. Clark or the staff could elaborate on the specifics of these measures.

In the realm of monetary policy, the recent reform of the preferential interest rate scheme administered by the Agricultural Credit Bank is welcome; however, the authorities should be encouraged to discontinue all such schemes as soon as feasible.

With respect to exchange rate policy, I join other speakers in welcoming the recent correction of the overvaluation of the Jamaica dollar; this correction should enable the program to be implemented in a stable exchange rate environment. Achievement of this objective will, of course, also depend critically on the maintenance of a sufficiently tight financial policy stance geared to a rapid disinflation and wage moderation.

However, the modalities envisaged for future exchange rate management present some difficulties. Certainly, the exchange rate should not be allowed to diverge substantially from its competitive level; nevertheless, the trigger mechanism that has been constructed for making exchange rate adjustments contains an element of automaticity that threatens to undermine a stable exchange rate's function as a nominal anchor for the economy. More specifically, the mechanism could send the message that shortcomings in financial and wage policies can be corrected painlessly by exchange rate adjustments.

The possibility--already alluded to by Mr. Cassell--that the details of the exchange rate mechanism's operation would be leaked to exchange market participants is another cause for concern. After all, the staff papers dealing with the mechanism are anything but leak proof. Knowledge of the operational details of the mechanism would provide the market participants with a handy guide for speculating against the Jamaica dollar, in the event that the trigger point for a devaluation were being approached. The possession of this kind of inside information would greatly complicate the task of stabilization.

Finally, I wish to distance myself from the assumption made on page 14 of the staff paper that deviations from the balance of payments objectives would indicate a need for exchange rate action. It is very disappointing to encounter continually in staff papers the casual use of potentially counterproductive language that seems to promote exchange rate action as an easy cure-all. Given the discussions that have taken place in the Board on the need for a balanced analysis and presentation of exchange rate policy issues, it is not at all clear why the staff did not adhere to the formulation in paragraph 23 of the letter of intent, which stipulates that in the event of balance of payments slippages, "consultation with the Fund management will take place regarding the need to take additional demand management and/or exchange rate action." This formulation is much more appropriate and commensurate with the need to pay due regard to financial stability considerations than the unbalanced and somewhat mechanistic view expressed in the staff paper.

I support the staff appraisal and the proposed decisions.

Mr. Prader said that as with many other programs, the main objective of the stand-by arrangement for Jamaica was the restoration of fiscal sustainability, which should lead to increased gains in external competitiveness vis-à-vis the other Caribbean Basin countries. The authorities planned to reduce drastically the overall public sector deficit from 4.4 percent of GDP in 1989/90 to 2.7 percent in 1990/91, primarily through price increases by the public enterprises. Although subsidies and unrealistic pricing of goods produced by public enterprises constituted the major distortions in Jamaica's economy, the inflationary impact of a sharp adjustment in tariffs might jeopardize either the inflation targets or, if a real appreciation of the exchange rate were allowed, the country's external competitiveness and its balance of payments position.

The adjustment in prices was inevitable and represented a major step in the right direction, Mr. Prader continued; before a decision was made on the rate of adjustment, however, care should be taken to avoid efficiency losses owing to overemployment, overstocking, and the inappropriate accounting practices of state enterprises. Since complete realization of the structural measures would take time, other revenue-enhancing measures, particularly a more rapid introduction of value-added taxes, should have been considered.

The other alternative--a real appreciation of the exchange rate--was favored as a means of containing inflation and providing coverage until relative prices had been realigned and external competitiveness had improved, Mr. Prader noted. If that option were chosen, the authorities would have to accept both a rise in domestic interest rates and the need for additional external financial assistance.

It was clear, as Mr. Cassell had remarked, that this would not be Jamaica's final stand-by arrangement with the Fund, Mr. Prader observed. Perhaps an extended arrangement would have been more appropriate, given the authorities' needs to secure exceptional medium-term financing and possibly reschedule their debts over a longer period than the duration of a stand-by arrangement, to cooperate closely with the World Bank, in order to implement the desired structural adjustments, and to make direct foreign investment more attractive by eliminating medium-term uncertainties. Politically, the feasibility of an extended arrangement vis-à-vis a stand-by arrangement would depend to a certain extent on the precise timing of the forthcoming 1994 elections; however, the authorities' intentions to formulate a development plan, in conjunction with the medium-term investment program that the World Bank was supporting, could be used as a complementary argument to support the adoption of an extended arrangement.

In conclusion, Jamaica's economy could remain manageable only if its structural impediments were attacked, Mr. Prader stated; to that end, the authorities should speed up the preparation of their medium-term plans. The proven resilience of the economy to natural disasters and the comprehensive measures under consideration were reasons to hope for a successful implementation of a medium-term program. He supported the proposed decisions.

Ms. Hansen made the following statement:

> We welcome Jamaica's request for a new stand-by arrangement and hope that the design of the arrangement under consideration today will help avert a number of the policy failings that have caused previous adjustment efforts to go astray.
>
> In our view, a welcome feature of the proposed stand-by arrangement is the introduction of an explicit trigger mechanism for adjusting the exchange rate, based on an appreciation of the real effective exchange rate and/or adverse developments in the balance of payments. Although we understand the authorities' desire to avoid devaluations, Jamaica's performance under its previous stand-by arrangement clearly shows that maintaining a fixed exchange rate in the face of inappropriate domestic policies will neither result in macroeconomic stability nor enhance confidence in the domestic economy. As experience in many other member countries has demonstrated, strong fiscal and monetary policies offer the best assurance that a country can achieve its balance of payments and growth objectives while maintaining a fixed exchange rate. Hence, although we hope that the trigger mechanism will not need to be activated, the existence of such a mechanism is useful.
>
> In this connection, we note with satisfaction that the overall fiscal deficit is expected to narrow from 4.4 percent of GDP to 2.7 percent, reflecting in large part a sizable improvement in the financial performance of key public sector enterprises following recent domestic price increases.
>
> However, the staff's suggestion that under the proposed stand-by arrangement, current expenditure will need to be tightened in the coming years following a large increase in spending this year raises a question as to whether the program is sending the appropriate signal about the need for fiscal restraint in the central government budget. The staff explains that the size of the increase in current expenditure in 1990/91 is due to special factors, including a transfer to the Jamaica Commodity Trading Company, but it may not be difficult to find special factors in future years as well. As for the Jamaica

Commodity Trading Company, it would be helpful to know why this transfer is necessary and whether reducing its functions or increasing competition from the private sector would improve its efficiency.

The staff paper notes that, after some delays, a new general consumption tax is expected to take effect on October 1, 1990, helping to offset an overall decline in tax revenue during the program period. What assurances are there that this tax will become operative in October, as currently planned, and what would be the budgetary impact if there were a further delay in the implementation of the tax?

We welcome the progress that has been made in reducing food subsidies and would urge the Government to phase them out entirely, replacing them with a well-targeted food stamp program, as needed. This action would help to ensure that food subsidies are confined to those who need them most, while reducing the overall cost to the government budget and, in all likelihood, increasing the transparency of the transfer. According to the staff paper, the Government has said that it intends to continue reducing food subsidies. Have the authorities presented a timetable for doing so?

With regard to monetary and credit policies, there is a strong need to ensure that interest rates remain positive and preserve their competitiveness with international rates, so as to encourage domestic savings and reverse the previous year's capital flight. The measures adopted for savings accounts held by nonresidents should be very helpful in this regard. The domestic savings deposit rates now seem to be slightly positive in real terms, and a deceleration of the rate of inflation should encourage the upward trend. However, since the authorities need to ensure that deposit rates are sufficiently attractive, they should not be too quick to lower the rates as the inflation rate declines. The continued use of preferential interest rates in various sectors of the economy that was alluded to in the staff report is disturbing; we hope that these rates will be phased out quickly.

Turning to Jamaica's external position, we note that the staff's balance of payments projections show persistent financing gaps over the medium term that will evidently need to be filled by repeated debt rescheduling. The need for rescheduling reinforces the importance of adjustment under the stand-by arrangement as a demonstration of good faith to creditors. Meanwhile, Jamaica's almost continuous use of Fund resources over the past dozen years has not been consistent with the objective of using the resources on a revolving basis; this credit history is yet another reason for the Fund to monitor the program closely, in order to ensure, as Mr. Cassell put it, that performance under this stand-by arrangement is a decisive step toward medium-term balance of payments viability.

The section of the staff paper on Jamaica's capacity to repay the Fund was welcome; however, it is curious that no mention was made of Jamaica's outstanding obligations to the World Bank, which persisted in the 60 to 75-day category for ten days following the circulation of the Fund paper. We hope that this omission was merely a reflection of the Fund's certitude that Jamaica would settle its obligations to the World Bank before the Fund's Board discussion--which, apparently, it did on March 16--and not a sign of indifference about overdue obligations to the Bank.

In conclusion, we support the proposed stand-by arrangement and hope that the authorities will take advantage of the framework that it provides to improve their fiscal and monetary management. Good performance under the arrangement would go a long way toward restoring confidence in Jamaica's economy, achieving the program's goals for private capital inflows, and facilitating the maintenance of the stable exchange rate that the authorities desire. We support the proposed decisions.

Mr. Al-Jasser made the following statement:

The proposed program represents an important step on the part of Jamaica toward resuming the adjustment effort that had been interrupted by the effects of the hurricane and by the subsequent expansionary financial policies. However, in light of the re-emergence of external payments arrears, the need for exceptional balance of payments financing in the medium term, and the continued sensitivity of external viability to exogenous factors, this program should be viewed only as a starting point for a long-term period of economic correction; commensurate debt rescheduling and financing should therefore be made available to ensure implementation of the program. It is gratifying to note that, although a prolonged user of Fund resources, Jamaica has been able to gradually reduce its net use of Fund resources and is expected to continue this process in the future. I broadly agree with the thrust of the program and support the requested stand-by arrangement.

The program quite rightly aims at a strong fiscal correction supported by a tight monetary policy that will reduce demand, raise domestic savings, and reallocate resources. It is gratifying to note that the envisaged fiscal restraint will be supported by a much-needed increase in the prices of public utilities.

However, given the large size of the public sector relative to the overall economy, an acceleration of the divestment process and elimination of remaining subsidies can go a long way toward correcting the underlying weaknesses in the economy, which have typically been reflected in high costs of capital to the private sector. It would also be helpful if new instruments of monetary management were introduced expeditiously, so that excessive dependence on direct credit controls can be avoided.

The program could have benefited from a stronger incomes policy than the current one. It is unfortunate that the annual guideline for wage negotiations in 1990/1991 has been raised by 25 percent, which is even higher than the anticipated rate of inflation. As a minimum, the guidelines should have been kept unchanged, in order to support the exchange rate.

Like Mr. Cassell and Mr. Goos, I believe that linking exchange rate policy to movements in the real effective exchange rate, which are based on changes in prices, could lead to an inflationary bias; this practice is therefore inconsistent with the objective of accelerating growth while reducing inflation. The program calls for an adjustment in the nominal rate whenever the real effective exchange rate diverges from the norm by 7 percent, irrespective of the cause of the appreciation. It would be easier to accept the rationale for this adjustment if the real effective exchange rate calculations were based on cost inflation data--relative wages, for example--that reflect competitiveness more accurately than price inflation data. In any event, a stronger commitment to controlling inflation would be preferable to a dependence on exchange rate adjustments, which will internalize and, even worse, legitimize inflation.

For an economy so vitally dependent upon the external sector, Jamaica maintains a large array of exchange and trade restrictions. Although the granting of temporary approval for their retention is acceptable, it is hoped that the enactment of adjustment measures will minimize the need to maintain these restrictions and multiple currency practices in the future. In particular, the authorities should move decisively toward eliminating the remaining restrictions on foreign direct investment; these steps would aid greatly in reducing the very large external debt burden.

I hope that the authorities will be able to implement this program effectively, thus establishing a durable path toward growth with stability and external viability.

Mr. Di said that he welcomed the authorities' renewed commitment to implement a program aimed at re-establishing the conditions for economic growth through strong fiscal adjustment and exchange rate stability. It was unfortunate that Jamaica's program for 1989/90 had been interrupted because of deviations in the performance of the economy. The unfavorable economic results of 1989, however, had basically been the repercussions of natural disaster and thus to a large extent had been beyond the authorities' control.

Economic conditions in the country apparently remained very difficult, Mr. Di remarked, with continued pressure on public finance resulting in adverse consequences for international reserves, including the re-emergence of external arrears. Yet, it was encouraging to note from the staff's report, and from Mr. Clark's opening statement, that the economy had shown considerable resilience in recovering from the effects of the hurricane. Moreover, it was reassuring to note from their letter of intent that the authorities had introduced additional fiscal and monetary measures in the past several months, with a view to containing the public sector deficit, stabilizing the foreign exchange market, and substantially reducing external arrears.

Reduction of the external debt burden through the implementation of reforms was one of the authorities' objectives in their medium-term adjustment plan, Mr. Di stated. Although considerable progress had been made in recent years in reducing the external debt--the debt/GDP had ratio has fallen from about 160 percent in March 1986 to 120 percent in March 1990--Jamaica was still one of the most highly indebted countries in the world on a per capita basis. Therefore, special attention should be given to making improvements in the external sector, and greater effort was needed to gradually reduce the heavy debt burden.

The authorities should do their part by adhering to strong financial policies and making every effort to maintain the country's external competitiveness, Mr. Di said. As the staff paper had described, Jamaica's external outlook was highly sensitive to changes in the underlying assumptions of the medium-term outlook, particularly those with respect to tourism, export prices of alumina and petroleum, and interest rate levels. Thus, adverse external developments in any one of those areas could worsen the country's external balance and, once again, disrupt the authorities' adjustment efforts. In that connection, recent policy actions taken by the authorities to adjust the exchange rate were welcome. Moreover, it was appropriate to maintain a trigger mechanism for further exchange rate adjustments in the event of erosion of the country's external competitiveness.

Although the authorities should make every effort to give priority to measures that would eliminate external arrears as quickly as possible, the implementation of appropriate economic policies was not sufficient, Mr. Di continued. It was also important for Jamaica to receive continuous support from the international community, especially the Fund, given the country's debt structure and its need for exceptional balance of payments financing over the next few years. The policies that the authorities had already adopted and the continued commitment to deepen the adjustment effort that they had demonstrated served to validate their request for another Fund stand-by arrangement. He concurred with the general thrust of the staff's appraisal of the Jamaican economic program for 1990/91 and supported the proposed decisions.

Mr. Thorláksson said that the outcome of an economic program depended to a great extent on the assumptions underlying the economic analysis, the impact of the conceived measures, and the determination of the authorities to implement the policies. It seemed that the third element had been somewhat lacking in Jamaica's most recent stand-by arrangement, as the failure to promptly or properly counter credit expansion and distortions in the exchange rate had been the main reason for the economy going off track. In all fairness, however, it should be remembered that the hurricane had inflicted considerable damage on the Jamaican economy at the beginning of the stand-by arrangement, and--despite subsequent modifications to the program--had ultimately helped to prevent its completion.

According to the staff, the economic program underlying the request for the new stand-by arrangement was an ambitious one, Mr. Thorláksson noted. The program was also highly sensitive to changes in international prices and interest rates and, therefore, still extremely dependent on the authorities' determination to implement the envisaged policies firmly and to take corrective action at the first sign of any divergence from the program.

Because of its magnitude, servicing the external debt was a heavy burden for Jamaica's already fragile external account, Mr. Thorláksson remarked. Clearly, the need for exceptional financing would persist for a number of years. It was crucial, therefore, to secure the external competitiveness of the economy, especially since such major industries in Jamaica as tourism and bauxite were highly dependent on international prices. In that context, the recent adjustment of the exchange rate and the incorporation of the exchange rate adjustment mechanism into the current economic program were welcome.

An exchange rate policy that was too flexible, however, might fuel the wage-price spiral and should therefore be cautioned against, Mr. Thorláksson continued. For instance, the authorities should not depreciate the Jamaican dollar as a means of absorbing an increase in the wage bill of the export industries. Moreover, the exchange rate policy had to be supported by strong fiscal measures and a tight monetary policy, in order to reduce the inflationary pressures on the economy and attract capital inflow. The willingness of the authorities to strengthen the program by introducing the additional fiscal measures that Mr. Clark had described in his opening statement was therefore welcome.

Fiscal policy had been quite successful in Jamaica over the past few years, Mr. Thorláksson commented. However, in view of the fall in tax revenues and the rise in expenditures, he welcomed not only the proposed introduction of the general consumption tax, which was aimed at strengthening the revenue side of the budget, but also the adjustments--both those already implemented and those proposed--to the prices charged by public enterprises. In addition, the authorities should continue to reduce food subsidies and to encourage all efforts to improve the financial position of the public enterprises. Bearing in mind Jamaica's predominantly good track record over the past few years, the large number of measures that had already been enacted, and the decline in Jamaica's obligations to the Fund over the program period, he supported the stand-by arrangement and the proposed decision on the exchange system.

Mr. Alfiler said that, since he agreed with the general thrust of the staff appraisal and the stand-by arrangement, he could support the proposed decisions. In addition, he was pleased to note from Mr. Clark's opening statement that the authorities had taken a number of important measures that should go a long way toward ensuring that the objectives of the program would be met.

It was appropriate that the 1990/91 program was an ambitious one, Mr. Alfiler continued, because the reversal of the gains that had been made in policy areas before the onslaught of the hurricane had dealt a blow to Jamaica's economy. The program's emphasis on strong fiscal adjustment and exchange rate stability was correct. On the fiscal front, it was important that revenue efforts should be enhanced, in order to compensate for the expected decline in the level of reconstruction assistance that had followed in the wake of Hurricane Gilbert and for the nonrecurrent sale of public assets in 1989/90. The authorities should therefore carry out their planned fiscal consolidation program steadfastly and accelerate work on the General Consumption Tax, with a view to avoiding further delays in its implementation.

On the expenditure side, Mr. Alfiler said, he supported the maintenance of a reasonable level of public investment outlays, in light of the country's longer-run growth needs; however, there might be room for a further tightening of current expenditures, particularly in public sector wages and transfers to the Jamaica Commodity Trading Company. Moreover, he endorsed the staff's call for closer monitoring of the expenditures program, as part of the effort to ensure that the desired fiscal adjustment took place. In the area of public sector enterprises, the adjustment of prices of public sector goods and services was essential, not only in view of the amount of public savings that would be generated, but also because of the effect that the price increases would have on the structural adjustment process in the private sector.

On the external front, the recent adjustment in the exchange rate should help both to restore the confidence that had been eroded by the accumulation of external arrears and to strengthen external competitiveness, Mr. Alfiler remarked. Any exchange rate adjustment, however, should be supported by monetary and fiscal restraint, in order to ensure that the program's objective of reducing the rate of inflation would not be compromised. In that regard, the policy actions taken by the authorities to tighten monetary and credit policies were welcome. In addition, he fully endorsed the authorities' intention to eliminate as quickly as possible the ceiling on individual commercial banks' credit that had been introduced in September 1989.

The willingness of major creditors to provide adequate financial support for the program was encouraging, particularly since financing gaps were expected to persist until well beyond the present arrangement, Mr. Alfiler observed. Firm adherence to the objectives of the Fund-supported program on the part of the authorities would ensure the realization of that financial support.

Mr. Ichikawa made the following statement:

> Hurricane Gilbert unfortunately caused a considerable delay in Jamaica's economic adjustment process and resulted in the modification of the previous stand-by arrangement; nevertheless, the failure to complete the revised stand-by arrangement was due to a considerable extent to the authorities' inadequate and slow adjustment of interest and exchange rates. In particular, the regrettable delay in tightening credit conditions put undue pressure on the foreign exchange auction. Moreover, the interest costs of the public sector under the current financing operation resulted in losses to the Bank of Jamaica--an outcome that this chair had cautioned against on a previous occasion. Regrettably, the combination of these adverse developments caused the re-emergence of external arrears and substantial capital flight.
>
> Against this background, we can support the authorities' suspension of the exchange auction and devaluation of the currency; however, these measures will not restore confidence in the economy unless they are fully supported by coordinated adjustments in fiscal, credit, and incomes policies. Therefore, this year's program should attack the inflationary pressures and the deterioration in the external balance head on.
>
> The emphasis on revenue-enhancing measures in the design of the program is welcome and, indeed, imperative, as the sale of public assets that was begun in the previous financial year will only have a one-time effect. In this context, the introduction of the General Consumption Tax--the pillar of the tax reform--should be effected without delay. On the expenditure side, the increase in current expenditures is a cause for concern. In light of the future growth of capital expenditure for social rehabilitation purposes, the unchecked growth of wage bills and transfers to public companies at this critical juncture may jeopardize the basis of balanced fiscal adjustment.

In order to support this necessary fiscal adjustment, the operation of the public enterprises must be improved. We welcome the price adjustment plan, including the increases in electricity tariffs and food prices and the progress in liberalizing prices. It is not at all certain, however, that the weight of the Jamaica Commodity Trading Company in the economy is appropriate. Perhaps it would be possible to limit the Company's scope while reducing its price controls--particularly at the wholesale level--with a view to improving market efficiency.

On the monetary front, the authorities reintroduced direct control measures to reinforce the tight credit stance of the Bank of Jamaica. These measures are warranted in the short term, as the authorities can allow only a slow expansion in the net domestic assets of the banking system. Nonetheless, we reiterate our concern about the undue costs that will be incurred by the Bank of Jamaica as a result of operational losses in the public sector: more transparent fiscal accounting is needed to establish a firm basis for effective monetary policy.

Although improvement is projected, Jamaica's external position remains very fragile. In particular, the low level of reserves, the large debt-service obligation, and, most important, the lack of medium-term viability are causes for concern. In the short term, the large financing gap must be filled by rescheduling debt and eliminating external arrears. As the staff rightly points out, the medium-term projection is sensitive to any changes made in the assumptions of the current account balance; the authorities should therefore maintain external competitiveness by providing a sound macroeconomic environment, including, inter alia, effective management of the current exchange arrangement. This task is all the more important in light of the necessity of preventing further capital flight.

We have a question regarding the Fund's financial involvement in Jamaica over the medium term. On page 17 of the staff paper, the statement is made that Fund resources will be used to fill the medium-term financing gaps. Is the staff thereby suggesting a continuation of Jamaica's prolonged use of Fund resources? The further danger in this situation is that the Fund might have to provide resources in order to refinance Jamaica's original purchases from the Fund.

In conclusion, despite the encouraging adjustment initiatives that have been taken for short-term problems, there remain a number of concerns and uncertainties with respect to Jamaica's medium-term outlook. Thus, like previous speakers, we strongly urge the authorities to persist in strengthening their adjustment efforts. We support the proposed decisions.

Mr. Hogeweg made the following statement:

Like other speakers, I am very disappointed that, after end-June 1989, the stand-by arrangement for Jamaica ran off track, beyond repair, and that Jamaica rapidly built up renewed external payments arrears. The new program that we are asked to approve today certainly contains most welcome--and very necessary--measures to redress this situation. Mr. Clark has stressed the prior action character of some of the measures, and, indeed, the medium-term scenario shows that more manageable debt-service payments are within reach; however, we should realize that the past year's failures have put the country at least a year back. Since Jamaica seems to run the risk of seeing the prospect of viability receding in time like a horizon that can never be reached, it is therefore vital that this program should, at the very least, be fully adhered to; preferably, even more should be done. It is justified that access has been set at a level that allows for a falling Fund exposure over the program period; with its recent track record, I, unlike Mr. Prader, do not believe that the time is ripe for an extended arrangement for Jamaica.

The seeds of failure already seemed present in the way the performance criteria for end-June 1989 were met: postponement of expenditures offset a larger than programmed credit expansion to the private sector, and external payments arrears were cleared by using advance payments on future exports and proceeds of sales of government assets. Those actions made raised questions about how the performance criteria had been designed, since it was evidently possible for Jamaica to qualify for a further drawing on the Fund at the expense, so to speak, of subsequent performance.

From the viewpoint of program design, it is clear that Jamaica's economy is very vulnerable to adverse external developments. Would some form of contingency mechanism not help prevent future derailments? The importance of a sound macroeconomic framework, combined with a correct mix of adjustment and financing, cannot be overemphasized. Only in a stable macroenvironment will it be possible for the World Bank to adequately address the question of essential structural adjustment in Jamaica.

I liked the statement in the staff paper that the program aims at re-establishing the conditions for economic growth through strong fiscal adjustment and exchange rate stability. This approach contrasts with that taken in many other programs, in which a specific, usually high, growth rate is aimed for, even when the need for short-term stabilization is a clear first priority. Furthermore, this approach seems to acknowledge that exchange rate stability may have some virtues. However, the rest of the paper stresses only the mechanism in the program that triggers devaluations beyond a certain magnitude of appreciation of the real effective exchange rate. With regard to this mechanism, I endorse Mr. Goos's remarks. I realize very well that Jamaica's balance of payments has been adversely affected in the past by failure to make timely adjustments to the exchange rate in the face of slippages in domestic financial policies; in addition, the judgment of the authorities as to the duration of the most recent exchange rate pressures was clearly, in retrospect, too optimistic; however, like Mr. Goos and Mr. Al-Jasser, I feel that the staff should encourage rather than discourage efforts by authorities to use exchange rate stability--at a competitive level--to their advantage. In this connection, does the staff believe that the program is restrictive enough to allow the exchange rate stability that is envisaged by the authorities?

I very much agree with the emphasis placed on fiscal consolidation in the program; it would indeed be most welcome if this emphasis could relieve the pressure on interest rates. The importance of the Fund-supported studies on more transparent ways of dealing with the quasi-fiscal losses of the Bank of Jamaica and on enhancing monetary policy instruments should also be stressed. In addition, the staff rightly points to the advantages of market-based instruments of monetary control; however, I would warn against relying prematurely on such instruments alone, in the absence of the financial infrastructure needed for their proper functioning. In my view, temporary recourse to direct instruments is certainly better than losing control over monetary expansion. Of course, direct instruments do not obviate the need for adequate interest rate levels, and monetary control should not be hampered by preferential interest rate schemes or by hesitations on the part of the authorities in the implementation of interest rate hikes. Fiscalization of central bank losses would certainly strengthen monetary policy instruments and might also facilitate a more independent stance for the Bank of Jamaica. I endorse the proposed decisions.

Mr. Cirelli made the following statement:

Despite some encouraging areas of performance in 1989--inter alia, total output and mineral and industrial production improved, and export performance was buoyant--the results of the previous stand-by arrangement were generally disappointing. The upsurge in domestic demand, the reinforced inflationary pressures, the continuation of large public sector deficits, the deterioration in the current account balance, and the increase in capital flight all contributed to a rapidly worsening economic situation and to the exchange rate crisis of the previous autumn. These events clearly testify to the sensitivity of a highly indebted economy to the occurrence of unfavorable economic developments; Jamaica's program has gone off track, and arrears have once again appeared.

In response to these imbalances, the authorities have put in place a program aimed at re-establishing an economy oriented toward a more sustainable rate of growth, hoping thereby to obtain Fund support. I support the proposed decision, since it is appropriate that the Fund should acknowledge the extensive efforts that the authorities have made; however, past experience--four stand-by arrangements over the previous six years--has not been particularly conclusive in establishing a sustainable macroeconomic framework. The authorities should therefore be aware that the ambitious program that they have embarked upon does not include any room for maneuver. More than ever before, the program requires firm implementation in order to avoid further slippages that could damage Jamaica's economy.

Strong action in the area of demand-management policies is clearly needed to correct the macroeconomic imbalances and to allow the resorption of the large debt burden that Jamaica has accumulated. To achieve these objectives, the program rightly focuses on the necessity of fiscal restraint, accompanied by tight credit and wage policies.

A strong fiscal adjustment is undoubtedly the cornerstone for the success of the program, and a tight internal policy is clearly needed to cut the excessive demand pressure that occurred in 1989, and to contribute to the external objectives of exchange rate stability. In the program, the burden of the adjustment falls more heavily on the public enterprises' deficit than on the budget deficit, for which stronger measures could have been envisaged. Although the authorities are to be commended for the actions that they have adopted in the area of public prices, some uncertainties, especially concerning the timely implementation of reforms, lead one to think that the forecasts might be somewhat optimistic.

The uncertainties related to the revenue objectives are reinforced by the realization that the projections of increased revenue are based partly on an expected improvement in the external trade balance, and on the introduction of the General Consumption Tax. The new tax has not yet been implemented, and, according to the staff paper, its effects on total revenues have not yet been assessed clearly. In this context, the authorities must be ready to reduce expenditures, in the event that revenue receipts do not reach the foreseen targets.

With respect to monetary policy, there is little that can be added to the report. An overdue tightening of policy took place in 1989, and the increase in interest rates must be used to contain excessive demand, even if, in these circumstances, the use of other direct transitory instruments could also be helpful. The reduction of the public sector's net indebtedness vis-à-vis the banking system could also help to attain the monetary objectives; nevertheless, the merits of such a reduction must be assessed in the context of, on the one hand, the conditions surrounding the increase in foreign borrowing, and, on the other, the exchange rate policy adopted by the authorities. Indeed, any automatically triggered depreciation would now increase the debt burden and have an adverse impact on the public deficit.

In order to achieve the external objectives and avoid a harmful spiral of devaluation, the implementation of tight demand policies is necessary. In this regard, the automatic triggering of an exchange rate adjustment could weaken the strength of the overall adjustment effort, rather than improve it.

With respect to the current account deficit, the assumptions underlying the balance of payments prospects seem to be on the optimistic side. Exports are expected to increase significantly while imports are expected to decrease. This would seem to be difficult to achieve, given the large component of imports in export products, particularly energy products, and could be accomplished only if a large resorption of stocks took place. It is true that tourism receipts are increasing sharply, but they are especially volatile. In reality, the balance of payments will remain fragile during the program period, with a continued pronounced dependency on exceptional financing and debt rescheduling under the auspices of the Paris Club. In this regard, the medium-term scenarios clearly show that lasting efforts will be required during the decade, as the projections, which are very sensitive to external developments, do not give a strong indication of medium-term viability.

In the trade sector, the authorities should be encouraged to go further in strengthening the liberalization process and reviewing the actual role of the Jamaica Commodity Trading Company.

The authorities have embarked on a courageous program that deserves the support of the Fund. The objectives are undoubtedly ambitious, and favorable conditions are required in many areas. Furthermore, the high level of debt and the high sensitivity of the economy to unfavorable events do not offer the authorities much leeway in coping with the problems that face them. Nonetheless, with this program, Jamaica has taken a major step toward resumption of the process of economic adjustment. We urge the events clearly testify to the sensitivity of a highly indebted economy to the occurrence of unfavorable economic developments; Jamaica's program has gone off track, and arrears have once again appeared.

In response to these imbalances, the authorities have put in place a program aimed at re-establishing an economy oriented toward a more sustainable rate of growth, hoping thereby to obtain Fund support. I support the proposed decision, since it is appropriate that the Fund should acknowledge the extensive efforts that the authorities have made; however, past experience--four stand-by arrangements over the previous six years--has not been particularly conclusive in establishing a sustainable macroeconomic framework. The authorities should therefore be aware that the ambitious program that they have embarked upon does not include any room for maneuver. More than ever before, the program requires firm implementation in order to avoid further slippages that could damage Jamaica's economy.

Strong action in the area of demand-management policies is clearly needed to correct the macroeconomic imbalances and to allow the resorption of the large debt burden that Jamaica has accumulated. To achieve these objectives, the program rightly focuses on the necessity of fiscal restraint, accompanied by tight credit and wage policies.

A strong fiscal adjustment is undoubtedly the cornerstone for the success of the program, and a tight internal policy is clearly needed to cut the excessive demand pressure that occurred in 1989, and to contribute to the external objectives of exchange rate stability. In the program, the burden of the adjustment falls more heavily on the public enterprises' deficit than on the budget deficit, for which stronger measures could have been envisaged. Although the authorities are to be commended for the actions that they have adopted in the area of public prices, some uncertainties, especially concerning the timely implementation of reforms, lead one to think that the forecasts might be somewhat optimistic.

The uncertainties related to the revenue objectives are reinforced by the realization that the projections of increased revenue are based partly on an expected improvement in the external trade balance, and on the introduction of the General Consumption Tax. The new tax has not yet been implemented, and, according to the staff paper, its effects on total revenues have not yet been assessed clearly. In this context, the authorities must be ready to reduce expenditures, in the event that revenue receipts do not reach the foreseen targets.

With respect to monetary policy, there is little that can be added to the report. An overdue tightening of policy took place in 1989, and the increase in interest rates must be used to contain excessive demand, even if, in these circumstances, the use of other direct transitory instruments could also be helpful. The reduction of the public sector's net indebtedness vis-à-vis the banking system could also help to attain the monetary objectives; nevertheless, the merits of such a reduction must be assessed in the context of, on the one hand, the conditions surrounding the increase in foreign borrowing, and, on the other, the exchange rate policy adopted by the authorities. Indeed, any automatically triggered depreciation would now increase the debt burden and have an adverse impact on the public deficit.

In order to achieve the external objectives and avoid a harmful spiral of devaluation, the implementation of tight demand policies is necessary. In this regard, the automatic triggering of an exchange rate adjustment could weaken the strength of the overall adjustment effort, rather than improve it.

With respect to the current account deficit, the assumptions underlying the balance of payments prospects seem to be on the optimistic side. Exports are expected to increase significantly while imports are expected to decrease. This would seem to be difficult to achieve, given the large component of imports in export products, particularly energy products, and could be accomplished only if a large resorption of stocks took place. It is true that tourism receipts are increasing sharply, but they are especially volatile. In reality, the balance of payments will remain fragile during the program period, with a continued pronounced dependency on exceptional financing and debt rescheduling under the auspices of the Paris Club. In this regard, the medium-term scenarios clearly show that lasting efforts will be required during the decade, as the projections, which are very sensitive to external developments, do not give a strong indication of medium-term viability.

In the trade sector, the authorities should be encouraged to go further in strengthening the liberalization process and reviewing the actual role of the Jamaica Commodity Trading Company.

The authorities have embarked on a courageous program that deserves the support of the Fund. The objectives are undoubtedly ambitious, and favorable conditions are required in many areas. Furthermore, the high level of debt and the high sensitivity of the economy to unfavorable events do not offer the authorities much leeway in coping with the problems that face them. Nonetheless, with this program, Jamaica has taken a major step toward resumption of the process of economic adjustment. We urge the authorities to stick to their commitment, since the task is not easy, and any relaxation such as occurred in the past would be detrimental to the whole economy.

Mr. Ahmed made the following statement:

In recent years, the sustained adjustment efforts of the Jamaican authorities, which have been supported by a number of arrangements with the Fund, have brought about a welcome reduction in financial imbalances and a resumption of economic growth. However, progress on these fronts was interrupted by the difficulties in public finances caused by Hurricane Gilbert, as well as by the uncertainty and related spending pressures surrounding the general elections that were held in 1989, and by hesitation at that time on the part of the authorities in making exchange rate adjustments and adopting other supportive policy actions. Unfortunately, these developments resulted in the stand-by arrangement with the Fund--as modified in February 1989--going off track and becoming inoperative.

Despite this setback, the Jamaican authorities remain firm in their determination to address the structural weaknesses in the economy and put it back on a path of sustainable growth. As a reflection of this determination, a new economic program has been designed with a view to fostering economic growth, achieving a major reduction in the external current account deficit, narrowing the overall public sector deficit through tight credit and wage policies, and liberalizing the economy for the purpose of attracting private capital inflows. These measures should enable the economy to grow at a yearly rate of over 3 percent in the medium term, in an environment of price stability and greatly reduced fiscal and external imbalances.

Although as the staff report acknowledges, the program is ambitious, it does, I believe, deserve the support of the Fund: the program represents a significant adjustment effort; it builds on a good record of policy implementation; and, above all, it reflects the authorities' strong resolve to persevere with corrective measures. I agree with the thrust of the staff appraisal and can support the decisions.

I was interested to note the staff paper's description of the operations of the wage guidelines, and the authorities' intention to modify these guidelines to allow for greater flexibility. Although the application of the guidelines in a few pilot cases will allow the authorities to experiment with different formulas, I would caution against establishing too rigid a link between wages and productivity differentials for many reasons including the difficult problems that arise in the measurement and--more important--the interpretation of conventional labor productivity indicators. Furthermore, it has been seen empirically that productivity differentials tend to vary quite substantially between enterprises; linking wage increases to these differentials could therefore result in a seriously distorted wage structure, which would obviously be an undesirable outcome.

Basically, wages should follow general underlying movements in the economy-wide cost of living index, and productivity differentials should not be reflected in the interindustry structure of factor rewards--as excessive wage claims, in this case. Instead, these differentials should be reflected in lower relative prices in the enterprises that attain above-average productivity gains. In this way, the benefits of technological progress are shared more widely through lower prices and higher real incomes for all. Furthermore, the full extent of the cost reductions that the above-average productivity gains have engendered can best be translated into lower prices by ensuring that the markets are kept sufficiently competitive. I wonder whether the staff could comment on this issue, particularly in the context of the discussions that were held with the authorities in drawing up the 1989/90 program.

In addition, I was interested in the details of the trigger mechanism for exchange rate action that has been built into the program. Under the trigger mechanism, whenever the average of the monthly index for the most recent three-month period indicates a cumulative real appreciation of more than 7 percent from the June 1988 level, the authorities will adjust the exchange rate by the amount needed to bring the real effective value of the Jamaica dollar back to that level. I was curious as to how the figure of 7 percent had been derived and wondered whether it should not perhaps be higher, or for that matter lower, and therefore whether there was any rationale for the 7 percent ceiling.

Finally, as the staff paper has brought out, an improvement in the balance of payments is a crucially important aspect of the authorities' program, in light of the goals of keeping financing gaps at a manageable level, maintaining an unimpaired debt-servicing capacity, and reducing the present large external debt burden. Nevertheless, the rather sketchy presentation of the external current account--especially as it relates to the prospects for exports--is somewhat disappointing. The staff appears to give almost exclusive attention to the need to maintain a competitive exchange rate and strong financial policies; however, although the importance of these factors should not be minimized, other considerations are equally important, and it is, in my view, insufficient to say only that the outlook for nontraditional exports is "favorable." A more extensive discussion on the evolution of markets abroad, the obstacles that Jamaica may face in penetrating these markets, and the need for policies to diversify both the export mix and the market destination would have been preferable. Moreover, reference to the "possible negative impact of a change in preferential arrangements for Jamaica's agricultural exports in the U.K. market"--which the staff, in any event, has apparently not taken into account--has not been made clear. What is the likelihood of such a change and will it affect the balance of payments in a significant way?

Mr. Jones commented that Jamaica's adjustment effort was continuing, despite some setbacks that had caused the previous stand-by arrangement with the Fund to become inoperative. There had been many positive developments during the past year: output growth had reached nearly 3 percent, after a substantial drop in 1988/89; the public finances had improved; and exports had performed substantially better than expected.

Meanwhile, the authorities had moved quickly to put together a program designed to reduce inflation and to further strengthen the financial position of the public sector, Mr. Jones said. The authorities' commitment to the adjustment process was demonstrated by their early implementation of some of the measures in the 1990/91 program. Solving the inflation problem, however, would require a careful balancing act, given that attainment of the fiscal objective would depend heavily on increasing the prices charged by public enterprises, including prices of basic imported goods, electricity, and other goods and services. In those circumstances, therefore, it was important to ensure that the increases were nonrecurrent, in order to avoid a conflict between the two goals of controlling inflation and improving the fiscal balance.

Exchange rate stability had been singled out as a key factor for determining the success of the program, Mr. Jones noted. A clearer specification of the precise role of the exchange rate in the program was needed, because exchange rate policy had seemingly been given the dual assignment of improving competitiveness and restraining demand.

The program had correctly been described as ambitious, Mr. Jones remarked; it would require exceptional assistance from the international community, given Jamaica's high debt-service ratio. He endorsed the proposed decisions.

Mr. García said that he welcomed the commitments that the Jamaican authorities had made to resume the pace of economic adjustment that had prevailed before the advent of Hurricane Gilbert and to restore financial balances to their prehurricane levels. These policies were most urgently needed, because Jamaica's excessive indebtedness and its vulnerability to several factors, most of which were beyond the Government's control, confronted the economy with serious restrictions in the medium term.

The fragile external financial situation of Jamaica would require strong policies to stimulate internal saving, capital inflows, and foreign investment, Mr. García remarked. In addition to a very active exchange rate policy aimed at avoiding losses in external competitiveness, the strategy would require a tight monetary policy stance and the removal of some restrictions in the financial market, such as a credit ceiling for individual banks. Instead of relying on measures of direct credit control, the basic instruments of monetary policy should be open-market operations by the Bank of Jamaica and the free-market determination of interest rates. The authorities' intention to introduce those policies in the near future was thus welcome.

Public finance was another area of concern, Mr. García observed. Over the past two years, the fiscal balances of the central government and the decentralized government agencies had improved substantially, moving from deficits to surpluses. However, the Bank of Jamaica and other public enterprises continued to suffer extensive losses, which needed to be reduced in the near future. In that context, the authorities' intention to establish a transparent fiscal process for the analysis and reduction of those losses was welcome.

It would be helpful if the staff could provide more details on the Government's plans for the further divestment of public enterprises and their assumption by the private sector, Mr. García continued. The divestment policy might continue to serve as an important source of financing in the coming years, while more permanent sources of revenue were being developed.

Comments from the staff on the structural trade reforms that were scheduled to be implemented over the course of the program period would also be appreciated, Mr. García said. The effect of the proposed reforms on the restrictions and distortions discussed in the staff paper, such as control over export proceeds, indirect subsidies for imported goods, and export subsidies would be of special interest.

He broadly agreed with the thrust of the staff appraisal, Mr. García remarked. Moreover, he supported the proposed decision and encouraged the authorities to maintain an active policy stance and avoid slippages under the new stand-by arrangement. In addition, the authorities should normalize financial relations with their creditors through the elimination of arrears, and the international community should support the Government's efforts.

Mr. Feldman said that he shared the staff's belief that Jamaica's economic program was ambitious and represented a significant adjustment effort that deserved of Fund support. He agreed with Mr. Cassell that the program's strength lay in its aim of stabilizing the economy; moreover, the large number of prior actions that Mr. Clark had drawn attention to further underscored the authorities' commitment to the adjustment effort.

He shared Mr. Clark's concern about the difficulty that Jamaica had experienced in entering into a debt initiative, Mr. Feldman continued. Given Jamaica's current circumstances and its previous record in fulfilling external credit obligations, even under very difficult conditions, perhaps the Fund should reschedule Jamaica's net repayments within the framework of an extended arrangement, rather than pursue the repayments during the program period. He supported the proposed decisions.

The staff representative from the Western Hemisphere Department said that, in the area of exchange rate policy, the intention was to start the program with an exchange rate level that would ensure competitiveness for Jamaica; indeed, if the program were implemented as specified in the letter of intent, it should be possible to maintain exchange rate viability during the program period. Of course, a number of uncertainties clouded the picture, including, inter alia, the significant reduction in inflation and subsequent restoration of confidence in the economy that the program relied on and which were by no means faits accomplis. For that reason, in the event that the application of determined fiscal and credit policies did not prevent a buildup of balance of payments pressures and a loss in competitiveness, a mechanism for testing and adjusting the exchange rate had been built into the program as a safeguard.

In that context, it should be noted that the staff's formulation of possible policy responses to balance of payments difficulties--discussed on page 14 of the staff paper--was not restricted to exchange rate actions, the staff representative continued. The relevant sentence read: "Also, evidence that the balance of payments objectives of the program were not being met would indicate a need for exchange rate action that would be taken as needed in conjunction with a tightening of financial policies." Therefore, the thrust of that sentence in the staff paper was not different from the comparable one in the authorities' letter of intent.

Mr. Goos said that the two formulations of policy options--in the staff paper and in the letter of intent, respectively--differed in meaning. The sentence in the staff paper preceding the one cited by the staff representative explained the workings of the exchange rate mechanism as follows: "Under such a trigger, whenever the average of the monthly index for the most recent three-month period indicates a cumulative real appreciation from the level of June 1988 of more than 7 percent, the authorities would adjust the exchange rate by an amount that would bring the real effective value of the Jamaica dollar back to that level." In other words, the mechanism would be used to maintain exchange rate competitiveness. The next sentence in the staff paper could therefore be read as a validation of the practice of responding to balance of payments pressures by making exchange rate adjustments.

It was difficult to accept that method of dealing with balance of payments problems, Mr. Goos remarked. Using the exchange rate as an easy cure-all clearly ran the risk of creating a vicious circle of rising inflation and further devaluations. The exchange rate should be used solely to maintain external competitiveness; if, balance of payments pressures were to emerge after the correct exchange rate level had been set, financial policies--including the adjustment of interest rates--should be the first and most important instruments used to combat those pressures.

The Chairman commented that, although the temptation to use exchange rate adjustments as a panacea was always present, it should be remembered that the Articles of Agreement had been drawn up precisely to prevent that kind of behavior. Furthermore, it was possible to read the sentence that the staff representative from the Western Hemisphere Department had cited differently from the way Mr. Goos had: the sentence could be interpreted as putting equal weight on the two options of adjusting the exchange rate and tightening financial policies, thereby minimizing the risk of appearing to favor the easy solution--exchange rate adjustment.

The staff representative from the Western Hemisphere Department noted that the program for Jamaica already placed a great deal of emphasis on fiscal adjustment and credit restraint, rather than on exchange rate adjustment. The program called for a reduction in the fiscal deficit--as measured by a definition that excludes the revenue from the proceeds of divestment--from 7.7 percent of GDP in 1989/90 to 4.4 percent in 1990/91. In addition, the interest rate on instruments used by the Bank of Jamaica for open-market operations had increased from 18 percent in 1989 to 28-30 percent recently, as a result of the substantial tightening of credit policy. As many speakers had emphasized, the balance of payments situation in Jamaica was difficult, the staff representative continued. It was therefore essential that the authorities maintain external competitiveness, in order to reduce the current account deficit and eliminate arrears in accordance with the program's guidelines. It was in that context that Mr. Cassell had expressed misgivings about the exchange rate mechanism, implying that perhaps the 7 percent threshold was too high, and that it would be necessary to make exchange rate adjustments before that threshold was reached.

The threshold for adjusting the exchange rate had admittedly not been determined in a very scientific way, the staff representative said. Similar mechanisms for exchange rate action had been used in previous agreements with Jamaica, and the thresholds had been set at various rates--for example, 5 percent and 5.8 percent.

Jamaica's short- and medium-term financial prospects had been the subject of much attention, the staff representative noted. With respect to the 1989/90 financing gap, US$33 million was expected to be covered by a rescheduling with the Paris Club. The financing gap for 1990/91 was US$142 million, of which US$112 million would be filled by reschedulings with the Paris Club and with commercial banks; the authorities were attempting to cover the remaining US$30 million by seeking balance of payments assistance from donors on concessionary terms and by rescheduling agreements with other bilateral creditors. Currently, approximately US$18 million of the remaining US$30 million gap was being filled with the support of bilateral donors on concessionary terms, and, based on preliminary estimates, rescheduling agreements with commercial banks would account for an additional US$3-4 million. Those agreements would reduce the 1990/91 gap to only about US$8 million, which should be completely filled in the process of Jamaica's ongoing rescheduling negotiations with other creditors. Financing gaps of US$175 million were projected for both 1991/92 and 1992/93, the staff representative observed. However, the calculation of those gaps did not take into account the outcome of the nearly completed rescheduling agreements with commercial banks; those agreements would provide approximately US$25 million each fiscal year. Similarly, the financing gap figures excluded the possible commitment of project assistance from bilateral donors under the Caribbean Group for Cooperation in Economic Development, which was expected to meet in Washington in April, as well as possible additional financing from the Inter-American Development Bank. Taking the new commitments into account, gaps of about US$100 million would still remain for 1991/92 and 1992/93; those financing gaps, however, could almost be covered completely by rescheduling agreements with the Paris Club.

Given the need for rescheduling by the Paris Club over the next two years, an extended arrangement might be more appropriate for Jamaica than a stand-by arrangement, the staff representative commented. That possibility had been under consideration when the previous program had appeared to be on track, and its successful completion could have led to the negotiation of an extended arrangement. Currently, however, circumstances were not ideal for negotiating such an arrangement; successful completion of the new stand-by arrangement would probably be a prerequisite for future consideration of an extended arrangement.

In the context of Jamaica's continuing use of Fund resources, future negotiations would take into account the Fund's access policy, the staff representative remarked. It was possible, although not certain, that the continuation of net repayments to the Fund from Jamaica would be stipulated as a condition for future agreements; in any event, it was not clear that the Fund's level of exposure would be undiminished.

On March 16, Jamaica had fallen 61 days behind on a loan from the World Bank but had paid up in the evening of the same day, the staff representative related. From the World Bank's point of view, that payment had cleared Jamaica's account, as the 60-day mark was the cutoff point for overdue obligations. The Fund staff had been in constant contact with the World Bank staff on that subject and could affirm that the request for a stand-by arrangement would not have been presented to the Board if Jamaica had been in arrears with the World Bank.

Some speakers had made suggestions for reducing the role of the Jamaica Commodity Trading Company in the economy, the staff representative noted. Jamaica's private sector was definitely moving in that direction, and the Government's responsiveness to the idea was evidenced by the actions described in the staff paper. It was expected that in the future those efforts would be intensified, particularly in connection with the negotiations for additional trade and financial sector loans from the World Bank. Those negotiations could result in the elimination of some of the monopolies of importation in Jamaica, including that on the importation of automobiles, and thus further minimize the Jamaica Commodity Trading Company's participation in the economy.

The wage guidelines had been increased from 10 percent to 12.5 percent during the past year, the staff representative said. However, because of Jamaica's past rate of inflation and its previous stringent wage guidelines, the application of the current guidelines had not produced a rise in real wages. The guidelines, although not the sole determinant of wages in Jamaica, did apply to about 25 percent of the labor force and thus were a useful tool for gauging the increase in wages.

The authorities' postponement of expenditures in June 1989 had not been designed merely to fulfill the quarterly performance criteria, the staff representative stated; rather, the delay in spending had been related to the fact that the new budget had only been approved in May. Some divestment proceeds had been obtained ahead of the schedule envisaged in the program, but such a schedule was merely indicative. The program allowed for flexibility in the management of this extraordinary source of revenue.

The problems that had developed in the following quarter could have been resolved if monetary policy had been implemented more decisively and if repeated attempts had not been made to maintain the exchange rate at an unsustainable level, the staff representative from the Western Hemisphere Department continued. Thus, the situation had become more difficult as policy errors had compounded the original problems. In that context, therefore, Jamaica's economic difficulties in 1989 could not legitimately be attributed to the design of the program.

Mr. Cassell said that, although he had no difficulty in accepting the intention behind the exchange rate mechanism, he foresaw certain problems that could develop in its practice. In theory, the authorities ought to start taking appropriate actions as soon as the real exchange rate began to appreciate, with the 7 percent threshold functioning purely as a safeguard; however, if the authorities felt that they had the leeway to allow an appreciation of almost 7 percent before taking action, they would find themselves in a situation with only one option--which was exactly the situation to be avoided.

The staff representative from the Western Hemisphere Department remarked that the exchange rate mechanism should be viewed only as a safeguard. Balance of payments targets had been included among the performance criteria, and if any criteria were not met--not just those in the area of exchange rates--discussions on the adoption of appropriate policies would begin immediately, with all possible actions--including exchange rate adjustments--open for consideration.

The Chairman commented that the establishment of an exchange rate mechanism in the stand-by arrangement for Jamaica had to be understood in the context of the long history of the Fund's relations with that country: on several occasions the Fund had experienced great difficulty in convincing the authorities to take timely action in the exchange rate field. The spirit of the mechanism was not to delay action until the 7 percent threshold was reached, but rather to ensure that all policies would be corrected before that point. The exchange rate mechanism should be viewed as a safeguard.

Mr. Goos said that he was intrigued by the reference to the use of similar exchange rate mechanisms in previous programs adopted by Jamaica; in light of the current discussion, it might be useful to hear more about those experiences.

There was a striking difference between the recent Board discussions on the Fund's overall arrears strategy--particularly in the emphasis on preventive action--and the discussions on specific countries' policies, Mr. Goos continued. For example, a consensus had been developing in the Board over the past few months to incorporate detailed records of countries' payments to the World Bank into the staff reports; however, the staff paper on Jamaica, while giving a very detailed record of its payments to the Fund, did not present equally detailed information on the country's financial dealings with the World Bank.

In recent Board discussions, the consensus had also developed that Fund-supported programs should generally aim at achieving medium-term balance of payments viability, Mr. Goos noted. There was a striking difference between that consensus--as expressed in the context of the Board's discussions on general preventive action--and the viewpoint espoused in the staff paper on Jamaica. Perhaps the present occasion was not the appropriate time to draw attention to the dichotomy, but it should be kept in mind during future discussions. In discussing preventive actions in general, it might be preferable to lay more stress on the feasibility of the various measures that were under consideration; in reviewing specific country cases, more consistency in applying general policies might be aimed for.

The Chairman remarked that Mr. Goos's point was well taken; however, it should be remembered that the Fund was still in the process of rethinking its procedures and strategies as they applied to individual countries. It was true that, if Jamaica's program had not already been formulated, the discussions held recently on general preventive action would undoubtedly had a much more decisive influence on the deliberations. In any event, the Fund had over the past four years reduced its exposure in Jamaica by one half. Ideally, the Fund would maintain a prudent level of exposure in the future while continuing to promote progress toward structural reforms.

The Executive Board then took the following decisions:

Stand-By Arrangement

The Government of Jamaica has requested a stand-by arrangement for the period from March 23, 1990 to May 31, 1991 in an amount equivalent to SDR 82 million.

The Fund approves the stand-by arrangement set forth in EBS/90/42, Supplement 1.

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

Decision No. 9392-(90/44), adopted
March 23, 1990

Exchange System

Jamaica retains restrictions in the making of payments and transfers for current international transactions and a multiple currency practice, as described in EBS/90/42, which are subject to the Fund's approval under Article VIII, Sections 2(a) and 3. Jamaica is implementing an economic program which contemplates liberalization of its exchange system, and, on this basis, the Fund grants approval for the retention of these restrictions and multiple currency practice until July 31, 1990 or the completion the next Article IV consultation, whichever is earlier.

Decision No. 9393-(90/44), adopted
March 23, 1990

DECISION TAKEN SINCE PREVIOUS BOARD MEETING

The following decision was adopted by the Executive Board without meeting in the period between EBM/90/43 (3/23/90) and EBM/90/44 (3/23/90).

2. KENYA - TECHNICAL ASSISTANCE

In response to a request from the Kenyan authorities for technical assistance in the fiscal field, the Executive Board approves the proposal set forth in EBD/90/90 (3/21/90).

Adopted March 23, 1990

APPROVED: January 24, 1991

LEO VAN HOUTVEN
Secretary