NOT FOR PUBLIC USE

INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 85/76

10:00 a.m., May 20, 1985

R. D. Erb, Acting Chairman

Executive Directors	Alternate Executive Directors
	J.-C. Obame, Temporary
C. H. Dallara	M. K. Bush
	H. G. Schneider
	X. Blandin
	T. Alhaimus
	M. Sugita
	B. Goos
	Jaafar A.
R. K. Joyce	L. Leonard
	J. Hospedales, Temporary
H. Lundstrom	
	W. K. Parmena, Temporary
	M. A. Weitz, Temporary
	E. M. Ainley, Temporary
	G. Ortiz
	J. de Beaufort Wijnholds
	A. V. Romuâldez
	O. Kabbaj
	A. Vasudevan, Temporary
	T. A. Clark
	N. Coumbis
Zhang Z.	Wang. E.

L. Van Houtven, Secretary
R. S. Franklin, Assistant

Also Present

C. Bernard, Latin America and the Caribbean Regional Office, IBRD. Exchange and Trade Relations Department: C. D. Finch, Director; W. A. Beveridge, Deputy Director; S. Kanesa-Thasan, P. M. Thomsen. Fiscal Affairs Department: R. D. Kibuka. Legal Department: J. K. Oh. Secretary's Department: J. W. Lang, Jr., Deputy Secretary. Treasurer's Department: W. O. Habermeier, Counsellor and Treasurer; D. Williams, Deputy Treasurer; T. B. C. Leddy. Western Hemisphere Department: E. Wiesner, Director; S. T. Beza, Associate Director; D. L. Budhoo, L. E. Escobar, J. Fajgenbaum, J. Ferrân, K. Flug, O. Gronlie, M. E. Hardy, S. N. Kimaro, C. S. Lee, S. C. Sosa. Advisors to Executive Directors: G. E. L. Nguyen, G. W. K. Pickering, E. M. Taha. Assistants to Executive Directors: W.-R. Bengs, Bo T., M. B. Chatah, G. Ercel, G. D. Hodgson, Z. b. Ismail, A. K. Juusela, M. Lundsager, D. J. Robinson, J. E. Rodríguez, A. A. Scholten, A. J. Tregilgas, E. L. Walker.

1. GROUP OF TEN - DEPUTIES' MEETING - REPORT BY STAFF

The Treasurer reported that, during the previous week, the Deputies of the Group of Ten had met in Basle and had completed the drafting of their Report to Ministers on possible improvements in the international monetary system. The report covered four subjects: the functioning of the floating exchange rate system; the strengthening of international surveillance over elements of the monetary system; the management of international liquidity, which included the role of the SDR; and the role of the Fund. The Ministers and Governors of the Group of Ten would meet in Tokyo on June 21 to discuss the Report of the Deputies, after which a press communiqué was expected to be issued.

2. JAMAICA - REVIEW UNDER STAND-BY ARRANGEMENT AND WAIVER OF PERFORMANCE CRITERIA

The Executive Directors considered a staff paper on a review under the stand-by arrangement for Jamaica together with a request for a waiver of performance criteria (EBS/85/107, 4/30/85).

The staff representative from the Western Hemisphere Department observed that, since EBS/85/107 had been issued, information had become available on performance with respect to the end-March and end-April performance criteria. The criteria for end-March related to fiscal program targets; in EBS/85/107, the authorities had requested that the targets on net international reserves, net external debt disbursements, private sector external arrears, and net domestic assets of the Bank of Jamaica be set for April 30.

In the year ended March 31, 1985, fiscal performance had been within the ceilings established in the program, the staff representative continued. The central government borrowing requirement had been J$683.5 million, or J$13.5 million below the program ceiling. At the same time, net international reserves of the Bank of Jamaica had been only US$13.2 million below the target of US$580 million, despite the fact that a drawing of US$27.5 milion under the World Bank structural adjustment loan (SAL) programmed for disbursement at end-March had actually been disbursed during April.

The net international reserves target for April had been exceeded by a margin of US$37.7 million, as the reserve position of the Bank of Jamaica had further improved from that at end-March, the staff representative remarked. Public sector arrears had been eliminated by the end of April, and private sector arrears had been reduced, as expected, to US$10 million. The authorities had also been able to comply with the debt disbursement ceilings.

A staff mission had recently returned from Jamaica, having carried out the 1985 Article IV consultation and initiated discussions on a program for the 1985/86 fiscal year that could be supported by a new stand-by arrangement, the staff representative from the Western Hemisphere Department observed. Under the new program, performance criteria would span the period from March 1985 through March 1986. Discussions were well advanced, and a letter of intent was expected to be submitted shortly to management; if the remaining outstanding issues were settled quickly, it was to be hoped that the relevant papers could be issued in June. Under the 1985/86 program, a decline of about 10 percent in nonbauxite-related imports and a decline of 3-4 percent in real GDP were expected. Further important fiscal adjustments were being carried out, in part to replace lost revenues from the bauxite sector. However, despite the adjustment efforts, the new program would require extensive debt rescheduling as well as incremental financing. About US$30 million of such financing had as yet not been identified. That matter would be taken up during a donors' conference beginning in Paris on May 21, and at the Paris Club meetings currently scheduled for late July.

Mr. Joyce made the following statement:

> Our discussion of Jamaica has two purposes: first, to review progress under the stand-by arrangement, which expires in June 1985, and, second, to consider modifications in that arrangement and certain measures taken recently by the authorities that will enable the 1984/85 program to be brought to a successful conclusion, thus laying the basis for a possible follow-on program for Jamaica in 1985/86.
>
> The proposed changes in the program arise in the first place from nonobservance at the end of December 1984 of performance criteria for net international reserves and external arrears. These shortfalls resulted largely from further delays in disbursement of an external loan that was received in February. Jamaica is requesting a waiver from these two end-December performance criteria.
>
> Subsequent to the review mission's visit to Kingston late last fall, the authorities began implementing measures that would ensure that the March targets would be met. The planned measures included increases of 20-25 percent in the prices of certain commodities and increases in interest rates. However, the civil disturbances associated with the sharp increase in the prices of petroleum products announced in mid-January forced the Government to delay implementation of the other price and interest rate changes that had been planned. Moreover, the disturbances themselves led to a reduction in tourist arrivals and a worsening of revenue and foreign exchange prospects. The sudden and unexpected announcement by ALCOA that it would close its operations in February made the economic outlook bleak, particularly for the medium term.

In these circumstances, it was clear that Jamaica needed to introduce further corrective measures as quickly as possible if the viability of the program itself were to be restored and a more realistic basis provided for any follow-on arrangement that might be negotiated for 1985/86. The Government decided that the original measures envisaged in January needed to be implemented and, in discussions with the Fund, identified additional measures that should be taken to achieve the objectives of the present program. It was clear, however, that these additional measures could not be put into position early enough to ensure that Jamaica would meet the performance criteria for March 1985 on net international reserves, net domestic assets, net disbursements of public and publicly guaranteed foreign indebtedness, and the level of international payment arrears, particularly given the negative impact of the January disturbances on tourism. Jamaica therefore is requesting that the applicable date for meeting these tests be shifted to the end of April 1985 and that the amounts be modified to take account of this delay.

The measures already taken or announced are set out in the Prime Minister's letter of intent dated April 26 and include:

(a) In April 1985 the prices of a number of imported products were increased to reflect exchange rate developments. Further changes will be made on a monthly basis in the light of changes in the exchange rate and other costs. Domestic sugar prices were increased by 37 percent on May 11.

(b) Jamaica has also reached agreement with the Fund on a trigger arrangement to ensure that further increases in the price of petroleum products will take place if there is a significant additional depreciation in the value of the Jamaican dollar.

(c) The Government moved during the past two months to increase the degree of monetary restraint by tightening credit policies. Measures have included a raising of cash and liquid reserve ratios and substantial increases in interest rates.

(d) The Government on April 13 imposed a new stamp duty on imports ranging from 10 percent to 30 percent, which applies to imported goods other than baisc foods, drugs, fertilizers, petroleum imports, imports from countries in the Caribbean Community and Common Market (CARICOM), and inputs and raw materials for export production. While this measure will generate substantial additional revenues in 1985/86 and hence compensate for the loss in bauxite revenues, the immediate returns during the life of the current program will not be large.

The free-floating exchange rate system introduced in November is functioning effectively. Progress has also been made in reducing or eliminating government subsidies and in liberalizing prices. Important changes introduced in the public service and in government programs have led to a 4 percent reduction in public sector employment in the current year.

Finally, as a result of earlier revenue and expenditure measures adopted by the Government in 1984, the fiscal deficit has been reduced from 16.5 percent of GDP in 1983/84 to 7 percent in 1984/85--a major accomplishment by any standards--and some reduction has been recorded in the external current account deficit despite recent adverse developments, although the improvement falls short of what was originally projected.

It is clear that Jamaica continues to face serious problems and that further significant measures will be needed through the medium term. Moreover, as the staff points out, continued large-scale debt relief and increased assistance from donors over an extended period will be required. As Directors may be aware, the Government of Jamaica is discussing with the Fund a new program for 1985/86. These negotiations should be concluded in the near future.

In conclusion, the current program represents an intensive and demanding adjustment effort by the Jamaican people. Moreover, despite a worsening of Jamaica's economic circumstances in the past few months, Jamaica has made substantial progress in attaining the program's objectives, and, subject to the granting of the waivers, will meet all the criteria under the program. Important corrective measures have been introduced to accelerate the pace of adjustment, to compensate for the weakening of the bauxite industry, and to prepare the way for further progress in 1985/86. In the light of these circumstances, I would ask the Board to agree to Jamaica's request for waiver and modification of the performance criteria as set out in the proposed decision.

Mr. Hospedales stated that his chair was in broad agreement with the staff appraisal, which, together with Mr. Joyce's statement, had given him a broader understanding of the deep-seated economic crisis faced by Jamaica and of the authorities' strenuous efforts to achieve internal and external balance, restore confidence in the economy, and create the conditions for a resumption of stable and sustainable growth rates. Jamaica was a prolonged user of Fund resources, and its performance indicated the strong and painful efforts that a small country with a narrow resource base had to undertake in response to a drastic and continuing deterioration in its external terms of trade, aggravated by high external debt.

The adjustment of the Jamaican economy had been costly, Mr. Hospedales considered. Real GDP growth had barely kept pace with population growth, per capita incomes had declined, and the rate of unemployment was alarming at 25 percent. Given the deep-seated crisis, the authorities had no alternative but to adjust the economy to the realities of the current situation.

The recent strengthening of adjustment measures provided clear evidence of the seriousness that the authorities attached to achieving external and internal balance. Their efforts toward that end had been commendable. On the monetary side, for example, liquidity and bank credit had been tightened and interest rates increased; both were key conditions for mobilizing domestic financial resources and improving the savings rate. In that regard, the benefits for long-term economic growth from efficient resource allocation could not be overemphasized.

Although improvements in public finances had yielded positive results, the recent deterioration in economic conditions in Jamaica made it imperative that far-reaching measures on the revenue side be implemented as soon as possible, Mr. Hospedales continued. He thus agreed with the staff that higher tariffs on imports should receive priority. Stricter expenditure control was also needed, and he urged the authorities to strengthen the statistical data base to ensure that the quality of performance could be adequately analyzed. The need for an appropriate wage policy to support tight monetary and fiscal policy was critical. Recent wage settlements had been in line with program levels, and he commended the staff for having taken a realistic position on the wage issue in the context of existing social conditions. The improvement in the internal generation of cash by public enterprises was welcome.

On the external side of the economy, Mr. Hospedales noted, the functioning of the exchange market had been improved, and the real effective devaluation of the Jamaican dollar had already had a positive impact on the economy's competitiveness and export growth. External financing arrangements seemed to be secure with the completion of debt rescheduling and restructuring. Clearly, however, large-scale debt relief and considerable concessional resources were still needed. Generally speaking, the situation in Jamaica remained grave. The deep-seated structural problems could be tackled only in a medium-term framework and in a flexible manner, and progress toward that end would be slow. For that reason, his chair believed that the program was in the right direction and that the performance of the Jamaican economy thus far had been satisfactory. Minor deviations from performance criteria, particularly deviations for technical reasons or on account of exogenous developments, should not be cause for any disruption in financing arrangements.

He could support the request of the Jamaican authorities for a waiver in respect of the performance criteria related to net international reserves and private sector arrears for end-December 1984, Mr. Hospedales remarked. The recent worsening of economic conditions and the prompt policy response by the Jamaican authorities also warranted his support for a waiver of performance criteria for end-March 1985 on net international reserves, net domestic assets of the Bank of Jamaica, and net disbursements of public and publicly guaranteed foreign indebtedness. Because of the need for additional time to implement corrective policy measures, new performance criteria should be established for end-April

1985 and the performance criteria on the elimination of private arrears should be extended through June 25, 1985. In conclusion, he could support the proposed decision.

Mr. Dallara stated that the review under the stand-by arrangement for Jamaica and the request for a waiver of performance criteria were troubling. Waivers were being requested for performance criteria that had already been modified once, and new modifications to performance criteria for end-March were being requested even though March had already passed. The modified performance criteria were apparently to apply to end-April, a time also already passed. Moreover, approval of the decision on the review under the stand-by arrangement for Jamaica would permit the authorities to purchase SDR 18 million, while verification of the end-April criteria would release the remaining SDR 18 million of the arrangement. Those two purchases could occur at a time when there was no indication from the staff that a new program--with policies, performance criteria, and targets for June and beyond--had been agreed upon. In the circumstances, the Executive Board would be permitting Jamaica to make two purchases, equal to more than 50 percent of the amount agreed under the program, when there was no assurance that the adjustment effort--already recognized as inconsistent--would be on track for the remainder of the year and beyond. The absence of any assurance of continued adjustment was even more difficult to accept against the background of a medium-term outlook that was so bleak that prospects for balance of payments sustainability and repayments to the Fund were unclear. Since those were the two key criteria against which any program should be evaluated--particularly a program for one of the most serious cases of prolonged use of Fund resources--he would defer his position on the proposed decisions until he had heard the views of other Directors and the responses of the staff to his concerns.

He could agree with those who felt that the Jamaican authorities had succeeded, in the context of the existing program, in taking several difficult steps to raise prices, reduce the central government deficit, and improve operations of the exchange rate regime, Mr. Dallara continued. Those steps should help to improve the economic situation in Jamaica. Also, the waiver requested for December might well be justified on the grounds that one foreign loan had not been disbursed until February and that other exogenous events might have affected the authorities' ability to fulfill the performance criteria. However, it was not clear that the adjustment measures adopted by the authorities were sufficient, given the adverse change in the medium-term outlook that had occurred in 1985; nor was it clear whether exogenous variables had been the only reason for the insufficient progress thus far. For example, the delay in the disbursement of the structural adjustment loan from the World Bank might, as he understood it, have been due to Jamaica's lack of progress in the adjustment effort.

Detailing some of his concerns about the country's performance and the procedures employed by the staff in bringing the program back to the Executive Board, Mr. Dallara observed, first, that staff estimates suggested that the central government deficit had fallen from 16 percent to 7 percent of GDP, an impressive accomplishment. However, it was unclear what had been happening in the remainder of the public sector, although there were indications that performance had been inadequate. Those indications were not necessarily obvious from any one table summarizing the consolidated public sector, but they could be deduced from several tables. For example, the Bank of Jamaica was carrying large losses, and Table 7 on page 16 showed that commercial bank claims on the Bank of Jamaica had been J$260 million above the amount originally programmed for 1984/85. Net claims on other elements of the public sector had also been much higher than originally programmed, although lower than in the revised program. Such extensions of banking system credit to various parts of the public sector indicated the possibility of a large operating deficit of the Bank of Jamaica and the overall public sector. Moreover, the "selected public entities" described on page 14 did not appear to have performed particularly well. Their better than expected financial performance was largely attributed to one-time cash inflows: the sale and lease-back of aircraft, and the short-term oil credits. While those had been helpful developments, the conclusion that he tended to draw was that, without much stronger continuing efforts to improve the financial position of those entities, performance in 1985/86 would worsen by comparison with the current fiscal year. He recognized, of course, that the recent price increases should help to reduce the operating losses of some public sector enterprises, as should the periodic changes in petroleum prices according to the agreed formula. One additional concern about the public sector enterprises was that they were permitted to use short-term foreign financing, since there was no performance criterion limiting it. Access to such financing could postpone adjustment and greatly exacerbate Jamaica's external debt problems.

The description of central government finances on page 13 of the staff paper, "suggesting significant problems in the recording of expenditures," led him to wonder whether the central government budget deficit had actually fallen as much as had been indicated, Mr. Dallara commented. His doubts had been reinforced by the comment on page 6 that domestic arrears might have been incurred by various parts of the public sector in the previous fiscal year. Also, with central government reductions in manpower equal only to two thirds of the programmed level, it was not clear what the shape of government finances would be in the future. In sum, he was uncertain from the information provided in the staff paper whether much progress had indeed been achieved in the overall fiscal area.

On the monetary side, Mr. Dallara said that he would be interested in hearing how recent policy changes, and the measures that might be included in any new program, would reduce the large deficit of the Bank of Jamaica. The floating exchange rate was supposed to end any subsidy that the Bank of Jamaica had previously been providing, although he was uncertain whether it would in fact do so, given the large extensions of credit from the banking system to the Bank of Jamaica. Furthermore, the tables in the staff paper seemed to indicate a restrained credit policy, with net credit to the public sector having fallen by 19 percent and credit to the private sector having increased by only 4.3 percent, while the level of imports had barely changed from the previous year. It was apparent that the staff had viewed monetary policy as insufficiently tight, given that it had begun to recommend a further tightening of reserve ratios and increases in interest rates as early as November 1984. Those increases had been implemented incrementally over the past several months, but they had not resulted in positive real interest rates for borrowers or savers. With inflation at 30 percent, the highest rate of return on a certificate of deposit was only about 22 percent. Moreover, given Jamaica's proximity to large international financial centers, it was unlikely that domestic savings would respond even in future to the tightening of reserve ratios and the increases in interest rates.

On the external side, the floating of the Jamaican dollar had resulted in a substantial depreciation of the currency and thus a favorable impact on nontraditional exports, which were reportedly up by 40 percent to non-CARICOM markets, Mr. Dallara continued. Such a supply-side response was indeed welcome, both for the improvement that it had brought to the balance of payments and for the employment and growth effects in the Jamaican economy. However, other items in the balance of payments seemed to have been unaffected by the float. Notably, imports had not yet responded to the higher local-currency cost, and the authorities had been compelled to levy a substantial import surcharge to generate fiscal revenue and further dampen import demand.

A greater concern related to the poor prospects for Jamaica's bauxite industry, Mr. Dallara noted. World markets were certainly weak, but the depreciation of the Jamaican dollar should have reduced costs in the bauxite/alumina industry; unfortunately, one foreign investor had closed its plant because of declining profit margins. While he had been given to understand that the Jamaican Government was reopening that plant, it was clear that the bauxite levy--an important source of revenue to the Jamaican Government over the years--had combined with the previously overvalued Jamaican dollar to narrow profit margins over time. Those elements had certainly inhibited foreign investors in Jamaica from modernizing their plants; as a result, Jamaica's output had become steadily less competitive as additional world capacity had come on stream. The combined effects of Jamaica's policies and world growth in capacity were currently being seen in the country; unfortunately, those trends might not be reversible in the immediate future, and stringent economic adjustment would be unavoidable.

He understood that an effort had been made to convince the Jamaican authorities to implement a foreign exchange auction system in 1984, and he recognized that substantial adjustment had taken place in the exchange rate, Mr. Dallara remarked. However, it was not clear that the rate was responding freely to market forces, since the Government of Jamaica determined the supply of foreign exchange to the market. Indeed, in March, the supply of foreign exchange had at times been double the normal amount. Furthermore, given Jamaica's economic difficulties, it was likely that the Jamaican dollar would continue to depreciate, although it appeared to have stabilized in recent weeks. As end-March reserves and arrears targets had been missed, and, given that short-term foreign borrowing had increased substantially, he wondered whether the rate was truly responding to market forces.

Developments in wages over the past year had given rise to uncertainty, Mr. Dallara commented. The staff had noted on page 17 of the paper that one of the wages under government control--namely, the minimum wage--had been increased by twice the programmed average percentage increase in wages. It was not evident what the wage settlement in the Central Government had been, although wage increases in the public entities were apparently on track. Strong efforts must be made to reduce government spending, efforts that must include lower wage increases in the public sector. On a related matter, it was not at all clear that the Government was making sufficient progress in divesting itself of certain public sector enterprises. Given the Government's weak balance of payments position, increased efficiency of the public enterprises was extremely important. It was his understanding that the Jamaican authorities were committed to selling off some of those firms, and he would be interested in hearing about progress toward meeting that commitment.

On broader policy concerns, Mr. Dallara considered, the staff report raised many questions about the progress toward and prospects for a sustainable balance of payments position in Jamaica. The medium-term balance of payments projections on page 18 left him with serious concerns about Jamaica's ability and/or willingness to adjust sufficiently to narrow the balance of payments gaps to a sustainable margin. By comparison with the previous year, the balance of payments outlook had deteriorated; while some of that deterioration might have been beyond the immediate control of the Jamaican authorities, it was clear that prospects for achieving a sustainable balance of payments position in the near future were bleak. Executive Board approval of the proposed decision would in all likelihood permit Jamaica to draw the remaining SDR 36 million under the current stand-by arrangement, despite the lack of any clear assurances that Jamaica would be able to make the required repurchases over the three-to-five-year repurchase period. He understood that civil disturbances had made the Jamaican authorities gravely reluctant to take the required adjustment steps; however, the late date at which the adjustment measures had finally been implemented had necessitated even larger adjustments. He was quite concerned that the additional adjustment effort needed might be difficult to implement and maintain. Being uncertain about the commitment to the adjustment effort, he was reluctant to approve further disbursements at a time so near the end of the current arrangement.

Given Jamaica's history of prolonged use of Fund resources and the high level of Fund credit outstanding as a percentage of quota, he would not normally have assumed that a follow-on program was being planned, although he was aware of discussions between the Fund staff and the Jamaican authorities on such a program, Mr. Dallara said. In the circumstances, he would have been more comfortable with an alternative approach under which only a small disbursement was proposed for the end of the current arrangement together with evidence of sound policies under a new program that could have been simultaneously circulated to the Executive Board for information or approval. Such an approach would at least have reassured him that a strong commitment to the adjustment effort was present. He had looked at a number of other programs in which waivers and modifications of performance criteria had been granted, thus permitting further purchases. However, in almost every instance, those waivers and modifications had been granted in the middle of an ongoing Fund program, and assurances had been provided that appropriate policies would be in place for the following six to nine months. In the Jamaican case, no such assurances had been given. It almost seemed that, with the delays in bringing the review of the stand-by arrangement to the Executive Board, the Fund was front-loading a new program for Jamaica before the program itself was agreed. He would be interested in staff comment on that characterization of the current situation.

Mr. Goos remarked that the picture of the Jamaican economy painted in the staff paper was far from encouraging. While there had been some commendable progress in 1984 in deregulating the economy, reducing the central government fiscal deficit, and tightening credit policy, some of the performance criteria under the program had had to be modified again. The factors contributing to the failure to observe the criteria originally set had been mostly temporary or due mainly to exogenous developments; however, Jamaica had a long history of uncompleted Fund programs, and it was thus a matter of concern that, according to the most recent staff projections, the outlook for the Jamaican economy had deteriorated significantly. In retrospect, the new projections raised serious questions about the adequacy of continuous Fund and World Bank support to Jamaica, and Executive Directors should perhaps ask themselves whether or not the two Boards had been too lenient and accommodating in approving such support in recent years, given the country's poor track record. His authorities strongly recommended taking the experience of the Jamaican case as a warning in dealing with similar cases in future.

The Jamaican authorities should do all in their power to prevent realization of the alarming medium-term balance of payments projections presented in EBS/85/107, Mr. Goos continued. The projected weakening of the external current account position could undermine the willingness of public and private creditors to engage in new rescheduling or financing arrangements with Jamaica. Already, external indebtedness and foreign debt service obligations had reached disquieting levels. Moreover, his concerns were compounded by the large repayment obligations to the Fund scheduled for the years ahead and by Jamaica's having experienced repeated difficulties in remaining current with the Fund over the past two years. There was thus an urgent need for a sustained and strong adjustment effort, which should be clearly reflected in the follow-on program currently being envisaged. In that regard, he shared many of Mr. Dallara's concerns about the bunching of purchases in the absence of any clear indication that a strong adjustment effort would in fact be made. Still, he was reluctantly prepared to go along with the proposed decision, recognizing that the Jamaican authorities were facing difficult domestic and external developments and that they remained committed to meeting program targets. He had been encouraged by the steps outlined in the letter of intent and by the impressive reduction in the fiscal deficit expected for 1984/85.

On the recommendations for the remainder of the program and beyond, Mr. Goos stated, he was in full agreement with the staff. In particular, he supported the need for reducing the public sector wage bill and maintaining tight monetary policies and an appropriate interest rate structure. Also of importance was the maintenance of a flexible exchange rate policy aimed at securing a realistic exchange rate structure and international competitiveness. He was of course aware of the difficulties in passing on to the domestic economy the effects of exchange rate changes; however, any attempt unduly to postpone such transmission by maintaining or introducing subsidies or other measures was bound to create even more difficult adjustment problems for the future. In that respect, he was encouraged by the Jamaican Government's decision to catch up on the price measures originally envisaged for the beginning of 1985.

On another matter, Mr. Goos observed, there were several indications in the staff paper that the analysis of the Jamaican economy was being hampered by considerable weaknesses in compiling and processing statistical data. A correction of those weaknesses was certainly in the interest of both the staff and the authorities. Finally, he would welcome, from the staff or Mr. Joyce some information on the current relations between Jamaica and the World Bank; in particular, he was interested in information on the current status of the structural adjustment loan.

Mr. Jaafar stated that he could support Jamaica's request for a waiver of performance criteria on arrears and the request to move the observance date for performance criteria from March to April, with some modifications. While accepting the authorities' explanation of the circumstances leading to their requests, he remained concerned about the poor prospects for the Jamaican economy in the medium term, in spite of the current program under the stand-by arrangement. Table 8 of the staff paper painted a clear picture of continued widening external imbalances with deteriorating current account positions, emerging financing gaps, and a high debt and debt service burden.

For the short run, the recent closing of the ALCOA plant and the possibility that others might close because of excess capacity in the alumina market did not augur well for Jamaica, especially since output from the alumina and bauxite mines formed a large proportion of Jamaica's exports and revenue earnings, Mr. Jaafar continued. Strong adjustment efforts were required in the face of such difficult circumstances, and, although more remained to be done, he was pleased to observe that much had been accomplished under the current stand-by arrangement. On the demand management side, budget deficits had been reduced to a manageable 7 percent of GDP for 1984/85 from an average of 16 percent of GDP in the previous four years. Although the deficit was still on the high side, the adjustment had in his view been strong. In addition, trade had been liberalized and a more flexible exchange rate regime had been introduced. Moreover, in line with those measures, monetary policy had been sufficiently restrictive. Unfortunately, despite those achievements, for which he strongly commended the authorities, the medium-term economic projections demanded continued and persistent pursuit of the measures already implemented. Room for maneuver was narrow, and alternatives to the approaches recommended in the staff paper did not seem at present to offer a better solution.

In public finance, expenditure restraint should be continued, Mr. Jaafar remarked. There was a limit in Jamaica to what revenue measures could be taken, particularly in view of the weak alumina and bauxite markets and the consequent poor prospects for exports. Revival of other nontraditional sectors should thus be pursued. On the expenditure side, more forcefulness was needed, although difficulties would be encountered in implementing expenditure cuts, particularly on the wage front. In his view, wage settlements should be more in line with productivity. The increase in the minimum wage by 30 percent effective in January 1985, for example, while essential to raise the standard of living, could prove costly. Greater restraint in wage settlements in the public sector was needed. Similarly, public sector enterprises must achieve operating surpluses through realistic pricing policies. The recent announcements of higher prices for oil products, sugar, and some imported items were steps in the right direction. It was also important to bear in mind the need to keep prices flexible, given the newly introduced flexible exchange rate. In conclusion, he could support the proposed decisions.

Mr. Schneider remarked that, while some progress had been made during 1984/85 under the stand-by arrangement for Jamaica, it had been far from sufficient to produce the basis for a favorable medium-term outlook. Recent adverse developments in Jamaica's bauxite/alumina industry, largely beyond the authorities' control, had made the adjustment effort even more difficult. Medium-term balance of payments projections at present showed that, even on optimistic assumptions, Jamaica's financing gap and balance of payments deficit would persist at current levels until 1990, while its debt service ratio would be critically high. He shared the staff's view that further substantial adjustment and continued large-scale debt relief and concessional assistance would be required in the years ahead.

On individual aspects of the authorities' economic policy stance, Mr. Schneider observed, one of the most important program requirements was the reduction of the public sector deficit. The overall central government deficit for 1984/85 was expected to be about 7 percent of GDP, representing a substantial shrinkage below the 17 percent of GDP recorded during the past four years. That shrinkage had been achieved through increases in revenues and through expenditure cuts. As shown in Table 6 of the staff paper, the latter had been achieved mainly at the expense of capital outlays, which had declined from 12 percent of GDP in 1981/82 to about 5.2 percent in 1984/85; the decline was likely to have a strong adverse effect on future growth rates. Although the ratio of current account expenditures to GDP had remained steady at 32 percent since

1980-81, that figure was much too high by comparison with similar countries and placed severe limitations on the use of demand management policies by the authorities. The focus of government budget policy should therefore be on the reduction of current expenditures rather than on continued cuts in capital expenditures.

Remarking on monetary policy in Jamaica, Mr. Schneider welcomed the measures taken in late 1984 and early 1985 to tighten liquidity in the banking system. Particularly noteworthy were the increases in interest rates and in the cash reserves and liquid asset requirements, which had prevented monetary aggregates from expanding beyond the program targets. Because of the need to monitor closely compliance with those requirements, the observance of the reserve requirement was placed on a daily rather than a monthly basis, although no indication had been given of how successful the approach had been.

The staff had explained on page 15 how the difference between Jamaican interest rates and the cost of borrowing abroad adjusted for the rate of depreciation of the Jamaican dollar had made the private sector reluctant to borrow abroad or to make use of its holdings of foreign assets, Mr. Schneider went on. Although low interest rates were no doubt partly responsible for the current situation, they were probably not the sole or even the principal cause. Other elements, such as the depreciation of the Jamaican dollar, the coverage of foreign exchange risks for the private sector, and uncertainty regarding Jamaica's economic future were also at work. In conclusion, in reluctantly giving his support to the proposed decisions, he expected the Jamaican authorities to continue vigorously to tackle the economy's difficult situation.

Mr. Wijnholds observed that the completion of the review of the current stand-by arrangement with Jamaica was the limited purpose of the current discussion, but it was quite important, since approval of the proposed decision would release the remaining rather large amounts available under the stand-by arrangement, assuming the performance criteria were met. In that regard, he had been happy to hear from the staff that Jamaica had met the performance criteria set for end-April.

From the beginning of the program, Mr. Wijnholds continued, it had been clear that a reduction of the fiscal deficit was crucial. External developments since that time had only reinforced the need to meet the target, as the external outlook for Jamaica remained bleak. Additional corrective measures were therefore inevitable, and he welcomed the steps that had recently been taken at great social cost. Unfortunately, rather less progress had been made with respect to the necessary simultaneous reduction of the external current account deficit. None of the reasons given by the staff for that lack of progress was particularly reassuring. Large losses by the Bank of Jamaica, more short-term commercial foreign financing by the rest of the public sector, and more domestic arrears of the Central Government had all been mentioned as possible reasons for the slow progress in reducing the external current account deficit. Those factors should in the circumstances influence the design of any follow-on arrangement with Jamaica. In that regard, while he was reluctant to recommend the introduction of more performance criteria, the situation with respect to domestic arrears and the use of short-term foreign credits should be scrutinized closely.

Of course, he might be too concerned about a lack of progress on the fiscal and external deficits, Mr. Wijnholds continued. Table 3 of the staff paper showed that, in the past two years, both deficits had registered commendable reductions. However, that did not mean that sufficient improvements had been made, and he agreed with the staff that further substantial adjustment would be required in future.

Some confusion seemed to exist with respect to the background of the proposed waiver, Mr. Wijnholds remarked. The staff had argued on page 3 of the paper the nonobservance of the December performance criterion on the reduction in external arrears had been due mainly to a temporary delay in the disbursement of a foreign loan. On page 7, however, the staff had suggested that the delay had accounted for only 30 percent of the shortfall. In the final analysis, the nonobservance of the December performance criterion seemed to be closely related to a higher than expected external current account deficit. Perhaps the staff could explain why the new exchange rate mechanism--which was basically a free float--had not prevented the external current account deficit from rising. Satisfactory assurances regarding the proper functioning of the exchange system seemed essential in any follow-on program. However, given the further fall in export earnings that would take place in 1985/86, the exchange rate could not be relied upon as the only factor to help to balance the foreign accounts. Exceptional external financing would also be required. As such financing was to be the subject of a forthcoming consultative group meeting, he wondered in passing how much new money was likely to be required.

In a longer-term framework, the need for additional borrowing was worrying, Mr. Wijnholds said. Jamaica's debt to various creditors, including the Fund, was already quite large, and its capacity to carry an even heavier load was in doubt. Current account deficits in the ranges projected in Table 8 of the staff paper suggested a cumulative net borrowing requirement of awesome magnitude. In conclusion, although he shared some of the concerns of other Directors with respect to the Jamaican economic situation, he could support the proposed decisions.

Mr. Ortiz observed that the difficult situation of the Jamaican economy had been aptly described on page 19 of the staff paper, which read: "Jamaica is confronting a critical economic situation as it attempts to correct deep-seated structural problems and at the same time to cope with a massive external debt and major difficulties in its principal export sector, bauxite/alumina. Even though significant adjustments have been made under the current stand-by arrangement, the difficult medium-term scenario outlined in [a previous paper] has now worsened considerably." The medium-term balance of payments projections presented in Table 8 painted a somber picture for the remainder of the decade. External debt as a percentage of GDP was projected to increase from 168 percent in 1984/85--one of the highest ratios in the Western Hemisphere and perhaps in the world--to 210 percent in the following fiscal year and to a peak of 231 percent in 1988/89. The debt service ratio would remain, on average, higher than 50 percent during the next three years. Leaving aside for the moment the question of how to close the financing gap in 1985/86 and beyond, the projections raised serious questions about the medium-term viability of Jamaica's external sector. The Jamaican case was clearly one in which questions of basic solvency and of the Fund's involvement must be raised.

The Fund's exposure in Jamaica represented a substantial part of the country's total external debt, Mr. Ortiz commented. The latest available data suggested that, in mid-1984, debt to the Fund had represented nearly 20 percent of the country's total external debt and nearly 30 percent of GDP. Although a strict internal adjustment program was long overdue, it was necessary to continue applying all the appropriate measures to improve macroeconomic management and microeconomic efficiency. It was doubtful whether a realistic program could be devised that would allow the Jamaican economy to service its current level of debt, even assuming a complete rescheduling of the principal. A significant amount of debt relief should be promptly made available if Jamaica were to regain its economic viability.

Within the strategy of the case-by-case approach to the debt problem that had been endorsed by all industrial countries and many of the major debtor countries in his constituency, the particular case of Jamaica had to be treated differently from others, and a good proportion of Jamaica's debt would eventually need to be dealt with in ways other than through the market mechanism, Mr. Ortiz continued. However, the longer debt relief solutions were postponed, the more difficult the economic situation was likely to become, given that it was more difficult in both economic and political terms to orchestrate a viable adjustment if the size of the problems to be tackled seemed insurmountable at the outset.

On specific issues, Mr. Ortiz noted that, although the central government deficit was expected to decline from 16-17 percent of GDP in the period 1980/81-1983/84 to 7 percent during the current program, the current account deficit was expected to decline by only 1 percent of GDP. The staff had found that small relative improvement in the external account rather difficult to explain, and he himself had experienced similar difficulties. Unless a drastic surge in private investment or a decline in savings took place during the year, the answer should be that the financial provisions of the remainder of the public sector had considerably worsened and that what was being observed was a transfer of the fiscal deficit from the Central Government. In the circumstances, the elaboration of a consolidated public sector budget had to be considered a priority.

Apart from the linkages between the budget deficit and the current account, Mr. Ortiz commented, the disappointing performance of the external sector during the program period pointed to one of the main structural problems confronting the Jamaican economy: the continued decline in bauxite and aluminum exports. The medium-term prospects for regaining previous levels of those exports were not particularly encouraging, given the existing world capacity and the relative decline in the demand for aluminum. It was obvious that Jamaica needed to diversify and increase its nontraditional exports; toward that end, the authorities must continue implementing a flexible exchange rate policy in line with recent developments.

One of the few encouraging signs in the staff paper was the strong increase in nontraditional exports to countries other than CARICOM countries, Mr. Ortiz observed. It was worth noting in that regard that the medium-term balance of payments projections assumed continued strong peformance of nontraditional exports, with average increases of 20 percent each year for the remainder of the decade. However, in spite of the optimistic assumptions regarding nontraditional exports and the growth in tourism receipts, the financing gap of the balance of payments would remain above 10 percent of GDP during the next few years.

The demand management policies undertaken by the Government, including steep increases in the price of petroleum products and other basic commodities as well as reductions in public sector employment, were all courageous and much-needed steps toward strengthening public sector finances, Mr. Ortiz considered. Still, according to the staff, public sector employment in relation to the size of the economically active population remained relatively high, perhaps on the order of one public employee for every seven or eight persons. He would welcome more precise figures from the staff as well as an indication of how that ratio compared with ratios in other Caribbean economies. Finally, in view of the circumstances outlined by Mr. Joyce and the staff, and given the authorities' serious intention to correct the domestic imbalances, his chair could, with reservations, support the requested waiver and proposed decisions.

Mr. Clark observed that Jamaica had made some progress in 1984, especially in the fiscal area, under what had necessarily been a demanding program, and some significant corrective measures had been introduced. Nonetheless, as Directors had noted during the first review, the authorities had found it possible to meet the program targets only by introducing a series of one-time measures and by requesting a string of waivers. Unfortunately, that pattern was being repeated, and the Executive Board was being asked to approve further waivers combined with the transfer of performance tests from end-March to end-April, a date already past. Furthermore, to compensate for slippages on the current account, the authorities seemed to have resorted to nearly J$100 million more in short-term borrowing than had been programmed. That borrowing had, inter alia, allowed the authorities to meet net domestic credit targets for the public entities, which would otherwise have been overshot by a considerable margin.

While unhappy about being asked to approve performance criteria after the event, he could go along with the proposed decision, Mr. Clark continued. Of more substantial concern than the procedural matters, however, was the deterioration in Jamaica's economic prospects following the closure of the ALCOA plant and the likely closure of ALPART, another alumina plant, together with the effects of those closures on the fiscal and external accounts over the next few years. It was his understanding that the ALCOA plant might be reopened under the auspices of the Jamaican Government, but the transfer of ownership clearly did not in itself resolve the economic difficulties of the industry. Like Mr. Dallara, he noted that the revised medium-term projections in the staff paper showed that the projected financing gaps had nearly doubled and would average about 13 percent of GDP for the remainder of the decade. In the circumstances, it was to be hoped that the forthcoming Article IV consultation discussion would be used as an opportunity for Directors to give serious consideration to Jamaica's medium-term prospects and to the policy strategy that should be applied in tackling the country's problems. It would also be important to consider the appropriate role for the Fund in that process.

On specific points of detail in the staff paper, Mr. Clark noted, first, the worrying hint on pages 6 and 13 that improvements in the fiscal position might be smaller than indicated by the available data. Second, the performance of the public entities looked rather poor when the effects of the Air Jamaica lease-back operation and the short-term borrowing by the oil company were excluded. Third, having noted the monetary measures taken by the authorities, he strongly endorsed the staff view that domestic interest rates were too low in relation to foreign rates adjusted for exchange rate changes; as a consequence, there was little incentive to take up available lines of foreign credit. Fourth, he was encouraged to see that nontraditional exports to markets outside CARICOM had risen substantially in 1984, especially given the prospects for other categories of exports over the next few years. Fifth, it was important for the authorities to maintain a flexible exchange rate policy and avoid unnecessary intervention in the market. In that context, he would be interested in staff comment on the operation thus far of the forward exchange market.

In conclusion, Mr. Clark said, following several years of Fund programs in which little adjustment had taken place, Jamaica had made some genuine progress in 1984; however, it was a matter of some concern that, after a long time and significant financial resources from the Fund, Jamaica was still far from external viability. Moreover, the latest developments in the bauxite industry had seriously worsened what had already been a difficult medium-term outlook. At a minimum, continued strong adjustment and substantial international financial assistance would be needed for some time.

Mr. Coumbis agreed with others that the Jamaican authorities had made substantial progress in many areas of the economy but that there remained certain areas where weaknesses persisted, particularly with respect to the country's external position. In fact, the current account deficit of the balance of payments had greatly exceeded the program target of 6.4 percent, and it was estimated to be only 1 percent lower than during 1983/84. No doubt, some factors beyond the country's control had influenced that result; however, exports other than bauxite and alumina had been well below the revised targets, and imports had exceeded the targets, even though changes in the exchange rate regime had allowed the price of the Jamaican dollar to respond more fully to market forces. While the Jamaican dollar had depreciated substantially during the program period, exports to CARICOM countries and nonbauxite-related imports had not been affected by the depreciation. Also disturbing were the substantial increase in the rate of inflation to 30 percent, stagnating GDP, increasing unemployment, the 18-month closure of the ALCOA alumina plant, and the expected closure of the ALPART alumina plant.

For the medium term, the financing gap of the balance of payments was expected to be about US$320-380 million, while the debt service ratio would fall from 58.4 percent in 1985/86 only to slightly more than 40 percent in 1989/90, Mr. Coumbis continued. He agreed with the staff that the outlook pointed to the need for stringent policies and for continued large-scale debt relief and concessional assistance over an extended period. He wondered, in passing, whether the staff had overlooked other deep-seated structural problems of the economy, which, if not tackled decisively in cooperation with the World Bank, would inhibit the attainment of permanent improvements in the country's financial imbalances.

Like other speakers, he was concerned that "the improvement in the finances of the overall public sector has not been as great as that in the Central Government," as the staff had said on page 6, Mr. Coumbis continued. It seemed that information on the operation of the rest of the public sector was deficient; from page 13, it could be seen that there had been some slippages in central government operations, with shortfalls in tax and nontax revenues and with government expenditures above programmed levels. There also appeared to have been some difficulty in recording central government expenditures and in estimating expenditures of the overall public sector. In general, however, the Jamaican authorities seemed to have been making a serious effort to adjust their economy, and Fund support was warranted. He could therefore go along with the proposed decisions and with the suggestion to move the measurement date for some performance criteria to end-April from end-March. He could also go along with Jamaica's request for a waiver on the amount of external public arrears.

On unemployment in Jamaica, Mr. Coumbis observed, some 5,000 public employees would be laid off from the government sector, and several thousand more would become unemployed with the closure of the two alumina plants. He wondered what the rate of unemployment in Jamaica was at present and what it would be once those layoffs had occurred. He would also welcome more information on the reasons for the closure of the two alumina plants, with some clarification of the extent to which the closings were related to the world crisis in aluminum or to unsuccessful economic policies in Jamaica. Finally, while accepting some of the concerns mentioned by Mr. Dallara about Jamaica's record of adjustment, he believed that Directors should take into account the social and political constraints in Jamaica in determining whether or not to go along with the proposed decisions.

Mr. Ainley agreed with Mr. Joyce that the Jamaican authorities were making a real attempt to implement the adjustment program approved in June 1984. Although there had been slippages in performance, the authorities had strengthened demand management policies; moreover, they had liberalized domestic prices and allowed the exchange rate to float freely. As a consequence, the fiscal deficit had been significantly reduced, and the balance of payments had improved somewhat. Nonetheless, Jamaica continued to face critical problems: growth was slow; inflation was high; and the foreign exchange position remained precarious. Despite successive Fund programs, long-standing structural weaknesses persisted. The bleak outlook for the medium term was at present even worse than projected in the staff report, following the recent closure of the ALCOA alumina plant. And as others had noted, the figures in Table 8 of the paper made depressing reading. In the circumstances, there was no alternative to a strengthened and sustained adjustment effort.

Although improvements had been registered, Mr Ainley said, there were doubts about some of the figures and some question whether the improvements had been due in part to factors--such as additional short-term external borrowing--that had not been anticipated when the program had been drawn up. During the previous review of the Jamaican stand-by arrangement, one of his colleagues had applied the term "ad hoc" to some of Jamaica's adjustment measures, and he himself found that the term continued to be applicable. It was to be hoped that, in any new program, the authorities would adopt consistent and complementary fiscal measures aimed at broadening the tax base and strengthening expenditure control as well as monitoring and recording procedures, streamlining the civil service, and overhauling the public sector enterprises. Such objectives would be politically and socially difficult to attain, but the authorities had no alternative. In a medium-term perspective, he would be interested, like Mr. Dallara, in knowing more about the progress toward privatizing some of the public sector enterprises in line with the authorities' earlier policy objectives.

The current restrictive stance of monetary and credit policy would have to be maintained to bring inflation down and strengthen the net foreign reserve position, Mr. Ainley continued. Recent steps taken to tighten credit policy were both appropriate and commendable, and he hoped that the authorities would work to channel sufficient credit to productive sectors within the agreed ceilings. Moderate wage settlements would be another critical element in any new program, and recent developments on the wage front were rather difficult to interpret. While the outcome had, on the whole, not been too bad, there was no room for relaxing the current wage guidelines in the future.

Problems on the external side were daunting, Mr. Ainley considered. The Jamaican authorities faced a massive debt burden at a time when the world markets for Jamaica's principal exports remained depressed. However, the shift to a market-determined exchange rate strategy should help to improve competitiveness, which, in turn, should benefit tourism and nontraditional exports. It was of course vital that Jamaica continue to honor its obligations to all creditors, including the Fund, especially since Jamaica would have to rely on debt relief and exceptional assistance from the international financial community for some time. In that regard, he joined Mr. Goos in asking for an update on Jamaica's relations with the World Bank.

On the proposed decision, which he could support, Mr. Ainley observed that Jamaica was requesting a waiver of two performance criteria at end-December and was asking that the test dates for the end-March performance criteria be changed to end-April, with some modifications. The failure to meet the end-December performance criteria had, in part, been beyond the authorities' control. More important, the authorities had lately taken firm measures to put the program back on track; it seemed reasonable to give them somewhat more time for those measures to work. However, he shared the reservations of previous speakers with respect to Jamaica's relatively poor record of adjustment, the capacity of the authorities to implement the necessary adjustment measures, the size of outstanding Fund credit to Jamaica, and the difficulties that the authorities had experienced in remaining current in their obligations to the Fund.

Mr. Parmena stated that he could support the proposed decision. The failure in December to meet the performance criteria had been due largely to factors beyond the control of the Jamaican authorities, who had remained committed to the adjustment effort and had been taking rather stringent austerity measures from the beginning of the program. For example, in November/December 1984, they had intensified the adjustment effort in the face of a deteriorating outlook for the external sector. They had also acted promptly when prospects for the external sector had deteriorated earlier in 1985 with downward revisions in the outlook for bauxite and aluminum exports. Clearly, certain of the measures adopted by the authorities required time to be implemented, and it was thus understandable that some performance criteria should be moved forward to end-April 1985.

The fiscal deficit in Jamaica had been reduced from 16.5 percent of GDP to 7 percent of GDP in 1984/85, and the authorities had managed to reduce public sector employment by 4 percent, achievements indicating that an adjustment effort was under way, Mr. Parmena continued. He agreed with other Directors that a serious problem existed in the external sector with respect to medium-term prospects for financing, a problem that underlined the need for involvement by the Fund, the World Bank, and other international financial institutions in the longer-term restructuring of the Jamaican economy. Given the willingness of the authorities to adjust, the Fund should maintain its financial support. In conclusion, therefore, he could go along with the proposed decisions.

Mr. Weitz, noting that he was in broad agreement with the staff report, considered that the economic situation in Jamaica was cause for serious concern. Under the current stand-by arrangement with the Fund, Jamaica was making a badly needed adjustment effort. The application of a flexible exchange rate system, some progress toward liberalizing the economy, the reduction in the central government deficit, the tightening of credit policies, and the increase in interest rates were all steps in the right direction that should be maintained. However while the authorities had implemented a set of economic measures aimed at dealing with the huge internal and external imbalances, some slippages had taken place, and the medium-term outlook was worrying.

On page 6 of the paper, the staff had observed that "the discrepancy between the relatively small adjustment of the current account deficit in the balance of payments and the large expected reduction in the overall deficit of the Central Government in 1984/85 is not easily explainable," Mr. Weitz noted. The staff had gone on to assume that the improvement in the finances of the overall public sector had not been particularly important, with the exception of the central government figures. Like others, he would appreciate further detail from the staff on that matter.

Given that the medium-term prospects for Jamaica were not encouraging and that further significant measures would be needed to correct imbalances in the economy, it was important to stress that the adjustment effort should be continued, Mr. Weitz remarked. Continued large-scale debt relief and increased assistance from donors over an extended period were essential. Finally, considering the adjustment actions taken recently by the authorities, he could support the proposed decisions, including the request for a waiver of the observance of the December performance criteria.

Mr. Blandin stated that, like others, he was prepared with reluctance to go along with the proposed decisions, including the request for waivers of the nonobservance of performance criteria. Indicating his deep concerns about the economic situation in Jamaica, he urged the authorities to follow the staff's advice and strengthen the adjustment effort. The Jamaican situation seemed critical, and prospects for the economy were far bleaker than at the time the arrangement had been approved. The medium-term balance of payments projections shown in Table 8 were particularly worrying, as was the fact that Jamaica had been obliged to resort to short-term indebtedness. Unfortunately, those developments could not be attributed solely to exogenous factors but must be seen against the background of Jamaica's track record.

Jamaica was clearly a textbook case of prolonged use of Fund resources, Mr. Blandin went on. Since 1973, Jamaica had benefited from three stand-by arrangements, two extended arrangements, and three purchases under the compensatory financing facility. Its indebtedness to the Fund at present was equivalent to 430 percent of its quota. Yet, in spite of prolonged assistance from the Fund, Jamaica's economy continued to face serious financial difficulties and structural imbalances as reflected in high inflation rates, high debt service ratios, and sizable current account and fiscal deficits. In the circumstances, he was led to question whether preceding programs had been sufficiently ambitious. The 1984/85 stand-by arrangement had called for a major adjustment effort; unfortunately, unfavorable developments in the bauxite industry and a deteriorating outlook for the public finances and the balance of payments had imperiled the entire program. Furthermore, delays in implementing needed interest rate changes and pricing adjustments had contributed to the economic deterioration. In fact, the waiver on external arrears that the Board was being asked to approve was similar to the one that had been granted reluctantly in December 1984. To be fair, it must be acknowledged that, except for the two deviations mentioned, all other performance criteria had been observed. Moreover, as stated by earlier speakers, progress had been achieved in a number of areas, particularly the reduction of the public sector deficit. He urged the authorities to pursue and strengthen their adjustment effort in compliance with the letter of intent dated April 26, 1985 in order to avoid the re-emergence of external arrears.

Even if the current program could be brought to a successful conclusion with the modifications suggested by the staff, the magnitude of the task that lay ahead was enormous, Mr. Blandin continued. As shown in Table 8 of the staff paper, sizable financing gaps would exist for the remainder of the decade, a projection that raised serious policy concerns, especially given Jamaica's track record with the Fund. Hence, if a further stand-by arrangement were to be presented to the Executive Board for approval, three conditions should be met. First, the program should be comprehensive, consistent, and sufficiently strong to give the Board reasonable assurances that real progress would be registered during the period of the program and that medium-term prospects would improve somewhat. Second, the program should entail close corroboration with the World Bank. Economic and financial interventions by the Bank would be of paramount importance in the years to come. Finally, the Fund would have to play its catalytic role in presenting to the Executive Board ways for Jamaica to fill the financial gap for 1985/86. In that respect, the program would have to be sufficiently credible for bilateral or multilateral sources to provide further financial assistance to Jamaica.

Mr. Alhaimus agreed with those who had observed that the general economic situation in Jamaica had worsened considerably since the December 1984 review of the current stand-by arrangement. It was unfortunate that, despite the absence of any major policy slippages, the balance of payments outcome for 1984/85 would be significantly worse than previously expected, owing mainly to adverse developments in the principal export industry as well as to civil disturbances at the beginning of 1985.

What was perhaps of greater concern was the sharp deterioration in the medium-term outlook, Mr. Alhaimus continued. A comparison between the current balance of payments projections for the remainder of the decade and those made in December 1984 clearly illustrated the magnitude of the deterioration, with the cumulative current account deficits between 1985 and 1990 currently projected to be more than three times the deficits forecast only five months previously. In the circumstances, the authorities had no choice but to strengthen the adjustment effort further if they wished to have any chance of attaining a viable external position. It was significant that the authorities had responded to the worsening situation by adopting additional measures, particularly in the areas of credit, pricing, and government revenue. Those measures should be further strengthened in the period ahead.

Jamaica would also require exceptional financing on a large scale for some time to come, Mr. Alhaimus considered. A policy of strong and sustained adjustment was crucial not only to reduce the magnitude of the financing required but also to make it more likely that relief and other assistance would be forthcoming. In that respect, he noted that Jamaica had failed to observe the performance criteria on public sector arrears. It was thus important that the authorities adhere to the policy of avoiding new external arrears while normalizing the debt situation vis-à-vis all Jamaica's creditors. In conclusion, while he shared many of the concerns expressed by earlier speakers, he could go along with the proposed decisions.

Mr. Romuâldez remarked that, during the course of the current program under the stand-by arrangement, the authorities had significantly improved their adjustment record: the fiscal deficit had been reduced from 16.5 percent of GDP to 7.1 percent of GDP in 1984/85; the real effective exchange rate had been allowed to depreciate significantly during the program year; net domestic bank credit had been reduced as programmed; wage settlements negotiated during 1984 had been broadly in conformity with the 15 percent increase assumed under the program. Nonetheless, economic performance had gone off track in several respects. In contrast to program targets, real GDP growth had declined by 0.4 percent, consumer prices had risen on average by nearly 30 percent--double the planned rate--and the current account deficit of the balance of payments was expected to be reduced by only 1 percent of GDP, which would leave the deficit at nearly double the original target level for the year.

He could support the request for a waiver of the end-December performance criteria relating to net international reserves and external arrears, accepting the argument that the nonobservance of those criteria had been due mainly to the temporary delay in the disbursement of an external loan, Mr. Romuâldez continued. As for the request to eliminate certain performance criteria set for end-March and to establish new criteria instead for end-April, the authorities and the staff saw the request as justified, both because of recent adverse developments in the alumina industry and because of the authorities' need for additional time to implement consequent corrective policy measures that had been somewhat delayed following recent social unrest. The decision by one producer to halt alumina production in Jamaica until the world market for aluminum had recovered undoubtedly had major implications for Jamaica. The staff clearly did not expect the problem to be temporary; indeed, the medium--term outlook had deteriorated significantly since the introduction of the program, and, rather than a deficit of 1.6 percent as originally projected, the staff currently expected the current account deficit to be about 11.1 percent of GDP by 1989/90.

Although the worse than expected performance of exports could be explained in large part by external factors and by disappointing tourism receipts following the civil disturbances in Jamaica, he could not overlook the role that domestic policies had played in those developments, Mr. Romuáldez continued. If the program were to succeed, Jamaica's domestic policy problems have to be recognized and remedied. On the export side, the reasons for the continued stagnation in exports of traditional agricultural products--sugar and bananas--and for declining exports to CARICOM countries were not well documented in the staff paper. In the circumstances, he would appreciate an assessment by the staff of experience with the modified exchange system. The only oblique reference to that system was on page 19 of the paper, where the staff had suggested that the authorities "...will need to allow the auction market to function without restraint and to avoid intervention aimed at obtaining a given exchange rate result."

Domestic factors had been at work on the import side, with the staff reporting that "...imports in 1984/85 are now estimated to have been US$41 million higher than expected at the time of the last review, with nonbauxite-related imports at about the same level as in 1983/84 despite the large depreciation of the Jamaica dollar," Mr. Romuáldez remarked. One of the purposes of the ambitious fiscal adjustments sought under the program had been to constrain growth in imports. A tax package and expenditure reductions were to underpin the adjustment. Although the original fiscal task might have been achieved, the deteriorating circumstances during the program year had called for greater efforts than originally programmed. The authorities had apparently recognized the need for stronger adjustment and had imposed stamp duties on certain imports, effective April 16, which were expected to generate revenues equivalent to about 4 percent of GDP. However, the staff had "stressed its earlier recommendation that the phasing out of quantitative restrictions on imports should be accompanied by higher tariffs and that the economic rent accruing to importers who obtain licences under the remaining quota system should be taxed." He would appreciate some assessment by the staff of the new stamp duty as a proximate measure for achieving some of those objectives. Also, he wondered whether the efficiency costs of any higher tariffs would be offset by the prospective revenue benefits.

The review mission had suggested the need for tighter restraint on government expenditure, Mr. Romuáldez observed. Central government expenditures had been above the programmed amounts during the first nine months of the fiscal year, but the staff had provided no indication of the authorities' plans to reduce expenditure. The staff had merely noted that "of necessity, central government expenditure, particularly wage payments, will have to be reduced substantially, and the rest of the public sector will have to improve its financial performance." It seemed, in the circumstances, that the authorities' failure to adjust their fiscal plans in a timely and appropriate fashion might have contributed in no small way to Jamaica's persistent current account problems. He recognized that an adjustment program of the order currently indicated could pose a threat of social and political unrest; that risk should serve to underline the importance of responding as quickly as possible to the emergence of imbalances in the economy. The authorities in Jamaica had shown a willingness to take action to tighten credit further, raise interest rates, and adjust public finances in response to adverse developments. Nevertheless, many of the measures recently adopted should have been adopted earlier. For example, before the large price increases that had triggered social unrest earlier in the year, the price of petroleum derivatives had not been adjusted since January 1984. To allow the exchange rate to perform its function efficiently, it was important that public sector prices be adjusted promptly in view of changes in the exchange rate and other costs. Also, the previously low interest rates in Jamaica helped to explain the reluctance of the private sector to borrow abroad and to use its holdings of foreign assets.

Despite the concerns that he had voiced, Mr. Romuáldez said, he was prepared to go along with the proposed decisions, although the authorities should be aware that, as a result of the worsening prospects for alumina and tourism, growth in the economy for 1985 and beyond would be determined to a critical degree by the extent of fundamental structural adjustment that they were able to achieve in the domestic economy. He encouraged them to intensify their adjustment efforts and to be more consistent and prompt in implementing appropriate measures. It could not be overstated that support from the international community was likely to be forthcoming only in the context of an intensified, timely, and consistent adjustment effort.

Mr. Zhang considered that the Jamaican authorities had taken firm and strong adjustment measures but that their positive effects had often been offset by unfavorable external factors. In the circumstances, the Fund should perhaps not be too harsh in criticizing the authorities for what they had been unable to accomplish. In conclusion, therefore, he could support the proposed decisions.

Mr. Obame stated that, in broadly accepting the staff recommendations, he agreed with those who had described the serious difficulties faced by the Jamaican economy. He could go along with the proposed decisions and with the requested waiver of performance criteria, taking into account the additional adjustment measures adopted by the authorities.

The staff representative from the Western Hemisphere Department, recalling the concern of some Directors that the Board was being asked to approve modifications of performance criteria for dates that had already passed, remarked that some historical background might help to put the situation in perspective. The November-December review mission had taken the position that adjustments had needed to be made in a range of public sector prices to reflect the depreciation that had taken place in the exchange rate. The staff had also felt that the second review of the program should not be completed until those measures had been adopted. As Directors were aware, increases in gasoline prices implemented in mid-January had triggered social disturbances that had adversely affected the tourist season and had led to a considerable reluctance by the authorities to push forward rapidly with the remaining adjustments, which had covered mostly basic food commodities.

With the closing of the ALCOA plant and the worsening balance of payments prospects, the staff had held further discussions with the authorities aimed at encouraging them to face up to the deterioration as rapidly as possible, the staff representative continued. The issue at the time had been mainly one of strategy, hinging on whether to hold off facing some of the problems until negotiations for a new program were completed or to move to adjust as rapidly as possible. The staff had followed the second line of thought in making the completion of the review conditional on the adoption of a wider range of demand management measures; indeed, beyond required price adjustments, measures on the fiscal and monetary side that would address the emerging deterioration were set up as prior actions. Hence, in terms of the setting of the revised performance criteria, negotiation on the revisions had been completed in March, although the paper had not been brought to the Board at that time because it had not been possible for the authorities to take certain of the prior actions until April. In the end, the paper had been issued before end-April, but, because of the circulation rule, the Board discussion could not have taken place until after the end-April date had passed. All that aside, the essential point to remember was that the negotiation and the setting of the revised performance criteria had occurred well before the date in question, and the delay in bringing the matter to the Board had been related simply to the time required to formulate and implement an important set of adjustment measures.

On a related matter, Mr. Dallara had perhaps been accurate in his assessment that, as the situation stood, the purchases that the authorities would be allowed to make following the review could be regarded as part of a front-loaded 1985/86 program, the staff representative commented. The drawings were in fact related to measures that would stand the authorities in good stead for the next 12 months, and the blurring of the two programs had in some ways been intentional. The staff had worried that, if the existing program had been interrupted, confidence problems would have been exacerbated, and capital flight difficulties would have increased. As a matter of strategy, therefore, the staff had judged that it would be better to implement and maintain the existing program than to interrupt it and begin a period of negotiations in which some control over the situation in Jamaica might be lost. Discussions were well advanced toward a program for 1985/86, and the many important demand management measures already taken in the context of those discussions attested to the authorities' determination to face up to the emerging problems.

On whether the delay in the World Bank structural adjustment loan could be considered an exogenous factor affecting Jamaica's performance, the staff representative noted that Jamaica had had three successive structural adjustment loans from the World Bank; the conditionality of those loans, while far-ranging, had been complied with. It was fair to say that with the Fund, the World Bank and donor countries all acting simultaneously in Jamaica, the authorities sometimes had difficulties of implementation capacity, and the problems that had held up the World Bank structural adjustment loan at end-March 1985 had related mainly to specific actions that the World Bank had been requiring in two state enterprises, actions that the authorities had been unable to implement on time. As had been noted on occasion in discussions with the Prime Minister of Jamaica, the cumulative conditionality of various organizations often created an administrative overload for the authorities. It was fair to say, in that respect, that the delay in the structural adjustment loan by the World Bank, while related to some small difficulties of conditionality that had not been fulfilled, had been largely exogenous; indeed, the delay had been less than one month.

Questions had been raised by some Directors about whether the registered improvements in the central government accounts had been genuine, the staff representative recalled. The staff itself had shared such concerns, and the most recent mission to Jamaica had looked into the matter to see whether the improvement had been based on the accumulation of arrears. As far as the staff could tell, domestic arrears at present were no higher than normally, and performance of selected enterprises in the rest of the public sector had been at least as good as in the previous year. In any event, it should not be forgotten that the authorities had taken some major adjustment steps during the past 12 months. For example, gasoline prices had been raised by more than 100 percent, as had electricity and water tariffs, and those measures had tended to reinforce the performance of the rest of the public sector. The result was that the combined improvement in the deficit of the consolidated public sector had been about 9 percentage points, similar to the improvement in the central government accounts. Partially offsetting that improvement, however, was the deterioration in the position of the Bank of Jamaica, which was carrying a large part of Jamaica's external debt that had to be serviced. With the devaluation of the Jamaica dollar, the costs of servicing had risen substantially; at the same time, the Bank of Jamaica's domestic sources of income had been reduced. As a result, the net losses of the Bank of Jamaica in the financial year just ended had been close to J$600 million, or about 6 percent of GDP. In the previous financial year, the net loss had been equivalent to 3.5 percent of GDP. Hence, if the public sector were extended to include the Bank of Jamaica, the improvement in the overall position would be less dramatic than 9 percent of GDP; however, at 6-7 percent of GDP, the improvement should still be seen as substantial.

Interest rate policy had been a major feature of the prior actions that were part of the package under discussion, the staff representative observed. The staff felt that action taken on interest rates thus far had been too little and too late. In March and April, minimum saving rates had been raised by 5 percentage points, which in turn had boosted the entire structure of interest rates by a similar amount. As a result, deposit rates were currently at 20 percent or higher, and lending rates would shortly move to the 28-30 percent average range. Of course, against the background of inflation rates in Jamaica, including the pass-through effects of the major devaluation at the end of 1984 and in early 1985, it could be said that interest rates looked negative. However, looked at on an annual basis, the inflation rate of the past six months had been running at about 20-25 percent, which suggested that the current structure of interest rates was positive. In fact, considering that savings deposit income was tax free, interest rates even on the deposit side could be said to be substantially positive.

The depreciation of the Jamaica dollar had certainly improved the competitiveness of the bauxite sector, the staff representative remarked. One of the problems in that sector related to the bauxite levy, which in the view of the staff was unsustainable over the medium term. That was why the staff was operating on the assumption in the program under discussion that the levy needed to be reduced in the future. Still, it must be remembered that in 1984 the levy had accounted for one fifth of total central government tax revenues; hence, giving it up would have major fiscal implications at a time when there was already a pressing need to adjust the budget.

Problems had arisen with respect to the exchange rate system over the past 12 months, mainly because of fluctuations and interventions by the authorities, the staff representative observed. Under the system, auctions took place twice weekly, so that there was a twice-weekly decision to intervene, with the Bank of Jamaica deciding at each auction how much would be sold. The staff felt that, over time, the authorities must ensure that the exchange rate was subject to market forces; only in that context had the comment been made in the staff appraisal that the authorities should not let short-term political considerations encourage them to intervene for very short-term aims in the auction system.

With regard to questions on wages, the staff representative noted, the recent increase in the minimum wage had been the first since 1981 and, in any event, did not cover a large number of workers. Public sector wages were governed by a three-year contract, the final year of which had just passed. However, under the program currently being negotiated, wage increases were expected to be well below the projected rate of inflation in the government sector.

Like some Directors, the staff was disappointed in the progress that had been made by the Jamaican Government toward divesting itself of certain enterprises, the staff representative commented. However, a new Secretariat had been established in Jamaica to handle the proposed divestiture of 43 government enterprises, which, it was hoped, would take place during the forthcoming fiscal year. The Government had already divested itself of some 17 enterprises, and negotiations were under way for the divestiture of another 17, 9 of which were at the point where the conditions for divestiture could be publicly advertised. Hence, while progress toward divestiture had been slow and somewhat halting, it was expected to continue. In fairness to the Jamaican authorities, it had not been easy in the face of current balance of payments difficulties, domestic political pressures, and tight credit policies to find suitable buyers for many of the government enterprises slated for sale.

As many Directors had observed, the medium-term outlook for Jamaica was bleak, the staff representative said. However, the projections in the staff paper had been based on no domestic adjustment, and the combination of financing and adjustment had yet to be determined. What the figures did show was that major domestic adjustment was inevitable. The staff considered that a 15 percent reduction in nonbauxite-related imports was necessary over the next two fiscal years. It was not expected that the current account deficit would remain at 11 percent of GDP, as shown in the passive projections; rather, the staff's working assumption was for a deficit equal to 3-4 percent of GDP by the end of the decade.

One Director had argued that the cuts made in the capital budget were an undesirable form of adjustment in central government finances, the staff representative went on. While agreeing with that view, the staff considered that the fine distinction between current and capital spending in Jamaica should be kept in mind. Many of the expenditures classified as "capital expenditures" in Jamaica would be classified as "current expenditures" by the Fund's Fiscal Affairs Department. The cuts in the capital budget had been almost entirely in the area of capital transfers and net lending. The "institutionally funded projects" had by and large been executed as programmed, and the cuts in the capital budget had not affected what might be called "higher-quality" capital spending.

Concerning the use of short-term foreign credits, the staff representative noted that the program originally brought to the Executive Board for approval had been based upon the use of tight credit policies aimed at stemming the outflow of capital. In the period before the previous stand-by arrangement, nearly all Jamaica's short-term credit had dried up; to some extent, a re-establishment of short-term credit had been expected. In fact, the credit policy measures adopted during the previous quarter--including increases in interest rates and reductions in the amount of domestic credit--had been aimed at encouraging the use of short-term credit. Still, the staff had not expected such a large use of short-term financing by the public sector as had taken place, and the amount of such credit would of course be monitored in the new program.

As the staff had pointed out in the paper, the fact that the net foreign assets of the Bank of Jamaica had been almost on target meant that gross foreign assets had been higher than expected in the program, the staff representative observed. The reason why those foreign reserves had not been used to reduce arrears on time had also been noted: by the time some of the flows had come in--at end-December--there had not been sufficient time to repay the arrears, and, moreover, some reserves had in effect been tied up in short-term financing of oil.

As to why the exchange rate depreciation had not produced the expected improvement in the current account, the staff representative recalled that the major depreciation of the Jamaica dollar had taken place in the final six months of the program. Through September 1984, the exchange rate had fluctuated around J$4 per US$1 and had risen to J$5.5 per US$1 in early February 1985. In a sense, therefore, the impact of the devaluation could hardly be said to have been instantaneous. Moreover, the depreciation had not been immediately passed through to the general economy; for that reason, the staff had taken the position that public sector price adjustments should be implemented promptly. As to why imports had not been reduced as dramatically as expected, the staff was uncertain that the correct figures on imports had been used. The problem seemed to lie in the petroleum sector, as imports of petroleum had been higher than expected. The staff had been attempting to ascertain whether a customs figures carryover of some US$20 million had been incorporated from the previous fiscal year into the current fiscal year's account. Such a carryover could have caused some of the distortion between the changes in the fiscal accounts and the changes in the balance of payments. When the final data became available, it might well turn out that the current account deficit in the balance of payments was slightly lower than the figure used in the staff paper.

Further financial support would be necessary for Jamaica to carry forward the difficult and far-reaching adjustment effort that was required, the staff representative said. The program under discussion was based on an expected increase in net debt of about 8.5 percent and a decline in exports of goods and services of 5-6 percent. The trend was clearly disturbing, but it had to be viewed against the pace at which the domestic economy was able to adjust. For that reason, the staff was attempting to find incremental financing for Jamaica on highly concessional terms.

It had been suggested by Mr. Ortiz that, in view of the difficulties of the Central Government, the next program should closely monitor the overall public sector deficit, the staff representative remarked. Difficulties of monitoring aside, the envisaged program was aimed at controlling the entire public sector deficit through the establishment of ceilings on all external borrowing by the public sector as well as ceilings on domestic financing of the Central Government and a ceiling on the domestic financing of enterprises. In that respect, the staff was attempting to approach the problem from the financing side; by controlling the total access to financing, the authorities should find it possible to improve the coordination of policies in the entire public sector.

As mentioned by several Directors, unemployment was a serious problem in Jamaica, with the past 12 months' unemployment rate hovering at about 27 percent, the staff representative noted. Of course, the definition of unemployment in Jamaica was unusually wide, in that people were counted as unemployed even if they simply stated that they wanted to work; they did not have to show that they were looking for work. The rate of labor participation in Jamaica was high, at some 70 percent of the labor force for ages 14-65, and women represented a large part of the labor force. In the circumstances, a more internationally comparable definition of unemployment would probably show unemployment rates at about 16-17 percent. On a related matter, the level of employment of the Government seemed high, with one out of eight employed people working in the public sector, although that proportion was not particularly high by Caribbean standards. Of the 100,000 public sector employees, 25 percent worked in central government administration, another 25 percent were in the security forces, and the remainder worked mainly in education and health services. Certainly there was room for cuts in employment, but action to implement such cuts touched sensitive political areas. The 1984/85 program had involved cuts of 4-5 percent in public sector employment, and it was to be hoped that further progress could be made in employment cuts in the following year.

In response to a question from Mr. Clark, the staff representative remarked, very little activity had taken place in the forward exchange market. Commercial bankers in Jamaica had indicated that they had carried out very few transactions, and none at more than 30 days; the turnover had apparently been quite small.

With the support of three structural adjustment loans from the World Bank, there had been an ongoing effort in Jamaica to restructure the economy, a move that the medium-term outlook suggested was a matter of extreme urgency, the staff representative continued. Certainly, the exchange rate would play a central role in the restructuring effort; indeed, the adjustments implemented had already produced quite promising results in nontraditional exports. For many years, Jamaica had maintained an overvalued exchange rate, but great strides had been taken of late toward correcting the problem. With the market determination system being put in place, the exchange rate would be able to perform a role in effecting structural change.

The major liberalization effort that had taken place in the trading system had helped to ensure that investors and producers had access to needed imports without bureaucratic interference, the staff representative remarked. Moreover, the auction system had helped to create conditions in which structural changes could be effected. For the first time in many years, the private sector, provided that it was prepared to pay a market price, would have automatic, easy access to foreign exchange and would thus be able to undertake foreign commitments with the knowledge that it would be able to make payments on time and would not have to contend with bureaucratic or exchange rate obstacles. In addition, the elimination of all arrears by the Bank of Jamaica had been a great step forward in re-establishing the conditions under which the private sector could operate and begin to take up the slack in the economy.

The World Bank had invested heavily in the agricultural sector in Jamaica with a view to shifting agricultural marketing from government agencies to private-sector agencies, the staff representative said. Programs were under way to close down obsolete sugar factories and to transfer agricultural land from those factories to nontraditional exports. Also under way was the long-delayed revitalization of the banana factories. The Government had ambitious plans to improve nontraditional exports, including foreign investment in fish farming and winter vegetables. And an effort had been made to ensure that the industrial sector had priority access to development financing through the Export Development Fund and through the IDB-financed Rehabilitation Fund, which gave private-sector investors access to foreign exchange for the purpose of buying equipment.

Tax reform was a major problem in Jamaica, the staff representative considered. Income tax rates were quite high, but there was significant tax evasion. A project was currently under way to study the tax system, and, on the basis of the findings, the Government would look at ways of introducing tax reform over the next three to five years, with the aim of reducing inequities. Such reforms were of course difficult to implement in the short run; given the pressure on the budget, the Government could not afford to take risks that the tax reforms might lead to revenue losses.

The causes of the problems in the alumina industry were well known, the staff representative from the Western Hemisphere Department said. The alumina sector worldwide was in a structural imbalance at present because a number of countries and enterprises had independently decided in the late 1970s to increase capacity. As a result, over the past 18 months, some 4 million tons of new capacity had been added to the alumina sector worldwide, an increase of 15-20 percent that had put pressure on existing plants. At the same time, the Jamaican problem had been complicated by the fact that Jamaica was a relatively high-cost producer because of the bauxite levy. The viability of that levy was at present being questioned, and the staff and the authorities were nearing the conclusion that it would need to be reduced. In the meantime, by leasing the ALCOA plant, the Jamaican Government had in effect given up the levy on that plant because it was selling alumina more or less at cost, an action that had created problems in the budget as well as in the balance of payments.

The staff representative from the Exchange and Trade Relations Department recalled that Mr. Dallara had queried whether providing for a purchase of SDR 36 million by Jamaica upon completion of the review would be an appropriate course of action. Originally, the current program had by design been back-loaded, with one purchase of SDR 18 million linked to the end-December performance criteria and the completion of the next review; a further purchase of SDR 18 million had originally been linked to the end-March performance criteria. The intention had been that consultation discussions, begun in March, would provide the Executive Board with an opportunity to discuss the Jamaican situation before the negotiation of a new program for 1985/86. Unfortunately, because of the way in which the economic situation and the negotiations had evolved in Jamaica, the three separate stages that he had mentioned had fused into one. As a consequence, the staff had been forced to take a decision on whether to scrap the current program and begin a new one for 1985/86--with the consequent risk of losing control of the economic situation in the interim--or to follow the course of action that had led to the present Board meeting.

Although the gross amount of purchases following the current review would be SDR 36 million, the staff representative continued, large repurchases had fallen due during the five months since January, and net purchases from the Fund at the conclusion of the review would in fact be only SDR 11 million. On a related matter, given the difficult balance of payments outlook for the medium term, and the current outstanding use of Fund resources, the staff had been talking to the Jamaican authorities about a net repurchase during the next program. On a separate question, while short-term foreign credits were not subject to a performance criterion under the existing program, the intention was to establish a performance criterion for short-term credits of the public sector as a whole in the program.

Mr. Dallara said that he was pleased to note that the staff felt that the current structure of real interest rates was positive. It was also comforting to hear that the measures called for under the structural adjustment loan program with the World Bank had, basically, been fulfilled. Still, the staff's responses had left him with one or two uncertainties. For example, despite the indication that the staff had a good grasp of the status of the overall public sector, he was troubled by the indication on page 6 of the paper that "the information on the operations of the rest of the public sector is deficient...." Also puzzling were some elements of the assumptions underlying the medium-term balance of payments scenario. He had noted with interest the statement on page 17 of the report that,

> for the purpose of this projection, nonbauxite-related imports have been kept constant in volume terms in 1985/86[,] and the mix of additional adjustment and financing needed to close the financing gap in 1985/86 and beyond is left open.

He had understood that statement to mean that the staff had in effect incorporated in the assumptions the potential positive effects of measures already in place but that it had not assumed the implementation of any additional measures. His understanding had been confirmed somewhat by Mr. Ortiz's suggestion that the staff had assumed continuing significant growth in nontraditional exports in the years ahead, which had led him to believe that the staff had also assumed a continued efficient operation of the exchange rate market as well as a continued passthrough of price measures. He would appreciate any additional clarifications that the staff could provide on that matter.

As to whether or not the situation at the completion of the current review should be viewed as a back-loaded existing program or a front-loaded new program, Mr. Dallara remarked that, until policies being negotiated had been quantified and put into place, it will be difficult for the Executive Board to come to proper judgments about the medium-term balance of payments outlook. He had difficulty with the idea that the Board should be asked to make a judgment that the disbursements to be made available to the authorities were consistent with the broader mandate of the Board to ensure that adequate safeguards must be provided for the temporary use of Fund resources. He would be interested in hearing whether any other cases existed involving multiple back drawings recommended for disbursement in the absence of any additional information or agreed targets or policies for the following 6-12 months.

The staff representative from the Western Hemisphere Department replied that, during the most recent staff mission to Jamaica, two staff members had been assigned almost full time to monitor the rest of the public sector, beyond the Central Government. The task had been difficult, but the two staff members had made an effort to fulfill it by measuring the public sector deficit from the financing side, where the firmest data were available. All the data suggested that, apart from the Bank of Jamaica, the consolidated balance for the General Government and selected entities had improved from a deficit of 16.3 percent of GDP to a deficit of 7 percent of GDP, which had matched nearly precisely the improvement in the central government deficit as a percentage of GDP. Including losses of the Bank of Jamaica, the overall deficit had been 19.8 percent of GDP in 1983/84 and 13 percent of GDP in 1984/85, an improvement of 6.8 percentage points. In the General Government and the entities, the improvement had been 9.3 percentage points; hence, in spite of all the difficulties of monitoring, the rest of the public sector had behaved about as expected; certainly, its position had not deteriorated.

It was true that the medium-term projections provided by the staff were passive only in the sense that they did not take account of the fiscal adjustment measures that would be necessary to bring down aggregate demand and, therefore, imports into Jamaica, the staff representative continued. However, the staff had assumed in the projections that the export thrust would continue and was in fact projecting a rise in nontraditional exports of about 15 percent each year. It was expected that Jamaica would only broadly be able to hold its market share in tourism, which was projected to increase by no more than 5 percent each year in volume terms.

The staff representative from the Exchange and Trade Relations Department said that he could not recall whether any other instances existed in which the Fund had allowed a country to make up missed purchases in the absence of a specification of policies and performance criteria for some period ahead. However, the current stand-by arrangement with Jamaica would expire in June, and it was not possible for performance criteria to be specified for a period beyond the period of the existing stand-by arrangement. A possible approach would have been to scrap the existing program and move forward with an entirely new stand-by arrangement; that option had been considered and rejected because there would have been an intervening period during which there could have been slippages and loss of control. At the same time, while performance criteria could not be specified beyond the period of the stand-by arrangement, the review paper and the review process had included a discussion of several policy areas in which the authorities either had implemented or were expected to implement measures over the next several months. Since, as noted earlier, various stages of the review process had become fused, it was difficult to determine whether various policies were part of the existing or new program.

The staff representative from the Western Hemisphere Department added that the measures required for the completion of the review under the stand-by arrangement had been substantial and should not be underestimated.

During the past three months, the Jamaican authorities had carried out significant price adjustments on a number of products, introduced tax measures that should shore up the following year's budget, and raised the structure of interest rates by 4-5 percentage points. In a sense, those were prior actions relating to the next 12 months and should serve to provide a degree of assurance that policies were being put in place to address Jamaica's problems.

Mr. Joyce said that he appreciated the agreement of his colleagues to waive the four-week rule for consideration of the review under the stand-by arrangement for Jamaica and the authorities' request for a waiver of performance criteria. Consultative group meetings were being held in Paris later in the week, and any decisions adopted at the present meeting could have an effect on the donors' statements at the consultative group meeting.

Although Jamaica had clearly taken a number of important steps during the past year--particularly during the past several months--to deal with its problems, there remained a number of Directors who had deep concerns about the future of the Jamaican economy, Mr. Joyce continued. Some of them, while supporting the program, had done so only with reluctance or with reservations. In some cases, the hesitation of his colleagues to give full approval to the proposed decisions related to performance under the existing stand-by arrangement, the medium-term outlook for the Jamaican economy, and the procedures that had been followed in bringing the review and request for waiver to the Executive Board. He hoped to deal briefly with those reservations in order to provide assurances of the authorities' commitment to adjustment.

While progress had been made toward reducing the fiscal deficit, the effort to date admittedly had not been sufficient, particularly in the light of circumstances that had emerged in the past several months, Mr. Joyce commented. More needed to be done to strengthen the public finances, which was why the authorities had been negotiating with the Fund on a new program and why they had taken some measures during the past month that had gone beyond the immediate requirements of the current stand-by arrangement.

Responding to those who were concerned about the public sector enterprises in Jamaica, Mr. Joyce observed that the Fund staff mission had become involved in detail in the problems of those enterprises, particularly where structural changes were warranted. In general, the Fund seemed to be moving more toward involvement in the microeconomic situations of member countries than it had ever done in considering the more traditional shorter-term programs of earlier years. There was little that could or should be done about the situation; indeed, it was appropriate that the staff should be sufficiently involved to be able to answer detailed questions on the functioning of an economy or even on the functioning of individual parastatal enterprises.

Problems relating to short-term external financing had been of concern to his Jamaican authorities for some time, Mr. Joyce noted. In the context of the new program, it was important to ensure that effective constraints were placed upon such financing. On the issue of public sector employment and wages, his Jamaican authorities agreed that there was no room for relaxing efforts to reduce the size of public sector employment and to keep a tight hold on increases in public sector wages. Although the reduction in employment in the current year was less than originally envisaged, more could not have been done, given the economic circumstances in the country and the social unrest that had followed the increases in petroleum prices in January. Still, it was clear to all concerned that tight controls on wages would have to be maintained for some time.

He wished to assure his colleagues that there was no change in the attitude of the Government toward the privatization of public sector enterprises, Mr. Joyce commented. For various reasons, progress toward divestment had been less rapid than had been hoped; still, the intention was to stay the course and to proceed with divestment as soon as possible.

Welcoming the staff's indication that the interest rate structure at present was positive in real terms, Mr. Joyce observed that most rates in Jamaica were not subject to ceilings. The only controls, if they could be called that, were normal cash reserve and liquid asset ratios and a minimum interest rate for savings deposits.

The staff had offered some assurances about the way in which the exchange rate system in Jamaica was working, Mr. Joyce continued. The authorities' decision to provide greater freedom for the operation of the market had taken some time to become fully effective, but the exchange market was operating reasonably well. Certainly, the authorities intended to continue to allow the exchange rate to float freely in accordance with the understandings reached with the Fund.

The outlook for the medium term was bleak; indeed, if nothing more were done, the balance of payments in the medium term would probably not be sustainable, Mr. Joyce said. The Jamaican authorities accepted that, in light of all that had happened over the past several months, a strong and timely adjustment program was necessary. They had already taken some steps toward adjustment--such as the stamp tax--that were designed not so much to meet the targets of the current program as to lay the foundation for adjustment in future. How large the future adjustments would need to be was a matter still under discussion. On a related matter, he recalled that one Director had doubted whether a realistic program could be designed that would be sustainable, even with rescheduling. The authorities agreed that, in order to make the Jamaican situation sustainable over the longer term, special debt relief measures would be necessary. In any event, a close look must be taken at the debt situation in Jamaica and at the outlook for Jamaica's debt servicing.

On the question of prolonged use of Fund resources, Mr. Joyce observed that a number of Directors had prefaced their concerns by wondering how it was possible that Jamaica could still be in trouble after so many years of programs with the Fund. Part of the problem was undoubtedly due to inappropriate policies pursued in the past; given the operation of the democratic process, it had not always been possible in Jamaica to take steps that even the Government itself might have wished to take. It could also be said that Jamaica was still in trouble because the world around it was constantly changing, and responses to those changes were not always sufficiently rapid. What was true for Jamaica was true for many other developing countries that had over the years been prolonged users of Fund resources; while Executive Directors of the Fund were rightly concerned that the institution had become involved in a type of lending that had not originally been intended, it was not a simple matter for the Fund to disengage itself from such prolonged-use situations.

The procedures followed in the Jamaican case, while they had raised concerns among some of his colleagues, might well have been the most advantageous possible for both the Fund and the Jamaican authorities, Mr. Joyce commented. In effect, because of the fusing of events, the authorities had put into effect prior actions for a new program that had been described not as prior actions but rather as actions taken in the context of the existing stand-by arrangement. In other words, before concluding a stand-by arrangement, the staff and the authorities had begun to identify and put in place measures that would lay the foundation for any future program to which the Board might agree. Such a procedure provided a litmus test of the authorities' determination to adjust while avoiding the usual delays between the identification of needed adjustment measures and the implementation of those measures.

Mr. Dallara remarked that, while he was not entirely satisfied by the responses to all his questions, those responses had at least helped to clarify for him the situation in Jamaica. In particular, he was pleased to hear that the staff considered the overall structure of interest rates positive in real terms at present. Given the assurances provided by Mr. Joyce with respect to the commitment of his Jamaican authorities to the adjustment effort, he was reluctantly prepared to support the proposed decisions.

As for any possible new program with the Fund, Mr. Dallara considered, certain conditions should be met. First, the fiscal effort should be clarified and strengthened as appropriate, and public enterprises, wage developments, and public sector employment should be specifically addressed. Second, the functioning of the exchange auction system should be further strengthened to ensure that it was adequately performing its function and reflecting market forces. Third, external debt, particularly short-term debt, should be better monitored. Fourth, efforts to promote further structural adjustment, which was vitally important to the medium-term outlook, must be specified. Appropriate measures might include continued exchange rate action, modifications in marketing and pricing practices to allow for greater influence of market forces, tax reform, and private sector initiatives. In the area of tax reform, in particular, he urged early action. Reforms might be difficult to implement in the context of the current fiscal constraints, but action must be taken in the short run if the positive medium-term benefits of tax reform were to be realized. Fifth, financing needs over the medium term must be clearly spelled out.

Finally, Mr. Dallara said, with regard to the broader issue of prolonged use of Fund resources, the United States had great difficulty with the idea that Fund lending would continue over the long term for countries that were prolonged users of Fund resources, thus transforming the Fund into a source of long-term assistance rather than a source of temporary balance of payments financing. While there might well be a continuing role for the Fund in some countries, it was not clear that the role was to provide financial assistance.

The Executive Board then adopted the following decisions:

Review Under Stand-By Arrangement and Waiver of Performance Criteria

1. Jamaica has consulted with the Fund in accordance with paragraph 4(e) of the stand-by arrangement for Jamaica (EBS/84/101, Sup. 3, 6/13/84) and paragraph 32 of the letter dated April 25, 1984 from the Prime Minister and Minister of Finance and Planning and the Governor of the Bank of Jamaica, in order to review the progress made in implementing the policies affecting demand management and the exchange system and to reach understandings with the Fund regarding the circumstances in which purchases under the arrangement can be resumed.

2. The letter of April 26, 1985 from the Prime Minister and Minister of Finance and Planning and the amendment to the technical memorandum of understanding of April 25, 1984 and its supplement attached thereto shall be annexed to the stand-by arrangement for Jamaica, and the letters of April 25, 1984, October 22, 1984, and December 1, 1984 and the technical memorandum of understanding of April 25, 1984 and its supplement attached thereto shall be read as supplemented and modified by the letter of April 26, 1985 and the amendment to the technical memorandum of understanding of April 25, 1984 and its supplement attached thereto.

3. Accordingly, the references in paragraph 4(a)(iii) and (iv), 4(b) and (c) of the arrangement, respectively, to the limit on net domestic assets of the Bank of Jamaica, the targets for net international reserves, and net disbursements of new public and publicly guaranteed foreign indebtedness and the limits on external payment arrears originally set for the period to end-March, 1985 in the technical memorandum of understanding attached to the letter dated April 25, 1984 and its supplement attached to the letter of December 1, 1984 shall refer to the

limits and targets for the period to the end of April 1985, as set forth in the letter of April 26, 1985, and the amendment to the technical memorandum of understanding of April 25, 1984 and its supplement attached thereto.

4. Paragraph 2(a) of the stand-by arrangement shall be amended to read as follows:

> 2(a) Purchases under this stand-by arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 64 million, provided that purchases shall not exceed the equivalent of SDR 14.6 million until July 16, 1984, the equivalent of SDR 18 millon until October 16, 1984, and the equivalent of SDR 28 million until January 16, 1985, and the equivalent of SDR 46 million until May 16, 1985.

5. The Fund finds that, in the light of the letter of April 26, 1985 from the Prime Minister and Minister of Finance and Planning, no additional understandings are necessary concerning the nonobservance of the performance criteria relating to the target for net international reserves, and the limit on external public sector arrears for December 31, 1984, and the incurrence of new payment arrears after December 31, 1984, referred to in paragraph 4(a)(iv) and (c) of the arrangement and in paragraph 3 of the supplement to the technical memorandum of understanding attached to the letter of December 1, 1984, and that Jamaica may proceed to make purchases under the stand-by arrangement.

6. In accordance with Executive Board Decision No. 7908-(85/26) (2/20/85) on overdue payments to the Fund, the stand-by arrangement for Jamaica is amended to read as set forth in Attachment III to EBS/85/107 (4/30/85).

Decision No. 7978-(85/76), adopted
May 20, 1985

Exchange System

The approval of Jamaica's exchange restriction and multiple currency practice under Decision No. 7872-(84/181), adopted December 12, 1984 is extended until June 21, 1985 or the completion of the next Article IV consultation, whichever is earlier.

Decision No. 7979-(85/76), adopted
May 20, 1985

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/85/75 (5/17/85) and EBM/85/76 (5/20/85).

3. EXECUTIVE BOARD - MOVEMENT OF QUORUM TO SEOUL

The Executive Board approves the proposed arrangements for the movement of a quorum to Seoul during the Annual Meetings and for its return to Washington, as set forth in EBAP/85/127 (5/14/85).

Adopted May 17, 1985

4. ASSISTANT TO EXECUTIVE DIRECTOR

The Executive Board approves the proposal to appoint an Assistant to an Executive Director, as set forth in EBAP/85/128 (5/15/85).

Adopted May 17, 1985

APPROVED: March 4, 1986

LEO VAN HOUTVEN
Secretary