04

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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 85/108

10:00 a.m., July 17, 1985

J. de Larosière, Chairman
R. D. Erb, Deputy Managing Director

Executive Directors	Alternate Executive Directors
	L. K. Doe
C. H. Dallara	
	H. G. Schneider
	S. de Forges, Temporary
	T. Alhaimus
H. Fujino	
G. Grosche	
J. E. Ismael	
R. K. Joyce	L. Leonard
	J. Hospedales, Temporary
H. Lundstrom	H. Fugmann
E. I. M. Mtei	A. Abdallah
	C. A. Salinas, Temporary
	J. E. Suraisry
	E. M. Ainley, Temporary
	G. Ortiz
	J. de Beaufort Wijnholds
C. R. Rye	A. V. Romuáldez
	O. Kabbaj
A. K. Sengupta	A. S. Jayawardena
	T. A. Clark
S. Zecchini	N. Coumbis
	Wang E.

L. Van Houtven, Secretary
K. Baer, Assistant

Also Present

IBRD: S. T. Voyadzis, Latin America and the Caribbean Regional Office. African Department: A. D. Ouattara, Director; R. J. Bhatia, Deputy Director; A. I. Abdi, J. Artus, A. Basu. European Department: L. A. Whittome, Counsellor and Director; N. Streefkerk, H. Ungerer. Exchange and Trade Relations Department: W. A. Beveridge, Deputy Director; J. T. Boorman, S. Kanesa-Thasan, M. Nowak, P. M. Thomsen. External Relations Department: H. P. Puentes. Fiscal Affairs Department: R. J. Hurnard, R. D. Kibuka. Legal Department: G. P. Nicoletopoulos, Director; J. K. Oh, S. A. Silard. Research Department: H. C. Kim. Treasurer's Department: D. Williams, Deputy Treasurer; J. C. Corr, D. Gupta, M. F. Melhem, D. V. Pritchett. Western Hemisphere Department: E. Wiesner, Director; S. T. Beza, Associate Director; L. E. Escobar, J. Fajgenbaum, M. E. Hardy, C. S. Lee. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: A. A. Agah, D. Hammann, G. Nguyen, J.-C. Obame, G. W. K. Pickering, E. M. Taha. Assistants to Executive Directors: J. de la Herrán, C. Flamant, V. Govindarajan, G. D. Hodgson, A. K. Juusela, M. Lundsager, K. Murakami, W. K. Parmena, M. Rasyid, D. J. Robinson, M. Sarenac, A. A. Scholten, A. J. Tregilgas.

1. JAMAICA - 1985 ARTICLE IV CONSULTATION AND STAND-BY ARRANGEMENT

The Executive Directors considered the staff report for the 1985 Article IV consultation with Jamaica (EBS/85/162, 6/27/85). They also had before them a report on recent economic developments in Jamaica (SM/85/200, 7/10/85).

The staff representative from the Western Hemisphere Department stated that on July 11, 1985 the Bank Advisory Group of commercial banks had agreed to reschedule all principal falling due in 1985/86 and 1986/87, amounting to US$195 million over ten years, with a four-year grace period, at a rate of 1 7/8 percentage points over LIBOR. The banks had also restructured remaining maturities, most of which would fall due in the two following years, into a single loan to be repaid in ten equal installments. The debt restructuring arrangement, expected to be completed by October 1, 1985, was conditional on the approval of the proposed stand-by arrangement with the Fund and would be in line with the assumptions of the program.

The staff had also been informed that the U.S. Administration's request to allocate US$30 million of additional aid to Jamaica had not yet been approved by Congress, the staff representative commented. However, it was expected that approval would be granted soon. The program had been based on the assumption that US$15 million of those funds would have been made available in July. Although there was still a good chance that those funds would be disbursed on time, there could be a delay. Finally, the Paris Club meeting was scheduled for July 19, 1985, and all the prior actions required under the program had been taken.

Mr. Joyce made the following statement:

> Under the stand-by arrangement, which expired in June 1985, the Government of Jamaica introduced a number of important policy measures that led to significant adjustments in the Jamaican economy. Notable among the achievements under the previous stand-by arrangement were the elimination of external arrears, the establishment of the present market-determined exchange system, a substantial reduction in the overall public sector deficit, and a further tightening of credit policies. These results were achieved despite the increased difficulties that the authorities faced as a result of a worsening of the situation in the bauxite industry, the adverse impact of civil disturbances upon tourist revenues, and delays in disbursements of certain external borrowings. As a consequence of these problems, certain modifications and waivers in the stand-by arrangement were approved by the Board.
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> On May 20, we had a detailed discussion not only about Jamaica's immediate economic difficulties and the waiver request, but also about the medium-term prospects for the economy. The Government of Jamaica had announced a number of key measures to

deal with the immediate problems and intensify the adjustment process. It was felt that early implementation of these measures would provide a more secure basis for a possible follow-on program.

What we are considering today is a proposed 22-month stand-by arrangement, which takes account of the measures already introduced and indeed looks to a continuation and intensification of these policies. The full benefits of some of these changes--notably the reductions in public sector employment and in public services--will only be felt later in the current fiscal year. The Government is also aware that additional measures may be needed and will be taking further actions as required to meet the targets under the proposed stand-by arrangement.

The measures introduced this spring included a major increase in the tariffs on imports, a tightening of monetary policy, the raising of prices of certain basic foods, and a commitment to adjusting prices charged by public enterprises on a more timely basis. In addition, since our May discussion, the authorities have identified and are implementing a number of other spending cuts which will reduce expenditures by a further 1 percent of GDP in 1986/87. This is to be achieved mostly through substantial layoffs in the public sector and a reduction in public services in health, sanitation, and water. A second phase of expenditure cuts yielding a further 1 percent of GDP in 1986/87 will be identified and implemented by December 1985. There is also a contingency plan to cut back capital expenditures by almost 1 percent of GDP in 1985/86, in the event that major changes in the bauxite levy are made during the current year. This contingency plan is already being implemented pending completion of present discussions with the bauxite companies. These measures and further expenditure cuts to be effected in 1986/87 aim at reducing the deficit of the nonfinancial public sector from 6.4 percent of GDP to 4.7 percent of GDP in 1985/86 and to 2 percent in 1986/87. The central government deficit will be reduced to 6 percent in 1985/86 and 4 percent in 1986/87.

In the rest of the public sector, the Government plans to achieve overall surpluses of approximately 1.3 percent of GDP in 1985/86 and 1.9 percent in 1986/87. These surpluses will flow from the significant adjustment already made in the prices charged by the enterprises, better control over their agencies, and any further adjustments in prices that may be required in the light of changes in exchange rates and costs.

In the vital area of wage and price policies, the Government intends that wage adjustments in the public sector shall not exceed a maximum of 12.5 percent in 1985/86 and hopes that this figure will also serve as a useful guideline for wage settlements in the rest of the economy. Over the past few years, the Government has been reducing the scope of price controls in the economy, and all specific price controls will be eliminated before the end of 1985. Currently, only three basic items are subject to such controls.

The authorities in Jamaica are committed to continuing the policy of flexible interest rates in order to mobilize savings and achieve a better allocation of resources. During the past few months, interest rates have increased significantly, and both the minimum rates on savings and the average lending rates of commercial banks have been raised. The cash reserve requirements of commercial banks and nonbank financial institutions have also been increased.

The exchange rate will continue to be market determined. This policy, which was pursued vigorously during the previous stand-by arrangement, will complement demand management policies. Sharp reductions in the current account deficit are also expected over the next two years. However, the continued deficit in current account and the substantial external debt repayments coming due over the program period will require large-scale exceptional financing. The current program is premised on a refinancing by the commercial banks of 100 percent of the maturities falling due over the period. Rescheduling of government and government-guaranteed debt maturities by bilateral creditors will be sought from the Paris Club later this week. Rescheduling arrangements with other bilateral donors that are not participants in the Paris Club will be sought on terms similar to those given by the Paris Club. The program also requires that the international institutions and bilateral donors continue to provide large amounts of concessional financing.

The Government will intensify its efforts to deregulate the economy, reduce the scope of public sector involvement in the marketplace, and further liberalize the trade and exchange rate system. The authorities hope that these efforts will be assisted by further structural adjustment loans from the World Bank. The Government has also set up a Tax Reform Committee to make specific recommendations by the end of August on changes in the present system of taxation in Jamaica. A Green Paper has already been tabled in Parliament setting out the results of the Government's review of the tax system. It is hoped that through tax reform the Government will be able to ensure that greater incentives are provided to the private sector.

The difficult medium-term economic situation that Jamaica now faces clearly will require continued support by the international community, including substantial refinancing of existing debts and the provision of new financing through the end of the decade. In this effort, the Fund will have an important role to play as a catalyst and as a supplier of Fund assistance. It should be borne in mind, however, that even under the proposed program Jamaica will be making net repayments to the Fund during the next two years.

The current program is an ambitious one and involves major sacrifices by the people of Jamaica. Indeed, it is expected that real GDP will decrease this year by nearly 4 percent. The program is also vulnerable to external developments byond the control of the Jamaican authorities. Nor will it in itself solve all of Jamaica's difficulties, but it should permit Jamaica to achieve a more sustainable balance of payments position and thus lay the basis for more stable progress in the future.

Mr. Hospedales recalled that his chair had discussed the deep-seated economic crisis in Jamaica in May 1985, on the occasion of the review of the stand-by arrangement and the request for waiver of performance criteria. His chair remained committed to the view that there was a need for a determined and vigorous effort not only to adjust the existing structural imbalances, but also to embark upon large-scale debt relief so that an appropriate balance could be struck between adjustment and financing.

The staff report provided valuable insights and sound advice with which to evaluate Jamaica's economic problems, Mr. Hospedales observed. Although Jamaica had shown commitment to the staff's advice, the country's economic situation remained extremely serious. Jamaica's close association with the Fund and its access to other resources were indispensable to help the country to overcome its development problems, and the international community was to be commended for its response to the country's current problems.

The Fund-supported adjustment program in Jamaica had begun to show results in 1984, Mr. Hospedales continued. However, the improvement in the current and capital accounts of the balance of payments had unfortunately been achieved through a further compression of imports. Despite the emergence of several positive indicators, the Jamaican economy was far from stable. Although a buildup of international reserves and a reduction in external arrears had occurred, Jamaica's external debt service ratio remained high at 49 percent. The fiscal deficit had been more than halved, but the severe adjustment under the influence of a strong devaluation and restrictive monetary and fiscal policies had cut living standards drastically. Unemployment had reached the alarming proportion of 26.5 percent of the labor force. Despite restrictive financial policies, inflation had accelerated as a result of the devaluation. Jamaica had experienced an untimely deterioration in its terms of trade in 1985, consequent on the collapse of world market prices and the weakening demand for bauxite. In view of such developments, he supported the request by the Jamaican authorities for a stand-by arrangement.

The Fund had adopted a realistic and constructive approach in Jamaica, a country whose internal and external imbalances were as serious and critical as any among the member countries, Mr. Hospedales remarked. The authorities and the staff were to be commended for the design and financing of the program and for their ability to mobilize additional external financial resources. Such an approach to program design and financing should be followed by other countries in similar circumstances. The efforts and support of aid donors would be crucial for the success of the program.

Mr. Clark noted that two developments in the Jamaican economy had stood out in 1984. First, although performance under the previous stand-by arrangement had fallen short of target in several respects and although there had been too much reliance on ad hoc measures, some real adjustment had been achieved. Most important, the fiscal deficit had been reduced dramatically, in contrast with the previous 18 months, when the deficit had averaged over 15 percent of GDP. Set against that improvement, however, there had been a serious deterioration in the prospects of the bauxite sector, resulting in a reduction of fiscal revenues and a substantial worsening of an already bleak medium-term outlook. In sum, while progress had been made and while the authorities had shown considerably greater commitment to adjustment, the task ahead remained formidable. Jamaica was in the position of having to run fast even to stand still, and standing still was not enough, as the authorities well recognized.

In view of the condition of the Jamaican economy, the proposed program was necessarily ambitious, Mr. Clark continued. Against the background of a further fall in GDP of about 4 percent and an 11 percent fall in imports, the program would not be easy to implement. Nevertheless, given the fragility of Jamaica's external position, there was no room for slippage; a clear program of measures rather than a series of ad hoc responses would be needed in order to restore balance of payments viability in the medium term.

Jamaica's debt to the Fund stood at 27 percent of GDP, one of the highest such ratios in the world, Mr. Clark noted. The Fund's future financial role in Jamaica should therefore be a catalytic one. He welcomed the improvement in public savings projected for 1985/86, which was to be achieved despite the fall in bauxite levy receipts. The changes in the levy were essential if the bauxite industry were to continue operating in Jamaica. However, the fiscal improvement depended largely on increases in revenue. Unfortunately, the ratio of expenditure to GDP had declined only slightly, owing largely to the continuing increase in interest payments. In order to maintain a firm fiscal stance, it would be important for the authorities to restrain the public sector wage bill both by bargaining firmly in the coming pay negotiations and by making further progress in reducing the number of civil servants. If the proposed tax reform were likely to reduce tax revenues in the short term, the authorities should be ready to implement compensating measures. Why were motor vehicles and parts the only consumer goods excluded from the recent tariff increases?

There had been a welcome increase in interest rates to positive real levels, Mr. Clark observed. He wondered whether the domestic borrowing rates were adequate, or whether they induced borrowers to take up available lines of foreign credit.

Jamaica's external position was serious, with a ratio of debt to GDP exceeding 200 percent and interest payments accounting for one eighth of national income, Mr. Clark stated. Although the medium-term projections for the next two years indicated a high rate of growth of nontraditional exports, continued large concessional flows, and further reschedulings, substantial financing gaps were likely to remain for the rest of the decade. It would be essential for the projected growth in tourism and in nontraditional exports to be achieved. For that to occur, the exchange rate would have to remain competitive, and the authorities would have to implement additional structural measures.

In conclusion, he welcomed the proposed program and supported the proposed decisions but noted that Jamaica had a long way to go, Mr. Clark remarked. The country would require continued support from the international community, including the Fund. In addition, the authorities themselves would have to show a strong commitment to the new policies, continue their efforts to communicate the seriousness of the situation to the Jamaican people, and take further measures if necessary.

Mr. Ismael remarked that the authorities had performed well in managing the economy under the previous stand-by arrangement. They had achieved commendable progress in many areas, particularly in reducing the fiscal deficit, containing monetary growth, and increasing the economy's international competitiveness. Despite the progress achieved, however, Jamaica's external position had not improved significantly, owing to the weak performance of traditional exports and tourism and the continued high level of imports, which had been facilitated by significant inflows of short-term capital. The growth performance of the economy had also deteriorated, and the medium-term outlook remained bleak.

Of particular concern was the worsening medium-term balance of payments outlook, arising from Jamaica's heavy debt burden and the weakening world demand for its bauxite and alumina, Mr. Ismael continued. Even in the staff's rather optimistic balance of payments projections, large financing gaps would need to be met each year for the rest of the decade. Thus, the authorities would need to focus on a medium-term policy strategy to improve the country's external position, as well as to implement strong financial and structural policies on a sustained basis. Given the difficult situation and the need for resources to cover the large financing gaps, the Fund should continue supporting Jamaica's adjustment efforts.

However, the relatively high level of Jamaica's outstanding purchases of Fund resources was cause for concern, Mr. Ismael said. Jamaica had made continued use of Fund resources since the late 1970s, and the amount outstanding was not expected to fall significantly over the next three years. Under those circumstances, the Fund should perhaps limit itself to a catalytic role rather than try to meet Jamaica's demands for external resources.

The continued increase of government expenditure as a proportion of GDP was disappointing, especially in light of the need for Jamaica to reduce its public sector, Mr. Ismael remarked. Although expenditure increases had stemmed primarily from a rise in interest payments and from the need to increase the very low capital expenditure as part of the effort to rehabilitate the productive sectors, there was scope for a further reduction of recurrent expenditure in 1985/86. The authorities were taking measures to reduce recurrent expenditure in 1985/86 over and above what had been incorporated in the budget, but more significant efforts were called for.

The growth rate of broad money had declined consistently over the past few years, Mr. Ismael noted. Such a decline was crucial in order to hold down inflationary pressures resulting from adjustments of administered prices and exchange rates. However, the targets that had been set for the growth rate in broad money for 1985/86 and 1986/87--equal to or higher than the rate of increase in nominal GDP--seemed high. In 1986/87, the target was even higher than the expected inflation rates, in terms of both the GDP deflator and the consumer price index.

The authorities were to be commended for the generally flexible management of the exchange rate in the past few years, through the biweekly foreign exchange auctions, Mr. Ismael commented. The resulting depreciation of the Jamaica dollar had undoubtedly enhanced the country's international competitiveness. In view of the convergence that had taken place in the bid rates over the past several weeks, he supported the proposed decision on the approval of temporary extension of the use of the "Dutch" auction system through October 1985.

The likely closure of ALPART's alumina plants might have an impact on the balance of payments projections for 1985/86, Mr. Ismael observed. According to the staff, such a closure in mid-1985/86 would reduce the projected earnings from bauxite exports by US$74 million. Had any provision been made for the resources that would be required to fill the resulting external gap?

Finally, with respect to external debts, he welcomed the tentative rescheduling agreement reached with the commercial banks in May 1985, Mr. Ismael said. However, the data presented in the staff report pertained only to public sector debt. It would be useful if the staff could provide some information on the private sector's external debts and the impact of those debts on the overall picture of Jamaica's external debt burden.

Mr. Ainley remarked that Jamaica had made real efforts to adjust under the recent Fund program. Demand management policies had been strengthened, and the exchange rate had been allowed to float freely. As a result, the fiscal deficit had been reduced and external arrears eliminated, both important achievements.

However, Jamaica still faced acute problems, including negative growth, high inflation, growing unemployment, and a precarious external position, Mr. Ainley commented. Equally worrying, the medium-term outlook continued to deteriorate. In particular, the problems in the bauxite industry appeared to have reached crisis proportions. Even on relatively favorable assumptions, Jamaica would experience persistent current account deficits and sizable financing gaps until 1990. In such circumstances, there would be no easy options, particularly as Jamaica had already had considerable assistance from the international financial community, including the Fund. There was no alternative to stronger and sustained adjustment efforts, both at present and in the medium term, to move the economy out of its present difficulties and to retain the confidence and support of international creditors.

The new program focused appropriately on three main areas: demand management, exchange rate policy, and structural reform, Mr. Ainley remarked. In the short term, the main priority would have to be a strengthening of public finances on a lasting basis. Such a move would be crucial, since Jamaica's present problems could be traced to inappropriate fiscal policies during the previous ten years. He therefore welcomed the comprehensive measures taken to increase revenues and reduce current expenditure. The restructuring of the bauxite levy would have important implications for future revenues. Every effort should be made to reduce current expenditure further, in order to maintain public investment at the minimum required. Thus, he fully supported the continuing effort to streamline the civil service and to overhaul public enterprises, and hoped that the authorities would move ahead more quickly with their plans to privatize some of those enterprises. Such a move would not only benefit the budget, but also give the private sector a greater role in the economy.

Continued monetary restraint would be needed to keep inflation down and to build up net foreign assets, Mr. Ainley stressed. The operating losses of the Bank of Jamaica should be eliminated as soon as possible, if only to foster confidence in the financial system as a whole. The authorities' intention to channel credit to the productive sectors, within the agreed overall ceilings, was appropriate.

As in the past, moderate wage settlements were a crucial element for the success of the program; there was no margin to accommodate any deviation from the projected 12.5 percent wage increase for government employees, Mr. Ainley remarked. The authorities would have to abide by that target, which could set important guidelines for private sector settlements.

Externally, the problems were daunting, Mr. Ainley commented. However, the adoption of a market-oriented exchange rate strategy had helped to improve Jamaica's competitive position. It was vital that the exchange rate remain competitive, particularly if the hoped-for improvement in tourist receipts were to occur. Even if tourism did recover, Jamaica would continue to depend heavily on debt relief and on exceptional assistance for some time to come. The debt restructuring arrangement outlined by the staff was welcome, but Jamaica would have to continue honoring its obligations to all its creditors, particularly to the Fund, in order to ensure sustained progress toward economic recovery.

For the medium term, the program's renewed emphasis on much-needed structural reforms was appropriate, Mr. Ainley pointed out. As the staff had shown in Table 9 the task would be formidable. Of particular importance were the proposals to reform the tax system, introduce a new tariff structure, and develop the domestic capital market. Since those reforms would take time to implement, it was important that the authorities plan ahead, taking full advantage of technical assistance from the Fund and the World Bank.

In sum, he supported the adjustment program, which pointed Jamaica in the right direction, Mr. Ainley stated. Given Jamaica's prolonged use of Fund resources and its relatively poor track record, there was no room for any slippage or relaxation of the adjustment effort. He hoped therefore that the authorities would be especially diligent in carrying out the program. The Fund was asking a lot of Jamaica, in economic, political, and social terms; however, the program provided an opportunity for renewed growth and the attainment of a viable balance of payments position over the medium term and should therefore be pursued with determination.

Mr. Schneider concluded that despite the economic progress achieved during 1984/85 under the previous arrangement, Jamaica's economic situation would remain difficult in the years ahead. Moreover, recent adverse developments in the bauxite/alumina industry had placed further obstacles in the path of the country's adjustment effort. There was, therefore, no room for relaxation of adjustment efforts, and continued large-scale debt relief together with concessional assistance would be required in the medium term.

The success of the proposed program would depend primarily on the Government's ability to persist in its stabilization efforts and to implement policy measures of demand management and structural reform, Mr. Schneider said. Particularly, an intensification of structural reforms would be required. In the absence of structural improvements, the results of Jamaica's economic program would depend heavily on the strict implementation of demand management measures. Therefore, the comprehensive policies designed to foster structural changes in the economy were welcome. However, it was essential that the program's framework remain unaltered and that the execution of the program be closely monitored.

One of the major weaknesses of the Jamaican economy with which the program would have to contend was the high level of consumption, which in turn was reflected in a very low savings ratio and a sizable gap between domestic savings and investment, Mr. Schneider pointed out. National savings, excluding depreciation, had been about 1 percent of GDP in 1984, while domestic investment had been over 22 percent of GDP. It was therefore necessary for Jamaica to give priority to further reducing private and public consumption; in addition, by implementing active interest rate and tax policies, the authorities might achieve an increase in the savings ratio that would be more in line with investment.

He particularly welcomed the proposed tax reform, aimed at reducing income tax rates, widening the tax base, and improving the integration between corporate and individual taxes, Mr. Schneider continued. However, the reform might initially have a negative impact on revenues. Indeed, about half the total tax revenue came from income and profit taxation, which would be reduced under the reform. It was therefore vital that the authorities closely monitor total revenue while controlling public expenditure tightly; otherwise, the budget deficit would remain substantial and troublesome. In that context, it would also be desirable for the Fund to review the whole structure of expenditure within the framework of its technical assistance program.

With regard to the exchange rate policy, the staff indicated that the exchange rate would continue to be determined by "Dutch" auction techniques until end-October 1985, Mr. Schneider observed. Was a modification in or a replacement of the present system or technique envisaged in the future?

The Government's full determination in implementing the envisaged stabilization policies and structural reforms would be required to reduce the deep-rooted economic imbalances, a difficult task in both economic and political terms, Mr. Schneider concluded. However, there was no alternative. Jamaica had been a prolonged user of Fund resources since the late 1970s, but its economic situation had remained vulnerable in spite of recent progress. As the debt burden was extremely high and as exceptional external financing and debt relief would be required, the Government should demonstrate its willingness and determination to restructure the economy in order to ensure the continuation of urgently needed financial assistance from the international community. In view of Jamaica's high indebtedness to the Fund, the Fund's role should be a catalytic one. In the expectation that further progress would be achieved, he could support the proposed decisions.

Mr. Ortiz said that on the occasion of the previous review of the 1984/85 program for Jamaica, his chair had noted Jamaica's bleak economic outlook and had raised serious questions relating to the basic solvency of the country and the degree of Fund involvement. Jamaica's relative debt position was one of the highest in the Western Hemisphere and possibly in the world. In 1984, its debt to the Fund had represented about 20 percent of its total external debt and nearly 30 percent of GDP. Worse still, the outstanding external debt was projected to increase from 158.5 percent of GDP in 1984/85 to 217 percent at the conclusion of the proposed program in 1986/87.

In addition to the overwhelming difficulties raised by the high external debt were the poor prospects for the bauxite/alumina market and the problematic medium-term outlook for the balance of payments, Mr. Ortiz observed. Bauxite accounted for over half of total exports. In addition, a financing gap of about US$50 million remained for 1986/87, in spite of the optimistic assumptions about the behavior of nontraditional exports and the drastic import compression envisaged for 1985/86 and possibly for 1986/87. It was also assumed that there would be complete rescheduling of principal payments on external debt, continued use of Fund resources, and additional flows of bilateral aid.

The implications of a balance of payments constraint on economic activity were quite dramatic, Mr. Ortiz remarked. Real GDP was estimated to fall by an additional 4 percent in 1985/86, and no growth was contemplated for the following year. With continued fiscal and monetary contraction as well as a projected fall in imports, it was difficult to see how a further decline in economic activity could be avoided in 1986/87. In spite of the strong adjustment measures contemplated in the program, the overall balance of payments situation at the end of the requested stand-by arrangement would still be weak.

Against such a panorama, the feasibility of the program was questionable, Mr. Ortiz suggested. His chair had previously expressed doubts whether a realistic program could be devised to allow Jamaica to service its debt, allowing for complete rescheduling of principal. Those doubts had been reinforced by recent information and by the staff's assessment of the prospects of the Jamaican economy; in view of the continuing deterioration of the economy and of living standards, how could a program that contemplated strong adjustment be judged to be realistic?

Despite the difficulties that the Jamaican authorities were bound to encounter in implementing an adjustment program, the country did need to adjust, Mr. Ortiz stressed. The drastic deterioration of the economic situation over recent years could be attributed partly to the failure to adopt timely adjustment measures, even though the country had been under a continuous Fund program since 1978. Indeed, a strict adjustment program was long overdue, but not without Fund support. The Fund's continued involvement in Jamaica was inevitable, particularly in a catalytic role.

Jamaica's situation was so difficult that an economic program could be viable only if it were accompanied by sufficient debt relief, Mr. Ortiz noted. Substantial debt relief had been forthcoming, and exceptional bilateral financing had been made available to the authorities, but it was still insufficient in view of the country's economic situation. A large part of Jamaica's debt would have to be dealt with promptly by nonmarket mechanisms. The Fund had a role to play in proposing a long-term solution for Jamaica's debt problem. The longer a solution was postponed, the more difficult the economic situation was likely to become. The authorities would find it more difficult to gather political and social support for strict adjustment measures if the size of the problem seemed insurmountable.

With the basic question of the viability of the program unanswered, Mr. Ortiz said, it was difficult to see how structural adjustment policies could help to reduce the role of the public sector, stimulate private economic activity, encourage tax reform, and reinforce the privatization of government-owned commercial and industrial operations. In order to attain those objectives, the authorities would have to increase confidence in the medium-term viability of the economy.

His chair agreed with the basic thrust of the fiscal and monetary measures that had been detailed in the staff report and in Mr. Joyce's statement, Mr. Ortiz remarked. The proposed adjustment in the wage sector would imply a painful fall in incomes. In addition, flexible interest rates and interest rate policies would clearly be needed to facilitate the reduction of internal imbalances.

In conclusion, the difficult medium-term economic situation in Jamaica would require the continued support of the international financial community, Mr. Ortiz stated. The program was ambitious and would involve major sacrifices by the Jamaican people; the program's chances for success would depend largely on its perceived viability and the authorities' ability to implement specific economic measures.

Mr. Grosche stated that his chair had many reservations about Jamaica's request for a new stand-by arrangement. The country was clearly a prolonged user of Fund resources, having adopted a number of Fund programs since 1977 and with outstanding credit amounting to 365 percent of quota. In addition, the balance of payments situation was still far from sustainable. In fact, the medium-term prospects showed sizable financing gaps until the end of the 1980s. In the recent past, Jamaica had repeatedly failed to discharge its obligations to the Fund.

Given the critical situation, he wondered, first, whether a further program would be justified and, second, whether the proposed length of the program and the proposed amounts would be appropriate, Mr. Grosche stated. In view of Jamaica's disappointing record in the past, the desirability of yet another Fund program was questionable. However, in the final analysis, the new arrangement could be justified. The authorities had made some progress toward adjustment and had resolved to continue their efforts with renewed emphasis. Furthermore, the new program could encourage both private and public creditors to engage in new exercises and provide fresh money. Unfortunately, it appeared that private banks, in contrast to public creditors, were not ready to provide fresh money, thus underlining the urgent need for Jamaica to do everything to restore its international creditworthiness.

Concerning the length of the proposed program, he preferred a shorter, perhaps a one-year, stand-by arrangement for a variety of reasons, Mr. Grosche added. First, as few measures had been agreed upon for 1986/87, the proposed program would be burdened with many uncertainties, especially in the second half of the year. Second, the full effects of the tax reform to be implemented in 1986 were difficult to evaluate. Third, even after rescheduling, the country would be faced with a significant balance of payments gap in 1986/87. With respect to the proposed drawings, a somewhat smaller amount in terms of quota would have been preferable, an amount that would have allowed faster reduction of Fund exposure than currently scheduled. In deciding on the amounts, the Fund should avoid giving the impression that it was, in effect, rescheduling obligations that were falling due. Nevertheless, he could support the proposed decision as it stood, mainly on the ground that it seemed to address Jamaica's problems appropriately.

The authorities' intention to reduce the overall public sector deficit markedly despite shortfalls in bauxite receipts and higher interest payments was welcome, Mr. Grosche emphasized, but in order to achieve the objective of lower deficits, all taxes and duties would have to be paid promptly. As the tax reform under consideration could have a further positive impact, he wondered whether the submission of the relevant tax reform proposals to Parliament could be speeded up. Another step that might reinforce the momentum of fiscal adjustment was a contingency plan providing for additional expenditure cuts in the event of adverse developments. Finally, measures taken in March 1985 to increase tax revenues should not be regarded as a prior action for the new program, as they were originally designed to bring the recently expired program back on track. A new program should also embark on new action, as the measures taken in the marginal period did not seem to live up to the objectives of the 1986/87 program.

In 1984, the financing of the external current account deficit had been considerably eased by short-term capital inflows, Mr. Grosche noted. As those flows were estimated to be of only minor importance in 1985, he wondered whether additional exchange rate and interest rate policy measures were called for.

Mr. Wijnholds observed that for many years, the Fund had been intimately involved in the adjustment process in Jamaica. In the previous four years, real GDP had broadly stagnated, while the cumulative current account deficit had risen to almost 70 percent of annual GDP. Added to the effects of exchange rate depreciation, the increase in current account deficits explained the rise of total public external debt to 160 percent of GDP. Accordingly, the question arose whether the Fund's policies toward Jamaica had been inappropriate, whether they had not been carried out as planned, or whether they had been based on incorrect projections. Without attempting to answer those questions, he noted the difference between programmed and realized export growth in the four program years. Imports, on the other hand, had not been far off target.

The staff paper provided ample evidence that the Fund had indeed learned from the disappointing experience, Mr. Wijnholds pointed out. Almost no area of the Jamaican economy would remain untouched by the structural adjustment effort that had been identified as a condition sine qua non for lasting improvement of the situation. Moreover, export earnings had been projected cautiously for 1985/86, and there were hopeful expectations that export performance would not falter as it had done previously.

The medium-term projections were sobering, Mr. Wijnholds remarked. Net external interest payments would rise to 18 percent of GDP in 1986, and would still hover at about 17 percent of GDP in 1989/90. By the end of the decade, the current account deficit was projected to decline to 1.8 percent of GDP. GDP would remain broadly the same as in 1981-84. The debt/GDP ratio would exceed 200 percent in 1986 and would not improve by 1990. The staff considered that a current account deficit of 4 percent of GDP was likely to be sustainable over the long run: did it mean that the current account could remain at minus 4 percent of GDP from 1988/89 onward or that Jamaica should first reduce its external debt/GDP ratio through substantially smaller deficits or even surpluses?

Given the bleak outlook for the external debt situation, further exceptional financing should be highly concessional, Mr. Wijnholds stressed. Indeed, interest payments to the Fund and to the Bank imposed a heavy burden on Jamaica, especially as it was not eligible to receive IDA resources.

He wondered whether a reduction of the bauxite levy as assumed would be sufficient to make the companies profitable again, considering that without the levy, the Government was hardly able to earn foreign exchange on the leased ALCOA plant, Mr. Wijnholds remarked. The bauxite levy had clearly been an ill-conceived instrument to which the Government had clung for too long.

On fiscal policy, considerable progress had been made since 1981, Mr. Wijnholds commented. Noninterest expenditures had been reduced from almost 36 percent of GDP in 1981/82 to 25 percent of GDP in 1984/85--a substantial adjustment by any standard. Thus, it was unsurprising that no further progress was envisaged, except under the contingency plan. However, realization of the deficit target and the planned fiscal reform would require further steps in 1986/87; holding the line on wages would be a crucial element in order to achieve that target.

His chair supported the proposed stand-by arrangement and welcomed the net reduction in the Fund's financial involvement in Jamaica, which was necessary given the need to preserve the revolving nature of the Fund's resources, Mr. Wijnholds stated. It had not been made clear, however, why the duration of the stand-by arrangement was nearly two years, rather than the one year originally envisaged. He welcomed, in particular, the inclusion of a performance criterion for short-term external debt, which had not been included under the previous arrangement.

Mr. Coumbis remarked that despite the considerable adjustment effort that Jamaica had made so far, the overall economic situation remained difficult, as evidenced by the medium-term scenario. At the previous Board meeting on Jamaica, Directors had indicated the need for intense efforts in structural reform in view of the severe deterioration of economic prospects. The authorities should substantially reduce the consolidated public sector deficit while continuing to apply flexible interest rate and exchange rate policies. Furthermore, in order to close the financial gaps in the balance of payments, substantial refinancing and exceptional financial assistance would be needed in 1985/86 and beyond.

He agreed with the broad objectives of the 1985-87 adjustment program and could accept the proposed decision, although he was not fully convinced that the authorities would be able to carry through successfully with the demanding program, Mr. Coumbis said. Also appropriate were the prescribed policies, quantitative performance criteria, and assumptions about the rescheduling and the financial assistance that would be needed in order to close the financing gaps. Jamaica's high debt burden to the Fund being cause for concern, the Fund should confine itself to a catalytic role in Jamaica.

It would be difficult for the authorities to reduce the deficit of the nonfinancial public sector from 6.4 percent of GDP in 1985/86 to 2 percent of GDP in 1986/87, Mr. Coumbis remarked. With no room for slippages, the authorities would have to apply, as soon as possible, the impressive list of measures designed to boost revenues and reduce expenditures. Therefore, he welcomed their intention to offset any shortfall in levy receipts with new measures in order to preserve the target program. Furthermore, the authorities' commitment to adjusting the prices of goods and services sold by public enterprises in response to changes in exchange rates or other costs was appropriate. The Government had already set up a committee to make specific recommendations for changes in the tax system.

The authorities were to be commended for their commitment to keeping domestic interest rates broadly positive in real terms, Mr. Coumbis observed. However, the maintenance of selective credit controls was disappointing; his authorities' experience in Greece with such controls had not been satisfactory.

In order to achieve the balance of payments targets, demand management policies would have to be combined with a fully market-determined exchange rate, Mr. Coumbis stressed. However, in advising the authorities about the speed and the size of the depreciation, the staff should take into account the special social and political conditions existing in Jamaica.

He would appreciate learning whether there was a more specific program with priorities and time schedules that could be tailored especially to Jamaica, Mr. Coumbis concluded. The World Bank had been involved in Jamaica with three structural adjustment loans (SALs) and other project and structural loans. It could also play an important role in assisting the country to design a comprehensive, efficient, and workable medium-term plan.

Mr. Dallara recalled that during the discussion of Jamaica in May 1985, when the Board had approved Jamaica's request for a waiver and the related significant drawings under the program, several concerns had been raised. The presentation of a new program allayed some of the previous concerns, which had related not only to the adjustment effort and the difficult medium-term outlook, but also to the absence of any apparent continued commitment by the authorities. However, with the new adjustment program supported by a 22-month stand-by arrangement, it appeared that the authorities were intent on pursuing the adjustment effort: they had met all modified performance criteria in April 1985 and had eliminated all external arrears by June 1985. Furthermore, the authorities' ongoing implementation of the additional measures needed to retain current program targets appeared to be consistent with what had been outlined two months ago and with the new program. He therefore supported Jamaica's request for a stand-by arrangement.

Nonetheless, like other Directors, he continued to have serious concerns about the difficulties associated with implementing the program, Mr. Dallara remarked. The medium-term outlook was difficult, even with the implementation of present measures and the assumed implementation of measures in years beyond the program period. In addition, certain developments, particularly the reduced revenue that could be expected from the bauxite levy, appeared to have reduced the feasibility of attaining the programmed pace of adjustment unless adequate compensating measures were taken.

The authorities should be commended for the significant progress made in reducing the fiscal deficit during 1984, Mr. Dallara observed. Fiscal policy envisaged in the new program was appropriately restrained. In particular, he welcomed the restraints on wages, which were expected to increase by about half of the expected inflation rate in 1985, and the necessary, although difficult, curtailment in the number of public sector employees. There would be no scope for deviation from the plans in that area. Nonetheless, the central government fiscal deficit would remain high at 6 percent of GDP in 1985, owing in part to the expected reduction in revenues from the bauxite levy. The contingency plan for cutbacks in expenditure, primarily capital expenditure, by 0.8 percent of GDP was currently being implemented. He wondered whether that cutback was sufficient, given the uncertainties regarding the bauxite levy.

He was also somewhat concerned about the substantial adjustment gap of 3.6 percent of GDP mentioned in Table 6 of the staff report, Mr. Dallara stated. The text of the report referred to an adjustment gap of 4-5 percent of GDP, a substantial figure. Given the measures embodied in the program and the uncertainties that existed in the fiscal area over the 12 months ahead, it would be interesting to know what measures were being contemplated for 1986 to meet that adjustment gap. He recognized that additional measures would be determined as part of the review process, but, given the prolonged use of Fund resources, the difficult situation, and the length of the program, it would be legitimate to focus on the needed adjustment question at present.

As for the rest of the public sector, including the nonfinancial enterprises, an overall surplus was expected in 1985 and 1986, Mr. Dallara commented. The surplus was currently slightly lower than it had been in 1984, apparently owing to the one-time improvement brought about by the sale and lease-back of the aircraft in 1984. The authorities were committed to passing through the price effects of the exchange rate changes and thus would avoid subsidizing the services of state enterprises. However, according to the staff report, other current transfers, though declining from the level of 1984/85, would remain significant at 2.9 percent of GDP in 1985/86. He would appreciate any further explanation from the staff regarding the purpose of and potential for further reducing the transfers in view of the surplus in the nonfinancial enterprises. The divestment effort, which was expected to accelerate during the period ahead, was welcome and could contribute considerably to improving the medium-term outlook.

Referring briefly to the monetary accounts, his chair continued to be concerned about the operating losses of the central bank, which had reached substantial levels in 1984/85, Mr. Dallara stated. However, those losses were projected to fall significantly in 1985 and 1986, a welcome prospect. He urged the authorities to take all necessary steps to achieve the progress envisaged in that area, including exchange rate action. Regarding interest rates, Directors had been assured at the Board's previous discussion that interest rates were broadly positive in real terms. However, if inflation turned out to average about 23 percent in 1985, there was some doubt whether interest rates would be appropriate. Could the staff comment on recent developments in inflation and how they might affect interest rates? Restraint on credit would be crucial to achieving the balance of payments objectives; however, there was hope that a stronger fiscal effort would permit greater access to credit by the private sector, which had the greatest potential for growth. Accordingly, it was appropriate for the private sector to have access to the Export Development Fund, sponsored by the World Bank, for the provision of foreign exchange to purchase imports.

Regarding the external sector and the medium-term outlook, he was concerned about the adjustment gap and the general fiscal scenario in 1986 and 1987, Mr. Dallara reiterated. The authorities should continue to pursue an appropriate exchange rate policy. Continued reliance on the auction system was appropriate for the time being, as long as market forces were being reflected in the exchange rate. While there was no comprehensive information on the functioning of the exchange auction, he continued to have some doubts about the functioning of the exchange rate in the system, given that the Government determined the supply of foreign exchange to the market. Exchange rate changes had not perhaps been as great as might have been expected in view of the substantial deterioration in the external accounts. He realized that it was a difficult matter and asked for clarification on the operation of the exchange rate regime.

The medium-term outlook was difficult, Mr. Dallara observed. The path to a sustainable payments position was not yet defined, in spite of the strong assumptions that had been made regarding the future of the Jamaican economy. The projected level of imports for the next few years had been revised downward from the figures presented by the staff for the Board meetings in April and May 1985. For example, nonbauxite-related imports for 1986 and 1987 were currently projected at US$895 million, rather than the previous projections, which had been about US$200 million higher. Other projections had also changed, reflecting the need for adjustment measures directed toward the external accounts. The lower levels of imports should be taken into account in the course of the upcoming discussion in connection with the review and implementation of the program.

In the context of structural adjustment measures, the tax reform measures described in the staff report seemed appropriate, Mr. Dallara stated. With the current high marginal tax rates, there was a clear disincentive to earning taxable income. Therefore, the authorities should make tax reform a matter of high priority in the coming months. In the medium term, the plan would provide incentives for production, savings, and growth that would substantially outweigh any short-term costs. Although the Jamaican authorities might need to be compensated for the short-term revenue losses that might be involved in tax reform, he encouraged them to move ahead strongly with their plans. In the event of any short-term revenue loss, the necessary adjustments would have to be made, but they should in no way hinder the tax efforts. Also commendable was the progress made in trade and price liberalization, which would permit freer movement of resources within the Jamaican economy. The involvement of the World Bank in supporting the adjustment effort was essential to the prospect of achieving a viable balance of payments position in the medium term.

Despite the planned strong adjustment measures, he continued to have reservations about Jamaica's long-term use of Fund resources, considering the difficult medium-term outlook, Mr. Dallara remarked. The program involved a significant net repayment to the Fund and was appropriate with regard to phasing and access. Like other Directors, he was concerned about the 22-month program period, but as there was a need for a consistent and sustained effort for more than just one fiscal year and more than just one set of policies, a longer program period was perhaps appropriate. However, the use of Fund credit under the proposed arrangement was a matter of concern, given Jamaica's high levels of outstanding obligations to the Fund. Mr. Joyce had been correct in referring to the need for continued support for Jamaica by the international community, which had demonstrated its willingness to support Jamaica's adjustment efforts, but it could be problematic if the Fund went beyond its catalytic role to continue being a supplier of Fund assistance to the end of the decade, as Mr. Joyce had stated. Although there would have to be continued Fund involvement, the form of that involvement remained a question, given Jamaica's prolonged use of Fund resources.

Mr. Rye endorsed the staff proposal and supported the proposed decisions. Jamaica's adjustment record had improved considerably under the recently completed stand-by arrangement, and the authorities had made progress over the past year in correcting fundamental serious economic imbalances, such as the fiscal deficit. However, repurchases due from Jamaica over the period of the proposed arrangement amounted to just over SDR 105 million, more than the expected purchases under the arrangement, and Fund credit to Jamaica under tranche policies was expected to fall from 371 percent of quota to about 316 percent of quota. Because of the importance of the revolving nature of Fund resources, such a net repurchase position was entirely appropriate for a country with Jamaica's record of prolonged use of Fund resources; also appropriate was the relatively low annual access being proposed. While the Fund's continued involvement in Jamaica was essential for financing, the Fund should play a predominantly catalytic role.

Jamaica's position was precarious, Mr. Rye continued. The most startling aspect of the staff's medium-term projections was the conclusion that if Jamaica's current account deficit were to be brought down by the end of the decade to a sustainable level, nonbauxite-related imports would have to decline in volume during the program period by about 15 percent below their 1984/85 level. Such a figure for import reduction had the status of a target, not a forecast. Indeed, it seemed to be a central policy objective of the program, although its achievement was only indirectly addressed in the staff paper. The staff had stated only that the import target was to be attained through the programmed tightening of demand management policies in combination with a fully market-determined exchange rate intended to ensure that any excess demand for foreign exchange would be balanced by a depreciation of the Jamaica dollar. Those measures, together with the ceilings on official external borrowing, were expected to compress imports. Recent adjustments in oil and food prices and the newly imposed tariffs on imports also had roles to play in restraining imports.

The question whether the program could achieve the targeted reduction in imports was all the more relevant as the external account projections had been off the mark in 1984, Mr. Rye remarked. The staff had stated only that "rather than causing a major reduction in imports, the rapid depreciation of the Jamaica dollar combined with a tight credit policy led to a significant inflow of short-term capital." That statement was puzzling, although Chart 2 in the report on recent economic developments supported the view that the depreciation ought to have significant consequences for Jamaica's competitiveness and imports.

Structural reform policies were essential for the achievement of long-term economic viability in Jamaica, Mr. Rye concluded. In Table 9 of EBS/85/162, the staff set out the structural issues clearly; the format of that table should be used more widely in staff papers. The success of the stand-by arrangement would require comprehensive rescheduling arrangements and substantial concessional financing by international institutions and bilateral donors. Also crucial would be the authorities' ability to implement both the spirit and the letter of the program. There was no room for any relaxation of effort, and the authorities would have to stand ready to undertake further adjustments to preserve the program targets if confronted with any developments that threatened the restoration of balance of payments viability. In the past, failure by the authorities to adjust their plans in a timely and appropriate fashion in the face of adverse developments had contributed in no small way to Jamaica's persistent current account problems. He welcomed the authorities' recognition that the much larger external and fiscal gap that had emerged during the course of the previous program required an acceleration of adjustment over the medium term, and that external financing had reached the limits of its role. He urged the authorities to continue to act upon that realization.

Mr. Alhaimus observed that Jamaica continued to face a difficult situation. Despite the generally tight demand policies implemented under the stand-by arrangement that had expired in June 1985, the balance of payments continued to be under severe pressures, and the medium-term outlook remained bleak. Such a difficult situation persisted despite a series of arrangements with the Fund involving a relatively substantial use of resources. However, the major factor behind the disappointing outcome had been the severe crisis in the principal export industry, which had not only prevented the tighter policy stance from being reflected in the balance of payments, but also increased the scope and urgency of the structural reforms needed to restore sustained economic growth and achieve a viable balance of payments position in the medium term.

Given the difficult realities of the economic situation, the program provided a reasonable balance between adjustment and financing, Mr. Alhaimus contended. In addition to a further tightening of fiscal and monetary policies and the maintenance of a flexible exchange rate, the program included a number of important measures in the areas of pricing and structural reform in general, which over the medium and longer terms would be crucial for the revitalization of the economy.

He welcomed the further planned reductions in the public sector deficit involving significant measures on both the revenue and the expenditure sides, Mr. Alhaimus stated. The contemplated reform of the tax system was also welcome, as it would provide greater incentives for the productive sector. However, it was expected to have a negative impact on revenue, at least initially. Although that impact might be later offset by the longer-term positive effects on economic activity, he wondered whether the changes in the tax system could be formulated in a way that made them revenue neutral during a period when the Jamaican economy would be under severe pressures and when the room for further expenditure cuts would be significantly narrower.

He welcomed the steps taken to tighten credit and keep real interest rates positive, Mr. Alhaimus said. Achievement of the inflation target would depend on adherence to a tight monetary policy, which would also help to stimulate private savings and capital inflows. However, care should be taken to avoid letting real interest rates become so high that they dampened economic activity. Given the projected rate of inflation for 1985/86 of 15 percent, the present lending rate of about 30 percent and the rate paid on large certificates of deposit of about 25 percent were both too high. In any event, the authorities' use of selective credit measures could be a useful tool to mitigate the impact of tight credit on the productive sectors.

The outlook for the country's main export industry suggested that efforts should be intensified to maintain the momentum that had been gained in 1984 in nontraditional exports and also to promote tourism after the unfortunate setback earlier in 1985, Mr. Alhaimus continued. The tourism industry might be constrained by limited capacity, particularly if the flow of tourists recovered. The policy of encouraging private sector investment in the tourist sector was therefore welcome. The balance of payments situation required the maintenance of a flexible exchange rate policy, which had already proved quite beneficial to the export sector. And, while the authorities were apprehensive about a further major depreciation of the Jamaica dollar, their adherence to tighter demand management would itself make a substantial depreciation of the currency less likely.

The Jamaican economy would continue to face severe difficulties for some time to come, Mr. Alhaimus concluded. Even under quite optimistic assumptions, strict adjustment policies and exceptional financing would be needed for a number of years if balance of payments viability were to be achieved. Such narrow room for maneuver suggested that the authorities should do their utmost to implement the policies prescribed under the program and be ready to take any additional measures necessary to keep the program on track. It was also vital, given the magnitude of the balance of payments financing required over the next few years, that Jamaica avoid any new external arrears that might jeopardize the much-needed assistance and cooperation from its creditors.

Mr. Wang remarked that his chair supported Jamaica's request for a stand-by arrangement, and endorsed the proposed decisions.

Mr. Fujino remarked that structural reform was most important for the future stabilization and development of Jamaica's economy. In Table 9 of the staff report, the staff indicated those areas in which reform was being promoted and delineated the areas to be addressed. However, the text of the report indicated the difficulties that Jamaica was facing in structural reform. Cooperation between the World Bank and the Fund was needed. The World Bank had already made a positive contribution in the form of structural adjustment loans and project loans to essential sectors. Jamaica would, he hoped, represent a good example of the desirable cooperation between the Fund and the Bank. He endorsed the staff appraisal and supported the proposed decisions.

The staff representative from the Western Hemisphere Department stated that motor vehicles had been excluded from the recent tariff increases because they were already subject to a 57 percent retail sales tax, a 45 percent additional duty, and a fixed charge of $7,000. Moreover, interest rates had increased sharply in the previous three months, and there had been a consequent slowdown in the demand for credit. At present, lending rates were generally at about 30 percent or higher, and were certainly positive in relation to past inflation. Deposit rates were generally in the range of 20-22 percent, with the minimum savings rate at 20 percent, free of tax. Thus, even with inflation expected to decline to about 18 percent on an annual basis, the structure of interest rates was broadly positive in real terms.

The target rates for money supply had been set in relation to the projected growth of nominal GDP over the 12-month period covered by the financial program; there was no assumption of a change in velocity, the staff representative noted. The staff agreed that reliance on selective credit measures should be phased out and would initiate discussions with the authorities on reducing those measures.

With regard to the bauxite sector, the latest information indicated that two of the three partners of the ALPART plant were taking steps to buy out the third partner, the staff representative remarked. The third partner, ARCO, had already divested itself of almost all of its bauxite operations worldwide. Once the agreement had been completed, steps would be taken to close down the plant. However, such steps would not create a new financing gap in the program, which had been drawn up on the assumption that the ALPART plant would close by October 1, 1985.

Negotiations on the levy arrangements with the remaining companies operating in Jamaica were under way, the staff representative commented. The general thrust of the discussions was to move toward an income tax and a royalty. Although the staff was not aware of the exact nature of the discussions, the projections for the medium term assumed a halving of the present levy. Because that reduction might well come before the next fiscal year, the contingency plan for reducing government capital outlays by 1 percent of GDP in 1985/86 had already been drawn up and was being implemented.

With respect to the medium-term balance of payments outlook, tourism was projected to grow in volume terms by 5 percent each year, a rate roughly in line with the projected growth of the market for Caribbean tourism, the staff representative noted. There might be a capacity constraint, although a 5 percent growth in tourism could be handled for another year or two, especially since some hotels that had been closed or were under public ownership could be brought back into operation. Some investors had begun discussing the possibility of opening new hotels in Jamaica.

One Director had mentioned the desirability of the Fund's technical assistance in a review of public expenditure, the staff representative recalled. An official request had already been received from Jamaica, and a technical assistance mission from the Fiscal Affairs Department would be visiting Jamaica in August 1985 to help identify the second round of expenditure cuts to be agreed upon by September.

The staff and the Jamaican authorities felt that the foreign exchange auction system had been relatively successful, the staff representative commented. In view of the many changes that had been made over time to that auction system, there was a desire to avoid tampering with it excessively. Any evolution in the auction system would go in the direction of widening the market by increasing the number of participants to include, for example, public enterprises and the oil refinery, and also by reducing the role of the Bank of Jamaica. Minor changes that might be envisaged would be shifting to a weighted average rather than a clearing rate for determining the rate in between auctions, and perhaps removing the Dutch auction mechanism. However, the basic auction system was expected to continue in operation. The Jamaica dollar had depreciated further in recent weeks; at the latest auction, the rate had been J$5.78 per U.S. dollar.

Some Directors had commented on the inflows of short-term capital that had taken place in 1984/85, the staff representative stated. Those inflows had apparently included the re-establishment of trade credits for both the public and the private sectors. There had been a major balance of payments crisis in Jamaica in 1983, which had not been resolved until the stand-by arrangement with the Fund had been approved in mid-1984. During that period, almost all trade credit to Jamaica had dried up; consequently, large short-term capital outflows had occurred. To the extent that the large inflows in 1984 could be attributed to the re-establishment of trade credits, they had represented a one-time phenomenon that would not be repeated. For that reason, in the program for 1985/86, only a small further increase in the inflow of short-term capital of about US$40 million was expected. The ceiling for the increase in short-term credit for public agencies was US$20 million.

In previous years, Fund-supported adjustment programs for Jamaica had always been built on the premise that the bauxite/alumina sector would recover, the staff representative remarked. The 1981 extended arrangement had been based on the assumption that the fiscal deficit could be reduced gradually as the economy recovered. However, the recovery that had been expected in the second and third years of the program had not materialized, owing mainly to a contraction in the bauxite sector. The staff now recognized that the continued decline of the bauxite industry resulted from major structural problems. Reflecting that conclusion, the staff expected that another alumina company would close in Jamaica and that the bauxite levy would have to be reduced for the medium term.

The staff estimated that an external current account deficit of 4 percent of GDP was likely to be sustainable in the medium term, the staff representative commented. However, such an assumption was clearly difficult to make, given Jamaica's record of economic stagnation in the past two decades. In view of the present level of the current account deficit, a further major adjustment effort was required that would clearly need to continue for several more years. Indeed, with the poor growth prospects of the economy and the likely need to reduce Jamaica's outstanding debt, maintenance of a current account deficit of as much as 4 percent of GDP might be somewhat optimistic.

Some Directors had noted that a fiscal adjustment gap of about 4-5 percent of GDP was projected for 1986/87, the second year of the program, the staff representative stated. The 1986/87 fiscal projections were largely passive, and capital expenditures were projected to recover in relation to GDP under the medium-term public sector investment program (PSIP) that had been agreed with the World Bank. The adjustment gap implied that the level of capital expenditure envisaged in the PSIP could not be sustained. A cutback in the 1985/86 level would reduce the adjustment gap by about 2 percent of GDP. Furthermore, in view of the financing gap to be addressed next year, the staff had stressed the need to continue reducing current expenditure and to develop contingency measures to offset any adverse effects of the proposed tax reform on revenues.

A suggestion had been made that budgetary transfers and subsidies could be reduced; most of the transfers in the budget--about J$70 million--were to the University of the West Indies and the Kingston Hospital, the staff representative commented. Transfers also comprised public sector payments for utilities, of about J$80 million, and the counterpart of food aid grants, which were transferred through the budget to the food aid program. Subsidies of J$30 million on rural water supplies and of J$11 million on basic foods were also included among budgetary transfers. Thus, subsidies as such were quite small in relation to the size of the budget, and a compression of current transfers would be quite difficult, since they went largely to the University and the Kingston Hospital.

There was little information on private sector external debt and short-term debt, the staff representative noted. It could be surmised that there were large private sector holdings abroad of foreign exchange, as capital flight had taken place on a large scale from Jamaica during the 1970s. Short-term external debt of the main public enterprises stood at approximately US$116 million, a relatively small amount in the total external public debt of US$3.2-3.3 billion.

The staff representative from the World Bank stated that the Bank had had a dual role to play in Jamaica. In addition to the lending programs that it had been conducting with Jamaica, the Bank was helping to mobilize financial resource in the context of the Caribbean Group for Cooperation in Economic Development. The Bank contemplated a continuation of efforts to address export promotion of nontraditional products, the public sector deficit, and employment. At present, the Bank was contemplating continuing quick-disbursing policy-based operations, either through structural adjustment loans or in the form of sector adjustment loans in three areas. First, in the financial and industrial sectors, the Bank staff would be looking at policy issues regarding the equity market, interest rates, and housing finance, as well as the debt equity ratios of the industrial enterprises. Second, with regard to the public sector deficit, the Bank staff would be examining the financial performance of the public sector enterprises and would be monitoring the overall and individual financial performance of those enterprises. Third, with regard to agriculture, Bank staff would continue to examine sectoral issues, with emphasis on export promotion of nontraditional agriculture.

Considering the overall uncertainties in the Jamaican economy, it was important that sectoral adjustment and structural adjustment be implemented within the framework of appropriate stabilization programs, the staff representative remarked. Therefore, it was important for the Bank that those programs be implemented with the cooperation of the Fund. Indeed, there had already been substantial collaboration between the Bank and the Fund on the structural adjustment programs.

The Bank had just completed a substantive review of the public sector investment program, the staff representative of the Bank stated. However, it was not preparing a medium-term development plan, but, following the completion of an economic mission to Jamaica, a report would be prepared detailing the economic and social impact of the first three structural adjustment loans and the various medium-term needs of the country.

The Deputy Director of the Exchange and Trade Relations Department assured Directors that, in Jamaica, the Fund was acting primarily as a catalyst. The rate of access was equivalent to 43 percent of quota, very much in the range of most other programs in which the Fund would be considered to have a catalytic role; for example, the program proposed for Morocco had a 44 percent annual rate of access, that for the Ivory Coast had a 40 percent annual rate, and that for Madagascar had a 44 percent annual rate.

In Jamaica's case, scheduled repurchases over the next year and beyond were very high, reflecting the unusually high access that Jamaica had had to Fund credit in the past, the Deputy Director remarked. Nevertheless, the country's net use of Fund credit outside the special facilities would be reduced after the program period to approximately 316 percent of quota. Moreover, the new purchases should not in any way be regarded as a kind of rescheduling simply because withdrawing that amount of credit in less than a two-year period was something that the Fund had not done previously. Indeed, the Jamaican case was quite different from a case of rescheduling official credits through the Paris Club, where exposure was increased, or through the commercial banks, where exposure was maintained.

Some comments had been made on the length of the program, the Deputy Director noted. The staff had proposed a 22-month arrangement for Jamaica because it would be more convenient and practical to move to a fiscal-year basis in the Jamaican case. The staff had been faced with a choice of a 10-month program or a 22-month program; the 10-month option would have involved new discussions with the Jamaicans on another program at a very early stage. In addition, it seemed useful at present to identify the nature and size of the fiscal problem in the fiscal year starting April 1, 1986 because important choices to be made in current expenditure, particularly in relation to the size of the public service, should be considered at present and not at some later time. By encompassing the fiscal year 1986/87 into the program, the adjustment process would be facilitated.

It had been important for the success of the program to identify the size of the financing gap as precisely as possible, not only for the next several months, but also for 1986/87, as it had facilitated a two-year rescheduling by commercial banks, which in turn had indicated to official creditors the scale of finance that would be needed in the short and long run, the Deputy Director pointed out. The majority of purchases under the program, SDR 73 million, were reserved for 1986/87. The degree of back-loading merely indicated that a number of policy decisions would have to be taken in 1986.

Mr. Joyce observed that Directors had been concerned about the medium-term outlook and about the willingness and ability of the Jamaican authorities to execute a large-scale, difficult program. One Director had correctly pointed out that countries such as Jamaica, especially those carrying heavy debt burdens and with large and continuing structural problems, might not be able to execute the various conditions under the program. However, the Jamaican authorities believed that while the program was not easy, it could be followed successfully, and they remained committed to achieving the program's objectives. They agreed that there was no room for slippage. Jamaica would require continued international financial support on concessional terms for many years to come if those slippages were to be avoided.

Repurchases by Jamaica would amount to US$220 million during the program period itself and to US$150 million in net terms, Mr. Joyce noted. Those were large amounts that would require major efforts by the authorities. However, those repayments were appropriate, because of the need to maintain the revolving character of the Fund and to combine a stand-by arrangement, involving detailed adjustment measures and some financing from the Fund, with net repayments. Such a combination would be the only possible way to handle the problem of prolonged use of Fund resources. Indeed, the problem of prolonged use was not going to be solved overnight, and could be approached only through a mixture of repayment, adjustment, and Fund assistance where appropriate. He was concerned that Directors had expressed doubt about the scale of assistance to Jamaica as well as the role of the Fund. For example, one Director had been concerned that too much assistance was being extended by the Fund. Many Directors had rightly pointed out that the Fund's role in Jamaica should be predominantly catalytic, a role that the Fund was indeed maintaining. It was the judgment of the Fund staff and the authorities that the amount of Fund credit available to Jamaica was appropriate and wholly necessary to accomplish the objectives of the program and to achieve the degree of net repayment envisaged for the program period. If Fund assistance were sharply cut back, or if the Fund performed only a catalytic role, the country might not be able to reduce its exposure to the Fund. Jamaica would in fact continue to require Fund assistance for some period of time. Fund assistance would probably be combined with continued net repayments, and Jamaica's net exposure would be reduced through time.

The Chairman stated that he had been struck by the gravity of Jamaica's economic situation. In the four years 1981/82-1984/85, the average annual rate of GDP growth had been 1.25 percent, compared with the planned rate of slightly more than 3 percent. Fiscal performance had also been worse than expected: the central government budget deficit as a proportion of GDP had remained high at 15.5 percent in 1981/82, 14 percent in 1982/83, and 15 percent in 1983/84. The deficit had been reduced to 6.5 percent only in 1984/85, a year in which it had been realized that Jamaica could no longer be so dependent on the bauxite sector. The external current account deficits of more than 20 percent of GDP in 1981/82 and 1982/83 had clearly been unsustainable. They had since been reduced but remained high, at more than 10 percent of GDP. Jamaica's economic performance had certainly been affected by various unfavorable developments, but the authorities had not reacted to those events in a timely fashion; they were only now beginning to take action with respect to fiscal and exchange rate policies.

The Fund would have to continue its involvement in Jamaica, given the country's extremely difficult situation, particularly the bleak outlook for bauxite production, the Chairman pointed out. However, the Fund's role would have to be increasingly of a catalytic nature. It was crucial to focus the international community's attention on the bleak medium-term outlook for Jamaica. The authorities had indicated their intention to implement the program fully, but even if they demonstrated their commitment by adopting the programmed measures with determination and resolution, external assistance would still be needed on a large scale and on concessional terms. Without a combination of financing and adjustment, it would prove very difficult to implement the program. It was to be hoped that, with World Bank assistance, the Fund could trigger the additional financial resources that would be needed in the years to come.

The Chairman then made the following summing up:

Executive Directors agreed with the thrust of the appraisal in the staff report for the 1985 Article IV consultation with Jamaica and Jamaica's request for a 22-month stand-by arrangement. They felt that important progress had been made during 1984/85, especially in reducing the public sector deficit and in adjusting relative prices. However, the further structural deterioration

Mr. Sengupta commented that Mr. Mtei's opening statement clearly indicated the authorities' determination to meet their obligations. The cable from the Governor of the Bank of Tanzania dated June 18, 1985 indicated that most of the overdue payments would be made by the end of August 1985. Mr. Mtei's statement that obligations falling due after that date would also be met as soon as possible was welcome.

In dealing with the recent case of Jamaica, the Board had correctly taken into account the general very difficult situation in the country and had noted that financing was essential to the adjustment effort, Mr. Sengupta recalled. As indicated in paragraph 4 of EBS/85/155, the situation in Tanzania was also extremely difficult. The Board should bear in mind the very low level of gross reserves and offer all assistance in the hope that Tanzania would discharge its overdue obligations as soon as possible.

Mr. Doe said that economic conditions in Tanzania were clearly unfavorable. The authorities must move decisively to implement a comprehensive adjustment program within a medium-term framework to prevent further financial and economic deterioration.

In view of the authorities' intention to settle their overdue obligations by the end of August 1985 and to refrain from incurring any further unpaid obligations, the Fund should adopt a flexible and understanding attitude regarding Tanzania, Mr. Doe remarked. Any decision on Tanzania's overdue obligations should be postponed until after August 1985.

Mr. Leonard noted the importance that Tanzania attached to maintaining good relations with the Fund. He hoped that it would be possible for the authorities to realize their expectations and that all assistance necessary for doing so would be available. However, he disapproved of the possible delay in future payments. Members should be current in their payments to the Fund. The proposed decision was acceptable.

Mr. Fujino said that he welcomed Mr. Mtei's assurance on the settlement of overdue obligations by end-July and end-August 1985. Nevertheless, the possible continuous delays in future repayments were worrying. He hoped that repayments would be made on time in the future. The basic question of delays in implementing strong adjustment measures would have to be considered by the authorities in the near future.

Mr. Flamant remarked that Mr. Mtei's opening statement was reassuring. The proposal to hold the next discussion on August 26, 1985 was acceptable.

Mr. Clark said that the proposed date of August 26, 1985 for the next discussion on Tanzania's overdue obligations was acceptable. He hoped that by then the authorities would have eliminated the arrears to the Fund.

Although Tanzania had continued to face serious balance of payments problems and a growing shortage of foreign exchange, the present difficulty in settling the outstanding obligations to the Fund was due to the seasonal nature of the country's export earnings, which were usually at their lowest level in May and June of each year, Mr. Mtei continued. Having passed that low point in 1985, the authorities were looking forward to clearing all the outstanding obligations with the Fund in coming months.

The authorities attached great importance to their relations with the Fund and had given the highest priority to eliminating their overdue obligations to the Fund, notwithstanding their continuing balance of payments problems, Mr. Mtei observed. They were fully aware of the importance of the revolving character of the Fund's general resources and intended to do everything possible to avoid impairing the Fund's ability to assist other members.

Mr. Dallara remarked that it was not clear to him when the staff proposed to have the Executive Board return to the matter of Tanzania's overdue obligations.

The Secretary remarked that the agreed procedure was that the Board would return to the matter one month from July 17, 1985. Since that date would fall within the Board recess, the matter could be brought to the agenda for Monday, August 26, the first meeting date after the recess.

Mr. Dallara stated that he welcomed the assurances provided by Mr. Mtei that his authorities intended to discharge their overdue obligations to the Fund as soon as Tanzania's foreign exchange situation permitted. He also welcomed their intention to settle the obligations due at the end of March by the end of July. The repeated efforts by the Managing Director in recent months to secure payments on schedule had not been successful; indeed, the authorities' commitment to settling obligations due at the end of August 1985 had apparently changed. The communication from the Governor of the Bank of Tanzania dated June 18 indicated that the remaining overdue obligations would be paid by the end of August; at present, only the obligations due through mid-June would be settled by the end of August 1985. While he appreciated the authorities' efforts, a proposal that would delay payments by two months was unacceptable.

Mr. Grosche said that he welcomed Mr. Mtei's assurances regarding the payment of overdue obligations but he regretted Tanzania's failure to meet those obligations on schedule. The authorities' intention to delay discharging their obligations was of particular concern. The subsequent Board discussion on Tanzania should be held on August 26, 1985.

Mr. Suraisry remarked that he, too, welcomed Mr. Mtei's comments on the authorities' intentions and supported the proposed decision. Table 2 showed that the amount of overdue payments to the Fund in 1985 was small. The authorities should therefore be in a position to repay the Fund promptly.

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The staff representative from the Treasurer's Department noted that in his cable to the Minister of Finance of Tanzania on June 20, 1985 the Managing Director had indicated that both he and the Executive Board were concerned about the continued delays in the payment of overdue obligations.

Mr. Mtei remarked that the authorities had indicated in their letter to the Fund dated June 18, 1985 that the overdue obligations as of the middle of June 1985 would be repaid by the end of August 1985. The foreign exchange situation was serious, and the authorities were making every effort to settle their obligations.

The Chairman noted that in the cable from the Governor of the Bank of Tanzania dated June 18, 1985 it was stated that the authorities proposed to effect the repurchase due March 15 no later than the end of July 1985; any remaining overdue obligations would be paid by the end of August 1985. The cable had also stated that "it is our intention to ensure that future obligations are paid within about two months of the due dates."

In effect, two questions had been raised regarding the authorities' intentions to settle their overdue obligations, the Chairman continued. Did the authorities intend to pay all the remaining overdue obligations as of the end of August by the end of that month, or only those obligations overdue as of mid-June? The second question concerned the authorities' intention to maintain a sort of cushion in the form of two months' delay in settling their obligations. That intention obviously was not in keeping with the spirit of the provisions of the Articles governing repurchases.

Mr. Mtei remarked that he would communicate to his authorities the various interpretations given to their cable dated June 18, 1985. He would also encourage them to eliminate all the remaining overdue obligations by the end of August 1985 if they indeed had the resources to do so.

The Executive Board then adopted the following decision:

1. The complaints of the Managing Director dated June 19, 1985 on Tanzania, as amended (EBS/85/155, Sup. 2), are noted. They shall be placed on the agenda of the Executive Board for August 26, 1985.

2. The notice of the Managing Director dated June 19, 1985, as amended (EBS/85/155, Sup. 2), on the failure by Tanzania to fulfill obligations under Decision No. 5069-(76/72) on the Trust Fund is noted. The notice shall be placed on the agenda of the Executive Board for August 26, 1985.

3. Consideration of the complaints in accordance with Rules K-1 and S-1 and of the notice particularly affects Tanzania. The member shall be informed by rapid means of communication of this matter and of its right to present its views through an appropriately authorized representative.

Decision No. 8036-(85/108) G/S/TR, adopted
July 17, 1985

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/85/107 (7/15/85) and EBM/85/108 (7/17/85).

3. APPROVAL OF MINUTES

a. The minutes of Executive Board Meetings 84/148 through 84/150 are approved. (EBD/85/168, 7/9/85)

Adopted July 15, 1985

b. The minutes of Executive Board Meeting 84/151 are approved. (EBD/85/169, 7/10/85)

Adopted July 16, 1985

4. EXECUTIVE BOARD TRAVEL

Travel by an Assistant to Executive Director as set forth in EBAP/85/182 (7/11/85) is approved.

APPROVED: April 10, 1986

LEO VAN HOUTVEN
Secretary