

**Statement by Thomas A. Bernes, Executive Director
for Jamaica
January 10, 2000**

1. My Jamaican authorities wish to thank management and staff for their intense interest, dialogue, and helpful advice over the last twelve months and, in particular, during the recent 1999 Article IV Consultation. Directors will note the absence of a separate statement by the Government of Jamaica (GOJ) which underscores an emerging convergence of views between staff and the GOJ over policy options to address the macroeconomic challenges that Jamaica must tackle. Let me also congratulate staff for the timely Selected Issues Paper and commend the work done on the foreign exchange market (in response to the specific request made by the GOJ) in particular.

Background

2. Since Jamaica's exit from its last EFF program with the Fund in March 1996, it has enjoyed constructive engagement with Fund staff and management on economic policy and benefited from excellent technical assistance from MAE on financial sector issues. The GOJ wishes to maintain this valuable relationship, and while it does not foresee any financial relationship with the IMF, it does see a role for the Fund in providing advice to other multilateral and bilateral agencies that may be considering financing projects in Jamaica. In particular, Jamaica commends the Fund's most recent recommendations to the European Union for continued donor assistance. This signaling role, in our view, is an important function that the Fund can exercise as part of its surveillance in countries like Jamaica, which are not in Fund-supported programs.

3. Jamaica is pleased to note that this year's staff report has highlighted many of the achievements under the GOJ's economic strategy. Directors will recall that in the last two years especially, staff and others expressed doubts about Jamaica's ability to deliver output growth and, aired concerns about Jamaica's external position. However, we note and credit staff for their recognition of the efforts of the authorities in recent times.

4. In the overview in paragraph 34, staff note that "*several shock absorbers have helped cushion Jamaica's vulnerability to a full blown crisis*" including the fact that close to half of all bank deposits are held in foreign-owned banks, and that almost one third of all domestic debt is held by financial institutions. I would add that Jamaica's sizeable informal economy and buoyant level of remittances from abroad also helped to cushion the economy. Staff also comment in perhaps one of the most poignant statements of the report, that "*reflecting this setting, recent movements in velocity, real domestic interest rates, and sovereign bond spreads give little suggestion that the private sector considers a crisis to be imminent*". Indeed in November, 1999 Standard and Poor's assigned Jamaica its single "B" long-term foreign currency and single "B+" long-term local currency sovereign credit ratings.

5. Further, the staff appraisal opens with the statement that "*Jamaica has achieved considerable success in reducing inflation, restructuring the financial system after the crisis*

in 1995-96 and further liberalizing the economy through tariff reduction and privatization." While recognizing the major challenges that the country continues to face, my authorities appreciate the more balanced perspective adopted by staff. Jamaica applauds this approach to acknowledge the merits of their strategy, and stands ready to move forward in a continued dialogue with the Fund. This is crucial as Jamaica looks to the international community for support to achieve its economic objectives.

1999: Another Challenging Year

6. Given the excellent and balanced portrayal of recent economic developments included in the staff report, I will refrain from reiterating details here. I wish only to remark that against the background of an adverse external environment, especially in global financial markets, and due to exogenous shocks (inter alia falling commodity prices, rising oil prices, and the untimely loss of part of the bauxite market due to a fire in a plant overseas), Jamaica's limited output performance was disappointing in 1999.

7. Furthermore, Directors will recall that in April, at the time of the FY 99/00 Budget, in which the Minister of Finance, attempted to introduce a number of far-reaching fiscal measures, including higher gasoline taxes, major social unrest and riots erupted in protest. It is in this context that Directors are asked to view the authorities' policy stance, *which remains qualitatively different from the scenario preferred by staff only in pace. My Jamaican authorities recognize the perniciousness of the current debt dynamics and remain equally concerned about external competitiveness—the two main concerns of the IMF.*

8. The GOJ believes that the proposed alternative by staff, for large upfront adjustment in the exchange rate and fiscal accounts (through a massive primary surplus in the range of 14 percent of GDP), has tremendous risks which have not been fully explored and analyzed in the staff report. Furthermore, while the GOJ recognizes that there is a need to improve the competitiveness of domestic firms, it believes that the strategy is a complex one which must deal with certain inherent structural problems.

9. Jamaica's experience does not support the argument that the solution lies mainly through adjustments in the exchange rate. Directors familiar with Jamaica need only recall the many episodes of exchange regime tinkering over the many Fund-supported programs to realize that it takes a long and arduous time for a depreciation-inflation-wage spiral to work its way out to lower inflation and realignment of relative prices. My authorities have been down this path and wish to avoid it at all costs.

Policy Issues

10. *Fiscal Policy. A larger primary surplus is being pursued at tremendous social cost.* The GOJ is determined to meet its fiscal objectives of a reduced overall deficit over the medium term and has every intention to meet its fiscal targets in FY 2000 and beyond. Directors will note that the tax burden in Jamaica is already very high (with a revenue to

GDP ratio of close to 30 percent) . As mentioned by staff and noted above, Jamaica's potential to tax further is constrained. The existing tax payer base is over-stretched and intolerant of any additional tax burden.

11. The GOJ however, is convinced that through better tax administration (a process that has been ongoing for several years now with technical assistance of donors) and a tight rein on expenditures, fiscal goals can be met. On the specific targets proposed by Fund staff in their alternative scenario, the GOJ, like most governments, would find it extremely difficult to deliver a primary balance of 14 percent of GDP over the medium term and considers that the current 10-11 percent of GDP effort more realistic for reducing the debt- to-GDP ratio over this period.

12. ***Exchange Rate Policy and External Competitiveness.*** Staff argue and have done some work to show that Jamaica appears to have lost ground in the area of external competitiveness in recent years, taking several different measures into account, including the real effective exchange rate and unit labour costs. My authorities are also concerned that some loss of external competitiveness has occurred between 1995 and 1998 particularly in the manufacturing sector, but do not underestimate the impact of NAFTA on domestic firms. Further, they would underscore that in the major export sectors of bauxite and tourism (constituting the bulk of foreign exchange earnings), other factors play a far more significant role in the growth or expansion of these industries while the exchange rate plays only a minor role. These include labour costs (determined in a wage bargaining environment via trade unions) and the impact of crime in the case of tourism.

13. I should remind Directors that *Jamaica's exchange rate continues to be market-determined and the Bank of Jamaica intervenes only to smooth out major fluctuations.* In response to "more exchange rate flexibility" as suggested by staff on various occasions, I note that the Jamaican dollar has depreciated by 14 percent since the beginning of FY 2000. This type of movement does not indicate a rate that is sticky in any particular direction. It is worth noting that there is no curb market for foreign exchange nor queuing, which suggest that the demand for foreign currency is satisfied in Jamaica.

14. ***Monetary Policy and Inflation Targeting.*** In the recent Board discussion on inflation targeting, I emphasized the importance of the central bank's credibility and a strong sense of ownership on the part of the national authorities as crucial components in programs that seek to use an inflation targeting framework in their conduct of monetary policy. In Jamaica for the last four years, the key to the lowering of inflation to single digit levels has been the Bank of Jamaica's (BOJ) inflation targeting strategy. There is no doubt that the Jamaican public has vested credibility in the BOJ as inflation has been reduced over this period and the *policies remain consistent.* My authorities therefore find the logic in paragraph 48, which underpins the thrust of the staff's scenario, very difficult to follow. Moreover the downside risks associated with the latter are already noted in paragraph 8 above.

15. ***Financial Sector and Structural Reforms.*** The exacerbation of recent economic problems, including the large increase in domestic debt has been associated with the ongoing

resolution of the financial sector crisis which started in 1995. While the impact of the crisis, as noted by staff, could have been significantly worse in terms of capital flight and a full blown crisis, the deft handling of the crisis by the authorities, in my opinion, is largely responsible for the maintenance of investor confidence. Since then, and with considerable success in 1999 in particular, Jamaica is beginning to see some reflow of liquidity through divestment proceeds and sale of assets of the failed institutions. This remains the greatest challenge, and the authorities agree with staff that FINSAC-related debt poses a serious risk and needs to be dealt with expeditiously. In this regard, Jamaica will be seeking to obtain technical and financial assistance from the Inter-American Development Bank (IDB) in the coming months and would need the support of the Fund and others in helping to secure this assistance.

Way Forward

16. Paragraph 63 of the staff report sums up eloquently the way forward for Jamaica: *“perseverance with adjustment, even if at a slower pace than recommended by staff”*. I would like to draw Directors’ attention to staff report Tables 9, 10, and Figure 7, which attempt to illustrate the quantitative distinctions between the two scenarios. I find that the main difference is in the timing and speed with which Jamaica reaches a more manageable debt level with interest rates roughly 2 percentage points lower than in the authorities’ baseline. However, the staff’s scenario will involve a major change in the monetary and exchange rate policies to be supported by an even greater fiscal effort, one that remains politically out of range. The impact of these changes are uncertain to deliver the kind of growth projected under the proposed scenario, and the risk of a major loss of confidence in the government’s ability to maintain sound policy cannot be overestimated.

17. *Gradual approach is best.* The GOJ intends to continue along its strategic path (baseline as indicated in the report) while seeking to speed up reforms in the structural areas, notably to continue to divest assets where possible and to find ways to improve the functioning of the civil service in particular and the public sector in general. No doubt Jamaica will continue to seek support from the international community in the coming years as it remains committed to reducing poverty and improving the standard of living for its citizens.

18. I am pleased to report that no major Y2K problems were encountered during the transition to the year 2000. Jamaica looks forward to maintaining a strong relationship with the Fund and looks forward to another year of beneficial discussions with staff as it continues to tackle its economic problems. Finally, Jamaica intends to participate in the Fund’s pilot study on transparency and will publish its staff report as indicated earlier.