MINISTRY PAPER NO: 1

Further policies for economic growth and establishment of new par value for the Jamaica Dollar

Members of the Honourable House of Representatives are asked to consider and approve the exchange rate measures introduced by the Government which:

(i) establish a new parity for the Jamaica Dollar at J$1 equivalent to $1.10 (US);

(ii) substitute the US Dollar for the £ sterling as our intervention currency; and

(iii) provide further opportunities for economic growth.

2. Last year, the Government presented to the Legislature and the country, detailed analyses of the structural weaknesses of the Jamaican economy and a corrective plan of action. The analyses briefly showed that whilst the main outward manifestation was the continued loss of foreign reserves, the basic problem has been the inability or failure of the economy to produce the goods and services which are demanded by the private sector (including personal consumption), and the Government. Over the five years to December 1971, this excess demand on the economy amounted to J$504 million and for 1972 the excess is between J$150 million and J$170 million. Up to December 1971, the excess was fully met by foreign capital inflows. For 1972, the excess was accommodated by running down reserves by approximately J$50 million.

3. The first phase of the action plan was directed at stemming the drain on reserves. Failure to halt the fall would have resulted in -

(a) defaults on payment of our foreign liabilities both in the private and public sectors,

(b) inability to borrow abroad;

(c) drying up of further foreign private investment;

(d) restrictions on consumption so severe (simply because of inability to pay for imports) that serious hardship would have been caused at all levels of the society.

4. As it has transpired, the various restraint programmes on credit, foreign exchange expenditure and imports have been administered with the minimum of serious inconveniences, without halting economic growth and with the achievement of the first objective of stemming the drain on reserves. This was only possible because of the detailed advance planning which was undertaken by frequent consultations with the Banks, Chamber of Commerce, Jamaica Manufacturers' Association and important companies and by the understanding shown by the majority of the people. Appendix I gives information on the latest state of the reserves and other economic indicators as at 31st December, 1972.

Appendix I

5. The programme of restraint must of necessity continue but at the same time phase 2 of the programme must now move into high gear. The positive policies already commenced in agriculture and tourism must be intensified./

intensified. A precondition of success, however, in increasing local production is that a competitive edge must be given to local producing entities over imports, and incentives must be given to exports. The uncompetitive position of locally produced goods vis-a-vis imports can be demonstrated by one simple test - whenever incomes are increased either by bank credit or through the Budget, the increased incomes are spent largely on imported goods rather than on locally produced goods. In other words, efforts to stimulate the economy by budgetary action or by credit merely exacerbates external payments problems. Local production is not effectively stimulated. Whether this disparity in competitiveness is caused by low productivity, poor technology, tastes and attitudes of consumers, the simple fact is that it exists and means that local costs are out of line with foreign costs as reflected in our exchange rate. The most effective way to adjust this relationship between local costs and foreign prices is to adjust the exchange rate.

6. Up until Tuesday, 16th January, 1973, the Jamaica dollar was floating with sterling at a level determined by conditions irrelevant to the Jamaican economy in relation to the rest of the world. The United Kingdom supports the present rate of float of the £ sterling in accordance with its judgment as to what is best for the UK economy. There is no obvious reason why these considerations which are good for the UK are also good for Jamaica. Accordingly, for the first time, Jamaica is looking at its own position and not merely following the exchange rate value of the United Kingdom currency. We have done this by fixing a rate of exchange which is considered appropriate in Jamaica's best interest. Since the decision to float with sterling, the Jamaica dollar has in effect been devalued from $1.2260 (US) in June 1972 to $1.172 (US) in December 1972. In considering further moves, three rates have been examined:

J$1	=	$1.15 (US)
J$1	=	$1.10 (US)
J$1	=	$1.00 (US)

It has been decided that the rate which meets Jamaica's best interests is J$1 = $1.10 (US). This is based on the following reasons which deal both with the elimination of floating and the determined rate.

Cessation of Floating

7. (a) It is already pointed out that even if we were to continue floating, it would have been irrational to continue floating as sterling floats. The original decision to float with sterling was based on the rationale that the float would have been for a short period. It is clear, however, from official UK statements that there was no longer a predictable time for the cessation of the sterling float, and Jamaica perforce had to re-examine its position.

(b) Trade alignments between the UK and Jamaica have shifted considerably from the UK:

		J$m.		
1960	Total Jamaica Foreign Trade	268.3		
	Trade with UK	88.8	OR	33%
	Trade with US	33.8	OR	12.6%
1970	Total Jamaica Foreign Trade	744.6		
	Trade with UK	145.5	OR	19.5%
	Trade with US	310.5	OR	41.7%
1970	Total Tourists receipts	79.6		
	Total from US	64.8	OR	81.4%
1971	Total capital inflows	156.2		
	Total from UK	5.1		
	Total from US	134		

The facts show that the main trade and payment alignment is with the US and the rest of the world outside the UK. Sterling loans for both the Government and private sectors are impossible to obtain on satisfactory terms and the majority of loans and new investments come from the United States or in non-sterling currencies.

(c) There are some practical problems to be considered. Prior to the decision to establish a new parity, Jamaica's currency was fixed in relation to sterling and CARIFTA currencies but floating against the currencies of the rest of the world. After repegging, Jamaica's currency will have a fixed rate against the US dollar, all European currencies, including the Japanese yen, Australian and New Zealand dollar, all Latin American currencies, but Sterling and the Canadian dollar will float against the Jamaica dollar. The Canadian dollar is floating independently and whether we remain fixed with sterling or the US dollar, the Canadian dollar will continue to float against the Jamaica dollar until repegged.

There will be a radical change, therefore, in exchange rate quotations. Instead of the US dollar being quoted at a fluctuating rate against the Jamaica dollar, in practice the US dollar will be quoted at relatively stable buying and selling rates, and it is sterling which will fluctuate against the Jamaica dollar. The US dollar will be used as the intervention currency, and for quotation of the Jamaican currency against the rest of the world. The exchange rate for other foreign currencies will be derived by using the Jamaica/US dollar rate and the US dollar/third country rate. For example, if the US dollar/Yen rate is:

$1 (US) = 301.1 Yen and J$1 = $1.10 (US)

Then J$1 = $\frac{301.1 \times 1.10}{100}$ Or 331.2 Yens.

Similarly with sterling. If sterling floats to -

£1 = $2.33 (US)

Then J$1 = $\frac{£1 \times 1.10}{2.33}$ Or £0.47

(d) The Tourist Trade will be an immediate beneficiary of this more stable relationship with the US dollar, and so will all other trading and investment relationships. The hesitancy now displayed in accepting loans,

investments/

investments and credits because of the floating rate will be removed and this should make a significant contribution to new investments.

(e) Special mention must be made of the banking system. All banks even the non-UK ones have operated their foreign clearing amounts through London. The banks have also operated open overdrafts in sterling and intensive discussions were undertaken with them as to the operational changes which will be necessary to deal with the use of the US dollar as the intervention currency. It is obvious, however, that the making of this adjustment is not difficult because so many sterling area countries have adjusted their operations to cope with a floating sterling. In fact, discussions have been concluded with the Banking Community on the necessary operational adjustment.

8. Outside of banking, there are other institutions and persons who may have incurred debts in sterling and have accustomed themselves to operating on the basis of a fixed relationship between the Jamaica dollar and sterling but these are in no different position from the much larger group in Jamaica who have had to live with uncertainty in the US dollar/ Jamaica dollar relationship, but who will now, for the first time experience the benefit of a fixed relationship.

Fixing The Rate

9. The new rate proposed is J$1 = $1.10 (US) or $1 (US) = J$.9090. This represents a devaluation of 6.5% against the present rate of J$1.175, a devaluation of 15.57% against our official rate of J$1 =$1.30 (US) and 8.3% against the rate prior to December 1971 of J$1 = $1.20 (US). A greater devaluation would have provided the maximum incentive to economic growth and cutting back of imports. However, it is recognised that the post-devaluation problems of increased import costs could result in social problems which could not be adequately countered. On the other hand, a lesser devaluation might have resulted in adverse effects on Jamaica's primary exports should the UK repeg its currency at a rate lower than Jamaica's. A rate, therefore, of J$1 = $1.10 (US) gives not all, but some of the economic incentives to local production we need. It results in increased import prices but not of the magnitudes which would be so great as to create an unmanageable situation. Further, it is credible, provided the other policies recommended below are also followed. It cannot be too frequently stressed that a change in the exchange rate cannot by itself confer the beneficial effects sought. There must be back up policies.

10. The classic argument against devaluation is that Jamaica's main markets are secure, that the prices are mostly determined outside our control or by negotiation and that change in the exchange rate will not necessarily result in more sugar and bananas being bought abroad. This argument fails to examine the effect of exchange rate changes on the supply side. There are markets which we cannot supply because it is unprofitable to the producer to do so. This is partly because of low productivity and poor technology and partly because local costs have risen faster than foreign prices received for exports. By increasing the yield to the local producer

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in domestic currency (by a change in the exchange rate) he makes a larger profit or eliminates his loss and, therefore, has an incentive to produce more than before. Further, by increasing the price of imported goods (through a change in the exchange rate), the locally produced goods become more competitive with imported goods. There is no question, therefore, that the agricultural sector producing for export and local consumption will benefit from the exchange rate change.

11. The manufacturing sector would also benefit. Imported raw materials will go up in price, but unless these materials are 100% of the cost of the locally produced goods, the cost in local currency of imported finished goods must go up proportionately more than the cost of locally produced goods. The competitive advantage of the locally produced goods becomes greater as the proportion of raw material imports becomes smaller. Thus, both for the local market and exports, production could become more competitive.

12. Tourism: The position here is quite clear. If prices have been quoted in Jamaica dollars, the tourist would pay less in his own currency and this should be an incentive to more tourists to come. If the prices in foreign currencies remain the same, the hoteliers etc. would earn higher profits.

13. Bauxite: The Government will receive the same amount of Income Tax in foreign currency where the tax is fixed in foreign currency; but it will also receive more taxes in local currency on conversion.

Cost of Living and Distribution of the Adjustment Burden

14. The effects of the cost of living traditionally has captured attention as being the most important factor to be considered. In fact, the adjustment in import prices which results from a change in the exchange rate is one of the means by which the strains on the economy are reduced, i.e. equating consumer demands with the productive capacity of the country. If money incomes remain the same but the total goods and services available has to be cut back (because we cannot use any more foreign reserves to pay for the excess) then the adjustment must come from

(i) greater savings

(ii) higher prices (or lower consumption through Paying the same for less).

The important issue is which sector of society bears the burden of adjustment. Up to the present, the economic policies have resulted in providing cheap imported food for a largely urban and wage-earning class which has steadily increased its money incomes at the expense of the rural agricultural sectors.

15. The net effect of the adjustments now proposed is to redress somewhat the imbalance by increasing the cash incomes of the rural agricultural sector. The exchange rate change is therefore a powerful means of righting some of the imbalances of income distribution between the rural and urban sectors. The cheap imported food policy has itself been one of the most important deterrents to a viable local agriculture producing the food needed by the people.

16. As regards the question of the increase in the cost of living, a rough calculation can be made as to the effect of the increased import costs on goods for local consumption (disregarding imported goods which enter into exports and are, therefore, not consumed locally). It is calculated that a present levels of imports, and with personal consumption expenditure estimated at J$ 850m. for 1972, the increased import bill in local currency will add J$33.3m. or 4% of estimated personal consumption.

Back up Measures:

Back up Measures

17. A. Credit Policy

(a) The current credit restraint programme will be continued with injection of two positive adjustments:

(i) credit must be redirected to the productive sectors including agriculture;

(ii) every assistance must be given by the banks, the Jamaica Development Bank and other institutions to assist business to restructure their capitalisation involving more long term financing, new public issues of shares and debentures and less reliance on short term financing.

(b) Bank Rate has been increased by 1% to 7%. This represents a technical adjustment in response to upward movements in interest rates which have taken place in Jamaica over the past six months. Such movements were out of line with a 6% Bank rate. In addition it will bring Jamaica in line with the increases in rates which have been worldwide.

The Bank Rate change is not a signal for an across the board increase by 1% of all interest rates since it is purely a technical means to catch up with the realities of interest rates.

18. B. Exchange Control

Present policies will be continued and the administration of the law improved. Action in this area ensures that foreign exchange earned by our exports, tourist trade etc. are in fact available for our essential needs.

Increased Production

19 The Government has already embarked on positive programme for expanding agricultural production and increasing the flow of tourists. This thrust will not only be intensified but extended to embrace other areas of the economy in order to take full opportunity of the advantages which will exist for promoting economic growth. Action is being taken to review Jamaica's commercial policy and overall incentive programmes for industrial expansion consistent, of course, with our obligation under the CARIFTA/Common Market Agreements. The Government is determined that the conditions for success in the area of increased production must obtain.

Use of International Monetary Fund ....

Use of International Monetary Fund Resources

20. Since there can never be certainty that all the measures taken will have the desired advantageous response, there is need for insurance if only in the short term when the economy would be gearing itself for a successful assault on the problems of considerably increased economic growth. To cope with this contingency and deal with emergencies, it is proposed to negotiate with the International Monetary Fund stand-by facilities amounting to US$26.5 million of special drawing rights.

21. Members of the House of Representatives are accordingly asked to approve the action of the Government in fixing a new parity for the Jamaica dollar as outlined in preceding paragraphs. In due course, I will move an appropriate Resolution.

DAVID H. COORE
Deputy Prime Minister & Minister of Finance
18th January, 1973.

APPENDIX I

ECONOMIC REPORT

Position of Reserves etc.
at 31/12/72

RESERVES

The reserves increased in November and December as follows:

			J$m	
	1971		1972	
September	134.2	- 5.1	90.5	-16.2
October	142.4	- 8.2	81.5	- 9.0
November	131.8	-10.6	82.2	+ 0.7
December	132.2	+ 0.4	85.0	+ 2.8

Movement of reserves on quarterly basis was as follows:

				J$m
	1969	1970	1971	1972
January to March	+17.4	+32.6	+39.2	+25.0
April to June	- 3.6	+ 7.1	+ 7.9	-38.8
July to September	-15.9	-13.0	- 8.8	-27.4
October to December	- 9.3	- 9.1	- 2.0	- 5.5

The quarterly figures show the dramatic imporvement in the last quarter of 1972 over the second and third quarters, and move in line with previous years.

BANK ADVANCES AND DEPOSITS

Bank advances at 27/12/72 had declined to J$418.5 million compared with the ceiling figure at 10/11/72 of J$425.9 million. Bank deposits at 27/12/72 amounted to J$452.7 million compared with J$446.1 million at 10/11/72. It will be seen therefore that the liquidity position in the commercial banks has increased.