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JAMAICA/IMF PROGRAMME

In April 1981, the Government of Jamaica entered into an agreement with the International Monetary Fund (IMF) for the provision of financial resources under the Extended Fund Facility (EFF) arrangements, to support the Jamaica Three-Year Economic Recovery Programme. The targeted flows would amount to 478 million SDRs over the three-year period. The major objectives of these arrangements were firstly, to improve the Balance of Payments which had deteriorated significantly in past years; secondly to restore the gross foreign exchange reserves of the Bank of Jamaica to levels appropriate to and acceptable for normal commercial financial activities; thirdly, to ensure a sustained flow of foreign exchange earnings in the future in order to support the requirements of the Jamaican economy for imported goods and services.

2. As a complementary measure, the GOJ developed a multi-year Structural Adjustment Programme to support its export-led economic growth strategy and to underpin the objective of securing an adequate level of sustained foreign exchange flows. These programmes provided the framework within which external assistance has been forthcoming from multilateral and bilateral external agencies, Donor Countries, and external commercial banks.

3. In the first year - 1981/82 - of the EFF Programme, the targets and objectives were successfully attained. The economy recorded positive growth of 2.5%* of GDP; inflation was contained within low single digits; the Balance of Payments recorded a surplus; and the gross Foreign Exchange Reserves of the Bank of Jamaica improved from US\$73.6 million to US\$130.7 million. The second year, 1982/83, was affected by the onset of the worldwide economic recession. More specifically, both output of bauxite/ alumina and projected external financial flows deteriorated below programme

* GDP growth rate for the Calendar Year 1981 was 3.28%. For the Calendar Year 1982 it was 0.2%.

levels. Nonetheless the real sector, again recorded positive growth albeit of a marginal nature while inflation was again contained within single digits. However, there was a deterioration in Jamaica's Balance of Payments by US\$147.0 million as the country was unable to secure the level of external financing required and planned for in 1982, while exports contracted in the face of severe recession within the USA and other markets. Loans from the international commercial banks of US\$50 million did not materialize in the face of steps taken by a number of major debtor countries in the region to secure a rescheduling of external debt, thus making the banks reluctant to extend their exposure to countries in the region. Jamaica's exports of bauxite and alumina fell by US\$250 million in 1982.

4. The 1983/84 programme was designed to recover the Balance of Payments improvement officially projected over the three-year period, with a target of US\$125 million for the year ending March 31, 1984. The new foreign exchange regime was put in place to allow Jamaica to draw on foreign exchange which was within the system, but which played no part in the development process. In doing so, a second rate of exchange (the parallel rate) was formally established while transactions on the official market continued to be undertaken at a fixed exchange rate of J\$1.78 = US\$1.00. Transactions in the parallel market were undertaken at a floating rate determined within the commercial banking system. On the basis of the new programme the Fund granted a waiver for those breaches of the performance criteria which occurred at March 31, 1983, thereby facilitating a continuation of the EFF Programme with resources of 149.7 million SDRs for 1983/84.

5. The first two tranches of the 1983/84 programme were disbursed on schedule on attainment of the performance criteria at June 30, 1983. For the third tranche, due October 15, 1983, the Bank of Jamaica submitted calculations of the performance criteria at September 30, 1983, in support of disbursements of 37.4 million SDRs. However, a disagreement arose on certain technical aspects of the performance criteria computations.

The Bank of Jamaica concluded and advised on Friday October 7, 1983, that based on their computation, Jamaica had met the performance criteria for that quarter. However, on Monday October 10, 1983, the Fund Staff advised that based on their findings, Jamaica had not observed the performance criteria for reducing due obligations for oil payments and the understanding to remain current on external interest payment. Moreover, Fund Staff subsequently maintained that action by the Bank of Jamaica in rescheduling short-term credit to avoid potential arrears was a manifestation of underlying problems facing the EFF Programme in 1983/84. In particular, there existed a strong view that the dual market Foreign Exchange system was not yielding sufficient resources to adequately benefit the Jamaican economy.

6. Arising out of the impasse pertaining to the performance criteria computations, and the fact that neither side would change position taken in this matter, it has been agreed that a 15-month Standby Credit Facility should replace the remaining six months of the EFF Programme as of January 1, 1984, to run to March 31, 1985. This Facility could provide total resources of around 147 million SDRs. This sum exceeds the 74.8 million SDRs which would have remained under the EFF Programme to March 31, 1984. The effects of the new Programme on the Exchange regime and the Trade and Payments System are outlined below.

Exchange Regime

7. The dual market Foreign Exchange system (the parallel market) was introduced on January 10, 1983 with the objective of capturing the foreign exchange resources existing within the system through the establishment of rates which are competitive with those in the "street" market, and utilising the resources so captured for the importation of essential goods and services.

8. With the establishment of this market, certain designated earners of foreign exchange were required to surrender their earnings at the official market rate. These include - Bauxite/Alumina, Sugar, Bananas, Hotels, In-Bond Shops, Rent-a-Car Agencies and Tour Operators. Certain

designated foreign exchange payments were to be made at the official rate of exchange including public debt and private debt payments, basic foods, petroleum and petroleum products, essential imports for the tourist sector, school books, drugs, infant feeds and certain service payments. In June 1983, non-official market transactions were further expanded by shifting to the parallel market a wider range of payments including oil. By August 1983, modifications were made to the commercial bank exchange market to deal with such undesirable features as "tied" sales of foreign exchange, so as to ensure priority supply of foreign exchange resources to meet oil payments and make foreign exchange available on a wider basis, to all importers, rather than allow the market to be cornered by the big purchasers of foreign exchange.

9. Currently, the system has resolved itself into three sub-markets:

- i) the official market of the Bank of Jamaica;
- ii) the commercial bank rate; and
- iii) the "street" market rate.

The "street" market has grown in size while the flows at the disposal of the banks have become insufficient to meet the needs of the market. The shortfall in the supply of foreign exchange to the official market, the inability of the market to meet the total demand placed on it and the growth in the "street" market which has stemmed from this, are the result of two factors:

- (a) the leakage of funds which would have gone into the commercial banks and/or the Bank of Jamaica, into the "street" market in which exchange rates which are strongly competitive with the parallel market rates have been established. A substantial portion of these leakages has been from the tourist sector.

- b) the withholding of foreign exchange from export sales that would have flowed into the Bank of Jamaica and/or the parallel market. It is estimated that sums earned from export sales and withheld in overseas accounts amount to approximately US\$60 million at July 25, 1983.

In order to ensure that the sums withheld are surrendered and the practice discontinued and in order to minimize the leakages which have been taking place, the Exchange Control Act (Amendment) (No.3) Order 1983 dated 10th day of October, 1983 was promulgated.

10. The administration of the official foreign exchange market system has been bombarded with special pleadings for exemption. These special pleadings have come from the bauxite industry which has sought application of the parallel market rate in respect of funds transferred to Jamaica to meet the local cost of its operations; the hotel sector which has sought a 100% conversion of earnings within the parallel market, and non-traditional exporters in manufacturing and agriculture who have sought to be allowed to dispose of 100% instead of 50% of their export earnings in non-CARICOM markets within the parallel market. There are also the users of fertilizers, farm tools and other products who have sought to have these items transferred from parallel market treatment to official market accommodation as a means of reducing their production costs.

11. In order to deal with the problem of leakages of foreign exchange from the system and increase the amount of foreign exchange required for the purchase of raw materials, construction materials, machinery, spare parts and essential consumer items as well as provide inducements to producers of goods and services, it has been decided to replace the parallel market system by a unified system. As will be shown below, this system will improve the profit making capability of a number of sectors. The notable exceptions will be electricity generation and transportation. The system is not expected

to lead to price increases of imported goods except basic food items which are currently imported at the official rate of exchange of J\$1.78 = US\$1.00. In order to hold basic food prices at current levels, the increased cost from the new exchange arrangement will be met by the Central Government up to March 31, 1985, and thereafter will be phased out over the two-year period March 31, 1985 to March 31, 1987.

12. The exchange rate which will be applicable for spot transactions will be maintained within a specified band, the mid-point of which will be adjusted fortnightly on the basis of the weighted average of actual rates for spot transactions in the market during the previous fortnightly period. Under this system, one daily rate for spot transactions will be established jointly by all commercial banks within the specified band. This system would provide the flexibility to adjust to the competitiveness of the "street" market and also accommodate external market conditions. The result of such a system is that the current official rate of J\$1.78 to US\$1.00 would have been devalued by the extent of the difference between this rate and the applicable rate within the specified band, established for spot transactions. Under this arrangement, the new unified rate will commence at \$1.00 (US) = \$3.15 (J). With the establishment of the appropriate rate competitiveness against the "street" market will be strengthened and resource availability within the commercial banks should improve.

13. To support and strengthen the proposed system, commercial banks will be permitted to accept fixed-term foreign currency deposits from non-residents and residents of Jamaica. Deposits of residents would be used for "bona-fide" transactions relating to imports and service payments. Deposits would be accepted at interest rates which are internationally competitive.

14. A Parity Order establishing the new exchange rate regime has been laid on the Table of this House.

Trade and Payments System

15. A system of quotas and import licences has been used as an allocator of foreign exchange for imports. The quota system was introduced in January 1983 as an important part of the new mechanism to improve the efficiency in foreign exchange allocation and facilitate forward planning on the part of producers. Under this system import ceilings for broad categories of commodities were established and each firm was given allocations which established limits to the amount of goods which it may import. Approvals to import goods were given only to importers who had been assigned quotas or who had been explicitly exempted. Exemptions were given to all exporters.

16. An important aspect of the economic programme is the time-table established in 1981 for the phasing out of the Import Licensing System. This is deemed to be a basic prerequisite for the proper functioning of a market oriented economy. Given the improvement in the exchange regime which is expected from the establishment of a unified exchange market and the effect of this on the allocation of foreign exchange, it is considered appropriate at this time, to take another major step in the deregulation process by dismantling the existing quota and licensing system for all imports with the exception of items which are currently on the Restricted List, a range of non-essentials and low priority goods.

17. The list of items to be subject to import quota and licensing is to be worked out during the month of December, 1983.

Public Sector

18. The Public Sector buys and sells most of the foreign exchange in the official market, and will therefore be directly affected by a unified exchange system. The fiscal impact on the Central Government will be

positive, because its foreign exchange inflows, in the form of tax revenue and loans, exceed its outflows. Many public enterprises, on the other hand, are net foreign exchange purchasers, and will therefore suffer increased costs. Public Enterprises which earn revenues in Jamaican dollars but have elements of foreign operational costs and/or foreign debt servicing, would experience incremental expenditure which at present prices would erode profitability or increase losses. Further, if the foreign costs of investment programmes are not matched by foreign loan inflows, investment expenditure would increase.

19. For the remainder of the Financial Year 1983/84, the incremental benefits to the Central Government Budget will be used, so far as is possible and necessary, to cushion in whole or in part, the impact of the adjusted exchange system on the operational costs and foreign debt servicing of a group of selected Public Enterprises including the Jamaica Public Service Company, National Water Commission, Jamaica Railway Corporation. However, for 1984/85, the National Water Commission will be accommodated by the Budget in respect of incremental costs arising from the new exchange arrangements so as to prevent further rate increases. The Jamaica Public Service Company and the Jamaica Railway Corporation will absorb the incremental expenditure through cost efficient programmes. In the case of the Jamaica Public Service Company, a whole regime of rate structuring is being looked at. The opportunity arising from the new exchange arrangements will be used to examine a rate structure in which a flat rate is applied to household consumers who constitute the largest segment of the company's customers and a metering system for larger users. The flat rate system will go a far way to resolving a number of problems faced by householders including complaints concerning wide variations in monthly charges and the misreading of meters. All things considered, the new system could lead to greater economy in the use of electricity.

Prices

20. Currently, basic food imports supplied by the Jamaica Commodity Trading Company are charged out at the official market exchange rate. The items concerned are wheat, corn for cornmeal and animal feed, soya meal, rice, soya oil, canned mackerel, sardines and herrings, corned beef, dried salted fish, milk solids, Canadian biscuit flour, baking and counter flour. The incremental costs for these items which arise directly from the adjusted exchange system, will be subsidised from the Central Government Budget for the remainder of 1983/84 through to March 31, 1985. Thereafter the subsidies will be removed over a two-year period to March 1987.

21. All other goods are currently imported at the parallel and "street" market rates. The prices of these commodities reflect the exchange rates of the existing parallel and "street" market system. Therefore, no additional price increase is warranted from the unification of the exchange system.

22. The import price levels arising from the new exchange arrangements now present a new scenario in so far as the local production of rice, corn, and soya are concerned.

23. In the case of rice, the AGRO 21 Programme envisages our growing about 50% of annual consumption from 7,000 acres of cultivation by 1986. There are 4,600 acres already confirmed for development. With the increase in the import price of rice under the new exchange arrangements, the basic ingredients exist for the targeting for self-sufficiency within a reasonable timeframe.

24. The viability of the production of corn and soya under the programme will now be subject to re-examination with a view to sponsoring the development of projects in these crops at the earliest possible time.

25. The AGRO 21 Programme envisages significant expansion in the production of beef, dairy products and fish during the next two to three

years. The new exchange arrangements will now provide an increased competitive edge for substantial expansion in the development of these sub-sectors for import substitution. Consequently the expansion programmes for rice, dairy products, beef and fish will allow for marked reduction in Jamaica's import dependence for these products.

26. Petroleum Products: The imports of petroleum products were transferred to the parallel market in June 1983 and the price of gasoline was increased by some 29 per cent. However, since then, the price of imported crude has increased by some US\$2.00 per barrel while parallel market rates have also risen and in addition, there is now the impact of the unified exchange rate system. All these factors will affect the price of gasoline and other petroleum products. It will therefore be necessary to increase the price of gasoline and other petroleum products. Announcement of these price increases will be made early in 1984.

OTHER SECTORS

27. Since the introduction of the parallel market system, there have been increases in the cost of imports of all goods and services transacted within this market. This has given rise to production cost increases as well as increases in the prices of a wide range of consumer items. These increases are now reflected in the Consumer Price Index and the inflation rate for 1983 which is currently projected at 18.5%.

28. With unification of the foreign exchange system, there will be gains to a number of producing sectors (the notable exceptions being electricity generation and transportation) as each unit of foreign exchange earned by them will now mean a larger number of Jamaican dollars. At the same time, the import cost of these sectors will not increase except for basic food processing, transportation, etc. as the imported items which they use are already purchased at exchange rates of at least J\$3.00 = US\$1.00.

Unification of the exchange system and the devaluation of the currency means therefore that the economy is being placed in a position to secure substantial gains in income and foreign exchange earnings.

29. The gains to the farming community in terms of Jamaican dollar revenues from the exchange rate adjustment will be applied in a manner that will give greater benefits to farmers in terms of improved prices and bonuses in those agricultural activities which are not now in a loss position. Where there are losses, the revenue windfall will be applied to reduce the debt of the entities in question and finance rehabilitation in order to secure improvements in operations and net benefits to farmers at the earliest opportunity.

30. Bauxite and Alumina: The impact of the exchange rate system will give a windfall to the bauxite and alumina companies, which will have the effect of reducing the total foreign exchange inflows from the companies into the country. Accordingly, the new bauxite levy regime currently being formulated will deal with the question of foreign exchange inflows as well as matters pertaining to the levy as one negotiation. The levy negotiations are expected to be completed during the next month.

31. Hotel Sector: Hotel earnings deposited with the Bank of Jamaica are estimated to amount to \$130 million (US) for 1983/84 and \$150 million (US) for 1984/85. Hotel imports financed from the official market could be at a level of \$12 million (US) in 1983/84 and an estimated \$13 million (US) in 1984/85. Other hotel imports as well as private hotel foreign debt servicing are already on the non-official foreign exchange market. It is estimated that the adjustment of the exchange system based on mid-point values would increase revenues to the hotel sector by a net J\$200 million for 1984/85. This increase in revenues to the sector will be shared between the fiscal budget and the hotels. The portion which goes to the revenues by way of a special tax, will be used to subsidise the prices of the imported basic foods listed above.

32. Sugar Industry: The Sugar Industry Authority should achieve incremental earnings of around J\$53.00 million for the crop year commencing November 198 . The revenue gains to the industry in 1983/84 would go to meet the funding currently required to make the industry viable. The industry will

therefore be placed in a position to meet urgent refurbishing and revitalization costs from its own earnings rather than borrow to meet these costs which must be incurred if the industry is to survive. With this revitalization, the industry would be placed in a position to benefit significantly in subsequent years from exchange adjustment.

33. Bananas: On the basis of the current operations of the marketing company concerned with the Banana Industry and based on the present guaranteed price level, the company would break even at levels of exportable fruits in the region of 25,000 - 30,000 tons. It is likely to achieve these levels in 1984. With an export level of 30,000 tons in 1984, the new exchange arrangements would mean incremental earnings of approximately J\$11.0 million. This would go to reduce the Banana Company's outstanding debt obligations as well as alleviate those problems faced by farmers arising from cost increases in fertilizers and agricultural tools.

34. The projections are that the Banana Industry could attain exportables of 110,000 tons by 1986. The marketing operations based on present guaranteed prices for bananas, would be extremely profitable amounting to around J\$70 million. The Banana Company should be in a position to pay its debt on an appropriate annualised basis from the profits which it would earn.

35. Non-Traditional Agricultural Exports (Coffee, Cocoa, Citrus and Pimento)

Based on current estimates of export volumes and prices, there would be incremental earnings to those crops of approximately J\$12.8 million in 1984. In the cases of the coffee, pimento and cocoa industries the major share of these incremental earnings would be available to be put toward the improvement of prices to growers as these industries are currently in a profit position. Improved prices to growers should put these sub-sectors in a very strong position to exploit current market opportunities and secure significant benefits from the new exchange market arrangements.

36. Coffee: For the 1983/84 crop the gain to the Coffee Industry Board arising from the new exchange arrangements is estimated at J\$4.5 million. Even after certain expenses are met, there remains the leeway to effect significant increases in growers' prices. The price increases would provide the type of incentives for production expansion which farmers have been seeking.

37. Pimento: Based on current estimate of export volume and price for 1984, incremental revenues arising from the new exchange arrangements are of the order of J\$4.6 million. As this industry is profitable at current prices these incremental earnings would allow for substantial increases in growers' prices even after certain expenses are met and allowance is made for increase in reserves.

38. Cocoa: The industry could secure incremental earnings in 1984 of the order of approximately J\$3.0 million as a consequence of the new exchange arrangements. This industry would be in a position to increase growers' prices as a consequence of this development.

39. Citrus: The industry could secure incremental reserves of under \$1.0 million and given its current debt position, it would be obliged to put these earnings against debts.

Non-Traditional Manufacturing

40. The stimulus to exports will assume two primary forms. First, a unified exchange rate system will make existing exports more profitable. This is a direct result of the fact that the exporter will get more Jamaican dollars from each unit of foreign exchange earned. With this increase in the amount of Jamaican dollars received per unit of foreign exchange sales, the manufacturer will have every inducement to increase his overseas sales and to organize himself to take advantage of overseas market opportunities. Price survey information indicates a significant improvement in the competitiveness of products from the garment, processed foods, and plastic products sub-sectors.

41. It is crudely estimated that with the new exchange arrangements, the incremental net foreign earnings of the sector could exceed US\$30 million in 1984/85 and US\$40 million in 1985/86, provided there is strong response on the part of manufacturers to the inducements provided under these arrangements.

42. In the assessment of the improvement in export profitability which will arise from the exchange arrangements, account has been taken of the fact that exporters to CARICOM now purchase their raw materials which go into production for export to CARICOM at the agreed rate of J\$2.25 = US\$1.00 and with the new exchange arrangements in which there is unification of rates, the procurement of all raw materials will now be at the new rate.

Edward Seaga
Prime Minister & Minister of
Finance & Planning

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