CaPRI
Caribbean Policy Research Institute
Taking Responsibility

JAMAICA AND THE IMF: ADDRESSING THE ISSUES

Written by Latoya Richards
Edited by John Rapley and Damien King

A BACKGROUND BRIEF
2nd of October 2009
B-09-002

Caribbean Policy Research Institute
Guango Tree House
29 Munroe Road
Kingston 7, Jamaica
www.capricaribbean.org

Due to the projected gaps in its foreign exchange earnings over this fiscal year as a result of the global economic crisis, the government of Jamaica has been contemplating a lending relationship with the International Monetary Fund (IMF). This has caused much deliberation among Jamaicans, many of whom have had to live through actual experiences with the structural reform policies which Jamaica had to undergo under its previous experiences with the Fund.

This briefing explains the economic circumstances influencing Jamaica's planned move to resume its relationship with the Fund, and possible implications for a new IMF loan arrangement.

Table 1: Net International Reserves (US$Mn)

Month	Stock	One Month Change
08-Oct	1802.6	-448.5
08-Nov	1794.0	-8.6
08-Dec	1772.9	-21.1
09-Jan	1765.0	-7.9
09-Feb	1601.9	-163.1
09-Mar	1628.6	26.7

Source: Bank of Jamaica – Quarterly Monetary Policy Report (January to March 2009)

JAMAICA: CHANGING CIRCUMSTANCES

As a small developing economy, Jamaica is vulnerable to particularly sharp fluctuations in its external accounts. Such fluctuations often result in imbalances in the country's external and fiscal accounts and thereby necessitate the use of corrective monetary and fiscal policies.

Presently, Jamaica finds itself in the midst of a severe global economic crisis, involving significant short-falls in the foreign exchange market: between January and March 2009, net capital inflows contracted by US$542.0 million relative to the last quarter of 2008. Reduction in foreign currency due to the increased demand generally associated with loss in investor confidence, the fallout in the country's main foreign exchange earners (bauxite and tourism) and decline in remittance inflows have further compounded the degree of instability in the market for foreign exchange.[1]

[1] The Jamaica dollar depreciated by 9.4% between January and March 2009, an amount that is higher than the average 0.7% for previous first quarters over the past five years. See, Bank of Jamaica, "Quarterly Monetary Policy Report (October – December 2008)." Volume 9, No. 3. Accessed July 15, 2009: http://www.boj.org.jm/uploads/pdf/qmp_report/qmp_report_october_december2008.pdf

In an attempt to minimize the impact of these foreign exchange market developments on volatility in the exchange rate, the central bank had to draw on the exchange reserves of the country--- the Net International Reserves (NIR). The NIR declined considerably (see Table 1) following the Bank of Jamaica's injection of foreign currency, with US$478.2 million leaving the country during the last quarter of 2008.[2] Furthermore, official and private flows were insufficient to finance the current account deficit between January and February 2009, thus the NIR consequently declined by approximately US$8 million in January 2009 and US$163.1 million in February 2009.[3] These developments in the foreign exchange market further exacerbated the country's longstanding fiscal and current account deficits. It is estimated that the country is now facing short-falls in foreign exchange earnings of approximately US$1.3 billion for the fiscal year -- the equivalent of 10 per cent of GDP.[4]

Sourcing Funds: Possible Options for the Government

Accessing funds remains a challenge for the government of Jamaica. All prospects to raise funds on the international capital market seem dismal against the background of the adverse conditions in the global economy. The collapse of some major financial institutions in the US and the recent downgrading of Jamaica's credit ratings further diminished investor's appetite for Jamaican bonds. Therefore, in closing the current gap the government of Jamaica would have to explore three possible options:

[2] The decline in the NIR during the October 2008 quarter resulted from the central bank's sale and loan of foreign currency to the market. See, Bank of Jamaica, "Quarterly Monetary Policy Report (October – December 2008)." Volume 9, No. 3. Accessed July 15, 2009: http://www.boj.org.jm/uploads/pdf/qmp_report/qmp_report_october_december2008.pdf

[3] Although there was an increase in the NIR by March 2009 as official and private flows sufficiently financed the current account deficit, the NIR experienced an overall decline of US$144.4 million for the first quarter of 2009, relative to the last quarter performance in 2008. Also see, Bank of Jamaica (January to March 2009). "The Balance of Payments (Preliminary) Statistical Update," Accessed July 15, 2009: www.boj.org.jm.

[4] Jamaica Gleaner (July 2009), "Shaw explains IMF absence." Accessed July 13, 2009: http://www.jamaica-gleaner.com/gleaner/20090713/business/business2.html.

(a) implementing drastic reform measures which would require major cuts in fiscal spending over the short-term;

(b) borrowing domestically; or

(c) borrowing from multilateral sources such as the IMF.

Option (a) is necessary as it will help to curb the country's rising debt level, and if done effectively will likely address structural problems inhibiting growth. However, the political climate of the country might not permit such changes and the kind of fiscal discipline required could be a major challenge to the government. Furthermore, these changes would not only have to be drastic but, if we are to go this route, the country would have to immediately see significant cutbacks, so that we can close the present and forecasted gaps in the fiscal accounts this year.

Accessing credit through the domestic capital market---option (b) --- is likely to be affected by investor preference for short-term debt.[5] In other words, since local investors show a strong preference for debt with short-term maturities, this could pose a problem to the government of Jamaica since the existing deficits require financing on a sustainable basis in order to minimize associated risks of debt refinancing. Furthermore, greater dependence on the local bond market is likely to lead to increased interest rates. This would lead to increasing future taxes or further government spending cutbacks. Either would inhibit the return of growth.

The third option (c) offers two advantages. One is that multilateral loans are less expensive in comparison to those offered on the international capital market, and the other is that these loans often carry long-term maturity. Increasing the amount of multilateral credit, like any debt-raising initiative, will increase the country's debt level in the long-run. According to the 2008 CaPRI report on Jamaica's debt, if the government were to double Jamaica's share of multilateral debt while reducing the share of bonded debt commensurately, this could slightly reduce the number of years needed to meet the thresholds of a balanced budget.[6]

[5] Ministry of Finance and Public Service (April 2009). "Debt Management Strategy FY 2009/10," Ministry Paper No. 25. Accessed July 13, 2009: http://www.mof.gov.jm/budget_memo/docs/2009/20090605-DebtStrat0910.pdf

[6] CaPRI (2008), "Jamaica's Debt: Exploring Causes and Strategies," (Working Paper Series).

Although the debt levels have since changed, should Jamaica approach the IMF for funding, the lower cost debt would likely produce the same outcome.

It is this third option that has stimulated much discussion among Jamaicans in recent months. Some of the concerns raised are shaped by memories of the structural reform policies to which Jamaica was once subjected in the 1970s and 1980s. Arguably, these past reform policies were associated with rising debt levels and considerable economic and social losses.[7] But even as the government contemplates accessing credit from the IMF, it is worth noting the changes within the IMF since the last loan agreement in 1992,[8] and the implications of these changes.

Box 1: Jamaica in the 1970s -2000s

Jamaica, like many developing countries, has followed the dominant developmental patterns of the world. The economic policy of the government of the 1970s, for instance, contained strong elements of government-led growth as well as a policy of non-alignment. The decades that followed showed a more market-led development model, evidenced by the country's participation in the US-led Caribbean Basin Initiative, for instance.

The country also increased its presence in the international capital market. This period saw the country borrowing consistently from international commercial banks as well as multilateral sources (including the IMF) and bilateral creditors. Today most of Jamaica's borrowing is done within the domestic financial system, which has developed considerably.

A Changing IMF: Possible Implications for Jamaica

Since the 1970s there has been a transformation in the world economy as evidenced by a shifting from a heavy dependence on government-led growth policies during the 1970s to increased interdependence of economies and wide-spread support for multilateral trade liberalization throughout the 1980s and onwards. Jamaica is a prime example (see Box 1). The level of access to international capital markets has also increased since the 1980s, resulting in a fundamental transformation both in the scale and complexity of the international capital flows throughout the 1990s and 2000s. Undoubtedly, these changes have presented new challenges to the international financial system, and addressing them must become an imperative of the international community.

The IMF has shown cognizance of the implications of these changes. Thus, it calls for a sharper focus on crisis prevention and capital account risks.[9] In consequence, it too has had to

[7] The reform programmes under the IMF and the World Bank caused deterioration in the quality and scope of social services, declining purchasing power, chronic unemployment, falling standard of living. See Girvan, Norman, Richard Bernal and Wesley Hughes (1980*). The IMF and the Third Word: The Case of Jamaica 1974 – 1980*. Kingston, Jamaica: Ian Randle, pp. 148.

[8] The last loan agreement was an Extended Fund Facility (EFF) that was arranged on December 11, 1992 and expired on March 16, 1996.

[9] Rodrigo de Rato (September 2004). "IMF at 60: Evolving Role, Current Challenges," Speech presented at the Breakfast Meeting with the Council on Foreign Relations New York.

transform its operations in order to tackle the changing circumstances of the global economy.

Today, the more than six-decade old IMF has begun to increase its transparency by allowing greater access to timely and useful information on more than three-quarters of its member countries. It has also broadened its accountability to the extent that it not only engages in dialogue with member governments but also with civil society organizations, religious groups, labour unions and other organizations. Recently, it has attempted to address the shifting needs of its expanding membership, some of whom require special provisions in order to reduce poverty levels.[10] Consequently, one of the new provisions which the IMF has introduced is the Poverty Reduction and Growth Facility (PRGF), which is a low-interest lending facility for low-income countries.

Changes have been made to the IMF's lending framework. The Fund has introduced a Flexible Credit Line (FCL) Facility to provide large and upfront loans to member countries with strong economic fundamentals. The Standby Arrangements have also been enhanced to offer greater flexibility and is intended for member countries which do not qualify for FCL. The cost and maturity structures have been simplified in order to make borrowing more affordable.[11] Even more important is the Fund's recent 'modernisation' of its conditionality framework, following ongoing extensive review since 2000.[12] This new framework should ensure that conditionality is streamlined to support the borrower country's macroeconomic objectives.[13]

---

[10] The IMF seeks to help in the eradication of extreme poverty in support of the Millennium Development Goal objectives. It says it has so far seen 'encouraging improvements in economic performance and social indicators in countries where stability has been complemented by structural reforms and the targeting of public spending to areas of greatest benefits to people such as in Mozambique, Tanzania and Uganda." See, Rodrigo de Rato (January 2005). "Is the IMF's Mandate Still Relevant?" Article published in *Global Agenda.*

[11] See International Monetary Fund (March 2009), "To Help Countries Face Crisis, IMF Revamps its Lending," IMF Survey Magazine. Accessed July 17, 2009: http://www.imf.org/external/pubs/ft/survey/so/2009/NEW032409A.htm

[12] See, International Monetary Fund (April 2009), "IMF Conditionality," Factsheet.

[13] The Fund argues that where there is country ownership of policies and support thereof, borrowers are more likely to effectively implement policies that will attain macroeconomic objectives (this position also complements the Fund's efforts to increase its level of accountability).Graham Haache (May 2006). "The Evolving Role of the IMF and its Dialogue with Parliamentarians," Remarks at the Seminar for Parliamentarians of the Kyrgyz Republic.

It is highly unlikely that Jamaica will be exempt from conditionality all together --- a reality that would have to be faced in the event that Jamaica decides to borrow from the IMF. After all, this is really no different from any bank looking at a loan applicant's finances and advising of the conditions under which a loan can be made. As such, Jamaica would likely be subjected to one or both kinds of conditionality: *ex ante conditionality*, which requires that the country meets well-defined qualification criteria; and/or the traditional *ex post conditionality,* which dictates that the country would have to undergo reforms.[14]

Jamaica would likely face ex-post conditionality given its existing structural weaknesses, such as its inefficient tax system, high public debt and consistent current account deficit. However, unlike the conditions attached to the loans in past arrangements, the IMF would see to it that the country primarily accepts the responsibility for selecting, designing and implementing reform policies. Moreover, once a policy program has been agreed with the IMF, the implementation of such policies will be monitored in the context of program reviews rather than structural performance criteria. Rather than fixed targets, Jamaica is likely to be asked to meet broad strategic objectives, and its progress will be monitored accordingly.

[14] See, International Monetary Fund (April 2009), "IMF Conditionality," Factsheet.

Change is Inevitable

While it is indeed important for Jamaica to close the existing foreign exchange gap, it is equally important for the country to acknowledge that it might have to undergo painful adjustment whether or not we go to the IMF. As already discussed, once a loan agreement is contemplated, it is imperative for us to determine our own country programme for presentation to the IMF. It will no doubt require changes in public sector affairs, albeit under milder terms and conditions than we have undergone with previous arrangements. On the other hand, even if the government foregoes an IMF loan, given the difficulty with raising funds to fill its existing fiscal gap, it will probably have to make drastic spending cuts while reforming taxes so as to increase government revenue. Otherwise, if the current account continues to deteriorate and international reserves continue to dwindle, the dollar will depreciate even more, until the higher cost of imports forces the required contraction.

This is not the first time Jamaica has faced this dilemma: painfully going it alone versus painfully going to the IMF (see Box 2). Few economists would dispute that a difficult restructuring of the Jamaican economy is necessary, though they may debate what type of restructuring should be done. But it is really not the IMF that will cause us any future pain, so much as the the need to remedy the economy's existing structural imbalances. One may therefore well ask, if we are to make painful adjustments, why not get the IMF to assist us?

Box 2: Comparing Options: The 1997 Emergency Production Plan Versus the IMF Programme

Jamaicans have long memories of the harsh "conditionality" which accompanied its earlier experiences with the IMF. When fiscal or balance-of-payments crises strike, the IMF does not automatically come into play. Countries can choose, and sometimes do, to go it alone. In those cases, to avoid outright economic collapse, governments will implement home-grown adjustment programmes.

In 1977, Jamaica was in the midst of an economic crisis. High oil prices and declining exports had worsened in the country's balance of payments. With foreign exchange reserves running low and debt rising, the government recognized serious action was needed. Prime Minister Michael Manley considered the option of crafting a home-grown adjustment programme instead of going to the IMF for assistance. He summoned some of his economic advisors to devise a plan that would not involve the IMF. This came to be known as the Emergency Production Plan, or EPP.

It is interesting to contrast the two approaches. They differed sharply in their goals – one was to create a socialist economy, the other was to restore market principles – but both called for serious belt-tightening on the part of the citizenry.

Proposed Conditions under the EPP

The Manley administration's Emergency Production Plan of 1977 had strong elements of self-reliance and democratic socialism. It called for:

- Nationalisation of all banks and insurance companies, the flour mill, the cement plant and the oil refinery
- New resources of raw material supplies to be sourced from socialist countries, provided they could trade supplies in exchange for credit in bauxite-alumina and other available exports
- Allocating foreign exchange to give preference to raw material imports over consumption goods
- Favouring firms with large labour forces or producing for basic needs and export in the allocation of raw materials
- Encouraging Jamaicans to change their consumption habits in favour of local goods by, for instance, eating less rice, saltfish or wheat-based staples like bread and dumplings, and eating more local roots like yam and cassava; or preferring locally-made clothes and shoes over imported ones
- Building houses out of locally-available wood rather than concrete

Even with these adjustments, the plan recognized there would still be a foreign-exchange shortfall, which it was hoped socialist countries like the Soviet Union would help cover. Such support was not forthcoming, however.

Conditions under the IMF's Economic Reform

The IMF and other multilateral institutions generally diagnosed eight main problems of the Jamaican economy: *excessive wages increases, overvalued exchange rate, excessive fiscal deficit, excessive monetary expansion, excessive restrictions on trade and payments, lack of business 'confidence', excessive state intervention in the economy and excessive price controls.* The Fund thus called for:

- Privatization of 18 public companies, including agricultural processing plants, hotels, major shares in the cement company, 51% per cent of shares in the National Commercial Bank and agricultural lands
- Contracting out of a number of public sector services, including garbage collection, the managing of municipal markets and cleaning of public hospitals
- Currency Devaluation
- Tariff Reduction
- Deregulation of the labour and foreign exchange markets
- Elimination of price controls
- Deregulation of the financial system.
- Public sector lay-offs

In the end, Manley judged the EPP was not feasible, and opted to go to the IMF. We will never know if the Emergency Production Plan, had it been adopted, would have succeeded in putting the Jamaican economy on a growth path. In the short term, the IMF one did not, though scholars can debate whether it might have laid the foundations for the return to growth in the 1980s. What is clear is that whatever programme Jamaicans would have opted for, it would have been painful. The same is likely to be the case today.

Sources: The Jamaican People, George L. Beckford, Norman Girvan, Louis Lindsay and Witter Michael. Pathways to Progress: The People's Plan for Socialist Transformation, Jamaica, 1977-78 Morant Bay, Jamaica, W.I.: Maroon Publishing House, 1985; and Evans, Trevor, Carlos Castro and Jennifer Jones (1995). *Structural Adjustment in Central America and the Caribbean.* Managua: CRIES

CONCLUSION

The country faces significant gaps in its external and fiscal accounts. With limited credit options given the current international economic environment, economic restructuring is an imperative for sustainable recovery. To this end, the IMF offers a viable solution, one that will not only address the immediate problems affecting the country but could possibly provide the right backing needed to address Jamaica's longstanding structural problems. The IMF has abandoned loan conditionality as we once knew it. Moreover, it now expects the borrowing country to devise its own broad strategy, which it will then approve. So while the pain of adjustment cannot be escaped, the International Monetary Fund does appear to be a more friendly partner than it once seemed.

The Caribbean Policy Research Institute (CaPRI) is an independent think tank affiliated to the University of the West Indies (Mona).

This Background Brief series is undertaken with the financial support of the Government of Canada provided through the Canadian International Development Agency (CIDA).