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UNITED STATES INTERNATIONAL DEVELOPMENT COOPERATION AGENCY
AGENCY FOR INTERNATIONAL DEVELOPMENT
Washington, D. C. 20523

JAMAICA

PROJECT PAPER

PRODUCTION & EMPLOYMENT V

AID LAC/P-235

Loan Number:532-K-601
Project Number:532-0100

CLASSIFICATION: UNCLASSIFIED

AID 1120-1

PAAD	AGENCY FOR INTERNATIONAL DEVELOPMENT PROGRAM ASSISTANCE APPROVAL DOCUMENT	1. PAAD NO. 532-K-601 532-0100 2. COUNTRY JAMAICA 3. CATEGORY Cash Transfer 4. DATE July 30, 1985

5. TO: A/AID, M. Peter McPherson	6. OYB CHANGE NO.
7. FROM AA/LAC, Malcolm Butler, Acting MB	8. OYB INCREASE TO BE TAKEN FROM: Economic Support Fund
9. APPROVAL REQUESTED FOR COMMITMENT OF: $ 34,500,000	10. APPROPRIATION LES5-85-35532-KG-31 ($11 million) LESA-85-35532-KG-31 ($4.5 million)

11. TYPE FUNDING	12. LOCAL CURRENCY ARRANGEMENT	13. ESTIMATED DELIVERY PERIOD	14. TRANSACTION ELIGIBILITY DATE
☐ LOAN ☒ GRANT	☒ INFORMAL ☐ FORMAL ☐ NONE	FY 1985	

15. COMMODITIES FINANCED

16. PERMITTED SOURCE	17. ESTIMATED SOURCE
U.S. only:	U.S.: US$34,500,000
Limited F.W.:	Industrialized Countries:
Free World:	Local:
Cash: US$34,500,000	Other:

18. SUMMARY DESCRIPTION

This amendment to the on-going Production and Employment V loan will provide an additional US$34.5 million grant from Economic Support Funds. The purpose of the loan is to provide immediate balance of payments support to assist the Government of Jamaica in its economic recovery program and to encourage the GOJ to proceed with efforts to remove restrictions on the economy which hinder longer term development. An amount of dollars equivalent to the dollar amount of the grant will be made available to the private sector for the importation of spare parts, capital goods and industrial and agricultural inputs from the US within one year of disbursement. Further, the GOJ will deposit the local currency equivalent of US$34.5 million in a special account for use on high priority development efforts of the GOJ.

The grant will be disbursed in two tranches. In addition to satisfying the standard conditions precedent involving the submission of a legal opinion, the designation of authorized representatives and a financing request, the GOJ will agree to fulfill the following CPs prior to the first disbursement of

(continued on page I)

19. CLEARANCES		DATE
LAC/DR:DBJohnson		7/29/85
LAC/CAR:MDagata		7/29/85
LAC/DR:WWheeler		7/29/85
GC:HFry		7/30/85
PPC/EA:CJoel		7/30/85
AA/PPC:RDerham		7/30/85

20. ACTION

☒ APPROVED ☐ DISAPPROVED

AUTHORIZED SIGNATURE — DATE July 31 1985

TITLE

M/FM/CONT:CChristensen

ARA/ECP:RBeckham

CLASSIFICATION: UNCLASSIFIED

US$20,000,000: (1) To agree to develop and implement a program of investment promotion emphasizing simplification and acceleration of the investment approval process and (2) Resolve in a manner satisfactory to AID, outstanding covenants under prior ESF agreements. (See Annex I attached, "Memorandum of Conversation . . . . " for specific issues involved).

Conditions precedent to subsequent disbursement of US$14,500,000 will be:

(1) Completion of review of case studies of efficacy of investment approval process;

(2) Development of a plan for modification of elements of economic policy that deter investment;

(3) Adoption of agreed amendments to investment approval process; and

(4) Submission of a timed plan to rationalize the structure and regulation of the coffee sector.

The GOJ will also agree to several special covenants pertaining to:

(1) Divestment of public enterprises;

(2) Development of a timed plan for rationalization of the structure and regulation of markets for agricultural commodities that are controlled by Commodity Boards;

(3) Development of a plan for institutionalization of an Internatinal Investment Promotion Program;

(4) Publication of an official "Investors Guide"; and

(5) Inauguration of the Investment Promotion Program.

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Introduction and Background

The purpose of the proposed amendment to the FY 1985 ESF agreement with the Government of Jamaica is to provide an additional $34.5 million of Balance of Payments support. Disbursement is planned in two or more tranches. The first tranche of $20 million is required by the GOJ by July 15, 1985. Subsequent tranches will be disbursed following satisfaction by the GOJ of conditions precedent, the details of which are under negotiation. However, the full $34.5 million is to be disbursed by September 30, 1985. In the Mission's FY 1985/86 Action Plan, approved in May 1985, an economic analysis was presented which showed the strong adverse effect on the Jamaican economy of the severe contraction of the bauxite/alumina sector. In that document a supplemental FY 1985 ESF grant of $65 million was proposed to mitigate the contractionary effects of this unexpected exogenous shock. The Mission has subsequently been informed that $34.5 million has been identified that can be made available. Of this amount $30 million represents new ESF funds and $4.5 million will be shifted from ESF funds in support of the Technical Consultation and Training Grant project to Cash Transfer.

As was observed in the Action Plan, a foreign exchange gap of approximately $125 million would have to be filled to hold the expected reduction in real GDP for JFY 1985/86 below 2 percent. Most observers expect the decline to be in the neighborhood of 4 percent if a Paris Club rescheduling can be concluded this summer, and an additional $30 million of ESF assistance is forthcoming during US fiscal year 1985. Thus the increment proposed in this PAAD will soften the impact of adverse external conditions, but it is not likely to prevent a significant contraction in production and employment.

No plausible extrapolation of Jamaica's balance of payments experience over the past four years would suggest an infusion of foreign exchange of sufficient magnitude to compensate for the loss of foreign exchange earnings that will be occasioned by the bauxite/alumina contraction. A substantial devaluation of the Jamaican dollar over the past year, combined with improved access to US markets through the CBI has created a strong incentive to export. However, production is constrained by the lack of foreign exchange for imported inputs and the relatively stringent credit restrictions being employed to restrain demand. Thus the only realistic hope for an extraordinary stimulus to economic activity is a strong surge of foreign investment, particularly in the export sector, and market efficient import substitution. As noted above, a favorable exchange rate and duty free access to US markets constitute important incentives. Nevertheless, in order to attract increased investment it will be necessary to address other conditions important to investment decisions.

Certainly there is no guarantee that a strategy focused on linked foreign investment and export promotion will succeed in preventing a major economic contraction. However, the potential consequences of such a downturn on the social, economic and political stability of the country are great, and the alternative strategies much less promising. Consequently the country team believes it a political and economic imperative to put forth every possible effort to incite extraordinary results.

Accordingly, we propose as the central theme of this supplemental ESF agreement, a major GOJ program to promote and attract private foreign and domestic investment and production in the tradeable goods sectors. To this end we propose only three conditions of assistance, each of which is related directly to the objective of attracting foreign exchange. The conditions will carry specific provisions with respect to investment promotion, export promotion and divestment of public enterprises.

Analysis of Jamaican Economic Conditions.

A. Progress Toward Achievement of the Economic Objectives of the Seaga Government

Over the past four years, Jamaican economic policy has been significantly transformed. The pace of the transformation has been erratic and, from our perspective, has often seemed inordinately slow. Nor is the transformation complete, as several important economic policy elements are not yet in place. Owing most importantly to adverse external economic conditions over which Jamaica has little or no control, the key measures of overall economic performance--unemployment, price inflation, real per capita income--show no palpable improvement over 1980. Undeniably, the slow pace of policy reform has left the economy more vulnerable to external shocks than it would be if the policy reform program had been completed. Market efficient import substitution and export expansion, for example, have been made more profitable by exchange rate movements. However, production for these markets remains obstructed by government regulation of export marketing and supplies of certain critical imported inputs.

Nevertheless, comparing present economic policy not only with what we hope it will become, but with what it was in 1980, the progress that has been made is fully as striking as the changes needed to complete the transformation.

A detailed narrative on the policy changes that have been adopted in support of stabilization and structural adjustment would be too lengthy to serve the purpose at hand. However, the Table below, taken from the IBRD's "Jamaica: Economic Situation and Public Investment" (April 1985), presents a summary review of the policy reform program. While there is room for debate as to the critical acuity of the IBRD summary, there can be no doubt that the Government has made almost unprecedented progress toward the policy environment the GOJ endorsed in the program outlined in Ministry Paper 9 of 1981.

Policy Area	Development Issues	Policy Reform to Date	Issues to be Addressed
Foreign Exchange Allocation System	The exchange rate had previously been maintained at an overvalued rate, leading to noncompetitiveness of exports, excessive demand and the need to allocate foreign exchange by administrative means.	A two-tier exchange rate system was introduced in January 1983. This was replaced in November 1983 by a unified rate which is determined at twice-weekly foreign exchange auctions. Under the auction system, the rate has moved from J$3.15=US$1.0 to over J$5.0=US$1.00 at end of 1984.	Government should continue to ensure the maintenance of a competitive exchange rate.
Trade Regime	The system of quantitative restrictions and import licensing had led to excessive levels of protection for manufacturing industry in particular, and to an over-administered system for allocating import licenses.	A program to remove all QRs over a five year period was adopted in 1982. In addition the licencing system has been simplified, and is now limited primarily to imports of consumer goods.	The liberalization program should be continued. Upon completion of a comparative advantage and incentives study, a new tariff structure should be installed to provide a reasonable degree of protection to domestic industry, and encourage exports.
Central Government Savings	The Central Government's overall deficit was running at 14-17% of GDP until 1984-85.	In FY 1984/85, the overall deficit was reduced to 7.8% of GDP. In addition a tax reform program has been put in place to render the system more efficient and to adapt it to give more incentives to effort and savings.	The Government should continue to reduce the overall deficit to a substainable level, probably about 4% of GDP. Given the high level of taxation and low level of capital expenditure, efforts should be concentrated on reducing current expenditure and transfers.
Public Enterprises Savings	Most enterprises have been either making losses or only marginal contributions to savings. This has been primarily due to inappropriate pricing and inadequate management. In addition, there are too many enterprises involved in activities which could be carried out by the private sector.	Management audits have been carried out for the main enterprises, and pricing policies have been extensively revised. Financial targets and monitoring systems have been developed. A list of enterprises targeted for divestment has been drawn up.	Efforts must continue to ensure that substantial current savings are generated by the enterprises and that individual enterprises' action programs are carried out. The divestment program, which has to date had few positive results, must be pursued vigorously.

olicy Area	Development Issues	Policy Reform to Date	Issues to be Addressed
ublic Investment	The public sector investment program (PSIP) had grown rapidly, but with few controls, little monitoring, no clear decision process, and without integration with the capital budget.	A three-year rolling PSIP has been developed at a more appropriate level. A monitoring system has been developed, and a formal decision making process is in place. Much progress has been made in this area.	Efforts to continue to integrate the PSIP process with the budget process. Continued improvements in appraisal techniques and approval procedures will also be needed as will efforts to make the monitoring system more relevant.
rivate Investment	Most sources of long-term capital had disappeared. The approval process for private investment had become very cumbersome.	The Government established the National Development Bank (NDB) and the Agricultural Credit Bank (ACB) as apex institutions chanelling long term resources through commercial banks.	Having established itself on the marketplace the NDB should now streamline its procedures so as to improve efficiency and the speed of response. While JNIP seems to have done a good job, it should continue efforts to improve coordination with other Government institutions.
nterest Rates, rivate Savings, and Monetary Policy	Interest rates have proved very "sticky" in nominal terms. While generally freely fixed, certain rates are determined centrally. Taxation on savings was high.	Time deposits over one year were made tax-free. The overall level of rates has been raised as part of a tight money policy. Liquidity ratios have been raised from 36% to 44%.	Yields on different forms of savings should be treated more equally in the Government's ongoing tax reform program. The Bank of Jamaica should phase out liquidity ratios and rely on base money management, and, at the same time, reduce the level of the Government's overdraft facility.
ousing Finance	Housing finance is dominated by public institutions. The National Housing Trust (NHT) is financed by a 5% payroll tax, The Jamaica	Few substantial changes on housing finance policy have been enacted.	The Government should urgently consider closing the JMB and foster a private secondary mortgage market. With the high

Policy Area	Development Issue	Policy Reform to Date	Issues to be Addressed
	Mortgage Bank (JMB) has not effectively provided a secondary mortgage facility, and is technically bankrupt. A ceiling on private mortgage lending rates has been maintained below average interest rate levels.		unemployment rate, an alternative way to fund NHT should be identified. The mortgage interest rate ceiling should be removed to permit building societies to compete for savings.
Money and Capital Markets	Most Jamaican companies have very high debt/equity ratios. The stock exchange has been very limited in operations. Corporate taxes are very high and dividends are double-taxed. The money market is very thin, and the main paper that exists is 90 day treasury Bills and 10 year local registered stock.	Little attention has been paid to this area to date.	To encourage the development of an equities market, Government should give tax breaks to new public companies and remove the double-taxing of dividends. The Stock Exchange should be widened in membership. As an initial boost to the money market, Government should broaden the range of its financial instruments. A state deposit insurance scheme should be and financial institutions' supervision should be strengthened.
Export Incentives	The system of protection combined with an overvalued exchange rate led to anti-export bias, and a low level of nontraditional exports outside the regional market.	In addition to liberalization and devaluation, some explicit incentives have been introduced. Under the two-tier exchange rate regimes, non-traditional exporters received a preferential rate. A scheme to rebate raw materials import duties to exporters has been designed.	As an interim measure, the tax rebate scheme should be introduced urgently. Upon completion of the comparative advantage study, the new tariff system should provide for exporters to operate on a free trade basis. Attention should also be given to the allocation of credit for exporters. Most important however, will be the maintenance of a competitive exchange rate.

olicy Area	Development Issue	Policy Reform to Date	Issues to be Addressed
arketing and echnical Assistance to Exporters	This has long been an area of effort by successive Governments. These efforts have sometimes been unfocussed and inadequately funded, and have frequently been concentrated in public institutions.	Action programs to promote individual exports have been developed, with major success in the garments area. More recently, Government has established a Technical Assistance Fund for exporters to finance individual companies' activities.	While these efforts should continue, attention should also be paid to the further rationalization and coordination of the various public institutions in this sector.
auxite and Alumina	Since the imposition of the bauxite levy in 1974, and the oil crises of the 1970s, Jamaica has become uncompetitive in bauxite/alumina production, which has fallen from 15 million tons in 1976 to under 8 milllion tons in 1983 and 1984. In 1985, the industry is in deep crisis, with production likely to be not more than 5.5 million tons. Alumina production is dependent on imported oil.	The bauxite levy was restructured in 1984 to encourage higher production, and the devaluation has lowered local costs.	The deepening crisis in this industry calls for urgent review by Government. Discussions should be held with the companies to find out what can be done to save the industry, including changes in the levy, and shared coal conversion costs. Efforts to negotiate barter deals also deserve to continue.
urism	Tourists arrivals stagnated in the 1970s, and little new construction took place. Profit levels fell with the overvalued exchange rate, and infrastructure became run down.	A vigorous promotion campaign and a better international image has led to a rapid increase in arrivals. Profitability has been restored and some rehabilitation has taken place, particularly in hotels previously operated by the Government's National Hotels and Properties, and now leased to the private sector. The tourism sector has been the brightest spot.	Disturbances in Jamaica in January 1985 led to the first setbacks since 1980 for the industry, but should soon be forgotten. The promotion campaign should continue, and JNIP should focus attention on the search for new investors in tourism, since capacity constraints are beginning to emerge.
xternal Marketing rganizations for gricultural Exports	The EMOs (for coffee, cocoa, citrus and pimento) have subsidized inefficient non-markteting activities through low producer prices made possible by their monopsony position. However, they have succeeded well in creating a special market for these exports.	Producer prices have been revised upwards. Non-marketing activities are being divested to the private sector. Private marketing of such crops is now permitted under certain conditions. Export-based pricing formulae are being developed.	The ongoing reform program should be completed, including early introduction of the pricing formulae. The deregulation of marketing should continue but with due regard to the maintenance of quality control, and protection of Jamaica's special export markets.

Policy Area	Development Issue	Policy Reform to Date	Issues to be Addressed.
Sugar	Sugar production has been gradually declining, productivity is very low, and very large public subsidies have been necessary.	Factories have been closed, management reorganized, and domestic prices raised. Despite major efforts, little progress was made. More recently, expert management has been contracted to run the industry, which has been further rationalized and a sugar rehabilitation program have been developed.	The new program to rescue sugar deserves support. However, Government will have to be strong in its support of the new management, and may have to face further hard decisions. Where appropriate, programs to utilize existing sugar lands for other crops should be devised.
Bananas	Bananas suffered a similar fate to sugar, although compounded by the effect of the 1980 hurricane. 1984 saw a record low level of banana production	The industry is in the process of a radical restructuring. New modern plantations are being developed, and most nonmarketing activities of the Banana Company have been divested.	While production is expected to rise, Government remains in firm control of the sector. Full deregulation should be pursued, including banana marketing, and the potential of the private exporters should not be ignored. After a few years, the new Government projects should be divested.
Nontraditional Agriculture	This is the one of only two sectors (together with Government) that showed positive growth in the 1970s. This was mostly through production for the local market rather than exports. However agricultural services are both expensive (in terms of public expenditure) and relatively uncoordinated.	The Government has launched the ambitious AGRO 21 program designed to continue import substitution and produce new export crops. In addition, some rationalization of credit delivery, extension services, and research has taken place.	These efforts are worthy of support and should be continued. The Ministry of Agriculture should be considered as the first candidate for action under the Administrative Reform Program. Further rationalization of research and extension services should continue. Specific diversification program will also continue to be needed.
Public Administration	The public service grew very rapidly in the 1970s. In particular, many parastatals were created to bypass the restrained civil service salary structure, which weakened Central Government. Financial and personnel control became inadequate.	An administrative reform program (ARP) has been launched, including senior civil services salary revisions, the introduction of performance (program) budgeting, and decentralized personnel policies. At the same time, the fiscal program has reduced the number of public employees.	This ambitious program should be pursued vigorously. In particular, efforts to raise senior salaries should continue despite fiscal problems. Given the need to reduce the deficit further, additional personnel cuts will be necessary, and the ARP should help to make this a more rational process.

Policy Area	Development Issues	Policy Actions to Date	Issues to be Addressed
Energy	Jamaica has virtually no energy resources, relying on imported oil for 98% of commercial energy requirements. Extensive efforts since 1974 have revealed no exploitable oil deposits, or economical sources of hydro power. Only peat deposits and small hydro schemes have proved possible. In addition, pricing policies for electricity and gasolene have at times been inappropriate.	Pricing policies have been revised to pass on the full costs of imported petroleum. An energy conservation program has been launched as part of a National Energy Plan. Further studies of peat, hydro and coal conversion have been carried out within a least cost power generation study. Oil exploration has continued unsuccessfully.	Energy options are limited for Jamaica. Coal conversion seems to be an option worthy of deeper study, and mini-hydro schemes deserve support. Peat development should be approached very cautiously. Some reorganization and improved coordination of public institutions is warranted.

Certainly most observers would agree that the number of accomplishments in implementing the Seaga Government's program has far exceeded the shortcomings. Unfortunately though, the ultimate objective of achieving a high and sustainable rate of economic growth, along with a distributional pattern that disseminates the benefits broadly across the community, can only be achieved when the full program is implemented and external conditions cooperate. Up to this point, external conditions have been singularly uncooperative. This has caused the Government to falter and hesitate in the implementation of some of the more difficult policy changes, and that in turn appears in retrospect to have worsened the impact of the adverse external conditions.

B. Strategy for 1985-1987

The next three years will be difficult. Modifications in priorities and in short term approaches will be necessary by all parties to Jamaica's development strategy. But the longer term objectives have not changed. In this paper USAID/Jamaica undertakes to set forth the part it proposes to play in adjusting to new economic exigencies that influence development prospects, while supporting the Government of Jamaica in fulfilling the program of economic transition upon which it embarked in 1981.

Under the circumstances, the Mission's strategy for the remainder of the present year and U.S. fiscal years 1986 and 1987 must depart from that set forth in the FY 1985 CDSS and its FY 1986 update. The objective of the amended ESF strategy for those years is: (a) to consolidate and defend the gains in structural adjustment and stabilization to date; and (b) to institutionalize an accelerated and intensified program of promotion of investment, and export production.

C. Macroeconomic Influences on USAID Strategy
-Revised Macroeconomic Outlook

In the wake of the shutdowns of Reynolds last year, Alcoa in February this year, and the near certain closure of Alpart later this year, the attention of the Government, the public and Jamaica's foreign assistance donors has naturally been focused on these disasters. However, it is important to recall that the economic prospects for Jamaica were precarious even before the closures. Balance of payments data in Table 1 below suggest the extent of the problem as it developed in 1984.

Export performance was expected at the beginning of 1984 to improve 38 percent for the year owing largely to an improved world market for bauxite and alumina. However, also anticipated were export earnings increases of 74 percent from bananas, 2 percent from sugar, 15 percent from non-traditional agriculture, 32 percent from other non-traditional exports, and 13 percent from tourism. As it turned out, none of these expectations were met. As the year progressed, it became painfully evident that the projections would not be realized, and successive export earnings estimates were scaled down.

Table 1

Balance of Payments Performance:
1983 and Estimates for 1984

	1983	1984 Estimates — Source and Date of Estimates: IBRD Jan.84	IBRD Oct.84	BOJ Mar.85	Shortfall from Jan. Estimates
		(Millions of US$)			
Merchandise Exports (fob)	685.7	949.2	803.9	783.7	210.5
Merchandise Imports (fob)	1281.1	1332.0	1241.7	1181.8	150.2
Trade Balance	-595.4	-382.8	-437.8	-443.1	- 60.3
Non Factor Services (Net)		310.3	340.5		
Total Services (Net)	121.5			4.7	46.1
Unrequited Transfers (Net)	101.5	162.0	162.0	127.0	-35.0
Current Account Balance	-375.4	-170.0	-215.8	-311.4	-141.4
Capital Accounts					
Public Capital (Net)	321.0	234.7	344.1	357.6	-122.9
Private Capital (Net) (Includes Errors and Omissions and Arrears)	-240.2	35.0	55.0	127.1	141.4
Capital Account Balance	80.8	269.7	399.1	484.7	-215.0
Change in Reserves (- indicates increase)	294.6	-99.7	-183.3	-173.3	- 73.6

1/ - indicates surplus over estimate

Imports were compressed but by less than the export deficit. Moreover, it is not obvious that the poorer than expected export performance, aside from bauxite/alumina, was attributable entirely--or even primarily--to the relatively low foreign exchange earnings. Regardless of the cause, it is clear that the financial resources available to Jamaica in 1984 were below expectations, and that conditions worsened during the year. Under the circumstances, the achievement of a US$260 million reduction in net international liabilities in JFY 1984/85 reflects a commendable discipline under difficult circumstances. The Embassy/AID team had, in September 1983, presented the argument in Washington that additional resources on the order of US$100 million would be required to prevent a reduction in real GDP in 1984. That reduction now seems clearly to have occurred. Thus the 1985 shock is superimposed on sluggish prior year performance that would have made 1985 a difficult year without further bauxite/alumina contractions.

Recent estimates have put the gross foreign exchange loss associated with the closure of Alcoa and Alpart at levels ranging up to US$215 million. After deducting the cost of imported inputs this would imply a net loss of $100 to $110 million which, it is assumed, would be absorbed by further compression of non-oil imports. Taking the estimated 1984/85 level of these imports as the base, this implies an import reduction of approximately 11 to 13 percent. Historically (1970 - 1983) the ratio of the geometric growth rate of non-oil imports to that of non-bauxite/alumina GDP is 1.00 to 0.11. Therefore, if this relation could be expected to hold on a yearly basis (which it does not)1/ a 13 percent reduction in non-oil imports would be expected to be associated with 1.4 percent contraction in non-bauxite/alumina GDP. Adding the bauxite alumina contraction, which represents approximately 3 percent of GDP, the total decline would be 4.4 percent of GDP. On a per capita basis the reduction would be 5.9 percent.

Prime Minister Seaga has announced the conclusion of an agreement that would reopen Alcoa on a break-even cash flow basis. If this arrangement yields the expected results, it will restore net foreign exchange earnings equivalent to local operating costs. Thus the foreign exchange loss from Alcoa's operations would drop by about US$12 million. This part of the drop in bauxite/alumina GDP would also be restored.

1/ In fact this ratio is quite variable on a year to year basis. Nevertheless, the signs of the trend values of the two variables are the same. Moreover, it is clear in theory that reductions in inputs induce a tendency to reduced output, although the lags of the relationship have not been formally evaluated.

Alpart's production in 1984 yielded approximately US$50 million in foreign exchange earnings for Jamaica. If Alpart's closure resulted in a US$50 million reduction in non-oil imports, the relationship cited above would imply an associated reduction in non-bauxite GDP of 0.67 percent. The bauxite component would reduce GDP by an additional 2 1/2 to 3 percent. Thus the combined effects would reduce GDP by something like 3 1/2 to 4 percent.

The same calculations for Alcoa imply an additional reduction of 1 3/4 to 2 percent, bringing the total effect of the two closures to the 5 to 6 percent range. If Alcoa reopens under the agreement outlined by Prime Minister Seaga, the GDP contractions would drop to a range of 3.8 to 4.8 percent, of which roughly 1 percent would be non-bauxite production. It is evident therefore that the reopening of the Alcoa facility will do very little to alleviate the aggregate economic outlook, although its impact on morale may be considerable.

This analysis also suggests that the implication of the Alcoa closure for 1985 performance is not significantly greater than that of the bad news of 1984 for that year. What distinguishes this year's shocks is that they follow on the heels of serious setbacks in 1984, and their combined impact will be substantially greater.

A conservative starting point for assessing productive capacity is the historical peak of actual performance. For Jamaica, the GDP peak occurred in 1973. In that year GDP reached J$1.73 billion, or J$878 per capita (US$965[1/]). From 1960 to 1973 real GDP increased at an annual rate of 4.6 percent. If, beginning in 1985/86, GDP advanced at an average annual rate of just 3.5 percent, it would take 5 years to regain the 1973 peak. If GDP declines 4 percent in the first year of that interval and rises 2 percent in the second year, then for the remaining 3 years an average real growth rate of 6.6 percent would have to be recorded in order to reach the 1973 GDP level by 1990.

Over the past 25 years, annual growth rates above 6 percent have occurred only three times,--1964, 1970, and 1972. In each of these years there were significant increases in export earnings and in imports. Interestingly, the trade balance also turned sharply more negative in each of these years reflecting the importance of external capital to the three episodes of rapid growth. Private unrequited transfers from abroad were positive in

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1/ This is below the U.S. dollar measure of per capita GDP in 1980. However the difference reflects the overvalued Jamaican dollar in 1980. In terms of Jamaican dollars of constant purchasing power <u>in Jamaica</u>, per capita GDP was 25 percent lower than in 1973.

each year while public transfers reflected net outflows. Long term capital flows were strongly positive and at historically high levels.

In preparing the program for the World Bank's SAL II, the Bank and the GOJ developed a scenario calling for significant changes in the sectoral distribution of GDP over the 1984-90 period. The overall growth of GDP was projected at an annual rate of 3.1 percent. The projections are presented in Table 2 below.

The change in the outlook for Jamaican bauxite and alumina requires adjustments in this scenario. In 1985, the bauxite and alumina contribution to GDP will fall by two-thirds. If we take that as a base from which to project the 1986 - 1990 bauxite contribution, and assume no growth for the remainder of the decade, then the average rate of "increase" for the full 1984 - 1990 period would be -13.5 percent.

Table 2
Projected Output Growth
1984 - 1990

	Avg. Annual % Change 1984 - 90	1983 Percent Share of GDP
Agriculture	3.9	7.8
Mining	6.9	6.1
Manufacturing	3.4	16.0
Construction	5.9	6.1
Government	0.6	19.4
Other	2.9	44.5
GDP	3.1	99.9

Data that have become available since the World Bank projections were prepared suggest that they were based on underestimates of 1984 bauxite performance as well as the overestimates of out year bauxite earnings. However, if current estimates of 1984 GDP by the GOJ as well as the principal donors are correct, the non-bauxite sectors performed significantly below the level required to meet even the average growth rate projected for the aggregate. If they had, GDP would have grown 3.3 percent in 1984. Most observers now believe that GDP registered no real growth in 1984, in spite of better than expected bauxite/alumina earnings.

If the non-bauxite sectors had performed up to expectations in 1984, and did so again in 1985, the closure in 1985 of Alpart and reduced earnings from Alcoa would not be expected to reduce GDP in this year by more than one percentage point. Moreover this calculation allows for reductions in production due to the reduced availability of foreign exchange to finance imported inputs.

Table 3 shows revised projections (by USAID) of GDP growth, by sectors, after taking into account the closure of Alpart and operation of Alcoa under the recently announced restructuring. In the lower half of the table are projections prepared by the GOJ. The two differ substantially in terms of both the aggregate growth rate (14.6 percent in 6 years estimated by USAID/J compared to 4.7 percent by the GOJ) and the sectoral performances. The USAID/J estimates anticipate positive growth in all sectors except mining and Government payroll. The GOJ estimates anticipate a continuing contraction in manufacturing and construction as well as mining, a negligible drop in the Government payroll share in GDP, and an exceptionally large increase in agriculture between now and JFY 1986/87. Under the present policy structure the GOJ estimates may not be unduly pessimistic for the aggregate. In a dramatically improved investment and export environment, the USAID/J estimates would, in our judgement, be attainable.

The USAID/J scenario represents average real growth to the end of the decade of only 2.25 percent per year. It reflects, therefore, a relatively modest achievement, and would defer regaining the 1973 peak level of GDP by at least a year, and possibly by 3 years. However, if 1985 is as bad as it could turn out to be, it would be difficult to achieve the rates set out for either of the two sub-periods. In all sectors other than Mining and Government, achievement of these hypothetical growth rates would be noteworthy. Without a strong infusion of external resources in fact, it would be unlikely that they would be realized.

Table 3
Projected Growth of GDP
by Sector
(USAID Estimates, April 1985)

	Avg. Annual Percentage Growth Rates 1984-87	1987-90	Percentage Growth In Output from 1984 to: 1987	1990	Percentage Shares of GDP 1984	1987	1990
Agriculture	5.0	5.0	15.8	34.0	7.6	8.5	9.1
Mining	-13.0	-13.0	-34.1	-57.4	6.7	4.1	2.5
Manufacturing	3.5	4.0	10.9	24.7	16.0	16.6	17.4
Construction	6.0	6.0	19.1	41.9	6.1	6.8	7.6
Government 1/	0	0	0	0	19.4	18.3	17.0
Other	3.0	3.0	9.3	19.4	44.4	45.6	46.4
GDP	2.2	2.3	6.6	14.6	100.2	99.9	100.0

(GOJ Estimates, May 1985)

	Avg. Annual Percentage Growth Rates 83/84-86/87	86/87-89/90	Percentage Growth In Output 1983/84 to: 86/87	89/90	Percentage Shares of GDP 83/84	86/87	89/90
Agriculture	7.6	1.8	24.9	32.3	7.9	10.3	10.0
Mining	-10.5	9.6	-34.0	-13.1	6.4	4.3	5.3
Manufacturing	-3.0	2.2	-9.2	-3.2	15.6	14.7	14.4
Construction	-8.8	7.6	-28.6	-11.0	6.1	4.5	5.2
Government 1/	-0.3	-0.3	-1.0	-1.5	18.9	19.4	17.8
GDP	-1.3	2.9	-3.8	4.7	100	100	100

1/ Includes compensation of employees only.

D. Assistance Requirements

The hypothetical resource requirements for this scenario are derived as follows:

	(A)	(B)	(C)	(D)	(E)	(F)
	Implied Import Level	Exports of Goods	Other Current A/C Sources (Net)	Estimated Capital Flows 1/	Debt Reduction 3/	Foreign Exchange Gap 2/ [A-B-C-D-E]
			(Millions of US$)			
1985	-1554	720	165	389	-53	333
1986	-1616	859	143	400	-50	266
1987	-1739	990	164	400	-50	235

1/ Presently programmed foreign assistance flows are included in this column, including those from AID, IMF, IBRD, IDB, UNDP, and other bilateral donors

2/ Does not include Paris Club and related debt rescheduling which, by World Bank estimates, could supply $209 million of the 1985 gap.

3/ Includes that portion of net foriegn debt entered as liabilities in the "net foreign assets", or "change in reserves", calculation

The following implications of this analysis are important to the interpretation of what happens if the gap is filled:

1. Overall GDP declines by a fraction of 1 percent in 1985, but the non-bauxite component increases by about 4 percent.

2. For every US$100 million of the gap that is not filled, non-bauxite GDP will rise by about 1 percentage point less in 1985.

3. In 1986 GDP growth becomes positive, reaching about 3 percent, and remains at that rate in 1987.

4. The gap becomes successively smaller after 1987, but can only vanish if there is a major acceleration of inflows of private capital.

Gap estimates involve implicit forecasts of the future which, for purposes of this analysis and most similar analyses, are made "informally" to use the most charitable characterization. Estimates of sectoral distributions of growth and contraction suffer still more from informality. Nevertheless, we submit the foregoing as our best estimate under the severe time and resource constraints under which it was prepared. In its qualitative dimension we are quite confident that it portrays accurately the key economic forces that can be discerned at this time. As it now appears, U.S. balance of payments assistance will be required, at levels well above currently approved planning levels, for the next three to five years.

The duration would be closer to three years if any combination of events would enable Jamaica to develop an international reputation as an "investment haven". As the remaining regulatory, bureaucratic, and structural obstructions are swept away and comprehensive tax reform is put in place, the odds of developing such a reputation will improve. At the present, however, the prospects of events of this psychological import are too nebulous to incorporate into projections.

Jamaica quite evidently has the capacity to absorb the full amount of the resources in the gaps we have estimated for 1985 - 1987, and could very probably absorb double those amounts when the structural adjustments are completed. We are proposing ESF assistance of double the amounts included in previous planning exercises for fiscal years 1986 and 1987, and a supplementary program of $34.5 million for fiscal year 1985. This would fill approximately one half of the $70 million gap that has been estimated for a scenario in which GDP declines by roughly 4 percent in JFY 1985/86.

Negotiating Strategy and Conditions of Assistance

The proposed supplement to the FY 1985 ESF program is part of the aggregate assistance package through FY 1987 as described in the Mission's Action Plan. Accordingly, the negotiating strategy for this grant anticipates and is an important link in our policy dialogue program for the full period. This program also was described in the Action Plan.

In the opening round of discussion with the GOJ on the supplement, the Mission identified these three areas as the subjects on which the conditions of assistance would be focused.

1. Investment Promotion

The perception persists that the Jamaican bureaucracy is a serious obstacle to investors. According to this perception the problem can be traced to two causes. First, the present regulations governing investment, and the associated bureaucratic structure, appear to be vestiges of the centrally planned economy toward which the previous government had moved.

This is reflected in the requirement for government review and approval of plans with respect to the technology to be employed, the pace of expansion of production capacity, product mix, source of raw materials, and location of operations. In a market directed economy these decisions would be governed by relative prices, rates of return, and costs except in clear cases in which an important public interest issue dictated regulation. Thus the application process itself suggests a government bias against private decision making in the economic realm.

The second cause of the perceived cumbersomeness of the bureaucratic procedures is that the investor must seek various approvals, licenses, and documents from multiple ministries. These requirements reportedly are not uniform and the basis for decisions as to which requirements apply to particular investors and for granting or witholding approval, are often discretionary. According to some anecdotal reports, responsibility for determining the exact steps in the process and for asking the right questions, resides ultimately with the investor himself, rather than with the investment promotion agency. Predictably, major last minute surprises often emerge under this system.

The Mission's information on the details of the procedures is imperfect, and efforts to obtain clear information have met with limited success. This suggests that a consistent, unambiguous procedure that is understood among Government agencies with responsibility for investment promotion, may not exist.

To deal with this problem we propose to ask the Government to agree to a collaborative study by the USG and the GOJ to determine the actual experience of foreign and Jamaican investors who have been through the process, and to compare their experience with published statements of the procedure. We will propose detailed case studies of foreign and domestic investors' efforts to win approval for investment projects. The cases will include investors who have gone forward with their projects as well as investors who have abandoned their efforts in Jamaica.

On the basis of the case studies recommendations will be advanced for simplifying the procedure, placing clear responsibility for shepherding proposals through the necessary bureaucratic procedures on a GOJ investment officer, and guaranteeing prompt consideration of and decisions on project proposals.

We intend to propose that, after a streamlined procedure has been agreed upon, the GOJ would publish a description of the procedure in a new Investors Guide. This publication would include an official Investment Policy Statement, and a brief description of the principal elements of public economic policy that relate to the operation of a private enterprise. These policy elements would include:

(a) Prices Policy
(b) Import Policy
(c) Labor and Wage Policy
(d) Tax Policy
(e) Foreign Exchange Policy
(f) Divestment Policy
(g) Investment Incentives Policy
(h) Export Marketing Policy

Each of these policy areas would be evaluated in the study process to determine its likely influence on investment decisions. Where modifications are indicated an action plan for their implementation will be developed.

Also included in the Investors Guide would be brief descriptions of Government projects and programs such as the Export Marketing and Promotion Project now in preparation for AID funding, the proposed crop diversification project and AGRO-21 projects. Eligibility requirements for participation will be clearly stated.

If, in the course of studying the investment promotion system, it becomes evident that an Investment Code would facilitate the attraction of investors, a plan for its preparation will be developed.

The Investment Guide is envisioned as a living document that can be revised and amended as conditions warrant. Thus it is not anticipated that its preparation would have to be deferred until the investment review and approval process is perfected. In fact we propose to advance in our initial negotiating position, the following schedule of performance pursuant to this conditon.

Element of Condition	Latest Completion Date
- Written agreement to undertake the study and preparation of the Investors Guide (in Memorandum of Understanding).	Prior to signing of ESF agreement
- Public announcement of Major Investment Promotion Effort Similar to Tourism Promotion Program	Concurrent with signing of agreement
- Completion of Case Studies and Agreement on Recommendations	September 15, 1985

- Plan for any agreed modifications of elements of economic policy important to investment promotion	September 15, 1985
- Adoption of agreed amendments of the investment approval process emphasizing speed and complicity	September 15, 1985
- Publication of Investors Guide	December 15, 1985
- Plan for Major International Investment Promotion Program	December 15, 1985
- Inauguration of Investment Promotion Program	December 31, 1985

2. Deregulation of Export Commodities

The agricultural commodity board system is likely to inhibit investors contemplating agricultural project investments. It also appears to inhibit a more robust development of export earnings from existing production capacity. Yet existing interests resist reform of this system ostensibly on national welfare grounds. Highly qualified outside experts, with no vested interest in the Jamaica situation, will be called upon to prepare for the Government an objective professional analysis of the present structure of each relevant market, and recommendations for changes in support of the goals of the Government's economic recovery strategy. Coffee would be our candidate for the first such effort.

(a) Coffee

The deregulation of coffee has lagged owing largely to strong negative representations made to Government by the Coffee Industry Board and certain private interests in this sector. An intensive dialogue has been in progress on this subject and it appears likely that the issue can now be satisfactorily resolved over the next two to three months. Accordingly we propose a covenant on this issue that will be a condition precedent to the second disbursement. This covenant will require that the GOJ develop a timed Action Plan for the implementation of changes in the structure and regulation of the coffee sector that are mutually agreed to be in the interest of Jamaican economic recovery, and announcement of the changes, before September 30, 1985 (i.e. prior to disbursement of the second tranche).

USAID/J will offer to fund an internationally prominent expert(s) in the area of coffee production and marketing to review present arrangements and recommend modifications designed to maximize export earnings from this sector.

(b) Other Agricultural Commodity Markets

Other commodity boards also continue to exercise restrictions on decisions of producers. In order to further the deregulation, particularly in areas having significant export earnings potential, we propose to include a covenant requiring a review of the structure of each of the crop markets controlled by commodity boards, and a timed plan for their rationalization consistent with the findings of the reviews and national economic recovery. The Action Plan will be developed with the assistance of consultants whose work USAID/J will offer to finance. It will be completed before disbursement of the second tranche. We propose to include in the covenant an understanding that no USFY 1986 ESF assistance will be negotiated until the plan has been implemented.

3. Divestment

Over the past few months the GOJ appears to have developed some degree of institutional momentum toward divestment of 38 public enterprises identified for divestment in previous ESF agreements. However, these enterprises with few exceptions, have little prospect for becoming viable economic entities. Their divestment will relieve the government of the fiscal burden associated with their ownership. However, their pecuniary value is slight, and disposition of the concerns or their assets is of little value in terms of encouraging investment in productive, employment generating activity. The more important enterprises from this perspective - National Commercial Bank, Air Jamaica, Jamaica Telephone Company, hotels, agricultural lands, for example - do not appear to have been aggressively targeted for divestment.

Given the urgency of acting promptly and decisively to identify new sources of financing and inducing private investment, it is our intention to intensify discussions of the more important enterprises. The context of the discussions will be their potential to attract private investment, and thereby permit GOJ funding of investment in critical infrastructure related to production of public goods of greater importance to the mass of the population. Portfolio switching of this type has the added advantage of permitting the GOJ to display greater responsiveness to the growing public demands for the Government to "do something" to relieve the deteriorating quality of life of the people, without exceeding the budgetary restrictions of the IMF agreement.

This issue of more agressive activity in the area of divestment is the subject of conditions or previous ESF agreements. However, progress has been disappointing. Consequently, our strategy is to use the leverage of a new agreement to tighten the performance, and to focus GOJ attention on the potential of this activity to address increasingly urgent social and political concerns as well as the more obviouis economic imperatives.

At the present time the Mission is awaiting an Aide Memoire from Governor Barber, stating the present status of the divestment program and plans for the immediate future. Consequently we have not yet formulated the exact terms of the condition to be proposed. Those will be developed in the next rounds of discussion and negotiation.

Local Currency Programming

In an April discussion with Acting Mission Director Dagata, Prime Minister Seaga stated that he would like to seek additional ESF assistance in order to finance redundancy (severance) payments for a large number of public sector employees. This purpose was sustained in subsequent discussions. The Mission also inquired of the visiting IMF team as to the implications of such additional funds for the performance targets of the IMF agreement. The tentative position of the IMF team was that the Government could use up to the equivalent of US$15 million to finance additional redundancy payments.

The local currency equivalent of approximately $20 million will be used to finnce redundancy payments for an estimated 12,000 employees. The remainder of the local currency fund will be used to finance other high priority development activities of the GOJ.

Annex 1

MEMORANDUM OF CONVERSATION

DATE: June 26, 1985

SUBJECT: Bi-Monthly meeting with GOJ pursuant to FY 1985 ESF Agreement; June 4, 1985

Participants: GOJ: Horace Barber (Presiding), Bank of Jamaica; Owen Jefferson, Bank of Jamaica; Winston Carr, Bank of Jamaica; Shirley Tyndall, Ministry of Finance; Clive Taylor, Bank of Jamaica; Asgar Ally, Bank of Jamaica; Headley Brown, Planning Institute of Jamaica.

USG: Martin Dagata, AID; Todd Stewart, Embassy; Matt Lorimer, Embassy; Julius Schlotthauer, AID; Samuel Skogstad, AID.

The agenda for this meeting was suggested in a letter from Mr. Dagata to Governor Barber, dated May 24, 1985. Governor Barber concurred in the agenda by telephone June 3, 1985.

The agenda items and a summary of the discussion are presented below in the order in which they were discussed.

1. Import Restrictions. The order removing most imports from administrative import restrictions was published as Ministry Paper 12 of April 13, 1985. It was noted by Mr. Dagata that a number of items had subsequently been placed back on the list of items requiring import licenses. Governor Barber expressed surprise at this and stated that he would consult the Minister of Industry and Commerce, Mr. Vaz, and the Prime Minister about the development, and communicate their response to Mr. Dagata by letter.

Mr. Stewart asked whether the action might not induce producers of other goods to seek a similar restoration of protection for them, (the Jamaica Manufacturers Association, for example). Governor Barber was embarrassed as well as surprised by the whole thing. He directed to Headley Brown the following question: "Does this mean we are going backward, to more and more protection?"

Dr. Brown stated that the restoration of licenses on some goods was consistent with the Government's intention of removing licensing and QR's by January 1986, when the "comparative advantage study", now in progress, is completed. He observed also that even given this action, the present state of import liberalization is ahead of schedule.

Mr. Dagata pointed out that Governor Barber's letter of March 26, 1985 stated that the liberalization of the import regime would be accelerated and was quite specific about what goods would not be removed from licensing and QR's. It was on the basis of that letter, not policy prior to the letter, that the final $20 million tranche of the FY 1985 ESF loan was disbursed. Governor Barber agreed to look into the matter and include his response in an Aide Memoire.

2. <u>Relaxation of Exchange Controls.</u> It was agreed that Asgar Ally, Clive Taylor, and Samuel Skogstad would resume meeting to develop a scope of work for the study of this issue. Governor Barber noted that most restrictions on repatriation of profits and original investment sums for foreign investors had already been removed. Mr. Stewart asked if we could have a written statement of the present regulations as this would be helpful in talking to US investors about investment in Jamaica. Mr. Stewart stated that we would publicize the information with the Commerce Department to help them to rebut a rather widely held view that Jamaica does not freely permit profit and original capital repatriation. Governor Barber agreed to provide the statement.

Dagata asked Governor Barber what the present official i ude toward foreign investment is. Governor Barber said the ad met with serious foreign investors. He said that US investors are mainly concerned about:

(1) Finding projects with a good 13-15 year outlook for earnings;

(2) Political stability; and

(3) Absence of red tape that hinders the process of repatriating profits.

Mr. Dagata stated the view that red tape during and before the consideration by Government of investment proposals, is a problem as well.

Governor Barber asked Headley Brown if he would put together a "flow chart" listing the sequence of steps required to win GOJ approval for an investment proposal. Dr. Brown opined that most delay in the process occurs because investors "don't know what they want to do, or want to do something that can't be done in Jamaica". He agreed, however, to put together such a chart for "the normal case".

Mr. Stewart asked if we could also have a copy of the rules of the game for the NRA.

3. <u>Price Controls</u>. Governor Barber agreed to send USAID a written progress report on price decontrol and provide monthly reports on prices decontrolled.

4. Deregulation of Coffee. Governor Barber stated that he was informed that lowland coffee has already been deregulated and that deregulation of Blue Mountain Coffee awaited a response from USAID to the Coffee Industry Board's proposal.

No member of the USG group had heard anything about lowland coffee having been deregulated. Governor Barber agreed to check further into the situation and get back to us.

5 and 6. Deregulation of Tractor Imports. Governor Barber agreed to get the document that accomplished deregulation of imports of tractors of 40 horsepower or more, and the advertisement of the deregulation, to USAID, along with a status report on disposition of the smaller, Italian tractors.

7. Private Participation in Ownership of NCB. Dr. Brown stated that PSOJ has completed a study of methods of opening NCB to private ownership participation through sale of shares of its stock. The study focuses on NCB and its subsidiaries alone, not on sale of shares of a holding company that would own NCB and other enterprises. However, his plan would work as well within the holding company context. Dr. Brown will soon forward the study to the appropriate Minister (Finance). After the Minister has received it, Governor Barber will call him about it in relation to the covenant.

8. Hotel Equity Examination. This study, due June 30, has been assigned to Dr. Brown (he thinks). No progress on this one could be reported. A program to decontrol fertilizer imports is also in Dr. Brown's hands and he expects it to be implemented by the June 30 deadline.

9. Financial Reports of Public Enterprises. The Government has, according to Governor Barber, issued instructions to public entities to file the required financial reports in a timely manner. A special GOJ unit has been established to receive the reports and monitor performance under this covenant. He will check on the progress to date in b·inging about compliance, and report his findings to USAID/J.

10. Investment Banking Firm Assistance. Two firms, Morgan Grenfell and Samuel Montagu have expressed interest in assisting the Government in examining avenues of privatization and divestment. Governor Barber was not sure what progress has been made on this issue but believes Morgan Grenfell will put together a report for NIBJ. He promised to have a report on the GOJ's examination of the subject ready for the next bi-monthly meeting.

11. <u>Export Marketing of Citrus</u>. Governor Barber reported that he has been informed by the Ministry of Agriculture that citrus export marketing has been deregulated. The only issues remaining are issues regarding production quotas and minimum production levels to qualify for deregulation. When asked if documentation is available showing the deregulation steps, he promised to look into the matter and report to us on his findings.

12. <u>Report on Performance Under Past ESF Covenants</u>. The assignment to prepare this report was given to the Ministry of Finance. Governor Barber asked Shirley Tyndall to find the status of this and report back tomorrow (June 7). Governor Barber will contact USAID/J on this after he has heard from Shirley Tyndall.

13. <u>Comprehensive Tax Reform Project</u>. Governor Barber reported that he has checked with the Revenue Board on access of the tax consultants to appropriate officials. The Board informed him there was no problem in this regard and the project is on track.

We reminded Governor Barber that, from the earliest discussions between USAID/J and the GOJ on this project (in 1982), passage of the Revenue Administration Bill, was understood to be an integral part of comprehensive tax reform.

Yet the bill still has not been passed. The legislation is required to bring the Income Tax Department under the control of the Revenue Board. Our understanding is that the consultants have been unable to begin actual work (as opposed to discussion) on income tax administration, because the Department does not believe any assistance is required. At present, the Revenue Board lacks legal power to order the Income Tax Commissioner to cooperate. Governor Barber stated that the Bill is now before parliament and is expected to be passed this month. He agreed to send us a written report on this matter and on each outstanding issue from ESF agreements.

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JUL 30 1985

ACTION MEMORANDUM FOR THE ADMINISTRATOR

THRU : AA/PPC, Richard Derham

FROM : A-AA/LAC, Malcolm Butler

SUBJECT: Jamaica Production and Employment V PAAD (532-0100)

Proposed Action: Approval of a grant amendment to the Production and Employment V loan agreement.

Background: The PAAD proposes an additional $34.5 million in ESF assistance to the Government of Jamaica (GOJ) as a grant amendment to the ongoing Production and Employment V (P&E V) loan. This program, which would total $99.5 million with the proposed amendment, is intended to provide balance of payments support to the GOJ and to assist the Government in continuing its economic stabilization program, removing restrictions on the economy which hinder long-term development, and promoting increased production and employment. While policy reforms have been implemented somewhat more slowly over the past four years than had been hoped for, significant progress has been made: a competitive exchange rate system has been introduced, a program to remove all quantitative restrictions and price controls adopted, and the overall fiscal deficit reduced. The present P&E V loan agreement contains covenants which have promoted these reforms, and the proposed amendment incorporates additional covenants to build upon the progress achieved under the ongoing program.

In spite of these policy reforms, the Jamaican economy has experienced a lack of growth over the past five years, due in large part to the severely depressed conditions in the world market for bauxite and alumina, which has resulted in the recent shutdown of two alumina plants. The GDP is expected to decline by 4% in Jamaica Fiscal Year [JFY] 1985/86. A modest decline of about 1% is anticipated in JFY 1986/87. Still, additional balance of payments support to the Government will be needed as it continues its program of economic reform.

The GOJ will make available $34.5 million for the import of U.S. goods and inputs, and will also deposit the local currency equivalent of this amount in a special account. Approximately $20 million from this account will be used to finance redundancy (severance) payments, part of the GOB's program to reduce the public payroll and increase public sector savings. The remainder of the local currency fund will be used to finance other priority development activities of the GOB.

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Discussion: In planning the implementation of its IMF program, the Government of Jamaica had counted on a disbursement of $20 million from AID in time to meet the July 31 targets for net international reserves and arrearages. Very recent estimates indicate that the GOJ is some $10 to $15 million shy of meeting those targets at this point. Failure to meet the targets would seriously damage Jamaica's prospects for success in its stabilization effort. It is very important that the USG come through with the promised assistance, which it publicly pledged to Jamaica at the recent Consultative Group meetings.

The LAC Bureau's DAEC reviewed and approved the PAAD on July 12, 1985. Minor modifications were subsequently made to the PAAD as agreed at the review. These modifications slightly changed the Mission's proposed conditionality. Two disbursements were recommended. Conditionality for the first tranche of $20 million was the resolution of outstanding covenants under prior ESF agreements and an agreement to develop a program that would expedite the investment approval process. The conditions precedent to disbursement of the second tranche of $14.5 million would have required: (1) completion of case studies of the investment approval process; (2) development of a plan to modify investment policies; (3) amendment of the investment approval process; and (4) submission of a plan to rationalize the operation of the coffee [illegible].

At the time the PAAD was reviewed, LAC expected to forward it for your approval in a few days. However, it has taken longer than expected to find a financing source for the grant. A total of $15.5 million has now been found -- $4.5 million from another project in the Jamaica OYB, and $11 million of ESF deobligated from the Syria program. This is expected to enable the GOJ to barely meet the IMF targets. However, there are only three days left until the July 31 test date. If we are to provide the promised assistance, there will not be time to negotiate and review compliance with the planned substantive CPs discussed above. Accordingly, immediate disbursement of the funds available in a single tranche is recommended, without the planned conditions. The substance of the above CPs has been incorporated into covenants in the Agreement, and specific dates established for GOJ compliance. This arrangement will permit the covenants to be converted into CPs in a future amendment, if additional funds are found and obligated under this PAAD. The wording of the covenants has been changed from the wording in the revised PAAD to make it consistent with a draft agreement proposed by the Mission, which had already been discussed with the GOJ. The substance is essentially the same. The wording changes were cabled to the Mission on July 29 to give them time to discuss a draft agreement with the

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GOJ. A copy of that cable is attached (TAB A). Your signature on the attached cable (TAB B) advises the Mission that the PAAD is approved, and that it is authorized to sign an agreement with the Government of Jamaica which incorporates the wording previously cabled.

Recommendation: That you approve the proposed PAAD amendment (TAB C), which authorizes an increase of $34.5 million in grant funds for the Jamaica Production and Employment V balance of payments program; and authorize the attached cable (TAB B) which (1) advises the Mission that it may sign an agreement for $15.5 million, and (2) amends the PAAD by deleting Conditions Precedent to Disbursement of these funds and establishing new wording for the covenants to be included in the agreement.

Approved: Marshall Brown

Disapproved: ______________

Date: July 31, 1985

Attachments: TAB A - Cable on changes in draft agreement.
TAB B - Proposed Outgoing Cable
TAB C - PAAD Amendment

Clearances:
AA/PPC:RDerham ______ Date ______
GC:HMFry ______ Date 7/30/85
~~PPC/PDPR:ARosenberg~~ ______ Date ______
PPC/EA:CJoel ______ Date 7/30/85

Draft:LAC/DR:MJune/EZallman:632-0246:1179N:cmj

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AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON D.C. 20523

JUL 30 1985

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FROM : A-AA/LAC, Malcolm Butler

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In spite of these policy reforms, the Jamaican economy has experienced a lack of growth over the past five years, due in large part to the severely depressed conditions in the world market for bauxite and alumina, which has resulted in the recent shutdown of two alumina plants. The GDP is expected to decline by 4% in Jamaica Fiscal Year [JFY] 1985/86. A modest decline of about 1% is anticipated in JFY 1986/87. Still, additional balance of payments support to the Government will be needed as it continues its program of economic reform.

The GOJ will make available $34.5 million for the import of U.S. goods and inputs, and will also deposit the local currency equivalent of this amount in a special account. Approximately $20 million from this account will be used to finance redundancy (severance) payments, part of the GOB's program to reduce the public payroll and increase public sector savings. The remainder of the local currency fund will be used to finance other priority development activities of the GOB.

<u>Discussion:</u> In planning the implementation of its IMF program, the Government of Jamaica had counted on a disbursement of $20 million from AID in time to meet the July 31 targets for net international reserves and arrearages. Very recent estimates indicate that the GOJ is some $10 to $15 million shy of meeting those targets at this point. Failure to meet the targets would seriously damage Jamaica's prospects for success in its stabilization effort. It is very important that the USG come through with the promised assistance, which it publicly pledged to Jamaica at the recent Consultative Group meetings.

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Approved: Marshall Brown

Disapproved: ______________

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AA/PPC:RDerham ______ Date ______
GC:HMFry ______ Date 7/30/85
~~PPC/PDPR:ARosenberg~~ ______ Date ______
PPC/EA:CJoel ______ Date 7/30/85

Draft:LAC/DR:MJune/EZallman:632-0246:1179N:cmj

CLASSIFICATION: UNCLASSIFIED

AID 1120-1

PAAD

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROGRAM ASSISTANCE APPROVAL DOCUMENT

1. PAAD NO.: 532-K-601 532-0100
2. COUNTRY: JAMAICA
3. CATEGORY: Cash Transfer
4. DATE: July 30, 1985
5. OYB CHANGE NO.:
6. OYB INCREASE:

TO BE TAKEN FROM: Economic Support Fund

7. TO: A/AID, M. Peter McPherson

7. FROM: AA/LAC, Malcom Butler, Acting

8. APPROVAL REQUESTED FOR COMMITMENT OF: $ 34,500,000

10. APPROPRIATION: LES5-85-35532-KG-31 ($11 million)
LESA-85-35532-KG-31 ($4.5 million)

11. TYPE FUNDING: ☐ LOAN ☒ GRANT

12. LOCAL CURRENCY ARRANGEMENT: ☒ INFORMAL ☐ FORMAL ☐ NONE

13. ESTIMATED DELIVERY PERIOD: FY 1985

14. TRANSACTION ELIGIBILITY DATE:

15. COMMODITIES FINANCED:

16. PERMITTED SOURCE	17. ESTIMATED SOURCE
U.S. only:	U.S.: US$34,500,000
Limited F.W.:	Industrialized Countries:
Free World:	Local:
Cash: US$34,500,000	Other:

18. SUMMARY DESCRIPTION

This amendment to the on-going Production and Employment V loan will provide an additional US$34.5 million grant from Economic Support Funds. The purpose of the loan is to provide immediate balance of payments support to assist the Government of Jamaica in its economic recovery program and to encourage the GOJ to proceed with efforts to remove restrictions on the economy which hinder longer term development. An amount of dollars equivalent to the dollar amount of the grant will be made available to the private sector for the importation of spare parts, capital goods and industrial and agricultural inputs from the US within one year of disbursement. Further, the GOJ will deposit the local currency equivalent of US$34.5 million in a special account for use on high priority development efforts of the GOJ.

The grant will be disbursed in two tranches. In addition to satisfying the standard conditions precedent involving the submission of a legal opinion, the designation of authorized representatives and a financing request, the GOJ will agree to fulfill the following CPs prior to the first disbursement of

(continued on page 1)

19. CLEARANCES	DATE
LAC/DR:DBJohnson	7/29/85
LAC/CAR:MDagata	7/29/85
LAC/DR:WWheeler	7/29/85
GC:HFry	7/30/85
PPC/EA:CJoel	7/30/85
AA/PPC:RDerham	7/30/85

M/FM/CONT:CChristensen

ARA/ECP:RBeckham

20. ACTION: ☒ APPROVED ☐ DISAPPROVED

AUTHORIZED SIGNATURE — DATE: July 31 1985

TITLE

CLASSIFICATION: UNCLASSIFIED

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