

RDKAY 287

AID 1120-1 PAAD	AGENCY FOR INTERNATIONAL DEVELOPMENT PROGRAM ASSISTANCE APPROVAL DOCUMENT	1. PAAD NO. 532-0111
		2. COUNTRY Jamaica
		3. CATEGORY Cash Transfer
		4. DATE December 13, 1985
5. TO: A/AID, M. Peter McPherson	6. OVS CHANGE NO.	
7. FROM AA/LAC, Dwight Ink	8. OVS INCREASE	
9. APPROVAL REQUESTED FOR COMMITMENT OF: \$ 70,000,000		10. TO BE TAKEN FROM: Economic Support Fund
11. TYPE FUNDING <input type="checkbox"/> LOAN <input checked="" type="checkbox"/> GRANT	12. LOCAL CURRENCY ARRANGEMENT <input checked="" type="checkbox"/> INFORMAL <input type="checkbox"/> FORMAL <input type="checkbox"/> NONE	13. ESTIMATED DELIVERY PERIOD FY 86
19. COMMODITIES FINANCED		14. TRANSACTION CURRENCY & DATE

16. PERMITTED SOURCE U.S. only: Limited F.W.: Free World: Cash: \$70,000,000	17. ESTIMATED SOURCE U.S.: \$70,000,000 Industrialized Countries: Local: Other:
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18. SUMMARY DESCRIPTION

Production and Employment VI will provide an additional \$70 million grant from Economic Support Funds. The purpose of the grant 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 U.S. within one year of disbursement. Further, the GOJ will deposit the local currency equivalent of U.S. \$70 million in a special account for use on high priority development efforts of the GOJ.

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TO SECSTATE WASHDC IMMEDIATE 3473

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AIDAC, JOINT STATE/AID MESSAGE

STATE FOR AID/LAC

E.O. 12356: W/A
TAGS: EFIN, EAID, ECON, JM
SUBJECT: PROGRAM ASSISTANCE APPROVAL DOCUMENT (PAAD)
FOR FY 86 ESF GRANT TO JAMAICA

1. PAAD FACE SHEET, BLOCK 18: PRODUCTION AND EMPLOYMENT VI WILL PROVIDE AN ADDITIONAL U.S. DOLS 70 MILLION GRANT FROM ECONOMIC SUPPORT FUNDS. THE PURPOSE OF THE GRANT 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 U.S. WITHIN ONE YEAR OF DISBURSEMENT. FURTHER, THE GOJ WILL DEPOSIT THE LOCAL CURRENCY EQUIVALENT OF U.S. DOLS 70.0 MILLION IN A SPECIAL ACCOUNT FOR USE ON HIGH PRIORITY DEVELOPMENT EFFORTS OF THE GOJ.

2. 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 ALSO COVENANT TO UNDERTAKE THE NECESSARY STEPS TO FACILITATE THE TIMELY PASSAGE OF ENABLING LEGISLATION CONSISTENT WITH THE OBJECTIVES OF THE BOARD OF REVENUE ASSISTANCE PROJECT.

TEXT OF PAAD FOLLOWS.
PROGRAM ASSISTANCE APPROVAL DOCUMENT

I N D E X

- I. INTRODUCTION AND SUMMARY
- II. ANALYSIS OF JAMAICAN ECONOMIC CONDITIONS
 - A. THE ECONOMIC BACKGROUND
 - B. THE PRESENT SITUATION: HARD TIMES AND A "FRESH LOOK"
 - C. USAID STRATEGY FOR 1986 - 1987
- III. CONCLUSION
- APPENDIX I. FURTHER MACROECONOMIC INFLUENCES ON USAID STRATEGY
 - A. THE BALANCE OF PAYMENTS
 - B. PUBLIC FINANCES

I. INTRODUCTION AND SUMMARY

3. THIS PAAD PROPOSES AND JUSTIFIES U.S. DOLS 70 MILLION IN FY 1986 ESF ASSISTANCE FOR JAMAICA IN SUPPORT OF ITS EFFORTS TO RECOVER FROM OVER A DECADE OF DOWNWARD DRIFT IN REAL INCOME INITIATED IN THE NINETEEN SEVENTIES BY THE SHOCK OF PETROLEUM PRICE INCREASES AND PRODUCTION INHIBITING POLICY RESPONSES, AND REINFORCED IN THE NINETEEN EIGHTIES BY THE NEAR COLLAPSE OF ITS MAJOR EXPORT INDUSTRY (BAUXITE/ALUMINA). THE DOLS 70 MILLION FOR FY 1986 IS OVER AND ABOVE THE DOLS 19 MILLION OF ESF ASSISTANCE PROMISED FOR FY 1985 BUT NOT DELIVERED UNTIL OCTOBER, 1986, AND CHARGED TO THE CURRENT YEAR'S APPROPRIATION. ADDITIONAL RESOURCES WILL MOST PROBABLY BE REQUIRED LATER IN THIS FISCAL YEAR.

4. 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. THE NET CONTRIBUTION OF THE BAUXITE/ALUMINA SECTOR TO THE BALANCE OF PAYMENTS IN 1984 WAS ABOUT U.S. DOLS 220 MILLION AND IS EXPECTED TO FALL TO HALF THIS SUM IN 1985 AND EVEN LESS IN 1986.

5. FOR FY 1985/86, GDP IS EXPECTED TO FALL BY 3 TO 5 PERCENT. TO RESTRAIN THE CONTRACTION EVEN TO THIS RATE HOWEVER, ADDITIONAL RESOURCES IN THE RANGE OF DOLS 80 TO DOLS 100 MILLION WILL HAVE TO BE IDENTIFIED.

6. USAID PROPOSES TO USE ITS ESF RESOURCES TO HELP JAMAICA:

-- STAY IN ACCORD WITH THE IMF PROGRAM AND

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E.O. 12356: N/A

TAGS: EFIN, EAID, ECON, JH

SUBJECT: PROGRAM ASSISTANCE APPROVAL DOCUMENT (PAAD)

- MEET ITS OBLIGATION TO CREDITORS ;

- -- MINIMIZE POLITICAL AND SOCIAL TENSIONS WHICH
- WOULD RESULT FROM MORE SEVERE ADJUSTMENT
- MEASURES;

- -- CONSOLIDATE, DEFEND, AND CONTINUE THE
- SIGNIFICANT PROGRESS MADE IN POLICY REFORMS
- AS A PART OF THE STRUCTURAL ADJUSTMENT AND
- STABILIZATION PROGRAM;

- -- SHOW U.S. SUPPORT FOR DIFFICULT BUT IMPORTANT
- STRUCTURAL ADJUSTMENTS IN GENERAL AID, IN THE
- PRESENT JAMAICAN FISCAL YEAR, THE
- IMPLEMENTATION OF THE GOJ'S INCOME TAX
- REFORM PROPOSAL IN PARTICULAR.

7. SO IMPORTANT IS THE LATTER ELEMENT TO THE
STRUCTURAL ADJUSTMENT OF THE JAMAICAN ECONOMY THAT IT
ALONE IS SUFFICIENT TO JUSTIFY THE SUPPORT OFFERED
THROUGH THE FY 1986 ESF GRANT.

8. JAMAICA FAILED, IN SEPTEMBER, TO MEET THREE
CLOSELY INTERRELATED TESTS OF THE NINE QUANTITATIVE
PERFORMANCE TARGETS OF ITS STAND-BY AGREEMENT WITH
THE IMF. ACCORDING TO GOJ CALCULATIONS, NET
INTERNATIONAL RESERVES (NIR) WERE SHORT AND NET
DOMESTIC ASSETS (NDA) WERE IN EXCESS OF THEIR
RESPECTIVE TARGET LEVELS BY THE EQUIVALENT OF U.S.
DOLS 23.6 MILLION. FOREIGN DEBT PAYMENT ARREARS WERE
U.S. DOLS 1.7 MILLION ABOVE THE TARGET LEVEL OF ZERO.
MOST OF THE MODEST MARGINS BY WHICH NET NIR AND NDA
MISSED THEIR TARGETS IS ACCOUNTED FOR BY THE INABILITY
OF A.I.D. TO FIND THE FINAL DOLS 19 MILLION OF THE
DOLS 30 MILLION SUPPLEMENTAL FY 85 ESF GRANT THAT THE
UNITED STATES PLEDGED AT THE CARIBBEAN GROUP MEETING
LAST SUMMER. AFTER ADJUSTMENT FOR THAT SHORTFALL OF
RESOURCE INFLOWS, THE ACTUAL NDA LEVEL WAS 0.7 PERCENT
ABOVE THE TARGET CEILING AND THE ACTUAL NIR MEASURE
WAS 0.8 PERCENT BELOW THE TARGET FLOOR. AS A RESULT,
THE GOJ WAS UNABLE TO MAKE A DOLS 13 MILLION DRAWING
IN OCTOBER.

9. IN ORDER TO KEEP THE STAND-BY ALIVE, AND HOPEFULLY
BE ABLE TO MAKE THE OCTOBER DRAWING, THE GOJ IS
SEEKING A TECHNICAL WAIVER. DISCUSSIONS ARE BEING
HELD WITH THE IMF ON THE ENTIRE RANGE OF QUALITATIVE
AS WELL AS QUANTITATIVE ELEMENTS OF THE PROGRAM AS SET
FORTH IN THE LETTER OF INTENT SUBMITTED BY THE GOJ AS

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PART OF ITS REQUEST FOR THE STAND-BY PROGRAM. SUCH
DISCUSSIONS HAVE BEEN TAKING PLACE IN WASHINGTON AND
KINGSTON AND ARE EXPECTED TO CONTINUE THROUGH DECEMBER
IN ANTICIPATION OF AN IMF BOARD MEETING ON THE WAIVER
IN MID JANUARY, 1986. SECURING THE WAIVER IS CRUCIAL
BECAUSE THE GOJ MUST BE IN COMPLIANCE WITH THE IMF
PROGRAM WHEN THE SEMI-ANNUAL COMMERCIAL BANKER'S GROUP
MEETS ON JANUARY 15, 1986, OR IT FACES SUBSTANTIAL
PENALTY INTEREST SURCHARGES.

10. WHEN NEWS OF THE IMF TEST PROBLEM CIRCULATED, AND
ALSO BECAUSE OF THE TYPICAL WIDER SEASONAL DIVERGENCE
BETWEEN NORMAL FOREIGN EXCHANGE SUPPLY AND DEMAND, THE
JAMAICAN DOLLAR FELL PRECIPITOUSLY AGAINST THE U.S.
DOLLAR. THE PRICE OF THE U.S. DOLLAR ROSE FROM DOLS
5.95 IN THE LAST AUCTION IN SEPTEMBER TO DOLS 6.40 ON
OCTOBER 24. IN JUST LESS THAN ONE MONTH THE PRICE OF
U.S. DOLLARS HAD INCREASED IN ALMOST THE SAME
PROPORTION AS IN THE PREVIOUS SIX MONTHS. AT PRICES
ABOVE 7 DOLS 6.00 EQUAL US DOLS 1.00, SIZEABLE
INCREASES IN THE LOCAL PRICES OF PETROLEUM PRODUCTS
AND IMPORTED BASIC FOODS WOULD BE TRIGGERED ACCORDING
TO AGREEMENTS WITH THE IMF AND IBRD.

11. WITH THE 1985/86 TOURIST SEASON CLOSE AT HAND, AND
WITH BITTER MEMORIES OF THE WIDELY PUBLICIZED STREET
DEMONSTRATIONS THAT HAD ERUPTED FOLLOWING THE JANUARY,
1985 GASOLINE PRICE INCREASE, PRIME MINISTER SEAGA'S
GOVERNMENT MADE THE POLITICAL JUDGMENT THAT INCREASES
IN THESE SENSITIVE PRICES WERE CATEGORICALLY
UNACCEPTABLE. (SERIOUS DAMAGE TO THE TOURIST
INDUSTRY, WHICH EARNED U.S. DOLS 362.0 MILLION IN NET
FOREIGN EXCHANGE IN 1984/85, WOULD INFLICT YET FURTHER
DAMAGE ON THE ECONOMY.) ACTING ON THIS JUDGEMENT,

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SEAGA ORDERED THE BANK OF JAMAICA TO PUT EXTRA FUNDS INTO THE AUCTION (PART OF THE FUNDS USED FOR THIS PURPOSE WERE DIVERTED FROM SCHEDULED DEBT PAYMENTS, INCLUDING AMOUNTS DUE TO THE IMF. PROCEEDS FROM THE SALE OF FOREIGN REAL ESTATE OWNED BY THE GOJ WERE ALSO PARTIALLY ALLOCATED TO THE FOREIGN EXCHANGE AUCTION). FUNDS AVAILABLE TO THE AUCTION HAD BEEN AVERAGING U.S. DOLS 2.5 TO DOLS 3.0 MILLION. ON OCTOBER 29 THE AUCTION FUND WAS U.S. DOLS 8.0 MILLION AND ON OCTOBER 31, U.S. DOLS 6 MILLION WERE SUPPLIED. THESE WERE FOLLOWED IN SUCCESSION BY SUPPLY LEVELS OF DOLS 5 MILLION, DOLS 3.5 MILLION, DOLS 6.0 MILLION AND DOLS 4.0 MILLION. THE BACKLOG OF DEMAND WAS CLEARED OUT AND THE RATE FELL QUICKLY TO J DOLS 5.50 EQUALS U.S. DOLS 1.00 AND HAS REMAINED THERE FOR THE PAST FIVE AUCTIONS. SEAGA HAS DECLARED PUBLICLY THAT J DOLS 5.50 IS A PRICE THAT MAKES JAMAICAN EXPORTS COMPETITIVE AND JAMAICAN LABOR COSTS ATTRACTIVE TO INVESTORS, AND THAT HE INTENDS TO HOLD THE PRICE AT THAT LEVEL. MOST OBSERVERS AGREE THAT COMPETITIVENESS IS ACHIEVED AT J DOLS 5.50, ALTHOUGH THE DEMAND IS STILL HIGH FOR U.S. DOLLARS.

12. SIMULTANEOUSLY WITH HIS INTERVENTIONS IN THE AUCTION, SEAGA ACKNOWLEDGED THAT THIS COURSE IS NOT IN KEEPING WITH THE TERMS OF THE IMF STAND-BY AGREEMENT. TO DEAL WITH THIS HE WROTE TO THE MANAGING DIRECTOR OF THE IMF PROPOSING THAT THE THREE PRINCIPAL DONORS, IMF, IBRD, AND A.I.D., SEND A JOINT, HIGH LEVEL TEAM TO JAMAICA TO REVIEW THE ECONOMIC SITUATION AND TAKE A "FRESH LOOK" AT THE KIND OF POLICY PROGRAM THAT WOULD BE APPROPRIATE FOR A COUNTRY IN JAMAICA'S CIRCUMSTANCES. HIS POSTURE HAS BEEN BOLD AND AGGRESSIVE, AND HE HAS STATED PUBLICLY THAT IMF-TYPE PROGRAMS HAVE NO SUCCESSFUL TRACK RECORD AND ARE LONG OVERDUE FOR SOME RE-THINKING. SEAGA'S MOVE CAN ESSENTIALLY BE INTERPRETED AS FORCING THE IMF TO REVIEW ITS PRESENT NEGATIVE EFFECT ON THE BALANCE OF PAYMENTS: SCHEDULED REPAYMENTS TO THE FUND TOTAL U.S. DOLS 97.0 MILLION IN JFY 85/86 AND U.S. DOLS 123.7 MILLION IN 1986/87, WHILE POTENTIAL STAND-BY DRAWINGS ARE ONLY U.S. DOLS 77.5 MILLION AND U.S. DOLS 58.3 MILLION RESPECTIVELY. WHAT SEAGA WANTS IS A LESS UNFAVORABLE REPAYMENT SCHEDULE AND EASIER TERMS (CONDITIONALITY) FOR MAKING THE DRAWINGS.

13. SEAGA'S PUBLIC POSITION SHOULD NOT BE TAKEN AS A STATEMENT THAT HE HAS ABANDONED THE PRINCIPLES OF

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DISCIPLINED MONETARY AND FISCAL MANAGEMENT AND SERIOUS STRUCTURAL REFORM. RATHER, HE HAS EMPHASIZED THE IMPORTANCE OF FLEXIBILITY TO ADJUST THE PACE OF POLICY AND STRUCTURAL REFORM TO EXTERNAL ECONOMIC CONDITIONS THAT PLAY A DOMINANT ROLE IN THE LOCAL ECONOMY BUT ARE BEYOND THE COUNTRY'S CONTROL.

14. EVIDENCE OF HIS COMMITMENT TO THE ORIGINAL OBJECTIVES OF HIS ECONOMIC RECOVERY PROGRAM IS ABUNDANT. TWO CURRENT ACTIVITIES ARE PARTICULARLY STRIKING. FIRST, HIS COMPREHENSIVE TAX REFORM PROGRAM IS NOW EXPECTED TO BECOME LAW BY THE END OF JANUARY, 1986. SECOND, HIS TECHNICIANS ARE WORKING OUT WITH THE IMF A PROGRAM TO ASSURE THAT IMPORT DEMAND IS SUFFICIENTLY COMPRESSED THROUGH MONETARY POLICY IF ADDITIONAL RESOURCES ARE NOT FORTHCOMING. THIS WILL COMPENSATE FOR THE POTENTIAL EXCESS DEMAND ASSOCIATED WITH HIS NEW POLICY STANCE WITH RESPECT TO THE EXCHANGE RATE AND BASIC COMMODITY PRICES. HE IS ALSO MOVING STEADILY FORWARD IN THE AREAS OF INVESTMENT PROMOTION, DEREGULATION, AND RESPONSIBLE FISCAL MANAGEMENT. THE "FRESH LOOK", THEREFORE, IS NOT PERCEIVED BY SEAGA AS A SEARCH FOR A LESS OPEN OR LESS DISCIPLINED ECONOMIC SYSTEM, BUT FOR A POLICY SET THAT CAN PURSUE THOSE GOALS WITHOUT IN THE PROCESS INCITING SOCIO-POLITICAL RESPONSES THAT RENDER THE WHOLE PROCESS COUNTERPRODUCTIVE.

15. SEAGA'S "FRESH LOOK", HOWEVER IT IS FLESHED OUT BY THE IMF/IBRD/AID TEAM, WILL HAVE TO BE A CAREFUL BALANCING ACT. ON ONE SIDE IS THE PRECIPICE OF POLITICAL DISCONTENT THAT COULD DISRUPT THE TOURIST INDUSTRY AS WELL AS FOREIGN INVESTMENT. ON THE OTHER SIDE IS THE EQUALLY DANGEROUS PRECIPICE OF RUPTURE WITH THE FUND AND A CASCADE OF DEBT DEFAULT.

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E.O. 12356: N/A
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11. ANALYSIS OF CURRENT JAMAICAN ECONOMIC CONDITIONS

A. THE ECONOMIC BACKGROUND

16. OVER THE PAST FIVE YEARS, THE JAMAICAN ECONOMY HAS UNDERGONE SOME OF THE MOST WRENCHING STRUCTURAL AND POLICY CHANGES EVER UNDERTAKEN BY A DEMOCRATICALLY ELECTED GOVERNMENT IN SO LITTLE TIME. UPON ASSUMING OFFICE, PRIME MINISTER SEAGA TOOK THE HELM OF AN ECONOMIC SYSTEM THAT, HAD BEEN TURNED IN THE DIRECTION OF A CENTRALLY PLANNED, SOCIALIST MODEL. IN THE PROCESS OF TAKING THAT DIRECTION, PARTICULARLY AT A TIME WHEN THE OIL PRICE INCREASES WERE ADMINISTERING A SEVERE SHOCK TO THE ECONOMIC SYSTEM, THE JAMAICAN ECONOMY HAD SUFFERED A 25 PERCENT REDUCTION IN PER CAPITA INCOME IN A LITTLE LESS THAN A DECADE, HAD SEEN UNEMPLOYMENT JUMP TO 28 PERCENT, HAD EXPERIENCED A HEMORRHAGE OF HUMAN AND FINANCIAL CAPITAL, AND WAS PLAGUED WITH SHORTAGES OF GOODS AND SERVICES AND RAMPANT INFLATION. THE JAMAICAN CURRENCY HAD BECOME SERIOUSLY OVER-VALUED WHILE PEGGED AT J DOLS 1.78 TO THE U.S. DOLLAR, WHILE ITS VALUE IN JAMAICAN GOODS AND SERVICES WAS RAPIDLY ERODED BY PRICE INFLATION AND "PRINTING PRESS" FINANCING OF A BLOATED PUBLIC SECTOR PAYROLL. THE MACROECONOMIC CONSEQUENCE OF THE POLICY SET THAT WAS IN PLACE WHEN SEAGA TOOK OFFICE WAS THAT PRODUCTIVE INVESTMENT AND EMPLOYMENT, SAVING, AND EXPORTS WERE SUBJECT TO SEVERE DISINCENTIVES, WHILE EXCESSIVE CONSUMPTION AND IMPORTS WERE REINFORCED BY PROFLIGATE MONETARY AND FISCAL MANAGEMENT.

17. AGAINST THIS BACKGROUND THE SEAGA GOVERNMENT EMBARKED UPON AN ECONOMIC RECOVERY PROGRAM, THE FIRST TASK OF WHICH WAS TO ARREST THE RAPID CONTRACTION OF REAL PRODUCTION AND LIKEWISE THE EQUALLY RAPID EXPANSION OF AGGREGATE DEMAND. FOLLOWING THE EXPECTED STABILIZATION OF THE ECONOMY WOULD COME THE LONGER TERM AND MORE DIFFICULT CHANGES REQUIRED TO INDUCE NOT ONLY INCREASES IN REAL PRODUCTION, BUT SIGNIFICANT CHANGES IN ITS COMPOSITION. PRODUCTION FOR EXPORT WAS EXPECTED TO RESPOND TO THE CORRECTION OF POLICIES THAT PENALIZED EXPORTS AND SUBSIDIZED BOTH IMPORTS AND PRODUCTION FOR LOCAL MARKETS. PRIVATE INVESTORS WERE EXPECTED TO RESPOND POSITIVELY TO THE SHIFT TO A POLICY ENVIRONMENT MORE HOSPITABLE TO THE PRIVATE SECTOR. INCREASED PRODUCTIVE ACTIVITY IN THE PRIVATE SECTOR WAS EXPECTED TO CREATE JOBS THAT COULD ABSORB

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UNEMPLOYED WORKERS AND WORKERS RELEASED FROM THE GOVERNMENT PAYROLL.

18. MULTILATERAL AND BILATERAL DONORS--MOST IMPORTANTLY THE IMF, IBRD, AND A.I.D.--PROVIDED FINANCIAL AND TECHNICAL SUPPORT FOR THE PROGRAM, SO THAT THE ADJUSTMENTS COULD BE PHASED IN SMOOTHLY. THROUGH THIS SUPPORT, FOREIGN EXCHANGE WOULD BE AVAILABLE TO ACQUIRE THE RAW MATERIALS AND CAPITAL GOODS NEEDED TO EXPAND PRODUCTION, AS WELL AS CONSUMER GOODS TO RE-STOCK EMPTY SHELVES. THE DONORS, IN EFFECT, AGREED TO LEND AGAINST THE INCOME EXPECTED TO BE GENERATED FROM A SUCCESSFUL ECONOMIC RECOVERY PROGRAM.

19. IN SPITE OF THE APPEAL OF THE MEDIUM AND LONG TERM OUTCOME AS DESCRIBED ABOVE, IT WAS RECOGNIZED BY THE GOVERNMENT OF JAMAICA (GOJ) AND THE DONORS ALIKE THAT THE SUCCESS OF THE PROGRAM WOULD DEPEND ON THE ABILITY AND WILLINGNESS OF THE JAMAICAN PEOPLE TO ACCEPT SOME PAINFUL CHANGES. PRICES OF IMPORTED GOODS HAD BEEN HELD ARTIFICIALLY LOW BY A COMBINATION OF AN OVER-VALUED EXCHANGE RATE AND GOVERNMENT IMPOSED DOMESTIC PRICE CONTROLS. THIS ENCOURAGED OVER-CONSUMPTION AND EXCESSIVE USE OF SCARCE FOREIGN EXCHANGE, AND CLEARLY COULD NOT BE SUSTAINED INDEFINITELY. MANY INEFFICIENT LOCAL INDUSTRIES HAD BEEN PROTECTED AGAINST EXTERNAL AND DOMESTIC COMPETITION, AND WERE BENEFICIARIES OF COST SUBSIDIES VIA THE OVER-VALUED JAMAICAN CURRENCY. THESE WOULD HAVE TO ADJUST AND MAKE THEMSELVES MORE EFFICIENT, OR FAIL. THE DESIRED EXPANSION OF THE RELATIVE ROLE OF THE PRIVATE SECTOR IN THE ECONOMY WOULD REQUIRE THAT A LARGER SHARE OF TOTAL RESOURCES BE CHANNELLED TO THAT SECTOR. THIS WOULD REQUIRE TRIMMING THE PUBLIC SECTOR'S SHARE THROUGH REDUCTIONS IN GOVERNMENT

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EXPENDITURES, PROJECTS, AND EMPLOYMENT.

20. IN THE SCENARIO AGREED TO BY THE GOJ AND THE DONORS, THESE CHANGES WOULD BE ENACTED IN AN ENVIRONMENT OF EXPANDING REAL OUTPUT AND RESOURCE AVAILABILITY. CONSEQUENTLY, WHILE THEY WOULD NECESSARILY INVOLVE POCKETS OF HARDSHIP, THESE WOULD BE EASED BY THE GROWTH IN THE ABSOLUTE SIZE OF THE ECONOMIC PIE.

21. AS IS NOW WELL UNDERSTOOD, THE ORIGINAL SCENARIO TURNED OUT TO BE UNOULY OPTIMISTIC. FIRST, A ROBUST RECOVERY OF THE WORLD MARKET FOR BAUXITE AND ALUMINA WAS ANTICIPATED IN THE ORIGINAL PROGRAM--INDEED IT WAS THE KEYSTONE OF THE PLAN. THIS DID NOT OCCUR. ON THE CONTRARY, BAUXITE AND ALUMINA HAS VIRTUALLY COLLAPSED AS JAMAICA'S KEY FOREIGN EXCHANGE EARNER. THIS SHORTFALL OF FOREIGN EXCHANGE INFLOWS HAS HAD AN IMPACT ACROSS ALL SECTORS OF THE ECONOMY DUE TO THE RELIANCE OF VIRTUALLY EVERY SECTOR ON IMPORTED INPUTS. THE SCENARIO HAS CHANGED FROM ONE IN WHICH THE VARIOUS SECTORS WERE VYING IN HEALTHY COMPETITION FOR BIGGER SLICES OF A GROWING PIE, TO ONE IN WHICH EACH SECTOR IS DESPERATELY SCRAMBLING TO SURVIVE IN THE FACE OF INCREASING RESOURCE REQUIREMENTS AND DECLINING RESOURCE AVAILABILITY. THUS THE PAIN ASSOCIATED WITH CHANGES IN THE STRUCTURE OF ECONOMIC ACTIVITY IS MADE MORE SEVERE BY A REDUCTION IN THE ABSOLUTE LEVEL OF ACTIVITY. EACH SECTOR, INCLUDING THE PUBLIC SECTOR, HAS RESISTED VIGOROUSLY THE ENSUING PRESSURE TO REDUCE ITS CLAIMS AGAINST INCREASINGLY SCARCE RESOURCES. PROJECTS AND PROGRAMS THE VIABILITY OF WHICH DEPENDED ON THE EXPANDING ECONOMY SCENARIO, WERE NOT TRIMMED AS RAPIDLY AS RESOURCE AVAILABILITY CONTRACTED.

22. IN SPITE OF THE DRASTIC DIFFERENCE BETWEEN THE ACTUAL ECONOMIC ENVIRONMENT DURING THE SEAGA GOVERNMENT'S TENURE AND THE ENVIRONMENT ORIGINALLY ANTICIPATED, THE REQUIRED STRUCTURAL ADJUSTMENTS ARE THE SAME. IN CERTAIN AREAS, THE SEAGA GOVERNMENT DRAGGED ITS FEET AND, UNDOUBTEDLY, SHIFTED AN INORDINATE SHARE OF THE BURDEN ONTO THE PRIVATE PRODUCTIVE SECTORS. DIVERSIFICATION WAS NOT AGGRESSIVELY PURSUED AS A SOURCE OF FUNDING FOR NEEDED INFRASTRUCTURE IMPROVEMENTS. THE OVER-VALUATION OF THE JAMAICAN DOLLAR CONTINUED TOO LONG AS THE GOJ

RESISTED THE INEVITABLE DEVALUATIONS DICTATED BY MARKET FORCES. PUBLIC EXPENDITURES WERE TOO SLOW TO BE REDUCED. NEVERTHELESS, WHILE THE OPTIMUM PACE AND PATTERN OF ADJUSTMENTS IS ALWAYS OPEN TO DEBATE, THERE CAN BE NO DOUBT THAT THE PROFILE OF ECONOMIC POLICY HAS CHANGED RADICALLY AND IN THE DIRECTIONS ESTABLISHED AS APPROPRIATE BY THE GOJ AND THE DONORS AT THE OUTSET OF THE ECONOMIC RECOVERY PROGRAM. CRITICAL ELEMENTS OF THE ADJUSTMENTS ARE AS FOLLOWS:

(1) EXCHANGE RATE. THE FIXED EXCHANGE RATE REGIME HAS BEEN ABOLISHED AND THE RATE IS NOW ESTABLISHED AT TWICE-WEEKLY AUCTIONS CONDUCTED BY THE BANK OF JAMAICA. THE LOCAL CURRENCY PRICE OF ONE US DOLLAR HAS INCREASED 209 PERCENT, FROM J DOLS 1.78 IN NOVEMBER 1980 TO J DOLS 5.50 IN NOVEMBER 1985. WHILE THE GOJ IS TRYING TO STABILIZE THE RATE AT THE VERY COMPETITIVE RATE OF J DOLS 5.50, THE CONTINUING EXISTENCE OF THE AUCTION SYSTEM MEANS THAT TO DO SO IT MUST PUT IN ENOUGH DOLLARS TO EFFECTIVELY SATISFY DEMAND. THUS IT STILL RETAINS AN IMPORTANT ROLE.

(2) GOVERNMENT FINANCE. THE OVERALL GOVERNMENT BUDGET DEFICIT HAS DECLINED FROM 17 PERCENT OF GDP IN JAMAICAN FISCAL YEAR 1980/81 TO 7 PERCENT IN 1984/85. A FURTHER REDUCTION IS ON TRACK FOR 1985/86. BANK FINANCING OF THE DEFICIT IN 1984/85 WAS NIL COMPARED TO 59 PERCENT IN 1980/81.

(3) PUBLIC SECTOR PAYROLL. THE PUBLIC SECTOR PAYROLL REACHED A PEAK THAT HAS BEEN ESTIMATED AS HIGH AS 133,800 WORKERS IN 1980. THIS HAS BEEN REDUCED SIGNIFICANTLY

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AIOAC, JOINT STATE/AID MESSAGE

STATE FOR AIO/LAC

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AND, IN THE PRESENT FISCAL YEAR ALONE, THE
GOVERNMENT ESTIMATES THAT 7,000 ADDITIONAL
PUBLIC SECTOR JOBS WILL BE ELIMINATED.

(4) PRICE CONTROLS. IN 1980, 60 ITEMS WERE
SUBJECT TO GOVERNMENT PRICE CONTROLS. BY
NOVEMBER 1985 THE NUMBER OF ITEMS SUBJECT TO
PRICE CONTROLS HAD BEEN REDUCED TO 3,
ALTHOUGH PERCENTAGE MARK-UPS ON KEY
COMMODITIES ARE STILL REGULATED. THE
PRICE OF GASOLINE HAS RISEN 263 PERCENT FROM
J DOLS 3 PER GALLON IN 1982 TO J DOLS 10.90
AT PRESENT. THE COST OF A MARKET BASKET OF
BASIC FOODS CONSUMED BY LOW INCOME FAMILIES
(J DOLS 50 PER WEEK OR LESS) IN DECEMBER
1980, INCREASED FROM J DOLS 20 TO J DOLS 47
FROM DECEMBER, 1980, TO AUGUST, 1985.

(5) QUANTITATIVE IMPORT RESTRICTIONS. IN
1980 ALL IMPORTS REQUIRED LICENSES, AND 364
TARIFF ITEMS WERE SUBJECT TO QUANTITATIVE
LIMITS. IN NOVEMBER, 1985, ALL BUT 76 ITEMS
STILL SUBJECT TO EXPLICIT QUANTITATIVE
RESTRICTIONS WERE REMOVED AND ONLY 160 ITEMS
REMAINED SUBJECT TO LICENSING. MANY OF THESE
WERE ITEMS SUCH AS FERTILIZERS, EXPLOSIVES,
AND PHARMACEUTICAL PRODUCTS.

(6) AGRICULTURAL COMMODITY BOARDS. BANANAS,
SUGAR, COFFEE, CITRUS, PIMENTO, CACAO, AND
COCONUTS HAVE TRADITIONALLY BEEN GROWN AND
MARKETED UNDER RIGID REGULATION BY GOVERNMENT
CONTROLLED COMMODITY BOARDS. THE FIRST FOUR
HAVE BEEN SUBSTANTIALLY DECONTROLLED COMPARED
TO THEIR SITUATION FOUR YEARS AGO. FURTHER
REGULATORY REFORMS ARE NEEDED AND ARE UNDER
REVIEW. NEVERTHELESS, THE STEPS THAT HAVE
BEEN TAKEN ARE SIGNIFICANT AND ARE REFLECTED
IN POSITIVE IMPROVEMENTS IN COST AND EARNINGS
PERFORMANCE. FOR EXAMPLE, BANANA PRODUCTION
FOR EXPORT IS RECOVERING RAPIDLY. SUGAR
ACREAGE IS BEING REDUCED IN FAVOR OF WINTER
VEGETABLES AND OTHER EXPORTS UNDER THE AEGIS
OF AGRO 21. PLANTINGS OF COFFEE HAVE
INCREASED SUBSTANTIALLY. NEW EXPORT MARKETS
HAVE BEEN FOUND FOR JAMAICAN CITRUS.

(7) DIVESTMENT OF STATE ENTERPRISES. EARLY
IN THE SEAGA GOVERNMENT'S ECONOMIC RECOVERY
PROGRAM, THE GOVERNMENT BEGAN TO SHED THE
THE OPERATION OF ESSENTIALLY COMMERCIAL
ENTERPRISES, PARTICULARLY TOURIST
FACILITIES. WHILE LEASES AND MANAGEMENT
CONTRACTS WERE MORE OFTEN EMPLOYED THAN
OUTRIGHT SALE, THESE ENTITIES WERE BROUGHT
UNDER THE DISCIPLINE OF MARKET FORCES
AND THE NECESSITY TO FUNCTION AS PROFIT
SEEKING BUSINESSES. AFTER A SUBSEQUENT
PERIOD OF RELATIVE INACTIVITY, THE DIVESTMENT
(OR AS THE GOJ PREFERS, THE "PRIVATIZATION")
ACTIVITY HAS BEEN REVITALIZED. TEN
ENTERPRISES HAVE BEEN DIVESTED SINCE 1984,
ELEVEN MORE ARE IN THE NEGOTIATION STAGE FOR
DIVESTMENT, AND TWENTY-ONE MORE ARE HAVING
THEIR FINANCIAL STATUS REVIEWED AND BROUGHT
UP TO DATE FOR EARLY DIVESTMENT. A RECENT
PROPOSAL BY PRIME MINISTER SEAGA TO PLACE
ALL OTHER STATE OWNED ENTERPRISES INTO A
HOLDING COMPANY WHOSE EQUITY SHARES WOULD IN
TURN BE OFFERED TO THE PUBLIC, IS NOW BEING
FORMALLY EVALUATED. IT IS NOT, IN OUR VIEW,
PROMISING, AND WE DOUBT THAT THE FEASIBILITY
STUDY WILL SUPPORT THE CONCEPT. THIS
ACTIVITY IS HIGH ON THE AGENDA OF DISCUSSION
TOPICS BETWEEN USAID AND THE GOJ FOR FURTHER
ACCELERATION OF THE PROCESS.

(8) INVESTMENT PROMOTION. MEASURES HAVE
BEEN ADOPTED TO FACILITATE THE PROCESS OF
ELICITING AND APPROVING PRIVATE INVESTMENT
PROPOSALS FROM BOTH DOMESTIC AND FOREIGN
INVESTORS. YET CONTINUED GROUING BY ACTUAL
AND POTENTIAL INVESTORS SUGGESTED THE NEED

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AIDAC, JOINT STATE/AID MESSAGE

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FOR A REVIEW OF THE PROCEDURES. ACCORDINGLY
THE GOVERNMENT'S JAMAICA NATIONAL INVESTMENT
PROMOTION (JNIP) AND THE U.S.G. TEAM IN
JAMAICA COLLABORATED IN A SURVEY RESEARCH
PROJECT TO LEARN OF THE ACTUAL EXPERIENCES OF
FIRMS IN THE PROCESS. THE RESULTS OF THE
SURVEY WERE PRESENTED TO PRIME MINISTER SEAGA
WITH RECOMMENDATIONS FOR STREAMLINING THE
PROCESS. AS A RESULT, AN INTER-AGENCY
COMMITTEE HAS BEEN FORMED AND IS CHAIRED BY
THE PRIME MINISTER. THE COMMITTEE MEETS
WEEKLY AND DEALS PROMPTLY AND EFFECTIVELY IN
INSTANCES IN WHICH THE GOVERNMENT'S STRONG
PRO-INVESTMENT POLICY IS BEING BLOCKED BY
BUREAUCRATIC OBSTACLES. JNIP HAS ALSO BEEN
EMPOWERED TO PLAY A STRONGER FACILITATIVE
ROLE. MORE DIFFICULT STUMBLING BLOCKS, MOST
NOTABLY CUSTOMS ADMINISTRATION, ARE UNDER
REVIEW AT PRESENT, AND MANY WILL BE ADDRESSED
IN RADICAL ADMINISTRATIVE AND INSTITUTIONAL
REFORMS THAT ARE EXPECTED TO BE ADOPTED BY
THE END OF CALENDAR YEAR 1985. SIGNIFICANT
RESOURCES AND CLOSE ATTENTION FROM THE
HIGHEST LEVELS OF GOVERNMENT ARE BEING
FOCUSED ON THIS PRIORITY ACTIVITY. CORPORATE
TAX REFORM MEASURES, PROPOSED BY THE SYRACUSE
UNIVERSITY GROUP, WILL ALSO PROVIDE
SIGNIFICANT INCENTIVES TO INVESTMENT IN THE
FORM OF IMMEDIATE EXPENSING OF INVESTMENT AND
REMOVAL OF DISCRIMINATORY TREATMENT OF EQUITY
AS OPPOSED TO DEBT.

(9) TAX REFORM. A TEAM OF TAX CONSULTANTS,
FUNDED BY USAID/J, HAS RECENTLY COMPLETED A
TWO AND ONE-HALF YEAR COMPREHENSIVE TAX
REFORM STUDY. THE RESULTS AND
RECOMMENDATIONS HAVE BEEN PRESENTED TO THE
GOVERNMENT. AS PART OF HIS STRATEGY TO SELL
THE TAX REFORM TO THE PUBLIC, PRIME MINISTER
SEAGA THEN APPOINTED A PRIVATE TAX STUDY
COMMITTEE COMPRISED OF RESPECTED LEADERS OF
TRADE UNIONS, THE PRIVATE SECTOR ORGANIZATION
OF JAMAICA (PCOJ), THE CHARTERED ACCOUNTANTS
ASSOCIATION, THE BAR ASSOCIATION AND PUBLIC
INTEREST ORGANIZATIONS. THIS COMMITTEE WAS
CHARGED WITH RESPONSIBILITY FOR STUDYING THE
REPORT AND RECOMMENDATIONS AND RETURNING WITH

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ITS OWN RECOMMENDATIONS FOR ACTION. THE
COMMITTEE HAS COMPLETED ITS WORK ON THE
PERSONAL INCOME TAX, AND MADE ITS
RECOMMENDATIONS FOR SWEEPING CHANGES. THE
PRINCIPAL CHARACTERISTICS OF THE CHANGES THEY
HAVE RECOMMENDED ARE (A) A FLAT RATE OF 35
PERCENT, ON INCOMES OVER JOODS 7,500 SO THAT
TAX ON INCOMES ABOVE THE EQUIVALENT OF U.S.
DOLS 2,545 IS REDUCED BY APPROXIMATELY 20
PERCENTAGE POINTS AND THE LOWEST INCOME
EARNERS ARE RELIEVED FROM INCOME TAXATION
ENTIRELY; (B) A SIMPLIFICATION OF THE SYSTEM
OF EXEMPTIONS AND CREDITS BY ALLOWING ALL
TAXPAYERS FIXED EXEMPTIONS; AND (C) FOCUSED
ADMINISTRATIVE RESOURCES ON BRINGING TAX
EVADERS ONTO THE TAX ROLLS. THE GOVERNMENT
INTENDS TO HAVE THE NEW SYSTEM APPROVED BY
PARLIAMENT BY THE END OF JANUARY, 1986, WITH
AN EFFECTIVE DATE OF JANUARY 1, 1986. THE
CHANGES THE GOVERNMENT PROPOSED COULD REDUCE
TAX COLLECTIONS BY AS MUCH AS JOODS 200
MILLION IN THE FIRST YEAR. TAXES ON INTEREST
INCOME, AN UP-DATED PROPERTY TAX ROLL AND
IMPROVED ENFORCEMENT WILL PARTIALLY MAKE UP
FOR THE LOSS. GIVEN THE GOV'S COMMITMENT TO
MEET THE TARGET REDUCTIONS IN THE FISCAL
DEFICIT AS AGREED WITH THE IMF, COMBINED WITH
THE DRASTIC REDUCTION IN REVENUE FROM THE
BAUXITE LEVY, THE TAX REFORM WE EXPECT TO BE
IMPLEMENTED WILL BE ONE OF THE MOST
SIGNIFICANT STRUCTURAL REFORMS YET ADOPTED.
INDEED, WE CONSIDER IT TO BE OF THE SAME
LEVEL OF IMPORTANCE AS THE FINANCIAL FREEING
OF THE PRICE OF FOREIGN EXCHANGE IN THE
AUCTION, WHICH OCCURRED A YEAR AGO.
ACCORDINGLY, JUST AS THAT CHANGE WAS

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- CONSIDERED SUFFICIENT BY ITSELF TO WARRANT FY 1985 ESF SUPPORT, WE BELIEVE THAT THE EXPECTED REFORM OF THE PERSONAL INCOME TAX IS SUFFICIENT JUSTIFICATION FOR THE DISBURSEMENT OF THE PROPOSED FY 1986 ESF GRANT.

23. IT IS NOT THE INTENTION HERE TO SUGGEST THAT THE PACE AND DEGREE OF POLICY AND STRUCTURAL REFORM IN JAMAICA HAVE BEEN ABOVE CRITICISM. STEPS TOWARD A MORE MARKET ORIENTED ECONOMY HAVE OFTEN BEEN FOLLOWED QUICKLY BY PARTIAL RETREATS. THE TEMPTATION TO INTERVENE IN THE MARKET SYSTEM HAS OFTEN PROVED IRRESISTIBLE TO A GOVERNMENT MANY OF WHOSE KEY PLAYERS ARE INEXPERIENCED IN THE MYSTERIES OF A PREDOMINANTLY PRIVATE, OUTWARD LOOKING, COMPETITIVE MARKET ENVIRONMENT. THE EMBASSY/USAID TEAM HAS REPORTED FREQUENTLY AND IN CONSIDERABLE DETAIL ON WHAT WE HAVE CONSIDERED TO BE IMPERFECTIONS IN BOTH THE DESIGN AND THE IMPLEMENTATION OF VARIOUS ELEMENTS OF PUBLIC ECONOMIC POLICY.

24. THE ISSUE THAT DEMANDS USG ATTENTION AT THE PRESENT JUNCTURE, HOWEVER, IS NOT WHETHER JAMAICA HAS ADHERED PRECISELY TO THE FORM AND PACE OF POLICY REFORM WE WOULD CONSIDER OPTIMAL. RATHER IT IS WHETHER JAMAICA'S PERFORMANCE MERITS IMMEDIATE AND CONTINUED SUBSTANTIVE SUPPORT, GIVEN U.S. FOREIGN POLICY OBJECTIVES. IN THE JUDGEMENT OF THE COUNTRY TEAM THE ANSWER IS UNEQUIVOCALLY AFFIRMATIVE. THE SECTIONS THAT FOLLOW SET FORTH ADDITIONAL FACTS AND ANALYSIS UPON WHICH THAT CONCLUSION IS BASED, OUR ESTIMATE OF THE MAGNITUDE OF ASSISTANCE REQUIRED, AND THE STRATEGY WE PROPOSE TO ENSURE THAT ESF ASSISTANCE IS UNDERSTOOD BY THE GOJ TO REPRESENT SUPPORT FOR CONTINUING THE DIFFICULT STRUCTURAL ADJUSTMENT PROCESS RATHER THAN AS A MEANS OF AVOIDING IT.

B. THE PRESENT SITUATION: HARD TIMES AND A "FRESH LOOK"

25. THE GOJ'S PRESENT DILEMMA PITS ECONOMIC REALITY AGAINST POLITICAL NECESSITY. THE ECONOMIC REALITY IS THAT JAMAICA'S COMMAND OVER REAL EXTERNAL RESOURCES HAS NOT ONLY FAILED TO IMPROVE AS ANTICIPATED, BUT HAS DECLINED ABSOLUTELY. FOR EXAMPLE, APRIL, 1984, ESTIMATES PREPARED BY THE BANK OF JAMAICA ANTICIPATED THAT IN JFY 1985/86, U.S. DOLS 1,393 MILLION WOULD BE

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AVAILABLE TO FINANCE IMPORTS AND TO BUILD INTERNATIONAL RESERVES. IN JUNE, 1985, THE ESTIMATE WAS REVISED DOWNWARD TO U.S. DOLS 1,178 MILLION. SIMILARLY, JUNE, 1983, ESTIMATES BY THE BOJ AND THE IMF PROJECTED U.S. DOLS 1,345 MILLION IN IMPORTS AND RESERVE IMPROVEMENT FOR JFY 1983/84. THE ACTUAL OUTCOME SHOWED IMPORTS OF ONLY DOLS 1,265 MILLION AND A DOLS 312 MILLION DECLINE IN NET INTERNATIONAL RESERVES. THUS IT IS HARDLY SURPRISING THAT UPWARD MOVEMENTS OF THE PRICE OF FOREIGN EXCHANGE HAVE FAIRLY CONSISTENTLY EXCEEDED EXPECTATIONS. THE COUNTRY HAS LITERALLY EXPERIENCED SUCCESSIVE REDUCTIONS IN ITS REAL WEALTH. IN THE ABSENCE OF AN INFUSION OF ADDITIONAL RESOURCES THEREFORE, REAL IMPOVERISHMENT, IN THE AGGREGATE, IS INESCAPABLE. NO AMOUNT OF JAMAICAN ECONOMIC POLICY ADJUSTMENT CAN ALTER THAT HARSH FACT IN THE NEAR TERM.

26. THE POLITICAL NECESSITY, AS PERCEIVED BY PRIME MINISTER SEAGA AND BY EMBASSY/USAID, IS TO PREVENT THE BURDEN OF THE AGGREGATE CONTRACTION FROM FALLING INORDINATELY HEAVILY ON THE LOWER INCOME SEGMENTS OF THE COMMUNITY. THE DEMONSTRATIONS THAT FOLLOVED THE JANUARY, 1985, ROUNDOFF OF GASOLINE PRICE INCREASES HAD A LARGE SPONTANEOUS PARTICIPATION. THIS SENT A CLEAR SIGNAL THAT THE PATIENCE OF THE GENERAL PUBLIC WITH A SEEMINGLY ENDLESS SERIES OF ECONOMIC HARDSHIPS WAS NEAR ITS LIMIT. THE DAMAGE THAT APPEARS TO HAVE BEEN DONE TO THE VERY SENSITIVE TOURISM SECTOR BY THE JANUARY DEMONSTRATIONS COULD BE MORE SEVERE THIS YEAR SHOULD NEW DEMONSTRATIONS OCCUR. SINCE THE COLLAPSE OF THE BAUXITE/ALUMINA SECTOR, THE TOURISM SECTOR IS TOO IMPORTANT TO PUT IN JEOPARDY BY IGNORING SIGNS THAT POINT TO A FRAGILE SOCIO-POLITICAL STABILITY.

27. PRIME MINISTER SEAGA IS PAINFULLY AWARE THAT

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ABANDONING THE DISCIPLINE OF HIS PROGRAM WITH THE IMF WILL NOT CHANGE THE ECONOMIC REALITY OF REDUCED REAL RESOURCE AVAILABILITY. HIS CALL FOR A "FRESH LOOK" AT THE JAMAICAN ECONOMIC SITUATION AND THE REQUIREMENTS OF THE IMF PROGRAM, IS NOT, WHEN CAREFULLY ANALYZED, A CALL FOR APPROVAL FOR RESORTING TO THE PRINTING PRESS TO FINANCE SUBSIDIES FOR PETROLEUM PRODUCTS AND BASIC FOODS. INSTEAD, HE SEEMS TO BE ASKING FOR A REVIEW OF POLICY ALTERNATIVES TO THE CONTINUED UNRESTRAINED DEPRECIATION OF THE JAMAICAN DOLLAR, WHICH IN TURN TRIGGERS INCREASED PRICES OF IMPORTED BASIC FOOD AND GASOLINE. AS AN ALTERNATIVE, HIS TECHNICIANS HAVE BEEN DEVELOPING QUANTITATIVE MODELS TO APPLY SUFFICIENTLY RESTRICTIVE MONETARY POLICY TO CHOKO OFF THE EXCESS FOREIGN EXCHANGE DEMAND THAT DRIVES THE DEPRECIATION. IT IS A RISKY STRATEGY. IT IS RISKY BECAUSE IT ASSUMES THAT THE EXCHANGE RATE CAN IN FACT BE STABILIZED AT THE TARGET RANGE. IN ADDITION TO THE SUCCESSFUL IMPLEMENTATION OF THE FISCAL AND MONETARY MEASURES DESCRIBED BELOW, PLUS OCCASIONAL DELIBERATE VARIATIONS OF THE SUPPLY OF FOREIGN EXCHANGE AT THE AUCTION, THE SCENARIO ASSUMES THAT THERE WILL BE NO ADDITIONAL EXOGENOUS SHOCK THAT COULD CAUSE BUYERS AT THE AUCTION TO LOSE CONFIDENCE OR OTHERWISE BID UP THE PRICE OF FOREIGN EXCHANGE.

28. AT THE SAME TIME, IT IS A DISCIPLINED STRATEGY, AND ONE THE IMF FEELS IS PLAUSIBLE IF NOT DESIRABLE. IN ORDER TO ACHIEVE THE TARGETED EXCHANGE RATE, THE GOJ AND IMF HAVE AGREED THAT THE MONETARY BASE WILL HAVE TO CONTRACT BY J DOLS 400 MILLION IN THE REMAINDER OF JFY 85/86 THROUGH A PACKAGE OF FISCAL AND MONETARY MEASURES. ON THE MONETARY SIDE, THE BANK OF JAMAICA HAS ALREADY BEGUN TO AUCTION OFF J DOLS 300 MILLION IN CERTIFICATES OF DEPOSIT (J DOLS 50.0 MILLION AT AN AVERAGE RATE OF 23 PERCENT). ON THE FISCAL SIDE, THE GOJ HOPES TO RAISE J DOLS 100 MILLION IN NEW TAXES ON IMPORTS. THESE FUNDS WILL THEN BE "STERILIZED" BY BEING LODGED IN THE BANK OF JAMAICA.

29. THIS STRATEGY WILL ENABLE JAMAICA TO REALIZE THE CRUCIAL, IMMEDIATE OBJECTIVE OF SECURING ITS FINANCIAL POSITION NOT ONLY WITH THE IMF BUT ALSO THE WHOLE HOST OF DONORS AND CREDITORS SUCH AS THE IBRD, A.I.D., THE C.C.C., THE COMMERCIAL BANKS, ITS SUPPLIERS OF OIL, AND OTHERS.

30. NEVERTHELESS, MANY OBSERVERS FEEL THAT MONETARY

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POLICY IS ALREADY SO TIGHT THAT IT IS ADVERSELY AFFECTING REAL INVESTMENT AND PRODUCTION. IF THIS VIEW IS CORRECT, AND IT IS CERTAINLY PLAUSIBLE, THE EFFECT OF THE POLICY MAY BE TO SHIFT THE PAIN OF REDUCED REAL RESOURCE AVAILABILITY ONTO WORKERS BY WAY OF INCREASING UNEMPLOYMENT. THAT RESULT COULD PROVE TO BE AS DESTABILIZING AS PRICE INCREASES, THOUGH IT MIGHT NOT OCCUR AS QUICKLY.

31. THERE IS, HOWEVER, A POSITIVE PROSPECT FOR THIS APPROACH. IF THE GOJ IS SUCCESSFUL IN HOLDING THE EXCHANGE RATE WITHIN REASONABLY NARROW LIMITS (SAY J DOLS 5.50 - J DOLS 5.70 EQUAL U.S. DOLS 1.00), THE RATE OF PRICE INFLATION SHOULD BE SLOWED MARKEDLY. THIS IN TURN COULD HAVE THE EFFECT OF REDUCING NOMINAL INTEREST RATES WITHOUT REDUCTIONS IN THE REAL RATE AND PERHAPS EVEN WITH INCREASING REAL RATES. STILL, THERE IS THE DANGER THAT THE IMMEDIATE EFFECT OF THE PROGRAMMED MONETARY STRINGENCY WOULD BE A CREDIT CRISIS WHICH WOULD CAUSE NOMINAL INTEREST RATES TO RISE FURTHER BEFORE FALLING. IF AND AS WEALTH OWNERS BEGIN TO BELIEVE THAT THE PRICE AND EXCHANGE RATE STABILITY WILL ENDURE (OR THAT RATE DECREASES ARE ALMOST AS LIKELY AS INCREASES), AND REAL RATES OF INTEREST WILL REMAIN POSITIVE, THE INCENTIVE TO CAPITAL FLIGHT WOULD BE SIGNIFICANTLY EASED. IT IS WIDELY BELIEVED THAT JAMAICANS HOLD MANY MILLIONS OF DOLLARS IN FOREIGN BANK ACCOUNTS. TIGHT DOMESTIC MONETARY POLICY, STABLE PRICES, A STABLE AND CREDIBLE EXCHANGE RATE, POSITIVE REAL RATES OF INTEREST, AND RELATIVELY LOW TAXES (UNDER THE IMMINENT REFORM OF THE INCOME TAX REGIME) ALL SERVE TO ENCOURAGE AN INFLOW OF THESE AND OTHER FOREIGN FUNDS TO JAMAICA.

32. AS THE FOREGOING DISCUSSION SUGGESTS, THE NEAR

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AIDAC, JOINT STATE/AID MESSAGE

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E.O. 12356: N/A
TAGS: EFIN, EAID, ECON, JM
SUBJECT: PROGRAM ASSISTANCE APPROVAL DOCUMENT (PAAD)
FOR FY 86 ESF GRANT TO JAMAICA

THE SUCCESS OF THIS STRATEGY WILL DEPEND IMPORTANTLY ON (1) THE PUBLIC'S PERCEPTION OF THE CREDIBILITY OF INTEREST RATES, PRICES, AND THE EXCHANGE RATE GIVEN THE UNDERLYING REAL MARKET FORCES, (2) THE RELATIVE SPEEDS WITH WHICH GAINERS AND LOSERS FROM THE POLICIES REACT, AND (3) THE MAGNITUDES OF THOSE RESPONSES. TO THE EXTENT THAT SIGNIFICANT FOREIGN EXCHANGE INFLOWS DO OCCUR, AND TO THE EXTENT THAT HIGHER TARIFFS CHOK OFF IMPORT DEMAND, THE RECESSIONARY IMPACT OF A RESTRICTIVE DOMESTIC CREDIT POLICY AND ITS RECESSIONARY IMPACT ON CREDIT AVAILABILITY WILL BE OFFSET. IF, AS SOME OBSERVERS BELIEVE, HISTORICALLY HIGH NOMINAL RATES OF INTEREST DETER INVESTMENT REGARDLESS OF WHETHER THE INFLATION-ADJUSTED RATE IS POSITIVE OR NEGATIVE, REAL PRODUCTIVE INVESTMENT MIGHT BE FURTHER ENCOURAGED.

33. IN CANDOR, WE MUST OBSERVE THAT THE FOREGOING SCENARIO IS UNLIKELY. THE PROBLEM IS THAT, IN THE ABSENCE OF SIGNIFICANT AND PROMPT INFLOWS OF NEW RESERVES, THE PROPOSED EXCHANGE RATE POLICY WILL REQUIRE THAT IMPORT DEMAND BE REDUCED BY SOMETHING LIKE U.S. DOLS 100 MILLION, (LESS THE EFFECT OF TARIFF INCREASES). TO ACCOMPLISH THIS PRIMARILY THROUGH GENERAL MONETARY POLICY COULD, WE ROUGHLY ESTIMATE, REQUIRE AN ADDITIONAL REDUCTION OF NATIONAL MONEY INCOME OF TWICE THAT MUCH, OR APPROXIMATELY 20 PERCENT. EVEN IF THIS OVER-ESTIMATES THE DEPRESSANT EFFECT BY THREE OR FOUR TIMES, THE RESULT IS ECONOMICALLY DISASTROUS. THE PROSPECT OF REPLACING ALL OF THAT BY WAY OF PRIVATE INFUSIONS OF FOREIGN EXCHANGE, IN THE SAME TIME PERIOD, SEEMS REMOTE AT BEST. NEVERTHELESS, IN THE ABSENCE OF ADDITIONAL RESOURCES, THERE MAY BE NO OTHER RECOURSE IF THE EXCHANGE RATE AND PRICES ARE TO BE HELD IN THE NEIGHBORHOOD OF THEIR PRESENT LEVELS. AND TO THE EXTENT EXTRA RESOURCES ARE GENERATED, PROSPECTS IMPROVE.

C. USAID STRATEGY FOR 1985 - 1986

34. THE MISSION'S STRATEGY IS TO SUPPORT SENGU IN HIS EFFORTS TO MAKE THE BEST OUT OF SEVERAL VERY DIFFICULT ALTERNATIVES. WITH RESPECT TO THE DOLS 51 MILLION IN AVAILABLE ESF, OUR STRATEGY IS TO PUT THIS IN PLACE AFTER THE GOVERNMENT HAS APPROVED THE TAX REFORM FOR SUBMISSION TO PARLIAMENT, BUT IN TIME TO ASSIST THE

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GOJ TO MEET THE PERFORMANCE REQUIREMENTS TO PERMIT APPROVAL OF THE TECHNICAL WAIVER BY THE IMF BOARD; THE OCTOBER, 1985 DRAWING OF DOLS 13 MILLION MAY BE MADE; AND THE COMMERCIAL BANK GROUP MEETING OF JANUARY 15, 1986 SATISFIED THAT JAMAICA IS CONTINUING ON A PATH OF DISCIPLINED FISCAL AND MONETARY MANAGEMENT. THE US DOLS 30.0 MILLION, FY 1986 PL-460 TITLE 1 PROGRAM WILL REINFORCE OUR ESF SUPPORT. MOREOVER, WE ARE ENERGETICALLY ACCELERATING OUR DEVELOPMENT ASSISTANCE PORTFOLIO TO NOT ONLY GET THE MACRO EFFECT OF MORE RAPID IMPLEMENTATION, BUT WE ARE SHIFTING ITS FOCUS TO SUPPORT MORE DIRECTLY, INVESTMENT, PRODUCTION, CONTINUATION OF ESSENTIAL SOCIAL SERVICES, AND IMPLEMENTATION OF THE TAX AND INVESTMENT EFFORTS. OTHER MAJOR DONORS ARE DOING LIKEWISE. FOR EXAMPLE, A WORLD BANK TEAM WILL SPEND DECEMBER, 1985, LOOKING FOR WAYS TO ACCELERATE IBRD PROJECTS. THE "FRESH LOAN" TEAM WILL MOST CERTAINLY BE MAKING PROPOSALS FOR FURTHER SHIFTS IN EMPHASIS AS WELL AS ADDITIONAL RESOURCES. SUPPLEMENTAL ESF BEYOND THE REMAINING DOLS 19 MILLION AS WELL AS INCREASED PL-420 TITLE 1 TO REPLACE THE US DOLS 60 PLUS MILLION IN CCC-GSM 102 CREDITS ARE BOUND TO EMERGE FROM THEIR REPORT.

35. TAX REFORM, IN TERMS OF ITS BOLDNESS OF CONCEPTION AND POTENTIAL FOR MAJOR STRUCTURAL REFORM, IS A NECESSARY AND SUFFICIENT STEP FORWARD TO JUSTIFY THE DISBURSEMENT OF THIS DOLS 51 MILLION TRANCHE. THE TIMING OF THIS DISBURSEMENT SO THAT THE IMF WAIVER IS SECURED AND THE COMMERCIAL BANKS ARE SATISFIED IS ABSOLUTELY ESSENTIAL. THERE PROBABLY WILL NOT BE ANOTHER CHANCE TO KEEP THE JAMAICAN ECONOMY FROM SLIDING INTO THE "GUYANA MORASS". IF THE JANUARY 15, 1986 WINDOW OF OPPORTUNITY IS NOT SEIZED, THE COMMERCIAL BANKS DEBT SERVICING DEAL COMES APART, THE CCC-GSM 102 FOOD SUPPLY LINE WILL BE INTERRUPTED, THE PARIS CLUB WILL NOT MEET, THE FAA SECTION 620 (C) AND

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BROOKE-ALEXANDER PROVISIONS WILL COME INTO EFFECT, AND
SIMILAR IBRD AND IDB PROVISIONS WILL DRY UP THOSE
SOURCES AS WELL.

III. CONCLUSION

36. AN ECONOMIST RECENTLY SUMMARIZED JAMAICA'S
STRUCTURAL BALANCE OF PAYMENTS PROBLEM AS ONE OF A
"DOMESTIC IMBALANCE CREATED AND SUSTAINED BY
OVERBLOATED GOVERNMENT EXPENDITURES FINANCED BY
CENTRAL BANK CREDIT CREATION TO ACCOMMODATE THE
PROFLIGACY OF GOVERNMENT'S SPENDING, MORE OFTEN THAN
NOT, INSPIRED BY INCOME REDISTRIBUTION CONSIDERATIONS
WITH SCANT REGARD FOR INCOME GENERATING PROCESSES,
INSTITUTIONS AND NORMS."

37. THIS STATEMENT WAS MADE NOT BY A REPRESENTATIVE OF
THE IMF, WORLD BANK OR USAID, BUT, RATHER, THE NEWLY
APPOINTED DIRECTOR OF THE PLANNING INSTITUTE OF
JAMAICA. THE APPENDIX OUTLINES THE HIGHLY PROMISING
EFFORTS OF THE SEAGA ADMINISTRATION TO IMPLEMENT
FISCAL REFORMS TO REDUCE PUBLIC EXPENDITURES FROM
THEIR HIGH AND UNSUSTAINABLE LEVELS AT PRESENT. THIS
SECTION ALSO POINTS TO POSSIBLE ORDERS OF MAGNITUDE
FOR A SUPPLY SIDE RESPONSE FROM EXPORTS IN THE MEDIUM
RUN AS A RESULT OF A MORE PROPITIOUS POLICY
ENVIRONMENT.

38. AT THE PRESENT, HOWEVER, JAMAICA STANDS AT A
CROSSROADS. TWO BASIC SCENARIOS FOR ITS FUTURE ARE
CONCEIVABLE. UNDER THE PESSIMISTIC SCENARIO, THE
SHORT RUN PROBLEM OF ADJUSTING TO CONTRACTING REAL
AGGREGATE RESOURCES WILL NOT BE RESOLVED. AS THE
POLITICAL AND SOCIAL FABRIC UNRAVELS, TOURISM WILL BE
SERIOUSLY AFFECTED, AND THE ENTIRE ECONOMY WILL
FALTER, THEREBY CREATING A VICIOUS CYCLE OF ECONOMIC
CONTRACTION. IN THE END, JAMAICA WOULD BE REDUCED TO
LEVELS OF IMMISERATION ON A PAR WITH HAITI.

39. UNDER THIS SCENARIO, THE ROAD TO HAITI RUNS
THROUGH GUYANA, I.E., BY BREAKING, AS GUYANA DID, WITH
THE IMF. BREAKING WITH THE IMF HAS THE CASCADING
EFFECT OF SEVERING RELATIONS WITH THE WHOLE HOST OF
DONORS AND CREDITORS, SUCH AS THE IBRD, A.I.D., THE
COMMERCIAL BANKS AND OTHERS. THE END RESULT IS TO BE
CUT OFF FROM INTERNATIONAL FINANCIAL MARKETS AND
LOSING THE OPPORTUNITY TO DEAL WITH SHORT RUN ECONOMIC
CONTRACTIONS BY FINANCING RATHER THAN ADJUSTMENT.

40. THE OTHER SCENARIO STANDS IN STARK RELIEF TO THIS
ONE. UNDER THE OPTIMISTIC ONE, JAMAICA WILL, WITH
DONOR ASSISTANCE, WEATHER THE PRESENT SHORT RUN
CRISIS, AND REALIZE THE INHERENT POTENTIAL OF ITS
STRUCTURAL ADJUSTMENT PROGRAM. ITS EXPORT LED,
PRIVATE SECTOR DOMINATED STRATEGY WILL COME TO
FRUITION, AND LEVELS OF MATERIAL PROSPERITY DESIRED BY
MOST JAMAICANS WILL BE SLOWLY BUT STEADILY
APPROACHED. THIS WILL HAVE THE EFFECT OF REINFORCING
POLITICAL AND SOCIAL STABILITY WHICH IN TURN WILL
FACILITATE FURTHER ECONOMIC DEVELOPMENT. BUT THIS IS
NOT A QUICK SOLUTION UNDER ANY CIRCUMSTANCES. IT
REQUIRES CONTINUING ADJUSTMENT AND REFORM BY THE GOV,
CONTINUED SUPPORT BY DONORS, TIME, AND SOME FAVORABLE
BREAKS.

41. FOR THE REASONS OUTLINED IN THIS PAAD, THE U.S.
COUNTRY TEAM BELIEVES THAT WITH OUR ASSISTANCE JAMAICA
CAN STILL OPT FOR THE LATTER SCENARIO AND THAT
JAMAICA'S PERFORMANCE AND IMPORTANCE MERITS IMMEDIATE
AND CONTINUED SUBSTANTIVE SUPPORT TO HELP IT OVERCOME
ITS SHORT RUN CRISIS.

APPENDIX I. FURTHER MACROECONOMIC OBSERVATIONS

A. THE BALANCE OF PAYMENTS

42. AS NOTED EARLIER, THE NET LOSS TO THE JAMAICAN
ECONOMY FROM THE CONTRACTION OF THE BAUXITE AND
ALUMINA SECTOR IS LIKELY TO BE U.S. DOLS 100 - 110
MILLION IN 1985. THIS CONTRACTION HAS TO BE
CONSIDERED PERMANENT IN THAT THE NOW CLOSED, HIGH
ENERGY COST ALUMINA PLANT HAS EFFECTIVELY BEEN
REPLACED BY NEW, EFFICIENT PLANTS IN OTHER COUNTRIES

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WITH CO-LOCATED, LOW COST ENERGY SOURCES. INDEED, FURTHER CLOSURES OF JAMAICAN ALUMINA PLANTS MAY OCCUR IN THE FUTURE FOR THIS SAME REASON.

43. THE BOJ AND IMF HAVE RECENTLY PREPARED VARYING SCENARIOS ON THE IMPACT OF THIS LOSS FOR JAMAICA'S BALANCE OF PAYMENTS IN JFY 1985-1986. BOTH PROJECTIONS ASSUME THAT GDP WILL DECLINE BY 3 PERCENT. THE BOJ MODEL, ASSUMING USAID ESF INFLOWS OF U.S. DOLS 65 MILLION, PROJECTS NO UNFINANCED FOREIGN EXCHANGE GAP. THE IMF MODEL, ON THE OTHER HAND, ASSUMING USAID ESF INFLOWS OF U.S. DOLS 50 MILLION, PROJECTS AN UNFINANCED FOREIGN EXCHANGE GAP OF U.S. DOLS 134 MILLION. (THE BASIC DIFFERENCE BETWEEN THE TWO PROJECTIONS IS TO BE FOUND IN THE BOJ'S MORE OPTIMISTIC ASSUMPTIONS ABOUT PRIVATE CAPITAL INFLOWS.)

44. BASED ON THE EXTREME POINTS OF THESE TWO ESTIMATES, THEN, JAMAICA'S NEED FOR ESF WOULD RANGE FROM U.S. DOLS 65 MILLION TO U.S. DOLS 184 MILLION. THESE LEVELS WOULD BE HIGHER, OF COURSE, FOR A TARGETED DECLINE IN GDP OF LESS THAN 3 PERCENT.

45. 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 HAS BEEN OCCASIONED BY THE BAUXITE/ALUMINA CONTRACTION. WHILE THERE IS NO PANACEA FOR JAMAICA'S BALANCE OF PAYMENTS DIFFICULTIES IN THE MEDIUM RUN, THE CUMULATIVE IMPACT OF THE VARIOUS STRUCTURAL ADJUSTMENTS SHOULD BEGIN TO MAKE ITSELF FELT BETWEEN NOW AND 1990 IN THE FORM OF INCREASED INVESTMENT AND EXPORTS OF AGRICULTURAL PRODUCTS AND MANUFACTURES, PLUS INCREASED TOURISM EARNINGS.

46. JAMAICA'S IMPORT BILL IN 1985 AND A PLAUSIBLE PROJECTION BY THE WORLD BANK FOR 1990, IN CONSTANT U.S. DOLLARS, AND THE SOURCES OF FOREIGN EXCHANGE REVENUE TO MEET THE IMPORT BILL ARE GIVEN IN TABLE III. THE 1990 FIGURES ASSUME A POSITIVE GDP GROWTH RATE OF 2 PERCENT PER ANNUM FROM 1987 ONWARD. WHILE THE BANK'S ASSUMPTION THAT THE LEVEL OF IMPORTS WILL GROW AT 9 PERCENT A YEAR SEEMS HIGH, IMPORTS ARE NOW VERY COMPRESSED, AND AN EXPANSION OF IMPORTS WILL BE NEEDED IF GDP IS TO SHOW ANY REAL GROWTH. THE

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FIGURES FOR 1990 ARE MADE "INFORMALLY" TO USE THE MOST CHARITABLE CHARACTERIZATION. SUCH FIGURES ARE INTERESTING, NONETHELESS, BECAUSE THEY INDICATE THE POSSIBLE ORDERS OF MAGNITUDE OF THE IMPACT OF POLICY REFORMS.

- ILLUSTRATION OF JAMAICA'S FOREIGN EXCHANGE NEEDS AND SOURCES (CONSTANT U.S. DOLS MILLION)

1985 1990

FOREIGN EXCHANGE NEEDS

- IMPORT OF GOODS	1009	1552
- IMPORT OF FACTOR SERVICES (NET)	309	344
- IMPORT OF NON-FACTOR SERVICES	321	468
- DEBT REPAYMENTS	400	450
- TOTAL NEEDS	2039	2814

MAIN REVENUE SOURCES

- EXPORTS	612	1125
- BAUXITE, ALUMINA	(322)	(407)
- SUGAR	(58)	(74)
- BANANAS	(6)	(14)
- OTHER AGRICULTURAL	(24)	(45)
- OTHER NON-TRADITIONAL	(170)	(521)
- OTHER EXPORTS	(32)	(119)
- TOURISM	472	700
- OTHER NON-FACTOR SERVICES	145	239
- REMITTANCES	155	175
- PUBLIC CAPITAL (MAINLY FOREIGN ASSISTANCE)	700	550
- PRIVATE INVESTMENT	50	100
- CHANGE IN RESERVES	-75	-75

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- (INCREASE MINUS)

- TOTAL REVENUE 2039 2814

SOURCE: DERIVED BY USAIO/J FROM INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT: JAMAICA: ECONOMIC SITUATION AND PUBLIC INVESTMENT, VOL. 1, P. 42.

47. THE FIGURES HIGHLIGHT THE NEED FOR A VERY STRONG GROWTH PERFORMANCE IN EXPORTS AND OTHER FOREIGN EXCHANGE EARNINGS. EXPORTS WILL HAVE TO GROW BY 13 PERCENT PER YEAR, AND OVERALL FOREIGN EXCHANGE EARNINGS BY 6.7 PERCENT PER YEAR. THIS IN TURN REQUIRES THAT THE REFORMS IN THE POLICY AREAS WHICH AFFECT THE EXPORT SECTOR IN GENERAL AND THE DIFFERENT SUBSECTORS IN PARTICULAR BE CONSOLIDATED AND IN SOME INSTANCES EXTENDED. THE PROJECTIONS ALSO ASSUME THAT THE SUBSECTORS WILL EXPERIENCE NO MAJOR EXOGENOUS SHOCKS. CLEARLY, THE DECISION TO ALLOW MARKET FORCES TO DETERMINE THE PRICE OF FOREIGN EXCHANGE PROVIDED A SUBSTANTIAL BOOST TO EXPORTERS. A BRIEF SURVEY OF THE MAJOR SUBSECTORS EARNING FOREIGN EXCHANGE DEMONSTRATES THAT THIS POLICY REFORM WAS A NECESSARY IF NOT SUFFICIENT CONDITION FOR EXPANDING FOREIGN EXCHANGE EARNINGS.

48. TOURISM - THE GROWTH IN RECEIPTS SINCE 1980 HAS BEEN THE RESULT OF A VIGOROUS PROMOTION CAMPAIGN AND AN OVERALL BETTER INTERNATIONAL PERCEPTION OF JAMAICA. AT PRESENT THERE IS A NEED TO SEARCH FOR NEW INVESTORS. THE ESTIMATES FOR 1990 INDICATE THAT TOURISM WILL IN ALL LIKELIHOOD REMAIN THE PREEMINENT EARNER OF FOREIGN EXCHANGE. THIS UNDERSCORES THE NECESSITY OF NOT EXPOSING THIS FRAGILE SECTOR TO THE POLITICAL AND SOCIAL TURMOIL THAT MIGHT ACCOMPANY ANY DRASTIC SHORT RUN ADJUSTMENT MEASURES.

49. NON-TRADITIONAL EXPORTS - THE PROJECTIONS ASSUME THAT NON-TRADITIONAL EXPORTS WILL RISE BY 25 PERCENT PER ANNUM. WHILE THIS SEEMS HIGH, A 20 PERCENT GROWTH RATE WAS ACHIEVED IN 1983, MAINLY ON THE STRENGTH OF 807 GARMENT OPERATIONS. USAID INTENDS TO DEPLOY SIGNIFICANT RESOURCES TO EXPAND NON-TRADITIONAL EXPORTS OVER THE COMING YEAR THROUGH A PACKAGE OF TC&TG ACTIVITIES. THE POTENTIAL FOR USAID INTERVENTION IN THIS AREA WAS THE SUBJECT OF A RECENT ASSESSMENT. MEMBERS OF THE ASSESSMENT TEAM CONCLUDED THAT A SERIES OF INTERRELATED NEEDS WERE REQUIRED TO PROMOTE NON-TRADITIONAL EXPORTS, INCLUDING MARKETING

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INFORMATION, TECHNICAL ASSISTANCE, TRAINING, AND FINANCE. NOT SURPRISINGLY, THE TEAM FOUND THAT THE EXCHANGE RATE REFORM WAS A NECESSARY IF NOT SUFFICIENT CONDITION FOR EXPANDING NON-TRADITIONAL EXPORTS. THE TEAM CONCLUDED THAT, IN ADDITION TO GARMENTS AND APPAREL, OTHER PROMISING SUBSECTORS INCLUDED ELECTRONICS, HANDICRAFTS, FURNITURE, FRESH FRUITS AND VEGETABLES, FLOWERS, PROCESSED FOOD, DRINK AND TOBACCO, DATA ENTRY, AND PACKAGING.

50. BAUXITE AND ALUMINA - THE WORLD BANK FIGURES ASSUME SOME RECOVERY IN THIS SUBSECTOR BY 1990, WHILE EMBASSY/USAID BELIEVES THAT THE RECENT CONTRACTIONS WILL BE MORE OR LESS PERMANENT. FOR THE SECTOR TO DEMONSTRATE A STRONG RECOVERY, SOME COMBINATION OF THE FOLLOWING EVENTS WOULD HAVE TO OCCUR: (A) A STRONG RECOVERY OF WORLD DEMAND FOR BAUXITE AND ALUMINA; (B) SUSPENSION BY GOJ OF THE PRODUCTION LEVY IN THE SHORT RUN AND RESTRUCTURING IN THE LONG RUN TO MAKE IT MORE OR LESS EQUIVALENT IN ITS TAX BITE WITH OTHER PRODUCERS; (C) INVESTMENT TO INCREASE THE ENERGY EFFICIENCY OF JAMAICA'S ALUMINA PLANTS, ESPECIALLY THE ALPART FACILITY, WHICH WAS RECENTLY CLOSED. THE REOPENING OF ALPART, UNDER ANY FORESEEABLE CONDITIONS, IS MOST UNLIKELY.

51. OTHER AGRICULTURAL EXPORTS - THE EXTERNAL MARKETING ORGANIZATIONS FOR COFFEE, COCOA, CITRUS AND PIMENTO HAVE SUBSIDIZED INEFFICIENT NON-MARKETING ACTIVITIES THROUGH LOW PRODUCER PRICES MADE POSSIBLE BY THE MONOPSONY POSITION. RECENT REFORM PROGRAMS INCLUDE REVISING PRODUCER PRICES UPWARDS AND DIVESTING MARKETING ACTIVITIES TO THE PRIVATE SECTOR. REGULATION OF MARKETING SHOULD CONTINUE FOR THIS SECTOR TO INCREASE ITS FOREIGN EXCHANGE EARNINGS.

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52. BANANAS - THE INDUSTRY IS IN THE PROCESS OF RADICAL RESTRUCTURING. THE OLD, INEFFICIENT, JAMAICAN OWNED BANANA COMPANY HAS BEEN ABOLISHED. OWING TO DEVALUATION, PRODUCER PRICES HAVE REACHED RECORD HIGHS. HOWEVER, GOVERNMENT'S ROLE IN THIS SECTOR IS STILL TOO LARGE.

53. SUGAR - LARGE PUBLIC SUBSIDIES HAVE BEEN NECESSARY TO KEEP THE INDUSTRY ALIVE. RECENTLY, IN AN EFFORT TO REFORM THIS SUBSECTOR, SOME FACTORIES HAVE BEEN CLOSED, DOMESTIC PRICES RAISED, AND EXPERT FOREIGN MANAGEMENT HAS BEEN CONTRACTED TO RUN THE INDUSTRY. A SUGAR REHABILITATION PROGRAM HAS BEEN DEVELOPED FOR THAT PART OF THE INDUSTRY PRODUCING FOR ASSURED MARKETS.

54. FOREIGN INVESTMENT - AS DESCRIBED EARLIER, A RECENT GOJ - USG STUDY ON INVESTMENT HAS RECEIVED SERIOUS GOJ CONSIDERATION. PROJECTED SUCCESS WILL REQUIRE SUSTAINED EFFORT AND CLOSE COORDINATION BY MANY GOJ AGENCIES.

B. PUBLIC FINANCES

55. ALTHOUGH OVERALL LEVELS OF PUBLIC SECTOR EXPENDITURE REMAIN HIGH AS A PERCENTAGE OF GDP, THE SEAGA ADMINISTRATION HAS TAKEN POSITIVE STEPS TO REDUCE THE OVERALL DEFICIT, AND TO RATIONALIZE THE CAPITAL AND CURRENT EXPENDITURE PROCESS.

56. IN 1981, THE SEAGA GOVERNMENT ADOPTED A FOUR PART POLICY TO DEAL WITH THE PROBLEM OF PUBLIC FINANCES: ON THE EXPENDITURE SIDE, (1) BY CONTAINING CURRENT EXPENDITURE, (2) BY INCREASING DOMESTIC REVENUE, (3) BY RAISING HIGHER LEVELS OF FOREIGN FINANCING OF THE DEFICIT TO RELEASE DOMESTIC RESOURCES FOR THE PRIVATE SECTOR AND (4) ON THE REVENUE SIDE, BY REFORMING THE TAX SYSTEM, AS OUTLINED IN AN EARLIER SECTION.

57. LITTLE IMPROVEMENT HAD BEEN MADE IN PUBLIC EXPENDITURES PRIOR TO 1984/85. HOWEVER, A MAJOR EFFORT HAS NOW BEEN MADE, AND THE CENTRAL GOVERNMENT'S OVERALL DEFICIT FELL IN 1984/85 TO UNDER 3 PERCENT OF GDP, A CUT OVER 8 PERCENT OF GDP IN ONE YEAR. THIS WAS ACHIEVED BY HOLDING DOWN BOTH CURRENT AND CAPITAL EXPENDITURES WHILE REVENUE ROSE BY OVER 50 PERCENT IN RESPONSE BOTH TO THE DEVALUATION AND THE CONSEQUENT INFLATION AND CERTAIN REVENUE MEASURES THAT WERE TAKEN, (ALTHOUGH THESE ONLY ACCOUNTED FOR ABOUT 25

PERCENT OF THE INCREASE). CURRENT EXPENDITURES FELL BY ABOUT 12 PERCENT IN REAL TERMS, INCLUDING A REDUCTION IN THE CENTRAL GOVERNMENT'S LABOR FORCE BY SOME 4,000 POSTS, OR ABOUT 4 PERCENT OF THE CIVIL SERVICE.

58. WITH RESPECT TO CAPITAL AND CURRENT EXPENDITURES, MOST OF THE DISCUSSION OF JAMAICA'S SITUATION CENTERS ON ITS PUBLIC SECTOR INVESTMENT PROGRAM (PSIP). THE ADOPTION OF A THREE YEAR PSIP, TO BE ANNUALLY REVIEWED AND UPDATED, WAS AN IMPORTANT PART OF JAMAICA'S IBRD SPONSORED STRUCTURAL ADJUSTMENT PROGRAM. THE FOCUS ON A MULTI-YEAR PUBLIC INVESTMENT PROGRAM HAD A NUMBER OF DIFFERENT OBJECTIVES: (I) TO PERMIT AN OVERALL VIEW OF THE ENTIRE PUBLIC SECTOR, INCLUDING THE CENTRAL GOVERNMENT AND ALL THE MAJOR PUBLIC ENTERPRISES, IN TERMS OF THE INVESTMENT EFFORT AND ITS FISCAL AND MONETARY IMPACT; (II) TO ENABLE THE GOVERNMENT TO GAIN BETTER KNOWLEDGE AND CONTROL OF THE INVESTMENT AND FINANCIAL PERFORMANCE OF THE PUBLIC ENTERPRISES; (III) TO FORECAST THE IMPLICATIONS OF EXISTING INVESTMENT FOR THE FUTURE FISCAL SITUATION; AND (IV) TO HELP ENSURE THAT THE PUBLIC INVESTMENT PROGRAM SUPPORTED THE GOALS OF THE ECONOMIC STABILIZATION AND STRUCTURAL ADJUSTMENT PROGRAM. AS A PART OF THE PSIP, A MONITORING SYSTEM WAS DEVELOPED AND A FORMAL DECISION-MAKING PROCESS IS IN PLACE. PRIME AREAS FOR IMPROVEMENT INCLUDE INTEGRATING THE PSIP PROCESS AND THE BUDGET PROCESS. CONTINUED IMPROVEMENTS IN APPROVAL OF TECHNIQUES AND APPROVAL PROCEDURE WILL ALSO BE NEEDED, AS WELL AS EFFORTS TO MAKE THE MONITORING SYSTEM MORE RELEVANT.

59. AN IMPORTANT AREA FOR FURTHER ANALYSIS LIES IN THE

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E. O. 12356: N/A
TAGS: EFIN, EAID, ECON, JM
SUBJECT: PROGRAM ASSISTANCE APPROVAL DOCUMENT (PAAD)
FOR FY 86 ESF GRANT TO JAMAICA

RELATIONSHIP AND RELATIVE IMPORTANCE OF CAPITAL VERSUS CURRENT EXPENDITURES. TWO POINTS NEED TO BE STRESSED. FIRST, WHILE EVERYONE AGREES IN PRINCIPLE WITH THE NEED TO IDENTIFY THE IMPACT OF THE INVESTMENT PROGRAM ON CURRENT EXPENDITURES, NO EXPLICIT AGGREGATE ANALYSIS OF THIS HAS BEEN INCLUDED IN ANY PSIP SO FAR, ALTHOUGH SOME DISCUSSION TAKES PLACE AT THE PRE-SELECTION STAGE. PARTICULARLY DURING A PERIOD WHEN FISCAL CONSTRAINTS ARE SEVERE, IT IS CRITICAL TO IDENTIFY ADDITIONAL REQUIREMENTS AS A PART OF THE ANALYSIS. IDEALLY, THE GOVERNMENT SHOULD LOOK AT PUBLIC EXPENDITURES IN THEIR ENTIRETY, AND PREPARE A THREE YEAR PROJECTION OF BOTH CURRENT AND CAPITAL PROGRAMS WITH A COMPREHENSIVE FINANCING PLAN. WITH THE INSTITUTION OF A PERFORMANCE BUDGETING SYSTEM AND THE INTEGRATION OF AN ACCOUNTING SYSTEM IN SUPPORT, JAMAICAN INSTITUTIONS WILL BE A STEP CLOSER TO THAT GOAL. SECOND, THERE HAS BEEN A SERIOUS LACK OF

OUTLINE MAINTENANCE ALLOCATIONS IN THE RECURRENT BUDGET FOR ROADS, SCHOOLS, AND GOVERNMENT BUILDINGS. 60. RECENTLY, AN ADMINISTRATIVE REFORM PROGRAM HAS BEEN LAUNCHED, AGAIN UNDER IBRD SPONSORSHIP. IT INCLUDES REVISIONS OF CIVIL SERVICES SALARIES, THE INTRODUCTION OF PERFORMANCE BUDGETING, AND DECENTRALIZED PERSONNEL POLICIES. AT THE SAME TIME, THE GOJ'S FISCAL PROGRAM HAS REDUCED THE NUMBER OF PUBLIC EMPLOYEES. GIVEN THE NEED TO REDUCE THE DEFICIT FURTHER, ADDITIONAL PERSONNEL CUTS WILL BE NECESSARY, AND THE ADMINISTRATIVE REFORM PROGRAM SHOULD HELP TO MAKE THIS A MORE RATIONAL PROCESS. (DRFTD: OPEP: SS/MMC/ APRVD: OPEP: SSKOGSTAD)
SOTIRHOS