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# MINISTRY PAPER NO 9/2010

## Jamaica's Request to the International Monetary Fund (IMF) For a 27-Months Stand-By Arrangement (SBA) Ending March 2012

**INTRODUCTION**

The Honourable House of Representatives is being asked to note the following:

(1) the Letter of Intent (LOI) between the Government of Jamaica and the International Monetary Fund; and

(2) Jamaica - Memorandum of Economic and Financial Policies.

These documents provide an overview of prior actions taken by the Government of Jamaica, as well as measures to achieve macro economic stability, and benchmarks/targets to be achieved over the next twenty-seven (27) months.

Audley Shaw, MP
Minister of Finance and the Public Service
January 19, 2010

ANY REPLY OR SUBSEQUENT REFERENCE SHOULD BE ADDRESSED TO THE FINANCIAL SECRETARY AND THE FOLLOWING REFERENCE NUMBER QUOTED:-

Telephone No. 92-28600-16
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**MINISTRY OF FINANCE AND THE PUBLIC SERVICE**
**30 NATIONAL HEROES CIRCLE**
**P.O. BOX 512**
**KINGSTON**
**JAMAICA**

Kingston, Jamaica
January 15, 2010

Mr. Dominique Strauss-Kahn
Managing Director
International Monetary Fund
Washington, DC 20431

Dear Mr. Strauss-Kahn:

For many years, Jamaica has struggled with the twin challenges of low economic growth and high public debt. As a result of the fragile economic situation and underlying vulnerabilities, the economy has been seriously affected by the ongoing global economic and financial crisis. Growth is projected to fall a cumulative 5 percent between 2008 and 2009. Moreover, the high debt levels and limited access to financing have left us no other option but the implementation of short term pro-cyclical fiscal and monetary policies which, in turn, have reinforced the negative effects of the global shocks on the economy.

The main objective of this programme is to restore macroeconomic stability and create conditions for strong and sustained growth and to enable the economy to benefit from the recovery in the global economy. Through the sustained implementation of a strong and credible fiscal adjustment programme and key structural fiscal reforms, the programme puts the public debt levels on a clearly downward path. This fiscal programme will be supplemented upfront by decisive action to tackle, in close coordination with creditors, the large and expensive debt burden.

The Government of Jamaica is deeply committed to the objectives and measures underlying this programme, and intends to pursue them regardless of any formal lending arrangement with the International Monetary Fund (Fund). In the current context, however, we believe that support from the Fund and other multilateral financial institutions will help further boost investor confidence, including the provision of a liquidity cushion to avoid shortfalls in external inflows that could put the programme at risk. Given the broad-based nature of our reform agenda, we believe that sustained multilateral engagement over the medium term is essential, including through the provision of technical assistance in priority areas. To this end, we are requesting a 27-month Stand-By Arrangement (SBA) through March 2012 in an amount equivalent to SDR 820.5 million or 300 percent of quota (about US$1,300 million) that will support the programme detailed in the attached Memorandum of Economic and Financial Policies (MEFP).

The Government believes that the policies described in the MEFP are adequate to achieve the programme's objectives, however, if necessary, the Government stands ready to take any additional measures that may be required. The Government will consult with the Fund on the adoption of these measures and in advance of revisions to the policies contained in the MEFP, in accordance with the Fund's policies on such consultation. The Government will also provide the Fund staff with all the relevant information required to complete programme reviews and monitor performance.

The authorities will observe the standard performance criteria against imposing or intensifying exchange restrictions, introducing or modifying multiple currency practices, concluding bilateral payments agreements that are inconsistent with Article VIII of the Fund's Articles of Agreement, and imposing or intensifying import restrictions for balance of payments reasons.

During the period covered by the programme, there will be quarterly quantitative performance criteria (Table 2) and structural benchmarks (Table 3). During 2010, there will be quarterly reviews to be completed by end-May, end-August, and end-November. These reviews will be associated with the observance of the relevant performance criteria.

The Fund is hereby authorized to publish this letter and the attached MEFP, to facilitate access to and review of Jamaica's policies both locally and internationally.

Very truly yours,

Audley Shaw, MP
Minister of Finance and the Public Service
Jamaica

Very truly yours,

Brian Wynter
Governor, Bank of Jamaica
Jamaica

APPENDIX

# JAMAICA—MEMORANDUM OF ECONOMIC AND FINANCIAL POLICIES

## I. Background and Recent Developments

1. **Jamaica faces severe economic challenges.** During most of the past decade, economic growth has been low, at 1 percent a year on average. At the same time, inflation has remained relatively high, while the external current account balance registered large deficits. Anaemic growth and recurring bouts of financial market instability have been rooted in increasingly high levels of public debt, which reached 135 percent of GDP at the end of 2009. Sustained high debt service obligations and large refinancing needs have resulted in costly risk premiums and helped crowd out private sector investment. The high debt levels have also exposed the country to adverse shifts in market sentiment. With interest payments alone accounting for 60 percent of government revenues, the fiscal accounts are stretched too thin to pursue productivity-enhancing social and infrastructure investment.

2. **As a result of these structural vulnerabilities, the Jamaican economy has been deeply affected by the global crisis.** Real GDP contracted by 1½ percent in FY 2008/09 and is projected to fall by an additional 3½ percent in FY 2009/10. Tourism, remittances, and mining have been negatively impacted by the weakening in the global environment. At the beginning of the crisis, the Jamaican currency came under intense pressure, depreciating by 22 percent against the U.S. dollar. This reflected investors' concerns about potential fiscal and external financing gaps as global private credit dried up. International reserves, which initially fell significantly, have stabilized at a lower level in recent months. The Bank of Jamaica (BOJ) responded decisively to stabilize financial market conditions. The BOJ raised interest rates above 20 percent; intervened in the foreign exchange market to limit excessive volatility in the value of the currency; and established special facilities and procedures to provide liquidity and ensure normal functioning of the interbank and foreign exchange markets. The global crisis has also negatively affected the fiscal accounts, with lower revenue and a significantly higher interest bill. As a result, the budget deficit for FY 2009/10 is projected to exceed the original budget target by a wide margin. The government is therefore confronting large financing gaps in a context where external markets remain closed.

## II. Programme Objectives and Strategy

3. **The government is firmly committed to implementing policy reforms to fundamentally transform the Jamaican economy and create the conditions for strong and sustained growth.** The overarching objectives of this programme are to put the public debt/GDP ratio firmly on a downward trajectory, entrench fiscal discipline and accountability, and significantly raise real GDP growth rates. The programme rests on three central and interrelated pillars: (i) an ambitious fiscal consolidation strategy, focused on streamlining expenditure and reforming the public sector, including the divestment of non-

core public bodies; (ii) a comprehensive debt management strategy that decisively addresses the debt overhang; and (iii) reforms to further strengthen the financial system. Monetary policy will aim at bringing inflation down to mid-single digit levels and maintaining it at those levels, within the context of exchange rate flexibility.

4. **To help soften any negative impact on the poor, the programme includes important measures to strengthen the social safety net.** The government is well aware that adverse economic conditions are generating drastic changes in Jamaica. The contraction in activity has led to a significant increase in layoffs, exacerbating the already high unemployment rate. The most vulnerable social groups, with low levels of human capital, are most affected by the decline in economic activity. The programme has been designed to ensure that the adjustment burden is effectively shared across society and economic agents. Safeguards have been included to ensure that the social safety net is not only preserved but broadened, with special attention being given to enhancing those social programmes that are well targeted and far-reaching.

## III. Medium-term Macroeconomic framework

5. **The programme aims at yielding permanent growth dividends by raising growth to 2 percent by FY2011/12, with upside risks to the outlook over the longer-term.** After registering a decline during this fiscal year, real GDP is projected to rise by ½ percent in FY2010/11. The growth outlook over the programme period reflects both a gradual pick-up in activity in the mining sector, as global demand recovers, and continued investment and growth in Jamaica's highly competitive tourism sector. Restoring fiscal and debt sustainability will help reduce sovereign risk premiums and boost private sector investment. This will benefit agriculture and other activities with linkages to the tourism sector.

6. **Under the programme, inflation will trend down to the 6–7 percent range over the medium term.** Despite a temporary increase in inflation this fiscal year, resulting from the introduction of new tax measures, underlying price pressures will remain limited, given the absence of strong demand or foreign exchange market pressures. In this context, inflation is projected to fall from 12 percent in FY 2009/10 to less than 8 percent in FY2010/11. In subsequent years, monetary policy will continue to focus on quickly bringing inflation to 6 percent.

7. **Fiscal policy is aimed at eliminating the overall public sector deficit over the medium term and putting the debt-to-GDP ratio on a clear downward trajectory.** The overall public sector deficit is projected to fall from 12¾ percent of GDP in FY2009/10 to 1 percent in FY2013/14. This improvement is consistent with a significant reduction in the interest bill and an increase from 6 percent of GDP to 9 percent in the primary surplus of the central government. The debt-to-GDP will decline steadily from 140 percent in FY2009/10 to below 120 percent over the next four years. Fiscal consolidation measures will be underpinned by core structural reforms—fiscal responsibility legislation, central treasury management, and public bodies and employment reforms—that entrench fiscal discipline.

8. **In this context, the balance of payments is expected to improve markedly over the medium term.** Higher national savings as a result of fiscal adjustment, the gradual recovery in world demand, and a recovery in remittances are projected to help narrow the current account deficit from about 9½ percent of GDP in FY2009/10 to about 8¾ percent in FY2010/11 and, further, to around 5 percent of GDP over the medium term. This improvement, coupled with a projected recovery in foreign direct investment, will result in solid overall balance of payments surpluses beginning in FY2011/12. Gross international reserves are projected to remain at around 3¼–4 months of imports of goods and services during the programme period and stay around 3¾ months over the medium term.

## IV. Macroeconomic Programme

### A. Fiscal Policy

9. **The government is committed to reducing the overall public sector deficit from 12¾ percent of GDP in the current fiscal year to 5 percent in FY2011/12.** The public debt ratio is projected to fall from 140 percent of GDP at end FY2009/10 to 136 percent at end FY2011/12, including Fund credit. Consistent with these figures, the central government's primary surplus would rise from 6¼ percent of GDP in the current fiscal year to 7 percent in FY2010/11 and 7¾ percent in FY2011/12. The deficit of the public bodies is projected to decline from 3 percent of GDP to near balance in FY2011/12. Achieving these objectives requires a combination of corrective revenue and spending measures, and specific actions to reduce the interest bill. The government is committed to pass a FY2010/11 budget consistent with the program outlined below and in the attached macro-framework tables. The government believes that the measures outlined below will be sufficient to achieve these targets but is committed to take additional action to meet the targets if needed.

**Revenue and spending measures for the remainder of FY2009/10 and in FY 2010/11**

10. **To safeguard public finances, the government has introduced three packages of measures over the past year, aimed at boosting revenue by over 3 percent of GDP.** In the first phase of measures, introduced at the time of the FY 2009/10 budget, the government raised the excise tax on gasoline by J$8.75 per litre, and broadened the General Consumption Tax base by eliminating exemptions on several items. The second package, aimed at generating annualized revenue equivalent to 0.3 percent of GDP, became effective on October 1, 2009 and included increasing the GCT rate on telephone services from 20 percent to 25 percent and increasing the departure tax to J$1,800. The third package aimed at generating revenue equivalent to 1¾ percent of GDP, became effective on January 1, 2010 (prior action). This package includes the following measures:

- **General Consumption Tax (GCT)** (yield: 0.5 percent of GDP). The GCT rate was raised from 16½ percent to 17½ percent. In addition, residential electricity consumption above 200 kwh and commercial/industrial electricity consumption are subject to GCT at 10 percent; the rate of GCT applicable to the tourism sector has been increased from 8.25 percent to 10 percent; and commercial importers are now required to pay a 5 percent advanced GCT payment on all taxable imported goods.

- **Personal income tax.** Tax rates for income over J$5 million but below J$10 million and for income over J$10 million have been adjusted from 25 percent to 27.5 percent and 35 percent respectively, until March 31, 2011. The yield is estimated at 0.1 percent of GDP.

- **Fuel tax**. An ad valorem fuel tax of 15 percent was applied. It is expected to generate revenue equivalent to 0.9 percent of GDP on a full-year basis.

- **Other taxes**. A freeze was introduced in the granting or renewal of discretionary waivers of duties and taxes; excise taxes on cigarettes were raised; and license fees for large motor cars were increased as were the common external tariff on various luxury items. The yield is estimated at 0.3 percent of GDP.

11. **On the expenditure side, the freeze on wage and salary increases will be maintained through FY2011/12, and primary spending in FY2010/11 will be reduced by 1¼ percent of GDP, excluding the one-time costs associated with divesting Air Jamaica.**

- **Wages and salaries.** The government is committed to maintaining the current public service wage freeze on salary increases into FY2011/12, while it develops a comprehensive reform of the public sector. Wage and salary increases agreed for periods prior to FY2009/10 that have not yet been paid will be paid in instalments over the medium term. Similar treatment will also be applied in the event that an award is made to health care workers in the reclassification case now under arbitration. Overall, this scheduling across the medium term will help generate savings of close to 1 percent of GDP in FY2010/11. New compensation agreements will be better aligned with the budget process and budget constraints to ensure that the government's objective of reducing the size of the wage bill from 11¾ percent of GDP to about 9½ percent over the next four years is achieved.

- **Cost containment in recurrent expenditure programmes**. The budget for FY2010/11 will freeze or reduce allocations in a number of areas. Most notably, a nominal freeze will be extended to purchases of goods and services, awards, and indemnities, and travel costs will be cut by 10 percent. Allocations for public utility costs in ministries and agencies will be reduced by at least 5 percent, benefiting from a recently-launched energy saving programme. A nominal freeze will also be implemented on tuition subsidies for tertiary education at the level of the FY2009/10 budget, while a system of means testing will be introduced. Subsidies on external school examination fees will be reduced, by improving the incentive structure (e.g. providing reimbursement based on results). These measures will provide a combined fiscal saving of 0.5 percent of GDP.

12. **To help protect the poor, the social safety net will be significantly enhanced.** Resources within the social assistance envelope will be reallocated to the better targeted programmes. Spending on these programmes will be increased by at least 25 percent in FY2010/11 (0.3 percent of GDP). In particular, this increase will benefit the school feeding programme, which provides breakfast and lunches to children; and the Programme of Advancement through Health and Education (PATH), which provides conditional cash transfers to five categories within the poorest income groups. Coverage of PATH will be expanded from the current 327,000 to 360,000. A Steps to Work programme, aimed at improving the employability of working age members of PATH households has been launched. The government will also be pursuing efforts to expand the social safety net to assist persons below the poverty line who do not qualify for PATH assistance.

13. **In the area of public bodies, which has been a constant drain on public resources, significant improvement is to be achieved in the following key public bodies:**

- **Air Jamaica will be divested or liquidated.** The elimination of losses from Air Jamaica is a key priority for the government. To that effect, the government is committed to finalizing an agreement for the sale of the company to a strategic partner, or to arrange the liquidation of the company. The arrangement will not entail subsidies or guarantees of any kind to the airline or to the strategic partner. The costs associated with the divestment of the airline, including for the cancellation of airplane lease agreements, fees to workers, and tax payments due to foreign tax administration agencies will be addressed (prior action).

- **The activities of Petrojam will remain streamlined.** To avoid further increases in the public debt due to the activities of public bodies, the government will not participate in the planned Petrojam refinery expansion project. The cost of this project—estimated at around 10 percent of GDP—is prohibitive in the current economic and fiscal context. The government is exploring with the foreign shareholder the possibility of alternate means of financing the project that will involve no Jamaica liability. In any case, no public sector debt, directly contracted or guaranteed by any public sector institution, will be involved in the financing of this project.

- **Divestment of the assets of Sugar Company of Jamaica will continue** Already, two factories have been sold, and the government is seeking to divest the remaining three factories. In the interim, these factories will be either leased or put on a strict zero-deficit budget by March 2010.

- **The net operational loss of the Jamaica Urban Transit Company (JUTC) will be reduced by 40 percent.** An increase of not less than 40 percent in bus fares approved by the Office of Utility Regulations in October 2009 will be implemented effective April 1, 2010. Further improvements in the financial situation of this company will be achieved from recent initiatives to curb illegal bus and taxi operators and continued improvements in cost efficiency.

**Public Debt Exchange**

14. **The government will engage its creditors in a debt exchange aimed at securing fiscal savings by exchanging existing high cost debt for new instruments that have lower coupons and longer maturities.** The success of the exchange is essential to closing the government's financing gap. It will also reduce the periodic bouts of financial market instability arising from large rollover requirements and improve the structure of the debt to ensure sustainability. The debt exchange will be undertaken in January 2010, in advance of the IMF's Board meeting to approve the requested SBA (prior action). Its key elements are as follows:

- **Objectives**. The exchange explicitly targets achieving: (i) interest saving of at least 3 percent of GDP next fiscal year; and (ii) a reduction by at least two thirds in maturing domestic debt over the next 36 months.

- **Bonds exchanged**. The operation targets a high proportion of the government's domestically-issued bonds (J$701.4 billion, or 65 percent of GDP), with a special focus on short-dated instruments (i.e., those maturing within the next two years) and high-coupon fixed-rate instruments. If necessary, the government intends to strategically exercise call options embedded in existing bonds in support of the debt exchange.

- **New bonds**. A mix of fixed and variable interest instruments, including inflation indexed bonds will be offered in the exchange, with the aim of developing new benchmark securities along the yield curve. The exchange is to be par-neutral. The lower interest rate coupons will still provide investors positive real rates of return, based on improved prospects for underlying inflation and exchange rate fundamentals.

15. **The debt_exchange has been designed carefully, recognizing the need to avoid jeopardizing the stability of the domestic financial system.** Development of contingent measures is an important aspect of this design. A contingency planning framework is in place with the Financial Regulatory Council (FRC) taking the leadership role for ensuring appropriate coordination and communications. FRC is an interagency policy level group, chaired by the BOJ. Moreover, supervisors perform monthly stress tests (more frequently if circumstances warrant), which allow them to identify and develop plans for institutions which might be impacted under the various stress testing scenarios. Further, funds from the multilateral institutions will be devoted to establishing a Financial Sector Support Fund (FSSF) in the amount of approximately US$1 billion, immediately following disbursement under the IMF programme. This fund will be established by the government and administered by the BOJ.

16. **Deposit taking institutions, securities dealers, and insurance companies will be eligible for access to the FSSF provided the institution and the group to which the institution belongs tender in the debt exchange at least 90 percent of eligible assets.** Institutions and groups must participate by first exchanging instruments that generate the highest savings to the government (taking into account both coupon and maturity). The government will authorize access to the FSSF, informed by the assessment and recommendation of the FRC.

17. **The FSSF will be overseen by the FRC.** The FRC will use the existing technical working group (TWG), also chaired by BOJ staff, to assess applications from institutions seeking financial assistance. Assessments will be made of the liquidity needs of the system and the financial condition of the institution requesting support. The work of the TWG will be ongoing, and it will provide periodic reports to the FRC. The FRC will monitor specific thresholds, which will trigger further evaluation and action by the primary supervisor.

18. **The FSSF will be used primarily to provide temporary assistance to institutions in the event of liquidity needs, including from external borrowing on margin.** The disbursement of funds will be secured by eligible collateral, which would be Government of Jamaica (GOJ) instruments. Institutions should be required to repay liquidity support extended under the FSSF as quickly as possible. After a period of 6 months, this liquidity should be repaid or become subject to a punitive interest rate. We have developed a framework for supervisory action based on the level of liquidity support provided as a percentage of capital. If the stock of liquidity reaches certain levels, institutions will be subject to escalating supervisory response including inspections, intensive monitoring, and intervention. The authorities will consult with the Fund once 50 percent of the FSSF resources have been disbursed.

19. **All necessary measures will be taken to ensure stability of the financial system.** Institutions receiving support will be subject to intensive supervision. Any institution receiving support for recapitalization will be required to submit an agreed plan of recapitalization and operational restructuring, restrictions on dividend payments, and other measures as determined by supervisors. For safety and soundness reasons, supervisors have the authority to intervene in all institutions. This authority includes taking temporary management, which suspends the rights of shareholders and managers for at least 60 days. The government maintains its commitment to resolving any institution which does not meet the full solvency requirements, in accordance with existing legal and regulatory frameworks and consistent with the objective of maintaining financial system stability.

20. **Beyond the debt exchange, the government will strengthen its debt management strategy.** The strategy will include an explicit assessment of the cost-risk analysis of alternative portfolio options, and enhance transparency and communication with market players and rating agencies by June 2010. The government will also seek technical

assistance from the IMF to look into institutional features of the government securities market in order to make it more competitive.

## B. Structural Fiscal Reforms

21. **The programme prioritizes a set of structural fiscal reforms that aim at entrenching fiscal discipline and bolstering transparency.** These reforms will help ensure that the gains achieved during the programme period will be sustained and deepened over the medium term.

### Public Sector Reform

22. **The government is committed to rationalizing the public sector with a view to improving efficiency and cost effectiveness.** A committee appointed by the Prime Minister is reviewing the existing structure of the public sector and will present recommendations by September 2010 on the formulation of a new structure. The current structure is characterized by many entities with unclear or overlapping functions. The government commits to implementing the core recommendations of the committee no later than FY2011/12 and to gradually reduce the wage bill from 11½ percent of GDP at present to around 9½ percent in the medium term. In this context, the government believes that it is critical to increase its control over public sector compensation and ensure that public employment costs are transparently reported. To achieve these objectives the government will:

- Complete a census of all government positions, compensation, and description of function (by end-June 2010).
- Create and maintain a comprehensive database of employment and compensation in the public sector, updating on a regular basis the census information (by end-June 2010 and thereafter).
- Finalize and present the Prime Minister's Committee Report on Public Sector Reform (by end-September 2010).
- Complete a time-bound public employment reform action plan, which will be implemented in time for the FY2011/12 budget (by end-December 2010) (structural benchmark).

23. **The ongoing rationalization and reform of Jamaica's public bodies will continue over the medium term.** This reform has been a priority of this administration since taking office. The government's three-pronged plan aims at: (i) divesting commercial entities; (ii) merging entities when feasible to bolster efficiencies; and (iii) winding-up inactive entities. Guiding the government's approach are two fundamental principles: the

priority given to reducing public debt and the need to reduce the size of the public sector, particularly through divesting activities that ought to be carried out more efficiently by the private sector. The government has identified twenty parastatal entities to be divested. With respect to mergers and the winding up of inactive entities, the government has also identified a wide set of candidates. It is expected that a number of entities will be merged and more than 50 inactive enterprises will be closed over the next 3 years. A plan to this effect will be completed in time to be implemented beginning in the upcoming fiscal year. A Fiscal Responsibility Framework (see below) will increase the entities' accountability by requiring approval of their budgets by Parliament, while transparency will be increased through a stricter enforcement of reporting and auditing standards. In order to ensure that sought after efficiency gains are realized, the government plans to agree to performance targets with the management of each entity, in line with the nature of each entity's core functions.

## Tax Reform

24. **The government will deepen reforms to strengthen tax administration.** In the short term, this includes: (1) adopting a comprehensive reform strategy including a time bound action plan to unify the domestic tax administration; (2) vesting the necessary legal and administrative powers in the Tax Administration Director General instead of the respective commissioner of each department; (3) expanding the large taxpayers office; (4) facilitating compliance through streamlined procedures; and (5) developing an interface between the domestic tax and customs IT systems to exchange information between departments. By June 2010, a time-bound action plan will be designed to implement these reforms.

25. **Key tax policy reforms will also be undertaken.** The government remains committed to significantly scale back the system of tax incentives and exemptions in order to significantly broaden the tax base, reduce distortions in the system, and allow a phased reduction in the corporate tax rate to a more competitive level. The freeze in granting of discretionary waivers on duties and taxes is the first step in this process. The government will prepare and announce by September 2010 a strategy for the reform of tax incentives. At the same time, the government is committed to spearheading the revival of negotiations on tax coordination under the auspices of CARICOM.

## Public Expenditure Management

26. **The government will enact legislation before the end of FY2009/10 to establish a fiscal responsibility framework (FRF).** The overall objective is to operationalize the key principles of prudent fiscal management in order to ensure that the institutional framework is consistent with achieving the government's short- and medium-term fiscal targets. The FRF will provide for clearly articulated fiscal policies, including a medium-term fiscal framework; greater transparency through various reporting requirements;

stricter accountability in the management of public finances; and a better level of oversight of fiscal policy and the management of public funds. The FRF will provide for improved public financial management through expanding the coverage of the budget to all general government institutions; enshrining the principle of no spending without prior budget appropriation; and requiring approval by parliament of the budget of each of the "self financed" public bodies. By March 2010, the FRF will be integrated into the Financial Administration and Audit Act, while the Public Bodies Management and Accountability Act will also be amended to ensure consistency with the FRF (structural benchmark).

27. **Central Treasury Management System.** The government is pursuing the establishment of a central treasury management system (CTMS) to bring responsibility for treasury management functions under one agency. The CTMS will establish a Treasury Single Account (TSA) to improve cash management. The government plans to consolidate all general government cash resources in the TSA. All funds, including special funds, owned by general government entities and held in financial institutions would be transferred to the TSA and those accounts would then be closed. The government is receiving assistance in establishing the CTMS from several multilateral agencies including the IMF. A step-by-step plan for consolidation will be fully completed by end-June 2010 with the help of IMF technical assistance (structural benchmark). This includes the preparation of an inventory of all accounts of general government entities, sources of inflows, rules for outflows, and the existing balances. The government is committed to have an operational CTMS system by end-December 2010 in order to support the implementation of the FY2011/12 budget.

## C. Monetary and exchange rate policy

28. **Monetary policy will focus on reducing inflation and supporting the operations of the domestic financial system.** The BOJ will safeguard the programme's inflation objective. In the aftermath of the debt exchange, the BOJ will monitor closely operations in the financial system to identify liquidity pressures.

29. **The BOJ will continue to manage monetary policy within the framework of a managed floating exchange rate regime.** The BOJ will allow the exchange rate to move freely while using its instruments to ensure stability in credit and foreign exchange markets in the short and medium term. To that end, the programme will contain clear reserve targets to safeguard the adequacy of reserve coverage—a key policy priority in the current context.

## D. Strengthening the Financial System

30. **Important work needs to be undertaken to respond to the challenges posed by Jamaica's highly interconnected financial institutions.** Implementing recommendations made during the 2006 IMF/World Bank Financial Sector Assessment Program (FSAP) will introduce a number of reforms by June 2011. The government plans to pass an omnibus banking law that will allow for more effective supervision of financial conglomerates,

including by harmonizing the prudential standards that apply to commercial banks, merchant banks, and building societies. Toward this end, the BOJ's concept paper for an omnibus banking law and the related legislative and regulatory framework to strengthen the oversight of the financial sector (as identified in the 2006 FSAP),will be reviewed and revised, in consultation with IMF (structural benchmark). The Bank of Jamaica Act and the Financial Services Commission Act will both be amended to further strengthen supervisory tools. Stronger capital adequacy standards will be developed for all financial institutions to achieve fullest compliance with international standards, in consultation with the Fund. Additionally, supervisors will adopt rules which require them to take remedial measures against a weak entity within specific timeframes (prompt corrective action) (December 2010).

31. **The Bank of Jamaica Act will also be amended to establish the legal framework to underpin its responsibility for overall financial system stability by December 2010**. This will allow the BOJ to access data from parent or affiliate institutions that might not be a part of a conglomerate group. It will also provide a stronger basis for the BOJ to provide financial support to nonbanks, if needed for securing financial system stability during periods of extreme volatility. The BOJ will develop procedures for providing liquidity facilities to primary dealers.

32. **There are several additional reforms pertaining specifically to deposit-taking institutions that will be developed, in consultation with the Fund.** Other key reforms will deal with enhancing capital rules to address all market risks (December 2010), including equity and interest rate risks; improving the frameworks for AML/CFT (March 2010); and combating unregulated financial organizations by June 2010 (structural benchmark).

33. **The government will reform the securities dealer sector to strengthen its ability to withstand shocks going forward.** A major problem with the securities dealer sector as currently structured is that liquidity and maturity risk are held on the security dealer's balance sheet and capital requirements are not comprehensive, as identified in the FSAP. In keeping with FSAP recommendations and technical assistance from CARTAC, the government is taking steps to shift risks to investors by encouraging the development of collective investment schemes, including by amending the Unit Trust Act. Amendments to this act will come into effect by December 2010. Thereafter, the existing freeze on new registrations of unit trusts (and new unit trust products) will be lifted. At the same time, the government is committed to removing structural impediments to the development of a vibrant local mutual fund market, including by exempting mutual funds from onerous provisions in the Companies Act of Jamaica by December 2010.

34. **In addition, the government will continue strengthening the regulatory and supervisory framework of the securities dealers sector.** Reforms to enhance capitalization and margin requirements, to include a liquidity risk component and an operational risk component will be developed in consultation with the Fund. It is expected

that draft regulations will be ready by August 2010, to be fully implemented by March 2012. Until that time, we will place a temporary freeze on issuing new licenses for securities dealers whose business model is based on repos and other short-term liabilities, except coming out of mergers and/or acquisitions of existing firms (structural benchmark). The government is committed to ensuring that any new applicants have robust financial resources, a well-diversified business model and knowledgeable management and staff. The government will also press ahead with an initiative underway to improve the stress testing and contingency planning capacity of the Financial Services Commission (FSC). Draft legislation will be presented to Parliament for approval in early FY2011/12 to close gaps in the power of the FSC to conduct consolidated supervision, in line with the BOJ's omnibus banking bill. Dealers' repo contracts are a source of risk. Dealers will be required to register customer interest against underlying instruments in a central securities depository by September 2010. To ensure that the enhanced legal framework is technically sound and the agreed timetable in the program is met, the FSC would require IMF technical assistance to develop the new risk-based capital framework to incorporate elements such as operational risk and liquidity risk.

## V. Financing under the Programme

35. **In support of the economic programme, the government envisages the need for financing from multilateral sources of US$2.4 billion over the next two years.** Of this, about half would be required upfront to address immediate budget financing and balance of payments needs as well as the establishment of the FSSF. Total funding from the IMF is expected to be SDR 820.5 million or 300 percent of quota (about US$1,300 million), with about half provided up front. Loan commitments over the next two years from the IDB, World Bank, and the Caribbean Development Bank are US$1.1 billion. In addition, Jamaica will continue to draw financing from the PetroCaribe facility and to strategically access external commercial markets, which are expected to re-open before the end of the next fiscal year. Remaining financing needs will be filled through domestic financial sector borrowing.

## VI. Safeguards Assessment

36. **The government fully recognizes the importance of completing a safeguards assessment of BOJ before the first review of the Stand-By Arrangement.** To facilitate such an assessment, the central bank's external auditors have been authorized to hold discussions directly with Fund staff. An IMF mission to conduct the safeguards assessment is scheduled for February 2010 and the BOJ will provide Fund staff with all necessary information in preparation of that mission.

## VII. Programme Monitoring

37. **The programme will be monitored on a quarterly basis, through quantitative performance criteria, indicative targets, and structural benchmarks.** The phasing of access under the arrangement and the review schedule are set out in Table 1 of this memorandum. The quantitative performance criteria and indicative targets through end-March 2011 are set out in Table 2. Targets for the remainder of FY2010/11 will be identified at the time of the second programme review. Programme reviews will assess the achievement of the quantitative targets and focus on progress in key structural reforms. In this context, the first programme review will focus on the FY 2010/11 budget and the implementation of the fiscal responsibility framework. The review will also examine the plans for recapitalizing financial institutions. The second review will focus on fiscal reforms, specifically in the debt management, tax, and public financial management areas. It will also review progress in the various initiatives aimed at strengthening financial system regulatory and supervisory framework. The third review will focus on public bodies and employment reforms as well as progress in financial sector reforms. Structural benchmarks are set out in Table 3.

Table 1. Jamaica: Schedule of reviews and Purchases

| Date | Amount of Purchase Millions of SDR | Percent of Quota | Conditions |
|---|---|---|---|
| January 27, 2010 | 414.3 | 151.5 | Approval of arrangement |
| May 31, 2010 | 63.7 | 23.3 | First review and end-March 2010 performance criteria |
| August 31, 2010 | 31.9 | 11.7 | Second review and end-June 2010 performance criteria |
| November 30, 2010 | 31.9 | 11.7 | Third review and end-September 2010 performance criteria |
| February 28, 2011 | 127.5 | 46.6 | Fourth review and end-December 2010 performance criteria |
| May 31, 2011 | 31.9 | 11.7 | Fifth review and end-March 2011 performance criteria |
| August 31, 2011 | 31.9 | 11.7 | Sixth review and end-June 2011 performance criteria |
| November 30, 2011 | 31.9 | 11.7 | Seventh review and end-September 2011 performance criteria |
| February 28, 2012 | 31.9 | 11.7 | Eighth review and end-December 2011 performance criteria |
| Total | 796.7 | 291.3 | |

Table 2: Jamaica: Quantitative Performance Criteria 1/

| | 2010 | | | | 2011 |
|---|---|---|---|---|---|
| | end Mar. 6/ | end Jun. | end Sept. | end Dec. | end Mar. |
| | Performance criteria | | Indicative targets | | |
| **Fiscal targets** | | | | | |
| 1. Primary balance of the central administration (floor) 2/ 3/ | 66.9 | 12.1 | 31.5 | 51.7 | 83.3 |
| 2. Overall balance of public entities (floor) 2/ 3/ | -29.6 | -3.0 | -6.0 | -8.9 | -11.9 |
| 3. Central government direct debt (ceiling) 3/ | 1260.4 | 1287.2 | 1306.6 | 1325.2 | 1332.4 |
| 4. Cumulative net increase in central government guaranteed debt (ceiling) 2/ 4/ | 32.8 | 3.0 | 3.0 | 3.0 | 3.0 |
| 5. Central government accumulation of domestic arrears (ceiling) 5/ | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| 6. Central government accumulation of tax arrears (ceiling) 7/ | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| 7. Consolidated government accumulation of external arrears (ceiling) /8 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Monetary targets** | | | | | |
| 8. Cumulative change in net international reserves (floor) 8/ | -351 | -534 | -673 | -617 | -651 |
| 9. Net domestic assets (ceiling) | -49.1 | -33.7 | -20.6 | -11.2 | -18.5 |

1/ Targets as defined in the Technical memorandum of Understanding.
2/ Cumulative flows through April 1 to March 31.
3/ Excludes government guaranteed debt. In billions of Jamaican dollars. The central government direct debt excludes IMF credits.
4/ In billions of Jamaican dollars.
5/ Includes debt payments, supplies and other committed spending as per contractual obligations.
6/ Includes February and March 2010, under the assumption that the program begins on February 1, 2010.
7/ Includes all arrears in refunding taxpayers owed refunds stipulated by law.
8/ In millions of US dollars.

Table 3: Jamaica: Programme Conditionality.

| | *Measure* | Conditionality | Timing |
|---|---|---|---|
| | **Prior Actions** | | |
| **Government Finances** | | | |
| 1 | Adopt a tax policy package yielding around 2 percent of GDP (MEFP, paragraph 10). | Prior action | December 2009 |
| **Public debt management** | | | |
| 2 | Launch and complete debt exchange operation that, in comparison to the existing securities, achieves an estimated saving of over 3 percent of GDP in FY2010/11 and a reduction in the amount of debt maturing during 2010-2012 by at least two thirds. (MEFP, paragraph 14). | Prior action | January 2010 |
| **Public entities** | | | |
| 3 | Reach agreement on divestment of Air Jamaica or initiate plans to liquidate the airline by June 2010 (MEFP, paragraph 13). | Prior action | January 2010 |
| | **Structural Benchmarks** | | |
| **Institutional Fiscal Reform** | | | |
| 4 | Complete a time-bound plan to establish a central treasury management system by end-2010 (MEFP, paragraph 28). | Benchmark | June 2010 |
| 5 | Pass a fiscal responsibility framework and accompanying legislative amendments (MEFP, paragraph 27). | Benchmark | March 2010 |
| 6 | Design a public employment and compensation reform (MEFP, paragraph 23). | Benchmark | December 2010 |
| **Financial sector reform** | | | |
| 7 | Review and revise, in consultation with IMF, the BOJ's concept paper for an omnibus banking law and the related legislative and regulatory framework to strengthen the oversight of the financial sector (as identified in the 2006 FSAP), (MEFP, paragraph 30). | Benchmark | March 2010 |
| 8 | Draft a concept paper, in consultation with the IMF, on all major elements to be included in legislation and other measures to address unregulated financial organizations (MEFP, paragraph 32). | Benchmark | June 2010 |
| 9 | Introduce a temporary freeze on issuing new licenses for securities dealers whose business model is based on repos and other short-term liabilities (MEFP, paragraph 34). | Benchmark | February 2010 |

| Jamaica: Medium Term Macro-Economic Targets | 2007/08 | 2008/09 | 2009/10 | 2010/11 | 2011/12 | 2012/13 | 2013/14 |
|---|---|---|---|---|---|---|---|
| ***GDP (Real)*** | | | | | | | |
| % Chg | 0.6 | -1.6 | -3.5 | 0.6 | 1.9 | 1.9 | 2.0 |
| **GDP @ Current Mkt. Prices*** | 923 | 1037 | 1071 | 1194 | 1317 | 1445 | 1582 |
| % Chg | 13.2 | 12.3 | 3.3 | 11.5 | 10.3 | 9.7 | 9.5 |
| ***Inflation*** | | | | | | | |
| Annual Pt to Pt | 19.9 | 12.4 | 12.2 | 7.3 | 7.0 | 6.5 | 6.0 |
| Annual Average | 12.4 | 20.2 | 9.0 | 11.2 | 7.1 | 6.7 | 6.3 |
| ***Balance of Payments*** | | | | | | | |
| Current Account/GDP | -16.9 | -18.0 | -9.4 | -8.8 | -6.6 | -5.9 | -5.0 |
| NIR | 2083 | 1629 | 1378 | 1078 | 1325 | 1450 | 1761.0 |
| Gross Reserves | 2106 | 1664 | 2051 | 2151 | 2598 | 2640 | 2579.0 |
| Gross Reserves in weeks of imports | 12.1 | 12.8 | 14.8 | 14.6 | 17.0 | 16.7 | 15.8 |
| **Fiscal Balance** | -3.8 | -7.3 | -10.0 | -6.5 | -4.3 | -2.6 | -0.7 |
| (Primary balance) | 7.8 | 4.8 | 6.2 | 7.0 | 7.7 | 8.3 | 9.1 |