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JAMAICA

January 13, 2014

POLICY LETTER

Jamaica Competitiveness Enhancement Programme

Mr. Luis Alberto Moreno
President
Inter-American Development Bank
Washington, D.C.

Dear Mr. Moreno:

The Government of Jamaica (GOJ) continues to undertake a broad set of structural reforms aimed at promoting strong and sustained economic growth

One of the priorities of the overall structural reform is an improvement of the business climate in Jamaica, which includes: (i) a sound predictable macroeconomic framework that maintains low inflation; a stable exchange rate system and competitive interest rates; (ii) a simple and competitive tax system; (iii) the creation of social partnerships involving the Government, opposition, private sector and trade unions; (iv) an improvement in access to finance; and (v) a reduction in the cost of business transactions.

Notwithstanding the objectives of the structural reform agenda, the global crisis has highlighted structural weaknesses in the economy which have exacerbated the negative impact of the crisis and restricted Jamaica's recovery efforts. The structural reforms aimed at improving the business climate would, therefore, play a pivotal role in aiding Jamaica's recovery effort.

To assist in the improvement of the business climate, the GOJ has engaged the Inter-American Development Bank to provide a third programmatic loan to support the "Competitiveness Enhancement Programme", with technical assistance during its execution in 2010.

The Competitiveness Enhancement Programme consists of five components that are designed to support the Government's overall objectives. The five components include: (a) the institutional framework for competitiveness: (b) tax reform, (c) reduction in the budgetary burden of state owned enterprises; (d) improved access to finance and financial market development; and (e) reduction of business costs through expedited land titling and registration.

This policy letter, thus, sets out the macroeconomic background in which the second programmatic loan to support the Competitiveness Enhancement Programme was implemented and the status of each component.

I. Background

The global economy is just now slowly recovering from the deepest recession since the Great Depression of the 1930s and Jamaica like so many other countries was buffeted by the attendant exogenous shocks that emanated while recovering from the internal shocks of broad-based financial sector meltdowns over the 1996-1998 period and significant private sector contraction in aggregate terms because of economic and social uncertainties. Many of the economic gains of the previous decade were erased. However, Jamaica has been one of a few countries that also chose that time interval to embark on an ambitious reform agenda aimed at mitigating the impacts of the crisis as well as laying the groundwork for increased economic growth and macroeconomic stability over the medium term. In order to address the impact of the global economic downturn and advance the reform agenda, Jamaica entered into a new borrowing relationship with the IMF in February 2010 under a 3-year Stand-By Arrangement (SBA). The strategy included fiscal consolidation, improvement in competitiveness, debt reduction, modernization of the financial sector and improved social protection programs. However, the IMF SBA was suspended in 2011.

Negotiations began in the first quarter of 2012 toward a new agreement. The absence of an IMF agreement resulted in restricted flows from the International Development Community and heightened uncertainty within the domestic economy. In furtherance of the execution of the reform agenda the Government of Jamaica entered into an IMF 4-year Extended Fund Facility (EFF) for approximately US$948.1 million (representing 225% of Jamaica's quota) in May 2013 after months of negotiations between the Government and the Fund, including consultations with local stakeholders in the private sector and trade unions. The EFF is supported by other International Development Partners (IDPs), including the World Bank and the IDB, which have each committed US$510 million over the next four years. The program places significant emphasis on frontloaded reform with a view to facilitating faster economic recovery with the principal objective being to place public debt on a sustainable downward trajectory, thereby creating a virtuous cycle of debt sustainability and higher economic growth. As such, Jamaica requires annual primary surpluses of 7.5 percent over an extended period of time to reduce debt-to-GDP to the targeted 96% by March 2020.

Whereas the economy has now begun to show signs of recovery, it is readily recognized that such a process remains tenuous and that there is further need for additional macroeconomic and structural reforms to facilitate sustained socially inclusive growth over the medium term. In this regard the main pillars of the program are: (i) structural reforms to boost growth and employment; (ii) actions to improve price and non-price competitiveness; (iii) frontloaded fiscal adjustment with the attendant reforms; (iv) debt reduction while maintaining financial stability; and (v) improved social protection programs. Indeed the current dynamic dictates that it is imperative that the policy framework guiding economic activity over the medium term must be aimed at facilitating macroeconomic stability, within the confines of an entrepreneurial economy led by the private sector that is competitive and business oriented but which boasts broad-based and inclusive economic growth.

This within a context where the Jamaican economy has basically stagnated over the past four decades and where per capita real income has grown by only about 0.12 percent per year on average. It is instructive to note that in 2007 real wages were 67 percent of their attained levels in 1972. This has occurred against the backdrop of high investment to GDP ratios (approximately 30 percent) which imply highly inefficient investment. This is in stark contrast to comparator economies where high investment ratios, have been accompanied by improvements in productivity and growth. For 2012, GDP decreased in real terms by 0.5 percent. Inflation was 8.0 percent relative to 6.0 percent realized in 2011 within the context of a stable exchange rate and interest rates on a downward trajectory. Nevertheless, the Jamaican economy continued to be plagued with the chronic problems of disequilibria in its internal and external accounts. The strategy of trying to encourage growth through the public sector has not been successful. Furthermore, within the context of restrictive fiscal space utilizing public investment as a means of promoting growth in the country will be limited. The Government and IDP community collectively recognize that the only way to raise the long-run economic growth rate is to dramatically improve the performance of the private sector. Therefore, in an attempt to restore long-run growth over the medium-term, GOJ has embarked on a programme to facilitate an improvement in the business environment along with the institution of various reforms to improve national competitiveness.

The current policy framework of fiscal consolidation aims at establishing macroeconomic stability conditions that could serve as a platform for economic growth. However, as with all stabilization programs, these are necessary but not sufficient conditions for growth, and should be complemented by strategic interventions to foster growth at the industry and firm level. However these targets require a strategic shift that necessitates steadfast and dedicated technical and analytical work to identify and remove longstanding structural impediments which have led to the underperformance and weak competitiveness of the economy. It will also involve promoting modernization and global competitiveness in areas of competitive advantages and in crafting a new paradigm for the relationship between the public sector and the private sector to one more aligned with the tenets of a private-sector led market based economy.

Recent Developments

Economic performance over the first half of FY 2013/14 has been mixed, reflecting a challenging economic environment as aggregate demand remained weak, unemployment levels rose and the purchasing power of individuals declined. Following six consecutive quarters of economic contraction, real GDP is estimated to have expanded by 0.5% during the September 2013 quarter, supported by growth in tourism, mining and agriculture. For FY 2013/14, real economic growth is currently projected at 0.8%, which is in line with the growth projected at the time of the budget.

Twelve-month point to point inflation reached 10.2% in November 2013, mainly driven by the pass-through of depreciation of the Jamaica dollar into domestic prices, seasonal price adjustments and increased administered prices, such as utility rates and transport price.

The external situation has improved with the current account deficit now projected at 10 percent of GDP for FY 2013/14, compared to 12.5% in FY 2012/13. Net international reserves (NIR) stood at US$910mn by end-September 2013, largely reflecting seasonal effects, and in compliance with the EFF's NIR target. As of end-November 2013, NIR fell to US$836mn however a gradual improvement to US$1,246mn is expected by end-March 2014 due to programmed inflows from multilateral institutions and improvements in net private capital flows.

Fiscal performance was quite resilient during the first half of the fiscal year with all the quantitative performance criteria and indicative targets for September 2013 under the EFF met or surpassed. In addition, all structural benchmarks to September 2013 under the programme were met, except for the tabling of the Fiscal Incentive Legislation, which was tabled in October with the agreement of the IMF, rather than the scheduled September. The delay in tabling which was accommodated by the IMF, allowed additional technical inputs to inform development of the Bill however the enactment of the regime will not be affected by the delay in tabling. The Bill was passed in both Houses of Parliament and became law in December 2013.

At end-November 2013, both the Central Government primary surplus and fiscal deficit were better than budgeted. Provisional data indicate that Central Government operations to November 2013 generated a fiscal deficit of $24,917.2mn, compared to the targeted deficit of $30,032.7 mn. The primary surplus amounted to $42,533.4 mn, which was 3.0% better than the $41,296.8 targeted.

With respect to the EFF, there have been two quarterly reviews in 2013, which have both been successfully completed. The Government of Jamaica continued to roll-out several initiatives aligned to its Growth Agenda, which is a comprehensive package of strategies and initiatives aimed at systematically improving the facilitatory framework for business operations.

Short Term Prospects

The Jamaican economy is estimated to have grown during October – December 2013 (1.0 percent) and to grow in FY 2013/14 (0.8 percent). It is important to note, that downside risks which may adversely impact these estimates include; a worsening in global macroeconomic conditions which would adversely impact the demand for Jamaican goods and services; unfavourable weather conditions, particularly drought conditions which would constrain the output of agricultural goods and water production. On the other hand upside risks also exist, including faster than anticipated growth in the global economy which would spur the demand for Jamaican exports, namely tourism, alumina and manufactured goods. Additionally, the country is likely to benefit from: (i) an increase in domestic confidence levels as the GOJ remains committed to the economic programme which is supported by an IMF loan under the Extended Fund Facility; (ii) the continued implementation of the Growth Agenda which has elements associated with improving the business environment, such as credit access, and strategic investments inclusive of Agro Parks and the construction of new energy plants; and (iii) heightened civil engineering activities associated with an earlier than anticipated start of road rehabilitation under the Major Infrastructural Development programme. For October 2013-March 2014, the Jamaican economy is expected to grow by 1.3 per cent.

I. Structural Reforms Associated with the Programme

a. Institutional Framework for Competitiveness.

The GOJ has created a sustainable Forum, dubbed Partnership for Jamaica (PFJ) in July 2013, replete with a fully functioning technical secretariat to promote public-private dialogue for discussion and agreement between the Government, Private Sector, Academia, Trade Unions and Civil Society. Regular meetings are being held with the entity maintaining its centrality of focus on its core objectives of promoting and reaching consensus on economic growth. Further, work continues apace at the National Competitiveness Committee (NCC), which supports initiatives at the level of the firm geared towards the improvement of the country's competitiveness. The NCC has developed an agenda for reforms for 2012 -2015. The NCC has a dedicated technical secretariat that is fully coordinated with that which obtains for the PFJ to avoid overlap and ensure efficiency and optimization of effort.

b. Tax Reform

In order to maintain a sound macro-economic framework with sound fiscal and monetary policies, moderate public debt levels, low inflation, competitive interest rates, a stable exchange rate system and a business-friendly regulatory framework, the GOJ continues to adhere to its timetable for the implementation of a programme of comprehensive tax reform designed to simplify the tax system, increase equity, remove disincentives and distortions to investment and job creation and ensure greater compliance. The Tax Reform process is ongoing with the key objective of generating adequate revenue through: simplifying the taxation system; reducing economic distortions; broadening the tax base and eliminating ministerial discretion in the granting of waivers and incentives. Reform activities undertaken include:

- The Charities Bill which was passed in November 2013 introduced the concept of Registered Charities with clear requirements for designation as such. Statutory provisions will govern the tax related operations of Registered Charities.
- The Fiscal Incentive Bills which were passed by both Houses in December 2013 will see the replacement of the multiplicity of discretionary tax waivers and sectoral tax incentives by a rules-based and standardized system of incentives. The Bills passed were the Fiscal Incentives (Miscellaneous Provisions) Act; and the Income Tax Relief (Large Scale Projects and Pioneer Industries) Act 2013. The Fiscal Incentives (Miscellaneous Provisions) Act 2013 sets out the reforms to be carried out to corporate tax including the introduction of an Employment Tax Credit (ETC), changes to the capital allowance regime, and revision of provisions governing the utilisation of tax losses. The Bill also deals with "grandfathering" & transitional arrangements relating to change from the old to the new incentives regime.
- Broader Tax Reform efforts including administrative changes at both Tax Administration Jamaica and Jamaica Customs geared at facilitating easier payment of taxes and improving compliance.

- Legislation to Enhance Fiscal Rules which aims to entrench fiscal discipline and consolidate the gains of fiscal consolidation in the medium term, to achieve a sustained reduction in public debt to facilitate greater fiscal transparency and secure the gains of the fiscal consolidation efforts. This is expected to be effective by April 2014.

Tax reform will continue to address issues related to the further rationalization of labour taxes, among others. After the initial impetus provided by the Competitiveness Enhancement Program (JCEP), as at July 2013 corporate income tax (CIT) for unregulated companies and personal income taxes (PIT) are harmonized at a rate of 25 percent.

Indeed, as a precursor to the more substantive aspects of the reform process, the preparation of an annual Tax Expenditure Statement (TES) has been institutionalized and has been published annually to date, consequent to the passage of Fiscal Responsibility Legislation in March 2010. The TES indicates the degree of tax exemptions which are currently being provided and provide a framework for optimizing tax revenues. Further the GOJ has prepared a document entitled "Estimates of Tax Expenditures in Jamaica 2007 – 2009", which provides further evidence of the internalization of the methodological and attendant data quality issues.

Also, the GOJ continues to work on simplifying and lowering the cost of paying taxes. Several initiatives with the objective of reducing complexity have been implemented, such as an electronic tax collection system and a single window for trade facilitation.

c. Reduction in budgetary burden of state-owned enterprises

As part of a sound fiscal reform, the budgetary component continues to be addressed in order to reduce the current fiscal deficit by reducing expenditure in some areas such as, expenditures related to loss-making state controlled enterprises that put pressure on the budget. In that regard, to date, the remaining sugar estates under the Sugar Company of Jamaica and Air Jamaica have been divested and whereas the divestment of a number of other state controlled enterprises, including Clarendon Alumina Partners are underway, in the interim they have been collectively subject to a rigorous process of rationalization which has led to significant reductions in or elimination of budgetary support. In addition, Cabinet approved a new institutional framework to streamline the process of carrying out PPPs in 2012, mandatory evaluation and assessment of fiscal contingencies and strengthening of the technical capacity of the Development Bank of Jamaica (DBJ).

d. Access to Finance and Financial Market Development.

Given the challenges associated with channelling financial resources to productive sectors and limitations on the use of moveable assets as collateral for loans, a legal framework to enable corporations or entrepreneurs to use movable property to access credit under much simpler and less costly conditions for SMEs was developed. In this regard the Secured Interest in Personal Property legislation was enacted as at December 2013 and the attendant Collateral Registry was operationalized as at January 2, 2014. This is complementary to the establishment of a functioning framework for the regulation and supervision of credit bureaus, including: (a) enactment of the Credit Reporting Act (2010) and attendant regulations; (b) implementation by Bank of Jamaica of its action plan for supervision of Credit Bureaus; (c) two licenses for Credit Reporting Operators awarded - as at January 2014, one Credit Bureau is fully operational; and (d) implementation of the awareness campaign.

In addition, the Government has taken steps toward enhancing the efficient and secure functioning of the financial system by improving the payment and settlement systems, including the strengthening of the legal framework to resolve issues of finality of payments and protection of the payment system, as well as the provision of a legal framework for electronic transactions. In addition as part of the modernization of the National Payments System, the Government has made progress in: (i) implementing the Real Time Gross Settlements (RTGS) mechanism; (ii) creating a Central Securities Depository; and (iii) establishing an enabling legal framework which facilitated the development of the Government Securities Dematerialization Bill.

Jamaica has also made important progress in micro finance and in e-commerce. With the enactment of the Electronic Transactions Act, e-commerce and e-banking activities have increased substantially. The Government of Jamaica, therefore, continues to work assiduously to increase electronic financial activities by providing an enabling environment for the use of mobile devices for financial transactions (m-banking). Whereas two commercial banks in Jamaica are currently offering M-Banking services to their existing customer base, the GOJ in its quest to increase access to finance to the unbanked, has sought to establish a pilot programme utilizing the M-banking modality for its conditional cash transfer programmes, inclusive of the Programme of Advancement through Health and Education (PATH), NIS Pension benefits and for transfers to students. In furtherance of that process, a cost benefit analysis was developed, coupled with consultation with stakeholders regarding the regulatory issues to be addressed with respect to the implementation of m-banking. The wider promulgation of m-banking in Jamaica will be done in adherence to international best practices as it relates to 'Know your Customer, Money Laundering and Financing Terrorism'. This has included the establishment of Guidelines for Electronic payment of Retail Services Regulations, including provisions regarding money laundering and for the provision of mobile services. The Development Bank of Jamaica (DBJ) after receiving the approval of the Bank of Jamaica (June 2012) has launched a 'non-commercial' pilot of a new mobile money facility for microfinance loans, called M3, and has made J$1.55 billion available to 10 approved lenders for distribution in the test phase. The project is being implemented in partnership with National Commercial Bank Jamaica (NCB) (as the account holder for the micro-finance lenders) and Transcel Limited (as technology provider).

e. Business Environment.

Many aspects of the business environment for productive enterprises in Jamaica relate to the interface between the public sector and businesses at various stages of their operations. While improvements have been made in addressing a number of these areas, including improvements in company registration procedures, a more far-reaching reform of the business environment will make a significant contribution to the prospects for economic growth. Thus, in addition to the initiatives outlined above, the GOJ is taking further actions to address some of the remaining issues. This includes the tabling of Insolvency Legislation as at December 23, 2013 and the introduction of a Business Registration Superform.

In order to provide an environment in which citizens have greater access to credit that depends on fixed property as collateral, the Government has maintained the policy thrust to provide a less-costly, more efficient mechanism to transfer land ownership (specifically decedent estate). This includes a reduction of fees, commissions and duties on land transfers, thus facilitating a well defined, secure and transferable right to land.

II. Government Support for the Programme

Implementation of the Competitiveness Enhancement Programme will require a major effort at interagency coordination, and the timely availability of technical and financial resources for the smooth implementation of policy measures and expeditious use of funds. Furthermore, to assure timely and well-coordinated management of the various initiatives contemplated under the programme, the Planning Institute of Jamaica is designated as the executing agency for the programme, with the support of the Ministry of Finance and Planning.

The Government of Jamaica reiterates its commitment to the Competitiveness Enhancement Programme presented in this letter and welcomes the technical and financial support of the Inter-American Development Bank provided through the requested loan.

Yours sincerely,

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Minister of Finance and Planning