PROJECT PROFILE (PP)

JAMAICA

I. BASIC DATA

Project Name:	Fiscal Structural Programme for Economic Growth	
Project Number:	JA-L1038	
Project Team:	Gerardo Reyes-Tagle (IFD/FMM), Project Team Leader; Angel Melguizo (SCL/LMK), Alternate Team Leader; Javier Jimenez Mosquera (LEG/SGO); Camila Mejia and Hunt Howell, (Consultants); and Marina Massini (IFD/FMM).	
Borrower:	Jamaica	
Executing Agency:	Ministry of Finance (MoF)	
Financial Plan:	IDB: Ordinary Capital	US$80 million
	Total:	US$80 million
Safeguards:	Policies triggered	None
	Classification:	None

II. GENERAL JUSTIFICATION AND OBJECTIVES

2.1 **Background**. During the last three decades, Jamaica has experienced persistent low growth, accompanied by high fiscal deficits and public debt levels, low public capital investment and a weak external position.[1] Borrowing needs and high cost of servicing debt have reduced fiscal space, led to financial repression and crowded out investment and growth. In the years following the global economic crisis (2008/09) the situation worsened stressing even more the public finances (see electronic link Table 2.1).[2]

2.2 As of FY2013/13, annual growth remains anaemic (-0.2%), inflation has not receded (9.7%) and the unemployment rate (16.3%) is rising. The fiscal position is weak and debt levels and service cost are unsustainable. Covering the gross financing needs has posed a challenge as international markets remain closed to the GoJ. Also, domestic financial institutions have limited room and a strong aversion to investing in new government paper.

2.3 The fiscal situation has been further exacerbated by structural weaknesses in the following three areas: (a) tax revenues: a weak tax system characterised by a shallow tax base given the excessive amount of tax expenditures granted; tariff structure distortion and low collection of taxes; (b) public expenditure: (i) overlapping programs and duplication of benefits due to poor budget

1 Repeated efforts to overcome these structural problems, have failed to result in an enduring recovery. Jamaica has signed several IMF supported arrangements, but their implementation over the years has not been fully successful. In this regard, in 2010, the Government of Jamaica (GoJ) signed a Stand-By Arrangement (SBA), which soon went off-track. Starting with slippages in wage costs the targeted fiscal consolidation, which was critical to a sustained improvement in debt sustainability, failed to materialise.

2 In the period 2008-13, real Gross Domestic Product (GDP) annual growth averaged -0.4%, annual inflation increased at an average rate of 11% and the ratio debt service to tax revenue averaged 26%.

expenditure quality control; and (ii) lack of mechanisms to contain current expenditure (i.e. wage costs and goods and services); and (c) budgetary process: lack of efficient mechanism to ensure a sustainable budgetary balance.

2.4 In addition to the above, the National Insurance Scheme (NIS), which provides universal social security insurance and is the first-pillar in Jamaica's pension system, poses serious fiscal challenges. Since 2005/06 benefits and expenses of the NIS have already surpassed contributions. Recent actuarial analysis indicates that the system will be in deficit starting in 2029, and the fund will be fully exhausted between 2035 and 2039.[3] While the law provides for universal social security insurance, in practice only 20% of the working-age population was covered by the NIS (equivalent to a 37% of total workers) and only 27% of the elderly are receiving pension benefits under the NIS.[4] These gaps in social insurance will put additional pressure on the budget, through the probable extension of non-contributory benefits.

2.5 **Justification.** During FY2012/13, the authorities tightened fiscal policy and prepared a comprehensive economic reform. The GoJ introduced a budget for FY2012/13 aimed at raising the central government's primary surplus to 6% of GDP (from 3.2% in the previous year). It also included tax measures estimated to increase revenues by around 1.6% of GDP. Furthermore, the government strengthened its Fiscal Responsibility Framework (FRF), including a sanctions regime for unbudgeted spending. In addition to these measures, the GoJ signed an Extended Fund Facility (EFF) programme with the IMF in May 2013. The three-year programme's main pillars include: (i) structural reforms to boost competitiveness and growth; (ii) key reforms to support fiscal adjustment; (iii) debt management measures to regain debt sustainability; and (iv) social protection programmes to help the most vulnerable.

2.6 To comply with the conditions set under the EFF programme for FY2013/14, the GoJ has committed to table in Parliament, before the end of CY2013, the Charities and the Omnibus Incentive Tax bills. The framework of both bills and the comprehensive tax reform was based on Technical Assistance (TA) provided by the Bank and it is aimed at simplifying the tax system, reducing import tariff dispersion, removing economic distortions, limiting tax exemptions and eliminating ministerial discretion to grant incentives. If successfully implemented, the reform is expected to promote growth, broaden the tax base, lower tax rates and reduce the scope for rent seeking.

2.7 As of September 2013, the GoJ had complied with all the quantitative targets and the timetable for the previous steps needed to approve and implement the structural benchmarks under the IMF's EFF programme. The second IMF review is expected by December 2013. By March 31st 2014, it is expected that the GoJ

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[3] Eckler (2013), Actuarial Analysis and Roadmap for the NIS in Jamaica (work in progress).

[4] Based on Bank analysis of NIS administrative data and Jamaican 2012 Labor Force Survey (LFS). Elderly are defined as females aged 60 and over, and males 65 and over.

enacts the Fiscal Rule and the Omnibus Banking bills. The former aims at ensuring a sustainable budgetary balance to be incorporated in the annual budgets, while the latter aims at facilitating effective supervision of the financial sector.

2.8 The NIS may become a source of fiscal pressure for Jamaica if no action is taken to improve its fiscal sustainability. This potential impact should be taken into account in the design of the Fiscal Rule. Furthermore, the low coverage levels of the NIS among the working-age population and the elderly will likely exert political pressure to extend non-contributory benefits to these uncovered groups, adding to fiscal imbalances. Therefore, the Ministry of Labour and Social Security (MLSS), on which the NIS depends, will develop a green paper on reform of the NIS. As a first step, the MLSS will present a concept paper that focuses on improvements to the NIS financial condition and proposes ways to extend its coverage in a sustainable way.

2.9 **The Bank's strategy with the country and sector**. The current Country Strategy 2013-14 (CS), focus on supporting efforts to re-establish fiscal sustainability, maintain social stability, and promote private-sector led growth. This PBP will be processed in the context of a financial support plan coordinated between the IMF, WB and IDB, whereby the Bank has committed to provide up to $510 million in total disbursements to Jamaica during the four year EFF period (2013–17). The proposed timing and magnitude of its disbursements are both consistent with the arrangement whereby disbursement of investment operations are assured and the remaining space can be allocated to policy based operations, designed to support the financing needs of under the EFF. The first operation of this PBP, for $80 million, would be followed by a second in 2015 and a third in 2016 (after the close of the EFF) for an indicative total of $200 million[5].

2.10 The authorities have recognised the need to restore fiscal sustainability trough strengthening tax revenue, tightening control of public expenditure and lowering debt-to-GDP ratio. In addition to the continuous TA support that the Bank has provided, the authorities have requested financial support in the form of a Programmatic Policy-Based (PBP) loan.

2.11 **The objective of the Bank Programme** is to support the GoJ's efforts to improve its fiscal balance in the short and medium term. This will be done through: (i) reforming tax policy and strengthening revenue collection efforts; (ii) implementing a more effective control over budgetary expenditure; (iii) improving the fiscal sustainability of the NIS; and (iv) implementing the Fiscal Rule to ensure a sustainable budgetary balance[6].

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5 The proposed PBP is fully consistent with the Financing Envelope of the CS which anticipated a total of $140m for budget support in 2014.

6 The current operation forms part of a package of two policy based operations being prepared by the Bank in response to a request from GoJ to increase the frontloading of the EFF financial support package agreed between the IMF, WB and IDB. The decision to provide the support is based on Jamaica's strong performance under the EFF, the significance of the reforms and the demonstrated need for IFI support to avoid premature access to domestic financial markets.

2.12 **Component I. Macroeconomic stability.** As with any budgetary support loan, a general condition for the disbursement of the tranche of this program is a stable macroeconomic policy consistent with the program objectives. This will be set out in the country's Policy Letter to the Bank.

2.13 **Component II. Tax policy and administration reform.** This component has two objectives: (1) reduce distortions and improve efficiency of the tax system, and (2) improve effectiveness and efficiency of revenue collection. Therefore, in addition to the measures adopted in FY2012/13 to increase tax revenue (see ¶2.3), the GoJ will implement a comprehensive tax reform including measures to: (i) standardise import tariffs to a level of 20% (in line with CARICOM and other international agreements); (ii) raising tariffs of some import goods from zero to 5%; (iii) increase tax revenues by eliminating the General Consumption Tax (GCT) 0% rate (except for exports), establishing a minimum income tax, and capping losses to be offset against income for Corporate Income Tax / Personal Income Tax purposes; and (iv) curtail tax expenditures by implementing the Charities Act and the Omnibus Incentives Tax Act.

2.14 The Charities Act will define the rules under which charity organisations can operate, including the tax treatment and the administrative processes followed by TAJ to monitor their activities. The Omnibus Incentive Tax Act is structured as follows: (a) a Fiscal Incentives Bill which will: (i) allow for a repeal of a range of existing tax incentive legislation, with appropriate grandfathering/sunset provisions; (ii) make reference to the requirements for eligibility of the new labour tax credit and mega/pioneer projects incentive provisions; and (iii) lay out the administrative/regulatory requirements for the implementation and management of the new incentive regime; (b) amendments to the Income Tax Act, which provide for: (i) application of the labour tax credits under the Income Tax Code; (ii) the revised treatment for capital allowances; (iii) the revised treatment of tax losses; (iv) the Minimum Business Tax (MBT); and (v) provisions aimed at enhancing anti-avoidance mechanisms; and (c) amendments to the Customs Duty Act, specifying the revised Common External Tariff (CET) regime in line with the tax incentive policy framework.[7]

2.15 **Component III. Improving the quality of expenditure.** This component has three objectives: (1) contain public expenditure growth; (2) improve the efficiency and transparency of the public bodies and public sector; and (3) increase effectiveness of social spending. The authorities will implement measures to control the growth of expenditure, which include: (i) a no nominal salary increase policy to meet an annual wage bill target of 9% of GDP for FY2015/16; (ii) an action plan for rationalizing

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7 Items (i) - (iii) constitute the "omnibus incentive reform", and the legislative provisions to give effect to this reform. will be drafted and tabled together; i.e. it is intended that the new 'Fiscal Incentives Bill" along with the consequential amendments to the Income Tax and Customs Duty Act (as well as any other tax law so affected) will be tabled by end-October. Apart from the fact that items (i) - (iii) are mutually reinforcing from the point of view of policy, their implementation is also self-reinforcing. For instance, the Corporate Income Tax (CIT) reforms would need to become effective on January 1, 2014 (the same time as the new Fiscal Incentives Bill is intended to come into effect) if the revised incentive regime is to be effective in FY 2014/15.

public bodies; (iii) attainment of an overall balance of the financial accounts of public bodies; (iv) measures in the education system as regards to teacher hire and school accountability; and (v) measures in the health care system to reduce program duplication. In addition, the GoJ will: (i) implement a comprehensive public sector reform to enhance efficiency and support a medium term wage bill containment; (ii) implement the public bodies rationalization program, including the presentation of their annual reports within six months of the end of the fiscal year; and (iii) further education sector reforms aimed at greater cost recovery at the tertiary level.

2.16 **Component IV. Strengthening the National Insurance Scheme (NIS).** The objective of this component is to implement a fiscally sustainable NIS. The Ministry of Labour and Social Security (MLSS) will submit to the Cabinet Committee a concept paper that includes: (i) adjustment of the contribution rate; (ii) adequate indexation of pensions; and (iii) measures to increase in coverage. Furthermore, the NIS will publish a triennial actuarial report of the National Insurance Fund (NIF), covering both the short and long run. In addition, as part of the program, the GoJ will table in Parliament the NIS reform as a White Paper.

2.17 **Component V. Fiscal rule framework.** The objective of this component is to assure that the GoJ has made a binding commitment to achieve a long-term fiscal sustainability path. The GoJ will establish a legally binding fiscal rule to ensure sustainable budgetary results to be incorporated in the annual budgets starting with the 2014/15 budget. The fiscal rule will: (i) be subject to periodic (5-yearly) parliamentary reviews to ensure consistency with the debt reduction objectives defined by the GoJ; (ii) establish an automatic correction mechanism to be triggered when substantial cumulative underperformance of the annual overall budget balance target occurs; and (iii) include an escape clause, to be activated only by Parliament in the event of major adverse natural shocks. The GoJ will also fully implement the Central Treasury Management System.

III. SAFEGUARDS

3.1 In accordance with the Directive B.13 of the Bank's Environment and Safeguards Compliance Policy (GN-2208-20 and OP-703), no ex-ante environmental impact classification is required. In addition, this operation will not have direct or significant impacts on the environment or on the country's natural resources.

IV. RESOURCES AND TIMETABLE

4.1 Annex V describes the expected preparation timeline that includes: (i) distribution of the Proposal for Operation Development to the QRR by December 2nd, 2013; (ii) distribution of the Draft Loan Proposal to the Operation Policy Committee by January 7th, 2014, and (iii) presentation to the Board of Directors by February 12th, 2014. The estimated amount for mission travel and consultancy is US$74,000.

Annex I

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SAFEGUARD POLICY FILTER REPORT

PROJECT DETAILS	
IDB Sector	REFORM / MODERNIZATION OF THE STATE-FISCAL POLICY FOR SUSTAINABILITY AND GROWTH
Type of Operation	Other Lending or Financing Instrument
Additional Operation Details	
Investment Checklist	Generic Checklist
Team Leader	Reyes-Tagle, Gerardo (GERARDOR@iadb.org)
Project Title	Fiscal Structural Program for Economic Growth
Project Number	JA-L1038
Safeguard Screening Assessor(s)	Reyes-Tagle, Gerardo (GERARDOR@iadb.org)
Assessment Date	2013-10-16

SAFEGUARD POLICY FILTER RESULTS		
Type of Operation	Loan Operation	
Safeguard Policy Items Identified (Yes)	Activities to be financed by the project are in a geographical area and sector exposed to natural hazards* (Type 1 Disaster Risk Scenario).	(B.01) Disaster Risk Management Policy– OP-704
	The operation itself has a potential to exacerbate hazard risk* to human life, property, the environment or the operation itself (Type 2 Disaster Risk Scenario).	(B.01) Disaster Risk Management Policy– OP-704
	The operation is in compliance with environmental, specific women's rights, gender, and indigenous laws and regulations of the country where the operation is being implemented (including national obligations established under ratified Multilateral Environmental Agreements).	(B.02)
	The operation (including associated facilities) is screened and classified according to their potential environmental impacts.	(B.03)
	The Bank will monitor the executing agency/borrower's compliance with all safeguard requirements stipulated in the loan agreement and project operating or credit regulations.	(B.07)
	Operation for which ex-ante impact classification may not be feasible. These loans are: Policy-based loans, Financial Intermediaries (FIs) or loans that are based on performance criteria, sector-based approaches, or conditional credit lines for	(B.13)

	investment projects.	
	Suitable safeguard provisions for procurement of goods and services in Bank financed projects may be incorporated into project-specific loan agreements, operating regulations and bidding documents, as appropriate, to ensure environmentally responsible procurement.	(B.17)
Potential Safeguard Policy Items(?)	No potential issues identified	
Recommended Action:	Operation has triggered 1 or more Policy Directives; please refer to appropriate Directive(s), including B13, for guidance. No project classification required. Submit Report and PP (or equivalent) to ESR.	
Additional Comments:		

ASSESSOR DETAILS

Name of person who completed screening:	Reyes-Tagle, Gerardo (GERARDOR@iadb.org)
Title:	
Date:	2013-10-16

COMMENTS

No Comments

ENVIRONMENTAL AND SOCIAL STRATEGY (ESS)

According to the environmental policy and the safeguards fulfilment established by the Directive B.13, this type of policies sector loan does not qualify. The objective of the programme is to give the country support in its goal of ensuring fiscal sustainability through the improvement of public finances. Therefore, it is not expected that the programme carries negative environmental nor social impacts, and that it is why it is not considered necessary the preparation of an Environmental and Social Strategy for the programme.

INDEX OF COMPLETED AND PROPOSED SECTOR WORK

Description	Date	Reference or links
IMF´s Extended Fund Facility	05/2013	http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=38173937
IMF First Review of the EFF	09/2013	http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=38173907
IMF. Article IV Jamaica		http://www.imf.org/external/np/sec/pn/2012/pn1256.htm
Independent Macroeconomic Assessment	11/2013	http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=XXXX
Tax Burden in Jamaica	2013	http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=38174007
IDB´s Tax Reform Proposal (confidential)	2013	http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=38173957
IMF Working Paper – Jamaica Debt Exchange	2013	http://idbdocs.iadb.org/wsdocs/getDocument.aspx?DOCNUM=38173944

Annex V

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