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INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

PROGRAM DOCUMENT

FOR THE PROPOSED

FIRST PROGRAMMATIC FISCAL SUSTAINABILITY DEVELOPMENT POLICY LOAN

IN THE AMOUNT OF US$200 MILLION

TO

JAMAICA

February 8, 2010

Poverty Reduction and Economic Management
Caribbean Countries Management Unit
Latin America and Caribbean Region

JAMAICA — GOVERNMENT FISCAL YEAR
April 1 – March 31

CURRENCY EQUIVALENTS
US$1.00 = J$89.2
(as of January 15, 2010)

WEIGHTS AND MEASURES
Metric System

SELECTED ABBREVIATIONS AND ACRONYMS

AAA	Analytical and Advisory Assistance
BOJ	Bank of Jamaica
CAD	Current Account Deficit
CAR	Capital Adequacy Ratio
CARICOM	Caribbean Community
CARTAC	Caribbean Technical Assistance Center
CAS	Country Assistance Strategy
CCRIF	Caribbean Catastrophe Risk Insurance Facility
CCT	Conditional Cash Transfer
CDB	Caribbean Development Bank
CEM	Country Economic Memorandum
CFAA	Country Financial Accountability Assessment
CIDA	Canadian International Development Agency
CPAR	Country Procurement Assessment Report
CPI	Consumer Price Index
CPS	Country Partnership Strategy
CTCS	Caribbean Technology Consultancy Service
DBJ	Development Bank of Jamaica
DFID	U.K. Department for International Development
DMU	Debt Management Unit
DPL	Development Policy Loan
EU	European Union
FAA	Financial Administration and Audit Act
FS DPL1	First Programmatic Fiscal Sustainability DPL
FRF	Fiscal Responsibility Framework
FRS	Fiscal Responsibility Statement
GCT	General Consumption Tax
GDP	Gross Domestic Product
GNI	Gross National Income
GNP	Gross National Product
GOJ	Government of Jamaica
HIPC	Heavily Indebted Poor Countries
IBRD	International Bank for Reconstruction and Development
IADB/IDB	Inter-American Development Bank
IDA	International Development Association
IFC	International Finance Corporation
IMF	International Monetary Fund
JLP	Jamaica Labour Party
LAC	Latin America and the Caribbean
MOF	Minister of Finance and the Public Services
MOU	Memorandum of Understanding
MTF	Medium-Term Framework
NEPA	National Environmental Planning Agency
NROCC	National Road Operating and Construction Company
PATH	The Programme for Advancement through Health and Education
PAYE	Pay-As-You-Earn
PBL	Policy-Based Lending
PBMA	Public Bodies Management and Accountability Act
PED	Project Execution Document
PER	Public Expenditure Review
PEFA	Public Expenditure and Financial Accountability
PIOJ	Planning Institute of Jamaica
PFM	Public Financial Management
PSED	Public Service Establishment Division
PSTU	Public Sector Transformation Unit
SBA	Stand-By Arrangement
FS DPL2	Second Programmatic Fiscal Sustainability DPL
UNDP	United Nations Development Programme
USAID	U.S. Agency for International Development

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This DPL was prepared by a team led by Zafer Mustafaoglu and Rashmi Shankar. The team included Denis Medvedev, Mariano Lafuente, Theo David Thomas, Joseph Mubiru Kizito, Andresa Lagerborg, Michiel Paris, Santiago Florez Gomez, Riccardo Trezzi, Friederike Norma Koehler, Martha Garcia, Tammy Pertillar, Cornelia M. Tesliuc, Enos Esikuri, Elizabeth Currie, Juliet Williams, and Ole Hagen Jorgensen. The team gratefully acknowledges the support and guidance of Yvonne M. Tsikata, Marcelo Giugale, Rodrigo A. Chaves, Auguste Tano Kouame, and Badrul Haque. The peer reviewers were Marina Wes (ECSP2), and James Brumby (PRMPS).

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Loan and Program Summary
Government of Jamaica

(First Programmatic Fiscal Sustainability Development Policy Loan)

Borrower:	Government of Jamaica
Implementing Agency:	MINISTRY OF FINANCE AND THE PUBLIC SERVICE
Financing Data:	*IBRD Loan Amount:* US$200 million *Terms:* The Borrower has requested a US dollar commitment-linked IBRD Flexible Loan with a variable spread, with level repayment of principal payable in 30 years (including 5.5 years of grace period). The Borrower wishes to maintain all risk management options embedded in the loan and to finance the front-end fees out of the loan proceeds. Front-end fee is 0.25 percent on principal amount.
Operation Type:	First in a series of programmatic single-tranche Development Policy Loans (DPL)
Main Policy Areas:	The proposed operation supports the Borrower's efforts aimed at: (i) enhancing fiscal and debt sustainability; (ii) increasing the efficiency of public financial management and budgeting processes; and (iii) further strengthening Tax Administration and increasing tax revenue generation capacity.
Key Outcome Indicators (March 2011):	(i) Increase in the primary budget surplus of the Central Government by 1.8 percentage points of GDP by FY2010/11 (Baseline: 4.8 percent of GDP at end-FY2008/09); (ii) No more deferred financing (Baseline: Average annual deferred financing from FY2000/01 to FY2005/06 was J$497 million) (iii) Fiscal savings of at least 1.5 percent of GDP generated due to Government's Debt Management Activities (Baseline: Interest paid by Central Government was 16.0 percent of GDP in FY2009/10) (iv) Reduced losses of Public Bodies generate savings of at least 1 percentage point of GDP by FY2010/11 (Baseline: Public entities balance was -2.8 percent of GDP in FY2009/10)
Program Development Objectives and Contribution to CAS:	The Program Development Objectives are to: • *Enhance fiscal and debt sustainability,* by supporting reforms to increase control on public spending and debt generation, reduce debt service burden and improve debt management, reduce financial vulnerabilities, increase public spending effectiveness, and fortify the country's ability to cope with the adverse consequences of the on-going global economic downturn. • *Increase the efficiency of public financial management and budgeting processes,* by supporting efforts to improve the efficiency of public expenditures and investment, and strengthen control of public finances and the effectiveness of government budgeting practices. • *Further strengthen Tax Administration and increase tax revenue generation capacity,* through measures aimed at enhancing audit and control, improving client services for tax payers, broadening tax base, simplifying tax payments, and introducing greater uniformity in tax policy. Given the decline in fiscal revenues under the current global environment, these efforts are particularly important for improving the fiscal balance to create space for productive expenditures and help foster growth in the medium term. *Contribution to the Country Partnership Strategy (CPS):* The proposed DPL is fully consistent with the FY10-13 Country Partnership Strategy which has been scheduled

	for Board discussion on February 23, 2010. The FY10-13 CPS further reflects the government's focus on addressing fiscal and debt challenges, especially given the impact of the global crisis on Jamaica.
Risks and Risk Mitigation:	*There are four significant risks to the program supported by the proposed DPL including:* **Economic:** The current global financial crisis and economic downturn have led to significant contraction of GDP, added to high borrowing needs, and a large depreciation of the currency. GDP declined by 1.6 percent in FY08/09 and is projected to decline further by about 3.5 percent in FY09/10. Public debt went up from 124 to an estimated 139 percent of GDP between FY08/09 and FY09/10. There is further downside risk if the global environment does not improve as envisaged. *Mitigation: Since Jamaica is vulnerable to external shocks, prospects for mitigation are limited. Development partners have put together resources for on-demand technical assistance in support of the government's fiscal and debt sustainability program. To mitigate liquidity risks and ease financing constraints, the GoJ has sought a multilateral package of support from the World Bank, the IMF (US$1.25 billion or 300 percent of Jamaica's special drawing rights quota), the IDB, and the CDB.* **Political risk to implementation capacity:** The current government came into power in the fall of 2007, but has had a narrow majority in Parliament, making the government's program vulnerable to special interests. Political opposition may delay progress in implementation of reforms. This concern has been amplified in the context of the decline in economic activity due to the global crisis, which may also cause social unrest and weaken political will. *Mitigation: The risk is reduced by the Government's consultative approach to reform implementation and the facilitation of dialogue on fiscal and economic costs of inaction among country stakeholders. IFIs and other donors are heavily focused on building consensus for advancing critical public sector reforms to improve fiscal and debt sustainability. The Government's communication strategy over the next two years should focus on both explaining the benefits of reforms and the costs of postponement.* **Institutional capacity and reform implementations:** The Government has embarked on substantial public sector reforms which require changes in institutional structures and significant enhancement in institutional capacity for an effective implementation. The reform process might be delayed as institutions try to adjust to the changes and enhance their capacity. *Mitigation: Jamaica has well established institutions. The development partners have been providing technical assistance for institutional capacity building and advancing public sector reforms.* **Natural Disasters:** Jamaica is highly vulnerable to natural disasters—droughts, floods and hurricanes—that threaten economic growth and poverty reduction, and direct government resources away from long-term investment plans. *Mitigation: The damage to major private sector enterprises is partly covered by insurance. The GoJ participates in the Caribbean Catastrophe Risk Insurance Facility. The Bank is assisting Jamaica through investments in natural disaster risk mitigation with the Hurricane Dean Emergency Recovery Loan and technical assistance for its safety net program to mitigate adverse consequences on poverty. In January 2009, the National Water Sector Adaptation Strategy and Plan of Action to address climate change were established with Bank assistance and provide recommendations on key investments to mitigate the negative impacts of climate change in the water sector. In addition, the GoJ has presented a draft National Disaster Management Act to Parliament for enactment.*
Operation ID No.	P113893

FIRST PROGRAMMATIC FISCAL SUSTAINABILITY DEVELOPMENT POLICY LOAN TO JAMAICA

I. INTRODUCTION

1. **This program document describes the proposed single-tranche First Programmatic Fiscal Sustainability DPL (FS DPL1) in the amount of US$200 million for Jamaica.** The proposed operation builds on the progress made under the Bank's previous Fiscal and Debt Sustainability DPL (January 2009) and supports the Government of Jamaica's (GoJ) reform program aimed at improving management of public finances and reducing the debt burden on the economy. This reform program is critical to the GoJ's strategy to create fiscal space for priority social and investment spending and increase the growth potential of Jamaica. The FS DPL1 will also support the maintenance of macroeconomic stability while the GoJ adjusts to the deterioration in the global environment while continuing to implement the longer term reform agenda for fiscal and debt sustainability. The FS DPL1 supports actions to (a) promote fiscal sustainability through control of overall public sector balances and debt generation, and rationalization of Public Bodies; (b) improve the efficiency of public financial management and budget process; and (c) strengthen the Tax Administration capacity, reduce tax distortions and enhance the efficiency of the tax system. The Government has made progress on these key components of its reform program, even in the context of the ongoing global economic crisis.

2. **While current global conditions have added to existing challenges, the Government has remained committed to the long term reform agenda.** Jamaica has been severely hit by the global economic crisis and the impacts are likely to persist over the medium term. Output declined by 1.6 percent in FY2008/09 and is projected to decline by another 3.5 percent in FY2009/10, largely due to the near collapse of the bauxite industry and reductions in remittances and tourism receipts. Unemployment is on the rise and poverty implications of declining economic activity are considerable. The GoJ is fiscally constrained and has no room for adopting countercyclical policies. Nonetheless, the Government has responded by expanding the conditional cash transfer program, PATH, limiting the growth of public sector wages, easing liquidity conditions, and trying to stabilize the exchange rate. However the sharp decline in growth has led to an increase in the fiscal deficit and in the debt to GDP ratio, though the latter is projected to decline in the medium term, due mainly to improvements in the Central Government and public sector balances as the fiscal and debt management reforms start to have an impact.

3. **The GoJ recognizes the importance of achieving and maintaining medium and long run sustainability**. The Government has developed a well articulated medium-term economic program to improve fiscal sustainability, reduce the debt overhang and put the economy on a high growth path, while maintaining and even expanding social spending to protect the most vulnerable groups. As part of this program, the Government announced a debt exchange offer on January 14, 2010 with the objective of reducing the interest rate on, and extending the maturity profile of a portion of, outstanding domestic debt. The Government estimates that fiscal savings from the debt exchange will be at least 3 percent of GDP during FY2010/2011. The offer does not involve any hair-cut in principal. Following the announcement of the debt exchange, Jamaica's credit ratings were downgraded by rating agencies. However, the same

rating agencies also highlighted that upon successful completion of the debt exchange, credit ratings for Jamaica would be upgraded since the debt exchange would reduce the debt service burden and improve the prospects for sustainability. Nonetheless, the downgrading presents short-term challenges and the debt exchange itself may reduce the liquidity in domestic markets—making it harder for the Government to secure financing in the short term. To maintain macroeconomic stability and ensure resources are available to support the longer run fiscal and institutional reform program, the GoJ has adopted the strategy of seeking financing from the international financial institutions (IFIs).

4. **The proposed DPL supports the GoJ's efforts to improve fiscal balances and reduce costly public debt in a sustainable fashion.** These efforts will mitigate the impact of the crisis and help maintain macroeconomic stability, while providing the means to generate additional fiscal space necessary to accelerate growth and address social challenges in the medium run. The Government aims to cut by half the central government's budget deficit and achieve an overall public debt to GDP ratio of less than 120 percent by 2014/15, based on the latest projections of the global economic environment by IFIs. The proposed loan will contribute to the financing necessary for Jamaica to minimize the effects of near-term global financial market volatility. It will also support the GoJ's active debt management operations to reduce the net present value of public debt in a manner consistent with the GoJ's fiscal and debt management objectives.

5. **The GoJ's program is the basis for support from international financial institutions and donors, including the World Bank, the IMF, the CDB, the EU, and the IDB**. These operations will provide financial support to Jamaica as it implements difficult policy actions in an adverse global environment. There is a significant level of donor coordination and fiscal and debt sustainability has been the centerpiece in all donors' programs. The financial support from the IFI's for the Government's reform program is expected to reach extraordinary levels, nearly 20 percent of GDP. The proposed operation is thus part of a significant effort by multilaterals to help the GoJ sustain its long-term development agenda.

6. **The Government has agreed with the IMF on a Stand-By Arrangement (SBA) to manage short term difficulties and support the longer term reform agenda**. The authorities and the IMF have reached an agreement on a set of policy measures to credibly reduce fiscal deficits and debt service burden and improve fiscal and debt sustainability. The SBA, in the amount of US$1.25 billion, will cover a period of 27 months and was approved by the Board of Executive Directors of the IMF on February 4, 2010.

7. **The Government launched a Debt Exchange on January 14, 2010, with a view to reducing debt servicing on and improving the maturity profile of its outstanding domestic public debt.** As of February 3, the government has estimated a participation rate of above 95 percent in the debt exchange – reflecting wide acceptance by bond holders. The multilateral package of support from the IFIs will also provide market liquidity and reduce risks to participants in the debt exchange, should any arise, while supporting the Government as it implements its medium-term reform program. The Bank proposes to synchronize disbursement with that of the IMF's SBA, which is to be front-loaded with approximately US$650 million made available upon approval on February 4, 2010.

8. **The IFI's have coordinated closely on their support for the GoJ's reform program.** The policy actions supported by this DPL are complemented by those in the proposed IMF SBA

for Jamaica, which also focuses on structural fiscal reforms aimed at supporting the GoJ's objective of longer-run sustainability, as well as in the public sector reform programs (PBLs) of the IDB and CDB. All these institutions are supporting measures to improve fiscal and debt management, rationalize Public Bodies, and strengthen tax administration and policy. The World Bank is also coordinating with the IMF and the other IFIs in the phasing of disbursements and in the sequencing of the policy actions. This coordination is important to ensure that the Government's financial needs are met in a timely manner while reform momentum is maintained.

9. **The Government is aware of the importance of forging political consensus for the reform program and has worked to create strong, broad-based support among stakeholder groups.** The Government has been consulting with the social partners for about two years, lately chaired by the Prime Minister. Participants in this consultation are senior leaders of the main political opposition, leading business personalities, trade unionists, and university professors. Together with a carefully crafted communication strategy for targeted groups, the Government received a broad acceptance of its reform program. In particular, when it offered a debt exchange program in mid-January 2010 with longer maturity and significantly lower coupon rates on the same face value, it received over 95 percent acceptance as of February 3, 2010. The high level of participation, as well as the broad support in the media, reflects the Government's efforts to build ownership and consensus on key reforms. Indeed, in discussing the debt exchange in the Parliament, the opposition party highlighted that the debt exchange is just the first step and would not be sufficient on its own and that the Government needs to have a more broad-based reform program. During the same discussion, the opposition questioned the equity of increased tax measures but not the need for it, reflecting the broader acceptance of the reforms by the opposition. The Government is continuing to deepen the social partnership efforts to foster consensus and build wider ownership of the reform program.

10. **The proposed operation is rooted in the FY10-13 Country Partnership Strategy (CPS) of the Jamaica and the World Bank**. The FY10-13 CPS includes fiscal and debt sustainability as a main component for macroeconomic stability. This DPL is envisaged in the CPS as the first in a series of programmatic single tranche operations designed to support the government's reforms aimed at fiscal and debt sustainability.

II. COUNTRY CONTEXT

A. Political Context

11. **Jamaica has a history of stable political institutions.** Since its independence in 1962, Jamaica has had a Westminster-style parliamentary democracy with two main parties: the Jamaica Labor Party (JLP) and the People's National Party (PNP). After 18 years in the opposition, the JLP won the 2007 general election and holds 32 seats compared with the PNP's 28. The country is characterized by a high degree of personal freedom, freedom of expression, and vibrant free press; with respect to the latter, Jamaica consistently ranks in the top 10 percent globally, ahead of many developed democracies.

12. **The new administration has prioritized reducing poverty, combating crime and violence, jump-starting the economy, and strengthening the governance framework, particularly in relation to combating corruption.** The Government of Jamaica (GoJ) has

embarked on an ambitious reform program aimed at achieving higher growth and addressing social challenges. The Government has prepared and tabled in Parliament its comprehensive long-term development plan, Vision 2030. The GoJ has also developed a Medium-Term Socio-Economic Framework to achieve more near-term goals.

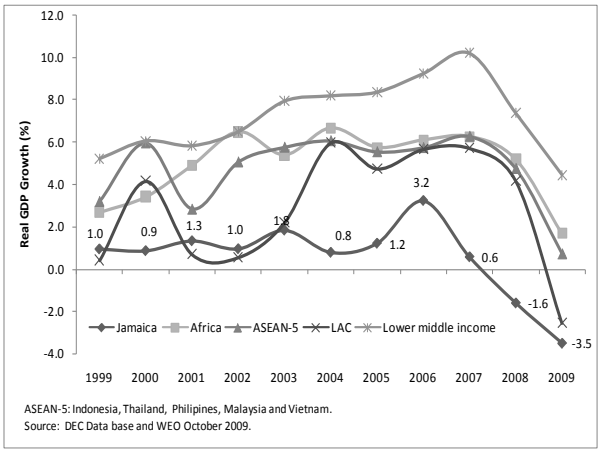
13. **The GoJ recognizes that without reducing debt and controlling the debt generating process, public investment and social needs, such as improving health, education and addressing crime and violence, will not be met.** It has outlined critical priorities to lower debt, including the establishment of a comprehensive Fiscal Responsibility Framework, rationalization of public enterprises, comprehensive tax reform, improving public sector efficiency, and improving the business climate as a means for placing the country on a more sustainable fiscal and growth trajectory. These priorities have become even more pertinent in the context of the current global financial market crisis. Therefore, the GoJ has recognized the need to undertake liability management and is fully committed to doing so.

B. Economic Context

14. **Jamaica is a lower middle-income country with high life expectancy and relatively low poverty.** Jamaica's per capita GNI was approximately $4,870 in 2008 (latest available year) and it is the largest English-speaking country in the Caribbean. Jamaica enjoys the advantages of proximity to its largest trading partners, language, time zone, and natural resource endowments. The population, of about 2.7 million, enjoys relatively high life expectancy (73 years), and the country has achieved a marked reduction in poverty from 28.4 percent of the population in 1990 to 9.9 percent in 2007. Although poverty reduction has been more pronounced in the urban areas, rural poverty has also come down by more than half in the same time period.

15. **Jamaica's growth has been low and the country has underperformed vis-à-vis the region.** The average real GDP growth rate over the past 30 years amounted to 1 percent per year; excluding the exceptional growth years in the run-up to the 1996 crisis, the economy has on average stagnated. Between 2005 and 2008, growth averaged even less than 1 percent while the LAC region grew at an annual average of 5.2 percent over the same period (Figure 1).

Figure 1: Jamaica's Growth in International Perspective, 1999-2009



Source: WEO and WB Staff calculations

16. **Jamaica's poor growth performance has a number of possible explanations, though further research is required for a complete solution of the puzzle.** For a better understanding of the picture, two different types of factors playing role in the growth process need to be separated: (a) the statistical measurement problems leading to underestimation of the actual output and (b) the factors leading to low economic growth rates.

17. **On the measurement side, low growth performance in the last decade can also be**

largely attributed to problems arising from increasing informality in the Jamaican economy. The actual growth rates could be higher once rising informality is accounted. Productive capital stock might have also been overestimated as a non-negligible part of the investment could be toward crime protection which is a sunk cost to the economy[12]. Similarly, a part of investment could be just the replacement of the capital eroded by the hurricanes.

18. **Adverse external factors, weak financial regulation and the resulting banking crisis in the second half of the 1990s, the loss of competitiveness due to real exchange rate appreciation and rising real wages, increasing costs associated with rising crime, and an increasing burden of government consumption have all contributed to low growth in the past decade.** The low total factor productivity that might be caused by debt overhang has also been a major driving factor behind poor economic performance. The quality of education may not be supportive of productivity gains although schooling ratios are high and education is widespread.

19. **The large share of public resources devoted to debt service and the wage bill are additional constraints on Jamaica's growth.** The public debt-to-GDP ratio averaged 135 percent of GDP over the past decade and bound 38 percent of total government expenditures, or 13 percent of GDP, to debt servicing. Over the past ten years, wages and salaries featured on average 31 percent of total expenditure, or 10 percent of GDP. Combined, these factors diverted resources from strongly needed investment in education and infrastructure and aggravated other growth constraints.

20. **Another important driver of poor growth is low total factor productivity (TFP).** TFP has declined by 0.5 percent a year from 1960 to 2000, while the LAC average has increased by 0.2 percent per year and the global average by 0.9 percent. This is linked to several factors, including poor educational outcomes — two-thirds of the labor force has never received any formal training and Caribbean Examination Council (CXC) Pass rates in math and English are low compared to their Caribbean peers — large emigration of skilled workers, a large informal sector, labor market rigidities that have limited the expansion of formal employment, and high unemployment rates.

21. **Finally, high private investment rates in Jamaica are yet to translate into high growth.** Investment rates were as high as 30 percent of GDP on average over the past decade but the share of public investment spending has been low, typically below 4 percent of GDP in recent years. Given the complementarity between public and private investment, countries with very low public investment, such as Jamaica, appear to grow more slowly, even if private investment remains high. These issues will be more fully explored in the Bank's forthcoming CEM on Growth in Jamaica. Additionally, the country's vulnerability to climate variability and change and high incidence of natural disasters required investment into replacement of the capital stock. Low productivity, high incidences of crime, as well as high energy costs, particularly electricity, further hampered investment efficiency.

22. **Growth has been strongly driven by services which account for 70 percent of total**

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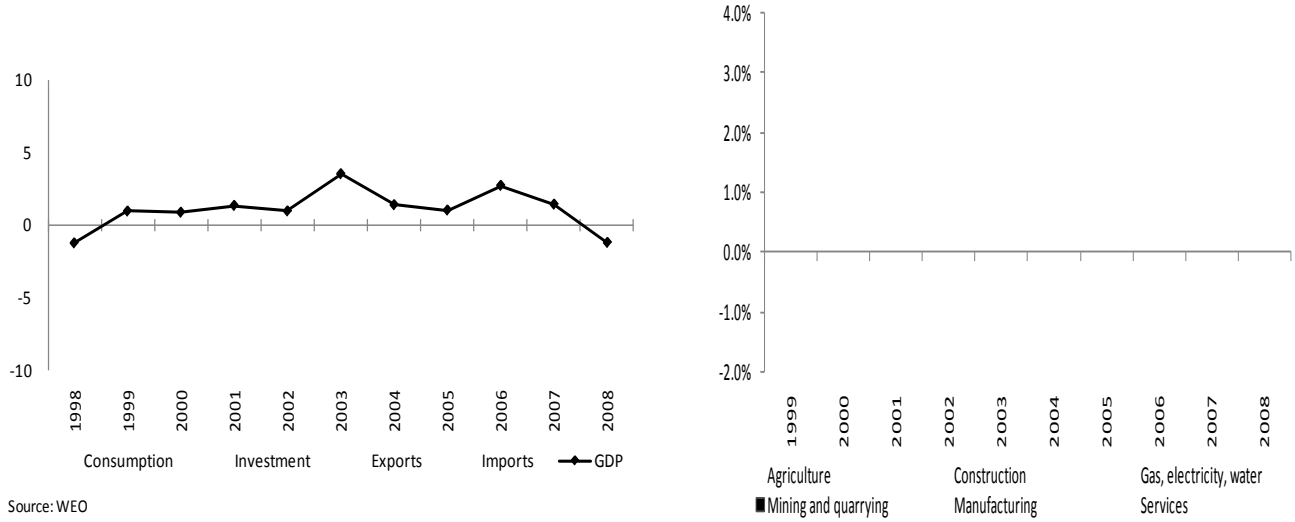
[1] See "The Informal Sector in Jamaica", December 2006, Inter-American Development Bank. Also see "Public Debt and Productivity: The Difficult Quest for Growth in Jamaica" by Rodolphe Blavy, IMF Working Papers No: 06/35.

[2] See World Bank Country Economic Memorandum (CEM) for Jamaica: The Road to Sustained Growth, 2003.

value added. Services and construction accounted for more than 100 percent of growth in the past decade, while both agriculture and manufacturing had a negative contribution of around 13 percent each. The service sector is dominated by tourism, finance and insurance services.

23. **Jamaica's growth has been mainly driven by domestic demand with only a modest contribution from exports.** Consumption and investment on average accounted for more than 100 percent of GDP growth in Jamaica over the past decade (Figure 2). Some of the weakness in export performance can be explained by real exchange rate appreciation since 2002, but other reasons include concentrated product mix consisting primarily of tourism and bauxite and dependence on the US as primary export destination.

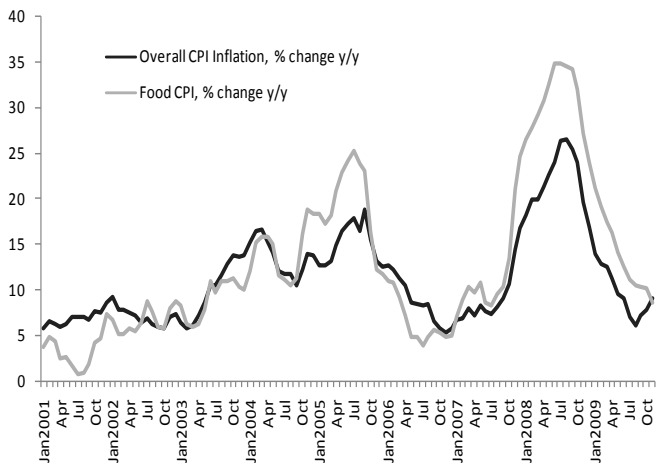
Figure 2: Growth decomposition



Source: WB Staff calculations based on WEO and LDB

24. **Consumer price inflation has been high and volatile in the last two decades, reflecting macro-fiscal imbalances and the vulnerability of the country to external shocks.** After a decade of high inflation in the 1990s, consumer price increases slowed significantly in the 2000s. The average annual CPI inflation declined to 9.9 percent during 2000-07 from 28.8 percent in 1990-99, but volatility has been high with two peaks around 2005 and 2008.

Figure 3: Consumer Price Inflation in Jamaica



Source: Statistical Institute of Jamaica (for the CPI), the Bank of Jamaica (for the food CPI)

25. **Fiscal planning has been constrained by structural weaknesses in the management of public sector finances.** The central government budget process is weak, as evidenced by spending commitments outside the budget. There has also been inadequate control over scores of insufficiently transparent off-budget public entities that both help finance, and are financed by, the central government. Although the entities' accounts are published, they are not presented consistently in a way that is amenable to formulating and assessing the overall direction of fiscal policy. Furthermore, fundamental reform of public employment management has been lacking, resulting in periodic upward spikes of the wage bill. The government's ongoing efforts to develop and implement fiscal responsibility legislation are targeted at addressing these issues.

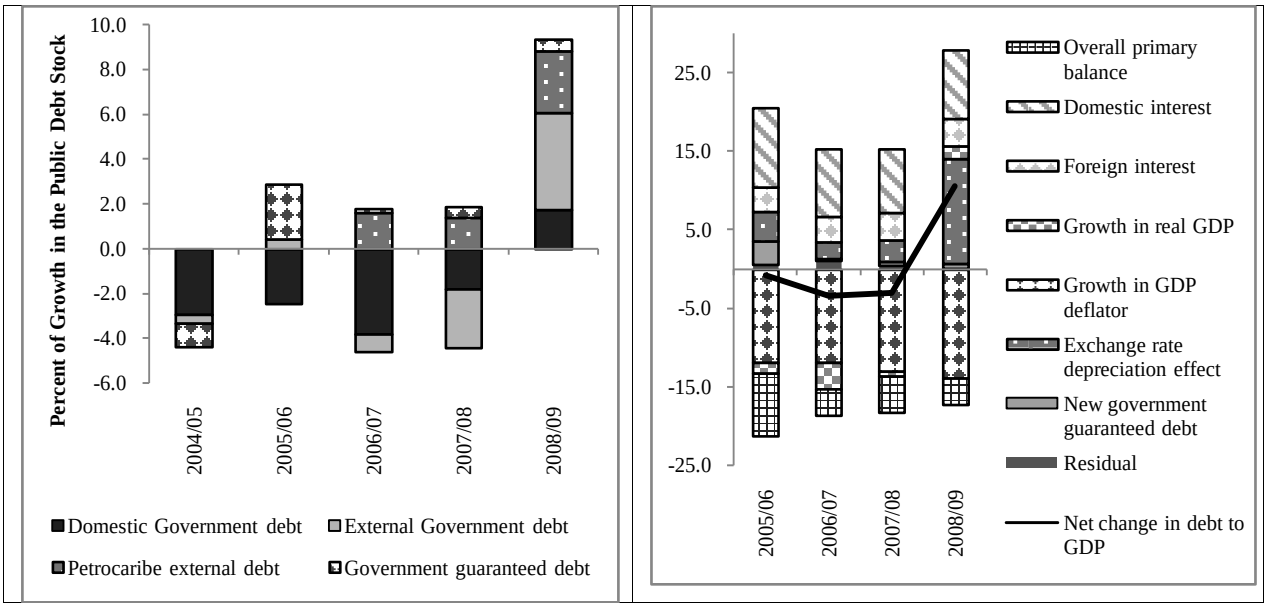
26. **The Government is among the largest employers in Jamaica, providing work for nearly 120,000 persons (4.5 percent of the population).** Teachers and support staff at schools represent about a third of the total public sector workforce, followed by central government administrative employees (18 percent) and employees from statutory bodies (15 percent). The number of established positions within the Central Government has remained relatively constant since 2004. Permanent civil service posts, authorized by the Civil Service Establishment Act, have remained close to 41,000 employees for the last five years.

27. **At 10.8 percent of GDP in FY2008/09, Jamaica's central government wage bill was in line with international standards, but increased significantly in the past year, and absorbs a considerable amount of government resources**. Jamaica's wage bill is only slightly above the average for Caribbean states (10.7 percent of GDP). However, while expenditures on salaries and wages have remained relatively constant at about 31 percent of GDP, they have increased as a percentage of total tax revenues from 41 to 45 percent. This increase in the wage bill was due to salary increases negotiated with more than 70 bargaining units of public sector employees. Some of these units are included under the Joint Confederation of Trade Unions, which has signed three biennial Memoranda of Understanding (MOU) with the Government since 2004 with the objective of moderating the growth of the public wage bill. In the latest MOU—MOUIII (2008-2010)—the agreed wage increases were 15 percent in year 1 and 7 percent in year 2, but year 2 increases have not been implemented due to the government's fiscal challenges.

28. **Jamaica has a high public sector debt burden with a debt to GDP ratio of 124 percent of GDP at the end of FY08/09.** Total public debt increased from 84 percent of GDP in 1997 to 123.3 percent of GDP by 2003 following the financial crisis of the mid-1990s. Although, the debt ratio decreased to 113.5 percent by FY07/08, it rose again to 124 percent in FY08/09. Government guaranteed debt and external debt of PetroCaribe were important sources of increase in the total debt stock since FY2006/07 (Figure 3). High debt servicing on both domestic and foreign debt was also an important source of deterioration in the debt ratio. Additionally, the recent exchange rate depreciation caused external currency debt to increase in value.

29. **Stronger control of Public Bodies—whose debt is about 19 percent of GDP—is critical for reducing the public debt ratio.** Despite high primary surpluses of the central government, debt levels hardly fell. This was partially because of materialization of contingent liabilities of some public bodies[3]. Despite the risk of having to service the public bodies' non-guaranteed debt, which is mostly owed to the domestic private sector, the GoJ's debt management strategy focuses on direct and Central Government guaranteed debt only. With the consolidation of public bodies into the central budget, a process that is supported by this proposed loan, the non-guaranteed debt portfolio will be integrated into the Debt Management Unit's mandate.

Figure 4: Contributions to the increase in public debt and causes of changes in debt-GDP ratio



30. **The composition of Jamaica's public debt indicates exposure to currency, interest and roll-over risks.** Although the share of debt indexed or denominated in foreign currency has come down from about 90 percent in FY1990/91, it was still more than half of public debt as of FY2008/09. Nonetheless, debt from multilateral or bilateral creditors amounts to 36.7 percent, a significant ratio, and this provides some stability in debt dynamics. The exposure of public debt to changes in interest rates is also significant: as of November 2009 variable-rate instruments

[3]. Public Bodies' fiscal accounts are not consolidated with the Central Government's accounts; therefore debt assumed by the Central Government is referred to as other debt accumulating flows.

accounted for about 51 percent of the domestic and 20 percent of the external debt. Although most of the external debt has a maturity longer than 5 years, nearly three quarters of the domestic debt matures in five years or less.

Table 1: Jamaica Public Debt Stock 2003/04-2008/09 (Percent of GDP)

	2003/04	2004/05	2005/06	2006/07	2007/08	2008/09
Public debt stock	**123.3**	**120.6**	**119.9**	**116.5**	**113.5**	**124.0**
Government debt	117.1	114.3	111.8	106.2	101.1	107.9
Domestic	73.4	70.6	67.6	63.0	60.9	62.9
External	43.6	43.6	44.1	43.2	40.1	45.1
Official	21.4	20.0	17.0	15.3	13.5	16.6
Commercial	0.0	0.0	27.2	27.9	26.7	28.4
PetroCaribe	6.2	6.4	0.1	2.0	3.6	6.8
Government guaranteed debt	4.7	5.0	8.0	8.2	8.8	9.3
External	1.5	1.3	6.7	6.8	7.2	7.4
Domestic			1.3	1.4	1.6	2.0
Memorandum Items						
Domestic currency debt	57.9	58.6	58.1	55.3	55.1	54.2
Foreign currency debt	48.4	48.7	51.0	52.0	51.0	59.2
US$ linked debt	17.0	13.4	10.8	9.2	7.4	10.6

Source: World Bank Staff Calculations based on data from the IMF and national sources.

31. **The Jamaican financial system is dominated by the commercial banking sector**. The banking system is comprised of commercial banks, building societies, merchant banks (licensees under the Financial Institutions Act), and credit unions. In terms of assets (deposits), as of June 30 2009, commercial banks and building societies represent 71 (69) and 19 (21) percent of banking system assets (deposits), respectively. The commercial banking system has not been a source of risk to the domestic financial system during the crisis. Commercial banks have been able to tap international capital markets for funds to maintain their liquidity and capital positions during the crisis and prudential ratios – non-performing loans to capital, loan loss provisions, liquidity to liability ratio – have all shown steady improvement.

32. **Heavy exposure of the domestic financial system to government securities is an important source of vulnerability**. As of September 2009, domestic investors held an estimated J$961.4 billion in government debt. In contrast, loans at depository institutions totaled J$379.5 billion. Insurance companies and pension funds—the largest institutional investors in the market—hold 60 and 39 percent of their assets, respectively, in government securities. Banks are required to maintain more than a quarter of their deposits and borrowings (prescribed liabilities) in government and liquid assets. Securities dealers, many of which are affiliated with commercial banks, are the largest single holders of government securities, and they finance their inventory by borrowing directly from retail investors who are thus exposed to the risk of dealer balance sheets.

33. **The main source of risk is the combination of high government debt brokered by securities dealers and the fact that these dealers carry highly liquid and largely dollar-denominated liabilities.** Approximately 46 percent of securities dealers' repurchase agreements (repos) are US$ denominated, and most of these are collateralized by government securities originally issued outside of Jamaica. Thus, dealers dominate the market for liquid liabilities

which is heavily weighted toward US$ assets. Starting October 2008, there was a large increase in Central Bank loans to domestic securities' brokers. These loans were financed by heavy borrowing at US overnight rates, leading to an increase in the cost of issuing domestic debt and financing the fiscal deficit. Thus, the spike in domestic interest rates and depreciation of the Jamaican dollar in the second half of 2008 and first half of 2009 were at least partially caused by these higher financing costs. Although interest rates have returned to near pre-crisis levels, the vulnerabilities illustrated by these developments remain.

34. **In terms of business environment, Jamaica ranks among the mid-performers, though its ranking has deteriorated in the past year.** Jamaica fell to 75th place—compared to 67th (out of 181 countries) a year ago—in terms of the overall ease of doing business. Despite the overall deterioration, however, some improvements have been recorded in simplifying tax payment procedures and property registration due to the ongoing reforms in tax administration.

C. Recent Economic Developments, Impact of the Crisis, and Macroeconomic Outlook

35. **The impact of the global crisis on Jamaica has been substantial and is likely to continue over the medium-term**. In FY 2007/08, real GDP growth decelerated to 0.6 percent from 3.2 percent the prior year due to the adverse impacts of Hurricane Dean and the food and fuel price crisis. GDP grew by -1.6 percent in FY2008/09. The estimate for FY2009/10 is -3.5 percent, with growth being projected to recover to 1.9 percent by FY2011/12 (Table 3). The crisis affected Jamaica through four main channels: decline in tourism, lower export demand and remittances from the US, worsening financial conditions, and decline in domestic demand and credit growth. The assumption on growth in the medium-term is partly a reflection of the recovery after the sharp contraction due to the global crisis and is also based on the assumption of improved domestic demand as a result of projected global recovery and improved quality of public expenditures following fiscal adjustments and borrowing from the multilaterals. The cumulative decline in real GDP is estimated to be around 5 percentage points during FY2008/09 and FY2009/10. The real GDP is projected to recover gradually and reach the pre-crisis level by FY2013/14. This gradual recovery will be supported by the improving global economic activity, rising FDI inflows and related increase in construction activity, fall in interest rates following fiscal consolidation, recovery in international aluminum prices and gradual increase in aluminum production, rise in tourism activity and increase in agricultural production. Domestic credit growth is also projected to increase by 11 percentage points between 2009/10 and 2010/11 as interest rates soften.

36. **The financial sector has been adversely affected by the crisis, though it weathered the turmoil in global markets well.** As of June 2009, the solvency indicator was adequate as reflected by the CAR of the banking system, which was 15.4 percent, similar to that observed in June 2008 (15.6 percent), and higher than that observed in December 2008 (13.9 percent). Between June 2008 and June 2009, the rate of credit growth was 20 percent, which was funded partially by deposits, borrowings (including repos), and a shift in bank portfolios away from investments. The return on assets remained largely unchanged over the same period. However, there are signs that the Jamaican financial sector has suffered from the effects of the international financial crisis. The Non-Performing Loan ratio (NPLs over Total Loans) has increased from 2.2 percent in June 2008 to 3.6 percent in June 2009. Over the same period, the ratio of provisions for loan losses over NPLs declined from 120 percent in June 2008 to 91

percent.

37. **The heavy reliance of the financial sector on government debt implies increased sensitivity to the pressures faced by the Government due to the external environment**. The crisis has revealed vulnerabilities in some Jamaican financial institutions, which have used government bonds as collateral for external credit lines. As markets discounted Jamaican bond prices, due to greater perceived risk, and the value of the collateral dropped, institutions needed to present more assets to maintain the minimum value of the collateral or close their line of credit. In addition, as the global financial crisis continues, there is a greater risk of contagion from foreign markets to local markets through the presence of foreign banks, which represent 35 percent of total bank assets in Jamaica as of June 2009.

38. **The Central Bank has acted to increase liquidity and ease credit constraints to the banking sector.** Credit to the private sector is expected to increase from J$33 billion to J$49 billion between FY2008/09 and FY2009/10. In addition, the central Bank has provided an emergency credit line to financial firms that were suffering dollar liquidity constraints due to a drop in the value of collateral, from which $168 million was drawn. The Government has also accessed the IDB's Growth Stability Fund for $200 million for on-lending to commercial financial institutions to support credit to firms that suffer financing constraints from the loss of suppliers' credits.

39. **A key challenge facing the authorities is to reduce external vulnerabilities while maintaining internal balance and recovering reserves**. The Jamaican dollar depreciated against the US dollar by around 15 percent (from J$76.93 to J$88.06) from December 2008 to February 2009, but since then the exchange rate has been close to J$89 (averaging at J$89.6 in December 2009). In order to contain exchange rate depreciation between August 2008 and July 2009, the Bank of Jamaica raised interest rates on 90 and 180 day certificates of deposit (CDs) to 17.5 and 19.0 percent, respectively. Interventions by the Central Bank have resulted in a year-on-year decrease of 2.1 percent in net international reserves, which now account for about thirteen weeks of imports of goods and services.

40. **The Government is constrained in how much it can increase priority expenditures by limited fiscal space.** The Government introduced a mini stimulus package favoring mostly the tourism sector through a temporary reduction in the general consumption tax in December 2008 and, as a Christmas bonus, tax-free small gifts from abroad. To mitigate the impact of the crisis on the poor, the Government increased benefit levels and expanded the coverage of the conditional cash transfer program (PATH) from US$30 million at the end of 2008 to US$34 million in FY2009/10. However, further increases have been limited by the lack of fiscal space. The Government has issued a circular freezing public sector salaries in April 2009, followed by the Prime Minister's announcement of a two year wage freeze in December 2009. Nonetheless, in the FY09/10 budget 56.5 percent of the appropriation is dedicated to interest payments on outstanding government debt and another 22.5 percent is for civil servants pay, leaving just 21 percent for office maintenance, supplies and service provisions.[4] Debt reduction is therefore a

[4] The government issued Circular No. 12, on April 17, 2009, as a temporary measure to contain the wage bill in 2009/2010. The circular suspended the implementation of the second phase of salary increases for public sector employees (including those from government companies and public bodies) as agreed under MOU III. The government later agreed with teachers and nurses retroactive wage settlements through the Supplementary Estimates to the Budget, in September 30, 2009.

key component of the Government's strategy to expand fiscal space.

41. **Inflation is falling from its 2008 highs and is expected to continue to moderate over the medium term following a temporary rise in FY2010/11.** Fueled by high food and fuel prices, inflation rose to more than 20 percent in FY2008/09. However, with lower energy prices and falling domestic demand, consumer prices are expected to ease to 9.0 percent in FY2009/10. Inflation is expected to pick up temporarily in FY2010/11 mostly due to rise in taxes and recovering commodity prices. In the medium term, inflation is expected to average at 7.8 percent over FY2010/11-FY2013/14.

42. **Tourism revenues and remittances have declined but are expected to recover with the global economy.** Tourism receipts are expected to increase from 14.3 to 16.0 percent of GDP between FY2008/09 and FY2009/10, while net private transfers—mainly remittances—are expected to average 15.9 percent of GDP between 2009/10 and 2013/14 during the global recovery.

43. **The goods trade balance improved markedly in the second half of 2009.** The goods trade balance recorded a deficit of US$2,271.6 million, an improvement of US$1,592.1 million when compared to the corresponding period in 2008. This resulted primarily from a reduction in imports of US$2,824 million (or 46 percent), which was significantly influenced by a reduction in imports of mineral fuels of US$1,910 million. The improvement observed in the goods subaccount was partially offset by a US$1,232 million (or 54 percent) decline in exports, stemming mainly from a reduction in alumina exports of US$698 million. However, this decline was more than offset by the fall in imports due to reduced domestic economic activity and falling international commodity prices. The resulting narrowing of the current account deficit mitigated the impact of the global crisis on Jamaica's external financing needs.

44. **On the capital account side, flows from official and private sources were sufficient to finance the current account deficit.** Consequently, the net international reserves increased by US$160.3 million during January-September 2009.

45. **In the medium-term, current account deficit is expected to narrow from 18 percent of GDP in FY2008/09 to 9.4 percent in FY2009/10 and 5.0 percent in FY2013/14.** The medium-term dynamics are linked closely to the projected global recovery and stronger export revenues. Higher interest payments on external debt and a projected decline in the imputed profit remittances from private direct investment are expected to reduce net foreign income. Foreign direct investment flows are projected to fall even further over the next two years, but pick up in FY2011/12.

46. **Central government revenues are estimated to have improved to 28.3 percent of GDP in FY 2009/10 from 27.3 percent in FY2007/08.** This improvement has been underpinned by stronger tax collection efforts, which have yielded a reduction in tax arrears on interest, income, and corporate profits by virtue of the tax amnesty this fiscal year. Revenues have also been boosted by the introduction of a series of tax packages introduced over the course of FY 2009/10. However, these positive developments have been somewhat offset by lower receipts on the bauxite levy and consumption taxes amid the slowing pace of economic activity (Table 2).

Table 2: Impact of the Crisis on the Bauxite Levy
(J$ billions)

	2008/09	2009/10	Percent change
Revenue and Grants	276.2	326.4	18.2
Tax Revenue	246.2	291.7	18.5
Non-Tax Revenue	16.1	1.9	-88.5
Bauxite Levy	4.4	0.2	-96.9
Capital Revenue	1.9	7.4	295.9
Grants	7.6	10.3	35.2

Source: MOF

47. **Rising debt service costs as well as higher spending on wages, salaries, and capital goods have been the main drivers of overall deficits in recent years**. Between FY2005/06 and FY2008/09, revenues increased by 0.4 percentage points of GDP while expenditures increased by 4.5 percentage points of GDP. Spending increases have mainly been driven by higher interest payments (which averaged 12.2 percent of GDP between FY2005/06 and FY2008/09), capital expenditure (which increased by 2.3 percentage points of GDP), and wages and salaries (which increased by 2.0 percentage points) over between 2005/06 and 2008/09). Consequently, the primary surplus deteriorated from 9.9 to 4.8 percent of GDP between 2005/06 and 2008/09.

48. **To contain spending growth, increases in interest expenditures and the wage bill have been offset somewhat by cuts in capital spending.** The cost of debt service is projected to increase from 12.2 percent of GDP in FY2008/09 to 16.0 percent of GDP in FY2009/10. The latest settlements with teachers and nurses, agreed before a general wage freeze for all public sector employees was announced, have contributed to an increase in the wage bill as a percentage of the GDP to 11.8 percent in FY2009/10 from 10.8 in FY2008/09, although the wage bill is expected to decline to 10.9 percent in FY2010/11.[5] To partially offset these increases, the GoJ had to reduce capital spending from 4 percent of GDP in FY2008/09 to 3.3 percent in FY2009/10.

49. **The consolidated fiscal deficit is expected to worsen in the short term to above 12 percent of GDP but narrow again in the medium term to 0.5 percent in FY2013/14.** This projection takes into account government reforms (supported by this DPL) to improve fiscal balances and reduce debt generation through stricter control of fiscal spending and Public Body rationalizations to stem ongoing losses. It also takes into account expected increases in tax revenues due to reforms implemented in tax administration and the three tax packages introduced in FY2009/10 (See Annex 6 for details). For instance, the government's most recent tax package announced in December 2009 is expected to produce 2 percentage points of GDP additional tax revenues—thereby increasing the primary budget surplus. The Government implemented a wage freeze in April 2009, which was extended for another two years in December 2009. The wage freeze is meant to be a temporary measure to control fiscal spending and contain the increase in wages as a ratio to GDP while the Government is preparing a reform action plan for wage and human resources management in the public sector.

[5] The third Memorandum of Understanding, not fully implemented due to the wage freeze, specifies a nominal wage adjustment of 15 percent in FY2008/09 and 7 percent in FY2009/10.

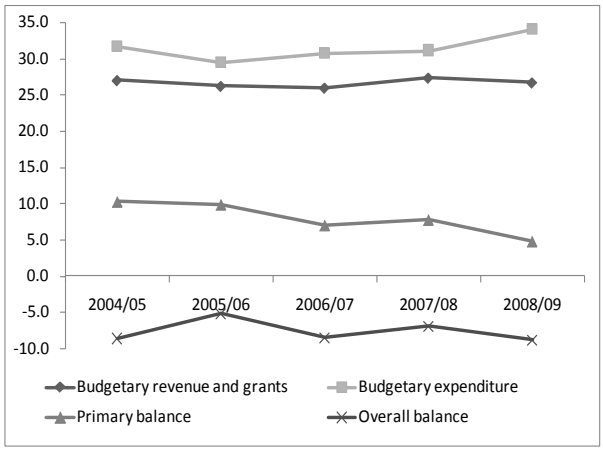
50. **At the central government level, primary surpluses are projected to increase from 4.8 percent of GDP in FY2008/09 to 9.1 percent in FY 2013/14 due to fiscal reforms and expected global recovery**. Consequently, the overall central government deficit would decrease in the medium term from a projected 10.0 percent for FY2009/10 to 0.7 percent in FY2013/14. Likewise, Public Bodies' deficits would decrease from a deficit of 2.5 percent in FY2008/09 to a slight surplus of 0.2 percent in FY2013/14. However, the impact of fiscal reforms would be lower if global conditions were to deteriorate further or if the growth in the Jamaican economy were to recover slower than anticipated (also see Annex 5 for a detailed discussion of the impact of shocks to growth and fiscal balances). On the positive side, the IMF SBA and the financial support by the key development partners should help the Jamaican economy recover quickly along with the global economy. Nonetheless, while fiscal balances are expected to improve over the medium-term, the impact of the global external environment implies that the Government may not be able to balance its budget as quickly as anticipated prior to the global slowdown.

51. **After the initial rise reflecting the adverse impact of the crisis, the debt to GDP ratio is expected to decrease in the medium term to 115.6 percent in FY2013/14, compared to 124.1 percent in FY2008/09** (Figure 6). The baseline scenario of the debt sustainability analysis (seen Annex 5 for details) indicates that, given the global external environment and even with the implementation of the government reform plan, the public debt ratio is unlikely to fall below 100 percent of GDP by FY2011/12 as originally anticipated by the government. Even under the most favorable scenario, total debt is not expected to fall below 110 percent of GDP in FY2013/14. At the same time, however under the most extreme scenario of no reform, debt is expected to increase from 140 percent to 143 percent of GDP over the same period.

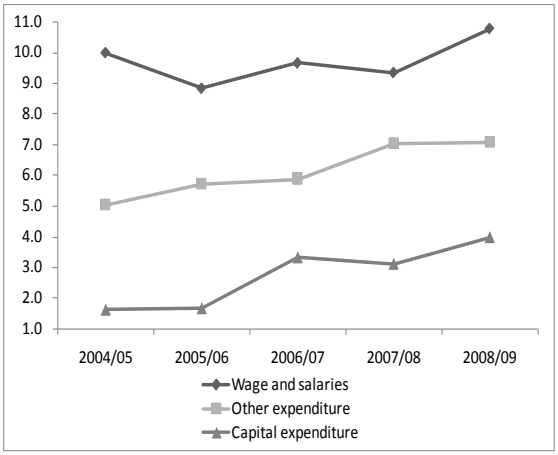
52. **Refinancing and interest risks are substantial, but affect primarily domestic debt.** In FY2010/11, nearly 9 percent of total debt will be due for repayment, representing 12.2 percent of GDP. Although this represents a significant maturity concentration, the risks are limited to domestic debt, which accounts for 86 percent of the total due for repayment. The maturity exposure is likely to increase in the medium term, rising to 23.1 percent of GDP in FY2012/13. Combined with interest payments, the total debt service obligations could reach 34 percent of GDP in that year. However, this assessment does not account for the impact of the Debt Exchange launched January 14, 2010 (Box 1). Successful completion of the debt exchange – current participation rates are estimated to be over 95 percent – will reduce roll-over risks significantly.

53. **The gross financing needs of Jamaica are estimated to increase in FY2009/10 and reach 19.8 percent of GDP, equivalent to US$2.39 billion** (see Annex 5, Table B2). The increase is due to higher interest payments (up from 12.2 percent of GDP in FY2008/09 to 16.0 percent of GDP in FY2009/10) while principal repayments are estimated to decrease to 9.9 percent of GDP (from 10.2 percent in FY2008/09). Out of J$735.6 billion of domestic debt, more than J$200 billion will mature within the next twelve months. More specifically, J$14.6 billion will mature between February and March 2010, while J$208.9 billion (representing 29.8 percent of total domestic debt) will mature in FY2010/11. In contrast, just 0.6 percent (US$38.9 million) of total external debt will mature within the next twelve months.

Figure 5: Overall fiscal balances and primary expenditures (percent of GDP)



Source: World Bank and IMF calculations

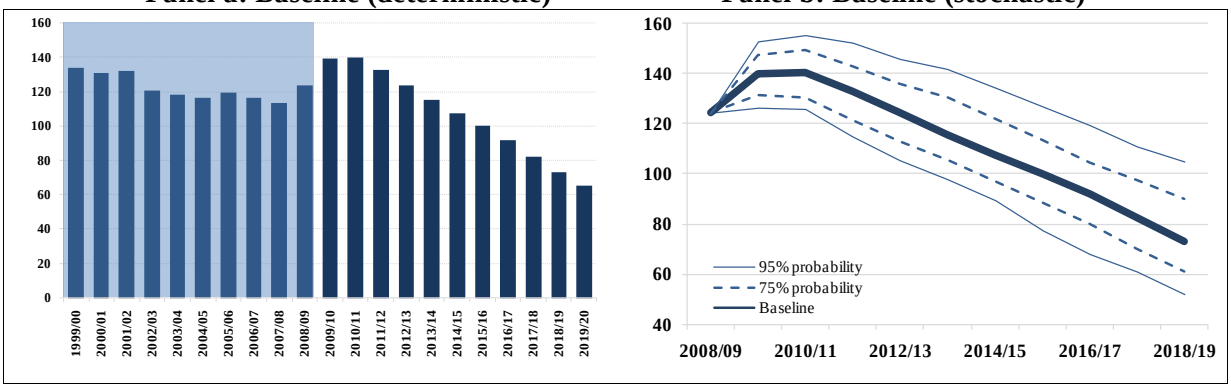


Source: World Bank and IMF calculations

54. **Financing requirements are projected to be covered mainly by multilateral financing in the short term.** The largest inflows are projected to be from the IMF's front-loaded SBA of US$1.25 billion of which US$650 million is to be disbursed in FY2009/10 (Annex 5, Table B2). However, in the longer run, reducing the gross financing needs to sustainable levels will depend on Jamaica's ability to increase foreign exchange earnings and reduce the fiscal deficit.

Figure 6: Expected evolution of public debt

Panel a: Baseline (deterministic) **Panel b: Baseline (stochastic)**



Source: World Bank staff projections

Box 1: Jamaica Debt Exchange Offer

On January 14th, 2010 the Government of Jamaica announced a domestic debt exchange program that involves J$701 billion, virtually all its domestic debt. The debt exchange involves the consolidation of over 350 securities into 23 new benchmark bonds, the conversion of some securities from callable to non-callable, and the introduction of inflation-indexed bonds. The debt exchange attracted over 95 percent participation, as of February 5, 2010, with no hold-out groups, and is expected to generate significant fiscal savings, of at least 3 percent of GDP in FY2010/11. Interest expenditures-to-revenue ratio is expected to decline to about 45 percent from about 65 percent in FY2009/10.

Under the debt exchange offer the coupons were significantly lower and maturities were extended. The offer is a par-for-par exchange of principal amounts with "no haircut". However, it envisages substantial reduction in yields. The average interest rate on J$ instruments is expected to decline to near 12 percent from an average of 19 percent, while interest on US$ fixed instruments is expected to fall to 7 percent from about 9 percent. The program implies the minimization of the initial variable exposure through temporary fixing of all variable rate instruments for 3, 6 or 12 months. The focus is on short term instruments since they represent a majority of the total domestic debt. In order to spread maturity concentration of short-term bonds, instruments with a maturity lower than three years are packaged in one single group and are offered to be exchanged with longer maturity instruments. The program also gives flexibility to variable rate bondholders to exchange their securities with either variable rate or fixed rate or CPI-Indexed instruments. The debt exchange finally ensures that the US$ instruments will be payable in US$. The Government aims to obtain 100 percent participation rate.

Three factors were crucial to the success of the debt exchange offer. First, the probability assigned by bondholders to its operational success was large. Second, the announcement that the failure of the program may cause the Government to "consider measures that no one, citizens or creditors, would find at all agreeable." Investors seemed to have perceived a high probability that a low level of participation and failure of the debt exchange would have triggered unwanted implications for bond holders. Third, the perceived probability that the government would adopt unconventional measures to put non participating investors in a significantly disadvantaged position relative to participating investors.

Table 3: Medium-term Macroeconomic Framework for Jamaica 1/

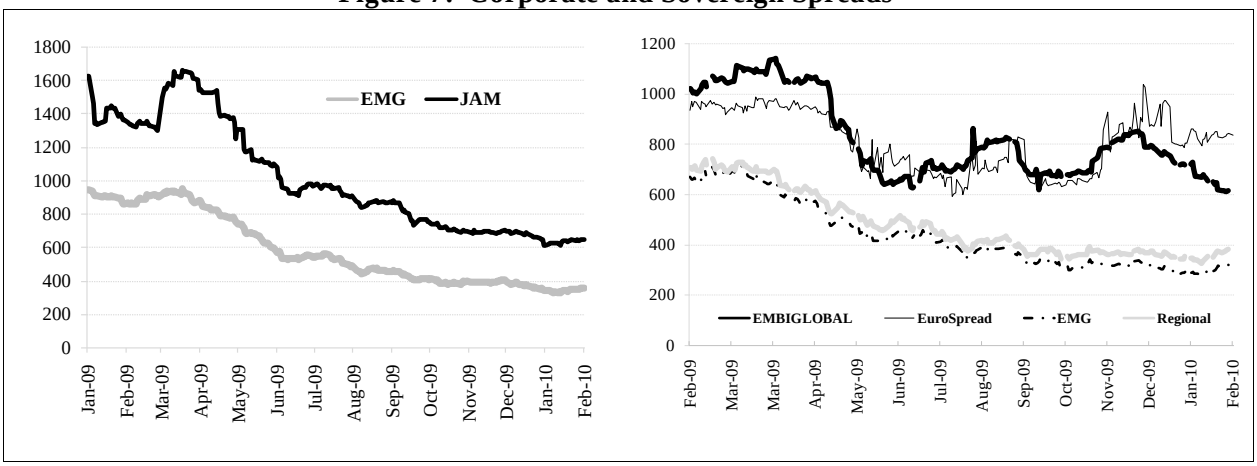
	2005 /06	2006 /07	2007 /08	2008 /09	2009 /10	2010 /11	2011 /12	2012 /13	2013 /14
				(Annual percentage changes)					
Real GDP	1.2	3.2	0.6	-1.6	-3.5	0.6	1.9	1.9	2.0
Consumer price index (average)	14.8	7.4	12.4	20.2	9.0	11.2	7.1	6.7	6.3
Exchange rate (end of period, in J$/US$)	65.3	67.6	70.8	88.0	…	…	…	…	…
End-of-period REER (percent change, appreciation +)	4.0	-0.7	4.0	-10.1	8.9	0.3	0.0	0.0	0.0
Treasury bill rate (average, annual percent)	13.0	12.3	12.5	17.0	17.5	13.1	10.6	10.5	11.0
Unemployment rate (in percent)	11.6	10.8	9.7	10.6	…	…	…	…	…
				(In percent of GDP)					
Budgetary revenue	26.2	25.9	27.3	26.6	28.3	27.7	27.8	27.9	27.9
Budgetary expenditure	29.5	30.8	31.1	34.0	38.2	34.2	32.1	30.5	28.6
Primary expenditure	16.3	18.9	19.5	21.8	22.0	20.7	20.2	19.5	18.8
Interest payments	13.2	11.9	11.6	12.2	16.0	13.4	11.2	10.5	9.5
Central government balance 2/	-3.3	-4.8	-3.8	-7.3	-10.0	-6.5	-4.3	-2.6	-0.7
Of which: primary balance	*9.9*	*7.0*	*7.8*	*4.8*	*6.2*	*7.0*	*7.7*	*8.3*	*9.1*
Overall Public sector balance	-5.2	-8.5	-8.2	-9.4	-12.7	-7.5	-4.9	-2.5	-0.5
Of which: public bodies	*-1.9*	*-3.7*	*-4.4*	*-2.1*	*-2.8*	*-1.0*	*-0.6*	*0.1*	*0.2*
Public debt 2/ 3/	119.9	116.5	113.5	124.1	139.7	140.2	132.7	124.2	115.6
Memo items:									
Current account balance	-10.5	-9.7	-18.4	-18.0	-9.4	-8.8	-6.6	-5.9	-5.0
Of which: exports of goods, f.o.b.	16.0	17.9	18.3	17.0	11.8	12.0	12.6	12.9	13.2
Of which: imports of goods, f.o.b.	40.0	42.3	50.4	50.0	38.9	39.0	39.5	39.0	38.4
Net international reserves (in millions of US$)	2078.1	2329.4	2083.4	1628.6	1,378	1,078	1,325	1,450	1,761
Net off-budget expenditure	*1.0*	*1.5*	*1.1*	*-0.4*	*0.0*	*0.0*	*0.0*	*0.0*	*0.0*

Sources: Jamaican authorities; IMF, and Bank staff estimates and projections.

Notes: 1. Fiscal years run from April 1 to March 31. 2. Calculation of overall balance includes debt issued to BOJ to cover its cash losses and, until 2007/08, debt related to off-budget projects financed initially by the private sector. 3. Public sector debt includes PetroCaribe debt. The baseline projection is based on the IMF's assumptions (reform scenario), including fiscal adjustment consistent with primary balance targets and US$0.5 billion of fixed-rate high yield domestic debt is successfully placed as part of the GoJ's liability management operations.

55. **Current sovereign and corporate spreads reflect higher country risk.** EMBI Global Sovereign spreads are at 613 basis points for Jamaica as of February 1, 2010, and are over 200 basis points higher than the regional average. Spreads on Jamaican corporate loans above US$300 million—CEMBI spreads—are almost double the LAC average (Figure 7). Moody', Fitch and S&P downgraded Jamaica's long-term local currency debt several times and in more than one step to their current levels, respectively Caa2 (from B1), C (from B) and SD (from B). These downgrades reflect the belief that increased macroeconomic pressures and a sharp fiscal deterioration have resulted in unsustainable debt dynamics, as well as agencies' reaction to the GoJ's announcement of the domestic debt exchange described above. S&P classified the offer as a selective default while Fitch considers it as a coercive debt exchange (CDE). However, S&P underlined that: "Overall, the domestic efforts, together with the ongoing multilateral support (including the expected IMF stand-by program of $1.25 billion), should help Jamaica manage its long-standing fiscal and structural problems going forward." In this context, Standard & Poor's expects to assign a 'B-' sovereign credit rating and 'B-' debt ratings to the new bonds upon the completion of the debt restructuring and issuance of the new bonds, which is scheduled for Feb. 16, 2010. Markets reacted rather calmly to the event, as evidenced by the slight narrowing of the EMBBI Global spread by 9 basis points and the increase in the CEMBI Broad of 19 basis points on January 14th, compared to the day before.

Figure 7: Corporate and Sovereign Spreads



Source: JP Morgan and World Bank calculations *Source: JP Morgan and World Bank calculations*

56. **Overall, the macroeconomic policy framework is assessed as being adequate for the proposed DPL, as further evidenced by the approval of a US$1.25 billion Stand-by Arrangement with the IMF on February 4, 2010 (See Annex 4).** Progress continues with the fiscal reform, in spite of challenges imposed by the global crisis. Monetary policy has remained prudent and oriented towards containing inflationary pressures and exchange rate depreciation, while attempting to stimulate growth of credit to the domestic sector. External balances remain stable in spite of the sharp decline in exports of goods. Tourism, remittances, and international reserves are recovering. The IMF's Stand-by Arrangement (SBA) of $1.25 billion was approved by the IMF Board on February 4, 2010, which would provide additional support to balance of payments.

III. GOVERNMENT PROGRAM: FISCAL SUSTAINABILITY

52. **The government's fiscal sustainability reform program is part of its medium-term socio-economic policy framework.** The framework sets out the broad package of policies, strategies and programs proposed by the Government for implementation over the period 2009-2012, and is focused on fiscal and debt sustainability, establishment of an efficient and equitable tax system, financial system stability and price stability. It supports the overall vision, goals and outcomes of Jamaica's long term development plan, Vision 2030, and is the vehicle that transforms these long term goals and outcomes into medium-run priorities, strategies, programs and measures.

53. **The fiscal and debt sustainability component of the government's reform program aims to contain and reduce debt, enhance revenues, and increase the efficiency of public sector spending and investment**. This component rests on three pillars:

- **Pillar I:** *Promoting Fiscal Sustainability Through the Control of Public Sector Balances and Debt*

  - Reforms include the establishment of a Fiscal Responsibility Framework, consolidating the budget (Central Government and Public Bodies), rationalizing the functions of Public Bodies, divesting loss making commercial Public Bodies, and containing the growth of the public sector wage bill.

- **Pillar II:** *Increasing the Efficiency of Financial Management and Budget Processes*

  - Reforms include improving the prioritization of investment of the public sector, and enhancing the monitoring, evaluation and performance of public spending and procurement. This pillar also supports improving accounting and financial reporting, as well as mechanisms to control spending.

- **Pillar III:** *Reducing Distortions and Enhancing the Efficiency of the Tax System*

  - Reforms include improvements in both tax policy and administration that are geared toward greater uniformity in the tax code with a view to reducing distortions, and improving compliance.

54. **The government is taking bold steps to address the root causes of the problem to ensure medium term fiscal and debt sustainability.** The government is aware of the fact that without addressing the root causes of the problem, short term solutions would not be sufficient to permanently reduce the debt overhang and put the economy on a high growth path. Therefore the government's program includes measures to fundamentally change the public expenditure management structure and control the process that led to a large debt accumulation in the past. Public bodies' rationalization plan, introduction of Fiscal Responsibility Framework and improvements in fiscal discipline, better management of wage bill and human resources in the public sector, improvements in debt management practices and tax reforms are all expected to increase medium term fiscal sustainability and put the debt to GDP on a declining path.

A. Pillar 1: Promoting Fiscal Sustainability through the Control of Overall Public Sector Balances and Debt

Finalization and Approval of the Fiscal Responsibility Framework

55. **Containing the growth of public debt and reducing the overall debt burden is critical to establishing fiscal solvency, flexibility, and space.** Given that Jamaica is a low-growth economy and must cope with volatility and the uncertainty associated with frequent external shocks, the expansion of fiscal space is necessary both for development spending and for providing the GoJ with a cushion in the event of necessity. High debt servicing greatly complicates fiscal management and targeting of development objectives. As described in the previous section, high rollover and interest risk introduce further uncertainty into the fiscal planning process and contribute to higher costs of credit. Constrained financial markets, during and post-crisis, only highlight the urgency of Jamaica's need to reduce the public debt ratio.

56. **Considerable progress has been made in debt management over the past decade, and further reforms continue.** Jamaica's debt management practice has undergone significant transformation since the transfer of debt management responsibilities from the Bank of Jamaica (BOJ) to the Ministry of Finance and the Public Services (MOF). Core debt management functions are consolidated in the Debt Management Unit (DMU) under the Economic Management Department. Debt management strategy is developed and has been reviewed on an annual basis since 2000. It is published on the MOF web site, as are periodic statistics on debt stock and its composition, as part of a strategy to improve transparency of debt management operations. Control of government guarantees has been strengthened, new domestic debt is mostly marketable, and international markets have been accessed regularly since 2001. Nevertheless, further efficiency gains can be obtained. For example, the authorities are currently undergoing organizational reform that will replicate market practice in financial institutions and advanced debt management office practices, by creating a structure with front, middle and back offices organized by function, rather than by sources of funding. This reform will reduce duplication of functions, diminish operational risk, and enable comprehensive analysis of the total debt portfolio.

57. **Despite the progress, two important challenges remain on Jamaica's path to fiscal solvency**:

- Improving the credibility of the public sector's fiscal framework: This is a prerequisite for an adjustment process that will gradually reduce the heavy debt burden in order to create additional fiscal space for development priorities.
- The fiscal environment has suffered from a range of weaknesses, which the GoJ is addressing through its medium-term fiscal reform program. These include:
  - Absence of allocation of fiscal responsibilities across governance bodies;
  - Budget and financial management characterized by poor control of public enterprises, which have contributed to high deficits and debt;
  - Financial Administration and Audit Act gave authority to the MoF to permit deferred financing (which authority has been revoked);
  - An ad hoc wage bargaining process, involving several bargaining unions, that has led to rapid increase in wages;

- Lack of transparency, consolidation, and coordination in budget reporting and accounting; and
- Financial legislation is fragmented and thus difficult to follow. This is exacerbated by the inclusion of many provisions that more properly should be included at the level of regulations or even financial instructions.

58. **The Government has commenced the development of the Fiscal Responsibility Framework (FRF), designed to strengthen the budget process by enhancing the mechanisms for transparency and establishing clearer goals, targets, and limits for public spending, deficits, and debt**. The Government issued a paper in November 2008 that authorized the MoF to initiate a consultative process with stakeholders and legal experts in order to prepare a draft FRF for Cabinet submission and then for submission to Parliament. The FRF would introduce the principles of responsible fiscal management (Box 2) through amendments to the FAA (Financial Administration and Audit Act) and the PBMA (Public Bodies Management and Accountability Act) and also improve fiscal transparency through detailed reporting requirements and greater parliamentary oversight over the expenditures of all public bodies. It is important to note that the Government has reviewed and proposed amendments to all financial legislation to make it more manageable and to combine the various pieces into a comprehensive public financial management act.

59. **The FRF specifies that the Minister of Finance will be responsible for the development and implementation of a fiscal policy framework, supervision and monitoring of public financing, and coordination of international and intergovernmental fiscal relations**. Each year the MOF will table in Parliament a fiscal policy paper, including the Fiscal Responsibility Statement (FRS) and the Fiscal Management Strategy (FMS). The FRS specifies an acceptable overall fiscal balance and level of total public debt and sets out the fiscal policy measures necessary to achieve these targets. The FMS assesses current and projected financing needs and presents a three year plan for the development of the economy, including the level of public expenditure as percentage of GDP. In addition, the FMS will establish targets over a set of fiscal indicators, e.g., annual public borrowing, the overall balance, and the primary balance. The MOF will also provide an explanation to Parliament in the event of any deviation from these targets and the Minister will have to inform Parliament of any changes in policy.

60. **The ultimate objective of the FRF is the promotion and enhancement of prudent fiscal management, accountability and transparency towards the achievement of explicit targets for public debt, public sector wage bill, and the overall fiscal balance**. A central feature of the FRF is the emphasis on greater transparency in the preparation of annual estimates of revenue and expenditure and any changes in policies or practices. The Auditor General will review the fiscal policy paper to ensure that it complies with the principles of prudent fiscal management. These principles are specified in the FRF as prudent management of contingent liabilities, maintenance of debt at sustainable level, gearing of borrowing towards productive purposes, and management of expenditures at levels consistent with revenues.

Box 2: Good Principles for A Fiscal Responsibility Framework

Experience from a range of other countries with fiscal responsibility rules suggests that Jamaica needs to consider the following in the design of the framework:

- ***Fiscal rules need to be meaningful, but flexible enough to cope with uncertainty and volatility.*** It will take time to establish fiscal credibility and to strengthen the framework gradually. Overly ambitious objectives at the outset of the program could undermine the credibility of the framework if they are immediately missed. This is why the initial focus of many responsibility laws is increasing transparency, with targets being gradually strengthened as experience and capacity develops. The framework should look to set multi-year fiscal parameters, targets or objectives for key parameters, as does the Jamaican FRF – but in addition could also aim to spell out possible adjustment mechanisms and processes in the event of shocks (while being clear about what constitutes such a "shock").
- ***Fiscal responsibility rules require widespread political/public support.*** The political environment needs to be prepared for the introduction of fiscal rules. Introducing a framework that will be broken at the first cyclical downturn may do more harm than good to budget credibility. The dissemination and (often public) consultation process is therefore extremely important. It should help to develop support for realistic, but stretchable, initial targets. To this end, the GoJ has been engaged in a long process of consultation that has led to widespread recognition of the need for fiscal reform to achieve debt sustainability.
- ***The fiscal framework strategy should be comprehensive, with strict controls over exceptions.*** A fiscal strategy that does not explicitly cover all of the public sector, especially public enterprises in Jamaica, will not have much benefit, as it will be too easy to subvert the rules—for example by providing guarantees/debt to public enterprises and financial institutions. While exceptions can be made for special cases, such as natural and economic disasters, institutions should be in place to discourage abuse and ensure that these are genuine e.g. approval for any exception should be done in a highly transparent manner, possibly through a requirement to explicitly and publicly inform parliament, and with a clearly specified transition path back to the targets. The proposed Jamaican FRF does specify exceptions and could be further strengthened through the specification of transition paths back to targets consistent with the medium-term objectives, in the event of a deviation.
- ***The institutional "rules of the game" should encourage compliance.*** Formal penalties for non compliance with fiscal rules may be weakened because they are largely self-policing. Nonetheless, the presentation of a fiscal policy document with the budget can be useful in itself, as is the reporting and political accountability over the previous year's fiscal policy aims. The process must encourage politicians to take ownership for setting targets—they must have incentives to make these commitments (that obviously entail some risks). Techniques include more shared decision making with parliament or independent agencies auditing the fiscal/macro economic assumptions. The Jamaican FRF provides for reporting by the Minister of Finance to Parliament for example, as discussed in Paragraph 59, without including sanctions for non-compliance.
- ***Transparency is of central importance to the achievement of fiscal discipline.*** The GoJ is fully aware that this involves making available sufficient information on plans and outcomes to enable a judgment on their adequacy through independent verification of the information and the FRF has provisions for presentation of information in this context. The FRF as submitted to Parliament also entails enhancing the role of Parliament and the Auditor-General in this process.
- ***The new framework should consist of nominal, rolling multi-year targets for public sector spending and debt.*** Fiscal rules need to be easily understood and put in to a credible medium-term context, to ensure that problems are not simply being deferred to a future budget (including the generation of future liabilities) and that the transition path is clearly established. Fiscal rules with embedded expenditure targets tend to be associated with larger and longer adjustments, and high success rates. The Jamaican FRF sets medium-term targets on the debt to GDP ratio and overall deficit and specifies that the Fiscal Management Strategy presented to Parliament include a 3 year plan with targets for various fiscal indicators and annual borrowing.

61. **Following the submission of the FRF to Parliament on February 2, 2010, the Government will have completed the drafting of all necessary legislative changes to pave the way for the FRF to be in place for the FY2011/12 budget process.** The FY2011/12 budget, prepared in the last three months of 2010, will be bound by the medium-term fiscal targets—including debt creation and the overall deficit—specified in the FMS. With the FRF underpinning the FY2011/12 budget, the Government's commitment to fiscal discipline will gain in credibility as the targets and the policies necessary for their achievement would be announced ahead of time. The implementation of the FRF will also aid the Government in the preparation of the next Medium Term Socio-Economic Policy Framework 2012-2015.

62. **The Government has set out to improve debt sustainability with both short-term and medium-term policy actions**. The short-term policy actions include the conclusion of a Debt Exchange Program with high participation (above 95 percent as of February 3, 2010), while the medium-term actions include preparation and implementation of a strategic plan to re-organize the Debt Management Unit (DMU) in accordance with international best practice and enactment of a new Public Debt Law with a clear focus on strategic debt management

63. **As part of its strategy to reduce the net present value of debt, the Government of Jamaica launched a Debt Exchange Program on January 14, 2010.** The purpose of the exchange offer is to reduce the high debt burden through reducing the interest rate on a portion of outstanding debt and improving the maturity profile of the debt. The exchange is supported by a US$1.25 billion IMF Stand-by Arrangement approved by the IMF's Board of Executive Directors on February 4, 2010. The key features of the Debt Exchange Program are summarized in Box 1. The savings under the broadly successful debt exchange are estimated by the Government to amount to 3.2 percent of GDP during FY 2010/11.

64. **The Government's medium-term strategy for improving debt management hinges on the successful transformation of the DMU into a new organizational structure involving a front, middle, and back office.** The current structure—based on sources of funding—involves duplication and higher operation risk, and is not in line with international best practice. The Government is planning to prepare a strategic plan to re-organize the DMU, which would include the design and implementation of a training program for all DMU staff, in particular of middle and front office staff in risk identification, quantification and management of the aggregate debt portfolio, and in debt management strategy design and implementation.

65. **The establishment of a middle office DMU function will be an important first step towards the formulation and implementation of a formal medium-term debt management strategy (MTDS).** In the re-organized DMU, staff with analytical responsibilities would be expected to manage a cost-risk model for quantifying trade-offs and obtaining a better understanding of the potential impact of alternative debt management strategies on the budget under different economic and financial scenarios. This would allow the DMU—and in broader term, the Government—to take into account, among others, cost-risk trade-offs, monetary and fiscal policy constraints, the characteristics of BOJ's primary debt issuance and constraints of the domestic debt market. Furthermore, the middle office would have a control function that examines and monitors compliance to established processes and procedures.

66. **Preparation and subsequent submission to Parliament of a new Public Debt Law is another important component in the Government's reform program.** The current

framework is fragmented and dated: there are several Acts which focus more on ceilings to borrowing through instrument-types, rather than specifying the overall objectives of debt management, the requirement to develop a strategy and to report on its implementation, and specified purposes for borrowing. The planned legislative changes may specify limits as part of the proposed fiscal rules, in the context of the overall budget ceiling, and in the debt management strategy in line with the fiscal framework.

67. **Actions Supported by the Bank under the First Programmatic FS DPL:**

- The Borrower, through MoFPS, has submitted to the Borrower's legislature on February 5. 2010, for approval thereby, a bill containing the proposed amendments to the Borrower's Financial Administration and Audit Act and the Borrower's Public Bodies Management and Accountability Act, for purposes of introducing into said legislation a fiscal responsibility framework.
- The Borrower, through MoFPS, has officially announced on January 14, 2010 a domestic debt exchange offer to reduce the Borrower's net present value of its public debt.
- The Borrower's legislature has enacted the Act to Amend the Financial Administration and Audit Act of 2010 dated January 29, 2010 which eliminated MoFPS' authorization to approve any deferred financing.

68. **Expected Outcomes from the First Programmatic FS DPL (FY2010/11):**

- Increase in the primary budget surplus of the central government by 1.8 percent of GDP by FY2010/11 (Baseline: 4.8 percent of GDP at end-FY2008/09).
- Fiscal savings of at least 1.5 percent of GDP generated due to GoJ's Debt Management Activities (Baseline: Interest payments by Central Government was 16.0 percent of GDP in FY2009/10).
- No more deferred financing (Baseline: Average annual deferred financing from FY2000/01 to FY2005/06 were J$497 million).

69. **Actions Expected to be Supported by the Bank under the Second Programmatic FS DPL (Indicative Triggers):**

- Amendments to Financial Administration and Audit Act and the Public Bodies Management and Accountability Act have been enacted and the Fiscal Responsibility Framework (FRF) is being fully implemented.
- The Government has started implementing a time bound action plan for strengthening institutional and technical capacity of the Debt Management Unit, including the establishment of (a) a new functional organization structure with front, middle and back offices (b) the development of a Medium Term Debt Management Strategy and (c) the enactment of a Public Debt Law that provides a unified framework for strategic debt management.

70. **Expected Outcomes from the Second Programmatic FS DPL (FY2011/12):**

- The FY2011/12 budget process, which commences in the final quarter of CY2010, is developed within the FRF and is bound by the FRF's medium term targets for debt creation and the overall fiscal deficit.
- (a) A detailed borrowing plan is published by the Debt Management Unit, which fully

operationalizes the Medium Term Debt Management Strategy; and (b) Quantitative limits on instruments and lenders are established in line with the overall budget ceiling established by the FRF.

Rationalization of Public Bodies

71. **The Government's public sector rationalization plan supports the objectives of achieving fiscal sustainability and growth by creating a transformed cohesive public sector that is performance-based, efficient, cost effective, and service oriented.** Public Bodies, comprising Statutory Bodies, Statutory Authorities and Government owned companies, are an important segment of the public sector in terms of revenues, expenditures, and employment. Public bodies would generate an estimated deficit of around 5 percent of GDP in the absence of reforms in 2009/2010 as opposed to the current estimate of a deficit of 2.8 percent of GDP.

72. **Nonetheless, public bodies have played an important role in employment and investment in recent years**. The FY2009/10 budget reported that investment in infrastructure and development by 12 of the main Public Bodies amounted to 1.8 percent of GDP per year over the last five years. For FY2009/10 the Government intends to direct part of its fiscal stimulus efforts through increasing the investment of public entities. Projections for the fiscal year ending March 2010 suggest that the Public Bodies will have gross total assets of around J$427 billion, equivalent to around 40 percent of GDP. Based on the government's estimates from 2007, Public Bodies would employ approximately 17,829 employees, or about 15 percent of the total public sector workforce. However, this data is not systematically collected and may not be up-to-date.

73. **There were approximately 200 Public Bodies registered with the Public Enterprises Division (PED) of the Ministry of Finance and the Public Service (MOF) at the end of FY 2008/09.** Of these, 95 or 47.5% are characterized as self-financing—these are entities that have some authority to collect revenue, borrow and spend outside of the central government budget, but in most cases with MOF and/or line ministry approval—while the remainder is included in the central government budget and financial reporting, submitting monthly reports to the Public Expenditure Division. The budgeting, control and reporting requirements for all public entities is set out in the 2001 Public Bodies Management and Accountability Act (PBMA)[6]. However, both types of entities create contingent liabilities for the central Government, which can go unreported.

74. **Sixty-five of the self-financing Public Bodies are subject to close monitoring by the PED while the corporate plans and budgets of 54 of these self-financing Public Bodies were summarized in the FY2009/10 annual report, Jamaica Public Bodies Estimates of Revenue and Expenditure.**[7] The number of entities reported in the annual estimates was down from the previous year, following the exclusion of some key entities, such as Air Jamaica and the Sugar Company of Jamaica (SCJ) that had been expected to have been privatized during the

[6] http://www.mof.gov.jm/programmes/frm/ped/default.shtml

[7] The annual reports, along with the list of registered entities and their parent ministries, can be found on the PED webpage: http://www.mof.gov.jm/programmes/frm/ped/default.shtml. The Report includes actual financial data (t-2) an estimate for the preceding year (t-1) and a budget projection for the upcoming year (t).

year.[8] In FY2009/10 only 12 public bodies were required to companies submit accounts in the "Statement A" format that enables consolidation with the cash based central government accounts. This limits the ability to assess and formulate fiscal policy.

75. **A strategic action plan has been submitted to Cabinet with a view to facilitating the establishment of an efficient, responsive and cost effective framework of operations for the Public Sector, consistent with good governance, and in line with the GoJ's development objectives.** This action plan was developed by the Public Sector Transformation Unit (PSTU), launched by the Prime Minister and has been fully operational since November 2009. The PSTU's recommendations are to be implemented through transition teams in each Ministry. The scope of work of the PSTU will include: (i) prior reviews of all Ministries, Departments and Agencies, including Public Bodies, to determine what functions should be retained, privatized, contracted out, abolished or be merged with other sector entities; (ii) the development of a master rationalization plan with milestones and cost estimates; (iii) the implementation of a Government Wide Network (GovNet) including establishment of integrated IT systems; and (iv) the implementation a Strategic Human Resource Management Structure/System.

76. **Implementation of reforms suggested by the PSTU will be conducted by transition teams during the PSTU's 18-months operational mandate and will continue after the PSTU has completed its work by May 2011**. The PSTU is working with a Consultative Monitoring Group, fully functional since December 2009, including representatives from the private sector, universities and trade unions, to ensure extensive consultations and engagement in social dialogue with stakeholders at all levels.

77. **As noted above, the FRF also includes measures aimed at improving the governance of public entities**. Critical amendments to the PBMA have been submitted for Parliamentary approval as part of the FRF. The key features of these amendments include: (a) prohibiting Public Bodies from entering into negotiations to issue debt without prior approval by the Minister of Finance; (b) requiring Public Bodies to submit corporate plans and any modifications to the Minister of Finance for endorsement and the Parliament for approval; (c) requiring the Minister of Finance to prepare an annual report to Parliament of estimates of revenue and expenditure for all Public Bodies; and (d) requiring Public Bodies to submit information on their financial operations to the Financial Secretary. These amendments also include regulations to strengthen the Financial Distribution Policy, Acquisition of Shares, Code of Conduct for Directors, and Code of Audit Practices. Additionally, the MOF is providing training in corporate governance to the leadership of Public Bodies.

78. **Most important, the FRF includes a provision for submission of public bodies' accounts to Parliament for approval – unprecedented in Jamaica – which will directly support the PSTU's strategy to improve public sector governance.** An annual Budget Memorandum in FY2010/11 will include a discussion of the movements of the consolidated public sector with a summary table showing at least the main aggregates for the consolidated public sector. The inevitable data gaps and discrepancies would be acknowledged and addressed over time, but such consolidated budgeting and reporting should help to support the measures proposed under the FRF. Clear targets would also be set for expanding the coverage and quality

[8] The divestment program has inevitably been adversely effected by the global financial crisis, delaying the proposed schedule.

of reporting in the annual Estimates of Revenue and Expenditure report for public entities. The Government is aiming to increase the coverage of entities reporting in the "Statement A" format. Milestones in producing consolidated fiscal accounts (consistent with international Government Financial Statistics standards) will also be established. The winding-up of inactive Public Entities would be completed within a reasonable timeframe (e.g. end-2010). The costs and benefits of the program should be evaluated, including any fiscal savings, and published on the PED webpage.

79. **The program for the rationalization and restructuring of public bodies is also continuing, although progress has been slow.** The Rationalization Plan developed in FY2008/09 identified 74 inactive Public Bodies to be wound-up, 35 to be merged and 21 to be privatized. According to a December 2009 Cabinet note, of the 74 inactive public bodies identified for winding-up, 20 have actually been wound-up, 11 will not be wound-up because they are either still active or the process has been terminated or suspended, 3 are slated for divestment, and 2 are unknown and may not be public bodies. Of the remaining 38 inactive public bodies to be wound-up, 6 are nearly completed (with facilitating documents already filed with the Companies Office of Jamaica), the status of one entity is 'uncertain', while the winding up of 31 entities is at various stages in the process. Of the 35 entities to be merged, the regulatory functions of 3 bodies have been proposed for merging: the Port Authority of Jamaica, Airports Authority of Jamaica, and the Maritime Authority of Jamaica. A feasibility study has determined that the Jamaica Civil Aviation Authority should remain an independent body. Steps have been taken by the Ministry of Agriculture to merge the operations of the Agricultural Support Services Projects Limited, the Agricultural Development Corporation and the Agricultural Marketing Corporation into one entity: the Agricultural Investment Fund.

80. **The Government's divestment program remains a priority, though progress has slowed down mainly due to the financial crisis.** The Government has divested their interests in two of the five sugar estates slated for divestment. The divestment of lands of the former Cotton Polyester Textile Company Ltd. and Ariguanabo Co. Ltd. are at an advanced stage. Other major assets in the process of divestment include the Wallenford Coffee Company, the Urban Development Corporation's shares in the hotel industry and the remaining three sugar estates. However, other divestments, including that of Air Jamaica, have experienced delays. In regard to Air Jamaica, the Government has received a proposal from Caribbean Airlines and is presently negotiating the terms of the agreement. While negotiations proceed, a number of measures have been taken to improve the operational efficiency of the body, including the reduction of the workforce by 500 employees and the exiting from loss making routes. This has led to a decline in losses by 61 percent between end-2008 and end-2009.

81. **The Government's medium-term priorities include winding up of all remaining inactive public bodies by the end of FY2011/12 as well as the completion of privatization of public bodies scheduled for divestment.** The completion of winding-up of Public Bodies identified in the Rationalization Plan—38 of which (out of original 74) remain to be wound-up as of December 2009—will proceed simultaneously with the work of the PSTU, allowing the Government to take advantage of synergies across the two work programs. As the global economy recovers, the divestment proceedings are expected to advance quicker than in the recent past.

82. **Actions Supported by the Bank under the First Programmatic FS DPL:**

- The Borrower's Prime Minister has approved on January 8, 2010 a strategic project for restructuring the Borrower's public sector 2009-2011.
- The Borrower, through MoFPS, has submitted to the Borrower's legislature on February 5, 2010 for approval a bill containing the proposed amendments to the Borrower's Public Bodies Management and Accountability Act, for purposes of vesting in the Borrower's legislature the authority to approve the annual budget of Public Bodies.

83. **Expected Outcomes from the First Programmatic FS DPL (FY2010/11):**

- The 2010/11 budget circular has explicitly established the Government's intention to produce consolidated public sector tables in the 2010/11 Budget memorandum (Baseline: No such instructions provided in earlier years).
- The 2010/11 budget circular has set explicit targets for the coverage of public entities in the FY2010/11 annual Estimates of Revenue and Expenditure (Baseline: No such targets provided in earlier years).
- Reduced losses of Public Bodies generate savings of at least 1 percentage point of GDP by FY2010/11 (Baseline: Public entities balance was -2.8 percent of GDP in 2009/10).

84. **Actions Expected to be Supported by the Bank under the Second Programmatic FS DPL (Indicative Triggers):**

- Public Bodies Rationalization Plan has been fully implemented.

85. **Expected Outcomes from the Second Programmatic FS DPL (FY2011/12):**

- (a) The winding-up of inactive Public Entities without legal impediments has been completed (as of December 2009, 38 inactive bodies remain to be wound-up); (b) Pending divestments of public bodies that were slated for privatization have been completed.

Improving Efficiency and Effectiveness of Public Service Compensation and Incentives

86. **Significantly fragmented pay negotiations represent an obstacle for managing a sustainable wage bill.** While managing a sustainable wage bill is a major challenge during a fiscally difficult period for the government, the fragmented pay negotiation process, involving more than 70 bargaining units, exacerbates the situation further. The Government has attempted to start addressing this issue through the development of a point-factor job evaluation system for the public sector. The system was applied to all health sector positions, with the objective of simplifying wage negotiations with the sector's 27 bargaining units and improving the attraction and retention of qualified personnel on this area. While the proposal is in its final stage after a lengthy consultation process with unions, the fiscal costs associated with the reclassification exercise needed impede its implementation in the medium term. The Government acknowledges that pay reform is a priority but that additional analytical work, expert advice and a better fiscal position to finance one-time costs are required for its implementation.

87. **Improving the efficiency and effectiveness of public sector compensation will require a stronger control of compensation in statutory bodies**. The payroll of statutory bodies is not factored into the central government's wage bill. Given that many of these bodies contribute to the government's deficit, the central government's wage bill represents only a partial picture of the actual proportion of public sector compensation in the government's

finances. The absence of strong control by the Government of workforce size and compensation policy of statutory bodies represents a considerable challenge for managing a sustainable wage bill.

88. **The Government is taking measures to contain the wage bill both in the short and medium-term.** A temporary wage freeze for all public sector employees, including those from public bodies, was introduced in April 2009 as a temporary measure to contain the wage bill during a challenging period for Jamaica from a fiscal perspective. As a follow up measure, the Prime Minister has announced in December 2009 that no salary increases will take place for the following two years. While some unions have started to request for salary increases, such as Jamaica's Teachers Association (JTA), the Government remains committed to avoid increasing the wage bill.

89. **The PSTU's action plan for improving public sector efficiency and effectiveness through the development of a Human Resource Management (HRM) system is expected to contain the wage bill in the medium-term.** The HRM System to be developed by the PSTU includes the following components: (a) Rationalization of the Services Commissions; (b) Development of a Framework for the consolidation of strategic human resource management functions; (c) Development of a Framework to facilitate the free movement of staff throughout the Public Sector; (d) Development of a Framework for Succession Planning and Leadership Development; (e) Development of a Framework for Knowledge Management; and (f) Review of existing legislation pertinent to Human Resource management. The Government expects the HRM system to be applicable to all public sector employees and fully functional by the end of FY2011/12.

90. **The launching of employment surveys by the Public Sector Establishment Division (PSED) for all Ministries/Departments/Agencies (MDAs) in July 2009 represents an important effort toward ensuring the collection of basic information on public employment across the Central Government and is a key input in the rationalization effort**. The Government has completed the censuses for the five so called "strategic ministries" (Education, Health, National Security, Finance and Agriculture), covering 38 percent of the established positions in December 2009 and is currently organizing and analyzing the data obtained. The censuses include information on qualifications and age group, and will be entered in the government's public employment database currently under construction. This information will strengthen workforce planning as it will help to reassess needs, track the growth in the size of the public sector more accurately and avoid overstaffing. It is expected that statutory bodies will be included in the next phase of the data collection effort by the PSED.

91. **The plan for restructuring the public sector, initiated by the Prime Minister and including consultation with the private sector, universities and unions, represents a commitment by the Government to undertake a serious and holistic rationalization exercise to improve the use of government resources in wages and salaries.** The wage freeze in place since April 2009 will contain the wage bill in the short-term and will allow the PSTU's 18-month public sector restructuring exercise to take place and implementation of more stable

measures to contain the wage bill.[9] By the end of FY2011/12, the implementation of the PSTU Strategic Project Plan in at least 10 MDAs is expected to reduce the wage bill to below 10 percent of GDP, therefore bringing it in line with fiscal sustainability. These efforts will be further aided by the expected completion of employment surveys for all MDAs, allowing the transition teams to work more efficiently.

92. **Actions Supported by the Bank under the First Programmatic FS DPL:**

- The Borrower has completed: (a) a separate employment survey of all employees in each of the following sectors: (i) health; (ii) national security; (iii) finance; and (iv) agriculture; and (b) a separate employment survey of administrative employees in the education sector; said surveys aimed at establishing the number of employees in the respective sectors.
- The Borrower, through MOFPS, has issued Circular No. 6 ref. 59/33, dated February 2, 2010 approving a wage/salary freeze for all of the Borrower's public sector employees until March 31, 2012, and said resolution is in full force and effect.

93. **Expected Outcomes from the First Programmatic FS DPL (FY2010/11):**

- Information is available on the number and posts of public sector employees in the five strategic sectors, which represent almost 40 percent of total public sector workforce, laying the groundwork for the public sector workforce restructuring being undertaken by the Public Sector Transformation Unit (PSTU) (Baseline: No employment surveys processed as of FY 2008/09).
- The Centralized Human Resource Management (HRM) database is fully functional and has updated and accurate information on public employment in the five strategic sectors, including age and qualifications of individual employees (Baseline: No data published as of FY 2008/09).

94. **Actions Expected to be Supported by the Bank under the Second Programmatic FS DPL (Indicative Triggers):**

- Employment surveys (censuses) for all non-self-financing Public Bodies have been completed.
- Recommendations identified by the PSTU to restructure the public sector are implemented by transition teams in at least 10 ministries, departments and agencies.

95. **Expected Outcomes from the Second Programmatic FS DPL (FY2011/12):**

- A centralized HRM database covering total public employment is fully functional.
- The wage bill as a percentage of GDP is at or below 10 percent (Baseline: 11.8 percent of GDP by end- FY2009/2010).
- Transition teams are in place in at least 10 ministries, departments and agencies (MDAs) to implement the recommendations of the Public Sector Transformation Unit.

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[9] "The Prime Minister articulated the achievement of a major goal for this restructuring, as a reduction of the cost of the Public Sector to below 10% of GDP, whilst simultaneously addressing the imperatives of a leaner more efficient responsive and accountable Public Sector"(PSTU Strategic Project Plan, page 3).

B. Pillar 2: Increasing the Efficiency of Financial Management and Budget Processes

Achieving Fiscal Discipline and Strategic Allocation of Resources

96. **The annual budget is not yet bound by a medium term fiscal perspective** that could help to connect the annual budget to longer-term policy and sustainability objectives, and enhance the ability of the Government to adjust to shocks. It is also important to have a medium-term perspective to support the selection, planning, design and execution of multi annual investments.

97. **Adopting a Medium-Term Framework (MTF) for fiscal policy can strengthen risk analysis in countries like Jamaica that are highly vulnerable to external shocks.** Establishing a sustainable long-term fiscal framework is particularly important given the high level of public debt in Jamaica. However, the current planning practice is subject to considerable uncertainty (measures of sustainable spending may vary over time) and budgets often respond to short-term policy considerations. Therefore, a well-designed, rolling MTF should help clarify fiscal policy choices, considering both immediate and longer-term objectives and their likely consequences.

98. **Adopting a Medium-Term Framework (MTF) for fiscal policy can strengthen risk analysis in countries like Jamaica that are highly vulnerable to external shocks.** Establishing a sustainable long-term fiscal framework is particularly important given the high level of public debt in Jamaica. However, the current planning practice is subject to considerable uncertainty (measures of sustainable spending may vary over time) and budgets often respond to short-term policy considerations. Therefore, a well-designed, rolling MTF should help clarify fiscal policy choices, considering both immediate and longer-term objectives and their likely consequences.

99. **Although Jamaica had developed a Medium Term Socio-Economic Framework for 2004-07, links to the annual budget, the prioritization of investment plans, and the incorporation of recurrent cost implications of investment were not well developed**. The Planning Institute of Jamaica (PIOJ) also did not develop the framework into a rolling instrument to aid budget management, nor has the 2004-07 exercise been updated since its expiration. Consequently, the annual budget is not yet anchored by a medium term fiscal perspective.

100. **The simplest form of MTF is a medium-term fiscal framework (MTFF) that entails a comprehensive statement of fiscal policy objectives, against which fiscal performance can be assessed,** with integrated medium-term macroeconomic projections, and (aggregate) fiscal targets based on macroeconomic stabilization and fiscal sustainability considerations (a top-down approach). The FRF should provide the impetus for developing such a rolling MTFF. Even a simple MTFF can help incorporate longer-term perspectives into budget planning processes and promote predictability, fiscal discipline, transparency, and accountability. It may also help bolster support for prudent fiscal policies among policymakers and the public, and get the political debate to span longer horizons.

101. **More sophisticated MTF stages involve deepening the link between the macro fiscal aggregates and sector spending allocations.** The introduction of sector plans and a multi-year investment budget, which also incorporates recurrent cost implications, is a common starting

point for more widespread reform. The proposed framework in Jamaica for capital investment prioritization and management should help to better establish this link between government policy, planning and budget allocations.

102. **Under the Public Sector Modernization Vision and Strategy 2002-2012, the Government intends to introduce a Medium Term Expenditure Framework (MTEF)**. The MTEF is designed to improve inter/intra sectoral resource allocation and provide greater budgetary predictability for ministries and agencies, which should contribute to improved macroeconomic performance (2009/10 Budget Memorandum). The Government is gradually implementing the MTEF through the following measures:

- The Government has set a target for Ministries/Departments/Agencies (MDAs) to spell out integrated three-year plans and budget proposals. Around 40 percent of MDAs have produced the requisite prioritized plans. The Cabinet Office and the MOF are considering whether to enact legislation to increase compliance for the submission of Corporate and Operational Plans, similar to the annual budget.

- The Government is in the process of developing a methodology to improve the system for evaluating and managing public investments. With technical assistance from the IDB, the Government has developed a tool to standardize the evaluation/appraisal of investment projects. The tool is based around a set of indicators to ensure that projects meet specified criteria, including consistency with government priorities, sector strategies and technical processes that include feasibility studies, cost-benefit analysis, and the elaboration of future recurrent cost implications of investments. Each project will be given an overall rank. The target is to ensure that eighty percent of projects are approved based on a strictly technical weighting, while twenty percent would be based on political discretion (though this would be subject to the technical evaluation). The authorities are hoping to have the tool in place for end-October along with a Manual for Investments to help guide line ministries in the use of the tool. Some training has already been undertaken in line ministries, although the tool will not be in place for the 2010/11 budget preparation process.

- The Government is also developing an information management tool to record capital spending—it will enable the Government to run various scenarios (e.g. for differing financing levels) and to act as a "project bank". It is intended that the new system be expanded in the future to capture the life cycle costs of projects, and in this way can form the basis for the proposed medium-term fiscal framework. Training has already been conducted for staff on the development of an MTEF and further technical assistance and capacity building has been proposed.

103. **The Government is planning to continue to build on the above reform program by:**

- Piloting the medium-term budget perspective, in 10 ministries, using the new investment management systems, for the 2011/12 budget. This will entail careful costing of the projects capital including future recurrent costs.

- The methodology for evaluating project proposals should, where appropriate, be piloted in selected Public Entities through their parent Ministries for the 2011/12 budget. While the evaluation might not be applicable to purely corporate investment decisions made by a few of the public entities, all fiscal and quasi-fiscal operations should be assessed using similar standards.

Improving Public Financial Management

104. **An assessment of the Public Financial Management (PFM) arrangements of Jamaica was carried out in 2007.** This assessment was based the Public Expenditure and Financial in Accountability (PEFA) framework. It examined five key dimensions of the PFM system: budget credibility; policy based budgeting; predictability and control in budget execution; accounting, recording and reporting; and external scrutiny and audit.

105. **The legal and regulatory framework for PFM in Jamaica is well defined.** While the constitution sits at the pinnacle of this framework, the key instrument for PFM is the Financial Administration and Audit Act (FAA). This framework provides for a clear definition and allocation of duties and responsibilities for implementing the processes through which public finances are managed. Moreover, the Government has recently prepared and presented to Cabinet a framework for fiscal responsibility that will define the boundaries of authority for public managers. There is a clear process that guides the elaboration of the budget, and the country has a budget classification system that is effective in facilitating the recording and availability of information on budget execution transactions. The Government also maintains a comprehensive system of centralized bank accounts that facilitates management of the Government's cash balances. Whereas significant delays were registered in the past with respect to the preparation of financial statements, considerable progress was registered for the preparation of the financial statements in 2009. The rate of completion within stipulated deadlines increased substantially amongst the reporting entities, with the five biggest ministries (approximately 60% of budget expenditures) all reporting within the deadline. Lastly, the Government has moved to strengthen the Office of the Auditor General in recent years through the implementation of a strategy that seeks to strengthen its operational capacity. The Government has also commenced work on the elaboration of guidelines and manuals for the consolidation of public bodies. There has been some progress in the enhancement of institutional arrangements within the agency that is responsible for oversight of public bodies. In this respect, the job descriptions of staff have been defined and the Government has embarked on an exercise to fill existing vacancies. Lastly, the Office of the Auditor General has completed its operational plan, which will ensure more independence and effectiveness of the audit function. It calls for staff training and a new focus on performance and IT audit approaches.

106. **There exist significant challenges for strengthening the financial management environment in Jamaica.** While the Government continues to take measures to introduce a Medium Term Economic Framework in order to strengthen budget preparation, significant intermediate building blocks that are required to ensure the success of this introduction are still not fully in place. These include institutional foundations such as staff resources, training and guidelines on the preparation and costing of sectoral strategies, and ensuring the proper appraisal of investment projects. In addition, while the introduction of accrual accounting is advancing, challenges persist in ensuring the correct sequencing of the intermediate steps required to introduce the appropriate levels of staffing resources and knowledge. At the same time, there is a challenge in ensuring the proper sequencing of these reforms together with the development of the information systems. In addition, more attention needs to be given to ensuring that the current cash accounting basis is properly understood and that accounting practices are sufficiently strong to form a proper basis for the introduction of the accruals basis. Lastly, it is imperative that the GoJ hastens the introduction of procedures to ensure that the

fiscal results of publicly owned enterprises, on which sufficient information already exists, are consolidated with those of the rest of the public sector.

107. **The Government has initiated reform measures for strengthening financial management and budget processes**. The key measures that the Government has been taking or planning to take include:

- Improving accounting and financial reporting through training of its staff in order to enhance their capacity to implement accrual accounting. The Government will also complete its review of the accounting classification, and the implementation of the IFMIS.
- Enhancing the internal and external control systems through the strengthening of the Internal Audit Directorate and expanding the scope of work of the Government's Internal Audit Units
- Implementing the Auditor General's operational plan by undertaking further training of its staff, making reviews of financial statements timelier and expanding the scope of audits to include performance audits.

108. **Actions Supported by the Bank under the First Programmatic FS DPL:**

- The Borrower's Auditor General has continued to implement an annual operational plan within the framework of the five-year strategic corporate plan including relocation of its staff to updated physical facilities, and completion of 90 percent of planned audits.

109. **Expected Outcomes from the First Programmatic FS DPL (FY2010/11):**

- The timeliness of annual appropriation accounts submission of selected Ministries, Departments, and Agencies to Auditor General has improved, as indicated by a decrease in accounts outstanding by 20 percent (Baseline: 158 accounts outstanding in December 2008).

110. **Actions Expected to be Supported by the Bank under the Second Programmatic FS DPL (Indicative Triggers):**

- The Government has fully implemented the new methodology for evaluating capital investments in all line Ministries.
- All MDAs have submitted and published their MTEFs.

111. **Expected Outcomes from the Second Programmatic FS DPL (FY2011/12):**

- New investment management system is in use in 10 Ministries.
- All MDAs have implemented their MTEFs for the FY2011/12 budget cycle.

C. Pillar 3: Reducing Distortions and Enhancing the Efficiency of the Tax System

112. The Government of Jamaica plans to reform its tax regime with a view to improving the efficiency of tax administration and revenue generation. Highly variable rates with many exemptions, special regimes, and zero-rating reduce tax revenue by an estimated 30 percent and also distort and hinder growth of the economy. Tax administrators also face barriers to getting information and pressing enforcement, making tax evasion and avoidance relatively easy. For

taxpayers who seek to comply, the complexity of the system makes it difficult to do so.

Tax Policy Reforms

113. **Progress continues despite the impact of the ongoing global crisis on the tax base.** Although major personal income tax (PIT) and corporate income tax (CIT) simplifications were postponed due to the impact of the global crisis on Jamaica, the Government has taken measures to broaden the tax base and improve efficiency by reducing tax exemptions and introducing three packages of tax measures over the past year.[10] The first package was introduced as part of the FY 2009/10 budget. The Government raised the excise tax on gasoline by J$8.75 per liter, and broadened the General Consumption Tax (GCT) base by eliminating exemptions on several items. The second package was introduced 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 was introduced on January 1, 2010 and included the following measures:

- **General Consumption Tax (GCT**). 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 the 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.

Tax Administration Reforms

114. **Progress has been achieved in improving Tax Administration**. The Government has been implementing a major Tax Administration reform to increase the tax base, enforce compliance, increase efficiency and effectiveness of the Tax Administration and Customs Department, and thereby boost government revenues. In FY09/10, the government's tax reform efforts focus on: improving compliance, improving information and communication technology, and improving enforcement.[11]

115. **In the context of tax administration reform, a number of important steps have been undertaken**: i) a large taxpayer office was established on April 15, 2009 with two offices in Kingston and Montego Bay. As of end-December 2009, the 205 largest taxpayers were covered and the authorities are aiming at taking 200 more companies into the scope of the Office by end FY2009/10; ii) a Customer Care center was established on April 1, 2009 with the objective of improving customer service, standardizing the response to tax related inquiries by tax payers, and keeping tax payers current with their taxes. The Center covers the entire country and all

[10] See Annex 6 for additional details on the tax measures introduced.
[11] The authorities have received support from the World Bank, US Treasury, IRS, CARTAC and USAID.

types of taxes; iii) a Forensic Data Mining Unit was established in June 2009. The Unit is increasing tax compliance and enforcement by making use of forensic techniques to gather information about the tax obligations of tax payers and check this against the actual filing of taxes so as to prevent tax evasion. Through November 2009, the Unit has identified 11,000 new taxpayers who were subsequently presented with new assessments; iv) a High Intensity Team was established in June 2009. The team is comprised of auditors and collectors and—as a field extension of the Forensic Data Mining Unit—puts forward a combined effort to improve collections; v) a Special Enforcement Team was established in July 2009. The Team is comprised of 6 people and focuses on enforcing compliance after other efforts have failed.

116. **The Government continues its efforts to improve the efficiency of tax collection by offering tax payers new and improved ways of filing and paying taxes.** In October 2009, the Tax Administration made it possible for taxpayers to electronically file and pay the GCT, PAYE (Pay As You Earn), and HEART (Human Employment and Resource Training/National Training Agency) taxes. Testing for electronic filing and payment of individual and corporate income taxes is underway and is expected to be completed by the end of February 2010. Over the course of CY2010, the Government expects to extend electronic filing and payment to all taxpayers and all types of taxes.

117. **Actions Supported by the Bank under the First Programmatic FS DPL:**

- The Borrower has implemented three tax packages dated May 6, 2009, September 29, 2009 and December 23, 2009, respectively, for purposes of: (a) improving efficiency and uniformity of tax policy by reducing the number of items excluded from taxation; and (b) improving revenue generating capacity through increasing excise tax rates on several items.
- The Borrower has continued to implement its tax administration reform project, which commenced on January 12, 2009, as evidenced by the establishment of a large tax office, a customer care center, a forensic data mining unit, a high intensity unit and a special enforcement team.

118. **Expected Outcomes from the First Programmatic FS DPL (FY2010/11):**

- Increased number of corporate (CIT and GCT) and (non-PAYE) individual tax payers on the tax roll reflected in 15 percent increase of the number of tax payers for 2008/09 compared to 2007/08 (Baseline: 58,655 of taxpayers in 2008/09).

119. **Actions Expected to be Supported by the Bank under the Second Programmatic FS DPL (Indicative Triggers):**

- (a) The GoJ has continued progress on implementation of a uniform tax code; (b) the GoJ has established a one-stop shop for all tax payments to ease cost of paying taxes; and (c) E-filing extended to all taxpayers and to all types of taxes.

120. **Expected Outcomes from the Second Programmatic FS DPL (FY2011/12):**

- Improved PEFA rating of "Collection of tax payments" to B in FY2010/11 from a baseline of: D+ in 2007/08.

D. Prior Actions and Indicative Triggers for the Programmatic Fiscal Sustainability DPL Series and Progress since the Previous Fiscal and Debt Sustainability DPL

121. **The current operation is proposed as the first in a series of single-tranche programmatic DPLs and builds on the progress achieved since the previous DPL (January 2009).** The Government's reform agenda is part of a well-specified, medium-term program designed to support macroeconomic stability and fiscal and debt sustainability with a view to further longer-run development objectives. The reform program is ambitious and substantive, and is expected to be completed over a period of two years due to the perception within the country that the need for fiscal and debt management reform is urgent. Therefore, the Bank's support to the Government's program is proposed as a series of two programmatic development policy operations. The policy actions and outcome indicators supported by the proposed programmatic series are sequenced to match the GoJ's phased approach to reforms, which is necessary in the context of the specific conditions and procedures that prevail in Jamaica, and build on progress achieved since the previous DPL (January 2009).

122. **The Government has made noteworthy progress in key reforms since the previous Fiscal and Debt Sustainability DPL approved in January 2009.** During the twelve months preceding the FS DPL1 operation the Government has continued working on the different areas covered by the previous DPL achieving key policy reforms. For example, the GoJ completed proposed amendments to the Fiscal Responsibility Framework submitted in draft to Cabinet based on extended consultations with IFIs, including the IMF, and other key stake holders. The objective of these consultations was to ensure that the legislative changes sent to Parliament in February 2010 incorporated lessons learned from international good practice and reflected a broad level of debate and consensus. Box 3 provides more detailed information on the connection between closely related policy actions supported under previous DPL and those supported by the current proposed operation.

Box 3: Progress since the Previous DPL (January 2009)

Policy Action	Actions supported by previous DPL (Jan. 2009)	Progress made and actions supported by FS DPL 1 (Feb 2010)
Fiscal Responsibility Framework (FRF)	MoF has submitted to the *Cabinet* proposed amendments to the Financial Administration and Audit Act and the Public Bodies Management and Accountability Act, which introduce a FRF.	GoJ built on proposed amendments to FRF submitted to Cabinet and completed consultations series with IFIs (including the IMF) and other key stake holders to ensure legislative changes sent to *Parliament* in February 2010 incorporated international good practices and reflected a broad level of consensus
Abolition of Deferred Financing	Government communicated commitment to cease deferred financing	Enactment of *legislation* abolishing the authority to permit deferred financing
Employment Surveys	The GoJ has completed an education sector employment survey (teachers, who represent about 21 percent of the public sector workforce)	The GoJ has completed employment surveys in *five strategic sectors*, accounting for 40 percent of the public service: Education (administrative staff), Health, National Security, Agriculture and Finance.
Auditor	AG is implementing its action plan for	Government is continuing to implement the

General's (AG) action plan	institutional and professional capacity building; and the Minister of State in the Ministry of Labor and Social Security and the Deputy Leader of the House, on behalf of the MoF, have submitted to Parliament for approval a proposal to update legislation governing the internal audit departments and audit committees (the Financial Administration and Audit (Amendment) Act, 2008).	annual operational plans within the framework of the strategic 5-year corporate plan. In addition to implementing 3 value for money audits since the previous DPL, the Auditor General's office has continued with training programs and has implemented the plan to move to upgraded physical facilities.

123. **The forward looking nature of the Bank's proposed support through the Second Fiscal Sustainability DPL is aligned with the planned phases of the Government's medium-term structural reforms.** The summary of the Government's reform program provided above in this section includes a brief description of the next phase of reforms under each pillar. For convenience, the substantive policy actions of the Government's program that are supported by the proposed series – both the current and the next operation – are listed below. Box 4 presents prior actions for the First Programmatic Fiscal Sustainability DPL (FS DPL1) and Box 5 lists the indicative triggers to be supported by the Second Programmatic Fiscal Sustainability DPL (FS DPL2).

Box 4: Prior Actions Supported By the FS DPL1

Pillar I. Promoting Fiscal Sustainability Through the Control of Public Sector Balances and Debt

- The Borrower, through MoFPS, has submitted to the Borrower's legislature on February 5, 2010, for approval thereby, a bill containing the proposed amendments to the Borrower's Financial Administration and Audit Act and the Borrower's Public Bodies Management and Accountability Act, for purposes of introducing into said legislation a fiscal responsibility framework.
- The Borrower, through MoFPS, has officially announced on January 14, 2010 a domestic debt exchange offer to reduce the Borrower's net present value of its public debt.
- The Borrower's legislature has enacted the Act to Amend the Financial Administration and Audit Act of 2010 dated January 29, 2010 which eliminated MoFPS' authorization to approve any deferred financing.
- The Borrower's Prime Minister has approved on January 8, 2010 a strategic project for restructuring the Borrower's public sector 2009-2011.
- The Borrower, through MoFPS, has submitted to the Borrower's legislature on February 5, 2010, for approval a bill containing the proposed amendments to the Borrower's Public Bodies Management and Accountability Act, for purposes of vesting in the Borrower's legislature the authority to approve the annual budget of Public Bodies.
- The Borrower has completed: (a) a separate employment survey of all employees in each of the following sectors: (i) health; (ii) national security; (iii) finance; and (iv) agriculture; and (b) a separate employment survey of administrative employees in the education sector; said surveys aimed at establishing the number of employees in the respective sectors.
- The Borrower, through MOFPS, has issued Circular No. 6 ref. 59/33, dated February 2, 2010 approving a wage/salary freeze for all of the Borrower's public sector employees until March 31, 2012, and said resolution is in full force and effect.

Pillar II. Increasing the Efficiency of Financial Management and Budget Processes

- The Borrower's Auditor General has continued to implement an annual operational plan within the

framework of the five-year strategic corporate plan including relocation of its staff to updated physical facilities, and completion of 90 percent of planned audits.

Pillar III. Reducing Distortions and Enhancing the Efficiency of the Tax System

- The Borrower has implemented three tax packages dated May 6, 2009, September 29, 2009 and December 23, 2009, respectively, for purposes of: (a) improving efficiency and uniformity of tax policy by reducing the number of items excluded from taxation; and (b) improving revenue generating capacity through increasing excise tax rates on several items.
- The Borrower has continued to implement its tax administration reform project, which commenced on January 12, 2009, as evidenced by the establishment of a large tax office, a customer care center, a forensic data mining unit, a high intensity unit and a special enforcement team.

Box 5: Indicative Triggers for the Second Programmatic Fiscal Sustainability DPL (FS DPL2)

Pillar I. Promoting Fiscal Sustainability Through the Control of Public Sector Balances and Debt

- Amendments to Financial Administration and Audit Act and the Public Bodies Management and Accountability Act have been enacted and the Fiscal Responsibility Framework (FRF) is being fully implemented.
- The Government has started implementing a time bound action plan for strengthening institutional and technical capacity of the Debt Management Unit, including the establishment of (a) a new functional organization structure with front, middle and back offices (b) the development of a Medium Term Debt Management Strategy and (c) the enactment of a Public Debt Law that provides a unified framework for strategic debt management.

Pillar II. Increasing the Efficiency of Financial Management and Budget Processes

- The Government has fully implemented the new methodology for evaluating capital investments in all line ministries.
- All MDAs have submitted and published their MTEFs.

Pillar III. Reducing Distortions and Enhancing the Efficiency of the Tax System

- (a) The GoJ has continued progress on implementation of a uniform tax code; (b) the GoJ has established a one-stop shop for all tax payments to ease cost of paying taxes; and (c) E-filing extended to all taxpayers and to all types of taxes..

IV. BANK SUPPORT TO THE GOVERNMENT'S PROGRAM

A. Link to the Country Partnership Strategy

123. Economic stability – particularly fiscal and debt sustainability – is a key component of the FY10-13 Country Partnership Strategy (CPS) with Jamaica and is the rationale for the proposed loan. The proposed DPL for US$200 million is the first in a series of programmatic DPLs envisaged in the FY10-13 CPS. The Government of Jamaica expressed keen interest in maintaining and deepening the country's strategic dialogue with the Bank when it took office during the previous CPS period. The CPS further reflects the government's focus on addressing fiscal and debt challenges, especially given the impact of the global crisis on Jamaica.

124. **The focus of the DPL is on supporting continued progress with the strategy and design of policies and legislative reforms for achieving improved efficiency of government spending and sustainable debt reduction.** As described in Section III, considerable progress

has been made on these fronts. The Government's efforts are based on three critical and interrelated development challenges in Jamaica under the Economic Stability Pillar of the CPS.

- **First, promoting fiscal and debt sustainability by consolidating overall public sector balances, rationalizing public bodies, and containing the wage bill.** Controlling the debt generating process in Jamaica requires enhanced debt management and accountability of Central Government and Public Bodies' as laid out in the proposed Fiscal Responsibility Framework, rationalization and restructuring of public entities, and improved efficiency of management of public sector salaries.

- **Second, the importance of improving transparency and efficiency of public financial management and budget processes.** While the legal and regulatory framework for effective budgeting and transparent financial management exists, a more forward-looking process for prioritization of expenditures is needed to ensure effective allocation of resources. This requires timely preparation of financial statements, continued efforts in the transition to accrual accounting framework, further improvements in auditing and operational capacity to improve the efficiency of budget allocation.

- **Third, reducing distortions and enhancing the efficiency of the tax system.** Jamaica's complex tax system is characterized by variable tax rates and many exemptions which distort economic incentives and reduce tax revenue in an already tight fiscal environment. To reduce distortions, raise fiscal revenues, and improve equity, the Government is taking measures to broaden the tax base, reduce the number of special tax regimes and exemptions, simplify tax payment processes, and increase tax compliance. The Government is also taking actions to directly reduce the tax burden on low earners by raising income tax thresholds, particularly for the elderly.

B. Collaboration with the IMF and other donors

125. **The Bank has consulted with the IMF, the IDB and the EU delegation in Jamaica during the preparation of this operation.** Consultation with the IMF has been particularly close in the context of preparing the macroeconomic assessment and the debt projections. The policy actions supported by this operation complement the IMF SBA approved on February 4, 2010 as well as the IDB PBL programs, which are also focused on structural reforms aimed at maintaining fiscal sustainability in the longer run. The main synergies between the policy reforms supported by the Bank, the IMF, and the IDB are:

(a) Development and submission to Parliament of a Fiscal Responsibility Framework with a view to implement fully by 2010/11;
(b) Public Sector Rationalization;
(c) Improving Efficiency of Public Expenditure Management and of Tax Policy and Administration; and
(d) Strengthening of Debt Management.

126. **The GoJ has negotiated a package of support from the IMF (to support international reserves) and the Bank and IDB (budgetary support).** This will also provide market liquidity and reduce risks, if any should arise, in the context of the debt exchange launched on January 14, 2010 – as of February 3, participation rate is estimated to be above 95

percent. In particular, support under the IMF's SBA will be helpful to the GoJ in this context, since it will disburse on a front-loaded basis (approximately US$650 million on approval on February 4, 2010). The IFI's are coordinating with each other as well as with other lenders such as the CDB to provide timely support under difficult circumstances.

Box 6: Donors' Activities in Jamaica

A total of eighteen International Development Partners[12] (IDPs) are active in twelve sectors with most support directed to the social sector (39%), followed by budgetary support (30%) with strong support for growth and competitiveness. In 2008, ongoing development partner support amounted to US$2.1 billion, of which 18.6 percent was grant. As of end-2008, the largest development partner was IDB with US$673 million, followed by Venezuela[13] with US$410 million, CDB with US$314 million, the EU with US$257 million and the World Bank with US$120 million (Table 5). In addition, Japan provides significant amount of PHRD and JSDF grants through the World Bank.

Two bilateral IDPs (CIDA and DFID) have regional strategies while USAID, IDB and the World Bank have country strategies. All strategies and sectoral support are provided in line with government priorities articulated through the PIOJ and in the MTF.

The depth of coordination among international development partners has increased, particularly since the 2008 upgrading and strengthening of the Bank country office. The Bank participates in the annual retreat between the Government and development partners, and it chairs the thematic group on Debt and Growth. The International Finance Corporation (IFC) co-located with the World Bank in August 2009. This will strengthen coordination and increase access to its advisory services, public-private partnerships work, and foster deeper private sector development.

IDB: As identified in the recently completed and the upcoming Country Strategy for Jamaica, key areas of IDB support include public financial management and private sector development, where the IDB specifically supports improvements in the incentive framework and the business environment. Specific reforms include reducing the transaction costs for titling and registering land, increasing access to credit for sole proprietors and small businesses, and improving incentives for informal businesses to become formal.

EU: EU support to Jamaica is anchored in the 10th EDF Country Strategy Paper and National Indicative Program for 2008-2013. With a total allocation of €110 million for programmable resources and €12.9 million for emergency assistance, the EU is the most important grant donor in Jamaica. The country strategy aims to assist Jamaica in its macroeconomic reform program as presented in the government's Medium Term Framework and to support the Government in reducing crime and violence and supporting human rights. The resources available under the program are allocated as follows: 55 percent for general budget support, 30 percent for sector budget support; and 15 percent for national capacity building. Apart from EDF funding, other instruments of EU involvement in Jamaica include projects by the European Investment Bank (EIB), activities financed under the Regional Indicative Programme (RIP) for the Caribbean, and the Banana Support Programme.

[12] CDB, China, CIDA, Czech Republic, DFID, EU, India, IDB, International Atomic Agency, Japan, Korea, OAS, San Jose Accord, UNDP, UNICEF, USAID, Venezuela, and World Bank.

[13] Jamaica signed the PetroCaribe agreement with Venezuela in 2005. This agreement allows Venezuela to supply crude oil and petroleum products to Caribbean countries on concessional financing terms.

USAID: The USAID program of assistance to Jamaica is rooted in the 2010-2014 Country Assistance Strategy, which focuses on social and economic issues that contribute most directly to crime and violence. Under the new CAS, programs in Jamaica are organized around four priority goals: reducing crime and corruption through efforts in law enforcement restructuring and reform, promoting economic development by supporting trade, investment, and agricultural competitiveness, investing in human capital by improving quality and equity of primary and secondary education, and HIV/AIDS prevention.

DFID: DFID's involvement in Jamaica is conducted under the DFID Caribbean regional umbrella, with annual spending of £13 million in 2010/11. In Jamaica, the DFID program is focused on strengthening security and justice. Active programs include the Commonwealth Debt Initiative (CDI), which has benefitted Jamaica since 1998, police reform and police capacity building, the Jamaicans for Justice initiative, Community Security Initiative (a two-year £1 million program), and rehabilitation of Jamaican offenders. Another important activity over the last five years has been the Jamaica Social Policy Evaluation (JASPEV) project, which supports the government's strategic plan for a more effective social sector delivery system by the year 2015.

UNDP: UNDP activities in Jamaica are based on the 2007-2011 Country Programme Action Plan. The Action Plan identifies three thematic areas as the focus of the UNDP program: poverty reduction through improved economic planning, debt management, tax reform, and more efficient public spending; crisis management through conflict prevention, justice and security sector reform, and disaster risk management; energy and environmental security.

CIDA: CIDA's development assistance program focuses on three main areas: improving governance, strengthening the private sector, and improving environmental management. Through Canadian Partnership Branch, CIDA co-finances projects in Jamaica by Canadian non-governmental organizations and institutions working in areas such as cooperatives, education, family planning, youth and community development. Since 1989, CIDA's Industrial Cooperation Program has financed 24 initiatives by Canadian businesses seeking to develop partnerships with Jamaican companies. CIDA's priorities include strengthening of key central agencies responsible for the environment and supporting HIV/AIDS prevention and treatment programs.

CDB: Since assuming office in 2007, the current government has benefitted from nearly US$200 million in CDB loans, which have supported educational and community development projects, agricultural support, and natural disaster recovery. In February 2009, CDB disbursed the first tranche of a two-year, US$100 million policy-based loan to the government. Furthermore, citizens, especially from rural areas, have been beneficiaries of the CDB's Caribbean Technology Consultancy Service (CTCS), a program that supports the development of small businesses throughout the region.

C. Relationship with Other Bank Operations

127. **The proposed operation would be the first in a programmatic series of two single-tranche loans focused on fiscal sustainability and builds on a previous Fiscal and Debt Sustainability DPL approved in January 2009.**

128. **The actions supported by the proposed operation are part of a longer standing policy dialogue that has been supported through both AAA and lending activities**. The most recent of these operations, as well as operations in the pipeline, are the Energy Investment Loan and Technical Assistance (P112780, FY2011), Employment generation Investment Loan (P116993, FY2010), Education Transformation Capacity Building (P107407, FY2010), Rural Economic Development Initiative (P105122, FY2010), Community-based Landslide Risk

Reduction (P116471, FY2010), Debt Market Development Project (P114298, FY2009), and Addressing the Debt Problem (P106757, FY2009). The overarching themes in the Bank's Jamaica program have been the focus on economic stability and on promoting inclusive and sustained growth through four sub-pillars: (i) strengthening human capital; (ii) strengthening non-labor competitiveness; (iii) reducing crime and violence; and (iv) promoting rural development and reducing vulnerability.

129. **The DPL is also designed to complement the ongoing and planned investment lending program under the CPS by supporting the government's efforts to provide a stable macroeconomic framework and improved public sector effectiveness to stimulate growth and fund priority social and investment programs.**

D. Lessons Learned

130. **The Bank has maintained an active engagement with the authorities in Jamaica through the program support outlined in various Country Partnership Strategies, and several key lessons have been learned that have informed the design of the proposed operation.** Key lessons relevant in the context of lending operations were that lending activities should (i) take into account fiscal constraints and avoid lumpy disbursements, such as those associated with civil works or infrastructure projects and (ii) consider the implementation capacity of government agencies, which restricts the effectiveness of investment lending in some cases. Bearing these lessons in mind, the previous Fiscal and Debt Sustainability DPL (January 2009) was aligned with the Government's policy reform program, its current institutional capacity, and its liquidity needs. The proposed programmatic series will build on the success of the first operation.

E. Analytical Underpinnings

131. **The DPL supports the Government's medium-term development strategy, and draws upon a large body of analytical work, including the Poverty Assessment, Country Economic Memorandum, Public Expenditure Review, PEFA, and the CFAA/CPAR**. Within this framework, it focuses on policies and institutional aspects related to fiscal and debt sustainability. The policy actions supported by the DPL and expected medium-run outcomes are outlined in the policy matrix in Annex 1. Box 6 presents the links between prior actions and various AAA work.

Box 7: Links between DPL and Prior Analytical and Fiduciary Work

Analytical Reports — Recommendations		
		Links to DPL Actions: Annex 1
Poverty Assessment (2006)	Maintain macroeconomic stability, notably through low inflation, to avoid "taxing" the poor.	**I.1**
	Expand the Program of Advancement through Health and Education (PATH) program to newly displaced households [which a reduced burden of debt service would allow] to prevent economic shocks from doing permanent harm to the poor.	**I and III**
	Reduce payroll taxes and increase the value added tax [e.g., by expanding coverage of the base] to reduce the wage wedge and increase labor demand.	**III.1**
	Undertake regular monitoring and evaluation of program outcomes.	**II.1**
Country Economic Memorandum (2002)	Reduce growth of public sector wage bill.	**I.3**
	Privatize public entities and reduce contingent liabilities.	**I.2**
	Reduce tax rates and expand the tax base.	**III.1**
	Maintain credible macro policies.	**I.1**
Public Expenditure Review (2005)	Make sustained reduction in the debt a Government priority.	**I.1& I.2**
	Reduce contingent liabilities (arising from deferred financing and from public sector loans such as in sugar and highways), and make them more transparent.	**I.2**
	Rationalize the tax system to reduce the wide dispersion of effective rates.	**III.1**
Climate Change Vulnerability and Capacity Assessment of the Water Sector	Use water pricing to encourage efficiency.	**1.2 & III.1**
	Stronger integration and stricter enforcement of physical and environmental laws and regulations to reduce risks to life and property from extreme rainfall, and coastal flooding events.	
	Expand the existing water trading market.	
Fiduciary Reports — Recommendations		
Country Fiduciary Assessment (CFAA/CPAR 2006)	Address the fundamental issues of indebtedness and efficiency of expenditures in consideration of the fiscal situation.	**I.1 & I.2**

	Move to a Medium-Term Expenditure Framework to improve the predictability of the budget and the link between policy, planning and budget allocation.	**II.1**
	Improve the quality and timeliness of financial reporting.	**II.2**
	Expand oversight coverage of public enterprises by Parliament and the Auditor General.	**I.1 & I.2**
PEFA (2007)	Expand coverage of effective fiscal controls to include off-budget entities.	**I.1 & I.2**
	Improve effectiveness of the Audit Committees and Auditor General, inter alia, through more timely submission of financial statements.	**I.1 & I.2**
	Improve fiscal discipline and strategic allocation of resources.	**I.1 & II.1**
Non-World Bank Reports		
CARTAC/IMF: Jamaica: Strategy for Reform of Tax Incentives (2008)	Grant no new tax holidays, and phase out existing holidays.	**III.1**
	Repeal or scale back significantly the powers of the Minister of Finance to grant discretionary waivers of taxes.	**III.1**
	Reduce the corporate tax rate to 30 percent.	**III.1**
	Develop systematic costing of all expenditures, to be included in tax expenditure budgets published with annual budgets.	**II.2**
Tax Policy Review Committee (Matalon report) (2004)	Reduce exemption list for the GCT.	**III.1**
	Increase individual income tax threshold.	**III.1**
	Amalgamate the various payroll taxes.	**III.1**
	Harmonize personal and corporate income tax rates.	**III.1**

F. Poverty and Social Impacts and Country Consultation

132. **The Government has consulted extensively with country stakeholders, including the cabinet and members of Parliament on fiscal reform, Public Body rationalization proposals, and tax reform issues.** Through the Planning Institute of Jamaica (PIOJ), the Government has undertaken a broad consultation process on its long-term development plan—Vision 2030—which incorporates many of the reforms supported by this DPL and was tabled in Parliament in May 2009. Vision 2030 was publicly announced and consultations have taken place throughout the country including consultations with various target groups.

133. **In addition, the Public Sector Transformation Unit, which is implementing the Public Bodies rationalization program, has a well-structured consultative process.** The governance structure of the transformation project includes a Sub-Committee of the Cabinet chaired by the Prime Minister, to approve, give direction and oversight to the restructuring of the Public Sector, and the Consultative Monitoring Group (CMG) comprising representatives of Government, private sector, trade unions, academia and the Opposition to review the strategies

being pursued by the PSTU and monitor their implementation. Implementation and change management "transition" teams will be formed in each ministry and department, and will include Human Resource Practitioners, Communication Specialists, Information Technology Specialists, Union representatives and staff at all levels of the organization. These Teams will be kept fully abreast of changes taking place in their organizations, and will be able to assist their colleagues to grasp all of the critical issues. They will be able to direct staff to the various support services provided to facilitate the transition within and across Ministries and Agencies.

134. **The Bank has been closely working with other donors to put in place grant resources for technical assistance to support the government's debt and growth agenda.** The Bank's development partners include DFID, UNDP, CIDA, USAID, the IDB, the CDB, and the IMF. DFID and UNDP have committed financing resources to support the implementation of the reforms. CIDA support would be in kind whereas USAID support will be conducted in parallel. The IDB has a long relationship with the Ministry of Finance, the Office of the Prime Minister and the Planning Institute of Jamaica providing technical assistance in public financial management, budget processes, central government operations, and investment prioritization. The IDB has a companion technical assistance to their PBL. The IMF, directly and through CARTAC, has been providing technical assistance through advisory services on tax issues and topical issues such as investment schemes and the stability of the financial system.

135. **The actions supported by this DPL are expected to have a positive overall distributional impact, although some groups may experience adverse impacts in the short-run.** The distributional impacts of the Government's reform program are not straightforward to assess: they will vary among different groups; different elements of the program will have different impacts; some of the impacts will be direct and others are likely to be indirect; the timing of those impacts will vary; and finally it is difficult to separate impacts due to the reforms from those due to the financial crisis. To the extent that the measures supported by the DPL play a role in the government's ability to lower inflation, reduce the income tax burden for lower income groups, improve prioritization of public expenditures, and enhance the efficiency and fairness of the tax system, their overall impact on poor people's income and access to services is expected to be positive. This is confirmed by the Poverty Assessment and the Public Expenditure Review, which indicate that the high debt has adversely impacted the poor by reducing fiscal space for priority social spending and investment programs, while macroeconomic volatility and inflation have had a disproportionately negative impact on the poor. In particular high inflation in the past has eroded the purchasing power of the main social safety net program PATH and thus diminished its contribution to short term poverty alleviation and reduced the incentives for human capital accumulation. To address this issue, the Government had to adjust the benefits by almost 40% in 2008. Likewise, the distributive impact of reducing the number of favored tax exemptions and raising the income threshold for income taxes is expected to be pro-poor, as is improving expenditure efficiency and strategic allocation of public spending.

136. **The package of tax reforms supported by the DPL series is likely to have large and direct distributional impacts.** Accordingly, the Bank plans to initiate a study on full Social and Poverty Impact Analysis of the tax reforms supported by the DPL series, provided the data for this analysis is available, and otherwise to support the production of such data.

137. **Poverty and social impact analysis has been completed for the Sugar Industry, due to its size and employee characteristics, and further analysis is planned to assess the**

distributional impact in other sectors. The divestiture of the Sugar Industry is, by far, the most important in terms of its potential impact on the poor. The industry employs over 30,000 people, mostly unskilled, and has a significant amount of land under cultivation. The divestiture is designed to improve productivity in this sector and bring new technologies so that farmers can increase yields. Even if divestiture were not to take place, there would likely be a significant impact on the industry in the coming years as the EU trade preferences for Jamaican sugar expired in September 2009 (with a six-year transition period). Economic and social impact analyses were completed in 2006, with the assistance of the EU, for the Sugar Transformation Strategy, inclusive of the sugar privatization. The studies' recommendations, including the need for a better government communication strategy and assistance for displaced workers, has helped to guide the divestiture process. The GoJ has expanded its communication strategy through consultations on its development plan and is taking actions to minimize the impact on the poor (including, providing severance payments to farmers that exit the industry as well as support and training for alternative employment).

138. **The poverty and social impacts due to Public Body rationalizations, particularly due to employment dislocation, are routinely addressed as part of the rationalization process**. While the aggregate impact of the fiscal savings and debt reduction associated with the rationalization of Public Bodies will be to create a more efficient and transparent allocation of public spending and investment, some groups may be adversely impacted in the short-term. The Development Bank of Jamaica, through its Privatization Unit, which supports Government appointed enterprise teams, has the overall mandate to divest specifically assigned public assets/entities. As a part of that process, the Development Bank of Jamaica evaluates impacts of the prospective investors' development plans, which must include an evaluation of employment and social impacts, and propose mitigation measures.

139. **In other areas of the reform program, the government strategy is to identify the poverty and social impacts of the reform program and the economic downturn, and provide remedial measures.** On December 14, 2008, the GoJ announced that it had set up a special program through the HEART Trust/National Training Agency to retrain laid-off workers in order to assist them to gain alternative employment. The Bank is also supporting the strengthening of the PATH program, which provides conditional cash transfers for the poor. The program is well targeted and also helps the poor during periods of natural disasters with additional payments, which occurred after Hurricane Ivan. In 2008 the benefit level was adjusted for inflation and further increased to provide additional incentives for students to complete secondary school. This represents a substantial increase in PATH budget from 2007 levels (reaching 14 percent of the population).[14] PATH is also piloting a "Steps to Work"

[14] PATH or Program for the Advancement through Health and Education is a conditional cash transfer (CCT) program geared to provide cost effective social assistance to the extremely poor in exchange of them complying with conditions that promote the development of their human capital. The largest proportion of beneficiaries is drawn from the poorest quintile (poorest 20 percent), which is better targeting when compared to many similar programs in the LAC region. The program's benefit level were adjusted twice in 2008: once to keep with inflation and maintain its purchasing power (April 2008) and once to allow for higher incentives for secondary school kids and boys at all grade level to encourage them to attend school and complete high school (December 2008). In response to the financial crisis, the government has expanded coverage in 2009 by 10 % to reach 327,000 beneficiaries at the end of December 2009 with plans to reach 360,000 beneficiaries by March 2010. This roughly corresponds to about 14% of the population. Despite deteriorating fiscal situation PATH is being considered a

initiative aimed to help working able adults in PATH families to engage in activities that will help them find and retain gainful employment such as job search assistance, medical education, training, and small business assistance. While an economic crisis could result in budget constraints that limit the PATH CCT program, it is expected that the actions supported by the DPL will help reduce the likelihood of a crisis as well as protect priority social spending through supporting the government's Medium-Term Expenditure Framework. Planned analytical work by the Bank, in the context of the upcoming CEM, to be completed by June 2010, will explore the sequencing, sectoral, and distributional impacts of the Government's reform program.

G. Environmental Aspects

140. **The specific policies supported by this DPL operation are not expected to entail likely significant impacts on the environment, forests or other natural resources**. However, Jamaica has the arrangements to assess and manage such effects. In April 2001, the National Environment and Planning Agency (NEPA) was formed as a means for conducting environmental impact assessments under acceptable international standards. In 2003, a Strategic Environmental Assessment Policy was drafted and presented for approval in Jamaica as a means to better facilitate the integration of environmental sustainability into the development objectives of the country. While the policy has not been fully implemented, the implementation of key aspects of the SEA Policy starting in 2006 was the first of its kind in CARICOM. In addition, the Development Bank of Jamaica and other investment promotion agencies (e.g., Jamaica Trade and Invest, formerly JAMPRO) require that all proposed projects conform to the environmental laws of Jamaica and must comply with the regulations stipulated by the National Environment and Planning Agency. Depending on the size and importance of the public entity/asset, a formal Environmental Impact Analysis may be required. An Integrated Environmental Assessment was completed in April 2009 for the divestiture of the Sugar Company by the Sugar Industry Authority and the Ministry of Agriculture has already taken steps to initiate the process of Strategic Environmental Assessment in January 2009. GoJ recognizes the vulnerability of the country's economy to climate variability and change. Consequently, in January 2009, Jamaica completed a National Water Sector Adaptation Strategy and Plan of Action to address climate variability and change. The Strategy and Plan of Action makes explicit recommendations on key measures (capacity, institutional, policy and legislative, etc) aimed at mitigating climate-related shocks and disasters.

Box 8: Good Practice Principles on Conditionality

Principle 1: ***Reinforce ownership.***
The operation was developed within the objectives of the Government's Medium-Term Socio-Economic Policy Framework and 25-year National Development Plan – Vision 2030, which is being widely consulted with stakeholders and broader civil society and which will establish clear

priority program and adequate budgetary allocation has been made for FY 2009/20010. In parallel the government, with support from a World Bank investment operation, is in the process of improving targeting of PATH through a continuous process of recertification of beneficiaries and improvements in the proxy means targeting mechanism.

development priorities. The priority legislative agenda is developed in consultation with the Parliamentary leadership on an ongoing basis. The Bank support focuses on (1) promoting fiscal sustainability through controlling overall public sector balances and debt generation; (2) increasing the efficiency of public financial management and budgeting processes; and (3) reducing distortions and enhancing the efficiency of the tax system. These focus areas, including the rationalization of Public Bodies, have all benefitted from broad political support. The DPL is strongly underpinned by prior and ongoing analytical and fiduciary work, including the Country Economic Memorandum (2010), Poverty Assessment (2006), the CFAA/CPAR (2006), and PEFA (2007), as well as non-Bank AAA, including the Matalon Report on Tax Reform (2004) and the IMF/CARTAC report on Tax Incentives (2008).

Principle 2: ***Agree upfront with the Government and other financial partners on a coordinated accountability framework.***
The Bank's support is summarized in a brief and focused policy matrix. It is expected, that the Bank, the CDB, and the IDB will be providing support in the form of loans or contingent credit. The IMF Board approved a SBA for Jamaica on February 4, 2010. The Bank, the IMF, and the IDB draw on the country's development plan, thereby ensuring coordination among them and consistency of support. All three institutions have been supporting measures to improve fiscal and debt management, rationalize Public Bodies, and strengthen tax administration and policy.

Principle 3: ***Customize the accountability framework and modalities of Bank support to country circumstances.***
The Country Financial Accountability Assessment (CFAA), completed in 2006, indicates that the fiduciary environment in Jamaica is generally adequate, stating that the treasury management is solid and the internal control has in place a legal framework and independence, which are the basis for a sound Public Financial Management (PFM) system. The funds from the proposed DPL-DDO would be handled through this system.

Principle 4: ***Choose only actions critical for achieving results as conditions for disbursement.***
The Bank's policy matrix has only 10 prior actions (Annex 1). They address key development policies prioritized in the CPS including actions in promoting fiscal and debt sustainability to enhance growth and reduce poverty and inequality.

Principle 5. ***Conduct transparent progress reviews conducive to predictable and performance-based financial support.***
As agreed with the government, this DPL is the first in a series of two programatic operations, timed to meet the country's financing needs, and is to be evaluated and monitored for results. Monitoring and evaluation of the program will take place within the government's own processes. The policy matrix contains a range of outcome indicators (10), which are assessed as part of the operation implementation and are closely linked to the supported policy actions.

141. **As measures supported by the DPL program are expected to improve the potential for attracting new investment in the future (including in infrastructure), there will be a need to strengthen Jamaica's national institutional capacity to identify and address environmental policy and regulatory issues**. Indeed the successful implementation of this DPL program would create the fiscal space needed for GoJ to invest in critical environmental public goods such as protection of watersheds and forests, protection and management of coastal resources, zoning and flood prevention, better integration of institutional mandates, and stricter/effective enforcement of physical planning and environmental laws and regulations. With this in mind, GoJ and partners continue to support initiatives geared toward the proper

management, conservation and protection of the environment and natural resources for sustainable development.

H. Fiduciary Aspects

Public Financial Management System

142. **The 2007 Public Expenditure and Financial in Accountability (PEFA) built on the assessment of Jamaica's PFM environment during a joint Country Fiduciary Assessment (CFAA/CPAR) that was conducted in 2006.** The two assessments provide an indication of strengths and weaknesses in the management of public finances.

143. **Generally, the fiduciary environment in Jamaica is adequate, principally as a result of the strong legal and regulatory foundation outlined in the Financial Administration and Audit (FAA) Act.** This framework provides for the basic principles for efficient management of public resources. The PEFA Assessment identified a number of areas where the system was performing adequately, including in the area of revenue forecasting, budget classification, and oversight of fiscal risk. However, it also identified some areas where improvement is required. These included multiyear fiscal planning, expenditure policy, quality and timeliness of the preparation of annual financial statements, external audits payroll controls and controls for non salary expenditure. Significant delays were noted in the preparation and submission of financial statements for audit.

144. **The Country Fiduciary Assessment identified some key recommendations that were adopted by the Government to address existing weaknesses.** These included the following: strengthening the link between policy, planning and budget allocation through the introduction of an MTEF and costing Corporate Plans; improving the quality and timeliness of financial reporting; improving cash predictability by defining a transparent mechanism for warrant releases that maintain budget consistency with Government priorities; strengthening the capacity of the Internal Audit directorate and increasing the financial independence of the Auditor General's office. The GoJ continues to implement these measures to improve management of the public resources to further mitigate fiduciary risks.

Foreign exchange system

145. **A Financial System Stability Assessment was carried out in 2006 jointly by the IMF and the World Bank.** Its conclusion was that the control environment in the Central Bank within which foreign exchange is managed is satisfactory. It also established that the Bank of Jamaica (BoJ) has well established procedures that ensure the integrity of its operations, with an effective internal audit department. Its financial statements are audited by an international firm of accountants and are published on the BoJ's website. Any findings and recommendations issued as a result of the audit exercises are considered by an Audit sub-committee of the Board.

146. **The proposed loan will follow the Bank's disbursement procedures for development policy support.** Loan proceeds will be disbursed once effectiveness has been declared. The proceeds of the loan will be disbursed into an account designated by the Borrower that is part of the country foreign exchange reserves account at the Central Bank of Jamaica. The administration of this loan will be under the responsibility of the Ministry of Finance. Given that the Borrower's current public financial management system is satisfactory and the

fiduciary environment at the Central Bank of Jamaica is adequate, no specific audit of the deposit account will be required.

I. Loan Administration

147. **The Bank would disburse the loan proceeds into an account of the Central Bank of Jamaica denominated in US dollars.** The Central Bank of Jamaica will immediately credit the disbursed amounts to the account of the Ministry of Finance and the Public Service, thus becoming available to finance budgeted expenditures. Within a week of this funds transfer, the Ministry will accordingly provide the Bank with a written confirmation.

J. Monitoring and Evaluation Arrangements

148. **The Ministry of Finance and the Public Service will play the primary role in coordinating monitoring and evaluation of program implementation.** The Government and the Bank will take advantage of several important data sources to assess progress of the DPL, including:

- Central and nonfinancial public sector budget monitoring from the Ministry of Finance and the Public Service
- Statistical Institute of Jamaica
- Central Bank of Jamaica reports and analysis
- Reviews and analyses of laws and implementing regulations by the Bank and other stakeholders
- Data from key Government agencies such as PIOJ and the Auditor General
- Financial audits and follow up of CPAR and CFAA recommendations
- Bank, CDB, IDB and IMF supervision missions and reports. Jamaica is under intensified surveillance from the Fund which produces a bi-annual staff report that assesses its economic and financial stability. The World Bank has been closely coordinating with the Fund on its monitoring of the economic and financial situation.

K. Risks

149. **The Jamaican program, to be supported by the proposed DPL, faces four types of significant risks: economic, political, institutional and natural disasters. Risks and mitigation measures are summarized below.**

150. **Economic:** The current global financial crisis has severely impacted the Jamaican economy through falling exports of services and goods—tourism, bauxite/alumina, and light manufacture—and declining remittances. The sizeable depreciation of the nominal exchange rate has increased the government's cost of servicing its variable rate debt and raised the cost of rolling over existing debt. Output declined by 1.6 percent in FY2008/09 and is projected to decline by another 3.5 percent in FY2009/10, largely due to the near collapse of the bauxite industry and reductions in remittances and tourism receipts. The central government's overall budget deficit has widened, despite the Government's strong efforts to contain it, mostly due to fall in tax revenues and increased debt service burden. Unemployment is on the rise with possible significant social implications. The full impact of the crisis has not been documented yet, but its social implications look worrisome as seen from the police reports of increased

property crimes. A lagged recovery and further deterioration in economic conditions may stall or reverse reform actions and put strain on debt sustainability. In addition, measures such as the public sector wage freeze may not be sustainable for a period of two years.

Monitoring and mitigation: Since Jamaica is vulnerable to external shocks, prospects for mitigation are limited. The Central Bank continues to target low inflation while also focusing on financial stability. The GoJ is continuing with its fiscal reform program to support debt sustainability in the medium-term. Other development partners have put together resources for on-demand technical assistance in support of the government's fiscal and debt sustainability program. To mitigate liquidity risks and ease financing constraints, the GoJ has sought a multilateral package of support from the World Bank, the IMF (US$1.25 billion or 300 percent of Jamaica's special drawing rights quota), the IDB, and the CDB. In addition, the proposed operation supports actions to improve fiscal balances and address the debt generating process, and, thus, reduces financing vulnerabilities. There is ongoing macro-monitoring and country dialogue and the Bank program would be adjusted to mitigate risks as much as possible if critical risks emerge. The wage freeze is being viewed in Jamaica as an urgent but temporary measure necessary to provide bridge support to the country while it implements its medium-term fiscal reforms. The idea is that the wage freeze will help control fiscal spending and contain the increase in wages (as a ratio to GDP) while the Government is preparing an action plan for human resources management in the public sector.

151. **Political:** The current government came into power in the fall of 2007, but it has had a small majority in Parliament, making the government's program vulnerable to special interests. The risk is that some MPs could object to, and block, specific policy reforms supported by the DPL. For instance, the Government has submitted a Fiscal Responsibility Framework (FRF) to Parliament and achieving concrete results would depend on enactment and implementation of the legislative changes envisaged under the FRF, which in turn could potentially be affected by the political stability. Similarly, reforms to rationalize the Public Bodies, and improve the tax code may face resistance, as various interest groups seek to maintain the status quo. While the growth contraction and pressing financial needs may exacerbate political concerns, it may also spur consensus on the need for near-term actions. Social unrest due to difficult economic circumstances may also threaten the political will to implement reform.

152. *Mitigation: The political risk is reduced by the Government's consultative approach to reform implementation and the dialogue among country stakeholders on the fiscal and economic costs of inaction. The IFIs and other donors are also heavily focused on building consensus for critical public sector reforms in the country. To mitigate risk from social unrest, the Government would have to develop a communication strategy focused both on explaining the benefits from the fiscal reforms and the cost of postponement.*

153. **Institutional capacity and reform implementations:** The Government has embarked on substantial public sector reforms which require changes in institutional structures and significant enhancement in institutional capacity for an effective implementation. The reform process might be delayed as the institutions try to adjust to the changes and enhance their capacity. For instance, consolidation of all public sectors may require substantial adaption in public entities. Similarly, moving to MTEF would require investing significantly in capacity building and aligning the orientation of the institutions towards medium term planning.

154. *Mitigation: Jamaica has well established institutions. The development partners have*

been providing technical assistance for institutional capacity building and advancing public sector reforms.

155. **Natural Disasters:** Jamaica is highly vulnerable to multiple natural disaster risks—particularly droughts, floods and hurricanes. The cumulative damage from the last three major storms— Ivan (2004), Dean (2007), and Gustav (2008)—was over US$1 billion. Natural disasters have the potential to derail economic growth and poverty reduction. They also pose a heavy fiscal burden, increasing indebtedness and redirecting public resources away from long-run development plans.

156. *Mitigation: The damage to major private sector enterprises is partly covered by insurance. The GoJ participates in the Caribbean Catastrophe Risk Insurance Facility. The Bank is assisting Jamaica through investments in natural disaster risk mitigation with the Hurricane Dean Emergency Recovery Loan and technical assistance for its safety net program to mitigate adverse consequences on poverty. In January 2009, the National Water Sector Adaptation Strategy and Plan of Action to address climate change were established with Bank assistance and provide recommendations on key investments (capacity, institutional, policy and legislative, etc) to mitigate the negative impacts of climate change in the water sector. In addition, the GoJ has presented a draft National Disaster Management Act to Parliament for enactment.*

Annex 1: OPERATION POLICY MATRIX

PROGRAM MATRIX FOR THE PROPOSED FIRST PROGRAMMATIC FISCAL SUSTAINABILITY DEVELOPMENT POLICY LOAN (FS DPL1)

Government Objectives	Issues	Policy Actions under the previous Fiscal and Debt Sustainability DPL (Approved in January 2009)	Policy Actions Supported by the First Fiscal Sustainability DPL (FS DPL1)	Expected Outcomes from FS DPL1 (by March 2011)	Policy Actions Supported by the Second Fiscal Sustainability DPL (FS DPL2) (indicative triggers are in bold)	Expected Outcomes from FS DPL2 (by March 2012)
Pillar I. Promoting Fiscal Sustainability Through the Control of Public Sector Balances and Debt						
I.1 Finalization and Approval of the Fiscal Responsibility Framework	*Containing the growth of public debt and reducing the overall debt burden is critical to establish fiscal solvency, flexibility, and space for social and investment spending.*	1. The MoF has submitted to the Cabinet proposed amendments to the Financial Administration and Audit Act and the Public Bodies Management and Accountability Act, which introduce a Fiscal Responsibility Framework (FRF). 2. The MoF has developed and approved an action plan for the consolidation of Public Bodies' and Central	1. The Borrower, through MoFPS, has submitted to the Borrower's legislature on February 5, 2010, for approval thereby, a bill containing the proposed amendments to the Borrower's Financial Administration and Audit Act and the Borrower's Public Bodies Management and Accountability Act, for purposes of introducing	1. Increase in the primary surplus of the central government by 1.8 percent of GDP by FY2010/11 (Baseline: 4.8 percent of GDP at end-FY2008/09). 2. Fiscal savings of at least 1.5 percent of GDP generated due to GoJ's Debt Management Activities (Baseline: Interest payments by Central Government were 16.0 percent of GDP in FY2009/10); 3. No more deferred financing (Baseline:	**1. Amendments to Financial Administration and Audit Act and the Public Bodies Management and Accountability Act have been enacted and the Fiscal Responsibility Framework (FRF) is being fully implemented.** **2. The Government has started implementing a time bound action plan for strengthening institutional and technical capacity of the Debt**	1. The FY2011/12 budget process, which commences in the final quarter of CY2010, is developed within the FRF and is bound by the FRF's medium term targets for debt creation and the overall fiscal deficit. 2.(a) A detailed borrowing plan is published by the Debt Management Unit, which fully operationalizes the Medium Term Debt Management Strategy; (b)

Government Objectives	Issues	Policy Actions under the previous Fiscal and Debt Sustainability DPL (Approved in January 2009)	Policy Actions Supported by the First Fiscal Sustainability DPL (FS DPL1)	Expected Outcomes from FS DPL1 (by March 2011)	Policy Actions Supported by the Second Fiscal Sustainability DPL (FS DPL2) (indicative triggers are in bold)	Expected Outcomes from FS DPL2 (by March 2012)
		Government accounts. 3. The MoF has: (a) ceased authorization of deferred financing in the Central Government since 2005; (b) communicated its commitment to the Cabinet (on December 10, 2007) and Parliament (on December 11, 2007) not to utilize any deferred financing arrangement.	into said legislation a fiscal responsibility framework. 2. The Borrower, through MoFPS, has officially announced on January 14, 2010 a domestic debt exchange offer to reduce the Borrower's net present value of its public debt. 3. The Borrower's legislature has enacted the Act to Amend the Financial Administration and Audit Act of 2010 dated	Average annual deferred financing from FY2000/01 to FY2005/06 was J$497 million)	**Management Unit, including the establishment of (a) a new functional organization structure with front, middle and back offices (b) the development of a Medium Term Debt Management Strategy and (c) the enactment of a Public Debt Law that provides a unified framework for strategic debt management.**	Quantitative limits on instruments and lenders are established in line with the overall budget ceiling established by the FRF.

Government Objectives	Issues	Policy Actions under the previous Fiscal and Debt Sustainability DPL (Approved in January 2009)	Policy Actions Supported by the First Fiscal Sustainability DPL (FS DPL1)	Expected Outcomes from FS DPL1 (by March 2011)	Policy Actions Supported by the Second Fiscal Sustainability DPL (FS DPL2) (indicative triggers are in bold)	Expected Outcomes from FS DPL2 (by March 2012)
			January 29, 2010 which eliminated MoFPS' authorization to approve any deferred financing.			
I.2 Rationalization of Public Bodies	*The Government's public sector rationalization plan supports the objectives of achieving fiscal sustainability and growth through a transformed cohesive public sector that is performance-based, efficient, cost effective, and service oriented.*	1. The MoF has approved a plan to achieve the rationalization of Public Bodies and the following actions have been taken by the GoJ consistent with the plan: (i) the divestiture of forty-nine percent of Petrojam Limited and significant advances in the divestiture of the GoJ's sugar cane industry assets	1. The Borrower's Prime Minister has approved on January 8, 2010 a strategic project for restructuring the Borrower's public sector 2009-2011. 2. The Borrower, through MoFPS, has submitted to the Borrower's legislature on February 5, 2010 for approval a	1. The 2010/11 budget circular has explicitly established the Government's intention to produce consolidated public sector tables in the 2010/11 Budget memorandum (Baseline: No such instructions provided in earlier years). 2. The 2010/11 budget circular has set explicit targets for the coverage of public entities in the annual Estimates of	1. Public Bodies Rationalization Plan has been fully implemented.	1. (a) The winding-up of inactive Public Entities without legal impediments has been completed (as of December 2009, 38 inactive bodies remain to be wound-up); (b) Pending divestments of public bodies that were slated for privatization have been completed

Government Objectives	Issues	Policy Actions under the previous Fiscal and Debt Sustainability DPL (Approved in January 2009)	Policy Actions Supported by the First Fiscal Sustainability DPL (FS DPL1)	Expected Outcomes from FS DPL1 (by March 2011)	Policy Actions Supported by the Second Fiscal Sustainability DPL (FS DPL2) (indicative triggers are in bold)	Expected Outcomes from FS DPL2 (by March 2012)
		and Petrojam Ethanol Limited, as evidenced by the Heads of Agreement signed by the GoJ with a potential buyer on June 27, 2008; (ii) the engagement of privatization advisors for the divestment of Air Jamaica Limited; (iii) the arrangement reached by the GoJ, in principle, to privatize Clarendon Alumina Partners, an entity which represents the GoJ's equity in	bill containing the proposed amendments to the Borrower's Public Bodies Management and Accountability Act, for purposes of vesting in the Borrower's legislature the authority to approve the annual budget of Public Bodies.	Revenue and Expenditure (Baseline: No such targets published in earlier years). 3. Reduced losses of Public Bodies generate savings of at least 1 percentage point of GDP by FY2010/11 (Baseline: Public entities balance was -2.8 percent of GDP in FY2009/10)		

Government Objectives	Issues	Policy Actions under the previous Fiscal and Debt Sustainability DPL (Approved in January 2009)	Policy Actions Supported by the First Fiscal Sustainability DPL (FS DPL1)	Expected Outcomes from FS DPL1 (by March 2011)	Policy Actions Supported by the Second Fiscal Sustainability DPL (FS DPL2) (indicative triggers are in bold)	Expected Outcomes from FS DPL2 (by March 2012)
		the Jamalco refinery; (iv) the preparation of a draft information memorandum in respect of the privatization of Mavis Bank Coffee Factory Ltd. to be issued to prospective bidders; (v) the identification of fifteen entities (including Wallenford Coffee Company Ltd. and Caymanas Track Limited) of commercial nature for privatization.				

Government Objectives	Issues	Policy Actions under the previous Fiscal and Debt Sustainability DPL (Approved in January 2009)	Policy Actions Supported by the First Fiscal Sustainability DPL (FS DPL1)	Expected Outcomes from FS DPL1 (by March 2011)	Policy Actions Supported by the Second Fiscal Sustainability DPL (FS DPL2) (indicative triggers are in bold)	Expected Outcomes from FS DPL2 (by March 2012)
I.3 Improving Efficiency and Effectiveness of Public Service Compensation and Incentives.	*Wages are estimated at 11.8 percent of GDP in FY2009/10 and managing this component of public expenditure is therefore a priority.*	1. The GoJ has completed an education sector employment survey which is the first step of an employment survey of the public sector to be included in a study to evaluate a medium-term strategy for public sector workforce skills needs and compensation.	1. The Borrower has completed: (a) a separate employment survey of all employees in each of the following sectors: (i) health; (ii) national security; (iii) finance; and (iv) agriculture; and (b) a separate employment survey of administrative employees in the education sector; said surveys aimed at establishing the number of employees in the respective sectors.	1. Information is available on the number and posts of public sector employees in the five strategic sectors, which represent almost 40 percent of total public sector workforce, laying the groundwork for the public sector workforce restructuring being undertaken by the Public Sector Transformation Unit (PSTU) (Baseline: No employment surveys processed as of FY 2008/09). 2. The Centralized Human Resource Management (HRM) database is fully functional and has	1. Employment surveys for all non-self-financing Public Bodies are completed. 2. Recommendations identified by the PSTU to restructure the public sector are implemented by transition teams in at least 10 ministries, departments and agencies.	1. A centralized HRM database covering total public employment is fully functional 2. The wage bill as a percentage of GDP is at or below 10 percent (Baseline: 11.8 percent of GDP by end-FY2009/2010). 3. Transition teams are in place in at least 10 ministries, departments and agencies (MDAs) to implement the recommendations of the Public Sector Transformation

Government Objectives	Issues	Policy Actions under the previous Fiscal and Debt Sustainability DPL (Approved in January 2009)	Policy Actions Supported by the First Fiscal Sustainability DPL (FS DPL1)	Expected Outcomes from FS DPL1 (by March 2011)	Policy Actions Supported by the Second Fiscal Sustainability DPL (FS DPL2) (indicative triggers are in bold)	Expected Outcomes from FS DPL2 (by March 2012)
			2. The Borrower, through MOFPS, has issued Circular No. 6 ref. 59/33, dated February 2, 2010 approving a wage/salary freeze for all of the Borrower's public sector employees until March 31, 2012, and said resolution is in full force and effect.	updated and accurate information on public employment in the five strategic sectors, including age and qualifications of individual employees (Baseline: No data published as of FY 2008/09).		Unit.
Pillar II. Increasing the Efficiency of Financial Management and Budget Processes						
II.1 Achieving fiscal discipline and strategic allocation of resources	*Ensuring the proper appraisal of investment projects with a view to improving resource allocation and*	1. The Public Sector Modernization Division of the Cabinet Office has prepared a draft technical			**1. The Government has fully implemented the new methodology for evaluating capital investments in all line**	1. New investment management system is in use in 10 ministries. 2. All MDAs have implemented their

Government Objectives	Issues	Policy Actions under the previous Fiscal and Debt Sustainability DPL (Approved in January 2009)	Policy Actions Supported by the First Fiscal Sustainability DPL (FS DPL1)	Expected Outcomes from FS DPL1 (by March 2011)	Policy Actions Supported by the Second Fiscal Sustainability DPL (FS DPL2) (indicative triggers are in bold)	Expected Outcomes from FS DPL2 (by March 2012)
	productivity of spending.	framework for the capital investment. prioritization, establishing the link between policy, planning and budget allocation.			**ministries.** **2. All MDAs have submitted and published their MTEFs.**	MTEFs for the FY2011/12 budget cycle.
II.2 Improving Public Financial Management	*Key challenges are institutional foundations such as staff resources, and training and guidelines on the preparation and costing of sectoral strategies.*	1. The Auditor General is implementing its action plan for institutional and professional capacity building; and the Minister of State in the Ministry of Labor and Social Security and the Deputy Leader of the House, on behalf of the MoF, have submitted to Parliament for	1. The Borrower's Auditor General has continued to implement an annual operational plan within the framework of the five-year strategic corporate plan including relocation of its staff to updated physical facilities, and completion of 90	1. The timeliness of annual appropriation accounts submission of selected Ministries, Departments, and Agencies to Auditor General has improved, as indicated by a decrease in accounts outstanding by 20 percent (Baseline: 158 accounts outstanding in December 2008).		

Government Objectives	Issues	Policy Actions under the previous Fiscal and Debt Sustainability DPL (Approved in January 2009)	Policy Actions Supported by the First Fiscal Sustainability DPL (FS DPL1)	Expected Outcomes from FS DPL1 (by March 2011)	Policy Actions Supported by the Second Fiscal Sustainability DPL (FS DPL2) (indicative triggers are in bold)	Expected Outcomes from FS DPL2 (by March 2012)
		approval a proposal to update legislation governing the internal audit departments and audit committees (the Financial Administration and Audit (Amendment) Act, 2008).	percent of planned audits.			
Pillar III. Reducing Distortions and Enhancing the Efficiency of the Tax System						
III.1 Improving Tax Efficiency and Administration		1.The MoF has: (a) issued: (i) the Provisional Collection of Tax (Income Tax) Order, 2008 on June 20, 2008 to increase the threshold above which individual income tax is due; (ii) the Provisional	1. The Borrower has implemented three tax packages dated May 6,2009, September 29, 2009 and December 23, 2009, respectively, for purposes of: (a) improving efficiency and	1. Increased number of corporate (CIT and GCT) and (non-PAYE) individual tax payers on the tax roll reflected in 15 percent increase of the number of tax payers for 2008/09 compared to 2007/08 (Baseline: 58,655 taxpayers in December 2008).	**1. (a) The GoJ has continued progress on implementation of a uniform tax code; (b) the GoJ has established a one-stop shop for all tax payments to ease cost of paying taxes; and (c) E-filing extended to all taxpayers and to all types of taxes.**	1. Improved PEFA rating of "Collection of tax payments" to B in FY2010/11 from a baseline of: D+ in 2007/08

Government Objectives	Issues	Policy Actions under the previous Fiscal and Debt Sustainability DPL (Approved in January 2009)	Policy Actions Supported by the First Fiscal Sustainability DPL (FS DPL1)	Expected Outcomes from FS DPL1 (by March 2011)	Policy Actions Supported by the Second Fiscal Sustainability DPL (FS DPL2) (indicative triggers are in bold)	Expected Outcomes from FS DPL2 (by March 2012)
		Collection of Tax (General Consumption Tax) Order, 2008 on May 9, 2008 to simplify the general consumption tax on motor vehicles; and (iii) the Provisional Collection of Tax (Stamp Duty) Order, 2008 on April 11, 2008 to simplify the special consumption tax on tobacco; and (b) submitted to Cabinet a proposal for amalgamation of statutory payroll deductions. 2. The GoJ has:	uniformity of tax policy by reducing the number of items excluded from taxation; and (b) improving revenue generating capacity through increasing excise tax rates on several items. 2. The Borrower has continued to implement its tax administration reform project, which commenced on January 12, 2009, as evidenced by the establishment of a large tax office, a			

Government Objectives	Issues	Policy Actions under the previous Fiscal and Debt Sustainability DPL (Approved in January 2009)	Policy Actions Supported by the First Fiscal Sustainability DPL (FS DPL1)	Expected Outcomes from FS DPL1 (by March 2011)	Policy Actions Supported by the Second Fiscal Sustainability DPL (FS DPL2) (indicative triggers are in bold)	Expected Outcomes from FS DPL2 (by March 2012)
		(a) issued a six-month tax amnesty for taxpayers with arrears due and payable on or before April 11, 2008; and (b) published a plan to continue its efforts to reduce tax arrears and improve revenue collections during its fiscal year 2008/2009 and beyond.	customer care center, a forensic data mining unit, a high intensity unit and a special enforcement team.			

Annex 2: LETTER OF DEVELOPMENT POLICY

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

Telephone No. 92-28600-16
Website: http://www.mof.gov.jm
Email: info@mof.gov.jm

MINISTRY OF FINANCE AND THE PUBLIC SERVICE
30 NATIONAL HEROES CIRCLE
P.O. BOX 512
KINGSTON
JAMAICA

February 05, 2010

POLICY LETTER

First Programmatic Fiscal Sustainability Development Policy Loan

Mr. Robert B. Zoellick
President
World Bank
Washington DC

Dear Mr. Zoellick

The Government of Jamaica appreciates and welcomes the technical and financial support of the World Bank and the avenues which it opens for the successful and gradual achievement of the goals, outcomes, and reform measures articulated in Vision 2030 Jamaica - National Development Plan and the Medium Term Socio-Economic Policy Framework 2009-2012.

The Government of Jamaica is fully committed to the sustainable development of the country and therefore strengthens and further advances structural reforms that are of paramount importance to improve the quality of life of the Jamaican people. This requires strong and sustained economic growth which will facilitate job creation and poverty reduction, greater security and safety, and effective governance, as well as education and training to boost production and productivity. Several challenges, including the debilitating debt situation and the current global economic crisis, will have to be overcome to achieve these objectives and create the appropriate framework and capacity for global competitiveness. However, the GOJ will take full advantage of the spirit of commitment and partnership that was engendered among key stakeholders during the preparation of the long-term development plan in order to address these and other challenges and thereby meet our objectives.

In order to accomplish this, the GOJ has committed itself to reducing the cost of debt servicing through improved fiscal management, controlling the deficit, and generating strong primary

surpluses. The current global financial crisis has placed an additional constraint on the economy in terms of higher debt servicing costs and has reduced growth as global activity has slowed, particularly impacting tourism and remittance inflows. The global financial crisis has resulted in the closure of the international capital market to emerging economies such as Jamaica and it is thus imperative that Jamaica continue to access resources from the multilateral institutions.

As Jamaica strives to achieve sustainable development, continued implementation of the reform agenda is critical. The reform agenda seeks to realign the economy with sustainable, growth-oriented strategies. The GOJ's priorities for the macro-economy in the context of the Medium-Term Framework 2009 - 2012 are:

a) The containment of public expenditures, and the national debt, through the introduction and implementation of the Fiscal Responsibility Framework. The goal is to contain the overall deficit and reduce the debt/GDP ratio to below 100 percent by FY2016/17.

b) Intensification of measures to improve the efficiency of the financial management and budget processes within the central government through the end of this fiscal year and continuing into FY2010-11. Specifically, public spending will be subject to improved monitoring and evaluation and mechanisms to control spending and improve accounting and financial reporting will be implemented.

c) Enhancement of both revenue collection and equity of the tax system through improvements in tax administration and tax policy. In particular, the unification of tax rates, improvements in customer service and the effective collection of taxes will be pursued.

I Background

Extricating the Jamaican economy from the current status quo of low growth, high debt and economic vulnerability will be challenging. However, the Government is fully committed to proceeding with the reform agenda, even in the context of the current global crisis. Factors that have contributed to the current situation are summarized below.

Impaired Economic Performance - In recent years, Jamaica has experienced low economic growth relative to its peers. Among the factors contributing to this growth performance are the high government debt burden, low productivity, and numerous factors preventing high investment from translating into growth. The global crisis has further restricted the possibility for growth in FY2009/10 and limited the recovery expected in FY2010/11.

Jamaica has a high public sector debt burden with a debt to GDP ratio estimated at 140 percent of GDP by end FY2009/10. Total public debt, including domestic and external debt, steadily increased from FY1996/97 through FY2002/03 following the financial crisis of the mid-1990s. Between FY2003/04 and FY2007/08, public debt to GDP declined before rising again in FY2008/09 on the back of the current crisis.

The composition of Jamaica's public debt indicates significant exposure to currency, interest and roll-over risks. More than half of the total public debt, including government guaranteed debt and PetroCaribe debt, in FY2008/09 was indexed or denominated in foreign exchange. The exposure of public debt to changes in interest rates is also significant. As of November 2009 variable-rate instruments accounted for about 51 percent of the domestic and 20 percent of the external debt. With a share of almost 63 percent, Jamaica has markedly relied on credit from the private sector in its external borrowing. Nearly 75 percent of the domestic debt has a maturity of five years or below while 80 percent of the external debt has a maturity longer than 5 years.

High private investment rates in Jamaica could not translate into high growth, due to low public investment, low productivity, vulnerability to natural disasters, crime, and high costs of other production factors. Investment rates were as high as 30 percent of GDP on average over the past decade, but low total factor productivity and low public investment have resulted in lower investment efficiency. Frequent natural disasters required investment in the replacement of the capital stock and the high incidences of crime, as well as high energy costs, particularly electricity, further hampered investment efficiency.

Business Environment and Trade - In terms of the business environment, Jamaica's rank declined sharply in 2008. Out of a sample of 183 countries included in the World Bank Doing Business Survey, Jamaica ranked 75th compared to 67th (out of 181 countries) previously. However, reforms in tax administration geared toward simplifying tax payment procedures have had some positive impact already, with Jamaica's ranking on this indicator improving significantly between 2009 and 2010.

Poverty and Inequality - Although poverty remains relatively high in rural areas, it has fallen substantially since the GOJ began monitoring living conditions in 1988. The incidence of poverty has fallen from 28.4 percent in 1990 to 9.9 percent in 2007. Poverty declined sharply in the Kingston metropolitan area, falling from 13.3 percent to 6.2 percent over the same period. This compares with a decline in poverty in rural areas from 37.5 percent to 15.3 percent.

II Impact of the Ongoing International Crisis

The current global crisis has already had a significant impact on the Jamaican economy that is likely to continue over the medium-term. During FY 2007/08 real GDP growth decelerated to 0.6 percent from 3.2 percent during the prior year due to the adverse impact of Hurricane Dean on agricultural output. GDP contracted by 1.6 percent in FY2008/09 and is expected to decline by another 3.5 percent in FY2009/10, recovering to 1.9 percent by FY2011/12. The impact of the external environment has been through four main transmission channels: decline in global tourism activities, the impact of declining US growth on exports and remittances, the tightening of international and domestic financial conditions, and a sharp decline in domestic demand and credit growth. Additionally, FY2008/09 reflected lingering impacts of the food and fuel price crisis of 2007-2008, but the inflation spike of 2008 has deflated and inflation is expected to continue to decline. Jamaica's recovery is linked to the recovery of global demand and private investment.

a) The current account deficit is expected to contract to 9.4 percent of GDP in FY2009/10 from 18 percent in FY2008/09 and further to 5.0 percent of GDP in FY2013/14 as the cost of fuel imports declines and export performance recovers.

b) Tourism revenues and wage remittances have fallen due to the ongoing global crisis, but this trend is expected to reverse. Tourism receipts are expected to increase from 14.3 to 16.2 percent of GDP between FY2008/09 and FY2009/10 and average around 15.7 percent of GDP between 2009/10 and 2013/14. Private net transfers, mainly remittances, are expected to average 15.9 percent of GDP between 2009/10 and 2013/14 as the global economy recovers from the crisis.

c) The consolidated fiscal deficit is expected to worsen in the short term to above 12 percent but to narrow again in the medium term to 0.5 percent in FY2013/14. While fiscal balances are expected to improve over the medium-term, the impact of the global external environment implies that the GOJ may not be able to balance its budget as quickly as anticipated prior to the global slowdown. Central government revenues are estimated to have declined due to decreasing export revenues and a fall in general consumption taxes. These effects have been partly counterbalanced by increased revenues from taxes on interest, income and corporate profits, boosted by improved collection on tax arrears due to the tax amnesty provided this fiscal year. In terms of expenditures, increases in interest expenditures and the wage bill have been counterbalanced by cuts in capital spending.

d) After the initial rise reflecting the adverse impact of the crisis, the debt to GDP ratio is expected to decrease in the medium term to under 120 percent in FY2013/14, compared to 140 percent estimated for FY2009/10. Given the challenging global environment, even

with the implementation of the government reform plan, net debt to GDP will not fall below 100 percent of GDP by FY2011/12 as originally anticipated by the GOJ. The current financial crisis has increased the cost of capital for heavily indebted sovereigns such as Jamaica, while depreciation pressures stemming from lower capital inflows could increase the cost of servicing the foreign exchange denominated component of debt. Both consolidated public sector debt and the Central Government's debt fell until the onset of the current crisis. Domestic debt is expected to fall to 54.1 percent of GDP by FY2013/14 driven by primary surpluses and higher GDP growth during crisis recovery.

e) Current sovereign and corporate spreads reflect a higher country risk resulting from the volatile international financial environment. EMBI Global Sovereign spreads for Jamaica, at 673 basis points as of January 13, 2010, are higher than the regional average and the average of all emerging markets. The impact of the global crisis on Jamaica's macroeconomic outlook is reflected in downward revisions to the sovereign ratings.

III Structural Reforms

The GOJ is determined to implement, advance, and strengthen the reform program within the framework of the long-term goals and outcomes of Vision 2030 Jamaica and the current Medium-term Socio-economic Policy Framework (MTF). The broad package of policies, strategies and programs that the Government is committed to implement over the period 2009-2012 focuses on fiscal and debt sustainability, establishment of an efficient and equitable tax system, financial system stability, and price stability.

The Government follows a three pillar program to reach fiscal and debt sustainability: 1) Promoting fiscal sustainability through the control of public sector balances and debt; 2) Increasing the efficiency of financial management and budget processes; 3) Reducing distortions and enhancing the efficiency of the tax system.

Promoting fiscal sustainability through the control of public sector balances and debt

The GOJ recognizes the necessity to contain the growth of public debt and to reduce the overall debt burden to establish fiscal solvency, flexibility, and space that it needs to cope with volatility and the uncertainty associated with frequent external shocks. In pursuit of this goal, the Government, has submitted the Fiscal Responsibility Framework (FRF) for Parliamentary approval and subsequent enactment, is implementing the plan to rationalize public bodies (including divestiture of loss-making public bodies), and is improving efficiency and effectiveness of public service compensation and incentives.

The Fiscal Responsibility Framework is designed to strengthen the budget process by enhancing the mechanisms for transparency and establishing clearer goals, targets and limits for public spending, deficits, and debt. The ultimate objective of the FRF is the achievement of explicit targets for public debt, the public sector wage bill, and the overall public sector balance. Together with the enactment of the legislation abolishing access to deferred financing, the ongoing initiatives to improve debt management in line with international best practice, and a debt exchange program launched in January 2010, the FRF is expected to lead to a decline in total public debt/GDP over the medium term and generate fiscal savings.

The GOJ is determined to act upon the paramount importance of debt management reform. In particular, the government is committed to the establishment of front, middle and back offices in the Debt Management Unit to improve the government's capacity for debt sustainability analyses and risk assessments. The reorganization of the DMU along international best practices will be completed in FY2011/12. Further, the GOJ will develop a Medium Term Debt Management Strategy, and will enact a unified Public Debt Law.

The GOJ's public sector rationalization plan supports the objectives of achieving fiscal sustainability and growth through the creation of a transformed cohesive public sector that is performance-based, efficient, cost effective, and service oriented. The Public Sector Transformation Unit (PSTU) was launched by the Prime Minister in November 2009 with a broad mandate to review the functions of all Ministries, Departments and Agencies (MDAs), develop a master rationalization plan, implement a Government-Wide Network, and the Strategic Human Resource Management System.

Critical amendments to the Public Bodies Management and Accountability Act (PBMA Act) that have been submitted to Parliament as part of the FRF, include (a) not entering into negotiations to issue debt without prior approval by the Minister of Finance; (b) requiring Public Bodies to submit corporate plans and any modifications to the Minister of Finance for endorsement and the Parliament for approval; (c) requiring the Minister of Finance to provide an annual report to Parliament of estimates of revenue and expenditure for all Public Bodies; and (d) requiring Public Bodies to submit information on their financial operations to the Financial Secretary. In FY2010/11, the GOJ will submit consolidated public sector tables to Parliament.

Through FY2010/11, the GOJ is committed to augment the fiscal and debt sustainability agenda by fully implementing the Public Bodies Rationalization Plan. This includes the winding up of inactive Public Bodies and further divestment of Public Bodies scheduled for privatization. Furthermore, as the Public Sector Transformation Unit (PSTU) issues its recommendations on rationalization and restructuring of the public sector, transition teams will begin implementing these recommendations with a target of having applied the recommendations to at least 10

Ministries, Departments, and Agencies (MDAs) in FY2011/12. These steps will generate savings of at least one percentage point of GDP due to reduced losses of public bodies.

Improving the efficiency and effectiveness of public sector compensation and incentives is one of the most important areas of sustainable fiscal reform. The GOJ has started addressing the problem of fragmented pay negotiations; however, additional analytical work, expert advice, and a better fiscal position to finance one-time costs are required for its implementation. In FY2010/11, the GOJ will implement the Human Resource Management System, currently under development. The Public Sector Establishment Division of the Ministry of Finance and the Public Service launched employment surveys for all MDAs in July 2009, and surveys for the five strategic sectors—Education, Health, National Security, Finance, and Agriculture—were completed in December 2009. As a result of these activities, the GOJ expects in FY2010/11 to have information available on the number and posts of public sector employees in the five strategic sectors as well as a fully functioning centralized Human Resource Management database. Additionally, the GOJ has taken measures to contain the wage bill in the short term by introducing a wage freeze for all public sector employees over the three year period April 2009-March 2012.

Increased efficiency of financial management and budget processes

In order to improve the ability of the GOJ to spend its resources more efficiently and reduce the risk of budget overruns it is important to bring accounting, recording and reporting standards in line with international standards. Several of the issues raised in the Public Expenditure and Financial Accountability Assessment in 2007 are the basis of reforms that the GOJ has either initiated or scheduled for implementation: (i) training of staff to enhance the capacity to implement accrual accounting, with a view to improving accounting and financial reporting; (ii) enhancing the internal and external control systems through the strengthening of the Internal Audit Directorate and expanding the scope of work of the GOJ's internal audit units; and (iii) implementing the Auditor General's operational plan by undertaking further training of its staff, expanding the scope of audits to include performance audits, and upgrading of the IT and physical facilities of the Auditor General's office.

In the next fiscal year, FY2010/11, the GOJ's medium-term program for public financial management reform includes several important steps. The GOJ is deploying the newly developed investment tool for evaluation of capital investments across all line Ministries. Additionally, the GOJ will require all MDAs to have submitted and published their Medium-Term Expenditure Frameworks (MTEFs) over the course of FY2010/11, with a view to implement these MTEFs for the FY2011/12 budget cycle which commences in the last quarter of CY2010.

Reducing Distortions and Enhancing the Efficiency of the Tax System

The GOJ is reforming tax policy and tax administration to increase efficiency and enhance revenue generation. Although major personal income tax (PIT) and corporate income tax (CIT) simplifications have been postponed due to the impact of the global crisis, the GOJ has taken measures to broaden the tax base, improve efficiency, and increase the equity of the tax system by removing a number tax exemptions, raising PIT thresholds, and raising tax rates on fuel, cigarettes, alcohol, and luxury items. The combined annual revenue impact of the new tax measures is expected to exceed two percent of GDP.

In addition to tax policy reforms, the GOJ has implemented important reforms in Tax Administration, which include the establishment of a customer care center (April 1, 2009) and a large taxpayer office (April 15, 2009) to improve customer service. To facilitate compliance, the GOJ has established within Tax Administration a Forensic Data Mining Unit (June 2009), a High Intensity Team (June 2009), and a Special Enforcement Team (July 2009)—all of which have already begun to yield positive results in terms of a greater number of assessments and increased compliance.

The GOJ is committed to further improvements in the tax system by continuing to remove tax exemptions while simultaneously protecting the needs of the most vulnerable parts of the population. In the area of Tax Administration, the GOJ will continue its efforts to consolidate collections by establishing "one-stop shops" for tax payments, abolishing the need for taxpayers to go to different offices to pay different taxes. Moreover, following a successful launch of an online filing and payment system for the General Consumption Tax, Pay As You Earn tax, and Human Employment and Resource Training/National Training Agency tax in October 2009, the GOJ is committed to rolling out an online filing and payment system for all taxes in FY2010/11.

Government commitment to continued reform program

The GOJ is aware that the reduction of the debt burden to fiscally sustainable levels requires a sustained period of thorough reform. These reforms span the areas of fiscal and debt sustainability, public financial management, and tax policy and administration. The policy actions specified above are rooted in a well-developed, medium-term program in support of macroeconomic stability, as well as fiscal and debt sustainability. The GOJ is committed to continue and strengthen this ambitious and substantive reform program for a sustained period.

IV Government and Stake holder Support for the Program

The GOJ's broad reform agenda in the context of the current financial and economic crisis has the support of stakeholders. The medium-term fiscal and debt management reforms are being

implemented in consultation with major stakeholders, including private sector and civil society representatives, and the Tripartite Social Partnership, which includes members of the opposition. The successful Jamaica Debt Exchange, with over 95 percent participation, is evidence of the strong consensus around the urgent need for the reform program.

Jamaica continues to benefit from the availability of technical and financial resources in order to facilitate the implementation of these policy and administrative changes in the areas outlined, and appreciates the strong support received from the International Financial Institutions. The GOJ will continue to contribute leadership and resources to drive and support the implementation of the reform program.

Yours truly,

Audley Shaw, M.P.
Minister of Finance and the Public Service

Annex 3: FUND RELATIONS NOTE

157. Jamaica, which became a member of the IMF on February 21, 1963, has a current IMF quota of SDR273.50 million (about US$ 434 million). The IMF conducts regular Article IV consultations with Jamaica and the latest one was completed by the IMF Executive Board on April 21, 2008. The most recent IMF mission to Jamaica took place during October 27, 2009 - November 6, 2009 to head discussions toward a Stand-By Arrangement with the Fund. On February 4, 2010, the Executive Board of the International Monetary Fund (IMF) approved a 27-month Stand-By Arrangement with Jamaica in the amount of SDR 820.5 million (about US$1.27 billion) to support the country's economic reforms and help it cope with the consequences of the global downturn. A disbursement of SDR 414.3 million (about US$ 640 million) will become available to Jamaica immediately.

Press Release No. 10/24
February 4, 2010

158. The key objectives of the Stand-By Arrangement are to support the Jamaican authorities' ample reform program to address deep-seated structural weaknesses in the country's economy, increase its growth potential, and make it less vulnerable to external shocks. To achieve these goals, the program focuses on a three-pronged strategy:

1) An ambitious plan that puts public finances on a sustainable path that includes much-needed public sector reform;
2) A debt strategy to lower exceptionally high interest costs and help address the problem of the debt overhang , and raise the productivity of public spending;
3) Financial sector regulatory reform to reduce systemic risks.

159. The Jamaican authorities are already implementing many of these actions, which are expected to improve the public sector fiscal balance by over 5 percent of GDP in FY 2010. Among them, a debt exchange aimed at generating interest savings of at least 3 percent of GDP and a 65 percent reduction in the amount of maturing debt over the next three years have been successfully carried out, with an acceptance level of almost 95 percent of bondholders. A tax package has already been enacted and is expected to produce an increase in revenues of around 2 percent of GDP. Loss-making public entities are being divested.

160. At the same time, the government's economic program is designed to ensure a significant increase in social spending for targeted programs. Spending will increase by at least 25 percent (equivalent to 0.3 percent of GDP) in the school feeding program and the cash transfer Program of Advancement through Health and Education (PATH). The administration 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 and improve their employability.

161. Approval of the Stand-By Arrangement is expected to generate about US$1.1 billion in funding from other international financial institutions. Part of the first disbursement will be used to establish a Financial Stability Support Fund, which will also include funds from other multilaterals and will help support the country's financial sector.

162. Following the Executive board discussion, Mr. Takatoshi Kato, Deputy Managing Director and Acting Chair, issued the following statement:

163. “Jamaica’s large debt burden has magnified the fallout of the global crisis by limiting the scope for a counter-cyclical domestic policy response. Fundamental economic reforms are needed to restore fiscal sustainability, safeguard economic and financial sector stability, and enhance Jamaica’s growth potential. The ambitious economic program demonstrates that the authorities are committed to meeting these challenges.”

164. “The authorities are to be commended for the strong measures taken to maintain economic stability. These include introducing a third tax package this fiscal year and extending the public sector wage freeze for two years. The 2010/11 budget provides for increased social spending while reducing recurrent expenditures. The government has successfully completed a domestic debt exchange operation, which has contributed to a more equitable sharing of the burden of the overall fiscal adjustment. The exchange has also struck an appropriate balance in terms of delivering necessary cash flow savings while taking appropriate account of the need to ensure financial sector stability.”

165. “In addition to these near-term measures, the Jamaican authorities have committed to a comprehensive agenda of structural reform to help address the root causes of the deep economic imbalances. The swift passage of fiscal responsibility legislation and adoption of a central Treasury management system are necessary to enhance budget control and bolster fiscal transparency and accountability. Rationalization of the public sector, including through compensation and employment reforms and the divestment of public entities, aims to secure durable fiscal savings.”

166. “The planned legislative and regulatory reforms will help reduce systemic risks to the financial system and strengthen the overall resilience of the economy to shocks. Key measures include the adoption of an omnibus banking law, an amendment to the Bank of Jamaica Act, and reforms of deposit-taking institutions and the securities dealer sector.”

167. **Recent economic developments.** Jamaica has been strongly impacted by the global economic slowdown. Real GDP declined by 1.6 percent in Fiscal Year (FY) 2008/09 (April 1-March 31), with economic conditions deteriorating sharply in the second half of the year. During the current fiscal year, real GDP contracted further, registering a decline of 3 percent during the first half of the year.

168. Bauxite and alumina production and exports fell by about 60 percent, while remittances—a traditional source of balance of payments support—suffered a sharp decline. Tourism has also been negatively affected, although it has proven to be far more resilient than in the rest of the Caribbean.

169. In FY2009/10, the external current account deficit is expected to narrow from 18 percent of GDP to 9.5 percent, as the contraction in imports exceeds by far that of exports. Inflation fell steadily from 26.5 percent in August 2008 to 9 percent in November 2009, reflecting weak domestic demand and a decline in global commodity prices from their mid-2008 peaks.

170. Government finances have deteriorated, constraining the authorities’ ability to respond to the global shock with countercyclical policies. The public sector deficit is projected to reach almost 13 percent of GDP in FY 2009/10. The interest bill rose by 38 percent, reflecting the effects of the depreciation and a steep rise in interest rates. The deficit of public entities remained large, at close to 3 percent of GDP. As a result of these combined shocks, concerns about economic prospects and the sustainability of Jamaica’s debt have placed significant

pressure on the currency over the past year and a half.

171. **Main program goals. Growth**: Economic growth is projected to shift from a contraction of 3.5 percent in FY2009/10 to an expansion of 0.5 percent in FY2010/11 and a further increase of 2 percent thereafter.

172. **Inflation**: While one-off tax measures are expected to result in a temporary spike in inflation to just over 12 percent by end FY2009/10, in the absence of strong demand or foreign exchange market pressures, inflation is projected to fall to an average of 11 percent in FY2010/11 and further to 6 percent over the medium term.

173. **Balance of payments**: The external current account deficit is projected to continue to narrow gradually from 9.5 percent of GDP in FY2009/10 to 5 percent over the medium term, based on the recent depreciation of the currency in real effective terms and the expected increase in national saving as a result of fiscal consolidation.

174. **Tax Reform**: The organization of the tax administration and improving tax compliance is expected to be modernized. The authorities are committed to implementing rapidly the recommendations of a 2008 Fund Technical Assistance mission, including by unifying domestic tax administration and enhancing compliance through streamlined administrative procedures

175. **Public Sector Reforms**: The organization of the public sector will be streamlined, with a view to reducing the wage bill as a share of GDP. A committee has been appointed to review the existing structure of the public sector which is characterized by many entities with unclear or overlapping functions. The committee will present recommendations on a new structure by December 2010.

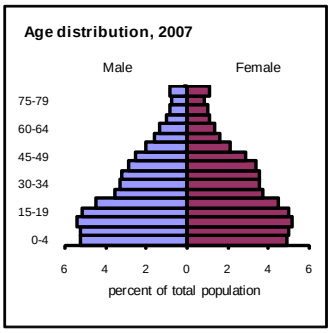
176. **Financial sector reforms**: Vulnerabilities in the financial system will be addressed, particularly the high exposure of securities dealers to government risk. The Jamaican government is committed to improving financial sector companies' ability to withstand shocks, by enhancing capital adequacy and margin requirements. The Bank of Jamaica will take explicit responsibility for overall financial system stability.

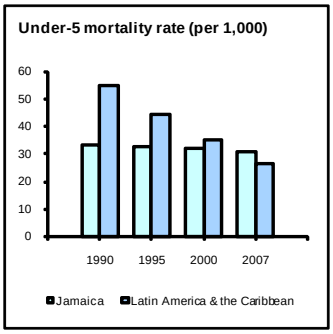
Annex 4: COUNTRY AT A GLANCE

Jamaica at a glance

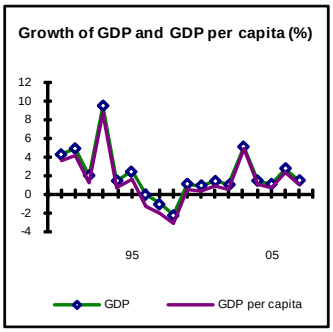
1/19/10

Key Development Indicators	Jamaica	Latin America & Carib.	Upper middle income
(2008)			
Population, mid-year (millions)	2.7	561	824
Surface area (thousand sq. km)	*11*	20,421	41,497
Population growth (%)	0.5	1.2	0.7
Urban population (% of total population)	*53*	78	75
GNI (Atlas method, US$ billions)	*11.8*	3,252	5,854
GNI per capita (Atlas method, US$)	*4,400*	5,801	7,107
GNI per capita (PPP, international $)	*5,300*	9,678	12,072
GDP growth (%)	*-1.6*	5.7	5.8
GDP per capita growth (%)	*-2.1*	4.4	5.0
(most recent estimate, 2003–2008)			
Poverty headcount ratio at $1.25 a day (PPP, %)	<2	8	..
Poverty headcount ratio at $2.00 a day (PPP, %)	6	17	..
Life expectancy at birth (years)	73	73	71
Infant mortality (per 1,000 live births)	26	22	21
Child malnutrition (% of children under 5)	3	4	..
Adult literacy, male (% of ages 15 and older)	81	92	95
Adult literacy, female (% of ages 15 and older)	91	90	93
Gross primary enrollment, male (% of age group)	95	120	112
Gross primary enrollment, female (% of age group)	95	116	109
Access to an improved water source (% of population)	93	91	95
Access to improved sanitation facilities (% of population)	83	78	83





Net Aid Flows	1980	1990	2000	2008 [a]
(US$ millions)				
Net ODA and official aid	125	271	10	26
Top 3 donors (in 2007):				
European Commission	4	7	33	38
Canada	8	28	5	7
Belgium	0	0	0	4
Aid (% of GNI)	5.1	6.5	0.1	0.2
Aid per capita (US$)	59	113	4	10
Long-Term Economic Trends				
Consumer prices (annual % change)	27.3	22.0	8.2	12.3
GDP implicit deflator (annual % change)	18.3	25.1	10.6	*15.1*
Exchange rate (annual average, local per US$)	1.8	7.2	42.7	88.0
Terms of trade index (2000 = 100)	..	..	..	..



	1980	1990	2000	2008	1980–90	1990–2000	2000–08
					(average annual growth %)		
Population, mid-year (millions)	2.1	2.4	2.6	2.7	1.1	0.8	0.5
GDP (US$ millions)	2,679	4,592	9,009	1,037	2.3	1.6	*2.1*
		(% of GDP)					
Agriculture	..	*8.0*	7.0	5.6	2.0	-0.6	-1.3
Industry	..	*37.1*	25.5	23.8	2.4	-0.8	1.1
Manufacturing	..	*17.2*	10.6	9.3	2.7	-1.8	-1.3
Services	..	*54.9*	67.4	70.6	-0.3	3.8	2.5
Household final consumption expenditure	63.8	64.9	74.2	90.7	..	..	..
General gov't final consumption expenditure	20.2	13.0	14.3	15.3	..	..	..
Gross capital formation	15.9	25.9	*29.2*	24.5	..	..	..
Exports of goods and services	51.1	48.1	*39.1*	35.6	..	..	..
Imports of goods and services	51.0	51.9	*51.9*	65.2	..	..	..
Gross savings	10.8	18.5	*23.0*	..			

Note: Figures in italics are for years other than those specified. 2008 data are preliminary. .. indicates data are not available.
a. Aid data are for 2007.

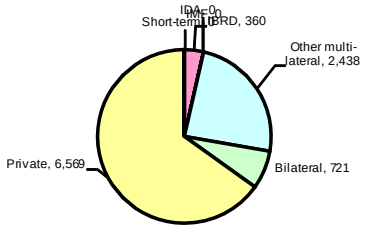
Development Economics, Development Data Group (DECDG).

Balance of Payments and Trade	2000	2008
(US$ millions)		
Total merchandise exports (fob)	1,555	2,311
Total merchandise imports (cif)	3,429	6,792
Net trade in goods and services	-822	-4,481
Current account balance	-356	-2,439
as a % of GDP	-4.0	-18.0
Workers' remittances and compensation of employees (receipts)	892	*2,144*
Reserves, including gold	1,049	1,803

Central Government Finance		
(% of GDP)		
Current revenue (including grants)	25.1	26.6
Tax revenue	22.8	24.2
Current expenditure	24.8	34.0
Overall surplus/deficit	-1.7	-7.3
Highest marginal tax rate (%)		
Individual	25	*25*
Corporate	33	*33*

External Debt and Resource Flows		
(US$ millions)		
Total debt outstanding and disbursed	4,724	14,618
Total debt service	704	1,109
Debt relief (HIPC, MDRI)	–	–
Total debt (% of GDP)	52.4	124.0
Total debt service (% of exports)	18.4	*12.2*
Foreign direct investment (net inflows)	..	..
Portfolio equity (net inflows)	..	..

Composition of total external debt, 2007

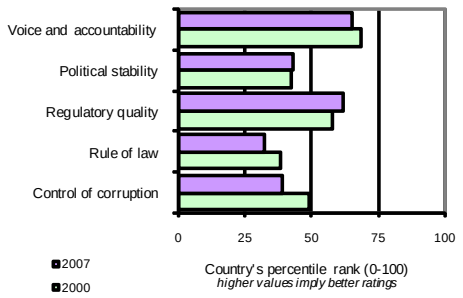


US$ millions

Private Sector Development	2000	2008
Time required to start a business (days)	–	8
Cost to start a business (% of GNI per capita)	–	7.9
Time required to register property (days)	–	54

Ranked as a major constraint to business (% of managers surveyed who agreed)	2000	2007
Access to/cost of financing	..	*72.2*
Tax rates	..	*60.0*
Stock market capitalization (% of GDP)	39.8	95.7
Bank capital to asset ratio (%)	*9.2*	*8.7*

Governance indicators, 2000 and 2007



Source: Kaufmann-Kraay-Mastruzzi, World Bank

Technology and Infrastructure	2000	2007
Paved roads (% of total)	70.1	*73.3*
Fixed line and mobile phone subscribers (per 100 people)	33	114
High technology exports (% of manufactured exports)	0.2	2.3

Environment		
Agricultural land (% of land area)	47	*47*
Forest area (% of land area)	31.5	*31.3*
Nationally protected areas (% of land area)	..	*15.0*
Freshwater resources per capita (cu. meters)	*3,593*	3,514
Freshwater withdrawal (billion cubic meters)	0.4	..
CO2 emissions per capita (mt)	4.0	*3.8*
GDP per unit of energy use (2005 PPP $ per kg of oil equivalent)	3.8	*3.6*
Energy use per capita (kg of oil equivalent)	1,516	*1,724*

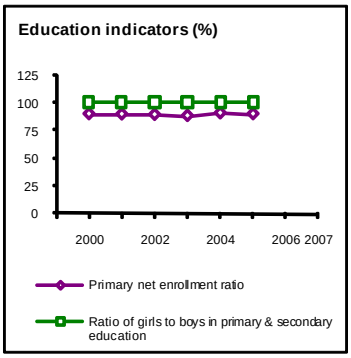
World Bank Group portfolio	2000	2007
(US$ millions)		
IBRD		
Total debt outstanding and disbursed	415	400
Disbursements	98	19
Principal repayments	60	48
Interest payments	22	22
IDA		
Total debt outstanding and disbursed	–	–
Disbursements	–	–
Total debt service	–	–
IFC *(fiscal year)*		
Total disbursed and outstanding portfolio	58	202
of which IFC own account	20	118
Disbursements for IFC own account	0	27
Portfolio sales, prepayments and repayments for IFC own account	5	5
MIGA		
Gross exposure	93	168
New guarantees	0	37

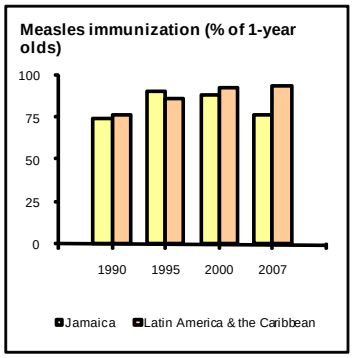
Note: Figures in italics are for years other than those specified. 2008 data are preliminary. 1/19/10
.. indicates data are not available. – indicates observation is not applicable.

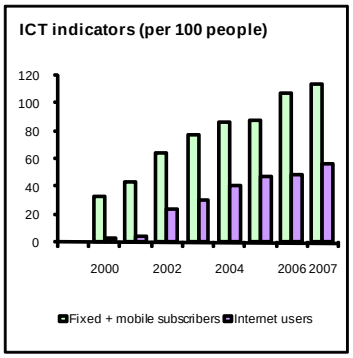
Development Economics, Development Data Group (DECDG).

With selected targets to achieve between 1990 and 2015
(estimate closest to date shown, +/- 2 years)

	Jamaica			
Goal 1: halve the rates for extreme poverty and malnutrition	**1990**	**1995**	**2000**	**2007**
Poverty headcount ratio at $1.25 a day (PPP, % of population)	*<2*	*<2*	*<2*	*<2*
Poverty headcount ratio at national poverty line (% of population)	..	27.5	18.7	..
Share of income or consumption to the poorest qunitile (%)	5.8	*6.4*	*5.4*	*5.2*
Prevalence of malnutrition (% of children under 5)	..	4.0	3.8	*3.1*
Goal 2: ensure that children are able to complete primary schooling				
Primary school enrollment (net, %)	*96*	..	90	*90*
Primary completion rate (% of relevant age group)	91	..	87	*82*
Secondary school enrollment (gross, %)	64	*66*	86	*87*
Youth literacy rate (% of people ages 15-24)	..	..	*92*	94
Goal 3: eliminate gender disparity in education and empower women				
Ratio of girls to boys in primary and secondary education (%)	*102*	..	101	*101*
Women employed in the nonagricultural sector (% of nonagricultural employment)	50	49	47	*48*
Proportion of seats held by women in national parliament (%)	5	*12*	13	13
Goal 4: reduce under-5 mortality by two-thirds				
Under-5 mortality rate (per 1,000)	33	33	32	31
Infant mortality rate (per 1,000 live births)	28	27	27	26
Measles immunization (proportion of one-year olds immunized, %)	74	90	88	76
Goal 5: reduce maternal mortality by three-fourths				
Maternal mortality ratio (modeled estimate, per 100,000 live births)	..	..	..	*170*
Births attended by skilled health staff (% of total)	*79*	*95*	*97*	*97*
Contraceptive prevalence (% of women ages 15-49)	*55*	*66*	*69*	..
Goal 6: halt and begin to reverse the spread of HIV/AIDS and other major diseases				
Prevalence of HIV (% of population ages 15-49)	0.3	0.9	1.4	1.6
Incidence of tuberculosis (per 100,000 people)	7	7	7	7
Tuberculosis cases detected under DOTS (%)	..	*92*	100	83
Goal 7: halve the proportion of people without sustainable access to basic needs				
Access to an improved water source (% of population)	92	93	93	*93*
Access to improved sanitation facilities (% of population)	83	82	83	*83*
Forest area (% of total land area)	31.9	31.7	31.5	*31.3*
Nationally protected areas (% of total land area)	..	..	..	*15.0*
CO2 emissions (metric tons per capita)	3.3	3.9	4.0	*3.8*
GDP per unit of energy use (constant 2005 PPP $ per kg of oil equivalent)	4.2	4.4	3.8	*3.6*
Goal 8: develop a global partnership for development				
Telephone mainlines (per 100 people)	4.4	11.7	19.1	13.6
Mobile phone subscribers (per 100 people)	0.0	1.8	14.2	100.0
Internet users (per 100 people)	0.0	0.1	3.1	56.1
Personal computers (per 100 people)	..	0.5	4.6	*6.8*







Note: Figures in italics are for years other than those specified. .. indicates data are not available. 1/19/10

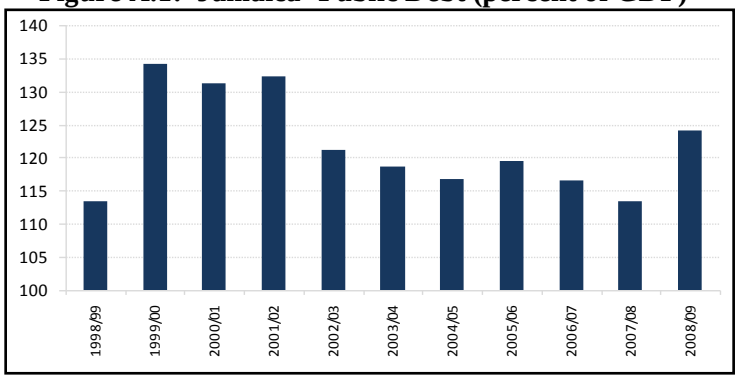
Development Economics, Development Data Group (DECDG).

Annex 5: DEBT SUSTAINABILITY ANALYSIS AND FINANCING REQUIREMENTS

A. Debt Sustainability Analysis

177. **This annex presents a Debt Sustainability Analysis (DSA) conducted using Monte Carlo simulations.** First, a baseline scenario is constructed using the latest projections for the Jamaican economy by the IMF. Several alternative scenarios are constructed to analyze the impact of different shocks on the path of debt to GDP ratio and to understand the sensitivities of the debt dynamics to changes in baseline assumptions. A combined shock scenario is also presented to test the medium term evolution of Jamaica's public debt. We estimate FY2009/2010 figures and project the following ten years. The key assumptions for the baseline scenario are summarized below.

Figure A.1: Jamaica' Public Debt (percent of GDP)



Source: World Bank Staff Calculations

Table A.1: Debt Sustainability Analysis, Key Assumptions.

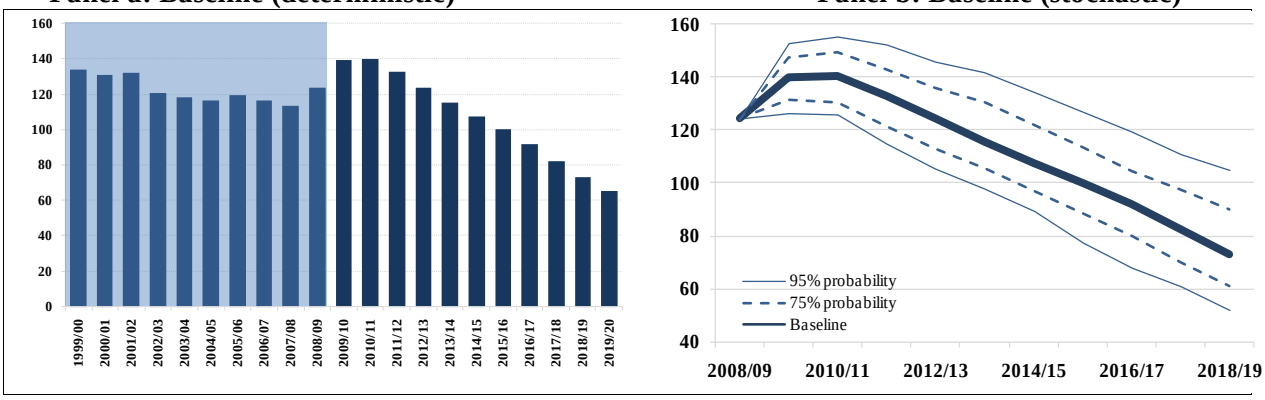
Debt Sustainability Analysis Key Assumptions												
		Est.	Projections									
Fiscal Year	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
Baseline Scenario												
GDP growth (%)	-1.6	-3.5	0.6	1.9	1.9	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Average Nominal Interest Rate (%)	13.5	15.5	12.4	10.9	10.4	10.0	10.0	10.0	10.0	10.0	10.0	10.0
Average Real Interest Rate (%)	-0.6	8.5	1.5	2.6	2.7	2.6	2.6	2.6	2.6	2.6	2.6	2.6
Exchange Rate (end of period, J$/US$)	88.0	89.2	93.9	98.4	102.5	106.3	106.3	106.3	106.3	106.3	106.3	106.3
Exchange Rate (average J$/US$)	76.3	88.8	91.5	96.1	100.4	104.4	104.4	104.4	104.4	104.4	104.4	104.4
Inflation Rate (GDP deflator, %)	14.1	7.0	10.9	8.3	7.7	7.4	7.4	7.4	7.4	7.4	7.4	7.4
Growth of real primary spending	10.1	-2.6	-5.5	-0.8	-1.3	-1.7	-1.7	-1.7	-1.7	-1.7	-1.7	-1.7
Primary Balance (% of GDP)	4.8	6.2	7.0	7.7	8.3	9.1	9.1	9.1	9.1	9.1	9.1	9.1
Treasury Bill Rate (end of period, %)	21.5	14.0	11.0	9.8	11.2	10.7	10.7	10.7	10.7	10.7	10.7	10.7
Treasury Bill Rate (average of period, %)	17.0	17.5	13.1	10.6	10.5	11.0	11.0	11.0	11.0	11.0	11.0	11.0

178. **The baseline scenario assumes fiscal consolidation.** In the baseline, Jamaica is expected to post a 6.2 percent primary surplus in FY2009/10 and to further consolidate the fiscal position in the following four years (8.0 percent primary surplus on average). The key variables are then kept constant, with primary surplus of 9.1 percent of GDP through

FY2019/2020. In the baseline, the debt to GDP ratio is estimated to be 139.7 percent of GDP in FY2009/2010 and peak the following year at 140.2 percent of GDP before decreasing and eventually reaching 115.5 percent of GDP by FY2013/14 and 65.4 percent of GDP by 2019/20. The evolution of the debt to GDP ratio is driven by the assumptions embedded in the baseline scenario. First, a large fiscal consolidation that generates an improvement in the primary balance starting with the base year (2009/10). Second, GDP growth is projected to be higher than its average of 1.5 percent between 2003 and 2008. Third, the real interest rate remains below its level in FY2009/10 throughout the period.

Figure A.2: Jamaica' Public Debt/GDP Ratio

Panel a: Baseline (deterministic) **Panel b: Baseline (stochastic)**



Source: World Bank staff projections

179. **In order to capture uncertainty regarding the evolution of macro variables in the medium run, Monte Carlo simulations based on 20,000 replications were also implemented under the baseline assumptions**. Probability bands were constructed under the assumption of normal, independent and identically distributed shocks with zero mean and standard deviations at their four-year averages for the growth, inflation, and real interest rate variables. The results indicate that with a very high probability, debt ratios will be falling over the medium term. For instance, with 95 percent probability, the debt to GDP ratio will be below 130 percent by FY2013/14 and below 110 percent by FY2019/20.

Table A2: Baseline Scenario - Results

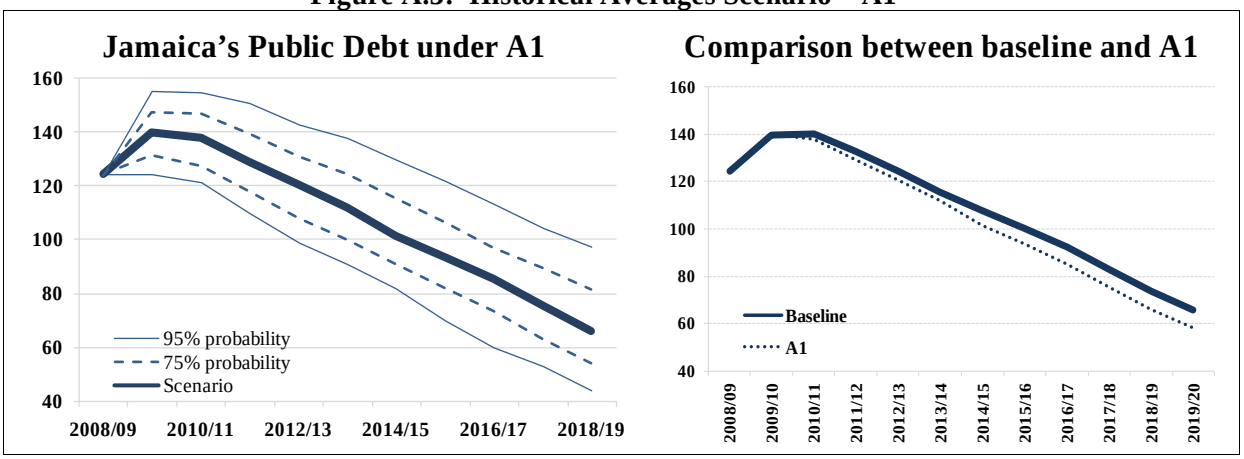
(In percent of GDP)												
		Est.	Projections									
	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
Baseline Scenario												
GDP growth (percent)	-1.6	-3.5	0.6	1.9	1.9	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Inflation (GDP deflator, percent)	14.1	7.0	10.9	8.3	7.7	7.4	7.4	7.4	7.4	7.4	7.4	7.4
Average Real Interest Rate (percen	-0.6	8.5	1.5	2.6	2.7	2.6	2.6	2.6	2.6	2.6	2.6	2.6
Primary Balance	4.8	6.2	7.0	7.7	8.3	9.1	9.1	9.1	9.1	9.1	9.1	9.1
Total Debt	**124.1**	**139.7**	**140.2**	**132.7**	**124.2**	**115.6**	**107.4**	**100.2**	**92.1**	**82.6**	**73.2**	**65.4**
Interest payments	12.2	16.0	13.4	11.2	10.5	9.5	8.9	8.3	7.6	6.8	6.0	5.4

Alternative Scenarios

180. **Additional scenarios were constructed to explore debt sensitivity to key macro variables and to reforms aimed at reducing the overall public debt.** Debt dynamics and sensitivity to key variables are illustrated below. Six additional scenarios and eight sub-scenarios are presented below with comparisons to the baseline scenario**.**

181. **The first alternative scenario (A1) assumes three key variables at their historical (2003-07) averages: the GDP growth rate, the real interest rate, and the primary balance.** This assumption entails a consistent primary surplus of 8.7 percent of GDP for the fiscal years after 2010/11, a GDP growth of 1.8 percent and an average real interest rate of 1.4 percent and is thus more optimistic than the baseline. In this scenario, public debt is estimated to be 139.7 percent at the end of FY2009/10, and decreases steadily during the projected period to reach 111.6 percent of GDP by the end of FY2013/14 and 58.0 percent by the end of FY 2019/20.

Figure A.3: Historical Averages Scenario – A1



Source: World Bank staff projections

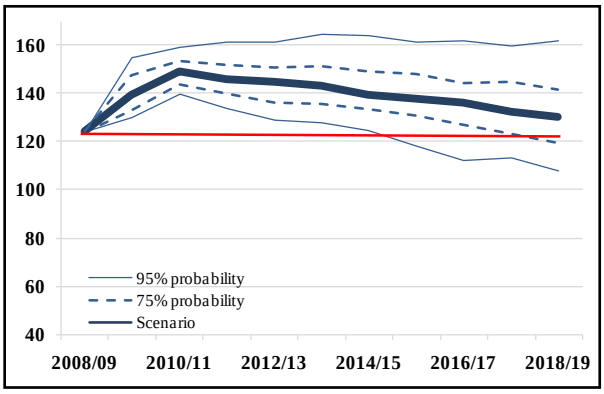
182. **The sensitivity of debt to fiscal assumptions is highlighted by the second alternative scenario (A2).** A2 is divided in two sub-scenarios A2a and A2b. A2a assumes no fiscal reform and thus a smaller primary fiscal surplus of 4.0 percent of GDP, constant in FY2010/11 – FY2019/20. On the other hand, A2b assumes a larger fiscal consolidation than the baseline (constant primary balance of 9.5 percent of GDP in the period FY2010/11 – FY2019/20). Under A2a the debt to GDP ratio would peak in FY2010/11 at 149.3 percent and eventually decrease to 143.0 percent by FY2013/14. However, as shown by Figure A4, the debt to GDP ratio is higher than its initial level even at the end of FY2019/20. A2b is the most favorable scenario for debt dynamics. Under A2b the debt to GDP ratio is projected to decrease in every year and reach 52.9 percent by the end of the considered period. The results highlight the importance of maintaining a sizeable primary budget surplus for reducing the debt to GDP ratio over the medium term.

183. **Jamaica's public debt is highly sensitive to exchange rate dynamics.** This is explored in the third alternative scenario (A3). This scenario includes two sub-scenarios according to the type of exchange rate shock. The first sub-scenario (A3a) assumes a 30% depreciation in FY2010/11 while the second sub-scenario (A3b) assumes a constant 10% depreciation in each FY of the considered period. In both sub-scenarios the debt to GDP ratio would peak in

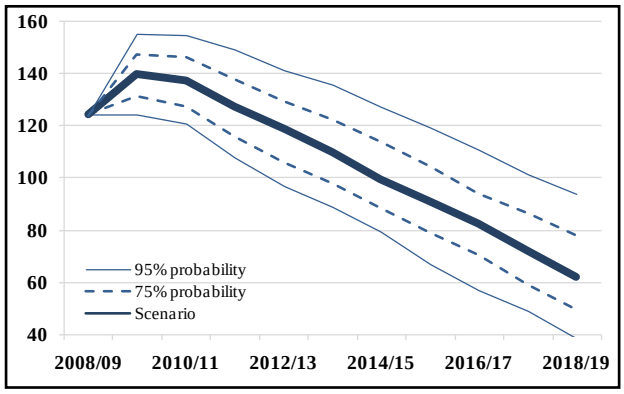
FY2010/11 at much higher levels than the baseline (182.2 percent under A3a and 160.8 percent under A3b) but in both cases it is projected to decline over the entire period given the large primary surplus and the positive rate of growth assumed in the baseline scenario.

Figure A.4: Alternative Fiscal Scenarios – A2a and b

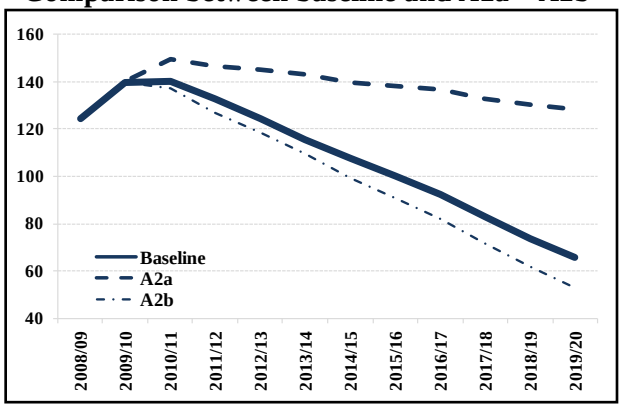
Jamaica's Public Debt under A2a



Jamaica's Public Debt under A2b



Comparison between baseline and A2a – A2b



Source: World Bank staff projections

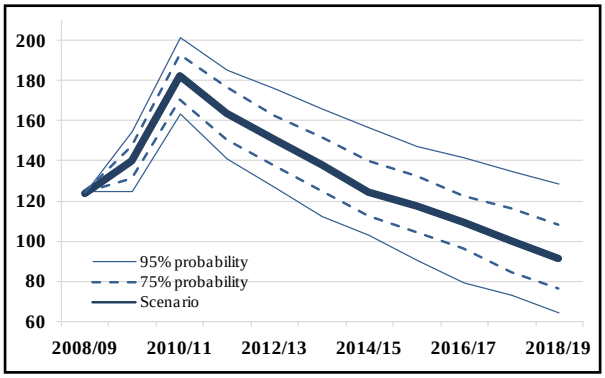
184. **The sensitivity of Jamaican public debt to exchange rate movements is a direct consequence of its composition.** As of January 2010, roughly 50 percent of the total public debt is denominated in foreign currency. The great majority (84.5 percent) of domestic debt is denominated in local currency while the rest is either indexed to US$ (4.1 percent), issued in US$ (11.4 percent), or in Euro (0.1 percent). The external debt is mostly in US$ (77.56 percent), with the rest in Euro (17.84 percent), Yen (2.45 percent), GBP (0.34 percent), and other currencies (1.81 percent). Jamaica has 11 outstanding bonds issued on international markets, all of them with a fixed coupon. Figure A6 summarizes the characteristics of Jamaica's external debt.

185. **The public debt dynamics of Jamaica are also sensitive to shocks to GDP growth.** This is explored in the fourth alternative scenario (A4) which assumes a negative (-0.6 percent) rate of growth in FY2010/11 (A4a) and a more pessimistic growth (1 percent less than the baseline) for the entire period FY2010/11 – FY2013/2014 (A4b). Under A4a and A4b the debt to GDP ratio is projected to peak at (respectively) 145.8 percent and 141.8 percent before

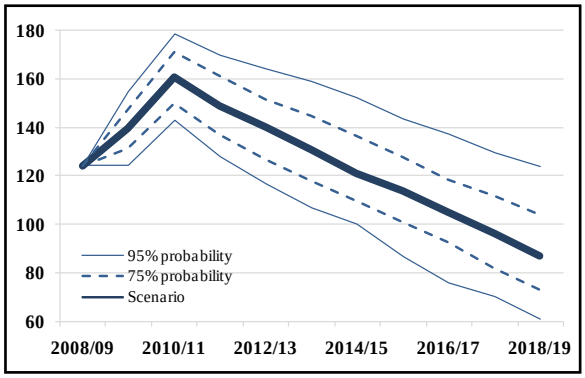
eventually decreasing to 70.8 percent and 82.1 percent at the end of FY2019/20.

Figure A.5: Impact on Public Debt of Exchange Rate

Jamaica's Public Debt under A3a



Jamaica's Public Debt under A3b



Comparison between baseline and A3a – A3b

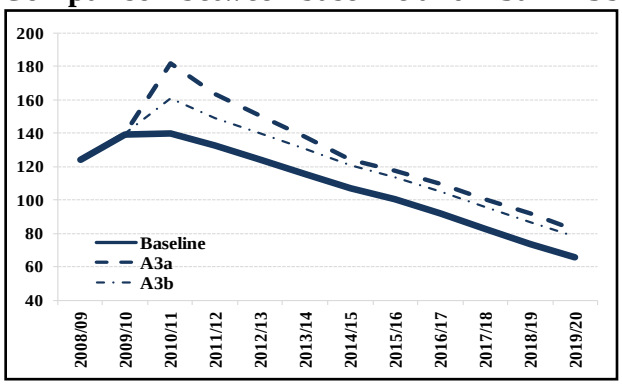


Figure A.6a: Jamaica's Public Debt by Currency Denomination

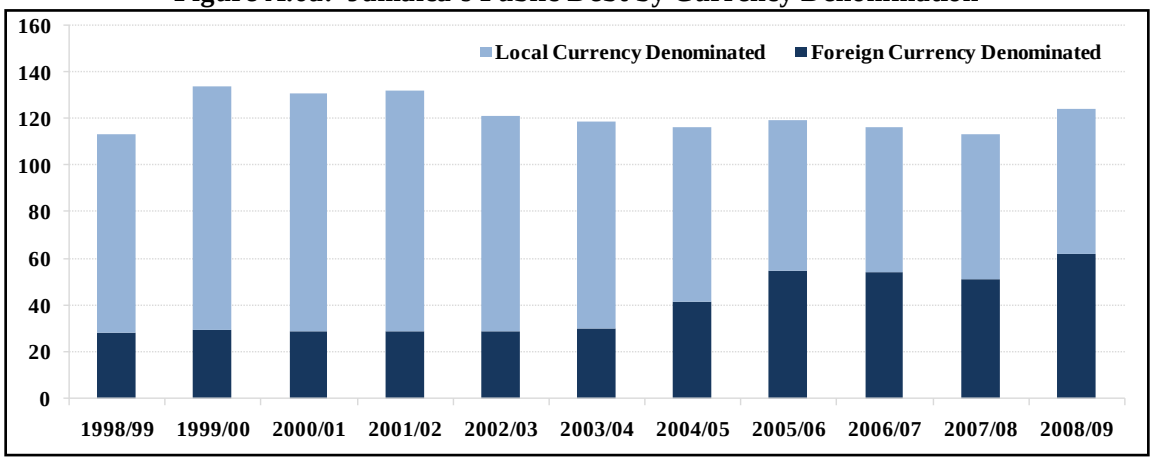
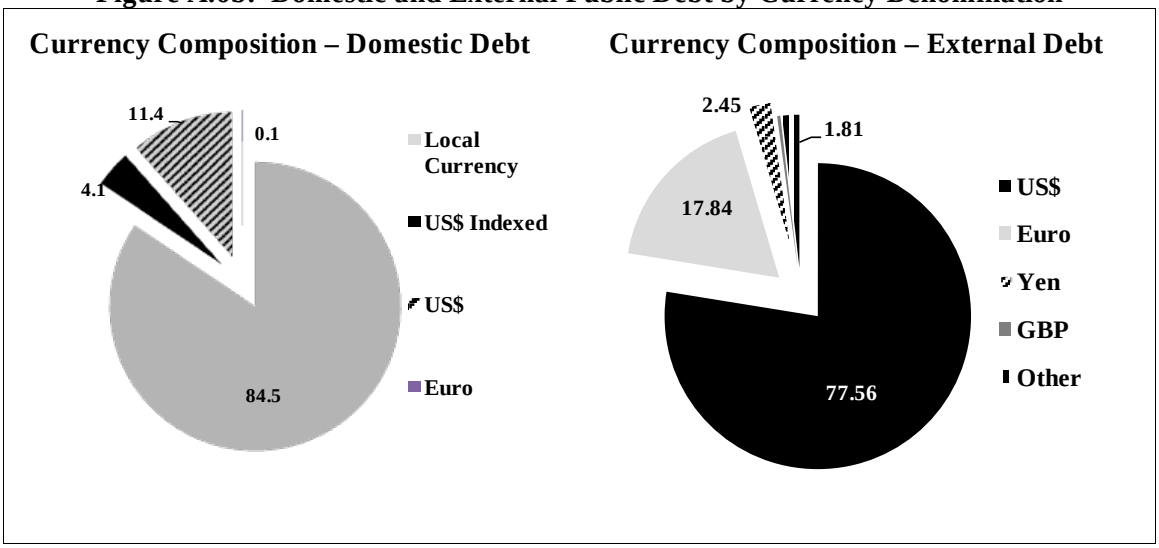


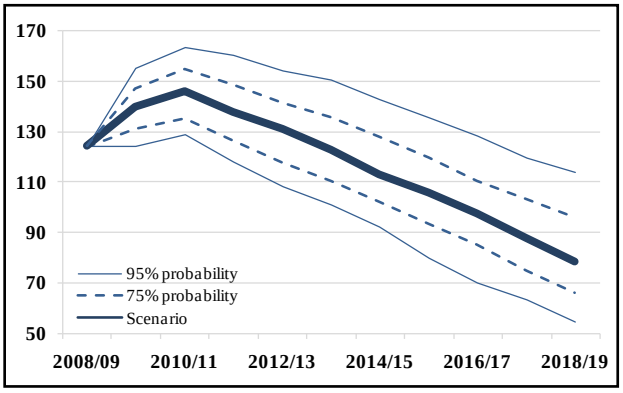
Figure A.6b: Domestic and External Public Debt by Currency Denomination



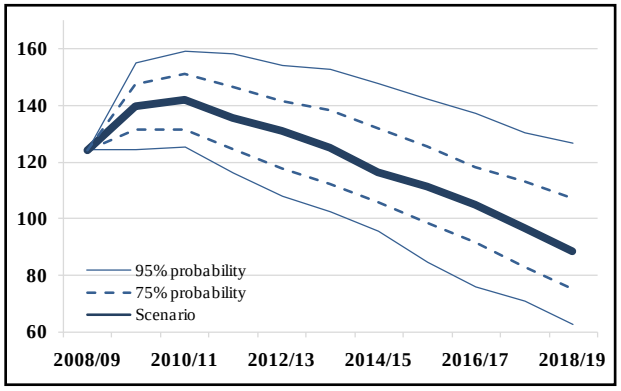
186. **Jamaica's public debt shows a lower degree of sensitivity to the interest rate.** In the fifth alternative scenario (A5) we shock the interest rate in FY2010/11 (2 standard deviations). The debt to GDP ratio remains close to the baseline scenario and decreases to 73.4 percent by the end of FY2019/20.

Figure A.7: Impact on Public Debt of GDP Growth

Jamaica's Public Debt under A4a



Jamaica's Public Debt under A4b



Comparison between baseline and A4a – A4b

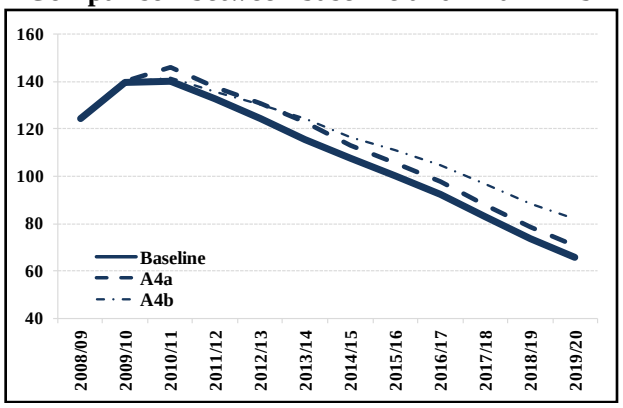
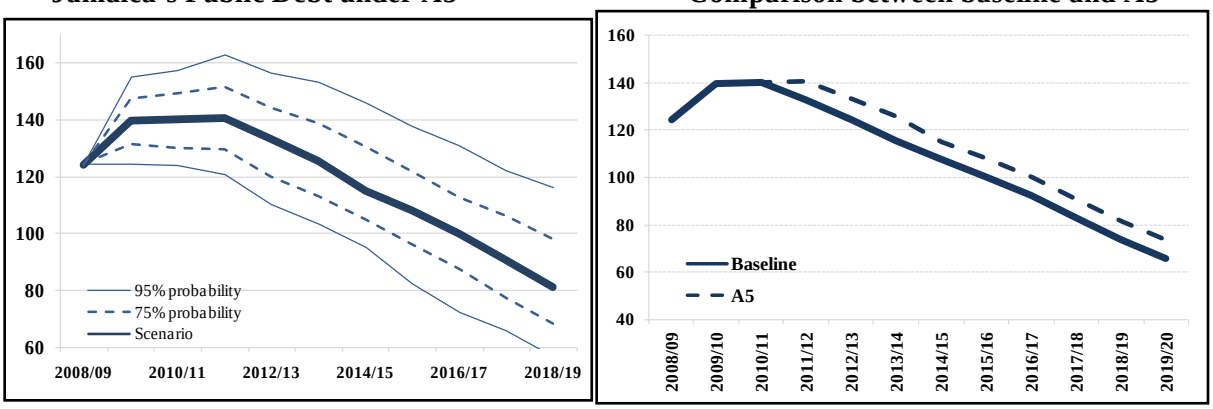


Figure A.8: Impact on Public Debt of Interest Rate Shocks

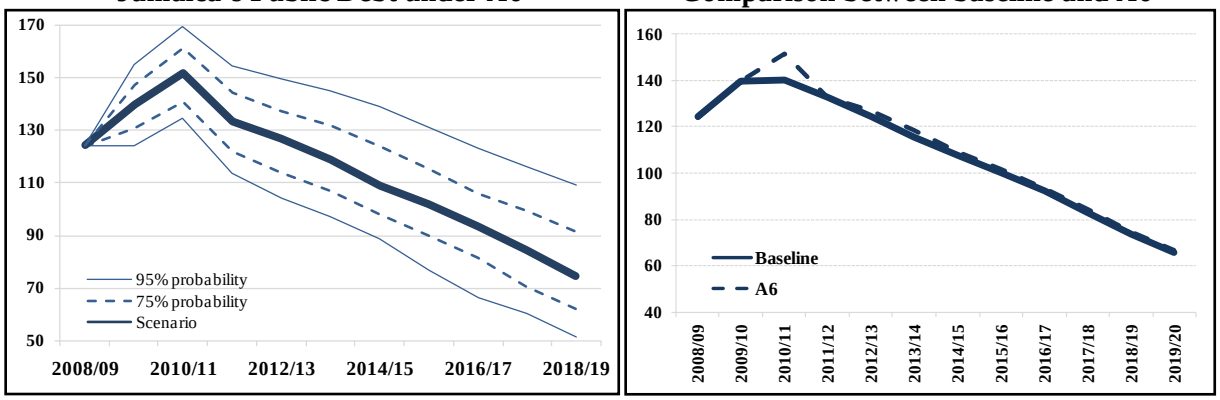
Jamaica's Public Debt under A5 **Comparison between baseline and A5**



187. **In the last alternative scenario (A6) we combine a one-time depreciation (10% depreciation in FY2010/11) with a small negative shock to growth of -0.4 percent in FY2010/11.** The effects are substantial with the debt to GDP ratio exceeding 151.0 percent in FY2010/11 before eventually decreasing to 118.7 percent in FY2013/14 and to 66.7 percent by the end of FY2019/20.

Figure A.9: Combined Shock

Jamaica's Public Debt under A6 **Comparison between baseline and A6**



188. **The composition and structure of public debt in Jamaica are important indicators of debt sustainability.** The proportion of public debt denominated in local currency has declined from 78.1 percent of GDP in FY2001/02 to 49.69 percent of GDP in FY2008/09 as shown in Figure A6a. Most of foreign currency denominated debt is in US$ while a large proportion of the remainder is in Euro.

Table A.3: Summary of Results

Debt Sustainability Analysis - Results
(In percent of GDP)

	Est.		Projections									
	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
Baseline Scenario												
GDP growth (percent)	-1.6	-3.5	0.6	1.9	1.9	2.0	2.0	2.0	2.0	2.0	2.0	2.0
Inflation (GDP deflator, percent)	14.1	7.0	10.9	8.3	7.7	7.4	7.4	7.4	7.4	7.4	7.4	7.4
Average Real Interest Rate (percen	-0.6	8.5	1.5	2.6	2.7	2.6	2.6	2.6	2.6	2.6	2.6	2.6
Primary Balance	4.8	6.2	7.0	7.7	8.3	9.1	9.1	9.1	9.1	9.1	9.1	9.1
Total Debt	**124.1**	**139.7**	**140.2**	**132.7**	**124.2**	**115.6**	**107.4**	**100.2**	**92.1**	**82.6**	**73.2**	**65.4**
Interest payments	12.2	16.0	13.4	11.2	10.5	9.5	8.9	8.3	7.6	6.8	6.0	5.4
Alternative 1: Variables at historical average												
Total Debt	**124.1**	**139.7**	**137.6**	**128.8**	**120.3**	**111.6**	**101.3**	**93.5**	**85.1**	**75.3**	**65.8**	**58.0**
Interest payments	12.2	16.0	13.1	10.9	10.2	9.2	8.3	7.7	7.0	6.2	5.4	4.8
Alternative 2: Fiscal Shock												
2a: NO fiscal reform												
Total Debt	**124.1**	**139.7**	**149.3**	**146.3**	**145.0**	**143.0**	**139.6**	**137.9**	**136.3**	**132.3**	**130.1**	**127.9**
Interest payments	12.2	16.0	14.2	12.4	12.3	11.8	11.5	11.4	11.2	10.9	10.7	10.5
2b: Fiscal consolidation												
Total Debt	**124.1**	**139.7**	**137.3**	**127.1**	**118.6**	**109.8**	**99.1**	**90.9**	**82.0**	**71.7**	**61.8**	**52.9**
Interest payments	12.2	16.0	13.1	10.7	10.1	9.1	8.2	7.5	6.8	5.9	5.1	4.4
Alternative 3: Shock to Exchange Rate												
3a: 30% depreciation in FY 2010/2011												
Total Debt	**124.1**	**139.7**	**182.2**	**163.8**	**150.4**	**137.8**	**124.4**	**117.7**	**109.3**	**100.5**	**91.5**	**81.9**
Interest payments	12.2	16.0	17.4	13.8	12.8	11.4	10.3	9.7	9.0	8.3	7.5	6.8
3b: 10% depreciation in FY 2010 - 2020												
Total Debt	**124.1**	**139.7**	**160.8**	**149.0**	**140.0**	**130.8**	**120.9**	**113.8**	**105.0**	**96.0**	**86.9**	**78.4**
Interest payments	12.2	16.0	15.3	12.6	11.9	10.8	10.0	9.4	8.7	7.9	7.2	6.5
Alternative 4: Shock to Growth												
4a: Negative Shock in FY2010/2011												
Total Debt	**124.1**	**139.7**	**145.8**	**137.6**	**130.8**	**122.8**	**112.9**	**105.7**	**97.8**	**88.0**	**78.6**	**70.8**
Interest payments	12.2	16.0	13.9	11.6	11.1	10.1	9.3	8.7	8.1	7.3	6.5	5.8
4b: Negative Shock in FY 2010 - 2020												
Total Debt	**124.1**	**139.7**	**141.8**	**135.6**	**130.7**	**124.7**	**116.4**	**111.2**	**104.8**	**96.7**	**88.5**	**82.1**
Interest payments	12.2	16.0	13.5	11.5	11.1	10.3	9.6	9.2	8.6	8.0	7.3	6.8
Alternative 5: Shock to Interest Rate in FY2010/11												
Total Debt	**124.1**	**139.7**	**140.3**	**140.7**	**133.3**	**125.7**	**115.1**	**108.2**	**100.0**	**90.9**	**81.1**	**73.4**
Interest payments	12.2	16.0	13.4	11.9	11.3	10.4	9.5	8.9	8.2	7.5	6.7	6.0
Alternative 6: Combination of Recession and Depreciation												
Total Debt	**124.1**	**139.7**	**151.6**	**133.0**	**126.8**	**118.7**	**109.0**	**101.8**	**93.3**	**84.3**	**74.6**	**66.7**
Interest payments	12.2	16.0	14.5	11.2	10.8	9.8	9.0	8.4	7.7	7.0	6.1	5.5

B. Financing Requirements

189. **The gross financing needs of Jamaica are estimated to increase in FY2009/10 and reach 19.8 percent of GDP, equivalent to US$2.39 billion.** The increase is due to an increase in interest payments (from 12.2 percent of GDP in FY2008/09 to 16.0 percent of GDP in FY2009/10) while principal repayments are estimated to decrease to 9.9 percent of GDP (from 10.2 percent in FY2008/09).

190. **External financing requirements are projected to be covered mainly by multilateral financing.** The largest inflows are projected to be from the IMF's front-loaded SBA of US$1.25 billion, of which 650 million is to be disbursed in FY2009/10.

191. **The debt maturity profile presents challenges to debt management.** As shown in Table B2 and Figure B1, out of J$735.6 billion of domestic debt, more than J$200 billion will mature within the next 12 months. More specifically J$14.6 billion will mature between February and March 2010, while J$208.9 billion (representing 29.8 percent of total domestic debt) will mature in FY2010/11. Less concern is raised by external debt since only 0.6 percent (US$38.9 million) of total external debt will mature within the next twelve months.

Table B.1: Gross Financing Needs

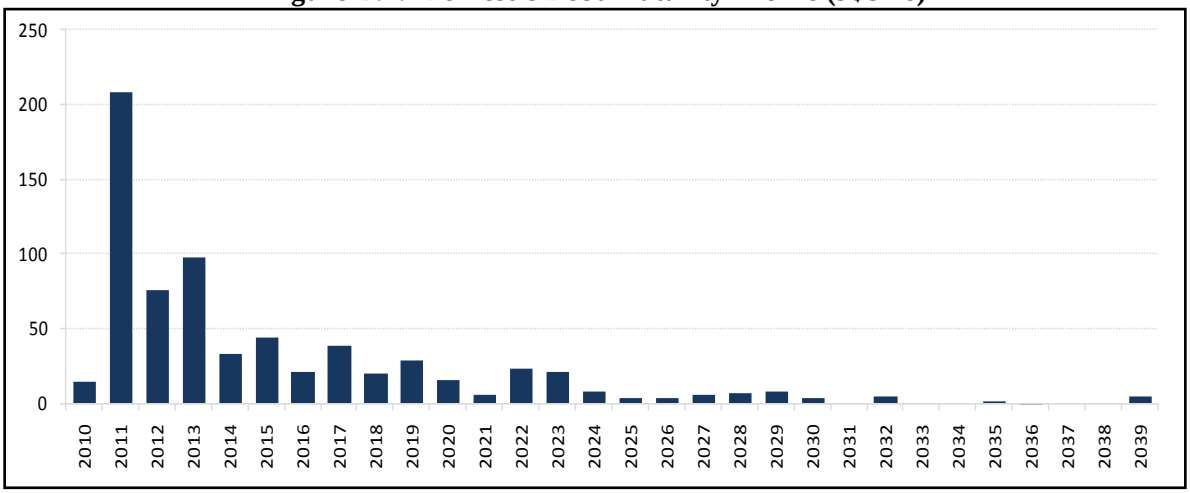
					Est.	Projections			
	2005/06	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
Principal Repayments	**19.6**	**20.2**	**10.7**	**10.2**	**9.9**	**12.2**	**13.3**	**23.1**	**21.8**
of which external	4.6	7.3	3.3	3.0	2.2	1.7	4.9	4.3	4.1
of which domestic	15.0	12.9	7.5	7.2	7.6	10.5	8.4	18.8	17.8
in billions of US$	2.22	2.49	1.42	1.39	1.19	1.59	1.82	3.33	3.31
in billions of J$	140	165	99	106	105	146	175	334	345
Interest Payments	**13.2**	**11.9**	**11.6**	**12.2**	**16.0**	**13.4**	**11.2**	**10.5**	**9.5**
of which external	3.2	3.3	3.4	3.5	3.6	3.2	1.9	2.1	2.3
of which domestic	10.0	8.6	8.1	8.7	12.4	10.2	9.3	8.4	7.3
in billions of US$	1.49	1.46	1.53	1.65	1.93	1.75	1.54	1.52	1.44
in billions of J$	94	97	107	126	171	160	148	152	151
Gross financing need 1/	**22.9**	**25.0**	**14.5**	**17.5**	**19.8**	**18.7**	**17.5**	**25.7**	**22.5**
in billions of US$	2.59	3.08	1.92	2.38	2.39	2.44	2.40	3.70	3.41
in billions of J$	164	204	134	182	212	223	231	371	356
Total Debt	**119.9**	**116.5**	**113.5**	**124.1**	**139.7**	**140.2**	**132.7**	**124.2**	**115.6**
in billions of US$	13.5	14.3	15.0	16.9	16.8	18.3	18.2	17.9	17.5
in billions of J$	856	950	1047	1286	1496	1674	1748	1794	1828
Memorandum									
Nominal GDP (in billions of J$)	714	815	923	1,037	1,071	1,194	1,317	1,445	1,582
GDP (in billions of US$)	11.3	12.3	13.2	13.6	12.1	13.1	13.7	14.4	15.2
Exchange rate (end of period, in J$/US$)	65.3	67.6	70.8	88.0	89.2	93.9	98.4	102.5	106.3
Primary fiscal balance	9.9	7.0	7.8	4.8	6.2	7.0	7.7	8.3	9.1
Current account balance	-10.5	-9.7	-18.4	-18.0	-9.4	-8.8	-6.6	-5.9	-5.0

1/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

Table B.2: External financing and IFIs

Estimated Financing Requirements	**2009/10**	**2010/11**	**2011/12**
Current account	-1,129	-1,142	-906
Capital and Financial Account	867	842	1,153
(includes net inflows from IFIs except IMF)			
IMF	650	400	200
Change in reserves	387	100	447
Financing gap	0	0	0
(IFIs)	1,335	785	317
IMF	650	400	200
IDB	400	150	50
World Bank	200	200	0
Others (includes CDB)	85	35	30

Figure B.1: Domestic Debt Maturity Profile (J$blns)



Source: World Bank staff calculations

Table B.3: Jamaica's Public Debt Maturity Profile (as of December 2009)

Domestic Debt Maturity Structure (J$ mn)

	Up to 1 Year	1 - 5 years	5 - 10 Years	> 10 Years	Total
Local Registered Stocks	19,724.4	79,601.7	44,105.2	40,491.1	183,922.4
Treasury Bills	3,806.0	0.0	0.0	0.0	3,806.0
Land Bonds	0.0	0.0	0.0	352.6	352.6
Debentures	128,600.1	206,170.5	61,144.6	31,613.5	427,528.7
US $ Indexed Bonds	15,377.7	14,656.5	0.0	0.0	30,034.1
US$ Denominated Bonds	37,929.8	31,767.8	13,183.5	895.9	83,777.1
Euro Denominated Bonds	0.0	514.9	0.0	0.0	514.9
Commercial Bank & Public Sector Entity Loans	742.2	2,730.8	2,100.0	103.1	5,676.1
Other	0.0	0.0	0.0	0.2	0.2
Total	**206,180.2**	**335,442.1**	**120,533.4**	**73,456.3**	**735,612.0**
Percentage	28.0	45.6	16.4	10.0	100.0

External Debt Maturity Structure (US$ mn)

	Up to 1 Year	1 - 5 years	5 - 10 Years	> 10 Years	Total
Bilateral	12.4	158.5	228.0	623.9	1,022.8
Multilateral	15.8	402.6	348.7	659.2	1,426.3
IDB	6.5	205.6	87.6	358.7	658.4
IBRD	7.1	31.8	229.0	114.0	381.9
Other	2.2	165.1	32.1	186.5	386.0
Commercial Bank	3.5	55.8	252.6	0.0	311.9
Other Commercial	7.2	7.4	29.3	0.0	43.9
Bonds	0.0	700.3	1,246.6	1,925.0	3,871.9
Total	**38.9**	**1,324.6**	**2,105.2**	**3,208.2**	**6,676.7**
Percentage	**0.6**	**19.8**	**31.5**	**48.0**	**100.0**

Source: National Authorities

Annex 6: SUMMARY OF NEW AND REVISED TAX REVENUE MEASURES

192. **In an effort to broaden the tax base, increase the uniformity of the tax system, and boost fiscal revenues, the Government of Jamaica introduced three sets of amendments to existing tax measures during the current fiscal year.** The proposed measures span a range of tax instruments and include significant changes to the rates and structure of income taxes, general and specific consumption taxes, license fees, customs exemptions, and import tariffs (Table C1).

193. **The first package, introduced in April 2009, lowered income tax thresholds while simultaneously removing some income tax preferences, broadened the GCT base, imposed a tax on dividends, and increased the specific tax on petrol and petroleum products.** The revised GCT listings were published in a separate communication from the Ministry four days after the announcement of the revenue measures. The combined revenue impact of the new measures was estimated by the Ministry of Finance to surpass J$18 billion. The most important of these—accounting for nearly three quarters of the total—was the imposition of an additional tax of J$8.75 per liter of petrol, which was the first increase in the fuel tax in ten years. At the same time, a number of items in this package were expected to have negative consequences for revenue. For example, the increase in the general income tax threshold as well as the income tax threshold for pensioners was estimated to result in the narrowing of the tax base by 136,500 individuals. Similarly, a reduction in stamp duty and transfer taxes—designed to stimulate the real estate market—was estimated to reduce revenues by J$644 million.

194. **In May 2009, the GoJ revised the first package measures by re-introducing some of the GCT exemptions and offsetting the revenue impact by increasing and restructuring the SCT on cigarettes and alcohol.** The list of items which were awarded exempt status included printed matter, salt, rolled oats, syrup, soups, motor spirit, and lubricating oils for commercial fishing. The harmonization and increase in the SCT rate for alcohol and the increase in the SCT rate for cigarettes were estimated to more than compensate for the revenue loss associated with putting the above sensitive items back on the exclusion list. Furthermore, 20 percent of the additional revenues expected from the increase of the SCT on cigarettes were designated to be remitted to the National Health Fund.

195. **The second package, introduced in September 2009, increased the departure tax for tourists and the GCT rate on telephone calls and instruments.** The departure tax, which has remained unchanged since July 1999, was increased from J$1,000 to J$1,800 to reflect the depreciation of the Jamaican dollar vs. the US dollar since that time. Thus, the departure tax was restored to its original value of approximately US$20. The increase in the GCT rate on telephone equipment follows the introduction of the first package of tax reforms (April 23, 2009), which removed this category from the GCT exemption list.

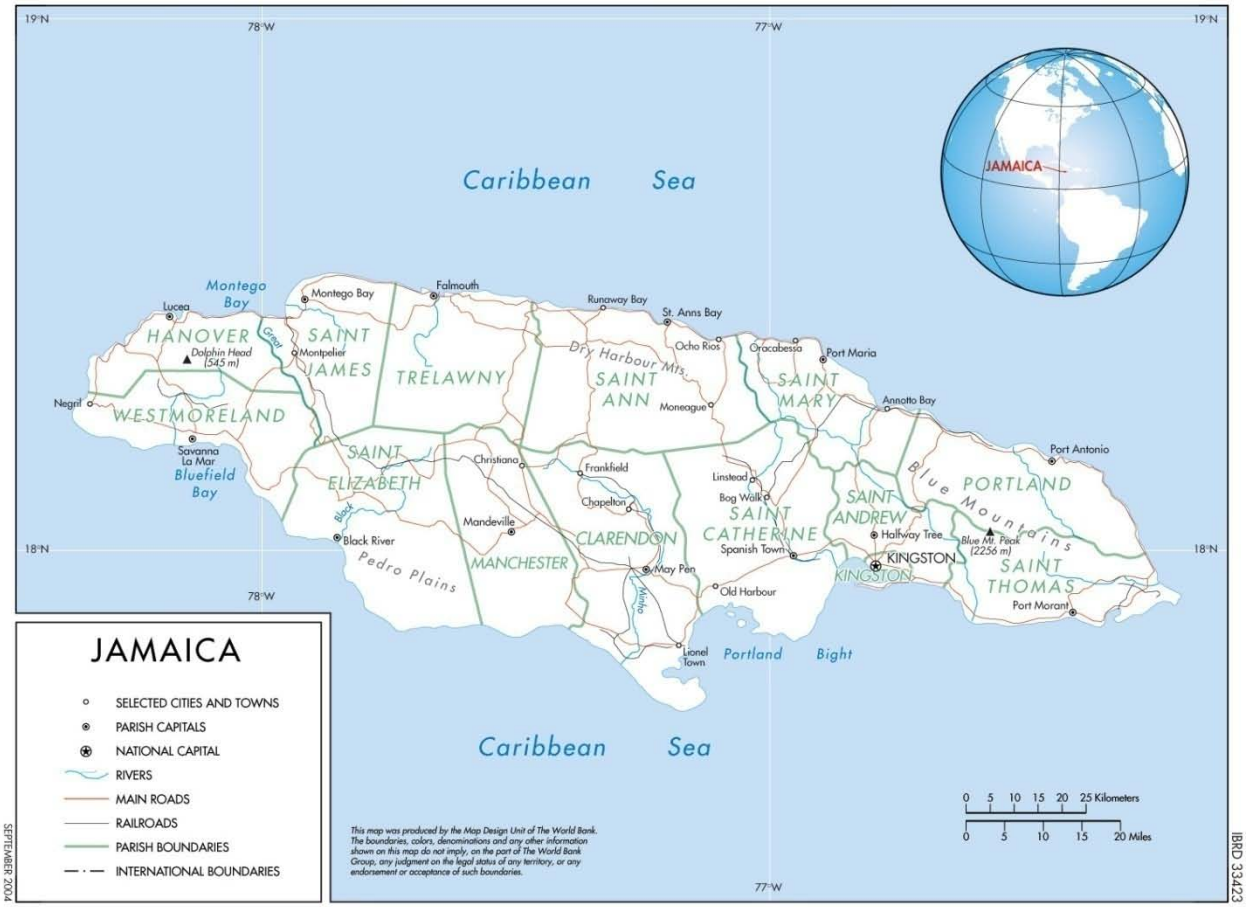
196. **The third and final package, introduced on December 17 and revised on December 23, implemented a number of measures including increases in GCT and SCT rates, broadening the GCT to include the supply of electricity, increases in income tax rates for high earners, removal of customs exemption, and increases in license fees and customs duties for certain luxury items, including vehicles.** More than half of the estimated revenue impact of these measures—valued at nearly J$22 million, or 2 percent of GDP in 2009—is expected to come from the increase in the standard rate of the GCT from 16.5 percent to 17.5

percent and the re-introduction of the ad valorem component of the SCT on fuel (15 percent). Other measures include further increases in taxes on cigarettes and the tourism sector, higher income taxes for individuals earning more than J$5 million annually, higher license fees for motor vehicles with engine size of three liters or more, and substantial increases in the Common External Tariff (CET) on flat screen televisions over 30 inches, large motorcycles, guns, pleasure boats, and jewelry.

Table C.1: Revenue measures introduced during the FY2009/10

Date introduced	Description of revenue measures	Expected revenue impact (J$ million)
April 23, 2009 (Ministry Paper 26/09)	Increase in income tax threshold	-5,330
	Removal of income tax preferences	1,200
	Reduction in stamp duty and transfer tax rates	-644
	Imposition of GCT on telephone instruments	736
	Removal of GCT exemptions	7,500
	Increase of SCT on petrol and CUF on petroleum products	13,328
	Imposition of withholding tax on dividends for non-residents	1,341
	Total expected revenue impact	**18,131**
May 6, 2009 (Ministry Paper 42/09)	Increase of SCT on cigarettes	1,840
	Increase of SCT on alcoholic beverages	530
	Total expected revenue impact	**2,370**
September 29, 2009 (Ministry Paper 107/09)	Increase of departure tax	609
	Increase of GCT on telephone calls and telephone instruments	1,100
	Total expected revenue impact	**1,709**
December 23, 2009 (Ministry Paper 128/09, revised)	Increase in the standard rate of GCT	3,600
	Re-introduction of the ad valorem component of the SCT	9,400
	Increase in SCT on cigarettes	1,400
	Increase in the rate of GCT applicable to the Tourism Sector	1,200
	Electricity for commercial and industrial customers	1,453
	Pre-payment of GCT on value added merchandise at customs	2,900
	Increase in income tax for high income earners	1,317
	Increase in license fees for luxury vehicles	32
	Removal of certain customs exemptions	25
	Increase in Common External Tariff rate on luxury items	485
	Total expected revenue impact*	**21,812**

Note: GCT stands for General Consumption Tax, SCT for Special Consumption Tax, and CUF for Customs User Fees. For the first three sets of measures, estimated revenue impacts are provided for FY2009/10; for the last set, revenue impacts are annual estimates.
Source: Jamaica Ministry of Finance.


JAMAICA
Caribbean Sea
Caribbean Sea
Montego Bay
Lucea
HANOVER
Dolphin Head (545 m)
Great
Montpelier
SAINT JAMES
Montego Bay
Falmouth
TRELAWNY
Runaway Bay
St. Anns Bay
Ocho Rios
Dry Harbour Mts.
SAINT ANN
Moneague
Oracabessa
Port Maria
SAINT MARY
Annotto Bay
Negril
WESTMORELAND
Savanna La Mar
Bluefield Bay
SAINT ELIZABETH
Black
Black River
Pedro Plains
Christiana
Mandeville
MANCHESTER
Frankfield
Chapelton
CLARENDON
May Pen
Minho
Linstead
Bog Walk
SAINT CATHERINE
Spanish Town
Old Harbour
Lionel Town
Portland Bight
SAINT ANDREW
Halfway Tree
KINGSTON
KINGSTON
Blue Mt. Peak (2256 m)
Blue Mountains
PORTLAND
Port Antonio
SAINT THOMAS
Port Morant
19°N
78°W
77°W
18°N
JAMAICA
SELECTED CITIES AND TOWNS
PARISH CAPITALS
NATIONAL CAPITAL
RIVERS
MAIN ROADS
RAILROADS
PARISH BOUNDARIES
INTERNATIONAL BOUNDARIES
0 5 10 15 20 25 Kilometers
0 5 10 15 20 Miles
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