PROGRAM INFORMATION DOCUMENT (PID)
APPRAISAL STAGE

January 21, 2017
Report No.: 112224

Operation Name	Second Competitiveness and Fiscal Management Programmatic Development Policy Financing
Region	Latin America and Caribbean
Country	Jamaica
Sector	Central government administration (100%)
Operation ID	P158637
Lending Instrument	Policy-Based Guarantee
Borrower(s)	Government of Jamaica
Implementing Agency	Ministry of Finance and the Public Service
Date PID Prepared	January 21, 2017
Estimated Date of Appraisal	January 24, 2017
Estimated Date of Board Approval	February 28, 2017
Corporate Review Decision	Following the corporate review, the decision was taken to proceed with the preparation of the operation.

I. Country and Sector Background

1. **Jamaica has experienced uneven growth and high public debt for almost three decades.** Natural disasters and adverse external shocks, coupled with weak fiscal discipline and the materialization of contingent fiscal liabilities, resulted in persistent fiscal deficits that have kept public debt above 100 per cent of GDP for the past fifteen years. Jamaica's sizeable debt burden has depressed investor sentiment and crowded out private sector investment needed for job creation and economic growth. High debt service obligations have limited the government's fiscal space for spending on poverty reduction and public goods.

2. **Jamaica launched far-reaching economic reforms in 2013 to establish macroeconomic stability and pave the way for faster and more inclusive growth.** The country was on the brink of crisis in February 2013. It was suffering the after-effects of Hurricane Sandy, five quarters of GDP contraction, rapid currency depreciation, and dwindling international reserves. There were doubts about the government's capacity to make large upcoming debt service obligations. To avert this crisis, the government embarked on a course of fiscal consolidation backed up by reforms to improve macroeconomic policy-making institutions and the investment climate. The International Monetary Fund (IMF), World Bank, and Inter-American Development Bank (IDB) approved a large package of financial support for Jamaica, committing almost US$2 billion in combined financing (including this DPF series), anchored on a four-year IMF Extended Fund Facility (EFF) program. The EFF focused on debt restructuring, fiscal consolidation and financial sector reforms. The IDB has focused on tax reform, including the legislation to reform the incentive system. The World Bank has been supporting structural and institutional reforms to lay the foundations for future growth, enhance competitiveness, social protection and resilience, and improve public sector management. The World Bank and IDB are coordinating their assistance in the different sectoral areas to ensure complementarity and consistency.

3. **Reforms have succeeded in stabilizing the economy and reducing debt.** Quarterly GDP growth rates have been positive since late-2013, and debt has dropped by 25 percentage points of GDP since the start of reforms. But with debt at 120 percent of GDP, Jamaica continues to suffer from one of

the largest debt overhangs in the world, and real GDP in 2016 is still 2 percent below its 2007 level. The new government elected in February 2016 is reorienting the reform program towards faster growth, while preserving a commitment to fiscal prudence. These priorities are reflected in the precautionary program under the Stand-by Arrangement (SBA) that the IMF approved in November 2016.

4. This proposed Development Policy Financing (DPF) operation supports reforms aimed at removing impediments to economic growth and debt sustainability. The operation is part of a broader package of multilateral support provided by the IMF and the Inter-American Development Bank.

II. Operation Objectives

5. **The development objectives of the proposed operation are to support the Government of Jamaica's (GOJ's) policies aimed at (i) improving investment climate and competitiveness and (ii) sustaining fiscal consolidation and enhancing public financial management.** The first pillar of the proposed operation supports increased economic growth by reducing regulatory compliance costs associated with commercial development projects, reducing electricity costs and diversify sources of supply towards those that emit less greenhouse gasses, and helping to establish Jamaica as an international logistics hub. The second pillar focuses on strengthening the fiscal position by improving budget and debt management procedures, reforming the public sector pension scheme, and stronger public investment management systems. Both pillars build on the government's own agenda for facilitating growth and reducing debt. The two pillars are mutually reinforcing. Even with significant progress on improving competitiveness, investor confidence will not return without sustained progress on fiscal consolidation. Not only would this help reduce public debt to a sustainable level, it would also send a signal of reform commitment to investors.

III. Rationale for Bank Involvement

6. **The government has demonstrated a track record of reform.** Since 2013 the government has pursued reforms that have succeeded in cutting debt and establishing conditions for economic growth. Fiscal consolidation, reinforced by a strengthened fiscal responsibility framework, has been the centerpiece of the economic reform program. Through these measures the government is addressing the unsustainable fiscal policies and debt accumulation that historically have been the main sources of macroeconomic vulnerability. The government has reduced its debt/GDP ratio by 25 percentage points—an unparalleled accomplishment. The new fiscal responsibility framework requires the government to continue maintaining high primary fiscal surpluses to bring public debt below 100 percent of GDP by 2020 and to a long-term level of 60 percent by 2026.

7. **The government's development program is receiving strong financial and technical support from multilaterals and donors.** The IMF has supported the economic reforms since 2013 through the EFF and now the precautionary SBA. The World Bank has collaborated closely with the IMF and IDB throughout work on this programmatic DPF series to ensure synergies in the package of reforms being supported and to avoid duplicative efforts in the technical assistance provided. IMF has supported reforms on macro and fiscal stability, and the financial sector. IDB has focused on tax policy. This DPF series complements that support. In some cases, such as the prior action on fiscal rules in DPF1, all three institutions have supported a significant reform. The World Bank has also collaborated closely with DFID, which has provided a trust fund for broad ranging public sector reforms in Jamaica.

8. **This DPF series contributes to achieving the World Bank Group's twin goals by supporting the government in eliminating two major obstacles to poverty reduction and shared prosperity in Jamaica, namely chronically high debt and low growth.** High debt service obligations consume fiscal space that could be devoted to pro-poor spending and growth enhancing public investments. A cumbersome regulatory environment discourages private investments that would generate employment and economic growth.

IV. Tentative Financing

Source:	($m.)
Borrower	0
International Bank for Reconstruction and Development	0
Commercial banks	300
Total	300

V. Institutional and Implementation Arrangements

9. **MOFPS has responsibility for the coordination, monitoring and ensuring completion of the prior actions.** Various ministries support program monitoring and evaluation. The World Bank has an extensive and active program in Jamaica in several of the policy reform areas identified under the DPF, and monitoring of results of the DPF actions will therefore be continued through the other World Bank programs.

VI. Risks and Risk Mitigation

10. The overall risk rating of this operation is high in light of the critical importance of political and governance, macroeconomic, and capacity and implementation risks in determining the success of this programmatic operation.

11. **Macroeconomic risks are high.** While the economy has stabilized, the recovery is still fragile and vulnerable to a range of external shocks, as discussed earlier in Section **Error! Reference source not found.**. A severe growth slowdown, significant increase in interest rates, or major external imbalance could stall the broader economic reform program supported by this proposed DPF operation. Fiscal consolidation measures would be difficult to maintain during a growth slowdown, as would the employee contributions mandated in the new public sector pension system. Even if policies supported by the proposed operation are implemented as planned, expected outcomes from these reforms might not materialize if economic conditions deteriorate. For example, during an economic downturn, investors might postpone renewable energy projects facilitated by the energy sector reforms or new projects in SEZs. Public bodies could suffer large financial losses that trigger a government bailout. GOJ is improving its fiscal and monetary policy-making systems with the expressed goal of mitigating macroeconomic risks. For example, MOFPS has improved its fiscal risks monitoring and its capacity to manage debt sustainability risks, and BOJ is strengthening its monetary policy toolkit so that it can respond to financial market shocks more effectively. Similarly, the Building Act aims to increase the economy's resilience to natural hazards, and by enabling diversification out of oil, electricity sector reforms are reducing the economy's vulnerability to volatility in world oil prices. The precautionary SBA represents an additional measure to mitigate macroeconomic risks.

12. **Risks to institutional capacity for implementation and sustainability are substantial.** The multi-faceted reform agenda raises the risk that government capacity and fiscal resources could be stretched thin, implementation could be delayed, and enforcement of new legislation could be weak. The volume of legislation required since 2013 has stretched Jamaica's legislative capacity thin. In addition, the public sector wage freeze has hampered the government's ability to attract and maintain talent and made it difficult to create new positions. Several reforms require the government to hire personnel with scarce skills (e.g., personnel for the SEZ Authority and new procurement institutions, or personnel needed to assess proposed PPPs in the context of public investment management), and there is a risk that the government will not be able to fully implement some of these reforms within the timeframe needed to achieve this proposed DPF operation's expected outcomes.

13. **Fiduciary risks are substantial.** The draft 2016 PEFA report concluded that the Jamaica PFM environment is strong, but nevertheless has weaknesses in risk-management, multi-year budgeting and

treasury operations. To mitigate these risks, GOJ is continuing the ongoing PFM reform process. Once the 2016 PEFA report is finalized, GOJ will prepare a time-based action plan to address the weaknesses areas noted in the PEFA.

14. **Governance and political risks are substantial.** Fiscal consolidation by its nature has the potential to provoke political opposition due to cuts in spending programs and the public sector wage bill. Political support for investment climate reforms could dissipate if policy measures do not generate tangible results (e.g., in the form of jobs or income growth). Vested interests that derive benefits from cumbersome business regulations may succeed in blocking reforms. GOJ is proactively working to mitigate these risks by strengthening the stakeholder consultation mechanism—through revamping EPOC and complementing it with an oversight committee for public sector transformation reforms.

15. Although all identified risks cannot be eliminated, they are being managed by a comprehensive and close partnership with the client that (i) advises on technical issues underpinning a range of structural reforms, (ii) supports reform implementation, and (iii) monitors reform progress frequently by our strong presence on the ground. Risks are also being managed by close collaboration with the IMF, IDB, and other partners.

VII. Poverty and Social Impacts and Environment Aspects

Poverty and Social Impacts

16. **The policy reforms proposed under this operation are intended to reduce poverty and increase shared prosperity in the long-term.** Reforms to boost competitiveness are intended to stimulate economic growth and job creation. While there are short-term negative impacts from fiscal adjustment, these fiscal measures are ultimately focused on reclaiming fiscal space for social programs, which have been crowded out by high debt service costs. The PSIA of the specific reforms supported by the DPF has focused on a review of documents, the latest available data for the 2012 Jamaica Survey of Living Conditions, and staff projections of poverty rates. Annex 4 summarizes the social and environmental impacts.

17. **Fiscal consolidation can have small short-term negative impacts but it is necessary for the long-term sustainability of social spending.** It is associated in the short term with lower growth and weaker job creation. Increased user fees and adjustments in public service delivery can also have short-term effects on poverty. Maintaining a large primary fiscal surplus necessary for the long-term sustainability of social spending, however, which has been threatened by the high costs of Jamaica's debt burden. Measures to increase the efficiency of current public expenditures can have positive impacts through increasing the focus of planning and budgeting processes on performance. To the extent that social outcomes, efficiency, and cost effectiveness are prioritized, the positive impacts of social programs on reducing poverty and vulnerability are expected to increase.

18. **Policy reforms in Pillar 1 are expected to have positive or neutral impacts in the short and long term.** The electricity sector reforms are expected to have a direct and positive impact on Jamaican households by reducing production and ultimately end-user costs. Over 93 percent of households in Jamaica have electricity, and they devote an average of 5.8 percent of total household expenditures to their electricity bill. The poorest 20 percent of the households spend an average of 5.7 percent of total expenditures on electricity. This share is slightly higher for quintiles 2–4 and lowest for the richest quintile, which spends an average of 5.1 percent on electricity. The streamlining of the development and building application approval process will indirectly benefit Jamaican households through increased economic activity, and the Building Act will directly benefit them through increased safety in the built environment. The logistics and trade facilitation reforms are expected to be relatively neutral in terms of effects on households in the short term, but are expected to contribute to job growth in the medium term as they aim to increase Jamaica's attractiveness as an international logistics hub.

19. **Of the reforms proposed in Pillar 2, public sector pension reform has some distributional effects, while others are not expected to have direct poverty or social effects**. Public sector employees in Jamaica enjoy higher job security and better access to public services, and are under-represented among the poor (7 percent are poor compared to 19.9 percent for the general population) and among the poorest 40 percent (16.6 percent). The current rules of the public sector pension system imply regressive redistribution from the average taxpayer to public employees. The proposed increase in employee contributions would result in small reductions of the disposable income, potentially affecting a small percentage (less than 4 percent) of public sector employees who are vulnerable to fall into poverty. More than a third of those vulnerable households are beneficiaries of the Program of Advancement Through Health and Education (PATH)—the government's flagship conditional cash transfer program.

20. **Overall the GOJ's reform program, which the proposed DPF supports, prioritizes the protection of the poor and vulnerable, with an ongoing emphasis on safeguarding social spending and increasing the social safety net.** PATH currently benefits 15 percent of the Jamaican population. Despite its size and coverage being protected during the broad fiscal consolidation that has occurred, a significant share of the poor population receives no cash transfers and for those receiving benefits the income support received is limited. The design of the social assistance system reflects many constraints

linked to the high level of informality, administrative capacity and limited fiscal resources. As a result, a large part of the poor population does not receive income support (only about 60 percent of the population in the bottom two deciles is enrolled in PATH). Furthermore, the generosity of benefits is low. On average, PATH benefits represent less than 5 percent of the income of the poorest 10 percent of the population. The government has committed to maintaining the real value of social spending over the next three years.

Environmental Aspects

21. **The National Environmental Protection Agency (NEPA) is the central institution in Jamaica's environmental protection framework.** NEPA's mandate comes mainly from the Town and Country Planning Act, the Natural Resources Conservation Authority Act, and the Land Development and Utilization Act. These laws give NEPA the power to directly request environmental impact assessments (EIAs) from any applicant for a permit or from any person who is doing any undertaking that is likely to have adverse effect. This framework requires a detailed screening and approval process for industrial and development projects, and it includes disclosure of environmental instruments, consultations, and monitoring of proposed mitigation options. Environmental licenses are also required for a variety of other projects not requiring full EIAs. NEPA staff are well versed in the environmental clearance process and the specific content of environmental management plans and status of mitigation options on specific complex infrastructure projects. Disclosures of environmental impact assessments for review are placed in local media, parish councils, and on the NEPA website. Also, minutes of stakeholder meetings are placed verbatim on the NEPA website. NEPA's operations are financed equally by appropriations from the GOJ budget and from fees derived from permits and licenses.

22. **Prior actions related building code implementation and electricity reform are expected to have neutral or positive environmental effects.** The Building Act requires compliance with Jamaica's new building code, which inter alia promotes energy efficiency, rainwater harvesting, and resilience to natural hazards, including those stemming from climate change. The Act provides climate change mitigation and adaptation co-benefits. It requires the construction of environmentally-friendly and energy-efficient buildings. The building regulatory system includes the 11 International Code Council codes (referred to in the Act), including the "International Energy Efficiency Code." The new building code also requires new structures to avoid or withstand increased force and frequency of hydro-meteorological hazards such as extreme wind, flood, storm surge and sea level rise. The Act provides for new mechanisms that will enhance the implementation of building regulation and building codes. The Electricity Act establishes a new legal and regulatory framework for generation, transmission and distribution of electricity that encourages diversification away from oil-fired plants and makes it easier to bring online renewable energy projects. It provides climate change mitigation co-benefits. GOJ estimates that reducing dependence on generation from petroleum will mitigate the equivalent of 1.1 million metric tons of carbon dioxide per year by 2030 (7.8 percent of emissions) compared to the business as usual scenario modeled in its INDC.[1] Diversification away from oil-fired plants requires construction of new generation facilities. Like all large construction projects in Jamaica, these are required to comply with NEPA's environmental protection requirements.

23. **The SEZ Act prior action may have neutral to negative effects.** The Act is expected to encourage more investment in trade logistics, business process outsourcing, and agro-parks. Expansion of agricultural activities in Jamaica, as well as the development of large infrastructure projects associated with the GLHI, could impose new risks to the environment. The Act requires the SEZ Authority to ensure that the environment is protected in SEZs. The Act does not establish different environmental protection standards inside SEZs. Instead, it requires SEZ developers to comply with the robust environmental

[1] Government of Jamaica, "Intended Nationally Determined Contribution of Jamaica Communicated to the UNFCCC," November 2015.

management system and environmental protection laws prevailing outside of SEZs. New investments in port infrastructure or in expansion of businesses supplying firms in the SEZs that might be encouraged by increased activity in SEZs are also required to comply with these environmental protection laws.

24. **The customs reform prior action is not expected to have direct effects on the environment.** GOJ has adopted ASYCUDA World and required its use by traders. The use of ASYCUDA to speed up customs clearance is unlikely to have any direct effects on the environment. Integrating ASYCUDA with other systems, such as those related to licenses for importing hazardous materials and substances, may enable GOJ to enforce compliance with licensing more effectively and with less red tape for traders.

VIII. Contact point

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