Looking Back to Look Forward to the Post EFF Transition

Within the last 90 minutes, the Government of Jamaica and the Western Hemisphere Department of the International Monetary Fund announced a new three year Precautionary Standby Agreement in the sum of US$1.7 billion, to supplant and succeed the current Extended Fund Facility. While this pre-empts some of the intended discussion of this panel, it is still important to consider what may have been the optimal post EFF arrangement based on Jamaica's experiences with IMF programmes.

Looking Back

1. In looking back, it is imperative to recognize that any borrowing arrangement with the IMF is Jamaica's programme and not the IMF's. I recall an off the record exchange with an IMF team leader after a particularly heated meeting when he indicated that he does not live in Jamaica and would be returning to his domicile in Washington. Jamaicans have to live with the consequences and opportunities of any borrowing agreement with the IMF.
2. Recognizing this truth that it is Jamaica's programme, Jamaica benefits best by employing its best technical resources in head to head negotiations with the IMF. The Honourable Edward Seaga had lost political capital through administering sharp adjustment in 1984 and 1985 and then employed the best Jamaican technical resources available to him in successfully resisting through 1986, IMF demands for up front devaluation of the Jamaica dollar. The argument was won on technical grounds using Jamaican technical and intellectual resources.
3. Relations with the IMF have improved overtime. Jamaica's extended history of borrowing from the IMF dates back to 1977 (There was an earlier agreement that Jamaica did not draw on). Relations in the 1970s and 1980s were substantially antagonistic owing in part to technical dogmatism and attitudinal superiority on the part of fund staff. There was mutual distrust between Government of Jamaica and IMF technical staff including perceptions that either side would use or misuse information to support predetermined positions. In a game of "spy vs. spy", there was usually a rapid shuffling of papers at the reported approach of the IMF resident representative who was reputed to have the capability of speed reading upside down. The same resident representative and the IMF in general were subject, in the mid-1980s, to public expressions of hostility including letters in the press.
4. In the ideologically polarized 1970s and 1980s, domestic hostility to the IMF was facilitated by pedagogic caricature of the IMF as representing "the four Ds": devaluation, deflation, debt and as I am reminded by the audience, divestment (privatization). This was a part of a representation of "the Washington Consensus" as captured in mainstream textbooks such as Todaro and Smith's "Economic

Development”. This was about a consensus centred on economic liberalism or reliance on market forces and shrinking the role of the state in favour of presumed private sector dynamism. The element of debt accumulation through the recycling of “petro dollars” accompanied by adjustment programmes that inhibited growth, was elegantly captured in Cheryl Payer’s “The Debt Trap”. While the temperature of ideological polarization has cooled considerably, and the IMF has engaged some introspection on its programmes, the issues of growth inhibited by stabilization and overreliance on largely imperfect markets are still significant challenges to borrowers from the IMF.

5. In 2010 I was scolded by a distinguished Caribbean economist regarding my remarks to the St Kitts and Nevis Chamber of Commerce regarding the changing ethnic and national composition of IMF Staff teams and missions. Relative to the 1970s and 1980s when IMF Staff was more dominantly Caucasian, if not first world, more recent IMF teams have had a more decidedly non-Caucasian and “third world” composition. Indeed we have been able to point to mission chiefs resident representatives and desk officers that attended the University of the West Indies and worked with central banks in the region. The burden of the criticism was that the IMF is a monolithic bureaucracy (much like what the Plantation School referred to as a “total institution” that rigidly shapes the perspectives of its members). There is some substance to this criticism as staff missions proceed from narrowly constructed briefs that are pre-approved across several departments within the IMF bureaucracy. This underlines the imperative for Jamaica to be represented by its best available technical resources. It is still true however, that there is now greater collegiality in the sharing of information and some willingness on the part of the IMF to at least listen to the perspectives of the Government of Jamaica.
6. IMF programmes do not directly stimulate growth in the immediate term. Sharp fiscal adjustment to reduce the burden of public debt and debt servicing creates fiscal space to enhance the capacity of government to facilitate growth in the medium to long term. The challenge is how to get there (fiscal space) from here (sharp adjustment out of debt) where sharp adjustment is a near term brake on growth.
7. Defining a growth strategy relative to the imperatives of adjustment is not an IMF programmatic priority. The IMF is not a development bank and has no seminal mandate for growth facilitation. Neither the IMF nor any of the multilateral or bilateral partners can be given responsibility for either designing or implementing a growth or development programme for Jamaica. This would be an abject abdication of national responsibility. The IMF and other international “partners” may offer advice and fund elements of what should be a more comprehensive growth programme (business environment reforms for example). The complex integration of a comprehensive growth strategy and its detailed implementation has to be the responsibility of the Government and people of Jamaica.

8. The IMF is rooted in its 1944 Bretton Woods origins, to avoid trade restrictions by reinforcing commitment to its Article VIII, supported by prudent fiscal and monetary policy and building adequate foreign reserves. Debt threatens monetary and fiscal stability and there is a recognition of an imperative to balance stabilization with growth and to preserve social safety nets to ameliorate the impact of adjustment on the most vulnerable.

Every Letter of Intent from the Minister of Finance and the Central Bank Governor to the Managing Director of the IMF compulsorily includes the following:

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

An IMF programme by its essential purpose and nature contains neither a comprehensive growth strategy nor a programme for comprehensive social transformation and empowerment.

9. The IMF's Independent Evaluation Office has made critical observations on IMF structure, programme design and implementation. With the existing "shareholding" distribution of the IMF, it's Articles, and with power deeply rooted in its Treasury, Legal and Strategy Policy and Review (SPR) Departments, IMF programme design has not undergone fundamental change. (Much like a "total institution".)
10. Jamaica's current debt crisis was conditioned largely by the financial sector meltdown of the late 1990s. This informs the challenge to balance financial regulation with an imperative to enhance the contribution of the financial sector to financial transformation. High interest rate spreads (between deposit and lending rates) have proven stoutly resistant to policy and moral suasion and the financial system has not broadly invested in the information necessary to reduce risk in lending to emerging and non-traditional industries and borrowers.
11. For decades, Jamaica with other kindred nations, has been struggling in vain against the stricture regarding the ineligibility of Highly Indebted Middle Income Countries (HIMICs) for special debt relief. International financial institution resistance may be born of an interpretation that middle income means national capacity to pay down debt, ignoring the political economy of highly skewed income distribution. Middle income suggests that there are some rich people who should have the ability to contribute more, but this ignores the economic and political power of the rich to protect their positons of privilege. In both the 2010 Standby Agreement and the 2013 Extended Fund Facility, the IMF insisted on "debt exchanges' as prior conditions, ostensibly to ensure that holders of wealth shoulder a part of the burden of adjustment. One result has been the collapse of

the domestic market for public debt which is now being cited by the IMF as a basis of dollarization.

12. Not unrelated to the abortion of Jamaica's 2010 EFF, there had been great cynicism in Washington regarding Jamaica's commitment to programme implementation. This created a context for protracted negotiations for the 2013 EFF, its extensive prior actions and multitude of structural benchmarks, and less generous upfront financing than was afforded under the 2010 Standby Agreement. In the hiatus between the disappearance of the 2010 programme (between 2010 and 2011) and the establishment of the EFF in 2013, there was a marked retreat from loan and grant financing to Jamaica on the part of multilateral and bilateral "development partners" and a shift from budget support (where the Government has flexibility in deploying the financial resources) to investment/project loans.
13. This retreat is related to an insistence of other IDPs on an IMF programme as a "seal of approval" to underpin implementation and capacity to repay where required. An IMF "seal of approval" does not however guarantee agreement between other institutions regarding "burden sharing" in the financing of Jamaica's economic programme. This lack of agreement was the context of Jamaica's existing programme attracting less than the desired quantity of financing from the IDPs.
14. A recent IMF Staff report highlighted concerns regarding the progressive dollarization of the Jamaican economy. Some 45% of banking system deposit liabilities are denominated in foreign currency, mostly United States dollars. This is a major problem because it progressively undermines the capacity and effectiveness of the Central Bank in influencing spending and economic activity through monetary policy. In the extreme situation of 100% dollarization, the economy entirely loses any capacity for independent monetary policy and exchange rate policy disappears, leaving the entire burden of macroeconomic stabilization on fiscal policy. Without monetary/exchange rate policy, fiscal choices become more stark and painful. This is the same as what happens under a rigid exchange rate peg but without the capacity of the Central Bank to earn seigniorage from its power to issue domestic currency. Dollarization is not a state that independent countries willingly choose before the fact. It is the price of economic policy failure; an inability to convince wealth holders to hold their assets in domestic currency.
15. The IMF discussion of dollarization cites the collapse of the domestic debt market but without citation of its genesis in the debt exchanges on which it required. There is also reference to differential reserve requirements which may be prejudicial against the holding of deposits in local currency. There is no citation of the predictability of the impact of ambitious foreign reserve targets in a context of an underfunded programme in driving the nominal depreciation of the exchange rate. This nominal depreciation of the exchange rate is seen as desirable by the IMF as underpinning real effective exchange rate depreciation to either restore or maintain competitiveness. In the face of concessions that the Jamaica dollar is "competitive"

and the reality that the balance of payments deficit on current account has all but disappeared, there is concern about the ongoing nominal depreciation of the Jamaica dollar.

16. The citation of competitiveness and the improved current account deficit is largely irrelevant in the discussion of ongoing exchange rate depreciation and dollarization. It is remarkable that the discussion ignores the fundamental expectations driven link between ongoing depreciation and dollarization. In a context of ongoing depreciation that becomes predictable and expected, rational wealth holders will protect themselves by shifting their financial assets into foreign currency. This can only be arrested by realigning the relative rates of return between local currency and foreign currency by either changing expectations in the foreign exchange market or increasing local currency interest rates. The longer the unidirectional depreciation of the exchange rate continues, the more difficult it becomes to change expectations and reverse dollarization
17. Related to the impact of market expectations formation on dollarization, there has been very limited public discussion of Jamaica dollar money supply and demand although an IMF programme used to be referred to as a monetary programme. While dollarization represents weakening demand for Jamaica dollars as a store of value, the Central Bank cites its provision of liquidity to ensure the stability of the banking system. This provision of liquidity may to some extent finance the capacity for dollarization.
18. In a similar vein, inflation targeting has been and is being cited as an objective of the Government of Jamaica. Inflation targeting presumes an institutional and technical capacity for independent monetary policy. Effective independent monetary policy is not feasible in a highly dollarized economy where monetary policy effectively becomes that of the United States. Inflation targeting therefore demands a substantial and progressive reversal of dollarization. Inflation targeting demands a single policy focus by the central bank: the inflation target. Multiple alternative objectives including low interest rates to stimulate growth and adequate liquidity for financial system stability cannot be equally important conjoint objectives. Inflation targeting cannot be meaningful in an environment of fiscal dominance (large and unpredictable fiscal deficits potentially financed by money creation) as fiscal imperatives may undermine the independence of monetary policy. Despite fiscal progress through commitment and sacrifice, debt sustainability is still a decade away and the risks to fiscal integrity remain substantial.

Looking Forward

Current programme implementation has continued through regime change. The current issue is what follows the current borrowing arrangement? These are some of the pertinent considerations:

1. Jamaica is still a long way from debt sustainability. 120% to 95% by 2020 and 60% (the rule of thumb benchmark for debt sustainability) by 2025.
2. The IMF Staff and Board have a substantial list of outstanding concerns. For example, the IMF Press Release at the conclusion of the May 2016 mission includes:

   "***Fiscal discipline is critical for further reducing debt and creating space for productive capital spending. Combating crime, reducing the costs of energy and tax compliance, and improving infrastructure are essential to attract private investment. Greater banking sector competition, reforming financial sector taxation, reducing collateral requirements, improving credit risk assessment, and developing non-traditional financial services will help improve access to financial services and reduce the interest rate spread***."

   The IMF Board Press Releases at the end of its conjoint 11th and 12th reviews of Jamaica's EFF express concerns about the government wage bill and enhancing public employment efficiency.

   The release also reflected the Board as considering the following macroeconomic risks:

   I. Reform fatigue, capacity constraints, in the context of the thin parliamentary majority of the current government and sluggishness in growth and job creation undermining public support for reform and fiscal prudence.

   ii. Uncertainty regarding the revenues from the ongoing PIT reforms.

   iii. Government financing could be challenged by the still fragile domestic bond market, competition from potential corporate issuances, and the reliance on financing from international markets and other IFIs (both of which are dependent on continued strong program performance).

   iv. Growth could also be affected by natural disasters, a worsening of the Zika virus (particularly insofar as it impacts tourism), and an economic slowdown in trade partners.

   v. Derisking activities from overseas banks may interrupt international financial flows.

   In looking beyond the EFF, Pension Reform, Public Sector Reform and revenue certainty in the face of Personal Income Tax (PIT) Reform Phase II identify themselves as major challenges.
3. Does Jamaica have the will to sustain the primary surpluses to meet the debt sustainability targets without an IMF programme?
4. With the promise of tax relief having morphed into tax reform with the creative support of the IMF, is the Government capable of raising the $16 bn for phase 2 without the explicit support of an IMF programme?
5. Given the IMF's assessment of Jamaica still falling short of foreign reserve adequacy, how is reserve adequacy being cited as a basis for having a precautionary programme rather than an explicit borrowing relationship? What

type of relationship will sustain a desirable reserve accumulation path especially with the possibility of negative exogenous shocks?

6. Will the other IDPs believe that Jamaica has the will to continue implementation towards debt sustainability without a borrowing agreement especially given Jamaica's falling off the 2010 programme?
7. Will IDPs sustain funding if Jamaica ends borrowing from the IMF especially in a context of past differences about "burden sharing"?

Given the severe nature of Jamaica's outstanding programmatic needs, Jamaica may well find implementation and sustained commitment easier under continuation of a continued borrowing agreement. I would have recommended a continuation of an explicit borrowing relationship rather than the precautionary arrangement that has been announced. Regardless of its nature, a continuing relationship has to be secured in a context of:

a) Rigorous negotiations using the best technical resources available to Jamaica.
b) Exploring any room for flexibility in fiscal and foreign reserve targets to balance the imperatives for growth and de-dollarization.
c) Accepting that an IMF programme is an opportune vehicle for the implementation of difficult policy decisions in an as yet fragile policy environment.
d) Ensuring effectiveness of implementation through Jamaica owning the resulting policy decisions and not hiding behind the IMF.
e) Recognizing that neither the IMF nor any of the other IDPs can be accorded the responsibility of articulating and implementing a comprehensive growth programme for Jamaica
f) Realizing that definition and coordination of macroeconomic and growth policy is ultimately a Jamaican responsibility and Jamaica must take responsibility for itself.
g) Understanding that growth strategy is neither anecdotal nor piecemeal. It demands comprehensive integrated planning and macroeconomic benchmarking and mapping by the national authorities of Jamaica.

A continuing programme relationship with the IMF is indicated. The choice of a precautionary programme may be premature in the context of continuing fragility of foreign reserves and public indebtedness and not knowing about the extent of financing commitments from other IDPs. Jamaica needs to employ its best technical resources in negotiations especially regarding competitiveness, exchange rate depreciation and dollarization. Essential issues of growth and social empowerment will not be resolved within the "four corners" of the programme and have to be addressed effectively by the Government and people of Jamaica.

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