# PROGRAM INFORMATION DOCUMENT (PID)
## APPRAISAL STAGE

January 9, 2014
Report No.: 83948

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| **Operation Name** | Economic Stabilization and Foundations For Growth Development Policy Loan |
| **Region** | LATIN AMERICA AND CARIBBEAN |
| **Country** | Jamaica |
| **Sector** | Central government administration (100%) |
| **Operation ID** | P145995 |
| **Lending Instrument** | Development Policy Lending |
| **Borrower(s)** | Government of Jamaica |
| **Implementing Agency** | Ministry of Finance,<br>Government of Jamaica<br>Kingston, Jamaica<br>Tel: -876-932-5416 |
| **Date PID Prepared** | January 8 , 2014 |
| **Date of Appraisal** | November 4, 2013 |
| **Date of Board Approval** | December 12, 2013 |
| **Corporate Review Decision** | Following the corporate review, the decision was taken to proceed with the operation |

## I. Key Development Issues and Rationale for Bank Involvement

Jamaica's progress on poverty and shared prosperity has been seriously undermined in the recent past due in large part to economic shocks being amplified by the structural weaknesses of the economy. Jamaica has experienced low growth, high public debt, and serious social challenges for almost three decades. These factors have eroded Jamaica's competitiveness, leading to economic stagnation and volatility. For the past 30 years real per capita GDP increased at an average of just 1 percent per annum, making Jamaica one of the slowest growing developing countries. Nevertheless, Jamaica managed to reduce its poverty rate from 19.9 to 9.9 percent of the population between 1997 and 2007. The global financial crisis resulted in a significant reversal of this progress, as poverty increased sharply to 17.8 percent in 2010, and unemployment reached 16 percent in 2013 (compared with 9.7 percent in 2007), with youth unemployment at 30 percent.

The crisis particularly impacted the poor and middle class. While a large part of the population suffered from negative real consumption growth, economic difficulties disproportionately affected the bottom 40 percent of the population. This has led to higher inequality, reversing a previously positive trend. The share of consumption of the bottom 40 percent of Jamaica's population, which had improved from 16.7 percent to 17.8 percent between 2001 and 2007, fell slightly to 17.3 percent in 2010. Rural areas were the hardest hit by the crisis, with the poverty level increasing from 17 percent in 2008 to 23.2 percent in 2010.

The Government of Jamaica (GoJ) has articulated a comprehensive program of fiscal consolidation, monetary and exchange rate reforms, and a strategy to promote private sector led growth. The GoJ signed an IMF Extended Fund Facility (EFF) for SDR 615.4 million (about US$932.3 million) for the period of April 2013 to March 2017, to support its reform program. The Government's economic reforms will also benefit from substantial support from the World Bank and the IDB, with each having agreed to allocate US$510 million over the next four years. Together, the three multilaterals are supporting a wide range of structural reforms designed to stabilize the economy, reduce debt, restore confidence, and build the foundations of growth and resilience. The Fund-supported program has focused on debt restructuring, fiscal consolidation and financial sector reforms. The IDB focuses on tax reform, including the legislation to eliminate a complex set of tax waivers. The Bank is playing an important role supporting structural and institutional reforms to lay the foundations for future growth, enhance competitiveness, social protection, public sector management and resilience that are critical to the goals of debt reduction and sustainable growth. The Bank and IDB are closely coordinating their assistance in the different sectoral areas to ensure complementarity and consistency.

## II. Proposed Objective(s)

The objective of the proposed DPL is to support the Government of Jamaica's efforts to implementing a set of policy and institutional reforms to increase competitiveness and improve fiscal management. Reforms aimed at improving competitiveness include investment climate related actions that will remove identified constraints to doing business, such as contract enforcement, delays in obtaining construction permits, access to finance, and lack of support to Micro, Small and Medium Enterprises (MSMEs). Even with significant progress on improving competitiveness, investor confidence will not return unless sustained progress is demonstrated on the fiscal front. This requires success at addressing the key underlying causes of the rigid expenditure patterns that make fiscal adjustment difficult, namely the large wage bill (currently 10.5 percent of GDP), the defined benefit pension program for civil servants that is entirely funded by budgetary outlays, and the public sector investment program, which is unable to deliver growth dividends in its present, un-prioritized form. It also requires decisive action on eliminating discretionary tax waivers and addressing the fiscal health of public enterprises which, in the past have been a large drain on the budget.

**Pillar 1 Improving the Investment Climate and Competitiveness** focuses on helping to establish the necessary conditions that would facilitate higher and productive private sector investment which is necessary for growth in Jamaica. To help create the condition for more productive private investment, the proposed DPL supports Government initiatives already underway which are expected to have a transformational impact on resolving key investment climate bottlenecks and supporting small business growth**.**

On improving the investment climate, the DPL focuses on reforms in select critical areas. One of these areas is the weak enforcement of contracts. Civil courts—the main vehicles for dealing with commercial disputes in Jamaica—are severely backlogged with some cases taking years before being heard. The DPL supports reforms to increase the civil jurisdiction of the lower courts to improve the efficiency of disposing of commercial disputes. Another issue is the building permits process. Applications, fees, and requirements for building permits vary by parish, and once submitted it is difficult to track the status of the application. This creates problems for investors who have to navigate different processes, but more importantly need a more reliable time frame to line up financing and construction planning. A final investment climate area supported by the DPL is improving access to credit. Small creditors have limited access to finance as banks and financial service institutions are reluctant to extend credit without standardized credit reporting and assessment. The DPL supports the establishment of the credit bureaus in Jamaica– two have been licensed and are operational now. The credit bureaus will collect credit information and perform credit analysis required by the banks and other financial service institutions that extend credit to the private sector, particularly for MSMEs which have limited access due to lack of information about them.

As MSMEs are responsible for the majority of the employment in Jamaica and are important potential drivers of future economic growth, the DPL is supporting the GoJ adoption of a MSME & Entrepreneurship Policy. This policy represents a significant step to provide a coordinated and targeted framework to support MSMEs in an effort to expand their contribution. The policy framework, which was established through extensive collaboration, includes measures to reduce bureaucracy and increase efficiency including simplification of tax procedures, incentives to install energy efficient technology in MSMEs, and measures to position MSMEs to take advantage of the proposed logistics hub for better integration into global supply chains.

**Pillar II Improving Public Financial Management for Sustained Fiscal Consolidation** focuses on strengthening fiscal consolidation efforts by supporting efforts to enhance expenditure management, efficiency and rationalization and bolster revenue mobilization prospects. Given tight fiscal space, there is a need for increased efficiency in the use of public monies, and also better risk management of financial liabilities. Efforts are underway to contain the long term costs of large expenditure items, such as pensions and wages to preserve the gains from recent fiscal consolidation efforts. Tax policy is to be radically overhauled. Better public sector oversight will support fiscal risk management, and budgetary reforms will strengthen budget management. The public sector investment program is being streamlined to achieve fiscal efficiency. The proposed DPL supports numerous Government initiatives to transform and rationalize Jamaica's public sector, improve the management of the wage bill for better service delivery while meeting GoJ's fiscal consolidation targets, and improve the budget process.

## III. Institutional and Implementation Arrangements

The Ministry of Finance and PIOJ will be responsible for the coordination, monitoring and progress of the DPL prior actions. The government has also appointed a point person in the PIOJ for coordinating the implementation of the reforms. Monitoring and evaluation will be supported by the various ministries, who will provide the baseline and updated data, and work with the Bank specialists to inform them of progress and potential bottlenecks in implementation. The Bank has an extensive and active program in Jamaica in several of the policy reform areas identified, and additional monitoring of the DPL will be conducted in conjunction with this program.

## IV. Risks and Risk Mitigation

**The overall risk of the operation is high.** Jamaica is entering a demanding transition period, where difficult reforms will only yield results in terms of growth acceleration and shared prosperity over the medium term. There is a risk that political commitment may weaken and social tensions increase, or that natural disasters derail fiscal consolidation efforts and set back the reform program. The program supported by the DPL faces three types of risks: economic, governance and political, and capacity risks.

**Macroeconomic risk.** The Jamaican economy remains highly vulnerable to external shocks and natural disasters. The combination of a large current account deficit, low foreign exchange reserves, high unemployment and limited fiscal space significantly reduces the Government's flexibility to absorb unforeseen shocks. Growth targets are ambitious, and require both good policy and a favorable external environment. *Mitigation:* The Bank is monitoring this risk closely with the IMF and IDB, and will pace assistance under a possible future programmatic series which will contribute further to strengthen the country's overall macroeconomic framework.

**Governance and political risks.** Jamaica faces a heavy reform agenda which could lose steam if negative impacts of reform begin to reduce political and popular support, and if vested interests come in the way. The DPL complements difficult reforms underway under the IMF EFF, which have virtually exhausted the government's political capital, hurt vested interests, reduced spending and solicited heavy debate in Jamaica on the benefits of reforms. *Mitigation*: The authorities are fully aware of this risk and are promoting continuous consultation and awareness-raising around benefits of sector reforms. The Bank, through the DFID trust fund, is providing technical assistance on the development and implementation of a communication strategy for more effective outreach from the MoF to other parts of the government on the reform agenda. In addition, the Government has signed a Social Partnership Agreement (SPA) with the Private Sector, Trade Unions and Civil Society which is intended to form a broad coalition around the reform agenda could ensure the sustainability of reforms and mitigate against a relapse of political commitment.

**Capacity risks.** The broad reform agenda raises the risk that government capacity and fiscal resources are stretched thin, implementation is delayed and enforcement of new legislation is weak. Legislative capacity has been stretched given the large amount of new legislation that needs to be drafted and approved over the next few years. In addition, an ongoing public sector wage freeze has greatly hampered the government's ability to attract and maintain talent and made it difficult to create new positions to implement the reforms. *Mitigation*: The Bank has secured financing for training opportunities for existing staff in the MoF as well as for technical assistance, including in the form of special advisors focused on design and implementation of key reforms so that they might be able to take on some of these tasks without additional hiring requirements.

## V. Poverty and Social Impacts and Environment Aspects

*Poverty and Social Impacts*

Poverty and social impacts of policy measures supported under this DPL are expected to be either positive or negligible, with some reforms expected to have a more direct positive impact on the poor and vulnerable groups than others. Policy reforms in Pillar 2, in particular, will have important redistribution effects by means of improved fiscal efficiency and improved quality of public expenditures and controls. A reform of the public sector pension system can lead to better management of government liabilities, which in turn will improve fiscal sustainability and increase fiscal space for needed pro-poor expenditures. The unsustainability of the current defined benefit pension scheme needs to be addressed or it will have more severe implications for overall fiscal expenditures. Pension reforms will have an impact on the income stream expected as accrual rates will be lower, though this is in part mitigated by grandfathering those with less than 5 years to retirement, reducing the accrual rates of those already in the system, and only applying the new lower accrual rates to new hires.

*Environmental Aspects*

It is expected that the policies and reforms supported by this operation will not have any negative environmental impacts. An on-site review was taken to cover all prior actions. Of the prior action, there was a particular focus on construction permits. The streamlining of construction permits has a potentially positive impact on the environment in that it would enhance conditions for sustainably managed private sector growth, as transparency in the transaction process would provide opportunities for informed urban planning decisions. However the approval process for construction permits requires the co-ordination and integration of various Government Agencies, under the existing legislative framework. As such, the intention to accelerate the issuance of construction permits should take into consideration the requirement to incorporate results of consultations with these Agencies and other stakeholders, including civil society, in cases of projects where the National Environmental Protection Agency (NEPA) has determined that a full Environmental Assessment is required.

## VI. Financing

| Source | | ($m.) |
|---|---|---|
| Borrower | | 0 |
| International Bank for Reconstruction and Development | | 130 |
| | Total | 130 |

## VII. Contact point

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