

# OED Précis



Operations Evaluation Department

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## Structural Adjustment in Jamaica, 1981-85

*Among the Bank's earliest experiences in structural adjustment lending was its support of Jamaica's structural adjustment program in the early 1980s. In 1981-85, with a series of three SALs and a record high level of lending to Jamaica, the Bank spent 6.5 times as many staff weeks per capita on Jamaica as the average for all the LAC countries.*

*OED evaluated Jamaica's economic policies in 1981-85 and the experience with the Bank's three Jamaica SALs.\* It found that most of the adjustment in Jamaica did not take place until well after the three SALs were completed. Some of the reasons for the delay were the government's policy stance, the macroeconomic effects of very large inflows of balance of payments assistance, including the SAL proceeds, in the early years of the program, and the effects of severe external shocks. But better analytical work by the Bank and a more decisive use of loan conditionality could have improved performance. Recommendations are offered for future operations.*

### Stabilization and adjustment measures

The need for stabilization and adjustment grew out of the decline in Jamaica's economic performance in the later 1970s. Fiscal and balance of payments constraints had made the government's social welfare policies increasingly hard to sustain, especially since little

had been done to boost and diversify the growth of exports in this highly export-dependent nation. Higher taxes, new controls on wages, prices, and imports, and larger foreign borrowing in the late 1970s did not stop the depletion of external reserves. The new government elected in 1980 undertook stabilization and adjustment measures heavily financed by the IMF, World Bank, and USAID. The Structural Adjustment Program (SAP) was supported by a series of three structural adjustment loans (SALs) from the Bank, approved in 1982, 1983, and 1984. Its aims were to foster export-led development, a greater role for the private sector, and more viable public sector finances.

At first the measures taken were too gradual and timid to have much impact on resource allocation. By 1984-85, the government found more stringent measures were necessary. It devalued the currency and put tighter controls on credit and on public spending. To protect vulnerable groups, it introduced a food stamp program in July 1984. Sharp increases in utility rates and the consumer prices of petroleum products—provoking street riots in January 1985—and the imposition of a new tax on imports, helped to reduce the public sector deficit by 60 percent.

Stabilization and adjustment efforts were made much harder by a collapse in the world bauxite market. In making the projections underlying SAL III, the Bank had assumed that bauxite prices would recover. But in 1985 Jamaica's net foreign exchange earnings from bauxite and alumina in fact dropped by almost 60 percent; the country's terms-of-trade shock in that year was more than 9 percent of GDP.

By the closing of the third SAL in 1985, some progress had been made in:

- reducing the size of the government bureaucracy;
- reducing the public sector deficit;
- correcting the overvalued exchange rate; and
- rationalizing import licensing.

But in several ways the economy, now burdened with a massive foreign debt, was worse off than at the start of the first SAL:

\* "Program Performance Audit Report: Jamaica Structural Adjustment Loans II and III and Overview of Structural Adjustment Loans I-III", Report No. 8018, August 11, 1989. Copies are available from OED Library, H6150

- total output was lower than in 1979;
- the public sector deficit, though much reduced, was still more than 13 percent of GDP;
- external public debt was 180 percent of GDP, up from 61 percent in 1979, and interest payments on external debt took one fourth of export earnings;
- the numbers of unemployed seeking jobs had grown by almost one fourth, despite massive emigration;
- government spending on health, education, and social services had been cut back, and living standards of the poor had worsened.

The main reasons why progress under the SAP was limited in 1981-85 were: excessive delays in adjusting the fiscal balance and the exchange rate, with massive reliance on foreign financing; subsequently, excessive tightening of public spending and credit, which crippled public investment and the private sector; and the adoption of fiscal measures inconsistent with the SAP.

After completion of the third SAL, the Bank and Fund stopped lending to Jamaica for two years. It was not until 1987 that major structural reforms of the tax system, import system, import regime, public sector, and financial sector were implemented, with the support of new sectoral adjustment loans from the Bank.

### Major issues

*Postponement of policy changes; design of conditionality:* The general thrust of the SAP supported by the three SALs was realistic and in line with the development needs of Jamaica's small open economy. But major structural reforms should have been carried out decisively in the early years of the program. The government that came to power in 1980 had been elected with a mandate for change. Political support for such reforms

would have been strong in its early years, and growth and employment would have recovered sooner, reinforcing the prospects for the program's success.

The SALs, for their part, were experimental in design. They were overloaded with detailed conditions on peripheral matters, while their lack of precise conditions on essential actions allowed the urgently needed reforms to be delayed. In closing the second SAL, for example, the Region noted that "On a strictly legal basis Jamaica has complied with the conditions of both loans", yet the expressed goals of the adjustment program were far from being met.

*Analytical framework:* Though the Bank had done much ESW on trade policy and industrial protection, in 1980 it did not have in place an operational mechanism to help the new Jamaican administration design the adjustment program. And it lacked the statistical and analytical framework to ensure that policy changes in different parts of the economy would be consistent with one another—for example, by relating public sector finances and foreign capital inflows to the savings-investment balance of the private sector or to the external sector.

Without such a framework it would have been hard to see the right balance between domestic adjustment effort and foreign aid. In fact, in the early 1980s the massive balance of payments lending to Jamaica led to the real appreciation of the exchange rate. This discouraged the export diversification sought by the SALs and allowed the maintenance of large unsustainable fiscal and current account deficits.

Some commentators have suggested that the massive lending occurred for political reasons. Even if it did, more firmly-rooted economic analysis could have shown the desirability of disburs-

ing the adjustment loans more slowly, as economic reforms were introduced.

*Coordination with IMF:* Following normal practice, the Bank relied completely on the Fund on questions of Jamaica's short-term economic management and stabilization. In retrospect, the Bank should have reviewed the medium-term adjustment program more systematically, to see whether it was compatible with the stabilization measures being supported by the Fund. Such a review would probably have drawn attention in advance to inconsistencies. For example:

- the imposition of additional; unprogrammed import duties to help the stabilization effort conflicted with the import liberalization goals of the SALs;
- the implicit limits on government spending associated with the fiscal deficit targets of the stabilization program limited the prospects for the structural reforms envisaged under the SAP.

*Effects on living standards:* In designing the SALs the Bank believed that the best way to reduce unemployment and improve the living conditions of the poor was through the adoption of better economic policies which would yield higher income levels for the country as a whole. The SALs did not include special provisions to help the poor during the period of adjustment or to monitor the evolution of social conditions. Neither did the Bank focus on the fact that available data on social conditions were very limited, and would not permit reasonable monitoring during the implementation of the SAP.

Some analysts have charged that the stabilization and adjustment efforts during 1984-85 caused particular and perhaps avoidable hardship for the poor. Available data show deteriorating trends in various indicators of living stan-

dards, beginning in the late 1970s, but no drastic worsening in 1984-85. The trends strongly suggest, however, that some extension and better targeting of safety net and nutritional programs would have been desirable, starting from the inception of the SAP. (See Box.)

*Monitoring:* For the three SALs the Bank's supervision effort was considerable. But though it helped to facilitate loan implementation in many ways, supervision focused almost entirely on formal compliance with loan conditionality and not enough on the broader progress of the SAP. For example, supervision missions did not highlight the increasing overvaluation of the currency, because exchange rate management was not part of the SAL conditionality. If it could design and use a broader conception of monitoring, the Bank would be able to see signs of danger as they arose, and take corrective actions in time.

*Overall assessment:* Loan design improved with experience over the course of the three SALs. And the preparatory work, studies, and learning by doing facilitated the reforms that Jamaica implemented in the later 1980s. But the delays in implementing policy change in the SAL period were costly to the economy, both in income forgone and in the enormous burden of foreign debt that has prolonged the hardship of adjustment. Better design and execution of the SALs could have speeded up the reforms, bringing about a faster economic recovery and reducing the social costs of the prolonged stagflation. The following general recommendations may still have relevance today, for Jamaica or more broadly.

### Recommendations

- *Conditionality* should be limited to a few basic policy elements that are vital for the

### Living Standards

Most of the short-run impact of stabilization and adjustment on employment seems to have been neutral or positive, without significant deviations from secular trends even for the usually more vulnerable demographic groups, youth and women. There is some evidence that real wages declined. Governmental transfers fell, but not by much when compared to the underlying trends, which were in general already downward; in Jamaica, as in many other countries, these transfers have tended to be poorly targeted, benefiting middle-income groups much more than the poorest.

Trends in demand for food suggest that food consumption per capita dropped by 6 percent in 1984 and by 1 percent in 1985. For small children, time-series data point to some true nutritional deterioration in 1984-85, apparently in line with a longer-term

trend. Data do not permit one to assess the effects of the provision of food under government programs. The Food Stamp Program (FSP) introduced in 1984 provided subsidies on staple foods, but mainly on those grains consumed mostly by the relatively well-off. A General Food Subsidies Program, introduced in 1986, also seems to have favored relatively well-off consumers.

Real government expenditures on services, including education, in 1984-5 were significantly below their trend levels. Effects of such cutbacks take time to be felt. But in the short term, the limited evidence of deterioration in services was matched by evidence of improvements.

*See "Impact of Macroeconomic Adjustment on the Poor and on Social Sectors in Jamaica", in Report R8018.*

success of the adjustment program. Loans should not be cluttered with micro conditions which can divert the attention of Bank staff and government officials from the essential issues. Attempts to use SALs as vehicles to solve problems that are affecting the execution of project loans are unlikely to succeed.

- *Coordination with the IMF is indispensable.* This calls for (1) reliance on the IMF in its areas of competence; (2) rigorous efforts to check the consistency of structural adjustment programs, to be supported by Bank lending, with government stabilization programs, to ensure their compatibility.
- *Need for sensitivity analysis:* In economies that, like Jamaica's, are particularly sensitive to developments in the international economy, to the effects of weather on agriculture, and/or to underly-

ing social and political conditions, the Bank should undertake sensitivity analysis before lending for adjustment, and consider the possibility of alternative economic packages and mid-course corrections should conditions change.

- *Arrangements for monitoring implementation* should be carefully planned at the time of design, and provisions made for defining the indicators—social as well as economic—to be used. Early efforts may be needed to strengthen the statistical base, to ensure supervision missions will have enough data to complete their evaluations. Supervision should not be limited to evaluating legalistic compliance with conditions, but should assess the overall behavior of the economy and social conditions, and aim to identify danger signals early enough for the Bank and government to adopt corrective actions.

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