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**2005/2006 JAMAICA BUDGET OPENING PRESENTATION**

**Dr. The Hon Omar Davies  
Minister of Finance & Planning  
Thursday, April 14, 2005**

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|  |    |
|--|----|
| INTRODUCTION .....                       | 1  |
| FISCAL ACCOUNTABILITY .....              | 3  |
| REVIEW OF CALENDAR 04 AND FY 04/05 ..... | 6  |
| MEDIUM TERM OUTLOOK .....                | 9  |
| EXPENDITURE HIGHLIGHTS.....              | 11 |
| TAX REFORM / FINANCING THE BUDGET.....   | 15 |
| CONCLUSION.....                          | 21 |

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### INTRODUCTION

Significant Budget Presentation. My twelfth. Every one has been presented with the support of Deputy Financial Secretary Henry and Financial Secretary Tyndall.

Two “powerful” professional public servants. Between them have given 39 and 46 years, respectively to the public sector. The country owes them much. Nuff respect`!!!

Also said goodbye to Deputy Financial Secretary Velma Blake at the end of March. Major period of transition for the Ministry of Finance.

At the same time, we wish to welcome Mr. Colin Bullock, presently Deputy Governor at the Bank of Jamaica who will assume responsibility as Financial Secretary with effect from May 1. Mr. Bullock has had many years of experience in macro economic management of the country. Played a major part in structuring the foreign exchange system which presently serves us so well. Well respected, domestically and internationally. New challenges are significant and he is walking in the footstep of a giant. Nonetheless, utmost confidence that he will do well.

In this introductory statement I wish to briefly sketch the context within which this presentation is being made. For a host of reasons, it is a critical budget and even if we focus on one objective, that of eliminating the deficit, it is an event worthy of note and analysis.

Some critics/analysts will ask what is there to show for a decade and a half in office by this Administration. I do not believe that we need to say a great deal about improving physical infrastructure. As regards the economy, we now have one which is more open, more competitive; more diversified than any time in our history.

This means that contrary to utterances, some of which I heard on Tuesday, we are better placed than most of our peers to meet the challenges of globalization which has resulted in painful adjustment processes, creating “winners” and “losers”.

We cannot stop the changes brought by globalization even if we don’t like all of them. And where our national interest is threatened we will continue to defend it. Furthermore, we struggle not only on our behalf but also for other countries. Nonetheless, we intend to be amongst the “winners”.

The winners are those who are educated and trained, motivated, flexible and involved in activities producing goods and services of quality and at a price demanded by the external world.

It is our task as Government to make more and more of our people, and indeed the whole country, “winners” - not only because it is a noble objective but simply because we have no option as the global trends will continue whether or not we are on board.

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---

Hence, this presentation on the Budget must be viewed and judged within the context of the Administration's objective which includes:

- a) maintenance of a stable macro economy
- b) increased investment in social capital
- c) creation of increased employment
- d) increased investment in infrastructure; and
- e) a more responsive public sector

In terms of the structure of the Presentation, the approach will be as follows. First a brief discussion on fiscal accountability – particularly in light of recent deliberations of the Public Accounts Committee.

Next a review of calendar year 2004 and fiscal year 2004/2005.

I will then look at the socio economic outlook for the medium term dealing in particular with the rationale for aiming to balance the budget. Then I will highlight aspects of the expenditure budget, with particular emphasis on supporting access to tertiary education. Finally, I will speak about the reform of the tax system and the financing of the budget and wrap up.

## FISCAL ACCOUNTABILITY

All governments, wherever in the world, handle resources on behalf of taxpayers and citizens of a country. Consequently, members of the public have an absolute right to be fully briefed on how commitments are made by Government, whether ministries or departments. Simultaneously, there is an obligation on the part of the sector entities to ensure that, whatever actions are taken are within the context of clearly defined rules which can withstand public scrutiny.

There is no perfect system anywhere and every government has to seek to continuously update its **modus operandi** to adhere to best practices. This Administration has sought to consistently improve these best practices to ensure increased accountability for public funds.

We must not forget the significant steps which have been taken – not the least of which is the opening up of Standing Finance Committee and the Public Accounts Committee to the public and to the media. We have also strengthened the Office of the Contractor General among other initiatives. In recent times we have sought to bring greater order to the use of Deferred Financing to implement needed projects, particularly in the area of infrastructure. Within that context, the Administration has tabled updates on Deferred Financing as per the system agreed to by this Parliament.

Recently, some concerns have been raised about the provision by the Ministry of Finance of Letters of Undertaking without these being subject to the granting of Parliamentary guarantees. This discussion must be seen in relation to the restructuring of the Deferred Financing Programme.

Let me first indicate that contrary to some assertions, the granting of such LOUs is within the legal purview of the Ministry of Finance, based on legal opinions provided by the Attorney General's Office.

Today, I have tabled a Ministry Paper detailing the total set of Letters of Undertaking (LOUs) as at March 31, 2005. The total amount covered by such LOUs is \$16.9 billion

Of this total, \$4.2 billion represents our obligation incurred through the DBJ in the agreed approach to streamline the Deferred Financing Programme. Rather than having several contractors negotiate with individual banks, with varying financial terms, contractors were financed centrally through the DBJ.

One important new issue has emerged. The Auditor General has expressed a concern that the language contained in some LOUs, specifying the obligations of the Ministry of Finance, has become increasingly similar to that contained in Letters of Guarantee which have to be submitted to Parliament for approval.

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**2005/2006 JAMAICA BUDGET OPENING PRESENTATION**

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---

This is a valid concern, not only because it comes from the Auditor General, but also because it makes sense. I have indicated to this Honourable House, during the debate on the Second Supplementary Estimates, that the Ministry of Finance must lead by example and when the Auditor General raises a concern we must respond.

Let me now state for the record, that it has been my experience in dealing with the Auditor General, that whenever he raises concern about a matter, he is always equally willing to assist with determining a solution. This case is no different.

What then do we propose to do about all the concerns listed, whether raised by the Auditor General, the Opposition Spokesman on Finance or members of the public?

The first step is submitting on a regular basis a full listing of support provided by the Ministry of Finance to any institution indicating the terms of the loan, as well as the institution which had advanced the funds. It is proposed that this report be tabled in the House a maximum six weeks after the end of each quarter of the fiscal year. Today I have tabled the first such report, giving details of the situation, as at March 31, 2005.

Secondly, I have arranged a meeting involving the senior public sector officials concerned with ensuring fiscal accountability. The participants will be the Auditor General, the Financial Secretary, the Cabinet Secretary, the Financial Secretary-Designate the Solicitor General and myself. The objective of this meeting is to air all concerns, but more important, to develop clear rules governing the practical operations on the way forward.

When I make reference to practical operations, consider for example the needs of Petrojam which has routinely benefited from 365 day credit supported by LOUs from the Ministry of Finance. I do not believe any reasonable person would seek to delay the granting of such an LOU until it has received a Parliamentary approval. Petrojam has never failed to honour even one of these obligations. If a ship laden with oil arrived during our summer recess, should I ask that they wait until Parliament resumes before they unload?

The third step to be taken, following the meeting of the officials is to meet with the Bankers' and Security Dealers' Associations to address specifically the matter of their requirements in terms of security for loans granted to the various public sector bodies.

The final point which I would wish my colleagues to consider is an assessment of the cost benefit analysis of the Ministry providing this support as opposed to the creditor institution charging an interest rate which is solely related to the financials of the entity which wishes to borrow. It is a fact, particularly in instances where support is by virtue of bilateral assistance, that an MOF Letter of Support or Guarantee is a non-negotiable requirement for concessionary interest rate.

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**2005/2006 JAMAICA BUDGET OPENING PRESENTATION**

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---

I sincerely hope the tabling of the Ministry Paper, as well as my outlining the steps going forward will reassure members of this Honourable House, but moreso the general public that the operations of the Government in general, and the Ministry of Finance in particular, in this area, can stand up to any level of scrutiny.

In the final analysis, the MOF, as the Ministry charged with maintaining fiscal accountability through the public sector, and indeed even more broadly, in the private financial sector, must lead by example. We welcome all genuine efforts to increase transparency and ensure that the most rigid standards are maintained.

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## 2005/2006 JAMAICA BUDGET OPENING PRESENTATION

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---

### REVIEW OF CALENDAR 04 AND FY 04/05

Economic performance in both calendar 2004 and FY 04/05 was affected by shocks - both domestic and external. Domestically the country was affected by two hurricanes, moreso Ivan in September. Externally, the upward movement in oil prices impacted on all aspects of the economy.

Up until mid year, growth was on target at approximately 3%. During that period, export agriculture grew by 8.1%, manufacturing by 5.7%. However, there was significant fall off in the last four months of the calendar year. Export agriculture declined by 13.8%, while manufacturing growth slowed to 2.1%

Nonetheless, growth was 1.2% for the calendar year, the 6<sup>th</sup> consecutive year of growth since 1999, with construction up by just under 5%, manufacturing by 3.6% and mining by 3.1%.

Not surprisingly the sector which was most badly hit was agriculture which declined by over 10%.

Hurricane Ivan had an almost identical impact on inflation as on growth. For the first seven months of the calendar year inflation totalled 6%. However, in October and November inflation increased by another 6% mainly as a result of significant increase in the price of domestic agricultural products. The end result for the calendar year was 13.7%.

For the fiscal year the outturn was 13.2%. However, the first three months of calendar year 2005 (last quarter of FY 04/05), inflation was 1.4%.

This provides the credibility for the projection of single digit inflation for calendar year 2005 and FY 05/06.

The stability in the FE market as well as the Government's commitment to the medium-term fiscal targets, allowed the Central Bank to systematically reduce interest rates during the fiscal year. Rates on 180-day and 365-day instruments were reduced by 5.95 and 6.60 percentage points, respectively.

There was an improvement in the BOP over the year and the NIR as at March 31, stood at over (US)\$1.9 billion. It is significant that this is nearly \$250 million above the original projection for March 31, 2005.

Whilst there is some justification for questions posed about the cost of maintaining an NIR of this level, very few people stop to consider the benefits, both direct and indirect of a strong NIR. The evidence of these benefits can be seen by what happened after Hurricane Ivan. Many expected problems in terms of shortages or instability in the foreign exchange market!

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**2005/2006 JAMAICA BUDGET OPENING PRESENTATION**

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Thursday, April 14, 2005**

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But despite the virtual closure of the tourism sector, there was no such instability in the FE market. Why? Because everyone had the reassurance of a strong NIR.

As regards the fiscal deficit, our original target was 3%-4% of GDP. The outturn was 4.8% of GDP. Nonetheless, it is accepted at home and abroad, that the outturn represented a significant achievement, given the impact of Ivan.

I need to say something about the assertion that I am overly concerned about the assessment by external creditors of our economic performance. Of course I am concerned because I am aware that external creditors have been entrusted as guardians of other people's savings and we who seek to borrow these savings need to win and maintain their confidence. We know what targets/criteria provide them with confidence and we seek to pursue them, consistent with our national socio-economic objectives.

Let me make it clear that it is quite naïve to assume that there is a distinction between the targets/criteria which provide confidence for external, as opposed to domestic creditors. There is no longer any such distinction. The same requirements which hold internationally hold domestically.

It is ironic that there are those who continue to advocate us accessing more resources from the multilateral institutions e.g. the IMF and World Bank on the grounds that these are cheaper funds.

Let me put this matter in context. Jamaica remains a full fledged member of both institutions and will continue to play a critical role in all multilateral bodies, speaking not only for ourselves, but also on behalf of all countries in similar socio-economic position.

As regards the IMF, we took the decision in 1996 after creating history by passing 12 consecutive tests of an EFF agreement, not to borrow any more from that institution. Simply put, we said we would honour our debt obligations and pay down our debt as per our agreement. As we speak that debt is now zero.

Without any fanfare, mission accomplished.

Why did we take this decision in 1996 to cease borrowing from the IMF? We did so because having "successfully" passed 12 consecutive Tests, an examination of the major macro-economic indicators showed that inflation remained high, we had very little reserves, there was very little growth in the economy and foreign investments was limited.

Our assessment was that the standard "one size fits all" IMF macro-economic programme had failed. Incidentally, this was not the first time such an assessment was made. Recall the Tripartite Assessment. Hence we decided to design our own programme, using our own technicians.

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**2005/2006 JAMAICA BUDGET OPENING PRESENTATION**

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Thursday, April 14, 2005**

---

However, we did not stop there. We took a firm stand in international fora against traditional IMF-type policies, e.g. devaluation as the prime method to foster economic growth. Similarly, we refused to accept cross conditionalities whereby certain World Bank/IDB loans were only accessible if a country were in a borrowing arrangement with the IMF.

Despite the obvious benefits of cheaper long-term funds to assist with the rescue of the financial sector, we stood firm until the multilaterals backed down from these positions.

In both instances our positions have now been accepted and other countries have now benefited from the stance which Jamaica took. I know that at one stage it seemed that we were being overly combative, running the risk of being punished by the multilaterals in Washington.

But leadership is not for the faint-hearted. We discovered that our principled position caught the attention and support of influential decision-makers in Washington – Stanley Fischer (IMF), Enrique Iglesias (IDB), and Ciriaco De Falco (IDB).

## **MEDIUM TERM OUTLOOK**

As is usual, we present our major macro-economic targets for a three year period. However, increasingly as we come to grips with managing the economy from the perspective of these variables we will need to focus more on specific regions/sectors/groups which need special attention.

A critical element of the macro-economic programme is our target of a balanced budget for 05/06. I need to say something on this matter. A question being posed – interestingly initially in the business community - is whether aiming to balance the budget for fiscal year 05/06 is not going to be too strenuous, given the needs for additional expenditure in the social sectors and for physical infrastructure.

First of all, let me commend those who have entered the debate. This reflects an important positive development. Members of the private sector are demonstrating greater understanding that the decisions faced by the political directorate are not simply about macro-economic targets but ultimately these must translate to human development.

If I may digress for a moment and speak about a major macro-economic target of this Administration, bringing inflation under control. The main reason for targeting inflation is that it is the most cruel tax on the poor.

Our success in taking inflation is perhaps the major cause of the achievement of cutting poverty by a half since 1992. In 1992 it was 33.9%. The most recent SLC shows that it was 16.1% last year.

So why do we persist with the target of a balanced budget? There are several reasons. The first is that a deficit, however well-intentioned, can only be covered by increased borrowing and we all agree that the country is already too highly indebted.

We cannot continue to put off tackling head on, the issue of the debt. One cannot, on the one hand, speak about the need to curtail the growth of debt and at the same time support a continued deficit.

Secondly, there is a practical cost to running a deficit. The interest rate that the country is charged for its borrowings, both domestic and external, is higher the greater the demand by Government for credit. This means that, not only will foreign creditors exact a penalty if the deficit remains, but so will domestic creditors.

It plays well to the media to suggest that the Administration is too concerned about the assessment of external creditors and too little about domestic issues. The fact is that, whether we seek to borrow in Kingston or in New York, Washington or Milan, the larger our deficit the

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**2005/2006 JAMAICA BUDGET OPENING PRESENTATION**

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Thursday, April 14, 2005**

---

higher the interest rate. That money paid out is needed for other areas but can only be saved through fiscal discipline.

Another important consideration is that the BOJ will not be able to continue its aggressive path of interest rate reduction if the Ministry of Finance continues to demonstrate a huge appetite for debts.

There is yet another reason why we must stick to the balanced budget target and it relates to the Memorandum of Understanding with the public sector workers. Our ability to have “remained in the ring” over the last two years is due, above all other factors, to the existence of the MOU which has removed any increases in wages and salaries for two years (April 1, 2004 to March 31, 2006). In concrete terms, this has “saved” us additional expenditure of \$5 billion in both FY04/05 and 05/06.

Despite the cooperation of the unions and the workers, I believe it is only fair and sensible to accept that this “freeze” cannot continue indefinitely. Put another way, the budget for 06/07 must build in allocations for increased wages and salaries if we are to retain quality people in the service. If we fail to balance the budget in 05/06, accommodation of any new wage increase in 06/07 will imply a continuation of a deficit position or will require a major tax package.

For all these reasons, whilst recognizing the good intentions of those who propose a postponement of the balanced budget, the Administration is firmly convinced that the pros of attaining this target in fiscal year 05/06 overwhelmingly outweigh the cons.

In terms of economic growth, the last survey of business confidence reveals the highest level recorded since this survey commenced. It is a reflection of what is happening on the ground. The rate of capacity expansion in the tourist sector is unprecedented. We must also recognize that investment in tourism, a service industry, first shows up in the construction sector with all the positive spin-offs.

The towns of Ocho Rios, Falmouth and Montego Bay can all testify to this impact.

## EXPENDITURE HIGHLIGHTS

We have had before us for two weeks now the Expenditure Budget and so there is no need for us to allocate much time to go into the details. However, I feel obliged to make specific reference to three areas which have received special consideration because of the national recognition of the need for additional resources.

I speak specifically of Education, National Security and the Fire Services. As regards National Security, I will only speak briefly as the Minister will be making a contribution to this Debate next Wednesday. The Prime Minister who has invested much of his time and energy in piloting the radical changes needed in education will be discussing this sector in his presentation on the 26<sup>th</sup>.

In terms of education, the allocation of just under \$38 billion represents 11% of the total Expenditure Budget and is a 24% increase over the allocation for last year.

I have noted that some "analysts" in terms of addressing this significant increase have sought to reduce its impact by arguing that, if we adjust for inflation, it is not as impressive as it seems initially.

A simple word to correct this misrepresentation. As the Minister of Education has pointed out on a variety of occasions, the bulk of the Recurrent Expenditure from her Ministry goes into wages and salaries, which is what one would expect. Given the benefit of the MOU, it means that in this fiscal year the usual movements in line with inflation for wages and salaries have not taken place and hence much of this increase (24%) represents real additionality.

The same applies for National Security where there has been an increase of 16% above allocations for the last fiscal year. Furthermore, there are possibilities of the total sum available to the Ministry being enhanced as there is an agreement between our ministries which will allow National Security access to additional funds depending on their success in various crime fighting activities.

Fire Services - We are all concerned about the need to restore capabilities of the Department. Attempts to politicize the issue – unbecoming and pointless.

I simply wish to inform the House that whilst there is no provision in the Expenditure Budget for the acquisition of new engines and equipment, the Ministry of Finance has authorized the Ministry of Local Government to go to tender to supply needed engines, spare parts and equipment - based on the requirements developed by the Ministry and the Fire Department.

The only constraint given to bidders is that their financing must include a one-year moratorium as the debt cannot be brought onto the Budget until FY 06/07.

However, the trucks and equipment will begin arriving during this year.

### **Access to Tertiary Education**

I now turn to the question of financing the access to tertiary education by students but particularly those from the poorest households. Let me make two introductory points in this regard. The first is that the demand for tertiary education has grown at a faster pace than anyone could have predicted 15 to 20 years ago. This demand is not simply related to a desire for upward social mobility, which perhaps was the major causal factor 40 to 50 years ago.

Rather research has shown both here and worldwide that a prudent selection of tertiary training will make such an investment by an individual the most significant and profitable one in her/his life time.

Associated with the increased demand for tertiary training/education is the dilemma of how should this access by an increasing number of persons be facilitated. Given difficulties at the Early Childhood, Primary and Secondary levels and given the higher per capita cost of tertiary training, it is necessary that the beneficiaries of training at the tertiary level assume an increased share of the cost of their education. This is not just a Jamaican phenomenon but also worldwide. Follow the debate in Britain.

Everyone, everywhere agrees that there is need for additional resources at the tertiary level.

Failure to provide additional resources will either lead to a reduction in standards or an inability to cater to the increasing number of persons who rightfully seek to improve their educational levels. Neither option is acceptable. Therefore, we must seek to ensure that as many persons as possible who qualify to do so are able to benefit from tertiary training. But this commitment to ensure access cannot be seen as the sole responsibility of the State.

One of the interesting developments of recent years is the extent to which there is growing recognition amongst the population of the benefits of further education/training. This has been demonstrated by the rapid expansion of new offerings by a wide range of tertiary institutions, many from abroad. Logically, these services can only be provided if there is a willing group of purchasers demonstrating "economic" demand. Simply translated, this means there are persons who not only wish to have access to tertiary training but are willing to pay for it themselves.

Throughout this discussion there remains a critical concern of this Administration based on the very tenets on which the political organization, of which we are members, was established. Even as we subscribe to the general objective of improving the educational levels of the country, our priority concern must be to ensure that no qualified student is denied access because of the economic circumstances of the household from which she/he originates.

Before I speak to specific initiatives which we will be undertaking to address the issue of access, let me say something about recent research on the changes which have taken place over

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**2005/2006 JAMAICA BUDGET OPENING PRESENTATION**

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Thursday, April 14, 2005**

---

time in the socioeconomic characteristics of students at our tertiary institutions. The data which I will present relate specifically to UWI but there is no question that it is applicable across the board.

The research is by a team from the Department of Sociology, headed by Dr. Pat Anderson.

Consider for example, the data on changes over time in the communities from which students originate. In 1983, 60% of the first year students admitted to the UWI were from urban Kingston and St Andrew. Other towns and rural areas accounted for 30%. In 2003 urban Kingston and St Andrew accounted for 36%, other major towns and rural districts for 41% while Portmore and Spanish Town have increased from 10.3% to 23% over the 20-year period.

But there is also a broadening of the social class background of students over that period. In 1983 students from lower middle class, working class and poor households accounted for 60% of student intake. In 2003, this percentage had increased to 75%.

Of importance is that this increase in access for lower income students was taking place as the number of first year students increased by over 140%.

What do these figures indicate? Despite some justified dissatisfaction with the education system, let us not be over critical. The fact is that all of us know that in an increasing number of households, even the poorest ones, there is either a student at a tertiary institution or someone aspiring to be one.

Most of these new entrants have been financed by the re-vamped SLB. The increased demand for tertiary training requires changes to the SLB and it is to that issue I now turn.

Since 1996 the re-vamped SLB has provided \$3 billion in loans and grants to the poorest students, in excess of \$460 million.

Despite this impressive performance for the reasons stated above, we are cognizant of the need to do more in response to increasing demand.

Today, I am pleased to announce that the members of the Jamaica Bankers' Association have agreed to partner with the Government to support the expansion and upgrading of the facilities offered to students by the SLB.

Let me pause to pay tribute to the members of the JBA who very quickly "bought into" the national vision to expand access to tertiary education.

Specifically, the membership of the JBA has agreed to make a sum of \$1.75 billion available to the SLB on concessionary terms. This first support will be for a period of five years at an interest rate of 7% per annum.

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## 2005/2006 JAMAICA BUDGET OPENING PRESENTATION

**Dr. The Hon Omar Davies**  
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**Thursday, April 14, 2005**

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This additionality of resources will make possible the following changes in the operations of the SLB with effect from academic year 2005/06.

- (a) All students who qualify will be able to borrow the full tuition for studies at approved tertiary institutions. The discrimination between university students and students at other tertiary institutions will now be removed;
- (b) grants offered to the very poor will be increased. For university students the amount will move from \$35,000 to \$50,000, while for other institutions the figure moves from \$12,000 to \$25,000;
- (c) students who are pursuing the Degree Programme in Nursing will now qualify for assistance; and
- (d) the rate of interest charged on new loans will be reduced from 16% to 12%.

I need to say something about the interest rates. The fact is that unlike a straightforward bank loan, the interest charged on loans to students by the SLB has to be capitalized over the period of study. Hence, there cannot be a straightforward comparison between the cost of funds to the SLB and the interest rates charged to students.

I need also to make a few brief observations on the means test of family income for determining eligibility for loans. As in the case of any means test, this is a controversial matter. We know that the present system is not perfect but I wish to assure beneficial partners and their families that this test is subject to ongoing refinement.

Furthermore, the SLB will establish, on a limited basis, for obvious reasons, a pilot programme to assist persons who just failed the means test but who are nonetheless vulnerable and require short term assistance to address cash flow difficulties.

Even whilst I commend the JBA members on joining with the Government in this national effort, I would urge them to develop a broader range of savings instruments and loan programmes to meet the increasing demands for financing human capital development. Such an outlook is not only good corporate citizenship, it is an investment in future profits as the students who you treat well today will be your best customers tomorrow.

Finally, I end this section by appealing to beneficiaries of the SLB and their families, urging them to fulfill their obligations to the programme. The SLB is meant to be a revolving loan programme, but it will not have any money to lend if a significant percentage of beneficiaries refuse to honour their obligations.

Whilst the institution has been successful in reducing delinquency levels, the current rate of 23% is still unacceptable. I do not accept the general excuse that people do not repay because they cannot repay. If there are problems, go into the SLB and make arrangements to adjust your payment schedules.

## TAX REFORM / FINANCING THE BUDGET

The financing of this year's Expenditure Budget is taking place within the context of two significant developments. The first is the government's commitment, articulated three years ago, to balance the Budget.

Secondly, financing of this year's budget is within the context of a comprehensive review of the Jamaican Tax System which has been undertaken over a two year period by a committee headed by Mr. Joseph M Matalon, with technical support from a group of tax experts from the Georgia State University.

As I have indicated earlier, the target of a balanced budget is not important only in a symbolic way, although that must not be scoffed at - just like the paying off of the IMF - but there are also practical benefits.

For fiscal year 2005/06 we project that domestic borrowing will be reduced. This reduced level of domestic borrowing will undoubtedly assist in accelerating the reduction in interest rates, both domestic and external.

In terms of the work of the Committee headed by Mr. Matalon, I wish to use this opportunity to formally place on record the Ministry's, and indeed the Government's appreciation for the voluntary contribution made by these Jamaican citizens in a most important area. Their analysis was comprehensive and their proposals are wide-ranging.

The recommendations which have been advanced identify eight (8) main problems which characterize the Jamaican tax structure. Many of these difficulties are directly derived from the fact that the last comprehensive assessment was carried out over twenty years ago.

The eight major problems identified by the Committee are:

- i) weaknesses in tax administration
- ii) an overly complicated system
- iii) a system which generates inadequate revenue
- iv) the *ad hoc* nature of the system
- v) the narrowness of the tax base
- vi) the special problems created by tax incentives
- vii) horizontal inequities; and
- viii) efficiency costs

The Committee's recommendations are in response to the major problems which they identified. I wish to reiterate that the Government and the Cabinet fully appreciate the rationale for the set of recommendations which they have advanced.

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## 2005/2006 JAMAICA BUDGET OPENING PRESENTATION

**Dr. The Hon Omar Davies**  
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**Thursday, April 14, 2005**

---

However, for a host of reasons, it is simply not possible to implement the comprehensive reform in one movement. For example, whilst recognizing the special problems of tax incentives, it is simply not possible to eliminate them overnight for a host of reasons, including the need to ensure that any action taken does not put our producers at a disadvantage compared to foreign competitors.

The Government proposes to implement the reforms on a phased basis over a four year period in order to protect the revenue base, avoiding a jolt in the system and perhaps most importantly to allow the tax administration time to adjust to the changes needed to increase efficiency.

Note that four of the problems identified – weakness in tax administration; *ad hoc* nature of the system; overly complicated system; and efficiency costs are inter-related.

The Budget Profile – As you are aware, the projected expenditure for 05/06 is \$347.2B. Of that, we expect to borrow \$142.7B, exactly equal to amortization. We expect revenue and grants to total \$196B, leaving a gap to be filled of \$9.35B.

In terms of the growth of tax revenue, we project an increase of 14% over 2004/05. This assumption we consider reasonable as the rate of revenue growth over the last three fiscal years has been 14%, 27% and 15%, respectively.

Built in the increased collection for fiscal year 2005/2006 is an aggressive collection of arrears.

As regards the borrowing for next year, we intend to tap the local market for \$107.6B and the external market for approximately (US)\$500M.

Revenue Measures – I begin with the positives for tax payers. The Matalon Committee proposed increasing the income tax threshold to \$275,000 per annum and then indexing it to inflation. However, this increase would be accompanied by the elimination of all allowances except reimbursable expenses. It would also require the elimination of tax preference schemes, including accommodation and hotel gratuity allowances.

The Government accepts the proposed threshold and that it should be indexed to inflation. However, we propose that it be done over a 18 month period. To compensate for the phasing, we will not be removing some of the special allowances recommended by the Committee at this stage, including the hotel gratuity scheme.

The decision therefore is to increase the threshold to \$169,104 effective July 1, 2005, and to \$193,440 effective January 2006 and \$275,000 effective January 2007. Thereafter, the threshold will be indexed to inflation.

A special word for pensioners. As of July 1, pensioners under 65 will have tax free income of \$240,101 and those over 65 will have one of \$259,104. As of January 1, 2006, the tax free allowances for the two groups will be \$238,440 and \$283,440, respectively.

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**2005/2006 JAMAICA BUDGET OPENING PRESENTATION**

**Dr. The Hon Omar Davies  
Minister of Finance & Planning  
Thursday, April 14, 2005**

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I have been told by several accountants that introducing the new threshold in the middle of the year will create difficulty for them but the Cabinet, on the insistence of the Prime Minister, decided that immediate action should be taken, particularly in light of the contribution made by public workers to the fiscal targets through the MOU.

These two increases in the threshold will result in the loss in revenue of \$1.4B during this fiscal year.

That is the cost – On the other hand, it will benefit 54,600 taxpayers in July and an additional 12,100 when the new threshold comes into being in January 2006.

Transfer tax on estates – Currently the present transfer tax payable on estates at death is structured as follows:

- i) The first \$10,000 – exempt
- ii) the next \$10,000 – 7.5%
- iii) the next \$40,000 – 10%
- iv) the next \$50,000 – 12.5%
- v) over \$50,000 – 15%

This structure is not only complicated but also has resulted in many persons not seeking to probate estates because of the total cost involved - legal fees and taxes.

We intend to as of June 1, 2005 simplify the system as follows:

- i.) estates valued less than \$100,000 – no transfer tax payable
- ii.) estates valued over \$100,000 – 7.5% on the value in excess of \$100,000.

This change not only represents a major benefit for many middle and low level income persons, we anticipate that with the “cleaning of the system” there will be a net gain of \$300M as many families who had previously delayed taking action, because of the cost will seek to tidy up these affairs.

This will come into effect on June1, 2005.

Property Tax - The Matalon Committee proposed the removal of the property tax caps, which to be frank, has led to an overly complicated system. The Administration accepts the proposal, in principle, and the following will be implemented with effect in this fiscal year.

- i) there will be a flat tax of \$600 on the first \$300,000 of valuation; and
- ii) a rate of 0.5% on the amount in excess of \$300,000

This will yield \$280M for the parochial revenue fund. Hence, this additional amount will not accrue to the Consolidated Fund. It should be noted that even with this additional amount, the collection from property taxes will not be adequate to meet the costs of garbage collection and street lighting. Hence, there is still need for the Consolidated Fund to provide support for these services.

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## 2005/2006 JAMAICA BUDGET OPENING PRESENTATION

**Dr. The Hon Omar Davies**  
**Minister of Finance & Planning**  
**Thursday, April 14, 2005**

---

SCT on Cigarettes - In 2003 an excise duty of 23% was imposed on cigarettes but the specific SCT remained the same. The proposal is to increase the SCT rates by 16 2/3% and retain the current structure of the tax. The specific tax rate is to be increased to \$1,920 per thousand cigarettes and the *ad valorem* rates of 39.9% will be applied to the excess over the floor price \$4,338.13. The measure is estimated to yield \$300M.

Effective date for implementation of this measure is April 15, 2005.

Gross Profit Tax for the Gaming Industry – In virtually all jurisdictions the problem of the plethora of taxes on the gaming industry has led to difficulties in monitoring. Currently, existing in Jamaica is a levy on Bookmakers, Lotteries, on instant games, lotteries tax, a bet winning tax and the tax on gaming machines.

It is proposed to introduce a gross profit tax, details of which are provided in the Ministry Paper.

It is expected that the revised structure will result in revenue gains of \$300M. The effective date of the implementation is June 1, 2005.

Tax on the Tourism Sector -The GCT was introduced in 1991 at the standard rate of 10% following representation from the low income interest. 50% of the standard GCT was applied to the sector.

In 1993 when the standard rate was increased to 12.5% the tax on the tourism sector was raised to 6.25% with the clear understanding that the special tourism rate would last for four years.

Subsequently, despite increases in GCT the special tourism rate has not been changed. Furthermore, this special rate has been implemented by way of a waiver as it was never legislated and so there is a whole range of GCT rates which are used in the sector as it applies to commissions, gratuity and non-tourism supplies.

An analysis of the GCT returns which have been filed by hotels indicates that the GCT net contribution by the sector equates to approximately 2% of the tax inclusive income.

Furthermore, there are great variations on the charges for similar activities within the sector. For example, commissions as a percentage of tourism revenues range between 30% at a high and just over 2% as a low.

To correct this anomaly the following changes will be made.

- i) GCT rate on the sector will be 50% of the standard rate, that is 8.25%.
- ii) This rate will be included in the first schedule of the Act.
- iii) Commission will be capped at 15% of gross income and gratuity as 5% of the gross income.

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**2005/2006 JAMAICA BUDGET OPENING PRESENTATION**

**Dr. The Hon Omar Davies  
Minister of Finance & Planning  
Thursday, April 14, 2005**

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- iv) Deductions for ground transportation will be abolished.
- v) The special alcoholic beverage credit will be abolished, given the new regime recently instituted for wines and spirits for the sector.
- vi) This change will bring additional revenue of \$600M with implementation date May 1, 2005.

General Consumption Tax (GCT) -I have made repeated mention of the objectives of simplifying the system. These were highlighted time and time again by the Matalon Committee. One special area which has led to a major difficulty of auditing and a loss of revenue relates to the number of items which are given zero rated status. Because of the large number of zero rated items on which GCT is not charged but for which input credit can be claimed auditing of this claim is difficult and has facilitated abuse and evasion.

In other words there are numerous examples of credit being claimed on items which are exempted and not zero rated. The solution is to drastically reduce the number of zero rated items and the proposal is to transfer all zero-rated items to exempt, with the exception of exports, diplomats and international agencies and government.

This will have no impact on price levels as no GCT will be charged on final sales.

The result of this measure will result in an increase of \$3.6B in collection.

The GCT threshold will be increased to \$1M turnover per annum, thus removing 6,900 businesses from the GCT roll, freeing the auditors to concentrate on the real areas where revenue is lost.

The GCT on building materials will be brought up to standard rate yielding an additional \$370M in revenue.

The standard GCT rates will be increased to 16.5% resulting in an incremental yield of \$5.32B. This will have minimal impact on prices of basic foods as these are presently exempt and will remain exempt.

In recapping, we are proposing to:

- i) raise the income tax threshold to \$169,000 on July 1, thus releasing 54,600 from paying taxes;
- ii) raising the threshold again on January 1, 2006, releasing another 12,100 from paying taxes;
- iii) raising the threshold for pensioners;
- iv) eliminating transfer tax on estates of \$100,000 and under;
- v) imposing a flat property tax of \$600 for values of \$300,000 or less

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**2005/2006 JAMAICA BUDGET OPENING PRESENTATION**

**Dr. The Hon Omar Davies  
Minister of Finance & Planning  
Thursday, April 14, 2005**

---

On balance, there will be a net increase in revenues of \$9.355B which is adequate to close the gap and balance the budget.

## CONCLUSION

As we move forward into this new period, there are some special challenges that we will face hard choices that must be made and changes in attitudes that are essential for survival and development. In this light, let us look at 6 main issues, all relating to Planning.

Issue #1: the subject of oil. We produce not a one gallon of oil, but our consumption patterns do not reflect this reality. Together, we have made the discussion of an appropriate response to the oil crisis a game of one-upmanship. It matters not who started it but the game is over and we had better realize it. The movements in oil prices are not simply a threat to our balance of payments but to exchange rate stability, inflation control and to the whole economy.

In terms of numbers, our oil bill last year was (US) \$940 million, up from (US) \$640 million on 2002. There is no (legal) export earning which can grow at a similar rate to compensate.

How can we arrive at a consensus about oil and the way forward and avoid the politicizing of this life-and-death issue for our country? The first step is to have dialogue that seeks to generate light instead of heat.

I intend to propose, through the Leader of Government Business, that a Joint Select Committee be established to carefully examine the threat to our economic future caused by the unpredictable movements in the international oil market and to recommend measures which this Parliament – all of us – can put forward to the country. We have a responsibility to the people of Jamaica to do this.

Issue #2: Crime and violence. My colleague Minister will be speaking in this debate and will address the issue in detail. I need to report however, that despite the fiscal constraints, there will be a significant increase over last year in the allocation for national security.

Crime and violence deeply affect the well-being of all of us. I speak from experience as an MP representing some of the communities most affected by violence. In addition to the lives cut short, very great damage is done in denying residents the opportunity to live normal lives. They are not free to go about their daily business.

But it is the children who suffer the most heartbreaking damage. First, there is the trauma they experience and then there is another disturbing consideration. Every day that a child is forced to stay home from school, a piece of that child's preparation for the future is sacrificed. Not attending school eventually becomes a punishment for life, as the next generation is denied some or all of their opportunity to climb out of poverty and move up the social and economic ladder.

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## 2005/2006 JAMAICA BUDGET OPENING PRESENTATION

**Dr. The Hon Omar Davies**  
**Minister of Finance & Planning**  
**Thursday, April 14, 2005**

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This leads me to Issue #3 – the restructuring and revamping of our educational system. My colleague, the Minister of Education, has an enormous and difficult challenge. Yet she has good reason to smile today. Not only have we sought to put her in a position this fiscal year to begin the process of revamping the system, but there is more to come. Later in the Parliamentary year we will be coming to Parliament with specific proposals on providing a predictable and sustainable financing stream for the transformation process, which we all agree is critical.

Let us move on to Issue #4 – the SESP Programme. I have deliberately positioned it after speaking about Education and Training. I understand and appreciate the cries of my colleague MPs who fought valiantly for more funding for the SESP Programme. I know it represents a safety valve, especially in relation to projects for young people in the 15 to 24 year old age group, with no or low levels of skill and no job, and often living below the poverty line. And today I am making the commitment to you that if the revenue flows perform well, we will seek to do some additional allocation.

At the same time, I have a responsibility to make it clear that the problems being faced by our young people cannot be solved by stop-gap short-term measures. Are we only going to keep giving the “one-one” fish to provide a meal for a person here and there? Or are we going to provide our young people with the opportunities and facilities to learn to fish and be able to feed himself or herself for a lifetime? At some point we have to choose.

I have no doubt that the development solution for our young people lies in transforming the education and training system so that our graduates are equipped for jobs or other income-earning opportunities to lift them out of poverty.

Issue #5: Provisions for the fire services. I have already indicated the steps being taken to supply the Department with the requisite number of trucks and equipment to be able to give the society the protection it deserves. Even as we await the completion of the tender process, the Minister and I have discussed temporary measures such as repairing existing vehicles already in the fleet.

Issue # 6: the informal sector of the economy. One of the critical objectives of the tax reform programme is to bring more persons now operating in the twilight zone into the formal system, a move that will allow them to access certain benefits and to make their fair contribution. We cannot continue to have fixed income workers bearing the brunt of contributing. We need to pull everyone in to feel a part of the society and the economy.

I speak of the small business person, the taxi operators and the own-account operator. My message is: you too have a place in this economy and we cannot reap the full potential of this economy, if you stay outside looking in. The onus is on Government to invite you in.

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## 2005/2006 JAMAICA BUDGET OPENING PRESENTATION

**Dr. The Hon Omar Davies**  
**Minister of Finance & Planning**  
**Thursday, April 14, 2005**

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Government Departments must develop the kind of policies that will facilitate as many persons as possible to voluntarily become a part of the formal system. Self criticism is important. I have to admit that several areas under my own Ministry create some of the bureaucratic obstacles that make it difficult for some small entrepreneurs to enter the formal system. This is why we have started taking the steps to remove or reduce these obstacles.

I recently met with the leadership of the National Association of Taxi Operators and they are coming on board. One fascinating discovery from that meeting was that part of their fear was that they would be taxed on all that they collect. This is not true. We showed them that they, like any other business were entitled to take out expenses before even beginning to calculate taxes. We have worked out a formula and I am confident that the full membership will step from the twilight zone into the formal economy.

I have outlined six of the major issues that, as a nation impatient for development and prosperity, we must take on and solve. We can do it. I know we can do it and it will be done, because we have reached a point at which we can face the future with more certainty about our capabilities than ever before.

For the tight management of the economy, which is the plank that supports human development, we have a first class technical team in place. Even as some members of the guard are changing, I am proud of the team that we have built and I rank them against the best anywhere in the world.

There is absolutely no doubt in my mind that this country is better poised than every before for a long period of sustainable economic growth and development. The evidence is overwhelming that finally, we are beginning to reap some of the benefits of an orderly, disciplined approach to the management of the economy.

Look at the evidence of management, discipline and order, starting with the budget presentation itself:

- More information than ever before is now being provided for both MPs and the general public
- Data on inflation is now available 10 to 12 days after the end of the last month
- We have reduced the lag time in reporting on trade data
- And very importantly, moving away from months of uncertainty about the budget every year with a disastrous effect on public sector and private sector business, we have now firmly established that the Budget Debate must be completed during April.

Look at the evidence, in fiscal responsibility:

- Eliminating deficit financing is no longer an elusive dream – we have come a long way to arrive at this point where we can say with pride that we are in the final year of deficit spending.

Look at the evidence in the macro economic achievements

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## 2005/2006 JAMAICA BUDGET OPENING PRESENTATION

**Dr. The Hon Omar Davies**  
**Minister of Finance & Planning**  
**Thursday, April 14, 2005**

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- I no longer have to come before this Honourable House and explain why there's a shortage of foreign exchange and face the business people, household heads and creditors who could not do proper planning because of the level of instability of the Jamaican dollar.
- The macro economic indicators are stable.
- Investment in the economy is now better than it has been for a whole generation – and this is just the beginning.
- The confidence of investors, home and abroad, is higher than ever before. Just look at what has been happening in the stock market over the last year.

Look at the evidence of the impact of the macro economic achievements on the lives of the Jamaican people:

- The poverty rate has been cut in half – moving from 33.9% to 16.1% in 2004.
- The new construction projects alone, arising out of increased investor confidence, have created thousands of jobs – just recently I was at Jamaica Grande which has employed over 1000 persons to work on reconstruction and refurbishing.
- Access to tertiary education has been improved

Yes, we still have challenges to face and overcome. Yes we are still working hard to make sure more jobs are created and more funds can be allocated to social programmes. But we had to start somewhere and the most pressing need was to lay the foundation of stability. I can truly say that we have gone even further than that.

No one needs to tell me that the economic model is imperfect and that there are remaining difficulties. But it must be quite clear by now, to everyone, except those who refuse to see, that after a long search we have the makings of a workable economic model. Beg as much as I can, no coherent alternative has been advanced.

After years of searching and refining for the best way to take Jamaica forward, the evidence is here that the model we are pursuing, the same model that has been mocked and decried, is producing positive results – investments, growth and stability and jobs.

Let us not throw away the fruits that are now almost ready for reaping and for which so many have made sacrifices, with careless talk and cheap politicking. My call to the Opposition and to all the Jamaican people is for a meeting of the minds, a coming together of persons of good intentions to work out the difficulties that remain to be tackled. We have come this far by consensus and good will among all the sectors – supporting a vision and the courage to pursue a difficult and sometimes painful but necessary path of progress. This is no time to stop the movement towards genuine dialogue and co-operation for transformation.

Even in this Budget where we have been forced to take something from the tax payer to assist with closing the deficit, we have given back more –

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**2005/2006 JAMAICA BUDGET OPENING PRESENTATION**

**Dr. The Hon Omar Davies  
Minister of Finance & Planning  
Thursday, April 14, 2005**

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- (a) to fixed income worker – twice in the year
- (b) to the pensioners
- (c) to the small owners of property
- (d) to families formerly burdened with the duties payable on small death estates

The prospects for the Jamaican economy and the development of our people have never been better in a whole generation. I say to Jamaicans everywhere: be confident in the future, for increasingly, we are standing on firmer economic ground – a stable macro economy and higher rates of investment to support the creation of more jobs and greater educational and training opportunities.

This is where the real hope is. This is the real path to social stability, equity and true prosperity. Let us be proud of our achievements so far and let us keep moving forward with confidence and determination.