

BUDGET CLOSING PRESENTATION 2004/05

On

Wednesday, April 28, 2004

By Dr. the Hon. Omar Davies, MP

Minister of Finance & Planning

A: INTRODUCTION

1. Protocol
2. Very interesting Debate: high quality Debate has reflected both in terms of the contributions made as well as comments by analytic members of the media.
3. Two new comers to Budget Debate – Opposition Spokesman on Justice and the Minister of Industry and Tourism – sincere commendation to both.
4. My personal assessment – we have come a far way and in particular wish to comment to the Opposition. It is all too easy for these Debates to sometimes degenerate into wild accusations. Or promise to tax less and spend more.
5. Nonetheless certain specific issues have been raised and must be addressed.
6. We will deal with areas where questions were posed, information requested or proposals made. This will be addressed in a factual manner.
7. Now we come to two core areas; first, the proposal of the Opposition Spokesman to Speak to allocate an additional \$6.7B to be financed in the main from “savings” of \$7B.
8. Then, we will address the Leader of the Opposition’s proposal re the reestablishment of a fixed exchange rate system.
9. Finally, we will wrap up the Debate.

B: POLICY ISSUES/CLARIFICATIONS/INFORMATION REQUESTED

1. In this section I will provide responses and clarification for a set of questions/issues raised by Opposition Spokespersons.

ALCOA Investment

2. The Opposition Spokesman on Finance posed six questions about the proposed investment. I must confess surprise at some of the questions, as several of the answers are already in the public domain. Nonetheless I will respond.

Environmental Impact Assessment

3. The contract for carrying out the impact assessment has been awarded and the study has started.

Dust Nuisance and Emission Standards

4. These standards have been established as well as the indicators to be measured.

Manpower Planning

5. Significant work has been done in this regard with collaboration with HEART and Jamalco for the establishment of a state of the art training facility at Breadnut Valley. Both the company and HEART will be investing in the facility which will serve as a platform for a modern apprenticeship system in Jamaica, serving not only the B/A sector but manufacturing and other sectors.

Details of Skilled Workers required

6. This work has already been done and the details are as follows:
(READ FROM LISTING)

Implications for Transportation

7. As should be known, Jamalco has a well established rail system which has now been extended to the new mining areas in South Manchester. The plant is served by dedicated port, Rocky Point, which is adequate to meet its needs for importation of raw material and capital goods and the export of alumina.

8. Details concerning the equity investment swap. (The question is not clear.) As a result of the expansion the agreement is that GOJ's share of Jamalco will be reduced to a minimum of 30%. Accordingly, after due valuation, the Government will contribute to the investment such that its shareholding does not fall below 30%. The valuation will take into account issues such as cost of production and the existing value of the assets.

Bauxite Fund/Rehabilitation

9. The issue of the problems caused by displacement of persons prior to and subsequent to mining is of concern to both the Government and the Opposition. In fact, my colleague the Minister of Health and Member of Parliament for Central Manchester has been the leading advocate for closer monitoring of the effects.
10. It is for this reason that the Government has established a programme implemented by JBI to address some of the needs of communities affected by bauxite mining. There is need for additional work including the impact of settlement patterns, the need for land for expansion of population centres near to mining areas and perhaps most important, the need for programmes to facilitate economic activity in the post-mining period.
11. Work has been done but there is more to be done and Cabinet has commissioned a comprehensive study leading to further interventions. However, in direct response to the Spokesman proposal for a \$500M fund, we must be careful about expanding this process of establishing specially dedicated funds. This is one country and the resources garnered through the Consolidated Fund are to be aimed at addressing national problems. We run the risk of segmenting the Consolidated Fund into specific areas, thus reducing our flexibility to address new problems.
12. The second point to be borne in mind is that we need to be very careful in addressing the issue of what needs to be done in these areas such that we do not convey the impression that the companies are "the enemy". They have come here at our invitation. In many instances they have been better corporate citizens than many other companies. They recognize their civic responsibilities and it is for us as a country to seek to identify how

we can collaborate with them in addressing needs in the areas affected by mining.

13. Let us not pretend that all the problems which we now identify were caused by their activities, as many of these areas had long suffered from a deficiency in facilities, etc.
14. It is apparent that there is an opportunity for the JBI/JBM to provide a comprehensive briefing to all members of the House on the state of the Bauxite alumina industry, the challenges we face and the potential benefits for not only the country but the communities in close proximity to the operations.
15. I have asked my colleague Minister with responsibility for mining to facilitate this exchange.

Relationship with the IMF

16. The Opposition Spokesman has made a big “song and dance” about our proposed agreement with the IMF and argues that “there now appears to be some “back-pedaling” on the need for a monitoring arrangement with the IMF”.
17. Let me address this issue very clearly. We have nothing to hide. I have announced that the Fund and the GOJ have agreed on the parameters within which such a programme would be developed. A small technical team from Jamaica visited Washington to work through the preliminary numbers and targets for the medium term. However, pending the presentation of the actual budget numbers they could only go so far.
18. Furthermore, because virtually all the technical team, as well as myself, are totally involved in completing the budget process during April, the decision was taken that any further work would await my annual post-budget visit to Washington which will occur in mid May. Immediately following that, the IMF technical team will be coming to Jamaica to carry out its Annual Article IV Consultations. The discussions will then move forward given that the full data on the last fiscal year, as well as the Government’s programme for fiscal year 2004/05 and the medium-term will now have been completely spelt out.

19. It should be clear to one and all that the better than expected out turn in terms of the fiscal, among other targets, would have improved Jamaica's bargaining position in terms of the structure of the programme to be monitored by the IMF Board. Simply put, there is an agreed phasing of our discussions to which both parties are committed.

GDP Measurement

20. During his presentation in discussing the attainment of the fiscal, the Opposition Spokesman departed from his prepared text to make the assertion that our attainment of the fiscal deficit target (5.8% of GDP) was facilitated by us inflating the GDP figures for fiscal year 2003/04.
21. In other words, by increasing the size of the denominator, the clear implication is that the deficit was artificially compressed. I took the unusual step of interrupting his presentation to seek clarification but given that his further utterances did not assist, I committed myself to address the matter in my Closure.
22. Let me begin by making the point that Jamaica's data collection agency – STATIN – has a world-wide reputation of excellence and integrity. Neither political party, either in Government or in Opposition, has sought to question this integrity. Even if any member of the political directorate were so inclined, the professionals at STATIN defend their independence with great zeal.
23. The GDP figures are the exclusive responsibility of STATIN. In fact, I do not know the out turn for the fiscal year either in terms of real growth or nominal GDP until a few days before my presentation. Therefore, I wish for the public to understand that there has never been and there is no question of political interference in those matters.
24. Question therefore, what is the basis of the Opposition Spokesman's charge? I would prefer to believe that it a lack of understanding of the way in which nominal GDP is calculated. The size of the GDP is a reflection of the level of economic

activity in the country within any specified period. By definition, since that activity has a value in current terms, the GDP in current or nominal terms must reflect inflation and hence nominal GDP, **ceteris paribus**, in a year with increased inflation, will grow more quickly than in a year when inflation is low.

25. There are well-established statistical techniques for correcting the impact of inflation. They use a “deflator” which then reflects the GDP in constant terms. But the nominal GDP does reflect the actual value of our economic activity in current dollar terms for any specified period. There can be no other way around it. The debt is calculated in nominal terms, expenditure is stated in nominal terms; the deficit is stated in nominal terms and hence all comparisons are made, based on current dollars.
26. The Opposition Spokesman asserts that “the GDP was recently inflated by 15% and this is another reason why his fiscal target looked so attractive”. A question which arises, is that increase in nominal GDP unusual? The answer is a resounding “no”. It may be useful to point out to the Opposition Spokesman that in 1983 nominal GDP increased by 19.2%, compared to the previous year. In 1984 by 34.8%, in 1985 24.7% , in 1986 by 22.4% and I could give more examples.
27. Is it that we have such difficulty in accepting a positive result like meeting the deficit target and have to put a negative spin on it. That is one explanation. The other is that the Opposition Spokesman just did not understand. Whatever the explanation, let us move on.

Energy Issues

28. In his presentation, the Opposition Spokesman spoke about the need to look at options other than a tax on fuel including producing ethanol, developing more wind turbine and mini hydro projects, etc.
29. The Administration support all those initiatives. In fact, we go further in that the SCJ is examining investment in some co-generation projects which could reduce dependence on imported

oil and boost revenues for the company but the reality is that, that will take us only so far.

30. The plain fact is that for the medium-term, Jamaica will be dependent on imported fuel. We need to take a national more mature view on the pricing of this scarce imported commodity and again I am calling for a Joint Parliamentary Group to examine this issue and take the politics out of the policies.

Expenditure on Education

31. All three Opposition Spokesmen blasted the Government for supposedly renegeing from the commitment to allocate a certain minimum percentage of the expenditure to education. The issue was first raised during the Standing Finance Committee and I indicated that the agreement which had been hammered out in Parliament was deficient in terms of not being specific enough.
32. I posed the question as total expenditure includes, as we all know, a large chunk of debt servicing. In fact debt servicing accounts for \$228B of the total of \$328B.
33. In that debt servicing figure, several of the loans being repaid are directly related to education. Hence, in the external debt payments over \$835M (principal plus interest) is related to debts incurred for projects in education. Similarly, in the domestic debt servicing over \$4.8B is related to payments for educational projects. Therefore, in summary, debt servicing for educational projects account for \$5.7B.
34. The question which I posed then and I pose again - should not this figure be added to the amount which appears under the Ministry of Education? If this were so done, the total expenditure on education would be \$35.9B which would be approximately 11% of the budget.
35. The Prime Minister has already spoken to the issue that it is not simply more money and that is a point which we all comprehend. But in terms of the charge of a betrayal of an agreement, let us first clarify exactly what we meant in this agreement.

Productivity Changes

36. I now turn to an issue raised by the Leader of the Opposition in his presentation, the extent to which Jamaica had lost competitiveness worldwide and regionally. He cited various studies to support his point.
37. Let me address the issues directly but begin by noting that there is often a tendency for us in Jamaica to point to a loss in competitiveness in a manner of “Lawd we dead now”. But nobody poses the question if we have lost competitiveness in ‘X’ why will we be better in ‘Y’?
38. The second point which we need to realize is that the whole nature of the Jamaican economy has been radically changed over the last 30 years. Simply put the service sector now dominates the economy accounting for over two-thirds of GDP. Yet we still persist as if we were back in the days when output was bauxite, alumina, sugar and bananas. How many people would argue that our tourism product is inferior to that of Barbados or the Bahamas. How many people would argue that our entertainment services were inferior.
39. I am not for one moment writing off the traditional sector, but there is a need for us to come into this new century and realize that whilst we wish to maintain a multi-sector economy, services will be the main driving force for the future.
40. Nonetheless, I want to address specifically the issue of productivity even in the traditional sectors and I will select two, bauxite/ alumina and Sugar.
41. In both areas, the fact is that we had lost competitiveness compared to other producers. But we have not stood still, and we have not accepted that the situation was beyond redemption.

Productivity in Bauxite Alumina

42. In 1998 it took an average of 1.7 man hours to produce a tonne of alumina. In 2003 the figure had dropped to 1.28 man hours a decrease of 24.7%. That is improved productivity.

43. That is the national average, but the plant with the highest level productivity moved from 1.7 man hours per tonne in 1998 to .96 man hours 2003 and expects to move to .8 man hours per tonne in 2004.
44. But increased productivity comes not only from improved labour productivity, but also in how you utilize resources. When our alumina plants were designed, oil was so cheap that it made no economic sense to conserve. Our last plant was based on oil at US(\$1.50 per barrel.
45. Increased oil prices have forced improvements. In the case of the least energy efficiency operation, oil consumption has declined from 3.6 barrels to produce a tonne of alumina to 2.85 barrels.
46. In the case of the most energy efficient, they have reduced their consumption from 2.10 barrels to 1.74 barrels to produce a tonne of alumina.
47. Let me turn to another old industry which through Government's intervention has started significant recovery – the sugar industry.
48. As an aside, for those who had proclaimed its death, please note the intention of Worthy Park to invest in a rum distillery. Rum can only be made from sugar cane.
49. Let us look at some of the data from SCJ which has just surpassed its production level of last year with several weeks to go in the crop. In terms of tonnes of sugar produced per factory employee, at Bernard Lodge the figure has moved from 72.9 in 2002 to 80 in 2004. At Monymusk it has moved from 71.8 for 2002 to 113 in 2004. In terms of tonnes of sugar produced per hectare, at Frome the figure has moved from 5.92 in 2002 to 6.48 for 2004. At Bernard Lodge it has moved from 4.67 in 2002 to 5.47 in 2004.
50. The Monymusk figure has moved from 4.17 tonnes of sugar per hectare to 6.27 in 2004.
51. We can provide you with more data along the same lines. The basic point which I wish to make is that rather than us looking at

global figures and lamenting our inability to compete, each factory, each plant, each sector must begin by examining where we are presently and realistically planning ways to increase output, increase productivity and to lower unit cost.

52. There are too many simply gifted in explaining what is wrong and why we cannot compete. There are too few who simply see greater output as a challenge, have rolled up their sleeves and begin to demonstrate that we can meet the challenge.

C: ALTERNATIVE BUDGET

1. The Opposition Spokesman on Finance in critiquing the estimates has pointed to several priority areas which he has allocated additional funds.

(a) The fire services	-	\$637M
(b) PIDP	-	\$170M
(c) Infirmaries	-	\$100M
(d) Education	-	\$2.6B
(e) Health	-	\$1B
(f) National Security	-	\$600M
(g) Industry & Tourism	-	\$400M
(h) Dedicated Bauxite Fund	-	\$500M
(i) Agriculture	-	<u>\$200M</u>
		\$6.247
2. A total of \$6.247 Billion in additional expenditure.
3. To be fair to him he is not suggesting that we increase the estimates tabled to the full amount, as he has identified several areas of “savings” which would finance his additional expenditure.
4. Major source of financing would be \$4B from reducing average interest rates by 1%.
5. Mergers and rationalization e.g. NIBJ/DBJ - \$1B.
6. Further divestment of assets - an additional \$1B.
7. The total of these initiatives is \$7B leaving, as he claims, a “surplus” for other areas which need some topping up.
8. The arithmetic is correct but very little else. It is imperative that these populist assertions be dissected and shown for what they are. Let us begin with the interest rate savings.
9. How did the Opposition Spokesman come to his figure of \$4B from a reduction of 1% on the average interest rate? He didn’t say. However, I believe that he used the total domestic debt of just over \$400B and hence a 1% reduction would, superficially, mean a \$4B

saving. Unfortunately, the issue is a little more complex than this. Please follow carefully.

10. To begin, 60% of the current stock of domestic debt has a fixed interest rate. Therefore any adjustment will have to apply to the other 40%. Let us now turn to that 40% of the domestic debt, with variable interest rates.
11. Interest payments are spread through the year and the stocks are re-priced either quarterly or semi-annually. Hence, any rate adjustment will impact on only approximately \$84B of the domestic debt. The 1% reduction, if it can be attained, would mean savings of approximately \$835M, maximum.
12. New debt to be issued is projected at \$122B and this we could argue that this would be affected by this “hoped for” reduction in rates. However, only about two-thirds of this will have any impact in 04/05 and hence a 1% reduction in rates will generate savings of approximately \$400M.
13. At best therefore, this reduction which is proposed by the Opposition Spokesman would yield approximately \$1.2B, if it is possible - not \$4B as he asserts and for which he has clear-cut expenditure plans.
14. If the Spokesman’s projections/calculations are unrealistic, as I have just shown, consider the pipe dream of the Leader of the Opposition, who speaks of a possible reduction of 5% on Government domestic bond offers which could yield \$22B in one year – thus wiping out the fiscal deficit.
15. Whilst these are technical issues, it is important that the public understands that these reductions which are so loosely referred to are simply not feasible. Furthermore, it would be unwise for any Government to proceed to commit itself to additional expenditure to be funded on possible savings from interest rates – that is spent and then hope for the best.
16. What happens if, per chance, due to shocks - domestic or external, interest rates move in the opposite direction? How would we then compensate for expenditure already undertaken?

17. Simply put, Mr Speaker, we have projected interest expenditure assuming a most aggressive reduction in interest rates. This interest rate assumption does not stand in isolation. It is consistent with all the other aspects of the macro-economic programme.
18. We cannot simply assume an average reduction of 1% and proceed to spend in advance. Furthermore, the \$4 B savings, is as I have shown, simply not possible – much less the \$22B suggested by the Leader of the Opposition.

Merger of DBJ/NIBJ

19. Let me say something about the intended merger of these institutions. The fact is that the previous merger - of the former ACB and NDB - was quickly effected because the institutions were very similar except for areas of focus. In this case, there is a difference in that NIBJ has significant equity stakes in a range of companies unlike the DBJ which is essentially a bank with a loan portfolio.
20. As such the analysis has demonstrated that, prior to effecting the merger, it is important that the various investments held by NIBJ be reviewed, so as not to affect the balance sheet of the DBJ which, as is generally accepted, is in excellent financial state. Put another way, there is need for us to separate those investments which have not been profitable prior to proceeding with the merger of the two institutions. The timetable is that this will be done during this fiscal year.
21. However, even when the merger takes place, gains will be in terms of increased efficiency levels and greater focus in terms of developmental initiatives. The total administrative budget for both institutions amounted to \$..... last year, hence there are no significant savings to be reaped from this merger.

Divestment Proceeds

22. A third area identified to fund the expanded budget as proposed by the Opposition Spokesman is “further divestments” yielding an additional \$1B.

23. The proposal re increased divestment which, to be fair emanates not just from the Opposition Spokesman, is sometimes based in ignorance. During the last fiscal year, the Government divested various assets to the tune of \$6.9B. This included sale of receivables from AIC, Sale of LOJ shares, sale of RJR shares, receipts from the sale of non-performing loans.
24. The truth is that this amount was far in excess of that which had been projected. For 04/05 it is projected that we will receive \$1.9B from similar divestments.
25. Members of this House should be assured that if it is at all possible to do better we will, but we cannot begin to spend money before it has been earned.

D: FIXED EXCHANGE RATE

1. A major point of discussion in this budget debate has been the proposal by the Leader of the Opposition that Jamaica should return to a fixed exchange rate system. That is there should be a fixed relationship between the value of the J\$ and the US\$. It was a subject to which he dedicated a great part of his presentation.
2. In response to some of my initial comments following his presentation, the Leader of the Opposition suggested that I needed a refresher course and that I needed to take a break from politics to review recent developments in the area. More of that anon.
3. The issue is so important that I believe that it deserves serious treatment and I wish to start by indicating that the debate about the most appropriate exchange system for any given country is not new, nor is it an end in itself, even despite the build up given to it by the Leader of the Opposition. Any exchange rate system is established to accomplish certain macro-economic objectives. What are these objectives?
4. I do not believe that any group of reasonable persons whether within this House or outside would have difficulty in identifying a set of objectives around which we could unite. The trick is whether or not they can be simultaneously achieved and if so, over what period.
5. This list of objectives would include
 - (a) stable predictable foreign exchange rate system
 - (b) low levels of inflation
 - (c) adequate foreign reserves to deal with the consequences of shocks domestic and external
 - (d) low interest rates
 - (e) growth
 - (f) expanded employment opportunities
6. The Leader of the Opposition cites various sources including some local academics in support of his argument. But one difficulty I face with his reasoning is that many of his references are dated with most of his data sets ending in mid 90's and in certain

instances up to 2000. One is left to wonder at this arbitrary cut-off point.

7. However, another difficulty with the discussion is that in certain instances the pursuit of the “fresh wind” leads the Leader of the Opposition into flights of fantasy. In making reference to the decision of his Administration in the late 1980’s to artificially fix the exchange rate he states -

“The lesson to be learnt, is the magically motivating dynamic force which a fixed exchange rate holds in the market” (page 47). (My emphasis)

8. This dramatic language would seem to move this matter into the realm of magic rather than where it should remain rooted - in hard analysis.
9. Another difficulty we face with the Leader of the Opposition’s presentation was a seemingly inherent contradiction between his advocacy of the fixed exchange rate juxtaposed with his demand that the market should play the dominant role.
10. On page 53 he proclaims “remove man from the centre of the equation and let market forces operate”.
11. I believe every one in this House was puzzled when that position was juxtaposed with “we must decide on the system we want to regulate the rate of exchange, then fix it and live with it as long as we can maintain its value (if possible, til God comes); if not, at least until two-thirds of the members in each House of Parliament make a change as should be provided by a system of law replacing the choice of man” (page 55).
12. So here we have a situation of an appeal to the “magical motivating dynamic force”, an exhortation to let the market forces run but at the same time a fixing of the rate and maintaining the established value, “if possible until God comes.”

13. Let us step back for a moment from this celestial reasoning and look at two of the examples quoted by the Leader of the Opposition – Argentina and Jamaica.

Argentina

14. Table 12 of the Leader of the Opposition's booklet provides data on the performance of the Argentina economy and a whole range of variables prior to and post fixing of the rate between the peso and the dollar on April 1, 1991. What is fascinating is that table 12 stops in the year 2000.
15. In this era of internet, it is impossible to believe that the Leader of the Opposition did not, and does not, have access to data for the period subsequent. Every one knows or assumes that he is up to date and is fully aware of what is happening not only in Jamaica but elsewhere. I certainly did, and I still do.
16. It is a fact that prior to 1991 Argentina suffered from hyper inflation which resulted in interest rates of the order so graphically outlined by the Leader of the Opposition in his presentation.
17. It is a fact that subsequent to the fixing of the relationship between the peso and the dollar – fixed by law - inflation was brought under control, the economy grew, interest rates declined and foreign investments increased.
18. But that is not the end of the story nor did Argentina cease to exist in 2000. One may have been tempted in that period to sing in glorious praise of the “magical motivating dynamic force which a fixed exchange rate holds in the market”.
19. The fact is that, that fixed rate, backed by legislation, locked Argentina into certain structural deficiencies which could not be adjusted in the face of the fixed exchange rate.
20. Were Argentina an isolated island living on its own, then that could have been addressed, but it was involved in a trading block, and it borders next door to Brazil which operates with a flexible exchange rate system. The result was that over time, even as various indicators showed the improvements cited by the Leader of

the Opposition, it was becoming apparent that the Argentina dream was becoming a nightmare. Its productive sector was becoming increasingly uncompetitive.

21. I visited Argentina during the period being hailed by the Leader of the Opposition – a period when inflation was zero and I understood why. Prices were the highest I had seen anywhere they could be raised no higher. Even leather goods of equal quality could be purchased elsewhere more cheaply – in a country previously renowned for high quality, reasonably-priced leather goods.
22. One takes no pleasure in what eventually occurred with Argentina. It is an issue to which I have made reference on previous occasions. A problem in a small domestic bank escalated as the Central Bank, totally devoid of any flexibility in responding to problems in the financial sector, because of the iron-clad legislation fixing the rate between the peso and the dollar, was unable to intervene. The result was that there was widespread panic leading to a virtual collapse of the economy and the society.
23. Within a short period the country became virtually ungovernable with five Presidents and five Ministers of Finance being changed in a period of five months, November 2001 to April 2002.
24. The highly touted magical formula of the legislation on the fixed exchange rate was abandoned as quickly as it had been implemented. Even today, although there has been some recovery, the problems remain.
25. Argentina has reneged on its debt obligations and has offered its creditors a maximum repayment of 25 cents in the dollar. Many financial institutions with a long history of doing business in Argentina have simply cut their losses and left the country.
26. Argentina cannot afford to use its reserves to clear its payment arrears as to do so, they would be wiped out. However, until some accommodation is reached with its creditors, it is forced to live outside of the formal credit system.

27. There is much more which could be said about this example but that is enough for the first part of the “refresher course”.

Jamaica

28. I now turn to the issue of another example of a fixed exchange rate system referred to by the Leader of the Opposition, that of Jamaica. In his presentation he cited his struggle with the IMF which in the mid 1980's was committed to devaluation as the principal macro-economic tool.
29. He indicates that after a long struggle in which he “stood firm” the then Managing Director of the Fund agreed with his decision to peg the rate of exchange at J\$5.50 to the US\$. He neglects to mention that this decision occurred only after the then Opposition held an all night vigil demanding that the exchange rate system be stabilized. But so be it. He may have forgotten, but we remember.
30. He then proclaims the “magical results” following the decision to fix the exchange rate.
31. History cannot be rewritten in such an arbitrary manner. It is true that the fixed exchange rate brought about increased stability. But it is also true that this rate, whilst fixed, was relevant for a decreasing percentage of the economy. The two major import houses at that time were taken out of the official foreign exchange market and their obligations were settled outside of normal operations. Even for those who participated, settlement of obligations was “when funds were available”.
32. Everyone knew that virtually every business and every individual had funds stashed away which they used to keep operations going, to be replenished whenever the Bank of Jamaica was able to provide them with some of the resources they had paid for months before.
33. It later became known that the Bank of Jamaica, itself, in order to prop up this artificially fixed rate, was purchasing dollars on the black market. Therefore, let no one be fooled about this “magically motivating dynamic force” which a fixed exchange rate holds in the market.

34. Like any other magical trick, once you get behind the smoke and mirrors – reality is different.
35. In looking at the issue clinically, the obvious reality is that any policy decision is that there are pros and cons.
36. The fixed exchange rate system, assuming that the fundamentals are right and the rate can be maintained, does provide all participants with a greater level of certainty and stability.
37. It also tempers inflation in that, **ceteris paribus**, a fixed rate will ensure that imported inflation will be the same level of that of your major trading partners and hence there is greater predictability in making long-term commitments.
38. However, there are costs and a critical one relates to the removal of flexibility to respond to domestic and external shocks.
39. The Argentine example demonstrates the potential negative consequences if the Central Bank is unable to respond to difficulties within the domestic financial sector. Consider the calamity if the BOJ had not been able to provide funding for distressed institutions during the period of turmoil in our financial sector.
40. I can hear those suggesting that this turmoil would not have occurred within the context of a fixed exchange regime. Argentina is the obvious response to any such assertions.
41. Consider also the difficulties in terms of the inflexibility of adjusting domestic costs as again the Argentine model demonstrated. It is a fact that the reduction in Jamaica's cost of production has been a critical factor in influencing the investment decision of ALCOA.
42. But there are other issues. We have come a long way since the fixed rate system of the late 80's. At that stage our NIR stood at minus \$560 million. Now we are at \$1.6 billion positive. Many fundamental questions arise -

- (a) at what rate would we fix the exchange rate system?
 (b) How would the rate be changed if we so desired – that is if we need to do so before God comes.
43. What of those who hold foreign exchange accounts - both companies and individuals? Would capital controls be reintroduced?
 44. The Leader of the Opposition failed to mention that all the Caribbean examples he cited had controls on capital flows in support of the fixed exchange rate system.
 45. But although he would prefer that man remains out of these decisions, how often would a re-assessment take place and how could we determine how much of a re-adjustment was needed?
 46. This proposal by the Leader of the Opposition is deserving of serious analysis but by offering it as a solution for all of our problems, he has done damage to his case. Can we forget that a few years ago the solution to all problems laid in the passage of the three bills? Where are the bills now? Have they been abandoned?
 47. The reality is that decision making with regard to exchange rate systems has become more sophisticated. There is a whole generation of decision makers in both the public and the private sector who are far more exposed to information and data, not just on Jamaica but on all our trading partners. An arbitrary decision to re-introduce a fixed exchange rate system just will not wash.
 48. Quote Professor Jeffery Frankel of Kennedy School, at Harvard University. “The Argentine crisis of 2001 dealt a severe blow to the conventional view that a country that was willing to make a firm and sincere institutional commitment to a rigidly fixed exchange rate, as under a currency board, could hereby import credibility, and achieve convergence in price levels and interest rates. The situation is far worse than the remarkable fact that a supposedly ironclad fix came undone in a short period of time. Argentina’s 1999-2002 recession has been so severe as to fully reverse the very good income gains during the heyday of the currency board, 1991-1998”.

E: CONCLUSION

1. As indicated in the Opening Presentation, this was a difficult Budget to craft – all ministries could do with more.
2. Opposition Spokesman quoted the Accountant General's comments – basic point being made - failure to adjust the level of expenditure consistent with resources.
3. Not just at the national level but within each ministry/department.
4. Have not sought to hide issues. There are significant challenges to be faced in 2004/2005.
5. However prospects are positive.
 - a) Domestic interest rates are coming down.
 - b) External fund rising - signs are positive. A year ago no one would lend us. Now the cry is - rates are too high.
6. In the midst of present situation, despite the positive prospects there is a critical lesson: do not spend before you earn, do not spend before you save.
7. Even after savings are realized, important policy consideration - balance between additional expenditure of paying down debt.
8. Apart from the concrete prospect projects on line, in the pipeline and being conceived, there is a new mood, a new attitude.
 - a) MOU
 - b) Decline in interest rates
 - c) Private sector initiative
9. Problem areas still remain. Inadequate skill levels, particularly amongst the young. Challenge to provide that group with remedial training. Challenge also to ensure present cohort in school graduate as skilled employable persons.

10. In the midst of bright prospects, physical degradation in inner city areas and deep rural areas. These groups cannot be left behind. Need to focus on intervention.
11. But this Debate is about the fiscal budget. Hence always to be kept in mind is that our creditors will punish us for failure to continue to demonstrate fiscal discipline. Confidence level has increased. Recent debenture closed early as it was over subscribed.
12. External bonds which traded below par mainly because Jamaicans who purchased participation were taxed have moved above par. Issue was reopened yesterday and yielded an additional US\$125M.
13. We deliberately chose to reopen this issue as we had explicitly inserted a clause to make interest paid to Jamaican nationals taxable.
14. We have not claimed that everything is going right; we could not claim that everything is going right. Challenges remain but there is no one in this House who could have predicted the positive outcomes we are experiencing given the negative results we faced even six months ago.
15. No one could have predicted that we would have made the deficit target.
16. No one could have predicted that interest rates would have been at this stage. No one could have predicted a recovery in the level of confidence in our external bonds.
17. But this has not come about by chance. This has come about because of focused, dedicated, hard work. There are real prospects for expanding economic activity and employment - reason enough to continue on the path we have outlined. This is not the time for wild speculative policy shifts based on inadequate or out of date information. This is a time to address issues of problems using analysis rather than appeal to “magical” solutions.
18. The public response, both domestic and external, has been rewarding. The message is clear. There is increased confidence in

the economy and in our ability to meet the challenges which we face.