IEO
Independent Evaluation Office
of the International Monetary Fund

BACKGROUND PAPER

BP/21-01/11

Growth and Adjustment in IMF-Supported Programs for Western Hemisphere

Reginald Darius and Marco Pinon-Farah

Address. 700 19th Street, N.W., Washington, D.C. 20431, U.S.A. Telephone. +1 202 623 7312 Fax. +1 202 623 9990 Email. ieo@imf.org Website. ieo.imf.org

 BP/21-01/11

IEO Background Paper
Independent Evaluation Office
of the International Monetary Fund

Growth and Adjustment in IMF-Supported Programs for Western Hemisphere

Prepared by Reginald Darius* and Marco Pinon-Farah†

June 30, 2021

* Senior Economist, African Department, IMF; and former Lead Evaluator, Independent Evaluation Office of the IMF.

† Consultant, Independent Evaluation Office of the IMF.

Contents Page

Figures

Table

ABBREVIATIONS

BOP	Balance of Payments
CDB	Caribbean Development Bank
CGF	Caribbean Growth Forum
CSP	Committee of Social Partners
ECCB	Eastern Caribbean Central Bank
ECCU	East Caribbean Currency Union
ECF	Extended Credit Facility
EFF	Extended Fund Facility
FDI	Foreign Direct Investment
FRL	Fiscal Responsibility Law
GDP	Gross Domestic Product
GFC	Global Financial Crisis
GPRS	Growth and Poverty Reduction Strategy
LEG	Legal Department (IMF)
LIC	Low-Income Country
MCM	Monetary and Capital Markets Department (IMF)
MEFP	Memorandum of Economic and Financial Policies
NDC	National Democratic Congress
NDX	National Debt Exchange
PATH	Programme of Advancement through Health and Education
PPP	Public Private Partnerships
PRGF	Poverty Reduction and Growth Facility
PRGT	Poverty Reduction and Growth Trust
REEF	Real Effective Exchange Rate
RGSM	Regional Government Securities Market
SB	Structural Benchmark
SBA	Stand-By Arrangement
SCF	Standby Credit Facility
SEED	Support for Education Empowerment and Development Programme
VAT	Value-Added Tax
WEO	World Economic Outlook

CHAPTER 1. GRENADA AND JAMAICA

REGINALD DARIUS*

---

* Senior Economist, African Department, IMF, and former Lead Evaluator, Independent Evaluation Office of the IMF.

EXECUTIVE SUMMARY

Grenada and particularly Jamaica both endured an extended period of low growth leading up to the global financial crisis (GFC), along with growing macroeconomic imbalances reflected in high public debt and large fiscal deficits. The widening fiscal deficit reflected not only the decline in growth but also fiscal expansion to shore up growth, which was largely unsuccessful, as the growth slowdown reflected structural weaknesses related to labor and product market distortions, accentuated by external economic shocks and frequent adverse weather-related events. The GFC magnified existing macroeconomic vulnerabilities as growth declined, macroeconomic imbalances widened further and access to both domestic and external sources of finance declined.

Both countries entered post-GFC IMF-supported programs in 2010, which were regarded as restoring macroeconomic stability, including to ensure fiscal and debt sustainability, the overriding challenge to achieving higher rates of growth. The programs involved tough fiscal primary balance targets and, in the case of Jamaica, a domestic debt operation. Despite some early successes, these programs quickly went off-track due to weak political ownership, weather-related shocks and external conditions that were less favorable than anticipated.

Economic conditions in both economies worsened following the premature end of the IMF-supported programs. Financing challenges also became more acute and growth remained weak. The countries again requested IMF-supported programs (Jamaica 2013 EFF and Grenada 2014 ECF) with broadly similar objectives as the previous programs but with greater attention to growth-enhancing reforms. Both programs included debt operations, with Grenada benefiting from principal haircuts on both domestic and external debt, while Jamaica's debt operation involved an interest rate reduction along with maturity extensions on domestic debt.

Jamaica's 2013 EFF, which was followed by the 2016 SBA, and Grenada's 2014 ECF, were viewed as highly successful. Debt was placed on a downward trajectory, fiscal targets were met (and surpassed in the case of Grenada), and structural reforms advanced. The Fund provided extensive TA on fiscal and financial issues, and other IFI's also provided support. The catalytic role of the Fund, beyond facilitating debt operations, was strong in Grenada, but less so for Jamaica.

Growth outcomes differed. Grenada experienced robust output expansion, driven largely by factors external to the program including expansion of the important tourism sector. Confidence effects from improved macroeconomic management also supported output growth. Jamaica's growth, however, remained subdued, as deep-rooted structural constraints, such as a weak business environment and high crime rates continued to suppress growth as the expected dividends from macroeconomic and structural reforms were slow to materialize. However, gains in confidence from improved macroeconomic management and steps to shift towards a more private sector led growth model started to take root prior to the disruption caused by COVID-19 in early 2020.

Strong domestic support for the post-2013 programs proved important to success in both countries as broad-based participation and decisive leadership were critical to strong program implementation. Direct attention to growth enhancing policies, beyond the confidence effects of macroeconomic stability and support for vulnerable groups, facilitated greater consensus and helped foster strong commitment.

I. INTRODUCTION

1. This background paper examines adjustment and growth under IMF-supported programs in two Caribbean economies. Grenada and Jamaica faced similar macroeconomic challenges. In both countries, debt was assessed as unsustainable after the economies experienced anemic growth during the decade preceding the Global Financial Crisis (GFC). Growth had been tepid from the 1980's in the case of Jamaica. The two island economies have similar economic structures, with both heavily dependent on the tourism sector and reliant on remittances as an important source of foreign exchange although Jamaica is more diversified. Grenada and Jamaica have been particularly exposed to external economic shocks and natural disasters and face limited institutional capacity and a high per capita cost of public administration capacity (Alesina and Spolaore, 2005; Ruprah and others, 2014).

2. A significant difference between the two countries is the structure of public debt, which had significant implications for program design. A substantial portion of Jamaica's public debt (about 50 percent) was held by domestic savers; principal repayments were protected under the constitution. In the case of Grenada, about 60 percent of public debt was external. Another key difference is the exchange rate regime. Grenada is part of a currency union with a fixed exchange rate, while Jamaica has a managed exchange rate. This implied that the burden on fiscal and structural adjustment was high for Grenada, while exchange rate policy was an important part of the policy tool kit for Jamaica.

3. The GFC magnified existing economic challenges and both countries entered IMF-supported programs in 2010 to help restore macroeconomic stability. The debt of both countries was assessed to be unsustainable but only Jamaica's program entailed debt restructuring, which was restricted to maturity extensions and lower interest rates and was applied only to domestic debt. In the case of Grenada, restoring debt sustainability was based on ambitious fiscal adjustment and optimistic growth assumptions. Both programs were premised on growth effects from gains in confidence associated with macro-economic adjustment and improvements in external demand.

4. The 2010 programs went off-track after a promising start and were replaced by a 2013 Extended Fund Facility (EFF) for Jamaica and a 2014 Extended Credit Facility (ECF) for Grenada. This time, both programs featured debt operations and included efforts to tackle growth in a more direct manner. Like the first post-GFC programs, they were based on ambitious fiscal and structural adjustment packages to restore macroeconomic stability. Jamaica's 2013 EFF was followed by the 2016 Stand-By Arrangement (SBA) which sought to consolidate gains achieved under the previous program. Both countries received emergency support in 2020 to help them address the COVID-19 pandemic, although this experience is not evaluated here.

5. This paper is based on an extensive review of internal Fund documents along with interviews with Fund staff and authorities involved in the five recent IMF-supported programs: Grenada 2010 and 2013 ECFs; Jamaica: 2010 SBA, 2013 EFF, and 2016 SBA. The rest of this paper

is organized as follows. Sections II and III will discuss the program experience for Grenada and Jamaica, respectively. Each section will deal with five sets of issues: Section A provides a brief background; Section B discusses the design of IMF-supported programs; Section C examines program implementation and outcomes; Section D outlines views of the authorities and Fund staff and Section E provides an assessment. Finally, Section IV concludes with some key lessons.

II. Grenada

A. Context

6. Small size, low growth, and high public debt and fiscal deficits, along with membership in one of only four currency unions in the world, the East Caribbean Currency Union (ECCU), present Grenada with a difficult set of macroeconomic challenges.[1] Grenada, with its heavy dependence on tourism and susceptibility to hurricanes, illustrates well the challenges of a fixed exchange rate regime, as fiscal policy and structural reforms are the main policy tools to achieve short-term stabilization objectives and spur long term growth.

7. The period immediately following Grenada's independence in 1974 was characterized by civil disturbances that saw the government overthrown. Following a period of limited democracy, constitutional government was restored in 1983. Since then, Grenada has established a strong democratic tradition, with labor unions as powerful players in the political process.

8. Grenada's recent macroeconomic problems can be traced to policies implemented to offset the growth slowdown experienced at the beginning of the 2000's. The government responded with expansionary fiscal policies financed via issuance of high interest-rate international bonds to support growth. While the fiscal expansion included increased capital spending, the growth impact was minimal as the slowdown in activity reflected structural weaknesses and sluggish external demand. Then in 2004 Grenada was hit by hurricane Ivan, one of the most devastating storms to make ground in the Caribbean (Acevedo, 2016), followed by hurricane Emily in 2005. These storms caused widespread devastation, estimated to be as high as 200 percent of GDP.

9. To address widening macroeconomic imbalances, Grenada entered a PRGF-supported program in 2006,[2] which was preceded by a debt exchange in November 2005 that covered

[1] The other ECCU members are Antigua and Barbuda, Dominica, St. Kitts and Nevis, Saint Lucia, and St. Vincent and the Grenadines, as well as Anguilla and Montserrat, which are overseas territories of the United Kingdom.

[2] Grenada became Poverty Reduction and Growth Trust (PRGT)-eligible in 1986, its per capita gross national income exceeds the IDA operational cut-off, but remains PRGT-eligible given the presence of serious short-term vulnerabilities.

about 40 percent of total public debt at the time.[3] The 2006 Poverty Reduction and Growth Facility (PRGF) arrangement aimed to restore fiscal and debt sustainability, support growth, reduce financial sector vulnerabilities and increase the country's ability to withstand severe weather events. The 2006 PRGF included large upfront fiscal efforts with underlying adjustment of about 4½ percent of gross domestic product (GDP). The program projected medium-term growth of about 4 percent per annum and aimed to reduce public debt from about 90 percent of GDP in 2006 to 60 percent of GDP by 2020, in line with the Eastern Caribbean Central Bank's (ECCB) recommended target.[4] The program included public financial management reforms that largely targeted revenue administration. However, program implementation was hampered by slow moving hurricane reconstruction efforts.

10. Growth remained anemic and reforms were not implemented. Growth rebounded in 2007 and 2008 on account of hurricane reconstruction spending but stalled in 2008 due to spillover effects of the GFC, which pushed the economy into recession. Inflation, which rose during the immediate aftermath of the two hurricanes, decreased sharply as the GFC (Figure 1). Anticipated fiscal and external adjustment fell below program goals. Initial debt reduction in 2007 and 2008, largely driven by increased output, was reversed in 2009 as growth faltered and Grenada continued to record primary fiscal deficits. Furthermore, the current account deficit remained elevated despite declining from the post hurricane reconstruction high.

11. The PRGF-supported program was succeeded by a two-year ECF arrangement in April 2010, with access of 75 percent of quota. This was followed by a three-year ECF in 2014, that provided access in the amount of 120 percent of quota. Grenada also has made use of the Fund's emergency facilities, with two purchases of 25 percent of quota each in the aftermath of the severe hurricane in 2004/2005 and of 100 percent of quota in 2020 in response to the COVID-19 pandemic (Figure 2).

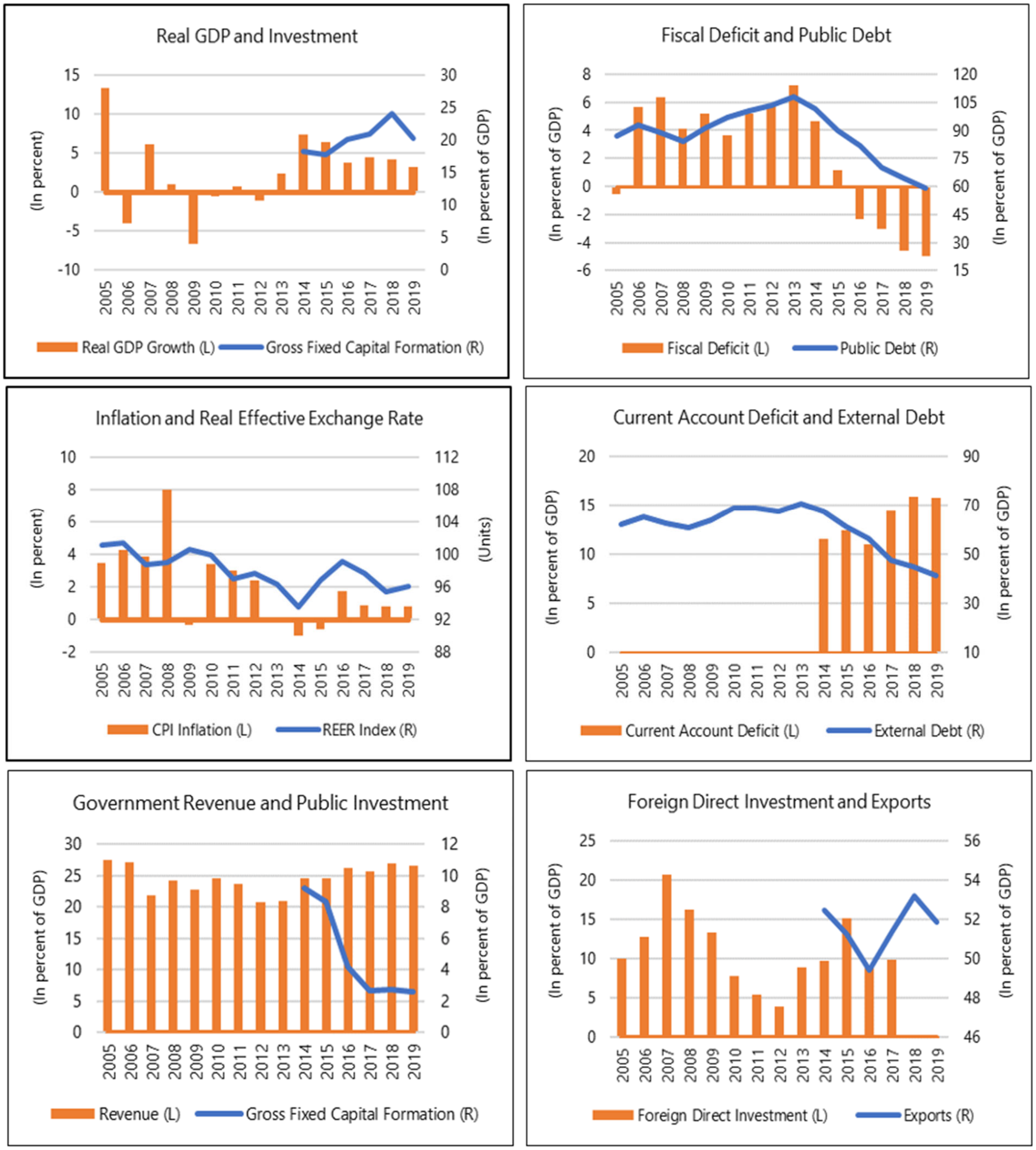
12. The 2010 ECF-supported program was put in place by the National Democratic Congress (NDC), which held a narrow parliamentary majority. Political conditions became more favorable for sustained program implementation after the general elections held on February 19, 2013, which resulted in the defeat of the incumbent NDC. The incoming New National Party (NNP) led by Dr. Keith Mitchell, who had governed the country between 1995–2008, won all 15 parliamentary seats. This result was repeated in 2018 with the NNP retaining control of the government and all the parliamentary seats.

---

[3] The debt exchange did not include haircuts, but principal arrears and past-due interest were fully capitalized. The new bond instruments had a 20-year maturity and initial interest rate of 1 percent, which increased after three years. The exchange resulted in a 35 percent NPV reduction and reduced debt servicing by about 83 percent during 2005–08.

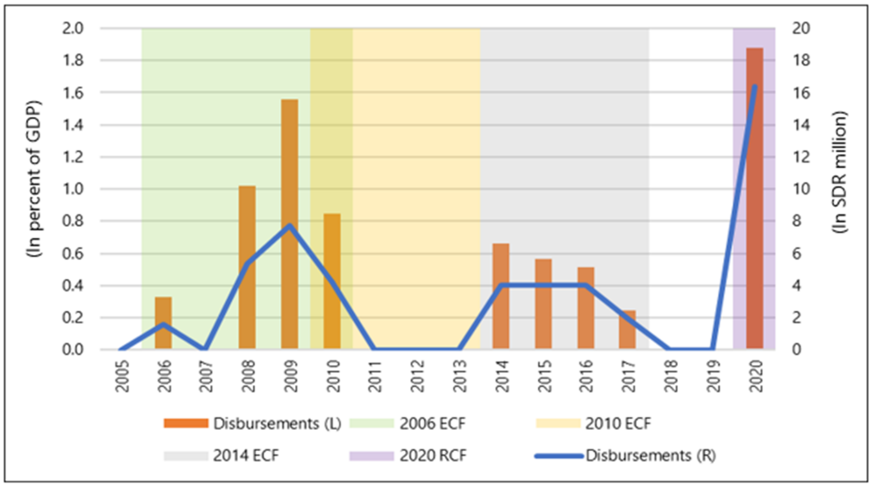
[4] The debt target was approved by the Monetary Council, but it is left to individual member states to design and implement policies aimed at reaching the target.

Figure 1. Grenada—Macroeconomic Developments



Sources: April 2020 WEO database; INS database; and FFA database.
Note: Available current account data pre and post 2014 were calculated using different mythologies, which generated vastly different data.

Figure 2. Grenada—IMF Disbursements



Source: IMF Members' Financial Data.

B. Program Design

Program Objectives

13. Fiscal sustainability, debt reduction, reduced financial system vulnerability and higher growth were the core objectives of both ECF-supported programs. The similarity of these objectives to that of the 2006 PRGF reflected continued macroeconomic instability and limited sustained gains derived from that program, due to inadequate domestic commitment, capacity constraints, and external shocks. Much like the 2006 PRGF, the 2010 and 2014 ECFs aimed to lower the public debt-to-GDP ratio to reach the ECCB's recommended target of 60 percent by 2020. Both programs included large upfront fiscal adjustment together with fiscal reforms to lock-in gains from the adjustment effort. The 2014 ECF also entailed comprehensive debt restructuring. The main financial sector objectives for these programs involved strengthened supervision of both commercial banks and the non-bank financial sector, including resolution of issues related to the collapse of the CL Financial Group[5].

14. Program projections anticipated moderate but steady improvements in growth and stable inflation. Staff's medium-term growth projections were more optimistic in the 2010 ECF at 4 percent compared to 2½ percent in the 2014 ECF (Table 1). Less optimistic growth projections in the more recent program were in line with recommendations of the 2013 ex post assessment to be more cautious. Anticipated improvements in growth were based on recovery in external demand and normalization of domestic conditions, with near term growth partly constrained by fiscal adjustment. Risks to the growth outlooked were identified to include weather-related

[5] CL Financial Group was the largest privately held conglomerate in Trinidad and Tobago and one of the largest privately held corporations in the entire Caribbean, before the company encountered a major liquidity crisis and subsequent bailout in 2009.

shocks, larger fiscal drag, and slower than anticipated global recovery. Inflation was projected to remain stable at 2 percent on account of weak demand and benign international commodity price developments, in the context of the currency union.

Table 1. Grenada—Growth and Fiscal Adjustment

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Real Growth											
2010 ECF proj.	-7.7	0.8	2.0	3.0	3.5	4.0	4.0				
2014 ECF proj.						1.1	1.2	1.7	2.0	2.4	2.5
Actual	-3.4	-0.5	0.8	-1.2	2.4	7.3	6.4	3.7	4.4	4.2	3.1
Primary Balance											
2010 ECF proj.	-3.8	0.3	2.0	3.3	4.0	4.4	4.8				
2014 ECF proj.						-2.4	1.3	3.5	3.5	3.5	3.5
Actual	-3.0	-1.5	-2.7	-2.5	-3.9	-1.1	2.1	5.2	5.7	6.5	6.0

Sources: WEO and IMF staff reports.

15. Strong country ownership was cemented with formation of the Committee of Social Partners (CSP) chaired by the Minister of Finance. The CSP's main objective was to foster a common approach between government and social partners as a strategic mechanism for the formulation and implementation of national policies and to serve as one of the main platforms to address growth. The CSP established a subcommittee with extensive responsibilities: (i) monitoring program implementation; (ii) reviewing monthly reports from the ministry of finance on performance criteria and structural benchmarks as set out in the Memorandum of Economic and Financial Policies (MEFP); (iii) assisting government to achieve agreed targets and benchmarks; and (v) recommending corrective actions as deemed necessary.

Fiscal Adjustment and Reforms

16. Large fiscal adjustment was viewed as unavoidable in both programs due to limited financing options, unsustainable debt levels, and constraints on achieving debt relief through debt operations. Adjustment measures were distributed about evenly between revenue and expenditure. Expenditure control was aimed at wage bill containment and reduced spending on goods and services. Capital expenditure was limited to priority projects with the highest employment generation potential.

17. Under the 2010 ECF, revenue gains were premised on improved value-added tax (VAT) compliance and simplification of collections (1 percent of GDP), introduction of a market-based property tax (0.2 percent of GDP) and improved customs collection (1 percent of GDP). Revenue measures under the 2014 ECF entailed a reduction in the minimum threshold for paying the personal income tax (PIT), thereby increasing the income tax coverage from 5 percent of income earners to about 19 percent. Other measures included: increased property tax rates and revaluation of assessed property values; increase custom services charge; a broadening of the VAT base through reductions in exemptions; and introduction of a financial activities and a small business tax.

18. The 2010 ECF-supported program targeted primary surpluses in the range of 3 percent to 5 percent of GDP over the medium term (see Table 1). DSA analysis by IMF staff suggested that Grenada's risk of external debt distress remained high, but new restructuring of debt to private creditors was not part of the program. The authorities decided not to pursue that path after initially exploring the issue but instead sought official debt relief and continued to seek additional relief from private creditors from the 2005 debt operation. Instead, the program relied on strong fiscal adjustment efforts to achieve the debt target. In view of slippages during the 2010 ECF, the 2014 ECF was based on even more ambitious adjustment and envisaged primary fiscal consolidation of 7¾ percent of GDP over three years to achieve a 3½ percent primary surplus, together with debt restructuring to place public debt on a firm downward path. This substantial and front-loaded fiscal adjustment, with about 75 percent of measures implemented in the first two years, was assessed to have minimal impact on growth as multipliers were estimated to be low given the country's small size and high degree of openness.[6] However, staff noted that the authorities did raise concerns about the impact of such a large adjustment on the nascent recovery.

19. Steps were taken to shield vulnerable groups from adverse effects of fiscal consolidation. Under the 2010 ECF, a Social Safety Net Committee (SSNC) was appointed to spearhead reforms of the social safety net system to include establishment of a central registry of beneficiaries, consolidation of major cash transfer programs, and establishment of a cash grant unit with technical assistance from the World Bank. The financial allocations to support the most vulnerable groups were increased with planned cash transfers to SEED of about 0.3 percent of GDP in the 2014 ECF.[7] Reforms to strengthen the SEED program in line with the objectives in the 2010 ECF were also envisaged with continued assistance from the World Bank.

20. Structural conditionality focused primarily on fiscal reforms (Table 2). These reforms aimed to address root causes of fiscal imbalances and focused on overhauling previous practices along with implementing fiscal responsibility legislation to transition towards a rule-based medium-term framework that would anchor fiscal policies (2014 ECF). To reduce the possibility of reform fatigue from the heavy legislative agenda, staff and the authorities agreed to introduce all required measures in the budget presented to parliament at the beginning of the 2014 ECF rather than at various stages.

---

[6] Gonzalez-Garcia and others (2013) provided an empirical evaluation of fiscal multipliers for ECCU members using panel-SVAR models. This work found that, over one to four quarters, multipliers of taxes and consumption expenditure are statistically non-different from zero, while public investment has a multiplier of 0.6. The authors argue that the ECCU members share several features including: a single currency, broad participation of the government in the economy, a high degree of trade openness, high levels of public indebtedness, and vulnerability to exogenous shocks.

[7] SEED is the Support for Education Empowerment and Development Programme, a consolidated cash transfer program encompassing public assistance, student support and school feeding.

Table 2. Grenada—Structural Benchmarks (SBs) and Legislative Agenda

	2010 ECF	2014 ECF		
		Request	5th Rev.	Legislative Agenda
Total SBs	9	5	25	Program related: 33
Growth SBs	0	1	1	of which growth: 3
Fiscal SBs	7	4	24	Fiscal: 30
MEFP growth measures	8	4	5	
Prior actions	2	5		

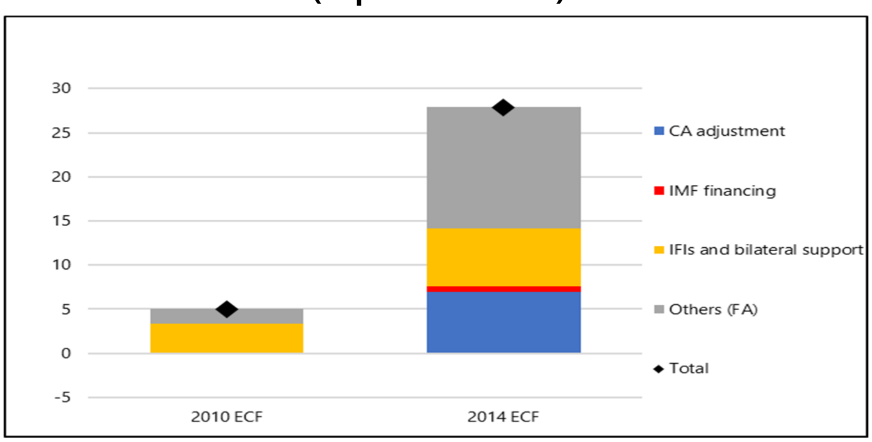
Source: IMF staff reports.

External Adjustment and Financing

21. The magnitude of current account adjustment differed between the programs. Under the 2010 ECF, the current account deficit was projected to improve marginally as both exports and imports of goods remained broadly stable. By contrast, current account adjustment played a more substantial role under the 2014 ECF in line with strong fiscal adjustment and projected export recovery (Figure 3). IFIs accounted for a significant share of financing to meet balance of payment needs in both programs but more so in the 2010 ECF when the contribution of CA adjustment was expected to be negligible.

22. The Fund's financial contribution was relatively limited—only around 1½ percent of GDP under the 2010 ECF—but the catalytic effect was expected to be strong (see Figure 3). The authorities expected to receive €9 million from the European Union (EU), US$8 million from the World Bank (WB), and US$6.4 million from the Caribbean Development Bank (CDB) during the first year of the program. In support of the 2014 ECF, the WB and the CDB arranged new lending, with planned disbursements of US$30 million during the three years of the program. The EU signaled a resumption of support for Grenada with planned disbursements of €12.4 million over five years, while the ECCB and Commonwealth also supported the program.

Figure 3. Grenada—Balance of Payments Need Decomposition
(In percent of GDP)

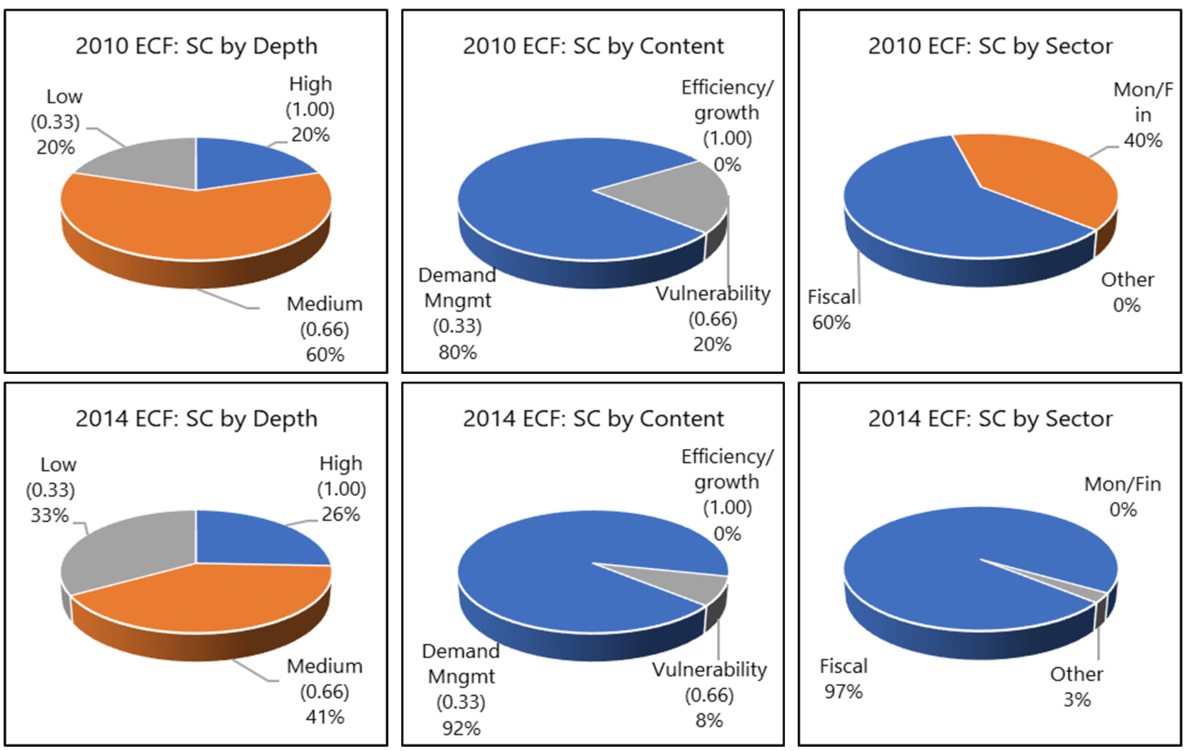


Sources: IEO calculations and Kim and others (2021).
Note: See Kim and others (2021) for a detailed explanation of the methodology.

Growth-Supporting Reforms

23. Both ECF-supported programs aimed to promote growth through structural reforms to facilitate private sector-led development and reduce poverty including through the creation of a more effective social safety net. In addition, the authorities planned to develop a new Growth and Poverty Reduction Strategy (GPRS) in both programs, supported by the CDB under the 2010 ECF. However, the 2014 ECF made growth a more central focus in line with recommendations of the 2013 Ex Post Assessment of Longer-term Program Engagement. Competitiveness was to be improved through public sector wage restraint in the context of a fixed exchange rate. Growth-related reforms included: (i) lowering the domestic cost of energy; (ii) improving the investment environment; and (iii) establishing a legal framework for public private partnerships (PPP). The MEFPs contained several growth commitments which were previously identified in Article IV consultations but not included as structural benchmarks. However, three quarters of the structural benchmarks were assessed as low to medium depth (Figure 4).

Figure 4. Grenada—Structural Benchmarks by Depth, Content and Sector



Sources: IEO calculations and Kim and Lee (2021).
Note: The numbers in bracket refer to the score (scaled between 0 and 1) assigned to the corresponding category. See Kim and Lee (2021) for a detailed explanation of the methodology.

24. The 2010 ECF growth agenda included implementation of the newly enacted Investment Promotion Act, which aimed to rationalize fiscal incentives and provide similar support to domestic and foreign investors along with measures to improve business facilitation processes. Efforts would continue to reduce the time to start a business, including registering and

incorporating a company through : (i) the special business and facilitation committee to help investors overcome administrative and other obstacles, (ii) additional civil Court to reduce delays and enhance contract enforcement, and (iii) separate Registrar of Lands and Deeds, to expedite the transfer of property in business transactions.

25. The 2014 ECF growth agenda was more comprehensive in scope and with greater depth. Reforms under this program entailed several legislative amendments to lock in the required institutional changes to help sustain envisaged gains (see Table 2). Structural reforms to support growth focused on improvements in the business climate and on reducing the cost of doing business (especially relating to electricity and import costs). This included strengthening the Investment Promotion Act of 2009 and having the Act acceded to law, which was expected to help: (i) streamline investment procedures; and (ii) codify requirements for investment, and all tax incentives. PPPs would be used to promote infrastructure development, with possible investments in healthcare, energy and infrastructure.

26. In the context of the fixed exchange rate, the 2010 ECF focused on a public sector wage containment to promote internal devaluation. The 2014 ECF aimed to broaden the strategy through steps to improve cost efficiency including, most importantly, a reduction in energy costs. Tight wage restraint in the public sector was expected to have a demonstration effect on private sector wages, lowering unit labor cost and improving competitiveness. Wage moderation was complemented by policies to reduce markups through liberalization of key sectors in the economy (renewable energy, nutmeg and cocoa trade) and review of the labor agreements with the port authority as well as revision of the Labor Code to introduce a shift system to help reduce costs and increase efficiency.

27. World Bank engagement was expected to provide substantial support to the reform program. The WB had an ongoing engagement assisting Grenada with reforms in the energy sector, and further assistance was expected during the 2010 and 2014 programs to overhaul the regulatory framework and improve the efficiency of SEED. The WB was actively engaged in activities identified in the MEFP and from 2012 led the Caribbean Growth Forum (CGF) in conjunction with the Inter-American Development Bank (IADB), the CDB, in collaboration with the United Kingdom Agency for International Development (DFID) and the Canadian International Development Agency (CIDA). The CGF sought to identify policies and initiatives aimed at supporting growth and creating jobs in the Caribbean region through analytical work, knowledge exchange, and inclusive dialogue.

Debt Reduction

28. Both programs aimed to restore debt sustainability and included additional actions to reach the ECCB's regional target of debt at or below 60 percent of GDP over the medium term. The 2010 ECF strategy was based largely on sustained larger fiscal adjustment supported by implementation of a debt management strategy (DMS) grounded within a three-year rolling budget framework from 2011, with explicit annual targets for the public debt-to-GDP ratio, to

promote more stable fiscal management. The 2010 ECF included a request for debt relief from bilateral official creditors, involving a request for a stock treatment of debt owed to the Paris Club (2.4 percent of total debt) and non-Paris Club official bilateral creditors (8.6 percent of total debt). The authorities also intended to reduce the debt burden by continuing good faith efforts to reach a collaborative agreement with Grenada's external commercial creditors who did not participate in the 2005 debt exchange, but discussions made little progress.

29. In the run-up to the 2014 ECF, it was realized that large fiscal adjustment would not be sufficient to restore debt sustainability and that a sizeable restructuring of government borrowing from the private sector would be required. Supporting the adjustment effort with a debt operation was important to lessen the burden of adjustment and dampen the impact on growth. Thus the 2014 ECF envisaged debt stock operations to reduce private debt and support fiscal adjustment, with financing assurances aimed at closing the financing gap during the 2014 ECF[8] (Box 1). Domestic debt accounted for about one-third of the total debt, half of which were treasury bills issued on the regional government securities market (RGSM) and about 8 percent were domestic bonds. The impact of debt restructuring on the financial sector was assessed to be moderate as exposure to the central government of banks (5–7 percent of total assets), credit unions and the insurance sectors was limited.

Box 1. 2015 Debt Restructuring

On March 8, 2013, Grenada announced its intention to pursue a new "comprehensive and collaborative" debt restructuring with private creditors, which was concluded on November 12, 2015. Restructuring entailed haircuts on all government debts except (i) multilateral debt, (ii) treasury bills issued in the regional government securities market (RGSM) (iii) loan facilities extended by the ECCB and (iv) National Insurance Scheme (NIS) domestic bonds (NISDB).

The main features of the exchange were as follows: face-value reduction of 50 percent for external and non-NISDB debt; capitalization of past-due interest; coupon rates for new instruments of 7 percent for external and non-NISDB and 3 percent for NISDB; maturity extended on average by 10 years for NISDB and five years for external and non-NISDB.

Using a discount rate of 13.9 percent, the total NPV haircuts were estimated at (i) 49 percent for external and non-NISDB debt and (ii) 59 percent for NISDB. Collective Action Clauses on US$-denominated bonds were triggered a minimum participation requirement of at least 75 percent of the total principal outstanding amount of eligible claims. The restructuring also entailed two novel features: a hurricane clause, which provided for immediate temporary debt moratorium in the event of another natural disaster, and a Citizenship by Investment Program revenue-sharing clause in new bond contracts.

Source: Asonuma and others (2016).

[8] All eligible debt restructured through a 50–60 percent nominal principal haircut was expected to generate between US$354–410 million, sufficient to cover the projected financing gap of about US$350 million during 2014–17.

Program Risks

30. Both programs identified weaker than anticipated growth, weather-related shocks and weak policy implementation as sources of risk to the targeted adjustment effects. Contingencies for these risks included increased expenditure control including gradual release of spending appropriations, steps to expand the income tax base, and contingency financing related to the citizenship-by-investment program[9] in the 2014 ECF.

C. Program Implementation and Outcomes

2010 ECF Arrangement

31. Despite some initial early successes, the 2010 ECF went off-track quickly as fiscal objectives were not met. At the first review all quantitative targets and structural benchmarks agreed under the program were met. The fiscal deficit declined as revenue intake from income and property taxes was higher than anticipated. Capital expenditure was contained, offsetting the lower than anticipated savings on government spending on goods and services. The current account deficit narrowed as weak domestic demand curtailed imports, which more than offset the decline in tourism receipts. Inflation rose on account of one-off price effects from the introduction of a VAT and higher global commodity prices. However, growth continued to falter as tourism and construction were affected by the lack of a firm recovery in the US and Europe and unemployment remained very high. Against this background, the aim to achieve a rising primary surplus in the fiscal accounts was not achieved.

32. The program was adjusted to show some flexibility in the face of disappointing growth returns. Despite the high debt burden the authorities applied for a loan of US$115 million (17.8 percent of GDP) from the Export-Import Bank of China (EXIM-China), with a grant element of about 40–45 percent to support and attract private sector participation to construct a luxury hotel. Staff cautioned the authorities, however, that in the context of debt sustainability concerns, the project would be better financed by the private sector. The authorities agreed with staff that if they were to go ahead, it would be critical to: (i) base their decision on an assessment of the returns from an internationally reputed third party; (ii) secure concessional financing; and (iii) obtain majority private sector participation. The authorities also requested and were granted an adjustment to the test date performance criterion on non-concessional external debt, to accommodate loans from Kuwait and OPEC to complete a feeder roads project that would benefit the agricultural sector.

33. The program was suspended in mid-2011 as the commitment to fiscal restraint diminished and macroeconomic conditions worsened. With elections imminent, there were further deviations from the fiscal adjustment path as the authorities implemented expansionary

[9] The Citizens by Investment Program was introduced in 2013 to attract investment. Applicants are required to pay a sizeable fee.

fiscal policies through increased spending in part due to political pressures. Macroeconomic conditions deteriorated as the fiscal deficit widened, debt increased, and financing pressures became more acute.

2014 ECF Arrangement

34. In contrast to the 2010 ECF, program implementation was strong under the 2014 ECF and core program objectives were met. Significant fiscal and current account adjustments were realized, public debt was placed on a sustainable path and growth rebounded strongly (Figures 5 and 6). All qualitative performance criteria were met and the authorities made continuous progress in implementing agreed fiscal and growth-related structural benchmarks and commitments.

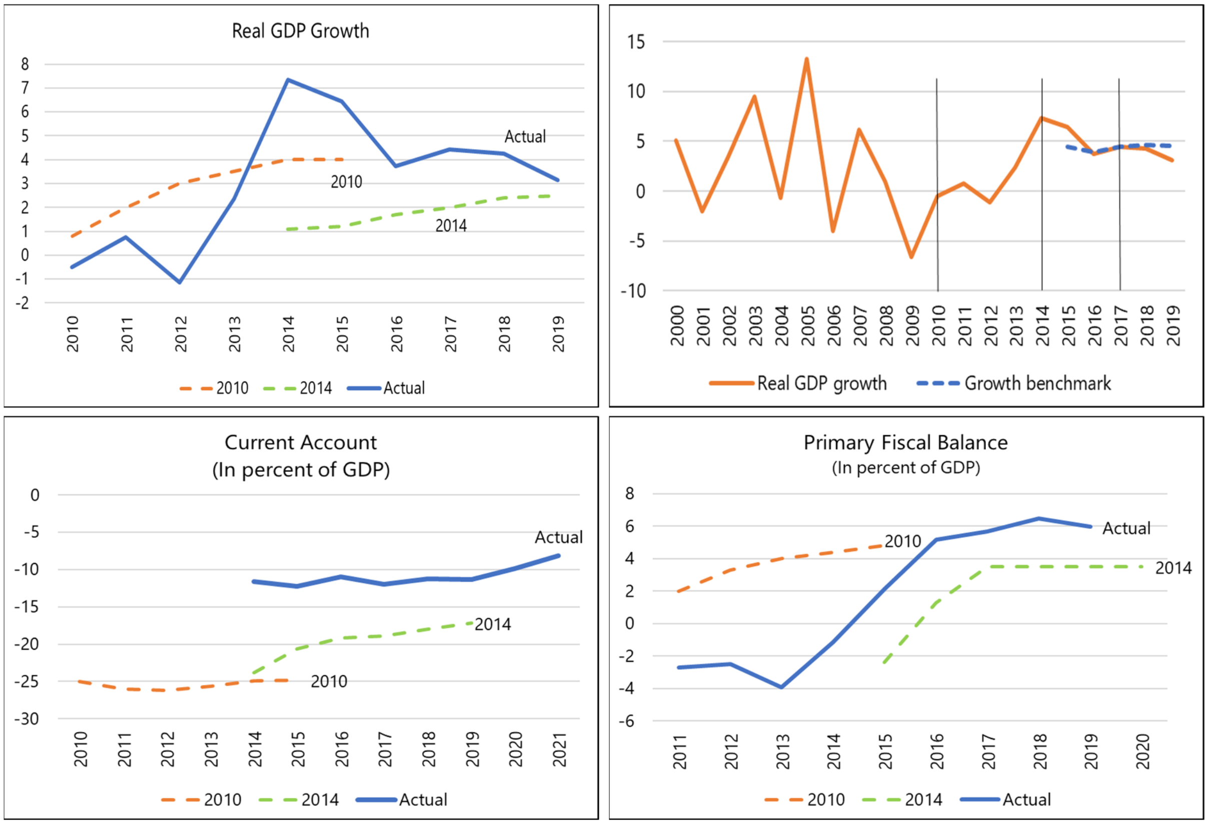
35. Confidence effects from macroeconomic adjustment and rising external demand helped support growth although unemployment remained elevated. Growth overperformed relative to projections, benefiting from favorable developments in the agriculture and tourism sectors that were not directly related to the program, including increased output of agricultural crops as a result of completion of the 10-year recovery cycle following the storm damage suffered in 2004/05 and through the construction of a major hotel which already was in train prior to program approval. Unemployment continued to trend downwards from over 35 percent but remained uncomfortably high at 28.6 percent in 2016.

36. Fiscal adjustment was stronger than programmed (see Figures 5 and 6). Solid fiscal performance was due to higher than anticipated intake of tax revenues, which was driven by robust economic growth and improved tax compliance helped by actions to improve tax administration. By the second review, about half of total programmed consolidation had been achieved and Grenada recorded its first primary fiscal surplus in over a decade. Payables to the private sector were largely eliminated, a key requirement of the program. In the final program year, Grenada recorded a primary surplus of 5.4 percent of GDP which exceeded the program target. Strong fiscal performance continued into the post-program period, as the gains made during the program were sustained by strong growth, improved tax compliance, and continued fiscal discipline anchored on the fiscal responsibility law.

37. Actual growth exceeded not only staff projections but also benchmark growth estimated by the IEO based on external cyclical factors.[10] This reflected favorable domestic developments associated with increased capacity in the tourism sector.

[10] The IEO benchmark model estimates a growth benchmark based solely on exogenous factors (see Kim and others, 2021).

Figure 5. Grenada—Outturn vs. Program and Growth

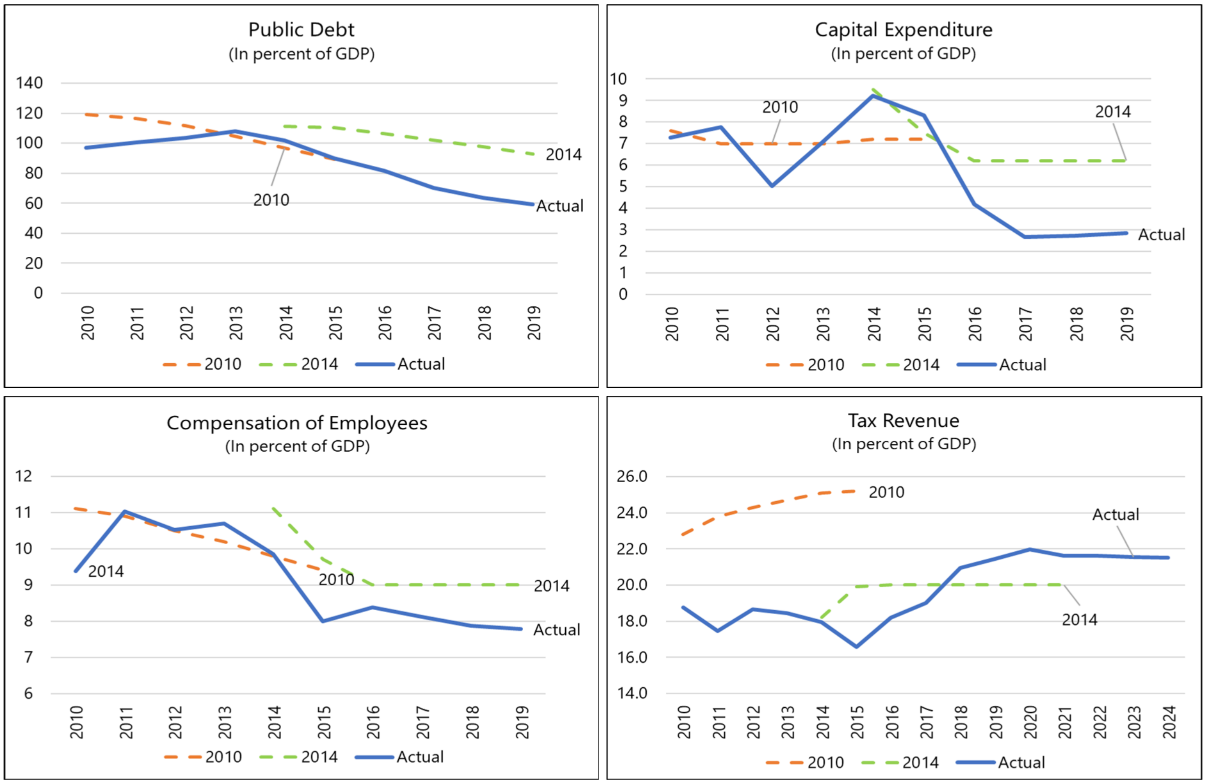


Sources: WEO; Grenada staff reports; IEO calculations; and Kim and others (2021).
Note: Dotted vertical lines represent start years of program and solid vertical lines the end year. Adjustment is measured in percent of GDP. Available current account data pre- and post-2014 were calculated using different mythologies, which generated vastly different data.

38. A new Growth and Poverty Reduction Strategy (GPRS) aligned with the program framework was unveiled in 2014, with a strong focus on competitiveness, growth, and job creation. Consistent progress was made with this growth agenda. Energy sector reforms lowered energy costs by strengthening the regulatory framework for electricity to support more efficient pricing with assistance from the World Bank. Market reforms to boost export competitiveness were also initiated through a program to commercialize government estates. In addition, the authorities approved a new investment bill to streamline investment requirements and remove red tape.

39. External adjustment also was stronger than anticipated. Current account adjustment initially was supported by improved competitiveness as the REER depreciated by about 6 percent from mid-2013 to mid-2014 reflecting low inflation and depreciation of the U.S. dollar against other major currencies. There is limited data available on domestic wage costs, and it is difficult to ascertain whether the expected demonstration effect on private sector wages was realized. Further improvements in the external balance were spurred by fiscal consolidation, lower oil prices, a rebound in tourism receipts, and reduced imports of tourism related construction goods.

Figure 6. Grenada—Debt, Expenditure and Revenue
(In percent of GDP)



Sources: WEO; Grenada staff reports; and IEO estimates.
Note: Dotted vertical lines represent start years of program and solid vertical lines the end year.

40. Government spending was broadly in line with the program design, as public sector wages were placed on a downward path, but capital spending fell appreciably (see Figure 6). Wage cost containment was achieved through attrition and a wage freeze; as envisaged public sector retrenchment was not required. Continued reduction in capital spending was due to: (i) implementation of the new charter of accounts;[11] (ii) capacity constraints in the public and private sector with limited qualified professionals such as architects, engineers, and project managers; and (iii) the operation of the new fiscal rule.

41. Spending on social programs increased but delays in reforming the flagship social assistance program, "SEED," implied that spending outcomes fell below the program indicative floor for several reviews, albeit by small margins. The World Bank provided support to improve targeting of social assistance. However, delays were experienced in unveiling a new tool for administering the program which led to a temporary freeze on processing of new applicants. The new beneficiary information system became operational during the third quarter of 2016.

[11] The new charter of accounts improved reporting on capital expenditures and some items previously categorized as capital spending were moved to current spending. In addition, under the fiscal rule initial spending plans were made based on projections of future inflation. If actual inflation fell below projections, spending targets were met through reductions in capital spending.

42. Stronger growth, fiscal surpluses, and debt restructuring provided the basis for a major improvement in debt sustainability. By end-2017, debt-to-GDP had been reduced by 36 percentage points to around 72 percent of GDP. Staff estimated that nominal GDP growth contributed about 50 percent of this decline, while fiscal consolidation and debt restructuring accounted for about 25 percent each. In total Grenada restructured 85 percent of the debt stock, including the restructuring of all Paris Club debt. The burden of the debt reduction in NPV terms fell mostly on external bondholders. The impact of the debt restructuring on financial stability was contained due to the financial system's low exposure to the government while debt held by the National Insurance Fund was not subject to haircuts, although it was subject to a reduction in NPV through maturity extension and lower interest rates.

43. The extensive legislative agenda supporting the agreed reforms largely was implemented. The authorities took advantage of their parliamentary majority to enact key legislation early in the program. Some delays in implementation were experienced due to capacity constraints and the large number of reforms. Staff noted that preparation of the strategy for wage bill management reform, revising the labor code, and drafting a new act for Grenada's investment promotion entity took longer than expected because of the need for broad stakeholder consultation. Nevertheless, overall structural benchmarks were met, mostly on schedule (see Figure 4). The Fund provided TA in several areas including strengthening cash management, debt management, and more effective cash flow forecasting through CARTAC. The World Bank provided TA to support establishment of a framework for PPPs, public sector reform, improved social protection framework and debt management.

44. Program implementation benefited from broad based social consensus. The CSP was critical to garnering support for the program by providing stakeholders with a medium through which they could participate and contribute in the design and delivery of program measures. Although the need to build support sometimes led to delays, key objectives were all met in the end.

45. The government continued to practice prudent fiscal management and to accumulate primary surpluses after the program ended, despite rising spending pressures, and public debt remained on a downward trajectory. Growth performance remained solid through 2019 reflecting continued strong external demand, gains made in increasing capacity in the tourism sector, and confidence effects from improved macroeconomic management.

D. Authorities and Staff's Perspectives

46. The authorities and domestic stakeholders commended the IMF for helping Grenada through what they regarded as an extremely challenging period, particularly valuing the 2014 ECF. The Fund was viewed as flexible and open to dialogue on various policy options. Officials at the technical level noted that policy details of the program were largely developed by the IMF team, but some modifications were made based on their suggestions.

47. The authorities noted that Grenada's experience showed it was possible to achieve strong adjustment and growth, even in the context of a fixed exchange rate regime. However, both staff and the authorities recognized that favorable factors external to the program contributed to the positive outcome. Fund staff were concerned about long-term growth prospects and whether Grenada would continue to adhere to the fiscal rule and follow-through on the fiscal accountability framework, but these fears did not materialize. The authorities credited the fiscal responsibility law (FRL) for ensuring that adjustment gains were sustained.

48. Staff noted that there was initially great skepticism internally about the likelihood of the 2014 ECF's success, given the mixed implementation record under the 2010 ECF and previous engagements, and the sizeable adjustment agreed to under the program. Staff said they were convinced by the new government's degree of commitment and greater political capacity given its large majority. Area department staff worked hard to convince the Fund of the authority's commitment to the program and organized joint meetings with other departments to help build confidence.

49. Staff also recognized that better-than-anticipated growth outcomes had reduced immediate concerns surrounding the impact of the significant fiscal adjustment on growth and helped to provide context for rigorous implementation of the structural reform agenda. Staff noted that key to raising confidence was to address the underlying fiscal and debt problems. Therefore, conditionality largely focused on these areas. Furthermore, in passing a large debt operation it was important to demonstrate to creditors that significant complementary efforts were being made on the fiscal side, a position that was aligned with that of the authorities. It was recognized that successful program implementation played an important role in supporting near- and medium-term growth. As an example, the authorities indicated that the private sector benefited from improved fiscal management, as the government had a history of accumulating significant levels of arrears on domestic payables, which were eliminated under the program.

50. Notwithstanding the overall appreciation, officials felt that staff was not proactive in discussing the growth effects of adjustment. The authorities noted an intense focus on restoring macroeconomic stability, particularly fiscal sustainability. The authorities indicated that discussions on the growth impact of adjustment occurred at their urging. Staff was mindful of these concerns but did not discuss or present any rigorous analysis of the growth impact of fiscal adjustment. Staff indicated that fiscal multipliers were derived from IMF studies, and were used in arriving at growth forecasts with the drag from fiscal contraction estimated to be modest.

51. Staff indicated that their analysis suggested that deep-rooted domestic bottlenecks related to factors such as the high cost of energy and weak business environment were the main obstacles to growth. Regarding the growth impact of structural reforms, staff did not make specific calculations and argued that attempts to generate more precise estimates would not be a good use of staff resources.

52. The authorities stated that debt relief was crucial and applauded the IMF's role in supporting the need for substantive debt restructuring. They were able to highlight the gains from the potential debt operation to help build domestic consensus around the program.

53. IMF financing was viewed as a minor component of the Fund's overall contribution. But the catalytic effect of the IMF-supported program was viewed as very consequential, with the World Bank and Caribbean Development Bank (CDB) injecting a large amount of resources, given increased confidence in a sound macroeconomic policy framework. Some officials felt that more development financing was needed but did not link it to increased IMF funding. Staff raised concerns about the constraints of the debt limit policy, which restricted potential funding from other IFIs as the only non-concessional financing permitted under the program.

54. The authorities highly valued the attention given to social protection in the 2014 ECF and indicated that it helped galvanize social consensus around a challenging program. Staff viewed the floor on social spending as helpful to protecting the most vulnerable as they recognized that the adjustment would have some impact on lower income groups, and it was important to signal IMF concerns in a meaningful way.

55. In general, staff and the authorities agreed that the three-year duration of the 2014 ECF was adequate. The authorities indicated that longer time frames would raise doubts that the authorities would be able to restore macroeconomic stability. On balance they felt confidence gains from timely resolution of macroeconomic issues outweighed gains from any easing of the adjustment burden associated with longer program duration.

56. The authorities indicated that the ambitious reform agenda did stretch their limited implementation capacity. They acknowledged that more time would have been helpful, but on balance were happy to have delivered within a tight timeline. The authorities highly valued the extensive TA provided by the IMF and agreed with staff that it played a significant role in the successful delivery of the reform agenda.

57. Staff indicated that country ownership of the program was very strong particularly with the formation of the CSP, which in part reflected the realization that strong and sustainable adjustment was needed to unlock debt relief. The decision to legislate all the required measures at the beginning of the program rather than at various stages was viewed as important in reducing the possibility of reform fatigue from the heavy legislative agenda. This was possible because of the strong parliamentary majority.

E. Assessment

58. Grenada's 2014 ECF is considered a success story as both internal and external adjustment were achieved along with robust economic growth. Staff and the authorities both acknowledged that growth outcomes benefitted substantially from factors outside the Fund program but agreed that the confidence effects from improved macroeconomic management were important as well as necessary. The restoration of macroeconomic stability more than a

decade after the devastating hurricanes of the mid-2000's laid a solid foundation for medium-term growth. The significant reduction in the debt burden through the contribution of stronger growth, fiscal consolidation, and a major debt operation was an important achievement that helped to pave the way for the authorities to reduce debt-related vulnerabilities and increase their buffers against external shocks through the creation of much needed fiscal space.

59. The success of the 2014 ECF compared to the short-lived 2010 ECF resulted from differences in design, implementation, and the external environment. Several factors contributing to the 2014 ECF's success included: (i) a more committed government; (ii) greater attention to ownership; (iii) successful execution of a major debt operation under the 2014 ECF; (iv) greater attention to growth; and (v) a more favorable external environment.

60. Staff structured the 2014 ECF based on conservative growth projections to place the focus on the strength of policy measures. This insulated the program from potential downside risk associated with lower growth. Projected average annual growth during the program and post-program periods were in line with the 10-year pre-program average of under 2 percent.

61. A noticeable difference between the 2010 and 2014 programs was the level of attention paid to growth. In the 2010 ECF, structural benchmarks covered mostly fiscal issues, although the MEFP contained several growth commitments. In the 2014 ECF, attention to growth in the MEFP was far more significant. While the Fund was not engaged in direct delivery of several of these growth-oriented measures, their inclusion in the program provided a mechanism for disciplined implementation and facilitated the joint delivery of separate engagements with other IFI's such as the World Bank and CDB.

62. One of the shortcomings of the 2014 ECF was that public capital expenditures stayed below program levels, which adversely affected growth since staff's estimates suggest that the multiplier effect on investment spending is higher than that for current expenditure. It is not clear, however, that additional impulse from public sector investment was essential for short-term growth in the context of robust private sector activity, Nevertheless, reduced capital spending on key infrastructure and growth-enhancing projects could moderate longer-term growth potential.

III. JAMAICA

A. Context

63. Jamaica has a long history of Fund engagement, obtaining 16 IMF-supported programs since becoming an independent nation in 1962. These programs were mostly unsuccessful due to weak and inconsistent policy implementation, coupled with a charged political environment that helped drive economic uncertainty (Clarke, 2019). Consequently, Jamaica was stuck in a negative spiral of low growth, high fiscal deficits, and a mounting debt burden which exceeded 100 percent of GDP from the early 2000s. Dealing with this debt posed a particular challenge as most of it was channeled through the local financial system from domestic sources.

64. The lack of success under IMF-supported programs, particularly from the late 1970s to mid-1980s, fostered mutual mistrust between the IMF and the Jamaican authorities and populace (Wigglesworth, 2020). Segments of the population held the IMF and IMF-suggested policies responsible for Jamaica's economic stagnation, while the IMF became weary of Jamaica's inability to implement the range and depth of reforms required to restore macroeconomic stability. This meant that putting in place a successful program required considerable effort to restore trust, with particular attention to earning broad stakeholder participation.

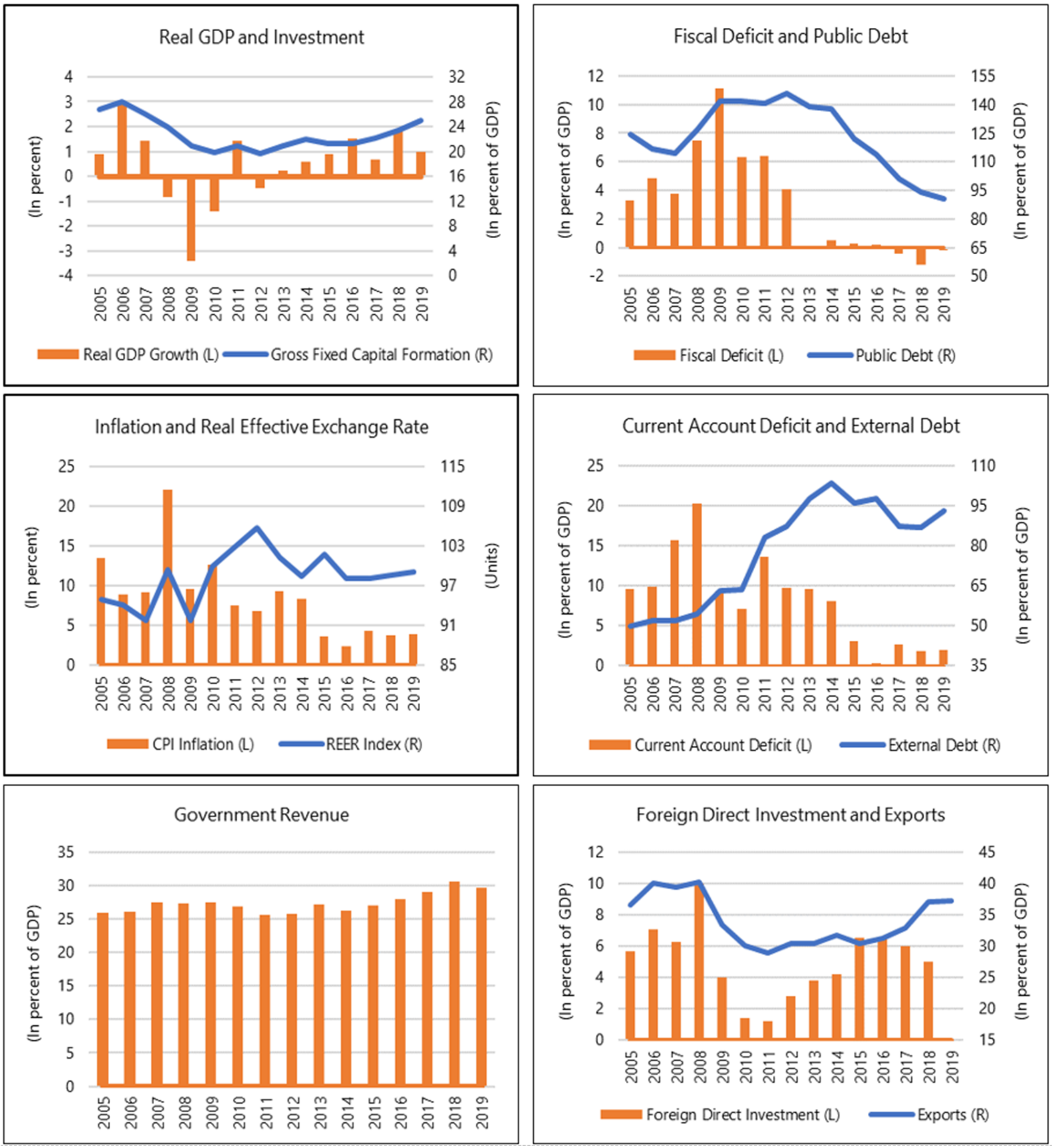
65. Within a highly competitive representative democracy, Jamaica has deep-rooted economic and social problems, complicated by a difficult crime situation and elevated levels of poverty. Jamaica has one of the highest homicide rates in the world, which represents a major growth constraint and is estimated to cost about 4 percent of GDP (Jaitman, 2017). Nevertheless, Jamaica has sustained a strong commitment to parliamentary democracy since independence. The political system is dominated by two main political parties with an extended history of alternating government since universal suffrage in 1944. Jamaica has a vibrant and powerful trade union movement that wields significant influence on wage negotiations and public sector reform as the government sector is heavily unionized.

66. Jamaica had near continuous IMF-supported arrangements over 1973–1996. The 1981 program was followed by six SBAs up to 1991 and a three-year extended facility in 1992. From 2004, Jamaica was under intensified IMF surveillance. In the lead up to the GFC, Jamaica experienced an extended period of anemic growth, large fiscal deficits, and high levels of public indebtedness (Figure 7). The GFC amplified Jamaica's macroeconomic vulnerabilities, accentuating internal and external imbalances. The economy was hard hit by the effects of the global economic recession and recorded three consecutive years of output contraction as FDI and capital formation declined. Both mineral and service exports contracted and remittances (a significant source of foreign exchange inflows) also were severely impacted.[12] These developments resulted in a significant widening of the current account deficit. As domestic demand weakened, and global commodity prices retrenched, inflation declined from a high of above 20 percent to about 10 percent.

67. Prolonged and deepening economic weakness contributed to further deterioration of the public sector deficit, which widened to over 10 percent of GDP by 2009. Public debt, which had jumped in the mid-1990s following resolution of a banking crisis, surpassed 140 percent of GDP in 2009 (see Figure 7). High public debt service requirements severely restricted resources available for economic and social development. With mounting concerns about debt sustainability and limited access to external funding, the public sector turned to the domestic financial sector to finance the government deficit, resulting in a steep increase in domestic debt to over 50 percent of the debt stock by 2009.

[12] IMF Country Report No. 10/267.

Figure 7. Jamaica—Macroeconomic Developments



Sources: April 2020 WEO database; INS database; FFA database.

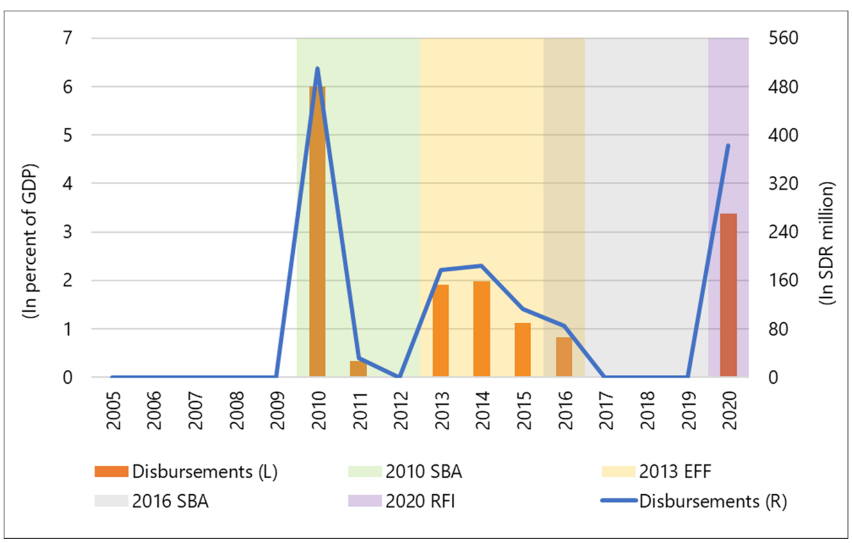
68. In September 2007, the Jamaica Labor Party (JLP) formed a new government, following a narrow electoral victory over the People's National Party (PNP), which had held office for 18 consecutive years. The new government underscored its intention to advance a wide range of reforms and announced plans to restore macroeconomic stability and spur growth. Their 2008/09 fiscal plan sought to balance the budget over a three-year period, which would help reduce public

debt to about 100 percent of GDP by 2013. This required raising the primary surplus by 3½ percent of GDP between 2008 and 2010. Measures to enhance fiscal management included: (i) enactment of fiscal responsibility legislation, (ii) improved public sector efficiency through rationalization of off-budget entities; and (iii) steps to ease difficulties associated with paying taxes. Policies to restore growth included plans to reform the business environment, including through streamlined investment procedures such as those related to land purchases, consolidate and streamline other regulatory requirements, and increase efficiency through privatization.

69. However, the government's attempt to stabilize the economy was largely unsuccessful as fiscal consolidation targets were missed. Furthermore, the economy weakened sharply in the context of the GFC. As the macroeconomic outlook worsened the authorities sought a new arrangement with the Fund.

70. Jamaica entered into a new 27-month SBA arrangement in 2010 with IMF financing of 300 percent of quota (Figure 8). This arrangement went off-track after a number of domestic and external shocks. Following a two-year hiatus, a four-year EFF was agreed to in 2013 with lower access of 225 percent of quota, with a first purchase equal to 50 percent of quota. This program was more ambitious and was implemented with considerable commitment. In 2016 Jamaica cancelled the EFF and entered into a new 3-year SBA, with increased access of 312 percent of quota. At signing, the authorities signaled their intention to treat the new arrangement as precautionary. In 2020, Jamaica received funding under the RFI of 100 percent of quota (SDR 382.9 million or about $527 million) to meet urgent balance of payments needs caused by the COVID-19 pandemic and its spillovers.

Figure 8. Jamaica—IMF Disbursements



Source: IMF Members' Financial Data.

B. Program Design

Program Objectives

71. Macroeconomic objectives were broadly similar across the three IMF-supported programs with growth becoming more prominent in the 2013 EFF and 2016 SBA. The objectives of these programs mirrored the macroeconomic goals outlined by the government and were broadly in line with recommendations contained in previous Article IV staff reports. Restoring debt sustainability was a central component of each program, as the high level of indebtedness was viewed as the overriding macroeconomic weakness. Since most of the debt was held domestically, this was to be achieved by generating substantial primary surpluses combined with debt operations to lower interest rates and extend maturities while addressing financial system risks. Core program objectives in the 2013 EFF were broadened beyond macroeconomic stability to include: (i) structural reforms to boost growth and employment; (ii) steps to improve price and non-price competitiveness; and (iii) further improvements of the social safety net. With macroeconomic stability broadly restored, the 2016 SBA further increased the focus on growth, jobs, and social protection along with further reduction in public debt.

72. Restoring debt sustainability was a major challenge as a significant share of the debt was held by the domestic financial sector and principal repayment was protected under the constitution. The 2010 SBA and 2013 EFF had to balance the need for debt operations to reduce the burden on fiscal adjustment with the need to preserve financial stability. External debt was excluded from both debt operations and domestic debt was restructured with maturity extension and lower interest rates such that the financial sector could withstand the effects. With no haircuts applied, the level of fiscal retrenchment needed to restore sustainability was high.

73. Reducing public indebtedness and supporting private sector lead growth were interconnected. Government deficits were largely financed by the domestic financial sector. Credit to the public sector at about 45 percent of GDP limited credit to the private sector to 20 percent of GDP, among the lowest in the Caribbean region.[13] The programs aimed to shift savings away from the public sector towards the private sector and at the same time to implement reforms to improve the environment for domestic enterprise. To prepare for this transition, the program sought to reduce financial sector risk, including through improved regulation and supervision.

Fiscal and External Adjustment

74. All three programs entailed tough primary surplus targets in line with the objective of reducing the debt burden. In the 2010 SBA, the central government primary surplus was targeted to increase from about 6 percent of GDP to 9 percent over the medium term (Table 3). The 2013 EFF targeted an upfront primary balance adjustment of 2 percent of GDP during the first

[13] Figure 3, IMF Country Report No. 13/126.

program year. In addition, it targeted central government primary surpluses of 7.5 percent of GDP and balanced budgets for the public entities throughout the program period. The 2016 SBA aimed to maintain a primary surplus of 7 percent of GDP during the program period.

75. Fiscal consolidation was supported by up-front expenditure measures with limited gains in revenue (see Table 3). The 2010 SBA included non-debt expenditure measures of 1.3 percent of GDP based on reductions in the wage bill and transfers. As part of the 2013 EFF, government introduced further upfront measures aimed at reducing expenditure by about 0.8 percent of GDP. A package of revenue measures was introduced in both the 2010 SBA and 2013 EFF to support the adjustment efforts. In the 2010 SBA this included: (i) introduction of a new ad valorem fuel tax; (ii) an increase in the general consumption tax (GCT) rate from 16½ percent to 17½ percent; (iii) an increase in the personal income tax rate for high income earners; and (iv) a 5 percent advanced GCT payment on all taxable imported goods. Revenue measures under the 2013 EFF revolved around broadening the tax base and equalizing rates as well as ad hoc increases.

Table 3. Jamaica—Fiscal and External Projections
(In percent of GDP)

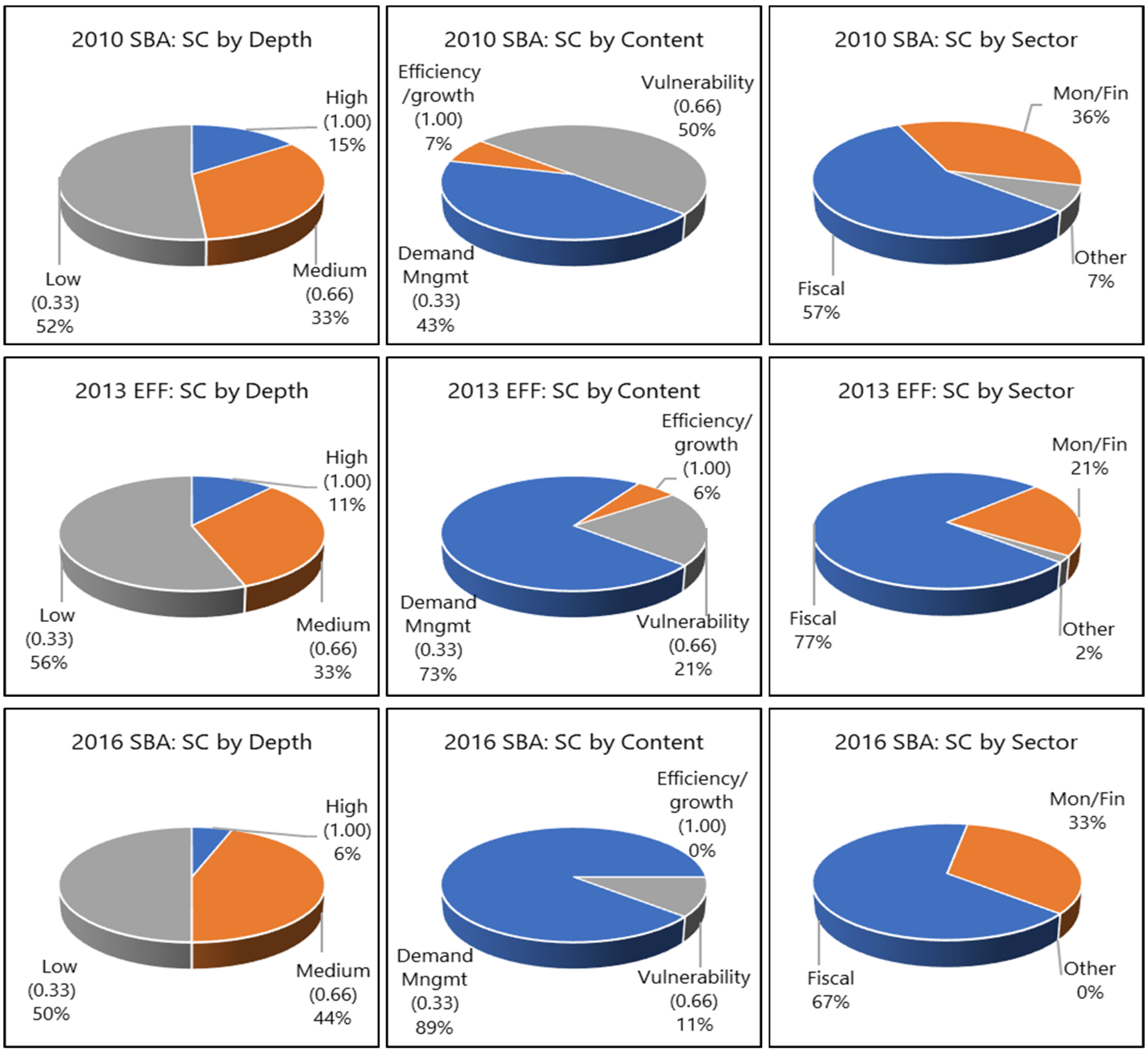
	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
2010 SBA											
Tax revenue	24.9	25.4	25.5	25.6	25.6						
Budgetary exp.	38.2	34.2	32.1	30.5	28.6						
Fiscal balance	-10	-6.5	-4.3	-2.6	-0.7						
Primary bal.	6.2	7	7.7	8.3	9.1						
2013 EFF arrangement											
Tax revenue				24	24.3	24.3	24.4	24.5	24.5	24.6	24.6
Budgetary exp.				30.4	27.4	27	26.4	25.8	25.5	25	24.5
Fiscal balance				-4.7	-0.4	-0.1	0.5	1.2	1.6	2.1	2.5
Primary bal.				5.2	7.5	7.5	7.5	7.5	7	7	7
Outcomes											
Tax revenue	25.4	25.1	25.1	24.3	23.5	24.4	24.1	24.1	24.9	26.1	26.2
Budgetary exp.	39.6	33.7	32.5	30.4	27.6	27.2	27.8	28.6	29.1	30.2	
Fiscal balance	-8.2	-1.5	-2.2	-1.3	2.7	1.0	1.7	2.2	2.9	4.5	
Primary bal.	6.2	4.6	3.2	5.4	7.6	7.5	7.2	7.6	7.5	7.5	6.5

Sources: WEO, GFSR, and IMF staff reports.

76. The 2016 SBA paid more attention to tax revenues including a tax reforms package focused on transition towards a more efficient and growth-friendly tax system based on rebalancing from direct to indirect taxes, which was introduced after a change in government in 2017. The program also aimed to shift government spending away from wages, which consumed about 10 percent of GDP, towards public investment in growth-enhancing projects and addressing infrastructure gaps.

77. The 2010 and 2013 programs both entailed front-loaded reforms with a heavy focus on measures to address fiscal and financial sector weaknesses. The 2010 SBA's reform agenda included: (i) fiscal responsibility legislation; (ii) strengthening the central treasury management system and tax administration; and (iii) rationalization of public employment and public enterprises. The 2013 EFF agenda was broadened to include reforms of the tax system, while the 2016 SBA sought to consolidate the gains made in the previous program and in addition entailed reforms to the public pension system, strengthening public financial management, along with tax and customs administrations reforms. However, structural conditionality under the program were assessed to be of low depth (Figure 9).

Figure 9. Jamaica—Structural Benchmarks by Depth, Content and Sector



Sources: IEO calculations and Kim and Lee (2021).
Note: The numbers in bracket refer to the score (scaled between 0 and 1) assigned to the corresponding category. See Kim and Lee (2021) for a detailed explanation of the methodology.

78. The programs aimed at enhancing social safety nets to support vulnerable groups. Spending on social safety net programs was to be increased by about 25 percent or 0.3 percent of GDP under the 2010 SBA. The 2013 EFF went further by raising the spending envelope for the PATH program enough to shield the bottom quartile from the negative effects of adjustment. Specifically, individual PATH benefits would be increased to maintain their real value.[14] This commitment was accompanied by steps to improve targeting of beneficiaries and implementation of welfare-to-work exit strategies for vulnerable households.

Exchange Rate and Program Financing

79. Exchange rate flexibility was a key component of the macroeconomic framework, to provide a shock absorber and to avoid exchange rate overvaluation that would frustrate external adjustment. The 2010 SBA and 2013 EFF both included commitments to exchange rate flexibility. The 2013 EFF also included measures to develop fully the interbank FX market, along with further steps towards a full-fledged inflation targeting regime. This regime was expected to be advanced further in the 2016 SBA, during which Jamaica was classified as having a floating exchange rate regime for the first time in its history. Reserve targets were included to safeguard the adequacy of reserve coverage—a key policy priority under the programs. In the periods leading up to approval of the 2010 SBA and 2013 EFF, the nominal exchange rate had depreciated significantly, and the Fund assessed the REER to be broadly in line with fundamentals in the former program and that some of the overvaluation had been offset in the latter program. In that context the programs allowed for the possibility of limited central bank intervention in the foreign exchange market to support the currency to mitigate potential adverse effects of a further depreciation on inflation and debt dynamics in the 2010 SBA (as about 45 percent of debt was external) and to avoid disorderly short run movements under the 2013 EFF.

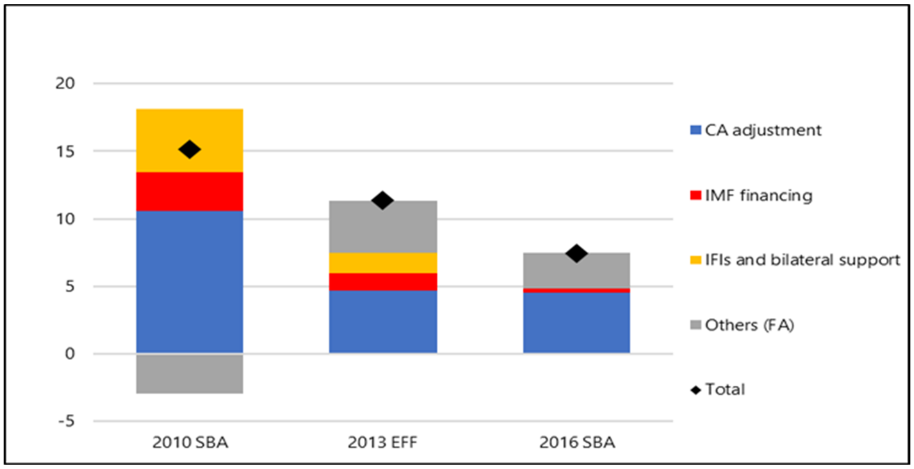
80. Current account adjustment was expected to be the largest contributor to meeting the program's balance of payment needs (Figure 10). The external current account was projected to improve rapidly under the 2010 SBA and 2013 EFF, helped by a rebound in exports driven by improved competitiveness and external demand, along with lower imports on account of restrained domestic demand in part due to fiscal retrenchment. In the 2016 SBA, previous adjustment gains were expected to be sustained with the current account deficit relatively stable at about 3 percent of GDP.

81. Under the 2010 and 2013 programs, the IMF was projected to make a small contribution to external financing (see Figure 10). It was also expected to have a strong catalytic effect as financial support was envisaged from other IFIs. Under the 2010 SBA the government requested US$2.4 billion from multilaterals, with substantial loan commitments from the IDB, World Bank, and the Caribbean Development Bank (CDB). The 2013 EFF anticipated continued external program financing from multilateral institutions. Additional financing was expected to be

[14] The Programme of Advancement through Health and Education (PATH), provides conditional cash transfers to five categories within the poorest income groups.

available through the Petrocaribe[15] facility under the 2010 SBA and 2013 EFF. The 2016 SBA envisaged that Fund financial support would catalyze new IDB flows for the duration of the program, with US$200 million available in the first year.

Figure 10. Jamaica—Balance of Payment Needs Decomposition
(In percent of GDP)



Sources: IEO calculations and Kim and others (2021).
Note: See Kim and others (2021) for a detailed explanation of the methodology.

Growth Outlook and Growth Supporting Policies

82. All three programs projected short-term growth stabilization and medium-term expansion (Table 4). The 2010 SBA, negotiated during a significant economic slowdown, forecast a turnaround in growth during the first year of the program from a contraction of 3½ percent to about ½ percent expansion, helped by improved external demand. The 2013 EFF anticipated some near-term recovery, which was strong by historical standards, but staff considered that rate of growth would be restrained by the effects of fiscal adjustment. The successor SBA again envisaged modest growth during the initial program year. Programs were premised on minimal growth impact of fiscal adjustment reflecting the openness of Jamaica's economy and that adjustment was to be achieved primarily through reductions in current expenditure.[16] The programs consistently projected an uptick in medium-term growth to between 2 percent and about 3 percent, based on positive spillovers from anticipated recovery in the global economy (2010 SBA), realized gains from the implementation of program reforms that would spur investment (2013 EFF), and productivity improvements through supply-side measures (2016 SBA).

[15] Petrocaribe is an oil alliance involving the Caribbean member states and Venezuela that offers the other member states oil supplies based on a concessionary financial agreement.

[16] Guy and Belgrave (2012) estimated fiscal multipliers for Jamaica ranging from 0.11 after four quarters and about 0.30 after the 24 quarters.

Table 4. Jamaica—GDP Growth Forecast and Outturn

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Program Request												
2010 SBA	-3.5	0.6	1.9	1.9	2.0							
2013 EFF			-0.2	0.8	1.4	1.8	2.2	2.5	2.7	2.7		
2016 SBA					0.2	1.1	1.7	2.1	2.5	2.7	2.8	2.8
Outturn	-1.4	1.4	-0.5	0.2	0.6	0.9	1.5	0.7	1.8	1.0	-10	

Sources: IMF staff reports and WEO.

83. Over time, programs tilted from the initial core focus on fiscal sustainability towards more attention to real sector reforms to support growth. The 2010 SBA viewed high debt and large financing obligations as a key growth constraint because of high-risk premiums which crowded out private investment. Restoring fiscal sustainability was expected to reduce risk premiums and boost investment. The 2013 EFF included structural reforms to reduce impediments to growth (energy, business, labor markets, improved public sector operations) and increase strategic investments.[17] In particular: the government would adopt an energy policy to achieve fuel-source diversification, facilitate energy conservation, and promote liberalization in delivery; establish flexible work arrangements, reduce the impact of high separation cost and continue new training and certification programs; and reduce costs of commercial dispute resolution, streamline the business registration processes and modernize the insolvency framework. The reforms-based growth approach was enhanced further in the successor 2016 SBA, which included growth friendly tax modifications and public sector transformation.

84. While growth-related structural benchmarks were limited and not particularly deep, the MEFP included extensive growth commitments (Table 5). The 2010 SBA request and the 2009 Article IV were prepared jointly and contained limited discussions on reforms to spur growth. However, the 2012 Article IV report discussed growth constraints in some detail and identified weak financial intermediation, distortions in labor and product markets, weak business environment, and high energy cost amongst the leading obstacles. Staff also identified enhanced exchange rate flexibility as important to help improve the economy's resilience to shocks and boost competitiveness. These reforms and strategies highlighted in the 2012 Article IV report were embedded in subsequent programs as commitments in the MEFPs. The World Bank's engagement in 2013 and 2016 was aligned to the government's outcomes-oriented medium-term framework and focused on supporting economic stability and promoting inclusive and sustained growth.

[17] This included: establishing Jamaica as a logistics hub—including expanding port, cargo and maritime facilities and economic zones; construction and commissioning of a 360-Megawatt Combined Cycle plant; and partnering with the private sector to establish nine agro parks to stabilize the agricultural supply chain and deepen inter-industry linkages.

Table 5. Jamaica—Structural Benchmarks and MEFP Growth Commitments

	2010 SBA		2013 EFF		2016 SBA	
	Request	Final rev.	Request	Final rev.	Request	Final rev.
SBs	6	13	17	42	10	23[1]
Growth SBs	0	0	0	2	0	0
Fiscal SBs		9	12	32	5	1
Prior Actions	3		4			
Financial Sector SBs	3	4	5	8	5	7
MEFP growth commitments	0	0	N/A	15	19	9

Source: IMF staff reports.
[1] Fifteen of which were related to public sector transformation.

Debt Sustainability and Strengthening Financial Stability

85. Restoring debt sustainability was a key component of each program. The Fund assessed Jamaica's debt to be unsustainable, and completion of debt operations was included as a prior action in the 2010 SBA and 2013 EFF. However, since a large share of the public debt was held by domestic individuals, debt operations avoided haircuts and were designed to include maturity extension and lower interest rates that could preserve the domestic financial system while external debt was omitted as it as was deemed complicated (unlikely to get sufficient voluntary participation) and costly in terms of future market access.[18] The Fund provided extensive support to the central bank to stress test the financial system's ability to absorb the effects of the debt exchange.

86. The first debt exchange in 2010 aimed to reduce Jamaica's debt overhang by cutting the public interest bill by about 3 percent of GDP in FY2010/11 and lowering domestic bond rollover requirements by three-quarters over the next three years. Going further, the "national debt exchange" (NDX) in 2013 aimed to deliver gross savings equivalent to about 8.5 percent of GDP by 2020.[19] The NDX again entailed significant lengthening of maturities and reduced interest payments on government's domestic debt. Debt reduction also was supported by further relief under the PetroCaribe arrangement. By 2016, Jamaica's debt was still assessed to be high with the projected decline vulnerable to risks from macro-fiscal shocks, contingent liabilities, and natural disasters. The 2016 SBA sought to continue to lower debt to under 60 percent of GDP in the medium-term through continued accumulation of primary surpluses and presumed growth benefits of reforms.

[18] Box 1 IMF Country Report No. 10/267 and IMF Country Report No. 13/126.

[19] The bonds included local currency (including fixed, variable and CPI-indexed bonds), locally issued U.S. dollar-denominated bonds amounting to approximately J$876bn, or 64 percent of GDP but excluded bonds issued in foreign jurisdictions or held by nonresidents.

87. To help safeguard the financial sector from the effects of the debt exchange, the 2010 SBA established the Financial Sector Support Fund (FSSF) to make liquidity available to financial institutions if needed. The FSSF was financed with a portion of the resources provided by the Fund. This mechanism was re-established under the 2013 EFF and provided with more resources, as the financial sector was assessed to have reduced scope to offset the loss of interest income.

88. Strengthening financial sector regulation and supervision were central to these programs. The broad range of reforms included enactment of the Omnibus Banking Act (2010 SBA and 2013 EFF) to establish a new structure for holding companies of financial conglomerates and subject such entities to consolidated supervision by the central bank. The Fund was expected to provide a substantive amount of TA in support of these reforms.

89. While the banking system was assessed to generally be well capitalized and profitable, the situation of security dealers with total assets of about 40 percent of GDP and inadequate levels of capital represented a significant source of concern related to the debt operations[20]. In addition, the inter-linkages within the financial conglomerates which dominated the financial system heightened the risk of spillovers. Specific measures were designed to address these risks and included making available collective investment schemes (CIS) and introduction of a new legal and regulatory framework to better protect clients' interests through standardized and more transparent retail repo instruments.

Program Risks

90. Programs faced multiple risks including policy slippage given the high degree of social and political consensus required; delays in implementation of fiscal reforms due to capacity, political and/or legal constraints; external economic and weather-related shocks; and larger than anticipated growth effects of fiscal consolidation. Implementation risks were addressed by building broad domestic support and ownership of the program. Specifically, domestic stakeholders were organized to support, monitor, and help shape the reforms, with creation of the Economic Policy Oversight Committee (EPOC) under the 2013 EFF, which comprised representatives from financial institutions, private sector organizations, civil society, and the trade unions. EPOC was initiated due to the desire of the financial sector and trade unions to have a mechanism through which they could hold the government accountable, and guard against a repeat of what transpired during the previous 2010 SBA. The authorities also established the National Social Protection Committee to oversee implementation of their social protection strategy, which was launched in July 2014. The strength of domestic commitment was demonstrated by the new government's decision to continue with the core objectives of the arrangement, following the 2016 general elections.

---

[20] IMF Country Report No. 13/126. Security dealers offered "retail repo" products that financed long-term, large-denomination government bonds with short-term, small denomination retail investments. The customers earned a guaranteed return and did not directly take on the risk of the associated government instrument, which remained on the securities dealers' balance sheets unmatched by sufficient capital and liquidity.

C. Program Implementation and Outcomes

2010 SBA

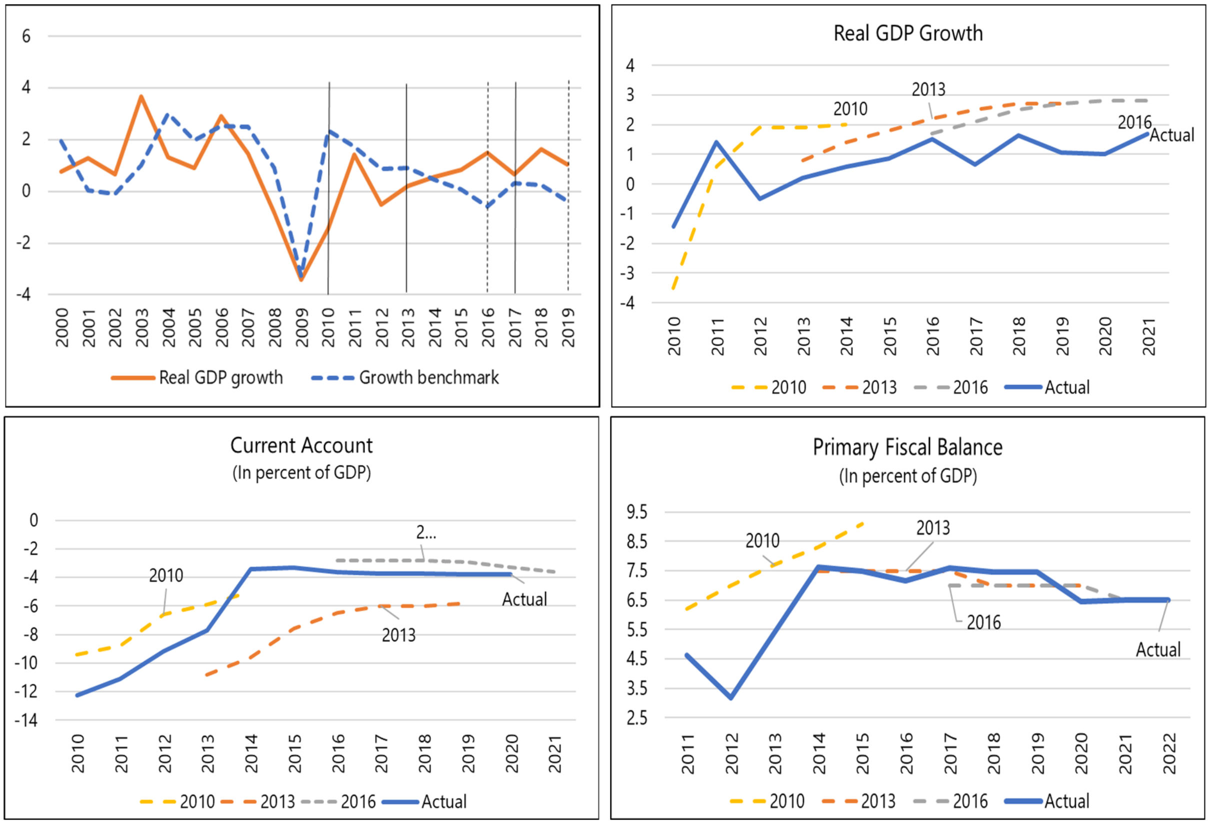
91. Fiscal slippages and limited progress with structural reforms derailed the 2010 program despite some initial successes. Prior actions were met, including a successful debt exchange and measures aimed at boosting revenue by over 3 percent of GDP. The results of the debt exchange were more favorable than assumed in the program. The amount of eligible bonds was broader than envisaged, and the participation rate was higher, resulting in significantly larger savings. Financial institutions, including the securities dealers, were able to absorb the lower-than-expected valuation and income losses from the debt exchange and no call was made on the FSSF.[21] All quantitative performance targets and structural benchmarks were satisfied for the first review, but slippage on the structural reforms started during the second review and continued into the third review with a missed benchmark related to debt in early 2011. These structural reform slippages were accompanied by mounting expenditure pressures, largely related to payment of outstanding salaries and allowances to public sector workers. Consequently, the program went off-track after three of the scheduled eight reviews were completed.

92. The collapse of the program occurred as the authority's stated commitment was undercut by adverse events. In the first review, staff indicated that "the authorities had demonstrated strong commitment to the program in a challenging economic environment," although they did voice their concerns about the impact of anemic growth, high unemployment, and rising poverty levels. However, adverse security developments weakened commitment to the program as violence flared up following the government's decision to commence extradition of an alleged prominent criminal leader. This prompted a one-month "state of emergency" that impacted program-related legislative agenda. In addition, fiscal targets were strained with the need for financing to repair damages to bridges, roads, and sewage systems caused by Tropical Storm Nicole.

93. Initial macroeconomic outcomes were positive, and growth recovered at a slightly faster pace than anticipated. The debt exchange helped stabilized public debt. However, growth remained weak in part because of weaker than anticipated growth in trading partners, climate shocks, and domestic security developments (Figures 11 and 12). Current account adjustment also turned out weaker than anticipated as international fuel prices were higher than predicted.

[21] As securities dealers actively repositioned their books toward shorter-term liabilities, allowing for rapid pass through of reduced interest-income. Commercial banks recovered lost interest income by lowering savings and deposits rates and introduced new banking fees. Financial institutions also introduced cost cutting and efficiency measures to lower operating costs.

Figure 11. Jamaica—Outturns vs. Program and Growth

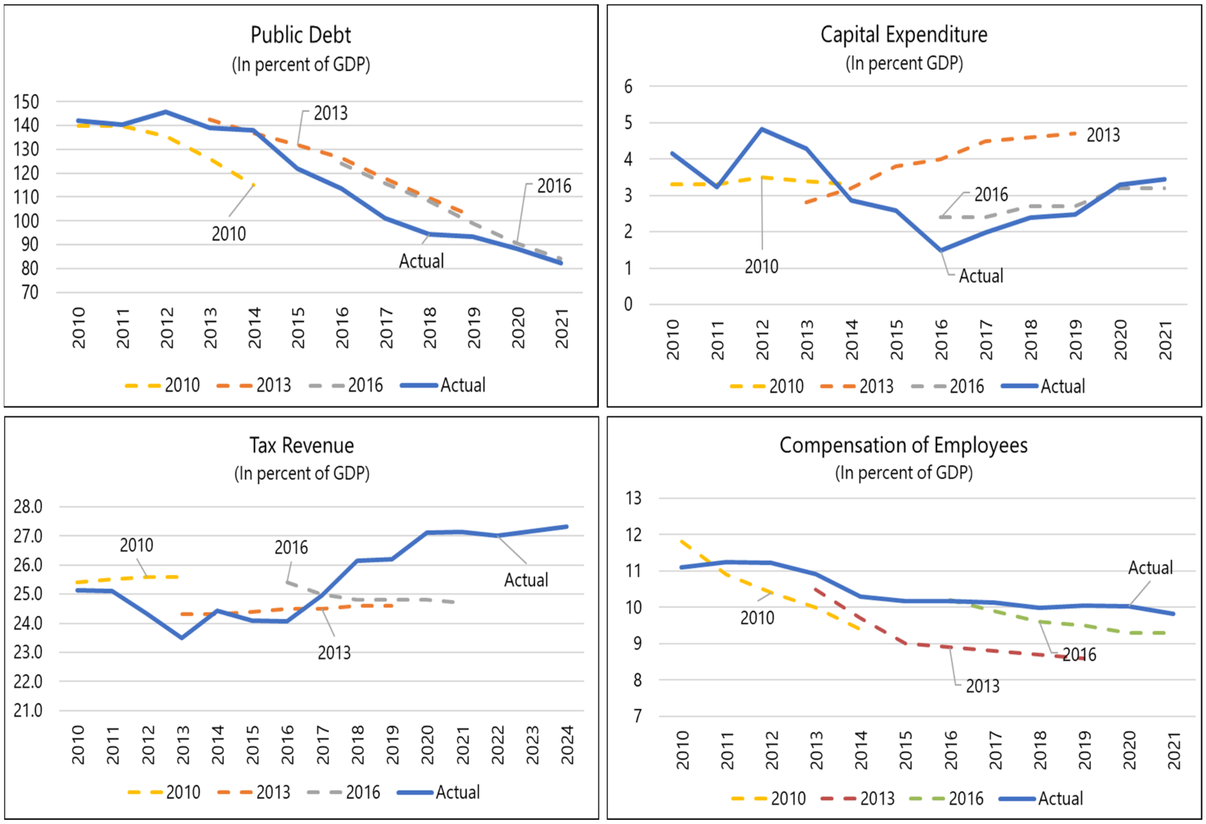


Sources: WEO; IMF staff reports; IEO calculations; and Kim and others (2021).
Note: Dotted vertical lines represent the beginning of the program and solid vertical lines the end. Figures beyond 2019 are staff's forecast. Adjustment is measured in percent of GDP.

94. Initial fiscal outcomes were positive with improvements in tax administration along with expenditure restraint. But strains started to appear with the need to accommodate unanticipated spending related to the State of Emergency and purchases of critical medical equipment. This was offset in part through reduced budgeted capital spending, cuts in recurrent expenditure, and reduction in discretionary tax waivers. In assessing the difficulties in containing spending, Fund staff argued that it partly reflected weak expenditure management due to inefficient enforcement of spending controls.

95. Economic conditions deteriorated after the program was discontinued in early 2011. Growth stagnated, the external current account deficit widened, debt remained high, and the fiscal deficit increased. The reform agenda also stalled as the government prepared for elections and structural benchmarks were missed (see Figure 9).

Figure 12. Jamaica—Public Debt Expenditure and Revenue



Sources: WEO; IMF staff reports; and IEO estimates.
Note: Dotted vertical lines represent the beginning of the program and solid vertical lines the end. Figures beyond 2019 are staff's forecast. Adjustment is measured in percent of GDP.

2013 EFF Arrangement

96. Renewed commitment under the 2013 EFF helped to restore macroeconomic stability. Inflation and the current account deficit recorded historical lows, international reserves increased, and access to international financial markets was restored quite quickly. Program implementation was strong, prior actions were met, and 13 out of the 15 planned program reviews were completed. Prior actions related to fiscal consolidation, including public sector wage measures, discretionary tax waivers, and public debt management and the debt exchange, were successfully completed. The government successfully implemented a tough fiscal program and generated primary surpluses of 7 percent of GDP and above through the duration of the program and the successful completion of the 2013 NDX put debt on a downward trajectory (see Figure 11). Continuous progress was made in implementation of the ambitious structural reforms agenda which aimed to improve fiscal systems and reduce bottlenecks to growth. The program was cancelled at the request of the authorities following the thirteenth review to pave way for a successor SBA arrangement, which would place greater emphasis on growth.

97. Successful program implementation was underpinned by achievement of the ambitious primary fiscal balance targets (see Figure 12). Subsequent lowering of the primary fiscal surplus target by half a percent of GDP, to provide space for additional capital spending, did not result in an immediate reduction of the primary surplus as revenues came in above expectations. Tax revenues were initially below projections as the implementation of tax reforms led to delays in tax assessments due in part to uncertainty about the pace at which grandfathered tax incentives would be removed.

98. The combination of sustained large primary surpluses and the NDX helped to realize the broader goal of putting debt on a sustained downward trajectory (see Figure 12). The objectives of the debt exchange were met with limited disruptions to the financial system, and Jamaica regained international market access and issued an external commercial bond on favorable terms. However, it took longer for Jamaica's government to reestablish domestic market access as the domestic financial sector absorbed the costs of the debt exchange. Supported by the Petrocaribe debt buy back, public debt decreased to about 113 percent of GDP by end 2016.[22]

99. Growth remained stable but subdued throughout the program period. In the early stages of the program, growth was held back by weak private consumption as disposable income was adversely affected by the combination of wage restraint, higher inflation, and weak employment growth. This was compounded by the impact of hurricane Sandy, drought conditions, and the chikungunya outbreak in 2014/15 which reduced labor productivity.[23] However, as the effect of the drought subsided there was an uptick in growth in 2015. Improved export performance supported growth as some gains in competitiveness were achieved with a more depreciated REER that reflected greater nominal exchange rate flexibility. Eventual marginal relaxation of the fiscal stance to allow for increased spending on vital priorities such as security was not anticipated to and did not have a significant effect on growth given the relatively small injection.

100. Growth outcomes were above the average for the 2008–2018 period but fell below staff projections. Jamaica' growth outturn for 2013 and 2014 were also below IEO's benchmark (see Figure 11). The dynamic changed in 2015 when Jamaica's growth was in line with the benchmark, rising above IEO's norm the following year.

101. The current account adjusted at a faster pace than anticipated (see Figure 11). The rapid adjustment was supported by a weaker economy, a more depreciated exchange rate, lower nonfuel imports, stronger-than-expected performance of non-traditional exports, and reduced fuel cost.

---

[22] In July 2015, the government of Jamaica bought back its stock of PetroCaribe debt from the government of Venezuela at a sharp discount. For a description of the operation, see Okwuokei and van Selm, 2017.

[23] Chikungunya is an infection caused by the chikungunya virus.

102. The combination of the NDX and other financial reforms, together with fiscal restraint, helped to reduce financial sector exposure to the government and raise credit to the private sector. The securities dealers' repo liabilities to retail clients decreased and the size of collective investment schemes (CIS), intended to replace retail repos, grew by as much as 60 percent in the first nine months of 2014. Credit to the private sector increased from 26 percent of GDP in 2010 to above 40 percent of GDP by 2019.[24] Again, the financial sector was able to absorb the impact of the 2013 debt exchange with no recourse to the FSSF as bank soundness indicators remained strong. Reduced values of government securities holdings of financial institutions were offset largely by declines in the yield curve and depreciation of the Jamaican dollar (in which they had a short position), which resulted in only minor reductions in total asset values.

103. Implementation of fiscal, financial, and growth reforms were strong. Program structural benchmarks were met (see Figure 9) and progress was realized towards achievement of the ambitious growth agenda as outlined in the MEFP, which gained increased focus as economic stabilization took hold. Sustained efforts in structural reforms included measures to reduce energy costs, improve the business environment, and develop critical infrastructure. In a few instances, implementation was delayed due to capacity constraints as the ambitious timetable for reform strained the country's administrative and legislative capacity, notwithstanding TA support from the IMF and the development banks (see below).

104. Domestic ownership of the program was strong, with the nation mobilized around the importance of ensuring program success. The strength of domestic commitment was demonstrated by the new government's decision to continue with the core objectives of the arrangement following the 2016 general elections. The new government however pushed for greater focus on growth, including through phased personal income tax reform to reorient the tax structure towards more growth friendly indirect taxation, which was accommodated in the program.

105. A wide range of TA was provided by the Fund. For example, FAD provided TA leading to the establishment of fiscal rules and in other areas such as central treasury management system, public financial management, and tax and customs administration. Extensive support was provided in ushering reforms to the primary dealers' market and strengthening the financial regulatory framework. The Fund also provided TA to the authorities on stress testing the financial system's ability to withstand the effects of the debt exchange. Fund TA was complemented by assistance provided by the IDB and the World Bank. The World Bank provided TA and capacity building for organizations and agencies that delivered support services in agriculture and rural tourism at the local level. In addition, the World Bank provided TA on statistics, crime, disaster risk reduction, and development of a strategy for a diaspora bond. The IDB provided TA on: (i) fiscal sustainability; (ii) social protection and safety; and (iii) financial sector and business climate.

[24] Figure 3, IMF Country Report No. 16/350.

2016 SBA

106. The 2016 SBA was a precautionary arrangement with no drawing of Fund resources being made. Macroeconomic stability was further entrenched, while growth remained positive but subdued. Growth remained below the Fund's short- and medium-term growth projections, which were revised downwards. Growth was adversely affected by frequent weather-related shocks in addition to other structural obstacles, including crime, bureaucratic processes, insufficient labor force skills, and poor access to finance. Growth did somewhat exceed the IEO's estimated benchmark. On a positive note, unemployment declined to an 11-year low but weak weather-related performance in the agriculture sector continued to temper gains in rural poverty.

107. External stability was largely restored, access to international markets regained, the exchange rate was managed more flexibly, and the domestic financial sector increased its resilience. Hard-won credibility from adjustment and reform efforts resulted in historically low yields on issuance of global bonds and international reserves rose to a historic high. In June 2018, Jamaica's de facto exchange rate arrangement was classified as "floating," retroactively from September 2017. The current account deficit remained low supported by improving competitiveness. At the end of the program, NPLs of the banking system reached a historic low (2.4 percent of total loans), loan loss provisions were adequate, and banks were well-capitalized.

108. Program implementation remained strong and all the scheduled reviews were completed. Fiscal policy maintained the commitment to hard earned fiscal sustainability and keeping public debt on a downward trajectory, while providing more support to growth. The amendments to the PIT system from direct to indirect taxes were implemented to enhance revenue and improve incentives. Tax revenues continued to perform well on account of improvements in tax administration and reforms to the tax system. This was accompanied by increased budget allocation for social spending to protect the vulnerable from the negative impact of the move towards more indirect taxes along with increased spending on security. These expenditures were in part accommodated through lowering the primary surplus target by ½ percent of GDP to 6½ percent in FY19/20. Some gains were made towards rebalancing from the public sector wage bill to outlays that are more supportive of growth and private sector job creation.

109. The Fund continued to support the authorities reform efforts with provision of TA. In particular, TA was provided to help develop liquid and deep FX markets and to pave the way for inflation targeting.

D. Authorities and Staff's Perspectives

110. Staff and government officials noted that Jamaica approached the Fund for financial support after the GFC as it faced dire economic conditions. Jamaica stood on the edge of a financial and fiscal cliff, with depleted levels of reserves and limited options to finance the widening budget deficit. But the long and painful history of Fund engagement with Jamaica suggested that a strictly macro adjustment program was unlikely to succeed because it would be

hard to maintain commitment to the program without visible results. The disappointing experience with the 2010 SBA underlined this lesson. Officials indicated that they spent a lot of time trying to get the Fund to negotiate the 2013 EFF due to residual skepticism following the 2010 SBA which quickly went off-track. The authorities stated that they had to enlist external support to help convey the need for urgent assistance to avoid immediate economic collapse.

111. Staff emphasized that while the core objective of the 2013 EFF was macro stability, they also focused on untangling the reasons why Jamaica was stuck in this perpetual cycle of low growth and inconsistent policies. Jamaican officials indicated that they did not have major differences with the IMF on the broad objectives of the program, but some officials were of the view that whilst strong fiscal adjustment was warranted, the Fund's proposed adjustment path was overly stringent. However, staff argued that there were no alternatives to large fiscal adjustment, in part to deal with debt sustainability concerns and raise confidence that this time it would be different but also as an important component of the larger strategy of reorienting the economy towards more private sector led growth.

112. Staff noted that while there were measures in the program to promote growth, payoff from these were long term. The key short-term channel they argued was a turn-around in confidence based on achieving macro stability anchored on significant upfront adjustment. Officials agreed that confidence effects from macroeconomic adjustment were important to restoring growth. However, many officials indicated that from their perspective policies which would directly spur growth were not given enough attention, particularly under the 2010 SBA and 2013 EFF. Some officials were of the view that programs should take a more deliberate and constructive approach to encourage growth policies as stability can be fleeting if not followed by strong growth. In that regard it was felt that more should be done to encourage other IFI's to support successful reforms programs through the provision of more resources to facilitate growth enhancing investments.

113. Officials at the technical level were of the view that that the Fund need to show greater appreciation of domestic and political capacity constraints in advancing needed legislative reforms. Officials noted that an overly ambitious agenda may not have the desired impact as attempts to meet accelerated timelines could reduce the effectiveness of the legislation due to limited capacity for legal drafting and insufficient consultation with relevant stakeholders. This in some cases resulted in delays later in the process as more iterations were needed to resolve policy issues. Officials indicated that program conditionality was largely set by staff and were often based on a faster pace of implementation than that suggested by the authorities. It was felt that embracing local knowledge on timing of reforms would improve the process greatly.

114. Staff indicated that the most difficult aspect of negotiating the 2010 SBA and 2013 EFF involved bridging the gap between what the Fund considered a sustainable adjustment path and what the authorities viewed as politically feasible. In that regard, the balance between fiscal adjustment and debt reduction was the most critical component of the negotiations. Given that most of the debt was owed to domestic savers and the key role of the domestic financial

intermediaries, the options for a major restructuring of debt were quite constrained. Hence, the mission team believed that strong upfront fiscal adjustment was unavoidable. Officials agreed that finding a way to lower the debt burden through a debt operation, while at the same time containing risk to the financial sector, was a critical aspect of the program's design.

115. Within the Fund, some departments pushed for a larger upfront debt restructuring and fiscal adjustment in the 2013 EFF, but it was recognized that an even more ambitious path would be even harder to achieve. Hence, these concerns were reflected in program design through tough prior actions to guard against failure and avoid past mistakes. Officials were firmly of the view that the needed debt operation should not compromise financial stability and were pleased that the program was designed to minimize the impact of the debt operation on the financial sector.

116. Staff were very cautious about the likelihood of success of both the 2010 SBA and the 2013 EFF. The Jamaican officials indicated that the 2013 EFF negotiations were protracted and felt that Jamaica was being punished because of the experience with the 2010 SBA. It was felt that the Fund did not appreciate that the earlier program went off-track because of the difficult and unexpected political developments, not because of a lack of commitment to delivering on the agreed policies. Officials also held the view that the Fund was unwilling to better understand that issues with the 2010 SBA were different from previous episodes, which they attributed to Jamaica being a small non-systemic country and the residual stigma associated with previous Fund engagements. The general sentiment within the Fund was that program success required deep commitment, and they were uncertain as to whether the authorities would be able to galvanize the domestic support necessary for implementation.

117. In designing the program, staff assessed that the fiscal multiplier was small and fiscal drag on growth consequently would not be severe. Staff noted that Jamaica had a history of generating high primary surpluses, and the additional effort, although large, was achievable. In addition, infrastructure spending suffered from significant capacity constraints some of which were related to bureaucratic hurdles. The authorities agreed that the impact growth of a slightly lower primary fiscal target was unlikely to be substantive and the possible confidence gains from more sustainable policies warranted strong fiscal adjustment. However, some officials were still of the view that a slightly less ambitious fiscal target would have improved the likelihood of success of the 2010 SBA and would have made more resources available to increase assistance to the vulnerable and capital projects under the 2013 EFF.

118. Staff pushed for more exchange rate flexibility at the onset of the 2010 SBA to improve competitiveness and export performance. The authorities pushed against Fund advice and insisted on a more gradual rate of depreciation. Officials believed that pass-through to inflation would be high and that the responsiveness of exports to a more depreciated exchange rate would be lower than anticipated by the Fund. Furthermore, they argued that most stakeholders viewed even slight increases in exchange rate variability as costly: domestic exporters did not like the unpredictability, while importers feared that it would shrink their market. The authorities argued that the exchange rate depreciation posed high risk to domestic ownership as the payoff

from such developments were gradual, at best, while import price increases would come quickly and reduce real incomes, which risked undermining national support for the program. The authorities indicated that they were committed to a more flexible exchange rate but remained wary of excessive downward volatility.

119. Staff observed that, in general, success of the program framework depended more on getting the policies correct and less on growth forecast precision. They suggested that the Fund's internal review process often overemphasized the role of the growth forecast. Jamaica's program, they argued, was designed with buffers which made the program less reliant on growth outcomes, with adjustment fully backed by supporting fiscal measures. In terms of outcomes, staff pointed to the numerous external shocks which affected Jamaica as a reason for the subpar growth performance, while acknowledging that their forecast at the onset did not fully cater for the asymmetrical nature of these shocks. Officials believed that IMF growth projections were too optimistic at the outset. They indicated that there was extensive debate with the Fund team on the assumed growth outlook, which the authorities felt was too sanguine regarding the impact and the pace at which the economy would respond to program reforms. However, they acknowledged that given the extent and nature of these reforms, it was difficult to calibrate the growth effects. In hindsight, staff noted that medium-term growth forecasts were probably slightly overoptimistic but cautioned that it would have been challenging to get domestic support for a program with even lower medium-term growth projected at the outset.

120. Staff stated that they did not undertake detailed growth impact assessments of structural reforms. The effect of these reforms was, however, broadly factored into the medium-term forecast. Some staff were of the view that attempting to calculate the growth impact of structural measures would not be a good way to use scarce mission resources. Nevertheless, growth measures in the MEFP were considered by staff to be a key component of the program, and reflected agreement reached with the authorities on these components of the government's agenda. The authorities applauded the Fund's willingness to support a broad-based program that embraced the authority's growth initiatives as important in helping cement domestic ownership.

121. Staff explained that the World Bank and other IFI's took the lead with more direct engagement on real sector issues. Staff were of the view that including more growth-related structural benchmarks into programs at an earlier stage would have distracted from the urgent task of restoring macroeconomic stability, which they viewed as paramount for output recovery. The authorities noted that while more direct attention to growth in the 2010 SBA and 2013 EFF could have been considered, they were mindful that the core goal was the restoration of macroeconomic stability. As the program progressed, staff indicated they sought to include measures to tackle growth in a more direct manner, a development which the officials welcomed. However, staff found it difficult to identify reforms that would generate substantive growth effects to include as structural benchmarks.

122. Staff and officials indicated that the expected catalytic role of Fund financing was not as strong as anticipated in terms of support from other IFIs. Staff noted that the initial access provided in the 2010 SBA was stretched to the limit. However, after a few reviews of the 2013 EFF, flows of net resources from the Fund were being reversed as payments came due from the 2010 SBA and other IFI's were not particularly keen on increasing their exposure as the Fund's net contributions decreased in view of concerns about credit and implementation risk. Thus, financing was mainly from previously committed pledges. The authorities indicated that their initial expectation under the 2013 EFF was that other IFI's would provide additional resources in addition to what was already in the pipeline, and were disappointed that, at least in one instance, the funding made available was largely limited to existing commitments. However, as the 2013 EFF progressed with strong implementation, IFI's became more willing to provide additional resources. The authorities appreciated the efforts of the Fund in negotiating with other IFI's on the size of their contributions to the 2013 EFF.

123. Staff indicated that they attempted to provide TA to support implementation of core program objectives. Staff stressed that Fund TA (particularly related to the financial sector and fiscal administration) had helped enhance capacity and were important to program success under the 2013 EFF and 2016 SBA. For their part, the authorities acknowledged that the TA provided by the IMF was critical to the economic reform program, was wide ranging, and contributed in some degree to the development of local technical expertise that helped sustain the reform momentum.

124. Staff were pleased by the strong commitment shown by the authorities in implementing the 2013 EFF and 2016 SBA as the authorities were determined to make a break from the past. Staff indicated that strong stakeholder support was critical and welcomed active participation of the unions, financial sector participants, and other civil society members through the EPOC as being important conditions to program success. The finance minister who negotiated the 2013 EFF played an integral role in getting the program off to a good start and was determined to restore macroeconomic stability. The role of the private sector was viewed as important as they keenly supported the Fund's engagement and pushed for increased accountability. Officials indicated that broad-based national ownership was essential and the EPOC model provided a mechanism to build trust through its accountability and transparency mechanism. EPOC provided the sense that the government was being held to account by an independent domestic body, which provided great reassurance to the public.

E. Assessment

125. Jamaica's recent IMF-supported programs are celebrated as a success story. The restoration of macroeconomic economic stability and sustained reduction in the debt burden represent significant progress. However, low growth remains an area of concern as the expected dividends from macroeconomic and structural reforms have been slow to materialize. On the public budget, wage spending still appears to be crowding out growth-enhancing capital

expenditure, with public investment generally weaker than anticipated. Staff identified the continued high cost of financing for private investment, along with crime, as significant constraints to growth.

126. Jamaica entered the 2010 SBA and the 2013 EFF under significant economic stress that required firm measures to overcome. The 2010 SBA faltered due in part to political developments that were difficult to anticipate. In the design of this program, restoring fiscal and financial sustainability were treated as paramount and viewed as the overriding challenge for achieving higher rates of growth. In that context, program structural benchmarks did not pay specific attention to measures that targeted growth directly.

127. The 2013 EFF also placed the achievement of fiscal and financial stability as the core underlying goals but far greater recognition was given to factors that directly supported growth. While structural benchmarks focused primarily on fiscal measures, an extensive range of growth-related reforms was also included in the MEFP as commitments, some of which were supported by the other IFIs and closely monitored by staff. Determined implementation of fiscal sustainability and financial sector stability measures and business sector reforms to support the private sector were all viewed as essential to revive growth.

128. In the Jamaican context, the approach of tackling the fiscal imbalances aggressively to restore confidence in fiscal sustainability and to create space for more private sector activity, while shielding the most vulnerable, seems to have provided a firmer foundation for achieving stronger growth. There were good arguments, in Jamaica's case, to suggest that adverse multiplier effects would be significantly offset by confidence gains. Jamaica has a history of strong fiscal dominance with the government as a major economic actor. This period of heavy government activism coincided with growth stagnation, a rising debt burden, and crowding out of lending for private investment. Moreover, available empirical estimates suggested that the multiplier effect of government spending was low, consistent with the openness of the economy.

129. Despite good progress towards restoring fiscal and debt sustainability, growth has continued to underperform, compared to program projections and other comparators. Growth outcomes were adversely influenced by a series of negative shocks that staff forecasts did not adequately account for despite their historical frequency and impact. Crime was recognized as a major constraint on growth; staff did consider including a structural benchmark related to security but decided against such a measure, which was beyond staff's expertise. However, the primary balance target was reduced to facilitate increased spending on security.

130. The 2013 EFF and 2016 SBA paid increased attention to policies directly related to growth. An increased focus on growth seems to have facilitated greater consensus and helped foster stronger commitment to the program. While growth did not accelerate as expected, commitment to the program remained strong due to the high level of country ownership, allowing more space for reforms to bear fruit.

131. Strong domestic support for the program proved important and contributed to the successful implementation of the 2013 EFF and 2016 SBA. The formation of EPOC was pivotal and reflected the desire of stakeholders for the 2013 EFF to succeed. In this regard, trade unions and the financial sector wanted a mechanism through which they could hold the government accountable, to guard against a repeat of what transpired during the previous 2010 SBA. The committee had the respect of the public and engaged in extensive communications with the nation, explaining program details in a manner which could be easily digested by the general public.

132. Implementation of the legislative agenda was challenging due to the paucity of domestic legal drafters and need for adequate consultation with stakeholders. In some instances, the rush to meet tight program test dates appeared to have affected the quality of the proposed amendments, resulting in more time being required to fine tune the legislation at a later stage. This experience suggests that the delivery of strong and impactful reforms can be jeopardized if programs focus too much on delivering legislation to parliament rather than ensuring that they are properly designed.

IV. LESSONS

133. The main lessons from the Grenada and Jamaica experience are as follows:

- Country ownership, broad based participation, and decisive leadership were essential to program success. Formation of the CSP in Grenada (2014 ECF) and EPOC in Jamaica (2013 EFF) were viewed as critical to strong program implementation. Private sector engagement, both in monitoring and providing oversight and as active contributors to policy formulation can help build domestic support to safeguard the program. Staff experience in program design, sound knowledge of country specifics, and cultivating solid working relationships with the authorities were also important.

- Program design should build in resilience, to the extent possible, from uncertainties affecting fiscal results and growth outcomes. In the case of Grenada's 2014 ECF, conservative growth projections were useful to anchor program targets and increase realism. While the authorities felt that conservative estimates implied more stringent fiscal measures, they did not disagree with staff's strategy, mindful of the experience in previous programs which were designed with overly optimistic growth projections. In the case of Jamaica, the 2013 EFF and 2016 SBA were designed to insulate fiscal outcomes from uncertainties regarding growth, given that Jamaica is subject to frequent weather-related disturbances with high uncertainty about the future growth path.

- Small open economies with small fiscal multipliers and favorable external conditions can achieve both significant fiscal adjustment and strong growth outcomes as demonstrated in the case of Grenada's 2014 ECF. Robust growth due to positive non-program related developments clearly supported program implementation.

- Domestic growth constraints such as crime in Jamaica and labor market and energy sector distortions in Grenada and Jamaica are deep rooted. Fund financing and staff expertise are not necessarily equipped to address these weaknesses in a direct manner. It therefore is important for IMF-supported programs to be complemented by interventions from other IFI's, such as the IDB and the World Bank, with the requisite expertise to tackle such issues.

- Growth dividends from reforms based on fundamental shifts in the underlying structure of the economy require time to materialize. Jamaica's 2013 EFF was premised on moving away from a public sector dominant economic model to one driven by the private sector. There appears to have been an overestimation of the pace at which such a transformation would occur.

- Direct attention to growth, beyond the confidence effects of macroeconomic stability, is likely to increase the likelihood of success in raising growth prospects. The Fund could still be parsimonious in terms of growth-related structural benchmarks and provide support for the authority's ambitions through MEFP commitments as obtained in the 2013 EFF for Jamaica and the 2014 ECF of Grenada. This can contribute to the implementation of broad-based growth-related structural reforms with the IMF-supported program providing a mechanism for monitoring progress.

- Well-designed debt operations that provided sizeable debt relief can be sufficient to substantially ease the burden of fiscal adjustment. This point is well illustrated by the case of Grenada, where a restructuring of external debt contributed importantly to restoring a sustainable public position. If debt is predominantly held by the domestic financial sector, as was the case in Jamaica, it can limit the gains from debt operations, but nevertheless play an important role.

- Support for social safety net programs were important in building domestic support. Despite the Fund's small direct financing contributions under Grenada's 2014 ECF, the realized benefits from debt relief and protection of social spending enhanced the IMF's credibility.

- Alignment of TA with structural reforms and support from partner IFIs can enhance policy implementation as was the case in both Grenada and Jamaica. Clarity on the structural priorities needed to achieve program objectives are important to ensure that adjustment measures are well supported by complimentary institutional enhancements.

- Capacity building efforts by the Fund were important and provided needed support to the domestic authorities and helped deliver on key reforms, particularly in the financial sector. However, even with extensive TA, implementation of structural reforms requires sufficient domestic capacity to generate the desired outcomes. An ambitious reform agenda, as was adapted in Jamaica and Grenada, can stretch the available absorption capacity, resulting in implementation delays as the provision of TA is not a substitute for domestic technical and political implementation capacity. Furthermore, program reforms should avoid excessively accelerated timelines, to the extent possible, that could either reduce the effectiveness of the legislation or delay its implementation due to inadequate consultation with stakeholders.

REFERENCES

Acevedo, S., 2016, "Gone with the Wind: Estimating Hurricane and Climate Change Costs in the Caribbean," IMF Working Paper /16/199, Washington.

Alesina, A., and E. Spolaore, 2005, "The Size of Nations," Cambridge, MA: MIT Press.

Asonuma, Tamon, and others, 2017, "Sovereign Debt Restructurings in Grenada: Causes, Processes, Outcomes, and Lessons Learned," IMF Working Paper, WP/17/171.

Clarke, N., 2019, "Lessons from Jamaica for Small Countries with Big Debts," Financial Times, February.

Gonzalez-Garcia, J., A. Lemus, and M. Mirkaic, 2013, "Fiscal Multipliers in the ECCU," IMF Working Paper 13/117.

Guy, K., and A. Belgarave, 2012, "Fiscal Multipliers in Microstates: Evidence from the Caribbean," International Advances in Economic Research, February.

International Monetary Fund, 2012, "Grenada: Ex Post Assessment of Longer-Term Program Engagement," County Report No. 14/19.

__________________, Jamaica, Various Article IV Reports, 2008–19 (Washington).

Jaitman, L., 2017, "The Costs of Crime and Violence New Evidence and Insights in Latin America and the Caribbean," Inter-American Development Bank, Washington DC.

Kim, Jun, and others, 2021, "Cross-Country Analysis of Program Design and Growth Outcomes: 2008–19," IEO Background Paper, BP/21-01/01 (Washington: International Monetary Fund).

Kim, Jung Yeon, and Kwang Yeon Lee, 2021, "Structural Conditions, Structural Reforms and Growth in IMF-Supported Programs," IEO Background Paper, BP/21-01/04 (Washington: International Monetary Fund).

Okwuokei, J.C, and van Selm, B., 2017, "Debt Restructuring in the Caribbean—the Recent Experience" in Alleyne et al, *The Caribbean: Unleashing Growth and Strengthening Resilience,* 2017, pp.151-173.

Ruprah, I., and others, 2014, "Is There a Caribbean Sclerosis? Stagnating Economic Growth in the Caribbean," Inter-American Development Bank, Washington DC.

Wigglesworth, R., 2020, "Inside the IMF's Outrageous, Improbably Successful Jamaican Program," The Financial Times, February.

CHAPTER 2. HONDURAS

MARCO PINON-FARAH*

* Consultant, Independent Evaluation Office of the IMF.

EXECUTIVE SUMMARY

This paper evaluates the IMF-supported programs in Honduras during 2008–19 in terms of how well growth and social inclusion were protected and fostered, while delivering the necessary adjustment. Honduras offers several features which makes it a valuable case study. The country has a long record of program engagement with the IMF, with varying degrees of success. It is one of the poorest and most unequal countries in Latin America, and violent crime rates are high. The Honduran governments have invested significant time and resources to alleviate poverty and reduce crime, with some success since 2014. Nevertheless, social conditions remain precarious and significant further progress is needed.

The case study evaluates the 2010 and 2014 Stand-By Arrangements (SBAs), both treated as precautionary and, where relevant, provides factual information on the 2019 SBA which is still ongoing. As has been the case elsewhere, the COVID-19 pandemic has had a large impact on Honduras' economy for 2020 and beyond, and the IMF has provided financial support through the existing SBA to deal with the crisis.

The experience in Honduras illustrates the importance of the authorities' ownership and broad domestic buy-in, as well as adapting conditionality to take into account local conditions, as essential for the success of IMF programs. The contrast between the 2010 and 2014 SBAs is a good example. The former failed amid insufficient buy-in by the authorities for the measures advocated by staff, in large part because of difficult social and political conditions. The successful 2014 program built on the previous experience by seeking a broader local consensus and securing ex ante most of the measures needed for the adjustment. In addition, staff's flexible approach during the 2014 program gave the authorities the time and space to adopt corrective measures when they were needed.

A valuable lesson regarding the balance between adjustment and growth objectives is the need for a good understanding of key policy trade-offs, taking into account the credibility channel. The 2014 program provides a strong example of the need to avoid the use of mechanistic fiscal multipliers in cases of balance of payments (BOP) crises, when the benefits from regaining credibility may offset the direct (negative) impact of the fiscal adjustment on aggregate demand. In this case, both the authorities and Fund staff correctly expected the adjustment to be expansionary, owing to a strong boost in confidence.

The programs for Honduras clearly illustrate the benefits of adopting a flexible exchange rate but also the importance of creating the appropriate conditions for its adoption. One of the areas of greater tension in program discussions was staff's insistence on adopting a flexible exchange rate arrangement, particularly after Honduras' peg resulted in a substantial appreciation of the exchange rate. In 2011, a crawling band system was adopted which prevented exacerbating the real appreciation, but the authorities limited the pace of nominal depreciation to preserve the exchange rate as a nominal anchor for inflation and to minimize balance sheet risks. While the real effective exchange rate was deemed broadly appropriate, or moderately overvalued, the need for a more flexible rate as external shocks absorber was further emphasized in the 2019 program, particularly given Honduras' significant vulnerabilities.

Experience with the 2010 and 2014 SBAs clearly demonstrates that removing key impediments to growth, including through structural reforms and addressing governance issues, is essential for meaningful and lasting economic progress. The design of the 2010, 2014, and 2019 programs entailed increasingly deep structural reforms with increasing attention to strengthening governance and the business environment particularly in the ongoing 2019 program.

I. INTRODUCTION

1. **Several factors make Honduras an interesting case study**. The country has a long record of engagement with the IMF, including multiple Fund arrangements in support of the authorities' programs. Since 2010, the strength of its policies has varied considerably, from being weak and declared off-track to more recently performing strongly. Similarly, the range of outcomes, has been wide, including in terms of growth.

2. **This evaluation focuses on IMF-supported programs and outcomes during 2008–19.** During this period, Honduras entered three combined Stand-By Arrangements (SBA)/Standby Credit Facility (SCF) arrangements in 2010, 2014, and 2019. As has been the case elsewhere, the COVID-19 pandemic has placed substantial stress on Honduras' economy requiring program modifications and drawings, but the associated challenges are beyond the scope of this case study. The evaluation draws on program documents and interviews with country officials and staff held prior to the COVID-19 pandemic.

II. CONTEXT

3. **Honduras is one of the poorest and most unequal countries in Latin America, and rates of violent crime are high**. It has a per capita income of about US$2,600 in 2019 with a population of some 9.1 million. Its Gini coefficient of 0.53 suggests that it suffers from the greatest degree of inequality in Central America. Over 60 percent of the population lives below the poverty line, including close to 40 percent in extreme poverty. It ranks 132 out of 189 countries in the UNDP development index (1 being the most developed). The governments of Honduras have invested significant time and resources to alleviate poverty and reduce crime, with some success particularly since 2014. Nevertheless, social conditions remain precarious and significant further progress is needed.

4. **With tight linkages to the United States and high exposure to changes in terms of trade, Honduras' economic performance is heavily influenced by external conditions.** Migration to the US, both legal and undocumented, has provided some relief to the difficult domestic security, social and economic conditions. The large population of Honduran origin in the US in turn provides the largest source of foreign exchange to the country via substantial worker remittances. Maquila (labor intensive processing plants) exports are another important source of foreign exchange. At the same time, trade tensions and US immigration policies pose important downside risks. Terms of trade are affected by oil import prices and commodity export prices (bananas, coffee, and palm oil).

5. **Honduras has a democratic political system dominated by two main parties, the liberal and conservative parties**. With the elites divided between the two parties, civil society has more weight than in other neighboring countries. Presidential elections are held every four years. Following the deposal of President Zelaya, who had been elected in 2008, and a constitutional crisis, President Porfirio Lobo (center-right National Party) began a four-year term in January 2010.

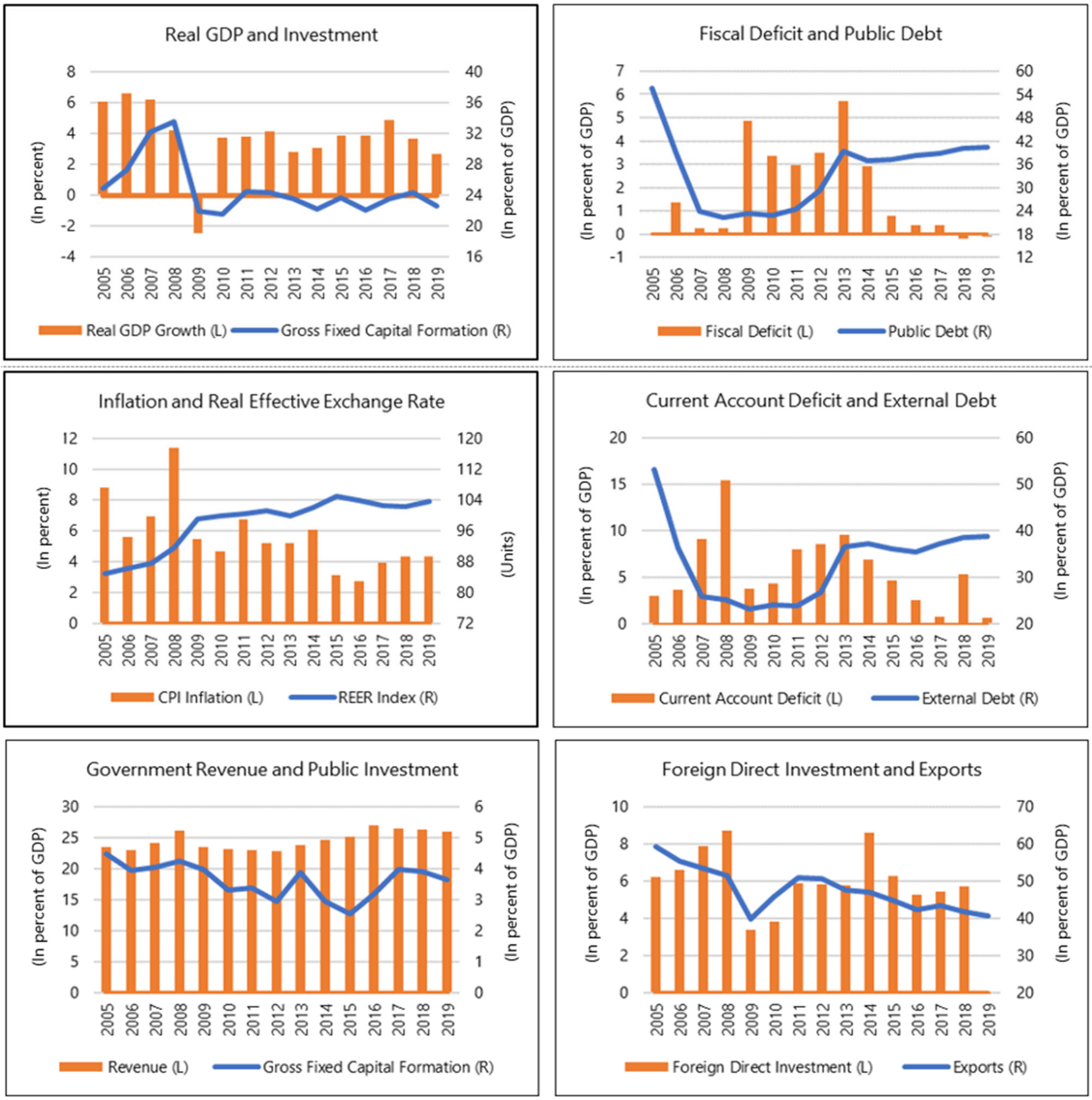
During his term, spending on social programs rose notably. President Hernandez (also center-right National Party) took over in 2014 and began a second term in January 2018. During his terms, security and social conditions have improved. Further expansion of safety nets, an increase in the security budget, and the overhaul of the police force contributed to a considerable reduction in violent crime. The poverty rate has declined but remains high at around 60 percent.

6. **After Honduras emerged from one of its worst political crises in 2009–10, economic growth temporarily accelerated but by 2013 economic imbalances had increased considerably (Figure 1).** Against the backdrop of a constitutional crisis and the impact of the global financial crisis, GDP contracted 2.4 percent in 2009. GDP growth turned positive in 2010 and further increased through 2012, before slowing down in 2013. Economic imbalances declined initially in 2010 and the exchange rate began to follow a crawl in 2011, after being pegged to the US dollars for many years. However, fiscal policies started to deteriorate in 2011–12. By 2013, large increases in spending and a high deficit of the state-owned electricity company had boosted the fiscal deficit to 7.5 percent of GDP, more than two-and-a-half times the level in 2010. As a result, public sector debt increased to 38 percent of GDP in 2013, about 14 percent of GDP higher than in 2010.

7. **Economic conditions improved significantly during 2014–17 in the context of more disciplined macroeconomic policies.** VAT tax increases and tax administration measures adopted early in the program, and the approval of a fiscal responsibility law later on, proved effective to lower the fiscal deficit and to protect consolidation gains. The fiscal deficit declined gradually to ½ percent of GDP by 2015, remaining below 1 percent of GDP thereafter. Economic activity accelerated reaching close to 5 percent by 2017. Inflation was halved to about 3–4 percent during 2015–17. The positive economic performance was facilitated by improved terms of trade and confidence, as evidenced by a marked drop in the country risk spreads. Reserve coverage increased to about 5¼ months of imports in 2017, up from 3¾ in 2013.

8. **During 2018–19, growth declined owing mainly to a deterioration in external conditions and adverse weather conditions.** GDP growth dropped to 2.7 percent in 2019, owing to a drought affecting the agricultural sector, weaker trade partners' growth, and a deterioration in terms of trade. Offsetting these developments to an important extent, worker remittances remained buoyant. Notwithstanding the challenging environment, the fiscal deficit was maintained broadly constant at about 0.9 percent of GDP. The inflation rate stayed close to the 4 percent midpoint of the central bank's target band, and reserves remained at about five months of imports during this period.

Figure 1. Honduras—Selected Economic Indicators



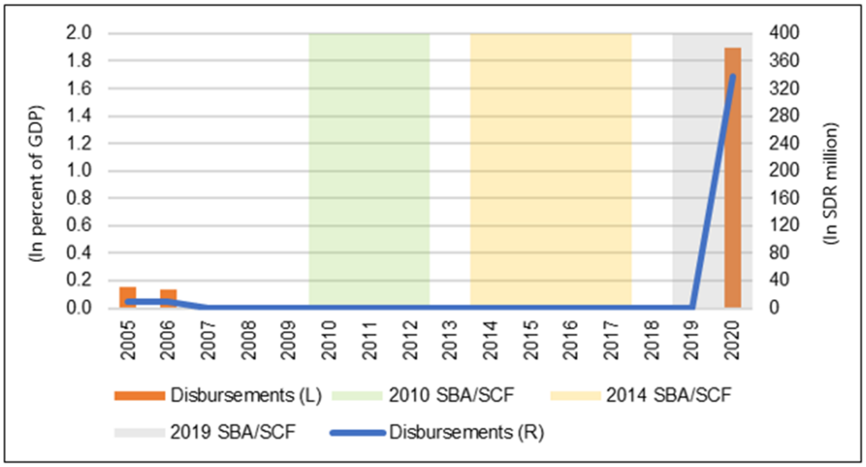
Sources: April 2020 WEO database; INS database; FFA database.

9. **As elsewhere in the world, the COVID-19 pandemic has impacted economic performance in Honduras**. GDP is estimated to have contracted by more than 9 percent in 2020, and significant resources have been needed to deal with the effects on the pandemic. Fortunately, the sharp deterioration in sentiment toward emerging markets observed early in 2020 subsided considerably as evidenced by Honduras successful placement in June 2020 of a 10-year bond in international markets at reasonable terms.

History of Fund Engagement

10. **Honduras has a long history of Fund arrangements.** Prior to 2008, it had three Poverty Reduction and Growth Facility[1] (PRGF) arrangements, the last of which expired in February 2007, after the third review when the program went off-track. In July 2008, a precautionary 12-month Stand-By Arrangement[2] (SBA) in an amount equivalent to SDR 38.85 million (30 percent of quota) was approved. During the period covered by this review, Honduras had three Fund-supported arrangements which blended access to the IMF's concessional and non-concessional lending windows (Figure 2).

Figure 2. Honduras—IMF Disbursements



Source: IMF Members' Financial Data.

11. **An 18-month SBA and SCF[3] in the amount of SDR 129.5 million (100 percent of quota) was approved in October 2010.** Only two out of five program reviews were completed (October 2010–March 2012) before the program went off track. The arrangement was treated as precautionary.

12. **A three-year SBA/SCF arrangement was approved in December 2014, with access set at SDR 129.5 million (100 percent of quota)**. The arrangement was treated as precautionary. On October 26, 2017, the final fifth and sixth semi-annual reviews were completed, without any purchases/drawings.

[1] The PRGF was a facility that provided concessional resources to LICs to support poverty reduction and growth. It was replaced in 2009 by the Extended Credit Facility (ECF) to make support more flexible and tailored to country needs

[2] Since its creation in June 1952, the IMF's SBA has been the workhorse lending instrument for non-concessional resources for emerging and advanced market countries.

[3] The SCF provides financial assistance to LICs with short-term BOP needs. The SCF was created under the Poverty Reduction and Growth Trust (PRGT) in 2009 as part of a broader reform to make the Fund's financial support more flexible and better tailored to the diverse needs of LICs, including in times of shocks or crisis.

13. **A two-year SBA/SCF was approved in July 2019, with access initially set at SDR 224.8 million (90 percent of quota)**. The program was intended to be treated as precautionary. However, facing urgent balance of payments and fiscal financing needs stemming from the COVID-19 pandemic, in March 2020 the authorities drew SDR 104.9 million. In June 2020 in the context of the second review of the program, access was augmented to SDR 387.2 million, or 155 percent of quota. The completion of the review released about SDR 169.9 million to further help Honduras deal with the COVID-19 pandemic, including for increased health care and social spending.

III. PROGRAM DESIGN

A. Program Growth and Adjustment Objectives

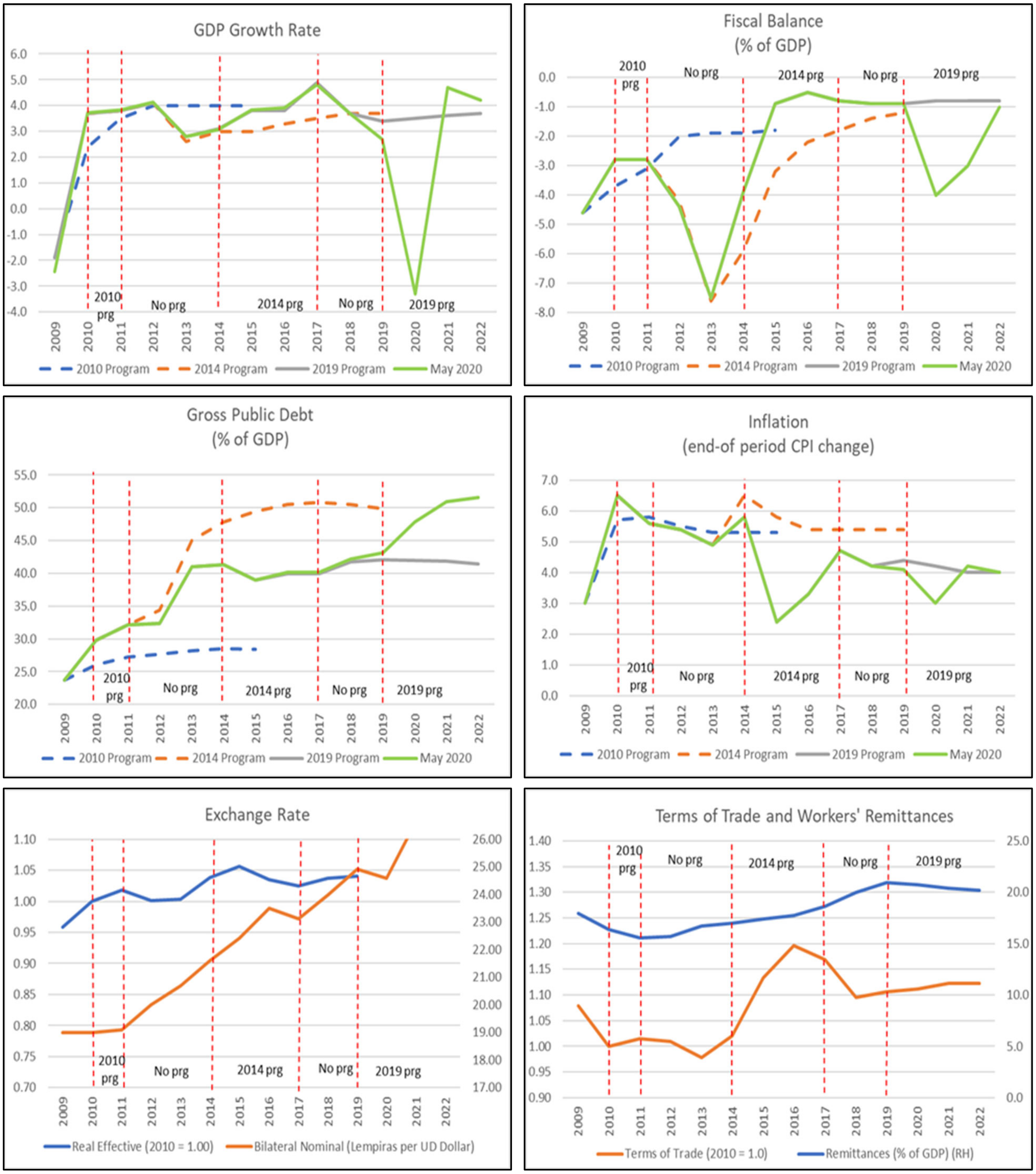
14. **The 2010 and 2014 programs targeted simultaneously a substantial fiscal adjustment and an increase in economic growth.** These programs were expected to catalyze access to external resources, even as the Fund arrangements were expected to be treated as precautionary. Starting from a better position in terms of economic imbalances and growth, the 2019 program sought to consolidate the adjustment achieved during the previous years, while deepening reforms to further promote sustained growth over the medium term. External balance of payment support was expected to play a lesser role, as access to global markets was expected to improve with the implementation of the program. Table 1 and Figure 3 show several of the key program targets at the time of approval and as adjusted following program reviews.

Table 1. Honduras—Overall Fiscal Balance, Including Grants[1]
(In percent of GDP)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
2010 SBA/SCF Request – October 2010	-4.6	-3.7	-3.1	-2.0	-1.9	-1.9	-1.8	…	…	…	…	…	…	…
1st Review – April 2011	…	-2.9	-3.1	-2.2	…	…	…	…	…	…	…	…	…	…
2nd Review – July 2011	…	-2.9	-3.1	-2.5	…	…	…	…	…	…	…	…	…	…
2014 SBA/SCF Request – December 2014	…	-2.8	-2.8	-4.2	-7.6	-5.9	-3.2	-2.2	-1.8	-1.4	-1.2	…	…	…
1st Review – September 15	…	…	-2.8	-4.2	-7.6	-4.3	-2.7	…	…	…	…	…	…	…
2nd Review – December 2015	…	…	-2.8	-4.2	-7.6	-4.3	-2.4	-2.0	…	…	…	…	…	…
3rd & 4th Review – October 2016	…	…	-3.2	-4.4	-7.5	-3.9	-1.0	-1.5	…	…	…	…	…	…
5th & 6th – October 2017	…	…	…	-4.4	-7.5	-3.9	-1.0	-0.5	-1.2	-1.2	-1.0	-1.0	-0.9	-0.9
2018 SBA/SCF Request – July 2019	…	…	…	…	…	…	-0.9	-0.5	-0.8	-0.9	-0.9	-0.8	-0.8	-0.8
1st Review – December 2019	…	…	…	…	…	…	-0.9	-0.5	-0.8	-0.9	-1.0	-1.0	-1.0	-1.0
2nd Review and Augmentation – May 2020	…	…	…	…	…	…	…	-0.5	-0.8	-0.9	-0.9	-4.0	-3.0	-1.0
Actual/latest projection	-4.6	-2.8	-3.2	-4.4	-7.5	-3.9	-0.9	-0.5	-0.8	-0.9	-0.9	-4.0	-3.0	-1.0

Source: IMF staff reports.
[1] Figures presented at time of approval and reviews. It contains historical and program targets as presented in program documents at the time.

Figure 3. Honduras—Evolution of Program Indicators



Sources: WEO database; INS database; FFA database; and IMF Members' Financial Data.

15. The following paragraphs describe key elements of the strategy and objectives, leaving further details about pro-growth policies and reforms for the following section.

2010 SBA/SCF[4]

- The program was anchored on a gradual decline of the fiscal deficit from 4.6 percent of GDP in 2009 to 2 percent of GDP by 2012–13 (see Table 1 and Figure 3). This path would result in a public debt ratio stabilizing below 30 percent of GDP by 2012–13, up from about 24 percent of GDP in 2009. Under these projections, the debt would continue to be in low risk of distress under the DSA.

- Fiscal consolidation would be achieved largely via higher revenues resulting from a tax reform (approved prior to the program), which included the elimination of the VAT zero rate, establishing an income tax on dividends and housing rent, increasing taxes on "sin" goods, as well as several tax administration measures. In addition, nominal wages were to be held constant, which would reverse by 2011 a sharp increase in the wage bill as a percent of GDP observed in 2009. These policies would provide some room for priority spending on public investment and anti-poverty programs.

- Monetary and exchange rate policies were geared at maintaining low inflation, safeguarding competitiveness, and strengthening the external reserves position. In this connection, central bank credit to the public sector was to be restrained and the monetary and exchange rate management frameworks were to be upgraded. While not in the original program, in 2011 an exchange rate peg to the dollar was replaced by a crawling band system of the Lempira/US dollar which continues to this day. A prudent wage policy, strengthening public enterprises, and reforms to improve the business environment would also support competitiveness.

- Program reforms were to be supported by IMF technical assistance (TA), with emphasis on the upgrading of the monetary policy framework and setting up the infrastructure for a well-functioning foreign exchange market and debt management.

- The balance of payments (BOP) need for 2011–13, as calculated by the IEO, was more than doubled[5] by a widening of the current account deficit (11.4 percent of GDP). Almost all of this was to be financed by project financing and private flows (22.6 percent of GDP). Multilateral and bilateral BOP support was expected to play a relatively small role (1.7 percent of GDP), with the IMF arrangement expected to be treated as precautionary (Figure 4).

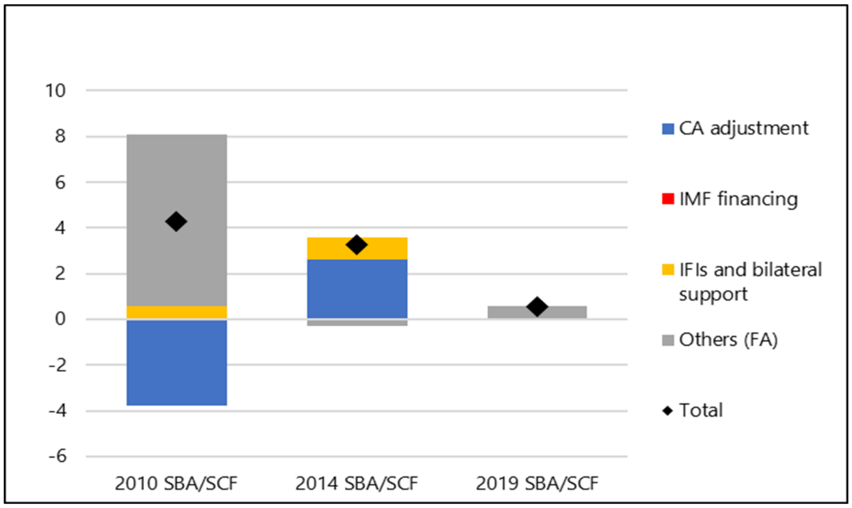
---

[4] IMF (2010).

[5] The current account deficit had narrowed substantially in 2009–10 resulting from a substantial drop in external financing, including for projects, owing in part to the unsettled political conditions at the time in Honduras.

- Growth was projected to accelerate from -1.9 percent in 2009 to 2.4 percent in 2010 and gradually to 4.0 percent by 2012–13, Honduras' long-term historic rate. The rebound would result as political uncertainties and social pressures eased and investor and consumer confidence returned.

Figure 4. Honduras—Balance of Payments Need Decomposition
(In percent of GDP)



Sources: IEO calculations, and Kim and others (2021).
Note: See Kim and others (2021) for a detailed explanation of the methodology.

2014 SBA/SCF[6]

- The program sought a major fiscal consolidation to contain the rapid growth of public debt seen during the previous years. The deficit was targeted to decrease from 7½ percent of GDP in 2013 to below 2 percent of GDP by 2017. This would stabilize the public debt at about 50 percent of GDP by 2016–17, after an increase of about 15 percent of GDP since 2010.

- Revenues would increase by some 2½ percent of GDP during 2014–17, mainly from VAT tax rate increases in December 2013, ahead of program approval, and significantly deepened reforms to improve tax administration, including dismantling the taxpayers' agency and creating a new tax authority from scratch, with IMF TA. An additional adjustment of government spending equivalent to 3 percent of GDP would be broadly split between reductions in current spending (limiting nominal wage increases and lowering electricity sector losses) and capital expenditures.

[6] IMF (2014).

- The authorities were to develop a medium-term fiscal policy framework with a clear fiscal anchor and fiscal policy targets during the program period, as a step toward the possible adoption of a fiscal responsibility law.

- Key fiscal reforms that were to be implemented under the program included a reform of the pension system and a strengthening of the electricity company.

- Monetary policy would be consistent with keeping inflation in check at around 5–6 percent and strengthening international reserves. The exchange rate was to be managed more flexibly within the existing crawling band, and steps would be taken toward adopting a more flexible system over the medium term. While not part of the initial program, the objective of adopting an inflation targeting regime was later adopted as part of the program. This required TA from LEG, MCM, and the Central America, Panama, and the Dominican Republic Technical Assistance Center to create the necessary infrastructure to conduct monetary operations.

- The BOP need for 2015–19, as calculated by the IEO, was to be filled by current account adjustment (10.4 percent of GDP), multilateral and bilateral BOP support (3.9 percent of GDP), and other financial account flows (1.7 percent of GDP). Again, no drawing on Fund financing was envisaged (see Figure 4).

- Fund technical assistance concentrated on the strengthening of tax administration, while continuing to support the central bank's institutional capacity and the operational framework for conducting monetary policy. World Bank projects supported the modernization of the power sector, social protections, safer municipalities, water and sanitation, and roads rehabilitation. It also provided technical and analytical support on public expenditure, poverty and inequality, and debt management.

- Real GDP growth was to increase from 2.6 percent in 2013 to 3½ percent of GDP by 2017. More favorable terms of trade, a growth pick-up in the US and, especially, improved confidence leading to higher private investment were expected to support the higher rates of growth.

2019 SBA/SCF[7]

- With significant fiscal consolidation achieved under the previous program, the fiscal deficit was to remain broadly constant below 1 percent of GDP throughout 2019–22. Strong program implementation was assumed to result in improved access to market financing, allowing Honduras to improve its debt profile considerably.

[7] IMF (2019a).

- Deepened structural reforms were aimed at addressing the financial condition of the electricity company, a legacy issue from the previous programs.
- Monetary policy was to be managed proactively so that inflation converged toward the midpoint of the 4±1 percent central bank target range. Measures to strengthen the financial system included a reform of the commercial banks resolution framework, which was incorporated into the program in the context of program reviews.
- Measures were to be adopted to further enhance the monetary policy framework to support the transition to a more flexible exchange rate, including by adjusting FX intervention rules in preparation for the elimination of surrender requirements, the regulations to support development of an FX derivative market, the use of treasury securities for monetary policy, and the development of an electronic platform to support a secondary securities market.
- Having achieved significant progress toward macroeconomic stability, the program introduced a significant emphasis on addressing governance concerns and improving the business climate through wide-ranging institutional reforms.
- The pace of exchange rate depreciation was to be increased to support the external sector and ease the cost of fiscal adjustment.
- The objectives of the program were to be supported by IMF TA on governance issues, including on the procurement and the selection of public investment projects, and continued support to strengthen the central bank's capacity. The World Bank and Inter-American Development Bank were expected to provide support in several key areas, including Institutional reforms in the electricity sector.

B. Strategies to Support Growth and Inclusiveness

16. The 2010 program sought to achieve moderately higher growth, while delivering needed fiscal adjustment, including through:

- Triggering a positive reaction in private sector investment and activity, in part through increased confidence resulting from commitment to stability and medium-term fiscal consolidation.
- Creating fiscal space for priority spending, including public investment and anti-poverty programs, by increasing tax collection, and containing current spending.
- Consolidating most anti-poverty spending in a well-designed conditional cash transfer program, with assistance from multilateral banks, and improving the targeting of electricity subsidies.
- Reforms to boost public sector spending productivity, particularly of public sector enterprises.

- While no upfront adjustment of the exchange rate was envisaged, the introduction of the crawling band in 2011 was expected to provide additional degrees of freedom to protect competitiveness. This followed a significant appreciation of the real effective exchange rate during the period when the exchange rate was fixed.

17. The 2014 program doubled down on key elements of the short-lived 2010 program, while incorporating valuable lessons learned to ensure a more successful implementation, including:

- A major VAT tax increase secured prior to the start of the program to create space for priority spending.

- Significantly deepened tax administration reforms, starting by dismantling the existing taxpayers' agency and creating a new tax authority from scratch.

- Protecting social programs spending levels, after a significant expansion in the previous years, thus substantially increasing the share of social spending in overall primary spending. A new program would consolidate existing social programs (notably the conditional cash-transfer program) and expand them by including assistance to improve housing for low-income families.

- Implementing key structural reforms to increase the efficiency of the electricity sector, including by allowing increased private sector participation in distribution; and to strengthen the pension and healthcare systems, the PPP framework, pensions, and the financial sector. The World Bank and Inter-American Development Bank were to play major roles in supporting the reforms of the electricity sector, pensions, and healthcare systems.

18. The 2019 program sought to promote sustained growth further through greater emphasis on deepening key structural reforms:

- Deeper and broader-ranging reforms of the electricity sector. This recognized that rising oil prices had demonstrated that earlier reforms had been insufficient.

- Reforms to improve a framework to manage public-private partnerships (PPP) and approving a new securities law.

- Inclusion of important measures to strengthen the business environment, improve governance, and to advance the fight against corruption. The roadmap to improve governance included a new central bank charter and enhancements to the budget process. Anti-corruption frameworks and measures added included the registry of beneficial ownership, the public officials' asset declaration system, and public procurement.

C. Realism of the Macro Framework

19. **The impact of programs as a whole on growth was an important part of the discussions**. Except for a brief mention of a low fiscal multiplier in the context of the 2014 request (estimated at 0.3), the program documents did not emphasize the impact of fiscal adjustment alone on growth. In particular, the 2010 and 2014 programs envisaged an acceleration of growth, even while a fiscal adjustment was to be carried out largely as a result of expected improvements in market and private sector confidence. During the review process for the 2014 program, some departments within the IMF expressed concern about the potential negative impact of a large and upfront adjustment on growth. However, the authorities' and staff involved in the discussions felt strongly that the program as a whole would be expansionary because of confidence effects.

D. Contingencies and Program Adjustments

20. **The programs for Honduras did not have explicit contingency measures, except for an adjuster on external disbursements, but in practice they were adjusted flexibly, particularly since 2014.** For example:

- During the early reviews of the 2014 program, there was a domestic legal interpretation of the social protection laws that could have made them potentially inconsistent with macroeconomic stability. Under agreed revisions to the program, authorities were provided the space and time to implement gradual measures to limit its impact and, later on, to address fiscal sustainability concerns through a fiscal responsibility law (FRL).

- The approval of the FRL, which had not been contemplated at the time of the approval of the 2014 program, provided a medium-term framework to lower gradually the fiscal deficit to 1 percent of GDP.

- Also, soon after the approval of the 2014 program, a local bank collapsed (following US sanctions imposed on the bank). Against this background, the program started taking a new more pro-active course toward protecting the financial system.

- The 2014 program also evolved toward the adoption of an inflation targeting regime, which in turn required a new law and monetary operations framework to allow the central bank to operate appropriately.

- Other adjustments to the program included further lowering current spending to allow increased spending on infrastructure on highways.

IV. PROGRAM IMPLEMENTATION AND OUTCOMES

A. Program Implementation

21. **Program implementation under the 2010 SBA was weak and performance under the arrangement soon went off-track, although progress was made in some areas** (see Table 1 and Figure 3).[8] Only two out of five program reviews were completed, owing to expenditures overruns by the central government and faster than envisaged growth of monetary aggregates. Fiscal deficits were initially kept within the program ceilings (see Table 1) but starting in mid-2012 the deficit began to increase reaching near historical levels by 2013. The program may have underestimated vested interests' resistance to some measures, including to the reform of the large taxpayers' office owing to weak capacity but also governance issues. However, progress was made in some areas, particularly in reducing the public sector wage bill and in pension reform. As mentioned before, the authorities also moved from a fixed exchange rate to a crawling-peg regime in 2011, which in broad terms prevented further appreciation of the real effective exchange rate.

22. **Performance under the 2014 SBA was generally strong with firm domestic ownership and the early adoption of difficult measures, helped by low oil prices.**[9] During 2014–17, great strides were made in reducing macroeconomic imbalances and strengthening policy frameworks. All program reviews were completed, although the 3rd and 4th reviews and the 5th and 6th reviews were combined to give the authorities time to correct for some program deviations. Key achievements during the program and remaining challenges include:

- The deficit was brought down well below targets throughout the program period and, by 2017, the deficit reached historic lows, international reserves historic highs, and inflation remained subdued. Confidence improved and Honduras's debt spreads declined steadily, translating into better financing terms for private and public investment.
- Progress on structural benchmarks was also satisfactory. Notable reforms were the adoption of an FRL; the overhaul of the tax administration; progress in modernizing the monetary and exchange rate policies toward the adoption of an inflation targeting regime; and the reform of the bank resolution framework.
- However, low oil prices masked weak financial, managerial, and governance conditions, particularly in the electricity sector.

---

[8] IMF (2011a, 2011b, and 2013).

[9] IMF (2015, 2016a, 2016b, 2017, and 2018).

- During the program period, the real effective exchange rate appreciated moderately, as the rate of depreciation of the bilateral crawling band with respect to the US dollar offset most of the inflation differential between Honduras and its training partners

23. **Financing available to Honduras during 2014–17 exceeded the assumptions under the 2014 program**. With confidence improving with favorable program performance and improving terms of trade, sovereign spreads dropped considerably, and the country was able to access international capital markets at favorable terms, including a 30-year bond in international markets at an interest rate of 6 percent.

24. **The 2019 SBA has been recalibrated to address the COVID-19 pandemic shock.[10]** During the first two reviews of the arrangement, which covered performance through end-2019, all PCs were observed as were almost all structural benchmarks. The program for 2020 and beyond was modified considerably in the context of the second review presented to the Board in June 2020 to address the health and financial needs related to the COVID-19 pandemic. In particular, the fiscal deficit targets were relaxed considerably, and access was augmented.

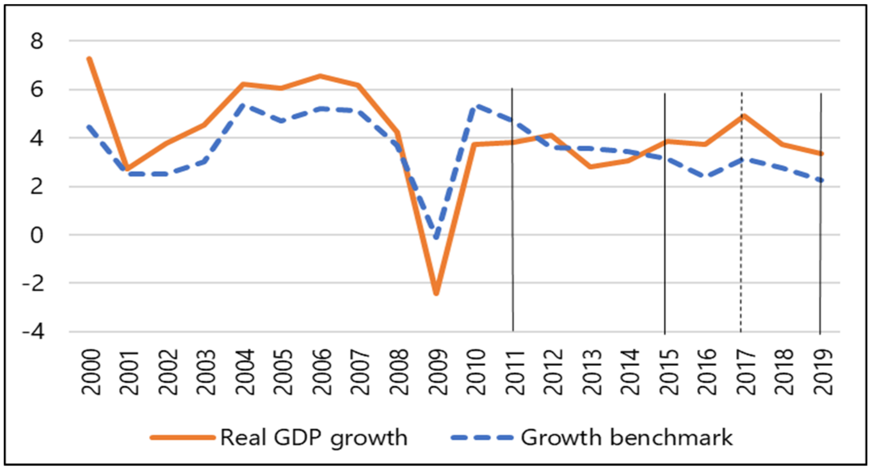
B. Growth Outcomes

25. **Growth under the 2010 SBA program was initially above target but decelerated after the program went off-track** (see Figure 3). This suggests that the program had a positive impact on growth. The IEO panel estimates based on external developments for 2011, the only full year when the program was still active, provides a growth benchmark higher than the observed growth rate of 3.8 percent (Figure 5). However, the IEO estimates do not take into account of the impact of Honduras' severe political crisis in 2009 and the unsettled social and political conditions in the ensuing years. In addition, it is also important to note that growth took a large turn for the better from -1.9 percent in 2009 to 3.7 percent in 2010 (the program included conditionality for the second half of 2010) and stayed at about the same growth rate in 2011.

26. **Growth during the 2014 SBA period was well above program projections.** This result was aided by low oil prices and significant increases in workers' remittances. IEO panel estimates suggest that, based on external developments alone, growth during in 2015–17 would have seen 3.6 percent, below the 4.2 percent actual (see Figure 5). These results suggest that the program has an expansionary impact on growth. At the same time, the IEO calculations may underestimate the positive impact of external developments, as its calculations do not include as an explanatory variable worker remittances, a major variable for Honduras, which increased considerably during this period.

[10] IMF (2019b and 2020).

Figure 5. Honduras—Growth vs. Benchmark



Source: IEO estimates.
Note: See Kim and others (2021) for a detailed explanation of the methodology.

27. **Subsequently, growth decelerated in 2018–19 when external conditions became less favorable.** Growth took a further major hit in 2020 from the COVID-19 pandemic as Honduras has been affected by reduced remittances and lower demand for its maquila exports.

V. AUTHORITIES AND STAFF'S PERSPECTIVES

28. **The authorities and Fund staff stressed that Fund-supported programs have generally been positive for growth in Honduras**. In particular, they contrasted growth rates before and after the approval of the 2014 program. Despite a sizable and upfront fiscal adjustment, growth accelerated considerably during 2015–17. In their view, a central issue driving this performance has been the credibility brought about by the adjustment, as reflected in a sharp drop in the country's sovereign spreads.

29. **Country officials highlighted that part of the success in recent programs can be attributed to a change in the way the Fund deals with the country.** They explained that both the 2010 and 2014 programs entailed deep and difficult measures but, in contrast with the former, the Fund displayed a more flexible attitude during the latter, giving the authorities time to find ways to implement their ambitious program taking into account domestic conditions. They felt that, in the past there were times when the Fund wanted to impose measures and even their timing without flexibility, even if it was not feasible for the authorities. For example, the 2010 program went off track soon after its approval, because in their view the IMF staff was not willing to give the authorities the space and time to make needed corrections. They faced demands to implement harsh measures, which they deemed as unfeasible, even though the country was just emerging from a major constitutional crisis and traumatic political shocks. Moreover, they explained that once the IMF stopped supporting the program, the economic authorities position weakened domestically, leading to a further deterioration in economic policies and conditions.

30. **The authorities and staff coincided that the 2014 program had important accomplishments, in part because it incorporated valuable lessons from the failed 2010 program.** For example, efforts to support revenues and to strengthen the revenue agency during 2010–11 were not successful as officials underestimated the governance and institutional difficulties that they would face. For the 2014 program, instead, they eliminated the tax directorate and created a new agency from scratch. Also, the incoming administration coordinated closely with the outgoing administration and, in consultation with the private sector, were able to increase VAT rates even prior to taking office. All of this created space to strengthen social programs and public investment. A noteworthy achievement was the approval of a fiscal responsibility law, which was intended to secure a more permanent, stable fiscal framework. Another important lesson incorporated is the need for the IMF to be sufficiently flexible and accept greater Honduras ownership.

31. **Staff indicated that the 2014 program sought a large and front-loaded adjustment at the insistence of the authorities despite IMF reviewing departments' misgivings.** Reviewing departments were concerned about the potential impact on growth and about the authorities' ability to deliver such ambitious adjustment. Staff directly involved in the program discussions stressed that this was a program largely designed by the authorities, with several measures adopted even before the negotiations were concluded. The authorities and staff believed that a well-designed and front-loaded adjustment, with due consultation with key stakeholders, could be achieved without a contractionary impact because of the likely benefits for credibility.

VI. ASSESSMENT AND LESSONS

32. **There are some questions as to whether the 2010 program was appropriately calibrated to protect growth and social stability, but the conclusion is not straightforward.** As previously noted, some country officials stressed that the IMF's lack of flexibility was partly to blame for the program going off track. While this may be true to an extent, it is also true that that the expansionary policies adopted by the authorities ultimately led to one of Honduras' highest fiscal deficits ever, suggesting that strong corrective measures were needed. The authorities, however, contend that the lack of an IMF-supported program weakened the economic authorities' capacity to respond to the economic deterioration that ensued after the program went off-track.

33. **The 2014 program was based on a realistic assessment of the likely impact of the fiscal adjustment on confidence and growth.** Strong domestic ownership and careful coordination among domestic key stakeholders permitted the execution of a large and mostly upfront adjustment and a rapid improvement in economic stability and confidence. The authorities and staff had the acumen to expect the fiscal multiplier to be negative at that particular juncture in Honduras, that is, that the fiscal adjustment would be expansionary. As previously discussed, the rapid drop in Honduras' sovereign spreads attest to this improved confidence. That said, a confluence of positive external developments also helped the country improve rapidly, including lower oil import prices and higher worker remittances.

34. **Economic performance following the 2014 program was generally positive, but the economy remained highly vulnerable to external developments.** While a sizable increase in remittances and lower oil import prices bolstered the economy during 2014–17, the considerable growth deceleration observed during 2018–19 coincided with increases in oil prices and lower trading partners' growth.

35. **Overall, experience with the 2011 and 2014 SBAs clearly demonstrates that tackling deep impediments to growth is essential for meaningful and lasting economic progress.** In particular, as recognized in designing the 2019 program, in addition to stable macroeconomic conditions, reforms to address head-on governance concerns and to improve the business environment are essential. Without tackling the underlying constraints on Honduras' capacity to grow, the country will not make substantial progress to converge to the higher income levels in the rest of Latin America.

36. **A clear lesson from the Honduran experience is that the success of Fund-supported programs depends to an important extent on domestic ownership and also on how conditionality/reviews are adapted to changing local conditions.** While it is essential to deliver the necessary adjustment, the viability of the programs (and of the adjustment itself) depends on the degree of the authorities' ownership and "buy-in" by key stakeholders. In this connection, the large adjustment carried out in 2014 was successful to an important extent because of significant domestic consensus, close coordination between outgoing and incoming administrations, and consultation with other groups, including the private sector. In addition, staff seems to have given the authorities time to adopt corrective measures when they were needed, for example, by combining program reviews. In contrast, the 2010 program was implemented amid exceedingly difficult economic and political conditions and weak buy-in by domestic actors. With the benefit of hindsight, it appears clear that the authorities were not in a position to implement the program successfully without significantly more time and flexibility. That said, it is far from a forgone conclusion that with added time and flexibility, the authorities would have been able to successfully implement the correction needed.

37. **A valuable lesson regarding the relationship between adjustment and growth objectives is the need for a good understanding of key policy trade-offs, taking into account the credibility channel.** The 2014 program provides a strong case to avoid the use of mechanistic fiscal multipliers in cases of BOP crises, when the credibility channel may offset the direct (negative) impact of the fiscal adjustment on aggregate demand. In this case, both the authorities and Fund staff correctly expected the adjustment to be expansionary, owing to a strong boost in confidence.

38. **Creating fiscal space for essential spending is important, as is also appropriately identifying what should be "essential spending."** Increased revenues and containing non-essential spending have proven instrumental in Honduras and elsewhere to finance infrastructure and social spending. Given Honduras' high levels of poverty, the conditional transfer programs and support for housing for low income families appear well-tailored for the country. A question

that also appears relevant is whether the program could give more explicit "space" for comprehensive anti-crime social programs and spending, given that in recent years efforts in this area appear to be paying off. In addition, future programs could further target strengthening the efficiency of public spending, where there is still considerable room for improvement.

39. **Having a full-fledged strategy to remove key impediments to growth and to address governance issues early in the design of a program are important for producing improved and lasting growth results.** The evolution of the design of the 2010, 2014, and 2019 programs has entailed increasingly deep structural reforms as the 2019 SBA/SCF, for the first time, seeks to address more head-on governance and corruption concerns. In this connection, the IMF's recent emphasis on governance diagnostic missions in cases where concerns are particularly acute have been particularly helpful to design a road map on governance and corruption issues.

40. **Appropriate flexibility is important for the success of IMF-supported programs, but it is equally important to focus on the "right" type of flexibility.** The authorities can legitimately indicate that they may need time to secure needed domestic support for the adoption of measures. They may also at times use social and other stability considerations to resist measures recommended by staff. However, "too much" accommodation by the Fund could be counterproductive, potentially increasing imbalances that may be hard to reverse later on. For example, it appears that staff's current acceptance of gradual foreign exchange liberalization, while the monetary arrangement is being modernized and conditions and instruments for more effective operations are being created is well placed. However, it is important to keep in mind that this has been facilitated by exceptionally favorable capital markets in recent years. A transition to a considerably more flexible exchange rate, which is not held hostage to needed preconditions and delays, will be important to address Honduras' extreme vulnerability to external conditions.

REFERENCES

International Monetary Fund (IMF), 2008, "Request for a Stand-By Arrangement," Country Report No. 08/241 (Washington).

__________, 2010, "Request for Stand-By Arrangement and an Arrangement Under the Standby Credit Facility," Country Report No. 10/322 (Washington).

__________, 2011a, "2010 SBA/SCF 1st Review," Country Report No. 11/101 (Washington).

__________, 2011b, "2010 SBA/SCF 2nd Review," Country Report No. 11/117 (Washington).

__________, 2013, "Honduras-Staff Report of the 2012 Article IV Consultation," Country Report No. 13/23 (Washington).

__________, 2014, "Request for A Stand-By Arrangement and An Arrangement Under the Standby Credit Facility," Country Report No. 14/36 (Washington).

__________, 2015, "2014 SBA/SCF – 1st Review," Country Report No. 15/283 (Washington).

__________, 2016a, "2014 SBA/SCF – 2nd Review," Country Report No. 16/4 (Washington).

__________, 2016b, "2014 SBA/SCF – 3rd and 4th Reviews and 2016 Article IV," Country Report No. 16/362 (Washington).

__________, 2017, "2014 SBA – 5th and 6th Reviews," Country Report No. 17/331 (Washington).

__________, 2018, "2018 Article IV," Country Report No. 18/206 (Washington).

__________, 2019a, "SBA/SCF – Request and 2019 Article IV," Country Report No. 19/236 (Washington).

__________, 2019b "SBA/SCF – 1st Review and Request for Modification of Performance Criteria – Staff Report," Country Report No. 19/377 (Washington).

__________, 2020, "2019 SBA/SCF – 2nd Review and Request for Augmentation and Rephasing Of Access, And Modification of Performance Criteria," Country Report No. 20/186 (Washington).

Kim, Jun, and others, 2021, "Cross-Country Analysis of Program Design and Growth Outcomes: 2008–19," IEO Background Paper, BP/21-01/01 (Washington: International Monetary Fund).

Kim, Jung Yeon, and Kwang Yeon Lee, 2021, "Structural Conditions, Structural Reforms and Growth in IMF-Supported Programs," IEO Background Paper, BP/21-01/04 (Washington: International Monetary Fund).