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The Solution

B/W Seaga

This week we bring you Part two of our four-week series of excerpts from Volume two of former Prime Minister Edward Seaga's autobiography ***My Life and Leadership: Hard Road to Travel****.*

IN 1985, the year in which the most severe adjustments were to be applied was also the year of the steepest decline in bauxite/alumina earnings which cut the contribution to foreign exchange earnings by 60 per cent (Table 1) and revenue by 48 per cent, the steepest cuts of the decade. From any logical point of view, 1985 should not have been a year of severe adjustments. The programme should have been softened and rescheduled once it was ascertained that the outcome of bauxite/alumina production and sales would have been exceptionally weak. The fact that the targets of the adjustment programme had to be achieved in a year in which bauxite resources would have been more depleted than ever, made me realize that although the strategy was correct, its pace of application and lack of discretion by the IMF on timing, were most counter-productive to the programme.

Several discussions with Fund officials failed to ease the pressure of performing under such rigorous conditions. It was not that we were not going to endeavour to achieve the targets but the political fall-out would have been so great that the government would fail to carry the people with the programme. Further, in a democratic setting with parish council elections pending, the IMF failed to recognize the danger of losing a government which supported the programme, by weakening its ability to lead.

I was angry at the stubbornness of the IMF but I would not take the approach of Michael Manley to castigate the Fund publicly and blame them for the difficulties being experienced. I decided to confront the IMF itself, in its own halls of power, notwithstanding the predicted prospects of failure.

WINSTON SILL/FREELANCE PHOTOGRAPHER

Edward Seaga with daughter Gabrielle at the launch of the former prime minister's 'My Life and Leadership: Hard Road to Travel', held at The Jamaica Pegasus hotel, St Andrew, last Monday.

The IMF/World Bank Joint Annual Meeting was to be held on October 9, 1985. I had decided to use the slot for Jamaica to address the Conference, to lay out the problem of the pace of adjustment and lack of discretion. I entitled the address 'Adjustment at a more Human Pace', adapting the title of the popular book by Richard Jolly and Giovani Corina, **Adjustment with a Human Face**. There was no better forum to move beyond the intransigent Fund officials than this meeting where both the President of the World Bank, Robert McNamara and Managing Director of the IMF, Jacques de Larosière, were presiding.

MAXIMUM SUPPORT

My presentation was prepared to draw the maximum institutional support. I delivered it with great passion.

Quotes from my presentation, spelled out the problems encountered: "The prevailing wisdom of these institutions, particularly the IMF, emphasizes adjustment programmes through tight demand management. The result is severe austerity which, in the final analysis, cuts services and reduces growth. This austere path carries social and political costs which are often counter-productive to the final objective of achieving adjustment without sacrificing credibility".

"It is as if the prevailing wisdom dictates that since there is no path of painless change, it matters not how painful the price of change may be. But it does matter. It matters to the human element which in the final analysis is ... the target of the adjustment process. We do not adjust economic systems. We adjust the lives of the people who make these systems work. It is short-sighted in the least to ignore the human element".

"Too often it is not recognised that when economic circumstances dictate the need

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for IMF programmes, at that point the level of adjustment needed is already inevitably drastic".

"But at that same time, accepting the need for drastic levels of change should not automatically imply an equally drastic pace of change".

I went on to offer a solution to slow the pace of adjustment from three to seven years, using the same amount of funds. I also called for greater flexibility in the implementation of policies.

I received an invitation by World Bank President McNamara to dine at his table in the luncheon interval where we could continue the discussion. At lunch, McNamara listened intently and with interest. Possibly, this matter had been a source of other complaints.

I was particularly concerned with the emphasis placed by the IMF on the use of devaluation as the principal adjustment tool in circumstances where only small depreciations of the rate were needed. Small depreciations had the same negative effect on commerce and investment as large devaluations. They unsettled the market by indicating expectations of further depreciations.

OVERHANG OF PASSION

In the Jamaican case, the currency had been devalued 43 per cent between 1980 and 1986.

I was still carrying my overhang of passion on the matter, that night, when I decided to move to another level. In my hotel room in Seoul I wrote a 29-page hand-written letter on hotel stationery, to be transcribed and sent to the World Bank, IMF and USAID. I expressed my case fully. I asked for a "fresh-look mission" comprised of one representative from each of the three institutions to review the status of the programmes initiated, their impact on the economy and the best course forward.

A Tripartite Mission was assembled by the institutions to carry out the proposed review. A detailed comparative assessment was undertaken with the Bank of Jamaica (BOJ), which concurrently did its own review. The result was transmitted to me by the governor of the Bank of Jamaica on June 4, 1986.

Briefly, both the BOJ and the Mission concurred on the broad elements of the programmes, but the BOJ did not accept the view of the mission, for a "sizeable immediate depreciation" of the exchange rate, as the means to stimulate the economy.

I knew that the recommendations of the Mission would strongly influence future IMF programmes and that a further depreciation would be required. On that basis, the BOJ put forward a proposal to give exporters a rebate to cover the price differential, which was making exports non-competitive. This would have closed the gap and avoided any disruptive impact, such as increased interest rates, price inflation or wage demands to compensate for the anticipated higher cost of goods and so on, which are the consequence of every depreciation. Devaluations were a great deterrent to investment because costs had to be continuously adjusted with each depreciation and profit margins changed, sometimes from profit to loss. Prospective investments were often shelved because of the difficulty in projecting capital requirements, cash flow needs and profit margins.

What made the IMF requirements illogical was that while the Jamaican economy needed devaluation to restore its strength from the weakness of the 1970s, depreciation, thereafter, had no impact on increasing earnings because the substantially greater part of export earnings were from tourism and bauxite/alumina, which did not adjust their US dollar prices with depreciation of the value of the currency.

These were not concerns of an organization like the IMF which dealt only with the straight economic considerations. But the psychological factors involved which created doubt and inability to forecast, affected decisions to invest or not. Any adjustment tha could remove the psychological barrier, so as to relieve any apprehension of further depreciations, would be a powerf stimulant for investment.

The IMF rejected the proposal. They wanted a 2½ per cent depreciation, which, though smal would be a negative step because would continue to raise apprehension of more to come, leading to further price movemen in expectation of the next round.

After prolonged attempts to obtain approval to cease any further depreciation and to use export rebates to compensate for any lack of competitiveness, I decided to take matters into my own hands. I instructed the BOJ t cease any payment to the IMF, except for debt obligations. The amounts due would be put in an escrow account, to be paid out when the IMF relented.

TECHNICAL OFFICERS

The BOJ negotiating team comprised of the Governor Dr Headley Brown, Deputy Governo Asgar Ali, and Derick Latibeaudiere, all highly qualifiec technical officers. They thought that I had gone too far. Nobody fights the IMF and wins. Asgar A came to ask me to release the funds, because the matter had nov become known in the IMF top circles and there was concern. Soon after, the Canadian director who sits on the Board of the IMF, and who represents Jamaica, cam to visit me. He expressed the concern of the Fund that other countries may follow my action. I told him that the IMF was being unreasonable as we had a perfectl reasonable substitute mechanism replace the use of depreciations which were a continuous source c disruption to commercial and investment interests, and this was deterrent to growth. He listened, made no commitment, and then departed. I made no commitment either.

A few weeks later, in Novembe 1986, I attended a conference at which I was asked to give an address at the University of South Carolina. Surprisingly, to me, Jacques de Larosière was also a speaker. After the conference ended, he invited me to sit with him in a quiet corner and we had frank talk. Talking to the managin director of the Fund was a better prospect for getting my argument across than talking to the staff. He was fully aware of both sides of tl argument.

After half-an-hour of discussior without any change in position, w parted. Soon after, the Fund staff advised the BOJ that Mr de

Table 3

Year	GDP	Inflation%	Employment
1980	-5.7	28.6	27.3
1981	2.5	4.9	25.9
1982	1.0	7.0	27.0
1983	2.3	20.7	26.3
1984	-0.9	26.8	26.5
1985	-4.7	23.4	25.0
1986	1.9	10.4	23.6
1987	5.2	8.4	21.0
1988 (Gilbert)	0.6	8.8	18.9
1989	4.6	17.2	18.0
1990	5.5	29.8	15.3

Larosière wanted a meeting in January before he retired from his position later that month. I visited the IMF with my BOJ team in January, 1987. The meeting was a stiff one, without either side yielding, and ended without any results. It was becoming frustrating to present the same arguments repetitiously, perhaps to see who would break first. At a second meeting, I asked a question which, out of politeness I had not wanted to ask: "Name one developing country in the world which has been a success story using devaluations imposed by IMF adjustments". There was silence, which I allowed to continue until it was embarrassing. "Time to try something new," I concluded. The meeting ended with the BOJ team being asked to return later that evening to finalize the discussion with the IMF staff. I sensed a positive response, and it was. The IMF agreed to allow the BOJ to maintain an exchange rate of US$1:00 to J$5.50 and the use of the draw-back scheme for export manufacturers. The new arrangement commenced March, 1987, with the introduction of a new one-year Stand-by Arrangement in that month.

NECESSARY CONFIDENCE

The news had the predicted effect of releasing investment by providing the confidence necessary to make reliable forecasts, and for commerce to operate with known dependable margins. So confident was the government of the outcome for 1987 after the announcement that the exchange rate would not undergo any further depreciation, that, when confronted by the union movement in that year, I was able to obtain acceptance that wage increases would not exceed 10 per cent, providing the rate of inflation was less than 10 per cent for that year. The inflation rate was 8.7 per cent, setting the stage for stable wages and prices.

From that point onwards, for the remainder of the decade, the economy operated on a 'pegged' exchange rate.

The 'pegged' exchange rate played the leading role in stimulating the economy, although there were other factors which also promoted growth.

After surviving for so many distressing years, the oil price-shock broke in early 1986. The price tumbled precipitously from US$27.56 per barrel to US$14.43 and lower and then held at somewhat higher, though still low prices, for more than a decade. The lower pricing for oil began to impact favourably on the economy in late 1987, helping to offset the continuing low earnings for aluminium in the economy.

SINGLE-FIGURE INFLATION

The result was that growth averaged 3.5 per cent per annum for the 1987-1990 period. Inflation was reduced to single figures, except in 1989 and 1990, in which the economy was overwhelmed by the ravages of Hurricane Gilbert. Unemployment declined from 23.6 per cent to 15.3 per cent. All the other macro-economic indicators were showing improvement and even the recalcitrant international reserves were improving by US$100M and more annually.

Table 3 provides annual data in these three critical variables of economic health, indicating the restoration of a path of recovery.

The bitter battle had come to a successful end. Recovery was in place but was still in a fragile condition. A new model for development, using a fixed exchange rate, had been established. We had come through the worst travails, weathered the storms and were now seeing a bright future for the first time in some 15 years. The corner had been turned.

This was the second recovery for the decade, the first being the 1981-83 period when the economy was turned around from the sustained negative direction of the decade of the 1970s.

I felt relieved that the high-risk policies and brazen gambles that I had taken to keep the economy afloat, had ended with a resumption of the climate of the growth and stability experienced in the post-Independence decade; or so I thought.