PROJECT INFORMATION DOCUMENT (PID)
APPRAISAL STAGE

Report No.: PIDA3716

Project Name	Jamaica Foundations for Competitiveness and Growth (P147665)
Region	LATIN AMERICA AND CARIBBEAN
Country	Jamaica
Sector(s)	Public administration- Industry and trade (15%), SME Finance (30%), Agro-industry, marketing, and trade (15%), General industry and trade sector (40%)
Theme(s)	Regulation and competition policy (10%), Micro, Small and Medium Enterprise support (45%), Export development and competitiveness (4 5%)
Lending Instrument	Investment Project Financing
Project ID	P147665
Borrower(s)	Ministry of Finance and Planning
Implementing Agency	Planning Institute of Jamaica
Environmental Category	B-Partial Assessment
Date PID Prepared/Updated	13-May-2014
Date PID Approved/Disclosed	13-May-2014
Estimated Date of Appraisal Completion	13-May-2014
Estimated Date of Board Approval	25-Jul-2014
Decision	

I. Project Context

Country Context

Over the past 30 years, Jamaica has experienced low economic growth and high fiscal deficits that have stymied development. Jamaica's real GDP per capita has increased at an average of just 1 percent per annum during this time. Natural disasters and financial shocks in this low-growth environment, coupled with discretionary and distortionary tax and other public expenditures, have resulted in persistent fiscal deficits. These deficits have been financed through significant domestic public sector borrowing, which in turn has led to both high financing costs with crowding out of private sector investments and macroeconomic uncertainty driven by unsustainable public debt ratios. These reinforcing cycles of low, opportunity-depriving growth and high debt have contributed to increasing crime, social vulnerabilities, and inequality. Unemployment reached 16 percent in 2013, with young women unemployed at 38 percent. The share of consumption of the bottom 40 percent of the population started a downward trend in 2010 after years of improvement.

This disappointing economic performance is directly traceable to low levels of productivity, not to

low levels of investment in physical capital. Growth in total factor productivity (TFP) has been negative in Jamaica in the past two decades, with TFP per worker lagging significantly behind most LAC countries. Concurrently, total fixed investment averaged 28 percent a year, similar to the levels of the fast-growing East Asia region and better than the LAC average. These productivity trends are reflected in the declining performance of traditional Jamaican exports over the past decade, including a fall in Jamaica's share of global exports of aluminum ores and concentrates from 11.9 to 6.1 percent, coffee from 0.38 to 0.07 percent, and travel services (a proxy for tourism) from 0.26 to 0.19 percent. The low-productivity allocation of public investment resources, together with missing incentives for private sector productivity upgrading and flexible adjustment in response to changing global market demands, have impeded growth.

An 'enclave' development model in key sectors has further limited productivity spillovers and prevented inclusive growth. The tourism sector for example is the largest foreign exchange earner. It is responsible for 10 percent of total employment in Jamaica, but has few backward linkages to other local enterprises; 70 to 90 percent of tourism-consumed food is imported, limiting a potentially significant source of growth for domestic agribusiness. A similar lack of incentives, or even disincentives to establish backward linkages, exists in other industries as well. The vast majority of firms in Jamaica are micro or small, many of which operate in wholesale or retail trade, and thus have not been included in job-generating productive value chains.

A decisive shift in this growth trajectory is now needed to restore confidence in the Jamaican economy. The low-growth high-deficit cycle culminated in March 2013 when government debt hit 146 percent of GDP and financial markets began to doubt the government's ability to make debt payments. As a result, in May 2013 the IMF, Bank, and IDB stepped in with a financial package, which included reforms in areas such as fiscal consolidation and overhaul of the tax framework to remove discretionary incentives. Since May 2013, the Government of Jamaica (GOJ) has demonstrated clear commitment to the success of the reforms, including the recognition of the need to stimulate growth and the need to work with the Bank, IDB, and IMF on the growth agenda. A range of additional reforms focused on strengthening the environment for private sector investment and productivity upgrading are now needed, especially given the limited fiscal space for GOJ productive expenditures.

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The macroeconomic situation continues to be fragile, and renewed shocks could derail the nascent recovery. Despite strong GOJ commitment to reforms, Jamaica faces substantial risks from external financing shocks as well as natural disasters, which could potentially result in renewed economic and fiscal crises. In particular, high debt levels create persistent financing risks, and a significant natural disaster could result in a setback for fiscal consolidation efforts. Failure to stay on track with the IMF agreement would hamper investor confidence that is cautiously building up. Moreover, Jamaica is entering a demanding transition period, in which major reforms will result in significant adjustment costs before they yield results in terms of growth acceleration and shared prosperity. This fragile macroeconomic context creates risk for any effort to stimulate investment and growth.

Sectoral and institutional Context

Existing private sector investment opportunities offer significant potential to increase competitiveness and growth. Jamaica, together with other countries in geographic proximity that are also investing in logistics upgrading, has the potential to benefit substantially from the changing shipping dynamics in the Western Hemisphere due to the expansion of the Panama Canal in 2016.

The GOJ Logistics Hub Initiative (LHI) plans for several billion dollars of private investment in infrastructure and other development to capitalize on Jamaica's existing deep natural harbor capacity, existing transport infrastructure, and strategic location; leading global logistics firms have already bid on some of the planned projects. The GOJ is establishing a new Special Economic Zone (SEZ) regime to attract large investors to benefit from Jamaica's more competitive position in the global logistics chain, with a focus on facilitating the participation of smaller firms in export value chains. Broadly, if the incipient improvements in the macroeconomic context and government fiscal position continue, there will be incentives for increased domestic and foreign investment in Jamaica.

However, several key interlinked constraints continue to inhibit private sector investment and growth. Regulatory inefficiencies delay investment projects and increase the costs of trading and expanding business operations. Inadequate preparation for public-private partnerships (PPPs) and other strategic investments results in potentially transformative deals not being brought to market or being structured in a way that does not generate positive spillover effects on the economy. SMEs lack capabilities to integrate into dynamic value chains, precluding the largest segment of the private sector (by number of firms) from high-potential job-creating business opportunities. In addition, constrained access to finance impedes SME investment to upgrade technology and limits the ability of SMEs to access working capital to stay in business. This range of constraints must be collectively addressed to achieve private sector-led growth in Jamaica that is transformational and inclusive.

Enhanced competition in the business environment is needed to attract and enable productivity-enhancing investment. Attracting new investors, and then ensuring that enterprises compete in a way that incentivizes productivity enhancements rather than rent-seeking, requires a business environment with efficient regulations and transparent competition-based rules of the game. Low productivity growth in the private sector in Jamaica has been driven by a business environment characterized by too little competition, namely too little entry, rivalry, and expansion by efficient firms. This environment affects the operations of existing firms and potential new global and local investors, thereby directly harming competitiveness. Jamaica's poor performance in many indices capturing different dimensions of competition and regulation reflects these constraints in the business environment. Several aspects of the investment climate in particular represent critical constraints inhibiting private sector operations. The process of obtaining requisite approvals and permits for private developers to advance construction projects can take multiple years, stalling investment projects across all areas of the economy. It costs $1,530 for the documents, port and logistics charges, and inland transport to ship a 20-foot container of goods out of Kingston Port to anywhere in the world, comparedto a Caribbean average of $1,100 and costs of $630 in Dubai and $450 in Singapore, two logistics hubs that Jamaica aspires to emulate and join as part of the global logistics network through its LHI. The OECD Product Market Regulations (PMR) indicators identify regulatory constraints to competition in key sectors such as energy and power, port operations, and trucking and road transport. Addressing these and other key regulatory issues is necessary to create an environment conducive to private sector productivity upgrading and growth.

Increased public sector resources and capacity are needed to attract strategic private anchor investments. Business environment reforms will send important market signals to potential and existing investors. But additional public efforts are needed in the short run to attract investments in industries in which Jamaica has a comparative advantage and that should generate economy-wide learning spillovers. In line with Jamaica's rich stock of productive assets, including natural harbor

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capacity and world-class beaches, existing comparative advantage appears highest in selected agribusiness industries, tourism, and logistics, with competitive advantages arising from potential positive spillovers from linkages between world-class investors in these industries and local enterprises, as outlined in Jamaica's Vision 2030. Large investments are also needed to improve the efficiency of existing and newly-required infrastructure assets per the government's LHI. Investments by global investors have the potential to inject competition and capabilities into these industries, provide international market access, and allow global knowledge in the form of new products, processes, and marketing to be diffused to local enterprises. However, current high fiscal constraints limit GOJ capacity to proactively prepare and market these deals to potential investors. This lack of resources to adequately prepare strategic investments has stalled the development of previous projects and confused GOJ relations with investors. It is essential to improve the institutional framework and financial capacity to facilitate and then oversee the implementation of large investment projects, especially considering the need to create incentives for productivity spillovers to smaller local firms and more broadly to ensure that these investments are in the long-term interest of all Jamaicans.

Small and medium-sized enterprises (SMEs) require skills and knowledge to integrate into global value chains. SMEs in Jamaica with the potential to grow lack knowledge and skills to upgrade productivity and thereby sell more competitive outputs and generate more jobs. , Limited awareness about global industry quality standards and market demands constrains the ability of smaller firms to link with larger firms and participate in global supply chains. Entrepreneurs and SME managers more broadly often lack the ability to develop a business plan or manage cash flows, and lack employees with sufficient, appropriate technical skills. The education system has failed to impart relevant skills required by the private labor market, and many of the most-skilled and entrepreneurial citizens have migrated; only 30 percent of the workforce that has remained in Jamaica is considered trained or certified. A number of public and private organizations in Jamaica seek to address this enterprise-level skills gap by providing business development services to SMEs. But additional interventions aimed at improving the quality and demand-driven relevance of training, especially with a focus on global standards, are critical to ensure that managers and workers are able to continue learning and upgrading skills to increase productivity, sales, and jobs.

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Increased access to finance is needed for SMEs, especially for technology-upgrading investments and innovation that will facilitate integration in value chains. For decades, the financial sector in Jamaica was able to lend to government at high interest rates. This created little incentive to lend to the private sector other than to relatively low-risk large companies, resulting in limited financial deepening and a failure of the financial sector to meet the needs of SMEs seeking to expand. The ratio of private credit to GDP is 27 percent, well below the LAC-wide average of 47 percent. Only 27 percent of firms in Jamaica have a line of credit at a bank compared to 48 percent of firms across LAC, and access to venture capital and broader capital markets is extremely limited. With ongoing fiscal consolidation, banks are intent on increasing their focus on commercial lending, including to SMEs. All banks now have dedicated SME departments and many banks have i nvested in technical capacity for SME credit assessment. However, limited market competition results in high lending spreads and bank profitability.

Several GOJ initiatives aim to improve SME access to finance for firms lacking collateral and proper financial statements, but current liquidity tightness hampers credit growth. Many SMEs, especially young firms, have limited bankability, due to lack of collateral or proper financial statements. Improvements in financial infrastructure, a public credit guarantee facility (CGF), and

programs to provide technical assistance to firms on financial management aim to facilitate access to credit for SMEs. However, credit institutions are experiencing tight liquidity conditions, particularly in local currency, affecting their ability to extend credit to the private sector. A variety of factors explain this situation, including increased deposit dollarization in response to exchange rate depreciation; illiquidity of government securities in secondary markets; and the introduction of the Central Treasury Management System (CTMS), through which government funds (largely in domestic currency) were transferred from private credit institutions to a single account at the Bank of Jamaica. Currently banks comply with statutory domestic liquidity requirements, but do not have extra JMD liquid assets to sustain credit growth in local currency.

Existing donor programs support GOJ efforts, but additional focus on stimulating private sector investments and productivity is needed to achieve growth. The current IMF and IDB financial support has facilitated structural reforms such as fiscal consolidation and tax reform. The WBG is providing a range of complementary support to advance the growth agenda. The Bank's Foundations for Growth and Resilience Development Policy Loan of December 2013 provides financial support to GOJ, and includes a focus on investment climate reforms. Additional investments, guarantees, and advisory services from the Bank, IFC, and MIGA support reforms to the regulatory environment, strategic investments, and SMEs and entrepreneurship in Jamaica. The proposed project has been designed in close collaboration with these development partners. It will complement these activities by targeting specific reform implementation needs and other resource and capacity constraints limiting private sector investment and productivity upgrading that are not being addressed elsewhere. The range of WBG support will be managed via a Joint Business Plan with the GOJ, which will ensure coordination of activities and accountability for results, benefitting the proposed project and all WBG activities supporting the growth agenda. The proposed project is also designed in close coordination with the IMF to ensure that the trade-offs between fiscal consolidation and growth are carefully considered.

II. Proposed Development Objectives

To strengthen the business environment in Jamaica for private sector investment and productivity upgrading.

III. Project Description

Component Name

Enhancing competition in the business environment

Comments (optional)

This component will provide TA and implementation support to address critical business regulatory issues that constrain firm entry, operation, expansion, and competition.

Component Name

Facilitating strategic private investments

Comments (optional)

This component will establish a Project Preparation Facility to finance feasibility and other studies to help GOJ bring strategic investments with private participation to commercial closure, and will provide TA and fund sector studies to increase GOJ capacity to prepare for and close strategic investments with private sector participation.

Component Name

Supporting SME capabilities and finance

Comments (optional)
This component will finance support to SMEs including supply chain learning and linkages through co-financing of training and other business development services, and access to finance through a line of credit.

Component Name
Learning through project implementation and M&E
Comments (optional)
This component will support project M&E to learn from implementation, including a communications campaign and a national business census to upgrade private sector data, as well as fund project management costs.

IV. Financing *(in USD Million)*

Total Project Cost:	50.00	Total Bank Financing:	50.00
Financing Gap:	0.00		

For Loans/Credits/Others	**Amount**
Borrower	0.00
International Bank for Reconstruction and Development	50.00
Total	50.00

V. Implementation

The project is designed to enable private sector-led growth in the Jamaican economy, in an inclusive and sustainable way. To achieve this impact, the range of interlinked constraints inhibiting private sector growth must be collectively addressed. Key regulatory barriers must be removed and competition incentives enhanced to facilitate new productivity-enhancing investments. Large strategic investments must be attracted to inject capital, new technologies and further value chain opportunities into the economy. SMEs require capabilities upgrading and finance support to be able to expand operations and increase employment, importantly through their participation in global chains facilitated through linkages with large new and existing local buyers.

A multi-pronged programmatic approach is needed to effectively address these interlinked constraints. An appropriate governance structure has been designed to implement this operation. The Implementation Agency (IA) responsible for overall project administration is the Planning Institute of Jamaica (PIOJ), which is part of Ministry of Finance and Planning (MOFP). PIOJ will oversee the work of Lead Coordination Agencies (LCAs) responsible for individual project components, which will include JAMPRO and the Development Bank of Jamaica (DBJ). A wide range of other Government of Jamaica ministries, departments, and agencies will also be involved in project coordination and implementation, including but not limited to the Ministry of Industry, Investment, and Commerce (MIIC), the Fair Trading Commission (FTC), the Port Authority of Jamaica (PAOJ), Urban Development Corporation, Factories Corporation, STATIN, and the Jamaica Productivity Center. Numerous private sector organizations will also be involved, including but not limited to the Private Sector Organization of Jamaica (PSOJ), the Jamaica Chamber of Commerce (JCC) and the Associated Chambers of Commerce, Jamaica Manufacturers Association (JMA), Jamaica Exporters Association (JEA), and the Small Business Association of Jamaica (SBAJ).

VI. Safeguard Policies (including public consultation)

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Safeguard Policies Triggered by the Project	Yes	No
Environmental Assessment OP/BP 4.01	×	
Natural Habitats OP/BP 4.04		×
Forests OP/BP 4.36		×
Pest Management OP 4.09		×
Physical Cultural Resources OP/BP 4.11		×
Indigenous Peoples OP/BP 4.10		×
Involuntary Resettlement OP/BP 4.12		×
Safety of Dams OP/BP 4.37		×
Projects on International Waterways OP/BP 7.50		×
Projects in Disputed Areas OP/BP 7.60		×

Comments (optional)

The project is not expected to have any direct negative social or environmental impacts. Certain project activities could have indirect negative impacts, such as the eventual investment projects that benefited from studies financed by the PPF and the operations of SMEs receiving loans financed by the project. The Environmental Assessment Safeguard Policy is triggered given these potential indirect impacts, and mitigation measures are being put in place to minimize the risk of negative impacts. These include: requiring that all Environmental and Social Impact Assessments (ESIAs) funded by the PPF comply with Equator Principles and IFC Guidelines; that feasibility and planning studies consider environmental and social assessment needs in scoping and planning; that all relevant GOJ and NEPA policies, including environmental and social impact assessment requirements, be complied with; and that DBJ's Environmental Policy and Management System, consisting of environmental screening and review procedures, be updated and implemented for the SME line of credit.

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VII. Contact point

World Bank

Contact: Thomas A. Vis
Title: Senior Private Sector Development Specialist
Tel: 458-0471
Email: tvis@worldbank.org

Borrower/Client/Recipient

Name: Ministry of Finance and Planning
Contact: Devon Rowe
Title: Financial Secretary
Tel: 876-922-8600
Email:

Implementing Agencies

Name: Planning Institute of Jamaica
Contact: Barbara Scott
Title: Deputy Director General
Tel: (876) 960-9339
Email: info@pioj.gov.jm

VIII. For more information contact:

The InfoShop
The World Bank
1818 H Street, NW
Washington, D.C. 20433
Telephone: (202) 458-4500
Fax: (202) 522-1500
Web: http://www.worldbank.org/infoshop