

BANK OF JAMAICA
FLOW OF FUNDS AND FOREIGN EXCHANGE BUDGETING DIVISION

FOREIGN EXCHANGE BUDGETING
IN AN
OPEN MARKET ECONOMY

- An Integrated Real And Financial Flows Approach

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FOREIGN EXCHANGE BUDGETING IN AN OPEN MARKET ECONOMY
- AN INTEGRATED REAL AND FINANCIAL FLOWS APPROACH

Foreign Exchange Budgeting forms an integral part of economic, financial and foreign exchange management in both centrally planned and market economies.¹ Although the nature and functions of the foreign exchange budget vary from country to country and from one kind of economy to another, the rationale for Foreign Exchange Budgeting is derived from the fact that it provides the mechanism for the Monetary Authorities to determine the use of foreign exchange resources "ex ante" rather than simply reacting "ex post". Hence policy-making becomes more internally oriented as a result of greater leverage to deal with the foreign constraint. Recent developments in the world economy such as the five-fold increases in oil prices and the deteriorating of the terms of trade against the non-oil exporting third world countries have resulted in the virtual depletion of the limited amount of their foreign exchange reserves. Countries with huge payments deficits were forced to borrow and with no improvement in their terms of trade were finding it difficult to meet their rising debt repayments and at the same time, the rising import bills as the current account deficits on their balance of payments widen.

Given the existing world economic conditions and the slow progress in achieving a New World Economic Order, Commonwealth Caribbean countries have no alternative but to rationalise the use of scarce foreign exchange not only to alleviate the hardships of the poorer sections of Caribbean communities but also to facilitate economic and social transformation at the national and regional levels. There is, therefore, greater need for foreign budgeting in the Caribbean and some countries in the Region have already institutionalised the concept of Foreign Exchange Budgeting as part of overall economic, financial and foreign

This paper has drawn heavily from the National Income Model developed by Dr. Gladstone Bonnick, Deputy Governor, Bank of Jamaica. Acknowledgements are also made to Mr. Maurice Berry, Director of Exchange Control and Mr. W. Carr, Assistant Director of Research, Balance of Payments Division.

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exchange management. Indeed partial approaches to Foreign Exchange Budgeting in most territories were implemented by an intensification of exchange control regulations on the use of foreign exchange.

2. NATURE OF FOREIGN EXCHANGE BUDGETS

A foreign exchange budget is similar to the budget of a company or the budget of the Government. It is essentially an estimate of receipts and payments of foreign exchange between the residents of one country and the residents of the rest of the world for a future period - a year or a quarter or a month. The nature of the budget differs from country to country, but in many cases the foreign exchange budget would almost correspond in structure to the standard presentation of debits and credits of the balance of payments table for a country. To a large measure, it is a presentation of the Balance of Payments Accounts on a cash flow basis for a future period and is simply an application of sound business practice within the framework of exchange control management. In some countries the budget serves as statistical guides to exchange and commercial policy, or as bases for measuring actual performance, rather than as instruments for controlling or restricting exchange transactions.

The budget may be used to estimate all the foreign exchange transactions that pass through the banking system or central exchange pool but does not necessarily take account of the country's entire balance of payments transactions. For example, inter-company transfers by multi-national companies may be captured in the balance of payments accounts but not in the foreign exchange budget since there was no cash transactions. As Mattera pointed out:

"Even in a highly restrictive system, some measure of exchange freedom or evasion appears inevitable, particularly in exchange receipts.

The full surrender of exchange receipts may be waived in respect of exports by foreign companies operating under special contracts, or the operation of certain domestic companies engaged in shipping or similar international services"².

3. THE FUNCTIONS OF THE FOREIGN EXCHANGE BUDGET

The main functions of the foreign exchange budget can be divided into two broad categories. First the foreign exchange budget is used as a mechanism to achieve structural change and as such is part of the long-term economic plan. In this context, the budget is used as an instrument of exchange rate strategy, commercial policy, monetary policy and would have much significance in the functioning of the economy and the progress towards the economic goals of the country. The budget may also serve as a basis for the implementing of desired policies in regard to the country's exchange reserves which in turn affect the domestic situation. It may, moreover, point in advance to the need for external financing. Similarly, the budget may have the function of assuming, to the extent possible, the repayment of foreign loans. Secondly, in the area of managing the foreign exchange reserves, the foreign exchange budget allows for greater precision in obtaining maximum yields from foreign exchange investments since the likely movements in the reserve position of the Central Bank would be known in advance. In this respect, depending on the foreign exchange position of the country, investment in time deposits, treasury bills etc. may not have to be encashed before maturity dates to meet unexpected swings in the payments position.

4. FOREIGN EXCHANGE MANAGEMENT IN THE CARIBBEAN

The transition from currency board to central banking in the larger territories of the Commonwealth Caribbean had given to the Monetary Authorities a limited degree of control over domestic money supply. Most of the central banks, however, found that given the openness of their economies, any expansion in the domestic money supply did not necessarily generate domestic inflation but rather exacerbated their balance of payments problems. In order to bring the balance of payments into equilibrium, the conventional remedy - a la I.M.F. - was the reduction of aggregate demand by cutting budgetary expansion (reducing central bank deficit financing and hence the domestic money supply), devaluation of the currency,

restriction of domestic credit, liberalisation of trade and payments restriction, a rigid wages policy and reduction in foreign borrowing. In other words, a return to the Currency Board system and making the central bank virtually impotent. The net effect of these policies would obviously be harshest on the poorest sections of the population and would result in consequential social and political unrest.³

Given these conditions, reliance on the traditional type of monetary and foreign exchange management in the Caribbean would accept the premise that the balance of payments problems of countries such as Jamaica are essentially of their own making and have very little to do with lop-sided world economic order and deterioration in the terms of trade.⁴ Accordingly, therefore, the monetary and foreign exchange management should be "demand management" policies. The foundation of this doctrine is the view that the balance of payments is essentially monetary phenomenon and any corrective measures must lead to the reduction of the real incomes of the population. In other words, the quality of life of the Caribbean sugar worker and his family should deteriorate even further and they would be even more under-fed, under-clothed, under-housed and under-educated.

In the context of the economic and social problems of the Caribbean, it becomes obvious that monetary and foreign exchange management must reject the notion that the balance of payments is a purely "monetary phenomenon" and should attempt to concentrate on the real side of the economy and the inter-relationship between the real and financial variables. We should also accept the fact that expansion of the domestic money supply through deficit financing without rigid physical controls to regulate the use of foreign exchange and an effective system to monitor foreign exchange receipts, would be counter-productive and inimical to real growth in small open economies.

It is in this context that a foreign exchange budget has to be conceptualised and a basic economic model constructed to measure the interaction between the Balance of Payments, Domestic Money Supply and the G.D.P.

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What is necessary, therefore, is at least a five-year plan and that the foreign exchange budget should be an integral part of the plan to ensure optimum allocation of resources.⁵

5. FOREIGN EXCHANGE BUDGETING IN JAMAICA

During the late 1960's and early 1970's, the Jamaican economy grew rapidly and the trade gap widened annually. The inflows of private foreign investment in the bauxite and alumina sector, the tourist sector and the manufacturing sector were more than adequate in meeting the current account deficit. However, in conventional terms, the balance of payments position was regarded as strong - net foreign reserves stood at \$132.2 mn. at the end of 1971 - but the underlying structural weakness of the economy remained and unemployment rose to 22.5% in 1973. As private foreign investment began to taper off, it became more difficult to close the trade gap given the import oriented nature of consumer demand and the fact that the manufacturing sector depended heavily on imported raw materials. In addition, the five-fold escalation in oil prices and international inflation made it even more difficult to close the trade gap after 1973.

In order to alleviate the rapid deterioration in the terms of trade and to compensate for gradual exhaustion of the bauxite deposits, the Government increased taxation on the bauxite and alumina companies with the imposition of the bauxite levy in 1973. The world price of sugar also rose in 1974. Export receipts increased by \$293 mn. or 92% in 1974 over 1973 and the trade gap fell to \$107 mn. in 1974 from \$161 mn. in 1973. However, as a result of increases in the invisibles the deficit in the current account was by only \$15 mn. or 9% in 1974. However, the net international reserves increased by \$54 mn. as a result of \$221 mn. of capital inflows of which \$139 mn. came from private sources. At the end of 1974, net international reserves peaked at \$130 mn., the equivalent of over two months' imports. After 1974, the foreign exchange began to worsen steadily - the current account deficit moved from \$152 mn. in 1974 to \$257 mn. in 1975 and \$275 mn. in

1976, while at the same time private capital inflows declined from \$139 mn. in 1974 to \$77 mn. in 1975 and to minus \$31 mn. in 1976 - and by the end of 1976 the foreign exchange reserves of the country were virtually depleted. The net international reserves stood at minus \$181 mn. as the central bank borrowed heavily to finance the overall balance of payments deficit of some \$300 mn. in 1975 and 1976. (See Appendix I for details of Jamaica's balance of payments position between 1972 and 1976)

On the real side of the economy, the situation was even worse as real G.D.P. declined steadily since 1973 as can be seen from the following table.

TABLE 1

Output and Prices
(Annual Percentage Change)

	<u>1973</u>	<u>1974</u>	<u>1975</u>	<u>1976</u>
Real G.D.P. at market prices	- 2.6	- 2.1	- 1.0	- 6.9
Per capita real G.D.P.	- 4.4	- 3.7	- 2.6	- 8.0
Consumer prices (annual average)	17.6	27.2	17.4	9.8

Source: Department of Statistics, Bank of Jamaica

It became evident that measures for structural transformation had to be intensified to make the economy more self-reliant and in the circumstances the foreign exchange situation had to be managed with precision, so in January 1977 a Foreign Exchange Budgeting Unit was established in the Central Bank.

6. AN APPROACH TO FOREIGN EXCHANGE BUDGETING IN JAMAICA

In the absence of an economic plan, a short-term forecasting model of the Jamaican economy was developed towards the end of 1976 and used as the basis for projections of the macro-economic aggregate for 1977 and 1978.⁶ In the meantime, the National Planning Agency began work on an Emergency Production Plan for 1977 and then subsequently a five-year Economic and Social Plan for the period 1978 - 1982.

The model differs from the more traditional models used as a basis for financial programming in that it focuses on the real variables rather than on the monetary variables which are mere identities in an accounting sense. The approach is not to derive current price estimates from G.D.P. constant prices on the basis of assumptions regarding behaviour of deflators; instead, a simple leakage/injection open economy Keynesian type model has been used to generate estimates of G.N.P. current prices.

The Model:

$$Y_t = C_t + G_t + I_t + (E - M)_t \quad (1)$$

$$C_t = C_{t-1} + b(Y_t^d - Y_{t-1}^d) \quad (2)$$

$$Y_t^d = Y_t - R_t - H_t - N_t + C_t \quad (3)$$

$$R_t = R_{t-1} + r(Y_t - Y_{t-1}) \quad (4)$$

$$H_t = hY_t \quad (5)$$

$$N_t = nY_t \quad (6)$$

$$I_t = I_t^g + I_t^s \quad (7)$$

$$I_t^g = S_t^g + K_t^m + L_t^x + L_t^l + nY_t \quad (8)$$

$$I_t^p = S_{t-1}^p - L_t^l + hY_t \quad (9)$$

$$S_t^g = R_t - G_t \quad (10)$$

where Y = GNP

G = Government recurrent expenditures

I = Investment (Gross Down)

R = Government receipts including CDF

N_t = NIS contributions Gross

H = Housing Trust deductions

S = Savings

C = Net Transfers from Overseas

L_t^l = Loans raised by Government locally net of repayments

L_t^x = Loans raised abroad net of repayments

K-m = Money creation by Bank of Jamaica

b, h, n, r = Parametric constants or policy determinable ratios

(E-M)_t = Target goods and services account balance

The system reduces to a single estimating equation:

$$Y_t = Y_{t-1} + \frac{1}{(1-b)(1-n-h-r)} \left\{ (1-b)C_{t-1} + bO_t + K_t^M + L_t^X + (E-M)_t \right\} \quad (11)$$

The model frankly assumes continued foreign exchange budgeting in order to achieve predetermined targets for $(E-M)_t$. The variables O_{t-1} , O_t , K_t^M are exogenously determined. The targetted values of the parametric constants are:

$$b = 0.9$$

$$n = 0.02$$

$$h = 0.025$$

$$r = 0.2$$

The model was therefore used to determine the national accounting aggregate and the following picture of the Jamaican economy in 1977 and 1978 emerged.

6.1 G.D.P. Constant Prices

Real GDP (i.e. in constant prices, 1975 base) has been arrived at on the assumption that the availability of foreign exchange to purchase imported inputs (mainly fuel and raw materials) has been in 1976 and will continue to be the main constraint on production in 1977 and 1978. The method simply involves forecasting the availability of foreign exchange, making a judgement as to the desirable allocation for imports of inputs of fuel and raw materials assuming that the relationship between real foreign inputs and real GDP does not change from the 1975 relationship during the period, and using that relationship we derive the estimates of GDP as follows:

TABLE 2

(Current prices in J\$ million)

	<u>GNP</u>	<u>GDP</u>	Growth in GDP %
1975	- 2596	2653	
1976	- 2831	2893	+ 9.0
1977	- 2843	2906	+ 0.4
1978	- 3068	3136	+ 7.9

GDP constant 1975 prices*

		<u>% Growth</u>
1975	- 2653	-
1976	- 2538	- 4.3
1977	- 1750	-31.0
1978	- 1811	+ 3.5

- * (1) Assumes imported raw materials including fuel increase in price at 6% per annum
- (2) Assumes observed ratio of raw material imports to GDP - Mining remains at 0.142
- (3) Assumes GDP in Mining = bauxite exports + .57 alumina exports.

Ktm was estimated at \$253 mn. for 1976 - money creation by the central bank lending to Government essentially spilled over into imports and outflows and were ultimately financed by an approximately equal decline in reserves.

6.2 Components of G.N.P.

Using the relationships in the model, an attempt has been made to breakdown G.N.P. into its components. The following numbers illustrate:

TABLE 3

	<u>J\$ mn.</u>			
	<u>1975</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>
Y_t^d	1984.1	2080.7	2090.1	2260.2
C_t	1673.0	1760.0	1768.5	1921.6
S_t^P	311.1	320.7	321.6	338.6
R_t	592.7	639.6	642.1	687.1
N_t	19.5	56.6	56.9	61.4*
H_t	-	70.8	71.1	76.7

If consumption can be held to the above levels and if the Government receipts figure is not far off then the level of government budget (recurrent and capital) will depend on the extent of loans the Government can raise locally and diversions from the Housing Trust by way of loans or sales of houses to the Trust. The following breakdown is for illustration only.

TABLE 4

(Calendar Years)

	<u>1976</u>	<u>1977</u>	<u>1978</u>
R_t	639.6	642.1	687.1
N_t	56.6	56.9	61.4
K_t^m	253.2	0	0
L_t^x	59.0*	48.0	80.0
L_t^l	36.0	51.0	180.0
L_h	-	20.0	20.0
G_t^T	1044.4	818.0	1028.5
I^D	345.9	321.8	198.3

*(Some net inflow went to private sector and quasi government)

On the face of it I_{77}^D will have surplus funds above what it can invest in the light of the drastic constraint placed on capital goods imports. In any event most of the capital goods imports will be associated with public sector projects. Therefore, it may be possible to have a higher level of local borrowing by Government without risk of greater inflationary pressure.

6.3 Forecast of Available Foreign Exchange

The forecast of available foreign exchange is based on a product by product picture of merchandise exports.

TABLE 5

MERCHANDISE - EXPORTS 1975 - 1978

	<u>J\$ mn.</u>			
	<u>1975</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>
Primary Products				
Bananas	14.8	14.0	14.0	20.0
Pimento and Ginger	8.1	9.3	10.2	10.4
Cocoa	1.7	1.7	1.9	2.1
Coffee	3.7	2.7	3.9	3.0
Bauxite	97.4	126.0	142.8	149.6
Other	6.2	6.6	7.3	7.5
	<u>131.9</u>	<u>150.3</u>	<u>180.1</u>	<u>192.6</u>
Semi-Processed Products				
Sugar	139.7	58.0	52.4	55.7
Molasses in bulks	-	-	-	-
Alumina	303.9	270.0	361.0	475.6
Other	3.2	3.5	3.5	3.9
Subtotal	<u>446.8</u>	<u>331.5</u>	<u>416.9</u>	<u>538.2</u>
Manufactured Goods	<u>70.9</u>	<u>63.0</u>	<u>74.2</u>	<u>81.6</u>
TOTAL	<u>649.6</u>	<u>554.8</u>	<u>671.2</u>	<u>809.4</u>

It will be noted that movement in the value of exports during the period is mainly attributable to increases in bauxite and alumina. Alumina figures are based on exports of 1.8, 2.3 and 2.9 mn. tons for 1976, 1977 and 1978 respectively at transfer prices of J\$150, J\$157 and J\$164 respectively. Bauxite reports are estimated at 6.3, 6.8 and 6.8 mn. tons respectively with transfer prices of J\$20, J\$21. and J\$22 respectively. In Table 7 estimates of

services, transfers and inflows (all net) are presented. Tourism (net) in 1977 is expected to be J\$40 mn. resulting from inflows of J\$100 mn. and J\$60 mn. expenditures by Jamaican travelling abroad. The improvement in 1977 is expected to result not so much from an increase in visitors to Jamaica as from a reduction in expenditure abroad by Jamaican tourists. The further improvement in 1978 is based on the assumption of firmer economic recovery in North America and an improvement in Jamaica's image and attractiveness as a destination resulting in an increase in visitors coming here. Transfers net of J\$17 mn. represents a decline of \$6.8 mn. from 1975 and a more significant decline from previous years. The explanation is reduction in inflows from source countries due to recession in 1976 and 1977 and due to the increasing "partial" emigration of Jamaican middle and high income families and a rising outflow for support and education etc. Investment income (net) largely reflects rising interest cost of foreign debt, while net inflow reflects mainly expected official inflows net of repayments on principal.

6.4 Allocation of Foreign Exchange

Table 6 shows how the permissible level of imports derived in Table 7 may be allocated among consumer goods, raw materials (including fuel) and capital goods.

TABLE 6

FOREIGN EXCHANGE ALLOCATION

<u>Year</u>	<u>Consumer</u>	Raw Material incl. fuel	<u>Capital</u>
1975	212.6	494.3	314.4
1976	165.8	453.9	230.3
1977	130.0	407.0	70.0
1978	150.0	450.0	170.0

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TABLE 7

FOREIGN EXCHANGE AVAILABILITY

	<u>1975</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>
Merchandise Exports		555	671	809
Tourism (net)		40	60	80
Transfers (net)		17	17	17
Investment Income (net)		-110	-125	-136
Net Inflow		+ 95	+ 38	+ 80
		<u>597</u>	<u>671</u>	<u>850</u>
+ RESERVES		+253	-	-
- Repayment of BoP Support		<u>-</u>	<u>- 64</u>	<u>- 80</u>
Imports c.i.f.		950	807	770

The objective is always to permit the highest level of performance and growth consistent with maintaining the inflow of indispensable consumer goods. We find that in 1977 future growth as determined by the importation of capital goods has to be given a lower priority than current output and employment, and capital goods imports have been curtailed in order to permit a greater allocation to raw materials. The \$130 mn. for consumer goods will only buy essential food imports, drugs and some spare parts for repair (but automobiles cannot be accommodated). Putting aside the import requirements for bauxite/alumina and assuming prices of imported raw materials are rising at 6% per year, (the expected rate of inflation in source countries, but which could be an underestimate if OPEC increases its oil prices any more than this) one can see that the rest of the economy will be severely restricted by the scarcity of imported inputs. The money terms allocation to the rest of the economy, i.e. not including bauxite/alumina, is as follows:

TABLE 8

US\$ mn.

<u>Year</u>	<u>Raw Materials allocated</u>	<u>Bauxite/Alumina</u>	<u>Rest</u>
1976	452	133	321
1977	407	184	233
1978	450	217	233

If the observed (1975) ratio of raw material imports to G.D.P. remains at 14.2% for the period to 1978, and if prices of raw material imports rise at 6% per annum, then G.D.P. in 1975 prices will be as presented in Table 2. The figures would be sensitive to the allocation of foreign exchange among sectors. Ideally, if we had at hand estimates of the import content of each sector's output, we would be able to say something about the effect of changes in intersectoral allocation of foreign exchange on real G.D.P. as a first estimation. The absence of an up-to-date import output table makes it impossible to take into account indirect import requirements of sectors and thus more precisely ascertain the effects of changes in allocation. Work has started on this approach. However, we can state that the general objective for allocation among sectors should be to maximise G.D.P. subject to market constraints and taking into account intersectoral relationships. Simply stated, sectors with low per unit import requirement should have larger share of foreign exchange provided the "social priority" of their output justifies it. Highest priority for foreign exchange must, however, be assigned to sectors and sub-sectors which are net earners of foreign exchange (which is why bauxite/alumina requirements were taken out first).

6.5 Policy Implications

The above analysis identified the crucial areas for policy decisions and consequential administrative arrangements necessary for the management of the foreign exchange budget. These include:

1. The extreme sensitivity of real G.D.P. to the availability of imported raw materials and fuel for operating available capacity. In order to sustain economic level at the 1976 level, some \$150 mn. additional foreign exchange inflows were required - \$120 for imported raw materials and \$30 mn. for capital goods.
2. The need for structural adjustment to arrest the decline in and to increase the production of exports, tourism earnings and import substitutes.
3. Allocation of foreign exchange should seek to afford the largest possible importation of inputs and the diversion to sectors with minimum import requirements consistent with output priorities, employment and inter-industry compatibilities. For example, an increase to up to three shifts per day in the industrial sectors to maximise use of existing capacity and reduce need for additional capital imports.
4. Government borrowing of \$200 mn. from the central bank to finance the 1977/78 fiscal deficit should result in additional price increases of 9% ($b = 0.9$). The foreign exchange budget provides the mechanism whereby the monetary authorities determine the foreign exchange situation and hence the effects of domestic money creation can now be quantified fairly accurately.
5. Restructuring of taxation to compensate for the reduction in the level of imports.
6. The need for higher administrative apparatus for foreign-exchange allocation, price control, distribution of basic necessities and control of money cost components of production.

7. The need for an incomes policy, not for traditional demand management reasons, but rather to ensure a more equitable distribution of income and reduction in unemployment.
8. The acquisition by Government of private enterprises such as the public utilities, made it necessary for Government to increase its foreign borrowing instead of the private borrowing of these companies on international capital markets.
9. The need for a flexible exchange strategy to facilitate structural change and reduction in the functional dependency of the economy. Exchange rate strategy should be seen as a major plank towards greater economic self-sufficiency without causing undue hardships on the poorer sections of the population.

7. CONSEQUENTIAL POLICY DECISIONS

As a result of indepth analysis of the available policy options the following decisions were taken:

(a) Maintaining the level of Economic Activity

In order to maintain economic activity at 1975 levels and prevent negative real growth in the economy, it was decided to increase Government foreign borrowing by \$190 mn. in the 1977/78 fiscal year.

(b) Raising of the Import Levels from \$600 mn. to \$750 mn. in 1977

It was estimated that if the level of raw materials was kept within the budget forecast of \$200 mn. some 50,000 jobs would be lost in the manufacturing sector. In addition, the restriction of capital goods imports to \$70 mn. would have adverse effects on the construction sector. Hence the entire increase in the import budget was earmarked for the productive sectors of the economy, especially manufacturing, construction and agriculture.

(c) Balance of Payments and Budgetary Support

In order to reduce Government borrowing from the Central Bank, it was decided to channel most of the foreign loans through the Government budget as a replacement for the estimated \$200 mn. borrowing from the central bank. Thus the price increases of about 9% which would have been generated by Central Bank money creation of \$200 mn. was virtually reduced to zero.

(d) The imposition of a dual exchange rate

In order to boost exports, reduce subsidies to the productive sectors such as sugar, bananas and tourism so that these sectors would be net contributors to the Government budget rather than receivers of subsidies, it was decided to adjust the exchange rate without exacerbating the rate of inflation. It was, therefore decided to split the exchange rate in two. The old rate - the Basic Rate of J\$1.00 = US\$1.10 - was maintained for the imports of basic foods such as rice, corn, wheat, soya etc.; fuel, drugs, animal feeds, fertilisers and yarn. In addition, the transactions of Government and the bauxite and alumina were kept at the basic rate. All other foreign exchange transactions were placed on the special rate or depreciated by 37½% whereby J\$1.00 = US\$0.80. However, on the 1st August, all petroleum imports were placed on the special rate but adjustments on the local tax to prevent the increase in domestic prices were made. Credits to the Exchange Rate Stabilisation Fund from the sale of foreign exchange to pay for petroleum imports compensated for the loss in the tax revenue. Also the bauxite and alumina companies were allowed to convert a small portion of their local costs foreign exchange inflows at the basic rate to accommodate the local purchases of imported commodities which were affected by the special rate.

The overall average rate of depreciation of the Jamaica dollar was 27%. The overall impact on the Consumer Price Index was estimated to be less than 5% since only 30% of the C.P.I. Basket would have been affected by the special rate.

(e) Stand-by Arrangement with the I.M.F.

A Stand-by arrangement for a two-year period - March 1977 to March 1979 - was concluded with the I.M.F. in June 1977.

Under this arrangement, Jamaica could purchase S.D.R. 64 mn. or 3 1/3 enlarged credit tranches from the I.M.F. over the period.

(f) The tightening of the incomes policy to ensure that wages and salaries were kept below the rate of inflation which was estimated to be around 15% in 1977. In addition, profits and dividends were also restricted to a maximum of 7% per annum.

(g) Increase in the Statutory Liquid Assets of the commercial banks

In the area of monetary policy, the statutory liquid asset requirement of the commercial banks was increased by five in two stages to 29.5%. This served to absorb a substantial amount of liquidity from the commercial banks.

8. MANAGING THE BUDGET

The management of the Budget is essentially done by two agencies - The Trade Administrator's Department and the Exchange Control Department. These activities are co-ordinated in the Foreign Exchange Budgeting Unit of the Bank of Jamaica.

8.1 Exchange Control - Regulation of Service Payments

Since 1972, Exchange Control regulations in Jamaica were being intensified as the balance of payments problems became more and more acute and in January 1977, all foreign exchange transactions except the basic private travel allowance of US\$55 per annum required the approval of the

Exchange Control Department. On account of the difficult foreign exchange position, the amortization of private debt was suspended for eighteen months except where the debts were due to foreign Government or Government owned institutions. Service payments such as profits and dividends and interest on private debt were to be made with 90-day lag and Royalty and Insurance Payments with 180-day lag until June 1978. In addition, no payments were to be allowed for gifts, maintenance, migration, bequests and grants except on humanitarian grounds. Payments for current imports and trade credits also required Exchange Control approval. (See Appendix B which gives the guidelines for service payments)

Since nearly all foreign exchange payments required Exchange Control approval, the Exchange Control Department was effectively implementing the foreign exchange budget.

8.2 The Trade Administrator's Department - Administration of the Import Budget

All imports were placed on licence and the Trade Administrator's Department was empowered to grant licences as determined by the foreign exchange budget. Foreign exchange allocations are made for the broad categories of imports and the Trade Administrator's Department allocate the amounts to the various importers. A schedule of payments has to be completed on each licence and this data is fed into the foreign exchange budget to correspond with the monthly foreign exchange payments which can be allowed by the Exchange Control Department of the Bank of Jamaica. Thus, each month an estimate of total payments is made and matched against estimated receipts. Payments in excess of receipts result in a loss of reserves and this is kept to a minimum since foreign reserves of the central bank is low. The scheduling of import payments on the basis of a monthly average for twelve months prevents the "bunching" of import payments at any one period of the year.

The scheduling of the cash flows in terms of "payments for imports" as opposed to the "level of imports", made it necessary to classify the licences granted for imports into the following categories:

- (a) Discretionary Import Licences - imports to be paid for out of foreign earnings during the year.
- (b) No funds import Licences - e.g. Imports of the bauxite sector and
- (c) Tied Import Licences - i.e. Imports against lines of credit and specific financing arrangements such as project loans and aid.

Discretionary Import Licences

The schedule of payments on the "discretionary import licence" form a part of the cash flow budget since foreign exchange would have to be obtained from the domestic banking system to pay for imports in the current budget year.

No Funds Imports Licences

Direct imports of the bauxite and alumina are classified as no funds imports on the grounds that no foreign exchange has to be obtained from the banking system to pay for these. However, these transactions would be part of the balance of payments accounts.

Tied Imports Licences

Tied imports are also excluded from the cash flow budget since no direct foreign exchange payment is incurred and as such exchange control approval is not necessary. Obviously, these imports would be part of the total "level" of imports and are included in the balance of payments accounts.

9. ESTIMATING MOVEMENTS IN THE RESERVES

Having estimated the sources and uses of foreign exchange on a cash basis, it is fairly easy to determine the movement in reserves. If payments exceed receipts, the reserves should decline accordingly and vice versa. However, since there is a lag between obtaining exchange control approval and the actual purchase of foreign exchange, an adjustment would have to be made to the surplus or deficit between payments and receipts as the case may be. Since there is no central Foreign Exchange Pool, F.E. approvals are used as a proxy for actual foreign exchange sales by the banking system. For example, in one month actual sale of foreign exchange may be greater than exchange control approvals for the sale of foreign exchange or vice versa. In a tight foreign exchange situation, however, the lag should hardly be more than three days of F.E. approvals on the average since foreign exchange is purchased as soon as approval is obtained. Data for the management of the foreign exchange budget is obtained from Form F.E. (See Appendix III)

10. CONCLUDING REMARKS

Foreign Exchange Budgeting as part of overall economic, financial and foreign exchange management is still in the evolutionary stages in Jamaica. So far, it has been an effective tool and part of the entire mechanism which is being developed for economic and social transformation in Jamaica. Already there are indications that the current account deficit is narrowing as a result of the measures which were taken earlier in the year.

The Foreign Exchange Budgeting exercise has given to policy-makers some valuable insights to better understand the behaviour of crucial variables in the working of the Jamaican economy.

The inter-relationships between the Money Supply, the Balance of Payments and the Gross Domestic Product can now be more easily quantified and estimated. This allows for a more precise analysis of the policy options provided that adequate and reliable data are readily available. Moreover, given the economic, social and political realities of the Caribbean and the attitude of the industrial countries, there is not much room for mistakes in policy decisions.

NOTES AND REFERENCES

1. For a detailed analysis of Foreign Exchange Budgeting in Latin America See A. Mattera, Foreign Exchange Budgets in Latin America, I.M.F. Staff Papers Vol. 4, 1954.
2. A. Mattera. Op. cit p. 291
3. The I.M.F. Approach to the Balance of Payments - a collection of research papers by members of staff of the I.M.F. has been brought together in: "The Monetary Approach to the Balance of Payments", I.M.F. Washington D.C. 1977.
4. For an analysis of Foreign Exchange Management with particular reference to small open economies, see: C. Y. Thomas "Reserve Adequacy and Regional Co-operation in Reserve and Payment Management" Regional Monetary Studies Conference, Jamaica, 1973; Courtney N. Blackman "Managing Reserves for Economic Development", Columbia Journal of Business 1976; and Asgar Ally "The Potential of Autonomous Monetary Policy in Small Open Economies - The Case of Jamaica", Journal of Development Studies, University of Sussex, 1975.
5. In Jamaica, a one-year Emergency Plan was drawn up for 1977 and work is now in progress on the Plan for 1978 - 82.
6. G. G. Bonnick: "National Accounting View of the Jamaican Economy, 1977 and 1978, National Planning Agency 1976.

BALANCE OF PAYMENTS SUMMARY OF JAMAICA
1972 - 1976

	J\$million				
	1972	1973	1974	1975	1976
A. Merchandise	-121.0	-161.2	-106.9	-144.8	-119.9
Exports (f.o.b.)	302.4	357.2	630.7	736.7	599.7
Imports (f.o.b.)	423.4	518.4	737.6	881.5	719.6
B. Services (net)	- 18.6	- 27.1	- 66.2	-136.0	-160.7
Foreign Travel	74.5	90.4	88.6	69.3	42.6
Investment Income	- 43.2	- 52.8	- 61.5	- 93.5	-105.1
Other	- 49.9	- 64.7	- 93.3	-111.8	- 98.2
C. Goods & Services (net)	-139.6	-188.3	-173.1	-280.8	-280.6
D. Unrequited Transfers (net)	22.3	24.0	21.3	23.8	5.4
Private	27.7	30.7	29.6	19.1	1.8
Official	- 5.4	- 6.7	- 8.3	4.7	3.6
Current Account Balance	-117.3	-164.3	-151.8	-257.0	-275.2
E. Net Capital Movements	59.8	124.7	221.1	189.9	41.5
Official	18.6	33.4	81.9	112.9	72.0
Private	41.2	91.3	139.2	77.0	- 30.5
F. Total A through E	- 57.5	- 39.6	69.3	- 67.1	-233.7
G. Allocation of SDRs	4.7	-	-	-	-
H. Total F plus G	- 52.8	- 39.6	69.3	- 67.1	-233.7
I. Change in Reserves (increase = -)	43.6	27.7	- 54.1	73.6	240.5
Holdings of SDRs	4.9	- 0.3	1.5	1.1	3.7
Reserve Position in the IMF	11.0	-	-	-	-
Government	1.9	0.4	2.9	- 3.4	0.1
Capital Development Fund	-	-	- 9.0	- 19.3	28.1
Bank of Jamaica	1.3	27.2	- 38.8	93.1	204.1
Other Banks	24.5	1.2	- 10.7	2.1	4.5
J. Net Errors and Omissions	9.2	11.9	- 15.2	- 6.5	- 6.8

Source: Bank of Jamaica

EXCHANGE CONTROL GUIDELINES

1. MIGRATION

- (a) Except for any special cases dealt with under (b) no remittances of capital or income will be allowed to persons who have migrated from Jamaica or migrate at any time in the future.
- (b) Application may be made to Exchange Control for submission to the Minister for consideration of any special cases on humanitarian grounds. Applications must be fully documented in writing, giving all relevant information. In the event the Minister considers the application favourably, the maximum amount which will normally be allowed will be \$4,000 in any 12-month period.
- In order to prevent hardship in the transition period to the new arrangements, application for remittances of income up to the 30th April 1977 will be considered provided that the maximum amount shall not exceed \$500 in any one month and \$1,000 in the period.
- (c) Persons migrating from Jamaica will be required to make a declaration to Exchange Control of all their assets and liabilities. In the absence of such declaration Exchange Control will not allow any transaction by way of sale, transfer or any dealings in these assets.

2. EDUCATION

- (a) Students already attending courses at institutions of Higher or Professional Education certified as such by the Ministry of Education will continue to receive funds abroad on the basis of rates and amounts already approved by Exchange Control on Form M. Remittances restricted to one semester or one term's expenses will be allowed on each application.
- (b) Students wishing to enter Institutions of Higher or Professional Education for the first time after 1st January 1977 will be required to provide a certificate from the Ministry of Education

/that

that the course of training is considered a priority course and it is either not available in Jamaica or the student cannot obtain admittance to an Education Institution in Jamaica. As in (a) above, the Ministry of Education must also have certified that the institution is one of Higher or Professional Education. Remittances will be on the basis set out in (a) above.

- (c) Students granted loans under the Students' Loan Scheme, or who hold Government scholarships or scholarships approved by the Ministry of Education will be permitted to have funds remitted on the basis set out at (a) above to the extent approved by the Students' Loan Bureau or the Ministry of Education as the case may be.
- (d) Persons already undertaking technical or trade training courses, not involving attendance at an institution of Higher or Professional Education will be allowed remittances to enable them to complete their courses. New applicants for these courses must satisfy Exchange Control that the course is a priority one and recommended by the Ministry of Education or Labour.
- (e) In all cases at (c) and (d) above, Exchange Control must be satisfied that the student has entered into an agreement with his employer, or the entity granting the loan or scholarship to return to Jamaica to work for an agreed period in the default of which the funds remitted or paid become a debt due to the entity.
- (f) In all other cases not covered by the above, students now studying abroad will be permitted to continue their courses until the end of the present academic year on the basis of Form Ms already approved but with actual remittances being restricted on each application to one semester or one term's expenses. At the end of this academic year, no further remittances will be allowed for students already on courses or for new students.
- (g) In all cases where it is considered that there are special circumstances justifying an exception from the above,

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written application must be made to Exchange Control making out a case. Exchange Control will transmit the application to the Minister for a decision. In no case should application be made in person.

- (h) In all the above cases, commercial banks are only permitted to make remittances on the basis of individual Forms F.E. as approved by Exchange Control.
- (i) All other Exchange Control requirements and procedures under this head, except as modified above, continue in force.
- (j) Examination fees, correspondence course fees payable by persons resident in Jamaica will be dealt with on the basis of individual applications.
- (k) In dealing with applications other than under (b) to (j) above, Exchange Control will be guided by the recommendation of a Committee drawn from the Ministry of Education and the Ministry of Labour, the University of the West Indies and the Students' Loan Bureau, as to the priority to be attached to courses.

3. MAINTENANCE

- (a) Except for any special cases dealt with at (b) no remittances for the maintenance of dependants resident outside of Jamaica will be allowed.
- (b) Applications may be made to Exchange Control for submission to the Minister for consideration of any special cases on humanitarian grounds. Applications must be fully documented in writing giving all relevant information. In the event the Minister considers the application favourably, the maximum amount which will normally be allowed will not exceed \$2,000 per annum for a wife and \$1,000 per annum for a child up to a maximum of \$2,000 per annum. In order to prevent hardship in the transition period to the new arrangements, application for remittances to dependants resident abroad prior to 1st January 1977 will be permitted at a monthly rate not exceeding the amounts mentioned above for the period ending 30th April 1977.

4. BENEFITS UNDER WILLS AND TESTACIES

- (a) Except for any special cases dealt with at (b) no remittances of capital or income will be allowed to beneficiaries under wills or intestacies.
- (b) Applications may be made to Exchange Control for submission to the Minister for consideration of any special cases on humanitarian grounds. Applications must be fully documented in writing giving all relevant information. In the event the Minister considers the application favourably the maximum amount which will be normally allowed will be \$4,000 for a 12-month period.

5. LIFE INSURANCE

No further transfers of life insurance contracts for Migrants will be approved. The Migrant shall be free, however, to continue premium payments in Jamaica and on surrender, or maturity of the policy or payment of a claim, the amount shall be added to his assets and dealt with under (1) above.

A resident will not be permitted to remit Life Insurance premiums in respect of any policy.

6. GIFTS

No amounts shall be available for remittance as a Gift.

7. MEDICAL EXPENSES

Remittances for medical treatment abroad will be allowed where two doctors in Jamaica certify in writing that the recommended treatment is not available in Jamaica. Exchange Control may also obtain an opinion from the Ministry of Health and will be guided thereby.

8. PROFESSIONAL ORGANIZATIONS, MEMBERSHIP FEES, SUBSCRIPTIONS ETC.

- (a) Fees payable to professional organizations abroad as a condition of membership of the professional organization will be allowed for remittance.
- (b) Group insurance (other than Life insurance) connected with the professional association of which the resident is a member and which is not available locally, will be eligible for remittance on the basis of individual evaluation by Exchange Control.
- (c) Subscriptions to learned journals, newspapers and magazines will be allowable.

9. TRAVEL

- (a) Funds will be provided for business travel only of an absolutely essential nature with priority being given where the applicant can demonstrate that such travel will result in the earning or saving of foreign exchange as a direct result of the trip. Application must be made to Exchange Control in each case.
- (b) Funds will only be provided for travel on behalf of the Government, Central and Local statutory bodies, or Government companies on the basis of written authorisation from the Ministry of Finance and the Ministry concerned. The application and letters must be forwarded to Exchange Control.
- (c) Sporting and cultural events abroad, conventions and meetings of professional societies etc.:
In each case whether or not the delegation has Government or private members, the application for funds must be accompanied by a letter of recommendation from the relevant Ministry.
- (d) Holiday Travel: An amount of \$50 per person per annum is allowable as from 1st January 1977. All previous unused allocations are cancelled, and amounts allowed under the emergency arrangements since 1st January 1977, will be applied against the year's allocation.

10. INSURANCE

- (a) Life insurance premiums may not be remitted abroad by any insurance company or agent.
- (b) For the period up to 30th June 1977, insurance premiums, whether remitted directly or through an agent or broker or in the form of reinsurance premiums shall in the first instance be placed in Blocked Accounts to the credit of the principals concerned and Exchange Control so advised. Applications on Forms F.E. must be made to Exchange Control for the remittance of individual amounts.
- (c) Head Office expenses and other charges payable to Head Office shall be placed in Blocked Accounts and held until 30th June 1977, by which date new guidelines will be issued and applications submitted to Exchange Control on Forms F.E. on the basis of the guidelines. Exchange Control shall be advised when the amounts are credited to the Blocked Accounts.

11. ROYALTIES, TRADE-MARKS, COMMISSIONS & FEES,
HEAD OFFICE EXPENSES, MANAGEMENT EXPENSES

Payments due under the above headings will be Blocked for the period to 30th June 1977. Thereafter new guidelines will be issued. All persons involved in making these payments should submit full details by 28th February, 1977. Failure to do so will result in elimination from consideration of any claims after 30th June 1977.

12. CONSULTANTS, ADVERTISING, TECHNICAL ASSISTANCE, FEASIBILITY STUDIES

Applications for remittance under existing contracts already approved by Exchange Control will be allowed on the basis of pro rata monthly payments up to 30th June 1977 or up to such earlier date when new arrangements are substituted. During this period all existing contracts must be submitted for review for a determination as to whether they should be terminated, modified or continued in their present form.

13. DEBTS IN FOREIGN EXCHANGE

All companies, institutions and persons having an indebtedness to a non-resident lender are required to provide the following details by 28th February 1977:

- (a) Principal of loan and terms;
- (b) amount outstanding at 1/1/77 distinguishing between principal and any outstanding interest;
- (c) the due dates for payment of interest and principal and shown on a quarterly basis commencing with 1st January 1977;
- (d) An estimate of the amount which will actually be available for payment of interest and principal in each quarter.

- (e) Normally approval will be given for remittances of interest and principal after examination of the information supplied above. Under normal circumstances approval will be granted for remittances in each quarter in respect of payments accrued and due in the immediately preceding quarter.
- (f) Where no specific due dates are incorporated in any loan agreement, payments shall be on the basis determined by Exchange Control after reviewing the information at (a), (b) and (d) above.
- (g) Remittances will only be allowed where income tax legally due has been paid or suitably secured.

14. PROFITS AND DIVIDENDS

- (a) Dividends payable to non-resident owners of shares shall be subject to the general guidelines limiting dividends payable by all companies to the equivalent of 7% of net worth of the company.
- (b) All branch operations in Jamaica for the purposes of profit remittances will be treated for Exchange Control purposes on the same basis as if they were subsidiary companies registered in Jamaica and accordingly the remittances of branch profits may not exceed the equivalent of 7% of the net worth of the operations in Jamaica.
- (c) All companies or branches in Jamaica planning to make dividend payments to non-residents or to remit profits on the basis of (b) above shall as from 1977 submit details of the estimated amount of dividends or profits and the estimated date of payment in each year by the 31st March.
- (d) Applications for remittances shall be accompanied by the Audited Accounts of the company and confirmation that the relevant taxes have been paid. Remittances will be allowed on the above basis after examination of the information submitted at (c) above.

15. EXTERNAL ACCOUNTS

Embassies, High Commissions, international organizations and their non-resident staffs and other non-resident holders of External Accounts may continue to have these accounts debited and credited as provided under existing guidelines. As from 1st April 1977, persons working in Jamaica on a Work Permit will only be permitted to credit to an External Account 20% of their gross earnings.

16. PENSIONS

Pensions may continue to be remitted on a monthly basis.

17. PURCHASE OF LOCAL ASSETS BY RESIDENTS FROM NON-RESIDENTS

- (a) Residents will only be granted permission to purchase local assets from non-residents where arrangements for remittances of the sale proceeds have been made satisfactory to Exchange Control. In general, where the non-resident is not a former resident of Jamaica (i.e. is not a migrant resident abroad) payment of capital monies over a period of less than 10 years will not be permitted.
- (b) Where the vendor is a former resident, the proceeds of sale remain part of his local assets and are dealt with as provided under 1 above.

(c) In all cases of sale of assets by non-residents to residents the vendor or his agent must agree in writing that Exchange Control may procure at his expense an independent valuation of the assets by a Valuer appointed by Exchange Control. The Valuer will provide :-

- (i) The value of the assets which would be used by a lender as the basis for the granting of a loan on the security of the asset;
- (ii) the market value of the asset which a willing buyer would reasonably be expected to pay to a willing seller having regard to economic factors then prevailing. Exchange Control shall be guided by these values in approving the price at which the asset is to be transferred and will not grant approval where the proposed transfer price is out of line with the valuation.

18. In all cases where payments are due by a resident to a non-resident, and the full amount cannot be remitted because of these guidelines, the non-resident is free to require the resident to lodge the difference to the credit of an account in an authorised bank in the name of the non-resident.

DAVID H. COORE
Deputy Prime Minister & Minister of Finance
19th January 1977.

ENTER ONE TYPE OF TRANSACTION ONLY ON EACH FORM

BANK OF JAMAICA

FOREIGN EXCHANGE REPORT
 (Under the Exchange Control Act)

Bank Transaction Date

Purpose

Applicant's Name Passport No. (for travel only)

Applicant's Permanent Address

Name of Beneficiary

Beneficiary's Address

FOREIGN COUNTRY

CURRENCY DETAILS	AMOUNT & TYPE OF CURRENCY	RATE OF EXCHANGE	LOCAL CURRENCY EQUIVALENT
<input type="text"/>	<input type="text"/>	<input type="text"/>	JS

METHOD OF PAYMENT / RECEIPT DRAFT T.T. CHEQUE CURRENCY M.O. L.C. M.T.

Amount of Foreign Currency (in words)

DECLARATION BY APPLICANT

I/We Declare That:

the above statements are true and that the foreign currency will be used solely for the purpose stated and I/We acknowledge that any permission given on this Form will lapse if not utilised within thirty days from the date of authorisation.

Applicant's Signature

STAMP OF APPROVAL AND DATE	STAMP OF BANK	STAMP OF BANK VERIFYING APPLICANT'S SIGNATURE
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FOR USE BY BANKS ONLY

SALE PURCHASE PRIVATE SECTOR PUBLIC SECTOR

**TYPE OF TRANSACTION
 REVISED CLASSIFICATION**

00	Business Travel	14	General Insurance	28	Tourist Refunds
01	Other Travel	15	Pensions	29	Interest - Central Government
02	Imported Goods (excluding Oil and Products)	16	Bauxite Company Transactions	30	Interest - Public Sector (Government guaranteed)
03	Imported Goods (Oil and Products)	17	Royalties	31	Interest - Public Sector (Other)
04	Exports*	18	Advertisements	32	Interest - Private Sector (Government guaranteed)
05	Migrants' Transfers	19	Film Rental	33	Interest - Private Sector (Other)
06	Requests / Grants	20	Dividends	34	Loans - Central Government
07	Private Gifts	21	Profits	35	Loans - Public Sector (Government guaranteed)
08	Maintenance	22	Charter Hire	36	Loans - Public Sector (Other)
09	Education	23	Port Disbursements (excluding freight)	37	Loans - Private Sector (Government guaranteed)
10	Passenger Fares	24	International Communication Charges	38	Loans - Private Sector (Other)
11	Commissions	25	Miscellaneous Current Transactions	39	Central Government Capital Transactions
12	Fees	26	Official Transfers	40	Other Public Sector Capital Transactions
13	Life Insurance	27	Remittances - Jamaica Embassies and Missions (including Statutory Organisations)	41	Private Sector Capital Transactions
				42	External Accounts
				43	Personal Income

* For exports insert CD2 number here: