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THE PRIVATE SECTOR ORGANISATION OF JAMAICA

A

10-YEAR REVIEW OF GOVERNMENT'S

FISCAL OPERATIONS

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Easterly and Schmidt-Hebbel (1993), in analysing the impact of Fiscal Deficits on Macro-economic performance, have found that money financing of the deficit (printing money) leads to higher inflation, while debt financing leads to higher real interest rates or financial repression (artificially negative real interest rates). Printing money to finance the deficit only occurs if borrowing from the Central Bank is encouraged.

Borrowing to finance the deficit impacts on the economy differently depending on the source of the borrowed funds. If the funds come from domestic sources (such as domestic commercial banks, T-Bills or LRS's), then domestic interest rates are expected to rise. Many studies have found however, that this increase in interest rates may not have an adverse effect on consumption (Giovanni 1983, 1985; Schmidt-Hebbel, Webb and Corsetti 1992) or on private investments (Serven and Solimano 1992). In fact consumption and investments in many developing countries are found to be interest inelastic.

Further government fiscal deficits theoretically have a negative impact on the external trade balance. For an open economy in equilibrium, for eg.:

$$I + G + X = S + T + M$$

This therefore implies: $G - T = (M - X) - (I - S)$

This means that an increase in the fiscal deficit will lead to either an increase in the external deficit or a reduction of net private sector investments (over savings), or both.

A fiscal deficit can finally lead to a crowding out of private sector investments if few investable projects remain or domestic interest rates become too high. Blejer and Khan (1984) and Khan and Reinhart (1990), however, have found that government capital expenditure can in fact crowd-in private sector investment (ie encourage an increase) depending on whether private and public investments complement or substitute for each other.

It is therefore against these backgrounds that the Jamaican Government's Fiscal Operations over the past ten years needs to be analysed.

The overall Deficit as a percentage of GDP has averaged 8.7% since 1984/85 but jumped to 18.66% in the last fiscal year 1994/95. This has resulted in an increased in domestic borrowing from an average of 4.54% of GDP from 1984/85 - 1993/94 to 20.6% in 1994/95. This further resulted in a significant increase in interest rates with nominal lending rates moving from 21.2% in the 1980's to 40% in the 1990's and 49.8% in 1994. Real interest rates also moved from a positive 5.6% in the 1980's to a negative 1.5% in the 1990's and a very positive 14.7% in 1994. Investment planning was therefore very difficult during this period.

The Internal Debt as a percentage of GDP presently stands at 35.4% down from 49% in 1989/90. However, the nominal stock of J$46.9 billion means that every on percentage point increase in domestic interest rates will increase domestic interest servicing J$0.47 billion. Prudent management of our National Debt is therefore of extreme importance.

The following tables and graphs therefore outline the government's fiscal operations. A more thorough report and analysis will be prepared at a later date.

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