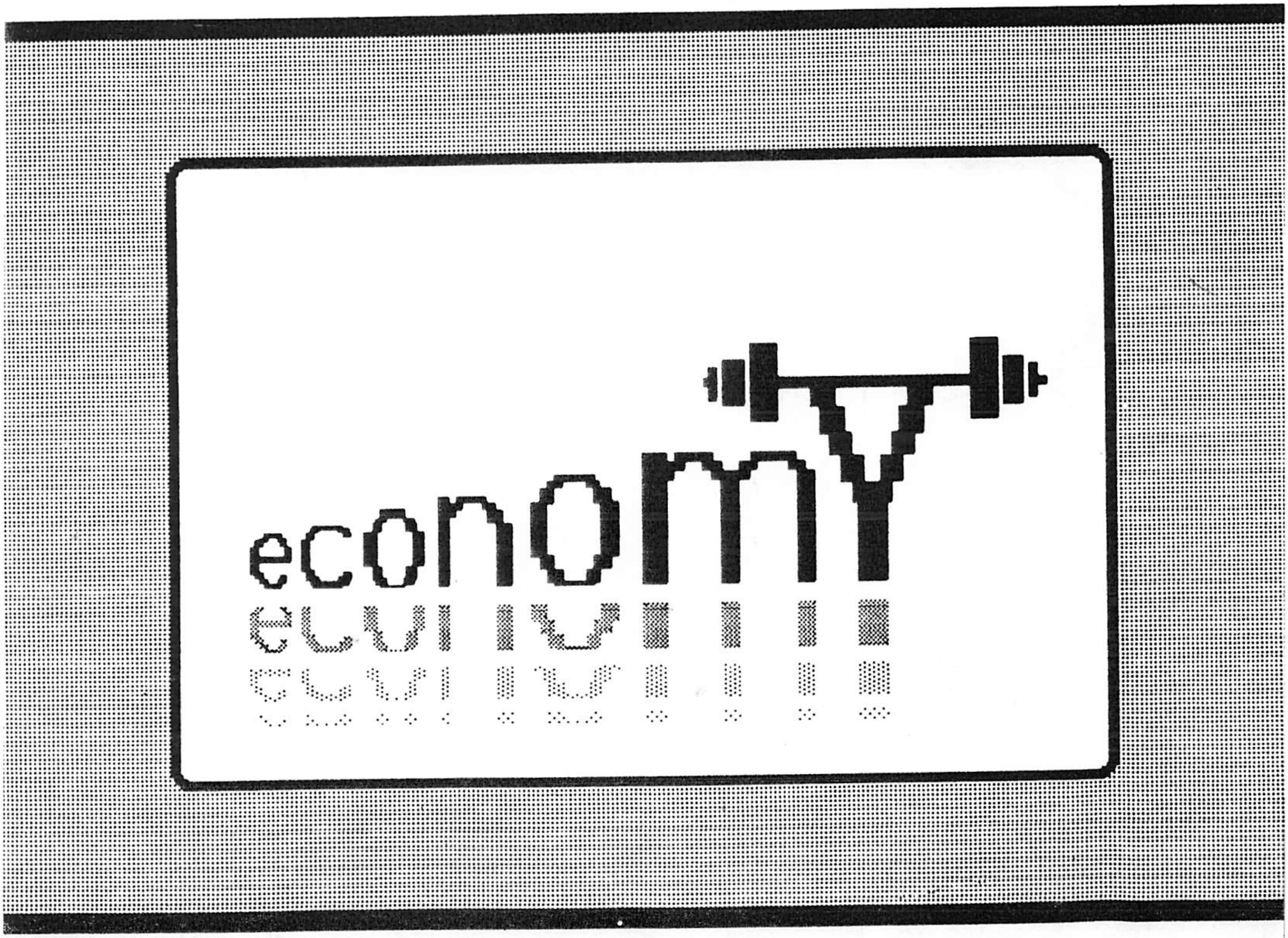
PSOJ THE PRIVATE SECTOR ORGANISATION OF JAMAICA

A POLICY FRAMEWORK FOR ECONOMIC DEVELOPMENT IN JAMAICA



Free Enterprise ... and Watch Jamaica Grow

A POLICY FRAMEWORK FOR ECONOMIC DEVELOPMENT IN JAMAICA

AUGUST 1985

PREPARED AND PUBLISHED BY

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From the President

IN EVERY SOCIETY, in every generation, there comes a time when conventional wisdom must give way to new, bold ideas. By far, two of the best examples which come to mind in the economic sphere are the **Wealth of Nations** by Adam Smith in the early 19th Century and the Keynesian economic philosophy in the early 20th century.

The PSOJ document, "A POLICY FRAMEWORK FOR ECONOMIC DEVELOPMENT IN JAMAICA", while not claiming to be in such illustrious company, represents in the Jamaican context, a radical departure from the mostly unsuccessful economic policies of the past, including the post-independence period.

This document outlines a philosophical approach within a market-oriented economy. It outlines policies which the PSOJ believes must be adopted if Jamaica is to achieve long-term, real, self-sustaining development.

The PSOJ presents this position based on a re-examination of the major tenets of past economic development policy initiatives. We expect that this document will generate much debate and I wish to take this opportunity to invite you to share your comment and opinions with us.

I hope that all who read it will find the document constructive and that the recommendations suggested on some of the vexed economic issues facing the country will be taken seriously.

The PSOJ hopes that the new perspectives offered in this document will serve to influence policy makers and the nation as a whole toward adoption of a market-oriented economy in Jamaica.

SAM MAHFOOD
President

A POLICY FRAMEWORK FOR ECONOMIC DEVELOPMENT IN JAMAICA

Contents

Preface

IT IS SELF EVIDENT that, in any democracy, elected governments have a legal and moral mandate to encourage, by administrative and other means, the creation of an environment conducive to the objectives of real economic and social development. The P. S. O. J. recognises the central role the government of Jamaica has to play in trying to meet competing demands for limited resources. It is against this background that the following proposals are made, in the belief that these proposals will generate the necessary increased activity to sufficiently widen the present limited resource base to meet most, if not all, these competing demands.

One of the fundamental principles of the P. S. O. J. and its members is the absolute adherence to the rule of law and the administration of justice, because it has been proven that where injustice is allowed, the rule of law is compromised; and where the law has broken down, injustice prevails. A democratic society is premised on the toleration of opposing beliefs; however, this is not, and cannot be, extended to a selective adherence to the law. The P. S. O. J. supports the government of Jamaica in the legal application of the law to those areas, companies, or persons who are found to have broken it. Similarly, government policy should be applied to all without favour, as this eliminates uncertainty and creates confidence in the system for prospective investors.

One of the intentions of this paper is to try to establish the most efficient economic mix between government and private interests. The provision of national security, public roads, street lights, education, social welfare, mediation between conflicting claims, and establishing of the rules and regulations for social, civil, political, and economic relationships are areas that most would recognise as the government's *prima facie* responsibilities. On the other hand, the private sector is most efficient at providing goods and services, and should be given the necessary tools to carry out this function. Theoretically, there should be no conflict between government interests and private capital, given the above broad areas of responsibilities. However, in practice, and particularly in the present economic system, conflicts are evident. While the P. S. O. J. firmly recognises the government's pivotal role and responsibilities in the above stated areas, there are areas of disagreement, such as government's continuing inefficient control of large and important areas of the productive economy and some administrative regulations that inhibit the development of a market system. It is to solutions to these problems that this paper addresses itself.

Delroy Lindsay
Lawrence F. Mansfield

An Executive Summary

I This paper attempts to set out the philosophical bases for the policies which the PSOJ believes are essential for long-term economic and social development of Jamaica. The arguments here presented are therefore not and should not be considered detailed economic proposals addressing the structural imperfections in the economy. Detailed analysis will be presented in a series of related papers on the various aspects of the economy. These will appear in subsequent publications.

II An economic system is a complex set of inter-relationships between different claimants in a society. It is therefore essential for government's actions to be consistent, not only from one time period to another, but as among policies in various spheres, to maximise the most efficient use of limited resources.

III Our most serious problem is our inability to make the payments abroad that are currently required for our imports and our foreign debt, out of the proceeds of our exports and tourism receipts. The gap has been financed until recently by new loans from abroad, but this only exacerbates the problem in the future. We must increase our earnings; to do this, our limited resources must be used as efficiently as possible. This means that, sooner or later, all industries, all productive activities, must justify their existence by their ability to survive without subsidy from the rest of the society or external source.

IV Large government budget deficits contribute to the balance of payments problem through giving people more money income to spend (partially on imports) without adding to the supply of foreign exchange needed to pay for them. This contributes to weaknesses of the domestic currency in foreign exchange markets, a problem that cannot be solved by pegging the exchange rate at a fixed value, since that only creates black markets. The solution is to eliminate, or at least drastically reduce the budget deficit while leaving the exchange rate free, thus permitting the complete abolition of the Exchange Control Act. In addition, government should compete, like everyone else, for foreign exchange.

V Monetary policy should strive to maintain a reasonably stable rate of growth of the stock of money and liquidity, and this rate should be related to the rate of growth of real output in the economy. However, if there is dis-equilibrium between the rate of growth in the money supply and real growth in the economy, the most likely result will be inflation. Similarly, "stop-go" or inconsistent monetary policies are not conducive to continued, sustained long-term investments and thus, economic growth.

VI The internal structure of the financial system is in need of reform if it is to function as a development instrument. Some areas identified as inadequate are development banking, venture capital markets, post-shipment financing, rebate on indirect taxes on exported goods, and a more equitable corporate tax structure.

VII All publicly-owned companies, in addition to all government interests in other companies, save those with national security implications, should be divested. There should also be a rationalisation of statutory bodies with a view to reducing their numbers to the absolute minimum. This would reduce government expenditure, and consequently its increasing tax demands, by re-allocating internal resources to the private and productive sectors.

VIII The present tax structure is a major disincentive to production and enterprise. Income, and to a lesser extent, corporate taxes, have increased dramatically while the benefits have diminished in direct proportion. The government should radically reform the tax structure, as opposed to tinkering with rates, by shifting the burden from earned to disposed income, or from direct to indirect taxation. This would not exclude a small flat rate income tax consistent with the proposed reduction in government's economic and other non-productive activities. This small flat rate is likely to increase government's revenue as compliance would increase sufficiently to offset the rate reduction.

IX The PSOJ is opposed to price controls and income policies, whether they be voluntary or statutory, because they tend to distort the internal economy and retard the efficiency of the market price mechanism. These administrative mechanisms are usually temporary in their effectiveness, However, in the long-term, the distortions of these administrative policies manifest themselves by compounding existing inefficiencies and simultaneously restrict efficiency by artificially holding factor prices below market rates.

X It is recognised that Jamaica is energy dependent but this should not be seen as a permanent disadvantage, because, as a nation, we produce goods for which we have comparative and absolute advantages. To maximise these advantages, the suggested fiscal and other policies incentives outlined by the PSOJ have to be implemented as a comprehensive whole rather than on a piece-meal basis.

Private companies should be allowed to generate electricity for their own consumption and sell any surplus to the JPS for use in the national grid.

XI The private sector and society generally recognise the government's prima facie responsibilities in the areas of assisting the economically defenceless, e.g. mentally or physically handicapped or those below the poverty line. However, because our social problems have multiplied rather than decreased over the years, we are recommending a radical departure from conventional wisdom. We propose a tax credit system for private companies engaged in retraining programmes, either in joint ventures with the government or unilaterally. These programmes should be job-related with specific emphasis on new technology.

XII The government must create an environment conducive to enterprise, risk-taking and reward, by removing existing barriers such as: political discretion in decision-making, competition between government and the private sector for limited domestic credit, government access to concessionary financing which crowds out the private sector from the productive economy, and most importantly, stability in policies to encourage confidence in long-term investment decisions.

Delroy F. Lindsay
August 1985

Introduction

THE JAMAICAN ECONOMY over the past fourteen years has been subjected to economic and social policies that were extreme and at times contradictory, even if, in some cases, they were never implemented. This result, therefore, had been to make the private sector cautious in its investment decisions, which in turn projects a negative image of its commitment to Jamaica's long term economic development. Another feature of the past fourteen years is the piece-meal approach of various governments in implementing economic strategies, whether derived from the "Democratic Socialist Model" or from the "Free Enterprise Model". An *ad hoc* selective and contradictory approach to the "market system" does more harm than good to the country and, importantly, to the public perception of the benefits to be derived from a market system.

This outline therefore seeks to define the broad philosophical approach that the private sector of Jamaica should adopt with respect to Jamaica's economic development, and to bring into clear focus an understanding of, and commitment to, a true market system. It is important that this document not be seen as an economic plan, with time-frames, implementation schedules, and cost-benefit analyses. It is more than that. It is a philosophical document, that attempts to set out the policies that are considered to be pre-requisites for an environment in which a market system can operate, and generate the maximum returns in the form of greater production, productivity, and real growth for the country. It is also intended to stimulate discussion, with a view to achieving a P. S. O. J. consensus position.

Overview

THE MACRO-ECONOMY

An economic system is a complex set of inter-relationships: between producer and consumer, tax collector and income earner, importer and domestic producer; and among all the business firms competing for productive resources and for markets. Any action by any of the participants in the economy inevitably has repercussions far beyond the immediate impact of that action. It is therefore essential for government's actions to be consistent, not only from one time period to another, but as among policies in various spheres. Government's regulations on the importation of foreign goods should not unduly handicap the production of goods for export, for example. Policies cannot be implemented on a selective basis, but must be consistent and inter-related at the broadest and the narrowest levels. Further, any tendency to concentrate on demand management without sufficient attention to the supply side of the economy is a negative approach which will tend to exacerbate rather than solve the structural problems of the economy.

1. Balance of Payments

The objective of economic policy should be to attain equilibrium in the country's balance of payments and, once attained, to maintain it, while simultaneously striving to attain equilibrium in the domestic economy.

Equilibrium in the balance of payments means a situation in which the total of:

(a) our earnings of foreign exchange from exports and tourism

plus

(b) new voluntary inflows of private and public capital funds that are within our capacity to repay

is equal to:

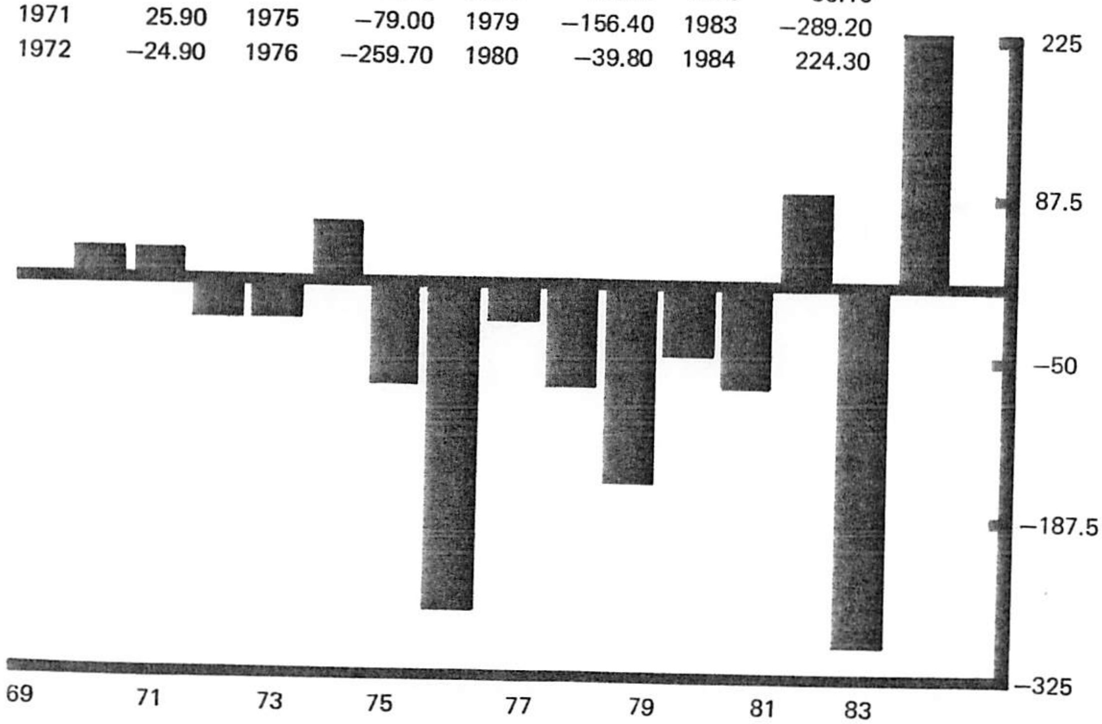
the total of our imports plus interest and dividend payments plus capital repayments that must be made.

Our basic problem at present is simply that the latter total is larger than the former. We have tried to increase our earnings of foreign exchange; our foreign debt payments have been rescheduled. Greater efforts must yet be made to increase our exports, particularly given the depressed international market for bauxite and alumina. We have received much aid from our friends abroad, and new loans have been extended to us, largely because our creditors are convinced we intend to make the sacrifices necessary to pay our debts.

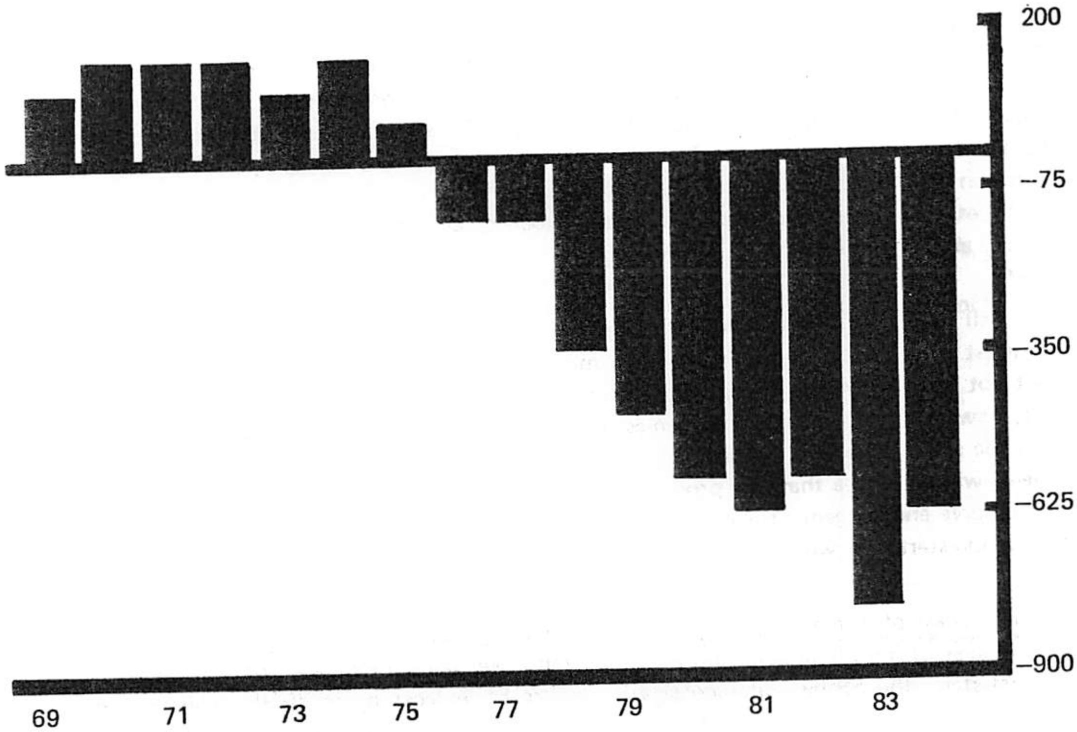
But we must be under no illusions; we must reduce our foreign debts to a level that we can sustain. The alternative is to default on our obligations. No sleight of hand, no financial magic can relieve us of this hard choice.

BALANCE OF PAYMENTS (US$ millions)

1969	−2.20	1973	−29.00	1977	−16.20	1981	−90.50
1970	21.10	1974	47.80	1978	−84.90	1982	86.10
1971	25.90	1975	−79.00	1979	−156.40	1983	−289.20
1972	−24.90	1976	−259.70	1980	−39.80	1984	224.30



NET FOREIGN RESERVES, BOJ (US$ millions)



1969	95.00	1973	111.70	1977	–154.60	1981	–636.00
1970	120.10	1974	152.70	1978	–324.20	1982	–545.60
1971	170.40	1975	49.10	1979	–469.40	1983	–807.40
1972	154.70	1976	–123.50	1980	–548.50	1984	–623.60

The consequence of default are so unpleasant that it seems unlikely that many people would choose that road if they were aware of what it entailed. With no liquid assets in our possession and with foreign credit cut off, we would **immediately** have to reduce our imports of goods and services to what we could pay for with our exports. This would mean a reduction of at least 25 percent of our imports, and that would only be the beginning of our problems. If anyone thought that the hardships we face now are intolerable, he would then look back on present conditions as a paradise indeed.

2. External Trade Policy

The urgent task that faces us is to increase our exports sufficiently to reduce our dependence on foreign gifts and foreign loans to a level that we will be able to sustain. In other words, we must come to pay for a larger and larger percentage of our imports with earned income and less and less from new credit. This export effort will require daring and skill on the part of the private sector to find and develop new markets, new products, new techniques of production, and perhaps new foreign partners. It will require the co-operation and ingenuity of government agencies to provide positive incentives for exports, to remove dis-incentices, to remove bureaucratic barriers and delays, and to permit maximum freedom for private initiative and experimentation.

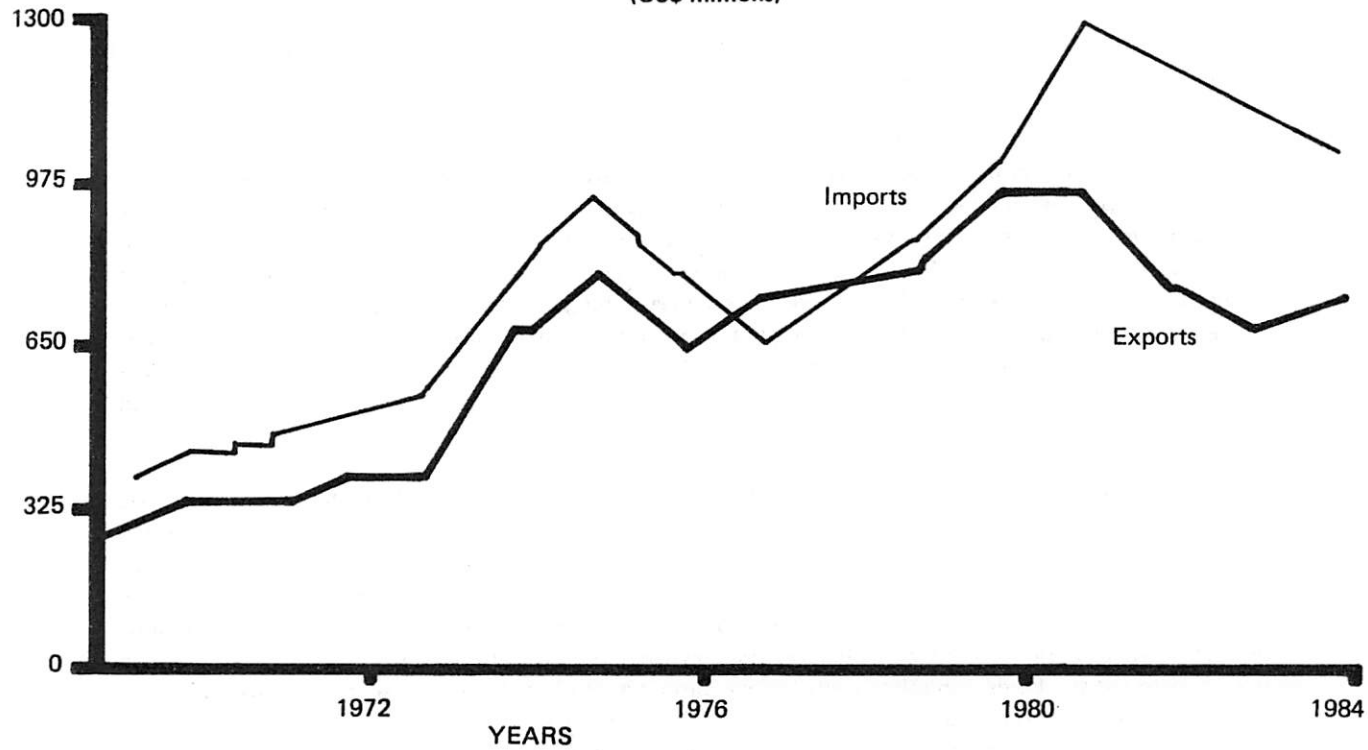
It will not always be possible to identify potential exporters in advance, so that governmental policies must be general in nature. Incentives must be available to anyone who meets specified criteria; they must not be doled out on a discretionary, *ad hoc* basis, as has been true too often in the past. Time after time, new products and new companies have been created while long established operations have faded from the scene. The inventiveness and imagination of the human mind, when allowed the freedom to experiment, will guarantee that this process will always continue. If we pass judgement on the export products that deserve encouragement ahead of time, and if we are wrong, we may waste resources in a vain effort to push a non-starter or, worse, deny resources to endeavours that might be outstandingly successful.

The process of dismantling the system of quotas, licences, and restrictions that are our inheritance from past policies of import substitution and fixed (and over-valued) exchange rates must proceed in stages. In the first stage, the quotas and licences will need to be replaced by tariffs that give the industries to which they apply a degree of protection from foreign competition roughly equivalent to that provided by the previous restrictions. This is a matter of simple equity, since previous government policy deliberately encouraged individuals to risk their money and to commit themselves to employment careers in those industries. Those individuals must, therefore, be given sufficient time to adjust to the new policies without having their livelihoods threatened unnecessarily.

There must, however, be no misunderstanding or blinking of the central fact — that adjust they must. The structure of the economy **must** change, from one of import-substituting manufacturing industries and agricultrual products complementing the large foreign exchange earnings of our raw material exports, to a structure of aggressive export marketing of manufactured goods and agri-business supplementing the (no longer adequate) raw materials exports. In this new environment, every enterprise, every productive activity will have to meet the test of economic efficiency as a part of the struggle for national survival. Exporters of all types -- agricultural, manufacturing, or tourism -- must be permitted to obtain their necessary inputs, whatever they may be, from the cheapest possible source, so as to maximise the variety and quantity of exportable goods and services and to minimise their costs. Any concerted attempt to make our exporters "buy Jamaican" for their inputs, where Jamaican prices are higher or quality lower, risks blunting or defeating the export drive.

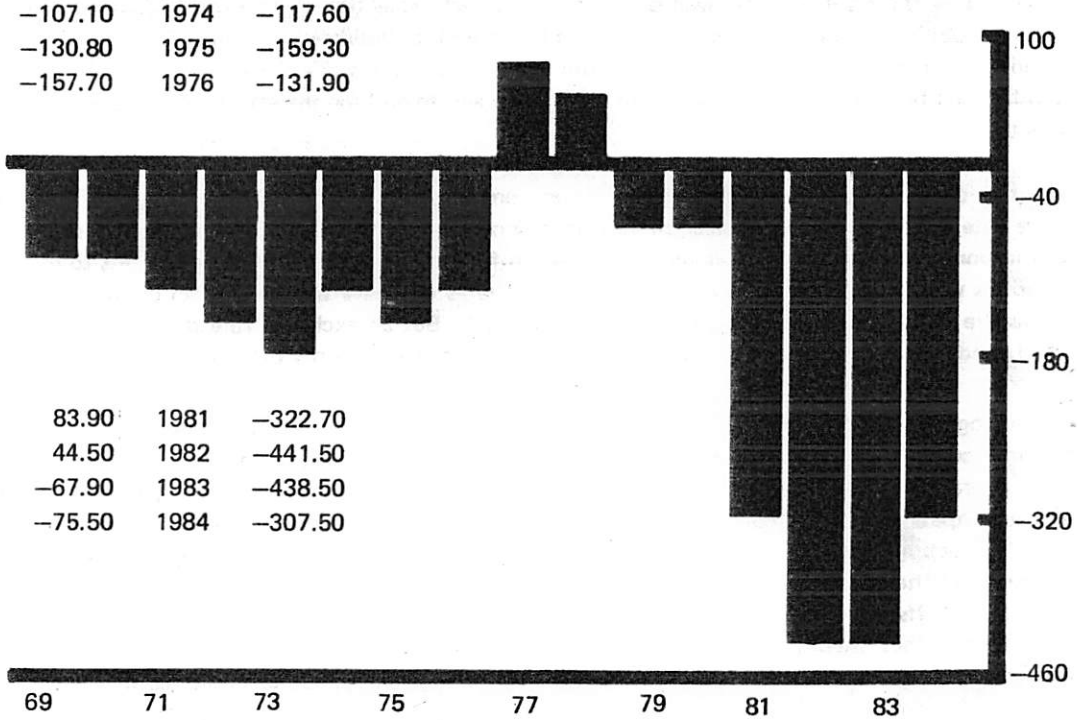
This much is readily understandable. There is a more subtle test for economic efficiency that must also be met if the necessary change in economic structure is to be brought about. Those industries that do not produce for export, but instead either serve strictly local needs or compete with imported goods, make use of physical inputs — of skilled labour, raw materials, capital goods — that may also be used by exporters. Such industries must, of course, bid against exporters in the markets for the inputs they both need. The larger the demand for these inputs, the higher the prices of these inputs and, therefore, the higher the costs of the exporters. If any of the import-competing industries is enabled to survive solely by virtue of protective tariffs, the demand for inputs needed by the export industries is artificially inflated; and this, of course, by raising input prices, reduces the competitiveness of our export products. In the long run, therefore, national survival requires economic efficiency, and economic efficiency requires that every industry be able to stand on its own feet without protection except that which is provided by revenue tariffs.

MERCHANDISE EXPORTS AND IMPORTS
(US$ millions)



BALANCE ON MERCHANDISE (US$ millions)

1969	–89.30	1973	–177.30
1970	–107.10	1974	–117.60
1971	–130.80	1975	–159.30
1972	–157.70	1976	–131.90
1977	83.90	1981	–322.70
1978	44.50	1982	–441.50
1979	–67.90	1983	–438.50
1980	–75.50	1984	–307.50



It may be argued that permitting the importation of finished goods in competition with locally produced goods will result in a drain of scarce foreign exchange that we can ill afford. Locally produced finished goods have an import content of, perhaps, 40 to 60 percent, whereas imported finished goods have, obviously, an import content of 100 percent. If, by permitting imports, we make it impossible for the high-cost segment of local producers in a given industry to survive, we will, it is true, make it necessary to spend more foreign exchange for that particular product. But the line of reasoning must be pursued beyond this point. The argument of the preceding paragraph is precisely that the resources employed by that segment of our given industry that was unable to survive -- skilled labour, raw materials, capital -- can now be extricated from a losing proposition and deployed in an export industry. The export industry will probably require some imported components; but even if the export industry's import content is greater than the displaced import-substitution industry, if it can use the resources more efficiently to produce more output per unit of input, we will gain more in additional foreign exchange earnings from exports than the additional foreign exchange we spend on imports. More simply put, if we concentrate our domestic resources in those industries where we are most efficient, we will be able to **afford** to import the things we need, and in the production of which we are not quite so efficient. A simple arithmetical illustration of the argument is shown in an appendix.

In the phased adjustment to the export-led economy we are proposing, therefore, the first stage will see the transition from discretionary, administrative, and quantitative controls on imports to a market-oriented system of tariffs. This will most likely be a period of considerable change, as entrepreneurs find new markets abroad made possible by exchange rate depreciation and the export incentives. New industries and business firms will form, old ones will disappear, as is to be expected in any dynamic economy. The tariff protection we propose for this stage will allow asset owners to liquidate fixed assets through depreciation in use, so as to put the funds into other assets for new products, as opportunities present themselves. Workers, too, should be given opportunities for retraining to match the new skill requirements of the new opportunities. This would be most effectively accomplished through allowances to employers for offsetting "on-the-job" training costs against company income tax (or personal income tax, where the employer is a single proprietor).

In the final stages of adjustment to the new export-oriented economy, some method must be used to ensure that the adjustments begun in the previous stage continue. Except in rare cases, this should be accomplished by the **gradual** withdrawal of tariff (and other) protection. The period of withdrawal of protection should in no case be shorter than the time required to liquidate the assets of the relevant industry; depending on the individual case, this might run four to eight years. Tax incentives for rapid depreciation could be used both to hasten the period of liquidation and to cushion the effects of the reduction of tariff protection.

It should be borne in mind that many import-competing industries will find that, with a realistic exchange rate, they need have no fear of foreign competition. In the past, the over-valued exchange rate made imports so cheap that smuggling was highly profitable, and no amount of complaints to the customs authorities was able to stop it. Extremely high tariff rates will have the same effect of encouraging smuggling as the existence of quantitative import controls did. But an exchange rate that correctly values imported goods is more effective protection for most industries than an army of customs inspectors.

We recognise that Jamaican manufacturers and farmers sometimes find themselves at a competitive disadvantage compared to foreign producers through no fault of their own and through no lack of efficiency in the operations under their control. Such disadvantages may result from much higher freight rates for imported inputs that other countries must pay, or from energy costs much higher than in countries producing competing goods, to mention only two possibilities. Furthermore, "dumping" of goods abroad by producers in other countries at prices below their domestic sales prices could seriously damage a Jamaican industry. Tariffs constitute one possible device for dealing with such problems; and the legislature may conclude that they should be used. For every such problem, however, we believe that there are better ways of handling the situation. The solution to high energy costs, for example, is, first and foremost, increased efficiency in the production and distribution of electricity and refinery products. When the limit to that has been reached, and if there is still a cost disadvantage to local producers, one possible solution would be to allow producers an offset against corporate profits taxes equal to the difference between local and foreign energy costs on the amount of their output until such time as government -- or a private owner, if government divests itself of the utility company -- brings energy costs into line with international norms. Alternatively, government could recompense the electricity company so as to allow it to sell to everyone at internationally competitive rates. The least desirable choice is to impose a tariff on imported goods sufficient to raise the import price by the amount of the energy differential. This penalises one particular set of consumers, with no offsetting advantage to anyone, whereas the other approaches put the burden on taxpayers in general.

Regardless of what method may be used to deal with special problems, such as these, we must carefully be on our guard to make sure that we do not throw out the baby with the bath water. If enough exceptions are made, everyone will maintain all the protection he has always had, no resources will be transferred to the dynamic sector of the economy, and we will be forced to find the solution to our balance of payments problem in reducing imports to the level of penury, rather than expanding exports to the level of prosperity.

3. Exchange Rate Policy

The exchange rates of the Jamaican dollar with other currencies should be determined by the forces of supply and demand in a free market. Whatever the validity of arguments for manipulation of other individual markets may be, this is the one market in which the potential damage to the economy from intervention is greatest. Much of the responsibility for the present imbalance between imports and exports rests with the maintenance, over many years, of an over-valued currency. A price for foreign currency in Jamaican dollars that was lower than buyers would willingly pay meant that imported products were made artificially cheap, and could only be kept out by quota restrictions. While encouraging Jamaicans to buy imported goods, the pegged exchange rate discouraged Jamaican exports, since if products were to be sold abroad their prices in foreign currencies had to be competitive with foreign products; and the low Jamaican dollar price of foreign currencies meant low Jamaican dollar prices for exported goods.

It is sometimes argued that, if foreign exchange is uncontrolled, the Jamaican dollar will depreciate without limit, on the theory that a Jamaican will always prefer to hold his assets abroad rather than at home, if given the choice. There may have been times in the past when that was almost literally true, but economic theory and common sense both point to the conclusion that there is some exchange rate that will convince owners of liquid assets that any advantage obtained by buying foreign currencies (safety, interest income, etc.) is offset by the cost of obtaining them. Furthermore, if the economic and political policies being pursued by the government are responsible, consistent, and growth-oriented, the exchange rates that will equate demand for and supply of foreign currencies will be reasonably stable and will not fluctuate wildly from one period to the next.

It is often said that the first step is the hardest -- that until confidence in the currency is restored, exchange controls must be retained, because if controls were removed against the recent history of a declining Jamaican dollar, there would be a rush to transfer funds abroad in advance of an expected further devaluation; but that in itself would cause the very devaluation every one feared.

There are two things to be said about this argument:

1. Speculation against a currency is strong and persistent only when it is known that its government is trying to maintain a specific target value for the currency but has inadequate reserves to do so. In this case there is no possibility of the domestic currency's value rising above the target value since, if it did, the government would buy all foreign currency offered on the market. In this case, speculators have a risk-free bet. If there is no target, or if the target is uncertain, speculators will think carefully before incurring a risk of loss.
2. Historically, large exchange rate reforms have only been successful when the government in question has taken the entire transformation in one step and has firmly maintained the policies required to enforce it. Examples are Germany in 1923 and again in 1948. France in 1958, and the United States in 1973. If a government tries to introduce a free market foreign exchange regime gradually, while retaining exchange controls, it is a signal to the financial community that the government has no confidence in the success of its experiment, and virtually guarantees that the experiment will fail.

Having said this much, no one would argue that it is desirable to have large fluctuations in the value of the Jamaican dollar; and there are some things that might be done that would help to reduce those fluctuations. Ever since 1978, we have had to depend on new foreign borrowing by government every year to make the required interest and amortisation payments on government's previously incurred foreign debt. Under these circumstances, the foreign exchange market, however organised, would have been starved for supplies. So long as this condition continues, there will be a chronic shortage of foreign exchange; and the exchange value of the Jamaican dollar is likely to continue to decline, unless the domestic economy is so starved of liquidity as to threaten the ability of even the most intrepid businessmen to mount any serious export effort. Particularly is this true since the virtual collapse of the bauxite-alumina industry. In these circumstances, a further rescheduling of our foreign debt offers the best hope of laying the foundations for greater export earnings in the future and contributing to the stability of the exchange rate in the present. If government is not forced to siphon off all but a small portion of foreign exchange receipts for debt service, the likelihood of further depreciation recedes and, with it, the speculative pressure against the currency. With that pressure removed, credit restrictions could be eased, and that would contribute to the financing of new export industries.

In a national economy that is integrated into the world economy, the decision to buy an imported component or imported raw materials for a product being produced locally is a business decision that should be made on considerations of cost and efficiency. In order for Jamaican exporters to compete with producers in other countries, they must be able to buy what they need where it is available at the time they need it. This means they must have the right to own foreign currencies, to use them as they see fit, and to buy and sell as they choose. Any other arrangement puts handicaps on local producers and hampers the search for economic efficiency. The present foreign exchange auction system represents a very considerable advance in the evolution toward a more rational ordering of economic relations with the rest of the world; and the first tentative opening of a forward market in U.S. dollars by the commercial banks offers exporters and importers a means of insuring themselves against lossess due to exchange rate fluctuations. The amount of foreign exchange changing hands at any one auction is, however, very small, and in such a thin market, small absolute changes of supply can produce disproportionately large changes in the price (the exchange rate). Rather than a system in which government takes what foreign exchange it "needs" and leaves the remainder for the auction, we believe that a straight-forward foreign exchange market, in which total supply is matched with total demand, is what we must eventually have. Such a system would logically be operated through the commercial banks. Government should compete, like everyone else, for foreign exchange; and it would be highly desirable for government's demand to be publicly known through its participation in an open free market. We have proposed a rescheduling of the foreign debt; the increase in available supply of foreign exchange that this will permit also makes possible a complete abolition of the Exchange Control Act.

4. Fiscal and Monetary Interaction

One of the elements that must be included in any responsible economic policy is control of the government budget deficit. While we recognise that the current account deficit cannot be eliminated in one fiscal year, it can and must be drastically reduced. As a goal, the current account should run a surplus from which to finance the expenditure in the government's capital budget. There may be times (as for example, during economic recession) when government's revenues shrink more rapidly than its expenditures, and there is a need to cushion the shock of recession for those elements of society most in need. At such times, government will almost certainly run a reduced current account surplus or even a deficit. This is admissible; but it must always be remembered that Jamaica is most likely to suffer recession when there is recession in the industrialised countries. The most likely result of such a situation is a balance of payments deficit; and this means that the ability of the Jamaican government to counteract the effects of a recession at home is necessarily limited by its ability to use its own international reserves (when it once more has some) or its ability to obtain medium-term financing from the I.M.F. or other sources.

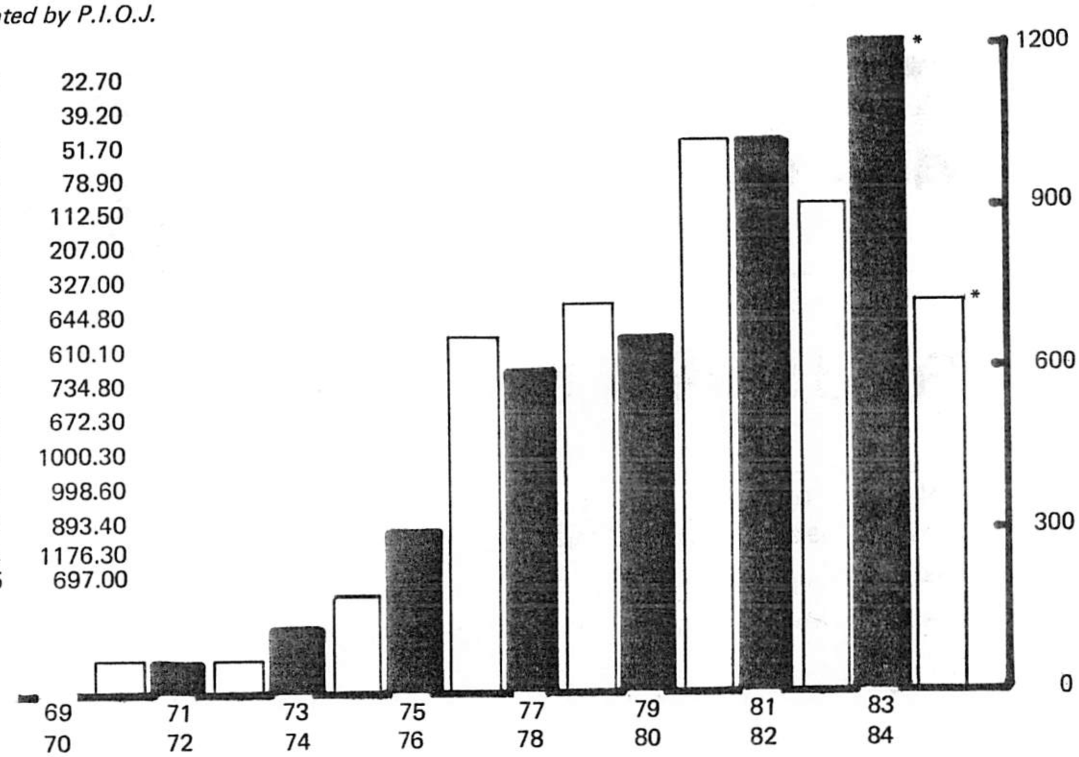
If the Central Bank is relieved of the necessity of financing huge government deficits, it will then once more be in a position to operate a sensible, sensitive monetary policy. Such a monetary policy should strive to maintain a reasonably stable rate of growth of the stock of money and liquidity, and this rate should be related to the rate of growth of real output in the economy. If the quantity of things to be bought increases slowly or not at all, then a very rapid rate of growth of money in the hands of the public is quite certain to cause an increase in average prices, i.e., inflation.

Equally important as the prevention of inflation is the need to foster economic growth through appropriate monetary and fiscal policies. Private investment in factory bulidings, farms, hotels, and other productive assests will be greater, the lower are the interest rates at which the funds to finance these projects must be borrowed. Low interest rates are to be preferred to high ones in order to encourage growth-generating investment, other things being equal. But low interest rates produced by a rapid expansion of

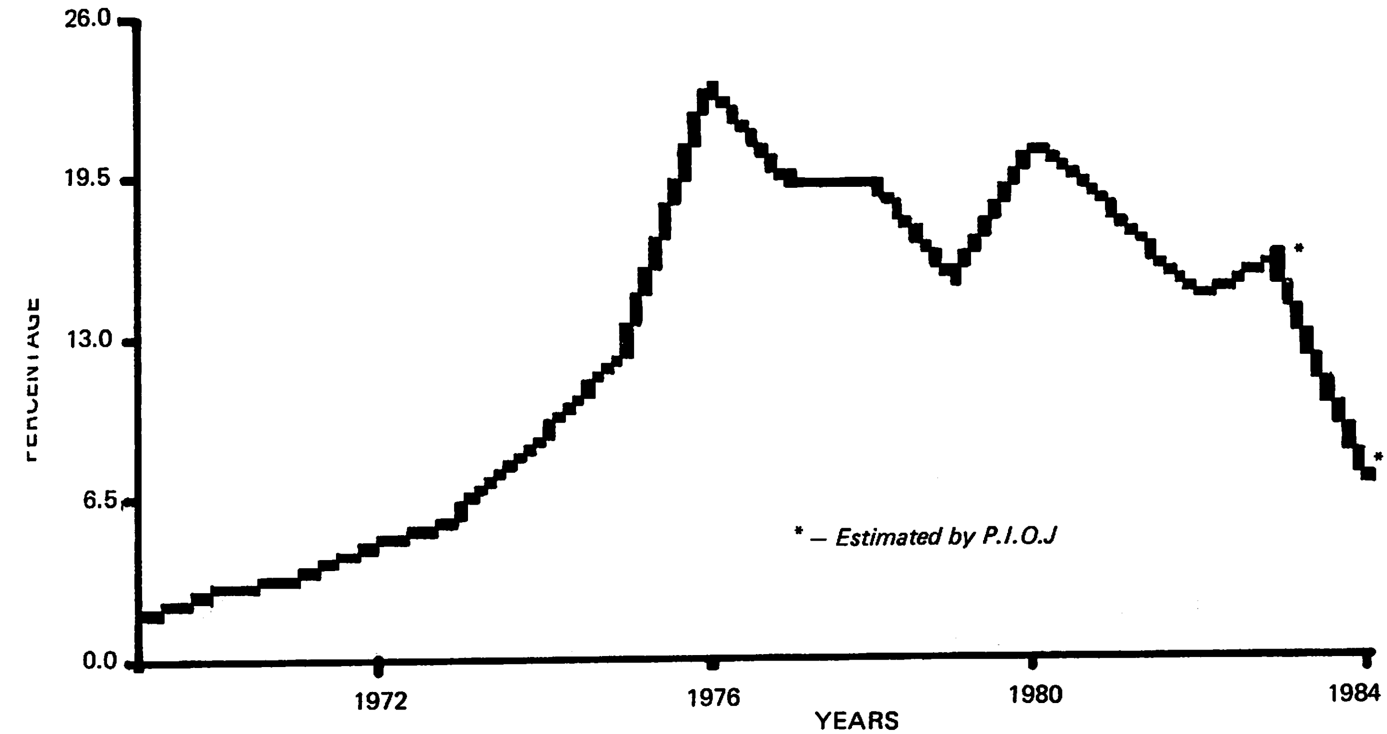
OVER-ALL GOVERNMENT DEFICIT (J$ millions)

* *Estimated by P.I.O.J.*

1969/70	22.70
1970/71	39.20
1971/72	51.70
1972/73	78.90
1973/74	112.50
1974/75	207.00
1975/76	327.00
1976/77	644.80
1977/78	610.10
1978/79	734.80
1979/80	672.30
1980/81	1000.30
1981/82	998.60
1982/83	893.40
1983/84	1176.30
1984/85	697.00



DEFICIT AS PERCENTAGE OF GDP
(Fisc yr. deficit/Fisc. yr. GDP)



the money supply will soon produce inflation, which will have to be suppressed by much slower money growth, which in turn will mean high interest rates. This sort of "stop-go" monetary policy is deadly to the process of continued, sustained economic growth, and should be avoided.

The monetary authorities will be helpless to operate a consistent monetary policy if government is running a large deficit. If this happens, and if inflation is to be controlled, more and more private borrowers will have to be excluded from the market for loan funds by higher and higher interest rates, caused by the increased competition for money to borrow; and investment and therefore economic growth must suffer.

Given a consistent set of monetary and fiscal policy goals for economic growth and price stability (and consistent performance), the private sector can be expected to produce increased foreign exchange earnings, greater employment, and a rising standard of living for all Jamaicans. But this process will be strengthened and accelerated if government will modify the internal structure of the financial system in certain strategic ways, and will be weakened and delayed if it does not.

Many Jamaican businesses have inadequate capitalisation for the increased scale of operations entailed in the structural readjustment programme. They need additional equity capital; they need to be able to borrow at medium- to long-term; they need funds for purposes that carry risks that are different from or greater than commercial banks are prepared to assume; in short, they need a development bank. The Trafalgar Development Bank, a private sector organisation, goes some considerable part of the way to meet these needs, but government has a responsibility to provide capital as well. The National Development Bank is not currently a true development bank because it does not accept these risks.

5. Fiscal Policy and the Public Sector

5a. The Public Sector and Divestment

The public sector is most inefficient in its consumption of limited domestic and foreign resources. The following represents some, by no means all, of the defects in its structure:

- It tends to be monolithic in structure
- It has no rational economic basis for performance evaluation
- It is seemingly unaccountable both in terms of set objectives and financial responsibility
- From its strategic position it impinges negatively on the private sector by diverting limited resources into uneconomic activity
- In its present state, it is a great strain on the fiscal budget
- It has brought about apparently unstoppable growth in statutory non-productive budget

All publicly owned companies, in addition to all government interests in other companies, save those with national security implications, should be divested as a matter of policy and urgency. There should be a rationalisation of statutory bodies with a view to reducing their numbers to the absolute minimum.

The political directorate should have no sanction on the decisions of the Divestment Committee. Divestment should be determined entirely by economic considerations.

5b. Budgetary policy

The government should remove from the expenditure side of the budget those bodies and activities whose economic benefits are insignificant or marginal to the task of nation building and which, if necessary, can be transferred to the private sector. In short, the government should concentrate on mediating rather than managing; and this approach would substantially reduce government expenditure while revenue would increase, following the stimulation that this and other suggested policy changes would give to the productive sector and enterprising individuals in the form of increased productivity and wealth creation.

6. Taxation

The present tax structure is a major disincentive to production and enterprise and reflects the growth of an unimaginative and inefficient central bureaucracy and its agencies in areas of the economy which should best be left to private enterprise. The bungling inefficiency and corruption of this unproductive edifice have to be financed through increased taxes, while the benefits have visibly diminished in direct proportion. To correct this cycle, the government has to reform the tax structure radically. The immediate point of departure should be a shift in the burden of income tax from earned to disposed income, or from direct to indirect taxation. While egalitarians would criticise this approach on grounds of equity, reality suggests that indirect taxes are more logical. Decisions on income disposal, like most other decisions in a free dynamic society, are best left to those whose interests are directly affected. The shift from direct to indirect taxation does not exclude the possibility of a small flat income tax; but any attempt to raise the rate while indirect taxes as suggested above are operative should be strongly resisted. Care should also be taken to ensure that the distribution of the tax burden be such that it does not react adversely on the productive sectors. Similarly, the levels of import and domestic duties should be reduced or eliminated with respect to export industries. In addition, the local related indirect taxes should be refunded to exporters, on goods that they export, as part of an overall incentive programme. This would have the positive impact of making more Jamaican goods export-competitive in Third Country markets.

Taxation has been used in many countries to induce people to favour saving and investment over consumption. In order to promote economic growth, it will be necessary, for some time to come, to foster such a bias against consumption. The rational way to do this is to tax the purchase of consumer goods (with exceptions for necessities) and give income tax rebates on that proportion of income saved. Since the object is to discourage the purchase of consumer goods not designated as necessities, all goods should pay the same tax, whether they be imported or locally produced. This will also discourage the importation of inputs required for local production of consumer goods, and will do so equally as effectively as a tariff would, while making it possible for exporters to import those same inputs if they need them.

The principal function of import taxes in the long run in Jamaica, therefore, should be the raising of a portion of government revenue. The maximum amount of revenue will be realised as rates of tax that will have to be determined by study and perhaps experimentation; but it is certain that more revenue will be raised by low-to-moderate rates by high ones.

It needs to be restated here that the above proposals are inextricably linked to the government's divesting itself of several productive and unproductive entities that now impact negatively on the budget and make necessary the present crippling rates of taxes.

7. Prices and Incomes Policy

One of the most important goals of economic policy should be price stability, by which is meant a situation in which the average of all prices does not change, either up or down. It does not, and cannot, mean complete rigidity of individual prices, because it is an essential element of successful adaptation to economic growth and movement that **relative** prices be free to change. Administrative control of prices is therefore impossible to reconcile with a dynamic economy, and must be reserved for the special cases, such as public utilities, in which market mechanisms cannot be expected to function efficiently.

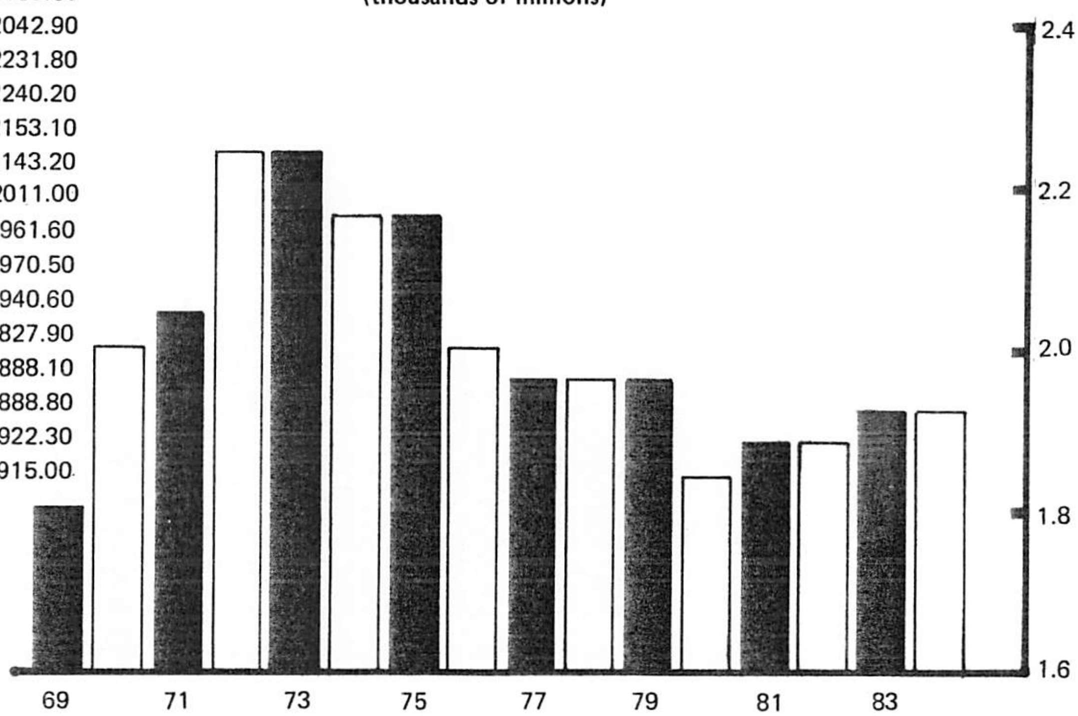
If the external trade, exchange rate, and fiscal and monetary policies described above are adopted, we can expect an eventual restoration of stable economic growth, with high levels of employment, rising incomes, and stable prices. In the immediate future, however, we face the reality of **rising** prices that are the result of inflationary pressures previously created by unwise policies and suppressed by price controls and exchange controls and quota restrictions.

If inflation becomes commonplace, if the average citizen anticipates inflation, he will, if he is even moderately intelligent, try in whatever way he can to protect himself; and the most obvious way to do so is to raise the price of what he sells (his stock in trade, or his labour) in advance of the rise in the general price level. Clearly, if everyone does this, no one wins and inflation perpetuates. This is equivalent, in economic terms, to anarchy in the political sphere, where no police force exists to prevent armed robbery, and the average citizen is at the mercy of brutal marauders.

In a growing economy, total output is increasing, and therefore so is total national income. In such a situation, it is quite possible for labourers, farmers, industrialists, and landowners all to have rising real incomes. Their money receipts can rise without creating inflationary pressures, so long as the increase in money rewards is no greater than the increase in their productivity. This is a workable criterion, then, by which to judge demands for income increases. We do not, however, suggest that it be used as a legal formula to control incomes. The P.S.O.J. is opposed to price control and incomes policies, whether they be

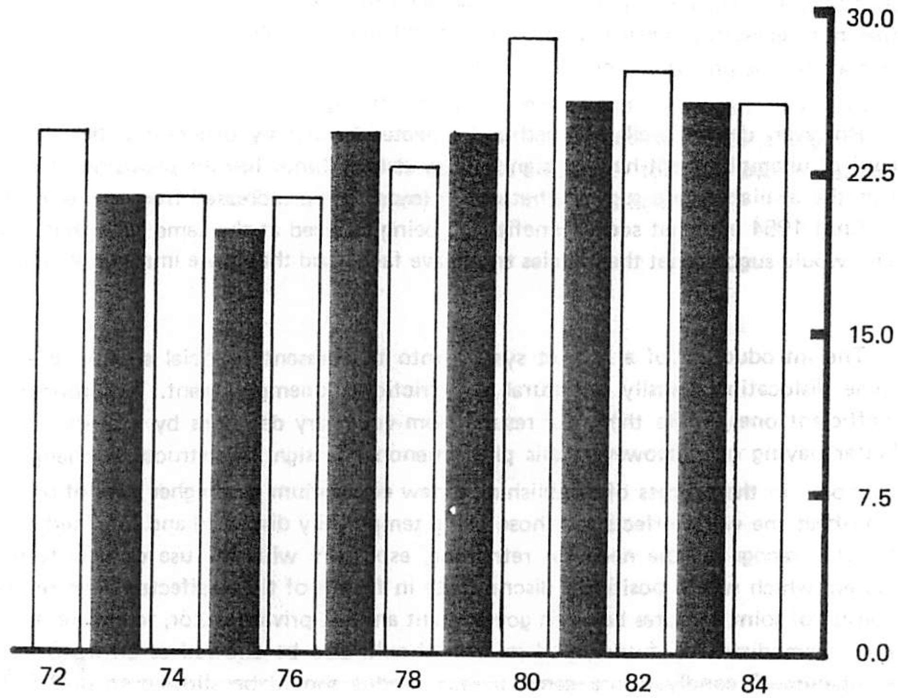
1969	1783.30
1970	1980.80
1971	2042.90
1972	2231.80
1973	2240.20
1974	2153.10
1975	2143.20
1976	2011.00
1977	1961.60
1978	1970.50
1979	1940.60
1980	1827.90
1981	1888.10
1982	1888.80
1983	1922.30
1984	1915.00

GROSS DOMESTIC PRODUCT (Constant J$)
(thousands of millions)



UNEMPLOYMENT RATE (Percent)

1972	23.40
1973	21.40
1974	21.70
1975	19.90
1976	20.50
1977	24.50
1978	23.00
1979	24.30
1980	27.80
1981	26.20
1982	27.00
1983	25.80
1984	25.60



"voluntary" or statutory. Total money income should be controlled by the general monetary and fiscal policies we have already discussed; its distribution must be determined by market mechanisms, modified compassionately by a system of public welfare that does not destroy incentives to economic efficiency. Compassion without efficiency is as bad, at least for a poor country, as efficiency without compassion. Either way, the economically defenceless are the ones who suffer.

8. Social Welfare

It is recognised that in any economic system there are certain functions which society expects the government to provide because, while the market economy efficiently allocates resources through the forces of supply and demand, there will always be residual areas, especially in human development, where the optimum benefit is not obtained or cannot be obtained. It is in these areas (e.g.), health care, education, and protection of the economically defenceless – those who are below the poverty line or mentally or physically handicapped) that the P.S.O.J. acknowledges the government's responsibility. This recognition does not necessarily mean that the government must manage this institutional structure; this could equally be done by the private sector.

However, despite well intended and repeated efforts by different political parties over the years, the level of unemployment has not significantly declined, nor has the provision of social benefits increased. In fact the available data suggest that unemployment has increased from a rate of 21.2% in 1968 to 25.6% in April 1984 and that social benefits are being reduced at the same time that charges are being imposed. This would suggest that the policies tried have failed and that more imaginative solutions are now called for.

The introduction of a market system into the present artificial economic environment may result in some dislocation, ususlly structural and frictional unemployment. The former results from older and inefficient ones, while the latter results from voluntary decisions by individuals to leave existing jobs for better paying ones. However, this phenomenon is a sign that structural changes are taking place in the economy in the process of establishing a new equilibrium at a higher level of production and productivity. To offset the worst effects for those being temporarily displaced and for fixed income earners (PAYE) the P.S.O.J. recognises the need for retraining, especially with the use of new technology, and a tax credit system which would positively discriminate in favour of those affected. The retraining programme should consist of joint ventures between government and the private sector, to ensure its relevance to real demand, both immediate and future, and its cost should also be allowed as an investment tax credit to private companies. Secondly, more generous tax credits should be allowed to qualify PAYE earners to offset some of the cost effects.

These measures must, however, be viewed as a short term prescription, as the benefits of the market system in time will eliminate the need for most of these policies. The long term interests of private capital are best served if disparities within a society are not seen as a permanent feature of any group or class. Equally, the full potential of a society is realised when criteria for success and achievement are based on meritocratic principles. It is therefore incumbent on private capital to ensure that all human resources in a society are fully developed; and, with fiscal incentives, resources can be channelled into areas of social needs. The avenues by which these resources are channelled to the poor can be many, such as the church or an expansion of the food stamp programme.

9. Energy

An economic fact of life is that Jamaica is deficient in traditional energy resources, e.g., gas, oil, and coal. This however, should not be considered a permanent disadvantage, because as a nation we produce goods for which we have a comparative and in some cases absolute advantage. A number of studies have identified industries with good potential for export expansion, such as garments, food, agro-industry, furniture, and electronics and electrical products. Efforts should therefore be directed at increasing production of those goods which the country can exchange, through the international price mechanism, for resources which we ourselves do not produce and cannot competitively produce. Japan is a successful example of this strategy.

Fiscal incentives should, however, be given to the private sector companies and individuals, to encourage the introduction of energy saving techniques such as solar energy and the production of local energy saving devices. In addition, private companies should be allowed to generate electricity for their own consumption and sell any surplus to the Jamaica Public Service Company for use in the national grid.

10. Management

It is a self-evident precondition of a market economy that recruitment to decision making positions must be in an open, objective, and competitive environment. Any other method of recruitment is self defeating. One of the greatest weaknesses in recruitment policies and therefore management of the public sector and to a lesser extent the private sector is the patronage structure, which operates, offensively in some instances, against the long term interests of the economy. A market economy must be complemented by a meritocratic recruitment structure which rewards success and punishes failure. The government, in its recruitment policy, tends to attach non-objective criteria to appointments, resulting in the retardation of real growth in the public sector and, consequently, the proliferation of mediocrity. Thus, until the government divests itself of those entities, their full economic potential and benefit to society will not be realised.

Conclusion

The government must put confidence in the private sector and the society by creating the environment conducive to enterprise, risk-taking, and reward, so that private businesses, local and foreign, will invest and develop the society. It is difficult to determine who should make the first move, given our history of mistrust between the government and the private sector; but the future of our country and our institutions is at stake and must not be the subject of a Mexican stand-off. In proposing these reforms we are confident that, given the necessary commitment by government and the private sector, they offer the best opportunity for real and long-term sustained growth of the economy. These proposals cannot succeed unless the people display confidence in the society by re-investing profits in their local businesses, as opposed to expatriating them to some assumed safe haven abroad.

The private sector, for its part, is therefore publicly making the commitment to the above programme by indicating its readiness to discuss with the government the global impact of the measures on the economy and the country, and specifically the private sector's increased investment and production schedule, given the adoption of this programme.


ENJOYMENT begins with EIGHT.
WRAY & NEPHEW
8
TROPICAL YEARS
Jamaican Rum
WRAY & NEPHEW
8
TROPICAL YEARS
Jamaican Rum
Wray & Nephew's
8
A rare rum of great distinction
PERFECTION.

Appendix

EXAMPLE OF SUBSTITUTION OF AN EXPORT INDUSTRY FOR AN IMPORT-SUBSTITUTION INDUSTRY

Assume that there is an import-substitution industry which produces a single product (x) at a selling price of $25 per unit. It employs 10 units of labour for every 1000 units produced. In the absence of imports, assume that consumers buy 100,000 units annually. Total expenditure is therefore $2,500,000, and total employment is 1000. Assume further that the import content of this industry is 40 percent, so that the import bill is $1,000,000.

Assume that the price of the imported product that competes with this industry is $20. Assume that domestic firms producing 50 percent of domestic output can meet this price and survive; the rest go out of business. If consumers still spend the same total amount of money on product X, they will buy 50,000 units from local producers at $20; this will cost $1,000,000. They will spend the remaining $1,500,000 on the imported product, buying 75,000 units. Total consumption is now 125,000 units instead of 100,000.

Let us assume that the resources formerly employed by industry X, including 500 units of labour, are diverted to industry Y (an export industry). The price of its product is $20, and its import content is 50 percent. If, with industry X's unused resources, industry Y is able to produce 200,000 units of product, total foreign exchange earnings will be $4,000,000. Foreign exchange payments would then be:

Local industry X (40% of $1,000,000)	$ 400,000
Finished goods imports	1,500,000
Export industry Y (50% of $4,000,000)	2,000,000
Total	$3,900,000

In this case, there is an increase in net foreign exchange earnings (+$100,000 vs. –$1,000,000) and an increase in the standard of living. Total physical consumption has increased for the same expenditure of money and the same use of real resources.

This case assumed that labour productivity was 4 times as high in the export industry (Y) as in the import-competing industry (X).

500 units of labour produce:
200,000 units of output in industry Y
50,000 units of output in industry X

The result of this assumption was exceedingly favourable for net foreign exchange earnings. To be **no worse off** than before in terms of net foreign exchange earnings, i.e., to have a net import bill of $1,000,000 both before and after, output of industry Y would only have to be 90,000. That is, productivity of labour in industry Y would only have to be 9/5 of that in industry X, in our example, for net foreign exchange receipts to be the same before and after adjustment. In terms of real world industries, this is not an unrealistic or unattainable figure.

Foreign exchange payments would be:

Local industry X (40% of $1,000,000)	$ 400,000
Finished goods imports	1,500,000
Export industry Y (50% of $1,800,000)	900,000
Total	$2,800,000

Foreign exchange earnings would be:	
90,000 units @ $20	$1,800,000

500 units of labour produce:
90,000 units of output in industry Y
50,000 units of output in industry X

As in the first case, the standard of living is higher; this results from transferring resources from the lower productivity industry to the higher productivity industry, even though, in this example, local consumers do not consume any of the output of the higher productivity industry.

Glossary

Balance of Payments:

(1) As an accounting statement, it is a list of all payments made to foreigners by Jamaicans and all receipts received from foreigners by Jamaicans. The statement is generally divided into three parts: A. The **current account**, which includes all transactions in goods and services and all gifts; B. the **capital account** , which includes all loans and transactions in financial assets and liabilities; and C the **reserve account**, which includes the changes in all the assets or liabilities owned or owed by Jamaican government entities that are internationally acceptable by governments in settlement of claims.

(2) As a measure of the net effect of our dealings with the rest of the world, we can speak of a "surplus" or "deficit" in the balance of payments. The balance of payments surplus or deficit is defined as the net change in assets minus liabilities recorded in the **reserve account** (C above). This net change is, in turn, equal to the difference between the balance on **current account** (A) and the balance on **capital account** (B).

Balance of Trade:

The difference between exports and imports of merchandise, valued "F.O.B.", i.e., not including ocean freight and insurance from the port of export.

Exchange control:

A system of laws and regulations designed to limit the uses to which spendable claims on foreigners may be put, the prices that may be charged for them, and the amount of such claims any citizen is entitled to buy or possess. There is no reason to have exchange control unless the supply of claims on foreigners is chronically insufficient to meet the demand for them. This, in turn, occurs because the Official "exchange rate, i.e., the ceiling price that may lawfully be paid in local currency for spendable claims on foreigners, is too low to persuade holders to part with them. In such a case, the local currency is said to be "over-valued".

Free foreign exchange market:

A legal environment which permits anyone to hold, sell, or buy spendable claims on foreigners at whatever price in local currency he chooses. Unlike a system of exchange control, an earner of foreign exchange (spendable claims on foreigners) is not required to sell it to the government or the central bank. In most countries, the price of spendable claims on foreigners (the exchange rate) is established very much like the price of potatoes or company shares, that is, in an organised but uncontrolled market. The principal traders in such a market are the major banks, who maintain constant contact with one another by telephone. As demand rises or falls relative to supply, prices of (foreign currencies in terms of the local currency) rise or fall, perhaps at times minute by minute. Governments may at times intervene in such a market for the purpose of either causing or preventing a change in exchange rates, by offering to sell or to buy foreign currencies. Until 1971, most of the principal world trading nations' governments maintained a practice of almost constant intervention to prevent any but very small exchange rate changes. Since 1973, those nations have only intervened sporadically, allowing their currencies to "float" most of the time.

Indirect taxation:

A system of taxation in which the point at which the tax is levied differs from the point from which the funds to pay the tax are derived. Examples of indirect taxes are tariffs, sales tax, liquor taxes, and so on The seller of the taxed item is typically charged with duty of collecting the tax, but is expected to shift it to the buyer by raising the price. A direct tax, on the other hand, is one that is levied on such things as income or profits. Presumably, a tax on profits (for example) is paid only if there is a profit, and there is no way to shift the burden of the tax to anyone else. In practice, the distinction, as to the ability to shift the burden of taxation, is not so clear-cut as this implies. Indirect taxes cannot always be totally shifted to the ultimate buyer because of sales resistance, and an unduly heavy level of direct taxation may make individuals or businesses hesitate to undertake risky projects to increase returns that will be almost totally confiscated.

Printed by THE HERALD LTD., 43 East Street, Kingston.