ECONOMIC ANALYSIS AND PUBLIC POLICY

IV

WHY THE JCTC SHOULD BE DISMANTLED

PREPARED AND PUBLISHED BY

THE PRIVATE SECTOR ORGANISATION OF JAMAICA

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Preface

This publication sets out the PSOJ's case for dismantling the Jamaica Commodity Trading Company. The paper has gone through a long period of gestation and has been circulated in various drafts to many persons on both sides of the issue. The subject of state ownership and control of economic activity has stirred a great deal of debate in the past, and doubtless will generate more as time passes. The case made here, we think, is both convincing and consistent with a free market alternative to the statist ideas which have traditionally dominated economic policy in Jamaica.

That those ideas have failed is abundantly clear. What is required is a new consensus around market-driven policies. Since 1985 the PSOJ has been documenting its ideas in a series of policy papers, of which this is the latest. Many of these ideas once seemed outrageously novel but have become the stuff of everyday discussion. We hope this paper will push the general debate forward.

I want to thank the members of staff in the Economic and Communications divisions of the PSOJ secretariat for the research, writing and editing of this paper, and the members of the PSOJ Economic Policy Committee who supervised its gestation. Our gratitude also to other persons who by their comments and criticisms forced us to review assumptions and re-check statements.

P. J. C. Thwaites
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Foreword

Though there have been several marketing boards for farm products, historically, the government had little or no direct involvement in the importation of goods. Even imports for government institutions were normally handled by private firms. The enlarged concept of state trading was predicated upon the assumption that government would allocate resources more efficiently and fairly since it would be acting in the "national interest" which was presumed to be separate from, and necessarily opposed to, private interest.

However, after a decade of operation, Jamaica's state trading corporation (under whatever nomenclature) does not provide any clear evidence of beneficial effects on the Jamaican economy; in fact, in several areas the effects have been negative.

The PSOJ is therefore of the view that the dismantling of the Jamaica Commodity Trading Company (JCTC) would be a powerful aid in resolving the distortions in our import policy structure. This in turn, if synchronized with other policies, would be a stimulus to investment and more efficient resource allocation.

In the development of this paper, several meetings were held with the current management of the JCTC and two past chief executives in order to clarify specific issues as they related to the role and functions of the JCTC.

These discussions were open and frank and special thanks must be given to the Managing Director of JCTC. However, discussions were constrained by the inability to obtain specific information from the Ministry of Industry and Commerce.

Delroy F. Lindsay
Executive Director
December 28, 1989
THE PRIVATE SECTOR ORGANISATION OF JAMAICA

1. Background

Government marketing boards for agricultural exports have long been a feature (largely unsuccessful) of the Jamaican economy, but it is only in comparatively recent times that the state has taken on large-scale importation of commodities. Jamaica Nutrition Holdings (JNH) was set up to import bulk supplies of food staples, and within three years the government expanded its role with the establishment of the Jamaica State Trading Company in 1977. JSTC thus became a major instrument in the policy of the time which was that government should play the dominant role in a mixed economy. The assumption was that government would allocate resources more efficiently and fairly than the private sector since it would be acting in the national interest - which was presumed to be separate from, and necessarily opposed to, private interests.

The organization initially was responsible for the importation of all commodities defined by the then government as critical to the national interest. Four subsidiaries were subsumed under the holding company:

- Jamaica State Trading Company (JSTC) which was responsible for the importation of food staples;
- Jamaica Building Materials (JBM) which was responsible for the importation of lumber and some other building materials;
- Jamaica Pharmacueticals and Equipment Supplies (JPES) which was responsible for the importation of all ethical pharmacueticals, all equipment for use in the public sector, all raw materials for the manufacture of pharmacueticals and all fertilizers.
- Jamaica Textile Imports which was intended to take over the importation of cotton, greige in all forms, synthetic yarns and leather for the footwear industry. However, this subsidiary was never operationalized.

The JSTC was seen as the major instrument for rationalizing the country's import programme to meet the official objective of providing basic commodities to the nation at the lowest possible prices and foreign exchange cost.

In 1981, after about five years of operation, and with the advent of a new government, the board of the JSTC conducted a review of the Group's activities. The review exercise assumed the continued existence of a state trading company but was to:

- limit trade activities to the importation of basic food, livestock feed, raw materials, basic construction materials and ethical pharmaceuticals; and the implementation of special government-to-government trading programmes;
- identify items in the trade portfolio which did not meet the criteria above and which, therefore, could be returned to the private sector;
- review the structure of the JSTC group to determine the most efficient form of administration.

The findings were that the JNH should retain responsibility for the importation of: basic food with the exception of pickled beef and frozen meats; lumber for construction, plywood, door skins for the manufacturing industry; and some pharmaceuticals. With regard to organization structure it was proposed that the JNH acquire the assets and liabilities of the JSTC, and subsequently the name was changed to the Jamaica Commodity Trading Company (JCTC).

In 1983 the company entered into barter arrangements with the governments of Guyana and the Soviet Union. Locally manufactured soya meal was exchanged for Guyanese rice while Jamaican bauxite and alumina were exchanged for motor vehicles. Contrary to previous operational guidelines and official policy pronouncements, the government expanded JCTC's trade portfolio and it became the sole importer of motor vehicles.

The theory and rationale of all state trading companies include the following assumptions:

I) A central purchasing authority optimizes the use of financial, human, and physical resources.

II) Government is better able to plan, use and monitor scarce foreign exchange, focussing it on "essential" imports and reducing "non-essentials".

III Bulk buying is facilitated, resulting in lower costs and the attendant economies of scale.

IV) Consumers benefit from lower prices.

V) State trading companies are able to access advantageous procurement agreements between governments - such as grants, gifts, surplus goods, and lines of credit - which are not made available to the private sector.

VI) State trading companies facilitate barter agreements between governments.

VII) They are required for handling strategic and otherwise sensitive materials.

VIII) They enable diversification of markets which may be important for political as well as economic reasons.

IX) Consumer price levels can be stabilized rather than fluctuate as the free market moves.

X) Cross-subsidies can be used to reduce the cost of items to the poor or other groups targeted by government for special concessions.

2. Economic Effects of the JCTC

Much of the above rationale may be questioned, since it takes for granted what needs to be proven. After a decade of operation, Jamaica's state trading company, under whatever nomenclature, does not provide empirical evidence of benefit to the Jamaican economy.

Monopoly Effect

The existence of this kind of state monopoly prohibits the operation of standard market economic theory to determine the effects of rational transactions. This problem is pronounced in the case of JCTC. Given the high level of subsidy, import restrictions and existing tariff structure, the private sector is not allowed to compete on an economic basis as state trading companies are shielded from market forces; that is, the power of the state and the resources of the treasury may and have been used for price discrimination and unfair competition.

The JCTC operates in a non-competitive environment. For while it does accept tenders from overseas suppliers it is under no competitive pressure in supplying the local market for those imports which it handles. The procedures which govern the purchase of these items depend primarily on the line of credit which is being used to effect the transaction and any specific procedures which apply to it. The domestic market has little or no choice in the goods handled by JCTC and notwithstanding the fact that the JCTC may consult the private distributive trade for product specifications, it is also a fact that the nation tends to get 'second best' in terms of quality, delivery and price of goods. The distributive trade has consistently complained about the quality of imported lumber, rice and salted fish.

Government-to-Government Agreements & Barter

As the government's central procurement agency for imported commodities Jamaica's state trading company has accessed a variety of lines of credit from both private and government sources. Concessionary credits have at various times been obtained from the United States, France, Switzerland, Canada, Australia, New Zealand, Holland, Venezuela and Hungary. Today, the United States and Canada are the two most important sources of trade credits.

The United States Agency for International Development (USAID) administers on behalf of the US government the PL480 Food Aid Programme Titles I and II. The Title I program is a loan facility for the purchase of corn, wheat and rice and other items.

The Title II program is monetised - that is, the sale proceeds of the imports of cheese, butter and corn are added to a Counterpart Fund which is used for approved government development projects. Items procured through these food grant programs are sold to the distributive trade and the proceeds are deposited in the Fund.

Another aspect of the Title II program allows the importation of milk powder and corn for the manufacture of nutribuns and fluid milk for children attending primary and all-age schools. This part of the program is co-ordinated by the World Food Programme. It is worth noting that PL80 commodities are available only if they are in surplus production in the United States.

The USAID has no objection to direct imports by the private sector, and precedents exist for official U.S. commodity aid to be routed directly to private sector users. For instance, the Jamaica Agricultural Development Foundation received ship-side delivery of dairy products under PL480 Title II arrangements. Proceeds from the sale of shipments help provide the capital for the JADF. The Jamaican government can therefore designate private sector organisations as the consignees for food aid and grants thus eliminating the need for the JCTC.

The Canadian government food grant is administered by the Canadian International Development Agency (CIDA). The main imports are dried codfish, fertilizers, canned sardines and a small quantity of wheat. The revenue from the sale of these items is also added to the Counterpart Fund.

Like the USAID, CIDA has no objection to directing its aid through a private sector entity. However, CIDA has indicated that they would have to be convinced by way of a government initiative that channelling the aid to a private sector entity would be in the 'national interest'. Precedents exist for official Canadian commodity aid to be routed directly to the private sector. Indeed, the importation of fertilizer, where Canada enjoys a virtual monopoly, was previously handled by the private sector.

In summary, the JCTC imports bulk commodities from North America under the PL480 and GSM102 programs and the Canadian government food grant. These are government-to-government aid programs which are used by the Jamaican government for balance-of-payments support. This is accomplished by the government using the aid or grant available under these programs to purchase agreed commodities and selling these to local producers and marketers. The aid loans have long repayment periods and low interest rates and so the local funds obtained from the sale of these commodities are used by the government for budget support. The commodities currently traded include corn, wheat, soyabeans, tallow and sardines.

These aid programs are used by the Jamaican government primarily for financial reasons; the goods are not actually given away but rather used to raise money. Consequently, the JCTC serves primarily a financial purpose. The view has been expressed that these aid programs may only be accessed by a government agency. This is incorrect, as presently these programs are being accessed by privately owned corporations in many other countries on behalf of their governments. Therefore, nothing in these agreements - whether grants, credits, monetised aid or even barter trade agreements - requires a state trading company or precludes private sector handling by way of competitive tender or other mechanism.

Recognising the usefulness to the government of the financial assistance provided by these programs, however, it is proposed that:

(a) JCTC's trading activities cease and are returned to the producers and marketers who use these commodities;

(b) A forward market mechanism be established in order to hedge against sudden changes in the exchange rate. (See Appendix II).

(c) JCTC be replaced by a financial entity, for example a department in the Bank of Jamaica or one of its subsidiaries, whose function is to administer the various programs that are negotiated as lines of credits;

(d) Government ensure the use of these lines of credit, as a priority, to purchase the commodities specified in the negotiations through the Bank of Jamaica by not allowing payments for such commodities by other means until the credits available under these programs have been fully utilised.

Cartel Effects

The JCTC has evolved into an ever-growing import monopoly in finished products or raw materials which are deemed 'basic' by the government. (For detailed listing see Appendix I). After importation, the items are sold to a select group of distributors who then resell them to wholesalers or retailers.

The allocation of goods to private sector distributors was based on their performance and market share between the years 1972-76. The first objection to this formula is that it freezes the individual market share of the existing distributors for those items exclusively imported by the JCTC. The second objection is that new entrepreneurs are prevented from entering the field. The proposal to share 15 percent of the existing distribution quota among new entrants is not a solution to the inherent problem. The government has imposed a quota cartel on the private sector in which it - the government - has the exclusive power to determine entry. This means that new entrants would be determined by political criteria and not on a competitive economic basis. The dynamic of competition is excluded by state fiat leaving relative efficiency or inefficiency of little or no consequence in market share for BOTH existing and potential distributors.

Cost Effects

The economy of bulk purchasing has been the main argument used to justify the continued existence of the JCTC. But reliability and timeliness of supply are also a function of real costs. The JCTC throughout its history has had an unsatisfactory record in this respect. This is evidenced by the periodic scarcity of items such as dried fish, milk powder, flour and canned sardines. The fact that this might have resulted from government's foreign exchange shortage is further evidence that the private sector should handle these commodities. Consumers have suffered as a result - again for the obvious reason that JCTC is a government monopoly.

In a free market the failure of one operator to satisfy consumers would soon be exploited by its competitor. It is important to note that since their release to private importers there have been no shortages in canned corned beef, canned mackerel and chicken necks & backs. Nor have prices gone up unreasonably; indeed, in some cases they have declined. Thus consumers benefit from competition among private sector firms.

The facility and cost benefits of bulk purchasing are certainly not exclusive to a government agency. On the contrary, this system may simply interpose an unnecessary 'middleman' tariff between the foreign supplier and the local user. Private companies are perfectly capable of direct importation of corn, soybean and wheat and since the products from these commodities are largely under price control, any economies from bulk purchase must be passed on to the consumer. Even without price controls (which is another issue) competition between private firms is the best guarantor of price restraint.

A system of competitive tender could be developed for public sector pharmaceuticals and the private sector should be allowed to import such pharmaceuticals as will satisfy the needs of their clientele.

Cross-Subsidies

The problem of cost is compounded by cross-subsidization which aims at price reductions for 'basic necessities'. Lower cost for some commodities are achieved through higher prices on others. The true cost to the economy of importing any commodity is distorted through cross-subsidy by government operating through JCTC.

The beneficiary of cross-subsidization is supposed to be the consumer who pays artifically low prices for imported food. The private sector has continuously disagreed with this policy as the practice not only distorts the economy in general but, more specifically, in its present form is extremely costly and inefficient. Because subsidy is applied across the board, the beneficiaries of subsidy include groups which do not need subsidy. For instance, a study done a few years ago revealed that the top 40% of income earners enjoyed $16.62 million of subsidy on edible oils and fats while the far larger group in the bottom 40% of income earners used only $3.65 million of subsidy. (See Appendix III). That large amounts of subsidised cornmeal, flour and edible oils are being consumed by people who do not need subsidy is economically and socially irrational. The impact on the most needy is diluted and resources are dissipated. Real prices are the most effective vehicle for conveying information in an economy. People are forced to make more rational decisions about buying and selling, production and consumption, and thus resources are allocated more efficiently.

To the extent that subsidies are unavoidable, the government should provide them only to persons who genuinely fall in the group identified as economically defenceless at any period. To this end, the existing programme of providing aid via food stamps should be the focus of future subsidies. Such a programme does not require a JCTC.

JCTC & Domestic Agriculture

A state trading monopoly and a policy of subsidized food imports are normally combined though not a logical necessity. In Jamaica's case the JCTC has been a ready-made instrument for political decisions which erode economic efficiency. The greatest impact has been on the agricultural sector.

Agriculture in developed countries is highly subsidized (although ceilings on farm prices are not controlled as in the case with many domestic commodities in poorer countries). Because the agricultural sector of developed countries is relatively small in their total economies, the agricultural subsidies have a similarly small effect on the efficiency of the total output of those economies. The subsidies, however, help to generate food surpluses which have no economic market but which the governments of these rich countries donate or sell at give-away prices and on extended credit terms to poor countries. This philanthrophy, whatever its stated intentions, has profoundly deleterious effects in the long term on the economies of poor countries with under-used agricultural capacity. Given extensive intersectoral linkages, the real effects of a policy of artificially cheap food are not easily grasped, while the political mileage is readily apparent, especially in the urban population.

First it should be pointed out that from a strictly financial viewpoint, it seems perverse to use credit for periods up to 20 years to finance imports which are generally consumed within six weeks. Extended credit should be used to finance capital imports which can generate value over an extended period.

Food aid to Jamaica may be described as economic colonialism. Subsidized imported food, which may be further subsidized through JCTC, is in effect a tax on domestic agriculture. The unequal competition of large-scale subsidised foreign food chronically depresses returns to the nation's farming sector. This inhibits investment which would upgrade technology and output in the sector, which in turn retards the development of agro-industry and general services in rural areas. By extension, the short-term advantage of cheap imported food to the urban population conceals the cost to the entire economy which loses employment potential, economic growth and balanced development.

Thus, the JCTC has in fact become a political instrument which helps to perpetuate the underdevelopment of Jamaica's agricultural sector and foreign dependency in the economy as a whole. •

Summary and Conclusion

3.

- Jamaica has had 10 years to test the rationale for a state trading apparatus which, under changing nomenclature, has gradually expanded its monopoly hold on various imports not because of competitive business efficiency, but by political fiat. Hence, governments have waged economic war against their own citizens and tax-payers in the private business sector.

- The state trading apparatus has not 'rationalized' imports. It has simply been a means for governments to take over what was being done by private firms before.

- The possible gains from bulk purchasing have been offset by the inefficiencies which are inevitable in any monopoly, however it is difficult to evaluate the true cost to the economy as the data necessary for qualification is not available to the public.

- The incidence of shortages, unnecessary surpluses, which imply inventory costs (e.g. 9 years supply of zinc sheets), unreliable quality and restricted choice have been increased rather than reduced by JCTC's monopoly.

- In those items released to private sector importers (e.g. canned corned beef), the competitive free market impetus has ensured consumers more reliable supply, more choice and acceptable prices.

- A state-imposed cartel for JCTC imports has been forced on to the private sector, freezing market share for those inside and prohibiting the entry of new entrepreneurs in the distributive sub-sector.

- Government-to-government grants, concessionary aid, credit and barter agreements negotiated by the Jamaican government do not require the existence of a JCTC. The shipping, delivery and distribution can be handled by the private sector by tender or other mechanism specified and supervised by the government. This was done before the advent of a state trading corporation and can be done again.

- The state trading monopoly has been an instrument for political control by way of price fixing and cross-subsidization which has distorted resource allocation and inhibited the competitive efficiency of market forces. Furthermore, the bulk of the subsidy is enjoyed by those consumers who do not need it.

- The JCTC has been in effect, if not in intent, an instrument of economic colonialism, retarding the domestic agricultural sector.

In summary, the state trading apparatus has been a significant impediment to Jamaica's economy. It is an unnecessary enlargement of the state sector - which implies greater political power over citizens, curtailment of the field for enterprise and the sphere of private decision-making - without any discernible gain to the economy or the welfare of the people. The PSOJ therefore urges that the Jamaica Commodity Trading Company be dismantled.

Appendix I

Commodities Handled by State Trading Companies

A. Imported by STC over its first five years of operations:

(i) Jamaica State Trading Company Ltd.:
Wheat, yellow corn, soya beans, skimmed milk powder, butter, milk powder, butter oil, milk feed, wet fish, rice, baking flour, chicken necks and backs, corned beef, dried salted fish, codfish, pickled fish, canned sardines, canned mackerel, pickled beef, chilled and frozen meats, any other basic food items.

(ii) Jamaica Building Materials Ltd.:
Wood and lumber, particle board, laminates, iron and steel, cement, sanitary ware.

(iii) Jamaica Textile Imports Ltd.:
Cotton, all forms of gauze, synthetic yarns, leather.

(iv) Jamaica Pharmaceutical and Equipment Supplies Ltd.:
All pharmaceuticals
All equipment for use in public sector institutions
All raw materials for pharmaceuticals manufacturing
Miscellaneous items: fertilizers, other agricultural chemicals, livestock feed raw materials, agricultural tools, newsprint for government-owned company.

B. List of Items imported by Jamaica Commodity Trading Company (JCTC):

Wheat, corn, soya meal, soya oil, milk solids, butter oil, baking flour, rice, corned beef, pigs tail, dry salted fish, pharmaceuticals, lumber for construction, pine, mahogany, plywood door skins, and motor vehicles.

Source: State Trading Corporation; Jamaica Commodity Trading Company

Appendix II

The Forward Market

How to Purchase US$ for the Future Payment for Imports

An importer wishes to purchase US$40,000 worth of raw materials. To this end, he agrees to the following terms: 40 percent cash, and 60 percent payable in 90 days from delivery. At this point, the importer can bid through the exchange auction for the US$16,000 needed for the down-payment and also places a bid in the forward market for the balance due in 90 days. What rate of exchange will the importer get? Assume the following:

- the clearing rate at the auction on the day of the bid is J$6.00 per US$;
- the interest rate available to investors in the U.S. is 10%;
- the interest rate charged on loans in Jamaica is 25% per annum.

The interest rate differential per annum is therefore 25%-10% = 15 percent. Given that the U.S. dollars are desired in 92 days, the relevant interest rate differential is given by 0.15 x (92/365) = 0.0378 or approximately 3.8%. Thus the forward rate that the importer will get is given by 6.00 x (1.0378) = 6.2268 - 6.23.

This rate is thus guaranteed, in that once the Bank of Jamaica accepts this bid, the importer is assured of receiving the US$24,000 that he needs to settle his bill on the desired date at the set rate.

Selling Foreign Exchange Credits Ahead of Time

If an exporter has granted credit to a foreign customer on a 90 day basis, what rate is he likely to obtain if he chooses to participate in the forward market and relinquish his right to receive dollars in 90 days?

Assuming the structure of interest rates above, we can further assume that the rate charged for short-term loans in the U.S. is 10.5 percent, whereas the rate available to large depositors in Jamaica is 9.5 percent or 2.38 on a quarterly basis. If the clearing rate is then received for whatever funds bid in the forward market, an exchange rate of 6.10 (i.e. 5.96 x 1.0238).

Appendix III

An Analysis of Price Control as a Subsidy Strategy

Distribution of National Household Expenditure

20% band incomes	average income	% spent on edible Oils and fats
highest 20%	$21,538	3.35-2.61%
2nd 20%	9,006	3.79-3.04%
3rd 20%	5,089	4.24%
4th 20%	2,344	4.63%
lowest 20%	1,172	4.83%

Number of households 500,000

Source: Quoted in Issues in Food Security in Jamaica O. Davies and M. Witter - March 1986 From E. Kennedy: Report Monitoring Evaluation of the Jamaica Food Stamp Program Report - 1985. Submitted to GOJ and USAID

20% band income	Total Income ($ Million)	$M spent on oils & fats	$M spent on oils only	Subsidy $M
highest	2,150	64.50	50.65	11.28
2nd	899	30.57	24.00	5.34
3rd	508	21.34	16.75	3.73
4th	234	10.76	10.76	2.40
lowest	117	5.62	5.62	1.25
Total	3,908	132.78	107.78	24.00

Notes:

1. Amount spent on oil: 12,000 tons @$4.49/lb. $107,760 thousand/yr
   Amount spent on fat: 5,000 tons @$2.50/lb. $ 25,000 thousand/yr
   Total expenditure on oils and fats: $132,760 thousand/yr

2. Assuming the two lowest income groups cannot afford fats, the average weekly expenditure on oil is $2.07 and $1.08 respectively.

Conclusion:

1. 69% or $16.63 million of the subsidy is spent on 40% of the households which are in the two highest income groups.

2. If this subsidy was targeted directly to the 60% of households in the lower income groups:

(a) each household would get $55 more on average per annum; they now average $25 per annum;

(b) the additional cost to the higher income groups would be $2.17 and $1.03 per week for the highest and second highest earning groups respectively.