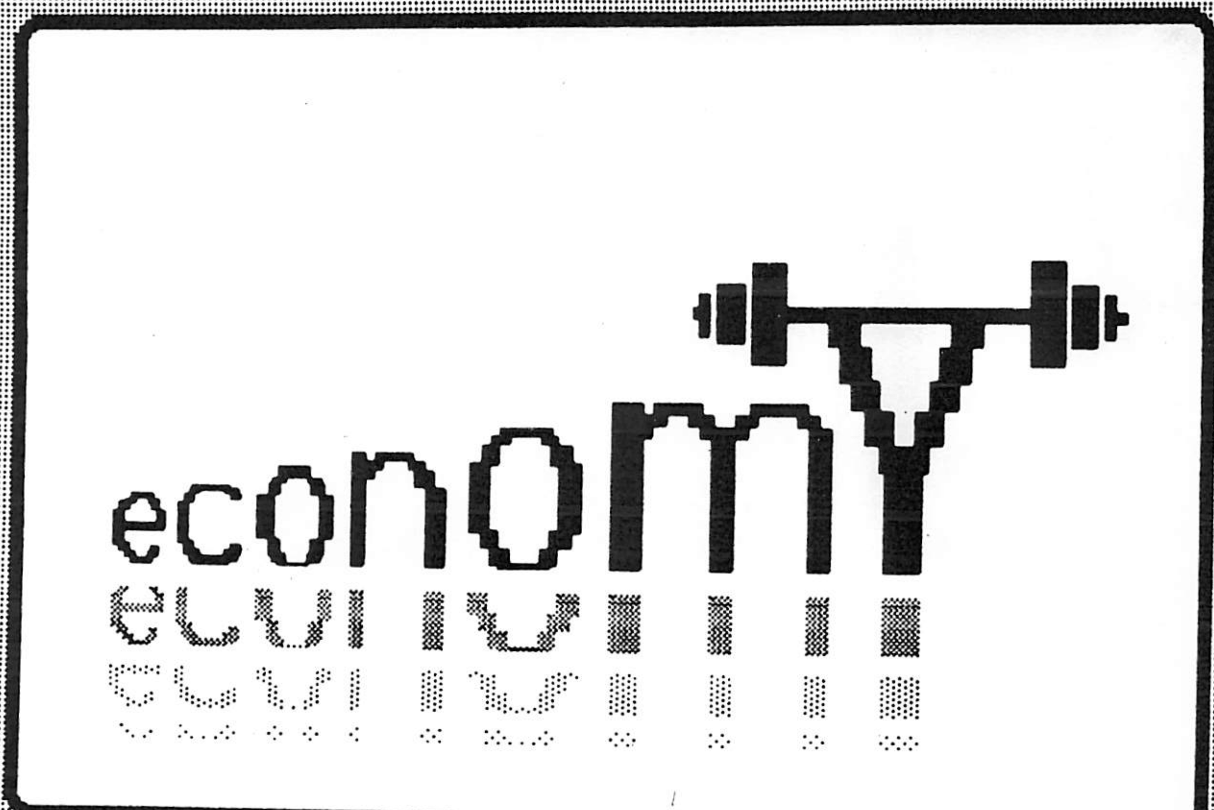
THE PRIVATE SECTOR ORGANISATION OF JAMAICA

A POLICY FRAMEWORK FOR ECONOMIC DEVELOPMENT IN JAMAICA II

A Progress Report



Free Enterprise ... and Watch Jamaica Grow

A POLICY FRAMEWORK FOR ECONOMIC DEVELOPMENT IN JAMAICA II

A Progress Report

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Contents

PREFACE

Since the writing of *A Policy Framework for Economic Development in Jamaica*, government has accelerated its economic reform programme in a number of areas. These particular initiatives are worth mentioning, because these 'structural adjustments' or 'market oriented reforms' are consistent with the major policy recommendations of this document, and because they now broaden the framework within which to assess the progress of economic reforms in Jamaica.

The most significant of these reforms relates to the almost complete removal of the exchange control regulations which took place on September 23, 1991. The change in effect established a free floating exchange rate with the rate of exchange of the Jamaican dollar being determined by the buying and selling rates of the commercial banks. Anyone is now free to hold foreign exchange in a bank inside or outside of Jamaica and there are no restrictions on individuals moving money out of the island. There is also no compulsion on any earner of foreign exchange to sell same to the Bank of Jamaica, who must now buy hard currency in the open market.

The only restrictions which exist at present are:

1. A requirement that only licensed dealers may purchase or sell foreign exchange;
2. Local financial institutions (including insurance companies and pension funds) must match their Jamaican liabilities with Jamaican assets.

In October 1991, the government introduced a value-added tax called the General Consumption Tax (GCT). This tax has been slated for implementation for some time but had been repeatedly postponed. Its introduction will go a far way in shifting the burden of taxation from production to consumption and as such will encourage the expansion of production. Despite initial uncertainty and confusion, the implementation of this new tax seems now to be proceeding fairly smoothly.

Finally, most of the remaining government subsidies have been removed and most goods and services are now reaching the market at their economic cost. This will remove many of the price distortions in the economy and this initiative forms part of government's commitment to reduce the fiscal deficit to 0.5% of GDP in the 92/93 financial year. The latter is a most worthy objective which we sincerely hope will be achieved in the time frame set out.

The majority of the work in this report was carried out under the dynamic leadership of Joseph Matalon, former chairman of the Economic Policy Committee, who was ably assisted by Joseph Cox, former Director of Economic Research and Glenford Millin, staff economist.

DELROY LINDSAY
Chairman
Economic Policy Committee
March, 1992

A Policy Framework for Economic Development

Overview

An economic system is a complex set of interrelationships: between producer and consumer, tax collector and income earner, importer and domestic producer, and among all business firms competing for productive resources and markets. Any action by any of the participants in the economy has repercussions far beyond the immediate impact of that action. It is therefore essential for government action to be consistent, not only from one time period to the next, but as among policies in various spheres. Regulation on the importation of foreign goods should not handicap the production of goods for export, for example. It should be obvious that policies designed for a specific case cannot be implemented without considering the implications elsewhere; they must be consistent and inter-related at the broadest and narrowest levels. To concentrate on demand management, to take another example, without sufficient attention to the supply side of the economy may exacerbate rather than solve the structural problems of the economy.

This document sets out a philosophical approach to policy reform. It recommends the free market system – which we believe to be the best economic framework and strategy for Jamaica. The following encapsulates the major policy recommendations:

1. A market determined exchange rate regime to facilitate international competitiveness and thereby encourage growth in exports.
2. Speedy reduction of the overall fiscal deficit.
3. A monetary policy designed to curb inflation while allowing for adequate liquidity for private sector growth.
4. Liberalization of the trade and tariff regime and removal of disincentives to exporting.
5. Continued progress in deregulation of economic activities and minimization of administrative procedures for new investments as well as existing enterprises.
6. The preceding will permit a gradual relaxation of exchange regulations. As the distortions and disincentives are removed, the economy will become increasingly responsive to price signals thereby assuring a stable rate of exchange with minimum intervention. This will create the conditions for the final act of liberalization – the abolition of exchange controls.

Introduction

Over the past 15 years at least, the Jamaican economy has been subjected to several attempts at stabilisation. Stabilisation policies are intended to produce steady economic growth. They are concerned with preventing violent swings in economic activity by correcting internal (budgetary imbalances) and external (current account imbalances) disequilibria. Hence, stabilization policies are essentially concerned with the *short* run as distinct from the *long*. Attempts to smooth out the trade cycle, however, often entail some compromise between the government's social and economic policies. The inappropriate weight given to social policies over economic mobility has been a feature of Jamaica and much of the Third World for the last two decades and is therefore responsible for much of the poverty in these countries.

This is an attempt to update and clarify the PSOJ's prescriptions for the effective economic development of Jamaica. In 1985 the PSOJ published a document, **'A Policy Framework for Economic Development in Jamaica'** which outlined the organization's basic economic prescription in a coherent philosophical framework of free market concepts. Several of these ideas have been adopted by government, and deregulatory and other measures have been implemented. The implementation of these measures have been piecemeal, however, which has tended to reinforce the distortions already existing in the economy. Given the government's apparent receptiveness to new thinking, the PSOJ has attempted in this revised edition of its policy framework to take into account the positive developments which have taken place since the original publication.

Since 1985 the PSOJ has published several other policy papers on narrower matters such as Foreign Trade and Exchange Rate. This revised edition takes into account some of the details which were unearthed from the sectoral papers. Over the same period changes in the international environment have seen a general disintegration of communist societies and a substantial rejection of the policies typical of centrally planned economies. The logical corollary is renewed interest in free market policies and the ideas of classical liberalism. This is the background against which the PSOJ's policy framework is updated in this document.

External Trade Policy

Jamaica is primarily a trading country. Contrary to autarkic views of self-sufficiency with which we have flirted in the past, trade offers the most practicable avenue out of the country's economic dilemma. The more we can earn from what is exported (or from efficient import substitution) the less we will have to curtail expenditure to maintain equilibrium with earnings. We must embrace the idea of international trade whole-heartedly and fearlessly, accepting that there will be setbacks but determined to master its challenges.

The urgent task is to increase our exports sufficiently to reduce our dependence on foreign loans and gifts. 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 courage 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 cooperation and ingenuity of government agencies to provide incentives for exports or, more important, the removal of *disincentives,* the removal of bureaucratic barriers and delays, and increased freedom for private initiative.

The imbalances on the internal and external accounts which have marked Jamaica's economy for so long typically manifested themselves in both fiscal and current accounts deficit. The disequilibria were triggered by inappropriate redistributionist policies which facilitated an unsustainable standard of living bolstered by excessive foreign and domestic borrowings, but unmatched by any production or productivity increases.

Attempts at stabilization were intended to eliminate or reduce the imbalance between aggregate demand and aggregate supply, both externally and internally, but it has become increasingly clear that this imbalance is often accompanied or caused by distortions in relative prices and other structural adjustment is simple: it means improving the efficiency of resource allocation in an economy so that productivity and output can both rise. This involves measures such as a market-determined exchange rate, removal of artificial price and wage distortions in product and factor markets, other deregulatory measures and trade liberalization – all measures to improve economic responsiveness and efficiency. A necessary corollary of this process would be a reduction of the size of the public sector in the economy, and an increase in its efficiency.

BALANCE-OF-PAYMENTS

A fundamental 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. Our basic problem at present is a perennial balance-of-payments deficit. A balance-of-payments deficit means that the reserves of the central bank are being depleted or its foreign indebtedness is rising. Over the past 18 years we have tried to increase our earnings of foreign exchange, we have had our foreign debt payments rescheduled, we have been involved in debt-equity swaps and currently there is a strong lobby for debt-forgiveness. The long-term solution, however, is to increase exports, but this is being hampered by an over-emphasis on short-term stabilization without compensating long-term policies which facilitate increased investment inflows and a more favourable business environment.

BALANCE-OF-PAYMENTS DIFFICULTIES

In principle, a country experiencing internal inflation could live within its budget constraints either by permitting its exchange rate to float or by strictly rationing available foreign exchange by some administrative system. The latter technique would, of course, entail the distortion costs associated with disparities between the domestic marginal rate of transformation in production and the marginal rate of transformation through trade.

In practice, however, few governments which have experienced consistent inflation have fully adopted either policy. Even when exchange controls, price and wage controls, and import-licensing systems are in place, the nominal exchange rate is often adjusted too little and too late, and excess demand for goods is satisfied partially by imports financed by running down reserves or borrowing from abroad.

As debt service obligations increase while foreign exchange earnings stagnate or decline, commercial and bi-lateral lenders are increasingly reluctant to extend further credit; thus the economy's ability to finance its import requirements become seriously impaired, often leading to IMF loans and their accompanying conditions. Substantial debt-servicing obligations in themselves confound the process of adjustment, because meeting the debt obligations invariably requires large expenditure cuts in the short term.

IMPORT POLICY

Reduced expenditure in Jamaica has been associated with quantitative restrictions (QRs) and licences in order to restrain import levels. However because of the import dependent nature of the Jamaica economy, quantitative restrictions and licences have resulted in the reduction of both imports and exports below the level and share of GNP that would prevail in the absence of the distortions. It should be stressed that there are import-competing industries that would have no difficulty retaining their domestic markets after all protective measures are removed. Indeed, some of them under the changed system could become exporters.

It is sometimes argued that a country is unable to develop export industries until those industries have a strong domestic base which must be assured by protecting the industries from foreign competition through the use of tariffs, quotas, etc. This belief may derive from the observation that a number of firms in the industrialized countries first became large and profitable in their domestic markets and only later branched out into international trade. The international business of many American firms, for instance, is a relatively small part of their total activity, and may seem to be the most dispensable part. However, what is true of these firms is certainly not true of a large number of European businesses (e.g., the Philips company, based in the Netherlands), or of the exporting firms of Japan, Hong Kong, Singapore and Taiwan. Nor, for that matter, is it true of all U.S. companies. I.T.T. for example, does most of its business abroad.

In any case, the reason that most U.S. firms have developed the domestic market first is that the United States provides the largest free trade area in the world, and thus permits the exploitation of the advantages of large scale production. In the very nature of things, countries such as Belgium, Holland, Singapore and Hong Kong cannot provide large internal markets and are forced to plunge into foreign trade in order to develop markets of the size needed to realise the economies of scale. Clearly, Jamaica is in the same position.

An alternative interpretation of the argument is that the marketing of a product abroad, particularly in the large, competitive markets of Europe and the U.S., requires a large investment of funds which only a firm with a secure financial home base can provide. Certainly the penetration of foreign markets may require a considerable investment, and the firmer the financial footing of the company the more likely it will be able to find the necessary funds. But it does not follow from this that a company that requires protection from foreign competitors at home is likely, simply because this protection makes the company profitable, to find and exploit markets for exports. The fact that it requires protection is **prima facie** evidence that it will not be able to sell its products abroad. In any case, financial security is more likely to be a **result** of commercial success than to be a cause of it.

EXPORT POLICY

Jamaica cannot develop by pursuing contractionary economic policies, because while these policies in the short term can result in temporary balance-of-payment equilibrium, unless foreign exchange earnings are expanded the economy will have to operate at a reduced level. Trade therefore represents the only avenue for any economy to grow and the imperative is the greater for import-dependent economies such as Jamaica. As is now well known, several resource-poor Asian countries have enjoyed exceptional economic growth by expanding exports. Among the five Asian "Tigers" or "Dragons" – (Japan plus Taiwan, Hong Kong, South Korea and Singapore) average real economic growth was at least 7 percent per capita for more than two decades. By the 1970s, *exports* grew at annual rates ranging from 5 percent to an astonishing 29 percent in South Korea. A number of similarities are clearly discernible in the economic strategies of the Asian "Tigers".

First, their economies were overwhelmingly privately-owned rather than state-owned. Second, their governments adopted outward-looking, export-led policies as against inward-looking, import-substituting, autarkic policies. Unlike huge countries such as China, India and the Soviet Union the "Tigers" never entertained illusions about self-sufficiency. Third, they kept effective tax rates low whatever the nominal rates may have been. Fourth, they never allowed their currencies to be overvalued against the US dollar and other international currencies. On the contrary, their currencies were chronically undervalued until recently, when their consistent trade surpluses led to pressure from the United States to revalue. Fifth, they all kept a tight rein on public expenditure, with cautious fiscal and monetary policies. Inter alia, inflation was kept low and interest rates on savings were kept positive. There was comparatively little government interference with prices except for those governments which actively promoted exports by incentives.

While the Asian "Tigers" stuck to broadly similar strategies they changed tactics with the utmost flexibility in response to changing comparative advantage. They employed different production methods (in particular, capital deepening) and shifted products (e.g. allowing their textile industries to decline) thereby freeing labour for use in other sectors. It is not being claimed that the strategies of the newly industrialized countries of East Asia were identical in every particular way. Singapore and South Korea, for instance, have had interventionist governments which have actively sought foreign investment in the first case and vigorously promoted particular export sectors in the other.

'Export Promotion' means that the country seeks to increase exports by deliberately stimulating chosen sectors through direct government action such as building an export processing zone, supporting R&D in particular products, or by targeting fiscal policy (e.g. tax credits and protection against foreign competition). Export promotion does not leave resource allocation decisions to the private sector. The government intervenes with the active targeting of export activities and employing measures such as protective tariffs, input subsidies, credit rationing, or tax breaks for certain export activities. Given its history of unsuccessful intervention, however, the Jamaican government, we believe, should favour market solutions for our export drive wherever possible.

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. 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 foreign exchange earnings from exports than the additional foreign exchange we spend on imports. 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.

We recognize that Jamaican manufacturers and farmers sometimes find themselves at a competitive disadvantage compared to foreign producers through no lack of efficiency in the operations under their control. Such disadvantages may result from much higher freight rates for imported inputs than other countries 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 dramatic sales prices could seriously damage a Jamaican industry. For every such problem, however, we believe that there are better ways than protectionism to handle the situation once the market is allowed to work. The solution to high energy costs, for example, is, first and foremost, increased efficiency in the production and distribution of electricity and refinery products. Secondly, rate structures should encourage conservation, and household energy use ought not to be subsidized by commercial users – as has been the case in Jamaica.

INVESTMENT AND CAPITAL FLOWS

An environment which will stimulate investment and encourage net capital flows is a complex mix of objective and psychological factors. Despite the divestment and deregulatory moves by successive administrations since 1986 there remains a strong anti-market and even anti-business culture in the state bureaucracy. Only accelerated deregulation and simultaneous reduction of the bureaucratic structure can significantly affect the lack of confidence which persists. Wage and price controls and subsidies will have to be removed and the price mechanism be allowed to work. The key price is the exchange rate, which must be allowed greater freedom than hitherto to respond to market forces within a framework of consistent and responsible monetary and fiscal policies. This must be done in tandem with a properly deregulated financial market and changes in the tax laws which would encourage equity financing as a real alternative to debt financing. This should be complemented by a careful reform of the securities and exchange laws so as to minimise abuses in the stock market. The steady reduction and eventual removal of exchange controls will be both a result and a cause of confidence.

If all the above reforms are implemented, increased investment – both foreign and local – will result and, coupled with a free flow of capital, will allow the private financing of major capital projects, the absence of which in the recent past has been used as an argument for state intervention in the economy.

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 high tariffs and quantitative restrictions. While encouraging Jamaicans to buy imported goods, the pegged exchange rate discouraged Jamaican exports.

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 very nearly 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 rate that will equate demand for and supply of foreign currencies will be reasonably stable and will not fluctuate wildly.

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 and that in itself would cause the very devaluation every one feared. There are two things to be said about this argument.

First, it should be noted that 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.

The second point is that 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, the United States in 1973 and Bolivia in 1985. 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, which virtually guarantees that the experiment will fail.

No one would argue that it is undesirable 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 amortization payments on government's previously incurred foreign debt. Under these circumstances, the foreign exchange market, however organised, has been starved. 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 businessman to mount any serious export effort. In the circumstances, a further rescheduling of 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 important 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. 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 regime represents a considerable advance in the evolution toward a more rational ordering of economic relations with the rest of the world; and the use of a forward market by commercial banks offers exporters and importers a means of insuring themselves against losses due to exchange rate fluctuations. The current regime, while being recognized as an important first step, still does not reflect a truly market determined rate. Supply is still heavily influenced by the central bank.* Therefore, the current regime suffers from the same major inadequacy identified with the previous auction system, and that is, the exchange rate is determined by a very thin market. Rather than a system in which government takes what foreign exchange it "needs" and leaves the remainder for the market.

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. The 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.

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*The BOJ takes the lion's share of receipts from traditional exports and tourism, and, of the remaining foreign exchange available in the Commercial banks, it takes between a quarter and a half. In each case it pays below market selling rates. In this situation a firm may be obliged to sell its foreign earnings to the government below market rate and later find that it has the buy foreign exchange at a higher price than it received earlier.

EXCHANGE CONTROL LIBERALIZATION

INTRODUCTION

Broad macro-economic policies, notably exchange rate and domestic interest rate policies, and increasing regulatory powers by the monetary and fiscal authorities have encouraged substantial outflows from Jamaica between 1970 and 1986. These foreign exchange losses have undoubtedly retarded economic growth, net saving and investment.

Throughout this period, exchange control and the perception by the public of an overvalued exchange rate have created conditions for anticipated devaluations and therefore provided strong incentives for a reduction of asset holdings in domestic currency. Negative real interest rates,* coupled with positive real interest rates and other pull factors in foreign currencies – mainly the U.S.A. – have also contributed to the process of capital flight.

History shows that intervention designed to thwart the market only generates tension and heightens expectations of increasing levels of control in other areas of the economy. This is clearly not conducive to the creation of a healthy economic environment capable of attracting foreign savings and investment. We must remove foreign exchange controls and guarantee capital repatriation as a first step in stimulating growth and investment in this country. The rationale for this can be substantiated by evaluating the experience of other developing countries with capital flight and exchange control.

*Even where domestic inflation is below nominal deposit rate, tax (which is deducted at source) renders the return to ordinary savers negative in real terms.

Internal
Fiscal Policy

Macroeconomic stability, business confidence and an increase in gross domestic investment are the main pre-requisites for sustained growth and development in the Jamaican economy. Generally, the policies that are necessary to bring this about have not been implemented by successive governments, even though there is no great mystery about what is required:

- tight control and even elimination of the budget deficit,
- non-inflationary monetary policies.

General financial indiscipline and obstinate refusal to follow these principles have been typical of the main actors in the public sector – namely, ministries and departments of central government, the local government authorities, statutory bodies and state enterprises. This fundamental failure has greatly aggravated the fiscal deficit and promoted substantial government borrowing, which has resulted in massive net internal and external debt.

The problem of deficit and debt began in the 1970s with a significant increase in the size and scope of the public sector. This expansion included several statutory bodies and public enterprises which replaced or competed with private sector economic activities. Since then the public sector has created major disincentives in the Jamaican economy[1] a fact which many analysts, domestic and foreign, have noted. a joint IMF/World Bank/USAID (the Tripartite) Mission which reviewed the Jamaican economy between January 26 and April 23, 1986, criticized the then government for allowing the state to remain as the dominant force in the economy. It concluded that "there remains substantial government involvement in, and control of, economic activity, and the structure of incentives is still complex and even haphazard." It also criticized the "various marketing monopolies for agricultural products . . . the government-owned trading corporation" and the overall behaviour of the state in the economy.[2]

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1 [Up to 1985], "the government owned 75 percent of the sugar industry, 60 percent of the tourism sector, all bauxite lands, the telephone company, the national railway, the national airline, the largest commercial bank, the only cement company, and the only oil refinery – purchased from ESSO in 1982. There were also 48 government ministries and departments, 230 statutory bodies, and over 200 public enterprises. Although the total number of public entities had declined somewhat since the PNP administration (1974-80) there were still 534 in existence. The Tripartite Mission recommended that the Seaga government carry out its promised program of free market-oriented structural reform, including privatization and currency devaluation" – Timothy Ashby (1990), **Missed Opportunities – The Rise and Fall of Jamaica's Edward Seaga,** Hudson Institute.

2. **Ibid**

DESCRIPTION OF JAMAICA'S FISCAL DILEMMA

The above conclusions are substantiated by the fact that from the 1970's, the government's expenditure has consistently exceeded its tax revenue. This trend has continued into the 1980s and, as Tables 1 & 2 show, the average difference between expenditure and revenue for the periods 1980/81 to 1983/84 and 1985/86 to 1986/89 was 13.8 percent. This uncontrolled public expenditure was financed by high annual internal debts. The fiscal years 1976/77 and 1983/84 are outstanding for record high deficits. The best evidence of this dilemma is reflected by the country's net internal debt (table 3), which averaged J$623.9m between 1971–1978 and increased by over 500% to J$4,088.5m between 1979 and 1986. A more balanced analysis can be obtained by using a conservative estimate of the percentage annual yield from government securities for short-term loans as a proxy for how much government pays out in debt-servicing. This appears in column 3 of Table 3, and it shows that the income to financial investors averaged J$58.0m between 1971–1978 and increased drastically by over J$600m in the 1980s. It should be noted that the rate of growth in internal debt servicing is more than twice the rate of increase in internal debt. On a point-by-point basis from 1971 to 1978, the debt service had moved from over $58m to over $665m.

An average of 78.1 percent of Jamaica's internal debt is financed by Local Registered Stock (LRS). Although the issue of these instruments (predominantly long-term in nature – about 25 years) has ceased since 1986, debt payments have to be maintained.[3] Further government reliance on demand management strategies to regulate the money supply in the economy partly through the issue of Certificates of Deposits (CDs) since 1985 has resulted in increasing interest payments. This is indeed an excess burden on the citizens of this country, since it is their tax-payments which financed the interest payments of money derived from the issue of CDs which lie idle at the Central Bank. Worse, interest payment for the issue of CDs is being financed largely through increasing taxation.

The empirical evidence is overwhelming to substantiate the causal link between excessive public expenditure and increasing budget deficit and debt. The high level of Jamaica's deficit and the related internal debt will constrain the performance of the economy over the years ahead. Excessive public expenditure – and the resultant debt burden – has not proven to be beneficial to the Jamaican economy. It is, in fact, associated with just the opposite: deteriorating public service and economic crises.[4]

The relationship between the overall budget deficit and other economic variables has long been the subject of debates. It is often argued that deficits

1. are inflationary;
2. help in the recovery from recessions and natural disasters;
3. shift the composition of output away from investment and net exports;
4. raise interest rates.

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3 On May 13, 1990, government advertised a prospectus for variable rate Local Registered Stock 2000. This loan is being raised to finance capital expenditure on projects for agricultural and industrial development, the improvement of transport and communications, construction of housing and other public works.

4 Dr. Derrick Boyd (1990), The Internal Debt, **Enterprise**, Vol. 7 PSOJ

While these arguments cannot be fully discussed here, some of the more relevant points will be outlined.

Economic theory shows that when an economy is not at full employment, as is the case with the Jamaican economy, increased public spending or tax reduction can produce some stimulus in aggregate demand and income through multiplier effects. The experience of the Jamaican economy, however, is that excessive public expenditure doesn't produce these desirable effects. Instead deficits are likely to cause high interest rates both directly through government borrowing in credit markets, and indirectly through uncertainty over likely economic effects, from state intervention. The cumulative effect of continuing large deficits translates into larger and larger interest cost. This was substantiated earlier by the more than 500% increase in debt service over an eight-year period.

The standard textbook model in macroeconomics which holds that a tax cut or an increase in government spending leads to increases in national income (GDP) through the so-called multiplier effect does not always work that way. The argument maintains that "either the extra government spending or the extra private spending from a tax cut would work its way through the economy, with a large fraction being continually re-spent until the ultimate impact was much larger than the original change in government spending or taxes."[5]

While this neo-Keynesian orthodoxy may be applied in some situations, one must be critical in evaluating the potential impact on aggregate demand of an increase in government spending and of the impact of tax reductions for constant levels of government spending.

Apart from the slight change shown in GDP (Table 1), which is not a significant casual effect of increased expenditure, the tendency is for an increase in deficit to bring about a rise in interest rates, and interest-sensitive activities such as private investment and net exports may be curtailed. Within this context it is also important to note that there are established functional relationships between the level of taxation on the one hand and the type of taxes levied, and on the other, key economic variables that influence economic growth.

Evidence from a World Bank study of 20 countries' experience with growth and taxation suggests that **countries with lower taxes experiences more rapid growth.** The summary for selected countries is presented in Table 4. The following points can be deduced:

1. In all cases, the countries that imposed a lower effective average tax burden on their consumers and enterprises achieved substantially higher real rates of GDP growth than did the more highly taxed countries.
2. Gross Domestic Investment (GDI) and exports grew at a higher rate in low-tax countries compared to high-tax countries.
3. Higher rates of economic growth allowed a substantial rise in real living standards in the low-tax countries, as shown by their higher levels of private consumption.

Among the different taxes, corporate income tax seems to be the strongest deterrent to investment. Research proves that progressive reductions in corporate profit taxes increase both business investment and capital stock substantially. Our government should consider this finding and the following points.

5 Michael J. Roskin (1987), **Reagan and the US Economy,** ICRG.

BROAD POLICY IMPLICATIONS

Substantial improvement is required in the control of all public sector expenditures. This can be effected in the first place by a reduction in the size of the public sector, and then by a general improvement in the efficiency and accountability of the remaining entities.

MINISTRY OF FINANCE

The Ministry of Finance must assume actual as distinct from nominal responsibility for the effective financial management of government. The overwhelming need is to eliminate the budget deficit and aim not only for a balanced budget but for a budget **surplus** to make up for Jamaica's low rate of saving, thereby also eliminating the internal debt in the medium term. Government expenditure should reflect government's true role as a **facilitator** rather than **manager** within a free market economy. It should concentrate spending on infrastructure and other services that enhance growth, such as education, health and security. Limited social welfare provisions must also be allowed for, but assistance should go directly to the recipients rather than via price subsidies.

ANNUAL ACCOUNTABILITY REPORT TO PARLIAMENT

The Minister of Finance should be required to present to parliament an annual report which reviews individually the operations of government-owned entities. This report should include audited financial statements and set out fully the extent of government interest with full disclosure of sources of funding, status of government subsidies or loans and plans for future financing.

PRIVATISATION PROGRAMME

The privatisation of government-owned and controlled entities is another pre-requisite for economic advancement. This process will improve accountability and facilitate fair private sector competition in the production of goods and services. The proceeds of divestment ought not be used to support recurrent expenditure. The proceeds should be reinvested in infrastructure and other basic services which are important pre-requisites for private investment. In developing its divestment strategy and mechanisms the following points should be given due weight. The proceeds of divestment to foreigners should be used to reduce existing debt and not to finance higher import levels. Secondly, wider share-ownership should be encouraged so that more Jamaicans can become property-owning stake holders in the nation's economic development.

TAXATION

According to Colbert, Louiz XIV's finance minister,

> ***"the art of taxation consists of so plucking the goose as to achieve a maximum of feathers with the minimum of hissing."***

Jamaican governments have certainly set out to get the maximum of feathers regardless of the hissing. Tax revenues as a percentage of GDP puts Jamaica among the world's high tax countries. Modern economic thinking also requires that in devising taxes, one of the principal concerns should be to minimize distortion in economic decision-making.

The level of individual and corporate taxes are major disincentives in the Jamaican economy. The relative rates administered in Jamaica are higher than those of comparable developing countries (see Table 4). Changes should therefore be made in the tax structure with a view to reducing overall taxation, broadening the tax base and shifting the impact to consumption and many from production.

A high taxation regime produces undesirable economic effects. Apart from price distortions, it transfers resources from the private sector to the government, which is less efficient in the use of resources. High taxes are usually justified as a means of redistributing resources to the poor. In fact, empirical evidence shows that by far the greater share of the resources thus garnered go to the public sector bureaucracy and relatively little gets to the intended beneficiaries. Another objective of our inefficient tax system should be to minimize administrative and compliance burdens in paying taxes. The ideal tax system is simple and easy to administer and thus, not excessively costly for taxpayers to comply with, so that huge amounts of resources are not consumed in collecting the revenue.

TABLE 1
Parameters of the Fiscal Accounts
J$M

YEAR	GROSS DOMESTIC PRODUCT	TOTAL EXPENDITURE	TOTAL REVENUES	OVERALL DEFICIT
1980/81	4,750.1	2,391.5	1,372.0	1,019.5
1981/82	5,267.2	2,553.3	1,483.0	1,070.3
1982/83	5,841.9	2,756.0	1,733.4	1,022.6
1983/84	6,897.0	2,902.1	1,724.8	1,177.3
1984/85	9,790.0	3,265.1	2,686.0	579.1
1985/86	12,013.7	4,671.0	3,668.5	1,002.5
1986/87	13,627.4	5,630.7	4,466.6	1,164.1
1987/88	17,354.1	6,509.2	5,445.8	1,063.0
1988/89	19,968.1	8,199.0	6,020.3	2,178.7
Averages	9,551.0	3,887.8	2,860.0	1,947.8

SOURCE: **Economic and Social Surveys**, Jamaica, 1980–1989, Planning Institute of Jamaica

TABLE 2
Parameter of Jamaica's Fiscal Accounts
1970-80 and 1981-89

Period	Avg. Annual Rate of Change in GDP (Current Prices)	Avg. Annual Tax Revenue as a %age of GDP	Avg. Annual Expenditure as a %age of GDP	Avg. Annual Deficit as a % of GDP
1980/81 to 1983/84	13.3	27.9	47.0	19.1
1984/85	–	27.4	33.4	6.0
1985/86 to 1988/89	18.6	31.2	39.7	8.5
Averages*	16.0	29.6	43.4	13.8

* Calculation excludes 1984/85 figures

SOURCE: **Economic and Social Surveys**, Jamaica, 1980–1989, Planning Institute of Jamaica

TABLE 3

	Avg. Net Internal Debt (J$M)	Local Registered Stock (LRS) as a % of Net Internal Debt	Proxy Avg. Estimate of Min. Income Debt Service (J$M)[1]
1971–1978	623.9	77.1	58.0
1979–1986	4,088.5	79.1	665.2

1 **Calculations are based** on Estimate of Minimum Income (J$M) derived from financing the internal debt, using short-term interest on government securities, submitted by Boyd 1990 in a statistical table.

SOURCE: Bank of Jamaica, **Statistical Digest**, July 1979 – November 1989.

TABLE 4
Real Average Annual Growth Rates
1970–1979 (in percent)

	1	2	3	4	5
Selected Countries	Total Tax Revenue as a % of GDP	Gross Domestic Product	Gross Domestic Investment	Exports	Private Consumption Private
Jamaica (High Tax)	23.8	0.9	–9.6	–6.8	–0.6
Zambia (High Tax)	22.7	1.5	–5.6	0.7	–2.2
Thailand (Low Tax)	11.7	7.7	7.7	12.0	6.9
Singapore (Low Tax)	16.2	8.4	6.0	11.0	7.2

* Note that Jamaica's expenditure (current prices) relative to GDP averaged 29.3 percent between 1970–79.

SOURCE: Compiled from World Bank Study, published by **Finance and Development 1985**

Monetary Policy

The objective of monetary policies lies somewhere between price stabilization and the promotion of economic growth. Many consider price stability as the more important since developing countries are more prone to inflation than the developed countries and monetary policies are considered to be more effective than fiscal policies in dealing with inflation. The rate of growth of money supply should keep abreast of output in order to avoid deflationary pressure. A rate of price increase of between 5 and 10 percent could bolster the level of profit, investment and rate of economic growth. In this way, monetary policy could facilitate the achievement of a higher rate of economic growth as well as full employment, another important objective. In the recent economic history of Jamaica, however, monetary policy has been used to distort the interest rate and exchange rate structure. Tight demand management policies have resulted in excessively high interest rates, credit ceilings, open market operations by the Central Bank and an over-valued exchange rate. In the Jamaican context, therefore, the excessive reliance on tight monetary policy has only served to deepen the economic malaise.

Monetary policies are also regarded as useful in the achievement of balance-of-payments equilibrium and in the stabilization of exchange rates in the developing countries. A country with a balance-of-payments surplus would reduce interest rates whereas developing countries which suffer from balance-of-payments deficits would raise interest rates to encourage the inflow of foreign funds to help bridge the balance-of-payments gap. It is therefore generally acknowledged that monetary policy could be used to promote external balance whereas fiscal policy should be used to promote internal balance and full employment.

To the extent that aggregate demand has to be curtailed to reduce external and internal disequilibria, monetary and fiscal instruments have to be geared to achieve this objective. This means that in the short run domestic consumption has to fall so as to reduce imports and leave a larger share of domestic output available for exports which help bridge the external gap. It also means that the budget deficit occasioned by an excess of government spending over revenues has to be eliminated either through a reduction in government spending or an increase in taxes. Because it is unrealistic in the circumstances of most developing countries to assume that taxes can or should be increased, most of the required reduction in aggregate demand should come from curtailment of government expenditures and use of more restrictive monetary policies. However if the central bank is relieved of the necessity of financing huge government deficits, it will be in a position to operate a sensible monetary policy. In fact, following the elimination of the deficit and reallocation of economic responsibilities between the private sector and the government, it is imperative that the central bank be given more freedom to act. This implies legal responsibility to stabilize overall price levels. It therefore involves a limitation on financing government overspending by the issue of currency, and abandonment of the senseless hope that development can be carried out through the management of monetary policy alone.

Where the public deficit no longer can be financed automatically by issuing money, borrowing or taxing, it becomes mandatory to reopen discussion on the size of the government and the state's role in the economy. Indeed, a decline in the public deficit would reduce the need for state financing and improve the outlook for interest rates. Reduced interest rates and a slowdown of inflation would in turn diminish uncertainty and extend the investment horizon for the private sector. Existing liquid resources currently held back for short term applications would then be released for productive investment. Once the risk of external constraints is eliminated through a long-term supply of resources and predictable interest rates, internal momentum will suffer fewer interruptions and the economy will be on a course of self-sustaining growth.

In under-developed countries there are objective limits to the extent that monetary policy can be tightened unilaterally. Because public sector demand for funds is inelastic, the usual result of tightening the money supply is to push real interest rates too high with a negative impact on the private sector.

Many Jamaican businesses have immediate capitalization. They need additional equity capital and the ability to borrow at medium to long term. In short, there is need for a long-term capital market.

A coherent monetary policy can be implemented only where basic sources of public sector imbalance are eliminated. The degree of substitution possible between fiscal and monetary policy in such economies is limited. Indeed, the monetary authorities cannot operate a consistent monetary policy where there is 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 rates, caused by the increased competition for money. Investment, and therefore economic growth, must suffer!

Given a consistent set of monetary and fiscal policy goals for economic growth and price stability, the private sector can be expected to produce increased foreign exchange earnings, greater employment and a rising standard of living for all. But this process will be strengthened and accelerated if government modifies the internal structure of the financial system in certain strategic ways. For example, the Jamaican financial authorities have consistently pursued a high interest rate policy ostensibly to maintain an attractive real rate of return for savers, but which really is maintained to protect the exchange rate. It is therefore clear that if the exchange rate were allowed to be market determined (freely floating) the utility of a high interest regime would be removed. This is not being advocated in isolation however. The liberalization of the exchange rate must be accomplished in tandem with a deregulation of the financial market.

This is critical at this time in which, despite a history of fierce monetary restraint, there has been continually high inflation, fuelled in part by the cost of credit.

If the development of the economy is to be accelerated, it is essential that the resources saved by surplus sectors be put to their optimal use and that the volume of such surpluses be expanded. Since both of these require the provision of transferrable savings, policies should facilitate the supply of the financial assets that are demanded by the surplus sectors. As credit markets become more efficiently organized, the asset portfolio for holding savings is widened to include bonds, shares, and similar long-term instruments.

The objective, however, is not simply to stimulate aggregate savings, but to expand the amount of transferrable savings. This can be achieved by way of an alteration in the structure of savings of the surplus spending units which are primarily within the household sector in developing countries. A substantial portion of these savings is generally invested in physical assets such as goods or property which contribute marginally to economic growth. Much of the savings invested in business enterprises may be wasted (i.e yield a lower rate of return than they could) in terms of opportunity costs as fragmented or non-existent financial markets influence savings to invest excessively in their own activities.

Economic growth requires increased productive capacity, which implies the optimum use of resources, whether capital or labour. The growth impact of given resources is a function not only of their magnitude but even more important the efficiency with which they are used. It is in this regard that the efficient development of financial assets in general becomes the pivotal point in any effective policy framework. This reinforces the imperative of a responsible monetary policy which protects the value of financial assets and encourages the growth of this type of transferrable saving instrument.

Prices and Incomes Policy

Jamaica has for long maintained a state-determined prices and incomes policy which has contributed to the effective depreciation of the standard of living of the average Jamaican worker. If the external trade, exchange rate, fiscal and monetary policies described above are adopted, we can expect an eventual restoration of stable economic growth with higher 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 inappropriate policies and suppressed by price control and exchange controls.

Three factors explain why, in the balance, state controls are inimical to the economic development of the nation:

1. In the general bargaining process that occurs in all political allocations, it is the visible vocal, easily mobilizable groups which defend their interests most effectively – urban wage earners and traders and large commercial and industrial interests.
2. Equal access to subsidized goods and service is extremely difficult to guarantee. Geography (closeness to roads, schools, etc.), knowledge, limits of fine-tuning or targeting of programmes because of administrative weakness – all lead to unequal benefit-sharing from subsidies.
3. Controls generate economic rents which tend to confer advantages on the more privileged sections of the society.

It is with these factors in mind that market-oriented policy reform is being recommended for all prices inclusive of the price of labour. Market-oriented policy will, other things being equal, lead to a faster growth of output and more responsive economic structures. These policies are likely to increase the volume of resources for investment by reducing capital flight and attracting new foreign capital.

Not only will new resources be generated but resources – existing and new – will be used more efficiently. Resources in the public sector are likely to be used more efficiently. Resource in the public sector are likely to be used more efficiently. Resources in the public sector are likely to be used more efficiently because of greater focus on priority tasks and productivity in the private sector will be stimulated by competitive pressures, including those that derive from greater import competition.

Where private competition is encouraged, furthermore, goods and services are virtually bound to be better in quality. This is perhaps clearest in such vital services as export marketing, transport, and retail trade. Competition-augmenting policies and programmes widen options to consumers and producers, and dilute monopolistic power – all changes conducive to greater productivity.

Regulations such as those geared to promote regional self-sufficiency, but which tend to encourage inefficient production, should be removed. A competitive environment with a pricing system based on real costs will encourage internal specialization and trade, with productivity-enhancing effects.

In recent times there has been some dismantling of price controls and subsidies, but the pace of adjustment should be accelerated. Almost nothing has been done to strengthen market forces in wage setting. Major non-market determinants of wages include IMF wage "guidelines", national as well as trade-specific minimum wages, and cartel action in some industries which has been reinforced by certain aspects of our labour legislation. The cumulative effect is a highly distorted labour market with steady migration of labour from the field for which they are trained at public expense, e.g teaching, farming, nursing and various medical technician skills.

Market determination of wages has several important implications for the success of an export-led growth model. It reduces economic inefficiencies and misallocation of resources which must arise where there are deep distortions in wages. This in turn will reduce distortions in productivity between sectors. Market wage determination will also encourage employers to utilize the available labour force efficiently, facilitating the pursuit of inherent comparative advantages.

Market processes diminish the expected-income incentive in rural-urban migration. Market wage determination avoids unnecessarily high production costs that hamper the country's ability to sell its products profitably in world markets. 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 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 income policies, whether they be "voluntary" or statutory. Total money income should be controlled by the general monetary and fiscal policies 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 as efficiency without compassion. Either way, the economically defenceless are the ones who suffer.

Finally, market-oriented policies and the more dynamic private sector they promote, will encourage the development of entrepreneurial capacities in the population. For all these reasons, growth rates are likely to rise and the economy become more flexible and dynamic when market-oriented reforms are introduced into systems previously characterized by extensive administrative regulation of the economy, legally created monopolies (e.g. JCTC), high protection against competition from imports and other policy biases against exports, and direct state participation in productive activities.

The Role of Government

The preceding discussion implies that the role of government is radically different from its role in a highly interventionist or socialized economy. To begin with, Government in a free market economy does not own or run businesses, nor does it set prices. Experience of different times, different societies and many type of industry reinforce the proposition that government-run business has a virtually irresistible tendency to inefficiency, however promising the beginning may be. In the private sector business is driven by the absolute necessity to make a profit. Several other considerations are likely to take precedence over profitability in public sector operations, hence the imperative of winning custom and using resources efficiently, which are basic to a private sector company's survival, are not critical to the growth and continuance of state-owned business.

Government-owned businesses are subject to political considerations in pricing, hiring and staffing practices as well as compensation, all of which may have little to do with profitability and efficiency, and the net effect of which is to waste scarce resources. When government businesses lose money the usual recourse is to fall back on grants and subsidies from the public treasury or loans guaranteed by the government. The first effect of this procedure is usually to make goods and services provided by the state more expensive than those provided by profit-driven private enterprise. The extra cost is usually camouflaged, however, because the expense is spread across all taxpayers. The second effect is to shift resources from other areas of government activity which may either lead to neglect or under funding of legitimate government services or to increased taxation to support the extra expense of the state.

Even where government does not directly run the business, we believe that it ought not to own business in the normal course of things because it ought not to be using what is ultimately taxpayers' money to compete against the very same taxpayers.

Some areas of government investment in business have to do with what are traditionally considered natural monopolies such as utilities and basic necessities such as water. While the case for government ownership here is stronger we still do not accept that there is any over-riding reason for this. Monopolies are obviously undesirable and public monopolies are no less undesirable for being state-owned. We believe it is preferable for the government to set up independent regulatory mechanisms while the monopoly utilities themselves are privately owned. In this way the government can be an independent arbitrator or advocate for the consumer in the absence of competitive forces. We believe that privately-owned utilities will also have the effect of freeing resources for the government to focus on those things for which it has inescapable responsibility.

What then does this leave the government to do? In relation to economic activity the government's role should be first to set the correct macro-economic climate, that is, to devise and maintain policies which minimise inflation and encourage savings, investment and economic growth. An essential ingredient of such policies is maintaining a sound currency. Second, the government should encourage competition in the provision of all goods and services and discourage monopolies and cartels whether of producers or labour. Third, its role is to ensure product quality and appropriate handling and labeling where health and safety are at issue. Finally, the government must ensure that property rights are protected and the apparatus for the enforcement of contract is available to all persons.

This takes us to the first and fundamental duty of government and therefore its primary role: the establishment and maintenance of law and order. It is the duty of the government to ensure the security of the country and defend the lives, liberties and property of its citizens so that they may pursue their interests in peace.

We believe the most important social value to be liberty. The object of a state, therefore, is to create and sustain an environment which allows the individual the fullest liberty consistent with the liberty of others. The state's duty consists of maintaining the liberties of citizens as a matter of right, not of privilege or favour by the state. People do not exist to serve the state; rather, governments are established by people to protect the people's rights. It follows from this that all powers not expressedly given to the government automatically belong to the people.

While the government ought not to do for people what people can do for themselves the government has a residual responsibility for the weak in the society, including the economically defenceless. Hence we believe the government should provide a basic social welfare service.

While we do not believe in equality of outcome or results, we believe that it is a desirable objective to try as far as practical to have equality of opportunity so that the talents of all may have a fair chance of development. We therefore support the policy of government providing schools which should be free of cost at the primary level and up to about the age of 16. Therefore there should be a system of financial contribution from students according to needs and means. An educated and trained population is an advantage to the community at large as well as to the individuals who benefit, so there is no logical basis to exclude from the provision of education. This is a legitimate communal service. On the same grounds a healthy population is a public as well as an individual good and to that extent, therefore, the government has a legitimate role in the provision of health care and protection of the environment.

Whatever the differences of view as to the degree to which the state should be involved in education, health and welfare there is widespread acceptance of the proposition that the government is legitimately responsible for the provision of basic infrastructure – that is, roads, bridges and other public engineering works, ports and other communication linkages, basic river training, water storage and irrigation works. These are all factors which are necessary for economic activities and the trading of goods and services, and are commonly available to all citizens. Hence they should be communally provided and maintained.

Appendix I

IMPLICATIONS OF EUROPE 1992 FOR THE CARIBBEAN

The development of the Single European Market and other major international changes (Uruguay Round, Lome IV, US/Canada Free Trade Agreement, developments in Eastern Europe) hold critical implications for the Jamaican economy. Generally, these developments are part of an accelerating movement towards global economic integration as well as, increased economic liberalization and deregulation. This phenomenon, is occurring simultaneously with other fundamental changes: a decline of socialism as an economic model and the proliferation of democratic regimes. As a corollary there is a reduction of ideological cleavage and military tension: economic power will increasingly become the more important element of power-projection in the world.

In 1992 most of Western Europe will become a single market with the free movement of goods throughout the European Community and a common tariff regime for all imports. This has major implications for Jamaica especially with regard to products such as, bananas, sugar, rum and tourism which currently have preferential access to the EEC, but could be adversely affected by a united European market.

FOREIGN DIRECT INVESTMENT

Already, the attraction of a large and dynamic single market is exercising a great pull effect on Foreign Direct Investment (FDI) from Japanese and American companies. Firms in individual European – member countries of the EEC are also finding it profitable to invest in other community countries. They have already began to position themselves through strategic alliances and acquisitions of a network of enterprises for the advent of the single internal market. The effect may be a decline of FDI flows to other regions, especially poor countries of the Caribbean and Africa. Such a decline would be felt most heavily in labour-intensive industries.

On the other hand, it is expected that competitive economic conditions within the EEC will intensify causing some TNC's to invest in developing countries. Generally, the Caribbean may benefit from investment by firms who will eventually find it advantageous to invest in developing countries associated with the EEC in the framework of the Lome convention. This arrangement will allow them to improve their competitiveness and profitability in the European market. A similar phenomenon can be observed in some Caribbean countries with preferential access to the United States market.

Additionally, increased economic growth in the Economic Community is likely to increase the demand for a multiplicity of imports from developing Caribbean countries. This feature should lead to investment by foreign affiliates of European companies. However, the extent to which firms from the Caribbean will benefit from such FDI will depend on their supply capabilities vis-a-vis both EEC and non-EEC firms and their relative competitiveness.

THE CHALLENGE FOR JAMAICA

Jamaica will have to diversify its economic base by concentrating on alternative export activities. We will have to develop and export goods and services of a higher local value-added to earn and save more foreign exchange and reduce our indebtedness.

The traditional export base won't be sufficient and the traditional government policies won't work.

Government will need to create the necessary environment to make it more conducive for both local and export production to take place. The 'economic climate' as a direct cause of economic growth should be recognized. The overly restrictive demand management policies which have been such a consistent feature of policy over the past 15 years, should be integrated with supply-side economic strategies that are geared towards increasing production.

DEVELOPMENTS IN EASTERN EUROPE – IMPLICATIONS

In the case of Eastern Europe, these countries are in the process of opening up to international trade and as a result will be less protected and dependent upon COMECOM. They are going to be forced to become competitive and consequently one can expect them to undertake a substantial process of economic adjustment. The success of this programme will be dependent upon access to medium to long-term finance, modern technology, raw materials and markets. Given this scenario, it means that Eastern Europe will eventually be competing with developing countries for developmental aid, grants, investment, markets and preferential arrangements from the developed countries. This is the context out of which we must assess the implications of developments in Eastern Europe for Jamaica.

Shearer (1990) noted in a critique on Jamaica's foreign trade with Eastern Europe, that although we have trade with these countries for many years, trade had tended to be dominated by Jamaican pimento exports, with little being imported in exchange. In the case of USSR, pimento has always been significant, similarly bauxite and alumina. However, these countries have generally sought to conduct trade on a barter basis with efforts to achieve a "balanced" or "partially balanced" trade and, as a consequence, have tended not to take an interest in promoting their goods commercially in the world market. Government and private sector entities must realize that this approach will definitely change over time; and as their products become more differentiated and competitive – developing countries will experience increased competition as sources of supply. On the demand side for Jamaican exports, two essential questions must be addressed: "What will we have to sell to these markets? And, what will they be interested in buying from us at prices that we regard as remunerative?" Research and development will be crucial, and therefore, we will have to monitor developments and investigate all possibilities for expanding our production, strengthening our ability to compete in foreign markets and finding markets for our products.

GATT – URUGUAY ROUND

In addition to the foregoing discussion, it is necessary to bear in mind that the general agreement for trade and tariffs (GATT) – Uruguay Round negotiations is scheduled to be concluded at the end of 1990. Present emphasis seems to be placed on liberalizing international trade. Consequently, tariffs are being lowered and also the effects of various protective arrangements are being reduced. These developments are consistent with the world-wide movement towards increased economic liberalization and deregulation. Interestingly, services are now being strongly proposed to be included in the current round of negotiations by the U.S.A. In order to fully grasp the significance of this pending development, one has to appreciate the fact that information technologies have made services more transportable and hence, more tradeable. Moreover, services are now diagonally integrated into a total system of wealth-creation. To illustrate, banks are now investing in travel agencies; cruise lines into hotels and hotels into airlines, among others. Evidently, the implications of these developments are tremendous for developing countries' service sector, particularly tourism. All of this means that the future developmental possibility of Jamaica must to some extent focus on the deployment of new technologies, in particular, information technologies that are geared towards new products and innovations for increasing competitiveness and wealth.

REGIONAL INTEGRATION

Given the rapid developments in the global economy – the rate and magnitude of change in Europe and the rest of the world, the most likely effect on Caribbean countries will be pressured to integrate as "One Caribbean". The spatial configuration of the Caribbean Islands though not entirely suitable for an integrated geographic development is nevertheless strategically poised for the forging of an integrated economic space. Such integration can proceed through a unified regional approach to the organisation and management of Caribbean production systems.

CARICOM ENTERPRISE REGIME

The recently established CARICOM Enterprise Regime (CER) for the promotion of greater regional investments particularly on the basis of joint venture, the promotion of regional entrepreneurship, management and technological capacity should be seriously considered and supported by business groups as it can be developed as the basis for Caribbean economic integration. The Agreement for the establishment of a Regime for CARICOM Enterprises formerly came into being on October 11, 1988 and since then has been ratified by seven member states of the Caribbean Common Market. The process is therefore in operation but needs to be diffused at a faster rate.

WHAT IS THE CARICOM ENTERPRISE REGIME (CER)?

"This is the legal framework governing the transportation, registration, operation, management, winding-up and dissolution of the form of business enterprise to be designated a CARICOM Enterprise. The regime is intended to assist regionally owned and controlled companies to grow and develop through easier access to the wider market and to operate relatively free of the constraints of national policy restricting:

a) market access;
b) capital movement;
c) employment of labour particularly skilled and supervisory.

As such, the regime is a positive vehicle for obviating the constraints of existing arrangements and for providing preferential treatment for certain entities." – CAIC

In addition to regional support by corporate businesses, we must continue to lobby for total dismantling of all individual barriers that bottleneck the flow of regional productive energies and activities, such that the resultant economic benefits can accrue to all members of the Caribbean. The proposed region-wide Common Stock Exchange, by Prime Minister Michael Manley, should further propel CARICOM towards greater economic integration.

September 10, 1991

EXCHANGE CONTROL LIBERALIZATION IN URUGUAY
A CASE STUDY

Professor Ramon Diaz from the Uruguay University of Montevideo reported that " . . . the Uruguayan government dismantled on one day in 1974 the exchange controls that for over four decades had submitted imports to a quota system, and for a shorter but considerable lapse had also severely restricted all other foreign exchange transactions."

Additionally, price controls were progressively relaxed and interest rate controls were abandoned in 1977.

RESPONSE TO EXCHANGE CONTROL LIBERALIZATION

By the new system "the available foreign exchange were allocated by the market rather than the bureaucrat's rationing system. For the first time, foreign investors found that they were free to remit interest and dividends home, indeed to repatriate all their capital if they so wished. Far from profiting from this newly gained liberty by sending capital out, they reacted to it by bringing more in. Since 1976 international reserves, after having dwindled for decades despite the obsessive official concern to preserve them, began to grow substantially.

There were other reforms adopted in the same spirit. Price controls were almost universally repealed. A tax reform that did away with hundreds of low-yielding taxes that were costly to administer, including the largely evaded personal income tax, made the value-added tax the mainstay of the system. By 1979 the Treasury accounts were back in the black for the first time in two decades. Finally, a gradual tariff reduction was announced, but for some reason the boldness that presided over external financial policy never extended over to commercial policy – the tariff reform never got very far."

In response to the breath of fresh air that the removal of controls allowed in, the economy reacted healthily. As shown by table (1) – exports started growing at nearly 10 percent a year. Investment grew even faster. Total output set a growth trend exceeding 4 percent, which looked both sustainable and also satisfactory.

TABLE 1
1974–81 Growth Period
(trends of real variables)

	1974–81 trend
Gross domestic product	4.1
Gross domestic investment	15.8
Private consumption	2.4
Exports	9.2
Imports	8.9
Agricultural production	1.5
Industrial production	4.5
Output of construction industry	12.7

Source: **World Economic Growth – Case Studies of Developed and Developing Nations, 1984.**

TABLE 2
Economic Indicators on Uruguay, 1962–6/1974–9

Period	Average Annual Growth of Net Domestic Product	Net Investment	Average Inflation Rate	Net Saving[a]	Net Receipt of External Resources[b]
1962–68	0.1	0.6	57.3	1.5	–0.9
1969–70	7.0	3.2	17.7	1.1	0.5
1971–73	–0.6	3.5	67.3	3.0	4.2
1974–79	4.0	7.6	82.7	3.4	2.5

a Deduction of net receipt of external resources from net investment
b Imports minus exports

SOURCE: **World Economic Growth, Case Studies of Developed and Developing Nations**

The four major periods being considered show:

- 1962–68 with low growth, investment and high inflation. This was regarded as the central period in posing the problem of low investment;
- 1969–70 with high growth in NDP and investment, and a considerable fall in inflation;
- 1971–73 with relatively high investment, negative growth and accelerating inflation;
- 1974–79 high inflation co-existing with high growth and investment. The conclusion which seems to offer itself is that: "it is not so much inflation as its repression by government controls that counts in this context".

Beyond that, the following deductions are to be taken into account:

- The average rate of return on total capital was a low of 4.97 percent for the period 1967–71 compared to a somewhat better, but still low rate of return on private capital of 5.8 percent. However, between 1974–78, the two rates averaged 6.6 and 7.8, clearly an upward trend after external control liberalization.

- Further, in the three periods before external control liberalization, the ratio of net saving in net domestic product was very low, when it averaged 1.86; but increased to 3.4 between 1974 and 1979.
- The remaining source of investment financing – external resources– fluctuated very intensely for the four periods and was even negative between 1962–68.
- Low saving meant that external resources became the dominant determinant of net investment. However, the availability of these was undoubtedly hindered by monetary instability and exchange control before 1974.

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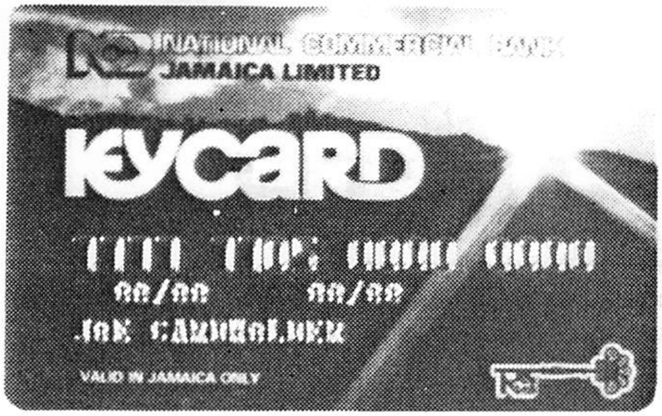

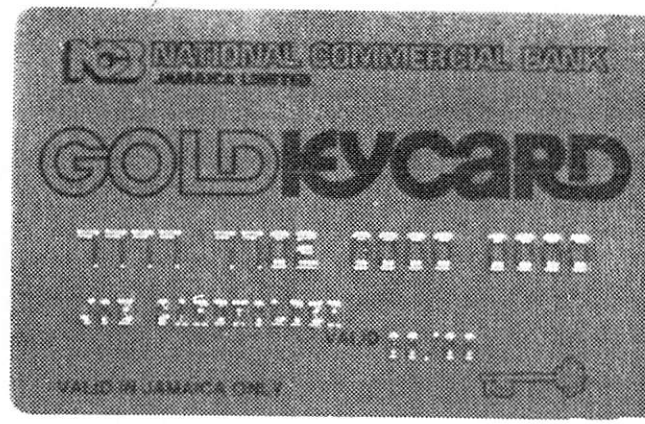

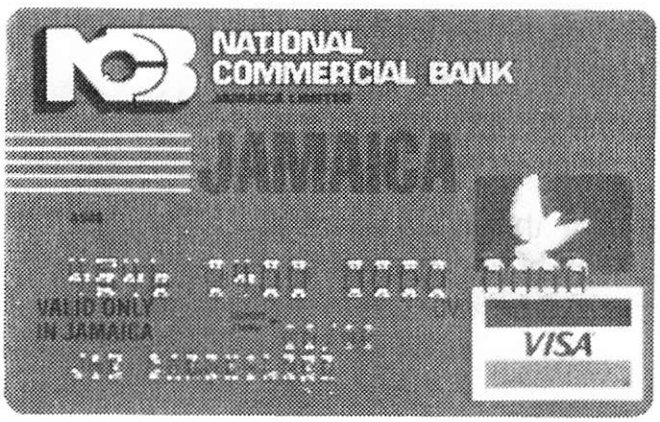

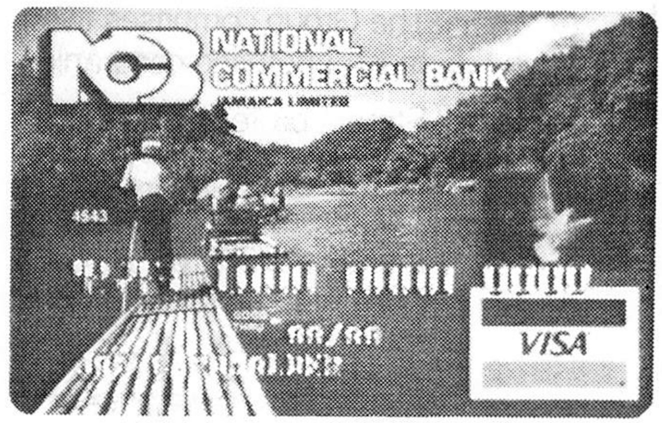

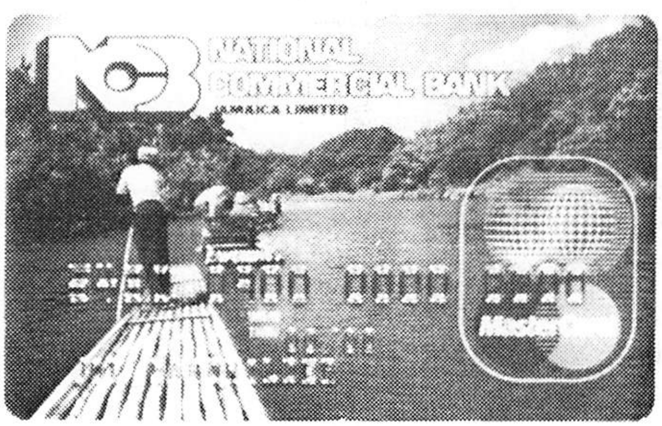

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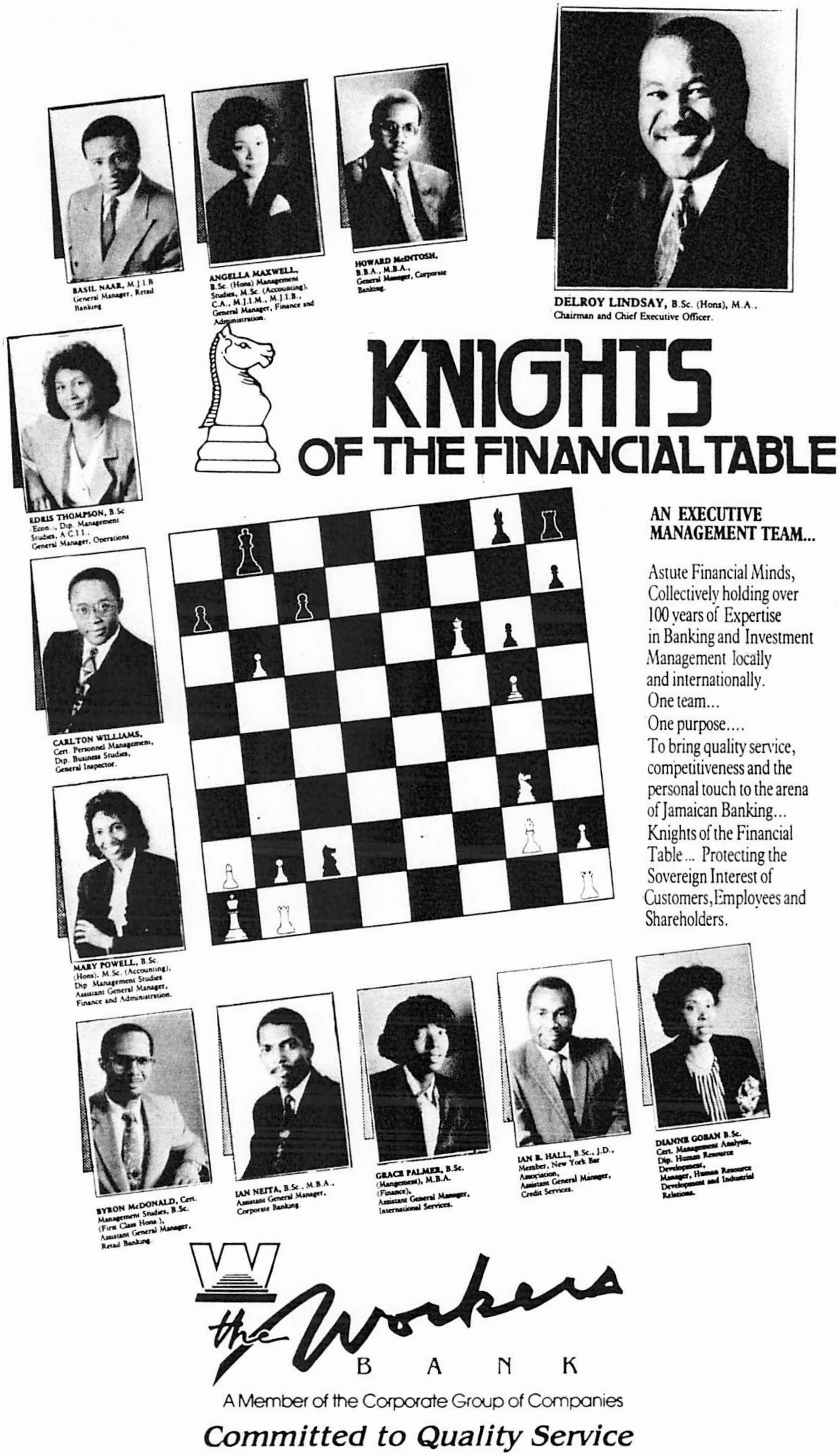
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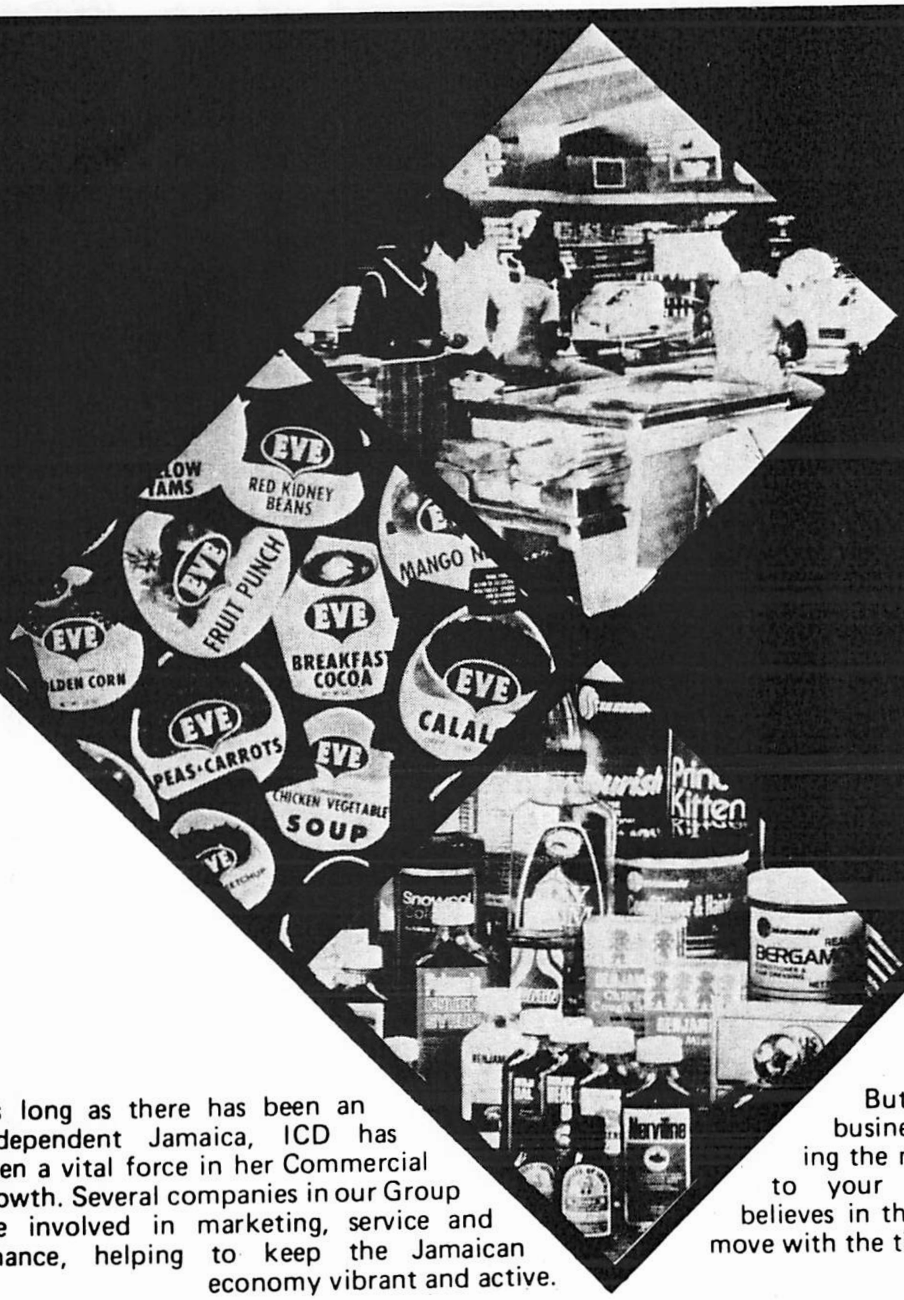

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