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## Jamaica

A Private Sector Assessment

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REPORT PREPARED BY ERI FOR THE INTERAMERICAN DEVELOPMENT BANK

AUGUST 2006  
Final

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## Jamaica: A Private Sector Assessment: Executive Summary

Jamaica needs a business environment that encourages private sector development to achieve: \_\_\_\_\_



### Higher GDP growth

Jamaica has hardly grown over the past 15 years. Achieving a reduction in debt without higher growth will be difficult.



### More Job Creation

Unemployment is high while skilled workers emigrate because of insufficient opportunity. The informal sector continues to expand.



### More Stability

The fiscal crisis reduces the private sector's confidence in the long term - a situation exacerbated by double digit inflation and high crime.



### Lower Costs

Costs of doing business are substantial due to high taxes and interest rates, poor infrastructure, and excessive regulation,

## The Private Sector Needs

### Less Involvement of the State in the Economy

- The public sector dominates the economy, crowding out private sector activity and creating a high cost, inefficient business environment.
- Government spending on wages and salaries has grown sharply, while spending on infrastructure, health and education has fallen, which threatens the long term foundation of Jamaica's prosperity.
- There are many public sector entities that require funding some of which are not self financing –which further pressures the fiscal situation.

### A Financial Market that Funds Entrepreneurs

- Financial markets are underdeveloped and do not finance investment and entrepreneurship effectively - particularly smaller businesses.
- The high public sector debt adds a large risk premium to interest rates.
- Banks do not lend to sole proprietors (i.e. most small businesses) or allow financial leases. Both of which reduce access to capital.
- The collateral framework does not permit the effective use of collateral as security for loans.

### Fewer Distortions

- Investment incentives distort the economy. They favor larger more capital intensive companies, promote informality by smaller firms and severely distort investment and resource allocation. They lower the relative cost of capital and encourage migration of skilled Jamaicans. At the same time, labor is plentiful and creating jobs is an urgent priority.

### Rural Development

- Poverty is much higher in rural areas – the rural economy is neglected and many elements of a private sector based rural sector are lacking.

### Improved Infrastructure

- The fiscal crisis has reduced infrastructure spending but its poor condition imposes substantial transactions costs on firms and reduces growth.
- The fiscal situation precludes government from infrastructure investment.

### Less Regulation

- Jamaica's bureaucracy is described as "overwhelming" and "crushing" and bureaucratic processes as "cumbersome".
- Jamaica is trying to make public sector agencies self-funding but user fees are high and processes are complex.

### A More Equitable and Simple Tax System

- Taxes are complicated and discretionary, which creates uncertainty and increases transactions costs due to the need for legal interpretation.
- The tax base is too narrow and burdens formal firms in sectors that do not receive tax concessions.
- Few taxes are collected from Jamaica's large informal sector (partly due to the tax system), which burdens formal firms even more. Prospects are poor for increasing collections given experience in other LAC countries with large informal sectors.

### A Modernized Legal System that Supports the Private Sector

- The legal framework for business does not support some modern legal practices and imposes substantial transactions costs on users.
- For most small businesses, the cost and inefficiencies of the legal system puts it beyond their reach. The result - weak incentives to be formal.
- The legal system makes it difficult and costly for lenders to recover collateral in the event of default.
- The bankruptcy system is slow, inefficient and costly.
- Outmoded privacy laws prevent the establishment of credit bureaus.

### Secure Property Rights

- Registering land that has no registered title is complicated and costly.
- Engaging in land transactions results in fees, charges and commissions that can amount to substantially more than 20 per cent of the cost of the transaction.
- For those with informal title, the process of titling and registration is so costly as to make it prohibitive.

## We Recommend

### Reforming Incentives

- Action 1: Start a dialogue with the government to review and reform the unsustainable system of incentives.

### Reforming the Financial Market

- Action 1: Reform the collateral framework to increase lending.
- Action 2: In addition to legal reform, support the creation of credit bureaus.

### Undertaking Tax Reform

- Action 1: Reduce the tax burden on formal businesses by simplifying the system, attempting to more equitably collect taxes and removing investment incentives.
- Action 2: Reform the tax system so it is sector, investment, and activity neutral - all should face the same tax burden; there should be minimal exemptions; it should be simple to administer and comply with; and the tax burden should be spread evenly and embody a societal consensus regarding equity.

### Reducing Regulation

- Action 1: Explore the implementation of sunset provisions by which agencies justify their regulations in writing otherwise they lapse.
- Action 2: Review actions to make agencies self sufficient – processes as well as user charges must be justified.

### Reforming the Legal System

- Action 1: Further modify the Company Act and Registry to reduce the costs of business registration and reduce the incentives for informality.
- Action 2: Fully review the bankruptcy process in Jamaica.
- Action 3: Reform the Arbitration Act to open the process to small businesses, and reduce litigation costs in the event of contract default.
- Action 4: Introduce a Private Police Act to allow for the private enforcement of legally binding contracts.
- Action 5: Reform the Financial Institution Act to allow for the collection of credit information in an effort to increase small business lending.
- Action 6: Assist the Parliamentary Counsel reduce the backing in pending legislation.

### Undertaking Land Reform

- Action 1: Undertake land reform that allows low cost registration and titling and allows informal land holdings to be made formal.
- Action 2: Review and reduce the fees, commissions and duties for land transactions.

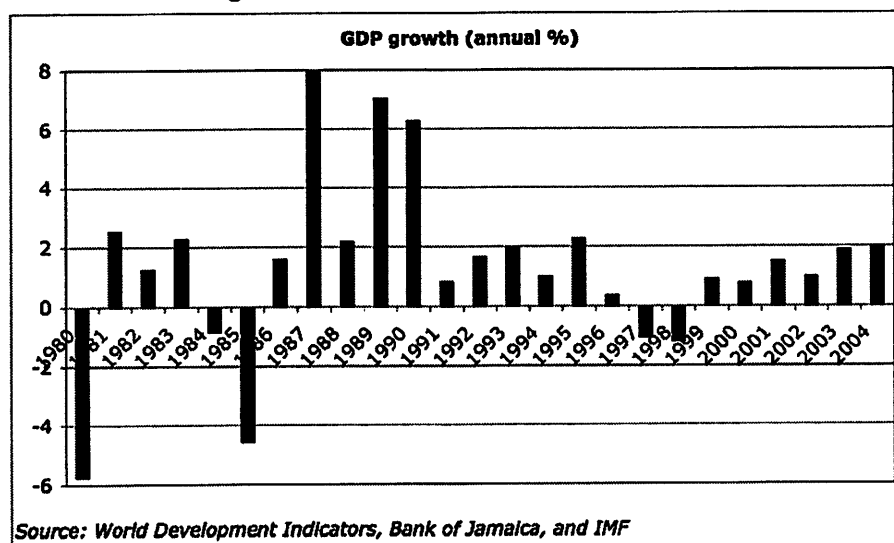
### Exploring New Ways to undertake Infrastructure Investment

- Action 1: Explore new ways of involving private sector operators in the provision of infrastructure through PPP, BOT and concession arrangements.
- Action 2: Undertaking further privatization will reduce the fiscal burden and improve efficiency.

## I. Introduction

1. Jamaica has gone through a period of severe fiscal crisis as public sector debt ballooned to nearly 150 per cent of GDP - one of the highest debt ratios in the world. Although the government has navigated the crisis effectively so far, the threat is far from over. Jamaica's policymakers must constantly confront the problems of debt management, budgetary restraint, and the need to devote a substantial portion of GDP to servicing the public sector debt. The stability of the economy rests on a knife-edge, especially in light of the low growth rates of the past 20 years. The low growth of the economy exacerbates the impact of the debt crisis, because the effects of the debt burden do not decline as a percentage of GDP.
2. This fiscal straitjacket makes the economy highly vulnerable to external shocks, requires increased tax collections and makes innovative policies difficult to implement. Yet, the only way out of the current situation is much more rapid growth than has been registered in the past. This growth can only come from the private sector, but the current incentives facing investors and entrepreneurs are not conducive to promoting a high growth environment and vibrant entrepreneurship.

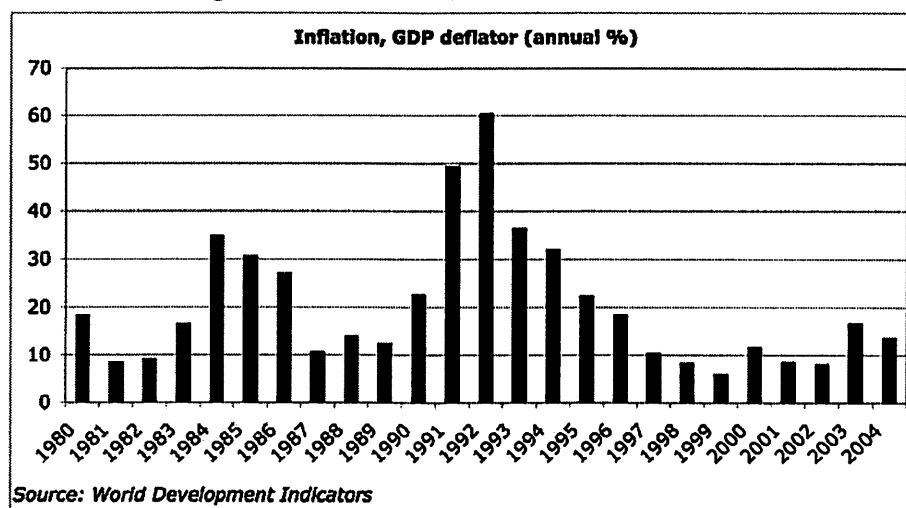
**Figure 1. GDP Growth, Annual %**



3. The central theme of this paper is that the continued low growth rates of the Jamaican economy constitute a second unnoticed crisis, but one whose effects are insidious and feed into and magnify the impact of the fiscal crisis. It is a crisis of low productivity, low growth, and private sector stagnation. The economy has failed to perform to its potential for many

years and the effect of the debt crisis on GDP has resulted in per capita income declining to levels that are hardly greater than they were at the time of independence. Private sector activity has stagnated in spite of relatively high levels of investment, implying that the marginal efficiency of investment is very low. There is currently more optimism about future economic prospects because of an improved growth outlook and lower inflation. However, the prospects for significantly higher growth rates in the near term, while better than in the past, are still not bright. In the view of the authors of this paper, sustained rapid growth in the future will only be achieved by implementing a substantial realignment of policies affecting investment and entrepreneurship to unshackle the private sector from the difficult situation in which it currently finds itself.

**Figure 2. Inflation, GDP Deflator**



4. Many observers in Jamaica maintain that actual growth has been much higher than the GDP statistics indicate. They point to a high level of investment, the sharp decline in poverty, the growth of electricity consumption that has substantially outpaced recorded GDP growth, and household surveys showing large increases in per capita consumption. Indeed, the increase in the size of the service sector to about 70 per cent of GDP makes estimating total value added in the economy a particularly challenging task. Analysis of just how much additional unrecorded growth has occurred is difficult. However, a comprehensive examination concluded that it is unlikely to be of an order of magnitude that would

substantially change views of the performance of the economy over the past 20 years<sup>1</sup>. Much higher growth rates in the future are needed if the Jamaican economy is to grow out of its current difficulties and supply improved levels of prosperity to all of its citizens.

5. Furthermore, structural developments in the economy give grounds for concern. It appears that the economy has evolved in three directions: the traditional manufacturing and agricultural sector, which have been stagnating; a dynamic, more modern services sector characterized by tourism; and the increasingly large informal sector dominated by trading and low productivity services.
6. It is hard not to be overwhelmed by the analysis and reports on every aspect of the Jamaican economy. Donors of all stripes have invested substantial amounts of money in such exercises - if the presence of reports on the economy were the main instrument for achieving economic success, the Jamaican economy would be booming. Unfortunately, this is not the case and any analyst visiting Jamaica is very quickly confronted by evidence of consultant and donor fatigue, both on the part of members of government, the civil service and the private sector. All recount numerous meetings with donors and consultants, many of whom leave to write reports that join the many already written that have gone largely unnoticed and unread. When told that another report is about to be produced, the typical reaction is - "not more studies" and "everything has already been said - we need action". And in some sense this is indeed true - much has been written. Unfortunately it is often hard to see any relationship between the vast quantities of analysis and the projects implemented in donor programs.
7. This report aims to make a contribution to promoting private sector development and higher growth in two ways. First, it will identify and prioritize some key areas for reform. Much of the existing work supplies long "action lists", many containing 30 or more recommendations in each sector, without indicating which reforms are central to promoting private sector development and which will do no more than improve a process that is already functioning. It is, therefore, difficult to obtain a clear sense of what needs to be tackled first from many of the existing studies. In contrast, this work will focus on key areas that, in the view of the authors, will yield the highest rewards. Second, the report aims to raise the level of awareness of the issues hampering the private sector and promote debate on appropriate policy actions.

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<sup>1</sup>. Havinga, I 2002, *Jamaica - Study on Growth and Competitiveness during the 1990s: An Assessment of Macroeconomic Performance and Policy Environment and a Statistical Review of the Compilation Methodology and Exhaustiveness of GDP Estimates*, Processed, World Bank

Change cannot be dictated from outside the country - it must come from within through debate and consensus building.

8. Perhaps this is a particularly propitious time for such change. The fiscal straitjacket in which Jamaica finds itself can only be cast off by a sharp increase in growth rates. Without this growth, it is hard to see a way out of the current dilemma posed by the high debt burden, high tax rates and increasing informality, which places a millstone on the backs of the formal sector that does pay tax. The government is acutely aware of the need for more investment and prosperity. Some suggestions regarding how this might be achieved appear in the following chapters.
9. In many areas of the economy that impact private sector activity, it is clear that reform in Jamaica is still only in its infancy. Much of the advice that has been received has been ignored. Perhaps this outcome results from a lack of prioritization but also, perhaps, because some of the reforms are politically difficult or they confront strongly vested interests either in government or the private sector. Reform itself is a process, with the analysis and identification of issues constituting only the first step. Dissemination, persuasion and the raising of issues to build consensus for change are as vital a part of implementing meaningful reform and change as identifying what needs to be done. This applies particularly strongly to the business environment reform that will transform Jamaica into a dynamic, private sector driven, high growth economy.
10. A central tenet of the analysis that follows is the importance of incentives in determining private sector behavior - for investment, innovation and entrepreneurship. The methodology employed is reflected in the following quote from economist Stephen Levitt.

“First, incentives are paramount. If you understand someone's incentives, you can do a pretty good job of predicting their behavior. Second, the appropriate data, analyzed the right way are key to understanding a problem<sup>2</sup>.

11. An examination of incentives uncovers the appropriate reform priorities and suggests ways to implement new policies. This approach provides a focus for identifying ways to encourage future investment through shaping the institutions that support entrepreneurship.

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<sup>2</sup> Levitt, Steven D. and Stephen J. Dubner, 2005, *Freakonomics: A Rogue Economist Explores the Hidden Side of Everything*, William Morrow, New York.



12. This paper is not meant to be a stand-alone piece of work. Rather than provide yet another overview of the economy and its performance, it assumes that readers already have a sound knowledge of the structure of the economy and the background for recent developments. Rather, it focuses on key issues that impact strongly on investment, entrepreneurship and private sector activity.
13. The paper also promotes a vision of the Jamaican economy that is different from that contained in many other reports, and perhaps different from the implicit view that exists in Jamaica itself. It is undoubtedly true that Jamaica is a difficult environment for private sector development – many reports describe the difficulties and distortions that exist in the economy. Within Jamaica, the vast array of incentives implicitly acknowledges this fact – the incentives are designed to offset these difficulties. However, the authors would like to promote an alternative vision, which sees Jamaica as a country where transactions costs are low; where businesses are not beset by the weight of bureaucratic burdens; where communications costs are low; where the skills of highly trained Jamaicans are rewarded in Jamaica rather than in North America or Europe; where rates of taxation are low, but where tax evasion is low; where the informal sector has shrunk to a fraction of its current size; and where prosperity is realistic for all its citizens. This vision is attainable, but it requires further analysis, commitment to reform, support from the donor community, and a commitment from those in Jamaica to bring about change.
14. The outline of the document is as follows. Chapter 2 provides an overview of the issues that impact private sector development in Jamaica. Chapter 3 discusses the impact of the macroeconomic crisis on investment and entrepreneurship and the negative incentives faced by investors and entrepreneurs. Chapter 4 examines the legal system and concludes that many of the legal institutions do not provide a foundation for modern business. Chapter 5 examines property rights in land and how these affect private sector development in Jamaica. Chapter 6 looks at the financial sector and the fact that it fails to finance local investment effectively. Chapter 7 summarizes the conclusions of this report and makes some suggestions for reform.

## II. A Brief Overview of Jamaica's Private Sector Environment

15. The purpose of this section is not to provide a comprehensive overview of the Jamaican economy, but rather to provide the reader with a feel for how the structure of the economy has evolved over the recent past and how this feeds into the analysis that follows. It also provides a brief summary of some of the structural aspects of Jamaica's economy that pertain to private sector development and attempts to provide an explanation for why these characteristics have evolved including, the large informal sector, the high investment-low growth conundrum, and the implications of the substantial role of the state in the economy.
16. There is no specific discussion of the causes and impact of crime on business in Jamaica. Other observers have undertaken this analysis extensively. The approach of this paper is to note that crime is a tax on private sector activity, but not to go beyond this. However, it is important to note that if the recommendations of this paper are adopted, higher growth and greater opportunity and secure property rights will lead to a reduction in the crime rate.

### A. The Private Sector and the Economy

17. Broadly, the private sector in Jamaica is made up of a number of disparate components. The "traditional sectors" consist of older manufacturing and industry, including garment production, and agriculture, mainly sugar and bananas. Manufacturing and agriculture together amount to about 22 per cent of GDP and have been declining because of the economy's fall in competitiveness and the loss of preferences. Mining, primarily bauxite and quarrying makes up close to 10 per cent of GDP, [which could rise, given the recent agreement to develop another large bauxite investment]. Tourism is an important sector that has been growing rapidly, increasing its share of GDP by the equivalent of more than two percentage points over the past 5 years spurred by the resumption of U.S. economic growth, and travel that had fallen as a result of 9/11. Construction, which accounts for about 8 per cent of GDP, has also been growing. Finally, the economy has a large informal sector, amounting to about 40 per cent of GDP, that appears to be growing in size and which, in the view of the authors of this paper, presents a long term threat to future growth.

18. Services dominate the export sector, accounting for 60 per cent of total goods and services exports. By far the dominant earner in this category is tourism. Merchandise exports consist almost entirely of primary commodities, the most important of which is alumina, which accounts for over 50 per cent of total merchandise exports. Sugar and bananas make up about 4 per cent of total exports. However, these industries are under continued pressure because of the erosion of EU preferences. Recent the EU announced a further unilateral cut in price supports under the African, Caribbean Pacific (ACP) preferences of nearly 40 per cent. Although this still leaves preference prices substantially above world levels, the sugar and banana producers in Jamaica will be forced into another painful series of adjustments.
19. The garment industry is also suffering from loss of preferences, as well as a decline in competitiveness. The North American Free Trade Agreement put substantial pressure on the industry – more recently competition from other Caribbean and Central American countries is eroding exports in this sector.
20. The recently announced bauxite investment should result in a large increase in bauxite exports. While this rise will undoubtedly be good for the economy, it is possible that the exchange rate effects of increased exports will further adversely affect the traditional exporting industries. A similar impact is also resulting from the large increase in remittances that now account for more foreign exchange earnings than merchandise exports!
21. Overall, these developments illustrate the openness of the Jamaican economy. The liberalization of the trade regime, which began in the late 1980s has not been reversed, and imports plus exports amount to over 100 per cent of GDP. While it is highly appropriate for an economy of the size of Jamaica to be open, the exposure to external shocks makes it essential that the domestic economy be very flexible. One of the conclusions of the analysis of this paper is that several factors diminish the economy's ability to adjust with minimum disruption to external shocks, or to a substantial internal shock since many of Jamaica's factor markets are highly inflexible.

## **A. Formality and Informality**

22. There is a large informal sector in Jamaica, which accounts for nearly 40 per cent of GDP and employment, by some estimates. Informal sector participants range from informal traders [higglers], to small workshops and manufacturing institutions, small-scale farmers, transport operators, service jobs in tourism, and so on. In addition, formal firms undertake

informal activity by performing a proportion of their work outside their normal accounting systems in order to reduce their tax burden. (See IDB 2004 for a very detailed analysis of the composition of the informal sector, including the activities in which informals engage, their level of education, and the types of informality that occurs.)

23. Informality has many causes. If the costs of being formal are high, as they are in Jamaica, the number of workers and companies who are willing to go through the processes to become formal is reduced. A following chapter outlines the legal requirements for forming a company and the associated substantial costs – many small businesses cannot afford the expense. Formality brings with it the need to comply with bureaucratic rules and regulations, which are extensive and greatly raise the costs of doing business. But, in an environment like Jamaica's, going through the costs of formalizing brings few benefits to smaller businesses - a powerful reason to remain informal. The main reasons for becoming formal are to give businesses access to finance to fund growth and to the legal system for entering and enforcing contracts. Neither finance, nor the legal system is, in practice, accessible for smaller businesses in Jamaica. Incentives for informality are therefore powerful and the size of the informal sector is unlikely to decline significantly if the situation does not change.
24. In broader terms the implicit agreement between a government and its citizens is that in return for paying taxes, government supplies essential public goods, such as policing, defense, the financing of school education, health services, a legal system and a sound system of property rights. In Jamaica, such public goods are generally of low quality – the mechanism of the state is unable to provide them effectively. There are reports, in fact, that in some areas criminal elements provide money for some of these services. The result is that in Jamaica, the government-citizen compact is weak, which also adds to the incentives for informality.
25. However, there are costs associated with being informal, which include:
  - o Informality traps participants in the informal sector in low wage, low productivity activities. It also means that formal competition is reduced and that larger, well-connected companies have a disproportionate advantage in the economy, through access to the legal system and finance. Conversely, however, they also pay an increasing share of taxes unless, as in Jamaica, some have tax exemptions. In such a case, traditional companies and small formal companies bear an ever increasing share of the tax burden.

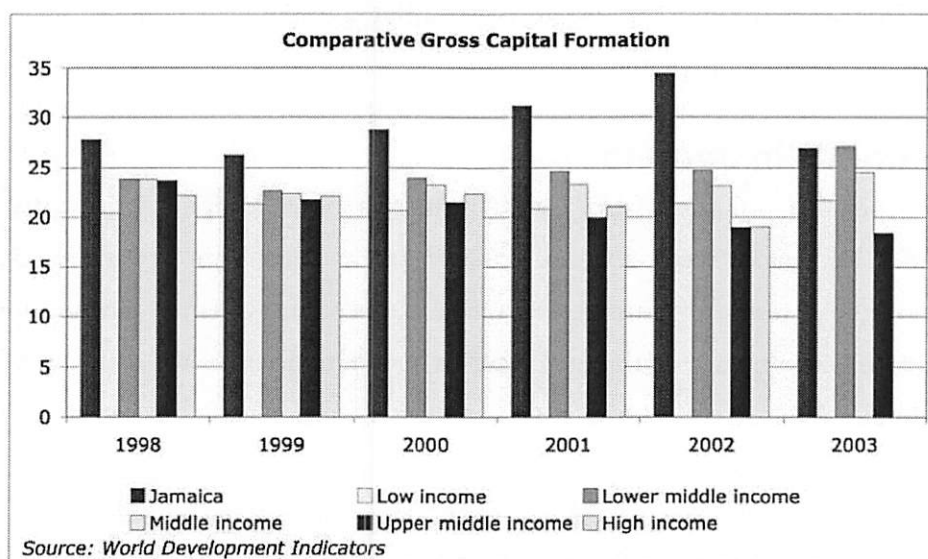
- Informality adds to the distortions in the economy because informal sector participants do not pay most taxes, do not adhere to regulations that have public good elements, such as health, safety, and product standards, and thereby have an unfair advantage relative to their formal competitors but also do not contribute to the functioning of society and the norms and ideals set out in its regulatory framework.

## **B. Investment in Jamaica**

26. Over 75 per cent of gross fixed capital formation is made up of private fixed capital formation. The private sector share has risen in recent years as the dire fiscal situation has resulted in the government cutting its investment expenditures sharply. The juxtaposition of high investment and low growth rates present a conundrum. The usual estimates of potential growth indicate that investment at the level recorded in Jamaica is sufficient to permit an average growth rate of 4 – 6 per cent, or even more, for countries at Jamaica's stage of development. Countries that are growing at the same rate as Jamaica typically have a much lower investment rate. For example, Fiji, a small country in the Pacific that has been struggling with low growth rates, has achieved annual growth of about 2 per cent per year over the past 10 years with a rate of gross fixed capital formation that is only half that of Jamaica's.
27. Why then has Jamaica's growth performance been so disappointing? There are a number of explanations none of which are entirely satisfactory by themselves, but which together probably explain the paradox of high investment and low growth. Analysis of the incentives faced by entrepreneurs and investors in Jamaica indicate that there is a substantial bias in favor of capital-intensive investment generally and in large projects in particular. By far the most significant source of this bias is the comprehensive system of investment incentives, which are discussed in detail in the next chapter. Calculations show that for an identical amount of investment in different sectors of the economy, pretax rates of return vary enormously.
28. Furthermore, since smaller businesses have little or no access to capital, their investment tends to be low. Lack of access to credit also hinders rural investment and production. Farm demand for working capital – seeds, fertilizer, plant protection agents, pay for workers prior to harvest – is enormous. But in Jamaica future crops cannot serve as collateral - there is no provision in the law that allows the use of assets that do not yet exist as collateral. Land

rights and titling and registration for smaller farmers is such that their land cannot be pledged.

**Figure 3. Comparative Gross Capital Formation, % of GDP**



29. The alternative to access to credit is internal finance. Obviously, however, the farmer who can save 20 per cent of the price of a tractor and get the rest on credit gets to use the tractor much sooner than the farmer who must save 100 per cent of the price. Access to credit speeds up growth. Lack of access to credit slows it down. In substantial parts of the economy, households currently are unable to afford anything beyond the fundamental necessities. Few have any opportunity to accumulate capital in order to cover start-up costs in private enterprise.
30. In the Jamaican economy, investment primarily takes place through large projects, where social rates of return have no more than a tenuous relationship to private rates of return because of the large wedge between the two that is caused by incentives. Smaller businesses that do not qualify for incentives could correct some of this imbalance through dynamically exploiting investment opportunities, but lack of access to finance limits their growth potential. The possibility of a small entrepreneur with limited means starting a business and expanding until it becomes large is extremely limited. Substantial investment remains in the purview of large companies and is dictated by being able to obtain the best incentive regime. The result is high investment in the economy, but low social rates of return and low rates of economic growth.

31. The widely reported crime problem also provides a “sink” into which investment is poured but which does not enhance productivity. In this sense, crime constitutes a double drain. First, it imposes a substantial tax on business through ongoing security costs. Second, it requires significant investment by the private sector in security apparatus that does not increase their output. Together, the two costs add up, by some estimates<sup>3</sup>, to the equivalent of several percentage points of GDP.

### **C. The Role of the State in Jamaica**

32. The state plays a pervasive role in Jamaica’s economy. It owns substantial assets, accounts for spending that is equivalent to almost 40 per cent of GDP, employs a significant part of the labor force and runs a large number of companies, boards and agencies. The spending picture is distorted by the very high level of interest payments, amounting to some 17 - 18 per cent of GDP that is required to service the debt. Public sector employment is extremely high, amounting to some 120,000 employees for a population of just over 2.5 million people. Jamaica’s large state presence in the economy creates problems because it is inefficient on the one hand providing poor and expensive services and it crowds out private sector activity on the other. It is often assumed in small island states that the presence of the state is necessary to ensure service provision, but often the private sector is willing and better able to play that role.
33. The other aspect of a large state presence is the pervasiveness of bureaucracy. During interviews with entrepreneurs, there was a universal observation that the bureaucracy in Jamaica is “overwhelming”, “crushing” and processes are “cumbersome”. These observations come as no surprise to visitors who have already witnessed the procedures associated with immigration, the singling out of business people who are forced to obtain visas, and the general inefficiency and lack of regard for those entering the country. Such attitudes and processes pervade much of the public sector. In this there is a disconnect between Ministers and some senior government officials who appear to have a genuine desire to improve the efficiency of the public sector and those at lower levels of the public service, who see no need to change or reform.

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3. <sup>3</sup> See World Bank 2004, which has a detailed discussion of the impact of crime on the Jamaican private attempts to identify determinants of crime.

34. Much has been written about the bureaucratic burden in Jamaica. Attempts are being made to reduce the amount of bureaucracy, in particular through a USAID funded initiative, entitled “Legs and Regs,” which is aimed at identifying and changing the most onerous laws and regulations that add to the costs of doing business. The Jamaica Chamber of Commerce is heavily involved in this initiative, which holds substantial promise if it can be implemented. However, it also depends heavily on the cooperation of the public sector, which has some vested interest in maintaining the status quo.
35. The government has also been intent on improving the financial capacity of various agencies by making them self funding. Often donors have supported these efforts. Agencies such as the Company Registry and the Land Office have become financially self sufficient by charging fees for their services. This reduces the burden on the tightly stretched budget. However, simply making an agency financially viable while continuing its inefficient practices does nothing to reduce the bureaucratic burden on the private sector while at the same time creating a more powerful vested interest that could resist real reform.
36. Some attempts have been made to change the perceptions of the public sector through education. JAMPRO [Jamaica’s Investment and Export Promotions Agency] initiated an imaginative program for public sector officials in which they had to navigate the processes and procedures of the bureaucracy. The agency reports a substantial change in attitude on the part of the officials who completed the course. The next phase was to be a program of reform implemented within the officials departments in government, but unfortunately funding dried up. Such experiments are worthy of donor attention and a revisiting of this project would be worthwhile.
37. Some of the consequences of state involvement in the economy are illustrated by the history of Air Jamaica, which was state owned, then privatized, then subsequently reacquired by the state. Besides the high transactions costs of this process, the losses generated by the airline over the past 10 years have been close to \$700 million, most of which has been absorbed through the budget. At the same time, public policy has been directed at promoting tourism as a source of revenue for Jamaica. In other words, the cost of the airline has essentially offset some of the benefits of tourism.



### III. Constraints to Private Sector Development

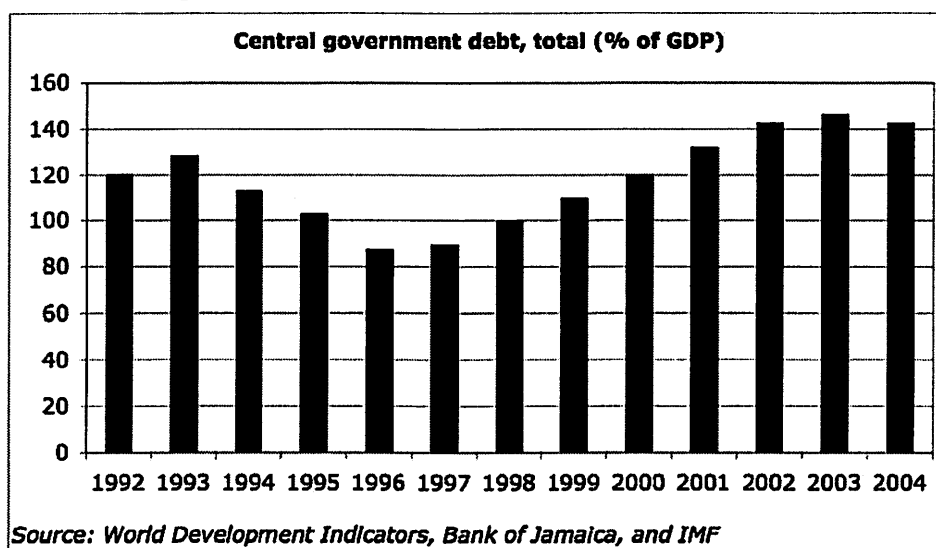
38. This chapter reviews the main constraints to private sector development in Jamaica. It outlines the implications for the private sector of the fiscal situation and how imbalances in the macroeconomy have impacted the microeconomic environment. It concludes that the macroeconomic imbalances place a severe strain on the promotion of private sector development in the country. It then examines competitiveness and the effect of the exchange rate, the labor market and total factor productivity on investment and private sector activity. It finds that there are severe distortions in the economy that skew investment decisions, misallocate resources and reduce the efficiency of investment, which in the longer run threaten the sustainability of growth. The chapter then analyzes taxes and incentives and how they create distortions in the economy that severely impact growth and threaten to feed into the macro economy. The chapter goes on to review the infrastructure situation in Jamaica and how it is negatively impacting private sector operations. The chapter ends with a brief overview of donor interventions to encourage private sector development in Jamaica. It concludes that many of the efforts have been directed at specific sectors or activities, while ignoring, and at times damaging, the general business environment.

#### A. The Microeconomic Implications of Jamaica's Macroeconomic Imbalances

##### 1) Introduction

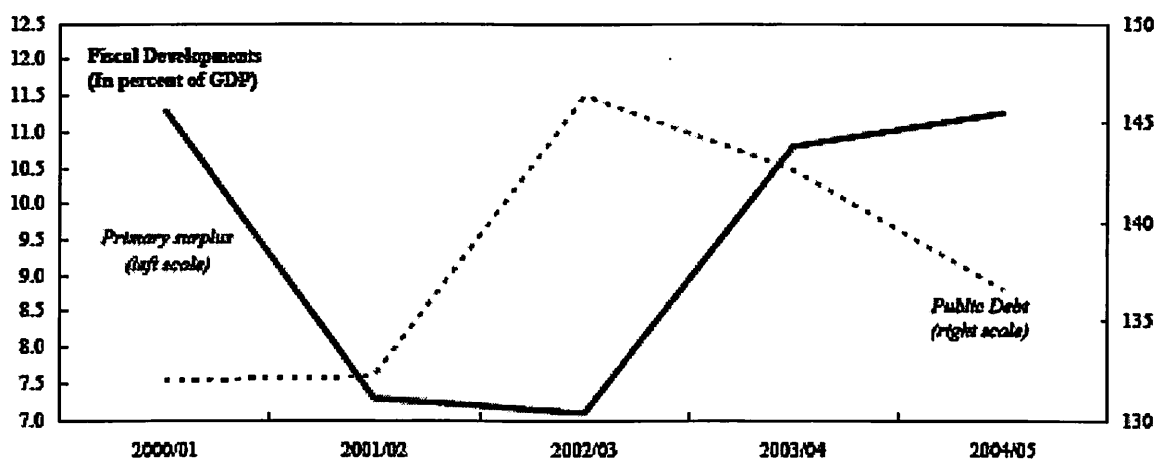
39. Jamaica has one of the highest ratios of central government debt to GDP in the world, something that has been a significant factor in the formulation of macroeconomic policy for many years. In recent years, the overall budget deficit has been greatly amplified by the large interest payments that are necessary to service the debt.

**Figure 4. Central Government Debt, Total**



40. Fiscal policy has been directed at running a substantial primary surplus (revenue minus expenditure net of interest payments), but the combination of high debt and high interest rates has resulted in substantial overall deficits, with the result that the public debt remains at the equivalent of over 140 per cent of GDP. Of this, the equivalent of about 50 per cent of GDP is either commercial external debt, or US\$ denominated locally held debt.

**Figure 5. Fiscal Developments (In percent of GDP)**



41. While macroeconomic issues are generally not thought to play much of a role as a private sector development issue, in reality fiscal imbalances have a profound effect on the business environment. Issues of systemic risk are central to investor confidence. The developments over the past few years in Argentina, where the economy declined by almost 25 per cent as a result of the macroeconomic collapse, is only one example of fiscal collapse having

enormous follow-on implications for the private sector. While the degree of macroeconomic fallout from the debt and budgetary crisis in Jamaica has been far less extreme than in Argentina, the impact on investment and entrepreneurship in the country has nevertheless been profound and long lasting. Although the country has displayed great skill in managing the after effects of the bailout of the financial system, the need to devote a large amount of current revenue to debt service requires high tax and interest rates, both of which negatively effect the growth rate. Unfortunately, debt payments as a percentage of GDP remain high, which prevents a reduction in the interest burden and perpetuate the conditions that reduce potential growth.

## 2) The Impact of Fiscal Imbalances on the Private Sector

42. The overall debt situation results in specific microeconomic effects that damage private sector dynamism. The most important of these are:
  - The tight fiscal situation has resulted in a sharp decline in infrastructure spending. In 2003/04 only 1.2 per cent of GDP was allocated to capital spending, representing a fourfold decline since 1997/98. But, as a following section points out, the poor state of Jamaica's infrastructure imposes substantial transactions costs on the private sector, severely harming growth prospects.
  - The public sector commands the equivalent of nearly 39 per cent of GDP, one of the highest among developing countries of its size and income level. (By comparison, when the industrial countries had a per capita GDP similar to Jamaica's their levels of tax and spending were the equivalent of 12 - 13 per cent of GDP.) A large portion of expenditure is constituted by interest payments (some 17 per cent of GDP). If these are not included, the size of the public sector appears to be smaller, although imbalances are concealed by very high public sector employment on the one hand and very low investment rates on the other.
  - Prospects for maintaining or reducing the tax burden are poor. The World Bank<sup>4</sup> points out that Jamaica has one of the highest tax collection rates in the Latin America and Caribbean (LAC) region. It maintains that prospects for accumulating additional revenue are promising because of the size of the informal sector - if taxes could be collected from

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<sup>4</sup>. The World Bank 2004 *Jamaica: Consolidation for Growth and Poverty Reduction: A Public Expenditure Review*

informals, revenue would rise. However, few governments in the LAC region have had success in collecting substantial amounts of taxes from their very large informal sectors.

- The need to continue to service the debt - the World Bank Public Expenditure Review suggests a primary surplus of 12 per cent of GDP as the target - requires increasing the tax burden on that portion of the formal business sector that is not receiving incentives. There is a substantial danger that more and more business activity will be forced underground or that the level of taxes will discourage investment in sectors that are not accorded incentives.
- The portion of government spending on wages and salaries has grown sharply, while the amounts spent on infrastructure, health and education has fallen over the past 6 years. As a result, the long term foundation of Jamaica's prosperity is being threatened. Although the *Memorandum of Understanding* with the public sector unions has enabled the government to achieve wage restraint and a reduction in real wages in the public sector, those reductions cannot continue for much longer and higher public sector wage bills are inevitable in the medium term.
- Although interest rates have come down, the still precarious state of public finances does not provide for the possibility of substantial further declines in interest rates. The systemic and structural risks associated with very high levels of public sector debt imply a substantial risk.
- The most recent budget does not take into account possible "off-budget" items, which represent liabilities and contingent liabilities that will have to be financed through public finances. The very large number of parastatal and quasi-parastatal agencies and institutions that comprise the public sector in Jamaica make the potential for accumulation of such items high and fiscal rectitude difficult to impose. While all governments accumulate such liabilities, the risk of doing so in Jamaica, with its already precarious state of public finances, is especially acute. Furthermore, owning and operating Air Jamaica given the current state of the worldwide airline industry presents particular dangers. Losses can mount with frightening speed, as a number of international airlines have discovered. The budgetary implications for Jamaica are profound.

### 3) Financial Sector Implications of the Fiscal Imbalances

43. The need to service a public sector debt of the size of Jamaica's requires high interest rates to induce debt holders to continue to hold Jamaican securities. To date, many investors have profited handsomely from their holdings as the government has displayed commitment to meeting its obligations and skill in debt management. Jamaican citizens hold a large proportion of the debt, denominated both in local as well as in international currency. There are those in Jamaica who claim that this reduces risk. Is this contention correct? On the one hand, it perhaps lowers the risk of a large scale abandonment of Jamaican government security holdings. On the other hand, a substantial portion is still held offshore and could be divested rapidly. If events occurred that caused the prices of Jamaican securities to fall sharply, it is hard to imagine that at least some domestic holders of debt would not also divest. Under such circumstances, the negative wealth effects on the Jamaican economy would be serious, as those individuals and institutions still holding large quantities of securities experienced substantial losses. In other countries where such events have occurred, GDP has generally declined, which would in turn increase the country's debt burden.
44. It is undoubtedly true, that whatever the risks, the high interest rates necessary to induce investors to continue to hold Jamaican Government securities imposes substantial costs on the economy. However, interest rates have declined recently and there appears to be a degree of confidence in Jamaica's bond issues on the part of international investors<sup>5</sup>. Nevertheless, Jamaica still has to borrow at a substantial premium over countries with stronger fiscal positions. Detailed income and wealth effect calculations of the impact of such rates are complicated, especially since Jamaican investors hold significant international debt issuances. However, the overall impact of high interest rates reduces loan demands, which also reduces income. The financial market chapter has an expanded discussion of these issues.

## B. Competitiveness of the Jamaican Economy

### *i. The Impact on Private Sector Activity of Developments in the Real Exchange Rate*

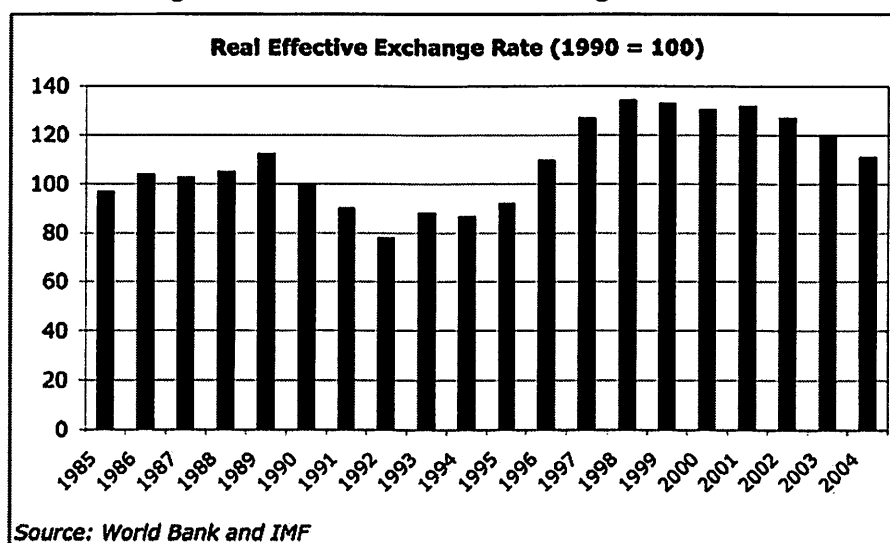
45. One of the best indicators of competitiveness is the real exchange rate REER. The following chart shows real exchange rate developments over the past 20 years. During the 1990s the real exchange rates soared, making it difficult for suppliers of locally produced goods and

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<sup>5</sup>. Recent bond issues have been substantially oversubscribed and interest rates have been declining.

internationally traded services to compete effectively – in other words, there was a sharp decline in competitiveness over this period. From its low point in 1992, there was a 40 per cent appreciation of the real exchange rate. The result was a fall in Jamaica's share in world exports [World Bank, 2004]. In addition, import competing industries suffered from increased competition, something that was compounded by a reduction in import barriers that occurred in the late 1980s and the early 1990s, when average tariff rates fell from more than 20 per cent to less than 10 per cent. The result was a sharp decline in domestic manufacturing and in the production of such agricultural commodities as poultry, meat, eggs and vegetables.

**Figure 6. Real Effective Exchange Rate**



46. However, more recently, trends in the real exchange rate have been reversed as the nominal exchange rate with the US dollar has declined from US\$1 – J\$45 to over J\$60. By early 2005, appreciation of the real exchange rate was no more than 10 percent above its 1990 level. These developments should have a positive impact on output. The World Bank [World Bank 2004] has estimated that the elasticity of Jamaica's share of world exports of goods and services is -0.8.
47. Up to date information on relative unit labor costs is not available. However, after increasing sharply during the 1990s<sup>6</sup>, it is likely that they have also declined substantially over the past two years, which should further improve Jamaica's competitive position.

<sup>6</sup> See IMF [2002]. Wage costs rose by nearly 20 per cent per year in US dollar terms during much of the 1990s.

48. It is difficult to determine the degree to which the real exchange rate is close to its equilibrium position, or even what the equilibrium rate means. For example, the very large growth in remittances over the past decade undoubtedly puts upward pressure on the exchange rate. Effectively, it implies that Jamaica will need to focus more on the provision of services than on the manufacture of goods, and that a core requirement for the economy will be flexibility. One of the themes of this paper is that there are many factors that inhibit flexibility within the economy and that this is imposing substantial costs.

## **ii. Labor Market Issues and Competitiveness**

49. Some private sector participants characterized the labor market as a severe constraint to private sector development in the country. On the surface, this seems paradoxical. The percentage of the total working population that is unionized is not large and labor legislation is not especially draconian in terms of the ability of employers to dismiss workers, or the payments that must be made to retrenched or dismissed employees. Further investigations reveal four problems, however.
- Although the unionized portion of the labor force is not large, it is powerful and has the ability to mobilize its members to strike. This influence extends across both the public sector and the formal industrial sector. The result has been that formal wages have risen substantially, adding pressure to unit labor costs described in the preceding section. Although the *Memorandum of Understanding* has promoted public sector labor harmony, the cost was the promise to refrain from labor shedding in the bloated public sector, which urgently needs rationalization – the wage bill in the public sector amounts to the equivalent of 12 per cent of GDP.
  - There are issues that affect flexibility in the formal labor market. First, firms that are downsizing their labor force, whether to increase efficiency or because of inadequate demand for their products, are faced with significant redundancy payments based on the length of service of employees. Second, a dismissed employee may contest the grounds for dismissal to a labor tribunal, the workings of which are slow and uncertain. While the process is underway, employees must be paid – since proceedings may extend for months, and in some cases years, the costs of dismissal can be very high.

- The Employment (Equal Pay for Men and Women) Act also introduces substantial uncertainties through the bureaucratic processes associated with the implementation of the Act, that are similar to grounds for wrongful dismissal.
  - In addition, there are substantial labor tax payments on employees that substantially raise the costs of employment. In addition to PAYE deductions, there are four additional payroll taxes that depending on the incidence of taxation, add between 30 and 45 per cent to the wage bill. These add to the capital intensive bias that already exists within the Jamaican economy.
50. The result of these rigidities has had three effects. First, overall formal employment has grown very slowly – less than 0.3 per cent per year. Second, employment in manufacturing has dropped sharply – and overall private sector employment for formal companies has declined by more than 40,000 jobs since 1996. Third, during many years in the 1990s formal wages in larger companies rose strongly – average weekly earnings in Jamaican dollar terms doubled in the 5 years from 1995 to 2000. Although wage increases have since attenuated, the earlier increases adversely impacted competitiveness. Furthermore, the effect of high labor costs on bigger companies was to push their investment towards capital intensity. The result has been high wages for those with jobs and lack of employment opportunities for those who are unemployed. Not surprisingly, emigration has continued at high rates, especially to Canada and the United States.
51. A further issue that will negatively influence competitiveness in the future is the declining quality of education, which is exacerbated by continued emigration of many talented well-educated Jamaicans. The World Bank reports that 30 – 40 per cent of grade 6 school leavers are functionally illiterate [World Bank, 2004]. Besides being a social problem, the long term ability of the Jamaican economy is threatened.

### ***iii. Developments in Total Factor Productivity***

52. Another indication of competitiveness is provided by developments in total factor productivity. Jamaica has a high rate of fixed capital investment – averaging over 25 per cent of GDP during the 1990s. This investment, however, was not translated into growth performance. Whilst seemingly contradictory, that investment does not necessarily lead to growth is illustrated by developments in the Soviet Union, where investment constituted over 40 per cent of GDP, yet growth was low or negative. Jamaica's low growth in the face



of high investment implies, on an arithmetic basis, that total factor productivity has been negative. This observation is confirmed by analyses of the supply side of growth, [Bartelsman, 2002], [Loayza et al., 2002]. Total factor productivity in Jamaica during the 1990s fell by an average of between 1 and 3 per cent per year<sup>7</sup>.

53. Not only does Jamaica have a low rate of return on physical capital, but it also appears to have a low rate of return on human capital. High rates of emigration have been a reality of the Jamaican economy for many years, so that the numbers of Jamaicans living overseas is beginning to rival those living in Jamaica. While this has the undeniable advantage of increasing the flows of remittances during a period when the balance of payments has a substantial debt service component, it also means that Jamaica is losing some of its best human capital. It also implies that solving the shortages of skilled labor that some employers describe will not occur through higher education expenditures and improved education alone – increasing the quality of education risks providing better opportunities for migration. The argument of this paper that the incentive structure of the Jamaican economy reduces the rate of return on capital applies to human capital as much as it applies to physical capital.
54. The Minister of Development chairs a Competitiveness Committee that includes representatives of the Public Sector, the private sector and labor unions. It has a mandate to examine legislative and regulatory reform and to look at issues of “micro-competitiveness”. This problems raised in this section would be good for the committee to consider.

## **C. Distortions Caused by Taxes and Incentives**

55. Jamaica has a complex system of taxes, stamp duties, transfer taxes and company taxation combined with an extensive set of incentives for investments in particular activities.

### **1) Stamp Duties and Transfer Taxes**

56. In Jamaica, Stamp Duty and Transfer taxes are levied on a wide variety of transactions. Their main purpose appears to be to raise revenue, although in the 2002/2003 tax year, proceeds from this tax amounted to less than 4 per cent of total revenues, two thirds of which is generated from stamp duty and transfer taxes on transactions in real property. The Stamp Duties Act [1937] governs stamp duties. Items covered by stamp duty include the repurchase of company annuities, leases, bonds, bills of lading, insurance policies travel tickets, bank

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<sup>7</sup>. The substantial range of estimates is a result of whether the impact of informality is included or not.

withdrawal slips customs warrants, deeds, powers of attorney, property settlements, share transfers, patents, mortgages, and licenses. In many cases, the valuation of the transaction is open to interpretation. For example, putting a value onto a share transfer is not straightforward because there are no hard and fast rules regarding how to arrive at their “market value”. The Stamp Duty office uses book values in cases where they do not accept a self reported value. Various reports indicate that the value of between 600 and 1000 real property transactions per year are challenged and referred to official valuers for further investigation. The Stamp Duty office has 15 full time officials who are charged with determining valuation, which implies that each valuer would handle 60 - 70 valuations per year.

57. There are three issues related to the impact of these taxes on private transactions in Jamaica:
  - The first relates to the complexity of the Act. Legal practitioners who have practiced law in Jamaica for many years described the law as “extremely complicated” and “open to wide interpretation”. The Stamp Duty Act has been amended several times and contains nearly 100 separate clauses and headings. There are ambiguities that require interpretations and uncertainties regarding which particular provisions apply to specific transactions. Such complexity usually requires legal expertise to interpret the relevant clauses applying to many of the transactions that involve standard business practices, which in turn greatly raises the transactions costs of contracting and exchange. For example, the Act provides for duty on 14 different categories of bonds, but gives exemptions under various circumstances in more than half of these categories.
  - Second, the complexity of the transactions and the wide possible interpretations give great power to the officials responsible for processing such transactions. The authors of this paper heard numerous cases of transactions delayed while valuations were obtained, as well as transactions being rejected because of official interpretations. Opportunities for corrupt practices aside, such discretion adds to uncertainties and raises the costs of business transactions.
  - Third, the stamp and transfer duties themselves are high, which increases the costs of transacting, and discourages borrowing and lending secured by collateral.

58. A recent publication<sup>8</sup> described the steps necessary to fulfill the requirements of the Stamp Duty Act on a property transfer. Eight separate steps are required, including waiting to see if the value of the transaction was referred for revaluation. If this occurs, a separate process kicks in involving a further set of procedures with the result that the transaction can be delayed by several months.
59. The end result of these taxes is a substantial contribution to informality, and dishonest and illegal dealings. In addition, they hamper the effective development of several markets central to the promotion of investment and entrepreneurship in Jamaica, in particular financial and property markets. The private sector seems to devote considerable resources to setting up such vehicles as offshore trusts to minimize the payment of these taxes. In other words, they provide a substantial disincentive to the private sector and greatly raise the costs of transacting.
60. A detailed discussion of tax reform options is beyond the scope of this paper. The excellent recent analysis of Stamp Duties and Transfer Taxes referred to above outlines a number of alternatives for reform. From the perspective of private sector development considerations, there is no question that the existence of these type of taxes discourages the type of behavior that Jamaica currently needs most urgently - investment, risk taking, entrepreneurship and the development of asset markets, particularly holdings of real property by the poorer sections of the community. It was therefore especially disappointing that the recent recommendations of the Tax Reform Commission did not include radically overhauling this system. Although revenue considerations are undoubtedly of great importance, without major changes to the environment for private sector development, the country will not grow out of its current fiscal bindings and remain indefinitely vulnerable to external or internal shocks that will not only hamper faster growth but threaten severe short and medium term declines in GDP.

## 2) Investment Incentives and Resource Allocation

61. There is a comprehensive set of incentives for various types of investments in Jamaica. These range from purchasing certain types of financial instruments to investing in hotels and tourist facilities. A recent study estimated that there are over 200,000 different incentives, but

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<sup>8</sup>. Roy Bahl, 2004, Property Transfer Tax and Stamp Duty, Jamaica Tax Reform Working Paper 2, Andrew Young School of Policy Studies, Georgia State University,

observed that it is really impossible to identify all of them accurately, and admitted that there may be more that were missed when the incentives were counted. The same study estimates that the incentives that have been identified imply revenue foregone of about 20 per cent of total government revenue.

62. It is impossible to provide a comprehensive overview of the incentives within the confines of a few brief pages - given the enormous number that currently exist, a succinct description is unfeasible anyway and this paper will confine itself to describing some of the consequences of incentive regimes. Mostly, they are negative. A study of one of the most comprehensive incentive regimes ever developed [in South Africa] concluded that in the end, they had little lasting effect, distorted resource allocation, and weighed heavily on the budget<sup>9</sup>. A recent analysis of incentives offered by the state of Ohio in the United States concluded<sup>10</sup> that tax incentives there have had a damaging effect on growth because they discourage smaller start-up companies that are often more dynamic. In the case of Jamaica, the incentives favor larger more capital-intensive companies and promote informality on the part of smaller firms. What is especially distortionary is that capital is scarce and labor abundant in Jamaica.
63. The incentive regime in Jamaica severely distorts investment and resource allocation decisions and there are grounds to believe that the net effect on the growth of the economy as a whole could be negative. In addition, such incentives may not be sustainable. They encourage informality and penalize those with a small amount of capital, which describes the large majority of native-born Jamaicans. The incentive regime therefore could have an adverse impact on the already uneven distribution of income in Jamaica.
64. In the tourist industry, a hotel operator can be granted a 10-year tax holiday and relief from import duties by building a hotel of 10 rooms or more. Larger hotel complexes - with 350 rooms or more - qualify for a tax holiday of 15 years. Both types of investment qualify for an abrogation of import duties on certain items such as furniture and bed linens for the same period as their tax holidays. Incentives lower the relative cost of capital in an economy where capital is scarce and costly while labor is plentiful. Creating jobs is one of the urgent priorities in Jamaica, a process that is undermined by the incentives. Further issues with incentive policies are:

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<sup>9</sup>. Holden, P.: "A Review of Regional Development Incentives", in G. Maasdorp (ed.) *Regional Development in Southern Africa*, Urban Foundation, Johannesburg

<sup>10</sup>. Reported in the *Wall Street Journal*, March 14, 2005

- The “All Inclusive” hotels are especially capital intensive, being the largest hotels on the island. cursory examination suggests that the linkages to the rest of the economy from these types of resorts are low relative to smaller hotels that are more integrated with the communities in which they are located. The all-inclusive hotels therefore generate smaller employment gains per dollar of capital invested than do hotels that are not as large. Yet incentives are directed most strongly at these large facilities.
- There is an internal contradiction built into the incentive policy. Incentives are targeted at sectors of the economy that JAMPRO and others see as having the greatest potential. This means that the sectors that grow most rapidly will be targeted for tax holidays.
- While the authors of this paper are extremely dubious at a “picking winners” strategy, it is hard to argue against the notion that Jamaica possesses comparative advantage in tourism. The long term implication of the incentive policy is that businesses in tourism and other rapidly growing sectors where incentive are offered will be exempted from taxation for extended periods of time, while those in the traditional sectors will be faced with what must be an increasingly onerous tax burden. The same applies to smaller businesses and those in the service sector. The forces that promote informality will, therefore, increase over time. The implication of such programs is that essentially those who are paying taxes are subsidizing those businesses that have tax holidays. Incentives of this type create two classes of businesses – those that have incentives and those that do not - and effectively penalize smaller indigenously owned businesses. In addition, an incentive policy such Jamaica’s becomes increasingly hard to change, the longer it goes on.
- Some argue that Jamaica has to compete with other countries offering incentives, so that there is no option if it wishes to attract investment. There is no strong evidence to support this view, however. The danger of trying to match other country’s incentive regimes is that Jamaica gets drawn into a “race to the bottom”, in terms of which investors play countries off against each other with the aim of achieving the most favorable conditions. Studies of incentive regimes elsewhere point to their ephemeral ability to retain investments once the incentive period has expired, the opportunities for corruption inherent in such programs, and the tax revenue foregone that such programs entail.

65. The authors have suggested elsewhere<sup>11</sup> that incentives of this type hinder, rather than promote private sector growth. A preferred strategy, by far, is one that is neutral with respect to investment decisions. Furthermore, giving incentives to particular sectors of the economy is equivalent in resource allocation effects of providing disincentives to those sectors that have not been favored.
66. Jamaica's tax regime is distorted and nominal rates of company tax are relatively high. A recent comprehensive study of Jamaica's tax system similarly remarked on the distortions that the incentive system presents:

“The present Jamaican tax system introduces a great number of distortions. For example, the efficiency of the individual income tax is significantly compromised by six features of the tax structure: the differential taxation of capital income, the difference in the corporate and individual income tax rates, the availability of allowances, incentives for certain industries, special tax treatment for certain sectors (tourism), and the proliferation of non-compliance.”<sup>12</sup>
67. Artana and Naranjo<sup>13</sup>, who calculated the distortions caused by incentives, reached the same conclusion. Among their findings were:
  - The incentives provide a strong bias towards capital expenditure in a country where capital is scarce and labor is plentiful.
  - The incentives also promote debt financing at the expense of equity financing, which increases project risk because of higher gearing.
  - The distortions caused by the incentives result in projects subject to the incentives crowding out investments that have a higher overall rate of return.
68. Due weight must, of course, be given to the macroeconomic situation, and in particular the fiscal accounts. Any change to the tax regime must not risk enlarging the fiscal deficit. It must be noted, however, taking the expenditure side of the fiscal situation as being a given is not the best way to encourage efficiency in the economy. Jamaica's public expenditure as a percentage of GDP is high among developing countries, amounting to over 35 per cent [including debt service payments]. Excluding debt payments, expenditure amounts to some

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<sup>11</sup>. See Holden, Paul and Sarah Holden, 2004, *Fiji, Promise Unfulfilled: A Private Sector Assessment of the Fijian Economy*, Asian Development Bank

<sup>12</sup>. Bahl, Roy and Sally Wallace *Comprehensive Tax Reform: Final Report*: Jamaica Tax Reform Project, 2004

<sup>13</sup>. Artana, Daniel and Fernando Naranjo, 2003 *Fiscal Policy Issues in Jamaica: Budgetary Institutions, the Tax System and Public Debt Management*, InterAmerican Development Bank

19 per cent of GDP. Is this appropriate at the country's current level of development? For example, when Australia had the same per capita GDP as that of Jamaica, general government expenditure [excluding debt payments] amounted to 12 per cent of GDP [Tanzi, 2000]. The pattern is similar in other industrial countries. Furthermore, capital spending and growth rates experienced by all these countries substantially exceeded the average growth of the Jamaican economy over the past 30 years. It is difficult to argue that Jamaica needs a public sector of the current size to promote growth, especially in light of declining public sector investment (equivalent to 2 per cent of GDP).

### 3) Taxation and Distortions

69. Nominal income and company tax rates in Jamaica are close to the average of other Caribbean countries. However, the complex system of tax incentives distorts the actual structure of taxation, with the result that the private sector in Jamaica is relatively highly taxed on the one hand, or not taxed at all on the other. Currently, revenue collection violates most of the premises of a good tax system. These include:
  - Neutrality with respect to different sectors, investments and activities. Equally placed companies, investors and individuals should face the same tax burden.
  - Exemptions should be kept to a minimum.
  - The system should be as simple as possible, both to comply with and to administer.
  - Ad hoc exemptions should be kept to a minimum.
  - The tax base should be as broad as possible, to spread the burden widely but fairly.
  - The tax system should embody a societal consensus regarding equity.
70. A recent, extremely comprehensive analysis of the Jamaica system of taxation<sup>14</sup> found that only the last of these criteria are currently satisfied. In general the tax system was judged to be distortionary, discretionary and to have a tax base that is too narrow<sup>15</sup>. The authors suggested an array of reforms, ranging from conservative to more comprehensive, as well as

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<sup>14</sup>. Bahl, Roy and Sally Wallace, 2004, *Comprehensive Tax Reform: Final Report*, Jamaica Tax Reform Project, funded by the InterAmerican Development Bank. This report is a summary of the findings and recommendations of 8 separate reports analyzing different aspects of Jamaica's tax system.

<sup>15</sup>. Using a general equilibrium model, the authors calculate that to raise the equivalent of an additional one per cent of GDP from the Gross Consumption Tax currently costs the equivalent of 2.2 per cent of the revenue raised, compared with an additional cost of 1.4 per cent if the base were to be broadened.

what they describe as a “a Compromise Package” that takes a middle ground between more radical reform and simply adjusting the existing system.

71. The findings of this study became the basis for a Working Committee on Taxation, made up of local business people, accountants, and government officials who examined its conclusions and reported back to government [The Matalon Report] with a series of recommendations to reform the tax system. The most important of these are:
  - An increase in the threshold for payment of the GCT, with a view to simplifying tax administration.
  - A unification of GCT rates and the elimination of special exemptions on several categories of goods, in particular bringing taxes on the purchase of motor vehicles and gasoline into line with GCT rates.
  - A reform of property taxes, including the introduction of a J\$300,000 threshold and a flat tax rate of 1 per cent.
  - The total elimination of Stamp Duty and a substantial reduction in Transfer Tax rates to a uniform 5 per cent.
  - The adoption of an individual income tax threshold of J\$275,184 which would then be indexed.
  - An elimination of the Education Tax.
  - Harmonizing the Corporate Income Tax rate with the Personal Income Tax rate. The Committee considered eliminating corporate income taxes, labeling such a step “an interesting reform choice” that would “signal a friendly investment climate in Jamaica.” However, they rejected the option on the grounds that the revenue costs would be too great.
  - The Committee noted the distortions caused by incentives and recommended that an independent study be commissioned to analyze the costs and benefits of the incentives.
  - Various recommendations for the simplification of payroll taxes.
72. The recent 2005/2006 budget acknowledged these recommendations, but indicated that comprehensive tax reform was not possible at this point. Nevertheless, some of the recommendations were accepted including the increase and indexation of the individual income tax threshold, and raising the GCT rate. While some changes were made to transfer



taxes on property – the threshold was raised to J\$100,000 – the proposals to eliminate stamp duties and reduce the transfer tax rate were ignored. In general, the changes will not have significant effect on resource allocation, or reduce the incentives for informality. And unfortunately, they do not begin to address the problems of distortions in the economy.

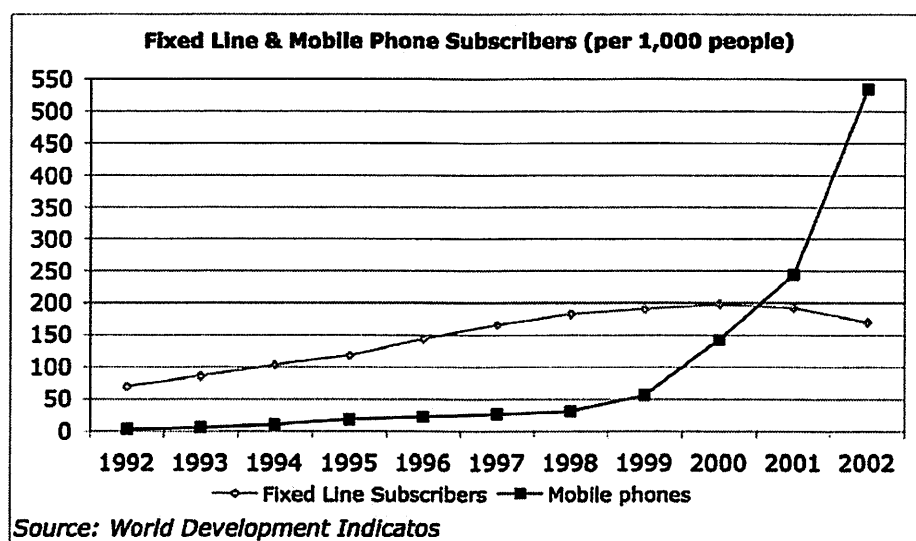
73. While this report is not about tax reform, it is about improving the climate for investment and entrepreneurship. One of the central conclusions is that Jamaica needs radical change in order to promote more rapid growth. For many years, the economy has been battered by macroeconomic crises, periodic natural disasters and large-scale emigration. It is time for change. The radical tax reforms of many of the countries in Eastern Europe, the Former Soviet Union and the most rapidly growing economy in the EU, Ireland, illustrate the potential for rapid growth that simplification and reform can bring about. In some of these countries, far-reaching tax reform has been combined with amnesties on penalties for failure to pay past taxes, on the condition that such payments be made immediately. Heavy penalties accrue to those who do not come forward and pay what they owe. Options such as this need to be considered in Jamaica. Incremental measures will not solve the underlying structural problems of the economy or make it more dynamic. While there are risks attached to substantial reform, in the view of the authors of this paper, the risks associated with gradualism are greater.

## **D. Infrastructure**

74. Infrastructure is an important component in encouraging growth. Small island economies in particular depend upon their contacts with the outside world – telecommunications and the transport infrastructure are vital parts of these links. Reliable power supplies are essential, not only for industry but also for tourism – if companies or hotels have to maintain backup generation facilities, costs and competitiveness are adversely affected. Road quality affects not only urban transportation and tourism, but also rural livelihoods – if farmers cannot bring their produce to market, agriculture will not thrive and urban migration will result.
75. In some areas of infrastructure, Jamaica has become one of the leaders in the Caribbean, particularly in the areas of cellular telephony. An initial privatization had given the monopoly for telephone communications to a single company for a 25 year period, together with a guaranteed rate of return. However, negotiation has led to a substantial relaxation of the monopoly through the entry of two additional mobile phone providers [although off-island

access is still in the hands of the original monopolist. This situation is about to change, as two international fiber optic cable connections are soon to come on-line. Since the liberalization, usage of cell phones in Jamaica has risen dramatically and the costs of calls have declined sharply. The provision of high-speed Internet services remains a monopoly and Internet charges are costly, something which will restrict the development of communications intensive industries, including tourism.

**Figure 7. Fixed Line and Mobile Phone Subscribers**



76. Many of those interviewed in Jamaica complained about the declining quality of infrastructure, mentioning in particular roads and ports. This is not surprising however, as government investment is constrained by the ongoing fiscal imbalances<sup>16</sup>. Nevertheless, the Kingston port compares favorably with other Caribbean countries. Furthermore, it has planned an extensive investment program that will continue to improve its facilities and operating efficiencies. Road maintenance has been particularly compromised by the fiscal crisis, and a large portion of the road network is in very poor condition<sup>17</sup>. Accident rates are high, which, together with the crime problem, is becoming increasingly publicized outside Jamaica. Publicity that could harm the long term prospects for the tourist industry. Similarly, railway track maintenance has suffered and large portions of the rail network are inoperative. Airport runway and facility maintenance and investment have also suffered, particularly in

<sup>16</sup>. This is also spilling over into the education and health areas, which have serious long run implications for the economy.

<sup>17</sup>. The IDB has a road project to build a coastal highway, but disbursement has been severely delayed as a result of the fiscal position of the government constraining its ability to take on further debt.

Montego Bay, the most important airport for tourist arrivals. Without additional maintenance expenditure, in all areas of the economy, the long run growth rate will be further compromised.

77. Regulation in the areas of telecoms and electricity has been improving, although the legal framework with which the regulators have to deal has important deficiencies. A recent analysis<sup>18</sup> concluded that the quality of regulation is improving, but that the legal framework for regulation needs to be examined in order to foster more competition and promote investment, something that the chapter on legal issues in this report supports.

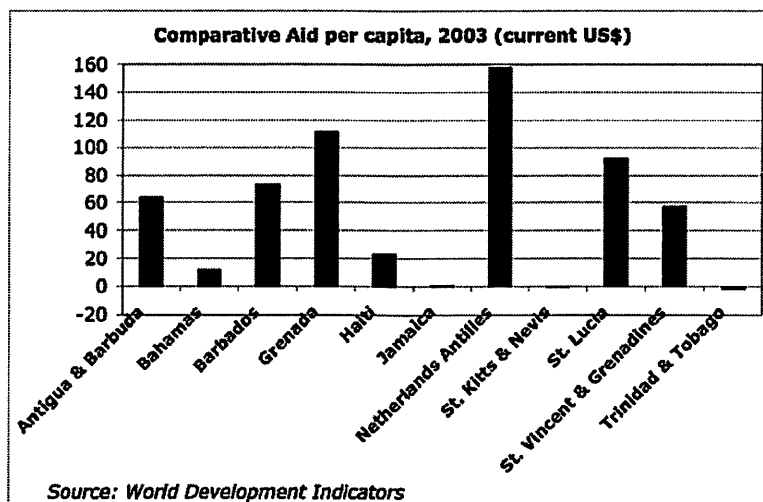
“Recent experience of privatization teaches several lessons, combining institutional aspects and properly regulatory ones. Regarding a general view, it is apparent that Jamaica has a general problem, concerning the lack of certainty created by the coexistence of new native institutions, and the British tradition legislation. Even though general concepts about regulation exist, many of them are solved through negotiations, ex post interpretations and so on. In particular to our concerns, the OUR, which is the main body in this area, should have much clearer rules for action in the future; at least as compared with those that existed when the most relevant privatizations occur. A clear regulatory framework and related policies should favor future privatization of water, including essential elements like precise formula and parameters to set prices of regulated services. Unlike the previous situation on electricity and telecommunications, precise and definite targets in investment should exist in the future for any regulated firm, and leave much less room for ex post negotiating contracts, as it is particularly clear today in the case of road infrastructure.” [IDB, 2003, p37]

## **E. Promoting Private Sector Development – What Can Donors Do?**

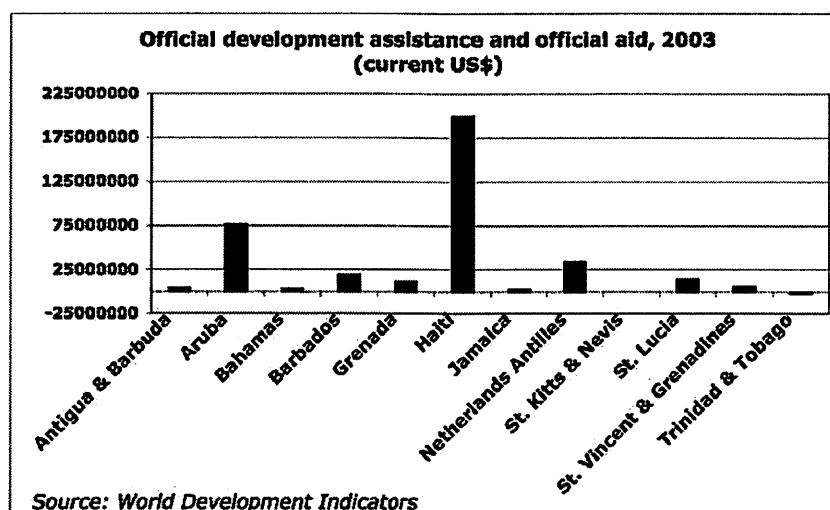
78. There are a large number of donors operating in Jamaica, including the IDB, the World Bank, the Caribbean Development Bank, the EU, several UN agencies, including UNDP and UNESCO, and a number of bilateral donors including USAID, the Canadian International Development Agency (CIDA) and the UK Department for International Development (DFID). In spite of the large donor presence, however, aid per capita is lower than for most other Caribbean countries, however.

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<sup>18</sup> IDB, 2003, Jamaica, *Privatization and Regulation Challenges*

**Figure 8. Comparative Aid per Capita**

79. One of the themes of donor interventions is to improve “capacity” in the government agencies and ministries. In many cases, however, donor strategy appears to be aimed at improving the efficiency of government agencies without examining what they are trying to achieve and the processes that they administer. But, the crushing bureaucracy of Jamaica is a constant theme of observers. It is possible to argue that if an inefficient bureaucracy is administering ill-advised regulations and processes, making it more efficient diminishes rather than enhances the country’s growth prospects.

**Figure 9. Official Development Assistance, 2003**

80. An example of such projects was the World Bank tax project implemented some 10 years ago. Its aim was to improve the efficiency and effectiveness of an inefficient and distortionary tax system. While the hope was to broaden the tax base, according to many

observers, the effect was the opposite, with existing taxpayers being singled out further and the size of the informal sector continuing to grow.

81. The Multilateral Investment Fund [MIF] has a number of projects in Jamaica related to private sector development issues. They involve: support to micro-enterprises in agri-processing and crafts; strengthening the regulatory framework for the Telecom and Energy sectors; and the securitization of workers remittances to enable one of the banks additional access to international funding [this is being done using the legal framework for securitization in the United States, since Jamaica's is inadequate to support securitization].
82. The above-mentioned USAID project entitled "legs and regs," is part of a much larger technical assistance program that does hold promise for change if it can be effectively implemented. As many observers have pointed out, over regulation and bureaucracy add greatly to the cost of doing business in Jamaica. There is pressing need for reform.
83. With respect to private sector development issues, however, there appears to be little coordination or unity of vision regarding what needs to be done. On the whole, interventions seem to be directed at sectors or activities rather than at improving the business environment more generally. Many recent development "fads" can be seen in the programs being implemented, including such concepts as "clusters" and lines of credit provision. Unfortunately, there is overwhelming evidence that providing lines of credit is rarely successful and often hinders financial market development. There is no evidence at all that promoting clusters improves economic development – their current vogue seems to be based on a "post hoc, ergo propter hoc" fallacy<sup>19</sup>.
84. Furthermore, evaluations by some donors contrast markedly with the findings of this PSA, and with the observations of the Jamaican private sector and JAMPRO. For example, the Web site of the New Economy Project<sup>20</sup> proudly proclaims that Jamaica is one of the least regulated economies in the world. Such observations, besides not reflecting reality, can also be damaging because they provide an excuse to postpone change that the economy so urgently needs.

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<sup>19</sup>. See, for example, Locke, Richard and Cristano Antonelli, 1990 "International Competitiveness, Technological Change and Organizational Innovation: Strategy and Structure of the Italian Apparel Industry in the 1980s," in Donald Lessard and Cristiano Antonelli, eds., *Managing the Globalization of Business*, Naples: Editoriale Scientifica.

<sup>20</sup>. This is a project funded by USAID. Details can be found at <http://www.neweconomyproject.com/release0028.html>

## IV. The Legal Framework for Business in Jamaica

### A. Introduction

85. An effective, low cost legal framework governing business transactions is central to the smooth and efficient functioning of the private sector. For example, when transaction costs for torts are low, the law's structure of business liability can improve economic efficiency by enabling firms to "internalize" costs that are external when the tort system is dysfunctional. This makes the private market better at separating economically efficient from inefficient firms, and rewarding the former while penalizing the latter. But there are numerous questions that surround the creation of efficient and appropriate business law. What rules should govern the entry of businesses into the market? What rules should govern the operation of different businesses -- partnerships, sole proprietorships, and corporations? Are these rules economically efficient? How will these rules be enforced? What are fundamental economic functions of a business registration system? A full legal analysis is beyond the scope of this private sector assessment. However, the sections that follow contain a broad overview of some of the legal issues that this paper identifies as being of central importance to promoting private sector development in Jamaica.
86. Law governing the operation of businesses in Jamaica is based on English Common Law, as are the practices and rules surrounding court proceedings. The governing legislation is a mixture of old and new laws. While a number of laws have been modernized, many are outdated and some laws relating to business practice in Jamaica are based on those extant in England in the 19th century. The result is that the legal framework for business in Jamaica is not suitable to support some modern legal practices. In addition, the legal system imposes substantial transactions costs on users, with the result that incentives to be formal are weak and is one of the reasons for the widespread informality that characterizes the Jamaican economy. The high transactions costs are not just because of the delays of going to court to resolve disputes - even in countries with well functioning legal systems obtaining and enforcing court judgments takes months rather than years. Rather, it is the underlying legislation that makes it costly to establish formal legal foundations for many types of transactions involved with the formation, running, and dissolution of partnerships, companies, and contractual relationships.

87. As is common in many developing countries, numerous legal practitioners, who are familiar with working within the existing legal framework, view it as functioning reasonably well. This is not surprising, given that they have many years experience dealing with the idiosyncrasies of the legal system. However, for the vast majority of small Jamaican businesses, the legal system is beyond their reach because of the costs of using it.
88. This chapter deals with the framework for business operations. The following chapter will examine property rights issues, both for land and buildings and for movable property.

## **B. Company Law**

89. Company law provides the foundation for the formation, operation and dissolution of businesses. An effective legal framework promotes contracting, dispute resolution, and the financing of firms.

### **1) The New Companies Act**

90. Recently, a new company law was introduced in Jamaica. [The Companies Act, 2004] that came into force in February 2005. It is designed to address shortcomings in the old law, which was seriously outdated, being based on the English Companies Act of 1948. The Act simplifies the formation of companies, allows for sole proprietorships and partnerships, and reduces both the reporting requirements and the auditing requirements for smaller companies. It is an amalgam of the Barbados, Canada and UK Companies Acts. Probably the most important feature of the new law is that it changes the requirements of registration from one in which companies being registered needed to state the types of business in which they were going to engage, into one in which the company can engage in virtually any activity that it wishes, except for those that are illegal, or those that its Articles of Incorporation specifically prohibit. Further simplifying and clarifying amendments include:
  - o Only the Articles of Incorporation and a Declaration of Compliance are necessary when filing for incorporation. At the same time, the Notice of Situation of the Registered Office must be filed, which reduces the opportunities for fraud.
  - o Single person companies are now permitted if companies are private, while public companies need no more than three directors.
  - o The new Act contains statutory requirements that the directors and officers of any registered company behave honestly, act in good faith and exercise care and diligence in

running the company. Directors have an obligation to give continuous attention to the affairs of the company and to state interests in associated or related companies. Directors can be disbarred by the Court for failure to act responsibly.

- Companies can be bound by pre-incorporation contracts.
  - Par value share issuance requirements have been abolished.
  - The new Act provides for much more flexibility with respect to capital requirements.
  - There is an improvement in the procedures for the registration of charges against company assets, although as a later section will point out, the collateral framework in Jamaica functions poorly.
  - Private companies<sup>21</sup> are not required to file audited accounts with the Registrar if they pass a resolution to this effect.
91. Although the new act is a substantial improvement on the previous act, problems remain, however:
- First, there is substantial confusion in the Act relating to issues connected with share capital, issued capital and stated capital. In addition, certain types of Mutual Companies have unclear capital requirements under the Act. Since these companies often represent communities, this could open the opportunity for fraud.
  - Second, there is ambiguity regarding obligations of existing companies, which were incorporated under the previous Companies Act. It is uncertain, at this point, the degree to which the new Act applies to these companies, particularly when their Articles of Association contain provisions that are in contradiction of the new Act. The Registrar of Companies is aware of this issue and is requesting that existing companies be compelled to apply for a “certificate of continuation” under the Companies Act of 2004. In terms of which they would have to file on a prescribed form that would then become the new certificate of incorporation.
  - Third, the new Act requires that directors “have regard to the interests of company employees in general, as well as to the interests of its shareholders”. This provision sets

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<sup>21</sup>. Except for private companies whose articles provide otherwise. However, all companies licensed under the Banking Act, insurance companies registered under the Insurance Act, companies licensed under the Securities Act, companies licensed under the Financial Institutions Act, companies licensed under the Building Societies Act or the Cooperative Societies Act, or any subsidiaries of such companies must produce audited accounts



up substantial potential conflicts. For example, the interests of the shareholders could require a scaling back of the size of the company, including a reduction in the workforce, which might be construed as being against the interests of company employees. There is no clarity regarding how such conflicts might be resolved.

- Fourth, the reporting requirements under the Act remain onerous. Under some interpretations, the Act requires that the tax registrations of directors and shareholders be filed.
- Fifth, the procedures for winding up insolvent companies are set out in detail in the Act, but the insolvency framework [The Bankruptcy Act of 1958] is based on the 1880 UK Insolvency Act. The combination of a new Companies Act, the bankruptcy sections of which are linked to a piece of legislation that is based on 19th century UK legislation. The outdated provisions of the Bankruptcy Act reduce the effectiveness of those sections in the Companies Act that deal with bankruptcy issues. Furthermore, since there are in some places overlapping issues, there is now greater confusion in the process and greater potential for delay than there was before the Companies Act was revised. In other words, it greatly reduces the efficacy of the reform of this section of the Companies Act.
- Finally, in several areas, the Companies Act is overly prescriptive, and typifies attempts by the government to control many aspects of business life in Jamaica. For example, in the case of contractual disputes, the Act sets in detail the fees for the Attendance in Court of different types of staff, including legal Counsel of different types and in different courts. Such fees are far better left to negotiations between the parties themselves.

## 2) Business Registration

### *i. Jamaica and the Principles of Business Registration*

92. A business registration system serves important economic functions in contract enforcement. The registered address permits one business to find another to settle liability claims. The system serves an essential economic function in stating whether a business employee has the right to obligate a business and permits potential lenders and creditors to determine this. But when there are problems with a registration system, large numbers of informal firms are generally observed.

93. An "informal" business is one that does not follow the legal requirements for registering a business. Why? The law often specifies unreasonable, difficult, and expensive requirements that reach well beyond the public policy and business development justifications for commercial registration. Informal firms find those legal requirements expensive and see the effect of formalization mainly as increasing their chances of being taxed without any corresponding benefit. Simultaneously, other legal framework issues mean that registration has no impact on their access to credit. Faced with high expected costs and low expected benefits, many businesses in Jamaica choose to operate informally.
94. Business registration legal issues may be divided in two groups: those laws that deal generally with business licenses, and those that deal with the registration of companies. A simple economic objective underlies business registration: a business should establish a certain domicile with the public so that the business can be found "legally" for purposes of contract enforcement or in case of damage, such as not paying its taxes, owing penalty fees for improper waste management, or owing a tort claim. Notices delivered to that address are considered "delivered" under the law. Business registration also provides a place for designating which officials in the firm have the power to obligate the firm, facilitating business transactions. Almost every legal system provides for some form of business registration. The laws in Jamaica, however, go far beyond these basic public policy objectives.
95. Most modern laws governing incorporation, such as in the U.S. state of Delaware, do not require detailed filing and these jurisdictions usually have the lowest annual fees as well as the most efficient registries. It is no surprise, therefore, that they are the jurisdiction with the largest number of corporate filings in the world. An essential element of incorporation is striking a balance between the legally required information and the necessary information to find the company and its representatives. For example, Delaware only requires one-page articles of incorporation with minimum information, which suffices to identify the legal entity, and establish its basic structure and the list of officers and directors that can bind the entity.
96. Problems with business registration almost always arise from underlying legal issues and are rarely a technical or organizational issue. If the underlying legal requirements dictate inefficient and costly administrative steps and practices, inefficiency and high transactions costs are enshrined in regulatory procedures in small countries that have severe human

capital shortages and few government resources. Well drafted laws can go a long way towards accommodating limited public sector capacity. Examples already exist – the system described above for the State of Delaware is one such. There are other examples, such as the foreign company registry in Republic of the Marshall Islands, the Vanuatu foreign companies registry and the Company Registry in Columbia.

97. Jamaica has chosen a publicly operated Companies Registry. However, even in industrial jurisdictions, public resources often scarcely meet public interest issues. Reforms that appear to work best usually involve a private sector solution - the private sector is in a better position to provide such services. Jamaica could modify its legislation to allow for limited administrative procedures that would require little or no institutional or financial support from the government yet would function far more effectively in terms of cost, accessibility and convenience than the existing Registry. The discussion that follows points out some of the problems of dealing with a publicly run registry, even though management appears to be competent and dedicated.
98. An important component of costs is the value of time spent by private individuals in complying with regulations. Governments frequently disregard the cost of time spent by private agents since the cost of that time is not directly reflected in government budgets. In addition, government decision makers frequently have an incentive to justify increased budgets and headcounts by extending regulation beyond what is required to meet public policy objectives. But this situation usually increases the privately borne compliance costs. These tendencies should be guarded against in designing efficient commercial laws. In Jamaica, those registering businesses can only do so in Kingston - investigation would probably reveal that as a result, the proportion of informal businesses increases, the further from Kingston they are located. Given the increasing incidence of informality, this is not a trivial issue for policymakers.

## ***ii. Business Registration in Jamaica***

99. Company registries serve the purpose of providing people doing business with a company access to information regarding officers, addresses, and in many cases details on whether the company has pledged assets to creditors, the issued share capital, and details of the structure of the company. There is a growing recognition among economists that much of this information is unnecessary and raises the costs of registration without providing

corresponding benefits. The certificates, papers, statements, or other records or documents required by Jamaica's law only serve to increase the costs of registration, the responsibilities of the Registrar's office, and the cost and complexity of the required computer and ancillary equipment. Instead of capturing information digitally, paper documents must be submitted in Jamaica. But applying technology to paper documents requires more expensive scanning and image management, which are many times more expensive than technical systems. Instead, the law should allow minimal essential information to be entered into an online database, which would then allow the public to search for information on the important aspects of the corporation. Currently, this is not possible in Jamaica as the necessary legislation authorizing electronic transactions of this form is inadequate. An important reform priority should be the passage of such legislation. The issue of recording information electronically also hampers the registering of security interests in movable property, the data on which are recorded in company files in the Registry. All searches for the existence of such interests still have to be done manually, which also increases the costs of pledging collateral to lenders.

100. The procedures and fees governing business registration in Jamaica are high and promote informality. While it is naive to believe that simply bringing down registration costs will lead to a large increase in new business registrations, there is no doubt that the costs of the current registration procedures raises barriers to formalization. The costs of registration take two forms: fees on the one hand and time and inconvenience on the other. The fees themselves are substantial within the Jamaican context. The registration of even a small company not having share capital is J\$7,000, the equivalent of several months per capita income. In addition, the annual filing fee, required by law, is J\$3,000, so simply maintaining a company in good standing is a costly exercise that is certainly beyond the capability of many small traders<sup>22</sup>.
101. The Company Registry has records for approximately 55,000 companies, representing the registration of a total of 65,000 since record keeping began and the removal of about 10,000 companies from the records. Currently, the Registry does not send out annual reports for each company each year [although the long term aim is to do this]. As a result, the records of many companies are not up to date, which often causes substantial delays in the processing of legal documents, requires a licensed attorney to resolve, and raises the costs of contracting

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<sup>22</sup>. By comparison, the charges for registration and filing the annual fee are substantially higher in Jamaica than they are in most US jurisdictions.

in Jamaica. The Registry employs some 90 people, 7 of whom are attorneys. The procedures require that all documents submitted to the Registry be reviewed, a process that adds time and expense to company registration.

102. The records of Companies established prior to 1994 are still in paper form. The computerization process only goes back that far. There is a long term project to extend computerization further back, but not a great deal of progress has been made on this. In addition, the records of the older company are often not up-to-date. This issue is also being tackled in the longer term.
103. Therefore, many aspects of the Company Registry in Jamaica substantially increase transactions costs, from the fees for the registration of companies to the procedures surrounding the recording of information. Although there has been an attempt to “modernize the Registry” through computerization, the exercise did little more than add to the process through the recording of information electronically. While this makes retrieving data more effective, it also puts an extra layer of administration on top of a framework that is inadequate in the first place. Reform of the process must tackle not only the inefficiencies related to the Registry itself, but also the underlying legal and regulatory problems.

## C. Bankruptcy

104. In Jamaica, a company may be wound up by court order. A bankruptcy prerequisite is that the company is not able to meet its liabilities within a three-month period from commencement of the winding up. Any creditor or group of creditors can approach the court for a bankruptcy petition if they are owed at least J\$3000, the debt is at least 14 days overdue and the debtor has been given 7 days notice in which to discharge the debt.
105. Under a court order for the winding up of a company, a receiver or liquidator will normally be appointed to finalize the company's affairs. The legal framework for bankruptcy in Jamaica provides a good system for separating secured loans from bankruptcy. Since the benefits that derive from pledging collateral are enormous, a sound bankruptcy law should not delay or diminish the collection of secured loans in bankruptcy. In Jamaica, secured creditors have priority. This feature includes land as collateral as well as goods sold on credit under a bill of sale and the company charge.

106. The World Bank doing business indicators ranks Jamaica as among the best systems of bankruptcy in Latin America and the Caribbean. But, this ranking does not reflect discussions with legal practitioners in Jamaica, who complain that the system is slow, inefficient and costly. Further investigation is clearly warranted. Analysis illustrates that the system presents some important drawbacks. Among these are:
- The court appointed trustee system in Jamaica is a more expensive mechanism than a creditors-appointed trustee or receivership. Similarly, the aspects of the process that are now administered by the courts, could be more efficient if administered by the creditors.
  - The bankruptcy trustee is entitled to charge a commission of 6 per cent on the realized value of all of the assets of the bankrupt entity. If the assets are sold by auction, the auctioneer is also entitled to a separate additional fee.
  - There is uncertainty in the law as to how much power the court has over the duties of the receiver. The receiver has the power to undertake private sales of the assets of the bankrupt company, a process that has led to substantial abuses in other countries where the creditors do not appoint the trustee.
  - Tax obligations and labor obligations have priority over secured creditors, which weakens the value of collateral. In the most modern systems, secured creditors have absolute priority.
  - Bankruptcy proceedings are not gazetted. Therefore, to ensure that a party in a contract is not being subject to proceedings [and there are substantial penalties to businesses that deal with bankrupt entities], inquiries have to be made with the Receiver to ensure that no proceedings are underway.
107. These considerations indicate that a full review of the bankruptcy process in Jamaica is warranted. Many other essential aspects of bankruptcy should be studied in detail, such as labor and tort claims, and standards for voiding fraudulent transactions. The present Act, however, seems to set out a costly procedural system for Jamaica both in terms of the legal costs and the time that the process takes.

## D. Arbitration

108. Merchants and business operators have settled disputes privately for more than a thousand years with good results. Arbitration is one modern version of this system. For all the ink

spilled about the rule of law and contract enforcement, this is a simple system for settling disputes within voluntary agreements. It is a system that allows dispute resolution outside of inefficient and costly courts. The gains from this approach go a long way in minimizing the cost of commercial litigation and the bitterness that often accompanies the end of an adversarial proceeding.

109. How the law treats the enforcement of arbitral awards can severely limit the economic usefulness of arbitration. Of particular importance is whether broad grounds exist for reviewing an arbitral award in the courts. When the arbitral court itself can order the use of force, or if a judge must automatically give orders to enforce arbitral rulings, with limited rights to review them, then arbitration can be fast and efficient. When arbitration law requires court intervention, and thus the need to hire a lawyer, to enforce the arbitral decisions, arbitration will have a much diminished effect. However, our prime concern is to increase the use of arbitration to resolve disputes in Jamaica. Therefore, the legal framework needs to change.
110. In Jamaica, the Arbitration Act [Cap 19, CT 42 of 1969] establishes an arbitration framework. However, this law is based on English legislation that is over 100 years old. Observers in Jamaica state that new legislation is needed to bring the law into line with modern practices. Among the issues that the current law does not address are:
  - The law does not recognize the possibility of mediation or adjudication.
  - The law allows for a party in an arbitration proceeding to suspend the proceedings by going to court for ruling in law. This can be used to hold up cases under arbitration, which negates one of the prime advantages as an alternative to going through the courts.
  - There is lack of centralized coordination of arbitration proceedings, with the result that the processes tend to be ad hoc, with little standardization of rules and procedures.
  - An arbitration award is enforced by leave of the Supreme Court or a Judge of the Supreme Court.
  - The law does not recognize international arbitration - one consequence is that Jamaica does not incorporate international enforcement of arbitral awards even though it is a signatory for the 1958 UNICTRAL convention.

111. What is missing in the current arbitration framework in Jamaica is an arbitration system available to smaller businesses as well as transactions that follow customary dispute resolution mechanisms with formal legal standing and enforceability outside a closed community network. A solution to this situation possibly includes creating arbitration centers that could be operated for small awards online and via email. Other tribunals could be localized and arbitrators could travel to the place of business of the parties for all transactions. The aim: to reduce litigation costs in the event of contract default. In the long run, online arbitration systems are likely to be cost effective for Jamaica even though the initial set-up costs may be high.
112. There have been attempts to establish an Arbitration Center in Jamaica that would standardize proceedings and rules. If this could be combined with facilities suggested in the preceding paragraph, there would be a substantial increase in the availability of public goods and a major incentive to bring businesses that are currently informal into the formal framework. This is an area that could benefit both from donor funding and technical assistance and has enormous potential to increase the availability of public goods in Jamaica.

## E. Enforcement of Business Property Law

113. Business property rights can be transferred either consensually or non-consensually. When it is non-consensual, it is generally through either theft or corruption. Consensual transfer generally occurs through a business transaction such as the sale of goods. These transfers are relevant because they impact business property rights and enforcement is necessary to ensure those rights are respected.
  - **Enforcement of Business Property Rights in the Event of Non-consensual Transfer.** Loss from theft and corruption represents a fundamental threat to property rights and, thereby, to private sector development. Two constraints prevent Jamaica's government from taking more action to protect property: insufficient police resources and insufficient public prosecutor resources for crime prosecution. In most countries, the police problem is partly addressed by the use of private police. But, the laws governing such police must balance their effectiveness with civil liberty protections. The public prosecutor problem is addressed by permitting private citizens to bring criminal charges before a court. Private crime prosecution is also a potentially important step for curbing



corruption, where the government itself may limit the public prosecution of corrupt officials.

- **Enforcement of Business Property Rights in the Event of Default on Consensual Transfer.** When property is transferred by consensual agreement there are more options for enforcing these agreements. Enforcement becomes relevant in the event of default by one of the parties to the agreement. Private options are generally more effective and efficient. But a private police act could accommodate some key aspects of enforcing property rights, regulating self-help repossession, consumer protection, and the seizure of property without court action when the property right is not disputed. Particular provisions should address the most common transactions in warehousing, ships, aircraft, automobiles, and intellectual property rights.

## F. Credit Information

114. Credit bureaus are clearinghouses for information about individuals. They gather and supply creditors and others with vast amounts of data about the financial status and personal attributes of individuals. They are considered one of the most important sources of information about the paying habits of consumers and play a central role in the development of financial markets. Credit grantors use credit bureaus for credit and financial information. Individual files always include identifying information such as the consumer's full name and address. In addition, they normally include employment information such as position, income, spouse's income, place, and length of employment (present and former), and other sources of income. A full credit history commonly appears, showing all existing lines of credit, payment habits, amounts, due dates, and more. Finally, the file includes significant public record information, including bankruptcies, tax and other liens, and lawsuits. Next to public records, the main source of this information is credit grantors themselves. Most large credit grantors with computer-based record-keeping systems disclose customer account information to credit bureaus every month. They simply supply their computer tapes (or copies) either to a central source, to which automated credit bureaus have access, or to local credit bureaus directly. This shared information will normally include customer name, account number, account type, date and type of last activity, scheduled payment dates, date an account was opened, highest credit accumulated, amounts currently owing or past due, any indication of billing disputes, and the grantor's rating. The rating typically discloses the

customer's usual manner of payment, and is coded so users can discern payment habits (X pays within 30 days, X pays between 60 and 90 days after due, Y numbers of repossession; Y placed for collection etc.). The purpose of credit bureau legislation is twofold:

- To facilitate local credit bureau creation, which makes more information about potential debtors available to creditors from a trusted third party.
- To regulate, but not over-regulate, credit bureaus so the public's legitimate rights, are protected in the information gathering and storing process. This legislation allows creditors to use more relevant criteria in deciding who obtains credit and lets creditors lower interest rates, make larger loans, and for longer periods.

115. Evidence points to the importance of credit bureaus in the development of unsecured lending by financial institutions<sup>23</sup>. Information about unsecured lending rests on the private market, which can share information in credit bureaus. The best legal frameworks that foster the development of credit bureaus are those that most liberally permit the use, compilation, and sharing of information. Essential in this situation is legal support for public access to courts and public registries. Unfortunately, in Jamaica legislation specifically prohibits the sharing of credit information. The Financial Institutions Act [1992] prohibits the divulging of any information regarding accounts:

“No official of any licensee and no person who by reason of his capacity or office has by any means access to the records of the licensee, or any registers, correspondence or material with regard to the account of any customer of that licensee shall, while his employment in or, as the case may be, his professional relationship with the licensee continues or after the termination thereof, give, divulge or reveal any information regarding the money or other relevant particulars of the account of that customer.” [Clause 44]

116. This prohibition places a significant barrier to the development of lending, especially to lower income customers and to smaller businesses. The result is that banks report borrowers serially defaulting, moving from one financial institution to the next to borrow, defaulting then going to another and repeating the process. Not surprisingly, banks have reduced sharply lending to smaller borrowers as a consequence. However, this has dire consequences

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<sup>23</sup>. See, for example, Arturo Galindo Margaret Miller, 2001 *Can Credit Registries Reduce Credit Constraints? Empirical Evidence on the Role of Credit Registries in Firm Investment Decisions*, InterAmerican Development Bank

for future private sector development and growth. Reform of such legislation is needed urgently.

## **G. Legislative Reform**

117. Most of the recommendations in this chapter require legislative action. This implies that new laws need to be drafted, preferably by a combination of foreign experts and local lawyers – the foreign experts should be knowledgeable regarding international best practices and the local lawyers familiar with the problems within Jamaica. The next stage of the process is to go through the formal drafting process for submission to the legislature. Here, however, significant bottlenecks exist. The Office of the Chief Parliamentary Counsel undertakes formal drafting. Currently, there is a substantial backlog in this office – some 70 laws are awaiting formal drafting and passage. For example, a draft e-commerce law was submitted to the Chief Parliamentary Counsel's office 12 months ago but so far no further action has been taken. Donor assistance in speeding up this process could pay substantial dividends.

## V. Property Rights in Land

### A. The Importance of Fixed Property Rights for Private Sector Development

118. There is now substantial evidence that the evolution of clearly defined property rights in land is a necessary condition for long term economic development<sup>24</sup>. Looking at the industrial countries, it is difficult to argue against this claim. Most countries in this group have strongly protected property rights, particularly for immovable property, and well functioning land markets. Financial markets that support the purchase and improvement of property exist in virtually all the industrial countries and constitute a major portion of the assets of their financial systems. Secure property rights for fixed property encourage investment in land and buildings, support financial market development, and promote more equal distribution of wealth.
119. In the vast majority of transition and developing countries, nobody except for the wealthy have the ability to finance the purchase or improvement of land and buildings. The failure arises from insecure property rights for fixed property that exists in most developing countries around the world. But, secure individual property rights are the foundation of an efficient market economy and there are no developed financial markets where property rights are weak. The multiple effects of secure property --the motivation to invest effort and resources to obtain and improve property, to put it to productive uses and to freely sell it -- have often been underestimated as factors in economic development. The effects on the less prosperous have been especially overlooked. Secure property rights allow the ownership of property held by occupational right to be converted into wealth through registered title. These rights give the poor a stake in the future and an incentive to invest, not only in their properties but also in the human capital of themselves and their children.
120. Records to document land ownership, assign rights, and record transfers of land have long historical antecedents. Land is a key component of the wealth of any nation - secure ownership of fixed property is a defining characteristic of all modern industrial economies. These countries have spent considerable time and energy defining land rights and

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<sup>24</sup>. For the most extensive example of evidence and advocacy, see Hernando de Soto. 2000 *"The Mystery of Capital, Why Capitalism Triumphs in the West and Fails Everywhere Else"* Basic Books, New York

establishing institutions to administer such rights. Secure land rights are also critical for the ability to exchange land.

121. In a broader context property rights to land and the associated ability to trade land, provides a pre-condition for the emergence of financial markets. In all developed economies, mortgages, and other sources of credit that depend on land as collateral are the paramount sources of credit which would not be possible without well-defined, secure, and transferable rights to land. Countries where property rights to land are not secure have much lower rates of investment and, eventually, growth than they might otherwise have. In most developed countries, the bulk of small businesses are started using loans that are backed by land.
122. Property rights are no less important for the welfare of the poor. Indeed, the lack of formalized property rights prevents poor people from turning their latent assets into live capital – one reason why the entrepreneurial spirit that is so visible in virtually the entire developing world is not translated into a more inclusive pattern of growth. Several empirical studies have related land registration to improved productivity through access to capital, which results in higher investment and more rapid growth<sup>25</sup>. However, by itself, a property-titling program is only one part of bringing the benefits of secure property rights to developing countries. Unless such programs provide full security of ownership, benefits may well be ephemeral. If registration procedures are costly and time-consuming, formal titles quickly revert to informal status.
123. Such considerations point to broader business environment reforms being needed to ensure the effectiveness of property titling reforms. Poor contract enforcement, or weak collateral laws greatly diminish the usefulness and value of titles. Secure registered titles in a well-developed legal environment allow property owners to mobilize the wealth inherent in their land holdings. However, it is important to note that the usefulness of titles as a means to promote financial market development, mobilization of wealth, and the efficiency of resource allocation rests on economic rather than technical considerations. Titling and registration systems must fulfill certain economic criteria in order for rights in fixed property to provide benefits of ownership. The most important of these are:
  - Titles are secure, in the sense that they cannot be challenged easily.

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<sup>25</sup> Frank F. K. Byamugisha, 1999, *The Effects of Land Registration on Financial Development and Economic Growth: A Theoretical and Conceptual Framework*, World Bank

- Titles are registered in a way that makes it easy to ascertain ownership.
  - Titles can be obtained at relatively low cost.
  - Registration is inexpensive.
  - Property transactions are inexpensive and require a minimum of approvals, permits and interventions by legal practitioners.
124. Registered titles provide sound collateral against which mortgages can be granted, something that requires a well-developed collateral framework. This issue is discussed at greater length in a later section.

## **B. Land Rights in Jamaica**

125. Jamaica has a Torrens system of land registration, in terms of which the government guarantees the accuracy of a land title. Both surveys and “Metes and Bounds” systems of plot boundary definitions are allowed. The procedures governing the registration of fixed property, the recording of titles, the maintenance of records, and surveying and mapping are administered by the National Land Agency located in Kingston.
126. While most land rights practitioners favor Torrens type systems, many economists are less enthusiastic. Torrens type guarantees lead to a more expensive filing system, require more trained personnel, and are costly. It also opens registration to the discretionary decisions of registry officials, setting the foundation for a registry system that is less predictable and secured. In Jamaica, a Referee of Titles decides on the validity and accuracy of registration applications and charges a fee of one per cent of the value of the title. The position is subject to Ministerial Appointment and is generally for life. This is not an economically efficient arrangement and raises the costs of registration.
127. By contrast, modern notice-filing registry laws provide for less expensive and more secured registration systems. Under notice-filing registry laws, the law provides for guaranteeing only the filing of information as provided by the parties, and entering it into a secured database. Thus, the registry becomes less expensive to operate, and more secure.
128. Fixed property registration and transfers are costly and time consuming. A combination of procedural requirements and fees and transfer taxes puts the possibility of owning secured registered property well beyond the means of a large proportion of Jamaica’s population.

129. The process for registering a parcel of land for which there is no registered title appears in the text box. It is elaborate and costly. There is a charge for registering, a charge for the Referee of Titles, a charge for the actual registration, a charge for the valuation of the property, if this is necessary, a surveyors charge if there is no plat for the property, and stamp duty for the registration. Representatives from the Land Registry estimated that the cost of an attempt to engage in sporadic registration and titling of a property could amount to J\$300,000. Recently there was an amendment to the Surveyors Act that allows for GPS surveys and allows areas to be declared eligible for titling without going through the process of sub-division, which should have the effect of speeding up titling in areas where such declarations are invoked.

**Figure 10. Procedures for Titling Land in Jamaica**

The documentation and procedures required for registering land as described on the National Land Agency Web Site are as follows:

- An application form prescribed by the Registration of Titles Act and signed by the applicant.
- A Statutory Declaration by the applicant to prove possession (a statutory declaration is a written statement confirmed by supporting statutory declarations to prove ownership from two persons who have known the land for at least 30 years and in cases where the applicant has no documentary proof of ownership, showing title for himself and predecessors in title for 40 years).
- An up-to-date certificate of payment of Property Tax.
- Survey pre-checked diagram (if the land is being registered by plan).
- Any other document you may have that proves ownership e.g. Receipt, Conveyance, Probate, Certificate of Compliance under the Facilities for Titles Act.
- Applications otherwise than by Plan must describe the land so as to enable identification of the location of the parcel on the ground by reference to a landmark and must state the names by which the property is known. The description must state the distances along each boundary and the compass direction of each boundary line, the names of the abutting properties, the names of adjoining owners, and where the abutting land is registered land, the title reference for the property.
- There may be other documents required depending on the facts of each case. Persons who wish to register land should therefore seek the assistance of a lawyer. Registration fees are paid when you submit your documents to the assessor at the Titles Office. You will be issued a dated official receipt with a number stamped on it, and the name of the person who lodged the application. The number printed on the receipt is your application number and must be quoted when making enquiries about your application. You must keep your receipt until your application is successfully completed.
- Stamp Duty and Transfer Tax are payable to the Taxpayer Audit and Assessment Department unless falling into any category of exemption.
- Your application will go through a series of processes as prescribed by law:
  - The documents will be checked.
  - The survey diagram will be sent to the Survey department to be checked to ensure that the land is not yet registered and the plan is acceptable.
  - Thereafter all the documents will be submitted to the Referee of Titles for consideration.
- When the Referee approves an application, the applicant is sent a Notice, which must be published in a particular newspaper for a period decided by the Referee of Titles.
- Currently all these procedures have to take place through the Kingston Office.

The website also lists schedules of fees - there are over 30 that could apply.

## B. The IDB Land Administration and Management Project

130. An IDB pilot project has been underway in the Parish of Saint Catherine to title some 13,000 new parcels and to clarify the titles for about 12,000 further parcels. It also aims to improve the land information management system and land use planning as well as establish a GPS-based national geodetic network. The total value of the project is \$12 million, although because of various delays a much smaller sum has actually been disbursed. Because of various delays in the acquisition of land, progress has been slow and costs per parcel have been substantially higher than anticipated [estimated by the officials of the Land Registry to be about \$J3,000 per parcel, against a target of \$J\$1,300. Further transactions involving these properties will incur the same costs as other properties currently outside the project.]
131. The authors of this paper do not share the enthusiasm that many land rights specialists hold for topographical mapping as an instrument for obtaining secured registered title. While such maps may assist with land use planning, they are not necessary for land registration systems. Such maps exist in dozens of developing countries, none of which have effective systems of property rights in land. While Jamaica's land registry will have information on registered titles, the system is too costly for the vast majority of poorer Jamaicans to use. Specifying boundaries with sufficient accuracy requires no more than the agreement of adjacent land holders regarding where one property ends and the next one begins. The value of having secure registered title far outweighs the benefits of mapping and cadastral programs, particularly given that such maps have rarely resulted in land titling systems that benefit the poorer members of the community.
132. To be effective, property must not only be titled and registered the first time, but subsequent land transactions must also be registered as well. A one-time waiver of transfer taxes and stamp duties will not engender future transactions, because they will incur the existing substantial costs. Project design should ensure that initiatives do not create a separate class of properties within the country, complicating administration and introducing further distortions. Recent work by the World Bank supports these observations:

“The analysis of World Bank operations in this area supports the paper's argument: while individual projects do deliver on promised outcomes (number of titles, number of mortgages, passing of laws and regulations, etc.), they are less successful in effecting long-term reforms and institutional development. This is hardly surprising given



the limited scope and time span (2-4 years) of individual projects. For isolated projects/actions to make sustainable contributions to reform and institutional development of land and real estate markets, they have to be bundled and sequenced as part of a comprehensive reform agenda.<sup>26</sup>

133. An ancillary issue arises from the costs of probate that occur when a landowner dies. This is a costly process that must be gone through in order to transfer title to the landowners' heirs. Lawyer fees, which are mandated, can consume a substantial portion of the value of the property of the poorer members of the community. The result is that in many cases titles remain in the name of persons who are deceased.

## C. Land Rights and Collateral

134. Therefore, the main characteristics of an effective system of collateral in land and buildings include:

- The person pledging the property must be able *to prove some alienable interest*— in the case of fixed property this means that the pledgor must have some interest like a lease, a contract with another owner, rights existing under recognized law, or a secure registered title. This requires that information on ownership of the property must be accessible at reasonably low cost and must be accurate.
- The pledges must be *easily perfected* – perfection means that it must be possible for lenders to determine whether the assets have already been pledged as security to other lenders – whether they have given a lender a security interest in the property by pledging it as collateral. This requires that information concerning security interests in the real estate – mortgages or other types – be accessible easily and cheaply.
- The pledges must be easily executed in the event of default. Executing on a pledge means taking possession of the asset that has been pledged as security in the event of default. *Court procedures must allow for the rapid possession* of the assets if the borrower defaults on the loan.
- *The transactions costs involved in pledging must be low.* In many countries (including, as we have seen, in Jamaica) transfer taxes, stamp duties, and legal fees are a significant percentage of the value of the pledge, which discourages the use of assets as collateral.

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<sup>26</sup> Galal Ahmed and Omar Razzaz *Reforming Land and Real Estate Markets*, World Bank, 2001

135. Mortgages are available in Jamaica for up to 25 years at interest rates of approximately 16 per cent. Legal practitioners report that in the event of default, it is difficult to repossess property with the process usually running into years rather than months in the event that repossession is contested, even though the courts now generally do not allow various stratagems that were used in the past.<sup>27</sup> The law requires banks to auction properties in order to ensure that they are not accused of preferential selling. Bankers report that in practice they are generally required to go through the auction process twice in order to prove that they made every effort to obtain the highest possible price.
136. Furthermore, the transactions costs of property transfers are extremely high. Transfer taxes and stamp duties account for some 13 per cent of the value of a transaction, while real estate agents fees are generally set at 5 per cent. Legal fees are set as a percentage of the value of the transaction and range from 1.5 to 3 per cent. In addition, if the tax authority challenges the valuation, a professional valuator is required to value the property, charging a fee of 3 percent. In the event that the purchaser takes out a mortgage, there is a fee of 0.625 per cent. Thus, up to 25 per cent of the value of the transaction can be taken up by fees.
137. It is no surprise, therefore, that one of the central markets that supports private sector development functions extremely poorly in Jamaica. For those with secure registered title, the costs of property transactions are among the highest in the world - several times those in the United States, for example. For the hundreds of thousands of poor people who have occupational title to their property, the wealth locked up is truly the 'dead capital' of Hernando de Soto's description. The value of the asset that they possess cannot be utilized in order to finance home improvements, to buy other properties or to raise funds to finance a new business. The costs of obtaining formal registered title are prohibitively expensive. Unfortunately, the land administration project of the IDB does little to address this issue.
138. The question needs to be asked regarding the approach that government and possibly donors should take to reforming land and real estate markets, with a view to benefiting all sections of the community, particularly the poor. Ad hoc solutions are rarely sustainable. Just as in other projects, there is no substitute for a careful analysis and diagnosis of the problems related to how the real estate markets function, the constraints that are faced, and the impact

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<sup>27</sup>. It was common to challenge the valuation on which the property was being seized as well as the calculations on which interest due were based.

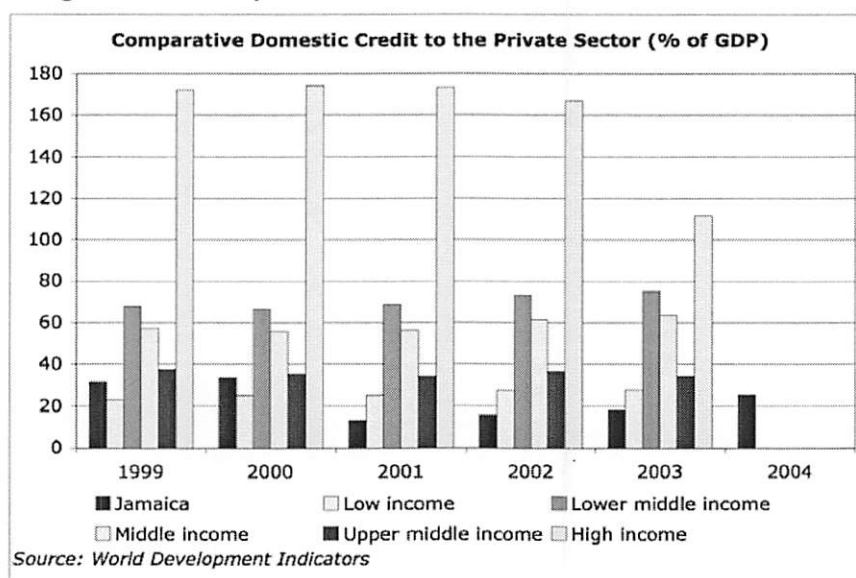
of various reform options. An assessment of this type would outline how to proceed with the reform and provide a clear prioritization and sequencing for the reform. It would link reform in the land/real estate market with financial market reform to make financing more easily obtainable through the ability to pledge land as collateral effectively. Such an initiative is needed urgently in Jamaica.

## VI. The Financial Sector and Private Sector Development

### A. Underdevelopment of Financial Markets in Jamaica

139. The Jamaican financial sector is severely underdeveloped, in spite of having a wide variety of financial institutions. Domestic credit to the private sector amounts to less than 20 per cent of GDP. As the banking crisis was cleaned up, domestic credit declined particularly sharply, especially from 2001 onwards. By 2004, private sector lending had not recovered to pre-crisis levels. Even during the 1990s, Jamaica's financial market development was low. On average, countries with per capita incomes of US\$1,000 or below had ratios of domestic credit to GDP of around 25 per cent, substantially larger than Jamaica. Countries with similar per capita incomes had ratios that are three times that of Jamaica.
140. Even in high income economies, bank credit is by far the most important factor in financing investment and entrepreneurship. It is reasonable, therefore, to conclude that financial underdevelopment is severely limiting Jamaica's long term growth potential.

**Figure 11. Comparative Domestic Credit to the Private Sector**



141. A number of factors are responsible. Currently, memories of the crisis remain strong in the business community, memories that have had a substantial impact on the willingness of business to expose themselves to large quantities of bank debt. Furthermore, commercial banks exclude substantial classes of borrowers and financial instruments that are

commonplace in other countries. For example, banks will not lend to sole proprietors, who make up by far the largest category of small businesses. Banks will not do financial leases, except to the largest companies, which means that equipment lending secured by the asset itself does not occur except in a limited number of cases. This especially harms smaller businesses - in the United States, for example, such lending makes up a very large proportion of the financing of smaller businesses. As the chapter on legal issues pointed out, this greatly reduces the incentives for formality on the part of smaller businesses and harms their ability to produce competitively. During the financial meltdown, commercial bank lending rates soared from 25 per cent to well over 100 per cent, if charges are included. The result was that large numbers of businesses were faced with interest bills that they could not afford, at a time when demand for their products was waning precipitously as GDP dropped. There were many bankruptcies, which added to the spiral of unsustainable debt and declining demand. Furthermore, there appeared to be substantial cross over in between share holding and lending, which meant that arms length dealings had not been observed. However, the financial bailout meant that depositors, who had also borrowed money, did not have to offset losses to the financial system on the one hand with loss of deposits on the other.

142. Although the winding up of defunct financial institutions following the banking crisis occurred with admirable efficiency, recovery of collateral did not begin to cover losses – there are reports that recovery rates were less than 20 per cent. This partly reflects the difficulties of recovery in a “meltdown” situation, and partly the inefficiencies of the collateral framework in Jamaica.
143. The macroeconomic imbalances, in particular the debt burden, add substantial macroeconomic risk premia to interest rates. Rates of return on new projects must incorporate this premium. The higher prospective rates of return, the riskier the project, which further means that companies will fail more frequently, in turn making lending riskier. Furthermore, high interest rates have resulted in banks holding very high concentrations of government debt, which constitute the equivalent of over 40 per cent of total deposit liabilities, one of the highest government debt/deposit ratios in the world.
144. While the crisis has contributed to financial market underdevelopment, it is not the prime cause. Credit to GDP ratios were low before the crisis. High inflation, which greatly adds to transactions costs and to the reliability of financial information has been a major contributor

to the risk of bank lending. In addition, the lending framework is inadequate. Creditors cannot lend with any certainty of being able to readily recover property pledged as collateral in a reasonable period of time. As a result, they tend to ask for personal guarantees on bank loans that are backed by real estate. Furthermore, since the process of repossessing and selling real estate assets is costly, the value of the collateral is usually several times the value of the loan, which raises the risk for borrowers.

145. The risk premium inherent in the debt results in high levels of real interest rates and substantial spreads between borrowing and lending rates. The paradoxical situation results in the banks complaining of a shortage of “bankable projects” and excess liquidity on the one hand while smaller businesses cannot access credit on the other. This situation is not unique to Jamaica – it occurs in many developing countries. A typical solution is to use a Development Bank, which ostensibly lends to projects that commercial lenders consider to be too risky. In practice, the development bank option rarely addresses the problems of lending risk and access to finance. Most development banks around the world are bankrupt, because of the very risk of the projects to which they lend, or because political interference pushes development banks to lend to well connected borrowers who frequently feel no obligation to repay their loans. At the other extreme, the few development banks that are solvent lend only to the highest quality borrowers at subsidized interest rates, crowding out commercial lenders. In Jamaica there is a dearth of financial instruments that deepen financial markets. There were only 10655 mortgages outstanding at the end of 2003. Even assuming that these are all for residential real estate, since there are about 600,000 households in Jamaica, this amounts to less than 2 mortgages for every 100 families, a tiny fraction of mortgage penetration rates in the United States.
146. The reason why banks in Jamaica do not lend is not hard to explain. Lending to all but the wealthiest borrowers is fraught with risk, something that is reflected in the structure of interest rates. The calculation in the following table breaks down the various components of interest rates. It separates current interest rates in Jamaica into their component parts, including macroeconomic risk, government borrowing risk, real property risks and risks associated with taking movable property as collateral for loans.
147. Similarly, such mechanisms as leasing and securitization, which have the potential both to make financing available to larger groups of borrowers and to spread risk [thereby lowering

interest rates], either do not exist or are used infrequently. The result is concentrated financing and low financial market development. For example, reform of the mortgage lending framework, plus reform of the legislation and regulations covering securitization would greatly improve financial market development.

148. The table compares interest rates in Jamaica with those in the United States, which has the world's most developed financial markets. The differences between interest rates in the two countries are then disaggregated into various components such as country risk, exchange rate risk and especially the risks associated with lending in Jamaica. It does not attempt to disaggregate a component explaining bank efficiency. Banks in Jamaica are undoubtedly less efficient than those in the United States, and this will explain part of the interest differential. However, the efficiency component would account for no more than one or two percentage points of interest.

**Table 1. Explaining High Interest Rates in Jamaica: March 2005**

	United States	Jamaica	Difference
1. Greater Macroeconomic Risk in Jamaica: This is the cost that the current macroeconomic situation imposes - investors in Jamaican Government US dollar denominated securities require a large premium to induce them to accept the risk of default.			
(a) Government Borrowing Rate in US dollars	2.5%	9.0%	6.5%
2. Exchange Rate Risk: This is the risk that investors in Jamaican Government securities denominated in Jamaican dollars will see their investment devalued by a drop in the exchange rate vis-a-vis the US dollar. Normally, this would incorporate inflation differentials, based on expectations of future price increases in both countries. Combining rows (b) and (c), it appears that investors do not expect any depreciation in the near future			
(b) Government Borrowing Rate in Jamaican Dollars		14.5%	5.0%
(c) Inflation Differential - US/Jamaica			5.0%
3. High Intermediation Spreads in Jamaica: The banking crisis has led to a reduced number of banks and probably less competition. Certainly, commercial banks in Jamaica have less competition than banks in the United States, hence spreads are higher.			
(d) Prime Business Borrowing Rate	5.5%	19%	
(e) Spread over government borrowing rate	3.0%	5.5%	2.5%
4. Movable Property is less adequate collateral for loans in Jamaica. The mortgage interest rate in Jamaica is slightly less than the prime business borrowing rate, illustrating that it is considered to be reliable collateral in spite of the difficulties of repossession. However, loans secured by equipment, automobiles and other movable property are considered to be much more risky			

	United States	Jamaica	Difference
(f) Mortgage Interest Rate	5.70% (30 year fixed)	16.5% (up to 25 years)	10.5%
(g) Equipment/Automobile Loan	6% - 8%	25% - 30%	
(h) Spread	0.3% - 2.3%	9.5% - 13.5%	7.2% - 11.2%
Source Federal Reserve Bulletin and Bank of Jamaica Website			

149. The calculations illustrate that borrowers in Jamaica pay a high premium because of the macroeconomic risk and the poorly functioning collateral framework. As in other economies, different sectors differ substantially in the best combination of real estate, equipment investment and human capital. Because real estate in Jamaica provides better security it permits lower interest rates for borrowing – the market therefore allocates more capital towards operations that are intensive in real estate. As other parts of this private sector assessment have pointed out, the whole structure of incentives in Jamaica is heavily biased towards capital intensive investment, something that is less than desirable in a country where there is substantial surplus labor.

## B. Regulation of the Financial Sector

150. Understandably, following the financial crisis, financial regulators in Jamaica have been supervising financial institutions very closely. Regulatory methodology is beyond the scope of this paper. However, lawyers and others reported that heightened regulation had not been matched by greater efficiency. Even simple financial transactions that require regulatory approval are subject to extensive delay. Neither the Financial Services Commission nor the Bank of Jamaica are reported to be responsive to requests for expediting rulings. Neither the banks, nor their legal advisors raised issue with the regulation itself. Indeed, they all emphasized that strong prudential regulation is essential for the financial system to continue to recover. Unfortunately, however, the delays in obtaining decisions from financial regulators match the other reports of similar inefficiencies that plague the interactions of the public sector with the private sector in Jamaica.
151. In addition, some of the provisions of the Financial Institutions Act have implications for financial market reform, particularly those relating to the use of collateral and the degree to which banks can take movable property as security for loans. These provisions will need to be examined within the context of any reform of the collateral framework.



## C. Movable Property Rights in Jamaica

152. In industrial countries, effective systems of collateral have played a central role in financial market development. Interest rate structures of lenders demonstrate conclusively that loans secured by collateral carry lower rates and longer terms the better they are secured. Such systems of effective pledging of collateral as security are missing in Jamaica.

### 1) Characteristics of a Well Functioning Collateral System

153. The economic usefulness of a legal system for security interests will depend on how well that system fulfills certain key requirements:

- The law must provide for creating an enforceable security interest against all economically important property – both tangible and intangible.
- It must apply to all important transactions in which security interests are created.
- The cost of creating such a security interest must be low relative to the value of the property.
- Enforcing the security interest must be inexpensive relative to the value of the property.
- The law and the institutions that implement the law must allow the lender to determine before the loan is made, with certainty and at little cost relative to the value of the property, whether any other lender has a superior claim to the collateral.
- The secured lender must be protected from hidden claims of third parties, including secured and unsecured creditors, a trustee in bankruptcy, or some purchasers of the collateral.

154. Often the features that cause problems in a secured transactions framework have no obvious justification in public policy. And even where they do have a public policy objective, the means of achieving the objective (tax collection, or protection of workers, debtors, and tenants) can impose a high cost on the country's economy by reducing access to credit. In addition, and most importantly, it is possible to use other policy measures to achieve these worthy objectives without compromising a country's access to credit.

### 2) Using the Collateral Framework in Jamaica

155. To understand what is necessary for establishing a framework for secured transactions, it is essential to understand the four economically important stages of being able to pledge

collateral that can be used to secure loans. Those stages are similar to those described in the section on pledging real estate, namely:

- *Creation.* The process by which the creditor establishes a security interest in a specific property (the collateral.)
- *Priority.* This is the process by which the lender establishes the priority of the security interest. This step ensures that the collateral has not been pledged to anyone else. It requires the lender knowing whether any other security interest might have been filed and when the filing occurred. In the most modern systems, the date of filing is recorded along with the time. In Jamaica, a company charge is only effective when it is entered in the company file in the Company Registry and when a security interest is discharged, it needs to be noted in the company file in the registry. In addition, a separate registry for bills of sale exists, so that both the Company Registry and the Bills of Sale Registry must be searched to ensure that the lender has priority.
- *Publicity.* This is the process that makes public the priority of the security interest. This ensures that other potential lenders are aware of the security interest, thereby minimizing the possibility of disputes over the ownership of the collateral.
- *Enforcement.* This is the process by which, upon the debtor's default, the creditor will seize and sell the collateral to satisfy his claim. The cheaper this procedure, the more value can be placed on collateral. In modern systems, this process only takes days, which means that lenders can realize a high percentage of the value of the collateral that they hold. In systems that do not work well, it can take months or even years. Such delays greatly degrade the value of movable property as collateral. In Jamaica, enforcement of judgments is slow and difficult. An order must be obtained from the court, which in itself is not quick. Once judgment is obtained, the winning lawyer must notify the bailiff at the parish level. Since there is only one bailiff per parish, who also serves the Supreme Court, the process is very slow. Typically, it can take 4 to 6 months to receive an answer. The net result is that lenders are forced to hold collateral many times the value of their loans. This raises the risks to borrowers as well – they stand to lose much more than the value of the loan.

156. To work effectively, each of these stages must be effective before the secured transactions framework can be used reliably as security for lending. Although there are forms of collateral

instruments available in Jamaica they are rudimentary and not easy to use, raising the costs of creating security interests. Some instruments that constitute standard forms of collateral in modern economies are not used at all in Jamaica. For example, floating charges over accounts receivable are not taken by banks, excluding one of the largest assets of many companies from being used as collateral.

157. The UK Law of Bailment that predated 1961 is the law that governs warehousing in the country. This law, however, is outdated, and not suitable for modern practices. Similarly, ships mortgages, commodities bills of sale, crop liens, back to back financing are available under outdated English Common Law structures. However, they require lawyers to draw up individual instruments and examine the law to ascertain what is permissible. As in many other Caribbean countries, high quality legal expertise is expensive, so the cost of creating security interests is high.
158. A further problem is that sole proprietors have little access to pledging collateral other than using Bills of Sale financing. Lenders indicated that they generally were not prepared to accept significant exposure under this instrument. In practice, therefore, the majority of businesses in Jamaica are excluded because they are sole proprietors.

### **3) Reforming the Collateral Framework in Jamaica.**

159. The collateral framework is outmoded and does not serve the needs of business. Jamaica's laws do not meet the necessary conditions that would allow for the inexpensive and predictable use of movable property as collateral. The framework for lending that meets the standards for creation, priority, publicity, and enforcement of security interests is not in place. While it is possible to use some forms of collateral, the process is costly, inefficient and risky to lenders—the existing framework does not permit the effective use of collateral as security for loans. These shortcomings have significant adverse economic consequences for Jamaica, by inhibiting the development of comparative advantages in such areas as agriculture, services and tourism, resulting in a loss of potential high value export opportunities. The current system inhibits the growth of businesses, prevents commercial opportunities from being fully exploited and especially disadvantages the poor among the Jamaican population who wish to operate as sole proprietors. The difficulty of purchasing equipment on credit harms productivity and inhibits growth.

160. The authors therefore recommend that the IDB assist the government in a reform of the collateral framework in Jamaica. Technical assistance would help reform comprehensively the legal, regulatory and technical framework for secured transactions. The outputs of the proposed TA would be:
  - An in depth analytical study of the legal framework for secured transactions, emphasizing the economic problems arising from features of the present *laws* and the potential economic gain from proposed reforms.
  - A legal and regulatory framework for secured lending, involving a new secured transactions law, an electronic transactions law, and abrogation of all legislation that might impinge on the ability to pledge collateral effectively.
  - Reforming the system for the repossession of collateral in the event of a default, including more effective repossession, as well as protection to ensure that unscrupulous lenders did not repossess assets to which they are not entitled.
  - An Internet-based notice filing archive, supplied on a turnkey basis.
  - The technical and administrative regulations governing the Internet-based notice filing archive for security interests.
  - A supplemental program for capacity building, public awareness building, and monitoring support.
  - A revocation of those sections of the Financial Institutions Act that prohibits the sharing of information on borrowers.
  - Establishing the legal foundations for the operation of credit bureaus and the sharing of financial information.
161. There have been many attempts at such reform in other countries, most of them unsuccessful. Legal analysis without corresponding analysis by economists of reform suggestions has failed in most countries in which they have been tried. Internationally known legal practice may not represent best economic practice. In many places, model laws have provided the foundation for attempts to reform the collateral framework. However, fiddling with model laws is often much less desirable than rewriting laws from scratch.
162. A good project requires close coordination between the economists, international lawyers, local lawyers, and technical experts. Local lawyers perform crucial functions both at the first stage, in research, and in the second stage, explaining the work to other local people. Failing

to integrate the local lawyers and the international experts can only produce poor results. The international experts cannot make sensible recommendations without considerable input from the local lawyers, so it is futile to depend on the international experts to rescue the work at the end. Furthermore, leaving legal drafting only to lawyers is a common donor practice but it is almost always a mistake. Economists and technical experts should be involved from the outset of the project, collaborating with lawyers in a diagnosis of the issues and elaborating drafting options.

163. Examples of successful reform do exist and serve as a model of what could be done in Jamaica. A recent reform of the secured transactions framework in Romania has transformed Romania's lending environment by facilitating the use of collateral as security for lending, not only from the banking system, but also from equipment suppliers, wholesalers, and agricultural suppliers. There were many similarities between the Romanian financial sector before this reform and that in Jamaica – severe financial underdevelopment, inability of a large sector of the economy to access credit, and a distrust of banks.
164. The secured transactions reform in Romania tightly integrated diagnosis, and the drafting of the laws and regulations and is one of the main reasons for its success. This methodology has rarely been followed in reform efforts elsewhere. Even in the United States, reforms of the collateral framework have proved to be much more expensive than they needed to be.<sup>28</sup>
165. Informing a technical assistance project of this nature would be a philosophy that would reverse many procedures that are common in the public sector in Jamaica. Such practices would be abjured that involve:
  - Creating forms asking for unnecessary information that is not required by the law.
  - Refusing action until unnecessary information is supplied.
  - Failing to collect information that the law requires and that creditors need.
  - Delaying the process by reviewing documents for authenticity or correctness.
  - Imposing excessive fees to raise revenue beyond the actual needs of the archive.
  - Using complicated fee structures with no basis in the law and that discourage credit.
166. These steps would go a substantial way towards promoting further development of the financial market in Jamaica.

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<sup>28</sup>. The State of Maryland reformed its secured transactions law, but left in the unnecessary condition that original documents had to be filed. This necessitated the development of a very expensive scanning system in order for the system to be accessible on-line. The final cost was over \$10 million, compared with substantially less than \$1 million for the Romania reform.

## VII. Conclusions and Recommendations

167. This paper has documented at some length the issues related to promoting private sector development in Jamaica. The inescapable conclusion is that transactions costs are high, resource allocation signals are distorted, the financial system does not intermediate effectively to fund investment and entrepreneurship, property rights are weak and the legal system is outdated. The modern mechanisms of business are available only to a small portion of the population. The vast majority of those outside formal employment are in the informal sector, which is characterized by low productivity.
168. The paper points out Jamaica's long run structural issues, in terms of which the more rapidly growing sectors of the economy are receiving subsidies in the form of tax and other concessions, with the implication that the "legacy sectors" will have to pay an increasing portion of the tax burden. In reality this will not occur, as they will gradually go out of business. The paper points out the microeconomic implications of the debt burden. While it is evident that the Jamaican authorities have managed living with the debt with great skill, the economy remains vulnerable to external shocks. Furthermore, the financial implications of the debt necessitate high interest rates that imply investments tend to be more risky than in lower interest rate countries. In addition, investment in vital infrastructure and social services, such as health and education has suffered, which further compromises longer term growth prospects.
169. The paper points out the burden that crime places on the private sector, likening it to a substantial additional tax. The high rates of investment have not brought concomitant growth. The marginal efficiency of investment is low, for reasons that the paper elucidates, including investments to reduce the impact of crime, which does increase productivity and distorted incentives, which directs investment into low productivity activities.
170. The paper confirms the observations of others regarding the overwhelming bureaucracy. It makes the point that efforts to improve the efficiency of the public sector without changing processes can raise, rather than reduce, transactions costs. It makes a similar point regarding the efforts to place independent agencies on a self

funded basis – the incentives for these agencies are not to improve efficiency but rather to raise revenue by setting substantial user charges. The irony is that the more the public sector attempts to control economic activity, the less control it actually has, as business opts to remain informal. The cost - foregone expansion and growth.

171. Currently, there is optimism in Jamaica as the exchange rate remains strong against the US dollar and interest rates are declining. Substantial new investment in the tourism and minerals sectors is occurring. Yet much needs to be done to raise the long term growth rate of the Jamaican economy and raise levels of prosperity for a large part of the work force. In spite of promising signs recently, the fundamental conditions for vigorous growth of the private sector are still not in place. While the new investments will undoubtedly provide stimulus to the economy, conditions in which entrepreneurship and investment can flourish do not exist. The business environment is weak and requires reform in several areas, some of them difficult politically.
172. Yet much of this has been said before, although perhaps with not as much focus on the impact on private sector development in Jamaica. In spite of the outpouring of advice, and in spite of the privatizations of the past decade in some areas there has been little improvement in the business environment. In particular, the public sector embodies a culture of control and inefficiency. Until this situation changes, informality will continue to grow. Clearly the message of the importance of the private sector in promoting growth and the necessity of a low cost business environment characterized by efficiency has not been absorbed. In the view of the authors of this paper, promoting this message through articles in the newspapers, op-ed pieces, radio and television interviews, workshops with the public sector and continued and intense dialogue should perhaps become the priority for all donors intent on promoting private sector development in the country. Furthermore, it is incumbent upon the donors to have a unity of voice, vision and consistency of projects. If one donor is attempting to reform the lending process, others should not undermine this by promoting credit lines.
173. Donors have funded a large amount of investigative research - the number of papers, analyses and initiatives is staggering. Yet the growth of the economy does not come close to matching the volume of the analysis. Several evaluations of the World Bank,

for example, have noted that there is a strong link between the success of projects and the underlying analysis, yet many projects continue to be implemented on a judgmental, rather than an analytical, basis. At the same time, the findings of much analysis are ignored.

174. What are the implications for the IDB of the preceding analysis?

- First, the need to engage in dialogue to promote private sector development is paramount, which will require some grant funding. There is a great need for debate on all of the issues related to private sector development identified in this paper. The IDB could take a lead role in the discussions of incentive policies, linking resolution to private sector development policies within a more general reform and country assistance. Similarly, debate and discussion is needed in the area of tax policy. While this might be outside the direct mandate of the IDB, continuing discussion within the parameters of the impact of the tax system on informality and on the structure of the economy would keep the issue at the forefront of debate about ways to improve the functioning of the economy.
- Second, there is a need for reform of the collateral framework. Currently lending occurs to the large well-connected companies, while smaller companies and sole proprietorships do not have access to finance. Lack of such access is also one of the more important reasons for informality. The system requires comprehensive reform, including: a new collateral law; abrogation of existing laws that impact on the ability to pledge collateral; a new system of recording security interests that is simple, can be accessed remotely, and is efficient; and a new way to repossess collateral in the event of default.
- Third, there is need for reform of the legal framework. To illustrate with a few examples - implementing an effective low cost arbitration framework that is accessible to small business would bring the benefits of formality closer to this group. Problems remain with the Companies Act, in spite of the recent rewriting of the law. The institutions associated with the commercial legal framework, such as the Companies Registry remain costly and less effective than they could be. The current banking legislation prevents the evolution of credit information, a factor that has been shown to promote financial market development. Substantial analysis



of the legal framework, with a focus on the economic effects of the existing structure is needed urgently.

- Fourth, land rights are hindering the development of the private sector, particularly in rural areas, and among smaller businesses. The existing land reform project should be closed down, but this does not mean that titling and registration is unnecessary – on the contrary there are few actions which can do more to promote poverty alleviation and upgrade the lives of the poor than successful, low cost, and sustainable titling and registration of property.
- Fifth, infrastructure is in dire straits, especially because government budget constraints have resulted in low public sector investment rates. The time is ripe for a review of the role of the government in providing infrastructure services in the economy. Management contracts, public-private partnerships, “Build-Operate-Transfer” arrangements, and some outright privatizations are all solutions to upgrading infrastructure. Rural development also requires substantial improvement and upgrading of infrastructure. Currently local roads, local ports, electricity and water supply, shipping services, air communications and telecom connections severely hamper virtually all private sector activity in rural areas. Unless there is improvement in these vital services, there is little possibility of promoting rural development.
- Sixth, in other areas as well, rural development policy is strikingly similar to more general interventions to promote private sector development, illustrating the extent to which business environment issues span the whole spectrum of reform measures. Jamaica’s agricultural sector is going through wrenching changes as a result of the reduction in EU support prices and guaranteed access for sugar and bananas. At the same time, casual observation indicates that there are untapped opportunities in the supply of specialty agricultural products to the US and Europe, particularly as Jamaica has several microclimates. But, the agricultural sector faces many constraints to its development so further work is needed on this topic.
- Seventh, the issue of bureaucracy and regulation is pressing. At the senior levels of government, there appears to be acceptance that regulatory and process reform is needed. At the middle and lower levels of government, such recognition is weaker

or entirely absent. A governance reform is needed urgently. However, merely trying to improve existing processes is counterproductive. Applying existing regulation more effectively will have a negative rather than positive effect on the economy. An alternative approach would be to introduce a “sunset clause” into the application of regulation. This would require all departments to justify all their regulations, in writing by a particular date. In the event that convincing justification is not forthcoming, or if it is not provided at all, the regulations would lapse. Such an approach has the potential to transform the regulatory environment in Jamaica.

Ultimately, without these reforms, Jamaica will remain a high-risk investment environment. Many investments are being made as a result of incentives, but their economic rate of return is often low, or even negative. Informality is endemic. The result is that productivity is low and longer term growth prospects are poor. Without change, the debt burden will remain an enormous drag on the economy. Only by improving efficiency, building lasting supportive institutions, reducing the hand of the state in economic activity, and lessening the risks associated with the macroeconomic environment will Jamaica unleash its private sector from the constraints that currently bind it. Only through such measures will all Jamaicans have an equal opportunity to contribute to the long term economic growth and prosperity of the country. While many of the activities suggested by the paper may be difficult to implement, it is critical that Jamaica get started as soon as possible along the path of economic reform so the future can be stable and secure for all Jamaicans.

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