ECONOMIC POLICY

AND

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ADLITH BROWN

Institute of Social and Economic Research
University of the West Indies

Mona, Kingston 7

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SUMMARY STATEMENT

The existing dilemma for economic policy in Jamaica demonstrates the conflicts which can arise between the requirements for external and for internal balance, or the high costs of external balance of terms of income and output growth. That basic conflict was only exacerbated by attempts to effect a new economic strategy in the context of poor domestic economic programme and continuously changing external economic conditions. More generally, the Jamaica experience of the 1970's would suggest that new directions in policy will of necessity focus on greater flexibility, on appropriateness in the timing of policy responses, and on a greater emphasis on the possibilities for extending the available range and mix of policies.

Current interest in altering international institutional arrangements as these affect capital flows to underdeveloped countries in fact reflect an awareness of the basic conflict between external and internal balance. The concern is with the possibility for reducing the conflict or for extending the scope for policy choice by lessening the external constraint. The discussions which relate to increasing the availability of medium term finance and balance of payments support on concessionary terms, on increasing the flow of aid, on arrangements for the finance of LDC debt, on the code for the transfer of technology summarise the responses at the international level to the basic issie.

For the underdeveloped country in deficit, the constraints on the capacity to adjust can be such that external balance can only be defined in the context of the need to limit untoward repercussions on incomes and income growth. For such countries, a crucial problem for policy arises from the fact that given the structural conditions such as obtain for example in Jamaica, deflationary policies can be associated with a fall in investment. It is therefore possible that a fall in incomes and employment can result without external balance being achieved.

The relevance of the structural conditions is that these determine the capacity to adjust, and the speed at which adjustment can take place. This is the relevance of the concentration of exports; of the wide range of necessary imports; of the dependence on direct inflows which have their counterpart in the merchandise account; and of the organisational and other difficulties which inhibit output expansion. These factors define the margin for policy induced variations in the short or medium term. They indicate that there are short run limitations to the removal of the external deficit. Those conditions also indicate that external balance is to be defined, not only in regard to the desired income change, but on the basis of the understanding of the interrelationships between the current and the capital account, and on the assumption of a desire or possible level of capital inflows.

The extent of available external finance or the level of capital inflows is one aspect of reducing the constraints. Another is what domestic policies reduce the conflict between the aims of internal and external balance, i.e. between income and employment growth at stable prices and without worsening income concentration on the one hand, and curbing the current account deficit on the other.

These were the main difficulties for economic policy in Jamaica in the 1970's. Oil and other import price increases added to the difficulties for policy, and lessened the areas of flexibility. The attempt to alter strategy in difficult external circumstances was further hindered by the lack of clarity on what measures were necessary for the proposed structural changes. The traditional use of monetary and fiscal policies to effect stabilisation and adjustment would in any event have encountered the constraints of the structural characteristics of the economy. Even more important was the fact that their effects ran counter to the main aims of the change in government policy. While the government faced difficulties in fashioning appropriate policies to meet the long run aims and restrain a growing external deficit, IMF policies were aimed at returning the eocnomy to its previous path. Neither succeeded. The greater leverage which the IMF had on account of its being lender of last resort, was reinforced by the lack of a coherent and consistent set of government proposals, the government's weakened financial position, and a lack of political cohesion. At the same time, IMF policies were incapable of maintaining investment, and the merchandise account of the balance of payments was improved at the cost of output growth and structural change.

Essentially, given the need to adjust, the scope for policy choice is enlarged by a greater dependence on selective measures. The aim is to limit or reduce the change in income for any given balance of payments change. The general emphasis of policy was however on curbing the level of demand. This has in any event been a characteristic of moneatry policies in Jamaica, which emphasise general deflation while the expansion of government expenditure takes up the slack. The more effective are deflationary monetary policies, the greater the reliance on the counterbalancing effects of government expenditures.

The difficulty for policy in the 1973-74 period was that the extent of the change required was never so large, and the shortfalls in inflows which usually precipitate the external crisis have usually been reversed. This was, for example, the case in 1969. Changes in output or income structure were not then under consideration; real adjustment did not have to take place, given new capital inflows. That was the significance of the oil crisis and the increases in prices of other intermediate goods imports between 1973 and 1974. The effect of those import price changes was to make real adjustment necessary, even at the usual level of capital inflows and even without the attempt to redistribute incomes. With the adjustment emphasis on aggregate demand, the reduction in income was larger than necessary. There was little scope in the short run for increasing exports or reducing further, the use of imports, given that import controls were already in effect.

The full range of possible policy measures was brought to bear: repeated devaluations, higher interest rates, direct controls on imports, increases in tariffs, and foreign exchange controls were all either strengthened or put into effect. The economy was deflated and investment and output fell.

The bauxite levy which was imposed in mid 1974, was used to mitigate some of the effects of the general deflationary policies. The levy which accrues in foreign exchange contributed to some easing of the external situation, and also provided the basis for an expansion of government expenditure. In addition, export price increases further eased the external situation.

By the beginning of 1975, the main impact of oil and other price increases had been absorbed. There was a net increase in reserves of $54.1 million, and the merchandise deficit was at its lowest since 1970. The deficit as a percentage of total imports was at its lowest since 1958-61, which was a period of high export growth.

To explain the crisis which later emerged in 1976, it is necessary to examine government policy after 1974.

The new economic strategy was aimed at income redistribution and employment expansion. Emphasis was on raising the level of money and real incomes at the lower end of the scale, on expanding incomes and employment in agriculture, and on expanding short-term employment.

Increasing unemployment and worsening income distribution had indicated, since the latter part of the 1960's that policy changes were required. The previous government had at the end of the 1960's attempted to address these issues within the framework of existing policies aimed at industrialisation for exports. The new government, which came to office in 1972, did not then alter that basic strategy. Initially, policy was dominated by the attempts to counteract the consequences of international monetary instability. By 1973-74, these efforts were overtaken by the increases in oil prices and the increases in prices of other basic raw materials. Towards the end of 1974, and after the bauxite levy had been imposed, the new strategy of democratic socialism was announced. There were however important difficulties with the new strategy. Although the aims were clear, the means for achieving these were never clarified. While public ownership and wage policies appeared to be the main instruments, these were not complemented by appropriate investment programmes. The extension of public investment and public ownership was represented by the transfer of assets from private to public, rather than by the creation of new assets. Yet, whatever the redistribution policies, the extent to which redistribution and growth could be effected would depend on whether growth could be resumed, and this proved to be the most difficult area for policy. This was in fact clearly outside the scope of the government budget. The basic difficulties were exacerbated by the decline in bauxite and alumina production which began in early 1975 and after the imposition of the levy. This removed an important area of flexibility, and the balance of payments constraint then became even more pressing. The government itself created additional difficulties by the association of democratic socialism with the denigration of private capital. Private capital withdrew and the government was not capable of effectively replacing this. At the same time, government policy allowed no scope for wider public as opposed to state participation.

A basic underlying problem arose from the fact that policies addressed to the balance of payments and inflation were not compatible with the aims of the new strategy. Monetary policies were in keeping with their traditional purpose, addressed to curbing inflation and the deficit on the balance of payments, through general deflation. As monetary policy forced contraction, the main areas of short-term employment - construction, distribution and other services - declined, while government short-term and recurrent expenditures expanded. Although there was a clear need to reactivate output and investment moneatry policy was directed at curbing demand and the balance of payments deficit. While the expansion of government expenditures at such times is traditional, if only to contain the possible increase in unemployment, the structure of those expenditures, more so than the extent was not warranted under the prevailing economic conditions. Further government revenues were however constrained. Slow economic growth and the restrictions on imports reduced the rate of growth of government revenue from taxation. Government borrowing both internal and external increased dramatically, both on account of the emphasis of public sector activity required by the new direction of policy, and on account of the traditional use of fiscal policy to counteract the deflationary effects of monetary policy. By end 1975, when greater selectivity was introduced as a means of stimulating investment and output while containing import demand, the business sector was in a slump, and capital was flowing out. The economy was maintained by government borrowing abroad. By March 1976, net foreign reserves were negative.

In 1977, the government signed a standby agreement with the IMF. Two aspects of this agreement are worth noting. After months of negotiation the government appeared to have settled on terms which reflected government policy. In particular, the government maintained the dual exchange rate, price control and subsidies, as well as its expenditure programme on employment and social welfare, and loose wage guidelines. It also maintained a tight money policy, directed at the level of aggregate demand. There did not appear to be a conflict between the aims of government and these policies, if the focus of monetary policy was to induce a switch from consumption to imports to investment rather than curtail aggregate demand, and to induce domestic output and domestic demand for locally produced goods even at the expense of some variation in the absolute size of the deficit. Further, there seemed little point in securing wage increases without attempting to translate at least some portion of these increases into new investment. The problem at this time was that the economy was in a slump and capital was flowing out. The curtailing of aggregate demand worsened the slump, while interest rate policies had no effect on stemming capital outflows nor inducing new inflows. Further, the merchandise account was already subject to direct controls. Foreign exchange controls as well as controls over foreign borrowing in the domestic market were also in effect. The agreement on the details of monetary policy, and the absence of any policies to induce investment meant that the effective model was the IMF model. The point of the IMF "tests" was to reinforce this, whatever else appeared to have been allowed. The only way out was to raise the level of investment. Since there was spare capacity, given the previous years decline in output, the implications for the external account need not have been excessive. The IMF model on the other hand was clearly directed at maintaining the existing dependence on foreign capital and enhancing the export sector. The assumption was that new capital inflows or export increases would finance a higher level of imports. The central aim of government policy was to change this and to induce a greater spread of domestic investment directed at the domestic market. But the government had no investment policy and monetary policy in fact further depressed domestic investment, especially in small businesses.

At end 1977, there was a drastic decline in the current account deficit, Merchandise imports were less than merchandise exports, at very low levels of capital inflows. This was itself a problem, since production could not recover at that level of imports. The decline in reserves was $14.6 million compared with over $200 million at the end of 1976. The IMF nevertheless suspended the agreement. The reason was the failure to meet the net domestic assets test, a consequence not simply of government over expenditure, but of the continuing shortage of foreign exchange.

The essence of the economic problem was however the low level of activity, the falling rate of investment, and increasing capital outflows.

It is not clear why the government entered into the second IMF agreement under the Extended Fund Facility, except that it was otherwise unable to secure external finance. This new agreement in effect completed the reversal of government policy and by the end 1978, the changes in the functional distribution of income which had been effected were reversed. The balance of payments improved, but output fell further as investment continued to decline. Such indicators as are now available for 1979 suggest that in spite of a favourable merchandise account and increased receipts from foreign travel, the over-all external account has worsened and domestic demand remains sluggish.

INTRODUCTION

The International Monetary Fund has been a focus of controversy in Jamaica, at least since 1977 when the Government negotiated a Stand By Facility amounting to J$68 million over two years. Since then at least, economic policy in Jamaica has been dominated by the International Monetary Fund in its dual role of lender of last resort and overseer of international monetary stability.

The need on the part of countries such as Jamaica for the functions of the IMF is not simply the external financing which the IMF itself offers. Of even greater importance is the role of the IMF as guarantor of international creditworthiness, especially given the limited flexibility which countries such as ours have in international financial markets. That lack of international flexibility coupled with the relatively unintegrated domestic economic structure, influence both the ability to adjust to economic disturbance and the timing and pace of any such adjustment.

The IMF in its primary role of guardian of the stability of the international monetary order, emphasises measures to ensure a speedy return to Balance of Payments respectability. It therefore impinges on poor countries which must depend on its function as lender of last resort. This function allows the influence which can determine a deficit country's economic policies.

This history of relations with the IMF since 1976 indicates that from the beginning Jamaican policy makers were aware of the difficulties which would be posed by an IMF programme. The essence of the programme was to lower domestic incomes to a level which would be compatible with external balances. The extend of the fall in incomes which would be necessary and the relatively short time period over which such adjustments would be required was cause for concern given both the high unemployment level and the highly skewed distribution of incomes. The government faced the additional difficulty of the fact that a reduction in unemployment and a more equitable income structure were among the more important points of its political platform. Further, by the time of the negotiations which culminated in the 1977 Agreement, real domestic incomes were already falling. The adjustment measures hastened the fall in incomes -- as such measures are intended to do -- but they produced instability. There was instability in that each round of income reduction which was required on account of the Balance of Payments constraint necessitated a further round of income reduction, since both the external account and the falling domestic incomes would reinforce each other to inhibit new investment.

There are several dimensions to the current economic conditions of falling incomes and output, alongside rising wages, unemployment and continued external imbalance. These are examined by distinguishing the approach to the external crisis which surfaced in March 1976, and the policy responses to the unfavourable coincidence of long-run difficulties and short-run external instabilities.

It is important to recognise that although the preoccupation with IMF adjustment policies date to 1976/77, adjustment measures were initiated as early as 1972/73. These centred on suppressing the level of aggregate demand and on the use of devaluation as a means of inducing export sector competitiveness and containing import growth. At the end of 1973 both internal and external conditions had worsened in so far as real output fell and the external deficit worsened in spite of an increase in capital flows.

The apparent recovery in the Balance of Payments in 1974 reflected not the adjustment measures of 1972/73, but the revision of bauxite and alumina prices, the bauxite levy, higher sugar prices and the recovery of investment inflows from the low level of $91.3 million to $139.2 million. The improvement in the external account was due to circumstances which were external to the economy. Output stagnated and the stabilization of consumption and the increase in domestic savings were not reflected tin increased investment. The focus on the need to undertake adjustment measures which depressed aggregate domestic demand reflected the lack of policy flexibility. At the same time, given the structural conditions which had emerged the main policy measures which were aimed at stabilization were in-effective. An added difficulty in the period was that against a background of increasing difficulty in obtaining adequate external finance, policy responses to changing international and domestic conditions were slow. It was to be expected, however, that in the past 1971 period, there would have been extreme difficulty in anticipating and even interpreting the changing international economic conditions.

Between 1972 and early 1974, however, the monetary and other measures which were the core of the adjustment programme, were generally accepted as appropriate, as was the case in earlier years. While the measures were more stringent than ever before, the basic assumptions underlying these, did not seem to be open to to question.

The policy changes which were announced after the bauxite levy in 1974, and including the attempt to ease suppression of aggregate demand, release imports and induce new investment indicated that there was beginning to be less than complete confidence in the effectiveness of policies of aggregate demand restraint in inducing new growth. These attempts were never consolidated into a coherent programme. Between 1975 and 1976, internal political differences among the government and bureaucracy were reflected in fragmented economic policies and a further loss in business confidence. In February 1975, for example, while the Bank of Jamaica reduced the Bank rate and relaxed monetary policy "as a continuation of the policy of gradual reflation", sections of the government and the ruling party inveighed against private capital, and threatened non-wage earnings. While the actual measures introduced between mid 1974, after the bauxite levy and early 1975, suggested a widening of the scope for economic activity, official political statements promised restriction, restraint and insecurity of earnings. Private capital withdrew. By 1976 the government budget was the main means for addressing the government priorities of increased employment and a better income distribution. The government was also the main source of new capital formation. The government seemed quite undeterred by the fact that government revenues and expenditures as they were then structured were quite unequal to the task. In any event, 1976 was an election year, and with the economic slump, government expenditure expanded by more than would ordinarily be necessary or prudrny, even in an election year. The increase was financed largely by money creation, while the external gap was financed partly by short-term high cost loans and partly by a further running down of reserves. This was already the pattern of the previous year, the fact of the elections in 1976 only extended further Bank of Jamaica financing and the external gap.

By the time of the first agreement with the IMF in July/ August 1977, the economic problem was not simply the external deficit and the negative not foreign exchange reserves, nor the size of the government debt. Real output had fallen, and Gross Fixed Capital investment was 16.5% of GDP compared with 31% in 1969. The requirements then were for policies to stimulate domestic economic activity and new investment. The priorities of the 1977 programme were inappropriate in so far as the emphasis on external balance and the time period over which this was to be achieved, further worsened domestic incomes and employment and new investment. Government approach to policy formation further weakened business confidence. The extent of IMF finance under the programme was quite inadequate to ease the Balance of Payments. At the same time, government policy as outlined in January 1977, IMF/Government policy of July/August 1977, and the Emergency Production Programme, all reflect the lack of awareness of the need to speedily reactivate investment.

The consequences of the programmes of the post 1976 period have demonstrated the difficulties which can arise because policies required for short-run adjustment which emphasize the arbitrary removal of a current account deficit run counter to the policies required to meet objectives of internal equilibrium and long run development. Specific issues involve the role of imports in maintaining growth momentum; the impact on income distribution of general measures which redcue aggregate income and demand; the dependence of the new manufacturing sector on domestic demand, and the responsiveness of domestic outputs to relative price changes when aggregate demand is declining.

The contradictions in the adjustment programme were only heightened by the apparent lack of clarity among policy makers in the post 1974 period and especially so after 1976 as to what policies were possible or necessary, to meet the main objectives. One such contradiction arises in respect of the role of investment generally and of foreign investment. The intention to diversify the sources of investment was not accompanied by a consideration of the need for new sources of investment nor yet the productive outlets for that investment. The failure to link investment priorities to the short-run adjustment programme in fact reflects the absence of an effective investment strategy.

The Period Before 1972

A brief review of some of the main characteristics of the economy is helpful to an understanding of the main policy problems which emerged in the 1970's.

Of particular significance in this regard is the increased importance of imports and import dependent sectors in the generation of income and employment. Sectors such as Construction, Distribution and Manufacturing which depend heavily on imports together accounted for over 31 per cent of National Income, and about 27 per cent of employment in 1970. Also of importance is the slow growth of the agricultural sector and the absolute decline in the output of export agriculture. In 1970 the agricultrual sector contributed 8.6 per cent of income and over 30 per cent of employment. Comparable figures for 1960 are 12.7 per cent of income and over 40 per cent of employment.

The fact that the large and rapidly growing sectors use rather than earn foreign exchange, emphasised the relative importance of the mining sector as a source of earned import capacity and as a source of capital inflows. Both the capacity to adjust to an external deficit and the time period over which such adjustment takes place, would be constrained by the concentration of the source of foreign exchange and the widespread dependence on imports. A fall in export receipts or in capital inflows, would in the absence of compensating finance, be readily transmitted to the rest of the economy partly because the level of activity in sectors such as Construction, Distribution and Manufacturing would be highly sensitive to changes in the external account.

After nearly two decades of laissez faire economic policies aimed at industrialization, there was some diversification of economic structure, but export production of bauxite, sugar and tourism remained the basis of the economy. Bauxite and Alumina had the largest share of total exports and in 1968 contributed over 49 per cent. Foreign direct investment in the export sectors and in particular the mining sector was the main source of economic dynamism. Between 1964 and 1968, for example, net capital inflows, averaged 39 per cent of Total Net Investment and in 1969 the share was 35 per cent. In 1970, of the Total Fixed Capital Formation 36 per cent was accounted for by the share of Bauxite and Alumina.

While there was little direct inflow to the non-export sectors there was nevertheless a high degree of interdependence between foreign and local investment. Local investments in construction, in service activities and in non-export manufacturing usually increased during periods when the level of inflows was high. As the mining sector evolved, it became the main source of earned foreign exchange, of inflows on capital account and an important stimulant to the construction sector. This last is particularly important because the construction sector was one of the main means of maintaining short term employment, especially among unskilled workers which make up the bulk of the labour force and of the unemployed.

The importance of the mining sector as a source of growth since the 1950's is well documented, in particular by Jefferson in his Post-War Economic Development of Jamaica, ISER, Jamaica, 1972. What is also of importance is that with the exception of the tourist sector, other sectors which grew rapidly, while they depended heavily on imports did not contribute much, if at all, to foreign exchange earnings. The manufacturing sector itself which which was by 1968 contributing 14.7 per cent of Gross Domestic Output was highly dependent on raw material imports. It had been hoped that these new industries would cater to the export markets, but they were in fact sustained by domestic demand. Distribution, Manufacturing and Construction sectors which had expanded rapidly during the 1960's, were also heavily dependent on imports. In 1969 the Distribution sector was the largest single contributor to Gross Domestic Product at current values. The continued expansion of those sectors depended on maintaining the flow of imports. The widening current account deficit after the mid sixties was a consequence not only of rising consumer demand, but also of the dependence of these rapidly growing sectors on imports. On the side of receipts, there was a declining trend in output of the main export crops and sluggish external prices. The trend in output in the traditional export agriculture sector would suggest that an increase in export receipts such as would counteract a shortfall of receipts on other items, would be unlikely in the short run, except through substantial increases in export prices.

The decline in foreign reserves in 1969, for the first time since 1966 emphasised the effects of long run trends on the external account and demonstrated the dependence on direct capital inflows. The factors contributing to the loss in reserves were the absolute decline in new investment inflows in that year, the increase in outflows on investment income account, as well as increases in import prices. With the recovery of capital inflows in 1970, and particularly the increase in inflows to the bauxite and alumina and tourist sectors, the external account improved. In spite of a larger current account deficit compared to 1969 the size of the inflows allowed an increase in reserves. The 1969/70 experience also emphasized the fact that the economy could maintain its momentum only if periodic shortfalls in net foreign inflows or in export receipts are fairly speedily reversed.

Although the immediate cause of concern in respect of the Balance of Payments was removed, and with that domestic pressures were lessened, the structural difficulties remained. Another trend which emerged in the period was the growth of unemployment in spite of high income and output growth rates. While Gross Domestic Product expanded at an average annual rate of 8.6 per cent between 1960 and 1970, unemployment was 13 per cent of the labour force in 1960 and 20.3 per cent of the labour force in 1970. The high level of unemployment led to a consideration of alternative economic strategies. In the meantime, however, the government budget was increasingly used to provide short-term employment opportunities, and to transfer real income. Long-term unemployment had been held in check by heavy out-migration in earlier years, but with the economy losing momentum and emigration outlets lessening, the unemployment situation was worsening. Low productivity and low incomes in agriculture were an important aspect not only of the low rate of employment growth but of the increasingly skewed pattern of income distribution as well. During the period 1953-1970, when gross output grew at an average annual rate of 9.7 per cent, the rate of growth of the agricultural sector was 3.0 per cent per annum. Average wages and salaries and average national income generated in agriculture were among the lowest in the economy.

The disparity in incomes is accounted for in large part, by the wide differences in wage rates across industries and between skilled and unskilled workers. The causes of these differences have implications for incomes policies. In so far as wage differences reflected not only differences in skill, education, or training but also the divergent rates of growth of the various sectors, then long run measures for reducing these differences would necessarily include measures to expand the growth of these sectors and upgrading of the labour force. Although there was a consideration of alternative economic strategies, the government budget was in fact used increasingly to provide short-term employment.

By the latter part of the 1960's, while external balance and new investment were maintained by capital inflows and the immediate pressures of unemployment were eased by government expenditure, it was clear that some departure in economic policy was required. This would be necessary if growing unemployment, worsening income distribution and the growing deficit on merchandise account were not to erode the real gains of the previous ten or more years.

Between 1960 and 1970 several new measures were introduced in an attempt to cope with the problems of increasing urban unemployment; with the limitations imposed on domestic policy by the continued dependence on foreign capital and the concentration of that capital; and with the widening deficit on the current account of the Balance of Payments.

There was no change in the underlying develo- ment strategy which emphasized industrialization based on private capital accumulation. Fiscal incentives would continue to be the main means of inducing new capital. The main adjust- ment in policy consisted of measures to diversify the sources and uses of investible funds; to "Jamaicanize" investment and to extend government participation in economic activity. The change which would be effected in the scope and operation of public sector activity is evident from a comparison of the views expressed in the Five Year Independence Plan 1963-68, with those of the Budget Speeches of the late 1960's. Government policy on private versus public investment as stated in the Five Year Plan, included the view that "investment in the fastest growing industrial sectors will be the concern of private enterprise". The general context was the definition of the role of government economic activity as that of providing the necessary social and infrastructural requirements, and short run stabilization of fluctuations so as to induce private sector expansion. The proposed changes in that role are evident from the 1969 Budget

Speech by the Minister of Finance. That contribution includes, for example, the statement, "government cannot afford to create the facilities for lucrative projects with high quick gains without joining in some of the participation, because of the need to build up Budget resources". Also mentioned was the need to increase the extent of private joint ownership through the initial purchase of investments which would later be made available to the public. The emphases was on "a stake in major investments" rather than on ownership and/or management of investments. The fact was that as private sector expansion failed to keep pace with labour supply, there was increasing pressure on government expenditure.

Between 1969 and 1971 total government expenditure increased by over 38 per cent from $185.6 mil. to $256.6 million. Of particular importance was the Special Employment Programme, which was introduced in the 1968/69 Budget and which accounted for $5.2 million or just under 10 per cent of the total capital Budget in that year. By 1971/72 the corresponding amount was $ million. A special investment programme, financed by government through the Jamaica Development Bank, was also introduced. These substantial increases in government expenditure were financed largely from domestic sources — from increased earnings and from borrowing. These included the creation of National Development Boards (1968), The National Lottery (1968), the Land Improvement tax (1968), additional consumption duties, travel taxes and the imposition of hotel guest taxes (1969), a restructuring of income tax regulations

(1969) and a company profits tax (1970). In spite of new sources of earned revenues, there was an increase of nearly 67 per cent in loan receipts between 1970/71 and 1971/72. External loans increased from $6.0 million to $23 million and the greater part of this consisted of Commercial Bank Loans.

Although there was considerable expansion in government expenditure and diversification in the sources of government revenue, both of which altered the structure of the budget, policy changes were well within the orthodox laissez faire framework.

Throughout the period, monetary policy was directed towards protecting the Balance of Payments. As inflationary pressures increased, particularly after the 1967 devaluation, monetary policy became increasingly concerned with the containment of aggregate demand. Traditionally, movements in the Jamaican Bank rate reflected movements in interest rates in the finance markets of our main sources of capital. One aim was to prevent the substitution of domestic financial capital for external funds. Another was to prevent such outflows as might occur in response to higher rates abroad. When, in addition, there were inflationary pressures high interest rates were usually combined with credit restrictions as a means of preventing excess domestic demand from worsening the current account deficit. One consequence was that domestic rates could be increased in response to rising rates abroad. regardless of domestic economic conditions. There could therefore be a tight monetary policy, in conditions which would require emphasis on stimulating domestic investment or domestic demand for locally produced goods. In such circumstances, fiscal policy was usually relied on to maintain the level of economic activity. The extent of the reliance on the government budget nevertheless depends on the extent to which monetary policy is considered to be flexible, even within the constraints of the need to protect the balance of payments. One aspect of such flexibility is the scope for the use of selective instruments.

Although during 1969-71 some selectivity was introduced in the use of monetary measures to curb import demand and inhibit foreign borrowing in the domestic market, monetary policy operated largely through the level of aggregate demand. In 1970, for example, although measures to control non-resident borrowing had been put into effect in 1969, and although both short-term and long term interest rates in international money markets were declining, the Jamaican Bank rate was maintained at the then relatively high rate of 6 per cent. The Bank of Jamaica Report (1970) while recognizing that "high interest rates could adversely affect economic growth" offered the following explanation: "lowering the Jamaican Bank rate could have been interpreted by the business community to mean that the current inflationary pressures in the economy had been checked and that such a lowering signalled a move towards easier credit and a general reflation of economic activity". The difficulty was that by the end of the 1960's it was clear that the current account deficit, increasing inflationary pressure and unemployment indicated a need to stimulate domestic output, even if consumer demand for some categories of imports were restrained. It was not until 1971, that credit restrictions which depressed the level of economic activity, were redefined to exclude transactions which did not involve the Balance of Payments.

In general, as far as investment was concerned the main interest was foreign investment inflows rather than the possibility for inducing local investment. While this reflected the fact that the dynamic of the economy centred on foreign investment inflows, the traditional use of monetary policy also meant that monetary policy could have only a minor role in diversifying investment and the structure of output. There was, for example, no indication that the possibilities for structuring interest rates so as to facilitate domestic investment was explored.

It might also be said that the aggregative approach of monetary policy had the effect of discriminating against private investment from domestic sources. While interest rates are high and credit restricted to protect the Balance of Payments such policies also restrict domestic borrowing on the domestic market for investment purposes unless adequate exemptions are offered, both to the purchasers of the final output and to the users of investment funds. Such rediscriminating facilities as were from time to time offered to public utilities, to the construction sector and to exports, for example, were limited in scope and would not necessarily meet the requirements of the productive sector for long term investment finance.

The use of monetary policy can also be seen as an aspect of the expansion in the scope and uses of fiscal policy. In general, restrictions on credit to the private sector often allowed accommodation of increased government sector credit which aggravated the income effects of deflationary monetary policies. This occurred between 1969 and 1971, as government expenditures increased as did the gross internal debt. Internal debt increased from $141.1 million to $210.3 million between 1969 and 1971. There was very little increase in external debt, which went from $100.1 to $110.0 million over the same period. Policy flexibility tended to depend on the government budget. Any decline in the level of economic activity was usually met by increasing government expenditures.

There is not then so much a question of the effectiveness of monetary policy during the period; rather its assigned role was limited. During the 1960's when general deflationary policies were used to contain the level of demand and protect the Balance of Payments, incomes were rising, even if output growth was slower than in the previous period. The inference is that the impact on domestic supplies of monetary restrictions on the level of aggregate demand may not be symmetrical between periods of rising incomes and periods of falling incomes. Further, for as long as investment inflows continued in the context of relatively stable international and domestic financial and monetary conditions, monetary policy could be assumed to have a positive influence on the capital account of the Balance of Payments.

This raises questions concerning the scope for the use of monetary policy particularly in the 1970's. When domestic output is falling, the external deficit reflects both the low level of economic activity in the export sectors as well as reduced inflows or even a change in the direction of capital flows unrelated to interest rate differentials. Further when the main source of inflation is the rapid increase in import prices, measures to stimulate domestic activity are as necessary as measures to contain the external deficit.

1972-1974

I. Between 1972 and mid 1974 economic policy was dominated by attempts to counteract the influence on the domestic economy, of the instability in exchange rates abroad and later the oil and other import price increases.

Although the new government which assumed office in 1972 espoused a socialist philosophy, there was not then any major change in strategy. There was nevertheless a significant change in that priorities were reordered and the focus of policy on income redistribution and employment through the government budget was more heavily emphasised. The rate of government expansion of government expenditure, was nevertheless somewhat lower in 1972 and 1973 than in the two preceding years. The average annual percentage increase for 1970 and 1971 was 18.2 per cent, while for 1972 and 1973, this was 15.7 per cent. Given two relatively larger increase in prices in 1973 than in any previous year, the increase in real expenditures would be less. The portion of public expenditure which was covered by new external debt increased significantly, as private capital inflows were reduced. Other charabteristics of public expenditure during those years are also of some significance for policy flexibility in later years. One was the extent to which new expenditures particularly in 1973 represented ongoing or recurrent committments which could be expected to increase without any short or medium term expansion in the output of goods or production capacity. Another was the extent of new expenditure on the transfer of assets as opposed to the creation of assets.

In 1972, the Balance of Payments was again cause for concern. By the end of the year there was a fall in reserves of £43.6 million. International monetary and exchange rate uncertainties combined to cause a substantial reduction in net capital inflows, an increase in outflows on investment income account and increases in merchandise imports as there was stock-piling of nearly all classes of imports. Some of the changes in the capital account were not unexpected. The decline in inflows to the bauxite/alumina industry, for example, was consequent on the scheduled completion of construction activity. In addition, there was the usual tendency for a falling off in new inflows and an increase in stock-piling of imports during an election year. These influences were exacerbated by the unstable international monetary conditions and the difficulties these created for domestic policy. In particular by 1972 there was even greater uncertainty than in the previous year concerning exchange rate policies. Although the main influences began during 1971, when the US dollar came under increasing pressure, net capital inflows were maintained. With the expansion of US dollar convertibility in August 1971 and the floating of the US dollar, exchange rate expectations contributed to instability. After the realignment of December 1971 and the Jamaican dollar was allowed to maintain parity with the pound sterling - the legal link having already been broken in 1971 - the Jamaican dollar appreciated in respect of the US dollar by about 4 per cent. To the usual uncertainties generated by the general elections were now added the fears of a devaluation. Given the character of the bulk of usual flows which are easily reversed in times of uncertainty, and the relative case with which domestic currency could at that time be converted into foreign exchange or imports, further detioration on the external account was to be expected. The decision to float with sterling did not stabilize expectations. For the first time since 1966 net private capital inflows in 1972 at the unusually low level of £41.2 million were less than net outflows in investment income account in that year.

There were nevertheless, during 1972, improvements over 1971 in real income output and employment, although exchange rate expectations remained unstable and capital outflows continued. Real output for the economy as a whole increased. The rate of growth of Gross Domestic Product at Purchasers value (constant 1974 prices) increased by 9.3 percent between 1971 and 1972, compared with 2.4 percent for the 1970 to 1971 period.

The continuing loss in reserves during the latter part of 1972 led to adjustment measures at the end of 1972 and early 1973. These measures focused on reducing the level of aggregate demand through a programme of restraint comprising monetary trade and fiscal measures. Import restraint was instituted at the end of 1972, and in January 1973 the J$ was devalued by 6.5%. Interest rates were increased. In February the J$ was again devalued consequent on the devaluation of the US dollar. Initially, and for the first half of 1973, external conditions appeared to have stablized and foreign reserves increased. While the fixing of the exchange rate and the replacing of sterling with the US dollar as the intervention currency early in 1973 appeared to have stablized exchange rate expectations, and stemmed the drain on reserves, other policy measures may have contributed to low business activity. The business sector remained cautious amid tight monetary policy and import controls. By the third quarter and even before the oil price increases, the prices of several basic imports increased by substantial amounts. There also appears to have been renewed fears of a further devaluation. The Bank of Jamaica Report (1973) records that there was "earlier settlement of import bill and private debt ... due to a widespread belief that the Jamaican dollar was going to the be devalued .... acceleration of the remittance of investment income payments and a significant increase in capital outflows related to emigration". The dramatic increase in oil prices further worsened the external balance, and created new sources of internal instability. By the end of the year foreign reserves fell by J$32.3 million. Total inflows on private and public account of $124.1 million, which was more thantwice the amounts of 1972 amounted to less than the merchandise deficit of $161.2 million.

Although there would be some lag in the impact of the price changes and particularly the oil price increases on the domestic economy, there were effects on the external account by end of 1973. Price changes alone would have added approximately $167.0 million to the import bill (on the basis of the External Trade Reports) if 1972 import volumes had been maintained. That is an amount larger than the current account deficit in any previous year. The fall in import volume accounted for approximately $73 million. The reduction in import volume occurred mainly in the consumer goods category and to a lesser extent in the capital goods category.

Import capacity was not maintained, not only because import prices rose, but also because of the relatively low level of long term inflows since 1972, because of associated increases in investment income outlows and because the traditional export crops, in spite of higher external prices continued to experience declining volume. The capacity to expand exports and reduce import demand consequent on high import prices, within a relatively short time period was in any event limited by a variety of factors. These include the high concentration of exports, the dependance of production on imports and the relative lack of short run substitutability between traded and non-traded goods.

External borrowing was particularly difficult in 1973 as international borrowing conditions were unfavourable. Of the total $49.7 million in official inflows, lines of credit accounted for J$38.9 million. These lines of credit accounted for a large part of the increase in gross external debt from $127.6 million to $177.3 million between December 1972 and December 1973. A net drawing of J$13.1 million was made under an IMF stand-by agreement.

Adjustment was effected partly through the decline in real income and partly through the fall in imports. It would be difficult to determine whether and to what extent a fall in import volume was consequent on real income changes, or on relative price changes, especially since imports were administratively controlled. It is likely, however, that the combination of high import prices, and restrictive monetary policies contributed to falling output. Real output fell in nearly all sectors which cater to the domestic market: domestic agriculture, footwear, tobacco, food manufacture, furniture, leather products and cement. The Construction and Distribution sectors experienced real output declines of 19.6 per cent and 14.2 per cent respectively. In fact the main indication of the decline in capital flows on the level of economic activity, was the decline in construction activity. It was mentioned above that the construction sector is among the first to be influenced by external changes in respect of either a reduction in imports or a slowdown in capital in flows. That sector - therefore among the more important indicators of current investment trends, of short-term employment and of business prospects. The balance of payments was contained at the expense of increases in real output.

In the absence of ade uate external finance the choice was either to initiate adjustment by reinforcing the downward effects of the change in the external account or allow a further less in reserves. The measures which were in keeping with earlier use of such policies worsened the internal situation. It is not clear that they had any positive effect on investment inflows nor that they inhibited outflows on investment income account and other forms of foreign exchange leakage, which were aspects of the deteriorating external account. The possibility is that such foreign exchange flows on capital asa well as on current account, and in particular the propayment of bills etc., reflected expectations which were either unstable or perverse. Monetary policies may also have been aimed at the merchandise account with the intention of preventing domestic inflation induced by autonomous import price increases and devaluation, from worsening the current account deficit. But import controls, which also tend to increase domestic prices were aimed at the merchandise account.

The consequence of the combination of import price increases, devaluation, restricted credit, higher interest rates, controls on imports and on the use of foreign exchange , as well as increased indirect taxes, was a significant fall in domestic demand and domestic output. It is difficult to escape the conclusion, at least from hindsight that policy over-reacted to the conditions of the external account, at the expense of maintaining domestic economic activity. Since the intention was to check demand and so contain the external deficit, a slowdown in the rate of growth was not unexpected, given the conditions in the export sector. The absolute decline nevertheless suggests that either import shortages restrained growth or that the policy influences on demand were fairly rapidly transmitted throughout the economy. The question is of course whether there was in fact a choice between some further less in reserves, whether through capital flows or increased current account deficit, and a substantially smaller bhange in output. One possibility for allowing a greater degree of freedom arises from reliance on selectively or disaggregation in the use of monetary and fiscal policies to maintain domestic activity. In this regard, given the sensitivity of the construction sector, the possibilities for using the interest rate structure credit availability and other incentives to private construction activity may have been useful. Such possibilities were not explored until the November measures which offered some relief, but which were too late to be effective given the extent of the decline which appears to have occurred by the end of the third quarter. It cannot be said that during this period the issue was democratic socialism. Rather, demand was constrained, credit was expensive, import shortages were beginning to be felt and business prospects were low. If the scepticism which is often voiced in respect of the efficacy of selective measures is admitted then the only real alternative was slowing the pace of adjustment.

While for the better part of 1972 and early 1973 the main policy problem was how to counteract the effects of the external account and continuing international instability on the domestic economy by end of 1973, were additional policy problems of internal disequilibrium. Given the apparent difficulty in obtaining external finance which could cushion the adjustment process there remains the question of whether there was any greater scope for policy, to alter the balance between the change in the external account and the extent of the change in domestic activity.

While the instabilities arising, from exchange rate movements abroad had diminished by early 1973, and not foreign reserves increased, import price increases added now difficulties during 1973. It became increasingly difficult to insulate the economy from external economic changes. In the absence of adequate inflows, adjustment measures were undertaken between the end of 1972 and early 1973.

It is clear that under existing structural conditions the external changes would necessarily induce unfavourable changes in the domestic economy, especially in the absence of the usual level of long term capital inflows, and the scarcity of extennal finance on favourable terms. It is also the case that the almost continuous and often unpredictable changes in the international economic environment put a premium on the speed of response as well as on the appropriateness of response. Economic events in the period nevertheless raise the question of whether the traditional approach to Balance of Payments disequilibrium contributed to the transmission of external influences and therefore allowed a larger fall in income than might have been necessary. More particularly, these events indicate a need to extend our understanding of the relation between policies for external balance and policies for internal balance under the economic conditions of the period. Of relevance in this regard is the dependence of current economic activity and investment on capital inflows and on imports and the fact that the capital account exhibited instability, apparently unrelated to domestic production conditions.

There is little doubt that the "survival measures" introduced in January 1974 would have further depressed the economy. Nor is it clear that there would be any balance of payments gains, in so far as an important source of the external imbalance originated in the capital account. Continued restraint in respect of imports would be necessary, although not necessarily through depressing aggregated demand and a further decline in income. The only real possibility for a retreat from further deflationary measures was through a combination of expenditure switching rather than expenditure reducing policies and an autonomous increase in either exports or capital inflows. The bauxite levy which was imposed in May 1974, retroactively to January 1974, was equivalent to a capital inflow while increased export receipts again from the bauxite/alumina industry provided the former.

1974 - 1976

Between 1974 and early 1976, economic policies, their timing and implementation and the impact of the overriding fragmentation in the political and administrative structure interacted to produce the crisis which emerged in early 1976.

For the first five months of 1974, the economy was under the influence of the "survival measures" which were intended to improve the external account by containing domestic demand. The determining factor appeared to be "the low level of foreign exchange reserves ...... equivalent to 1.5 months imported at the 1973 rate ...... /which/ was totally inadequate ..... with the impending increase in foreign exchange demand" (Bank of Jamaica Report: 1974). Monetary measures included: increased costs of credit, ceilings on commercial bank lending to maintain the average level of loans outstanding during the last quarter of 1973, and restrictions on credit to the commercial banks from the Bank of Jamaica. In addition, private holdings of foreign assets were to be liquidated and remitted to Jamaica within six months. Trade measures featured the restriction of imports, by specific licences and quotas and the complete exclusion of some consumer goods which were considered non-essential. Total imports for 1974 were not to exceed $645.0 million or about $40 million more that the value of imports in 1973. Fiscal policies were directed at compensating for the expected loss in customs and excise which would follow both the reduction in imports and the low level of domestic economic activity. The measures included: additional duties on imported spirits, increases in sales taxes on durable consumer goods and on increase in the price of gasolene of nearly 100 per cent. Supplies of gasolene to the domestic market were to be restricted by about 25 per cent of the previous year's supply. The package was completely deflationary and could improve the Balance of Payments by reducing the current account deficit at the expense of drastic cuts in incomes and employment, provided the capital account remained stable. In the absence of stability in the capital account and associated investment income flows, the balance of payments could worsen, even though the merchandise account improved.

The measures which were intended to stimulate domestic production and exports were long-run even if they could have been speedily implemented. These included increasing banana cultivation, the intention to rationalize the sugar industry so that the export quota could be met, as well as expanding beef, dairy and domestic food crops.

The combination of the worsening external imbalance, which was then due largely to external factors as import prices rose, and the worsening domestic problems of depressed output, inflation and high unemployment emphasized the specific constraints on economic policy. These constraints derive in large part from the structural characteristics of the economy, and from the consequences of development strategies which had been pursued since the 1950's. Of particular importance is the constraint imposed by the requirements of an industrialization programme based on imports and capital inflows.

Since maintaining growth dynamic depends on the flow of imports, the attempt to control the Balance of Payments deficit directly through the merchandise account can often only be achieved in the short run, at the expense of maintaining the stimulus to growth. Further, since the flow of imports depends on capital inflows, an important priority of Balance of Payments policy must be to maintain stability in the capital account.

The main difficulty in the early months of 1974, was that general deflation and import controls had contributed to an improvement in net foreigh reserves but at the expense of incomes, employment and real output growth.

As the Minister of Finance stated in his budget speech of 1974/75, the "survival measures" had put 'pressures on growth', which it was hoped could be relieved on the basis of the revenue from the bauxite levy imposed in May 1974. The main changes in the economic measures of January 1974 which were introduced after the May levy were as follows:

(a) imports were relaxed by allowing a higher ceiling of an additional $80 million, with the bulk of the increase ($35 million) going to capital goods imports. Some items were removed from licencing requirements and there was also a relaxation in the licencing requirements required for some items of raw material imports.

(b) Credit controls were eased by allowing an increase of 3 per cent per quarter. Banks were allowed to include as liquid assets long term loans to the productive sector, up to a maximum of

5 per cent of deposit liabilities. Interest rates were, however, maintained and the liquidity ratio of the commercial banks was raised from 21 per cent imposed in late 1973 to 23½ per cent.

(c) The reduction in gasolene supply to the domestic market was restored, while the new prices were maintained.

(d) Fiscal restraint which was planned in January 1974 was abandoned, and the budgeted expenditure of over $720 million, amounted to an increase of $144 million or nearly 60 per cent over 1973 expenditure.

The economic trends between mid 1974 and the beginning were mixed, but on balance indicated the possibility of economic recovery. The balance of payments position showed some improvement, partly on account of a revaluation of bauxite and alumina prices and increased output of these, of higher sugar prices in spite of low volume as well as the containment of merchandise imports. Net capital inflows were maintained. There was a marked change in distribution between private and public, as both direct government debt and government guaranteed debt increased.

There was real output growth in domestic agriculture, manufactured food and beverages and in the tourist sector. Agricultural food output was expanding, but it appeared that other sectors which showed improvement were in effect recovering lost ground. Other manufacturing activities such as flour, edible oil, fertilizer, battery and tyre production reflected shortages of imported material and work stoppages as prolonged industrial disputes became prevalent. Existing capacity was being reactivated in some subsectors but there was little new investment. Construction activity as well as activity in allied activities such as gypsum mining, cement, paint, wood and lumber production therefore continued to decline. The construction sector also suffered from the low level of new activity in bauxite and alumina, the reduction in imports of building materials, high raw material costs due both to shortages and rising import prices, high interest rates and emigration. Slow activity in the distribution sector reflected the constraints on imports. While therefore increased government expenditure, slightly easier credit ceilings and rising wages stimulated some sectors, the growth of new capitalj formation was slow. The indications were that economic recovery would be slow. The Bank of Jamaica Report (1975) was even more optimistic as indicated by the following:

"Unlike 1974 therefore, 1975 began with a more relaxed atmosphere. The crisis of the previous year had been diffused and there was general expectation that the gains recorded in 1974 would be consolidated......."

The year 1975 was nevertheless one of unmitigated disaster. The main economic event was the decline in bauxite and alumina output. After the first half of 1975, capital began to flow out at an alarming rate. By the end of the first quarter of 1976, net foreign reserves were negative (-$1.9 million). The approach to the crisis which was, as usual first evidenced on the external account, can be outlined by examining the more important characteristics of the period. These include: a highly unstable political climate, spiraling wages and prolonged industrial disputes, changes in the structure of government budget and the rapid expansion in government expenditure; and emigration of persons and capital.

It is difficult to over-estimate the unfavourable effects of the apparent fragmentation in political direction on business confidence and economic activity, particularly in the context of the difficult economic conditions already prevailing. It is not at all clear that instability resulted from the fact of the initiation of a strategy of democratic socialism rather than the manner of its implementation, the absence of clear policy guide-lines and the denigration of private capital which threatened the security of large and small businesses. In so far as small businesses are maintained on the spin-offs or the tackle-down effects of the activities created by large businesses, a reduction in big business activity is soon reflected in lagging activity in small businesses. Further, it is likely that small domestic based businesses rather than large businesses or export oriented businesses were already more affected by the restricted credit and high interest rates. Even if it was the intention to spare domestically oriented activities, both the existing economic structure and prevailing business norms and practices would have inhibited this. The attempt to distinguish between a capitalist mode of production and the unregulated accumulation of private capital was of no avail in the political climate initiated by the ruling party bureaucracy.

The apparent ambivalence or even contradiction in political strategy was mirrored in the failure to settle what was in fact a crucial issue of new economic policy. This is the relation between policies to redistribute incomes and policies to induce growth. This remains an important aspect of economic policy, still to be settled. The issues involved are not straightforward even when output and incomes are expanding but implementation of redistributive policies are considerably less difficult than during periods when growth is stagnant. The migration of skills and capital which usually accompanies redistributive policies also tend to be less severe during periods of high growth. Some general questions which arise are first: Under what conditions does the attempt to redistribute income -- or the failure to redistribute incomes -- retard growth; second, how is the location of the trade-off between growth and distribution affected by the kind and range of policies chosen as well as the timing and the implementation of these policies; third, how is the pace of redistribution affected by the growth conditions as well as the over-all rate of growth; and, fourth, what investment strategies and policies and necessary to support a policy of redistribution, and maintain or increase the growth momentum. In respect of this last question, it seemed the intention of policy makers to focus on a strategy of public investment by expanding the public sector share of asset ownership. There were two main difficulties. One was the lack of an appropriate functional distinction between public ownership as an objective of democratic socialist purpose and as the means through which the fact of public ownership would be used to achieve redistribution. While the political directorate clearly perceived the need to complement the perception of the political framework by altering the economic power structure, the means to change were missing. As the decision making process did not cohere, and as this was reinforced by political fragmentation, the practice of democratic socialism was more and more conducted within short-run constraints to orient short-run objectives. Unfortunately, the need to emphasize appropriate investment policies was paramount not only because of the attempt to change the political and economic direction. A focus on investment was also particularly necessary at that time because this is the only means through which short-run deflationary policies, such as were then in existence to protect the balance of payments can be made to complement or at least not retard long-run growth prospects.

The bauxite levy allowed some leeway to government policy, and allowed several redistributive measures which would not otherwise have been possible in the circumstances. But the ultimate advantage of the levy would be its usefulness in allowing time to reactivate other productive sectors and maintain existing sources of foreign exchange earnings and/or generate new sources. The levy did not correct the external imbalance, rather as the equivalent of an autonomous capital inflow it allowed time to reactivate the sources of growth. Government policy failed in this respect. The mixed economy which was being pursued depended not so much on a widening of the scope of investment and with that an increase in the public share, but on the replacement of private investment by public ownership. The fact that by early 1975, government financial manoeuvrebility now depended on the receipts from the levy, exacerbated the crisis, when the bauxite companies cut back production which resulted in a sharp fall in foreign exchange earnings. The increase in the revenue from the levy which resulted from the higher price of aluminium and the levy applicable in 1975 amounted to over $40 million, but this was inadequate to compensate for the fall in export receipts.

The government seemed either unprepared for the extent of the cutback in production or unable to activate effectively such alternatives as may have existed. Given the continuing discussions between the companies and the governments, as well as the diplomatic and other initiatives in respect of the Court for the Settlement of International Disputes, and the establishment of the IBA, it would seem that resistence to the measures by the companies was not unexpected. It was also the case that the bauxite levy was part of a set of measures directed at increasing the government's participation in and control of the exploitation of the resourcs, and that the bauxite measures together were as was stated, part of an over-all strategy for investment, which would be increasingly government controlled. From that perspective, it could be assumed that government's foreign policy initiatives, in particular, the efforts to diversify external relations initiated since 1972, were an integral part of the over-all strategy. One advantage of such diversification would be the associated diversification of the forms and sources of external finance; greater flexibility in obtaining temporary inflows, as well as diplomatic and other support which might be necessary to maintain what could be protracted negotiations with the bauxite companies. Further, some reduction in mining activity had been expected as the North American aluminium companies had announced reductions in aluminium production, which they expected would affect production of bauxite and alumina in Jamaica.

In 1975, actual inflows fell short of expected or desired inflows. Net capital inflows were $67 million less than the current account deficit of -$257 million. Capital inflows in 1975 consisted largely of government official inflows or government guaranteed inflows. This reflected the decline in bauxite/alumina investment as well as other traditional forms of inflows and the difficulty in finding new sources of long run finance.

The main policy response to the expected short-fall of foreign exchange receipts from the mining and tourism sectors was a reversal of the relaxation of import controls which took place after the levy. The import ceiling for 1975 was set at $900 million or about $50 million over the actual expenditure on imports in 1974. At the same time -- February 1975 -- the Bank rate was reduced as was the Commercial Banks Prime Lending rate. Productive sectors were, however, unresponsive and the commercial banks in general remained liquid for the first half of the year. By June

1975, there was a marked decline in economic activity. Bauxite and alumina production had by then declined by 13.5 per cent and 9.3 per cent respectively. The winter tourist season was poor and there were hotel closures.

The timing of policy announcements would have added to the economic uncertainty. The February announcements promised more restrictions in the form of an "anti-inflation" package in August, while the August measures promised additional contractionary measures in October. Each set of announcements strengthened the the expectation that there would be currency devaluation and further destabiliz the capital account. While deflationary measures were expected given the weak external position, the fact that these were spread out over months left ample time for all the usual means of avoiding foreign exchange losses. The announcement that wages and incomes would be controlled before precise details could be worked out also added to the demands for wage increases. The measures which were introduced in August 1975, to reactivate production and induce new investment were too late to be effective. Business confidence was low and the effects of the international recession were beginning to be felt. The drastic decline in foreign exchange reserves was only evident after mid 1975.

As real output and income continued to fall, more deflationary measures were introduced and imports were further restricted since the Balance of Payments did not improve. Although imports were in fact reduced, the measures could not restore balance since the source of the problem was now the capital account and the associated investment income account. The capital account reflected instability which was only worsened by repeated deflationary measures. Each round of income reduction would therefore necessitate new deflationary measures as capital inflows failed to increase and outflows on current and capital account continued. Although the deflationary measures were "designed to restore stability by restraining aggregate demand and thereby reduce inflation ......" the crux of the problem was the failure of investment which was itself related to the decline in capital inflows. The main trends in the Balance of Payments are shown in Table I.

The decline in capital inflows between 1975 and 1976 was associated with an increase in investment income outflows. Increases in the net outward movements in the usually small investment income account item "other" also indicate an acceleration in the outflow of funds. The effect of the decline in capital inflows was reinforced by the decline in bauxite and alumina receipts, as well as by the low volumes in sugar and other export crops, in spite of higher prices.

The view that the detoriation in the external account was not due to an escalation in expenditures on imports, is supported by the trends in imports. At least for the period 1970 - 1974, the growth rate of imports was on average 15.6 per cent per annum and below the export growth rate of 19.9 per cent per annum. For the 1974 - 1976 period, imports recorded a growth rate of just over one half of one per cent, while exports declined at the rate of just over 4 per cent per annum. The relatively lower growth rate of imports between 1970 and 1978, is a reversal of the trend between 1960 and 1970, when the higher rate of growth of imports was sustained by capital outflows. Between 1978 and 1974, the export growth rate exceeded the import growth rate. The main changes occurred between 1975 and 1976 when all classes of imports declined, with the largest declines occurring in imports of capital goods and consumption goods.

There were two separate influences on the merchandise account between 1974 and 1975. In the 1974-1975 period, there was an expansion in import expenditures on account of increases in both price and volume. The index of quantum nevertheless indicates a lower volume of imports in 1975 that in the years 1970 to 1972.. Terms of Trade indices are shown below. This increase in imports was

Tentative Terms of Trade

	Exports	Imports	Exports	Imports	Exports	Imports
	Value		Unit Value		Quantum	
1970	100	100	100	100	100	100
1971	98	105	90	107	99	90
1972	109	110	102	110	107	101
1973	113	127	102	145	111	88
1974	211	178	175	210	120	85
1975	228	215	265	225	86	96
1976	182	174	240	232	74	75
1977	247	164	210	251	113	65

Source: UNCTAD, Handbook of International Trade and Development Statistics, 1979.

Table 1

Balance of Payments Summary, 1970 - 1978

	1970	1971	1972	1973	1974	1975	1976	1977[1]	1978[1]
Merchandise	-89.2	-109.2	-121.0	-161.2	-106.9	-144.8	-119.9	85.0	56.9
Exports (f.o.b. adjusted)	285.1	286.1	302.4	357.2	630.7	736.7	599.7	691.1	705.6
Imports f.o.b.	374.3	395.1	423.4	518.4	737.6	881.5	-719.6	-606.1	-648.7
Services (Net)	- 56.2	- 51.4	- 58.9	- 27.1	- 66.2	- 136.0	-160.7	-165.1	-153.4
Foreign Travel	66.7	77.2	91.4	90.4	88.6	69.3	42.6	54.7	79.1
Investment Income	- 81.8	-85.7	-100.4	- 52.8	- 61.5	- 93.5	-105.7	-125.6	-131.7
Other	- 41.1	- 42.9	- 49.9	- 64.7	- 93.3	- 111.8	- 98.2	- 94.2	-100.8
Goods and Services (Net)	-145.4	-160.4	-179.9	-188.3	-173.1	- 280.8	-280.6	- 80.1	- 96.5
Unilateral transfer (net)	18.2	17.3	22.3	24.0	21.3	23.8	5.4	18.2	23.0
Current Account Balance	-127.2	-143.1	-157.6	-164.3	-151.8	- 257.0	-275.2	- 61.9	- 73.5
Net Capital Movements	134.1	160.2	117.0	124.7	221.1	189.9	43.9	51.7	5.4
Official	- 1.2	4.0	18.6	33.4	81.9	112.9	72.0	- 5.4	151.2
Private	135.3	156.2	98.4	91.3	139.2	77.0	-28.1	57.1	-145.8[2]
Over-all Balances	6.9	17.1	- 40.6	- 39.6	69.3	- 67.1	-231.3	- 10.2	- 68.1
Allocation of SDRS	5.3	4.7	4.7	-	-	-	-	-	-
Change in Reserves Increase = minus	- 17.6	-36.4	43.6	27.7	-54.1	- 76.3	238.1	14.6	68.1
Net Errors and Omissions	5.4	14.6	- 7.7	11.9	-15.2	- 6.5	- 6.8	- 4.4	-

1 at exchange rate J$1.00 = US$1.10; figures for 1978 are provisional

2 includes net errors and ommissions

Source: Bank of Jamaica, Reports and Statement of Accounts - various issues not matched by the growth in export receipts. In the following period, 1975 - 1976, expenditures on imports fell as both prices and volume declined. Export receipts, however, fell by a larger amount. A significant feature of the change in the merchandise account is the fact that the fall in import expenditures was in part the equivalent of the change in the capital account, because of the high percentage of direct imports. A large part of the capital inflows in a normal year is in fact represented by direct imports to mining, to tourism, to the utilities and to the export manufacturing sub-sector. That change in the capital account in 1975 - 1976 and the associated change in the merchandise account indicate a lower level of domestic investment in that time period. This is in itself deflationary.

The distinction between sources of the deficit are of relevance for remedial measures. In so far as the deficit is not explained by an increase in consumer demand for imports, and is in fact associated with a reduction in capital goods import, then expenditure switching rather than expenditure reducing policies are indicated, if there is not to be a cumulative decline in investment in incomes and in employment. The traditional Balance of Payments measures which were used during the period, in fact had no effect on the capital account nor on the investment income account. The question was already raised above, of whether, given the nature of the bulk of these flows, they were likely to be sensitive to such changes in monetary policy. The monetary and trade measures could, however, be expected to inhibit the possibilities for domestic substitution in respect of output and investment. The failure to maintain investment expenditure reinforced the cumulative decline which originated from the external account.

The available data suggest that concessionary inflows played no signigicant role in this period -- a fact which helps to account for changes in the structure and the cost of government debt. The total concessional inflows recorded between 1974 and 1976 amounted to US $76.9 million. Most of this amount represented bilateral flows from DAC member countries. Multilateral agencies accounted for US $22.6 million -- less than one third of the total. Data on financial flows are shown in Table 9.

The expansion in government expenditures which accompanied the deflationary monetary policies did not generate adequate investment, while the structure of revenue, of expenditure and of the government debt, which evolved created additional difficulties. The burden of maintaining economic activity was largely on government expenditure, at a time when revenues were constrained.

It has been argued above that the expansion of government expenditures to support employment and maintain the level of economic activity is traditional especially during periods of monetary restraint. It is nevertheless the case that the expansion in government expenditures, the structure of revenues, of expenditure and the debt which evolved created additional difficulties. As is usual in economies such as Jamaica it is often necessary to expand government expenditure precisely during periods when government revenues are constrained. The structure of the sources of revenue in fact imposed constraints. Any signigicant fall in imports has repercussions for government revenue, a substantial portion of which normally derives from customs and excise duties. Appendix Table shows the main sources of tax revenue. Of particular interest is the slow growth and ultimate decline in revenue from customs and excise, in spite of increases in the rates over the years. Other significant changes include the rapid increase in the range and contribution of other indirect taxes. Consumption duties, for example, which were negligible up to 1972 - 1973 were by 1976 22 per cent of total recurrent revenue. In fiscal year 1978 - 1979 these amounted to 35 per cent of total tax revenue, just slightly less than the percentage contribution of personal and corporate income taxes taken together. The distribution of personal incomes, and the high level of unemployment also limits the amount of additional revenue from increased taxes on personal incomes while, increased taxes on business are not easily effected when business output is falling. Between 1972 - 1973 and 1977 - 1978 for example, corporate taxes moved slightly from J$60.7 million to J$67.3 million, while total tax revenue just about doubled. The consequence therefore was the increase in the range of indirect taxes, which unless they are selective and progressively structured can in the context of increasing deflationary monetary policies counteract the need to maintain domestic output growth.

By 1975/76 government expenditure was about 35 per cent of Gross Domestic Product at Purchasers Values compared with about 23 per cent in 1972/73. By 1978/79 the comparable figure was 37 per cent. The over-all rate of expansion was not in itself the main source of difficulty particularly since an expansionary fiscal programme was necessary to insulate the domestic economy from the deflationary policies addressed to the Balance of Payments. Specific difficulties arose from the fact that the financing of this expenditure increasingly relied on Central Bank financing and on extending the scope of indirect taxes, and on external short term loans.

One important question which arises from the changes in the structure of government revenues, is whether and to what extent these counteracted or even negated simultaneous attempts to redistribute incomes through the government budget. The growth of expenditures on subsidies, for example, warrants further analysis. Between 1974 and 1976, increased expenditures on subsidies, which were then related to import price increases went from 1.2 per cent to 1.8 per cent of Total National Disposable Income. Between 1976 and 1977 the increase was from $43.9 million to $157.0 million and in the latter year amounted to 20 per cent of Total government recurrent expenditure.

The essential conflict in government financial operations was nevertheless the result of the simultaneous attempt to step up the pace of income redistribution, while counteracting the effects of the external account on total income and employment, at a time when capital inflows were being reversed and real output growth was negative. There simply did not exist the range of effective policy instruments to meet all those objectives at the same time. The limitations on the range of effective policy instruments is partly a consequence of the structure of the economy.

As far as redistribution itself is concerned it would not appear that this was based on any realistic assessment of the extent of resources which would be necessary to effect a given redistribution. In addition in so far as government ownership tended to centre on the transfer of assets, and the maintenance of existing assets, rather than the creation of new assets, the expansion in government expenditure was not matched by an expansion of the total resources available to effect any given income transfer. As long-run employment opportunities failed to increase, either through government or through private sector activity, and as the main short term private sector employment openings in construction, on the docks and in other miscellaneous services stagnated, government policy concentrated even more heavily on the "impact" programme for creating short term employment. While therefore government expenditure expanded substantially, this expenditure was not an adequate substitute for private sector investment as a source of new growth.

The difficulty was not simply the extent of the increase in government expenditure, but that these expenditures did not extend productive capacity nor did they induce private sector activity. Further, given the economic conditions of the period the government budget, inspite of continuous increases was simply not adequate for the traditional task of filling the gap left by private economic activity. The point is of some relevance for an appraisal of the period after 1976, when business economic activity declined even further. The traditional budget structure, whatever the increases, could not, given the basic structural characteristics of the economy, generate growth dynamic.

The fact that the expansion in government expenditures was increasingly financed from loan sources, and in particular by short term, high cost external loans, further constrained the budget flexibility. Tables 7c and 7b show the debt structure including maturity structure of debt. The rapid expansion in debt was evident by 1974 as both internal and external debt increased. The increase in internal debt nevertheless exceeded the increase in external debt and by 1975, the percentage contribution of internal debt to total debt was 55.8 per cent, compared to 12 per cent in 1972. In spite of the proliferation in domestic loan sources, the Bank of Jamaica financed the bulk of the increase of 40 per cent in total internal debt in 1976. As the external account worsened and capital outflows continued there was also the need for foreign exchange in addition to domestic loans. The increase in external debt was, however, associated with a shortening in the maturity structure of that debt. Debt of over 5 years amounted to 32.5 per cent in 1975 compared with 62.9 per cent in 1972. It is likely that this reflects the difficulty in obtaining long term loans, and is an aspect of the increasing reliance on Commercial Bank loans after

1974. The extent to which these new loans financed expenditures which did not on balance expand output and exports would suggest that the allocation of the use of foreign exchange was less than optimal. This too is an aspect of the structure of government expenditures, and the distribution between recurrent committments which can only yield returns over the long run and expenditures which yield returns directly or indirectly in the short or medium term. A high proportion of expenditures which were committed between 1972 and 1974, could not be easily reversed and would increase at a faster rate during periods of low growth. As output stagnated and foreign exchange became more scarce, there was an even greater need to expand government expenditures.

The trend in wages is a relevant aspect of the domestic economic situation during these years. Between 1973 and 1976 money wages more than doubled. Wage rates began to rise steeply after the exchange rate changes and price increases of 1972/73. The main contributory factor was, however, the influence of import price increases which began in 1973 and continued into 1974. Real wages also increased.

The data below, estimated by UNCTAD, gives an indication of the impact of import price increases on the domestic price level.

The primary impact of import prices on the general price level was concentrated in the years 1973 and 1974.

These wage trends in the period in the context of stagnating output have had two main effects which are of

	1971	1972	1973	1974	1975	1976
Change in GDP Deflator	10.2	5.5	27.6	24.1	13.1	10.2
Weighted change in Import Prices	2.5	1.4	11.3	14.2	3.5	1.2
Index of Real Wages			100	116	124	120
Index of Money Wages			100	150	106	212

significance for economic policy in the post 1976 period. First, they have been a means of transmitting the inflation which was initiated by import price increases. With output fairly constant, it can be assumed that wage rate increases exceeded the rate of productivity increase. At unchanged labour income share of Total Income (Output) goods prices could be expected to rise. There was in fact both an increase in labour's share and in goods prices.

To the extent that wage increases stimulated price increases, they also contributed to the difficulty of maintaining price controls which were part of government's 'anti-inflation' package. Even after import prices had stabilized there was continuous pressure for increases in the prices of controlled items, while there were substantial increases in uncontrolled prices, as producers, distributors and wage earners each tried to maintain their relative income share.

It is in any event difficult to control prices, except through continuous subsidy if wages are free to rise. Wage control is itself a complex issue even if the administrative and political difficulties are assumed absent. One alternative to wage control is to allow wage increases and to tax the surplus and convert this into new investment. Since private sector investment was low there could be a net gain. This alternative would be consistent with over-all government policy to increase the relative share of public sector investment in total investment. Personal income taxes and other taxes paid by persons did in fact increase as wages rose. As it happened, however, the increase in government expenditure on new capital formation as distinct from the capital budget, was low, as was the growth generating effect of that expenditure.

Another consequence of the wage trends relates to the structure of wages and prices rather than to their general levels. Changes in the wage/price structure mean changes in the cost structure of industry given that wage and price changes have not been equal and uniform. The available data do not now allow firm conclusions concerning changes in inter-industry wage differentials over the period. It is likely, however, that on balance there was a narrowing of wage differentials between skilled and unskilled and between industries. The question is whether and to what extent the structure of wage rate changes led to changes in relative proftiability rates, as distinct from profit levels, across industry. This determines whether on balance changes in wage structure operated to the relative advantage or disadvantage of, for example, exporting industries, or manufacturing, or agriculture, or the service industries. One point arising from a consideration of this is whether such shifts were in keeping with the planned or desired output and investment mix, of with domestic production and export production mix.

Few general conclusions can be made from the aggregate data now available. For the economy as a whole the share of wages in National Income increased from 57.1 per cent in 1974 to 63.7 per cent in 1976 while the share of the net surplus declined from 34 per cent to 20 per cent. The experience within and across industries varied. In general, activities which did not on balance experience negative growth, either maintained their share of the surplus or experienced a fall in the relative share which was less than that for the economy as a whole. In other industries, in particular in manufacturing and construction, the decline in the relative share of the surplus was greater than that for the economy. Given the fact that the change during the period was not limited to wage increases, it is not to be assumed that such changes, or more generally that changes in profitability during the period reflect only the influence of wage changes. The factors affecting the adjustment to wage increases would include: the ratio of imported inputs to total cost; the ratio of fixed changes (particularly interest and other financial costs) to total cost. The possibility for increasing product price and the elasticity of demand for output are also relevant. The fact that imports, interest and other financial charges had increased substantially over the period, and the fact that credit restrictions were in force, could have meant reduced profitability for some firms, whatever the wage rate increase. This would apply especially to the small firm, or the firm with little short run flexibility in its operational or financial structure. Information on the structure of industry by size is not available and recent published data do not include specific information on unincorporated business activity. Yet the effects of wage, price, interest rate trends and credit availability on this sector is necessary for assessing either the impact of past policy or the likely course of future policy. In 1978, the ratio of incomes from unincorporated enterprises to wage and salary income was approximately 1:3.5. The Labour Force Survey records that in 1972 the average employment in "Self employed and Independent Operations" was approximately 218 thousand or just over 35 per cent of the total employed labour force. A recent survey of small scale non-farm enterprises conducted by Davies, Fisseha and Kirton, reports that in 1978 there were 37,738 establishments employing over 79 thousand persons or 11 per cent of the total employed labour force.

Between 1974 and 1976 some redistribution of income was effected as represented by the change in the income shares. The output of the domestic agricultural sector also increased. These were, however, achieved in the context of declining total output and investment, and worsening balance of payments. The oil and other import price increases reduced policy flexibility, given the already existing balance of payments trends, so that a given redistributional change required even more resources. The cause of the increasing cost of redistribution was the falling off of investment and the decline in output and exports, as capital inflows were reversed. While there was a clear need for external finance the effect of the IMF programme was to reverse the effects of redistribution and change the direction of government policy. The emphasis was on stimulating the export of manufactured goods, and on suppressing domestic demand. The IMF policies did not, however, include an investment programme and the capital account of the balance of payments remained weak.

POST 1976

As repeated attempts to increase official inflows failed, the government finally came to terms with the IMF and signed a 2 year Stand By Agreement in July/August 1977. On balance, the main points of government policy prevailed. Under this agreement a total of US$79.6 million would be available over the two years to June 1979. Given either the usual level of inflows or the external financing actually required, it could not be assumed that the amount of finance under the IMF programme would be adequate to stimulate economic recovery. Rather, the fact of the agreement was expected to be the lever for additional inflows under the aegis of the IMF.

The terms included a continuation of the dual exchange rate policy initiated in April; reductions in the rate of wage increases as opposed to a freeze on wages, and a continuation of subsidies; restrictive monetary policies as well as a reduction in government expenditure. The agreement was circumscribed by tests relating to: (1) net foreign assets and net domestic assets of the Central Bank; (2) net banking system credit to the public sector and outstanding arrears, and (3) limits to new external medium and long term borrowing.

This agreement was terminated in December 1977 when the target for domestic credit expansion was not met. A new agreement was signed in May 1978. This new agreement, under the Extended Fund Facility was applicable to a higher 'tranche' and required more rigid conditions. The agreement covered a three year period and allowed a total of US$240 million. The terms included:

(1) unification of the dual exchange rates. A devaluation of 15 per cent at the beginning of the programme and monthly mini-devaluations of one to one and one-half per cent for twelve months.

(2) price liberalization and limitations on wage increases (including over time and fringe benefits) to a maximum of 15 per cent over the first two years.

(3) Increased taxes to yield $180 million in 1978/79; a reduction in government expenditure to yield current account savings equal to 21 per cent of capital outlays; increased prices of public utilities.

(4) The monetary measures initiated to ensure meeting the "tests" and in particular the net domestic assets

test were:

(i) Amendment of the Bank Act to allow the Commercial Bank's liquid assets ratio to be raised to 40 per cent. The period of notice was also reduced to 15 days from 30 days.

(ii) A ceiling equal to 10 per cent above the amount in May 1978, on commercial banks loans and advances to the private sector. This was further reduced to 5 per cent early in 1979.

(iii) Commercial banks were required to set aside cash reserves the equivalent of foreign payments arrears and pending payments with an exchange rate guarantee.

Selective exchange rate guarantees were suspended.

In May 1979 and after the "tests" were met, the government requested a revision of the agreement in order to obtain financing under the Supplementary Financing Facility. The terms which were similar to those agreed under the 1978 agreement included limits on new external borrowing.

This was the most deflationary programme yet. The emphasis was on reducing domestic consumption and increasing exports, so as to improve the external account. Wage restraint and a series of monthly mini devaluations which were scheduled to run until May 1979, were expected to improve the competitiveness of the export sector. A necessary assumption was that net capital inflows would increase considerably.

The analysis of the background to the foreign exchange crisis as well as the explanation of the slump in the domestic economy allow some understanding of the failure of the programme to effect improvement in the domestic economy. Consumption and real output declined, while price increases exceeded those of the mid 1970's. That neither investment nor net capital inflows increased could hardly have been unexpected. The economy was depressed and the improvement in the merchandise account, which had occurred since 1977 was due to the control of imports and the revaluation of export receipts consequent on devaluation. The over-all balance on current account nevertheless worsened in spite of continuing increases in net receipts from foreign travel, as investment income and other current account outflows increased.

At least one aspect of government policy was completely reversed as the labour income share at end 1978 was exactly what it was in 1974. The share of the surplus in total income accordingly also increased to the 1974 level, but the decline in output growth has accelerated. The fact of the change in government economic strategy which was effected through the operation of the admitedly arbitrary selective performance criteria is of some importance. It allows the question of whether IMF assistance in the higher credit tranches is available only within the context of IMF approved economic strategy. The performance tests limited the scope of government financial operations, and this is a separate issue from the exercise of restraining the government deficit.

IMF policies emphasize speedy adjustment defined in terms of external balance through reductions in domestic incomes and expenditures. The various "monetary" conditions are means to this end. Both the implicit definition of adjustment as well as the short time period over which adjustment was expected to take place were particularly inappropriate to the Jamaican circumstances.

The amount of foreign exchange supplied in support of the IMF programmes was unrelated either to the size of the deficit or the conditions governing the capacity for adjustment. Yet the extent of the financing available can determine the speed of adjustment and therefore also the extent of the necessary decline in income. The inadequacy of IMF Balance of Payments support combined with the "conditions" served to force the pace of adjustment.

The Jamaican experience would support the view that the relative inadequacy of Balance of Payments support coupled with the existence of and arbitrariness involved in the use of the "tests" in fact reduce the policy choices available to the country and are an important means of imposing IMF economic strategy. The IMF attempted to impose an export-led strategy and the policies accordingly implied a shift of resources towards exports. The government was in fact trying to change this strategy largely on account of the income and investment concentration associated with previous policies. At the same time, however, government policy offered no comprehensive set of measures aimed at effecting these changes. This no doubt limited the negotiating leeverage which the government may have had. So far as can be ascertained, for example, the policies adopted in the 1977 agreement, maintained the main points of the government programme. The major points at issue appeared to have been the exchange rate, wage policy and fiscal expenditure. These would have been important adjustments to the policy framework of the IMF. Their effectiveness was, however, reduced by the monetary measures with which they were combined, by the structure of the government's expenditure as it related to investment and the creation of investment opportunities, and the failure to use rising wages as a means to increase investment. Once that was the case, the aggregative money model became the operative part of the programme. The "tests" then only reinforced the rigidity of the model.

The IMF programme is consistent with an "export led" strategy and is based on the assumption that trade flows are sufficiently sensitive to relative price changes to effect the required increase in exports in a given time period. This assumption has not been warranted in the case of Jamaica. As is well known, because of the organizational structural and other characteristics of the export agricultural sector, the bulk of the change would need to be effected in the new manufacturing and tourist sectors on the one hand and in the domestic agriculture on the other. By 1976/77 there was a case for devaluation in respect of export manufacturing and tourism, as a means of maintaining existing markets and possibly expanding exports to CARICOM. Expansion in the short run, would however be limited by existing capacity. The relatively small size of the sector also limits the possible extent of the improvement in the trade balance. The impact of increases in the output of domestic agriculture on the trade balance, in the absence of import controls is likely to be even smaller, given the existing range of commodities and, as is the case in the export agricultural sector, the structural and organizational constraints on expansion and diversification.

These constraints on the trade balance improvement from the devaluation meant that the desired change in the trade balance required a larger fall in incomes than would have been necessary over a longer period, or if new investment could have been initiated. There were therefore two problems. There was need for substantially greater capital inflows than were available and greater selectivity and flexibility in the measures.

The widely differing conditions in and requirements of industries and sectors indicate the appropriateness of multiple exchange rates or a dual rate as was initiated in April 1977. The existing rate became a "basic rate" which was applicable to essential imports as a means of integrating the impact of higher domestic prices for imports on the cost of living. That rate also applied to the bauxite/alumina industry. The "Special rate" represented a devaluation of 37.5 per cent on the "basic rate" and was intended to stimulate the manufacturing sector. The dual rate could have been consistent with the IMF programme in so far as it improved the competitiveness of the new export industries, since the programme was aimed at export expansion. The dual rate may have presented the IMF with a moral dilemma, as it was not maintained under the EEF agreement. Alternatively, the mini-devaluations, which replaced the dual rate may have been seen as a sure means of reducing real wages which was an important aspect of the IMF programme. The dual rate combined with moderation in wage increases, would have allowed government policy more flexibility and avoided the dramatic price increases which were associated with the exchange rate changes. The dual rate, in the absence of the extent of the exchange rate change as under the mini devaluations, implied a longer adjustment period. The mini devaluations had no effect on the capital account, since capital was not moving in response to anticipated exchange rate changes.

That the structural conditions of the economy limited the effectiveness of the IMF programme was not the only source of the difficulty. Even more important was the fact that the persistence of the external disequilibrium which emerged in the 1970's was a consequence of a declining rate of investment, of decreasing capital inflows and eventually increasing capital outflows. Oil and other import price increases between 1973 and 1974, created difficulties on the external account and made internal adjustment necessary. This was not, however, the only source of the external imbalance. The external account normally involves a current account deficit, due largely to a trade deficit, which is financed by private capital inflows. Since the early 1950's at least the trade deficit has been in excess of 20 per cent of the value of imports. Between 1969 and 1976, the trade deficit as a percentage of the value of imports consistently exceeded 30 per cent with the exception of 1974 and 1975 when the figures were -23.3 per cent and -27.4 per cent respectively. The main change in the Balance of Payments were in the capital account, and in the investment income account as direct investment retreated. After 1973 there was little private inflow which was not guaranteed by government. The counterpart was a slowing down in domestic investment.

The policy requirement was for measures to stimulate investment and reactivate production, with the use of selective measures to contain the import leakage arising from increasing incomes. The recovery programme was not addressed to investment. Interest rate and credit policies became increasingly restrictive with each new set of measures. Yet, monetary policy did not appear to be an issue between the government and the IMF. The traditional use of monetary policy as already described was maintained. While this was consistent with the IMF programme it ran counter to what appeared to be government strategy. The IMF programme is based on export led strategy in which low wages are important to induce foreign capital and markets and to maintain the competitiveness of export goods abroad. Tight credit and high interest rates are consistent with this as was the case under the open industrialization policies. The new strategy of government seemed to call for increasing the share of local investment and diversifying the investment structure in keeping with the policies of income redistribution. This would require that the main aim of credit, interest rate and other policies be directed towards increasing and restructuring investment rather than towards containing aggregate demans so as to inhibit imports. Extensive import and foreign exchange controls already serve that purpose. Current practices depress both consumption and investment in order to inhibit import leakage, while changes in the structure of demand rather than the reduction of the absolute level of demand are more relevant to what appears to be the government's priorities. It might also be added that as capital outflows continue, given the unresponsiveness of direct flows to interest rate changes, the usual priorities of monetary policy become less relevant.

The IMF programme has had the effect of inhibiting local investment while hoping that external balance, fixed and unified exchange rates and a low ratio of wages to profits would induce foreign capital. The government strategy on the whole rejecting the unequal income distribution, and the low employment growth rate associated with that strategy, has not defined a set of policies which can induce an investment structure consistent with its changed priorities. Related aspects of the government programme which remain to be clarified include:

(a) the possible role and scope for local as against foreign capital, including private direct investment, and

(b) the role and scope for private as against public capital which can be distinguished from state capital.

Given the limits to new growth based on the existing import capacity of exports, the aim of increasing the growth of incomes depends on a current account deficit (net capital inflows). The aim of policy directed at external balance is then more appropriately considered in terms of the level and structure of the deficit including the form of net inflows.

Table 2

Net Foreign Reserves and Net Foreign Debt, 1970–1979

End of Period	(1) Net Foreign Reserves $ml.	(2) Net Foreign Debt $ ml.	(1) as a percentage of (2)
1970			
March	110.9	80.0	138.6
June	118.0	82.6	142.8
Sept.	135.0	88.6	130.3
Dec.	95.9	80.4	119.3
1971			
March	135.1	78.1	173.0
June	143.0	75.0	190.7
Sept.	134.2	72.0	186.4
Dec.	132.2	82.0	161.1
1972			
March	157.2	87.4	179.8
June	118.4	88.1	134.3
Sept.	90.5	86.7	104.4
Dec.	93.7	95.2	98.2
1973			
March	146.5	122.0	120.1
June	136.0	122.0	111.4
Sept.	105.5	126.0	83.7
Dec.	76.1	133.0	57.2
1974			
March	121.3	180.6	67.1
June	144.8	191.7	75.4
Sept.	168.8	233.1	72.4
Dec.	130.2	243.4	53.5
1975			
March	128.9	240.7	53.5
June	138.6	277.7	49.9
Sept.	75.7	277.9	27.2
Dec.	58.5	356.7	16.4
1976			
March	−1.9	367.1	–
June	−59.9		
Sept.	− 102.0		
Dec.	− 181.4	421.5	
1977			
March	− 151.8	422.0	
June	− 157.0	415.2	
Sept.	− 198.9	412.3	
Dec.	− 196.0	452.5	
1978			
March	− 218.9	569.0	
June	− 328.7	932.5	
Sept.	− 402.4	1033.8	
Dec.	− 447.4	1128.4	
1979			
March	− 404.6	1218.1	
June	− 525.0	1208.1	
Sept.			
Dec.			

Source: Bank of Jamaica: Statistical Dept.

TABLE 3

GROSS DOMESTIC PRODUCT IN PURCHASERS VALUES CONSTANT (1974 = 100)

	Total GDP	Agriculture Forestry Fishing	Mining & Quarrying	Manufacture	Electricity & Water	Construction	Distribution	Transport Storage & Communication	Finance & Insurance Services	Real Estate & Business Services	Govt. Revenues	Misc.	H/H [1] & Private non-pr.
1969	1839.8	138.0	206.8	317.3	13.8	325.7	317.5	104.5	57.6	132.7	136.6	105.1	31.5
1970	2054.1	140.5	233.9	329.4	14.3	389.0	352.6	109.8	65.7	155.9	163.3	120.2	35.0
1971	2101.9	164.5	243.6	355.0	15.9	329.2	365.4	115.4	72.9	156.9	158.6	123.9	37.2
1972	2273.6	167.0	252.2	371.2	17.7	347.4	427.4	132.6	82.1	167.6	185.9	131.3	38.2
1973	2215.2	157.2	261.7	303.0	19.2	279.3	366.7	141.9	91.4	173.5	222.7	125.0	42.2
1974	2244.4	150.9	290.3	359.0	19.3	263.4	360.6	150.9	105.6	176.0	247.2	130.0	30.0
1975	2211.9	165.3	227.6	390.0	23.1	211.9	441.6	142.4	100.6	211.9	210.3	112.2	29.7
1976	2028.3	153.3	184.5	375.9	23.0	168.9	357.6	137.3	87.1	212.9	234.9	108.5	27.3
1977	1908.7	178.6	217.3	339.8	23.4	129.3	340.0	136.1	90.0	216.7	257.7	100.9	28.9
1978	1955.3	186.6	221.7	323.5	23.7	132.9	300.2	131.0	88.2	211.6	268.4	102.9	23.9

1 Sub-totals will not add since imputed service charges have been excluded.

Table 4

Rates of Growth of Gross Domestic Product by Industrial Sectors at Constant Prices (1974=100)

	Total GDP	Agricul- ture, Forestry Fishing	Mining & Quarrying	Manu- facture	Elec- tricity & Water	Construc- tion	Distri- bution	Transport Storage & Communica- tion	Finance & Insurance Services	Real Estate & Business Services	Govt. Services	Misc.	H/H & Private non-profit
1969	–												
1970	12.2	6.1	13.1	3.0	4.0	17.9	11.1	5.1	14.1	17.5	19.6	14.3	13.6
1971	1.0	12.4	4.2	11.0	11.2	-14.3	3.6	5.1	10.9	0.6	- 2.9	3.1	3.9
1972	8.2	1.5	3.5	1.5	11.5	5.5	17.0	14.9	12.0	6.9	17.2	6.0	4.5
1973	-2.6	- 5.8	3.8	3.2	7.9	-19.6	-14.2	7.0	11.3	3.5	19.8	- 4.8	8.6
1974	1.3[1]	1.1	11.1	- 6.0	0.8	- 5.7	- 1.7	6.4	15.6	1.5	11.0	4.0	-10.0
1975	-2.6	1.4	-23.5	2.4	4.1	- 0.8	7.9	3.9	7.7	3.6	- 13.1	- 6.2	-21.9
1976	-8.5	-4.1	-19.0	- 5.1	2.7	-20.3	-16.7	-3.5	-13.4	0.5	7.6	- 3.3	- 9.0
1977	-2.0	7.9	17.8	- 9.6	-1.6	-23.4	- 7.5	-0.9	3.4	1.8	9.7	- 7.0	5.9
1978	-1.7	9.3	2.0	- 4.8	1.3	2.8	-11.7	-3.7	-2.0	-2.4	4.1	2.0	-17.4

Source: Department of Statistics, National Income and Product Accounts

1. Figures for 1974 have been revised . The Growth rate for Total GDP is now estimated at -0.7%. Significant differences are in Distribution [now estimate = -16.7%] in Electricity and Water [now estimate = 0.1] and in Real Esate [now estimate = 2.1].

Table 5a

Average Annual Growth Rates of Exports and Imports

	Exports	Imports
1950–1978	9.0	9.3
1950–1960	13.6	11.6
1960–1970	5.7	9.1
1970–1978	13.0	7.3
1970–1974	19.9	15.6
1974–1978	2.1	–3.3
1974–1975	13.5	20.0
1975–1976	–22.3	–10.7
1976–1977	35.2	– 5.7
1977–1978	– 0.9	– 4.0

Source: UNCTAD, Handbook of International Trade and Development Statistics, 1979.

Table 5b

Trade Balance as a % of Total Imports 1952-1978

	Value (US$ ml.)	%
1952-55	- 31	-29.2
1959-61	- 47	-23.6
1964-67	- 77	-24.5
1969-71	- 109	-37.6
1972	- 242	-39.0
1973	- 277	-41.4
1974	- 210	-23.3
1975	- 300	-27.4
1976	- 200	-30.7
1977	- 5	- 0.6
1978	- 40	- 4.9

Source: UNCTAD, Handbook of International Trade and Development Statistics, 1979.

Table 6

Finance Of Investment: Percentage Distribution

	1969	1970	1971	1972	1973	1974	1975	1976	1977	1978
Savings	43.5	46.9	34.5	34.3	38.4	34.7	26.2	–15.7	–13.1	–14.1
Consumption of Fixed Capital	26.6	31.7	29.9	36.5	31.9	38.0	36.2	50.6	74.6	57.4
Capital Transfers from the Rest of the World	– 0.9	– 1.3	– 1.1	– 1.4	– 1.2	– 1.5	.7	.8	1.7	1.4
Net Foreign Borrowing	30.8	22.7	36.7	30.6	30.9	28.8	36.9	64.3	36.8	27.1
Total Gross Accumulation	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Table 7a

Debt Structure, 1971 - 1978

	1971	1972	1973	1974	1975	1976	1977	1978
INTERNAL DEBT								
Treasury Bills	41.1	43.8	49.6	54.0	90.8	100.0	199.7	271.1
Local Registered Stock	148.3	189.8	227.2	289.0	326.7	390.1	1040.3	1270.4
Land Bonds	9.9	11.8	17.7	22.3	22.7	26.7	31.7	32.1
National Development Bonds	-	-	-	5.1	6.2	5.7	7.2	8.7
J. NIC	-	-	-	-	-	-	4.5	4.5
Bank of Jamaica	-	-	-	-	-	105.0	-	-
Commercial Bank loans	6.0	6.0	6.0	7.4	15.2	31.0	32.7	29.5
Jamaica Mortgage Bank	-	-	-	-	8.4	-	-	-
Other	4.7	5.4	7.9	10.3	11.0	10.2	7.1	26.5
Gross Internal	210.0	256.8	308.4	388.1	481.0	669.0	1323.2	1642.8
Less Sinking Fund	15.7	21.5	27.3	30.6	36.0	46.3	50.4	64.6
= Net Internal	194.5	235.3	281.1	357.5	445.0	622.7	1272.8	1578.2
EXTERNAL DEBT								
Market loans	64.2	71.5	69.0	67.8	56.6	41.6	42.2	54.8
International agencies	13.9	17.8	23.1	25.2	31.2	45.7	65.7	231.4
Inter-government	13.5	15.2	23.1	26.3	31.3	99.5	135.1	363.3
Lines of credit	18.4	22.3	61.2	-	-	-	-	-
Suppliers credit	-	0.8	0.9	2.3	1.8	0.8	1.1	1.2
Public Utilities	-	-	-	-	28.2	28.2	30.7	54.5
Commercial Banks and Affiliates	-	-	-	150.7	232.4	228.2	209.9	469.6
Gross External	110.0	127.6	177.3	272.3	381.5	444.0	484.7	1174.8
Less Sinking Fund	28.0	31.1	26.9	29.0	28.7	22.5	32.3	46.4
= Net External	82.0	96.5	150.4	243.3	352.8	421.5	452.4	1128.4
TOTAL GROSS DEBT	320.0	384.4	485.7	660.4	862.5	1113.0	1807.9	2817.6
TOTAL NET DEBT	276.3	331.8	431.5	600.8	797.8	1044.2	1725.2	2706.6

Table 7b

Maturity Structure of Public Debt, 1972 - 1978

(a) 1972 to 1974

	December 1972	%	December 1973	%	December 1974	%
Total Internal Debt	45.9	12.0	54.3	11.2	59.1	9.1
Total External Debt	338.3	88.0		88.8		90.9
Up to 5 years	96.5	25.1	128.4	26.4	201.5	31.0
5 to 16 years	151.1	39.3	156.9	32.3	211.5	32.6
Over 16 years	90.6	23.6	146.0	30.1	177.4	27.3
Unallocated	0.1	..	0.1	..	0.1	..
TOTAL DEBT	384.2	100.0	485.7	100.0	649.7	100.0

(b) 1975 to 1978

	December 1975*	%	December 1976	%	December 1977	%	December 1978	%
Total Internal Debt	481.0	55.8	668.9	60.1	1323.2	73.2	1642.8	58.3
Total External Debt	381.6	44.2	444.0	39.9	484.7	26.8	1174.7	41.7
Up to 5 years	100.6	11.7	107.8	9.7	176.6	9.7	536.4	19.1
5 to 10 years	190.2	22.0	224.6	20.2	162.4	9.0	191.1	6.8
10 to 15 years	43.7	5.1	57.4	5.1	57.6	3.2	96.7	3.4
Over 15 years	47.1	5.4	54.2	4.9	88.1	4.9	350.6	12.4
TOTAL DEBT	862.6	100.0	1112.9	100.0	100.0	100.0	2817.5	100.0

Table 3

Indicators of Trends in Items of Government Expenditure

	1971/72	1972/73	1973/74	1974/75	1975/76	1976/77	1977/78
Govt. Expenditure as a % of GDP	20.2	23.0	20.0	35.0	40.0	35.8	37.0
Gross National Debt as a % of GDP	..		29.0	31.3	30.4	53.0	66.6
Subsidies as a % of Govt. Expenditure	1.7	3.1	3.5	4.5	4.5	6.3	20.0
Debt Servicing Costs as a % of Recurrent Revenue	11.2	11.7	12.9	11.7	18.7	20.0	30.7
External Debt as a % of Total Debt	34.4	33.1	36.5	41.9	39.0	33.6	31.0
External Debt Servicing Costs as a % of Goods and Services	3.3	3.2	3.6	3.1	3.3	3.7	10.5