

## PUBLIC FINANCE IN JAMAICA 1971-76

BY

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### INTRODUCTION

In the early development of public finance, the major concern was the mobilisation of resources for the financing of wars and the fulfilment of certain accepted functions of government in the domestic economy. These functions involved basically the provision of goods and services which are consumed collectively by the society and which by their very nature would not be provided through private enterprise. Over time, governments took on to themselves the responsibility of providing other goods and services, which can be and are supplied by private enterprise because of the importance ascribed to such goods and services. Up to this point, the subject area of public finance was still confined to the transfer of resources to government and the optimal use of such resources, the operations of government remaining neutral with regard to the decision-making or economic choice of the rest of the economy.

Today, although the mobilisation and use of resources remains the main problem area of public finance, the neutral role formerly assigned to the government sector no longer obtains. Public finance has become, through the budget, an important policy mechanism through which the government seeks to manipulate or influence economic and social developments in accordance with its overall objectives. It is in this broader context, therefore, that the present topic will be treated.

In the following discussion an attempt will be made to examine the performance of public finance, and more specifically the budget, in Jamaica in the light of resource mobilisation and use as well as against the background of government's economic and social objectives and the implications of the operations of the government sector for the rest of the economy.

The economic, social and other objectives of governments, although tending on the overall to be common, are based on subjective political decisions. Before attempting an analysis along the lines suggested earlier, it is therefore necessary to outline the stated objectives of the government concerned.

In the Throne Speech in Parliament at the Spring Session 1972-73 setting out the policies which the Government of Jamaica intended to pursue, it was stated, *inter alia*, that: the unemployed in the country should be provided with gainful occupation

in the quickest possible time; the standard of living and quality of life of the people should be vastly improved, their skills upgraded and every effort made to reduce the social and economic gap within the community; and rapid movements in the cost of living should be restrained and so ensure that the community enjoys the full fruits of economic gains.

These objectives were later restated in the Throne Speech, Spring Session 1975-76 as follows:

the Government will continue to manage the economy in such a way as to maintain a high level of economic activity, restrain the rate of domestic price increases as far as is practicable, and provide employment for as great a number of people as possible.

It is clear, therefore, that the prime economic and social objectives of the Government of Jamaica in this period were: the promotion of economic growth and the improvement of employment opportunities; the maintenance of price stability; and the redistribution of income in order to achieve a greater degree of equity.

### The Mobilisation of Resources

The mobilisation mechanism needs to be such as to effectively satisfy the financing requirements of government, while at the same time fostering government's economic and social policy. In this respect, the structure or system of resource mobilisation is of great importance.

In Jamaica, the main sources of government's financing have been taxation and borrowing. The analysis will, therefore, be based on these sources in respect of the financial years 1971-72 to 1975-76.

In an assessment of the taxation system, one of the first problems to which we need to address our minds is the question of the efficiency of the system as a mechanism for the mobilisation of resources for the government sector. Two important criteria for efficiency are the responsiveness of the system to changes in national income and its administrative cost. With a growing population, the demand of the public for government services tends to increase continuously. In this situation, it is therefore desirable that tax revenue move at least in line with national income. Data for the period 1971 to 1975 show that tax revenue grew at roughly the same rate as Gross Domestic Product (GDP) at current prices and thus maintained a stable ratio to GDP. Total tax revenue (excluding the bauxite production levy) represented 17.0 per cent of GDP in 1971, 17.7 per cent in 1972 and 17.6 per cent in 1975 and averaged 17.3 per cent over the five-year period. This level of stability was not achieved through the automatic functioning of the taxation system, however, but resulted from the introduction of new taxes and increases in the rates of existing ones. The taxation structure was not, therefore, capable of automatically maintaining a constant or stable ratio between tax revenue and GDP and its efficiency in this respect is consequently questionable. Further, the administrative cost of the system or the total expenditure related to revenue collection tended to increase at a higher rate than the revenue intake. Using the expenditure allocations to the Income Tax Department and the Collector General's Department as a bench mark, the administrative cost rose by 166.7 per cent from J\$3.7m in financial year 1971-72 to J\$9.9m in 1975-76. On the other

TABLE I GOVERNMENT REVENUE - FISCAL YEARS

	J\$ m			
	Apr. 1971/ Mar. 1972	Apr. 1972/ Mar. 1973	Apr. 1973/ Mar. 1974	Apr. 1974/ Mar. 1975
<i>Tax Revenue</i>	228.8	260.1	324.3	394.5
Customs Duties	48.3	57.6	55.2	57.0
Excise Duties	48.4	56.1	56.3	53.0
Consumption Duties	2.6	3.6	22.9	41.2
Income Tax	109.3	115.7	147.4	187.6
Land and Property Tax	1.3	1.8	10.9	11.6
Stamp Duties	7.8	11.2	15.3	17.7
Motor Vehicle Licence	5.4	6.7	6.5	6.8
Other Licence	0.4	0.7	0.4	0.6
Entertainment Tax	1.7	1.7	0.8	1.9
Travel Tax	1.1	1.3	1.1	1.4
Betting and Gaming Lotteries	2.0	2.6	2.5	4.3
Tax De Sjour	0.5	0.7	0.6	0.8
Retail Sales Tax	-	-	4.6	7.3
<i>Non-Tax Revenue</i>	15.6	20.6	20.5	27.2
Post and Telegraphs	4.3	4.0	4.3	5.8
Debt Charges Reimbursement	1.4	1.9	0.8	0.2
Departmental and Other	-	-	-	-
Miscellaneous Revenue	9.9	14.7	15.4	21.2
<i>Recurrent Revenue</i>	244.4	280.7	344.8	421.7
<i>Capital Revenue</i>	4.6	5.0	4.8	10.5
Royalties	2.7	3.9	3.8	6.5
Land Sales	0.6	0.1	-	-
Loan Repayments	1.3	1.0	1.0	4.0
Transfers from CDF	-	-	-	-
<i>Total Revenue</i>	249.0	285.7	349.6	517.2
				Apr. 1975/ Mar. 1976
				486.2
				87.5
				53.0
				78.0
				203.9
				23.0
				15.7
				8.6
				0.3
				1.8
				1.8
				2.9
				0.7
				11.0
				29.3
				7.0
				0.1
				22.2
				517.5
				6.2
				5.0
				-
				1.2
				125.0
				648.7

Source: Accountant General - Statement of Revenue and Expenditure

hand, total tax revenue increased by 113.4 per cent from J\$228.8m in 1971-72 to J\$488.2m in 1975-76. The cost of collection therefore increased from 1.6 per cent of revenue intake in 1971-72 to 2 per cent in 1975-76. This means that expenditure in connection with revenue collection yielded diminishing marginal returns over the period.

The most significant change in total revenue during the review period was occasioned by the introduction of the bauxite production levy in fiscal year 1974-75. Transfers of levy proceeds to the Government's Consolidated Fund amounted to J\$85m in 1974-75 and J\$125m in 1975-76, representing 16.4 per cent and 19.3 per cent respectively of total revenue.

The other discretionary adjustments mentioned earlier were more or less confined to indirect taxes. (Indirect taxes are here defined as taxes which are paid by businesses, but which can easily be passed on to consumers by way of higher prices for the end product). The resultant price increases reportedly led to reductions in real demand in some cases, with the consequential adverse effect on production and employment. Some positive steps were however taken during the period to encourage domestic production and increase demand for labour. In 1975 incentives were provided by way of accelerated depreciation allowances for factories running two or more work shifts, tax rebates for training and employing additional persons, and the consolidation of group profits and losses for income tax purposes. The provision of accelerated depreciation was intended to encourage maximum utilization of existing plant and equipment and the introduction of more work shifts as well as to increase the cash flow of businesses so as to facilitate investment. In the case of tax rebates for training and employment, it was provided that any factory expanding production and employing additional workers would be permitted, for the purpose of tax returns, to add to its wage bill J\$10 per week over a one-year period for each additional worker employed as from 1 September 1975 over and above the work force as at 31 July 1975 (exclusive of supervisory and higher grades of employees). In recognition of the fact that businesses could be reluctant to expand through the launching of new companies where the tax laws prevent them from setting off the loss which the new companies may incur against the profits of other companies of the group, it was provided that, where companies are 100 per cent owned by the same group, they may consolidate profits and losses of the group operations in one income tax return and thereby be able to set off the loss of one company against the profits of another in the same group.

As noted above, the bias towards dependence on indirect taxes had the effect of pushing up prices. The share of indirect taxes in total tax revenue increased in the period 1971-72 to 1975-76 while the share of direct taxes declined correspondingly. Revenue from income tax as the dominant component of direct taxes declined from 47.8 per cent of total tax revenue in 1971-72 to 41.8 per cent in 1975-76. The share of customs duties fell from 21.1 per cent in 1971-72 to 17.9 per cent in 1975-76 and that of excise duties declined from 21.2 per cent in 1971-72 to 17.3 per cent in 1973-74 and 10.9 per cent in 1975-76. These declines were not due to a fall in the rate of taxation, but rather to restraint in imports due to the imposition of tight trade

restrictions in 1974 in the case of customs duties and to a general slow-down of domestic production in the case of excise duties. However, the decline in these categories of indirect taxes was more than offset by increases in the shares of other taxes such as consumption duties and retail sales tax. The share of consumption duties increased from 1.1 per cent in 1971-72 to 7.1 per cent in 1973-74 and 16.0 per cent in 1975-76. This rapid increase in the contribution of consumption duties was due to upward adjustments in the tax rates as well as to a widening of the tax base. Retail sales tax is a new tax introduced in 1973-74 and its contribution increased from 1.4 per cent in that year to 1.9 per cent in 1974-75 and 2.3 per cent in 1975-76. On the basis of these data, the conclusion may be drawn that the changes which took place in the tax structure in the period 1971-72 to 1975-76 had an inflationary bias.

Data are lacking on which to appraise the taxation system with regard to the redistribution objective. From the fact, however, that the share of indirect taxes had been rising at the expense of income tax, for example, it is fair to assume that the taxation system did not itself produce any improvement in the disparity of real incomes among the various income groups. Indirect taxes are invariably regressive and consequently reduce the real income of the lower income groups to a greater extent than that of the higher income groups. On the other hand, income tax payments are based on a progressive formula, whereby the rate of tax payable increases as taxable income rises, thus reducing the disposable income of the higher income groups to a greater extent in relative terms than that of the lower income groups. The unfavourable distribution effect of the relatively high level of indirect taxation was, however, moderated to some extent owing to the fact that such taxes as consumption duty and retail sales tax tended to bear more heavily on luxury items. But the use of the resources needs to be brought into focus before any meaningful assessment of the situation can be made.

### GOVERNMENT BORROWING

An increasing amount of total resource transfers to government was in the form of borrowing. Government borrowing rose from 17.2 per cent of all resources mobilised in 1971-72 to 33.6 per cent in 1975-76. Of total borrowing, the foreign element declined from 46.4 per cent in 1971-72 to 33.7 per cent in 1975-76. The reliance on foreign borrowing remained strong over the period, however, as financing from this source increased from J\$24m in 1971-72 to J\$110.5m in 1975-76, an increase of over 360 per cent during the five-year period. The increase in foreign borrowing would have been greater were it not for unfavourable international market conditions.

At the end of December 1975, total foreign loans outstanding stood at an estimated J\$385.4m compared with J\$110m at the end of December 1971. This rapid growth in foreign borrowing was accompanied by a significant shift in the maturity structure of the loans as well as by important changes in their institutional distribution. At December 1975, loans outstanding with maturity of up to 5 years accounted for 54.7 per cent of Government's total external debt and those with maturity of over 5 years and up to 16 years accounted for 40.8 per cent, while the share of loans with

TABLE 2 CONTRIBUTION OF INDIVIDUAL REVENUE ITEMS TO TOTAL TAX REVENUE (%)

	1971/72	1972/73	1973/74	1974/75	1975/76
Custom Duties	21.2	22.1	17.0	14.5	17.9
Excise Duties	21.2	21.7	17.3	14.3	10.9
Consumption Duties	1.1	1.4	7.1	10.5	16.0
Income Tax	47.8	44.5	45.5	47.6	41.8
Land and Property Tax	0.6	0.7	3.4	3.0	4.7
Stamp Duties	3.4	4.3	4.7	4.5	3.2
Motor Vehicle Licence	2.4	2.6	2.0	1.7	1.8
Retail Sales Tax	—	—	1.4	1.9	2.3
Others	2.4	2.7	1.6	2.0	1.4
	100.0	100.0	100.0	100.0	100.0

TABLE 3 GOVERNMENT BORROWING — FISCAL YEARS  
J\$m

	1971/72	1972/73	1973/74	1974/75	1975/76
Domestic Sources	27.7	57.1	33.4	121.5	217.2
Foreign Sources	24.0	26.1	64.2	72.2	110.5
Total Borrowing	51.7	83.2	97.6	193.7	327.7
Borrowing as a percentage of Total Transfers to Government (%)	17.2	22.6	21.8	27.3	33.6

TABLE 4 COST OF TAX COLLECTION — FISCAL YEARS  
J\$m

	1971/72	1972/73	1973/74	1974/75	1975/76
Expenditure of Income Tax Department*	1.2	1.2	2.0	2.4	2.8
Expenditure of Collector General's-Department*	2.5	3.0	3.3	5.3	7.1
Total Expenditure	3.7	4.2	5.3	7.7	9.9
Expenditure of Income Tax Dept./Income Tax Revenue (%)	1.1	1.0	1.3	1.3	1.4
Total Expenditure/Total Tax Revenue (%)	1.6	1.6	1.6	1.9	2.0

\*Government's Estimates of Revenue and Expenditure

maturity over 16 years was only 4.5 per cent. The comparable ratios at December 1971 are estimated at 20.3 per cent, 61.1 per cent and 18.6 per cent respectively. The shortening of the maturity structure was strongly influenced by changes in the components of the debt. Over the period, the relative importance of borrowing from foreign commercial financial institutions rose drastically. Such loans are usually of short to medium term maturity in contrast to borrowing by way of the issue of securities (market loans) and through international and government institutions. Apart from being of shorter maturity, the rates of interest and other conditions of credit from the commercial institutions are generally less favourable, thus putting great strain on the budget. Expenditure in respect of interest charges and repayments on foreign and local debt rose from 7.9 per cent of total government expenditure in 1971 to 13.1 per cent in 1975 and represented 1.8 per cent and 4.4 per cent respectively of GDP.

Foreign commercial loans outstanding rose from J\$18.4m in December 1971 to J\$228.1m in December 1975 while market loans remained stable at around J\$64m. Loans outstanding from international institutions such as the IBRD and IADB increased from J\$13.9m to J\$31.2m and inter-government loans (chiefly from the U.S. Agency for International Development and the Canadian Development Agency) rose from J\$13.5m to J\$31.3m over the same period. The stagnation in market loans was due to unfavourable conditions in the traditional markets overseas for Jamaica Government securities.

In a situation of relatively low economic activity in the private sector of the economy, the government was able to raise only a modest amount of financing through borrowing from the general public, including private financial institutions such as commercial banks and insurance companies. As a consequence, reliance on Central Bank financing rose substantially in the later years. Short-term accommodation by the Bank of Jamaica, which was effected for the first time in 1974-75, rose from J\$25m in that year to J\$105m in 1975-76, in addition to investments in Government securities.

This expansionary fiscal policy did not stimulate domestic production, but placed severe pressure on the balance of payments instead. In the case of foreign borrowing, there exists a foreign exchange counterpart to neutralize the balance-of-payments effect in the short term, but this element is absent in the case of Central Bank financing.

#### The Utilisation of Resources

We have so far tried to analyse the nature and structure of resource mobilisation as an instrument through which government's economic and social objectives may be attained, and in this sector the use of the resources transferred to government will be examined in a similar manner.

Expenditure increased by 223 per cent from J\$299.3m in 1971-72 to J\$966.9m in 1975-76.<sup>1</sup> The major factor in the increase was expenditure on the provision of general services. Expenditure on these services rose from J\$61.2m in 1972-73 to J\$258.4m in 1975-76. As a ratio of total expenditure, the outlay for general services rose from 15.5 per cent in 1972-73 to 26.4 per cent in 1975-76. The allocation to

general services in 1976-77 is estimated at J\$466.6m or 39.3 per cent of total expenditure. The data available indicate that the cost of government's operations increased continuously during the period under review. There was a substantial increase in administrative cost due to rising prices and increases in the rates of emoluments to government employees.

The increase in expenditure on general services was also directly related to government's objective of reducing unemployment significantly in the quickest possible time. This was to "be achieved through specifically increasing expenditure on existing projects with high labour content, and by adding some special employment projects".<sup>2</sup> In this context, building and construction projects were to play an important role as "a large direct employer of labour".

The problem of unemployment was approached on the basis of direct job creation within the government sector instead of on the basis of derived demand for labour. As such, employment creation was not made an integral part of a programme for economic growth. The result of the employment strategy adopted, together with other social programmes, was an increase in consumption demand at the expense of savings and investment. While expenditure on general services increased from 15.5 per cent of total expenditure in 1972-73 to 26.4 per cent in 1975-76, the share going to economic services declined from 30.1 per cent to 28.4 per cent and is estimated to fall further to 19.9 per cent in 1976-77. Allocation to social and community services declined from 40.2 per cent of total expenditure in 1972-73 to 34.5 per cent in 1975-76 and is estimated at 30.4 per cent for 1976-77. This overall decline in the relative importance of social and community services, however, conceals the emphasis which the government placed on such social items as education and housing. Expenditure on education and training rose from 16.3 per cent of total expenditure in 1972-73 to 18.1 per cent in 1975-76 and that on housing from 2 per cent to 3.2 per cent over the same period. These improvements were, however, offset by declines from 9.2 per cent to 7.5 per cent in health services, 3.9 per cent to 1.3 per cent in social security and general welfare and 7.2 per cent to 2.6 per cent in other services. While the expenditure budget was used to increase employment within the government sector, it was not successful in stimulating activity in the private sector.

The ratio of the relative increase in GDP to the relative increase in total government expenditure declined from 0.64 in 1972 to 0.46 in 1975, indicating that additional expenditure in each succeeding period was accompanied by a relatively smaller increase in GDP than in the preceding period.

This low responsiveness to government expenditure was also evident at the industry level. The ratio of government expenditure to value-added in the agricultural sector of the economy, as measured by the sector's contribution to GDP, was higher in the three years 1973 to 1975 than in 1971: there was a sharp unsustained rise in 1972. The ratio of government expenditure on trade and industry to the GDP contribution of the manufacturing sector rose persistently from 5.3 per cent in 1971 to 16.6 per cent in 1975. These figures indicate that expenditure in agriculture and trade and industry yielded diminishing marginal returns and therefore did not have, *ceteris paribus*, any significant impact on production.

TABLE 5 SELECTED RATIOS

	1971	1972	1973	1974	1975
Tax Revenue/GDP (%)	17.0	17.7	16.6	17.8	17.6
Excise Duties/GDP (%)	3.9	3.8	3.3	2.5	1.9
Consumption Duties/GDP (%)	0.2	0.3	0.6	2.0	2.1
Income Tax/GDP (%)	8.0	7.7	7.6	7.7	8.0
Land and Property Tax/GDP (%)	0.1	0.1	0.4	0.5	0.7
Stamp Duties/GDP (%)	0.5	0.8	0.8	0.8	0.5
Customs Duties/Imports (c.i.f.) (%)	10.0	11.8	8.8	6.8	7.9
Total Expenditure/GDP (%)	23.2	24.5	25.2	28.7	33.9
$\Delta$ GDP/ $\Delta$ Total Expenditure		0.64	0.85	0.63	0.46
$\Delta$ GNP/ $\Delta$ Total Expenditure		0.93	0.86	0.63	0.45
External debt service*/net exports of goods and services (%)	2.8	3.2	3.1	2.3	3.3
Agricultural Expenditure/GDP (%)	26.4	36.2	28.4	27.1	30.4
Manufacturing Expenditure/GDP (%)	5.3	11.0	12.0	13.5	16.6

\*On fiscal year basis.

Taken by itself, the expenditure programme can be regarded as having been inflationary. A large portion of the expenditure, as already noted, was not related to the provision of goods and services which are usually demanded by the public and to the expansion of productive capacity. Consequently, a substantial overhang was created between the monetary demand of the public for goods and services and the supply of these from domestic sources. The full inflationary impact of government's expenditure was not, however, reflected in the movement of the overall price level, as demand was satisfied to a large extent through imports. Another factor is that there was a significant level of capital outflows which helped to contain the growth of money supply.

In the area of income redistribution, three factors are of importance — the employment programme and transfers by way of subsidies and retiring benefits. The employment programme was confined to the government sector and was directed at the lowest income group, consequently some measure of redistribution was achieved. In absolute terms, expenditure in the form of subsidies increased significantly from J\$5.5m in 1972-73 to J\$12.9m in 1975-76, but its share of total expenditure declined marginally from 1.5 per cent to 1.4 per cent over the same period. In 1974-75 subsidies amounted to J\$16.4m or 2.1 per cent of total expenditure. Expenditure on retiring benefits rose from J\$7.8m in 1971-72 to J\$10.7m in 1975-76, but declined from 2.1 per cent to 1.1 per cent as a share of total expenditure.

TABLE 6 FUNCTIONAL CLASSIFICATION OF GOVERNMENT EXPENDITURES

	1972/73		1973/74		1974/75		1975/76 (Revised)		1976/77 (Estimates)	
	\$m	%	\$m	%	\$m	%	\$m	%	\$m	%
General Services	61.2	15.5	160.3	31.7	181.6	25.3	258.4	26.4	466.6	39.3
Social and Community Services	158.4	40.2	164.4	32.5	258.1	33.9	337.6	34.5	360.5	30.4
Economic Services	118.5	30.1	139.4	27.6	221.2	3.1	278.9	28.4	235.8	19.9
Miscellaneous	55.5	14.2	41.1	8.2	73.6	5.8	104.5	10.7	123.2	10.4
Total	393.7	100.0	505.2	100.0	734.5	100.0	979.3	100.0	1,186.4	100.0

Source: Memorandum on the Budget 1976-77

### Summary

To this point, we have discussed the mobilisation and use of resources separately, with full recognition of the fact that a meaningful analysis needs to take the totality of government's operations into consideration. The approach was, however, adopted for ease of analysis, and the present section will therefore deal with the budget as a whole in the form of a summary of previous discussions.

Data covering the fiscal years 1971-72 to 1975-76 and the calendar years 1971 to 1975 indicate that the taxation system was not efficient as an instrument of resource mobilisation for the provision of traditional or normal government services. The system is considered inefficient both in the sense that it was not capable of automatically maintaining a stable ratio between taxation revenue and national income and in the sense that the cost of collection tended to increase relatively faster than the revenue intake. On the other hand, the cost of government's administration rose rapidly compared to overall developments in the economy, thus suggesting inefficiency in the use of the resources at the disposal of the government sector. Because of the rising cost of revenue collection and the provision of government's general services, the economic and social returns of the resources transferred to the government sector tended to yield diminishing marginal economic and social returns.

The budget created a high and rapidly rising level of aggregate demand. But this did not stimulate investment in the private sector of the economy. Moreover, government's expenditure itself was of a highly consumptive nature. Consequently, the operations of the government sector do not appear to have had any positive effect on economic growth. Jobs were created directly within the government sector, but these were not, in general, linked to investment projects and did not therefore have any impact on the overall level of production. Instead, the expenditure involved helped to increase the cost of the provision of government's general services. Expenditure on education is of a productive nature, but such investments do not yield returns in the short run. Consequently, expenditure in this area did not begin to show returns in the review period. Increases in the rates of certain taxes could have had an adverse effect on production and employment in the private sector. The complex system of taxation, which results in tax being paid on tax in some cases, did not also tend to encourage investments. During the period under review, however, tax concessions were introduced to adjust the situation somewhat. On the overall, there is no evidence that the system of taxation and government's expenditure had the desirable impact on economic growth and employment generally.

In the area of prices, government's operations had a clear inflationary effect. This resulted from the new tax measures introduced during the period, the nature of expenditure and the composition of the financing. Increases in tax revenue were sought mainly through upward adjustments in indirect taxes, with the concomitant rise in the prices of final goods. The high consumption content of expenditure also had an upward bias on the price level. Of particular significance here is the high level of expenditure in the form of compensation to employees in the government sector as a result of an increase in the number of employees and in the level of their emolument.

The relatively large portion of financing through foreign borrowing and Central Bank resources was an additional inflationary factor. It had the effect of increasing the spending power of the public without a commensurate increase in the domestic production of goods and services. The extensive use of the proceeds of the bauxite production levy for budgetary purposes was also a strong inflationary factor. The overall inflationary effect of the budget was, however, offset to a significant extent through imports and the imposition of price controls on certain basic consumer items. There were also substantial outflows of capital which helped to reduce monetary demand.

Some redistribution of real income was effected through the provision of employment for the lowest income groups. There were adjustments in property taxes and motor vehicle licenses in this direction also. But, the redistribution achieved through these measures could have been cancelled out through the regressiveness of the taxation adjustments on the overall.

The overall inflationary impact of the budget had serious implications for the balance of payments and the country's foreign exchange reserves. The net foreign reserves declined from J\$132.2m at the end of 1971 to J\$56.7m at the end of 1975.

#### Assessment

In the foregoing analysis, it was noted that the cost of collecting tax revenue tended to increase at a higher rate than the revenue intake during the period reviewed. It seems to be necessary, therefore, for a cost-benefit analysis of the taxation system to be undertaken, with a view to improving the efficiency of the administration of the system and consequently minimizing the cost of collection as much as possible.

The narrowness of the effective tax base resulted in a situation in which the growth in the transfer of resources to the Government sector via taxation was at a slower rate than the increase in GDP. This problem could possibly be solved through the introduction of a comprehensive value-added-tax system in place of the numerous types of indirect taxes with their overlapping elements. There are three other major factors in favour of the value-added-tax system — lower administrative cost, responsiveness to change in tax rate, and the ease with which complete tax exemption may be effected. The administrative cost of the value-added system should tend to be lower owing to the fact that a complexity of taxes would be replaced by one tax. Due to the broadness of the tax base, the absolute increase in revenue intake resulting from a minimal increase in the rate of a comprehensive value-added tax should be fairly substantial. Under the current system of indirect taxation, it is difficult, if not sometimes impossible, to relieve goods and services of taxation completely, where desirable, due to the fact that tax is levied on tax through the various stages of production. But this problem is absent in a value-added-tax system, and such a system could therefore be of great advantage in an export promotion programme, for example. The introduction of such a system, however, entails public education and the matter would therefore need to be given careful study.

In view of the relatively high share of government expenditure allocated to the provision of general services, it seems desirable for a cost-benefit analysis to be carried out on the provision of these services, with the intention of minimizing cost or maximizing output with the available resources.

There is no evidence that fiscal policy achieved the stated objectives of the government during the review period and more efficient ways of achieving the objectives need to be adopted. Government expenditure needs to be more directly geared towards the expansion of productive capacity and the production of goods and services in key areas such as agriculture where the necessary incentives for private investment are not considered sufficiently attractive. This would require the direct involvement of the government sector in real production, which should be along efficient commercial lines. Self-supporting corporations could be set up to undertake such a task. This would be an alternative to the strategy of trying to stimulate production in the private sector through the creation of demand on the basis of high government expenditure of a basically consumptive nature. Through the commercial-type ventures suggested, the efficient allocation of resources would be assured and the operations of the government sector would have a direct impact on real production, and consequently on economic growth and the gainful employment of labour.

The data analysed so far indicate that government's operations were in large measure incompatible with the price stabilisation and income redistribution objectives. The taxation adjustments, in particular, were inflationary and regressive, while expenditure was largely consumption oriented. These effects were, however, mitigated to some extent through price controls on basic consumer items and income guidelines which sought to limit wage increases and reduce the disparity existing between income groups. The lower income groups were also provided with certain basic consumer items at subsidized prices through outlets of the Agricultural Marketing Corporation.

While not achieving its objectives, government's financial operations facilitated serious balance-of-payments problems. The high level of demand generated by the operations of the government sector did not serve to stimulate domestic production, but rather to encourage imports, thereby helping to deplete the foreign reserves. In this context, it is essential for fiscal policy to take cognizance of the constraints imposed by the level of foreign reserves at any point in time. The limits of overall demand expansion in the economy must bear some relation to the level of reserves. Fiscal policy, consequently, needs to be formulated within the framework of an overall policy which is consistent with the balance of payments capacity.

#### FOOTNOTES

<sup>1</sup> Financial Statements and Revenue Estimates.

<sup>2</sup> See Memorandum on the Budget 1973-74, p. 33.