The Jamaican Economy: Recent Developments and Prospects

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Background

For a very long time, the Jamaican economy was heavily regulated, with many prices being controlled. This resulted in prices bearing little relevance to relative scarcity. In such an environment, resources will be misallocated. The outcome was that there was little investment and little economic growth. The control of prices at levels other than their true economic level meant that the exchange rate did not reflect the relative competitiveness of the Jamaican economy. An overvalued exchange rate led to the Jamaican productive sector being placed at a disadvantage and the country having negative international reserves. Such an environment leads to instability and capital flight. There was need to structurally adjust the economy.

A process of structural adjustment in Jamaica took place between the mid-1980s and the mid-1990s. These adjustments included the elimination of price controls; liberalization of the financial system, which included freeing of the foreign exchange and financial markets; and a move toward market-based instruments of monetary management. There was also liberalization of the trade and the foreign exchange system. These adjustments, as was to be expected, caused the economy to exhibit massive price movements and short-term uncertainties. Considerable progress had been made in stabilizing the economy up to the mid-1990s. The fiscal position strengthened, with the primary surplus increasing to about 13 percent of GDP and the overall public sector position shifting into and remaining in a surplus position up to fiscal year 1995/96 (April 1995 to March 1996).

There was an improvement in Jamaica’s external position (including the elimination of external arrears) and a strong increase in the level of official international reserves. There was a decline in the ratio of public debt
to GDP by the mid-1990s. External debt was reduced from 103 percent of GDP in 1992 to about 59 percent of GDP in 1996; domestic debt remained in the range of 25 to 35 percent of GDP. In fiscal year 1995/96, interest payments on the total debt amounted to 10.6 percent of GDP. With a primary fiscal surplus, modest economic growth, and relatively low interest rate, the public debt profile appeared sustainable.

Unfortunately, the financial liberalization was not accompanied by a strengthening of the supervisory capacity of the monetary authorities. Different prudential requirements for banks and other financial intermediaries and the development of holding institutions, which included banks, merchant banks, building societies, and insurance companies, all regulated by different agencies and not operating at arms length, opened the door for regulatory arbitrage. The distinction between banks and other financial institutions became increasingly blurred. Short-term deposits were used to finance long-term investments (particularly real estate and tourism projects). In this environment, some of the financial institutions began to show signs of liquidity problems in 1995.

The government’s strategy, adopted in fiscal year 1996/97, emphasized tight monetary policy to reduce inflation and maintain a relatively stable nominal exchange rate. The aim of this policy stance was to improve private sector confidence and allow for real interest rates to decline and output to increase. The Central Bank moppped up liquidity, and the nominal exchange rate appreciated from US$1=J$38.85 in 1995/96 to US$1=J$34.98. Real interest rates rose sharply, and a recession started in 1996/97. The earlier fiscal consolidation was reversed. Wage settlements outpaced inflation by large margins. There was need for significant public sector borrowing. This added further pressure on interest rates. The broad downward trend of public sector debt that had been under way since 1991 was reversed. Although the ratio of external debt to GDP continued to decline, the ratio of domestic debt to GDP started to rise.

Rising interest rates and the economic recession worsened the problems in the financial system. Total gross cumulative support to the intervened financial institutions (those financial institutions in which the government had to intervene by way of buying bad debts and injecting money) amounted to approximately 40 percent of GDP. The jump in the public debt with high interest rates and weakening public sector primary balance created severe adverse debt dynamics for Jamaica.

The tight monetary policy was successful in reducing inflation. The twelve-month inflation rate declined to 4.9 percent in June 1999. It rose to 9.7 percent in April 2000 before ending the year at 6.1 percent. Output fell by a cumulative 4.2 percent during the four-year period 1995–1999, which can be attributed to the growing decline in competitiveness of the economy. The rate of decline has, however, slowed from 1.3 percent between 1995 and 1996 to 0.4 percent between 1998 and 1999. Unemployment remains high at about 15.7 percent during 1999, marginally up from 15.5 percent during 1998.

Real wage increases averaged about 13.5 percent a year in the large private establishments during the two-year period 1996–1998; the increase for 1999 over 1998 was 8.7 percent. In the goods-producing sectors, the average increase in real output per worker was 2.2 percent higher in 1999 than in 1998, whereas in the services sector it was 4.3 percent. Although increases in real wages continue to far exceed productivity growth, the gap has been narrowed considerably. Labor productivity marginally increased in the construction sector (by 0.7 percent), manu-
The external current account deficit widened to an average of 4.5 percent of GDP a year in 1997/98 to 1998/99 (3.5 percent of GDP when the purchase of two aircraft is excluded). Export of goods declined in volume terms, with most of the decline coming from nontraditional exports, including exports from the free zone. Export prices also fell during the period. Total imports also declined, but there was an expansion in the imports of consumer goods. Not only was the output of the economy not expanding but its productive capacity was also declining. The external current account deficit fell from 3.4 percent of GDP in 1998/99 to 2.1 percent of GDP in 1999/2000. When we examine the period January to August 2000, we observe that the current account balance stood at -US$96.2 million, compared with a figure of -US$18.3 million for the corresponding period in 1999. During this period, exports expanded by US$56.8 million, whereas imports expanded by US$176.2 million, thus causing the Goods Balance to deteriorate by US$119.4 million. Rising oil prices explain much of the increase in imports (crude oil imports increased by US$87.7 million).

The current account deficit over the 1997/98 to 1999/2000 period was financed almost entirely by foreign investment. The government's commercial borrowing on the international market was used primarily for official debt amortization. A cumulative overall balance of payment deficit of US$252.4 million was recorded during 1997–1999. For January to September 2000, there was an
overall balance of payments in surplus of US$585.3 million. Gross international reserves improved from around US$700 million at the end of 1998/99 to approximately US$1.02 billion in September 2000 (equivalent to sixteen weeks of imports and 186 percent of prospective public external debt service payments).

Private investment flows for the period January to August 2000 were US$279 million. This figure is US$110.9 million more than the figure for the corresponding period in 1999.

Public external debt relative to GDP continued to decline and was 46 percent of GDP at the end of 1999/2000, compared with over 50 percent at the end of 1996/97. The bulk of Jamaica’s external debt is to official creditors, with almost 45 percent to bilaterals, 34 percent to multilaterals, and 21 percent to private creditors (mainly bonds).

The fiscal deficit stood at 7.31 percent of GDP in 1996/97. This widened to 8.86 percent in 1997/98, then declined to 8.62 percent in 1998/99 and 5.98 percent in 1999/2000. The overall public sector debt (excluding FINSAC4 debt) moved from J$199.4 billion (97.4 percent of GDP) in 1996/97 to J$307.6 billion (119.77 percent of GDP) in 1999/2000. The total debt increased by 19.17 percent between 1998/99 and 1999/2000. When the FINSAC debt is included, the total public debt increased from 104 percent of GDP at the end of 1995/96 to 144 percent of GDP at the end of 1999/2000. The composition of the non-FINSAC debt has been changing over time, with the domestic portion accounting for a larger share. In 1996/97, the domestic portion of the debt was 42.7 percent; this changed to 46.8 percent and 53.9 percent in 1997/98 and 1998/99, respectively, before reaching 57 percent in 1999/2000. Central government revenues relative to GDP fell from 34.5 percent of GDP in 1995/96 to 30.8 percent and 29.5 percent in 1996/97 and 1997/98, respectively, before increasing to 31.1 percent in 1998/99 and then to 35.2 percent in 1999/2000. This improvement in government revenue is due primarily to better collection of taxes and increased imports.

The primary balance of the central government stood at 6 percent of GDP in 1996/97. This fell to 2 percent in 1997/98. Since then, this figure has been rising, first to 6.5 percent in 1998/99 and then to 11.4 percent in 1999/2000. The Public Sector Balance5 as a percentage of GDP moved from −10.6 percent in 1995/96 to −20.5 percent and −22.8 percent in 1996/97 and 1997/98, respectively, before moving to −17.6 percent in 1998/99 and then to −23.3 percent in 1999/2000. The debt-servicing (interest and amortization) charge as a percentage of total expenditure fell from 50.3 percent in 1996/97 to 47.5 percent in 1997/98 before rising to 54.1 percent in 1998/99 and then to 61.3 percent in 1999/2000.

As inflation was reduced, the central bank was able to steadily lower the reverse repurchase rate. In November 1996, this rate was 33 percent. This was continually lowered until August 1997, when the Central Bank started increasing this rate in response to pressure placed on the exchange rate. The rate was eventually increased to 29 percent in November 1997. Since April 1998, this rate has been reduced in phases. It now stands at 16.45 percent. The cash reserve requirements were reduced in stages, from 25 percent in August 1998 to their current level of 13 percent. The aim here was to induce lower commercial bank lending rates. Although government borrowing from the banking system remains large, it has been declining over time, moving from 27.5 percent of total credit in 1995 to 18 percent in 1999. Credit to the private sector in real
The Jamaican Economy: Recent Developments and Prospects

The targets that the government has set for itself for the period 2000/01 to 2001/02 are to have economic growth at 2 percent per year, contain domestic inflation within a band of 6 to 7 percent per year, and further strengthen the external position by building up international reserves to cover 200 percent of short-term external liability and 14.5 weeks of imports. The policy measures that will be used to achieve these objectives are contained in a three-pronged approach: (a) a plan to address the problems of the financial sector; (b) further fiscal consolidation, with the savings being used to address the debt from the financial sector, crucial public sector investment, and strengthening of the social safety net; and (c) appropriate exchange rate and monetary policies.

The target for the fiscal consolidation is to raise the primary surplus to 14 percent of GDP in 2000/01. This figure is expected to be at 13 percent in 2001/02. The reason for the decline is that during 2000/01, there was a onetime inflow of funds that resulted from the sale of telecommunications licenses (approximately 1 percent of GDP). With the inclusion of the FINSAC debt, it is anticipated that the fiscal deficit for 2000/01 will be less than 5 percent of GDP, a reduction of more than a half the previous year's level. A further 4 percent improvement is targeted for 2001/02, that is, a deficit of less than 1 percent of GDP. These targets are to be achieved through expenditure restraint and improvements in the collection of taxes. The government has already started to reap the benefits of improved tax collection. For the first nine months of the fiscal year 2000/01, Revenues and Grants increased by 15.8 percent (tax revenue increased by 17.5 percent) over the corresponding period for fiscal year 1999/00. Expenditure was reduced by 2.3 percent (recurrent expenditure rising by 0.1 percent and capital expenditure falling by 2.5 percent). The surplus on the primary balance increased by 64.7 percent. The trajectory for the debt burden (including FINSAC debt) is a decline from 144 percent of GDP in 1999/2000 to 125 percent in 2000/01 and 116 percent in 2001/02. The cumulative support of FINSAC to the financial sector up to 1999/2000 was US$2.5 billion (37 percent of GDP). The majority of this support was in the form of FINSAC bonds, however, which did not pay cash interest.
The government has already started to rationalize some of its operations. Attention is being paid to the areas of health and education as two of the big spenders on the recurrent side. The payment of overtime pay for doctors as well as other areas of public service and the student-teacher ratio in the educational system are receiving closer examination. It is anticipated that capital expenditures, which had declined significantly in recent years, will be increased from approximately 3 percent of GDP in 1999/2000 to approximately 4 percent of GDP in 2000/01. The government is, however, prepared to make adjustments to this figure to ensure that its broader targets are met.

The plan to deal with the FINSAC debt is as follows: (a) cancellation of FINSAC’s debt to the government (4 percent of GDP) and offsetting FINSAC’s debt to other public entities against these entities’ liabilities to the government (8.5 percent of GDP); (b) use of support obtained from the World Bank, the Inter-American Development Bank, and the Caribbean Development Bank (US$325 million, 4.5 percent of GDP) in addition to the expected proceeds of the sale of assets (2 percent of GDP) to payoff FINSAC debt; (c) placing the remaining FINSAC debt on the books of the central government as of the financial year 2001/02 with interest payments made by the government in cash from then on. To obtain assistance from the World Bank, Inter-American Development Bank, and Caribbean Development Bank for the FINSAC debt, the government entered into a Staff Monitored Programme with the International Monetary Fund.

During 2000, the Jamaican economy has experienced some encouraging signs. For the period January to August 2000, total merchandise imports increased by 11.2 percent over the corresponding period in 1999 (compared with 3 percent growth a year earlier and 4.4 percent decline two years before). Raw material and capital goods imports were mainly responsible for this increase. These categories increased by 15.9 and 13.7 percent, respectively. Consumer goods imports increased by only 3.5 percent. This signals an increase in the productive capacity of the economy.

For the period November 1999 to September 2000, sugarcane output declined by 13 percent. But due to an improvement in the ratio of tons of cane per ton of sugar, the output of sugar increased by 6 percent.

For the first nine months of 2000, coffee earnings increased by 39 percent over the corresponding period for 1999. This resulted from increases in both price and quantity.

For the fifth consecutive year, the Jamaican alumina subsector attained a record in output (up 1 percent over 1999). This was made possible by the incremental increases in capacity at all three companies. The crude bauxite subsector continued to be affected by the explosion that took place at Kaiser’s Gramercy, Louisiana, refinery in July 1999. During 2000, production of crude bauxite fell by 25.1 percent. Total bauxite production for 2000 decreased by 4.3 percent. With the Gramercy fallout, crude bauxite exports fell from approximately 4 million tons in 1998 to 2.8 million tons the following year and 2.1 million tons in 2000. The Gramercy plant partially resumed operation in November 2000 and is expected to be fully operational by the end of 2001. It is anticipated that Jamaica’s export of crude bauxite will double during 2001. Despite the decline in crude bauxite exports during 2000, estimated gross earnings increased by 4.7 percent. This was due to the increased alumina shipments and more favorable prices for aluminum on the international market. Prospects for the sector continue to be good. There is to be a US$60 million expansion of alumina production capacity by Alpart during 2001.
The Jamaican Economy: Recent Developments and Prospects

ite/alumina sector has benefited in the immediate past from the robust U.S. economy, which is now showing signs of slowing down. It is anticipated that the higher growth in Europe and continued recovery in Asian economies will absorb any slack in exports caused by a slowing of the U.S. economy. A slowdown in the U.S. economy will, however, cause a negative price effect.

Based on the Planning Institute of Jamaica’s Production Survey of Selected Commodities, the manufacturing sector showed a marginal increase of 1.8 percent during the first half of 2000 compared with the same period in the previous year.

The construction and installation sector had some very positive indicators. For the first half of 2000, housing starts and completions were up by 68.7 percent and 147.9 percent, respectively; cement sales increased by 10.2 percent; and the importation of construction material increased by 4.5 percent. Activities in the nonresidential construction subsector were mixed. Government activities, on the other hand, increased as work on major infrastructure projects continued.

Recovery in the financial sector continued in 2000. For the first nine months of 2000, the real assets-to-liabilities ratio of the commercial banks and credit unions increased by 4.1 percent and 16.1 percent, respectively. During the same period, the assets-to-liabilities ratios of building societies were reduced by 2.9 percent. Loans and advances from commercial banks recorded an increase of 6.3 percent between October 1999 and October 2000 in nominal terms, which translates into a real decline of approximately 2 percent.

January to November 2000 saw tourist arrivals increase by 11.1 percent compared with the corresponding period for 1999. The stopover category increased by 5.6 percent, whereas the cruise category increased by 20.4 percent. The industry benefited from a larger-than-expected number of arrivals of cruise vessels. Bad weather conditions in the eastern Caribbean diverted three vessels to Ocho Rios.

Electricity sales for the first nine months of 2000 increased by 7 percent; production increased by 8.1 percent. The large power category recorded the highest increase, 26.7 percent, whereas the residential category moved up by only 3.4 percent.

The agriculture sector continued to contract. According to the Planning Institute of Jamaica’s Index of Agricultural Production, output fell by 19.1 percent during the period January-June 2000 compared with the corresponding period in 1999. This is largely explained by drought conditions, which started in the latter half of 1999 and continued into 2000. Banana production declined by 31 percent during the period January-September 2000 compared with the same period in 1999.

The immediate prospects are that the economy will show signs of recovery, though modest. If further losses in competitiveness can be avoided and government reliance on debt financing can be contained, the Jamaican economy should return to a growth path in the immediate future.

Inflation of 6.06 percent for 2000 means that the government has been able to deliver four consecutive years of single-digit inflation. Inflationary expectations should therefore be curbed. Combined with fiscal prudence, this will go a long way in ensuring that future inflation targets are met. What happens in the international market for oil will have a significant effect on Jamaica’s inflation levels, however. As Jamaica’s inflation rate gets closer to those of its major trading partners, it becomes easier to ensure that the competitiveness of the economy does not deteriorate. It should be noted, however, that stability in the inflation level has not yet been consolidated,
as the twelve-month point-to-point inflation rate for each month varied by almost 4 percentage points in 2000 (the twelve-month point-to-point figure was 6.57 in January, 9.7 percent in April, and 6.06 in December).

The volumes of both exports and imports are projected to increase during 2001/02. The external current account deficit is expected to widen to about 4.5 percent of GDP as imports outstrip exports as the economy retools. Private remittances remain strong; they were estimated as being equal to about 11 percent of GDP in 1999/2000. Remittances are expected to stay strong, but they will be affected by the strength of the U.S. economy.

The core problems facing Jamaica are adverse debt dynamics associated with high real interest rates and a heavy burden of public debt as well as weak external competitiveness. This situation is aggravated by the large fiscal deficits generated by the central government. The first two are universally accepted as problems, but the third has not been publicly acknowledged by the government as a problem.

The government’s strategy for revival of the economy is a combination of the following: (a) a gradual approach to addressing the adverse debt dynamics through moderate improvement in the primary fiscal balance; (b) a continuation of the privatization efforts; and (c) maintaining a relatively stable nominal exchange rate in a manner that will not jeopardize the gains already made against infla-
tion in recent years. The government is very concerned that any sharp adjustment in the exchange rate could precipitate a spiral of higher prices and higher wages, which would require a further devaluation, leading to still higher prices and higher wages and the need for further devaluation. The underlying thinking seems to be that even if there is a competitiveness problem, this would have to be solved by increases in productivity outpacing real wage growth. But real wages continue to outpace productivity growth, thereby increasing the noncompetitiveness of the economy. For there to be long-term rapid sustainable growth, net value created per worker must increase. The government’s thinking also seems to be that there needs to be a period of relative price stability to allow efforts to be directed at productivity improvement. In the interim, however, the competitiveness of the economy is eroded. The authorities are of the view that once the credibility of the fiscal and monetary policies has been established, interest rates will be lowered, thus facilitating investment and growth. The target of bringing interest rates down to 14 percent by March 2001 seems unattainable at this stage. The 30-day reverse repurchase rate at the end of January 2001 stands at 16.45 percent, with the 365-day reverse repurchase rate at 20.5 percent. Over the past few months, the authorities have shown more willingness to entertain nominal exchange rate movements than they did before. This seems to be an outgrowth of a greater confidence in their ability to control inflation.

The government’s macroeconomic objectives over the medium-term 2000–2004 are to reduce inflation to that of the major trading partners (about 2–3 percent per year), accelerate growth in output (to 3–4 percent a year), and maintain a sustainable external position (reserves to cover fourteen weeks of non-bauxite-related imports). The expectation is that real interest rates will decline sharply, releasing budgetary resources to rehabilitate and expand infrastructure as well as spur economic activity.

The government’s strategy would require a primary surplus of 11 percent of GDP over the period. Barring any adverse shocks, the debt dynamics would improve, although gradually, with the ratio of debt to GDP projected to decline from the current 144 percent position to 130 percent by the end of 2004/05. If all goes well, this strategy would reverse the adverse public debt dynamics. Public debt would be put on a slowly declining trajectory over the longer term. Growth is likely to be weak over the period, however, thus leaving the economy in a very vulnerable position in relation to any shocks that might occur, domestic or external. Since competitiveness would only be obtained slowly, it is likely that the external current deficit would worsen to as much as 5 percent of GDP per year.

An alternative strategy would be to seek a quicker return to competitiveness by allowing the market to determine the exchange rate without official intervention and dealing more aggressively with the debt dynamics by relying on stronger up-front fiscal adjustments (the effects of which on the extremely vulnerable could be mitigated through strengthened safety nets). The long-term goal should be to reduce the ratio of debt to GDP to 60–75 percent over the next six to eight years. This would require a higher primary surplus level to be maintained throughout the period.

If more of the adjustment is shifted on the fiscal side, there could be some easing of the monetary policy stance without triggering inflation. Lowering interest rates in these circumstances could lead to some depreciation of the currency but would contribute to relieving the liquidity problem in the banking
sector. This alternative would require a shorter time period for significant growth to be attained in the economy. It would, however, carry a higher short-term social and political cost than the current strategy being pursued. It is unlikely that a government would adopt this faster adjustment program midway through its administrative life. Such a strategy, if it is to be adopted, is best done at the beginning of a term of office. The current mix of policies has not been overly friendly to exports and economic growth.

**Bibliography**

Planning Institute of Jamaica, *Economic and Social Survey of Jamaica*, various issues.
Planning Institute of Jamaica, *Economic Update and Outlook*, various issues.

**Notes**

1. The Financial Sector Adjustment Company (FINSAC) was established in 1997 to rehabilitate the financial sector after the financial sector crisis. The accounts of FINSAC have up to now not been included in the government's budget.

2. This figure is compiled by taking the fiscal balance and adding to it amortization payments and the balance from public sector entities not covered under the central government.

3. This figure is calculated by converting the alumina figure to an equivalent crude bauxite figure and adding it to the crude bauxite figure.