



**Government Financing of Economic Growth & Development in Jamaica:
Problems & Prospects by Helen McBain**

**Paper presented at
The Conference on Financing Development in the Caribbean
Sam Lord's Castle, Barbados.
December 4 to December 8, 1989**

**CONFERENCE ON
FINANCING
DEVELOPMENT
IN THE CARIBBEAN**

The Conference on Financing Development in the Caribbean is sponsored by Commonwealth Secretariat, Regional Programme of Monetary Studies and The Central Bank of Barbados.

Cooperating and supporting institutions: CARICOM, Caribbean Development Bank, Economic Commission for Latin America and the Caribbean, Commonwealth Fund for Technical Cooperation, Canadian International Development Agency and The World Bank.

Government Financing of Economic Growth and Development in
Jamaica: Problems and Prospects

by

Helen McBain
ISER, Mona

Abstract

This paper looks at the growth of government and the tendency towards increased budget deficits in Jamaica which constrain government expenditure to promote economic growth and development. Huge balance of payments deficits and shortage of foreign exchange led to policies of demand restraint under IMF-supported adjustment programmes during the 1980s. These were the major factors that determined improved fiscal management. However, politicians' pursuit of political power had a significant influence on fiscal policy prior to general elections which tended to lead government down the path of deficit financing. Potential sources of revenue for financing necessary expenditure seem to lie in greater tax compliance in the absence of significant growth in the productive sectors of the economy. Failing this, government will resort to debt which can only further constrain its financial capacity to promote economic development.

Government Financing of Economic Growth and Development in
Jamaica: Problems and Prospects

by

Helen McBain
ISER, Mona

I. Introduction: The Role of Government in Economic
Growth and Development

Government's role in the economy was traditionally to provide externalities to facilitate the process of economic growth based on private initiative. The economic depression associated with the second World War and the Keynesian prescriptions for restoring economic prosperity enlarged and extended that role to the management of the economy through the use of monetary and fiscal tools.

Classical economists believed that fluctuations in economic activities which upset the condition of full employment would be smoothed out by self-correcting forces operating within a marked economy. On the other hand, Keynesians felt that the market economy did not operate in the smooth manner assumed by the classical economists and hence government intervention was necessary to prevent rising unemployment. This intervention took the form of aggregate spending which government would either increase or decrease in response to inadequate or excess demand as the case may be. The growth of government has however increased over the years regardless of the state of the economy. This growth measured in terms of total expenditure to GDP has

been more significant for European countries such as the United Kingdom and the Scandinavian countries where welfare benefits constitute a greater component of expenditure than in a country such as the United States. Government has also grown in developing countries. In Jamaica, the ratio of total government expenditure to GDP was 23 percent in 1971 but increased to 33 percent in 1975.¹ In fiscal year 1980 the ratio was as high as 49 percent. By 1988/89 the ratio was reduced although it was still over 40 percent (Table 1).

The increased size and role of government in developed countries are justified in terms of the economic development that has been taking place and which requires increased investment in physical and human capital and in technology. For developing countries that role is justified by the very need for economic development which has been constrained by the economic and social structures in these countries. Governments in these countries therefore have to direct their roles towards two goals: that of ensuring economic growth and that of promoting economic development.

To ensure growth in typical aggregates such as national income government has to pursue policies that do not constrain the activities of the private sector which constitute the major part of the country's output. It also has to contribute to capital formation by investing in

1 E.S. Taylor, "Public Finance in Jamaica 1971-76", *Social and Economic Studies*, 26:4 (1977): 508.

social and economic infrastructure and in human resources. But economic development is much more than economic growth and government's role in increasing employment and per capita income as well as maintaining stable price levels. It involves transforming the economy by diversifying production and trade structures, creating linkages between sector and increasing the competitive levels of efficiency of more backward sectors, as well as improving living standards through a more equitable distribution of income. This has led to an extension of government's economic management from the area of policy to that of direct involvement in economic activity and hence to the growth of a sizeable public sector.

The Jamaican government's role in economic activity started from the latter part of the 1960s and increased significantly in the 1970s and early 1980s. The public sector incorporated services such as transportation and communications, banking, trading and the utilities and manufacturing activities, thus commanding significant resources in the country through a plethora of public enterprises. This tended to crowd out private sector activities in related areas through the monopolistic nature of these enterprises. In assessing the effectiveness of public sector-led development it can be said that development objectives have not been achieved especially in transforming sectors such as agriculture and hence Jamaica's dependence on imported food has increased. Some of the main

problems have been the inefficiencies of the public enterprises and their lack of accountability to the tax paying⁷ public. This has resulted in significant transfers from the central government's budget to cover losses incurred by the public entities. IMF data on government operations for the late 1970s shows that the bulk of transfer payments went to government entities. So that whereas transfers by governments in developed countries were mainly in the form of social welfare benefits and hence represented some redistribution of income in society, in Jamaica they represented a redistribution of income from taxpayers to government itself.

Government justified its increased role in economic activity largely on the ground that private sector investment failed to increase employment and that the private sector was risk averse to investment in the agricultural sector. Most of the enterprises acquired by the government in the 1970s were the result of imminent closure by the owners and hence a loss of employment.² Public enterprises thus became the vehicle for increasing or preventing the fall in employment levels. This policy was based on the assumption that the private sector did not promote economic development despite the incentives offered by government. However, the assumption was faulty since the government did not evaluate the system of incentives in

² See Adlith Brown and Helen McBain, "The Public Sector in Jamaica", in *Studies in Caribbean Public Enterprises in the Commonwealth Caribbean* (Mona, ISER, 1983).

relation to the desired objectives. The fiscal incentives tended to constrain employment generation and intersectoral linkages by lowering the value of capital and raw material imports and hence increase the use of labour. The cost to the government in terms of foregone tax revenue was not justified as increased outlays had to be made to maintain production and employment levels. This put severe pressure on the government's budget in a situation of reduced output and earnings and foreign exchange shortage during the late 1970s. Efforts have been made during the 1980s to divest some of the public enterprises. At the same time greater reliance has been placed on monetary and fiscal policies to stimulate economic growth which was stagnant in the late 1970s. There is tacit admission partly influenced by the international financial agencies and USAID that the size of government and the policies pursued in the 1970s were the main constraints on economic growth and development.

II. Policy Measures for Promoting Economic Growth

The general objectives of the Jamaican government of the 1980s were social and economic stability, improved standard of living and the maintenance of a stable and democratic system of government.³ These were to be achieved through economic growth and equity. Resuscitating economic growth and reducing the level of unemployment were

³ Prime Minister Seaga's Report to Parliament, 2 November, 1982.

the primary objectives of the government's Economic Recovery Programme. The government chose an option of moderate demand management with a focus on the supply side of the economy. Money supply growth was to be limited and central government expenditure was to be reduced. Employment was to be increased by expanding productive capacity in industry and agriculture since the size of the public sector was to be reduced through divestment of public enterprises and the reduction of government expenditure. The main incentives offered to the private sector to increase production and exports and thus reduce the trade deficit were deregulation of the economy and the reduction of the size and activity of the public sector as well as improvement in its performance. The latter was seen as critical to increasing business confidence to the economy. But although the government agreed to deregulate the economy (by removing price and other controls) under agreements with the IMF and World Bank, it moved very slowly in this direction between 1981 and 1989,

Taxation

The rate of economic growth can be influenced by fiscal policy in the form of incentives to save and invest or disincentives to consume. The government's main fiscal objectives were to reduce the fiscal deficit and bring expenditure in line with revenue and to reduce net credit by the domestic banking system to the public sector. These

formed part of its IMF-supported economic stabilization programme. Taxation policy was therefore initially geared more toward correcting the deficit than toward encouraging saving.

There were no new tax measures for increasing taxes for the first two years after the general elections in 1980. Instead, the emphasis was placed on improving the tax collection and tax compliance mechanism in order to increase revenue and thus reduce the deficit. A Revenue Board was created and efforts made to collect arrears on tax. Real tax revenue increased by 14 percent in 1981 and by half as much in 1982. Most of the increase was accounted for by customs and excise taxes, consumption taxes and stamp duties (Table 2). And these rose on account of the significant growth in imports of goods attracting duty such as motor cars, as well as the application of ad valorem rates which allowed revenue to benefit from price increases.

Economic activity declined after 1981 resulting in a fall in tax revenue. New measures were therefore introduced in 1983 to increase revenue which had been affected also by reduction in the bauxite production levy due to recession in the industry. The new tax measures included a new education tax of 1 percent on taxable earnings, new retail sales tax on secondhand vehicles and a special levy on the earnings of Life Insurance companies. New procedures were also instituted for assessing the income of self-employed persons. The nominal increase in taxes was due to inflation

and the devaluation of the Jamaican dollar in 1983. The new tax measures as well as continual efforts to improve tax compliance prevented the fall in real tax revenue which in fact increased by 1 percent in 1984 and by 8 percent in 1985.

Private consumption fell between 1981 and 1983 from 77 percent of net domestic investment to 75 percent (Table 3). And the contribution of private saving to net domestic investment increased from 3 percent of the net domestic product in 1981 to 9 percent in 1983 (Table 4). Foreign borrowing and domestic wage restraint were employed to maintain exchange rate stability and reduce inflation. Although interest rates were kept stable and relatively low, the ceiling on overall credit constrained the growth of domestic investment. Nevertheless, neither monetary nor fiscal policy was geared toward encouraging rapid growth in the saving rate. As a result heavy reliance was placed on foreign borrowing to finance increased investment.

The most significant development in tax policy was the tax reform programme introduced in 1987 but made effective from January 1986. It changed the progressive income tax system where the rate structure was 30 to 57.5 percent to a flat rate system of 33 1/3 percent on income above J\$8,580. This threshold was raised to J\$10,400 effective January 1989. The reduced rate was geared toward widening the tax base by eliminating tax evasion and including perquisites in taxable income. Tax credits were therefore abolished. The

main justification for the elimination of progressive tax rates was that high marginal tax rates discouraged private initiative, investment and work effort while encouraging tax evasion and increase in perquisites which are exempt from taxation.⁴ This reduction in marginal tax rates which was supported by the World Bank and USAID was part of supply-side measures encouraged by the US to stimulate production, productivity and hence economic growth. At the same time government introduced a 33 1/3 percent tax on interest earned on saving deposits in financial institutions. The intention was to reduce a \$200 million estimated loss in revenue in 1986. Stamp duty on imports was also increased substantially for consumer and capital goods (10-30%) but more modestly for raw materials (6-16%).

These measures led to a substantial growth in real tax revenue which increased by 63 percent in 1986. The income tax measures resulted in a rise of the tax take from \$477 million in 1985 to \$725 million in 1986. Tax growth for 1987 reverted to the 1985 level of 8 percent and declined by half as much in 1988. Income tax grew more modestly while consumption duty declined. Again as part of the World Bank/USAID recommendations government began the implementation of a tariff reform programme from 1987. The objective was to reduce the maximum aggregate rate of duty and to broaden the base on which tariff is applied. The

⁴ Planning Institute of Jamaica, *Economic and Social Survey of Jamaica, 1986*.

maximum duty rate was set at 68 percent in 1987 and reduced to 60 percent in 1988. This is eventually to be reduced to 30 percent which will be applied on consumer goods imports.⁵ At the same time, the tariff base is being progressively increased from its level of 20 percent of total imports. In 1988 revenue from customs grew by 9 percent compared to 19 percent the previous year. This suggests that the tariff reform could have an adverse effect on tax receipts from trade. But this would be mitigated by widening the tariff base. The effects can only be assessed after the total programme has been implemented.

Income tax reform contributed to the growth in savings in 1986. As a percentage of national disposable income saving was 8 percent in 1986 compared to 2 percent in the previous two years (Table 3). Monetary measures also contributed to this achievement: exchange rate stability, decline in inflation and a saving rate of 20 percent in 1985/86. Income tax incentives for business are to be implemented during the third phase of the tax reform programme when corporate taxes will be reduced from the existing maximum rate of 45 percent to a flat rate of 35 percent. At present businesses enjoy a number of tax incentives. Tax exemptions or holidays of 5 to 9 years are given to companies based on the amount of value added. For companies that do not qualify for these exemptions but which

⁵ From 1987 to 1990 import duties will be reduced to a maximum of 5% for utilities, 10% for raw materials, 20% for capital goods and 30% for consumer goods.

export outside of Caricom, tax reductions ranging from 25 to 50 percent are given based on the level of export profits in relation to total products. Under the 1987 IMF agreement exporters were given a tax rebate of 7 1/2% on non-Caricom exports in respect of imported inputs in their production process. Sugar, petroleum products and free-zone exports were excluded. This was to be an interim measure which would be terminated after completion of the tax and tariff reforms. Government set the termination date at December 1989 when a General Consumption Tax would be introduced to rationalize the various local taxes on trade and consumption. Private sector interests represented by the Private Sector Organization of Jamaica (PSOJ), the Jamaica Manufacturers Association (JMA) and the Jamaica Exporters Association (JEA) protested the decision and in fact called for the rebate to be doubled to 15 percent to increase Jamaica's export competitiveness which had been eroded by a fixed exchange rate since late 1985. This response is difficult to understand if a statement made by the Minister of Development, Planning and Production to the effect that the export rebate was grossly underutilized is correct.⁶

The fiscal incentives that have been and are to be offered to business presume both the ability and willingness of the private sector to invest in productive activities. The planned corporate tax reform may not increase business saving if the marginal propensity of business to save is

⁶ *The Daily Gleaner*, (Jamaica), 16 June, 1989, p. 14.

low. This would be the case where the share of distributed profits in total profits is high, a situation considered to be typical for less developed countries.⁷ In Jamaica there is a 37 1/2 percent withholding tax on dividends which is supposed to encourage re-investment rather than consumption of profits. However, there are factors other than fiscal incentives which determine investment decisions such as the investment climate and the rate of return on investment. The efficiency and innovativeness of local entrepreneurs are important in weighing the benefits to be derived from tax incentives to business against the tax revenue foregone by the government. In relation to the reduction of the marginal income tax rates, the assumption again is that high income earners have a higher marginal propensity to save than lower income earners. However, these groups tend to be heavily consumption-oriented as evidenced by their extravagant life style. Thus the government may be having tax revenue without the benefit of increased saving and investment in the productive economy.

Using tax policy to address economic growth and development objectives is not just a question of providing incentives to encourage savings and investment but also one of redressing the inequitable distribution of income in the society. The progressive income taxation that existed prior to 1986 was geared to reduce inequality in income but the

⁷ A.J. Peserck and J. Hanser, (eds.), *Government Finance and Economic Development* (Paris: OECD, 1966).

number of exemptions and tax credits led to tax evasion and narrowing of the tax base. The burden of taxes fell on employees subject to the P.A.Y.E. system. Tax revenue as a percent of total taxes declined while revenue from indirect taxes increased as greater reliance was placed on this source to make up for the loss in income tax due to tax evasion among other things.

Indirect taxes are usually considered regressive because they reduce the real income of those at the lower end of the income scale more than they reduce the real income of those at the upper end. However, because of the highly skewed distribution of income and the propensity for luxury consumption by high income earners, progressive consumption taxation would reduce the inequality in consumption and allow government to divest needed resources from non-essential consumption into areas that could contribute to economic development.

The most significant item of consumption good is motor vehicles which are subject to progressive consumption taxes. These taxes were used by the government to subsidise the cost of basic consumption goods and thus benefit lower income groups. However, basic foodstuffs which are usually imported are consumed by all income groups and therefore this policy could not be seen as redistribution in favour of low income groups. The high cost of this policy became evident in April 1989 when the government announced price increases on several of the basic commodities which it had

been subsidising. These subsidies had been financed not only by the surplus of the government-owned Jamaica Trading Corporation (JCTC) and hence by consumption taxes, but also by the transfer of surplus from the government-owned Jamaica Public Service Company (JPSCO.). The latter contributed to a stabilization fund, savings from reduced oil costs which were not passed on to consumers. However, the rise of oil and grain prices on the world market led to a deficit of about J\$500 million on the operations of these enterprises. Government therefore had to increase direct and indirect taxes in 1989 in order to finance capital expenditure in the 1989/90 budget.

Indirect tax increases were applied to retail sales, travel and telephone services whereas direct tax increases were in respect of the education tax. The latter along with other payroll deductions such as national insurance and national housing had been frozen at 1985 levels after the income tax reform programme was implemented in 1986. This was to have been an interim increase prior to the reform of these taxes. However, the old system was still in place in 1989 and offered the government a source of direct tax increases. The rate of education tax was doubled and applied to total emoluments whereas income tax is applied only to income above the threshold limit. There was no direct redistributive effect of these tax increases although they were intended to finance capital expenditure. To the extent that this expenditure is on projects that benefit low

income groups it can be said to be redistributive both in intent and practice. However, on the whole, taxation policy has not been successful in correcting the skewed distribution of income in the country. In fact, with the downturn in the economy from the late 1970s and the bias of adjustment policy in favour of the owners of capital income seems to have become more concentrated at the upper level.

Expenditure

The employment creation and income redistribution emphasis of fiscal policy during the 1970s was unsustainable in light of the deterioration in the fiscal deficit. During the 1980s, fiscal policy was geared toward reducing expenditure and hence the deficit. Expenditure was to be brought to a level of 30% GDP by 1984 and the current account deficit to 3% GDP in 1981. A current account surplus of 1 percent was the target for 1983. However, total real expenditure was more or less stable between 1980 and 1983. It was reduced significantly in 1984 (by 17 percent) but rose again from 1985 to reach a high of J\$3 billion or 43% GDP in 1987 compared with the level of J\$2 billion or 49% GDP in 1980. The current account deficit was reduced to 3 percent in 1984 and a surplus of 3 percent was realized from 1986 to 1988 (Table 5).

Most of government's total expenditure was the category "general services" which include administration and security. Whereas in the 1970s increased expenditure in

ability to promote growth and development through the budget since a significant part of expenditure grew toward debt service. Foreign exchange earnings have not increased to take care of these payments and hence government has had to resort to further borrowing and/or deferral of payment through debt rescheduling in order to maintain credit worthiness,

Debt financing grew significantly from 1983 becoming the major source in 1985. The growth in internal debt has been mainly in the area of short-term debt as government took advantage of commercial bank liquidity through Treasury Bill issues. The growth in short-term debt and government securities helped to substantially expand the monetary base between 1983 and 1985 and facilitated the erratic growth in the money supply which had been kept constant during the early years of the stabilization programme (Table 9). This also had an adverse effect on the balance of payments which deteriorated between 1980 and 1985. A significant feature of the late 1980s is the achievement of a surplus of J\$221 million on the government's current account in 1986 which grew in real terms to J\$239 million in 1987 and to J\$299 million in 1988 (Table 10). The balance of payments also improved considerably from 1986 thus substantiating the argument that there is a causal relationship between the

government's deficit and the deterioration in the balance of payments.⁹ We will now turn to a discussion of some of the determinants of government's fiscal policy and its outcome and the implications for economic growth and development.

The Monetary-Fiscal Entanglement

The use of monetary policy to restrain demand has had an adverse effect on the government's financial operations and the ability of fiscal policy to stimulate investment and economic growth. Credit restrictions and high interest rates while restricting consumption have not stimulated production and investment. The increase in the mandatory saving rate from 15 percent in 1984 to 20 percent in 1985 resulted in banks increasing their lending rates. In 1984 the prime lending rate was 19 percent. In 1985 it was increased to 23 percent. The saving rate was reduced to 13 percent in 1988 but this still contributed to the high cost of loan funds. An argument has therefore been made for government to deregulate the saving rate so that the cost of loanable funds can be reduced to facilitate increased investment especially since the demand for money tends to be more responsive to the inflation rate than to interest rates.¹⁰ Monetary policy of high interest rate to reduce

9 For an examination of this hypothesis in relation to Trinidad and Tobago see Patrick Baptiste, "Public Finance in Trinidad and Tobago", *Social and Economic Studies*, 26:14 (1977), 477-500.

10 *The Jamaica Record*, 11 June, 1989, p. 4.

consumption and increase saving has therefore conflicted with fiscal policy to encourage increased investment which require low interest rates.

Monetary policy to reduce bank liquidity facilitated deficit financing and the worsening deficit position of the public sector. Bank liquidity increased because of high interest rates and the ceiling placed on the growth of credit to meet IMF targets. The instrument used to control bank liquidity facilitated the growth of commercial bank credit to the public sector to finance the budget deficit. The statutory requirements for commercial banks' liquid assets ratio were increased which forced the banks to increase their mandatory holding of government securities to satisfy these requirements, thus providing a captive flow of funds to the public sector. This, of course, meant that less credit was available to the private sector; and what was available attracted high interest rates to compensate for the relatively lower interest rates on Treasury Bills. In 1985 the instrument of control was changed from statutory reserve requirements to open market operations. Bank of Jamaica Certificate of Deposits have since been used to limit bank liquidity and influence interest rates. As these funds are sterilized by the Bank of Jamaica the policy results in financial loss to the government and hence in an increasing public sector deficit.

The government's monetary policy has also had a significant effect on the type of investment undertaken by

financial institutions. The commercial banks have been putting an increasing amount of their assets into government and Bank of Jamaica securities. These tend to have lower risk and costs and higher returns than loans to the productive sector. In 1988, banks had about 39 percent of the total assets in the banking system in loans to the productive sector and about 29 percent in government and Bank of Jamaica securities. In March, 1989, (or at the end of the fiscal 1988) bank lending was 38 percent of total assets. However, their holding of government and Bank of Jamaica securities increased to 34 percent of the total assets in the system.¹¹ There is a significant demand for these securities as evidenced by the Treasury Bill auctions. Bids were oversubscribed by 35 percent at the auction in May, 1989.

Another instance of the entanglement of monetary and fiscal policy relates to the tax/interest rate deal which was made between the government and the commercial banks in July 1989. In an attempt to correct the increasing deficit position of the Bank of Jamaica, the government decided to terminate the interest payments on commercial banks' deposits at the Bank of Jamaica. The banker responded by announcing increases of between 1 and 2 percent in interest rates to cover the losses they would experience as a result of the decision to terminate interest on their reserves. In an attempt to avert such a move which the government thought

¹¹ *The Financial Gleaner*, 26 May, 1988, p. 1.

would impact negatively on investment, the government struck a deal with the banks whereby the former would remove the 10 percent surtax on bank profits imposed by the previous government if the latter did not increase interest rates. The government decided to forego a long-term and substantial part of its tax intake to prevent a rise in interest rates in the short-term. This could not have been the only option available but it has reduced the government's ability to finance development expenditure by reducing its tax receipts.

IV. Public Choice or Self-Interest and Power as the Main Determinant of Deficit Financing

The most significant problem affecting the ability of government to finance economic growth and development is the structural problem of budget deficits. These were incurred in the 1970s as government increased expenditure to maintain income and employment. The debt burden resulting from the policy is now a major constraint on government's ability to provide social services and undertake infrastructural investment. Public choice theory has been advanced to explain this phenomenon. It is based on an individualistic theory of politics where choices are determined by the self-interest of the individual. Governments are made up of individuals who as politicians pursue power in an electoral democracy. Macro-economic policy will therefore be pursued that promotes the political and electoral interests of the governing party. This is done within a political business

cycle whereby government contracts the economy after an election and expands it before the next election. This is because voters weight recent experience more heavily. Expenditure is increased to lower unemployment and increase income before the elections in order to buy votes. After the elections taxes are raised and expenditure cut (along with other monetary measures) to reduce the inflation generated by the pre-election expansionary policy.¹²

Keynesian ideas encouraged deficit financing which creates fiscal illusion among taxpayers by reducing the perceived price of public goods and services.¹³ Borrowing was seen by politicians to be less costly politically than increased taxation in an electoral period.

A look at some of the Jamaican government's policy actions within the context of this thesis is instructive. The government had been pursuing austere demand management between 1983 and 1985. The resultant decline in the economy and mounting political opposition led to a change in emphasis in late 1985 from demand restraint to expanding economic growth. Local government elections were due in July 1986 which at that time were as important as general elections because no election had been held since 1980 (the

12 Richard F. Wagner, "Boom and Bust: The Political Economy of Economic Disorder" in James M. Buchanan and Robert Tollison (eds.), *The Theory of Public Choices II*, (Ann Arbor, University of Michigan Press, 1984), 238-92.

13 See James M. Buchanan and Richard Wagner, *Democracy in Deficit: The Political Legacy of Lord Keynes* (New York: Academic Press, 1977).

Opposition having boycotted the 1983 elections) and because the 1986 elections were being seen as a referendum on the government's performance. As a result, the 1986 budget was expansionary as total expenditures increased in real terms by over 45 percent. The main feature of the current budget was an increase in subsidies geared to reduce basic food prices. This was facilitated by the saving from reduced oil prices. Capital expenditure increased by 75 percent and was concentrated in the area of infrastructural work expenditure on which more than doubled between 1985 and 1987. Road work which is a standard feature of pre-election expenditure increased almost threefold (Table 7). Despite the increased expenditure the budget deficit was reduced because of the significant increase in the tax take resulting from income tax reform and increase in consumption taxes. Although expenditure increased to influence votes deficit financing was not used to secure political support. After all, this was not general elections and the governing party, the Jamaica Labour Party (JLP) was confident that the government's economic policies would be positively evaluated, especially the improvement in the government's financial operations.

In 1988/89 which was general election year, total real expenditure doubled from the previous year. But revenue increased to cover expenditure especially the bauxite levy, as tax revenue did not grow significantly. An increased surplus was again realized on the current account. However,

the increase in capital expenditure was such that the overall budget deficit increased by over 100 percent in nominal terms and by over 50 percent in real terms. In the case of the 1989 elections deficit financing was used to secure electoral support. The fact that the JLP lost both the 1986 and the 1989 elections indicate that the public had other preferences and the pre-election expenditure did not influence voters who seemed to have weighted the less recent experience of the austere stabilization period as well as non-economic factors such as the personality and management style of the Prime Minister more heavily than the more recent experience of increased expenditure.

Increased expenditure to influence electoral votes has had an adverse effect on the operations of the public enterprises and therefore increased the overall public sector deficit which has been deteriorating for most of the 1980s. While government has been reducing the central government deficit the public sector deficit has been increasing. In 1987/88 the public sector deficit was 8.5% GDP which was to be reduced to 9.4 percent in 1988/89. However, indications are that deficit will be about 15% GDP in 1988/89. The deterioration in the accounts of the public enterprises resulted from increased expenditure associated with the effects of Hurricane Gilbert and the general elections of 1989. It is, however, difficult to really separate out the expenditure in terms of these categories. Nevertheless, increased expenditure on subsidies which

became more expensive with the increase in prices of imported basic commodities, were maintained because termination would have been met with disfavour by consumers in an election year. As the former Prime Minister Seaga once said, Jamaicans were a consumption-oriented people who had been accustomed to a standard of living which Jamaican governments had been able to provide for them.¹⁴

The growth of the public sector has therefore become a constraint on growth and development in an economy where production, productivity and exports have declined and imports have increased to satisfy demand. Privatization as a means of improving the finances of government has been advocated by the international lending agencies and has been pursued to some extent by the government especially in respect of hotels. Not only would a smaller government allow more resources to be channelled into growth and development through the private sector but it could also be more easily constrained by the public.¹⁵

V. Conclusion: Problems and Prospects

The government needs to pursue certain policies to promote growth and development in Jamaica. Through the fiscal budget it must undertake public investment in 1

¹⁴ See Seaga's contribution to the 1970 Budget Debate, Jamaica Hansard, *Proceedings of the House of Representatives*, Session 1970-1971, May-September, 1970.

¹⁵ See Paul Craig Roberts, "Idealism in Public Choice Theory", *Journal of Monetary Economics*, 4 (1978), 603-615.

physical and human resources (infrastructure, education and health) in order to increase productivity. However, the government is constrained by inadequate flows of revenue and foreign exchange. Foreign financing of such investment increases the debt burden under exports and foreign exchange earnings increase. To promote redistribution which is an important element of development government can use progressive consumption taxes. But whether this and/or progressive income taxes are relied on it is how the revenue is used that is important. Subsidising food used by all income groups cannot be justified. Subsidies may be better targetted at other goods and at specific groups such as utilities and housing for low income areas. Expenditure may be more profitably directed at providing amenities to rural communities and stimulating the development of agriculture. Another significant problem is how to encourage labour-intensive development and linkages between economic sectors. Short-term subsidies and tax reduction based on local value added may be appropriate along with a policy of differential interest rates.

The problem of controlling budget deficits is probably the most difficult. The government of the 1980s was committed to reducing the deficit under IMF stabilisation programmes and did this in respect of the fiscal deficit but the pursuit of political power dictated increased expenditure to satisfy particular constituencies prior to elections and this widened the public sector deficit (Table

11). Inefficiency and corruption as revealed in the Auditor General's Report in 1988 also contributed to the increasing deficits. The main solution to this problem which gained prominence over recent years is to divest public enterprises and thus reduce the size of the public sector. There is, of course, no guarantee that these enterprises would be operated more efficiently in the private sector. The difference is they would not be directly subsidised by the tax paying public.

The prospects for tax revenue growth to finance the necessary expenditure to stimulate growth and development are dependent on getting the economy on a positive and sustainable growth path. Economic growth itself will increase tax receipts. But all of this is dependent on a growing world economy and increased demand for Jamaica's exports. Revenue from the bauxite production levy which was imposed in 1974 declined in the 1980s because of the downturn in the international aluminium industry.

Conditions in the industry have improved recently resulting in an increase in receipts from the levy which had become an important element in the government's revenue. The project for increased tax receipts is also dependent on increasing tax compliance in areas such as betting and gaming. It is estimated that the government loses about J\$500 million per year in revenue due to illegal betting and gaming.¹⁶ In 1988 the receipts from these sources were J\$25 million. The

¹⁶ *The Daily Gleaner*, 21 July, 1989, p. 1.

estimated intake for 1989 is J\$37 million.¹⁷ The loss of the \$500 per year which is considered to be a conservative estimate gives an indication of the potential that exists for increased tax revenue.

¹⁷ Ministry of Finance, *Revenue Estimates and Financial Statements, 1989/90*.

References

- Baptiste, Patrick, "Public Finance in Trinidad and Tobago", *Social and Economic Studies*, 26:4, (1977), 477-500.
- Bourne, Compton, "Some Fundamentals of Monetary Policy in the Caribbean", *Social and Economic Studies*, 38:12, (1989), 265-90.
- Brown, Adlith and Helen McBain, "The Public Sector in Jamaica", in *Studies in Caribbean Public Enterprises in the Commonwealth Caribbean* (Mona: ISER, 1983).
- Buchanan, James M. and Richard Wagner, *Democracy in Deficit: The Political Legacy of Lord Keynes* (New York: Academic Press, 1977).
- Buchanan, James M. and Robert Tollison, (eds.), *The Theory of Public Choice - II* (Ann Arbor: University of Michigan Press, 1984), 238-72.
- Howard, Michael, "Public Sector Financing in Jamaica, Barbados and Trinidad and Tobago, 1974-1984", *Social and Economic Studies*, 28:3 (1989), 119-148.
- Musgrave, Richard A. and Peggy B. Musgrave, *Public Finance in Theory and Practice* (New York: McGraw-Hill, 3rd edition, 1980).
- Peacock, Alan T. and Gerald Hauser, *Government Finance and Economic Development* (Paris: OECD, 1963).
- Roberts, Paul Craig, "Idealism in Public Choice Theory", *Journal of Monetary Economics*, 4, (1978), 603-15.
- Taylor, E.S., "Public Finance in Jamaica 1971-76", *Social and Economic Studies*, 26:4, (1977), 1501-13.

Table 1

Size of Government as Expenditure/GDP Ratios, February 1980-February 1988

	<u>1980/81</u>	<u>1981/82</u>	<u>1982/83</u>	<u>1983/84</u>	<u>1984/85</u>	<u>1985/86</u>	<u>1986/87</u>	<u>1987/88</u>	<u>1988/89</u>
Total Expenditure as % GDP	49.2	46.3	46.6	49.0	37.7	38.8	41.8	42.9	41.7
Government Transfer Payments as % GDP*	13.0	11.5	11.1	14.0	10.2	7.3	7.4	7.5	8.3
Government Purchases as % GDP	36.2	34.8	35.5	35.0	27.5	31.5	34.4	35.4	33.4

Source: Ministry of Finance, Revenue Estimates and Financial Statements, various years.
 Planning Institute of Jamaica, Economic and Social Survey of Jamaica, various years.

* Grants and Contributions or Subscriptions, Subsidies, Awards and Indemnities and Retiring Benefits.

Table 2 Jamaica: Real Tax Revenue By Type, February 1980-February 1988 (J\$ Mn.)

	<u>1980/81</u>	<u>1981/82</u>	<u>1982/83</u>	<u>1983/84</u>	<u>1984/85</u>	<u>1985/86</u>	<u>1986/87</u>	<u>1987/88</u>	<u>1988/89</u>
Customs	42.4	83.8	99.2	90.1	86.2	88.4	122.7	152.3	169.2
Excise	16.0	21.0	16.3	15.7	12.8	11.2	16.5	15.4	15.1
Consumption	270.9	326.5	313.7	289.8	270.9	245.3	508.6	493.9	484.0
Income Tax	471.1	483.1	534.4	457.4	461.8	477.7	725.0	803.7	855.2
Land and Property	24.9	26.4	27.9	21.1	12.5	9.7	16.7	30.0	28.2
Stamp Duties	37.2	61.1	76.0	73.6	92.1	180.4	281.0	321.8	358.0
Sojurn Tax	6.2	5.1	6.5	8.3	22.0	24.9	31.4	30.0	30.0
Education Tax	-	-	-	4.7	20.1	19.4	27.5	28.0	30.5
Other	<u>54.5</u>	<u>51.5</u>	<u>62.5</u>	<u>57.6</u>	<u>53.4</u>	<u>61.2</u>	<u>95.7</u>	<u>98.3</u>	<u>101.4</u>
<u>Total</u>	<u>923.5</u>	<u>1058.8</u>	<u>1137.0</u>	<u>1018.5</u>	<u>1032.3</u>	<u>1118.4</u>	<u>1825.5</u>	<u>1973.7</u>	<u>2069.8</u>
Transfers from the CDF*	230.0	298.3	150.2	94.9	204.0	85.1	206.0	123.2	150.5
Real GDP	4866.7	5056.6	4891.8	4679.1	5030.8	5014.0	6783.1	7064.9	8191.1
% Change		3.9	- 3.2	- 4.3	7.5	- 0.3	35.2	4.1	15.9
Real Expenditure	2395.9	2342.3	2281.5	2293.3	1897.5	1949.4	2840.5	3036.6	3415.5
% Change		- 2.2	2.5	0.5	-17.2	2.7	45.7	6.9	12.4

Source: Same as for Table 1; * These represent bauxite levy payments in the Capital Development Fund.

Table 3: Jamaica: Savings and Consumption Expenditure, 1974-1986

	Savings as % National Dis- posable Income	Government Consumption as % Net Domestic Investment	Private Consumption as % Net Domestic Investment
1974	8.8	18.9	72.1
1975	8.6	19.8	71.5
1976	-2.6	23.6	79.0
1977	-1.8	23.6	78.1
1978	4.3	22.9	72.7
1979	6.0	21.9	71.9
1980	1.2	23.2	75.4
1981	-0.4	23.0	77.3
1982	-0.9	24.5	76.4
1983	3.3	21.7	74.9
1984	2.7	19.4	77.8
1985	2.6	17.6	79.6
1986	8.3	17.5	74.1

Source: Computed from Statistical Institute of Jamaica, National Income And Product 1986.

Table 4: Jamaica: Contributions to Net Domestic Investment as Percent of Net Domestic Product, 1974-1986.

	Government Savings	Private Savings	Net Capital Inflows	Net Domestic Investment
1974	6.2	2.9	7.1	16.2
1975	2.9	5.8	9.7	18.4
1976	-1.0	-1.5	12.5	10.0
1977	-3.4	1.6	4.6	2.8
1978	-2.3	6.4	2.3	6.4
1979	-1.8	7.7	5.2	11.1
1980	-3.1	4.3	6.2	7.4
1981	-3.6	3.2	12.8	12.4
1982	-6.3	5.3	13.9	12.9
1983	-6.4	9.8	11.2	14.6
1984	-6.2	8.7	13.0	15.3
1985	-4.0	6.6	14.8	17.4
1986	-0.5	8.6	3.8	11.9

Source: Computed from Statistical Institute of Jamaica, National Income And Product 1986.

Table 5

Jamaica: Revenue and Expenditure as % GDP, February 1980-February 1988

	<u>1980/81</u>	<u>1981/82</u>	<u>1982/83</u>	<u>1983/84</u>	<u>1984/85</u>	<u>1985/86</u>	<u>1986/87</u>	<u>1987/88</u>	<u>1988/89</u>
Tax Revenue	18.9	20.9	23.2	21.7	20.5	22.3	26.9	27.9	25.2
Customs	0.8	1.6	2.0	1.9	1.7	1.7	1.8	2.1	2.0
Excise	0.3	0.4	0.3	0.3	0.2	0.2	0.2	0.2	0.1
Consumption	5.5	6.4	6.4	6.1	5.3	4.9	7.5	7.0	5.9
Stamp Duties	0.7	1.2	1.5	1.5	1.8	3.6	4.1	4.5	4.3
Income Tax	9.6	9.5	10.9	9.7	9.1	9.5	10.6	11.3	10.4
Education Tax	-	-	-	0.1	0.4	0.3	0.4	0.4	0.3
Total Expenditure	49.2	46.3	46.6	49.0	37.7	38.8	41.8	42.9	41.7
Agricultural Expenditure	2.4	3.6	2.4	1.6	1.8	0.9	1.3	1.8	1.6
Industrial/ Commercial Expenditure	1.0	1.0	1.0	1.1	0.7	1.2	1.5	1.1	1.5
Current Account (Deficit)/Surplus	(2.3)	(5.4)	(7.7)	(12.6)	(3.6)	(2.7)	3.2	3.3	3.6

Source: Same as for Table 1.

Table 6

Jamaica: Real (Actual) Recurrent Expenditure by Objects, February 1980-February 1988 (J\$ Mn.)

	<u>1980/81*</u>	<u>1981/82</u>	<u>1982/83</u>	<u>1983/84</u>	<u>1984/85</u>	<u>1986/87</u>	<u>1987/88</u>	<u>1988/89*</u>
Personal Emoluments	371.9	382.7	382.1	351.1	296.3	249.7	335.4	387.5
Travel	27.6	40.7	25.7	28.9	26.7	26.0	31.5	40.2
Supplies	73.2	86.3	84.4	69.4	57.7	54.1	70.5	76.5
Grants	554.1	522.7	512.5	460.8	403.3	269.7	473.3	640.0
Subsidies	53.7	32.9	6.6	67.3	19.7	0.6	2.2	1.5
Retiring Benefits	23.5	24.1	26.4	25.1	25.9	25.4	29.2	30.2
Interest Payments	344.9	368.8	432.7	531.8	543.9	582.8	788.2	735.7
<u>(Transfer Payments)+</u>	<u>(632.4)</u>	<u>(581.5)</u>	<u>(546.4)</u>	<u>(554.8)</u>	<u>(450.0)</u>	<u>(297.2)</u>	<u>(506.0)</u>	<u>(683.8)</u>
<u>Total</u>	<u>1568.6</u>	<u>1596.0</u>	<u>1575.8</u>	<u>1652.6</u>	<u>1466.9</u>	<u>1401.3</u>	<u>1879.3</u>	<u>2148.4</u>

Source: Same as for Table 1.

* Revised Estimates

+

Table 7 Jamaica: Functional Classification of Real Capital Expenditure February 1980-February 1988 (J\$ mn.)

	<u>1980/81</u>	<u>1981/82</u>	<u>1982/83</u>	<u>1983/84</u>	<u>1984/85</u>	<u>1985/86</u>	<u>1986/87</u>	<u>1987/88</u>	<u>1988/89</u>
<u>General Services</u>	190.4	184.5	173.8	256.9	219.6	300.7	562.5	565.8	744.3
General Administration	185.7	165.3	153.5	247.6	214.5	293.3	548.0	549.4	724.0
Security Services	4.7	20.0	20.3	9.2	5.5	7.3	14.4	16.4	20.3
<u>Social and Community Services</u>	<u>118.0</u>	<u>145.3</u>	<u>158.8</u>	<u>88.8</u>	<u>68.5</u>	<u>61.7</u>	<u>89.8</u>	<u>145.0</u>	<u>259.6</u>
Education, Training and Cultural Development	11.5	19.0	23.7	26.0	20.0	25.0	30.4	57.8	85.0
Health	11.2	17.7	16.7	6.6	6.5	4.3	10.4	16.8	59.7
<u>Economic Services</u>	<u>501.8</u>	<u>458.1</u>	<u>371.1</u>	<u>292.7</u>	<u>142.4</u>	<u>185.6</u>	<u>308.7</u>	<u>375.3</u>	<u>396.6</u>
Agriculture	83.3	149.9	84.4	43.8	41.5	27.3	62.9	94.1	104.4
Industry and Commerce	31.2	36.7	40.6	44.5	35.5	52.8	93.8	86.6	121.4
Infrastructure	81.9	76.5	75.3	40.1	18.0	44.4	96.1	114.5	129.5
(of which Roads)	(60.3)	(29.3)	(61.0)	(25.9)	(12.0)	(32.6)	(81.1)	(81.3)	(95.0)
<u>Miscellaneous</u>	<u>0.8</u>	<u>0.8</u>	<u>1.1</u>	<u>2.1</u>	<u>=</u>	<u>=</u>	<u>=</u>	<u>=</u>	<u>=</u>
<u>Total</u>	<u>830.2</u>	<u>789.8</u>	<u>705.1</u>	<u>640.7</u>	<u>430.6</u>	<u>588.0</u>	<u>961.1</u>	<u>1086.3</u>	<u>1401.1</u>

Source: Same as for Table 1.

Table 8

Jamaica: Internal Debt, 1980-1986

(J\$ mn.)

<u>Internal Debt</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>
National Savings and Development Bonds	9.2	9.4	9.1	8.0	5.8	4.0	2.2	2.1
Treasury Bills	299.8	300.0	471.0	490.0	491.0	683.0	924.0	924.0
Local Registered Stock	1362.1	1616.5	2584.6	2825.3	3410.6	4592.2	5202.4	4912.7
Bonds	33.1	32.9	32.6	31.4	30.5	29.4	30.9	31.3
Commercial Banks	23.6	15.9	16.0	10.1	6.6	5.7	4.9	4.9
Bank of Jamaica Loans	25.0	382.5	15.5	118.1	370.8	615.3	523.3	-
<u>Other</u>	<u>38.6</u>	<u>100.9</u>	<u>80.7</u>	<u>68.2</u>	<u>83.4</u>	<u>75.5</u>	<u>46.5</u>	<u>43.1</u>
<u>Gross Total</u>	<u>1791.4</u>	<u>2458.1</u>	<u>3209.5</u>	<u>3551.2</u>	<u>4398.7</u>	<u>600.1</u>	<u>6734.2</u>	<u>5993.1</u>

Source: Planning Institute of Jamaica, Economic and Social Survey of Jamaica, various years.

Table 9

Jamaica: Monetary Base and Components, 1980-1988

(J\$ mn.)

	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>	
<u>Monetary Base</u>	<u>636.7</u>	<u>581.8</u>	<u>419.4</u>	<u>741.1</u>	<u>1424.4</u>	<u>1910.7</u>	<u>2283.0</u>	<u>2731.8</u>	<u>3749.4</u>	
Net Foreign Assets	-833.5	=1288.0	-1599.7	-3665.0	= 4805.9	- 6348.8	-6262.3	= 5439.8	= 4825.5	
Net Claims on Government	1257.4	1714.3	2115.0	3013.9	3175.2	3028.4	4013.5	2513.8	1849.7	
Net Claims on Commercial Banks	=100.7	41.4	-250.5	303.6	-66.0	-378.9	=1577.5	1765.0	-2726.1	
+ Other Items (Net)*	313.5	114.1	154.6	1695.8	3120.9	5610.0	6109.3	7422.8	9451.3	
				<u>Credit and Money Supply</u>						
Bank Credit	1425.2	1994.8	2626.7	3158.6	3395.3	3987.0	4931.6	6139.0	7428.7	
Money Supply (M ₁)	647.4	687.1	729.2	884.3	1012.4	1210.4	1668.6	1874.8	2908.8	

Source: Bank of Jamaica, Statistical Digest.

* (NFA + Claims on Government and on Commercial Banks) - Reserve Money.

Table 10

Jamaica: Real Reserve and Expenditure - February 1980-February 1988 (J\$ mn.)

	<u>1980/81</u>	<u>1981/82</u>	<u>1982/83</u>	<u>1983/84</u>	<u>1984/85</u>	<u>1985/86</u>	<u>1986/87</u>	<u>1987/88</u>	<u>1988/89</u>
<u>Revenue</u>									
Recurrent	964.8	1125.8	1198.6	1062.5	1283.9	1261.7	2101.0	2190.1	2313.5
Capital	<u>180.3</u>	<u>29.3</u>	<u>3.6</u>	<u>7.6</u>	<u>63.9</u>	<u>11.4</u>	<u>97.0</u>	<u>297.9</u>	<u>272.4</u>
<u>Total</u>	<u>1145.1</u>	<u>1155.1</u>	<u>1202.2</u>	<u>1070.1</u>	<u>1347.8</u>	<u>1273.1</u>	<u>2178.0</u>	<u>2488.0</u>	<u>2555.9</u>
<u>Expenditure</u>									
Recurrent	1565.7	1552.5	1576.4	1652.6	1466.9	1401.4	1879.4	1950.3	2014.4
Capital	<u>830.2</u>	<u>789.8</u>	<u>705.1</u>	<u>640.7</u>	<u>430.6</u>	<u>548.0</u>	<u>961.1</u>	<u>1086.3</u>	<u>1401.1</u>
<u>Total</u>	<u>2395.9</u>	<u>2342.3</u>	<u>2281.5</u>	<u>2293.3</u>	<u>1897.5</u>	<u>1949.4</u>	<u>2840.5</u>	<u>3036.6</u>	<u>3415.5</u>
<u>(Deficit)/Surplus</u>									
Current Account	(600.9)	(426.7)	(377.8)	(590.1)	(183.0)	(139.7)	221.6	239.8	299.1
Capital Account	<u>(649.9)</u>	<u>(760.5)</u>	<u>(701.5)</u>	<u>(633.1)</u>	<u>(366.7)</u>	<u>(536.6)</u>	<u>(884.1)</u>	<u>(788.4)</u>	<u>(1128.7)</u>
<u>Total</u>	<u>(1250.8)</u>	<u>(1187.2)</u>	<u>(1079.3)</u>	<u>(1223.2)</u>	<u>(549.7)</u>	<u>(676.3)</u>	<u>(662.5)</u>	<u>(548.6)</u>	<u>(829.6)</u>

Source: Same as for Table 1.

Table 11: Jamaica: Public Sector Fiscal Balances and Financing,
 Fy 1980/81 - Fy 1985/86 (J\$Mm)

	1980/ 81	1981/ 82	1982/ 83	1983/ 84	1984/ 85	1985/ 86
Central Government	-804.8	-849.9	-868.5	-1107.4	-554.1	-569.4
Rest of General Government	139.4	174.3	109.5	72.0	167.6	194.8
Selected Public Enterprises	-6.8	-23.7	-126.3	-93.4	-133.6	-167.2
Bank of Jamaica Losses	-	-	-41.6	-142.1	-576.0	-857.9
Other Losses Plus Discrepancy	-193.2	-152.0	-39.7	-125.3	-318.9	-163.7
Overall Public Sector Balance	-865.4	-851.3	-966.6	-1396.2	-1415.0	-1563.4
Domestic Financing	219.3	167.1	15.3	407.0	599.1	852.9
Foreign Financing	646.1	684.2	951.3	989.2	815.9	710.5

Source: Bank of Jamaica, Ministry of Finance and IMF estimates.