ISSUES IN ECONOMIC MANAGEMENT: MACROPOLICY CHANGES TO STIMULATE INDUSTRIAL GROWTH AND COMPETITIVENESS

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I. INTRODUCTION[1]

The concept of management has to be understood within the context of ultimate goals, intermediate objectives and the strategies and policies employed to achieve them. The ultimate goal of government in a developing country is (or should be) self-sustaining growth and development. To achieve this, a number of objectives have to be satisfied such as economic growth, balance of payments equilibrium, low inflation, low unemployment and improved income distribution. The challenge of economic management is how to use policy and policy instruments effectively to balance these objectives since it is difficult to attain all of them simultaneously within the same period. The policies employed by government to achieve these objectives range from the use of economic measures such as monetary, fiscal and state participation in economic activity to the use of political ones such as legislative and administrative controls and regulations.

In countries with developed economies, governments place greater emphasis on monetary policy to influence economic growth and employment. In developing countries such as those in the Caribbean, governments have relied largely on fiscal policy to influence these variables. In the 1960s and most of the 1970s, governments employed fiscal policies to encourage investment, exports and employment creation. Tax incentives were given mainly to large-scale enterprises, and public expenditure was undertaken to create the economic and social infrastructure to facilitate economic activity. From the late 1960s, governments became directly involved in economic activity through the acquisition of private enterprises and the establishment of state enterprises. These gave the governments additional levers in managing economies that were largely export-oriented but which were attempting to industrialise on the basis of import-substitutes for domestic markets.e IMF. The objective of the latter is a sustainable

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payments position for the country. The measures employed are in the main: adjustment of the exchange rate to increase competitiveness and export earnings and reduce imports; and restriction of credit especially to the public sector and increase in interest rates to contain demand. Austere stabilisation measures were only implemented after 1983 when significant deterioration occurred in the internal and external deficits. Strucn that facilitated the pursuit of economic adjustment under the aegis of the IMF and the World Bank.

II. THE NEO-ORTHODOX APPROACH AND POLICY CHANGES IN JAMAICA

The World Bank is the main architect and promoter of structural adjustment programmes in developing countries. The aim of these programmes is to produce a diversified export base and a more outward-oriented economy which would be better able to withstand external shocks. The ultimate goal is a sustainable balance of payments. In the neo-orthodox approach, fiscal deficits are the main cause of balance-of-payments deficits. The private sector receives inadequate credit due to the crowding-out effect of domestic financing of these deficits. The structural adjustment programme therefore encourages a reduction of the deficit through reduction of public expenditure and increases in the price of public goods and through tax reform.

Jamaica's structural adjustment programmes have been devised to support the stabilisation programme financed by the IMF. The objective of the latter is a sustainable payments position for the country. The measures employed are in the main: adjustment of the exchange rate to increase competitiveness and export earnings and reduce imports; and restriction of credit especially to the public sector and increase in interest rates to contain demand. Austere stabilisation measures were only implemented after 1983 when significant deterioration occurred in the internal and external deficits. Structural adjustment measures were also gradually implemented during the 1980s. In 1985, and at the end of three structural adjustment programmes (1982, 1983 and 1984) the World Bank concluded that the stabilisation programme had failed to achieve its objectives as the balance of payments did not improve. Significant policy distortions still remained, effective protection of enterprises was still high and many state enterprises were still to be divested. Reform of the public sector was also not accomplished.

The overall structural adjustment programme was changed to sectoral adjustment programmes in 1987. These were aimed at specific sectors - trade and finance, agriculture, energy and power and the public sector - and allowed the Bank to concentrate on specific policy options for each sector. Most of these centred on liberalisation, divestment, deregulation and public sector reform.

A new government began to accelerate the process of adjustment from 1989. A number of significant policy changes have been made. Most quantitative restrictions on trade have been removed. Controls through the monopoly of the state trading corporation and the commodity export organisations have been eliminated. High tariffs have been reduced to a current range of 0-45 percent (the previous high was 200 percent); and various domestic taxes have been rationalised into a general consumption tax. Most subsidies on interest rates and basic goods have been eliminated. The foreign exchange market has been liberalised and several state enterprises have been divested. Government has also been cutting back on functions and staff in the public sector.

We first of all want to look at how these measures accord with objectives being pursued by the government. A central objective of government and the international financial institutions is improvement in the balance of payments. This means increasing inflows - export earnings and capital inflows - and managing outflows - reducing imports and preventing capital flight. The inflow and outflow of capital are associated to a large extent with the investment climate and confidence in government. Increases in foreign exchange earnings/savings depend on the production and export sectors of the economy which in turn depend on a the above factors as well as others such as the policy and institutional environments.

An explicit objective in the government's medium term policy framework is the acceleration of the growth of exports. The main objective of the World Bank's structural adjustment loans is to foster export-led development. Both the government and the international financial institution place great reliance on market forces and the private sector to stimulate increased production and exports. To this end, macro and meso (sectoral) policies, along with institutional reforms, are used as incentives to achieve the stated objectives.

Because emphasis is placed on developing exports, the most significant reforms have been targeted at the trade and finance sectors. The foreign trade regime of Jamaica (and other Caribbean countries) has functioned primarily to protect industries engaged in import substitution manufacturing. Quantitative restrictions and other bureaucratic regulations were used to limit imports of final products. Capital and other imported inputs were subsidised through overvalued exchange rates and tariff concessions. The policy changes implemented under the sector adjustment programme were the elimination of quantitative restrictions, the reduction of tariff rates, devaluation of the dollar, liberalisation of the foreign exchange market, removal of price controls, the introduction of an import duty rebate scheme for exporters, reduction of corporate income taxes and the introduction of a general consumption tax to replace numerous domestic taxes.

The devaluation of the dollar is aimed at increasing the export competitiveness of the economy, while thetion to stimulate production for exports, investment is the other variable that government and the international institutions tried to influence. The liberalisation of the foreign exchange market was aimed at encouraging foreign direct investment and preventing the outflow of 'flight' capital. Reduction of personal and corporate income tax levels was intended to increase local savings and investment. This would also be enhanced by reduction of the government deficit and the resultant dissaving over the y reforms are also expected to increase economic efficiency by increasing competition among local producers and preventing arbitrary price increases. The only specific sector policies are those aimed at reforming the public sector institutions operating in the sector. For example, the export monopoly power of the export marketing boards in coffee, cocoa, citrus and pimento have been reduced and the pricing formulae for the products have been improved.

Besides trade and foreign exchange liberalisation to stimulate production for exports, investment is the other variable that government and the international institutions tried to influence. The liberalisation of the foreign exchange market was aimed at encouraging foreign direct investment and preventing the outflow of 'flight' capital. Reduction of personal and corporate income tax levels was intended to increase local savings and investment. This would also be enhanced by reduction of the government deficit and the resultant dissaving over the years. It would also enable the government to undertake infrastructural investment in support of the productive sectors.

The emphasis of the World Bank and the government on increasing investment to increase growth and exports is indicative of their adherence to neo-classical growth theory which posits a relationship between the savings/investment ratio, the capital-output ratio and rate of growth of output. The World Bank operates on the basis of this model (modified by the Chenery-Strout two-gap approach) and is concerned with determining the financing requirements of targeted rates of growth.

The government determined that gross investment grew at a rate of 24 percent during the 1980s but this resulted in low growth because of inefficiency of investment and resource allocation. This is reflected in a high incremental capital-output ratio (ICOR) of 11 for the period 1981-1983 which increased to 16 between 1986 and 1989.[2] The structural adjustment programme is aimed at removing the policy-induced distortions that are said to result in the low efficiency of investment in the productive sectors. This raises a number of issues.

First, the high rate of unproductive investment is linked to policy-induced distortions in factor markets. The removal of these distortions through trade liberalisation and public sector reform should therefore automatically lead to increased efficiency of investment. Second, increased investment is the necessary condition for increased growth and this becomes a sufficient condition once policy-induced distortions are removed.

A look at Jamaican data on investment and output during the decade of the 1980s tell a different story. Gross investment grew by 14 percent over the period 1981-1983 and by 15 percent over the period 1986-1989. The ICOR was 8 for the first period and 6 for the second period.[3] The ratio improved rather than deteriorated contrary to official claims. The austere stabilisation years of 1984 and 1985 saw negative growth despite increased investment whereas 1986 saw increased growth but a decline in investment. We know however, that investment growth in a short period does not necessarily result in corresponding output growth in the same

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[2] Government of Jamaica, "Jamaica Medium-/Term Policy Framework 1992/93 - 1994/95. May 1992, p.8.

[3] Based on Author's computation using the rates of growth of investment and output.

period due to gestation lag, among other things. Moreover, it has been recognised that increased saving/investment is not a sufficient condition for increased growth because of the absence of structural, institutional and other conditions which enhance the productivity of investment. However, the more serious concern is the assumption by the neo-classical model that investment is the sole (or main) determinant of growth. If there is unused or underutlised capacity little investment may be required to produce increased output. Moreover, factors other than capital contribute to output. Increased output can be generated by; (1) a greater labour to capital raio; (2) a higher quality of labour and other inputs; (3) reduced prices of inputs; (4) more efficient organisation of production; (5) improved access to information ; (6) enhanced techniques of production; (7) or a combination of all of these. This is not an argument against the importance of investment but rather cautions against simplified theoretical assumptions.

Policy prescriptions informed by ICORs calculated on the basis of investment and output growth rates can be misleading on account of the caveats entered above. It is also misleading to devise policy actions on the basis of aggregate growth and investment data. The more meaningful approach is to look at output as well as investment by sectors and by industries. The sectoral and industrial distribution of investment is difficult to obtain but it is the type of data government and the private sector need in order to influence growth in production and exports. By just looking at output growth, one can see that certain sectors declined while others experienced growth (Table attached). Despite the reforms under the structural adjustment programme, growth of output declined in most sectors with the exception of the financial sector which has grown significantly over recent years.

To get a better understanding of the trends in the real economy one has to look at the stabilisation component of adjustment which has been pursued since 1981. Price stability has been pursued through the use of monetary policy. However, restraining the growth of the money supply and raising interest rates have affected the growth of the productive sector as resources flowed into the financial sector where the rate of return on capital has been higher than in the productive sector. The change in the mechanism for allocating foreign exchange in 1989 led to continued decline in the dollar until its value was stabilised by private initiative in 1992. The rapid decline of the dollar led to high inflation rates in 1991 and 1992. Interest rates were raised to high levels to prevent speculation on the dollar which contributed to further deterioration in its value. This situation of price instability, as well as exchange rate instability, militated against the growth of net investment and visible exports but facilitated the growth of investment in financial assets where substantial profits were to be made; the interest rate and foreign exchange rate spreads of financial institutions facilitated the growth of profits in the sector. Monetary policy can be said to have led to a decoupling of the monetary and real economies, although foreign exchange shortage has led to the merger of merchant bank capital with trading capital (A number of trading companies have established merchant banks over recent years). What this points to is that policy in respect of the financial sector has to be consistent with policy regarding the industrial and export sectors.

III. THE ROLE OF GOVERNMENT IN PROMOTING INDUSTRIAL AND EXPORT GROWTH

The Jamaican government has defined for itself a limited role in promoting the growth and development of the economy. While it focuses on policy actions rather than direct involvement, its policies tend to address problems more at a macro than micro level. A more adequate way of addressing the balance of payments question is to examine or re-examine the industrial structure of the economy. What is important in the Rostovian 'stages of growth' thesis is the concept of growth industries. As an economy moves along the growth path new growth industries should replace mature ones. In the Caribbean, the leading industries have been those producing primary products - sugar, bauxite/alumina, oil etc. Movement along the growth path has been from primary commodities to services.

Sugar ------→ Banana // ------→ Tourism
Mineral
Oil

Earnings of the economies are export based and derive mainly from these industries. However, supply is limited by quota restrictions and demand conditions in external markets. Manufacture of import substitutes has been protected from external competition by macro policies. Non-traditional exports of agricultural and manufactured products have been developing slowly. The horticulure industry and the apparel segment of the textile and apparel industry seem to be the leading growth industries in these sectors.

If the key to sustaining the balance of payments is the development of exports with high elasticity of demand then countries will have to focus on manufactures. The challenge is to develop competitive capability in producing high-value exports. Government can assist this process through macro and microeconomic policies. Policies should however form part of an industrial plan to ensure coherence and consistency. The whole notion of planning fell into disrepute because of the failure of centrally planned economies as well as Caribbean attempts at planning in the 1960s and 1970s. However, industrial planning has been a feature of government policy in the successful Eastern economies of Japan and Korea.

The Jamaican government has relied on exchange rate adjustment to develop export competitiveness and on trade and foreign exchange liberalisation to increase non-traditional exports. The apparel segment has grown significantly largely on account of devaluation of the dollar along with access to the US market. However, the returns from this sector are not significant because of low value added. These types of low value exports are encouraged by tariff and exchange rate adjustment which lower factor costs. Factor costs are crucial only in industries where they make up the main costs and where technology is at a low level and can be easily acquired. But restricting the rise of factor costs only remove the incentive to upgrade and innovate and hence restrict firms to producing in price and cost-sensitive market segments.[4]

The role of government in promoting the development of industries and competitive exports is to provide the policy and institutional[5] environments conducive to such development. Some of the policies to be pursued should focus on creating and upgrading productive factors. Education and health policies are crucial as well as incentives to develop apprenticeship and other training programmes at the workplace.

Monetary and fiscal policies constitute the macro policy framework that can guide development along a desired path. Exchange rate changes should be pursued only in relation to the type of industries that government wants to promote, but this should be informed by the global developments in various industries. Credit policy should be biased in favour of targeted growth industries and interest rates should be at a low real cost (The Korean government subsidised interest rates to selected

[4] Michael Porter, **The Competitive Advantage of Nations.** London. Macmillan Press, 1990, p.77.

[5] The Author is currently carrying out a study on the legislative and bureaucratic constraints to the growth and development of small-scale business in Jamaica.

industries at the start of the economy's development programme in the early 1960s). The instability and inflationary tendencies in the Jamaican economy dictate a tight monetary policy but high interest rates to contain demand only serve to re-allocate resources from productive to non-productive activities. The resultant liquidity facilitates the growth of the informal credit market on account of the linkage between the formal and informal sectors.

Tax policies should aim at providing incentives such as tax credits to firms that upgrade and innovate. Government spending should be directed at establishing and upgrading the infrastructural base of economic activity. Government investment in infrastructure has been constrained largely by the significant debt burden resulting from deficit financing. Under the structural adjustment programme, government has been reducing its deficit by expenditure cuts (other than debt repayment) and by increasing revenue. Divestment of state enterprises is another mechanism for reducing the deficit as well as the size of government. Some of the proceeds are being used to finance micro enterprises. However, some of the significant revenue intake from divestment should go towards government investment in upgrading the infrastructure (including human resources) to enhance productivity growth and exports. Reliance cannot be placed on the private sector to invest in infrastructural development as is the case at present. A significant amount of private sector investment funds are being diverted to acquire shares in public enterprises. However, divestment represents transfer of ownership rather than addition to the capital stock.

Micro level policies such as trade policy has been pursued not only to stimulate increased exports but also to increase competition among local producers. This is the intention of trade liberalisation which removed quantitative restrictions and lowered tariffs. This policy tends to restrict competition to price. It has not been effective because, contrary to government expectations of reduced local prices, many established firms have captured the benefits of tariff reform. In devising policy to foster competition, the primary objective should not be the reduction of prices but should be the upgrading of productive factors and services to increase competitiveness. Policy should then focus on facilitating entry into the industry by new firms which can introduce competition based on quality, service and price.

The role of government in promoting growth and development cannot be a passive one. Government cannot divest itself of active participation by privatising public assets and by liberalising and deregulating the economy. European, Japanese and Korean growth and development have been fostered by strong and active governments. Whereas centralised and detailed industrial planning and targeting may be fraught with danger, collaboration between state and private enterprises and strong leadership by government are necessary conditions for getting the economy on a sustainable growth trajectory.

IV. CONCLUSION

To balance the various objectives of government is a challenge in economic management. The main difficulty has been maintaining price stability and at the same time improving the current account of the balance of payments. The Jamaican government has been involved in a stabilisation programme for over 10 years. It has also been involved in structural adjustment exercises for a decade. However, it has been unable to achieve either stability or balance of payments equilibrium on a sustained basis. Greater emphasis has been placed on the former at the expense of the latter while structural adjustment measures have not yet resulted in private sector dynamism except in the financial and tourism sectors. It would seem that priority should now be placed on developing growth industries and trading companies that can enhance export competitiveness. Devaluation and trade liberalisation are not sufficient conditions to achieve these objectives and in some cases are not even necessary conditions. Policies cannot determine objectives. Objectives determine the most appropriate set of policies that should be employed. We should seek to be clear about our objectives and then evaluate various policy measures to determine which should be employed at what time and in what manner.

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RATE OF GROWTH OF GROSS DOMESTIC PRODUCT BY INDUSTRIAL SECTORS AT CONSTANT PRICES: 1980-89

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Agriculture, Forestry and Fishing	-4.3	2.3	-7.9	7.3	10	-3.5	-2.1	5.2	-5.4	-4.3
Mining and Quarrying	9.9	1.3	-29	0.6	0.7	-19.5	6.6	4.9	-4.7	38
Manufacturing	-11	0.8	7.5	2	-4.2	0.4	2.4	6.3	2	7
Electricity and Water	1.4	0.9	3.5	8.9	0.1	2.4	13.9	7	-0.6	8.7
Construction and Installation	-28.3	0.4	15.9	6.7	-7.1	-8.3	3.1	13.9	14.7	19.3
Distributive Trade	-6.8	6.4	6.8	-5	-0.7	-9.1	5.8	11	1	3.5
Transport, Storage and Comm.	-4.2	1.6	0.5	5.3	3.1	2	9.6	7.1	0.8	4.1
Financing and Insurance Services	5.3	8.8	-1.5	21.4	-8.6	-7	16.6	3.4	16.4	15
Real Estate and Business Services	1.3	3.1	2.6	2.9	-1.8	-1.9	2.6	5.2	3.3	2.6
Producers of Government Services	-2.6	2.2	2.5	0.5	-4.2	-5.8	-3.6	0.6	3.5	-3.5
Miscellaneous Services	-7.7	2	7	3.4	0.8	2.4	4.9	7.5	-4.3	7.2
Household and Private Non-Profit Institutions	-6.7	2.1	7.5	0.2	2.8	2.3	7.2	3.8	4	-5
TOTAL GDP AT CONSTANT PRICES	-5.7	2.5	1.2	2.3	-0.9	-4.6	1.7	6.2	1.5	4.6