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SOME THOUGHTS ON THE EFFICACY OF BALANCE-OF-PAYMENTS POLICIES WITHIN THE CARIBBEAN COMMUNITY

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Caribbean Community (CARICOM) countries, with the exception of Trinidad and Tobago, have all faced balance-of-payments problems since the mid-1970s. The widening deficits reflect steep import price increases (particularly oil) as well as declining export volume, weak prices for major export commodities and rising debt service payments.

The persistent balance-of-payments problem and the concomitant shortage of foreign exchange have militated against the economic growth of the highly dependent CARICOM economies; consequently, there have been various attempts to stabilise the situation. This Paper presents a brief overview of the balance-of-payments situation and seeks to assess the efficacy of the current stabilisation policies. It also outlines some alternative strategies.

Overview of the Balance-of-Payments Situation

The combined current account deficit of CARICOM countries (excluding Trinidad and Tobago) increased from US$231.6 million in 1977 to US$895.1 million (see Table 1). The rate of increase was most rapid in the case of Jamaica and Guyana.

Jamaica's current account deficit increased continuously - reaching a level of US$426.8 million in 1981. There was a marked widening of the current account gap in 1981, reflecting a significant increase

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(26 per cent) in the level of imports during that year. Over the period 1977-80, Jamaica experienced a critical shortage of foreign exchange which stifled economic growth due to the unavailability of vital imports. In addition to declining export earnings and the high import bill, the balance-of-payments position was adversely affected by high debt service payments and outflows of foreign capital.

Guyana's balance-of-payments position has steadily deteriorated since 1979. A considerable fall in the volume of exports (particularly bauxite) in 1981 resulted in a current account deficit of US$174.0 million. In addition to increasing foreign borrowing and drawing down on reserves, it became necessary to accumulate commercial arrears. As in the case of Jamaica, economic growth in Guyana has been limited by the chronic shortage of foreign exchange.

The performance of the balance-of-payments of Barbados was more favourable than that of Jamaica and Guyana. After showing overall balance-of-payments surpluses in the years 1978-80, Barbados recorded an overall balance-of-payments deficit of US$19 million in 1981. The current account deficit for 1981 was 16 times greater than that for 1980. Weak performance in the sugar industry and the tourism sector was mainly responsible for the balance-of-payments pressures experienced in 1981.

Trinidad and Tobago consistently recorded balance-of-payments surpluses over the period 1977-81. The current account surplus in 1981 was lower than that for 1980, reflecting the decline in the surplus on merchandise trade brought about by a sharp fall in the volume of crude oil exports. The non-oil current account deteriorated markedly over the period with the deficit increasing by 136 per cent from US$730.8 million in 1977 to US$1 727.0 million in 1981. This deterioration in the non-oil current account was most significant on merchandise trade.

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In the case of the Less Developed Countries (LDCs), most countries faced persistent current account deficits over the last five years. The deterioration was most marked for Antigua and Barbuda and Saint Lucia. Slow growth in tourist earnings and significant increases in imports of food and capital goods were mainly responsible for the widening current account gaps in 1980-81.

The principal reasons for the marked deterioration in the current account position of CARICOM countries were the decline in the volume of major export commodities and the increase in the import bill. For the Region as a whole, export volume declined in most sectors over the last five years but the performance of the sugar industry was particularly poor. Sugar output declined in most countries over the period and total output for the Region in 1981 was at the lowest level in 30 years. Banana production has declined significantly due to destruction by hurricanes. Similarly, rice production in Guyana has followed the downward trend, declining every year since 1977, except in 1980. In the mining sector, bauxite and alumina production declined in Jamaica and Guyana.

Trinidad and Tobago is not yet faced with a balance-of-payments deficit but the surplus is being eroded by declining oil production. Petroleum production has declined in recent years due largely to the declining productivity of existing wells. Output in 1981 was the lowest in seven years.

Recently, the effects of the declining volume of exports on the balance-of-payments has been worsened by falling prices. There was a sharp drop in sugar prices during 1981 and the price for bananas in the United Kingdom (UK) market also declined. Aluminium prices fell by ten per cent, seriously affecting Jamaica which is the world's third largest producer of bauxite. The rate of growth of petroleum prices also slowed during 1981.

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In addition to declining export volume and weak export prices, the fall-off in tourist earnings as a result of the recession in the industrial countries has adversely affected the balance-of-payments position of Barbados and those LDCs heavily dependent on tourism.

CARICOM countries depend heavily on imported food, raw materials and capital goods. Consequently, imports have continued to increase even where countries are faced with declining export earnings. The sharp increases in import prices, particularly oil, severely affected the balance-of-payments position of the dependent CARICOM economies. Those countries which are heavily dependent on imported fuel have been burdened with rapidly increasing fuel bills. In 1980, for example, fuel accounted for 38 per cent of the import bill in Jamaica and 33 per cent in Guyana.

Adverse terms of trade is another factor which has contributed to the balance-of-payments problems for some countries. However, it has probably had less serious effects than the poor performance (in terms of output) of the major export sectors.

The increasing current account deficits have been largely financed by running down reserves and by foreign borrowing. Table II shows changes in net foreign reserves for Barbados, Guyana and Jamaica. The decline in reserves was most marked in the case of Jamaica. Greatly increased debt levels have resulted in high debt service payments for some countries (see Table III). These countries have been forced to divert a greater share of export earnings to debt servicing, thereby reducing the availability of foreign exchange to finance essential imports. Guyana and Jamaica, which relied heavily on private sources of credit, faced burdensome debt service payments due largely to the flexible interest rates and shorter maturities attached to loans obtained in private capital markets.

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Stabilisation Policies

Economic growth in CARICOM countries depends heavily on the availability of foreign exchange to maintain an adequate level of imports. The raw materials and capital goods needed to increase production are mainly imported. Table IV shows real Gross Domestic Product (GDP) growth for CARICOM countries over the last five years. It can be seen that economic growth was severely restricted in Jamaica and Guyana, the two Member States which experienced severe shortages of foreign exchange. While the foreign exchange problem might not have been the only factor militating against growth in these countries, it was certainly a very important factor.

The constraints imposed on overall economic growth by the deteriorating balance-of-payments situation led some CARICOM countries to introduce measures specifically designed to stabilise the balance-of-payments. The discussion here concentrates on the balance-of-payments policies of Jamaica, Guyana and Barbados.

Measures introduced to cope with the balance-of-payments situation in Jamaica included export stimulation, import restrictions and foreign exchange budgeting. In addition, Jamaica entered into an Extended Fund Facility (EFF) Agreement with the International Monetary Fund (IMF) in 1978, the terms of which included drastic devaluation of the Jamaica dollar (by a total of about 49 per cent), elimination of the Government deficit, credit controls to the public and private sectors, wage ceilings and removal of price controls. The EFF programme was suspended after Jamaica failed the performance tests at the end of 1979.

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In 1981, Jamaica embarked on an economic recovery programme supported by a new EFF Agreement with the IMF and a World Bank structural adjustment loan. The key component of the recovery programme is the promotion of export-oriented production (particularly non-traditional products) to generate increased flows of foreign exchange.

Under the terms of the structural adjustment loan, the Government is committed to ensuring the competitiveness of Jamaica's exports through the elimination of quantitative restrictions over a five-year period, commencing 1982. Measures have also been put in place to ensure efficient allocation of foreign exchange within the economy. These include decriminalising the informal foreign exchange market and simplifying the import licensing system. The simplified import licensing system provides for the automatic issue of no-funds licences for raw materials, spare parts and capital goods.

Similarly, Guyana has attempted to strengthen its balance-of-payments by means of widespread import restrictions, foreign exchange budgeting and the expansion of import substitution and export-oriented activities. However, the import restrictions imposed by Guyana have been more pervasive than those imposed by Jamaica. Guyana also sought balance-of-payments support from the IMF under an EFF Agreement in 1979, but the programme was suspended due to failure to meet the targets. In mid-1981, in an attempt to correct the ever-worsening situation, the Guyana dollar was devalued (by some 15 per cent).

Stabilisation policies in Barbados have been limited to restrictions on credit to consumers and to the distributive sector, aimed at curtailing the rate of growth of consumer imports. In September 1981, commercial banks were directed to reduce the level of their outstanding consumer instalment credit and personal lending, to ten per cent below the level for August 1981, by the end of March 1982. There were also increases in the average lending rate and

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the Central Bank general discount rate. In an apparent attempt to pressure commercial banks into introducing foreign funds into the system, the Central Bank raised reserve requirements in November.

Assessment of the Policies

The balance-of-payments crisis is the result of the heavy external dependence of our economies. Adjustment policies should, therefore be designed to bring about structural changes which allow for greater flexivility in response to changes in the external economy. It is in this context that the efficacy of the present stabilisation and adjustment policies must be examined.

The major policies which have been used in balance-of-payments management are - devaluation, restrictive monetary and fiscal policies, import restrictions, foreign exchange budgeting, the expansion of import substitution and export oriented activities.

The devaluation strategy has been unsuccessful in both Jamaica and Guyana. Theoretically, devaluation should cause a country's products to become cheaper vis-a-vis other countries, hence exports are encouraged and imports (which become more expensive) are discouraged. However, the structure of the CARICOM economies severely limit the benefits than can be derived from devaluation. A large portion of exports consist of primary products such as sugar and bananas which are sold under contractual arrangements. Furthermore, structural rigidities limit the ability of the export sector to respond quickly to whatever increase in demand results from lower relative prices.

In the case of manufactured exports, expansion of output requires imported inputs - the price of which would be increased by the devaluation. In Jamaica, for example, raw materials (including fuel)

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accounted for 62.5 per cent of total imports in 1978 and 67 per cent in 1979. It is clear that the higher prices for imported goods brought about by the devaluation must have resulted in substantial increases in the cost of local manufactured goods, thereby reducing their competitiveness on the world market.

On the other hand, the Region's imports are mainly raw materials and intermediate goods for which demand is fairly inelastic. Price increases will, therefore, not result in any significant reduction in the level of imports. In both Jamaica and Guyana, reduction in the level of imports was achieved by the strict system of import licensing rather than by devaluation. Rather than improving the balance of payments, devaluation resulted in unprecedented high rates of inflation in both countries. In the case of Jamaica, the crawling peg of 1977-78 undermined confidence in the currency which led to a flight of capital.

Restrictive monetary and fiscal policies are designed to affect the balance of payments through the level and composition of demand. In the short-term, such policies are successful in restraining the growth of imports, but they do not provide a long-term solution to the balance-of-payments problem which is essentially structural in nature.

Import restrictions and foreign exchange budgeting have been effective in limiting the growth of imports in Guyana and Jamaica. However, given the dependent nature of those economies, the severe restrictions have militated against economic growth. The expansion

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of foreign exchange earning capacity is highly dependent on imported inputs. Consequently, prolonged use of severe import restrictions has resulted in further tail-spinning of the economies. It would seem, therefore, that severe import restrictions in this context are counter-productive in the long run..

The system of direct controls on imports and the attempts to limit banking system credit to the Public Sector have more recently been complemented by efforts to expand import substituting and export-oriented production activities. CARICOM countries which are pursuing these policies, however, are for the most part accepting a prolonged dependence on circumstances outside of the Region. It is true that the debt obligations and present import requirements of these countries make foreign exchange earnings necessary. At the same time, however, the present course of action (which is being undertaken at great resource cost) would seem to be, a priori, increasing the dependence of the Region on the outside world. The strategy of import substitution has relied heavily on imported inputs while export expansion is dependent on external demand, hence increasing the external dependence of CARICOM economies in the long run. This increased dependence could mean even more intractable balance-of-payments difficulties of external origin in the future.

Conclusions

The balance-of-payments problem in CARICOM is not temporary. Forecasts of continued recession in the world economy indicate that CARICOM economies will continue to face serious balance-of-payments

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difficulties in the short-medium term. So far, attempts at managing the balance-of-payments problem have not been very successful. There is, therefore, an urgent need for the formulation of more appropriate strategies.

Some countries may seek to secure additional foreign financing to achieve stabilisation, but this is only a short-run solution as foreign borrowing increases the burden of future debt service payments. Moreover, the conditions prevailing in the international economy indicate that the terms and conditions of new borrowing are likely to be onerous. A first priority would be to ensure congruence with what is happening with the outside world.

The present policy of export expansion needs to be complemented by more vigorous market research to ensure that production is compatible with international demand. There is also a need to ensure the greatest possible use of regional inputs so as to reduce dependence on imports. Ultimately, the success of export expansion strategies depends on the ability to penetrate third country markets. It would seem, therefore, that in addition to trying to establish trading relationships with countries other than the traditional trading partners, CARICOM countries need to closely examine present policies on technology.

CARICOM will be competing with other producers for a fixed market in which quality and price of product will be key determinants of success. It must be recognised that technology is a major factor influencing both quality and price, while indigenous technology may be more appropriate in certain instances; perhaps the surplus generated at the first stage of the export cycle with high technology might allow

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countries to finance a broadening of the investment base in the second stage of the cycle.

The creation of a climate for the attraction of direct foreign investment seems to be necessary, in the absence of large sources of investible funds regionally to finance rapid increases in production. At the same time, however, countries have to be selective in attracting investors so as to ensure that the investment is in line with the Region's developmental objectives.

Recent developments in key export industries (sugar, bauxite, bananas, tourism) seriously threaten the viability of the regional economy over the longer term. Rising production costs and a highly volatile market seem to make sugar an unlikely industry on which significant earnings expectations should be based. The bauxite industry is likely to face increasing difficulties as the demand for aluminium weakens, while tourist earnings will continue to fall if the global recession deepens. At the same time, the banana industry is plagued by production problems and increased competition in the United Kingdom. In light of these developments, serious consideration must be given to changing the present export base in the long run. The time might indeed be right for CARICOM to examine collective approaches to adjustment with fundamentally sound concepts such as scale economies, scarce resource allocation and appropriate division of labour, in mind.

TABLE I

CARICOM COUNTRIES: BALANCE OF PAYMENTS CURRENT ACCOUNT BALANCES US$M

	1977	1978	1979	1980	1981
MDCs					
Barbados	- 51.6	- 31.5	- 19.0	- 5.8	- 96.5
Guyana	- 98.5	- 28.4	- 81.6	-117.6	-174.0
Jamaica	- 34.6	- 86.7	-142.6	-148.1	-426.8
Trinidad and Tobago	215.0	36.2	45.4	295.4	98.8
LDCs					
Antigua and Barbuda	- 9.6	- 2.2	- 23.3	- 39.6	- 56.1
Belize	- 19.2	- 15.8	- 29.5	- 12.9	- 22.0
Dominica	- 5.5	- 6.2	- 14.1	- 33.9	- 21.7
Grenada	5.3	- 4.4	- 15.1	- 15.1	- 21.6
Montserrat	1.1	- 0.9	- 2.6	- 5.9	- 6.3
St. Kitts-Nevis	- 1.2	- 0.6	- 3.2	- 10.4	- 11.5
Saint Lucia	- 11.4	- 23.5	- 27.9	- 33.3	- 51.6
St. Vincent & The Grenadines	- 6.4	0.0	- 7.3	- 9.4	- 7.0
Total (excluding Trinidad & Tobago)	-231.6	-200.2	-366.2	-432.0	-895.1

Sources: Central Bank of Barbados Annual Report 1981, Bank of Guyana Annual Report 1981, Bank of Jamaica Annual Report 1980-81, Central Bank of Trinidad & Tobago Annual Report 1981, World Bank Economic Memoranda 1982.

TABLE II

CHANGES IN NET FOREIGN EXCHANGE RESERVES (-INCREASE/+DECREASE) US$M

	1977	1978	1979	1980	1981
Barbados	+ 7.5	-29.1	- 11.0	-19.6	+ 18.5
Guyana	+29.2	- 9.8	+ 48.4	+84.2	+ 33.8
Jamaica	+16.1	+77.5	+140.9	+77.9	+154.9

Source: Central Bank Annual Reports 1980-81

TABLE III

CARICOM MDCs - EXTERNAL DEBT INDICATORS US$M

	1977	1978	1979	1980
Barbados				
Total debt outstanding	48.7	63.8	69.2	78.5
Total debt service	9.0	7.6	11.8	13.9
Debt Service Ratio	3.2	2.1	2.6	2.4
Guyana				
Total debt outstanding	397.7	427.5	467.7	519.0
Total debt service	32.7	46.8	90.6	70.0
Debt Service Ratio	11.9	15.0	29.8	17.0
Jamaica				
Total debt outstanding	945.1	1,055.0	1,143.2	1,299.1
Total debt service	152.9	195.4	208.5	189.3
Debt Service Ratio	14.8	16.6	15.9	12.8
Trinidad & Tobago				
Total debt outstanding	257.0	417.5	421.8	491.8
Total debt service	14.9	31.8	49.4	80.6
Debt Service Ratio	1.0	1.9	2.3	2.4

Notes: (a) Debt Outstanding is disbursed debt outstanding at end of period

(b) Debt Service ratio is defined here as the ratio of debt service payments to exports of goods and NFS.

Source: World Bank Debt Tables, December 1981

TABLE IV

CARICOM - REAL GDP GROWTH (PER CENT)

COUNTRY	1977	1978	1979	1980	1981
MDCs					
Barbados	3.8	4.8	7.9	4.8	-3.1
Guyana	3.0	-2.6	-1.4	1.8	-0.5
Jamaica	-1.9	-0.3	-1.4	-5.4	1.3
Trinidad & Tobago	7.8	7.9	5.3	7.4	6.0
LDCs					
Antigua and Barbuda	n.a	7.9	8.3	6.2	3.8
Belize	n.a	7.8	1.4	3.1	1.0
Dominica	3.4	9.1	-9.1	-9.0	8.0
Grenada	5.8	5.4	2.1	3.0	2.6
Montserrat	-4.5	6.1	11.9	7.8	3.4
Saint Lucia	5.9	13.5	4.4	-4.5	3.2
St. Kitts-Nevis	0.0	5.9	5.0	3.3	0.0
St. Vincent and The Grenadines	3.5	14.6	-0.6	1.1	9.0

Sources: (1) Caribbean Group: Current Situation and Prospects, IBRD May 1982

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