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**- STRUCTURAL ADJUSTMENT AND PRIVATIZATION -**

**AN EXAMINATION OF THEIR RELATIONSHIP IN FOUR CARIBBEAN COUNTRIES**

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## ABSTRACT

This paper traces the adjustment process in four Caribbean countries, the Dominican Republic, Guyana, Jamaica and Trinidad and Tobago in the 1980s. It uses a number of economic indicators to try to judge the extent to which policy managed to approach its goal of "adjustment". It also discusses the issue of privatization, perhaps the second most controversial buzz-word/concept after adjustment itself, to see beyond the doctrinaire positions taken in favour or against, how it fits within that panoply of policy tools necessary for economic management.

Privatization is used in its broader sense, to encompass the range of policy actions which move the economy from a State regulated toward a more market regulated basis. The section on privatization, while focusing on the State enterprises and the transfer of ownership and control away from public to private actors, cannot ignore the macroeconomic framework in which this transfer is to take place. Neither can it ignore the objectives of privatization which are increased efficiency and welfare. Deregulation and, in appropriate instances, regulation is therefore relevant in the context of structural adjustment as well as in considering the State enterprises, thus illustrating the strong link between the two issues captioned.

The paper suggests that the twin oil price increases in the period 1973 and 1979-1981, constituted severe shocks to most economies worldwide, including many Caribbean economies, and set in train a plethora of varying responses. In some, the initial policy responses were adequate to the initial task. In others, inappropriate policy responses created a further series of shocks to their economies. In the longer term, these early shocks themselves created a number of after-shocks, as different countries adjusted with varying rates of speed and effectiveness. It suggests that these after-shocks are still ricocheting around the globe to cause new and complex further rounds of compensating adjustment.

For the Caribbean, the economies of the Dominican Republic, Guyana and Jamaica are studied in some detail as they illustrate the intricate conjuncture of external and domestic policy shocks in the 1970s. For these economies and for Trinidad and Tobago, the second oil shock is taken as the departure point for the analysis. Nevertheless, an understanding of developments in the 1970s is necessary for any comprehension of the genesis of the disequilibrium and the debt crisis, itself a major complicating factor in the adjustment process in the 1980s. Developments in the 1970s, especially in Guyana and Jamaica, but also in Trinidad and Tobago provide insights into the link between public ownership and economic disequilibrium and hence, in part at least, a better understanding of the subsequent call for the divestment of public assets and for privatization.



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## INTRODUCTION

It is probably no exaggeration to suggest that the issue of "adjustment" has dominated the policy agenda in Caribbean countries throughout the 1980s. For some countries adjustment became a public issue after 1977, although the first oil shock in late 1973 meant that policy responses should have been initiated as early as 1974. Not surprisingly, many years of high profile debate on the pros and cons of adjustment itself, accompanied by sometimes severe policy impacts on the standard of living of a number of people, has shrouded the issue in considerable controversy and has for the first time brought the most arcane issues of economic policy into the public arena and indeed into everyday discussion in the Caribbean.

This paper attempts to chronicle the events of adjustment in four CDCC member countries in the decade of the 1980s, while using a number of economic indicators to trace the extent to which policy has managed to approach its goal of "adjustment". At the same time it tries to discuss the issue of privatization, perhaps the second most controversial buzzword/concept after adjustment itself, and to see beyond the doctrinaire positions taken in favour or against, how it fits within that panoply of policy tools for economic management.

Privatization is seen in its broader sense to encompass the range of policy actions which move the economy from a State regulated to a more market regulated basis. The section on privatization, while focusing on the State enterprises and the transfer of ownership and control away from public to private actors, cannot ignore the macroeconomic framework in which this transfer is to take place. Neither can it ignore the objectives of privatization which are increased efficiency and welfare. Deregulation and, in appropriate instances, regulation is therefore relevant in the context of structural adjustment as well as in considering the State enterprises, thus illustrating the strong link between the two issues captioned.

In the course of the discussion it is hoped to contribute to the debate in a number of ways, to answer to concerns of common people which question the very possibility of adjustment itself, framed in the common question of, "How is it possible that we have been adjusting for over a decade and we have not

managed to achieve it?" Or alternatively, "Can developing countries such as ours, vulnerable to external vicissitudes ever adjust?" It also hopes to contribute to the discussion on privatization, to revisit its rationale, outline some of the measures used, results achieved and lessons learned from the cases studied.

The discussion might usefully begin with an attempt to define how the term adjustment is used in this paper. It encompasses those policies relating to short-term equilibrium as well as some macroeconomic elements of a medium-term nature related to transformation of existing production patterns. It does not however go into detailed sectoral policies. It is conceptually useful to make a distinction between equilibrium and transformation, both of which should, however, be mutually consistent and operate in harmony to achieve structural adjustment. In this paper the former will be used to refer to the basic economic "housekeeping", that is, the achievement and maintenance, more or less, of macroeconomic equilibrium with the focus on the fiscal balances, the external balances mainly the current account, the external debt and economic growth rates used as a rough indicator of what is happening while the process of equilibration continues. In short, it seeks to examine how policy has managed the external and internal accounts in an economic space, that is, in large part exogenously determined and not amenable to significant expansion in the short term. In this context, the examination will seek to see if income and expenditure are contained within limits that do not necessitate the accumulation of liabilities which will hinder future growth. This rudimentary set of indicators deal mainly with short-term economic activities through the instrumentality of the annual budget exercise.

On the other hand, the issue of transformation might be equated with the broader subject of development itself which is concerned with enlarging the economic space and improving the quality of life. These concerns are related to the medium-to longer-term growth path and seek to secure the more effective and complete use of all domestic resources, in the context of anticipated changes at home and abroad and in a manner that is sustainable over time.

Clearly, the two issues of equilibrium and transformation are very closely interrelated, ideally requiring policies which should be mutually reinforcing. In the early stages of the adjustment process, focus was placed almost exclusively on short-term balance. As perceptions about the need to expand the economic space grew and the role that the State could most effectively play in economic development shifted, changes were made in the regulatory framework to improve the functioning of markets and permit unambiguous market signals to guide the decisions of economic actors. This process of privatization encompassed a range of policies including the deregulation and divestment which will be examined in some detail.

Any economy through time is subject to a number of shocks, which may derive from external or domestic sources. In the former case, they usually derive from the changing patterns of supply and demand of trading partners. In the latter case, they may be due to unforeseen natural disasters or shocks deriving from policy which might reduce external competitiveness or artificially increase the demand for imports. Usually, if not allowed to accumulate, these shocks are absorbed in the normal course of national management and the short-term course continues on some manageable equilibrium or near equilibrium. Sometimes shocks are sufficiently severe and far reaching, or come together in particularly awkward combinations to require rapid and complicated analysis of the prevailing new situation and the implementation of fairly drastic departures from familiar policy norms. Faulty diagnosis or slow response might allow a

situation to deteriorate and would extract a price in the form of a more difficult and protracted adjustment.

This paper suggests that the twin oil price increases in the period 1973 and 1979-1981, constituted severe shocks to most economies worldwide, including many Caribbean economies, and set in train a plethora of varying responses. In some, the initial policy responses were adequate to the initial task. In others, inappropriate policy responses created a further series of shocks to their economies. In the longer term, these early shocks themselves created a number of after-shocks, as different countries adjusted with varying rates of speed and effectiveness and these after-shocks are still ricocheting around the globe to cause new and complex further rounds of compensating adjustment.

For the Caribbean, the economies of the Dominican Republic, Guyana and Jamaica are studied in some detail as they illustrate the intricate conjuncture of external and domestic policy shocks in the 1970s. For these economies and for Trinidad and Tobago, the second oil shock is taken as the departure point for the analysis. Nevertheless, an understanding of developments in the 1970s is necessary for any comprehension of the genesis of the disequilibrium and the debt crisis, itself a major complicating factor in the adjustment process in the 1980s. Developments in the 1970s, especially in Guyana and Jamaica, but also in Trinidad and Tobago provide a perception of the link between public ownership and economic disequilibrium and hence, in part at least, a better understanding of the subsequent call for the divestment of public assets and for privatization.



## SUMMARY AND CONCLUSIONS

### Summary

#### The global environment

The oil price shocks in 1973 and 1979-1981 provide significant clues to any understanding of the turbulent years of the 1970s and the complex task of adjustment faced by many developing countries in the 1980s. The fivefold increase in petroleum prices in 1973 provided a significant discontinuity with past events. It managed almost overnight to transfer an enormous block of resources from the major petroleum consuming countries, both developing and developed, to the major producers. Among the oil dependent developed and developing countries alike, the oil price increases changed relative competitive positions to favour those having lesser dependence on oil and products less intense in energy use.

Perceptions and, therefore, the policy responses to the oil price rise differed, those countries possessing political leverage seeing the price increase as short-term and amenable to political pressure. Much effort was therefore expended by developed and developing countries to mitigate the impacts of the oil price rise on their economies. The developed countries sought to exert political pressure to secure price reductions and later special trading arrangements to recycle oil surpluses. The developing ones sought to establish political alliances, either globally through the non-aligned movement, or regionally by virtue of trade, ideological or religious ties to secure guaranteed supplies, special oil credits and other increased capital flows to finance deficits. In both these sets of countries the short-term macroeconomic balances were neglected and longer-term fundamental restructuring took a second order of priority to political activities.

For those countries having high petroleum dependence yet weak prospects of political leverage, the short-term prospects seemed dim and they set in train frenzied efforts to adjust to the changed factor costs. As macroeconomic policies filtered through these societies and prices were passed through, many successful firms were shocked out of their customary habits and into new and innovative modes of action. The outputs of many of these firms changed to reduce

the dependence upon natural raw materials and high energy inputs, while the modes of production also changed to emphasize high efficiency. Energy, considered by some to be the crucial factor of production, especially after the price increase, was about to be supplanted by information.

Widely differing reactions to a situation of global uncertainty brought forth changes in relative economic power. They caused a high degree of instability in the 1980s, as new economic actors came to the fore changing the traditional trading relations. These in turn affected the familiar external payments patterns, exchange rates, investment flows and created a new round of frictions predicated upon changed economic power.

Some of these stresses were particularly acute in the developing countries, especially those that depended upon minerals export and imported energy. Stresses were also acute for those that had attempted to finance the deficits in the early to mid-1970s with cheap recycled oil surpluses. For they had to face the second oil shock between 1979 - 1982 having accumulated large debts, greatly increased debt servicing burdens because of rapidly rising interest rates. They also suffered from reduced demand for their raw materials exports. The minerals exporters felt the effects of the debt crisis early, to be followed soon after by the oil exporters, as oil demand and prices declined steadily with the global economy. For the petroleum exporters, greatly expanded consumption patterns and increased public investments in the boom years could not be reduced in the short term, so that reserves were depleted and debts increased.

These factors manifested themselves in the growth performance of the various developing country groupings over the 1980s. Those countries that had developed the capability and specialised in the export of manufactures had a sustained good growth performance throughout the decade. Annual per capita product grew on average by 3.2 per cent, although performance declined towards the end of the decade as the global economy contracted.

The fuel exporting countries had a steady decline in per capita product, averaging -1.6 per cent per annum and recording slight growth in only two of the 11 years, in 1989 and 1990. Minerals exporters faced the full brunt of the global uncertainty, achieving growth in five of the 10 years yet with wild swings in performance. Overall the per capita product grew on average by 1.4 per cent.

### The genesis of disequilibrium

The Caribbean was not immune to these global developments. Most countries, except Trinidad and Tobago and to a lesser extent Barbados, were oil importers. They faced a severe adjustment problem after the first oil shock that was externally derived. But the shock was, in some respects, greater for the minerals exporters among them, the Dominican Republic, Guyana, Haiti and Jamaica, since they were particularly dependent upon petroleum for their downstream mining activities. Oil price increases shocked their economies by drastically increasing the import bill, while simultaneously reducing the medium-term competitive position of their industries *vis-à-vis* those minerals exporters that were also energy self-sufficient, such as Venezuela and Australia.

The immediate impact of the first oil shock was cushioned and accordingly the adjustment process was deferred for some of them by virtue of windfall earnings accruing from sugar and bauxite/alumina exports and after 1974 from export taxes. While these earnings could have been used to help the adjustment process by setting in train new energy conserving investments, such as tourism in the Dominican Republic or Jamaica, or agricultural output in Guyana, they were used to raise the subsidies for energy and food items, increase the public service and to finance the expansion of State enterprises. Even the substantial funds accruing from these sources were insufficient for the task. Moreover they were ephemeral, so that when they started to decline debt accumulated rapidly in these countries. For these countries also debt severely complicated policy in the 1980s and remained an unwanted legacy in the 1990s. So that coterminous with the external shock of oil there was a further shock, deriving from domestic policies.

To understand the need for structural adjustment, which began in earnest in the 1980s and continues to the present, it is necessary to be aware of

the economic structure and policies applicable to these countries before 1980 and even before 1973. The section entitled "The genesis of disequilibrium in the Caribbean - the 1970s" provides a brief outline of the genesis of disequilibrium in three of the four countries surveyed. The fourth country, Trinidad and Tobago, was also in disequilibrium. In the 1970s it was, however called a boom, with the underlying distortions to non-petroleum production disguised by large inflows of foreign exchange. At that time scant regard was paid to the 'Dutch disease' pervading the economy, with policy emphasis being placed on absorption and distribution of the new-found wealth. This emphasis was to change as the windfall ended in the early 1980s and adjustment of a more familiar type began soon after that.

### Adjustment and privatization policies

The 1980s was generally regarded to be a lost decade for many Caribbean countries as they became bogged down while readjusting their economies to face drastically changed circumstances. All of the four countries chosen as case studies were minerals exporters as they were most severely affected by these changes. Three of them, the bauxite producers were already in severe disequilibrium at the beginning of the decade. The fourth, Trinidad and Tobago, the sole exporter of petrochemicals, suffered the shock of collapsing oil prices and went into disequilibrium soon after that.

In the Dominican Republic, a new phase in its recent history was reached in 1966. This saw a return to internal stability after a period of civil conflict following the overthrow of the Trujillo dictatorship. These developments at the domestic level coincided with an external environment that was conducive to rapid growth. Accordingly, for the period 1966-1976, GDP growth averaged 7.6 per cent. During this 10-year period, fiscal policies that included a freeze on the size and wages of the public sector, were quite restrained, although deficits were incurred. The deficits were nevertheless sustainable, for at the end of the 1960s total foreign debt was 27 per cent of GDP, and had actually fallen by 1976. Reserves increased steadily during the period.

The period after 1977 provides an example of the high cost of postponed adjustment. As was the case with Guyana and Jamaica the commodities boom of the

early 1970s provided the means to cushion the impacts of the first oil shock. But adjustment was further postponed even when the boom had run its course and surpluses were no longer available for the purpose. Renewed attempts were made to insulate against the effects of the second oil shock and to emphasize economic growth, with consequent rapid erosion of public savings, the foreign reserves and the external debt.

The Dominican Republic entered the 1980s facing several adverse external developments and with an economy that was weakened by inappropriate domestic policies. Terms of trade shocks were caused by volatile sugar and minerals export prices, the former reaching a sharp peak in 1981, and oil price increases which caused the import bill for this commodity to increase 10-fold between 1973-1980. There was also a deterioration in exports, the volume index declining by 20 per cent between 1978-1982, caused by the recession in the developed countries and consequent reduced demand for sugar, bauxite and ferro-nickel. The third element of the external deterioration was caused by increasing global interest rates, which tripled the cost of debt service between 1978-1982. Simultaneously, domestic performance in manufactures began to decline and fiscal revenues began to contract.

Adequate domestic policy responses to the external shocks were not forthcoming in 1980s, although better progress was made in the theoretically more difficult task of finding export alternatives to sugar, than on establishing fiscal balance. Accordingly, once the determination was made to adjust the fiscal side, in 1990, the goal was achieved fairly rapidly.

Macroeconomic policy passed through three phases, beginning in 1982, 1985 and 1990, respectively. In the first phase, faltering attempts were made to adjust the economy, but this resulted in stagnation in 1984 and fairly severe economic contraction in 1985. In the second phase, attempts were made to stimulate the economy and following a change of government, while many external sector policies remained, fiscal policy was used to stimulate the economy, mainly through increased construction. This was intended to reactivate economic growth, and managed to do so in 1986 and 1987, but at a cost of widening the external deficit, postponing the fiscal adjustment and increasing the rate of inflation. After that, growth contracted, as the strategy was unsustainable. This in its turn fuelled inflation that

increased on average by over 50 per cent per annum between 1988-1991.

The third phase began in May 1990, when the New Economic Policy (NEP) was initiated. Its objectives were reducing inflation, returning to growth, eliminating the deficit, unifying the exchange rate and initiating several policy reforms. By 1992, most of the objectives set for the NEP had been met, in so far as stabilization was concerned. The challenge of maintaining stable growth over the medium term, however, remains.

The portfolio of public enterprises had a somewhat different genesis in the Dominican Republic than in the other countries studied, in that it came about almost by accident. Except public utilities, which as in most other countries were State-owned, many State enterprises came about by nationalizing the assets of the Trujillo estate in 1961. They were deemed to be the national patrimony. Currently, the State enterprises consist of the Dominican Electricity Corporation (CDE), the Dominican Corporation for State Enterprises (CORDE), the State Sugar Council (CEA), the price stabilization institute and several other small enterprises. CORDE was formed in 1966 as the umbrella organization to administer the non-sugar enterprises of the Trujillo portfolio. It was subsequently expanded to include other activities. By 1987 the portfolio of CORDE included the national airline, two mines, an insurance company, a car dealership, a real estate business and 17 manufacturing enterprises. These produced cement, glass, paper, vegetable oils, shoes, tobacco, chocolate, nails, sacks and ropes, textiles, paints, milled grains, leather and car batteries. It included salt mines and refineries and marble and plaster mines. Previously it had also administered a hotel, hardware stores and a disco.

In the 22 years for which data are available, CORDE has recorded a deficit in 17 years. While CORDE is justified by the argument that it performs a welfare function it has been sustained by taxpayers. Savings of the public sector enterprises as a whole became negative in 1979 and the deficit incurred by them grew to 3.8 per cent of GDP by 1980. Deficits exceeding 0.5 per cent of product were incurred in all years in the 1980s. Despite these huge losses there was no sustained effort for the rehabilitation, rationalization or privatization of public sector enterprises. The possible reasons suggested for this inaction were: 1) the firms met political needs and their sale would have

caused unemployment and tighter accounting controls; 2) they could provide cross-subsidies to the weaker enterprises, thus sustaining employment in them; and, 3) careful scrutiny would make explicit their losses, and expose the failure of government to operate them efficiently, evidence that was concealed by transfers. In the sugar industry, privatization was linked to the controversial question of land reform, while CDE, the electricity corporation, was so large that foreign participation, a politically sensitive solution, might be necessary to achieve privatization. Only recently, in the NEP, has consideration been given to privatization but this policy is still in its infancy.

The immediate post-Independence phase in Guyana focused on expanding economic and social infrastructure through major projects such as sea defence, rice rehabilitation, roads, airports, electricity, and so on. While the projects for which the debt was incurred were not self-liquidating, no difficulty was experienced in servicing it since foreign exchange earnings had grown faster than the debt, increasing by 20 per cent between 1966-1970. Moreover, the loans were made on concessionary terms, at low interest rates and with long grace periods. Accordingly, the debt service ratio declined from 4.3 per cent of exports at Independence to 3.4 per cent in 1970.

At the beginning of the 1970s all the vital signs of the economy were fairly healthy. GDP grew by 3.5 per cent, the external current account deficit rested at 9 per cent of GDP while the fiscal deficit was one half that, at 4.5 per cent. The external debt represented 35 per cent of GDP. In 1970 Guyana was declared a Co-operative Republic, with a central objective being that of securing national ownership and control of domestic resources. This policy was to have far-reaching implications for Guyana's fiscal and external accounts, its debt profile and its overall economic performance.

Debt incurred in 1971, due to nationalization accounted for 2/3 of the 83 per cent increase in the foreign debt of that year. The cost of nationalization in terms of the debt was to grow further in coming years. By 1976 the external debt consequent on nationalization represented 22 per cent of the total debt and exceeded the debt accumulated up to 1970.

By 1977 the economy had begun to contract after a period of steady growth throughout the decade.

An increase of 3.8 per cent in average annual real GDP had been achieved between 1970-1976, but 1977 recorded a real GDP contraction of 4.8 per cent, and started a phase of stagnation that was to continue far into the future. For the period 1977-1980 GDP declined by 4.2 per cent per annum. With decreased export performance and high fiscal deficits, (now averaging 22 per cent of GDP) the balance of payments collapsed, with the deficit on current account averaging 20 per cent of GDP for each of the five years. By 1980 the external debt had increased to 122 per cent of GDP with the internal debt accounting for a similar percentage. Public spending continued to grow despite attempts to moderate it between 1976-1978. By 1980 it was 62 per cent greater than in 1975.

At the start of the 1980s the Guyanese economy was already in severe disequilibrium. The policy environment and its relationship to adjustment since 1980 can be understood if the survey period is seen to represent two distinct phases. The first phase covers the period from 1980-1987 and the second phase extends from 1988 to the present.

In the first phase, scant effort was made to adjust the economy in any consistent fashion and is characterised as one of "Disequilibrium Ignored." Initially the economy contracted severely between 1981-1983, because of internal and external shocks. Slow growth was resumed for the period 1984-1986, as the adverse external environment improved. The initial growth impulse received in 1984 weakened progressively to 1986 so that the economy was in a state of torpor, with growth barely positive. The enormous debt problem had serious negative effects with the country unable to obtain new financing for investment or even for suppliers' credits to finance normal trade transactions. Consequent cash flow problems forced the use of cash to finance current transactions, or where this was not available in sufficient quantities, to resort to counter-trade. More significantly, individuals resorted to informal measures to survive and a significant portion of the economy was no longer subject to formal regulation or even accounting. For the longer term, the need to operate on a day-to-day basis distracted policy attention from the long-term measures to resuscitate the economy.

The second phase, which began in 1988 is characterised as one of "Committed Adjustment," when

a comprehensive adjustment programme with integrated and complementary policies was finally adopted together with financing programmes from the International Financial Institutions. Given the size of the disequilibrium which existed at this time and the magnitude of the policy changes necessary, it is not surprising that the period 1988-1990 witnessed great economic instability and further economic contraction. Nevertheless, strong growth was resumed in 1991 and sustained in 1992 as the policies seemed to take effect.

This phase of the adjustment programme has shown remarkable progress in a short time, yet serious problems remain. The short-term indicators are being brought into balance but the debt remains to complicate the task of adjustment. Many policies have been initiated to encourage export performance, notably the revised foreign exchange regime, the deregulation of prices and the programme of rationalization and divestment of the main public sector enterprises. The debt complicates the fiscal programme and the resumption of repayments has minimised the progress made in establishing fiscal balance. A backlog of public works focusing on basic infrastructure needs to be reduced to stimulate economic expansion. Several social programmes have also deteriorated, which unless fixed, will further limit the quality of life and human performance.

The public sector has dominated the economy from the early 1970s, accounting for more than 50 per cent of national investment from 1971. This share continued to increase throughout the decade resting at 81 per cent in 1978. The public sector was also the major creditor, the major export earner, the major employer and accounted for the major share of Gross Domestic Product. By 1988, which marked the peak of its power before public policy changed, the public sector employed 60 per cent of the work force, accounted for 70 per cent of GDP and 85 per cent of the exports. Under comprehensive administrative controls many preferences were accorded to the State sector, including access to foreign exchange, credit including preferential interest rates and agricultural inputs such as fertilisers, pesticides and so on. Despite this apparent preeminent position, production and export earnings declined rapidly and many government enterprises incurred significant losses, requiring massive transfers from the national budget.

Once a comprehensive programme of adjustment was adopted, the losses incurred by the

State sector needed to be stopped. The ERP introduced the issue of privatization here defined broadly to include divestment, either in whole as going concerns or by sale of the assets of the various entities or by management contracts. It also included joint ventures and lease agreements. A comprehensive mechanism was established, in the Public Corporations Secretariat, to oversee the divestment of 32 corporations operating under its jurisdiction. Of these, 14 had been totally or partially privatized by October 1992. Despite the elaborate institutional mechanism for overseeing the privatization process, the two largest transactions were carried out without the involvement of the Public Corporations Secretariat.

Before the election in 1992 the privatization process was subject to severe criticism by the then opposition party and tended to buttress public suspicions that enterprises were being sold too cheaply. After the election there was a hiatus, since the change of government created a high level of political uncertainty about the future of privatization and of the ERP as a whole. These fears were partly laid to rest, once the privatization programme was resuscitated. It was to be governed by open bidding and award procedures, fairly priced sales, the offering of company shares to the public, buyer assurances to modernize and/or expand the enterprises acquired and consumer protection. The first task of the privatization committee was, however, to review all past sales, so that the momentum developed in previous years was lost.

In Jamaica, the 1960s saw relatively high rates of economic growth, on average 6.6 per cent between 1961-1970. Growth was driven by strong external demand for bauxite/alumina and burgeoning tourism. The expansion was financed by net private capital flows that exceeded the current account deficit by almost 9 per cent for the period 1966-1971. This surplus, with modest official capital flows created a substantial increase in the reserves. For the first three years of the 1970s the growth performance of the previous decade continued, though at a reduced rate averaging 5 per cent; but by 1973 the impact of domestic and external factors had caused a change in previous trends.

GDP began to decline in 1974, averaging a contraction of 3.2 per cent per annum for the rest of the decade. The fiscal deficit that was 3 per cent of GDP in 1970, widened to 8 per cent in 1974 and

further to 21 per cent by 1980. The balance of payments current account that was in deficit to the tune of 11 per cent of GDP in 1970 remained under 10 per cent by 1975 because of buoyant export earnings. By 1980, however, this deficit had fallen to 6 per cent of GDP as exports expanded somewhat. There was however significant pent up demand for imports that were licensed, since public expenditures remained strong. The external debt had grown from 29 per cent of GDP in mid-decade to 65 per cent by 1980.

During the period economic policy was subject to much national debate, IMF policies not achieving a consensus within the administration and being abandoned by early 1980. The adjustment process was therefore hampered by policy inconsistency and uncertainty, a factor that also contributed to capital flight.

The adjustment programme in Jamaica manifested three distinct phases since 1980. The first phase, from 1981-1983, attempted adjustment with growth. The second phase reverted to orthodox adjustment that entailed economic contraction, while the third phase was an extension of the second but with increasing liberalization in the medium-term policy framework.

Domestic economic policies in Jamaica had changed by 1981, with the arrival of a new administration. Negotiations had been reopened with the IMF and a new Extended Fund Facility agreed. The new programme placed heavy reliance on external savings to resuscitate the economy. In fact, given the political climate in which these new policies were adopted, such bilateral inflows were to be forthcoming. They may have given the mistaken impression that they could on their own, provide sufficient impulses to pull the fiscal and external accounts into equilibrium. By October 1983 the Extended Fund Facility that was due for completion by March 1985 had to be abandoned due to an inability to meet the planned targets. The fiscal deficit then stood at 20 per cent of GDP as compared to the target of 10.5 per cent, and the Balance of Payments deficit was US\$362 million compared with a targeted surplus of US\$125 million.

The phase of adjustment with growth seems to have been misguided. Capital inflows did not significantly increase direct investment and even had increased exportables been forthcoming they would need to have been sufficiently competitive to win

market share in a declining global market. This would have been difficult at current levels of competitiveness. The result of increased inflows was increased consumption and with it the external debt.

The second phase of orthodox adjustment was fairly successful with appropriate policies being applied in conjunction with a conducive external environment. Exchange rate policy was improved and, though later weakened by managed floating, did not become significantly dysfunctional in the context of buoyant global demand. It was, however, inadequate to respond to a major shock, such as that delivered by hurricane Hugo.

This combination of external circumstances and domestic policies ensured that by 1988 the external current account had substantially achieved balance, compared to a deficit of 15 per cent of product in 1985. Some progress was also made on the fiscal account, bearing in mind the complicating effect of the growing debt burden, itself exacerbated by high international interest rates. A fiscal deficit equivalent to 20 per cent of product in 1983 declined to just over 6.5 per cent on average for the years 1984-1987. It mushroomed, however, to 14 per cent under the burden of repairing hurricane damage in 1988. Accordingly, the rate of growth of the debt moderated to an average growth of less than 7 per cent per annum for the years 1984-1988. This was in marked contrast to the average of 19 per cent per annum, in the preceding three-year period between 1980-1983. By the end of 1988 the debt had moderated, from a high of 178 per cent of product in 1985, to about 115 per cent of GDP and 178 per cent of exports. Despite this adjustment, after a period of contraction in 1985-1986, growth resumed in 1987.

The third phase, beginning with a new administration, manifested policy uncertainty in the face of intense exchange rate pressures following the hurricane. Its first reaction was to devalue and then fix the exchange rate, presumably in the hope of establishing market stability. Within a year, when the objective was not being achieved, this policy was reversed. It was replaced by a strong commitment to liberalization of the exchange rate prices the removal of subsidies and credit restrictions. In this new environment the failure to contain credit had adverse consequences for the exchange rate, the rate of inflation, and ushered in a period of economic instability and speculation.

Product grew on average by about 2.5 per cent for the period 1990-1992. The current deficit on the balance of payments contracted between 1990-1991 and achieved a small surplus in 1992. The external debt contracted by over 11 per cent between 1990-1992. Fiscal policy needed to take a more conservative stance in the face of liberalization, the continuing debt burden and the need to make provision for Central Bank losses. If amortization costs were excluded, a surplus of 2.5 per cent of product was achieved in 1991 and this increased to the equivalent of 2.9 per cent in 1992. The accelerated process of liberalization and insufficient policy coordination, however, took its toll in diminished stability, inflation increasing progressively from just over 8 per cent in 1988 to over 77 per cent in 1992.

State participation in the productive sectors was first mooted in the five-year Plan of 1963-1968. The period 1972-1980 saw redoubled efforts to increase State participation, the rationale being to stimulate growth and facilitate the redistribution of resultant benefits. Because of these developments the Jamaican Government had a portfolio of investments that had grown haphazardly up to 1981. It included activities in bauxite, petroleum, cement, 75 per cent of Jamaica's sugar output and 50 percent of hotel room capacity. It also included activities in finance and a State Trading Company. Estimates of the quantum of such holdings vary. One is that State-owned enterprises numbered 400 by 1980, though this number contracted to about 200 by the end of the decade, consequent on closures and divestment. It has also been estimated that government participated in directly productive activities in 198 companies, 81 per cent of which were wholly owned.

A combination of ideological and practical reasons surrounded the introduction of privatization in 1981. A change of government stressed a greater role for the private sector but focus was placed on the fiscal imbalances and the need to service a growing debt. Given the impact of the major State-owned entities on the fiscal account their reform became a priority. With an eye to fiscal performance, reforms transformed the operating balance of these entities from a deficit of 1 per cent of GDP in 1981 to a surplus of about 7 per cent of GDP by 1988. The emphasis was on making these entities profitable through cost recovery. Less concern was directed at efficiency. The focus instead was on reducing the backlog of investment but this had

the effect of increased the portion of government guaranteed debt attributable to them.

For the period 1985-1991, 39 of the enterprises listed were divested, as well as other properties being used for agricultural and other forms of development. Many mechanisms were used in the divestment process. These included leases, placements on the Stock Exchange, share sales for unlisted entities and offers of shares to employees, while some assets of other entities were sold before their closure.

Despite general support for privatization, some criticisms were voiced, so that phase two, in which 67 entities were earmarked for privatization, was launched in the context of changed administrative arrangements and regulations enacted to ensure greater transparency. Phase two of the programme had divested 16 public sector entities, up to the end of 1992. This took the form of lease of assets; outright sale; sale of equipment, land or shares; or in one case, that of the former government printing office, the creation of an Employee Ownership Share Plan. The proceeds from these activities, amounted to J\$1,062 million.

At the beginning of the 1980s, **Trinidad and Tobago** was riding on the crest of the oil boom, which began in 1973. The impact of the twin oil price windfalls, which provided strong positive impulses to government revenues and to the balance of payments, fuelled greatly increased government activity. This permitted the near doubling in the rate of growth of product, from 3.1 per cent per annum on average for the period 1965-1973, to 5.8 per cent per annum on average for the period 1973-1983.

The economy manifested two distinct phases over the decade. In the first phase, the aftermath of the second oil boom from 1980-1982, output increased by almost 20 per cent, based essentially on increased petroleum earnings and expansionary fiscal policies. Accordingly, the spending momentum, which got underway in 1980, accelerated, evidenced by the fact that government spending, which averaged about 32 per cent of product in the period 1979-1980, grew rapidly after that, being equivalent to one half of GDP by 1982. In that year current spending grew by 70 per cent, the rise being attributable mainly to increased public sector wages and salaries that grew by 119 per cent and transfers and subsidies that grew by 50 per cent. Within a year a fiscal surplus equivalent to 2.6

per cent of GDP in 1981 was transformed into a deficit equivalent to 12 per cent of GDP in 1982. The current external surplus equivalent to over 5 per cent of product went into deficit equivalent to over 8 per cent of product. A rapid erosion of the reserves also began. This was not sustainable.

The second phase, from 1983 to the present, was one of a cumulative contraction of real product by 33 per cent. In this phase fiscal policy was mixed, initially continuing the expansionary policies of the first phase but as this generated a rapid erosion of the reserves, adjustment measures became necessary and were initiated after 1983. Weak growth was achieved in 1991 but this was spurred by a slight recovery in petroleum prices and economic contraction was resumed for the period 1992-1993. Concealed within this summary was a fairly severe fiscal correction. Its extent was shown by the fact that government revenues averaged a fairly steady 35 per cent of GDP for the period 1973-1987. This fell subsequently to average 29.6 per cent between 1988-1992. The importance of the revenue decline needs also to be seen in the context of concomitant decline in real GDP. This would have been even greater had attempts not been made to compensate for significant declines in petroleum revenue, by increasing other forms of taxation.

During the period 1976-1985, expenditures grew faster than product, to peak in that year at 39 per cent of GDP. They fell subsequently to average about 33 per cent for the period 1988-1992. For 1993 a small surplus was projected with income and expenditure at 28 per cent of GDP. Wages to central government workers declined from a peak of 15 per cent of GDP in 1986 to just over 10 per cent in 1993. In the case of expenditures there was evidence of much effort to adjust to the contracting economy. Yet the burden of adjustment was put on capital spending. On average for the period 1989-1992, recurrent expenditures accounted for over 90 per cent of all expenditures. In 1993 it was over 94 per cent, which means that less than 6 per cent of product was available to reorient the economy and facilitate economic activity or provide new directions in human resources development.

The period under review witnessed severe economic contraction, product falling by one third between 1983-1993. Unemployment rose from about 10 per cent in 1982 to peak at 22 per cent in 1989, falling to 20 per cent in 1992. Pressure in the external account required progressive devaluation of the currency, the

rate moving from TT\$ 2.4 to the United States dollar to TT\$5.6 just after it was transferred to a floating regime. The level of economic contraction also severely weakened the financial system, which was required to adjust to greater credit risks caused by increased bankruptcies and depressed real estate prices. It also required a major restructuring of the sector. Improved surveillance by the central authorities was necessary and new measures were put into place to bolster financial institutions.

The State became widely involved in directly productive activity, following from policies enunciated in its third Five-Year Plan (1969-1973). This said that the State would take a heightened role in development, to create new job opportunities, to transform the economy and ensure overall national development. These objectives remained dormant until 1973, since the State lacked the resources to effect them. In 1972 the government had share holdings in 32 companies, with a book value of approximately TT\$ 60 million.

The size and scope of government activity grew rapidly after that, bolstered by the resources available from the oil price windfalls. By the end of 1986, the State held a portfolio of 166 enterprises with its share holdings valued at over TT\$3953 million. This portfolio covered such activities as oil, gas, petrochemicals, asphalt, airlines, hotels, banking, insurance, sugar, mixed farming, fruit and meat processing, grain milling, maintenance and so on. Of these, many of which competed directly with the private sector, 37 were wholly owned, 11 were majority owned, one was 50 per cent owned, and seventeen were minority holdings. At its peak in 1985, these enterprises employed over 34,000 people. Overall, the public sector absorbed on average 47 per cent of all salaried employees over the period 1989-1991.

The involvement of the State was far larger than the nominal value of the holdings would suggest. Loans, advances and subventions were readily made available to public enterprises and it is estimated that such assistance amounted to TT\$5,800 million between 1979-1984. In 1987 alone TT\$ 967 million, or almost 20 per cent of recurrent expenditure, was budgeted to cover operating debts and contingent liabilities relating to the State enterprises. Many were dependent on such support for their continued existence. Government transfers, mainly to public enterprises and public utilities, amounted to almost 10 per cent of GDP in 1991. The large State enterprises had also contributed



a large portion of the external debt, accounting for about 65 per cent of it in 1987. Based on the experience of existing public enterprises and the prevailing economic situation, the government decided to reduce the dominant role that the State had played in the economy between 1974 and 1986. While these policies were implicitly followed after 1986, they were made explicit in the Macro Planning Framework 1989-1995.

It was proposed that all holdings in which the government had a minority share should be divested. Recommendations were made regarding 20 enterprises. Twelve were recommended for divestment, six for liquidation, and in one case no action was to be taken.

By the end of 1991 four firms were liquidated, one was leased and five were divested. The proceeds from these divestments amounted to US\$6.8 million from public sale and US\$84.9 from private sale to foreigners. Proceeds were used to retire public debt.

With the arrival of a new administration there was a hiatus in the divestment process and a review of existing policies completed by the first quarter of 1993. Then 84 government companies were examined, with firm decisions made concerning 47 of them. The remaining 37 were still under review. Of the 47, it was decided to divest 28 of them, 11 were in various stages of liquidation and four of the remaining eight were to be restructured, the rest to remain in the public sector.

## Conclusions

### Structural adjustment

The adjustment process was not smooth for any of the countries surveyed. Nor is it complete, although in Jamaica it has been going for at least two decades. Management of the economy needs to be seen as a process of continuous adaptation to changing circumstances, so in a sense adjustment is never complete. Nevertheless, always there was a perceptible lag between the appearance of disequilibrium and a decision to act and when action was taken the process was untidy, often fraught with experimentation, policy reversals and sometimes errors of judgement. Not surprisingly, the process of attaining basic economic balance was prolonged and policies needed to reactivate newly and existing productive capacities were slow in forthcoming. The four case studies raise several issues that might shed light on the reasons for the protracted adjustment.

Time was lost in making structural changes because policy makers often misjudged the nature of the disequilibrium. In the early 1970s, negative shocks affecting the economies were treated as temporary, so that instead of adjusting to them fiscal measures were used to cushion consumers and defer adjustment. As the shocks persisted, adjustment eventually had to be applied but in the worsened economic state of a burdensome debt. Conversely, when windfalls arrived they were often treated as permanent, eliciting

increased capacities or services that were permanently dependent upon them. Severe political difficulties and economic dislocations were subsequently experienced when the windfall ceased and the services could not be sustained<sup>1</sup>.

Adjustment was also delayed in many instances by policy inconsistency. In none of the countries surveyed was there a consistent pattern of economic management in place to confront the adjustment problem. The prevailing paradigm manifested inherent elements of unsustainability, which may have led to or exacerbated disequilibrium. During the transition to new policy inconsistencies remained and might often have been increased as new ideas were accepted and applied piecemeal.

Initially, the dominant paradigm was State driven, inward-looking and market averse. It was based on the principle of public sector command and control. A plethora of regulations was created to circumscribe private action. Many of them were defensive, created on the spur of the moment to satisfy particular needs and had scant regard for their side-effects on the economy as a whole. Layers of regulations, often created distortions and sent inconsistent signals to economic actors, whether these were consumers or

producers. Confusion often encouraged risk averse behaviour.

Decision-making was centralized, demanding near-perfect information and timing for response from a few at the centre. Not surprisingly, errors of judgement made by these few affected the public as a whole. Difficult decisions were sometimes postponed or deflected because of lack of information or because of the political consequences. Often, regulations designed to control private actors, were bypassed by them, so that whole areas of policy operated under a fiction with decisions being made on the assumption of compliance, while significant areas of the economy went underground.

The change of the paradigm, to give greater emphasis to prices and the market, concomitantly also removed major areas from public sector control. Competing views of the role of the State thus engendered, needed to play themselves out before consistent and coherent policies could be formulated. The public sector itself, not surprisingly, became a major defender of State power, although its position was not unified since the new paradigm to divest State power was in part ushered in by elements of the selfsame public sector. The debate tended to polarize the society.

Further polarization followed the intervention of the International Financial Institutions. Since IFI policy conditions were known to conflict with the prevailing paradigm, the tendency was to delay recourse to them to the last possible moment. Once they were asked to provide adjustment finance, conditions were applied to ensure the curtailment of disequilibrium and the future repayment of loans. Delay, however, meant that economic performance had usually deteriorated to a situation where drastic and urgent corrective action was needed. Such actions were often politically unpopular.

Introduction of the IFI, into the policy process, spawned two further elements into the political arena. The first was to blame the IFI for unpopular policies. The second was to play the nationalist card, i.e., to try to prevent foreign influences from intervening in the formation of national policies. Both elements had the effect of distancing some political elites from the adjustment exercise, factors that created further policy uncertainty. This manifested itself even within the ruling parties. It also emboldened the

opposition to distance itself from current practice, causing discontinuity after a change of government. After a period of familiarization, the new regime usually had to initiate an embarrassing policy reversal, further eroding confidence and delaying the process.

IFI policies might also have suffered from insufficient fine-tuning to national circumstances, in areas such as timing and in the selection of the policy mix. This is different from the popular criticism that unique policies were needed for the unique economies of the Caribbean. The intervention of the IFI was intended to speed up the process of adjustment, and they could not be accused of being indifferent to the importance of time. Nevertheless, the intrusion of further political elements into the debate tended also to heighten the degree of contention and slow the process of change.

Gradualist policies were often advocated by governments, in the spirit of cushioning the shock of adjustment, because of policy uncertainty or as a rearguard action where IFI financing was needed but conditionalities were opposed. Gradualism took the form of negotiating longer deadlines for the achievement of targets, the postponement of new policies, or simply non-compliance with targets. Gradualism was often counter productive in extending the period before corrective measures were carried out. Since the costs of adjustment were likely to be felt long before the benefits, gradualism, by postponing the arrival of benefits was likely to induce adjustment fatigue and to discredit the process as a whole.

Adjustment was further hampered by a lack of articulation between short and medium-term policies, since business decisions were dependent upon a coherent combination of the two. Initially, the focus was on achieving short-term balances through the annual budget and coping with the huge debt burden. Because of the reasons outlined above, balance was not achieved in the short term. Meanwhile, scant regard was given to the longer-term policy framework.

New investment, either local or foreign, was delayed by the lack of coherence between policies. One policy objective was that the dominant role of government in driving the economy had to contract, to regain fiscal balance and to release resources for investment by private actors. This has been long in coming, not least because of the need to use surpluses to meet the debt burden. However, even where

resources were available, investment was tardy since many disincentives to private actors remained in place. The contentious nature of some of these new policies took long to carry out and at various times seemed far from certain. Private investors were, therefore, imbued with caution and needed to be convinced that policies would not be easily reversible. Confidence was not easily achieved since parties in opposition invariably opposed the adjustment policies, some going as far as to promise reversals. New investment was therefore slow in surfacing and the spiral of steadily contracting economic activity difficult to break.

Existing productive capacity needed also to be retooled where possible to make it viable outside the protective walls of the integrated market. Exchange rate and trade policies were major tools in the quest for export competitiveness. The former, a tool having immediate short-term impact was applied erratically, since it usually had adverse political consequences. Typically parity changes were delayed long after they became necessary so that in a scenario of high inflation, competitiveness was often fleeting. Yet, where parities changed, the impact on existing enterprises was not always positive since enterprises had been spawned and developed in an environment of over-valued rates thus being dependent upon imported inputs. Parity changes required that these inputs be substituted locally if financial health was to be maintained. Often this was not possible. Similar impacts were felt by the reduction of protection, since reduced tariffs exposed them to greater external competition. The adjustment process was, therefore, complicated by the fact that adjustment was also needed in the structure and operations of existing private operations. This adjustment needed to take place in fiercely competitive and more recently, in contracting global markets.

Domestic adjustment policies were often inconsistent with regional arrangements. CARICOM was, initially, more compatible with a regime based on command and control. Such a regime could, in theory, better deal with harmonized regional policies, in trade, production, exchange rates, and so on. In practice,

however, even where the tools existed and agreements were formally reached to use them, they were often not applied. Sometimes, when they were applied, policies were difficult to enforce. Commonly where decisions were made by small elite groups, application was hampered because they did not have sufficient public support.

The paradigm shift taking place at the national level in some countries was, however, also being replicated in regional policy, though unevenly and with a lag. As a result, those countries that had advanced furthest with the adjustment process were often most instrumental in seeking reforms at the regional level. Where exchange rates were out of line, unilateral changes created tensions within the movement shifting the balance of trade and engendering threats of retaliation. Even further tensions were created where policies shifted from fixed to floating regimes. Those countries moving fastest to increase export competitiveness became conscious of the anti-export bias conferred by high rates of effective protection, thus pushing for tariff reform. Conversely, those not adjusting needed protection to survive. Divided loyalties further complicated policy-making so that if regional and national policies were to be made compatible it meant that both would need to change together. This was even more difficult to achieve than national consensus. It also implied that the integration model that finally appeared would differ significantly from that initially conceived.

Simultaneously, the regional experience with disequilibrium and the adjustment process also induced some to advocate regional institutions to solve them. Examples are for a regional central bank and common currency. It was felt that a multi-country approach would constrain national fiscal and monetary policy to be less capricious than it had been in the past. On balance the regional integration initiative acted to slow the process of adjustment. While a regional trade regime need not be inherently opposed to outward trading policies and a market orientation, the one originally conceived for CARICOM still needs adaptation to these objectives.

### Privatization

None of the case studies could discuss all of the issues raised by privatization in any of the countries studied. Nevertheless, they have managed,

collectively<sup>2</sup>, to illustrate many issues necessary to arrive at some general conclusions.

Always, the public debate on privatization was vigorous and sometimes it was acrimonious. All the cases showed a common morphology that began with the issue of whether to privatize, then went on to examine what to privatize and finally to the stage of considering how best to privatize. The lags between these stages varied from country to country, depending upon several national characteristics. They included the coalitions of interest for or against privatization, public management of the issue, the administrative capabilities to manage public enterprises, and so on. It might be useful to explore each of these stages in greater detail.

### Privatization and public attitudes

The issue of whether to privatize arose from several sources. One was emulation of policies toward public entities abroad, which were being deregulated and privatized, in some cases after being dismantled and their component parts treated separately. This technique was also being practised in the private sector as a means to create more manageable, specialized and supposedly more efficient entities. A second source of influence was undoubtedly the international financial institutions. They were motivated in part by current practise, in part by comparative cross-country analysis, in part by the twin imperatives of establishing fiscal balance and increased efficiency and competitiveness. Many of these views surfaced as integral parts of adjustment programmes that they financed. Yet while much opposition to privatization was generated locally, the impetus for it did not come solely from outside.

Often, the political leadership and senior civil servants, especially those that were responsible for macro-policy, became advocates of it. For the public sector enterprises had become a two-edged sword. While the political elites were sometimes the beneficiaries of clientelism, they were increasingly becoming the victims of it, as the demand for favours outstripped the capacity of already overmanned and sometimes insolvent institutions to supply them.

Increasingly, as the public sector enterprises failed to deliver even the necessary basic services for which they were created and as they increased the tax burden on the great silent majority, far from being assets they became political liabilities. Moreover, in the face of a general economic malaise and the recognition that international competitiveness was declining, the inefficiencies of the public sector enterprises revealed themselves as an intractable<sup>3</sup> obstacle to general macro

economic correction. Moreover, the policy attention necessary to micro-manage them was not available to political directorates in the face of more pressing issues. Finally, the continuation of a hands-off policy, if initiated by the party in power, could not be assured in case of a change of government. Accordingly, the total removal of a public enterprise from the political arena held attractions to those in power.

The opposition to privatization, nevertheless, came essentially from domestic sources, the public sector elites, often at the sectoral level, in alliance with the trade unions, the opposition party(ies) and a large part of the intellectual community. Public choice theory<sup>4</sup> illuminates the motives of many public sector elites. It suggests that public bureaucracies tend to expand and to perpetuate themselves. Control over public enterprises was a source of responsibility and power. Delegation of responsibility to private actors reduced power, control and the basis for survival of the bureaucracy. Since the bureaucracy was already under threat, for the self same reasons as the public enterprise, those of fiscal balance and lack of effective delivery, their anxiety at the loss of power and even employment was understandable.

Public enterprise employees and their unions and other trade unions allied to them, were also motivated to oppose privatization, essentially because it entailed the adoption of a new and alien organizational culture. Risk was enormously increased at the corporate and individual levels. In the context of severe over manning, public enterprise employees feared job losses consistent with those taking place in the private sector as macro policy forced it to become more internationally competitive. Public enterprise employees also feared a new management style that would be less amenable to political influence and to the retention of perquisites that might not be customary in the private sector. The trades union movement itself, in the face of consistent failure to retard the pace of restructuring and labour dislocation in the private sector, was facing a threat to its very credibility. For them, privatization threatened more of the same, except that the will to fight was increased since the political directorate often presented what was perceived to be a more responsive target.

Opposition parties opposed privatization for a variety of reasons. The first was to be expected in the normal thrust and parry of the political process, as the opposition sought new alliances with those disenchanted

by current policy. Secondly, they feared the removal of possible future sources of patronage from their grasp and while in opposition, unlike incumbents, had no countervailing responsibility for effective current economic performance. Finally, since they lacked control of the process, they were unable to control the benefits accruing from privatization and feared the motives of those who had such control. So, even where an opposition party had no inherent objection to privatization, delay was prudent until better control of the process and concomitant use of the proceeds could be secured.

The intellectual community tended largely to oppose privatization, although this was not universally so. Issues of equity, political and national control and power predominated. The capacity of the State to practice price discrimination was cited as a major tool for effecting transfers to the neediest. These transfers took place in the provision of electricity, water, and basic foodstuffs, especially where flour, cooking oil, sugar and other staples were produced by State monopolies. Overmanning in one context might also be perceived as a valid attempt at job creation in another. Unemployment was also a source of concern, based on the experience of other countries undertaking similar policies. The focus of State enterprises toward social objectives, instead of simply on private profit, provided a further reason for supporting the former, especially in areas such as health and education. A more rigorous form of localization formed yet another reason for supporting State enterprises, since privatization might open activities to non-nationals, but even if it did not, means were not available to tie private capital exclusively to national development. Finally, some intellectuals might harbour similar motives to those held by opposition politicians, since the career path of the intellectual led more often to the political arena than into private enterprise.

The domestic private sector was expected to support privatization, although this support was not readily translated into action. Some private sector interests opposed liberalization, especially where regulated markets stifled competition and permitted them to earn super normal profits. Deregulation and the need for industrial restructuring, often left them with a dearth of resources available to invest in new enterprises, especially given the financial and organizational predicament of the public enterprises. Severe problems were anticipated to deal with overstaffing, a policy defended by militant unions,

while some enterprises were technically insolvent. In monopolies, regulatory frameworks were often not in place, they were opaque, or they were deemed by putative investors to be subject to excessive political control.

The groups arrayed against privatization, therefore, made it more likely that public advocacy would be predominantly against it, while many of those in support were either politically silent or ambivalent as far as action was concerned. Even if initially the mood was to reject privatization, the unsustainability of current practice, especially as this impinged on the fiscal budget, required that some action be taken to improve the performance of the public enterprises, whether they were ultimately to be privatized or not.

Such actions often included deregulation at the level of the wider economy, including price decontrol. It also included the reduction of trade barriers to increase the exposure to foreign competition, necessary to improve the functioning of the market especially in small countries. Other measures included deregulation of foreign exchange markets and interest rates, so removing the privileged position of State enterprises.

Better management, sometimes obtained by outside specialists, the end of transfers from the public purse and the requirement of early profitability, all tended to shift the internal operations of the enterprise closer to those obtaining in the private sector. Sometimes the firms needed an audit to figure out their assets. In most this was followed by organizational restructuring to reduce and retrain the staff complement. Sometimes financial restructuring was also needed, where attention had to be paid to outstanding debt, while in a few new investments were needed in equipment and improved technology. In this process, the constellations of interests ranged for or against privatization often began to shift.

Once public enterprises begin to operate more like private entities the fears of employees begin to recede. As they become more viable, employment and remuneration could expand and the conditions of service, including on-the-job training and morale improved. Solvent well-run entities also become more attractive to private investors. Simultaneously divestment became more attractive to the political directorate. Cross subsidies usually ceased, so that expectations of political benefit receded. Outright sale became attractive to incumbent politicians since the

proceeds could be used to retire debt or to improve social infrastructure. In this context, the debate began to shift, to consider which enterprises justified privatization and how best it could be achieved.

#### Selecting appropriate entities for privatization

In the determination of what to privatize, three key conceptual hurdles need to be crossed. The first relates to natural monopolies, prompting discussion on the distinction between ownership and control. Here consideration needs to be given to the mechanisms that are possible and workable to regulate monopolies, whether public or private. In either case representatives of the public and private sectors, workers and consumers are likely to be involved in the regulatory process. A further issue is whether, even with the appropriate institutional relationships, the monopoly can be controlled. Alternatively, public discussion might help in identifying the limit to the number of public enterprises that a small State can effectively control. Out of these discussions the issue of who owns the monopoly, might become a secondary issue to how effective control can be secured over it.

The second major issue relates to concern for the welfare of the neediest. This issue could stimulate discussion to identify the neediest individuals to whom transfers need to be made and the various alternatives available for making them. Here the discussion might focus on whether transfers need to be direct and in kind from the public enterprise. Or whether they might be better targeted indirectly, for example, as income transfers or coupons for the procurement of specific goods or services.

The third major issue relates to the allocation of benefits from privatization. Who benefits from the proceeds of the sale and has access to the assets to be sold. In the first case does the government use the income from divestment to meet recurrent expenditure, in which case imbalance is simply disguised, or does it use the proceeds to reduce debt or improve social or physical infrastructure. What is a fair price and how is it decided? Some discussion needs to focus on the paradox of privatization where governments wish to sell sometimes unattractive operations. Market values are often hard to determine, but in appropriate cases open bidding is usually acceptable. In larger utilities this method might not be feasible, although it might be

possible to break the utility into manageable components and use the bidding procedure for these smaller parts. Safeguards will be necessary always to ensure that public probity is maintained. Does privatization contribute to the concentration of ownership or does it serve to broaden it, both as between classes and between ethnic groups?<sup>5</sup> Where these social concerns militate against efficiency, trade-offs need to be made explicit so that the public can ponder the opportunity cost of the resources involved.

Other issues are likely to generate less controversy. These include whether the objective of the enterprise has been achieved or can be achieved, whether the circumstances justifying public ownership have changed, for example, whether the sector in which the public enterprise operates remains strategic or especially depressed.

The discussion of these issues will provide pointers about what might be privatized and how the privatization might best be effected at any given time. Since the discussion is likely to be protracted, perceptions are likely to change during the debate, experience showing that as familiarity with privatization grows areas and means, hitherto taboo, might become acceptable<sup>6</sup>.

#### Choosing appropriate methods for privatization

The organizational arrangements necessary to effect the process of privatization needs to be considered once the set of entities to be privatized have been decided. Arguments tend to favour a centralized approach. These say that a strong well-led central authority is needed to develop the momentum against vested interests for the status quo. It is also argued that only a central body can develop the expertise needed to ensure that privatization can take place under the best terms. Finally, it is suggested that greater transparency and better control and monitoring of the process is possible with one responsible agency. Conversely, it may be argued that one agency might become overloaded with the task, creating organizational and bureaucratic bottlenecks that could slow the process. In such cases it might be possible to identify a focal point, with clear mandate and leadership at a sufficiently high political level, to define the policies and to monitor the process. The responsibility for implementation might be delegated.

The issues to be considered by the appropriate focal point would include the following: 1) the extent and the pace of privatization; 2) public information policies, with emphasis on the issue of transparency; 3) the selection of entities to be privatized, evaluation in each case of the reason for privatization and determination of the most appropriate methods; 4) identification of the necessary prior action, at the level of the macro economy and within the chosen firms; 5) the sequencing of sales; 6) preparation of the appropriate legal framework, where necessary, i.e., new laws may be needed to abolish a monopoly, strengthen private property rights, provide effective legal enforcement or measures for dispute settlement, and so on; 7) consideration of support measures, which might condition the method of privatization to be used, in the effect of adverse social impacts, and make the necessary trade-offs where these conflict with enterprise efficiency or selling price; and, 8) valuation of the enterprise and the modalities that might be used in financing its sale.

In Jamaica, experience gained over time led to formal centralization of the privatization process in the NIBJ, operating under the aegis of the Office of the Prime Minister. Nevertheless, privatization continued to be conducted by other government agencies. Proposals submitted by the UNDP to the government of the Dominican Republic also favoured a single agency, the Restructuring and Transfer Office, under the aegis of the Ministry of Industry and Commerce. It was argued that since the initiative would play a catalytic role in reform of the business regulatory environment, the banking sector and the nascent securities market, it was best located in the Ministry of Industry and Commerce. In Guyana, the entity responsible for privatization comprised an inter-ministerial policy body and an executing committee. Assistance was received from consultants in valuing the entities to be privatized and in preparing them for privatization. The previous arrangements are currently being reviewed.

A full range of options has been used in transferring public entities. These include direct sale either outright or in partnership; private placements to selected investors in the field; public share offerings; auctions; sales to employees; liquidation; leasing, management contracts or operating concessions, sometimes in combination, sometimes before sale.

The means chosen for transfer will be influenced by the overriding policy of the State, for divestment with fewest links will be preferable where a new hands-off role for the State is envisaged. Where the motivations are more pragmatic, joint ventures and management contracts that retain some involvement will be more acceptable. Other concerns of the State might be speed of transfer, fiscal concerns and improving the quality of the market - all factors that could influence the means of transfer. Means of transfer will also be conditioned by the objective circumstances of the enterprise, public share offerings where the enterprise is large and profitable, liquidation and sale of assets where it is not solvent. Finally, the means of sale will be conditioned by socio-political considerations. For example, where management or workers oppose privatization, the disposal of shares, in whole or in part, to workers or managers might be a viable means of divestment. Similarly, where an issue such as widening participation in business activity is a goal some shares might be reserved for selected groups of small investors.

The sources of finance for privatization vary. Domestic capital is the most obvious source. At the macroeconomic level some credit needs to be available at reasonable rates so that domestic investors can acquire the assets put up for privatization. As the privatization initiative often takes place with economic stabilization this condition might not be easily achieved. Other means might be necessary to ease the transfer, such as management buy-out or buy-in schemes, with special credit schemes or arrangements to spread the transfer over time, from partial to total privatization. Similarly, the transfer might begin with a management contract, with the provision of a purchase option, linked to profitability or increase in value of the firm. Debt-equity swaps are another source of finance for privatization.

Foreign capital is a further source of financing, which often brings with it improved technology, management and marketing skills. The former is particularly relevant in telecommunications, the latter in areas such as privatized airlines while management is a commodity hard to find in most public enterprises. Foreign investment, however, is unlikely to come, for this or any other reason, without a stable macroeconomic environment that has achieved a fair measure of deregulation. Since privatization is one

policy measure being used in a larger package to achieve such an environment, capital inflows have not been as forthcoming in the early stages of the process as was hoped by some. Conversely, the sale of national assets is sometimes so controversial that policy makers are often loath to complicate the matter further with the issue of foreign ownership.

In general, it seems desirable to have an inter-ministerial group responsible for privatization policy and for overseeing the process. A privatization unit comprising public officials should be responsible for executing policy. Where appropriate expertise is not available to prepare entities for privatization this expertise should be contracted.

The privatization process should seek to maximize the proceeds from the sale of assets to be privatized, due attention being paid to the pace of divestment. This argues against an unduly protracted period of preparation before privatization. It also argues against special preferences being granted to either workers or managers of the firms to be privatized.

Special efforts should be made to ensure transparency in privatization transactions. Financial and operational information on all entities to be privatized should be widely disseminated so that all interested parties have equal access to it. Sales should also be widely publicised, wherever possible by public auction. Where sealed bids are necessary they should be opened publicly. Finally, fair compensation should be paid and retraining provided in those cases where employees lose their jobs because of privatization.

Special considerations apply in the treatment of **natural monopolies** such as electricity, water and telecommunications. As has been mentioned previously, effective regulation to monitor the quality and price of the product is necessary whether monopolies are in the public or private domain. Under these circumstances one might be indifferent to ownership, except where necessary investments are sufficiently large that they create a burden for a small State. Or where access to new and fast-moving technology is necessary for the effective development of the enterprise and indeed the country itself. This is currently deemed to be the case with telecommunications. Here a joint venture or sale to a foreign partner is the norm. In the former case, where the size of investment is great, a situation that

often obtains with the electricity utility, a range of options is available and is being evaluated in the region.

In all the cases examined, electrical utilities were being considered for privatization, with several options being considered. These include: a) subcontracting some functions to private firms, such as the maintenance of generating plants, or power lines, control of inventories, or maintenance and management of transport fleets; b) forming joint ventures with specialized companies to operate the companies in whole or various parts of it; c) reducing or eliminating government's share by bond offers or venture capital to private investors; d) outright privatization as a single going entity; e) where appropriate, dividing the utility into fully or partially integrated regional entities; and f) separating transmission from generation and distribution functions, with the former to remain under public ownership and the latter functions might be privatized.

It should be noted that breaking down many component parts of a monopoly can increase its exposure to competition. Where, for example, most independent private power stations vie for connection to the national grid, an element of competition can be introduced. Similarly, many other functions within the power sector can be defined and disaggregated and put to public tender, bringing a further element of competition.

Although the public perception might not yet be ready for it, similar arguments might be extended and the means found to improve the services provided in areas such as education or health. Currently concern is being expressed about the quality and availability of services in both these sectors and governments find it almost impossible to provide increased funding for them. More efficient ways of using current funds would meet with universal approval.

Essentially the issue is one of creating and maintaining an effective regulatory framework. This would define the quality of the product, the curriculum in education, or a set of fixed services in health. It would also set a scale of appropriate charges, consumers being given freedom to obtain the service from a provider of their choice. Whether that provider is public or private might become secondary, once the consumer was satisfied that quality, price and other issues such as equity, were satisfied.

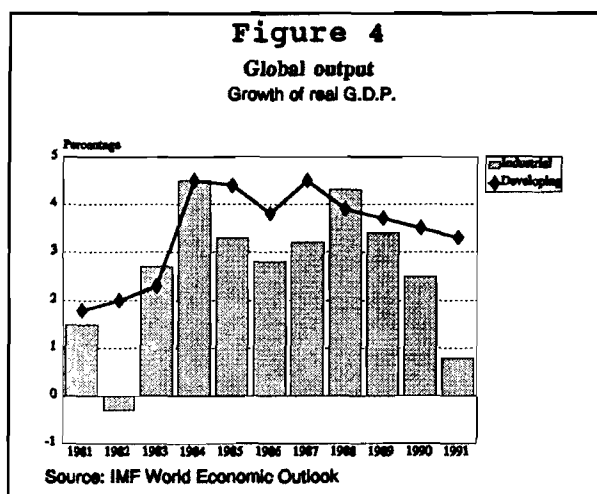
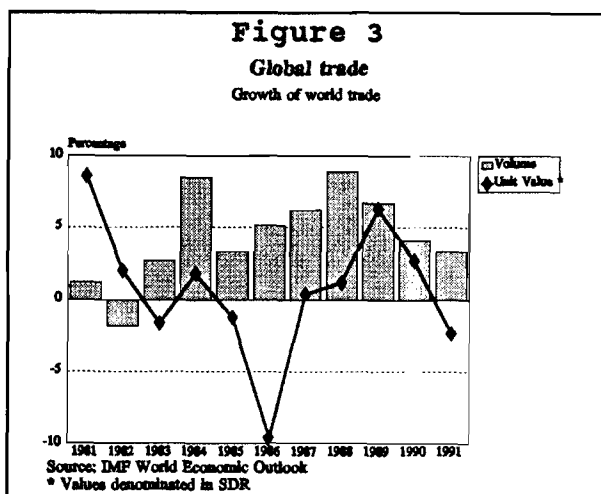
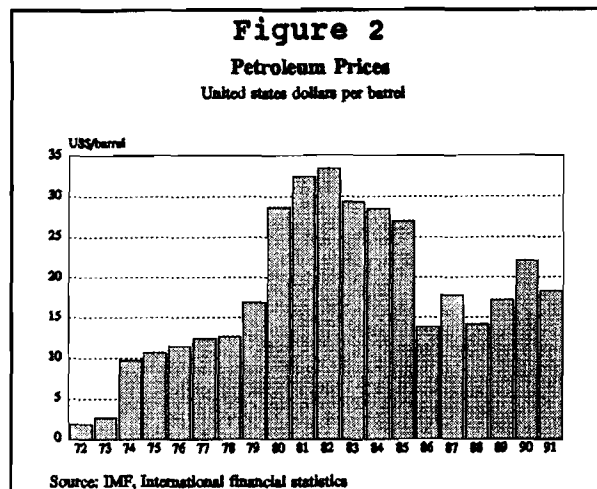
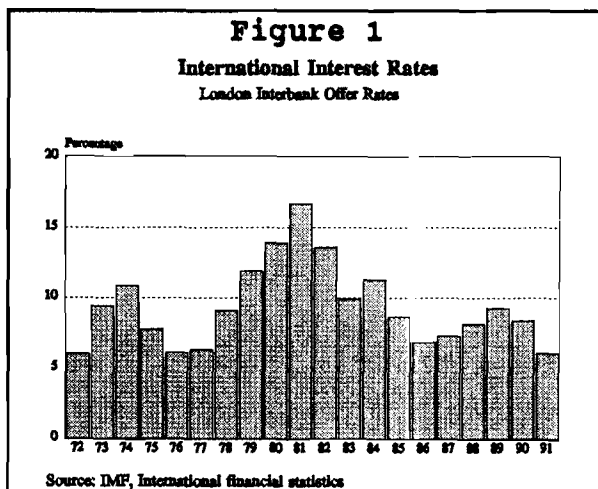


The public sector enterprises came about in the quest for better, more equitable and more efficient services. Much has been achieved by them, though the public is now demanding more, as the quality of these services seems insufficient to meet the challenges of the future. Simultaneously, the role of the State is being reconsidered, to shift it away from general diffuse

responsibilities, to concentrate on areas where its participation is unique and irreplaceable. Enterprise management is not deemed to be one of these. Conversely, it is a private sector specialization. New ways need to be explored to ensure better performance at all levels of the society. Privatization is one means being explored in an effort to achieve this objective.

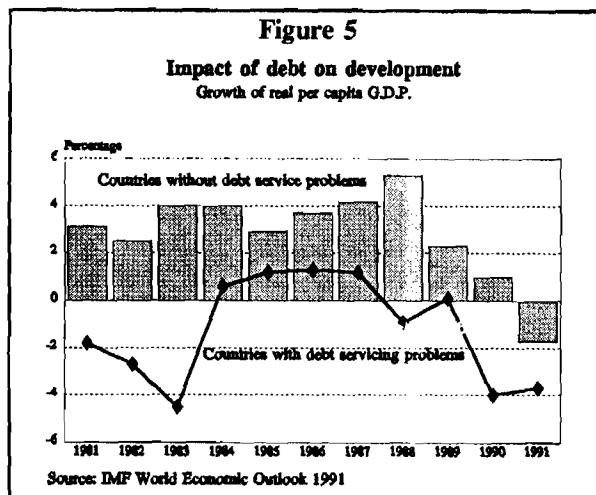
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## THE GLOBAL ENVIRONMENT



The oil price shocks in 1973 and 1979-1981 provide significant clues to any understanding of the turbulent years of the 1970s and the complex task of adjustment faced by many developing countries in the 1980s. For the oil shocks provided the catalyst which accelerated the pace of development of a number of technological factors which had unobtrusively been coming to fruition in the 1960s and were on the verge of becoming operational. These developments which were to change factor proportions and competitive

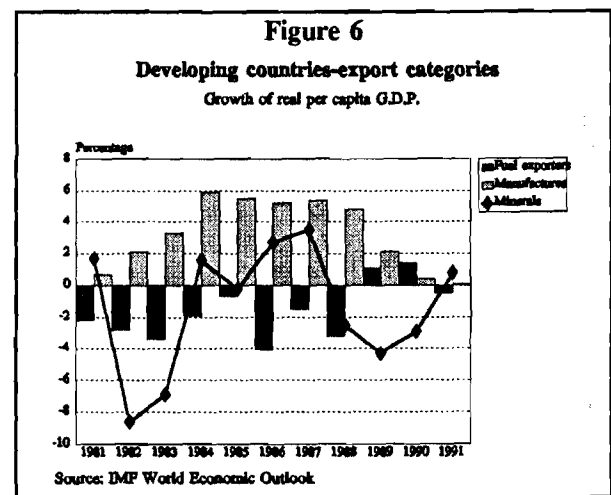
advantage in revolutionary ways, would have proceeded smoothly in the natural course of events, had all other factors remained on their expected trajectories. The fivefold increase in petroleum prices in 1973 provided a significant discontinuity with past events. It managed almost overnight to transfer an enormous block of resources from the major petroleum consuming countries, both developing and developed, to the major producers. Among the oil dependent developed and developing



countries alike, the oil price increases changed relative competitive positions to favour those having lesser dependence on oil for energy and a product mix less intense in energy per unit of output.

Perceptions and, therefore, the policy responses to the oil price rise were also important, those countries possessing political leverage seeing it as short term and amenable to political pressure. Much effort was therefore expended by some countries, both developed and developing, in their varying ways, to mitigate the impacts of the oil price rise on their economies. The developed countries sought to exert political pressure to secure price reductions and later special trading arrangements to recycle oil surpluses. The developing ones sought to establish political alliances, either globally through the non-aligned movement, or regionally by virtue of trade, ideological or religious ties to secure guaranteed supplies, special oil credits and other increased capital flows to finance deficits. The common result was that in both these sets of countries the short-term macroeconomic balances were neglected and longer-term fundamental restructuring took a second order of priority to political activities.

For those countries having high petroleum dependence yet weak prospects of political leverage, the short-term prospects seemed dim and they set in train frenzied efforts to adjust to the changed factor costs. Domestic energy prices were rapidly increased to reflect the new global prices, after a short period of rationing in some cases, in an effort to conserve on its use and minimize its balance of payments impact and



scant efforts were made to mitigate the impacts on consumer spending through increased public expenditure. For many successful firms, prices which were passed through shocked them out of the customary habits and provided the justification for new and unfamiliar modes of action.

The output mix of many of these firms changed to reduce the dependence upon natural raw materials and high energy inputs, while the modes of production also changed to emphasize high efficiency. Energy which was considered by some to be the crucial factor of production, especially after the price increase, was about to be supplanted by information. The oil price shocks provided the midwife for the birth of the information revolution, since information became the crucial ingredient to facilitate the new level of efficiency needed to compensate for their energy deficiency.

Information became the substitute for energy as it helped to conserve it both in energy using consumption goods as well as in production processes. It was also used to conserve upon labour as fewer people were used for greater output, by virtue of smart machines and robotics. More efficient use of people was also possible by the removal of many middle layers of management formerly used simply to coordinate and disseminate information within the productive process. Similarly middle-men operating as intermediaries between producers and consumers were about to be made redundant as consumers gained the information to access producers directly.

Information was used to conserve upon capital through more efficient use of it, through faster transfer and placement of it and through smaller inventories made possible by greater information about the frequency and composition of sales. Because of the significance of information it fostered the development of the fastest and most strategic industry of all, the microprocessors used for the purpose of applying information to society. In this race the greatest users of information had a competitive edge in knowing what was needed and how to produce it so that they were able initially to corner the market for microprocessors. Far from conferring a long-term disadvantage for some of the energy-dependent developed countries, the oil price shock therefore forced them to adapt faster and earlier to the realities of the later 1980s and early 1990s than those less dependent and with greater political leverage. This became more evident with the second price shock of 1979-1981 and the consequent recession in the early 1980s, where the newly efficient producers were able to secure increased market shares from their erstwhile superiors and further increase them once global trade increased in the late 1980s.

This change in relative economic power set in train a high degree of instability in the 1980s as new economic actors came to the fore changing the traditional trading relations, affecting external payments patterns, exchange rates, investment flows and creating a new round of frictions predicated upon changed economic power. Despite this turbulence, global output was sustained at a respectable rate throughout the decade, with the developing countries as a whole sustaining a somewhat higher rate of output growth than the industrialised countries. This growth performance was supported by fairly steady growth in world trade volumes, despite fairly wild shifts in the unit values of trade. The traditional trading alliances and economic institutions are nevertheless beginning to experience some stress in the face of the changing economic landscape.

Some of these stresses were particularly acute in the developing countries, especially those dependent upon minerals exports and imported energy, and those which had attempted to finance the deficits in the early

to mid 1970s with cheap recycled oil surpluses. They had to face the second oil shock between 1979 - 1982 having accumulated large debts, greatly increased debt servicing burdens, as a consequence of rapidly rising interest rates. They also suffered from reduced demand for their raw materials exports. The minerals exporters felt the effects of the debt crisis early, to be followed soon after by the oil exporters, as oil prices declined steadily with the global economy and demand for it. For the petroleum exporters, greatly expanded consumption patterns and increased public investments in the boom years could not be reduced in the short term, so that reserves were depleted and debts increased.

These factors manifested themselves in the growth performance of the various developing country groupings over the decade of the 1980s. Those countries which had developed the capability and specialised in the export of manufactures had a sustained good growth performance throughout the decade. Annual per capita product grew on average by 3.2 per cent, although performance declined towards the end of the decade as the global economy contracted (Figure 5).

The fuel exporting countries had a steady decline in per capita product, averaging -1.6 per cent per annum and recording slight growth in only two of the 11 years, in 1989 and 1990. Minerals exporters faced the full brunt of the global uncertainty, achieving growth in five of the 10 years, yet with wild swings in performance. Overall the per capita product grew on average by 1.4 per cent.

By 1982 with the recognition of the global debt crisis, the imperative for adjustment could no longer be denied. Among the developing countries, therefore, the task of economic management and the trajectory of economic growth would be determined in large measure by the extent to which some had accumulated a severe external debt burden while others, either by good fortune or by good management, had managed to avoid it. For the former countries, economic growth throughout the 1980s was substantially lower.

## THE GENESIS OF DISEQUILIBRIUM IN THE CARIBBEAN - THE 1970s -

The Caribbean was not immune to global developments. Most countries, with the exception of Trinidad and Tobago and, to a lesser extent, Barbados, were oil importers. They faced a severe adjustment problem after the first oil shock which was externally derived. But the shock was, in some respects, greater for the minerals exporters among them, the Dominican Republic, Guyana, Haiti and Jamaica, since they were particularly dependent upon petroleum for their downstream mining activities. Oil price increases shocked their economies by drastically increasing the import bill, while at the same time reducing the medium-term competitive position of their industries vis-à-vis those minerals exporters which were also energy self-sufficient, such as Venezuela and Australia.

The immediate impact of the first oil shock was cushioned and accordingly the adjustment process was deferred for some of them by virtue of windfall earnings accruing from sugar and bauxite/alumina exports and, after 1974, from export taxes. While these earnings could have been used to assist the adjustment process by setting in train new energy conserving investments, such as tourism in the case of the Dominican Republic or Jamaica, or agricultural output in Guyana, they were used to raise the subsidies for energy and food items, increase the public service and to finance the expansion of State enterprises. Even the substantial funds accruing from these sources were insufficient for the task. Moreover they were ephemeral, so that when they started to decline debt accumulated rapidly in these countries. For these countries also debt severely complicated policy in the 1980s and remained an unwanted legacy in the 1990s. So that coterminous with the external shock of oil there was a further shock, deriving from domestic policies.

In order to understand the need for structural adjustment, which began in earnest in the 1980s and continues to the present, it is necessary to be aware of the economic structure and policies applicable to these countries prior to 1980 and even prior to 1973. The section which follows provides a brief outline of the genesis of disequilibrium in three of the four countries surveyed. The fourth country, Trinidad and Tobago, was also in disequilibrium. In the 1970s it was however, referred to as a boom with the underlying distortions to non-petroleum production disguised by

large inflows of foreign exchange. At that time scant regard was paid to the "Dutch disease" pervading the economy, with policy emphasis being placed on absorption and distribution of the new found wealth. This emphasis was to change as the windfall ended in the early 1980s and adjustment of a more familiar type began soon thereafter. This section, therefore, treats with the Dominican Republic, Guyana and Jamaica only, with the Trinidad and Tobago case study commencing in the next section.

A new phase in the recent history of the Dominican Republic was reached in 1966, with a return to internal stability, after a period of civil conflict and the overthrow of the Trujillo dictatorship. These developments at the domestic level coincided with an external environment which was conducive to rapid growth. Accordingly, for the period 1966-1976, GDP growth averaged 7.6 per cent. During this 10-year period fiscal policies, which included a freeze on the size and wages of the public sector, were quite restrained, although deficits were incurred. The deficits were nevertheless sustainable, since at the end of the 1960s total foreign debt was 27 per cent of GDP, and had actually fallen by 1976. Reserves increased steadily during the period.

Productive investment was encouraged through extensive tax and tariff incentives; the latter leading to the development of import substitution industries. Growth during the period was, however, essentially export driven, since earnings from traditional exports such as coffee, sugar, cocoa and tobacco, were booming. The minerals sector, comprising ferro-nickel, gold, silver, and bauxite expanded rapidly in the 1970s, from almost nothing to about 25 per cent of export returns by the end of this phase; and services, such as tourism and those in the export zones began to grow.

In the light of such rapid export expansion, the impact of the oil price increases on the external account were initially cushioned by the concurrent boom in commodities prices. The impact was also insulated from the consumers since the government decided in 1974 to use the high sugar prices to subsidize the increased oil prices. Consumption of petroleum products did not therefore respond to the increased

international prices, and the adjustment opportunity offered by the boom was not seized.

The domestic investment policy, based on tax and tariff incentives, while expanding activities had eroded the tax base. It also encouraged the growth of some non-competitive enterprises producing for the protected local market. Between 1966-1976, the contribution of such sectors to the GDP grew by 9 per cent, while the contribution of non-tradables, mainly construction, grew by 13 per cent. This policy orientation had the effect of narrowing the foreign exchange earnings base, and ensuring that public sector savings were now only generated by those sectors benefiting from the commodities boom. The economy was accordingly made more vulnerable to the further external shocks which were to come.

Export prices which reached a peak in 1975 declined by 30 per cent in the years 1977-1979. Erosion of the external balance was therefore rapid after 1977, the current account deficit growing from US\$-265 m. in that year to US\$676 m. by 1980, the fuel bill alone accounting for US\$270 m of the increase and moving from 22 per cent of merchandise imports to 30 per cent in 1980. Output grew fairly strongly in 1977 and 1978, but as the aforementioned shocks hit the economy, GDP growth faltered in 1978 and actually declined in 1980.

Public sector savings in the Dominican Republic in 1977 were generated by taxes on a narrow range of export commodities such as sugar, cocoa, coffee, tobacco and by import duties. Property taxes are almost non-existent and income taxes are low. When the commodities boom ended government revenues therefore fell, at a time when imported energy prices were poised for their second increase. Tax revenues which had amounted to 17 per cent of GDP in 1970 fell to 11 per cent by 1978, where it remained until 1982 reaching a low of 9 per cent. The impact of rising energy prices on the economy was greater than it might have been since government savings were being used to meet a part of the price increase. Accordingly, as was the case with the first oil shock, consumption of energy products did not fall with the rise in prices, a factor which increased the impact on the external account. At the same time basic food items, many produced by public enterprises or imported, incurred increased subsidies or reduced duties in an attempt to insulate the population against

the rising cost of living. The consequent severe impact on the government savings, the balance of payments and the debt were therefore predictable.

The Dominican Republic after 1977 provides an example of the high cost of postponed adjustment. As is the case with Guyana and Jamaica the commodities boom of the early 1970s provided the means to cushion the impacts of the first oil shock, but adjustment was further postponed even when the boom had run its course and surpluses were no longer available for the purpose. Renewed attempts were made to insulate against the effects of the second oil shock and to emphasize economic growth, with consequent rapid erosion of public savings, the foreign reserves, and the external debt.

On Guyana's attainment of Independence in 1966 the economy was driven by activities such as sugar production, bauxite mining and processing, and the distributive trades, all substantially owned by private foreign interests. Debt outstanding was modest and primarily to the United Kingdom, in the form of bilateral loans (59 per cent), and bonds (38 per cent). Local business interests were limited to agriculture, local trading and minor manufacturing.

The immediate post-Independence phase focused on expanding economic and social infrastructure through major projects such as sea defence, rice rehabilitation, roads, airports, electricity, and so on. While the projects for which the debt was incurred were not self-liquidating, no difficulty was experienced in servicing it since foreign exchange earnings had grown faster than the debt, increasing by 20 per cent between 1966-1970. Moreover, the loans were made on concessionary terms, at low interest rates and with long grace periods. Accordingly the debt service ratio actually declined from 4.3 per cent of exports at Independence to 3.4 per cent in 1970.

At the beginning of the 1970s all the vital signs of the Guyanese economy were fairly healthy, GDP grew by 3.5 per cent, the external current account deficit rested at 9 per cent of GDP while the fiscal deficit was one half of that, at 4.5 per cent. The external debt represented 35 per cent of GDP.

In 1970 Guyana was declared a Cooperative Republic, with one of the central objectives being that of securing national ownership and control of domestic

resources. This policy was to have far-reaching implications for Guyana's fiscal and external accounts, its debt profile and its overall economic performance. The debt incurred in 1971 due to nationalization accounted for 2/3 of the 83 per cent increase in the foreign debt of that year. The cost of nationalization in terms of the debt was to grow further in coming years, so that by 1976 the external debt consequent on nationalization represented 22 per cent of the total debt and exceeded the debt incurred up to 1970.<sup>7</sup>

By the mid-point of the decade the external debt had increased to about 62 per cent of GDP, yet because of buoyant export earnings the deficit on the current account of the balance of payments averaged 6 per cent of GDP over the period 1971-1975. The fiscal deficit which moved somewhat erratically from year to year, nevertheless, averaged 7.6 per cent of GDP over the same period, and GDP grew on average by 4 per cent. Most vital signs remained good, though danger signals were now evident as public spending burgeoned by 232 per cent between 1971-1975, the external debt increased by over 207 per cent and internal debt by 272 per cent. In retrospect it might be seen that the vast increase in the public sector was facilitated by buoyant exports and rapidly increasing debt.

Despite these signs the debt service ratio was not significantly different from 1966 at 4.4 per cent, and this despite the impact of increased petroleum costs, which grew by 134 per cent from 1973-1976. As was evident in other countries, the commodity price boom of 1974-1975 seemed to disguise the underlying deterioration of the economy and induced increased public sector spending. By 1976 the debt service ratio had however jumped, from 4.4 per cent in 1975 to 12.6 per cent in 1976, and with declining output and external prices the stage was set for an economic and debt crisis.

By 1977 the economy had begun to contract after a period of steady growth throughout the decade. An increase of 3.8 per cent in average annual real GDP had been achieved between 1970-1976, but 1977 recorded a real GDP contraction of 4.8 per cent, and started a phase of stagnation which was to continue far into the future. For the period 1977-1980 GDP declined by 4.2 per cent per annum. With decreased export performance and high fiscal deficits, (now averaging 22 per cent of GDP) the balance of payments collapsed, with the deficit on current account averaging

20 per cent of GDP for each of the five years. By 1980 the external debt had increased to 122 per cent of GDP with the internal debt accounting for a similar percentage. Public spending continued to grow despite attempts to moderate it between 1976-1978. By 1980 it was 62 per cent greater than in 1975.

As was the case in other countries, the fall in commodity prices precipitated the decline in merchandise earnings, a fall in sugar prices being most noteworthy, but domestic factors also played their part. Foremost among these was a decline in output caused by organizational and management problems consequent upon the nationalization of the main productive sectors, including sugar, bauxite, trading companies, oil refining, communications, and some manufacturing enterprises. A failure to adjust to these declining conditions must also bear some blame for subsequent further deterioration. In this regard it will be noted that the fiscal current account deficit increased steadily between 1977 and 1984, 1982 being the sole exception to that trend. While the debt created a significant foreign liability, it did not bring forward new productive capacity, the change of ownership in fact precipitating a decline in output.

Between 1978 and 1980 a number of programmes were initiated with the International Monetary Fund (IMF). A standby agreement was negotiated in 1978 which had some success in reducing the overall public sector deficit from 22 per cent of GDP in 1977 to about 6 per cent in 1978, although current expenditure in fact increased slightly. In 1979 an Extended Fund Facility was initiated but abandoned in the same year as it failed to meet targets in the external sector, due to continued stagnation in export earnings and the impact of the second oil price shock. Reduced GDP was recorded for the year. A third Extended Fund Facility was formulated for 1980 and adopted in 1981 which emphasized increased production and diversification, and measures to contain the oil price bill. Export earnings for 1980 were quite good due to high prices received for bauxite products, sugar and rice. Accordingly, merchandise earnings hit a peak from which it was to decline to the end of the survey period. The increase was particularly fortuitous since it provided a cushion against the doubling of oil prices in 1979/1980, still allowing a GDP growth of about 2 per cent. Between 1970-1980 the exchange rate moved only marginally, from G\$2.0 per US\$ in 1970 to G\$2.55 in 1976, where it remained until 1981.

Similarly, in Jamaica, the 1960s saw relatively high rates of economic growth, on average 6.6 per cent between 1961-1970. Growth was driven by strong external demand for bauxite/alumina exports, and burgeoning tourism, which necessitated increasing investment in these sectors. The expansion was financed by net capital inflows in the form of private direct foreign investment. For the period 1966-1971 net private capital flows exceeded the current account deficit by almost 9 per cent.<sup>8</sup> This surplus together with modest official capital flows, official flows being on average 7 per cent of private flows, together created a substantial increase in the reserves.

In 1970 GDP grew by 7.7 per cent, the public sector deficit stood at 3 per cent of GDP, the deficit on external current account was 11 per cent. The external debt burden was quite manageable since the public debt was less than 16 per cent of GDP and debt service represented less than 3 per cent of exports of goods and services.

For the first three years of the 1970s the growth performance of the previous decade continued though at a reduced rate averaging 5 per cent; but by 1973 the impact of domestic and external factors had caused a change in previous trends. On the domestic front public expenditures expanded rapidly, in an attempt to deal simultaneously with issues of equity, to expand public sector activities, and to consolidate public ownership of the main income generating sectors. Accordingly, the overall public sector deficit began a long and steady growth averaging 46 per cent per annum between the fiscal years 1971/72 and 1973/74. At the same time the effects of the first oil shock were about to be felt. In 1973 alone, the external debt, reflecting these facts, but mainly due to the rapid growth in the fiscal deficit, grew by 129 per cent jumping from 8-18 per cent of GDP.

Between 1974-1975 the full force of the oil price increases impacted upon the import bill, expenditure for fuels increasing by 195 per cent between 1973-1975. The importance of the impact is shown by the fact that 28 per cent of merchandise exports was now needed to pay for oil compared to less than 15 per cent in 1972. By the end of 1975 the growth of export earnings which had hitherto been buoyant slowed down to 6 per cent, output of the manufacturing sector peaking in 1973, and bauxite/alumina in 1974.

In 1975 GDP declined for the second consecutive year, the fiscal deficit had grown to 8 per cent of GDP, but because of still buoyant export earnings the current deficit of the balance of payments was reduced to under 10 per cent. A window of opportunity existed after the first oil shock which would have permitted difficult but manageable adjustment by the end of 1975, had not the fiscal deficit run out of control. A large portion of this deficit went into public ownership.

In 1976 a number of adverse developments, both domestic and external, came together to cause the collapse of the economy; export prices fell; output fell for sugar, bananas and alumina; and tourism receipts which had been declining steadily from 1972, fell by 38 per cent over the previous year. As a consequence of this conjuncture of events, export earnings as a whole declined by 15 per cent. Reflecting the decline in the economy, current revenues declined by 8 per cent in fiscal year 1976/1977 although current expenditures continued to grow by 26 per cent. For the first time there was a current account deficit, and in an effort to stimulate activity in the economy, capital expenditure also increased by 10 per cent. The overall fiscal deficit in fact more than doubled in 1976 representing 15.5 per cent of GDP.

By 1977 the Jamaican economy was sufficiently in disequilibrium to warrant a serious effort to readjust. The assumptions on which past policies had been predicated, and particularly the expectation of continued strong export earnings, had not been realized and the economy continued in recession. Foreign commercial banks had suspended lending and social programmes continued to place heavy demands upon the budget.

Accordingly between 1977 and early 1980 Jamaican economic policy operated in close relationship with the International Monetary Fund. Measures to bring the economy once more into equilibrium were taken, and included a curb on public expenditures, restrictions on monetary expansion and a devaluation of the currency. Not surprisingly in the light of these policy measures, GDP contracted throughout the period. Yet imports, which contracted sharply in 1977, continued to grow faster than exports thereafter. Public spending despite reductions in the capital account continued to grow on average of almost 17 per cent per annum between 1977 and 1980.



While external capital flows resumed with the onset of Fund programmes, domestic investor confidence had been sufficiently eroded for local capital flight, estimated at US\$246 million in 1978, to nullify such inflows, which were US\$176.5 million.<sup>9</sup> For the first time Jamaica had a net outflow of private capital. The phenomenon of capital flight was in this case fuelled by low investor confidence, negative real interest rates and a perception that despite a large devaluation the currency was still overvalued, given the underlying economic performance. This capital flight was to continue until 1983.

At the end of 1977 external debt stood at U.S.\$926.2 million, or 28 per cent of GDP, and the debt service ratio at 14.5 per cent. By 1980 the debt had grown to US\$ 1.7 billion, equivalent to 65 per cent of GDP and the debt service ratio had increased to 24 per cent, if interest accruals are included.

Over the 1970s GDP began its decline from 1974, averaging a contraction of 3.2 per cent per annum for the rest of the decade. The fiscal deficit which was 3 per cent of GDP in 1970 widened to 8 per cent in 1974 and further to 21 per cent by 1980. The

balance of payments current account which was in deficit to the tune of 11 per cent of GDP in 1970 remained under 10 per cent by 1975 because of buoyant export earnings. By 1980, however, this deficit had fallen to 6 per cent of GDP as exports expanded somewhat, but mainly because of severe import compression. There was however significant pent up demand for imports as public expenditures remained strong. The external debt by now had grown from 29 per cent of GDP in mid-decade to 65 per cent by 1980.

During the period economic policy was subject to much national debate. This was because IMF policies were not achieving a consensus within the administration and were abandoned by early 1980. The adjustment process was therefore hampered by policy inconsistency and uncertainty, a factor which also contributed to capital flight, which continued albeit at a reduced rate in 1980 in spite of an expected change of government. Accordingly, the unsettled domestic economic climate further contributed to the growth of the debt since it had to be incurred not only to finance current transactions but also to compensate for capital flight.

## ADJUSTMENT POLICIES IN THE 1980s

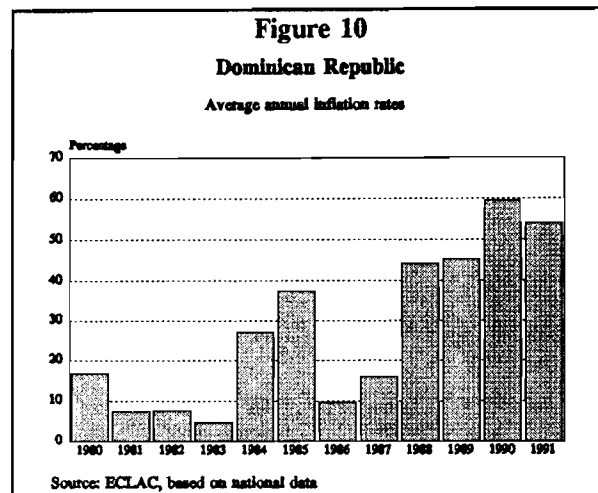
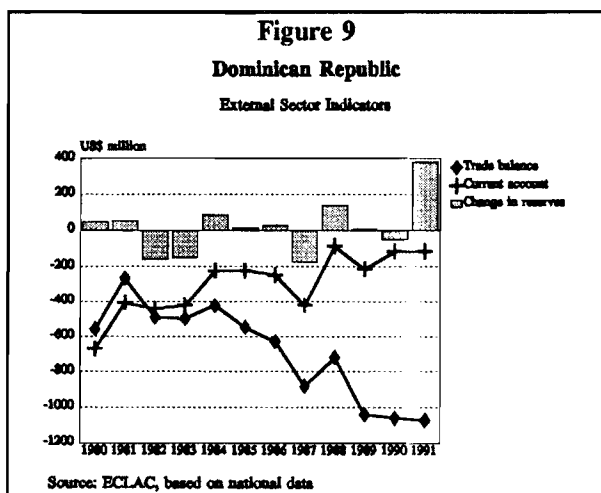
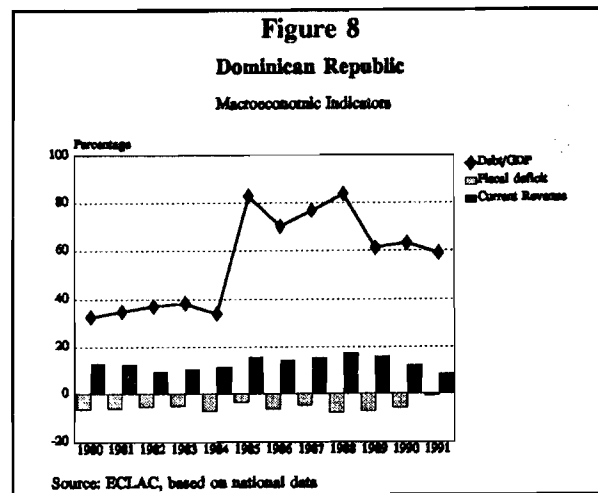
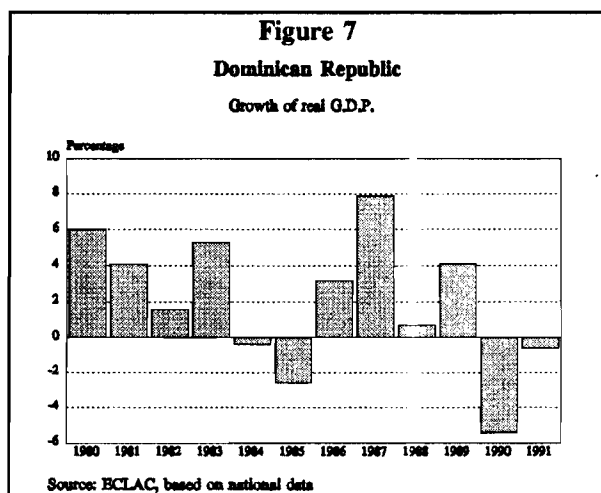
The 1980s was generally regarded to be a lost decade for many Caribbean countries as they became bogged down in the process of readjusting their economies to face the changed circumstances of the 1980s. All of the four countries chosen as case studies were minerals exporters as they were most severely

affected by these changes. Three of them, the bauxite producers were already in severe disequilibrium at the beginning of the decade, while the fourth, Trinidad and Tobago, the sole exporter of petrochemicals, suffered the shock of collapsing oil prices and went into disequilibrium soon thereafter.

### The Dominican Republic

The Dominican Republic entered the 1980s

developed countries and consequent reduced demand



facing a number of adverse external developments. Terms of trade shocks were due to volatile sugar and minerals export prices, the former reaching a sharp peak in 1981, and oil price increases which caused the import bill for this commodity to increase 10-fold between 1973-1980. There was also a deterioration in exports, the volume index declining by 20 per cent between 1978-1982, due to the recession in the

for sugar, bauxite and ferro-nickel. The third element of the external deterioration was due to increasing global interest rates, which tripled the cost of debt service between 1978-1982. At the same time, domestic performance in manufactures began to decline and fiscal revenues began to contract.

Underlying all these factors was the secular decline of sugar. This is demonstrated by the fact that sugar averaged 50 per cent of merchandise exports for the period 1969-1971, 34 per cent between 1979-81, but only 18 per cent for 1989-90. The adjustment task faced by the Dominican Republic narrowed itself essentially to finding export earnings to substitute for declining sugar receipts and to establishing a reorientation of the fiscal accounts, severely burdened by inefficient public sector enterprises.

An adequate domestic policy response was not forthcoming in the 1980s, although greater progress was made in the theoretically more difficult task of finding export alternatives to sugar, than on establishing fiscal balance. Accordingly, once the determination was made to adjust the fiscal side, in 1990, the goal was achieved fairly rapidly. Macroeconomic policy passed through three phases, which began in 1982, 1985, and 1990. In the first phase, faltering attempts were made to adjust the economy, but this resulted in stagnation in 1984 and fairly severe economic contraction in 1985. Attempts were made thereafter to stimulate the economy as early as 1985. Following a change of government, while much of the external sector policies remained, the emphasis of fiscal policy was placed more firmly on stimulating economic activity, mainly through construction activities. This was intended to reactivate economic growth, and managed to do so in 1986 and 1987, but at a cost of widening the external deficit, postponing the fiscal adjustment and increasing the rate of inflation. Thereafter, growth contracted, the external deficit resulting in currency depreciation which in turn fuelled inflation which increased on average by over 50 per cent per annum between 1988-1991. In May 1990, the New Economic Policy (NEP) was initiated, with the objectives of reducing inflation, returning to growth, eliminating the deficit, unifying the exchange rate and initiating a number of policy reforms. By 1992 most of the objectives had been met, in so far as stabilization was concerned and growth returned, although the challenge of maintaining stable growth over the medium term remained.

#### Uncertain adjustment

As was outlined in the introduction, fairly high rates of growth were achieved in the period 1981 to 1983, but this was achieved at high cost in terms of the external account, the reserves and the debt. Such growth was unsustainable so that with the onset of adjustment the economy lost some of the headway

made in earlier years, contracting in 1984-1985. Adverse consequences were most evident in the fiscal and external accounts.

On the fiscal side the causes were twofold. Tax revenues stagnated between 1979-1982. While the central government deficit averaged about 2.5 per cent of GDP from 1980-1983, the overall public sector deficit, which included transfers to a number of loss-making public enterprises, averaged about 5.7 per cent of GDP over the same period.

Between 1978-1980 the current deficit on the balance of payments doubled, resting at 10 per cent of G.D.P. by 1980. This was due in large part to the fuel bill, which accounted for US\$270 m. of the increase and represented an increase from 22 per cent of merchandise imports to 30 per cent by 1980. Although some action was taken to compress imports thereafter, the reduced level of imports was insufficient to safeguard against significantly increased external debt, the official component of which grew by 170 per cent between 1979-1982. Reserves were rapidly depleted after 1977, when they stood at about US\$1 m., to US\$ -391 million in 1981.

Adjustment efforts in the Dominican Republic began in the second half of 1982, only when the nation's creditworthiness had been eroded, so that new funds to finance the domestic and foreign deficits were difficult to obtain. Accordingly, the measures finally adopted needed to be quite stringent and to focus on containing the short-term crisis. The stabilization programme, negotiated in conjunction with the IMF and begun in 1983, focused on the containment of public expenditures, liberalization of the foreign exchange regime and included some debt rescheduling. It was implemented in the face of much public debate and had to be renegotiated some months later.

In the first year of the programme scant progress was achieved in reducing the fiscal or external deficits, although current revenue increased as a proportion of GDP and growth resumed after a weak performance in 1982. Efforts were redoubled in early 1984, all products except petroleum being subject to the parallel exchange rate and even that was included by mid-year. Nevertheless, some impact was being made on the external account. From 1980 the deficit on current account began to contract primarily due to the compression of imports, essentially consumer goods, so that by 1984 fuel imports constituted 40 per cent of the (contracted) imports.

### Adjustment with growth?

After further policy uncertainty in 1984 a new adjustment programme was initiated in January 1985, which emphasized a realignment of exchange rates, deflation of the economy and refinancing of the debt. There was, however, a large measure of inconsistency in the programme which sought to compensate for weak external performance with an expansionary fiscal policy. It was expected that this would be financed by increased fiscal revenues so that deficits could be contained. The reality was that although central government deficits were contained, the overall deficits increased because of weak public enterprises.

In the first year, 1985, these policies took effect in conjunction with a decline in the price of the main exports, severe drought and political uncertainty in the lead-up to a general election, due in the following year. The outcome was that there was a sharp decline in GDP, and a widening of the deficit on external current account. The fiscal stimulus was unable to halt the economic decline in that year, but managed to erode much of the progress achieved in reducing the fiscal deficit of the central government.

Growth was resumed in 1986 due to the lagged effects of the 1985 stimulus, and was driven for the rest of the decade by continued public investment, capital expenditure growing fivefold by the end of the decade. While a small surplus was achieved on central government account by 1989 despite this massive spending programme, the consolidated fiscal deficit remained in excess of 7 per cent of GDP by the end of the decade because of the parlous state of the public enterprises.

For the period 1986-1989 the merchandise deficit grew steadily, merchandise earnings fluctuating between US\$700-900 m. over the decade, while imports grew steadily between 1986-1989. The most notable trend in the balance of payments was, however, to be seen in services earnings. The latter reflected the underlying adjustment of the economy away from sole dependence on sugar toward free-zones and tourism, moving the services account rapidly into surplus for the first time in 1986, a surplus which was to grow rapidly and unbroken until the present. By the end of 1991 earnings from services were almost double the earnings derived from trade. Despite this sterling performance on the services side, the external deficit on current account averaged somewhat over 4 per cent of GDP for the period 1986-1989, with a peak of 8.3 per cent in

1987, no doubt reflecting the huge fiscal stimulus in 1987.

The external performance had its consequences in an erosion of the exchange rate, which was nominally market determined after 1985 and moved from an average of 2.9 in 1986 to 6.34 in 1989. Yet the exchange regime had been capriciously modified by decree to change from a free float to fixed rates at times multiple rates. In effect the official rates were not credible, with the parallel rate 45 per cent higher than the official rate by the end of 1989-early 1990. The external debt increased by 14 per cent. Another notable indicator related to debt service, which grew by 36 per cent between 1985-1986, and caused a shift in policy by the incoming government to suspend debt servicing for the remainder of the decade. Accordingly, arrears accumulated which amounted to US\$520 m. by end 1990, which would ultimately restrict access to new sources of credit. Prices rose rapidly from single digit inflation in 1986 to average a median annual variation of over 35 per cent for the following three years and a variation of over 100 per cent between December of 1989 and December of 1990.

The phase of adjustment with growth did not achieve much adjustment and the goal of growth, to which all other policy elements were sacrificed, became unsustainable after 1989. Some success was achieved in increasing revenues which had declined steadily since 1980. By 1982 current revenues had reached a low of 9.4 per cent of GDP but the proportion increased to over 17 per cent by 1988, although it has declined since. While criticism might be levelled at the composition of current and capital expenditure, since much of the construction was in non-productive projects, the overall quantum of expenditure, as expended at the central government level, did not create significant strain on the economy. Enormous transfers had to be made to non-viable public enterprises, however, so that the public finances deteriorated progressively.

In an effort to control the effect of fiscal permissiveness on the external accounts, the exchange rate regime tended to be unpredictable and inconsistent and a number of administrative controls were invoked on external trade. Price controls were also used to try to control the inflationary effects of the deficit, but this was doomed to fail and inevitably resulted in shortages. Investment in productive capacity fell, capital flight increased and the efficiency of such investment as took place, continued to decline because of the unpredictable

and distorting effects of a number of the policy instruments, including selective interest rates. Accordingly, the economy lost the opportunity to equilibrate itself and move to the next stage of rebuilding social and economic infrastructure and expanding productive capacity.

### The New Economic Policy

In the face of a severe economic crisis and after general elections a New Economic Policy was proclaimed in May 1990, underpinned by an economic solidarity pact between labour and business and which included a labour code. Where growth was given primacy in the past the new policy, which formed the platform of the incumbent party, now placed adjustment in the ascendency. The policy focused on the following elements:

- Balanced fiscal policy;
- Single market determined exchange rate;
- Market determined interest rates, with minimal administrative controls to the financial system;
- Policy reform, to relate to taxation, international trade, public administration and foreign investment, labour relations and industrial restructuring.

While it is still too soon to see the full effect of policy reforms, some progress has been made relating to the short-term indicators. The immediate economic emergency of 1990 seemed to be contained. Product which collapsed by over 5 per cent in 1990 was contained to a decline of 0.5 per cent in 1991 and growth, estimated to be nearly 7 per cent, resumed in 1992. End year price changes which were over 100 per cent in 1990, were contained to 4 per cent in 1991 and 1992. The overall fiscal deficit which was almost 6 per cent in 1990 was reduced to less than 1 per cent in 1991.

External sector performance improved, thanks mainly to private capital inflows, consequent on more credible exchange and interest rate policies. After being moved progressively from 6.3 in early 1990 the parallel and official rates were unified at 12.9 in June 1991 and were subsequently market determined. Since then the rate has stabilized at 12.8 (August 1992). Current capital outflows of US\$300 m. in 1990 were replaced by inflows of over US\$250 m. in 1991. Debt

relief of over US\$800 m. allowed a repayment of most of the arrears outstanding and a rebuilding of reserves of US\$380 m. The merchandise trade deficit widened slightly, however, since the sources of merchandise earnings, which needed a structural transformation, were unlikely to recover substantially in the short term. Services earnings including exports from free-zones, however, continued to grow and are expected to constitute the mainstay of earnings growth for the short to medium term.

Longer-term reform of taxation policy is designed to make it more equitable, resilient and stable. Subsidies have for the most part been removed, from commodities to the public and from public enterprises. The objectives of the new fiscal code are to make it internally consistent, to update the fiscal administration to increase its efficiency, to implement measures for permanently updating the real values of revenues, to increase the fiscal burden to make it more compatible with the level of development of the country, to protect wage earners in times of high inflation and to simplify the system so as to achieve a more equitable and transparent code and one that could be more efficiently collected.

A major element of tax reform policy, but one also having significant influence upon the longer term direction of the production structure, relates to tariff reform. Trade taxes have been simplified and increased, export taxes have been eliminated. The reform has consolidated the tariff schedule into seven ad-valorem import tax rates, from the previous 140, falling within a range of between 5-35 per cent. The market exchange rate will be used for valuation. The new schedule allows for a four year transitional period, during which the average nominal tariff rate will fall from 90 per cent to 20 per cent, if completion is achieved on schedule.

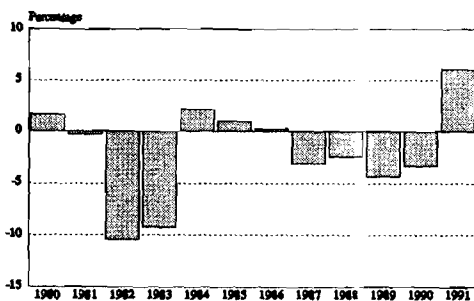
This new regime represents a significant simplification from one which suffered from the burden of 27 separate laws regulating imports. Previously there were three fixed exchange rates, applied to five different combinations of specific and ad-valorem taxes, making 15 different ways to impose duties. The new tariff is expected to improve the competitiveness of industry, to streamline the administrative arrangements surrounding international trade and make the new regulations less amenable to arbitrary interpretation.

## Guyana

Figure 11

## Guyana

Growth of real G.D.P.

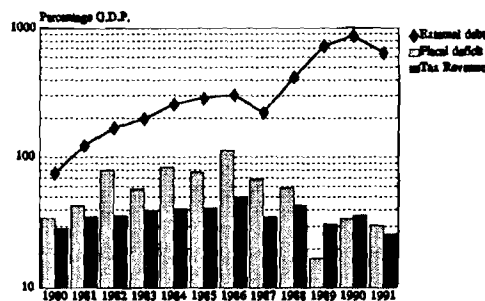


Source: ECLAC, based on national data

Figure 12

## Guyana

Macroeconomic Indicators

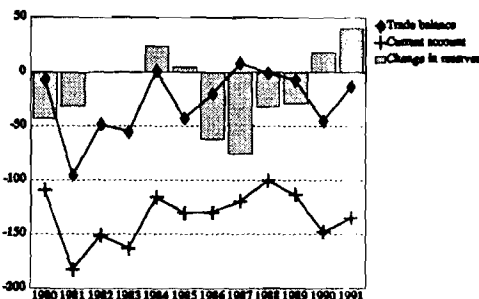


Source: ECLAC, based on national data

Figure 13

## Guyana

External Sector Indicators

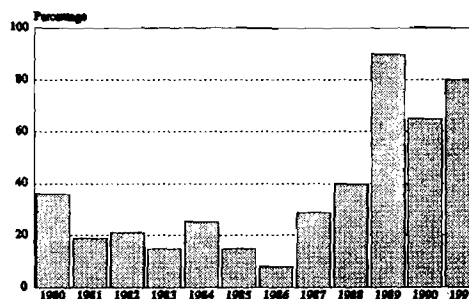


Source: ECLAC, based on national data

Figure 14

## Guyana

Average annual inflation rates



Source: ECLAC, based on national data

Guyana provides an example of an economy in which disequilibrium was allowed to increase over an extended period without appropriate adjustment policies being taken. The result was a steady haemorrhage of resources away from the formal economy, either abroad in the case of capital or skills, or into the informal parallel market where skills, capital and goods were diverted. The State is estimated to have controlled 80 per cent of the formal economy in 1980. This transfer of resources was therefore an unwitting transfer from the State sector to private actors who, because of the regulatory framework which favoured the State sector, had to operate outside of the formal economy in order to survive. The transfer was sufficient to lead some analysts to estimate that before remedial measures began, the informal economy had grown to enormous proportions, most believing that it exceeded the formal one in size.

At the start of the 1980s the Guyanese economy was already in severe disequilibrium. This is demonstrated by the fact that for the period 1979-1981 the external current deficit averaged over 20 per cent of GDP and the fiscal deficit averaged one third of GDP. In both cases the deficit was increasing rapidly. In 1980 the external debt was already three quarters of GDP.

The Guyanese policy environment and its relationship to adjustment may be understood if the survey period is seen to represent two distinct phases, the first from 1980-1987 and the second phase from 1988 to the present. In the first phase scant effort was made to adjust the economy in any consistent fashion. This phase will be characterised as "Disequilibrium Ignored". Initially the economy contracted severely between 1981-1983, as a result of internal and external

shocks. Slow growth was resumed for the period 1984-1986, as the adverse external environment improved. The initial growth impulse received in 1984 weakened progressively to 1986, however, and by 1987 the economy began to contract once more.

The second phase which began in 1988 will be characterised as one of "Committed Adjustment", when a comprehensive adjustment programme with integrated and complementary policies was finally adopted. This set of policies was implemented in conjunction with financing programmes from the World Bank and International Monetary Fund. Given the size of the disequilibrium which existed at this time and the magnitude of the policy changes necessary, it is not surprising that the period 1988-1990 witnessed great economic instability and further economic contraction, although strong growth was resumed in 1991 and sustained in 1992 as the policies seemed to take effect.

#### Disequilibrium ignored

For the three years 1981-1983 GDP declined, the most significant fall being recorded for the years 1982-1983 which averaged -9.8 per cent. This severe economic contraction was attributable to a decline in export earnings for Guyana's main exports, bauxite, sugar and rice as a result of intractable technical, financial and organizational problems in the industries. Poor weather further affected sugar and rice yields. At the same time earnings were affected by weak external demand and the consequent falling prices. These developments precipitated a devaluation in mid-1981, although the external current account continued to widen, averaging almost 32 per cent of product for the years 1982-1983.

During this period, public finances continued to deteriorate since expenditures continued to rise, while revenues reflecting poor economic performance declined. Most significantly, however, public corporations which had previously contributed to the current account now required public subsidies, necessitating increased borrowing. The fiscal deficit as a result averaged nearly 70 per cent of product over the three-year period.

Between 1980 and 1983 the external public debt more than doubled. If this was taken in conjunction with the severe contraction of GDP, the debt increased in proportion to product from 76 per cent in 1980 to the considerably larger proportion of 197 per cent by 1983.

The composition of the debt had by this time also changed, new inflows coming mainly from bilateral and multilateral financial institutions such as the IMF, IDB, and the World Bank, in their attempts to assist the government to stabilize and adjust the economy. In fact bilateral debt peaked in 1980, to decline slowly thereafter. Multilateral debt had grown slowly but steadily from 1977 and was to surpass bilateral debt after 1985.

Public sector enterprises made severe demands on new funds, foreign financing being needed by some domestic enterprises not having the capability to repay in foreign exchange. Accordingly commercial debt was to increase steadily until 1980 tapering off slowly thereafter as no new money was forthcoming. By 1980 reserves had become negative, by almost US\$185 m. and by 1981 the system had begun to accumulate arrears in the servicing of the debt. In 1982 it became necessary to engage in a further rescheduling exercise. Moreover it was now becoming increasingly difficult to obtain new external financing since arrears were accumulating at an increasing rate, US\$34 m. in 1981, US\$126 m. in 1982, to US\$270 m. in 1983.

For the years 1984 to 1986 the economy resumed moderate growth averaging just over 1 per cent but initial growth of over 2 per cent in 1984 was never surpassed as the economy lost momentum thereafter. Export earnings recovered from the nadir of 1983 and stabilized for the following three years at a figure marginally higher, mainly as a result of recovering earnings from the bauxite subsector up to 1985, with sugar increases compensating in 1986. The exchange rate was adjusted twice in 1984. On the second occasion the parity was linked to a basket of five major currencies. While there was a slow erosion of the currency thereafter, changes were still subject to administrative control and were insufficient to bring the external account into balance, given the fiscal policies being pursued. Nevertheless, the current deficit on external account narrowed slightly, to 27 per cent of product, compared with a deficit averaging 32 per cent for the previous three years. Overall public sector fiscal deficits continued to grow, averaging 91 per cent of product for the three-year period, owing mainly to the unresolved problems of the public sector enterprises.

The period is characterized by a modest increase in the actual inflows of new debt, which recorded 2 per cent growth between the end of 1983 to 1986, due mainly to an inability to secure new loans.

Increases, such as they were, came mainly from multilateral sources. Debt arrears had continued to mount rapidly, reflecting the inability of the economy to meet outstanding obligations. In 1983 the country was able to meet almost one half of its debt servicing costs, but by 1986 this capacity was reduced to only 16.5 per cent of scheduled debt repayments. If the accumulated arrears are included, however, the debt continued to mount steeply moving from under 200 per cent of product in 1983 to over 300 per cent of product by the end of 1986. Owing to the unavailability of external funds government deficits were increasingly covered by local borrowing after 1982 which had the effect of stifling any attempts by the private sector to raise funds on the formal capital markets.

By the end of 1986 the Guyanese economy was in a state of torpor, with growth in that year barely positive. The enormous debt problem had serious negative effects on Guyana's economy. The country was unable to obtain new financing for investment or even for suppliers' credits to finance normal trade transactions. Consequent cash flow problems forced the use of cash to finance current transactions, or where this was not available in sufficient quantities, to resort to counter trade. More significantly, individuals resorted to informal measures in order to survive and a significant portion of the economy was no longer subject to formal regulation or even accounting. For the longer term, the need to operate on a day to day basis, distracted policy attention from the need to take the fundamental longer term structural and organizational measures needed to reincorporate and resuscitate the economy.

Performance in 1987 was mixed, for while the growth impulse of the previous period had ended and product fell by over 3 per cent, a number of other indicators began to improve since both the fiscal and external deficits contracted. Export performance improved for all the traditional staples, owing to a propitious external environment and favourable climatic conditions while imports remained stable. Fiscal performance also showed some consequent improvement as revenues improved and capital spending was curtailed. Current expenditure remained out of control, however, and while government demonstrated some willingness to begin adjustment success would only be achieved with more stringent and coordinated measures.

## Committed adjustment

By the middle of 1988 Guyana embraced new economic policies which emphasised deregulation and departed substantially from the near command economy pursued since Independence. These policies, which received the support of the international financial institutions, held out the prospect not only of putting the economy on a viable footing but also of some forgiveness of the huge debt and renewed external capital flows to assist economic recovery. Once announced, in the first quarter of 1989, the policies were implemented with despatch.

Prices were decontrolled, initially with food and consumer items in 1988, so that only sugar remains controlled. Trade was substantially liberalized, tariffs coming into line with other CARICOM countries which were themselves in the process of progressively reducing their Common External Tariff. Import prohibitions on food and other items were rescinded.

The trade in foreign currency was liberalized, initially by establishing a dual system, of private originally parallel market dealers or cambios operating in conjunction with the banks. While the banks operated a fixed administered rate, the private dealers continued to operate market determined rates. Gradually various categories of transactions were transferred formally to the cambios and the official rate moved to converge with the cambio rate, until both rates were unified in 1991. Since September 1991 the single official exchange rate has been fully responsive to market forces in a free float. While the depreciation needed was steep and created inflationary pressures, the process was a relatively orderly one.

With respect to the productive sectors, which were substantially State owned, the eventual goal of full privatization was enunciated with many state enterprises slated to be sold, closed or leased. In the interim, some of the larger operations, such as the bauxite and sugar industries, were to be rationalized and made more efficient prior to their divestment.

Policies intended to reduce the fiscal deficit and make the budget more robust were put into place. Revenues were increased by new tax measures, the elimination of a number of tax exemptions and by recouping the real cost of utilities such as electricity,



which increased by a factor of four in real terms between 1989-1991. A one time tax was levied on commercial banks to capture some of the windfall gains accruing to them as a result of currency depreciation. A more comprehensive tax reform programme was also being prepared for implementation in 1992. Recurrent expenses were cut by reducing the number of government ministries from 18 to 11 and a number of posts eliminated. Wage guidelines for public officials limited salary increases to a ceiling of 20 per cent. Capital spending remained modest, given the parlous state of the economy, but were refocused on rehabilitating the depreciating infrastructure.

Monetary policy was modified to better reflect market forces. Competitive bids for treasury bills were initiated in 1991 and provided the Central Bank with information for setting the bank rate. Banks were subsequently allowed to set competitive interest rates and discriminatory credit policies were abandoned.

It took some time for these far reaching policies to bear fruit. Social and economic dislocations and unfavourable weather conditions worked together to postpone economic growth, and product fell in the years 1989-1990. Strikes and work stoppages reduced output in the traditional export sectors. Power outages also adversely affected production. In the first phases of currency realignment the traditional export sectors were also disadvantaged, since they remained on the old fixed exchange rate which lagged behind the cambios, to which the non-traditionals were linked and from which they reaped commensurate benefits. Flooding in 1990 impeded sugar and rice production and inundated the mines. Both fiscal and balance of payments indicators accordingly deteriorated during this period. Fiscal performance was adversely affected by the poor performance of the traditional export sectors sugar and bauxite, which were State enterprises so affecting the public sector performance directly. Consumer prices increased sharply owing to the removal of subsidies and the effects of currency depreciation.

With the major elements of the reform programme in place by 1991 growth resumed and was sustained into 1992, despite the country having to face a turbulent election and a change of government for the first time since Independence in 1966. Growth exceeded 6 per cent in 1991 and is estimated to have exceed 7 per cent in 1992. Growth was led by improved export performance, notably due to increased agricultural output. Rice exports were stimulated by

price deregulation and sugar benefited from industry rationalization and reinvestment. Performance in the mining sector was mixed, with poor bauxite/alumina performance, though in both years gold and diamond output increased dramatically, as official prices more accurately reflected those of the free market. In part this increase reflected the reincorporation of gold and diamonds into the formal economy.

The trade deficit was accordingly reduced in 1991 as exports increased faster than imports. Increased interest payments on the external debt had their effect on the current account which only fell marginally from the previous year. Capital flows from multilateral agencies as well as some debt relief and inflows consequent on the divestment of some public enterprises allowed the replenishment of reserves. The external debt fell slightly.

The fiscal deficit fell in relation to product from the previous year, mainly as a result of improved performance by the public enterprises which achieved a surplus. Current revenue exceeded targets because of better tax administration, although debt servicing costs eroded the gains that had been made elsewhere on the current expenditure budget. Capital expenditure was constrained by the shortage of counterpart funding and limited to urgent infrastructure repair. Inflation remained high in 1991, with an average growth of 80 per cent, although the rate of growth moderated in the second half of the year. This cooling off was sustained in 1992 as price increases averaged 15 per cent for the year.

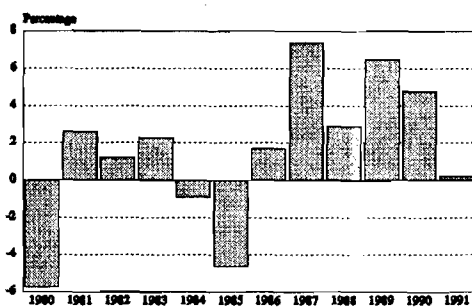
This phase of the adjustment programme has shown remarkable progress in a short time, yet serious problems remain. The short-term indicators are being brought into balance but the debt remains to complicate the task of adjustment. A number of policies has been initiated to encourage export performance, notably the revised foreign exchange regime, the deregulation of prices and the programme of rationalization and divestment of the main public sector enterprises. The debt complicates the fiscal programme and the resumption of repayments has minimised the progress made in establishing fiscal balance. Yet debt forgiveness, which has started, seems to be the only way to enable the economy to regain a firm foundation. A backlog of public works focusing on basic infrastructure needs to be reduced to stimulate economic expansion. A number of social programmes have also deteriorated which unless fixed will further limit the quality of life and human performance.

## Jamaica

Figure 15

## Jamaica

Growth of real G.D.P.

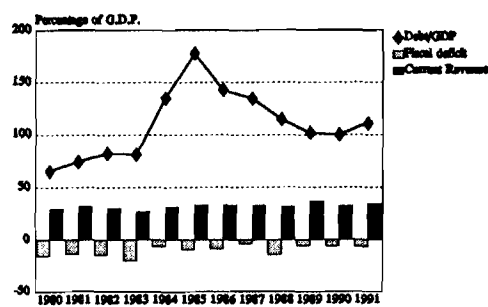


Source: BCLAC, based on national data

Figure 16

## Jamaica

Macroeconomic Indicators

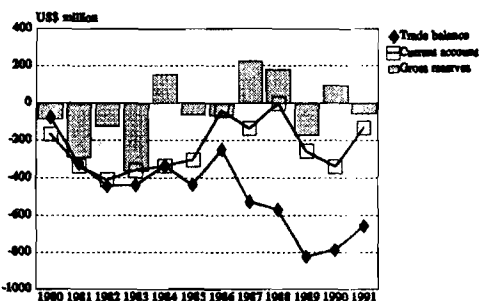


Source: BCLAC, based on national data

Figure 17

## Jamaica

External Sector Indicators

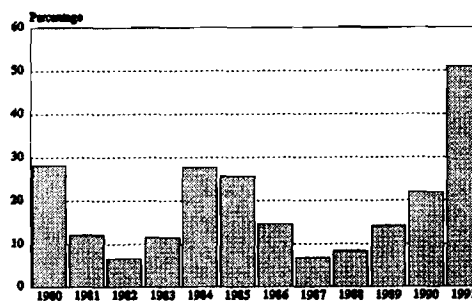


Source: BCLAC, based on national data

Figure 18

## Jamaica

Average annual inflation rates



Source: BCLAC, based on national data

Jamaica commenced the 1980s with an economy in severe disequilibrium. This is illustrated by some basic indicators for the years 1979-1980 inclusive where the economy contracted on average by 3.8 per cent, the external current account was in deficit equivalent to over 6 per cent of product and the fiscal deficit averaged 14 per cent of product. The external debt averaged 57 per cent of GDP or 115 per cent of exports of goods and services. In all cases the indicators were deteriorating from 1979.

Despite the stated commitment of a new administration to its correction, the decade was spent in trying to meet that objective and the effort continues into the decade of the 1990s. In the first five years the major economic indicators actually worsened, under a failed attempt to adjust through economic expansion.

During this period global developments were not favourable and most notably a precipitous decline in bauxite/alumina earnings served to complicate the adjustment task. Some adjustment was evident from 1986 to the end of 1988, but it was faltering and finally derailed by hurricane damage in the third quarter of that year. The hurricane, which was the most serious natural disaster in over 100 years, destroyed not only the major sources of wealth generation but required a reversal of the painfully achieved trend toward reduced government fiscal deficits. Nineteen eighty-nine saw a new administration committed to rigorous adjustment and a policy of deregulation, the latter chosen perhaps in order to remove many of the policy elements from capricious control. But by the end of the survey period it became evident that even a deregulated economy required careful and consistent economic policies.

### Adjustment with growth?

By 1981 domestic economic policies in Jamaica had changed, with the advent of a new administration. Negotiations had been reopened with the IMF and a new Extended Fund Facility was agreed. Based on the premise that the period 1974-1980 had witnessed a cumulative decline of 16 per cent in GDP and a reduction in the capital stock, the new programme placed heavy reliance on external savings to resuscitate the economy. In fact, given the political climate in which these new policies were adopted, such bilateral inflows were to be forthcoming and perhaps provided the mistaken impression that they could on their own, provide sufficient impulses to pull the fiscal and external accounts into equilibrium.

Within this context, the adjustment programme in 1981 was intended to orient the economy towards export promotion rather than import substitution, and a new trade regime was adopted to reduce the anti-export bias of the economy. While the exchange rate was to be a part of this package its use was delayed until 1983 and even then its use was tentative, an error of judgement which was made tenable in part because of strong bilateral capital inflows. The programme also had the objective of balancing the fiscal account. A multi-year public investment programme was prepared so as to provide a broad overview of all public sector activities, to make their operations more transparent, controllable and responsive to the aims of the structural adjustment programme. In line with the declaration that government would provide a facilitating rather than direct role for the productive sector, a number of the existing public sector enterprises were to be closed, others earmarked for divestment to the private sector and the remainder to be put on a viable footing.

Moderate economic growth, averaging about 2 per cent per annum, was achieved between 1981-1983. This compares with a contraction averaging about 2.7 per cent for the previous three-year period. This growth which was due to aforementioned external capital flows was, however, achieved at the price of a rapid increase in the external debt, which grew on average by 19 per cent per annum between 1980-1983. Capital flight which had moderated between 1980-1982 was resurgent by 1983, reflecting once more doubts about economic policy. Export earnings had also contracted after 1981, due to declines in traditional agricultural exports, but especially in the alumina and

bauxite sectors, hit by reduced global demand. The merchandise trade deficit accordingly increased significantly between 1980-1983 and in the light of the increasing debt so did the external debt which was over 80 per cent of GDP or 239 per cent of exports of goods and services in 1983. This decline was recorded in spite of a resurgent tourism industry.

By October 1983 the Extended Fund Facility which was due for completion by March 1985 had to be abandoned due to an inability to meet the planned targets. The fiscal deficit then stood at 20 per cent of GDP as compared to the target of 10.5 per cent, and the Balance of Payments deficit was US\$362 million compared with a targeted surplus of US\$125 million. A major factor in the non-compliance with targets was exogenously derived, an unanticipated decline in bauxite/alumina earnings, upon which the economy and all the targets had been dependent for viability. Had these remained the same as in 1981 near balance would have been achieved on current account.

### Orthodox adjustment

After 1984 a new emphasis was placed on adjusting the economy and managing the growing external debt. This new policy was spearheaded by a one-year Standby Arrangement with the International Monetary Fund which commenced in April 1984. It aimed to recover the time lost in implementing structural adjustment over the previous two years. At the same time and in recognition of the increasing debt burden the emphasis which had been placed in the past on capital inflows as the engine of growth was abandoned and autonomous means would need to be found to stimulate domestic growth. Specific targets were set in the agreement in relation to reducing the central government deficit, achieving an overall balance of payments surplus and reducing the rate of credit creation.

In support of these measures attention was given to exchange rate policy in an attempt to improve export competitiveness and reduce the degree of policy uncertainty in the economy. A floating band arrangement had been instituted in November 1983, at which time the dual rate was unified and the official rate moved from J\$1.78 per US\$ to \$4.3. During the period November 1993-1994 the rate fluctuated between 4.0 - 4.3 per US dollar. In November 1984 a free float was instituted and the rate depreciated to J\$ 6.1. The mechanism of floating together with various

modifications, in effect a managed float, was to continue until 1989 during which time the rate appreciated and was stabilized at J\$5.5.

For the period 1984-1988 the external environment was propitious for Jamaica. Global growth resumed and with it global demand, oil prices fell and the bauxite alumina industry gained a fillip from the combined effects of both factors. Domestic interest rates were moved to positive levels and net private capital inflows resumed. This combination of external circumstances and domestic policies ensured that by 1988 the external current account had substantially achieved balance, compared to a deficit of 15 per cent of product in 1985.

Some progress was also made on the fiscal account, bearing in mind the complicating effect of the growing debt burden, itself exacerbated by high international interest rates. A fiscal deficit equivalent to 20 per cent of product in 1983 declined to just over 6.5 per cent on average for the years 1984-1987, before mushrooming to 14 per cent under the burden of repairing hurricane damage in 1988. Accordingly, the rate of growth of the debt moderated to an average growth of less than 7 per cent per annum for the years 1984-1988, a marked contrast to the average of 19 per cent per annum, in the preceding three-year period between 1980-1983. By the end of 1988 the debt had moderated, from a high of 178 per cent of product in 1985, to about 115 per cent of GDP and 178 per cent of exports. Despite this adjustment, after a period of contraction in 1985-1986, growth resumed in 1987 and has been sustained until 1992.

#### Adjustment with accelerating liberalization

What had been a slow though steady process of adjustment was cut short by a sharp shock to the economy in the form of hurricane Gilbert, which struck the island in the third quarter of 1988. Damage to housing was enormous, affecting 55 per cent of housing stock. In the eastern portion of the island 20 per cent of houses were totally destroyed. Infrastructure, mainly electricity, water and roads, was also badly damaged and productive activities were severely disrupted. In agriculture the banana industry was almost wiped out and other tree crops severely damaged. Manufacturing was disrupted by inoperative infrastructure. Hotels were damaged and flooded and the steady growth of tourism received a setback. All these effects were to have an adverse impact on the external account in 1989.

The rebuilding effort made enormous demands on credit and public spending, which the external account, despite reinsurance inflows, was unable to sustain in the light of weakened foreign exchange earning capacity. Exchange rate policy, despite various unsuccessful attempts to make it more transparent, was still discretionary. While depreciation took place during the year, it was not sufficiently responsive to the severe shock of the hurricane. The matter was exacerbated by currency speculation, as economic agents doubted the credibility of the existing rates. At this point the managed auction was suspended, in effect fixing the exchange rate. Concomitantly, monetary policy was tightened in late 1989, but by this time there was significant deviation from plan targets. The growth rate of GDP in 1989 mirrored the increase in the external current deficit, 6.5 per cent GDP growth, with an erosion of the current account from balance to a deficit equivalent to 6.5 per cent of product. The fiscal deficit, while declining from the huge increase of the previous year, remained above target at 5.4 per cent of GDP.

Policy objectives for fiscal year 1990/1991 were determined in conjunction with a new Standby Agreement, to cover the period January 1990-March 1991. These policies called for the fiscal deficit to be reduced to 4.8 per cent of GDP, continuation of restrictive monetary policies, improvement in the reserves and phased reduction in external payments arrears. The programme was suspended after three months as preliminary results were unsatisfactory. New policies were adopted in the third quarter of 1990, which would retain the basic objectives of stabilization but would accelerate the liberalization process in order to facilitate economic transformation. This round of liberalization included facilities which allowed residents and non-residents to hold foreign exchange accounts. Banks were allowed to trade freely in foreign exchange, the official rate being a composite of the market exchange rates charged by the various commercial banks. Savings rates were also deregulated, banks being authorized to set their own rates.

The outcome of these policies was mixed, due in part to a troubled external environment, sparked by the Gulf hostilities leading to oil price instability and weakening economic performance in the industrial countries. Nevertheless, product grew by 4.8 per cent although at the cost of widening the external current deficit, mainly caused by weak tourism growth. The capital account improved, private capital flows increasing, because of greater confidence in the

economy and reserves increased. The fiscal deficit, however, worsened by about 0.5 per cent to over 6 per cent of product, though if interest and amortisation charges on the debt were excluded a surplus of over 15 per cent of product would be achieved. Inflation increased, mainly because of depreciation in the exchange rate with the introduction of the new inter bank foreign exchange system, but also because of the deregulation of the energy market and the pass-through of all increases to the consumer, following instabilities in the petroleum market.

Fiscal year 1991-1992 saw a continuation of stabilization policies. Price controls were by now almost completely removed, remaining only on transportation, sugar and kerosene. Subsidies continued to be reduced and the privatization programme advanced. New taxation measures were also introduced in the form of a General Consumption Tax partly compensating for trade taxes reduced due to implementation of the Common External Tariff. The year was also notable for a full liberalization of foreign exchange policies, which allowed the holding of foreign exchange both locally and abroad. This phase of the liberalization was advanced by six months to September 1991, despite difficulties experienced earlier in the year with containing the money supply. Efforts to stimulate the economy early in the year led to the removal of credit restrictions, adjustments to the liquid assets ratio and reduction of interest rates. Some of these policies had subsequently to be reversed as increased credit was channelled into currency speculation. The intended effect, to increase private sector investment, was not achieved.

Product grew on average by about 2.5 per cent for the period 1990-1992. The current deficit on the balance of payments contracted between 1990-1991 and achieved a small surplus in 1992. The external debt contracted by over 11 per cent between 1990-1992. Fiscal policy needed to take a more conservative stance in the face of liberalization, the continuing debt burden and the need to make provision for Central Bank losses. If amortization costs were excluded a surplus of 2.5 per cent of product was achieved in 1991 and this increased to the equivalent of 2.9 per cent in 1992. The accelerated process of liberalization and insufficient policy coordination, however, took its toll in diminished stability, inflation increasing progressively from just over 8 per cent in 1988 to over 77 per cent in 1992.

Reflection on the economic policies and performance of the period 1981-1991 leaves one with some conclusions. The phase of adjustment with growth seems to have been misguided. Capital inflows did not significantly increase direct investment, and even had increased exportables been forthcoming they would need to have been sufficiently competitive to win market share in a declining global market. This would have been difficult at current levels of competitiveness. The result of increased inflows was increased consumption and with it the external debt.

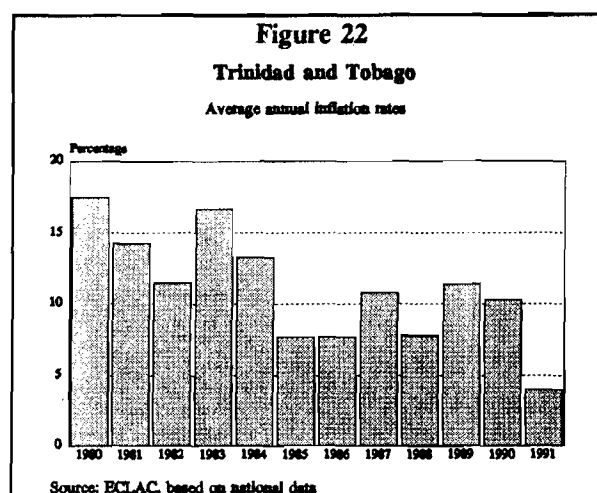
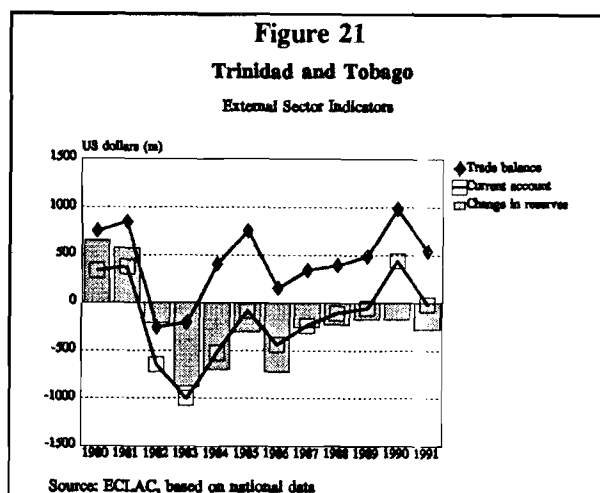
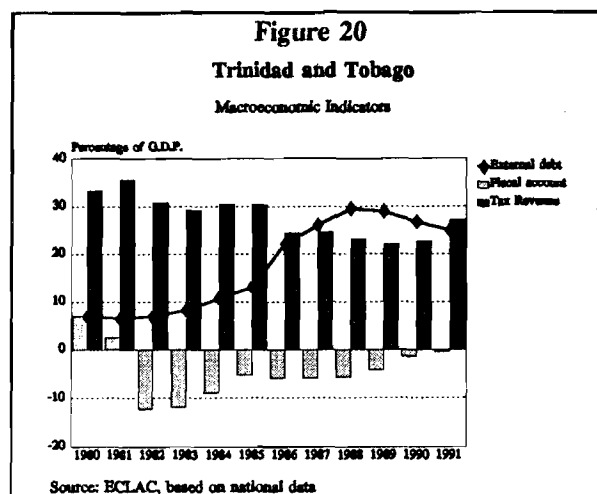
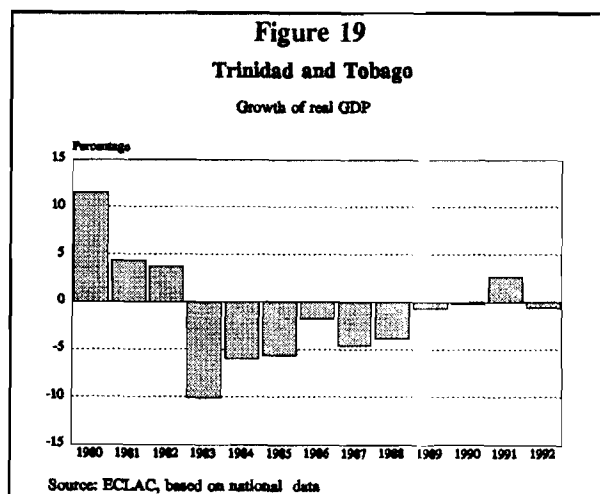
The second phase, of orthodox adjustment, was fairly successful with appropriate policies being applied in conjunction with a conducive external environment. Exchange rate policy was improved and though later weakened by managed floating did not become significantly dysfunctional in the context of buoyant global demand. It was, however, inadequate to respond to a major shock, such as that delivered by hurricane Hugo.

The third phase, beginning with a new administration, perhaps understandably, manifested some policy uncertainty in the face of intense exchange rate pressures following the hurricane. Its first reaction was to devalue and then fix the exchange rate, presumably in the hope of establishing market stability.

Within a year, when it was clear that the objective was not being achieved, this policy was reversed to be replaced with a strong commitment to liberalization, both of the exchange rate and the administrative arrangements governing the holding of foreign exchange by nationals. The price as well as the suppressed demand for foreign exchange were unleashed simultaneously. While this was in itself a prescription for a fairly rapid depreciation, it was facilitated by a rapid increase in credit thereafter. The failure to contain credit had adverse consequences for the exchange rate, the rate of inflation, and liberalization policies as a whole. It may have sent a confused signal to other countries of the region searching for the appropriate policy instruments.

It is clear that liberalization of the foreign account should await the establishment of some balance in the economy, at the least in the fiscal account. In this case, liberalization may have been adopted to provide incentives to exportables thus facilitating structural change and to remove some politically controversial policy tools from political discretion.

## Trinidad and Tobago



At the beginning of the 1980s the economy of Trinidad and Tobago was riding on the crest of the oil boom, which began in 1973. The impact of the twin oil price windfalls, which provided strong positive impulses to government revenues and to the balance of payments, fuelled greatly increased government activity. This permitted the near doubling in the rate of growth of product, from 3.1 per cent per annum on average for the period 1965-1973, to 5.8 per cent per annum on average for the period 1973-1983.

In fact 1980 constituted the peak of the oil boom, as measured by the export earnings from mineral fuels, since the price rises compensated up to then for output which peaked in 1978. The adjustment

task faced by Trinidad and Tobago in the 1980s was, therefore, to manage the contraction of public sector activity in line with the steady decline of oil revenues and to stimulate alternative forms of wealth in the private sector.

By the end of the decade the public finances had achieved some measure of adjustment to reduced inflows from the petroleum sector, though the task of changing the structure of expenditure away from recurrent and towards capital spending was proving to be intractable. More telling, however, was the inability of the policies pursued to bring forth new sources of dynamism to re-energise growth and reabsorb idle resources, especially unemployed labour.

The economy manifested two distinct phases over the decade. In the first phase, the aftermath of the second oil boom from 1980-1982, output increased by almost 20 per cent, based essentially on increased petroleum earnings and possible expansionary fiscal policies. By 1982 expansion was achieved by incurring deficits, in the fiscal account of 12 per cent of product and in the external current account of 8 per cent of product.

The second phase, from 1983 to the present, was one of a cumulative contraction of real product by 33 per cent. In this phase fiscal policy was mixed, initially continuing the expansionary policies of the past but as this started a rapid erosion of the reserves, adjustment measures became necessary and were initiated after 1983. Weak growth was achieved in 1991 but this was spurred by a slight recovery in petroleum prices and economic contraction was resumed for the period 1992-1993.

#### Expansionary adjustment?

Initial warning signals that the petroleum dynamo was losing its momentum had appeared in 1978 as output started to decrease. These were ignored as prices jumped for the second time in 1979-1980. The increased inflows were sufficient to finance new bursts of government spending, which increased product by 16 per cent for the period 1980-1981 while at the same time permitting fiscal and balance of payments surpluses and substantial increases in reserves.

A second warning signal was provided in 1982 as export earnings began to decline. This was, however, treated as a temporary fall in prices and attempts were made to use domestic spending to sustain growth in the face of a fall-off in export earnings. Accordingly, the spending momentum, which got underway in 1980, accelerated, evidenced by the fact that government spending, which averaged about 32 per cent of product in the period 1979-1980, grew rapidly thereafter, being equivalent to one half of GDP by 1982. In that year current spending grew by 70 per cent, the rise being attributable mainly to increased public sector wages and salaries which grew by 119 per cent and transfers and subsidies which grew by 50 per cent. Within a year a fiscal surplus equivalent to 2.6 per cent of GDP in 1981 was transformed into a deficit equivalent to 12 per cent of GDP in 1982 and a current external surplus equivalent to over 5 per cent of

product went into deficit equivalent to over 8 per cent of product. A rapid erosion of the reserves also began.

#### The phase of economic contraction

While high levels of government activity were sufficient to push up GDP in 1982, similar levels of activity were unable to repeat the trick in 1983, product falling precipitously by over 10 per cent. Although government expenditure was somewhat curtailed, the trend of rapidly increasing revenues was also reversed for the first time since the oil boom began, so that the large fiscal deficit remained substantially unchanged. The external current deficit widened further, to 13 per cent of product as export earnings continued to fall. As a consequence, the economy suffered a further haemorrhaging of its foreign reserves which fell by almost fourfold over the previous year. The year 1983 marked the beginning of a period of steady decline of the economy of Trinidad and Tobago which continued until 1989.

Adjustment measures were applied progressively between 1983-1985 in the form of controls on government spending, mainly investment spending, and foreign exchange rationing to control merchandise imports and foreign travel. Subsidies to public enterprises were also brought under greater scrutiny. These measures were effective, with the fiscal deficit falling from over 12 per cent of product in 1982 to 5.2 per cent in 1985. Similarly the policies relating to the balance of payments, although creating suppressed demand in the economy brought the deficit from 12.9 per cent in 1983 to 1.1 per cent in 1985. These policies, however, also brought with them an increase in unemployment and a further erosion in the reserves.

A renewed phase of adjustment became necessary by the end of 1985, however, for the oil prices were about to begin a precipitous fall. This was illustrated by the price index, falling to 48 by 1986 compared with the base year of 1980. Stronger adjustment measures were adopted, including a devaluation of the currency by 50 per cent, the new rate covering three quarters of imports but excluding some essential foods, medicines and educational items. In view of the oil price decrease which was to follow, these measures were hardly sufficient to restore equilibrium in the external account. As a result, further import restrictions were applied. Despite these measures, the external deficit widened again to 9 per cent. On the fiscal side the deficit also widened

slightly, although the need for fiscal caution remained. The reserves fell twice as fast as in the previous year.

By the end of 1986 a new administration came to power, and with it further policy changes were initiated. Exchange rates were unified in early 1987 and a further devaluation of 18 per cent took effect in August of 1988. Efforts were redoubled to establish fiscal balance by increasing revenues and reforming the public sector. Tax revenues continued the precipitous fall which started in 1982 and this trend was not reversed until 1989. Reform of the public sector was also a slow and divisive process. Initial efforts to contract the size of the public sector met with resistance from those affected, while the alternative strategy of containing its cost by reducing emoluments paid to public servants was eventually to be frustrated by the courts. Nevertheless the fiscal balance was contained to the same level as the year before i.e., just under 6 per cent of GDP in 1987 and it fell steadily thereafter, and is expected to record a small surplus in 1993.

The extent of the fiscal correction was demonstrated by the fact that government revenues averaged a fairly steady 35 per cent of GDP for the period 1973-1987. This fell subsequently to average 29.6 per cent between 1988-1992. The magnitude of the revenue decline needs also to be seen in the context of concomitant decline in real GDP. The decline would have been even greater had attempts not been made to compensate for significant declines in petroleum revenue by increasing other forms of taxation.

During the period 1976-1985, expenditures grew faster than GDP, to peak in that year at 39 per cent of GDP. They fell subsequently to average about 33 per cent for the period 1988-1992. For 1993 a small surplus was projected with income and expenditure at about 28 per cent of GDP. Wages to central government workers declined from a peak of 15 per cent of GDP in 1986 to just over 10 per cent in 1993. In the case of expenditures there was evidence of much effort to adjust to the contracting economy. Yet the burden of adjustment was put on capital spending. On average for the period 1989-1992, recurrent expenditures accounted for over 90 per cent of all expenditures. In 1993 it was over 94 per cent, which meant that less than 6 per cent of product was available to reorient the economy and facilitate economic activity or provide new directions in human resources development.

Reduced revenue inflows to the public sector required a reassessment of the role of the State, and the divestment or closure of loss-making public enterprises. Concomitant with the contraction of State activity was the need to formulate policies to encourage increased activity in the private sector. Support from the IMF in 1989 and from the World Bank in 1990 provided funding for a revised tax system and public sector reform. Income tax rates were simplified and supplemented by consumption taxes in the form of a value added tax.

The external current deficit which was 9 per cent of product in 1986 fell steadily in the face of stringent fiscal and latterly, monetary policy to achieve a small surplus by 1992. Reserves continued to fall, though this was progressively reduced from a decline of US\$722 million in 1986 to record moderate surpluses in 1989-1990, although the reserves were further depleted in 1991-1992.

Policy attention was also directed to the external sector, to increase its competitiveness and to reorient resources toward foreign exchange earning activities. A major aspect of this thrust was the aforementioned greater willingness to use of exchange rate policies for the purpose. This was also supplemented by a progressive deregulation of the external regulations with regard to imports and payments mechanisms so as to gradually expose local producers to external competition.

Exchange rate pressures increased in the period leading up to and just after the elections at the end of 1991. A new administration came to power also facing increased pressures to expand public expenditure. The immediate policy response was to tighten domestic credit policies and increase direct taxes. After a period of consolidation, in which the fiscal account was brought into approximate balance, the exchange rate was deregulated through the mechanism of a managed float, commencing in April 1993. The rate went from the prevailing fixed rate of 4.25 to 5.75 and has remained relatively stable up to the time of writing.

The period under review witnessed severe economic contraction, product falling by one third between 1983-1993. Unemployment rose from about 10 per cent in 1982 to peak at 22 per cent in 1989, falling to 20 per cent in 1992. This level of contraction also had repercussions for the the financial system.



## PRIVATIZATION - POLICIES AND PERFORMANCE

The current focus on privatization springs from a number of diverse elements, which are both normative and practical. At one level it might be seen as a reaction to the policy of nationalization which was in vogue in the 1970s. But at a more practical level it is also being driven by severely constrained fiscal budgets. For the purposes of this discussion, privatization will be used in its broadest sense, to encompass all those actions used to transfer assets and influence from the public to the private sector. It will include divestment in its various forms as well as liberalization policies intended to improve the functioning of the market.

At the level of concepts, the debate is dominated by differing perceptions about the appropriate role of the State in directly productive activities. Arguments relating to efficiency vs. equity are often exchanged, as are discussions juxtaposing individualism and individual liberty to collectivism and group action. Various arguments are proffered to emphasize the efficiency and impersonality of the market on one hand, as opposed to the pressures of special interest groups upon, and the lack of appropriate information available to, the public sector to cast doubt on its competence in this sphere of action. The proponents of State intervention point to the frequency of market failure and the inability of the market to deal with questions of equity. They inveigh that markets are likely to be imperfect in small developing countries. Proponents of the market respond that market imperfections often result from policies of closure or excess protectionism and that there are more direct ways of dealing with externalities or of securing equity.

In effect, the debate relates to whether market or policy failure is most pervasive and whether the market is competent to judge the scope and pace of a range of normative issues. These differing viewpoints are perennial and ebb and flow throughout time as one side comes into fashion and the other side loses it.

In the context of the recently independent Caribbean, new elites came to power imbued with the belief that development had been severely hampered by former leaders and their private agents, who were more concerned with development in the colonial metropole than in the region itself. Accordingly, it was believed

that after Independence, development would follow if the new nationalist elites had the necessary commitment to the task of local development and possessed sufficient control over the means of production to achieve it. Since this was a commonly accepted view, in the aftermath of decolonization it was considered logical that control of the commanding heights of the economy should be entrusted to these new political elites. Such considerations were present in the policy stances adopted by Guyana, Grenada, Jamaica and Trinidad and Tobago, although different rationale were advanced to justify intervention.

A number of practical considerations also guided the public sector in intervening in directly productive activities. Intervention was defended where the private sector was reluctant or too weak to engage in activities deemed to be necessary for development. Acquisitions were made, sometimes reluctantly, of enterprises in danger of failure, so as to maintain foreign exchange earning capacity and protect jobs. This was evident in Jamaica in the mid-1970s, where a number of hotels, in danger of closure, were acquired by government. In the Dominican Republic a number of enterprises, formerly owned by the dictator Rafael Trujillo, were ceded to the State upon his ouster, since public funds were said to have been involved in their operation. In Trinidad and Tobago, a number of public enterprises were spawned in an effort to invest petroleum windfalls, accruing to the State, in productive downstream enterprises. Others facing closure were also acquired.

Similarly, privatization was adopted for the practical reasons of establishing better fiscal balance and reducing the external debt burden. The cost of acquiring or creating major national assets had often been a severe burden on the public purse. The subsequent failure of many of these State acquisitions to achieve or maintain viability continued to erode the public finances long after a private entity would have gone into bankruptcy or achieved viability. Action was often delayed by public debate and the lobby of special interest groups. Whatever the merits of the contending views, the debate tended to create policy uncertainty and induce paralysis in adopting remedial measures. In the interim the cost of delay was paid in increasing local and foreign public debt so that often the choice became either divestment or closure.

In the Dominican Republic, the portfolio of public enterprises came about almost by accident. With the exception of public utilities which, as in most other countries, were State-owned, many of the State enterprises came about by nationalizing the assets of the Trujillo estate in 1961 at which time they were deemed to be the national patrimony. Currently, the State enterprises consist of the Dominican Electricity Corporation (CDE), the State Enterprise Corporation (CORDE), the State Sugar Council (CEA), the price stabilization institute and a number of other small enterprises.

The Dominican Electric Company (CDE) was a State monopoly which controlled the main generating plants and was the sole retailer of energy to the private sector. It was not the sole producer, since private parties were increasingly producing for their own use, but up to the end of 1989, when the law was changed, their surpluses could only be sold to CDE. Despite the change in the law no significant increase in electricity generation has been forthcoming from the private sector, in part because of an inadequate regulatory framework.

The CDE ran into serious cash flow problems in 1974, since it was dependent upon imported oil for 75 per cent of its electricity generation and at the same time suffered from a rigid tariff policy, rates remaining unchanged between 1955-1979. Additionally, the corporation suffered from poor generating efficiency and high distributional losses, because of inadequate investment and maintenance, large scale theft and underbilling and excess employment. By 1980 the losses of CDE were equivalent to 0.9 per cent of GDP and waste from the aforementioned inefficiencies was estimated at almost US\$50 million annually. This was to grow rapidly to over US\$90 million by 1982.

As outages became more frequent, private producers increased their installed capacity and invested in standby generators for emergency use. By 1991 it was estimated that the CDE system accounted for less than 60 per cent of installed capacity, private producers for their own use almost 30 per cent, while the sugar and bauxite companies accounted for the rest. In that year only 40 per cent of the population had access to electricity and the demand for industrial purposes was expected to increase rapidly.

Efforts are currently underway to put the CDE on a better financial footing, through improved management and increased tariffs. Increased generating

capacity is being put into place and the distribution network is being rehabilitated. The deficit has declined to 0.1 per cent of GDP. CDE does not, however, have access to sufficient resources to meet the full needs of the country but privatization in part or in total is being inhibited by an inadequate regulatory framework for the industry. The issue of a regulatory framework is, however, relevant to all monopolies or near monopolies, whether public or private.

The Dominican Corporation for State Enterprises (CORDE) was formed in 1966 as the umbrella organization to administer the non-sugar enterprises of the Trujillo portfolio. It was subsequently expanded to include other activities. By 1987 the portfolio of CORDE included the national airline, two mines, an insurance company, a car dealership, a real estate business and 17 manufacturing enterprises. These produced cement, glass, paper, vegetable oils, shoes, tobacco, chocolate, nails, sacks and ropes, textiles, paints, milled grains, leather and car batteries. It included salt mines and refineries and marble and plaster mines. Previously it had also administered a hotel, hardware stores and a disco<sup>10</sup>.

In the 22 years for which data are available CORDE has recorded a deficit in 17 years. While CORDE is justified by the argument that it performs a welfare function, it has in fact been sustained by taxpayers. Various efforts have been made to correct the inefficiencies in the CORDE group of companies, notably in 1982 where excess employment was estimated to be 20-25 per cent. It was also proposed to employ a consulting firm to decide which of the CORDE portfolio should be privatized. No action was taken on the question of privatization and this was resisted until 1993, when an official statement was made to the effect that some CORDE enterprises would be considered for privatization. After 1982 some progress was made toward returning CORDE to viability, profits being recorded between 1983-1985, but losses have been the norm since. Subsequently numerous cases of fraud have been unearthed.

The State Sugar Council (CEA) was created to administer the Trujillo sugar holdings, which up to 1986 represented 55 per cent of the total land area devoted to sugar production in the Dominican Republic. The CEA which had been consistently profitable and a major contributor to public savings, averaging over 2 per cent of GDP for the years 1977-1979, became a net dissaver in 1980. This deficit increased to 1.2 per cent of GDP in 1982.

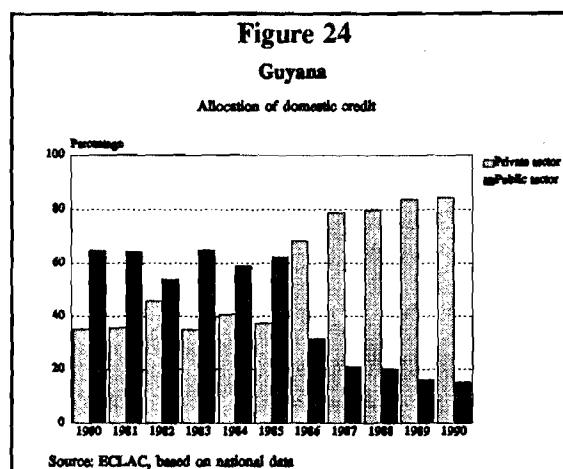
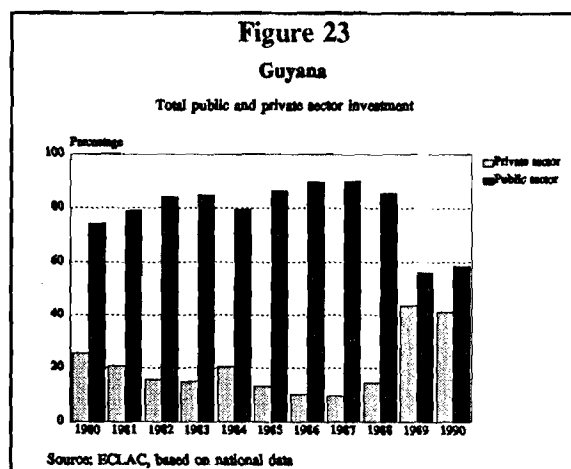
As prices on the world market fell, other less favourable aspects of the CEA came to the fore. These included high prices paid for sugarcane from non-CEA producers, high transport costs, and low (controlled) domestic prices. Sugar production overall continued to fall throughout the 1980s, in part because of the reduced preferential quota to the United States, which was 500,000 tons in 1982, and declining world market prices. The State sugar sector suffered even greater shocks, however, being hampered by inefficiency in its operations. A number of social demands were also being made of it, so that it was unable to adjust to the rapidly changing global market. The CEA, therefore, continued to demand transfers averaging about 0.7 per cent of GDP from 1980 until 1991, the last year for which data are available.

A constellation of other enterprises cluster under the rubric of other small enterprises. They comprise the Port Authority, Agricultural Bank, Airport Commission, Water and Sewerage, Industrial Development Corporation, National Water Institute, and the Cooperative Development and Credit Institute.

Most of the nationalized public enterprises were initially profitable, but this was slowly eroded as they were asked to provide subsidies to various groups and management was chosen for reasons other than for their managerial qualities. In general the few profitable

enterprises were decapitalized to subsidize the many unprofitable ones, to provide product to governmentally favoured projects or to provide transfers to the Presidential Fund. Many enterprises suffered from inadequate maintenance and became insolvent. They were either closed as a result, or sold. In fact these cases constituted the few concrete instances of privatization.

Savings of the public sector enterprises as a whole became negative in 1979 and the deficit grew to 3.8 per cent of GDP by 1980. Deficits exceeding 0.5 per cent of product were incurred in all years in the 1980s. Despite these huge losses there was no sustained effort for the rehabilitation, rationalization or privatization of public sector enterprises. The possible reasons suggested<sup>11</sup> for this inaction were: 1) the firms met political needs and their sale would have caused unemployment and tighter accounting controls; 2) they were able to provide cross-subsidies to the weaker enterprises, thus sustaining employment in them; and, 3) careful scrutiny would make explicit their losses, and expose the failure of government to operate them efficiently, evidence which was concealed by transfers. In the case of the sugar industry, privatization was linked to the controversial question of land reform, while CDE, the electricity corporation, was so large that foreign participation, a politically sensitive solution, might be necessary to achieve privatization.



In Guyana the public sector dominated the economy from the early 1970s, accounting for more than 50 per cent of national investment from 1971. This share continued to increase throughout the decade resting at 81 per cent in 1978. The relative shares of investment and credit during the 1980s are illustrated at Figures 23 and 24. The public sector was also the major creditor, the major export earner, the major employer and accounted for the major share of Gross Domestic Product. By 1988, which marked the peak of its power before public policy changed, the public sector employed 60 per cent of the work force, accounted for 70 per cent of GDP and 85 per cent of the exports<sup>12</sup>. Under comprehensive administrative controls many preferences were accorded to the State sector, including access to foreign exchange, credit including preferential interest rates and agricultural inputs such as fertilisers, pesticides and so on. Despite this apparent preeminent position, production and export earnings were declining rapidly and many government enterprises incurred significant losses, requiring massive transfers from the national budget as outlined in the previous section.

This economic power was concentrated in enterprises falling within two holding companies. BIDCO dealt with the mining sector construction and trade. The remaining companies fell within the ambit of the Guyana State Corporation, GUYSTAC, which included the sugar industry, rice marketing, timber milling, fishing, textiles, electricity generation, telecommunications and air transport. Mining, sugar and rice marketing were the major sectors, accounting for about half of the operating revenues. The financial difficulties of the State monopolies in these sectors accounted for the major burden on the budget. Nevertheless, the output of most enterprises had been declining and capacity utilization of the public enterprises was estimated to average about 35 per cent. Output sometimes was as low as 20 per cent of capacity. Measures were proposed by 1984 to try to improve the efficiency of public sector enterprises, by restructuring GUYSTAC and the Guyana Rice Board and by financial restructuring of the Guymine. This required rehabilitating some factories and applying more representative prices where outputs were underpriced to the public. Yet these measures were unable to contain the fiscal haemorrhage or to significantly improve output. Enterprises that had become accustomed to privileged positions in the economy seemed incapable of internally carrying out the drastic measures needed to ensure competitiveness and secure increased output.

Many impediments faced by these enterprises were macroeconomic in nature and affected private enterprises and the society as a whole. Any meaningful solution to the plight of the public enterprises would have required a combination of micro- and macroeconomic measures for the sectors to become viable. These policies would need also to be sufficiently credible so that they would not be perceived to be reversible on political whim.

A more comprehensive programme of macroeconomic reforms was initiated with the Economic Recovery Programme (ERP) announced in mid-1988 and underpinned by the IMF. The ERP also introduced the issue of privatization. The term was broadly defined to include divestment, either in whole as going concerns or by sale of the assets of the various entities. It also included reaching management contracts of a hands-off nature, to remove elements of political control and to improve performance prior to divestment and it included joint ventures and lease agreements.

A comprehensive mechanism was established, in the Public Corporations Secretariat, to oversee the divestment process. This included a Divestment Unit that did operational tasks based on the directions of the Divestment Policy Group. The latter was chaired by the President, and included the Ministers of Trade, Finance, Agriculture and Industry and took all major operational decisions, such as the acceptance of bids. The Divestment Unit also reported to Cabinet, through one of its subcommittees called the Monitoring Committee. This comprised an expanded membership of the divestment Policy Group, to include others, notably, the Governor of the Central Bank. The Monitoring Committee functioned as general policy maker for the divestment process.

A group of 32 corporations operated under the Public Corporations Secretariat. Of these, 14 had been totally or partially privatized by October 1992. Despite the elaborate institutional mechanism for overseeing the privatization process, the two largest transactions, Demerara Woods Ltd. and Guyana Telecommunications, were carried out without the involvement of the Public Corporations Secretariat.

Management contracts were negotiated for the Guyana Sugar Corporation and for the production activities of Guymine, in both cases as possible precursors to full or partial divestment. A joint venture arrangement was agreed with the Guyana

Telecommunications Company, government retaining a minority 20 per cent to ensure that it had a monitoring capability in the operations of the company.

In the sugar sector, a management contract was entered with Booker Tate to take over the daily operations of GUYSUCO. The agreement provided initial success with steadily increasing sugar output, exports increasing by 35 per cent between 1989-1992. Considerable new investment will be needed to ensure continued output and this is not available from public sources so that private sector participation will need to be encouraged. Guyana has steadily lost its market share in the bauxite refractory market. This deterioration has been due in part to insufficient investment to upgrade depreciating plant and equipment also to deficient management. Attempts to entice the former owners of the nationalised mining operations to enter joint ventures with government have not been successful as they are wary of incurring the risk related to the considerable investment required.

Several problems arose regarding an accurate determination of the selling price for these enterprises. Given that many enterprises were not currently profitable and continued to drain resources, the pressures to divest were heightened while prospective purchasers were discouraged. This illustrated a major paradox of privatization, trying to sell unattractive or insolvent entities. The public tended to regard the process as opaque, secretive and difficult for them to evaluate, thus engendering suspicion. Some enterprises also lacked up-to-date audited accounts. Accordingly, there were some complaints that investors got national assets below their "market value," while others complained that the pace of divestment was too slow.

Prior to the election in 1992 the privatization process was subject to severe criticism by the then opposition party. This tended to buttress the suspicions of the public that some enterprises were being sold too cheaply. The political factor dampened the pace of the divestment process prior to the election. After the election there was a hiatus, since the change of government created a high level of political uncertainty about the future of privatization and of the ERP as a whole.

These fears were partly laid to rest, once the privatization programme was resuscitated, within the framework of five principles. These were stated<sup>13</sup> as, "open bidding and award procedures, fairly priced

sales, the offering of company shares to the public, buyer assurances to modernize and/or expand the enterprises acquired and consumer protection." The first task of the privatization committee was, however, to review all past sales, so that the momentum developed in previous years was lost.

Besides the dominant bauxite and sugar sectors, several public enterprises remain with decisions not yet taken as to whether, or how, they would be privatized. These included areas such as rice paddy and rice grading, engineering, the oil company, Guyana airways, the Guyana National Shipping Company, the national printers, Guyana Stores, packaging industries, newspapers and broadcasting and the liquor/distilling corporation. In total, government participation remained in 30 companies, including seven in the financial sector which accounted for over half the total financial assets.

Jamaica represented, perhaps, the most widely publicized case of divestment in the Caribbean. This was in part due to a clash of competing ideologies pre- and post 1980. In the former case, the policies were for a high level of State participation, in the latter, post 1980, a policy was adopted to reduce the role of the State since it was seen to have over-extended itself, with consequent detriment to the economy as a whole and specifically to the fiscal accounts and the debt. Yet too much should not be made of the ideological divide within the political parties as public sector growth was evident under both jurisdictions while privatization was pursued by both after 1980 and 1989, respectively.

A second reason for the Jamaican profile on this issue was the fact that it was an early starter with policies of privatization, such policies being enunciated in early 1981. Latterly, it has also extended the scope of privatization beyond that contemplated by most other countries in the region.

As a consequence of its longer experience, Jamaica also provided a better indication of the consequences of the policy and of the difficulties and limitations being encountered in the process of privatization. Since its approach mixed ideological and pragmatic considerations it also provided examples of inconsistency, i.e. efforts by government to acquire a major productive enterprise in the alumina sector in the mid-1980s, coexistent with a major divestment effort in other areas, such as tourism.

State participation in the productive sectors was first mooted in the five-year Plan of 1963-1968. Initially, three sugar factories in danger of closure were acquired, and the Hotel Corporation of Jamaica formed to stimulate tourism development through hotel construction. It was, however, in the public utilities that most activity was focused, notably water and the formation of the Public Utilities Commission, to oversee the operations of the private electricity, telephone and public transport monopolies. After evaluating their operations and exposing some of their measures for securing "supernormal profits", the electricity company was acquired in 1969, telephones in 1970 and public transport in 1974.

The period 1972-1980 saw redoubled efforts to increase State participation. The motivation was to stimulate growth and facilitate the redistribution of resultant benefits. State expansion was financed with the proceeds of a bauxite levy. This enabled the State to reacquire lands owned by foreign mineral companies; to expand the delivery of housing to low income groups; to develop State purchasing of bulk items and to increase its exposure in the media. A number of other acquisitions were undertaken in reaction to situations as they arose and were motivated by a desire to sustain activities that were in danger of closure, whether due to a lack of business confidence in the prevailing government policies or in other cases of genuine insolvency. This was the case particularly in the tourist sector and in some retail distributive trades.

As a consequence of these developments, by 1981 the Jamaican Government had a portfolio of investments which had grown haphazardly. It included bauxite, petroleum, cement, 75 per cent of Jamaica's sugar output and 50 per cent of hotel room capacity<sup>14</sup>. It also included activity in finance and a State Trading Company. Estimates of the quantum of such holdings vary. One estimate, by the Ministry of Finance and Planning, is that State-owned enterprises numbered 400 by 1980<sup>15</sup>, though this number contracted to about 200 by the end of the decade, consequent on closures and divestment. It has also been estimated that government participated in directly productive activities in 198 companies, 81 per cent of which were wholly owned.

The main categories were: (a) agriculture, 51 enterprises, 76 per cent of which were wholly owned; (b) housing, three enterprises, two of which were wholly owned; (c) financing institutions, 43 in total, 40 of which were wholly owned; (d) external trade,

three wholly owned; (e) tourism, 30 entities, 83 per cent wholly owned; (f) industry and commerce, 49 entities, 84 per cent wholly owned; (g) public utilities, 19 entities ranging from airlines, merchant shipping, telecommunications, etc, 11 of which were wholly owned; and, (h) media enterprises, three, all wholly owned.

A combination of ideological and practical reasons surrounded the introduction of privatization in 1981. A change of government stressed a greater role for the private sector. At the same time the adjustment programme, agreed with the IMF and World Bank, was designed to orient the economy towards export promotion rather than import substitution, balance the fiscal and external accounts, and to stimulate economic growth, with responsibility being placed on the private sector to provide the engine for such growth. In line with the declaration that government would provide a facilitating rather than direct participation in the productive sector, a number of the existing public sector enterprises were to be closed, others were earmarked for divestment to the private sector and the remainder were to be put on a sound financial basis.

As outlined in a foregoing section, adjustment efforts between 1981-1984 were tentative and ineffective. The divestment programme was similarly hampered, two enterprises being sold and the public transport system franchised to private operators between 1981-1985, under the auspices of the newly formed divestment committee. Yet the Agricultural Marketing Boards were transformed in function; some hotels had been leased and a start had been made to contract out municipal services which were not being effectively performed. The programme then lost momentum, which was not regained until the second more rigorous phase of adjustment commenced in 1985.

In this phase, focus was placed on the fiscal imbalances and the need to service a growing debt. Given the importance of the major State-owned entities their reform became a priority. With an eye to fiscal performance, reforms transformed the operating balance of these entities from a deficit of 1 per cent of GDP in 1981 to a surplus of about 7 per cent of GDP by 1987. The emphasis was on making these entities profitable through cost recovery. Less concern was directed at efficiency. The focus instead was on reducing the backlog of investment but this had the effect of increased the portion of government guaranteed debt attributable to them.

Renewed impetus was given to the privatization programme by a reconstituted divestment committee. The administrative arrangements for privatization differed somewhat from those adopted for phase one. There the Divestment Committee comprised a number of senior civil servants and businessmen, acting in an ad hoc manner. Pressure of their substantive responsibilities meant that sufficient policy attention was not available for privatization.

The new arrangements meant that while the Divestment Committee remained responsible for the overall process, responsibility for managing the divestment process on a day-to-day basis rested with the Privatization Secretariat, comprising officials of the National Investment Bank of Jamaica, (NIBJ), officials of the appropriate ministries and selected external consultants. This group was responsible for preparing the prospectus of the entity to be divested, negotiating with interested parties, recommending the selected applicant for cabinet approval and effecting the transfer once the sale had been approved. Nevertheless, the Divestment Committee remained only one of many sources of privatization, the National Hotels and Properties, the Factories Corporation and the Agricultural Development Corporation group of companies still having responsibility for the divestment of entities falling within their purview. The Ministry of Public Utilities and Transport was also responsible for assigning deregulated bus routes. For the period 1985-1991, 39 of the enterprises listed were divested<sup>16</sup>, as well as other properties being used for agricultural and other forms of development.

A wide variety of mechanisms were used in the divestment process and included leases, placements on the Stock Exchange, share sales for unlisted entities and offers of shares to employees, while some of the assets of other entities were sold prior to their closure. While most sales were made through public offers, some government share holdings were also disposed of under private treaty. Other mechanisms were also used, such as placing two sugar companies under management contract, the closure of the national bus company while transferring its functions to private minibus operators, contracting out street cleaning and certain hospital services to private operators, privatization of the administrative and trading arm of the banana industry and partial divestment of two banks, one by public share offer, the other by public tender. The proceeds from privatization flowing into the NIBJ amounted to J\$1256.4 million, and proceeds

to NHP amounted to J\$882.2 million for the sale of hotels. This total of J\$2138.6 million did not include annual lease payments or proceeds accruing to the other divesting entities.

The privatization exercise entered a second phase in 1991, coterminous with a renewed push by the government toward liberalization and in the context of a Fund/Bank programme for the period 1990-1991. This phase was initiated, after an initial hiatus, by a different administration to that which initiated phase one, so that the two major political parties had become committed to the privatization process and represented a further intensification of the programme to include electricity, railways, water, airport services and air transport. The importance of this development was that the debate on this issue was conducted on how best to achieve the goals of privatization rather than on whether to privatize or not.

Much of the impetus for privatization, nevertheless, continued to come from outside, from the aforementioned Bank and Fund programmes, as well as a belief that accelerated privatization would augur well for qualification for the Enterprise of the Americas Initiative. At the same time, a fairly broad measure of consensus by now existed within the country for it, in part because of a belief that the public sector had overextended itself, in part because it was seen to be a haven for non-viable entities, in part because of disenchantment with its actual performance and in part because of general acceptance of the success of phase one of the privatization programme.

Despite this general acceptance, some criticisms were voiced, so that phase two, in which 67 entities were earmarked for privatization, was launched in the context of changed administrative arrangements. Attempts were made to centralize all divestments under the NIBJ, answerable to a Cabinet subcommittee chaired by the Prime Minister. Emphasis was also placed on a number of principles which were to govern the process. These included, public announcement of the entities to be privatized; market valuation to be used to determine the disposal price; arms length transactions with equal opportunity given to all, except where foreign exchange requirements were a feature of the transaction or where special arrangements were being made for employees; and public announcements would be made on the privatization of each entity. Essentially, these provisions were initiated to ensure greater transparency in the privatization process<sup>17</sup>.

Phase two of the programme had divested 16 public sector entities, up to the end of 1992<sup>18</sup>. This took the form of lease of assets; outright sale; sale of equipment, land or shares; or in one case, that of the former government printing office, the creation of an Employee Ownership Share Plan. The proceeds from these activities, amounted to J\$1,062 million<sup>19</sup>.

In Trinidad and Tobago the State became widely involved in directly productive activity, following from policies enunciated in its Third Five Year Plan (1969-1973). This indicated that the State would take a heightened role in development, to create new job opportunities, to transform the economy and ensure overall national development. These objectives remained dormant until 1973, since the State lacked the resources to effect them. Subsequently, these goals were further amplified to stress three others; localization, that of facilitating the transfer of control of foreign holdings to locals; the developmental goal, that of facilitating the development of new local industries; and the goal of rescuing jobs in private enterprises which were in danger of closure. Once resources permitted, public involvement was further justified in areas considered to be pioneering, where local expertise was not readily available and risk was deemed to be too high for the private sector. State involvement was also justified for the establishment of heavy industry, where large injections of venture capital or external loan financing were needed<sup>20</sup>.

In 1972 the government had share holdings in 32 companies, with a book value of approximately TT\$ 60 million. The size and scope of government activity grew rapidly thereafter. By the end of 1986, the State held a portfolio of 166 enterprises with its share holdings valued at over TT\$3953 million. This portfolio covered such activities as oil, gas, petrochemicals, asphalt, airlines, hotels, banking, insurance, sugar, mixed farming, fruit and meat processing, grain milling, maintenance and so on. Of these, many of which competed directly with the private sector, 37 were wholly owned, 11 were majority owned, one was 50 per cent owned, and 17 were minority holdings. At its peak in 1985, these enterprises employed over 34,000 people. Overall, the public sector absorbed on average 47 per cent of all salaried employees over the period 1989-1991.

The involvement of the State was far larger than the nominal value of the holdings would suggest. Loans, advances and subventions were readily made available to public enterprises and it is estimated<sup>21</sup> that

such assistance amounted to TT\$5,800 million, between 1979-1984. In 1987 alone TT\$ 967 million, or almost 20 per cent of recurrent expenditure, was budgeted to cover operating debts and contingent liabilities relating to the State enterprises, many of which are dependent on such support for their continued existence<sup>22</sup>. Government transfers, mainly to public enterprises and public utilities, amounted to almost 10 per cent of GDP in 1991. The large State enterprises had also contributed a large portion of the external debt, accounting for about 65 per cent of it in 1987.

Whatever the theoretical or practical benefits which might accrue to the economy because of State involvement it was recognized that the State enterprises represented a severe and unsustainable burden on the public purse. Many public acquisitions intended to save jobs were not viable and had scant hope of ever achieving viability. Where the possibility of improvement existed the necessary capitalization, better management or modernization was not forthcoming.

Other reasons for declining viability were: (a) unwillingness to quantify the resources which would be needed to implement implicit social and political objectives, often evident in the pricing of public utilities, and evaluate them in the light of the opportunity costs of these resources; (b) an inability to set clear goals and objectives for the public enterprises and to adhere to them; (c) a lack of accountability; and (d) ineffective management.

Based on the past experience of existing public enterprises and the prevailing economic situation, the government decided to reduce the dominant role that the State had played in the economy between 1974 and 1986<sup>23</sup>. While these policies were implicitly followed after 1986, they were made explicit in the Macro Planning Framework 1989-1995. In 1987 the Rampersad Committee was appointed to make recommendations for the rationalization of the State sector. Internal initiatives toward privatization were subsequently buttressed, by an IMF standby agreement in 1989 and by a World Bank Structural Adjustment Loan in 1990, which included provisions for the reform of both the public enterprises and the public utilities.

The overall policy framework was modified to state that rather than engage in directly productive activities, government would seek to create an appropriate environment conducive to the operations of the private sector and to provide the necessary supporting infrastructure. It would also provide fiscal



incentives to induce new ventures. Exceptions to the above would apply to enterprises deemed to be of national importance, either where the private sector could not initiate action on its own because of financial or technological reasons, or where a strategic industry needed to be controlled, in which case equity participation of the State would be limited to 50 per cent.

For existing public enterprises the following options were outlined: (a) reduce public participation where the potential existed for the enterprise to be viable; (b) close those operations which are not viable and whose continued operations could not be justified on social grounds; (c) rationalize those entities which were established to circumvent deficiencies in the public sector bureaucracy so as to make them more efficient and accountable; and, (d) restructure and make more efficient those enterprises deemed to be in the national interest. Where subsidies were necessary for a particular purpose, they would be quantified and the enterprise expected to operate on commercial criteria for the other areas of its operation. Mergers would be used where necessary to promote efficiency.

In summary, privatization was proposed where the initial objectives of State ownership had been fulfilled, where the need to promote a more balanced distribution of ownership was deemed to be necessary, due to the government's need for additional financial resources or to better allocate its financial resources, or where it was judged that an operation might be more efficiently carried out by the private sector.

The principles governing divestment were to take into account appropriate market conditions in determining the selling price, the need to further avoid the concentration of equity, the need to terminate government liabilities regarding future operations, and retention of controlling interest in enterprises deemed to be of strategic importance.

The Rampersad Committee proposed that all holdings in which the government had a minority share should be divested. Recommendations were made regarding 20 of the remaining wholly owned or majority owned enterprises. Twelve were recommended

for divestment, six for liquidation, and in the case of the Solid Waste Company no action was to be taken. By the end of 1991 four firms were liquidated, one was leased and five were divested. The proceeds from these divestments amounted to US\$6.8 million from public sale and US\$84.9 from private sale to foreigners. The proceeds were used to retire public debt.

With the advent of a new administration there was a hiatus in the divestment process and a review of existing policies completed by the first quarter of 1993<sup>24</sup>. At that time 84 government companies were being examined, with firm decisions made with regard to 47 of them. The remaining 37 were still under review. Of the 47, it was decided to divest 28 of them<sup>25</sup>, 11 were in various stages of liquidation and four of the remaining eight were to be restructured, with the remainder to be retained in the public sector.

A full range of options was used in the divestment process. In some cases shares were sold, in some instances preference being given to existing shareholders. In other cases mergers, in the banking and petroleum sectors were prescribed, or strategic alliances were proposed, in the case of the national airline, or a joint venture in the case of a Tobago hotel. In some cases assets would only be partially divested, i.e. the Methanol Company. In the case of the financial sector where some entities were in financial difficulty mergers would be encouraged.

In general the pace of privatization was slow. The issue was on the political agenda since the early 1970s, although not seriously considered until after the mid-1980s. Public ownership was accelerated in response to political disturbances in 1970. Politically emphasis was placed on achieving better ethnic balance and securing greater localization of assets and decision-making. These rationale still remain. Many of the State owned enterprises, especially those in downstream petroleum activities, are large in relation to the capacity of domestic entrepreneurs to purchase or manage them so that divestment needs foreign participation. This has been secured in the case of ISCOTT and TSTT though government participation remains large. It might set a precedent for further activities although opposition to privatization remains.



## NOTES

1. This has prompted one writer to advocate that Caribbean policy makers should in future treat windfalls as temporary and adverse external shocks as permanent.
2. For example, the sugar industry which was examined in the Dominican Republic case was relevant to and had many parallels with, the sugar industries in Guyana, Jamaica and Trinidad and Tobago. All have suffered declines, in line with depressed global prices and reduced quotas, but the State-owned enterprises have been slower to adjust to these developments than their less constrained counterparts in the private sector. Privatisation has been, or is being considered in all instances, though the conclusions reached have differed. Similarly, with the electrical power industry. All in the recent past have been public sector monopolies. All have suffered decapitalization, as rates have not moved in line with costs, especially where they were dependent upon imported petroleum. All failed to keep up with demand, the consequent outages jeopardising economic development and reducing the quality of life.
3. The efficiency of one or more public enterprise was improved from time to time, for instance in the Dominican Republic but the key to maintaining good performance over a broad front of entities over the long term seemed to elude most countries.
4. This group holds that public sector decision makers are rational maximizers of self-interest, just as are private sector decision makers. However, rather than seeking profit they seek approval, by providing benefits for which revenues to finance them are not levied. The consequences are often inflated public sectors and growing deficits. See Buchanan, James; Tullock, Gordon: "The Calculus of Consent".
5. In Jamaica the PNP government, former advocates of State ownership as a means of reducing the control of established oligarchies, now champions of deregulation and the establishment of a more competitive economy for precisely the same reason. Adam, C.; Cavendish, W.; Mistry, P.; Adjusting Privatization : Op. cit.
6. This was evident in Jamaica where initially emphasis was put on leasing hotels rather than outright sale. Over time resistance to privatization itself softened. Experience with the lease agreements also revealed weaknesses in that method of privatization which tended to emphasise short-term profitability, to the detriment of longer-term capital investment. Similarly, there was initial resistance to total privatization of the telecommunications sector, which was considered to be strategic. Yet as the State was unable to allocate the necessary financial and technical resources for upgrading, it progressively reduced its share from 83 per cent to 20 per cent over a three-year period.
7. Danns, D. - Guyana's Debt Problem. Paper presented to the 19th Regional Programme for Monetary Studies, November 1987.
8. Jefferson, Owen. Some aspects of Jamaica's External Debt, Bank of Jamaica, January 1988.
9. Ibid.
10. Thoumi, Francisco. "Privatization in the Dominican Republic and Trinidad and Tobago". From "Privatization of Public Enterprises in Latin America"; Ed. William Glade.
11. Thoumi, Francisco. op. cit.
12. Marshall, Elsa R. Privatisation of Public Enterprises, Policies, Methods and Procedures. Bank of Guyana.
13. Statement of the Minister of Finance in Washington February 1993. The Journal of Commerce, February 11, 1993.
14. Adam, C. Cavendish, W.; Mistry, P.; Adjusting Privatization P 110-112.

15. Allen, Mary. "Privatization and monetary developments in Jamaica". Presented to the 23rd annual conference of the Regional Programme of Monetary Studies, November 1991.

16. Ibid.

17. It has also been suggested that the first phase of privatization focused simply on the process of changing ownership. The second phase focused on putting the programme in the context of an overall private sector development strategy, which included appropriate regulatory framework, or deregulation where appropriate, which had as its goal a more competitive domestic economy. Adam, C.; Cavendish, W.; Mistry, P.; Adjusting Privatization : Op. cit.

18. Source: PIOJ; Economic and Social Survey of Jamaica 1991, 1992.

19. Ibid.

20. Source: National Planning Commission of Trinidad and Tobago; "Medium term Macro Planning Framework 1989-1995".

21. Ibid.

22. Ibid.

23. Yet even during this period the positions held on State ownership were not doctrinaire. The 1972 "White Paper on Public Sector Participation", as well as the Bruce Committee, convened to "make recommendations on the divestment of shares in public enterprises", recognized the option of divestment. Source: Sergeant, K. and Forde, P.; "The State Sector and Divestment in Trinidad and Tobago: Some Preliminary Findings" November 1991

24. Statement by Junior Finance Minister Ken Valley to Parliament, reported by the Trinidad Guardian of April 24, 1993.

25. Ibid. Four of these enterprises had by then been sold, for almost US\$ 200 million, a further ten were in various stages of divestment.



