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AN EVALUATION OF ECONOMIC PERFORMANCE OF CDCC COUNTRIES

*With Special Reference to the Genesis and Evolution
of the External Debt Between 1977-1986*



UNITED NATIONS

ECONOMIC COMMISSION FOR LATIN AMERICA AND THE CARIBBEAN
Subregional Headquarters for the Caribbean

Preface

This paper which is the second in a series of initiatives intended to evaluate the economic performance of member countries of the Caribbean Development and Co-operation Committee (CDCC) over a ten year period, has its genesis in the document entitled "An evaluation of the Economic Performance of CDCC countries (1974-1984)", reference number LC/CAR/G.182, dated 1 March 1986.

The initial document had as its objective a general overview of economic developments in the sub-region, taking as its departure point the first oil shock, which began to have its impact on Caribbean countries in 1974. It attempted to trace the structural changes which had taken place in these economies over the ensuing ten years, and was intended to complement the shorter term view taken in the annual economic surveys where such shifts might not be as clearly discernable.

While the initial document was of the nature of a stock taking exercise, it was intended that subsequent initiatives would focus on specific topics of interest. The external debt has been selected for this issue, for while it can be properly regarded as a symptom of past policies, it has nevertheless become an issue in its own right. Moreover, the debt was virtually ignored in the original survey, due to a scarcity of data. While this deficiency is now being partly remedied at the national level, there is, nevertheless, little work so far on the external debt as it relates to the Caribbean region as a whole, and there remains a lack of clarity as to whether the region has a debt problem, and if so what is its genesis, what are its characteristics, its effect on development, and what measures might be taken to limit its impact. This paper is accordingly, an attempt to initiate an examination of some of these issues.

The data used in the evaluation are compiled primarily from the annual economic surveys conducted by the Economic Commission for Latin America and the Caribbean (ECLAC,) which in turn rely essentially on official sources of national data; and, on the specialized subregional institutions such as the Caribbean Development Bank (CDB), and the East Caribbean Central Bank (ECCB). Data from the International Monetary Fund (IMF) and World Bank (IBRD) are used quite extensively in the section relating to global developments, and in those segments of the regional analysis relating to the balance of payments and the debt. Gratitude to these institutions is accordingly acknowledged.

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Executive Summary

For Latin America the external debt has been the major international policy issue since mid-1982, and it continues to dominate the agenda of North-South discussions to the present time. This is not surprising, since six Latin American debtors account for over 88% of the exposure of the major banks to the developing countries¹ and instead of being resolved despite intense effort over the past six years, the problem of the debt continues to be as intractable as ever.

For the Caribbean the debt as an issue has until recently been down-played partly because of the smaller overall magnitudes which are involved and the fact that their debt management initiatives have involved the bilateral donors and the multilateral financial institutions rather than the major private banks. These initiatives have accordingly not been regarded as newsworthy. Yet for some of the countries surveyed the problem is just as intractable as for the larger debtors, evidence of debt service difficulties coming to light as early as 1978. Moreover, many of the innovations which are currently being explored with the private banking system, in order to achieve some measure of debt relief, are denied Caribbean countries since their debt is primarily owed to governments or the Multilateral Financial System.

While taking the openness of Caribbean countries and their consequent vulnerability to external shocks as given, major emphasis has been placed on an evaluation of domestic policy choices. This orientation is made even more valid since the debt incurred in Caribbean countries, with the partial exception of the Dominican Republic, is either government incurred or guaranteed as a consequence of the growth of state or para-statal enterprises. Accordingly some time is taken in each case to examine the fiscal budget, its growth, its volume and the emphasis given to public expenditure, bearing in mind its ultimate impact upon the external account, and the external debt.

The three major debtor countries, the Dominican Republic, Guyana and Jamaica, have a number of characteristics in common, they are highly dependent on sugar and minerals, mainly bauxite for their export earnings, they are highly dependent upon petroleum for their energy needs, and they misjudged the nature of international developments in the mid-1970s implementing expansionary fiscal programmes, in an attempt to sustain artificially high levels of economic activity at a time of declining revenues, so that fiscal deficits became uncontrollable. All three countries had by this time achieved extensive government ownership of productive enterprises which were

¹ Source: B.I.S., International Banking and Financial Markets. Relates to the period June 1986.

losing money, so creating a drag on the taxpayer. As a result of this combination of factors their debt burden has grown rapidly over the survey period.

The seven countries comprising the Organization of Eastern Caribbean States (OECS)² treated in this section demonstrate in acute form the constraints faced by small open island economies. Moreover, as members of one currency area with one central bank, which acts within statutory limits on the extension of credit to member countries and which requires unanimity of membership on any change of parity, a measure of flexibility in the use of monetary and exchange rate policies for adjustment which is available to other countries surveyed is denied them. The strong link between fiscal policy and the external debt which is evident in the other countries surveyed is therefore even more accentuated in the case of the OECS countries.

The result of these factors is that a shock to the economy whether generated externally, or otherwise such as by natural disasters, is usually passed through without the usual measures of insulation. While this means that adjustment is often painful and immediate it also ensures that there is little leeway for postponed adjustment thus ensuring that many aspects of disequilibrium are not allowed to become chronic and cumulative.

For the most part, therefore, the debt has not become as severe a problem for the OECS as is the case in other countries and servicing the debt has for most countries been manageable. Nevertheless, there are quite significant differences between these and the other countries surveyed and among the countries themselves which are worthy of further investigation.

The other case treated, that of the petroleum producing country of Trinidad and Tobago, provides an interesting contrast to the other countries surveyed since it operated on a different phase of the trade cycle. The two oil shocks accordingly produced windfall gains for Trinidad and permitted rapid economic expansion at a time when other Caribbean countries were grappling with the problems of contraction.

Yet, similar underlying economic philosophies also encouraged expansion of public expenditures, both recurrent and capital. In the former case the rationale was employment creation and an attempt to better fit the public sector to manage the process of development. In the latter an attempt to capture windfall profits from petroleum so as to diversify the economy and accelerate development. Nevertheless, as petroleum prices contracted after 1982, Trinidad faced many of the problems bedeviling the oil dependent debtors, such as the need to implement a sufficiently

² Antigua and Barbuda, Dominica, Grenada, Montserrat, St. Kitts/Nevis, St. Lucia and St. Vincent and the Grenadines are the seven island states comprising the OECS.

timely and effective adjustment to reduced revenues, and to reduce the burden on the budget of large public enterprises that were not viable. As in the case of other Caribbean countries, policy shifts were difficult to execute so that, by the end of the survey period, signs of a debt problem were discernable as was the need to increase the pace of economic adjustment if Trinidad and Tobago was not also to face the dangers of excessive debt.

In conclusion two major themes have permeated the study. The first is the nexus between the fiscal account, the external account, and the external debt. The second which is a corollary to the first, evaluates the rate of growth and the composition of the fiscal deficit.

Public expenditure policy provides a clear understanding, in the countries surveyed of the reasons for the growth of the external debt. When this related to current expenditure and the debt was incurred for activities which would not be self-liquidating benefits derived from such expenditure would be chimerical since they would have to be cut back in the future. Moreover, as these artificial benefits would have been internalized, reduction or discontinuation of them would be seen as an undue hardship by the beneficiaries. Debt incurred for capital expenditure, however, held the prospect for repayment but repayment would only be forthcoming over the long-term in the case of infrastructure, or if a number of conditions necessary to secure commercial viability were met in the case of directly productive activities.

For the countries studied, the debt was incurred for three principal purposes:

(a) To sustain the level of economic activity and often non-productive employment during a period of foreign exchange shortage, caused by the two oil shocks and reduced earnings from exports. The assumption on the part of the policy-maker was that the foreign exchange constraint would be temporary and the debt would be repaid as the export boom returned. The assumption did not hold, however, since the debt was incurred at historically low but variable rates of interest, which were soon to return to the normal trends. Moreover, the export boom period of the late sixties and early seventies was not to return so that repayment became problematic.

(b) To achieve some measure of structural transformation. Efforts by the state in this regard may be divided into two phases:

(i) Initially, emphasis was placed on the structure of ownership moving away from foreign and private to local and public ownership and control. This was characterized by the acquisition of existing and often declining activities added to which was in-experienced and often deficient management. Accordingly, the internal efficiency of the firms declined at the same time that external conditions were forcing international

competitors to become more cost effective. Foreign exchange surpluses were therefore not generated to repay the debt, indeed the converse was true so that these enterprises served to increase the debt burden.

- (ii) The second phase of structural adjustment was initiated in recognition of the changing patterns of international trade which did not favor the export of raw materials and primary commodities but rewarded the development of manufactures and services. While debt incurred for adjustment would ultimately generate new sources of foreign exchange, the process by which new export generating ideas could be identified and the necessary resources put into place was necessarily long and fraught with risk. The urgent need to reorient activities to new ways served to highlight the lack of adequate depth in human skills, which while proving to be adequate to perform the familiar and well worn socio-economic tasks were unable to provide a sufficiently rapid and flexible response to rapidly changing external conditions. For the countries surveyed the debt incurred for this purpose was obtained for periods which are too short to show returns before repayment, so that rescheduling has become an ongoing characteristic of debt management.

(c) To establish directly productive activities, as the state in an effort to force the pace of growth, became involved in relatively large commercial ventures. These projects which had been financed on strictly commercial terms often concealed a large infrastructural component. Moreover, sufficient attention had not been paid to their commercial viability, due both to an inadequate understanding of international marketing trends, or due to an underestimation of the importance of managerial competence on overall operational efficiency. Accordingly, projects came on stream which were of suspect viability, constituting a further source of debt. Even where the conceptual hurdle of divestment had been overcome, local private investors were hesitant to take the risk of trying to turn around large enterprises which had proved ill- conceived. In other cases, where the projects were viable they were often so large as to create a severe debt servicing burden in the short to medium-term.

The debt which must be seen as a symptom of past policy choices had, nevertheless, for a number of the countries surveyed, become a severe impediment to future economic growth, and absorbed so much of the recurrent budget that basic services such as health and education had to be severely curtailed. There is currently no realistic expectation that sufficient growth can be achieved in the medium-term so as to grow out of the debt problem. Moreover in the cases of Antigua, Cuba, the Dominican Republic, Guyana and Jamaica the burden of servicing the debt was sufficiently onerous for them to have accumulated arrears at various times since 1978. Most of these countries were exploring measures appropriate to their specific debt

problems in order to provide some degree of debt relief and some of these measures are discussed.

While changing future expectations quite drastically, the debt had also served to focus attention on the role of the state in economic activity and particularly the growth, size, and use of fiscal deficits. The debate about the desirability of state involvement is unresolved, but there now seems to be an emerging consensus that all enterprises should be subject to similar micro-economic disciplines, whether they are public or private. Moreover, there is a growing awareness of the limited capacity of the state apparatus to discharge its primary functions, so that an expansion into commercial activities is being regarded with greater caution than hitherto. This is especially true since government guarantees have tended to relax the safeguards normally applied by the lender to any commercial venture and public ownership tends to transfer the costs of failure away from those responsible for making the original decisions.

Finally, the period under review has brought about a clearer understanding of the manner in which the component parts of the economies interact as well as a more realistic search for the sources of real economic growth. It has also served to create a fresh awareness of the constraints facing the policy maker and therefore to caution him of the limits beyond which he might not go in his efforts to force the pace of development.

Introduction

For Latin America the external debt has been the major international policy issue since mid-1982, and it continues to dominate the agenda of North-South discussions to the present time. This is not surprising, since six Latin American debtors account for over 88% of the exposure of the major banks to the developing countries³ and instead of being resolved despite intense effort over the past six years, the problem of the debt continues to be as intractable as ever.

For the Caribbean the debt as an issue has until recently been down-played partly because of the smaller overall magnitudes which are involved and the fact that their debt management initiatives have involved the bilateral donors and the multilateral financial institutions rather than the major private banks. These initiatives have accordingly not been regarded as newsworthy. Yet for some of the countries surveyed the problem is just as intractable as for the larger debtors and many of the innovations which are currently being explored with the private banking system in order to achieve some measure of debt relief, are denied them since their debt is primarily owed to governments or the Multilateral Financial System.

The debt must, however, be seen against the somber backdrop of the region's poor economic performance as a whole, to which it has now become a major contributor. Since 1981, Latin America has been suffering from "the most severe economic crisis for the last fifty years".⁴ The crisis which has persisted to the present, is widespread and multifaceted and has affected all categories of countries, though not all to the same extent. It has been characterized by a "failure to achieve growth, external balance, and price stability simultaneously."

(Accordingly), "the sequential pursuit of these basic macroeconomic equilibria in recent years, oftentimes at the expense of one another, has tended to render tenuous, if not short lived, what achievements there have been. Thus, inflation, (accelerated by heavy devaluations) or stagnation (due to compression of imports) has often been the price of correcting external imbalances; recession and worsened income distribution (the outgrowth of unduly restrictive demand policies), the price of slowing inflation; and external maladjustment (due to overheated demand), the price of recovery. The cumulative effect of such see-saw policy responses has been to accentuate cycles in the region's economies and so, to preclude solid and sustained growth."

³ Source: B.I.S., International Banking and Financial Markets. Relates to the period June 1986.

⁴ ECLAC: "The Economic Crisis: Policies for Adjustment Stabilization and Growth." (LC/G.1408 dd 4 April 1986)

"Such instability is a reflection, not so much of policy shortcomings, as of the limited degrees of freedom imposed on policy by the acute scarcity of foreign exchange deriving from a long unfavorable external context and a heavy debt burden. This has made the region's economies more sensitive to demand and supply shocks, be they external or domestic in origin."⁵

These comments made in the context of Latin America as a whole, are amply demonstrated in the case of the three major Caribbean debtors, the Dominican Republic, Guyana, and Jamaica, and some of these characteristics are present in other Caribbean countries to greater or lesser extent.

By 1987 the Latin American debt problem had become sufficiently intractable for Brazil to suspend interest payments on its debt, for Peru to limit debt service to a fixed percentage of its export earnings, and for Ecuador to announce a moratorium on its repayments, while a number of other countries such as Bolivia, Costa Rica, Ecuador, Honduras, and Nicaragua were in arrears on their interest payments.

In the Caribbean the situation was somewhat similar as Antigua, Cuba, the Dominican Republic, Guyana and Jamaica had accumulated arrears at various times since 1978, and most of these countries were exploring measures appropriate to their specific debt problems in order to provide some degree of debt relief. The following chapters attempt to shed some light on the causes and the structure of the debt problem in the Caribbean and to describe some of the measures being explored to secure relief.

While taking the openness of Caribbean countries and their consequent vulnerability to external shocks as given, this paper has placed major emphasis on an evaluation of domestic policy choices. This orientation is made even more valid since the debt incurred in Caribbean countries, with the partial exception of the Dominican Republic, is either government incurred or guaranteed as a consequence of the growth of state or para-statal enterprises. Accordingly some time is taken in each case to examine the fiscal budget, its growth, its volume and the emphasis given to public expenditure, bearing in mind its ultimate impact upon the external account, and the external debt.

⁵ ECLAC: Economic Panorama for Latin America 1987. (LC/G.1481 September 1987).

services over the survey period as set out below:

SELECTED DEBT INDICATORS						
Country	Debt/G.D.P.			Debt Service ratio		
	1977	1980	1986	1977	1980	1986
CATEGORY 1						
Guyana<1>	39.9	85.1	292.9	14.2	22.3	81.4
Jamaica	28.2	82.2	147.8	14.5	24.0	58.9
Dominican Rep<2>	27.0	31.8	70.8	30.7	59.7	18.0
CATEGORY 2						
Antigua	50.0	73.0		...	6.3	9.3
Dominica	33.2	62.9		...	4.1	9.1
Grenada	22.9	52.5		...	4.1	15.8
Belize	28.3	45.2		...	1.4	9.7
Haiti	20.5	34.2		...	4.9	12.0
St. Vincent	34.8	31.2		3.5
St. Kitts/Nevis	26.2	29.5		...	1.1	8.3
Trinidad/Tobago	6.8	22.4		...	6.1	11.3
Barbados	9.5	20.7		...	1.9	6.7
St. Lucia	18.5	20.2		...	1.8	2.6
Bahamas	8.4	9.9		...	2.6	8.8

Source: ECLAC, derived from national data.

<1> Includes arrears.

<2> Includes private debt; 1986 debt service ratio relates to interest payments only.

Table 1

The three major debtor countries, falling into category 1, have a number of characteristics in common. They are highly dependent on sugar and minerals, mainly bauxite for their export earnings, they are highly dependent upon petroleum for their energy needs, and they misjudged the nature of international developments in the mid-1970s implementing expansionary fiscal programmes, in an attempt to sustain artificially high living standards at a time of declining revenues, so that fiscal deficits became uncontrollable. All three countries had by this time achieved extensive government involvement in productive activities which were losing money so creating a drag on the taxpayer. As a result of this combination of factors their debt burden is quite high compared to the other major debtors in the region. (Figs.1 and 2.)

Nineteen seventy-six marked a watershed in the economic development of these countries, for it was at that time that the full impact of external events, (energy price rises having to some extent been cushioned between 1973-1975 by buoyant sugar prices and strong demand for minerals) and the effects of domestic policies came together to change the trend of economic performance from that which prevailed in

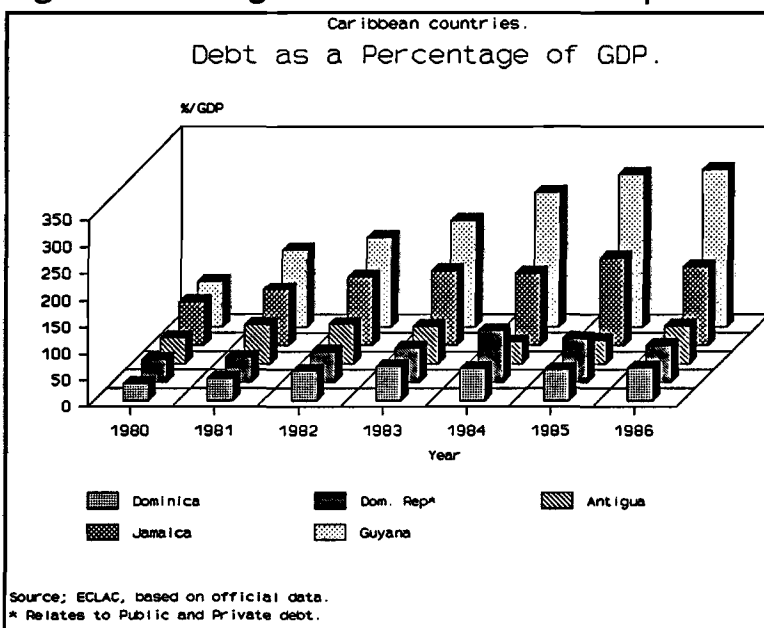


Figure 1

the previous decade. For these countries "the crisis" began in 1976 and the debt is to be seen as the symptom of this crisis. It is nevertheless, also true to say that for these countries the debt now, of itself, constitutes the major impediment to future growth, a claim which cannot be made for other Caribbean countries at the present time, with the possible future exception of Trinidad and Tobago, which manifests different characteristics and will accordingly be treated separately.

While the period covered by this survey is 1977-1986, it is impossible to get a clear insight into the genesis of the debt problem without an examination of the development path pursued by these countries for the decade prior to 1977. The analysis will therefore open with a brief outline of economic developments in these countries during that period. After 1977, the main theme of the paper will focus on the measures adopted in an attempt to cope with the crisis of 1976; initially through financing mechanisms and their contribution to the debt; and, latterly through structural adjustment measures, the financing of which made its own contribution to the Debt.

Indeed, by the end of the survey period that portion of the debt incurred with the multilateral financial institutions had become sufficient, both in terms of its volume and the inflexible conditions surrounding its repayment, to jeopardize the adjustment process it had been incurred to achieve. As the path of these developments is traced special note will be taken along the way of growing interest rates in the late 1970s, the second oil price shock, the global debt crisis of 1982, and the subsequent scarcity of new private capital inflows, decline in the demand for minerals, and the cumulative effect that these have had on the management of the debt.

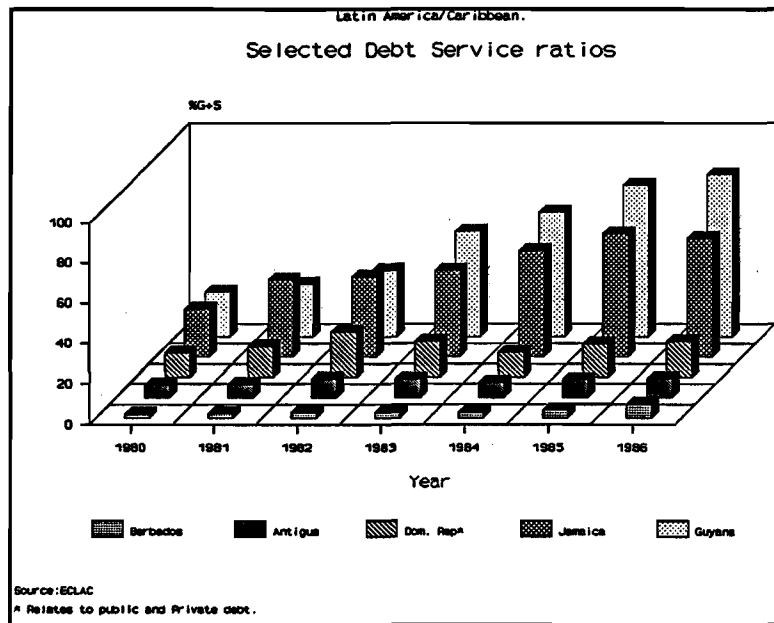


Figure 2

The Genesis of the Debt Problem

For the countries examined in this section the trends policies and outcomes show many similarities. Up to the beginning of the seventies economic growth was rapid, and based essentially on foreign direct investment, followed closely by high external prices for minerals and sugar. In an atmosphere of relative prosperity, at a favorable point in the trade cycle, policy emphasis shifted from maximizing economic performance towards securing the ownership of such income generating activities into the hands of the state. As a consequence the state apparatus expanded so that pressure was placed on the budget to pay for newly acquired assets and to pay for the increased public service.

By 1973 the first oil price shock had begun to impact on the external accounts of all three countries, which were highly dependent upon petroleum imports for energy. The adjustment process was, however, postponed due to still buoyant export prices, and the failure of policy makers to judge the extent and duration of the petroleum price increases. These increases in turn were not automatically passed on to the consumers so that demand did not adjust to the increased price. When commodity prices declined, and soon after demand for bauxite/alumina contracted, the balance of payments became vulnerable, due to a number of factors which included: decreased earnings; increased expenditures for petroleum; and increased demand for imports not matched by productive output due to greatly expanded budget deficits.

In the Dominican Republic 1966 ushered in a return to internal stability after a period of civil conflict. This favorable development 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%. During this ten 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% 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 seventies, from almost nothing to about 25% 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, and 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%, while the contribution of non-tradables, mainly construction, grew by 13%. 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 benefitting from the commodities boom. The economy was accordingly made more vulnerable to the further external shocks which were to come.

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%) and bonds (38%). Local business interests were limited to agriculture, local trading and minor manufacturing.

The post independence phase focussed on expanding economic and social infrastructure through major projects such as sea defences, rice rehabilitation, roads, airports, and electricity. 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, the former increasing by 20% between 1966-70. 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% of exports in the former year to 3.4% in 1970. The ratio of bilateral debt had by this time increased to 79% of the total, although contacts had recently been initiated with the multilateral institutions. Commercial debt remained insignificant at this stage.

In 1970 Guyana was declared a co-operative republic, with one of the central objectives being that of securing national ownership and control of domestic resources, a policy which was to have far reaching implications for Guyana's debt profile. The debt incurred in 1971 due to nationalization accounted for 66% of the 83% 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 debt incurred for that purpose was greater than the total external debt incurred up to 1970 (Fig. 3).

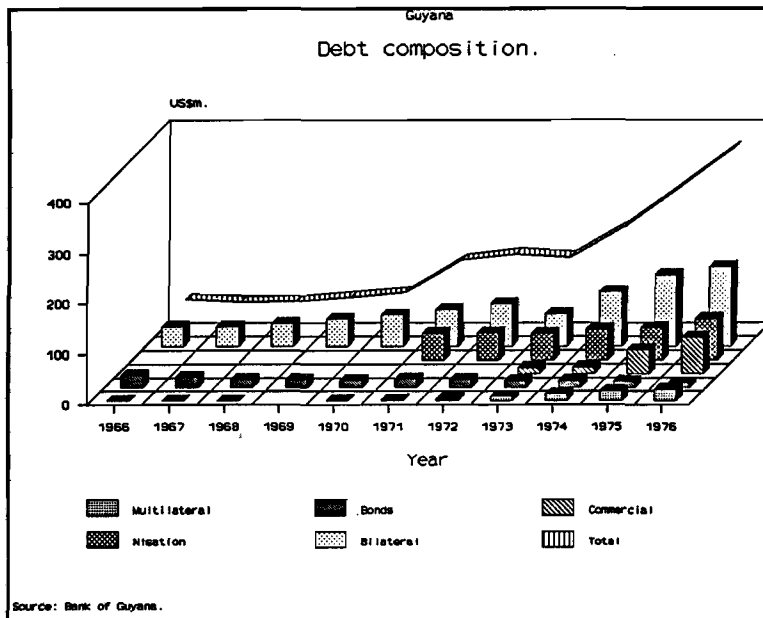


Figure 3

After its attainment of independence Guyana was able to further diversify its sources of foreign loans, and while bilateral debt continued to predominate the sources of these loans expanded to include non-aligned, eastern European and OPEC countries, in addition to the customary OECD sources. These funds were initially used for financing projects, but from 1974 balance of payments support was also provided from bilateral sources.

Multilateral funding also grew steadily during this period

although the overall proportion was still modest at less than 7% of the total in 1976, funding going to finance infrastructure projects and to institutions such as the Mortgage Finance Bank and the Agricultural Industrial Bank, for on-lending.

Of even greater significance for the long-term debt profile was the growth in commercial debt, incurred to provide working capital for the nationalized entities. It began in 1973, at 8% of the total external debt, yet by 1976 had grown to 20%. This debt was to have serious implications for the long-term debt service, since it had short maturities, at variable interest rates, yet was used to finance long-term development.

From 1970-1976 Guyana's external debt increased by 358%, yet until the previous year 1975, the debt service ratio was not significantly different from 1966 at 4.4%, and this despite the impact of increased petroleum costs, which grew by 134% 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, which in the case of Guyana grew by 197% between 1973-1976. By 1976 the debt service ratio had however jumped, from 4.4% in 1975 to 12.6% in 1976, and with declining output and external prices the stage was set for an economic and debt crisis.

Similarly, in Jamaica, the decade of the sixties saw relatively high rates of economic growth 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%.⁶ This surplus together with modest official capital flows, official flows being on average 7% of private flows, together created a substantial increase in the reserves. In 1970 total external public debt was less than 16% of GDP, and debt service represented less than 3% of exports of goods and services.

For the first two years of the seventies the growth performance of the previous decade continued; 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 increased by 157% between the fiscal years 1971/72 and 1973/74, moving from 3% to 5% of GDP. At the same time the first effects of the first oil shock were about to be felt. In 1973 the external debt, reflecting these facts, but mainly due to the rapid growth in the fiscal deficit, grew by 64%.

Between 1974-75 the full force of the oil price increases impacted upon the import bill, expenditure for fuels increasing by 195% between 1973-1975, equivalent to 28% of merchandise exports compared to less than 15% in 1972. By the end of 1975 the growth of export earnings which had hitherto been buoyant slowed down to 6%, output of the manufacturing sector peaking in 1973, and bauxite/alumina in 1974. The public sector deficit continued to grow, by a further 96% over the previous year resting at 9% of GDP for fiscal year 1975/1976. The external debt had by 1975 grown to 31% of GDP; the debt service ratio representing 7.4% of export earnings. Reserves which had begun to decline in 1972, continued to fall each year with the exception of 1974.

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% over the previous year; and, as a consequence of this conjuncture of events export earnings as a whole declined by 15%. Reflecting the decline in the economy, current revenues declined by 8% in fiscal year 1976/1977 although current expenditures continued to grow by 26%. 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%, the overall budget deficit increasing by 88% to represent 19% of GDP. Not surprisingly the reserves continued to fall, representing 0.3 months of imports by the end of 1976. The debt had by this time increased to represent 30% of GDP.

⁶ Jefferson, Owen, Some aspects of Jamaica's External Debt, Bank of Jamaica, January 1988.

Evolution of the Debt Problem

The ten year period 1977-1986 witnessed a structural change in the global economy. Rates of growth in the OECD countries had generally fallen, after an initial phase of high growth and inflation. The economic contraction was caused in part by a fear of the effects of continued inflation which had reached historically high levels and the principal means used to contain it, a contraction in the money supply, had the effect of slowing down growth and increasing interest rates.

More fundamentally, however, due to the conjuncture of a number of technological developments, there had been a rapid reconfiguration of many economic activities, the growth of new ones, and the obsolescence of others. At the same time those activities having the most potential for future growth were knowledge, rather than labor or raw materials intensive, so that the relationship between growth in the industrial centers and growth in the demand for primary products from the developing countries had changed, to the disadvantage of raw materials producers. Producers of innovative and internationally competitive manufactured articles, both in the industrial centers and in some of the newly industrializing developing countries, had at the same time been favored.

This period of rapid change was also characterized by increased uncertainty and unpredictability in the system of international trade and finance, due in part to the aforementioned changes in production technologies and shifts in demand, but also because of the rapidly growing degree of integration in the international economy. The consequence was rapid and unforeseen reactions to nullify domestic policy measures, rapid and enormous shifts in capital and goods, rapid changes in exchange rates, and the intensification of protectionist measures, sometimes in response to the above. Attempts to coordinate the policies of the economies of the major industrialized countries had lagged behind such developments, and accordingly the process of domestic economic development was made more complex.

These global developments had impacted adversely on Caribbean and Latin American countries as declining terms of trade and historically high interest rates made it difficult for them to meet the large debt obligations which had been incurred in the previous time period.

By 1977 the efforts of the international banking sector were focussed on recycling the petro-dollars and it was felt that as long as the process of recycling continued the deflationary impact of the oil price increase would be avoided. Interest rates at this time were historically low and often negative in real terms, though loans were made for short durations and at variable interest rates, and they were easily negotiated once they had received the imprimatur of governments. Once in possession of government

guarantees creditors were not unduly concerned with the purposes for which the loans were incurred, and the debtors did not resist the temptation to use such funds to finance internal consumption of already overheated economies.

As interest rates began to recover, the cost of debt servicing became a serious factor and by the second oil shock the preconditions were set for the debt crisis.

The Dominican Republic

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 seventies 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.

Adjustment efforts began in 1982, only when the nation's creditworthiness had been so eroded that no new funds were forthcoming to finance the domestic and foreign deficits. Accordingly, the measures finally adopted needed to be quite stringent. The stabilization programme, negotiated in conjunction with the IMF and which began in 1983 and included some debt rescheduling, was abandoned within six months.

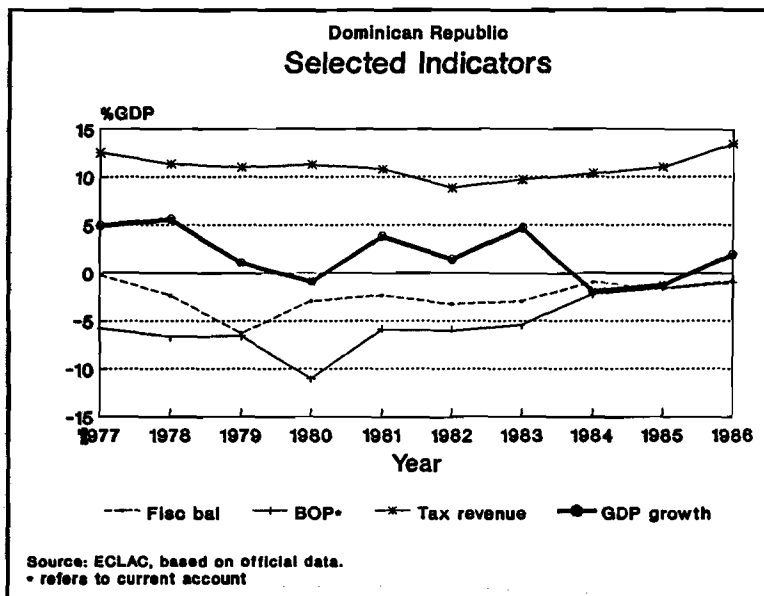


Figure 4

After further policy uncertainty in the intervening period, 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. By the end of the survey period some success had been achieved in restoring economic equilibrium but at quite high social cost and the indications were that reflation of the economy had begun earlier than had been planned and before an adequate degree of adjustment had been achieved.

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. Fairly high rates of growth were achieved in the following period particularly in 1981 and 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. By the end

of the survey period growth was again being stimulated, although significant imbalances remained in the economy (Figure 4).

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. 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, consumption of energy products did not fall commensurately with the rise in prices, a factor which increased the impact on the external account. At the same time a number of 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.

Tax revenues which had amounted to 17% of GDP in 1970 fell to 11% by 1978 where it remained until 1982 reaching a low of 9%. This figure compares with almost 29% for Jamaica in the same year. With the onset of the adjustment programme in 1983 and a reformed tax structure, which included an emergency surcharge on imports of 10% and increased rates for electricity, revenues recovered somewhat to stand at 13% by the end of the survey period.

Erosion of the external balance was also rapid after 1977, the current account deficit growing from US\$-265m. in that year to a low of US\$676m. by 1980, the fuel bill alone accounting for US\$270m of the increase and moving from 22% of merchandise imports to 30% in 1980. 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% of the (contracted) imports. After 1982 the import bill remained fairly

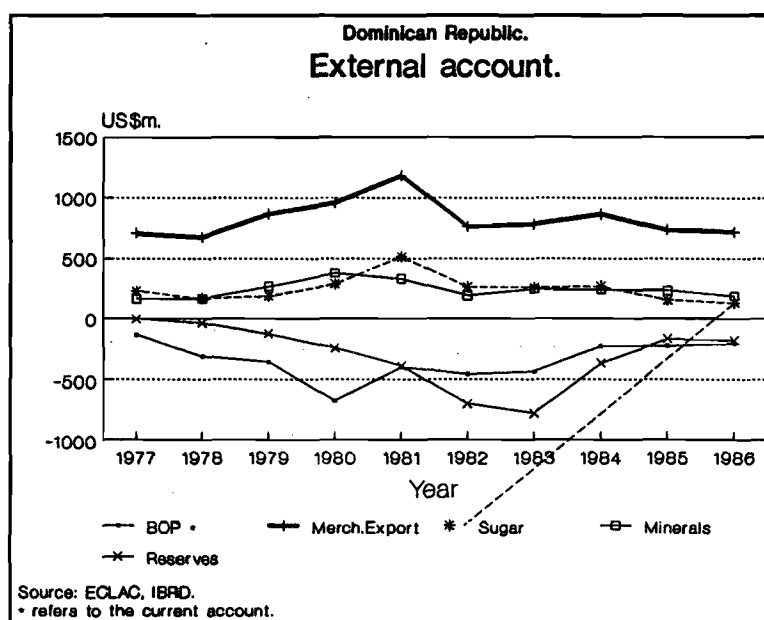


Figure 5

stable, the current account deficit declining to about US\$200 million by the end of the survey period. (Figure 5).

Reserves were rapidly depleted after 1977, when they stood at about US\$1m., to US\$391 million in 1981. Within two years this deficit on the reserves had almost doubled to US\$781m, the rapid erosion of the external account reflecting in part the undervalued exchange rate. During the period there was also significant capital flight, itself a reflection of loss of confidence in the economic policies being pursued. Between 1982 and 1984 the average exchange rate depreciated by about 90% and together with other adjustment measures impacted favorably on the balance of payments.

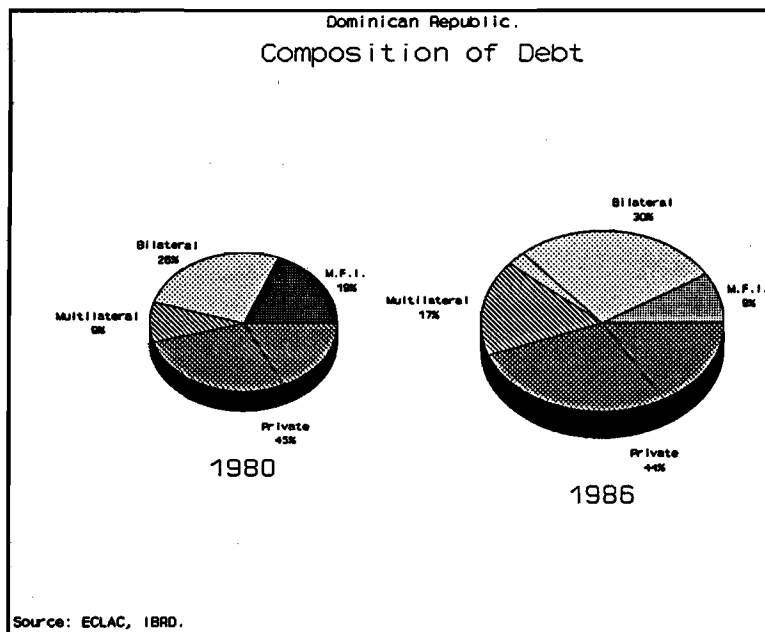


Figure 6

The external debt increased from about 27% of GDP in 1977 to almost 32% in 1980 at which time it required the equivalent of 12% of exports of goods and services to service the government guaranteed portion of the debt. The most dramatic increase in the debt was recorded in 1980, of 58%, although in the next three years it increased by almost another 52%, standing at almost US\$3300m by the end of 1983. Servicing the debt now required 18% of exports although this had declined from the previous year which required 22%. The decline was due to a

rescheduling which took place in early 1983, in conjunction with the IMF programme. For the period 1984-1986 inclusive there was a further increase in the overall debt, but the rate had moderated somewhat to 10% for the period, due in part to concerns about the overall size of the debt which now represented 71% of GDP and the cost of debt service. The latter had however, decreased slightly to require just under 18% of exports.

Changes in the composition of the debt are illustrated (Figure 6). In 1978 private debt amounted to 50% of the total but this was to show a steady decline over the survey period to 45% in 1980, and 42% by 1986. The selection of 1986, however does not provide an accurate picture of the trend in the interim, for as the overall debt increased, the proportion of government guaranteed debt increased. This trend

became most marked after 1983, which registered a fall in the proportion of private debt from the level of 1982 to 34%, the figure declining slowly thereafter, until the last year of the survey period which showed increased private flows due to the imprimatur of the IMF programmes. During the period bilateral and multilateral flows grew at moderate and steady rates.

The Dominican Republic has been active throughout the survey period in an attempt to improve the terms and conditions relating to its debt, and yet has experienced difficulty in meeting its obligations. While government had been able to obtain its external financing on favorable terms up to 1975, with growing current account deficits it became necessary to seek new sources of funding from the private commercial banks, despite the imposition of less favorable terms.

Management of the debt portfolio became a pressing government priority by 1976 and a moratorium was agreed in that year for US\$60m to finance oil imports in 1977. Refinancing of US\$360m. of the external public debt was also negotiated in 1979 which increased the share of long-term credit from 51% to 59% of total debt. Despite this respite arrears continued to accumulate in 1980. In early 1982 an agreement was entered into between the central bank and commercial banks to reschedule US\$400m in arrears.

In December 1983, a further debt renegotiation was carried out for US\$500m. to defer payment for five years with a one year grace period ending in January 1985. Efforts to renegotiate the bilateral debt were delayed in 1983 and 1984 pending an agreement with the IMF, which was finally negotiated in December 1984.

In 1985 comprehensive negotiations were once more conducted with the private banks for US\$790m. extending the period of repayment to 13 years with a grace period of three years and a semi-grace period of two years and interest at $1 \frac{3}{8}$ over LIBOR. The debt outstanding to the Paris Club was by now US\$290m, of which US\$172m represented arrears up to December 1984. New repayment periods were agreed at rates which were determined by the individual governments, but in general the terms were less favorable than had been agreed with the commercial banks earlier in the year.

For the first eight months of 1986 repayments proceeded in accordance with the agreements reached in 1985, but on accession of a new government new policies were articulated regarding the cost of debt service and by the end of the survey period renewed negotiations were in train, and various measures being mooted such as debt-equity swaps in order to ameliorate the debt burden.

Guyana

In 1977 the economy of Guyana had begun to contract after a period of steady growth throughout the decade. An increase of 29% in real G.D.P. had been achieved between 1970-1976, but 1977 recorded a real G.D.P. contraction of 2.6%, and started a phase of stagnation which was to continue throughout the survey period (Fig.7).

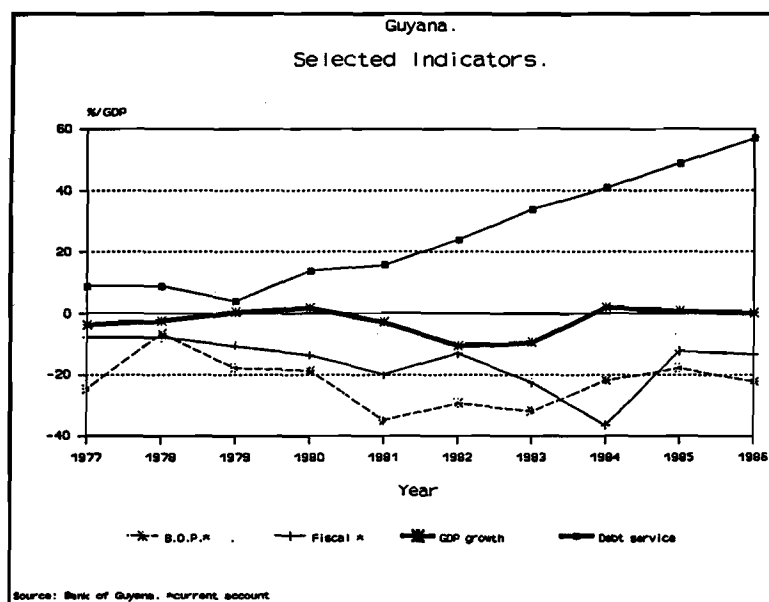


Figure 7

As was the case in other countries the fall in commodity prices precipitated the economic decline, 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. Accordingly the external debt consequent on nationalization represented 22% of the total debt and exceeded the debt incurred up to 1970.⁷ 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 IMF. A standby agreement was negotiated in 1978 which had some success in reducing the overall public sector deficit from 22% of G.D.P. in 1977 to about 6% in 1978, although current expenditure in fact increased slightly. In 1979 an Extended Fund Facility was

⁷ Danns, D. - Guyana's Debt Problem. Paper presented to the 19th Regional Programme for Monetary Studies, November 1987.

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 G.D.P. 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 proved particularly fortuitous since it provided a cushion against the doubling of oil prices in 1979/1980, still allowing a G.D.P. growth of about 2%.

For the three years 1981-1983 G.D.P. declined consecutively, the most significant fall being recorded for the years 1982, 1983. Economic contraction is attributable to a decline in export earnings for Guyana's main exports, bauxite, sugar and rice. (Figure 8)

Output contracted due to intractable technical, financial and organizational problems in the industries, to which was added poor weather which 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.

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 became a drag on the public purse, necessitating increased borrowing. The fiscal deficit on current account continued to decline, by 1983 representing more than 20% of GDP.

The external debt in 1977 stood at 40% of G.D.P. and the debt service burden had started to grow rapidly, standing at 14.2% of exports in that year, and up from a mere 4.4% two years earlier, for as the debt increased export earnings had started to contract due in part to weakening external prices. In the following year Guyana had already reached the limit of its debt servicing capacity and was forced to reschedule

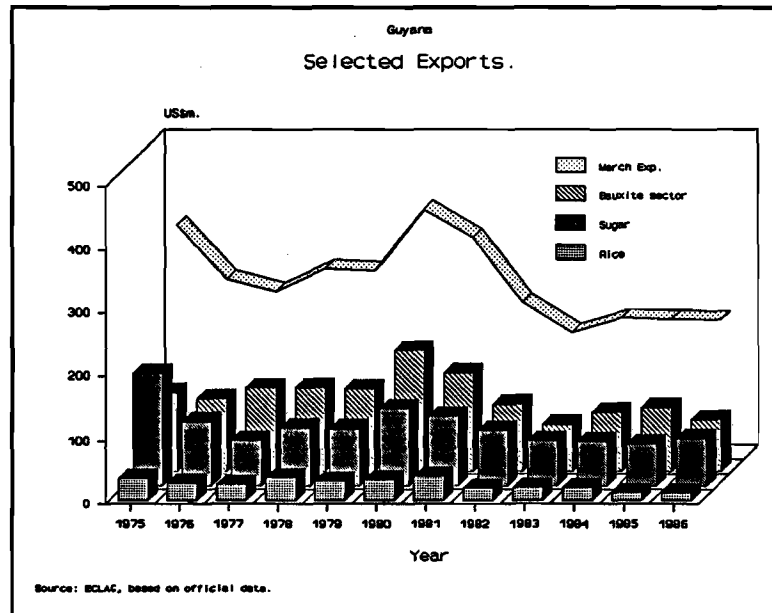


Figure 8

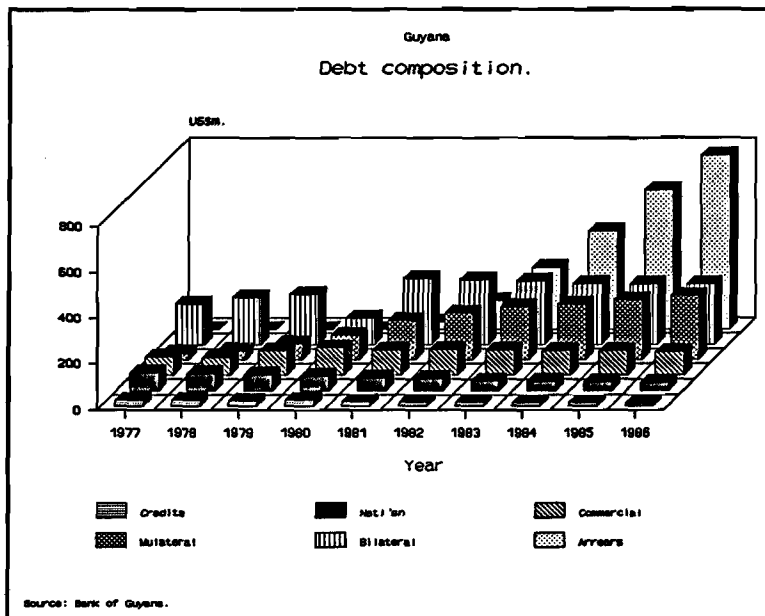


Figure 9

some of its debts. Yet between 1978 and 1983 the external public debt more than doubled and the debt service ratio moved from 15.3% to almost 53%.

The composition of the debt had by this time changed, new inflows coming mainly from bilateral and multilateral donors, as well as the 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. (Figure 9)

Public sector enterprises continued to loom large in the demand for 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\$185m. 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\$34m in 1981, US\$126m in 1982, to US\$270m in 1983.⁸

For the years 1984 to 1986 the economy resumed moderate growth averaging about 1%. Export earnings recovered from the nadir of 1983 and stabilized for the following three years at a figure marginally higher due mainly to recovering earnings from the bauxite sub-sector up to 1985, with sugar increases compensating in 1986. The exchange rate was adjusted twice in 1984, on the second occasion to move with a basket of five major currencies. While there was a slow erosion of the currency after that time it was still widely believed to be overvalued by the end of the survey period. Overall public sector fiscal deficits continued to grow, due mainly to the unresolved

⁸ Danna D. op. cit.

problems of the public sector enterprises. The central government current account deficit, however, declined to about 13% of GDP in 1986, showing a reduction over 1984 when the deficit was greatest.

The period is characterized by a modest increase in the actual inflows of new debt, in fact 2% growth between the end of 1983 to 1986, due mainly to an inability to secure new loans the increases, such as they were, coming 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% of scheduled debt repayments.⁹

Due to the unavailability of external funds government deficits were increasingly covered by local borrowing after 1982. While emphasis has not been placed on the internal debt in this paper, note should also be taken of its growth, which impacts upon the money supply, the rate of inflation and ultimately upon the external account.

By the end of the survey period the Guyanese economy was in a state of torpor. Disbursed debt amounted to US\$706m, a 2% growth over the previous year, while arrears in excess of that figure had accumulated, at US\$771m. The external debt including accumulated arrears stood at the equivalent of 293% of G.D.P. The total amount of debt service falling due was over US\$202m, equivalent to 57% of GDP and over 80% of export earnings, yet the system was only able to meet 16% of this figure. Despite this small outflow there was a negative transfer of resources as outflows exceeded new inflows by 138%. In the same year imports into the economy amounted to 102% of total export earnings, and net international reserves were US\$-543m.

Guyana has taken several initiatives to cope with its debt burden. While it has undertaken to pay all its debt it has nevertheless assigned priorities to the various categories of debt for repayment purposes, to favor the multilateral debt. In fact it has not been able to fulfill its obligations to all the institutions in this category, far less to meet its obligations consequent on nationalization, to the bilateral creditors or to the commercial banks.

Debt rescheduling has already been mentioned, that of 1982 involving a consortium of twenty-nine banks, in which principal owed was converted into a long-term loan with interest rates being 2.5% above LIBOR. Agreements have also been entered into with individual creditors for specific sums, such as ALCAN, for debt owed for nationalization of bauxite installations, to provide a five year extension to the original

⁹ Dannels, D. op. cit.

20 year agreement, retirement of the debt being made on the basis of supplies of bauxite.

Some countertrade arrangements have also been made in relation to CARICOM debt and efforts have been made to convert some loans to grants. These measures worthwhile as they are, do not significantly relieve the debt burden since relatively small sums are concerned. Moreover, multilateral debt for which there are no current relief measures comprises 20% of the total debt, or 40% if arrears are excluded.

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

Jamaica

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 an upturn in 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 faster than both and so did the debt (Figure 10).¹⁰

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.¹¹ 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

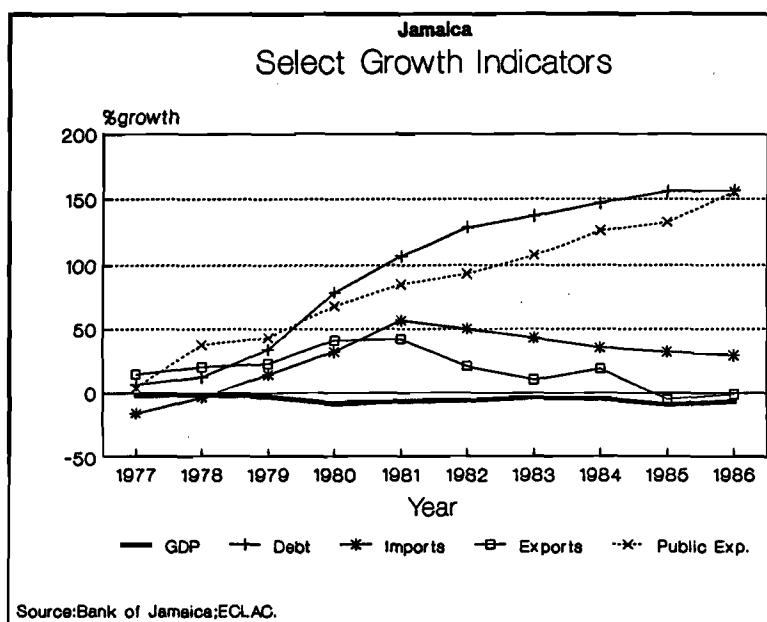


Figure 10

¹⁰

Figure 10 shows the cumulative totals for the period.

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Jefferson, Owen "Some aspects of Jamaica's external debt" Bank of Jamaica, Kingston Jamaica. January 1988.

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% of GDP, and the debt service ratio at 14.5%. By 1980 the debt had grown to US\$ 1.7 billion, equivalent to 82% of GDP and the debt service ratio had increased to 24%, if interest accruals are included. A trend was by now discernable for the debt to move away from commercial banks, for whereas in 1978 40% of the total was owed to them this had fallen to 26% in 1980 and was to fall further to just under 11% by the end of the survey period. During the same time period bilateral debt moved from 30% of the total in 1978 to about 51% in 1986, and multilateral debt from 18% to 36%. The changed structure of the debt was to have implications for later debt management policy. (Figure 11).

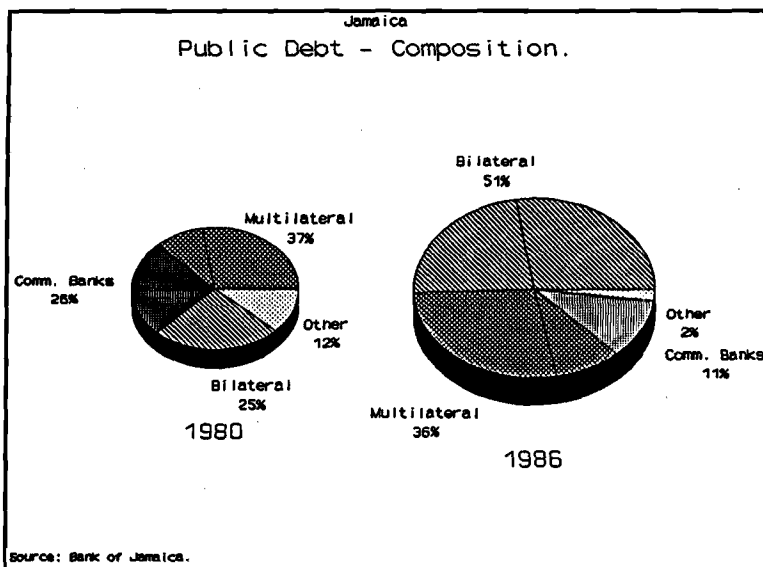


Figure 11

During the period 1977-1980 economic policy was subject to much national debate, I.M.F. policies not achieving a consensus within the government and being 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 policies. 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.

While the "mixed" economy advocated in the 1970s encompassed specific efforts by the state to reacquire lands owned by mineral and sugar 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 evolving government policies or in other cases of genuine insolvency. This was the case particularly in the tourist sector or retail distributive trades.

As a consequence of these developments, by the end of 1980 the Jamaican Government had a portfolio of investments in directly productive activities of 198 companies, 81% of which were wholly owned. The main categories were:

- (a) Agriculture 51 enterprises 76% of which were wholly owned;
- (b) Housing, 3 enterprises, 2 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, thirty entities, 83% wholly owned;
- (f) Industry and Commerce, 49 enterprises 84% wholly owned;
- (g) Public utilities, nineteen entities ranging from airlines to merchant shipping to tele-communications, eleven of which were wholly owned; and,
- (h) Media enterprises, three, all of which were wholly owned.

By 1981 domestic economic policies had changed somewhat and a new Extended Fund Facility was negotiated with the I.M.F. Based on the premise that past years had witnessed a reduction in the capital stock, the new programme placed continued reliance on external capital flows to resuscitate the economy. The structural adjustment programme in 1981 was also designed to orient the economy towards export promotion rather than import substitution, to re-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. 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.

Judged by its stated objectives the performance with regard to the public enterprises was mixed. The overall quantum of public investment remained high and even grew, averaging 10% of GDP and half of total investment over the decade of the eighties. While the overall orientation of capital expenditure was away from the directly productive and social sectors towards public utilities and transport, there were some instances of increased investment in directly productive activities, such as the expansion of the Cement Company, the expansion of coffee production, or efforts to gain control

of a bauxite operation which government had previously leased. Other injections of funds were necessary to prepare entities for divestment such as the refurbishing of hotels. But underlying many of the seeming contradictions the basic orientation was one of support for the private sector, resources flowing to them primarily through the National Development Bank and the Agricultural Development Banks.

Capital transfers to the rest of the public sector were significantly reduced as the financial performance of the public enterprises improved. Transfers to Agricultural Marketing Boards were reduced as they were put on an economic basis, and many programmes were transferred to producers and made self-financing. Electricity and water utilities recorded substantially improved performance and government disengaged from the area of low cost housing. Taken together with a complete reform of the tax system the overall public sector deficit had declined from as high as 22% of GDP to 6.5%.¹²

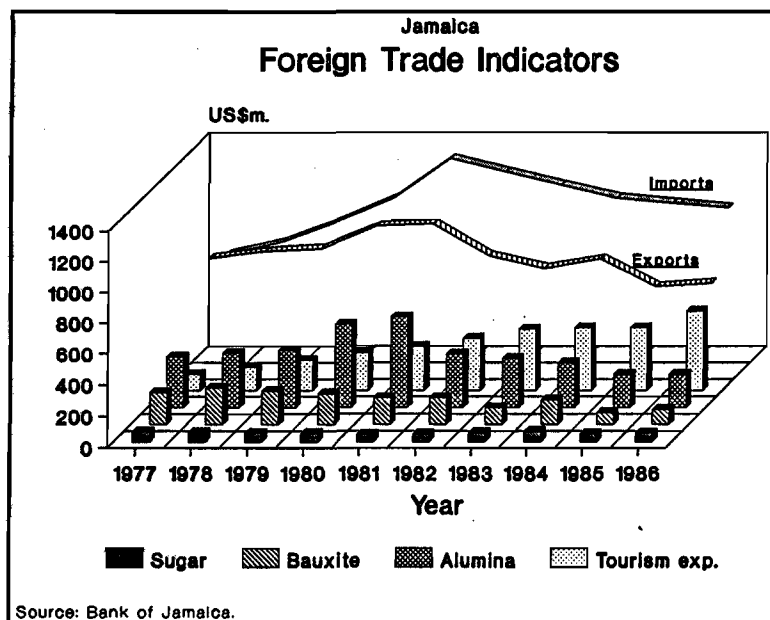


Figure 12

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 debt service ratio standing at 43% by 1983.

Moderate economic growth was achieved between 1981-1983, as opposed to contraction in the previous three year period, due to a heavy reliance on external capital flows, but this was achieved at the price of a rapid increase in the external debt, which grew on average by 19% between 1980-1983. Capital flight which had moderated between 1980-1982 was resurgent by 1983, reflecting once more a lack of credibility in the prevailing policies. Export earnings had also contracted after 1981, due to declines in traditional agricultural exports,

¹²

In fiscal year 1986-1987. This has been achieved despite a collapse of Jamaica's major export, bauxite/alumina, and the losses of the Bank of Jamaica due to the debt consequent on the depreciation of Jamaica currency. The country has, however, paid a high price in terms of retrenchment in the public sector, reduction in the social services and in the reduction in maintenance of physical infrastructure.

The latter would have been greater had it not been for a resurgent tourism industry (Figure 12).

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. Central government deficits exceeded 16% of GDP at that time as compared to the target of 10.5%, and the Balance of Payments deficit was US\$ 306 million compared with a target surplus of US\$125 million. A major factor in the non compliance with targets was an unanticipated decline in alumina revenues, upon which the economy and all the targets had been dependent for viability.

The external debt had grown at undiminished speed in this phase to almost US\$3 billion or 140% of GDP, by the end of 1983.¹³ Because of declining export earnings the debt service ratio had also increased from 24% in 1980 to 43% of export earnings, if accruals are included. Actual payments possible amounted to somewhat less, however, at 27.9%.

Between 1984 and the end of the survey period in 1986, a new emphasis was placed on adjusting the economy and managing the growing external debt. By the end of 1986 it was clear that these objectives were being realized, though at the cost of economic stagnation. nevertheless the debt represented almost 148% of GDP and the debt service ratio had grown to almost 59%.

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 reduced, fiscal and monetary measures being substituted 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 a floating band arrangement had been instituted in November 1983, in an attempt to establish an exchange rate equilibrium. By November 1984 the currency had been devalued by over 60% and the mechanism of floating with various modifications was to continue until the end of the survey period.

¹³ The figures are somewhat deflated since Central Bank debt, i.e. debt owed predominantly to the I.M.F., was not until recently included in official debt figures. For 1980 this amounted to US\$67m., it had grown to US\$1355m. by 1983, declining to US\$1004m. by 1986.

Domestic interest rates were moved to positive levels after a period of negative rates from 1978 and net private capital inflows resumed, totalling US\$236.6 million. These inflows reduced the burden placed on the economy by the cumulative current account deficits of US\$622.7 million so that the official flows could be used to cover the remaining gap and to rebuild the reserves. Accordingly the rate of growth of the debt moderated to an average of below 7% for the three years 1983-1986, a marked contrast to the previous three year average of 19%, between 1980-1983. By the end of 1986 the debt represented about 148% of GDP and the debt service ratio stood at 43%. The decline in international oil prices by the end of the survey period also served to provide a fillip to the economy and made many of the targets possible.

In 1978 Jamaica had reached the limits of its debt servicing capacity and sought to reschedule repayments of principal with the commercial banks. The exercise was repeated in 1981 and in each subsequent year to the end of the survey period. From 1981-1986 US\$412.5m was treated in this manner.¹⁴

Ad hoc arrangements of a similar nature had also been worked out with various bilateral agencies, and were formalized in Paris Club meetings between 1984-1986. Between 1981-1986 US\$932.6m of bilateral loans were rescheduled.

As indicated, the debt composition has moved steadily in favor of bilateral debt which was amenable to treatment within the Paris Club arrangements. The multilateral debt which encompasses a significant portion of the total is not, however, amenable to rescheduling, so that no relief has been available for that portion of the debt.

In an attempt to remove this constraint Jamaica had proposed that the IMF establish a new loan facility, or revive the little used Extended Fund Facility, that would be quick disbursing and policy based and could be used to repay due obligations. While establishing new debt it would provide longer maturities so having the same effect as a rescheduling. The proposal also was intended to induce Paris Club members to reschedule for longer periods than the one year period which is the norm, since IMF surveillance would provide a monitoring mechanism on their behalf.

Efforts have also been made by Jamaica to reduce the debt through the mechanism of the debt equity swap whereby a creditor bank might sell a hard currency loan to a foreign corporation, perhaps at a discount. The corporation in turn would present the obligation to the Central bank which would pay in local currency, currency which the corporation would in turn use to establish a new export oriented enterprise

¹⁴ Jefferson, Owen op.cit.

in Jamaica. By the end of the survey period not much success had been achieved through this mechanism.¹⁵

From the preliminary analysis it was seen that the Jamaican economy was in serious disequilibrium prior to 1977. By that year Jamaica had entered into an economic adjustment programme with the Fund, and this relationship was to continue throughout the survey period, with two gaps, in 1980 and 1983, when two succeeding programmes had to be abandoned due to non-compliance with targets and new ones negotiated. In each case a new approach was taken, so that during the survey period Jamaica's development policy might conveniently be divided into three phases as follows:

1. **Reluctant adjustment from 1977-1980** Economic adjustment had become necessary by 1977, after a period of rapid expansion ushered in by an administration committed to using the public sector as the driving force for economic growth. Despite attempts to get involved in directly productive activities its primary focus was with redistribution and the delivery of social services, at a time when the underlying productive capacity of the economy was contracting. The need to change this policy by 1977 was not universally accepted, adjustment policies were seen as running counter to previous policies and holding the risk of eroding the benefits gained from previous years. Accordingly, the programme received less commitment than was necessary to make it succeed and it was abandoned in early 1980 in the midst of widespread policy debate as to its merits. A national election was accordingly called on that basis. During this three year phase the national debt increased at an annual average rate of 18.8%.

2. **Expansionary adjustment from 1981-1983.** The second phase was initiated on the assumption that renewed investor confidence would respond to a large injection of external resources to increase foreign exchange earnings, particularly in non-traditional exports and minerals. Moreover it was expected that the new external resources would be forthcoming because of renewed confidence in the prevailing domestic policies and accordingly the issue of short-term stabilization was not emphasized. In the event the speed and magnitude of the adjustment which would be forthcoming was overestimated; resources, particularly private foreign investment did not flow at the anticipated speed; the creation of new non-traditional earners took longer than anticipated; and, most important of all, earnings from the minerals sector collapsed. In the circumstances adjustment with growth had to be abandoned since the cost of providing the necessary finance was too high. In this phase the external debt continued to increase at about the same rate as before of about 19%.

¹⁵ Davis, Novellette, "Debt Conversion: The Jamaican Experience." Research department, Bank of Jamaica. Paper prepared for 19th annual conference Regional Programme of Monetary studies, November 1987.

3. **Contractionary adjustment from 1984-1986.** The third phase recognized the need to reestablish equilibrium prior to further expansion. For the two years that this policy was followed the economy showed encouraging signs of adjustment, though at a cost of great social and economic contraction. During this phase the debt continued to grow, though at a reduced rate of 6.5% per annum on average. The remaining question was whether the process would be given sufficient time to establish an equilibrium and whether an effective policy of investment and expansion could be grafted to it, such as to achieve a smooth transition from the short to the medium-term policies and ensure a long and durable process of economic growth to resume.

Organization of Eastern Caribbean States

The seven countries comprising the Organization of Eastern Caribbean States (OECS)¹⁶ treated in this section demonstrate in acute form the constraints faced by small open island economies. Moreover, as members of one currency area with one central bank, which acts within statutory limits on the extension of credit to member countries and which requires unanimity of membership on any change of parity, a measure of flexibility in the use of monetary and exchange rate policies for adjustment which is available to other countries surveyed is denied them. The strong link between fiscal policy and the external debt which is evident in the other countries surveyed is therefore even more accentuated in the case of the OECS countries.

The result of these factors is that a shock to the economy whether generated externally, or otherwise such as by natural disasters, is usually passed through without the usual measures of insulation. While this means that adjustment is often painful and immediate it also ensures that there is little leeway for postponed adjustment thus ensuring that many aspects of disequilibrium are not allowed to become chronic and cumulative.

For the most part, therefore, the debt has not become as severe a problem for the OECS as is the case in other countries and servicing the debt has for most countries been manageable. Nevertheless, there are quite significant differences between these and the other countries surveyed and among the countries themselves which are worthy of further investigation. (Tables 1 and 2).

Over the survey period, the OECS countries had suffered from external shocks similar to those experienced by the rest of the Caribbean, namely, reduced demand and prices for their exports and oil price increases in 1979-1980 which caused a rapid deterioration in the external account. Subsequent increases in the price of manufactures further eroded the terms of trade.

At the same time shocks of domestic origin also impacted upon the economies notably in the banana industry, the main foreign exchange earning non-service activity, which was badly weakened in 1979 and 1980 by hurricanes in Dominica and St Lucia and by volcanic ash in Saint Vincent and the Grenadines. As a result of these factors, exports of bananas declined by 50% between 1979 and 1980. By 1981 strenuous efforts at replanting had effected a recovery so that output in that year had regained 1977 levels. Further expansion of the industry and diligent quality control assisted by fortuitous weather conditions allowed production increases of 75% by the end of the

¹⁶ Antigua and Barbuda, Dominica, Grenada, Montserrat, St. Kitts/Nevis, St. Lucia and St. Vincent and the Grenadines are the seven island states comprising the OECS.

EXTERNAL DEBT - OECS COUNTRIES							
Debt outstanding at end of period (US\$m.)							
	1980	1981	1982	1983	1984	1985	1986
Antigua	45.5	46.7	54.0	55.7	51.0	64.9	133.9
Antigua<2>	45.5	76.6	84.4	88.7	57.6	75.8	180.7
Dominica	17.7	24.4	34.4	40.9	43.8	48.8	56.6
Grenada	14.4	26.2	32.1	46.8	48.4	49.3	54.2
St. Kitts	10.0	11.9	10.9	11.5	16.6	19.0	19.1
St. Lucia	18.2	25.1	28.3	29.9	28.0	28.8	32.0
St. Vincent	17.0	19.2	21.2	22.7	22.8	24.3	29.6
Montserrat	1.5	2.0	2.4	2.7	3.6	3.7	3.0

Source: ECCB; IBRD.
 <1>Public sector incurred or guaranteed.
 <2>Including arrears

Table II

DEBT SERVICE PAYMENTS - OECS COUNTRIES (US\$m.)							
	1980	1981	1982	1983	1984	1985	1986
Antigua	6.7	7.0	7.3	9.4	9.1	10.2	11.1
Dominica	0.6	1.1	1.4	2.8	4.4	4.2	4.9
Grenada	1.6	1.5	2.2	2.2	6.4	8.6	7.6
St. Kitts	0.5	0.5	0.7	0.7	1.1	1.5	4.8
St. Lucia	1.4	1.5	4.2	2.0	3.1	4.3	3.3
St. Vincent	0.7	1.5	1.5	1.7	2.3	3.1	3.1
Montserrat	0.1	0.1	0.1	0.2	0.4	0.4	0.3

Source: ECLAC; IBRD; CDB; OECS.

Table III

survey period, notable performances being recorded by Dominica after its total devastation, and Saint Lucia. Earnings from the industry fluctuated somewhat more than usual as a result of relative changes in the rates of exchange of the US dollar, to which the EC dollar is tied and the UK pound the currency of payment for bananas, so that in the early 1980s as the US dollar appreciated, local earnings fell relatively but these recovered as the US dollar started its depreciation towards the end of the survey period.

Other merchandise exports include sugar, cocoa, spices and a small but growing manufacturing sector. Of these sugar is the most important, though being produced for export only in St. Kitts. It is nevertheless a declining industry there, as elsewhere in the Caribbean, with output peaking in 1979. Subsequently output and earnings have declined, from 40% of exports of goods and services of St. Kitts in 1981, to 20% in 1985. Falling output is due to reduced yields per acre as a consequence of drought, deficient management

and inadequate harvesting practices, while earnings were further affected by reduced preferential quotas into the US market, in the face of production costs which make Caribbean sugar un-competitive at free market prices. Similar problems bedevil the other agro-based exports, volatile markets and low technology farming being endemic, while manufacturing has been geared to the protected regional (CARICOM) market which suffered from declining demand throughout the survey period. Manufacturing exports to third markets, mainly of the export processing enclave type, faced stiff competition from adjacent countries with higher labor productivity.

Merchandise export earnings stagnated between 1977 and 1979 for the aforementioned climatic reasons, although there was substantial recovery in 1980 with a jump in earnings of 64%.¹⁷ In the ensuing period growth was again slow, increasing by about 9% between 1980-1984. Rapid growth in merchandise earnings was again resumed toward the end of the survey period, lead by increased yields and good prices for bananas, with an increase of 41% between 1984-1986 (Figure 13).

While the OECS has managed to sustain its merchandise exports and increase them over time, it is tourism which has been the engine of growth for these countries.

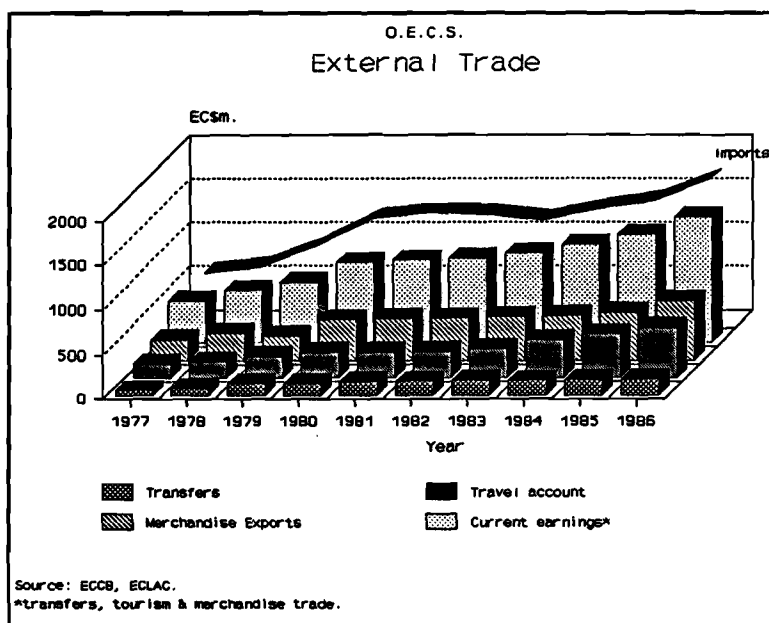


Figure 13

¹⁷ Williams, A.M., and Augustine J.C., "Adjustment and External Debt in E.C.C.B. member states", Research Department, ECCB. Acknowledgement is due to the authors for providing the aggregative data on OECS member countries, which has made much of this analysis possible.

The performance of the tourist sector has been good, whether judged by the increase in long stay tourist arrivals, which grew by 81% over the survey period, or by estimates of gross tourism expenditures which increased by 300%. While foreign exchange earnings from the travel account have shown faster growth than merchandise exports, estimates of gross tourism earnings which might better reflect the true impact of the industry, suggest that tourism contributes considerably more foreign earnings in absolute terms than merchandise exports.¹⁸

The other main source of foreign earnings, private remittances, mainly from OECS nationals living abroad, also showed steady and sustained growth. Evaluation of the external account would be incomplete, however, without mention of the official grants which are provided from various sources and in various forms to the OECS. Grants equivalent to about 26% of merchandise exports were provided in 1979, the proportion declining steadily to about 19% of exports by 1983. In 1984 the quantum of grants rose significantly to 31%, due in part to special assistance to Grenada, although this has declined slowly thereafter to the end of the survey period.¹⁹

Imports have outstripped current earnings so that deficits on current account have been incurred throughout the survey period. (Figure 14). The deficits peaked at 29% of GDP between 1980-1981 declining to 13.5% of GDP in 1985, although increasing once again to 16.5% by the end of the survey period.

The overall deficit of the grouping as a whole showed rapid growth between 1977 and 1982 and again in 1986, the overall trends being significantly influenced by developments in Antigua and Barbuda.

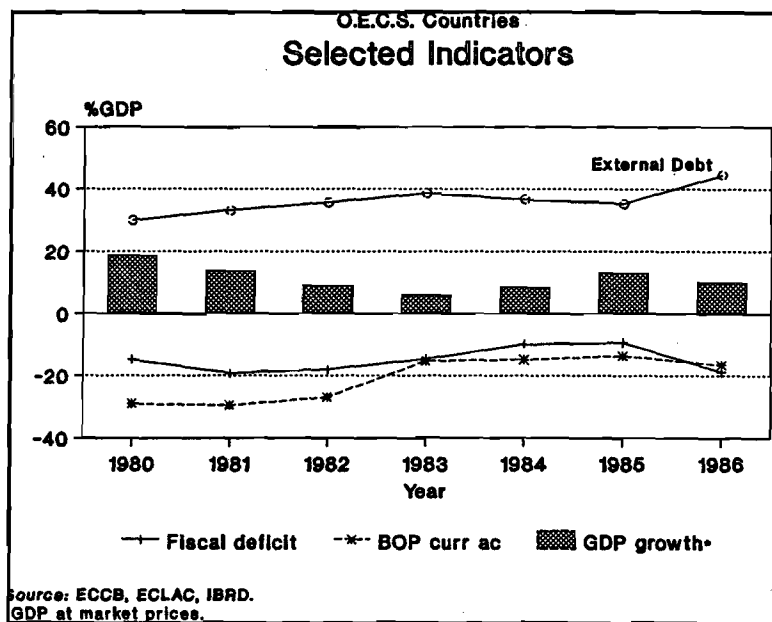


Figure 14

¹⁸ For example merchandise exports were US\$ 86 m., US\$ 169 m., and US\$ 245 m. in 1977, 1980, and 1986 respectively, compared with US\$ 208 m., US\$ 336 m., and US\$ 828 m., for gross tourism earnings.

Antigua and Barbuda recorded greatly increased fiscal deficits in 1978, during the period 1982-1983, and again in 1986. In each case the increases were caused by the public sector undertaking fairly large hotel investments which in turn required significant infrastructural support. Noteworthy also, is the fact that these large projects required financing at commercial rates in view of the ostensible nature of the investments, with a consequent impact upon the debt service profile.

Accordingly, the external debt for Antigua grew rapidly in two phases between 1977-1981, at almost 30% per annum, so that the debt moved from almost 35% of GDP in 1977 to 75% of GDP in 1981. It was subsequently to fall to 42% of GDP in 1984 before increasing sharply to 73% by the end of 1986 as a result of a US\$160m. tourism project to run for the period 1986-1988 inclusive. Since the funds were obtained at commercial rates, average interest rates increased from about 4% in 1977 to 5.6% in 1980 declining to 4% by 1984, but the average is projected to increase to 7% in 1987 as the impact of the new phase of borrowing is felt.

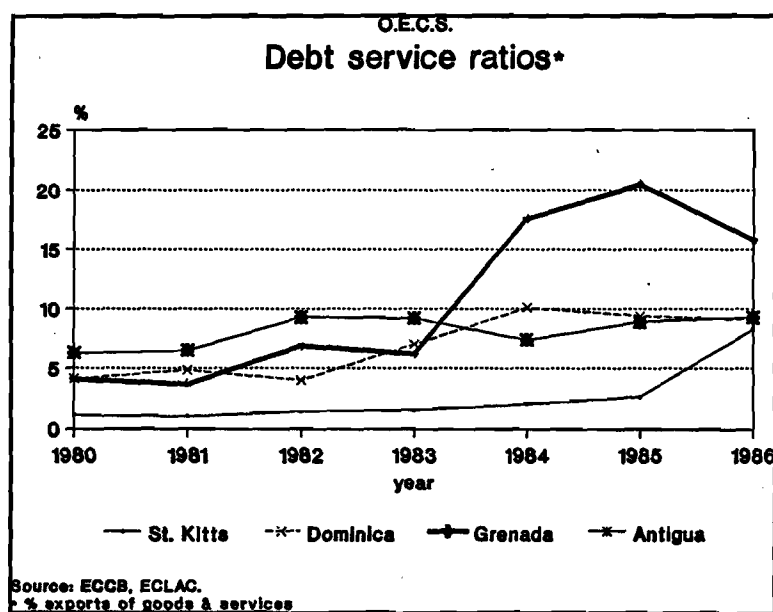


Figure 15

Perusal of the traditional measure of debt service, in this case the ratio of debt service to exports of goods and services, the full impact of the debt service burden is concealed, for the ratio (including accruals) moved from 2.3% in 1977 to 6.3% in 1980 and 9.3% between 1982-1983. Yet because of the large increase in new debt during 1986, the debt service ratio is projected to increase to 12.6% in 1987 (Figure 15). Nevertheless, these ratios do not provide an explanation of the cause of debt arrears building up from 1980, when they were 2.3% of GDP to the end of the

survey period when arrears had accumulated to the value of 14.1% of GDP, and this might better be explained by the ratio of debt service obligations to government revenues, which were 21.7% in 1980 and 19.8% in 1986.

In **Dominica** a rapid growth in the fiscal deficit in 1979-1980 reflected efforts at rehabilitation after hurricane damage. Subsequent expenditures remained quite high as the public expenditure programme focussed on restoring and upgrading support infrastructure in transportation, energy, health and water.

During the period 1981-1985, Dominica operated under a stabilization programme with the IMF. which included a number of initiatives to increase revenues, reduce recurrent expenditures and eliminate transfers to loss making public enterprises. As a result of these efforts the overall deficit, after grants, fell from 35% of GDP in 1981 to about 20% in 1985, falling even further to 4% of GDP in 1986.

The external debt has grown steadily over the survey period from 14.4% of GDP in 1979, to 66% of GDP by 1983, debt being used mainly for hurricane rehabilitation and upgrading infrastructure. There was a modest decline in 1986 to 63% of GDP. Due to the concessional nature of the debt however, the cost of servicing it was more modest at just over 9% of exports by the end of the survey period. Debt is owing mainly to institutions, over 70% outstanding to the CDB. The IMF. is also a major creditor in view of continuing programmes since 1981.

Grenada recorded very rapid increases in the fiscal deficit after 1980, from 22% of G.D.P. to 45% of GDP. in 1982, due primarily to the costs of financing a new international airport, a single project which created a significant burden on that country. By 1983 the deficit had contracted to 35% of GDP. due to a containment of capital expenditure. From that year on the deficits were financed substantially by external grants in aid so that in 1974 although current expenditures continued to rise, the effect of grants and the further compression of capital expenditure reduced the deficit to 12% of GDP. The deficit was to grow once again in 1986 despite a further contraction of capital expenditures, since transfers to loss making public enterprises and interest payments on the debt had both increased. Moreover revenues decreased due in part to difficulties in administering a major fiscal reform programme.

Grenada's external debt grew more slowly than GDP. between 1977 and 1980, declining from 15% to 12% of GDP. It grew by 79% however between 1981-1983, due to the impact of financing the airport, part of which was incurred at commercial rates, and other infrastructural projects so that the commercial component of the debt moved from a negligible amount in 1980 to about 30% of the total by 1983. Accordingly by 1984, debt service ratios had increased rapidly from 6.2% in 1983, to 17.6% in the following year, and just over 20% in 1985. Further, arrears had started to build up by 1983, continuing to the end of the survey period.

Public finance in St. Kitts-Nevis was dominated by two factors during the survey period. The first was the decline in current revenues from 33% of GDP. in 1981 to 25% in 1985, due to the abolition of income taxes and the sugar levy. This decline was arrested in 1986 by the implementation of new tax measures which increased current revenues to about 30% of GDP. The second major factor related to government involvement in the sugar industry, its decline in performance resulting from external factors as well as local management problems, and the assumption of the resultant debt of the National Agricultural Corporation (NACO).

Both had significant impacts upon the overall fiscal deficit which has varied between 6-9% of GDP. with the exception of 1979-1980 when it averaged about 18% and again in 1985 on the assumption of NACO debt when the deficit rose to 15% of GDP.

The external debt grew fairly slowly from 1977 to 1983, in fact from 18% of GDP. to 23.5% of GDP. By 1985 this had increased to 31% declining slightly by the end of the survey period. Accordingly, debt service ratios which had remained fairly constant up to 1983 grew slowly to 1985 before recording a sharp increase in 1986 to 8.3%.

For the remaining OECS countries deficits were relatively moderate with an increasing trend between 1977 and 1982 decreasing thereafter to 1985, only to resume an increase in 1986. For all countries there has been a struggle to contain recurrent expenses, to moderate the public sector wage bill and to increase its efficiency so as to reduce the level of subventions to it. The perception that the government had the responsibility to act as the employer of last resort had lost the currency that it had acquired in the early 1980s, although the battle to control the growth of the public sector in such small economies remains a formidable one and highlights one of the structural limitations of very small size.

Trinidad and Tobago

In 1977 the economy of Trinidad and Tobago had been riding on the crest of the oil boom which began in 1973. In the three year period 1974-1976 inclusive the economy had grown by almost 4% per annum on average; government revenues had increased at an annual average rate of 80%; while expenditures had also increased rapidly on average by over 50% per annum. Nevertheless, the fiscal balance which was negative in 1973 at -2.4% of GDP grew thereafter to rest at 7% of GDP in 1976.

The external account also registered healthy gains, merchandise trade moving from a deficit in 1973 to record a surplus of TT\$1850 m. for the three years. Similarly, the overall balance which recorded a deficit of TT\$43m. in 1973, provided an increase of TT\$2058m. to the reserves for the subsequent three years.

The external debt had declined relatively and absolutely between 1973 and 1976, from 10% of GDP in the former year to just over 2% in 1976. Unemployment had fallen by 2 percentage points during the period.

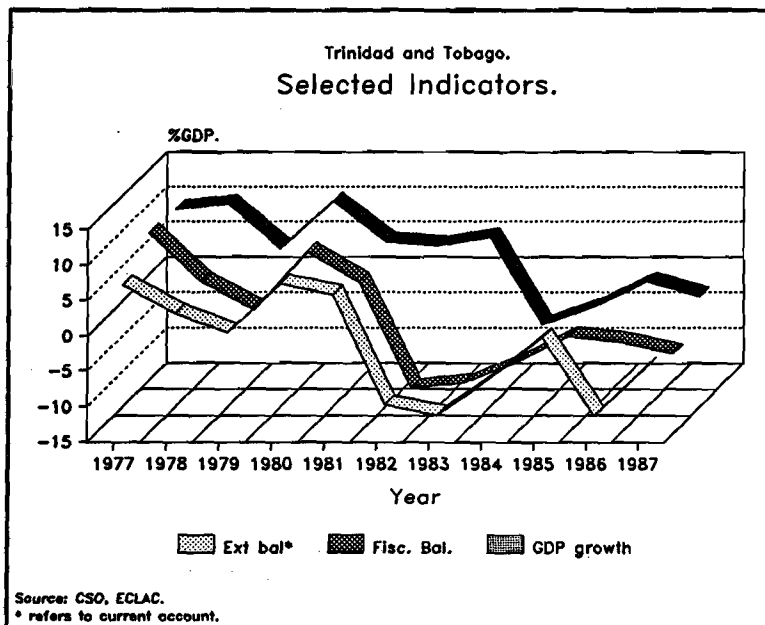


Figure 16

Similar trends were recorded for 1977, but by 1978 a number of these trends began to change quite quickly, most noteworthy of these being a reduction in the rate of growth of exports with consequences for the merchandise balance and the fiscal surplus, the later falling from 9.6% of GDP in 1977 to 2.7% of GDP in 1978. The abrupt change was consequent upon a reduction in the rate of foreign exchange earnings from mineral fuels, the increase in earnings in 1978 being 1.5% compared with an increase of 15% in the previous year. Similarly government revenues

recorded a drastic reduction in growth from 30% in 1977 to 4.5% in 1978. The dependence of the economy on the oil sector was clearly demonstrated at this time as was the fact that while the revenue side could contract quite significantly in the short term increases in expenditure both local and foreign were gathering a momentum that

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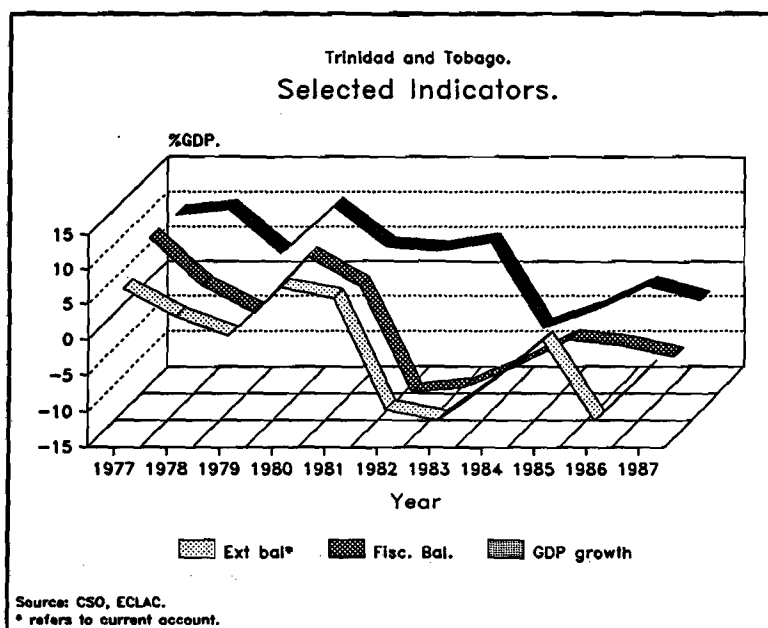


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Similarly government revenues recorded a drastic reduction in growth from 30% in 1977 to 4.5% in 1978. The dependence of the economy on the oil sector was clearly demonstrated at this time as was the fact that while the revenue side could contract quite significantly in the short term increases in expenditure both local and foreign were gathering a momentum that

would be difficult to control. Nevertheless, GDP continued to grow rapidly at 10% in 1978 (Figure 16).

Nineteen seventy-nine was a year of relatively moderate growth in GDP, 3.5% being the slowest since the onset of the oil boom. Deficits were incurred in the fiscal balance and the external current account. Yet with the second oil price increase of 1979-1980 rapid GDP growth was resumed, and revenues continued their upward growth, with total revenue moving from 36% of GDP in 1979 to 43% of GDP in 1980. The fiscal and external balances returned to a healthy surplus. But, in retrospect, the fortunes of 1980 which provided the high-point of the oil boom, disguised the signals which were being transmitted from as early as 1978 and which indicated a need for caution.

From 1981 a decline in petroleum revenues began so that by 1982 a deficit in merchandise trade had been created, and this was to continue in 1983 (Figure 17). Due to the aforementioned momentum which had been created in spending there was an even more rapid decline in the fiscal and external balances, both moving once again into deficit in 1982 from which they were not to recover for the remainder of the survey period.

The rapid increase in public spending was possible because the windfall gains from petroleum accrued directly to the government via taxation of the oil companies. While it had been decided that these funds would be used for productive purposes, and for this purpose Special Long-Term Funds had been created, the leakage into non productive activities was nevertheless substantial. As a consequence recurrent expenditures grew rapidly from 17% of GDP in 1973 to over 31% by 1981. Subsequent efforts to reduce this have not been successful since it remained at almost 33% of GDP in 1986. On the other hand capital expenditure which was about 4% of GDP in 1973 rose to a peak of almost 19% of GDP in 1980, and bore the brunt of the contraction in the subsequent years falling to just over 5% in 1985, although this increased once more to 8% in 1986.

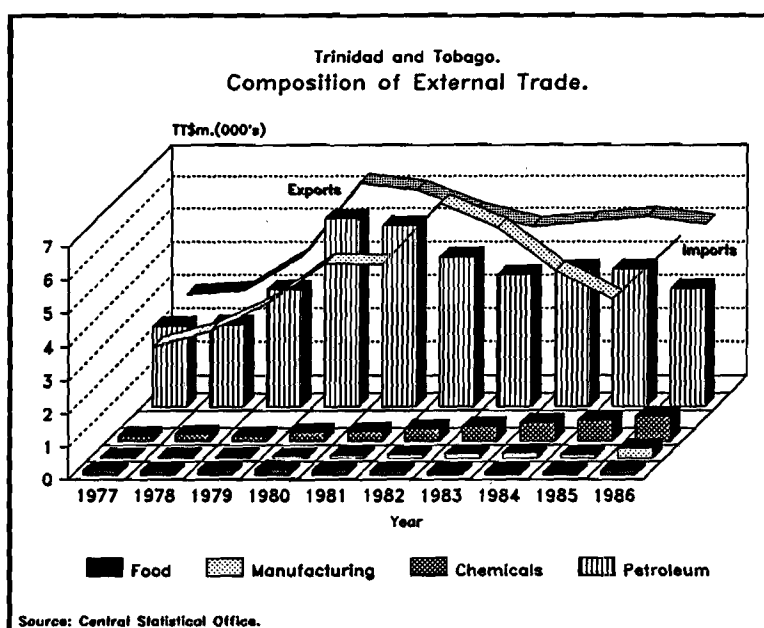


Figure 17

The Special Long-Term Funds which were intended for investment purposes set aside about TT\$14 billion between 1974-1983. Of this amount about one third went to economic sectors; almost 40% was used for infrastructure, which was nevertheless often needed to facilitate the establishment of some of the large petro-chemical and other projects being implemented; and, over 20% of the funds were used for social projects. Resources in the funds were depleted by 1986. Some of the projects which required considerable resources suffered defects in project evaluation prior to their implementation, and inexperienced management once they came on stream.

In fact in Trinidad and Tobago the state is widely involved in directly productive activity, a legacy of burgeoning government revenues in the 1970s, and reflecting a widely shared philosophy that the state should control the "commanding heights" of the economy, coupled with the belief that the state could accelerate the development process by pioneering large or difficult investments. The state sector also expanded as the government took over non-viable entities in an effort to save jobs.

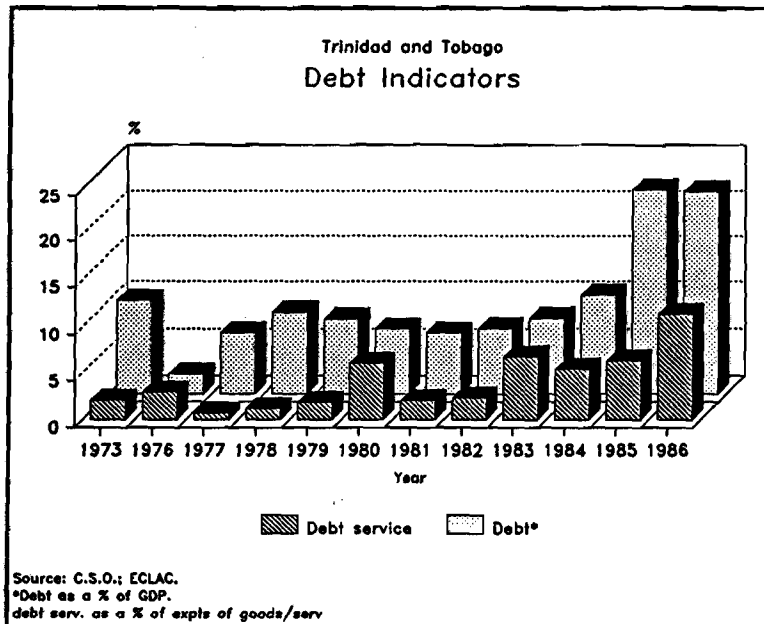


Figure 18

In 1970 the state held investments in 32 companies; by 1980 this had risen to 61; and, by the end of 1986 the state held a portfolio of 66 enterprises, employing over 32,000 persons, and covering such activities as oil, gas, petro-chemicals, asphalt, airlines, hotels, banking, insurance, sugar, mixed farming, fruit and meat processing, grain milling, maintenance and so on. Of these, many of which compete directly with the private sector, thirty seven are wholly owned, eleven are minority owned, one is 50% owned, and seventeen

are minority holdings.

The involvement of the state is far larger than the nominal value of these holdings would indicate and which is estimated to have been TT\$3953 m. in 1986. Loans, advances and subventions have been readily made available to them and it is estimated

that such assistance has amounted to TT\$5,800m. between 1979-1984.²⁰ The large state enterprises also account for a large portion of the external debt, about 42% of it in 1986.

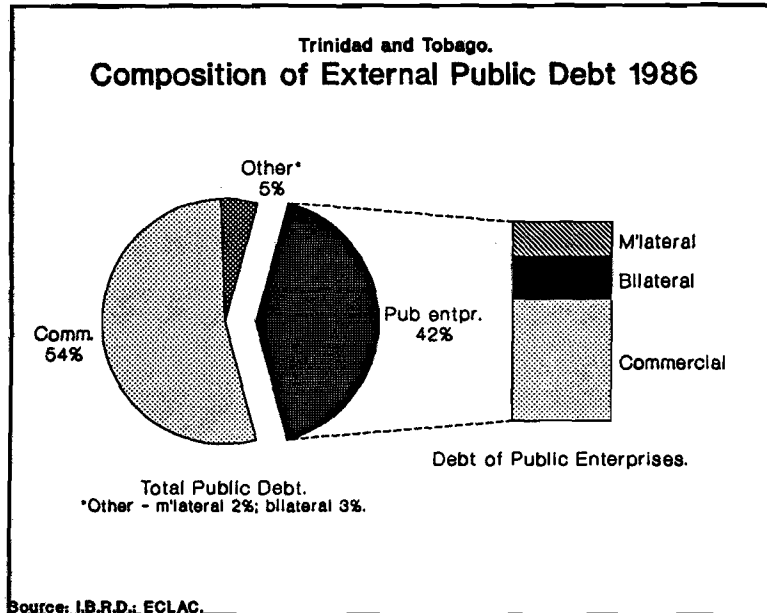
Accordingly, the state enterprises currently represent a severe burden on the economy and measures are currently being explored to reduce the drag on the public purse, by inter alia, divestment, closures, or recapitalization.

The external debt which had hovered between 6.5%-7.0% of GDP from 1977 to 1982, with the exception of 1978-1979, grew quite quickly in quantum due to the financing requirements for several major government commercial projects and infrastructure (Figure 18).

Between 1983-1985 this growth accelerated to average over 60% per annum, so that it moved from 8% of GDP in 1983 to rest at 22% of GDP by the end of the survey period. Similarly the debt service ratio which had grown slowly between 1977 and 1982 (with the exception of 1980) when it was 2.4% of exports, increased in 1983 to 6.8%, increasing further to 11.3% in 1986. The increase in the debt service ratio is due in no small part to the decline in petroleum earnings which fell by 37% in value between 1980 and 1986, and shows the risk of using the debt service ratio as an indicator where export earnings are dominated by one product which is sensitive to the vagaries of the international market.

A number of features regarding its external borrowing policy were unique to Trinidad when compared with its Caribbean neighbors. Firstly, as the recipient of windfall gains from oil, with a consequent rapid increase in GDP, it was not eligible for concessional financing. The predominant proportion of loans were therefore obtained at commercial rates, and carrying variable interest rates (Figure 19).

²⁰ In 1987 alone TT\$967 m, or almost 20% 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. Moreover the state enterprises are estimated to account for an even greater portion of the debt than indicated above at 65% of the public debt in 1987. (Source National Planning Commission - Medium Term Plan. Pp. 10, 116.)

**Figure 19**

Unlike most other countries in the sub-region a large proportion of the loans were earmarked for commercial projects. Nevertheless, a substantial portion of the commercial debt was incurred for general development purposes²¹ which held out no promise of generating resources for repayment.

Yet even in the case of funds earmarked for directly productive enterprises in the state sector, there was much doubt about their capacity to generate the resources needed to repay the

debt due to the aforementioned difficulties being experienced in making these operations viable.

²¹ De Silva, Charles. "External Indebtedness in Trinidad and Tobago: the case of a middle income oil exporter." Page 9. It is estimated by the author that about 60% of the commercial debt was incurred for "general development purposes".

Conclusions

In conclusion, two major themes have permeated the study. Firstly, the nexus between the fiscal account, the external account, and the external debt. The second which is a corollary to the first, evaluates the rate of growth and the composition of the fiscal deficit.

Public expenditure policy provides a clear understanding, in the countries surveyed of the reasons for the growth of the external debt. When this related to current expenditure and the debt was incurred for activities which would not be self-liquidating benefits derived from such expenditure would be chimerical since they would have to be cut back in the future. Moreover, as these artificial benefits would have been internalized reduction or discontinuation of them would be seen as an undue hardship by the beneficiaries. Debt incurred for capital expenditure, however, held the prospect for repayment but repayment would only be forthcoming over the long-term in the case of infrastructure, or if a number of conditions necessary to secure commercial viability were met in the case of directly productive activities.

For the countries studied, the debt was incurred for three principal purposes:

(a) To sustain the level of economic activity and often non-productive employment during a period of foreign exchange shortage, caused by the two oil shocks and reduced earnings from exports. The assumption on the part of the policy maker was that the foreign exchange constraint would be temporary and the debt would be repaid as the export boom returned. The assumption did not, however, hold since the debt was incurred at historically low, but variable, rates of interest which were soon to return to the normal trends; and the export boom period of the late 1960s and early 1970s was not to return so that repayment became problematic.

(b) To achieve some measure of structural transformation. Efforts by the state in this regard may be divided into two phases:

(i) Initially, emphasis was placed on the structure of ownership moving away from foreign and private to local and public ownership and control. This was characterized by the acquisition of existing and often declining activities superimposed upon which was in-experienced and often deficient management. Accordingly, the internal efficiency of the firms declined at

the same time that external conditions were forcing international competitors to become more cost effective. Foreign exchange surpluses were therefore not generated to repay the debt, indeed the converse was true so that these enterprises served to increase the debt burden.

- (ii) The second phase of structural adjustment was initiated in recognition of the changing patterns of international trade which did not favor the export of raw materials and primary commodities but rewarded the development of manufactures and services. While debt incurred for adjustment would ultimately generate new sources of foreign exchange, the process by which new export generating ideas could be identified and the necessary resources put into place was necessarily long and fraught with risk. The urgent need to reorient activities to new ways served to highlight the lack of adequate depth in human skills, which while proving to be adequate to perform the familiar and well worn socio-economic tasks were unable to provide a sufficiently rapid and flexible response to rapidly changing external conditions. For the countries surveyed the debt incurred for this purpose was obtained for periods which are too short to show returns before repayment, so that rescheduling has become an ongoing characteristic of debt management.

(c) To establish directly productive activities, as the state in an effort to force the pace of growth, became involved in relatively large commercial ventures. These projects which had been financed on strictly commercial terms often concealed a large infrastructural component. Moreover, sufficient attention had not been paid to their commercial viability, due both to an inadequate understanding of international marketing trends, or due to an underestimation of the importance of managerial competence on overall operational efficiency. Accordingly projects came on stream which were of suspect viability, constituting a further source of debt. Even where the conceptual hurdle of divestment had been overcome local private investors were hesitant to take the risk of trying to turn around large enterprises which had proved ill-conceived. In other cases, where the projects were viable they were often so large as to create a severe debt servicing burden in the short to medium-term.

The debt which must be seen as a symptom of past policy choices had, nevertheless, for a number of the countries surveyed, become a severe impediment to future economic growth, and absorbed so much of the recurrent budget that basic services such as health and education had to be severely curtailed. There is currently no realistic expectation that sufficient growth can be achieved in the medium-term so as to grow out of the debt problem. Moreover in the cases of Antigua, Cuba, the Dominican Republic, Guyana and Jamaica the burden of servicing the debt was sufficiently onerous for them to have accumulated arrears at various times since 1978, and most of these countries were exploring measures appropriate to their specific debt

problems in order to provide some degree of debt relief and some of these measures are listed.

While changing future expectations quite drastically, the debt had also served to focus attention on the role of the state in economic activity and particularly the growth, size, and use of fiscal deficits. The debate about the desirability of state involvement is unresolved, but there now seems to be an emerging consensus that all enterprises should be subject to similar micro-economic disciplines, whether they are public or private. Moreover, there is a growing awareness of the limited capacity of the state apparatus to discharge its primary functions, so that an expansion into commercial activities is being regarded with greater caution than hitherto. This is especially true since government guarantees have tended to relax the safeguards normally applied by the lender to any commercial venture and public ownership tends to transfer the costs of failure away from those responsible for making the original decisions.

Finally, the period under review has brought about a clearer understanding of the manner in which the component parts of the economies interact as well as a more realistic search for the sources of real economic growth. It has also served to create a fresh awareness of the constraints facing the economic planner and therefore to caution him of the limits beyond which he might not prudently go in his efforts to force the pace of development.

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