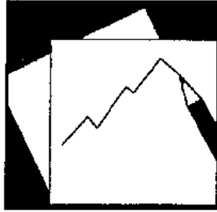

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Caribbean Approaches to Economic Stabilization

Alvin D. L. Hilaire

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Caribbean Approaches to Economic Stabilization

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Abstract

The views expressed in this Working Paper are those of the author(s) and do not necessarily represent those of the IMF or IMF policy. Working Papers describe research in progress by the author(s) and are published to elicit comments and to further debate.

In the late 1980s Barbados, Guyana, Jamaica, and Trinidad and Tobago found themselves in severe economic difficulties. Their ensuing economic strategies were all market-based, featured fiscal contraction and trade liberalization, multilateral support loans and, later on, tax and financial sector reforms. However, exchange rate, monetary and public sector wage policies varied greatly. Choice of exchange rate regime was not as fundamental to successful stabilization as was fiscal action, complemented by, but without undue reliance on, monetary policy. The policies employed to reduce debt and to diversify the economic bases also help t lessen vulnerabilities to future economic shocks.

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I. Introduction

The English-speaking Caribbean countries share a number of characteristics: they are small—the largest island is 11,424 square kilometers, although mainland Guyana is much larger at 214,970 square kilometers—open, price takers in international markets, and mainly export primary products or tourist services. They import most of their manufactured products, and trade is focused on the United States. Historical and cultural links contributed to their economic integration, which has evolved into a customs union, and government administrative arrangements are quite similar, a legacy of the British colonial era. A subset of the smaller countries have retained a common currency. Nonetheless there are several important economic differences based on their variations in natural endowments—Trinidad and Tobago is the only oil exporter, Guyana depends on timber, gold, and rice, Jamaica produces bauxite, while the smaller countries rely more heavily on agriculture and tourism.

In the late 1980s, the four largest countries simultaneously faced severe economic problems. In Barbados, fiscal laxity combined with a depressed tourism market, Trinidad and Tobago was confronted with sharp drops in oil prices, while Jamaica and Guyana entered new phases in their adjustment programs that had begun since the 1970s. A decade later, the former two countries had made relatively successful adjustments while the latter two continued to experience difficulties. At the same time, fresh approaches were being made to solidify regional integration, including enhanced factor mobility, while opening up trade between the Caribbean and the rest of the world.

This paper examines the challenges faced by these four Caribbean countries on the eve of the 1990s and assesses their respective responses, highlighting those developments that helped or hindered economic performance. The paper is laid out as follows: Section II examines the initial conditions under which the stabilization efforts were launched. Section III compares the fiscal, monetary, trade, and exchange rate components of the adjustment programs, taking into account the role of external balance of payments adjustment finance. Section IV then relates the strategies pursued to the economic performance in the late 1990s, drawing out the policy lessons, while Section V concludes.

II. Initial Conditions[2]

A. Barbados: Depressed Tourism and Fiscal Laxity

Barbados is relatively undiversified, and for many years relied almost exclusively on sugar exports, the most important source of foreign exchange up to the 1960s. The island's topography, however, featuring shallow soils and broken relief, contributed to relatively high costs, while the rain-fed nature of sugar cultivation in Barbados made it extremely susceptible to droughts. On top of this, poor management and rising labor costs depressed profitability, driving a large number of sugar growers into debt, mainly to a government-owned

[2] See Table 1.

bank. These conditions eventually drove the company that ran the sugar-processing factories into bankruptcy, prompting a major government-supported debt-rescheduling exercise and the introduction of a foreign management team.

As sugar was declining, tourism picked up, sparked by the advent of jet transport, and eventually became Barbados' principal export. The initial spurt in tourism activity mainly involved foreign investors, followed by local small-scale hoteliers, with financing made available through a state development bank. Tourism suffered a severe blow in the early 1970s as rising international oil prices and air transport costs combined with economic stagnation in the western world. Tourism recovered thereafter but growth was sporadic in the 1980s.

Attempts at diversification of the Barbados economy included government incentives for manufacturing, including import trade restrictions; light manufacturing received a significant boost in the 1970s by way of exports to a booming Trinidad and Tobago economy. At that time, Barbados was able to weather the high price of oil imports by stepping up its own oil production to satisfy about one-third of domestic needs. In the mid-1980s Barbados also started to promote offshore business and financial services, in competition with The Bahamas, Bermuda, the Netherlands Antilles, and the Channel Islands, encouraging a large number of businesses through attractive tax legislation.

As the 1980s drew to a close, tourism and sugar were depressed, and manufacturing faltered badly with the contraction of the Trinidad and Tobago market. At the same time, rapid fiscal expansion led to growing government deficits which were initially financed by foreign borrowing, but latterly by credit from the central bank. Rising unemployment created pressures for the government to provide more jobs in the public service and fiscal discipline waned even further. The repercussions of this state of affairs on the balance of payments were strong and direct. The external current account slipped into deficit, foreign exchange reserves plummeted, the specter of default on foreign loans loomed, and the parity of the Barbados dollar, pegged to the U.S. dollar at BDS$2 = US$1 since 1976, came under threat.

B. Guyana: Struggling with External Debt

Guyana possesses a wealth of natural resources, including gold, diamond, bauxite, and timber, and cultivation of rice and sugar is significant. While its economy is more diversified than Barbados, Guyana does not produce oil and hence caught the full brunt of the oil price increases in the 1970s. Another critical factor in Guyana during that period was the pervasive involvement of the state in economic activity, which contributed to its overwhelming debt burden and severely limited the flexibility of the country's adjustment.

Under the umbrella of a socialist model of development, Guyana had conducted widespread nationalization and public investment, claiming virtually every foreign enterprise of any significance, facilitated in the early 1970s by a large windfall derived from buoyant sugar prices. The areas of government involvement included the sugar and bauxite industries,

Table 1. Indicators of Initial Conditions, 1987

	Period	Barbados	Guyana	Jamaica	Trinidad and Tobago
	(In percent; unless otherwise stated)				
	Real Sector				
Per capita GNP ($US)	1987	$5,795	$651	$1,267	$3,959
GDP growth (average annual)	1980-87	1.3	-1.4	0.5	-1.1
Mining/GDP	1987	0.8	10	5.4	26.2
Agriculture/GDP	1987	8.2	27.6	8.5	2.8
Manufacturing/GDP	1987	9.5	12.9	16.4	7.3
Tourism/GDP 1/	1987	13.1	...	...	...
Government services/GDP	1987	13.7	17.4	16.3	16.8
Unemployment rate	1987	17.9	...	21.0	22.3
Inflation	1987	3.6	28.7	11.2	13.4
	Fiscal/Debt				
Public sector balance/GDP	1987	-5.9	-33.9	-5.4	-7.1
Public debt/GDP	1987	69.4	535.7	151.6	61.0
External public debt/GDP	1987	40.2	332.9	133.2	47.5
	Financial				
Money & quasi-money/GDP	1987	45.8	103.2	45.2	49.2
Broad money growth	1987	14.3	46.3	12.6	3.5
Real interest rate	1987	5.8	-10.6	17.7	0.6
Nominal interest spread (percentage)	1987	5.1	3.9	9.8	5.5
	External				
Exports of goods and services/GDP	1987	46.0	71.7	50.5	33.9
Current account/GDP	1987	-1.3	-45.5	-4.8	-4.7
Reserves minus gold (US$ million)	1987	145.2	8.4	174.3	187.8
Non gold reserves/imports 2/	1987	14.6	1.7	7.3	7.7
Exchange rate (domestic $ per US$)	1987 (1980)	2.00 (2.00)	10.00 (2.60)	5.50 (1.78)	3.60 (2.40)
Real effective exchange rate appreciation 3/	1980-87	11.5	-30.5	-26.9	2.8

Sources: IMF, *International Financial Statistics*, Bank of Guyana, *Statistical Bulletin*; Planning Institute of Jamaica, Economic and Social Survey; Central Statistical Office, National Income of Trinidad and Tobago; Central Bank of Barbados, Annual Statistical Digest; World Bank, *World Development Indicators*.

1/ Except for Barbados, tourism is not separately identified in the national accounts.

2/ In weeks of imports.

3/ December 1987 relative to December 1979. A positive change refers to an appreciation.

major financial institutions, and consumer and marketing agencies. Erected alongside this was an extensive system of price controls, trade restrictions and foreign exchange rationing occasioned by excess demand for foreign currency at the official exchange rate.

Public sector control of many commercial activities proved to be highly unprofitable as state enterprises did not respond nimbly to changing market conditions. The wholesale replacement of management in nationalized firms overstretched available management capacity in the public sector and net fiscal transfers to these firms accelerated. Against this backdrop, a pervasive set of unofficial activities emerged, most notably in the markets for imported goods and foreign exchange, frustrating the effectiveness of policy interventions that were centered around official transactions.

The economy went into a deep recession and the fiscal deficit widened in the mid-1970s. Attempts to redress the situation by severe fiscal contraction were completely derailed by the second oil price shock of 1979–81 and the deficit spiraled out of control. Notwithstanding the provision of credit for much of its oil-import bill from the Trinidad and Tobago government, external arrears mounted and all other foreign credit lines were stopped. Later on in 1983–87 attempts to restructure state enterprises, reduce public sector employment, and increase competitiveness through periodic devaluations had little real effect. Over time, maintenance on economic and social infrastructure was foregone, public facilities and basic utilities deteriorated rapidly, and a major exodus of skilled and professional personnel from Guyana took place. The government took to domestic financing of its deficit, macroeconomic imbalances worsened, and the balance of payments difficulties became even more intractable. By 1988, external payments arrears had mounted to over US$500 million, equivalent to over three times the country's GDP.

C. Jamaica: Fiscal Deterioration

While bauxite was a main product, Jamaica also relied on tourism, benefitting from its proximity to North America. Manufacturing activity was also stimulated by quantitative import restrictions (itemized in a so-called "Restricted List"), fiscal incentives and the setting up of free-trade zones. Already existing fiscal and external imbalances were compounded by the oil shock in 1973–74, the initial effect of which, however, was muted by two years of windfall receipts from sugar exports and higher bauxite revenue following the government's decision to unilaterally impose a new levy on bauxite companies. The government devoted these resources to a large capital development program, designed with the primary aim of reducing unemployment. Shortly thereafter, the bauxite companies retaliated, drastically cutting bauxite production as alumina prices softened. Consequently, the government found itself with a large cut in revenue, a soaring oil-import bill and a big unemployment relief program, all on the eve of a general election. In the circumstances, the government opted to finance a growing fiscal deficit by borrowing from the central bank and from abroad.

A balance of payments crisis ensued, aggravated by the government's promotion of a socialist program, which contributed to private disinvestment in many areas and capital outflow. Attempts by the government to ration dwindling foreign exchange reserves proved

futile and a large parallel foreign exchange market emerged, with rates significantly more depreciated than the official exchange rate. International reserves ran out in 1976. At the beginning of 1977 the Jamaica dollar was devalued. Nonetheless, the fiscal situation continued to deteriorate, and the government heightened regulation of business and increased state participation in the economy. Foreign exchange shortages continued, depressing output in the large range of activities that relied on imported inputs, while inflation accelerated and political and social tensions escalated, sparking a large wave of emigration.

A new government took office in 1980 and embarked on a series of major adjustment measures, including sharp devaluation, cuts in public expenditure, firing of almost 10,000 public sector workers, and privatization. Such measures helped to restore confidence in economic management and attracted a significant amount of external public sector loan financing. Public utility services, roads, and other essential infrastructure improved. Overall, however, the strategy proved inadequate to stabilize the balance of payments and restore growth trends, especially in the face of very depressed markets for bauxite and alumina. The impact of the economic austerity measures on the population was made worse by the arrival of Hurricane Gilbert in September 1988.

D. Trinidad and Tobago: Reversed Fortunes After an Oil Boom

During the second world war, production and export of oil became the dominant economic activity in Trinidad and Tobago, while sugar, which provided a significant amount of direct employment, continued to be exported. In order to diversify the economy, in the 1960s the state started to promote manufacturing through a range of tax incentives, duty-free concessions on inputs, subsidised factory space, financial support, and protection from import competition (the "Negative List").

The oil sector functioned like an enclave, operated mainly by foreign corporations and, with capital-intensive operations, employing relatively few workers at high wages. Taxes on oil company exports provided the main channel linking the oil sector to the rest of the economy. Consequently, with the quadrupling of international oil prices in 1973/74, the government's revenue surged. Initially, expenditures were very restrained and a substantial proportion of the oil windfall was saved. International reserves soared, and the boom was underway in Trinidad and Tobago, at a time when Jamaica and Guyana were in recession.

After a year or so, government expenditure picked up and a classic "Dutch disease" experience unfolded. National income and demand expanded, but since prices in the tradeables sector were limited by international prices, the relative price of nontradeables to tradeables rose markedly. The outlet for increased demand for tradeables was accomodated by imports as the real exchange rate appreciated. Within this general picture, strong quantitative import restrictions effectively moved some 'tradeables' into the nontradeables category as the government continued to encourage domestic manufacturing: a stark example was the protection afforded to domestic car assembly firms which were able to reap enormous rents in this period. The government also made investments in large projects, such

as steel and petrochemicals, with the explicit intention of reducing the country's dependence on petroleum.

By the time the oil boom was punctured in the early 1980s, the country had grown accustomed to a certain lifestyle and necessary adjustment measures were delayed. Government and private consumption were slow to adjust. With a large and sticky current expenditure bill, a significant part of which was devoted to wage payments, the government initially scaled back capital spending, but fiscal deficits nonetheless emerged. The collapse of real estate prices spread through the economy, helping to take down a number of financial enterprises which had built their portfolios on the expectation of continued buoyancy in the real estate market and a steady growth in personal incomes. Trinidad and Tobago ran through a very large stock of foreign exchange reserves which had been accumulated during the oil boom. Serious adjustment only began around the mid-1980s with the tightening of import and exchange controls and a devaluation in 1985.

III. Characteristics of Adjustment Programs

A. Basic Strategies and External Influences

As discussed above, the countries were all susceptible to fluctuations in international commodity prices and incomes. The oil shocks in the 1970s, however, benefitted oil-exporting Trinidad and Tobago, but had adverse impacts on the other countries, particularly Guyana and Jamaica. At the same time, a prosperous Trinidad and Tobago economy provided a good export market for products from the other countries. The burden of debt weighed heaviest on Guyana and Jamaica, significantly limiting their capacity for maneuver due to the large amount of public resources that needed to be devoted to debt service. Unemployment was high in all four countries, putting pressure on governments to directly provide jobs and welfare programs. In terms of prior policies, Jamaica and Guyana were similar in that they had for some time been in an adjustment mode, with several IMF programs, attempts at fiscal adjustment, and varieties of exchange rate regimes. The other two countries had fixed exchange rates, but Barbados, unlike Trinidad and Tobago, had had an IMF stand-by arrangement in the early 1980s.

Economic adjustment brings with it political cost as, more often than not, the pain is immediate but the gain may take time to appear. As the Caribbean strategies unfolded in the late 1980s and beyond, popular discontent with contractionary policies was displayed at the polls (Table 2). In dramatic fashion, the Peoples National Movement (PNM), which had held the reins of power in Trinidad and Tobago for over three decades, was voted out in favor of the National Alliance for Reconstruction (NAR) in 1986, only to return in 1991 when the NAR's program was deemed to be too harsh. In Jamaica, which had more of a tradition of electoral change, the Jamaica Labor Party (JLP) would lose to the People's National Party (PNP) in 1989. In Guyana, the Peoples National Congress (PNC) ceded power to a Peoples Progressive Party (PPP)/Civic Party coalition in 1992. Barbados was not isolated from the political impacts of adjustment as the Barbados Labor Party (BLP), which had lost the general election in 1986, returned to head the government in 1994.

Table 2. Main Elements of Economic Strategies, 1985–98

	Barbados	Guyana	Jamaica	Trinidad and Tobago
Political changes 1/	–86 BLP 86–94 DLP 94– BLP	–92 PNC 92– PPP/CIVIC	–89 JLP 89– PNP	–86 PNM 86–91 NAR 91–95 PNM 95– UNC/NAR
Overall strategy	• Market oriented • Fixed exchange rate with income restraint • Diversification into high-end tourism/offshore services	• From 89 market oriented • Reduce state participation, encourage foreign investment • Secure external debt relief	• Market oriented • Rapid trade and financial liberalization • From 93 focus on lower inflation	• Market oriented • Trade liberalization supported by devaluations • Diversification into natural-gas based industries
Balance of payments support 2/ 3/	• 92/93 IMF Standby program	• 90–98 IMF Standbys/ ESAF arrangements • 89–90 IDA SACs	• 85–96 IMF Standbys/ extended arrangement • 82–85 IBRD SALs; 93– PSDA	• 89/91 IMF Standbys • 90 IBRD SAL; 91 BEIRL
Fiscal policy	• Initially compress capital spending; cut public sector wages • Move from direct to indirect taxes • VAT in 97	• Cut capital spending ; reduce public sector work force • Move from direct to indirect taxes • Streamline consumption tax	• Reduce public sectorwork force; restrain capital spending • Initially increase indirect taxes • General Consumption Tax in 91	• Initial cut in capital spending; voluntary retrenchment program; cut public sector salaries • Move from direct to indirect taxes • VAT in 93
Monetary policy	• Minimum deposit rate • Reserve requirements	• Reserve requirements • Limited open market operations	• Reserve requirements • Aggressive base money targeting from 95 using open market operations	• Reserve requirements high • Slow move to indirect instruments
Trade policy	• Reduction in CARICOM CET • Reduced import QRs • Temporary import surcharges	• Reduction in CARICOM CET • Reduced import QRs • Temporary import surcharges	• Reduction in CARICOM CET • Reduced import QRs • Temporary import surcharges	• Reduction in CARICOM CET • Reduced import QRs • Temporary import surcharges
Exchange rate policy/capital controls	• Fixed exchange rate • Capital controls on outflows	• Variety of exchange rate regimes (single peg; basket peg; discrete devaluations; cambios; floating) • Complete liberalization of capital controls in 96	• Variety of exchange rate regimes (discrete devaluations; auctions; floating) • Full liberalization of capital controls in 91	• Discrete devaluations in 85, 88, floating in 93 • Full capital account liberalization in 93

1/ Political parties in power during 1985–98.
2/ Refers to IMF upper credit tranche or IBRD/IDA balance of payments support.
3/ SAL/SAC (structural adjustment loan/credit); PSDA (private sector development adjustment loan); BEIRL (business expansion and industrial restructuring loan).

An interesting similarity, notwithstanding the changes in political power in these countries was the convergence among parties in their economic agendas. In large measures, the economic thrust of the Caribbean programs in the late 1980s and 1990s was quite independent of the specific ruling parties of the day, even in Guyana and Jamaica, where previously there was a clearer demarcation of economic agendas, along either "socialist" or "capitalist" lines.[3]

All of the four countries' overall strategies were market oriented, broadly intended to reduce state participation in economic activity and stimulate the private sector. For Guyana in particular, encouraging foreign investment was a major pillar of economic policy under its comprehensive "Economic Recovery Program;" its large debt overhang was so overwhelming that Guyana also put much effort into securing external debt relief. With its adherence to a fixed exchange rate strategy, Barbados concentrated on expenditure reduction policies, incorporating economy-wide income restraint, and made efforts to diversify into offshore financial services. Trinidad and Tobago combined expenditure reduction with expenditure-switching measures and used devaluations to compensate manufacturers for opening them to import competition. Jamaica concentrated on rapid trade and financial liberalization and subsequently focused on lowering inflation, through tight monetary management, as a cornerstone of economic policy. In their adjustment programs, all of the countries sought balance of payments support from the IMF (Table 3) and the accompanying conditionalities, featuring quarterly performance criteria on reserves accumulation, central bank domestic assets, and fiscal performance, brought an added degree of similarity to the framework of the adjustment programs. Balance of payments support loans from the World Bank had a similar effect, particularly in requiring a certain pace of trade liberalization.

B. The Nature of Fiscal Adjustment

Fiscal action was a main component of Caribbean adjustment programs: it was initially contractionary in order to cut domestic absorption, and then incorporated tax reforms to improve incentives for private sector activities.

The **Barbados** adjustment program clearly put fiscal contraction as the central element in stabilizing the economy, as devaluation was completely ruled out. Following central government deficits averaging 4.3 percent of GDP in fiscal years 1986/87 to 1990/91 (fiscal years begin in April), a comprehensive tightening of fiscal operations was launched. On the expenditure side, nominal wages in the public sector were cut by 8 percent in late 1991 and frozen in the following year, while 11 percent of public sector workers were fired. Capital formation was sharply reduced, particularly through deferment of projects which did not have a large foreign-financed component. To improve revenue, a stabilization tax of 1.5 to

[3] Policy continuity was also very evident in Trinidad and Tobago, the only one of the countries in which there was a change of government at each election since 1986.

Table 3. IMF/World Bank Balance of Payments Support,* 1980–98

(Amounts in US$ million)

Country	Type of arrangement	Date of Arrangement	Date of Expiration or Cancellation	Amount Agreed	Amount of IMF Loans Drawn	Undrawn Balance at Expiration/Cancellation ©
Barbados	IMF Stand-By	1982–Oct 1	1984–May 31	30	30	...
		1992–Feb.7	1993–May 31	17	11	6
Guyana	IMF Extended Arrangements	1979–Jun 25	1980–Jun 24 1/	49	8	41 ©
		1980–Jul 25	1982–Jul 21 2/	114 3/	39	75 ©
	IMF Stand-By	1990–Jul 13	1991–Dec 31 4/	36	36	-
	IMF ESAF	1990–Jul 13	1993–Dec 20	60	60	-
		1994–Jul 20	1998–Apr 17 5/	37	37	-
	World Bank SAC I	1989		120 6/		
	World Bank SAC II	1990		75 6/		
Jamaica	IMF Extended Arrangements	1979–Jun 11	1981–Apr 12 7/	201	66	135 ©
		1981–Apr 13	1984–Apr 12	399 8/	336	62
	IMF Stand-By	1984–Jun 22	1985–Jun 21	62	62	-
		1985–Jul 17	1986–Jul 16 9/	111	40	71 ©
		1987–Mar 2	1998–May 31	66	66	-
		1988– Sept 19	1991–May 31 10/	64	32	32 ©
		1990–Mar 23	1991–May 31	63	63	-
		1991–Jun 28	1992–Sep 30 11/	33	33	-
		1992–Dec 11	1996–Mar 16 12/	79	63	16
	World Bank SAL I	1982		76		
	World Bank SAL II	1983		60		
	World Bank SAL III	1985		55		
	World Bank PSDA	1993		75		
Trinidad and Tobago	IMF Stand-By	1989–Jan 13	1990–Feb 28	75	75	-
		1990–Apr 20	1991–Mar 31	65	65	-
	World Bank SAL	1990		40 13/		
	World Bank BEIRL	1991		27		

Sources: International Monetary Fund; International Financial Statistics; and World Bank, Annual Reports.

* Upper Credit Tranche IMF Arrangements; World Bank "nonproject" loans, primarily for structural adjustment; SAL/SAC- structural adjustment loan/credit, PSDA-private sector development adjustment loan, BEIRL-business expansion and industrial restructuring loan.

1/ Cancelled prior to expiration date of June 24, 1982.
2/ Cancelled prior to expiration date of July 24, 1983.
3/ Increased from US$ 89 million in July 1981.
4/ Extended from July 12, 1991.
5/ Extended from July 19, 1997.
6/ Additional credits on these loans were given in subsequent years.
7/ Cancelled prior to expiration date of June 10, 1981.
8/ Approved amount increased from US$ 205 million in June 1981.
9/ Cancelled prior to expiration date of May 31, 1987.
10/ Extended from November 30, 1989; cancelled on March 23, 1990.
11/ Extended from June 30, 1992.
12/ Extended from December 10, 1995 to February 24, 1996, and then to March 16, 1996.
13/ Cofinanced by Japan Eximbank for an additional $40 million.

5 percent was imposed on incomes, the basic consumption tax rate was raised from 10 to 17 percent, the consumption tax on petroleum increased, and a 20 percent tax on luxury imports was levied. Postal, water, gas, transport charges, and rents on public housing were also raised. To improve the finances of the national insurance scheme (NIS), contribution rates were increased and unemployment benefits and severance payments reduced. As a result, the fiscal position improved, as the overall public sector balance moved from a deficit of over 7 percent of GDP in 1990/91 to a small surplus in 1992/93. The sale of shareholdings in various public entities helped in the financing of government operations.

A program to reform the Barbadian tax system was launched in 1993, initially with a focus on direct taxation. By 1995 the stabilization tax and some other payroll levies were abolished, the number of personal income tax brackets was reduced from 6 to 2, the corporation tax rate was equalized with the top personal income tax rate at 40 percent, and many exemptions were eliminated. A value-added tax (VAT) was introduced at the start of 1997 with a basic rate of 15 percent, except for hotel accommodations at 7.5 percent. The VAT significantly simplified the tax system as it replaced 11 indirect taxes, and also proved to be revenue enhancing.

Given the deep-seated nature of the economic imbalances, the fiscal adjustment in **Guyana** was more protracted. There was a series of attempts to rein in the public sector wage bill, which did not include nominal wage cuts, like in Barbados, since inflation was relatively high, especially given exchange rate adjustment and removal of price controls; nonetheless, real public sector wages declined precipitously, leading to a large exodus of skilled workers from the public service.[4] To contain the wage bill, the government reduced the size of the civil service by almost one-half between 1991 and 1998. The fiscal position also improved with the decline in interest payments associated with debt relief, reductions in transfers, and initial cuts in capital spending. To address the deteriorating infrastructure and social facilities, however, capital expenditure was increased by about 2 percent of GDP between 1993 and 1996 and focussed on roads, drainage, irrigation, education, and health.

In terms of tax reform, starting in 1989, all specific consumption taxes in Guyana were converted to *ad valorem* bases and the number of rates was eventually reduced from 14 to 3, while state corporations were no longer exempt from consumption taxes and import duties. In 1991, tax reform intensified with an increase in the personal income tax threshold, a replacement of the six personal income taxes by three and withdrawal of all previous allowances and deductions. In the following year a single rate of 33.3 percent was levied on personal taxable income. The corporation tax was steadily reduced to 35 percent by 1995 (45 percent for "commercial companies") while the system of corporate tax holidays was abolished. Several excise duties were abolished and replaced by consumption tax.

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[4] In an attempt to retain qualified public workers, wage policy since 1994 was designed to bring public sector wages eventually to within 10 percent of comparative private sector earnings.

Large-scale divestment of state assets made a significant contribution to financing the fiscal operations in Guyana.[5]

Like Guyana, **Jamaica** was already involved in fiscal adjustment actions by the mid-1980s. Between 1984 and 1986 a round of macroeconomic measures included a large devaluation and on the fiscal side, cuts in public expenditure, involving the layoff of almost 10,000 public sector employees, reductions in subsidies, and increases in public utility tariffs and national insurance contributions. Capital expenditure was also reduced, but rose in the aftermath of Hurricane Gilbert to deal with reconstruction projects. Several public entities were also privatized, and a more comprehensive approach was adopted in 1991 for streamlining the sale of hotels and other public assets, but the divestment program tapered off in later years.

Tax reform also characterized the Jamaican adjustment program, with the replacement of several indirect taxes by a General Consumption Tax (GCT) of 10 percent in October 1991, later raised to 12.5 percent in 1993. Various charges and fees were also increased, the coverage of the withholding tax on interest income broadened and a substantial revaluation of properties for tax purposes effected. The fiscal position improved markedly in the early 1990s, notwithstanding a large public sector wage increase prior to the March 1993 general elections, and public sector operations moved into surplus. However, large central bank losses partly associated with the adoption of a very tight monetary policy contributed to the deterioration of the fiscal position, while slow economic growth retarded the government's revenue inflows. In the late 1990s, as discussed below, support to a financial sytem in crisis was to put a further enormous strain on the public finances.

In **Trinidad and Tobago** the basic fiscal challenge was how to unwind the large recurrent expenditure bill set in motion during the oil boom to redistribute the oil windfall. Initially, however, it was capital spending that was cut.[6] The new government elected in 1986 embarked on a drastic fiscal adjustment, almost immediately reducing the central government wage bill by suspending cost of living allowances and merit pay increases (subsequently reversed by the industrial court as illegal) and later on cutting nominal public sector wages by 10 percent. The public sector work force was also reduced, in part because of a voluntary severance program. Tariffs of the public utilities and services were raised and further investment on energy-related projects postponed. Many state enterprises were also liquidated and the government sold its shares in several large energy-based companies.

As regards tax reform, in 1988 the oil-tax regime was revised to encourage oil companies to engage in production and exploration. In 1989 the 11 different marginal tax rates on personal income were replaced by 4 rates, while the maximum was brought down from 50 percent to

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[5] In the period 1989–93 alone, 13 corporations were sold.

[6] On the current expenditure side, public sector wage increases of over 50 percent were still being concluded in 1982.

45 percent and later to 35 percent. The non-oil corporation tax was lowered to 45 percent by effectively eliminating a "business levy" and "national recovery impost" that had been introduced in 1987 and 1988. A VAT was introduced in 1990 at 15 percent, and several other taxes were abolished.

In comparative terms, the fiscal dimensions of adjustment were quite similar across countries, but there were important differences with regard to the components of the packages:

(i) because it was easier to control, all countries initially laid a heavier emphasis on expenditure reduction as opposed to revenue increases. Capital expenditure, in particular, was sharply cut;

(ii) the number of public sector workers was reduced in all cases, although the approach to nominal wages differed: Barbados and Trinidad and Tobago cut nominal wages, unlike Jamaica and Guyana. However, in the latter two countries, especially Guyana, public sector real wages were severely eroded by inflation, and both lost a significant number of skilled public servants to emigration. In these cases, the governments, in attempting to bring down inflation, faced ongoing challenges to deal with demands by public sector workers for compensation for *past* declines in real wages;

(iii) in all countries, but especially in Guyana and Trinidad and Tobago which had a large public enterprise sector, divestment of state assets was used to finance public sector operations and to reduce debt. In the case of Jamaica, there was some reversal of the process in the late 1990s when several enterprises faced economic difficulties and also in the aftermath of the financial system crisis;

(iv) Tax policy for the most part involved an initial increase in rates of indirect taxes and either higher rates or new "stabilization" taxes on income, in order to improve revenue. This was followed by a streamlining of the tax regime through consolidation of indirect taxes into a value-added or consumption tax, and a compression and lowering of direct tax rates accompanied by elimination of many tax deductions (Table 4). Trade liberalization by way of tariff reductions also meant that import duties became less important as a source of revenue for the governments.

As Table 5 shows, all of the four countries had initial success in reducing their fiscal imbalances. Over the five-year period 1987 to 1992, central government and overall public sector deficits, as shares of GDP, were reduced or eliminated. Subsequently, however, between 1992 and 1997 the picture changed and while Barbados, Guyana, and Trinidad and Tobago stabilized or improved the fiscal balance, Jamaica's fiscal position had deteriorated by over 10 percent of GDP, converting the earlier surplus into a sizable deficit. Debt relief helped Guyana to reduce the burden of interest payments; in the case of Jamaica, however, domestic debt expanded out of control in the context of a very tight monetary policy and the issue of new government instruments in support of the financial system in the mid-1990s.

Table 4: Main Features of Tax Regimes: 1992 and 1997 1/

		Barbados	Guyana	Jamaica	Trinidad and Tobago
Direct taxes	1992	**Personal:** 5 marginal rates, highest at 50 percent. **Corporation tax:** 35 percent.	**Personal**: 3 marginal rates, highest at 40 percent. **Corporation tax**: 35 percent.	**Personal:** flat rate on taxable income of 33.3 percent. **Corporation tax:** 33.3 percent; 30 percent on building societies; 7.5 percent on life assurance companies.	**Personal**: 4 marginal rates, highest at 40 percent. **Corporation tax** (nonpetroleum companies): 45 percent.
	1997	**Personal:** 2 marginal rates, highest at 40 percent. **Corporation tax:** 40 percent; for small local businesses 25 percent.	**Personal**: single rate of 33.3 percent. **Corporation tax**: 35 percent on manufacturing-noncommercial corporations; 45 percent on others.	**Personal:** flat rate of 25 percent. **Corporation tax:** 33.3 percent, 30 percent on building societies; 7.5 percent on life assurance companies.	**Personal**: 2 marginal rates, highest at 35 percent. **Corporation tax**: 35 percent.
Indirect taxes	1992	**Sales (consumption) tax:** standard ad valorem rate of 17 percent; other rates of 20-40 percent on selected items, 60-80 percent on cars, specific rates on petroleum, beverages, tobacco, matches and cement. Also **many other domestic taxes**, including hotel and restaurant sales tax, property rental, entertainment tax, surcharge on overseas telephone calls, tax on quarriable materials etc.	Mainly a **consumption tax** with seven rates ranging between 0 and 150 percent; most rates between 10 and 30 percent.	Mainly a **GCT (general consumption tax)**: standard rate of 10 percent; food, agriculture, medical and educational services, exports and other items zero rated; special GCT rates on motor vehicles, tobacco, alcohol, petroleum.	Mainly a **VAT:** standard rate of 15 percent; books, health services, transport, real estate, basic food, agricultural imports, hotel accomodation zero-rated or exempt.
	1997	Mainly a **VAT (replaced 11 other indirect taxes)**: standard rate of 15 percent; 7.5 percent on hotel accomodation; basic food, medical, educational and financial services zero-rated or exempt.	**Consumption tax:** 0-10 percent on primary inputs and capital goods, 15-30 percent on intermediate inputs and final goods, special rates on alcohol and tobacco.	**GCT (general consumption tax)**: standard rate of 15 percent; 12.5 percent on cement, concrete, steel bars; 0 percent on exports and other items; special rates on motor vehicles, alcohol, tobacco, petroleum.	**VAT:** 15 percent on all goods and services; health services, transport, real estate, basic food, agricultural imports, hotel accomodation zero-rated or exempt.

Sources: International Monetary Fund, country reports.

1/ On domestic incomes and products. Imports were subject to the CARICOM CET (see Table 6) and other surcharges.

Table 5. Fiscal and Debt Dynamics: 1987-1997

(in percent of GDP)

	Barbados			Guyana			Jamaica			Trinidad and Tobago		
	1987	1992	1997	1987	1992	1997	1987	1992	1997	1987	1992	1997
Central government												
Current revenue	27.1	28.1	32.1	32.9	37.3	31.9	29.8	28.7	26.7	30.5	26.3	25.3
Direct taxes	7.4	10.4	9.9	12.2	12.4	11.4	12.7	12.4	10.7	20.5	14.1	13.0
Indirect taxes	18.3	15.5	20.8	17.5	23.0	27.1	15.9	14.7	14.7	6.9	10.5	9.7
Other	1.4	2.2	1.4	3.2	1.9	-6.6	1.2	1.6	1.3	3.1	1.7	2.6
Current expenditure	27.3	25.2	27.5	69.1	42.9	27.0	25.7	21.4	29.7	31.7	27.2	24.3
Wages and salaries	12.4	10.7	11.3	12.5	4.5	5.9	8.2	5.1	11.9	13.6	10.8	8.9
Interest	3.5	4.6	4.4	35.6	22.4	9.5	9.9	9.0	10.1	3.5	5.3	4.7
Other	11.4	9.9	11.8	21.0	16.0	11.6	7.6	7.3	7.7	14.6	11.1	10.7
Current balance	-0.2	2.9	4.6	-36.2	-5.6	4.9	4.1	7.3	-3.0	-1.2	-0.9	1.0
Capital revenue 1/	0.1	0.0	0.1	3.0	4.1	5.7	3.9	1.0	0.2	0.0	0.0	2.3
Capital expenditure	6.4	3.0	5.5	17.0	8.8	15.6	8.1	5.3	5.4	4.2	1.9	2.4
Central government balance	**-6.5**	**-0.1**	**-0.8**	**-50.2**	**-10.3**	**-5.0**	**-0.1**	**3.0**	**-8.2**	**-5.4**	**-2.8**	**0.9**
Public sector balance	**-5.9**	**2.0**	**-0.2**	**-33.9**	**-25.6**	**-3.0**	**-5.4**	**2.2**	**-9.0**	**-7.1**	**-2.1**	**-1.2**
Financing	5.9	-2.0	0.2	33.9	25.6	3.0	5.4	-2.2	9.0	7.1	2.1	1.2
Domestic	2.9	-4.0	0.9	-2.0	20.4	1.7	-2.6	-1.0	7.8	6.8	4.4	5.3
External	3.0	2.0	-0.7	35.9	5.2	1.3	8.0	-1.2	1.2	0.3	-2.3	-4.1
Debt dynamics												
Public sector debt	69.4	80.7	70.1	535.7	569.0	244.0	151.6	115.9	125.9	61.0	61.7	49.2
Internal debt	29.2	45.1	50.6	202.9	38.6	33.9	18.4	25.5	76.6	13.5	18.3	22.4
External debt	40.2	35.6	19.5	332.9	530.4	210.1	133.2	90.4	49.3	47.5	43.4	26.8
Memo item:												
Central government primary bal	-3.0	4.5	3.6	-14.6	12.1	4.5	9.8	12.0	1.9	-1.9	2.5	5.6

Sources: International Monetary Fund, country reports; Bank of Jamaica, *Statistical Digests*; Central Bank of Trinidad and Tobago, *Quarterly Economic Statistics*.

1/ Includes grants.

By 1997 about 38 percent of central government revenue in Jamaica was devoted to interest payments, posing an enormous fiscal challenge to the authorities.

C. Monetary and Financial System Policies

In a simple model of an open economy with a fixed exchange rate and perfect capital mobility, monetary policy is ultimately ineffective as attempts by the central bank to increase (decrease) the domestic money supply are eventually frustrated by capital outflows (inflows).[7] In principle, the Caribbean countries had some degree of autonomy in monetary policy during their stabilization programs given the existence of exchange rate flexibility and/or capital controls. Nonetheless, the general focus of monetary policy, rather than taking center stage, was to *complement* fiscal policy by keeping a lid on central bank credit to the public sector. Also, in keeping with the market-oriented spirit of reform, credit and interest rate restrictions to the private sector were lowered. As all of the countries also had to deal at some stage with financial sector problems, particularly among state institutions, further reforms were effected.

Since its establishment in 1972 the Central Bank of **Barbados** primarily used credit and interest rate controls, and liquidity requirements on bank deposits.[8] In the adjustment program in the early 1990s, limits were put on central bank credit to the public sector, while, to slow private sector credit, the liquid assets requirement and minimum deposit rates were raised, and the ceiling on loan rates removed. To discourage commercial bank borrowing from the central bank, the discount rate was increased, together with the penalty interest on reserve deficiencies. A plan to phase out a number of the direct controls was started and in a few years all selective credit controls had been removed, leaving a minimum deposit rate (4 and later 5 percent), and a liquidity requirement of 29 percent of bank deposits, of which 6 percent must be in cash. This was subsequently lowered to 25 percent. Occasionally, the central bank moved government deposits out of the commercial banks and also sold treasury bills to tighten liquidity conditions.

Barbados did not experience a full-fledged banking system crisis but needed to address problems arising from the weak performance of state banks that caused a fiscal drain. In particular, the government-owned Barbados National Bank (BNB) was overexposed to a depressed sugar sector while the Barbados Development Bank was burdened by nonperforming loans to small hotels. The government issued bonds to restructure the sugar industry debt, engaged in an internal reorganization exercise and later capitalized the BNB. The development bank was eventually closed. In a relatively calm financial environment,

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[7] See for example, International Monetary Fund (1987).

[8] Made up of an unremunerated cash reserve to be held at the central bank and the rest to be held in eligible government instruments.

new financial legislation was put in place in 1997, strengthening the supervisory powers of the central bank, and including prudential regulations along the lines of the Basel Accord.

Given its overall macroeconomic situation, financial markets in **Guyana** have developed relatively slowly compared to the other countries, dominated by commercial banks and many small credit unions. Prior to 1988, the financial system was characterized by ceilings on loan interest rates, selective credit controls in the form of guidance for direct lending to priority sectors, and high minimum liquid assets and reserve requirements. Directed credit resulted in a concentration of bank investments in projects with low rates of return and a buildup of nonperforming loans. Such a climate of control engendered disintermediation. From 1988, in keeping with the market-oriented Economic Recovery Program, interest rates and credit controls were liberalized, and a competitive process was introduced for placing treasury bills. Subsequently, the reserve requirements were raised to mop up excess liquidity and made applicable to nonbank deposits and foreign currency deposits. The central bank also used government treasury bills, with the proceeds sterilized in special accounts, in conducting open market operations.

Overexposure to the rice sector created major problems for the state bank, the Guyana National Cooperative Bank (GNCB), and in 1995 it was merged with a state development bank, its nonperforming loans were transferred to a debt-collection agency, and much of its liabilities (equivalent to 4½ percent of GDP) were assumed by the government. Between 1994 and 1997 the government also sold its shares in other banks. On the legislative side, a new Financial Institutions Act was passed in 1995, which increased the supervisory role of the central bank, and established new capital adequacy requirements and other regulations to limit risk and concentration of ownership of financial institutions. Furthermore, in 1998 the Bank of Guyana Act was revised, allowing for recapitalization of the central bank by raising its authorized and paid up capital to G$1 billion from G$6 million.[9]

Monetary policy in **Trinidad and Tobago** was similar to Guyana as regards the early use and then abandonment of interest and selective credit controls, reliance on liquid assets and reserve requirements, and later introduction of a limited form of open market operations. During its economic adjustment program, Trinidad and Tobago occasionally employed marginal reserve requirements, and also gradually reduced its "secondary reserve requirement" (which mandated that financial institutions should keep a certain proportion of deposits in treasury bills), in order to reduce this captive form of bank loans to the government. For a certain period, banks also needed to consult with the central bank before increasing credit to state enterprises and statutory authorities, while, to discourage bank

[9] The Act also allowed a further transfer of foreign-debt liablities from the central bank to the government (US$145 million of such liabilities had been transferred in 1997), prohibited the central bank from extending credit to the central government or public enterprises, and authorized the bank to issue and trade its own securities for open market operations.

borrowing from the central bank, the discount rate was increased. Notwithstanding its moves toward open market operations through sales and purchases of government short-term instruments in the late 1990s, the central bank continued to rely on reserve requirements, increasing these on occasion to curtail liquidity and reduce pressures in the foreign exchange market.

Trinidad and Tobago also experienced several instances of financial sector turmoil in the dozen or so years following the collapse of international oil prices. The oil boom had provided a tremendous fillip to the growth of financial institutions, particularly nonbank deposit takers, which emerged in a completely unregulated environment. Poor management, lending, and control practices were masked by surging incomes and profits of their customers, especially in the areas of real estate and construction. Legislation was passed in 1981 to deal with nonbanks but, with a slowing economy, the incidence of nonperforming loans accelerated and bank supervisors, accustomed to dealing with just 6 commercial banks, were ill equipped to deal with an additional 20 institutions. As it turned out, several nonbanks received liquidity support from the central bank (and a consortium of commercial banks), some were eventually closed, and supervisory legislation was updated and a deposit insurance scheme was introduced in 1986. Later on, the central bank restructured two commercial banks, provided them with liquidity support, transferred their bad loans to a debt-collection agency, and eventually merged their operations with a third bank. In the face of these challenges, new financial legislation was enacted in 1993 that set prudential norms for the banks on capital adequacy, provisioning, risk exposure, and concentration of credit.

Of the four countries, **Jamaica** placed the most reliance on monetary policy. Initial reliance almost exclusively on nonmarket-based instruments (selective credit, interest controls, liquid assets requirements) gave way to more extensive use of market-based policy instruments. The move in this direction actually started in 1985, but there was a major policy reversal in 1989 in response to a surge in credit and exchange rate pressures and measures such as credit ceilings were reintroduced. The liberalization restarted in 1991, interest rates were deregulated and credit controls were abandoned. Following annual inflation rates of about 40 percent in the early 1990s, the Jamaican authorities decided to train economic policy sharply on curbing inflation. Monetary policy took center stage. A comprehensive system of open market operations was erected, primarily using central bank holdings of government securities, and effected through primary dealers. The tight monetary policy was successful in bringing inflation down to single digits by 1998, though at the cost of high real interest rates.

Like Trinidad and Tobago, but somewhat later and for different reasons, financial institutions in Jamaica experienced a period of rapid growth in a largely unregulated setting. In the former, a booming economy was the catalyst in the 1970s; in the latter, financial and external capital liberalization, high inflation, and the availability of a large amount of government instruments at attractive interest rates sparked the surge of new financial entities in the early 1990s. Some packaged themselves to take advantage of differential reserve and other requirements (such as a lower reserve requirement on nonbanks compared to banks). A number of financial conglomerates were set up, linking insurance companies, commercial banks, merchant banks, building societies, etc. Banking supervision was unable to keep track

of the bewildering array of institutions and instruments, and concentration of credit and related party lending became pervasive, together with maturity mismatches of assets and liabilities.

As tight monetary policy led to a dramatic decline in inflation and concomitant increase in real interest rates, the deepening recessionary conditions weakened loan portfolios. A full-scale crisis was underway by 1996–97. The government responded by publicly announcing its guarantee of all deposits and life insurance policies. A resolution company, the Financial Sector Adjustment Company (FINSAC), was set up to manage the process, and the central bank and government provided liquidity support and capital injections. FINSAC eventually took over most of the domestic financial institutions, several of which the state had divested less than a decade before. Simultaneously, the central bank stepped up open market operations to offset liquidity injections and to keep down pressure on the exchange rate. Prompted by these financial sector problems, legislation was amended in 1997 to improve the supervisory capacity of the central bank over banks, near banks and building institutions, increasing capital requirements, and limiting the granting of unsecured credit and credit to related parties. A year later, a deposit insurance system was introduced.

The above review of monetary and financial sector policies in the adjustment experiences points to the following:

(i) Except for Jamaica in the late 1990s when it adopted formal inflation targeting, monetary policy was not central to the adjustment programs, its focus being on limiting public sector access to central bank financing.

(ii) Credit policies in the 1990s were unlike those in earlier periods, when tight credit programs implied micromanagement of the direction of commercial bank credit to the private sector. All countries moved in the direction of more market-determined instruments of monetary policy, maintaining, however, the use of reserve requirements. High reserve requirements have been associated with the large spread observed between lending and deposit rates (Figure 1).[10] Except for Barbados, controls on interest rates were dropped, and Jamaica made the most intensive use of open market operations.

(iii) All of the countries had to deal with problems in the financial sector and provided central bank and fiscal support for restructuring. Deposit insurance was only available in Trinidad and Tobago for most of the 1990s. Jamaica faced the deepest crisis and the government offered a blanket guarantee on all deposits.

(iv) Financial sector problems in Trinidad and Tobago and Jamaica prompted an improvement in legislation for supervising the banking system and introducing prudential

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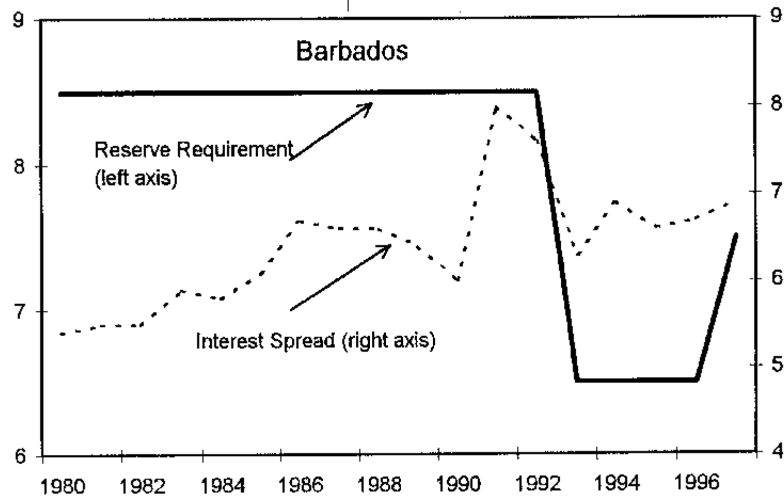
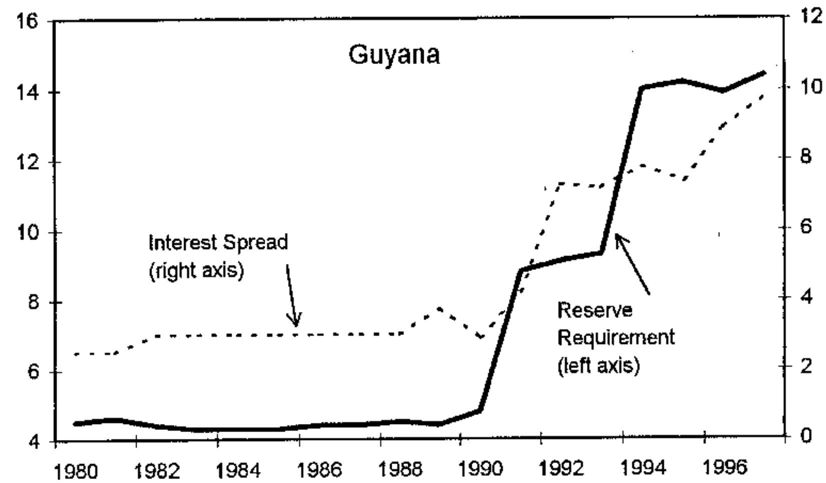
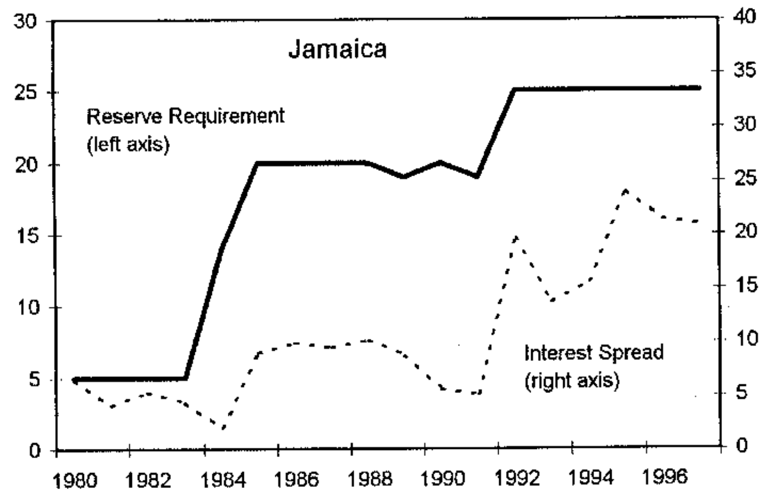
[10] The spread also reflects other factors such as the riskiness of bank portfolios. This was evident in the case of Jamaica around the period of the financial crisis when there was a buildup of nonperforming loans.

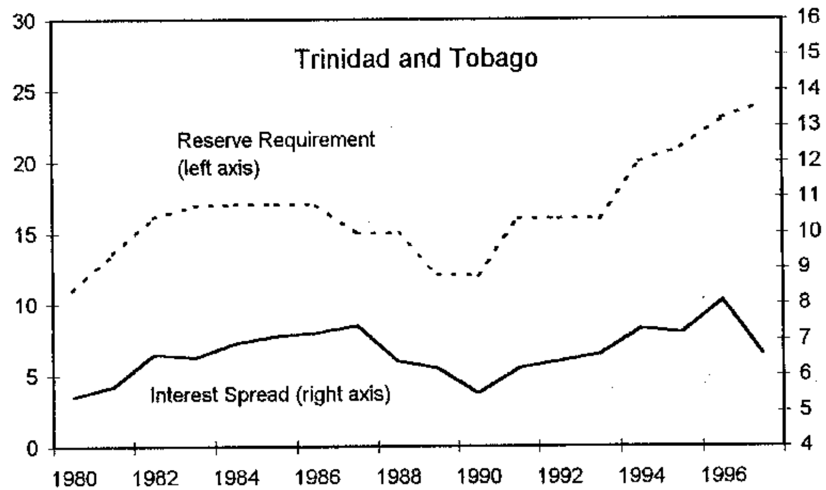
Figure 1. Reserve Requirements and Interest Spreads

(In percent)









Sources: Central Bank of Barbados; Bank of Jamaica; Bank of Guyana; and Central Bank of Trinidad and Tobago.

norms along international lines. Barbados and Guyana also improved their legislation and supervision but in relatively calmer financial environments.

D. Trade and Exchange Rate Regimes

At the heart of the stabilization programs was the need to reduce external imbalances to levels that could be financed on a sustainable basis. In this vein, apart from fiscal and other measures to reduce domestic absoption, several policies were directly focussed on the external current and capital accounts. Most countries used currency depreciation to foster expenditure switching away from imports and improve profitability in exports. On the other hand, trade measures such as reduced tariffs and quantitative import restrictions were employed more as *medium-term* devices to improve welfare, as in the short run the impact on the trade account was adverse. Current account liberalization preceded opening of the capital account.

As discussed earlier, imports were subject to a significant degree of control up to the 1980s in the Caribbean, in large measure based on an argument that import substitution would foster domestic manufacturing. The idea was that after a temporary period of protection, trade could then be opened up as the manufacturers would be strong enough to withstand competition.[11] In practice, manufacturers became dependent on protection, and in periods of balance of payments difficulties, the typical reaction was to increase import tariffs and tighten quantitative restrictions, even on trade with other Caribbean countries. A good example of this was the so-called "EC-0" system adopted in Trinidad and Tobago in 1983, which combined tough import restrictions with item-by-item foreign-exchange budgeting.

In contrast, in the stabilization programs of the late 1980s and 1990s, trade was *liberalized*, with quantitative restrictions being phased out and replaced by temporarily higher import duties that were themselves lowered over time. The roots of this change lie in the adoption by the governments of a more medium-term perspective that the economies would be more efficient in a liberalized trading environment. Such a perspective was no doubt influenced by the global move toward more open trade, which found expression at the regional level in a program to reduce the common external tariff, and in immediate practical terms in the conditionalities accompanying stabilization loans from the World Bank.

Membership in CARICOM brought a commonality to trade policy as all countries subscribed to the common external tariff (CET) on extra-regional imports. There were two major

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[11] In practice, Trinidad and Tobago relied the heaviest on import restrictions to support domestic manufacturing, while similar attempts in Guyana collapsed because of the lack of foreign exchange for inputs and energy. In Jamaica, the stimulus to manufacturing was based on free trade zones, with special access to the United States market particularly for garments; as such the Mexican devaluations in the early 1980s severely hurt Jamaican manufacturing. Barbados' manufacturing depended greatly on the state of the Trinidad and Tobago market.

revisions to the CET in the 1990s. In February 1991, the rate structure was brought down from a range of 0–70 to one of 0–45 percent, and in 1993 to 5–20 percent,[12] to be implemented over a five-year period (Table 6). Moreover, the structural adjustment loans that Guyana, Jamaica, and Trinidad and Tobago received from the World Bank specifically set out timetables for removal of quantitative import restrictions, to be replaced by temporary import surcharges.[13] The side benefit was that governments gained a temporary revenue windfall by collecting the import surcharges, which effectively substituted for some of the former rents reaped by importers.

In terms of the capital account, none of the countries, save perhaps for Jamaica for a brief period in the late 1990s, had a problem with excessive private capital inflows.[14] The main concern with respect to private capital was one of speculative outflows in periods of exchange rate uncertainty. In general, existing exchange regulations on the capital account provided for restrictions on capital outflows by requiring prior approval from the central banks. Consequently, it was the *administration* of the regulations that was tightened, and not the scope of the regulations themselves, to stem capital outflows or relaxed when the pressure eased. Eventually, three countries—Jamaica, Guyana, and Trinidad and Tobago—formally abolished all exchange controls and liberalized their external capital accounts. Barbados did not follow suit.

There were clear differences of approaches to exchange rate policy among the four countries. Barbados steadfastly adhered to a fixed exchange rate at an unchanged parity. This was formally expressed in the "Protocol for the Implementation of a Prices and Incomes Policy" which covered the period 1993 to 1995 and made provision for an economy-wide wage freeze, as well as two subsequent agreements among the government, business, and labor leaders.

Jamaica and Guyana made the transition from fixed to floating through a variety of arrangements, including single fixed rates with a common peg, basket pegs, multiple rates, and discrete devaluations. Jamaica also held regular foreign exchange auctions while Guyana adopted a "cambio" market arrangement in merging official market transactions with a large parallel market. Under these arrangements, the nominal values of their currencies depreciated

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[12] The only exceptions were agricultural products (with a 40 percent rate), agricultural inputs (0 percent), goods on a list of "revenue-raisers" and "noncompeting goods" in some of the smaller countries (0 percent).

[13] Although Barbados did not eventually get a SAL, it followed a similar liberalization program but at a slower pace.

[14] In the periods where high domestic interest rates attracted short-term capital to Jamaica the authorities did not restrict or tax the inflows, but opted to sterilize and/or allow some appreciation of the Jamaica dollar.

Table 6. CARICOM Common External Tariff Rates, 1992-98

Categories	For the Period 2/1/91-1/1/93	For the Period 1/1/93-12/31/94	For the Period 1/1/95-12/31/96	For the Period 1/1/97-12/31/97	From 1/1/98
Noncompeting inputs					
Primary	0-10(LDCs 0) 1/	0-5	0-5	0-5	0-5
Intermediate	0-10(LDCs 0) 1/	0-5	0-5	0-5	0-5
Capital	0(0) 1/	0-5	0-5	0-5	0-5
Competing primary inputs	30	20	15	10	10
Competing capital goods	30	20	15	10	10
Selected exports	30	20	15	10	10
Competing intermediate inputs	30	25	20	15	20 2/
Noncompeting final goods	30	25	25/30 2/	20/25 2/	20 2/
Agro-industry	45	30/35 2/	25/30 2/	20/25 2/	20 2/
Garments	45	30/35 2/	25/30 2/	20/25 2/	20 2/
General manufactures	45	30/35 2/	25/30 2/	20/25 2/	20 2/
Sensitive goods					
List A		Suspended rates	Suspended rates	Deleted	Deleted
List B		Suspended rates(LDCs)	Suspended rates(LDCs)	Deleted	Deleted
List C		Minimum rates	Minimum rates	Minimum rates	Minimum rates
List D - parts I and II		Suspended rates(LDCs)	Suspended rates(LDCs)	Deleted	Deleted
Safety		0	0	Deleted	Deleted
Cost of living		0-20	0-20	Deleted	Deleted
Social economic and cultural		0-20	0-20	Deleted	Deleted
Agriculture		40	40	40	40
Agriculture inputs		0	0	0	0

Source: Mcintyre, A. (1993).

1/ Rates not in parentheses refer to those applying to more developed countries (MDCs: Barbados, Guyana, Jamaica, Trinidad and Tobago).

2/ The lower of the two rates refers to countries implementing the trade reform on a fast-track basis, i.e., Jamaica, St. Lucia, St. Vincent and the Grenadines, Antigua and Barbuda, and Guyana.

substantially, in the case of Guyana from G$10=US$1 at the end of 1987 to G$162 by 1998. Over this period the Jamaica dollar depreciated from J$5.5 = US$1 to J$37.1. Trinidad and Tobago chose a different path, using discrete devaluations in 1985 and 1988 and then floating in 1993; between 1987 and 1998 the value of the Trinidad and Tobago dollar to the U.S. dollar moved from TT$3.6 to TT$6.3.

Figure 2 shows the exchange rate developments in effective terms: it shows that between 1987 and 1992 in Jamaica and Guyana domestic currency depreciation was faster than inflation differentials with the rest of the world, resulting in a marked depreciation of both currencies in real effective terms. During that period there were small real appreciations of the Barbados and Trinidad and Tobago currencies. The picture differs subsequent to 1992 with the highest real appreciations occuring in Jamaica and Guyana.

In summing up the developments of external sector policies, it is useful to demarcate several stages. Using an approach based on comparative country studies done by the National Bureau of Economic Research in 1978 and the World Bank in 1991 we delineate five phases:[15]

- Phase I: Widespread quantitative restrictions (QRs), high tariffs, exchange controls on current and capital account and fixed exchange rate.
- Phase II: Reduced QRs, high tariffs, import surcharges, exchange controls on current and capital account and fixed exchange rate.
- Phase III: QRs mainly on agriculture, lower tariffs, lower import surcharges, exchange controls mainly on capital account, fixed exchange rate.
- Phase IV: QRs mainly on agriculture, lower tariffs, lower import surcharges, exchange controls mainly on capital account, flexible exchange rate.
- Phase V: Minimal QRs, low tariffs, no exchange controls, flexible exchange rate.

Applied to all the English-speaking Caribbean countries over the period 1971 to 1997, the results appear in Table 7. The principal findings are:

(i) In the 1970s the largest Caribbean countries relied on quantitative import restrictions to stimulate domestic manufacturing sectors.

(ii) Guyana and Jamaica entered Phase II in the early 1980s. Trinidad and Tobago's entry was later, at the end of the 1980s, largely because it had a very large manufacturing sector and therefore wanted to move more slowly in removing protection. The reduction

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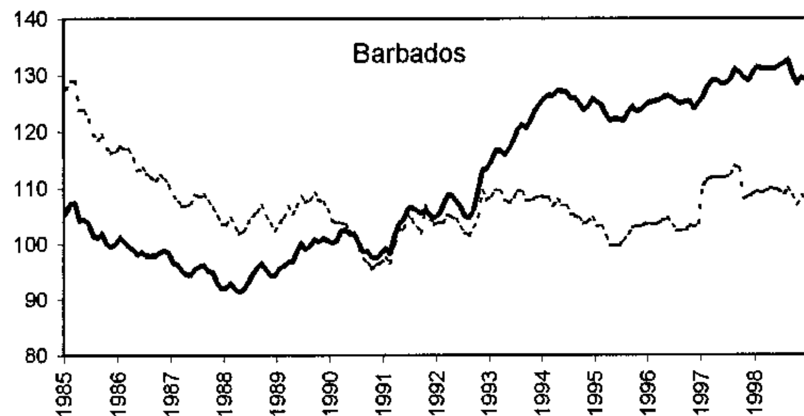
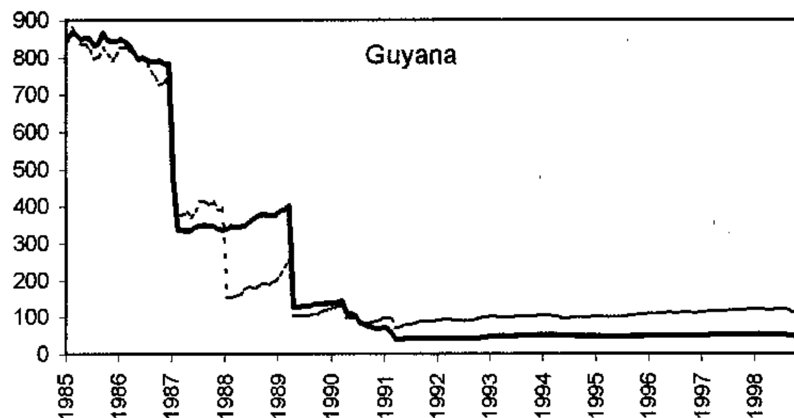
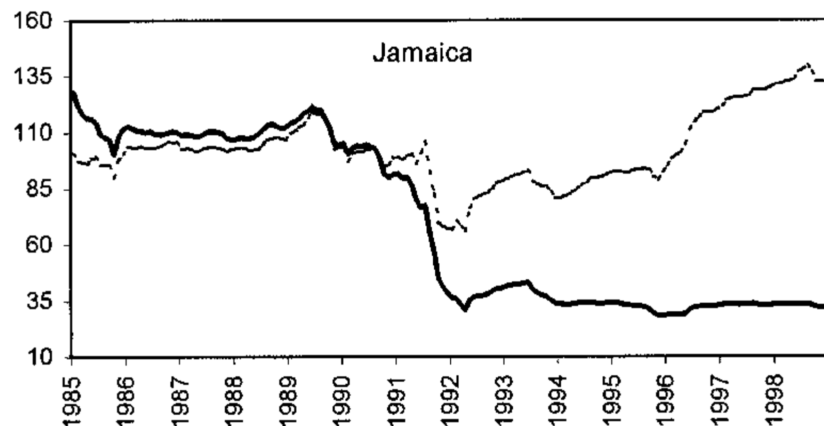
[15] See Bhagwati, Jagdish N., and Krueger, Anne O (1978) and Papageorgiou, Demetris, Michael Michaely and Armeane M. Choksi (1991).

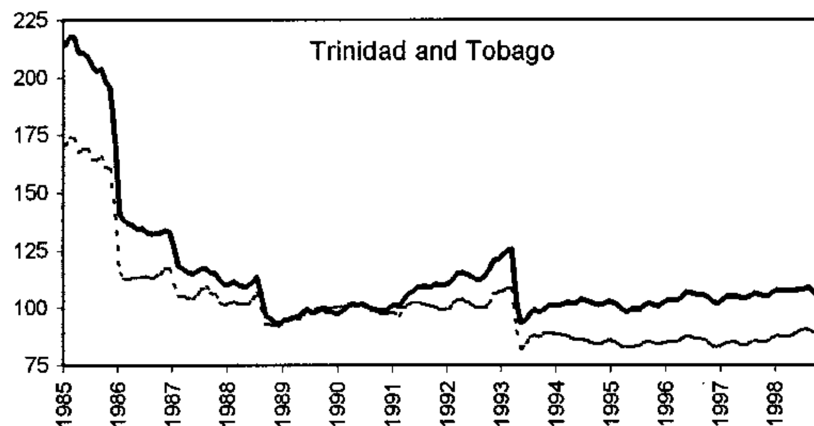
Figure 2. Effective Exchange Rate Indices

(1990=100) 1/









---- Real effective exchange rate
— Nominal effective exchange rate

Source: International Monetary Fund.

1/ Trade-weighted (increase = appreciation)

Table 7. Phases of Exchange Control Regimes in the Caribbean 1/

Country	1971 - 1975	1976 - 1980	1981-1985	1986-1990	1991-1997
Antigua and Barbuda	II	II	II	II	III
Bahamas	II	II	II	II	III
Barbados	**II**	**II**	**II**	**II**	**III**
Belize	II	II	II	II	III
Dominica	II	II	II	II	III
Grenada	II	II	II	II	III
Guyana	**I**	**I**	**II**	**III IV**	**V**
Jamaica	**I**	**I**	**II**	**III IV**	**V**
Montserrat	II	II	II	II	III
St. Kitts and Nevis	II	II	II	II	III
St. Lucia	II	II	II	II	III
St. Vincent and the Grenadines	II	II	II	II	III
Trinidad and Tobago	**I**	**I**	**I**	**II**	**III V**

1/ Definition of Phases of Exchange Control Regimes.

Phase I: Widespread QRs, high tariffs, exchange controls on current and capital account, fixed exchange rate.
Phase II: Reduced QRs, high tariffs, import surcharges, exchange controls on current and capital account, fixed exchange rate.
Phase III: QRs mainly on agriculture, lower tariffs, low import surcharges, exchange controls mainly on capital account, fixed exchange rate.
Phase IV: QRs mainly on agriculture, lower tariffs, import surcharges, exchange controls on capital account, flexible exchange rate.
Phase V: Minimal QRs, low tariffs, no exchange controls, flexible exchange rate.

of QRs in these countries was formalized under conditionalities of multilateral credit facilities.

(iii) Guyana and Jamaica moved progressively through all five stages. Stages II, III, and IV were concentrated in the late 1980s and early 1990s, in which the transition was marked by rapid currency depreciation as the countries experimented with different exchange rate arrangements.

(iv) In moving to Phase V, Trinidad and Tobago jumped over Phase IV, abandoning controls on both current and capital account transactions in switching from a fixed to a flexible exchange rate system. Apparently, the poor experience of Guyana and Jamaica informed the Trinidad and Tobago decision, particularly since the precedent set by the former two countries may have given rise to expectations that continuous depreciation would ultimately result in adoption of a float.

(v) In none of the Caribbean cases was there a policy reversal in the sense of reversion to an earlier stage of liberalization.

IV. The Outcomes and Lessons

A. Indicators of Performance

The contractionary nature of the stabilization programs initially resulted in a reduction of macroeconomic imbalances, but the resumption of sustainable growth was not achieved in all cases. Table 8 provides several indicators of performance over the ten-year period 1987 to 1997. The first panel looks at external balance, as the countries faced the challenge of stabilizing their currencies, stemming the loss of foreign exchange reserves, servicing their external debt, and strengthening the external current account. The second panel looks at inflation, growth, and employment as indicators of internal balance. The third panel, taken from the UNDP's Human Development Report 1998, provides a snapshot of several welfare indicators in the late 1990s.

Barbados had experienced a period of intense pressure on the domestic currency around 1990–91 but this subsided as the sharp fiscal adjustment, accompanied by economy-wide income restraint, helped to restore both internal and external balance. International reserves picked up, the external debt-to-GDP ratio narrowed while growth was restored in a low-inflation setting. Choosing a somewhat different path, Trinidad and Tobago also emerged from recessionary conditions with low inflation in the late 1990s. The immediate result of the floating of the currency in 1993 was a depreciation from TT$4.20 to TT$5.75 to the U.S. dollar, which eventually settled at TT$6.3, supported in part by central bank intervention in the foreign exchange market. A marked increase in capital imports in 1997 moved the external current account into deficit following the surpluses of the previous five years.

In the case of Jamaica, the main story is the impressive reduction in inflation to under 10 percent by 1997 from about 58 percent in 1992. As discussed earlier, however, the

Table 8. Indicators of Economic Performance and Human Development

	Barbados			Guyana			Jamaica			Trinidad and Tobago		
	1987	1992	1997	1987	1992	1997	1987	1992	1997	1987	1992	1997
External balance												
Reserves (US$)1/	145	140	**265**	8	188	**316**	174	324	**682**	188	172	**706**
Reserves to imports	2.4	2.1	**2.4**	0.2	4.1	**4.7**	1.1	1.4	**2.1**	1.5	1.5	**2.6**
Exchange rate 2/	2.0	2.0	**2.0**	10.0	126.0	**144.0**	5.5	22.2	**36.3**	3.6	4.3	**6.3**
External current account/GDP	-1.1	9.0	**-0.4**	-45.5	-42.4	**-14.2**	-4.8	-0.1	**-5.4**	-5.9	1.7	**-10.0**
External debt/GDP	40	36	**20**	333	530	**210**	133	90	**49**	48	43	**27**
Internal balance												
Inflation	3.6	6.0	**7.7**	28.7	28.2	**3.6**	11.2	57.5	**8.8**	13.4	6.5	**3.7**
Growth	2.6	-5.7	**2.6**	0.8	7.8	**6.2**	7.8	1.5	**-0.2**	-4.6	-1.7	**3.5**
Unemployment	17.9	23.0	**14.4**	...	...	**...**	21.0	15.9	**16.5**	22.3	19.6	**15.0**
Public sector balance/GDP	-5.9	-2.0	**-0.2**	-33.9	-25.6	**-3.0**	-5.4	2.2	**-9.0**	-7.1	-2.1	**-1.2**
Human development 3/												
Human development Index (HDI)			**0.909**			**0.670**			**0.735**			**0.880**
HDI rank in the world			**24**			**100**			**84**			**40**
Life expectancy at birth			**76.0**			**63.5**			**74.1**			**73.1**
Infant mortality rate 4/			**11**			**60**			**10**			**15**
Doctors per 100,000 people 5/			**113**			**33**			**57**			**90**
Adult literacy rate (in percent)			**97.4**			**98.1**			**85.0**			**97.9**
Population without access to safe water (in percent) 6/			**0**			**39**			**14**			**3**
Population below national poverty line (in percent) 7/			**...**			**43**			**32**			**21**

Sources: International Monetary Fund, country reports; and UNDP, Human Development Report 1998.

1/ Total reserves minus gold.
2/ Local currency to U.S. dollar (end of period).
3/ From UNDP, *Human Development Report 1998*: The HDI is based on income per capita, life expectancy and schooling; data refer to 1995, except where otherwise stated.
4/ Per 1,000 live births (1996).
5/ 1993.
6/ 1990-96.
7/ 1989-94.

tradeoff was slow growth and rising unemployment as the high real interest rates that accompanied tight monetary policy currency led to depressed output. A measure of external balance was nonetheless reattained as reserves were built up and the external debt burden declined. With its extremely heavy debt burden, Guyana faced the most formidable constraints, but with a considerable degree of debt forgiveness, and more in the pipeline,[16] external debt to GDP ratio has fallen, there have been improvements in the current account, and an increase in international reserves related to significant inflows of direct foreign investment. Internally, inflation in 1997 dropped to about the same rate as in Barbados and there was commendable growth, although from a very low base, and the economy had still not retained its size of the early 1970s. The welfare indicators show, moreover, that Guyana still lags significantly behind the other countries.

B. Policy Lessons

Examination of the experiences of the four Caribbean countries reveals several lessons that can inform ongoing or future stabilization efforts:

(i) Fiscal policy needs to be at the core of a prudent macroeconomic policy framework. Government's net spending constitutes a direct part of domestic absorption, is under the control of the authorities, and affects the resources available for domestic investment.

(ii) The role of fiscal policy should not be confined to contracting absorption but should encompass improvement of incentives for private sector activity, via tax reform if necessary. The composition of government expenditure should also take into account the implications for growth. In particular, although capital spending may be the easiest to cut in the short term, it directly affects an economy's growth potential.

(iii) Economy-wide income restraint is desirable for successful adjustment as it supports prudent fiscal policy and external competitiveness.

(iv) Monetary policy should be supported by fiscal policy; it should not be overburdened as high interest rates adversely affect investment and growth and eventually weaken the fiscal position.

(v) Exchange rate policy should be clear, and appropriately supported by other policies, notably fiscal and incomes policies. This helps to build credibility for the adjustment program. The actual choice of fixed or floating regime is not as important.

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[16] In 1999 it was announced that Guyana would receive over US$400 million in external debt relief from multilateral and Paris Club creditors under the Initiative for Heavily Indebted Poor Countries (HIPC).

(vi) Public debt poses major constraints to adjustment programs, by severely limiting the room for maneuver of the fiscal authorities. As far as possible, therefore, policies should try to reduce the burden of public debt.

(vii) A narrow output base makes countries very vulnerable to external shocks. Consequently, policies that help to diversify a country's range of production activities assist in reducing such vulnerabilities.

V. CONCLUSIONS

Four of the larger English-speaking Caribbean countries simultaneously faced severe balance of payments difficulties in the late 1980s. These were all open economies, each producing a relatively narrow range of products, and members of a regional customs union. The main differences in initial conditions lay in the actual product mix across countries, the relative roles of the state in production, and the magnitude of debt commitments, which would pose constaints to policy options. Their choices of stabilization strategies held certain common elements, in that they were all market-based, featured fiscal contraction and trade liberalization, and were supported by multilateral balance of payments loans. Tax reforms were also included, generally in the later stages of the stabilization programs. Timing of measures, public sector wage policies, the relative importance of monetary policy, and the choice of exchange rate regime differed among the countries. They would also confront financial sector problems of varying degrees, prompting fiscal support, bank restructuring, new legislation and in some cases, the introduction of deposit insurance.

As it turned out, by the late 1990s, Barbados and Trinidad and Tobago had both reattained internal and external macroeconomic balance, although growth and an expansion of capital imports has led to a reappearance of deficits on the external current account. Guyana's situation has improved, in part due to significant debt relief, but the country's social indicators are still weak, while Jamaica's recovery was set back by a fresh round of problems in the financial system, and large internal debt commitments pose major difficulties. While the stabilization programs were conducted on an independent basis by each country, their designs were influenced by the experiences of others, conditionalities attached to multilateral loans and CARICOM trade commitments. Enhanced labor and capital mobility in the Caribbean, currently being proposed under the CARICOM arrangement, would create an avenue for diffusion of economic shocks by way of resource movements. Moreover, the common legacy of the stabilization episodes includes less complicated tax systems, more liberal trade regimes and stronger financial legislations which, in the absence of major policy reversals, would improve the basis for dealing with the inevitable challenges to come.

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