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*Relevance of the Balance of Payments objective to the
Identification and Design of a Diversification Programme for the
Agricultural Sector*

This paper will attempt to interpret the issue concerning the Balance of Payments, in a broadened framework to include macro-economic considerations in general, going into the identification and the design stages of an agricultural diversification programme.

Where an economy runs into adverse external shocks one usually starts with the Balance of Payments, certainly in the current Caribbean context of external shocks, and works backwards, seeking to diversify and develop the export sector, including agriculture, rather than starting off on the assumption that you want to diversify your agriculture and wish to ascertain the implications for the Balance of Payments and its objectives. Put differently, what considerations should be borne in mind in a diversification programme as one focuses on those issues? Most of the issues relating to agriculture in general and export agriculture in particular, arise because of problems in the incentive structure affecting agriculture, and in this connection market forces and exchange rate issues are central. Problems in the Balance of Payments essentially force one, or force countries in the region to focus backwards as to what can be done to close the external gap, to ease the problems arising from constraints in the Balance of Payments, and in this connection both the merchandise trade gap and the overall reserve position are important focal points.

What follows, is an attempt to look at the issue from both sides. To do this, however, a bit of history and a statement as to where we are at present is useful to provide some perspective. Then there will be an attempt to describe some of the current problems in the region, because I believe in attempting to describe where we are, and how we got there, we will have uncovered, in a sort of case study approach, some of the issues relevant to the considerations in the agricultural sector. I should then attempt to focus on Jamaica, and to identify some of the issues there, both with respect to the

agricultural sector and with respect to other matters of trading generally. I should then attempt to identify some of the relevant issues within CARICOM as a whole, and then zero in more closely upon the economic factors, and the Balance of Payments considerations, which go into concerns of an agricultural nature.

STATEMENT OF CURRENT
BALANCE OF PAYMENT PROBLEMS

The Caribbean is a region that is undergoing very severe crisis in the Balance of Payments. Whether Trinidad and Tobago or Jamaica or any of the other countries, with a few notable exceptions, the situation since 1980 has been a prolonged crisis in the Balance of Payments, and by extension a crisis in the management of the whole economy.

In this connection, the problem in the Balance of Payments can be defined in the following way: A Balance of Payment problem is the result of a protracted failure to adjust to changes in the external environment and it reflects in large measure the domestic imbalances consequent upon this. I am certain that some economists would probably disagree or find fault with that definition but it will serve, as a useful working rule. This kind of Balance of Payments problem has been experienced in the Caribbean ever since the late 1960s. The oil shocks created fundamental imbalances against which the countries have not yet fully recovered. The main reason I would advance for the problems is that, during the 1960s and again during the 1970s, the countries concentrated, unduly so, on what you might describe as an inward-looking import substituting industrialisation strategy without identifying a strategy for shifting gears to an export orientation. This issue is highlighted because it is necessary to understand the ramifications of that policy if we are to come to terms with regards to agriculture.

The inward-looking substitution

strategy was intensified in the 1970s in response to the perceived failure to create jobs fast enough in the 1960s. In this connection it is useful to remember that the 'Treaty of Chaguaramas', creating CARICOM, which attempted to broaden the individual domestic markets to include the entire English-speaking Caribbean was signed in April 1973, only six months before October 1973 when OPEC increased the price of oil some four-fold. This essentially undid what CARICOM was trying to do in attempting to broaden the domestic market without sufficient regard for extra regional competitiveness and an overall third country export thrust. Put differently, the attempt to broaden the import substitution base to a wider corridor was the wrong strategy move, in hindsight albeit, in light of the soon changed external environment. The oil shock required that the region as a whole should have opened itself up more fully to reflect the increased openness of the economies and the increased and urgent need to adjust to the fundamental imbalance created by the oil shock of 1973-74 and again in 1979 and 1980.

In the 1979 to 1980 period, not only was the Caribbean affected, but the whole world went into a very severe recession. This was to seriously affect the heavily indebted Jamaica. The onset of the credit crisis, because of the changed international financial posture, was to fundamentally alter the modalities of economic life of the region. Certain countries like Jamaica had to make very fundamental and radical restructuring of their economies by the middle of the 1980s and continuingly so.

CHARACTERISTICS OF AN IMPORT SUBSTITUTION POLICY

The characteristics of an import substitution policy which I would like to focus on, however, are as follows:

(i) An import substitution policy usually ultimately leads to an economy with a high import content, reflecting to a very large extent, the attempt to keep the import cost low through exchange rate manipulations. Such countries have a tendency to over-value their exchange rates to ensure that price of goods, including raw materials and capital goods on the domestic protected, small scale, high unit cost market remains as low as possible, particularly to urban consumers. This essentially functions as a tax on agriculture that makes the export price to

agriculture depressed, and thus there is the scissors effect, I'd call it, i.e., trying to keep the cost of manufacturing low while at the same time taxing agriculture to accomplish this.

(ii) It tends to be characterised by adverse government interference in agriculture. Governments tend to cream off the surpluses in agriculture, and they do this in several forms. One of the forms which was most disastrous in Jamaica, and I suspect in the Caribbean as a whole, was the use of the marketing boards which essentially not only stood between the producer farmer and the market place, but in many cases, certainly in the Jamaican experience, themselves dabbled in all kinds of money-losing enterprises, in many instances unrelated to marketing of the product. These organizations which acted as filters between the producer and the market-place, creamed off the surpluses and where there were no surpluses to be creamed off generated enormous losses to be passed on to the state as guarantor, with consequential fiscal effects. These commodity/marketing boards were creating very serious problems in the Caribbean, and in the Jamaican experience as I shall indicate further on, they were probably the main contributing factor to the decline of agriculture in the late 1960s as well as during the 1970s.

To the extent that these organisations shield the farmers from the discipline of the market-place they tend to generate producers, both in agriculture and in manufacturing, who are more concerned about what they produce than with what they can market. This is a very fundamental point. In a country with an export orientation, the concern is with satisfying the market, and the market, therefore, dictates what, how, and when you produce. With an inward orientation it is rather a production orientation in protected markets where you have local monopolies, sanctioned by government in many cases, who essentially produce at will. What the consumer is forced to purchase is far removed from the influences of competition. Not only is there the problem of shoddy goods in manufacturing, but also a particular kind of psyche, and a particular kind of social attitude and social classes of individuals who do not have the creativity, or the will and drive to break through into foreign markets, which is really what economies need to accomplish. If Governments are going to protect, what they really ought to do is to provide the incentives for the locals to become masters of the art of

marketing, masters of the art of satisfying the international market-place, not masters of the art of special pleading within the local socio-political environment, that leads to the creation within these environments of special classes of individuals who disprotect and who require avenues to power, political and otherwise, within the region for the furtherance of their economic goals. That's precisely what an inward-oriented, inefficient import substituting economies leads to.

(iii) An import substitution policy leads to very little utilization of domestic inputs, largely because of over-valued exchange rates. Besides there is little or no protection afforded to domestically produced inputs, largely reflecting the zero or near zero tariffs on competing imports. These forces leave the economies open to the vagaries of the market-place, dumping in some instances, certainly in agriculture which will be referred to later on.

(iv) Also, because the government is providing out of limited resources, incentives for manufacturing, it tends to create disincentives to agriculture. Rather than providing incentives across the board to the export and import competing sectors they are essentially given to inefficient manufacturing, while in fact disprotecting agriculture and withdrawing services from that sector. This affects agriculture negatively resulting in a gradual decline in the sector.

(v) There tends to be a neglect of infrastructure and of research and development in manufacturing, and in agriculture. This condition obtains in large measure because with the domestic market so heavily protected there is little, if any, incentive to engineer new products; there is little incentive to spend time, energy and resources on research and development to fit the market-place. The concerns do not centre around providing the better mouse trap which requires understanding and providing for the demands of the market-place but rather around the exploitation of the market-place with whatever obsolete equipment can be obtained at concessional tariff rates and over-valued exchange rates.

(vi) There tends to be negative real interest rates prevailing in the financial sector. As a result, people tend to over-borrow from banks and in the long run, given negative interest rates, there tends to be an excessive acquisition of fixed assets of various kinds, i.e. cars, houses, consumer durables, land, etc., rather than the acquisition of financial instruments. As such, the financial regime

does not foster the development of the financial sector, and this has strong implications for agriculture. In particular it means that the credit systems are underdeveloped within the domestic environment largely reflecting the paucity of aggregate savings. As this continues more and more, the country governments seek funding from outside to supplement the diminished savings within. There are increasingly large expenditures on consumption at the expense of savings and investment. This in turn leads to the neglect of infrastructure largely reflecting the diminishing funds flowing into investments.

(vii) The overprotected environment tends to be characterised by the presence of excessively steep Government indirect taxes heaped upon the locally produced manufactured goods. One finds in many cases that the largest shares of product cost reflect Government taxes: consumption taxes, excise taxes, excess stamp duties, to such an extent that they dwarf by several magnitudes the production cost of the items. As a result, Governments like this environment that provides them with a fairly easily identifiable source of revenues, the distorting effects of which are not easily transparent, but which constitute a powerful export deterrent with adverse consequences for agriculture, manufacturing and services alike.

An import substitution policy however is a rational policy under certain conditions, and very importantly it tends to fit into the strategy mix of a rational export-led policy. An import substitution policy tends to be a second phase of a well coordinated export-led strategy, because once exports are up to a certain level this permits efficient import substitution to take place. As such, much of the imports which previously could not be produced efficiently can now be produced at competitive costs, largely because much of it is actually being exported, so the unit cost of production is now at international competitive levels with the small domestic market absorbing an increasingly smaller share of total output. So that the strategy mix really ought to be: import substitution up to a point, then shift at some point to an export-led strategy which would itself lead backwards into further import substitution of the inputs needed, and probably very importantly into some of the capital inputs needed.

There may be room for argument as to whether industrailisation should begin with import substitution or with export expansion.

Whatever the merits of the argument, the focus ought never to be exclusively, or for extended periods, on an import substitution policy, which creates the kinds of imbalances and the kinds of psychoses which were earlier discussed.

EMPIRICAL RELEVANCE OF THE ECONOMIC FACTORS OUTLINED

Is there any empirical evidence that illuminates the theoretical constructs here in the Caribbean? The answer is in the affirmative. In the case of Jamaica the following facts are offered. If one looks at the real exchange rate, (Table 1 and Figure 1) trade weighted or any other way one finds that the exchange rate in Jamaica, (except for the periods 1975 to 1977 and 1980 to 1983) has not in fact deviated too far away from parity with say 1965 as a base. The 1975-77 appreciation reflects the domestic reaction to the first oil shock, while the 1980-83 appreciation reflects another domestic response to (a) the second oil shock, (b) the credit crisis flowing from the second shock together with the changed international financial picture, starting with October 1979, and (c) deliberate domestic choice. The main disprotective elements I would identify to be the excessive intervention bordering on interference of governments, and the presence of several commodity marketing boards that dealt a very severe blow to export agriculture over the period.

The exchange rate is very important nonetheless, because if you try to correlate the exchange rate with domestic agriculture you will find that when the exchange rate depreciated in real terms, there was also a fairly strong surge in domestic agriculture. Export agriculture was not so affected, with the main impediment here being those commodity boards that were behind the scenes creating very serious rampage in the economy in the Jamaican context.

In the broader CARICOM context, unfortunately, there is not available, at least at this time, any index of the real exchange rate. What I do have is some data relating to the imports and exports of agriculture for the region as a whole (Table 2). Except for the brief period between 1973 and 1975 when sugar prices escalated to enormous heights, the Caribbean has had what you would describe as an agricultural/food deficit, that is, we were importing more food than we were exporting.

At the present time the deficit in the region as a whole is about US\$0.5 Billion. For Jamaica the deficit in the food bill is about US\$70 Million per annum, and this has been so for some time (Figure 2). This is a switch from the 1960s when Jamaica was a surplus agricultural economy.

The effects of commodity prices is very interesting. In the case of sugar, the fluctuating price has had a very dominant part to play in the surpluses or deficits, as the case might be, for CARICOM as a whole. and if you look at the trade deficit carefully, you find that Jamaica was probably the most dominant factor in the entire period with the 1982/83 experience highly relevant when Jamaica's trade deficit dominated the picture within the CARICOM region. (Figures 3 and 4).

So in terms of the need for adjustment, we have the situation in the region where, not only do we have a tremendous negative gap in the trade deficit, we also have a negative gap on the food side. In Jamaica's case, the gap has been partially closed by focusing on export services, and so it is not necessarily the best thing to focus only on the merchandise gap. One ought to really look at the full current account in addition to the sub accounts, but for purposes of this discussion, I think we can focus on the trade gap and ask ourselves what it is that we have to do.

IMPLICATIONS FOR ECONOMIC RESTRUCTURING AND PROGRAMMING OF AGRICULTURAL DIVERSIFICATION

There is need to examine the potential for diversification. What room is there for diversification? What room is there for growth in the external sector? With a US\$5 billion food gap within CARICOM there is an enormous gap, if not to be closed, to be significantly diminished over time. There is also the issue of the possible differential treatment needed for traditional crops and for non-traditional crops.

The paper now focuses on the economic factors which are important when dealing with these issues. One could identify the following:

- (1) There is need to have a closing of the trade gaps over some finite period of time
- (2) There needs to be a fairly broad-based diversification of the portfolio of crops produced both for domestic use, and for export from the region, at least to reduce the

Table 1: *Basic Trade Data in US\$M and Real Trade Weighted Exchange Rate for Jamaica: 1965 - 1987*

Period	Total Im-ports	Total Ex-ports	Food Im-ports	Food Ex-ports	Food Balance	Mer- chan- dise Trade Balance	Food gap as % of total Trade Gap	% chng in trade Gap 65=100	Trade wtd effect. E rate 64 = 100
1965	289.1	107.3	57.2	78.8	21.6	-181.8	-11.9	100.0	100.0
1966	327.3	228.1	57.2	78.8	21.6	-99.2	-21.8	54.6	101.0
1967	344.1	222.5	57.2	78.8	21.6	-121.6	-17.8	66.9	103.4
1968	384.6	219.7	57.2	78.8	21.6	-164.9	-13.1	90.7	111.5
1969	436.1	254.2	57.2	78.8	21.6	-181.9	-11.9	100.1	110.3
1970	525.6	341.9	57.2	78.8	21.6	-183.7	-11.8	101.0	108.5
1971	564.1	346.9	57.2	78.8	21.6	-217.2	-9.9	119.5	108.1
1972	610.8	374.7	57.2	78.8	21.6	-236.1	-9.1	129.9	106.9
1973	665.0	390.2	57.2	78.8	21.6	-274.8	-7.9	151.1	111.5
1974	936.0	731.0	57.2	78.8	21.6	-205.0	-10.5	112.8	97.8
1975	1123.3	759.3	196.3	197.0	0.7	-364.0	-0.2	200.2	93.1
1976	912.9	630.1	196.3	197.0	0.7	-282.7	-0.2	155.5	87.7
1977	859.9	768.5	196.3	197.0	0.7	-91.4	-0.8	50.3	85.0
1978	878.1	796.2	196.3	197.0	0.7	-81.9	-0.9	45.0	109.3
1979	992.9	818.2	196.3	197.0	0.7	-174.7	-0.4	96.1	118.3
1980	1473.0	963.0	196.3	197.0	0.7	-510.0	-0.1	280.5	108.6
1981	1473.0	974.2	196.3	197.0	0.7	-498.8	-0.1	274.3	102.4
1982	1375.9	768.5	196.3	197.0	0.7	-607.4	-0.1	334.1	99.2
1983	1281.0	685.7	197.4	116.2	-81.2	-595.3	13.6	327.4	97.5
1984	1183.3	702.4	206.5	117.6	-88.9	-480.9	18.5	264.5	156.7
1985	1143.3	568.5	181.4	111.2	-70.2	-574.8	12.2	316.2	180.5
1986	969.2	589.7	176.7	122.9	-53.8	-379.5	14.2	208.7	163.6
1987	1234.3	708.8	196.8	139.8	-57.0	-525.5	10.8	289.1	171.7

Source: Planning Institute of Jamaica

* Trade weighted effective exchange rate 1965 = 100

Table 2: *CARICOM Balance on Extraregional Food Trade*

	<i>EC\$'000</i>				
	1970-73	1974-76	1977-80	1982-83	1984
MEAT / MEAT PREPARATIONS	- 86,457	- 117,941	- 204,908	- 281,617	- 320,449
DAIRY / EGGS	- 88,826	- 136,808	- 214,127	- 312,200	- 311,947
FISH / FISH PREPARATIONS	- 21,317	- 35,554	- 52,681	- 80,143	- 97,942
CEREALS / LEGUMES	- 117,610	- 259,729	- 332,256	- 453,560	- 563,693
FRUIT / VEGETABLES	21,006	65,046	39,183	- 56,394	26,650
SUGAR / SUGAR PRODUCTS	250,217	641,871	629,399	465,448	479,892
COFFEE / COCOA / SPICES	- 9,457	48,988	77,080	43,773	45,956
MISCELLANEOUS FOOD PREP.	- 13,865	- 26,824	- 45,768	- 71,403	- 89,345
OILS AND FATS	- 8,224	- 27,714	- 40,881	- 140,640	- 149,903
ALL GROUPS	- 74,533	151,335	- 144,959	- 886,736	- 980,780

volatility attendant on agriculture in general, and attendant on export agriculture in particular.

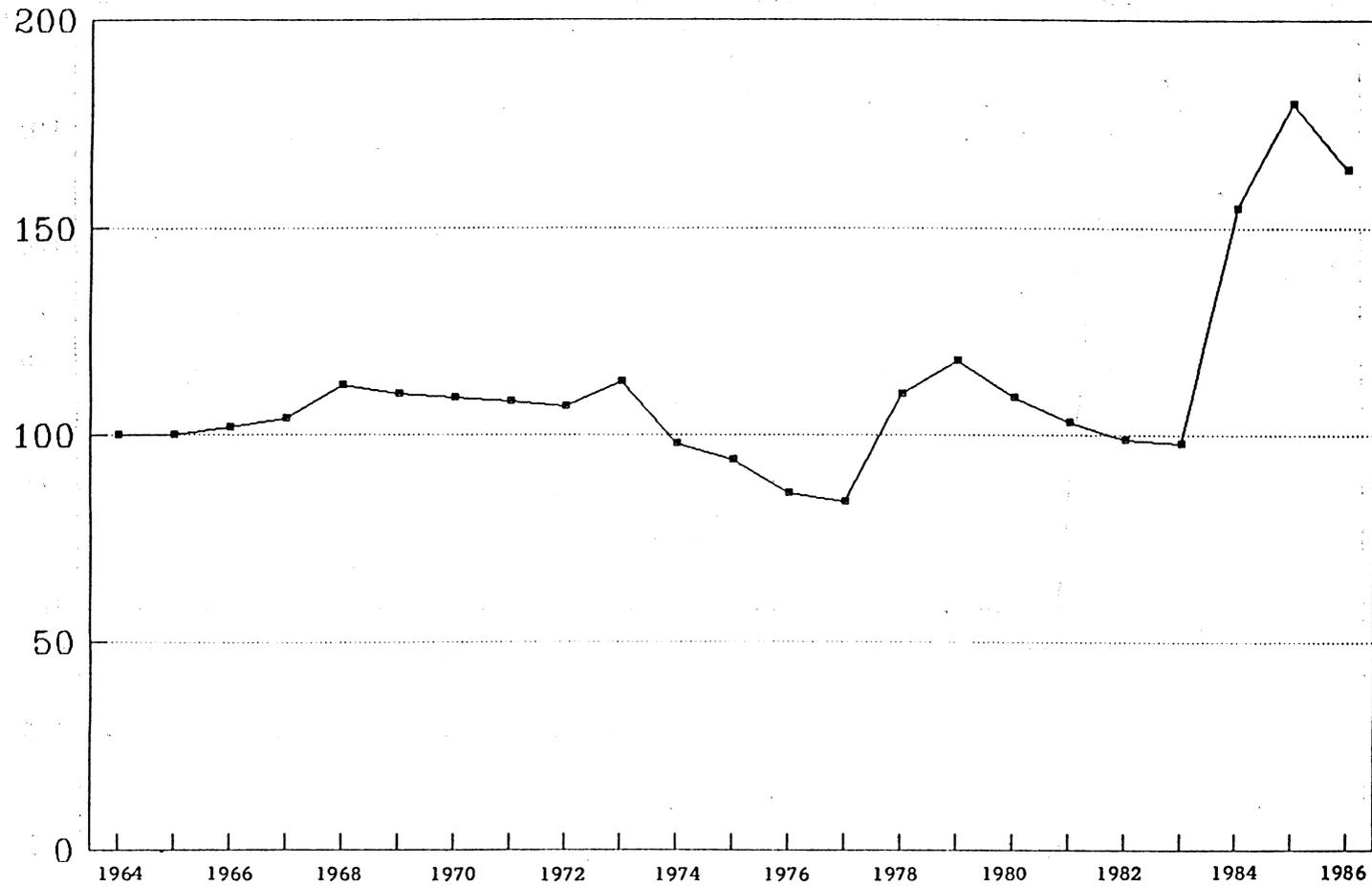
(3) There needs to be a focus on the real exchange rate. Exchange rates must be kept competitive because competitiveness and productivity are necessary for export of any kind. It is very clear that in any long run sense that unit cost, or unit price, must continue to decline, or be kept in line with international developments to compete internationally, which is the only way to effectively raise real incomes and living standards within the community. As agriculture becomes more and more in line with manufacturing, i.e. as agriculture is viewed less and less in classical terms and as a backward sector, and is more and more seen as manufacturing using land as a base, it is increasingly clear that market forces need to be seen as the guiding principle, with less dependence on administrative fiat than currently obtains.

(4) Risk bearing, risk sharing and risk shifting need to be developed, largely again reflecting the high risk nature of agriculture, and because of the need to shield the farmer somewhat from the enormous volatility attendant on farming. There needs to be some measure of stability in production, and stability in incomes to farmers, and so some

kinds of mechanism need to be developed, not perhaps the kinds in the United States or in the EEC, but some kind that does not lead to continued overproduction and to the kinds of fiscal imbalances which can very easily develop if not carefully thought out and informed by long run market conditions.

(5) Tariffs are necessary because the domestic market needs some measure of protection. The issue of protection will be developed somewhat because it is considered important, and it is an issue that is being discussed extensively at the present time within CARICOM, with respect to all producing sectors. A tariff structure is being designed to have a number of important features. Firstly, it should ideally be a CARICOM-wide tariff rather than the current four tariff regimes within the single trading region. A single tariff would mean, for the first time a Common External Tariff, (CET) as the name suggests, which would provide a mantle of protection around the CARICOM region as a whole, and within which production can take place. The tariff should not be too high, because under ideal circumstance the tariff really should be zero. The dictum, "a tax on imports is a tax on exports", needs to be borne in mind. Any tax on imports raises production costs and

Figure 1: Trade Weighted Exchange Rate, Jamaica 1964 – 1986



* Base year is 1964 with index of 100.

* An increase above 100 indicates a real depreciation of the currency.

Figure 2: *Food Trade Gap for Jamaica (1965 — 1987)*

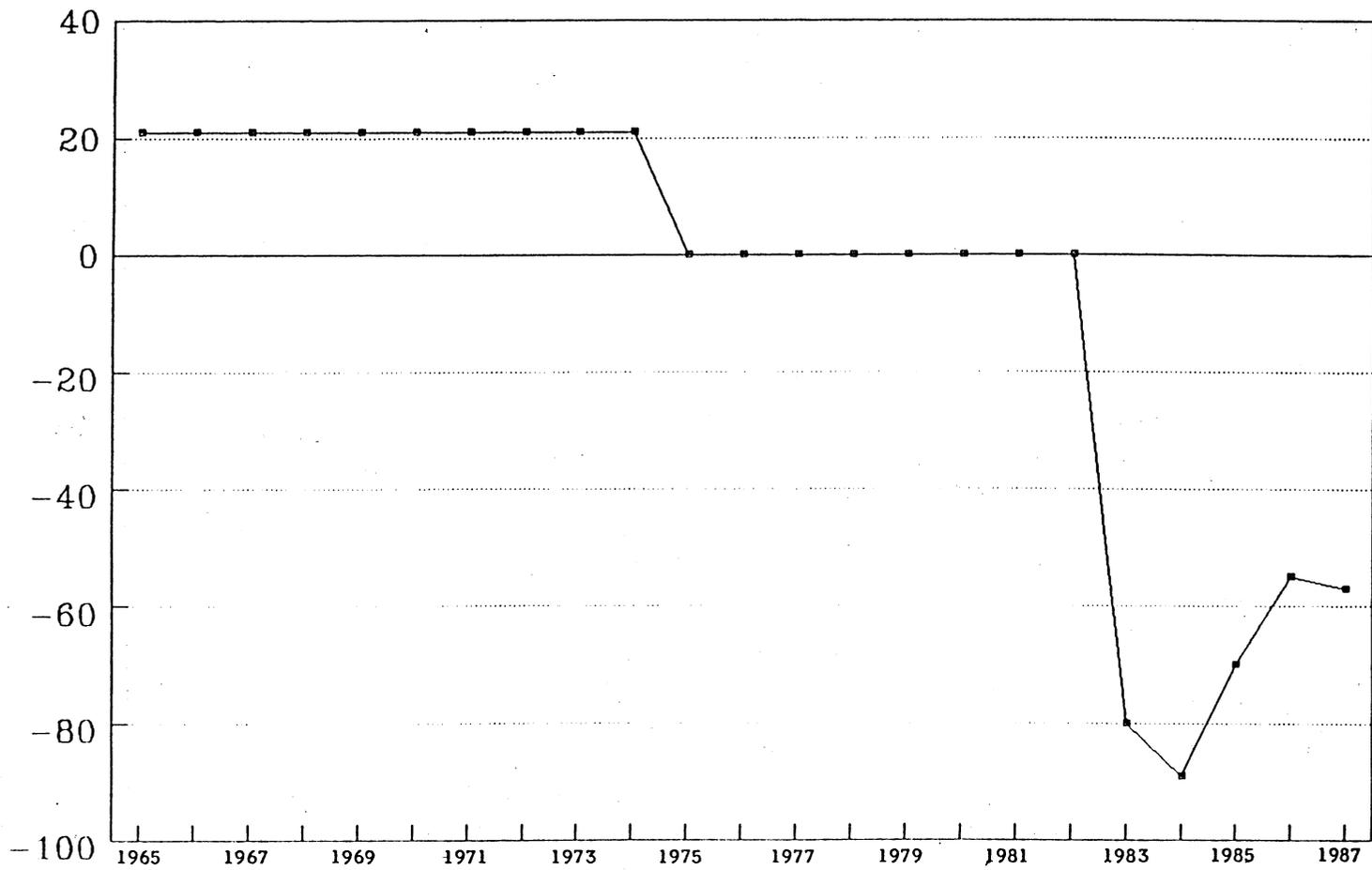


Figure 3: *Merchandise Exports and Imports for Jamaica (1965 – 1987)*

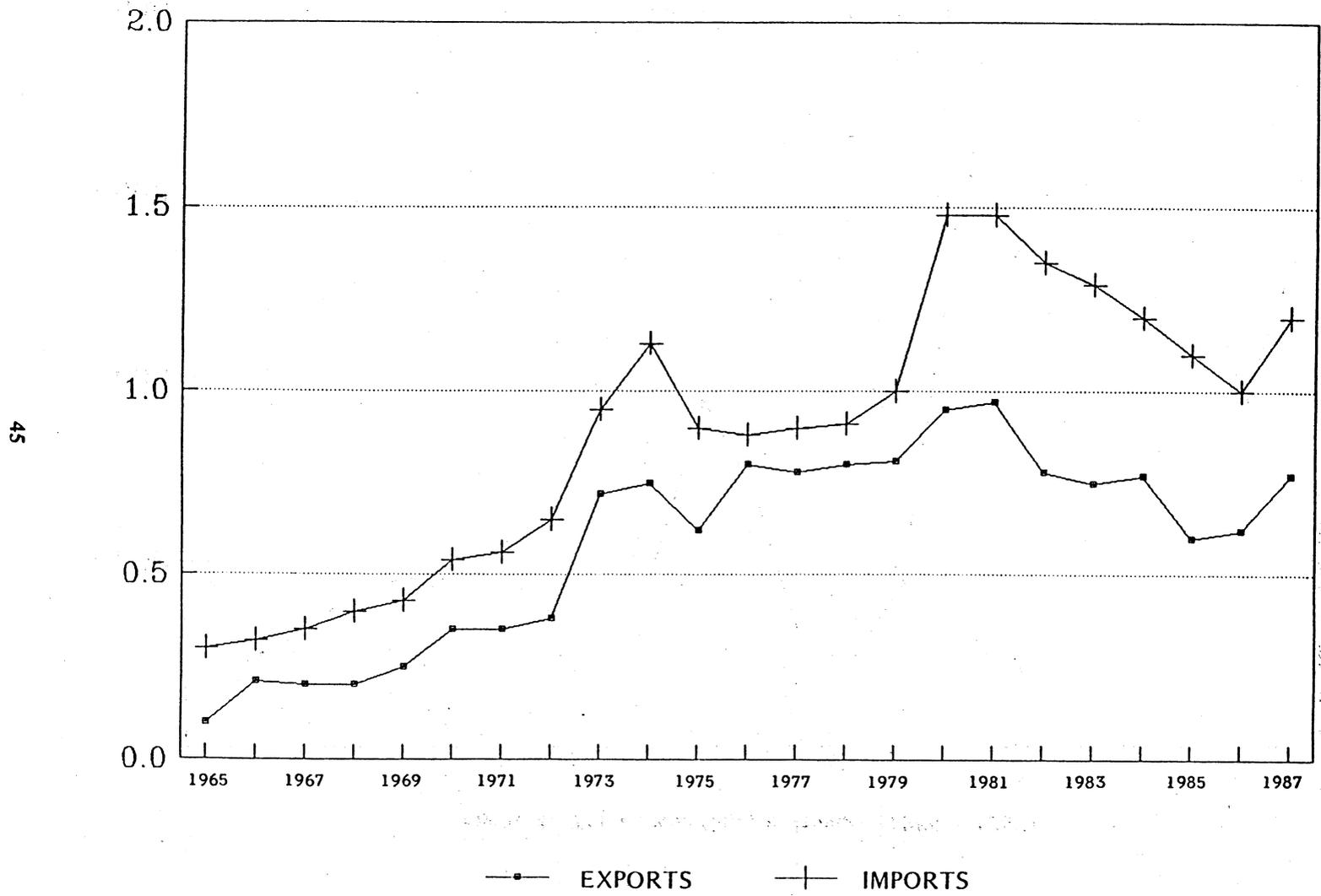
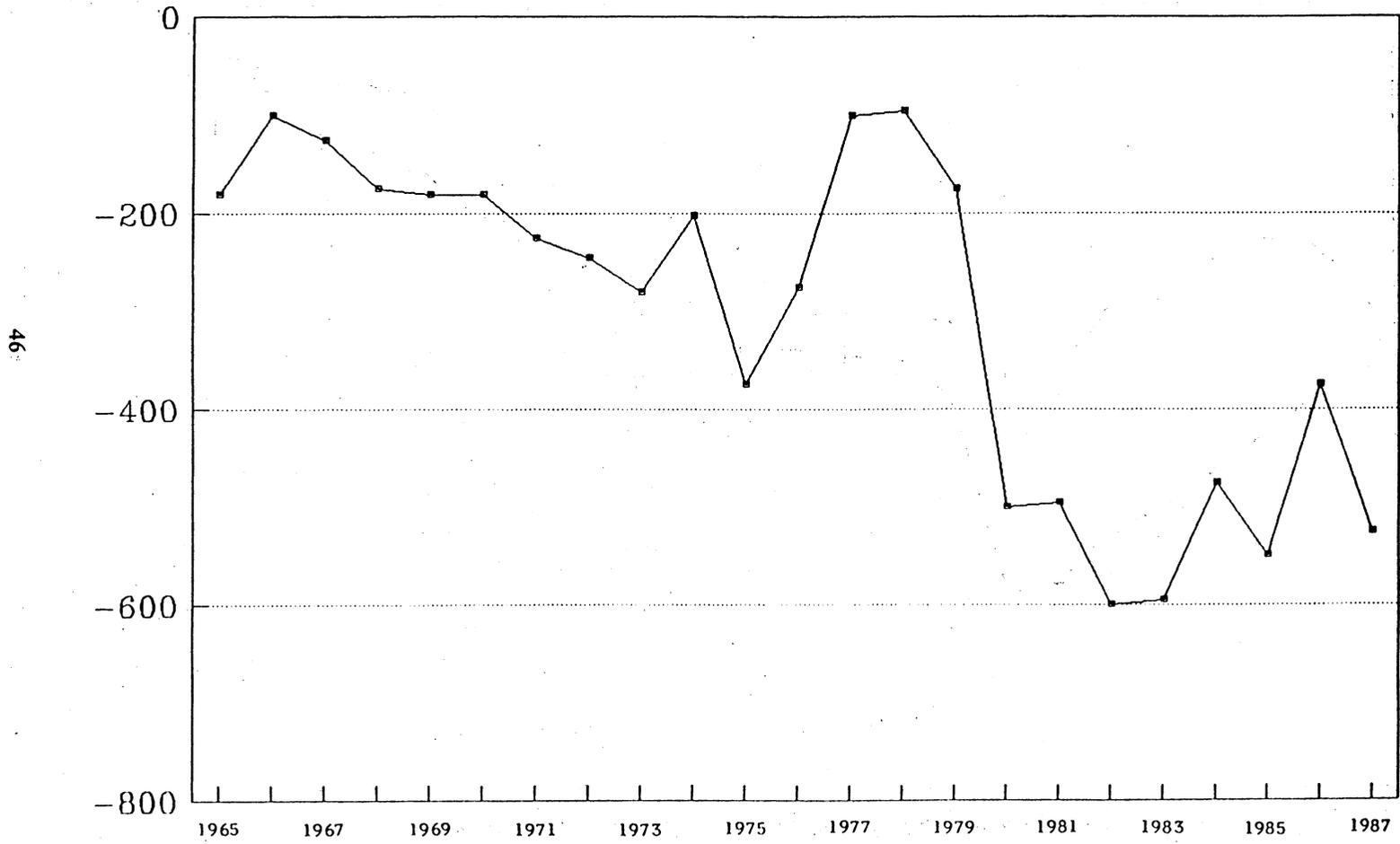


Figure 4: *Total Trade Gap for Jamaica (1965 – 1987)*



therefore lifts domestic prices relative to international prices. It is therefore necessary to keep the tariffs as low as possible, while providing the margin of protection necessary. It is desirable to separate revenue considerations from tariff considerations.

In the Jamaican case we prefer to operate with a tariff system, rather than a quota system, with a rebate of the import taxes to third country exporters. We rebate the import taxes so as to bring the export prices back in line with international prices, having given the domestic producers some measure of protection.

In Jamaica, the main problems in domestic agriculture are the below average productivity, internationally and regionally, the very poor agricultural infrastructure, the lack of adequate credit facilities to certain farmer groups, the lack of an efficient marketing infrastructure available to farmers, and the lack of adequate research development and extension services, particularly with regard to non-export agriculture. In this environment, we believe that the tariffs need to be somewhat higher than in manufacturing generally, for protection, while policies are focused very pointedly on the agricultural sector. These policies ought to be designed to re-orient the sector towards a more efficient production and distribution base. As such, the tariff will diminish over time.

Tariff issues should also recognize the phenomenon of, and potential for, dumping within our region. It is very easy to dump a trailer load of potatoes or meat or whatever, from New York or from Miami and in so doing destroy the production in any territory within the region. This highlights the need to focus on anti-dumping mechanisms that will work.

(6) Another issue is the question of long versus the short run gestation periods for agricultural investments. One of the difficulties in agriculture, is to bring about some measure of concordance between the outflows and inflows associated with any investment programme, to ensure that the gestation period for the investment is as short as possible. One might spend money introducing coffee but it might take five or seven years before you start exporting the product. The question of the gestation period, and the matching of inflows and outflows over the planning horizon become very critical in dealing with the Balance of Payments scheduling problem.

(7) There is still a place for sugar in the world in terms of growth, particularly so, if, what the United States and the EEC are now saying regarding their own tariffs and their own subsidies can be taken seriously. The United States is fighting a very desperate battle, to reduce the excessive subsidies to agriculture in a fairly rapid and a deliberate fashion. I think this can only help regions such as ours, because as the reduction of subsidies take place and as the overproduction which it encourages is removed, we are likely to see a more rational and a more balanced environment for agriculture on a comparative basis in the world around us. The United States should not really be producing sugar cane, Europe should not be producing beet sugar. I think those things belong to tropical countries; I sincerely hope that the impetus currently being developed behind the Uruguay Round is sustained, and that the EEC removes the very large subsidies, and that Japan removes its enormous subsidies to its inefficient agriculture, so that countries like ours can trade, in the future, (hopefully in the not too distant future) on the basis of our own comparative advantage, rather than being forced into a sort of forced-ripe manufacturing, which is really not suitable in the short run to our societies.

CONCLUSION

The paper has discussed the economic factors and the relationship between the Balances of Payments and diversification in terms of broad macro-economic policies. I have not mentioned the micro-economic linkages. If there is one area where macro-economics need to be tied to the micro-economic, it is in agriculture. Matters of agronomic practices, matters of training, matters of lifting the entire cultural level of the farming communities have fundamental implications for urban drift, for the quality of life, for risk taking, for the willingness to save and to invest, and to accept new technologies, these have very fundamental micro-foundations. But they can only become effective within a larger macro-economic context, such as I have elaborated in this paper.