Development Challenges in Jamaica

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Abstract

This policy brief presents a summary of the development challenges facing the country.

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Development Challenges in Jamaica

Medium-Term Economic and Social Trends

Jamaica is a small, open economy, characterized by low growth and high debt. Since 1990, Jamaica's average real GDP growth rate has been approximately 1 percent per year, well below the 3 percent and 4 percent averages of other Caribbean member countries of the IDB and the average for Latin America and the Caribbean, respectively. Years of high deficits, public enterprise borrowing, financial sector crises and bailouts resulted in rapid debt accumulation that has stifled growth and development. As a result, standards of living, as measured by per capita GDP, have remained stagnant for the past five decades.

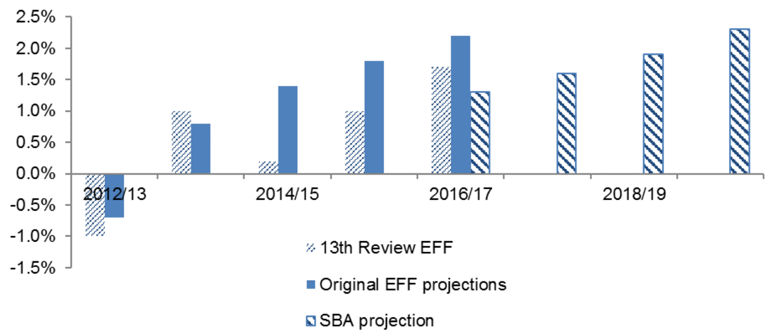
Jamaica signed a four-year Extended Fund Facility (EFF) arrangement with the International Monetary Fund (IMF) in May 2013, with the aim of restoring macroeconomic and debt sustainability and promoting structural reform. The EFF provided a roadmap for fiscal and external sustainability, aimed at reducing the debt-to-GDP ratio from 145.3 percent in FY2012/13 to below 100 percent by FY2019/20. In addition, the EFF revived the unfinished structural reform agenda embedded in the 2010 IMF program that stalled in mid-2011. A new three-year precautionary Stand-By Arrangement (SBA) was put in place in November 2016, and Jamaica's performance and policy implementation since the launch of the 2013 IMF program has been strong, with fiscal surpluses meeting or exceeding targets, and debt reduction progressing faster than initially expected. Despite successful implementation of a number of the program's structural measures, a major hurdle remains with respect to reducing the public-sector wage bill, which accounts for about one third of government revenues.

Prior to the global economic and financial crisis that began in 2008, the poverty headcount ratio—i.e., the proportion of the population living below country-specific poverty lines—had been decreasing steadily, reaching a low of 10 percent in 2007. Unfortunately, this progress has been reversed since that time, as economic shock led to reductions in output, employment, and remittances from abroad. Poverty has increased in every subsequent year. This increase was more pronounced in urban areas, where the poverty headcount ratio nearly quadrupled from 5 to 19 between 2007 and 2012. Despite the economic stabilization ushered in by the IMF-supported program since 2013, poverty has remained stubbornly high, as represented by a headcount ratio of 21 percent in 2015—double the 2007 result.

Medium-Term Economic and Social Outlook

Jamaica's economic growth over the last four years has been disappointing (Figure 1). However, there are signs that the Jamaican economy might finally reap the benefits of macroeconomic stabilization and improving investor confidence. Credit growth is accelerating, the business climate is buoyant, and many sectors are performing well. Consequently, employment has been increasing, which should also translate into a lasting impact on poverty.

Figure 1. Economic Growth Projections



Source: International Monetary Fund.

Growth rates are now projected to accelerate to 2.3 percent by 2019/20. In the absence of rapid increases in oil prices, inflation should remain within the target band of 4 to 6 percent—well below historical levels. The current account deficit is projected to remain below 4 percent, with narrowing external imbalances driven in part by continued fiscal restraint.

Risk Factors

The international environment remains favorable for Jamaica. The outlook is based on the continuing strong performance of Jamaica's major trading partners—the United States, Canada, and the United Kingdom— and moderate commodity prices, especially for oil. The outlook is, however, not without risks. The world economy is performing well but faces headwinds, including geopolitical, trade-related, and security issues. Moreover, further monetary tightening in the United States could hamper Jamaica's access to international finance.

Domestically, the positive outlook assumes fiscal prudence, and continued reforms to further reduce debt levels while making the economy more competitive. Finally, as a small island economy, Jamaica is vulnerable to climatic shocks, which could be accentuated by climate change. While Jamaica has been spared by major hurricanes in the last few years, natural disasters or other climate-related events affecting the agriculture or tourism sectors could have severe impacts on the economy.

Development Challenges

Jamaica has a relatively-narrow export base and remains dependent on commodity imports, particularly fuel. In addition, Jamaica depends heavily on remittances, which are equal to about 15 percent of GDP. Exports are concentrated, with three-quarters destined for the United States, Canada and the United Kingdom. These countries are also home to most tourists visiting Jamaica, and the source of remittances.

Jamaica remains one of the world's most indebted countries. With two-thirds of revenues dedicated to interest payments and salaries since the mid-1990s, infrastructure and social expenditure have been crowded out, reducing economic growth and compromising social outcomes. High public-sector financing needs and increased domestic interest rates have further crowded out domestic credit, with consequences for productivity growth and job creation.

Following a recent tax reform, expenditure rationalization is needed. The two main expenditures continue to be interest payments (8 percent of GDP in FY2016/17), and public-sector salaries (over 9 percent of GDP). While debt service payments will decrease as the government makes progress towards debt reduction, the wage bill can only be addressed via public sector modernization and reforms to increase the sector's efficiency. The current level of the public wage bill has been driven by several rounds of salary increases, resulting in an increase from the equivalent of 5 percent of GDP in FY1995/96 to almost 11 percent in FY2009/10. The magnitude of the problem is highlighted by peer comparison—public wages average about 8 percent in the Western Hemisphere, 6 percent in Europe, and 5 percent in Asia and the Pacific. Reform of state-owned entities (SOEs) is also crucial, as these have been a major source of debt accumulation via contingent liabilities. Similarly, public pension reforms are needed to avoid future fiscal risks.

Jamaican businesses face several challenges. Despite recent reforms, Jamaican businesses still struggle with red tape and excessive bureaucracy. In international comparisons, Jamaica's business climate is weak in the areas of taxation, accessing electricity, resolving legal disputes, obtaining construction permits, and trading across borders. In terms of innovation, Jamaican firms struggle with gaps in the legal framework for intellectual property, as well as weak policies and institutions for innovation.

Private firms have difficulties accessing adequate levels of financing. The share of Jamaican firms with a loan is low, and firms report that a lack of access to credit is a key impediment to growth. High electricity prices have also been a drag for businesses. Despite a decrease from US$0.39 to US$0.27 per KWh between 2012 and 2015, Jamaica's average electricity tariff was high when compared to other countries in the region and across the world—e.g., Barbados at US$0.24 per KWh, Trinidad and Tobago at US$0.06 per KWh, and the United States at US$0.1 per KWh. Electricity generation is still dependent on old, inefficient diesel generators, and it is subject to considerable technical losses, including those from theft.

Tackling inequality, reducing poverty, and protecting the most vulnerable requires addressing differences in quality and access to basic services, as well as the provision of a social safety net. In terms of education, access has improved considerably, and school enrollment has increased to a net enrolment rate of 99 percent for pre-primary education, 92.5 percent from grades 1 to 6, and 80 percent for grades 7 to 9. At the same time, social protection through Jamaica's conditional cash transfer program supports poorer households while improving health and education outcomes for vulnerable mothers and children. However, quality and access for these services varies substantially, as do outcomes in terms of health and education.

Non-communicable diseases (NCDs) have become a major financial burden in the health sector, while emerging infectious diseases threaten economic stability. Insufficient investment in infrastructure, equipment, supplies, and human resources has compromised the quality of health services, particularly the primary care system, which in turn has led to avoidance of primary health care facilities and an overwhelming demand for hospital services. The challenge of providing health services is aggravated by an increased burden from NCDs, which have surpassed communicable diseases as the main cause of mortality and morbidity.

Conclusion

The pace of Jamaica's economic growth has been disappointing. Authorities are making strong progress towards macroeconomic and fiscal stability but achieving higher growth rates has proven more challenging. There are increasing signs that the Jamaican economy might finally reap the benefits of lower debt and a track record of fiscal prudence, which have already spurred more rapid credit growth and improving private sector confidence. Nevertheless, Jamaica continues to face vulnerabilities that require prudent policies that can lay the foundation for lasting economic growth.

The IMF program serves as an anchor for economic policies. The ongoing SBA focuses on entrenching both prudent policies and the reform of economic institutions, including a shift from direct to indirect taxes, strengthening the social safety net, and reallocating public resources to infrastructure spending. The program also foresees a strengthening of monetary policy and the central bank's operational capacity as it shifts to inflation targeting, greater exchange rate flexibility, and a focus on building international reserves. Finally, financial sector stability should be enhanced via a strengthening of financial supervisory capacity and improvements to the crisis resolution framework.

Structural reform requirements are, however, much more complex and diverse than the requirements of macroeconomic stabilization. Reform efforts aim to directly address some of the country's central development challenges. Most notably, modernization of the public sector can bring efficiency gains, reduce red tape, and create a more effective public sector. Related to this, the introduction of the National Identification System can provide important efficiency gains, for instance, by improving the targeting of social programs, or facilitating transactions between businesses and the public sector.