



Tuesday, 13 September 2011

Address

to the

**Jamaica Chamber of Commerce
Luncheon Meeting**

“Productivity in Jamaica”

**Brian Wynter
Governor
Bank of Jamaica**

Ladies and Gentlemen:

I am delighted to be asked to share some thoughts with you today on the Jamaican economy. It is always worth repeating that the path to sustainable growth for Jamaica requires that we first stabilise the economy by reducing and then eliminating the sources of instability. Prime amongst these are the unsustainable fiscal imbalances caused by the extremely high debt burden. Quite apart from the economic distortions that this unhealthy situation created or exacerbated in the past, the fiscal dominance that it produced served to hamper and eventually neutralise the scope of monetary policy to manage inflation. The resulting vicious circle of high inflation, volatile exchange rates, high interest rates, low growth, high fiscal deficits and rising debt levels needs no elaboration for even the most casual observer of Jamaica's modern economic history. The stabilisation of the Jamaican economy, which is my normal and expected theme, is being tackled by confronting the sources of instability. The Government's medium-term economic programme is aimed squarely at carrying out the reforms that we need to complete in order to do this. It has been supported by the sacrifices of public sector workers (through the salary freeze), bondholders (through the JDX) and taxpayers (through tax increases) and it has been underwritten by hard currency loan commitments amounting to 20% of GDP from the Inter-American Development Bank, the World Bank, the Caribbean Development Bank and the International Monetary Fund as well as generous grants provided by the European Union. This is the economic programme that people are talking about when they talk about the "IMF programme".

The success experienced so far in the approximately 20 months since the announcement of the tax package in December 2009 and the JDX in January 2010 has exceeded our expectations. The world has continued to be deeply troubled by the macroeconomic instability unleashed by the financial crisis of 2008-2009 and the "Great Recession" in developed economies that followed it, with devastating effect on our own economy. Yet in Jamaica, interest rates have continued to fall to record levels in the context of declining inflation, a stable exchange rate and increasing confidence that medium-term stability is not just within our grasp but now has to be factored into the base case of any prudent medium-term economic or financial forecast. The Fiscal Responsibility Law, which

introduces greater transparency and accountability into the fiscal policy framework, is going through its first test. While the jury must still be out at this stage in the process, the signs of a positive verdict on this reform look promising.

It may be useful, then, for me to step away from my normal subject and turn our thoughts towards a more profound issue that needs to be tackled. Today, I would like to speak on the subject of productivity in Jamaica. Jamaica's weak economic growth over the last decade has been predominantly attributable to generally low productivity levels in the economy.

Total factor productivity, which captures the overall efficiency of production, has declined at an average rate of 2.1 per cent every year over the period 1990 to 2010. Similarly, labour productivity, which measures output per worker, contracted at an average rate of 0.5 per cent per year over the same period. Jamaica's labour productivity has lagged behind its major trading partners as well as a number of emerging market economies. Against this background, Jamaica's annual economic growth over the past decade has averaged 0.8 per cent. This is in contrast to average economic growth of 2.6 per cent per year for our Caribbean neighbours.

A number of factors have contributed to Jamaica's low productivity over the years. These include:

- i deficiencies in human capital,
- ii high levels of crime,
- iii fiscal distortions and
- iv a poor work ethic.

Deficiencies in human capital

First, the poor quality of the labour force has been a major contributor to Jamaica's low productivity. Information on literacy and training clearly points to human resource under-development. The latest available data from the United Nations Development Programme Human Development Index 2010 show that only 86 per cent of the Jamaican

labour force is literate¹. This is in comparison to 95 per cent and 97 per cent for other Caribbean² and high-growth economies, respectively. In addition, the 2010 report on Jamaica's labour force showed that 72 per cent of the labour force came to the job with no formal training and there was a similar deficiency with regard to on-the-job training³. Further, the labour market data showed that 64 per cent of new job seekers did not have any form of certification. Interestingly, a recent study by the World Bank⁴ found that returns to schooling in Jamaica were higher than in Trinidad & Tobago. Further, it found that the returns to schooling were considerably higher at the upper educational levels. This implied that the scarcity of human capital was more pronounced at the tertiary level.

High levels of crime

Second, there is a negative correlation between the crime rate and productivity. A recent study⁵ undertaken by the World Bank showed that annual expenditure on crime control in Jamaica represented approximately 5.0 per cent of GDP. Of that amount, Government spending on security accounted for 3.1 percentage points, private spending on security accounted for 1.3 percentage points and public health expenditure as a result of crime accounted for 0.3 percentage points. Crime has therefore diverted valuable resources from productivity-enhancing investment. Further, crime also affects productivity by reducing the number of productive work hours. In a business opinion survey conducted by the World Bank, 39 per cent of firms indicated that they were less likely to expand their businesses because of crime⁶. This underscores the disincentive that crime creates for investment. Given this perception, major investments in Jamaica have tended to be in 'enclave' activities, such as all-inclusive resorts as well as mining and export free zones, which have low spill-over effects on the economy.

Fiscal distortions

¹ United Nations (2010), "Human Development Report 2010: The Real Wealth of Nations – Pathway to Human Development" available at <http://hdrstats.undp.org/en/indicators/default.html>

² Includes Trinidad & Tobago, Barbados and the Dominican Republic.

³ Statistical Institute of Jamaica (2010), 'The Labour Force 2010'

⁴ Artana, Auguste and Panadeirost (2010) as referred to in World Bank (2011), 'Jamaica Country Economic Memorandum', Unlocking Growth, Report no. 60374-JM

⁵ World Bank (2011), 'Jamaica Country Economic Memorandum', Unlocking Growth, Report no. 60374-JM

⁶ *ibid*

With respect to fiscal distortions, the third factor, various studies such as by the World Bank⁷ have shown that Government's tax revenues have been reduced by an estimated 20 per cent due to an inconsistent and complex tax code, which includes numerous exemptions and special privileges. This along with a high debt-servicing cost and a large wage bill have reduced the fiscal space available for productivity-enhancing public spending, including public investment that is complimentary to private investment. Expenditure on critical areas such as health and education has also been constrained because of these factors. Further, the complex system of taxes and incentives creates distortions for the allocation of capital and lowers the productivity of investment.

Poor work ethic

Finally, a relatively poor work ethic has also contributed to Jamaica's low productivity and economic growth. This was corroborated by a study undertaken by the World Bank in 1996⁸. In the study it was suggested that poor work habits and attitudes were partly due to an inadequate mass transit system, which made it difficult for workers to get to their jobs and resulted in worker frustration. In addition, there was dissatisfaction with the widening gap between managers and workers in the workplace. The report also showed that poor worker-management relations led to a high frequency of industrial disputes and work stoppages, especially from the early 1970s to the mid-1980s. The majority of the work stoppages, which had a negative effect on labour productivity, were due to wages and employment conditions. While there have been improvements in the work environment since then, there are still concerns which serve to inhibit productivity.

The Way Forward

The link between the development of human capital, crime and productivity underscores the imperative for strategies to enhance educational outcomes and restore a sense of law and order in the Jamaican economy. In this regard, the efforts being made by the Ministry of Education to improve literacy levels in primary and secondary schools are welcome steps towards enhancing the quality of human capital. In addition, students

⁷ *ibid*

⁸ World Bank (1996) "Jamaica: Achieving Macro-Stability and Removing Constraints on Growth" (Country Economic Memorandum, Report no. 15542-JM, May 21).

leaving school should be encouraged to go on to either skills training or tertiary institutions to deepen the pool of available qualified personnel.

Recent statistics showing a significant reduction in the level of violent crime are also encouraging. I will not venture opinions on or solutions to the well-examined and well-ventilated subject of how to defeat Jamaica's crime problem. I can emphasise, though, that a sustained reduction in the incidence of violent crime over the medium-term will be a powerful factor in improving our economic productivity.

With respect to fiscal distortions, reducing them is one of the commitments in the Government's medium-term economic programme that I referred to at the beginning of these remarks. The Green Paper on Tax Reform is already within the public's purview and includes proposals to deal with tax incentives and exemptions. In addition, the economic programme, which seeks to address fiscal consolidation and debt sustainability, includes reforms to improve the preparation, implementation and reporting of budgets, continuing divestment of public bodies and reforms to improve the provision of public services.

Improvements in the general attitude to work will also contribute to increasing productivity. Instilling these attitudes in homes and schools and reinforcing them at the work place is a task for social, labour and employment policies where success can be looked for mainly in the long-term. Industries may find that more immediate returns can be obtained through the implementation of productivity incentive schemes, which link wage increases to productivity, and human resource management initiatives aimed at improving worker participation and enhancing job-related skills.

Ladies and Gentlemen, the impediments to increased productivity are not insurmountable. But they require strong institutional foundations – monetary arrangements that anchor inflation expectations; educational institutions that prepare each succeeding generation with the knowledge and attitudes that they need in order to earn satisfactory incomes; and institutions that provide the social services that help to define a

civilized modern society. It is more about the way we think about nurturing and mentoring those for whom we are responsible and less about setting the exchange rate to 'maintain competitiveness'. In this regard, the solution to some of these issues calls for cooperation between Government, private sector and workers to ensure the most effective and efficient use of resources to achieve the desired results.

Thank you.