

# Air Jamaica And Government Spending

The Sunday Herald carried recently a very good investigative piece on Air Jamaica losing \$JA33 Billion dollars over 10 years. It should be noted the last time Air Jamaica made a net profit was in 1974 of \$US 250,000 under President Guillermo “Bigge” Machado(a Jamaican President). The Government has come out and said clearly they will continue to support Air Jamaica. In addition not mentioned in the article, IATA has stated that World Airlines for 2004 will lose \$US5 Billion dollars. More importantly this speaks to a greater issue of Government spending and its effect or lack of thereof.

In contrast to the vast literature on determinants of economic growth, there has been less research on the cyclical behavior of macroeconomic aggregates (Inflation, Unemployment and Production) in developing countries. One reason for this is the relatively weak quality of data and its frequency in many developing countries. For example, quarterly GDP data are available for only a limited number of countries, and even when they are available they are usually of significantly lower quality and reliability than annual estimates. Another constraining factor is that developing countries often experience abrupt economic changes, making it particularly difficult to separate cyclical influences from structural breaks.

A better understanding of the factors underlying the cyclical pattern of macro economic aggregates is useful for at least two purposes. First, examining the relationship between overall economic activity and fiscal and monetary aggregates has analytical value from the perspective of business cycle modeling. Second, as Agénor and Montiel (1996) argue, this type of analysis can make a valuable contribution to the design of stabilization and adjustment programs (which Jamaica has had numerous problems with over the last 25 years)

In examining data from 51 countries a number of areas were paramount:

- 1) Co-movements of government spending and output.

- 2) The short-term variations between government spending and output from any longer-term relationship.
- 3) The variation in the relationship between government spending and output by focusing on key political and economic determinants.

With few exceptions (mostly for Latin America), existing studies of developing countries like Jamaica have either focused on the long-run relationship between spending and output, or have examined the *volatility* of growth and its relationship to the *volatility* of various fiscal aggregates (see, for example, Fatás and Mihov, 2003), without examining the factors underlying the cyclical behavior of the latter.

Three policy implications can be drawn from this argument:

- 1) In many countries there may be scope for fiscal rules or fiscal responsibility laws that limit the discretion for procyclical fiscal policy during upswings in the business cycle.
- 2) A strengthening of checks and balances— that is, a greater dispersion of power—is fully compatible with good economic policymaking, since it helps reduce the cyclicity of government outlays.
- 3) In many countries there is a long-term relationship between the level of output and government spending. In these countries, short-run cuts in spending, or surges in government outlays, will eventually be erased as the government spending/GDP ratio returns to its long-term average. In countries like Jamaica, special care will need to be taken to ensure that spending cuts achieved over the short run are accompanied by longer-term structural reforms to ensure these savings are durable.

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