Is increasing productivity the solution to the economic woes of Caribbean SIDS?

Economic context of Caribbean SIDS

Economic Conditions in several developed economies have improved considerably since the 2008 financial crisis; with forecasts for the fourth quarter of 2014 and beyond looking fairly upbeat. This is in contrast to most countries within the Caribbean where the characteristics of high debt, chronic poverty, little to no growth and high unemployment persist.

Most of the Caribbean islands belong to a special grouping of islands commonly referred to as Small Island Developing States (SIDS). SIDS are a distinct group of developing countries facing specific social, economic and environmental vulnerabilities. The commonality in these islands lies in the development challenges which they face; these include: small size, limited natural resources, remoteness from large markets, and vulnerability to natural disasters and economic shocks. The economic growth and development of SIDS has been slowed by high communication, energy and transportation costs. Additionally, public administration and some private sector functions are disproportionately more expensive within SIDS in comparison to developed countries. This is due in part to their smallness and the lack of opportunities to enjoy economies of scale. The smallness of SIDS make it difficult and almost impossible for government policy to have any significant impact on their economic situation.

The external current account balance for many Caribbean SIDS has deteriorated significantly during the latter half of the last decade. This was mostly as a result of the decline in tourism and related receipts, rising energy prices and other commodity imports, and the loss of preferential market access. High levels of public debt built up from prolonged fiscal deficits and slow growth have also plagued Caribbean economies. Sustained fiscal consolidation complemented by structural reforms is now required to remedy Caribbean economies. In layman's terms "The economic reality within Caribbean SIDS can only improve if we reduce our public debt and borrowing by making changes to how we do certain things in our economies."

One option available to Caribbean SIDS which is likely to encourage economic growth is increasing productivity. Improving productivity is one structural reform which can be considered low hanging fruit for the region. Economic growth and productivity are intricately linked, and research has shown that increasing productivity will unlock economic growth, allow for efficiency gains and allow for a better allocation of resources in an economy. A number of countries have already recorded successes by pursuing a regime of improved productivity. Regionally some of the larger countries such as Jamaica and Trinidad & Tobago have made significant strides in improving productivity and competitively; whilst internationally India and the Republic of Mauritius have helped to advance their respective economies through improvements in productivity.

What is productivity?

It is important to not confuse productivity with production, output or efficiency. The concepts are all linked but one is not synonymous with the other. Productivity describes the relationship between outputs and inputs. Simply put, productivity is a measure of how well an individual, organisation, industry or country converts input resources (labour, materials, machines etc) into goods and services. An increase in productivity occurs when an increase in output occurs with a less than proportionate increase in inputs, or when the same output is produced with fewer inputs.

Productivity is interpreted at three broad levels: the national level, the sectoral level and the enterprise level. The national level which is the broadest level is the aggregate of all the sectors within an economy. At the national level the state is required to create an environment conducive to productivity enhancement. The sectoral level relates to specific segments of an economy, such as agriculture or financial services; whilst the enterprise or individual level is the smallest unit for understanding productivity and refers to either an individual or entity.

A relationship exists among the three levels, as the enterprise level is the building block for the sectoral level, and the sectoral level the building block for the national level. Any improvement or deterioration at the lower levels will result in a comparable change at the national level. It therefore stands to reason that interventions which are made at the enterprise level are sure to result in some change at the national level.

Do increases in productivity benefit the economy?

Empirically, it has been proven that there is a positive correlation between productivity increases and economic growth. However, the gains are not automatic, but are derived from a combination of well-targeted, strategic interventions. Measures meant to generate growth must be directed at both the public and private; and attention given at all the levels of productivity.

The benefits from productivity are realisable at all three levels and are by no means mutually exclusive. Productivity gains at the enterprise and sectoral levels will redound to productivity gains at the national level.

Productivity improvements at the enterprise and sectoral levels should result in increased profitability, business growth and increased competitiveness for the related businesses and sectors.

Advancements in productivity increase a businesses' profitability as additional goods and services are produced with the same level of inputs, or the same level of goods and services is produced from fewer inputs. The result is a greater net output, as either the total output has increased or the total input has decreased. The higher net output presents an opportunity for growth to businesses and industries. The savings created from the reduced requirement on input can be re-invested into new projects and product lines. The benefits to an economy from business growth are two fold; business growth may require the business to hire new employees thus creating employment, and growth will result in increased revenues for the business/industry, therefore the potential for greater tax revenue for governments. Businesses and industries will also enjoy enhanced competitiveness as their business processes would now be more efficient therefore creating the potential for price reductions for their goods and services. All three of the above gains will benefit the local economy as they create the possibility for increased tax revenue as a result of the rise in economic activity.

The gains from productivity at the national level are similar to those at the enterprise and sectoral level but are aggregated for the economy as a whole. The primary gains from increased productivity at the national level lie in: resource re-allocation, efficiency gains and increased competitiveness.

The higher output of goods and services, together with reducing levels of inputs, increases the wealth of the country and drives economic growth. The very notion of increases in output implies that the net effect would be an increase in the country's gross domestic product.

In so much as productivity is not the same as efficiency, there will be efficiency gains in an economy once productivity has increased. Furthermore, the decrease in demand for some inputs will mean that these inputs must now be redeployed elsewhere in the economy. Once these inputs are engaged, and do not remain idle, this will cause a further increase in output.

Efficiency gains are perhaps one of the greatest benefits of increased productivity. As explained above, more will be able to be accomplished with fewer resources, a factor particularly important for most Caribbean SIDS in recent times given resource constraints. The new found efficiency will allow countries to redirect resources to reduction of public debts or resources can possibly be channelled into activities intended to stimulate investment and therefore grow the economy.

The increased productivity for businesses and sectors will make the country as a whole more competitive both regionally and globally. The products and services offered by the country then become more desirable on the global market. Improved competitiveness not only protects current jobs, but will attract some of much needed foreign direct investment which will create additional jobs and greater opportunities for employment at all levels.

Overcoming the economic conditions of high public debt, high unemployment and low growth is a hugely daunting task. One cannot expect such change overnight, nor will it come quickly and easily. The path to an improved economic condition will be challenging and will require patience and discipline. A comprehensive package of economic reforms is needed to address the deficiencies which exist in Caribbean economies at present. One critical transformation will be the pursuit of increased productivity. Raising productivity and ultimately, economic growth cannot be avoided on the journey to achieving sustained economic growth. Equally important, productivity cannot be pursued half-heartedly, but must be pursued in full and in earnest to enjoy the many gains which are present.