|  |
| --- |
| Economic pitfalls: The scourge of trade and exchange rate dependence |

|  |
| --- |
| **Structural trade dependence** The point of departure for evaluating the effects of the on-going global economic crisis on Guyana’s economy should be rooted in the reality that, by global standards, Guyana is structurally far too small, too poor and too open to withstand severe external economic shocks; particularly when these shocks emanate from economies with which we have the strongest trade, financial, and investment ties and are considered the worst since the Great Depression of the 1930s.   The economy faces enormous economic pitfalls because of its structural trade dependence. Merchandise exports were valued at US$768 million in 2009. This was about one-half the value of our GDP for that year and considerably less than the value of our imports (US$1.2 billion).  Indeed the value of our merchandise imports was about one-and-a-half times the value of our merchandise exports!  Further, net trade in services (exports less imports) was negative (minus US$118 million) in 2009. For the record, our re-export of goods stood at US$12 million in 2009, and this has averaged between 1-2 percent of merchandise exports during recent years.  Of greater importance, the value of total trade (exports, re-exports and imports of goods and services) has averaged 1.3 to 1.7 times GDP for the past several years (2003-2009). By Caricom, other developing country, or for that matter global standards, Guyana has an exceptionally high index of trade dependence. It is over-exposed to global economic recession. If estimates of our recent economic performance suggest otherwise, I would prefer to start by challenging the validity of those estimates and their underlying techniques, rather than ignoring the logic of these compelling conditions. For clarity, in future columns I shall address the controversy over the 2009 GDP performance, hoping to introduce important considerations related to this that have not yet been addressed.  The value of our merchandise imports has risen dramatically in recent years. From a figure of US$572 million in 2003, it reached US$1.06 billion in 2007. The 2010 Budget projects US$1.22 billion for this year. The merchandise trade balance has remained negative rising from minus US$59 million in 2003 to minus US$400 million in 2009. The broader current account deficit on the balance of payments has also risen from minus US$83 million in 2003 to minus US$220 million in 2009.  To round off this description readers should note that, during the 2000s, “manufactures” was the leading category of Guyana’s merchandise imports, accounting for about 60 per cent. The leading item in this category was “machinery and transport equipment,” which accounts for about one-quarter of imports. The remaining category of merchandise imports “primary products” accounts for approximately 40 per cent. The chief items are “fuels and lubricants” (about one-fifth of total imports) and “agricultural products” (about 14 per cent of total imports). For the remainder of this column I shall comment briefly on two other channels transmitting economic shocks, which directly pertain to trade; the exchange rate regime and the terms of trade.  Exchange rate regime As with trade dependence the Guyana exchange rate regime presents enormous pitfalls. Thus, although the Bank of Guyana Act, 1998 specifies that the nominal exchange rate for the Guyana dollar (against all currencies) is to be determined by prevailing conditions in the foreign exchange market, in practice this is not the case. The exchange rate is pegged to the US dollar, varying within two per cent of the prevailing US dollar rate.  The Bank of Guyana Act grants the Bank of Guyana authority to intervene in the foreign exchange market to contain exchange rate volatility and to maintain price stability.  A direct consequence of any change in the Guyana dollar exchange rate is to change both the local currency exchange price of its exports and imports. The ultimate consequences of this would depend on a complex set of factors, including those affecting our demand for imported goods and services as well as foreigners’ demand for our exports and the ability of the economy to respond to changing demand.  The IMF is responsible for global surveillance of exchange rate arrangements. It classifies Guyana’s exchange rate regime as a standard fixed-peg arrangement tied to the US dollar exchange rate. The consequence of this anchor is that, because the US dollar ‘floats’ as an independent exchange rate in relation to all other independent foreign exchange rates, including the Japanese yen, the European Union’s euro, the British pound, and the Chinese yuan, the Russian rouble and the Canadian dollar, our dollar follows suit.  The countries cited above have significant trade and financial relations with Guyana. Yet the value of our currency varies in relation to theirs solely as a result of the behaviour of the US dollar rate! And that variation reflects market configurations from the perspective of the US economy, not ours.  As is well known the US dollar has come under intense pressure during the global economic crisis.  Its appreciation and depreciation reflect how the US economy is responding to these pressures. This has virtually nothing to do with how the Guyana economy is performing. In this way we can see the effects of the global crisis being channelled through  exchange rate variations in relation to non-US currencies. There can be no insulation or buffer from these effects. Therefore, if they are negative, as is likely when the US dollar is under pressure, these exchange rate arrangements ensure that Guyana’s economy is adversely affected.  **The terms of trade** The common meaning of this term is the ratio of the index of export prices to import prices.  This has, however, been modified in two principal directions. First, the indexes have been adjusted for differential rates of inflation in the exporting country and the countries from which imports are obtained. This is termed the “real effective exchange rate.”   The second adjustment is to take into account the effect of productivity changes on price. This comes about because if the price of an export item is falling but productivity in the industry producing it rises faster than its price decline, there is income gain from the sale of the product. This type of productivity adjusted terms of trade is called the ‘factoral terms of trade.’  Unfortunately, one of the weakest areas of statistical data on Guyana is trade; this is mainly due to long delays in publishing data. According to WTO (2009) “the real effective exchange” has been appreciating in Guyana in recent years. This has been attributed to the rate of inflation in Guyana being higher than that in countries from which it derives its main imports.  I shall continue from this point next week, before going on to consider other channels of transmission of the global economic crisis. |