FISCAL POLICY AND ECONOMIC GROWTH:
ALIGNING THE 2014/15 BUDGET

Presentation to the Jamaica EMPLOYER’s FEDERATION CONVENTION,
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STRUCTURE

- Re-stating the “Growth Problem”: Causes and Solutions
- Re-stating the Growth Agenda: Strategic Priorities for the Medium-term
- The Role of Fiscal Policy
- Aligning Fiscal Policy to Growth: The 2014/15 Budget
RE-STATING THE GROWTH PROBLEM (1):

THE “GROWTH PUZZLE” = LOW GROWTH + HIGH DEBT + HIGH INVESTMENT
RE-STATEING THE GROWTH PROBLEM (2):
Sources: a Mix of Policy and structural Constraints

Solutions: A Mix of Policy and Structural reforms

[Reference: Gladstone Hutchinson & Donald Harris (eds) “A Growth Inducement Strategy for Jamaica in the Short and Medium Term” (Kingston: Planning institute of Jamaica, 2012)]
Table 1: The Analytical Framework of A Growth Strategy For Jamaica: A Mapping of Constraints, Contributing Factors and Corrective Strategies (Adapted from Hutchinson & Harris (2012))

<table>
<thead>
<tr>
<th>Key Constraints</th>
<th>Contributing Factors</th>
<th>Corrective Strategies</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Fiscal Gap</strong> (“Debt Overhang”)</td>
<td>Lack of adequate fiscal governance</td>
<td>Fiscal consolidation and governance reform; fiscal expenditure control; broad-based tax reform</td>
</tr>
<tr>
<td><strong>Capacity Utilization Gap</strong></td>
<td><strong>Supply-side:</strong> Deficiencies and distortions in the existing structure of economic incentives; poor business environment</td>
<td>Improving the business environment; broad-based tax reform; asset mobilization; social inclusion; fiscal expenditure re-prioritization</td>
</tr>
<tr>
<td>(“Underutilization of Productive Capacity”)</td>
<td><strong>Demand-side:</strong> Weakness in international competitiveness and global demand conditions</td>
<td></td>
</tr>
<tr>
<td>Key Constraints</td>
<td>Contributing Factors</td>
<td>Corrective Strategies</td>
</tr>
<tr>
<td>---------------------------------------------</td>
<td>-------------------------------------------------------------------------------------</td>
<td>--------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td><strong>Capital Efficiency Gap</strong> (“Economic Waste of Capital”)</td>
<td>Excessive construction costs; reduced productivity of private and public capital</td>
<td>Improving the business environment; fiscal expenditure re-prioritization; infrastructure investments; improvement of government procurement</td>
</tr>
<tr>
<td><strong>Sectoral Efficiency Gap</strong> (“Unbalanced Sectoral Structure of Production”)</td>
<td>High rate of investment in capital intensive sectors accounting for a small share of GDP or of employment and in sectors with low domestic linkages</td>
<td>Incentive reform; improving domestic linkages; logistics hub; regional ICT centres</td>
</tr>
</tbody>
</table>
Re-stating THE GROWTH AGENDA

- Macroeconomic stabilization (fiscal consolidation)
- Structural Reforms (tax reform; entitlement reform; property rights reform); competitiveness reforms – energy costs, business entry and exit; finance reforms)
- Social Inclusion (SME support; social protection)
- Environmental resilience
Role OF FISCAL POLICY

• Enhanced Fiscal Governance (fiscal adjustment and fiscal stabilization over the medium term)
• Enhanced Public Sector Efficiency
• Expenditure Prioritization (special reference to capital expenditure) to support the growth agenda
FUNDAMENTAL ROLE OF ENHANCED FISCAL GOVERNANCE

- Necessary for: increasing resilience to shocks; growth-supporting macroeconomic stabilization; permanent debt reduction.

  *(NB: A small open economy without a reserve or internationally traded currency cannot pursue “independent” monetary/exchange rate policies under ANY exchange rate regime)*

- Two dimensions of enhanced fiscal governance:
  - Fiscal Adjustment – implementing (possibly large) increases in primary surpluses
  - Fiscal Stabilization – creating institutions to lock-in the gains of fiscal adjustment
RE-STATING THE CONTOURS OF SUCCESSFUL “LARGE” FISCAL ADJUSTMENTS

- Combination of tax and expenditure adjustments, with the burden of adjustment falling on expenditure reductions
  - Tax enhancements focus on lowering average effective tax rates on highly taxed sectors, broadening the tax base (streamlining tax expenditures, and reducing evasion/avoidance, and strengthening tax administration capacity)
  - Expenditure reductions focus on reducing “non-productive” expenditures, reform entitlement programs (social insurance and public pensions)
  - Given the magnitude of adjustments required, renewed attention to be paid on increasing the efficiency and reach of social protection programs
RECENT FISCAL ADJUSTMENT EXPERIENCE IN JAMAICA

• Generation of sizable Primary Surpluses (Revenues minus Non-Debt Expenditures) – approximately 7.5% of GDP FY 2013/14, from XX %& YY %, respectively, in FYs 2011/12 & 2012/13; targeted for 7.5% over the medium term

• Tax reform, including fiscal incentive reform - new fiscal incentive regime effective January 2014 plus other elements of tax reform during 2014/15 – 2015/16 approved in the 2014 Tax Reform Blueprint

• Expenditure containment

• - declining expenditure as a % of GDP (while maintaining capital expenditures, including social protection expenditures in real terms)

• - larger reductions (as % of GDP) in recurrent expenditures compared to capital expenditures

• - to be complemented by phased public pension reform
## Main Parameters of Fiscal Adjustment

Table 2: Central Government Summary Accounts, 2012 - 2015

<table>
<thead>
<tr>
<th></th>
<th>2012-13</th>
<th>2013-14</th>
<th>2014-15</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue &amp; Grants</td>
<td>25.8</td>
<td>26.9</td>
<td>26.5</td>
</tr>
<tr>
<td>o/w: Tax Revenue</td>
<td>23.9</td>
<td>23.3</td>
<td>23.8</td>
</tr>
<tr>
<td>Recurrent Expenditure</td>
<td>27.1</td>
<td>24.4</td>
<td>25.0</td>
</tr>
<tr>
<td>o/w: Programmes</td>
<td>6.5</td>
<td>6.4</td>
<td>6.8</td>
</tr>
<tr>
<td>Wages &amp; Salaries</td>
<td>11.0</td>
<td>10.6</td>
<td>10.0</td>
</tr>
<tr>
<td>Interest</td>
<td>9.5</td>
<td>7.5</td>
<td>8.2</td>
</tr>
<tr>
<td>Capital Expenditure</td>
<td>2.8</td>
<td>2.4</td>
<td>2.1</td>
</tr>
<tr>
<td>Fiscal Balance (deficit = minus)</td>
<td>-4.1</td>
<td>0.1</td>
<td>-0.7</td>
</tr>
<tr>
<td>Overall Balance (deficit = minus)</td>
<td>0.1</td>
<td>-0.7</td>
<td>-0.1</td>
</tr>
<tr>
<td>Primary Balance (deficit = minus)</td>
<td>5.4</td>
<td>7.5</td>
<td>-</td>
</tr>
<tr>
<td>Target Primary Balance</td>
<td>6.0</td>
<td>7.5</td>
<td>7.5</td>
</tr>
</tbody>
</table>

**Memoranda:**

1. Projected fiscal balance, 2015/16 & 2016/7: 0.2% & 0.7%
2. Projected overall balance, 2015/16 & 2016/17: 0%
3. Actual primary balance vs target, 2011/12: 3.1% vs 5.0%

**Source:** Ministry of Finance & Planning (as % of GDP)
Strengthening FISCAL-STABILIZING INSTITUTIONS: Main features

- Increased transparency of fiscal decision-making
- Increased accountability for fiscal policymakers
- Enhanced capacity for oversight institutions
- Increased reliance on quantitative fiscal rules
Key FEATURES OF ENHANCED FISCAL RULES FOR JAMAICA (Legislation Approved March 31, 2014)

- Rules based on easily understood, easily observable targets explicitly derived from a forward looking, medium/long-term debt sustainability objective
  - Broad coverage of the public sector (to reduce fiscal illusion and hidden contingencies)
  - Legislative authority (within limits of the constitutional tradition), with sanctions
- Multi-year Automatic correction mechanisms
- Narrowly circumscribed escape clause
- Parliamentary reporting and oversight
CONTRIBUTION OF FISCAL POLICY TO PUBLIC SECTOR EFFICIENCY

• Enhanced efficiency of revenue collections – reforms of Inland Tax and Customs Administration

• Enhanced Efficiency of Public Financial Management (PFM) – ongoing PFM reforms, including Central Treasury Management

• Enhanced Efficiency of Public Investment Management (PIM)

• Contribution of workforce rationalization, re-organization and enhanced human resource management – includes establishment review, compensation review, centralized, strategic HR management system, supporting the implementation of shared corporate services
Table 3: Structure of Capital Budget, 2012 - 2015 (% of total)

<table>
<thead>
<tr>
<th>Expenditure as % of total non-debt capital expenditure</th>
<th>2014-15</th>
<th>2013-14</th>
<th>2012-13</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public Debt Management</td>
<td>73.1</td>
<td>71.1</td>
<td>68.1</td>
</tr>
<tr>
<td>Security &amp; Justice /a</td>
<td>8.1</td>
<td>6.1</td>
<td>6.2</td>
</tr>
<tr>
<td>Economic Affairs</td>
<td>46.4</td>
<td>39.3</td>
<td>49.7</td>
</tr>
<tr>
<td>o/w: Infrastructure /b</td>
<td>36.5</td>
<td>29.6</td>
<td>39.4</td>
</tr>
<tr>
<td>Environmental Protection &amp; Conservation</td>
<td>0.8</td>
<td>0.9</td>
<td>1.2</td>
</tr>
<tr>
<td>Housing &amp; Community Amenities</td>
<td>4.9</td>
<td>8.1</td>
<td>6.2</td>
</tr>
<tr>
<td>Health Affairs &amp; Services</td>
<td>6.4</td>
<td>5.7</td>
<td>4.5</td>
</tr>
<tr>
<td>Education Affairs &amp; Services</td>
<td>5.6</td>
<td>7.1</td>
<td>5.8</td>
</tr>
<tr>
<td>Social Security &amp; Welfare Services</td>
<td>14.9</td>
<td>11.1</td>
<td>8.6</td>
</tr>
<tr>
<td>Other /c</td>
<td>12.8</td>
<td>21.7</td>
<td>17.7</td>
</tr>
<tr>
<td>Total Non-debt</td>
<td>100.0</td>
<td>100.0</td>
<td>100.0</td>
</tr>
</tbody>
</table>

Notes:
/a: Includes Defence, Public Order and Safety Services
/b: Includes Road Construction & Repairs, Transport and Telecommunication services
/c: Includes Non-debt general Services, Recreation & Culture and Unallocated capex

Source: Ministry of Finance & Planning; computed by the Author
Feedback of economic growth to stronger fiscal policy

- Relationship of fiscal policy and economic growth is not “one-way”
- Efficient and sustained implementation of a broader structural reform agenda to enhance competitiveness will lay a stronger foundation for private-sector led growth
- Institutional reform within the private sector to take advantage of new investment opportunities will yield stronger growth – who leads this charge?
- Stronger growth enhances fiscal performance thru more buoyant tax revenues and greater fiscal space from a reduced debt burden => stronger support for growth-enhancing initiatives and expenditures

• CLEAR ROLE FOR THE JEF TO SUPPORT EFFICIENCY-ENHANCING REFORMS IN THE PRIVATE SECTOR
SUMMARY

Jamaica’s fiscal policy will contribute to economic growth directly thru:

- fiscal adjustment and stabilization to reduce the debt burden, and enhance the quality of fiscal governance
- gradual expenditure re-prioritization to capital investment, and increased efficiency of capex management

Jamaica’s fiscal policy will contribute to growth indirectly thru budgetary and institutional support for public sector (and other structural reforms) for increased efficiency and competitiveness

Jamaica’s fiscal performance will be improved through more robust economic growth, partly resulting from complementary, non-fiscal structural reforms

A VIRTUAL CYCLE FOR ROBUST GROWTH AND DEVELOPMENT? – WE (i.e. ALL SECTORS OF SOCIETY) WILL HAVE TO WORK HARD! TO ENSURE THIS GETS DONE!!