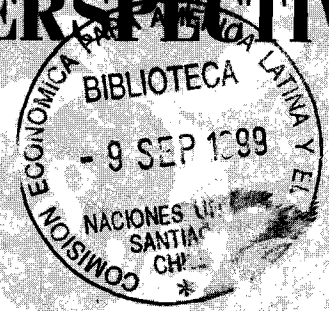


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# The **FISCAL COVENANT:** *Strengths, Weaknesses, Challenges* **CARIBBEAN PERSPECTIVES**



**UNITED NATIONS  
ECONOMIC COMMISSION  
FOR LATIN AMERICA AND THE CARIBBEAN**  
Subregional Headquarters for the Caribbean  
**CARIBBEAN DEVELOPMENT  
AND COOPERATION COMMITTEE**





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CARIBBEAN PERSPECTIVES**



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Port-of-Spain, Trinidad and Tobago, 1999



## TABLE OF CONTENTS

FOREWORD.....	i
ACKNOWLEDGEMENTS .....	ii
INTRODUCTION.....	1
<b>PART I: ADDRESSES</b>	
ADDRESS BY MS LEN ISHMAEL, DIRECTOR, ECLAC SUBREGIONAL HEADQUARTERS FOR THE CARIBBEAN .....	7
KEYNOTE ADDRESS BY THE MINISTER OF FINANCE OF TRINIDAD AND TOBAGO, THE HONOURABLE BRIAN KUEI TUNG.....	9
<b>PART II: THE SUBREGIONAL EXPERIENCE</b>	
AN OVERVIEW OF FISCAL ISSUES IN THE CARIBBEAN.....	15
<i>Mr. Sidya Ould El-Hadj, Economic Affairs Officer</i> <i>ECLAC Subregional Headquarters for the Caribbean</i>	
THE FISCAL CHALLENGE AND CARIBBEAN STATES AT THE TURN OF THE CENTURY .....	19
<i>Dr. Ramesh Ramsaran, ECLAC Consultant</i>	
<b>PART III: THE NATIONAL EXPERIENCE</b>	
THE ROAD TO A FISCAL COVENANT: A critical look at the Dominican Experience.....	73
<i>Dr. Rolando M. Guzmán, Economic Adviser</i> <i>Government of the Dominican Republic</i>	
THE NEW FISCAL COVENANT .....	97
<i>Mr. Calixte Leon, Director of Research, Development and Policy</i> <i>Government of Saint Lucia</i>	
FISCAL CHALLENGES IN THE NETHERLANDS ANTILLES 1991 – 1997 .....	104
<i>Mr. Elfried Paulina, Second Deputy Director for Finance</i> <i>Government of the Netherlands Antilles</i>	
TRINIDAD AND TOBAGO'S FISCAL COVENANT – A BRIEF PERSPECTIVE .....	112
<i>Mr. Vishnu Dhanpaul, Deputy Director, Monitoring and Coordination Unit</i> <i>Ministry of Finance, Government of Trinidad and Tobago</i>	
INCREASING PRODUCTIVITY IN THE PUBLIC SECTOR: THE JAMAICAN EXPERIENCE .....	117
<i>Mrs. Shirley Tyndall, Financial Secretary, Government of Jamaica</i>	
SELECTED ISSUES IN THE TRANSPARENCY OF PUBLIC EXPENDITURE IN JAMAICA.....	122
<i>Mr. A.P. Strachan, Auditor-General, Government of Jamaica</i>	
CREATING AN EFFICIENT AND EFFECTIVE PUBLIC SERVICE – THE PUBLIC SECTOR MODERNISATION PROGRAMME AND OTHER REFORM MEASURES.....	126
<i>Mr. Carlton E. Davis – Cabinet Secretary, Government of Jamaica</i>	



## FOREWORD

The United Nations Economic Commission for Latin America and the Caribbean (ECLAC), Subregional Headquarters for the Caribbean, is publishing the present volume of papers as one of a series of documents seeking to share lessons of experience in various aspects of economic and social development in the Caribbean. The papers included in this publication deal with the experiences of selected Caribbean countries in the area of fiscal management and fiscal reforms. In addition to the exchange of views on public finance management, which took place among the participants at the seminars where the papers were presented, in November 1998 in Trinidad and Tobago and in December 1998 in Jamaica, this publication seeks to bring to a wider audience of Caribbean policy makers the experiences of some of the countries with various issues of public finance.



Len Ishmael  
Director

## **ACKNOWLEDGEMENT**

The United Nations Economic Commission for Latin America and the Caribbean (ECLAC), Subregional Headquarters for the Caribbean wishes to record its gratitude to the Ministries of Foreign Affairs and Finance of Jamaica and Trinidad and Tobago and the Central Bank of Trinidad and Tobago for their support in the organization of the seminars. It also wishes to thank the presenters and the other participants for their contribution to the successful organization of the seminars and the preparation of this publication.



## INTRODUCTION

The structural reforms implemented by the countries of Latin America and the Caribbean, including trade liberalization, privatization, financial deregulation, exchange rate and tax reforms, the enactment of incentives to promote local and foreign investment and the institution of public sector reforms have ushered in a new era of economic management and a fundamental shift in the countries' approach to the promotion of social and economic development. The reforms undertaken have had profound effects on the role of the State in the economic and social development of the countries of the region and have given rise to a reassessment of that role within the context of the new approach to economic management.

The re-examination of the role of the State in the development process of the countries was accompanied by a re-examination of the fiscal regime. Privatization has provided increased revenues while at the same time creating extra demands on the public sector to regulate the newly privatized services. These extra demands had to be met with reduced public employment resulting from the reduction of public expenditures undertaken to reduce budget deficits. The trade liberalisation reforms have served to decrease public revenues from trade taxes and helped reorient the tax structure towards domestic taxes which consisted, more often than not, of value added taxes.

The reforms undertaken have generally resulted in sounder public finances in the Latin American and Caribbean region. This has, in fact, contributed a great deal to the current macroeconomic stability achieved in most of the countries of the area. However, that macroeconomic stability and the sound public finances it is based on remain vulnerable to both internal and external shocks. In addition, the fiscal policies which led to the current sound public finances have tended to neglect social equity goals, the promotion of which is the subject of considerable consensus in the region. Also, the efforts undertaken to increase the transparency of public accounts and the efficiency of the public sector are yet to achieve the expected results.

It is in consideration of all these issues that it is suggested that the objectives of macroeconomic stability, social equity, transparency and efficiency in the public sector will be better achieved if there is an agreement among the various sectors of society on the role of the State in economic and social development, the amount of resources it should manage, the sources of its revenues and the rules governing the allocation of public funds. Such an agreement which is referred to as the fiscal covenant will allow the State to play fully its role and make its essential contribution to the social and economic development of the region.

It is acknowledged that this is a difficult political and technical task. But it is also clear that this task has to be undertaken if the Latin America and Caribbean region is to make further progress towards changing production patterns with social equity. ECLAC, in its document: *The Fiscal Covenant: Strengths, Weaknesses, Challenges* puts forward what it considers to be the main elements required to renew or build a new fiscal covenant. These include fiscal

consolidation, raising the productivity of public expenditure, increasing transparency in public accounts, promoting social equity and establishing or strengthening democratic institutions<sup>1</sup>.

The present publication contains a collection of papers presented at two seminars organized by the ECLAC Subregional Headquarters for the Caribbean to examine the many issues of fiscal management raised in the document: *The Fiscal Covenant: Strengths, Weaknesses, Challenges*. The first seminar was held in Port of Spain, Trinidad and Tobago, on 23 November 1998 and the second was held in Kingston, Jamaica, on 5 December 1998. The first part of this publication focuses on the subregional perspective while the second part focuses on the national experiences. Mr. José Antonio Ocampo, Executive Secretary of ECLAC, participated in both seminars and presented the main document: *The Fiscal Covenant: Strengths, Weaknesses, Challenges*.

In her address to the seminar organized in Trinidad and Tobago, Ms Len Ishmael, Director of ECLAC, Port of Spain, reviews the reforms which had taken place in the region and which, she argues, have resulted in generally sounder public finances. She points out, however, that the results of the reforms were not as successful in the improvement of social conditions and welfare in the region where income inequality and worsening levels of poverty exist in several countries. She suggests in her address that better mechanisms are needed to improve the efficiency of social programmes and better target them to those most in need.

In his keynote address to the Seminar, the Honourable Mr Brian Kuei Tung, Minister of Finance of Trinidad and Tobago, shares the experience of Trinidad and Tobago with the fiscal and external disequilibria which the country faced in the 1980s. Trinidad and Tobago moved from a deficit of 13 per cent of GDP in 1983 to 1 per cent in 1991 and then budget surpluses from 1995 onwards. Over the period 1994-1998 real economic growth averaged 4 per cent, while inflation remained low, averaging 5 per cent, and unemployment was falling. However, the Minister indicates, in his address, that despite these positive developments, Trinidad and Tobago still faces many challenges, two of them being the issues of quasi fiscal deficits and pension reforms. These issues were receiving greater attention from the Government of Trinidad and Tobago.

In his presentation, Mr Sidya Ould El Hadj, Economic Affairs Officer, ECLAC, Port of Spain highlights briefly the Caribbean experience with the five elements of the Fiscal Covenant, namely, fiscal consolidation, the raising of the productivity of public expenditure, the challenge of making public expenditures more transparent, the promotion of social equity and the strengthening of the institutional framework of democracy. He notes the fact that fiscal reforms constituted an essential element of the economic stabilisation programmes undertaken in the Caribbean and that deficit reduction was initially implemented through capital and current expenditure reduction and, subsequently, through tax reforms. He also indicates, in his presentation, that the challenge of tax reform was most formidable in those Caribbean countries where international trade taxes constituted a significant part of total tax revenues.

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<sup>1</sup> For a full discussion of these issues see: ECLAC, *The Fiscal Covenant: Strengths, Weaknesses, Challenges*, Santiago, Chile 1998

Writing on the fiscal challenge and Caribbean States at the turn of the century, Dr Ramesh Ramsaran, ECLAC consultant, traces the progress of economic and social development in the Caribbean in the 1980s and 1990s focusing on the special characteristics of the countries, including their small size and their undiversified production and export structures and their success in achieving comparatively high levels of income. Examining the situations in Latin America and the Caribbean, he highlights some of the differences between Latin America and the Caribbean including those related to size, tradition, political systems, laws, military spending and experiences with inflation. However, the Consultant emphasizes that poorly functioning tax systems, tax avoidance, growing dependence on indirect taxes, inefficient spending, the impact of quasi-fiscal spending for the budget, lack of transparency in fiscal operations and social inequities were among the common concerns of the two subregions. Factors such as the failure of import substitution strategy and the erosion of the capacity of the State to provide free or heavily subsidized services are identified among those which led to the rethinking of the role of the State in the Caribbean.

In his paper, Dr Ramsaran also examines the tax and expenditure structures in the Caribbean, tax buoyancy and the reforms recently undertaken especially those related to the rationalization of social expenditures including those on social security systems. He discusses the volatility of Caribbean economies and its effects on the national budgets and identifies the need for new approaches to the booms and busts which have been an integral part of the history of the region and the challenges ahead including the uncertain future facing some of its major exports.

Mr Rolando Guzman, Economic Adviser, presents in his paper, the fiscal and other reforms undertaken in the Dominican Republic over recent years noting the success of these reforms as indicated by higher rates of growth and lower levels of inflation. He discusses the evolution of revenues and expenditures in the country and identifies weaknesses in both areas including those related to budget formulation, the dependency of revenues on the political cycle and the over-expenditures authorized by law for the government. He also discusses the quality of government expenditures and identifies a number of problems including the lack of coordination among government institutions and weaknesses in projects design capability which are two of the factors responsible for the low quality of public expenditure. The transparency of government expenditure is also examined and the unequal distribution of public funds among regions and sectors highlighted. The presentation also reviews the efforts under way, including a set of draft laws designed to remedy the weaknesses identified and strengthen fiscal policy in the Dominican Republic.

In his discussion of Saint Lucia's experience with the issues raised in the fiscal covenant, Mr Calixte Leon, Director of Research, Development and Policy, notes the relatively strong fiscal position, including fiscal surpluses, which Saint Lucia has been able to maintain since the mid-1980s. However, he indicates that the fiscal accounts of the country have been weakening over recent years and that the government has taken some measures including a target of public sector savings of 7 to 8 per cent for the year 1998/99 designed to maintain the good fiscal position and the economic stability that the country has enjoyed in the past. Mr. Leon also discusses the implementation of various reforms programmes including the standard integrated government tax administration system and the financial management reform project whose

objective include the improvement of the efficiency of revenue collection and the productivity of public expenditures.

In his presentation on the adjustment programme in the Netherlands Antilles, Mr Elfried Paulina, Second Deputy Director for Finance, traces the developments which led to the macroeconomic disequilibria experienced by the Netherlands Antilles in the mid-1990s. He then discusses the adjustment programme implemented by the country highlighting some aspects of the measures taken to increase revenue, reduce expenditure and resume growth. The difficulties in cutting expenditures and the success of raising revenues are examined in the presentation and the measures taken evaluated.

Giving a brief perspective on Trinidad and Tobago fiscal covenant, Mr Vishnu Dhanpaul, Deputy Director of the Monitoring and Coordination Unit of the Ministry of Finance, recalls the impressive gains in income and employment realized in Trinidad and Tobago during the period 1973-1981 as a result of the oil boom. He then discusses the inefficiencies which have crept into the management of the economy as a result of the boom and the inevitable adjustment which had to be undertaken when oil revenues started to decline. He reviews some of the measures taken as part of the restructuring programme and concludes that the adjustment was successfully implemented as indicated by the recent high levels of non-inflationary growth, low levels of inflation and unemployment and fiscal surpluses.

In her paper on Increasing the Productivity in the Public Sector: the Jamaican Experience, Mrs. Shirley Tyndall, Financial Secretary, highlights some of the achievements of the reforms undertaken in Jamaica over the last decade. These successes included the improvement of tax equity and efficiency and addressing the problem of social equity through the implementation of poverty alleviation programmes. She then discusses the lessons learnt from the first phase of the Administrative Reform Programme which, she argues, were factored into the second phase of the programme and later into the establishment of the Public Sector Modernization Project whose objective is to create a modern, efficient and transparent public sector.

Performance-linked incentive schemes, better working conditions and more training opportunities are among the areas of emphasis of the modernization project. Other reform programmes discussed in the paper include the Tax Administration Reform Project whose objectives include the broadening of the tax base and the reduction of tax evasion. Mrs. Tyndall also reviews the fiscal consolidation in Jamaica and the problems encountered, including the troubles of the financial sector, and outlines the measures taken by the government to strengthen public finances and reduce the debt burden.

In his discussion of the transparency of public expenditure in Jamaica, the Auditor General, Mr. A.P. Strachan, restates the principle according to which all government expenditures should be undertaken in a transparent manner and in the public's best interest. He then notes that although all government agencies are required to submit annual reports to Parliament accounting for their activities, most of them present mainly financial reports. These reports, he suggests, should be further strengthened to include statements on the achievements during the year and explanations of any substantial variations from the allocations approved by Parliament. In addition, the Auditor General notes the dearth of information on tax expenditures

and suggests that these expenditures should be clearly identified and brought to Parliament. The implementation of these suggestions, he argues, will result in more transparency in public expenditure and the strengthening of public confidence in government activities.

Finally, writing about the public sector modernization programme and other reform measures, Mr. Carlton E. Davis, Cabinet Secretary, outlines some of the factors including the technological revolution behind the need for change being felt around the world. This need, he argues, is particularly important in the public sector which has the propensity to affect the lives of all the people in the country. Mr Davis then discusses the Public Sector Modernization Project (PSMP) whose objectives include the improvement of customer service in government departments, the strengthening of government auditing and contracting capabilities as well as enhancing the efficiency, effectiveness and accountability of central ministries. Some of the measures taken and results achieved within the modernization project are also discussed in the paper.

## **PART I: ADDRESSES**

**ADDRESS BY MS LEN ISHMAEL, DIRECTOR,  
ECLAC SUBREGIONAL HEADQUARTERS FOR THE CARIBBEAN**

Mr Chairman, Minister of Finance, the Honourable Brian Kuei Tung, Executive Secretary of ECLAC, Mr Jose Maria Antonio Ocampo, Governor of the Central Bank, Mr Winston Dookeran, members of the Diplomatic Corps, distinguished delegates, ladies and gentlemen, it is indeed an honour to welcome you to today's regional seminar entitled: the Fiscal Covenant: Strengths, Weaknesses, Challenges, which is being co-hosted with the Ministry of Finance of the Government of Trinidad and Tobago. Your presence here today signals the importance that you and your respective countries attach to the formulation of appropriate policies to respond adequately to the fiscal and other challenges which lie ahead.

This seminar is taking place during rather turbulent times, when additional and far more complex challenges are facing the economies of our member States. The most recent of these challenges have been precipitated by the turmoil in the world economy started by the Asian Crisis in 1997, and the resultant widespread fear of an impending world recession. Our closest neighbours in Latin America are already feeling the negative effects of this crisis - one of which is the drop in commodity prices, a factor which is also significant for some Caribbean countries. Indeed, the crisis threatens to undermine the very foundation of the admittedly fragile macroeconomic stability which the countries of Latin America and the Caribbean have been able to achieve after more than a decade of painful structural reforms.

The recent passage of the deadly hurricanes, Mitch and Georges, over the countries of Central America and the Caribbean contributes to the turbulence of these times with devastating effects on the economies and the people of the region, wiping out, in the space of just a few hours, several decades of developmental gains. The successful continuation of the reform policies will, in no small measure, be dictated by the extent to which these countries are able to continually adapt to new realities and the ever present spectre of natural disasters.

There can be no doubt that the development process in Latin America and the Caribbean experienced a fundamental transformation after the implementation of structural reform programmes by most countries in decades of the 1980s and 1990s. Policies implemented focused on the achievement of macroeconomic stability and growth through the imposition of fiscal discipline, trade liberalization, engagement of the private sector as developmental partners, increased efficiency in the allocation of resources, privatization and the institution of better regulatory mechanisms. These policies have been instrumental in bringing about economic stabilization and a resumption of growth, although at moderate rates.

Fiscal policy, a major component of the stabilization policies implemented by these countries has resulted in much sounder public finances as indicated by lower fiscal deficits and a generally better approach to deficit and debt management. The momentous challenge facing these countries is the formulation of modalities to sustain this hard won stability and moderate rates of growth, within external man-made and natural environments which are oftentimes quite volatile.

While we are able to point to some successes on the macroeconomic front, the outcome of the reforms in improving social conditions and welfare in these countries have not been as encouraging. Increasing levels of income inequality and worsening levels of poverty have accompanied the reform process in several countries. In the Caribbean where social spending has historically tended to be higher as a percentage of GDP than in Latin America, social programmes including health care, education, public transportation and subsidized housing have resulted in services and facilities well below the level expected by the population, or justified by the amount of resources devoted to the various sectors as a result of inefficiencies in the allocation process. Although the poor have, no doubt, benefited from these programmes, those less in need have also benefited and mechanisms are still being sought to improve the efficiency of social programmes and to better target them to those most in need.

Although the Caribbean subregion has implemented reform policies similar to those implemented in Latin America, it is still useful not to lose sight of the specific characteristics of this subregion which significantly impact on the reform process. The high trade ratio levels of the Caribbean, the heavy reliance on preferential markets for exports, the high dependency on imports are all critical elements which significantly influence government revenues and expenditures. Some Caribbean countries depend heavily on indirect taxes especially those from international trade. This makes for trade liberalization and tax reform programmes which are inherently a lot more difficult to implement.

The purpose of this seminar is to discuss the wide range of issues raised in the Fiscal Covenant : Strengths, Weaknesses, Challenges at the regional, subregional and national levels, and to exchange views on the applicability of the recommendations made in dealing with the complex fiscal issues which confront the Caribbean as we enter the new century. The Seminar will start with a presentation of the main issues related to the Fiscal Covenant and will be followed by a presentation of the most critical fiscal challenges faced by Caribbean States. This discussion will be followed by four national presentations focusing on some of the issues which selected Caribbean countries are grappling with at the national level. And finally the last session will draw pertinent conclusions from the day's discussions and make recommendations for future directions and action.

I have no doubt that you will examine thoroughly the issues on the agenda and that your discussions will lead to conclusions and recommendations which will guide the future conduct of fiscal policy in the Caribbean.

Allow me to take this opportunity to thank the Honourable Minister of Finance for the honour of his presence, the Minister of Foreign Affairs, the Honourable Ralph Maraj for his ready assistance and support in the convening of this seminar, the Governor of the Central Bank for his personal efforts and that of his office, in facilitating this meeting, the Dutch Government for their generous contribution in support of this meeting, and lastly, but not least, permit me to extend, on our collective behalf, a particularly warm welcome to Mr. Ocampo on this his first official visit to the English-speaking Caribbean as the Executive Secretary of ECLAC. Welcome.

I wish you every success in your deliberations. Thank you.



**KEYNOTE ADDRESS BY THE MINISTER OF FINANCE  
OF TRINIDAD AND TOBAGO,  
THE HONOURABLE BRIAN KUEI TUNG**

Governor Dookeran  
Dr. Len Ishmael, Director, ECLAC Subregional Headquarters for the Caribbean  
Dr. José Ocampo, Executive Secretary, ECLAC  
Members of the Diplomatic Corps  
Distinguished Delegates  
Specially Invited Guests  
Ladies and Gentlemen,

It is indeed a pleasure for me to be here this morning at this one-day regional seminar organized by ECLAC on the Fiscal Covenant. I want to begin by taking this opportunity to welcome the Executive Secretary on the occasion of his first official visit to Trinidad and Tobago and to congratulate him on his recent appointment as Executive Secretary.

The Economic Commission for Latin America and the Caribbean has had a long tradition of excellence in economic analysis dating back to the days of Raúl Prebisch and its Port-of-Spain Office has contributed substantially to this. Over the past 30 odd years, the Office represented an important source of analysis and information on economic activity for the region and the Office must be commended for its efforts.

As a former Minister of Finance, Señor Ocampo, you are indeed well aware of and have obviously grappled with many of the fiscal issues with which we are confronted. Our experiences of the last two decades have confirmed that sound macroeconomic policies are critical to any country's ability to provide for the welfare of its citizens.

Today, as the last decade of the twentieth century draws to its end, the Trinidad and Tobago economy after several years of stabilization and adjustment is now on a path of non-inflationary growth. All the major macroeconomic indicators suggest that the economic recovery, which began in 1994, entered its fifth successive year in 1998 and will continue well into the next century.

Real economic growth averaged around 4 per cent over this period and has been accompanied by relatively low levels of inflation (5 per cent), falling unemployment rates (14 per cent in 1998), a reduction in the country's external debt (US\$1,526 million) and a rebuilding of the foreign exchange reserves (US\$1,186 million or 4.7 months import cover). When this performance is compared with the average for Latin America and the Caribbean, Trinidad and Tobago has performed creditably.

These changes in the macroeconomic fundamentals in the latter half of the 1990s are in stark contrast to what obtained in the 1980s. Indeed, some commentators have characterized the 1980s as a lost decade for Latin America and the Caribbean. In large measure, this is quite true

for Trinidad and Tobago as the economy adjusted downwards from an oil induced boom in the 1970s to some eight years of unrelieved declines in income, output and employment.

This was accompanied by severe disequilibria in both the fiscal and external accounts. Nevertheless, the changes that we observe today reflect in part the positive results of the adjustment and stabilization measures that were introduced in late 1988. With few exceptions, most of the ECLAC member countries undertook adjustment and stabilization policies under the aegis of the international financial institutions.

An important consequence of this has been that most of these countries, including Trinidad and Tobago, undertook a series of what has been called *first generation reforms* - trade liberalization, tax reform, financial reform and capital account liberalization. These reforms were designed to alter the structure of the economy and make it more competitive, market oriented, and placed on a path towards self-sustaining growth.

Ladies and gentlemen, a key element of these structural reforms in Trinidad and Tobago was, of course, tax reform – which is really a shorthand for a complete overhaul of the public finances. Another way of looking at this was that it represented a new role for the State. In the previous decades, the State had been viewed as critical to the development process – indeed in Trinidad and Tobago the old thinking had been that the State must be the ‘prime mover’ and take charge of the ‘commanding heights’ of the economy.

The subsequent experiences of - burgeoning fiscal deficits, an enormous State enterprise sector with several loss-making entities, a large transfer and subsidies budget and a high external debt burden have led to some reassessment of the limits of State intervention in the economy.

Clearly if macroeconomic stability and growth were important economic objectives, some reassessment was needed of the scope and composition of public sector expenditure and taxation over the medium term. What was needed was a rethinking of the role of the State!

Indeed, today the ECLAC researchers have now conceptualized these ideas into what they term the new Fiscal Covenant – the theme of today’s seminar. As I understand it, this new fiscal covenant has four key characteristics, fiscal consolidation, raising the productivity of public expenditure, transparency and the promotion of social equity.

In respect of the promotion of social equity, it is well recognized that social expenditure by government performs a key role in the redistributive process. Expenditure on health and education, in particular, have a long gestation period with results not immediately apparent since they contribute to the long-term development of human capital.

During the adjustment period, social investment expenditure fell dramatically in Trinidad and Tobago and indeed throughout Latin America, as the ECLAC report demonstrates. The data suggests that there was a 24 per cent fall in per capital social expenditure in Latin America.

While there have been reversals of these trends in the 1990s, the data also suggests that the Caribbean region has not shared in this positive development with expenditure averaging

around 9-11 per cent since 1987. In Trinidad and Tobago, we are conscious of the important distributional consequences of this kind of expenditure and we are committed to giving higher priority to social spending over the medium term.

In particular, we believe that once all the major elements of health sector reform are in place, this should go a long way towards redressing these particular imbalances.

Upon a closer examination of the new fiscal covenant, it is evident that the Trinidad and Tobago experience of fiscal consolidation has several important insights, some of which I wish to share with you today. As a matter of fact, the central government has achieved remarkable progress in this area over the adjustment period.

At the onset of the economic recession in 1983, the fiscal deficit had peaked at around 13 per cent of GDP, a situation which was clearly unsustainable. Under the adjustment programme, the Government committed itself to reduce the public sector deficit from 7 per cent of GDP in 1988 to 1 per cent by 1991. This was achieved primarily by wage and salary reductions to public sector workers, reductions in the transfer/subsidy budget and a rationalization of the tax system.

Ladies and gentlemen, it is important to note that the direct result of the painful adjustment process was a balanced budget by 1994 and surpluses since 1995. The reductions in the transfer/subsidy budget and the rationalization of the tax system were also key to the efforts at fiscal consolidation. The cornerstone of tax reform has been the successful implementation of the Value Added Tax (VAT) system in Trinidad and Tobago since 1990.

Together with other structural changes in the tax system, there has been a marked change in the composition of government revenues. For although the price of petroleum is a key ingredient in the budgetary process, the fact is that the oil sector now contributes no more than 20 per cent to the government revenues, while income taxes and VAT now account for 48 per cent.

These trends seem to suggest that there is still a greater reliance on direct taxes in the Caribbean, which may not be typical of the rest of the Latin American region. What is an appropriate direct/indirect tax mix for our economies appears not to have engaged the attention of economic theorists unduly, however, what is most important in Trinidad and Tobago is that the revenue system is administratively efficient and that public expenditures should be productive.

As noted earlier, fiscal consolidation implies a changing perspective of the role of the State in economic activity. For Trinidad and Tobago, this implied the divestment and/or liquidation of a number of State enterprises. Successful implementation of such a strategy had an immediate impact on the transfer/subsidy element of the public finances and ultimately the size of the fiscal deficit.

I do not suppose that this is the appropriate place to discuss the useful insights to be gained from the rich experience of divestment in Trinidad and Tobago. Suffice it to say that while the process is about three quarters completed, by 1996 proceeds from privatization were

estimated at around 10 per cent of GDP and have been used partly to reduce the external debt and partly to fund new capital projects. In addition, in many instances the privatization initiatives paved the way for additional new investment in the economy.

Ladies and gentlemen, I have noticed that the theme of this conference is the strengths, weaknesses, challenges of the new fiscal covenant. Despite our own positive experiences in some areas of the covenant, there still remain many challenges especially in respect of quasi fiscal deficits and pension reform.

Quasi-fiscal deficits have recently assumed greater importance in some countries in the region as governments have been confronted with the aftermath of the crises in their financial sectors and the eventual bailout of ailing financial institutions as, for example, Venezuela and Jamaica. And, yet, Trinidad and Tobago faced these very challenges in the mid-1980s with little or no regional experience on which to draw.

Our own solution to the so-called NFI crisis is well documented elsewhere, but the approach adopted by the monetary authorities in dealing with this crisis resulted in expenditure of the order of less than 1 per cent of GDP, well below the current estimates of the costs for Jamaica. Nonetheless, we need to be continually vigilant to ensure that such crises do not occur, but if they do, the State must not bear an inordinate share of the costs.

In an increasingly globalized world with interconnected financial markets, the possibility of financial crises and the contagion are not improbable. The key of course is to establish a strong regulatory framework with sound prudential guidelines.

Over the medium term, the issue of pension reform and its appropriate costs pose interesting challenges for the Ministry of Finance. Pension arrangements in Trinidad and Tobago are a mixture of public and private plans. The public system consists of a funded national insurance system, old age pensions which are non-contributory, and a pay as you go system (PAYG) for public sector employees.

We have begun this process of reform by tackling the National Insurance System whose benefits and contributions have remained unchanged since 1980. Actuarial reviews had suggested that there would be problems by the year 2000 if corrective actions were not taken. In my recent 1999 budget address, I announced that contributions as well as benefits will be increased so that the system will not be marginalized as we go into the next century.

The much more difficult task which remains is that of reforming the PAYG system. At present, the costs of providing public sector pensions are around 6-7 per cent of current expenditure. Translation of this system into a fully funded one will be a difficult challenge, but we have begun to examine the possibilities.

The Chilean model of pension reform has received a great deal of support in other jurisdictions and this is one approach that we will examine very thoroughly, in addition to other variants of the model. Trinidad and Tobago has a relatively young population with a median age

of about 25 years so that the issue of aging and pensions which is topical elsewhere will not serve to further complicate our discussions.

As you can see, our experiences over the past few years fall well within the theme of this conference and I expect that as you share experiences during the day, what has been tried and tested in some economies may provide useful insights for other countries. Allow me to close by extending to you warm wishes for a successful seminar.

## **PART II: THE SUBREGIONAL**

# **AN OVERVIEW OF FISCAL ISSUES IN THE CARIBBEAN**

by

Mr. Sidya Ould El Hadj, Economic Affairs Officer  
*ECLAC Subregional Headquarters for the Caribbean*

## **Introduction**

The macroeconomic disequilibria of the 1970s and 1980s have led to the implementation of a series of reforms in many Caribbean countries aimed at stabilizing the economies and improving their growth prospects. These reforms included the tightening of fiscal policies and the withdrawal of the State from many sectors of the economies, in particular, those sectors involved in the direct production of goods and services. Interactions between a changing international economic environment and domestic economic reforms have created the need to redefine the role of the State and the public sector, in general, in the management of the economy.

*The Fiscal Covenant: Strengths, Weaknesses and Challenges* discusses some major issues of public finance management in Latin America and the Caribbean and seeks to get some agreement and provide some guidelines on the way governments should conduct their fiscal operations. That agreement would determine the amount of resources put at the disposal of the State, the sources of these revenues and the rules of allocating them. It will also lend greater legitimacy to government actions and strengthen public finances.

The Covenant comprises five elements:

1. Fiscal consolidation;
2. The raising of productivity of public expenditure;
3. Making public expenditure more transparent;
4. Promoting social equity; and
5. Strengthening the institutional framework of democracy.

In this presentation, I propose to touch on each of the elements of the Covenant, highlighting briefly the experience of some Caribbean countries with selected issues.

## **Fiscal consolidation**

Fiscal policies constituted an essential element of the economic stabilization programmes implemented in the Caribbean and the improvement on public finances have contributed to the relatively good economic performance of some countries of the subregion. In general, the OECS countries have consistently turned out a good fiscal performance. This was indicated not only by these countries' generally lower deficits, but also by the surpluses which some of them achieved

in selected years. The exception was Grenada where double-digit deficits were experienced up to 1990. In the 1990s, fiscal deficits were generally lower in most Caribbean countries, except in Saint Kitts and Nevis, Belize and the Netherlands Antilles where they worsened in 1995 and 1996. A remarkable achievement of deficit reduction was that of Guyana where the deficit decreased from 50 per cent of GDP in 1987 to 3.3 per cent in 1996.

### Revenues

Tax revenues as a percentage of GDP vary a great deal in the Caribbean. They range from 10 per cent in Haiti, 18 per cent in Anguilla, Saint Kitts and Nevis and Antigua and Barbuda to over 30 per cent in Guyana, Barbados and Saint Lucia. Within those revenues, the direct/indirect tax mix varies significantly. It varies from the ECCB countries which collect 80 per cent of their tax revenues in indirect taxes, mainly taxes on international trade to Guyana where direct taxes constitute 40 per cent of the total tax revenues.

Deficit reduction in the Caribbean was initially implemented through the reduction of both current and capital expenditures. In that context salaries, wages and various employees' allowances were cut and public employment was reduced. More recently, reforms of the tax system and tax administration have received greater attention. These reforms have generally sought to simplify and broaden the tax system, combat tax evasions and introduce consumption taxes such as the VAT tax.

The challenge of tax reforms is most formidable in the countries which rely heavily on international trade taxes. In 1997, several of these countries collected 50 per cent of their tax revenues from international trade taxes. Antigua and Barbuda collected 56.9 per cent, Grenada 58 per cent and Saint Lucia 51.6 per cent. This heavy reliance on trade taxes has been an issue in the participation of these countries in free trade agreements within CARICOM and is likely to remain one in these countries participation in wider free trade agreements such as the Free Trade Area of the Americas (FTAA).

### **Raising the productivity of public expenditure**

Average public expenditure in the Caribbean stands around 36 per cent of GDP and has been on the decline reflecting the cuts in expenditure undertaken during the adjustment periods. Also, privatization and the consequent reduction of transfers and subsidies to public enterprises have contributed to the decrease in public expenditure. However, it should be noted that privatization was also undertaken to increase the efficiency and productivity of the targeted enterprises and improve their prospects for their viability. Another objective was to remove the State from the direct production of goods and services, while maintaining its responsibility for regulation and supervision. This regulatory and supervisory role was all the more crucial in the face of privatized national monopolies, such as water, electricity and telecommunications.

Public sector reforms were undertaken in many Caribbean countries with the objective of modernizing and improving the efficiency of the public sector, including those public sector enterprises which were not privatized. For example, in Saint Lucia a Financial Management Reform Project was recently initiated to ensure more effective use of government financial resources. The reform project includes budget reforms, a standardized integrated government



financial system, training, organization and management and best practice initiatives. The budget reforms included the introduction of programme budgeting in central government, the strengthening of the phases of the budget cycle and the introduction of the preparation of operational plans for all programme areas government-wide.

In the Dominican Republic, the process of budget formulation and execution is being renewed. The fact that public enterprises, local government and decentralized public institutions do not appear in the budget is one of the issues that a programme of future reforms will seek to address. Also, the existence of a section of the budget law which allows the executive to spend above the estimates approved by Parliament is another issue to be addressed.

### **The transparency of public expenditure**

There is a wide variety of fiscal incentives being used in the Caribbean mainly to promote investment in designated priority sectors, traditionally tourism and manufacturing, and more recently offshore finance and international business companies and other services. These incentives include tax holidays of up to 20 years, in some countries like the Dominican Republic. They also include tax exemptions for exports and imports of raw materials and equipment for production. These indirect expenditures which do not show up in the public accounts and are not subject to parliamentary scrutiny constitute a source of lack of transparency in public accounts and public management.

Presently, budget preparations usually involve the executive and the legislative but not the other sectors of civil society. However, there have been moves in some Caribbean countries to allow for wider participation in the budgetary process in order to improve the transparency of public accounts and put more focus on the accountability of public managers. Recently the Government of Saint Lucia declared its intention to create a Council of Social Partners with representatives from the public sector, the private sector, labour, religious denominations and NGOs to democratize further the budgetary process. Also, in Saint Lucia there are moves to quantify the amount of tax exemptions and concessions, loan guarantees and to append those estimates to the budget for debate in Parliament.

### **Promotion of social equity**

Government fiscal operations are an important tool to influence the pattern of income distribution in the country and to provide services for the more vulnerable members of society. One of the consequences of the crises of the 1980s and subsequent implementation of adjustment programmes was a decrease in government expenditures, including social spending. In some countries, like Trinidad and Tobago, social expenditures as a percentage of GDP continued to fall averaging 8 per cent in recent years notwithstanding the good economic performance of the economy in terms of GDP growth. In other countries, such as Barbados, social expenditure has continued to increase reaching 14 per cent in the mid-1990s.

In general, despite the downward trend in some countries, Caribbean countries devoted substantial resources to social sectors over the years. However, the use of these resources does not seem to have resulted in the outcome expected by the population whether in health, education and other social services which are critical to the efforts to reduce poverty and inequality of income. The issue seems to be the need to improve the efficiency and productivity of social spending.

There have also been efforts to improve social equity on the revenue side. These efforts were reflected in increases in tax thresholds, decreases in marginal tax rates and exemption of basic commodities from consumption taxes, such as VAT.

### **Strengthening of institutional framework of democracy**

The participation of the wider society in the debate leading to the preparation of the budget is starting to receive some attention in the Caribbean, the objective being to arrive at a broad consensus on the scope and composition of public expenditures and its sources of funding. This will increase the transparency in the management of public funds and strengthen the hands of governments in the management of the economy.

### **Conclusion**

The document *The Fiscal Covenant: Strengths, Weaknesses and Challenges* contains recommended courses of action on each of the issues related to public finances which are confronted by the Caribbean subregion. Although there are clear differences between Latin America and the Caribbean and differences among the Caribbean countries, themselves, the policy recommendations have direct relevance to the Caribbean subregion.

## **THE FISCAL CHALLENGE AND CARIBBEAN STATES AT THE TURN OF THE CENTURY**

by

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Even for large States with an abundance of natural resources, as well as for those that have managed to develop a diversified and resilient economy, the rapid changes in the global economic environment have created pressures to rethink a wide range of economic and social policies. For the smaller and more vulnerable States like those in the Caribbean, the question is literally one of survival, as special privileges are being eroded, and as they are being increasingly forced to compete with stronger and better endowed States on what is being termed 'a level playing field'. The imperative to adapt to this new environment calls for changes over a wide front, and for all actors in the social process to recognize the qualitative change in the texture of international relations and the more intense and sophisticated demands that are being placed on national resources. In the emerging post-cold war setting where emphasis is being placed on market-led development, the State's role has been relegated more to an enabling and facilitating one in which the development of sound institutions and the enforcement of an appropriate body of rules are seen as critical to economic order and private sector development. Unfortunately, in these discussions, the fiscal capacity of the State and its social responsibilities in cases where markets are absent or function poorly, tend to receive little attention. The proliferation of social safety-net mechanisms in the aftermath of structural adjustment programmes, and their widely recognized inadequacies have underlined the need for a more effective and capable State in its social role.

The recent problems in Asia have shown how easily a crisis can spread in an increasingly inter-connected world. Information technology has not only revolutionized production functions, but the acquisition and dissemination of knowledge is a major determinant of progress. There are new forces driving world trade and production, and since Caribbean countries are heavily dependent on the international economy, they are therefore forced to adapt to the global dynamics of change. Micro-economies have little influence on international economic trends and developments. Small changes in commodity prices can have major implications for domestic welfare. At the same time, the openness of the societies exposes local populations to external ideas, fashions and lifestyles that influence expectations and behaviour. The failure of insular import substitution policies to sustain the development momentum in the post-independence period, and changing international perspectives on aid and trade, not only require policy reforms, but new and stronger institutions capable of formulating and implementing public policy. The State, in particular, which assumed a large and key role in the post-independence development strategy has come under stress, and is being forced to examine its capability, to redefine its role and to find new ways to achieve social and economic objectives.

This paper is organized as follows. In order to put the role of the State in perspective and present fiscal problems in a development context, the first part discusses the characteristics and recent economic performance of Caribbean economies. The second highlights some of the main findings of the ECLACs recent report *The Fiscal Covenant* and their relevance to the Caribbean. The third and major section of the paper discusses fiscal trends in the Caribbean and some of the

challenges facing Caribbean governments. In the final section, some concluding observations are presented.

### **1. Economic characteristics and recent economic performance**

Almost all Caribbean countries are island economies, and are generally small both in terms of physical size and population (See Table 1). In terms of land area Guyana is the largest with an area close to 215,000 km<sup>2</sup>, but has a population of less than one million people. If Haiti (with a population exceeding 7 million) is excluded, only Jamaica and Trinidad and Tobago among CARICOM<sup>1</sup> countries have populations exceeding one million. Another salient feature of Caribbean economies is the openness of these economies which are highly dependent on international trade. In most cases, both imports of goods and services and exports of goods and services exceed 50 per cent of GDP respectively. In certain instances, (e.g. Antigua and Barbuda) the ratio exceeds 75 per cent.

Despite the efforts made to diversify their economies since independence, the countries of the region remain heavily dependent on a narrow range of activities for income, foreign exchange and employment. The structure of output, however, varies from one country to another. The economies of Antigua and Barbuda, Bahamas, Barbados and Aruba are dominated by tourism, which also makes a significant contribution in most of the others. The Caribbean economies were established to provide food and raw materials for metropolitan interests, and the crops and organization associated with the colonial economy still play an important part in the economic fabric today. The current Caribbean economies are hybrid production units reflecting the efforts to modernize and transform the economic structure while holding on to the past for support in the transition. In Trinidad and Tobago, for instance, sugar production still accounts for more than half of the value-added in agriculture, and even though the latter accounted for less than 3 per cent of GDP in 1997, it provided 9.5 per cent of employment as compared to 3.6 per cent for the petroleum and gas industries and 10.4 per cent for manufacturing. Incidentally, petroleum exports and petrochemicals account for over 75 per cent of export earnings. Despite the efforts made to promote a manufacturing sector as part of the diversification process, the sector has performed poorly in terms of employment creation and foreign exchange generation. In Belize, sugar (including by-products), bananas and citrus (including concentrates) contribute over 70 per cent to export earnings. In Dominica, bananas account for about 40 per cent of exports, around half of Saint Lucia's and over 40 per cent of Saint Vincent and the Grenadines'. In Jamaica, sugar, bananas and bauxite contribute over 50 per cent to this country's exports. In Guyana, sugar, bauxite and gold make up more than 60 per cent of domestic exports. As indicated earlier, a large part of domestic output is for foreign markets, while a significant share of domestic consumption and almost all capital needs are met by imports. In the case of the Organization of Eastern Caribbean States (OECS),<sup>2</sup> these islands have consistently run trade deficits, but exports of services (mainly tourism) have tended to cover these deficits. The inflows of private foreign capital have also helped the balance of payments position and contributed to the growth process. In the smaller islands private transfers from abroad are not an insignificant item in the balance of payments. Between 1990 and 1996 net inflows averaged over 25 per cent of the earnings from the export of goods.

Table 1

**Selected Demographic and Economic Statistics**

Countries	Area Km <sup>2</sup>	Pop. '000 (1996)	Pop. Growth Rate (%) (1990-96)	Pop. Per Km <sup>2</sup>	Average Annual Inflation Rate 1986-96	Total GNP <sup>a</sup> (1996) US\$MN	Per Capita (1996) <sup>a</sup> US\$	GNP Average Annual Real Growth Rate% 1990-96	Import Ratio <sup>1</sup> (1996)	Export Ratio <sup>2</sup> (1996)
<b>CARICOM Countries</b>										
Antigua & Barbuda	442	68	0.4	154	4.7	482	7,730	2.0	87	78
Bahamas	13,942	284	1.7	20	4.3	97 <sup>b</sup>	11,940 <sup>b</sup>	-1.0 <sup>c</sup>	59	55
Barbados	432	264	0.4	611	3.4	1,745 <sup>b</sup>	6,560	-0.2 <sup>c</sup>	54	56
Belize	22,960	222	2.7	10	3.1	600	2,700	0.7	56	50
Dominica	750	74	0.3	99	3.6	228	3,090	2.3	62	48
Grenada	345	99	1.4	287	3.0	285	2,880	0.6	66	43
Guyana	214,970	775	0.9	4	20.8	582	690	10.4	95	92
Haiti	27,750	7,336	2.1	264	16.7	2,282	310	-6.9	30	12
Jamaica	11,424	2,547	1.0	223	29.8	4,066	1,600	0.9	62	51
Montserrat	102	6	-18.5	59	4.5 <sup>c</sup>	13 <sup>d</sup>	2,490 <sup>e</sup>	3.5	70	43 <sup>f</sup>
St. Kitts-Nevis	269	43	-0.5	160	2.9	240	5,870	2.8	75	49
St. Lucia	616	147	1.0	259	4.0	553	3,550	2.4	71	63
St. Vincent	388	112	0.7	289	3.1	264	2,370	-0.3	67	53
Suriname	163,270	432	1.1	3	...	433	1,000	0.1	97 <sup>g</sup>	126 <sup>g</sup>
Trinidad & Tobago	5,128	1,264	0.8	246	8.7	5,017	3,870		43	43
<b>Other Caribbean Countries</b>										
Anguilla	91	11	4.3	121	3.9	55 <sup>d</sup>	7,380 <sup>h</sup>	...	101	72
Aruba	188	77	2.7	409	...	...	...	2.4	...	...
Dominican Republic	48,734	7,964	1.9	163	28.8	12,765	1,690	3.1	49	56
Netherlands Antilles	960	202	1.1	210	3.1	2,300 <sup>b</sup>	11,386 <sup>e</sup>	...	...	...

... not available

a. current prices  
b. 1995  
c. 1985-95  
e. per capita GDP

f. 1994  
g. 1993  
h. per capita GDP

1. Imports of goods and services as a % of GDP  
2. Exports of goods and services as a % of GDP

Sources: World Bank, *Atlas*, 1998; ECLAC, *Selected Statistical Indicators of Caribbean Countries*, 1996; CDB; IMF *International Financial Statistics*, Various Issues

In the Caribbean, the share of agriculture in total output has been declining for many years, though its importance in the economy should not be judged by this single statistic. Far more people are dependent on the sector than those directly employed and in some countries agriculture is a more significant net earner of foreign exchange than manufacturing. Caribbean economies have become increasingly service oriented with services accounting for more than 80 per cent of total output in many cases. The growth of tourism and financial activities in some cases has played a major part in this development (See Table 2).

In the 1960s the Anglophone Caribbean economies grew by about 4 to 5 per cent annually in real terms. Suriname and the Dominican Republic also experienced growth rates in the region of 5 per cent. A favourable international environment, stable or increasing commodity prices, aid flows, high levels of government spending and available opportunities associated with import substitution activities were the main factors behind the performance in the 1960s, and provided the basis for a great deal of the optimism in the period. Low inflation rates and low energy cost (petroleum was averaging between US\$2 and US\$3 a barrel) contributed to the favourable environment. The growth of GDP generally exceeded the population growth rate, so the growth rate of per capita GDP was positive, in some cases exceeding 2.5 per cent per year.

The 1970s with two oil shocks was a more difficult decade for the region, with some countries, such as the Bahamas and Jamaica, losing the momentum of the previous decade. While per capita real GNP grew by over 3 per cent per year in Barbados, Belize, Trinidad and Tobago, Suriname and the Dominican Republic, in Jamaica and the Bahamas it declined by an average of 2.8 and 2.9 per cent respectively between 1970 and 1980. In the OECS the performance was mixed with per capita income declining in Antigua and Barbuda, Dominica, Grenada, and Saint Vincent and the Grenadines. The dramatic increases in the price of oil benefited Trinidad and Tobago as an oil exporter, but had a disastrous effect on the balance of payments and economic performance of the oil-importing countries of the region.

Table 2

## Composition of GDP (at Current Factor Cost), 1970-1996

Countries	<u>Agriculture<sup>a</sup></u>				<u>Mining &amp; Quarrying</u>				<u>Manufacturing</u>				<u>Utilities and Other Services</u>			
	1970	1980	1990	1996	1970	1980	1990	1996	1970	1980	1990	1996	1970	1980	1990	1996
<b>OECS</b>																
Antigua & Barbuda	5	7	4	4	—	—	2	2	12	5	3	2	83	88	91	92
Dominica	32	31	25	20	—	1	1	1	6	5	7	7	62	74	63	72
Grenada	20	25	17	11	—	—	—	1	4	4	5	8	76	71	78	80
Montserrat	17	4	3	6	—	—	1	1	—	6	2	6	83	89	94	87
St. Kitts-Nevis	30	16	6	6	—	—	1	—	3	15	13	11	77	69	80	83
St. Lucia	16	12	15	9	—	1	1	1	3	9	8	7	81	78	76	83
St. Vincent	24	15	19	13	—	—	—	—	3	11	9	9	73	74	72	78
<b>Other CARICOM</b>																
Bahamas	...	...	3	4 <sup>b</sup>	...	...	—	1 <sup>b</sup>	...	...	3	3 <sup>b</sup>	...	..	94	92 <sup>b</sup>
Barbados	14	10	5	6	—	1	1	1	10	12	8	6	76	77	86	87
Belize	...	30	22	21	—	—	1	1	...	16	16	14	...	54	61	64
Guyana	19	28	43	46	20	16	10	19	12	12	9	4 <sup>c</sup>	49	44	42	31
Jamaica	7	9	7	8	13	15	9	6	13	11	19	17	67	65	73	69
Suriname	...	...	11	23 <sup>d</sup>	—	—	3	2 <sup>d</sup>	—	—	13	14 <sup>d</sup>	...	...	73	61 <sup>d</sup>
Trinidad & Tobago <sup>e</sup>	6	2	2	2	22	42	24	28	9 <sup>f</sup>	6 <sup>f</sup>	7 <sup>f</sup>	8 <sup>f</sup>	63	50	67	62

... not available

— nil or negligible

a. including forestry and fishing

b. 1995

c. excluding rice and sugar

d. 1993

e. GDP at market prices

f. excludes oil refining and petro-chemical industries

Sources: CDB; ECLAC; National Publications.

The 1980s was in some senses a defining period for Caribbean States. Some of the difficulties that reared their heads in the 1970s continued unresolved in the following decade in which some countries experienced lower growth rates while others lost gains made earlier. The differences in economic performance among States pursuing different paths to development, or at different levels of development, raised a variety of questions with respect to the efficacy of particular economic policies and strategies. In the 1980s, real GDP in the industrial countries grew by around 3 per cent per year on average as compared to 1 per cent for Sub-Saharan Africa, 8.4 per cent for East Asia and 1.6 per cent for Latin America and the Caribbean (LAC). Within the Caribbean some States far exceeded the average for the LAC region. The OECS and Belize, for example, which are regarded as weaker and more vulnerable, grew by about 5 to 6 per cent per year (See Table 3). On the other hand, in 1993 real GDP in Barbados was at the same level as that of 1980. In Suriname and Haiti, GDP hardly changed between 1980 and 1990, while in Guyana and Trinidad and Tobago it declined by 27 per cent and 32 per cent, respectively, in the period. Following the end of the oil boom, government real consumption expenditure in Trinidad and Tobago fell by 9 per cent between 1982 and 1990 but private real consumption expenditure dropped by some 47 per cent and gross capital formation by 67 per cent in the period. The shrinking of the Trinidad and Tobago market not unexpectedly had an adverse impact on activities in other CARICOM countries

In the industrial countries, real GDP per capita increased by over 2.3 per cent per year in the 1980s, as compared to 6.2 per cent for East Asia and 0.4 per cent for Latin America and the Caribbean. In Guyana real per capita GDP in 1990 was 12 per cent below that of 1980 and 26 per cent below that of 1970. In Trinidad and Tobago real per capita fell by 30 per cent between 1980 and 1990, reflecting the decline of the oil sector. In the OECS, however, real per capita GDP increased by about 4 to 5 per cent in the 1980s. In the 1990s, real GDP in the Latin American/Caribbean region has been growing by an average rate of about 3.3 per cent per year as compared to 1 per cent in the 1980s and 6 per cent in the 1970s. In terms of growth Chile and Guyana have been among the front-runners in recent years, with growth averaging over 6 per cent per year. Both in the 1980s and 1990s, Belize's growth rate has exceeded 4 per cent per year. Following the adoption of structural adjustment measures and large inflows of foreign capital, Trinidad and Tobago has returned to a positive growth path, with real per capita GDP growing by over 1 per cent per year in the 1990s. For most of the OECS countries the rate of growth has fallen in the 1990s, while Suriname, Haiti and Jamaica continue to perform poorly.



Table 3

**Growth of Real GDP,\* and Per Capita Real GDP, 1981-97  
(Percentages)**

CARICOM Countries	<u>Real GDP</u>							<u>Per Capita</u>		
	Average 1981-91	1992	1993	1994	1995	1996	1997 <sup>p</sup>	Average 1991-97	Annual Growth Rates (%) 1981-90      1991-97	
<b><u>CARICOM Countries</u></b>										
Antigua & Barbuda	6.9	1.3	5.1	6.2	-5.0	5.4	5.3	2.4	5.6	1.8
Bahamas	3.6	-2.0	1.7	0.9	0.3	3.0	...	...	...	...
Barbados	0.9	-5.7	0.8	4.0	2.5	4.9	3.0	0.7	0.7	0.3
Belize	4.9	9.5	4.3	1.5	3.8	3.5	4.5	4.3	1.9	1.6
Dominica	4.0	2.7	1.8	2.2	1.6	3.1	1.8	2.4	4.8	2.4
Grenada	5.0	1.1	-1.2	3.3	3.1	3.1	4.6	1.8	4.7	1.6
Guyana	-2.8	7.7	8.2	8.5	5.1	8.3	5.6	7.8	-3.4	6.7
Haiti	-0.7	-13.2	-2.4	-8.3	4.3	2.8	1.3	-2.4	-2.4	-4.3
Jamaica	2.5	1.5	1.4	1.1	0.5	-1.4	-2.3	0.3	1.1	-0.4
Montserrat	6.1 <sup>a</sup>	1.3	2.5	0.8	-7.6	-21.3	-20.8	-4.6 <sup>c</sup>	5.1	...
St. Kitts-Nevis	6.2	3.5	5.4	5.4	3.5	5.9	6.3	3.7	7.0	4.1
St. Lucia	7.0	7.1	0.6	2.5	1.1	-0.8	2.2	2.9	5.3	1.5
St. Vincent	6.8	6.5	-0.7	-3.0	8.2	1.3	2.2	2.5	5.5	1.6
Suriname	-0.3	5.8	-4.4	-4.2	5.2	3.0	...	1.0	-0.7	-0.2
Trinidad & Tobago	-1.7	-1.1	-2.6	5.0	3.2	2.8	2.9	2.4	-3.9	1.3
<b><u>Other Caribbean</u></b>										
Anguilla	8.9 <sup>b</sup>	7.1	7.5	7.0	-4.2	3.4	...	...	...	...
Aruba	...	4.0	5.0	5.9	5.7	3.9	...	...	...	...
Dominican Republic	2.7	8.0	3.0	4.3	4.8	7.0	7.4	4.7	0.2	2.8
Netherlands Antilles	...	5.2	-1.8	1.7	1.3	0.0	...	...	...	...
	*	at constant factor cost			b.	1986-91				
	...	not available			c.	1986-91				
	a.	1981-90			p.	provisional				

Source: ECLAC; Caribbean Development Bank ECCB.

As can be seen Table 4 per capita income in the OECS now exceeds that of Guyana and Jamaica respectively, and in the case of Antigua and Barbuda and Saint Kitts-Nevis, it is now higher than that of Trinidad and Tobago. Interestingly, in the 1960s the larger Caribbean States such as Barbados, Guyana, Jamaica and Trinidad and Tobago were deemed to have greater potential than the smaller OECS States and were to be treated as the 'More Developed Countries' in the Caribbean Community in the context of policies and measures designed to discourage polarization. Guyana is now regarded as one of the poorest countries in the Western Hemisphere. The effects of the unsatisfactory economic performances of the region's MDCs in the 1980s were felt not only in the flight of skills and capital, but also in the pace of economic integration which slowed down considerably. Of course, there is a school of thought which argues that with a higher level of integration, the region would have been better equipped to withstand the external shocks in the 1970s and 1980s.

One of the interesting phenomenon in the Caribbean is the ability of a number of very small economies, some not yet independent, to use their limited natural assets, location and fiscal systems to generate relatively high per capita incomes and employment rates. Anguilla (population 11,000), Cayman Islands (population 33,000), Turks and Caicos Islands (population 15,000), the British Virgin Islands (population 19,000) and Aruba (population 84,000) generate per capita incomes in the region of between US\$5,000 and US\$20,000. Montserrat (still a British dependency) with a population of 10,000 people enjoyed a per capita GDP of over US\$5,000 before the recent series of volcanic eruptions. The Bahamas (pop. 276,000) also enjoys a per capita GNP of over US\$10,000. Employment rates also tend to be high and some of these countries have shown remarkable resilience in recent years in recovering from depressed situations created by decisions taken outside their borders. In Aruba, following the closure of the Exxon's Lago refinery in 1985, unemployment soared to about 40 per cent. It is now estimated to be less than one per cent. These economies may never meet most of the standard criteria in terms of structural change used to define a state of development, but by encouraging the development of tourism and offshore financial activity they have been able to share in the international growth of these activities as traditional sources of income have faded.

Table 4

## Growth of Per Capita GNP, 1970-96

Countries	Nominal Per Capita GNP (US\$)						Average Annual Growth Rate of Real Per Capita GNP (%)			
	1970	1980	1985	1990	1995	1996	1970-80	1980-90	1985-95	1970-95
<b>CARICOM Countries</b>										
Antigua & Barbuda	370	1,380	2,030	4,600	7,690 <sup>a</sup>	7,330	1.7	4.7	2.7	4.9
Bahamas	2,300	3,450	7,150	11,510	11,940	...	-2.9	1.7	-1.0	1.7
Barbados	570	3,270	4,680	6,540	6,560	...	3.2	1.4	-0.2	1.9
Belize	590	980	1,130	1,970	2,630	2,700	4.8	2.5	4.4	3.9
Dominica	280	640	1,160	1,940	2,990	3,090	-3.1	3.0	4.0	2.5
Grenada	300	780	970	2,120	2,980	2,880	-0.6	5.1	6.6	...
Guyana	370	690	570	370	590	690	1.1	-3.2	0.8	-2.6
Haiti	110	280	350	370	250	310	1.8	-2.3	-5.2	-1.3
Jamaica	670	1,090	940	1,510	1,510	1,600	-2.8	-0.4	3.7	-0.8
Montserrat	...	2,107 <sup>b</sup>	3,083 <sup>b</sup>	5,730 <sup>c</sup>	5,840 <sup>c</sup>	...	...	...	...	...
St. Kitts-Nevis	320	960	1,520	3,330	5,170	5,870	1.7	6.0	4.6	5.2
St. Lucia	340	890	1,210	1,904	3,370	3,500	3.0	4.2	3.9	...
St. Vincent	240	540	840	1,610	2,280	2,370	-1.0	5.7	3.9	3.7
Suriname	530	2,770	2,570	3,050	880	1,000	6.8	-5.0	0.7	4.3
Trinidad & Tobago	860	5,010	6,010	3,470	3,770	3,870	3.9	6.0	-1.6	-0.1
<b>Other Caribbean Countries</b>										
Dominican Republic	350	1,190	810	820	1,460	1,600	3.3	-0.4	2.1	...

- ... not available  
a. estimated  
b. per capita GDP,  
c. per capita GDP,

Source: World Bank *Atlas*, Various Issues and *World Development Indicators*, Various Issues.

Recent economic performance and the relatively high per capita income associated with some Caribbean States should not lead to an under-estimation of the weaknesses and the degree of vulnerability from which these economies suffer. Periods of boom tend to alternate with periods of recessions. Volatility is the norm. Gains made in one period can be quickly lost in economic downturns triggered by domestic factors or external shocks. A boom in commodity prices, capital inflows and the growth of resource-based sectors such as tourism are among the leading factors which were behind the up-swing phases in recent years. Foreign exchange is the fuel that drives these economies, and by expanding import capacity, foreign earnings make possible a higher level of spending, and can lead to a temporary increase in welfare. Because of the high propensity to consume and import, a higher level of foreign earnings does not necessarily translate into a faster rate of domestic capital formation. In Caribbean societies with their democratic political arrangements, domestic policies tend to be highly responsive to populist pressures, and the enhanced capacity associated with phases of economic expansion can easily be dissipated in higher levels of consumption, or misdirected project selection and planning. The inability to sustain reasonable growth performances over long periods is not unrelated to modest savings rates and the failure to effect structural change resulting in greater economic resilience and more optimal use of resources.

Many questions in economic theory are analysed without reference to size, the assumption being that size does not matter. The exceptional performance of small countries like Hong Kong (6.3 million people), Mauritius (1.2 million people) and Singapore (3.0 million people) in recent years have raised doubts about whether size is a serious obstacle to development. Size, of course, does carry with it certain constraints in terms of resource availability and market potential. A small population goes hand in hand with a small Gross National Product and a narrow range of skills. A small home market is often a disincentive to large scale industries which require long production runs to reach optimum size and enjoy increasing returns to scale. Diseconomies of scale are associated with high unit costs of infrastructure, investment and production. Besides this structural disadvantage, small island economies, like those in the Caribbean, are exposed to the devastating effects of storms and floods against which there is little or no defense. Agriculture is particularly vulnerable. A limited supply of good agricultural land can also influence what is produced and the cost of production. The scope for mechanisation may be limited. Size and location are often seen as mixed blessings for Caribbean states, most of which are micro-island states. On the one hand, major improvements in living standards do not require massive investment or enormous export marketing opportunities. The "Caribbean's close economic and communications links with Europe and North America and the large expatriate communities there could provide the necessary resources and market niches for goods and service exports."<sup>3</sup> On the other hand, proximity to North America makes it easy for financial and human capital to migrate. Location between South and North America also attracts criminal activities, drugs and money laundering on a scale that puts the meagre resources of these governments under severe strain.<sup>4</sup>

Developments in technology affecting transport and communication and the lowering of protective trade barriers by most countries are altering the constraints of location and natural resource endowments. Policies are now recognized to have critical value. Notwithstanding the breakthroughs in technology and the effects of globalization, size can have an economic downside, since small economies will have great difficulty generating the volume of savings

necessary to finance the desired scale of investment. Some very small countries do not even have the space for a modern airport. Because of the size of the airport and the volume of traffic, they are bypassed by major airlines. Even national governments that try to fill the gap have difficulty maintaining viable airlines which in most cases have to be subsidized to stay in operation. Tourism is such a vital industry to the region that recently certain Caribbean governments were requested to provide subsidies to a foreign airline to continue operating its services to those countries.<sup>5</sup>

Economic and financial management in small open economies raises additional problems. Because of the nature of the products exported and special marketing arrangements, devaluation of the national currency to stimulate exports is not likely to have a great effect on demand. The heavy dependence on imported goods, too, limits the scope for expansionary fiscal policy. Narrow money and capital markets distort the savings/investment process and the situation is often compounded by regulations influencing competition among financial institutions and portfolio composition. In situations where a narrow range of financial securities exists, the pressure for savings to move abroad is strong. A high level of domestic savings does not necessarily lead to a high level of domestic investment. But there can also be another anomaly in that while domestic savings are flowing abroad, a country can become increasingly dependent on foreign savings to finance development.

Against this background the following section highlights some of the salient points in ECLAC's "The Fiscal Covenant". This is followed by a discussion on the role of the state and the fiscal challenge in the Caribbean.

## **2. ECLAC: The Fiscal Covenant – Strength, Weaknesses and Challenges**

Critical assessments of poverty in many countries in recent years have come to see the State as a major part of the problem, both in authoritarian and democratic systems. Experience has shown that neither form of government assures transparency, accountability, efficiency or broad based popular participation. Policies in themselves may not be bad, but are often made ineffective by incompetence, inefficiency, corruption, outdated laws and regulations, deficient institutions and weak governance and enforcement. The failure of the State in its developmental role in many countries has many interpretations, but there is a growing body of thought that democracy and development can be mutually reinforcing. The search is for a new kind of development State (or paradigm) where the State not only concentrates on activities it is in the best position to undertake, but operates with greater transparency and accountability while encouraging broader participation in decision-making and in the development process. In this context, concepts like 'social capital' which recognizes communities' traditions and knowledge as assets are gaining increased popularity.

There are differences between Latin America and the Caribbean in terms of country size, tradition, political systems, laws, military spending, experience with inflation, social security arrangements, fiscal performance and so on, but many of the social and fiscal concerns being raised in Latin America also have relevance in the Caribbean. Poorly functioning tax systems, tax avoidance, the growing dependence on indirect taxes in some cases, inefficient spending, the

implications of quasi-fiscal measures for the budget, lack of adequate transparency and social inequities have raised concerns in various territories in different degrees.

'The Fiscal Covenant' is the latest in the series of ECLAC's documents bearing on the theme "changing production patterns with social equity." The underlying premise of the study is that the State is a critical agency in promoting change and social equity, and how effectively it does this depends on the efficient and skilful practice of public finance and prudent fiscal management. Implicit in the study is the view that in the same way that a State can use public instruments to promote particular objectives, improper or incompetent use, consciously or unconsciously, can lead to resource wastage, create inefficiencies and hinder development. The budget is a powerful tool in influencing the directions for social and economic reforms.

States exist in a dynamic setting and new challenges arise every day. The study notes, for example, that liberalization and globalization "have tended to reduce the autonomy of national authorities in making and carrying out decisions, particularly in the realms of domestic economic policy" (p.6). Changes in world trading rules are bound to impact on the way States behave. Participation in regional integration agreements has implications not only for level of protection afforded domestic industries, but also for customs revenue as tariffs are reduced or eliminated. This has been a major dilemma faced by the small Caribbean States heavily dependent on import duties for public revenue. A few of them (e.g. the Bahamas) have low or no income taxes and depend on indirect fiscal measures. Table 5 shows the downward movements in CARICOM's Common External Tariff (CET) which was to be introduced in four phases, the last being implemented at the beginning of 1998. Most countries did not meet this deadline, while a few are yet to comply with the requirements of the third phase out of concern for the effects on revenue and the level of protection afforded domestic industries.

Pressures on the State have also come from international trends to which countries must adapt. "Globalization has accentuated the integration and inter-dependence of markets, imposing a certain discipline on macro-economic policy and public finance in response to the increased mobility of short term financial capital" (p.6). Caribbean States generally have not been affected by the movement of short term capital, but access to external markets have become increasingly contingent on opening up of their own economies to a greater extent. Under the emerging trade order, special preferences to which they have been traditionally accustomed are coming under scrutiny and are being phased out. Reciprocity in trade relations is a challenge which Caribbean countries will have to confront sooner rather than later. Unfortunately, in this move towards more open trade policies, both at the regional and international levels, the production base in Caribbean countries is still weak and underdeveloped, and new ways other than unqualified protection will have to be designed to encourage the production of goods and services that can compete internationally, both in terms of quality and price. Time is an important consideration, and this challenge has to be treated with a greater sense of urgency.

**Table 5**  
**CARICOM-Common External Tariff Rates**

CATEGORIES	1-1-1993 to 31-12-1994	1-1-1995 to 31-12-1996	1-1-1997 to 31-12-1997	1-1-1998
Agricultural Inputs	0	0	0	0
Non-competing primary inputs	5 (LDCs 0-5)	5 (LDCs 0-5)	5 (LDCs 0-5)	5 (LDCs 0-5)
Non-competing intermediate inputs	"	"	"	"
Non-competing capital inputs	"	"	"	"
Competing primary inputs	20	15	10	10
Competing capital goods	"	"	"	"
Selected imports	"	"	"	"
Competing intermediate inputs	25	20	15	15
Non-competing final goods	25	25-30	20-25	20
Agro-industry	30-35	25-30	20-25	20
Garments	"	"	"	"
General manufactures	"	"	"	"
Agriculture	40	40	40	40
LIST A	Suspended rates	Suspended rates	-	-
LIST B	Suspended Rates LDCs	Suspended rates LDCs	-	-
LIST C	Minimum rates	Minimum rates	Minimum rates	Minimum rates
LIST D Parts I and III	Suspended Rates LDCs	Suspended rates LDC	-	-
Safety	0	0	-	-
<b>Period of application</b>	<b>Period of Implementation</b>		<b>Rate structure</b>	
1.1.93-31.12.94	1.1.93-30.6.93		0-5 to 30/35%	
1.1.95-31.12.96	1.1.95-30.6.95		0-5% to 25/30%	
<b>1.1.97 - 31.12.97</b>	<b>1.1.97 - 30.6.97</b>		<b>0-5% to 20/25%</b>	
1.1.98 - Onwards	1.1.98-30-6-98		0-5% to 20%	

Given the effect which technology has had on communication, transportation and the location of production, the need to attract private foreign capital will have to take account of incentives and assurances offered elsewhere. In a competitive setting, a modern and efficient infrastructure is of critical importance. The tax regime and a responsive bureaucracy also influence investment. While compelled to respond to the pressures to expand incomes and output, the state also has to be concerned about its social responsibilities. Grants have been declining in the Caribbean, and a buoyant economy is essential to the growth of public revenues. The modern State has to encourage growth while being conscious of the need for equity, social justice and protection of the environment. Tax systems have to be structured so that public revenue can be responsive to the growth in output, or the State will be unable to meet its many obligations. In light of the growing demands on the State many countries are introducing market and quasi-market arrangements in the provision of infrastructure, utility services and even in social services such as social security, health and education. In Trinidad and Tobago, for example, private sector participation exists in telecommunications, water and electricity services and is also being introduced in the postal services. The modern State also has to pay serious attention to institutional issues related to moral hazards, corporate governance, bankruptcy laws and prudential regulations affecting both the financial and corporate sectors.<sup>6</sup> Not only has the recent experience in Asia underlined the significance of this aspect of the state's responsibility, but the collapse of the financial sector in Jamaica has shown how costly absence of an adequate regulatory framework can be. "During the last three years six commercial banks accounting for about sixty per cent of deposits in commercial banks, five life insurance companies accounting for over ninety per cent of premium income in the business, one-third of all merchant banks and some building societies have been rescued from insolvency by the injection of government support to recapitalize them." Further, the "central bank had to provide about J\$18 billion of special support to commercial banks in order to help them to meet withdrawals by depositors..."<sup>7</sup>

Tax regimes and tax performance varies widely across the region. In Latin America the tax take ranges between 10 per cent and 20 per cent of GDP. In the Caribbean the ratio is higher. In the ECCB area<sup>8</sup> the average is about 25 per cent, though in certain countries (e.g. Saint Kitts-Nevis and Antigua and Barbuda) it is around 16-18 per cent. In Barbados the ratio is nearer 30 per cent. In Guyana it is over 30 per cent. There are indications that the tax ratio has fallen a few percentage points in the mid-1990s compared to the 1980s. In these small countries, tax revenues are strongly correlated with export earnings and fluctuations in commodity prices or tourism earnings are quickly reflected in the level of public revenue and expenditure. Depressed commodity prices in the 1970s and increases in the price of oil were important contributory factors in the growth of the public debt, as governments tried to maintain the level of public expenditure.

Since the early 1980s, the State in the Caribbean has been blamed for many of the problems in which some countries find themselves, and it was widely accepted in the early days of structural adjustment that a reduced role for the State was necessary in restoring fiscal integrity and promoting growth. Great faith was placed in the magic of the market in resolving almost all problems. With experience, there has been a retreat from that extreme position. There is still a great deal of contention, however, over what the role of the State should be, and over what it should do, or not do. What is now more readily accepted is that the issue is not more State or less State, but a more effective State. And for a State to be effective it has to be a



capable State. A capable State is a *sine qua non* if markets are to operate effectively and efficiently.<sup>9</sup> Minimizing the State and reducing government action is one thing. How to improve public sector capacity remains the greater challenge.<sup>10</sup> Some actions taken to restore fiscal balance have in fact weakened the State in the Caribbean, as a result of the loss of professional skills, poor maintenance of infrastructure and demoralization of the work force.

In trying to capture the complex tasks facing modern governments, the authors of the Covenant define the 'Fiscal Covenant' as the "socio-political agreement that legitimizes the role of the State and establishes the areas and scope of government responsibility in the economic and social spheres (p.7). It is recognized, however, that there is no general agreement or consensus on what the State's role should or should not be, or on the extent of resources it should manage. This may well depend on the circumstances of individual countries. The 'Covenant' is seen to contain five basic aspects: consolidating the on-going fiscal adjustment process, raising the productivity of public management, making fiscal activity more transparent, promoting social equity and encouraging the development of democratic institutions. No order of priority is indicated, but on the face of it, States that have experienced financial crises or are in the process of undertaking policy reforms, should have little difficulty recognizing the significance of these challenges in a competitive market-oriented setting. While the State is being forced to retreat from direct production of goods and services, it retains a primary responsibility for creating conditions that can generate growth and create income. An efficient State must be seen as a critical means of achieving developmental objectives.

The report notes that since the early 1980s, there have been improvements in the public finances, and this has contributed to macroeconomic stability and growth in the region. Fiscal deficits have been reduced and the public debt is better managed even though it has not gone away. It also points out that not all the fiscal problems have been resolved and some targets (equilibrium) have been reached at great social costs. "Social equity goals, for example, generally received short shrift during the 1980s in the design of the tax structure and the composition of public expenditure". The report argues that "at any given point in the life of a nation there is a certain minimum level of equity that the society is responsible for ensuring" (p. 7). What it should have emphasized a little more is that this is not simply a moral or ethical issue. A society with a highly unequal distribution of income or wealth is more prone to crime and social instability which could undermine investment and growth than one where the mass of population shares in the gains from economic growth.

The tendency of some citizens to evade or avoid paying taxes touches a whole range of issues including corruption, the level of tax revenues, and the capability of the tax administration. "Tax evasion is a major cause of horizontal and vertical inequity, creating a much greater effective tax burden for those who comply with their obligations". In order to widen the tax base and facilitate tax collection, consumption and/or value added taxes have been introduced in several countries of the region. Taxing the self-employed has been a challenging issue in the Caribbean. These taxes have been intended more to raise revenues than to dampen demand. "The tendency to abandon direct taxes as a means of revenue, has, however, been carried out somewhat too far in Latin America. In OECD countries, for example, 65 per cent of tax receipts come from direct taxes (four fifths of that from personal income tax) while in Latin America direct taxes account for only 25 per cent of tax receipts (most of that from corporate income taxes)". The Caribbean fits somewhere between these two extremes. In Barbados, direct

taxes accounted for 43 per cent of tax revenue in 1995 and 1996 respectively, but with the introduction of Value-Added Tax (VAT) in 1997, the proportion is estimated to have fallen to 38 per cent, of which 18 per cent came from personal income taxes and 11 per cent from corporate taxes. In Trinidad and Tobago where the oil sector makes a substantial contribution to the tax take, direct taxes contribute over 60 per cent to tax revenue. Even if the oil sector is excluded the direct proportion still amounts to over 40 per cent. In this country the contribution of personal income taxes to total tax revenues also exceeds that of corporation taxes levied on the non-oil sector.

In the ECCB area the composition is closer to the Latin American position with direct taxes contributing around 24 per cent to tax revenue as compared to 18 per cent for tax on domestic goods and services and close to 60 per cent for taxes on international trade and transactions.

The 'Fiscal Covenant' pays a great deal of attention to fiscal transparency and its implication for revenue adequacy, the distribution of income and the tax burden. What governments can do depends critically on the level of revenue. "Tax evasion, tax avoidance and tax expenditure continue to be weak points in revenue collection." This has been a concern in several Caribbean countries even with the introduction of a VAT and the tendency has been to simplify the tax system and reduce the tax rates in order to encourage greater voluntary compliance. With respect to quasi-fiscal operations the Report makes a very significant observation that has not received a great deal of attention in the region. "National budgets fail to fully recognize certain government activities which have effects analogous to the collection of taxes or the granting of subsidies, yet are not subject to debate or approval by the legislature" (p.28). These include the replacement of explicit subsidies by concessions, lines of credit on easy terms or foreign exchange subsidies. The selling of a natural resource (e.g. natural gas in Trinidad and Tobago) at a subsidized rate to attract foreign investment would also fall in this category. Over the years, governments in the Caribbean have granted a range of fiscal incentives such as tax holidays, exemption from import duties on raw materials and equipment, accelerated depreciation allowances, etc. without really being certain about the need for or efficacy of these measures. Often they were granted because other countries were doing so.

Through the tax system and the provision of subsidies, Caribbean governments have attempted to make available to the lower income groups a range of goods and services below market cost. These have included food products, drugs, and utility services. The rich also benefited from these services. The Report makes the point that in Latin America the higher income groups are benefiting more from social expenditure. Some forms of expenditure (e.g. health care and primary education) benefit the poor more than the rich. Spending on social security and higher education tends to be regressive. Spending on housing falls somewhere in between. Redistributing income through subsidies is clearly not a straight-forward issue and how to design programmes to help the poor without benefiting the rich also remains a challenge in the Caribbean.

Following the adoption of structural adjustment programmes in the 1980s, falling real expenditure and increasing poverty have been a cause for concern. The Report notes that the 1980s were notable for a sharp reduction in social investment. "The decrease in the proportion of GDP devoted to social expenditure coupled with a decline in per capita income, led to a 24 per

cent drop in per capita social expenditure in Latin America. During the 1990s both these indicators have moved upwards; by 1995 per capita social expenditure in Latin America was already 18 per cent higher than in the early 1980s. It should be noted that the Caribbean has not shared in this positive trend in social expenditure; there such spending has fluctuated at around 9-11 per cent of GDP since 1987, with the trend being slightly downward and per capita spending has continued to drop". The report cautioned, however, that the situation varied from country to country, and that a very substantial portion of the growth in social expenditure goes to social security, and specifically to pension payments, which is the component with the least progressive distribution.

In making these conclusions, there is obviously a great deal of generalization, and one has to be careful about the policy recommendations that flow from them. Despite the improved performances of some Caribbean countries in the 1990s, the governments are understandably reluctant to use these as a basis for increasing current spending, given the highly volatile nature of these economies noted earlier. In Guyana real GDP in the mid-1990s was still at the level of the early 1970s. In Jamaica the situation was not much different. In Trinidad and Tobago real GDP in 1996 was almost at the same level as that of 1982. Having said this, however, it is worth noting, as the Report has, that average social spending in the Caribbean remains higher than that of Latin America and one might add even a large number of other developing countries. Data on social spending are not readily available for all the countries of the subregion, but the limited information suggests that the trends are not all in the same direction. In Trinidad and Tobago, for example, social expenditure as a per cent of GDP has been falling and now amounts to around 7 to 8 per cent of GDP. In Barbados, on the other hand, the social expenditure/GDP ratio has increased from less than 13 per cent in the early 1980s to over 14 per cent in the mid-1990s. In this country, per capita social expenditure has also been increasing. The real challenge facing the Caribbean, as will be argued later, is not so much increasing the level of social spending, but improving the productivity of this expenditure.

The observation on social security made in the Report also needs to be put in perspective. In both Trinidad and Tobago and Barbados pension and gratuities account for less than 20 per cent of social expenditures. From the information available in the report, most Latin American countries appear to be way ahead of the Caribbean in terms of reforms of pension schemes and the share of social security contributions in government revenue.

### **3. The Caribbean State and the fiscal challenge**

#### The role and growth of the State in Caribbean countries

There are certain functions that are expected of the State in every society. States, however, differ in terms of size, economic philosophy and their role in the economy. These factors help to determine how the economy operates, the depth of government involvement in the productive sectors and the extent of social and other services provided. The States in the Caribbean have come to see themselves as not only providing certain public goods, but as instigators of development, as entrepreneurs, as income redistributors and as providers of welfare. The theoretical thinking in the 1950s and 1960s encouraged the view that in the face of market failure and an undeveloped private sector the State needs to become an active agency of

change. Through controls, incentives and regulations, the economy could easily be engineered along prescribed paths and fiscal policy could address equity concerns. As developing countries are dependent on a few export commodities, instability was generally externally generated, and governments needed to be more concerned with economic transformation than with fiscal fine-tuning. The failure of the private sector to respond to many of the incentives provided encouraged the State to become more deeply involved in the economy. The democratic form of government and the competitive political systems have helped to shape the social role of the State as it feels compelled to respond to populist demands which often fail to recognize the constraints revenue imposes.

The challenge to the role of the State as the engine of growth and the pressures to rethink the scope of its functions and the way it provides certain services, have come from several sources, both internal and external. The failure of the import substitution strategy to diversify production structure, to generate the desired number of jobs and to create a more export oriented and competitive economy has been a major factor. With inadequate growth rates, the expansion of government revenues could not match the pressures to expand expenditure, given the level and quality of the services populations had come to expect from the State. The capacity of the State to provide free or highly subsidized services was seriously constrained by the performance of the economy and the inefficiencies which had crept into the system. With the private sector unable to create jobs to satisfy the increasing demand, governments often found themselves employing for employment sake, and wages and salaries began to command an increasing share of recurrent revenue. The close relationship between political parties and trade unions in some countries has not made it easy for governments to resist demands for higher remuneration. In most countries of the region unemployment remains at unsatisfactory levels (See Table 6), and the growth of the informal sector reflects the inability of the formal sector to accommodate the growing labour force. Even persons who have received formal training are having difficulty finding employment, and the shortages of certain kinds of skills in this situation have raised critical questions about the content and direction of educational programmes. The growth of the drug trade in the region has brought public policy even under more intense scrutiny.

**Table 6****Un-employment Trends, 1980-96**

Countries	1980	1985	1990	1991	1992	1993	1994	1995	1996	1997
<b><u>Selected</u></b>										
	<b><i>CARICOM Countries</i></b>									
Antigua & Barbuda	20.5	...	6.8	7.6	7.8	6.7	7.4	...	...	...
Bahamas	16.6	12.2	12.0	12.3	14.8	13.1	13.3	11.1	12.0	...
Barbados	11.4	18.7	15.0	16.0	23.0	24.3	21.9	19.6	15.8	14.6
Belize	..	15.1	14.8	13.8	11.9	9.8	11.1	12.5	13.8	...
Jamaica	27.3	25.0	16.0	16.0	15.4	16.3	15.4	16.2	16.2	...
Montserrat	5.4	5.3	1.0	6.0	9.0	10.0	8.3	...	...	...
Suriname	...	...	16.0	...	17.2	16.0	...	...	...	...
Trinidad & Tobago	8.7	15.3	20.0	19.0	19.7	19.8	18.4	17.2	16.3	15.3
<b><u>Other Caribbean Countries</u></b>										
Aruba	...	...	...	...	0.6	0.5	0.5	0.7	0.6	...
Dominican Republic	...	...	19.0	19.0	20.0	21.0	16.0	16.0	17.0	...
Netherlands Antilles	...	...	...	14.6	13.9	13.6	12.8	13.1	...	...

... not available

Sources: *IDB; CDB; ECLAC.*

Besides the issues that have been raised about development policies, the State as an institution has in many instances become unwieldy and ineffective. The expansion of the State enterprises sector in some cases placed severe pressure on management capacity, and with governments unable to attract persons with the desired skills at prevailing levels of wages and salaries, the problem grew increasingly acute. Systems of delivery were rarely reviewed and the returns on public expenditure have generally been falling, as more and more is being spent to achieve a given level of service. Lack of improvement in the working environment and outdated or inadequate tools and equipment have contributed to a high level of demoralization in the public service. Forced reduction in the level of employment may have mitigated the financial problem, but the public sectors have become less capable and need to be rationalized and put on a more productive basis.

Besides the fiscal problems, the problems affecting exports have reduced the import capacity of these countries which are dependent on foreign sources for food, raw materials, energy, capital equipment and a range of consumer goods. The servicing of the foreign debt brought additional pressures with the contraction of foreign exchange earnings. Some governments turned to the international financial institutions for assistance and implemented structural adjustment programmes in which they have committed themselves to streamlining the role of the public sector, encouraging private sector activity, adopting more open policies toward foreign investment and instituting market principles. A range of subsidies have been reduced or removed and utility rates are being brought nearer to the cost of production. There are many contentious issues surrounding the role of the State in a development context, but an emerging view is that a more capable and effective State is still a *sine qua non* for development in the context of a more open and competitive world economy.

Table 7 gives some indication of the size of the State (the Central Government) in Caribbean economies, using various measures. The contribution of government services to GDP varies widely, but is generally less than 20 per cent. In the cases of Guyana and Grenada, the contribution dropped from over 20 per cent in the early 1980s to less than 10 per cent in recent years. The governments' size in terms of final consumption in total expenditure on output seems to have come down in most cases from the early 1980s and varies between 15 and 20 per cent. If we use the criterion of total expenditure to GDP ratio, there is great fluctuation from year to year because of variation in the size of the capital budget. Experience has shown that when current revenues fail to expand, the capital budget is often the first to suffer. It is difficult to roll back recurrent expenditure without incurring deep social disaffection. In the mid-1990s, the total expenditure ratio has generally been over 30 per cent. When the public enterprises are included in the statistics, the State sector may assume a much more significant and larger role than these figures in Table 7 would seem to suggest.

**Table 7**  
**Government Services and Total Central Government Expenditure in Relation to GDP**  
**(As a % of GDP)**

Countries	<u>Government Services</u>			<u>Government Final Consumption Expenditure</u>			<u>Total Expenditure<sup>c</sup></u>		
	1983	1990	1996	1983	1990	1996	1983	1990	1996
<b><u>ECCB Area</u></b>	<b><u>18.2</u></b>	<b><u>16.2</u></b>	<b><u>17.0</u></b>	<b><u>20.6</u></b>	<b><u>17.8</u></b>	<b><u>19.6</u></b>	<b><u>38.6</u></b>	<b><u>28.7</u></b>	<b><u>28.0</u></b>
Anguilla	...	12.7	14.6	...	...	...	...	30.2	29.5
Antigua & Barbuda	16.7	18.0	17.8	19.1	17.5	21.0	...	26.8	26.8
Dominica	22.5	18.2	18.8	24.2	20.5	20.9 <sup>b</sup>	62.0	57.2	43.9
Grenada	20.5	21.1	7.0	22.1	21.6	19.2 <sup>b</sup>	81.4	46.3	35.8 <sup>a</sup>
Montserrat	15.6	13.6	20.7	...	...	...	31.5	34.2	39.5 <sup>a</sup>
St. Kitts-Nevis	21.9	17.0	18.2	23.4	19.2	17.4	51.2	30.0	41.4
St. Lucia	21.0	14.6	14.3	28.2	...	...	33.1	30.0	31.7
St. Vincent	18.7	15.7	17.3	22.8	18.0	25.8 <sup>a</sup>	38.2	41.3	33.0
<b><u>Other Countries</u></b>									
Bahamas	...	15.0	17.6 <sup>a</sup>	17.0	13.0	15.4 <sup>b</sup>	32.3	22.0	28.2 <sup>a</sup>
Barbados	13.9	18.5	17.7	16.4	20.2	20.2 <sup>a</sup>	32.3	40.4	45.4
Belize	13.1	11.5	12.4	20.9	14.4	16.0	39.0	33.0	32.0
Guyana	21.2	8.5	8.8	33.2	13.6	15.0 <sup>b</sup>	88.7	70.0	40.0
Jamaica	14.2	8.1	11.4	20.1	14.0	14.5	48.0	30.9	34.8
Trinidad & Tobago	13.5	10.6	8.8	20.9	16.2	16.0	47.0	27.4	26.7

... not available

a. 1995

b. 1994

c. includes 'net lending'.

Sources: Caribbean Development Bank; Official Publications.

## Box 1

### The State Enterprises Sector

The size of the State enterprises sector varies from country to country. At the time of independence in 1966, the major sectors in the Guyanese economy, such as bauxite and sugar, were controlled by foreign interests, with local private sector engaged in local trading and distribution, agriculture and small-scale manufacturing.<sup>11</sup> Starting in the early 1970s a process of nationalization significantly expanded State ownership in the economy to the point where by the early 1980s the State had become the major employer and was controlling over 90 per cent of the official import and export trade.<sup>12</sup> In 1980 employment in the public sector numbered almost 100,000 persons, with 58 per cent in enterprises owned by the State and 42 per cent in the central government. In the case of Trinidad and Tobago, it is estimated that by the early 1980s the State was associated with some 67 enterprises, 35 of which were wholly-owned, 14 majority-owned, while it exercised minority ownership in 17 others and was an equal partner in another. These enterprises were to be found in every field, including manufacturing, services, air and sea transport, telecommunications, broadcasting and television.<sup>13</sup> In 1995 the State enterprises sector contributed almost 15 per cent of GDP. "Taken as a whole the sector reveals no common financial, economic The size of the State enterprises sector varies from country to country. At micro or strategic organizing principle and the companies display no common factor or group of factors which have determined their status.."<sup>14</sup> In the case of Jamaica, it was estimated that by the late 1970s, the State owned more than 200 enterprises not counting a number of statutory bodies and government agencies. The activities of these enterprises spanned a broad spectrum, ranging from financial services and commodity trading to the production of meat, vegetables, garments, shoes and furniture.<sup>15</sup> It was estimated that these enterprises accounted for some 20 per cent of GDP.<sup>16</sup> Under the People's Revolutionary Government (PRG) that governed Grenada between 1979 and 1983, the number of State enterprises increased to 32 by 1982, and were to be found in all major areas of the economy including agro-industries, hotels, transport, electricity, banks, marketing and the utilities.

The expansion of the State sector in the Anglophone Caribbean accelerated following the attainment of independence in the early 1960s, and the process continued until the early 1980s when the fiscal difficulties became more acute. The motives behind the growth of State involvement were mixed. In the case of the public utilities the large investments required for improvements and the need to provide social services at an affordable cost (even if it meant providing subsidies) were guiding factors. Within a mixed-economy framework of development, the efficient provision of infrastructural services was seen as a critical incentive in helping the private sector to grow and develop. Following the attainment of political independence, there was an increasingly widespread view that independence would be meaningless if key decisions affecting the economy



continued to remain in foreign hands. Thus, taking control of the 'commanding heights' of the economy was not only seen as helping the development and planning process, but as a means of reinforcing political autonomy and self-reliance. In this context, the policy towards private foreign capital became highly selective, if not downright ambiguous, despite recognition of a role for foreign savings. In some cases the State stepped in where the local private sector was not interested because of the size of the capital required, or simply to save jobs. Some enterprises acquired were already losing concerns when the State acquired ownership or control. In other cases, poor management and neglect turned profit making companies into State liabilities. Where the profits made by some State companies were overwhelmed by losses made by others, this increased the pressure on the finances of the central government.

Because of the severe difficulties facing the public finance in a number of countries downsizing of the central government and reduction of the State enterprises sector have become major elements in stabilization and structural adjustment programmes. Privatization has not proceeded along the same lines in all countries of the region. In enterprises where the government still wishes to maintain substantial ownership control, management has been privatized, or a majority interest retained. In an effort to retreat from areas which are thought to properly belong in the private domain, the State in certain cases acted with great haste, opting to shed both profit-making and loss making enterprises without a well thought out policy of divestiture. Not all privatization exercises have turned out well, and where government is still involved in the enterprises the potential liability may have increased.

A tax system plays several roles in an economy. It can be used to allocate resources and provide incentives to develop depressed areas or encourage certain types of activities. It can also be used as a device in stabilization efforts and as a redistributive mechanism to assist lower income groups. Its main function, however, is to raise revenue for the government to carry out its various functions, but this objective always has to be balanced by concerns over the effect on effort and investment. There are limits to which a government can withdraw resources from the economy without affecting growth and development.

Since governments are always being called upon to provide more and better quality services, a desirable feature of a tax system is one where the marginal rate of tax exceeds the average rate, so that as incomes rise tax revenues rise proportionately faster and thus the average rate would also rise. Such a system is described in the literature as an elastic one. A system where the tax revenue rise proportionately slower than income (i.e. the marginal rate is less than the average rate) is described as inelastic and the average rate falls over time. Equality between the marginal and average tax rates results in a situation of 'unitary elasticity' i.e. tax revenues rise proportionately to income.

An examination of Table 8 shows that since the early 1980s the ratio of tax revenue to GDP in the ECCB area has tended to fall slightly to around 24 per cent. For the period 1983 to 1987 the buoyancy coefficient (which is used as a measure of elasticity in this case)<sup>17</sup> was less than one, though in some years in the longer period it exceeded one. In the case of the larger countries, the tax ratio in Barbados and Guyana is nearer 30 per cent, and in the former it seems to have increased since the early 1980s (See Table 9). It also seems to have increased slightly in Jamaica, but fell significantly in the case of Trinidad and Tobago, no doubt reflecting the decline in oil revenues. The buoyancy coefficients seem to indicate that the Barbados tax system is more elastic than that of Guyana, Jamaica and Trinidad and Tobago respectively.

**Table 8**  
**ECCB Area<sup>1</sup>: Revenue and Expenditure as a % of GDP**  
**(at Current Factor Cost), 1983-97.**

Year	Current Revenue	Current Expenditure	Tax Revenue	Capital Expenditure and Net Lending	Buoyancy Coefficient <sup>2</sup> (Tax Revenue)
1983	31.41	33.66	25.49	11.6	—
84	30.51	31.01	25.26	8.6	0.92
85	30.44	29.57	25.73	8.7	1.17
86	29.88	27.33	25.00	10.2	0.80
87	25.80	23.91	21.62	4.8	-0.22
88	28.65	25.44	24.54	9.2	2.04
89	28.80	34.50	25.00	8.9	1.18
90	28.92	26.14	24.84	8.1	0.92
91.	28.60	26.34	24.73	7.1	0.92
92	28.73	25.78	24.06	7.0	0.60
93	28.93	25.45	24.32	7.7	1.28
94	28.47	25.68	24.05	7.2	0.83
95	28.17	26.09	24.11	6.6	1.05
96	29.57	27.13	25.24	6.2	2.02
97	29.03	27.60	24.93	6.4	0.70
1983-97					0.97

1. Members of the Eastern Caribbean Central Bank (ECCB) Area are: Anguilla, Antigua and Barbuda, Dominica, Grenada, Montserrat, St.Kitts-Nevis, St. Lucia and St. Vincent and the Grenadines.

2. Author's estimate

Source: ECCB, *Annual Statistics Digest*, 1998.

**Table 9**

**Selected CARICOM Countries: Revenue and Expenditure as % of GDP, 1982-83<sup>a</sup> to 1996-97<sup>a</sup>**

	Current Revenue		As a % of GDP Current Expenditure		Tax Revenue		Capital Expenditure		Buoyancy Coefficient (Tax Revenue)	
	1982-83	1996-97	1982-83	1996-97	1982-83	1996-97	1982-83	1996-97	1983-90	1990-97
Barbados	25.2	31.5	23.5	28.4	23.4	29.0	6.0	5.2	1.2	1.2
Guyana	37.2	33.7	61.2	25.8	31.7	31.4	34.3	15.7	0.9	0.9
Jamaica	27.0	28.0	33.4	29.0	23.5	25.0	14.0	6.0	1.1	0.9
Trinidad & Tobago	36.0	26.5	32.4	25.1	29.6	24.1	15.6	2.2	0.8	1.0

- a. average for the period  
b. 1991-96.

Source: Official Publications.

Until the 1980s Caribbean tax systems grew increasingly complicated as governments effected arbitrary and ad hoc changes to meet a variety of different objectives. With the pressures to increase current expenditure, governments were always seeking new sources of revenue. Incentives and exemptions of various kinds were also introduced to encourage saving and investment, and some doubts have always persisted about the necessity for these measures, given the attendant loss of revenue and the failure of infant industries to grow up. The tax rates were changed with great regularity and in some cases attained punitive levels. In certain countries the top marginal rate exceeded 70 per cent at one time. New taxes in the form of levies or stamp duties on consumption and imports found their way into almost every Caribbean tax system. Revenue raising measures masquerading under a host of different names such as transport levy, unemployment levy, debt levy, a stabilization tax, etc were not always used for the purpose for which they were avowedly intended. A Health Surcharge in Trinidad and Tobago, for example, does not go directly to the health sector, but into the Consolidated Fund. In the 1980s several countries in the region were forced to review their tax systems as a result of inefficiencies relating to the disincentive effect on effort and the need to encourage investment, increasing tax evasion, unsatisfactory yields, and a growing complexity that defied rationality. In the 1980s the pressures to reduce tariff levels in the context of the obligations of regional and international trade liberalization and a more intense desire to attract skills and encourage investment were major factors in the rationalization process which addressed a variety of issues. Simplification was a major objective. A number of allowances and loopholes which were being abused were removed including some measures to encourage savings which the authorities thought were not necessary. The number of tax bands as well as the marginal and corporate tax rates have also been reduced.

A major feature in certain cases has been the removal of a number of consumption and other indirect taxes and the introduction of a Value Added Tax (VAT) which is akin to a sales tax, the ultimate burden being borne by consumers of the taxable goods and services. Concern about the regressive nature of the VAT has led to essential items being exempted or zero rated. A VAT was introduced in Barbados in 1997 and immediately accounted for 30 per cent of tax revenue. Some other consumption and stamp duties were reduced or eliminated at the same time, however. A VAT has been part of Trinidad and Tobago Tax System since 1990, and now accounts for about 20 per cent the total tax take. In both Barbados and Trinidad and Tobago, the VAT has been pitched at 15 per cent. In 1986 as part of a fiscal reform programme a 20 per cent VAT was imposed on goods and services imported or produced for sale in Grenada. Certain items were also exempted or zero rated. With the imposition of this tax a number of other taxes including income and corporation taxes were abolished which was not the case in Barbados and Trinidad and Tobago. This reform proved to be disastrous as tax revenues in 1986 fell by some 15 per cent below the 1985 level. As the VAT failed to perform a number of *ad hoc* levies were quickly introduced and personal and corporate taxes were reintroduced in 1994.

As can be seen in Table 10 there appears to be an increasing trend towards greater dependence on indirect taxes and the proportion for the latter now varies from almost 40 per cent in Trinidad and Tobago (where the direct taxes in the oil sector make a significant contribution) to almost 80 per cent in the ECCB countries as a group. The latter have long been dependent on indirect taxes because of their heavy dependency on international trade and because it is easier to tax goods as they enter the national borders. It is worth noting that the situation varies greatly

from country to country (See Table 11). Some countries like Saint Kitts-Nevis and Antigua and Barbuda have no personal income taxes and the tax regime is heavily biased towards indirect taxes. The Bahamas is a tax haven with no income, or corporation, withholding or capital gains tax (See Box 2).

**Table 10**  
**Trends in Direct and Indirect Taxes, 1983 and 1987**

Taxes	<u>ECCB Area</u>		<u>Guyana</u>		<u>Barbados</u>		<u>Jamaica</u>		<u>Trinidad &amp; Tobago</u>	
	1983	1997	1983	1997	1983	1997	1983	1997 <sup>a</sup>	1983	1997
Direct	29.0	22.0	44.0	41.0	49.5	38.0	55.3	45.0	80.0	63.2
Indirect	71.0	78.0	56.0	59.0	50.5	62.0	44.7	55.0	20.0	36.8
<b>Total</b>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	100.0	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>

a. 1996

Source: Official Publications.

As can be seen in Table 11 the contribution of taxes on incomes and profits in the ECCB area to total tax revenue and as a percentage of GDP has fallen since the early 1980s, while correspondingly, the contribution of taxes on international trade has become more significant. Barbados, Guyana, Jamaica and Trinidad and Tobago rely more heavily on income taxes than the smaller islands. Table 12 shows the significance of major groups of taxes in the revenue profile of individual countries. Taxes on income and profits as a per cent of GDP is highest in Trinidad and Tobago, Guyana and Dominica. With respect to taxes on international trade and transactions the ratio ranged from less than 5 per cent for Trinidad and Tobago, Guyana and Barbados in 1997 to over 12 per cent for most of the others. Barbados, followed by Guyana, now has the highest ratio as far as taxes on domestic goods and services are concerned.

Table 11

## ECCB Area: Composition of Tax Revenue, 1983-97.

Year	As a % of Total Tax Revenue			As a % of GDP <sup>1</sup>			
	Taxes on Incomes and Profits	Taxes on Domestic Goods and Services	Taxes on International Trade	Taxes on Incomes and Profits	Taxes on Domestic Goods and Services	Taxes on International Trade	Non-Tax Revenue
1983	29.1	19.3	49.6	7.4	5.0	12.6	5.9
84	28.1	19.5	50.7	7.1	4.9	12.8	5.3
85	26.0	22.0	50.2	6.7	5.7	12.9	4.7
86	23.8	16.3	58.2	6.0	4.1	14.6	4.9
87	19.3	23.9	54.9	4.2	5.2	11.9	4.2
88	18.9	22.6	56.6	4.7	5.5	13.9	4.1
89	19.1	17.9	61.4	4.8	4.5	15.3	3.8
90	20.8	15.9	61.9	5.2	4.0	15.3	4.0
91	23.7	15.5	59.5	5.9	3.8	14.7	3.8
92	24.6	15.1	59.1	5.9	3.6	14.2	4.7
93	22.6	15.8	60.4	5.5	3.9	14.7	4.6
94	23.7	16.7	58.4	5.7	4.0	14.0	4.4
95	23.0	17.2	58.3	5.5	4.1	14.1	4.1
96	23.2	17.3	57.9	5.8	4.4	14.6	4.3
97 <sup>p</sup>	22.0	17.7	58.9	5.5	4.4	14.7	4.3

- p. Provisional  
1. at current factor cost

Source: ECCB: *Annual Statistical Digest*, 1998.

Table 12

## Selected Taxes as a % of Current Revenue and as a % of GDP, 1980 and 1997.

Countries	As a % of Current Revenue						As a % of GDP					
	Taxes on Income & Profits		Taxes on Domestic Taxes on International		Taxes on International		Taxes on Goods & Services		Taxes on Domestic Trade & Transactions		1980	1
	1980	1997	1980	1997	1980	1997	1980	1997	1980	1997		
Anguilla	-	-	9.5	27.3	2.4	54.5	-	-	-	7.8	-	15.6
Antigua	10.0	7.8	11.2	20.0	69.6	56.9	2.4	2.0	2.7	5.0	16.9	14.0
Bahamas	-	-	19.0 <sup>b</sup>	17.0	53.0	58.6	-	-	3.6 <sup>b</sup>	4.0 <sup>a</sup>	10.0 <sup>b</sup>	12.7
Barbados	37.0	27.0	24.0	50.0	21.5	9.0	9.3	9.0	6.1	16.5	5.5	3.0
Belize	28.0	21.6 <sup>a</sup>	9.0	11.9 <sup>a</sup>	50.0	52.8 <sup>a</sup>	7.0	4.9 <sup>a</sup>	2.2	2.7 <sup>a</sup>	13.4	12.0 <sup>a</sup>
Dominica	30.8	24.0	5.4	13.0	53.1	45.0	10.2	8.6	1.8	4.5	17.7	15.4
Grenada	25.3	10.7	24.4	19.0	38.9	58.2	8.7	3.1	8.4	5.6	13.4	17.2
Guyana	39.2	36.6	33.0	32.3	9.0	13.0	11.7	11.8	9.9	10.4	2.6	4.2
Jamaica	35.0	35.0 <sup>c</sup>	33.6	27.6 <sup>c</sup>	4.2	25.8 <sup>c</sup>	8.6	9.8 <sup>c</sup>	8.3	7.8 <sup>c</sup>	1.0	7.3 <sup>c</sup>
Montserrat	27.3	32.1	23.3	11.6	30.0	43.0	7.1	9.5	6.1	3.4	7.8	12.6
St. Kitts-Nevis	11.3	20.3	2.5	12.2	60.8	42.4	5.6	5.8	1.2	3.5	29.9	12.0
St. Lucia	30.6	26.0	19.8	11.0	40.8	51.6	9.9	7.5	6.4	3.2	11.8	14.8
St. Vincent	27.4	26.6	9.1	12.7	46.0	41.5	9.3	9.4	3.1	4.5	15.6	14.6
Trinidad & Tobago	71.5	56.8	4.0	26.2	6.6	6.2	32.2	14.0	1.7	6.6	2.9	1.6

Note: The 1997 figures in most cases are provisional

- a 1995  
b. 1981  
c. 1996  
- nil or not available

Sources: Official Publications; IMF, *International Financial Statistics*. Various Issues; IMF, *Country Reports*, Various Issues.



## Box 2

### Profile of a Tax Haven: The Case of the Bahamas

The Bahamas is an archipelagic State consisting of some 700 islands with a land area of 13,939 km<sup>2</sup> and a population of 285,000. Its main activity is tourism, but over the last 25 years it has become one of the world's leading tax havens and financial centres with 413 banks and trust institutions registered at the end of March 1998. Despite its limited range of resources, the Bahamas enjoys the highest per capita GNP among CARICOM countries – over US\$12,000. The financial services sector is estimated to contribute about 15 per cent to GDP. Some other Caribbean countries have tried to promote offshore banking institutions without much success in an atmosphere where there is a great deal of international concern over the possible use of these institutions for money laundering relating to the growing drug trade and other illegal activities.

The Bahamas has no income, corporation or withholding taxes, and the government depends for its revenue on a range of devices, the most important of which is import duties. This is one reason why the country has chosen to be a member of the Caribbean Community, but not a member of the Common Market which would have required downward adjustment of the tariff schedules and even the revision of the entire tax regime. The estimated current revenue for fiscal year 1997/98 was as follows:

Non-Tax Revenue	B\$60.8	8.3%
Tax Revenue	B\$675.1	91.7%

The composition of tax revenues are shown below.

	%
Property	4.7
Gaming (Casino) Tax	3.1
Hotel Occupancy Tax	1.6
Departure Tax	8.8
Business and Professional License	3.6
Taxes on International Trade	66.2
(of which taxes on imports)	(64.6)
Other Taxes	12.0
<b>Total</b>	<b>100.0</b>

Tax revenues in recent years have averaged around 15 per cent of GDP and current revenue about 16 to 17 per cent. There tends to be very little or no savings on the current account, and the public debt has grown in recent years. The local foreign currency component more than doubled between 1992 and 1997, while the Bahamian dollar debt increased by 52 per cent over the period.

Tax reform is an ongoing process, and this is an area where the authorities have to tread carefully. Trade and economic activity can fluctuate from year to year because of factors beyond national control, such as weather conditions or market developments relating to particular commodities. There are still many unresolved issues in the reform process as governments try to reconcile the need for revenues with distributive concerns. Part of the thinking behind the trend to lower direct taxes, is that this would encourage greater compliance and far from resulting in a lower tax take, revenues are likely to increase. The growing dependence on indirect taxes intended to widen the tax base raises a number of questions, given the regressive nature of these taxes. To counter this negative aspect, certain items are zero rated or exempted from the VAT. The exemptions levels for the group of tax payers who are not required to pay income taxes has also been increasing. How to use the tax system to encourage saving and investment without jeopardizing the tax levels and increasing regressiveness remains a concern. The growing pressures to reduce tariffs and protection for domestic industry is a complex issue for the countries of the Caribbean highly dependent on tariffs for revenue and still recognizing the need to provide some level of protection to infant industries. The difficulties in implementing the Common External Tariff in CARICOM is intimately related to the importance of tariffs in national revenue systems.

With respect to current expenditure, there are several trends worth noting. In the ECCB group personal emoluments increased from less than 30 per cent in the 1980s to over 50 per cent in the 1990s. Transfers have also increased from less than 10 per cent in the early 1980s to around 15 per cent in recent years. The share on goods and services fell from almost 50 per cent in the early 1980 to around 23 per cent in the mid 1990s (See Table 13). Interest payments on the public debt have also fallen slightly from the 1980s. In contrast to these trends, the share of wages and salaries in current expenditure has been falling in Barbados, Jamaica and Trinidad and Tobago where the proportions are lower (See Table 14). In Guyana wages and salaries account for only 30 per cent in 1997 of current expenditure as compared to 50 per cent in many of the smaller islands. Structural adjustment programmes in the larger countries have led to a reduction in the public sector work force and a tight rein has been kept on upward movements in wages and salaries. In Barbados wage restraint has been facilitated by the signing of periodic prices and income protocols since 1993 between the government, employers and labour unions. In Guyana, the number of people employed in the Central Government has fallen from 42,000 in 1980 to around 12,000 in 1996. In the rest of the public sector employment declined by almost 50 per cent in the period. In Trinidad and Tobago as a result of rationalization of the State enterprises sector, transfers and subsidies declined from almost 50 per cent of current revenue in 1983 to 34 per cent in 1997. Interestingly, the share of interest payments rose in the period but never reached the levels of Guyana or Jamaica where debt servicing is still a problem. In Guyana the share of interest payments fell from 55 per cent of current expenditure in 1990 to 36 per cent in 1997. In Jamaica interest payments in 1996 accounted for 40 per cent of current expenditure. It will be seen later that though debt levels have come down in some cases, and there have been some relief, the external debt in particular remains an issue.

Table 13

**ECCB Area: Composition of Current Revenue and Current Expenditure  
(Economic Classification), 1983-1987.**

Year	As a % of Current Revenue		As a % of Current Expenditure				
	Tax Revenue	Non-Tax Revenue	Goods and Services	Personal Emoluments	Interest Payments	Transfers	Other
1983	81.16	18.84	49.03	28.72	10.83	9.23	2.19
84	82.81	17.21	48.42	27.26	12.17	9.96	2.19
85	84.54	15.46	48.81	28.14	11.94	8.75	2.36
86	83.68	16.33	51.04	26.44	10.00	9.76	2.76
87	83.80	16.20	49.53	27.51	11.68	9.53	1.75
88	85.66	14.35	50.81	26.64	10.48	9.60	2.47
89	86.79	13.21	24.80	52.95	9.31	12.62	0.32
90	85.99	14.01	24.85	51.96	9.54	13.64	0.01
91	86.50	13.50	24.92	51.87	9.56	13.65	0.00
92	83.75	16.36	24.18	52.72	8.79	14.30	0.01
93	84.09	15.91	23.82	54.76	7.32	14.10	0.00
94	84.52	15.48	23.73	54.29	7.37	14.61	0.00
95	85.60	14.41	23.93	53.27	7.32	14.77	0.71
96	85.37	14.63	23.28	53.49	7.87	15.36	0.00
97	85.25	14.75	23.08	52.95	8.25	15.71	0.01

Source: ECCB, *Annual Statistical Digest*, 1998.

**Table 14****Selected CARICOM Countries: Economic Classification of Current Expenditure, 1983-97  
(Percentage)**

	<u>Barbados</u>			<u>Guyana</u>			<u>Jamaica</u>			<u>Trinidad &amp; Tobago</u>		
	1983	1990	1997 <sup>c</sup>	1983	1990	1997	1983	1990 <sup>b</sup>	1997 <sup>a</sup>	1983	1990	1997 <sup>P</sup>
Wages & Salaries	42.5	44.2	40.8	26.0	14.0	30.7	40.0	36.5	35.6	41.8	35.7	38.9
Goods & Services	12.1	11.9	11.7	18.8	14.0	23.5	11.9	12.0	11.6	6.8	10.6	8.6
Interest Transfers &	12.9	13.8	17.6	47.5	55.1	35.6	33.1	38.9	40.4	3.2	17.8	18.4
Subsidies	32.4	30.0	29.8	7.7	16.9	10.2	15.0	12.6	12.4	48.2	35.9	34.1
<b>Total</b>	<b><u>100.0</u></b>	<b><u>100.0</u></b>	<b><u>100.0</u></b>	<b><u>100.0</u></b>	<b><u>100.0</u></b>	<b><u>100.0</u></b>	<b><u>100.0</u></b>	<b><u>100.0</u></b>	<b><u>100.0</u></b>	<b><u>100.0</u></b>	<b><u>100.0</u></b>	<b><u>100.0</u></b>

P .Provisional  
a. 1995.  
b. 1991  
c. 1996

Source: Official Publications.

In the 1980s debt servicing problems assumed significant proportions for a number of countries in the region. The failure of recurrent revenues to increase at the desired rates and the tendency for current expenditures to grow in response to social demands resulted in little or no central government savings. In some cases, non-profitable State enterprises exacerbated the financial problems of the central government. Table 15 gives some indication of the level of current budgetary savings in the 1980s and 1990s. To finance capital expenditures and even consumption some governments increased borrowing, both locally and abroad. With the failure of the economy to regain buoyancy, debt servicing became increasingly burdensome for some governments. In certain cases the stage was reached where borrowing was undertaken to service earlier loans as export earnings fell and private capital inflows declined. Table 16 shows the current account position in the 1980s and 1990s. In Trinidad and Tobago several years of surpluses preceding 1982 was followed by eight consecutive years of deficits. In Guyana the current account has been consistently negative since the mid-1970s. As a result of declining foreign exchange earnings, the scheduled external debt service ratio in Guyana increased from 11.2 per cent in 1976 to almost 100 per cent in 1989. The actual ratio in the latter year was, however, only 11.5 per cent. Jamaica also found itself unable to fully service its foreign debt and with the debt service ratio crossing 60 per cent at one stage, had to pursue rescheduling arrangements and seek the assistance of the international financial institutions. Trinidad and Tobago's external debt service ratio was less than 3 per cent in the early 1980s, but with the drop in oil revenues the figure climbed to over 30 per cent in the later part of the 1980s/early 1990s, and this country also had to seek relief from its creditors.

Table 15

## Central Government: Current Savings or Deficit (-) as a % of GDP

Year	Bahamas	Barbados	Belize	Guyana	Jamaica	Trinidad & Tobago	ECCB Area
1980	2.8	2.7	4.7	-11.6	4.0	21.6	...
81	2.6	1.0	2.0	-20.4	4.0	20.2	...
82	0.8	0.9	1.3	-29.3	2.9	4.8	...
83	0.3	2.4	0.1	-27.1	-8.6	1.8	-1.9
84	0.4	0.5	-0.2	-36.7	-1.4	1.4	-0.4
85	1.0	0.5	-2.0	-18.0	-0.7	1.9	0.7
86	1.4	1.6	2.0	-5.0	5.1	-0.8	2.1
87	1.5	1.2	3.8	-27.2	3.6	1.3	1.6
88	-0.2	4.5	7.3	-10.3	2.3	-2.3	2.7
89	-0.6	4.5	8.6	-4.9	4.1	-2.0	1.2
90	0.2	0.2	9.3	-14.6	4.9	-0.1	2.3
91	-1.1	2.7	7.3	-16.8	6.1	3.1	1.9
92	0.1	2.3	5.7	-11.3	7.3	-1.2	2.5
93	0.1	3.3	2.9	1.9	6.7	1.0	2.9
94	1.9	2.3	2.6	5.4	6.0	1.4	2.4
95	1.8	3.2	-0.6	6.5	7.4	2.0	1.7
96	1.0	0.9	2.2	10.8	-1.6	1.2	2.0
97P	0.8	5.0	2.6	4.0	-0.7	1.7	...

P. Provisional

... not available

Source: IDB, *Economic and Social Progress in Latin America, 1996, Report; Official Publications.*

Table 16

**Current Account Surplus/Deficit (-) of the Balance of Payments, 1980-1997  
(as a % of GDP)**

Year	Bahamas	Barbados	Belize	Guyana	Jamaica	Trinidad & Tobago	ECCB Area
1980	-5.8	-2.5	...	-22.2	-5.0	5.7	...
81	-9.4	-12.4	...	-32.3	-10.3	6.0	...
82	-8.7	-3.7	...	-29.5	-11.6	-7.5	...
83	-6.8	-4.1	...	-32.3	-9.4	-12.1	...
84	-6.3	1.4	-2.5	-22.1	-13.3	-6.0	...
85	-0.1	4.2	4.4	-21.1	-13.0	-0.6	...
86	1.1	0.5	5.2	-25.2	-0.8	-8.6	...
87	-2.4	-1.3	3.4	-35.0	-4.1	-4.7	...
88	-2.6	2.8	-0.8	-24.2	1.3	-2.0	...
89	-2.7	1.5	-5.3	-31.8	-6.9	-0.9	...
90	-1.1	-0.6	3.8	-37.8	-7.3	9.0	-16.7
91	-5.8	-1.6	-6.0	-34.0	-6.4	-0.0	-16.5
92	1.3	8.8	-6.0	-33.6	-0.9	0.6	-10.5
93	2.4	4.1	-9.2	-25.1	-4.4	-2.3	-10.6
94	-0.8	7.5	-7.2	-18.7	0.4	4.5	-10.8
95	-4.0	4.7	-0.5	-15.3	-4.7	5.2	-10.0
96	...	7.4	-0.4	-7.6	-4.0	1.2	-15.1
97 <sup>p</sup>	...	1.0	-6.8	-11.2	...	-12.0	...

... not available

Source: IDB, *Social and Economic Progress in Latin America*, Various Issues; CDB, *Social and Economic Indicators*, Various Issues.

As can be seen in Table 17 the outstanding external debt has come down a little for the larger countries in recent years. Debt write-offs have helped in certain cases. The debt service ratio has also been reduced, but with the continued need to borrow abroad to finance capital programmes, and given the range of unpredictable factors affecting foreign exchange earnings, comfortable debt servicing positions can easily become very acute. The debt servicing of the external as well as the internal public debt has implications for the budget. For the smaller islands the small external debt service ratio may not give a complete picture of the debt servicing burden. In Antigua and Barbuda, for example, interests payments alone (both on the domestic and foreign debt) were taking 12 per cent of recurrent revenue in 1997. In Grenada, the comparable figure was 10 per cent and in Dominica 9 per cent. When amortization is taken into account, these figures take on larger dimensions. The high proportion of current expenditure taken by interests payments in Guyana and Jamaica were noted earlier. With respect to the smaller islands it is worth noting that in the context of the difficulties to raise loans in international markets, capital grants have played a useful role in helping to finance capital expenditures. In many cases, these grants have been falling in recent years. In the case of Saint Lucia, for example, capital grants declined from EC\$56.3 million in 1993 to EC\$2.0 million in 1997. In Dominica, there has been a similar trend.

In light of the commitment to put greater emphasis on the development of the private sector as the engine of growth, governments have to be more careful about the effects of their operations on the macroeconomic environment. Borrowing from the Central Bank can affect the inflation rate, and overuse of the domestic private markets may influence interest rates in ways which discourage savings and investment. Money and capital markets are still underdeveloped, and even the limited use of open market operations by the Central Bank to influence liquidity has to be done



Table 17

## Growth of the Outstanding (Disbursed) External Debt, 1981-96.

Countries	<u>External Debt (US\$)</u>			<u>Debt as a % of GDP<sup>1</sup></u>			<u>Actual Debt Service Ratio<sup>2</sup></u>		
	1981	1991	1996	1981	1991	1996	1981	1991	1996
<b><u>OECS</u></b>									
Antigua	57.7	260.0	224.4	46.0	61.6	42.1	8.2	2.2	1.7
Dominica	17.0	84.8	101.2	28.8	47.8	43.2	3.4	4.2	7.1
Grenada	17.1	85.9	85.7	17.6	40.9	29.0	3.7	4.3	5.0
Montserrat	2.0	3.4	10.0	9.9	5.7	20.0	2.4	2.0	1.3
St. Kitts-Nevis	10.8	36.8	54.1	20.9	21.5	22.4	3.0	2.7	4.7
St. Lucia	17.8	70.2	126.8	13.6	16.7	22.1	1.3	2.0	3.3
St. Vincent	15.6	58.7	87.4	21.2	26.2	32.5	1.6	3.5	5.5
<b><u>Other CARICOM</u></b>									
Bahamas	98.0	412.3	357.8	7.9	14.3	10.0	4.7	4.2	4.9
Barbados	176.1	466.6	425.5	19.0	27.5	21.3	2.6	19.6	10.6
Belize	54.5	150.6	216.9	34.8	41.4	42.0	1.4	6.7	9.7
Guyana	635.7	1,855.3	1,498.7	112.0	350.4	208.9	21.7	20.3	18.7
Haiti	423.0	906.0	800.0	26.1	35.8	28.0	9.2	10.2	18.7
Jamaica	2,293.1	3,874.4	3,397.9	76.9	119.9	57.4	28.6	25.7	19.9
Suriname	26.0	123.0	162.5	5.1	...	30.6	0.6	...	4.3
Trinidad & Tobago	1,050.0	2,195.4	1,875.7	15.3	67.0	33.0	2.4	20.0	13.2
<b><u>Other Caribbean Countries</u></b>									
Dominican Republic	2,255.0	4,492.0	4,200.0	31.0	59.1	31.9	34.7	14.0	16.1

... not available

a. 1995

1 At market prices

2. Debt service payments as a % of goods and services.

Sources: ECLAC; Caribbean Development Bank, IMF, Country Reports.

There are limits to which a government can borrow to finance its activities, and this has become increasingly evident since the 1980s. With the stagnation or decline of public revenues, the quality and quantity of social services have deteriorated markedly in some countries. Traditionally, Caribbean countries have spent a not insubstantial proportion of public revenues on areas such as health and education, though the returns on such expenditures may not reflect this, given the present State of the social services. A functional breakdown of expenditures for all countries is not available. In the case of Barbados which has the highest Human Development Index in the Caribbean (0.909 in 1995), social spending has consistently averaged over 50 per cent of current expenditure in the 1980s and 1990s. As a per cent of GDP the ratio increased from under 13 per cent in the early 1980s to almost 15 per cent in recent years. In contrast current social expenditures in Trinidad and Tobago both as a proportion of total current expenditure and as a percentage of GDP have tended to fall in the 1990s. Per capita social spending in terms of current dollars, however, has been increasing. With respect to health expenditures, the ratio to GDP in the first half of the 1990s has averaged 3 per cent for Jamaica, 2.6 per cent for Trinidad and Tobago and 4.1 per cent for Barbados (See Table 18). With respect to public educational expenditures several countries of the Caribbean devote more than 5 per cent of GNP (See Table 19). Comparable 1995 figures for Chile was 2.9 per cent, Cost Rica 4.5 per cent, Dominican Republic 1.9 per cent, Singapore 3.0 per cent and South Korea 3.0 per cent.

**Table 18**  
**Selected Countries: Public Health Expenditure as a % of GDP**  
**(Average 1990-95)**

Country	%
Barbados	4.1
Jamaica	3.0
Trinidad & Tobago	2.6
Brazil	2.3
Mauritius	2.2
Chile	2.5
Singapore	1.3
Mexico	2.8
Thailand	1.4
Hong Kong	1.9

Source: World Bank, *World Bank Development Indicators*. 1998: Official Publications.

**Table 19**  
**Total Expenditure on Education**  
**(Most Recent Year)**

Countries	As a % of GNP	As a % of Total Government Expenditure
Aruba	4.5	15.9
Bahamas	4.0	16.3
Barbados	7.2	19.0
Belize	6.1	21.3
St. Kitts-Nevis	3.3	9.8
St. Lucia	9.9	22.2
St. Vincent	6.9	13.8
Trinidad & Tobago	4.5	10.3
Dominica	5.5	10.6
Jamaica	8.2	7.7
Haiti	1.5	20.0

Source: UNESCO

Even under severe financial pressures, Caribbean governments have not underestimated the role of human capital formation in economic development. Not enough attention, however, has been paid to such things like systems, organization, morale, curricula and efficiency. Despite calls for greater social spending in these countries one study has concluded that “failures in social delivery systems are principally the result of inefficiencies in the system themselves,” and “that greater progress is more likely to come from gains in efficiency than from increased spending.”<sup>18</sup>

One area of social spending where a great deal of attention has come to focus in recent years is the question of pensions, and the ability of current schemes to meet future obligations, given current funding arrangements and the age structure of the population. Social Security/National Insurance schemes in the Caribbean operate either with a simple pay-as-you-go formula, in which pensions of retired workers are paid out of contributions from those still working, or with some graduated premium arrangement in which contributions also make it possible to build up a partial reserve for paying future pension obligations.<sup>19</sup> Most government pensions plans in the region have generally been non-contributory and the observation has recently been made that the “liabilities towards the current generation of retirees and workers resulting from unfunded pension provisions constitute a huge hidden public debt.”<sup>20</sup> National Insurance Schemes are funded both by employers and employees and in most cases provide a limited range of benefits which have not kept pace with the cost of living. In some, with benefits payments exceeding contributions a crisis has arisen.

As a result of dissatisfaction with existing public pension and insurance schemes, there has been a significant growth in private arrangements over the years. As indicated earlier, governments are being forced to review public pension and insurance schemes in the context of high levels of poverty and unemployment rates and the likely impact on the budget. The situation in Trinidad and Tobago where the government provides a pension to retired public servants as part of the remuneration package highlights the dilemma. The scheme is a non-contributory unfunded one and was estimated to cost TT\$562 million in 1997. Five years later (2002), the payments will escalate to over TT\$1 billion. In 1997, old age pensions (including the food subsidy component, Widows and Orphans benefits, plus public service pension payments) amounted to one tenth of the national budget.<sup>21</sup> The Trinidad and Tobago government has indicated that it is moving towards a contributory privately managed system to ensure a guaranteed minimum pension.

The National Insurance Schemes which offer survivors' and disability pensions, injury and sickness benefits, maternity allowances, funeral grants, etc. have not generally met earlier expectations when they were established. In some cases benefits and contributions have been stuck at the same level for long periods of time and bear little relationship to current realities. In some instances employers (including governments) are in arrears to the scheme. In one case the government tried to reduce its arrears by the issuing of bonds which came to represent 90 per cent of the investment portfolio of the scheme at one point. The returns from investments are expected to enhance the benefits offered by the schemes, but in a number of cases questions have been raised over the way funds have been used. In Trinidad and Tobago where the level of contribution and benefits have not changed in 18 years recent reforms included increases in both contributions and benefits, but the systems in the Caribbean generally remain in need of basic reforms. With respect to other government pension schemes, the implication for the budget is

only one concern. The benefits paid on retirement are far from adequate and new approaches are urgently needed to deal with this issue.

### **Concluding observations and recommendations**

Despite their size and limited resources, most Caribbean countries have attained a standard of living higher than that of a large number of other developing countries, both in the hemisphere and elsewhere. As can be seen in Table 20, however, poverty remains a major concern, particularly in Haiti, Guyana and Suriname. Recent events in Montserrat and Saint Kitts and Nevis show how quickly economic gains can 'evaporate' as a result of natural phenomena and weather conditions. Even though there are signs of recovery from the difficult decade of the 1980s, the uncertain prospects facing major exports from the region point to a challenging period ahead. Caribbean economies rest on a tenuous basis, and fluctuations in foreign exchange earnings and government revenues are quickly reflected in the level of economic activity and in social conditions. In Trinidad and Tobago, for example, a small decline in the price of a barrel of oil can significantly affect the entire budget.

Despite pressures for the State to withdraw from certain lines of activities, it is difficult to underestimate the critical role it can play in creating an environment that can encourage real and financial development, given recent experiences in Latin America and the Caribbean and in Asia. In the Caribbean most States are burdened with outdated laws and regulations and remain unwieldy and ineffective, incapable of delivering the quality of services expected by the general population. Weak tax administration, low productivity of government spending, a demoralized and poorly equipped public service bureaucracy, lack of transparency in government operations and an inadequate savings effort have been widely recognized. Structural adjustment programmes have in some cases weakened the public service bureaucracy by depressing wages for long periods as part of the fiscal discipline package. The persistence of archaic social services delivery and pension systems for long periods without review, or fundamental reforms reflect the rot into which many States have fallen and the urgency for change.

Table 20

## Selected Demographic and Social Statistics

	Head Count Index <sup>a</sup> (Percentage Poor)	Life Expectancy At Birth (1996)	Infant Mortality Rate (per 1000 Live Births) (1996)	Adult Literacy Rate (1995)	Human Development Index Value (1995)
<b><u>CARICOM Countries</u></b>					
Antigua & Barbuda	12	75	18	95.0	.895
Bahamas	5	73	18	98.2	.893
Barbados	8	76	11	97.4	.909
Belize	35*	75	35	70.0	.807
Dominica	33	74	16	94.0	.879
Grenada	20	72	14	98.0	.851
Guyana	43*	64	59	98.1	.670
Haiti	65	55	72	45.0	.340
Jamaica	34	74	12	85.0	.735
Montserrat	...	...	...	...	...
St. Kitt-Nevis	15	70	24	90.0	.854
St. Lucia	25*	70	17	82.0	.839
St. Vincent & the Grenadines	17	72	18	82.0	.845
Suriname	47	71	25	93.0	.796
Trinidad & Tobago	21*	73	13	97.9	.880
<b><u>Other Caribbean Countries</u></b>					
Anguilla	...	...	...	...	...
Aruba	...	...	...	...	...
Dominican Republic	21*	71	40	82.1	72.0
Netherlands Antilles	...	76	11	...	...

... not available

a. Only those with an asterisk were calculated using a similar methodology

Sources: UNDP, Human Development Report, 1998; World Bank, World Development Indicators, 1997; J.L. Baker, Poverty Reduction and Human Development in the Caribbean, The World Bank, 1997.

Governments in the region are now well aware of the problems inherent in printing money to finance domestic expenditures and the effects of inflation on competitiveness, the exchange rate and the distribution of income. The present level of public debt in some countries does not allow a great deal of scope for continued borrowing. Increasingly, the level of public revenues will affect how governments function and how they deliver essential services in a changing technological environment. The growing partnership with the private sector already points the direction. The level of tax take has a fundamental bearing on what governments do or can do and ultimately it is the citizens who have to decide whether they are willing to pay for what they desire of their governments. The pressures being faced by some countries in the region with unresponsive tax systems is one manifestation of the difficulties that arise in the absence of consensus in this area. Falling aid and grant levels and the need to finance an increasing share of investment from domestic savings will exacerbate the pressures on tax systems and provide even greater impetus for reform in public sector operations. Given the importance of yield, there is a widespread view that the tax system should not be overwhelmed with distributive concerns.

It is worth recognizing that in the Caribbean there are a variety of tax regimes, and the approach to reform does not stem from the same concerns, or the same degree of urgency. Not all the countries of the subregion have the same level of interest in trade liberalization or the formation or expansion of trade groupings. There are different degrees of trade-offs between revenue and equity, and some governments rely more on expenditure policies than tax policy to address distribution concerns. While it has been noted that Caribbean States generally show better tax performances than Latin American countries, tax systems in the former may need to be more responsive to changes in income, if governments are to meet the growing demands being made upon them. As tariff levels come down revenue has to be recouped in other ways, and with the introduction of a VAT, certain governments have tended to sacrifice some equity in the interests of having a broader tax base. Updating and revising property taxes in the region offers some scope for increasing the level of progressiveness. The strengthening of tax administration throughout the region to deal with collection and evasion is an urgent necessity. The establishment of well trained tax intelligence units may well be worth their costs in terms of not only collection, but in securing a more equitable sharing of the tax burden. The need for budgetary reforms in the Caribbean has been recognized, but has not been treated as an urgent matter. The ECLAC Report has rightly noted that there is a wide range of transactions which have fiscal implications, but normally do not come under the oversight of the legislature. Subsidies of various kinds, tax holidays, exemptions from taxes and levies, etc. which are often the subject of agreement between governments and corporations, need to come under parliamentary scrutiny. Beside the fiscal implications, the efficacy of such measures need to be reviewed from time to time.

While some taxes are seen as regressive in that they have a greater impact on the poor than on the rich, government spending can also be regressive, since some components may benefit the rich more than the poor. Targeting is a major issue in social spending and governments in the region need to pay a great deal more attention to this question. In some areas like pension and higher education the question is not simply increasing or reducing expenditure but formulating arrangements which could allow a higher level of accessibility by the poor. Greater attention needs to be paid to efficiency in public spending. It makes little sense spending

public money on building schools and hospitals when the quality of the services continue to deteriorate. Inefficiency contributes to regressiveness.

The heavy dependence of the OECS countries on indirect taxes must be seen in the context of the structure of these economies and the limited tax administrative capacity. Participation in the regional integration movement has put downward pressure on tariffs, and there is need for a fundamental review of the entire tax structure. Tax instruments have different functions and are associated with different collection costs. There is need to establish the required protection levels and revenue needs of these countries in the context of Stated economic and social objectives and economic potential.

In the past, governments in the region have also tried to deal with the question of income distribution by subsidizing the utility services which generally occupy monopoly positions in the various territories. The tendency now is to introduce some degree of privatization as a way of modernizing the services and reducing the call on the finances of the central government. In such situations governments have a crucial role to play by putting in place a legal and operational framework to prevent the exploitation of the consumer. In monopoly situations there is a strong temptation to use rates and charges to cover inefficiencies in the systems. In other areas, such as finance, governments also have a critical role to play in ensuring transparency and developing public trust. When systems collapse, ultimately it is the government's responsibility, even when it is not directly involved. With respect to social security schemes some governments in the Caribbean have abused or neglected them, and there is need for a comprehensive review of the social security needs of the region.

The volatile nature of Caribbean economies and the effect on public revenues suggest the need for innovative approaches in dealing with booms and busts which are an integral part of the history of the region. An increased level of savings during periods when the level of economic activity is high could help deal with the difficulties that accompany a downturn, including the fluctuations in public spending. In a democratic setting the concurrence of major actors in the society including the trade unions would go a long way in making such an approach workable and effective.



### Endnotes

1. The members of the Caribbean Community (CARICOM) are Antigua and Barbuda, the Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Jamaica, Montserrat, Saint Kitts-Nevis, Saint Lucia, Saint Vincent and the Grenadines, Suriname and Trinidad and Tobago. At the Heads of Government meeting held in Jamaica in July 1997, Haiti was accepted as the fifteenth member on a conditional basis.

The Organization of Eastern Caribbean States is a sub-grouping within CARICOM, formed by the smaller islands in 1981 to “strengthen links between themselves by uniting their efforts and resources and establishing and strengthening common institutions which could serve to increase their bargaining power as regards third countries.” Members of the OECS are Antigua and Barbuda, British Virgin Islands, Dominica, Grenada, Montserrat, Saint Kitts-Nevis, Saint Lucia and Saint Vincent and the Grenadines.

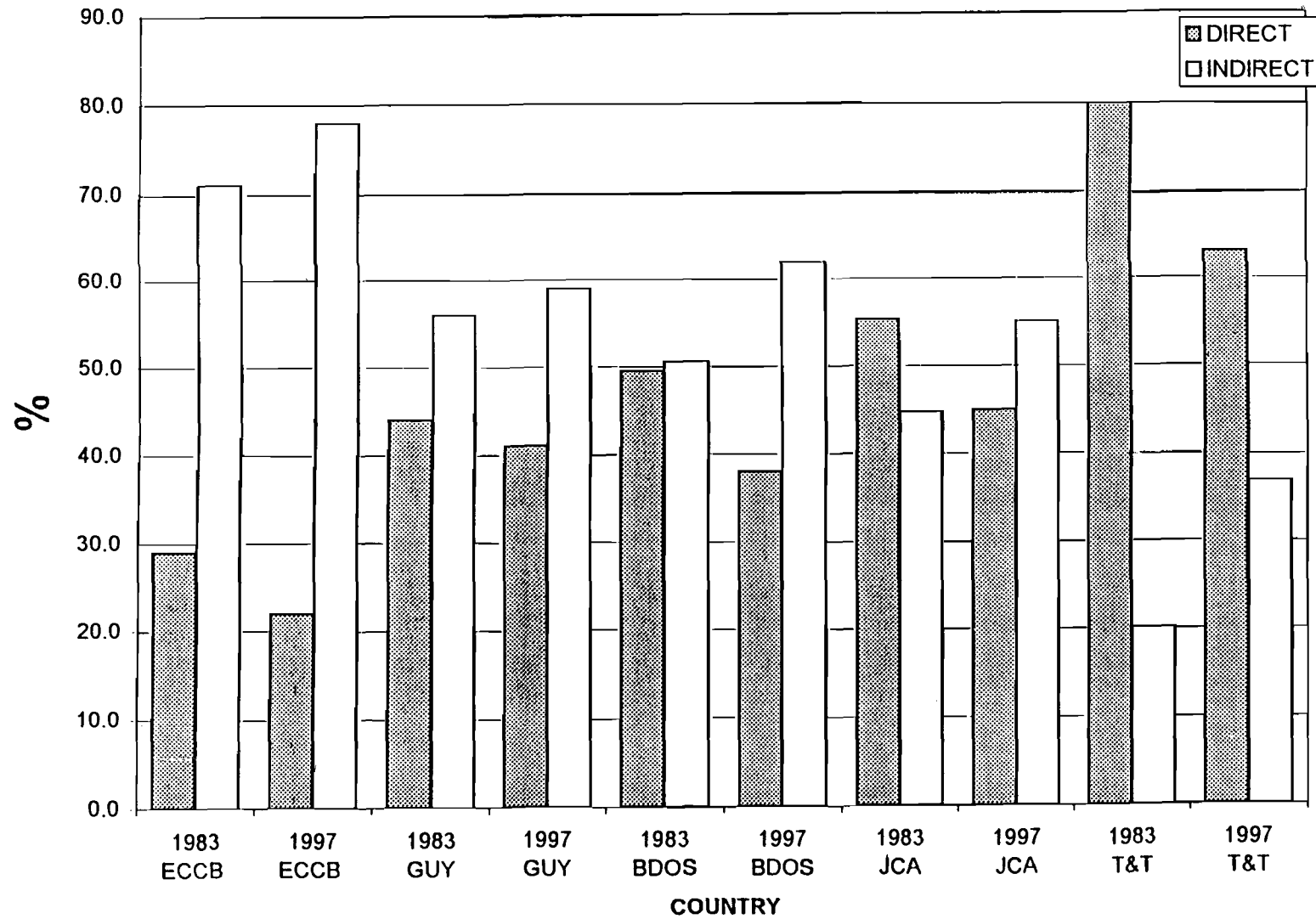
Members of the Eastern Caribbean Central Bank (ECCB) include all the OECS countries (with the exception of the British Virgin Islands) and Anguilla.

2. See note one for members.
3. See, S.B. Webb, *Prospects and Challenges for the Caribbean*, the World Bank, Washington, D.C., 1997, p.1.
4. Ibid.
5. According to a report in the Trinidad and Tobago Guardian of 24th January 1998, Dr. Kenny Anthony, Saint Lucia’s Prime Minister, announced the decision to pay American Airlines US\$1.5 million a year to maintain its direct flights from the USA. Saint Lucia joins Grenada and Antigua and Barbuda in paying such subsidies. Together the islands will pay US\$5 million annually.
6. See G.E. Perry and D. Ledermann, *Financial Vulnerability, Spillover Effects, and Contagion: Lessons from the Asian Crisis for Latin America*, The World Bank, Washington, D.C. , 1998, p.2
7. Gladstone Bonnick, “Storm in a Teacup or Crisis in Jamaica’s Financial Sector,” Adlith Brown Lecture delivered in Nassau in October, 1998.
8. See note one for definition.
9. See Merilee S. Grindle (ed.) *Getting Good Government: Capacity Building in the Public Sectors of Developing Countries*, Harvard University Press, 1997, p. 32.
10. Ibid.

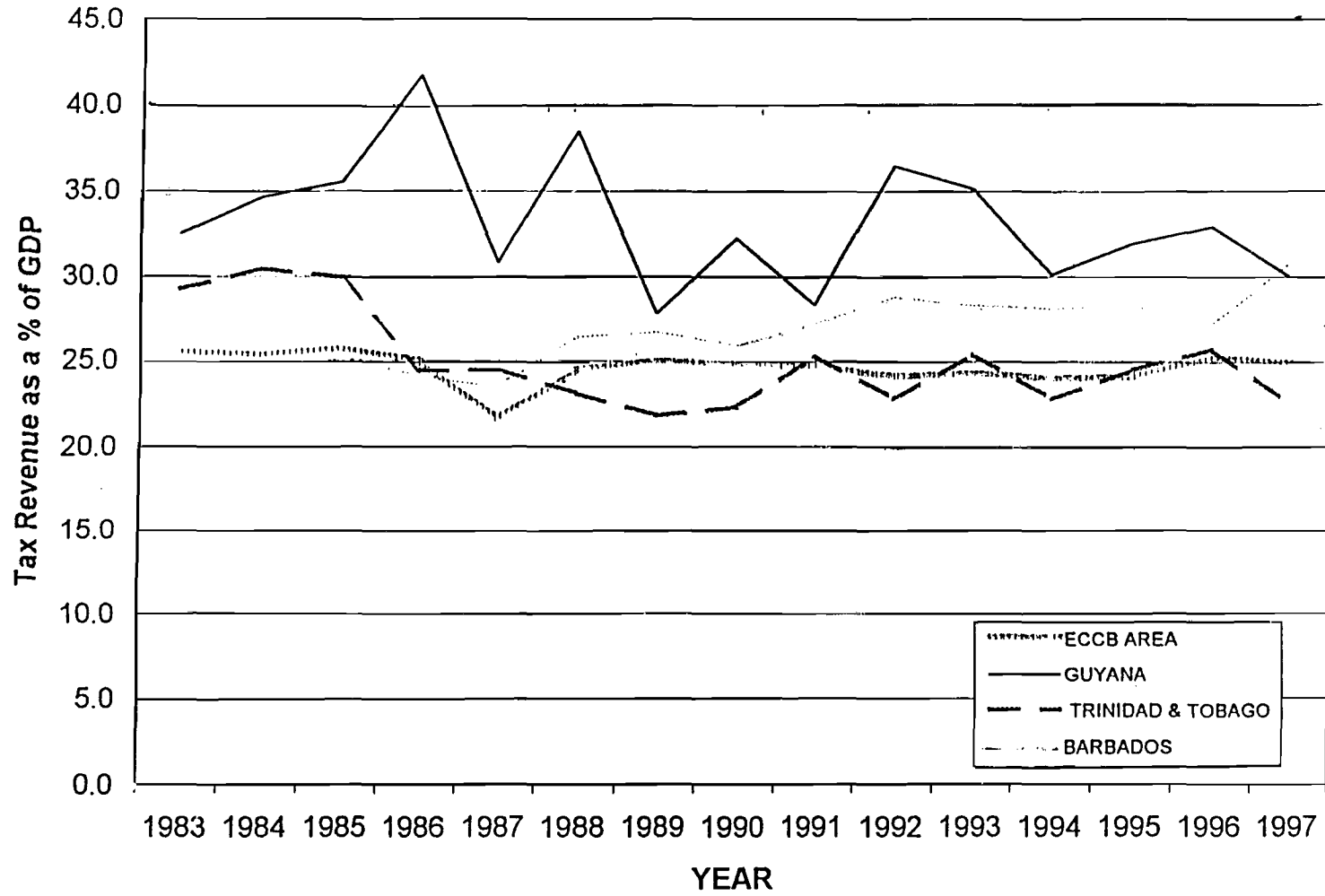
11. World Bank, *Guyana: A Framework for Economic Recovery*, Washington, D.C. May 15, 1985, p. VII.
12. Ibid.
13. Government of Trinidad and Tobago, *The Imperatives of Adjustment: Draft Development Plan, 1983-86*, 1983, p. 158.
14. Ibid.
15. See Roger Leeds in R. Ramamurti and R. Vernon (eds.) *Privatisation and Control of State-owned Enterprise*, The World Bank, Washington, D.C., 1991, p. 88.
16. Ibid.
17. The buoyancy coefficient reflects changes in revenues resulting from changes in the tax laws and tax rates.
18. IDB, *Economic and Social Progress in Latin America*, 1996 Report, Washington, D. C. 1996, p. 242.
19. Ibid., p. 209.
20. See Holzmann, On Economic Benefits and Fiscal Requirements of Moving from Unfunded to Funded Pensions, ECLAC, Santiago, 1997, p. 5.
21. Budget Statement, 1998.

Graph 1

THE DIRECT/INDIRECT TAX MIX 1983 & 1997

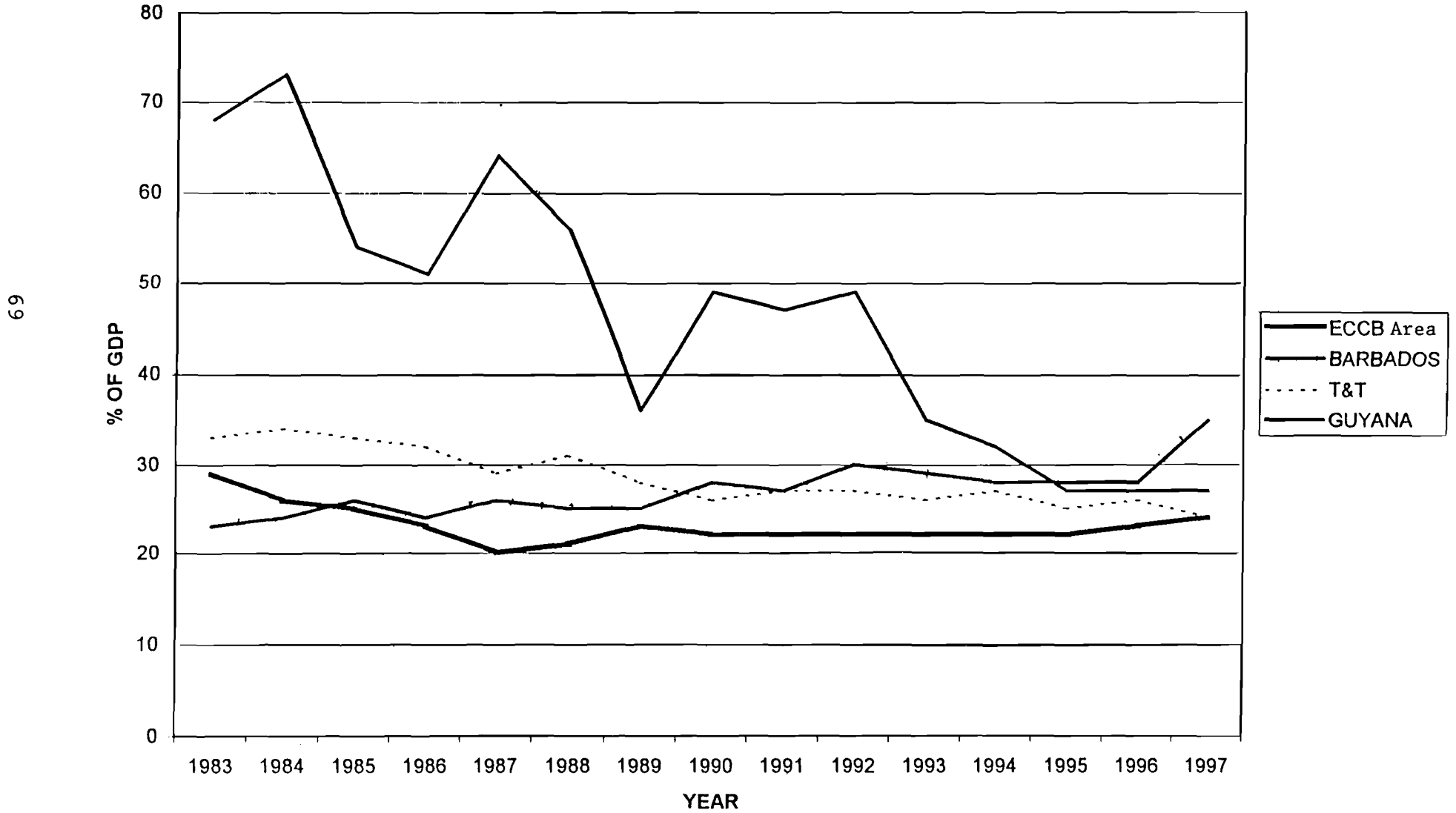


### TAX REVENUE AS A % OF GDP



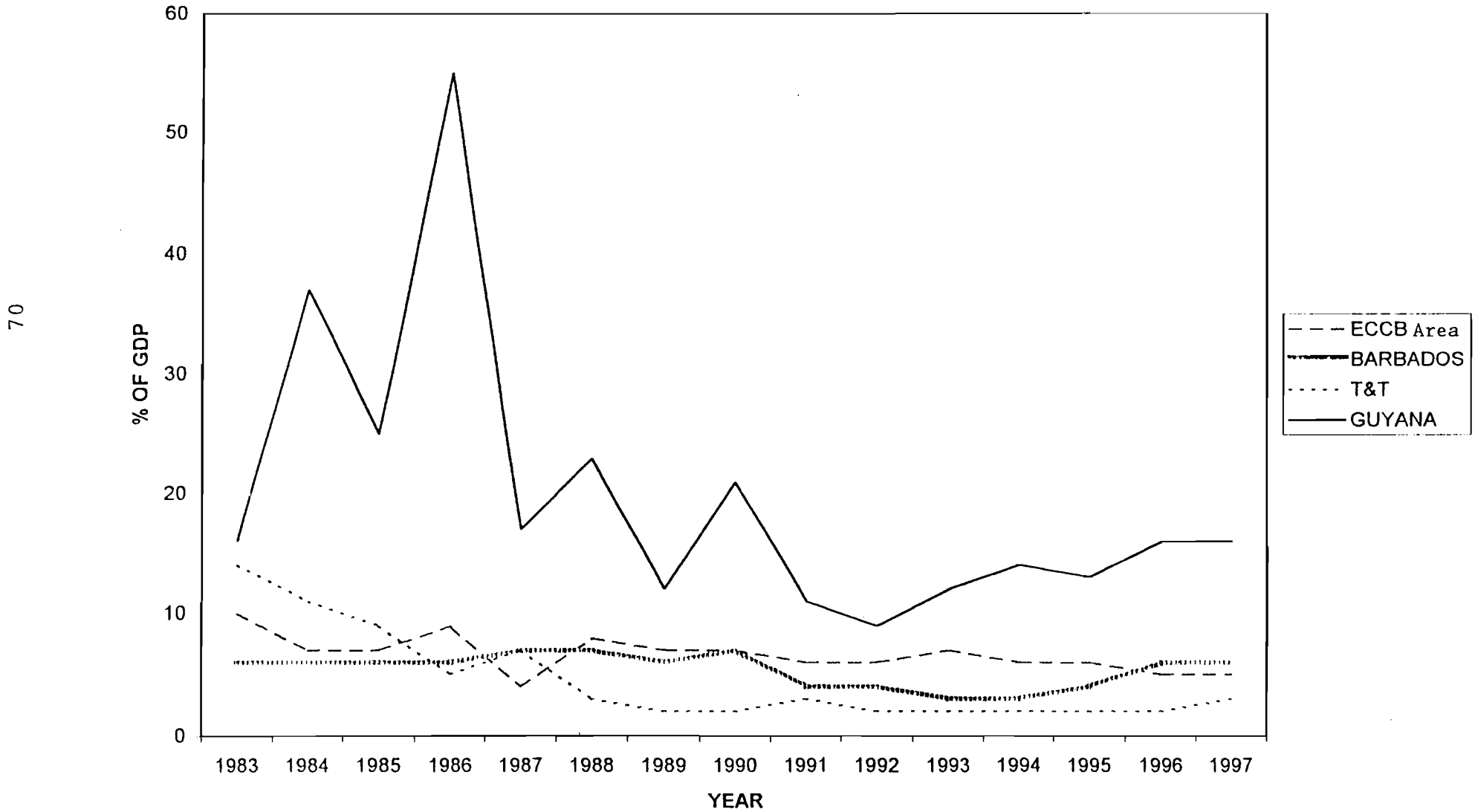
Graph 3

### CURRENT EXPENDITURE AS A % OF GDP

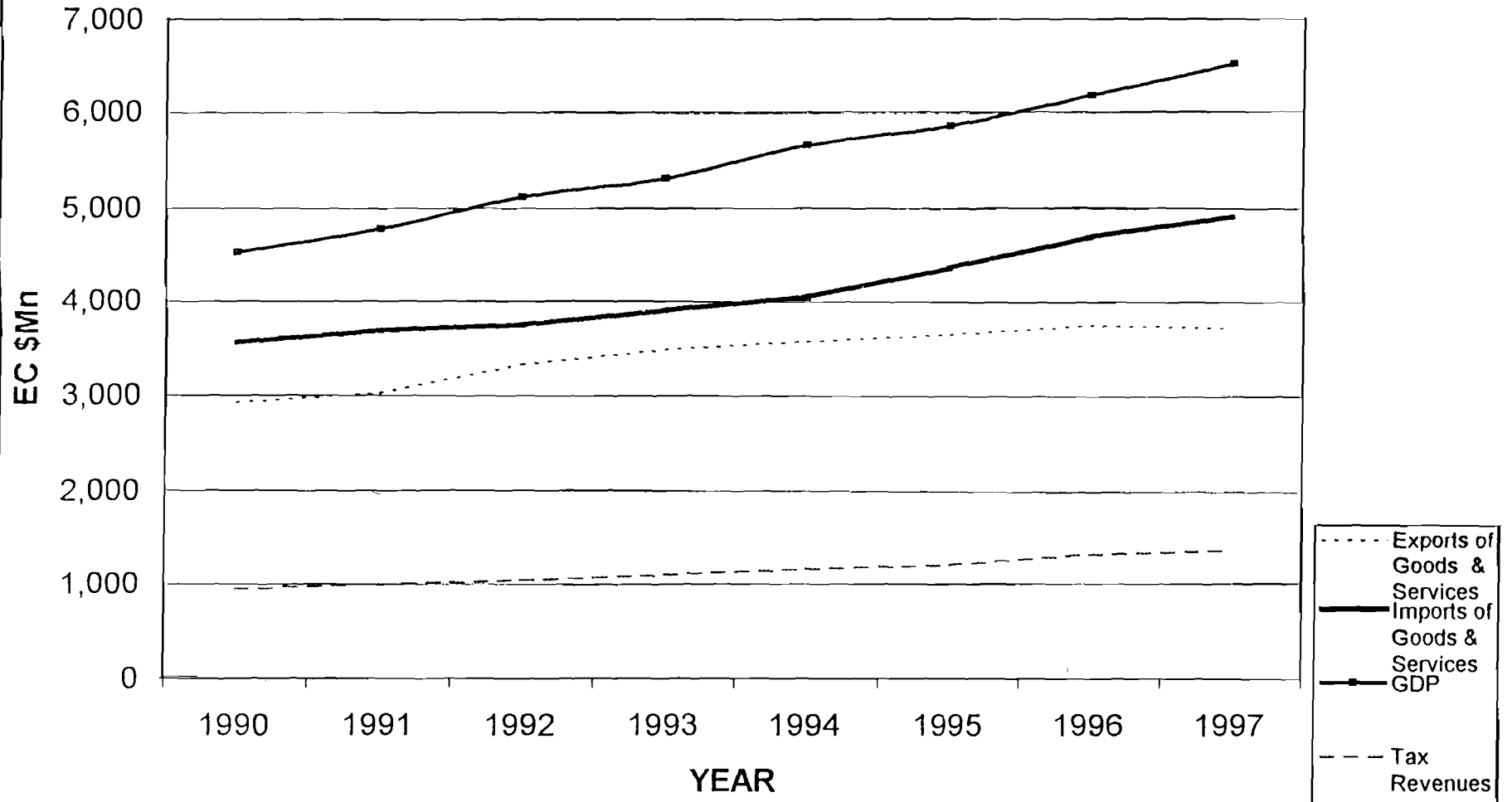


Graph 4

### CAPITAL EXPENDITURE AND NET LENDING AS A % OF GDP



## GROWTH OF TRADE, GDP AND TAX REVENUE IN THE ECCB AREA



## **PART III: THE NATIONAL EXPERIENCE**



# **THE ROAD TO A FISCAL COVENANT: A CRITICAL LOOK AT THE DOMINICAN EXPERIENCE**

by

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## **Introduction**

The relevance of fiscal policy in modern economies could hardly be over-emphasized. In most economies, for instance, governments control a considerable amount of resources and provide employment to a significant part of the labour force. In addition, tax and expenditure policies influence the allocation of productive resources ---including those beyond government's realms-- and the efficiency level of the overall economic activity. Finally, fiscal policy is considered to be a useful instrument to modify the distribution of income among distinct groups of society.

The important role of government in modern economies is in part a heritage from a Keynesian stage in which government was seen as a key to correct a market propensity to underemployment equilibrium. In Latin American countries, the Keynesian standpoint readily mixed with the structuralist thought, according to which a strong governmental intervention was a necessary condition to generate a sustainable development process. Those ingredients, and a long-lasting tradition of political absolutism, made governmental intervention one of the most distinctive features in Latin American economies.

The lessons derived from the economic crisis of the 1980s and the subsequent stabilization processes have challenged the predominant ideas regarding government's role in market economies. In particular, there is a clear tendency to rely on private initiative as the major instrument to generate employment and economic growth. On the other hand, the discussion during the last decade has also emphasized an important role for government action in the struggle against poverty and social inequalities. In order to face such a reorientation of its economic functions, fiscal policy should be modified in several ways.

The ECLAC document presented in 1998 represents an outstanding reflection on the current process of government transformation in Latin American and Caribbean countries. The document proposes organizing our ideas around four critical questions: (1) How to strengthen the current tendency toward greater financial responsibility? (2) How to improve the productivity of public expenditure? (3) How to guarantee the implementation of more transparent schemes of public administration?, and (4) How to promote the adoption of fiscal policies which contribute to a greater social equity? The analysis concludes that proper answers to these questions require a fiscal covenant among all relevant groups that operate in the economic environment.

The present article presents some stylized facts of the Dominican experience on the road towards a transformation of government intervention. The exposition follows closely the lines traced by the aforementioned ECLAC document. More specifically, we open the discussion with a brief description of the macroeconomic evolution of the Dominican Republic during the

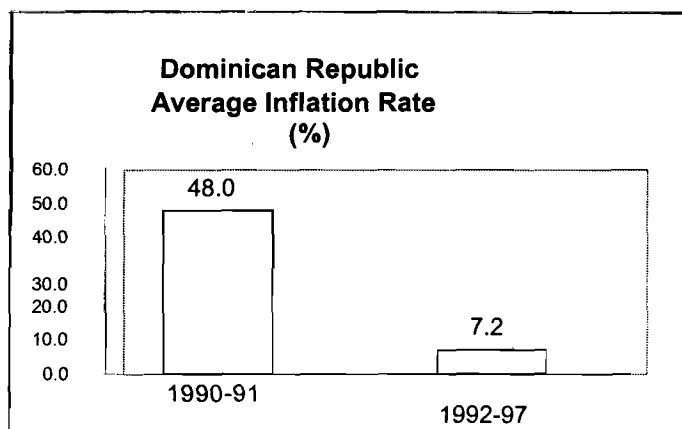
current decade. In the second section, some financial aspects of fiscal performance are evaluated. The third section discusses the quality of public expenditure and the institutional structure which influence such a quality. In section four, we analyze the degree of correspondence between budget prescriptions and actual execution by Central Government. The article ends with an evaluation of public expenditure from a social equity standpoint. The whole exposition relies largely on Guzmán and Lizardo (1998) and Guzmán et al (1998).

### 1. The macroeconomic environment

During the last five years, the Dominican economy has experienced a process of strong growth. This process started in 1992, when a GDP growth rate of around 8 per cent ended the traumatic occurrence of stagflation in the previous years. Later on, after a moderate growth in 1993, the expansionary trend was restarted in 1994, and GDP increased by around 4.3 per cent. The Dominican economy has preserved a continuous expansion since then.

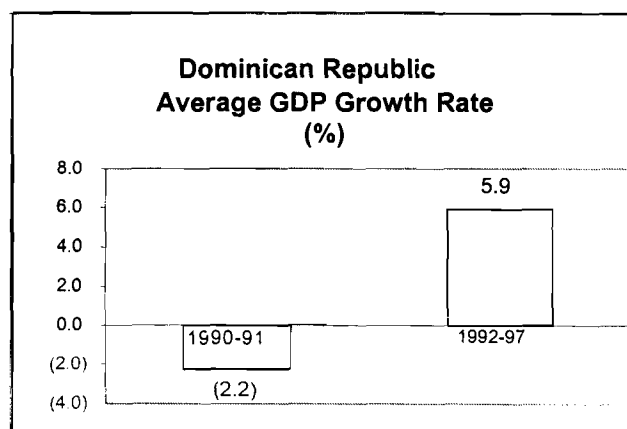
The strong economic growth has not been followed by inflationary tendencies: while during the period 1990-1991 inflation averaged 48 per cent, the average inflation for the period 1992-1997 has been only 7.2 per cent. Aside from a short-lived price outburst in 1994, the inflation rate has been below two-digit levels for the last five years. Such a combination of high growth rates and low inflation rates makes the Dominican economy an interesting case in the Latin American region.

**Figure 1**



Source: Quarterly Bulletin. Central Bank of the Dominican Republic. Several Issues

**Figure 2**

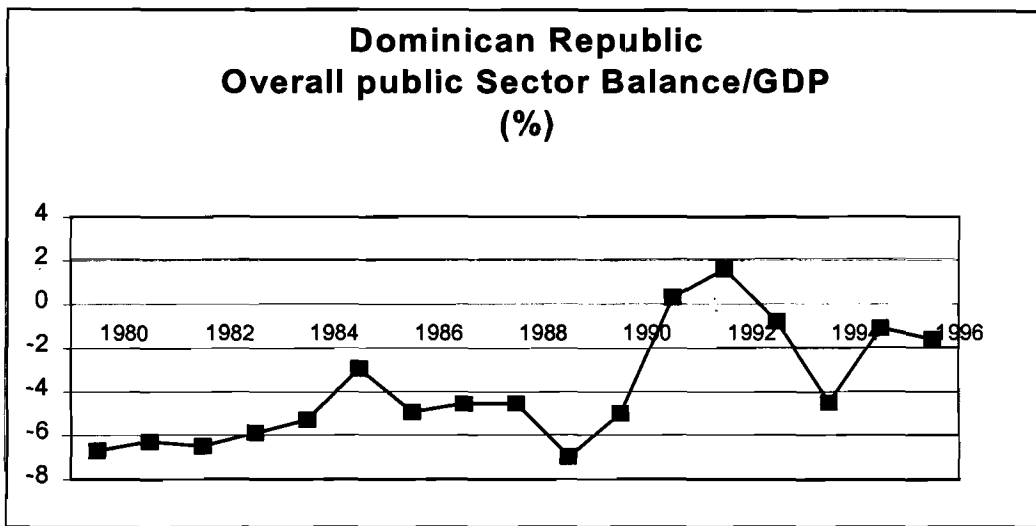


Source: Quarterly Bulletin. Central Bank of the Dominican Republic Several Issues

Such behavior might result from a variety of factors. First, the GDP growth reflects the dynamics of a set of key sectors ---such as tourism, communications, and free zone industry--- which showed a strong expansion since the previous decade. The boom of tourism and free zone industry, together with a significant amount of family remittances and direct investment, has contributed to the financing of the deficit of the current account resulting from the expansionary process.

Secondly, the economic growth is likely to be linked to a set of economic reforms initiated in the first years of the present decade. The reforms included the modification of the customs and internal tax structure, which were key contributors to a relative stability of fiscal balances. Indeed, the ratio of overall public sector balance/GDP has clearly decreased compared to the customary levels of a decade ago: while the overall deficit was near 5 per cent during the 1980s, it went down to around 3 per cent at the beginning of the 1990s and, finally, it has been around 1 per cent most of the time after 1993. It should be stressed that this measure of the deficit had tried to include the significant amount of undocumented debt, and not only the “top” part of the iceberg.

Figure 3



Source: Data Bank National Planning Office (ONAPLAN)

In spite of the positive performance of growth/inflation indicators, it is generally agreed that the persistence of a successful performance requires overcoming several risks inside and outside governmental spheres. In particular, there is a perception that the overall satisfactory performance may be covering some fragility on the fiscal front, which should be removed to guarantee the consolidation of the social and economic progress. The following sections will discuss some of those risks.

## 2. The process of fiscal consolidation

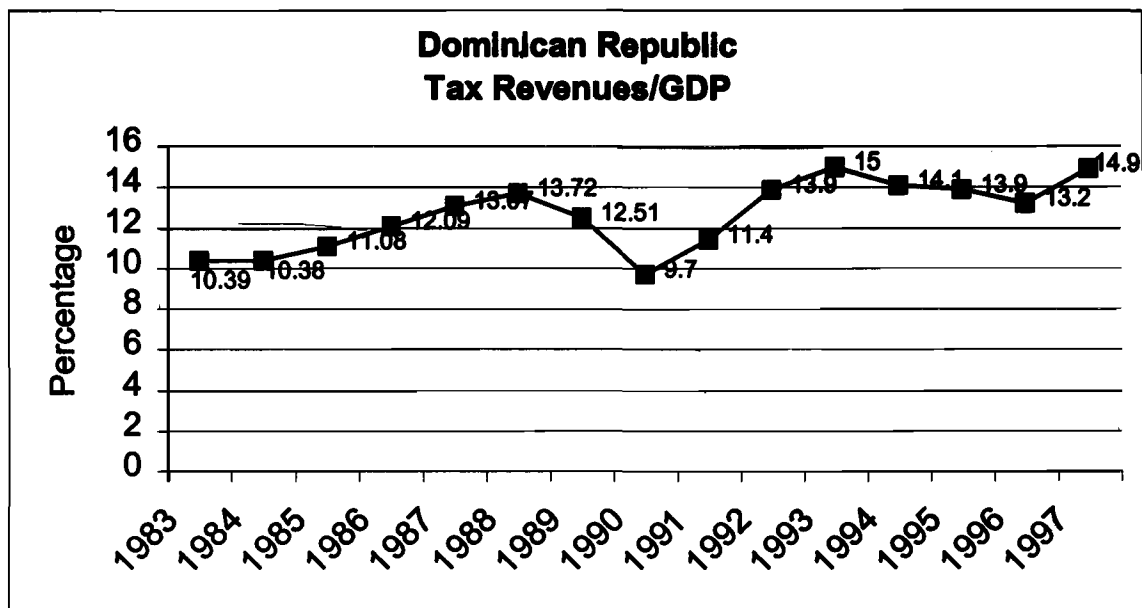
The non financial public sector of the Dominican Republic is formed by a set of ministries within the Central Government, a group of decentralized institutions, the local governments (or “ayuntamientos”) and several public enterprises. The set of decentralized entities is very heterogeneous, including water institutions, educational institutions, and even credit institutions, that depend largely on transfers from the Central Government. Since the Central Government is the largest institution, we will begin with a closer look at it, although a large part of the discussion will be somehow valid for the remaining entities. Here our attention

will be focused on the revenue side, while the expenditure side will be approached in the next section.

It is usually recognized that the relation between tax revenues and GDP is relatively low in the Dominican economy. Indeed, the ratio of tax revenues/GDP was near 10 per cent at the beginning of the 1990s. The ratio jumped to 13.9 per cent after a tax reform in 1992, and reached 15 per cent in 1993, but it decreased slightly during the next three years. In 1997, the combination of a notable effort with a favorable behavior of the revenues from oil taxes increased the tax coefficient to 14.9 per cent. This is still inferior to the average value of this index in Latin American countries ---which is near 18 per cent--- and significantly lower than the average for Caribbean countries ---which is above 20 per cent.

Tax revenues largely depend on two basic sources: customs revenues and a small set of sales taxes. In 1996, for example, both tariffs and sales taxes represented around 30 per cent of total tax receipts of the Central Government. The most important sales tax is the so-called Impuesto a las Transferencias de Bienes Industrializados y Servicios (ITBIS), which is a Valued-Added Tax. Although the ITBIS represents a major source of revenue for the Government, its receipts are considerably low compared to the theoretical potential of the tax. More precisely, ITBIS rate is 8 per cent but its revenues represent around 2.6 per cent of GDP. This is explained by a combination of a large amount of exemptions and persistent evasion. A preliminary study by a government agency has estimated ITBIS evasion rate to be above 40 per cent for the period 1992-1996, and around 23 per cent after the administrative effort which took place in 1997. It is likely that a high rate of evasion also exists in tariffs and income tax collection. In the case of tariffs, there is a general perception that under-valuation is a common practice in customs declarations, and that taxes are systematically evaded by many importers. Admittedly, the evasion is at least in part a result of very high tariffs, which are notably above the average rate in Latin American countries.

Figure 4



Source: Quarterly Bulletin. Central Bank of the Dominican Republic. Several Issues.

**DOMINICAN REPUBLIC  
NON FINANCIAL PUBLIC SECTOR**

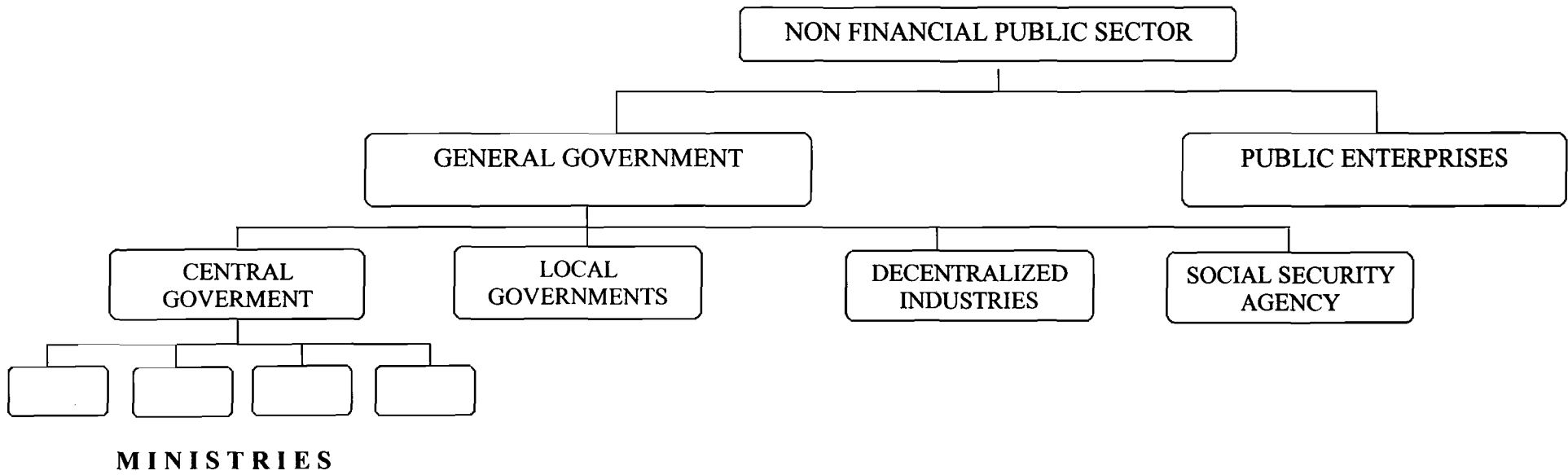
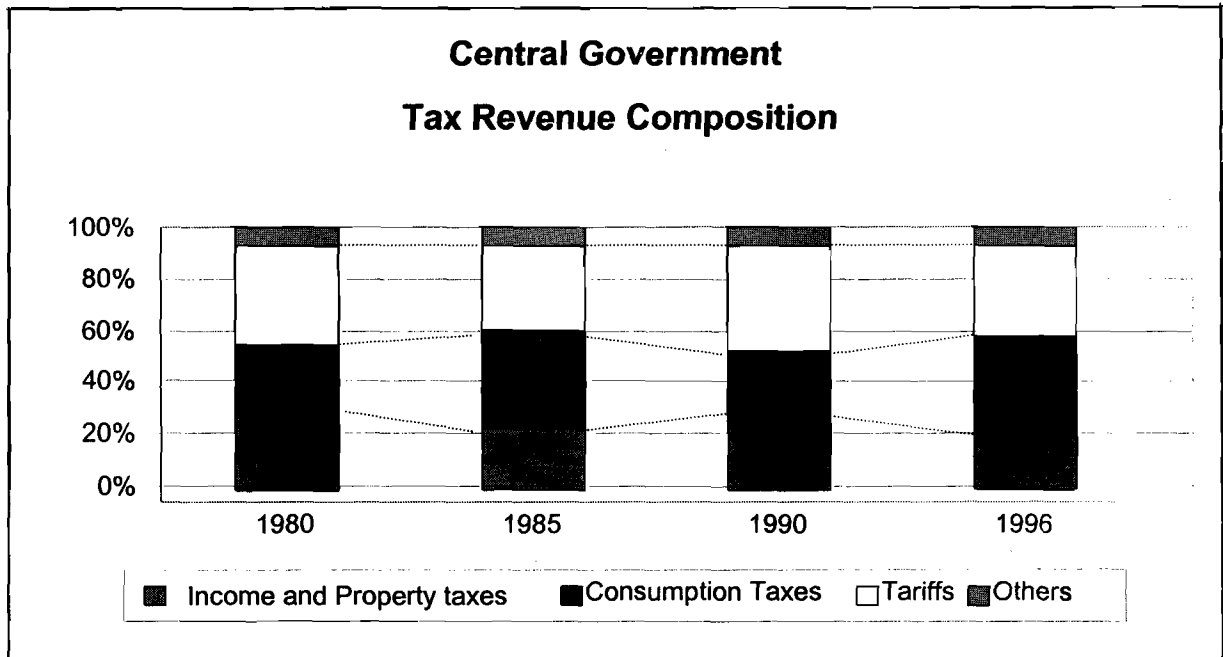
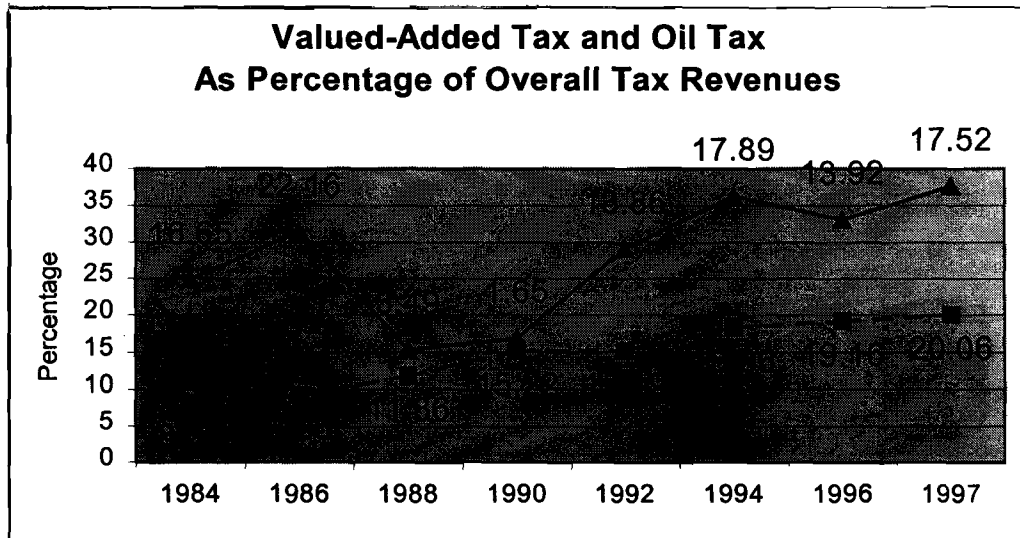


Figure 5



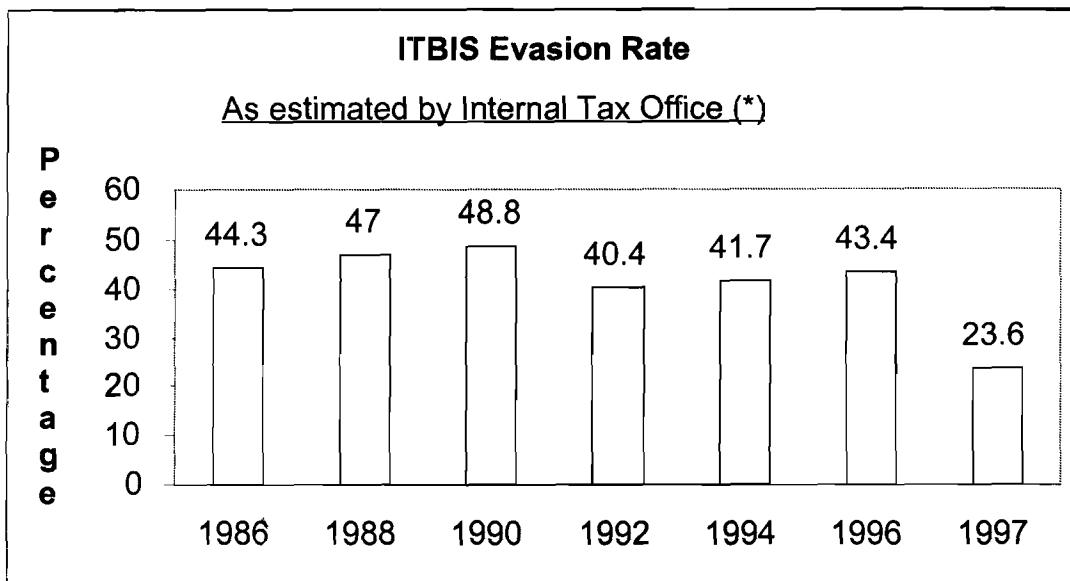
Source: Quarterly Bulletin. Central Bank of the Dominican Republic. Several Issues.

Figure 6



Source: Quarterly Bulletin. Central Bank of the Dominican Republic. Several Issues.

Figure 7



(\*) Unpublished estimation Dirección General de Impuestos Internos (DGII).

In the case of income tax, which represents around 20 per cent of tax revenues, rates are slightly progressive for individuals, moving from 0 per cent for low-income citizens up to 30 per cent for high-income groups. The corporate tax rate is 25 per cent. In spite of the fact that a large number of individuals are not subject to positive taxation, it so happens that personal tax revenues are almost one and a half times the corporate tax revenues. This reflects the fact that many firms understate taxable income or, presumably, overstate interest disbursements in order to reduce the amount of revenue subject to taxation.

Table 1

<b>Dominican Republic</b>		
<u>Income Tax Composition</u>		
<b>1994-1996</b>		
<b>Years</b>	<b>Corporate Tax</b>	<b>Individual Tax</b>
1994	41.2	59.8
1995	42.41	58.6
1996	41.43	59.6

Source: Schenone (1997).

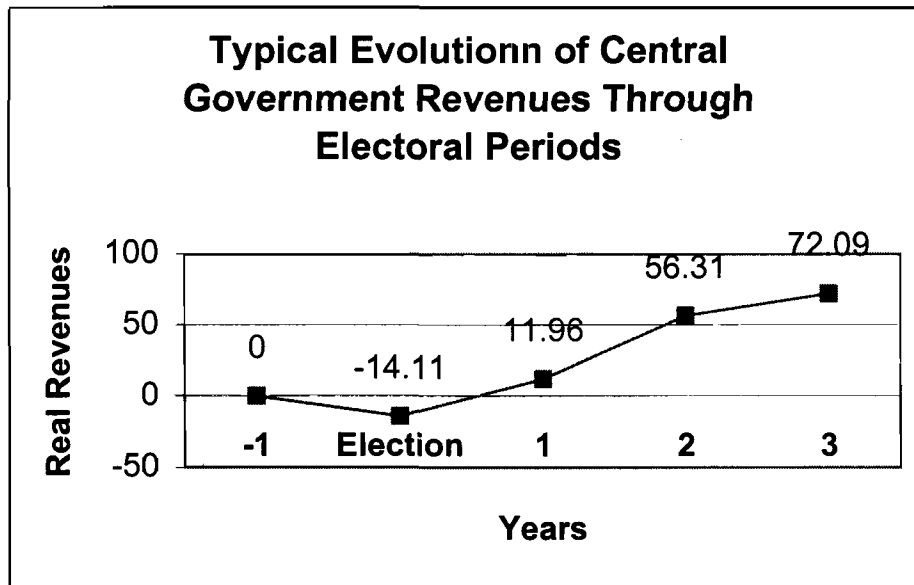
A great deal of effort was made, both by the Dirección General de Aduanas (Customs Office) and by the Dirección General de Impuestos Internos (Internal Revenue Office) to reduce tax evasion. Those efforts are partly responsible for the increase in tax revenue/GDP observed in



1997, but it should be expected that those efforts would rapidly reach diminishing returns. A more profound modification of tax collection mechanisms and tax structure is needed.

Another source of risk on government revenues is given by their high dependence on the political cycle. This has been documented in Guzmán and Lizardo (1998), which shows that the revenues of Central Government tend to decrease during electoral years, an effect that is largely responsible for increases in fiscal deficits during those years. This is represented in the following Figure, which shows the representative path followed by government revenue from the year preceding an election up to the year preceding the next election. See Guzmán and Lizardo (1998) for further details.

Figure 8



<b>A)</b>	-1= Election Year
	0= First Post Election Year
	1= Second Post Election Year
	2= Third Post Election Year
<b>B)</b>	Real Revenues are normalized to make them equal to zero at the pre-election year

Source: Guzmán/Lizardo (1998).

### 3. The productivity of public expenditure

#### The process of budget formulation

The analysis of budget formulation is a convenient starting point, to evaluate public expenditure, since the budget system reflects the efficiency of the overall planning and execution process. The Dominican Government Budget is designed at the Secretariado Técnico de la Presidencia, through two institutions ---the Oficina Nacional de Presupuesto (ONAPRES) and the Oficina Nacional de Planificación (ONAPLAN). The former institution prepares the budget document to be submitted to the National Congress, while the latter institution formulates the general priorities on which the budget should be based. The process is initiated with a letter from ONAPLAN to the different public institutions, describing the general criteria in accordance with the current "Development Plan" or, at least current, general strategy.

Frequently, priorities of the Development Plans have been a simple set of intentions and needs, rather than an investment programme properly stated. Thus, they included a large list of projects without clear analysis of costs and economic viability. The speed of execution of the different projects has, traditionally, been frequently ignored by budget designers. The budget document finally approved by Congress only describes the funds allocated to the different programmes, but goals and other indicators regarding incidence or effectiveness are not presented.

On the other hand, public enterprises, local governments and decentralized public institutions do not appear on the budget submitted to the Congress. Thus, in spite of the fact that the legislation requires that decentralized entities should submit their budget to the President and that they should not be entitled to any resources until receiving presidential approval, such a procedure has rarely been followed.

A particularly critical point of the current budget legislation is an article of the Budget Law which authorizes the Executive to use a fraction of those revenues above the estimation approved by the Congress. Clearly, this provides an incentive to revenue under-valuation and, indeed, under-valuation has been a traditional practice. Thus, the Executive has traditionally had a large amount of resources under its direct control, and that is the reason why the Presidency of the Republic systematically manages funds well beyond the amount finally approved.

At the end of the day, it is likely that this practice is a bad deal even for the Executive itself: to have a large amount of resources under its direct control and being able to use it without previous congressional discussion and public scrutiny, is to open a door to improvisation and political use of public resources. Although it could be reasonably argued that the Executive needs some resources to face contingency expenditures, this cannot justify the huge amount of resources that have traditionally been used. The reform of the old-fashioned Budget Law has been extensively discussed inside the Government, and a new proposal is likely to be ready in the near future.

### The composition of public expenditure

A distinctive feature of Central Government expenditure in the Dominican Republic is the sharp fluctuation of its economic structure. That is, while some administrations show a clear preference for current expenditure over capital disbursements, the opposite is true for others. This is clearly visible in the next Figure: on average, the current account represented 67.8 per cent and 73.8 per cent of total expenditure during the periods 1978-1982 and 1983-1986, respectively; during 1987-1996, that fraction was sharply reduced to 47.7 per cent. The current administration represents a middle way between the preceding governments, with a slight tendency towards more current expenditure.

In any case, the large portion of capital expenditure seems to be a peculiar case, above mode and mean of the remaining Latin American countries. Unfortunately, a large part of that expenditure was traditionally dedicated to housing projects with relatively low distributional power, and that implied some lack of concern for other socially and economically relevant areas. Indeed, until 1985 the public investment on housing projects was a small part ---less than 1 per cent--- of total government investment; but between 1986 and 1995 that fraction increased to more than 25 per cent. Although that increase was later reversed, the share of housing expenditure in government investment continues being significant. Similar statements are valid for urban investment. On the other hand, the share of resources invested in agriculture and transportation was declining during the period 1978-1996.

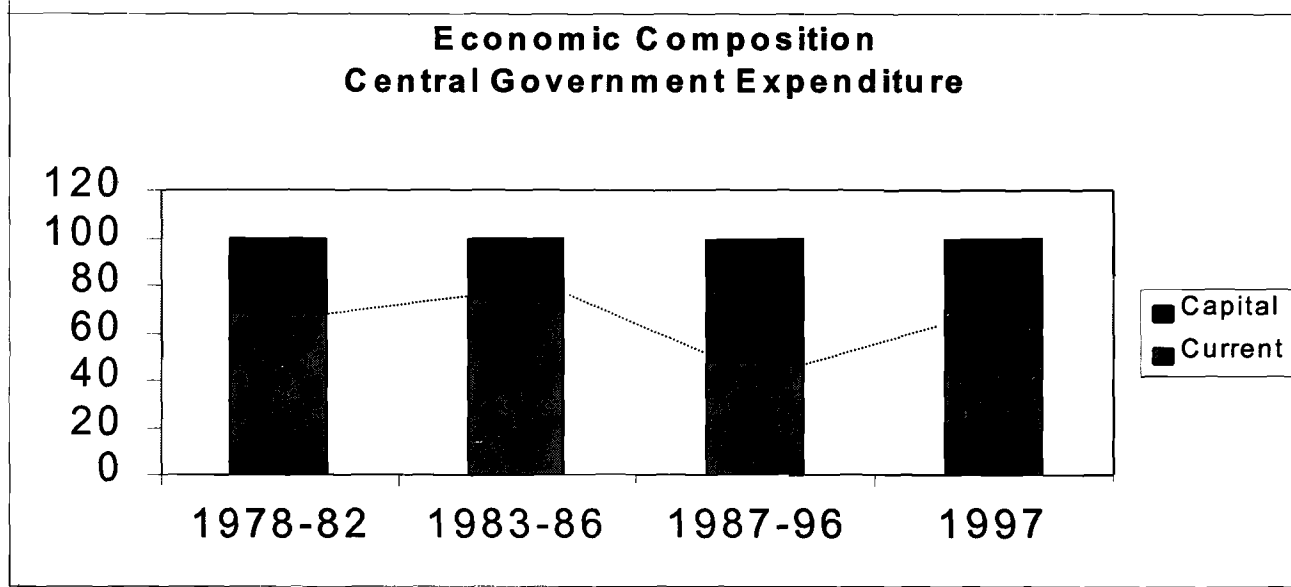
Several motivations may be behind the pattern described above. In the first place, it is likely that a part of the housing investments really reflected the needs of an economy experiencing strong migration flows from rural to urban zones. In addition, housing investment has been traditionally used as an employment booster, given its high labour-capital ratio. But it is also conventionally admitted that many urban projects basically responded to political motivations, and were oriented to the capture of votes in highly populated urban zones. In that sense, it could be reasonably argued that many public urban constructions during the last decades had a questionable justification from a social perspective.

### The quality of government expenditure

Unsurprisingly, the execution of the budget reflects the drawbacks of its formulation. On that matter, the reader is referred to Camilo (1998), who presents a vivid exposition. A set of critical points could be summarized as follows:

- Low coordination among different entities which deal with related matters. As an illustration, let us consider the case of the Instituto Nacional de Aguas Potables (INAPA) and the Instituto Dominicano de Recursos Hidráulicos (INDRHI). In spite of the fact that both institutions are closely concerned with water provision, the communications between them is very limited. So, it has been the case that work done by an entity has been sometimes damaged by the other.

Figure 9



Source: Budget Execution Report

National Budget Office of the Dominican Republic (ONAPRES). Several Issues.

- Limited tradition of project analysis by some public institutions. In fact, although many institutions dealing with project execution have a Project Department or Unit, most of them do not have a tradition of selection and systematic evaluation of their own projects.
- Low maintenance expenditure. Indeed, many institutions have the propensity to favour new projects ---which can be added to the list of works that can be “shown”--- rather than the maintenance of finished projects.
- Poor human capital. Obviously, the quality of public human capital is a very important factor closely linked to the effectiveness of public expenditure. Traditionally, however, the Dominican public sector has been unable to preserve and increase the quality of its human capital. An indirect evidence of that is the comparison between the public and private sectors’ minimum wages. It is seen that, in real terms, the minimum wage of the public sector has decreased from an index value of 100 in 1978 to less than 60 in 1996. That declining trend was reversed in 1997, when a significant increase of government wages was implemented. Of course, the positive effect of such a measure will depend on how the wage increase is linked to efficient incentive-punishment mechanisms, and to the elimination of political preferences as a base for public appointments.

#### 4. Transparency of public expenditure

The degree of transparency on fiscal policy might be measured through various criteria. One could evaluate the share of fiscal resources which are not known to the public. Alternatively, one could analyze the degree in which beneficiaries of fiscal expenditures are clearly identified, and so on. In this paper, transparency will be analyzed in a perhaps less indirect way, by answering the following question: To what extent does government execution correspond to budget prescriptions?

If budget execution differs in a systematic way from the prescriptions approved by Congress, this is, by itself, a source of opacity, since the public knows and discusses ex-ante the real plans of government. In other words, the National Budget is supposed to reflect the preferences of differing social groups, as well as government preferences. The approved Budget should be considered as a social covenant, and a sharp deviation from it should be seen as a subtle evasion of government obligations to society. That is why we take the comparison between budget prescriptions and actual executions as a valid evaluation of the transparency of fiscal policy.

In the Dominican Republic, a large fence between both concepts has been traditionally present. In institutional terms, the comparison between the amounts allocated for the distinct entities differ significantly from the amount finally executed. In functional terms, it is usual to have some sectors performing above budget allocations, while electorally less attractive sectors perform below.

Figure 10

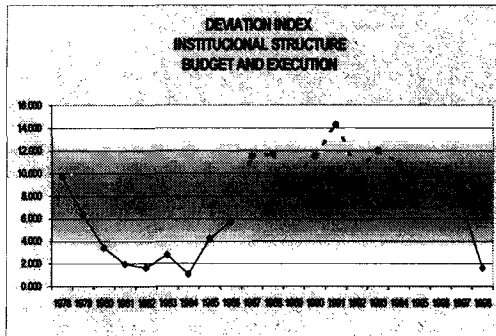
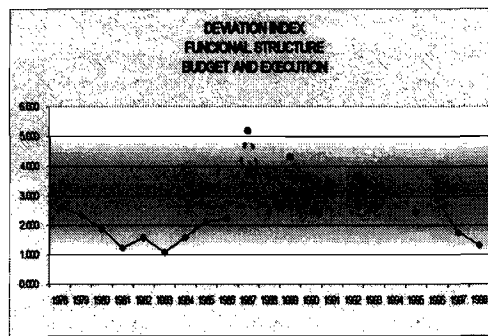


Figure 11



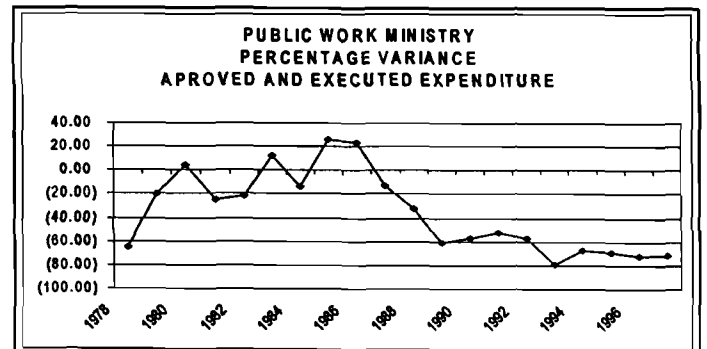
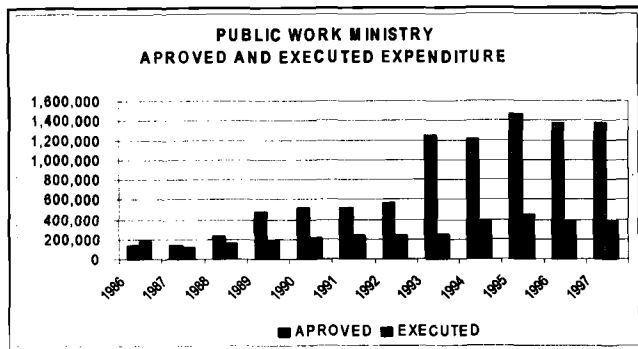
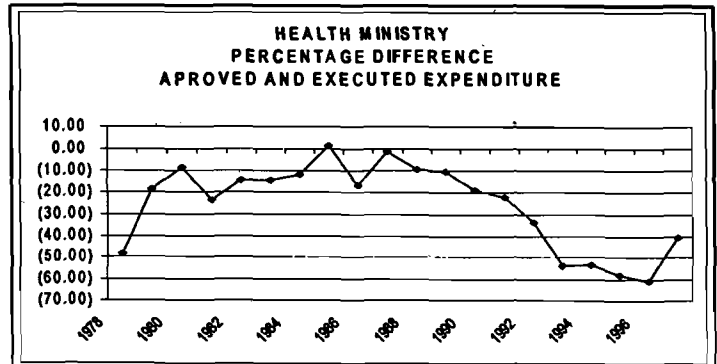
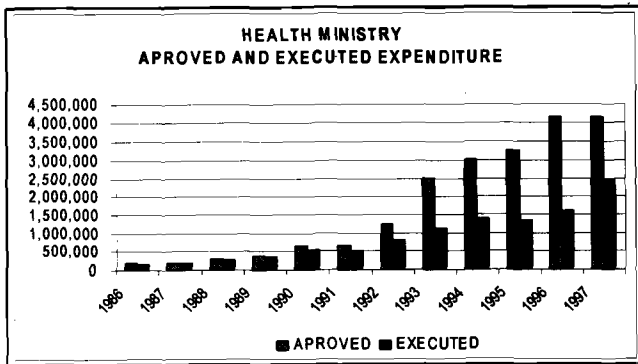
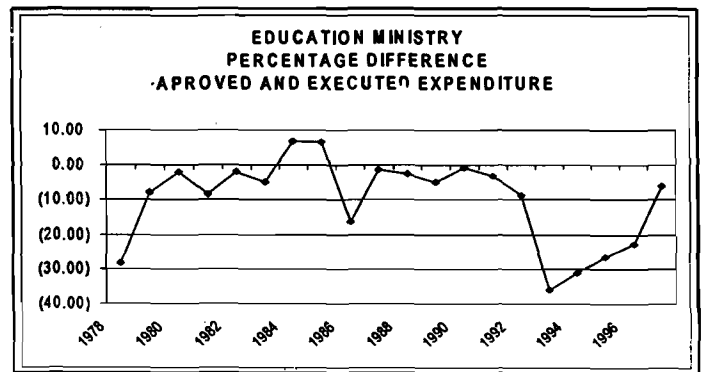
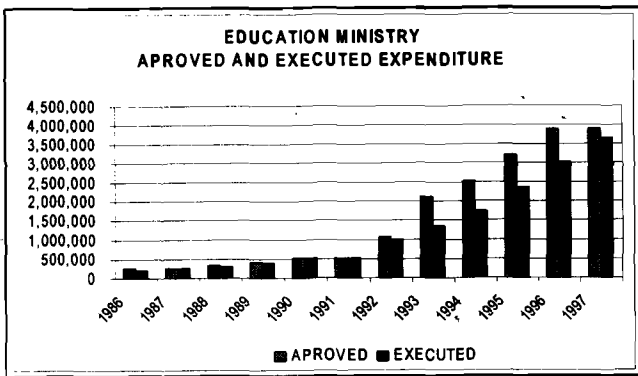
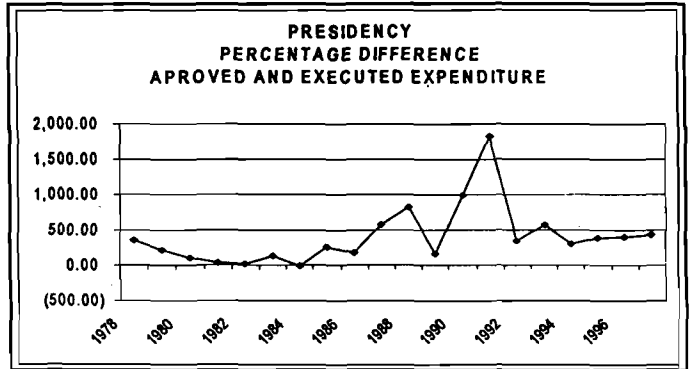
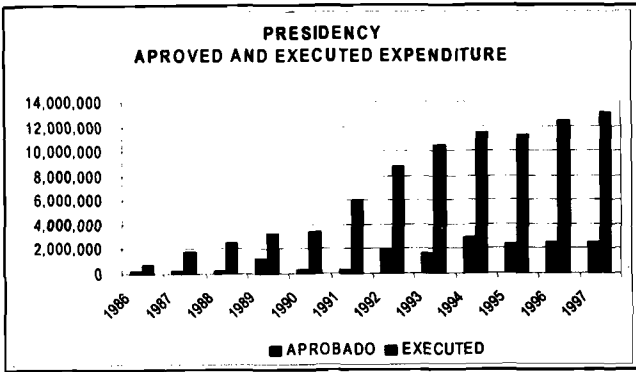
The Figures present a Root Squared Mean Error between the percentage composition of budgeted and executed expenditures of Dominican Central Government over the period 1978-1998. The left figure corresponds to institutional composition of expenditures, while the right one corresponds to its functional structure. The results are similar in both cases. It can be seen that the index began at a very high level, but it decreased persistently over the next six years. It began to increase after 1984, and the process turned stronger with the arrival of a new administration in 1986. A new effort to take budget dispositions into account seemed to have taken place after 1993, and it was reinforced after the arrival of the present Government. In any case, the performance of 1998 is just a return to the levels previously reached 10 years earlier. This leads to the conclusion that stronger efforts are needed to make budgets a real planning instrument.

There are other major areas in which the opacity of government actions is equally drastic:

- a) The transfers from central government to decentralized entities and public enterprises. As noted earlier, decentralized agencies are supposed to submit their budget programme to the Executive before being able to receive appropriations from Central Government. In practice, however, this legal formality is hardly ever satisfied. Generally, the required budgets are sent after several months of delay, during which huge amounts of resources might have already been transferred from Central Government to the institutions which presumably needed them.

In the same vein, transfers to public enterprises should definitely be halted after the capitalization programme of those firms is completed. The capitalization is the financial strategy chosen by the Dominican Government to allow the injection of fresh private money into public enterprises, but preserving public ownership of 50 per cent of equities. Presently, the capitalization procedures for the public energy company, which absorbed around 5 per cent of total Central Government expenditure during 1997, is expected to be finished during the first half of 1999.

Figure 12



Source: Budget Execution Report  
National Budget Office of Dominican Republic (ONAPRES)

- b) Likewise, although Law 17-97 requires that 4 per cent of internal resources of the Central Government, as stated in the Budget Law, should be transferred to ayuntamientos, the administrative expertise of those entities is not of a very high level. Thus, it is not clear how well the increased amount of money now managed by ayuntamientos is really being used. Moreover, some recent studies by the Commission for Reform and Modernization of the State found that the resources directly generated by the ayuntamientos have tended to decrease parallel to the increase in Central Government transfers to them. The quality of financial management and the economic soundness of local governments' projects should be an area to explore during the next years. The benefits from a more decentralized government structure should be combined with an appropriate use of public resources by ayuntamientos. Otherwise, the decentralization process itself will be subject to criticism.
- c) In the same vein, it should be said that transfers given by Government to the private sector are not always better used than in government institutions. The private entities which receive these transfers are hardly monitored by government. Many institutions receive transfers as a result of tradition or routine, and not because recipients are important from a social point of view. To improve its quality, the transfer to private entities should be sufficiently selective and focused on activities/institutions which are important to the government.
- d) A last critical point for concern is the management of internal debt of the public sector. In a clear contrast with the management of external debt---which, in general, is viewed as a commitment that the country should fulfil, the management of internal debt has generally been careless. Indeed, a large part of it is not properly documented, because it consists of commercial debt with suppliers of materials for public offices, small construction firms, and so on. Recently, the Executive submitted to Natural Congress a Law Proposal regarding ways of payments for overall internal debt with suppliers, construction firms and others, through a period of seven years. The project is being discussed by Congress.

## **5. Social equity and fiscal policy**

### a) General trends in social expenditure

The share of social expenditure in aggregate product has been traditionally low, although it shows a slightly positive trend during the last years. During the period 1995-1997, for example, the ratio social expenditure/GDP has been 5.6 per cent, 5.8 per cent, and 6.3 per cent, respectively. Those figures are significantly below the average ratio for Latin American countries during the same years.



Table 2

<b>COMPOSITION OF CENTRAL GOVERNMENT INVESTMENT (Percentages)</b>										
<b>1979-1996</b>										
<b>Year</b>	<b>Housing</b>	<b>Water</b>	<b>Agriculture</b>	<b>Irrigation</b>	<b>Transportation</b>	<b>Roads</b>	<b>Communications</b>	<b>Urbanism</b>	<b>Energía</b>	<b>Energy</b>
1980	0.33	5.67	16.72	0.23	38.95	3.84	0.05	8.75	1.07	25.41
1982	0.74	0.75	7.75	0.00	39.14	11.18	1.52	17.64	0.00	21.28
1984	2.47	1.39	20.04	4.19	33.30	7.28	0.92	8.06	0.14	22.22
1986	0.67	0.76	8.08	0.85	42.90	7.84	0.16	12.65	0.43	25.66
1988	26.46	6.58	8.03	1.04	19.32	4.59	0.10	13.82	1.11	18.94
1990	26.98	2.63	7.53	0.03	19.76	7.49	0.03	18.89	1.96	14.69
1992	16.84	4.15	7.73	0.01	23.85	3.09	0.00	23.65	1.11	19.57
1994	13.18	1.76	3.84	0.01	23.81	8.85	0.06	26.41	0.47	21.62
1996	10.03	1.80	2.04	0.00	38.63	4.02	0.01	25.19	1.15	17.39

Table 3

<b>EXPENDITURE ON SOCIAL SECTORS</b>										
<b>AS PERCENTAGE OF TOTAL EXPENDITURE 1978-1997</b>										
<b>Year</b>	<b>Education</b>	<b>Recreations/ Sports</b>	<b>Health</b>	<b>Social Security</b>	<b>Labor Programs</b>	<b>Housing</b>	<b>Water</b>	<b>Municipalities Services</b>	<b>Others</b>	<b>TOTAL</b>
1978	13.45	0.97	7.86	4.95	0.12	3.30	3.37	2.77	0.36	37.57
1980	13.00	0.74	6.92	5.61	0.16	1.21	2.57	2.70	0.80	33.70
1982	16.42	0.67	8.15	7.09	0.26	0.55	0.87	2.78	0.67	37.46
1984	15.40	1.74	8.12	7.54	0.14	0.56	1.15	4.54	1.06	40.26
1986	12.44	2.92	6.73	5.67	0.11	0.96	1.20	3.41	0.49	33.94
1988	10.09	0.85	8.09	3.12	0.06	8.63	5.12	2.60	0.28	38.86
1990	9.86	1.01	9.48	3.81	0.08	7.85	5.13	2.17	0.22	39.62
1992	8.93	0.92	7.41	2.02	0.11	4.36	9.44	1.88	0.15	35.23
1994	12.19	1.36	8.91	2.82	0.11	4.75	10.24	2.06	0.21	42.64
1996	13.40	1.22	9.12	3.71	0.10	3.59	5.00	3.19	0.23	39.55
1997	13.80	1.20	8.65	4.64	0.10	1.96	3.99	3.83	0.22	38.40

Source: Budget Execution Report. Several Issues. National Budget Office of Dominican Republic (ONAPRES)

At first sight, this could be interpreted as a result of the low share of social expenditure in the total government expenditure. Indeed, since 1978 the social expenditure has fluctuated between 33 per cent and 38 per cent of the Central Government total disbursements. Specifically, the ratio social expenditure/total expenditure averaged 35 per cent in the period 1978-1982, and it was augmented in the period 1986-1989 as a result of a significant increase on housing investment. Since then, the ratio has stayed around 38 per cent. A 1997 study by ECLAC reported an average value around 48 per cent for a large set of Latin American economies.

However, it could be argued that the share of social expenditure in the Dominican public expenditure is not so low after taking into account the income level of the country. For that matter, it is convenient to compare the Dominican case with a larger set of economies classified in accordance with the level of per capita income. The results in the next Table show that the share of social expenditure in the total expenditure of the Dominican Central Government is indeed one of the highest among the set of low income countries, and it is even superior to that in many middle income countries.

This suggests that the low ratio social expenditure/GDP in the Dominican economy is more a consequence of a low tax coefficient, than a result of a low ratio of total expenditures. This suggests that an increase on the ratio social expenditure/GDP cannot be achieved based on a reduction of other forms of expenditure, but it requires an increase in revenues, in order to ensure a greater amount of resources for the government.

Whereas the ratio of social expenditure/total expenditure has been relatively stable throughout the last decades, significant changes have taken place in the composition of social expenditure. In particular, the latter years have seen a significant increase on the investment on education and health, coupled with a decrease in housing and water expenditure. In spite of its increase, however, the public investment on human capital is still small, and it seems that there is room for significant improvement in that sense. As we argued earlier, the main problem is how to achieve that without diminishing other important areas of public needs. This suggests again the need for an increase in public resources.

Of course, any movement in that regard should be accompanied by a serious effort to increase the transparency and efficiency of government expenditures. A positive outcome in that direction is the fact that, during the last decade, there have been signals of a slight reorientation of resources toward programmes with greater redistributive power. For example, the composition of the expenditure on education has tended to be based towards expenditure on basic educational programmes. Because international evidence suggests that investment on basic education has greater potential for progressiveness than other educational programmes, such a change may be considered positive.

Table 4

<b>PUBLIC EXPENDITURE ON HEALTH AS PERCENTAGE OF GDP</b>	
<b>Regions</b>	<b>1990</b>
<b>All countries</b>	3.22
<b>Industrial countries</b>	5.88
<b>Latin America and Caribbean</b>	3.55
<b>East Asia</b>	1.28
<b>South Asia</b>	1.71
<b>Other Asian countries</b>	1.76
<b>Africa, South of Sahara</b>	2.42
<b>North Africa and M. Orient</b>	2.08
<b>Other European and Asian countries</b>	3.26
<b>Dominican Republic</b>	1.5

Table 5

<b>PUBLIC EXPENDITURE ON EDUCATION AS PERCENTAGE OF GDP</b>		
<b>Regions</b>	<b>1980</b>	<b>1990</b>
<b>All countries</b>	4.4	4.6
<b>Industrial countries</b>	5.9	5.7
<b>Latin America and Caribbean</b>	4.3	4.3
<b>East Asia</b>	3.4	4.1
<b>South Asia</b>	2.2	4.1
<b>Other Asian countries</b>	3.5	3.5
<b>Africa, South of Sahara</b>	4.5	4.3
<b>North Africa and M. Orient</b>	4.4	5.1
<b>Other European and Asian countries</b>	4.2	4.8
<b>Dominican Republic</b>	2.1	1.1

Source: ECLAC (1997). La Brecha de la Equidad.  
National Budget Office of the Dominican Republic (ONAPRES).

Table 6

<b>EDUCATION SECRETARIAT EXPENDITURE CLASSIFIED BY PROGRAMS AVERAGE PERCENTAGES 1978-1997</b>		
<b>YEARS</b>	<b>Denomination</b>	<b>TOTAL</b>
<b>1978-1982</b>	<b>Administration</b>	8.32
	<b>Basic education</b>	39.85
	<b>Second Level education</b>	16.82
	<b>Technical education</b>	3.04
	<b>Others</b>	31.96
	<b>TOTAL</b>	100.00
<b>1983-1986</b>	<b>Administration</b>	5.92
	<b>Basic education</b>	44.96
	<b>Second Level education</b>	15.31
	<b>Technical education</b>	2.61
	<b>Others</b>	31.20
	<b>TOTAL</b>	100.00
<b>1987-1996</b>	<b>Administration</b>	11.26
	<b>Basic education</b>	50.71
	<b>Second Level education</b>	10.41
	<b>Technical education</b>	2.63
	<b>Others</b>	24.99
	<b>TOTAL</b>	100.00
<b>1997</b>	<b>Administration</b>	18.09
	<b>Basic education</b>	47.16
	<b>Second Level education</b>	10.21
	<b>Technical education</b>	2.26
	<b>Others</b>	22.28
	<b>TOTAL</b>	100.00

Source: Budget Execution Reports. Several Issues.  
National Budget Office of the Dominican Republic (ONAPRES)

### Geographic distribution of social expenditure

The geographic aspects have been traditionally ignored in the analysis of the Dominican Government expenditure. This is a pity, because overwhelming evidence indicates that poverty and social needs have a clear geographic dimension. Moreover, the presence of externalities and complementarities tend to make difficult the orientation of private resources to those areas with low economic activity. This perpetuates a vicious dichotomy between poor and rich geographic areas, and the government intervention is strictly necessary to alter such an equilibrium.

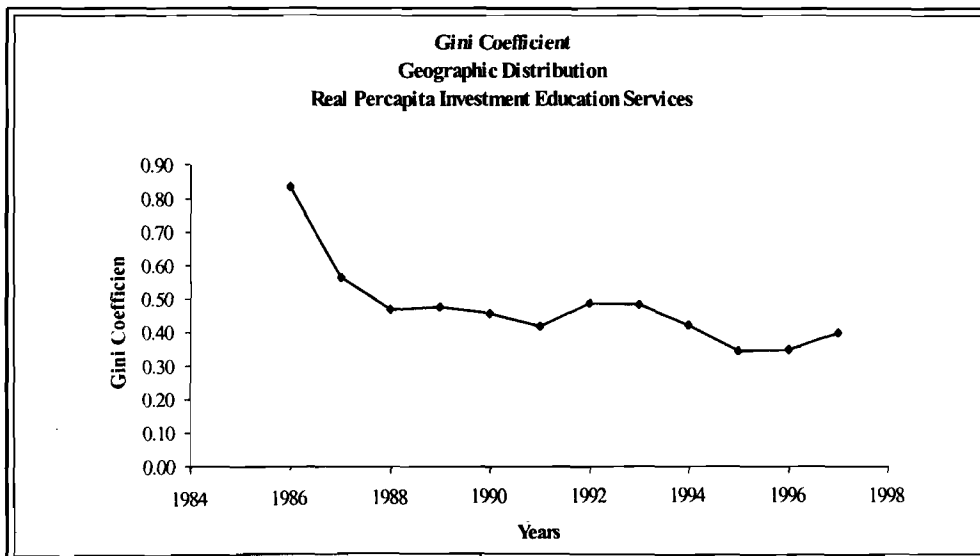
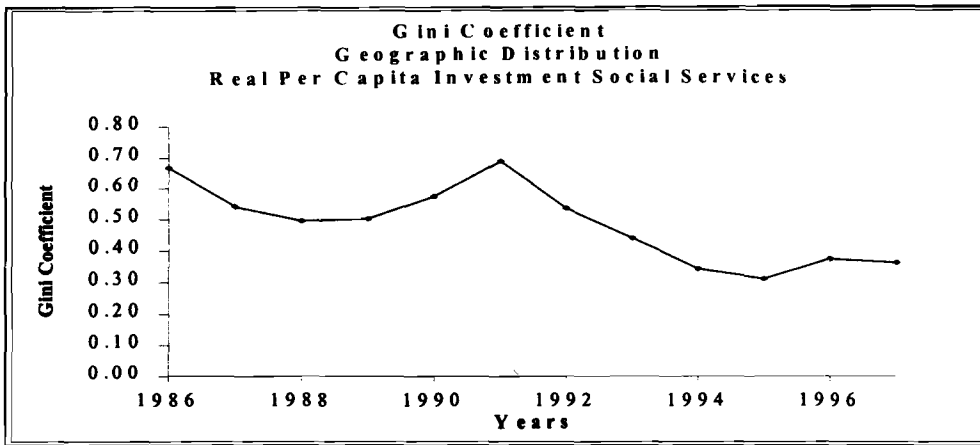
Then it is important to study to what extent the public expenditure has contributed to alleviate the regional inequalities in the Dominican Republic. Such a study was recently carried out by Guzmán et al. (1998), who analyzed the regional distribution of public social investment through the period 1978-1997. The main results of that research might be summarized as follows:

- a) The distribution of public expenditure is very unequal throughout regions and provinces. Using per capita investment, for example, it was found that some regions receive a per capita investment significantly superior to the per capita investment made in other regions. This is shown in the next Table, where per capita expenditure has been normalized in such a way that the per capita investment in the most favoured region is equal to 1. The figures corresponding to each other region equal the ratio between the per capita investment of that region and the per capita investment of the most favoured region.
- b) The inequality persists even when the differences on poverty levels are taken into account. In that sense, the authors constructed an index in which the per capita investment received by a region or province is adjusted to reflect the poverty level of that region. They show that the distribution of adjusted per capita public investment is still highly unequal throughout the different regions.
- c) Some provinces are systematically favoured in the sense that, throughout different periods, the adjusted per capita investment they received was persistently above the median values. On the other hand, other geographic areas were systematically not favored, in the sense that, throughout different periods, the adjusted per capita investment they received was persistently below the median values.

On the other hand, it should be acknowledged that some improvements have taken place in terms of regional allocation of public expenditures. This conclusion emerges from the comparison of the evolution of geographic concentration indices corresponding to overall public investment as well as the coefficient corresponding to investment on selected functions. This is done on the next sequence of figures, where we present the Gini coefficient for the geographic distribution of total public investment on social functions, as well as for public investment on two specific social functions ---education and health services. It is clear that the coefficient for total social investment and for investment on education have tended to decrease over the present decade, aside from a small increase in the years 1995-1996. However, in the case of health investment, a stagnation, can be noted over the period 1986-1993, followed by a deterioration

after 1994. Overall, it seems to be reasonable to say that the geographic distribution of social government investment has improved compared to the pattern of the previous decade, but the improvement has not been homogeneous over all sectors.

Figure 13:



Source: Guzmán et al (1998)

## **6. The reform of the Dominican State: Main features**

As in many countries, the Dominican State is being subjected to a process of sharp transformation. This covers different areas of Government activities ---such as trade and fiscal policy--- as well as the institutional structure of Government itself. For example, a recognizable need is to increase the coordination among various institutions, in order to minimize the possibility of contradiction or duplication of effort on regular government functioning. This has led to some government effort to implement a kind of economic and social cabinet, encompassing all major institutions dealing with the formulation and/or implementation of social or economic policies.

Another need is to increase the level of efficiency in the design, execution and supervision of government investment projects. This has led to the ongoing development of a Projects Bank at the Oficina Nacional de Planificación, with the mission of implementing a strict control of all government investment projects.

Other parts of Government transformation are being channeled through a set of Law Proposals which are being presently debated. This includes, among others: a) a new scheme to govern procurement procedures; b) a law which restructures the accounting and internal financial auditing procedures of the public sector; c) a new customs law; d) a transparent procedure for the payment of internal public debt; e) a law for restructuring current tariff structure; and, f) a law for market regulation. The elaboration of a draft law for the modification of the current budget law is also on the way.

It is not clear whether this set of proposals will be passed by Congress. In recent years, the predominance of opposition parties in Congress has been a persistent handicap for the advance of several relevant projects in the economic area. Indeed, an important problem for the Dominican Republic is how to enjoy the benefits of an independent Congress, but avoid moving into a state of stagnation as a result of political struggles. The solution to that problem will likely require a transformation of the political system itself, but that should be a matter for future discussion.

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## **THE NEW FISCAL COVENANT**

by

***Mr. Calixte Leon, Director of Research, Development and Policy  
Government of Saint Lucia***

I have been asked to share with you Saint Lucia's experiences in keeping with the "the New Fiscal Covenant" recently published by ECLAC. Although I have not been able to review the publication thoroughly, I understand the critical elements to encompass:

- ❑ Fiscal consolidation
- ❑ Raising the productivity of public expenditure
- ❑ Transparency; and
- ❑ The promotion of social equity

Our experiences must of necessity be viewed within the context that macroeconomic management has to be pursued in large measure through fiscal policy. This stems from the fact that the country's use of monetary and exchange rate policies is constrained by membership in the Eastern Caribbean Central Bank (ECCB). It would appear, therefore, that the Saint Lucia policy maker has very few policy instruments which can be freely used to maintain internal and external equilibria.

Unlike some countries in Latin America and the Caribbean which have experienced chronic budget deficits, Saint Lucia has maintained prudent fiscal policies which have facilitated economic stability and sustained growth over the years. Due primarily to our small size, limited resources, a stable political environment and the sharing of a common currency, there has been no radical shift in fiscal policy stance. The objective has always been, and continues to be, the generation of savings to finance, in part, our public sector investment programmes.

On the revenue front, the effort has been concentrated on efficiencies in collections with minor adjustment in the structure and rates of taxes. Current expenditures have been tightly controlled and held within affordable levels.

### **Fiscal consolidation**

As mentioned earlier, Saint Lucia has pursued prudent fiscal policies thus avoiding large budgetary deficits. In fact, since the mid-1980s, current surpluses have been recorded, peaking in Fiscal Year (FY) 1993/1994 at EC\$ 98.4 million or 8.7 per cent of GDP. More recently, however, the surpluses have been declining and new efforts at arresting the slide are being pursued. You might be asking: "What brought about this change?"

- ❑ Reclassification of the Public service in 1993/1994; and since Saint Lucia is a highly unionised

- Salary/wage increases for a new triennium in 1995/1996

In addition, the contraction in the banana industry over the last five years coupled with sluggishness in manufacturing has resulted in a downturn in economic activity. This new reality has forced some further consolidation with Government:

- Setting new fiscal targets:
  - Public sector savings/GDP ratio of 7 per cent and 8 per cent for FY 1998/1999 and 1999/2000, respectively<sup>2</sup>; and
  - A capital expenditure/total expenditure ratio of 30 per cent
- Declaring its intention to reform the taxation system. The objective here is to simplify the system while simultaneously increasing tax buoyancy.

Additionally, as the economy becomes increasingly service-oriented and regional efforts to liberalise trade take root, the taxation system must of necessity reflect this dynamism. This is critically important as, in our case, import related taxes account for approximately 56 of total tax revenue.

I alluded earlier to our efforts in gaining efficiencies in revenue collections. There are two significant projects being undertaken in our revenue agencies.

At the Inland Revenue Department the implementation of Standard Integrated Government Tax Administration System (SIGTAS) is nearing completion. This project, funded under ECEMP, involved the computerisation of the Taxroll and Income Taxation procedures.

At the Customs Department, DFID is assisting in the reform and modernisation effort. This will encompass, inter alia:

- Modernization of systems and procedures
- Maximization of revenue and law enforcement; and
- Full automation

Since June 1998 the effort has yielded/seen:

- The development of flexible anti-smuggling and audit teams
- A draft Strategy and Planning System

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<sup>2</sup> See Budget 98/99 for a brief on new fiscal measures introduced with the objective of increasing the level of savings.

- In excess of \$3 million of additional revenue; i.e. collections have exceeded earlier projections by that amount
- Eleven seizures of illegal drugs and 10 related arrests.

### **Raising the productivity of public expenditure**

Raising the productivity of public expenditure can be interpreted as government receiving value for the monies that it spends. In the case of Saint Lucia it is not possible to give a clear indication of whether or not the productivity of public expenditure has increased. However, recent policy and institutional changes have been made which, it is expected, will result in the more effective use of government financial resources. I speak here of the Financial Management Reform (FINMAN) Project which is currently being implemented. The main components of the project are:

- Legislative Reform
- The Standardised Integrated Government Financial Information System (SIGFIS)
- Budget Reform
- Training
- Organization and management; and best practice initiative

Although all of these initiatives are of considerable importance, in the interest of time, I wish to speak briefly on the budget reform exercise. This started in September 1997 with a three-phase approach:

- (a) Introduction of Programme budgeting in Central Government Operations;
- (b) Strengthening the phases of the Budget Cycle; and
- (c) Introduction of the preparation of Operational Plans for all programme areas government-wide.

Accomplishments to date include:

- The development of the 1998/1999 Budget, using programme performance budgeting. Two volumes of the estimates for FY 98/99 were tabled in Parliament; Volume I specifying Agency Mission Statements, Priorities, Key Results, Programme Objectives and Outputs for the FY and Volume II the resource allocation of the government's budget in a programme/activity format;

- ❑ The introduction of preliminary allocations or an “envelope of resources” issued with the estimates circular for the 98/99 fiscal year to each agency in the preparation of the estimates;
- ❑ The introduction of the top-down-bottom-up approach in budgeting; that is the setting of macroeconomic outlook and constraints by central agencies and the involvement of all levels of management in the budget process in the agencies;
- ❑ An integrative approach to the budgeting for capital and recurrent expenditures;
- ❑ The introduction of the preparation of new initiatives papers by all agencies to facilitate the prioritisation of resources;
- ❑ The establishment of budget committees in each agency to strengthen accountability and ownership of the budget;
- ❑ the introduction of computerisation in the budgetary process both at central agency and at the other Agencies; and
- ❑ The redefinition of the budget cycle to 24 months instead of the 18 months cycle.

A very significant development occurred only Friday last when every agency, headed by its Cabinet Minister, participated in the first mid-year review of the budget.

Government has also created a Public Sector Reform Unit in the Prime Minister’s Office to spearhead the public sector reform effort and the attendant rationalisation of the operations of government departments. In this regard, the Ministry of Finance, Negotiating and Statistics and the Ministry of Planning, Sustainable Development and the Environment were integrated into one central Agency – The Ministry of Finance and Planning while the Public and Teaching Service Commissions were amalgamated into a single unit.

Raising the productivity of public expenditures also involves the privatisation of the provision of goods and services provided by the State. Saint Lucia does not have a record of large-scale privatisation of State enterprises. In fact, there are few enterprises that could be. However, the Saint Lucia Banana Growers Association was recently privatised and government is currently pursuing the corporatisation of the Water and Sewerage Authority and the commercialisation of the Saint Lucia Marketing Board.

### **Transparency**

Transparency forms an important component of the principles of good governance. The lack of good governance in any society creates an environment conducive to corruption. Because such issues have strong political underpinnings they tend to be quite controversial and should therefore be confined to the purview of politicians. However, civil society should be based on

acceptable principles of good governance which would contribute to the country's economic stability.

In Saint Lucia the new administration has given high priority to the issues of governance and transparency. In his 1998 budget presentation the Prime Minister stated that *Government stewardship of public resources calls for full accountability and transparency on the part of public service managers and all other officials entrusted with public duties and responsibilities*. The move toward greater accountability and transparency is manifested in the current budget reform process. Moreover, government has further declared its intention to *democratise the budget by creating a council of Social Partners with representatives of the public sector, the private sector, labour, religious denominations, non-governmental organisations and regional institutions*. Parliament has also recently approved legislation requiring public officials to give reasons and explanations for decisions taken in serving the public. And of course, senior public servants and parliamentarians are now required by statute to declare their assets at varying intervals.

Although Saint Lucia has no experience of bail-outs in the face of exchange rate crises and the granting of guarantees to private investors, we do in fact have loan guarantees in respect of quasi government institutions (Our Statutory Boards). Therefore, transparency could be improved if we adopt the practice of quantifying the amount of tax exemptions and concessions, loan guarantees currently being offered. In fact, one of the recommendations for the tax reform exercise is to append such a compilation to the budget estimates for presentation to parliament.

The discussion above is very closely linked to the inadequacy in availability of fiscal information. We recognise that the presentation of accurate transparent and timely economic data and information is an important prerequisite for transparency in government. To this end the IMF initiated General Data Dissemination System will be introduced in Saint Lucia next January; we have been chosen as a pilot country for meta-data development. It is hoped that this initiative will assist in the presentation of accurate, transparent and timely data by Saint Lucia.

### **Promotion of social equity**

Finally, I come to the issue of the promotion of social equity. Tax and expenditure policies are two important tools used by governments to influence income distribution in any society. In Saint Lucia such policies have conventionally been used in order to achieve a more equitable distribution of income. Since 1986 the structure of personal income tax has become more progressive with:

- The tax threshold moving from \$3,000 in 1986 to \$10,000 in 1990; and
- A reduction in the tax rate applicable to the taxable income ranges.

However, it should be noted that since the structure has remained largely unchanged from 1990, this might have eroded the progressiveness of the income tax structure. This may be due to higher marginal tax rates faced by persons with taxable incomes in lower tax brackets but

which may now find themselves in higher tax brackets due to adjustments in salaries over the years. The following table shows the changes in the structure of income tax from 1986:

Year	1986	1988	1989	1990
Personal Allowance	\$3,000	\$6,000	\$8,000	\$10,000

Year	Taxable Income	Rate
1986	3,001 - 4,000	5%
	4,001 - 9,000	10%
	9,001 - 15,000	25%
	15,001 - 20,000	40%
	Over 20,000	50%
1988	6,000 & under	10%
	6,001 - 12,000	20%
	12,001 - 17,000	30%
	Over 17,000	40%
1989	8,000 & under	10%
	8,001 - 15,000	15%
	15,001 - 20,000	25%
	Over 20,000	30%
1990	10,000 & under	10%
	10,001 - 20,000	15%
	20,001 - 30,000	20%
	Over 30,000	30%

The above table shows that apart from increases in the tax threshold, the marginal income tax rate was reduced from 50 per cent in 1986 to 30 per cent in 1990. It also shows a progressive reduction in the tax rates for income earners in all ranges. This suggests that the income tax burden has been gradually reduced with a significant number of low income earners being removed from the tax net; no doubt contributing to social equity.

Government has also, over the years, increased current expenses on health and education, and to a lesser extent on direct transfers to the needy. It might be of interest to note that recurrent expenditures on health and education have averaged 36 per cent of actual total recurrent expenditures between FY 90/91 and FY 95/96. In addition, government's expenditure outlay towards social equity also includes capital expenditures towards social projects.

I have chosen to highlight the areas which I believe are in keeping with the subject at hand. In the discussion which follows you may wish to explore a bit further the various policies which have been implemented in the past.

I thank you for the opportunity to share our experiences with you but I also look forward to learn from the experiences of other presenters.

# **FISCAL CHALLENGES IN THE NETHERLANDS ANTILLES**

**1991 – 1997**

by

*Mr. Elfried Paulina, Second Deputy Director for Finance  
Government of the Netherlands Antilles*

## **Introduction**

The 1990s are to be described as a period of strong fluctuations in both economy and policy in the Netherlands Antilles and growing fiscal deficits that contributed to greater uncertainty in the community. Starting with moderate growth rates in 1990, the economy posted negative growth rates a few years later and started to decline. Government deficits contributed to a further decline of the economy through the balance of payments by artificially maintaining the level of consumption. The vulnerability of the economy of the Netherlands Antilles was clear because the islands were not endowed with raw materials. The rising uncertainty of the business community can be ascribed to the absence of both expenditure-reducing policies and expenditure-switching policies. It was not until 1996 that with assistance of the International Monetary Fund (IMF), a comprehensive programme of corrective measures was introduced. The proposals made to the IMF consisted of three sets of policies, namely, increasing revenues, decreasing expenditures and revitalising the economy. Up to 1998 only increasing revenues received a reasonable share of attention. As expenditure remained high the deficits continued to grow and the economy continued to decline. Due to the structure of the expenditures there was little space to embark on expenditure-switching policies. Personnel costs and interest payments constituted a substantial share of the expenditures.

## **Economic development during 1991–1995**

After a period of relative high growth levels at the end of the 1980s the economy started to slow down in 1992-1993 followed by a reversal in 1994-1995. Through the whole period, government expenditures continued to grow while revenues lagged behind. In 1995 increased collection efforts led to a growth of tax revenues, which continued up to the year 1997. It is, however, not completely clear whether the growth in 1996-1997 can be ascribed to these efforts or to new revenue-increasing measures. Since these measures had cost implications, government finance did not improve significantly or at all. One thing that is certain is that the strengthening of the collection team under the Directorate of Taxes led to an increase in government revenues.

As a result of the international developments and government policy, among others, the economy of the Netherlands Antilles started to decline in 1994 after two years of sluggish growth. Another factor contributing to the negative development was nature. Hurricane Luis negatively affected the production capacity of the Windward Islands and the foreign exchange generating capacity of the tourism sector of Saint Martin. Net tourism earnings declined by ANG 150 million in 1995 and another 50 million in 1996 (see annex). Though there was a short-lived positive development on the balance of payments due to payments of the damages by insurance companies, the Windward Islands' capacity to generate earnings was destroyed for at least two years after the hurricane.



The other sectors of the economy displayed a more stable development. The transportation sector had strong growth rates in 1994 and 1995. The oil refining sector, mainly concentrated in Curaçao, had a boost in 1995 as productivity increased and later as there was a decision of the Venezuelan oil company, *Petróleo de Venezuela, S.A. (PDVSA)*, to increase the production at its refineries. This sector is to be considered as generating primary income from abroad as the operation is a Venezuelan activity. Its vulnerability remains a serious concern as it depends on the strategies of PDVSA. The international financial services sector had a period in which the operational income grew considerably, but after 1995 there was a drop in these earnings which, for a long time, compensated for the falling earnings of the profit taxes (see annex). New financial products should add to its competitiveness.

### Some key economic figures

	1992	1993	1994	1995	1996	1997
<i>Real GDP growth</i>	2.8	4.4	2.4	-0.2	-1.3	-0.5
<b>Unemployment</b>	13.9	13.6	12.8	13.1	14.0	14.2
<b>Fiscal Balance</b>	-75.1	-67.1	-12.9	-64.8	-81.4	-33.3
<b>Balance of Payments</b>	-40	-52	-129	--30	-423	-207
<b>International Reserves</b>	526	605	467	718	607	660
<b>Prime Rate</b>	12.0	12.6	12.7	12.9	13.4	14.0
<b>Consumer Price Index<sup>3</sup></b>	1.4	2.0	1.8	2.8	3.6	3.3

Source: Department of Finance, Netherlands Antilles

One of the main contributors to the decline in the economy was the lack of investment as uncertainty among economic agents about government policies was growing and the tax-burden did the same. Introduction of new provisions, including wage increases for the labour force and the community, the burden of which was carried by the private business sector also led to a decrease of investment and an increase of unemployment. Wage costs rose because of the above-mentioned new provisions and the raising of minimum wages in 1993/1994. This resulted in a slow-down in the economy due to decreasing purchasing power. As public consumption was not curtailed the deficits continued because the tax base was narrowed.

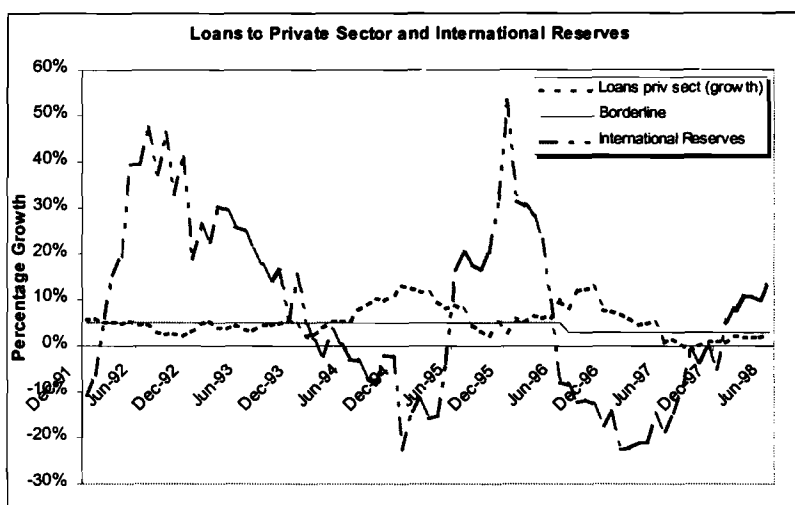
### Causes of the economic deterioration

Though the deterioration had some external causes, such as decreasing demand from abroad, there were also some internal causes. As already mentioned, government measures led to a contraction of demand for goods and services which led to falling investment in the private sector in 1996 and 1997 just as they were intended to do as a way to prevent the depletion of foreign reserves. The main reason, therefore, was the fact that huge consumption expenditures, boosted by the increase in payroll of, among others, civil servants encouraged import activity leading to a decline in the international reserves.

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<sup>3</sup> Curaçao Figures

The Central Bank of the Netherlands Antilles introduced a policy of Credit Restriction in 1990 which allowed for growth in credit extension by only 5 per cent over the previous year as a means of curbing the outflow of foreign exchange. The fact that interest rates in the Netherlands Antilles were already relatively high coupled with further increases of these rates as penalties for exceeding the limit were passed over to the clients. The tight monetary policy was enforced by other measures designed to absorb excess liquidity from the commercial banks in 1994. A further limitation to credit growth was implemented by including loans to governments in the restrictions in the same year. In 1996 the rate of credit growth became 3 per cent over the previous year.



Source: Department of Finance, Netherlands Antilles

The results of these monetary measures in combination with the high interest rates had a dampening effect on investment, which was already affected negatively by a lack of profitable investment opportunities. The excess liquidity in the commercial banks did not translate into higher investments as many of the loans extended to the private sector were extended to households for consumption purposes and contributed to an outflow of foreign exchange. On the other side, one can see that as of 1996 the demand for loans by the private business sector has been decreasing reflecting internal financing, financing with money from abroad or divesting. It seems that the high interest rates together with a business community reluctant to invest as long as there is no complete clarity on the direction of policy will maintain the current trend.

As the import cover ratio was fluctuating below three months of imports in the 1980s and from 1994 even below two months of imports within an atmosphere of growing public debts, a commission under the chairmanship of the late van Lennep was established to advise on the financial and economic issues of both the Netherlands Antilles and Aruba. The recommendations of this Commission related to increasing revenues, reducing expenditures and strengthening the economy. As a means of reaching these goals some other requirements are mentioned like the strengthening of the public sector apparatus. Most of these recommendations have been accepted, but the results are yet to be seen because of the short time that has elapsed.

### **Economic development during 1996 – 1998**

The widening of the fiscal deficits and the erosion of the international reserves were two of the reasons which led to the introduction of the Structural Adjustment Programme (SAP) in 1996. This Programme which more or less followed the recommendations of the van Lennep Commission consisted of:

- Revenue-increasing policies,
- Expenditure-reducing policies, and
- Revitalisation of the economy

Priority was given to revenue-increasing measures rather than expenditure-reducing policies. The reason was the fact that a large share of expenditures consists of wages and interest payments, which cannot be brought down in a very short period. Reducing investment of the purchase of goods and services would have provided little savings.

At the same time due to lack of liquidity there was little attention given to the overall economy. This short-term undertaking was not accompanied by a longer-run approach to reducing expenditures and paying more attention for the overall economy. The implementation of the Structural Adjustment Programme led to a further contraction of the economy as the revenue-increasing measures were meant to curtail spending of households and increase government revenues. As government spending was not reduced significantly, the deficits continued. The absence of expenditure-switching policies (from consumption to investment) can be explained by the low absorption capacity of the islands. Among the revenue-raising measures were the following.

- The introduction of Sales Tax as of 1 July 1996
- The introduction of a General Insurance for Special Illnesses
- Abolition of the foreign exchange provision and introduction of a license fee.

Other measures at the Island level also led to the contraction of the economy as tax free disposable income was cut in an effort to increase Island government revenues. It has been estimated by the Department of Economic Affairs of the Island Territory of Curaçao that purchasing power decreased by some 11 per cent in 1996.

### **The Structural Adjustment Programme**

The Structural Adjustment Programme formulated by the Antillean authorities in conjunction with the International Monetary Fund was introduced in 1996. The Programme started in July 1996 with the introduction of the Sales Tax in the Leeward Islands. In January 1997 a Turnover Tax was introduced in the Windward Islands. As of 1 January 1996 also the direct benefit principle was applied in waste collection in Curaçao in an effort to increase revenue, while in 1997 the Insurance for Special Illnesses was introduced. These measures

contributed positively to the public finances but the lack of attention to the expenditure side and the economy, as a whole, helped to derail economic activity.

### **Results of the Structural Adjustment Programme**

The results of the fiscal policies in 1996–1998 are both positive and negative. As the government, in cooperation with the IMF, introduced the SAP, monetary and fiscal balances improved and came under better control. However, the improvement of the fiscal balances was accompanied by an increase in the arrears of the government and, thus, increased indebtedness. And if it was not for the introduction of the Sales Tax in 1996 the arrears might have increased by some 120 per cent. At the same time, the economy contracted leading to an increase in unemployment, decreasing investment and lower GDP. As the Netherlands Antilles consist of five islands with some degree of self governance, there is one weakness in the system, since budgets of the smaller islands are approved by the Central Government and the deficit is also covered by Central Government.

In 1997 the Central Government and Island Government, in close cooperation with the Inter-American Development Bank, agreed on an agenda for economic recovery. In this agenda greater attention was to be given to developments in the private sector. Government actions should lead to higher levels of policy coordination, a more transparent taxation system, a shift from direct to indirect taxation and the revitalisation of the economy by creating sound conditions. For the latter goal, the Fund would supervise “a jump start fund” for projects which would be identified by the policy coordinating body.

Even though a long list of projects had been established, none of these projects materialised as the jump start funding was subject to the conditionalities of the Structural Adjustment Programme. As the new Government wanted to revise the SAP and have a new Financial Economic Recovery Programme and was in direct negotiation with the Kingdom of the Netherlands, these projects and all other SAP-related programmes were frozen.

As the islands of the Netherlands Antilles are richly endowed with human capital, natural beaches and a favourable climate, tourism has been identified as the agent of change to help the economy make the necessary recovery. Other recommendations, which have to be implemented, comprise the abolition of legislative distortions in the economy, i.e. market protection and the establishment of regulations. This will eliminate the red tape in decision-making and create a more flexible economy.

### **Financial and economic recovery 1998**

In an effort to reduce personnel costs, the Government introduced the possibility for public servants to leave government service in January 1998 with reduced pay followed by retirement pay. Almost 200 persons applied but only 160 were selected. Other efforts to reduce the personnel costs were the reduction of holiday pay, the revision of the pension system and a ceiling on working overtime. However the number of civil servants increased instead in the first months of 1998.

To give the economy a new boost, the Central Government, in cooperation with the Island Territory of Curaçao, set up a committee which will advise on the new direction that should be taken if the economy is to be revitalised and the government deficits to be curbed. The activities of this committee are in the final stage and are to be combined with the agenda prepared by the Inter-American Development Bank for economic recovery of the Netherlands Antilles.

The primary goal of the new recovery programme is the revitalisation of the economy through the development of private sector initiatives and the creation of a professional down-sized public sector. This will increase revenues through an updated increase in economic activity and reduce expenditures through the more efficient operations of the public sector.

Though the results of this programme cannot be measured yet as it has not even been implemented, one can assume that by lowering costs the tax burden on the community will decrease and create more room for private sector activities.

### **Conclusions**

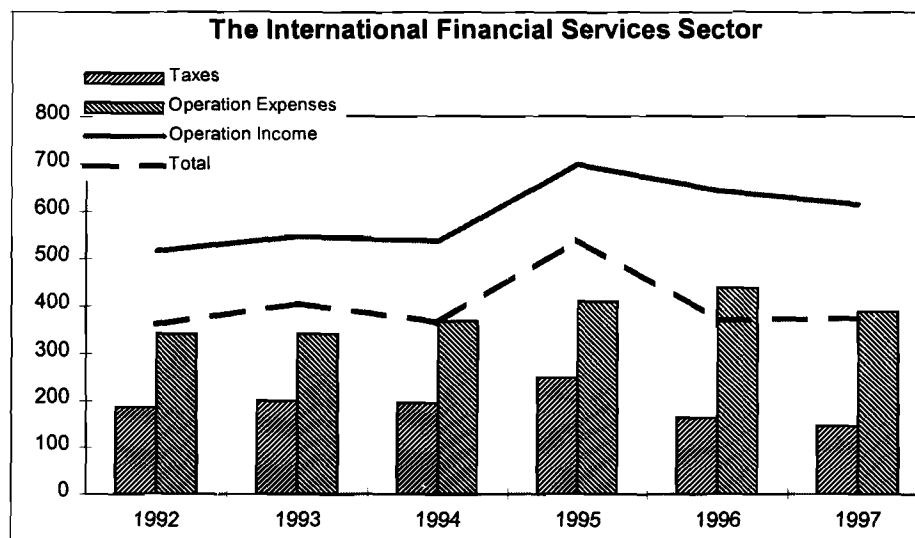
During the 1990s the Netherlands Antilles passed through some turbulent periods with alternating growth and decline of the economy. The structural deficits and the low level of international reserves led to the introduction of the Structural Adjustment Programme. As there was little fine-tuning between the three pillars of the programme and short-term results had to be achieved according to the programme, the development of the economy was somewhat lopsided. Revenue increasing as an instrument to correct the fiscal balances was easily implemented with positive results, but no attention was given to expenditure switching or reduction. Fiscal balances improved as did the quality of financial administration. On the other side, the economy was derailed as private sector output declined in 1995 and 1996. It might be stated that the easy way out was chosen, though this was not the case. Efforts to reduce spending have also taken place but had less impact as much of the expenditure of the governments are wage costs and interest payments which cannot easily be cut. Cutting expenditures thus remains a long-term target, which has to be addressed. This can be considered as a sign from the government to the private sector to stimulate investments

## Annex

### Revenues and expenditures 1992-1997

	1992	1993	1994	1995	1996	1997
<b>Taxes on property</b>	8.3	10.1	13.2	15.6	15.0	23.9
<b>Taxes on goods and services</b>	118.9	116.6	120.9	117.1	186.9	287.2
<b>Taxes on international transactions</b>	124.4	166.9	175.7	182.9	162.2	121.8
<b>Other taxes</b>	10.8	10.5	9.0	6.2	8.6	8.4
<b>Non tax revenues</b>	103.7	101.4	140.3	146.8	118.6	93.5
<b>Capital revenues</b>	0.1	0.0	0.3	0.2	0.2	0.0
<b>Grants</b>	6.9	9.8	8.0	8.5	6.7	7.7
<b>Total revenues</b>	<b>373.1</b>	<b>415.3</b>	<b>467.4</b>	<b>477.3</b>	<b>498.2</b>	<b>542.5</b>
Wages and salaries	230.0	251.3	273.5	305.5	301.8	290.6
Goods and services	83.6	77.2	80.9	93.3	89.9	92.6
Interest payments	42.0	38.9	43.9	48.1	54.4	74.9
Subsidies to public companies	0.0	3.0	5.0	1.5	8.3	5.5
Transfers	64.7	84.3	59.8	74.0	75.6	72.3
Capital expenditures	27.9	27.7	17.2	19.7	49.6	39.9
<b>Total expenditures</b>	<b>448.2</b>	<b>482.4</b>	<b>480.3</b>	<b>542.1</b>	<b>579.6</b>	<b>575.8</b>
<b>Balance</b>	<b>-75.1</b>	<b>-67.1</b>	<b>-12.9</b>	<b>-64.8</b>	<b>-81.4</b>	<b>-33.3</b>
Foreign amortization			10.5	12.7	0.0	0.0
<b>Balance after foreign amortization</b>	<b>-75.1</b>	<b>-67.1</b>	<b>-23.4</b>	<b>-77.5</b>	<b>-81.4</b>	<b>-33.3</b>

Source: Department of Finance, Netherlands Antilles

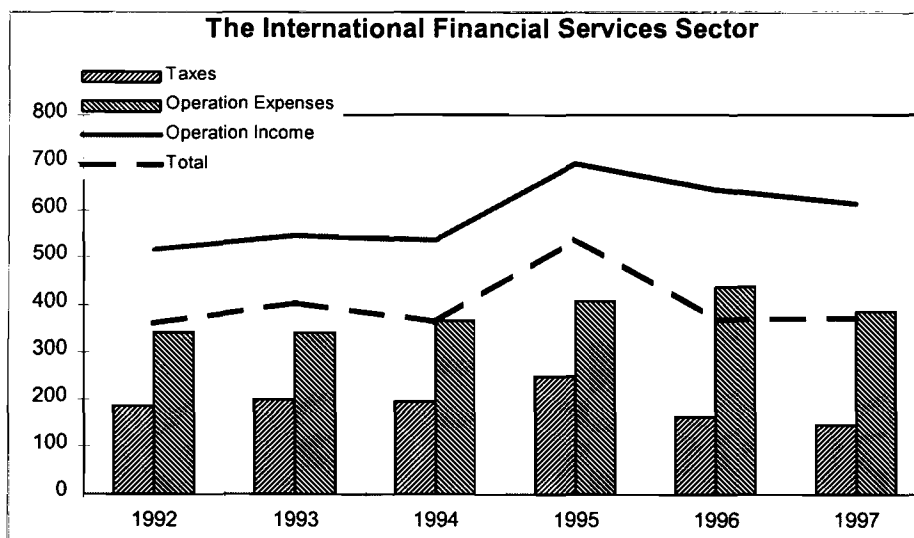


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Source: Department of Finance, Netherlands Antilles



Source: Department of Finance, Netherlands Antilles

## **TRINIDAD AND TOBAGO'S FISCAL COVENANT – A BRIEF PERSPECTIVE**

by

***Mr. Vishnu Dhanpaul, Deputy Director, Monitoring and Coordination Unit  
Ministry of Finance, Government of Trinidad and Tobago***

This presentation is based on the findings of several IMF and World Bank studies of Trinidad and Tobago. Due to the time constraint, I will concentrate mainly on one aspect of the ECLAC document, that is, fiscal consolidation.

Since the discovery and development of significant oil and gas deposits, Trinidad and Tobago's economy has evolved into a dual character – a dominant oil/gas sector with service industries as the main activity. Even prior to the first oil shock in 1973, the structure and performance of the economy were closely aligned to the fortunes of oil. At that time, the oil sector accounted for about 20 per cent of domestic value added.

During the period 1973-1981, the two surges in oil prices enabled Trinidad and Tobago to reap impressive gains in incomes, employment, public revenues and foreign exchange. The economy was faced with a massive upward adjustment process. Fiscal and monetary policies during these years accommodated oil-based expansion. After an initial saving of surplus earnings abroad, the Government embarked upon a programme of capital expenditure in heavy industry and infrastructure, without adequate assessment of financial and economic returns.

Per capital income reached US\$6,600 in 1982, ranking Trinidad and Tobago high among the middle income developing countries. The country also achieved relatively high levels and quality of educational and social services.

State enterprises and other governmental agencies mushroomed and government subsidies and current transfers increased to compensate for high wages and other inefficiencies in production. Foreign investment in domestic industries was promised through generous tax holidays, extensive tariff concessions on imported inputs and restrictions on entry in designated industries.

During this period, the trade regime became increasingly protectionist, featuring trade licensing with a growing negative list and quantitative restrictions on imports and the exchange system had fairly comprehensive controls on foreign exchange transactions. Inflation rose from about 4 per cent in 1971 to an average of approximately 15 per cent annually over the period 1972-1981 and the real effective exchange rate for the Trinidad and Tobago dollar appreciated by 24 per cent during this period. Largely because of oil/gas exports, the external current account registered significant surpluses and the level of international reserves was built up to US\$3.3 billion by end-1981.

Among the management challenges which the country faced was finding fiscal and monetary mechanisms for dealing with the Dutch disease, which occurs when windfalls earned from natural resources booms make it possible to create and sustain inefficient production outside of the major export sector, mainly through investments in assembly manufacturing,



commercial distribution, finance, transport, etc., all of which depend on expensive consumer tastes.

The economic setback began in 1982 when falling oil prices compounded a domestic trend of falling petroleum output from depleted oil wells. Just as the rise in oil prices had brought economic prosperity, so the fall in oil prices triggered a continuous decline in economic performance and led to undesirable macroeconomic imbalances. The petroleum sector's output shrunk sharply. Real GDP fell annually for the following six years.

Following the collapse of oil prices, all other macroeconomic variables reflected the deterioration in the economy. Unemployment which had been 10 per cent of the labour force in 1982 reached 16.6 per cent in 1986. Government savings declined from a surplus equivalent to 20 per cent of GDP in 1981, to a deficit equivalent to 1 per cent. This severely curtailed capital expenditures which dropped from 18 per cent of GDP in 1981 to 6 per cent in 1985. The external current account position changed from a surplus equivalent to 6 per cent of GDP in 1981 to a deficit equivalent to 16 per cent despite a severe compression of imports. The country's once comfortable cushion of gross foreign exchange reserves was also rapidly depleted.

In the face of falling oil prices, the Government needed to adjust the economy to the new external conditions and thus promote major structural changes. However, the Government viewed the oil price drop as temporary and based on the expectations of a rebound in oil export earnings, it attempted to maintain living standards by stimulating aggregate demand through an increased current expenditure programme, including transfers and subsidies, while severely reducing public investment.

The Government also adopted increasingly protectionist policies involving exchange controls and quantitative restrictions instead of improving the economy's competitiveness.

Although the Government introduced some adjustment measures between 1982 and 1985, fundamental reform only began in the mid-1980s after the country had depleted its foreign exchange reserves. Major adjustment issues had to be addressed as a result of the decline of the oil sector and the distortions induced by the 1974-1982 policies.

Measures implemented to rectify the distortions included shrinking the public sector, cutting subsidies and transfers and introducing efficiency criteria into the selection of public sector projects. Such measures focused on switching expenditure from consumption to investment and introducing economic pricing. This was intended to foster growth through a more efficient allocation of resources.

Additionally, the Government suspended cost of living allowances and annual merit increases to public servants and reduced production and consumption subsidies as well as transfer payments to State enterprises. In 1987, the Government also launched a comprehensive restructuring of the operations of State enterprises aimed at raising their level of efficiency and reducing their dependence on the Treasury.

With a view to stimulating private savings and investment, the Government reduced the marginal tax rate for individuals and reduced the corporation tax on companies as well as tax on interest income. Changes were also introduced in 1988 to the petroleum tax regime aimed at increasing the incentives for production. Further, the Government introduced medium-term planning within the context of its seven-year plan with the stated objectives of resuming economic growth, restoring fiscal and balance of payments viability laying the foundation for the diversification of the economy and ensuring that the burden of adjustment was shared equitably.

But the Government's efforts were severely hampered by the continuing decline in international oil prices, which led the country to seek financial assistance from the multilateral lending agencies in Washington, D.C.

Four years after graduation from World Bank lending, Trinidad and Tobago requested access to Bank funding. The Bank decided to resume lending in 1990 when the country's GNP per capita would fall below the graduation threshold. However, amidst renewed weakness in international oil prices, the Government obtained IMF financing prior to seeking a Structural Adjustment Loan (SAL) programme with the Bank.

The IMF Board approved a compensatory financing facility equivalent to US\$114 million in November 1988, and an understanding was reached on the letter of intent on a Standby Arrangement. The first IMF Standby was approved in January 1989 for a 14-month period for the equivalent of about US\$120 million and the second in April 1990 for an 11-month period for approximately US\$135 million.

The Standby Arrangements stabilized the economy, reversed the rapid depletion of official reserves and the decline in nominal GDP. Other major developments included reduced price controls and a partial withdrawal of import controls on non-oil manufacturing goods.

In January 1990, the World Bank approved a SAL for US\$40 million which was co-financed by the Japanese EXIM Bank for another US\$40 million. The main objectives of the SAL programme were to support the Government's adjustment efforts. The SAL addressed three broad categories which were identified as key to growth. These policies were: (i) public sector resource mobilization and allocation: State enterprise restructuring and divestiture, efficiency improvements for public utilities, public sector programming; (ii) the incentive framework: the trade regime and investment incentives; and (iii) the social impact of the adjustment.

At the time Ramesh Ramsaran noted in paper entitled "Growth and adjustment in a petroleum-based economy: Some aspects of the Trinidad and Tobago experience since the 1970s" in SES 42.4 (1993) that due to the two Standby Arrangements with the Fund, the SAL with the World Bank and the imposing presence of the Inter-American Development Bank (the country's major external lender) there was now a deep foreign input in policy relating not only to fiscal management but to medium-term growth.

The situation by the end of 1991 still required the country to improve macroeconomic imbalances, diversify its exports and achieve broad-based growth with employment creation. Structural reforms were needed to restore growth, by addressing the problems associated with: (i)

the trade and payments restrictions and complex trade procedures and tariff structure; (ii) the low private and public investment, and the poor public investment decisions; (iii) the poor resource mobilisation by public enterprises; (iv) the apparently poor cost-effectiveness of social expenditures; (v) a large and demoralized civil service; and (vi) a narrow tax base with high rates.

Since 1991, Trinidad and Tobago has progressed in establishing a sound macroeconomic policy framework that has placed the economy on a path of positive growth.

The country's fiscal covenant led the way for the reform of the country's tax and tariff systems and the modernisation of the country's administrative revenue collecting agencies. During this period, there was as well the introduction of the new value added tax system, designed to contribute to a more equitable taxation regime which was expected to boost central government's revenue position. Along with the introduction of this new taxation regime, initiatives were also undertaken to improve the existing income tax structure.

This programme involved the simplification of the tax structure through the reduction of the number of tax bands, and the removal of a number of tax incentives, such as tax credits, that made the taxation regime inefficient, inequitable and the subject of high evasion by taxpayers. To further decrease the tax burdens, the maximum marginal tax rates for both corporation tax and income tax were lowered.

These reform initiatives have no doubt resulted in a more transparent, efficient and simplified tax system, aimed at reducing the incidence of tax evasion and encouraging greater levels of compliance by the tax paying public.

In strengthening the administrative machinery, there have been considerable improvements in tax surveillance. Collection of tax revenues has also been on the rise, reflecting the strengths of our fiscal covenant. For example, tax revenue as a percentage of GDP has increased from approximately 17 per cent in 1989 to 23 per cent in 1996 and should be around 25 per cent in 1998. These rates, though, are still too low, and such efforts are being made to broaden the tax base and further enhance the operational efficiency and strengthen the revenue collection mechanism. More recently, Government has also signaled its commitment to establish an Internal Revenue System along the line of Revenue Canada. This new system is expected to improve administrative efficiency for all revenue collecting agencies in the near future.

Together with improvements in revenue collection, measures to curtail recurrent expenditure and rationalise public and State-owned enterprises have also formed an integral part of fiscal consolidation. Many State-owned enterprises have been privatised and divested to encourage greater efficiency in operations and resource allocation.

Efforts are underway to reform the current social security system. This new system is expected to decrease Government's contingent liability. Moreover, the new pension system will ultimately be transformed into an investment vehicle which is expected to impact positively on the national savings ethic.

But how can we judge the overall success of the country's fiscal consolidation programme?

John McDermot and Robert Wescott of the IMF in their article "Fiscal reform that works" suggested that a successful fiscal consolidation episode can be judged through the following indicators:

- A reduction of at least 3 percentage in the ratio of public debt to GDP after the fiscal tightening began.
- An increase in the level of economic growth over the period of fiscal consolidation, inclusive of the decline in the unemployment rate and the levels of short and long-term interest rates.

Based on these indicators we observe that for the past six years, Trinidad and Tobago has been transformed into a vibrant economy, sustaining positive levels of non-inflationary growth over this period. Growth projections for year end 1998 have also indicated yet another year of strong growth. We expect to register 5 per cent growth. This is the second highest growth rate recorded in Trinidad and Tobago since the oil boom in the early 1980s.

Despite the global trends of falling commodity prices and financial crises being experienced by the world's leading financial giants, Government has so far been able to implement appropriate measures to cushion the domestic economy from such destabilising events.

We continue to contain inflation at single digit rates, having registered rates as low as 3.3 per cent in 1996 and averaging 8 per cent in 1998, compared to 11.4 per cent in 1989. Coupled with strict exchange rate policy and stringent monetary policy, these rates are expected to be contained over the medium term.

Unemployment rates have been on the decline over the past five years. Registering an unemployment rate of 13.4 per cent in the first quarter of 1998, the lowest rate recorded in over 14 years. Economic growth has brought about substantial permanent job creation.

We have moved from financing large budget deficits of as much as TT\$763.8 million in 1989 (or -3 per cent of GDP) to registering fiscal surpluses up to 1998.

Trinidad and Tobago, though, continues to experience relatively high long and short-term interest rates. This is expected in light of the Government's policies to stabilise the exchange rate, contain inflation and control liquidity in the financial system. However, despite these events, our domestic currency has appreciated in real effective terms when compared to currencies of our trading partners. In addition, Trinidad and Tobago has also witnessed continuous decline in the public debt to GDP ratio. In 1993 the ratio was 70 per cent and it declined to 54 per cent in 1997. Our external debt service ratio also declined substantially over the same period moving from 30 per cent in 1993 to a little over 10 per cent by the end of 1997.

Based on this performance, I believe that one can safely state that Trinidad and Tobago has indeed had a successful fiscal consolidation episode.

## **INCREASING PRODUCTIVITY IN THE PUBLIC SECTOR: THE JAMAICAN EXPERIENCE**

by  
*Mrs. Shirley Tyndall, Financial Secretary*  
*Government of Jamaica*

Over the last decade Jamaica has made significant progress in all of the areas highlighted by the Fiscal Covenant, although much remains to be accomplished if increased productivity with social equity is to be achieved. The country has progressed with respect to:

- Improving tax equity and efficiency;
- Initiating programmes to reform public sector administration which have and will continue to generate improvements in the productivity of public expenditure;
- Initiating programmes to increase the transparency of all public sector operations, such as opening Public Accounts Committee hearings to the press, publishing of the Auditor General's Report, the proposed system for the award of Government contracts and the proposed new Freedom of Information Act;
- Addressing the problem of social equity through the implementation of poverty alleviation programmes;
- Strengthening the democratic institutions by expanding the areas of dialogue and consultation with the private sector through the establishment of institutions, such as the National Planning Council (NPC), and programmes for the strengthening of local government operations.

Over the past 20 years, Jamaica has implemented a number of adjustment strategies aimed at reforming fiscal institutions, policies and administrative procedures. These range from an administrative reform programme aimed at maximizing the productivity of human resources and improving the provision of public services by effecting improvements in the Financial Accounting and Budgeting Systems, to restructuring of the tax system in an effort to achieve equity and efficiency.

An Administrative Reform Programme (ARP) initiated in 1984 targeted the improvement of management structures, systems and operations of the public service to enhance efficiency, effectiveness and responsiveness of the public service to public needs. These objectives were expected to be attained through improvements in financial management, human resources management and line agency restructuring. As the Covenant points out, however, efforts to implement policies to improve the efficiency of public expenditure are not always sufficient. This was demonstrated in the ARP's initial attempt at improving human resources management, by targeting compensation improvement for civil service professional, managerial and technical posts and by attempting to lift the prestige of Government employment through the improvement of the working environment, training and the reward of performance. The results of this effort were limited.

Lessons learned from the first phase of the ARP led to the development of more specific objectives for the second phase of the ARP which commenced in 1991. These were:

- “The development and implementation of a budgeting system based on the programme budgeting structure and programme classification;
- Adapting and linking the accounting and cash management systems to the revised budget model;
- The development of a Financial Management Information System (FMIS) to support the budget, accounting, cash management and financial reporting processes as well as a Human Resource Management Information System (HRMIS);
- Training;
- Adjustment of administrative structures and job classification systems; and
- Measures to attract and retain a cadre of technically sound accounting and financial management personnel.”

With the exception of work on the job classification system which is ongoing, all objectives of the second phase of the ARP have been achieved. The Programme Budgeting Structure established is representative of the Government’s effort to incorporate results based management into the administrative culture. The Human Resources Management Information System is expected to provide accurate, timely and accessible data on public service employees enabling the effective operation of a computerized payroll and pensions system while the Financial Management Information System is the computer-based accounting system which complements the Programme Budgeting Structure. An additional computer-based information system, the Integrated Financial Management Information System (IFMIS), is currently being implemented. On the completion of this system, the Government will be in a position to fully implement an effective and modern Treasury Management System.

Building on the achievements of the ARP, a Public Sector Modernization Project (PSMP) has been established to create a modern, efficient, transparent public sector. Under this project, a major objective is to improve the productivity of public expenditure through fiscal decentralization which will involve the creation of Executive Agencies. These agencies are expected to improve the quality of service offered to the public, through the efficient use of resources, and to have output or performance based contractual arrangements with CEOs and senior managers who will be subject to appropriate penalties and rewards. The creation of Executive Agencies will reduce central controls and provide CEOs with autonomy with respect to financial resources, personnel and the procurement of goods and services. The Public Sector Modernization Programme will also develop performance linked incentive schemes for Public Service staff, create better working conditions, provide more training opportunities and increase the involvement of staff in the decision-making process.

Social expenditure has and will continue to be one of the priority areas of the Jamaican Government. Efforts to alleviate the social conditions of the citizenry is spread between the revenue and the expenditure side of the Budget. On the revenue side, there are periodic adjustments to the income tax threshold. This adjustment is expected to improve social equity as the relief is accorded to all taxpayers. Direct social expenditure is captured in the various Poverty Alleviation Programmes, such as the Social and Economic Support Programme (SESP), the Food Stamp Programme, the Special Training and Empowerment Programme (STEP) and the Social Investment Fund (SIF).

These programmes were instituted to “cushion the effects of the problems associated with poverty on the youth, the poor and the aged in inner-city communities and rural areas” by, among other things:

- “Providing training to access credit for micro enterprises;
- Providing training through government and non-government organizations;
- Providing assistance to students in public educational institutions up to the secondary level;
- Providing employment opportunities;
- Improving and constructing new facilities for the aged and the poor;
- Constructing and improving existing recreational facilities.”

A comprehensive system of tax reforms was initiated in 1986. Prior to the implementation of these reforms the country operated under a progressive income tax system with rates ranging from 30 per cent to 57.5 per cent plus a plethora of allowances and tax credits. The tax reform programme replaced this system with a flat rate system of 33.3 per cent, raised the income tax threshold, abolished the tax credits and rolled the allowances into salary. This change improved tax equity, created a safety net for the lower income groups and simplified tax administration. The income tax threshold has been periodically increased to adjust for the effects of inflation and in 1993 the personal income tax rate was reduced to 25 per cent. A withholding tax on interest earnings was also introduced in order to compensate for the loss in revenue from the reduced personal income tax rate.

In 1991, another major change was made to the tax system with the introduction of the General Consumption Tax which replaced a number of indirect taxes. This generated a significant increase in tax revenues in addition to further reducing administrative requirements.

With a view to enhancing the efficiency and effectiveness of revenue administration attained through the programmes implemented up to 1991, a Tax Administration Reform Project was developed and commenced operations in 1995/1996. The aim of this project is to:

- Broaden the tax base primarily through the assignment of taxpayer registration numbers to all individuals and entities conducting business with the Government;
- Strengthen the organization and management of tax administration;
- Improve controls to reduce tax evasion, in particular, through amendments to the Revenue Administration Act;
- Improve tax collection through the computerization of operations (the development and implementation of an Integrated Computerized Tax Administration System (ICTAS)); and
- Facilitate voluntary compliance through education and dissemination of information.

The adjustment measures described above contributed to the generation of fiscal surpluses from fiscal year 1989/1990 through 1995/1996. However, due to the impact of recent events in the international economy, weaknesses in the local financial system, the cost of achieving macroeconomic stability, and Government's efforts to strengthen the finances of certain para-statal entities, the country's progress towards fiscal consolidation has been slowed resulting in the generation of fiscal deficits in 1996/1997 and 1997/1998. These fiscal deficits can also be associated with the issue raised in the Covenant regarding the liberalization of financial variables, unaccompanied by a simultaneous effort to strengthen prudential regulation and supervision of financial institutions, leading to subsequent problems requiring rescue programmes. For example, the liberalization of the capital account required the establishment of a strong regulatory framework within which the financial institutions would have been expected to operate. Jamaica's response to the emergence of problems within the financial sector was to establish the Financial Sector Adjustment Company (FINSAC) to restructure the ailing financial entities alongside the implementation of prudential regulation and improved supervision. FINSAC's objective is to intervene, where necessary, rehabilitate and divest. This operation is currently in the second phase of rehabilitation involving the restructuring and reorganization of institutions although some divestment has already taken place. With respect to prudential regulation, amendments have been made to the Banking Act, the Financial Institutions Act, the Building Societies Act and the Industrial and Provident Societies Act.

Regulations governing Credit and Provisioning, Capital Adequacy and Qualification of Auditors have also been developed and a Deposit Insurance Protection Act has been put in place to provide a safety net for depositors. The regulations implemented, in addition to the current macroeconomic stability and the consistency of the medium-term policy which is geared toward maintenance of this stability, are expected to prevent the recurrence of difficulties within the financial sector which would further weaken the fiscal performance.



Current focus is on generating a fiscal surplus over the medium term, which is defined here as a three-year time line. Measures to achieve this surplus include the restructuring of public sector operations to make them more efficient, stabilizing/reducing recurrent expenditure through: the containment of wage and salary increases within the inflation range which is the priority target of the macroeconomic programme; lowering interest rates; and stabilizing spending on other recurrent areas of expenditure. Other measures for attaining a fiscal surplus over the medium term involve the completion of implementation of aspects of the current Tax Administrative Reform Programme such as the ongoing registration of tax payers under the programme to allocate taxpayer registration numbers to all individuals and entities conducting (or who should be conducting) business with the government. These measures are expected to enhance fiscal progress without sacrificing social expenditure and place the country back on the path of fiscal consolidation.

The single largest challenge to the plan for progress along the path of fiscal consolidation is management of the domestic debt, as, although significant progress has been made since 1993 in terms of reducing the external debt stock, the domestic debt stock has grown considerably over the last few years resulting in a total debt stock that has been increasing. The decline in the external stock is due to net debt repayment, debt forgiveness on the part of bilateral creditors and the conversion of debt to equity by commercial bank creditors. Focus is now on reducing the cost of debt by lowering domestic interest rates as well as replacing high cost domestic debt with lower cost external debt, extending maturities and examining the range and type of available instruments with a view to introducing new instruments, if found to be appropriate.

Ladies and gentlemen, from the foregoing list of measures which is not exhaustive, you will conclude that the reform efforts of the Government are in accord with the Fiscal Covenant and constitute a series of works in progress which will eventually lead to a leaner, compact, efficient, transparent and focused public sector.

## **SELECTED ISSUES IN THE TRANSPARENCY OF PUBLIC EXPENDITURE IN JAMAICA**

by

*Mr. A.P. Strachan, Auditor-General  
Government of Jamaica*

Governmental activities, whether undertaken by central government authorities, local government agencies, statutory bodies or government companies, are expected to be conducted in the public's best interest. Unless the disclosure of the transactions could compromise national security, I can think of no good reason why government expenditure should not be undertaken in a fully transparent manner. The more transparent the process the more likely it will be that expenditure is incurred in a fair and equitable manner, in keeping with the relevant rules and with greater regard for economy, efficiency and effectiveness.

Parliament has a key role to play in facilitating this transparency. Parliament is comprised of the people's representatives and under our system of Government is the supreme authority in the land. It has the constitutional power to impose taxes and to authorize the raising of public debt. It also has the authority to determine how central government resources should be spent. By the presentation of timely and meaningful budgets, financial statements, operational and audit reports, Parliament should be kept fully informed of Government's intended expenditure and achievements and its actual performance. Once these documents are tabled in Parliament they become public and therefore accessible to all and sundry.

The various agencies of Government are given the trust of managing public resources. Ultimately, they do so on behalf of the citizens and taxpayers. They are required to collect and/or expend public funds. They are expected to do so fairly, efficiently, effectively and economically. They must also ensure that the wishes of Parliament, the people's representatives, are adhered to. Public resources comprise, inter alia, taxes, royalties, proceeds from sale of goods and/or services, user fees, grants and loans. No one loves paying taxes although there are some who hopefully appreciate their necessity. People everywhere are extremely anxious that the taxes they grudgingly pay are properly used to achieve the objectives approved by Parliament. The wishes of Parliament are expressed in a variety of ways including legislation, resolutions and approved estimates of revenue and expenditure. All agencies of Government are required to submit annual audited financial statements within prescribed time limits to show, inter alia, their financial state of affairs, financial performance and the use of resources made available to them.

Although there have been moves to expand the information contained in the budgets of Central Government agencies to reflect anticipated work achievement, the reports on the stewardship of those agencies are mostly limited to financial data. It is necessary, in my view, for timely reports to be submitted to Parliament including what was actually accomplished as against what was budgeted and for clear explanations to be provided of the causes for any substantial variations. It is also, in my view, necessary to extend such requirements to statutory bodies and government companies and for stronger action to be taken to ensure that these

agencies present their annual reports and audited financial statements to Parliament on a timely basis.

A substantial portion of Central Government capital expenditure is financed by foreign financial institutions by way of loans. Under our present legal and accounting requirements it is necessary for the proceeds of all loans to Government to be paid into the Consolidated Fund. This is so whether the proceeds are disbursed by the lending agencies in cash or in kind. In-kind benefits include where the lending agency pays directly to suppliers and consultants for goods and services provided under the related loan projects. Many persons have difficulty in understanding and/or agreeing with these requirements. The requirements are, however, necessary to ensure that Parliament, retains control over the use of public resources. This is so because once resources reach the Consolidated Fund they may only be withdrawn therefrom in keeping with Parliamentary approval. This also ensures the need for Government to account to Parliament for the use of such resources. It is therefore necessary to ensure full compliance with these requirements which are important in facilitating transparency of government expenditure.

A serious potential challenge of transparency of government expenditure is posed by off budget transactions. There is often great pressure and temptation in times of budgetary and resource constraints to enter into what are sometimes referred to as the “deferred financing” of public transactions. For example, certain public works considered to be urgent but for which no budgetary provisions exist, may be undertaken by a contractor who is prepared to finance the project on the understanding that he will be paid over some agreed future period usually with appropriate interest charges added. Although expedient, this approach has a number of possible pitfalls. Firstly, if not properly controlled and centralized it can get out of hand with the Minister of Finance and Parliament being kept in the dark as to the extent to which future public resources are being committed. Secondly, it may cause the understating of public expenditure and liabilities. Thirdly, it undermines parliamentary control over public expenditure and the incurring of public debts. Finally, there is likely to be a tendency to give out public works to be so financed not on the basis of prescribed transparent procurement procedures but more on the basis of which contractor can provide the necessary funding. In negotiating the price of such works, the benefits of competitive tenders, the technical involvement of the Contracts Awards Committee and the need for Cabinet approval may be lost. Where it is found necessary to employ this means of financing public activities, it is vital that the prior written approval of the Minister of Finance be obtained and that subsequent budgetary provision be obtained and the necessary accounting done to bring Parliament into the picture and to ensure that the full amount of public expenditure and liabilities is properly reflected in the Government’s accounts and reports.

### **Tax expenditure**

Government by way of policy sometimes offers tax exemptions, deductions, credits, rebates or preferential rates to certain taxpayers. These have the effect of reducing the revenue intake and are an alternative to direct subsidy expenditure. They are often referred to as tax expenditure. Their objective is usually to encourage economic activities in targeted sectors or geographic locations. There is often little or no public information of the estimated and actual cost of these tax expenditures or of the projected and actual achievements of these programmes.

It is my view that this type of data should be presented to Parliament at least annually, either as part of the annual budget exercise or in annual reports submitted by the Tax Authorities.

The Financial Administration and Audit Act, and the Regulations and Instructions issued thereunder provide basic guidelines governing the expenditure of public funds. Expenditure must be in keeping with the wishes of Parliament, it must be within budgeted provision, must be properly substantiated, be incurred with due regard to the avoidance of waste and extravagance and prices or rates paid should be fair and reasonable. The Government has established clear rules for the procurement of goods and services. These include the use of procurement committees rather than leaving it up to any one individual to determine what should be purchased, from whom it should be acquired and at what price. The system requires the use of competitive price quotations and tenders to help ensure that the Government and the taxpayers get a good deal. Clear procedures also exist for the award of Government contracts and in the substantiation and certification of payments to be made thereunder. The existence of the Contractor General's office and the current moves to establish a National Conference Commission are attempts at improving transparency of government expenditure. It is important that there be strict compliance with the procurement and contract aware procedures.

It is vital that all areas of government operations and financial activities are subjected to rigorous internal and external auditing. Such audits have to be properly planned and executed. They should, inter alia, ascertain whether the wishes of Parliament were carried out, report instances of waste, extravagance and irregularities, comment on breaches of the law or failure to comply with Government stipulated policies and procedures. The audit should seek to ascertain whether governmental activities have been incurred with due regard for economy, efficiency and effectiveness and to make recommendations for improvement.

For many years attempts at cost containment and reduction of waste of public resources have been concentrated on central government agencies. It is, in my view, necessary for this scrutiny and effort to be extended to all statutory bodies and Government companies. Where such agencies are audited by private auditors I believe their audit mandate should be expanded to include value-for-money considerations and stricter attention to compliance with relevant government procedures.

It is also important that appropriate sanctions be imposed against persons who violate the rules established to facilitate transparency and to safeguard against the waste and abuse of public funds. Serious weakness and breaches observed by the audits should be brought to the attention of Parliament in timely reports of the Auditor General and Contractor General, which, when tabled, become public documents. The Public Accounts Committee of the House of Representatives has an important role to play in examining the reports of the Auditor General. This involves ascertaining the causes of problems reported and determining whether timely and appropriate actions are being taken to effect corrective measures. The Committee also makes recommendations as to how the situation may be improved. The deliberations of the Public Accounts Committee are open to the press and the public. It is very important that arrangements be made for the reports of the Contractor General to be given similar treatment by some committee of Parliament. The public disclosure of the contents of the reports of the Auditor General and Contractor General and of the deliberations and reports of the Public Accounts Committee are important elements in facilitating transparency of public expenditure. The media

and the public, by the expressions of their views on such matters can bring pressure to bear in ensuring that existing weaknesses are corrected.

In summary, it is vital that if the public is to have greater confidence in governmental activities that its expenditures are incurred as far as possible in a transparent manner. This will facilitate a fairer and more efficient, effective and economical use of public resources. The citizens and taxpayers should be kept fully informed of the intended purposes of government expenditure in as quantifiable a manner as possible. Thereafter, timely and appropriate public reports should be presented through Parliament indicating, inter alia, how resources provided to the various agencies of Government, including statutory bodies and Government companies, were actually used, what was achieved and the reasons for any substantial deviation between what was planned and what was accomplished.

**CREATING AN EFFICIENT AND EFFECTIVE PUBLIC SERVICE –  
THE PUBLIC SECTOR MODERNISATION PROGRAMME  
AND OTHER REFORM MEASURES**

by

***Mr. Carlton E. Davis – Cabinet Secretary  
Government of Jamaica***

Ladies and Gentlemen,

I thank you for the invitation to speak at this seminar that I consider to be timely and relevant. My very first impression is that you do have an impressive line-up of speakers, but I took comfort in the fact that given your tremendous work in the region and internationally, I would be among friends who share our passion for change.

Public sectors worldwide, both in developed and developing countries are answering the call for change. It is imperative that we do so because I believe that no other single entity has such a propensity to touch the lives of all peoples everywhere.

The public sector must advise governments on policies, must implement government policies, must carry out its business in a manner that will facilitate the private sector and non-governmental organizations, must provide an efficient service to the wider public and we must protect the poor and powerless, the weak and the disabled community. I suppose one could say that the public sector must be all things to all people.

Ladies and gentlemen, the very nature and character of our business demands that we constantly review and change how we do things and sometimes even what we do. That in itself is no easy task because public sectors tend to be conservative and traditional. However, there are social, political, economic and technological underpinnings which are driving the change at a pace that is unprecedented.

Reforms to the Jamaican public sector predate the 1940s. More recently, in the 1980s, we have had the Administrative Reform Programme (ARP) which sought to address the low morale of our staff and the disparity in compensation between private and public sector employees. It was during this period that we began the implementation of a Financial Management Information System (FMIS) and the Human Resource Management Information System (HRMIS).

Unfortunately, the ARP did not address, at any rate sufficiently, the systemic problems of the sector as they relate to finance and personnel. It was felt that if we were to make a quantum leap from inefficiency to efficiency, from poor and unresponsive service to quality service, then, we must address these systemic problems. The Public Sector Modernization Project (PSMP) seeks to do just that.

The present cost of the public sector in terms of wages and salaries is over \$33 billion dollars. That is equivalent to roughly 15 per cent of the Gross Domestic Product and 25 per cent of the Government's national budget. I do not think that I need to say that that represents a big

chunk of the economic pie. This cost plus our large debt burden leave us with very little room to manoeuvre; hence much of our efforts at bringing the fiscal situation back into balance will have to be focused on these two areas.

Ladies and gentlemen, the informatics and telecommunications revolution has created a borderless world economy. This phenomenon is accelerating the pace of reforms. Hand in hand with this revolution goes a change in the role of the State. External variables now have an increased bearing on the domestic agendas, narrowing the scope for national choices.

Requirements for external competitiveness have led to greater homogeneity of the institutional and regulatory frameworks of States and these requirements have left less room for widely differentiated national strategies.

Globalization has changed the role of the State in another dimension. It has completely shifted the emphasis of government action, now almost exclusively laid on making the overall national economy develop and sustain conditions for competitiveness on a global scale. It calls for a State that intervenes less and better; a State which is capable of mobilizing its scarce resources to attain selected priorities; a State which is able to direct its investment to areas which are key to enhancing the country's competitive position, such as infrastructure and basic public services including better education and health care; a State which is prepared to transfer to private hands, companies which are better managed by them and a State in which civil servants rise to the demands for better services.

These are some of the considerations that have helped us to define the way forward for the public sector. The PSMP is therefore concentrating on improving customer service in several departments, building a value for money culture, strengthening government contracting and audit capabilities, improving efficiency and effectiveness and accountability of central ministries and rationalizing the size of the sector by modernizing, privatizing and contracting out some services. A fundamental aspect of the PSMP is transformation of some 17 public sector entities into executive agencies in the first phase of the project.

The PSMP cannot at one fell swoop transform the public sector. Limitations of human and financial resources will make that impossible. Also this phase of the project is targeted at a relatively small percentage of the public sector. However, there are other reform initiatives that are taking place which will affect the wider public sector which I will address later. We hope that over time the public will begin to see the benefits.

The first four entities slated to become executive agencies are the Management Institute for National Development (MIND), the Registrar-General's Department (RGD), the Administrator General's Department (AGD) and the Office of the Registrar of Companies (ORC). They are now in transition and will become full executive agencies in April 1999.

These departments have completed their modernization and medium-term financing plans which will guide them over the next three years. These documents have set out specific production targets that are to be met over a specified time-frame and the level of financing that would be required to meet these targets.

I am pleased to announce the appointment by the Public Service Commission of the first four Chief Executive Officers (CEOs) who will head these entities. They are Mrs. Maria Jones (MIND), Mrs. Pat Holness (RGD), Mrs. Lorna Brown (AGD) and Mrs. Claudette Morgan-Greaves (ORC). I hope that I will not be required to comment on the consistency of the gender. I am prepared, however, to say, that the posts were advertised locally and overseas in keeping with our commitment to a transparent and objective change process.

These CEOs will in turn recruit their senior managers and the incumbents are expected to compete for their jobs. The CEOs and senior managers will be contracted officers. The days of guaranteed job security for public officers, at any rate at the senior levels, are numbered; performance will determine continued employment.

We are pleased with the achievements which we have seen so far. There are improvements to customer service, increased revenue generation and a greater level of consciousness for fiscal prudence.

An express service was introduced at the Registrar-General's Department which satisfies over 1,700 customers weekly. The Regional Office in Montego Bay which was opened in July of this year satisfies some 1,300 customers per month. Another Regional Office will be opened on 15 December in Mandeville.

You can now stay in your office or home and fax information to the office and receive your registered copies without having to wait in a line. Meanwhile, revenue collection has jumped from 5 to 72 million dollars. The projection is that this figure will reach 100 million dollars in the near term. The RGD is now operating on a break-even budget.

The operations of the Office of the Registrar of Companies (ORC) have been computerized and information on registered companies can now be accessed via the Internet. Documents such as the Memorandum and Articles of Association that used to take up to two days to complete are now being completed in 10-20 minutes.

A customer service supervisor and an additional information officer are now on the ground floor of the office where customers conduct their business. The New Companies Act will provide for the simplification of the Registration requirements for new and existing companies. The agency is operating a surplus and the collection will be transferred to the revenue collecting agency.

The Administrator General's Department is implementing better systems and controls to obtain more cash from estates for better investments. The backlog of case files is being cleared by staff and the properties being managed by the agency are being repaired so that beneficiaries can enjoy better rental returns. This department has also saved \$4 million on a full year by using less office space and reducing rental costs.

One of the problems identified in the public sector is the lack of skilled personnel. A new human resource policy emphasises training and staff development. The Management Institute for National Development (MIND) will support this new thrust. MIND will act as a change agent in providing management courses to the executive agencies. Some 13 new courses mainly



in finance, management and policy formulation have been introduced. Facilities have been expanded and refurbished to accommodate additional activities.

Other entities set to become executive agencies include the Works Department, the Planning Institute of Jamaica, the Town Planning Department, the Titles Office, the Survey Department, the Natural Resources Conservation Department; the land and environmentally related agencies will be merged into broad categories, Land and Environment, as a means of achieving efficiency and cohesion.

Ladies and gentlemen, the emphasis on policy is deliberate. Poor policy advice, no matter how well implemented, will not advance the development of the country. A new level of consciousness must emerge that appreciates the different and, at times, contending variables that impact policy decisions. Some of these relate to the young, the aged, the disabled community, the environment issues of equity. Then there is, of course, the sheer scarcity of resources, especially financial.

We are, therefore, strengthening the policy capacity of the public sector starting with the Office of the Cabinet. We want to strengthen the way the centre of Government operates. We have identified some considerations which will inform the way forward:

- Public services experiences in implementing current policies must be considered without constraining us to simply more of the same;
- Innovations must be considered without allowing untested novelty to overwhelm experience;
- Cross-cutting implications for other policy areas, which are themselves facing rapid change, must be addressed;
- Consultation with available expertise wherever it resides – NGOs, wider public or public office.

The PSMP will also seek to strengthen capacity of the ministries of environment and housing, and transport and works to concentrate on policy formulation and monitoring the implementation of related policies.

Ladies and gentlemen, I do not think that this reform exercise would mean much to anyone if we were not addressing the procurement system in the public sector. A government procurement regulation for the procurement of goods and supplies, services and civil works with public funds is being developed. It will supersede existing guideline documents which do not ensure efficiency and effectiveness in the system.

Last week, the Lower House debated and passed the legislation which will establish a National Contracts Commission (NCC). This Commission will be an independent body which will oversee the awards of contracts. The legislation will presently be debated in the Upper House. The Office of the Contractor General will assume a more pro-active role in the evaluation and awards of contracts. We hope that the matter of cost over-runs that plague the public sector will be addressed once these reforms come into effect.

We have accepted that for the PSMP to be meaningful there must be changes taking place in other areas. Earlier this year, the Prime Minister established a task force to examine the issue of improved customer service in the wider public sector and integrate a plan of action with costs for implementation over a one-year period. Subsequent to that task force, some 25 key entities were selected for customer service improvements.

These entities include hospitals, the National Insurance Scheme, the Immigration Department, National Water Commission, Jamaica Customs and the Island Traffic Authority. You will observe that these entities have a high level of interface with the public.

Some of these entities have already made notable improvements in the delivery of customer service. Some persons would notice improvements at the Norman Manley International Airport. More recently, the Customs Department has introduced the Customs Cargo Processing System (CCPS). This is a computerized system that allows the electronic transmission of import entry forms called the C78.

By using this system, brokers and business persons can do preliminary checks on these forms at their offices and transmit them via e-mail to Customs. They are required to visit the office once for about five minutes to collect the final document. The manual system requires two to three visits and long delays.

In addition to this customer service initiative, the Prime Minister recently established another task force, this time led by a member of the Upper House, to recommend a plan of action to reduce waste in the public sector.

Mr. Chairman, we have also turned our attention to the three largest ministries – health, education and national security – to see how we can realize better value for the money spent. The strategic reviews are now underway in these ministries and a report is expected in early 1999. This report will inform our decisions on what areas will require immediate implementation and which will require further work.

The rapid and profound technological changes have ushered in a new era in world economy. The instant global availability of information is changing, irrevocably, our society. The Internet, e-mail and teleconferencing have reduced transaction time and redefined our traditional concepts of time and place. They have created an environment of 24-hour trading. Our public sector must be on the cutting edge of this technology in order to ensure our competitiveness with the rest of the world. We face the challenge of doing more and better with less.

The traditional values of the best public sector emphasize merit, equity, probity, integrity and ethical conduct. We want to enhance these and we want to introduce some new ones to take us into the new era. The new culture must include leadership, quality customer service, productivity, openness and fiscal prudence. These are the foci of all the initiatives being undertaken to modernize the public sector. These are the values on which our customers will judge us.

I thank you





**UNITED NATIONS  
ECONOMIC COMMISSION FOR  
LATIN AMERICA AND THE CARIBBEAN  
Subregional Headquarters for the Caribbean  
CARIBBEAN DEVELOPMENT  
AND COOPERATION COMMITTEE**