

Why Does the Caribbean Need Fiscal Rules?

IDB Civil Society Meeting, Nassau

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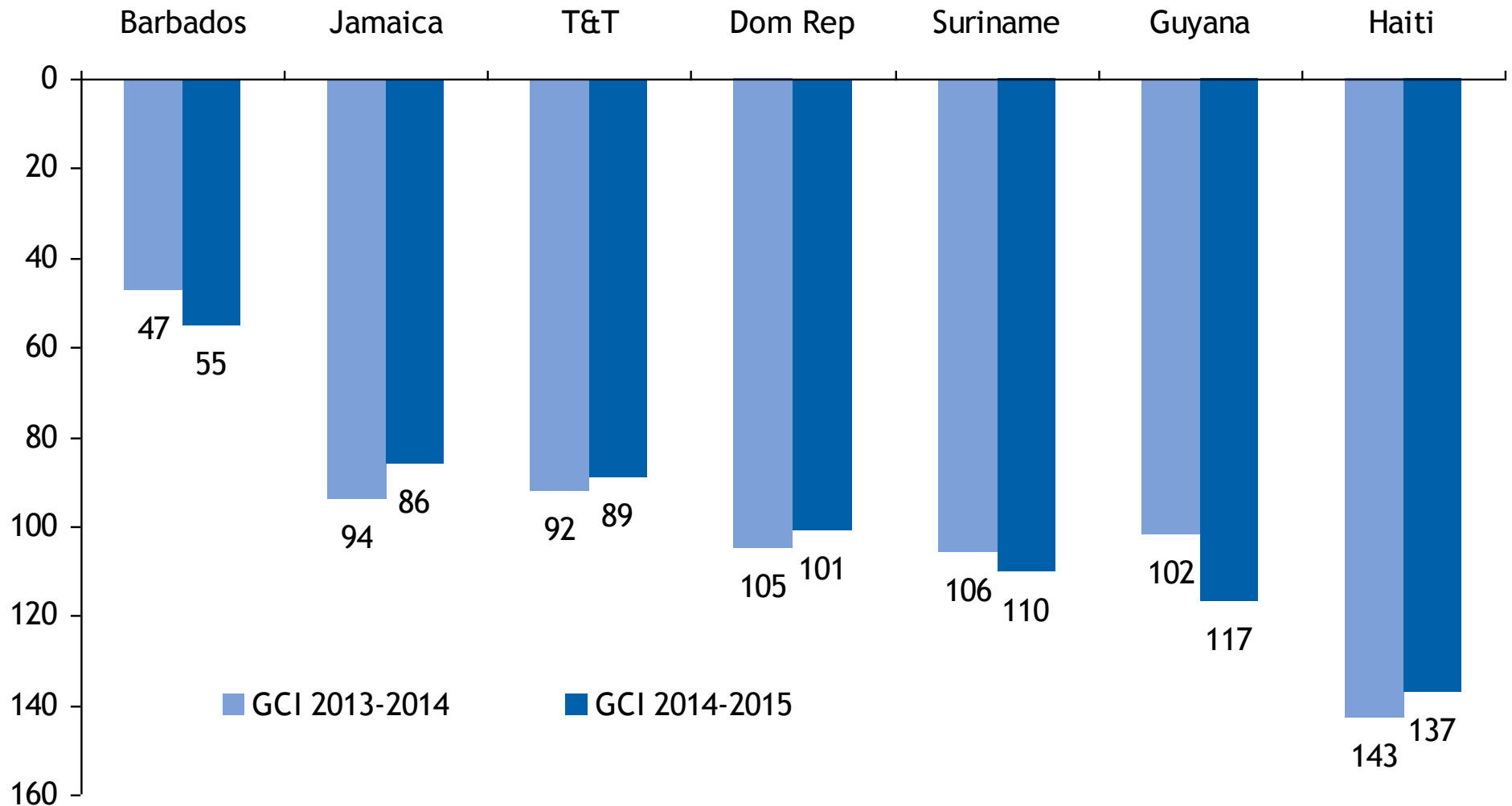
Outline :

- Why are we here?
- The Macroeconomic Caribbean Reality
- Does higher fiscal spending generate growth?
- High debt, low growth = higher poverty levels
- We need to break the high debt, low growth cycle
- Inclusive and sustainable growth is key to poverty reduction
- How to we break the cycle?
- What are fiscal rules and how do they work?

The World Economic Forum's Global Competitiveness Index for 2014-15 saw four Caribbean countries show improvement, while three deteriorated. But most of us are in the bottom half. Why?

Global Competitiveness Index : Caribbean

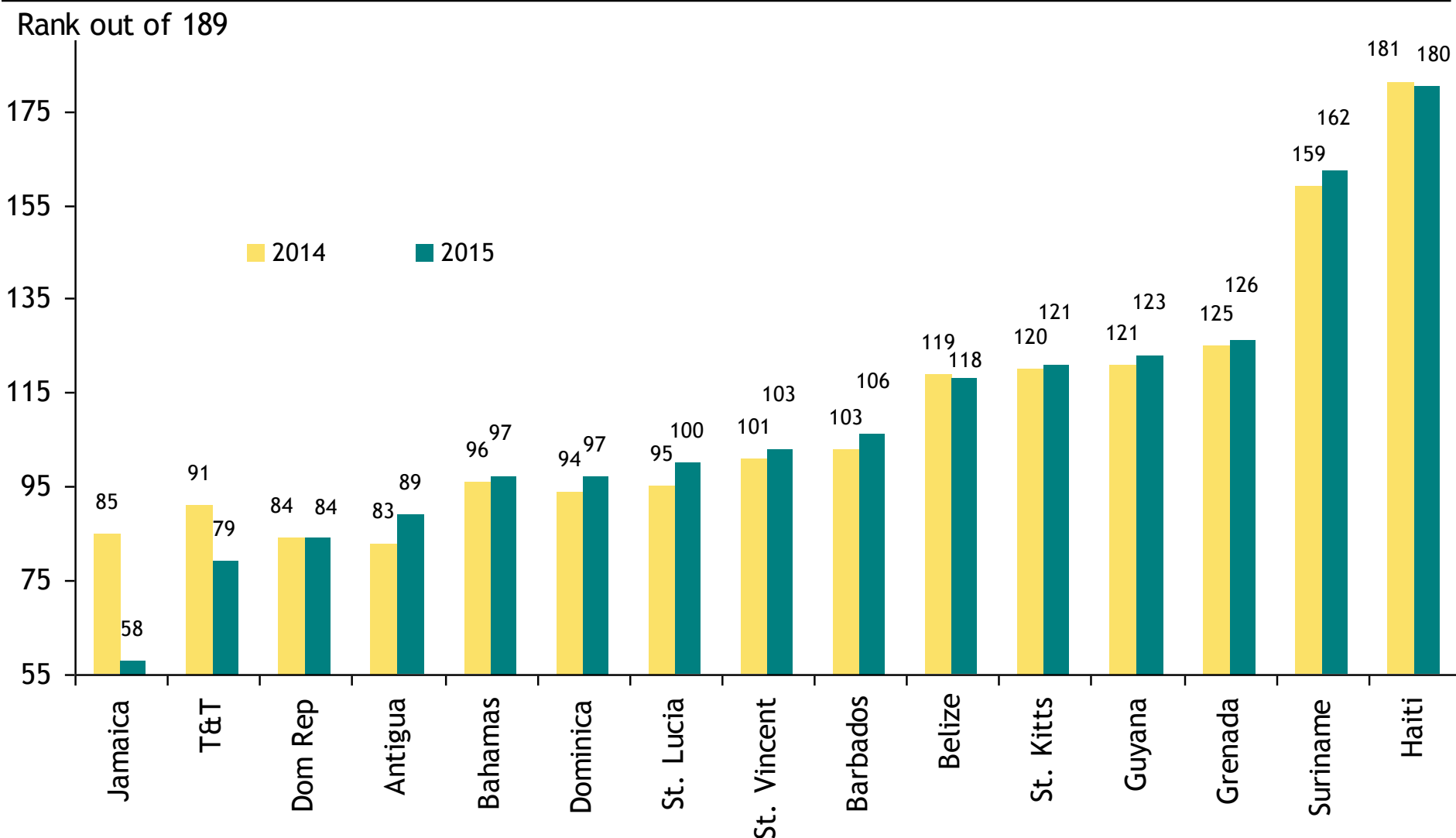
GCI rank out of 144



Source: World Economic Forum's Global Competitiveness Index, RBC Financial (Caribbean) Limited

The majority of Caribbean countries rank in the bottom half of the Ease of Doing Business Index, and most have not shown meaningful improvement outside of an IMF programme

World Bank Ease of Doing Business Ranking : Caribbean

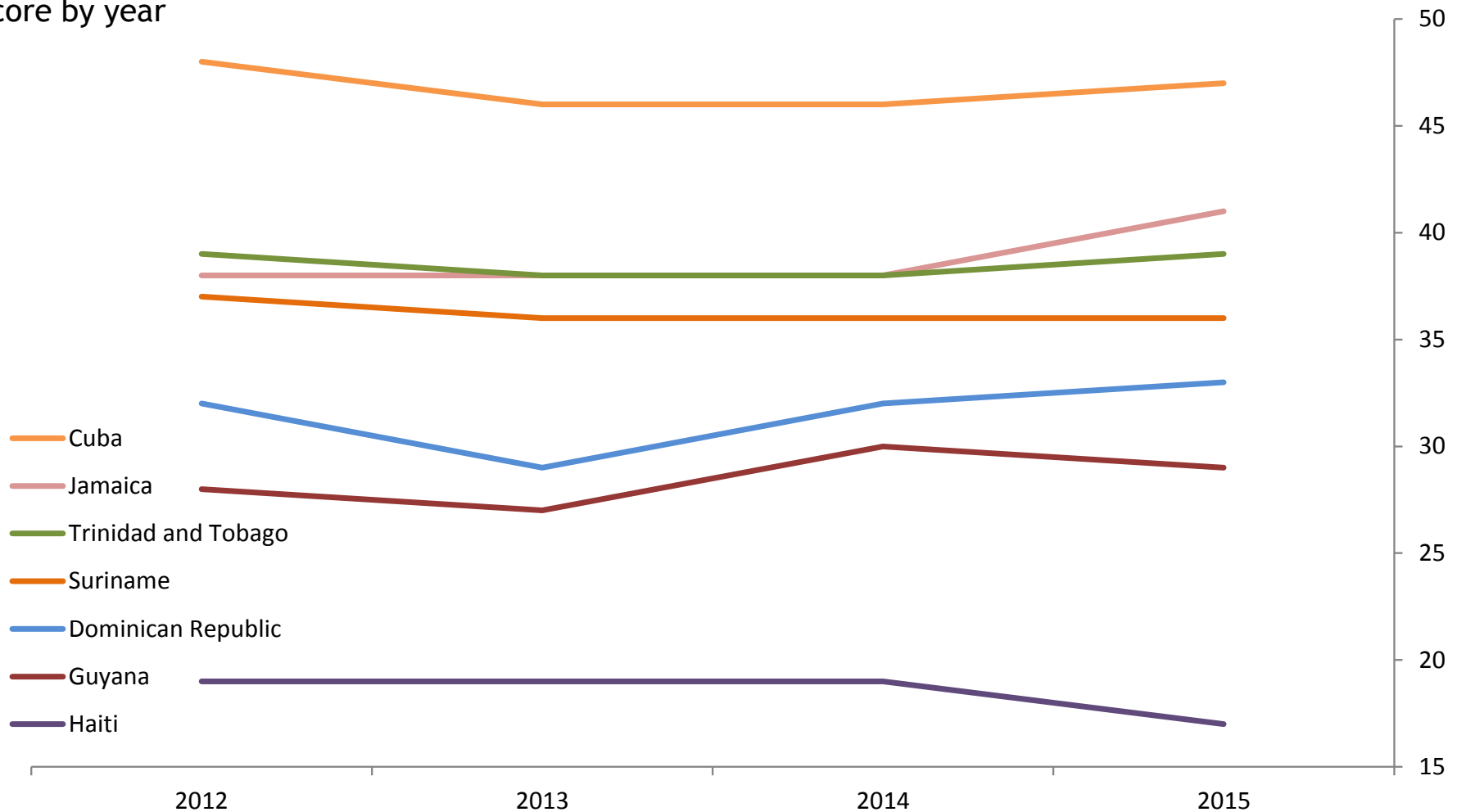


Source: World Bank Ease of Doing Business Report 2015, RBC Financial (Caribbean) Limited

The least corrupt country in the region is Cuba, and incidentally, it also has the highest proportion of female Parliamentarians in the Caribbean. Why is corruption so high amongst non-sovereigns?

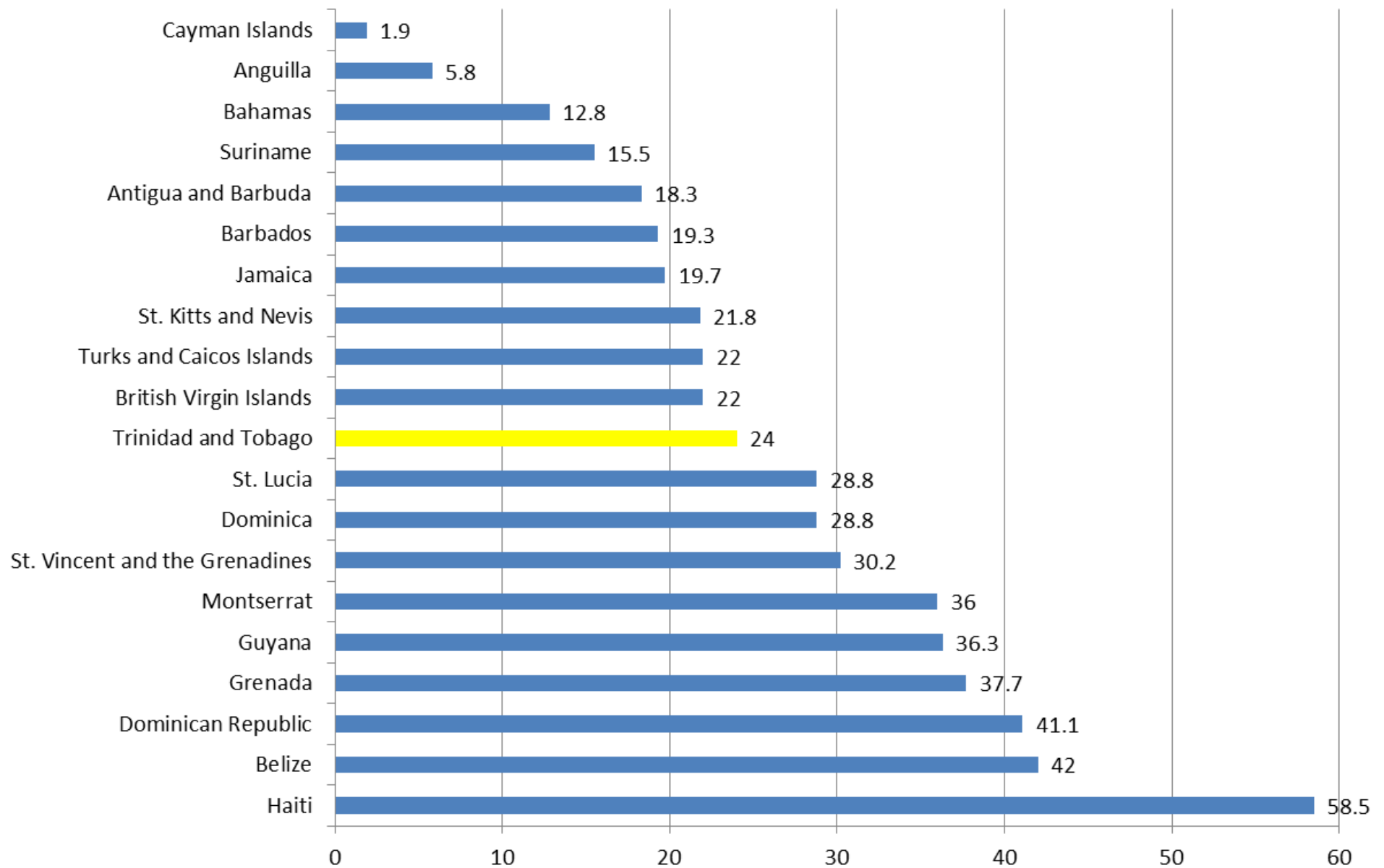
Corruption Perceptions Index Scores : Caribbean

Score by year



Source: Transparency International 2015 Corruption Perceptions Index, RBC Financial (Caribbean) Limited

One in five Caribbean residents lives below the poverty line and one in three is multidimensionally poor. Non-sovereigns are generally better off. Are we paying for independence or benefitting from it?



Governance / institutions is at the heart of confidence, which drives investment, productivity, competitiveness, growth and therefore prosperity. We have to start somewhere. But where?

- **Weak governance, institutions. Culture of impunity**
- **Low investor and consumer confidence**
- **Low levels of Gross Fixed Capital Formation / investment**
- **Low productivity**
- **Weak external competitiveness**
- **Longstanding current account deficits**
- **Persistent fiscal deficits**
- **Unsustainable debt levels / frequent restructures**
- **Brain drain / net outward migration**
- **Low population growth**
- **Slow growth, stagnant per capita incomes, poverty**

Consumption is mostly based on imports. Imports are a drain on growth. Government spending is more consumption based than investment based, and therefore also promotes imports

$$C + I + G + (X - M) = GDP$$

Where:

C = Consumption

I = Investment

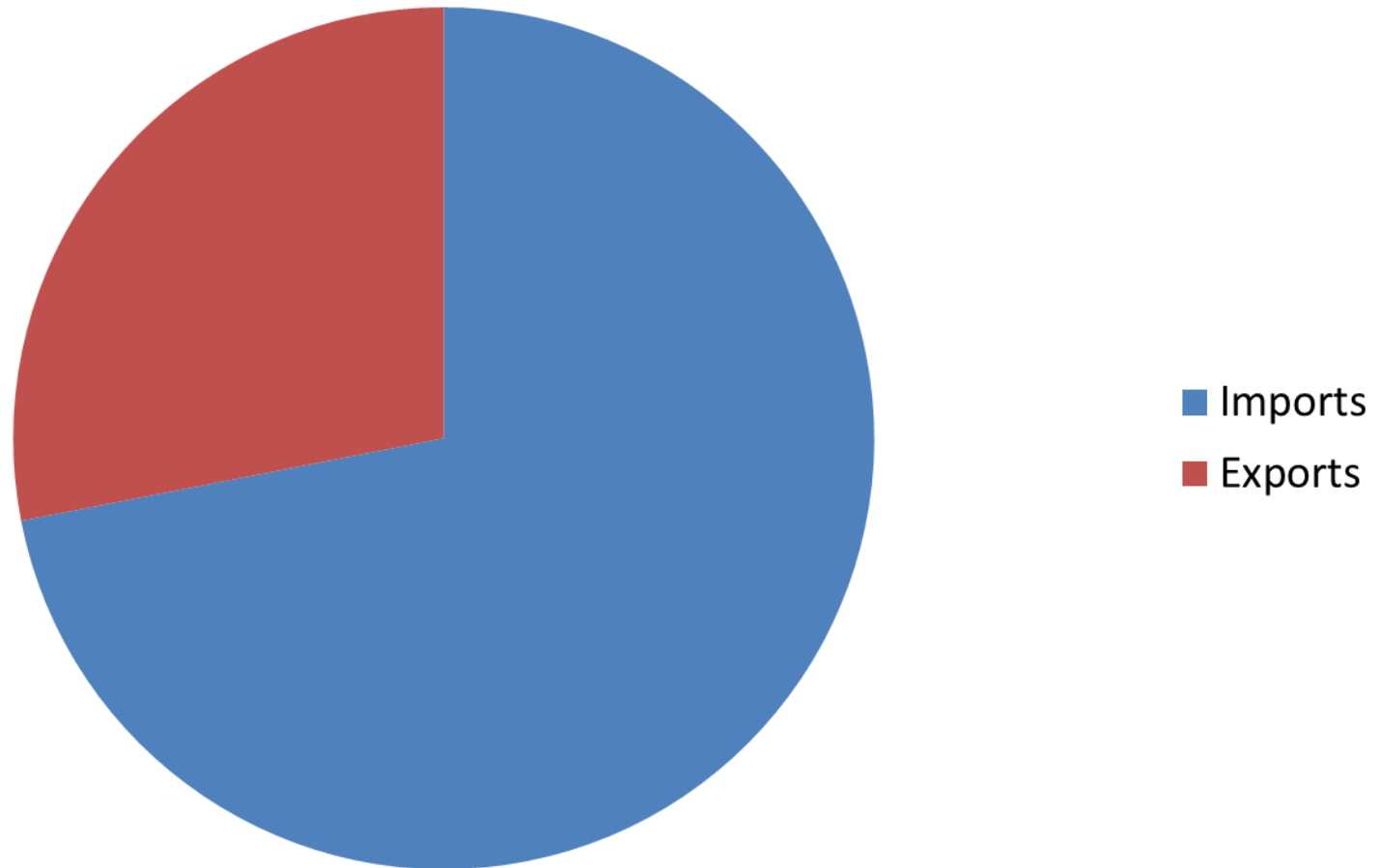
G = Government

X = Exports

M = Imports

Most of what we consume in the Caribbean is imported.

Some of what we produce and export, has an import component.



Higher consumption really does not lead to higher GDP, but to higher imports mainly. And higher government spending leads to higher consumption, which again drives imports.

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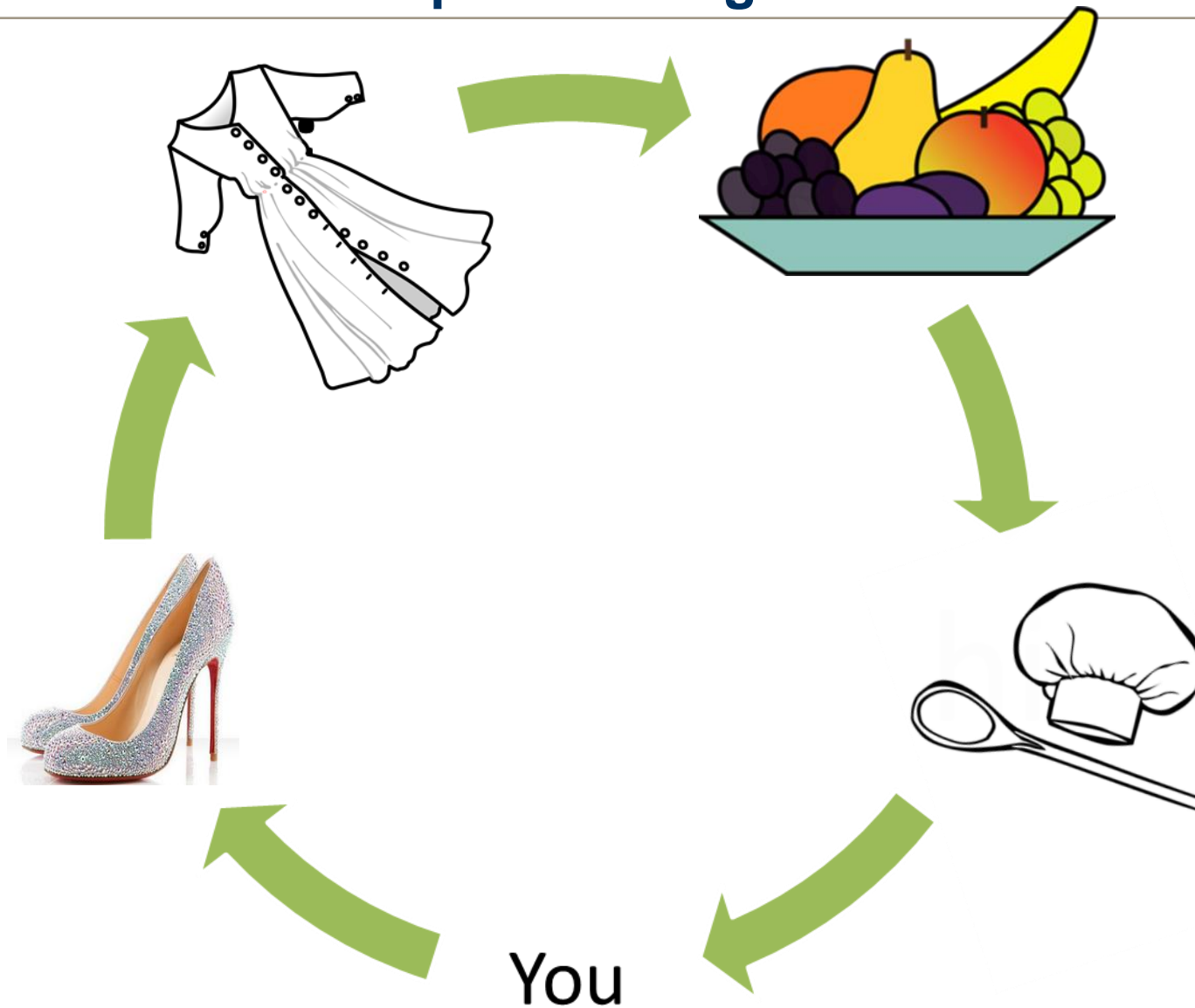
M = Imports

This phenomenon where higher consumption and higher government spending drives imports, is called leakage. And leakage diminishes the size of the multiplier.



LEAKAGE

Leakage causes the multiplier to lose potency. The circular flow of income is reduced by the amount that is spent on imports. This leaves less income to be spent on wages and taxes for example.



A 2006 United Nations Environment Programme report estimated leakage at around 80%, and for a few, even as high as 90% in the Caribbean. That means 80-90% of what we spend leaks as imports.



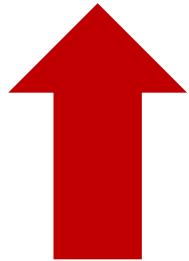
LEAKAGE

When governments overspend and borrow too much, it crowds out private sector borrowing and drives borrowing costs up. This means that private sector activity is stifled and growth is affected.



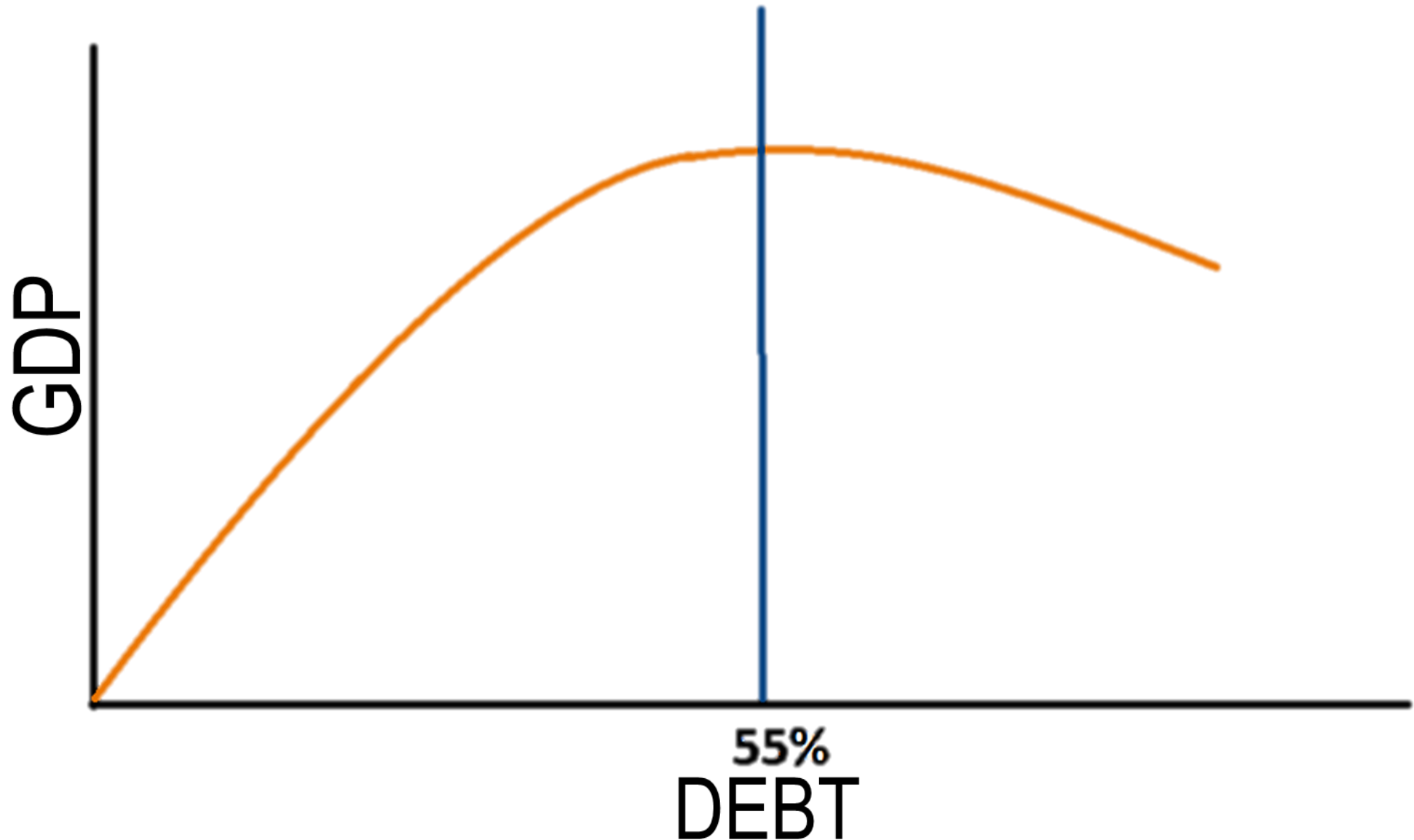
Higher Sovereign Debt / GDP Ratio

- Pressure on sovereign credit rating
- Domestic corporate credit ratings capped by sovereign rating



Driving Up Borrowing Costs

Some debt can actually enhance growth, but at higher levels, over 55-60% of GDP, each additional dollar of debt actually has a negative impact on GDP. So higher debt is also stifling growth.





No-or-Low Growth

- High Leakage
- Low Fiscal multipliers
- Unsustainable debt levels

Fixing The Problem

- How do we ensure that Governments don't try to spend their way out of a recession/ election campaign?
- How do we ensure when a Government borrows, it isn't to finance recurrent expenditure rather than investment?
- How do we limit the level of Debt / GDP below the sustainability threshold?



The conditions under which a government would voluntarily impose limits on its ability to spend are difficult to conceive and probably relatively uncommon.

- **Debt Rules** – a numerical limit on the level of public debt as a percentage of GDP
- **Budget Balance Rules** – target for the overall budget surplus / deficit
- **Expenditure Rules** – limits on total , primary and / or current expenditure, and / or on the variables that have repeatedly contributed to debt
- **Revenue Rules** – aimed at boosting revenues or decreasing tax burdens by setting revenue ceilings or floors

Fiscal Rules Promote Growth and Stability



What rules might a Fiscal Framework include?

- **Eliminate Primary Fiscal Deficits**
- **Fiscal Deficit $<$ GDP Growth Rate**
- **Tighter control on contingent liabilities**
- **A floor on well targeted social spending**

In summary, what should we do?

- **Acknowledge that higher Government spending does not create growth**
- **Recognize that the current model – high Government spending, high debt, low growth scenario we are stuck in, only promotes higher poverty and inequality**
- **Civil society should agitate for fiscal rules to be adopted and adhered to**

Thank you for your attention!

“A Crisis is a Terrible Thing to Waste”

Paul Romer, economist

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