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Public sector reforms in Pacific Islands

T.K. Jayaraman

Last week, our focus was on current account deficits in the region. This week our attention is on budget deficits.

There are important developments: three countries are involved. Two are from the region: Samoa and Papua New Guinea (PNG). The third one is the world's biggest economy, the United States (US).

The concerns are, however, different.

Economic theory says if you run persistent budget deficits over time, you will end up with debt and ruin yourself. That holds good for households, businesses and nations.

Generally, firms are punished quickly. But, governments postpone the arrival of the ultimate disaster with its powers to print money and pay for expenses as Zimbabwe did.

The case of America

With US, things are different. The US dollar is the reserve currency of the world. America is the economic power house of the world, with enormous appetite for imported consumer goods. Its budget deficits are financed by borrowing. Its debt is willingly held by China and others.

On Wednesday, the US Federal Reserve (the Fed) decided to continue monetary stimulus to improve the pace of slow recovery. The Fed has been adding about US$ 85 billion each month to the country's money supply for keeping interest rate low for encouraging consumption and investment. American funds will resume its one way journey to all emerging economies seeking higher return. Indeed, sweet news to everyone including China and India.

The Fed did not make any reference to the two-week shutdown of the economy, which has cost US$24 billion or about 0.5 percentage points from growth in the current quarter. There was also no reference to upcoming episode of the epic battle between the President's party, the Democrats and the opposition Republicans in mid January.

The US Fed is worried that fiscal policy is needlessly constrained. The latest news is that the deficit for America amounted to 4.1 percent of GDP and will be 3.9 percent of GDP this year, down from 10.1 percent in 2009. So, there is progress. Now, the concern is about business confidence. The recovery process needs stronger boost, not simply low interest rates. Government spending is the key to the recovery**.**

Our region

The revenue base of Pacific island countries is small. Only PNG is fortunate in terms of royalties and export taxes and other mineral based taxes, besides the usual individual and corporate income and profit taxes. PNG's budget deficits have been smaller, compared to those of other countries. Its 2012 budget deficit was estimated at 1.2 percent of GDP. The corresponding estimates for Fiji: 1.6 percent; Samoa: 5.6 percent; Tonga: 4.2 percent; and Vanuatu: 1.6 percent. The Solomon Islands is reported to have a budget surplus of 1 percent of GDP.

Rising government expenditure

The concern is with rising budget deficit. PNG has launched an expansionary budget to meet the fall in domestic demand consequent to the end of the US$ 19 billion liquefied natural gas project construction. It will result in an unprecedented budget deficit of 2.7 billion kina or around US$1billion. It would be 8 percent of GDP.

In his address at the economic policy analysis graduation at the national research institution, PNG's central bank assistant governor, Joe Teria wanted control on public expenditures. He referred to the depreciation of the floating currency, the kina and the resulting inflationary conditions as PNG depends on critical imports of food and manufactured consumer goods.

No doubt, BPNG has monetary policy instruments to control money supply and adequate reserves to intervene in the currency markets for halting further fall in the value of kina. They are not sufficient.

If uncontrolled, the public sector's excess demand spills over into the external sector and pushes the current account deficits upwards and the kina will again be under pressure.

Fiscal policy is beyond BPNG's reach. It is the prerogative of the government. It is the government which has to manage its budget.

Samoa

Samoa's budget deficits are responsible for its current account deficits, which are 13.4 percent of GDP in fiscal year (FY) 2013 as compared to 10 percent in FY 2012. It is estimated to hit 15.5 percent in FY 2014.

Since the *tala* is not a floating currency unlike the kina, there are no immediate pressures on the currency. The position cannot be sustained forever. The budget deficit, which is at 5.6 percent of GDP in FY 2012, will reach 7 percent in FY 2013 and 8 percent in FY 2014.

The Asian Development Bank has announced a grant of US$14 million to Samoa to achieve long-term fiscal stability and improve the country's growth prospects and for reducing vulnerability to fiscal shocks. The objective is to implement a public sector financial management reform programme.

It sounds good.

It is well known all the technical assistance programmes for public sector financial management are claimed to be home grown. In the end, they are consultants oriented.

The experts come and go.

Like the Lord Alfred Tennyson's brook, the public sector juggernaut will merrily saunter along!

"For men may come and men may go,
But I go on for ever".