Fiscal review – Some issues and suggestions

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The Government's decision to appoint a Fiscal Review Committee (the Committee) under the chairmanship of Richard Naidu with 14 members from both public and private sectors, is a most welcome decision from many points of view.

Apart from being timely, fiscal review is needed at this juncture when the economy faces fiscal difficulties, caused by the Covid-19 pandemic and the ongoing Russia-Ukraine conflict, which has raised fears about the future of globalization.

Secondly, it is overdue as the Deputy Prime Minister reminded the nation, that the last fiscal review was undertaken nearly two decades ago. During the past two decades, several things happened: some favourable and some unfavourable. Favourable events

include the transformation of Fiji from a highly taxed economy to a less taxed and a globalized, open environment.

The latter has boosted freer trade, greater mobility of labour and infusion of capital and technology, especially access to information and communication technology (ICT). There were reductions in rates of both indirect and direct taxation.

The VAT was lowered from 15 per cent to 9 per cent; the income tax threshold was raised to $30,000 and the company tax rate was reduced to 20 per cent. It was expected that a liberalized economy would lead to incentives to generate higher savings as well as greater investment in the private sector and creation of new jobs.

It was also expected that the public sector's role would be confined to the traditional one of preserving law and order and providing public goods like education and health, not to garner savings from the private sector and crowd out private investment.

Unfavourable events which included cyclones and floods besides the pandemic in mid-2019, gave rise to challenges, imposing expenditures unprovided for in the annual budgets. In addition, there were man-made disasters as well: poor selection of projects, inadequate appraisal and inefficient implementation and insufficient supervision also added to the woes.

The returns from some completed projects were below expectations. Annual public expenditures for the operation and maintenance of existing assets were rising. while annual public revenues were not keeping pace with public expenditures.

Fiji's fiscal deficits and public debt

The Covid-19 pandemic and its lingering impact during next two years affected tourism earnings as visitor arrivals plunged in 2020 and 20211. Annual fiscal deficit rose from 3.6 per cent in 2019 to an estimated 7.4 per cent in 2022.

The government resorted to public borrowing to bridge the gap. It was also easier, as the private sector had surplus financial resources in a depressed economy. The public debt rose from a relatively low level of 48.9 per cent of GDP in 2019 to an estimated 89 per cent in 2022.

The DPM expressed his concern that debt might soon reach a dangerous level, close to 100 per cent, if preventive steps are not taken. Unlike the private sector, governments have additional avenues for borrowing: (i) obtaining ways and means advance from central bank for a short period (90 days) for a maximum amount and at an interest rate, both mutually agreed to. This is known as temporary accommodation; (ii) another mode is called monetisation of deficit, equivalent to printing money.

The government can issue new bonds and direct central bank to buy them. No need for actual printing, as needed funds are transferred to government account by " click of a mouse". There are always temptations to seek help from the central bank.

It happened in Zimbabwe during Robert Mugabe’s time. India, the second largest economy in Asia also employed this avenue, where the government directly sold bonds to the central bank.

However, the legislative amendment to the Reserve Bank of India (RBI) Act in 2006 ended the practice, by banning government sale of bonds to central bank. The risks arising from deficit financing are obvious: inflation.It upsets internal balance (domestic price stability); it disturbs external balance (stability of currency); leading to depreciation of nominal exchange rate, resulting in real exchange rate appreciation if domestic price rises relatively higher than the world price level, hurting export competitiveness.

Trade deficit emerges, as it is known “the twin of domestic fiscal deficit”. A low rate of interest policy by central bank no doubt keeps interest costs for both old loans and new loans low.

However, such an accommodative policy for longer time would aggravate inflationary pressures. It is also likely to cast aspersions on central bank autonomy whether central bank is subservient to government.

The dominance of fiscal policy over monetary policy would not be approved by purists who believe in good governance.

Two suggestions

1. Co-ordination

The ToR is silent on the interconnection between fiscal and monetary policies. This is a critical area, as there are two different agencies. with same objectives: stability and growth. The government which is periodically elected in a democracy can have a shorter, myopic view due to election cycles.

The central bank is a permanent institution with responsibilities of maintaining internal and external balance.. Although various mechanisms for ensuring coordination between the Ministry of Finance and RBF) have been in place since 2001 (Ariff Ali and Jayaraman, “Monetary and fiscal policy co-ordination in Fiji”, *RBF Working Paper 2001/01*), an assessment would be appropriate.

A quick check reveals that the RBF Act has imposed limits on temporary advances to the government to meet shortfalls in revenue through its Ways and Means Facility. The government can borrow up to FJ$50 million at the interest rate of 0.50 per cent at one time during a financial year. These limits are mutually agreed upon before each year. As there are no legislative sanctions against selling bonds directly to RBF for funds, this particular avenue is open.

2. Need for two sets of recommendations

Introduction and passing legislative measures in the parliament require time; their effects would be felt only after some efflux of time. For these reasons, the international aid agencies have recognized the time element in reform process.

They use two terms: fiscal consolidation (FC) and fiscal adjustment (FA). They have two dimensions: time and size. Deficit reduction is aimed at over medium term by FC, whereas FA's objective is reduction in primary deficit in the in the short run.

Primary deficit is defined as difference between expenditures and revenue minus interest payment costs of previous year. New interest payments envisaged are not included. Government seeks to achieve expenditure reductions in areas, with scope for savings: civil service salaries and travel.

Organizational changes, including reducing the number of ministries and departments through reallocation of responsibilities and redeployment of staff and trimming number of embassies, consulates, would save resources. As for travel, one term, "abolish junkets" would work wonders! Impact would be felt in a short period.

Small increases in user fees would also be effective. The FC would comprise concrete policies aimed at reducing debt and debt accumulation over time.

It is certainly a medium-term effort, during which deficits could also be reduced by economic growth leading to more revenues and less expenditure.

So, the Committee would do well to prepare two sets of recommendations: short-term and long-term.

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