



ENHANCING JAMAICA'S FISCAL RESPONSIBILITY FRAMEWORK

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In my very first speech as Minister of Finance, I outlined the organizing principles that will frame policymaking at the Ministry of Finance. I have learned that in public life important points require repetition.

In my first speech, I outlined the view that a variety of interests with sometimes-conflicting agendas seek to influence policy – sectoral interests, labour interests, capital interests and even generational interests I said. I should have added media interests too. I characterized this as normal.

Policymaking, therefore, requires a balancing of these interests. But as we seek to balance interests there has to be an overarching vision that establishes priorities and frames decision-making.

For the Ministry of Finance, in an Andrew Holness administration, the organizing principles are the pursuit of economic independence, the expansion of economic opportunity for all i.e. economic growth and the protection of the vulnerable.

These priorities are sometimes in conflict with each other. Pursuing one can work against the other.

As a result, the policy options to support economic expansion have to be balanced by the mandate to secure our economic independence even as the urgency of economic independence has to be moderated by the need to protect the vulnerable.

However, these priorities can be made to complement each other: Our prospects for economic independence increase with sustained expansion of the economy while protection of the vulnerable preserves the social capital required to pursue both.

So, the organizing principles are: Pursuit and Maintenance of Economic Independence, expansion of opportunity for all and protection of the vulnerable.

Today, I wish to speak about the first of these. On other occasions I will address the other two planks ie the Ministry of Finance's role in the expansion of the economy and protection of the vulnerable.

Economic Independence

I will begin with a few words on economic independence.

Economic Independence is not about independence from the IMF. That would be a shallow and frankly unambitious interpretation.

In addition, the IMF has been a valuable partner to Jamaica and Jamaica has benefited enormously from the steadfast implementation of fiscal, monetary and structural reforms across two consecutive administrations and as a member of the Fund will, long into the future, continue to benefit from its technical advice.

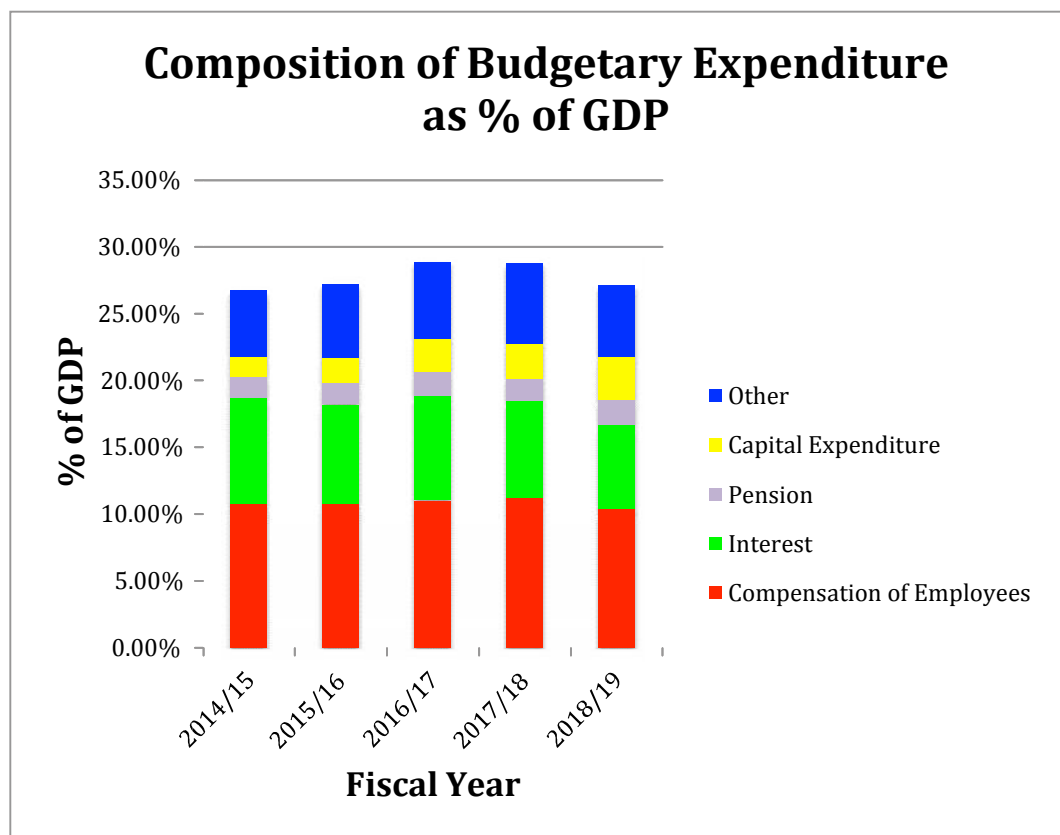
Economic Independence is not the freedom to do whatever we want. It is about implementing the right economic policies for Jamaica without prompting from anyone.

Economic independence is not an absence of inter-dependence. Jamaica is a small, open economy where trade in goods and services as a percentage of GDP is very high, at over 80%. There, will always be inter-dependence.

Economic independence, however, is among other things, about not being dependent on creditors for our basic needs. It requires that policy-making does

not just consider today, but it also considers tomorrow. Economic independence requires long-term thinking.

Economic independence also requires a domestication of the policymaking and consensus building processes and requires us to pursue policies that result in Jamaica having greater flexibility and an increased ability to address priority areas as determined by Jamaicans with responsibility and without compromising that very independence.



Source: MOF 2018/19 Fiscal Policy Paper

Note: Compensation includes (i) travelling allowances and (ii) employers contribution

Let me share with you the structure of the Jamaican budget over the last five years.

- Budgetary Expenditure is characterized by rigidity i.e. the items that are fixed long before the fiscal year begins - Interest, Pension and

Compensation make up, and have made up, a very large percentage of budgetary expenditure – 76% in 2014/15 and 69% in 2018/19. This is our reality, but is far from ideal.

- As a result growth inducing capital expenditure has been severely constrained. Though capital expenditure has doubled from 1.5% of GDP in 2014/15 to 3.2% of GDP in 2018/19, this is still insufficient to assist in delivering the pace of economic growth we desire.
- The category “Other” shown in blue represents most things we associate with Government and is left with a small share. This “Other” category has to address:
 - **All** goods and services used in GOJ in service delivery
 - Utilities and communication across all Ministries, all schools, police stations, hospitals etc etc.
 - Fiscal cost of natural disaster
 - Hospital supplies including drugs
 - School supplies
 - Human capital training supplies
 - Supplies used by police and military
 - Social safety net
 - Rental of property
 - And much more.

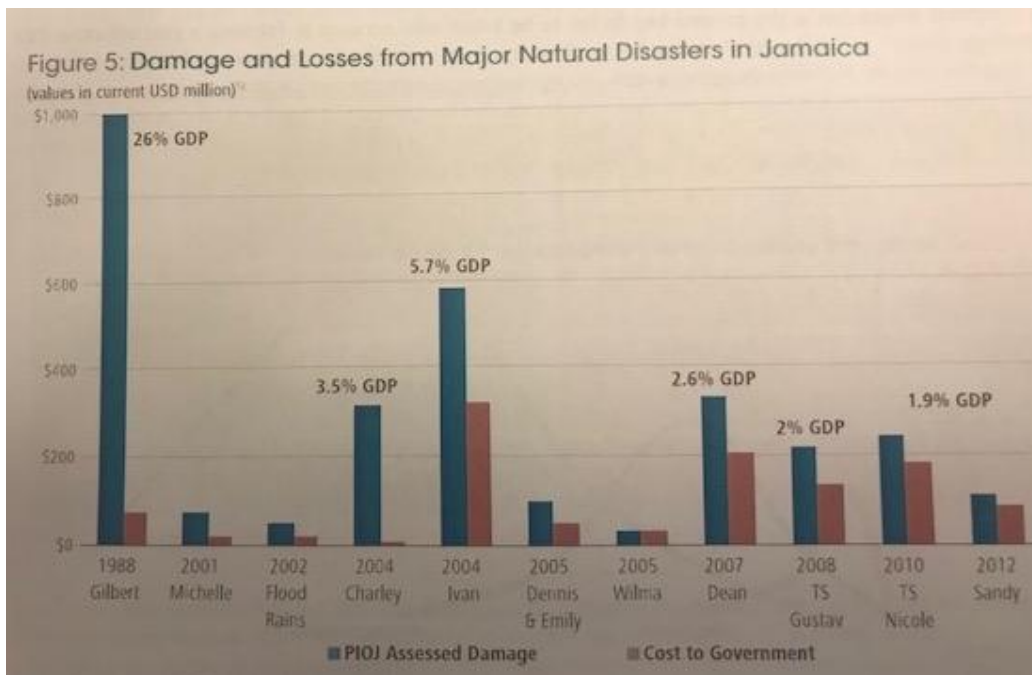
Fiscal Cost of Natural Disasters

Let me say a few words on the fiscal cost of natural disaster and the relationship with Fiscal Responsibility.

The following chart is from a World Bank study done for Jamaica and I have the permission of the Country Manager to reproduce.

It shows the fiscal cost of natural disasters to the Jamaican government over the period 1998 – 2012. The chart is alarming, but confirms what we intuitively know:

- The Fiscal cost of natural disaster is a persistent feature of the Jamaican experience and accounts for between 0.5% and 2% of GDP on a fairly regular basis.
- The Fiscal cost of natural disaster for at least half of the period shown in the graph would consume a large share of the resources available in the “Other” category of budgetary expenses (in the graphs) in those years.



Natural disasters mostly result in unplanned public expenditure or the reallocation of already committed financial resources to reconstruct, repair and/or rehabilitate roads, bridges and public buildings and to provide support to victims. Budgetary revenues also fall in natural disasters as, on a net basis, economic activity is often curtailed. As a consequence, governments often face budgetary pressures at exactly the wrong time.

The appropriate approach for Jamaica, given the frequency of natural disasters, must consist of the appropriate mix of disaster risk mitigation, adaptation and financing strategies. Today I am only addressing the financing and fiscal component.

The potential financing products include: Contingent Credit Facilities, Catastrophe Bonds, Natural Disaster Funds, Self Insurance among other products.

Given our historical experience, Fiscal Responsibility has to include the development of a strategic response to the fiscal cost of natural disasters that

takes into consideration the products available, our resource envelope and the frequency of natural disasters.

Therefore, with the technical assistance of our partners, we will develop a ***Public Financial Management Policy for Natural Disaster Risk*** combined with a long term operational plan for its implementation.

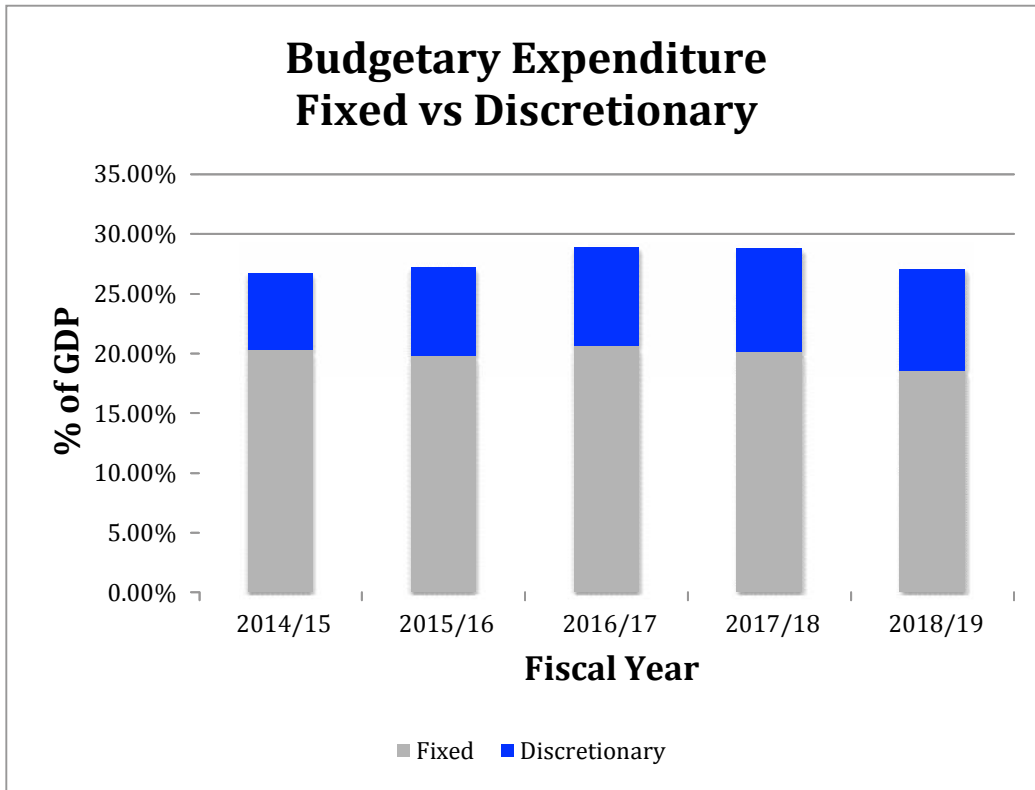
Fiscal Responsibility demands this. We must be reminded that Economic Independence for Jamaica requires us to carry our umbrella.

Fixed vs Discretionary Expenditure and Economic Independence

So, back to the composition of budgetary expenditure. The same numbers can be expressed differently, combining them into buckets of Fixed Expenditure (Compensation, Interest, Pension) and Discretionary Expenditure (Capital Expenditure and Other).

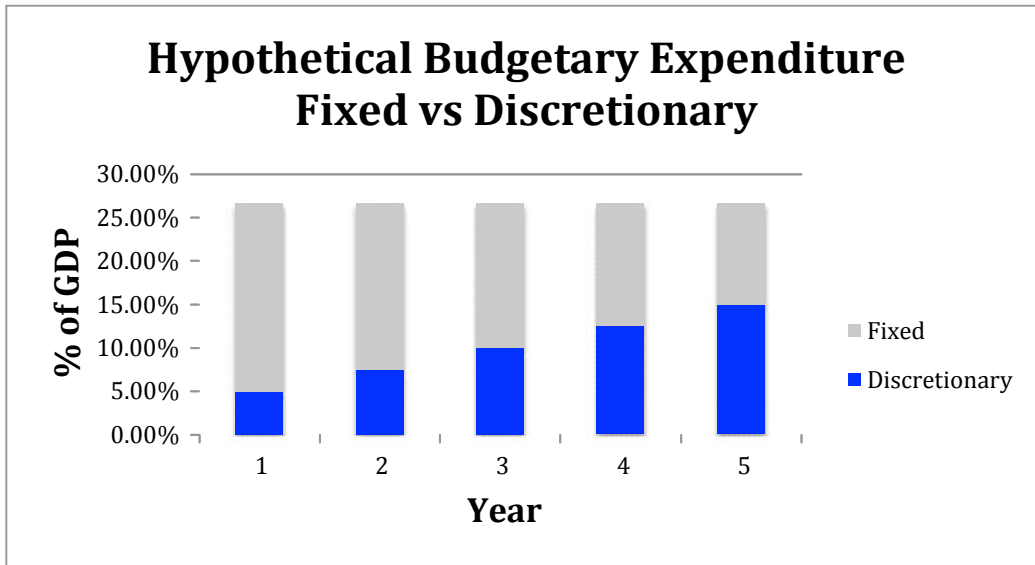
Fixed Expenditure we know in advance and does not change easily. It is fixed in the sense it remains regardless of what else is happening, and policy-makers have little discretion. Discretionary expenditure is expenditure over which policy-makers have choice and exercise discretion.

The graph below shows how Jamaica's fixed and discretionary expenditures have evolved over the past five years. Progress has been made in increasing discretionary expenditure and so we have been able to double capital expenditure as a percentage of GDP and significantly increase social safety net spending.



Source: MOF

In illustrating what I mean by Economic Independence, however, below is a hypothetical example of how budgetary expenditure could evolve as we make progress in reducing debt and growing the economy.



Economic Independence increases as the relative size of the blue box increases with respect to the size of the grey box.

By saying that policies of the Ministry of Finance will be anchored in the pursuit and maintenance of economic independence what I mean is that our policies will seek to expand the “blue box” so Jamaica can have the opportunity to address its priorities: infrastructure, other capital expenditure that enhances efficiency and productivity, security, other growth inducing spending as well as critically, improving protection of the vulnerable.

Economic independence is therefore its own cause and its own solution. Ladies and Gentlemen, economic independence is not a choice, it is an imperative.

Jamaica's Fiscal and Monetary Achievements

Jamaica's Macro-Economic performance, as measured by the key macro-economic indicators, has been exemplary under successive programs with the Fund:

- Debt has reduced dramatically;
- Fiscal health has been restored;
- Interest Rates are at record lows;
- Unemployment has fallen to 9.6%
- Inflation has substantially moderated
- Jobs growth has been robust and sustained

Economic growth, however, has lagged.

Much remains to be done, though we can make note of our collective achievement to date.

How has this all happened? Well, success has many parents and in this case deservedly so.

Today, however, is not meant to de-construct the period that we are still in but instead to prepare for what follows.

Suffice to say, that with sound technical advice and financial resources from the IMF, IDB and World Bank, broad domestic ownership by diverse stakeholders and responsible stewardship by successive administrations, much progress has been and continues to be made.

I would like, however, to spend time on just ONE of the many important components – the unprecedented level of public engagement and ownership of Jamaica's economic programme that has characterised the last five years.

This is symbolized in EPOC and its related partnership institutions PSTOC and the EGC.

The emergence of these institutions, however, would arguably not have been possible without the prior existence of the Partnership and the Social Dialogue that it introduced.

The Partnership saw a diverse group of stakeholders making the affirmative decision to collectively discuss challenges, share experiences and burdens, and brainstorm solutions in a collaborative spirit. Mutual understanding, the predisposition to listen and the courage to compromise were distinctive features.

The early successes of the Partnership and Social Dialogue built confidence and ushered in an era where stakeholders viewed government as critical but not necessarily the “be all and end all” .

The central lesson of the Partnership was that the consensus building mechanisms of non-governmental bodies had, and continue to have, an indispensable role to play.

It was against this background that the previous administration approached members of the financial community with a second debt exchange and the unions with a multi-year wage freeze as prior actions for entry into the Extended Fund Facility.

Both groups correctly insisted on the right to monitor Jamaica’s economic program in return for such sacrifices, in order to ensure that Jamaica maintained its commitments to the reforms embedded in the agreement with the IMF.

And so EPOC was born, and it has been a success. So much so that it has been replicated in other countries with IMF programmes.

Administrations changed in February 2016 and the new administration successfully completed the 11th, 12th and 13th reviews under the Extended Fund Facility (EFF), and in a positive surprise announced the early termination of the EFF and the entry into the Precautionary Stand-By Arrangement in November of 2016.

The Precautionary Stand-By Arrangement (PBSA), by its very design, represented a graduation from the Extended Fund Facility and was intended for Jamaica to take more ownership of its reform program with less “hand-holding” from the Fund:

As examples:

- The reviews by the IMF were less frequent – semi annually, compared with quarterly under the EFF.
- The Stand-By Arrangement was on a precautionary basis with committed but undrawn funds acting as an insurance policy rather than having drawn IMF resources parked at the Bank of Jamaica.

The expressed intent of both parties around the negotiating table, the IMF and GOJ, in the design of the PSBA, was for Jamaica to graduate from a program relationship with the Fund at its maturity, barring unforeseen circumstances.

Under this new program, while the quantitative performance criteria continue, the structural benchmarks have mostly been focused on public sector reform and to date all 14 of these structural benchmarks have been met.

As a result of the public sector focus of the reforms under the PBSA we decided that a separate monitoring body was required, one headed by a leader with labour credentials as opposed to a banker. So there was a bifurcation of monitoring roles with EPOC focusing on the macro-fiscal and PSTOC on public sector transformation.

In my first speech as Minister of Finance I contextualized the timing of my appointment as coming halfway into the current agreement with the Fund, which is eighteen months before it matures.

Given the success to date of our five year engagement with the IMF, with the likely prospect of Jamaica graduating from a program relationship with the Fund, it is important to consider the institutional arrangements that may assist in keeping Jamaica on the track towards greater economic independence.

Some have suggested “legislating EPOC”.

I don’t take that suggestion literally nor do I understand it to have been meant literally.

EPOC has no analytical capacity. It consists of full time, fully occupied, hard working leaders and was essentially created to monitor agreements between the GOJ and the IMF. In the absence of a Fund Agreement, and without the Fund’s analytical capacity and detailed written and published reviews, EPOC as constructed would not work.

What I believe could work, however, is legislating for the institutional permanence of the principles on which EPOC and its companion entities have been founded:

- Enhancing accountability of the policymaking process
- Deepening transparency of government finances
- Strengthening credibility of Jamaica’s fiscal path
- Promoting inclusiveness in the policy discussion space
- Taking greater societal ownership of Jamaica’s economic direction

The establishment of an institution that embodies these principles is crucial to the achievement and maintenance of Jamaica’s economic independence.

As a result, having been appointed at the end of March, the first Cabinet Submission that I prepared in April, as Minister of Finance and the Public Service, was a submission on this matter.

I am therefore pleased to announce that Cabinet has endorsed the concept of an Independent Fiscal Institution, such as a Fiscal Council, and the Government has procured the services of very experienced international technocrats in this area to help Jamaica with the design.

FISCAL COUNCILS

What are Fiscal Councils?

Fiscal Councils are permanent, independent, non-partisan institutions, staffed by competent, experienced and technically proficient persons that help promote economically sustainable fiscal policies across political cycles and that are created by legislation.

Since the advent of the global financial and economic crisis of 2008/2009 fiscal councils have proliferated as countries seek to implement measures to restore fiscal credibility.

The establishment of Fiscal Council, which can be constructed as an enhancement of the partnership models we now have, offers several advantages:

- Fiscal Councils foster greater transparency around fiscal policy by having legislated access to economic data, having sufficient analytical capacity and by providing unbiased information to the public.
- Fiscal Councils deepen democratic accountability, as policy makers have to maintain credible policies or explain what appear as deviations therefrom.

- Fiscal Councils alter the incentive/disincentive structure in the political economy raising the political cost of unsound policies or policy proposals.
- On the converse, Fiscal Councils reduce the political cost of complying with Fiscal rules.
- Fiscal Councils help to keep the public and policymakers informed and educated and by so doing reduce “fiscal illusion” where electorates and stakeholders wrongly believe that Government has more resources than it lets on.

It is important to note that crucial properties of credible fiscal councils are that:

- they are non-partisan in all of their activities.
- they are not policy decision makers nor do they try to be
- they only offer a second opinion
- they are neither Tsars nor Gods
- they are not a parallel Opposition
- they are not a parallel Government
- Fiscal Councils influence the public debate indirectly through the media impact of their reports but are not otherwise direct participants.

A most important feature of Fiscal Councils lies in their independence:

- Independence from partisan influence
- Independent access to the media
- Independence to choose communication strategy (except communication should be scheduled so as to avoid perception of partisan timing)
- Operationally Independent
- Independence enshrined in law

What does GOJ proposed that Fiscal Council in Jamaica do? (subject to cost)

A Jamaican Fiscal Council would be the guardian, interpreter and arbiter of Jamaica's Fiscal Rules.

Jamaica adopted a Fiscal Responsibility Framework (the "Framework") through the passage of legislation in 2010 and 2014. Among other things, this Framework promulgates the parameters of the budget calendar, provides for certain economic and fiscal reports and forecasts to be tabled in advance of the budget and includes Fiscal Rules that establish prescriptive expenditure boundaries and escape clauses from those boundaries in the event of natural disasters.

A Jamaican Fiscal Council could monitor compliance with Jamaica's Fiscal Rules.

A Jamaican Fiscal Council could keep the public informed on economic matters according to a scheduled calendar.

A Jamaican Fiscal Council could provide independent analysis on fiscal policy developments.

Our Fiscal Council could do other things as well, subject to our ability to afford it.

Approached in this way a Jamaica's Independent Fiscal Council would embody the principles of credibility, accountability, transparency, inclusiveness, ownership and permanence, which would help Jamaica maintain a path of fiscal prudence, enhancing our economic independence.

Now it is important to note that common sense and the experience of other countries dictate that the establishment of a Fiscal Council requires as a pre-requisite, or a parallel step, the strengthening of the macro-fiscal and public financial management capacities of the Ministry of Finance. This is an imperative. I will return to this topic at a future date.

Also, in a country short on technical resources, a Fiscal Council cannot be made to cannibalize existing macro-fiscal capacity in Ministry of Finance, for example, or other agencies. Capacity building therefore becomes a strategically crucial.

Roadmap to Fiscal Council

So what is the Roadmap to Jamaica's Fiscal Council?

The seeds of this were sown publicly at the High Level Conference jointly organized by the Government of Jamaica and the IMF and which the IMF Managing Director, Madame Christine Lagarde, attended in October of 2017.

In my then capacity as Ambassador of Economic Affairs I had the privilege of leading the organizing team from the GOJ end.

The conference involved three panel discussions, the topics of which were carefully chosen, as were the panelists.

The second panel discussion focused on Fiscal Policy and the Electoral Cycles and had Hon. Oliver Clarke as moderator with a balanced panel of Richard Byles, Hon. Bruce Golding, Hon. Bharrat Jagdeo and the Head of the Chile Fiscal Council all of whom brought different experiences and perspectives.

The conference stimulated discussion on Fiscal Councils as a potential solution for Jamaica. Richard Byles embraced the concept publicly, as did Peter Phillips as well as Mark Golding in his budget presentation earlier this year, all using the language that I have paraphrased as "legislating EPOC". Bruce Golding called for raising the parliamentary threshold for changing fiscal rules from a simple majority to a super-majority. (I also made this proposal, back in 2014, in a senate debate on the adoption of further fiscal rules).

Cabinet embraced the concept of an Independent Fiscal Institution in April and I am making this speech in May.

We intend to have a consultative approach to the design of the Fiscal Council involving all stakeholders: Unions, Private Sector, Financial Sector, Civil Society, Youth, Academia and the Opposition.

The government has engaged international experts who bring an appreciation of the theoretical foundations of such institutions as well as the practical experience of having advised on the design and formation of these in many countries in the world. They will visit in June and meet with stakeholders where we can incorporate the Jamaican experience into the design of our very own Independent Fiscal Council.

I use the word “ours” as, to be effective, it has to truly be ours in design and in implementation.

Jamaica’s Independent Fiscal Council will be an important cornerstone in Jamaica’s Fiscal Responsibility architecture and holds the promise of helping to keep Jamaica on a path towards the achievement and maintenance of economic independence long into the future.