

Is the Fiscal Responsibility Act (FRA) Fit for Purpose By Laurel Theresa Bain

Grenada and the tourist dependent economies of the Eastern Caribbean Currency Union [ECCU] are grappling to recover from the economic and social fallout from the Covid-19 Pandemic. During this recovery period, the Governments would depend on fiscal policy for stabilizing the economies and placing them on a path of sustainable growth and development.

In Grenada, fiscal policy is guided by the Fiscal Responsibility Act No. 29 of 2015 [the Act]. This Act provides a foundation for establishing a transparent and accountable rule-based fiscal responsibility framework in Grenada. The objectives of the Act are: (a) to ensure that fiscal and financial affairs are conducted in a transparent manner; (b) to ensure full and timely disclosure and wide publication of all transactions and decisions involving public revenues and expenditures and their implications; (c) to ensure that debt is reduced to, and then maintained at a prudent and sustainable level by maintaining primary surpluses that are consistent with this object; and (d) to ensure prudent management of fiscal risks.

The Fiscal Responsibility Act was passed by Parliament on 29 May 2015 and by the Senate on 5 June 2015. In assessing the objectives of the Act consideration must be given to the economic and social environment. In the year preceding the passing of the Act the economic environment was buoyant. The international economy had recovered from the global financial and economic crisis and recorded growth of 3.6 percent in 2014. In the ECCU, the tourism industry recovered, and in most countries, there was the implementation of the Citizen by Investment Programme and the associated construction of hotels and villas. The private sector was therefore actively engaged in the economies and contributed to the economic growth of 3.8 percent in 2014.

Grenada's economy grew by 7.3 percent which reflected the growth in tourism and construction. Given the high dependence on tourism and education services, the private sector played an important role in stimulating economic growth. The improved economic activity and inflows from the Citizen by Investment Programme boosted Government finances, and with the debt restructuring, the debt to GDP ratio declined.

The economic and social landscape has changed drastically from the 2014 period. The global lockdown in 2020 due to the Covid-19 Pandemic caused a drastic shrink in global national income and unemployment soared to unprecedented levels. The social sectors, particularly education and health, were challenged. The tourist dependent economies of the ECCU were severely affected and economic activity contracted by 16 percent. Consequently, the governments assumed a more active role in the economy.

Grenada was no exception. The economy contracted by an unprecedented 12.6 percent with the accompanying growth in unemployment. Private sector activity almost ceased with the halt in tourism and the exit of the students from the St Georges University. The education sector was dislocated. Economic recovery is expected to be slow and tedious. These

developments were unforeseen at the time of the crafting of the Fiscal Responsibility Act. In this environment, the Government is expected to play a significant role in economic recovery.

Even under normal economic conditions, the restrictions of the Fiscal Responsibility Act inhibit its use as a fiscal policy instrument to transform the economy. The transformation of the economy requires well targeted capital expenditure which has implications for Government primary expenditure. Improving education and health services, even under normal economic circumstances, could, in some years, significantly increase primary expenditure on personal emolument and goods and services.

A binding annual primary expenditure rule of two (2) percent in real terms, limits the discretionary powers of the Government to allocate resources to meet the needs of the economy at a particular time. This discretionary power is extremely important during this recovery period when resources need to be allocated to the provision of education, health, and other social services.

The binding primary expenditure rule is also applied to capital expenditure financed from domestic resources. This affects government's ability to undertake major infrastructure projects that are financed from domestic resources. Expenditures on capital projects are lumpy and is difficult to be constrained within the binding expenditure rule of two [2] percent real growth. While fiscal rules and targets allow for fiscal discipline, they should be designed with flexibility to facilitate the use of fiscal policy to manage the economy. This is most important during this recovery period as Government addresses the economic and social impact of the Pandemic.

At this time, the fundamental issues relating to the Fiscal Responsibility Act are [i] Whether the application of the Act conforms to the tenets of accountability and transparency in fiscal policy [ii] If fiscal policy is the main instrument for economic management, is there need for amending the Act; and [iii] How appropriate is the application of the Act, in its current form, for addressing the need to restore the economy to sustainable growth.

Issues of data deficiencies, transparency, and consistency have been identified in the application of the Fiscal Responsibility Act. These need to be addressed. In previous articles: 'Transforming the Economy with Fiscal Policy - Reforming the Fiscal Responsibility Act – Parts 1 and 2' areas for amending the Act to improve transparency and consistency, and as an instrument for economic development were highlighted.

Additionally, the Fiscal Responsibility Oversight Committee [FROC], in its 2019 Annual Report, indicated that recommendations for amending the Act were put forward by the International Monetary Fund (IMF). The FROC has also recommended amendments to the Act and, in its 2019 Annual Report, stated: "As it stands given the extensive amount of amendments which the FROC, MOF and IMF believe are necessary to enhance the FRA, it is the FROC'S respectful submission that the current legislation – the Fiscal Responsibility Act No. 29 of 2015 – should be repealed and replaced".

During the Covid-19 Pandemic, the expenditure rules and targets in the Fiscal Responsibility Act were rightfully suspended. In March 2020, the Escape Clause in the Act was invoked, and the expenditure rules and targets were suspended for that fiscal year. In December 2020, the suspension of the fiscal rules and targets was extended to the 2021 fiscal year. The Recovery Plan Memorandum, as required by subsection 10[4] of the Act, should have been submitted to Parliament. The Recovery Plan Memorandum is expected to set out the measures to secure compliance with the fiscal rule, target, or corrective measure and should inform fiscal policy in Grenada over the medium-term.

A reform of the Fiscal Responsibility Act is however required. In reforming the Act, the operational relationship between the Consolidated Fund and the National Transformation Fund will need to be well defined. The resources from the National Transformation Fund, defined by the Government as ‘grants’, are used to finance capital projects. As a source of development financing, transparency and accountability are required on the operation of the National Transformation Fund

In implementing an amended Fiscal Responsibility Act, the existing data deficiencies must be addressed. Comprehensive data on the public sector must be presented. At present, data is provided only on central government operations while the Act covers central government along with qualifying statutory bodies and state-owned enterprises. As a result of the lack of comprehensive data on the public sector, the Act is not applied as legally required.

The opportunity should now be taken by the Government to thoroughly examine the Fiscal Responsibility Act for consistency, transparency, accountability and as a policy instrument to facilitate economic development. These findings should guide the reform of the Fiscal Responsibility Act making it fit for purpose.

Knowledge is Power and experience is the Greatest Teacher.

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Ms Bain has undertaken assessments of the economies of the Eastern Caribbean Currency Union (ECCU) and research on fiscal policy and taxation issues in the ECCU. She is the Author of the books: Fiscal Policy The Economy and The Tax Structure of the Member Countries of the ECCB. Ms. Bain has worked extensively with international development agencies and regional institutions.

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