Fiscal Management for Sustainable Development

March 14 2012
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By

H. Leon and R. Smith

The chapter focuses on the role of fiscal management in sustainable development, defined broadly as the ability to achieve intergenerational equity—meeting the needs of both the current and future generations. We explore whether clear legal and administrative frameworks are in place to guide fiscal management, and whether principles of sound financial management are being practiced, important factors in achieving and sustaining macroeconomic stability and growth. We review the elements of fiscal management, including the use of a medium-term budgeting framework (strategy, execution, and monitoring), using the Jamaican experience over the last 30 years as backdrop, and highlight links among the development of the economy, people, and institutions, as we underscore the need for appropriate financing strategies to implement integrative solutions.

What is Sustainable Development?

Sustainable development can be defined as “development that meets the needs of the present without compromising the ability of future generations to meet their own needs” (Brundtland Report, 1987). Sustainable development requires strong policies to promote adequate and steady rates of growth, a proactive effort to maintain competitiveness against global partners, a governance structure to engender trust and respect of authority, and a social agenda that can be accepted as reasonably fair, if not equitable. It involves making choices among conflicting short-term objectives while pursuing long-term goals; and pursuing macroeconomic stability while undertaking social, institutional, and infrastructural development. Given limited resources, an important aspect of sustainable development is the pursuit of a “societal consensus” on relative development needs. This relativity is typically framed within “fixed” political ideologies, but ought to be recognized as dynamic and addressing changing realities. In turn, a “consensus” requires transparency, accountability, and adequate mechanisms for effective communication with all sectors of society.

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Macroeconomic and financial stability are important for business confidence and therefore integral for achieving sustained growth—instability increases uncertainty, discourages investment, impedes economic growth, and hurts living standards. The macroeconomic environment is closely linked to the general business cycle, which is in turn strongly influenced by, among other things, fiscal policy (tax, expenditure, and borrowing). Tax and expenditure policies can change aggregate demand and supply, influence behavioral incentives and competitiveness, and affect composition and size of balance sheets and financial decisions of institutional units. Fiscal policy can therefore play a significant role in promoting sustainable development. It is clear then that, tax, expenditure, and financing decisions of the Government should follow broad principles that translate into the efficient collection and effective utilization of resources, aimed at achieving the long-term objectives of a country, generally accepted as sustainable growth, a reduction in poverty, and an improvement in standards of living.

The role of Public Financial Management

“Sound Public Financial Management (PFM) ensures accountability and efficiency in the management of public resources, which are critical to the achievement of public policy objectives…” (World Bank, 2004). In short, sound PFM practices ensure that fiscal policy, actions taken by the Government, have the intended effect. The effectiveness of policy can therefore be gauged, and improved, through proper and regular assessments of the systems in place for the collection of taxes and the efficiency with which the government is able to produce public goods.

A sound PFM system is not only a priority for governments, but also for donors seeking to ensure the effectiveness of financial support provided. Review of PFM systems can provide important information on the constraints to effectively implementing development programs, by analyzing risks that funds channeled though public systems will not be efficiently utilized, for the purpose provided. In recognition of the significant role played by PFM in economic development, and the increase in the provision of donor funding in recent years, multilateral financial institutions such as the World Bank and the International Monetary Fund (IMF)
have increased support, both financial and technical, for PFM reform programs.

In practice, PFM systems are assessed based on operational performance, as well as the transparency and effectiveness of processes and institutions. Key PFM indicators attempt to assess various critical objectives (World Bank, 2005), such as:

1. **Is the budget generally realistic and implemented as intended?** This involves evaluating fiscal outturns relative to approved budgets. Generally, in assessing expenditures, areas outside the government’s control such as debt servicing are excluded from the analysis. It is also important to look at variations in the composition of expenditure. If there are wide deviations in composition, this could imply a significant departure from policy. On the revenue side, the accuracy of revenue forecasts, abstracting for external shocks, is a critical issue.

2. **Are the risks to the fiscal position effectively monitored and managed?** The breadth of aggregate fiscal risk oversight should be evaluated. The government’s effectiveness at assessing and monitor risks associated with the activities of the various Ministries, Agencies, and Departments of government (MDAs), as well as public bodies, is an indication of how ready it is to take corrective measures. Additionally, the accessibility of budget information to the public is an important measure of transparency.

3. **Does the budget reflect the stated government policy?** The extent to which government policies are reflected in the budget will depend on the participation of the various MDAs. In addition, policy-based budgeting is best achieved when political heads set the aggregate allocations/limits in the early stages of budget preparation. Critically, fiscal planning and expenditure-budgeting should take a multi-year perspective, as policies implemented in one year generally have implications for subsequent years.

4. **Is the budget implemented in a predictive manner? Are effective systems in place to ensure control of the use of public funds, including procurements?** The extent to which tax administration systems facilitate taxpayer compliance, through effective and transparent assessments of tax liability, as well as efficient methods of tax collection are important consideration for a sound PFM system. Additionally, the
government’s ability to properly record and manage its debt and guarantees will allow for accurate debt service budgeting and timely payments. Adequate cash management systems reduce borrowing and interest costs, as available balances can be easily identified. The effectiveness of internal controls (including on procurement), internal audit, and payroll controls are also important indicators.

5. **Are records and information on government operations sufficiently maintained to aid in decision-making and allow for proper reporting?** This requires analysis of the timeliness, accuracy, and adequacy of information on fiscal projections and outturns, as well as the availability of procurement information and audit reports.

6. **Does the fiscal control mechanism allow for transparency in and proper scrutiny of government operations?** This involves an assessment of the scope and nature of external audit, the follow-up action taken by the executive based on audit outcomes, and the involvement of the legislative branch in scrutinizing audit reports. Another important indicator of sound PFM systems is the rigorousness of the legislature’s debate and scrutiny of the annual budget law.

**Public Financial Management: Case Study of Jamaica**
We illustrate the use of PFM in a case study of Jamaica over the last twenty two years. The paper covers the period 1989 to 2011, spanning the 18 year rule (1989 to 2007) of the People’s National Party (PNP), and the subsequent 4 years of the Jamaica Labour Party (JLP) administration (2007 to 2011).

**Stylized Facts**
In the early 1980’s, the Government undertook a program aimed at revitalizing the Jamaican economy, following a period of heavy Government intervention in the 1970’s. Growth however, remained poor in the early 1980s, and while there was a marked improvement in the fiscal account (the deficit declined from 17 percent in FY1980/81 to 10 percent by 1983/84\(^2\)), real GDP per capita declined by 7.5 percent between 1981 and 1985 (see World Bank, 2011). It was generally recognized that institutions were weak, and various structural

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\(^2\) Jamaica Staff Report for the 1985 Article IV Consultation and Request for Standby Arrangement.
impediments were limiting growth and competitiveness, and that the erosion of social capital needed to be reversed.

In the mid-1980’s the country began a program of structural reforms which would see the removal of price controls; tax policy and tax administration reform; and a reduction in the size of the public sector. In an effort to promote economic efficiency, the Government undertook a divestment program, privatizing completely or selling controlling interest in a number of entities, although still retaining strong involvement in many sectors.

Jamaica’s macro-economic performance in the late 1980’s to early 1990’s was mixed. Growth, though positive, declined from an average of over 4.5 percent for the period FY1988/89\(^3\) to FY1990/91 to an average of less than 1 percent between FY1991/92 and FY1995/96. The Net International Reserves position, which was negative in FY1989/90, improved steadily, but remained negative up until FY1993/94. The central government position moved from deficits in the late 1980’s to surpluses in the early to mid 1990’s. Accordingly, debt which was as high as 193.5 percent of GDP at end FY1991/92, declined to a little over 72 percent of GDP at end FY1997/98.\(^4\) Inflation, which was generally above 20 percent, rose to over 100 percent in FY 1991/02, following the liberalization of the foreign exchange market in 1990 and the capital account in 1991. Interest rates were relatively high, averaging in excess of 30 percent for the 5-years period, FY1989/90 to FY1993/04.

In the second half of the 1990’s, the government performance deteriorated. The performance reflected the impact of the financial crisis and the consequent increase in public sector liabilities. The liberalization of the financial sector, which began in 1986, resulted in a rapid expansion in the number of institutions, and exposed significant problems within the banking and insurance sector (see Kirkpatrick and Tennant, 2002). The crisis began with illiquidity problems in the life insurance sector, owing to a mismatch in assets and liabilities. These

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\(^3\) Jamaica’s fiscal year begins in April.

\(^4\) Source: Ministry of Finance, Debt Management Unit.
institutions were, at the time, using short-term savings to fund their long term investments in assets such as real estate. The affiliation between troubled insurance companies and commercial banks resulted in a flight to foreign-owned commercial banks, prompting government intervention. The crisis is estimated to have cost the Government in excess of J$100 billion (about 40 percent of GDP). The increase in the debt burden in the 1990’s resulted in a significant increase in interest cost, from approximately one third of total expenditure to in excess of 40 percent of expenditures (see IDB, 2003). It became apparent that a drastic increase in the primary balance would be required to reduce debt-to-GDP ratio, which had increased from just over 80 percent (see IDB, 2003) at the end of FY1997/98 to 123.6 percent by FY2003/04. The decline in economic activity over the period increased unemployment and the rising cost to service the debt reduced the fiscal space to address physical and social infrastructure and provide adequate social safety nets for the vulnerable.

In the early to mid 2000’s Jamaica went through a period of economic recovery, following four years of negative growth (1996/97 to 1999/00). This was accompanied, however, by relatively high external current account deficits (compared to the 1990’s) and continued government deficits. Despite climbing debt, Jamaica’s debt-to-GDP ratio declined, due to faster growth in nominal GDP, resulting in a steady improvement in Jamaica’s debt dynamics up until the advent of the global financial crisis in 2008.

Table 1. Fiscal Performance Indicators

<table>
<thead>
<tr>
<th>% of GDP</th>
<th>Total Public Sector Debt</th>
<th>Fiscal Balance</th>
<th>Primary Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>1999/00</td>
<td>83.7</td>
<td>-3.5</td>
<td>8.2</td>
</tr>
<tr>
<td>2000/01</td>
<td>92.4</td>
<td>-0.8</td>
<td>10.1</td>
</tr>
<tr>
<td>2001/02</td>
<td>108.9</td>
<td>-4.9</td>
<td>6.9</td>
</tr>
<tr>
<td>2002/03</td>
<td>118.9</td>
<td>-6.8</td>
<td>6.1</td>
</tr>
<tr>
<td>2003/04</td>
<td>123.6</td>
<td>-5.6</td>
<td>10.5</td>
</tr>
<tr>
<td>2004/05</td>
<td>120.6</td>
<td>-4.7</td>
<td>10.3</td>
</tr>
<tr>
<td>2005/06</td>
<td>120.0</td>
<td>-3.3</td>
<td>9.9</td>
</tr>
<tr>
<td>2006/07</td>
<td>117.1</td>
<td>-4.9</td>
<td>7.1</td>
</tr>
<tr>
<td>2007/08</td>
<td>114.2</td>
<td>-3.8</td>
<td>7.9</td>
</tr>
<tr>
<td>2008/09</td>
<td>126.1</td>
<td>-7.4</td>
<td>4.9</td>
</tr>
<tr>
<td>2009/10</td>
<td>141.4</td>
<td>-10.9</td>
<td>6.1</td>
</tr>
<tr>
<td>2010/11</td>
<td>143.4</td>
<td>-6.2</td>
<td>4.5</td>
</tr>
</tbody>
</table>

Source: International Monetary Fund and the Ministry of Finance
Prior to the global crisis, Jamaica was faced with a persistent savings gap (financed by borrowing), low growth, and high debt. The global economic slowdown resulted in significant worsening in the current account deficit, which increased from approximately 10 percent of GDP in FY2006/07 to a little over 20 percent of GDP at end FY2007/08. In FY2008/09, exports declined by close to 20 percent, while remittances fell by approximately 33 percent. Foreign direct investment also declined, even after abstracting for extraordinary flows in FY2007/08 related to the sale of a local rum manufacturing firm to an external entity (see Bank of Jamaica Balance of Payments of Jamaica Report, 2008). The widening current account deficit put significant strain on reserves and the exchange rate and the economy contracted by more than 2 percent in FY2009/10, with a significant hit to major sectors. Government revenues declined, mirroring the slowdown in economic activity, while the increase in interest rates spurred interest cost on debt\(^5\). Borrowing increased to cover the expanding deficit, reversing the four consecutive years of improvement in the debt-to-GDP ratio. Jamaica’s economic and social condition had become unsustainable, as evidenced by high debt, low growth, high unemployment, high crime levels, and increasing poverty.

Jamaica’s performance, as reflected in the Human Development Index\(^6\) (HDI) for the period 1990-2011, indicates that although Jamaica scored above the World and Latin America and the Caribbean (LAC) averages up until 2009, Jamaica has fallen behind the LAC region in recent years. Further, although Jamaica remained above the World average between 2009 and 2011, there has been little improvement in Jamaica’s performance over the period, implying slippage relative to other nations.

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\(^5\) In order to stabilize the domestic currency, the central bank tightened its monetary policy stance sharply, increasing it policy rate by 680 basis point to 21.5\% on December 1, 2008.

\(^6\) The Human Development Index is a comparative measure of life expectancy, literacy, education, and standard of living for countries worldwide. The index awards a maximum of 1, with 0 being the lowest score possible.
Table 2. Human Development Indicators for 2011

<table>
<thead>
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</thead>
<tbody>
<tr>
<td>Arab States</td>
<td>0.516</td>
<td>0.578</td>
<td>0.609</td>
<td>0.634</td>
<td>0.639</td>
<td>0.641</td>
</tr>
<tr>
<td>East Asia and the Pacific</td>
<td>0.498</td>
<td>0.581</td>
<td>0.622</td>
<td>0.658</td>
<td>0.666</td>
<td>0.671</td>
</tr>
<tr>
<td>Europe and Central Asia</td>
<td>0.680</td>
<td>0.695</td>
<td>0.728</td>
<td>0.744</td>
<td>0.748</td>
<td>0.751</td>
</tr>
<tr>
<td>Latin America and the Caribbean</td>
<td>0.624</td>
<td>0.680</td>
<td>0.703</td>
<td>0.722</td>
<td>0.728</td>
<td>0.731</td>
</tr>
<tr>
<td>Jamaica</td>
<td>0.637</td>
<td>0.680</td>
<td>0.702</td>
<td>0.724</td>
<td>0.726</td>
<td>0.727</td>
</tr>
<tr>
<td>South Asia</td>
<td>0.418</td>
<td>0.468</td>
<td>0.510</td>
<td>0.538</td>
<td>0.545</td>
<td>0.548</td>
</tr>
<tr>
<td>Sub-Saharan Africa</td>
<td>0.383</td>
<td>0.401</td>
<td>0.431</td>
<td>0.456</td>
<td>0.460</td>
<td>0.463</td>
</tr>
<tr>
<td>World</td>
<td>0.594</td>
<td>0.634</td>
<td>0.660</td>
<td>0.676</td>
<td>0.679</td>
<td>0.682</td>
</tr>
</tbody>
</table>

Source: UNDP International Human Development Indicators

The Global Competitiveness Report (GCR) for 2008/09 to 2011/12 shows Jamaica’s relatively poor performance, generally ranking in the bottom half of the sample in key areas of Institutions, Infrastructure, Macroeconomic Stability, and Health and Primary Education (Figure 1, Panel 1). Additionally, in all but the Institution pillar, Jamaica’s ranking declined steadily over the four year period. Jamaica’s macroeconomic condition has been covered at length so we focus will focus on the other three pillars.

The Institutions pillar goes beyond the evaluation of legal frameworks, and seeks to measure the government’s ability to manage public finances. Some key indicators of the soundness of Institutions are presented in Figure 1, Panel 2. While Jamaica has shown great improvement in the area of public diversion of funds, there has been significant decline in areas such as the business cost of crime, transparency of government policy, and favoritism in government decision making. Critically, Jamaica ranked in the bottom five in the business cost of crime in all years.

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7 The GCR breaks down the basic requirements for competitiveness into four pillars: Institutions, Infrastructure, Macroeconomic Stability, and Health and Primary Education.
“Extensive and efficient infrastructure is critical for ensuring the effective functioning of the economy, as it is an important factor determining the location of economic activity and the kinds of activities or sectors that can develop in a particular instance.”

Jamaica fell 15 places in the area of quality of roads, over the four year period. Other areas remained relatively unchanged, with Jamaica ranking poorly on quality of electricity supply and fixed telephone lines. Jamaica has general performed poorly in the Health and Primary Education pillar, with significant deterioration in infant mortality, life expectancy, and primary school enrollment rankings.

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8 GCR 2011-2012
Evaluation of Jamaica’s PFM systems prior to the Global Financial Crisis

Legislative Framework

Jamaica’s Public Financial Management is governed by three key pieces of legislations; the Constitution of the Jamaica, the Financial Administration and Audit (FAA) Act, and the Public Bodies Management and Accountability Act (PBMA). These legislations were however, weak in encouraging good principles of Public Financial Management, including budget credibility, transparency, control in budget execution, and proper accounting and reporting.

The Constitution of Jamaica

The constitution stipulates that all revenues, except where the law provides otherwise, should be deposited to a “Consolidated Fund” and only be paid out with written authorization, by way of a warrant, from the Minister of Finance. It further specifies that the Minister of Finance should prepare and present to Parliament, an Appropriations Bill setting out the proposed expenditure, on a yearly basis. Once approved, the Bill becomes an Act, which sets the boundaries on expenditure for the relevant financial year. Statutory expenditure, which mainly comprises debt service costs, is the first call on revenues, and does not need to be voted on or approved by parliament. Additionally, the Minister may authorize the payment of unexpected expenditure through a contingency fund.

The Financial Administration and Audit (FAA) Act

The FAA Act reinforces stipulations in the Constitution regarding the depositing and withdrawal of funds from the Consolidated Fund, and sets out the duties of the AG as:
1. Assessing the accuracy of the accounts.
2. Ensuring that procedures applied are sufficient to allow for proper assessment, collection, and allocation of revenues.
3. Ensuring that money is spent efficiently, and for the purpose approved by parliament.
4. Assessing whether procedures are sufficient to allow for proper assessment of programs and services.

Public Bodies Management and Accountability Act (PBMA)
Public bodies are governed by the Public Bodies Management and Accountability Act (PBMA). The Act sets out the guidelines for conduct of public bodies in areas of governance and accountability and the duty of care to be provided by directors and officers. The Act stipulates that Board of Directors for all bodies should take the necessary steps to ensure efficient management; put in place sufficient controls and reporting systems; develop performance targets; and advise the responsible Minister on general management policy matters. Each entity is required to submit a draft corporate plan yearly for approval by the Minister. The corporate plan should include general information about the entity, an operating and capital budget, with justification, as well as performance targets. The PBMA act empowers the responsible Minister, to appoint external auditors to examine the procedures of the public body, to assess whether resources are being used efficiently and effectively.

PFM Performance Measurement
We assess Jamaica’s PFM systems prior to the global financial crisis, noting that the importance of sound PFM systems increases greatly in difficult circumstances, such as those brought on by the crisis in late 2008.
Table 3. Fiscal Deviations from Original Budget

<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td><strong>Revenue &amp; Grants</strong></td>
<td>3438.7</td>
<td>-2427.8</td>
<td>-17795.6</td>
<td>-7923.6</td>
<td>8944.1</td>
<td>-29847.0</td>
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<tr>
<td>Tax Revenue</td>
<td>-2623.3</td>
<td>-5153.1</td>
<td>-16940.3</td>
<td>-6734.2</td>
<td>1887.3</td>
<td>-18855.0</td>
</tr>
<tr>
<td>Non-Tax Revenue</td>
<td>1240.1</td>
<td>35.9</td>
<td>1871.7</td>
<td>1238.9</td>
<td>3894.4</td>
<td>-2148.0</td>
</tr>
<tr>
<td>Bauxite Levy</td>
<td>370.4</td>
<td>124.4</td>
<td>128.0</td>
<td>267.9</td>
<td>730.1</td>
<td>-4198.5</td>
</tr>
<tr>
<td>Capital Revenue</td>
<td>4786.9</td>
<td>2671.1</td>
<td>637.5</td>
<td>-502.4</td>
<td>1183.1</td>
<td>-6690.6</td>
</tr>
<tr>
<td>Grants</td>
<td>-335.3</td>
<td>-106.1</td>
<td>-3492.4</td>
<td>-2193.6</td>
<td>1249.2</td>
<td>2045.1</td>
</tr>
<tr>
<td><strong>Expenditure</strong></td>
<td>7336.2</td>
<td>3475.3</td>
<td>3244.3</td>
<td>7399.5</td>
<td>16098.6</td>
<td>2279.0</td>
</tr>
<tr>
<td>Recurrent Expenditure</td>
<td>10897.9</td>
<td>830.7</td>
<td>5046.1</td>
<td>12778.2</td>
<td>13577.9</td>
<td>5555.4</td>
</tr>
<tr>
<td>Programmes</td>
<td>-4360.2</td>
<td>3851.3</td>
<td>2608.3</td>
<td>1431.2</td>
<td>15598.6</td>
<td>-620.0</td>
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<tr>
<td>Wages &amp; Salaries</td>
<td>6300.1</td>
<td>496.1</td>
<td>1721.3</td>
<td>5949.3</td>
<td>-2274.4</td>
<td>4513.8</td>
</tr>
<tr>
<td>Interest</td>
<td>8958.0</td>
<td>-3516.7</td>
<td>716.6</td>
<td>5397.7</td>
<td>253.6</td>
<td>1661.7</td>
</tr>
<tr>
<td>Domestic</td>
<td>11000.1</td>
<td>-1048.8</td>
<td>996.2</td>
<td>4958.6</td>
<td>-464.7</td>
<td>2471.5</td>
</tr>
<tr>
<td>External</td>
<td>-2042.2</td>
<td>-2467.9</td>
<td>-279.6</td>
<td>439.0</td>
<td>718.4</td>
<td>-809.8</td>
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<tr>
<td>Capital Expenditure</td>
<td>-3561.7</td>
<td>2644.6</td>
<td>-1801.9</td>
<td>-5378.7</td>
<td>2520.7</td>
<td>-3276.5</td>
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<tr>
<td><strong>Fiscal Balance</strong></td>
<td>-3897.5</td>
<td>-5903.1</td>
<td>-21039.9</td>
<td>-7154.5</td>
<td>-32125.9</td>
<td></td>
</tr>
</tbody>
</table>

Source: Ministry of Finance

Budget Credibility

During FY2003/04 to FY2008/09, Jamaica recorded higher than budgeted fiscal deficits in every year. The deviations have reflected higher than expected expenditure, as well as overly optimistic revenue projections, including grants. On the revenue side, shortfalls significantly reflected deviations in tax revenue, which were below budget in all years, with the exception of FY2007/08. The shortfall in tax revenue also reflected lower than anticipated growth. Expenditure was for the most part higher than budgeted, owing to higher recurrent expenditure. With the exception of FY2003/04, expenditures did not respond effectively to counter revenue shortfalls, exacerbating the problem. Importantly, the data shows that there was shifting across expenditure categories. Wages and Salaries were above

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9 Budget here refers to the original budget passed by parliament at the start of the fiscal year.

10 Here we abstract for the deviation in debt service costs, which are beyond the government control. Non-interest expenditure was approximately $1.6 billion below target.
budget for much of the period. Deviations in this category have historically reflected higher than anticipated wage settlements. Capital expenditure, generally thought to be more highly correlated to growth, was, for the most part, lower than expected over the period, partly offsetting higher recurrent expenditure, a significant shift from policy announced in the budget.

Comprehensiveness and transparency
The budget documents submitted annual allow for analysis of expenditure by Ministry and by economic classification. The information is generally comprehensive, and includes macroeconomic assumptions; the previous year’s budget outturn and explanation for deviations from budget, the expected fiscal outturn for the upcoming year, and its composition; the composition of deficit financing; details on debt at the start of the fiscal year, and the expected stock at the end of the fiscal year; and the expected impact of policy changes (for example, tax measures) in the upcoming year. However, in general, the future implications of expenditure decisions are not elaborated on in the budget documents.

Financial oversight is challenging, particularly because of the large number of public bodies (over 200). A clear picture of risks is not always available. Entities that are not covered under the central government’s budget generally report to the Ministry of Finance on a quarterly basis, but this information is not published. Consequently, their activities are not scrutinized as well as the activities of the central government.

Policy-based budgeting
The Government of Jamaica’s budget memoranda suggests that consideration is not always given for the medium/long-term implications of decisions made in the short-term. Budgets were presented for the fiscal year in question with only sparse reference to subsequent fiscal years, and with limited detail on major items. The Debt Management Strategies, prepared by the Ministry of Finance, spoke broadly to risks, but presented no Debt Sustainability Analysis.
Predictability and control in budget execution

Jamaica’s budget presentation begins with a presentation by the Minister of Finance, within the first two weeks of April, and concludes two weeks later when the Minister makes his closing presentation. This time table has generally been adhered to; however, this process does not meet sound PFM recommendations that the budget be approved before the start of the fiscal year.

The Government of Jamaica actively monitors and updates cash flow forecasts on a monthly basis for the central government, and is thus able to assess performance in-year. However, this is not done for the public bodies.

Accounting Recording and Reporting

The lower level of oversight of public bodies means that the Ministry of Finance has only a partial picture of their activities during the year. This has led to over spending and the building of arrears over the years. Additionally, the decentralized approach to cash management means that the Ministry is unable to monitor which entities have excess balances in-year.

Effective external scrutiny and audit

The role of the Auditor General’s Department (AUD) is to promote transparency, and accountability in Government operations. The AUD is responsible for conducting independent audits on the executive agencies and public bodies, and reporting on the findings. The aim is to improve the use of public resources. The AUD, however, has not had sufficient resources to conduct financial and performance audits yearly on all entities, and has been forced to prioritize its audits. When an audit is completed and signed off by AUD, a submission of the findings is immediately made to parliament. After receiving the audit report, the legislature reviews the report, based on its schedule. The assessment is passed to the Public Accounts Committee (PAC) for follow-up.\(^\text{11}\) The PAC, although responsible for

\(^{11}\) Parliamentary oversight is carried out mainly through Public Accounts Committee and the Public Administration and Appropriations Committee. The Public Accounts Committee is responsible for examining reports made by the Auditor General.
acting on the reports, is not bound by law to act within any specific time period. However, the PAC generally addresses significant control issues, based on materiality, efficiently.

The AUD annual report, containing results of the compliance audits, must be completed within nine months after the close of the fiscal year. The annual report is available for public scrutiny on the AUD website.

**Jamaica’s Reform Agenda – Post Global Financial Crisis**

In light of Jamaica’s economic and social challenges, recent administrations have embraced PFM as a tool for engineering structural change in the economy. In the last few years Jamaica has embarked on a program of reforms, supported by the IMF and other multilateral agencies, aimed at addressing structural issues that hinder fiscal consolidation. The Government’s reform agenda focused on improving tax compliance, and expenditure management; reducing deficits among public entities; and improving the efficiency of the public sector. Jamaica began a 27-month Standby Arrangement with the IMF in February 2010, aimed at reducing debt from 140 percent to 115 percent of GDP by 2014. The arrangement included quantitative targets (primary balance, debt accumulation, and the public bodies’ outturn), as well as the structural reforms related to fiscal consolidation (Tax Reform, Public Sector Reform, and Public Expenditure Management).

**Public Expenditure Management**

Public Expenditure Management reform is aimed at addressing issues such as the narrow coverage of the budget, and poor oversight of autonomous public bodies, which have contributed to budget overruns over the years. The government undertook a legislative reform agenda, which included revisions to the FAA Act and PBMA Acts, aimed at strengthening fiscal management and enhancing accountability. The amendments to the FAA

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12 Performance and Information Technology audits are not included in the annual report. They are tabled separately, immediately after completion of the audit.

13 Autonomous public bodies are self financing and are therefore not included under the central government budget.
Act in 2010 sought to strengthen the powers of the Minister of Finance, the Financial Secretary, and the Auditor General. Importantly, the amendments introduced a new section into the FAA Act, the Fiscal Responsibility Framework (FRF).

Financial Administration and Audit (FAA) Regulations 2011
The amendments to the FAA Act require the Minister of Finance to implement policies congruent with the long-term strategic objectives of the government. It obligates the Minister to submit to the Houses of Parliament a Fiscal Policy Paper (FPP) with:

- **A Fiscal Responsibility Statement** including the measures to be taken to facilitate a reduction in the debt-to-GDP ratio; promote stable and predictable taxation, minimize incentives and exemptions, and promote growth and reduce poverty through appropriate expenditure policy; and achieve the desired fiscal outcomes. The statement should provide details on the long-term fiscal objectives of the government, new fiscal measures, and provide a broad assessment of risks to the program.

- **A Macroeconomic Framework** outlining the key assumptions informing the revenue and expenditure estimates for the next three financial years. It should include an assessment of the possible impact of changes in policy on key variables such as growth and inflation.

- **Fiscal Management Strategy** providing an assessment of the projected finances of the government, for a period of no less than three years. It must provide a comparison of the fiscal outcomes relative to target for the previous financial year and the implications for current and future fiscal performance. It further requires the Minister to provide a report on policy changes since the presentation of the previous Fiscal Policy Paper (FPP).

Information in the report should included revenues broken out by major source; expenditure by economic classification and by sector ministry; a detailed explanation of the consistence of the wage bill relative to target; details on current debt, anticipated new borrowing and the expected trajectory of debt, consistent with medium-term objectives.

The Auditor General is now required to examine the FPP and submit an assessment to the Houses of Parliament within six weeks of the Minister’s submission. Critically, the legislation does not eliminate the use of a supplementary expenditure, but indicates that a report must be provided on the rational for the excess, and its expected impact on subsequent fiscal years,
and any corrective action to be taken that will minimize the deviation. The excess spending must then be approved by the Public Administration and Appropriation Committee. Although the legislation indicates that the spending must be of an “urgent nature,” it provides no guidelines on the matter.

*Public Bodies Management and Accountability Regulations 2011*

The legislation governing Jamaica’s Public Financial Management was arguably not as effective as it could be, in ensuring proper management of public funds, and long-run fiscal and debt sustainability. The reforms to the Act require Public Bodies to prepare and submit information for the Fiscal Responsibility Paper, covering performance for the current and previous financial years, any changes in policy direction within the last 12 months, and their estimated impact, and explanations for substantial deviations for budget.

*Public Debt Management Act 2011*

The Act (not yet passed)\(^{14}\) obligates the Minister of Finance to efficiently manage debt to ensure that the financing needs of the government are met at the lowest possible cost over the medium term, compatible with the macroeconomic objectives of the government. It therefore requires the Minister to prepare and present, for the approval of Cabinet, a Medium-Term Public Debt Management Strategy informed by the macroeconomic environment, market conditions, and the future borrowing requirements of the government. The act vests the authority to raise loans solely in the Minister and places limits on the amount of borrowing that can be done within any fiscal year, as well as the amount of guarantees Cabinet can approve so as to achieve a reduction in the government guaranteed debt-to-GDP ratio over the long term.

*The Central Treasury Management System*

In addition to the legislative reforms, the government embarked on a program to implement a

\(^{14}\) When the Houses of Parliament are dissolved (as occurred for the December 29, 2011 general elections), any bills before the Parliament have to be re-tabled after the new Parliament reconvenes.
Central Treasury Management System (CTMS), “geared towards improving the Central Government’s financial management and budget processes by creating greater efficiencies” (Government of Jamaica, Fiscal Policy Paper FY2011/12). The Government recognized that the current system was inefficient, contributing to higher than necessary financing costs.

Under the CTMS, a Treasury Single Account (TSA) would be established to facilitate the transactions of the central government and public bodies, improving the Government’s oversight and ability to manage cash. The project is well on the way, but has been delayed, mainly due to limited resources, in particular staffing. So far, wages and salaries, utilities, and debt of the central government are processed under the updated procedures, and the majority of the multitude of accounts (some dormant) have been closed, resulting in improved efficiency in payments and cash management.

Tax Reform

In 2008, an IMF Technical Assistance mission recommended that the Government, reform the tax system, look at unifying domestic tax administration, increase the powers of the Director General of Tax Administration, expand the large taxpayers’ office, and streamline processes to increase compliance.

Tax reform has been approached from both a policy perspective and an administration perspective. Tax administration, which was previously conducted through the Taxpayer Audit and Assessment Department (approving waivers and hearing appeals), and Inland Revenue Department (collections), was combined under the Tax Administration Jamaica. A Large Taxpayer Office was also constituted, from teams across the island that dealt with audits of large taxpayers.

On the policy side, the Minister of Finance has presented to parliament a Green Paper on Tax reform, developed with the assistance of the Inter-American Development Bank.

The Green Paper lays out the objectives of the tax reform as:

1. Achieving simplicity and equity in the tax system;
2. Improving compliance;
3. Encouraging growth and competitiveness by engendering policy certainty; and
4. Meeting demands of revenue, while maintaining macroeconomic and social stability.

The tax reform, which has been delayed, is expected to be finalized in FY2012/13, following an extensive period of consultation with various private sector organizations and civil society groups.

Public Sector Reform
Public Sector reform agenda is aimed at, among other thing, reducing wage-to-GDP ratio, eliminating overlapping functions, and upgrading Information, Communication, and Technology (ICT). The Public Sector Transformation Unit (PSTU) was established in November 2009, with the mandate of facilitating the transformation for efficient, effective, and economical government. The PSTU has developed a Public Sector Rationalization plan, which has been approved by cabinet, and is now a White Paper.

A critical goal of public sector reform is to move the public bodies to a balanced budget. In this regard, Jamaican began the process of reducing the public sector, through mergers and divestments. The government has successfully privatized Air Jamaica and Sugar Company of Jamaica, two of the three main loss-making entities targeted for divestment in the IMF-SBA. Clarendon Alumina Production Ltd is in the process of being divested.

Public Sector Pensions Reform
In addition to the reforms above, the government is exploring implementing a contributory pension scheme, owing to the rising costs associated with financing retirement benefits. The Ministry of Finance’s Green Paper on Pension Reform explores several reform alternatives, and recommends a mandatory contribution rate of 5 percent for all public sector workers. The Green Paper further recommends the establishment of a computerized database, to facilitate electronic processing, and allow more accurate estimates of pension expenditure.

15 Currently, nurses and teachers make no contribution, while police contribute 1.6 percent of salary.
Strengthening of the Auditor General’s Department (AUD)
Following the widening of its mandate to include the review of the FPP, an Economic Assessment Unit was established within the AUD, to help meet its statutory review function. In addition to the structural changes at the AUD, operational changes were implemented to affect the way audits are conducted. The AUD has adopted a risk-based approach to auditing, shifting focus from transaction and compliance to greater focus on reviewing business activities. This allows for a more efficient allocation of resources towards high-risk areas. In addition, the AUD has moved from a dedicated staffing approach, to a pooling method in assigning staff to audits. Staff is assigned from the pool, based on the competence and experience required to conduct the audit. Notwithstanding, the AUD can be strengthened further, including through the provision of resources to hire appropriate personnel and making the AUD financially autonomous.

Conclusion
It is clear that sound Public Financial Management systems play a critical role in attaining fiscal and debt sustainability. PFM is also broad enough in impact to play a critical role in helping to promote sustainable development.

Jamaica’s cycle of low growth and high debt has significantly constrained the Government’s ability to provide vital services, with serious social implications. The tax system has not provided adequate resources to meet critical development needs, and the effective use of resources collected by the Government has been impacted by less than optimal cash and expenditure management over the years. High debt and vulnerability to outside shocks, including hurricanes, and the absence of appropriate buffers have limited the government’s room to maneuver.

The Government has realized that the countries precarious position needs to be addressed in a holistic way, by implementing strong macroeconomic policies, improving institutions, and promoting social cohesion. In particular, systems need to be put in place to improve not only resource collection, but also the effective management of those resources.
The reforms program begun in recent years can play a significant role in addressing Jamaica’s main PFM challenges. However, there are additional areas that must be addressed. The strengthening of the AUD is crucial, owing to its role as watchdog over government operations. Legislation can also be improved, providing greater definition for example of what is considered urgent enough to warrant excess spending. The Government must also consider specifically defining the repercussions of unapproved spending.

Sound PFM systems alone cannot bring sustainable development, but sustainable development requires sound PFM. Jamaica, like other countries, must continue to work on improving the collection and use of limited resources to ensure its future growth and development.
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