PARLIAMENTARY BUDGET OFFICE
TECHNICAL RESEARCH SUPPORT UNIT
FINANCIAL CYCLE GAP ANALYSIS

"Conduct a financial cycle gap analysis on Jamaica's budgetary practices by comparing Jamaica's budgetary practices to internationally recognised best practice models."

GAP ANALYSIS:

Executive Summary

The gap analysis represents a description, comparison and assessment of Jamaica's Parliamentary budget practices. The ten principles of good budgetary governance outlined in the 'OECD Recommendation of the Council on Budgetary Governance' (2015) are the framework of analysis.

This gap analysis reports on Jamaica's position with respect to Principle 1 of the Organisation for Economic Co-operation and Development (OECD) recommendations: '***Manage budgets within clear, credible and predictable limits for fiscal policy***' (OECD 2015). This principle incorporates the following best practices:

- Clear and verifiable fiscal rules
- Avoids the build-up of large, unsustainable debts
- Provision of an independent perspective on government's implementation of fiscal policy throughout the financial year.
- All elements of revenue, expenditure and broader economic policy are consistent and managed in line with available resources

Overall, Jamaica's legislation (such as the Public Debt Management Act, Financial Administration and Audit Act and Public Bodies Management Act) adequately addresses these issues, and facilitates the establishment of Committees and the preparation of documents that are relevant and necessary for the implementation of these best practices. For instance, legislation outlines fiscal rules (such as debt and fiscal balance targets) and mandates the provision of an independent perspective on government's implementation of fiscal policy (in the person of the Auditor General). Furthermore, the Minister of Finance is, by law, obligated to present strategies to avoid large, unsustainable debts and to manage revenue and expenditure in line with available resources prior to the start of each financial year.

Nevertheless, the execution of legislation is lacking in terms of timing and practicality. Some of the practices currently undertaken by the Government serve to assuage the damage caused by previous mismanagement e.g. reducing already large, unsustainable debts instead of preventing them from escalating to that level in the future. At times, current practice may even palliate shortcomings of budget governance without tackling the root issues (e.g. revision of fiscal targets without a thorough change in budgetary structure to support efforts to meet newly set targets). Moreover, independent monitoring extends to fiscal policy (which is a positive contribution made by the Auditor General) but is limited in relation to public debt management. Finally, the limited adherence to legislation mandating the submission of appropriation accounts at the end of the financial year undermines the capacity to manage expenditure and revenue in line with available resources due to the lack of information on revenues and expenditure and, subsequently, available resources.

The research draws attention to the fact that the existence of the budget balance rule and debt rule increases accountability and reflects the government's commitment to adhering to fiscally prudent and conservative measures. However, the lack of any legislative limitations on the number and extent of amendments in fiscal rules may undermine the original purpose of these rules.

Given the government’s commitment to lower its debt to GDP ratio, bodies such as the Public Debt Management Committee are necessary in that their duty should be to ensure that Government’s financing measures are executed at the lowest possible cost, over the medium to long term. The Economic Programme Oversight Committee (EPOC) provides debt management oversight to the extent that lowering or adjusting the country’s ‘wage bill’ is consistent with prudent fiscal measures.

With respect to the independent analysis of government's implementation of fiscal policy throughout the financial year, the Auditor General’s mandate provides for reports on the economic outturns, performance and macroeconomic projections for the succeeding year and the medium-term. The Economic Programme Oversight Committee (EPOC) monitors Jamaica’s economic growth strategy and macro-economic framework in keeping with Jamaica’s targets under the IMF Agreement.

We also found that legislations surrounding the submission of appropriation accounts (namely, the Financial Administration and Audit Act) only provide guidance on what should be done, and not how negligence can be dissuaded or mitigated. Greater focus should be placed on strategies to ensure that appropriation accounts are submitted to determine the exact level of resources available during each financial year.

Who are we?

This gap analysis is being conducted by researchers in the Parliamentary Budget Office & Technical Research Support Unit, Jamaica. The researchers are responsible for providing technical research and analytical services to support and strengthen the institutional capacity of the Office of the Clerk to the Houses of Parliament. The researchers operate within the terms of reference of a two-year pilot project which has been established to assist in strengthening Parliament’s capacity to oversee and scrutinise the management of public finances.

Why are we doing this?

This gap analysis is the first in a ten part series that will provide a description and assessment of Jamaica's current budgetary practices, as well as compare current practice to that of internationally recognised best practice models.

Transparent and effective public expenditure mechanisms are integral to the overall good governance of public finances. It is intended that the data provided will be the basis for further dialogue, assessment and critique of Jamaica's budgetary practices.

Additionally, it is expected that with independent assessment of current budgetary practices in Jamaica, there will be greater improvement in public financial accountability and effectiveness.

It is also intended that that the gap analysis will assist Jamaican Parliamentarians to be better able to oversee decisions pertaining to the formulation, implementation/execution and revision of the Budget.

What is to come?

Part II in the series on Jamaica's budgetary practices will continue with the description, assessment and comparison of Jamaica's budgetary practices, in relation to Principle 2 of the OECD Recommendation on good budgetary practices (2015): 'Closely align budgets with the medium-term strategic priorities of government.'

The second gap analysis will entail a comprehensive overview of key indicators relating to Jamaica's medium-term expenditure framework and the medium-term public debt management framework, the relationship between various government institutions that play a role in the budget process, and the frequency of processes for reviewing existing expenditure policies, including tax expenditures in a manner that helps budgetary expectations to be set in line with government-wide developments.

Peer Review

In the spirit of transparency, openness and inclusion, the Parliamentary Budget Office & Technical Research Support Unit, Jamaica, has requested expert review and critique of the draft publication and intends to do so for all of its research papers and publications.

GAP ANALYSIS

PRINCIPLE/ BEST PRACTICE	CURRENT PRACTICE IN JAMAICA	ASSESSMENT & COMPARISON OF CURRENT PRACTICE
	Principle 1: Manage budgets within clear, credible and predictable limits for fiscal policy[1]	
1.1 Clear and verifiable fiscal rules	There are specific, numerical targets and accompanying deadlines in relation to the following areas of Fiscal Policy Management[2]: ▪ ***Annual Fiscal Budget Balance*** – make government revenue be equal to government spending by 31 March 2019 ▪ ***Debt-to-GDP*** - reduce the public debt-to-GDP ratio to 60% or less by 31 March 2026 ▪ ***Wage-to-GDP*** – reduce public sector wages to 9% of GDP by 31 March 2019 These targets are further contextualized with an ***Escape Clause*** that outlines the circumstances under which these targets (and the measures taken to meet these targets) can be temporarily changed (e.g. national security, national emergency or any other occurrence that is severe in its impact on the economy).	The existence of the budget balance rule and debt rule increases accountability and reflects the government's commitment to using fiscal measures that lean towards lower expenditures and greater revenue. The Financial Administration and Audit (FAA) Act originally stated that the public debt-to-GDP would be reduced to 100% or less of GDP by 31 March 2016. However, new debt-to-GDP targets were introduced under the IMF Extended Fund Facility (EFF) signed on to by Jamaica on 1 May 2013[3], namely 100% or less by March 2020 and 60% or less by March 2026. These targets were written into Jamaican law through an amendment of the FAA Act in March 2014. These show how much influence international financial institutions have on Jamaica's local budgetary governance. The fiscal rules outlining the original targets outlined in the FAA Act were clear and verifiable, but may not have been realistic or possible because economic growth was so much weaker than expected, and has negatively affected efforts to reduce the debt-to-GDP ratio. Even though debt exchanges and the fiscal adjustment accomplished what they were supposed to, assumptions about growth still had to be lowered several times under the EFF.[4] There is no law that sets a limit on the number of times and/or the number of ways in which these rules can be changed. This makes it difficult for the government to be held accountable because of how often and how easily these rules and targets can be changed.

[1] OECD. Public Governance and Territorial Development Directorate. Recommendation of the Council on Budgetary Governance. February 18, 2015. Retrieved from http://www.oecd.org/gov/budgeting/Recommendation-of-the-Council-on-Budgetary-Governance.pdf

[2] Financial Administration and Audit Act Section 48C (1) (a) - (c) and (2)

[3] Jamaica: First Review under the Extended Arrangement under the Extended Fund Facility and request for Modification of Performance Criteria. IMF Country Report No. 13/304. October 2013. Retrieved from http://www.boj.org.jm/uploads/news/cr1595_1st_review_under_eff.pdf

[4] Debt, Fiscal Adjustment and Economic Growth in Jamaica. Juan Pedro Schmid Xavier A. Malcolm. IDB Policy Brief No. IDB-PB-249. January 2016. Retrieved from https://publications.iadb.org/bitstream/handle/11319/7438/IDB-PB-249_Debt_Fiscal%20Adjustment_and%20Economic%20growth_final.pdf?sequence=1

1.2 Avoids the build-up of large, unsustainable debts	The coverage of the debt rule extends as well to central government, public bodies and the general government. The Public Debt Management Committee (PDMC) was established to monitor the implementation of the Public Debt Management Act (PDMA) and the Medium Term Public Debt Management Strategy.[5] The Strategy, which is tabled in the House of Representatives (Lower House of Parliament) guides the management of the public debt over the stated period. The Strategy also builds on previous debt management strategies, with the aim of meeting the Government's borrowing needs at the lowest cost, minimizing risks in the portfolio, and promoting the development of the domestic debt market. The PDMC assesses the policies, strategies and operations of debt management and the management of contingent liabilities with a view to ensuring consistency with PDMA and the macroeconomic, monetary and fiscal policies of the Government.[6] The Public Debt Financing Committee (PDFC) is constituted to make recommendations to the Financial Secretary in respect of debt instruments; review other debt management related transactions; review the evaluations of	According to the World Bank the 1996 financial crisis is the genesis of the country's current fiscal problems.[8] Conversely, King and Richards (2008) accredit the nation's unsustainable debt and fiscal problems to erroneous policy decisions and external shocks that uncovered the country's structural vulnerability. The external shocks were exacerbated by the exchange controls which were implemented; these weakened the incentive to export and fostered hoarding of foreign exchange. Notably, the country's fiscal sustainability was compromised by excessive distributive policies as it pertains to the expenditure side, given that the country's revenue base was shrinking as a result of the adverse impact of exchange controls and importation restrictions. Between 1973 and 1980 Jamaica's GDP was reduced by 26% as the fiscal deficit increases from J$95 million in 1973/74 to J$515 million in 1978/79. Additionally, it was noted that the most severe impact to the country's fiscal stability came from the oil crises of 1976 and 1979.[9] Given the government's commitment to lower its debt to GDP ratio, bodies such as the PDMC should strive to ensure that financing measures and payment structures are done at the lowest possible cost over the medium to long term. The PDMC and the PDFC function as control mechanisms, which assess and recommend that decisions made by the government are in keeping with the PDMA, and specifically in accordance to attaining a sustainable debt and fiscal policy. Additionally, the PDMA gives credence to a Debt Management Branch that comprises of a Debt Strategy and Analysis Office. The annual budget balance rule and the debt-to-GDP rules allow for gaps to be highlighted more easily and advises on ways to bridge these gaps. Instead of operating and reporting on a year-to-year basis, the government conducts assessments at the onset of each financial year to identify progress made in attaining long-term debt targets at interims. <u>Fiscal Sustainability Analysis</u> Fiscal sustainability means that government debt does not grow continuously as a share of the economy. The goal is to identify if policy changes are required to avoid unsustainable public debt accumulation in light of the economic and fiscal impacts of social dynamics (e.g. population ageing)[10].

[5] Public Debt Management Act Section 7 (2) (a).
[6] Public Debt Management Act Section 7 (2) (b).

	funding requests by specified public bodies; review and monitor issues relating to the cost or pricing of contingent liabilities etc.[7]	A fiscal sustainability report is imperative given that medium term report gives a short analysis of the nation's fiscal outlook. While the fiscal sustainability provides a long-term projection of the country's fiscal outlook and the possible implication measures such as newly implemented tax has on the country's ability to reduce debt or keep debt at a sustainable level. Fiscal sustainability reports are produced by countries such as Canada and the United Kingdom, which cover a 50-year period to assess the government's spending, revenues and other activities to highlight whether these actions underscore a sustainable path for the country (as in the case of the UK). Currently, a fiscal sustainability analysis is not included in public dialogue in Jamaica. It is therefore recommended that the Minister of Finance and/or the Parliamentary Budget Office prepare an annual sustainability report.
	In Jamaica, accounting officers in government ministries, the Financial Secretary and the Accountant-General must be authorized and approved by the Minister of Finance to enter credit agreements (where goods and services given are to be paid for later, and hereby create public debt).	In Canada, the Minister of Finance is authorized to borrow money within borrowing limits that are approved by the Governor in Council (who is appointed by Cabinet). This provides a more consistent and in depth scrutiny of debt management. (EPOC, 2017).

[8] Reid, T. (2013). EVALUATING THE SUSTAINABILITY OF JAMAICA'S FISCAL DEBT POLICIES.
[9] King, D., & Richards, L. (2008). Jamaica's Debt: Exploring Causes and Strategies. *Caribbean Policy Research Institute*.
[10] Office of Budget Responsibility. Retrieved from http://budgetresponsibility.org.uk/
[7] Public Debt Management Act Section 8.

1.3 Provision of an independent perspective on government's implementation of fiscal policy throughout the financial year.	In keeping with Section 122 of the Jamaican Constitution and Sections 29 (1), 48B (6) & 48E of the FAA Act (& Regulations), the Auditor General carries out independent, ex-post, yearly monitoring and audit of the accounts of all offices and departments of Government, as well as provide a pre-budget review and a mid-year evaluation of fiscal policy.	With respect to government's implementation of fiscal policy throughout the financial year, the Auditor General examines and reports on the economic outturns, performance and macroeconomic projections for the succeeding year and the medium-term (FAA Act Section 48E). In some Jurisdictions like Canada, a 'Fiscal Monitor' is used by the Department of Finance to release monthly updates on the government's fiscal performance to that point in the fiscal year, including an estimate of revenues, expenses and the budgetary balance[11]. This allows for key stakeholders to have continuous access to information on the Government's fiscal policy throughout the financial year, as opposed to months after the year has ended.
	The Executive prepares a Medium-Term Public Debt Management Strategy, on the recommendation of the Public Debt Management Committee, and is responsible for managing the debt in a sustainable manner[12]. The Public Debt Management Committee monitors public debt management throughout the financial year in general, and the implementation of the Medium Term Public Debt Management Strategy in particular[13].	There is limited independent oversight and monitoring of Jamaica's public debt. Since 2013, an Economic Programme Oversight Committee[14] has provided independent monitoring and assessment of Jamaica's fiscal performance over the life of Jamaica's Agreements with the International Monetary Fund[15]. EPOC's mandate includes monitoring Jamaica's economic growth strategy and macro-economic framework in keeping with Jamaica's targets under the new IMF Agreement (EPOC, 2017). A technical subcommittee meets monthly to conduct ongoing analysis of the Precautionary Stand By Agreement with the IMF (EPOC, 2017)[16]. The Committee provides debt management oversight to the extent that lowering or adjusting the country's 'wage bill' is consistent with prudent fiscal measures.
1.4 All elements of revenue, expenditure	Further to the FAA Act Section 48B (4), the Minister of Finance tables the Fiscal Responsibility Statement before the start of the financial year. The Statement specifies what is considered a prudent level of fiscal balance and	The Statement explains the broader economic strategies and rules which will guide how the government spends and earns/collects money throughout the upcoming financial year. The review of these standards by the Auditor General allows for greater scrutiny and therefore more comprehensive standards used to define the parameters of "prudent fiscal management" as

[11] Department of Finance Canada. Fiscal Monitor. Retrieved from https://www.fin.gc.ca/pub/fm-rf-index-eng.asp
[12] Public Debt Management Act Sections 4, 5 & 6.
[13] Second Schedule Parts 1 & 2 of the Public Debt Management Act.
[14] Jamaica Information Service. February 10, 2017. "Jamaica on Track to Meet IMF Targets." Retrieved from http://jis.gov.jm/jamaica-track-meet-imf-targets/
[15] International Monetary Fund. November 11, 2016. "IMF Executive Board Approves US$1.64 billion Stand By Arrangement for Jamaica." Retrieved from https://www.imf.org/en/News/Articles/2016/11/11/pr16503-IMF-Executive-Board-Approves-US164-billion-Stand-By-Arrangement-for-Jamaica
[16] Economic Programme Oversight Committee. "Monitoring Jamaica's Plan". Retrieved from http://epocjamaica.com/about/

and broader economic policy are consistent and managed in line with available resources	total debt, the fiscal policy measures that will be used to achieve these levels, and a declaration in which the Minister of Finance promises to obey principles of prudent fiscal management in his efforts to achieve policy goals. The FAA Act requires that Accounting Officers in each public body submit quarterly reports to the Minister of Finance throughout the financial year.	set by the Minister of Finance. The United Kingdom provides a useful best practice model to follow. Two fiscal rules have been defined and actively used by the government since 1997. Parliament has never adopted a statute to endorse the two rules, which are contained in the government's 1998 Economic and Fiscal Strategy Report. The first rule is a "golden rule": it requires over the cycle that the government will borrow only to invest and not to fund current spending. Second, public sector net debt as a proportion of GDP must be held at a stable and prudent level, which is currently defined by Her Majesty's Treasury as below 40% of GDP over the economic cycle[17].
	The 2014/2015 Estimates of Revenue outweighed actual revenue by JMD $107,630,516,564 according to receipts from the Consolidated Fund for that period.	The significant difference between the estimates of revenue tabled and the revenue received by the Consolidated Fund show that the resources that are actually available may be less than what is estimated.
	The Auditor General conducts performance and compliance audits throughout the fiscal year to determine how funds are spent.[18]	The performance and compliance audits conducted by the Auditor General reveal very useful information about overpayments made and funds that needed to be recovered by select public bodies. However, these audits are only done on a sample of programmes and projects, and therefore do not cover all financial transactions and activities conducted by public bodies.
	All public bodies should submit financial statements (appropriation accounts) to the Auditor General within four (4) months of the end of the financial year[19]. However, the Auditor General's Reports in 2013 and 2016 noted that various public bodies had not submitted reports for several years. In 2015, the Accountant General reported that some bodies had not submitted appropriation accounts since 2006[20].	The Auditor General's Reports in December 2013 and December 2016 noted that several government ministries, agencies and other public bodies had not submitted Appropriation Accounts for several years. Without the appropriation accounts, it is difficult to determine the exact amount of funds spent by public bodies within a financial year, and subsequently how much money is left over and can still be attributed as available resources. The law only states how and when appropriation accounts should be submitted; however, it does not speak to what should be done when appropriation accounts are not submitted, far less how to discourage non-submission. Greater focus should be placed on strategies to ensure that appropriation accounts are submitted to determine the exact level of resources available during each financial year.

[17] "The Legal Framework for Budget Systems: An International Comparison". OECD Journal on Budgeting. Volume 4, No. 3. 2004. p. 89

[18] Financial Administration and Audit Act Section 30 (1)

[19] Public Bodies Management Act Section 2B (3) (2), Section 22 and Second Schedule Part I

[20] "Auditor General's Department Says It's Not To Be Blamed For Audit Backlog". *The Gleaner*. 17th August 2015. Retrieved from http://jamaica-gleaner.com/article/lead-stories/20150817/auditor-generals-department-says-its-not-be-blamed-audit-backlog

	The Jamaican Government assumed loans totaling US$1.3 billion (J$143.3 billion) or 9.7 per cent of gross domestic product (GDP) on behalf of state entities for the period January 2010 to March 2014, according to the medium-term debt-management strategy tabled in Parliament in 2014[21]. Considering those developments and in keeping with the wide range of fiscal and other reforms being undertaken by the Government, explicit contingent liabilities were then limited to no more than 8% of GDP by the end of March 2017 and 3% by March 2027[22]. The Public Debt Financing Committee, which is established in the Public Debt Management Act, is mandated to, among other things, review and monitor issues relating to the cost or pricing of contingent liabilities and determine the monthly financing programme to deal with these liabilities.[23]	Contingent liabilities are obligations that are explicit, if the Government contractually acknowledges its responsibility to cover the beneficiary under specific circumstances, or implicit when the government is expected to assume them out of a “moral” obligation to act, usually related to a high opportunity cost of not intervening[24]. Contingent liabilities pose significant risks to the budget, as well as to the stock of public debt if they are not properly monitored and provisions are not made in the budget to accommodate them.[25] Unfortunately, this has been the case in Jamaica, and has resulted in significant costs to the Jamaican public in the form of higher taxes, and to the Government in terms of increased expenditures and debt[26]. The establishment of the Public Debt Financing Committee in 2012 is a welcomed initiative that mandates the government to execute greater scrutiny in the issuance of funds to public bodies and the monitoring of debt generated by these bodies. The introduction of this Committee is a form of mitigation of the negative effects of ballooned contingent liabilities; however, a best practice would involve mechanisms to prevent this escalation in the first place. During his address at the 2017 Budget Debate, Prime Minister Andrew Holness cited the Government’s absorption of debt generated by public bodies as a significant source of contingent liability, which “introduces rigidities and does not allow the Government of the day to properly respond to the urgent problems of the day.” The Prime Minister also noted that Jamaica has over 200 public bodies, in comparison to other small economies, such as Singapore, which has only 50.[27] A strategy to reduce the number of public bodies could be explored as a possible best practice.

[21] “Gov't Assumes $143b Public Bodies Debt”. The Gleaner. 21st May 2014. Retrieved from http://jamaica-gleaner.com/gleaner/20140521/business/business5.html
[22] Public Debt Management Act Section 18 (a) and (c).
[23] Public Debt Management Act Section 8 (a) – (g).
[24] Medium Term Debt Management Strategy 2016-2019 p 37.
[25] “Gov't Assumes $143b Public Bodies Debt”. The Gleaner. 21st May 2014. Retrieved from http://jamaica-gleaner.com/gleaner/20140521/business/business5.html
[26] Ibid.
[27] Statement by the Most Honourable Prime Minister Andrew Holness for the National Budget Debate 2017.