Importance of the Fiscal Targets

The Government is now striving to meet its fiscal targets in the face of a number of challenges facing the Administration and the country at this time. The passage of Hurricane Ivan placed additional strain on the already limited fiscal resources, due to recovery activities which pushed the Government's programmes budget $3.4 billion above projections for the April-to-January period. Reduced economic activity in the weeks immediately following Ivan also led to a falloff in tax revenues which were nearly $7 billion less than planned for the same period. These twin effects of lower revenues and higher programme spending have contributed to a $4.8-billion worsening of the fiscal deficit relative to what was projected for the period.

The Government had initially set a deficit target of 3% to 4% of GDP for the 2004/05 fiscal year. However, given the impact of Hurricane Ivan on the economy, this target was revised in November to 4.4% of GDP. The targeted debt-to-GDP ratio was also revised upwards from 135% to 138% given the expected slowdown in full-year economic growth.

It is imperative that the Government adhere to its revised targets for 2004/05 if it is to contain its borrowing costs going into the new fiscal year. This cost containment will be a crucial component of the fiscal agenda which is intended to achieve a balanced budget by March 2006, thus paving the way for Jamaica to begin reducing its national debt in the medium term. Any significant deviation from this year's targets will almost certainly result in an increase in the country's borrowing costs next year, thus making it more difficult to achieve the balanced-budget goal. The higher interest costs would also threaten to erase the fiscal improvements which were set in motion last January with the historic MoU wage agreement between the Government and trade unions.

There has been some concern that the recurrent budget tends to prioritize debt servicing at the expense of critical social areas such as education, health and national security. The view has also been expressed that the present borrowing programme only serves to exacerbate the problem by adding to the country's debt stock, thus increasing interest payments during the year. However, the reality is that the GOJ's present revenue stream cannot adequately finance the operational needs of the public sector, and the already dire state of a number of our social services would not allow for the level of cost cutting that would bring about a balanced budget without further impairing the country's social infrastructure. Consequently, the shortfall between public revenues and expenses necessitates the use of debt financing at this time, and a strict adherence to interest repayment is integral for maintaining open lines of credit until the state's operations can be fully self-financed.

The drive to reduce interest rates and preserve Jamaica's credit rating is part of the effort to secure the sustainability of the fiscal operations, thus ensuring that the core social programmes can be provided on an ongoing basis. In addition, by eliminating the fiscal deficit and ultimately reducing the debt burden, a greater proportion of the country's resources could be allocated towards key priority areas such as education reform and crime control.

With these issues in mind, we now examine recent trends in the fiscal accounts with a view to assessing the feasibility of the targets that have been set. We have broken down the accounts on a monthly basis to examine the key drivers which have influenced the deficit so far and the implications for the accounts through March. As mentioned above, Hurricane Ivan was definitely the major factor impacting the fiscal year-to-date performance, contributing to a significant slippage in the deficit relative to projections. Figure 1 illustrates the path of the fiscal balance on a monthly basis vis-à-vis what was planned for the year. As the chart shows, the hurricane reduced the fiscal surplus in September to $0.15 billion, down from the projected level of $0.96 billion for that month. The fiscal balance also fell some $3 billion short of projections in January from a planned surplus of $1.22 billion to a deficit of -$1.8 billion. However, the chart also reveals that even before Ivan, the fiscal balance was not consistent in meeting its monthly targets. Although the Government outperformed its deficit targets for the months of May and June, the other pre-Ivan months showed slippages from the budgeted levels. Only one monthly target has been met since the hurricane. This was in November when the deficit amounted to -$1.72 billion, some $1.1 billion better than the expected amount of -$2.85 billion.

The underperformance of revenues for the April-to-January period was largely influenced by a falloff in Tax revenues, a decline which began in August and was exacerbated by the storm in September (see Figure 2). Since then, Tax revenues have continued to underperform on a monthly basis, falling some $2.4 billion below budget for the month of January. The Government's two biggest tax earners, PAYE and GCT were both negatively impacted by September's events, but PAYE made a strong rebound in October to better its budget by over $1 billion for that month (see Figure 3). GCT did not recover as strongly as discretionary consumer spending was dampened in the wake of the storm. Some other tax items remain a concern such as Company taxes and the Special Consumption Tax (SCT), both of which have consistently slipped below budget since the start of the fiscal year. Company taxes and SCT have underperformed by $2.77 billion and $2.65 billion, respectively for the April-to-January period.

On the expenditure side, the overrun in the Programmes budget since Ivan has been partially offset by savings in the area of Interest payments, particularly in October and November (see Figure 4). In October, for instance, Interest charges were a whopping $1.3 billion lower than planned, and this helped to compensate for a $1.36 billion hike in Programme spending relative to projections.

Outlook for the Full-Year Target

The Government has now tabled its second Supplementary budget, which projects a total expenditure of $200.8 billion for the year, excluding debt repayment or amortization (see Table 1). This figure comprises recurrent expenditures of $189.78 billion and Capital spending of $11.03 billion and represents an increase of some $4.8 billion over the original budget tabled at the start of the fiscal year. The revision largely reflects a projected $4.38 billion overrun in Programmes relative to initial expectations. Although the Government expects to save some $2.7 billion in Interest payments, this will be counterbalanced by an estimated $2.6 billion hike in Capital expenditures relative to what was projected a year ago. Wages & Salaries, however, should fall roughly in line with initial estimates.

On the revenue side, the outturn is not expected to deviate significantly from previous projections. Strong year-to-date gains made in areas such as PAYE, Grant funding and the local Stamp Duty should help to cushion the full-year performance.

In terms of debt repayment, the Government will amortize roughly $4.5 billion less than planned as it has rolled over a sizeable amount of debt related to the operations of Air Jamaica.

The latest fiscal estimates anticipate a deficit of roughly $24.9 billion, some $4.6 billion worse than the $20.3 billion projected last April. In order to meet the new target, the Government will strive to rein in its expenditures to a maximum of $34.6 billion for the February-March period, including Programme spending of no more than $5 billion. The Administration will target a Wage bill of $11 billion for the two-month period, while Interest payments should be kept within the range of $14.3 billion.

If the new projections are on point, the deficit will be in the region of 4.5% of GDP for this fiscal year. Of course, this assumes a reasonably accurate estimate of GDP growth for the year. Growth in the last quarter was lower than anticipated. However, based on the current indicators which point to increased activity in sectors such as construction and alumina, we can surmise that GDP growth for the March quarter will be supportive of the fiscal targets.

Table 1: GOJ Budget, Fiscal Year 2004-05

	Original Budget	Revised Supplementary	Variance		Actual Outturn, Apr-Jan	Implied Target, Feb-Mar
Expenditures	**196,012.6**	**200,818.2**	**4,805.6**		**166,217.1**	**34,601.1**
Recurrent	187,551.3	189,784.7	2,233.4		159,402.3	30,382.4
Programmes	28,229.7	32,606.7	4,377.0		27,531.9	5,074.8
Wages & Salaries	63,020.7	63,541.7	521.0		52,504.6	11,037.1
Interest	96,300.9	93,636.3	(2,664.6)		79,365.8	14,270.5
Capital Expenditures	8,461.3	11,033.5	2,572.2		6,814.8	4,218.7
Amortization	**132,100.0**	**127,210.3**	**(4,889.7)**		**115,497.7**	**11,712.6**
Total Expenditures (Incl. Amortization)	**328,112.6**	**328,028.5**	**(84.1)**		**281,714.8**	**46,313.7**

Figure 1: Fiscal Balance, 2004/05

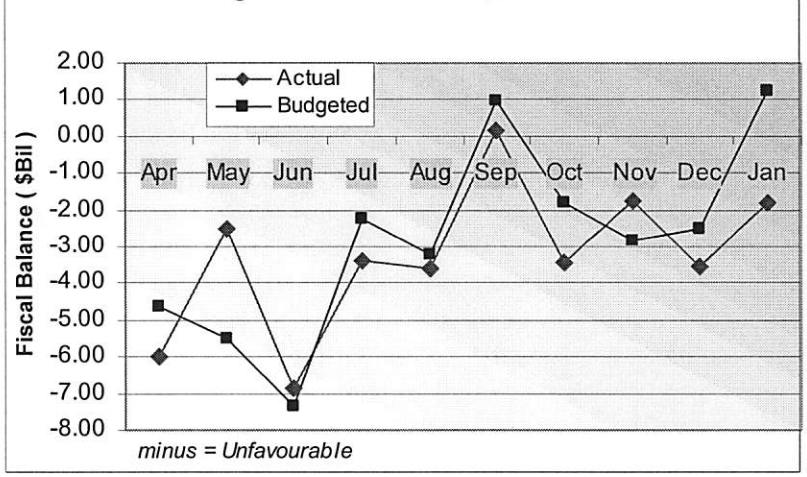


Figure 2: Variance from Budget - Revenues

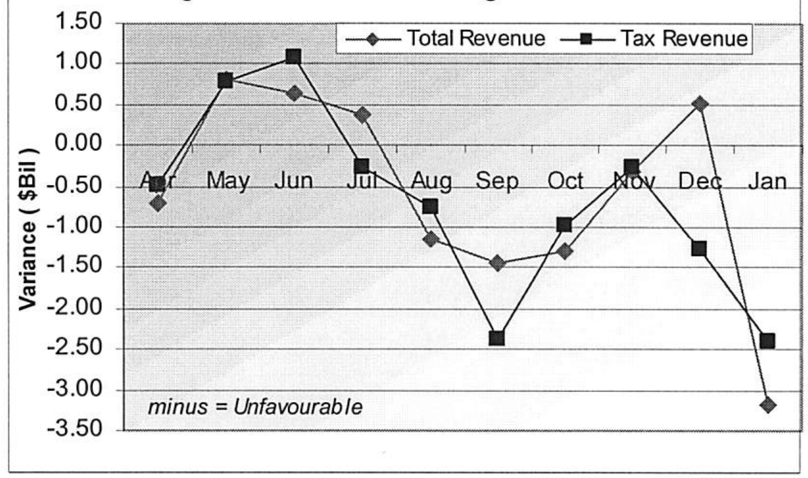


Figure 3: Variance from Budget - PAYE & GCT

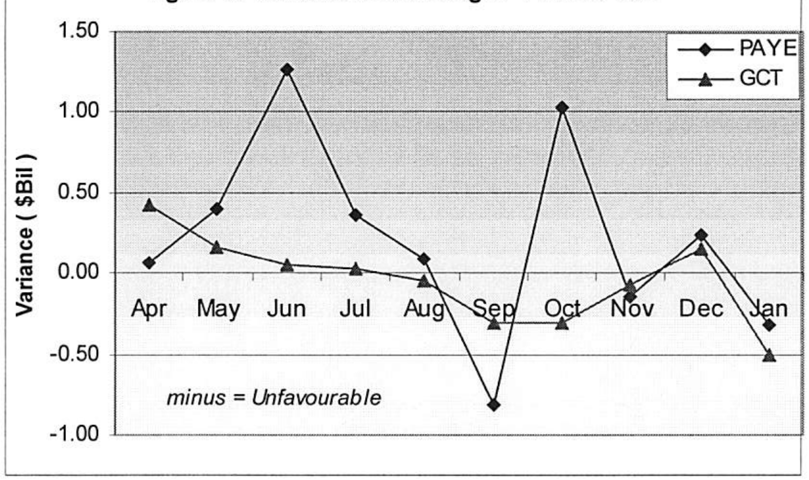
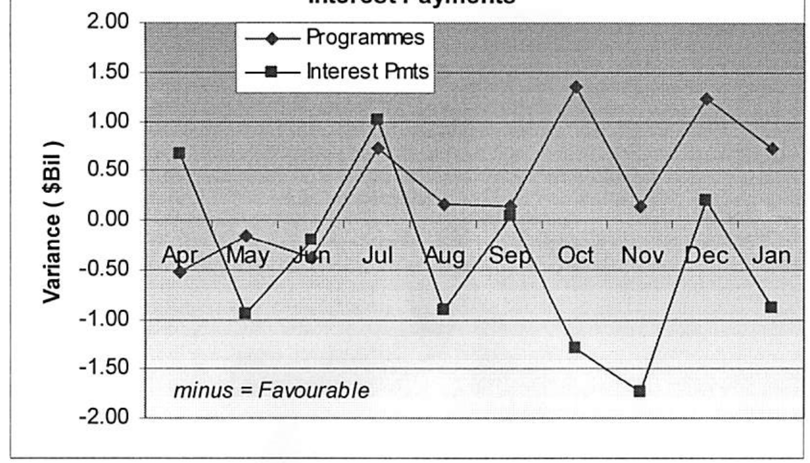


Figure 4: Variance from Budget - Programmes & Interest Payments



Source: Ministry of Finance & Planning

Prepared by the PSOJ Research & Financial Services Unit

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