**Fiscal Policy Rules and Implementation in Jamaica: The PSOJ's Reaction**

**Definition and Scope of Fiscal Rule**

The critical Fiscal Rule (FR) legislation is to be implemented under the Economic Reform Programme agreed with the IMF. Here, the Private Sector Organization of Jamaica will explain the nature of FRs and the likely implications for the Jamaica economy. The FR can be defined as "A rule that imposes a long-lasting constraint on how a government can spend or collect revenue by setting numerical limits on budgetary aggregates".

These rules provide a credible frame work in which the government crafts fiscal policy that is in line with established parameters. By virtue of the limits, these rules are aimed at correcting distorted incentives and containing the overspending action of the government, which has been a significant contributor to our high debt to GDP ratio, and the economic restrictions we find ourselves in. This will ensure that governments practice fiscal responsibility and the country's debt to GDP ratio which currently stand at over 130 percent is sustainable. The sustainable target of 60 percent is expected to be achieved in 2026, under the current IMF programme.

For the most part, these rules are intended to promote budgetary discipline. They seek to confer credibility on the conduct of macroeconomic policy by acting as a visible constraint on potentially damaging short-term spending, with no long-term benefit, as well as an effective commitment device to fiscal discipline. FRs is thus a part of the solution to the problem where governments commit to a prudent fiscal policy but deviate from it without giving sufficient thought to the long-term impact on the economy. These rules are meant to be rigid and hence flexibility is created by developing flexibility clauses that allow the policy maker to deviate under predetermined economic and other conditions.

**Developing an Effective Fiscal Rule**

The IMF has developed a framework that establishes the components of an effective FR, which include a clear link between the numerical target of public debt sustainability, and the ultimate objective of economic and social development. In addition, the rule must have sufficient flexibility to respond to shocks so that the rule should not make the economy worse. In the same vein, there must be a clear institutional framework that enables the government to observe the factors contributing to the movement away from the numerical targets and therefore find solutions to the problems. Additionally, FRs should be simple and transparent so that players in the financial sector can understand them and monitor government's actions.

## Types of Fiscal Rules

There are four types of FRs outlined by the International Monetary Fund. The Budget Balanced Rules (BBR), these are the most widely adopted rules, the Expenditure Rules (ER) , Debt Rules (DR), and Revenue Rules(RR), which is the less applied set of rules. In practice the rules are often combined and applied simultaneously, for example Australia simply utilizes the Expenditure Rule; France utilizes both the Expenditure and the Revenue Rules, while the United Kingdom utilizes both the Balance Budget and the Debt Rules.

## Jamaica's Fiscal Rules

There are five key elements of the FRs that has been developed and implemented in Jamaica. These include, a limit on the annual budget, the application of an automatic correction mechanism, the use of an escape clause when required, fiscal coverage and enforcement and compliance. The newly developed FRs also addresses the reform of the tax system which is said to be a critical component of Jamaica's economic reform programme.

The limit that is to be placed on the annual budget is to achieve a reduction in public debt to no more than 60 percent of the country's Gross Domestic Product by the end of the 2025/26 fiscal year. The rules come equipped with an automatic correction mechanism which is expected to be triggered by a substantial deviation from the annual overall balance target. The rule will however exempt some specified social spending from potential adjustment.

In addition, the FRs includes an escape clause; however the use of this clause is limited to major adverse shocks and can only be triggered by the approval of the Jamaican parliament. The nature and degree of the shock will have to be validated by an independent party before the escape clause can be initiated by the Ministry of Finance and Planning. The Rules that are being implemented in Jamaica also contains a section that outlines the fiscal activities that are carried out by the public sector as well as the associated fiscal operational risks.

A critical component of the rule based frame work is that it utilizes parliamentary hearings and public statements by officials as a mechanism to promote transparency and accountability. Additionally, the new rules require the Minister to explain deviations from the fiscal path stipulated by the Rules. The Minister will also outline the measures required to correct the deviations away from the fiscal rule target, and the timeline.

## Major Issues and Challenges in Designing Fiscal Rules

A major challenge in the design of FRs is the time horizon. Backward looking rules are engineered to balance the budget over the economic cycle, while forward looking rules are designed to forecast budget positions for a number of years in the future. On the other hand, near-term rules are designed to deal with borrowing in the current year. The forward looking rule is said to be flexible and protective of the daily management of the country's finances from shock to the country's spending. Forward looking rules also prevent the government from implementing policies just for the sake of meeting targets.

There are always mitigating economic conditions or shocks that may cause a country to abandon these rules temporarily. This means that flexibility must be taken into consideration when these rules are being written; this ensures that the economy can make the necessary readjustments.

There is no doubt that having Fiscal Rules in place add to the confidence needed for creating the confidence in an economy, where the historical experience has been one of fiscal mismanagement. In addition, the massive public debt has stifled private domestic investment by causing the local cost of capital to reach record levels and have contributed to a harsh business environment in which Jamaican businesses are some of the most heavily taxed in the world.

**Conclusion**

The PSOJ is in support of this initiative which should change the way in which government has managed the fiscal accounts of Jamaica. While empirical evidence suggests that FRs have been generally a success factor for fiscal adjustment, the PSOJ by no means believe that this initiative is a panacea, and is well aware that the success of Jamaica's new FR is heavily dependent on our own institutional capacity.