Practical Ways to Build Resilience in Small States

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Is the path to economic resilience different for SIDS?

- SIDS recently gained independence between 20 to 50 years ago.
- There are distinctive environmental and security issues that confront the newly independent SIDS.
- We argue that the degree of autonomy SIDS possess to stabilise their economies, depend on the extent to which they are indebted or dependent of aid.
  - The design of stabilisation programs depend on the conditionality programs emanating from their creditors and aid donors.
- **How can SIDS minimise the use of debt in managing their economies?**

Survey on Fiscal Adjustments for SIDS

- Study benefitted from a survey on SIDS that was executed.
- Responses were received from 20% of the SIDS in the Commonwealth.
  - Responses spanned the Caribbean, Pacific and Indian Ocean.
- The full survey results would be reported with fuller responses.

Macroeconomic stabilisation in SIDS

- Macroeconomic stabilisation in small island developing states (SIDS) is
  - The smoothing of excessive fluctuations in the economy.
    - Usually to address Inflation and growth fluctuations.
    - Use of Monetary/Fiscal policy to stabilise the economy.
  - The correction of economic imbalances.
    - This involves strengthening fiscal balance, balance of payment accounts and debt.
- Macroeconomic stability in SIDS should also come to terms with environmental risks.

Monetary Policy: Market Fundamentalist Era

- The orthodoxy today is to confine Monetary policy to stabilisation of excessive fluctuation.

- The current thinking by IFIs is to urge countries to move towards market based monetary policy. This includes
  - market based exchange rates,
  - Market based policy rate.

- The drawback in implementing market based monetary policy is that it requires SIDS to develop sophisticated money and capital markets.
  - At present SIDS are a long way from having such market sophistication.

- Even then, SIDS would lack the capacity to stage independent monetary policy the more integrated their markets are with the global markets.

Fiscal policy as a stabilising device

- Degree of autonomy to embark on macroeconomic stabilisation span the continuum from
  - greater autonomy where the country is not under any conditionality programs, to
  - little autonomy where the country is under external programs emanating from donor programs.
- Where the country is not under conditionality programs, the fiscal framework is influenced by electoral cycles.
  - These countries often lack a common framework across political parties to guide the allocation of funds across sectors/programs regardless of the political party in power.
- Country is more likely to follow fiscal rules where it is under external programs and rules are prescribed by the donors or lenders.

Aggregate supply vs Demand Management

- External lenders and aid donors tend to orient their conditionality programs towards the targeting of aggregate supply in order to bring about macro economic stability.
  - Programs often entail expenditure cuts to restrict supply.
  - Conditionality programs tend to bear broad similarities between SIDS that are indebted and those that receive aid.
- Indigenous programs tend towards stimulating aggregate demand.
- However, their ability to sustain aggregate demand is subject to fiscal space.
- Where fiscal space is tight, the use of taxes is more likely to be used as a stabilising tool.

Fiscal Stabilisation Methods

- SIDS have had to undergo stabilisation measures advocated by both creditors and aid donors.
  - Typical IMF arrangements involve expenditure restraint , improved fiscal revenues and to prioritise infrastructural along with development projects.
    - roll back of the state from markets in a bid to bring fiscal expenditure closer to revenue.
    - Turner-Jones (2012) contend that fiscal consolidation can reduce pubic debt.
  - Liberalisation of markets – Market clearing or market fundamentalism.
    - FX market–Exchange Rates, monetary policy, money and capital markets.

Design of Fiscal Rules

- Fiscal discipline can be achieved through the following of fiscal rules.

❑ Development of a Cadre of Fiscal rules.

- ➢ Balance Budget Rules
- ➢ Debt Rules
  - ✓ Limits on budget deficits
  - ✓ Limits on domestic and external debt
- ➢ Golden Rule: Borrowing should only be for investment purposes.
- ➢ Limits on Subsidies (Tuvalu)
- ➢ Targets on investment targets

- Schaechter et al (2012) reported that the number of countries world wide using fiscal rules grew from 5 in 1990 to 76 by the end of March in 2012.
  - Of the countries adopting rules in 2012, 10 were SIDS.
    - Antigua and Barbuda, Jamaica, Malta, Mauritius, St. Kitts and Nevis, St. Lucia, St. Vincent and the Grenadines, Dominica, Grenada and Togo.

- We further argue that the design of fiscal rules must take the external current account balance into account.

External influences on fiscal design

- We suggest that the design of fiscal rules should take the external current account realities into account.
  - Dillon et. al. (2011) shows that for the small states in the Caribbean, causality runs from external current account to fiscal balance.
- Countries under programs have followed fiscal programs prompted by lending agencies. Some of these devices include
  - ❑ Medium term budgeting as suggested by the IMF.
  - ❑ Fiscal Transparency as suggested by the IMF.
  - ❑ Program based budgeting
  - ➢ Allowing the medium-long term to be manifested in terms of short-term measures.
  - ➢ Financing of budget to be performance based.
  - ➢ Forces government to make expenditure choices.

Capacity of SIDS to independently design and implement Fiscal rules?

- SIDS appear to lack the political will and financial capacity to independently design and implement there own rules.
  - SIDS lack the necessary institutions to monitor enforcement.
  - Rules followed are often designed by external agencies which sponsor programs.

- Highly indebted countries such as those of the Caribbean have had to rely on the IMF and world bank for loans.

- Rules in other territories have been influenced by
  - AusAID, NZAID, Asian Development Bank and World Bank, European Union, African Development Banks (ADB) and its affiliate: Development Partners International.

Is externally driven rules Desirable?

- SIDS lack the autonomy to independently execute and maintain fiscal rules.
- Advantages of the externally driven rules is that
  - Governments are obligated to follow rules regardless of election cycles given that their funding depend on it.
  - It provides a means of independent and external monitoring of rules.
- Downside risks is that countries may not develop a sense of ownership of rules.

Getting a bang out of each dollar

- Under conditionality programs, fiscal programmes are devised for a multiyear basis.
  - designed for the medium to long term.

- At the moment, SIDS may not follow medium to long term fiscal policies, where they function outside of conditionality programs.

Economic stabilisation and growth in SIDS susceptible to extreme weather events

- Natural disasters can derail stabilisation efforts of SIDS.
- Recovery efforts heavily depend on donor support.
- However, reconstruction can cause a surge in imports of reconstruction materials.
  - This can worsen the external current accounts by leading to greater imports to support reconstruction efforts.
- Balance of payment stability is therefore vulnerable to natural disasters.

Threat of ecological and environmental

- SIDS are vulnerable to climate change, sea level rise, flooding and temperature changes.
  - Often forced to divert resources from intended social investments following natural disasters.
- Growth of SIDS need to factor in ecological and environmental concerns.
  - This is necessary for sustainability in the context of non renewable resources.
    - Loss of biodiversity
    - Important for renewal of tourist activities.
  - Sustainable growth in tourist dependent SIDS is subject to renewal of tourist activities.
  - SIDS should aim for qualitative growth and development.
- Failure to develop policies for sustainable use of resources.
  - The environ should be a critical part of economic planning.

Weak focus on environment

- SIDS lack long-term stable financial resources to address a multiplicity of environmental concerns.
- Lack of integration of sector policies, inadequate institutional capacities, ill-defined priorities and unclear operational objectives.
- Scientific advice concerning ecological and environments matters is often not incorporated in planning.
- Long term monitoring is often lacking.
  - Finance to address environmental concerns are largely donor driven.

Cushioning the high cost of security and environmental matters

- SIDS should seek regional technical assistance to overcome high cost of modern security and related technologies.
- Economic policies to strengthen environmental protection and resilience should be quantified and deliberately made a part of national budgets.

Some suggestions on the environment

- Environmental matters are critical to the predictability of fiscal balance.
- SIDS need to quantify aspects of environment and ecological diversity with a view of doing market pricing of these commodities.
- New economic indicators of sustainability to signal the state of key resources.
- Governments should try to attract private sector in aspects of environmental concerns.

Concluding Remarks

- Macroeconomic stabilisation in SIDS rests on external balance and their degree of autonomy.
  - SIDS with external current account surpluses are more likely to have the fiscal space to stabilise their economies.
  - SIDS are more likely to follow fiscal rules if they are under external programs.

- For SIDS that are not under conditionality programs, fiscal balance is more likely to be shaped by electoral cycles.

Concluding Remarks

- The type of macroeconomic stabilisation policies employed by SIDS depend on their autonomy and fiscal space.
  - Where they have autonomy and fiscal space, SIDS are more likely to favour stimulus policies to stimulate demand.
  - When countries are under donor supported programs, stabilisation programs tend to restrain supply.
- SIDS may lack the will to independently design and enforce their own fiscal rules.
- Consequently, there are advantages to rules been externally designed under conditionality programs.

Concluding Remarks

- Environmental and climatic factors are relevant to the stabilisation of SIDS.
  - Extreme whether events impact on the stability of the production of goods and services.
- The environment should be taken into account to avert fiscal imbalances.
  - Environmental design should incorporate science and new economic indicators.
  - Government should try to incorporate the private sector into environmental design.

Challenges remain for SIDS

- Need to engineer the use of fiscal rules.
- To find the judicious mix between aggregate demand and supply strategies.
- SIDS should negotiate alternative measures than GDP per capita with respect to qualifying to access low cost resources from the IFIs.
- Need to quantify and budget for the cost of environmental challenges.
- SIDS should seek to collectively bargain on meeting global security matters.
  - Challenge can be ably assisted by pursuing integration strategies.