Financing Government Operations

By Laurel Theresa Bain

The Financing, which is the most important component of the fiscal account, is often omitted from the presentation of government finances. Government operations could result in an overall surplus, that is, total domestic revenue and grants or monetary gifts are more than Government total expenditure. Alternatively, Government operations could result in a deficit, that is, total expenditure is more than total domestic revenue and grants or monetary gifts.

The financing component of the fiscal account shows how the Government utilizes a surplus or how a deficit is financed. At the end of June 2022, the Government realized an overall surplus after grants of $99.3M as outlined in a previous article on 'Government Finances and the Economy'. If the financing component was included in the accounts, it would have provided information on how that surplus was utilized.

The financing component of the accounts is important in this environment where the report of the Director of Audit has not been submitted to Parliament as prescribed by the Constitution. Therefore, the financing could be used as a 'rapid test' to check the integrity of the fiscal account. In countries with limited fiscal data and where information is available on government transactions with financial institutions and creditors, the financing component is used to determine the outcome of government operations.

The construction of the financing component of the fiscal account requires the application of knowledge with accuracy and precision. This process could be compared with a medical doctor undertaking heart or brain surgery. The operation is delicate and requires accuracy and precision as an error could affect the functioning of the body. Similarly, errors in calculating the financing could affect the integrity of the fiscal accounts.

The calculated financing must be equivalent to the overall surplus or the overall deficit. In the case of the overall surplus after grants of $99.3M at the end of June 2022, the total financing should account for this surplus. The financing is determined by an aggregation of government transactions during the year, that is, loans and deposits with domestic financial institutions, external financial institutions and creditors, and any other entities with whom the Government engages in financial transactions.

Consistent with international standards, loan disbursement is not classified as receipts and principal repayment is not included in expenditure in undertaking analysis of government operations. These are classified as financing and hence the importance of including the financing component in the fiscal accounts. The financing shows the impact of government operations on the Central Government debt and by extension the stock of public sector debt.

The financing of government operations from domestic sources is generally reflected in its net transactions [borrowing and depositing] with the Eastern Caribbean Central Bank, the National Insurance Scheme, financial institutions mainly the commercial banks and credit unions, and any benefactor willing to engage in financial transactions with the government. An examination of the accounts of these financial institutions would determine whether the Government deposited funds with or borrowed from the institutions and entities. The aggregation of these financial transactions provides information on the impact of Government operations on the Central Government domestic debt. If the aggregated loaned funds from the domestic institutions exceed deposits, the Central Government domestic debt has increased. Alternatively, if deposits exceed the loaned funds, Central Government debt has declined.

Financing from external sources is related to Government transactions with external financial institutions and creditors. The external financing shows how much external loan funds were disbursed to the Government by creditors and how much was government principal debt repayment to external creditors. The net effect of disbursement and principal repayment provides information on the impact of government operations on the external debt. If disbursements exceed principal repayment, the Central Government external debt has increased. However, if principal repayment exceeds disbursement, Central Government debt has declined. The Government may hold external assets and during the fiscal year either increased or reduced its stock of external assets. This is recorded in the financing as changes in foreign assets. The transactions do not impact on the public debt.

The accumulation of arrears is a peculiar form of financing government operations. It could be described as ‘forced borrowing’ from suppliers as the government has received goods and services but no payment has been made to the suppliers. It is effectively an interest free loan to the Government from suppliers of goods and services. The Government could either accumulate arrears which is the forced borrowing, or it could reduce its arrears with its creditors.

The financing component provides important information on whether government operations resulted in an increase or decrease in the public debt. Therefore, there are checks and balances to ensure that the financing is correctly constructed. The reported financing should be consistent with the detailed information provided in Vote 22, ‘charges on account of the public debt’, in the Estimates of Revenue and Expenditure and the Annual Borrowing Plan that is included in the Medium-term Debt Strategy. The financing items must also be consistent with the other economic accounts, specifically the financial sector and the balance of payment. The Government records of its loans and deposit transactions with financial institutions should be consistent with that reported by the institutions. The official external transactions in the form of loan disbursement and principal repayment must be consistent with that reported in the balance of payment. The changes in the Government foreign assets must also be registered in the balance of payment.

Given the importance of the financing, it is desirable that the actual financing for 2021, the preliminary financing for 2022, and the planned financing for 2023 be included in the Estimates of Revenue and Expenditure for 2023. Additionally, the public accounts for 2021 could only be properly closed after the Report of the Director of Audit is presented to Parliament. This step in the budgetary process has remained outstanding over the previous years and needs to be addressed to improve fiscal transparency and accountability.

Knowledge is power and experience is the greatest teacher.

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