

Budget Alert 3.4 Managing the Economy with Fiscal Policy- Part 1

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As outlined in previous Budget Alert articles, fiscal policy is the main instrument for managing Grenada's economy, and, in general, the economies of the Eastern Caribbean Currency Union (ECCU). The constraints of applying monetary policy in the ECCU were outlined in Budget Alert 3.2: Policy Options for Managing the Economy. This series of articles focuses on the concept of fiscal policy, the expected role of fiscal policy and the impact of fiscal policy.

Fiscal policy refers to the actions of governments in raising revenue and spending to influence economic activity for improving the welfare of the population. These policies are generally presented annually in the national budget. The annual adjustments in fiscal policy are informed by the fundamental fiscal policy stance of the government, and this was vividly demonstrated in Grenada over the past three decades.

After a period of high dependence on the Government to push the growth and development of the economy, the philosophy that guided fiscal policy changed in 1986 when the Government advocated a greater role for the private sector. This informed fiscal policy as the Government attempted to minimize its involvement in the economy by reducing its revenue intake and its operational expenditure. The adverse impact of such a fiscal policy stance on the public finances resulted in a reversal of this policy in the early 1990s, with a greater reliance on revenue from taxes on income and profits to restore fiscal balance.

In 1996, there was a re-orientation of the fiscal policy stance to release funds for private sector activity by the elimination of the full fledged personal income tax and applying the tax to high income earners. The need for revenue to finance the development needs of the country would have influenced the decision to retain some elements of revenue from the taxation of personal incomes. Again, the need to generate adequate revenue to finance government expenditure was manifested in 2016 as the Government entered into the IMF supported Structural Adjustment Programme, and the tax reach was broadened.

The fundamental lesson from the swings in the fiscal policy stance is that, in small open developing economies, governments have some fundamental functions to perform, and adequate revenue must be raised in a form that is considered equitable to the population to finance its expenditure.

Utilizing domestic revenue and contracting debt as needed to finance the budget underpin the current fiscal policy. Grants, which are gifts from countries and entities, provide an easy means of financing government expenditure, but these are uncertain, inadequate, and sometimes

conditions are attached. Therefore, adequate domestic resources must be generated to finance government expenditures, and these are the tax and non-tax sources of revenue.

In Grenada, and similar to the other countries of the ECCU, taxes are the main source of domestic revenue. With the establishment of Grenada's Citizenship by Investment programme in 2013, revenue from non-tax sources has become an important component of domestic revenue. For example, in 2010, non-tax revenue was 6 percent of domestic revenue, and this proportion increased to an estimated 29.6 percent in 2023. Despite this development, taxes will continue to be the main source of domestic revenue.

It is in this context that the estimated arrears in taxes and penalties of over \$700M must be examined. The tax system is heavily dependent on taxes of imports, and except for the domestic elements of the Value Added Tax, payment of taxes should be linked to the receipt of such goods. It will therefore be enlightening to disaggregate the arrears by type of tax, the associated penalties, and the average duration of these arrears and penalties. There may be issues other than an unwillingness to pay taxes that are contributing to these arrears.

Taxes are legislated compulsory payments. The payments are not directly linked to the receipt of goods or services from the Government. The population, as a whole, benefits from the expenditure of the Government. The lack of this direct link between the payment of taxes and the receipt of goods or services has led to the concept of the 'burden' of taxation. There is no quantifiable direct cost/benefit associated with the payment of taxes, and hence, there is not an automatic trigger to pay taxes. Therefore, the tax administrative systems must facilitate the ease of paying taxes on a timely basis. Appropriate and broad-based education and customer services, and a simplified digitalization of payments could contribute to higher tax compliance.

Willingness to pay tax is also linked to the perception by the population of the efficiency of Government expenditure. If the expenditure system is viewed as inefficient, encouraging wastage and the goods and services provided by the Government are poor and inadequate, tax compliance will be weak. The tax system will be viewed as burdensome, and individuals will seek to evade and avoid paying taxes. The Government will then have to allocate additional resources for tax enforcement, resulting in an inefficient tax system.

The other source of revenue is non-tax revenue. This differs from taxes in that the payment is linked with the receipt of a direct good or service from the Government. The substantial increase in non-tax revenue over the years is mainly associated with the inflows from Citizenship by Investment. This source of revenue could be volatile and therefore it is necessary to invest these resources in projects that contribute to sustainable economic growth and development.

The other non-tax revenue is from fees and sales from Government departments; fines and forfeitures; and rents, dividends and profits. Over the years, the scope of the fees from Ministries

and Departments has broadened, particularly related to essential services such as education and health. The structure of the non-tax revenue could be burdensome to the lower income earners. It is therefore important that both tax and non-tax sources of revenue be examined in assessing fiscal policy.

Knowledge is power and experience is the greatest teacher.

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26th May, 2023

Disclaimer: This article is written in my personal capacity and not in my capacity as Chairwoman of the Fiscal Responsibility Oversight Committee.