Budget Alert 5.6: Implications of a Deficit Budget

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A surplus budget is generally anticipated. However, fiscal policy dictates that, at some times, the budgets will be in deficit over a cycle. In the 2025 national budget, presented to Parliament on 7th March 2025, an overall deficit of $337.4M is estimated for 2025. This deficit was influenced by a projected decline in revenue which was combined with higher expenditure when compared with 2024. The factors contributing to the growth in expenditure and the falloff in revenues are not the main subject of analysis in this article, Instead, the article focuses on the implications of the overall fiscal deficit. This fiscal deficit implies that the Government plans to spend more than it projects to collect in tax and non-tax revenue, and any grants that it may receive during 2025.

Budget surpluses as well as budget deficits are integral to the pursuit of fiscal policy. A main objective of fiscal policy is to achieve economic growth to generate employment, thereby improving the welfare of the population. In so doing, the aim is to maintain an acceptable steady growth rate, and at times, growth will be unusually high due to exceptional financial inflows in the economy. However, it is understandable that the economy will be negatively affected by adverse shocks requiring intervention by the Government.

The adverse economic shocks, interrupting periods of economic growth, were evident during the 2007/8 financial and economic crisis and the Covid-19 Pandemic. In these circumstances, the Government has to play an important role of stabilising the economy. In its Stabilisation role, government has to manage the economy to maintain steady growth, thereby reducing or eliminating periods of booms (periods of abnormally high growth rates) and depressions (periods of economic decline or extremely low growth rates), and the accompanying wide fluctuations in incomes. To undertake the stabilisation function, the Government must generate adequate reserves during the growth periods to facilitate higher expenditure when the economy is adversely affected by shocks.

In the absence of reserves, there are other options for financing a deficit and these include: i. Creating or printing money through borrowing from the Central Bank, which is restricted by the Eastern Caribbean Central Bank (ECCB) Agreement, and this policy has the consequence of increased imports, higher inflation and reduction in official reserves; ii. Increases in domestic revenue through higher taxes and non-tax revenue, thereby increasing the burden of government on the population and introducing uncertainty among economic agents; and iii. Borrowing, which increases the cost of government to be borne by the current and/or future generations, particularly if the resources are not channelled into productive investments.

For the 2025 national budget, there is the need to respond to the impact of the natural disasters that occurred in 2024. The allocation of financial resources in response to the climatic disasters commenced in 2024 and continued into 2025. In 2024, the high inflows from the Investment Migration Agency (IMA) and the proceeds from the Caribbean Catastrophe Risk Insurance Facility (CCRIF) supported the higher expenditure. With the projected lower revenue from the IMA and the non-existence of funds from CCRIF in the estimated receipts for 2025, and the need to respond to the economic shocks and to implement expenditure related reforms, a deficit budget is estimated for 2025.

To finance the deficit, the Government intends to borrow $100M on the Regional Government Securities Market (RGSM), and to apply $287M of its reserves or savings to the 2025 budget.

As fiscal policy is implemented over a cycle, an important factor is whether there are reserves or savings to apply to financing the 2025 national budget. A review of the fiscal performance over the past two years showed that the fiscal outturn resulted in an overall surplus of $286M in 2023 and $310.5M in 2024, accumulated overall surpluses over the past two years of $596.5M, compared with the overall deficit of 337M for 2025. There is also the Contingency Fund of $44.9M which adds to the favourable positive financial position of the Central Government. (Medium Term Economic and Fiscal Strategy Report 2025-2027, Ministry of Finance, Government of Grenada, 2025; Report on Contingency Fund, Government of Grenada, 2025).

These financial resources have resulted in significant deposits of the Government in the financial system, which are available to be used during periods of adverse economic shocks. Alternatively, the country will be continuously building up reserves and given the nature of the economy and the financial system, these reserves will be invested externally.

Notwithstanding, overall deficits should not be pursued as a constant fiscal policy. Recurring widened overall fiscal deficits, financed by reserves, in an open economy with limited administrative and technical capacity, could lead to increased imports, higher cost of inputs into production and particularly labour, and general inflation. Also, persistent fiscal deficits could introduce uncertainty among economic agents, particularly if it is perceived that this will lead to the introduction of measures to boost domestic revenue.

Based on the fiscal performance over the past two years, financial resources are available to finance the estimated deficit for 2025. The available funds are reflected in the financial position of the Government at the financial institutions. However, over the medium-term, the Government will need to balance its policy for managing its reserves with that of debt management to meet the objective of sustained economic growth and transformation of the economy.

Knowledge is power and Experience is the greatest teacher.

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

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