Public Debt, Economic Growth and Sustainability in Fiji: Status, Challenges and the Way Forward

Dr Janesh Sami (PhD, Australia)
School of Economics
The University of the South Pacific

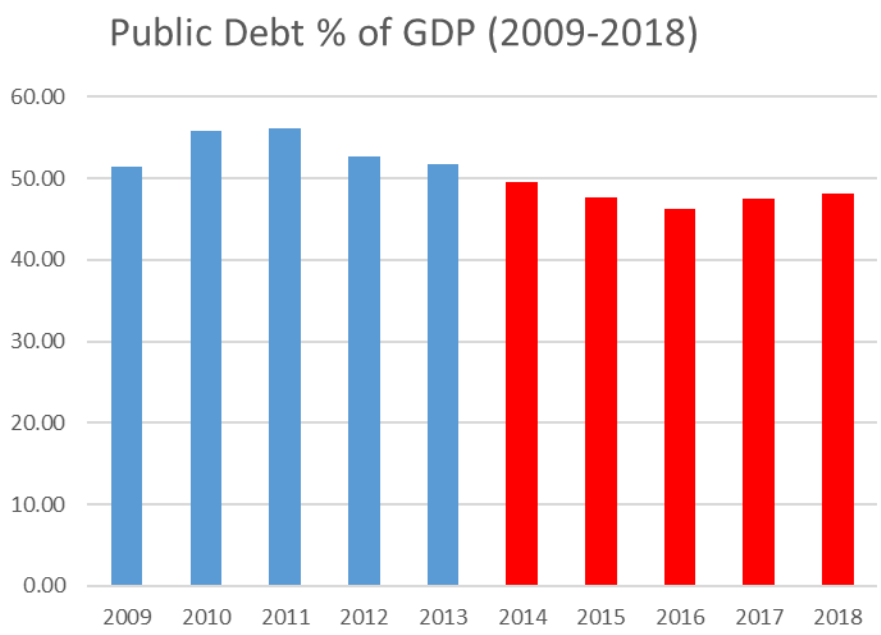
Overview

- Introduction
- Recent Trends in Public Debt
- Impact of Public Debt on Economic Growth
- Sustainability of Budget Deficit
- 2019/2020 Budget
- Key Challenges, Policy Options and The Way Forward
- Concluding Remarks

Introduction

- Following the global financial crisis, the rapid rise in public debt around the world has received significant attention.
- Unsustainable public debt has significant implications for macroeconomy, financial markets and investor confidence.
- Since 2006, the Fijian government's expansionary fiscal policy stance and debt build-up has triggered significant debate in academic and policy circles.
- The main objective of this presentation is to contribute to the debate based on empirical analysis using available macroeconomic data.

Recent Trends in Public Debt



- Rise in public debt is not recent. Actual data suggest rising trend since 2000.
- Data for post-GFC period suggest that public debt has gradually declined.
- Government has managed to keep public debt % of GDP below 50% since 2014.
- Average (2014-2018) : 47.8%
- Much of our debt is domestic ; however level of external debt has started to rise after 2013.

Impact of Public Debt on Economic Growth

- Some theoretical arguments linking public debt and growth
  - Higher public debt reduces savings and capital accumulation through higher interest rates and lowers growth (Blanchard, 1985; Diamond, 1965)
  - Higher public debt necessitates expenditure cuts or taxation that hampers growth (Teles & Mussolini, 2014)
  - Higher public debt restrict government's ability to conduct countercyclical policies and raises output volatility and lowers growth (Hausmann & Panizza, 2011)
- Empirical evidence so far remains mixed on how public debt impacts growth. Growing literature for developed economies.
- The theoretical framework and methodology is described in Gounder and Sami (2019) and available at SOE working paper page: https://www.usp.ac.fj/index.php?id=22922

Table 1: Impact on Public Debt on Economic Growth

Long-Run Model		Short-Run Model		Model Diagnostics	
Variables	Coefficient	Variables	Coefficient		
In k_t	0.135 (0.273)	*ΔIn* k_t	0.051 (0.110)		
In Debt $_t$	**-0.223**** **(0.094)**	***ΔIn Debt*** $_t$	**-0.135***** **(0.043)**	$\bar{R}^2$	0.576
In Credit $_t$	0.272** (0.106)	***ΔIn Debt*** $_{t-1}$	**-0.135***** **(0.039)**	X^2_{SC}	0.027 (0.869)
In Trade $_t$	0.897*** (0.183)	*ΔIn TRADE* $_t$	0.194*** (0.062)	X^2_{NORM}	2.490 (0.288)
		ΔIn CREDIT $_t$	0.102*** (0.033)	X^2_{HET}	0.045 (0.833)
		ECM $_{t-1}$	-0.376*** (0.096)	X^2_{FF}	2.039 (0.153)

- Results are robust to : a) alternative sample period ; b) inclusion of additional control variables (inflation and FDI); c)nonlinearity; d) controlling for political coups.

Sustainability of Budget Deficit

- Sustainability is a difficult concept to define and different methodological approaches have been used in the literature to examine sustainability of budget deficit (public debt).
- Weak and unsustainable fiscal position can have serious disruptive macroeconomic consequences.
- Sample period (1970-2018)
- Time series analysis of government expenditure and revenue based on theoretical framework of Hakkio and Rush(1991) was conducted.
- The results suggest that there is a meaningful long-run relationship between government expenditure and government expenditure.
- The estimated slope coefficient is close to 1 (suggesting strong sustainability).

Sustainability Results

Table 2: Estimates of Long-Run Elasticities

Variable	OLS	FMOLS	DOLS	CCR	ARDL
Cons	-0.068*** (-2.937)	-0.059** (-2.573)	-0.051* (-1.908)	-0.057** (-2.588)	-0.069** (-2.687)
$\boldsymbol{In\ Govt\ Exp_t}$	0.971*** (35.506)	0.976*** (40.706)	0.984*** (28.027)	0.976*** (44.222)	0.942*** (28.716)

Note: The reported values are coefficients. Figures in brackets are the test-statistics. *** indicates statistical significance at 1 percent level; ** indicates statistical significance at 5 percent level; * indicates statistical significance at 10 percent level.

- Results are robust to use of alternative estimators.
- The results indicate the budget deficit is sustainable.
- Fiscal policy has been on a sustainable path and government shouldn't face any major difficulty in fulfilling its debt obligations.

Some remarks on sustainability results

- **However, sustainable budget deficit does not imply there is room for careless spending.**
- Fiscal reforms are still necessary so that the government can respond to :
    - oil price shocks
    - lower sugar prices
    - global slowdown
    - natural disasters
- Fiscal reforms are also necessary to avoid distortionary taxation in future and support growth.
- Government should avoid further increases in external debt to help reduce vulnerability to adverse external developments.

2019/2020 Budget

- 2019/2020 is a commendable budget given its focus on environment and sustainability.
- Good Efforts for Environment Protection : Ban of single-use plastic bags by January 2020; promote use of reusable plastic bags; tax incentive for waste management companies and extension of ECAL to few more items.
- The government expects the budget deficit to fall from 3.5% to 2.7%.
- Positive steps by the government to encourage investment and exports :
  - Review of Investment Act;
  - Digitalization of government services;
  - After-care Support services;
  - Capability Program for Exporters

- The government has allocated $8m more towards sugar industry, which may not be enough.
- Sugar Industry has made little progress (see FSC Annual Report 2018) and the government has allocated $8m more towards sugar industry, which may not be enough ($62.3m to $70.4m).
- The recent announcement by the government to investigate $200m loss incurred by FSC in 2004 is a step in the right direction.
- Reduced allocation for Ministry of Agriculture ($96.8m to $78.7m)
- Review of Financial Management Act 2004 to improve transparency and accountability is commendable.

Key Challenges ,Policy Options and the Way Forward

- How should fiscal policy support growth given that growth projections has been revised downwards by IMF and the Reserve Bank of Fiji ?
- Policy Options
  - Strengthen fiscal transparency (reporting of government operations; publishing of audited reports)
  - Revenue Collection – focus on compliance, identify additional sources of government revenue.
  - Role of ICT in strengthening and modernizing the fiscal system.
  - Regular evaluation of expenditure plans (are the tax payers getting value for money spent ?)
  - Strengthen legal framework for fiscal discipline ; Strengthen policy schemes so that are not misused by people.

Concluding Remarks

- Recent policy developments suggest that the government is trying to reduce public debt. However, more needs to done.
- Fiji's average growth rate over the period 2013-2017 has been around 4.6%.
- Two major findings (based on empirical analysis) :

  a) **Public debt has negative impact on economic growth in Fiji.**

  b) **Budget deficit in Fiji is sustainable. Fiscal policy has been on a sustainable path.**

- A prudent fiscal policy supported by fiscal reforms will assist the Fijian government to:
    - maintain fiscal sustainability and investor confidence;
    - build fiscal space to respond to adverse external economic and climatic shocks;
    - improve sectoral growth prospects and;
    - continue the economic growth performance.
- With much lower growth rate projected for 2019-2021, the time is just right for the government to initiate fiscal reforms.

The End