# INTEGRATED DEVELOPMENT PLANNING

## IDP DISCUSSION PAPERS
## THE IDP PERSPECTIVE

## ON ECONOMIC RECOVERY

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## Introduction

1. Dominica is a small-island developing economy. It has a very narrow resource base. A population of 70,000; a labour force of 36,000; continuous migration of skilled workers a land area of 750 $km^2$; and a land resource supporting export agriculture and nature tourism. The economy is very open with imports equivalent to 65% of GDP and exports 25%. It is vulnerable to a range of exogenous factors and faces particular challenges in achieving sustainable development.

2. The two key external factors that will essentially determine the pace and direction of economic growth are ***international trade relations*** (including donor support) and ***natural disasters***. So one of the prime concerns of any development plan has to be ***<u>vulnerability</u>*** of the economy and society to natural hazards and external shocks. In fact, Vulnerability has been the premise for every conceivable development strategy since independence (Agricultural Diversification; Tariff Protection; Promotion of the Services Sector). Economic performance and external shocks have been inseparable since Hurricane David in 1979.

3. To the concept of "Vulnerability", the IDP added another one i.e., Economic Exclusion. That is because globalization and trade liberalization can link different sectors of the economy to external stimuli for growth to the exclusion of other sectors and individuals.

4. There is also an internal factor that is contributing to the lack of direction in economic growth. That is "**limited vision**" [See Footnote1] not necessarily by politicians, but also by senior officials in the Ministry of Finance and Planning.

- It takes Hurricane David to bring home the message of Agricultural Diversification;
- It takes a WHO ruling to understand international competitiveness and the limitations of preferential trade access.
- It takes Hurricane Lenny to bring a better understanding of the need to invest in a stronger transportation network and sea defence;
- It takes a severely dislocating fiscal crisis to understand that Government cannot develop the economy alone even if it borrowed all the money it can;
- It is taking a lot for those who should know to understand that you cannot stabilize the fiscal situation without growing the economy.

## Understanding the Process of Economic Recovery

5. It is important for us to distinguish between the traditional "Shock Approach" to economic recovery and the "Gradual Approach" that probably characterizes the IDP.

6. The "Shock Approach" is represented by proposals for drastic measures by the Ministry of Finance:

- Reduction of public expenditures (reduce civil service salaries)
- Increase in the collection of tax arrears
- Reduction in the Debt/GDP ratio

- Removal of Concessions
- Increase in fuel prices

7. The theoretical premise for the shock approach is that commodity and factor markets will absorb the adjustments, and even though they may produce some unemployment and dislocation during the process, what will emerge are new economic relationships in which Government and the private sector will be able to re-establish health balance sheets. The theory assumes that economic activity, even somewhat reduced during the transition, will continue through the adjustment.

8. There are opposing views to this approach:

**Table 1: Contradictory Views on the Approach to Adjustment**

| **Categories** | **Shock Approach** | **Gradual Approach** |
|---|---|---|
| **Adjustment Costs** | Shock Approach leads to high adjustment costs but these are short-run costs and once incentives are apparent to reallocate resources, markets reestablish themselves and personal incomes recover | Gradual approach considers the labour and capital are not readily transferable. The starting points are close to economic destitution and collapse of confidence in the market must be prevented. |
| **Credibility** | Shock measures send clear unambiguous signals that the reforms are credible and stakeholders have no other choice but to adjust accordingly | Gradualism assumes that credible changes come from changing the roles that stakeholders play as well as introducing new measures |
| **Feasibility** | The shock approach relies less on any specific sequence of actions. Its approach is to ACT and let the pieces fall in place. | The Gradual approach suggests that institutional capability and political good will may be needed to make the adjustment feasible. That not only takes time but should be made explicit to all stakeholders |
| **Risk of the other approach** | Lower production; Higher unemployment; domestic capital flight; migration of skilled personnel; rural poverty and economic exclusion. | Ambiguous signals; no clear time frame; sequential successes important; susceptible to distortion and direction changes |

9. There are three important adjustment considerations that come from the IDP:

· That households and businesses would not be able to reestablish solvency in the short-run and the economy can spiral down into a case where another set of reforms would be necessary.
· That the potential for a rapid expansion under new arrangements (lower deficit, more realistic petroleum prices, etc.) are an illusion because of the open nature of the economy and the established migratory pattern of both labour and capital.
· The risk-aversion behaviour is a logical response for both savings and investment decisions because the problem is both with the measures and with the weakness of market mechanisms in Dominica

## Perspective on the Recovery Process:

10. The fundamental assumption of the Draft IDP is simply this, "***Government cannot do it alone***". Government cannot sustain fiscal stability by simply announcing its policy measures; Government cannot attract capital inflows without the support of the local private sector; Government cannot increase the impact of Social Investments without the active participation of civil society.

## Stabilization and Growth

11. **The rules are changing**. It is quite normal for decision makers to bring to a planning process, their perceptions of the rules for success. However, if the rules for success have changed, then such persons must be willing to revisit their views/positions as to what constitutes a successful development strategy and what is an appropriate Planning process. The process and strategies that take full advantage of the new rules are the ones that will become successful in the future.
12.The fact is the rules have changed. International conventions, global events, attitude changes in donor and recipient countries have collectively changed the rules for succeeding in Trade negotiations, Donor support, Fiscal Management and Decentralization, social responsibilities, Private Sector involvement and Civil Society support. *The Paradigm Shift).*
13.The IDP responds as follows:
· It include the concept of **Economic Inclusion** to the strategies for growth because if we are to grow by linking to a globalized world economy it is possible for achieve GDP growth in some sectors of the economy with the exclusion of other members of society.
· It targets domestic expenditures (Income support to the rural economy, boosting domestic demand) as a first step instead of focusing on domestic saving and investment. It is concerned that corporate and household balance sheets would deteriorate further with our approach to fiscal adjustment.
· It includes a Social Investment Fund to mobilize the concept of "Sharing costs of the delivery of social services across different levels of Governance".
· It includes the concept of local area Concept Plans initiated by non-state entities as we share the responsibility for re-generating economic growth.

## Fiscal Adjustments

14. The challenge of fiscal stabilization is an immediate concern. It involves:

- Achieving a positive cash-flow on the Fiscal Balance sheet;
- Maintaining investment levels in order to increase production of goods and services in all sectors in the face of a declining role for the PSIP and an unwillingness of investors to take risks given the current state of the economy. ***(Performance of the Economy)***

15.The recognition that there is a symbiotic relationship between the health of the Government's balance and the health of the balance sheet of the private sector and individual households, provides the legitimacy for inputs by the private sector and civil society into the decisions of public expenditures. The IDP provides a Framework (**MTPEF**) which would seek to achieve consensus in the purpose and composition of public expenditures. ***(Fiscal Situation)***

16.Increasing the performance in revenue collection including the collection of tax arrears must be considered as a legitimate part of the equation even though some methods are likely to have high negative impact on growth. Two other measures that must be considered are:

- Sharing the tax burden more equitably through the eventual introduction of the VAT;
- Sharing the costs of some social and economic programme expenditures through lower levels of governance.

17.The latter can be achieved by either transferring the delivery of some social and economic functions to locally organized stakeholders or funding them through the Social Investment Fund which itself attracts significant donor support. The IDP process also provides the necessary entry points for decisions on sharing in the benefits and responsibilities of fiscal expenditures. ***(Fiscal Situation)***

## Sustaining Fiscal Policy

18.There are very many ways of measuring the sustainability of Fiscal Policy. These include the following:

**Fiscal Policy Sustainability [See Footnote 2]**

| **Test Methods** | **Conclusion** |
|---|---|
| Test stationarity of fiscal deficit and debt | If both are stationary then it implies that fiscal policy is sustainable |
| Test whether discounted debt series is stationary with mean zero | A weak evidence that the discounted debt series is stationary implies fiscal policy is unsustainable |
| Test whether Government revenue and spending inclusive of interest are co-integrated | A cointegrated relationship is evidence of a sustainable fiscal policy. |

| | |
|---|---|
| Test whether real Government tax revenue, expenditure and real interest payments are co-integrated. | A co-integrated relationship implies that fiscal policy is sustainable. |

19.The Fiscal policy is sustainable if it is seen to cause the fiscal deficit to converge towards a common point. If the policy leads to a continuous expansion in the deficit, then it is not sustainable. The second set of tests call for a strong co-integrated relationship between Government revenues and Government spending. The Fiscal Policy must imply a primary surplus at some point in time. If the Fiscal Policy implies a perpetual primary deficit no amount of debt reduction can make such a policy sustainable.
20.In the IDP perspective, Fiscal Stabilization immediately translates into placing the fiscal policy within a “growing the economy”. The challenge is creating an enabling environment in which:
a) The private sector can develop, flourish and provide employment necessary to raise incomes;
b) The Public Sector can become more efficient and professional, providing quality service with a reduced staff size.
c) Civil Society can support a more equitable delivery of social services in education, health, community development and social welfare.

21. All three of these challenges are directly addressed within the IDP and they are addressed within the context of what the relevant Ministries can do in cooperation with the other stakeholders *(See Papers on “Implication for Ministries”*).
22. The IDP strategy for bringing about a co-integration of revenues and spending is as follows:
a) Detach some spending from the national budget
· Build capacity for cost sharing across different levels of governance and for development/investment initiatives from all stakeholders;
· by sharing the costs through different levels of governance;
b) Maintain a level of social and economic investment through the instrument of a Social Investment Fund;
c) Clearly identify the content and approach expected in the Country Support Strategy.

## Protecting against another round of seeking debt relief.

23. If the Fiscal Policy is not sustainable, we will be faced with another round of negotiations for debt relief and the next one will pose a very serious challenge to the sovereignty of this country. The donors have issued a veiled warning at the April 26 2001 meeting that will not be favourably disposed to continued approaches for relief support.
24. There are a lot of Policy conditions that are attached to seeking additional relief at the completion point. These include:
· Projections of the NPV of the debt-to-export ratio;
· Debt service to export ratio;

- Any sizeable new borrowing and on what terms;
- Any significant outstanding arrears to private creditors;
- Any fundamental change in the country's economic circumstances;
- Any exogenous factors beyond the control of local officials.

All of these point to the question of sustainability of Fiscal policy referred to above

## Public Expenditure Management Systems

25. At a Press Briefing on The World Economic Outlook, the Director of Research at the IMF noted that with respect to Latin American economies, "..persisting economic difficulties in most countries in the region and their continuing vulnerability to external financial crisis underscores at least one basic fact: that there is no elixir that, if applied, will easily restore its sustained high growth. At the same time, i***mportant lessons can also be drawn. Developing sound institutions helps economic performance. Weak institutions dampen it."[See Footnote 3]***

26. What are some of the characteristics of a good Public Expenditure Management System:

- Clear legislative basis for budgeting, with easy-to-apply rules that are fully adhered to;
- A coherent macroeconomic and budget framework , appropriately classified;
- A comprehensive budget – no extra-budgetary activity;
- A powerful central Ministry to ensue budget discipline, including accurate costing of expenditure activities;
- Formal constraints on budget deficits and expenditures;
- Adequate technical capacity in parliamentary committees, central agencies of the executive and spending ministries including the capability to compare the costs of competing expenditure policies;
- An effective accounting system that produces timely and quality fiscal reports;
- Functioning audit arrangements to ensure compliance to handling uncertainty and economic shocks such as shortfalls in revenues, grants or other financing or unexpected expenditure pressures;
- Civil service salaries that are adequate to retain skilled staff;
- Accountability and transparency arrangements emphasizing clarity of roles; public availability of budget information; open budget preparation, execution and reporting; and independent assurance of integrity.[See Footnote 4]

## Getting the composition of Expenditures right

27. The composition of expenditure can only be "right" in two contexts:
· There is a consensus on the nature of the core expenditures but not necessarily the level.
· There is commitment to capture and utilize the economic and social benefits of these expenditures

28. Here, the IDP focuses on three core opportunities for getting expenditures right. These are:
· Facilitating Private Sector and Civil Society's participation in national budget exercise through the Medium-Term Public Expenditure framework;
· Coordinating the efforts of the current extra-budgetary funds; and
· Instituting a Social Investment Fund;
.
29. Again, the level of expenditures is not only related to what is given in the national budget. We have extra-budgetary funds that are available and are being utilized but in a most uncoordinated and unproductive manner. The IDP seeks to integrate these also into development, hence support for local area concept planning and local development committees.

## Restoring Macroeconomic Stability

30. The IDP programme for fiscal adjustment has five initiatives:
1) ***The first initiative is to seek short-term debt relief.*** Some of the measures that need to be considered in order to reduce the internal Balance include:
§ Accessing immediate financial support from CARICOM member states both on a bilateral basis but preferably through the CARICOM **Regional Stabilisation Fund**;
§ Concluding a **Standby Agreement** with the IMF to cover current liabilities;
§ Gaining access to **PRGF funds** for a 3-year period based on clear commitments within an Integrated Development Plan; ***(Restoring Fiscal Balance)***
2) The second initiative is to ***enhance internal surveillance and assessments of the impact of both domestic and external debt.*** Here, the IDP seeks to combine qualitative analysis of the country's circumstances with vulnerability indicators and other quantitative tools. The main objective is to develop a medium and long-term strategy for the management of both domestic and external debt and to strengthen the system for control and management of the public debt. The measures proposed include:
§ Strengthening the role of the Debt Management Unit by ensuring its opinion on current and future debt becomes part of the decision process of incurring pubic debt.

§ Strengthening internal control procedures. This would include both the Auditor General's role as well as contributions by the Debt management unit.

§ Making the Report of the Auditor General submissable to a special review committee of Parliament before being presented to the full Parliament.

§ Improvement in the quality of fiscal data with more graphical expression of the fiscal situation.

3) ***The third initiative is on standards and codes,*** where among other things the IDP seeks to provide a stronger basis for Government to make judgments about the allocation of Public Sector investment options. The measures include:

§ Preparing a medium and long-term strategy setting out the overall parameters for a sustainable debt management policy and the post-IMF Debt reduction.

§ Extracting from this strategy a "Code of Financial Management Practices" in the Public Sector and share this with the major stakeholders.

§ Encourage the Financial Institutions to generalize to their practices from this code and to establish a Code of Financial Management Practices in the Private Sector. ***(Debt Management)***

4) ***The fourth area is that of rebuilding the confidence of the financial sector.*** A key initiative in this regard is for Government to reestablish a collective working relationship with financial service institutions, instituting a system of information sharing particularly on the potential impact of Government's policies on the financial sector and for Government to become part of an informal network that ensures that financial resources are made available to entrepreneurs and "development committees" especially in the rural areas and those severely affected by the collapse of the Banana Industry. ***(Policy on reestablishing Confidence of the Financial Institutions)***

5) ***The fifth area is that of fiscal transparency.*** Here, the IDP is requiring that Government make a fundamental shift in its approach to fiscal management and seek to actively involve the private sector and civil society in policy and programme decisions. The three major operational changes which the Government must undertake in order to be truthful to the spirit and the letter of the concepts of an Integrated Development Planning Process are:

· Ensure that the PSIP funding objectives find their justification in the Integrated Development Plan. This is not only necessary for attracting donor support but will provide credence to the participation of many individuals and groups in the IDP process.

· Become "intentional" in its enunciation of macro-economic policy in general and expenditure policy in particular. Stakeholders need to determine their course of action on some level of predictability in terms of the instruments that the Government will use and the results that can be expected.

· Bring into the picture of debt management other types of assets and liabilities that the Government manages and which can influence the credibility of the Government.[See Footnote 5]

6) A public position on Fiscal Transparency is an important first step and in our current situation we have identified seven components of an adequate position. These are:

i. Create a process for the preparation of the Budget that would see the commitment of stakeholders expressed before the fact (i.e. its presentation in Parliament) not after the fact.

ii. Determine Fiscal Expenditure levels both within the level of expected revenues and also within the context of medium term achievements.

iii. Express as a New Code of Fiscal Conduct, Measures for Expenditure Control.

iv. State the Adjustment that would be made to Expenditure Targets not only in the current fiscal year but also as part of a medium term plan.

v. Improve the quality of reporting Fiscal Data so as to be in a position to share meaningful information.

vi. Make public the procedure that we will follow in incurring any new public debt and be willing to share the results of work done by the Debt Management Unit of the Ministry of Finance and Planning

7) The <u>Mechanisms for Fiscal Transparency</u> are as follows:

a) A Medium Term Public Expenditure Framework (MTPEF) reflecting a consensus between the Public Sector, Private Sector and Civil Society.

b) The Overall Deficit as the preferred indicator of the Fiscal Stance.

c) Sensitivity analysis of the MTPEF estimates.

d) Expressions of the code of conduct that will govern future financial relationships between the Government and the NCB and the DSS.

e) Sharing of Fiscal Data reflecting quarterly changes in net financial position (Cash Flow) of Government.

## Social Investment and Growth

30. The **Social Investment Fund** differs from any other development intervention in that it does not pre-determine the specific nature of investments to be carried out in any community but rather establishes a multi-Sectoral range of investment options. Depending on the particular social fund, communities can express their priorities in two ways;

a) They can form a community project committee and develop a project proposal; or

b) They can submit a project proposal through a local intermediary agent such as the local government, an NGO, the PTA at a local school or some other grass-roots organization.

31. Both mechanisms contrast with the more centralized investment choice model in which a central Ministry or central planners alone determine the size and location of public investments. This more decentralized form of investment selection is know as "demand driven" to denote its derivation from a local set of preferences and actions that emerge more closely, if not directly, from the beneficiaries themselves.

32. What the IDP does is to give some guidance to the indicative goals of a Social Investment Fund that would target Public Works, Social Projects, agricultural inputs provision, general food security, asset improvements, risk reduction, local area plans, direct production support, technical services intervention and training for new opportunities.

1) The following measures have been proposed to initiate the SIF:

- Establish the Social Investment Fund with an allocation equivalent to 10% of the total social services expenditures.
- Establish the financing agenda of the SIF along thematic lines.
- Invite donor support for either direct individual projects or for project activities along thematic lines:
- Utilize the SIF to support small-scale projects, identified and implemented through community participation.

· Include in the SIF Grant Portfolio community sub-projects sponsored by eligible NGOs and CBOs for demand-driven investments in education, health/nutrition, small scale infrastructure, agriculture productivity, natural resource management, developing social capital, empowering women, providing economic opportunities for youth.

2) The Social Investment Fund has a very important part to play in economic recovery:

· It can become an instrument for targeting social and economic investment as well as for sharing both the costs and the responsibility for implementing some social investment projects.

· It can become a source of funding that is relatively independent of the budgetary priorities of the Government and is run by a Board of Directors responding to the development needs of other stakeholders,

· Government can increase the level of the Fund by seeking donor support for either the SIF or for project components in the SIF outside of the framework of its own mutual obligations to bilateral and multilateral funding sources.

· The SIF can become an effective instrument for maintaining the focus of the various non-budgetary funding opportunities on the major themes of the IDP.

## Some Indicative Goals of the Social Investment Fund

| **Targeting** | **Generating Employment and Income** | **Supporting Investments** | **Strengthening Social Delivery Structure** | **Local Government Participation** |
|---|---|---|---|---|
| *Public Works* | Support to include rural labour and youth | Support to direct infrastructure improvements initiated at Community level | Addressing local areas with serious employment problems | Supporting local government efforts at attracting enterprises |
| ***Social Projects*** | | To support enterprise development | To increase cohesion among local community organizations | To give autonomy to local Government efforts |
| ***Agricultural Inputs provision*** | Support labour supply to targeted banana farms | Support enterprise development in input supplies (Organic farming) | | |
| ***General Food Security*** | Supporting local NGOs targeting pockets of extreme poverty | Connecting local farm production with basic food needs | Supporting land use patterns to strengthen national food production systems. | Targeting extreme cases using means tests |

| | | | | |
|---|---|---|---|---|
| ***Asset Improvement*** | Skills acquisition programmes | Supporting small investment in on-farm structures | Identification of skills availability at community level | |
| ***Risk reduction*** | Reducing debt/equity ratios in small enterprises | Supporting Credit insurance; Technical Assistance | Providing technical skills in putting together financial packages for small projects | |
| ***Local Area Development Plans*** | | Supporting local community/area development committees | Supporting Voluntary Community Efforts | Supporting Local Government Physical Planning. |
| ***Direct Production Support*** | Promoting complimentary production (livestock production) | Covering Technical assistants to small scale production investments. | Contributing to increased awareness of production opportunities at community level | Identification of demand driven programmes |
| ***Technical Services Intervention*** | | Technical Support to investment programmes | | Technical Support to Local/regional development committees |
| ***Training for newopportunities*** | Addressing skill needs of community tourism | Increasing skills base of rural location for alternative investments | | |

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[1] In “Dominica: natural disasters and economic development in a small island state” Charlotte Benson and Edward Clay, Overseas Development Institute, these researchers noted that ‘Limited vision may have been an additional confounding factor, as historically the island swung from one dominant crop to another and this pattern was simply repeated” p.10

[2] See “Analysing the Sustainability of Fiscal Deficits in Developing Countries” John T. Cuddington, July1996/March 1997. Georgetown University.

[3] **Press Briefing on the World Economic Outlook** by Kenneth Rogoff Economic Counsellor and Director, Research Department. International Monetary Fund Wednesday, September 25, 2002

[4] These principles are embodied in the IMF’s Code of Good Practices in Fiscal Transparency. (www.imf.org)

[5] IDP Report on Sensitisation, Research, Analysis and Planning, p.28