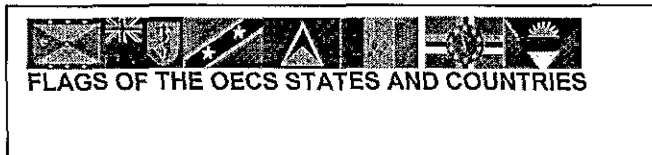
FISCAL REFORM IN THE CONTEXT OF SMALL OPEN ECONOMIES


FLAGS OF THE OECS STATES AND COUNTRIES

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FISCAL REFORM IN THE CONTEXT OF SMALL OPEN ECONOMIES

Abstract:

The most pronounced disruptive issue in small open economies over the last two decades has been the issue of fiscal reform. In this paper we offer some suggestions on Fiscal Reform in the Context of the Small, Open, Microstate Economies of the Organization of the Eastern Caribbean States. The suggestions we present are structured under a reaction and response scenario of three main areas: ***expenditure reform (including fiscal discipline), taxes reform, and regional cooperation****. The main contextual idea is that these three areas are to be seen as pivotal in the fiscal reform of small open economies, especially the small open economies of the OECS.*

The paper reviews some macroeconomic data of the OECS and from those data draws some conclusions about some appropriate measures to be put in place, to enable the microstates of the OECS to move forward with a strategy of fiscal reform. Indeed, it is our view that all of the countries of the OECS should rein in their expenditures, not to stifle development, but to manage development. They should pay serious attention to reform the taxes regimes, in terms of structure and scope; and finally, they should seek to institutionalize regional cooperation relative to capacity building in the area of expenditure and tax reform and revitalization.

INTRODUCTION

The most pronounced disruptive issue in small open economies over the last two decades has been the issue of fiscal reform of these countries. In the context of the member states of the Organization of Eastern Caribbean States (OECS), the need for a response to fiscal reform is best articulated by an analysis of the countries' expenditures, taxes, and debt profiles. A number of studies have been done to indicate that the countries are on a tightly strung wire as far as fiscal issues are concerned.

If we use data from the countries, and from the publications of the Eastern Caribbean Central Bank, from the International Monetary

Fund and from the World Bank, we can draw some conclusions that all of the countries of the OECS should take warning. In all of the countries there are a few economic issues that are the proverbial "fiscal burdens" that are poised to break the donkey's fiscal back. The ***Debt to GDP ratios*** are outside of the norms of what are considered acceptable in international circles. ***The External Current Accounts deficits as a percent of GDP*** seem to be widening every day, and ***public and publicly guaranteed external debt are rising steadily***, and in some cases, exponentially.

While all of the countries are not in the hole, by contagion effects of some counties, the OECS could be termed to be in a precarious position. The celebrated case is Dominica, but by association, no one country is really outside of the loop of fiscal instability. It is country one today, but it could be countries two and three tomorrow.

The paper is structured as follows. Following this introduction, we first present some illustrative information on some macroeconomic data as means of highlighting some of the dynamics of the OECS as a whole. Second, we present some correlations of the data and pertinent ratios, which ratios could be seen as or used as guidelines or benchmarks by the authorities in the respective countries. Third we present two indicative simple regression analyses, merely as indicative expressions of the internal core of the links in the economies. Fourth we present a discussion on Expenditure Reform in a holistic, politico-economic space, including comments on fiscal discipline. Fifth, we offer discuss taxes reform moving from a state of what is and what ought to be. Sixth, we discuss regional cooperation, as it pertains to expenditure reform and taxes, particularly as it pertains to institutional capacity building.

ILLUSTRATIVE INFORMATION

In the following tables, for illustrative purposes, we present some OECS data for Gross Domestic Product By Economic Activity, in millions of EC Dollars [Current Prices]; this is followed by Population; Government Revenue and Government Expenditure, over the period 1992 through 2001.

These data provide a first approximation of where the countries/states were over the last ten years. The data are introduced to give an initial view of the macroeconomic picture of the countries in question. We will make some preliminary statements on where the

countries/states should be going over the next several years and use these four aggregate bases as the foundation for further discussion. Indeed, given these data as well as Gross Capital Formation, Exports and Imports, we can get a fairly decent impression of the nature of the countries in question. We will not do any detailed regression analysis with the data, but we will do some preliminary, indicative analysis. The essentiality of our discussions would revolve around descriptive statistics, and some rudimentary impressions regarding the correlations among the variables.

From a practical point of view our point of departure our thrust will be on the data, graphs, correlations and some preliminary analysis. At the end we will make some suggestions based on our discussions and seek to underscore why the three areas are critical in fiscal reform in the OECS.

Before we begin, however, it is to be noted that we are firm believers in fiscal policy and monetary policy interfacing. Any analysis that centers on the fiscal phase of economics must, of necessity, take the monetary phase of economics into account. Fiscal reform must go hand in hand with monetary reform. We are assuming that the monetary component is under control in the OECS. This is a pivotal assumption in all of our discussions. We have no reason to believe otherwise; hence, our thrust will only be on the fiscal side of the "economic scissors." To underscore our point, it must be reiterated that fiscal reform must go hand in hand with monetary reform in every developmental trajectory in the OECS. Anything short of such a scenario would be like what the old folks say, ***"you would be spinning top in mud."***

Our first table, Table One, therefore presents the aggregate data for GDP, population, Government Revenue and Government Expenditure over the period, 1992-2001. If we abstain from the argument of the aggregation problem, or put it another way, if we believe that we can meaningfully add up all of the GDPs of the OECS, then Table one is our first thrust into the economies of the OECS.

TABLE ONE: GROSS DOMESTIC PRODUCT, POPULATION, GOVERNMENT REVENUE AND GOVERNMENT EXPENDITURE OF THE OECS, 1992-2001

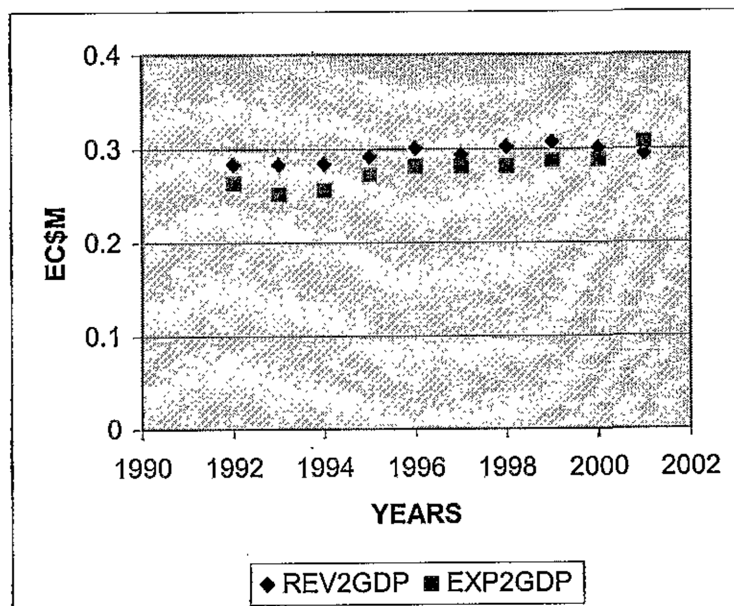
YEAR	***GDPEA*** [CP, EC$M]	***POPULATION*** [Mid-Year]	***Government REVENUE*** [EC$M]	***Government EXPENDITURE*** [EC$M]
1992	4322.40	541,419	1228.20	1140.19
1993	4491.51	547,274	1275.56	1131.33
1994	4795.81	552,209	1363.00	1228.72
1995	4962.82	558,455	1449.57	1353.87
1996	5199.32	559,741	1566.60	1466.06
1997	5496.25	559,470	1628.02	1549.33
1998	5875.51	560,309	1774.79	1657.38
1999	6198.55	565,499	1902.93	1784.79
2000	6451.37	568,658	1942.06	1863.02
2001	6472.33	577,953	1905.24	1989.68

National Accounts Statistics, 2001 and 2002, Eastern Caribbean Central Bank, for Years ended 31 December 2001 and 2002, Tables 1.1, p. 31 and 21, respectively and p. 29[2002] and p. 31 and 40 [2001]

We note, from a mere cursory view, that the Revenue stream, in aggregate, exceeds the Expenditure stream. At the levels of some individual states, the Expenditure profile is way above the Revenue profile. The individual countries' pictures have varied over time and have varied between and among countries. But when all of the countries are taken together, as members of the OECS or members of the Eastern Caribbean Currency Union, the picture is cause for concern, but not cause for alarm in the aggregate. It is safe to say, however, that there are ***disassociation factors*** between the growth of countries and their own-accounts in terms of economic development. That is why a discussion on the idea of fiscal reform in the OECS gets to the heart of the matter.

In Graph One, we illustrate the trends in Revenue to GDP and Expenditure to GDP. There we note that both of the series are trending upwards, but slightly. It is evident that the picture is an illusory one because it is not telling the full story of some of the underlying fundamentals of some of the countries. On this aggregate basis, it almost seems as if there are no major problems in the OECS. But as we are well aware, this is the aggregation problem.

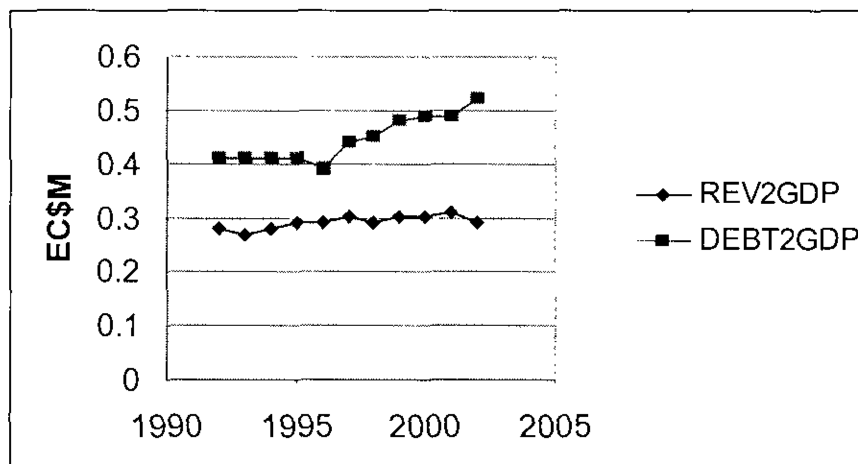
GRAPH ONE: REVENUE AND EXPENDITURE TO GDP



Source: **Data obtained from *National Accounts Statistics*, 2001 and 2002, Eastern Caribbean Central Bank, for Years ended 31 December 2001 and 2002**

Graph Two, on the other hand, shows a very clear view of the departure of the ***Debt to GDP*** ratio from the ***Revenue to GDP*** ratio. This is instructive in that economic and political planners may see these ratios are guidelines or benchmarks to approach, but not to broach, as the case may. They provide the parametric framework in which countries may wish to operate or not to operate.

GRAPH TWO: REVENUE AND DEBT TO GDP



Source: For original data, see Table One.

If Revenue to GDP could be thought of as ***enhancing*** the capacity of a country to grow, Debt to GDP could be thought of as the ***exhausting*** the ability of the country to develop. Like everything else, this statement has some caveats. It depends on the nature of development in the countries in question.

Next, we consider revenue, expenditure, debt and GDP to the population. Intuitively we are trying to see the relationships among these variables and, as a consequence, determine if the countries have many degrees of freedom relative to any kind of reform. While our primary focus is on fiscal reform, that reform must be scoped in the context of the overall structural reform of the economies.

Table Two illustrates the data for revenue, expenditure, debt and GDP relative to the population. These ratios are useful targets relative to a country's capacity to grow and or to develop.

TABLE TWO: REVENUE, EXPENDITURE, DEBT AND GDP TO POPULATION

YEARS	REV2POP	EXP2POP	DEBT2POP	GDP2POP
1992	2270.24	2107.56	3275.51	7899.76
1993	2331.92	2068.25	3360.18	8211.17
1994	2469.20	2225.94	3558.57	8688.06
1995	2597.80	2426.29	3649.61	8893.93
1996	2794.5	2617.96	3658.68	9284.50
1997	2912.38	2771.61	4274.81	9832.29
1998	3169.27	2959.61	4703.95	10491.98
1999	3368.02	3158.92	5293.08	10970.94
2000	3413.11	3274.20	5590.90	11338.08
2001	3296.26	3442.35	5860.26	11197.80

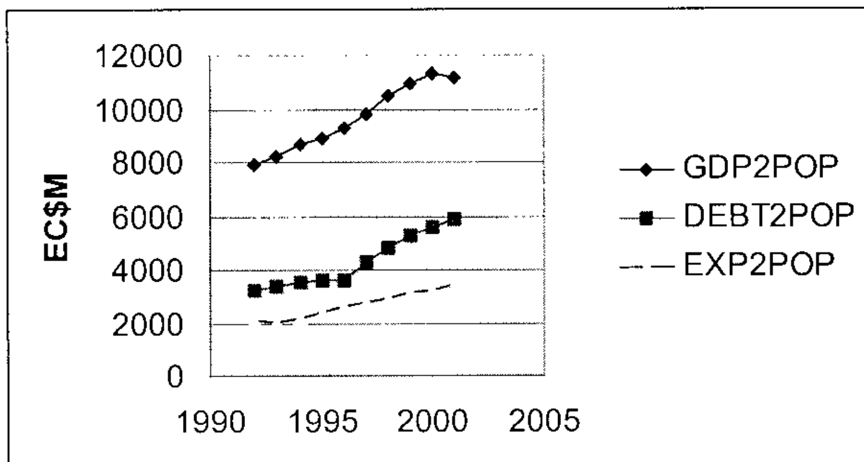
Source: **Original Data from ECCB National Accounts Statistics, 2001 and 2002**

They ratios only give some preliminary insights. At this stage of our discussions, however, they are also instructive in that they all portray some frames of reference relative to the population of the OECS.

This issue of population is a very sensitive one. When one considers that some OECS countries have been losing population as a result of natural disasters, and not developing a large population base as a result of low reproduction rates, it puts the region in a bind. Population is necessary. That is why the move in the OECS to have freedom of movement of people in the region is a powerful economic and political thrust. We will make some brief comments on this idea when we discuss the concept of regionalism under one of the variables in our three-variable scenario.

From Table Two, we abstract a graph to show the expenditure to population, debt to population, and GDP to population in the OECS. We illustrate these ratios in Graph Three. It is a very interesting graph in terms of the gaps between and among the ratios. The per capita GDP is moving upwards, reasonably, in line with some

GRAPH THREE: GDP, DEBT AND EXPENDITURE TO POPULATION



Source: See Table Two.

expectation of trend and growth; however, the expenditure and debt to GDP highlight a cause for concern. One caveat must be noted here. At the end of the series, the per capita GDP is showing a slight downward trend. No doubt this could show an up-tick given new growth prospects in the region. Our rationale for fiscal reform assumes an even greater significance when one considers the Debt to GDP ratio and the Expenditure to GDP ratio in Graph Three. We must make the usual caveat of ***ceteris paribus*** when it comes to the data. Nevertheless, it seems that concern is in order as far as debt and the region's capacity to spend and its ability to carry debt go. The burdens of both aggregates are not to be taken lightly.

CORRELATION COEFFICIENTS

In Tables Three to Six we present some correlation coefficients for the data we have presented. We present the data in aggregate and we present the data in ratios.

The correlations are given to underscore the fact that there are clear links between and among the data that we have selected and which data we have presented in a heuristic manner. For the most part, up to now, we have given a practical analysis using data that could lead us into inferential statistics. The time series is too short to do any detailed analysis, even though we will do some indicative work to highlight an elementary point. In this regard, the correlations that we present are both insightful and surprising in one instance.

TABLE THREE: PEARSON CORRELATIONS

	REVENUE	GDP	EXPEND	POPULAT	DEBT
REVENUE	1.00	.994**	.984**	.906**	.959**
GDP		1.00	.991**	.932**	.977**
EXPEND			1.00	.950**	.976**
POPULAT				1.00	.911**
DEBT					1.00

**Correlation is significant at the 0.01 level (2-tailed).
N= 10

In Table Three we obtained strong positive correlations for all of the variables as they relate to revenue. A linear relationship was indicated for all of the variables, positive direction, strong links and values of ***R*** all exceeding .90. A significant correlation indicates a reliable relationship, not necessary a strong correlation. But in our case, the relationships were reliable, strong, and positive. Hence, GDP, Expenditure, Population and Debt are very useful indicative variables for Revenue growth in the OECS. Of course, ***we have to remember the elementary note that correlations do not imply causation.*** Likewise, we would have to consider the issue of the Durbin-Watson if we were to develop any detailed regression analyses.

Admittedly there have been a number of intervening and mitigating factors that have helped or strangled the normal developmental processes in some of the countries of the OECS. When we allow for the disruptive effects of these variables, which could rightly be considered ***external factors***, there were, and there continue to be, other ***internal variables*** that were and are under the control of the decision-makers. Our external/internal dimension is best illustrated by some correlations of revenue, exports and gross capital formation, as illustrated in Table Four. Here, too, we note a case that may be considered an anomaly. This would be a problem if we did not know the nature of the economies of which we speak. The correlation links of the variables to exports ***seem*** to be the opposite of what is expected. But, of course, we know that there are cases where similar results have been found in the region.

TABLE FOUR: PEARSON CORRELATIONS

	REVENUE	EXPORTS	IMPORT	GCAPFORM
REVENUE	1.00	-.416	.989**	.995**
EXPORT		1.00	-.388	-.414
IMPORT			.1.00	.978**
GCAPFORM				1.00

**Correlation is significant at the 0.01 level (2-tailed).
N= 10

In Table Four, we obtained correlations that were strong, positive and reliable in terms of revenue to import and Gross Capital Formation. Surprisingly, however, there is a weak negative relationship between revenue and Exports. Exports are negatively correlated with all of the variables, and weakly linked in all cases. This was surprising in the sense that, notionally, one would have thought that the relationship would have been positive. Ramsaran also found similar results for Trinidad and Tobago for the period 1980-1990.

Ramsaran (nd., Table 2, p. 13) correlated Revenue to Exports, Exports to GDP and Total Expenditure to GDP over four time frames: 1970-1980; 1980-1990; 1990-2000 and 1970-2000. It is only in the 1980-1990 time frame that there is a negative relationship, and a weak one at that. Specifically it was negative -.23. All of his other variables are similar to ours in terms of strength, magnitude and direction.

The internal variables, in our view, have a two-dimensional scale. One scale pertains to the links between and among the variables. Those links we see or can infer from the correlations. The second scale pertains to our idea that credence has to be given to ***institutional reform***. In this instance we turn to the interaction among four components, namely revenue to GDP, expenditure to GDP, debt to GDP and exports to GDP. These, to us, provide some clues as to the capacity of the countries to manage their internal and external dynamics as far as growth and development are concerned. The Debt to GDP, in particular, is like the talk of the town as far as countries go. If countries control Debt to GDP, the economy could be controlled.

TABLE FIVE: PEARSON CORRELATIONS

	REV2GDP	EXPE2GDP	DEBT2GDP	XPOR2GDP
REV2GDP	1.00	.711*	.832**	-.732*
EXPE2GDP		1.00	.879**	-.767**

DEBT2GDP			.1.00	-.732*
XPORT2GDP				1.00

* Correlation is significant at the 0.05 level (2-tailed)
**Correlation is significant at the 0.01 level (2-tailed).
N= 10

We next turn to the internal capacity of the country to bear debt, and to service debt. There are three strong and significant correlations; these are those with the double asterisks in Table Five. Revenue to GDP is positive, but it is only significant at the 5% level of significance. So is its relationship to Exports to GDP. On the other hand, Revenue to GDP is negatively related and strongly so, to Exports to GDP. Exports to GDP are negatively correlated to all of the three variables. This is surprising, again, given that we are discussing countries that depend on exports. On the one hand it is surprising, but on the other it is not really surprising if we consider the leakage of the export-multiplier.

Our next thrust is to consider the correlations of GDP per capita and revenue per capita. These are benchmark correlations. We dub them benchmark correlations in that they give some ideas of the possible planning parameters of the countries in terms of where the countries ought to go, where they could go, and how they could manipulate the variables attendant with the correlations.

TABLE SIX: PEARSON CORRELATIONS

	GD2POP	**REV2POP**	**REV2EXPE**	**DEBT2GDP**
GDP2POP	1.00	.981**	-.669*	.846**
REV2POP		1.00	-.646*	.848**
REV2EXPE			.1.00	-.774*
DEBT2GDP				1.00

* Correlation is significant at the 0.05 level (2-tailed)
**Correlation is significant at the 0.01 level (2-tailed).
N= 10

Once again we were able to get significant linkages between the variables. GDP to population is strongly, positively correlated to Revenue to population and Debt to population. Likewise, Revenue to population is strongly correlated to Debt to GDP. On the other hand,

as we would imagine, the revenue to expenditure ratio is negatively correlated to the Debt to GDP. All of the correlations are significant, although there are differences in terms of the strength and the level of significance.

Finally, we give some ***indicative illustrations*** of two regression analyses from the data. We present the model summaries, the coefficients and ANOVA results. These results are merely given as a first approximation. The time series, useful though it may seem, is to short to permit as to do the robust analysis that we wanted. Thus, we give the results but only as a second best solution.

MODEL SUMMARY[b]

Model	**R**	**R Square**	**Adjusted R Square**	**Std. Error of the Estimate**	**Durbin-Watson**
1	.994[a]	.988	.986	30.833	1.374

[a] Predictor: (Constant). GDP
[b] Dependent Variable: Revenue

COEFFICIENTS[a]

Model	**Unstandardized Coefficients**	**Standard Error**	**t**	**Significance**
(Constant)	**-190.910**	**70.732**	**-2.699**	**.027**
GDP	.331	.013	25.660	.000

a. Dependent Variable: Revenue

ANOVA[b]

Model	**Sum of Squares**	**Df**	**Mean Square**	**F**	**Significance**
Regression	**625989.92**	**1**	**625989.92**	**658.451**	**.000[a]**
Residual	**7605.61**	**8**	**950.70**		
Total		**9**			

[a] Predictor: (Constant). GDP
[b] Dependent Variable: Revenue

As we are aware, the standard error gives a measure of dispersion for the predicted equation. Using the predicted equation, 68% of the data will fall within one standard error of the estimate of the predicted value. Just over 95% will fall within two standard errors. In the estimate above, 95% of the time, the estimated Revenue will be within EC$61.67 million of being correct, that is 2 times 30.833.

From the coefficient table our predicted equation is:

Revenue =-190. 910 + 0.331GDP.

In other words, if GDP is zero, Revenue will be minus 190.91 million EC dollars. If GDP is EC$5,000 million, say, then Revenue should be: -190.91 + .331 (5000) = **EC$1464.09**. Given our discussion of the standard error of the estimate, 95% of the time GDP of $5000 million would generate Revenue between (EC$1464.09 - EC$61.67 = **EC$1402.42**) and (EC$1464.09 + EC$61.67 = **EC$1525.76**). Although the GDP response is low, it is very significant as is evident from the t-value of 25.66.

Finally, in the context of the first indicative regression equation, we consider the Analysis of Variance, specifically the F value and its level of significance. If the level of significance is less than 0.5, then we have a significant linear regression. If it is larger than .05, we do not have a significant linear regression. In our case we have a significant linear regression.

Thus in the first simple linear regression analysis where GDP was used to predict Revenue in the OECS, a significant regression was found ($F(1,8) = 658.451, p<.001$), with an R^2 of .988. Predicted Revenue is equal to -190.91 + .331 (GDP) when GDP is measured in EC million of dollars. On average, Revenue will rise by EC$331,000 for a one million rise in GDP.

The next indicative regression that we present is the revenue to population as a function of debt to GDP and GDP to population, or GDP per capita as it is conventionally called. Following the same procedure as above we observe the summary model, the coefficients and the ANOVA.

This second regression is like the one above, except that in this case we have two variables as predictors. The ***R Square*** here, as we know, is the ***coefficient of determination*** that will tell us the proportion of the variable in the dependent variable (Revenue to Population) that can be explained in the independent variables Debt to GDP and GDP to population. We are mindful of the closeness of these variables, but nevertheless, we are able to get some preliminary information on which we can make some first approximation discussion or decision.

From the model summary, 96.3% of the variation in Revenue to Population can be explained by the differences in Debt to GDP and per capita GDP. (There is ***a seductively dangerous notion*** here that the more Debt to GDP the more Revenue to Population. The second part that the higher the per capita GDP, the higher the Revenue to population makes more sense, and is less problematic).

Using the standard error, 95% of the time our estimate of the Revenue to population will be within EC$188.88 million (2 x 94.441) of being

correct. The Durbin-Watson, used here for illustration, is around the proverbial 2.00. Durbin and Watson (1950: 409-428 and 1951: 159-178) give the essence of their path breaking articles on this DW statistic. We could claim that there is no serial correlation, since the DW statistic is approximately or equal to 2.00. Of course, we are assuming that the errors are ***white noise***. This would be too heroic an assumption to make given the length of the time series.

MODEL SUMMARY[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.990[a]	.995	.953	36.202	1.898

[a] Predictors: (Constant). DEBT2GDP, GDP2POP
[b] Dependent Variable: REV2POP

The prediction equation for Revenue to population in this regression is:
REV2POP = -222.718 + .402GDPPOP - 1832.120DEBT2GDP

where all variables are in millions of EC dollars. So, if the per capita GDP is EC$5,000 and the Debt to GDP is EC$10,000, then the capacity of the country as expressed in terms of its Revenue to population will be: -222.718 + .402(8,000) - 1832.12(.50) = **EC$2077.16 millions**. At Debt to GDP of 60% and 100%, respectively, the Revenue to population ***will fall*** to **EC$1893.97 millions** and **EC$1161.11 millions**, respectively.

COEFFICIENTS[a]

Model	Unstandardized Coefficients	Standard Error	t	Significance
(Constant)	**-222.718**	**126.019**	**-1.770**	**.1930**
GDPPOP	.402	.0212	18.96	.0000
DEBT2GDP	-1832.120	605.714	-.302	.0.193

a. Dependent Variable: REV2POP

ANOVA[b]

Model	Sum of Squares	Df	Mean Square	F	Significance
Regression	1695553.62	2	847776.808	646.84	.000[a]
Residual	9174.557	7	1310.651		

Total		9			

[a] Predictor: (Constant). DEBT2GDP, GDP2POP
[b] Dependent Variable: REV2POP

Like the example above, in the first regression, we can make some inference from the Analysis of Variance, specifically the F value and its level of significance. If the level of significance is less than 0.5, then we have a significant linear regression. If it is larger than .05, we do not have a significant linear regression. In our case we have a significant linear regression.

We now turn to ***a quasi-heuristic approach*** to the three areas that we have designated the three important areas of concern for microstates, especially the OECS. We say ***quasi-heuristic*** for a simple reason. In the traditional heuristic approach one seeks to discover, to learn, something along empirical lines, using ***rules of thumb***, to find solutions or answers. We appeal to the code of conduct as far as the ***rules of thumb*** are concern. We do this for a simple reason.

Over the last three years, we have had the opportunity to operate at a very practical level as far as decision-making is concerned in the wider Caribbean. It is very clear to us that much of what we do in the halls of academia have little relevance, is far too abstruse, and is too often way out in left field from the core of the problems confronting the region. While it is useful to do first best problems, and engage in first best solutions, oft times second best solutions will bring you closer to your target. In this regard, asymptotic progress is nearly as good as the real macoy. This is not to suggest that asymptotic progress should be the b-all and the end-all. What it does suggest is, we in academia have to craft our work to be more utilitarian as far as the policy makers are concerned. Thus for the next part of this paper we will try to approach the fiscal reform in the OECS along the rules of thumb approach, and in line with a practical frame of reference.

EXPENDITURE REFORM (Including Fiscal Discipline)

When all factors are taken into consideration, most of the countries of the OECS have been pursuing a pattern of expansive fiscal policy over the last two decades. We are aware of the fact that this policy has been around for longer that 20 years, but 20 years give a sense of history as far as the observations are concerned. Even though we don't give data for 20 years in the paper, the ten-year set of data still gives some good insights that could form the basis of what could be done.

The OECS is blessed with having within its midst, a strong, well-run and well-regulated monetary institution, in the presence of the Eastern Caribbean Central Bank, ECCB. Even though the ECCB has played a pivotal role in taming the tiger of fiscal "indiscipline" in the region, albeit in an indirect way, the OECS fiscal stresses and strains over the years have come about as a result of the expansive fiscal policy pursued by some OECS members.

Fiscal policy was used to stimulate the economy. It was also used to help some members of the political directorate make some, ostensibly, easy political decisions. Or alternatively, as some persons would say, it helped the political to make decisions easier than would be the case under normal circumstances. Some people also believe that fiscal policy was used to undergird the longevity of some members of the political directorate, in some states. Much of this is anecdotal evidence since there are no studies, to date, to demonstrate the nexus between the political directorate longevity and fiscal policy.

In the traditional approach to fiscal expansion, we are told that there are three ways that a state can raise the GDP to some given level. These are through government purchases, reduction in taxes, or increases in transfer payments by a quantum sufficiently to close the resource (some people call it the recessionary) gap between actual and potential GDP.

Over the period of analysis in this paper, we observe that the governments were engaged in higher government spending because this was seen as the quick and easy cure to generate some growth in the economy. Given the various hypothetical government expenditures multipliers, additional amounts were injected in the economies in all sorts of ways to push up GDP by some quantum.

In some instances large housing estates were built, hotel costs were underwritten, roads were built, etc. It is felt that since the countries face the challenges of an increasingly liberalized, call that hostile, international environment, characterized by the erosion of preferential trade preferences, on which they have traditionally depended, the steep descent in availability of concessionary aid resources, it was felt that the countries had to spend to get their people at the level of development that a modern society desires for its people.

It was agreed, by all, that the countries in the region, the entire region, had to reposition themselves. In the OECS we are of the view that a major plank in that repositioning has to do with expenditure and expenditure reform in the context of fiscal reform.

The countries knew that spending was essential. So, their action was to spend and spend and spend. Linked to this action of spending was the idea that full employment, or near full employment, was a desired plan.

While countries spent, there was the thought of some that the lowering of income taxes to achieve some fiscal stimulus was a desirable move. This was talked about but avoided by nearly all countries, except two. Other countries avoided the income tax elimination or reduction because of the anticipated political uncertainty of such an action.

Countries like Antigua and Barbuda and St. Kitts and Nevis, which long ago eliminated income taxes refused to reintroduce income taxes for fear of what the political fallout will be. In the mean time, many other forms of taxes were introduced to capture what was loss by the abolition of the income taxes or from the erosion of the tax base. Over the same period of our analysis, some countries explored the idea of "doing something" about transfer payments. This was a conceptual idea, more or less. In some of the countries attempts were made to get a plan of action in place to have retirements benefits from nationals in Britain repatriated to the home of the nationals. Much "talk" was engendered, but to date nothing of ***major*** significance taken place.

In the end, the one constant factor was the expansive and explosive Government expenditures. There is a continuous upward trend of the data. We are mindful of the fact that there have been a series of natural disasters and that these natural and man-made disasters, like September 11, in the USA, negatively impacted the growth and growth prospects of the region. The OECS, given its vulnerability, was particularly hard hit. Hence one can appreciate the upward trend in the expenditure over the time frame.

Like a colossus striding the waves, the GDP for the region showed an upward trend also, almost too good to be true. But here again, nearly all of the countries were showing some evidence of growth, low though it was. Of course, since September 11, 2001, the picture of growth has changed. According to the ECCB (March 2003: 1), the preliminary "data for the first quarter of 2003 indicated that economic activity in the Eastern Caribbean currency union improved relative to the performance in the corresponding quarter of 2002." (Furthermore, the)..."current operations of the combined central governments resulted in a deficit that was below the level in the first quarter of 2002." Of course, a quarter does not an economy make. But it augurs well for the future.

The Expenditure to GDP ratio is pivotal as is portrayed by Graph One. We observe the distinctive upward drift of the Expenditure to GDP ratio ***a la*** Wagner's thesis and or ***the disassociation factor*** in government

expenditures. The 1996 to 1998 period is particularly intriguing. That was the time when the expenditure for the entire region started to mirror the revenue, until finally it over took it in 2001.

The Expenditure to GDP ratio clearly shows the fiscal expansive postures of the OECS. These data reflect the sub-region in aggregate. At the individual states' level some of the intricacies, fragility and vulnerabilities of the states are clearly revealed. Thus at the individual nation states, the expansive fiscal policy has a greater negative impact than the aggregate picture shows.

In Graph Two, where we portray the OECS Debt to GDP ratio, we see an upward "steady" trend of the ratio. Of all of the reasons for alarm, this ratio as, illustrated in Graph Two, is the most problematic. This ratio is the one issue that serves to handicap and undermine the region's ability for any meaningful growth trajectory. There is a catch-22, however. Debt incursion is necessary for growth expansion. But debt incursion, done in a haphazard manner, could have long-term structural impediments as far as growth and development are concerned.

In the context of the Debt to GDP ratio we note, from Graph Two, a jump discontinuity between 1996 to the present. From that year there has been a seemingly upward trend in the Debt to GDP ratio.

In the case up to now, the public sector has grown absolutely and relatively. Government expenditure has grown and it has grown relative to GDP and relative to Debt. There is a certain necessary impediment, as we have noted, but in terms of axioms, debt for its own sake is a millstone. If the debt is used to generate growth, and if the country has the capacity to pay off the debt, then the debt is not a problem, per se. However, when the debt gets factored into the scheme of things, as if it were a structural feature of development, then there is a problem. Put another way, if Debt and Debt to GDP are taken for granted, then the countries are in a serious situation.

The ability of the OECS to carry debt depends on the size of the debt (which could be seen as a displacement, exhaustive or loss opportunity cost factor); the expenditure obligations of the countries; and on the size of the GDPs from which all expenses must be paid. In the OECS there are razor-thin decisions as far as these abilities to spend and repay are concerned.

There are a variety of demands on the public fisc, the public purse, for goods and services. There are many competing voices seeking to be heard. There are many persons seeking to obtain benefits from various Ministers of Government and for the constituencies. Thus expenditure, and not necessarily budgeting, becomes the art of who can promise the most and who can deliver the most. A politician, therefore, becomes a person who

wears two hats. One hat is the Ministerial, Statesman's hat, and the other hat is the political, politician, constituency hat. In many respects there are conflicting interests and demands in the use of these two hats. The end result is that budgets that were balanced, or were to be balanced by law, are left unbalanced. This is not necessarily done to break the law, but to satisfy the wishes of the rising tide of expectations of the electorate. No politician likes to know that he or she says ***no*** to a constituent.

Decision-makers in the OECS, these microstates, are faced with extremely difficult and tough questions, every day. Here, we constantly allude to our axiom of small: ***In small countries, small things are big***. The political directorate must ask, do they fund a short-term work experience for the burgeoning unemployed, but educated, young people in the society? Do they build houses for the poor and middle-income citizens? Do they give a bonus or "goat water" salary at the end of the year? Do they do all of the above? Do they make some good faith gesture to the people? Do they make good faith gestures to their die-hard supporters who they know need their help? Do they pander to the whims, fancies and strictures of international financial institutions and hold their people to ransom? ***Do they pull in their belts, ostensibly around the waist, but really around the necks?***

All told, whatever is done, the expenditure profile will either be kept within some limits or explode exponentially. There will either be a convergence in line with revenues, or a divergence from revenues, as the graphs have shown thus far.

Fundamentally, over the last 20 years, the fiscal policy of the OECS countries was geared to closing a resource gap. For all practical purposes, all of the OECS countries could be said to have been in some type of resource gap. It is also tantamount to a resource-starved gap, as we normally define resources in Economics.

When aggregate demand exceeds an economy's capacity to produce, leading to an inflationary gap, a restrictive fiscal policy is best operationalized. In the case of the OECS, there was no such need since aggregate demand did not exceed the economies' capacity over the period under study.

For the most part, over the years the countries have been facing a situation whereby the economies had to choose between a spending policy and a tax policy.

From all macroeconomic scenarios, fiscal policy can be causal in moving the economy in a desired direction by either changing government expenditures or by changing taxes. We all know that if the governments want to expand the economy they can either raise Government expenditures

or lower taxes. Either policy will shift up the total expenditure and raise equilibrium GDP on the demand side. This action works well in a closed economy. In open economies like those in the OECS, the overarching presence of leakages in the import/export multipliers, and the weaknesses in the many other multipliers means that the full impact of government expenditures is never what one expects the multipliers to be.

The question that is of supreme importance, therefore, is what strategy should the governments pursue? Should the governments lead via government expenditures? Or should they lead via taxes? Whichever one they take on, it creates a role for government that is laced with controversy. The pivotal question still is, what is or what should be the role of government in the economies? In small economies, many advocates argue that the governments must play a pivotal role.

Many other persons claim that governments should stay out of running the economy and should merely be the helper of the last resort. This is the small government or ***minimalist*** role of government. According to this minimalist view, tax cuts should be instituted when the macroeconomic conditions in the economy call for expansionary fiscal policy and for reduction in government expenditure when there is a need for a restrictive policy.

Here again, the rhetoric is far from the reality. Most politicians in the OECS are of the view that they are in office to spend to enhance the general welfare of the people They see their roles as fiscal expansionists, and not as fiscal "restrictionists." They operate in a liberal frame, not a conservative vein. The region's pressing needs are such that the politicians have to deal with poverty eradication or elimination, improved health care delivery, particularly as it pertains to HIV/AIDS, improvement in educational advancement, better schools, efficient transportation, improvement in and more housing, safer streets and cleaner environment.

The underpinning and prevailing view among many persons on the public sector side and a growing number of persons in the private sector is that the governments should spend, and should increase government expenditure primarily because the economies of the OECS need to be stimulated. Regional entities have taken up the battle cry and are calling for "adjustment and stimulation." Note the consistent call of the Eastern Caribbean Central Bank on this issue. Linked to increased spending is also the suggestion that improved public services should be paid for by increasing taxes. In a nutshell, therefore, what all of this reduces to is the following: Some people believe that governments in the region are only geared to self-perpetuation of themselves. The argument against "big"

government is that those who decide to be in government simply want to lead big governments to line their pockets. So the argument goes.

Such an argument invariably comes from the private sector and the opposition members. But, in all fullness, the glass is either half full or half empty. It is easier to play a cricket match in the stands than when you are at the pitch.

The leaders in the private sector think that they could do better than the leaders in the public sector. At the end of the day, however, from our ***close observation*** of the private sector over the last few years, the OECS private sector is not fully equipped to take the bull by he horns and turn around the OECS economies. It is our view that were they in the driver's seat, they would also spend to move the countries along some given growth and development trajectory. The opposition would do likewise, given the opportunity.

GOVERNEMENT EXPENDITURE (Other Issues beyond Fiscal discipline)

In the OECS there is a clear thinking among the political directorate that economic performance in their respective countries must be linked to political, legal, institutional and social artifacts. Development is not taken for granted. Development is pushed or allowed to move forward depending upon the notion of the given party in power. As we have shown in the case of St. Kitts and Nevis, even though one party favors a liberal, democratic, people-oriented path, and the other favors a liberal, capitalist path, the institutionalization of the government is still at peak performance under the regimes when they are in office. It does not matter which party is in power. The role of government is at a very high level. The case of rhetoric versus reality comes into play when we consider this issue of government expenditure and its associated discipline.

Economic development is the OECS is not seen as a mere movement from underdevelopment, to some Rostovian take-off, to some self-sustained growth. Most of the political leaders are of the view that any kind of economic growth in the OECS has to follow some direct involvement of the government in the creation and evolution of institutions in which the government has some definitive say.

The debate about the role of the government and the role of the private sector is best captured as one of response and reaction. The public sector reacts and the private sectors responds. The public sector responds, the private sector reacts. This significant fact makes it possible for the public sector and the private sector to squabble back and forth, and at the end of the

day come up with some compromise. In many respects the compromise is by default. However, today some countries in the OECS are including the public sector in their decision-making when it comes to the preparation of the annual budgets. St. Kitts has been doing this for years.

Nevertheless, there are no institutional rules that say how the governments should spend and why they should spend. What is left is an ad hoc set of rules developed by external financial institutions that state that if given ratios are breached, then economic hell and damnation will visit the countries that dare break the sacred ratios.

In some instances, while recognizing that countries in the OECS are doing their utmost to make ends meet, there are still off-handed comments. In such instances, what is said is more powerful than what is not said. Take, for example, an excerpt from the most recent IMF 2003 Article IV Consultation with St. Kitts and Nevis.[1]

> ***The overall fiscal deficit including grants rose to 16 percent of GDP in 2002, mainly due to higher capital expenditure, net lending to public enterprises, and higher interest payments*** **(Presumably on debt?...The note did not say).** ***Primary expenditure out-stripped revenue growth by 5 percent of GDP, increasing the primary deficit to around 9 percent of GDP. To meet its financing needs, the government borrowed from regional banks and issued paper in the Regional Government Securities Market (RGSM). This allowed it to remain current on all obligations to domestic and external creditors and suppliers.***
>
> But, now comes the coup in the following statement.
>
> ***Public debt rose by around 18 percentage points in 2002, to nearly 160 percent of GDP, reflecting the deficits of the St. Kitts central government and the Nevis Island Administration, the losses of the sugar company (3-4 percent of GDP annually) and of other public enterprises.***

[1] "Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of the Executive Directors, and this summary is transmitted to the country's authorities. [A Pubic Information Notice is then released…which in essence summarizes the views of the Executive Board as expressed at a given time]. [See IMF, ***Public Information Notice***, PIN, External Relations Department, October 24, 2003].

The intriguing feature about this comment is this, the IMF recognizes that St. Kitts and Nevis is doing something to help itself. It recognizes that the government has to spend. But by giving the impression that since the debt to GDP ratio is 160% percent of GDP, it looks as if the country is not doing anything to help itself. Clearly the IMF recognizes that many man-made disasters are fundamentally responsible for a significant quantum of that debt to GDP ratio. And clearly the IMF gave kudos to the country for floating bonds on the Regional Government Securities market. But yet, an off-handed note sends notices that if the vaunted Debt to GDP ratio is breached, then tie your fiscal tubes.

Many countries in the OECS have been following, under duress or under self-imposed discipline, IMF-type rules and regulations as far as government expenditure is concerned. The problem is this. The political directorate recognizes that they have a role to play in the eradication of poverty, in the expansion of economic growth, and the improvement of the welfare of the masses. In all of the political manifestoes of the parties in the OECS, all of them strive for economic growth and development. And all of them strive for a growth and development in which they have some role to play.

While this may not sit too well with the die-hard private sector persons, and those who subscribe to a minimalist role for the state, there is an abundance of evidence that economic growth alone is insufficient to eliminate poverty. Some state or governmental directives have to be institutionalized.

Donald G. Freeman (2003, p. 358), in "Poverty and the Macroeconomy: Estimates From U.S. Regional Data," pointed out in no uncertain terms that "it is clear that economic growth alone has not been sufficient to eliminate poverty (even) in the United States." It did not matter whether one used time series data, pooled times series or other econometric specifications, it was still obvious that the eradication of poverty in countries could not be left up to the whims of economic growth only. While there were clear evidence that there is a positive link between the unemployment rate and poverty, there was also a negative link between an increase in the mean income and a decline in the poverty rate.

Specifically, using "pooled time-series cross-section estimates of nine census divisions, each 1-percentage-point increase in unemployment rate results in an 0.5-point increase in the poverty rate, and each 1-percentage-point increase in mean income results in a 0.25- to 0.33-point decline in the poverty rate." (Freeman, 2003, p. 370). "The principal policy implication of this...is that for the poverty rate, the macroeconomy - particularly

employment conditions but also increases in mean income - still matters and always has." (Furthermore), "A strong macroeconomic environment appears to be only a necessary condition for reducing poverty; further progress may require ***measures beyond the scope of macroeconomic policy.***" (Freeman, p. 371, our emphasis).

We wish to make it patently clear. For the small countries in the OECS, measures beyond the scope of the macroeconomy must be put in place to lift the economies and many persons out of the persistent poverty that befuddles them and traps them in a world of destitution.

When the OECS countries spend, they are not all spending on questionable grounds. Some of the spending may be questionable in terms of the manner in which it was spent. But, by and large, when the countries spend, for the most part, they do so because of their commitment to eradicating poverty, improving the welfare of the lives of many of their people, and making more people taste what a few experience every day. Oftentimes, in the process of this expenditure, the countries run a foul of the vaunted ratios of International Institutions. But the questions must be asked: Do these ratios have human faces? Are they merely ratios of illusions? Are they just ratios of restrictions? Or are they intended to be guidelines for future discipline? Sometimes it appears as if the ratios are like swords of Damocles over the proverbial heads of the people of the OECS.

Peter G. Klein and Hung Luu (2003) make a very important point in their article "Politics and Productivity." Their main contention is that "countries with lower taxes, milder regulatory burdens, lower inflation, fewer restrictions on foreign ownership, and so on are likely to produce output more efficiently than countries with policies that restrict production, inhibit capital formation and reduce competition." (Klein and Luu, 2003, p. 434).

The OECS is caught between a rock and hard place. Many of these features are in the region at varying levels of institutionalization. The one good thing that the region has is its level of political stability. Except for the one aberration of Grenada in the 1980's, there has been political stability in the region. And as Klein and Luu (2003, p. 434) note, "economic freedom and political stability affect economic performance by enhancing technical efficiency. Now, one is not saying that technical efficiency is at any marked level in the whole of the OECS. But, there is clearly some evidence that foreign direct investors feel comfortable investing in the region, because hey see some levels of efficiency in some sectors. Witness the increasing investment in tourism plant in Antigua, St. Lucia and St. Kitts and Nevis within recent years.

If foreigners are willing to invest in the OECS, then it behooves the governments to put in place the requisite infrastructure. Thus, in a nutshell, the works of Freeman, Klein and Luu center on the conclusion of the latter two authors. They contend that "they are convinced that productivity analysis can benefit from a closer study of political and regulatory institutions, and that the new institutional economics can benefit from more explicit theorizing about the channels through which institutional factors affect aggregate performance." (Klein and Luu, 2003, p.445).

We now turn to tax reform in the OECS.

TAXES REFORM

Over the last 20 years the countries of the OECS have gone through a series of ups and downs relative to where they want to go in terms of economic growth and development. The one factor that has seen a myriad of changes is taxes. There are a multitude of taxes and tax heads in the OECS. It almost appears as if taxes and tax heads have become a game. How do we introduce a new tax head in the fastest possible time? That seems to be the question of note. How do we recapture revenue lost when we eliminated a revenue head that was revenue enhancing, for one that is now revenue hemorrhaging?

There are many problems with the taxes and the tax heads in the OECS. We note, ***en passant***, five of the problems, but simultaneously five of the opportunities to make a new start.

First, it is extremely difficult to administer the myriad of taxes in the region. The efficiency in terms of revenues to administrative costs is decidedly in favor of costs. In other words, on average it is costing the governments in the region more to collect taxes that they are collecting in revenues. This has developed as a result of the whole panoply of taxes as well as the variety of ***nuisance taxes.*** [For a comprehensive discussion of these issues, see ***New Approaches to Taxation and tax Administration in the Eastern Caribbean Currency Union***, vol. 1: A Framework for Tax Reform, OECS Tax Reform and Administration Commission, June 2003]

Second, there are too many archaic, sub-optimal structures in place, as far as tax administrative procedures are concerned. Linked to these administrative procedures are impediments in the tax systems that seem to be obtuse at best, convoluted at worse.

Third, there is a need for more and greater transparency in terms of tax collection. There is too much scope for malfeasance and misfeasance in the systems. As a result of these lax features in the administration of the tax systems, persons and businesses are generally

enticed to push the envelope of tax evasion far from the envelope of tax avoidance.

Fourth, taxes and the associated system of administration are handicapped and hampered by the too liberal displays of political interference and discretion in terms of how the full impact of taxes is administered. Hence, the neutrality and impartiality that taxes should have are not there in the first instance. When there is some semblance of neutrality in place, the technical capacity of the administering officers leaves much to be desired. Thus the optimal return of the revenues are far removed from what is possible under first best principles.

Fifth, it is to be noted that all of the countries are at a distinct disadvantage when it comes to dealing with complex, path-breaking tax cases. The private sector seems to have the upper hand in this regard. The private sector is able to procure the best tax lawyers, while the public sector has to depend on the up-from-the-ranks, routine civil servants, to deal with complex, complicated tax issues. This does not mean that some of the public sector offers are not very skilled at what they do. It means that there is clearly an asymmetrical relationship in terms of the knowledge base and technical finesse that both sides of the tax divide have.

The upshot of all of these challenges is the fact that the public sector finds that it is constantly and consistently confronted with an extremely high cost of doing business. What should normally be less expensive in terms of running a government in the OECS is particularly expensive. It is expensive because of the many loopholes, weak institutional structures, deliberate efforts to undermine by some segments of the population, and more skilled abilities put in place by some in the private sector so that they can defeat the public sectors in what is construed as tax gamesmanship. What should be done about taxes and taxes reform in the OECS? For this we turn to regional cooperation.

REGIONAL COOPERATION

In this last section we will offer some ideas based on our discussions thus far. We will couch the ideas in terms of the necessary fiscal reform in the OECS. By way of a thrust we will refer to ***the need for the countries to adjust and put in place a stimulus package.*** We close by arguing that while other policies could work, and while a combination of other policies may be

put in place, ***fiscal reform in the OECS is a sine qua non for economic development***. Of necessity, that reform must take into consideration elements of the three features that we offer in this paper, namely ***expenditure reform (including fiscal discipline), taxes reform, and regional cooperation.***

Over the years chronic public sector deficits and exponentially rising government have been of signal concern in both developed and developing countries. In small, microstate economies, like those in the OECS, the concern about fiscal imbalances are always on the agenda of discussions. Fiscal imbalances tend to siphon off scarce funds from the private sector; fiscal imbalances tend to retard economic growth, and in train depress standards of living. Fiscal imbalances impose heavy intergenerational burdens. Fiscal imbalances can escalate into scenarios where global market forces seriously imperil small and large states.

In the OECS, fiscal imbalances and weaknesses in taxes and tax administration have generated a cloud over the development of the region. While some countries are doing well, some know what hell is like or some see hell in the distance. As they march along razor-thin edge of existence, there is no doubt that controlling government deficits and debt are fundamental to their long-term survival. Debt to GDP levels, if left to run at will, could impair all positive growth prospects, and could in the final analysis lead to financial crisis and disruptive economic systems.

This suggests that fiscal reform is a must. Without this the OECS as we know it today could be under the gun of others for a long time to come. And when the degrees of freedom to make your economy right is placed in the hands of others, you are not sure what the final outcome will be. It is in this light, therefore, that we close this paper on the issue of regional cooperation.

The OECS is a small region, from the point of view of population and GDP. The countries are sufficient close, and sufficiently integrated for there to be a higher level of integration. The role of the state will continue to be of magnanimous import in the OECS for the foreseeable future. In many of the countries, the private sector depends on the public sector for over half of their existence and livelihood. That being said, it suggests that across the region, the sates should cooperate in their spending and taxes regimes to support and to shore up each. Expenditure discipline is vital. Countries should so organize their fiscal affairs that what they do are done to enhance the entire region, and not to harm the region. Murmuring is heard about contagion, and thus far overt contagion has not reared its ugly head from one state to the next. But it must be clear that behind the scenes, some

international institutions look with disdain when anyone country in an Economic Union or Currency Union is off track, relative to the others. So, in this regard, there is contagion, although it may not be agenda item one.
The states have no choice but to play a maximally efficient role because the private sector, despite all of the grumbling, and protestations to the contrary, have not demonstrated, in no uncertain terms, that they could do any better than the public sector. In this instance, taxes and tax reforms come into play.

There ought to be greater regional cooperation in tax reform, taxes, and tax administration. Customs, Inland Revenue Departments across the region should be more closely knit. This is not to say that there should be a super-agency for customs and Inland Revenue. No, the idea is that they know be all well versed in the latest techniques of tax administration, forensic accounting, be able to identify tax fraud and be themselves sufficiently trained to be on part with those luminaries who take pride in pushing the tax avoidance envelope close to the tax evasion fire.

Regional cooperation in this case suggests that some level of sovereignty will have to be given up. But, in the last analysis, that is what regionalism is all about. If the OECS were to move forward without the strictures of international institutions being imposed on them, they would have to do for themselves and not let others do for them. They would have to clearly contain expenditure, but at the same time not balance budgets on the backs of the people. The public sector will still have to play a decisive role, but at the same time not shutting out the private sector.
Over the next several years, there ought to be a fiscal program across the OECS that seeks to on a permanent basis, and on a supremely efficient way, the gulf between aggregate expenditure and income in the countries. Second, inflation, though not a major problem, should still be kept under wraps, since this could distort the debt profile of the countries. Third, the countries should all try to generate and develop stable macroeconomic environments that are conducive to economic growth. This suggests that the OECS Secretariat and the Eastern Caribbean Central Bank would have to play more decisive roles in advice to the respective states. This may seem as if staff workers are being encouraged to make decisions for CEOs. But at the end of the day, all of the fiscal adjustments in he OECS, all of the fiscal reforms on the region, any monetary reform in the Currency Union will require fiscal adjustments and major tax reforms, and effective tax administrations.

In the final analysis, this call for a regional approach to fiscal reform is scoped on the grounds that as we look at the expenditure of the OECS, the taxes, the relationships to the many macroeconomic data, as illustrated in the first part of this paper, it is clear that all is not well in Camelot. The OECS is

blessed with a system where the exchange rate regime and he monetary arrangements of the ECCB have been, and we suspect will continue to be, of tremendous import to the region. The major fly in the fiscal ointment is the imbalances in the system. Imbalances in spending, necessary though some of the spending is, and imbalances in debt, necessary though some of the debt is, cannot be allowed to go on forever, as they have happened in the past. By serendipity the region has maintained levels of price stability. Investor confidence is still reasonably high. Economic growth is still positive, all things being equal. If, however, the region is to grow without unfettered fiscal detriments, fiscal balances must be sustained, debt structures must be managed better, the financial system must be organized some more, and there should be a greater degree of capacity building in the OECS among the professionals and h technocrats who have to ensure that the fiscal system functions, and functions efficiently. In our view, a reform of the fiscal system, bearing in mind that the state cannot be a minimalist state, is a sine qua non for stability, growth and development in the OECS. While our focus was set specific to the OECS, we are of the view that many of the points made in this paper are applicable to small, microstate, economies everywhere.

From a policy perspective, the paper suggests that the countries of the OECS should pay closer attention to their macroeconomic aggregates, and in very simple, but efficient ways look at the internal ratios as parameters and guidelines for planning. The focus should be on expenditure, debt, taxes and regional cooperation to fit in the fiscal matrix. The policy makers should seek to retrofit the economies along the suggested lines, thereby recharging the "fiscal batteries", and use fiscal reform to stimulate economic growth and development.

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