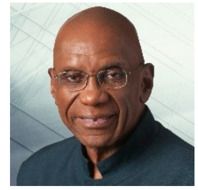
Economic Letter March 2025



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Making Sense of Government Finances

On February 11 the Barbados Government laid in Parliament a document showing its intended finances for the fiscal year that begins in April and ends on March 31, 2026. On the cover page of the document it states that the excess of expenditure over revenue is expected to be the equivalent of US$600 million, or about 8½% of GDP. What are we to make of this number?

We know that the government is living within its means when the tax and other revenues are sufficient to cover current expenditures, including all wages, purchases of goods, supplies and services, subsidies and transfers to statutory bodies and individuals, interest payments and depreciation. This is the balance on the current account, and prudent management suggests that current expenses should always be fully covered by current revenues, with something extra to contribute to capital expenditure projects.

When the government maintains a surplus on the current account we know that all borrowing is for roads, ports and airports, hospitals, schools and other public facilities. All government loans are devoted to capital expenditures that improve public services and improve the attractiveness of the economy to local and foreign investors.

Other concepts of the government deficit are often found in public discussions. The overall deficit is the difference between government revenue and total expenditure, the sum of current and capital expenditure. The overall deficit is less informative than the breakdown into the current balance and capital expenditure. Government finances will not be sustainable if the government maintains an overall balance at the expense of capital expenditures which are essential to maintain the country's international competitiveness. Loss of international competitiveness because of deteriorating infrastructure and public facilities results in economic stagnation, declining government revenue and shortages of foreign exchange.

A third concept, the primary balance, is of interest to the IMF and international lenders mainly. It is the difference between revenue and expenditures other than interest payments, that is, the amount that is available from government revenues to meet interest obligations. However, the primary deficit does not tell us whether the government is servicing debt at the expense of other government priorities, either on the current or capital account. Should that be the case, the government finances may not be sustainable, even though the primary deficit is in surplus.

Let us now return to the deficit as announced by the Barbados Government, which uses none of the above definitions. In addition to all current and capital spending the Barbados government adds to expenditure the total of all debt that matures in the 2025/26 fiscal year. The amount of US$600 million is the total required to finance the overall deficit for the fiscal year plus the amount of debt that will have to be repaid or refinanced.

The most informative indicator of prudent management of government finances in the interests of economic growth and balance of payments stability is a small surplus on the current account, together with affordable local and international borrowing to finance capital expenditures. The other measures of the deficit have more limited usefulness, and are of interest mainly for borrowing strategies and debt management.

My Economic Letters may be found under "Commentary" at DeLisleWorrell.com.