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NEWS



Not Too Small

Not Too Big

A Right-Sized Government



The events and developments taking place in our world provide us with numerous teachable moments.

Mr Tax Man



However, the lessons that each of us will take from these events are up to us. Our world is the greatest teacher, but sometimes we are not the best students, which is why we continue to re-live the past of generations gone by.

My Meetings with Bill



Your Financial News continues to strive to capture tiny snippets of the many lessons from our universe. In this issue we explore issues related to taxation, government spending and the size of government.

Enjoy!

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Not Too Small,

Not Too Big.

A Right-Sized Government

S. L. Welsh

The book, "A Simple Government" by former Arkansas Governor, Mike Huckabee, has as its subtitle "12 Things We Really Need From Government (and a trillion that we don't)". This sub-title struck me as being particularly interesting, given the numerous things that governments in this part of the world are called upon to deliver on:

1. *Tourism*
 2. *Education*
 3. *Health Care*
 4. *Agriculture and Fisheries*
 5. *National Security*
 6. *Social Security*
 7. *Social Services*
 8. *Public Finance*
 9. *Consumer Affairs*
 10. *Trade, Industry and Commerce*
 11. *Air and Sea Ports*
 12. *Customs*
 13. *Statistics*
 14. *Prisons*
 15. *Justice and Legal Affairs*
 16. *International Affairs*
1. *Foreign Affairs (including Embassies and International Representation)*
 2. *Environmental Affairs*
 3. *Community Development*
 4. *Cultural Development*
 5. *Youth Affairs*
 6. *Gender Affairs*
 7. *Public works*
 8. *Utilities*
 9. *Housing*
 10. *Sports*
 11. *Labour*
 12. *Immigration*
 13. *Information and Communication Technology*
 14. *Human Resource Development*
 15. *Postal Services*
 16. *Etc, etc, etc...*

I am not sure how this list can be narrowed down to 12. Certainly there are 'things' that can be effectively absorbed by the private sector. However, there are other 'things' that may not be private sector oriented - either that they are not profitable for the private sector, or the cost to the end-user would be too onerous to bear as a result of not having a large population over which the costs

can be spread more effectively and efficiently.

Additionally, the private sector may not have the capacity to deliver on some 'things' or may discriminate in the provision of a particular service, hence the reason for a not so simple government in my part of the world.

The quandary, however, is that the bigger the size of government, the more money required to fund government activities and hence increase government spending, which leads to increase deficits, which in turn leads to increase taxation and /or borrowing.

Is there a middle ground between simple and big government for us in this part of the world?

One would not want a government that is too simple and hence under-delivers on its mandate or too big and by nature, crowds out private sector initiative and runs up a huge operational bill that must be funded by taxpayers.

I feel like goldilocks when she looked at the beds and said, 'This

A Right-Sized Government *Cont'd*

one is too small'... 'This one is too big' ... 'This one is just right.'

Like everyone else I would like to hold on to as much of my hard earned dollars as possible - *The tax man is not included in my circle of friends.*- However, like everyone else I want to live in a country where critical infrastructure and services are provided for to allow me to pursue a good quality of life.

I am not looking for government to do everything, I am just looking for government to do those things which are necessary for sustainable economic and social development. It is not just about how much money is spent but where it is spent. Right-size for me, is about doing the right things with the right amount of money.

In my part of the world where the private sector can be characterised as small and developing, I need a government

to do more than 12 of the right things. But am I asking for too much, especially when I consider the following quote from Thomas Jefferson which has me revisiting my list of what I want a government to do?

“A government big enough to give you everything you want, is strong enough to take everything you have.”

Thomas Jefferson

Mr Tax Man



YFN: If you are looking for hot topics, **taxation, the size of government and government spending** are high on the short list. So in this issue we have placed economist and central banker, John Venner in the hot seat.

Hi John welcome to YFN.

John: Thanks.

YFN: John, here are the questions we want to throw at you, so let's get started:

- *How can a country strike the right balance when it comes to the issue of taxation?*
- *How much of a person's income can be considered as a reasonable amount to be directed to taxes versus funding personal consumption and investments? And,*
- *What do the public need to understand to appreciate the purpose and value of taxation?*

John: Well, the starting point in this discussion has to be about the role of government. What role do we want our governments to assume?

Let's look for example at taxation in Europe; particularly in the

Scandinavian countries - Sweden, Denmark and Norway- where taxation is very high (*many people pay 50% of their income in taxes and some even pay up to 60%*). The reason for this is that Scandinavians have apparently come to a decision that they want good public health care, good public education, and good social services, and are willing, literally, to pay for these services (with tax dollars).

On the other hand, In the USA, the philosophy seems to be more private sector driven. People want to be given the freedom *“to pay their own way”* so to speak, and the tax rate, even though many persons are screaming

Mr Tax Man Cont'd

about it, is much lower than in the Scandinavian countries. So it all boils down to what communities want and what they are willing to pay .

Similarly, in this region we have to decide what we want and open our wallets accordingly. Just this morning I was listening to the sports news; volley ball wants a stadium, basketball wants a stadium, culture wants a stadium, and all those things are good, but the question is; how do we pay for these? And when do we pay for these?

So on the one hand a person will say *‘I want to endorse a high level of public services’* while on the other hand *‘I want lower taxes and I don’t like the debt situation’*. Clearly there is a mismatch.

YFN: So, how do we strike the right balance?

John: One has to go back to the question of; ‘What is the role of government?’ Now, when you look at it, most people would say, ‘individually, we cannot protect our coastline’. Therefore, it behooves some central entity to protect our coastline. This would

involve the coast guard, and all that comes under the ambit of security. Note we haven’t yet made reference to the air force, police or fire services. All of these have a cost.

Then consider that in Anguilla the Federal Aviation Administration indicated that Anguilla needed a minimum-sized fire services at the airport for the airport to be recognised as an international airport. Subsequently, the number of persons in the fire service increased from 0 to 52. The government had to take on that increase in expenditure, in spite of the revenue challenges faced.

Then there is the ferry service between St. Maarten and Anguilla. There are certain international safety standards that have to be met. As such the government had to increase expenditure in several different areas related to the ports to satisfy that criteria. And this is not a choice.

Then the U.K government advised Anguilla that it needed to focus on the probation and rehabilitation of its prisoners. This required the hiring of twenty eight probation officers.



These are just a few examples of the financial responsibilities that are either forced upon a government or are required of a government to meet international standards. And it is only through taxation that these expenditures can be covered.

Then there is basic infrastructure – like roads for instance. When you go to the USA or Europe or Canada, you drive on highways and they have tolls. In Jamaica they also have tolls. But just imagine driving on the by-pass road in a small island like St. Kitts and having to pay a toll. Is there sufficient traffic to pay off for that road? And the infra-structure of setting up toll booths is it worth the expense considering the small volume of users? So our public infra-structure becomes only the preserve of the public sector, given our small size. And that’s not going to change even if we integrate. The numbers will still be relatively small.

Mr Tax Man Cont'd

YFN: You raised an issue of small size. The question is, 'given our small size and that we still have to have infra-structure that meets international standards – *education, roads, airports, health care and other services* – can our population, adequately fund our public sector expenditure?

John: Only if we have very high incomes. If the economy of a country is based mainly on the production of low value goods and services, then the country is not going to generate the incomes necessary to finance its operations. So this speaks to the growth path of a country and the economic choices it has to make. A country cannot choose low-end agriculture and expect high-end economic health. The two don't go together.

YFN: Could some of the services that governments provide be re-directed to the private sector?

John: Yes, but it is not so cut and dry. I'll use Anguilla as an example once again. The government sought to privatize health services, but then certain responsibilities still required the over-sight of the ministry of health, so therefore

they weren't cost savings in a sense, the government still had to transfer funds to the health sector and still had to maintain areas in this sector.

The only way out that I see, for small countries to get around the size challenge is through greater usage of technology.

Consider that in a small country with a population of 12,000, a statistical department has to provide the same services as a country like Jamaica with a population of approximately 2.9 million or the United States with a population of approximately 300 million.

Now in the country of 12,000 there is a much smaller base on which to pay for this service. So the only way to really accomplish this in a cost efficient manner is to leverage technology.

YFN: But John, aren't you introducing another capital expenditure for governments in relation to the acquisition of the technology? Also remember that technology changes so fast that one may be forever playing 'catch-up' – forever buying without the broad tax base to support this

ongoing expenditure. Are small islands in a catch 20 situation?

John: Not necessarily. You don't always have to keep up with every version, for example, of Microsoft Word as it comes out immediately or whatever new technology that may exist. You make an investment up front and you say *"ok, look, I have invested in this in 2011, I am going to keep it for 5 years."* then you train the people accordingly and utilise the software.

You have to have the discipline to say, "I don't have to get the very latest version, 'because it is not going to give that extra value added immediately. So you can hold strain for a couple years. Then make a decision to move on to the next version. So it's that sort of process.

In St. Vincent and the Grenadines – I think they're making a good move in terms of inviting engineers from India to come to the island and conduct software classes for the citizens. The objective is to focus on ICT development as opposed to just ICT consumption. So what they are hoping to do in St. Vincent is have the Indian engineers train the citizens on how to develop and market

Mr Tax Man Cont'd

software products. This will ensure that a level of technology capacity is developed in country.

YFN: In relation to tax regimes, can one make a qualification as to which regime - low tax or a high tax regime - provides the framework for a better quality of life for taxpayers?

JOHN: Both have their share of problems. In the region we have, for example, Anguilla which is a low tax jurisdiction with high end tourism and off shore services. However the downturn in the global markets adversely affected that country. The countries in the region with higher taxes did not fare any better.

So it is not a matter of one regime being better than another. Again these things are eclectic depending on the nature of the country, what you dealing with and what hand God has dealt.

Each country has to be savvy in terms of recognising potential problems. So a country has to conduct its own risk management. Stress test, may be a better phrase. And then the country has to be nimble considering “these are the risks.

They are real. They could be real. And therefore, there is a need to insulate the economy from these risks” Diversification of the economy or increasing productivity or pursuing the development of high-end jobs may provide risk mitigation solutions.

In the case of Anguilla, the country depended mainly on a particular clientele from a particular country and so there were not ‘many degrees of freedom’ in which to manoeuvre’ during the global economic downturn.

Economics is a messy business. And it is not a clean science. It is not to say that once you do these things, everything will be okay. And you have to be on top of your game every day. When you think you have it made, things will change under you and sometimes it is when you are involved in it that you fail to see the issues.

That’s where the IMF comes in as a useful partner, in the sense that when countries and policy makers are involved in something everything seems okay to them and so they may not be very good at identifying

Impact	Extreme/ Catastrophic	5	10	15	20	25	30
	Major	4	8	12	16	20	24
	Moderate	3	6	9	12	15	18
	Minor	2	4	6	8	10	12
	Insignificant	1	2	3	4	5	6
		1	2	3	4	5	
		Remote	Unlikely	Possible	Probable	Highly Probable	
		Likelihood					

and quantifying the risk. Hence the need for external evaluation.

The Fund provides that level of evaluation. One may not always agree with the solutions provided by the Fund, but at least their diagnostics are fairly useful in terms of assessing the situation. So for countries and institutions it’s very important to have that external evaluation to be able to assess what one is doing because when one is intimately involved it is very hard to be objective.

YFN: Is it possible to have a flexible tax policy which moves up or down to address economic imbalances? Or is it that once the tax rate moves up, there is no downward trajectory?

JOHN: That has happened in some countries.

The bigger issue, however, is the

Mr Tax Man Cont'd

The Debt Trap need for countries to save in good times. One of the problems noted is that in good days (in times of surplus) there are lots of pressure on expenditure and most countries do not save.

But expenditures and wages keep creeping up all the time. So when an economy is experiencing a downturn, there is not that level of flexibility in terms of reducing the tax to stimulate activity, because expenditures have grown beyond where they should be.

Governments need to have the discipline to make sure that there is not too much FAT in their expenditures, be it in terms of wages, which takes up almost 50% of the expenditure; or transfers to statutory bodies which eat up a lot of government revenue. Governments also have to manage their debts even in the good times.

Many times when a country is doing well, the thinking is that the government does not have to be tight in terms of the type of debt it contracts and therefore when the downturn

comes the country finds itself with these exorbitant interest rates that consume significant revenue. That is normally the rub.

But basically, governments' role in addition to ensuring national security is to have countercyclical policies so that when things are in a downturn governments will be expected to introduce stimulus packages – either in terms of expenditure increase or tax reductions.

Most countries are not in a position to do this because of the lack of savings. Spain was able to be in a strong position to address problems with its banking system because during periods when the banks were profitable, the government creamed off some of the funds from the profits and set aside as savings. When banks ran into trouble with this recent global financial crisis, Spain had funds to basically protect its banks.

So there are countries that have shown that level of forward thinking while other countries seem to operate day by day, in terms of thinking that it's the next political cycle that will have this problem and therefore there is income to spend, and it WILL be spent, sometimes albeit in

response to voter pressures.

YFN: Is there such a thing as tax payers being over-taxed?

John: Yes. The point at which a worker decides, 'look it doesn't make sense putting in the extra effort because, I am not receiving the true worth for my efforts, so why be more productive.' When extra effort is not rewarded commensurately, it becomes stifling. Productivity decreases.

And remember no country is a country unto itself. Other countries are competing for workers.

YFN: So in such a case, this can trigger an exodus of skilled labour from a country?

John: Right. A country can tax itself out of skilled workers, so one also has to look at the taxation system in terms of worker productivity.

YFN: How can a government strike a balance between; the expectations of people (*what the government must provide*) and the income to fund these expectations. This seems to be a real tight rope for governments to walk, especially in small

Mr Tax Man Cont'd

developing countries where this dilemma appears to be more pronounced given the population size constraint.

How do we bring about that mental shift where we're not looking to governments to be the "be all" and "every all"?

John: Well one has to view this from a financial basis. Governments spend our money, so therefore if we ask for a certain stadium or an athletic track, it is not the government paying for it, it is we, the taxpayers. Hence there is a need to discuss what we want, what we can afford, and what we are willing to pay. This is why the national economic councils (Tripartite committees) were established; to foster discussion as to what the country can really bare.

We need to have those discussions in the public to understand that if this sector is going to get this concession or if this road is to be built – it is coming at a cost, and we must weigh the costs versus the benefits.

For example given that in our region a physical toll booth may not be a cost effective way to pay

for a new road then that road must be paid for through some other form of taxation.

Then one has to evaluate the cost benefit of the proposed road – what is the 'spin-off' going back to the issue of productivity? So for instance, if one is driving through the capital, in the absence of the new road, one may spend 15 minutes idling. Consider the pollution, the time wasted, the gas consumed, the deterioration of the car and frustration – All these things have a cost. Now if the construction of a new road can eliminate these frustrations then the benefits must be factored into the decision related to the construction of the new road -

The less time people spend getting from one place to another is the more time they can spend with their family or at work and therefore productivity would have increased. So the social impact must be evaluated. But even after taking into consideration those non-financial areas, the road still has to be paid for, so that productivity has to be translated into something profitable.

Therefore **when a country devises its public sector investment programmes, it has to ensure that included**

are some very strong programmes that are going to generate significant financial returns to pay for the social programmes.

In St Lucia, St Vincent, Dominica, when these countries borrowed from the Caribbean Development Bank (CDB) to put in what they call 'Feeder Roads' to increase access to agricultural lands, the governments did not get a revenue from the specific 'Feeder Roads'. However, by increasing banana exports, more revenue was generated which in turn came back into the government coffers thus providing the government with the income to repay the loan for the Feeder roads.

The key therefore for governments is to have well thought out and developed Public Sector Investment Programmes (PSIPs). This would allow for a mix of projects (social and financial). The prisons don't generate income, schools don't generate income, but there are some very good projects that would open up infrastructure or airports which will increase tourism traffic and this will allow for income to be generated to fund the social projects– *health care, schools, roads.*

Mr Tax Man Cont'd

There is a need for us to look at our economies in a holistic fashion and see how each one links to the other. So one project might be revenue based and one might be expenditure based but there has to be a connection. Hence, **taxation polices cannot be done in isolation. A government has to look at the total economy and assess the levels of productivity, export, education etc.**

Additionally this is not an issue that should be dealt with it on a budget cycle in terms of 1 year. It requires a long term plan which is based on a thorough assessment of where the country is, and where we want it to go.

One of the deficiencies in our region is that we don't have 10 or 20 years plans, I think China has a 50 year plan. And every couple years they look to see if it's in alignment.

In our region we don't have that projection – in terms of what we're capable of, where we want to go and have consensus on how to get there.

There is a need for us to foster a

level of public discussion to evaluate projects by asking some key questions—

- Is this in the national interest?
- How will this affect the economy in 5 years going forward or 10 years going forward?
- What are the implications for the individual as a constituent public?

These issues must permeate our discourse.

ABOUT THE INTERVIEWEE

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Managing Resources



Brain Teaser

The old saying goes

“Time is Money”.

It follows therefore that a good time manager is a good money manger.

How good are you with managing the resource, time (money)?

Solve this brain teaser.

The Singing Contest starts in 17 minutes. The Voice Choral has a four-member choir seeking to win, the prize money of \$2,000.00. The

members must all cross a bridge to get to the Singing Contest, which is on the other side of the bridge.

All four persons begin on the same side of the bridge. You must structure their trips so that they get to the other side within 17 minutes. It is night. There is one flashlight. A maximum of two people can cross at one time.

Any party who crosses, either 1 or 2 people, must have the flashlight. The flashlight must be walked back and forth, it cannot be discarded.

Each choir member walks at a different speed. A pair must walk together at the rate of the slower man's pace:

John	1 minute to cross
Mary	2 minutes to cross
Luke	5 minutes to cross
Peter	10 minutes to cross

For example: if John and Peter walk across first, 10 minutes have elapsed when they get to the other side of the bridge. If Peter then returns with the flashlight, a total of 20 minutes have passed and you have failed the mission.

Note: There is no trick behind this. It is the simple movement of resources in the appropriate order. There are two known answers to this problem. There are no tricks to this like meeting halfway or anything.

Good luck!



My Meetings with Bill

S.L.Welsh

*I don't have a problem
meeting my expenses;
They are everywhere.*

*I am not sure if it is the same
for you?*

*But for me this much is true;
Everywhere I go, I meet **Bill**.*

*I go to sleep with my lights on,
I meet a bigger electricity **Bill**.
But I guess it is better to sleep
with lights on
and meet big **Bill**,*

*than to sleep in darkness
and meet up with the big bad
boys from over the hill.*

*I go to the supermarket, yes,
you guessed it, I meet **Bill**.*

*Jane says that Bill changed his
name to VAT.*

But I say no, it is not that.

*VAT is what **Bill** is eating to
make him so fat.*

*But he is still **Bill**, just a bigger
Bill.*

*I say everywhere I go, I'm
meeting **Bill**.*

*I get sick, I meet **Bill**.*

*But, I am going to the doctor
still.*

*Now, get this message in your
head.*

*Money is no use to you if you
are dead,
so don't cut spending when it
comes to your health.*

Bills, Bills, Bills to pay

*If I am to keep up with you, I
need more pay.*

*Everywhere I go, I am meeting
Bill.*

Bill, Bill Bill ... Why don't you
just keep still?

*I can't even keep two dollars in
my till.*

Now If I were to tell the truth

*I can't blame my financial
struggles on **Bill**,*

*for it is I who is responsible
for many unnecessary
meetings with him.*

*I go out with my peeps and
party like there is no tomorrow
and meet up with a pretty big
entertainment **Bill**.*

*I shop for clothes till I drop,
because I don't know when to
stop*

*and end up with a humongous
shopping **Bill**.*

*I chat endlessly on my cell
phone,
got to stay connected with my*

*pals while I roam,
and then find myself with a
huge phone **Bill**.*

*I plant pretty flowers but no
food*

*and so I have to buy
everything I consume
and hence the reason for the
size of my food **Bill**.*

*I must have that new
furniture set,
even though I know in my
heart of hearts I can't afford it
yet,
and end up with a ridiculously
big hire purchase **Bill**.*

Bill, Bill Bill...

*I can't believe you are with me
still.*

*Now, we wouldn't be meeting
with such frequency*

*If only I could just control how
I handle my money.*

*If I could just tell myself,
'enough is enough.'*

*No more frivolous
consumption, I don't need any
more stuff.*

*Then I can say ...'see you later
Bill."*

*Today we will not be meeting
each other.*