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The Implication of Capital expenditure on government borrowing and Public Debt: A Case of Fiji Islands

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Abstract: *This paper examines the link between Government capital expenditure and the government debt in Fiji from 2006 to 2020.The main aim of this study is to determine the impact of government capital expenditure on government debt. The regression analysis was used to find the results with data collected. The result displays a positive connection between government capital expenditure and government debt. Knowing these effects will help policy makers of this country to revisit its fiscal policy in order to decrease its debt and sustain it.*

Keywords: Government Budget; Government Borrowing; Government Capital Expenditure

1.0 Introduction

A country's budget has aspects of its expenditure segregated into the operating expenditures and capital expenditures. It is suspected that most developing countries have to tradeoff between capital and operating expenditures due to resource constraint and Fiji is no exception. It had been argued that Fiji Islands devote unnecessarily high allocation to operating expenditure to manage its over-grown civil services Furthermore, the allocation of these expenditure are highly dependent on the overall economic policy. Many at times, in a bid to become a progressing economy, central authorities unwillingly raise debts levels.

Fiji's total population stands at 884,887 where the annual growth rate are 0.6 % because of low birth rate and out-bound migration. In 2020, GDP for Fiji was 3.93 billion US dollars with 2019 GDP per capita of US$13853.40. The Fijian economic system is envisioned to shrivel by 1.3 % in 2019 among the worldwide slowdown, vulnerable domestic demand and low commercial enterprise self-belief, and 21.7 % in 2020 due to the Pandemic. The key groups concerned within the formulation of the Budget are; (1) the Ministry of Economy (budget coverage) (2) Fiji Revenue and Customs Service (sales regulations) and (3) The Reserve Bank of Fiji (fiscal coverage).

In the recent years, Fiji government has directed policy goals towards capital expenditure, in 2007 the capital expenditure increased from $169 million to $198 million, in 2008 the capital expenditure increased to $266 million, from $335 in 2009 to $340 in 2010 from $495million in 2011 to $534 million (r)in 2012,$ 711 million in 2013 to $866 million in 2014, $1263 million in 2015 then decreased to $1213 million in 2016,increased to $1383 million in 2017,decreased to $1134 million in 2018,$1098(r) million in 2019 and increased to $1208 (b) million in 2020..

Despite huge amount of capital expenditures, there is still a trifling stage of development witnessed. Public expenditure on all sectors of the economy is expected to lead to economic activity in the sense that capital expenditure will improve the productive base of the economic system which in flip will cause growth. The interest by economists and other jurisdictions on the role of government capital expenditure is still inconclusive.

Public debt is money owed through government or total debt of all governmental entities. Public debt is described as the overall financial responsibilities received with the aid of parliamentary groups of a country, which incorporates money that is owed to people, mutual funds, pension funds, overseas governments and others. Public debt is one of the methods of funding government operations; governments also can create cash to settle money owed as a way to keep away from interest payment, although creation of cash will most effective reduce interest price and will now not cancel the debt itself which can also reason hyperinflation. And in some other times government might increase tax a good way to finance debt reimbursement in the economy. Public debt is of two types: internal or domestic debt (due to financiers in the nation) and overseas or external debt (due to overseas financiers).

It has been found that there may be a correlation among government capital expenditure and government debt within the economy and that increase in deficit spending with the aid of government can even increase in the amount of debt. Government borrowing shrinks available funds and will increase the fee of capital, thereby inflicting businesses to abandon investment tasks within the economy. Similarly, if government spends greater than her receipts (deficit), her decision to borrow price range to finance that deficit will in most cases end result to crowding out of personal investments and deadweight loss on future taxation. This means that after governments borrow from financial markets, they efficiently crowd out different fascinated borrowers (personal traders) and compel

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them to pay higher interest costs which has the ability to discourage investment implicitly the better value of capital will then make the personal investors to abandon the enlargement plans that could have introduced superb financial final results. The multiplier impact of government spending has not helped out in counterbalance of impact of public debt within the economic system which necessitates in addition increase in taxes and places burden on current/future generations.

This study is guided by the central research question: What Implication does capital expenditure have on government borrowing? Consequently, the aligned subsidiary questions being investigated are: (1) what is the proportion of capital and operating expenditure mix, (2) proportion of internal and external borrowing and (3) to gauge the change in public debt. The first objective is assessed with regression analysis. In addition, data is collated from Budget supplements (ministry of Economy) and Reserve Bank of Fiji Addresses. The rest of the paper is arranged as follows; section 2 focuses on existing literature. While the consequent section 3 focuses on capital and operating mix for Fiji. Section 4 highlights the Fiji's government borrowing. Trends in public debt are evaluated in section 5 followed by results and analysis. The final segment provides concluding remarks.

2.0 Literature Review

Bruckner and Tuladhar (2010), financial better public capital expenditure can extend the tax base, due to the inferred economic stimulus on output thereby expanding financial sales. On the opportunity hand, better public capital expenditure can boom the lengthy-run real interest charge, due to the alleged upward push within the marginal output of private capital (Groneck, 2010), for this reason worsening the debt company. Uguru (2016) studied the link between public debt and government expenditure Based on his result, he endorsed the government of Nigeria to hurriedly lessen its operating expenditure and cognizance extra on capital expenditure. He also suggested the want for diversification of the economy so that you can reduce tons reliance on crude oil proceeds and thereby decreasing the tendency of the government contracting more debt responsibility.

Antra Bhatt (2015) investigated the lively nature of Government expenditure components and public debt based .He defined that public expenditure is assessed as 'effective' and 'much less-effective' based at the intent that a percent of the efficient Government expenditure amends disequilibrium inside the public debt within the long-run. He pronounced the situations from the model which said that as infrastructure rises, debt decreases, that means that past its most beneficial degree, an increase in infrastructure ought to nonetheless affect public debt inversely; but, this can be on the value of 'crowding out' of personal funding. He encouraged that key policy implications towards growing public capital expenditure is to stabilize public debt ultimately. Obademi (2012) in the long run the joint effect of debt is negative while in the short run its positive. He concluded that even though within the short-run the effect of loans in the economy became positive, the effect of debt within depressed financial increase as of ineffectual debt control.

Adofu & Abula (2010) investigated connection among internal debt and economic activity in Nigeria. He stated that domestic debt has affected the increase of the economic system depressingly. The author advocated that Government internal borrowing ought to be dispirited and that increasing the government revenue through tax. However, Reddy (2006) stated that deficits can be financed both by using elevating taxes or borrowing. Raising taxes aren't a favored alternative because of its predictable implications on investment and it is also now not a politically accurate flows. Duc-Anh, Phu and Arnelie (2015) studied the connection between capital expenditure and public debt. The authors pronounced Government debt in two types, domestic and external debt. Their study display that an growth inside the tax charge on earnings to asset results in an growth in government expenditure, consumption, and domestic debt which brings indefinite effect on external debt. They in addition clarified that once the productivity of capital on manufacturing is low (high) the external debt firstly raises then decreases.

Grace (2014) inspected the consequences of tremors of Government debt and government expenditure on human capital improvement and development searching at the role of monetary constraints thru the creation of presidency price range constriction for a set of favored growing nations from 1980-2013. The look at captured fiscal demanding situations facing developing countries in growing capital expenditure that is necessary for sustainable progress. The consequences revealed that high stocks of government debt, past the 30-40% debt /GDP verge, affect investment on output increase through proscribing government expenditure resources to be had for emerging investment. The end result of the take a look at also shows that government expenditure has an advantageous role to play in developing capital and sustainability appears unsure for international locations which have economic constrictions. The study concluded that developing nations that are faced with monetary demanding situations like, excessive public debt and negative sales prospects for government expenditure sustainability ought to not rely on domestic assets but are seeking global support on potential constructing .

Aizenman, J., Kletzer, K. and Pinto. B. (2007) assessed the most effective public funding and financial policy for developing international locations that have confined tax and debt volumes. The observe envisioned a steady returns to scale (CRS) endogenous increase version in which public expenditure is an enter inside the production manner, in nations in which distortions and coverage enforcement neglect have an effect on financial capabilities, as caught by using a utmost operative tax price. They defined how

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consistent variations in growth prices throughout countries may want to motive differences in public finance, public expenditure and public infrastructure. They argued that the glide of public expenditure increases output, the government need to no longer borrow to finance it because the ensuing rise in public debt would decrease welfare and increase fee. By their result, the great public debt has the pleasant fiscal policy which have to preserve the debt-to-GDP ratio is persistent in the economy without or with a required restriction on tax revenue as a percentage of GDP.

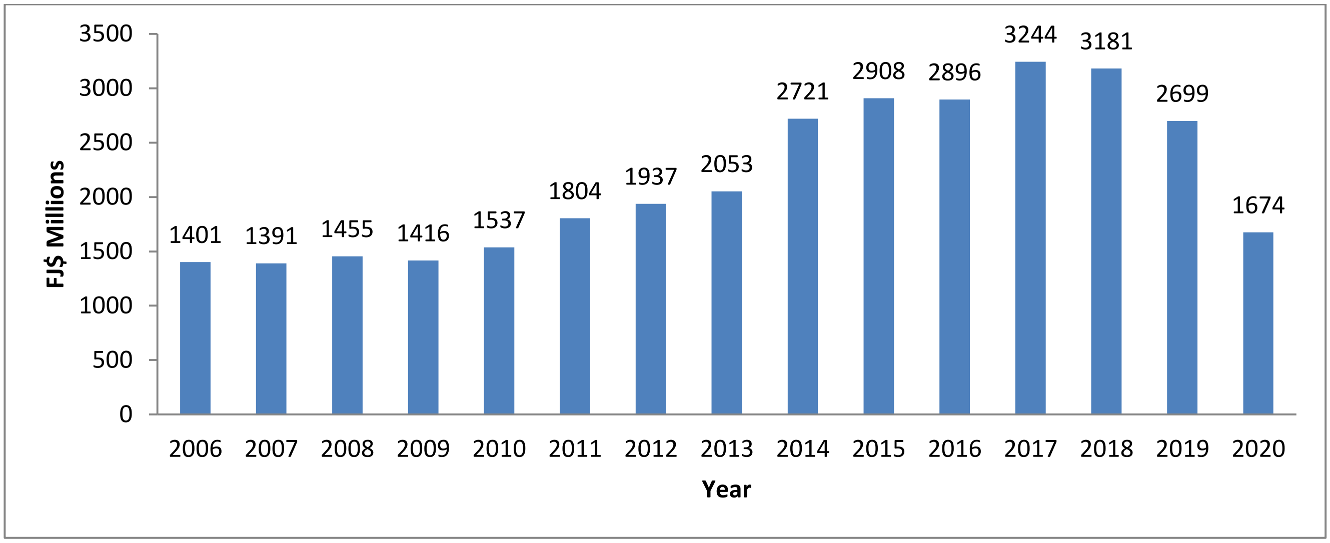
According to UNCTAD (2020), there are considerable uncertainty about the destiny about the cease to the pandemic and its economic results, in order to hit private quarter investment plans, specifically foreign direct investments. OECD (2020) estimates that higher uncertainty modeled through a upward push of handiest 10 foundation points in funding danger premier in all nations in the first 1/2 of 2020 increases the price of capital and decreases investment substantially. Further to expanded price of capital, the alternative funding impact ought to rise up due to delays in capital expenditure. Apart from the personal quarter, funding flows into projects beneath government to authorities' cooperation among China and different economies are heavily hit by the COVID19 outbreak, at the least briefly. China subsidized personal and public investment initiatives were nearly halted - as cash, fabric, and task workforce cannot glide among China and the associate nations. There is an opportunity that even as China tries to salvage from the pandemic, there will be delays or discounts in the size of destiny economic aid, loans, and investment flows to the partners economies in comparison to what China originally dedicated.

The shock then will be amplified via an instantaneous supply chain disruptions of necessary manufacturing inputs and instantaneous drop in call for; call for goods and offerings declines as clients observe 'saving for emergency', 'be patient', and 'hoarding' all through the crisis (Baldwin & Tomiura, 2020). Also, as pandemic spreads across the world, foreign demand for a financial system's goods may also droop drastically, which in flip will depress production (this could create a state of affairs termed as deliver-demand doom loop through Fornaro & Wolf (2020). However, there may be a critical factor of the call for response. In a pandemic pushed panic surroundings, call for shocks may be extraordinary for (i) important items and (ii) nonessential (such as luxurious) goods. Essential goods are those which can be necessary for dwelling, as an example, meals, medicinal drug, and refuge; at the same time as non-important goods inclusive of automobiles, tourism are not a need for living. In a plague state of affairs, call for essential goods such as meals and medication goes sharply up, even as that for non-essential true sharply declines, seeing that human beings generally tend to save money for their fitness emergencies, buying and outside amusement are restricted, and panic drives humans to no longer spend until it is truly pressing.

3.0 Capital Operating Expenditure Mix

Government budget is a period of forecasted government revenue and expenditure. Figure 1 illustrates buoyant performance in revenues with record high collection of approximately FJ$ 3.244 billion in 2017 indicating a potential growing economy and improved compliance efforts. However, the revenue collection declined from 2018 with a major anticipated drop in the year 2020. Tax revenue forecasts receipts the anticipated monetary shrinkage, stoppage in imports and decline in commercial enterprise activity. The prediction is based totally on current month-to-month tax collections, which might be nearly half of pre-disaster tax outturns, and predicted revenue harms curtailing due to the tax deduction in 2020-2021.

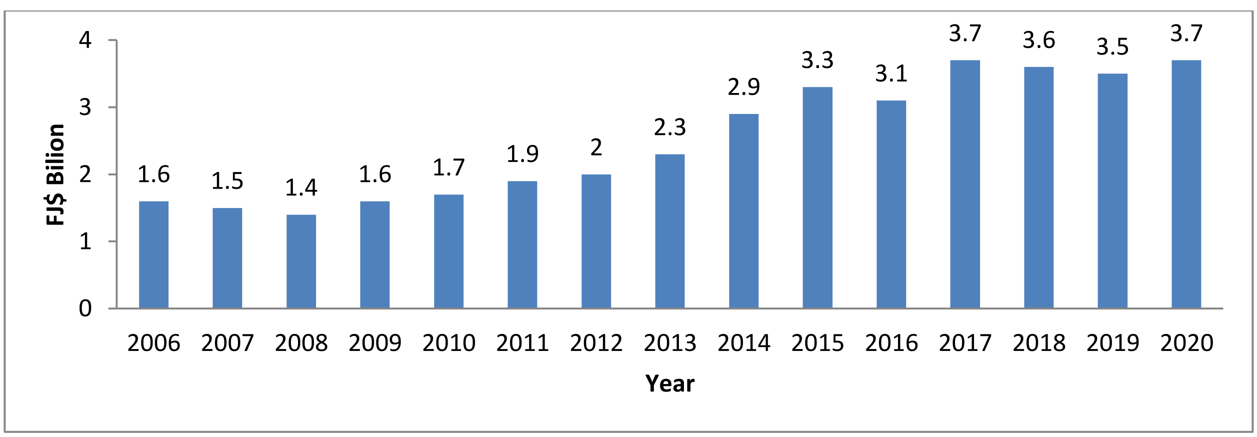
Figure 1: Fiji Government's Revenue



Source: Budget Supplements 2005 - 2020

The expenditures fluctuated from 2006 to 2018 (Figure 2). Government expenses had been pegged above FJ$ 3billion since 2015. A lot of attention was drawn on refining operative effectiveness and the need to shape economic barriers following the large reconstruction spending post TC Winston and the successive herbal disasters in 2018. In Year 2020 despite the most important anticipated drop in revenue, government's expenditure has increased to $3.7b. Capital expenditure is the cash spent via the government at the improvement of machinery, equipment, constructing, health facilities, schooling, and so on. It also includes the expenditure incurred on obtaining constant belongings like land and funding through using the government that offers profits or dividend in destiny While (Jayaraman, 2006) stated that Operating Expenditure is nothing but housekeeping expenditure dominated by wages and salaries.

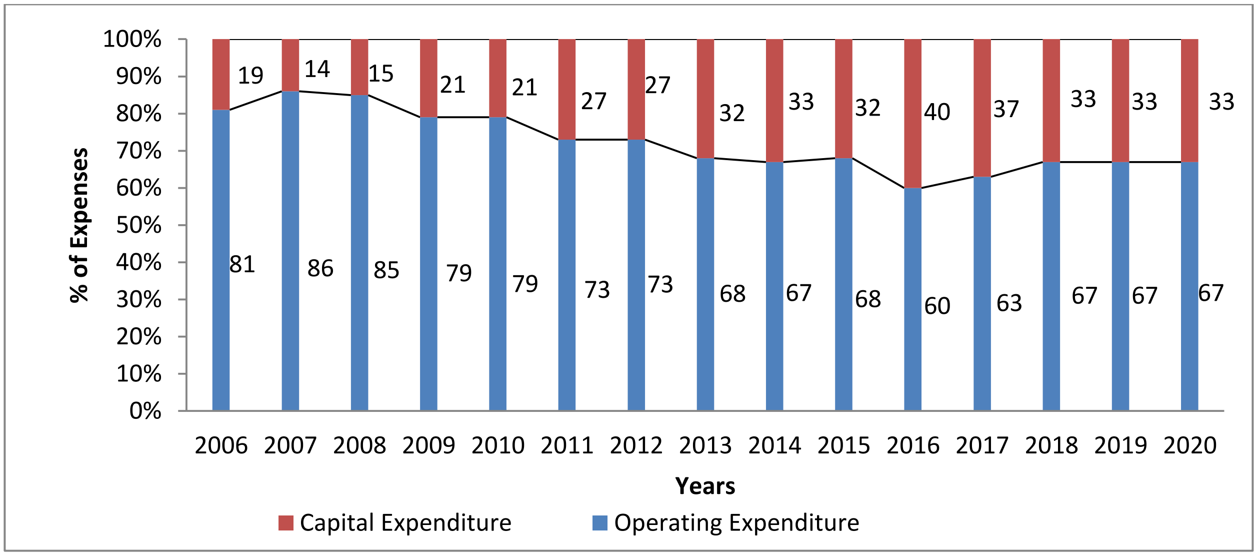
Figure 2: Government Expenditure



Source: Budget Supplements 2005 - 2020

The Government's medium-term goal is to re-stability expenditure closer to capital stock by using increasing its proportion from round 20% to 30%. Due to low investment stages the Government introduced in its 2009 Budget the "speedy monitoring" of capital initiatives through its Public Sector Investment Programme (PSIP). Performance-primarily based planning is being instigated according with the Financial Management Act, 2004 to recover responsibility, transparency, and spending controls, maintained through Finance Instructions and Finance Manuals accepted in 2005. Fiji is shifting toward right sizing the proportion of assets allotted between operational and capital expenditure for Government.

Figure 3: Fiji's Expenditure Mix: Capital vs Operating



Source: Budget Supplements 2005 - 2020

Figure 3 displays quality of fiscal deficits improved with greater resources channeled to capital expenditure from the FY2006 to 2016 then there was a slight decline in capital expenditure in FY 2017 to FY 2020. Expenditure on non-crucial programs and capital initiatives had been on hold. Economic recuperation will entail the proper merge of focused monetary procedures and necessary financial assistance via the Reserve Bank of Fiji to maintain employment, preserve residing requirements and encourage business interest. The expenditure mix has been changed in courtesy of capital in popularity of the necessity to reintroduce and reconstruct the country's infrastructure. Operating capital expenditure blend for the FY 2014 changed into 67:33 at the same time for 2015 it was 68:32. For the 2016 Budget, the emphasis on capital expenditure expenses remains with a planned expenditure blend of 60:40. For 2017 the Capital Operating mix was 63:37.The remaining fiscal years, around 33 % of Government's expenditure was on capital tasks, which included the development and preservation of roads, bridges, water & sanitation facilities in addition to the purchase of machinery & equipment. An additional three percentage was spent on the provision of scholarships and scholar loans for tertiary education. (Reserve Bank of Fiji, 2021)

Capital expenditure suggests long run strategies and expenditure on fixed assets. Capital expenditure can help the prosperity of the network and enhance community services in influencing the people. To boom capital expenditure, the government is anticipated to preserve to find out the sources of sales so that reliance on the vital authorities may be decreased and can decorate the welfare of the community. Governments also are expected to restructure human capitals to reduce employee's expenditure via way of highlighting excellent over quantity that allows you to arrange the distribution of nearby expenditure for infrastructure. Therefore capital expenditure should be a crucial challenge for governments so one can assist the welfare of society (Mardiasmo, 2009). Hakhu (2015) endorsed that key policy implications in the direction of growing capital expenditure should be made while completing it with non-public funding incentive to alleviate government debt.

4.0 Government Borrowing

Government's financial deficits had been financed through a mixture of Internal and external borrowings. Fiji government prefers to keep internal and external borrowing blend of 70:30 (+/- 5 percentage). Governments have the choice to borrow from people, companies, and multilateral lending institutions consisting of the World Bank and the Asian Development Bank (ADB) and even other governments. Domestic debt owed with the aid of a government (money a government borrows from its residents) is a part of the country's countrywide debt. It is a form of fiat advent of money, in which the government obtains finance now not by using creating it de novo, however through borrowing it. Typically, authorities troubles Treasury-payments (T-bills) or government bonds to elevate these price range. The T-bills are brief-term (less than three hundred and sixty five days) promissory notes supplied through governments to achieve transient in revenue collections. Government bonds are for more than twelve months wherein the issuer guarantees to pay a set quantity of interest throughout the term of the bond. When a central authority issues bonds, traders bid to shop for it and generally the bidder who tenders the bottom interest fee is chosen (Ministry of Economy, 2016).

<u>Figure 4: Government Debt Mix</u>

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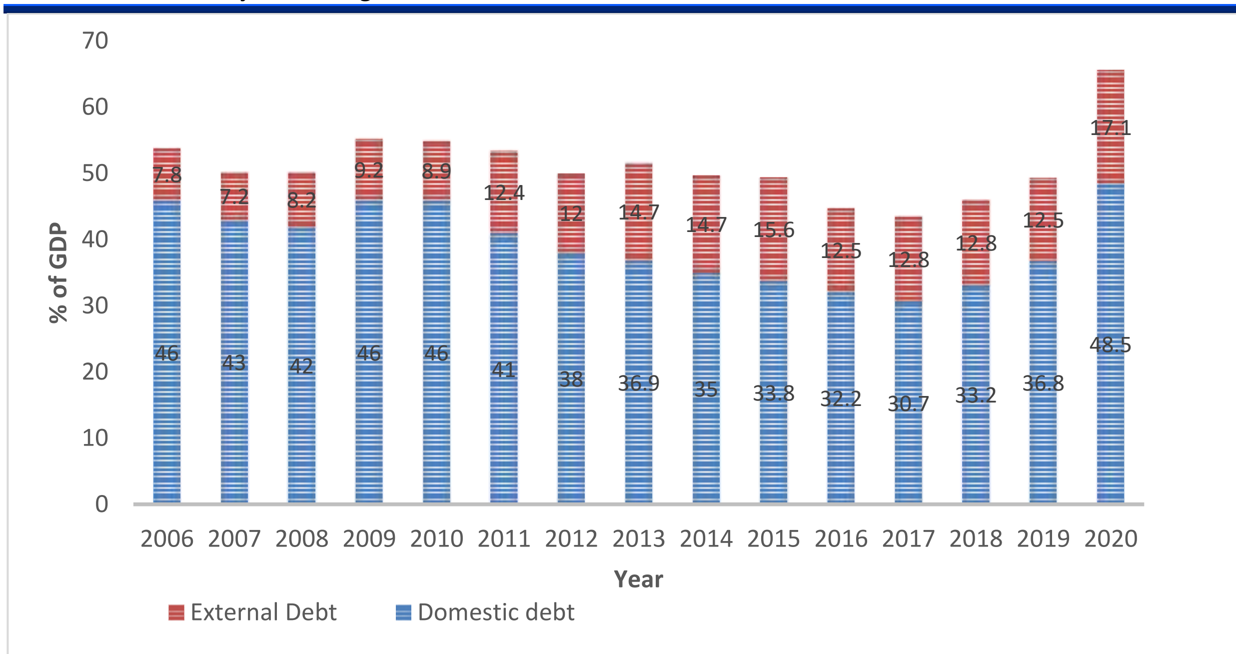

Source: Budget Supplements 2005 - 2020

Domestic debt was $4.96 billion in July 2020, equal to 48.5percent of GDP. The main supply of borrowings was done domestically factually by FNPF, banks and insurance companies who holds largest government bonds. Due to COVID-19 Response has raised $90 million Bonds which together with Fiji Infrastructure Bonds, Viti Bonds and treasury bills include the economic units issued in FY2019-2020. Government maintains extended Treasury bill levels and regular issuances in the market as an road for liquidity threat control for commercial banks, at the same time as financing Government's brief shortfalls and actively growing the market yield curve, especially within the brief-cease .Governments have the choice to problem those bonds, each regionally and outside. However, in Fiji's case, maximum external borrowings are direct ns which can be tied to a selected infrastructure projects. Majority of Government debt (74%) has been financed through domestic borrowing (T-bills and bonds) and changed into close to $5 billion on the give up of FY 2019-20. The Fiji National Provident Fund (72 %) accompanied via the coverage agencies (16%) are the primary holders of Government bonds while business banks usually preserve T-bills (Ministry of Economy, 2016).

External debt made up spherical 26 % of Government debt or $1.7 billion on the quilt of the FY 2019-2020 or same to 17.1 percent of GDP. Depicts Government's outside debt function from 2016 to 2020.The main creditors had been the ADB, the Export-Import Bank of China (EXIM China), and International Bank for Reconstruction & Development (IBRD and part of the World Bank Group) and the Japan International Cooperation Agency (JICA) .Government effectively accessed the ADB Subprogram 2 coverage based mortgage, the World Bank Second Fiscal Sustainability and Climate Resilience Development Policy Loan and the Japan International Cooperation Agency (JICA) Stand-thru Loan in the route of FY2019-2020.

There are apparent advantages from this, particularly; the debt servicing expenditure stays inside the domestic economic system as an alternative then flowing out. Besides, change rate dangers are also reduced. Nevertheless, on account that our alternate fee is fixed, this will no longer be a lot of a concern. The disadvantage to immoderate borrowing from domestic marketplace is that it'll undermine private sector borrowing. Fiji's financial sector isn't always that economical. Perusal of market lending fees provides a clear picture of how government's immoderate borrowing from home resources has inclined the market. The doubtlessly great loaning rates also can mean excessive profit on capital and consequently appeal to foreign capital. The different difficult with domestic borrowing is that, normally, creditors in the domestic marketplace are less rigorous than the external sources. Thus, borrowing is seen as relaxed opportunity to any monetary stress for that reason elevating debt ranges.

5.0 Trends in Public debt

Government debt, is the amount of money owed by government. Debts owed via the government is frequently evaluated comparative to the dimensions of the economy

Figure 5: Total Government Debt

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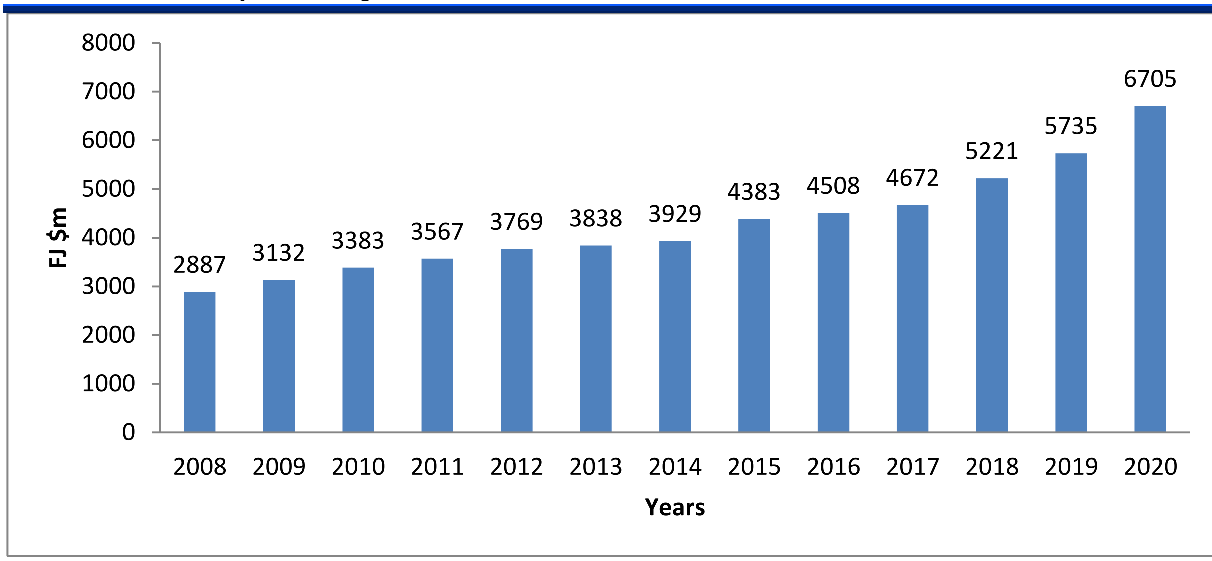
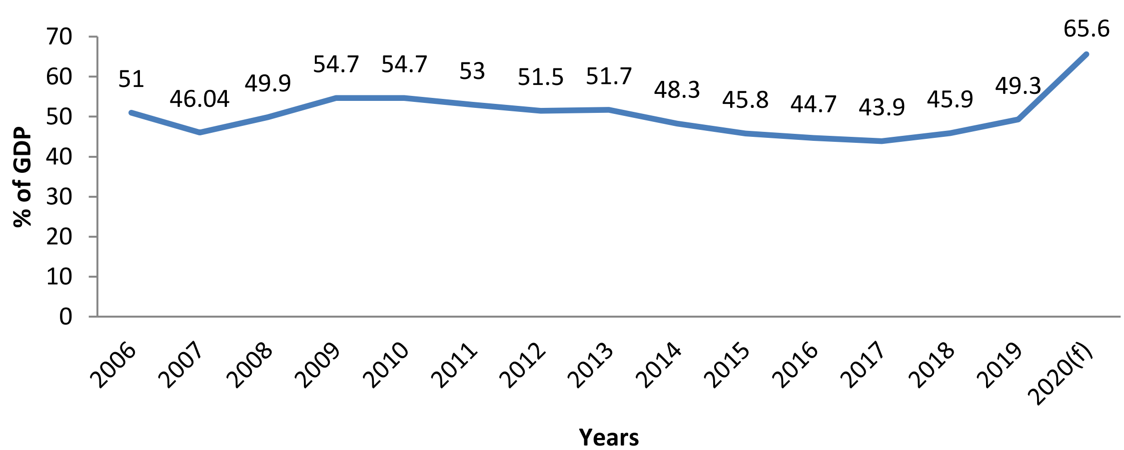


Source: Budget Supplements 2005 - 2020

In Pacific island international locations (PICs), external resource in phrases of offers from bilateral assets inside the beyond had been financing capital prices of governments to a sizeable extent. In some PICs, outside useful resource had also been financing their modern-day budgets, through imparting support for wages and salaries and different home tasks prices. Fiji receives external offers most effective to the quantity of 2% of GDP, the least within the place, with the end result its annual financial deficits in current years must be financed via extended public borrowing (Jayaraman, 2006).

Figure 6: Debt as Percentage of GDP



Source: Budget Supplements 2005-2020

Figure 6 illustrates Debt as % of GDP was 51% in 2006 which decreased by4.96% in 2007, then increased by 3.86 % in 2008 with 4.8% increase in 2009 and 2010, then it decreased in by 1.7 % in 2011then 1.5 % in 2012, it slightly increased by 0.2% in 2013, then it decreased respectively in 2014,2015,2016,2017 by 3.4%, 2.5%, 1.1% and 0.8 %.Gradually it increased in 2018 (2%), 2019(3.4%) and 2020 by 16.3%. Although government debt is sustainable it is liable to giant risks since revenues are expected to further decline. Debt increased July 2020 to $6.7 billion or s65.6 percentage of GDP (from 49.3 % in 2019 financial 12 months) since an improved borrowing in the 2019-2020 COVID-19 Response Budget to deal with the better deficit of 8.2 %.

The extensive increase in debt to GDP is likewise accredited to the descending review of nominal GDP assumed the large monetary narrowing estimated for this economic 12 months Total debt at the give up of July 2018 stood at $5,220.5 million equal to 45.9 percent of GDP (Figure 6). The growth in debt from 49.9 percentage of GDP in July 2017 became largely because of extra expenditure on refurbishment works within the reverberation of TC Winston and returned herbal failures in 2018. Approximately

$500 million, equivalent to round four percentage of GDP, become channeled by way of Government in the direction of reconstruction and rehabilitation (Ministry of Economy, 2016). Goundar (2020) mentioned that the present day debt ratio is depressingly impacting long run financial activity.

6.0 Results and Analysis

This research exploits regression analysis of data analysis. Government capital expenditure was compared with public debt. Table: 1, 2 and 3 presents regression analysis summary output.

Table 1: Regression Statistics

Multiple R	0.837571539
R Square	0.701526083
Adjusted R Square	0.678566551
Standard Error	720.7425656
Observations	15

Source: Authors computation

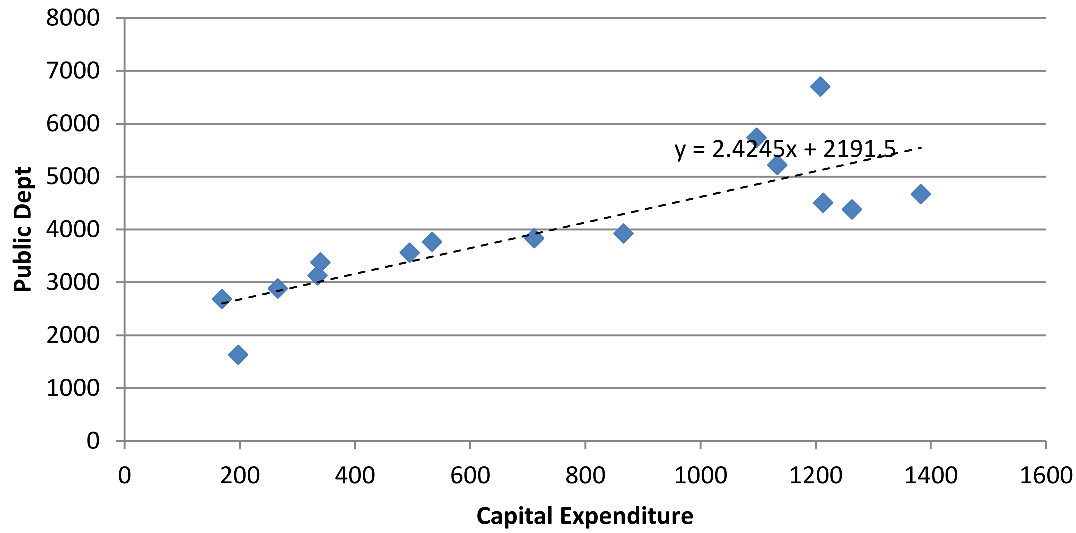
As shown in table 1 the multiple R is 0.837571539 which indicates that government capital expenditure is having a positive relationship with public debts. The computed coefficient of determination shows that 83.75% of the total disparities in the reliant on variable are accounted for by the variation in the explanatory variable while 16.25 % of the total disparity in public debt is attributable to the impact of other aspects not included in the regression equation. R^2=70.15% is moderately high to be dependable for policy decision; it tells more on the (true) connection among public debt and public capital expenditure in Fiji.

Table 2: Analysis of Variance (ANOVA)

	df	*SS*	*MS*	*F*	*Significance F*
Regression	1	15872346.37	15872346.37	30.55489456	9.74665E-05
Residual	13	6753107.997	519469.8459		
Total	14	22625454.36			

Source: Authors computation

Figure 7: Capital Expenditure & Public debt



Source: Budget Supplements 2005 - 2020

Figure 7 shows a positive correlation between capital expenditure and public debt. It shows that higher level of capital expenditure increases the correlation between investment and public debt. Another obvious implication of this result is that government borrowing in is caused by means of government deficit budgeting, a situation which is widely known in Fiji. It consequently will become vital that the government budgeting system want to be reexamined to make certain that allocated performance is executed in our budgeting and that borrowing to finance price range deficit should be performed precisely and unaffectedly.

7.0 Conclusion and policy Implications

The increase in Fiji's capital expenditure did not recover considerably the debt state of affairs of the governments. The operating expenditure is substantially better than the capital expenditure. Thus, the borrowings of the state governments have an increase improving outcome, however the different manner spherical. The outcomes also imply that elements often related to the budget control skills of the governments and decisive effect on the upward thrust in government borrowing to finance capital expenditure.

For a feasible fiscal system, debt ratio must be sustainable over a long time. Debt can be sustainable while government intake expenditure and transfer payments are to be met from revenue receipts of the government, whilst public funding and net government guide to personal funding need to be funded through borrowing. The outcomes of this examine reject this hypothesis. In the effects expounded on this look at, a developing debt suggests the inefficiency in economic managing of the government in an experience that government expenditure on capital fails to fund. Therefore, more importance is to be placed on capital expenditure than on public consumption to make public debt sustainable on the subnational juncture.

The country's strong track record in domestic revenue mobilization limits its ability to sustainably fund higher expenditure levels from additional domestic revenues. Strengthening debt sustainability and building up fiscal buffers therefore requires expenditure-side consolidation measures. While there has been broad agreement between the government and the IMF and World Bank that fiscal consolidation is needed it will have to be gradual over the medium-term to avoid undermining growth performance and progress in human development—and in light of ongoing funding commitments, including for the substantial capital investment program.

A full financial recuperation would require the proper focused of the monetary measures and sufficient monetary easing by using the RBF to withstand employment, preserve residing requirements and encourage business activity. Further Research on Capital Expenditure and Public debt could be done for at least 30 years of data collection for more relevant and comparable results.

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