

Medium-term budgetary framework

The presentation of the Federal Budget for any particular year always contains a final chapter in the Budget-in-Brief document on the Medium-term Budgetary Framework (MTBF). This indicates the strategy of the Government in terms of ensuring sustainability of the public finances of the country by setting targets usually over the next three years in the change in the level of the revenue and expenditure of the Federal and provincial governments combined. This yields the target fiscal deficit and the implied Public Debt to GDP Ratio. However, the new Government failed to present its MTBF along with of the Revised Budget for 2018-19.

The budgetary framework on the revenue front usually gives the break-up into FBR revenues, other tax revenues and non-tax revenues. The expenditure is shown separately for current expenditure and development expenditure. The former is disaggregated into interest payments and other expenditure in order to enable the derivation of the 'primary deficit.'

A major exercise of developing the MTBF for the three-year tenure of the last IMF Program was undertaken in the second half of 2013 and the resulting framework was presented in the Budget in Brief of 2013-14. The medium term was defined as extending from 2013-14 to 2015-16, with 2012-13 as the base year.

The framework was ambitious in line with the Fund's expectations. The fiscal deficit in the base year, 2012-13, was 6.4 percent of the GDP, excluding the retirement of circular debt in the power sector of 1.6 percent of the GDP. The target set was to bring down the budget deficit to 4 percent of the GDP by 2015-16. Clearly, this represented a major process of adjustment with on average an annual rate of reduction in the deficit of 0.8 percent of the GDP.

The strategy to achieve the deficit reduction of 2.4 percent of the GDP was based on half the adjustment by raising the total revenues to GDP from 13 percent to 14.2 percent of the GDP. The other half was proposed on the expenditure side involving a reduction in total expenditure as a percentage of the GDP from 19.4 to 18.2 percent. In this sense the strategy was balanced involving equal effort both on the revenue and expenditure sides of the budget.

Within revenues, the entire focus was on raising tax revenues. There was the prospect that non-tax revenues were likely to fall as the process of privatization was completed and the inflow of funds from the Coalition Support Fund was likely to decline sharply. Consequently, non-tax revenues were projected to fall sharply from 3.4 percent to 2.2 percent of the GDP by 2015-16. Consequently, the required increase in the tax to GDP ratio was large at 2.4 percent of the GDP. On average, the fiscal effort involved an increase annually in the tax to GDP ratio of 0.8 percent.

The targets on the expenditure front involved substantial cuts on the current expenditure side and a big jump in development expenditure, so as to sustain the growth process in the economy. Current expenditure was to be reduced from 16.0 to 12.9 percent of the GDP. Development expenditure was to be raised from 3.4 to 5.3 percent of the GDP. Consequently, the target of the level of total expenditure was 18.2 percent of the GDP. This implied that the fall was 1.2 percent of the GDP, equal to half the required adjustment.

What have been the results of implementation of the budgetary framework from 2013-14 to 2015-16? The performance on the revenue front was truly extraordinary. The tax to GDP ratio increased more than targeted by 2.8 percent of the GDP. Further, there was also some success in exceeding the non-tax revenue target by 0.5 percent of the GDP. Overall, the performance on the revenue front was unprecedented with a

rise of 2.1 percent of the GDP. In particular, the much maligned FBR must be recognized positively for a very successful mobilization of tax revenues.

As opposed to success on the revenue front, there was a big failure in containing current expenditure which exceeded the target level in the terminal year of the framework by as much as 3 percent of the GDP. Inevitably, development spending had to be substantially cut in relation to the target for 2015-16 by 1.6 percent of the GDP. Overall, there was failure in reducing total public expenditure and it increased by 0.2 percent of the GDP by 2015-16.

The end result was nevertheless a big reduction in the fiscal deficit from 6.4 percent of the GDP in 2012-13 to 4.6 percent of the GDP by 2015-16. Overall, the medium-term framework prepared under the aegis of the IMF Program can be considered as having been successfully implemented. The fiscal deficit in 2015-16 was the lowest in ten years. The performance criteria in the IMF program ensured a degree of fiscal discipline and a commitment to adhere to the budgetary framework to the extent possible.

Following the end of the Fund program, another MTBF was prepared with 2015-16 as the base year up to 2018-19 and presented in the Budget in Brief of 2016-17. Unfortunately, this framework was very badly implemented and the fiscal deficit in 2017-18 was as much as 3.1 percent of the GDP above the target of 3.5 percent of the GDP. The failure again was most pronounced in the containment of expenditure.

The absence of an MTBF in the presentation of the Revised Budget for 2018-19 by the new PTI Government is a big gap and needs to be filled on a top priority basis. This will be necessary if a new IMF programme is to be negotiated. It will also reduce uncertainty by highlighting the fiscal policy in the mid-term, say up to 2021-22, with 2017-18 as the base year. The IMF programme, if it is successfully negotiated, will be operative from 2019-20 to 2021-22.

What should be the contours of the new MTBF? The process of adjustment will have to be exceptionally large given the peak deficit of 6.6 percent of the GDP in 2017-18. The recommended deficit target for 2021-22 is 4.5 percent of the GDP. The reduction of 2.1 percent of the GDP is considered tough but feasible. This will imply on average annual reduction in deficit by 0.7 percent of the GDP, with some front loading of the decrease.

A set of targets has been developed for incorporation into the new framework. Enough fiscal effort should be made to raise the tax to GDP ratio from 13 percent to 14.5 percent. Non-tax revenues are unlikely to show significant buoyancy and rise only marginally to 2.5 percent of the GDP. Overall, the budgetary framework should envisage the overall increase in revenues from 15.2 percent to 17 percent of the GDP. Three fourths of the increase, that is, 1.4 percent of the GDP, will be from Federal revenue sources and one fourth or 0.4 percent of the GDP from provincial taxes.

The level of total public expenditure will be equivalent to the target revenues plus the fiscal deficit that is 21.5 percent of the GDP in 2021-22. The level of development spending will need to be raised to provide 'fiscal space' for key CPEC, water and power projects, including especially the Diamer-Bhasha and Mohmand dams. This is essential to ward off the prospect of severe water shortage by 2025. As such, it will have to be pitched at least at 5 percent of the GDP.

Consequently, the overall level of current expenditure will have to be brought down from 17 percent to 16.5 percent of the GDP. Interest payments are expected to rise from 4.4 percent to 5 percent of the GDP by 2021-22. As such, other current expenditure will have to be brought down from 12.6 percent to 11.5 percent of the GDP. This expenditure is on defense, other current expenditure of the federal government and current expenditure of provincial governments. Reducing non-interest current expenditure will perhaps be the biggest challenge.

Overall, the proposed MTBF, shown in the Table, can achieve the following. First, it will represent a vigorous resource mobilization effort. Second, it enforces fiscal discipline leading thereby to significant containment of current expenditure. Third, it creates enough space for expansion in development spending,

especially on large dams. Fourth, it leads to generation of a primary surplus of 0.5 percent of the GDP from a primary deficit of 2.2 percent of the GDP in 2017-18. All this will enable a sizeable adjustment in public finances. The overall fiscal deficit will come down by over 2 percent of the GDP to 4.5 percent of the GDP by 2021-2022.

The government may wish to announce its MTBF which also achieves the above-mentioned objectives. A 'Mini Budget' is to be announced shortly. This will be the ideal time to announce the MTBF, along with a description of the major reforms and steps to be taken to achieve the different targets. This will not only begin to satisfy the donors but will also lead to considerably less uncertainty in the markets about future government policies in the fiscal domain.

Table 1: A Suggested Medium-Term Budgetary Framework

	2017-18	2021-22
	(Actual)	(Target)
Total Revenues	15.2	17.0
Tax Revenues	13.0	14.5
Non-Tax Revenues	2.2	2.5
Total Expenditur	21.8	21.5
Current	17.0	16.5
(interest paymen	(4.4)	(5.0)
Development	4.7	5.0
Deficit		
Primary	-2.2	0.5
Overall	-6.6	-4.5

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