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Public debt on an explosive path

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Even though a clamouring about previous government's contribution to public debt had started from the beginning, things were relatively contained during the period the country was undergoing the IMF program. However, no sooner was the Fund programme completed, the floodgates of overspending were opened.

The public debt is the cumulative total of fiscal deficits incurred by a country annually (surplus would reduce public debt). The speed of its accumulation depends on the size of the deficit. In the last two years, we have seen an incredible reversal of fiscal discipline from the remarkable achievement that was made in the first three years.

The deficit rose from 4.3% of GDP in 2015-16 to 5.8% or Rs 1848 billion in 2016-17 and is projected to increase to 7.1% or Rs 2450 billion (or perhaps more) in 2017-18. This is a phenomenal increase in deficit financing, as nearly 3% more than the budget amount (exceeding by a trillion rupees) were spent. There is another side of the deterioration that is not captured by the deficit number but it adds to the public debt. One, for the first time in the last four years, there has been a significant depreciation of the rupee during the year - 16% in 2017-18. Such a high level of depreciation entails a capital loss on our foreign outstanding debt in rupee terms. The loss is estimated at a minimum of Rs 1500 billion. Two, there are reports that provinces have over-spent their balances by over-drawing their accounts with the SBP. Punjab and Sindh have reportedly overdrawn Rs 50 billion and Rs 10 billion, respectively. These provinces together receive more than 75% of the divisible pool transfers. In the budget, it was estimated that the provinces would provide a surplus of Rs 300 billion. With over-spending reports, rather than surplus, the provinces would be contributing to further increase the deficit.

In this background, public debt has seen exceptional increase in recent years. The evolution of public debt in the last six years is given below:

	Public Debt	Debt to GDP Ratio
2012-13	14.32	64.0
2013-14	15.99	63.5
2014-15	17.38	63.3

2015-16	19.68	67.5
2016-17	21.41	67.0
2017-18*	24.76	70.0

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Evidently, there is an explosive growth in the public debt during the current year, as the debt to GDP ratio has shot up to 70% of GDP. There is an overall six percentage points increase in GDP during the tenure of the present government. The test for explosive debt path is whether primary deficit (revenues minus expenditure excluding interest payments) is negative or not. With such massive deficit, we will have major deficit in the primary balance. Both in the last and current year, primary deficit is very high and such a sustained primary deficit could unleash explosive growth in debt.

It needs to be underlined that the numbers for 2017-18 are up to March 2018 and debts for one full quarter have to be compiled and added. Unfortunately, the last quarter has been most distressful for fiscal deficit. The deficit in the first three quarters was reported at 4.3% of GDP or Rs 1481 billion in the fiscal operations released by the Ministry of Finance. Note that this level of deficit was budgeted for the entire year. On the other hand, as we mentioned earlier, the actual deficit for the year is reportedly crossing 7.1% or Rs 2450 billion. The capital loss is estimated at Rs 1500 billion, due to 16% depreciation, which would take the marginal increase in debt during the year to Rs 3950 billion. Then there would be very likely the drawdown on the government's deposits from the banking system, which would further add to the debt. All told, the addition to debt since last year is estimated at a minimum of Rs 4 trillion, which would take the public debt to Rs 25.2 trillion or 73% of GDP. This is an unprecedented addition to public debt in one year, and hence the year could record perhaps the worst fiscal performance in recent economic history of the country.

The fiscal responsibility and debt limitation act, 2005 (FRDLA, 2005) had a limit of 60% of GDP. Under the Fund programme, perhaps impressed by initial successes in fiscal adjustment, the Government agreed to further tighten the fiscal legislation. The FRDLA was amended in 2016 with two major changes. First, the federal fiscal deficit was to be brought down to 3.5% by the year 2017-18, which we have failed to do miserably. Prior to this, there was only the requirement of eliminating revenue deficit on a consolidated basis, which was done away with. Second, and more importantly, over a ten-year period, it was stipulated that the debt would be brought down to 50% of GDP, with a reduction path of 0.5% per year, in the first five years, starting 2017-18, and 0.75% per year in the next five years.

Viewed in this background, the state of fiscal affairs is pathetic. Far from following the new path of fiscal adjustment, we are falling behind by a long margin. The fiscal affairs are badly in need of major repair.

The fiscal disarray has been contributed by a variety of factors. First, the tax revenues, which were growing at a respectable rate of 16% (though budgeted growth was 19%) during the first ten-month of the year, which dipped to less than 10% during the year. This is slightly better than the worst performance of 8% growth registered last, and far inferior to about 20% in the first three years of the previous Government.

Second, the collection of non-tax revenues was no less disappointing. In the first three quarters, only 39% of budgeted revenues were collected.

Third, the expenditures were hugely out of line with those budgeted. Reportedly, Rs 200 billion were paid for clearing circular debt, which were unbudgeted. Also, the exporters' packages were also not budgeted and whatever was paid on this account was unbudgeted.

Fourth, a report has indicated that development budget was cut by as much as 25% to contain further increase in deficit. Thus, unfortunately, while such a high deficit was incurred, the development spending was subjected to a cut.

While one can sympathize with the new government, the fact remains its challenges are multiplying. It would have no time to celebrate its victory. It has to get down to work without any loss of time.

(The writer is former finance secretary)

