

## **Fiscal deficit remains main threat to economy**

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It is reported that fiscal deficit was recorded at 6.1% of GDP (Rs 2100 billion), in the first eleven-month of the fiscal year. Not only is this a very alarming figure, it is reflective of a high degree of economic mismanagement and, we hate to say that, it is either a deliberate attempt to misrepresent facts or the economic managers are unaware of the consequences of their actions. The point is illustrated with the evolution of the deficit number during the current fiscal year.

At the time of the announcement of the budget for 2017-18, the deficit was targeted at 4.1%(Rs 1480 billion) against an actual deficit of 5.8% (Rs 1864 billion) during the previous year 2016-17. After the first quarter it was reported that the deficit was 1.2% (Rs 441 billion) (after announcing a much lower deficit of 0.9% (Rs 324 billion) during the press conference of the then Finance Minister in October last year). This, however, was not too off the mark on an annualized basis. After the end of the first half (Jul-Dec), the deficit was reported at 2.2% (Rs 796 billion), a likely over-run of 0.3% on an annualized basis, which was again not too off the mark. Then came the early budget in April 2018, where the revised budget estimate for the year was revealed. To everybody's surprise, the revised deficit was pitched at 5.5% (Rs 1892 billion), indicating an overrun of 1.4% (Rs 412 billion) compared to the original budget. This was significantly out of line with the expectation developed on the basis of first two quarters' results. Either the recognition of some of the expenditures was delayed or the Government had decided to completely abandon even a pretense of fiscal discipline and responsibility.

Then, within few weeks of the budget, the results for the third quarter were out, which showed a nine-month deficit of 4.3%, indicating, on a pro-rata basis, an annual deficit of 5.8% (Rs 1995 billion), almost as it was in 2016-17. This was again surprising as the budget speech had claimed a figure of 5.5%. It is difficult to fathom how the numbers were changing so rapidly.

Then the interim Finance Minister, in her maiden press conference on 12-6-2018, disclosed that the budget deficit for the current year is likely to be 6.1% (Rs 2098 billion), which is a full 2% (Rs 618 billion) higher than the original target. It is simply reckless and unsustainable.

Unfortunately, the saga doesn't end there. On 14-6-2018, it was reported that the deficit had reached 6.1% (Rs 2100 billion) in the first eleven months of the fiscal year. If the speed with which the deficit has risen in the second half (3.9% in five months), the deficit could reach as high as between 6.9%-7.0% (Rs 2374-Rs 2408 or nearly a trillion higher than the budgeted target). It is further reported that in the month of May alone (last month of the previous government) deficit of 0.6% (Rs 206 billion) was incurred. It is difficult to recall if a government would have ever indulged in spending frenzy at such a large scale. True, it was the closing month of the government, but it cannot be insensitive to the needs of propriety in public spending. It is not yet clear whether the three-month salary announced for the federal government employees as a parting gift was cancelled or not. If that is not cancelled it would have an extra impact of Rs 150 billion, that would add to an already precarious situation.

On the other hand, the revenue situation looks grim. The 11-month FBR tax collections were recorded at Rs 3274 billion, showing a growth of only 14.4% against the required growth of 19.2%. A big shortfall in revenues is expected when the year closes on 30th June. There are reports that the last minute refund of Rs 31 billion announced by the Government on its last day in office was not booked in May but on 1st June. So the month has ominously started with a negative Rs 31 billion. The revenue shortfall would further erode the prospects of any let up in the deteriorating fiscal state.

As the new government starts its term after July 25 elections, there would be a déjà vu after five years. In

2013, the country faced a similar situation on the policy front (though at the time the economy was weak, with little growth and high inflation, both missing at present) as the deficit was 6.2% without recognizing circular debt. It ended up at 8.2% after including circular debt (a significant part of which was non-payment of tariff differential subsidies as well). A far worse situation is currently faced by the country on account of the circular debt, though at present much of it is accumulation of losses and non-recoveries of bills. All the same, the system is threatened for lack of liquidity even though the requisite capacity is available. If the new Government chose to clear a significant part of the circular debt through re-capitalization of DISCOs, the deficit would rise even further.

In fact, during the last six months, in several articles in these pages, we have been warning that the deficit was heading to as high a level as 7.0%. Our contention was based on the unprecedented increase in the current account deficit of the balance of payments (BOP), which is now headed toward 6% of GDP, highest in more than a decade. Fiscal deficit has nearly a one-on-one relationship with the Current Account deficit. Only a very large demand, emanating from high deficit, could fuel such a large deficit in the current account.

The instability triggers as the country runs out of reserves to finance the external account deficit. Hard currencies are not available unless these are earned through higher exports of goods and services or their limited supplies are preserved through a moderate import demand.

The dilemma we face is that not much would be done until a new government is in office. The Caretakers had a poor start as they initially indicated that they would open a dialogue with the Fund (Article-IV) but a hard response from a member of the Senate has made them change their mind, vowing they would not be engaging in any talks. The country has to suffer in silence for two more months as the people continue to suffer the vagaries of economic indiscipline. Even when the new Government is in place, it would not be bringing cakes and pastries for partying. They would have to saddle with the harsh realities of cleaning up a mess of an unprecedented scale. So, the nation has to fasten its belts as it braces for a hard landing over at least a six-month period after the new government has a chance to layout its plans and put them into action.

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