DAWN

Galloping deficit

Page NO.01 Col NO.01

Pakistan's fiscal deficit in the first 11 months of the outgoing fiscal year has sadly far exceeded the budgeted 4.1 per cent target despite last minute assurances by former Finance Minister Dr Miftah Ismail that it would stay below 5.5pc of GDP.

His promise of $1.5 to $2 billion foreign flows from China remained a pipedream but higher international debt repayments over this last week, before the close of fiscal year, remains a stark reality. In fact, some Chinese investments in the power sector now appear to be at risk.

In her first public appearance, caretaker Finance Minister Dr Shamshad Akhtar has reported the 11-month deficit at 6.1pc of GDP and public debt at 70pc of GDP. The deficit may reach close to 7pc at the end of the year owing to lower than committed cash surpluses from provinces, revenue shortfall by the Federal Board of Revenue (FBR), higher than estimated debt servicing and static running expenditures of the government.

The irony is that the deficit story was built on false foundations from the very beginning

This is despite the fact the public sector development programme (PSDP) expenditure has been contained at Rs752bn as of June 22, 2018 against a budget target of Rs1,001bn for the full year.

As the exchange rate keeps on deteriorating, adding to the debt build up and a record $16bn current account deficit (almost 6pc of GDP), the fiscal and monetary sector is fast entering the danger zone, coupled with little policy action given the inherent limitations of the interim government.

The situation has already been compounded by a credit rating downgrade by Moody's in the wake of depleted foreign exchange reserves.

In fact, an apple-to-apple comparison may put the current year deficit close to the level witnessed in 2013 if a fresh power sector circular debt stock of Rs547 billion is also taken into account besides almost Rs500bn parked in Power Holding Company Limited and being serviced through surcharges in consumer tariff.

The fresh circular debt stock is more critical given the fact that receivables of the distribution companies have crossed Rs779bn as of June 4, 2018 which are mostly unrecoverable and have to be written off. These so called "one-off" write-offs have been the most common feature of the power sector and the federal budget for almost 15 years now, with the amount making fresh records each time.

The irony is that the deficit story was built on false foundations from the very beginning. Revenue targets were set against the will of the tax machinery and a host of tax exemptions kept rolling down the road to facilitate Chinese investors.

In a departure from tradition, on October 9, 2017 the fiscal deficit was officially announced by then finance minister Ishaq Dar at 0.9pc of GDP. Mr Dar claimed credit for the lowest deficit in 10-years despite slippages in non-tax revenues; particularly due to the non-realisation of disbursement from the United States.

The overall deficit decreased to 0.9pc in the first quarter of 2017-18 compared to 1.3pc recorded in the first quarter of last year, he announced only a week after the completion of the quarter. Contrarily, the reconciled numbers released in November put the first quarter deficit at 1.2pc while full year deficit target of 4.1pc was surpassed in the first three quarters when it stood at 4.3pc of GDP.

The Power Division on the other hand has reported increasing power losses and receivables, and fewer recoveries, attributing most of the sector's ills to the absence of political will in addressing the chronic crisis. As of June 4, power sector receivables crossed Rs779bn, up 32pc from Rs589bn in 2015.

Ironically, private sector receivables have surged by 46pc to Rs633bn last week from Rs434bn at end-June 2015. The increase appeared strange in view of disconnections by distribution companies on default beyond two months by common consumers. Private receivables increased by 8pc to Rs469bn in 2016, followed by 18.3pc increase to Rs555bn in 2017 and another 14pc rise to Rs633bn in 2018. The receivables against disconnected defaulters stood at Rs99bn.

On top of that, public sector receivables have again gone past Rs146bn compared to Rs156bn at end-June 2015. In fact, public sector receivables have also maintained a steady journey, increasing by 8.33pc to Rs169bn in 2016 and then falling 32pc to Rs115bn in 2017 as part of a massive write off of Rs50bn allowed to Sindh government consumers in 2016.
As if that was not enough, there are now indications that even Chinese investments in a few major energy transactions are in jeopardy owing mainly to poor financials of the power sector. This comes at a time when overall foreign direct investment has shown slightly lower inflows in first 11 months of the current year.
In testimony before a senate panel, the chief executive officer of one of the largest private power sector operations in the country — Hub Power Company — Khalid Mansoor reported that his company was working on $3.5bn energy projects under China-Pakistan Economic Corridor (CPEC) but their financial closure had been stopped due to ‘bad mouthing’ in Chinese market by existing investors of Sahiwal Coal project over non-payments.
He stated that consortiums would fall apart unless salvaged by the caretaker government that had been requested to intervene.
Separately, he said he had also sensed that Shanghai Electric Limited (SEL) may walk away from taking over K-Electric from the Abraaj Group because of lack of clarity and slow progress on tariff and security clearance. The SEL had promised a $9bn investment to upgrade K-Electric.
Published in Dawn, The Business and Finance Weekly, June 25th, 2018