INTERNATIONAL THE NEWS

Economic reforms

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We return to our series on economic reforms. An area that is truly the most intractable problem of fiscal finances is public expenditures. While a great deal of attention is focused on calls for raising revenues, few voices ask to restrain expenditures, which are growing without much scrutiny.

We consider trends in expenditures during two democratic governments, with the year 2006-07 serving as the base. In 2006-07, the total consolidated (federal and provincial combined) expenditures stood at 19.5 percent of GDP. Over the next decade, the expenditures rose to 21.7 percent – an increase of 2.2 percentage points, which would translate to Rs880 billion at present. It is also important to note that this increase is not continuous; rather, there has been considerable volatility. But the rising trend is unmistakable. It is imperative to examine which expenditures are responsible for this growth.

The current expenditure has varied between 15 percent and 18 percent of GDP, with the figure standing at 17.4 percent last year. This essentially captures the rise in overall expenditures. However, its various components have shown a great deal of variation. Interest payments – the single largest component – has shown some variation but remained within the range of between 3.8 percent and 4.8 percent.

For the most part, defence expenditure was declining from 2.7 percent to 2.5 percent. But in the last three years, it has increased to three percent of GDP. Government grants is an important head of expenditure. It comprises a variety of transfers made to provinces, special areas (Azad Jammu and Kashmir, Fata and Gilgit-Baltistan), losses of railways, and other grants. This head has seen the greatest amount of volatility. It has ranged from 0.9 percent to 2.3 percent of GDP and has averaged around 1.5 percent.

The head of subsidies has long remained a real burden on the budget. In 2007-08, subsidies were as high as 3.8 percent because of the oil price shock and the decision of the government to not pass on the prices to consumers. Subsequently, a similar fate was met when governments started accumulating the so-called tariff differential subsidy (TDS). The country saw multiple tariffs determined for Discos, but only the most efficient tariff was made applicable throughout Pakistan, leading to huge subsidies, which rose to 2.8 percent in 2011-12.

Since then, and after the PML-N government made major price adjustments under the IMF programme, these subsidies have come down to the rather small level of 0.3 percent in the last fiscal year.

The most significant rise in current expenditures is at the provincial level. From 4.2 percent in 2009-10, the current expenditure has risen almost uninterruptedly to reach six percent of GDP in 2017-18. Not surprisingly, this period of rising expenditure is the same when more resources were transferred to provinces under the new National Finance Award. There were some years when the provinces saved part of their resources and avoided spending to help the federal government meet the fiscal deficit target under the IMF programme. However, it was undone as soon as the Fund programme was completed in September 2016.

The development expenditure has seen the most volatile trend. Starting with 4.6 percent in 2006-07, it slumped to only 2.6 percent in 2010-11. But it gradually rose to 4.9 percent in 2016-17 and was recorded at 4.4 percent last year.

The fiscal deficit was 4.1 percent in 2006-07 and has since then been the real bane of the economy. It averaged to around six percent, with some years when under the Fund programme it was as low as 4.6 percent. Since development spending has been consistently less than five percent, it is evident that deficit was incurred even to finance current expenditures.

We can learn the following lessons from this review. First, the undesirable increase in expenditures has primarily come from increased provincial expenditures. Meanwhile, provinces can justifiably claim that additional resources transferred to them were meant to be spent on the subjects they are responsible for. This brings the ball back into the federal government's court, as it hasn't cut back on spending despite a shorter envelope of resources at its disposal. Under the circumstances, fiscal adjustment is nearly impossible to make.

Second, without correcting the situation soon, we are facing an explosive path of public debt accumulation. The prime minister also noted this situation wherein we are borrowing for even current expenditures (such as payment to employees). The primary deficit has to be eliminated, which is as high as 2.2 percent of GDP, exactly the same amount by which expenditures have risen over the last decade.

Third, we need to recognise that a fiscal policy where spending decisions are divorced from raising revenues is bound to fail. Politicians are frequently annoyed when they are informed that not all expenditures they desire can be incurred. Such advice is often termed as 'non-cooperation'. But they would frown on any suggestion to raise resources, whether it involves taxes or recovering the cost of electricity and gas supplies. The national exchequer is most vulnerable during election times when unreasonable demands on expenditures are made and realised.

Fourth, our system of fiscal responsibility also promotes profligacy. The constitution, regrettably, provides nearly an unchecked authority on spending. As explained in a previous article, 'Public debt: boon or bane?' published in these pages on September 4, for a government that controls the National Assembly, virtually any amount of expenditure can be secured, irrespective of resource availability.

What is more, a government may under-pitch intended expenditures to show an austere budget but then use the instrument of supplementary grants to incur higher expenditures. It shouldn’t be surprising, then, to see that in the last decade on most occasions the fiscal deficit target promised at the time of the budget was significantly breached at the end of the year. The parliamentary approval of supplementary grants, under Article 84, is delayed until the presentation and approval of the next budget. In the listless hours of the budget session, last year’s supplementary grants are approved.

To be continued

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