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Historical Trends in Expenditure

“The purpose of the government is to enable the people of the nation to live in safety and happiness. Government exists for the interests of governed, not for the governors." - Thomas Jefferson

The idea of democracy and a resultant welfare state with inclusive growth has been romanticized in Pakistan for a very long time. The proponents of welfare state have been highlighting the role of government to stimulate a level playing field between have and have nots. Yet somewhere in the entire process of ensuring interests of the governed, a lot of expenditures incurred are found to be not meant for the governed at all. Let’s take a deeper look into the patterns of expenditures and also the efforts to curb unnecessary expenditures in the face of huge fiscal deficit – a permanent feature of Pakistan’s economy.

The fiscal deficit in 2019 increased to 9.1 % owing to unprecedented fall in tax revenues and sharp rise in current expenditures. This rise in current expenditures kept total expenditures at a higher level. Higher interest payments, untargeted subsidies and loss making SOE’s remain the major challenges to the fiscal discipline along with covid 19. The current expenditure contributed around 85.1 % in total expenditure. The rise in domestic interest rate increased the share of markup payments to 29.4 % in 2019. The defense related expenditure increased to 16.1 %. The higher energy related subsidies due to power generation led to a significant increase in subsidy share of current expenditure. The subsidies registered a growth of 75 % in July-March 2020. The inter –Disco tariff differential (133.9 billion), WAPDA (8.5 billion) for receivables from FATA and additional 10 billion subsidy to Utility Stores Corporation (USC) led to the rise. The grants increased by more than 50 % as compared to the previous year. The other components of current expenditures includes:

superannuation allowances and pensions, grants (other than provinces), other general public services, public order and safety affairs, economic affairs and social protection. At provincial level the increase in non-tax revenue was observed in profits from hydroelectricity and irrigation. In FY 2018, the total and current expenditures were higher than the last five-year average. The growth in total expenditures decelerated to 10.1 % as compared to growth of 17.3 % in FY 2017. The major reasons behind slow growth were reduction in development expenditures and net lending. The current expenditure increased because of increase in provincial current expenditures. The share of current expenditures in total expenditure increased from 76.4 % in FY 2018 to 78.2 %. The share of provincial current spending was recorded at 19.6 % which led to primary deficit. The share of defense expenditure, mark up payments and current subsidies in current and total expenditure did not register any significant variations.

In FY 2017 the fiscal deficit increased to 5.8 % of GDP primarily due to low provincial surplus, short fall in revenue collection and increased in project loans on account of CPEC related activities. The total expenditure stood at 21.3 % of GDP as compared to 19.9 % in FY 2016. The major factor was the development expenditure that recorded the growth of 30.1 %. The fiscal deficit of provinces because of increased expenditures and low revenue collection. There are expectations of further increase in development expenditure in the next fiscal year.

A significant reduction was observed in primary deficit in FY 2016. The current expenditure maintained the same share in GDP as in FY2015 with a slight increase in the share of development expenditures. The significant fall in the markup payments and subsidies reduced the growth of current expenditure. There was a substantial decline in power subsidies owing to improved performance of DISCOs, rationalizing tariffs, reducing delays in tariff determination. The provinces showed better fiscal discipline resulting from controlled current expenditures and higher revenues collection. A sharp decline in non-tax revenue was observed due to decline in surplus profit of SBP and decline in receipts under CSF.

1.1 PSDP

The July-March 2020 witnessed a sharp increase in development expenditure both at the federal and provincial level. The provincial PSDP increased remarkably and grew by 38.4 %. A significant part of this was allocated to agriculture and food, transport and construction.

There was a sharp decline in PSDP spending both at the federal and provincial level in 2019. Thus development expenditure declined in 2019. The net lending also followed development expenditure.

The PSDP spending remained low at the end of FY2018, as directed by the Election Commission which prohibited initiating any new development project. The PSDP thus reported a negative growth of 7.7 % as compared to growth of 33.1 % in FY2017. Noteworthy is the difference between provincial and federal PSDP expenditures. The federal PSDP showed a negative growth of 20.6 % while the provincial PSDP registered a growth of 3.3 %.

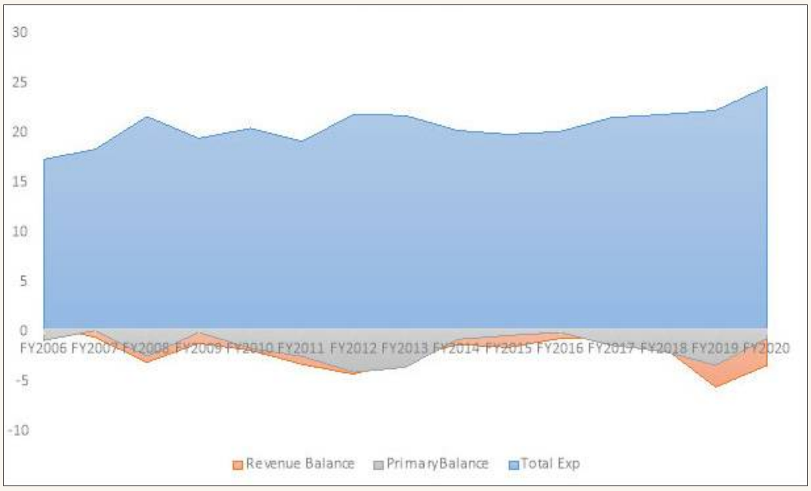
The size of federal PSDP increased during FY 2017.

1.2 Social protection

The development expenditure for BISP reported a significant growth of 53.7 % in FY 2018 as compared to FY 2014.

The allocation under BISP increased substantially and reached 121 billion in FY 2018.

The allocation to BISP increased in FY 2017.



Graph 1: Trends in Components of Expenditure (as % of GDP)

2 Measures taken to curb Expenditure

In year 2020, the binate challenge of increasing expenditure on health and social protection and mitigating the impact of COVID 19 impact on economy has brought fiscal accounts under immense pressure. On the fiscal side, a comprehensive fiscal stimulus package was introduced. In order to meet the financing requirement for these expenditures, additional resources have also been mobilized through various international financial institutions including IMF, World Bank, ADB etc.

The fiscal deficit in FY 2019 was the highest during the last five years. In its attempt to manage public expenditure more efficiently, the government strived to achieve a legal framework in which public spending units can acquire greater autonomy but with greater accountability. The absence of legal provision was identified as one of the major barriers to address the paramount challenge of improvement in governance and public service delivery. The reforms, named as Public Financial Management Reforms (PFMR), were aimed at achieving a better coordination between federal and provinces to rule out the overlapping expenditures and leakages from the system. The public sector enterprises were expected to increase efficiency and be self-reliant.

- The Program for Result (P4R) modality, one of the initiatives of PFMR, was implemented by ministry of finance with the support from world bank. The main objective of the program is to improve the system to ensure efficient management of public finances.

- The assignment account procedures were revised and new procedures were laid out. The assignment account rule was extended on current budget allocations to cater the needs of autonomous bodies. These accounts were prohibited for ministries, division, departments, sub ordinate offices, projects and organizations where there is only government funding. The principal accounting officer were asked to maintain an internal audit cell to improve internal controls. No cheques can be drawn in the name of project authorities for the transfer of funds from consolidated funds to commercial bank accounts. The practice of allocating one line budgets was discontinued. The sub assignment account was introduced. Constituted under the main assignment account, the sub assignment transactions are reflected in the main account ensuring transparency. the ministries and divisions can achieve additional budget through supplementary grant only through approval formal approval of cabinet.

In FY 2018, the efforts directed towards the introduction of wide ranging reforms in the area of fiscal management. This included the power sector reforms and the restructuring of Public Sector Enterprises (PSEs). The objective is to reduce the unproductive expenditures and create fiscal space for social safety nets and growth oriented projects. In the last five years the total development expenditures have increased from 3.5 to 5.3 % of GDP in FY 2017. The monitoring of expenditures was emphasized to avoid un budgeted expenditure and to ensure that expenditures are made in the light of flow of receipts. A ban was placed on purchase of all types of vehicles both form current and development expenditures except for operational vehicles of law enforcing agencies.

The FY 2017 marked the execution of wide ranging restructuring reforms in the power sector and the PSEs.

- **Power Sector Reforms**

Under the framework of National Power Policy 2013, major governance reforms were introduced in the power sector. The subsidies to the power sector were significantly reduced. A Circular Debt Capping Plan was finalized to manage the power sector's financial flows, subsidies and stock. To avoid the accumulation of new arrears, the reforms focused on improving DISCOs performance, rationalizing tariffs and reducing delays in tariff determination. The prudent overhauling of the financial and management system of GENCOs and DISCOs was approved to make the sector sustainable. In addition to these governance reforms, the efforts were made for the right fuel mix in the power sector.

- **PSEs Reforms**

The pillars of revival of public sector organizations reforms program included divestment through strategic partnership and public offerings, ensuring enforcement of public governance laws and restructuring plans and regulations. The diversity in the nature of PSEs led to multifaceted reforms with common objective. The divestment in banking sector resumed. Pakistan Railways was cited as a success story that reported higher revenues in FY 2014, 2015 and 2016 after the implementation of revitalization program. The revitalization program included rationalization of tariffs, expenditure controls and improved occupancy rates. PIA was converted in a company PIAC under the company ordinance to run PIA with an up to date legal system.

Box 2: Impact of Public Investment on Growth: Evidence from Recent Research

Papers	Result
Bint-e-Aijaz, Maryam and Nazima Ellahi (2012)[5]	Negative impact on the growth rate, mainly investing in the sectors, which are unproductive and inefficient.
Ghani, Ejaz and Musleh-ud-Din (2006)[6]	Public investment has a negative, but insignificant, impact on growth.
Khan, M. Tariq Yousuf and Komei Sasaki. (2001)[7]	Sufficiently large during the early period but decreases over time.
Elahi, Nazima and Adiqa Kiani (2011)[8]	Role of public investment is negligible due to its inefficiency.
Saghir, Rabia and Azra Khan (2012)[9]	Government development expenditures have an insignificant impact on growth.

The main heads of expenditure remain unchanged leaving government in dire need of fiscal space only to increase the development expenditures. A clear look at the expenditures reveal that the government in the 21st still aims at building the infrastructure. This approach is clearly the outcome of HAQ/HAG model which Pakistan has been pursuing for the past sixty years Haq et al, (2020). The study shows that mere focus on physical infrastructure through discrete projects or "brick and mortar" development has fizzled the true essence of development in Pakistan. Various econometric studies as reported in box 1, also support the Haq et al (2020). The studies show that public investment does not drive either economic growth or private investment. A closer look into the political economy of planning shows that these findings are not surprising. These projects are creating only assets that are more expensive than they should be and the returns are seldom maximized. Why this is happening? The answer lies in the fact that these projects are approved on the basis of political imperatives rather than Cost-Benefit Analysis. The HAQ/HAG model emphasized on expenditures even if they were carried out with foreign aid, without analyzing the outcome of inputs. The sectoral share of PSDP shows that we have yet to deviate from the brick and mortar strategy and spend for the governed.