

Fiscal Affairs and Constitution

Ghalib had once remarked that میری تعمیر میں مضر ہے ایک صورت خرابی کی (In my construct, there is an element of malady). The genesis of fiscal malaise originates from the budgetary provisions contained in our constitution. The constitutional provisions relating to fiscal affairs are summarized below (for simplicity we have restricted the text)

Article-77 requires that no tax shall be levied except by or under the authority of Parliament. Article-78 requires that all revenues of the federation, all loans raised and moneys received as repayment of loans shall form part of the Federal Consolidated Fund (FCF). Other moneys, including those deposited in the Supreme Court or any other court, shall form the Public Account (PA) of the Federation. Article-79 specifies that the custody of federal consolidated funds and public accounts shall be regulated by an Act of the Parliament; or until such time by the rules made by the President.

The above provisions provide for the setting of a fiscal system for the federal government. The manner in which finances will be expended and procedures to be adopted for seeking authorization from the parliament is specified in the next five articles 80-84.

Article-80 requires Federal Government shall, in respect of every financial year, cause to be laid before the National Assembly a statement of the **estimated receipt and expenditure or Annual Budget Statement (ABS)**. (2) The Annual Budget Statement shall show separately (a) the sums required to meet expenditure described by the Constitution as expenditure charged upon the FCF; and, (b) the sums required to meet other expenditures proposed to be made from the Federal Consolidated Fund;

81. Specifies expenditures which are charged upon the FCF such as President, Judges of the Supreme Court, Chairman, Deputy Chairman, Speaker and Deputy Speaker, Auditor General, Chief Election Commission, and some other offices.: (a) the remuneration payable to the President and other expenditure relating to his office, and the remuneration payable to (i) the Judges of the Supreme Court [and the Islamabad High Court]; (ii) the Chief Election Commissioner; (iii) the Chairman and the Deputy Chairman of Senate; (iv) the Speaker and the Deputy Speaker of the National Assembly; (v) the Auditor-General, all debt services obligations

82. The charged expenditures may be discussed in National Assembly but **would not be presented for voting** (emphasis added). So much of the ABS as relates to other expenditure shall be submitted to the National Assembly in the form of demands for grants, and the Assembly shall have the power to assent to or to refuse to assent to, any demand, or to assent to

any demand subject to a reduction of the amount specified therein: No demand for a grant shall be made except on the recommendation of the Federal Government.

83. (1) The Prime Minister shall authenticate by his signature a schedule specifying (a) the grants made or deemed to have been made by the National Assembly under Article 82, and (b) the

several sums required to meet the expenditure charged upon the FCF but not exceeding, in the case of any sum, the sum shown in the statement previously laid before the National Assembly. (2) The schedule so authenticated shall be laid before the National Assembly, but shall not be open to discussion or vote thereon. (3) Subject to the Constitution, no expenditure from the FCF shall be deemed to be duly authorized unless it is specified in the schedule so authenticated and such schedule is laid before the National Assembly as required by clause (2).

Article-84, finally allows the federal government the leeway to spend more than allocated funds or fund unbudgeted expenditures or incur excess expenditure in a given head. For such purpose the federal government shall cause to be laid before the National Assembly Supplementary Budget Statement or, as the case may be, an Excess Budget Statement, setting out the amount of that expenditure, and the provisions of Articles 80 to 83 shall apply to those statements as they apply to the Annual Budget Statement.

This then is the budgetary scheme specified in our constitution. The following important conclusions are evident:

First, regarding the power of taxation (Art-77) it is not per-se a budgetary provision because it can be used at any time during a fiscal year. The budgetary documents as such don't include taxation proposals or, in general, sources of revenues to meet expenditures;

Second, the Budget proper is what has been specified in Arts-80 to 83, which simply means charged expenditures and voted demands approved by the National Assembly and which have been included in the Schedule of Expenditures duly signed by the Prime Minister and placed before the National Assembly.



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Evidently, the constitution doesn't require the government to commit to a given level of deficit i.e. the difference between receipts and expenditures. The ABS requires the specification of revenue receipts but it doesn't constitute an element of an approved budget. The only occasion where the fiscal deficit is mentioned is in the budget speech of the finance minister who would indicate his plan to contain it within a certain limit. However, this commitment is observed in the breach than honor. A comparison of the last five budgets shows that on the average deficit at the time of budget was announced at 5.6% whereas in the final outcome it was 7.3%. An over-run of nearly two percentage points is a phenomenal sum and contributes directly to rising public debt and increasing debt servicing costs. To appreciate how much two percentage points would mean, note the projected GDP for 2022-23 is 78,000 billion and two percent would be equal to Rs.1560 billion, a phenomenal sum.

There are two aspects of constitutional provisions that afford unprecedented freedom to the government to act as it wishes so long as it has the majority in the National Assembly. First, no accountability for revenue collection performance and, second, the open license provided under Article-84 where it may go beyond the approved budget and do things not envisaged and also incur excess expenditure beyond the budget limit and get all this approved with the Assembly alongside the next year budget as supplementary budget.

There are two more provisions in the constitution, that have a very significant bearing on fiscal affairs, namely Article 160, which deals with the National Finance Commission regulating the distribution of tax revenues between federation and provinces, and Article 166 which vests borrowing powers to federal government against the security of the FCF. Article-160 requires detailed analysis which we would do some other time, but for now, our focus is on Article-166.

Article-166 says: The executive authority of the Federation extends to borrowing upon the security of the Federal Consolidated Fund within such limits, if any, as may from time to time be fixed by Act of Majlis-e-Shoora (Parliament), and to the giving of guarantees within such limits, if any, as may be so fixed.

This provision and the way it has been used since inception is the real bane of our fiscal system. To start off, note that in Article 77 it was prohibited that no tax shall be imposed except under the authority of the parliament. Furthermore, under Article 79 all revenues (tax and non-tax) and all loans and repayments thereof would be credited to FCF. Given the fact that the money is fungible (indistinguishable whether raised through tax or borrowing) prudence would require that the same sense of propriety should be exercised for each debit to the consolidated fund irrespective of its source. But inherently, the makers of the constitution have not treated them at par. While raising taxes was

subject to a parliamentary act, no such condition was required for borrowings and consequently, until 2005, when benign legislation, called Fiscal Responsibility and Debt Limitation Act (FRDLA), 2005, was enacted, the executive authority was unbounded to contract as much debt as it would like.

The FRDLA had set 60% as the debt to GDP ratio limit. It was envisaged if there was an over-run in the limit, the Finance Minister would issue a statement outlining the reasons behind the breach which would be corrected speedily over the shortest possible time. While this law worked for some time (by default) in 2016, IMF pushed an undesirable amendment which reduced the limit to 50% to be achieved over a 15-year period. This was completely in vain as under the very Fund program the ratio surpassed 90% but for the revised GDP figures, which have brought it back to around 80%.

To measure the dependence on debt in funding the budget, we look at the share of expenditure financed by debt. During the period 2016-21, on average the contribution of debt in financing the consolidated (federal and provincial) expenditure has been 30% while in some years it was close to 40%. In fact, things are far worse when we consider the situation of the federal government finances. At the federal level for the same period, as much as 53% of the budget was financed from borrowing. The net revenues of the federation are barely sufficient to meet interest payments. Evidently, the government has reconciled that tax effort would never be able to support current levels of expenditures. Dr. Arshad Zaman, the former chief economist of Pakistan, once remarked that privileged classes simply tell the government they would not pay (due) taxes but would happily lend to it.

Given the precarious fiscal conditions, in the near future debt accumulation would remain on the rise and therefore the share of debt financed expenditures would continue to rise. It may also be underlined that debt dynamics depend on interest burden which rapidly rises and contributes to even higher debt particularly when interest rates are rising, as at present where rates are the highest in nearly a decade. This is indicative of the fact that on this account also the path of debt accumulation would be rising rapidly unless painful actions are not taken to curb the easy access to debt.

It may be mentioned that there are two useful contributions made by the debt law, namely the debt policy and fiscal policy statements submitted to the parliament each year. They contain a wealth of information for policymakers and researchers but that has nothing to do with the main aim of the law, which has been miserably defeated because of toothless law.

Curiously, it is a widespread belief among responsible officers that loans are harmless compared to the use of revenue. They would frequently approach the ministry of finance for funding projects while boasting that they have lined up financing and thus it would not cost much to the exchequer.

The debt law has failed to reign in debt accumulation within the prescribed limit. Without a provision that would provide for some punitive measures for breach of debt limits, it would be unrealistic to expect any change in fiscal practices.

About the Author: The writer is the former Secretary, the Ministry of Finance and also held the position of Special Assistant to the Prime Minister (SAPM) on Revenue & Finance.