

## EXPENDITURE MANAGEMENT

The purpose of public spending in any country is to allocate resources efficiently for investment and growth, improve distribution of income and stabilise the economy. These goals are achieved through direct provision of public goods and services, income transfers and social protection and selective interventions when the economy is on an unstable trajectory.

In Pakistan, there are three tiers of government – federal, provincial and local – but the third tier where most of the interaction between an ordinary citizen and the government takes place has been almost dormant in the last decade. The devolution under the 18th Amendment has strengthened the provincial governments but devolution to the local governments has not taken place.

A snapshot picture shows that the total public expenditure in 2020/21 was 21 percent of GDP. Government footprint (although difficult to measure with some degree of confidence) in the form of administered price setting, regulatory overburden, legal and judicial interventions, inspections, NOCs is much larger. PIDE estimates place it at 67 percent based on certain assumptions. Federal government spending was 65 percent and the provincial spending 35 percent of the total. The share of the provinces from their own sources in the country's total revenues is only 10 percent; the bulk of their expenditure is financed from the divisible pool and the federal transfers. The wages (salary and allowances) of the employees account for 3.6 percent of GDP and 19 percent of the combined current expenditure incurred by the federal and provincial governments

A weakness observed in the provincial budgets is that development expenditure only accounts for 20 percent of the total outlay. It was expected that after the 18th Amendment and the 7th NFC Award the growth in development expenditure would accelerate. On the contrary, the relative growth in non-development expenditure, particularly salary and allowances, has been rapid.

Lower allocations for development (mainly infrastructure, human development) have the opposite effect to what the country is aspiring to achieve – which is: increased investment and expansion of domestic productive capacity aligning it with growing aggregate demand. This mismatch between domestic supply and aggregate demand, which gives rise to unmanageable current account deficit, has become the bane for policymakers. They have to resort to external borrowing to fill this gap, raising the debt-to-GDP ratio. So the current policy of allocating only one out of five rupees for development is inadequate for investment, growth and balance of payments. Were the higher allocations towards current expenditures moving towards achieving our Sustainable Development Goals (SDGs) it would have been satisfying, but that is not the case. The allocations for SDGs should not be made to the MNAs or MPAs but to the elected local governments.

We divide the consolidated expenditure into two categories. The first is inflexible – where the budget-makers have no room for maneuver as these are contractual and obligatory items that have to be paid under all circumstances. Defence expenditure, although frozen in nominal and curtailed in real terms in the last few years, (in FY22 it would amount to 2.3 percent of GDP) has to meet a minimum threshold to respond to the external threat perceptions. The second is discretionary spending – where cuts and savings can be affected.

Inflexible expenditures – interest payments (26.5 percent), defence (12.7 percent) and pensions (9.3 percent) together preempt 54 percent of the total consolidated expenditure but would be much higher in FY23 as the interest payments burden has risen sharply. Of course, there is a lot of room for improvement in debt management through choices of timing, tenor, volumes, instruments, fixed/ floating, bank/non-bank, external/domestic, and asset liability match. For example, Sukuk floatation through PSX opened up the investor base beyond the traditional banks and the competition gave very favorable rates to the government.

Under the discretionary expenditure, education, health and social protection receive 21.7 percent followed by development 9.3 percent, civil administration

5.7 percent, subsidies 4.1 percent, contingencies 3.4 percent and net grants 1.4 percent. It may appear gratifying that 50 percent of the provincial budgets is spent on education, health and social protection but poor governance, weak management, superficial monitoring and over-centralisation have not allowed the desired results to emerge.

Salaries and wages paid to government employees account for 19 percent of the total consolidated expenditure mostly to lower cadres. At the provincial level the wage bill forms around 50 percent of the current expenditure – of which three-fourths is taken away by education, health and the police. The size of employment in the federal and provincial governments has to be brought down gradually by abolishing all the vacant posts in Grades 1-16 except teachers, health workers and technical personnel. The scope for reduction in the running of civil administration is quite large in the provinces where there has been a proliferation in allowances of all kinds and unwarranted expansion in the workforce.

From a citizen's, and more critically a taxpayer's, perspective, the key question is what functions these 3.2 employees perform in the delivery of basic public goods and services for which they are paid. First, look at the federal government and its deployment according to its constitutional responsibilities. Thirty-five percent of federal employees were serving in security, and law and order agencies (civilian armed forces such as the Rangers, Frontier Constabulary, police, FIA, Intelligence Bureau, and civilians working at GHQ, PAF, PN headquarters and establishments), 20 percent were engaged in provision of infrastructure services such as Railways, Postal Services, Highways, Ports, Aviation. Power generation, transmission and distribution, oil and gas had 18 percent and the remaining 27 percent were engaged in social sectors, commercial and trade promotion, tax collection, regulatory, judicial and quasi-judicial (tribunals), training and research, external relations, media relations, parliamentary support, and the Islamabad Capital Territory.

At the provincial level, the three sectors where 75 percent of total employees work are education (41 percent), police (19 percent) and health (15 percent).

The remaining 25 percent is distributed among irrigation, works and housing, agriculture, industries, planning and development, food, water and sewerage, urban development, financial management, revenue collection, local governments, general administration etc.

Education, health and police claim 72 percent of the wage bill of the provincial governments. At the aggregate national level, education and health employees claim almost 50 percent of the total wage bill. The salaries of public-sector teachers are much higher than those in the private sector and have multiplied four times in the last ten years. Whether their performance and output are commensurate with the salaries paid to them is a question mark. The learning outcomes are weak – with more than 20 million children out of school – literacy rate and health indicators are lagging behind other countries in the region and the Human Development Index hasn't moved very much during the last three decades.

Our universities used to have teachers who got their degrees from Ivy League and other top leading schools of the world. While today the numbers have multiplied manifold, it is hard to find those who have been trained at top universities abroad. The situation at the school level is even more pathetic where some of the teachers can't spell ordinary common use words properly. A provincial department cannot well manage more than 36,000 primary schools scattered over 36 districts from Lahore.

Having dwelt upon the size, growth and functions the more interesting question is about the skill mix of these government employees. We classify Grades 1-5 as unskilled, Grades 6 to 16 as semi-skilled and Grades 17-22 as skilled. In the federal government, 95 percent of the employees are in the first two categories and only 5 percent in the third category. The unskilled – naib qasid, qasid, gardener, messenger etc – form 50 percent of the workforce while 45 percent are semi-skilled, that is: drivers, clerks, assistants, superintendents etc.

Almost 85 percent of the wage bill is preempted by the unskilled and semi-skilled while 15 percent goes to the skilled. Comparator studies have shown that officers in Grades 17-22 are underpaid while those in Grades 1-16 are

overpaid in relation to the private sector. As the government moves towards e-governance there is an urgent need to reconfigure the skill composition and bring in agriculture experts, scientists and technologists, economists, financial analysts, engineers, IT experts into the government. This should be done through the process of attrition where the posts in Grades 1-16 when they become vacant are abolished and the corresponding savings used to recruit and increase the salaries of specialists and skilled employees.

In a knowledge economy we have to rely upon domain experts in our decision-making process. The huge cost overruns and prolonged delays in completing our development projects and poor outcomes betray the absence of know-how in the design, preparation, appraisal, and execution of our development projects..

The aggregate losses of 85 commercial SOEs in 2018-19 were Rs143 billion – financed through government grants, loans, commercial loans and unfunded liabilities. Ten top loss-making companies account for 89 percent of the aggregate losses. But just looking at the losses is not enough. Many profitmaking companies are generating subpar returns. A comprehensive report has been prepared after a careful review of each enterprise and specific recommendations have been made with respect to each one of them. This report should be implemented as early as possible to avoid the recurring losses and maximise returns from others.

Thus opening up the PPP arrangements widely, engaging CSOs and INGOs and reforming the SOE sector would leave funding at the disposal of the government for R&D to both public and private sector, skill upgradation of labour force, universal primary schooling, climate transition financing, social protection, health insurance and other priorities that cannot be funded otherwise and are critical for the future development of the country.

To conclude, a strategy for Expenditure rationalization should consist of the following elements; (a) abolish the Federal Divisions and organizations which have been transferred to the provinces (b) devolve powers and financial resources from the provincial Governments to elected local governments (c) reduce the size of the Government by gradually abolishing the unskilled and

semi skilled posts in Grades 1-16 through attrition , adopt E Governance and bring in specialists and experts at planning, project , policy making positions and implementing agencies (d) leverage the private sector for large infrastructure projects through public private partnership and provide only viability gap financing from PSDP (f) engage reputable and credible civil society service providers to expand education and health facilities, particularly in backward and rural areas, (f) target food, fuel, fertilizer subsidies on the poor through BISP ,(g) privatise or transfer management to the private sector for non-strategic state-owned enterprises, (h) invest in R&D and knowledge economy, and climate change adaptation and mitigation and (i) shift pension payments to Direct Contributory scheme. The federal and provincial governments' role has to be reoriented in drawing performance agreements, monitoring, auditing the finances and holding the local governments, CSOs, PPPAs accountable for the results promised in their agreements. The skill mix for this kind of orientation would differ from what is available at present. Retraining of officers in developing performance indicators, automation and computerisation, data analytics would be urgently required in addition to inducting subject matter experts in place of the colonial inheritance of clerks, assistants, superintendents. The social cost benefit calculus of public expenditure would improve significantly.