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<https://www.dailymirror.lk/print/features/achieving-fiscal-targets-long-procrastination-will-continue/185-41950>

Achieving fiscal targets: Long procrastination will continue

Not even governments can perpetually spend more than they earn, without jeopardising the economy. Therefore, the fiscal targets of the present government – to systematically reduce the budget deficit over a period – are a sensible step in the right direction. But deficits are not the only barometer of fiscal success. If revenue is drying up, not only do the deficit targets become difficult to achieve but pursuing them becomes painful for the economy.

Sri Lanka has previously had budget deficits exceeding 8 percent. But since the end of the war, the deficit has been declining and the estimate for 2013 is 5.8 percent of gross domestic product (GDP). If this is what is indeed achieved, it would be a record low. But that is not the only record low. The 2013 revenue estimate, at a mere 13.8 percent of GDP is another.

When record low budget deficits overlap with record lows in government revenue, there is a problem – not only for the sustainability of deficit targets but also for the health of the economy.

Long procrastination on deficit targets

The story of deficit targets is a story of long procrastination. The Mahinda Chinthana policy framework in 2005 set out a deficit of below 5 percent by 2011 (Exhibit 1). In 2009, with a deficit of 9.9 percent of GDP, this looked impossible, so the 5 percent target was postponed to 2013. In 2012, this target

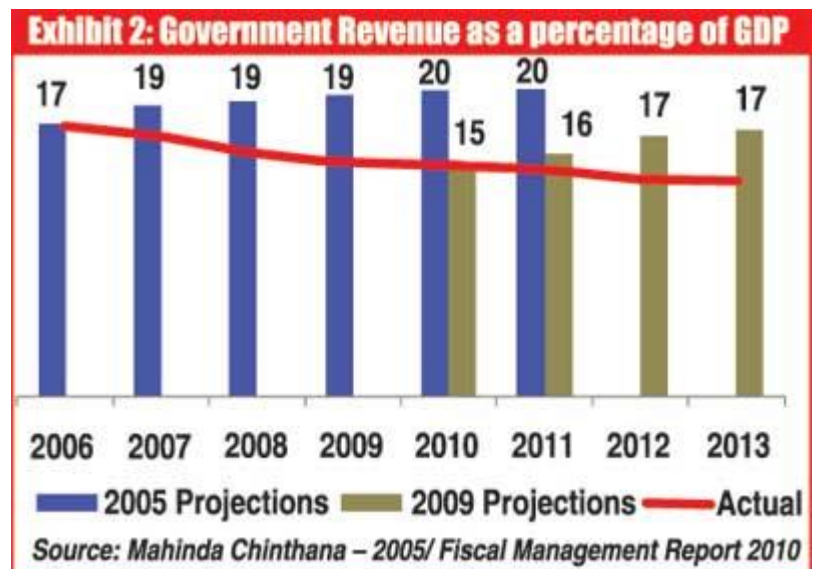
was further postponed to 2015. As Exhibit 1 shows, post war, there is definitely progress in the direction of the target and yet the target has remained elusive.

What is the problem?



Government revenue is a problem

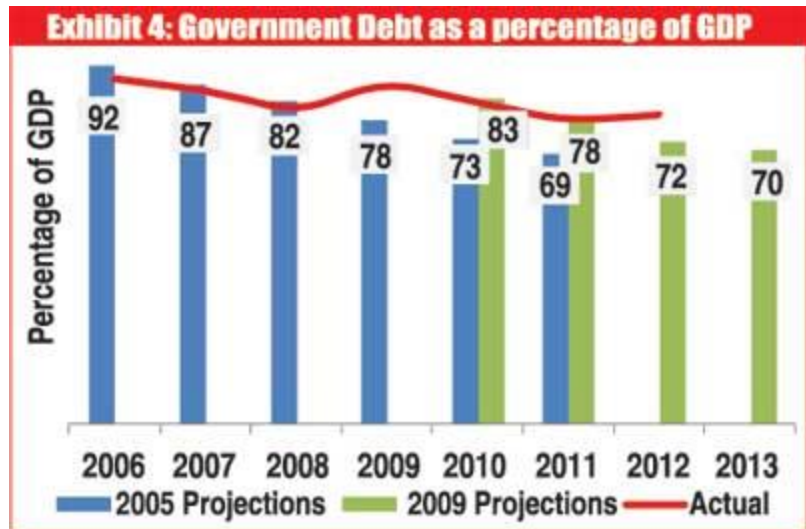
The revenue targets set in 2005 were ambitious. The Mahinda Chinthana policy framework targeted to increase government revenue to 20 percent of GDP by 2010. However, actual outcomes are moving in the opposite direction to that which was targeted (Exhibit 2). Therefore, in 2009, fresh and less ambitious targets were set and the long



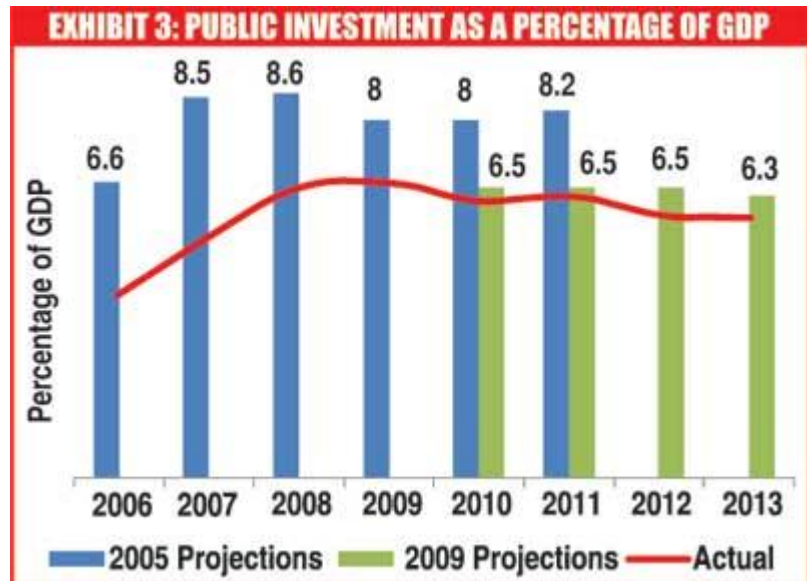
procrastination has set in here as well.

Meanwhile, large non-strategic concessions to investments (ironically under the strategic investment promotion act) threaten to undermine tax paying firms while also having repercussions on both short and long-term revenue. (Verité Research's Budget 2014 report provides a detailed list).

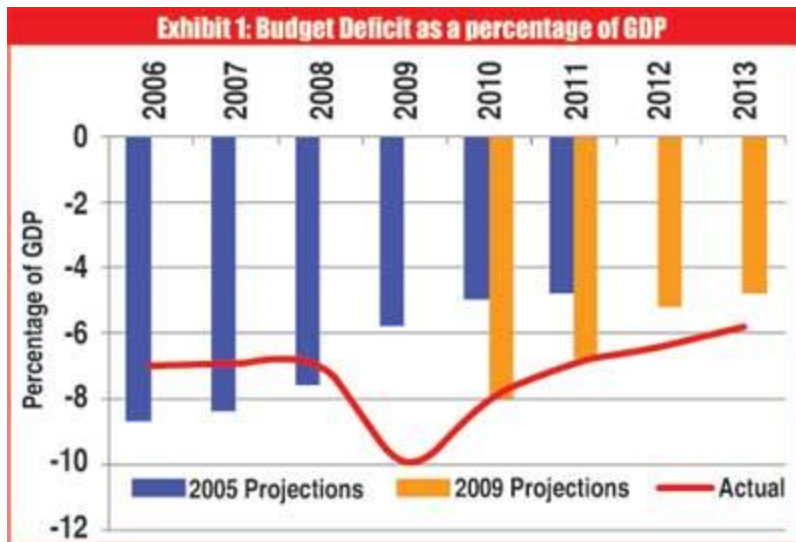
In 2012, the actual revenue was below even the 2009 projections and the targets were once again revised downwards. In 2009, it was expected that revenue would reach 17 percent of GDP by 2013. In 2012 revenue is expected to reach only a modest 15.1 percent even by 2015 (revenue as a percentage of GDP was 2 percent higher in 2006). But how are deficit targets being approached, when revenue targets are being missed by a wide margin?



Source: Mahinda Chinthana – 2005/ Fiscal Management Report 2010



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Public investment is paying part of the price

It has long been a fallback strategy of Sri Lankan governments to manage the deficit by cutting back on planned levels of capital expenditure (public investment).

In 2005, the government set ambitious targets to maintain public investment at historically high rates of 8+ percent of GDP (Exhibit 3). But lower revenue implies that either or both the deficit and expenditure targets have to give. Large expenditure cuts have come from this public expenditure target. In 2009 the targets were reduced to 6+ percent of GDP. However, the actual public investment has been falling behind even these lowered targets to below 6 percent in the last two years (yet remaining substantial compared to the levels in the 1990s).

Debt rises when deficits don't decline

The government deficit has to be financed by debt. In 2005, the target was to bring debt to below 70 percent of GDP by 2010 (from over 90 percent). But deficit targets have not quite panned out and that has caused debt to be much higher than planned. In 2009, the actual level of debt was still above 80 percent. This prompted the familiar strategy of postponing the target to 2013. In 2012 the target of 70 percent was further postponed to 2014. In the budget just concluded it has been shifted all the way back to 2016 - yet another case of

long procrastination (Exhibit 4).

Spending priorities need correction

William O'Brien's poem by the title 'Better To Try And Fail Than Never To Try At All' is a reminder that criticism should caution against discouraging a good attempt. Certainly there has been much "trying" in terms of achieving fiscal targets.

But as Verité Research's report on Budget 2014 describes in detail, in this chasing of targets the expenditures that have been cut, in addition to public investment, are critical social expenditures and public goods, including in health and education. The superfluous expenditure on large unproductive initiatives (Deyata Kirula and Mihin Air being classic examples) continue to be pumped-up by the budget.

Fixed payments such as salaries, pensions and interest payments account for over 70 percent of recurrent expenditure. Therefore, the combination of reducing debt, cutting the deficit and maintaining public expenditures, in the wake of declining revenue, is an impossible cocktail. Any solution will need to include a radical commitment to better spending priorities and pushing back on wastage and the unproductive. But going by Budget 2014, the long procrastination seems set to go on for quite a while longer.

(Verité Research provides strategic analysis and advice for governments and the private sector in Asia. Comments welcome, email insights@veriteresearch.org)