Who bleeds for the Budget?

Previous Verité Insights have documented the “long-procrastination” in the achievements of targets set out in the budget. The mismatch between expectation and reality has been particularly a problem in the area of government revenue. This Insight locates the sectors that have suffered with budget cuts to compensate for the revenue shortfalls.

Biggest losses and greatest pain
Exhibit 2 shows for 2012 (2013 actuals are not available as yet) both the actual budget cuts in billions of rupees across categories of expenditure and the level of pain created by those cuts. The pain is calculated by stating the cut as a percentage of the final budget allocation. The logic is simply a cut of 10 billion from a budget of 200 billion will hurt less (cause less pain), than the same cut from a budget of 50 billion.

Transport and Communication faced the largest budget cut – 44 billion. That means this sector bled for more than one third of the revenue shortfall. The pain factor for Transport and Communication was almost 20 percent (that is how much was cut in relation to what was received). But the sector that suffered the greatest pain was Agriculture and Irrigation: while the cut was 26 billion, the pain factor was almost 34 percent.

The other sectors subject to substantial pain factors are Energy and water supply (17.4 percent), Public order and safety (17.4 percent), Welfare (16.2 percent), Community services (14.5 percent) and the Health sector (11.1 percent).

Unkindest cuts
Perhaps the unkindest cuts of all were from Public order and safety and from Community services, where the actual allocation was reduced not only in relation to what was budgeted but also in absolute amounts compared to the allocation in the previous year (in 2011).

It is also unkind (and probably unwise) that a few categories of expenditure have been disproportionately bled, to cover up for the revenue shortfalls. Seventy five percent of the revenue shortfall was covered up by bleeding (taking away money from) just three budget categories: Transport and Communication (36 percent), Agriculture and Irrigation (21 percent) and Welfare (18 percent). Additionally, Health bled for another 9 percent of the revenue shortfall.

Defence vs. the rest
The police and the military: A new development is that the police has been separated from the Defence Ministry, under Public order and safety. The final budget for Public order and safety was Rs.45 billion, after it was cut by 7.8 billion, with a pain factor of 17.4 percent. But the final budget for defence is recorded as Rs.163 billion after it is cut by a mere 1.6 billion with a pain factor of just 1 percent. The approach to cutting suggests that police was given less priority than the military.
Published in the Daily Mirror on 5th March 2014
Deference for defence: In fact, the defence spending, despite having amongst the highest budget allocations, faces the lowest level of absolute cut and the lowest level of pain, of any spending category. The defence spending is also disguised by the fact that not all allocations directed towards the military are counted in defence spending.

For instance, spending on the Kothalawela Defence Academy would be counted under education. A curious feature of Budget 2014 was that the total capital expenditure allocation for this military academy was 16.3 billion, which was an amount greater than the combined total capital expenditure for all the other universities in Sri Lanka.

**Interest payments are an indictment on budget accounting**

There is a category of expenditure where the difference between the budgeted amounts and actual expenditure is puzzling and worrying. That is interest payments. Increased dependency on international commercial borrowing has in recent years significantly increased the cost of interest payments. But the discrepancy between what was estimated and what was actually paid out is flabbergasting.

The budget estimated 13 billion in interest payments but when the final numbers came in, interest payments were four times that estimate – a whopping 52 billion. Un-anticipated depreciations in currency could have added 10 to 20 percent to an estimate but it could not have increased it by 400 percent. Much more than in the case of most other expenditures, the government debt and its terms are well-known and the interest payments on existing debt should be predictable with a high degree of accuracy. But budget accounting has mis-estimated it by miles.

The problem in such mis-estimation is not only the inaccuracy of information provided to parliament and public during budget debates but that other sectors will again face further unexpected budget cuts in order to meet this extra interest payments. In fact, the mis-estimation of interest payments to the revenue shortfall problem by a third – which then explains is why the budget cuts in the various sectors adds up to more than 100 percent of the revenue shortfall.

**Prognosis on 2013-2014**

An important implication from this analysis is that going by previous years, spending promises made in the budget and lauded in public are in fact quite unreliable. This same pattern can be expected when the final numbers are eventually reported for 2013 as well. The Verité Research analysis of Budget 2013 last year predicted that the revenue targets were unrealistic and would not be achieved. This prediction turns out to be correct: revised estimates now indicate a significant shortfall in revenue. When the next Central Bank Report is published, we will know again which sectors paid for it and how much pain they suffered.

This is a recurring problem. The government has two options in the forthcoming year: choosing between maintaining a low budget deficit – which is important for international financial ratings and lower borrowing costs – or keeping its budget
promise to the public.

If the government chooses to break its budget promises, rather than face a high deficit, perhaps this analysis might help it reconsider the sectors which will bleed for the price of poor accounting and financial management.