Fiscal Policy Statement

2013-14

Debt Policy Coordination Office
Ministry of Finance

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Table of Contents

Acknowledgements

This Policy Statement has been prepared to fulfill the requirement laid out under Section 6 of the Fiscal Responsibility and Debt Limitation Act 2005. I would like to acknowledge the input of various Ministries, Departments, Divisions and Agencies, particularly, timely data provision by Budget Wing (MoF), Economic Affairs Division. I would like to recognize the efforts put in by Mr. Muhammad Ikram, Deputy Secretary (DPCO), Muhammad Umar Zahid, Financial Analyst (DPCO), Arsalan Ahmed, Financial Analyst (DPCO), Ms. Saadiya Razzaq, Consultant and Mr. Arslan Shahid, Consultant in the realization of this comprehensive document.

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Lists of Tables & Figures

1.0 Introduction

1.1 Pakistan's economy faced plethora of challenges on both internal and external fronts during the past five years including extremism, unstable law and order situation, lingering energy shortages, insufficient external inflows, unprecedented floods in 2010 and torrential rains in Sindh during 2011. Given the "Developing" status of Pakistan, these challenges added further intricacies in striking a right balance in terms of fiscal consolidation. Therefore, the importance of a prudent fiscal policy – aiming at mobilizing resources through taxes and public savings for funding public goods and services, correcting fiscal imbalances, promoting investment and growth through optimal allocation of resources and improving tax system policy – has gained significance.

1.2 The growth slowed to 3.6 percent in 2012-13 as compared with 4.4 percent a year earlier. This falloff mainly stemmed from service sector which witnessed slow growth of 3.7 percent from 5.3 percent last year. Within services, markedly weaker growth in transportation and general government services substantially outweighed faster growth of financial services, wholesale and retail trade. Agriculture expanded by 3.3 percent which was slightly lower than 3.5 percent growth realized a year earlier. Robust 5.2 percent growth in construction – reflecting flood rehabilitation – helped to boost industrial growth to 3.5 percent. Despite energy shortages, large-scale manufacturing edged upward to 2.8 percent, following several years of near stagnation. Performance in other sectors was broadly consistent with 2011-12.

1.3 Fiscal performance in 2012-13 replicated the pattern of past years as expenditure outstripped revenue by a wide margin, reflecting the continuation of excessive subsidies and lower tax collection. The fiscal deficit increased to 8 percent against the budgeted target of 4.7 percent of GDP mainly owing to around 19 percent slippages in FBR budgeted tax revenue, under estimation of subsidies and interest payments. The fiscal deficit includes Rs.322 billion on account of settlement of power sector circular debt without which the fiscal deficit is calculated at 6.6 percent.

1.4 In 2012-13, inflation averaged 7.4 percent which was down from 11 percent a year earlier on the back of easing in food and other prices. Bank lending to the government continued to increase rapidly, raising broad money growth to around 16 percent while net foreign assets declined. The situation remained challenging at external front as current account posted a deficit of US$ 2.3 billion which was equal to 0.9 percent of GDP.

1.5 Energy imbroglio continued to hurt macroeconomic outlook. It triggered a vicious cycle, putting adverse impact upon GDP, industrial growth, employment, private and foreign investments and the much needed process of fiscal consolidation. During 2012-13, over 95 percent of the total subsidy was consumed by the power sector, which amounted to Rs.344 billion as against its budgeted target of Rs.185 billion. Severe energy shortages continued, lashing an estimated 2 percentage points from GDP. Moreover, a persistent increase in the burden of debt servicing put pressure on government's budgetary position as nearly 41 percent of total revenue were consumed on this account against 40 percent in 2011-12.

1.6 The new government that took office in June 2013 quickly signaled restoring economic sustainability and rapid growth as high priorities. It articulated its economic vision based on trade and investment, market considerations, enhancing private sector involvement, limiting itself within the broader limits imposed by the available resources and broadening the base of resource mobilization for running the government. It also accorded high priority to resolve energy crisis, up-gradation of infrastructure base, building up foreign exchange reserves and correcting fiscal and external imbalances. This indigenous reform program to revamp the economy through structural measures was supported by the International Monetary Fund (IMF) which provided much needed support worth US$ 6.6 billion to be disbursed in three years.

2.0 Fiscal Policy Statement

The Fiscal Policy Statement is presented to fulfill the requirement of Section 6 of the Fiscal Responsibility and Debt Limitation (FRDL) Act 2005 which stipulates that:

(1) The Federal Government shall cause to be laid before the National Assembly the Fiscal Policy Statement by the end of January each year.

(2) The Fiscal Policy Statement shall, *inter alia*, analyze the following key Macroeconomic indicators, namely:-

- (a) Total revenue;
- (b) Total expenditure;
- (c) Total fiscal deficit;
- (d) Revenue deficit; and
- (e) Total public debt

(3) The Federal Government shall explain how fiscal indicators accords with the principles of sound fiscal and debt management.

(4) The Fiscal Policy Statement shall also contain:-

(a) The key measures and rationale for any major deviation in fiscal measures pertaining to taxation, subsidy, expenditure, administrated pricing and borrowing;

(b) An update on key information regarding macroeconomic indicators;

(c) The strategic priorities of the Federal Government for the financial year in the fiscal area;

(d) The analysis to the fullest extent possible of all policy decisions made by the Federal Government and all other circumstances that may have material effect on meeting the targets for economic indicators for that fiscal year as specified in the Medium-Term Budgetary Statement; and

(e) An evaluation as to how the current policies of the Federal Government are in conformity with the principle of sound fiscal and debt management and the targets set forth in the Medium-Term Budgetary Statement.

3.0 Budget Strategy 2012-13

3.1 The key aspects of the budget strategy are given below:

- Containment of the fiscal deficit to 4.7 percent of GDP.
- Enhancement of the overall federal revenue to Rs.3,234 billion.
- Removal of subsidies on differential tariff rates in the power sector.
- Targeted subsidies on the food and health sector.
- Reduction of public debt to 60 percent of the GDP or less.
- Rationalization of current expenditure to improve efficiency.
- Formulation of the new growth strategy to enhance the current fiscal performance.
- Effective management and restructuring of the Public Sector Enterprises (PSEs) to revitalize their financial and liquidity position so as to restrict the explicit and implicit liabilities that may add to the public debt burden.

3.2 The budget 2012-13 focused on key areas of revenue mobilization and curtailment of expenditure. Besides it focused to protect the vulnerable groups through a range of measures to restrict the impact of the fiscal consolidation policies on such groups. On the expenditure side, the focus was on austerity measures to contain rising expenditure and targeted development expenditure in the provinces on an equitable basis. The budget envisaged economic reforms to stabilize the economy and control the rising burden of public debt.

4.0 Historical Perspective on Fiscal Development

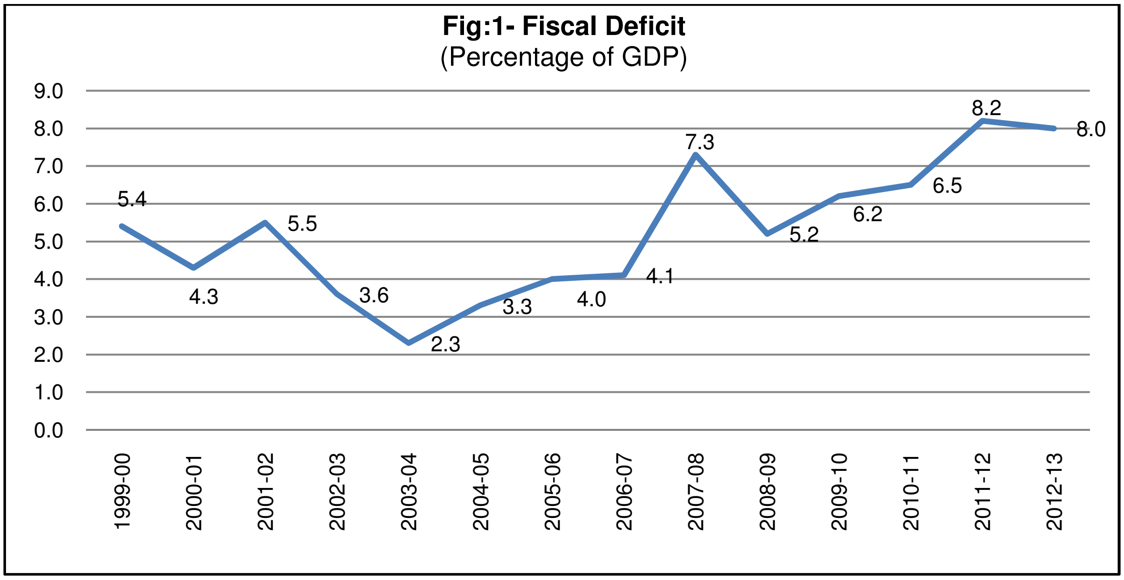
4.1 Historically, Pakistan experienced mix of high and low periods in terms of fiscal performance over the last two decades. A meaningful comparison between different periods over the last two decades is shown in Table-1:

Table:1 - Fiscal Indicators (as percentage of GDP)

Year	Real GDP Growth	Fiscal deficit	Expenditure			Revenue		
			Total	Current	Development	Total	Tax	Non-Tax
1992	7.6	7.5	26.7	19.1	7.6	19.2	13.7	5.5
1993	2.1	8.1	26.2	20.5	5.7	18.1	13.4	4.7
1994	4.4	5.9	23.4	18.8	4.6	17.5	13.4	4.1
1995	5.1	5.6	22.9	18.5	4.4	17.3	13.8	3.5
1996	6.6	6.5	24.4	20.0	4.4	17.9	14.4	3.5
1997	1.7	6.4	22.3	18.8	3.5	15.8	13.4	2.4
1998	3.5	7.7	23.7	19.8	3.9	16.0	13.2	2.8
1999	4.2	6.1	21.9	18.6	3.3	16.0	13.3	2.7
2000	3.9	5.4	18.9	16.4	2.5	13.4	10.6	2.8
2001	2.0	4.3	17.4	15.3	2.1	13.1	10.5	2.6
2002	3.1	5.5	19.6	16.2	3.4	14.2	10.7	3.5
2003	4.7	3.6	18.4	16.0	2.4	14.8	11.4	3.4
2004	7.5	2.3	16.4	13.8	2.6	14.1	10.8	3.3
2005	9.0	3.3	17.2	14.5	2.7	13.8	10.1	3.7
2006	5.5	4.0	17.1	13.6	3.4	13.1	9.2	3.9
2007	6.8	4.1	18.1	14.9	3.2	14.0	9.6	4.4
2008	5.0	7.3	21.4	17.5	3.9	14.1	9.9	4.2
2009	0.4	5.2	19.2	15.5	3.7	14.0	9.1	4.9
2010	2.6	6.2	20.2	16.0	4.2	14.0	9.9	4.1
2011	3.7	6.5	18.9	15.9	3.0	12.3	9.3	3.0
2012	4.4	8.2	19.6	15.5	4.1	12.8	10.2	2.6
2013	3.6	8.0	21.0	16.0	5.0	13.0	9.6	3.4

Source: Economic Survey, Debt Policy Coordination Office Staff Calculations

4.2 The decade of 1990's experienced high fiscal imbalances. The fiscal performance of the country saw considerable improvement during the period starting from 2002-03 to 2006-07 primarily because of (i) rescheduling of foreign debt of US$ 12 billion that brought down the debt servicing from 42 percent in 2000-01 to 22 percent of the revenue in 2005-06 (ii) huge flows of foreign grants that increased non-tax revenue and inflows from Coalition Support Fund (CSF). Post 2006-07, fiscal performance declined considerably as the average fiscal deficit remained around 7 percent of GDP during 2008-13. It was mainly due to challenges on internal and external fronts and policy inaction on important matters including adverse security situation, energy shortages, lower tax base, persistent losses posted by the PSEs, flooding and torrential rains, increasing debt servicing requirement, higher than budgeted subsides and gradual dilapidation in the socio-economic infrastructure. Trend analysis of fiscal deficits over the years 2000-13 is depicted through Fig-1.



4.4 Overall, analysis of the last two decades of fiscal performance revealed that high subsidies remained a major burden on fiscal account combined with falling tax to GDP ratio. Tax revenue as a percentage of GDP stood on average at 13.7 percent during 1992-96, has decreased to an average of 9.7 percent during 2008-2013. Low tax to GDP ratio has also translated into falling total revenue to GDP ratio, as it decreased from an average 18 percent during 1992-96 to 13.4 percent during 2008-13. Interestingly, even during the period of fiscal improvement (1999-2004), tax to GDP ratio continued to slide. Going forward, both spending and revenue measures have important implications for the economy and these implications need to be taken into account if the fiscal consolidation efforts underway are to be sustainable.

5.0 Fiscal Performance during 2012-13

5(i) Total Revenue

5.1 The total revenue of the government comprised tax revenue and non-tax revenue. Tax revenue included direct taxes and indirect taxes while non- tax revenue mainly consists of government receipts on its investments and provision of services. The Government envisaged a plan to mobilize the revenue by including the informal sectors of the economy to expand the tax base. In the non-tax revenue, apart from inflows from the CSF, the imposition of the Windfall Levy on crude oil and the development surcharge on gas infrastructure development were also introduced. These measures helped to raise the non-tax revenue by around 52 percent which mitigated the declining trend in non tax to GDP ratio compared with last year.

5.2 It was decided to rationalize tax rates to make the taxation system more efficient and transparent. The income tax slabs were reduced to 5 and only the portion above the tax free threshold was subjected to tax providing relief to the income tax payers. In addition, the tax rate on dividends was raised from 25 percent to 35 percent while reducing the minimum tax rates on company profits to 0.5 percent from 1 percent. Government removed the zero-rated products from the sales tax to expand the sales tax net. In order to reduce the smuggling of goods, the sales tax rate on certain commodities was reduced from 16 percent to 5 percent. Furthermore, to avoid multiplicity all sales tax rates were set at a uniform rate of 16 percent. Federal excise duty on construction was reduced from Rs.500 per metric tonne to Rs.400 per metric tonne with the aim to support the construction activities; however, it aggravated the fading base of the federal excise duties.

5.3 Government reduced the maximum rate of custom duty and aligned the tariff categories with the major trading partners such as United States and European Union to improve the efficiency of the custom duty collections. It also focused on full imposition of the petroleum levy to enhance the total revenue.

5(ii) FBR Collection

5.4 During 2012-13, FBR managed to collect Rs.1,936 billion in terms of the total tax collection against the target of Rs.2,381 billion, a slippage of 19 percent. This amount represented a growth of 3 percent in the tax revenue when compared with previous year which was the lowest in 13 years showing a potential slowdown in the country's tax collection. It is imperative to consider the tax revenue collection against the targets set which highlights the growing need for effective tax collection machinery.

Table-2: A Comparison of Tax collection against established targets 2012-13 (Rs. in billion)

Tax Head	**Budget**	**Provisional Collection**	**Achievement of Target (%)**
Direct Taxes	932.0	735.8	78.9
Sales Tax	1,076.5	841.3	78.2
Federal Excise Duty	125.0	119.5	95.6
Customs Duty	247.5	239.6	96.8
All Taxes	**2,381.0**	**1,936.1**	**81.3**

Source: FBR Year Book 2012-13

5.5 Host of variables that resulted in missing the original target are as follows.

1) The macroeconomic projections of the government did not materialize as the real GDP grew by 3.6 percent against a target of 4 percent. This restricted the economic potential to be translated into tax revenue.

2) The dutiable imports grew by 8 percent against the target of 15 percent, whereas, the large scale manufacturing grew by 11 percent against the target of 17 percent resulting in reduction of tax revenue.

3) The tax collection target for 2012-13 was based on the estimation of last years' budget target of 1,952 billion, however, in essence only Rs.1,883 billion were collected reducing the base of the target by Rs.69 billion.

4) The shifting of sales tax invoices to Punjab Revenue Authority and the suspension of section 153 A bred a combined reduction of Rs.49 billion.

5) The government reduced the sales tax rate from Rs.7 to Rs.4 per unit of electricity for steel melters and re-rolling units and on certain items to 16 percent from as high as 22 percent. It also reduced FED rate on sugar from 8 percent to 0.5 percent on quantity. This had strong implications on the government's tax collection potential.

6) The lack of enforcement of the field staff coupled with a lack of audit and other management issues also led to a reduced tax collection.

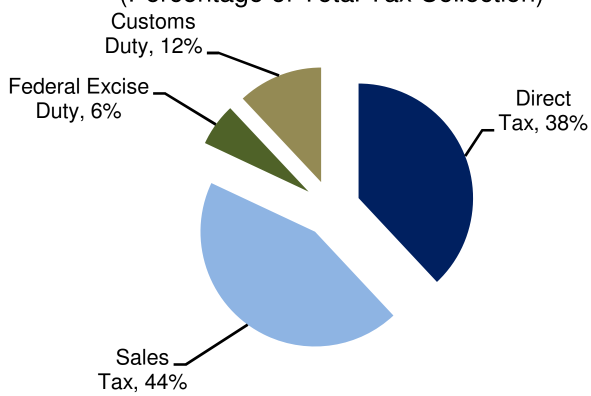
5(iii) Tax wise Analyses

5.6 The FBR Tax to GDP ratio in the 2012-13 stood at 8.5 percent deteriorating slightly from 8.6 percent in 2011-12. The analysis of taxes collected by FBR is as follows:

Direct Taxes

5.7 Direct taxes comprised mainly income tax, capital gains tax, worker welfare funds and worker profit participation funds. The income tax is further sub categorized into voluntary payments, collection on demands and withholding taxes (WHT).

Fig:2 - Tax Wise Analysis
(Percentage of Total Tax Collection)



Head Wise Analysis of Direct Taxes

5.8 Direct tax constituted 38 percent of the total FBR tax revenue for the year and stood at Rs.736 billion. This represented a mere 0.5 percent growth over the previous year's tax collection of Rs.732 billion. This trend is consistent with the overall slowdown in tax revenue growth. In addition, the direct taxes collection reflects 79 percent of the target fixed in the budget which leaves a wide scope for improvement in the estimation, administration and collection of these taxes. Table below shows the head wise performance of each component of direct taxation.

Table-3: An analysis of Direct Tax Collection (Rs. in billion)

Tax Head	2012-13	2011-12	Growth (%)	% share in 2012-13	% share in 2011-12
Voluntary Payments	244.9	237.4	3.2	31.7	28.9
Collection on Demand	89.4	130.0	(31.2)	11.6	15.8
W.H.T	436.1	422.4	3.2	56.5	51.5
Miscellaneous	1.7	31.0	(94.5)	0.2	3.8
Gross Income Tax	**772.1**	**820.7**	**(5.9)**	**100.0**	**100.0**
Total Net Income tax	**735.8**	**731.9**	**0.5**	**-**	**-**

Source: FBR Year Book 2012-13

a - Voluntary payments

5.9 Voluntary payments represented 32 percent of the total direct tax collection in 2012-13, this reflected a small improvement from 2011-12 where voluntary payments constituted 29 percent of the direct taxes collected. There has been an increase of 3 percent from the previous year. Voluntary payments with returns stood at almost the same level of around Rs.15 billion which is a potential consequence of the administrative issues that FBR has been struggling to cope up with. The advance tax collection has reflected a slight improvement of around 4 percent with a collection of Rs.230 billion in 2012-13 against a collection of Rs.222 billion in 2011-12.

b - Collection on Demand

5.10 Collection on demand decreased by Rs.41 billion or 31 percent compared with its collection of Rs.130 billion in 2011-12 and poised at Rs.89 billion in the 2012-13. This reduction is nearly 2 percent of the total tax collection for the year. The decline was a result of a lack of audit for several years which has failed to raise the demand for new tax payers. Therefore, it is imperative for the government to improve its audit and administration of the tax collection to revert this adverse trend in the coming fiscal years.

c - Withholding Taxes

5.11 Withholding tax was the main contributor in direct tax with 57 percent share in 2012-13. The collection of WHT stood at Rs.436 billion with around 3 percent growth from the previous year's collection of Rs.422 billion. The table below shows the head-wise breakup of the WHT collections during the fiscal year 2012-13.

Table-4: Head Wise Collection of WHT (Rs. in billion)

Collection Head	Collection		Growth %
	2012-13	2011-12	
Imports	103.2	85.3	21.0
Salary	50.1	57.3	(12.6)
Dividends	19.2	17.6	9.1
Bank Interest	35.3	33.8	4.4
Contracts	111.5	106.5	4.7
Exports	23.2	23.3	(0.4)
Cash Withdrawal	12.4	12.5	(0.8)
Electric Bills	16.0	14.6	9.6
Telephone	27.1	36.9	(26.6)
Sub total	398.1	387.8	2.7
Share in WHT (%)	91.3	91.8	-
Total WHT	**436.1**	**422.4**	**3.2**
% share In Income tax	56.2	51.8	-

Source: FBR Year Book 2012-13

5.12 The improved performance in the collection of WHT from imports was mainly due to an increase in the dutiable imports by 8 percent translating into 21 percent growth in collection from imports when compared with 2011-12. In addition, the imposition of 5 percent tax on items that were previously exempted from taxation helped in increasing the WHT collection from imports.

5.13 Growth was also recorded in WHT collection from Dividends (9 percent) Contracts (5 percent) and Bank Interest (4 percent). The slowdown in the global and local economy and the absence of viable investment opportunities has led the private sector companies to pay greater proportions of profits as dividends to their shareholders resulting in higher WHT collection. Similarly, an increase in bank interest rate resulting coupled with the tendency to invest in saving accounts has generated a higher WHT collection on bank interest.

5.14 Reduction in tariff subsidies leading to an increased price per unit of electricity has led to a growth in the WHT collection from the electric bills (10 percent). However, despite these strong trends, there was a decrease in the WHT collection on Salary by 13 percent, exports by 0.4 percent, cash withdrawal by 1 percent and Telephone by 27 percent. The increase in the tax free band of salary from Rs.350,000 to Rs.400,000 per annum and the increase in the minimum tax free cash withdrawal limit from Rs.25,000 to Rs.50,000 caused a 13 percent and 1 percent reduction in the tax collection respectively.

Indirect Taxes

5.15 Indirect taxes mainly include sales tax, federal excise duties and custom duties. Indirect tax constituted 62 percent of the total tax collection during 2012-13.

Sales Tax

5.16 Sales tax was the biggest contributor constituting 44 percent of the total tax revenue. This made it a vital component of taxation regime where effective collection of sales tax would have a positive impact on the overall tax revenue growth and aid the government in achieving an improved tax to GDP ratio. Sales tax grew by 4.5 percent during 2012-13 entirely from increase in the collection on domestic products.

a - Sales Tax from Imports

5.17 Sales tax has two main components, sales tax from imports and sales tax from domestic market. The share of sales tax on imports constituted about half of total sales tax collection and remained at last year's level as growth in imports almost remained stagnant during 2012-13. The table below shows the respective contributions from imports as well as from the domestic market. In the backdrop of increased dutiable imports, the sales tax collection on this segment has potential for improvement.

Table-5: Sales Tax Collection (Rs. in billion)

Collection Head	2012-13		2011-12		Gross Growth %	Net Growth %
	Gross	Net	Gross	Net		
Sales tax on imports	430.4	430.4	430.4	430.4	-	-
Sales tax on domestic products	440.6	410.9	419.8	374.5	5.0	9.7
Sub total	871.0	841.3	850.2	804.9	2.4	4.5

Source: FBR Year Book 2012-13

5.18 The following table shows the commodities that contributed towards the sales tax at the import stage. Only five commodities contributed 55 percent share in total sales tax on imports. These include POL products with 36 percent share followed by edible oil with 8 percent, vehicles 6 percent and iron and steel 5 percent.

Table-6: Commodity Wise Collection of Sales Tax at Import Stage(Rs. in billion)

Commodities	Collection			% share
	2012-13	2011-12	% growth	
POL Products	156.3	157.3	(0.6)	36.3
Edible Oil	32.3	34.9	(7.5)	7.5
Vehicles	26.8	28.1	(4.7)	6.2
Iron and Steel	21.8	21.8	(0.3)	5.1
Plastic Resins	20.6	26.1	(21.1)	4.8
Machinery and Appliances	19.5	22.6	(13.7)	4.5
Electric Machinery	14.5	14.1	3.0	3.4
Fertilizers	10.6	18.9	(44.2)	2.5
Organic Chemicals	10.0	9.6	4.0	2.3
Organic / Inorganic Chemicals	6.9	6.5	6.2	1.6
Sub Total	319.2	339.9	(6.1)	74.2
Others	111.2	90.5	22.8	25.8
Gross	430.4	430.4	0.0	100.0

Source: FBR Year Book 2012-13

5.19 The sales tax collection from POL products declined by 0.6 percent, edible oil by around 8 percent, vehicles by 5 percent. The larger proportionate decrease was witnessed in collections from fertilizers (44 percent), plastic resins (21 percent) and machinery and appliances (14 percent) having combined share of 12 percent in sales tax collection from imports. The “other products” which is a combination of a variety of commodities showed a strong growth of 23 percent, forming a quarter of all the sales tax collection at the import stage. However, this was greatly offset by the declining trends in other contributing products. It is imperative that the Government needs to improve its sales tax collection machinery to minimize inefficiencies so that increase in imports could adequately be translated into enhanced sales tax collection.

b - Sales Tax from Domestic Market

5.20 Sales tax from domestic market made up for the other half of total sales tax collection. The main contributing commodities were POL products (43 percent), natural gas (9 percent) and telecom (5 percent).The following table shows the 15 main commodities that contributed 80 percent of the total sales tax collection.

Table-7: Commodity Wise Collection of Sales Tax from Domestic Market (Rs. in billion)

Commodities	Collection			% share 2012-13
	2012-13	2011-12	% growth	
POL Products	177.6	149.6	18.7	43.2
Natural Gas	36.3	28.8	26.1	8.8
Telecom	18.3	49.1	(62.7)	4.5
Fertilizers	15.6	13.6	15.0	3.8
Cigarettes	14.5	12.5	15.9	3.5
Cement	10.9	7.6	44.0	2.7
Aerated Waters	10.8	8.9	21.3	2.6
Electrical Energy	8.9	9.2	(2.9)	2.2
Sugar	8.3	9.7	(14.8)	2.0
Machinery Parts	7.4	0.6	1,098.4	1.8
Services	6.2	16.2	(61.5)	1.5
Margarine	4.9	5.2	(5.8)	1.2
Scraps of Iron of Steel	3.4	3.5	(1.2)	0.8
Motor Cars	3.2	2.4	31.6	0.8
Liquefied Petroleum Gas	2.7	1.6	74.4	0.7
Sub Total	329.1	318.4	3.4	80.1
Other Sectors	81.8	56.1	45.8	19.9
Sales Tax (Domestic) Net	410.9	374.5	9.7	100.0

Source: FBR Year Book 2012-13

5.21 The growth in the sales tax collection was mainly from POL products, natural gas, cement, cigarettes and fertilizers which grew by 19 percent, 26 percent, 44 percent, 16 percent and 15 percent respectively. The main reason for increase in the tax collection from POL products was owing to increased oil prices in the global market which translated into increased sales tax collection. A strong collection from the cement sector was in correlation with increased construction activities driving up the demand for cement and related products. On the contrary, collection on telecom, sugar, services and electrical energy sectors registered negative growth. The reasons for decline are summarized as follows:

1) The telecom sector showed a 63 percent decline as the Punjab related telecom services were transferred to the Punjab Revenue Authority.

2) The tax rates on sugar commodities were reduced from 22 percent to 16 percent causing loss of Rs.4 billion in tax revenue.

3) Heavy input tax adjustment against sales tax on services claimed by provincial authorities such as Punjab Revenue Authority caused a decreased tax collection of 62 percent from the services sector. The impact amounted to Rs.34 billion in terms of tax revenue transferred.

5.22 Growth of 46 percent was recorded in the collections from “other sectors” combining a variety of different commodities; this neutralized the declining trends in the telecom, sugar, and services sectors helping to register overall growth of 10 percent in the total sales tax collection from domestic market.

Customs Duty

5.23 Customs duty imposed on dutiable imports constituted around 12 percent of the total tax revenue collected and contributed a reasonable share in the total tax collection. Customs duty collection stood at Rs.239 billion against Rs.217 billion in the previous year showing a growth of 10 percent, corresponding to an 11 percent increase in the volume of dutiable imports. FBR managed to achieve 97 percent of the targeted Customs duty of Rs.248 billion. The following table reveals the head wise collection of the customs duty.

Table-8: Commodity Wise Collection of Customs Duty (Rs. in billion)

Commodities	Budget 2012-13	Collection			% share 2012-13	Target Achieved (%)
		2012-13	2011-12	% growth		
Vehicles	48.8	42.3	43.1	(1.8)	17.0	86.7
Edible Oil	21.6	20.2	18.4	9.9	8.1	93.8
POL Products	22.4	20.4	17.6	16.2	8.2	90.9
Mechanical Machinery	13.8	12.4	11.6	6.5	5.0	89.4
Electrical Machinery	12.0	10.4	9.9	4.8	4.2	86.5
Plastic Resins	9.6	8.8	8.8	0.2	3.5	91.8
Iron and Steel	10.9	7.1	7.8	(9.7)	2.8	64.9
Paper and Paper Board	8.2	5.2	6.6	(21.3)	2.1	63.4
Organic Chemicals	5.6	3.9	3.9	1.1	1.6	70.4
Tea and Coffee	4.5	3.7	3.5	5.2	1.5	82.3
Sub Total	157.4	134.4	131.2	2.4	53.9	85.4
Other Sectors	101.8	115.6	94.2	22.7	46.1	113.6
Gross	259.2	250.0	225.4	10.9	100.0	96.5
Refund/Rebate	11.7	10.4	8.5	22.6	-	88.9
Net	247.5	239.6	216.9	10.5	-	96.8

Source: FBR Year Book 2012-13

5.24 Customs duty collection was dominated by 10 commodities comprising 54 percent share in the total custom duty collection. The major share came from vehicles (17 percent) followed by POL products (8 percent), edible oil (8 percent), mechanical machinery (5 percent) and electrical machinery (4 percent).

5.25 The custom duty collection from vehicles registered a 2 percent decline over the previous year’s collection of Rs.43 billion. The current year’s collections stood at Rs.42 billion making up 87 percent of the budgeted figure of Rs.49 billion. Custom duty collections from edible oil grew by 10 percent and stood at Rs.20 billion in 2012-13 against the previous fiscal year’s collection of Rs.18 billion constituting 94 percent of the budgeted amount.

5.26 The custom duty collections from POL products increased by 16 percent and stood at Rs.20 billion. Despite the growth, the custom duty collections missed the budgeted target of Rs.22 billion, by 9 percent. In addition, the collections from mechanical machinery rose by 7 percent and stood at Rs.12.4 billion. The collections from mechanical machinery were 89 percent of the budgeted amount. Other sectors registered strong improvement from 2011-12 with 22 percent growth alongwith achieving 113 percent of the budgeted target.

Federal Excise Duty

5.27 Federal Excise Duty (FED) is levied on selected commodities at import and domestic stages. FED contributed around 6 percent in the total taxation revenue in 2012-13.The bulk of FED collection was from domestic sources. Owing to its narrow base, 5 major commodities including cigarettes, beverages, services, cement and natural gas contributed approximately 73 percent of the FED collection. The collection declined by around 3 percent and stood at Rs.120 billion in comparison with the previous fiscal year's collection of Rs.123 billion. The total FED collection was 96 percent of the targeted amount of Rs.125 billion. The following table gives a commodity wise break-up of the FED collections.

Table-9: Commodity Wise Collection of FED(Rs. in billion)

Commodities	Budget 2012-13	Collection			% share 2012-13	Target achieved %
		2012-13	2011-12	% growth		
Cigarettes	56.7	62	53.5	15.9	51.8%	109.3
Total Services	10.2	13.3	10.4	27.9	11.1%	130.4
Natural Gas	14.5	11.6	12	(3.3)	9.7%	80.0
Beverages	7.8	10.9	12.7	(14.2)	9.1%	139.7
Cement	14.1	3	0.8	275.0	2.5%	21.3
Perfumery & Cosmetics	1.8	0.2	2.4	(91.7)	0.2%	11.1
POL Products	5.1	0.2	5.8	(96.6)	0.2%	3.9
Sub Total	110.2	101.2	97.6	3.7	84.6%	91.8
All Other	14.8	18.4	25.1	(26.7)	15.4%	124.3
Gross	125	119.6	122.7	(2.5)	100.0%	95.7
Refund/Rebate	-	0.2	0.2	-	0.2%	-
Net	125	119.4	122.5	(2.5)	99.8%	95.5

Source: FBR Year Book 2012-13

5.28 Among major items, cigarette was the largest contributor having 52 percent share in the total FED collection followed by services (11 percent), natural gas (10 percent) and beverages (9 percent). The FED collection from cigarettes showed an increase of 16 percent and stood at Rs.62 billion. Moreover, it achieved 109 percent of the budgeted amount of Rs.57 billion. The collection from beverages registered a decline of 14 percent over the previous year and stood at Rs.11 billion. However, despite this decline, the collection from beverages stood at 140 percent of budgeted target.

5.29 The tax collection from natural gas declined by 4 percent and stood at Rs.11.6 billion in 2012-13 against the previous fiscal year's Rs.12 billion. Furthermore, the collections from natural gas were 80 percent of the budgeted amount of Rs.15 billion. FED collection from services increased by 27 percent and recorded at Rs.13 billion by achieving 130 percent of the budget target. The collections from the cement sector recorded a healthy growth of 272 percent with Rs.3 billion in 2012-13. Despite the growth in the construction industry, collections from cement sector were only 22 percent of the budgeted amount of Rs.14 billion. Perfumery and POL dropped by 91 percent and 97 percent respectively and recorded at Rs.0.2 billion each.

5.30 The Government also relied on other sources of indirect taxes which mainly included the petroleum levy, airport taxes and other taxes. During 2012-13, collection from petroleum levy stood at Rs.110 billion against the target of Rs.120 billion showing a strong growth of 82 percent on the previous fiscal year's collection of Rs.60 billion. This had a positive impact in stabilizing the country's fiscal account. The other taxes have however dropped down from Rs.4 billion to Rs.3 billion registering 29 percent decline.

5(iv) Non- Tax Revenue

5.31 Non-tax revenue is mainly contributed by dividends, SBP profits, defense receipts, development surcharge on gas and royalty on oil & gas. These receipts during 2012-13 increased by 52 percent over the last year and achieved 99.5 percent of the budgeted target of Rs.730 billion. The table below shows the main contributions to the government's non-tax revenue and their performance against targets.

Table-10: Sources of Non-Tax Revenue (Rs. Billion)

Sources of Taxation	**Budgeted 2012-13**	**2012-13**	**2011-12**	**% growth**	**% share**	**Variance**
Interest	15.4	14.8	12.9	15.2	2.0	(0.6)
Interest (PSE's)	19.7	11.6	10.4	10.8	1.6	(8.1)
Dividends	64.6	63.5	49.7	27.8	8.7	(1.1)
Defense	150.6	180.4	9.8	1734.8	24.8	29.8
SBP profits	200.0	220.0	204.0	7.8	30.3	20.0
Citizenship & Naturalization	14.8	16.2	10.9	48.5	2.2	1.4
Development Surcharge on Gas	30.9	32.2	23.0	40.1	4.4	1.3
Discount Retained on Crude Price	22.5	15.5	20.0	(22.7)	2.1	(7.0)
Royalty on Oil and Gas	58.2	65.2	62.8	3.8	9.0	7.0
Windfall Levy	5.3	23.8	0.0	-	3.3	18.5
Gas Infrastructure Development Cess	30.0	33.6	0.0	-	4.6	3.6
Petroleum Levy on LPG	1.0	0.0	0.0	-	0.0	(1.0)
Others	117.3	50.1	74.9	(33.1)	6.9	(67.2)
Gross Receipts	**730.3**	**726.7**	**478.5**	**51.9**	**100.0**	**(3.6)**

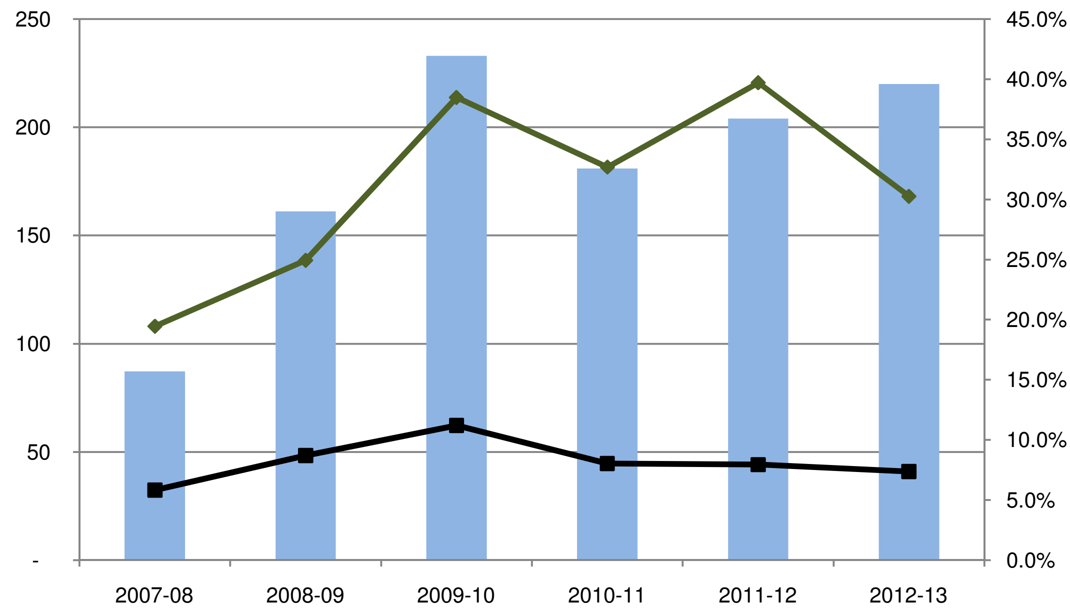
Budget Wing, Finance Division

5.32 Around 81 percent of non tax receipts were from 6 heads with a major contribution from SBP profits (30 percent) followed by defense (25 percent), royalty on oil & gas (9 percent), dividends (9 percent), gas infrastructure development (5 percent) and development surcharge on gas (4 percent).

5.33 Receipt of CSF increased the revenue from the defense sector to Rs.180 billion from Rs.10 billion last year. Meanwhile, the receipts from dividends stood at Rs.64 billion, 28 percent higher than the last fiscal year. The government also introduced windfall levy, gas infrastructure development cess which had a combined impact of Rs.57 billion or 8 percent of the non-tax revenue.

5.34 The SBP profit increased by 8 percent during 2012-13 compared with last fiscal year. This growth can be associated with the increased borrowing from SBP in the shape of Market Related Treasury Bills (MRTBs) and resulting interest servicing costs. The graph below shows the historical profits from SBP depicting a gradual increase over past few years.

Fig-3: Profit Receits from SBP
(PKR in billion & percentage of Non-Tax Revenue and Total Revenue)



6.0 <u>Total Expenditure</u>

6.1 The government's total expenditure consists of the current expenditure and development expenditure. The current expenditure mainly includes interest payments, pensions & annuities, subsidies and defense expenditure. The government's total expenditure during 2012-13 remained at Rs.4,816 billion against the budgeted amount of Rs.4,484 billion, showing an increase of 22 percent over the last fiscal year. Almost 76 percent of total expenditure were current expenditure, whereas, around 24 percent were development expenditure and net lending. Current expenditure increased by 15 percent, whereas development expenditure registered an increase of 6 percent during 2012-13.

6(i) Current Expenditure

6.2 Current expenditure mainly included the general public services and defense expenditure and recorded at Rs.3,660 billion in the 2012-13 compared to Rs.3,122 billion in the previous year showing an increase of 15 percent. The current expenditure exceeded the budgeted amount of Rs.3,452 billion yielding a variance of Rs.208 billion in absolute terms, implying the need to rationalize these expenditure.

General Public Services

6.3 The expenditure on general public services, comprising around 52 percent of the current expenditure, remained at Rs.1,884 billion in 2012-13. The general public services mainly included the interest payments on foreign and domestic debt, the pensions and annuities and grants to provincial government. Interest payments on foreign and domestic debt constituted almost 50 percent of these expenditure and 27 percent of current expenditure. This amount was 4.3 percent of the GDP and 45 percent of the total tax revenue in 2012-13. This was a result of widened fiscal deficit yielding increased borrowings mainly from the domestic sources.

Table 11: Consolidated fiscal position of the government in the fiscal year 2012-13

	Budgeted 2012-13	Provisional		% growth	% of GDP	Variance
		2012-13	2011-12			
Total Revenue	3,378.5	2,982.3	2,566.4	16.2	13.0	(396.2)
-Tax Revenue	2,583.6	2,199.2	2,052.8	7.1	9.6	(384.4)
-Non Tax Revenue	794.9	783.1	513.6	52.5	3.4	(11.8)
Total expenditures	4,484.2	4,816.3	3,936.1	22.4	21.0	332.1
a) Current expenditure	3,452.2	3,660.4	3,122.5	17.2	16.0	208.2
of which Interest payments	925.8	991.0	889.0	11.5	4.3	65.2
Domestic	845.6	920.4	821.1	12.1	4.0	74.8
Foreign	80.2	70.6	67.9	4.0	0.3	(9.6)
Provincial current expenditure	1,113.0	1,095.2	967.8	13.2	4.8	(17.8)
b) Defense expenditure	545.4	540.6	507.1	6.6	2.4	(4.8)
Development expenditure and net lending	1,032.0	1,139.9	743.8	53.2	5.0	107.9
c) Development expenditure	1,027.3	777.1	731.8	6.2	3.4	(250.2)
PSDP	873.0	695.1	664.7	4.6	3.0	(177.9)
Other Development expenditure	154.3	82.0	67.1	22.2	0.4	(72.3)
Net lending	4.7	362.8	12.0	2,918.5	1.6	358.1
d) unidentified expenditures	-	16.0	69.8	(77.1)	0.1	16.0
Overall fiscal balance	(1,105.7)	(1,833.9)	(1,369.7)	33.9	(8.0)	(728.2)
% of GDP	(4.7)	(8.0)	(6.6)	20.7	-	(3.3)
Financing of fiscal balance	1,105.7	1,833.9	1,369.7	33.9	-	728.2
a) External sources	134.9	(1.7)	128.7	(101.3)	-	(136.6)
Domestic sources	970.8	1,835.6	1,241.0		-	864.8
Non-Bank	487.0	378.0	529.4	(28.6)	-	(109.0)
Bank	483.8	1,457.5	711.7	104.8	-	973.7
GDP at market prices	23,655.0	22,909.0	20,653.0	10.9	-	(746.0)

6.4 Superannuation and pension costs were another major component of the public services cost. Pension cost witnessed 23 percent growth with Rs.173 billion as compared to Rs.140 billion in the previous fiscal year. This was mainly the result of increased pension rate by the government. Pension cost remained around 4 percent of the total expenditure in 2012-13, reflecting an efficient control on the pension and superannuation allowance. The table below shows the detail of expenditure on general public service in 2012-13.

Table-12: Components of General Public Expenditure (Rs. in billion)

Expenditure	2012-13	2011-12	% growth	% share
Interest on domestic debt	920.4	821.2	12.1	50.5
Interest on foreign debt	70.6	67.9	4.0	3.9
Superannuation allowances & Pension	172.6	140.4	22.9	9.5
Grants (other than provinces)	232.7	224.3	3.8	12.8
Other general public service	427.6	218.6	95.6	23.4
Gross receipts	**1,823.9**	**1,472.4**	**23.9**	**100.0**

Source: Budget Wing, Finance Division

Subsidies

6.5 The total subsidies amounting to Rs.358 billion or 1.6 percent of the GDP were paid during 2012-13. This amount came down from Rs.513 billion paid during 2011-12, depicting a decline of 30 percent. The government paid Rs.344 billion to the power sector constituting 96 percent of total subsidies. The power sector remained devouring more and more subsidies, leaving less room for other needy segments of the economy. The other major recipient of the subsidies was the food and agriculture sector which consumed only Rs.9 billion. The rising amount of subsidies resulted in the shape of growing burden on the government's resources and implies the need for macro-economic restructuring to make the power sector viable, independent and self-sufficient. The government is embarked on the path to economic restructuring to mobilize revenue, consolidate the fiscal situation and revive the economy. This is expected to improve the socio-economic outlook and reduce the burden of subsidies to protect the vulnerable groups of the society.

Table-13: Subsidies (2008-2013) - (Rs. in billion)

Subsidies	Power sector	Food and Agriculture	Oil Refineries	Others	Total
2012-13					
Budget estimate	185.3	11.2	7.7	3.4	208.6
Actual subsidies	344.1	8.7	3.4	1.8	357.9
% share	96.1	2.4	1.0	0.5	100.0
2011-12					
Budget estimate	147.3	11.1	7.9	0.1	166.4
Actual subsidies	464.0*	35.3	6.2	7.5	512.9
% share	90.4	6.9	1.2	1.5	100.0
2010-11					
Budget estimate	87.3	27.2	10.8	1.4	126.7
Actual subsidies	334.8**	25.7	10.8	9.3	380.6
% share	88.0	6.8	2.8	2.4	100.0
2009-10					
Budget estimate	66.7	37.9	15.0	0.3	119.9
Actual subsidies	178.8	22.2	11.2	1.3	213.5
% share	83.7	10.4	5.3	0.6	100.0
2008-09					
Budget estimate	88.4	30.6	140.0	1.2	260.2
Actual subsidies	109.8	29.3	67.7	6.6	213.4
% share	51.5	13.7	31.7	3.1	100.0

* Includes one off payments of Rs.312.8 billion and Rs.78.2 billion to the power sector and commodity operations respectively
** Include electricity subsidies amounting to Rs.120 billion.

Source: Budget Wing, Finance Division

6(ii) Development Expenditure

6.6 Development expenditure comprised 3.4 percent of total GDP and 16 percent of the total expenditure during 2012-13 with a 6 percent growth. Expenditure through Public Sector Development Programs (PSDP) constituted almost 90 percent of the development expenditure. The majority of the PSDP expenditure, around 53 percent, were carried out by the provinces. Following a past trend, the development expenditure were curtailed to Rs.777 billion against the budgeted amount of Rs.1,027 billion. The net lending increased to Rs.363 billion against the budgeted target of Rs.5 billion. However, the government remains committed to invest more resources towards the targeted development expenditure in the wake of the current socio-economic environment.

7.0 Provincial Expenditure

7.1 In 2009-10, the government announced the 7th NFC (National Finance Commission) award. This was a step towards greater provincial autonomy and fiscal devolution whereby the Provincial Governments were given greater authority and responsibility for their revenue collection as well as resource allocation. The provinces expressed their commitment to raise their taxes and contain the expenditure, thereby, reaching a fiscal surplus. In line with this commitment, provinces have recorded surpluses during 2012-13 supporting the fiscal deficit.

7.2 The total provincial expenditure in 2012-13 increased by 9 percent to Rs. 1,482 billion compared with Rs.1,356 billion in the previous year. The proportionate share of the provincial expenditure (in total expenditure) during 2012-13 stood at 31 percent, declining from 34 percent in the previous year reflecting prudent control over the total expenditure. Likewise, the proportionate share of the provincial current expenditure also decreased slightly to 30 percent from 31 percent of last year. However, in the nominal terms, the current expenditure increased by 13 percent amounting to Rs.1,095 billion in 2012-13 in comparison with the previous fiscal year's Rs.968 billion.

7.3 The provincial public sector development expenditure decreased from Rs.375 billion to Rs.372 billion. The economy is largely powered by two provinces Sindh and Punjab where decreased development spending was witnessed. However, Baluchistan increased its development spending compared with last fiscal year.

7.4 Amongst the provinces, Punjab witnessed a fiscal surplus on the back of an improved tax collection with 84 percent growth to stand at Rs.77 billion. Punjab contributed 51 percent to the total provincial tax revenue. Its total expenditure of Rs.691 billion showed an increase of 15 percent in the fiscal year 2012-13. Being the largest province, Punjab contributed around 47 percent in the total expenditure and 36 percent of the provincial current expenditure.

Table-14: Provincial Fiscal Operations (Rs. in billion)

Fiscal Operations	2012-13	2011-12	% growth	% share
Total Revenue	1,544.4*	1,334.0**	15.8	51.8
a) Tax Revenue	150.7	107.2	40.6	6.9
b) Non-Tax revenue	71.3	48.0	48.4	9.1
Total expenditure	1,481.6	1,356.1	9.3	30.9
a) Current expenditure	1,095.2	967.8	13.2	29.9
b) PSDP	371.5	375.4	(1.0)	53.5
Fiscal Surplus/ (Deficit)	**62.8**	**(22.1)**	**384.0**	**3.4**

* Includes Rs.1,214.9 billion received from the federal government

**Includes RS. 1,089 billion received from federal government

Source: Budget Wing, Finance Division

7.5 Sindh managed to increase its tax revenue by 13 percent through efficient tax collection measures. Sindh's tax revenue of Rs.68 billion contributed around 45 percent in the total provincial tax revenue. The province contributed 27 percent in the total provincial expenditure. The total expenditure of the province reduced by around 2 percent over the previous fiscal year and stood at Rs.404 billion in 2012-13.

7.6 Khyber Pakhtunkhwa (KPK) collected tax of Rs.4 billion during 2012-13 which improved from Rs.3.7 billion showing an increase of 12 percent. The province contributed a meager share of 3 percent in the total provincial tax revenue and relied mainly on the share of provincial revenue from the federal government which grew by 12 percent in the 2012-13. On the other hand, KPK total expenditure grew by 10 percent to stand at Rs.248 billion contributing 17 percent share in the total provincial expenditure. The growth in expenditure is correlated with an adverse security situation and a dilapidated social infrastructure.

7.7 Baluchistan is country's least populous province, the lack of developed infrastructure and weak administrative machinery could be seen in the frail tax collection figures shown for the 2012-13, as the total tax collection was Rs.1.1 billion against Rs.1 billion last year and forming 0.8 percent of the total provincial tax revenue. It is imperative that the province should build capacity to increase its indigenous resources. Baluchistan has been mainly reliant on its share from the federal government which increased by 17 percent over 2011-12.The total expenditure increased by 20 percent and stood at Rs.138 billion. This was mainly a result of 40 percent increase in development expenditure during 2012-13 which stood at Rs.40 billion. An increased share from the divisible pool along with grants received from the federal government led the province to a fiscal surplus of Rs.15 billion in 2012-13.

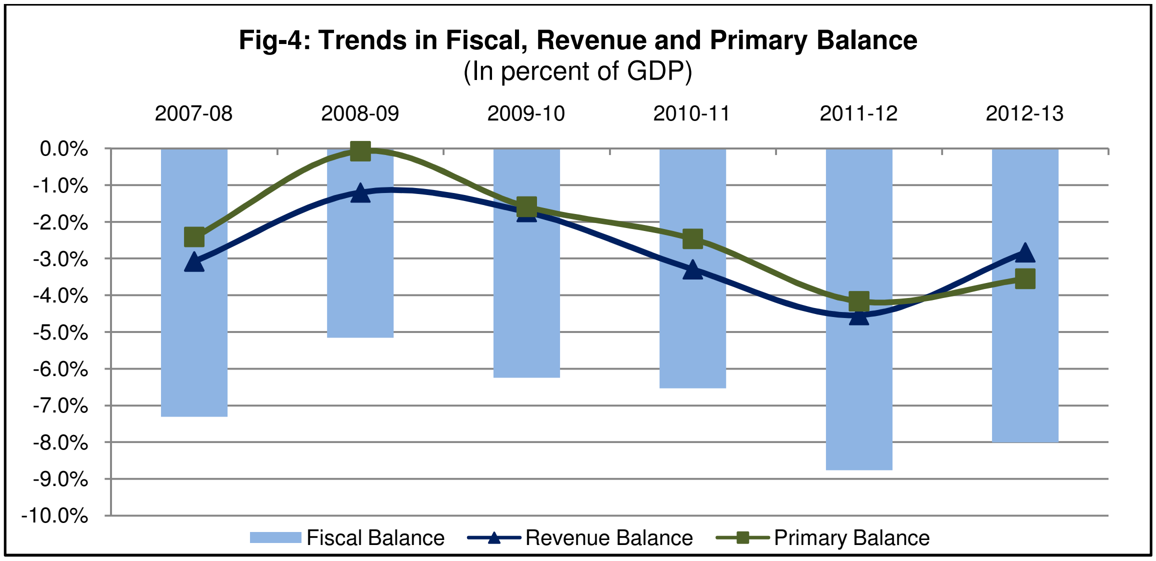
8.0 Fiscal, Revenue and Primary Balance

8(i) Fiscal Balance

8.1 The structural problems continued to put pressure on the fiscal balance, which has been the case for the last few years now. The fiscal deficit during 2012-13 was 8 percent including payment for the resolution of the circular debt accounting 1.4 percent of GDP. The deviation from initial estimates was largely on account of three factors: (i) underestimation of subsidies; (ii) underestimation of interest payments owing to increased domestic borrowings; (iii) lower collection against the targeted FBR tax revenue. The fiscal deficit exceeded the target despite an inflow of Rs.180 billion under CSF and Rs.53 billion surplus generated by the provinces.

8(ii) Revenue Balance

8.2 Revenue balance is the total revenue adjusted for current expenditure. Governments require fiscal space to spur development activities in the economy. For development spending, however, governments need to generate a revenue surplus or at least maintain zero revenue balance. Revenue deficit stood at Rs.649 billion or 2.8 percent of GDP in 2012-13 as compared to 4.5 percent of the last year. In the wake of the current socio-economic environment, the government remained committed to increase the development expenditure.



8(iii) Primary Balance

8.3 Primary balance is the total revenue adjusted for non-interest expenditure. A negative primary balance essentially means that the government is borrowing money to pay interest payment on the debt stock. The primary balance has receded from a deficit of 0.1 percent in 2008-09 to 4.2 percent in 2011-12. In line with the revenue deficit, the primary deficit aggregated to Rs.814 billion or 3.7 percent of GDP in 2012-13. The current situation suggests an immediate need for the introduction of fiscal discipline to rationalize expenditure and redress the fiscal predicaments.

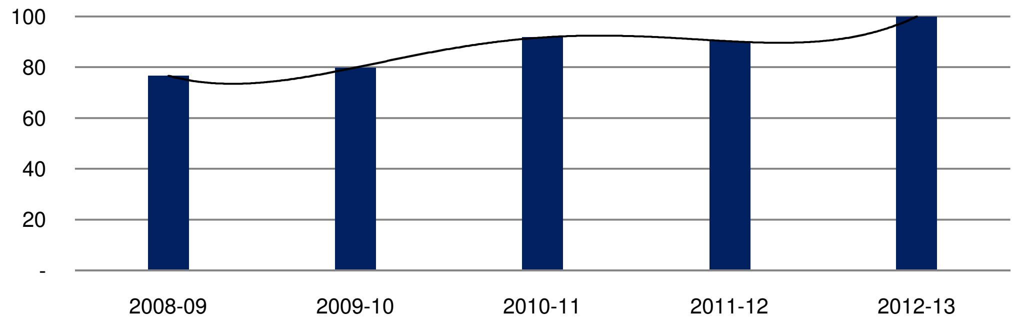
8(iv) Financing of Fiscal Deficit

8.4 The fiscal predicament left the government in a difficult situation as it has to rely on borrowings, predominantly domestic, to meet its financing requirements. The limited availability of external flows resulted in net external outflows of Rs.1,676 million.

8.5 In the course of 2012-13, Rs.1,835 billion was generated from internal avenues against a budgeted target of Rs.971 billion. Bulk of the domestic financing came from banking sources (80 percent of the domestic borrowing). The non-bank inflows were Rs.378 billion, 22 percent lower than the budgeted estimate.

8.6 Government committed (a) net zero quarterly borrowing from SBP baring ways and means limit and (b) repay SBP outstanding debt as of April 2011 in next 8 years in compliance with the State Bank of Pakistan Act. The Government borrowed Rs.506 billion from SBP during 2012-13 as compared to Rs.508 billion during 2011-12. Moreover, total government borrowing from SBP stood at Rs.2,168 billion as on June 30, 2013. As required by the SBP Act, an average annual repayment of Rs.361 billion is essential for the next six years to retire the outstanding debt stock prior to 30th April 2019. This demands higher generation of revenue and/or higher mobilization of external flows.

Fig-5: Domestic Financing of Fiscal Deficit
(Percentage of GDP)



9.0 Fiscal Performance July-September, 2013

9.1 Total expenditure recorded at Rs.1,116 billion (4.3 percent of the GDP) against the revenue of Rs.829 billion (3.2 percent of the GDP), thus, overall fiscal deficit stood at Rs.286 billion or 1.1 percent of GDP in the first quarter of the current year against an annual budgetary limit of 6.3 percent of GDP. The provincial surplus of Rs.92 billion has helped in containing the fiscal deficit at 1.1 percent.

Tax Revenue

9.2 Tax revenue as a percentage of GDP increased slightly to 2.1 percent as compared with 1.9 percent in the corresponding period last year. The Government managed to raise its total tax revenue on the back of an increased tax collection by the FBR as well as the provinces. The FBR tax collection improved by 17 percent over the same period last year and stood at Rs.469 billion.

Non Tax Revenue

9.3 Non-tax revenue posted a growth of 22 percent during first quarter of 2013-14 majorly due to contributions from SBP profit. SBP profit stood at Rs.80 billion against Rs.50 billion in the corresponding period last year. The development surcharge on gas generated Rs.21 billion showing a growth of over 400 percent from the corresponding period in the preceding fiscal year.

Expenditure

9.4 Current expenditure increased by 7 percent during first quarter of 2013-14 compared with the same period last year. Current spending was Rs.868 billion with interest payments decreasing slightly to Rs.301 billion. The main contributor has been servicing of domestic debt accounting 95 percent of the total interest payments. Spending on PSDP stood at Rs.79 billion against Rs.68 billion during the corresponding period last year. Government has taken certain economic measures to curtail the expenditure with effective management of financial resources.

10.0 Economic Reforms

10.1 Main focus of reform strategy is on improvement in corporate governance, restructuring of PSEs and Strategic Partnership through Privatization. The government has formed a high level Commission for ensuring transparency in appointment of heads of key public sector organizations and bodies. In order to institutionalize corporate governance initiatives for PSEs, the Public Sector Companies (Corporate Governance) Rules, 2013 have been approved by the Government. The Rules help clarify roles of different stakeholders involved in the management of PSEs. A gradual shift towards majority of independent directors in the Board of Directors (the Board) has been stipulated in the rules. Role and functions of the Board have been clarified and offices of Chairman and CEO have been separated.

10.2 An initiative of further improving corporate governance of PSEs is being undertaken by initiating development of a database on financial information of PSEs. This will help in improving the transparency of PSEs operations and aid in identifying PSEs in need of restructuring or eventual disinvestment.

10.3 The recent initiatives in terms of restructuring of the three large PSEs – Pakistan Steel Mills (PSM), Pakistan International Airlines (PIA) and Pakistan Railways (PR) are highlighted below:

I. Pakistan Steel Mills

Average capacity utilization (CAPU) consistently declined since 2007-08 as follows:

Table-15 Average Capacity Utilization - PSM

Period	CAPU Percentage
2007-08	82
2008-09	64
2009-10	40
2010-11	36
2011-12	19
2012-13	13
July 2013 to December 2013	7

Economic Reform Unit, Finance Division

10.4 PSM has incurred loss amounting to Rs.29.5 billion during 2012-13. Its accumulated losses and liabilities as at June 30, 2013 amount to Rs.92.7 billion and Rs.102 billion, respectively.

10.5 The Economic Coordination Committee (the ECC) in its meeting held on September 7, 2013 decided that the Chairman Board of Investment and Ministry of Industries should come up with a proposal for long-term solution of the problem. The ECC also decided that the PSM will remain a public sector enterprise as the government seeks a strategic partner with a minority stake who can run the management of the PSM. While discussing a proposal for an interim relief, it was decided to approve a three months' bailout package amounting to Rs.2.9 billion for salaries and requisite working capital.

10.6 The Board of PSM was reconstituted in October 2013 with the addition of five members from the private sector to provide stewardship in turning around the loss making entity. The Board has identified a number of options for PSM, which include:

i. Attempt to Revive,

iii. Keeping PSM operational and privatizing within 12 months,

iii. Restructure, revive and privatize within 12 months.

10.7 The government plans to hire financial advisors by end March 2014 to prepare a comprehensive restructuring plan and seek for potential strategic private sector participation through divesting 26 percent shares to strategic investors by end December 2014.

II. Pakistan Railways

10.8 Ageing and shortage of equipment, overstaffing, and large debts continued to weigh on railway operations. The Railway Board is being revived to give strategic guidance to railway operations. The government allocated an amount of Rs.33.5 billion as a grant to take up for losses during 2013-14 against the amount of Rs.33.4 billion of the previous year. Monthly installments are being released in this regard. For the development schemes, the government allocated Rs.31 billion in Public Sector Development Program for 2013-14 against the amount of Rs.25.8 billion made during 2012-13. The government may need to continue support of PR in the forthcoming years required for improvement in rolling and non-rolling assets.

10.9 There are four major indicators to determine the performance of PR, which include revenue generation position, number of passengers, punctuality of trains and public facilitation. PR has recently shown improvement in all these indicators. A comprehensive restructuring plan is being developed, which will include improvements in business processes and institutional framework, financial stability and service delivery. The plan is expected to be ready by end March 2014.

III. Pakistan International Airlines (PIA)

10.10 There is a need to restructure the management and financial structure of PIA for its long-term sustainability. In this regard, following are the broad options:

i. Turnaround PIA keeping the current ownership structure,

ii. Management Outsourcing and / or Partial Disinvestment through strategic partnership or a capital markets transaction,

iii. Separate good PIA from bad PIA – Shut down PIA and launch a new carrier.

10.11 It would be pertinent to mention that irrespective of the path chosen (except for continuing business as usual – which is not an option), demand a certain level of rigorous financial restructuring, reduction in costs, removal of administrative and management lacunae, staff reductions, route rationalization, fleet rationalization and expansion. To facilitate this and provide credibility to the process, it is imperative that a reputable international firm may be hired on an emergent basis as 'Financial Advisor' to devise the long-term strategy and oversee implementation of the key ingredients of the business plan.

10.12 Accordingly, the government will hire financial advisors by end March 2014 to seek potential strategic private sector participation in the company. The Government plans to privatize 26 percent of PIA's shares to strategic investors by end December 2014 (structural benchmark). In the meantime, PIA will continue leasing more efficient airplanes and rationalizing routes.

IV. PSE Reforms: Going Forward

10.13 Government is envisaging privatization / disinvestment of PSEs representing the most viable transactions. In the first phase, the government has developed a Privatization Strategy for 32 PSEs along with an indicative mode of related divestments. The Strategy is modeled around privatizing a mix of PSEs in the oil and gas, banking and finance, power, industrial, transport and real estate sectors. One of the elements of the strategy is Strategic Partnership, which entails transfer of management to investors through partial sale of shares, depending on sectoral dynamics, PSEs' economic size and status and market appetite. This element of the Strategy aims at enhancing the value of the government's shareholding through much needed investments, modernization and up-gradation of PSEs.

10.14 The government's strategy will also focus on divesting its shareholding in various entities especially in oil and gas, power and financial sectors through capital market transactions, both on international and domestic markets. This will help in broadening and deepening domestic capital market. It will facilitate foreign direct and portfolio investments, as well as mobilize; savings of individuals, households and institutional investors of Pakistan by providing them an opportunity to take ownership in the successful businesses, through public offering of shares. The program also includes divestments through direct sale of assets and units to investors.

V. Power Sector Reforms

10.15 The plan for energy sector revival is focused on promoting investment in coal and gas to meet immediate needs, with hydel in the medium term, along with renewable energy to take the country towards sustainable energy in the earliest possible timeframe. Government's vision is to ensure that public sector funding is supplemented with flow of private sector funds to finance the needs of the sector. Foreign, as well as, domestic investors are being facilitated to invest in the country and the Government is endeavoring to provide all necessary support in the form of an enabling environment and infrastructure to ensure a viable return on investment.

10.16 In the short duration since the elections held in May 2013, the government has fully cleared payables of power sector entities against the Independent Power Producers (IPPs) and public sector power entities amounting to Rs.480 billion. The clearance of the stock of circular debt has added 1,700 MW of electricity to the national grid and eased load shedding considerably in the country.

10.17 Government has moved in the direction of providing targeted subsidy to only the vulnerable segments and moving towards better cost recovery leading to a financially stable power sector. In the first phase, tariffs for industrial, commercial and bulk consumers have been rationalized to recover full cost of service. Tariffs of all consumer categories have been rationalized except those consuming less than 200 units a month who have been protected from any tariff rises. In short-run, ensuring gas prioritization to power sector is expected to deliver savings in cost of production and utilize existing capacity more cost effectively. To improve supply from publically owned plants, regular efficiency testing of GENCOs is being initiated. Rehabilitation of GENCOs by early 2014 is likely to add 500 MW to the capacity with 1-2% improved efficiency.

10.18 Over a longer time horizon, the government aims to achieve a less oil dependent power generation mix through development of indigenous energy resources particularly hydel and coal. To improve the high cost fuel mix in power generation, the Executive Committee of the National Economic Council (ECNEC) has recently approved four development projects in power sector having a combined generation capacity of 3,511 MW. The approved projects include K-I and K-II Nuclear Projects situated in Karachi (Province of Sindh; generation capacity 2,200 MW), Nandipur (Province Punjab; generation capacity 425 MW; cost Rs.57.38 billion) and Neelum-Jhelum hydro electric project (AJK; generation capacity 969 MW).

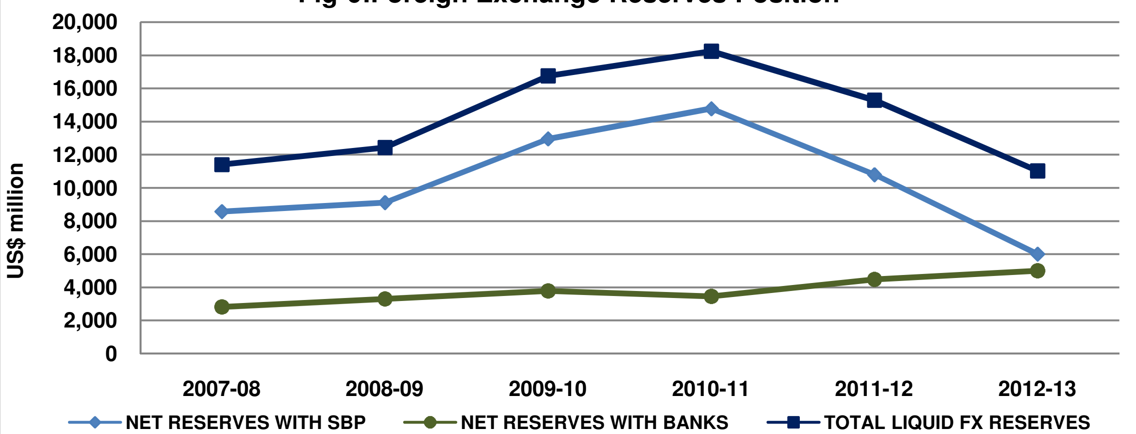
10.19 In order to tackle the various issues in the power sector in a more holistic manner, the Government has developed a National Power Policy (2013), which provides a roadmap to overcome the present energy crisis and fully meet the future needs of power in the country. The goal is to provide affordable energy in the country through efficient generation, transmission and distribution systems. The main targets are to i) fully eliminate load shedding by 2017; ii) decrease cost of generation from 12 c/unit to 10 c/unit by 2017; iii) decrease transmission losses from 25% to 16% by 2017; iv) improve collection of bills to 95% by 2017.

10.20 The policy envisages provision of affordable electricity in the country by replacing generation from expensive imported fuels by cheaper indigenous resources led by coal, hydel and renewable energy sources, respectively. The plan is to move power generation from high cost resources to affordable resources by 2017. The projects have been assigned medium-to-long-term timelines for completion in order of priority.

11 - External Sector Assessment

11.1 Pakistan's Balance of Payment remained under stress during 2012-13 owing to heavy repayments against IMF loans, net outflow to other International Financial Institutions (IFIs) and subdued foreign investments. In absence of sufficient financial inflows, the financing of external deficit amounting US$ 2 billion and IMF SBA repayments of US$ 2.5 billion was done through liquid foreign exchange reserves due to which SBP reserves fell down from US$ 10.8 billion at the start of the year to around US$ 6 billion at the end of 2012-13.

Fig-6:Foreign Exchange Reserves Position



11.2 The balance of payment remained under stress despite the improvement in the current account which posted a deficit of US$ 2.5 billion in 2012-13 which was nearly the half of the deficit recorded last year. The current account was supported by inflows of US$ 1.8 billion under CSF and a decline in trade deficit. Improvement in trade account was entirely on account of recovery in exports mainly from food, textiles and jewelry. On the other hand, imports decreased compared to last year's level because of the decline in the imports of food, transport, POL, and other agriculture items which offset the rise in the import of machinery, textile and metal.

11.3 Inflows under current transfers continued to compensate the deficits recorded in trade, services and income account. Over the past few years, worker remittances have become the most important source of foreign exchange receipts. The launch of Pakistan Remittances Initiative (PRI) has helped in increasing the remittances coming through official sources considerably from 75 percent in 2009-10 to 90 percent in 2012-13.

Table-16: Summary of Balance of Payments (US Dollar in billion)

	2011-12	2012-13
I - Current Account Balance (A+B+C+D)	(4.7)	(2.5)
Trade Deficit	(15.8)	(15.4)
(i) Exports	24.7	24.8
(ii) Imports	40.5	40.2
Services	(3.2)	(1.5)
of which		
Transportation	(2.0)	(2.0)
Government	0.9	2.5
Of which: Coalition Support Fund	0.0	1.8
Services	(3.2)	(3.7)
Payments include		
Repatriation of profits by oil firm	1.5	1.7
IMF Charges & interest on off. external debt	0.8	0.7
Current Transfer	(17.5)	(18.1)
of which: Worker remittances	13.2	13.9
II - Capital Account	0.2	0.3
III - Financial Account	1.3	0.3
(i) Net Foreign Investment	0.6	1.3
FDI	0.7	1.3
Portfolio	(0.1)	0.0
(ii) Other Investment (net)	0.7	(1.0)
Net acquisition of financial assets	0.0	(0.5)
Net incurrence of liabilities	0.7	(0.5)
IV - Errors and Omissions	(0.1)	(0.1)
V - Overall balance (I+II+III+IV)	(3.3)	(2.0)

Source: State Bank of Pakistan

11.4 Capital account showed increase of 44 percent mainly owing to increase in project grants up from US$ 180 million during 2011-12 to US$ 250 million. The surplus in the financial account declined substantially owing to net repayment of external debt, which offset nominal increase in foreign investment during the year. Net foreign investments picked up in 2012-13 to reach at US$ 1.3 billion compared with just US$ 0.6 billion last year. However, the level of FDI remained low mainly due to security concerns and vulnerability of Pakistan's external account. On the other hand, Pakistan was unable to attract portfolio inflows despite the strong performance of domestic stocks.

11.5 Despite sharp fall in foreign exchange reserves in 2012-13, the depreciation of Pak Rupee was limited to 5.4 percent compared with 9 percent in 2011-12. Moreover, movement in exchange rate was also less volatile especially in the second half of the year. This improvement was mainly due to reduction in current account deficit in 2012-13 which reduced the pressure on the Pak Rupee. Nominal depreciation in Pak Rupee, coupled with the decline in headline inflation, led to an improvement in the Real Effective Exchange Rate (REER) during the year. Compared with the appreciation of 4.5 percent last year, the REER depreciated by 2 percent in 2012-13, which if sustains, may increase the competitiveness of goods and services.

12.0 Review of Public Debt

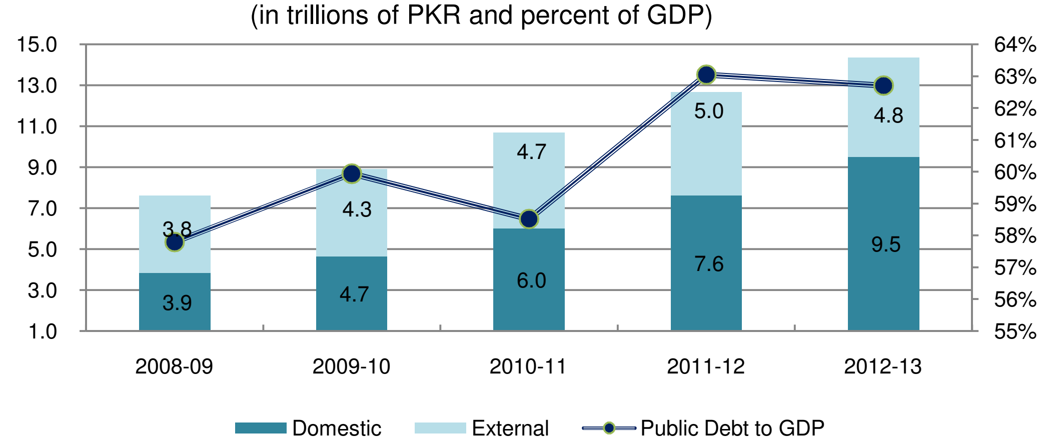
12.1 The portion of total debt which has a direct charge on government revenue is taken as public debt. Public debt is a measure of government indebtedness. It includes debt denominated in rupee as well as in foreign currency. Each of these types of debt has its own benefits and drawbacks, with a trade-off between costs of borrowing and exposure to various types of risks, which need to be balanced, in order to ensure ample and timely access to cost efficient funding.

12.2 Public debt stock as on June 30, 2013 reached at Rs.14,366 billion representing an increase of Rs.1,699 billion or 13 percent higher with that of last fiscal year. This built-up in public debt was mainly attributed to increase in domestic debt by Rs.1,880 billion, whereas, external debt witnessed a decline of Rs.181 billion. With external source of funding shrinking over the past few years, it was the hefty repayments against IMF loans and translation gain on account of appreciation of

US Dollar against Japanese Yen which led to fall in the external debt during 2012-13. Although, in dollar terms, external public debt decreased by around US$ 4.6 billion, however 5.4 percent depreciation of Pak Rupee against US Dollar narrowed this effect in rupee term.

12.3 Over the past few years, government relied mainly on the domestic borrowing which resulted in gradual increase of its share to around 66 percent of the total public debt compared to 51 percent in 2008-09. The built-up in domestic debt is mainly attributed to large fiscal deficits and absence of sufficient external inflows during past few years. Increased demand on government budget for the purpose of interest servicing, security and subsidies which consumed around 63 percent of the revenue signifies that expenditure were fairly rigid even in the face of a committed effort to curtail the fiscal deficit. The evolution of funding mix adopted during last few years showed an implicit borrowing strategy that increasingly relied on short-term domestic borrowing owing to insufficient external financing.

Fig-7: Evolution of Public Debt
(in trillions of PKR and percent of GDP)



12.4 Public debt was recorded at Rs.15,334 billion as on September 30, 2013 registering an increase of Rs.968 billion or 7 percent in first three months of the current fiscal year. This rise in public debt is attributed to increase in domestic debt by Rs.641 billion and external debt by Rs.327 billion. The government was able to contain fiscal deficit at 1.1 percent of GDP for first quarter of 2013-14 largely because of Rs.92 billion provincial budget surpluses.

12.5 The first quarter of the current fiscal year noticed a translational loss of US$ 665 million on account of cross-currency movement against US Dollar. This loss is mainly due to depreciation of US$ against SDR (US$ 329 million), Japanese Yen (US$ 140 million) and Euro (US$ 160 million). In spite of this translational loss, external public debt declined marginally in US Dollar term as compared to end-June, 2013 owing to net negative external financing. However, in Pak Rupee terms, it increased by Rs.311 billion owing to 6.4 percent depreciation of Pak Rupee against US Dollar.

Table-17: Public Debt

	2008	2009	2010	2011	2012(P)	2013(P)	2014(P)*
(Rs. in billion)							
Domestic Debt	3,266	3,852	4,651	6,016	7,637	9,517	10,158
External Debt	2,788	3,776	4,260	4,685	5,030	4,849	5,176
Total Public Debt	**6,044**	**7,629**	**8,911**	**10,700**	**12,667**	**14,366**	**15,334**
(In percent of GDP)							
Domestic Debt	30.7	29.2	31.3	32.9	38.0	41.5	39.1
External Debt	26.1	28.6	28.7	25.6	25.0	21.2	19.9
Total Public Debt	**56.8**	**57.8**	**59.9**	**58.5**	**63.0**	**62.7**	**59.0**
(In percent of revenue)							
Domestic Debt	217.8	208.1	223.8	267.0	297.6	319.1	---
External Debt	185.3	204.0	205.0	208.0	196.0	162.6	---
Total Public Debt	**403.1**	**412.2**	**428.8**	**475.0**	**493.6**	**481.7**	**---**
(In percent of total debt)							
Domestic Debt	54.0	50.5	52.2	56.2	60.3	66.2	66.2
External Debt	46.0	49.5	47.8	43.8	39.7	33.8	33.8
Memo:							
Foreign Currency Debt (US$ in billion)	40.7	46.4	49.8	54.5	53.2	48.7	48.8
Exchange Rate (Rs./US$, End of Period)	68.3	81.4	85.5	86.0	94.5	99.7	106.1
GDP[a] (Rs. in billion)	10,638	13,200	14,867	18,285	20,091	22,909	26,001
Total Revenue (Rs. in billion)	1,499	1,851	2,078	2,253	2,567	2,982	---

P:Provisional
* end-September, 2013
[a] The base of Pakistan's GDP has been changed from 1999-00 to 2005-06

Source: State Bank of Pakistan, Economic Affairs Division, Budget Wing and Debt Policy Coordination Office Staff Calculations

13.0 Servicing of Public Debt

13.1 Public debt services provides information of the resources that a country has to allocate to servicing its debts and the burden it may impose through crowding out other uses of financial resources. Comparing debt service to a country's repayment capacity yields the best indicator for analyzing whether a country is likely to face debt-servicing difficulties in the current period.

13.2 During 2012-13, public debt servicing reached at Rs.1,209 billion against the budgeted estimate of Rs.1,178 billion. Public debt servicing consumed nearly 41 percent of revenue. Ideally, this ratio should be below 30 percent to allow government to allocate more resources towards social and poverty related expenditure.

Table-18: Public Debt Servicing - (2012-13)

	Budgeted	Actual (P)	Percent of Revenue	Percent of Current Expenditure
	(Rs. in billion)			
Servicing of External Debt	80.2	70.6	2.4	1.9
Repayment of External Debt	252.0	217.9	7.3	6.0
Servicing of Domestic Debt	845.6	920.4	30.9	25.1
Servicing of Public Debt	1,177.8	1,208.9	40.5	33.0

P: Provisional

Source: Budget Wing and Debt Policy Coordination Office Staff Calculations, Finance Division

13.3 As most of the borrowing was arranged from domestic sources specifically through banks, therefore, major deviation from budget was witnessed in domestic debt servicing which exceeded the budgeted amount by approximately Rs.75 billion. Further analysis revealed that the deviation from budgeted amount was majorly witnessed in Treasury Bills and Pakistan Investment Bonds for the amount of Rs.48 billion and Rs.21 billion respectively.

Table-19: Break-Up of Domestic Debt Servicing (2012-13)

	Budgeted	Actual
	(Rs. in billion)	
1- Permanent Debt	**165.7**	**194.9**
- Prize Bonds	26.0	32.7
- Pakistan Investment Bonds	97.0	117.8
- Government Ijara Sukuk	40.9	42.8
- Others	1.8	1.7
2- Floating Debt	**429.7**	**479.4**
- Treasury Bills	257.2	304.7
- Market Related Treasury Bills	172.5	174.7
3- Unfunded Debt	**248.7**	**241.0**
- National Saving Schemes	237.7	236.2
- Others (Postal Life Insurance, Provident Funds etc.)	12.5	10
Total (1+2+3)	**845.6**	**920.4**

Source: Budget Wing, Finance Division

13.4 Out of total repayment of foreign loans, government paid Rs.112 billion and Rs.31 billion to multilateral and bilateral donors respectively.

14.0 Report on Compliance with FRDL Act 2005

The Fiscal Responsibility and Debt Limitation (FRDL) Act, 2005 approved on 13 June 2005, requires that the federal government take measures to reduce total public debt and maintain it within prudent limits thereof. The following sections identifies the various limits prescribed by the FRDL Act, 2005 and reports on progress thereof.

The FRDL Act, 2005 requires the following:

(1) Reducing the revenue deficit to nil not later than the thirtieth June, 2008 and thereafter maintaining a revenue surplus

Revenue balance has been in negative since 2005 because of increasing exogenous and endogenous challenges including campaign against extremism, fragile law and order situation, continued energy shortages, narrow tax base, non-materialization of sufficient external inflows, unprecedented calamity of floods in 2010, torrential rains in Sindh in 2011 and increasing debt servicing requirement.

Table-20: Revenue Balance (Percent of GDP)

Revenue Balance*	2008	2009	2010	2011	2012	2013
	(3.1)	(1.2)	(1.7)	(3.3) [(a)]	(4.5) [(b)]	(2.8) [(c)]

*Adjusted for grants
[(a)]includes arrears of electricity subsidies amounting Rs.120 billion or 0.7 percent of GDP
[(b)]includes "one off" payment of Rs.391 billion on account of debt consolidation or 1.9 percent of GDP
[(c)] includes payment for the resolution of the circular debt amounting Rs.322 billion or 1.4 percent of GDP

(2) Ensure "that within a period of ten financial year, beginning from the first July, 2003 and ending on thirtieth June, 2013, the total public debt at the end of the tenth financial year does not exceed sixty percent of the estimated gross domestic product for that year and thereafter maintaining the total public debt below sixty percent of gross domestic product for any given year."

Public debt to GDP was recorded at 62.7 percent as on June 30, 2013. Crossing of this threshold by 2.7 percent was mainly due to the actual deficit being higher than projected. The public debt also includes loans from IMF amounting to US$ 4.4 billion or 1.9 percent of the GDP as on June 30, 2013. The borrowing from IMF is only utilized towards Balance of Payment support and is reflected in foreign currency reserves of the country.

Table-21: Debt to GDP (Rs. in billion)

	2008	2009	2010	2011	2012	2013
Domestic Currency Debt	3,266	3,852	4,651	6,016	7,637	9,517
Foreign Currency Debt	2,788	3,776	4,260	4,685	5,030	4,849
Total Public Debt	**6,044**	**7,629**	**8,911**	**10,700**	**12,667**	**14,366**
GDP	10,638	13,200	14,867	18,285	20,091	22,909
Total Public Debt (as percent of GDP)	**56.8**	**57.8**	**59.9**	**58.5**	**63.0**	**62.7**

(3) Ensure "that in every financial year, beginning from the first July, 2003, and ending on the thirtieth June 2013, the total public debt is reduced by no less than two and a half percent of the estimated gross domestic product for any given year, provided that social and poverty alleviation related expenditure are not reduced below 4.5 percent of the estimated gross domestic product for any given year and budgetary allocation to education and health, will be

doubled from the existing level in terms of percentage of gross domestic product during the next ten years."

The condition of reducing debt to GDP by 2.5 percent annually was envisaged in the FRDL Act, 2005 to achieve the core objective of reducing Debt to GDP below 60 percent by the end of 2012-13. As the government achieved this landmark in 2005-06 and remained within the threshold of 60 percent, the sub-limit of annual reduction of 2.5 percent was no more applicable.

Social and poverty alleviation related budgetary expenditure remained at 8.3 percent of GDP. Additionally, expenditure on health and education stood at 0.7 percent and 2.1 percent of GDP. The FRDL Act, 2005 stipulates that the spending on health and education shall be doubled to 1 percent and 3.2 percent respectively in ten years beginning from 1st July, 2003, hence, this target was not achieved.

Table-22: Social Sector Expenditure

	2008	2009	2010	2011	2012	2013
Social sector and poverty related expenditure (as percent of GDP)	9.8	7.4	7.5	8.3	9.9	8.3
Expenditure on education (as percent of GDP)	1.8	1.8	1.7	1.8	2.2	2.1
Expenditure on health (as percent of GDP)	0.6	0.6	0.6	0.6	0.7	0.7

(4) Not issue "new guarantees, including those for rupee lending, bonds, rates of return, output purchase agreements and all other claims and commitments that may be prescribed, from time to time, for any amount exceeding two percent of the estimated gross domestic product in any financial year: Provided that the renewal of existing guarantees shall be considered as issuing a new guarantee."

New guarantees including rollovers, issued by the government in 2012-13 amounted to Rs.136 billion or 0.6 percent of GDP.

Table-23: New Guarantees Issued

(Rs. in billion)	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**
New guarantees issued	139	276	224	62	203	136
(as percent of GDP)	**1.3**	**2.1**	**1.5**	**0.3**	**1.0**	**0.6**

Pakistan's public debt position deteriorated during past few years owing to higher interest payments, large subsidies specially food and energy, growing security spending needs, narrow tax base and rising international commodity prices. Given the severity of these constraints, the government was unable to fully comply with some provisions of FRDL Act, 2005. However, the government remains fully committed to adhere to all the provisions of FRDL Act, 2005 in future.

15.0 Conclusion

15.1 Pakistan economy experienced another challenging year as the fiscal deficit was recorded at 8 percent of GDP against the budgeted target of 4.7 percent in 2012-13. The tax revenue collection remained 19 percent below the budget target and the expenditure surpassed the target by 22 percent which led to the exacerbating fiscal deficit. The higher fiscal deficit is added to public debt and consumed a major chunk of revenue to service it. Financing mix of deficit is also an area of concern as it is skewed towards domestic sources particularly on bank borrowing owing to lower external receipts. It is crowding out the private sector and is affecting investment, economic growth and ultimately compromising revenue generating capacity of the economy.

15.2 The present government is committed to accomplish objectives outlined in the FRDL Act, 2005. Fiscal policy would continue to explore opportunities for augmenting the resource envelop. At the same time, expenditure would be rationalized and non-productive outlays would be curtailed as announced in Budget 2013-14. These include (i) Other than the obligatory expenditure of debt servicing, defense, pay and allowances of civil servants and grants, there will be a 30 percent cut on all other expenditure (ii) Government intends to replace un-targeted subsidies with targeted subsidies to reach to poor and vulnerable segment of the society (iii) Government is determined to fully reform and restructure public sector corporations. Alongside, full financial restructuring will be carried out to enable them to run on sound commercial basis and reduce their dependence on national exchequer.

15.3 The economic vision is based on trade and investment, competitive advantage and market considerations, enhancing private sector involvement, limiting its role to only large scale investment and limit itself within the broader limits imposed by the available resources, broadening the base of resource mobilization for running the government.

15.4 Prudent fiscal policy together with strong implementation and accountability of principles is essential for macroeconomic stability. It will help to reduce inflation, strengthen economic growth, and mitigate risks of falling foreign reserves and debt burden. By placing a high priority on structural reform and revenue generation, and establishing a comprehensive framework for management of PSEs, the government will be able to finance the envisaged expenditure while containing excessive borrowing and maintaining fiscal sustainability.