Fiscal Policy Statement 2015-16

Debt Policy Coordination Office
Ministry of Finance
Government of Pakistan

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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 strategic input and policy guidance provided by Finance Minister, Senator Mohammad Ishaq Dar and Finance Secretary, Dr. Waqar Masood Khan. I would like to acknowledge the input of various Ministries, Departments, Divisions and Agencies, particularly for timely provision of data by Budget Wing (Ministry of Finance) and Economic Affairs Division. I would like to recognize the efforts put in by Mr. Sajjad Ahmad Shaikh, Director, Mr. Muhammad Ikram, Deputy Secretary, Mr. Muhammad Umar Zahid, Financial Analyst, Mr. Arsalan Ahmed, Financial Analyst, Ms. Huma Dad Khan, Research Associate, Mr. Muhammad Siddique, Assistant Director and Mr. Zaheer Abbasi, Section Officer in the realization of this comprehensive document.

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1.0 Introduction

1.1 Pakistan's economy has been facing problems for years, which resulted in a near-crisis like situation in 2013 mainly owing to unstable security situation, crippling energy crisis and ensuing large foreign exchange requirements with alarmingly lower level of foreign exchange reserves. Besides, a number of deep structural problems, that have been there for decades, added to the woe in form of weak financial position rooted in low tax revenue, limited exports growth, insufficient investment in human capital development, weak infrastructure and low economic activities. Economic growth of the country, which remained subdued until 2013, started to rebound on account of comprehensive reforms agenda adopted by the government including relief in energy shortages, restoring investor's confidence, reforming public sector enterprises, increasing the tax revenue and austerity measures to rationalize the current expenditure. GDP posted 4.2 percent growth during 2014-15, up from 4 percent last year.

1.2 Government was able to substantially reduce near-term vulnerabilities. It was supported by conducive policies, low oil prices, strong remittances, contained fiscal deficit and declined inflation while foreign exchange reserves improved considerably. The near-term economic outlook for Pakistan is now broadly favorable, although, structural bottlenecks may impede higher potential growth. The main challenges are to reinforce the recent gains in economic stability and generate a sustainable growth momentum by accelerating structural reforms. Key priorities include fiscal consolidation, widening the tax net to enable higher investment in infrastructure and social sectors, fixing the energy sector issues, restructuring / privatizing loss-making public sector enterprises, improving the business climate for higher growth, continuing the policy agenda to foster financial sector development and continued foreign exchange reserve accumulation.

1.3 Overall, fiscal deficit during 2014-15 was recorded at 5.3 percent of GDP, which was lower than 5.5 percent witnessed during the last year. However, compared with budget target for the year, the fiscal deficit was slightly higher. While the fiscal consolidation during the year was challenged by lower than expected tax revenues, expenditures remained under control. Key factors affecting tax revenues were: (i) significant decline in oil prices, which adversely affected sales tax collection; (ii) continuing issues with tax enforcement; and (iii) subdued manufacturing activity.

2.0 Fiscal Policy Statement

2.1 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 expenditures;

(b) total revenues;

(c) total fiscal deficit;

(d) revenue deficit; and

(e) total public debt.

(3) The Federal Government shall explain how fiscal indicators accord 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 a 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 2014-15

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

- Containment of the fiscal deficit at 5 percent of projected GDP;
- Enhancement of consolidated revenues to Rs. 4,221 billion;
- Improvement of tax to GDP ratio to13 percent;
- Rationalization of subsidies and discouraging its indiscriminate use;

- Realization of low cost foreign borrowings to finance fiscal deficit and reduce the burden of debt servicing;
- Rationalization of current expenditure to improve efficiency; and
- Enhancement of efficiency of the tax machinery by removing anomalies and distortions in the current tax system.

3.2 Budget 2014-15 focused on key areas of revenue mobilization and curtailment of expenditure. Besides, it stressed upon protection of vulnerable groups through a range of measures to minimize the impact of fiscal consolidation policies on such groups. On expenditure side, focus was on austerity measures to contain rising current expenditure and increase development expenditure 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 Last decade has been filled with multiple ups and downs in terms of fiscal performance of Pakistan. A comparison over the last two decades is shown in Table-1:

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

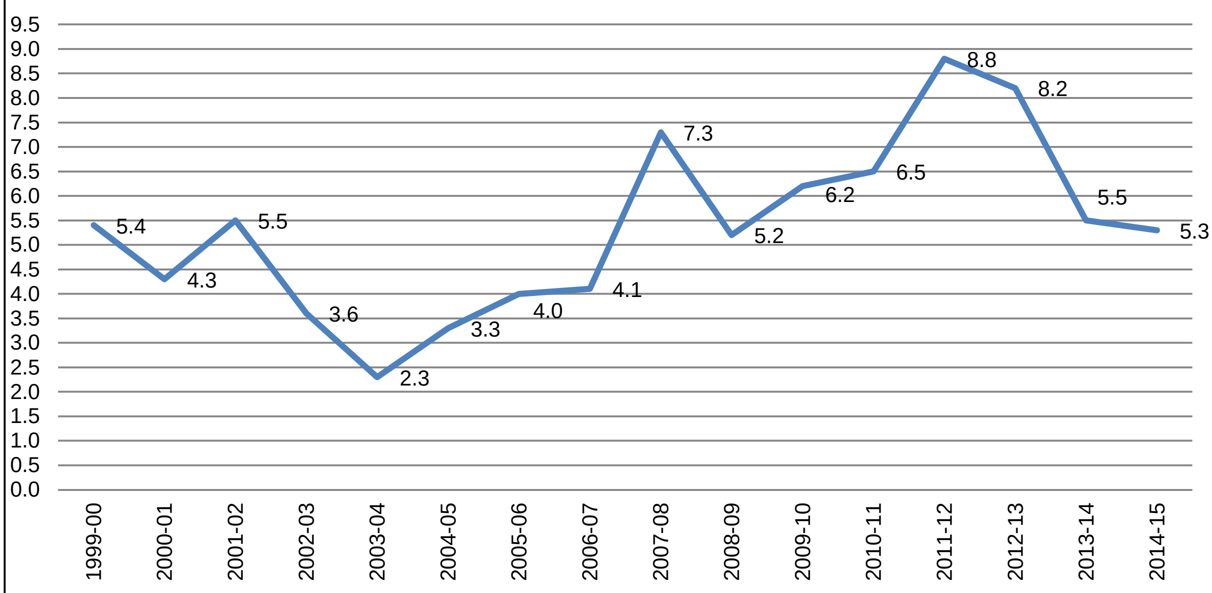
Year	Real GDP Growth	Fiscal deficit	Expenditure			Revenue		
			Total	Current	Development	Total	Tax	Non-Tax
1992	7.6	7.5	26.7	19.1	7.6	19.2	13.7	5.5
1993	2.1	8.1	26.2	20.5	5.7	18.1	13.4	4.7
1994	4.4	5.9	23.4	18.8	4.6	17.5	13.4	4.1
1995	5.1	5.6	22.9	18.5	4.4	17.3	13.8	3.5
1996	6.6	6.5	24.4	20.0	4.4	17.9	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

Year	Real GDP Growth	Fiscal deficit	Expenditure			Revenue		
			Total	Current	Development	Total	Tax	Non-Tax
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	3.8	8.8	19.6	15.6	4.1	12.8	10.2	2.6
2013	3.7	8.2	21.4	16.3	5.1	13.3	9.8	3.5
2014	4.0	5.5	19.8	15.8	4.0	14.3	10.1	4.2
2015	4.2	5.3	20.3	16.2	4.1	14.4	11.0	3.3

Source: Economic Survey of Pakistan & Debt Policy Coordination Office Staff Calculations, Finance Division

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 and (ii) huge flows of foreign grants and inflows from Coalition Support Fund (CSF) that increased non-tax revenue. 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 ailing PSEs, floods and torrential rains, increasing debt servicing requirements, higher than budgeted subsides and gradual dilapidation in the socio-economic infrastructure. Trend analysis of fiscal deficit over the years 2000-15 is depicted in Fig-1.

Fig-1: Trends in Fiscal Deficit (Percentage of GDP)



4.3 An analysis of the last two decades of fiscal performance reveals that high subsidies remained a major burden on fiscal account combined with falling tax to GDP ratio. Interestingly, even during the period of fiscal improvement (1999-2004), tax to GDP ratio continued to decline. Tax revenue as percentage of GDP, which stood at an average of 13.7 percent during 1992-96, 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 of 18 percent during 1992-96 to 13.4 percent during 2008-13. The fiscal performance improved considerably during last two years, both in terms of revenue mobilization and expenditure management. Going forward, both spending and revenue measures have important implications for the economy and these need to be taken into account if the ongoing fiscal consolidation efforts are to be sustainable.

5.0 Fiscal Performance during 2014-15

5(i) Total Revenue

5.1 Total revenue of the government comprises tax revenue and non-tax revenue. Tax revenue includes direct taxes and indirect taxes while non-tax revenue mainly consists of government receipts on its investments and provision of services. Total revenue grew by 8 percent and despite non-tax revenue exceeding the budget target by 3 percent, total revenue slightly missed its budgetary target to achieve 93 percent for the year 2014-15 as compared to last year's 100 percent. The budget 2014-15 envisaged a growth rate of 30 percent in total taxes – major part of which was to be collected by FBR; however, actual growth rate of taxes realized during the year was around 18 percent. The reason for the deviation from budgetary target was less collection in tax revenue which could achieve 90 percent of its annual target mainly owing to decline in international oil prices which resulted in lesser collection on account of indirect tax revenue (refer table-12 for details).

5.2 Tax revenue witnessed 18 percent growth in 2014-15 and accounted for around 11 percent of the GDP. Direct taxes, being the major contributor to the total tax collection amounting Rs. 1,029 billion, depicts the government's approach towards rationalizing taxation policies and tax trajectory into right direction for fair and equitable revenue mobilization. While amongst the non-tax revenue, contribution mainly came from SBP profits and defense receipts through CSF that constituted a combined share of over 65 percent in total non-tax revenue (refer table-11 for details).

5(ii) FBR Collection

5.3 FBR collected Rs. 2,588 billion against budget target of Rs. 2,810 billion for 2014-15 which represented an achievement of around 92 percent against the target, a same level achieved last year. FBR tax collection grew by 14 percent during 2014-15 as compared to last year's 16 percent. The overall tax to GDP ratio improved slightly to 14.4 percent from last year's 14.3 percent.

Table-2: Comparison of Tax collection against targets 2014-15 (Rs. in billion)

Tax Head	Original Budget	Provisional Collection	Achievement of Target (%) 2014-15	Achievement of Target (%) 2013-14
Direct Taxes	1,180.0	1,029.2	87.2	90.7
Sales Tax	1,171.0	1,088.8	93.0	95.1
Federal Excise Duty	178.0	163.9	92.1	83.3
Customs Duty	281.0	306.1	108.9	86.4
All Taxes	**2,810.0**	**2,588.0**	**92.1**	**91.6**

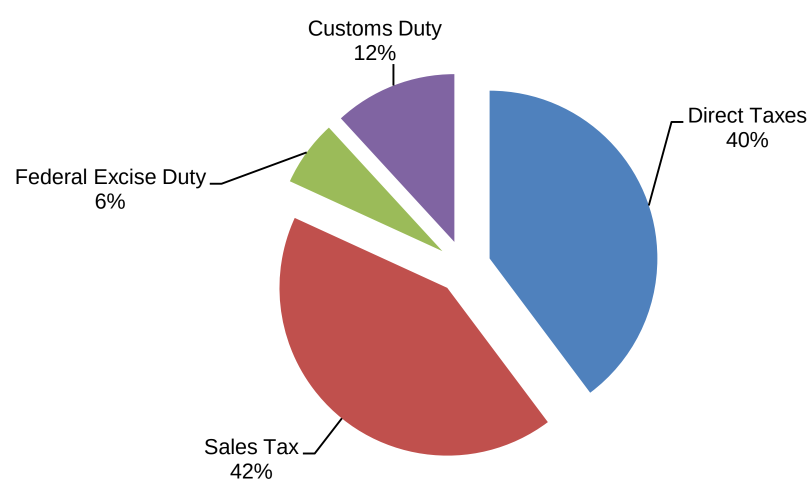
Source: Fiscal Operations 2014-15

5.4 The tax collection target of Rs. 2,810 billion set for 2014-15 was challenging due to multifaceted issues like energy crisis and law and order situation. This target was set assuming FBR revenue collection at Rs. 2,275 billion during 2013-14 which was based on projected growth in GDP, inflation, tax buoyancy and other major economic indicators. However, tax collection fell short by Rs. 21 billion against the budget target and stood at Rs. 2,254 billion in 2013-14, resulting in a revised target of Rs. 2,605 billion for 2014-15.

5(iii) Tax wise Analysis

5.5 The FBR tax to GDP ratio improved to 9.5 percent in 2014-15 from 8.9 percent last year owing to improved tax collection. The breakup of taxes collected by FBR in 2014-15 is as follows:

Fig-2: Tax Wise Analysis
(Percentage of total tax collection)



Head Wise Analysis of Direct Taxes

5.6 Direct taxes comprise mainly income tax and other direct taxes including worker welfare fund and worker profit participation fund. The contribution of income tax in total direct taxes was around 99 percent. The income tax is further sub categorized in voluntary payments, collection on demands and withholding taxes (WHT).

5.7 Direct taxes contribution was 40 percent in total tax receipts during 2014-15 as compared to 39 percent last year and stood at Rs. 1,029 billion which reflected a significant growth of around 16 percent. This trend is consistent with overall increase in tax revenue growth and constituted around 11 percent of GDP in 2014-15. The direct taxes collection achieved 87 percent of the assigned target, slightly lower than the last year's achieved target of 91 percent. This shows room for further improvement in estimation, administration and collection of taxes. The following table shows head wise performance of each component of direct tax:

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

Tax Head	2014-15	2013-14	Growth (%)	% share in 2014-15	% share in 2013-14
Voluntary Payments	287.6	262.6	9.5	26.0	27.7
Collection on Demand	115.5	80.6	43.3	10.4	8.5
W.H.T	691.1	578.4	19.5	62.4	61.0
Miscellaneous	12.6	26.1	(51.7)	1.1	2.8
Gross Direct Taxes	**1,106.8**	**947.7**	16.8	100.0	**100.0**
Total Net Direct Taxes	**1,029.2**	**884.1**	16.4	-	**-**

Source: FBR Review 2014-15

a - Voluntary payments

5.8 Voluntary payments recorded a growth of around 10 percent and stood at Rs. 288 billion as compared with Rs. 263 billion last year. Main contribution in the voluntary payments was in advance tax, which grew by 8 percent and recorded at Rs. 270 billion in 2014-15. Share of voluntary payments represented 26 percent of the total direct tax collection in 2014-15 compared with its share of 28 percent in 2013-14. Payment with returns also grew by 30 percent during 2014-15. This reflects efforts put forth by the concerned tax authorities to persuade taxpayers for filing their returns and steps taken for broadening tax base have started to produce results.

b - Collection on Demand

5.9 Owing to effective income tax field formations, collection on demand improved in 2014-15 by around Rs. 116 billion as compared to last year collection of Rs. 89 billion. The reason for this better performance was mainly a result of crucial initiatives taken for effective audit and administration processes in the taxation structure which were due for several years.

c - Withholding Taxes

5.10 Withholding tax was the main contributor in direct taxes with 62 percent share in 2014-15. The collection of WHT stood at Rs. 691 billion, witnessed a growth of 21 percent from the previous year's collection of Rs. 572 billion. The nine major components of withholding taxes contributed around 87 percent of total withholding tax collection. The table below shows the head-wise breakup of the WHT collections during 2014-15:

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

Collection Head	Collection		Growth %
	2014-15	2013-14	
Contracts	176.8	129.9	36.1
Imports	147.4	123.8	19.1
Salary	79.5	64.6	23.1
Bank mark-up	49.8	40.7	22.4
Telephone	44.7	52.0	(14.0)
Dividends	29.4	24.2	21.5
Electric Bills	27.5	19.8	38.9
Exports	26.2	26.4	(0.8)
Cash Withdrawal	23.3	18.6	25.3
Sub total	**604.6**	**500.0**	**20.9**
Share in WHT (%)	87.5	87.7	-
Total WHT	691.2	571.7	20.9
% share In Income tax	62.5	60.3	-

Source: FBR Review 2014-15

5.11 Noticeable growth in withholding tax collection was witnessed in electric bill (39 percent) followed by contracts (36 percent), cash withdrawals (25 percent), salary (23 percent), bank mark-up (22 percent) and dividends (22 percent). The overall growth was attributable to effective monitoring of withholding tax by creating special monitoring units and rationalization of tax rates.

Indirect Taxes

5.12 Indirect taxes mainly include sales tax, federal excise duties and custom duties. Indirect tax constituted 60 percent of the total tax collection during 2014-15.

Sales Tax

5.13 Sales tax was the largest contributor constituting 42 percent of total tax revenue and grew by 9 percent during 2014-15. Out of total gross sales tax collection, more than half of total sales tax is contributed by the sales tax collected on domestic products amounting Rs. 579 billion, while rest is collected from sales tax on imports. However, in net terms, the sales tax collection on imports surpassed the sales tax collection on domestic products.

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

Collection Head	2014-15		2013-14		Gross Growth %	Net Growth %
	Gross	Net	Gross	Net		
Sales tax on imports	553.1	553.0	495.4	495.3	11.6	11.6
Sales tax on domestic products	578.5	534.8	533.4	501.1	8.5	6.7
Total	**1,131.6**	**1,087.8**	**1,028.8**	**996.4**	**10.0**	**9.2**

Source: FBR Review 2014-15

5.14 Main factors affecting sales tax collection were: (a) an overall decline in the inflation rate largely due to sharp fall in prices of petroleum products, which are the largest source of sales tax collection; and (b) decline in sales tax collection on fertilizers and natural gas due to lower supplies. Moreover, lack of documentation in retail trade activates continued to be a source of concern.

a - Sales Tax from Domestic Market

5.15 Net sales tax collection from domestic market contributed around 49 percent of the total net sales tax collection with an increase of around 7 percent over the last year. The major 9 commodities contributed around 71 percent in total net sales tax collection in the domestic market as depicted in table below:

Table-6: Commodity Wise Collection of Sales Tax from Domestic Market (Rs. in billion)

Commodities	Collection			% share 2014-15
	2014-15	2013-14	% growth	
POL Products	233.2	230.7	1.1	43.9
Electrical Energy	23.7	19.7	20.3	4.5
Cement	23.3	20.1	15.9	4.4
Natural Gas	22.8	31.6	(27.8)	4.3
Fertilizers	22.5	24.0	(6.3)	4.2
Cigarettes	21.0	17.7	18.6	4.0
Sugar	10.9	9.2	18.5	2.1
Motor Cars	9.3	3.8	144.7	1.8
Aerated Water	8.8	8.8	-	1.7
Sub Total	**375.5**	**365.6**	2.7	**70.7**
Other Sectors	159.3	135.5	17.6	30.0
Sales Tax (Domestic) Net	**534.8**	**501.1**	**6.7**	**100.7**

Source: FBR Review 2014-15

5.16 The collection of sales tax in domestic market has been highly concentrated in few commodities. Decline in international oil prices and import compression of the petroleum products has reduced the contribution of POL products to around 44 percent in sales tax from domestic market compared to last year's 46 percent. POL products remained the top revenue generator in domestic sales tax collection and stood at Rs. 233 billion in 2014-15. Collection from natural gas sector declined by 28 percent due to higher refunds amounting Rs. 7 billion against Rs. 5 billion, resulting in lower net collection of sales tax from natural gas.

5.17 Sales tax collection from electrical energy recorded a growth of 20 percent despite increase in refund payments and rationalization of tariff price on electricity consumption. A significant growth of 145 percent was observed in motor cars which was attributed to increase in production of automobile industry by 30 percent in 2014-15. Performance of other sectors (including food products) achieved around 18 percent of growth and contributed 30 percent in overall sales tax collections from domestic market.

b - Sales Tax from Imports

5.18 Sales tax collection from imports grew by 12 percent and contributed 51 percent in total sales tax collection during 2014-15. POL products remained a leading contributor with 30 percent share in total sales tax at import stage. The share of top three categories; POL products, iron and steel and machinery (electrical and mechanical) cumulatively contributed over 50 percent of total collection of sales tax imports. The major contributions from top ten commodities contributed around 73 percent of the total sales tax collection from imports, depicted in table below:

Table-7: Commodity Wise Collection of Sales Tax at Import Stage (Rs. in billion)

Commodities	Collection			% share 2014-15
	2014-15	2013-14	% growth	
POL Products	166.0	169.6	(2.1)	30.0
Iron and Steel	41.9	27.6	51.8	7.6
Mechanical Machinery	38.0	26.1	45.6	6.9
Electrical Machinery	35.4	18.8	88.3	6.4
Vehicles	34.3	26.0	31.9	6.2
Plastic Resins	30.7	27.8	10.4	5.6
Edible Oil	16.6	33.9	(51.0)	3.0
Fertilizers	13.7	12.8	7.0	2.5
Organic Chemicals	13.0	13.3	(2.3)	2.4
Oil Seeds	12.7	5.6	126.8	2.3
Sub Total	**402.3**	**361.5**	11.3	72.7
Others	150.8	133.8	12.7	27.3
Gross	**553.1**	**495.3**	**11.7**	**99.4**

Source: FBR Review 2014-15

5.19 Sales tax collection from POL products fell by 2 percent due to decline in international prices of petroleum products. Collection from iron and steel sector grew by 52 percent mainly owing to improved activities in the construction sector/ infrastructure projects. Similar improvements were observed in collection from mechanical and electrical machinery of around 46 percent and 88 percent, respectively.

5.20 The sales tax collection from edible oil recorded a noticeable fall of 51 percent, due to sharp decline in dutiable imports of oil products. Organic chemicals also witnessed a decline of 2 percent in-line with 1 percent drop in its value of imports.

Customs Duty

5.21 Customs duty used to be the largest revenue source but faded away on account of trade liberalizations in 1990s. During 2014-15, custom duty contributed around 20 percent and 12 percent in the indirect taxes and total taxes, respectively. Dutiable imports constituted around 57 percent of the total imports during 2014-15. Custom duty grew by 27 percent in 2014-15 achieving 119 percent of its budget target and stood at Rs. 306 billion against Rs. 241 billion collected in 2013-14. This is mainly due to necessary actions taken by the government for withdrawal of exemptions/concessionary grants and replaced zero percent slab by 1 percent. Commodity wise collection of the customs duty is given below:

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

Commodities	Budget 2014-15	Collection			% share 2014-15	Target Achieved (%)
		2014-15	2013-14	% growth		
Vehicles	40.1	49.4	36.3	36.1	15.7	123.2
POL Products	16.8	24.4	16.8	45.2	7.7	145.2
Electrical Machinery	10.7	22.6	11.3	100.0	7.2	211.2
Edible Oil	21.7	21.1	20.7	1.9	6.7	97.2
Mechanical Machinery	14.0	20.1	13.7	46.7	6.4	143.6
Plastic	11.0	13.2	11.1	18.9	4.2	120.0
Iron and Steel	5.6	10.7	5.8	84.5	3.4	191.1
Paper and Paper Board	5.8	8.2	5.9	39.0	2.6	141.4
Organic Chemicals	4.4	6.4	4.3	48.8	2.0	145.5
Textile Materials	4.9	6.0	4.8	25.0	1.9	122.4
Sub Total	**135.0**	**182.1**	**130.7**	**39.3**	**57.8**	**134.9**
Other Sectors	135.1	133.0	119.0	11.8	42.2	98.4
Gross	**270.1**	**315.1**	**249.7**	**26.2**	**100.0**	**116.7**
Refund/Rebate	12.4	9.1	8.7	4.6	-	
Net	**257.7**	**306.0**	**241.0**	**27.0**	-	**118.7**

Source: FBR Review 2014-15

5.22 The top ten commodities have contributed around 58 percent in the custom duty collection, exhibiting positive growth in all commodities. Similar to last year, major tax collection came from vehicles contributing 16 percent in customs duty collection mainly due to significant growth in dutiable imports of vehicles by 32 percent. This was followed by POL products contributing around 8 percent in custom duty collection. Although the decline in international oil prices led to reduced imports of petroleum products by 16 percent, however, withdrawal of exemptions on crude oil, furnace oil and motor spirit resulted in improved collection by 45 percent.

5.23 Similar to sales tax collection on mechanical and electrical machinery, customs duty collected on machinery segment witnessed significant growth (100 percent in electrical and 47 percent in mechanical machinery). Combined, they contributed around 14 percent in the customs duty collection.

5.24 Other sectors segment also performed well with around 12 percent growth and contributed around 42 percent in the total customs duty collection. In general, overall customs duty collections on all the major items achieved their budget targets and even exceeded in many commodities.

Federal Excise Duty

5.25 Federal Excise Duty (FED) is imposed at import and domestic stages. The performance of FED achieved 91 percent of its target, with the major contribution coming from international travel segment with 48 percent growth. FED contributed around 6 percent in total FBR tax collection during 2014-15. The base of FED is quite narrow and top 5 commodities contributed around 91 percent of the total FED collection. The FED tax collection increased by 17 percent and recorded at Rs. 162 billion compared with Rs. 138 billion last year.

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

Commodities	Budget 2014-15	Collection			% share 2014-15	Target achieved %
		2014-15	2013-14	% growth		
Cigarettes	90.4	82.5	72.1	14.4	50.8	91.3
International Travel	19.3	27.7	18.8	47.7	17.1	143.5
Beverages	11.5	13.3	12.5	6.4	8.2	115.7
Cement	11.2	12.1	11.2	8.0	7.5	108.0
Natural Gas	12.9	11.5	12.1	(5.0)	7.1	89.1
Sub Total	**145.3**	**147.1**	**126.7**	16.1	90.6	101.2
All Other	32.7	15.2	11.4	33.3	9.4	46.5
Gross Total	**178.0**	**162.3**	**138.1**	**17.6**	100.0	**91.2**
Refund/Rebate		-	-	-	-	-
Net Total	**178.0**	**162.3**	**138.1**	**17.6**	-	-

Source: FBR Review 2014-15

5.26 Cigarettes remained the top contributor in FED constituting more than half of the FED collections (51 percent). Second largest source of contribution was from international travel which constituted around 17 percent. Cement sector achieved 108 percent of its budget target and grew by 8 percent mainly owing to revived construction activities. While, natural gas posted a fall of 5 percent with its contribution declined marginally to Rs. 11 billion, which may be attributable to rationalization in gas tariffs.

Other Taxes

5.27 Government also relied on other sources of indirect taxes which mainly include petroleum levy, airport taxes and other taxes. During 2014-15, collection from petroleum levy stood at Rs. 131 billion against the target of Rs. 123 billion and posted a growth of 27 percent on the previous year's collection of Rs. 104 billion. During 2014-15, gas infrastructure development cess and natural gas development surcharge were reclassified into other taxes (previous classification was non-tax revenue) which increased the other taxes base.

Table-10: Analysis of Other Taxes Collection (Rs. in billion)

Tax Head	2014-15	2013-14	Growth (%)	% share in 2014-15	% share in 2013-14
Petroleum Levy	131.4	103.5	26.9	58.7	58.0
Gas Infrastructure Development Cess	57.0	31.8	79.2	25.5	17.8
Natural Gas Development Surcharge	25.9	38.5	(32.8)	11.6	21.6
Other Taxes (ICT)	9.3	4.6	101.0	4.2	2.6
Airport Tax	0.0	0.1	(50.0)	0.0	0.0
Total Other Taxes	**223.6**	**178.6**	25.2	100.0	100.0

Source: FBR Review 2014-15

5.28 Gas infrastructure development cess witnessed significant growth of 79 percent in 2014-15 mainly owing to increased financing in large infrastructural projects for importing natural gas. Meanwhile, natural gas development surcharge witnessed a decline of 33 percent owing to drop in international oil prices which serves as pricing indicator for gas as well.

5(iv) Non-Tax Revenue

5.29 Non-tax revenue witnessed a substantial decrease mainly due to reclassification of gas infrastructure development cess and natural gas development surcharge into other taxes category (tax revenue) and stood at Rs. 850 billion. Non-tax revenue was mainly led by SBP profits and defense receipts. Unlike preceding year 2013-14, post office/PTA profits contributed only Rs. 4 billion in 2014-15 as compared to last year contribution of Rs. 95 billion which was mainly led by issuances of 3G and 4G licenses. Similarly, another cause of low non-tax revenue was a sharp downfall in mark-up receipts from PSEs, attributable to declining interest rate environment.

5.30 The decline in the international oil prices led to 76 percent lesser revenue collected under discount retained on crude price to record at Rs. 10 billion during 2014-15 as compared to Rs. 41 billion last year.

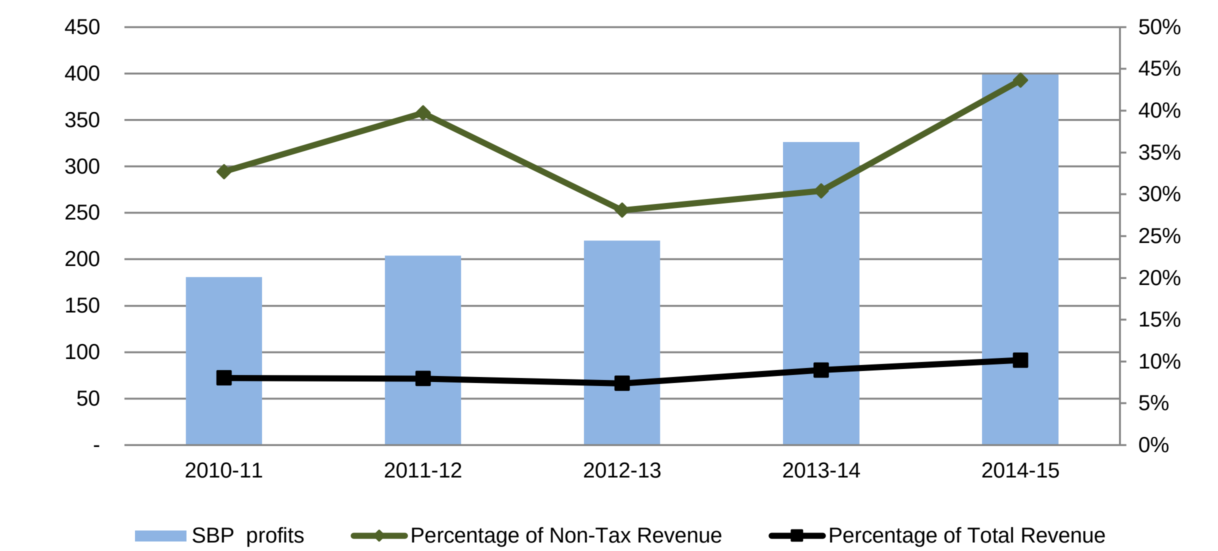
Table-11: Sources of Non-Tax Revenue (Rs. in billion)

Sources of Taxation	Budgeted 2014-15	2014-15	2013-14	% growth	% share	Target Achieved %
SBP profits	270.0	399.0	326.2	22.3	46.9	147.8
Defense	140.2	157.1	117.2	34.0	18.5	112.1
Dividends	82.0	74.1	65.9	12.4	8.7	90.4
Royalty on Oil and Gas	81.4	74.1	76.4	(3.0)	8.7	91.0
Foreign Grants	35.0	21.8	12.3	77.2	2.6	62.3
Citizenship & Naturalization, Passport f	20.0	18.7	19.0	(1.6)	2.2	93.5
Mark-up (PSE's)	26.0	14.1	65.8	(78.6)	1.7	54.2
Mark-up	13.0	12.9	14.1	(8.5)	1.5	99.2
Windfall Levy	17.0	12.1	14.6	(17.1)	1.4	71.2
Discount Retained on Crude Price	20.0	9.6	40.7	(76.4)	1.1	48.0
Profits: Post Office / PTA	71.1	3.6	94.8	(96.2)	0.4	5.1
Others	40.6	53.2	120.1	(55.7)	6.3	131.0
Gross Receipts	**816.3**	**850.3**	**967.1**	**(12.1)**	**100.0**	**104.2**

Source: Budget & Fiscal Operations 2014-15

5.31 SBP profits remained the top contributor to the non-tax revenue, followed by defense payments. SBP profits increased by 22 percent during 2014-15 compared with last year and stood at Rs. 399 billion exceeding the budget target of Rs. 247 billion. The historical trend of SBP profits is highlighted by the graph below:

Fig-3: Profit Receipts from SBP - (Rs. in billion)



5.32 Over 80 percent of non-tax receipts were from 4 heads with SBP profits (47 percent) followed by defense (19 percent), dividends (9 percent) and royalty on oil and gas (9 percent). Receipt of CSF largely constituted the revenue from the defense sector.

6.0 Total Expenditure

6.1 Government's total expenditure is the aggregate of two major components; current expenditure and development expenditure. Current expenditure constituted around 80 percent of the total expenditure with around 11 percent growth in 2014-15. Although, development expenditure and net lending witnessed a decrease of 8 percent during 2014-15 as compared to last year, however, Public Sector Development Program (PSDP) registered a noticeable growth of 14 percent. Defense expenditure grew by 12 percent mainly due to ongoing security spending needs. Total expenditure was recorded at Rs. 5,565 billion in 2014-15 as compared to Rs. 5,241 billion last year with 6 percent growth against the growth of 9 percent witnessed last year.

Table-12: Consolidated fiscal position of the government in the fiscal year 2014-15

	Budgeted 2014-15	Provisional		% growth	% of GDP	% of Budget 2014-15
		2014-15	2013-14			
Total Revenue	**4,220.60**	**3,931.0**	**3,637.3**	8.1	**14.4**	93.1
Tax Revenue	3,337.20	3,017.6	2,564.5	17.7	**11.0**	90.4
Non Tax Revenue	883.4	913.4	1,072.8	(14.9)	**3.3**	103.4
Total expenditure	**5,642.40**	**5,565.3**	**5,241.1**	6.2	**20.3**	98.6
a) Current expenditure	**4,462.3**	**4,424.7**	**4,004.6**	10.5	**16.2**	99.2
of which mark up payments	1,325.2	1,303.8	1,147.8	13.6	**4.8**	98.4
Domestic	1,224.6	1,208.1	1,072.8	12.6	**4.4**	98.7
Foreign	100.6	95.7	75.0	27.5	**0.3**	95.1
Provincial current expenditure	1,365.0	1,387.1	1,173.3	18.2	**5.1**	101.6
Defense expenditure	700.1	697.8	623.1	12.0	**2.5**	99.7
b) Development expenditure and net lending	**1,180.00**	**1,140.6**	**1,236.6**	(7.8)	**4.2**	96.7
Development expenditure	1,172.8	1,113.2	1,136.0	(2.0)	**4.1**	94.9
PSDP	1,011.0	987.7	865.5	14.1	**3.6**	97.7
Other Development expenditure	161.8	125.5	270.5	(53.6)	**0.5**	77.6
Net lending	7.2	27.4	100.6	(72.8)	**0.1**	380.6
c) Unidentified expenditure	-	(177.6)	(215.1)	(17.4)	**(0.6)**	-
Overall fiscal balance	(1,421.8)	(1,456.7)	(1,388.7)	4.9	**(5.3)**	102.5
% of GDP	4.9	(5.3)	(5.5)	(2.7)	**(0.0)**	(108.6)

	Budgeted 2014-15	Provisional		% growth	% of GDP	% of Budget 2014-15
		2014-15	2013-14			
Financing of fiscal balance	1,421.8	1,456.7	1,388.7	4.9	**5.3**	102.5
a) External sources	309.9	181.0	511.7	(64.6)	**0.7**	58.4
Domestic sources	1,111.9	1,275.6	877.0	45.5	**4.7**	114.7
Non-Bank	884.0	383.6	553.3	(30.7)	**43.4**	43.4
Bank	227.9	892.0	323.7	175.6	**3.3**	391.4
GDP at market prices	29,078.0	27,384.0	25,401.9	7.8	**100.0**	94.2

Source: Budget & Fiscal Operations 2014-15

6(i) Current Expenditure

6.2 Current expenditure mainly constitutes general public services and defense expenditure. Current expenditure was recorded at Rs. 4,425 billion in 2014-15 as compared to Rs. 4,005 billion in 2013-14, registering a growth of 11 percent and constituted 99 percent of its budget target of Rs. 4,462 billion.

General Public Services

6.3 Around 50 percent of the current expenditure were allocated towards expenditure on general public services which stood at Rs. 2,105 billion in 2014-15. The general public services mainly included the mark-up payments on foreign/domestic debt, pensions and annuities and grants. Mark-up payments on domestic debt constituted over 50 percent of general public services expenditures and 22 percent of the total expenditure, while mark-up payments on foreign debt constituted around 4.5 percent of these expenditure and less than 2 percent of the total expenditure. Mark-up payments on domestic and foreign debt comprised 4.8 percent of GDP and utilized 33 percent of the total revenue.

6.4 Superannuation and pension costs were another main component of the general public services. Pension cost witnessed 3 percent growth and recorded at Rs. 185 billion as compared to Rs. 180 billion of previous year.

Table-13: Components of General Public Expenditure (Rs. in billion)

Expenditure	2014-15	2013-14	% growth	% share 2014-15
Mark-up on domestic debt	1,208.1	1,072.8	12.6	57.4
Mark-up on foreign debt	95.7	75.0	27.5	4.5
Superannuation allowances & pension	185.2	180.2	2.8	8.8
Grants (other than provinces)	288.1	283.2	1.7	13.7
Other general public service	328.2	380.1	(13.6)	15.6
Total	**2,105.3**	**1,991.3**	**5.7**	**100.0**

Source: Fiscal Operations 2014-15

Subsidies

6.5 Total subsidies reduced to around Rs. 242 billion as compared to Rs. 306 billion last year. Despite a decline of 21 percent in 2014-15 compared with previous year, subsidies exceeded its budget target by 19 percent. Although the government planned to reduce subsidies on some segments including power sector in-line with tariff rationalization, subsidies to power sector missed its budget target by 19 percent and constituted for 91 percent of the total subsidies in 2014-15. It is also worth mentioning that no subsides were given by the government to petroleum sector and oil refineries mainly because of the decline in the international oil prices. The second largest recipient of the subsidies was food and agriculture sector which consumed Rs. 20 billion. The amount of subsidies to power sector increased burden on the government's resources and implies the need for macroeconomic restructuring to make the power sector viable, independent and self-sufficient. Government is embarked on the path to economic restructuring to mobilize revenue, consolidate fiscal situation and revive the economy with the expectation to improve the socio-economic outlook and reduce the burden of subsidies to protect the vulnerable groups of the society.

Table-14: Subsidies (2011-2015) - (Rs. in billion)

Subsidies	Power sector	Food and Agriculture	Oil Refineries	Others	Total
2014-15					
Budget estimate	185.0	15.0	2.0	1.2	203.2
Actual subsidies	221.0	20.3	-	0.3	241.6
% share	91.5	8.4	-	0.1	100.0
2013-14					
Budget estimate	220.1	15.0	4.0	1.3	240.4
Actual subsidies	292.3	12.5	0.0	0.9	305.7
% share	95.6	4.1	0.0	0.3	100.0
2012-13					
Budget estimate	185.3	11.2	7.7	3.4	208.6
Actual subsidies	344.1	11.2	0.8	2.0	358.1
% share	96.1	3.1	0.2	0.6	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

* 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 and net lending comprised 4.2 percent of total GDP compared with 4.9 percent last year. Development expenditure decreased to Rs. 1,141 billion in 2014-15 from Rs. 1,237 billion last year and posted a decline of 8 percent. This was due to reduction in development expenditure besides PSDP and lesser net lending to PSEs. Development expenditure constituted around 21 percent of the total expenditure during 2014-15 and constituted around 97 percent against the budget target of Rs. 1,180 billion. This reflects effective strategy to forecast the expenditures and achieve budget targets within the limits of available resources. The net lending, although reduced from Rs. 101 billion to Rs. 27 billion, still surpassed the budget target of Rs. 7.2 billion. Going forward, the government needs to invest more resources towards the targeted development expenditure in the wake of the current socio-economic environment which will contribute in economic growth.

7.0 Provincial Fiscal Operations

7.1 Provincial governments posted overall surpluses of around Rs. 87 billion in 2014-15 against the target of Rs. 289 billion. The provinces could not generate the assigned surplus mainly due to a massive increase in their current expenditures and shortfall in their tax revenue. Provincial current expenditures grew by 18 percent as compared to 7 percent last year, where investments in different social safety net programs, social sector (health, education, and housing) and provision of general public services (public order and safety affairs) remained the major drivers for increase in current expenditures of the provinces.

7.2 Despite a considerable growth in provincial current expenditure, the development budget of provinces was underutilized and provinces spent Rs. 499 billion in 2014-15 against the targeted amount of Rs. 650 billion allocated for provincial PSDP. The following were the two main causative factors:

- Limited understanding about generating surpluses between federal and provinces;
- Timing of federal funds transfer to the provinces.

7.3 Balochistan led amongst the provinces and spent around 35 percent of development expenditure on health, education, housing and community services. KPK and Sindh also spent significantly higher amount on health, education and social protection programs. In terms of infrastructure spending, Punjab remained at top and spent a major portion of around 42 percent of development expenditure on construction of roads and transportation.

Table-15: Provincial Fiscal Operations (Rs. in billion)

Fiscal Operations	2014-15	2013-14	% growth	% share
Total Revenue*	1,902.4	1,767.4	7.6	48.4
a) Tax Revenue	206.0	190.0	8.4	6.8
b) Non-Tax revenue	75.6	49.4	53.0	8.3
Total expenditure	1,898.9	1,617.9	17.4	34.1
a) Current expenditure**	1,400.1	1,187.4	17.9	31.6
b) PSDP	498.8	430.5	15.9	50.5
Fiscal Surplus/ (Deficit)	**87.3**	**196.9**	**(55.7)**	**-**

* Includes Rs. 1,406.3 billion and Rs.1, 538.7 billion received from the federal government in 2013-14 and 2014-15 respectively.
**Includes Rs.14.1 billion and Rs.12.9 billion as mark-up paid to federal government in 2013-14 and 2014-15 respectively.

Source: Fiscal Operations 2014-15

7.4 Regarding revenues, the total tax collection of the provinces grew by 8 percent in 2014-15, though provinces after 18th amendment and 7th NFC award have higher fiscal responsibility and resources, but still facing issues related to institutions, capacity building and resource mobilization. A remarkable improvement was witnessed in provincial non-tax revenue that was raised by 53 percent in 2014-15 with a main contribution in the form of federal grants.

7.5 Amongst the provinces, despite lower GST rate as compared to other provinces, Sindh showed improved tax collection mainly due to broad taxation base and exemptions withdrawn by the provincial government in 2014-15. Punjab generated largest surplus, followed by Sindh and Balochistan while KPK recorded budget deficit.

7.6 There is a need for the provinces to strengthen their newly established provincial revenue authorities and formulate mechanism for levying sales tax on service as well as on the most crucial area of agricultural income tax with an exception of Balochistan, which has yet to establish its own tax revenue authority. Hence, provinces have to follow fiscal consolidation path by raising their revenue which will support the federal government in bridging the gap in the fiscal account.

8.0 Fiscal, Revenue and Primary Balance

8(i) Fiscal Balance

8.1 Pakistan's fiscal balance improved significantly in 2013-14 as compared with 2012-13. The actual fiscal deficit of 5.5 percent was not only lower than 8.2 percent last year but also lower than its budgeted target of 6.6 percent. During 2014-15, fiscal deficit further reduced and recorded at 5.3 percent of GDP. This improvement in fiscal deficit slowed down the pace of public debt accumulation. However, the government relied mainly on domestic market during

2014-15 to finance its fiscal deficit as compared with 2013-14 i.e. the government financed around 88 percent of its fiscal deficit from domestic sources during 2014-15 as compared with 63 percent during last fiscal year.

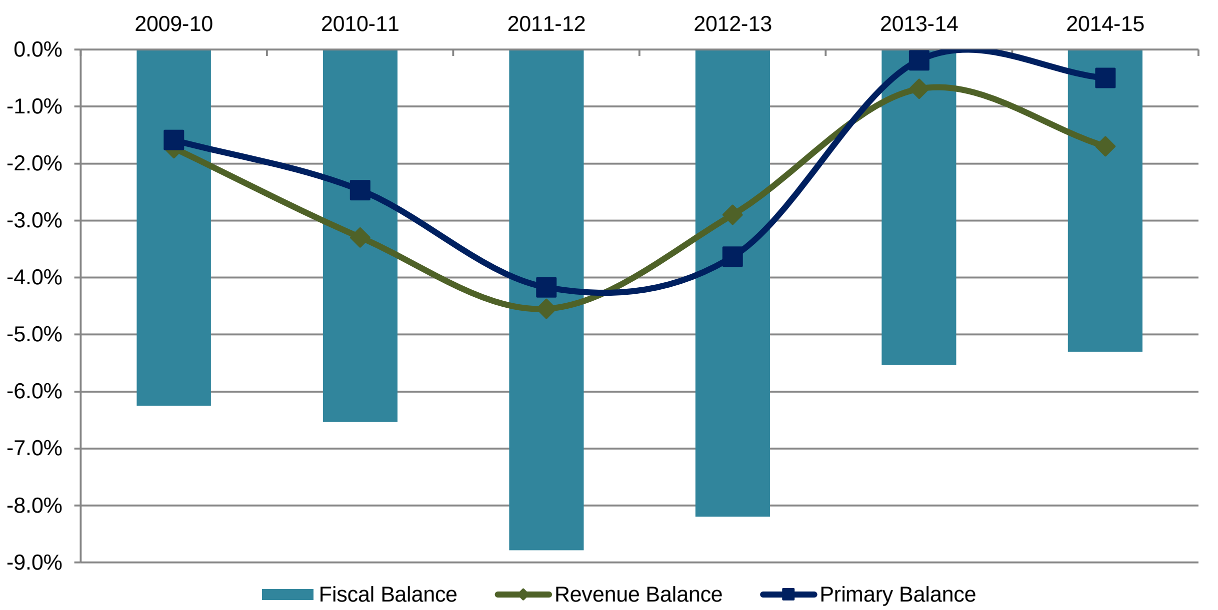
8(ii) Revenue Balance

8.2 Revenue balance is the total revenues minus current expenditure. The persistence of revenue deficit indicates that the government is not only borrowing to finance its development expenditure, but partially to finance its current expenditure. Revenue deficit increased to 1.7 percent of GDP in 2014-15 as compared with 0.7 percent of GDP in 2013-14due to higher growth in current expenditure (on account of one off expense of TDPs, security situation and floods) as compared with the growth in total revenues. There is a need to bring revenue deficit to nil as envisaged under Fiscal Responsibility and Debt Limitation Act, 2005 so that borrowing is used to supplement development activities which will enhance repayment capacity of the country.

8(iii) Primary Balance

8.3 Primary balance is the total revenues minus non-interest expenditure or fiscal deficit before interest payments. Primary balance is an indicator of current fiscal efforts since interest payments are predetermined by the size of previous deficits. Primary deficit improved significantly in 2013-14 and recorded at 0.2 percent of GDP compared with 3.6 percent in 2012-13. However, it increased slightly in 2014-15 and recorded at 0.5 percent of GDP owing to reasons elaborated in the paragraph earlier. Achieving a primary surplus is normally viewed as important, being usually necessary for reduction in public debt to GDP ratio.

Fig-4: Trends in Fiscal, Revenue and Primary Balance
(In Percent of GDP)



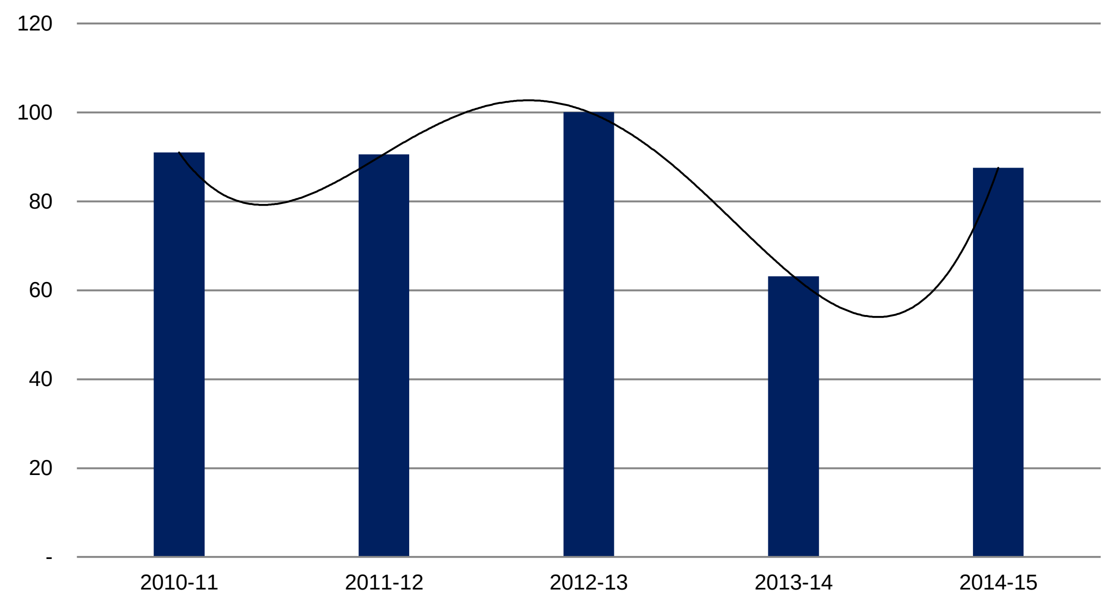
8(iv) Financing of Fiscal Deficit

8.4 A considerable improvement was witnessed in the financing mix of fiscal deficit during 2013-14 as government was able to finance around 37 percent of its budget deficit from external sources. However, the significant contributor in the financing of budget deficit remained the domestic source (bank and non-bank).

8.5 Within the banking system, the major source of financing remained commercial banks while portion of debt of SBP was retired. Out of total banking system mobilization, most of debt was obtained in the form of PIBs followed by T-bills.

8.6 The non-bank sources mainly include national savings schemes and private sector investment in government securities. While financing from national savings schemes increased sharply from Rs. 150 billion in 2013-14 to Rs. 261 billion in 2014-15, however, private sector investment in government securities declined following the reduction in interest rates.

Fig-5: Domestic Financing of Fiscal Deficit
(Proportion of total fiscal deficit)



9.0 Fiscal Performance July-September, 2015

9.1 Total revenue grew by 12 percent and recorded at Rs. 937 billion as compared to Rs. 840 billion last year. While, total expenditure grew with a slower pace of 8 percent and stood at Rs. 1,265 billion, which resulted in a fiscal deficit of 1.1 percent of GDP, slightly lower than 1.2 percent last year. It was primarily due to better control on current expenditures and withdrawal of some tax exemptions. Provinces posted a deficit of Rs. 29 billion as compared to a surplus of Rs. 58 billion last year, where provincial revenue stood at Rs. 366 billion and total expenditure recorded at Rs. 395 billion.

Tax Revenue

9.2 Tax revenue as a percentage of GDP continued to increase to 2.4 percent as compared with 2.2 percent in the comparable period last year and stood at Rs. 724 billion. Collection was relatively better in raising the tax revenue but remained slightly below the target due to lesser sales tax collection by Rs.16 billion and imports compression by around 13 percent. Moreover, refund payments increased to Rs. 22 billion as compared with Rs. 9 billion in the comparable period last year. FBR is geared to take further improvement measures through enhanced documentation of the economy, simplification of tax procedures and effective enforcement.

Non Tax Revenue

9.3 Non-tax revenue grew by 0.7 percent and stood at Rs. 213 billion in the first quarter of 2015-16. Major contribution came from defense sector essentially from CSF amounting Rs. 76 billion, followed by SBP profit of Rs .67 billion. Cumulative collection of Rs. 34 billion came from royalties on oil & gas and dividend.

Expenditure

9.4 Mark-up payments remained the major factor in total expenditure and grew by 1 percent during first quarter of 2015-16. Defense expenditure grew by 0.5 percent and stood at Rs. 146 billion. Development expenditure was also increased due to social sector spending in education, health, and housing amenities. The PSDP component of development expenditure embarked a significant growth of 62 percent and recorded at Rs. 146 billion in the first quarter of 2015-16 compared with Rs. 90 billion during the same period last year owing to improved construction activities. Government is committed to curtail the current expenditure with effective management of financial resources.

10.0 Economic Reforms

10.1 Reform strategy is focused on improvement in corporate governance, restructuring of PSEs and strategic partnership through privatization. The updates in terms of restructuring/reforms of the three large PSEs – Pakistan Steel Mills (PSM), Pakistan International Airlines (PIA) and Pakistan Railways (PR) are highlighted below:

I. Pakistan Steel Mills (PSM)

10.2 PSM enjoyed a strong financial and operational status until 2007-08. Subsequently, deterioration in capacity utilization and increase in raw material prices negatively affected its overall functioning and profitability. PSM has posted losses since 2008-09 and operated under its sub-optimal capacity.

10.3 A comprehensive restructuring plan has been implemented for PSM to prepare for potential strategic private sector participation in the company. Financial package has been allocated for PSM to increase capacity utilization. Financial advisors for PSM were appointed in April 2015 who have completed due diligence process and submitted their report to the Cabinet Committee on Privatization (CCOP).

II. Pakistan Railways (PR)

10.4 Railway revitalization strategy has been implemented, under which PR has been making institutional, operational and financial progress since 2013-14 as reflected in their operations alongwith improved financials. Important initiatives being undertaken under the revitalization strategy which include:

- Appointment of railway board in February 2015;
- Launching of international consultancy for developing proposal to manage railways engineering facilities on public private partnership basis;
- Pakistan Railway Freight Transportation Company (PRFTC) has been licensed to harness freight opportunities of 35 million tons of coal; and
- Railways real estate company geared towards enhancing revenue generation by tapping new land development and management opportunities.

10.5 PR’s provisional revenues increased by 46 percent during 2014-15 and stood at Rs. 32 billion as compared to Rs. 22 billion in 2013-14, primarily due to continued focus on improved service delivery, appropriate mix of freight and passenger services, tariff and route rationalization as well as removing cost redundancies in business operations. Since July 2013, 58 new locomotives have been added to PR’s fleet for both passenger and freight service (including new procurement and rehabilitation of old locomotives) which increased the revenues from freight operations by approximately 138 percent in 2013-14.

III. Pakistan International Airlines (PIA)

10.6 An initial plan for PIA has been developed which envisages the introduction of fuel efficient aircrafts, route rationalization, separation of core and non-core activities and HR rationalization with the objective of making PIA a sustainable and profitable entity in the long run. The plan provides an overall picture of financial position and future prospects based on operational strategies being implemented in these focal areas. Cornerstone of the business plan being put forward is a shift in strategy from high capacity, low frequency operations to high frequency optimum capacity operations. Success of this plan depends on lowering the level of liabilities as high debt cost will continue to pose challenges for operational viability and sustainability.

10.7 Financial advisors have been appointed for PIA to seek potential options for restructuring and strategic private sector participation in the core airline business. The diligence process has been completed which will be followed by transaction advisory and finalization of restructuring options.

IV. Power Sector Reforms

10.8 Energy sector reform is a key component of the structural reforms agenda of the present government. Government developed a National Power Policy 2013-18 which focuses on improved governance structure, supportive legal framework, financial sustainability, supply-demand side management and promoting private sector participation in the sector. Implementation of this policy will help to improve the governance and financial viability of power sector.

10.9 Implementation of the government plan has pushed the structural reforms forward. In an effort to move to full cost recovery, the government has rationalized tariffs. The differential, between the NEPRA Determined Tariff (NDT) and proposed tariff for 2013-14, has decreased substantially and subsidies are being phased out except for the vulnerable consumers in the residential and agriculture categories. Further, NDT is applied to the other categories. Consequently the Tariff Differential Subsidy (TDS) has come down from 0.8 percent of GDP to 0.4 percent of GDP. The timely payment of TDS is being ensured on a monthly basis.

10.10 Significant efforts are being made to ensure financial sustainability of the system. Mechanisms are under consideration to cap the overdue payments to a minimum sustainable level. Mechanism of at source deduction of public sector overdue payables is being implemented and a feeder to feeder monitoring to curtail losses is being pursued. New Electricity Act will help improving litigation mechanism for power sector receivables. Revenue based load management is being carried out in order to ensure smooth recovery of payables. An effort is underway to incorporate all costs to reflect in the tariff structure to arrest build-up of circular debt. In addition, three Distribution Companies (DISCOs) will file multi-year tariff petition during the 2015-16 along with five year investment plan.

10.11 Operations of Central Power Purchase Authority (CPPA), as an effective financial manager of the system, have improved. To increase transparency in the system, monthly due amount and payments by the DISCOs to CPPA, and by CPPA to the generators will be made available on the website of CPPA. Further, overhaul of financial and management system in DISCOs and Generation Companies (GENCOs) is imperative to improve their performance to a sustainable level. In this regard, performance contracts have been signed with DISCOs to tackle losses, raise payment compliance, improve energy efficiency and service delivery. Moreover, professional board members of DISCOs have been appointed to improve corporate governance. In the medium term, disinvestment of DISCOs is also being planned.

10.12 On the regulatory side, capacity building of NEPRA is imperative to strengthen the regulatory framework to meet the current needs and evolving dynamics of the power sector. A diagnostic audit is being carried out to identify areas where reforms are required. NEPRA will effectively oversee the performance of power sector, and publish quarterly performance standards and indicators of the DISCOs on its website. NEPRA has been allowed to pass on Fuel Price Adjustments (FPA) without prior clearance from the government. Entry and middle management positions in NEPRA have been added to strengthen technical capacity of NEPRA. Development and effective implementation of energy efficiency codes – Pakistan Energy Efficiency and Conservation Act to promote energy efficiency in the country shall play a critical role towards meeting energy needs in the country. The overall objective of above reform process is to ensure smooth financial flow in power sector through reduction in build-up of circular debt.

Improved Fuel Mix

10.13 Efforts are underway to improve power sector fuel mix in the country to reduce price of power basket and improve financial viability. Under the reforms, a large capacity addition is planned from wind, solar, nuclear, hydel and coal power projects till 2019-20. The emphasis is towards achieving a less oil dependent power generation mix through development of indigenous energy resources particularly hydel, coal and renewable energy resources for sustainable and affordable energy supply in the country. Three hydel plants: Tarbela (4th extension), Chashma, Neelum Jehlum and few other small dams are expected to provide additional generation within next three years. Independent Power Producers and GENCOs are also being encouraged to covert from oil to coal based power generation. In addition, development of support infrastructure to import 1000MW under CASA is also included in the plan. Power sector has been given priority in terms of allocation of gas for power generation. All these efforts will improve the energy mix thereby reducing dependence on oil and ensure reasonable tariffs for consumers ultimately leading to financial sustainability.

10.14 Going forward, the medium term emphasis will remain towards achieving a less oil dependent power generation mix. On the regulatory side, capacity building of NEPRA is envisaged to strengthen the regulatory framework to meet the current needs and evolving dynamics of the power sector. Moreover, development and effective implementation of energy efficiency codes – legislation to promote energy efficiency in the country – will play a critical role towards meeting energy needs in the country.

V. Future Economic Reforms

10.15 Implementation of PSEs reform strategy will continue in 2015-16 and beyond to achieve the medium term objectives set forth. Government is making efforts to develop a database on investment tracking and performance monitoring that will provide evidence based decisions for revival of PSEs. Efforts will be made to ensure implementation of the Public Sector Companies Corporate Governance Rules 2013 to improve the governance structures in PSEs. The Rules will help to clarify role 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. Government is also working towards reforming the regulatory bodies to improve their efficiency and performance.

11.0 Review of Public Debt

11.1 The portion of total debt which has a direct charge on government revenues as well as the debt obtained from the IMF is defined as public debt. Pakistan's public debt has two main components, namely domestic debt (incurred principally to finance fiscal deficit) and external debt (raised primarily to finance development expenditure).

11.2 During 2014-15, improvement in current account, relatively contained fiscal deficit and revaluation gain on account of appreciation of US dollar against major currencies, slowed down the pace of public debt accumulation. The maturity profile of domestic debt continued to improve in 2014-15 as the share of Pakistan Investment Bonds (PIBs) in total domestic debt increased to 34 percent by end June, 2015 from 30 percent in 2013-14 and only 14 percent in 2012-13. During the year, the policy rate was significantly reduced mainly owing to comfort on external account and sharp reduction in inflationary expectations. Specifically, during the four consecutive monetary policy decisions from mid-November 2014 to May 2015, SBP reduced the discount rate by a cumulative 300 basis points to a multi-decade low of 7 percent[1]. The conducive economic environment coupled with supportive monetary policy provided an ideal opportunity for the government to revise coupon rates on PIBs. Accordingly, the government was also able to rationalize the cost of domestic debt by aligning the rates on domestic debt instruments with the market yields. Moreover, ownership structure witnessed gradual shift from SBP to commercial banks, as the government retired portion of debt to SBP during 2014-15.

11.3 Government was able to mobilize external inflows from multilateral and bilateral development partners and continued its presence in international capital markets with successful launch of 5 year Islamic International Sukuk Bonds in November 2014. Pakistan entered the International Capital Market at the time, when interest rates were low and appetite for sovereign papers was high. This enabled the government not only to retire the expensive domestic debt but also helped to increase the foreign exchange reserves of the country. Encouragingly, the foreign exchange reserves crossed US$ 15 billion[2] mark by end December, 2014 which provided access to IBRD funding.

[1] The ceiling rate reduced further following a 50 basis point cut in SBP's target rate, effective from September 14, 2015.
[2] The foreign exchange reserves exceeded US$ 20 billion as at end September, 2015.

11.4 Public debt was Rs. 17,381 billion or 63.5 percent of GDP as at end-June 2015 compared with 63.8 percent during the same period last year. This reduction in public debt to GDP ratio is mainly attributed to improvement in fiscal and current account balances and revaluation gain on external public debt portfolio. Public debt recorded an increase of Rs. 1,389 billion during 2014-15 as compared with the increase of Rs. 1,673 billion witnessed during the preceding fiscal year. The primary source of increase in public debt was in domestic debt that positioned at Rs. 12,199 billion representing an increase of Rs. 1,279 billion, whereas, external debt at Rs. 5,182 billion represented an increase of Rs. 110 billion as compared to end June 2014.

11.5 In US Dollar terms, external public debt in fact recorded a decline of US$ 0.4 billion during 2014-15 as compared with last fiscal year despite net positive disbursements. This decrease in external public debt is attributed to revaluation gain on account of appreciation of US Dollar against other international currencies as well as repayment of external loans. However, net reduction in external public debt on this front was overshadowed by the depreciation of Pak Rupee by 3 percent against US Dollar which led to increase in external public debt in Pak Rupee terms.

Table-16: Public Debt

	2010	2011	2012	2013	2014(P)	2015(P)	2016(P)*
(Rs. in billion)							
Domestic Debt	4,654.3	6,016.7	7,638.1	9,521.9	10,920.0	12,198.9	12,718.7
External Debt	4,351.9	4,750.2	5,057.2	4,796.5	5,071.5	5,181.8	5,424.1
Total Public Debt	9,006.2	10,766.9	12,695.3	14,318.4	15,991.5	17,380.7	18,142.8
(In percent of GDP)							
Domestic Debt	31.3	32.9	38.1	42.5	43.6	44.5	41.5
External Debt	29.3	26.0	25.2	21.4	20.2	18.9	17.7
Total Public Debt	**60.6**	**58.9**	**63.3**	**64.0**	**63.8**	**63.5**	**59.2**
(In percent of revenues)							
Domestic Debt	224.0	267.1	297.6	319.3	300.2	310.3	---
External Debt	209.4	210.9	197.0	160.8	139.4	131.8	---
Total Public Debt	433.4	477.9	494.7	480.1	439.7	442.1	**---**
(In percent of total debt)							
Domestic Debt	51.7	55.9	60.2	66.5	68.3	70.2	70.1
External Debt	48.3	44.1	39.8	33.5	31.7	29.8	29.9
Memo:							
Foreign Currency Debt (US$ in billion)	50.9	55.3	53.5	48.1	51.3	50.9	51.9
Exchange Rate (Rs. /US$, End of Period)	85.5	86.0	94.5	99.7	98.8	101.8	104.5
GDP[(b)] (Rs. in billion)	14,867.0	18,276.4	20,046.5	22,379.0	25,068.1	27,383.7	30,672.0
Total Revenue (Rs. in billion)	2,078.2	2,252.9	2,566.5	2,982.4	3,637.3	3,931.0	**---**

P:Provisional *end-September, 2015

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

11.6 Government developed its first Medium Term Debt Management Strategy (2013/14 – 2017/18) with the aim to lengthen the maturity profile of its domestic debt and mobilize the external inflows. Accordingly, an improvement was observed in most of the public debt sustainability indicators during last two fiscal years. The refinancing risk of the domestic debt reduced at the end of 2014-15 as indicated by percentage of domestic debt maturing in one year reduced to 47 percent compared with 64 percent at the end of 2012-13. Exposure to interest rate risk reduced as percentage of debt re-fixing in one year decreased to 40 percent at the end of 2014-15 as compared with 52 percent at the end of 2012-13. Share of external loans maturing within one year was equal to around 28 percent of official liquid reserves at the end of 2014-15 as compared with around 69 percent at the end of 2012-13 indicating improvement in foreign exchange stability and repayment capacity (Refer section 9 for details). Government is also set to publish its updated Medium Term Debt Management Strategy(2015/16 - 2018/19) as the macroeconomic realities have changed since 2012-13. The purpose is to ensure that both the level and rate of growth in public debt is fundamentally sustainable while meeting cost and risks objectives.

11.7 One of the objectives of Medium Term Debt Management Strategy (MTDS) was to facilitate the development of debt capital market. A well-developed debt market for long term investment is essential for the growth of economy as it provides additional avenues for raising funds besides providing investment opportunities to the investors. In accordance with the commitment of the government to develop debt capital market, the government debt securities (T-bills, PIBs and Government Ijara Sukuk) are made available for trading at the stock exchanges. Further, the government is taking various steps to provide an efficient and liquid secondary debt market to the investors.

11.8 Public debt was recorded at Rs. 18,143 billion as at end September 2015, registering an increase of Rs. 762 billion during first quarter of 2015-16. Out of this total increase, increase in domestic debt contributed Rs. 520 billion while government borrowing for fiscal deficit was Rs. 273 billion during first quarter of 2015-16. This differential is mainly attributed to increase in government deposits with SBP which was utilized by the government in October 2015. During first quarter of 2015-16, the government mobilized more through the net issuance of T-bills (Rs. 434 billion) followed by PIBs (Rs. 55 billion) and NSS (Rs. 54 billion) while the stock of MRTBs was retired by Rs. 58 billion.

11.9 External public debt increased by US$ 1 billion during first quarter of 2015-16 and recorded at US$ 51.9 billion. This increase was primarily driven by US$ 515 million commercial loans and US$ 500 million Eurobonds. In addition, 8th tranche under IMF Extended Fund Facility (EFF) added US$ 497 million in external public debt. An amount of US$ 910 million was repaid during the first quarter of 2015-16. In Pak Rupee terms, the depreciation of Pak Rupee against US Dollar by 2.7 percent during first quarter of 2015-16 contributed further increase in external public debt.

12.0 Servicing of Public Debt

12.1 A rising debt burden has implications for the economy in the shape of a greater amount of resource allocation towards debt servicing in the future. In order to meet high debt servicing obligations, an extra burden is placed on limited government resources and may costs in the shape of foregone public investment or expenditure in other sectors of the economy. 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 over time.

12.2 During 2014-15, public debt servicing was recorded at Rs. 1,589 billion against the annual budgeted estimate of Rs. 1,686 billion. Public debt servicing consumed nearly 40 percent of total revenues during 2014-15. Ideally, this ratio should be below 30 percent to allow government to allocate more resources towards development and social sectors.

Table-17: Public Debt Servicing - (2014-15)

	Budgeted	Actual (P)	Percent of Revenue	Percent of Current Expenditure
	(Rs. in billion)			
Servicing of External Debt	100.6	95.7	2.4	2.2
Repayment of External Debt	360.7	285.2	7.3	6.4
Servicing of Domestic Debt	1,224.6	1,208.1	30.7	27.3
Servicing of Public Debt	1,685.9	1,589.0	40.4	35.9

P: Provisional Source: Budget Wing and Debt Policy Coordination Office Staff Calculations, Ministry of Finance

12.3 Domestic interest payments constituted around 76 percent of total debt servicing which is due to increasing volume of domestic debt in overall public debt portfolio. Domestic interest payments grew by 13 percent during 2014-15 compared to 17 percent recorded in 2013-14. Further analysis of domestic debt servicing revealed that large portion was paid against PIBs (Rs. 389 billion), followed by Market Related Treasury Bills (Rs. 270 billion), T-Bills (Rs. 170 billion), Special Savings Certificates and Accounts (Rs. 99 billion) and Bahbood Saving Certificates (Rs. 89 billion).

13.0 Report on Compliance with FRDL Act 2005

The Fiscal Responsibility and Debt Limitation (FRDL) Act, 2005 approved on June 13, 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 deficit was recorded at Rs. 471 billion or 1.7 percent of GDP in 2014-15.The government is striving to achieve a revenue surplus so that borrowings are only utilized towards financing the development needs of the country.

Table-18: Revenue Balance (Percent of GDP)

	2010	2011	2012	2013	2014	2015
Revenue Balance*	(1.7)	(3.3)[(a)]	(4.5)[(b)]	(2.9)[(c)]	(0.7)	(1.7)

*Adjusted for grants
[(a)]includes arrears of electricity subsidies amounting to Rs. 120 billion or 0.7 percent of GDP
[(b)]includes "one off" payment of Rs. 391 billion on account of debt consolidation or 2 percent of GDP
[(c)] includes payment for the resolution of the circular debt amounting to 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 ratio is on declining trajectory since 2012-13. The fiscal consolidation achieved during last two years has paved the way for a reduction in public debt, which fell from 64 percent in 2012-13 to 63.5 percent at the end of 2014-15.Public debt also includes loans from the IMF amounting to US$ 4.1 billion or 1.5 percent of the GDP as on June 30, 2015. The borrowing from the IMF is only utilized towards balance of payment support and is reflected in foreign currency reserves of the country. In the medium term, public Debt to GDP ratio is expected to be less than 60 percent in accordance with the provisions of the Fiscal Responsibility and Debt Limitation (FRDL) Act, 2005 through effective fiscal and debt management.

Table-19: Public Debt to GDP (Rs. in billion)

	2010	2011	2012	2013	2014	2015
Domestic Debt	4,654.3	6,016.7	7,638.1	9,521.9	10,920.0	12,198.9
External Debt	4,351.9	4,750.2	5,057.2	4,796.5	5,071.5	5,181.8
Total Public Debt	**9,006.2**	**10,766.9**	**12,695.3**	**14,318.4**	**15,991.5**	**17,380.7**
GDP	14,867.0	18,276.4	20,046.5	22,379.0	25,068.1	27,383.7
Total Public Debt (as percent of GDP)	**60.6**	**58.9**	**63.3**	**64.0**	**63.8**	**63.5**

(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 expenditures 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 public debt to GDP ratio by 2.5 percent annually was envisaged in the FRDL Act, 2005 to achieve the core objective of reducing public debt to GDP below 60 percent by end of 2012-13. As the government achieved this landmark in 2005-06, the sub-limit of annual reduction of 2.5 percent was no more applicable.

Social and poverty alleviation related budgetary expenditures increased to 7.9 percent of GDP in 2014-15. Additionally, expenditures on health and education stood at 0.8 percent and 2.2 percent of GDP respectively.

Table-20: Social Sector Expenditure

	2010	2011	2012	2013	2014	2015
Social sector and poverty related expenditure (as percent of GDP)	7.5	8.3	9.7	8.5	7.7	7.9
Expenditure on education (as percent of GDP)	1.7	1.8	2.0	2.1	2.1	2.2
Expenditure on health (as percent of GDP)	0.6	0.6	0.7	0.7	0.8	0.8

(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."

During 2014-15, the government issued new guarantees including rollovers amounted to Rs. 156 billion or 0.6 percent of GDP.

Table-21: New Guarantees Issued

(Rs. in billion)	2010	2011	2012	2013	2014	2015
New guarantees issued	224	62	203	136	106	156
(as percent of GDP)	**2.1**	**1.5**	**0.3**	**1.0**	**0.4**	**0.6**

Given the fiscal constraints mainly on account of high interest payments, large subsidies, growing security spending needs and structural bottlenecks, the government is gradually moving towards achieving the thresholds as stipulated in Fiscal Responsibility and Debt Limitation Act, 2005.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.

14.0 Conclusion

14.1 After several years of weak economic performance, most of the macroeconomic indicators witnessed improvement during the last two fiscal years. During 2014-15, GDP growth slightly increased while key macroeconomic indicators such as fiscal and current account balance improved, inflation rate declined, foreign exchange reserves increased and public debt to GDP ratio declined. Most of the public debt sustainability indicators improved as the government was able to further lengthen the maturity profile of its domestic debt and accordingly refinancing and interest rate risks reduced. External debt sustainability also improved owing to increase in debt carrying capacity of the country.

14.2 The near-term economic outlook for Pakistan is now broadly favorable, although, structural bottlenecks may impede higher potential growth. Almost all the components of fiscal operations have achieved their budget targets and support that the current policy is operational in the right direction to ensure macroeconomic stability and conducive environment for development. The central element of government's economic program was to reduce the budget deficit through a combination of raising tax revenue and reducing current expenditure, especially untargeted subsidies and restructuring of ailing PSEs to eliminate their continuing burden on the public exchequer. From a revised estimate of 8.8 percent of GDP during 2012-13, fiscal deficit was brought down to 8.2 percent before the actual close and from there on, it has been reduced to 5.3 percent in 2014-15. This performance has paved the way for arresting the deteriorating public debt profile in the country.

14.3 Fiscal policy should continue to explore opportunities for augmenting the resource envelop. At the same time, revenue mobilization should be given priority along with rationalization of current expenditure as envisaged in budget 2015-16. The elements of the vision presented were: a) GDP growth to gradually rise to 7 percent by 2017-18; (b) Inflation will be contained to single digit; (c) Investment to GDP ratio will rise to 20 percent in the medium term; (d) Fiscal deficit would be brought down to 3.5 percent of GDP; (e) Tax to GDP ratio will be increased to 13 percent; and (f) Foreign exchange reserves would be maintained at a sustainable level. Further, the principles of sound fiscal and debt management as outlined in the Fiscal Responsibility and Debt Limitation Act, 2005 shall be adhered to in the coming years.

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