FISCAL POLICY STATEMENT 2016-17

Debt Policy Coordination Office
Ministry of Finance

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Ministry of Finance
Government of Pakistan

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1.0 Introduction

1.1 For many years, the economy of Pakistan has gone through multiple problems including unstable security situation, crippling energy crisis and ensuing large foreign exchange requirements with alarmingly lower level of foreign exchange reserves. Severe structural problems have been there which contributed in form of weak financial position rooted in low tax revenue, limited exports growth, insufficient investment in human capital development and weak infrastructure resulted in low economic activities. Government has been able to significantly reduce economic vulnerabilities and implemented various growth-supporting structural reforms over the past three years. Consequently, economy continued to maintain its growth momentum for the third year in a row with real GDP growing at 4.71 percent in 2015-16 which is the highest in eight years and also curtailing fiscal deficit to 4.6 percent of the GDP down from 8.2 percent in 2013.

1.2 One of the key factors to the continuing growth momentum was conducive policy environment. Higher infrastructure spending by the government and decades' low interest rates provided a boost to domestic demand and easing in the energy supply situation addressed a key bottleneck holding back industrial performance. An improvement in the security situation supplemented these policy measures. Further on the stability front, the government rebuilt external buffers, contained inflation and reduced fiscal imbalances while strengthening social safety nets to protect the most vulnerable segment of the society. Encouragingly, the government successfully completed IMF EFF program which is indicative of government's strong commitment in implementing difficult structural reforms in the areas of taxation, energy, monetary/financial sectors and public sector enterprises. Government also strengthened public financial management and tax administration, reduced tax concessions and exemptions and untargeted energy subsidies and began implementing strategies to improve the business climate.

1.3 Fiscal consolidation remained on track for the third consecutive year, as the fiscal deficit for 2015-16, as a percentage of GDP, continued to fall. Helped by strong growth in tax revenue and a stringent control over current expenditure, the fiscal deficit for 2015-16 declined to 4.6 percent of GDP, from 5.3 percent in the previous year. The FBR tax collection recorded a strong growth of over 20 percent in 2015-16, and surpassed the annual target for the first time since 2006. This improvement was largely attributed to: (i) new tax measures, especially aimed at enhancing the scope of differential taxation structure for return filers and non-filers; (ii) additional measures implemented during 2015-16 to make up for the revenue shortfall; and (iii) various other tax measures implemented including changes in duty structure on petroleum products.

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 net revenue receipts;
  - (c) total fiscal deficit;
  - (d) total Federal fiscal deficit excluding foreign grants (from 2017-18);
  - (e) total public debt; and
  - (f) debt per capita.

(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 2015-16

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

- Containment of the fiscal deficit at 4.3 percent of projected GDP;
- Enhancement of consolidated revenue to Rs.4,313 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;
- Enhancement of efficiency of the tax machinery by removing anomalies and distortions in the current tax system; and
- Bringing foreign exchange stability through building reserves.

3.2 Budget 2015-16 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 structural economic reforms to stabilize the economy and put it on a growth trajectory.

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:

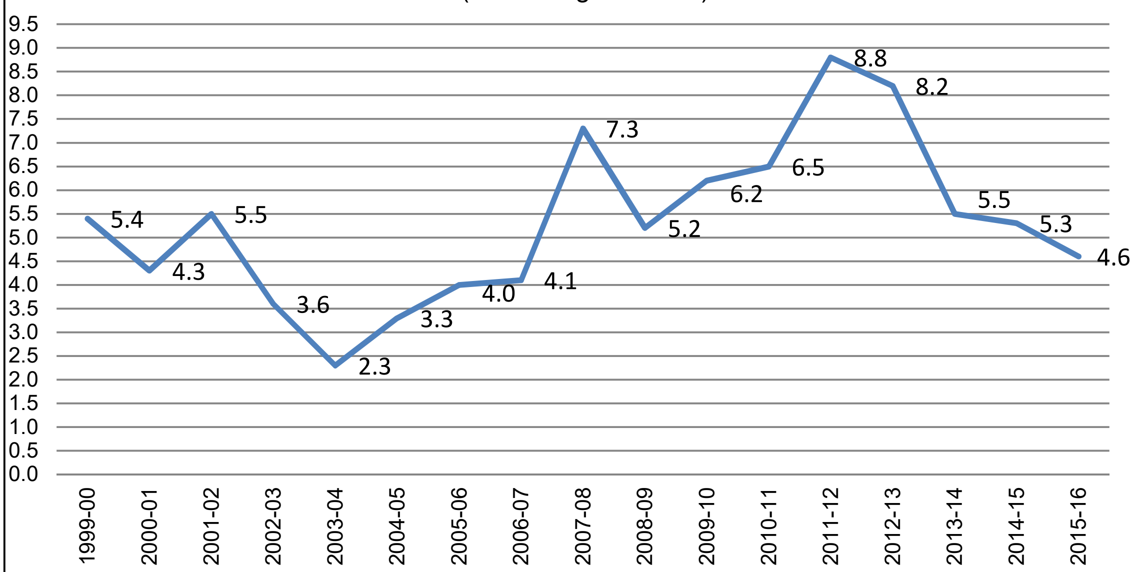
Table-1: Fiscal Indicators (as percentage of GDP)

Year	Real GDP Growth	Fiscal deficit	Expenditure			Revenue		
			Total	Current	Develop-ment	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	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
2016	4.7	4.6	19.6	15.9	4.4	15.0	12.4	2.7

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 inflows of foreign grants and 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 fiscal years 2000-2016 is depicted in Fig-1.

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



4.3 An analysis of over 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 1992-1996 to 13.4 percent during 2008-2013. The fiscal performance improved considerably during last three years, both in terms of revenue mobilization and expenditure management. During 2015-16, total revenue improved to 15 percent of GDP. 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 2015-16

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. The total consolidated revenue of the government during 2015-16 stood at Rs.4,447 billion compared with Rs.3,931 billion last year. The net revenue receipts of the federal government during 2015-16, after transfers to provinces, stood at Rs.2,218 billion up from Rs.2,124 billion last year.

5.2 The pace of revenue mobilization accelerated to 13 percent during 2015-16. The major improvement was seen in tax revenue, while non-tax revenue could not keep up the pace during the year. This improvement in tax revenue was mainly from higher sales of oil and gas products (both local and imported) in the country, which not only pushed up the collections of sales tax on these items, but also supported collections under infrastructure development cess, gas development surcharge and petroleum levy. Meanwhile, taxation measures during the year also proved effective in expanding the resource base.

5.3 Total tax revenue witnessed 21 percent growth in 2015-16 and accounted for 12.4 percent of the GDP. Direct taxes, being the major contributor to the total tax collection amounting Rs.1,192 billion, depicts the government's approach towards rationalizing taxation policies and tax trajectory into right direction for fair and equitable revenue mobilization. FBR surpassed its budgetary target for the first time since 2006. The growth of over 20 percent in FBR tax collection can be traced to various tax measures introduced by the government from time to time: (i) increase in customs duties; (ii) upward revision in regulatory duties on a range of consumer items; (iii) change in the duty structure of petroleum products; (iv) increase in FED on cigarettes and (v) differential withholding tax rates for filers and non-filers.

5.4 While amongst the non-tax revenue, major contribution came from SBP profits and defense receipts through CSF that constituted a combined share of around 48 percent in total non-tax revenue.

5(ii) FBR Collection

5.5 FBR is responsible for a major portion of tax collections. During the fiscal year 2015-16, FBR has taken a number of initiatives to improve service delivery, enhance resource mobilization efforts and increase tax to GDP ratio. In the last few years, these reforms have started providing positive results in shape of improved compliance, higher revenue growth and increased tax to GDP ratio. During the last three fiscal years ending 2016, FBR's revenue collection has shown substantial improvement. The net collection has jumped to Rs.3,112 billion from Rs.1,946 billion in 2012-13, registering around 60 percent growth. Likewise, the FBR tax to GDP rose from 8.7 percent in 2012-13 to 10.5 percent in 2015-16. The details of tax collection against targets is depicted in the table below:

Table-2: Comparison of Tax collection against targets 2015-16 (Rs. in billion)

Tax Head	Original Budget	Provisional Collection (2015-16)	Achievement of Target (%) 2015-16
FBR Taxes	**3103.7**	**3112.0**	100.3
Direct Taxes	1,347.9	1,191.6	88.4
Sales Tax	1,250.3	1,323.7	105.9
Federal Excise Duty	206.4	190.6	92.3
Customs Duty	299.1	406.2	135.8
Other Taxes	**314.5**	**265.1**	**84.3**
Federal Tax Revenue	**3,418.2**	**3,377.1**	**98.8**
Total Tax Revenue	**3,672.2**	**3,660.4**	**99.7**

Source: Budget & Fiscal Operations 2015-16

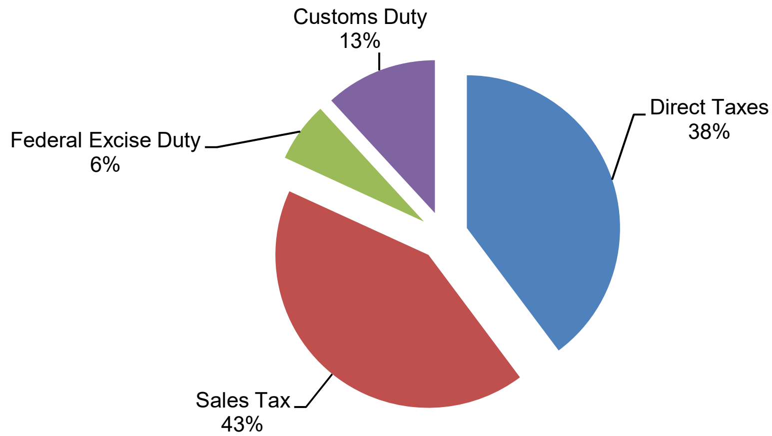
5.6 During 2015-16, FBR was able to surpass the budget target by collecting Rs.3,112 billion against a budget target of Rs.3,104 billion on the back of strong customs duty collections and sales tax collections. This was a remarkable achievement since FBR tax collection grew by over 20 percent during 2015-16 as compared to 14 percent last year. This growth was historic in two ways i) it was a highest ever increase in FBR tax collection of Rs.524 billion in a single year ii) the FBR tax collection crossed Rs 3 trillion mark for the first time. Some targets in direct tax collections and federal excise duties were missed, however, most segments of FBR witnessed significant growth.

5.7 The tax collection target of Rs.3,104 billion set for 2015-16 was a challenging one. However, FBR was equal to the mark to achieve it with customs duty collections (136 percent) and sales tax collections (106 percent). This was contributed by improvement in persistent issues like energy supplies and law and order situation. However, the areas for improvement include direct tax collections, which form over one third of the total FBR collection, and federal excise duty, which were able to achieve 88 percent and 92 percent of their targets, respectively.

5(iii) Tax wise Analysis

5.8 The FBR tax to GDP ratio improved significantly from 9.4 percent in 2014-15 to 10.5 percent in 2015-16, in line with government policy regarding improved tax collection. The proportion of taxes collected by FBR for each segment in 2015-16 witnessed slight changes as compared with 2014-15. The breakup of taxes collected by FBR in 2015-16 is as follows:

Fig-2: Tax Wise Analysis
(Percentage of total FBR tax collection 2015-16)



Head Wise Analysis of Direct Taxes

5.9 Direct taxes is categorized in voluntary payments, collection on demands and withholding taxes (WHT) while the contribution of other taxes in direct taxes is negligible (less than 1 percent).

5.10 Direct taxes contribution was 38 percent in total tax receipts during 2015-16, slightly lower than the last year, to stand at Rs.1,192 billion. However, a significant growth of around 16 percent was witnessed over 2014-15. Direct taxes collection achieved 88 percent of the assigned target, slightly higher than the last years' achieved target of 87 percent. This is an outcome of efforts put in by FBR during 2015-16. The following table shows head wise performance of each component of direct tax:

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

Tax Head	2015-16	2014-15	Growth (%)	% share in 2015-16	% share in 2014-15
Voluntary Payments	340.7	287.6	18.5	26.9	26.0
Collection on Demand	87.9	115.5	(23.9)	6.9	10.4
W.H.T	831.4	691.1	20.3	65.7	62.4
Miscellaneous	5.0	12.6	(60.3)	0.4	1.1
Gross Direct Taxes	**1,265.0**	**1,096.0**	**15.4**	**100.0**	**100.0**
Total Net Direct Taxes	**1,191.6**	**1,029.2**	**15.8**	-	-

Source: FBR & Fiscal operations 2015-16

a - Voluntary payments

5.11 Voluntary payments recorded a significant growth of around 19 percent and stood at Rs.340 billion as compared with Rs.288 billion last year. Main contribution in the voluntary payments came from advance tax, which grew by 12 percent and recorded at Rs.302 billion in 2015-16. Share of voluntary payments represented 27 percent of the total direct tax collection in 2015-16 slightly up from its share of 26 percent in 2014-15. Payment with returns witnessed substantial growth of 115 percent during 2015-16. This also reflects efforts, effective enforcement and skillful persuasion by the field formations making taxpayers to comply with tax laws, file tax returns and pay their due share of tax in the form of advance tax and tax with returns.

b - Collection on Demand

5.12 This segment is very important since it reflects departmental efforts in revenue collection. Unfortunately, the field formations faced issues such as teething problems in IRIS program, jurisdiction issues confronting tax collection officers and litigation issues for field formations in liquidating arrears. This resulted in collection on demand to fall to Rs.88 billion in 2015-16 compared with Rs.116 billion collected last year.

c - Withholding Taxes

5.13 Withholding tax was the main contributor in direct taxes with around 66 percent share in 2015-16. The collection of WHT stood at Rs.831 billion, witnessed a growth of 20 percent from the previous year's collection of Rs.691 billion. The nine major components of withholding taxes contributed around 85 percent of total withholding tax collection. The table below shows the head-wise breakup of the WHT collections during 2015-16:

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

Collection Head	Collection		Growth %	% share 2015-16
	2015-16	2014-15		
Contracts	220.1	176.8	24.5	26.5
Imports	179.7	147.4	21.9	21.6
Salary	92.3	79.5	16.0	11.1
Bank mark-up	48.2	49.8	(3.2)	5.8

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

Collection Head	Collection		Growth %	% share 2015-16
	2015-16	2014-15		
Telephone	47.7	44.7	6.6	5.7
Dividends	42.0	29.4	43.0	5.1
Cash Withdrawal	29.5	23.9	23.4	3.5
Electric Bills	25.5	27.5	(7.2)	3.1
Exports	24.9	26.2	(5.0)	3.0
Sub total	**709.9**	**604.6**	17.3	85.3
Total WHT	831.4	691.1	20.3	100.0
% share In Income tax	65.7	62.5	-	-

Source: FBR

5.14 Noticeable growth in withholding tax collection was witnessed in dividends (43 percent) followed by contracts (25 percent), cash withdrawals (23 percent), imports (22 percent), salary (16 percent) and telephone (7 percent). Overall growth was attributable to effective monitoring of withholding tax by creating special monitoring units and rationalization of tax rates. The major three segments (contracts, imports and salary) contributed around 59 percent in total withholding taxes, showing reliance on few items. Growth from contracts reflected increased pace of public development projects and their onward delegation to private contractors.

Indirect Taxes

5.15 Indirect taxes mainly include sales tax, federal excise duties and custom duties. Indirect tax constituted 62 percent of the total FBR tax collection during 2015-16.

Sales Tax

5.16 Sales tax was the largest contributor constituting 43 percent of total tax revenue and grew by 22 percent during 2015-16. Out of total net sales tax collection, more than half (52 percent) of total sales tax is contributed by the sales tax collected on imports amounting to Rs.684 billion, while rest is collected from sales tax on domestic products.

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

Collection Head	2015-16	2014-15	Net Growth %
	Net Collection	Net Collection	
Sales tax on imports	683.5	553.0	23.6
Sales tax on domestic products	640.2	534.8	19.7
Total	**1,323.7**	**1,087.8**	**21.7**

Source: FBR & Fiscal Operations 2015-16

5.17 This increase in sales tax collection can be traced to a change in petroleum tax structure and higher sale of petroleum products in the country. Other important revenue spinners were steel, machinery & vehicles, where the government benefited from higher imports. Similarly, sales tax collection at domestic stage witnessed a positive growth of 20 percent, led primarily by POL products. Meanwhile, as domestic cement sales firmed up, the government's revenue collection from this source also increased.

a - Sales Tax from Imports

5.18 Sales tax collection from imports grew by 24 percent and contributed 52 percent in total sales tax collection during 2015-16. POL products remained a leading contributor with 32 percent share in total sales tax at import stage. The share of top three categories; POL products, iron & 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 72 percent of the total sales tax collection from imports, depicted in table below:

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

Commodities	Collection			% share 2015-16
	2015-16	2014-15	% growth	
POL Products	219.1	166.0	32.0	32.0
Iron & Steel	54.0	41.9	28.6	7.9
Mechanical Machinery	50.6	38.0	33.1	7.4
Electrical Machinery	42.3	35.4	19.6	6.2
Vehicles	42.2	34.3	23.1	6.2

Plastic Resins	33.5	30.7	8.8	4.9
Organic Chemicals	13.3	13.0	1.9	1.9
Fertilizers	12.8	13.7	(6.3)	1.9
Tea & Coffee	11.4	7.3	56.9	1.7
Oil Seeds	10.9	12.7	(14.0)	1.6
Sub Total	**490.1**	**393.1**	**24.7**	**71.7**
Others	193.5	160.0	20.9	28.3
Gross	**683.6**	**553.1**	**23.6**	**100.0**
Refund/Rebate	**0.1**	**0.1**	**86.0**	**-**
Net	**683.5**	**553.0**	**23.6**	**-**

Source: FBR

5.19 Sales tax collection from POL products increased by 32 percent during 2015-16 despite 28 percent decline in the imports of POL products. This was because customs duty is also a base of sales tax, higher revenue in POL products in customs substantially improved the collection of sales tax on petroleum products. Collection from iron & steel sector remained strong and grew by 29 percent mainly owing to continued activities in the construction sector/infrastructure projects resulting in 13 percent growth in iron & steel imports. Tea & Coffee segment made an entry in the top 10 commodities, replacing edible oil, with a healthy growth of 57 percent over the last year.

5.20 Following the last year trend with continued decrease in sales tax collection on edible oil, the segment could not make up to top 10 commodities this year. Following similar lines, collection from oil seeds witnessed a 14 percent decline. Collection on fertilizers witnessed a decline of 6 percent on back of similiar percentage decline on value of imports.

b - Sales Tax from Domestic Market

5.21 Net sales tax collection from domestic market contributed around 48 percent of the total net sales tax collection with an increase of around 20 percent over the last year. The major 10 commodities contributed over 70 percent in total net sales tax collection in the domestic market as depicted in table below:

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

Commodities	Collection			% share 2015-16
	2015-16	2014-15	% growth	
POL Products	269.8	242.2	11.4	42.1
Electrical Energy	37.5	24.4	52.9	5.8
Cement	28.3	23.3	21.6	4.4
Cigarettes	23.8	21.0	13.3	3.7
Natural Gas	18.2	14.4	26.4	2.8
Services	15.7	8.0	95.6	2.5
Sugar	15.5	10.9	42.4	2.4
Food Products	15.1	12.3	22.6	2.4
Aerated Water	13.2	8.8	48.9	2.1
Fertilizers	11.5	22.5	(49.0)	1.8
Sub Total	**448.6**	**387.9**	**15.6**	**70.1**
Other Sectors	191.7	146.9	30.6	29.9
Sales Tax (Domestic) Net	**640.2**	**534.8**	**19.7**	**100.0**

Source: FBR

5.22 The collection of sales tax in domestic market has been highly concentrated in few commodities. Although the proportion of contribution from POL products has been declining in past 2 years, it still remained the top revenue generator in domestic sales tax collection and stood at Rs.270 billion in 2015-16. Collections from all top 10 commodities registered a positive double digit growth with an exception of fertilizers.

5.23 The largest growth of 96 percent was witnessed in the collections from services sector which made its inclusion in the top 10 contributing commodities for the year 2015-16. This was followed by electrical energy (53 percent), aerated water (49 percent), sugar (42 percent) and natural gas (26 percent). The collections from other items such as food products, cement, and cigarettes grew by 23 percent, 22 percent and 13 percent, respectively.

Customs Duty

5.24 Customs duty constituted around 21 percent and 13 percent of the indirect taxes and FBR taxes, respectively. The gross and net collection from customs duty during 2015-16 were recorded at Rs.418 billion and Rs.406 billion, respectively, entailing growth of 33 percent each. This significant growth has cast healthy influence on the overall growth of the FBR taxes and contributed in historic achievement of country's target for 2015-16. The major reasons of this robust growth were 28 percent rise in dutiable imports mainly due to measures like withdrawal of SROs and upward revision of tariff slab from 1 percent to 2 percent on certain goods during budget 2015-16. Likewise, effective rate of duty has also increased from 11.7 percent to 12.1 percent during 2015-16. Commodity wise collection of the customs duty is given below:

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

Commodities	Budget 2015-16	Collection			% share 2015-16	Target Achieved (%)
		2015-16	2014-15	% growth		
Vehicles	49.7	61.9	49.4	25.4	14.8	124.6
POL Products	18.3	38.0	24.4	55.6	9.1	207.2
Iron & steel	10.0	30.2	10.7	182.2	7.2	302.4
Mechanical Machinery	21.0	26.2	20.3	29.1	6.3	124.8
Edible Oil	21.4	25.9	21.2	22.3	6.2	121.0
Electrical Machinery	24.1	21.4	22.6	(5.3)	5.1	88.7
Plastic	13.6	15.8	13.2	19.8	3.8	116.5
Articles of Iron & Steel	6.3	9.9	6.4	53.9	2.4	157.0
Paper and Paper Board	8.5	8.9	8.2	8.9	2.1	105.1
Sub Total	**172.9**	**238.3**	**176.4**	**35.1**	**57.0**	**137.8**
Other Sectors	135.1	179.9	138.9	29.5	43.0	133.1
Gross	**308.0**	**418.1**	**315.3**	**32.6**	**100.0**	**135.8**
Refund/Rebate	12.4	12.0	9.1	31.9	-	
Net	**295.6**	**406.1**	**306.2**	**32.6**	-	**137.4**

Source: FBR & Budget 2015-16

5.25 The top nine commodities have contributed around 57 percent in the custom duty collection, exhibiting positive growth in all commodities except for electrical machinery. Similar to last year, although a slight decline in share from 16 percent, major tax collection came from vehicles contributing 15 percent in customs duty collection mainly due to significant growth in dutiable imports of vehicles by 25 percent. This was followed by POL products contributing around 9 percent in custom duty collection with a notable growth of around 56 percent.

This growth was mainly driven by around 172 percent growth in the dutiable imports and including items like motor spirit and crude oil from 0 percent to 2 percent, and furnace oil to 5 percent during 2015-16.

5.26 A significant growth of 182 percent was witnessed in iron & steel to place it at third largest contributor in the customs collections with a share of 7 percent. Dutiable imports increased by 12 percent while duty free imports also witnessed an increase of 16 percent. This implies that tariff rationalization of iron & steel has played pivotal role in the increased collection of customs duties. Similarly, the collection from articles of iron & steel also increased by 54 percent mainly due to 17 percent rise in the dutiable imports.

5.27 Similarly, collection of customs duty from mechanical machinery grew by 29 percent during 2015-16. Collection of customs duty from edible oil witnessed a growth of 22 percent while electrical machinery recorded decline of 5 percent despite dutiable imports growth of 7 percent during the same period.

5.28 Ceramic products, classified in others since it was not specifically budgeted, also witnessed a significant growth of 61 percent. This contributed in other commodities to grow by around 30 percent. Overall, custom collections on all top nine commodities surpassed their budget targets except for electrical machinery.

Federal Excise Duty

5.29 Federal Excise Duty (FED) is imposed at import and domestic stages. FED achieved 91 percent of its target, with the highest contribution from cigarettes and tobacco of 48 percent. FED contributed around 6 percent in total FBR tax collection during 2015-16. The base of FED is quite narrow and top 5 commodities contributed around 94 percent of the total FED collection. The FED tax collection increased by 16 percent and recorded at Rs.188 billion compared with Rs.162 billion last year.

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

Commodities	Budget 2015-16	Collection			% share 2015-16	Target achieved %
		2015-16	2014-15	% growth		
Cigarettes & Tobacco	97.1	90.9	82.5	10.3	48.3	93.6
Services	36.4	40.8	28.1	45.2	21.7	112.2
Beverages & Concentrate	16.1	18.0	13.3	35.0	9.6	111.7
Cement	16.3	14.5	12.1	20.2	7.7	89.1
Natural Gas	15.8	11.9	11.6	2.3	6.3	75.1
Sub Total	**181.8**	**176.2**	**147.6**	**19.3**	**93.7**	**96.9**
All Other	24.7	12.3	14.6	(15.8)	6.6	50.0
Gross Total	**206.4**	**188.5**	**162.3**	**16.2**	100.2	**91.3**
Refund/Rebate	-	0.4	0.02	-	-	-
Net Total	**206.4**	**188.1**	**162.2**	**15.9**	-	-

Source: FBR & Budget 2015-16

5.30 Cigarettes and tobacco remained the top contributor in FED constituting around 48 percent of the total FED collections. Second largest source of contribution was from services segment which constituted around 22 percent and surpassed its budget target to achieve 112 percent with a growth of 45 percent. Beverage and concentrate segment also achieved 112 percent of its budget target and grew by 10 percent. While, natural gas despite registering an increase of 2 percent, missed its budgetary target to stand at Rs.11.9 billion.

Other Taxes

5.31 Government also relied on other sources of indirect taxes which include petroleum levy, gas infrastructure development cess, natural gas development surcharge, airport tax and other taxes. Other taxes grew by 19 percent during 2015-16, but achieved 84 percent of their budgetary target. Collection from petroleum levy stood at Rs.149 billion against the target of Rs.135 billion (achievement of 111 percent), while posting a growth of 14 percent. This is depicted in the table below:

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

Tax Head	Budget 2015-16	2015-16	2014-15	Growth (%)	% share in 2015-16	Target achieved %
Petroleum Levy	135.0	149.3	131.4	13.7	56.3	110.6
Gas Infrastructure Development Cess	145.0	79.8	57.0	39.9	30.1	55.0
Natural Gas Development Surcharge	30.0	32.7	25.9	26.2	12.3	108.8
Other Taxes (ICT)	4.4	3.4	9.3	(64.0)	1.3	76.9
Airport Tax	0.2	0.0	0.0	(15.6)	0.0	18.0
Total Other Taxes	**314.5**	**265.1**	**223.6**	**18.6**	**100.0**	84.3

Source: Budget & Fiscal Operations 2015-16

5.32 Although largest growth of 40 percent was witnessed in gas infrastructure development but it could only achieve 55 percent of budgetary target. Other taxes (ICT) witnessed a decrease of 64 percent but owing to a lower base, it did not have large impact on the total collections. Likewise, airport taxes also witnessed a decrease of 16 percent.

5(iv) Non-Tax Revenue

5.33 Non-tax revenue witnessed a decrease and stood at Rs.703 billion in 2015-16 mainly on back of missing foreign grants, lesser than budgeted SBP profits and lesser receipts from the sale of 3G/4G licenses. However, SBP profits and defense receipts remained the largest contributors with combined share of around 48 percent. Receipts in the PTA collections segment revived with auction of 3G/4G licenses, but fell short of its budgetary target. Mark up from PSEs increased to Rs.58 billion from Rs.14 billion last year, surpassing its budgetary target along with dividends segment.

5.34 International oil prices remained low and led to 5 percent lesser revenue collected under discount retained on crude price to record at Rs.9 billion during 2015-16 as compared to its target of Rs.21 billion.

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

Sources of Taxation	Budgeted 2015-16	2015-16	2014-15	% growth	% share	Target Achieved %
SBP profits	280.0	227.9	399.0	(42.9)	32.4	81.4
Defense	154.0	107.0	157.1	(31.9)	15.2	69.5
Dividends	88.1	88.5	74.1	19.5	12.6	100.5

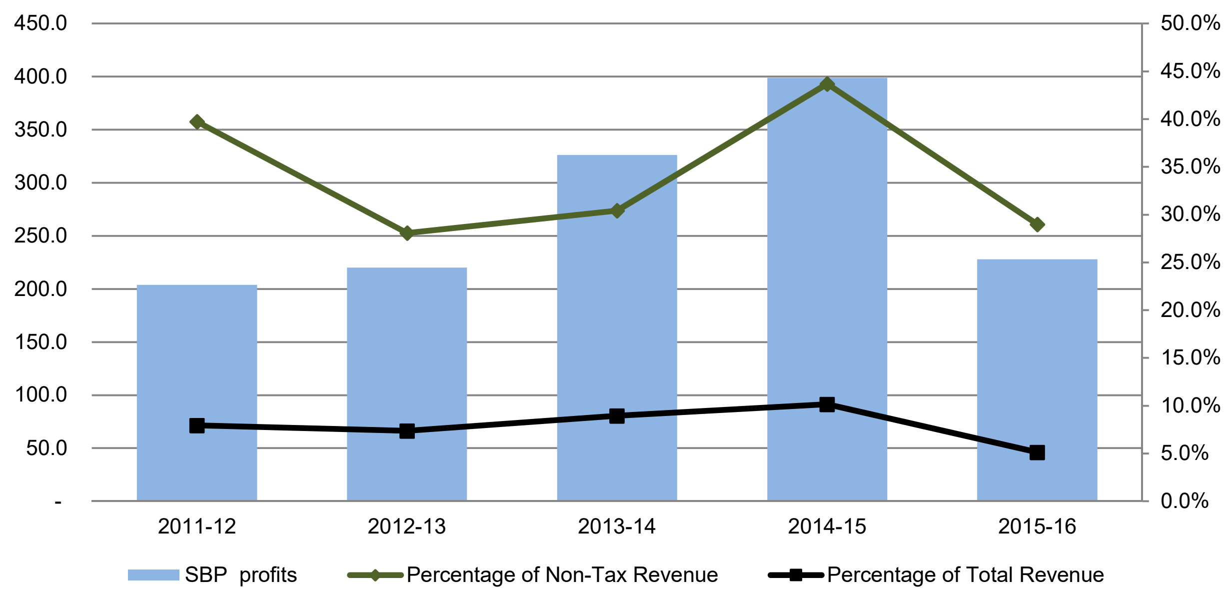
Table-11: Sources of Non-Tax Revenue (Rs. in billion)

Sources of Taxation	Budgeted 2015-16	2015-16	2014-15	% growth	% share	Target Achieved %
Others	82.6	66.8	53.2	25.6	9.5	80.9
Royalty on Oil and Gas	58.6	57.7	74.1	(22.1)	8.2	98.5
Mark-up (PSE's)	57.2	57.7	14.1	309.5	8.2	101.0
Profits: Post Office / PTA	70.0	34.3	3.6	853.9	4.9	49.1
Citizenship & Naturalization, Passport fee	25.0	20.8	18.7	11.4	3.0	83.3
Mark-up (Provinces)	12.0	9.8	12.9	(24.4)	1.4	81.2
Discount Retained on Crude Price	21.0	9.1	9.6	(5.1)	1.3	43.4
Windfall Levy	18.0	1.6	12.1	(86.5)	0.2	9.1
Receipt from UN mission	27.6	21.6	21.8	(0.9)	3.1	78.3
Gross Receipts	**894.5**	**703.0**	**850.3**	**(17.3)**	**100.0**	**78.6**

Source: Budget & Fiscal Operations 2015-16

5.35 SBP profits declined by 43 percent during 2015-16 compared with last year and stood at Rs.228 billion achieving 81 percent of its budget target of Rs.280 billion. The historical trend of SBP profits is highlighted by the graph below:

Fig-3: Profit Receipts from SBP (Rs. in billion & percentage of Non-Tax Revenue and Total Revenue)



5.36 As a proportion of non-tax revenue, SBP profits (32 percent) and defense (15 percent) are followed by dividends (13 percent) and royalty on oil and gas (8 percent). Likewise, the share of SBP profits also declined in terms of non-tax revenue vis a vis total revenue.

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 81 percent of the total expenditure with 6 percent growth during 2015-16 against 11 percent in 2014-15. Development expenditure and net lending witnessed a growth of 15 percent during 2015-16 as compared to last year on the back of significant growth of 20 percent witnessed in Public Sector Development Program (PSDP). Mark up payments registered a decline of 3 percent mainly owing to 5 percent decrease in mark up payments on domestic debt, while mark up payments on foreign debt registered an increase of 18 percent. Defense expenditure grew by 9 percent on account of ongoing security spending needs. Total expenditure was recorded at Rs.5,796 billion in 2015-16 as compared to Rs.5,388 billion last year with 7.6 percent growth and achieved 97 percent of its budget target, which supports the austerity vision of the government. This resulted in overall fiscal deficit to stand at 4.6 percent of GDP against 5.3 percent witnessed last year.

Table-12: Consolidated fiscal position of the government in the fiscal year 2015-16

	Budgeted 2015-16	Provisional		% growth	% of GDP	% of Budget 2015-16
		2015-16	2014-15			
Total Revenue	**4,634.7**	**4,447.0**	**3,931.0**	**13.1**	**15.0**	**95.9**
Tax Revenue	3,672.2	3,660.4	3,017.6	21.3	**12.4**	99.7
Non Tax Revenue	962.5	786.6	913.4	(13.9)	**2.7**	81.7
Total expenditure	**5,962.9**	**5,796.3**	**5,387.8**	**7.6**	**19.6**	**97.2**
a) Current expenditure	**4,592.6**	**4,694.3**	**4,424.7**	**6.1**	**15.9**	**102.2**
of which mark up payments	1,279.9	1,263.4	1,303.8	(3.1)	**4.3**	98.7
Domestic	1,168.7	1,150.8	1,208.1	(4.7)	**3.9**	98.5

Foreign	111.2	112.6	95.7	17.7	**0.4**	101.2
Provincial current expenditure	1,465.0	1,550.0	1,387.1	11.7	**5.2**	105.8
Defense expenditure	781.2	757.7	697.8	8.6	**2.6**	97.0
b) Development expenditure and net lending	**1,370.3**	**1,314.1**	**1,140.6**	**15.2**	**4.4**	**95.9**
Development expenditure	1,374.4	1,301.5	1,113.2	16.9	4.4	94.7
PSDP	1,210.0	1,185.8	987.7	20.1	4.0	98.0
Other Development expenditure	164.4	115.7	125.5	(7.8)	0.4	70.4
Net lending	(4.1)	12.6	27.4	(53.9)	0.0	(311.4)
c) Unidentified expenditure	**0.0**	**(212.1)**	**(177.6)**	**19.4**	**(0.7)**	**-**
Overall fiscal balance	(1,328.2)	(1,349.3)	(1,456.7)	(7.4)	(4.6)	101.6
% of GDP	**4.3%**	**4.6%**	**5.3%**	(14.0)	**0.0**	105.3
Financing of fiscal balance	1328.2	1349.3	1,456.7	(7.4)	4.6	101.6
a) External sources	345.8	370.5	181.0	104.7	1.3	107.1
b) Domestic sources	982.4	978.9	1,275.6	(23.3)	3.3	99.6
Non-Bank	649.5	191.8	366.1	(47.6)	0.6	29.5
Bank	282.9	787.0	892.0	(11.8)	2.7	278.2
Privatization Proceeds	50	0	17.4	(100.0)	-	-
GDP at market prices	**30,672**	**29,598**	**27,493**	**7.7**	**100.0**	**96.5**

Source: Budget & Fiscal Operations 2015-16 & 2014-15

6(i) Current Expenditure

6.2 Current expenditure mainly constitutes general public services and defense expenditure. Current expenditure was recorded at Rs.4,694 billion in 2015-16 as compared to Rs.4,425 billion in 2014-15, registering a growth of 6 percent against 11 percent last year. However, this surpassed its budget target by mere 2 percent.

General Public Services

6.3 Around 45 percent of the current expenditure were allocated towards expenditure on general public services down from around 50 percent last year to stand at Rs.2,103 billion in 2015-16. The general public services mainly included the mark-up payments on foreign/domestic debt, pensions & annuities and grants. Mark-up payments on domestic debt constituted over 50 percent of general public services expenditure and 20 percent of the total expenditure, while mark-up payments on foreign debt constituted around 5 percent of these expenditure and less than 2 percent of the total expenditure. Mark-up payments on domestic debt declined by 5 percent compared with last year owing to low interest rate environment. The total mark up payments (domestic & foreign debt) stood at 28 percent of total revenue down from 33 percent last year and constituted 4.3 percent of GDP compared with 4.8 percent last year. This supplemented the efforts by the government to rationalize expenditures.

6.4 Superannuation and pension costs are another main component of the general public services. The segment witnessed 20 percent growth to stand at Rs.223 billion compared with Rs.185 billion.

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

Expenditure	2015-16	2014-15	% growth	% share 2015-16
Mark-up on domestic debt	1,150.8	1,208.1	(4.7)	54.7
Mark-up on foreign debt	112.6	95.7	17.7	5.4
Superannuation allowances & pension	222.5	185.2	20.2	10.6
Grants (other than provinces)	361.9	288.1	25.6	17.2
Other general public service	255.2	328.2	(22.2)	12.1
Total	**2,103.1**	**2,105.3**	(0.1)	**100.0**

Source: Fiscal Operations 2015-16

Subsidies

6.5 Total subsidies were reduced to Rs.207 billion as compared to Rs.242 billion last year. Although a decline of around 15 percent in 2015-16 was witnessed compared with previous year, subsidies exceeded its budget target by almost 50 percent mainly on account of power and agriculture sector. Government planned to reduce subsidies on some segments including power sector in-line with tariff rationalization. However, subsidies to power sector missed its budget target by 45 percent and constituted for 83 percent of the total subsidies in 2015-16. 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.34 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 (2012-2016) - (Rs. in billion)

Subsidies	Power sector	Food and Agriculture	Oil Refineries	Others	Total
2015-16					
Budget estimate	118.0	18.6	1.0	0.0	137.6
Actual subsidies	171.2	34.1	-	1.9	207.2
% share	82.6	16.5	-	0.9	100.0
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

* Includes one off payments of Rs.312.8 billion and Rs.78.2 billion to the power sector and commodity operations respectively.

Source: Budget Wing, Finance Division

6(ii) Development Expenditure

6.6 Development expenditure and net lending comprised 4.4 percent of total GDP compared with 4.2 percent last year. Development expenditure and net lending increased to Rs.1,314 billion in 2015-16 from Rs.1,141 billion last year posting a growth of 15 percent. This growth was mainly led by 20 percent growth in PSDP. Development expenditure and net lending constituted around 23 percent of the total expenditure during 2015-16 and constituted around 96 percent against the budget target of Rs.1,370 billion. This reflects an effective strategy to forecast the expenditures and achieve budget targets. 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 showed a better fiscal performance during 2015-16 to post healthy surplus of Rs.207 billion compared with Rs.87 billion last year, by keeping expenditure under control. On the revenue side, the tax collections improved significantly, while the dependence on federal resources remained intact.

7.2 Provincial taxes posted a significant growth of 38 percent during 2015-16. Major revenue came from General Sales Tax (GST) collected on services, in which Punjab and Sindh registered notable improvements. Sindh, which had the wider taxable services available like shipping and ports, was able to exceed its annual revenue target. Punjab showed improvement in other collections especially from stamp duties while KPK missed its annual target due to difficult law and order situation in the province, and the continuation of operation Zarb-e-Azb in adjacent parts of the province.

7.3 In broader terms, the sector-wise breakdown of expenditures is similar across provinces, while general public services constitute the bulk of current expenditure. In most provinces, economic affairs segment dominate their development progress. However, some variations also exist within development expenditure, e.g. Punjab's emphasis on economic affairs segment (particularly construction and transport) is quite prominent, whereas KPK's development spending was almost similar in each segment.

7.4 The consolidated provincial expenditure grew by 13.3 percent in 2015-16. This increase, visible both in current as well as development expenditure, was attributed to multiple factors such as:

(i) Punjab's current expenditure which reflects higher storage and interest expenses associated with wheat procurement program of the Punjab Food Department;

(ii) Punjab's development spending for economic affairs segment increased further in 2015-16, which mainly represents initiation of construction and transport projects in the province;

(iii) Local bodies' elections in Sindh during 2015-16 increased its spending on general public services during the year.

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

Fiscal Operations	2015-16	2014-15	% growth
Total revenue*	2,293.9	1,902.4	20.6
a) Tax revenue	283.3	206.0	37.6
b) Non-tax revenue	93.3	75.6	53.0
Total expenditure	2,152.2	1,898.9	13.3
a) Current expenditure**	1,559.8	1,400.1	11.4
b) Development expenditure	592.4	498.8	18.8
c) Statistical discrepancy	65.7	83.8	(21.6)
Fiscal Surplus/ (Deficit)	**207.4**	**87.3**	**-**

* Includes Rs.1,538.7 billion and 1,862.2 billion received from the federal government in 2014-15 and 2015-16 respectively.
**Includes Rs.12.9 billion and Rs.9.8 billion as mark-up paid to federal government in 2014-15 and 2015-16 respectively.

Source: Fiscal Operations 2015-16

7.5 Within each province, the nature and level of tax collection varies, based on its particular environment and kind of business activity. Therefore, the amount of work required to mobilize revenues also differs. However, provinces are at various stages of reforming their tax collection mechanism, with the hope of higher return. Particularly, Punjab, being the largest province, has strengthened its tax policy and administration to increase revenue mobilization as per its potential. Sindh has posted a sharp increase in its collection from sales tax on services with the help of the Sindh Revenue Board, but its collection from other sources remained subdued. Meanwhile, Balochistan and KPK are gradually aligning their tax collection machineries to streamline their revenue collection.

7.6 The contribution of two biggest components of GDP, i.e., services and agriculture in provincial collection remains very low, indicating a sizable room for improvement. However, increase in provincial collection is expected in upcoming years owing to creation of dedicated structures for collection of sales tax on services, revision in property valuation system and computerization of land records. In addition, motor vehicle taxes, stamp duties and provincial welfare taxes have significant unrealized potential to compliment provincial revenue.

8.0 Fiscal, Revenue and Primary Balance

8(i) Fiscal Balance

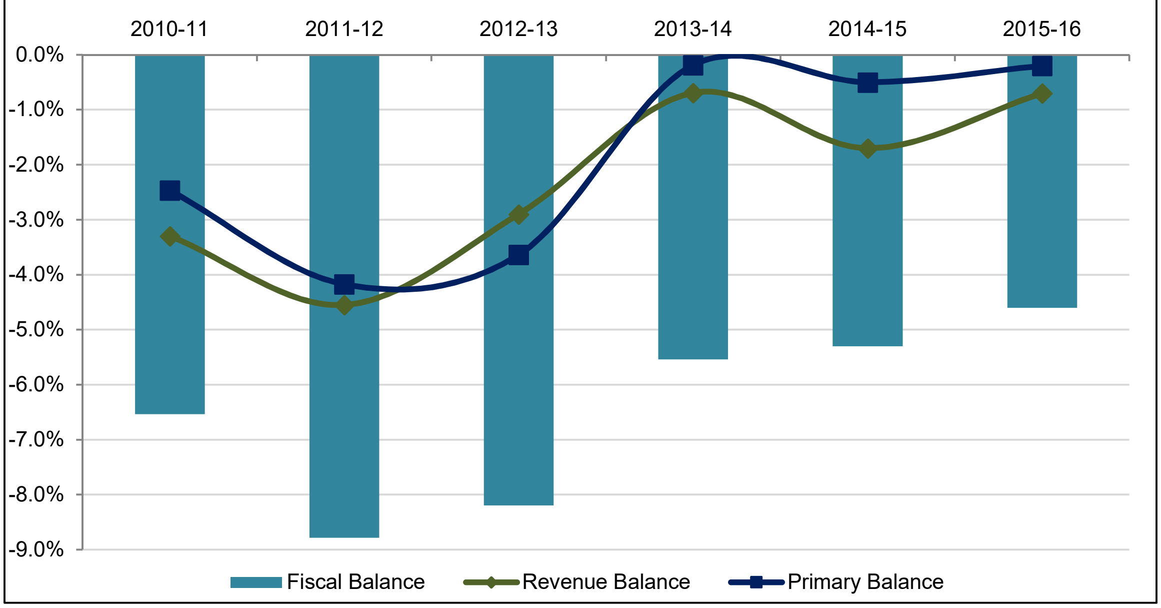
8.1 Fiscal consolidation remained on track as fiscal deficit continued to fall for the fourth year in a row. Fiscal deficit was contained at 8.2 percent in 2012-13 (down from a projected 8.8 percent), due to the concerted efforts by the government soon after assuming the office. Fiscal deficit was reduced significantly in 2013-14 and recorded at 5.5 percent of GDP (lower than its budgeted target of 6.6 percent) and recorded at 5.3 percent of GDP in 2014-15. Fiscal deficit was reduced further at 4.6 percent of GDP during 2015-16 mainly owing to the following:

- FBR tax collections witnessed growth of over 20 percent during 2015-16;
- Interest payments recorded a significant decline and stood at 28 percent of government revenue during 2015-16 as compared with 33 percent in 2014-15 mainly due to low interest rate environment, downward revision of coupon rates of PIBs during last two fiscal year and higher growth in revenue as mentioned above;
- While deficit reduction was already visible at the federal level, surpluses in provincial accounts further consolidated the fiscal position.

8(ii) Primary and Revenue Balance

8.2 Significant reduction was observed in primary and revenue deficits[1] during 2015-16 as the government has adhered strictly to its objective of fiscal consolidation. Revenue deficit was reduced to 0.7 percent of GDP during 2015-16 from 1.7 percent during 2014-15 as the growth in total revenue (13 percent) outpaced the growth in current expenditure (6 percent) during 2015-16. Similarly, primary deficit was reduced to 0.2 percent of GDP during 2015-16 from 0.5 percent during 2014-15 as the growth in total revenue overshadowed the growth in non-interest expenditure during 2015-16.

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



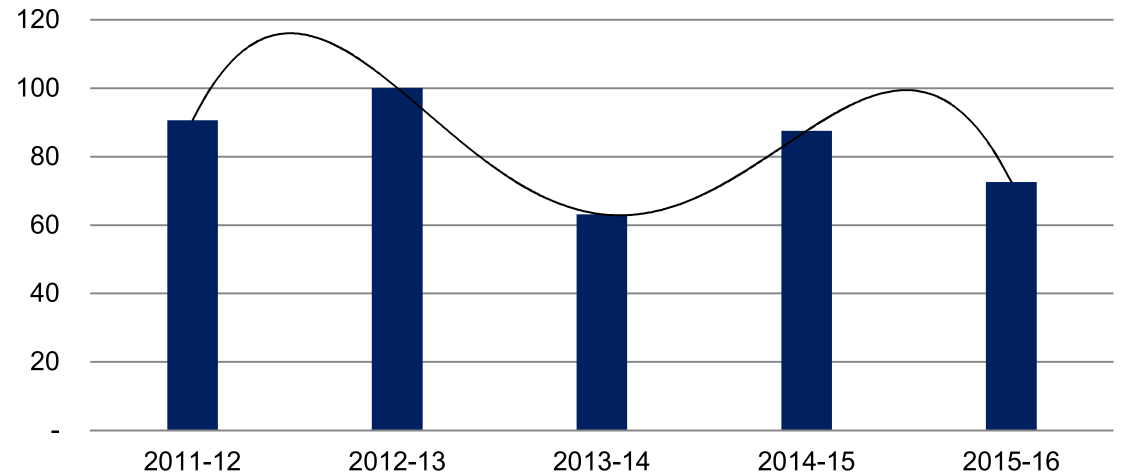
8(iii) Financing of Fiscal Deficit

8.4 Apart from reduction in fiscal deficit, another positive development was shift in financing mix of fiscal deficit i.e. around 27 percent of fiscal deficit was financed from external sources during 2015-16 as compared with only 12 percent during 2014-15, which reduced the pressure on the domestic resources.

[1] Revenue balance is the total revenue 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.
Primary balance is the total revenue 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.

8.5 Within the banking system, the major source of financing remained commercial banks while a portion of borrowing from SBP was retired. Out of total banking system mobilization, most of debt was obtained in the form of PIBs followed by T-bills. The non-bank sources mainly include national savings schemes and private sector investment in government securities.

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



9.0 Fiscal Performance July-September, 2016

9.1 Total expenditure grew by 3 percent during first quarter of 2016-17 as compared with 8 percent last year. However, total revenue witnessed a decline of 8 percent and recorded at Rs.862 billion as compared to Rs.937 billion last year. Total expenditure grew with a slower pace and stood at Rs.1,300 billion, which resulted in a fiscal deficit of 1.3 percent of GDP, slightly up from 1.1 percent in the first quarter last year. While tax collections slowed down, non-tax also witnessed decline. Government initiated reforms on the revenue side which may not be fruitful in the short run, but will bring long term benefits to the overall tax structure, going forward.

Tax Revenue

9.2 Tax revenue grew by 2 percent in the first quarter 2016-17 with the comparable period last year. However, tax revenue as a percentage of GDP stood at 2.2 percent as compared with 2.4 percent in the comparable period last year to stand at Rs.739 billion. FBR collections, which form major tax collection proportion, were low mainly owing to (i) reduced corporate rate by 1 percent; (ii) exemptions in taxes on green field industrial undertakings; (iii) increase in tax credits for employment generation; (iv) government's decision to keep POL prices unchanged; and (v) decline in production of cigarettes following increase in excise duty. These measures may have adverse implications in the short run, they are expected to contributing favorably by stimulating economic growth and increasing the size of the overall tax base going forward.

Non Tax Revenue

9.3 Non-tax revenue fell by 42 percent and stood at Rs.123 billion in the first quarter of 2016-17. This was mainly due to absence of coalition support fund and lower profits received from SBP. Further, dividends from Public Sector Enterprises (PSEs) also declined.

Expenditure

9.4 Total expenditure increased marginally by 3 percent in the first quarter 2016-17 compared with 7 percent growth registered in the comparable period last year. This was mainly owing to decline in current expenditure while growth in development expenditure remained intact. Mark-up payments declined by 0.4 percent during first quarter of 2016-17. Development expenditure was driven by provincial governments which for the first time overtook federal spending. Provincial governments spent 37 percent more during first quarter 2016-17 as compared with last year. Going forward, the government is committed to expand revenues and curtail the current expenditure with effective management of financial resources.

10.0 Economic Reforms

10.1 Implementation of Government's multi-faceted reforms for revival of Public Sector Enterprises (PSEs) is based on a number of pillars, which include divestment through strategic partnership and public offerings, strengthening enforcement of corporate governance rules, implementation of restructuring plans and regulatory reforms. Transactions included the sale of minority shareholding in United Bank Limited, Allied Bank Limited, Habib Bank Limited and Pakistan Petroleum Limited and the strategic sale of National Power

Construction Company. Through these divestments, the Government has raised Rs.173 billion, including over US$ 1.1 billion from foreign investors. Financial Advisors have been hired for structuring public offerings for the Distribution Companies (DISCOs) and Generation Companies (GENCOs). The governance of DISCOs, three GENCOs, and the NTDC has been transferred to new boards of directors and management. Expression of Interest has been invited for acquisition of upto 40.25 percent in the share capital of KAPCO and transaction is expected to be completed during 2016-17. The State Life Insurance Corporation has been given a corporate status and its public offering is in process along with Mari Petroleum Company Limited. Further, the restructuring process of House Building Finance Corporation (HBFC) has been completed and due diligence is being carried out for SME Bank by finalizing its transaction structure for approval. A road map for corporatization of Postal Life Insurance has also been developed for broader institutional and stakeholder approval. 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 A comprehensive restructuring plan has been implemented for Pakistan Steel Mills to prepare for potential strategic private sector participation in the company. Financial advisors were hired in April 2015 and due diligence was completed in August 2015.

10.3 Initially, Government of Sindh showed interest in taking up ownership of PSM. However, in the absence of an agreement with the Government of Sindh, the process to attract strategic private sector participation has been restarted with a view to conclude it by June 2017. Meanwhile, PSM management and the government are working together to ensure that financial losses are contained.

Pakistan Railways (PR)

10.4 Railway Revitalization Strategy is being implemented, which envisages improvements in business processes and the institutional framework, financial stability, and service delivery. As a result, PR has been making progress since 2013-14 as reflected in its operational and financial data for 2013-14, 2014-2015 and 2015-16. Revenues in 2013-14 and 2014-15 have improved by 32 and 45 percent, respectively. This was possible through rationalization of tariffs, expenditure controls, and improved occupancy rates. Revenues further increased by 15 percent for 2015-16 (Rs.36.5 billion from Rs.31.9 billion in 2014-15). During 2015-16, PR added 39 new locomotives for freight service and is in the process of procuring 55 locomotives for coal transportation to Sahiwal and Jamshoro coal power plants.

10.5 Appointment of the Railway Board was completed in February 2015 and company's financial accounting practices are being strengthened, including moving from a cash to accrual basis accounting (IFRS), automation and reconciliation of land assets database, transition from conventional audit procedures to risk based audit methodology, notifying an appropriate public private partnership (PPP) framework and focusing on improving the transparency and efficiency of the procurement process through implementation of Enterprises Resource Planning.

III. Pakistan International Airlines (PIAC)

10.6 The present government has strategized to convert PIAC into a company under Companies Ordinance 1984 in order to improve corporate governance that can help in attracting strategic private sector partnership in the core airline operations, and move PIA under a more efficient and up to date legal framework. A business plan for PIA has been developed, which envisages the introduction of fuel efficient aircrafts, route rationalization, existing product improvements, focus on separation of core and noncore activities, formulation of a comprehensive governance plan and human resource rationalization with the objective of making PIA a sustainable and profitable entity in the long run.

10.7 Cornerstone of the business plan is a shift in strategy from high capacity, low frequency operations to high frequency optimum capacity operations. Execution of business plan will help to improve its revenues and reduce losses. The restructuring plan will be followed by divestment of 26 percent GOP equity stakes to strategic partner with management control. During the first nine months of current calendar year ending September 30, 2016, the seat factor has improved to 73 percent.

11.0 Review of Public Debt

11.1 Public debt is defined as the debt of the government (including Federal Government and Provincial Governments) serviced out of consolidated fund and debt owed to the International Monetary Fund. 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 Gross public debt was Rs.19,678 billion as of end June 2016 while net public debt stood at Rs.17,825 billion. Government has been able to contain the fiscal deficit for the third year in a row, however, increase in public debt was higher than financing of fiscal deficit during 2015-16. Apart from fiscal deficit, increase in the government credit balances with State Bank of Pakistan/commercial banks, debt from the IMF and dual revaluation loss on account of depreciation of US Dollar against other foreign currencies as well as depreciation of the Pak Rupee against the US Dollar contributed to the increase in public debt. External debt in US Dollars increased by 13 percent during 2015-16 due to net external inflows and revaluation loss due to the depreciation of the US Dollar against other foreign currencies. It is worth noting here that cumulative growth in external public debt was around 6.2 percent during last three years (2013/14-2015/16).

11.3 The average cost of gross public debt was reduced by 70 basis points during 2015-16 owing to smooth execution of the MTDS. Interest rates on domestic debt instruments fell quite sharply due to conducive macroeconomic environment and supportive monetary policy which led to a reduction in the average cost of domestic public debt portfolio by 100 basis points during 2015-16. The average cost of the external loans obtained by present government comes to around 3 percent which is significantly lower than the domestic financing cost even after one builds a margin of capital loss due to exchange rate depreciation. In rupees term, external public debt as percentage of GDP declined from 21.4 percent in 2013 to 20.4 percent in 2016. Moreover, overall average cost of public debt fell since external public debt is dominated by concessionary lending from multilateral and bilateral development partners. Public debt per capita stood at Rs.100,707 during 2015-16 while net public debt per capita was Rs.98,356.[2]

11.4 Government was able to mobilize external inflows from multilateral and bilateral development partners and continued its presence in international capital markets through the issuance of Eurobonds in September 2015. The new bond was a substitution of domestic borrowing with lower cost of around 108 basis points compared with the yield of Pakistan Investments Bonds (PIBs) at that time. To the extent of the proceeds from bonds, the government reduced domestic debt by the same amount. Besides, the new issue protected loss of reserves due to payment of bond of similar amount due in March 2016.

Table-16: Public Debt

	2011	2012	2013	2014	2015(P)	2016(P)	2017(P)*
(Rs. in billion)							
Gross Domestic Debt	6,016.7	7,638.1	9,521.9	10,920.0	12,198.9	13,626.9	14,399.0
*Net Domestic Debt	5,173.5	6,831.6	8,686.2	9,551.3	10,804.8	11,773.5	12,138.3
External Debt	4,750.2	5,057.2	4,796.5	5,071.5	5,181.8	6,051.1	6,139.4
Gross Public Debt	10,766.9	12,695.3	14,318.4	15,991.5	17,380.7	19,678.1	20,538.4
***Net Public Debt**	9,923.6	11,888.8	13,482.7	14,622.8	15,986.6	17,824.6	18,277.6
(In percent of GDP)							
Gross Domestic Debt	32.9	38.1	42.5	43.4	44.4	46.0	43.0
*Net Domestic Debt	28.3	34.1	38.8	37.9	39.3	39.8	36.2
External Debt	26.0	25.2	21.4	20.1	18.8	20.4	18.3
Gross Public Debt	58.9	63.3	64.0	63.5	63.2	66.5	61.3
***Net Public Debt**	54.3	59.3	60.2	58.1	58.1	60.2	54.5
Memo:							
Foreign Currency Debt (US$ in billion)	55.3	53.5	48.1	51.3	50.9	57.7	58.7
Exchange Rate (Rs./US$, End of Period)	86.0	94.5	99.7	98.8	101.8	104.8	104.6

[2] Based on estimated total population of 195.4 million as per economic survey 2015-16

	2011	2012	2013	2014	2015(P)	2016(P)	2017(P)*
GDP(b) (Rs. in billion)	18,276	20,046.5	22,385.7	25,168.8	27,493.1	29,597.9	33,509.0
*Net of government deposits with the banking system - Source: IMF Public Sector Debt Statistics Guide for Compilers and Users (2013)							
P:Provisional						*end-September, 2016	

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

11.5 An improvement was observed in most of the public debt risks indicators during last three fiscal years in-line with the objectives set forth in Pakistan's first MTDS (2013). Refinancing risk of the domestic debt portfolio reduced through lengthening of the maturity profile as percentage of domestic debt maturing in one year was reduced to 51.9 percent at the end of June 2016 compared with 64.2 percent at the end of June 2013. Exposure to interest rate risk was also reduced as the percentage of debt re-fixing in one year decreased to 44.4 percent at the end of June 2016 compared to 52.4 percent at the end of June 2013. Similarly, share of external loans maturing within one year was equal to around 31.9 percent of official liquid reserves at the end of June 2016 as compared with around 68.5 percent at the end of June 2013 indicating improvement in foreign exchange stability and repayment capacity.

11.6 Government updated its Medium Term Debt Management Strategy (2015/16 - 2018/19) as the macroeconomic realities have changed since 2012-13. While it incorporates the new economic realities such as new market conditions and the overall economic cycle yet it focuses on the same principles as laid out in the first MTDS (2013) i.e. the guiding principle remains lengthening of the maturity profile of domestic debt and mobilization of sufficient external inflow in the medium term while making appropriate tradeoffs between the cost and risks. Encouragingly, the public debt risk indicators have improved during all four quarters of 2015-16 and are on track to achieve the targets set under the updated MTDS.

11.7 One of the objectives of 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. Government is taking various steps to provide an efficient and liquid secondary debt market to the investors.

11.8 Gross public debt was Rs.20,538 billion as at end September 2016, while net public debt was Rs.18,278 billion. Domestic debt recorded an increase of Rs.772 billion during the first quarter of 2016-17 while government domestic borrowing for financing of fiscal deficit was Rs.369 billion during the said period. This differential is mainly attributed to increase in government credit balance with SBP/commercial banks during the first quarter of 2016-17 which was mostly utilized by the government in October 2016. Hence, the pace of domestic debt increase is expected to be smoothened in second quarter of 2016-17.

11.9 Government was required to meet its PIBs maturity amounting to Rs.1,427 billion during the first quarter of 2016-17. Given the impact of maturing amount on the appetite of domestic debt market, the government planned well in time and started mobilizing more through fresh issuance of PIBs and Government Ijara Sukuk (GIS) to cover up the existing PIBs maturities i.e. the government issued Rs.2,271 billion from January 2015 to September 2016 and that too at lower yield and higher duration. Although the government was able to more or less neutralize the overall impact of PIBs maturity on domestic debt sustainability indicators, however, the entire PIBs amount was challenging to re-finance during the quarter through fresh issuance of PIBs which resulted in positive quarterly borrowing from the SBP. It is worth noting here that net zero quarterly borrowing was tied with the fixation of ways and means limit which is in a process of finalization.

11.10 External public debt increased by around US$ 1 billion during first quarter of 2016-17 and recorded at US$ 58.7 billion. Government mobilized US$ 1.83 billion during first quarter of 2016-17, mainly from commercial banks (US$ 900 million), bilateral sources contributed US$ 423 million (mainly funded by China amounting US$ 405 million and IMF (US$ 102 million) and multilateral development partners (US$ 405 million). Government also repaid US$ 1.08 billion during the first quarter of 2016-17. Rest of the increase in external public debt was contributed by translational losses on account of depreciation of US Dollar against other foreign currencies.

12.0 Servicing of Public Debt

12.1 During 2015-16, public debt servicing was recorded at Rs.1,599 billion against the annual budgeted estimate of Rs.1,686 billion. Public debt servicing consumed nearly 36 percent of total revenues during 2015-16 against 40 percent during last year. This improvement was contributed by low domestic interest rates on account of conducive economic environment and supportive monetary policy. Following factors contributed towards reduction in domestic interest cost:

- Coupon rate on PIBs was revised downwards during last two fiscal years;
- Yields on Treasury Bills (T-Bills) and PIBs also fell sharply due to low interest rate environment and smooth execution of MTDS which also supported extension in maturity profile of domestic bond portfolio. Since interest rates on retail debt instruments are linked with the yields of T-Bills and PIBs, rates on retail debt instruments was also revised downward accordingly;

Table-17: Public Debt Servicing - (2015-16)

	Budgeted	Actual (P)	Percent of Revenue	Percent of Current Expenditure
(Rs. in billion)				
Servicing of External Debt	111.2	112.6	2.5	2.4
Repayment of External Debt	405.8	335.3	7.5	7.1
Servicing of Domestic Debt	1,168.7	1,150.8	25.9	24.5
Servicing of Public Debt	1,685.7	1,598.7	35.9	34.1

P: Provisional

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

12.2 Domestic interest payments constituted around 72 percent of total debt servicing which is due to increasing volume of domestic debt in overall public debt portfolio. Domestic interest payments witnessed decline of 5 percent during 2015-16 as compared with the last fiscal year due to the above mentioned reasons. Further analysis of domestic debt servicing revealed that large portion was paid against PIBs (Rs.483 billion), followed by T-Bills (Rs.175 billion), Market Related Treasury Bills (Rs.163 billion), Bahbood Saving Certificates (Rs.93 billion) and Special Savings Certificates and Accounts (Rs.71 billion).

13.0 Report on Compliance with FRDL Act 2005

13.1 The FRDL Act, 2005 requires that the federal government take measures to reduce total public debt and maintain it within prudent limits thereof. Government made amendments in FRDL Act during 2015-16 to provide better operational guidance for fiscal policy making and safeguard debt sustainability over the medium term by imposing certain limits on the federal government budget deficit and public debt to GDP ratio. With these limits, fiscal policy is expected to anchor at a prudent stance, leading to additional gradual consolidation and strengthening long-term debt sustainability.

The following sections identifies the various limits prescribed by the FRDL Act, and reports on progress thereof.

(1) limiting of Federal fiscal deficit excluding foreign grants to four percent of gross domestic product during the three years, beginning from the financial year 2017-18 and maintaining it at a maximum of three and a half percent of the gross domestic product thereafter;

The above clause related to limiting the federal fiscal deficit (excluding grants) to four percent is effective from 2017/18.

(2) ensuring that within a period of two financial years, beginning from the financial year 2016-17, the total public debt shall be reduced to sixty percent of the estimated gross domestic product;

The above clause related to reducing the total public debt to GDP to 60 percent by 2017-18. Gross public debt was recorded at 66.5 percent of GDP while net public debt stood at 60.2 percent of GDP as at end June, 2016. Public debt to GDP ratio witnessed increase in 2015-16 despite reduction in fiscal deficit which was contributed by other non-deficit factors as per the following details:

- Dual revaluation losses on account of depreciation of US Dollar against other foreign currencies and appreciation of US Dollar against Pak Rupee;

- Inflows from the IMF contributed towards increase in public debt despite not being utilized for fiscal deficit financing;
- Increase in credit balances of the government with SBP/commercial banks.

Government is committed to reduce public debt to GDP ratio to 60 percent by 2017-18 as envisaged through amended FRDL Act.

(3) ensuring that within a period of five financial years, beginning from the financial year 2018-19 total public debt shall be reduced by 0.5 percent every year and from 2023-24 and going upto financial year 2032-33 a reduction of 0.75 percent every year to reduce the total public debt to fifty percent of the estimated gross domestic product and thereafter maintaining it to fifty percent or less of the estimated gross domestic product; and";

The debt reduction path in terms of GDP has been envisaged after 2017-18 to reduce the public debt to GDP ratio to 50 percent by 2032-33 and thereafter maintaining it at or below that level.

(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 2015-16, the government issued new guarantees including rollovers amounted to Rs.191 billion or 0.6 percent of GDP.

14.0 Conclusion

14.1 Most of the macroeconomic indicators witnessed improvement during the past three fiscal years. During 2015-16, GDP witnessed a growth of 4.71 percent which was highest in the last eight years while key macroeconomic indicators such as fiscal balance improved, inflation rate declined and foreign exchange reserves increased. An improvement was observed in most of the public debt risks indicators during last three fiscal years in-line with the objectives set forth in Medium Term Debt Management Strategy. Refinancing risk of the domestic debt portfolio reduced through lengthening of the maturity profile as percentage of domestic debt maturing in one year was reduced to 51.9 percent at the end of June 2016 compared with 64.2 percent at the end of June 2013. Exposure to interest rate risk was also reduced as the percentage of debt re-fixing in one year decreased to 44.4 percent at the end of June 2016 compared to 52.4 percent at the end of June 2013. Similarly, share of external loans maturing within one year was equal to around 31.9 percent of official liquid reserves at the end of June 2016 as compared with around 68.5 percent at the end of June 2013 indicating improvement in foreign exchange stability and repayment capacity.

14.2 The economic outlook for Pakistan is positive supported by international rating agencies and financial institutions. With an improved macroeconomic environment, better energy supplies, and subsiding security concerns, business sentiments are conducive. In addition, smooth progress on CPEC-related projects will ease infrastructure and energy constraints and also create demand for industrial output. Economic activity would also benefit from pro-growth policies alongwith low policy rate which has made funding easier for businesses and consumers. Similarly, growing development spending, despite a planned reduction in fiscal deficit, would continue to support infrastructure-related industries. Therefore, domestic demand is likely to remain strong, as reflected by leading indicators like credit expansion to businesses, consumer financing, and trade. Government envisages a GDP growth of 5.7 percent for 2016-17 with major contributions to this increase are expected to come from a recovery in agriculture sector, followed by robust growth in industrial activities and the services sector. In conjunction, the need for expediting reform process related to energy sector PSEs and other loss-making organizations (like PSM, PIA) can hardly be overemphasized. The country can continue to pace itself towards a high growth trajectory by removing structural bottlenecks.

14.3 To bolster macroeconomic stability, the government has made amendments to the Fiscal Responsibility and Debt Limitation (FRDL) Act by defining the ceiling for the Federal Government budget deficit at 4 percent of GDP (excluding foreign grants) during the period 2017-18 to 2019-20 and 3.5 percent of GDP thereafter. Public debt shall be reduced to 60 percent of estimated GDP until 2017-18, and thereafter a 15-year transition has been set towards a debt-to-GDP ratio of 50 percent. At the same time, revenue mobilization should be given priority alongwith rationalization of current expenditure as envisaged in budget 2016-17. The elements of the vision presented were: a) GDP growth to gradually rise to 7 percent by 2018-19; (b) inflation will be contained to single digit; (c) investment to GDP ratio will rise to 21 percent at the end of medium term; (d) Federal fiscal deficit would be brought down to 3.5 percent of GDP; (e) tax to GDP ratio will be increased to 13.9 percent; and (f) foreign exchange reserves would be maintained at a sustainable level.