Fiscal Policy Statement 2017-18

Debt Policy Coordination Office
Ministry of Finance
Government of Pakistan

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1. Introduction

1.1 Government inherited a fragile economy in 2013 characterized by low investments, high inflation, low GDP growth, high fiscal deficit, low Tax to GDP, low level of foreign exchange reserves and a looming external debt default with rising power sector circular debt and severe energy crisis. Government soon after assuming responsibilities launched a home grown program of economic reforms and over the period of four years achieved remarkable economic turnaround which is recognized by international community as well. GDP growth of 5.3 percent in 2016-17 is the highest in last ten years. Fiscal deficit was reduced from 8.2 percent in 2012-13 to 5.8 percent in 2016-17 while Pakistan's real economic growth continued to accelerate amid supportive domestic and external environment.

1.2 Key drivers of growth included strong consumption, growth in credit to private sector, low interest rate environment, contained inflation, a robust services sector, recovery in agriculture along with stable exchange rate. In addition, foreign direct investment increased by 4.6 percent during 2016-17 as a result of ongoing CPEC projects and other large investments. On the other side, the current account deficit widened due to increase in imports of machinery, industrial raw material and petroleum products. These imports are expected to enhance productive capacity of the economy towards higher output and exports in future. Supported by the factors mentioned above, strong growth and improved prospects are considered as key factors that led international credit rating agencies like Standard's & Poor's, Moody's and Fitch to improve Pakistan's ratings while maintaining country's economic outlook as 'stable'.

1.3 Fiscal deficit was 5.8 percent of GDP in 2016-17 compared with 4.6 percent in 2015-16. The revised fiscal deficit target was set at 4.2 percent of GDP for 2016-17 mainly on back of i) estimated provincial surplus of around Rs.290 billion and ii) Federal Board of Revenue (FBR) achieving its revised target of Rs.3,521 billion. However, provinces posted a deficit of Rs.15.9 billion (missing target by around 1 percent GDP) and FBR revenue collection also fell short of target by around 0.5 percent of GDP.

2. 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. Budget Strategy 2016-17

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

- Containment of fiscal deficit at 3.8 percent of projected GDP in 2016-17;
- Enhancement of consolidated revenue to Rs.4,915 billion;
- Improvement of tax to GDP ratio to 13.9 percent in medium term;
- 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;
- Beginning 2017-18, in three years, the federal deficit would be brought down to 4 percent of GDP and maintaining at 3.5 percent thereafter;
- 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 2016-17 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. Historical Perspective on Fiscal Development

4.1 Pakistan’s economy has experienced multiple trends in fiscal performance over the decades. A comparison is shown in Table-1, which represents the trend of fiscal imbalances over past 25 years.

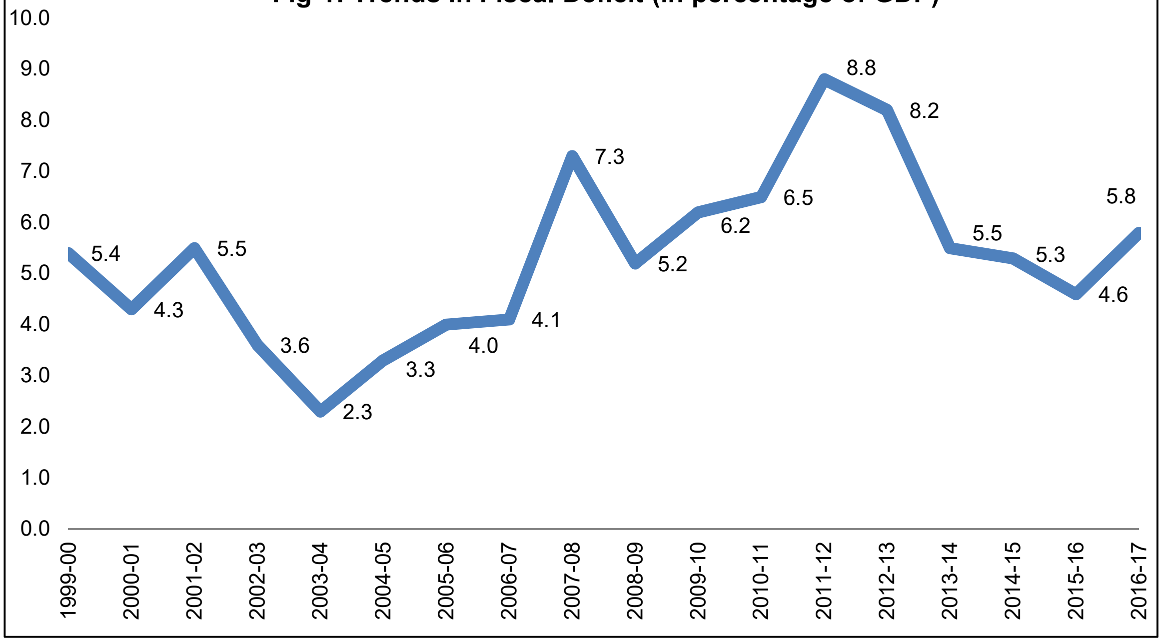
Table-1:Fiscal Indicators (as percentage of GDP)

Years	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	5.8	4.0	17.1	12.6	4.5	13.1	9.8	3.3
2007	5.5	4.1	19.5	14.9	4.6	14.0	9.6	4.4
2008	5.0	7.3	21.4	17.4	4.0	14.1	9.9	4.2
2009	0.4	5.2	19.2	15.5	3.5	14.0	9.1	4.9
2010	2.6	6.2	20.2	16.0	4.4	14.0	9.9	4.1
2011	3.6	6.5	18.9	15.9	2.8	12.3	9.3	3.0
2012	3.8	8.8	21.6	17.3	3.9	12.8	10.2	2.6
2013	3.7	8.2	21.5	16.4	5.1	13.3	9.8	3.5
2014	4.0	5.5	20.0	15.9	4.9	14.5	10.2	4.3
2015	4.1	5.3	19.6	16.1	4.2	14.3	11.0	3.3
2016	4.5	4.6	19.9	16.1	4.5	15.3	12.6	2.7
2017	5.3	5.8	21.3	16.3	5.3	15.5	12.5	3.0

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

4.2 The decade of 1990's experienced high fiscal imbalances. Fiscal performance of the country saw considerable improvements during the period starting from 2002-03 to 2006-07 primarily because of (i) rescheduling of external debt of US$ 12 billion that brought down the debt servicing from 42 percent in 2000-01 to 22 percent of 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 2008-2013. It was mainly due to challenges on domestic 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 2000-2017 is depicted in the following graph:

Fig-1: Trends in Fiscal Deficit (in 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 four years, both in terms of revenue mobilization and expenditure management. During 2016-17, total revenue increased to 15.5 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. Fiscal Performance during 2016-17

5(i) Total Revenue

5.1 Total revenue of the government is bifurcated into 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 of the government stood at Rs.4,937 billion during 2016-17 as compared with Rs.4,447 billion during 2015-16. Net revenue receipts of the federal government, after transfer to provinces, grew by 16 percent and recorded at Rs.2,583 billion.

5.2 Total revenue grew by 11 percent during 2016-17 and unlike last year, improvement was witnessed in both tax and non-tax revenue as macro taxation measures undertaken by the government proved effective in expanding the revenue base. FBR collected Rs.3,361 billion during 2016-17 against Rs.3,112 billion during 2015-16 entailing a growth of 8 percent. Despite this encouraging growth, FBR achieved 93 percent of its target of Rs.3,621 billion (Table-2). Revenue collection crossed Rs.3 trillion mark consecutively for the second year with an additional amount of around Rs.249 billion collected in 2016-17 over the last year. Direct taxes, being the major contributor in the total tax collection were recorded at Rs.1,343 billion. Government continues the approach towards rationalizing taxation policies and tax trajectory into right direction for fair and equitable revenue mobilization.

5.3 While amongst the non-tax revenue, major collections came from SBP profits and mark up from PSEs, which shows the combined share of around 36 percent in total non-tax revenue. In addition, one-off revenue receipts of Rs.100 billion came from disinvestment of government stakes in Pakistan Security Printing Corporation and Rs.64 billion were mobilized from the sale of two LNG power plants under the Pakistan Development Fund which contributed towards the increase recorded in non-tax revenue during 2016-17.

5(ii) FBR Collection

5.4 FBR is responsible for a major portion of tax collections. During 2016-17, FBR took various initiatives to improve service delivery, enhance resource mobilization and improve tax to GDP ratio. These reforms have started providing positive results in shape of improved compliance, higher revenue growth and increased tax to GDP ratio. During the last four fiscal years ending 2017, FBR's revenue collection has shown substantial improvement. The net collection jumped from Rs.1,936 billion in 2012-13 to Rs.3,361 billion in 2016-17, registering around 74 percent growth. Similarly, FBR tax to GDP increased from 8.6 percent in 2012-13 to 10.5 percent in 2016-17. The details of tax collection against targets are depicted in the table below:

Table-2: Comparison of Tax Collection against Targets (2016-17) - (Rs. in billion)

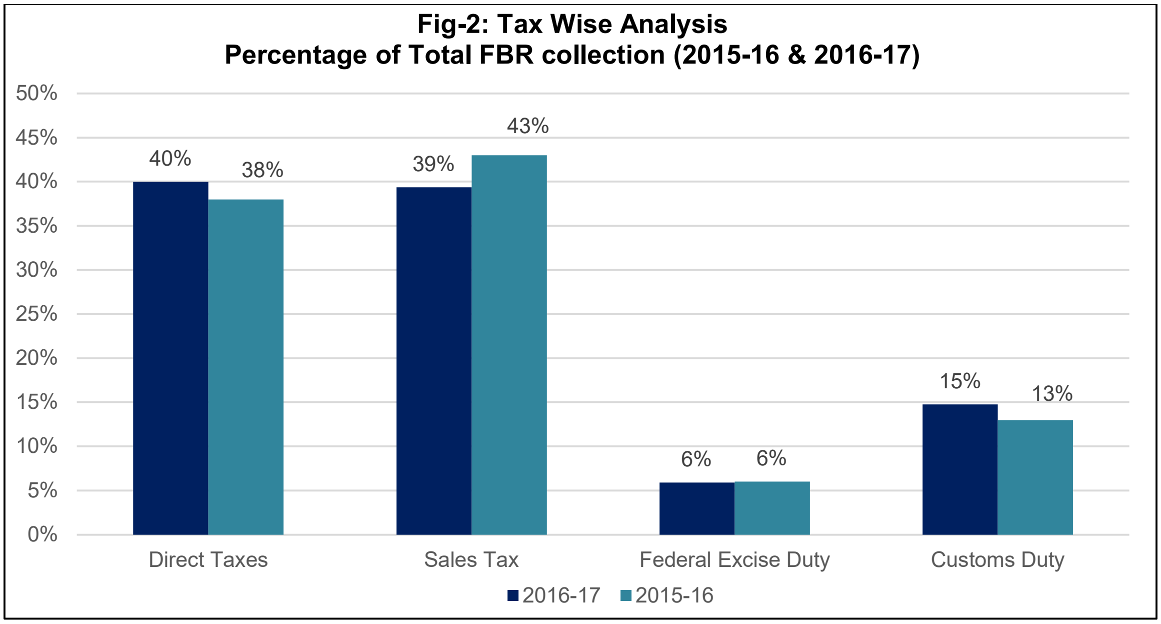
Tax Head	Original Budget	Provisional Collection (2016-17)	Provisional Collection (2015-16)	Achievement of Target (%) (2016-17)
FBR Taxes	**3,621.0**	**3,361.0**	**3112.0**	92.8
Direct Taxes	1,558.0	1,343.2	1,191.6	86.2
Sales Tax	1,437.0	1,323.3	1,323.7	92.1
Federal Excise Duty	213.0	198.6	190.6	93.2
Customs Duty	413.0	496.0	406.2	120.1
Other Taxes	**335.1**	**286.4**	**265.1**	**85.5**
Federal Tax Revenue	**3,956.1**	**3,647.5**	**3,377.1**	**92.2**
Total Tax Revenue	**4,306.0**	**3,969.2**	**3,660.4**	**92.2**

Source: Annual Budget 2016-17 & Fiscal Operations 2016-17

5.5 During 2016-17, the FBR original target of Rs.3,621 billion was revised downward to Rs.3,52 1 billion mainly due to relief measures in sales tax which affected FBR tax revenues. The relief measures were taken on POL products, fertilizers, pesticides and Prime Minister's Textile package aimed at boosting economic activity in the country. These measures were aimed to enhance GDP growth, create jobs which are expected to result in increased revenues in the medium and long term.

5(iii) Tax wise Analysis

5.6 FBR tax to GDP ratio remained at the last year level and recorded at 10.5 percent in 2016-17. The pace of direct tax collection slowed down owing to decline in corporate profitability – especially profitability of the banking sector as well as reductions in tax rates and announcement of tax incentives. In addition, growth in sales tax collection remain subdued due to reduction in sales tax rates on POL products in a bid to protect domestic consumers from rising international oil prices. The proportion of taxes collected by FBR for each segment in 2016-17 witnessed some change compared with 2015-16 as depicted in the graph below:



Head Wise Analysis of Direct Taxes

5.7 Direct taxes are primarily categorized in voluntary payments, collection on demands and withholding taxes (WHT). Direct taxes contribution was 40 percent in total FBR tax receipts during 2016-17, slightly higher than the last year, to stand at Rs.1,343 billion reflecting a growth of 13 percent over the corresponding period last year. Direct taxes collection achieved 86 percent of the original target (Table 2). 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	2016-17	2015-16	Growth (%)	% share in 2016-17	% share in 2015-16
Voluntary Payments	370.5	340.8	8.7	26.3	27.0
Collection on Demand	92.8	87.9	5.6	6.6	7.0
W.H.T	944.1	831.4	13.6	67.1	66.0
Gross Direct Taxes	**1,407.4**	**1,260.1**	**11.7**	**100.0**	**100.0**
Total Net Direct Taxes	**1,343.2**	**1,191.6**	**12.7**	-	**-**

Source: FBR & Fiscal Operations 2016-17

a- Voluntary Payments

5.8 This component includes payments with return and advances. In this head, an amount of Rs.371 billion was generated during 2016-17 as compared to Rs.341 billion collected during last year. Collection from Voluntary Payments recorded a growth of 8.7 percent. Major component of Voluntary Payment is advance tax where a sum of Rs.325 billion was collected against the collection of Rs.302 billion during last year. Collection from advance tax grew by 7.5 percent during 2016-17. The second component of Voluntary Payments is payment with returns, which showed a substantial growth of 18 percent during 2016-17 supported by better efforts, effective enforcement and skillful persuasion by the field formations compelling taxpayers to comply with tax laws, file tax returns and pay due share of tax in the form of advance tax and tax with returns.

b- Collection on Demand

5.9 Collection on demand slightly improved during the year and reached at the level of Rs.93 billion during 2016-17 from Rs.88 billion during 2015-16. It is imperative to mention here that there were certain issues faced by the field formations which affected revenue collection under this head during 2016-17. It includes issue of jurisdiction in newly installed Iris program. These teething problems were resolved with the passage of time. The second issue confronted was related to arrear collection, which was stuck in litigation at various levels.

c- Withholding Taxes

5.10 Withholding tax (WHT) contributed a major chunk of around 67 percent in gross direct tax during 2016-17. The WHT collection during 2016-17 was Rs.944 billion against Rs.831 billion, indicating a growth of around 13.6 percent. The nine major components of withholding taxes contributed around 84 percent of total WHT collection, depicted in the table below:

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

Collection Head	Collection		Growth %	% share 2016-17
	2016-17	2015-16		
Contracts	259.5	220.1	17.9	27.5
Imports	197.0	179.7	9.6	20.9
Salary	111.2	92.3	20.5	11.8

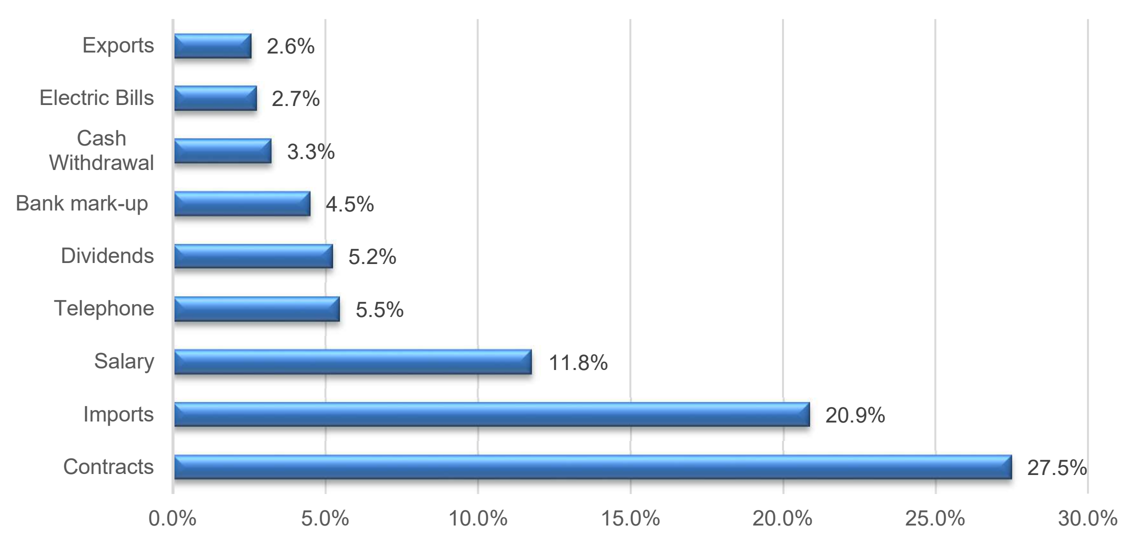
Table-4: Head Wise Collection of WHT (Rs. in billion)

Collection Head	Collection		Growth %	% share 2016-17
	2016-17	2015-16		
Telephone	51.8	47.7	8.6	5.5
Dividends	49.5	42.0	17.7	5.2
Bank mark-up	42.6	48.2	(11.6)	4.5
Cash Withdrawal	30.9	29.5	3.3	3.3
Electric Bills	25.8	25.5	1.2	2.7
Exports	24.3	24.9	(2.6)	2.6
Sub total	**792.6**	**709.9**	11.7	84.0
Total WHT	**944.1**	**831.4**	**13.6**	**100.0**
% share in Gross Direct Tax	67.1	66.0	-	-

Source: FBR & Fiscal Operations (2015-16 & 2016-17)

5.11 Noticeable growth in withholding tax collection was witnessed in salary (21 percent) followed by contracts (18 percent), dividends (18 percent), imports (10 percent) and telephone (9 percent). The highest contributor in withholding taxes was contracts with around 28 percent share, followed by imports (21 percent) and salary (12 percent). These three items contributed around 60 percent in total withholding taxes, showing high reliance on few items. The shares of major items are reflected in graph below:

Fig-3: Percent Share of Major WHT Items in Total WHT (2016-17)



Indirect Taxes

Indirect taxes mainly include sales tax, federal excise duties and custom duties. Indirect tax constituted 60 percent of the total FBR tax collection during 2016-17.

Sales Tax

5.12 Sales tax collections stood second in top revenue generating sources for FBR tax receipts after direct taxes. It constituted around 39 percent of FBR tax collections in 2016-17 with the collection of Rs.1,323 billion against almost the same level of Rs.1,324 billion collected last year (Table-2). This could be explained with the fact that the government absorbed some of the increase in international oil prices by reducing the sales tax on domestic POL prices, which had a direct impact on sales tax collections. These relief measures added to the FBR's challenges in achieving even the revised target of Rs.3,521 billion for 2016-17.

a. Sales Tax from Imports

5.13 Sales tax from imports is a significant component of sales tax receipts as the share of sales tax (imports) in total sales tax net collection was around 52 percent during 2016-17. Apart from imports, customs duties are also a basis for determination of sales tax on imports. Ten commodities contributed a major chunk of around 75 percent in sales tax (imports) collection. The detailed data indicates that 62 percent of sales tax imports was contributed by POL products, iron & steel, vehicles, mechanical and electrical machinery.

Table 5: Commodity Wise Collection of Sales Tax at Import Stage (Rs. in billion)

Commodities	Collection			% share 2016-17
	2016-17	2015-16	% growth	
POL Products	212.0	219.1	(3.3)	30.5
Mechanical Machinery	62.9	50.6	24.2	9.0
Iron & Steel	55.3	54.0	2.5	8.0
Vehicles	53.1	42.2	26.0	7.6
Electrical Machinery	50.0	42.3	18.1	7.2
Plastic Resins	35.6	33.5	6.3	5.1
Organic Chemicals	13.4	13.3	0.7	1.9
Oil Seeds	13.3	10.9	21.2	1.9
Rubber Products	12.1	10.0	20.8	1.7
Tea & Coffee	11.2	11.4	(1.9)	1.6
Sub Total	**518.8**	**487.3**	**6.5**	**74.7**
Others	176.0	196.3	(10.3)	25.3
Sales Tax (Import) Net	**694.7**	**683.5**	**1.6**	**-**

Source: Federal Board of Revenue

5.14 Total collection of sales tax at import stage increased slightly by around 2 percent to stand at Rs.695 billion during 2016-17 against Rs.684 billion in the previous year. POL products were the leading source of sales tax collection at import stage with share of around 31 percent.

5.15 All major commodities exhibited growth in the collection of sales tax driven by their respective value of imports. Although POL products maintained the largest share as mentioned above, the collection from POL products experienced a decline of 3 percent during 2016-17 as compared with last year.

b - Sales Tax from Domestic Market

5.16 Collection of sales tax from domestic market is concentrated in few commodities as evident from the fact that four commodities (POL products, electrical energy, cement and collection from withholding agents) contributed over 50 percent in the sales tax from domestic market during 2016-17. The share of major 10 commodities was 68 percent in sales tax from domestic market as depicted in table below:

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

Commodities	Collection			% share 2016-17
	2016-17	2015-16	% growth	
POL Products	225.8	274.8	(17.8)	35.9
Electrical Energy	45.7	37.5	21.7	7.3
Cement	29.7	28.3	4.9	4.7
Withholding agents	23.6	21.8	8.1	3.7
Sugar	23.4	15.5	51.5	3.7
Aerated Waters/Beverage	18.7	13.2	41.7	3.0
Cigarettes	17.6	23.8	(26.1)	2.8
Food Products	15.6	15.1	3.0	2.5
Motor Cars	13.4	8.9	51.5	2.1
Iron & Steel Products	12.3	10.2	20.8	2.0
Sub Total	**425.9**	**449.2**	**(5.2)**	**67.8**
Other Sectors	202.7	191.0	5.8	32.2
Sales Tax (Domestic) Net	**628.6**	**640.2**	**(1.8)**	**100.0**

Source: Federal Board of Revenue

5.17 Out of ten major items, with an exception of cigarettes and POL products, all items registered a growth during 2016-17. Sugar and motor cars witnessed highest growth of around 52 percent each, followed by aerated water/beverage (42 percent), electrical energy (22 percent), iron & steel products (21 percent) and withholding agents (8 percent).

5.18 Although the share of POL products declined from 43 percent to 36 percent in 2016-17, it still remained the top contributor in sales tax from domestic market followed by electrical energy (7 percent) and cement (5 percent). The decline in collection from POL products can be attributed to the government's decision to reduce sales tax rate to keep domestic POL prices stable.

5.19 Moreover, lower collection in case of fertilizer, which is not part of major commodity-wise collection of sales tax, also declined due to reduction in sales tax rate under the Kissan Package, whereas collection from cigarettes was affected by substantial decline in production and sale of domestically manufactured cigarettes following an increase in FED.

Customs Duty

5.20 Customs duty constitutes around 25 percent and 15 percent of the indirect taxes and FBR taxes, respectively (Table-2). Net collection from customs duty during 2016-17 stood at Rs.496 billion entailing growth of 23 percent. This rise can also be attributed to increase in imports, coupled with upward revision in duty structure. Hence, customs duty surpassed its budgeted target by around 20 percent.

5.21 Around 60 percent of customs duty has emanated from 10 major commodities. It is encouraging that all these major revenue spinners have exhibited growth in the collection except edible oil due to decrease in its rate from 13 percent to 11 percent. Commodity wise collection of the customs duty is given below:

Table-7: Commodity Wise Collection of Customs Duty (Rs. in billion)

Commodities	Collection			% share 2016-17
	2016-17	2015-16	% growth	
Vehicles (Non-Railway)	78.3	61.9	26.4	15.4
POL Products	60.9	38.0	60.4	12.0
Machinery & Mechanical Appliances	35.6	26.2	36.0	7.0
Iron & steel	33.2	30.2	9.9	6.6
Electrical Machinery	26.1	21.4	22.0	5.1
Edible Oil	24.9	25.9	(3.7)	4.9

Table-7: Commodity Wise Collection of Customs Duty (Rs. in billion)

Commodities	Collection			% share 2016-17
	2016-17	2015-16	% growth	
Plastic Resins	17.0	15.8	7.8	3.4
Articles of Iron & Steel	11.6	9.9	17.2	2.3
Paper & Paperboards	9.6	8.9	7.9	1.9
Textile Materials	8.4	7.0	19.1	1.6
Sub Total	**305.7**	**245.3**	**24.6**	**60.3**
Other Sectors	201.4	171.3	17.6	39.7
Gross	**507.1**	**416.6**	**21.7**	**100.0**
Refund/Rebate	11.1	12.0	(7.4)	-
Net	**496.0**	**404.6**	**22.6**	-

Source: Federal Board of Revenue

5.22 Vehicles (Non-Railway) the leading revenue spinner, contributed 15 percent in the customs duty during 2016-17 and recorded a robust growth of 26 percent. The POL products were the second major contributor of customs duty. Collection of customs duty from POL products exhibited growth of 60 percent during 2016-17. Machinery & Mechanical Appliances was the third major revenue source of customs duty during 2016-17 with a growth of 36 percent.

5.23 Collection of customs duty from Electrical Machinery grew by 22 percent, Textile Materials (19 percent), Articles of Iron & Steel (17 percent) while the collection of customs duty from edible declined by 3.7 percent. Edible oil is mainly subjected to specific rate of customs duty.

Federal Excise Duty

5.24 Federal Excise Duty (FED) constituted around 10 percent of indirect taxes and 6 percent of the taxes collected by FBR, respectively (Table 2). The collection from federal excise duty registered a growth of 5.6 percent during 2016-17 as compared with last year. The net revenue stood at Rs.199 billion in 2016-17 against Rs.191 billion recorded during the last year. However, the revenue target of FED was missed by around 7 percent.

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

Commodities	Collection			% share 2016-17
	2016-17	2015-16	% growth	
Cigarettes & Tobacco	66.3	90.9	(27.1)	33.4
Services	47.0	40.8	15.1	23.7
Cement	36.8	14.5	153.4	18.5
Beverages & Concentrate	22.5	18.0	24.6	11.3
Natural Gases	12.8	11.9	7.2	6.4
Edible Oil/RDB Palm Oil	2.6	4.0	(34.5)	1.3
Vehicles Motor (Imp)	2.4	2.0	25.6	1.2
Perfumery & Cosmetics	0.8	0.3	138.2	0.4
Sub-total	**191.2**	**182.4**	**4.8**	**96.3**
Others	7.4	8.5	(13.8)	3.7
Gross	**198.6**	**191.0**	**4.0**	**100.0**
Refund	0.0	0.4	(99.5)	-
Net	**198.6**	**190.6**	**4.2**	**-**

Source: Federal Board of Revenue

5.25 The largest growth came from cement segment (153 percent) followed by Perfumery & Cosmetics (138 percent). Meanwhile, FED collection from beverages registered 25 percent growth in 2016-17. This was an outcome of upward revision in duty structure of aerated water, which increased to 11.5 percent in 2016-17 from 10.5 percent in 2015-16.

5.26 Cigarettes and tobacco remained the top contributor in FED constituting around 33 percent of total FED collections. In fact, following an increase in FED rates, cigarettes production fell significantly as people switched to non-duty paid brands available in the market. In response, FBR set up a task-force to confiscate illicit brands and impose penalty on businesses making illegal sales. This measure brought some recovery in the falling FED revenue from cigarettes. Moreover, a system of online tracking and monitoring of e-stamped cigarettes was introduced to discourage the use of brands against which duty was not paid. However, the decline in FED on cigarettes was more than offset by a significant rise in FED on beverages.

5.27 Meanwhile, the cement sector contributed 19 percent to FED reflecting both higher dispatches (on the back of increased domestic demand, especially from ongoing

CPEC-related infrastructure projects) and an increase in FED rates during 2016-17.

Other Taxes

5.28 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 (ICT). Other taxes grew by 8 percent during 2016-17 and achieved 86 percent of their budgetary target. Collection from petroleum levy stood at Rs.167 billion against the target of Rs.150 billion (achievement of 111 percent), while posting a growth of 12 percent. This is depicted in the table below:

Table-9: Analysis of Other Taxes Collection (Rs. in billion)

Tax Head	Budget 2016-17	2016-17	2015-16	Growth (%)	% share in (2016-17)	Target Achieved (%)
Petroleum Levy	150.0	166.7	149.3	11.7	58.2	111.1
Gas Infrastructure Development Cess	145.0	42.1	79.8	(47.2)	14.7	29.1
Natural Gas Development Surcharge	35.0	73.3	32.7	124.4	25.6	209.3
Other Taxes (ICT)	5.0	4.3	3.4	28.0	1.5	85.8
Airport Tax	0.1	0.0	0.0	7.4	0.0	24.2
Total Other Taxes	**335.1**	**286.4**	**265.1**	**8.0**	**100.0**	85.5

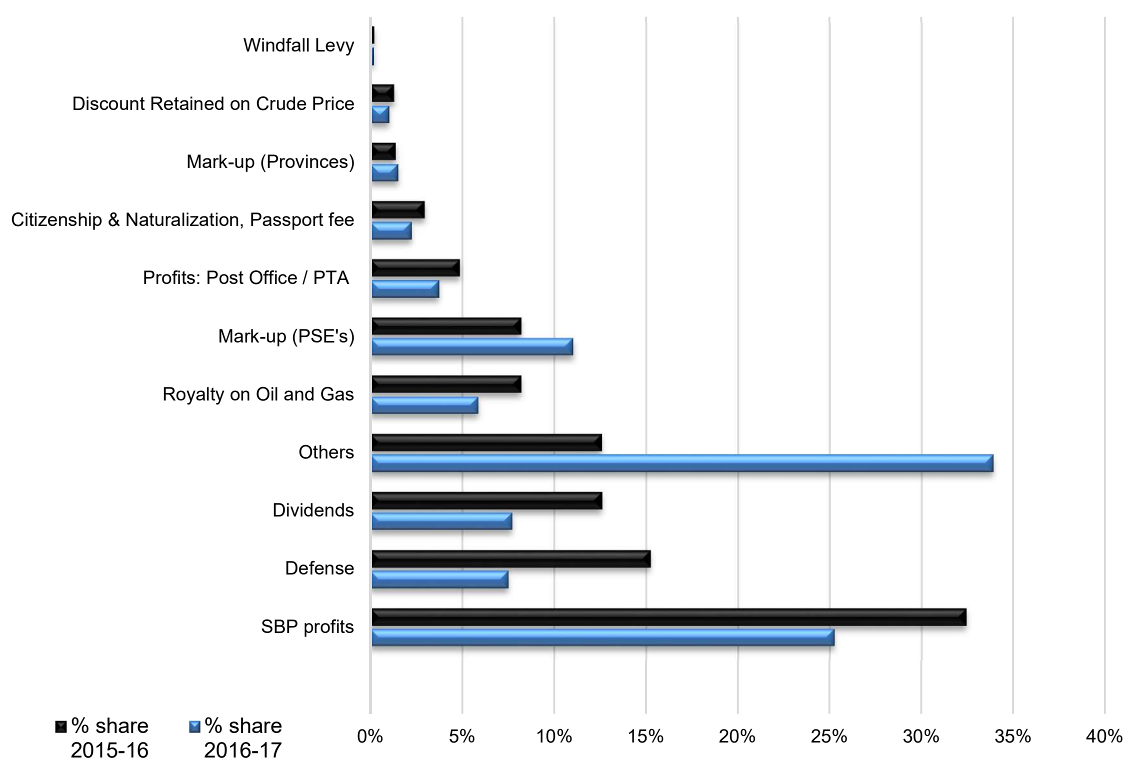
Source: Budget & Fiscal Operations 2016-17

5.29 The largest growth of 124 percent was witnessed in Natural Gas Development Surcharge which achieved more than double its budgetary target on back of increased gas consumption. On the other hand, considerable decrease in growth was witnessed in Gas Infrastructure Development Cess (GIDC). GIDC was passed in the finance bill 2011, however it was challenged in various courts. Therefore, the collection under GIDC head still remains low because of the filed petitions against the ordinance. Meanwhile, other taxes and petroleum levy witnessed growth by 28 percent and 12 percent, respectively.

5(iv) Non-Tax Revenue

5.30 Non-tax revenue recovered strongly in 2016-17 and stood at Rs.902 billion and grew by 28 percent (Table-10) against a decline of 17 percent in 2015-16. SBP profits remained the largest contributor in non-tax revenue collection but unlike previous year, some changes in revenue sources for non-tax collection were observed. The increase in mark up from PSEs and provinces contributed significantly towards the growth of non-tax revenues. In addition, one-off revenue receipts like sale proceeds from Pakistan Security Printing Corporation and LNG Power Plants, which were acquired under Pakistan Development Fund, were the main factors that contributed towards the increase in non-tax revenue collection. The revenue collection from most of the other heads remained below target for the year (Table 10). The changes in revenue sources for non-tax collection are illustrated through the graph below:

Fig-4: Structure of Non Tax Revenue



5.31 Despite increase in non-tax revenue collection by 28 percent, the share of SBP profits and defense have declined by 7.1 percent and 7.7 percent, respectively. Revenues from defense receipts declined by Rs.39 billion while Mark-up from PSEs increased by Rs.42 billion. Head wise comparison of non-tax revenue collection can be seen in the table below:

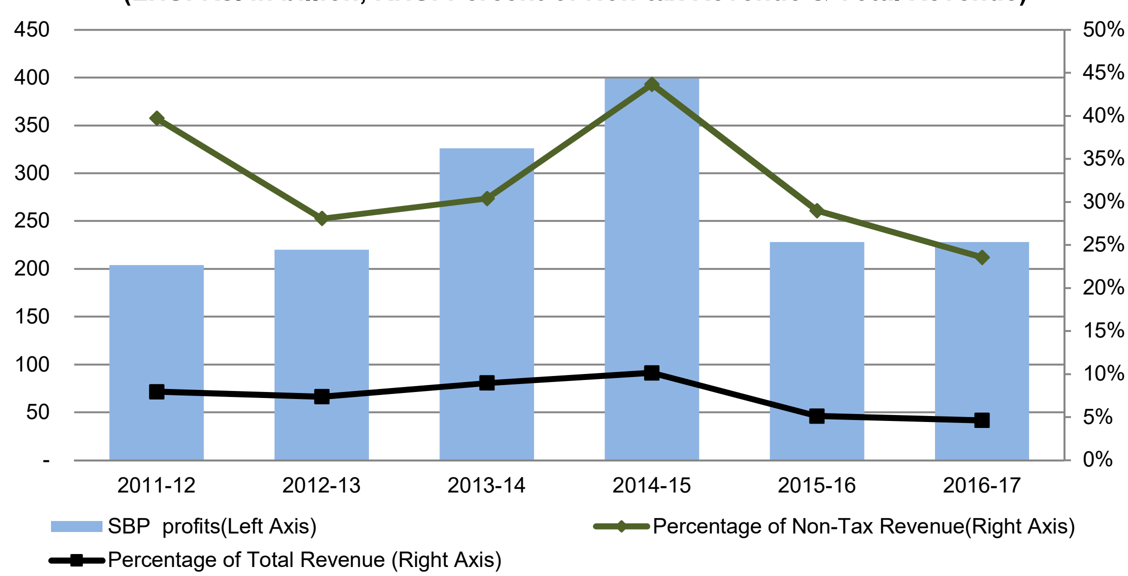
Table-10: Sources of Non-Tax Revenue (Rs. in billion)

Sources of Taxation	Budgeted (2016-17)	2016-17	2015-16	% growth	% share	Target Achieved (%)
SBP profits	280.0	227.8	227.9	-	25.3	81.4
Defense	170.0	67.8	107.0	(36.6)	7.5	39.7
Dividends	85.1	69.7	88.5	(21.2)	7.7	81.9
Others	160.8	305.7	88.6	245.0	33.9	191.7
Royalty on Oil and Gas	43.0	53.0	57.7	(8.1)	5.9	123.3
Mark-up (PSE's)	81.1	99.7	57.7	72.8	11.1	122.9
Profits: Post Office / PTA	81.0	33.6	34.3	(2.0)	3.7	41.2
Citizenship & Naturalization, Passport	25.0	20.1	20.8	(3.4)	2.2	80.4
Mark-up (Provinces)	13.5	13.6	9.8	38.8	1.5	100.7
Discount Retained on Crude Price	10.0	9.1	9.1	-	1.0	91.0
Windfall Levy	10.0	1.6	1.6	-	0.2	16.0
Gross Receipts	**959.5**	**901.7**	**702.8**	**28.3**	**100.0**	**94.0**

Source: Budget & Fiscal Operations 2016-17

5.32 SBP profits remained almost the same during 2016-17 compared with last year and stood at Rs.228 billion, achieving 81 percent of its budget target of Rs.280 billion set for the year. As a proportion of non-tax revenue, SBP profits contributed 25 percent followed by Mark-up on PSEs (11 percent), dividends and defense (8 percent each) and royalty on oil and gas (6 percent). The historical trend of SBP profits is highlighted by the graph below:

Fig-5: Profit Receipts from SBP (LHS: Rs. in billion, RHS: Percent of Non-tax Revenue & Total Revenue)



6. Total Expenditure

6.1 Government's total expenditure is the aggregate of two major components; current expenditure and development expenditure. Total expenditure was recorded at Rs.6,801 billion in 2016-17 as compared to Rs.5,796 billion last year with 17 percent growth and surpassed its budget target by around 3 percent mainly owing to higher development expenditure. Current expenditure constituted around 76 percent of the total expenditure with 11 percent growth during 2016-17. Development expenditure and net lending witnessed a significant growth of 28 percent during 2016-17 as compared with last year on the back of growth of 33 percent witnessed in Public Sector Development Program (PSDP). Mark-up payments registered an increase of 7 percent while defense expenditure grew by 17 percent on account of ongoing security spending needs. This resulted in overall fiscal deficit to stand at 5.8 percent of GDP during 2016-17 against 4.6 percent of GDP during last year.

Table-11: Consolidated fiscal position of the government in the fiscal year 2016-17

	Budgeted 2016-17	Provisional		% growth	% of GDP	% of Budget 2016-17
		2016-17	2015-16			
Total Revenue	**5,347.0**	**4,936.7**	**4,447.0**	**11.0**	**15.5**	**92.3**
Tax Revenue	4,306.0	3,969.2	3,660.4	8.4	12.5	92.2
Non Tax Revenue	1,041.0	967.5	786.6	23.0	3.0	92.9
Total expenditure	**6,623.0**	**6,800.5**	**5,796.3**	**17.3**	**21.3**	**102.7**
a) Current expenditure	**5,041.0**	**5,197.9**	**4,694.3**	**10.7**	**16.3**	**103.1**
of which mark-up payments	1,360.0	1,348.4	1,263.4	6.7	4.2	99.1
Domestic	1,247.0	1,220.3	1,150.8	6.0	3.8	97.9
Foreign	113.0	128.2	112.6	13.9	0.4	113.4
Provincial current expenditure	1,681.0	1,725.7	1,550.0	11.3	5.4	102.7
Defense expenditure	860.0	888.1	757.7	17.2	2.8	103.3
b) Development expenditure and net lending	**1,582.0**	**1,680.7**	**1,314.1**	**27.9**	**5.3**	**106.2**
Development expenditure	1,592.0	1,693.5	1,301.5	30.1	5.3	106.4
PSDP	1,435.0	1,577.7	1,185.8	33.1	5.0	109.9
Other Development expenditure	157.0	115.7	115.7	0.1	0.4	73.7
Net lending	(10.0)	(12.8)	12.6	(201.5)	(0.0)	128.2

c) Unidentified expenditure	**-**	**(78.0)**	**(212.1)**	**(63.2)**	**(0.2)**	**-**
Overall fiscal balance	**(1,276.0)**	**(1,863.8)**	**(1,349.3)**	**38.1**	**(5.8)**	**146.1**
percent of GDP	3.8	5.8	4.6	28.3	-	153.6
Financing of fiscal balance	1276.0	1863.8	1349.3	38.1	5.8	146.1
a) External sources	234.0	541.4	370.5	46.1	1.7	231.4
b) Domestic sources	1042.0	1,322.4	978.9	35.1	4.2	126.9
Non-Bank	539.0	276.6	191.8	44.2	0.9	51.3
Bank	453.0	1,045.8	787.0	32.9	3.3	230.9
Privatization Proceeds	50	-	-	-	-	-
GDP at market prices	**33,509**	**31,862**	**29,598**	**7.6**	**100.0**	**95.1**

Source: Budget & Fiscal Operations 2015-16 & 2016-17

6(i) Current Expenditure

Current expenditure mainly constitutes general public services and defense expenditure. Current expenditure was recorded at Rs.5,198 billion in 2016-17. The component wise analyses of current expenditure are as follows:

General Public Services

6.2 Around 44 percent of the current expenditure were allocated towards expenditure on general public services down from around 45 percent last year to stand at Rs.2,262 billion in 2016-17. 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 18 percent of the total expenditure, while mark-up payments on foreign debt constituted around 6 percent of these expenditure and less than 2 percent of the total expenditure. Mark-up payments on domestic debt increased by 6 percent compared with last year. The total mark-up payments (domestic & foreign debt) stood at 27 percent of total revenue down from 28 percent last year and constituted 4.2 percent of GDP compared with 4.3 percent last year.

6.3 Superannuation and pension costs are another main component of the general public services. The segment witnessed 37 percent growth to stand at Rs.304 billion compared with Rs.223 billion.

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

Expenditure	2016-17	2015-16	% growth	% share 2016-17
Mark-up on domestic debt	1,220.3	1,150.8	6.0	53.9
Mark-up on foreign debt	128.2	112.6	13.9	5.7
Superannuation allowances & pension	303.8	222.5	36.5	13.4
Grants (other than provinces)	352.1	361.9	(2.7)	15.6
Other general public service	257.7	255.2	1.0	11.4
Total	2,262.0	2,103.1	7.6	100.0

Source: Fiscal Operations 2016-17

Subsidies

6.4 Total subsidies declined by 25 percent to Rs.155 billion compared with last year in-line with the government objectives to rationalize subsidies. However, subsidies exceeded its budget target by 10 percent mainly on account of food and agriculture sector. Government planned to reduce subsidies on some segments including power sector in-line with tariff rationalization. Therefore, subsidies to power sector remained up to its budget target while constituting 76 percent of the total subsidies in 2016-17. It is also worth mentioning that no subsides were given 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.37 billion. The amount of subsidies to power sector remain a 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-13: Subsidies (2013-2017) - (Rs. in billion)

Subsidies	Power sector	Food and Agriculture	Oil Refineries	Others	Total
		2016-17			
Budget estimate	118.0	22.3	-	0.3	140.6
Actual subsidies	118.0	36.7	-	0.3	155.0
Percent share	76.1	23.7	-	0.2	100.0

Table-13: Subsidies (2013-2017) - (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	34.8	-	1.2	207.2
Percent share	82.6	16.8	-	0.6	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
Percent 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
Percent 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
Percent share	96.1	3.1	0.2	0.6	100.0

Source: Budget Wing, Finance Division

6(ii) Development Expenditure

6.5 Development expenditure and net lending increased to 5.3 percent of total GDP compared with 4.4 percent last year. Development expenditure and net lending increased to Rs.1,681 billion in 2016-17 from Rs.1,314 billion last year posting a significant growth of 28 percent. This was mainly led by 33 percent growth in PSDP. Development expenditure and net lending constituted around 25 percent of the total expenditure during 2016-17 and surpassed the budgetary target of Rs.1,582 billion by 6 percent. This reflects an effective strategy to increase spending on account of development expenditure to support economic growth. Going forward, the government continues 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. Provincial Fiscal Operations

7.1 The revised total fiscal deficit target was set at 4.2 percent of GDP for 2016-17 wherein one of the main reason was estimated provincial surplus of around Rs.290 billion. However, provinces posted a deficit of Rs.15.9 billion (missing target by around 1 percent GDP). This was against the surplus of Rs.207 billion posted last year. It was largely attributable to a significant increase in provincial development expenditure, while revenue collection grew at a slower pace.

7.2 The weakening in the provincial fiscal position was concentrated in 4th quarter of 2016-17. The fiscal operations up to 3rd quarter indicated that the provinces were well on-course to achieve the annual surplus target. However, in the last quarter, the expenditures increased by Rs.993 billion, largely due to higher development spending. In fact, all the provinces posted deficits in 4th quarter, with the largest contribution coming from Sindh. Similar to the trends in expenditure, against improved revenue position witnessed up to July-March, 2016-17, the growth in provincial revenue mobilization also deteriorated during 4th quarter 2016-17.

7.3 The trends in provincial revenue mirrored those of federal revenue. The growth in provincial revenue fell to 6 percent in 2016-17, after persistently rising for the last two years. This was largely due to declining growth in provincial non-tax revenue, while growth in tax revenue also tapered off. General Sales Tax on Services (GSTS), motor vehicle tax and stamp duties were the major contributors to provincial revenue during 2016-17. Property taxes also posted a growth which is due to the revenue efforts by provinces such as Land Automation Systems and Invoice Monitoring System on various services. However, revenue from excise duties and other sources of provincial tax collection registered a decline as compared to last year.

7.4 The provincial expenditures grew by 20 percent during 2016-17 as compared to 13 percent in 2015-16. The major contribution came from development expenditures which grew by 44 percent while current expenditures almost maintained their last year’s growth. The break-up of development expenditure shows that general public administration and economic affairs accounted for most of the share.

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

Fiscal Operations	2016-17	2015-16	% growth
Total revenue*	**2,428.2**	**2,293.9**	**5.9**
a) Tax revenue	321.8	283.3	13.6
b) Non-tax revenue	79.5	93.3	(14.8)
c) Federal Loans and Grants	61.2	55.1	11.0
Total expenditure	**2,591.5**	**2,152.2**	**20.4**
a) Current expenditure**	1,739.3	1,559.8	11.5
b) Development expenditure	852.2	592.4	43.9
Statistical discrepancy	**147.4**	**65.7**	**124.3**
Fiscal Surplus/ (Deficit)	**(15.9)**	**207.4**	**-**

* Includes Rs.1,862 billion and 1,966 billion received from the federal government in 2015-16 and 2016-17 respectively.
**Includes Rs.9.8 billion and Rs.13.6 billion as mark-up paid to federal government in 2015-16 and 2016-17 respectively.

Source: Fiscal Operations 2016-17

7.5 Under the provincial autonomy and fiscal decentralization with the passage of 18th constitutional Amendment, the provinces were allowed to collect sales tax on services and to tax real estate and agriculture income. As a result, the provinces' own tax revenue started to increase both in terms of GDP and total provincial revenue with the introduction General Sales Tax on Services (GSTS), first by Sindh in 2011 and then by Punjab in 2012. The provincial revenue further received impetus from reforms and tax measures introduced by Punjab and Sindh during the last two years.

7.6 Notwithstanding some improvement in recent years, the progress in provincial own tax collection has been less encouraging when looked in the context of its contribution to overall tax collection. Since 2010-11, the provincial own tax revenue increased by 0.5 percentage points to 1.2 percent of GDP in 2016-17.

8. Total Fiscal Deficit

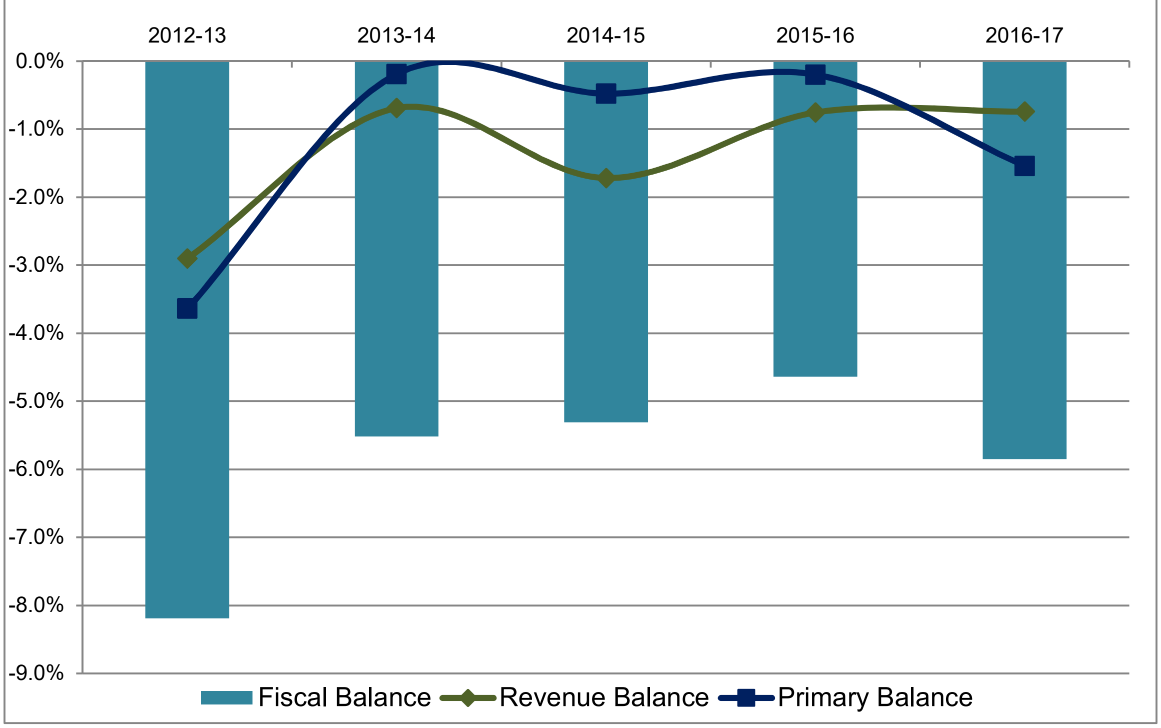
8(i) Fiscal, Primary and Revenue Balance

8.1 The revenue deficit[1], which excludes development expenditure, recorded at 0.7 percent of GDP in 2016-17 compared with 0.8 percent during the preceding fiscal year. This reduction in revenue deficit shows that growth in revenue outpaced the

[1] 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.

growth in current expenditure during 2016-17. Thus, from expenditure side, fiscal deficit was driven largely by an increase in development expenditures and recorded at 5.8 percent during 2016-17 compared with 4.6 percent during the preceding fiscal year. Similarly, the primary deficit[2], which excludes interest payments, increased to 1.5 percent of GDP during 2016-17 from 0.2 percent during 2015-16 owing to the same reason. The consolidated development expenditures maintained the momentum observed during the last few years owing to ongoing number of infrastructure projects. Accordingly, actual PSDP spending at federal level and annual development plan at provincial level cumulatively grew from Rs.695 billion in 2012-13 to Rs.1,577 billion in 2016-17. Furthermore, relatively contained interest payment during the last few years created additional fiscal space for increased development spending. The trends in fiscal, revenue and primary balance are depicted in the graph below:

Fig-6: Trends in Fiscal Revenue & Primary Balance (In percent of GDP)

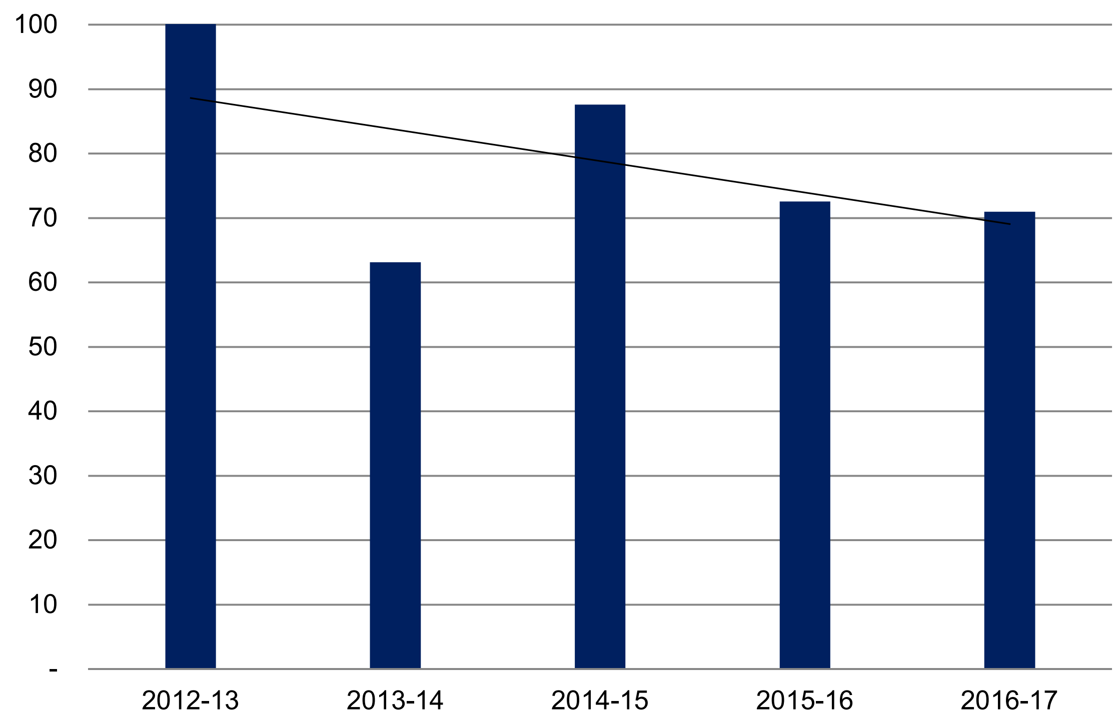


[2] Primary balance is the total revenues minus non-interest expenditure or fiscal deficit before interest payments. Primary balance is an indicator of current fiscal efforts since interest payments are predetermined by the size of previous deficits.

8(ii) Financing of Fiscal Deficit

8.2 Government financed around 71 percent of its budget deficit from domestic sources while the rest was financed from external sources. Within domestic sources, banking sector contributed around 79 percent while the rest was contributed by non-banking sector. Out of total banking system mobilization, most of debt was obtained in the form of short term domestic debt instruments. The non-bank sources mainly include national savings schemes and private sector investment in government securities.

Fig-7: Domestic Financing of Fiscal Deficit (Proportion of Total Fiscal Deficit)



9. Fiscal Performance July-September, 2017

9.1 The growth of 19 percent in total revenue outpaced the growth of 13 percent in total expenditure, resulting in fiscal deficit of 1.2 percent of GDP during first quarter of 2017-18, which was slightly lower from 1.3 percent recorded in first quarter last year. Government initiated reforms on the revenue side which are expected to bring long term benefits to the overall tax structure, going forward.

Tax Revenue

9.2 Tax revenue grew by 21 percent in the first quarter 2017-18 with the comparable period last year. Tax revenue as a percentage of GDP stood at 2.5 percent as compared with 2.2 percent in the comparable period last year to stand at Rs.911 billion. FBR collections, which form major tax collection stood at Rs.765 billion. The revenue collection trend during the first three months of 2017-18 augurs well for the efforts of FBR towards achievement of the assigned annual revenue targets.

6(iii) Non Tax Revenue

9.3 Non-tax revenue increased by 2 percent and stood at Rs.113 billion in the first quarter of 2017-18. The major contributing factor towards the growth of non-tax revenue was on account of profits received from SBP. Further, other non-tax revenue sources such as defense, passport fee, discount retained on crude prices and windfall levy against crude oil also improved.

6(iv) Expenditure

9.4 Total expenditure increased by 13 percent in the first quarter 2017-18 compared with 3 percent registered in the comparable period last year. This was mainly owing to increase in current expenditure while growth in development expenditure declined. Mark-up payments improved by 8 percent during first quarter of 2017-18. Going forward, the government is committed to expand revenues and curtail the current expenditure with effective management of financial resources.

10. Economic Reforms

10.1 Government is in a process of implementing multi-faceted reforms for revival of Public Sector Enterprises (PSEs) to improve their financial and operational performance, to reduce their burden on the national exchequer and to bring their debt at sustainable levels. The PSEs reforms are based on 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.

10.2 In order to institutionalize corporate governance initiatives for PSEs, the Public Sector Companies (Corporate Governance) Rules 2013 have been approved by the government. The Rules help clarify roles of different stakeholders involved in the management of PSEs. A gradual shift towards majority of independent directors in the Board of Directors (the Board) has been stipulated in the rules. Role and functions of the Board have been clarified and offices of Chairman and CEO have been separated. Compliance of PSEs registered under the Companies Ordinance, with the provisions of the Corporate Governance Rules is being monitored on an annual basis.

10.3 The divestment program, which resumed in 2012-13, after a significant gap, has helped raise Rs.173 billion, including over US$1.1 billion from foreign investors. Transactions included the sale of minority stakes in United Bank Limited (UBL), Allied Bank Limited (ABL), Habib Bank Limited (HBL) and Pakistan Petroleum Limited (PPL), and the strategic sale of National Power Construction Co. (NPCC). Government is currently working on three transactions for 2017-18 that include Mari Petroleum Company Limited (MPCL), SME Bank and Pakistan Steel Mills. Privatization Commission is in the process of finalizing the appointment of financial advisors for the divestment of up to 18 percent of shares in MPCL to domestic and international investors through the Pakistan Stock Exchange. Pre-qualification of interested parties for the strategic sale of Government's 94 percent shareholding of SME Bank Ltd is being finalized. The reform strategy being followed in case of the three major PSEs – Pakistan Railways, Pakistan International Airlines and Pakistan Steel Mills is outlined below:

I. Pakistan Steel Mills (PSM)

10.4 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.

10.5 The process to attract strategic private sector participation has been restarted in the absence of an agreement with the Government of Sindh, which was earlier offered transfer of PSM's ownership. The transaction structure for Strategic Sale of Pakistan Steel Mills has been approved by the Privatization Commission Board. A liability settlement plan in consultation with NBP, SSGC, PSMC and Ministry of Industries and Production is being finalized.

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 annual financial data. Revenues in 2014-15 and 2015-16 have improved by 45 percent and 15 percent, respectively. This was possible through rationalization of tariffs, expenditure controls, and improved occupancy rates. Revenues further increased by 10 percent for 2016-17 (Rs.40.1 billion from Rs.36.5 billion in 2015-16). Renovation of old locomotives and procurement of approximately 350 new locomotives over the past four years has allowed PR to significantly expand its freight operations. The operation of freight trains from Karachi to up-country has been increased by 13 percent from 2,920 in 2014-15 to 3,309 in 2016-17. This has been achieved whilst efficiency savings in staffing have reduced Pakistan Railways' headcount from approximately 95,000 as of 30 June 2013 to 70,000 as of 30 June 2017.

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.

II. 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 new CEO has been appointed and a new business plan is under development focusing on separation of PIA's core and noncore activities. The PIA management is working to further limit financial losses by: (i) increasing performance by route rationalization and fleet modernization and expansion, (ii) reducing financial and operational costs, and (iii) providing better services to gain customers' confidence. 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.

11. Review of Public Debt

11.1 Total public debt is defined as debt of the government (including Federal Government and Provincial Governments) serviced out of consolidated fund and debts owed to the International Monetary Fund. Total debt of the Government is public debt less accumulated deposits of the Federal and Provincial Governments with the banking system. 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 Public debt was Rs.21,407 billion while total government debt stood at Rs.19,634 billion at end June 2017. Public debt increased by Rs.1,729 billion during 2016-17, which was significantly lower than the increase of Rs.2,297 billion recorded during the preceding fiscal year despite higher fiscal deficit witnessed in 2016-17. About 71 percent of the increase in public debt was contributed by domestic debt and 29 percent by external debt. This was in-line with the budget deficit financing as government financed around 71 percent of its budget deficit from domestic sources while the rest of the budget deficit was financed from external sources. In absolute terms, increase in public debt was lower than fiscal deficit financing during 2016-17 which is attributed to:

- Government utilized its deposits held with the banking sector primarily to retire some of the in-year borrowings from State Bank of Pakistan;

- Despite substantial external inflows, the net addition to external public debt (in Pak rupees) was lower than external financing of fiscal deficit, mainly due to revaluation gains on account of appreciation of US dollar against other international currencies.

Table 15:Public Debt

	2013	2014	2015	2016(P)	2017(P)	2018(P)*
(Rs. in billion)						
Gross Domestic Debt	9,521.9	10,920.0	12,198.9	13,626.9	14,855.0	15,375.5
*Net Domestic Debt	8,686.2	9,551.3	10,804.8	11,773.5	13,081.7	13,509.9
External Public Debt	4,796.5	5,071.5	5,181.8	6,051.1	6,552.1	6,683.4
Gross Public Debt	14,318.4	15,991.5	17,380.7	19,678.1	21,407.1	22,058.9
***Total Government Debt**	13,482.7	14,622.8	15,986.6	17,824.6	19,633.8	20,193.3
(In percent of GDP)						
Gross Domestic Debt	42.5	43.4	44.5	46.8	46.6	42.8
*Net Domestic Debt	38.8	37.9	39.4	40.5	41.1	37.6
External Public Debt	21.4	20.1	18.9	20.8	20.6	18.6
Gross Public Debt	64.0	63.5	63.3	67.6	67.2	61.4
***Total Government Debt**	60.2	58.1	58.3	61.2	61.6	56.2
Memo:						
Foreign Currency Debt (US$ in billion)	48.1	51.3	50.9	57.7	62.5	63.4
Exchange Rate (Rs./US$, End of Period)	99.7	98.8	101.8	104.8	104.9	105.4
GDP$^{(b)}$ (Rs. in billion)	22,385.7	25,168.8	27,443.0	29,102.6	31,862.2	35,919.0
*Net of government deposits with the banking system						
P:Provisional						*end-September, 2017

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

11.3 The composition of public debt in terms of maturity profile witnessed slight changes during 2016-17. Both demand and supply factors contributed towards the change in composition of public debt. Demand for medium to long term government securities was relatively lower in anticipation of change in the interest rates, inflation and liquidity conditions while the government was cautious about the cost-risk tradeoff as market participants were seeking higher than usual rates on long-term securities. Accordingly, the share of public debt maturing within one year increased to around 42 percent at end June 2017 compared with around 40 percent at end June 2016 while it was around 46 percent at end June 2013. However, this increase was compensated by reduction in cost of public debt portfolio as evident from the fact that the government's interest expenditure was reduced to 27 percent of total revenue during 2016-17 as compared with 33 percent during 2012-13. It reaffirmed the need to evaluate debt risks indicators in conjunction with cost as Medium Term Debt Management Strategy (MTDS) emphasizes tradeoff between cost and risk indicators

11.4 Encouragingly, cost and most of the risk indicators of public debt portfolio have witnessed improvement during four years in-line with the objectives set forth in Pakistan's first MTDS (2012/13-2017/18). The average cost of gross public debt was reduced by over 100 basis points during last four years owing to smooth execution of the MTDS. Refinancing Risk of domestic debt portfolio was reduced from 64.2 percent in 2013 to 55.6 percent in 2017. Exposure to interest rate risk was also reduced, as the percentage of debt re-fixing in one year decreased to 47.8 percent in 2017 compared to 52.4 percent in 2013. Similarly, share of external loans maturing within one year was equal to around 27.7 percent of official liquid reserves in 2017 compared with around 68.5 percent in 2013 indicating improvement in foreign exchange stability and repayment capacity.

11.5 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.

11.6 Government was required to meet Pakistan Investment Bonds (PIBs) maturity amounting to Rs.1,427 billion during the first quarter of 2016-17. Given the impact of maturing amount on 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 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 neutralize the overall impact of PIBs maturity on domestic debt sustainability indicators, however, the entire PIBs amount was challenging to re-finance during first quarter through fresh issuance of PIBs which resulted in positive quarterly borrowing from the SBP. However, the reliance on SBP borrowing was reduced in subsequent quarters of 2016-17 as government retired some of its borrowing from SBP which enabled the government to meet its net zero quarterly limit under the amended SBP Act 1956 during last three quarters of 2016-17. However, borrowings from SBP remained positive during first quarter of 2017-18 as the government required to meet PIBs maturity amounting Rs.597 billion which could not be refinanced from medium to long term instruments due to demand and supply side factors mentioned earlier. It is worth noting here that net zero quarterly borrowing was tied with fixation of ways and means limit which is yet to be finalized

11.7 Public debt was Rs.22,059 billion while total government debt was Rs.20,193 billion at end September 2017. Gross Public debt increased by around Rs.652 billion during first quarter of 2017-18. Out of this total increase, increase in domestic debt was Rs.521 billion while government borrowing from domestic sources for financing of fiscal deficit was Rs.433 billion. This differential is mainly attributed to increase in government credit balances with the banking system. Similarly, external public debt recorded an increase of around Rs.131 billion which was predominantly driven by translational losses on account of appreciation of international currencies against US Dollar and depreciation of Pak Rupee against US Dollar.

11.8 In US Dollar terms, external public debt increased by around US$ 0.9 billion during first quarter of 2017-18 and recorded at US$ 63.4 billion at end September 2017. Government mobilized US$ 1,468 million during first quarter of 2017-18, mainly from multilateral sources (US$ 642 million), commercial loans (US$ 472 million) and bilateral sources contributed US$ 354 million (mainly from China amounting US$ 317 million). Government also repaid US$ 1,349 million during the first quarter of 2017-18. Public debt per capita stood at Rs.107,519 during 2016-17 while net public debt per capita was Rs.98,613.[3]

12. Servicing of Public Debt

12.1 Comparing debt service to a country's repayment capacity yields the best indicator for analyzing whether a country is likely to face debt-servicing difficulties in a given

[3] Based on estimated total population of 199.1 million as per economic survey 2016-17

period. During 2016-17, public debt servicing was recorded at Rs.1,893 billion against the annual budgeted estimate of Rs.1,945 billion. Public debt servicing consumed nearly 38 percent of total revenues while interest servicing consumed around 27 percent of total revenue during 2016-17 compared with 33 percent during 2012-13.

Table 16:Public Debt Servicing(Rs. in billion)

	2016-17			
	Budgeted	**Actual**	**Percent of Revenue**	**Percent of Current Expenditure**
Repayment of External Debt	585.2	544.3	11.0	10.5
Total External Principal Repayment (A)	**585.2**	**544.3**	**11.0**	**10.5**
Servicing of External Debt	113.0	128.2	2.6	2.5
Servicing of Domestic Debt	1,247.0	1,220.3	24.7	23.5
Total Interest Servicing (B)	**1,360.0**	**1,348.4**	**27.3**	**25.9**
Total Servicing of Public Debt (A+B)	**1,945.2**	**1,892.7**	**38.3**	**36.4**

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

12.2 Domestic interest payments constituted around 90 percent of total interest servicing which is due to increasing volume of domestic debt in overall public debt portfolio. Encouragingly, in absolute terms, domestic debt servicing remained almost at the same level of 2014-15 despite increase in domestic debt stock by around Rs.2.7 trillion during last two years owing to low domestic interest rate environment and smooth execution of MTDS. Further analysis of domestic debt servicing reveals that large portion was paid against PIBs (Rs.502 billion), followed by Treasury Bills (Rs.201 billion), Market Related Treasury Bills (Rs.151 billion), Bahbood Saving Certificates (Rs.96 billion) and Special Savings Certificates and Accounts (Rs.84 billion).

13. Report on Compliance with FRDL Act 2005

The FRDL Act, 2005 requires that the federal government take measures to reduce total public debt and maintain it within prudent limits thereof. Government has made amendments in FRDL Act 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. 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 provision related to reducing the total public debt to GDP to 60 percent is effective from 2017-18. Government remains committed to reduce public debt to GDP ratio to 60 percent by 2017-18 as envisaged through amended FRDL Act. Accordingly, gross public debt witnessed reduction and settled at 67.2 percent of GDP while total government debt stood at 61.6 percent of GDP as at end June, 2017.

(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 2016-17, the government issued new guarantees including rollovers amounted to Rs.599 billion or 1.9 percent of GDP.

14. Conclusion

14.1 Most of the macroeconomic indicators witnessed improvement during the past four fiscal years. During 2016-17, GDP witnessed a growth of 5.3 percent which was highest in the last ten years. An improvement was observed in most of the public debt risks indicators during last four 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 55.6 percent at the end of June 2017 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 47.8 percent at the end of June 2017 compared to 52.4 percent at the end of June 2013. Similarly, share of external loans maturing within one year was equal to around 27.7 percent of official liquid reserves at the end of June 2017 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 along with 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 6.0 percent for 2017-18 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 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, revenue mobilization should be given priority along with rationalization of current expenditure as envisaged in budget 2017-18. The elements of the vision presented were: a) GDP growth to rise to 6 percent by 2017-18; (b) inflation will be contained below 6 percent; (c) investment to GDP ratio will rise to 17 percent in 2017-18; (d) Federal fiscal deficit would be brought down within stipulated limit in coming years; (e) tax to GDP ratio will be increased to 13.7 percent; and (f) foreign exchange reserves would be maintained at a sustainable level.