4 Fiscal Development

Introduction:

Fiscal policy is an instrument of economic development that can have major impacts on income distribution and poverty through taxes, public borrowings and public expenditures.

Nearly four years after the start of global financial crisis, the global economy is now recovering. In advanced countries, the crisis was accompanied by a rapid and deep deterioration of public finances. The sluggish pace of fiscal consolidation has caused fiscal sustainability risks in major industrialized countries. The need for fiscal consolidation and sustainability is one of the key macroeconomic issues currently facing many developed and developing economies around the world. The sustained adjustment in the fiscal balance covering both revenue and expenditure measures, is urgently required. Previous challenges of fiscal & financial repair, reforms and rebalancing of global demand remained outstanding.

Pakistan's economy mainly remained immune to global financial crisis because of its lesser exposure to international finance. Loss of growth momentum in the wake of high commodity prices, coupled with the peculiar law and security situation, and power outages has aggravated threats to macroeconomic stability. Intensification of war on terror put additional burden on public finances at a time when weaker domestic economic activity is taking its toll on revenue mobilization efforts. Fiscal balance deteriorated in 2009-10, and some adjustment is expected in fiscal deficit but it is far off than target.

Key reforms for revenue mobilization have to be delayed owing to peculiar internal and external pressures. It widened fiscal imbalance from 5.3 percent of GDP in 2008-09 to 6.3 percent in 2009-10 against the target of 4.9 percent. The additional burden on expenditure was not supported by commensurate increase in revenues, but weaker economic activity constricted revenue generation process. Resultantly, fiscal deficit deteriorated to 4.3 percent of GDP in the period July-March 2011 as compared to 4.2 percent in the comparable period of last year. The target for 2010-11 has to be adjusted upward from 4.0 percent of GDP to 5.3 percent of GDP. Even meeting this target requires massive adjustment in development expenditure and some additional revenue measures in April 2011.

Major Developments

A low and declining tax-to-GDP ratio and increasing public debt stock has imposed a constraint on fiscal stimulus to support revival of growth momentum needed for the economy. The Reformed General Sales Tax (RGST) is in the Parliament. Other major reforms like harmonization of tax administration have taken place and strengthening of Risk Based Audit is under process. The government has also announced various temporary tax policy measures through Presidential Ordinance to generate additional revenues of Rs 53 billion during the last quarter of 2010-11. The administrative measures and vigilance will be helpful in generating another Rs 24 billion. These steps will also be helpful in achieving the revised collection target of Rs 1588 billion.

Major development was the announcement of 7th NFC award in budget 2010-11 and for the first time the distribution of funds has been made on multiple criteria of population, poverty and backwardness, revenue collection/generation and Inverse population density. In addition to the above, number of economic and financial reforms were undertaken, which are briefly discussed below:

Austerity Plan

Main objective of the plan is to provide a road map to attain austere and cost effective fiscal governance through:

- Rationalization of Expenditure
- Optimization of Available Resources
- Process Re-engineering and
- Efficiency of Operation

The salient feature of the Austerity plan is the rationalization of government size through a reduction in the number of Federal Ministries and devolution of subjects to the provinces

Restructuring of Public Sector Enterprises

Restructuring of PSEs has been initiated in order to improve overall corporate governance of PSEs and service delivery, and to move to a structural surplus and increased public sector savings. An overall framework for restructuring of following eight PSEs has been devised:-

- Pakistan International Airlines (PIA), Pakistan Steel Mills,
- Pakistan Electric Power Company (PEPCO),
- Pakistan Railway (PR), National Highway Authority (NHA),
- Pakistan Agricultural Storage and Services Corporation (PASSCO),
- Trading Corporation of Pakistan (TCP) and
- Utility Stores Corporation (USC)

Progress has been made including restructuring Board of Directors of eight Power Sector Distribution Companies (DISCOs), National Transmission and Dispatch Company (NTDC), Pakistan Steel Mills (PSM) and Pakistan Railway in line with the guidelines developed by the Cabinet Committee on Restructuring (CCOR).

Power Sector reforms

The power sector reform plan developed by the government requires the following:

- Improved governance structure
- Supportive legal framework
- Financial sustainability
- Supply side management
- Demand side management
- Promote private sector participation in the sector

The implementation of the power sector reform plan is in progress. Dissolution of PEPCO has been initiated to ensure autonomy to power sector companies and human resource transfer plan of PEPCO employees is on track. Technical, financial and managerial audits of DISCOs and GENCOs have been completed to identify weak areas and ensure financial transparency.

Key issue of circular debt and receivables of power sector both current and previous are being addressed. The total power sector subsidy in 2010-11 is expected to be in the range of Rs181.4 billion to Rs 227.9 billion. In order to address this, monthly fuel adjustments are being passed on to consumers. There have been regular increases in power tariff in the form of surcharge to narrow down the cost and revenue differentials of the power sector companies. The estimated power sector subsidy is expected to decrease substantially in the coming years. In this regard, work on NEPRA amendment to empower NEPRA to notify tariffs as determined from July 2011 is underway. Efficiency gains are likely to reduce cost differentials and tariff differential subsidy.

Fiscal Policy Development

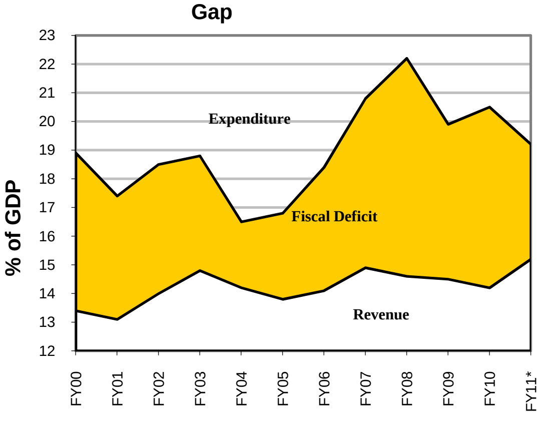
Pakistan is confronted with the issue of stagnant tax to GDP ratio for more than a decade now, as overall tax-to-GDP ratio fluctuated in a narrow band of 9-11percent owing mainly to structural deficiencies in the tax and administration system both at federal and provincial government level. Pakistan is characterized having lowest tax-to-GDP ratio not only in peer countries but even in the region as well. The composition of the current expenditure is narrowly based and offers little room to take burden of critical fiscal adjustment. The debt and security related spending is taking almost three-fourth of the current expenditure and thus room for adjustment is very low. The lack of availability of external financing has further aggravated the fiscal predicament as the burden unfairly falls upon domestic financing. Consequently, there is a limited fiscal space, which is crucial for a sustainable economic growth.

Table 4.1: Fiscal Indicators as Percent of GDP

Financial Year	Real GDP Growth	Overall Fiscal Deficit	Expenditure			Revenue		
			Total	Current	Development	Total Rev.	Tax	Non-Tax
2000	3.9	5.4	18.9	16.4	2.5	13.4	10.6	2.8
2001	1.8	4.3†	17.4	15.3	2.1	13.1	10.5	2.6
2002	3.1	4.3†	18.5	15.7	2.8	14.0	10.7	3.3
2003	4.7	3.7	18.8	16.2	2.6	14.8	11.4	3.4
2004	7.5	2.3	16.5	13.7	2.8	14.2	11.0	3.2
2005	9.0	3.3†	16.8	13.3	3.5	13.8	10.1	3.7
2006	5.8	4.3*†	18.4	13.6	4.8	14.1	10.5	3.6
2007	6.8	4.3*†	20.8	15.8	5.0	14.9	10.2	4.7
2008	3.7	7.6	22.2	18.1	4.4	14.6	10.6	4.4
2009	1.7	5.3	19.9	16.0	3.8	14.5	9.5	5.1
2010	3.8	6.3	20.5	16.9	3.5	14.2	10.2	3.9
2011(B)	2.4	4.0	18.0	14.6	3.4	14.3	10.5	3.8

† Statistical discrepancy (both positive and negative) has been adjusted in arriving at overall fiscal deficit numbers.
** Include earthquake related expenditure worth 0.8 and 0.5 percent of GDP for 2005-06 and 2006-07, respectively.*

Fig-4.1: Trends in Revenue-Expenditure Gap



The fiscal position, viewed in terms of key fiscal parameters like revenue, expenditures and fiscal deficit indicate a notable change since 1990's. Total expenditure and total revenue witnessed near stagnation and both items moved up and down in very narrow band. The shocks are absorbed by development expenditure. Pakistan's expenditure remained lowest among developing countries at the same level of development. Tax-to-GDP ratio in the table-4.1 hides many distortions, implying massive under-taxation.

During the decade of the 2000s, Pakistan has undergone many tax and administration reforms but no major improvement in revenues is observed in the past 10 years because on the revenue side, tax to GDP and hence revenue to GDP either remained stagnant or showed a secular decline.

Relatively, a similar pattern holds for expenditure to GDP, with total expenditures showing an overall decline since 2007-08. The decline in total expenditure (1.7 percentage point of GDP) is shared by current expenditure (1.2 percentage points) and development expenditure (0.9 percentage points) during the past 3 years. However in 2010-11, the total expenditure is expected to reach at Rs. 3257 billion or 18.0 percent of GDP. On the other hand, total revenues are expected to rise by Rs 2,574 billion or 14.6 percent of GDP.

Fiscal deficit as a percentage of GDP has declined from 7.6 percent in 2007-08 to 5.3 percent in 2008-09 on account of a drastic cut in development expenditures. Nonetheless, the fiscal consolidation witnessed in 2008-09 evaporated with an increase in fiscal deficit by 6.3 percent in

2009-10, which was 1.5 percent more than the budget estimate for 2009-10 due to large additional subsidies for the electricity sector. Meanwhile, the catastrophic floods, which hit Pakistan in the summer of 2010, reduced growth and posed a further challenge to public finances by depressing budget revenues and necessitating additional spending to meet the humanitarian and reconstruction needs, thereby necessitating upward adjustment in the fiscal deficit target from 4 percent of GDP at the time of budget announcement to 5.3 percent of GDP.

Box-2: **South Asian Fiscal Consolidation Dilemma**

South Asia has the largest fiscal deficit among developing countries with the region-wide deficit estimated at 8.2 percent in 2010. The high fiscal deficits in the region reflects a number of longstanding structural factors, with significant pressures emanating from both the revenue and expenditure sides. In particular, tax mobilization in the region is low. South Asia's general government tax revenues averaged 14.3 percent as a share of GDP in 2009—compared with Europe and Central Asia (21.4%), Sub- Saharan Africa (16.5%) and Latin America and Caribbean (16.4%)—and represented less than 12 percent of GDP in ***Pakistan (10.2 percent)***, Nepal (11.8 percent) and Afghanistan (7.2 percent). India's tax base is broader at 16.5 percent. Reforming taxation system for additional revenue mobilization is critically important for sparing more resources for social sector development.

On the expenditure side, ***the region carries a particularly heavy burden in the form of high interest payments***. Relative to total expenditures, interest payments averaged 18.2 percent in 2009, by far the highest share among developing regions and at least twice as high, with the exception of Latin America and the Caribbean (11%). This reflects elevated interest payments as a share of total outlays in Bangladesh (17.3 percent) India (17.7 percent), Pakistan (25.5 percent), and Sri Lanka (25.8 percent). Recent efforts at ***budget consolidation have been missed in Pakistan, because of revenue shortfalls, overrun on power sector subsidies and elevated security expenditures, as well as flood-related expenditures.***

Structure of Tax Revenue

Pakistan has historically a punctured tax base with some sectors are under-taxed and some are not taxed at all. Agriculture and services sector accounts for three-fourth of national income but its contribution hovered around 10 percent of GDP. Petroleum sector accounts for around 27 percent of tax revenue. This unfair distribution has proved to be distortionary and incentivizing massive tax evasion. This explains very low tax-to-GDP ratio and failure of many tax reforms going on for the last two decades because only indicator of tax administration's efficiency is tax-to-GDP ratio. Large size of informal economy is peculiar characteristic of developing countries but Pakistan's case is more serious as tax-to-GDP ratio is the lowest not only in the developing world but also in the region as it hovers at a 9.2 percent as compared to around 15 percent in Sri Lanka and 16 percent in India.

Fig-4.2: FBR Tax Rev as % of GDP

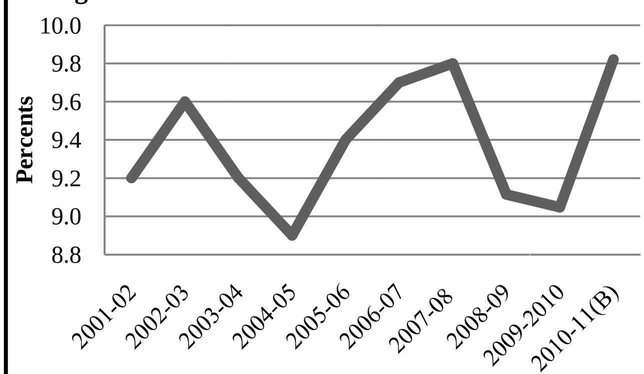


Table 4.2: Structure of Federal Tax Revenue *(Rs. Billion)*

Year	Total (FBR)	Tax Rev as % of GDP	Direct Taxes	Indirect Taxes			
				Customs	Sales	Excise	Total
2000-01	392.3	9.4	124.6	65	153.6	49.1	267.7
			[31.8]*	{24.3}^	{57.4}	{18.3}	[68.2]

2001-02	403.9	9.2	142.5	47.8	166.6	47.2	261.6
			[35.3]	{18.3}	{63.7}	{18}	[64.7]
2002-03	460.6	9.6	148.5	59	205.7	47.5	312.2
			[32.2]	{18.9}	{65.9}	{15.2}	[67.8]
2003-04	518.8	9.2	165.3	89.9	219.1	44.6	353.6
			[31.9]	{25.4}	{62}	{12.6}	[68.1]
2004-05	588.4	8.9	176.9	117	235.5	58.7	411.4
			[30.1]	{28.5}	{57.2}	{14.3}	[68.9]
2005-06	713.4	9.4	224.6	138	294.6	55	487.9
			[31.5]	{28.3}	{60.4}	{11.3}	[68.5]
2006-07	847.2	9.7	333.7	132.3	309.4	71.8	513.5
			[39.4]	{25.8}	{60.3}	{13.9}	[60.6]
2007-08	1007.2	9.8	387.5	150.6	376.9	92.2	619.7
			[39.6]	{24.7}	{60.3}	{14.6}	[60.4]
2008-09	1161.1	9.1	444.0	148.0	452.0	117.4	717.4
			[38.2]	{20.6}	{63.0}	{16.4}	[61.8
2009-10	1327	8.9	529.0	162.0	516.0	121	799.0
			[39.9]	{20.3}	{64.6}	{15.1}	[60.2]
2010-11B	1667	9.2	657.7	180.8	674.9	153.6	1009.3
			[39.4]	{17.9}	{66.9}	{15.2}	[60.5]

as % of total taxes ,
^ as % of indirect taxes
B Budget estimates

Source: Federal Board of Revenue

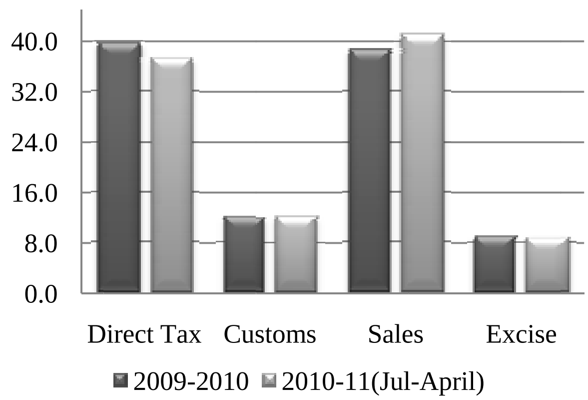
The internal structure of taxation has undergone substantial changes as the share of income tax has risen significantly from around 31 percent in 1999-2000 to 39 percent in 2010-11 and indirect taxes are paving the way for direct taxes. The main culprit is the falling share of customs and excise duties mainly because of tax and tariff reforms. Trade related taxes or customs duty has lowered its share in indirect taxes from 24 percent at the start of the decade and 20 percent at the end of the decade. Similarly excise duty is being replaced by sales taxes and thus its share in the indirect taxes has declined. Sales tax has becoming very important consumption tax and it accounts for two-third of indirect taxes. Going forward, this level of taxation has to be increased through major overhaul of the taxation system and administration. The reforms needed to increase the tax to GDP ratio 13-15 percent during the next five years, a number of additional Tax Policy and Administrative Reforms initiatives have been announced, which are as follows:-

Reforms

Reformed GST

It is evident by international experience that adoption of a VAT is associated with a long run increase in the overall tax-to-GDP ratio of about 3-5 percent. For Pakistan, R-GST/VAT is envisaged to be a key structural reform in documenting the economy, broadening of the tax base and improving the overall efficiency of the tax system. The proposed Federal Reformed GST (RGST) Bill was tabled in the National Assembly and provincial R-GST bills were also tabled in the provincial assemblies. It has been recommended by the Senate and National Assemblies Standing Committees. Extensive negotiations are underway to develop a consensus with the political parties, the provinces as well as the major stakeholders to ensure smooth implementation of R-GST.

Fig-4.3: %age of Total tax



Through a combination of Presidential Ordinance and withdrawal of SRO base exemptions, amendments have been made in the Sales Tax Act 1990, Income Tax Ordinance 2001 and Federal Excise Act 2005. The following tax measures have been taken through these amendments:-

1. Withdrawal of sales tax exemption on agriculture inputs like tractors, pesticides, and fertilizer both at domestic and import stages. Now these are subjected to 17 percent GST
2. A onetime surcharge of 15 percent has been imposed on withholding and advance taxes payable during financial year 2011; and
3. Special excise duty rate has been increased from 1 percent to 2.5 percent on non-essential items for the remaining period of tax year 2010-11.

The facility of zero-rating on plant, machinery and equipment including parts thereof has also been withdrawn by amending SRO No.549(I)/2008, dated 11-06-2008, through Notification SRO No.230(I)/2011, dated 15-03-2011. These goods are now liable for sales tax at the rate of 17 percent. Moreover, zero-rating on five major export oriented sectors (textiles, carpets, leather, sporting goods and surgical goods) has been restricted to registered manufacturers-cum-exporters and exporters for export purpose only by an amendment in SRO NO 509(I)/2007, dated 09-06-2007, through Notification SRO No.231(I)/2011, dated 15-03-2001. Domestic supplies of these sectors will now be liable to sales tax at different rates of 4 and 6 percent.

FBR has rescinded its Notification SRO NO.564 (I)/2006, dated 05-06-2006 where under sales tax was being charged on sugar at the assessable value of Rs 28.88 per kg. Now sales tax at the rate of 8 percent will be charged on the actual price of sugar. All these measures are likely to generate additional revenue of Rs 53 billion during remaining period of 2010-11

Measures to improve tax administration and collection

Recent measures taken to improve tax administration and strengthen tax collection are listed below:

a. Restructuring of the Organizational Setup of FBR

- The number of members has been reduced from 12 to 8. One Member (Inland Revenue) has replaced two Member domestic operations, (North and South). The new team has been created by placing special emphasis on skills that match FBR's needs.

b. Compliance and Enforcement Measures

- Focused efforts are being undertaken to reduce non-filers and short-filers in income tax and sales tax.

c. Broadening of Tax Base

- National Database and Registration Authority of Pakistan (NADRA) approached to help in identifying potential taxpayers through data-mining on 83 million CNIC holders based on a taxpayer profile which takes into account age, education, employment, residence type, bank accounts, travel pattern, NTNs issued etc. FBR has created a dedicated Directorate General for pursuing these potential taxpayers.

d. Sales Tax Refunds

- An expeditious payment refund system (EPRS) has been setup in FBR and rolled out all over Pakistan since July 2010 where refund claims of manufacturers/exporters are being processed online within 48 hours of filing of the refund claims. Issuance of all refund cheques has been centralized to finalize refund to taxpayers within seven days of their claims being cleared.

e. Tax Audits

1. Audit Policy 2010-11 (Tax Returns 2009)

The audit policy and risk criteria have been developed for the financial year 2010-11 (for returns of 2010). Salient features of the policy are given below:

1. To expand audit coverage of large and medium taxpayers gradually
2. To devise risk based selection criteria rather than random method for audit for major sectors of economy.
3. To increase the professional capacity by creating sectors' specialist in:
   - Textile sector, Hotel services, Transport sector, Private construction
   - IT based forensic audit, Petroleum exploration & refining
   - Banking Sector, Insurance Sector

a. To include with-holding agents and post-refund Sales Tax audit in the next Audit Plan.

f. Customs Modernization Reform

Under customs modernization reform, a major initiative taken up under the restructured TARP, is the development of a Pakistan Customs Valuation Gateway website containing data pertaining to commodities, as available in various international bulletins in an effort to control under-invoicing. Directorate General of Intellectual Property Rights (IPR) has been established to enhance efficacy of customs in IPR related work and provide back-up for enforcement to Customs Collectorates.

Review of Public expenditure

Public expenditure remained under tremendous pressure in the year under review as commensurate increase in revenues was not available. There is a need for strengthening the public finances in order to enable the government for higher spending on development and poverty reduction, and to increase much-needed social outlays over the medium term. As discussed earlier, that fiscal consolidation could not be maintained in 2009-10 largely because of a sluggish growth in revenues, persistence of security related pressure on public expenditures and greater than budgeted subsidies. The expenditure overrun instead of reduction in development expenditures is a major cause of concern but equally important is revenue shortfalls.

Total expenditures (TE) rose to Rs 3,007.2 billion or 20.3 percent of GDP in 2009-10 as compared to Rs 2,531 billion or 19.9 percent of GDP in 2008-09; however it is likely to decline to 18.0 percent in 2010-11 on account of slashing of development expenditures. In the current expenditure the decline is coming from non-interest-non-defence spending. Expenses under the head of running of the civil administration increased by 23.4 percent, mainly due to the impact of higher salaries and allowances for federal government employees in 2010-11. Similarly, during July-March, 2011, flood relief measures claimed an unbudgeted 1.7 percent of consolidated public expenditures. During July-April, 2011, the government has disbursed Rs 30 billion under *watan* card scheme.

Current expenditures (CE) during 2009-10 not only surpassed the 2008-09 level but also the projected amount by a significant amount. The elevated current expenditures was primarily due to higher than projected spending on defense and security related spending along with a significant continuation of subsidies for energy, food items (wheat & sugar) and cash transfers. Consequently, to alleviate the brunt of an increase in current expenditure and to ease the deficit pressure, the government resorted to limit the development spending below target level during 2009-10, thus it remained at 3.5 percent of GDP as compared to 3.8 percent during the same period of 2008-09. In order to meet the fiscal target for 2010-11, the development spending is expected to remain conspicuously low at 3.4 percent of GDP, which was 3.6 percent of GDP at the time of budget announcement.

Table 4.3 : Trends in Components of Expenditure **(As % of GDP)**

Year	Total Expenditure (A)	Current Expenditure (B)	Interest Payments (C)	Defense (D)	Development Expenditure (E)	Non Interest Non-Defence Exp (A-C-D)	Fiscal Deficit	Revenue Deficit/Surplus (TR-Total CE)	Primary deficit (TR-NI Exp)
1999-00	18.5	16.4	6.8	3.9	2.5	7.7	-5.4	-3	1.7
2000-01	17	15.3	5.9	3.1	2.1	8	-4.3	-2.2	2
2001-02	18.5	15.7	6.1	3.3	2.8	9	-4.3	-1.7	1.6
2002-03	18.4	16.2	4.8	3.3	2.6	10	-3.7	-1.4	1.2
2003-04	16.9	13.7	4	3.3	2.8	9.7	-2.3	0.3	1.1
2004-05	17.2	13.3	3.4	3.2	3.5	10.5	-3.3	0.5	0.04
2005-06	18.4	13.6	3.4	3.2	4.8	11.8	-4.3	0.5	-0.8
2006-07	20.6	15.8	4.4	2.9	5	13.3	-4.3	-0.9	-1.3
2007-08	22.2	18.1	5.1	2.7	4.4	14.4	-7.6	-3.4	-2.4
2008-09	19.9	16.0	5.2	2.6	3.8	12.1	-5.3	-1.5	-0.2
2009-10	20.5	16.7	4.3	2.5	3.5	13.4	-6.3	-2.7	-1.9
2010-11B	18.0	14.6	3.9	2.4	3.4	11.7	-4.0	-0.4	0.1

B : Budgeted,

The share of current expenditures in total expenditure has significantly declined from 89.9 percent in 2000-01 to 82.5 percent in 2009-10, and expected to decline further by 1.4 percent, mainly due to a substantial fall in interest payments. On the other hand defense expenditures, accounted for 15.1 percent of current expenditure in 2009-10. While as percentage of GDP it remained at 2.5 percent in 2009-10 and likely to remain slightly below than this level in 2010-11. However, in absolute terms, defense expenditure rose to Rs 375 billion during 2009-10 against Rs 329.9 billion in the same period of 2008-09. Nevertheless the budgeted target is set at Rs 442 billion for the 2010-11 which is around 2.4 percent of GDP.

Fiscal Performance: July-March, 2010-11

Pakistan's economy was jolted by devastating floods at the start of the fiscal year and thus started weakening economic activity, that in turn had a bearing on revenue mobilization. Demand on fiscal accounts increased due to relief and rehabilitation support to flood victims. Resultantly, a significant part of PSDP for 2010-11 has been diverted towards rehabilitation activities. IMF released $450 million as Emergency Natural Disaster Assistance (ENDA).

According to the consolidated revenue & expenditure of the government, total revenues grew by 6.2 percent during July-March 2010-11 and reached to Rs1,489 billion as compared to Rs1,402 billion in the same period last year. The increase is mostly coming from higher tax revenues partially contributed by direct taxes on the back of advance income tax payments and growth in taxes on goods and services and international trade due to increase in rupee imports. On the other hand, growth in non-tax revenues decreased by 5.7 percent mainly because of a decline in transfer of SBP profits.

Within overall revenues, FBR taxes witnessed a growth of 12.6 percent during July-April, 2011 and reached Rs 1156 billion against Rs 1026.5 billion in the same period last year. However, other tax revenues neutralized this growth. Negative growth in non-tax revenues neutralized further total revenue growth to just 6.2 percent. Total expenditure increased at much faster rate of 11.5 percent during July-March 2010-11 and thus widened the revenue-expenditure gap. Un-sustainability of the fiscal balance emanates from the persistent growth in expenditure caused by flood relief activities, security related expenditure and delay in the implementation of tax reforms. External resources for financing of budget deficit amounted to Rs 61 billion, and insufficiency of the external financing shifted more reliance on domestic resources to finance the fiscal deficit during July-March 2010-11. Fiscal deficit as a percentage of GDP stood at 4.3 percent during the first nine months of 2010-11 against the revised target of 5.3 percent for the whole fiscal year.

Table 4.4 Consolidated Revenue & Expenditure of the Government

	Budget Estimate	Projections	Prov. Actual Jul-Mar	Prov. Actual Jul-Mar	Growth Jul-Mar
	2010-11	2010-11	2009-10	2010-11	2010-11
A. Total Revenue	2,574	2,351	1,402.00	1,489.00	6.2
a) Tax Revenue	1,889	1,776	1,029.60	1139	10.6
Federal	1,809	1,710	994.2	1097	10.3
of which FBR Revenues	1,667	1,588	909.6	1020	12.1
Provincial Tax Revenue	80	66	35.4	42	18.6
b) Non-Tax Revenue	686	576	372.4	351	-5.7
B. Total Expenditure	3,257	3,312	2,027.80	2261	11.5
a) Current Expenditure	2,641	2,835	1,720.90	1935	12.4
Federal	1,891	2,025	1,283.60	1423	10.9
- Interest	699	727	473.5	505	6.7
- Defense	442	442	269.8	335	24.2
Provincial	750	810	437.3	512	17.1
b) Development Expenditure & net lending	617	398	303	231	-23.8
PSDP	610	390	286.5	225	-21.5
c) Net Lending	7	8	16.5	6	-63.6
d) Provision for flood relief	-	80	-	39	-
e) Unidentified Expenditure	0	-1	0	56	0
C. Overall Fiscal Deficit	-683	-961	-625.8	-771	23.2
As % of GDP	-4	-5.5	-4.2	-4.3	7.1
Financing of Fiscal Deficit	591	903	625.9	746	19.2
i) External Sources	92	135	92.6	61	-34.1
ii) Domestic	499	768	533.3	685	28.4
- Bank	166	418	210.9	353	67.4
- Non-Bank	333	350	322.5	332	2.9
- Privatization Proceeds	0	0	0	0	0
GDP at Market Prices	18,063	18,063	14,837	18,063	15.1

Slippages on Revenue & Expenditure during Last Three Years

A well designed fiscal policy comprising of well articulated revenue and expenditure reforms is always supportive to promote economic growth. An efficient revenue mobilization can help to condense fiscal imbalances and fund much needed public goods and services, while on expenditures side, change in composition of public spending can re-adjust public resources away from current consumption towards growth promoting investment. During the last three years expenditure overrun surpassed the revenue increases, thereby resulting in breaching fiscal deficit targets persistently. The task of fiscal adjustment became even difficult.

Table-4.5: Slippages in Revenue-Expenditures

Items	2007-08			2008-09			2009-10		
	B.E	Actual	% Change	B.E	Actual	% Change	B.E	Actual	% Change
Total Revenue Receipts (Net)	1,476	1,499	1.6	1,809	1,851	2.3	2,155	2,078	-3.6
Total Expenditure	1,875	2,277	21.4	2,392	2,531	5.8	2,877	3,007	4.5
Overall Fiscal Deficit	-399	-777	-	-582	-680	-	-722	-929	-
as % of GDP	4.0	7.6	-	4.7	5.3	-	4.9	6.3	-

Pakistan has experienced overwhelming fiscal challenges in the recent past in particular during 2007-08 on account of revenue-expenditure gap that lies in the structural weaknesses of Pakistan's tax system. Additionally, government's effort for fiscal consolidation was relentlessly challenged by domestic and external sectors imbalances in confluence with deteriorating security environment, deepening of the global financial crisis, and persistent inflationary pressures etc. It was therefore, 2007-08 witnessed massive slippage in fiscal deficit, which was at 7.6 percent of GDP against the target of 4 percent. However, in 2008-09 under the IMF-SBA, the government took various budgetary measures to attain fiscal consolidation. Consequently, fiscal deficit declined to 5.3 percent but still higher than the target of 4.7 percent due to intensification of war on terror and over draft from the Punjab government.

On the other hand 2008-09 observed a consolidation of the government's fiscal position at the expense of development expenditures. Hence, the revenue deficit improved considerably. While it could not be sustained in 2009-10 due to multiplicity of factors including widening of fiscal deficit on account of current expenditure and lower revenue collection, security spending, IDP related expenditures together with electricity subsidies. Total expenditures increased by 4.5 percent, nevertheless, lower since 2007-08. The government curtailed development spending in order to dilute the impact of higher than budgeted current expenditures. In spite of this, fiscal deficit increased from 5.3 percent of GDP in 2008-09 to 6.3 percent in 2009-10.

FBR Tax Collection

Tax collection by the FBR was targeted at Rs 1667 billion at the time of presentation of the budget for fiscal year 2010-11 under certain assumptions like higher growth trajectory, aggressive taxation and tax administration reforms. However, the devastation caused by floods during July and August 2011 obscure some of the optimism regarding economic activity and reforms. Acute energy shortages have eclipsed prospects of better large-scale manufacturing — the main source of tax revenues. Consequently the target was downward revised to Rs 1,588 billion. Despite unfavorable economic conditions, FBR exhibited reasonable performance during first nine months for current fiscal year. Revenue collection of FBR stood at Rs1,156 billion during July-April 2010-11, thereby reflecting 12.6 percent growth over Rs 1,026.5 billion collected during the corresponding period of last year.

Direct Taxes

The gross and net collection has registered a growth of 6.9 percent and 10.7 percent during the first nine months of 2010-11. Major revenue spinners of direct taxes are withholding tax, voluntary payments, and collection on demand.

Indirect Taxes

During July-April, 2010-11, the gross and net collection has witnessed a growth of 16.9 percent and 13.8 percent, respectively. It has accounted for 62.8 percent of the total FBR tax revenues. Within indirect taxes, sales tax increased by 15.6 percent. The gross and net sales tax collection during the period under review has been Rs 522.9 billion and Rs 482.5 billion, respectively showing growth of 19.8 percent and 15.6 percent, respectively over the corresponding period of last year. Of net collection, almost half of total sales tax is contributed by sales tax on domestic goods and services, while the rest originate from imports. Within net domestic sales tax collection, major contribution has come from POL products, telecom, services, natural gas, sugar and cigarettes. On the other hand, POL products, edible oil, plastic resins, vehicles, iron & steel and machinery have major contribution in the collection of sales tax from imports.

Table 4.6: FBR Tax revenues **Rs Billion**

Revenue Heads	2009-10	2010-11	July-April		% Change	Achievement
	(Actual)	(B.E)	2009-10	2010-11		(Percentage)
A. DIRECT TAXES						
Gross			430.4	460.3	6.9	
Refund/Rebate			42.1	30.3	-28.0	
Net	**521.2**	**657.7**	**388.3**	**430**	**10.7**	**65.4**
B. INDIRECT TAXES						
Gross			662.3	773.9	16.9	
Refund/Rebate			24	47.9	99.6	
Net	**799.2**	**1009.3**	**638.2**	**726**	**13.8**	**71.9**
B.1 SALES TAX						
Gross			436.3	522.9	19.8	
Refund/Rebate			19	40.3	112.1	
Net	**516.1**	**674.9**	**417.3**	**482.5**	**15.6**	**71.5**
B.2 FEDERAL EXCISE						
Gross			95.2	101.9	7.0	
Refund/Rebate			0.025	0.001	-96.0	
Net	**121.9**	**153.6**	**95.2**	**101.9**	**7.0**	**66.3**
B.3 CUSTOM						
Gross			130.7	149.2	14.2	
Refund/Rebate			5.0	7.6	52.0	
Net	**161.2**	**180.8**	**125.7**	**141.6**	**12.6**	**78.3**
TOTAL TAX COLLECTION						
Gross			1,092.7	1,234	13.0	
Refund/Rebate			66.2	78.3	18.3	
Net	**1320.4**	**1667**	**1,026.5**	**1,156**	**12.6**	**69.3**

Custom duty collection has registered a growth of 14.2 percent and 12.6 percent in gross and net terms, respectively. The gross and net collection has increased from Rs 130.7 billion and 125.7 billion during July-April 2009-10 to Rs 149.2 billion and Rs 141.6 billion during July-April 2010-11. Major revenue spinners of custom duty have been automobiles, edible oil, petroleum products and machinery. A growth of 7.0 percent has been registered in the net collection of federal excise duty (FED) during July-April 2010-11 as the net collection stood at Rs 101.9 billion in this period as against Rs 95.2 billion during corresponding period of last year. The major revenue spinners of FED are cigarettes, cement, beverages, natural gas, POL products and services.

Medium Term Budgetary Framework (MTBF)

Main objective of MTBF program is to align public expenditures with government strategies in more predictable way. The reform program is extending its domain to sensitive systematic issues such as working on Public Finance Act to allow MTF budgeting a legal cover, capacity building within Finance Division, enacting budget preparation manual, output monitoring function, linkages with PIFRA and design of curriculum for civil services trading and induction courses. Following areas need attention under MTBF reforms;

- Adopting programmatic basis of budgeting, building on the existing output based budgeting methodology.
- Supporting the embedding of MTBF in PIFRA-II through Financial Management Application and necessary training to help the line ministries to take the charge of compiling their detailed budgets.
- Transition from Financial Advisers to Chief Finance & Accounting Officers through a viable transition mechanism, this reform will need 1-2 years to be fully functional.
- Need to create linkages with provinces at the time of development of Budget Strategy Paper and find avenues to create a unified approach of output based budgeting across Pakistan. Provinces have started MTBF initiative; however, support will be needed to harmonize with federal initiative.
- Further synchronizing the monitoring function with output monitoring (both financial and non-financial) which has become a regular feature of the Ministerial activities.
- Institutionalizing the MTBF in the Ministry of Finance

Major modification to the MTBF budget preparation implemented with effect from 2009-10 include the following:

- Introduction of budget ceilings for all federal ministries.
- Strengthening the strategic process of budget preparation in each federal ministry.
- First step towards result based budgeting
- Clear identification of the cost of services (outputs) to be delivered.
- Preparation of 'Medium Term Budget estimates for Service Delivery' (GREEN BOOK).

Provincial Budget

The total outlay of four provincial budgets for 2010-11 stood at Rs 1,290 billion, which is 29.4 percent higher than the outlay of Rs 997 billion for the last year. Balochistan buoyed by more expected resource flows from the federation witnessed the highest increase of 37.4 percent in budgetary outlay followed by Sindh (30.8 percent), Punjab (28 percent) and KPK (26.4 percent).

Table 4.7: Overview of Provincial Budgets **(Rs Billion)**

Items	Punjab		Sindh		KPK		Baluchistan		Total	
	2009-10 RE	2010-11 BE	2009-10 RE	2010-11 BE	2009-10 RE	2010-11 BE	2009-10 RE	2010-11 BE	2009-10 RE	2010-11 BE
A. Total Tax Revenue	**359.2**	**533.2**	**214.1**	**308.6**	**82.9**	**163.6**	**41.1**	**100.6**	**697.3**	**1106**
Provincial Taxes	36.8	90.1	26.8	50.1	3.5	15.5	1.4	5.8	68.6	161.5
Share in Federal Taxes	322.4	443.1	187.3	258.5	79.4	148	39.7	94.8	628.8	944.5
B. Non-Tax Revenue	**36.8**	**29**	**13.8**	**308.6**	**4.7**	**3.2**	**1.3**	**2.9**	**56.7**	**53.8**
C. All Others	**26.9**	**7.6**	**17.9**	**12.1**	**40**	**32.7**	**31.5**	**20.4**	**116.2**	**72.8**
Total Revenues (A+B+C)	**422.9**	**569.9**	**245.8**	**339.3**	**127.6**	**199.5**	**74**	**123.9**	**870.2**	**1232.6**

Items	Punjab		Sindh		KPK		Baluchistan		Total	
	2009-10 RE	2010-11 BE	2009-10 RE	2010-11 BE	2009-10 RE	2010-11 BE	2009-10 RE	2010-11 BE	2009-10 RE	2010-11 BE
a) Current Expenditure	**318.2**	**386.8**	**224.8**	**268.3**	**109**	**127**	**52.7**	**83.4**	**704.8**	**865.5**
b) Development Expenditure	**134.7**	**193.5**	**83.5**	**135.1**	**46.3**	**69.3**	**27.2**	**26.3**	**291.8**	**424.2**
i) Rev. Account	80.8	100.1	21.8	21.2	9.8	11.5	0	0	112.3	132.7
ii) Cap. Acount	54	93.4	61.7	113.9	36.5	57.8	27.2	26.3	179.5	291.5
Total Exp (a+b)	**453**	**580.3**	**308.3**	**403.3**	**155.3**	**196.3**	**79.9**	**109.8**	**996.6**	**1289.7**

Source: Provincial Finance Wing, Ministry of Finance

The overall provincial revenue receipts for 2010-11 are estimated at Rs1233 billion, which is up by 42 percent compared to last year. However, total revenue of the provinces registered a growth of 20 percent in 2009-10 as compared to 18 percent in 2008-09. The accelerated growth was mainly due to increase in provincial share in federal revenues under new NFC award and of combined with federal and foreign developmental grants to the provinces.

Table 4.8: 3-Years Overview of Provincial Budget **(Growth)**

	2007-08	2008-09	2009-10	FY09	FY10
A. Total Tax Revenue	**504.1**	**612**	**697.3**	21.4	13.9
Provincial Taxes	50.3	57.3	68.6	13.9	19.7
Share in Federal Taxes	453.8	554.7	628.8	22.2	13.4
B. Non-Tax Revenue	**59.6**	**58**	**56.7**	-2.7	-2.2
C. All Others	**48.2**	**52.9**	**116.2**	9.8	119.7
Total Revenues (A+B+C)	**611.9**	**722.8**	**870.2**	18.1	20.4
a) Current Expenditure	**497.5**	**688.9**	**704.8**	38.5	2.3
b) Development Expenditure	**262**	**314**	**291.8**	19.8	-7.1
i) Rev. Account	99.1	118.1	112.3	19.2	-4.9
ii) Cap. Acount	162.9	195.9	179.5	20.3	-8.4
Total Exp (a+b)	**759.5**	**1002.9**	**996.5**	32.0	-0.6

Despite a significant growth in total revenues, the consolidated fiscal balance deteriorated in 2009-10 since an exceptional growth in total expenditure has outpaced revenue growth. Province-wise breakup reveals that the rise in overall balance was entirely generated by Punjab and Sindh. On the other hand KPK managed to have a surplus balance on account of a large sum in received in the form of federal loans and grants along with the profit from hydro electricity.

Allocation of Revenues between the Federal Government & Provinces

Fiscal decentralization or decision making at lower level is believed to be an effective strategy to promote economic growth and development. It is the empowerment of fiscal responsibilities to the sub-national governments, involving devolution of powers to tax and spend along with arrangements for correcting the imbalances between resources and obligations. The distribution of resources and fiscal equalization transfers are a controversial issue around the world. However in Pakistan, significant efforts have been made in order to restructure the balance between the federal and provinces. The 7th NFC award is the major development under which the share of the provinces increased from 45 percent during 2009-10 to 56 percent in 2010-11 and it would increase to 57.5 percent in the remaining period of the NFC award. While the share of the federal government in the net proceeds of divisible pool stood at 44 percent in 2010-11, while it will remain at 42.5 percent in 2011-12 onwards.

Table 4.9: Transfers to Provinces (NET) **(Rs. Billion)**

	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11B
Divisible Pool	204.8	244.6	320.6	391.3	477.4	574.1	865.8
Straight Transfer	40.5	56.8	70.3	65.9	82.4	81.2	167.9
Special Grants/ Subventions	35.3	63.5	29.3	33.3	40.6	82.0	54.4
Project Aid	15.5	17.5	16.8	19.1	26.3	16.0	31.4
Agriculture Sector Loan-II	1.4	2.8	2.6	1.1	0.0	0.0	0.0
Japanese Grant	0.1	0.1	0.1	0.0	0.0	0.0	0.1
Total Transfer to Province	**297.6**	**385.2**	**439.7**	**510.8**	**626.8**	753.3	1,119.5
Interest Payment	24.3	21.6	18.0	19.9	18.5	18.7	16.6
Loan Repayment	28.7	14.7	40.2	25.4	21.0	24.0	25.9
Transfer to Province(Net)	**244.6**	**348.9**	**381.5**	**465.6**	**587.3**	710.6	1,077.0

Source: Budget in Brief,2009-10

In the 7th NFC award, the distribution of the resources has been made on a multiple criteria which consist of population (82%), poverty/backwardness (10.3%), revenue collection/ generation (5.0%) and area or inverse population density (2.7%). Hence, the transfers to provinces has been projected to increase to Rs 1,077 billion, an increase of 51.6 percent in the 2010-11 over the actual transfer of Rs 710.6 billion in 2009-10.