Chapter 4

Fiscal Development

Fiscal Development

Fiscal policy significantly impacts the economic direction of any country through various measures such as taxation, public expenditures and public borrowing. The effectual implementation and adjustment of these fiscal measures determines the resource allocation, its distribution, economic stabilization and development. Therefore, sound fiscal policy is considered to be a decisive component not only for a sustainable economic growth but also for better fiscal management both in developed and developing countries. It has also been recognized that better fiscal management can effectively mobilize savings and efficiently allocate the resources to achieve the development goals.

Global economic downturn 2008-09, intensely affected the countries across the world, however emerging economies constricted significantly less than advanced economies mostly because of sound macroeconomic and financial policies. Their stronger fiscal position helped them to attain enough fiscal space to implement packages to offset the contraction in the world economy.

On the other hand, hostile fiscal developments, particularly increasing debt levels in most of the advanced economies in the aftermath of financial crisis exemplified the importance of long term fiscal sustainability for macroeconomic stability. Nonetheless, measures to improve fiscal sustainability in EU supported the revival of fragile global economic conditions in third and fourth quarter of 2012 along with the accelerated growth in emerging economies. It has also contributed to stabilize the financial conditions along with the decline in bond spreads in the Euro area, while prices for many risky assets particularly equities rose globally.

Accordingly, short-term fiscal risks also lowered in advanced countries due to gradual decline in deficits. Fiscal deficit in advanced economies declined by 0.75 percent to 5.9 percent of GDP in 2012 as compared to 6.6 percent of GDP in 2011 and is projected to decline further by 1.2 percent to 4.7 percent of GDP in 2013. While the global economic growth is projected to increase by 3.3 percent in 2013 against 3.2 percent in 2012.

Recent recovery is characterized by three speed recovery due to rising bifurcation between the US and the Euro area on one hand and strong economic conditions in emerging and developing economies on the other. Despite the fact that the biggest short term risks to global economy (euro area breakup and a sharp fiscal contraction in the US) have been neutralized successfully, still advanced economies are confronting with the challenge of balanced and sustained fiscal consolidation and continuation of financial sector reforms in order to decrease the risks in the financial system. It is expected that addressing these two main challenges will help in reducing the downside risks.

Pakistan economy is no exception to global economic uncertainties and challenges for sustained fiscal consolidation efforts. However during the past five years the economy faced myriad challenges on external and internal front including power crisis, persistent inflationary pressures, ,unprecedented floods , low tax to GDP ratio, high fiscal deficit, mounting public debt, high interest payments, high growth in subsidies on account of circular debt and resource drain through PSEs. The efforts to achieve fiscal sustainability were challenged as the expenditure overrun surpassed the revenue increases. Moreover, delays in key reforms for revenue mobilization owing to unfavorable external and internal environment also contributed in fiscal predicament. Despite all these challenges the economy performed well while recognizing this fact that to move out from high level of debts and to ease the fiscal burden, raising tax revenues and lowering government spending is vital. Therefore, the fiscal consolidation efforts remained at the top of macroeconomic agenda through prudent expenditure management and better resource mobilization.

Fiscal deficit was successfully brought down from 7.3 percent in 2007-08 to 5.2 percent in 2008-09 as a result of government's effort to attain fiscal discipline under IMF Stand by Arrangement Program (SBA). Whereas in 2010-11, it rose to 6.5 percent on account of multiple factors including lower revenue generation, security spending together with electricity subsidies. Additionally, unprecedented floods in 2010 and torrential rains in 2011 and energy crises jeopardized government's efforts; resultantly revenue and expenditure targets were missed. But it is worth noting that amid mounting pressures on public spending, government's various corrective measures during the past five years to rationalize expenditure and broadening of tax base have brought fiscal deficit to 6.8 percent from 7.3 percent ,expenditures were brought down and revenues posted a reasonable growth over previous years. Total expenditures declined from 21.4 percent of GDP in 2007-08 to 19.6 percent of GDP in 2011-12. Similarly, to keep the fiscal deficit at sustainable level, containment of current expenditures was also targeted by adopting austerity measures as current expenditures reduced to 15.5 percent of GDP in 2011-12 from 17.4 percent of GDP in 2007-08. On the other hand various tax measures helped FBR to collect Rs. 1883 billion in fiscal year 2011-12 against Rs. 1,008 billion in 2007-08. Thus FBR tax collection showed a tremendous growth of 86.8 percent since 2007-08.During July-March, 2012-13, FBR collection reached to Rs.1,352.3 billion against Rs 1,280.4 billion in the same period last year, posting a growth of 5.6 percent.

Fiscal Policy Development

It has been widely recognized that a prudent fiscal policy (low level of fiscal deficit and public debt) plays a significant role not only in reducing the risks of economic crisis but can also improve country's fiscal capacity to finance larger fiscal deficit without endangering economic stability and debt sustainability. Since the inception of global financial crisis in 2008-09, countries around the world dealt with the issue of consolidating their budgets while at the same time sustaining the economic growth. However, recent improvement in global economic situation has somewhat lowered short-term fiscal risks. Still concentrated efforts are required to contain the spending at reasonable level.

Over the years, Pakistan's fiscal policy remained under immense pressure owing to continued security related issues, greater than targeted subsidies, flood related expenses and global financial crisis. Although, Pakistan's economy was not directly affected from financial crisis, however, in confluence with unplanned expenditures mentioned above during the past five years resulted in mounting fiscal pressures. Besides, the government borrowed heavily from external and internal resources in order to finance the fiscal deficit, due to which a huge amount of money was paid towards interest payments. All these factors relentlessly affected Pakistan's fiscal capacity to finance the fiscal deficit. Nevertheless, during the past three years the efforts to contain the fiscal deficit within reasonable limit through an expenditure management strategy, austerity measures and reforms in Public Sector enterprises (Box-1) have yielded the result. Moreover, during past two years the government consolidated the outstanding power sector debt of worth Rs. 511 billion (Rs 120 billion in 2010-11 and Rs 391 billion in 2011-12.). This one of settlement during 2010-11 and 2011-12 will be helpful in making substantial savings on interest payments in coming year.

Box-1:
Public Sector Enterprises

The restructuring of Public Sector Enterprises (PSEs) has been initiated for improving economic and financial governance, with the focus on the three large PSEs – Pakistan Steel Mills (PSM), Pakistan Railway (PR) and Pakistan International Airlines (PIA). Key aspects of restructuring model include (i) restructuring Boards of Directors (BoDs) of PSEs; (ii) inducting professional management including CEOs, CFOs and key managers; (iii) developing viable turn around plans; (iv) ensuring implementation of plans in an independent manner with the support of government under the mandate of Cabinet Committee on Restructuring (CCOR).

The BoDs of PSM has been reconstituted and a new CEO has also been appointed. Its immediate financial needs have been addressed through a bailout package of Rs. 14.6 billion for FY13. New business plan of PSM is focused on maximum utilization of capacity and a path of achieving breakeven point. Smooth availability of raw materials to PSM is being ensured to ensure future profitability. Quarterly releases are being made based on achievement of KPIs as agreed in the Business Plan. The BoDs of PR has been reconstituted with involvement of high caliber professionals. Credit line of PR from Pakistan State Oil has been enhanced to ensure smooth supply, while an asset management company has been established for optimum utilization of PR's assets. Private Sector involvement is the focus moving forward with trains being run under Public Private Partnership. Financial viability is being pursued through improving revenue and support by the Government both through grant and allocation of Public Sector Development Program. A new CEO of PIAC has been appointed and afive year Business Plan has been developed, which envisages introduction of fuel efficient aircrafts, route rationalization, separation of core and noncore activities and human resource rationalization with the objective of making PIAC a sustainable and profitable entity in the long run. The cornerstone of the business plan is a shift in strategy from high capacity, low frequency operations to high frequency optimum capacity operations. The five year plan provides an overall picture of financial position and future prospects based on operational strategies being implemented in these focal areas and would require continued financial support from the government to succeed.

Given the difficult international and domestic economic environment during the past five years, fiscal position deteriorated in terms of key fiscal indicators such as revenues, expenditures and fiscal deficit. As shown in Table 4.1, total expenditures as percentage of GDP remained volatile on account of unplanned expenditures since 2007-08. Apart from security and flood related expenditures, subsidies in power and electricity and interest payments also consumed significant amount of Government's revenue. Additionally, loss making PSEs has also drained budgetary funds from productive uses.

Consequently, mounting pressures to finance the budget due to unplanned expenditures especially in the presence of limited foreign assistance and persistent shortfall in revenues brought various challenges for the fiscal authorities to keep the budget deficit within the reasonable limits. Moreover structural deficiencies in the tax system also contributed to create the considerable deviation in fiscal deficit from its original target. Therefore, budgetary management during the past few years remained heavily on the containment of investment spending and borrowing from the banking system. This along with other factors contributed significantly in the slowdown of economic growth.

Table 4.1: Fiscal Indicators as Percent of GDP

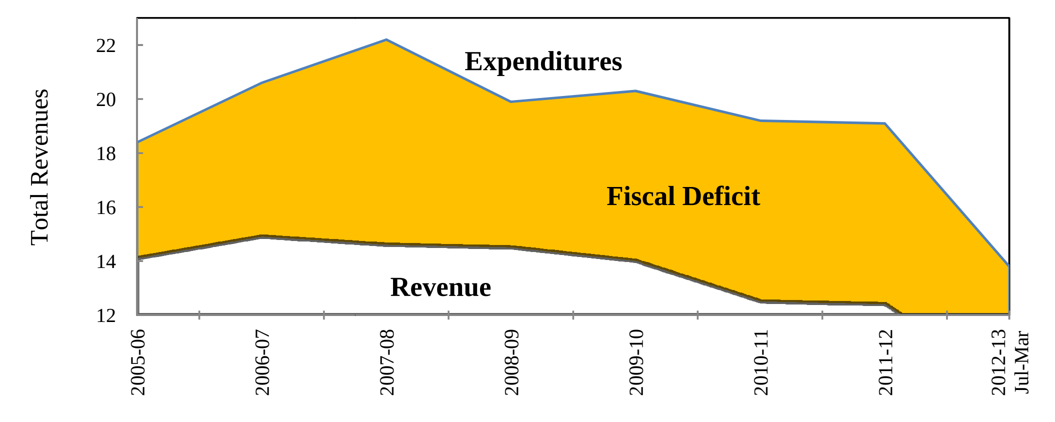
Year	Real GDP Growth	Overall Fiscal Deficit	Expenditure			Revenue		
			Total	Current	Development	Total Rev.	Tax	Non-Tax
2006-07	5.5	4.1	19.5	14.9	4.7	14.0	9.6	4.4
2007-08	5.0	7.3	21.4	17.4	4.2	14.1	9.9	4.2
2008-09	0.4	5.2	19.2	15.5	3.6	14.0	9.1	4.9
2009-10	2.6	6.2	20.2	16.7	3.5	14.0	10.1	3.9
2010-11	3.7	6.5	18.9	15.9	2.8	12.4	9.3	3.0
2011-12	4.4	6.8	19.6	15.5	3.6	12.8	10.3	2.4
2012-13 B.E	3.6*	4.7	19.0	14.6	4.4	14.3	11.1	3.2

*: Real GDP estimated for 2012-13

Note 1: The base of Pakistan's GDP has been changed from 1999-2000 to 2005-06.

All the key fiscal indicators surpassed their budgeted targets set for relevant years, however several efforts to contain the expenditures and to increase the revenues during past five years resulted in significant decline of fiscal deficit from 7.3 percent of GDP in 2007-08 to 6.8 percent of GDP in 2011-12. Total expenditures as percentage of GDP declined from 21.4 percent in 2007-08 to 19.6 percent of GDP in 2011-12. It is expected to decline further by 0.6 percentage point to 19.0 percent in 2012-13. In total expenditures, current expenditures were contained at 15.5 percent of GDP in 2011-12 from 17.4 percent in 2007-08, while it is expected to decline further in 2012-13 at 14.6 percent of GDP. On the other hand development expenditures stood at 3.6 percent in 2011-12 as compared to 4.2 percent of GDP in 2007-08. It is expected to rise by 4.4 percent in 2012-13. Out of total development expenditures, Rs 873 billion was earmarked to PSDP (allocation of Rs 360 billion to federal government and Rs 513 billion to provincial government). On the revenue side, tax to GDP ratio remained within the narrow band of 9.1 to 10.3 percent since 2007-08 to 2011-12. Total revenues declined from 14.1 percent in 2007-08 to 12.8 percent in 2011-12 on account of decline in non-tax revenues from 4.2 percent in 2007-08 to 2.4 percent of GDP in 2011-12. However, total revenues are expected to increase by 14.3 percent in 2012-13 owing to increase in tax revenues up to 11.1 percent and non-tax revenues up to 3.2 percent of GDP in 2012-13. The figure 4.1 reflects the widening of fiscal deficit during the past 5 years due to decrease in revenues and increase in expenditures.

Fig: 4.1-Fiscal Deficit



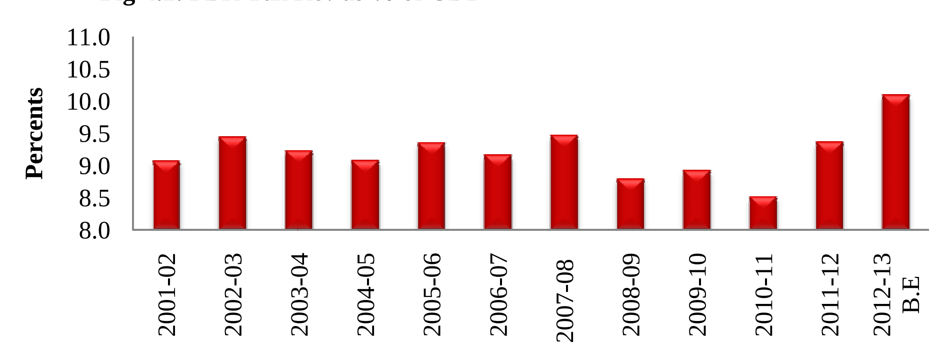
Structure of Tax Revenue

A well designed tax structure of the country not only improves the economic and industrial competitiveness but also contributes toward stimulating industrial activity and accordingly growth in the economy. The strong base of a tax system provides a more stable source of income needed to finance the public expenditure with an aim to relieve poverty and deliver public services. Historically, Pakistan's tax system undermined due to structural weaknesses like narrow tax base, massive tax evasion and administrative weaknesses etc. These structural weaknesses have taken a toll on overall tax collection as the country has witnessed a lowest tax-to GDP ratio not only in the developing countries but also within the region.

Despite the increase in tax revenues, FBR tax to GDP ratio varied between 8.5 to 9.6 percent during the past 12 years. During July-April, 2012-13 FBR tax to GDP ratio stood at 6.6 percent against 7.1 percent recorded in the same period last year.

Present tax structure of Pakistan is distortionary and incentivizing massive tax evasion. Additionally, some sectors are under taxed and some are not taxed at all which reflects the narrow tax base. In particular, there is a least contribution in taxes from the major sectors of our economy (agriculture and services), as agriculture is contributing 2.5 percent in tax against its 21.4 percent share in GDP, while services sector is contributing 36.7 percent against its major share in GDP i.e. 57.7 percent. There is a broad consensus that tax to GDP ratio can only be enhanced if all sectors of economy contribute proportionately toward tax revenue.

Fig-4.2: FBR Tax Rev as % of GDP



Tax structure in Pakistan has witnessed substantial changes over the years as the share of direct tax increased from 35.3 percent in 2001-02 to 39.2 percent in 2011-12 and is expected to increase further by 39.1 percent in 2012-13. Sales tax share in total tax collection increased from 41.2 percent in 2001-02 to 43.0 percent in 2011-12. Share of Custom duty in indirect taxes has increased from

18.3 percent in 2001-02 to 19.0 percent in 2011-12, whereas it is expected to decrease by 17.1 percent in 2012-13. On the other hand the share of excise duty in indirect taxes has declined from 18 percent in 2001-02 to 10.7 in 2011-12 and it is expected to decline further by 8.0 percent in 2012-13. Sales tax as an important consumption tax accounts for 74.3 percent of indirect taxes.

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
2001-02	404.1	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	151.9	68.8	195.1	44.8	308.7
			[33.0]	{22.3}	{63.2}	{14.5}	[67.0]
2003-04	520.9	9.2	165.1	91.0	219.2	45.6	355.8
			[31.7]	{25.6}	{61.6}	{12.8}	[68.3]
2004-05	590.4	8.9	183.4	115.4	238.5	53.1	407.0
			[30.1]	{28.4}	{58.6}	{13.0}	[68.9]
2005-06	713.5	9.4	225.0	138.4	294.8	55.3	488.5
			[31.5]	{28.3}	{60.3}	{11.3}	[68.5]
2006-07	847.2	9.2	333.7	132.3	309.4	71.8	513.5
			[39.4]	{25.8}	{60.3}	{14.0}	[60.6]
2007-08	1,008.1	9.5	387.9	150.7	377.4	92.1	620.2
			[38.5]	{24.3}	{60.9}	{14.9}	[61.5]
2008-09	1,161.1	8.8	443.5	148.4	451.7	117.5	717.6
			[38.2]	{20.7}	{62.9}	{16.4}	[61.8]
2009-10	1,327.4	8.9	526.0	160.3	516.3	124.8	801.4
			[39.6]	{20.0}	{64.4}	{15.6}	[60.4]
2010-11	1,558.2	8.5	602.5	184.9	633.4	137.4	955.7
			[38.7]	{19.3}	{66.3}	{14.4}	[61.3]
2011-12	1,882.7	9.4	738.4	216.9	804.9	122.5	1,144.3
			[39.2]	{19.0}	{70.3}	{10.7}	[60.8]
2012-13 B.E	2,381.0	10.1	932.0	247.5	1076.5	125.0	1,449.0
			[39.1]	{17.1}	{74.3}	{8.0}	[60.9]

[]as % of total taxes

Source: Federal Board of Revenue

{} as % of indirect taxes

In order to increase the tax revenues as percentage of GDP, Pakistan tax policy should be focused on increasing the buoyancy of tax system, broadening the tax base, reducing distortions and phasing out exemptions. It is therefore during the past few years the government has taken various measures to increase revenues through various initiatives. Sales tax rate has been reduced from 17 percent to 16 percent, all special excise duties have been removed, 392 regulatory duties have been abolished and major rationalization in excise duties; Federal Excise Duties have been eliminated or rates decreased. Moreover, during the current year various measures to increase the revenues expected to generate additional tax revenues of Rs 41 billion (Box-2)

Box-2:
Revenue measures during 2012-13

- The sectors with zero rating facility have been brought under tax as 2 percent sales tax was imposed on local supplies of five leading export sectors (Sports, Surgical, Carpet, Textile and Leather.
- Standardized withholding tax regime at the import stage by imposing a uniform rate of 5 percent tax on the imports of commercial and industrial importers, mobile telephone sets, silver, all fibers, yarns, fabrics and goods covered by the five leading export sectors.
- Broadening of Sales tax Withholding regime.
- Withdrawal of concessionary rate of 5 percent on tea.
- Enhance scrutiny sales tax refund.

- Review of sales tax regime on mobile phones.
- Enhancement of rate from 2 to 5 percent on import of cooking oil/vegetable ghee.
- Clearance of smuggled vehicle.

Review of Public Expenditures

Public expenditures can play an important role in physical and human capital formation over time and can be a effective tool in boosting economic growth. In Pakistan, public expenditures remained under great pressure during the past five years.

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

Year	Total Exp. (A)	Current Exp. (B)	Interest Payments (C)	Defence (D)	Development Exp (E)	Non Interest Non-DefenceExp (A-C-D)	Fiscal Deficit	Revenue Deficit/Surplus (TR-Total CE)	Primary deficit (TR-NI Exp)
2006-07	19.5	14.9	4.2	2.7	4.7	12.6	4.1	-0.8	-1.2
2007-08	21.4	17.4	4.8	2.6	4.2	14.0	7.3	-3.3	-2.5
2008-09	19.2	15.5	5.0	2.5	3.6	11.7	5.2	-1.4	-0.2
2009-10	20.2	16.7	4.4	2.5	3.5	13.3	6.2	-2.7	-1.8
2010-11	18.9	15.9	3.9	2.5	2.8	12.5	6.5	-3.5	-2.6
2011-12	19.6	15.5	4.5	2.5	3.6	12.6	6.8	-2.8	-2.3
2012-13B	19.0	14.6	4.0	2.3	4.4	12.7	4.7	-0.3	-0.7

B: Budgeted
* Excluding Rs 120 billion in 2010-11 and Rs 391 billion in 2011-12 on account of debt Consolidation.

During the past few years, greater than targeted budget deficit together with deficit financing from domestic sources, has resulted in a sharp increase in interest expenditures. Interest payments have increased from Rs.716.6 billion or 3.9 percent of GDP in 2010-11 to Rs.901.9 billion or 4.5 percent of GDP in 2011-12. As percent of the current expenditure it stood at 28.9 percent during 2011-12. It is expected to reduce by 4.0 percent of GDP in 2012-13. The rise in interest payments during the period indicates the growing unsustainability of the fiscal account.

The other major fiscal leakage is subsidies to loss-making PSEs and the power sector. During July-March, 2012-13 actual disbursement against the budgeted subsidy of Rs.208.6 billion stood at Rs.270 billion, thus already surpassed the target by Rs.61.4 billion in first nine months of current fiscal year. It is expected to increase further due to loss making PSEs and the persistent rise in circular debt in the power sector.

Contrary to it, expenditures like pension payments, defense, and PSDP remained under control. Total expenditures (TE) amounted to Rs.3,937.8 billion or 19.6 percent of GDP in 2011-12 as compared to Rs. 3,455.1 billion or 18.9 percent of GDP in 2010-11. It is budgeted to remain at Rs 4,484.2 billion or 19.0 percent of GDP.

Current expenditures (CE) are expected to remain at Rs.3,452.2 billion or 14.6 percent of GDP in 2012-13. During the fiscal year 2011-12, CE were Rs. 3,122.5 billion or 15.5 percent of GDP as compared to Rs. 2,900.8 billion or 15.9 percent of GDP in 2010-11. Development expenditures (DE) in fiscal year 2011-12 reached to Rs.731.9 billion or 3.6 percent of GDP against Rs.506.1 billion or 2.8 percent of GDP in 2010-11. During 2012-13, DE is expected to remain at Rs.1,032.0 billion or 4.4 percent of GDP.

The share of current expenditures in total expenditures has declined significantly from 84.0 percent in 2010-11 to 79.3 percent in 2011-12. It is expected to decline further by 2.3 percentage point to 77.0 percent in 2012-13 on account of expected decline in interest payments and defence expenditures. Defence expenditures account for 16.2 percent of current expenditures in 2011-12 against 15.5 percent in 2010-11. In the current fiscal year it is expected to reduce by 0.4 percentage points to 15.8 percent.

Fiscal performance

According to the consolidated revenue and expenditure statement of the government, total revenues grew by 22.6 percent during July-March, 2012-13 and stood at Rs. 2,141.9 billion compared to 1,747.0 billion in the same period last year. The total collection in tax revenues amounted to Rs.

1,557.6 billion against Rs. 1,393.9 billion in the same period last year, posted a growth of 11.5 percent. It was mainly on account of insignificant growth in federal tax revenues which are recorded at 8.4 percent, of which FBR tax revenues increased by only 5.6 percent during July-March, 2012-13. While the remaining growth was contributed by the receipts from Petroleum Development Levy as it stood at Rs. 81.0 billion during July-March 2012-13 against Rs.38.2 billion during the same period last year.

Table 4.4 Consolidated Revenue & Expenditure of the Government

	Budget Estimates 2012-13	Prov. Actual		Growth
		July-March 2011-12	July-March 2012-13	July-March 2012-13
A. Total Revenue	**3,378.5**	**1,747.0**	**2,141.9**	**22.6**
a) Tax Revenue	**2,614.5**	**1,393.9**	**1,557.6**	**11.5**
Federal	**2,534.5**	**1,336.2**	**1,448.0**	**8.4**
of which FBR Revenues	2,381.0	1,280.4	1,352.3	**5.6**
Provincial Tax Revenue	80.0	**57.6**	109.6	**90.3**
b) Non-Tax Revenue	**764.0**	**353.2**	**584.3**	**65.4**
B. Total Expenditure	**4,484.2**	**2,641.9**	**3,188.1**	**20.7**
a) Current Expenditure	**3,452.2**	**2,154.1**	**2,642.0**	**22.6**
Federal	**2,339.2**	**1,478.7**	**1,887.1**	**27.6**
- Interest	925.8	**624.5**	772.2	**23.7**
- Defense	545.4	**348.0**	405.8	**16.6**
Provincial	1,113.0	**675.4**	**754.9**	**11.8**
b) Development Expenditure & net lending	**1,032.0**	**428.0**	**445.8**	**4.2**
PSDP	**873.0**	**375.6**	**407.4**	**8.5**
Other Development	**154.3**	**45.4**	**37.3**	**-17.8**
c) Net Lending	**4.7**	**6.9**	**1.1**	**-84.1**
C. Overall Fiscal Deficit	**1,105.7**	**894.9***	**1,046.2**	**16.9**
As % of GDP	4.7	**4.5**	4.6	**-**
Financing of Fiscal Deficit	**1,105.7**	**894.9**	1,046.2	**16.9**
i) External Sources	134.9	**47.4**	-4.1	**-108.6**
ii) Domestic	**970.8**	**847.5**	**1,050.3**	**23.9**
- Bank	483.8	**443.8**	856.7	**93.0**
- Non-Bank	487.0	**403.7**	193.7	**-52.0**
GDP at Market Prices	**23,655**	**20,091**	**22,909**	**14.0**

Source: EA wing calculations and Budget Wing, Finance Division
Note: Gas development surcharge is included in tax revenues.
* Excluding one of payment of Rs.391 billion on account of debt consolidation.

FBR tax collection was severely affected during July-March, 2012-13 on account of number of exemptions, tax evasion, and fake claims for refunds and rebates as well as power and gas shortages affected manufacturing sector to perform less to their capacity utilization. Moreover, the growth in automobile sector remained negative due to import of second hand cars as well allowing smuggled vehicles. Additionally, collection of sales tax on services has also been devolved to the provincial government.

On the other hand non tax revenues posted a growth of 65.4 percent as it stood at Rs.584.3 billion during July-March, 2012-13 against Rs.353.2 billion in the comparable period last year. Better yields from oil and gas revenues, dividend, defence services, newly imposed gas development infrastructure cess and central bank profits were the main contributors in high returns from non-tax revenues, consequently overall revenue to GDP ratio increased to 2.6 percent in the first nine months of current fiscal year against 1.8 percent last year.

Total expenditures posted a growth of 20.7 percent as it is amounted to Rs. 3,188.1 billion during July-March, 2012-13 against Rs.2,641.9 billion in the same period last year on account of high interest payment. During the past few years, persistently high budget deficit compelled the government to borrow from domestic sources to finance the budget led to a sharp rise in interest payments. During July-March, 2012-13 interest payments stood at Rs. 772.2 billion against Rs.624.5 billion in the comparable period last year, thus posted a growth of 23.7 percent.

The overall fiscal deficits during the period under review increased to Rs. 1,046.2 billion against Rs.894.9 billion. As percentage of GDP, it registered a slight increase of 0.1 percentage points to 4.6 percent from 4.5 percent of GDP during July-March, 2011-12. However, consolidated fiscal deficit during July-March, 2011-12 has been recorded at 6.4 percent of GDP including 1.9 percent debt consolidation of Rs 391 billion arrears of electricity. The fiscal deficit remained within the reasonable limits owing to Rs 103.0billion provincial budget surpluses and $1.8 billion reimbursed by the US under Coalition Support Fund (CSF).

External sources to finance the budget deficit declined by more than 100 percent, consequently during the current fiscal year, the entire budget deficit was financed through domestic sources, particularly the banking system as it increased by 23.9 percent during July-March, 2012-13. The resource mobilization through non-bank sources reduced significantly owing to decline in holdings of treasury bills by the institutional investors.

FBR Tax Collection

FBR tax collection for the fiscal year 2012-13 was targeted at Rs.2,381 billion which was 26.4 percent higher over the actual collection of Rs.1883.0 billion during 2011-12.

During the first ten months of 2012-13 registered a weak growth of 5.5 percent in FBR tax collection due to energy/gas shortages, security issues, failure to implement tax reforms and decline in imports. The total collection stood at Rs.1,505.3 billion against Rs.1,426.2 billion during same period last year. Achievement of the current target is contingent upon not only on better economic conditions but effective implementation of tax administration reforms is also crucial.

Table 4.5: FBR Tax Revenues (Rs. Billion)

Revenue Heads	2011-12	July-April		% Change
		2011-12	2012-13	
A. DIRECT TAXES				
Gross		607.9	596.7	-1.8
Refund/Rebate		79.0	43.0	
Net	**738.4**	**528.9**	**553.7**	4.7
B. INDIRECT TAXES				
Gross		943.6	989.3	4.8
Refund/Rebate		46.3	37.7	
Net	**1,144.3**	**897.3**	**951.6**	6.1
B.1 SALES TAX				
Gross		673.2	697.2	3.6
Refund/Rebate		38.0	27.8	
Net	**804.9**	**635.2**	**669.4**	5.4
B.2 FEDERAL EXCISE				
Gross		95.8	91.2	-4.8
Refund/Rebate		0.2	0.4	
Net	**122.5**	**95.6**	**90.8**	-5.0
B.3 CUSTOM				
Gross		174.6	200.9	15.1
Refund/Rebate		8.1	9.5	
Net	**216.9**	**166.5**	**191.4**	15.0
TOTAL TAX COLLECTION				
Gross		1551.5	1586.0	2.2
Refund/Rebate		125.3	80.7	
Net	**1,882.7**	**1426.2**	**1505.3**	5.5

Source: FBR

Direct Taxes

The net collection of direct taxes has registered a growth of 4.7 percent during July-April, 2012-13, while the gross collection witnessed a decline of 1.8 percent during the period under review. Bulk of the tax revenues of direct taxes were realized from income tax. The net collection has gone up from Rs.528.9 billion to Rs 553.7 billion. Major revenue spinners of direct taxes are withholding tax, voluntary payments and collection on demand.

Indirect Taxes

The gross and net collections of indirect taxes have witnessed a growth of 4.8 and 6.1 percent respectively. It has accounted for around 63 percent of the total FBR tax revenues.

Within indirect taxes, growth in net collection of sales tax increased by 5.4 percent. The gross and net sales tax collection during July-April, 2012-13 stood at Rs. 697.2 billion and Rs.669.4 billion respectively posting a growth of 3.6 and 5.4 percent respectively over the corresponding period of 2011-12. The growth in sales tax was significantly affected due to the transfer of services to provinces. In fact, around 52 percent of total sales tax was contributed by sales tax on import during July-April, 2012-13, while the rest was contributed by domestic sector. Within net domestic sales tax collection, the major contribution came from POL products, telecom services, natural gas, fertilizers, other services, sugar, cigarettes, beverages, cement, electrical energy etc. On the other hand, POL products, plastic, edible oil, fertilizers, iron and steel, vehicles, machinery, chemicals, oilseeds etc contributed significantly to the collection of sales tax from imports.

Custom duty collection has registered a growth of 15.1 and 15.0 percent in both gross and net terms respectively. The gross and net collection has increased from Rs.174.6 billion and Rs. 166.5 billion during July-April, 2011-12 to Rs.200.9 billion and Rs.191.4 billion respectively during July-April, 2012-13. The major revenue spinners of custom duty have been automobiles, edible oil, petroleum products, machinery, plastic, iron and steel, paper and paperboard etc.

The collection of Federal Excise Duties (FED) during July-April, 2012-13 has recorded a negative growth on account of withdrawal of excise duty on most of the petroleum products and perfumery & cosmetics. The net collection stood at Rs.90.8 billion during July-April, 2012-13 as compared to Rs.95.6 billion during the same period last year. The major revenue spinners of FED are cigarettes, cement, beverages, natural gas, and international travel services etc.

Provincial Budget

The total outlay of the four provincial budgets for 2012-13 stood at Rs.1,761.7 billion, 19.4 percent higher than the outlay of Rs.1,475.4 billion last year. Punjab witnessed the highest growth of 23.6 percent in budgetary outlay, followed by KPK (17.8 percent), Sindh (17.4 percent) and Baluchistan (9.5 percent). The overall provincial revenue receipt is estimated at Rs 1,804.3 billion for the fiscal year 2012-13, which is 22.4 percent compared to last year. The increase is mainly attributed to the transfer of GST on services to the provinces. During 2011-12 provincial revenues witnessed the growth of 25.1 percent.

Table 4.6: Overview of Provincial Budgets (Rs Billion)

Items	Punjab		Sindh		KPK		Baluchistan		Total	
	2011-12 RE	2012-13 BE	2011-12 RE	2012-13 BE	2011-12 RE	2012-13- BE	2011-12 RE	2012-13 BE	2011-12 RE	2012-13 BE
A. Tax Revenue	**621.4**	**758**	**345.5**	**419.5**	**183.6**	**222.6**	**104.4**	**125.9**	**1254.9**	**1526**
Provincial Taxes	44.3	55	64	73.1	3.6	4	5.7	5.4	**117.6**	**137.5**
GST on Services	36.6	40.5	25	32	8.9	8.9	3.7	4.1	**74.2**	**85.5**
Share in Federal Taxes	540.5	662.5	256.5	314.4	171.1	209.7	95	116.4	**1063.1**	**1303**
B. Non-Tax Revenue	**34.2**	**28.4**	**73.6**	**82.7**	**21.7**	**26**	**16.8**	**16.6**	**146.3**	**153.7**
C. All Others	**-16.7**	**-10.6**	**24.8**	**48.3**	**31.1**	**34.8**	**33.5**	**52.1**	**72.7**	**124.6**
Total Revenues (A+B+C)	**638.9**	**775.8**	**443.9**	**550.5**	**236.4**	**283.4**	**154.7**	**194.6**	**1473.9**	**1804.3**
a) Current Expenditure	**468**	**532.9**	**309.5**	**315.3**	**161**	**191.6**	**85.2**	**107.3**	**1023.7**	**1147.1**
b) Development	**165.5**	**250**	**156**	**231**	**84.5**	**97.6**	**45.7**	**36**	**451.7**	**614.6**

Table 4.6: Overview of Provincial Budgets (Rs Billion)

Items	Punjab		Sindh		KPK		Baluchistan		Total	
	2011-12 RE	2012-13 BE	2011-12 RE	2012-13 BE	2011-12 RE	2012-13- BE	2011-12 RE	2012-13 BE	2011-12 RE	2012-13 BE
Expenditure										
Total Exp (a+b)	**633.5**	**782.9**	**465.5**	**546.3**	**245.5**	**289.2**	**130.9**	**143.3**	**1475.4**	**1761.7**

Source: Provincial Finance Wing, Ministry of Finance

Allocation of Revenues between the Federal Government and Provinces

Fiscal decentralization policy aimed at delegating fiscal powers and responsibilities from the national to sub national governments in order to achieve economic efficiency, equality and macroeconomic stability. It also ensures effective governance through financial autonomy of provincial governments.

In Pakistan the resource distribution is made through the National finance Commission (NFC) award. Historically the resource distribution was based on the single criteria of population. Consequently the distribution of powers between the federation and provinces remained a critical issue. Recognizing the importance of other factors, 7th National Finance Commission accounted for revenue generation, poverty and inverse population density.

Table 4.7: Transfers to Provinces (NET) (Rs. Billion)

	2008-09	2009-10	2010-11	2011-12	2012-13 BE
Divisible Pool	477.4	574.1	834.7	1,063.1	1,303.0
Straight Transfer	82.4	81.2	163.0	145.6	155.9
Special Grants/ Subventions	40.6	82.0	54.1	53.9	56.7
Project Aid	26.3	16.0	21.9	47.8	66.0
Program Loans	0.0	0.0	0.0	4.6	10.8
Japanese Grant	0.0	0.0	0.1	0.7	0.8
Total Transfer to Province	**626.8**	**753.3**	**1,073.7**	**1,315.0**	**1,592.5**
Interest Payment	18.5	18.7	18.5	12.9	15.4
Loan Repayment	21.0	24.0	32.4	36.1	31.5
Transfer to Province(Net)	**587.3**	**710.6**	**1,022.8**	**1,266.0**	**1,545.5**

Source: Various issue of Budget in Brief

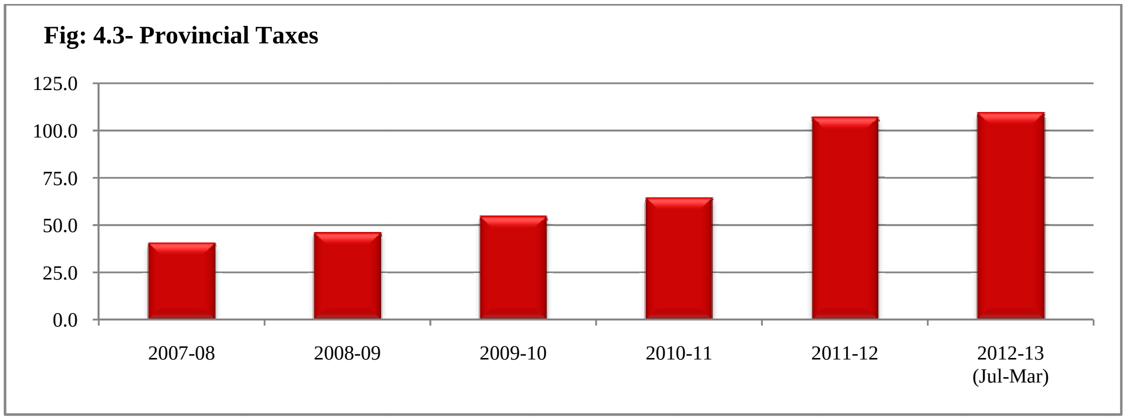
The most significant aspect of this award was that it has ensured the financial autonomy of the provinces by increasing their share in divisible pool from 50 percent to 56 percent in 2010-11 and 57.5 percent from 2011-12 onwards. According to the seventh NFC award, the distribution of the resources is based on multi-weighted criteria which consist of population (82 percent), poverty/backwardness (10.3 percent), revenue collection/generation (5.0 percent) and area or inverse population density (2.7 percent).

On the other hand share of federal government in the net proceeds of the divisible pool stood at 44 percent in 2010-11 and 42.5 percent from 2011-12 onwards. Total transfers to provinces have been projected to increase to Rs 1,545.5 billion: an increase of 22.1 percent in 2012-13 over the actual transfer of Rs 1,266.0 billion in 2011-12.

Table 4.8: 5-Years Overview of Provincial Fiscal Operations (Rs. Billion)

Items	2007-08	2008-09	2009-10	2010-11	2011-12	July-March	
						2012-13	2011-12
A. Tax Revenue	498.2	571.7	688.3	1,063.9	1,197.1	1,002.8	819.8
Provincial Taxes	40.8	46.1	54.8	64.6	107.2	109.6	57.6
Share in Federal Taxes	457.4	525.6	633.5	999.3	1,089.9	893.2	762.2
B. Non-Tax Revenue	78.0	83.8	67.9	62.3	48.0	49.0	36.0
C. All Others	91.0	95.0	120.0	85.1	88.6	73.7	76.2
Total Revenues (A+B+C)	667.2	750.5	876.2	1,211.3	1,333.7	1,125.5	932.0
a) Current Expenditure	457.0	564.2	646.2	831.2	980.6	766.3	687.1
b) Development Expenditure	214.1	201.8	258.4	245.6	375.4	219.9	175.0
Total Exp (a+b)	671.1	766.0	904.6	1,076.8	1,356.0	986.2	862.1

Figure 4.3 depicts the rising trend in provincial tax growth since 2007-08, particularly during first nine months of current fiscal year it posted a significant growth of 90.3 percent.



Major part of this growth achieved through the collection of sales tax on services by Punjab and Sindh. Similarly provinces received the significant amount of the federal government as their share from the divisible pool along with additional grants. Hence the provincial resource mobilization performed remarkably well during the first nine months of fiscal year 2012-13 with the growth rate of 20.8 percent as it stood at Rs.1,125.5 billion against Rs.932.0 billion in the same period last year.

Another significant feature of provincial fiscal operation is the containment of total expenditures, which reduced by 14.4 percent during July-March, 2012-13 on account of slow growth in current and development expenditures. On account of high revenues and decrease in expenditures, the provinces posted a surplus of Rs.103.3 billion during July-March, 2012-13.Punjab posted the surplus of Rs. 42.0 billion followed by Baluchistan (Rs.21.9 billion), Sindh (Rs.20.1 billion and KPK (Rs.19.3 billion).

Medium Term Budgetary Framework (MTBF)

This is the fourth year of budget preparation as per the Medium-Term Budgetary Framework (MTBF) reform, which started in 2009 after the approval of the Cabinet in February 2009. Progress has been made over the past three years in advancing the reform initiative. This includes adoption of the practice of preparation and submission for approval by Cabinet of any analytical Budget Strategy Paper, which is also shared with Parliamentary Standing Committees on Finance and Revenue and political parties. Under the reform initiative, an equally important element of performance based budgeting has been successfully implemented across the federal government. In addition to annual input (funding resources) based budget, the Finance Division also presents output (services to be rendered and their performance benchmarks) based budget to the Parliament each year in shape of a book called "Federal Medium-Term Budget Estimates for Service Delivery" (also known as MTBF Green Book).

The Green Book is a result of the reform agenda under which budget is made more comprehensive and linked to policy plans and service delivery performance of Principal Accounting Officers.

To review the performance defined in the MTBF Green Book, the Finance Division is enhancing its capacity to periodically monitor the budget spent together with the performance achieved by Ministries / Divisions of the federal government. For this purpose, the Finance Division is currently compiling "Government Performance Report" for the completed year 2011-12. This report will define expenditure against the original budget by services, and performance achieved against the defined plan. The Finance Division intends to circulate the report for the attention of the Cabinet and Parliamentary Standing Committees.

Future Roadmap

For the management of public finances the Finance Division has developed a draft 'Public Finance and Administration Act' that it intends to lay in the Parliament for enactment. The draft Act is proposed as per the Article 79 of the constitution that requires an Act to regulate public finances.

In addition, the Planning Commission intends to further improve the budgetary processes by introducing Results Based Management. The aim is to delegate the authority of planning and financial management to the Principal Accounting Officers and improve focus on achievement of results. In this regard, the Planning Commission is articulating; a) enhancement of its mandate to focus on national planning and not just the public sector projects, b) creation of a mechanism where Government organisations prepare ‘business plans’ harmonising both recurrent and development budgets but focusing on achievement of results, and these plans are thoroughly reviewed by Planning Commission and Finance Division before they are presented to Cabinet for approval, and c) to become an Apex monitoring and evaluation organization to regularly report performance of the Government against stated strategic plans. The MTBF provides fundamental platform to introduce Results Based Management, which has been approved as part of the New Framework for Growth by the National Economic Council in May 2011.

In addition, the Finance Division will take steps to enhance capacity of Parliamentary Standing Committees in review and oversight of the performance budget, and monitoring reports.