FISCAL DEVELOPMENT

I. Introduction

A sound fiscal position is an essential pre-requisite for achieving macroeconomic stability, which is increasingly recognized as a critical ingredient for promoting strong and sustained economic growth and lasting poverty reduction. A prudent fiscal management can mobilize domestic savings increase the efficiency of resource allocation and help meet development goals. A lax fiscal policy on the other hand, can lead to higher inflation, higher interest rates and crowding out of private investment, all of which hamper growth and poverty reduction. The importance of a sound fiscal policy therefore, cannot be overemphasized. Pakistan has experience serious macroeconomic imbalances in the decade of the 1990s mainly on account of its fiscal profligacy and accordingly paid a heavy price in terms of deceleration in economic growth and investment and associated rise in the levels of poverty. Considerable efforts have been made over the last seven years to inculcate financial discipline by pursuing a sound fiscal policy. Pakistan has succeeded in reducing fiscal deficit from an average of 7.0 percent of the GDP in the 1980s and 1990s to an average of 3.5 percent during the last seven years. The associated public debt also declined sharply from over 100 percent of GDP to 53 percent this year. Pakistan's hard earned macroeconomic stability is therefore, underpinned by fiscal discipline.

II. FISCAL POLICY DEVELOPMENTS

The fiscal policy stance remained decidedly growth-oriented yet prudent and sustainable with a focus on declining debt service, alleviating poverty and investing in infrastructure. Pakistan has made considerable progress in recent years on fiscal side. The overall fiscal deficit that averaged nearly 7.0 percent of the GDP in the 1990s has declined to 3.4 percent (excluding earthquake spending) in 2005-06. The underlying fiscal deficit is targeted at 3.7 percent of GDP (excluding earthquake spending) for the current fiscal year (2006-07) which is slightly higher than the deficit level of the previous year (3.4% of GDP). Higher deficit was targeted to finance higher public sector development program (PSDP), particularly towards financing infrastructure projects. Pakistan needs to strengthen its physical and human infrastructure to sustain growth momentum.

A cursory look at Table 5.1 reveals important structural shift in patterns of revenue and expenditures. On the revenue side, the tax-to-GDP or revenue-to-GDP exhibits a secular decline over the last one and a half decade. On the expenditure side, total expenditure and its components also exhibit a secular decline as percentage of GDP. Fiscal deficit as percent of GDP also declined substantially during the period. However, reduction in fiscal deficit owes mainly to sharper reduction in expenditure – more so to development expenditure – rather than improvement in revenue effort. Reduction in fiscal deficit since 1999-2000 owes partly to the improvement in revenue side and partly to the rationalization of expenditure – particularly in the shifting of expenditure from current to development and leaving the total expenditure to remain stagnant at around 18 percent of GDP. Going forward, a further reduction in fiscal deficit must come from improvement in revenue. The improvement in tax effort should not be limited to Federal Government alone. The Provincial Governments will have to do much more to enhance their provincial tax-to-GDP ratio from the current stagnant level of 0.5 percent to at least 1.0 percent of GDP in the medium-term.

Table 5.1: Fiscal Indicators as Percent of GDP

Year	GDP Growth	Fiscal Deficit	Expenditure Total	Expenditure Current	Expenditure Development	Revenue Total Revenue	Revenue Tax Revenue	Revenue Non-Tax
1990-91	5.4	8.8	25.7	19.3	6.4	16.9	12.7	4.2
1991-92	7.6	7.5	26.7	19.1	7.6	19.2	13.7	5.5
1992-93	2.1	8.1	26.2	20.5	5.7	18.1	13.4	4.7
1993-94	4.4	5.9	23.4	18.8	4.6	17.5	13.4	4.1
1994-95	5.1	5.6	22.9	18.5	4.4	17.3	13.8	3.5
1995-96	6.6	6.5	24.4	20.0	4.4	17.9	14.4	3.5
1996-97	1.7	6.4	22.3	18.8	3.5	15.8	13.4	2.4
1997-98	3.5	7.7	23.7	19.8	3.9	16.0	13.2	2.8
1998-99	4.2	6.1	22.0	18.6	3.4	15.9	13.3	2.7
1999-00	3.9	5.4	18.7	16.5	2.2	13.5	10.7	2.8
2000-01	1.8	4.3	17.2	15.5	1.7	13.3	10.6	2.7
2001-02	3.1	4.3	18.3	15.7	2.8	14.0	10.7	3.3
2002-03	4.8	3.7	18.5	16.2	2.2	14.8	11.4	3.4
2003-04	7.5	2.4	16.7	13.5	3.1	14.3	11.0	3.3
2004-05	9.0	3.3	17.2	13.3	3.9	13.8	10.1	3.7
2005-06	6.6	4.2*	18.5	13.6	4.8	14.2	10.6	3.6
2006-07 B	7.0	4.2*	17.6	12.7	4.9	13.4	10.5	2.8

B Budgeted *Source: Economic Survey Past issues*

Note: The base of Pakistan's GDP has been changed from 1980-81 to 1999-2000, therefore, wherever GDP appears in denominator the numbers prior to 1999-2000 are not comparable.

* Include earthquake expenditure of 0.8% and 0.5% of GDP, respectively

III. Tax and Tariff Reform

Adequate level of revenue generation is a *sine quo non* for the public policy to meet expenditure obligations. Inadequacy of revenue generation directly affects the government's resource position and the availability of socially desirable public goods. In Pakistan's economic history until fairly recently, the mismatch between revenue collection and budgetary requirement was a norm rather than an exception. Since the situation required radical changes, broad-based tax policy and administrative reforms were initiated by the Central Board of Revenue (CBR) to improve upon the resource mobilization effort and increase tax compliance by providing congenial environment to the taxpayers. Within parameters of structural weaknesses of tax structure, the government began wide-ranging tax and tariff reforms and worked on fiscal transparency, aimed at reducing tax rates, broadening the tax base to hitherto untaxed or under taxed sectors, and shifting the incidence of taxes from imports and investment to consumption and incomes. The tax and tariff reforms are aimed at simplification of tax system, improvement in resource mobilization, boosting economic activity to ensure robust economic growth, reducing the cost of doing business for trade & industry, reducing tax burden for lower income strata of the society and promoting a taxpayer friendly culture.

The reduction in tax rates was intended to stimulate investment and production and promote voluntary tax compliance. Broadening of the tax base was intended to ensure the fair distribution of the tax burden among various sectors of the economy. Among the various tax policy reforms, the most significant are the continuous raising of the basic threshold of income tax, reduction of corporate rate to ensure parity between the rates applicable to private, public, and banking companies, re-introducing uniformity of GST rate, and continuous reduction and rationalization of import tariff rates.

As a result of the wide-ranging tax and tariff reforms as well as reforms in the tax administration tax collection by the Central Board of Revenue (CBR) has picked up, the overall budget deficit as percentage of GDP has declined, the revenue deficit has been narrowed to almost extinction. Consequently, public debt as a percentage of GDP has declined and Pakistan is now moving towards fiscal consolidation. During the last seven years, tax collection has increased by 81.0 percent and the overall fiscal deficit which averaged almost 7.0 percent of GDP during the

1990s has been reduced to 3.4 percent in 2005-06 of GDP. The revenue deficit (the difference between total revenue and total current expenditure), has been narrowed from 2.4 percent of GDP in the 1990's to 0.2 percent in 2005-06. The revenue surplus was projected at 0.02 percent of GDP in 2006-07. The primary balance (total revenue minus non-interest total expenditure) remained in surplus for the last seven years. However, primary balance turned negative for the first time in 2005-06. An improved tax structure will reduce the deadweight loss associated with raising a given amount of revenue and a reduction in the relative share of trade taxes and increases in the relative shares of taxes on income and consumption could be taken as evidence of an improvement in the tax system.

IV. Tax Administration Reform

The Government has channeled its efforts towards raising revenues, and bringing equity and efficiency in the tax system by operating on functional lines to render efficient services to the taxpayers by ensuring uniform application of laws with integrity, efficiency and high degree of professionalism. The reform process for tax machinery has been designed to churn out long term benefits through efficiency gains. Tax Administration Reform Program (TARP) include, the implementation of universal self-assessment, creation of a functional organization, building of a taxpayer service function, use of modern work layout for conducting tax administration, creation of database for management reporting, audit selection, statistical analysis, and automation in CBR and its field formations. The tax administration reform strategy is concentrated on policy reforms, administrative reforms and Organizational reforms. The policy reforms cover simplification of laws, introduction of universal self-assessment, elimination of exemptions, reducing dependence on withholding taxes, and effective dispute resolution mechanism. The administrative reforms aim at transforming income tax organization on functional lines, re-engineering of manual processes of all taxes with the aim to reduce face to face contact between taxpayers and tax collectors, increasing effectiveness of CBR, and improving skills and integrity of the workforce. The organizational reforms include re-organization of CBR headquarter on functional lines, reduction in number of tiers, reduction in workforce from existing level with enhanced financial packages. Simultaneously, the Government has constituted a Cabinet Committee for Federal Revenue (CCFR) to provide functional autonomy to the CBR.

In the tax administration reform program, substantial investment is being made in infrastructure development, end-to-end automation of business processes, and human resource development. Tax administration reforms in the CBR include among others, promulgation of new income tax law, universal self-assessment system for income tax, intensification of GST management, streamlining of refund system of sales tax, introduction of the DTRE Scheme, and establishment of Large Taxpayers Units (LTUs) and Medium Taxpayers Units (MTUs) in the country. Another development that has reduced considerable hassle of the taxpayers is the speedy clearance of goods at Karachi port under the CARE Project. This project has introduced computerized Processing of Customs documents (PACCS) under which the "Goods Declarations" can be filed by an importer "on line" without physical interaction with customs officials. The processing has reduced the clearance time of goods to few hours from more than ten days. This step reduced the up-front the cost of doing business considerably. This new system has revolutionized the working of Pakistan customs, which is now at par with the modern set ups.

V. Outcomes of Reforms

The package of reforms which include wide-ranging tax and tariff reforms, and reforms in tax administration, have started yielding dividends. During the six years from 2000-01 to 2006-07, tax collection by the CBR increased by 81.0%. The revenue deficit (the difference between total revenue and total current expenditure), a measure of government dis-saving, was at a deficit of 0.2% of GDP in 2005-06 compared to a deficit of 2.2% in 2000-01. It has further progressed towards revenue surplus of 0.6 percent of GDP in 2006-07. Pakistan has attained revenue surplus first time since 1984-85 in 2003-04 when it recorded 0.8 percent of GDP surplus. During the last four years this is second time when revenue surplus is mobilized and in the remaining two years revenue deficit existed, though at an insignificant level, as a result of some unavoidable increase in committed expenditure heads. The revenue surplus has significance in inter-generational distribution of debt burden. Fiscal Responsibility and Debt Limitation Act 2005 envisages a revenue surplus starting from 2007-08.

The primary balance (total revenue minus non-interest total expenditure) was in a surplus from 1999-2000 to 2004-05 but turned into deficit of 0.9% of GDP in 2005-06 due to the increased spending on earthquake related activities. Primary deficit is projected in 2006-07 for similar reason. The positive aspect of reforms is the structural transformation in the structure of taxes which has undergone considerable changes since the 1990s. Firstly, the share of direct taxes in total taxes (collected by the CBR) has increased from 18 percent to over 38.5 percent in July-April 2006-07. The share of indirect taxes declined from 82 percent to 61.5 percent during the same period. Even within the indirect taxes, dramatic changes have taken place. The collection from custom duty used to account for 45 percent of total tax collection and 55 percent of indirect taxes in 1990-91, its share has now been reduced to 18.6 percent and 32.3 percent, respectively. This is the consequence of the tariff reform implemented by successive governments since 1990-91. The share of sales tax increased at a tremendous pace from 14.4 percent to 41 percent of total taxes and from 17.6 percent to 60.3 percent of indirect taxes during the same period. Central excise as a tax is loosing its importance and gradually being faded out. Its shares in total taxes and indirect taxes were 22.5 percent and 27.5 percent, respectively in 1990-91. These have now been reduced to 8.3 percent and 12.3 percent, respectively during the same period [See Table 5.2 and Fig-1].

Table 5.2: Structure of Federal Tax Revenue (Rs. Billion)

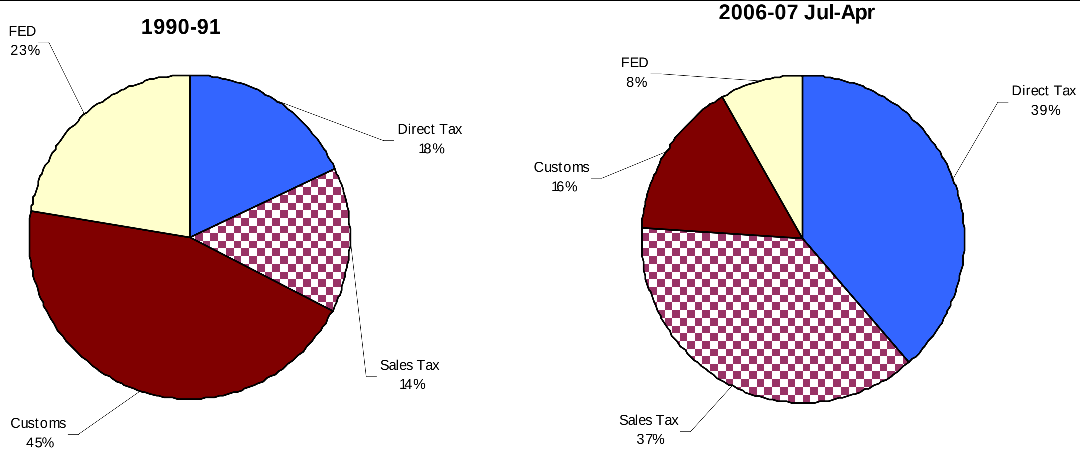
	Tax Revenue				Break-up of Indirect Taxes		
Year	Total (CBR)	As % of GDP	Direct Taxes	Indirect Taxes	Custom	Sales	Central Excise
1990-91	111.0	11.0	20.0	91.0	50.0	16.0	25.0
			[18.0]	[82.0]	(54.9)	(17.6)	(27.5)
1994-95	226.0	12.0	62.0	164.0	77.0	43.0	44.0
			[27.4]	[72.6]	(47.0)	(26.2)	(26.8)
1995-96	268.0	13.0	78.0	190.0	89.0	50.0	51.0
			[29.1]	[70.9]	(46.8)	(26.3)	(26.9)
1996-97	282.0	12.0	85.0	197.0	86.0	56.0	55.0
			[30.1]	[69.9]	(43.7)	(28.4)	(27.9)
1997-98	293.7	11.0	103.3	190.4	74.5	53.9	62.0
			[35.0]	[65.0]	(39.1)	(28.3)	(32.6)
1998-99	308.5	10.0	110.4	198.1	65.3	72.0	60.8
			[35.8]	[64.2]	(33.0)	(36.3)	(30.7)
1999-2000	346.6	9.1	112.6	234.0	61.6	116.7	55.6
			[32.5]	[67.5]	(26.4)	(49.9)	(23.7)
2000-01	392.3	9.4	124.6	267.7	65.0	153.6	49.1
			[31.8]	[68.2]	(24.3)	(57.4)	(18.3)
2001-02	403.9	9.2	142.5	261.6	47.8	166.6	47.2
			[35.3]	[64.7]	(18.3)	(63.7)	(18.0)
2002-03	460.6	9.6	148.5	312.2	59.0	205.7	47.5
			[32.2]	[67.8]	(18.9)	(65.9)	(15.2)
2003-04	518.8	9.2	165.3	353.6	89.9	219.1	44.6
			[31.9]	[68.1]	(25.4)	(62.0)	(12.6)
2004-05	588.4	8.9	176.9	411.4	117.2	235.5	58.7
			[30.1]	[68.9]	(28.5)	(57.2)	(14.3)
2005-06	712.5	9.2	224.6	487.9	138.2	294.6	55.0
			[31.5]	[68.5]	(28.3)	(60.4)	(11.3)
2006-07 B	835.0	9.5	264.7	570.3	157.5	343.8	69.0
			[31.7]	[68.3]	(32.3)	(70.5)	(14.1)

B Budgeted *Source: Central Board of Revenue*

* Beginning from 1999-2000, Pakistan's GDP was re-based at 1999-2000 from a two decades old base of 1980-81. Therefore, wherever GDP appears in denominator the numbers prior to 1999-2000 are not comparable.

Note: Figures in square bracket are as percentage of tax revenue. Figures in parentheses are as percentage of indirect taxes.

Fig-5.1:Structure of Taxes



The pace of change in the tax structure, particularly in indirect taxes has gained considerable momentum over the last eight years. The share of customs duty in overall collection is declining persistently from 33 percent to 19.0 percent while the share of central excise has declined from 31 percent to 8.0 percent since 1998-99. The share of sales tax increased from 36 percent to 62.5 percent. The basic philosophy of tax and tariff reform has been to move away from investment and production based taxes (indirect taxes) to income (direct taxes) and consumption (sales tax) based taxes. Pakistan has succeeded in changing the composition of its taxes but much more effort will be needed to enhance the share of direct taxes in total taxes.

VI. Trends in Expenditure

The Government is moving ahead on its agenda to improve expenditure management and fiscal transparency. The total expenditure remains more or less stable in a narrow band of 17 to 18.8 percent of GDP during the last seven years. Substantial decline in interest payments from as high as 7.5 percent of GDP in 1998-99 to 2.7 percent of GDP in 2006-07, has provided fiscal space to re-orient expenditure in favour of development expenditure. Resultantly the share of current expenditure in total expenditure declined from 89 percent of total expenditure in 1998-99 to 72 percent in 2006-07. In addition, the share of development expenditure more than doubled from 11 percent to 28 percent in the same period. The development expenditure bore the brunt of structural adjustment of the 1990s as it declined from as high as 7.5 percent of GDP in 1991-92 to 2.5 percent of GDP by 1999-2000. During the last seven years the development expenditure improved from 2.2 percent of GDP in 2000-01 to 4.9 percent of GDP in 2006-07. Second largest component of the current expenditure, namely, defence spending remained stagnant at around 3.1 percent to 3.3 percent of GDP during the last seven years. This shows strong focus of the government on removing infrastructural bottlenecks and building physical assets. The Government is achieving the goal of fiscal stabilization without compromising spending on the social sector. Non-defence-non-interest expenditure has improved from 7.8 percent of GDP in 1999-2000 to 11.9 percent of GDP in 2006-07. The historical trends in the expenditure are documented in Table-5.3:

Table 5.3: Trends in Components of Expenditure (As % of GDP)

Period	Total Expenditure	Current Expenditure	Development Expenditure	Interest Payments	Defence	Non-Defence Non-Interest Expenditure
1980-81	22.9	13.6	9.3	2.1	5.5	15.3
1984-85	24.7	17.7	7.7	3.5	6.7	14.5
1989-90	25.9	19.3	6.5	5.5	6.9	13.6
1994-95	22.8	18.4	4.4	5.2	5.6	12.0
1999-2000*	18.9	16.5	2.4	6.9	4.0	7.8
2002-03	18.6	16.4	2.2	4.9	3.3	10.4
2003-04	16.7	13.5	3.1	4.0	3.3	9.4
2004-05	17.2	13.3	3.9	3.9	3.3	10.0
2005-06	18.5	13.6	4.8	3.2	3.2	12.1
2006-07 B	17.6	12.7	4.9	2.8	2.9	11.9

B Budgeted *Source: EA Wing Finance Division*

Note: The GDP was rebased w.e.f. 1999-2000, so figures thereafter may not be comparable with earlier years

The above Table is a clear reflection of the state of affairs prevailed during the two decades of the 1980s and the 1990s. One thing was common between these two decades that development expenditure was the victim of all sorts of fiscal consolidation and expenditure rationalization. The current expenditure increased substantially in the 1980s but could not keep pace because of slowdown in the growth and stagnation of revenues in the 1990s. Defence expenditure in terms of percent of GDP was rising in the 1980s but since then declined throughout the 1990s but stabilized during the last seven years. The non-defence non-interest expenditure was persistently declining since the 1980s because of rising defence spending and interest payments. The combined impact of two committed expenditure items (defence and interest payments) went as high as 59 percent of total expenditure and 66 percent of current expenditure in 1998-99. This has declined to just 32 percent and 43 percent, respectively in 2006-07 which indicate a paradigm shift in allocation of expenditure among priority sectors as a result of growing fiscal space.

VI.I. Trends in Real Expenditure

The nominal monetary value of expenditure is a direct charge on budget but the composition of expenditure in real terms (after adjusting for inflation) provides real food for thought. An analysis of real growth patterns in expenditure reveals some interesting facts. Total real expenditure grew at a brisk pace of 7.7 percent per annum, on average, in the 1980s owing to sharp acceleration of 10.5 percent in real current expenditure. Development expenditure grew by modest 2.7 percent on average in real terms but interest payments grew by 18.1 percent, reflecting tremendous pace of accumulation of public debt. Interestingly, real defence spending followed the higher growth path and grew by 8.9 percent on average. Such a level of fiscal indiscipline in the past forced Pakistan to undergo a painful period of structural adjustment in the 1990s.

Table 5.4: Trends in Real Expenditure (1999-2000=100) (% Growth)

Period	Total Expenditure	Current Expenditure	Development Expenditure	Interest Payments	Defence	Non-Defence Non-Interest Expenditure
1980s	7.7	10.5	2.7	18.1	8.9	4.9
1990s	2.8	4.5	-2.6	8.9	0.4	0.9
1990-I	2.4	3.9	-1.7	4.2	0.7	3.0
1990-II	3.1	5.0	-3.5	13.7	0.1	-1.2
2000-03	3.4	3.2	7.4	-7.4	-1.9	13.9
2003-07*	6.2	1.2	25.6	-6.7	3.7	12.0

* Budget estimat for 2006-07 *Source: EA Wing Finance Division*

The rate of growth of real expenditure slowed in the first half of the 1990s but at the expense of the development expenditure which has to decelerate by 1.7 percent on average to contribute 2.4 percent growth in real expenditure in the period. The current expenditure on the other hand grew by 3.9 percent, thanks to only 0.7 percent growth in defence spending and a relatively slower growth of 4.2 percent witnessed in interest payments. Non-defence non-interest expenditure also grew by modest 3.0 percent in real terms. Even the sharp fall in real development expenditure which decelerated sharply by 3.5 percent in the second half of the 1990s could not restrict current expenditure to grow at a faster pace of 5.0 percent, mainly because of massive 13.7 percent average growth in interest payments. Resultantly, total expenditure grew by 3.1 percent per annum in the period, however, non-interest non-defence expenditure decelerated by 1.2 percent per annum. The second major item defence spending inched up marginally by 0.1 percent per annum.

During the last seven years the real growth in current expenditure hovered around 2 percent per annum. Total expenditure grew by 3.4 percent in the first three years (2000-03) but accelerated to 6.2 percent during the last four years (2003-07). The main contribution is coming from development expenditure which grew by 7.4 percent per annum in first three years (2000-03) and by 25.6 percent in recent four years (2003-07). Non-defence non-interest expenditure grew by 13.9 percent and 12.0 percent in these two periods, respectively. This sharp growth is mainly contributed by massive fall in real incidence of interest payments which depicted negative growth of 7.4 percent and 6.7 percent in first and second period. Defence spending, however, bounced back after deceleration of 1.9 percent in 2000-03 to posting a positive real growth of 3.7 percent, mainly because of security concerns on eastern and north-western borders. Contrary to common perception, defence expenditure has remained depressed during the period 1990 to 2003 owing to relatively favourable security environment existed in the period.

VII. Fiscal Performance during the Year

Revenues. The structure of Pakistan's taxation changed considerably since the 1990s. The share of direct taxes in tax revenues increased from 18.0% in 1990-91 to 32.0% in 2006-07 budget estimates. The share of indirect taxes in tax revenues declined from 82.0% to 68.0% during the same period. The basic philosophy of tax and tariff reforms has been to move away from investment and production based taxes towards income and consumption based taxes.

Table 5.5: Gross and Net Revenue Receipts

Rs. Billion

	2006-07		2005-06		Growth (%)	
Months	**Gross**	**Net**	**Gross**	**Net**	**Gross**	**Net**
July	54.5	46.2	41.5	34.6	31.2	33.5
August	54.0	46.3	50.3	44.9	7.3	3.1
September	101.5	91.4	78.4	72.5	29.5	26.1
October	60.4	53.3	56.3	49.2	7.3	8.4
November	67.1	59.0	53.5	47.6	25.5	24.1
December	123.9	114.2	86.6	75.1	43.0	52.1
January	55.6	52.2	53.4	45.9	4.2	13.6
February	56.8	52.4	56.0	49.5	1.5	5.9
March	89.3	81.9	79.2	70.5	12.7	16.2
April	66.4	59.5	63.6	57.2	4.4	4.1
July-April	**729.5**	**656.5**	**618.8**	**547.0**	**17.9**	**20.0**

Source:CBR

During the 1990s Pakistan was confronted with lower tax-to-GDP ratio primarily due to the existence of a narrow tax base, over-reliance on taxes on imports, the complexity of the tax regime and weak tax administration. In 2000-01, the Government tightened fiscal management and implemented structural reforms across all major sectors of the economy. Tax administration reforms were focused on improving tax compliance. Improvements in tax collection were sought by implementing a tax amnesty scheme and extending the general sales tax to the services sector. The tax revenue has surpassed the target for the third year in a row but nominal GDP is increasing at a faster pace then tax collections therefore the tax-to-GDP ratio remained almost stagnant.

Total revenues are budgeted at Rs. 1163.1 billion in 2006-07 compared to Rs. 1087.0 billion in 2005-06, showing an increase of 7.0%. This was primarily due to a rise of 15.5 percent in tax revenue on the back of increases in federal tax revenues are projected to rise by 17.5 percent. Provincial tax revenue is projected to decline by 12.6 percent. Non-tax revenue consists of receipts from civil administration and defence, profits of SBP, PSE and user charges of services, etc are targeted to decline by 13.3 percent by moving to Rs.277.3 billion in 2006-07 as against Rs.320.0 billion last year. The federal tax receipts consist of revenue collected by the CBR, surcharges and some other minor collections. CBR accounts for more than 90 percent of the tax revenue.

VII.l.i Analysis of CBR Tax Collection

The Central Board of Revenue (CBR) is targeted to collect Rs. 835 billion in 2006-07, which is 17.1 percent higher than last year's collection. CBR has exceeded the revenue target of Rs. 645.2 billion fixed for the first ten months of current fiscal year (July-April 2006-07) by Rs. 11.3 billion. The net collection stood at Rs. 656.5 billion as against Rs.547.0 billion in the comparable period of last year, thereby showing an increase of 20 percent. The direct taxes contributed most of the increase as they have surpassed the target by Rs.52.4 billion and recorded massive growth of 50.9 percent. This increase has compensated much of the revenue shortages on account of sales tax and customs duties by Rs. 22.5 billion and Rs. 19.0 billion, respectively owing to slowdown in imports. The massive than the anticipated slowdown in imports growth from 30.6 percent to 10.3 percent during July-April 2006-07, resulted in negative growth in dutiable imports with adverse implications for import related taxes.

Table-5.6: Direct Taxes: Gross and Net Revenue

Rs. Billion

	2006-07		2005-06		Growth (%)	
Months	**Gross**	**Net**	**Gross**	**Net**	**Gross**	**Net**
July	11.6	10.1	8.9	7.6	31.1	32.4
August	12.9	11.1	10.3	9.0	25.1	23.2
September	52.0	45.3	34.2	31.6	52.2	43.5
October	17.9	16.1	12.9	11.1	38.8	44.7
November	17.4	13.9	12.3	10.2	41.4	37.0
December	80.4	76.2	41.0	34.9	96.4	118.7
January	13.5	12.5	12.9	10.1	4.5	23.7
February	14.8	13.8	12.7	10.5	16.5	31.0
March	42.8	38.9	31.7	27.8	34.9	39.8
April	17.8	15.1	17.2	14.9	3.5	1.3
July-April	**281.3**	**252.9**	**194.2**	**167.6**	**44.9**	**50.9**

Source:CBR

The gross and net collection has increased by 17.9% and 20.0% respectively during July-April 2006-07. The overall refund/ rebate payments during first ten months of current fiscal year have been Rs. 73.0 billion relative to Rs. 71.9 billion paid back during the corresponding period of past fiscal year. Among the four federal taxes, the highest growth of 50.9% has been recorded in the case of direct tax receipts, followed by FED (20.7%) and sales tax (7.5%). On the other hand, customs duties have witnessed a negative growth of 2.3%.

Table-5.7: Sales Tax Gross and Net Revenue Receipts

Rs. Billion

	2006-07		2005-06		Growth (%)	
Months	**Gross**	**Net**	**Gross**	**Net**	**Gross**	**Net**
July	28.7	24.0	20.0	15.7	43.6	52.6
August	25.2	20.9	24.4	22.8	3.7	-8.2
September	32.9	30.6	26.2	24.5	25.5	25.3
October	26.0	22.0	27.2	23.6	-4.3	-6.8
November	31.8	28.1	25.8	23.5	23.1	19.5
December	24.7	20.5	26.4	22.6	-6.6	-9.2
January	26.4	24.8	25.3	22.2	4.3	11.7
February	26.2	23.7	26.7	23.6	-1.9	0.5
March	26.7	24.1	27.2	23.9	-2.1	0.8
April	30.3	27.0	28.5	26.1	6.2	3.2
July-April	**278.9**	**245.8**	**257.8**	**228.5**	**8.2**	**7.5**

Source:CBR

VII.l.i (a) Detailed Analysis of Individual Taxes

Direct Taxes: The collection of direct taxes has grown at fastest pace in recent economic history. Both gross and net collections have witnessed robust growth of 44.9% and 50.9% during the first ten months of current fiscal year. The positive thing about direct taxes is that major source of the robust growth is voluntary compliance by the taxpayers. Not only that a sizable growth of around 25 percent has been registered in the number of returns filed by the taxpayers, the tax payments with returns have also increased by 137 percent. Secondly, there has been 43 percent increase in the advance tax payments, the taxpayers on the basis of self-assessment of their expected income. This change has been due to improved profitability of the corporate sector, particularly the banking, telecommunication and oil & gas sectors that have recorded strong growth. Incidentally, these are the sectors that have gone through a difficult phase of reforms which ultimately has led to their improved efficiency.

Table-5.8: Customs Duties Gross and Net Receipts

Rs. Billion

	2006-07		2005-06		Growth (%)	
Months	**Gross**	**Net**	**Gross**	**Net**	**Gross**	**Net**
July	10.2	8.1	9.7	8.4	4.5	-3.7
August	11.2	9.7	11.6	9.1	-3.2	7.1
September	11.2	10.1	12.6	11.2	-11.3	-9.7
October	10.9	9.8	11.5	9.9	-4.8	-0.5
November	12.3	11.5	11.2	9.7	9.9	17.7
December	12.9	11.6	14.8	13.3	-13.2	-12.6
January	10.3	9.6	10.9	9.5	-5.6	0.8
February	10.2	9.3	11.7	10.5	-12.6	-10.9
March	13.9	13.0	15.0	13.6	-7.7	-4.3
April	11.3	10.4	12.1	10.4	-7.3	-0.1
July-April	**114.4**	**103.1**	**121.3**	**105.5**	**-5.7**	**-2.3**

Source:CBR

Sales Tax: The gross and net sales tax collection has been Rs. 278.9 billion and Rs. 245.8 billion, respectively which are higher by 8.2 percent and 7.5 percent over the corresponding period of last year. The refund payments have increased by 13.4 percent during the period under review, mainly on account of the unexpected refund claims by the electrical energy sector. Of net collections, 42.5 percent is contributed by sales tax on domestic production and sales, while the rest originates from imports. Within net domestic sales tax collection, major contribution has come from telecom services, POL products, electrical energy, natural gas and cigarettes. On the other hand, POL products, vehicles, iron and steel and plastic raisins have major contribution in the import stage collection of sales tax. The growth in sales tax collection is hampered by slower pace of imports.

Customs Duties: Negative growth of 5.7 percent and 2.3 percent has been recorded in gross and net collection of customs duty during July-April 2006-07 over last year owing to the shrinking base coupled with the decline in imports of iron and steel, sugar, and fertilizer. It may be recalled that the imports of these items surged significantly during 2006-07 because of supply constraints in the domestic market.

Federal Excise: The net collection stood at Rs. 54.9 during July-April 2006-07 as against Rs.45.4 billion in the same period last year, which implies a significant growth of 20.7 percent in the collection of FED reflecting improvement in the industrial growth in the country. The federal excise has a very narrow base with five commodity groups, namely, cigarettes, cement, POL products, natural gas and beverages have contributed around 85 percent of FED receipts. The Month wise comparison of gross and net collection is reflected in Table 5.9. Based on the above analysis there are indications that the CBR would not only achieve the target of Rs. 835 billion but most probably it would surpass the target by a reasonable margin.

VII-II. Review of Public Expenditure

Pakistan continues to maintain fiscal discipline for the last several years. *Total expenditure* is targeted at Rs. 1536.56 billion or 17.4 percent of GDP for the fiscal year 2006-07. Total expenditure was projected to be 8.6 percent higher than last year (2005-06). During the first nine month (July-March) of the current fiscal year total expenditure is estimated at Rs.1168.5 billion or 76 percent of the annual target [See Table-5.10]. *Current Expenditure* is targeted at Rs. 1126.19 billion for the current fiscal year (2006-07) which means it would remain almost stagnant at the level of 2005-06. During July-March 2006-07, provisional estimates suggest an expenditure of Rs.925.3 billion which is 83.6 percent of the target. The higher increase in current expenditures during the last two years is mainly on account of earthquake-related spending amounting to 0.5 percent to 0.8 percent of GDP. The major components of current expenditure include interest payments and defense spending which also show increases. *Interest payments* are targeted at Rs. 239.5 billion for the current fiscal year which are slightly lower than Rs. 241.2 billion but during July-March 2006-07, it already exceeded the target. *Defense spending* for the year is targeted at Rs. 250.2 billion — 3.8 percent higher than last year and during July-March 2006-07, the spending has reached Rs.172.8 billion which is 69 percent of the full year target [See Table 5.10]. It is expected that the defence spending may remain on the target for the year 2006-07.

Table-5.9: Federal Excise: Gross Vs Net Revenue

Rs. Billion

	2006-07		2005-06		Growth (%)	
Months	**Gross**	**Net**	**Gross**	**Net**	**Gross**	**Net**
July	4.0	4.0	3.0	2.9	35.2	39.7
August	4.6	4.6	4.1	4.1	14.1	13.2
September	5.4	5.4	5.4	5.3	0.7	1.4
October	5.5	5.5	4.6	4.6	17.9	17.9
November	5.6	5.5	4.1	4.1	35.0	34.1
December	5.9	5.9	4.4	4.4	33.0	34.2
January	5.3	5.3	4.2	4.1	28.0	28.5
February	5.6	5.6	4.9	4.9	14.4	14.5
March	6.0	6.0	5.3	5.3	13.3	13.6
April	7.0	7.0	5.7	5.7	23.0	23.0
July-April	**54.9**	**54.7**	**45.6**	**45.4**	**20.3**	**20.7**

Source:CBR

Provincial Current Expenditure. Provincial current expenditure is expected to decline marginally in 2006-07, from Rs. 312.8 billion in 2005-06 to Rs. 312.3 billion. However, provincial current expenditure as percentage of total expenditure has declined over the last three years. As a percentage of GDP, provincial current expenditure has remained stable at around 4.0% between 2000-01 and 2006-07.

Public Sector Development Program. The size of the PSDP has increased substantially. Development expenditure is targeted at Rs. 435 billion for the year 2006-07 as against revised estimate of Rs.313.7 billion in 2005-06. During the first nine months (July-March) of the current fiscal year 2006-07, development expenditure amounted to Rs.241.8 billion or only 58.3 percent of the yearly allocation. This expenditure is likely to pick-up in the last quarter of the year. Total PSDP consists of federal component and provincial component. The size of the federal PSDP was budgeted at Rs.270 billion and provincial PSDP was estimated at Rs.115 billion; totaling Rs.385 billion. An amount of Rs.50 billion was budgeted for earthquake related spending, therefore, the total size of the PSDP was budgeted at Rs.435 billion. However, an operational shortfall of Rs.20 billion in PSDP was anticipated in 2006-07.

Table-5.10: Consolidated Revenue & Expenditure of the Government *(Rs. Billion)*

	2003-04	2004-05	Revised Estimate 2005-06	Budget Estimate 2006-07	Jul-Mar 2006-07*
A. Total Revenue	**805.8**	**900.0**	**1087.0**	**1163.0**	**895.7**
a) Tax Revenue	**617.9**	**632.6**	**766.9**	**885.7**	**633.8**
CBR Revenue	518.8	588.4	712.5	835.0	607.2
Provincial Tax Revenue	34.1	34.6	51.2	44.8	26.5
Others	65.0	9.6	3.2	5.9	0.0
b) Non-Tax Revenue	**187.9**	**248.4**	**320.0**	**277.3**	262.0
B. Total Expenditure	**940.4**	**1195.5**	**1414.6**	**1536.6**	**1168.5**
a) Current Expenditure	**763.1**	**942.7**	**1104.5**	**1106.5**	**925.3**
i) Federal	**582.4**	**688.6**	**791.7**	**794.2**	**647.8**
- Interest	202.5	210.2	241.2	239.5	252.6
- Defense	184.9	211.7	241.1	250.2	172.8
- Others	195.0	266.7	309.4	304.5	259.6
ii) Provincial	**180.7**	**254.1**	**312.8**	**312.3**	**277.5**
b) Development Exp. & Net Lending	**177.3**	**252.8**	**310.1**	**430.0**	**241.8**
PSDP**	161.0	228.0	313.7	**435.0**	**244.2**
Net Lending	16.3	24.8	3.6	5.0	-2.4
C. Overall Fiscal Deficit	**-134.5**	**-217**	**327.6**	**373.5**	272.8
As % of GDP	2.4	3.3	4.3	4.2	3.1
Financing of Fiscal Deficit	**134.5**	**217**	**327.6**	**373.5**	**272.8**
i) External Sources	-4.5	120.4	148.5	171.7	93.7
ii) Domestic	139.0	96.6	179.1	201.8	179.1
- Bank	63.7	60.2	66.8	140.1	116.6
- Non-Bank	64.1	8.1	22.3	6.7	45.8
- Privatization Proceeds	11.2	28.3	90.0	75.0	16.7
GDP at Market Prices	**5641**	**6500**	**7594**	**8808**	**-**

** Provisional* *Source: Budget Wing, Ministry of Finance*

The *overall fiscal deficit* is targeted at Rs. 373 billion or 4.2 percent of GDP for 2006-07. The Government is well placed to meet this target as fiscal deficit during the first nine months remained at 3.1 percent of GDP or 73 percent of the yearly target. On the basis of the developments on revenue and expenditure front, the overall fiscal deficit during the first nine months (July-March) of the current fiscal year stood at Rs. 272.8 billion or 3.1 percent of GDP. Earthquake accounted for sizeable amount of fiscal deficit and underlying fiscal deficit excluding earthquake expenditure is targeted at 3.7 percent of GDP for 2006-07. *Revenue balance* (revenue minus current expenditure)— a measure of government's savings or dis-savings, was targeted to be in surplus to the extent of 0.6 percent of GDP. During the first nine months (July-March) of the current fiscal year, the revenue balance has remained in deficit to the extent of Rs.29.6 billion or 0.3 percent of GDP. It is expected that by the end of the fiscal year revenue balance may end up with surplus.

VIII. Federal Budget 2006-07

The total outlay of the federal budget 2006-07 is Rs.1314.8 billion which is 6.7 percent higher than revised estimates of last year. Current expenditure is budgeted at Rs.879.8 billion— lower by 4.2

percent over last year whereas development expenditure is budgeted at Rs.435 billion which is higher by 38.7 percent over last year. Total resource availability is budgeted at Rs.1099.7 billion or 2.2 percent higher over revised estimates of last year. Net revenue receipts are budgeted to fall by 2.3 percent on account of higher transfers to provinces as well as fall in non-tax revenue receipts. Provinces are financing greater amount of PSDP in the current year and at the same time generating more cash balances which are budgeted to almost double from Rs.27 billion to Rs.53.8 billion. Provincial cash balances are contributing to overall fiscal prudence in the economy. Federal Budget is making all out effort to reduce non-productive current expenditures which is reflected in the lower level of current expenditure. Table-5.11 highlights the salient features of Federal Budget 2006-07 and a comparative budgetary position of 2005-06.

Table-5.11: Comparative Budgetary Position *(Rs. Billion)*

	2005-06		2006-07
	Budget	Actual	Budget
RESOURCES – Total	**980.5**	**1,075.7**	**1,099.7**
Internal Resources	768.1	841.7	860.4
Revenue Receipts (Net)	643.1	721.3	704.6
Capital Receipts (Net)	50.6	18.7	16.4
Financing of PSDP by Provinces	41.0	74.7	85.6
Change in provincial cash	33.5	27.0	53.8
External Resources	212.4	233.9	239.3
EXPENDITURE – Total	**1,098.5**	**1,232.5**	**1,314.8**
Current Expenditure	826.5	918.8	879.8
Development Expenditure	272.0	313.7	435.0
PRIVATIZATION PROCEEDS	20.0	90.0	75.0
BANK BORROWING	98.0	66.8	140.1

Source: Ministry of Finance, Budget Wing.

IX. PROVINCIAL BUDGETS

The total outlay of the four provincial budgets for 2006-07 stood at Rs.401.5 billion, which is 17.1 percent higher than the outlay for last year (Rs.343.0 billion). Punjab witnessed the highest increase of 16.5 percent in budgetary outlay followed by the Sindh (2.5%). NWFP and Baluchistan witnessed decline in the expenditure mainly because of the correction in the higher expenditures of the last year. The overall provincial revenue receipts for 2006-07 are estimated at Rs. 525.5 billion, which is 16.8 percent higher than last year. Tax revenue accounting for 76.4 percent of overall revenue receipts, amounted to Rs.338.2 billion which is 20.4 percent higher than last year and non-tax revenue is estimated at Rs.124.0 billion which is 16.1 percent higher than last year. The total budget outlay of Rs. 611.1 billion is shared in the ratio of 68 percent and 32 percent between current and development expenditures, respectively. The allocations for development expenditure are 6.7 percent lower than last year and for current expenditure, they are higher by 11.9 percent. The main components of the Provincial budgets 2006-07 in comparison with revised estimates of last year are presented in Table-5.12.

Table.5.12: Overview of Provincial Budgets *(Rs. billion)*

	Sindh		N.W.F.P		Punjab		Baluchistan		Total	
	05-06	06-07	05-06	06-07	05-06	06-07	05-06	06-07	05-06	06-07
Item	(R.E)	(B.E)	(R.E)	(B.E)	(R.E)	(B.E)	(R.E)	(B.E)	(R.E)	(B.E)
A. Total Tax Revenues	***108.8***	***116.5***	***38.2***	***45.4***	***173.3***	***217.0***	***22.7***	***22.6***	***343.0***	***401.5***
Provincial Taxes	31.0	29.5	3.5	2.5	26.7	30.3	1.0	1.0	62.2	63.3
Share in Federal Taxes	77.8	87.0	34.7	42.9	146.6	186.7	21.7	21.6	280.8	338.2
B. Non-Tax Revenues	***18.2***	***31.1***	***27.3***	***22.2***	***51.8***	***57.0***	***9.5***	***13.7***	***106.8***	***124.0***
Total Revenues (A+B)	**127.0**	**147.6**	**65.5**	**67.6**	**225.1**	**274.0**	**32.2**	**36.3**	**449.8**	**525.5**
a) Current Exp.	***126.2***	***139.2***	***60.7***	***54.5***	***160.6***	***191.4***	***30.3***	***37.5***	***377.8***	***422.6***
b) Development Exp.	***42.7***	***33.9***	***25.1***	***26.6***	***89.6***	***100.0***	***19.3***	***10.8***	***176.7***	***188.5***
i) Rev. Account	6.2	4.0	4.3	5.4	45.4	41.9	0.0	0.0	55.9	51.3
ii) Cap. Account	36.5	29.9	20.8	21.2	44.2	75.3	19.3	10.8	120.8	137.2
iii) Op. Shortfall	0.0	0.0	0.0	0.0	0.0	-17.2	0.0	0.0	0.0	0.0
Total Exp. (a+b)	**168.9**	**173.1**	**85.8**	**81.1**	**250.2**	**291.4**	**49.6**	**48.3**	**554.5**	**611.1**

Source: Finance Division, (PF Wing)

Table-5.13: TRANSFERS TO PROVINCES (NET)

(Rs. In Billion)

	2002-03	2003-04	2004-05	2005-06	2006-07 (B)
Divisible Pool	158.5	176.4	204.8	244.6	321.1
Straight Transfer	34.3	38.5	40.5	56.8	57.2
Special Grants/ Subventions	26.3	32.8	35.3	63.5	29.3
Project Aid	12.9	12.9	15.5	17.5	26.7
Agriculture Sector Loan-II	12.0	12.0	1.4	2.8	2.6
Japanese Grant	0.1	0.1	0.1	0.1	0.1
Total Transfer to Provinces	**244.3**	**264.7**	**297.6**	**385.2**	**436.9**
Interest Payments	28.0	26.9	24.3	21.6	22.8
Loan Repayments	18.8	11.8	28.7	14.7	16.0
Transfer to Provinces (Net)	**226.0**	**226.0**	**244.6**	**348.9**	**398.1**

Source: Budget in Brief, 2006-07

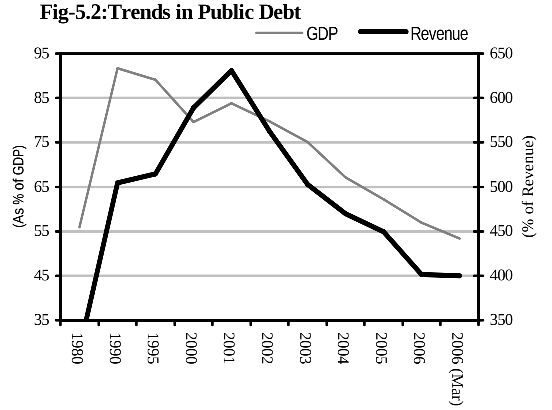
X. Allocation of Revenue between the Federal Government and Provinces.

The Constitution governs the relationship between the Government and the provinces with respect to the distribution of a divisible pool of taxes. According to the Constitution, every five years, the President forms a National Finance Commission (NFC) consisting of the Minister of Finance of the Government, the Minister of Finance of each of the provincial governments and other presidential appointees in consultation with the Governors of the provinces. The NFC then recommends to the President the distribution to be made between the Federal Government and the provinces with respect to the divisible pool of taxes consisting of income tax, sales tax, export duties on cotton, customs duties, excise duties (excluding excise duty on natural gas) and any other tax that may be specified by the President. Soon after the receipt of the recommendations of the NFC, the President implements these through a Presidential order specifying the share of the net proceeds of the taxes to be allocated to the provinces and the federal government. [The recommendations of the NFC together with an explanatory memorandum of action taken thereon are required to be sent to both Houses and to Provincial Assemblies]. Under the Constitution, the President has the power to amend or modify the distribution of revenues as may be necessary or expedient. Since 1997, the share of the Government in the divisible pool has been fixed at 62.5% while the share of the provincial governments has been fixed at 37.5%. Beginning 2006-07, the share of the provincial governments in the divisible pool will rise annually to 41.5%, 42.5%, 43.75%, 45.0% and 46.25% thereafter in coming years. An account of transfer to provinces is given in Table-5.13.

XI. Public Debt

Pakistan's public debt grew at an average rate of 15 percent per annum during the 1990s, much faster than the growth in nominal GDP (13.9%). The root cause of rising debt burden has been the persistence of large fiscal and current account deficits. Pakistan, on average, sustained fiscal and current account deficits of almost 7 percent and 5 percent of GDP, respectively during 1990-99. In many developing countries including Pakistan, the "twin deficits" have been the prime cause of low economic growth. An important channel through which fiscal deficits damage growth performance is by reducing national saving and crowding out domestic investment. National saving rate declines because of the negative public savings (revenue deficit). Low national saving rate forces government to resort to foreign savings to achieve investment and growth targets. Greater reliance on foreign savings leads to greater accumulation of external debt. This is exactly what has happened in Pakistan in the 1990s. Large fiscal and current account deficits led to the accumulation of domestic and external debt which increased country's vulnerability to external shocks, reduced investment rate, and consequently slowed economic growth. Thus, there exist a strong negative relationship between fiscal deficits and economic growth. When a country like Pakistan sustains such a large fiscal and current account deficits for so long a period is bound to experience deceleration in economic growth.

Fig-5.2:Trends in Public Debt



It is in this background that the first and foremost challenge for the government some seven years ago had been to arrest the rising trends of debt. The government is following a debt strategy the salient features of which include reduction in the fiscal and current account deficits, lowering the cost of borrowing, raising revenue and foreign exchange earnings, and debt re-profiling from the Paris Club. To provide legal cover to debt reduction strategy a Fiscal Responsibility and Debt Limitation Act 2005 has been promulgated in June 2005. To fulfill the legal requirements of the FRDL Act 2005, Debt Office, Ministry of Finance has presented twou reports namely, Fiscal Policy Statement 2006-07 and Debt Policy Statement 2006-07 before the Parliament in January 2007.

As a result of the credible strategy being followed by the Government, the public debt- to-GDP ratio, which stood at almost 85 percent in end June 2000, declined substantially to 56.9 percent by the end of June 2006 — 28.0 percentage points decline in country's debt burden in 7 years. By end March 2007, public debt further declined to 53.4 percent of the GDP for the year. In absolute terms public debt grew by 7.6 percent during July-March 2006-07.

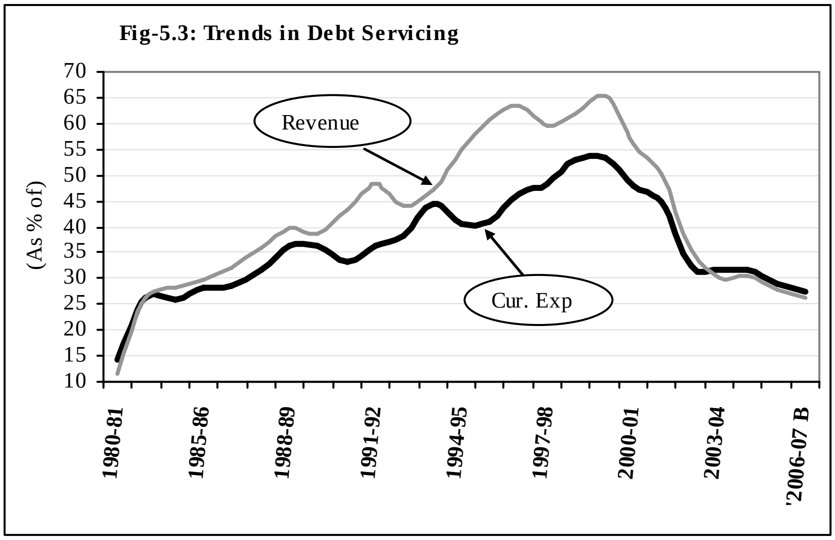
Table-5.14: Public Debt, FY90-FY07

	FY90	FY95	FY99	FY02	FY03	FY04	FY05	FY06	FY07(Mar.)
					(In billions of Rs.)				
Domestic Currency Debt	374	790	1389	1715	1854	1979	2133	2299	2512
Foreign Currency Debt	428	873	1557	1795	1769	1808	1913	2022	2138
Total Public Debt	801	1662	2946	3510	3623	3787	4045	4321	4650
					(In percent of GDP)				
Rupees Debt	42.8	42.3	47.3	39.0	38.4	35.1	32.8	30.3	28.8
Foreign Currency Debt	48.9	46.8	53.0	40.8	36.7	32.0	29.4	26.6	24.6
Total Public Debt	91.7	89.1	100.3	79.7	75.1	67.1	62.2	56.9	53.4
					(In percent of Revenue)				
Rupees Debt	235	245	296	275	257	246	237	214	216
Foreign Currency Debt	269	270	332	288	245	224	212	188	184
Total Public Debt	505	515	629	562	503	470	449	401	400
					(In percent of Total Debt)				
Rupees Debt	46.6	47.5	47.2	48.9	51.2	52.3	52.7	53.2	54.0
Foreign Currency Debt	53.4	52.5	52.8	51.1	48.8	47.7	47.3	46.8	46.0
Memo:									
Foreign Currency Debt ($ Billion)	19.5	28.1	30.2	29.9	30.6	31.2	32.1	33.6	35.2
Exchange Rate (Rs./U.S.$, E.O.P)	21.9	31.1	51.6	60.1	57.7	57.9	59.7	60.2	60.7
GDP (in Rs. Billion)	874	1866	2938	4402	4823	5641	6500	7594	8707
Total Revenue (in Rs. Billion)	159	323	469	624	721	806	900	1077	1163

Source: Various Economic Survey, EAD, Budget Wing (MoF) and calculations by DPCO staff.

It may be pointed out that public debt is a charge on the budget and therefore it must be viewed in relation to government revenue. Public debt was 562.5 percent of revenue by the end of the 1990s. Following the debt reduction strategy in which raising revenue was one of the key elements, the public debt burden in relation to total revenue has declined substantially to 401.0 percent by end-June

2006 and further to 400 percent by end-March 2007 to the projected revenue for the year. Although Public debt is now on a solid downward footing, sustaining the momentum will be a continuing challenge.



The rising stock of public debt has had serious implications for debt service obligations during the 1990s. By the end of the 1990s (in 1999-2000), almost 69 percent of total revenues were being consumed by one budgetary item, namely, debt servicing, leaving only 31 percent to be spent on development programs, the social sector, civil administration, defence etc. Quite naturally, it was highly inadequate to finance these budgetary items. The development budget faced the burden of adjustment as it continued to shrink from 6.5 percent in 1990-91 to 2.5 percent by the end of the 1990s. The high and growing public debt burden was the major factor responsible for slowdown in economic growth, to less than 4 percent per annum in the 1990s and the consequent increase in poverty incidence. Consequently, the Government's annual development budget continued to shrink from 6.4% of GDP to 2.5% of GDP during the same period. Both physical and human capital deteriorated sharply during the period, constraining the country's future growth potential. During the last seven years, the debt servicing liabilities have declined sharply from 65.4 percent of revenue in 1999-2000 to 27.8 percent of revenue and from 53.5 percent to 27.8 percent of current expenditure in 2005-06. The subsequent fiscal space created by bridging the revenue-expenditure gap and low debt servicing cost has enabled the Government to increase poverty and social sector related expenditures from Rs. 89.8 billion or 2.2% of GDP in 2000-01 to Rs. 326.7 billion or 4.2% of GDP in 2005-06.

Table-5.15: Real Cost of Borrowing Public Debt

	Real Cost of Borrowing for		
	External Debt	**Domestic Debt**	**Public Debt**
1980s	3.4	1.0	2.3
1990s	2.7	3.2	2.9
1990-I	-3.0	-1.9	-2.4
1990-II	5.5	5.7	5.6
2000-03	1.7	6.3	4.3
2003-07	-4.1	0.6	-1.7

Source: DPCO Staff Calculation

XI.I. Dynamics of the Public Debt Burden

What are the main factors behind the increase in public debt over the last two decades? The rise appears to be largely accounted for by the high real cost of borrowing and stagnant government revenue. As stated earlier, public debt consists of debt payable in rupees and debt payable in foreign exchange. The real cost of borrowing for these two components of public debt is measured differently. As shown in Table-5.15, the real cost of Pakistan's domestic debt has varied greatly over time. The higher interest rate, to a large extent, was wiped out by the sharp acceleration in inflation in the 1990s. The average real cost of borrowing for the domestic component of the public debt was 3.2 percent because of double digit inflation for most of the 1990s. Further dis-aggregation of the 1990s suggests that the real cost of domestic borrowing was negative (1.9%) in the first half of the 1990s but rose sharply (5.7%) in the second half, mainly because of a decline in inflation. During the first three years of the decade (2000-03), the real cost of borrowing for domestic debt was 6.3 percent owing to lower inflation but in the last four years (2003-07) the cost of borrowing declined to 0.6 percent mainly due to rising inflationary pressure in the economy.

The issue of measuring the real cost of foreign borrowing (debt payable in foreign exchange) is complex. In the case of the rupee component of debt only the interest cost is taken into account but in the case of foreign borrowing, interest cost as well as the cost emanating from the depreciation of the rupee (or capital loss on foreign exchange) are taken into account. Thus, the capital loss on foreign exchange is added to the real interest cost. The average real cost of foreign borrowing was 2.7 percent per-annum in the 1990s [See Table-5.15]. Further dis-aggregation reveals that the real cost of borrowing was much higher (5.5%) in the second half of the 1990s mainly on account of a sharp depreciation of the rupee viz the US dollar and falling domestic inflation. Interestingly, the real costs of both the domestic and foreign debt averaged more or less the same in the second half of the 1990s. During the first three years of the current decade (2000-03), the real cost of borrowing for foreign exchange denominated loan declined to 1.7 percent and further turned into negative 4.1 percent in the last four years (2003-07). During the first three years (2000-03), the interest rates, appreciation of rupee along-with domestic inflation contributed to lowering of interest rates but in the next four years (2003-07), the depreciation of rupee along-with higher inflation contributed to negative incidence of real cost of borrowing. The low implied cost of external borrowing has contributed to overall declining trend in real cost of borrowing during the last seven years.

As a result of the sharp fluctuation in the real cost of borrowing for both domestic and foreign debt, the dynamics of the growth in public debt also changed over the last two decades. The changing dynamics of public debt is well-documented in Table-5.16. The growth in the public debt burden averaged 2.0 percent per annum during the 1990s. Interestingly, the rate of real growth in public debt decelerated to 4.9 percent but the decline in the public debt burden was not substantial because of a slowdown in the real growth of revenues. Real public debt grew at a faster pace of 6.2 percent during the second half of the 1990s as did the public debt burden which rose by 3.7 percent against a marginal rise of 0.4 percent during the first half of the 1990s. The real cost of borrowing was highest at 5.6 percent per annum, on average, during the second half of the 1990s. A sharp real depreciation in the exchange rate causing real cost of borrowing to rise, slower real growth in revenue and a low level of international as well as domestic inflation have been responsible for the rise in the public debt burden in the second half of the 1990s.

Table-5.16: Dynamics of Public Debt Burden

	Primary Fiscal Balance	**Real Cost of Borrowing**	**Real Growth of Debt**	**Real Growth of Revenues**	**Real Growth of Debt Burden**
	% of GDP	% Per Annum			
1980s	-3.7	2.3	10.6	7.6	3.0
1990s	-0.3	2.9	4.9	2.9	2.0
1990-I	-1.8	-2.4	3.6	3.2	0.4
1990-II	1.1	5.6	6.2	2.5	3.7
2000-03	1.6	4.3	1.4	6.9	-5.5
2003-07*	0.7	-1.7	-3.3	5.7	-9.0

** Up to March 07*

The pendulum swung to other extreme during 2003-07 when the real cost of foreign borrowing turned negative (-4.1%) from 1.7 percent in 2000-03. The parameters witnessed considerable changes in the first three years and the last four years. During the first three years (2000-03), the interest rates and inflation were benign alongwith appreciation of Pak-rupee. On the other hand in the last four years (2003-07) interest rate and inflationary pressure bounced back, and rupee depreciated against major currencies. The real cost of borrowing for domestic debt increased substantially to 6.3 percent on average during 2000-03 as against 5.7 percent in the second half of 1990, mainly on account of a sharp deceleration in inflation. However, the real cost of borrowing for public debt averaged 4.3 percent during 2000-03, slightly lower than 5.6 percent in the second half of the 1990s. The improvement in the real cost of borrowing for external debt on the one hand and fiscal consolidation effort on the other resulted in a sharp decline in the debt burden during 2000-03. The main contributor to this decline came from massive increase in real revenues and a slower real growth in debt. During 2003-07 the real growth in revenues slowed down owing to inflationary pressure in the economy, however, the public debt declined witnessed a negative growth in real terms by 3.3 percent which helped in deceleration in debt burden to the extent of 9.0 percent.

As shown in Table 5.16, the primary fiscal balance remained in surplus to the extent of over one percent of the GDP in 2003-07 and the real growth of debt also registered a decline of 3.3 percent and at the same time revenue grew at an average rate of 2.3 percent per annum. The combined effect of growth in revenue and sharp reduction in debt growth resulted in a sharp decline of (7.2% per annum) in the country's debt burden during the last seven years. An analysis of the dynamics of the public debt burden provides useful lessons for policy-makers to manage the country's public debt. First, every effort should be made to maintain a primary surplus in the budget. Second, the interest rate and inflation environment should remain benign. Third, the pace of revenue growth must continue to rise to increase the debt carrying capacity of the country. Center to all these lessons is the pursuance of prudent monetary, fiscal and exchange rate policies.

XII. Domestic Debt

Borrowing from domestic financial sources has several advantages including avoidance of exchange rate risk, lower liquidity risk and ability to deflate debt through higher inflation. On the other hand in most developing countries financial sectors are comparatively small which limits availability of loanable funds. Excessive borrowing by the public sector could lead to crowding out of the private sector as well as high interest rates and inflation. As the financial sector in Pakistan has expanded the government has relied more on borrowing from the domestic sources which at the end of first nine months of 2006-07 accounted for 54.0 percent of total public debt.

By end-June 2006 total domestic debt stood at Rs. 2312 billion which was 30 percent of GDP. The outstanding stock of domestic debt rose by Rs 211.8 billion and domestic debt stock stood at Rs.2523 billion by end-March 2007 which is 28.4 percent of GDP. It has risen by 9.1 percent by end-March 2007 over end-June 2006. This moderate growth of domestic debt compared to the trend growth rate of the 1990s, together with the increasing revenues and accelerating economic growth, implies that the economy's debt carrying capacity has been improving for the last seven years. The increase mainly emanates from floating debt while other two components, unfunded and permanent, witnessed decrease or stagnation even in absolute terms. The rise in the debt stock during the last nine months is because of financing requirement for rehabilitation work in earthquake affected area and extraordinary rise in development expenditure for infrastructure. However, the stock of domestic debt as percent of GDP declined from 35.7 percent in 2003-04 to 30.0 percent in 2005-06 and further to 28.4 percent by end March 2007.

XII.I. Composition of Domestic Debt

The domestic debt in Pakistan consists of permanent debt (medium and long-term), floating debt (short-term) and un-funded debt (medium and long-term, mostly national saving scheme-related). The increase in the domestic debt during 2006-07 in absolute terms was primarily came from a rise in the stock of floating debt, while it was complemented by modest rise in stock of the other two debt classes, permanent and unfunded. The share of floating debt which was undergoing substantial decline during the last five years, bounced back and escalated to 40.7 percent in 2005-06 and by end March 2007 it escalated to 43.1 percent. While the stock of unfunded debt continued to decline for the last four years in a row, mainly because of lowering of interest rates and the ban on institutional investments in NSS schemes, the fall in stock of permanent debt stemmed from rationalization of issuance of long-term PIBs to subside speculative element and keep long-term interest rate hospitable to long-run investment.

A slower rise in domestic debt combined with an increase in GDP growth and a fall in debt servicing cost led to an improvement in Pakistan's debt servicing capacity. The ratios of domestic debt to GDP and to tax revenue both decreased during 2006-07. The following tables provide a summary of outstanding domestic debt and domestic debt service requirements for the periods indicated.

Table-5.17: Outstanding Domestic Debt **(Rs. Billi**

	End June					End March
	2002	**2003**	**2004**	**2005**	**2006**	**2007**
Permanent Debt*	424.8	468.8	570.0	526.2	514.9	540.2
Floating Debt**	557.8	516.3	542.9	778.2	940.2	1086.5
Unfunded Debt***	792.1	909.5	899.2	854.0	859.2	896.6
Total	**1774.7**	**1894.5**	**2012.2**	**2158.4**	**2314.3**	**2523.4**
Total Domestic Debt as % of GDP	40.3	39.3	35.7	32.8	30.0	28.4

* Market Loans, Federal Government Bonds, Income Tax Bonds, Government Bonds (L.R. – 1977), Special Government Bonds For SLIC (Original), Special Government Bonds for SLIC (Capitalization), Bearer National Fund Bonds (BNFB), Special National Fund Bonds, Fe

** Treasure Bills (3 Months), Market Treasury Bills, MTBs for Replenishment.

*** Defence Savings Certificates, National Deposit Certificates, Khas Deposit Certificates, Special Savings Certificates (Reg), Special Savings Certificate (Bearer), Regular Income Certificates, Bahbood Savings Certificates, Khas Deposit Accounts, Saving

P = Provisional.

Source: Debt Management Section, Ministry of Finance.

XII.I.i Unfunded Debt

The stock of unfunded debt continued its downward slide for last three years in a row started since 2002-03. The decline in unfunded debt in 2002-03 was the first ever decline in stock of unfunded debt for last three decades. By June 2006, the stock of unfunded debt went marginally up by Rs.2.5 billion over its June 2005 level. However, by March 2007, the stock of unfunded debt witnessed an increase of Rs.40 billion in the stock. This type of debt instrument is comprise of National Savings Schemes (NSS). In response to various reforms in the NSS, the unfunded debt tends to rise in the first nine months of current fiscal year (July-March 2006-07).

XII.I.ii Floating Debt and Permanent Debt

The stock of floating debt continued to rise in 2006-07 also and reached Rs 1086.5 billion. However, the stock of permanent debt increased as well by Rs 26 billion after decline for the last two consecutive years. The Government has started taping money from auction of PIBs to satiate appetite for long-term paper and to promote the idea of secondary market development. The government is keeping a balance between long-term and short-term securities. The trade-off between short-run and longer run maturity is intricately designed to keep debt servicing cost lower.

XII.II. Domestic Debt Burden

The government strategy to keep balance between the long-term domestic debt and short-term debt meant that government's domestic debt servicing cost continued to fall in 2006-07. While the domestic debt servicing is expected to decline by 2.7 percent in 2006-07 as against massive rise of 16.3 percent and 14.2 percent during the last two year (2004-05 and 2005-06). This fall must be viewed in the context of the rising stock of the debt as well as the slight adjustment in the composition of the stock towards short-term debt in the last two years. This shows an increase in the interest payments on floating debt, while those on permanent debt and unfunded debt declined. The latter was due to a combination of: (1) maturities of expensive long term debt issued in past years; and (2) the net decline in the stock of long-term domestic debt

Figure 5.4: Structure of Domestic Debt, FY99-FY07
(In percent of total domestic debt)

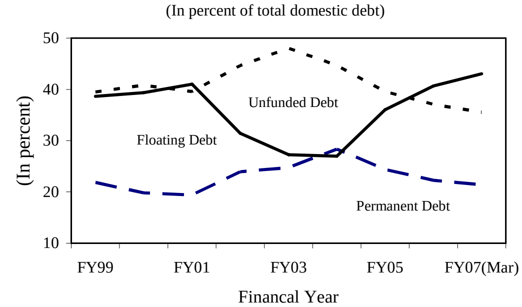


Table 5.18: Domestic Debt & Its Interest Payment

Year	Domestic Debt (Rs.bln)	Interest Payments (Rs.bln)	Interest Payments as % of Tax Revenue	Total Revenue	Total Expenditure	Current Expenditure	GDP (mp)
1990-91	448.2	35.7	27.5	20.8	13.7	18.2	3.5
1991-92	531.5	50.3	30.6	21.7	15.6	21.9	4.2
1992-93	615.3	62.7	35.2	26.0	18.0	23.0	4.7
1993-94	711.0	77.5	37.2	28.4	21.3	26.4	5.0
1994-95	807.7	77.9	30.2	24.1	18.2	22.5	4.2
1995-96	920.3	104.5	34.2	27.5	20.2	24.7	4.9
1996-97	1056.1	126.5	39.0	32.9	23.4	27.3	5.2
1997-98	1199.7	167.5	47.2	39.0	26.4	31.6	6.3
1998-99	1452.9	175.3	44.9	37.4	27.1	32.0	6.0
1999-00	1642.4	210.2	51.8	41.0	29.6	33.5	5.5
2000-01	1799.0	183.5	41.6	33.2	25.6	28.4	4.4
2001-02	1774.7	184.6	38.5	29.6	22.3	26.4	4.2
2002-03	1894.5	160.5	28.9	22.3	17.9	20.3	3.3
2003-04	2012.2	154.8	25.4	19.2	16.8	20.3	2.7
2004-05	2158.4	180.1	28.5	20.0	16.5	20.8	2.8
2005-06	2311.6	204.0	26.6	18.8	14.4	18.5	2.7
2006-07*	2523.4	198.4	22.4	17.1	12.9	17.9	2.3

* Budget Estimate *Source: Finance Division (Budget Wing)*

As a result of prudent fiscal management over the last 7 years, the burden of interest payments on the domestic debt has declined sharply, thereby, releasing resources for development and social sector programs. A cursory look at the table-5.18 is sufficient to see that interest payments as a percentage of total revenue have been reduced to one-half (41 percent to 20 percent) over the last seven years. Similarly, share in total expenditure declined from 30 percent to 16 percent during the same period. Most importantly, as percentage of GDP, interest payments declined from 6 percent to 2.7 percent in the last six years.

XIII. Conclusions

Fiscal prudence and discipline is essential for preventing macroeconomic imbalances and realizing full growth potential in an economy. Pakistan has made considerable stride towards fiscal consolidation over the last seven years. The overall fiscal deficit is down from an average of 7.0 percent of GDP in the 1990s to 3.3 percent in 2004-05. However, the fiscal deficit bounced back to 4.2 percent of GDP in 2005-06 and 2006-07, mainly on account of expenditure incurred on rehabilitation work in earthquake affected areas in these two years. Encouraging thing is that revenues remained buoyant. The underlying fiscal deficit mainly remained below four percent of GDP for the last seven years. The associated public debt burden also declined sharply from over 100 percent of GDP in 1999-2000 to close to 53.4 percent by end March 2007.

Fiscal consolidation has undoubtedly contributed to lead the economy to higher growth trajectory accompanied by macroeconomic stabilization. Fiscal balance remained under pressure during the last two fiscal years owing to massive earthquake-related spending but the government kept its commitment towards higher social sector expenditure. Revenue performance definitely helped easing some pressure on the earthquake-related spending. Going forward, Pakistan will have to allocate substantially large resources for strengthening the country’s physical and human infrastructure to sustain the growth momentum. The emerging development horizon need substantial resources to finance infrastructure and current narrow tax base would be restraining factor. The government will therefore, has to make efforts to broaden the tax base i.e. to hitherto untaxed or under taxed sectors. Broadening of tax base will enable the government to reduce marginal tax rates which is catalyst in stimulating investment and production besides enhancing voluntary tax compliance. Broadening of tax base will ensure the fair distribution of the tax burden among various sectors of the economy. The overall services sector including wholesale and retail trade as well as agriculture are potential candidates for broadening the tax bases.

TABLE 4.1

FEDERAL GOVERNMENT OVERALL BUDGETARY POSITION

(Rs Million)

Fiscal Year/ Item				2005-06 (R.E)	2006-07 (B.E)
A. REVENUE					
1.	Direct Taxes			224,988	268,200
2.	Indirect Taxes			488,454	566,800
	i.	Customs		138,384	157,100
	ii.	Sales Tax		294,798	341,600
	iii.	Federal Excise		55,272	68,100
3.	Total Tax Revenue			713,442	835,000
	(1+2)			755,934	864,371
4.	Surcharges			42,492	29,371
	i.	Natural Gas		22,257	18,071
	ii.	Petroleum		20,235	11,300
5.	Non-Tax Revenue			272,881	246,600
6.	Total Revenue Receipts Gross (3+4+5)			1,028,815	1,110,971
B. EXPENDITURE					
9.	Current Expenditure*			791,703	794,192
	i.	Defence		241,063	250,182
	ii.	Debt Servicing		241,191	239,506
	iii.	Grants		212,226	144,242
	iv.	Economic Services	@	67,572	74,663
	v.	Health & Education		21,108	23,506
	vi.	Other		8,543	62,093
10.	Development Expenditure(PSDP)			215,104	315,041
11.	Total Expenditure (9+10)			1,006,807	1,109,233

RE- Revised Estimate

Source: Budget Wing, Finance Division, Islamabad

B.E.- Modified Budget Estimate

@ : Include Law and Order, Social, Economic and Community Services

* Current expenditure here includes earthquake related spendings

TABLE 4.2

SUMMARY OF PUBLIC FINANCE (CONSOLIDATED FEDERAL AND PROVINCIAL GOVERNMENTS)

(Rs Million)

Fiscal Year/ Item	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06 R.E.	2006-07 (B.E)	% Change 2006-07/ 2005-06
Total Revenues (I+ii)	*429,454*	*468,601*	*512,500*	*553,000*	*624,100*	*720,800*	*805,827*	*900,014*	*1,076,600*	*1,162,700*	*8.0*
Federal	400,342	429,691	477,600	514,000	584,000	673,600	745,895	842,900	992,200	1,060,000	*6.8*
Provinical	29,112	38,910	34,900	39,000	40,100	47,200	59,932	57,114	84,400	102,700	*21.7*
I) Tax Revenues	354,754	390,726	405,600	441,600	478,100	555,800	617,899	659,410	803,700	916,100	*14.0*
Federal	338,042	375,078	386,800	422,500	459,300	534,000	583,818	624,700	766,900	864,400	*12.7*
Provincial	16,712	15,648	18,800	19,100	18,800	21,800	34,081	34,710	36,800	51,700	*40.5*
ii) Non-Tax Revenues	74,700	77,875	106,900	111,400	146,000	165,000	187,928	240,604	272,900	246,600	*-9.6*
Federal	62,400	54,613	90,800	91,500	124,700	139,600	162,077	218,200	225,300	195,600	*-13.2*
Provinical	12,300	23,262	16,100	19,900	21,300	25,400	25,851	22,404	47,600	51,000	*7.1*
Total Expenditures (a+b+c)	*634,014*	*647,778*	*709,100*	*717,900*	*826,250* *	*898,200*	*940,359*	*1,116,981*	*1,401,900*	*1,536,241*	*9.6*
a) Current	529,919	547,279	626,400	645,700	700,200	791,700	763,077	864,500	1,034,700	1,106,200	*6.9*
Federal	407,219	424,443	477,900	479,000	524,600	599,800	582,380	664,200	789,100	774,200	*-1.9*
Provinical	122,700	122,836	148,500	166,700	175,600	191,900	180,697	200,300	245,600	332,000	*35.2*
b) Development(PSDP)	104,095	98,286	95,600	89,800	126,250	129,200	160,988	227,718	365,100	435,000	*19.1*
c) Net Lending to PSE's	-	2,213	-12,900	-17,600	-200	-22,700	16,294	24,763	2,100	-4,959	-
d) Statistical Discripency	-	-	9,700	14,800	-11,700	3,200	-	0	-86,307	0	-
Overall Deficit	-204,560	-179,177	-206,300	-179,700	-190,450	-180,600	-134,532	-216,967	-325,300	-373,541	-
Financing (net)	204,992	179,177	206,300	179,700	190,450	180,600	134,532	216,988	325,200	373,500	-
External (Net)	38,761	97,070	69,700	120,700	83,100	113,000	-4,475	120,432	148,900	171,746	-
Domestic (i+ii)	*166,231*	*82,108*	*136,600*	59,000	107,350	67,600	139,007	96,556	176,300	201,754	-
i) Non-Bank	118,202	155,919	*96,700*	*92,000*	85,000	119,500	64,097	8,050	8,100	6,661	-
ii) Bank	48,029	-73,811	39,900	-33,000	14,000	-55,600	63,698	60,179	70,900	140,093	-
iii) Privatization Proceeds	-	-	-	-	8,350	3,700	11,212	28,327	97,300	55,000	-
Overall Deficit Excl.											
Memorandum Item											
GDP (mp) in Rs. Billion	2,678	2,938	3,826	4,210	4,453 0	4,876	5,641	6,500	7,594	8,707	14.7
					(As Percent of GDP at Market Price)£						
Total Revenue	16.0	15.9	13.4	13.1	14.0	14.8	14.3	13.8	14.2	13.4	
Tax Revenue	13.2	13.3	10.6	10.5	10.7	11.4	11.0	10.1	10.6	10.5	
Non-Tax Revenue	2.8	2.7	2.8	2.6	3.3	3.4	3.3	3.7	3.6	2.8	
Expenditure	23.7	22.0	18.8	17.4	18.3	18.5	16.7	17.2	18.5	17.6	
Current	19.8	18.6	16.4	15.3	15.7	16.2	13.5	13.3	13.6	12.7	
Development	3.9	3.3	2.5	2.1	2.8	2.2	3.1	3.9	4.8	4.9	
Overall Deficit Incl. E.quake Exp.	7.7	6.1	5.4	4.3	4.3	3.7	2.4	3.3	4.3	4.3	

B.E: Budget Estimates

R.E: Revised Estimates

Source: Budget Wing, Finance Division, Islamabad

£ Beginning from 1999-2000, Pakistan's GDP was rebased at 1999-2000 Prices from two decades old base of 1980-81 Therefore, wherever, GDP appears in denominator the number of prior to 1999-2000 are not comparable.

TABLE 4.3

CONSOLIDATED FEDERAL AND PROVINCIAL GOVERNMENTS REVENUES

(Rs Million)

Fiscal Year/ Item	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06 (R.E)	2006-07 (B.E)	% change 2006-07/ 2005-06
Total Revenue (I+II)	429,454	468,601	512,500	553,000	624,100	720,800	791,100	900,014	1,076,600	1,162,700	8.0
Federal	400,442	429,691	477,600	514,000	584,000	673,600	740,900	842,900	992,200	1,060,000	6.8
Provincial	29,012	38,910	34,900	39,000	40,100	47,200	50,200	57,114	84,400	102,700	21.7
I. Tax Revenues (A+B)	354,754	390,726	405,600	441,600	479,335	555,800	608,400	659,410	803,700	916,100	14.0
Federal	338,042	375,078	386,800	422,500	460,224	534,000	580,300	624,700	766,900	864,400	12.7
Provincial	16,712	15,648	18,800	19,100	19,111	21,800	28,100	34,710	36,800	51,700	40.5
A. Direct Taxes (1+2)	105,098	105,588	115,672	128,556	147,403	157,886	169,858	193,075	230,298	278,054	20.7
Federal	103,182	103,476	112,600	124,585	142,649	151,976	165,300	176,930	215,000	268,200	24.7
Provincial	1,916	2,112	3,072	3,971	4,754	5,910	4,558	16,145	15,298	9,854	-35.6
B. Indirect Taxes (3+4+5+6+7)	249,656	285,138	289,931	315,732	331,932	396,109	439,996	466,286	595,739	639,892	7.4
3. Excise Duty	62,922	62,691	56,934	50,325	48,572	45,437	46,228	60,813	58,702	70,749	20.5
Federal	62,011	60,572	55,600	49,000	47,189	44,002	44,600	58,670	55,000	68,100	23.8
Provincial	911	2,119	1,334	1,325	1,383	1,435	1,628	2,143	3,702	2,649	-28.4
4. Sales Tax*	53,942	68,680	116,767	153,500	166,618	195,138	219,100	235,533	294,600	341,600	16.0
5. Taxes on International Trade	74,496	78,654	61,600	65,000	47,817	68,835	89,900	117,243	138,200	157,100	13.7
6. Surcharges*	42,911	61,927	38,912	30,200	54,854	68,230	61,400	26,769	50,800	18,071	-64.4
6.1 Gas	6,364	9,855	13,500	12,300	18,867	21,358	16,800	16,165	26,300	18,071	-31.3
6.2 Petroleum	36,547	52,072	25,400	17,900	35,987	46,872	44,600	10,604	24,500	0	-100.0
7. Other Taxes **	15,385	13,186	15,718	16,707	14,071	18,469	23,368	25,928	53,437	52,372	-2.0
7.1 Stamp Duties	4,814	5,287	6,397	5,230	5,721	6,631	7,564	10,573	13,033	15,110	15.9
7.2 Motor Vehicle Taxes	2,113	2,368	2,803	3,121	3,195	3,893	4,638	5,749	7,476	8,206	9.8
7.3 Foreign Travel Tax*	1,464	1,769	1,350	1,048	1,097	4,054	2,088	2,050	2,739	3,713	35.6
7.4 Others	6,994	3,762	5,168	7,308	4,058	3,891	9,078	7,556	30,189	25,343	-16.1
II. Non-Tax Revenues	74,700	77,875	106,900	111,400	146,000	165,000	182,700	240,604	272,900	246,600	-9.6
Federal	62,400	54,613	90,800	91,500	124,700	139,600	160,600	218,200	225,300	195,600	-13.2
Provincial	12,300	23,262	16,100	19,900	21,300	25,400	22,100	22,404	47,600	51,000	7.1

* Revenues under these heads are exclusively Federal.

** Mainly include Provincial Revenues.

B.E Budget Estimate

R.E. Revised Estimates.

Source: Budget Wing, Finance Division, Islamabad

TABLE 4.4

CONSOLIDATED FEDERAL AND PROVINCIAL GOVERNMENTS EXPENDITURES

(Rs million)

Fiscal Year/	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
Item									RE	(B.E)
Current Expenditure	*529,911*	*547,279*	*626,400*	*645,700*	*700,200*	*791,700*	*763,077*	*864,500*	*1,034,700*	*1,106,200*
Federal	407,211	424,443	477,900	479,000	524,600	599,800	582,380	664,200	789,100	774,200
Provincial	122,700	122,836	148,500	166,700	175,600	191,900	180,697	200,300	245,600	332,000
Defence	136,164	143,471	150,400	131,200	149,254	159,700	184,904	211,717	241,063	250,182
Interest	202,356	220,100	262,247	249,252	273,894	235,304	226,256	219,744	260,021	262,285
Federal	196,251	213,259	245,100	234,500	245,300	209,700	202,500	210,196	237,119	239,507
Provincial	6,105	6,841	17,147	14,752	28,594	25,604	23,756	9,548	22,902	22,778
Current Subsidies	8,840	15,035	23,239	29,028	29,221	57,114	67,920	66,673	101,238	76,039
Federal	6,268	9,533	14,700	19,900	25,488	50,000	62,500	57,800	86,300	74,010
Provincial	2,572	5,502	8,539	9,128	3,733	7,114	5,420	8,873	14,938	2,029
Gen. Administration*	61,431	66,950	92,108	100,981	91,024	100,210	120,023	130,531	157,353	157,353
Federal	27,344	26,650	47,500	70,700	56,300	60,900	75,500	81,400	103,100	103,100
Provincial	34,087	40,300	44,608	30,281	34,724	39,310	44,523	49,131	54,253	54,253
All Others**	121,120	101,723	98,406	135,239	156,807	239,372	163,974	235,835	275,025	360,341
Development Expenditure	*104,095*	*98,286*	*95,600*	*89,800*	*126,250*	*129,200*	*160,988*	*227,718*	*365,100*	*435,000*
Net Lending to PSEs	-	2,213	-12,900	-17,600	*-200*	*-22,700*	*16,294*	*24,763*	*2,100*	*-4,959*
Total Expenditure	*634,006*	*647,778*	*709,100*	*717,900*	*826,250*	*898,200*	*940,359*	*1,116,981*	*1,401,900*	*1,536,241*
Memorandum Items:				(Percent Growth over Preceeding period)						
Current Expenditure	16.4	3.3	14.5	3.1	8.4	13.1	-3.6	13.3	19.7	6.9
Defense	6.8	5.4	4.8	-12.8	13.8	7.0	15.8	14.5	13.9	3.8
Interest	25.6	8.8	19.1	-5.0	9.9	-14.1	-3.8	-2.9	18.3	0.9
Current Subsidies	-25.8	70.1	54.6	24.9	0.7	95.5	18.9	-1.8	51.8	-24.9
General Administration	33.8	9.0	37.6	9.6	-9.9	10.1	19.8	8.8	20.5	0.0
All Others	11.2	-16.0	-3.3	37.4	15.9	52.7	-31.5	43.8	16.6	31.0
Development Expenditure	21.7	-5.6	-2.7	-6.1	40.6	2.3	24.6	41.5	60.3	19.1
Total Expenditure	17.2	2.2	9.5	1.2	15.1	8.7	4.7	18.8	25.5	9.6
					As % of Total Expenditure					
Current Expenditure	83.6	84.5	88.3	89.9	84.7	88.1	81.1	77.4	73.8	72.0
Defense	21.5	22.1	21.2	18.3	18.1	17.8	19.7	19.0	17.2	16.3
Interest	31.9	34.0	37.0	34.7	33.1	26.2	24.1	19.7	18.5	17.1
Current Subsidies	1.4	2.3	3.3	4.0	3.5	6.4	7.2	6.0	7.2	4.9
General Administration	9.7	10.3	13.0	14.1	11.0	11.2	12.8	11.7	11.2	10.2
All Others	19.1	15.7	13.9	18.8	19.0	26.7	17.4	21.1	19.6	23.5
Development Expenditure@	16.4	15.5	11.7	10.1	15.3	11.9	18.9	22.6	26.2	28.0
Total Expenditure	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Budget Wing, Finance Division

* Also include law & order, social, Economic and Community Services.

** Include mainly Provincial Expenditures.

@ Include net lending

Note: Variation in figures of interest payments of table 4.4 and 4.5 is on account of different methodology and sources of data collection used by Budget Resource Section and Debt Management Section of Finance Division.

BE: Budget Estimates

RE: Revised Estimates

TABLE 4.5

DEBT SERVICING

Fiscal Year/ Item	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06 RE	2006-07 BE	%Change 2006-07/ 2005-06
											(Rs million)
A. Interest Payments	202,356	220,100	273,909	254,234	278,671	241,678	236,849	250,611	276,565	262,285	-5.2
A.1 Federal	196,251	213,259	256,762	239,482	250,077	216,074	202,940	216,042	244,648	239,507	-2.1
Interest on Domestic Debt	167,513	175,273	210,155	188,482	189,477	166,874	161,540	176,342	202,548	190,786	-5.8
Interest on Foreign Debt	28,738	37,986	46,607	51,000	60,600	49,200	41,400	39,700	42,100	48,721	15.7
Foreign Loans	24,836	30,335	34,691	40,355	68,134	45,571	111,258	35,030	63,603	50,651	-20.4
IMF Drawings	1,555	1,707	2,513	2,909	2,483	0.0	1,295	423	0	0	
Food Credit/Short											
Short Term Borrowings	2,347	3,133	6,167	4,187	2,483	1,840	288	445	814	1,213	49.0
Euro Bonds	-	2,811	3,236	4,690	4,812	3,609	2,242	4,720	5,774	7,762	34.4
$ Denomination Bonds				-		429	265	198	264	265	0.2
A.2 Provincial	6,105	6,841	17,147	14,752	28,594	25,604	33,909	34,569	31,917	22,778	-28.6
B. Repayments/Amortization of Foreign Debt.	83,961	122,980	97,071	96,160	164,905	64,234	69,765	55,724	85,411	65,211	-23.7
Foreign Loans	59,327	77,431	78,608	74,623	68,134	46,207	45,978	54,258	63,603	56,336	17.2
Food Credits	24,634	45,549	18,463	21,537	96,771	18,027	23,787	1,466	21,809	13,264	1387.6
C. Total Debt Servicing (A+B)	286,317	343,080	370,980	350,394	443,576	305,912	306,614	306,335	361,976	327,496	18.2
MEMORANDUM ITEMS					(As Percent of GDP)£						
Interest on Domestic Debt (Federal)	6.3	6.0	5.5	4.5	4.3	3.4	2.9	2.7	2.7	2.2	
Interest on Foreign Debt	1.1	1.3	1.2	1.2	1.4	1.0	0.7	0.6	0.6	0.6	
Repayment of Foreign Debt	3.1	4.2	2.5	2.3	3.7	1.3	1.2	0.9	1.1	0.7	
Total Debt Servicing	10.7	11.7	9.7	8.3	10.0	6.3	5.4	4.7	4.8	3.8	

\- nil

Source: D.M. Section, Finance Division,Islamabad

B.E: Budget Estimates

R.E. Revised Estimates

Note: Variation in figures of interest payments of table 4.4 and 4.5 is on account of different methodology and sources of data collection used by Budget Resource Section and Debt Management Section of Finance Division.

£ Beginning from 1999-2000, Pakistan's GDP was rebased at 1999-2000 Prices from two decades old base of 1980-81 Therefore, wherever, GDP appears in denominator the number of prior to 1999-2000 are not comparable.

TABLE 4.6

INTERNAL DEBT OUTSTANDING (AT END OF PERIOD)

(Rs million)

Fiscal Year/ Type of Debt	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06 (A)	2006-07 B.E.	% Change 2006-07/ 2005-06
Permanent Debt	317,402	325,569	349,212	424,767	468,768	570,009	526,179	514,879	528,303	2.6
Floating Debt	561,590	647,428	737,776	557,807	516,268	542,943	778,163	940,233	930,062	-1.1
Un-funded Debt	573,945	671,783	712,010	792,137	909,500	899,215	854,044	859,162	893,386	4.0
Total	1,452,937	1,644,780	1,798,998	1,774,711	1,894,536	2,012,167	2,158,385	2,314,274	2,351,751	1.6
					(Percent Share in Total Debt)					
Memorandum Items:										
Permanent Debt	21.8	19.8	19.4	23.9	24.7	28.3	24.4	22.2	22.5	
Floating Debt	38.7	39.4	41.0	31.4	27.3	27.0	36.1	40.6	39.5	
Un-funded Debt	39.5	40.8	39.6	44.6	48.0	44.7	39.6	37.1	38.0	
Total Debt as % of GDP (mp)	49.4	43.0	42.7	39.9	38.9	35.7	33.2	30.5	27.0	

R.E: Revised Estimates

Source: D.M. Section, Finance Division,Islamabad