Fiscal Development

A sound and prudent fiscal policy is considered to be an important determinant of achieving inclusive growth because it helps in attaining desired economic and social objectives through efficient combination of government expenditures and taxation. This way it ensures fiscal prudence which not only deals with fiscal risks and high public debt but is also indispensable for reducing poverty and improving social outcomes.

There is a wide consensus that a sound fiscal policy not only promotes macroeconomic stability but also directs more public resources to social development. Hence there is a dual impact of fiscal policy on the economy. First it helps to encourage the inclusive growth through public spending and secondly it maintains fiscal sustainability through public revenues.

While recognizing the importance of fiscal discipline for inclusive growth, countries around the world place fiscal restraint at the top of their economic agenda. Recent data reveals that advanced countries (except Japan, where fiscal consolidation plan is expected to start this year) have successfully narrowed down the fiscal deficit through fiscal consolidation plan, however, underlying fiscal vulnerabilities are still high on account of persistently high debt, weak growth prospects due to risks to fiscal forecasts along with medium term policy uncertainty and persistent deflationary concerns. Fiscal deficit in advanced economies is projected to remain at 4.3 percent in 2014 against 6.2 percent recorded in 2012.

Fiscal vulnerabilities are equally high in emerging and low income countries. As deficit remained significantly high as most countries opted to defer fiscal adjustment in 2014. However, few countries like Jordan, Morocco and Pakistan strengthened their primary fiscal positions, mainly by cutting expenditures. On the other hand China and India recorded moderate improvements in the cyclically adjusted deficit, supported by higher revenue and spending cuts, respectively.

Fiscal deficit in emerging economies is expected to remain at 2.5 percent in 2014 against 2.1 percent in 2012 and in low income economies it is expected to rise by 3.9 percent in 2014 from 2.8 percent in 2012.[*]

Considering the case of Pakistan, fiscal predicament remained one of the major concerns due to failure to develop an effective tax system to raise the revenues up to the level which was required to finance government spending. Its repercussions were felt on fiscal side of the economy as efforts to achieve fiscal sustainability were severely hampered due to unplanned expenditures on one hand and continuous shortfall in revenues on the other. Over the past few years, Pakistan’s economy witnessed numerous challenges such as unprecedented floods, low tax to GDP ratio, high fiscal deficit, mounting public debt, high interest payments, untargeted subsidies and resource drain through PSEs, which resulted in expenditure overrun.

Additionally, failure to exploit other avenues and delays in key reforms for revenue mobilization and regulate current expenditure to overcome revenue deficit resulted in constant revenue shortfall over expenditure due to which governments in past were compelled to restrict the development spending. Moreover, less than expected external inflows further intensified the situation.

Fiscal deficit widened from 5.2 percent of GDP in 2008-09 to 8.2 percent of GDP in 2012-13 mainly driven by weak tax collections, energy sector subsidies, and increased provincial government spending. Total expenditures rose from 19.2 percent of GDP in 2008-09 to 21.4 percent of GDP in 2012-13, while on the other hand total revenues declined from 14.0 percent of GDP to 13.3 percent of GDP during the same period. On the other hand, FBR tax collection despite increase in absolute term from Rs. 1,161.1 billion in 2008-09 to Rs.1946.4 billion

[*] Fiscal Monitor (IMF) , April, 2014

remained at 8.7 percent of GDP. However, with the continuous efforts to address the long standing structural issues, fiscal sector witnessed remarkable improvement during first nine months of current fiscal year, as overall fiscal deficit remained at 3.2 percent of GDP during July-March, 2013-14 against 4.7 percent recorded last year. IMF has described this improvement as "strong" and agreed that government's reform program is on right track and economy is moving into right direction.

Fiscal Policy Development

Present government is well aware of this fact that sustained fiscal discipline is the cornerstone of long term economic growth as it creates fiscal buffer not only to cover rising public expenditures but also helps in coping with any untoward situation. The government is therefore determined to build up strong fiscal reserves through its reform agenda with particular focus on controlling the expenditure along with raising the revenues. Main aspiration is to boost the inclusive growth and moving towards sustainable fiscal and external positions. At the same time, it also aims to reduce the potential risks to the economy through permanent resolution of long standing structural impediments.

In the past, absence of prudent expenditure management and failure to increase the revenues owing to delays in key structural reforms particularly in energy sector and for tax broadening posed serious risks to macroeconomic outlook of the country. Moreover, loss making Public Sector Enterprises (PSEs) in confluence with heightened security concerns, untargeted subsidies and higher interest payments further jumbled the public finances.

All the key fiscal indicators surpassed their budgeted targets set for relevant years, which largely a reflection of structural deficiencies particularly in tax system. Hence, budgetary management during the past few years remained difficult on account of containment of development spending and rising borrowing from the banking system.

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
2005-06	5.8	4.0	17.1	12.6	4.5	13.1	9.8	3.3
2006-07	5.5	4.1	19.5	14.9	4.6	14.0	9.6	4.4
2007-08	5.0	7.3	21.4	17.4	4.0	14.1	9.9	4.2
2008-09	0.4	5.2	19.2	15.5	3.7	14.0	9.1	4.9
2009-10	2.6	6.2	20.2	16.0	4.4	14.0	9.9	4.1
2010-11	3.7	6.5	18.9	15.9	2.8	12.3	9.3	3.0
2011-12	3.8	6.8	19.6	15.6	3.7	12.8	10.2	2.6
2012-13	3.7	8.2	21.4	16.3	5.1	13.3	9.8	3.5
2013-14 B.E.	4.4	6.3	20.4	15.2	5.1	14.0	10.6	3.4

*: including net lending.

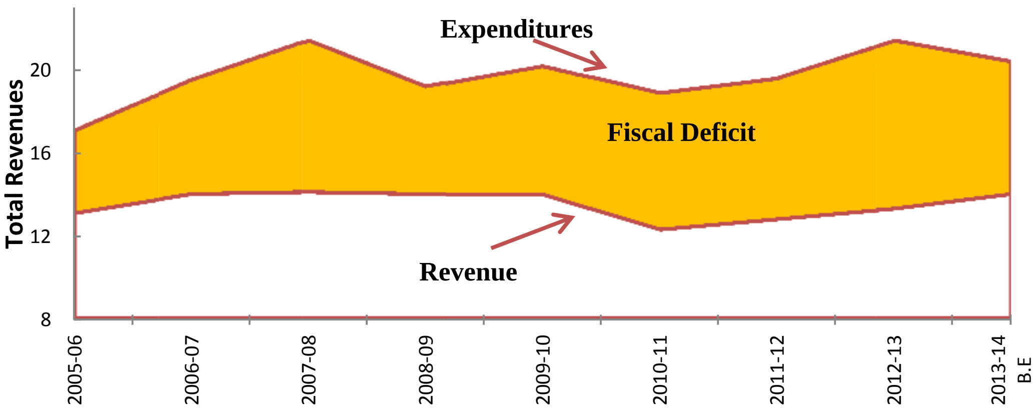
Note: Estimated growth during fiscal year 2013-14 is 4.14 percent

A cursory look at the Table 4.1 shows that fiscal deficit increased from 5.2 percent of GDP in 2008-09 to 8.2* percent of GDP in 2012-13 due to expenditure overrun and less than targeted revenues. During the period under review, total expenditures remained volatile and increased from 19.2 percent of GDP in 2008-09 to 21.4 percent of GDP during fiscal year 2012-13. In total expenditures, current expenditures rose from 15.5 percent of GDP in 2008-09 to 16.3 percent of GDP in 2012-13. On the other hand development expenditures and net lending stood at 5.1 percent of GDP in 2012-13 against 3.7 percent of GDP recorded in 2008-09.

On the revenue side, tax to GDP ratio remained within the narrow band of 9.1 to 10.2 percent of GDP since 2008-09 to 2012-13. Total revenues reduced from 14.0 percent of GDP during the fiscal year 2008-09 to 13.3 percent of GDP in 2012-13 mainly due to decline in non tax revenues from 4.9 percent of GDP in 2008-09 to 3.5 percent of GDP in 2012-13. Sluggish performance in total revenues is mainly attributed to less than targeted tax revenues due to failure to implement the tax reforms and a slowdown in economic activity on account of energy crisis.

* This includes the power sector circular debt settlement of Rs.342 billion or 1.5 percent of GDP in June 2013 while remaining Rs.138 billion were paid off during the first month of current fiscal year, 2013-14.

Fig: 4.1 Revenue-Expenditure Gap (% of GDP)



However, during the current fiscal year, various measures have been taken to ensure the fiscal sustainability. In this regard, present government is stringently focused on improving the fiscal accounts through fiscal consolidation efforts which includes phasing out of electricity subsidies, restructuring/privatization of bleeding PSEs (Box-1), and raising the tax and non tax revenues during fiscal year 2013-14.

Box-1: - Public Sector Enterprise (PSE) Reforms

Main focus of PSE Reform Strategy is on improvement in corporate governance, restructuring of PSEs and Strategic Partnership through Privatization. The government has formed a high level Commission for ensuring transparency in appointment of heads of key public sector organizations and bodies.

The Economic Coordination Committee (ECC) of the Cabinet has approved a three-month bailout package of Rs 2.9 billion for Pakistan Steel Mills (PSM) for salaries and the requisite working capital, which has already been released. In addition, the ECC has recently approved payment of Rs.960 million for salaries of PSM employees for the months of December 2013 and January 2014. The BoDs of PSM was reconstituted in October 2013 with the addition of five members from the private sector and the BoDs have recently identified a number of viable options of dealing with PSM's problems. The ECC recently approved a restructuring plan for PSM in April, 2014 amounting to Rs. 18.5 billion which envisages achieving 77 percent capacity utilization of PSM by June, 2015.

A bailout package of Rs. 16 billion was approved by ECC in July 2013 for PIA, out of which Rs. 14.65 billion have been released upto April 2014. This has helped improve flight schedule and undertake smoother Hajj operations due to leasing of 6 additional aircraft. An amount of Rs. 33.5 billion has been allocated as a grant to Pakistan Railways (PR) out of which Rs.27.9 billion has been released up to April 2014. For the development schemes, GoP has allocated Rs. 30.97 billion in Public Sector Development Program (PSDP) for FY14. A comprehensive Railway restructuring plan is under development and will be finalized by September, 2014. The plan includes improvement in business processes and institutional framework, financial stability and service delivery. The Railway board is also being revived. Finance Division is also making efforts to develop a database on GoP Investment Tracing and Performance Monitoring that will help make evidence based decisions for revival of PSEs.

The government is envisaging privatization/ disinvestment of 31 PSEs representing the most viable transactions. The indicative mode of related divestments has been finalized.

In a recent development, Eleven companies in the oil & gas, banking & insurance and power sector have been identified for block sales and primary or secondary public offerings, from the list of 31 Public Sector Enterprises (PSEs) approved by the Cabinet Committee on Privatization (CCOP). Three Financial Advisors have been hired for United Bank Limited (UBL), Pakistan Petroleum Limited (PPL) and Oil and Gas Development Company Limited (OGDCL) in May 2014.Minorty shares in UBL and PPL will be offered to domestic and international investors by end June 2014, subject to investor interest and global market conditions. OGDCL shares will be offered for sale early next fiscal year. Financial advisors for Allied Bank Limited (ABL) and Habib Bank Limited (HBL) will be hired by September 2014 for offering minority shares of these banks within six months afterwards.

Financial advisor for National Power Construction Co (NPCC) will be hired by end June 2014 to finalize sale offer by end December 2014. In addition, financial advisors for sale of shares of Faislabad Electric Supply Company (FESCO) and Northern Power Generation Company Limited (NPGCL) will be appointed next year.

For Pakistan International Airlines (PIA), a financial advisor will be appointed by end-June 2014 to seek potential options for restructuring and strategic private partnership

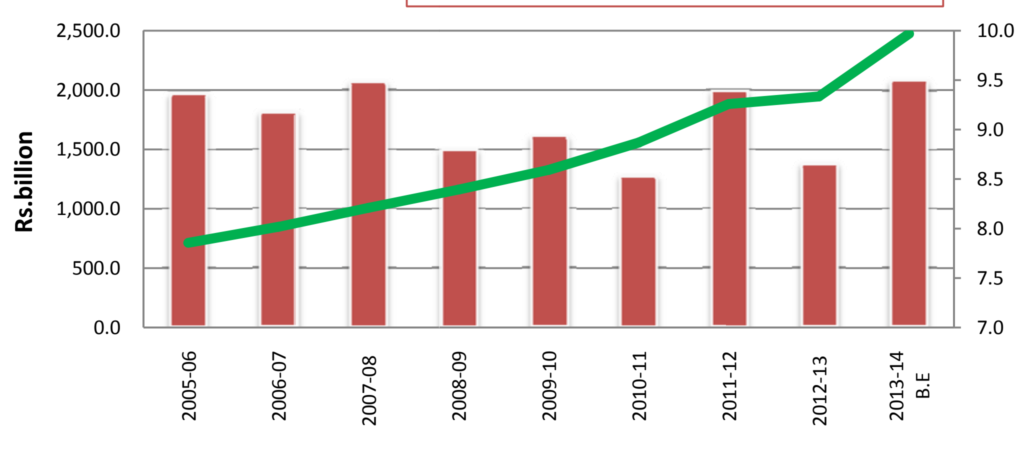
With various steps to control the expenditures and to increase the revenues, fiscal deficit is expected to reduce to even less than 6.0 percent against the target of 6.3 percent of GDP in fiscal year 2013-14, while it will be brought down further to 4.0 percent of GDP over the medium term. Similarly, total revenues are expected to reach at 14.0 percent of GDP in 2013-14 from the current level of 13.3 percent, of which tax revenues are expected to increase by 10.6 percent and non tax revenues by 3.4 percent of GDP during the current fiscal year. Revenue targets are expected to achieve on account of government's wide-ranging policy for the fiscal year 2013-14 and onwards to enhance resource mobilization efforts in the country. Whereas, total expenditures are set to remain at 20.4 percent of GDP in 2013-14, of which current expenditures are expected to remain at 15.2 percent and development expenditures and net lending at 5.1 percent of GDP.

Structure of Tax Revenues

Governments around the world use number of sources in order to finance their spending, which can be categorized as domestic and external. Domestic resources consist of savings, tax and non tax revenues, whereas foreign sources include foreign direct investment, borrowing, and foreign aid etc. Domestic resource mobilization is more effective for a sustainable growth as well as to finance physical infrastructure along with the provision of social services. Nevertheless, the most efficient and effective way to enhance country's domestic resource mobilization effort is to develop its tax system.

Unfortunately, most of the developing countries could not develop such a system mainly due to agrarian nature of their economy and lack of harmony at national level and Pakistan is no exception to it. Raising tax to GDP ratio significantly is critical in order to ensure fiscal sustainability and rebuilding ample resources which in turn can be used for much needed social and investment expenditures while lowering the fiscal deficit.

Fig: 4.2- FBR Tax Revenue



Unfortunately, Pakistan's tax system has not been stabilized as evident from the historical data (Table: 4.2). Structural weaknesses like narrow tax base, massive tax evasion and administrative weaknesses significantly undermined the overall tax collection as the country has witnessed a low total tax-to GDP ratio. As shown in Fig: 4.2 , despite the increase in tax revenues, FBR tax to GDP ratio remained narrow and varied between 8.5 to 9.5 percent during the past 8 years.

Table 4.2: Structure of Federal Tax Revenue (Rs. in billion)

Year	Total (FBR)	Tax Rev as % of GDP	Direct Taxes	Indirect Taxes			
				Customs	Sales	Excise	Total
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]

Table 4.2: Structure of Federal Tax Revenue (Rs. in billion)

Year	Total (FBR)	Tax Rev as % of GDP	Direct Taxes	Indirect Taxes			
				Customs	Sales	Excise	Total
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	1,946.4	8.7	743.4	239.5	842.5	121.0	1,203.0
			[38.2]	{19.9}	{70.0}	{10.1}	[61.8]
2013-14B.E	2,475.0	9.5	975.7	279.0	1,053.5	166.8	1,499.3
			[39.4]	{18.6}	{70.3}	{11.1}	[60.6]

[]as % of total taxes
{} as % of indirect taxes
Source: Federal Board of Revenue

Pakistan's tax structure has witnessed extensive changes over the years as the share of direct tax increased from 31.5 percent in 2005-06 to 38.2 percent in 2012-13 and is expected to increase further to 39.4 percent in 2013-14. On the other hand, share of Sales tax in total tax collection increased from 41.3 percent in 2005-06 to 43.3 percent in 2012-13 and is expected to reduce to 42.6 percent. Custom duty in indirect taxes has reduced from 28.3 percent in 2005-06 to 19.9 percent in 2012-13 and expected to reduce further to 18.6 percent in 2013-14. While share of Federal excise duty in indirect taxes has declined from 11.3 percent in 2005-06 to 10.1 percent in 2012-13 and expected to increase to 11.1 percent in 2013-14. Sales tax as an important consumption tax accounts for 70.3 percent of indirect tax.

In the above scenario, the government is sternly focused on developing revenue mobilization strategy particularly through formulating an effective tax system in order to create fiscal space. Present government is determined to enhance resource mobilization efforts in the country and increase tax to GDP ratio from the lowest level of 8.7 percent to 15 percent in the next few years. For this purpose, a comprehensive strategy is being devised which comprises of three broad categories such as: a).broadening of tax base, b).removing anomalies in the taxation system and c). improving tax compliance (Box: 4.2).

Box-2: Tax Measures

Broadening the Tax Base

For broadening the tax base, several initiatives have been taken and some are in pipeline. Initially, the objective is to incorporate 300,000 new taxpayers. In this regard, more than 80,000 notices have already been issued, and a total of 100,000 notices will be issued by June 30, 2014. Similarly, a detailed plan for outreach program including provisional assessment, collection procedures, penal actions and prosecution proceedings has been chalked out.

Rationalization of Concessionary Regime and withdrawal of exemptions/ SROs

In order to provide level playing field and equitable tax system in the country FBR has devised a plan for rationalization of concessionary regime and withdrawal of exemptions. The plan has been approved by the government and is being implemented.

Administrative Improvement Initiatives

Initiatives for administrative improvement in all the taxes have been finalized and implementation strategy is developed and launched. Certain policy reforms have already been taken and GST coverage has been expanded. Exemptions have been restricted to food items, health, education and agriculture produce.

To resolve issues relating to sales tax FBR has successfully prepared and implemented Computerized Risk Based Evaluation of Sales Tax (CREST). Another major step has been the development of a fully automated sales tax refund processing system for manufacturers/exporters where refund claims are processed within 48 hours. Sales tax refund cheque issuance has been centralized at FBR HQ to guarantee that cheques are issued to taxpayers within seven days of clearance of claims and to reduce refund pendency.

Taxpayers Facilitation

Introduction of an e-filing process accessible to taxpayers for income tax, sales tax and excise at e-FBR portal has been ensured. Automation of systems has helped in minimizing the contact between taxpayer and tax officer and as a consequence the complaints of harassment has been reduced accordingly. Compliance has been made easier through simplicity of procedures and introduction of an e-filing process accessible by taxpayers for income tax, sales tax and excise at e-FBR portal. Automation of systems has helped in minimizing the contact between taxpayer and tax officer and as a consequence the element of harassing has been reduced accordingly.

Strengthening Tax Audit

A risk based audit has been reintroduced to accompany the self-assessment scheme and to overcome weak tax compliance. Substantial progress has been achieved for infrastructure up-gradation and development with the introduction of the Integrated Tax Management System (ITMS) which is available to all the field formations.

Customs Modernization and control

Customs modernization reforms are being introduced, aiming at simplifying, standardizing and automating customs clearance procedures supported with strong post-clearance audit controls. Online connectivity of Customs posts has been developed. Risk management principles have been adopted and a Vehicle and Container Tracking System for monitoring transit trade is being procured. The Afghan Pakistan Transit Trade Agreement (APTTA) 2010 has replaced the 1965 agreement, with better controls and enhanced facilitation.

An integrated, risk-based automated customs clearance system (WEBOC) has been indigenously developed which minimizes interaction between taxpayers and tax collectors, thereby minimizing the malpractices.

Human Resource Management

Human Resource Management has been improved and major structural initiatives are being taken by FBR in its organizational reform program.

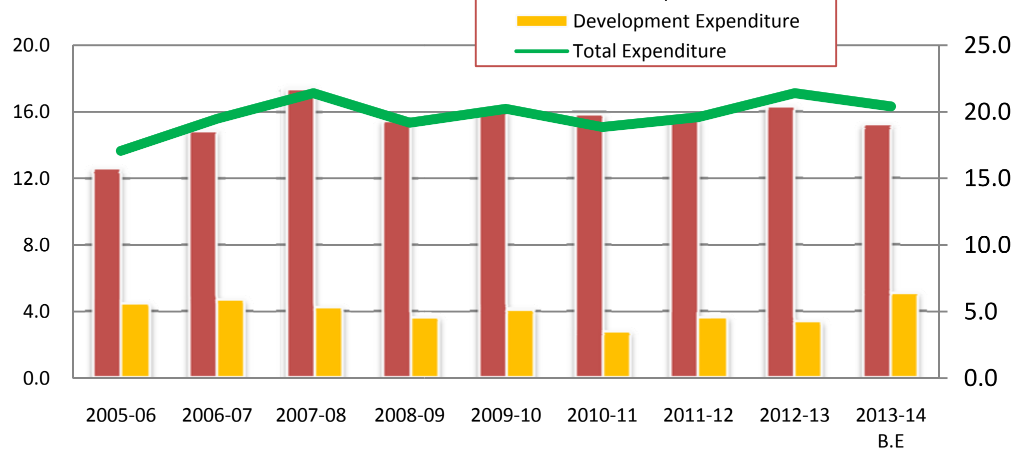
Source: Federal Board of Revenue (FBR)

Review of Public Expenditures

Efficient expenditure management is an important economic tool for poverty reduction strategies and key development goals because it creates adequate fiscal space which is required to reinforce the provision of public services like health, education, and basic infrastructure. However, in this regard, composition of public expenditure plays a decisive role. Generally public expenditures can be categorized as current and development. In order to improve the economic performance of a country, it is critically required to have an efficient mix between the two.

Expenditure management in Pakistan always remained difficult on account of various challenges on external and internal front. High interest payments, untargeted subsidies particularly to loss making PSEs and energy subsidies resulted in sharp increase in total expenditures. At the same time, absence of effective resource mobilization strategy and less than expected external inflows caused serious concerns for fiscal sustainability, as fiscal deficit rose by 6.8 percent on average during the past five years.

Fig: 4.3 Expenditures % of GDP



A brief look at Table 4.3 reveals this fact that total expenditure as percent of GDP is on constant rise, as it rose to 21.4 percent in 2012-13 against 19.6 percent of GDP in 2011-12 and reached to Rs.4,816.3 billion in 2012-13 from Rs.3,936.2 billion in fiscal year 2011-12. As mentioned earlier, higher expenditures are largely the reflection of higher energy subsidies. Moreover, high debt servicing, compensation to pensioners and high public sector development spending further contributed to this rise. However, during current fiscal year 2013-14, it is expected to reduce to 20.4 percent of GDP on account of prudent expenditure management strategy with an aim to contain the fiscal deficit within reasonable limit.

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

Year	Total Expenditure (A)	Current Expenditure (B)	Interest Payments (C)	Defence (D)	Development Expenditure (E)	Non Interest Non-Defence Exp (A-C-D)	Fiscal Deficit	Revenue Deficit/ Surplus (TR-Total CE)	Primary deficit (TR-NI Exp)
2005-06	17.1	12.6	2.9	2.9	4.4	11.2	4.0	0.5	-1.1
2006-07	19.5	14.9	4.0	2.7	4.7	12.8	4.1	-0.8	-1.4
2007-08	21.4	17.4	4.6	2.6	4.2	14.2	7.3	-3.3	-2.7
2008-09	19.2	15.5	4.8	2.5	3.6	11.8	5.2	-1.4	-0.3
2009-10	20.2	16.0	4.3	2.5	4.1	13.4	6.2	-2.1	-1.9
2010-11	18.9	15.9	3.8	2.5	2.8	12.6	6.5	-3.5	-2.7
2011-12	19.6	15.6	4.4	2.5	3.7	12.7	6.8	-2.8	-2.4
2012-13	21.4	16.3	4.4	2.4	3.5	14.6	8.2	-3.0	-3.7
2013-14B	20.4	15.2	4.4	2.4	5.1	13.5	6.3	-1.2	-1.9

Source: Budget Wing, Finance Division and EA Wing's Calculations.

Current expenditures as percent of GDP increased to 16.3 percent in fiscal year 2012-13 from 15.6 percent of GDP in 2011-12 and reached to Rs.3,660.4 billion from Rs.3,122.5 billion in 2011-12. Thus posted a growth of 17.2 percent. By the end of current fiscal year 2013-14, it will further reduce to 15.2 percent of GDP.

Interest payments increased from Rs.889.0 billion in 2011-12 to Rs.991.0 billion during 2012-13, while as percent of GDP it stood at previous level of 4.4 percent recorded in 2011-12. During fiscal year 2013-14, it is projected to increase to Rs.1,153.5 billion or 4.4 percent of GDP. Persistently high fiscal deficit over the past few years have considerably contributed to this rise in debt servicing.

Similarly, defence expenditure despite a decline to 2.4 percent of GDP in 2012-13 from 2.5 percent of GDP in 2011-12, increased in absolute term and reached to Rs.540.6 billion in 2012-13 from Rs.507.2 billion in 2011-12. In 2013-14, it is estimated to reach at Rs.627.2 billion or 2.4 percent of GDP.

During fiscal year 2012-13, development expenditures grew by only 6.2 percent and reached to Rs.777.1 against Rs.731.9 billion in 2011-12. While as percent of GDP it reduced to 3.5 percent in 2012-13 against 3.7 percent in 2011-12. On the other hand, together with net lending it has posted a growth of 53.2 percent during fiscal year 2012-13 on account of power sector debt settlement. During July-June, 2013-14, development expenditures are expected to reach at Rs. 1,326.8 billion, of which Federal PSDP is budgeted at Rs.540 billion and provincial PSDP at Rs.615 billion.

The share of current expenditure in total expenditure has declined from 79.3 percent in 2011-12 to 76.0 percent in 2012-13, while it is projected to decline further to 74.8 percent during the current fiscal year 2013-14. Defence expenditures accounted for 11.2 percent in 2012-13 against 12.9 percent share in 2011-12, and it is budgeted to remain at 11.8 percent during 2013-14. While share of interest payments in total expenditure has also declined from 22.6 percent in 2011-12 to 20.6 percent in 2012-13 and it is projected to increase to 21.8 percent in 2013-14.

Fiscal performance

The government is immensely determined to reduce the fiscal deficit to around 4.0 percent over the medium term through broadening the tax base, reducing tax exemptions, reforming tax administration, removal of bottlenecks like, energy shortages, bleedings PSEs and circular debt.

According to the consolidated revenue and expenditure statement of the government, total revenue grew by 16.6 percent during July-March, 2013-14 and stood at Rs. 2,477.4 billion compared to Rs.2,124.9 billion in the same period of 2012-13. Total collection in tax revenues amounted to Rs.1,786.2 billion against Rs.1,527.8 billion in the same period last year, thus posted a growth of 16.9 percent. Significant growth in tax revenues was mainly on account of considerable rise in federal tax collection by 16.3 percent, of which FBR tax collection grew by 17.9 percent during the period under review. FBR tax collection during July-March, 2013-14 reached to Rs.1,574.8 billion against Rs.1,335.2 billion in the same period last year. During the first nine months of current fiscal year, FBR tax revenue stood at 6.2 percent against 6.0 percent of GDP last year. Improved performance in FBR tax collection is mainly attributed to increase in tax rates.

Table 4.4: Consolidated Revenue & Expenditure of the Government

	2013-14 B.E	July-March		Growth
		2013-14	2012-13	
A. Total Revenue	3,646.7	2,477.4	2,124.9	16.6
a) Tax Revenue	2,768.1	1,786.2	1,527.8	16.9
Federal	2,598.1	1,650.0	1,418.3	16.3
of which FBR Revenues	2,475.0	1,574.8	1,335.2	17.9
Provincial Tax Revenue	170.0	136.2	109.6	24.3
b) Non-Tax Revenue	878.6	691.2	597.0	15.8
B. Total Expenditure	5,297.2	3,289.0	3,171.1	3.7
a) Current Expenditure	3,963.0	2,904.6	2,642.0	9.9
Federal	2,778.0	2,083.2	1,887.1	10.4
- Interest	1,153.5	909.1	772.2	17.7
- Defense	627.2	451.7	405.8	11.3
Provincial	1,185.0	821.4	754.9	8.8
b) Development Expenditure & net lending	1,334.3	555.8	445.8	24.7
PSDP	1,155.0	393.0	407.4	-3.5
Other Development	171.8	77.0	37.3	106.6
c) Net Lending	7.5	85.9	1.1	-
e) Statistical discrepancy	-	-171.3*	83.3	-
C. Overall Fiscal Deficit	1,650.6	811.7	1,046.2	-22.4
As % of GDP	6.3	3.2	4.7	-
Financing of Fiscal Deficit	1,650.6	811.7	1,046.2	-22.4
i) External Sources	168.7	-50.1	-4.1	-
ii) Domestic	1,481.8	861.7	1,050.3	-18.0
- Bank	975.0	436.9	856.7	-49.0
- Non-Bank	506.8	424.8	193.7	119.4
GDP at Market Prices	26,001	25,402	22,489	13.0

Source: Budget Wing, Finance Division

*: The high statistical discrepancy is due to the impact of a transfer receipt from a friendly country amounting to Rs 157 billion which has been kept separately in an account " Pakistan Development Fund ". Without this, impact of statistical discrepancy would come to Rs 14 billion which would imply a deficit of Rs 969 billion i.e. approximately 3.8% of GDP which is significantly less than the last year's deficit of 4.6% of GDP.

During July-March, 2013-14 non tax revenues posted a significant growth of 15.8 percent and amounted to Rs.691.2 billion against Rs.597.0 billion in the same period last year. Of which Rs.205.0 billion were accumulated as SBP profit, followed by Rs.77.8 billion under defence, Rs.67.7 billion from universal support fund (USF), and Rs.62.3 billion from Markup(PSEs & Others). It is pertinent to mention that realization of $674 million during July-March, 2013-14 has also contributed to this significant growth in non tax revenues. While, after receiving third tranche of $375 million under CSF, total inflows to date reached to $1.05 billion. Materialization of CSF funds will not only provide further comfort to fiscal accounts but will also help in improving the external accounts in the remaining months of current fiscal year 2013-14.

On expenditure side, total expenditures amounted to Rs.3,289.0 billion during July-March, 2013-14 against Rs.3,171.1billion in the same period of 2012-13, posted a growth of 3.7 percent. Of which, current expenditures during July-March, 2013-14 reached to Rs.2,904.6 billion as compared to Rs.2,642.0 billion in the same period of 2012-13, registered a growth of 9.9 percent. It is worth to mention that total expenditures registered a decline during the second and third quarter of current fiscal year on account of contained current expenditures.

Interest payment grew by 17.7 percent and reached to Rs.909.1 billion during July-March, 2013-14 from Rs.772.2 billion during the same period of fiscal year 2012-13.

Similarly, untargeted subsidies which remained a key issue and major drain on country's limited fiscal resources mainly those in the power sector, have absorbed a significant amount of resources over the years. However, during July-March, 2013-14 subsidies remained lower than last year as it reached to Rs.201.8 billion from Rs.270.0 billion in the comparable period of 2012-13. Of which electricity subsidies stood at Rs.192.0 billion against 265.5 billion in the same period of fiscal year 2012-13, hence reduced by 27.7 percent. Overall decline in subsidies during the first nine months of current fiscal year was mainly due to rise in power tariffs for commercial, residential and industrial users, in October, 2013.

Box-3: Prudent Expenditure Management

In order to maintain fiscal discipline, the government has focused on prudent expenditure management through various initiatives such as:

- Secret service expenditures of all Ministries /Divisions/ Attached Departments /Autonomous Bodies ceased except Intelligence Agencies.
- Discretionary funds for Prime Minister and Ministers discontinued.
- Allocation of PM's House/ PM Office reduced voluntarily by 40 percent. Moreover, 30 percent cut in current budget of Ministries/Divisions except pay and allowances resulted in saving of billion rupees.
- Working of foreign missions reviewed and being right-sized leading to expected savings of Rs 2 billion annually.
- Cabinet Committee on Restructuring has directed all Ministries / Divisions to review for rationalizing their strengths for the purpose of rightsizing.
- Fee/remuneration for government nominated directors in PSEs capped at Rs 600,000/- per annum. Amount over and above will be deposited into government treasury.
- The government is implementing a plan to phase out electricity subsidies over the life of the program. The federal government has approved at the highest level with support of the provinces, a National Energy Policy entailing periodic increases in the average tariff, aiming at eliminating the tariff differential subsidy for all consumers except the most vulnerable over the next three years.
- Similarly to reduce the size of public expenditure the government is moving forward with the privatization of restructuring of 31 public sector enterprises.

Furthermore, government has also initiated various energy reforms for which a National Power Policy (2013) is developed which will provide a roadmap to overcome the present energy crisis and fully meet the future needs of power in the country. The goal is to provide affordable energy in the country through efficient generation, transmission and distribution system. Present government is highly determined to achieve the expenditure level which will be consistent with macroeconomic stability. It is therefore, government envisages phasing out of electricity subsidies. Additionally, various steps are being taken to eliminate the circular debt for effective implementation of prudent expenditure management strategy (Box-4).

Box-4: Measures to eliminate the circular debt

- Conversion of oil based plants to coal to reduce cost of generation.
- Installation of plants on hydel sources
- Provision of maximum gas for gas based plants
- Improvement in recovery position and reduction in losses
- To control theft of power.
- Maximum provision of energy to Industrial Sector to improve revenue and overall economy of the country.
- Payment of tariff differential subsidy by GoP on time
- Moving towards targeted subsidy regime (protecting residential consumers up to 200 units) and moving closer to recovering the cost of service through tariff rationalization
- Reduction in time taken for determination of tariff for a fiscal year

On the other hand, development expenditures and net lending grew by 24.7 percent and reached to Rs.555.8 billion during July-March, 2013-14 against Rs.445.8 billion in the comparable period last year. However, expenditures under PSDP reduced by 3.5 percent during first nine months of current fiscal year. The decline is largely attributed to slow execution of development expenditures. This stance of government is rather more cautious in executing plans. In this regard, government is giving priority to only those sectors of the economy whose revival is crucial for the sustainable economic growth of the economy like irrigation, water, power, infrastructure and education. However, expenditure under PSDP is likely to gain momentum in the remaining months of current fiscal year.

It is worth to mention that over all fiscal deficit reduced to 3.2 percent against 4.7 percent recorded in the same period last year on account of healthy provincial surplus to the tune of Rs.257.9 billion, strong growth in tax and non tax revenues and contained expenditures.

FBR Tax Collection

During July-April, 2013-14, FBR has collected Rs.1,744.8 billion (provisional) against Rs.1,505.5 billion in the comparable period of fiscal year 2012-13, reflecting a growth of around 15.9 percent. During July-April, 2013-14 FBR tax revenues as percent of GDP rose by 6.9 percent as compared to 6.7 percent of GDP during the same period of 2012-13.

Direct Taxes

The net collection of direct taxes has registered a growth of 18.9 percent during the first 10 months of 2013-14. The net collection has gone up from Rs.553.5 billion to Rs.658.1 billion. Bulk of the tax revenues of direct taxes is realized from income tax. The components of income tax are withholding tax, voluntary payments and collection on demand.

Table 4.6: FBR Tax Revenues (Rs. in billion)

Revenue Heads	2012-13	July-March		% Change
		2012-13	2013-14	
A. Direct Taxes				
Gross		596.6	708.9	18.8
Refund/Rebate		43.0	50.9	
Net	**743.4**	**553.5**	**658.1**	18.9
B. Indirect Taxes				
Gross		989.5	1,125.2	13.7
Refund/Rebate		37.6	38.5	
Net	**1,203.0**	**951.9**	**1,086.7**	14.2
B.1 Sales Tax				
Gross		697.2	825.5	18.4
Refund/Rebate		27.8	30.5	
Net	**842.5**	**669.4**	**795.0**	18.8
B.2 Federal Excise				
Gross		91.4	104.0	13.8
Refund/Rebate		0.2	0.0	
Net	**121.0**	**91.2**	**104.0**	14.0
B.3 Custom				
Gross		200.9	195.6	-2.6
Refund/Rebate		9.6	8.0	
Net	**239.5**	**191.4**	**187.7**	-1.9
Total Tax Collection				
Gross		1,586.1	1,834.1	15.6
Refund/Rebate		80.6	89.4	
Net	**1,946.4**	**1,505.5**	**1,744.8**	15.9

Source: Federal Board of Revenue

Indirect Taxes

Sales Tax

Within indirect taxes, net collection of sales tax increased by 18.8 percent. The sales tax gross and net collection during July-April, 2013-14 has been Rs.825.5 billion and Rs.795 billion respectively showing growths of 18.4 percent and 18.8 percent respectively over the corresponding period of 2012-13. In fact, around 51percent of total sales tax has been contributed by sales tax on import while the rest has been contributed by domestic sector. Within net domestic sales tax collection, the major contribution emanated from POL products, fertilizers, natural gas, cement, electrical energy, beverages, cigarettes, tea, sugar, iron & steel etc. On the other hand, POL products, plastic, edible oil, vehicles, machinery, chemicals, oilseeds etc contributed significantly to the collection of sales tax from imports.

Customs Duty

Custom duty collection has registered a negative growth of 2.6 percent and 1.9 percent in both gross and net terms respectively. The gross and net collection have declined from Rs.200.9 billion and Rs.191.4 billion during July-April, 2012-13 to Rs.195.6 billion and Rs.187.7 billion respectively during 10 months of 2013-14. The major revenue spinners of custom duty have been automobiles, edible oil, petroleum products, machinery, plastic, iron and steel, paper and paperboard etc. The commodities like vehicles, edible oil, POL products and iron & steel have registered negative growth.

Federal Excise Duty

The collection of federal excise duties (FED) during July-April, 2013-14 has recorded 14.0 percent growth. The net collection stood at Rs.104.0 billion during July-April, 2013-14 as against Rs.91.2 billion during the same period last year. The major revenue spinners of FED are cigarettes, cement, beverages, natural gas, international travel etc.

Provincial Budgets

The main components of the provincial budgets 2013-14 in comparison with revised estimates of last year are presented in Table-4.6. According to which the total outlay of the four provincial budgets for 2013-14 stood at Rs.1,973.7 billion, 20.7 percent higher than the outlay of Rs.1,635.6 billion last year.

Table 4.6: Overview of Provincial Budgets (Rs Billion)

Items	Punjab		Sindh		Khyber Pakhtunkhwa		Balochistan		Total	
	2012-13 RE	2013-14 BE	2012-13 RE	2013-14 BE	2012-13 RE	2013-14 BE	2012-13 RE	2013-14 BE	2012-13 RE	2013-14 BE
A. Tax Revenue	**660.2**	**828.4**	**342.9**	**424.3**	**192.3**	**234.3**	**116.9**	**129.4**	**1,312.3**	**1,616.4**
Provincial Taxes	90.5	126.7	73.3	91.4	8.1	10.3	1.2	1.6	**173.1**	**230.0**
GST on Services (transferred by Federal govt)	1.5	0.0	0.0	0.0	4.3	1.9	1.5	4.5	**7.3**	**6.4**
Share in Federal Taxes	568.2	701.7	269.6	332.9	179.9	222.1	114.2	123.3	**1,131.9**	**1,380.0**
B. Non-Tax Revenue	**36.8**	**30.7**	**83.6**	**95.9**	**32.1**	**40.1**	**15.8**	**19.1**	**168.3**	**185.8**
C. All Others	**19.7**	**-2.0**	**47.7**	**28.4**	**26.1**	**24.1**	**34.0**	**32.1**	**127.5**	**82.6**
Total Revenues (A+B+C)	**716.7**	**857.1**	**474.2**	**548.6**	**250.5**	**298.5**	**166.7**	**180.6**	**1,608.1**	**1,884.8**
a) Current Expenditure	**549.8**	**607.6**	**342.1**	**356.0**	**195.0**	**211.0**	**104.8**	**117.3**	**1,191.7**	**1,291.9**
b) Development Expenditure	**166.9**	**290.0**	**143.3**	**229.9**	**88.1**	**118.0**	**45.6**	**43.9**	**443.9**	**681.8**
Total Exp (a+b)	**716.7**	**897.6**	**485.4**	**585.9**	**283.1**	**329.0**	**150.4**	**161.2**	**1,635.6**	**1,973.7**

Source: Provincial Finance Wing, Ministry of Finance

Punjab witnessed the highest growth of 25.2 percent in budgetary outlay, followed by Sindh at 20.7 percent. Khyber Pakhtunkhwa posted a growth of 16.2 percent, while Balochistan witnessed a growth of 7.2 percent. Overall provincial revenue receipt is estimated at Rs. 1,884.8 billion for fiscal year 2013-14, 17.2 percent higher as compared to last year.

Tax revenue, accounting for 85.8 percent of overall revenue receipts, amounted to Rs.1,616.4 billion which is 23.2 percent higher than last year and non-tax revenue is estimated at Rs.185.8 billion which is 10.4 percent higher than last year.

The total budget outlay of Rs. 1,973.7 billion is shared in the ratio of 65.5 percent and 34.5 percent between current and development expenditures, respectively. The allocations for development expenditure are 53.6 percent higher than last year and current expenditure is higher by 8.4 percent.

Allocation of Revenues between the Federal Government and Provinces

Process of fiscal decentralization is an important component of improving the public sector performance as it involves delegating fiscal powers and responsibilities to provincial governments.

Hence it ensures provincial autonomy as provinces can make decisions about expenditure management and increasing revenues, plan projects and manage other public functions.

In Pakistan, at present 7th NFC award is operative which is considered to be a major step towards fiscal decentralization between the federal government and provincial governments.

Table 4.6: Transfers to Provinces (NET) (Rs. Billion)

	2009-10	2010-11	2011-12	2012-13	2013-14 BE
Divisible Pool	574.1	834.7	1,063.1	1,117.5	1,380.0
Straight Transfer	81.2	163.0	145.6	103.5	122.3
Special Grants/ Subventions	82.0	54.1	53.9	61.2	51.4
Project Aid	16.0	21.9	47.8	71.3	77.5
Program Loans	0.0	0.0	4.6	4.2	
Japanese Grant	0.0	0.1	0.1	0.0	0.0
Total Transfer to Province	**753.3**	**1,073.7**	**1,315.0**	**1,441.5**	**1,728.1**
Interest Payment	18.7	18.5	12.9	14.8	13.3
Loan Repayment	24.0	32.4	36.1	32.1	34.8
Transfer to Province(Net)	**710.6**	**1,022.8**	**1,266.0**	**1,394.5**	**1,680.0**

Source: Various issue of Budget in Brief.

This has not only increased the provincial autonomy through enhancing their share in the Divisible Pool (taxes) from 50 percent to 56 percent in fiscal year 2010-11 and to 57.5 percent from fiscal year 2011-12 onwards but has also allowed widen the range of responsibilities from the federation to the provinces.

One of the important developments under 7th NFC award was that for the first time, multiple criteria (Population, Poverty or backwardness, revenue collection or generation and Inverse population density) were adopted to determine inter-provincial shares, whereas in all the previous awards, population was the only criterion.

During 2013-14, net transfer to provinces are projected to increase to Rs. 1,680.0 billion, an increase of 20.5 percent over the revised transfer of Rs. 1,394.5 billion in 2012-13.

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

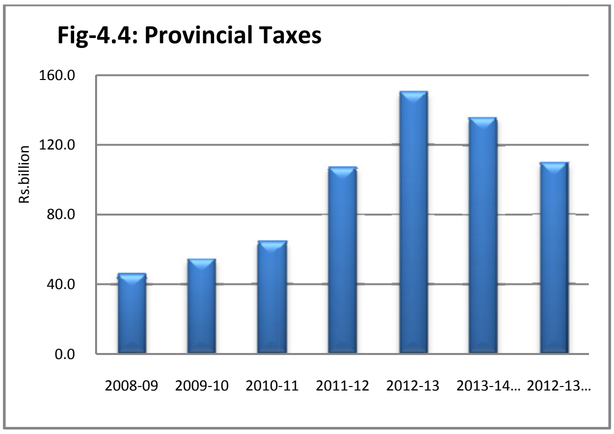
Items	2008-09	2009-10	2010-11	2011-12	2012-13	July-March	
						2013-14	2012-13
A. Tax Revenue	571.7	688.3	1,063.9	1,197.1	1,365.7	1,154.0	1,002.7
Provincial Taxes	46.1	54.8	64.6	107.2	150.7	136.2	109.6
Share in Federal Taxes	525.6	633.5	999.3	1,089.9	1,215.0	1,017.8	893.2
B. Non-Tax Revenue	83.8	67.9	62.3	48.0	71.3	34.7	49.0
C. All Others	95.0	120.0	85.1	88.6	107.4	59.4	73.7
Total Revenues (A+B+C)	750.5	876.2	1,211.3	1,333.7	1,544.4	1,248.0	1,125.3
a) Current Expenditure	564.2	646.2	831.2	980.6	1,110.0	831.4	766.3
b) Development Expenditure	201.8	258.4	245.6	375.4	371.5	199.7	219.9
Total Exp (a+b)	766.0	904.6	1,076.8	1,356.0	1,481.6	1,031.1	986.3

Source: Fiscal Operations (various issues), Budget Wing

Table 4.8 illustrates a healthy picture of provincial fiscal operations over the period of five years; particularly post devolution period shows significant growth in provincial tax revenues. It is pertinent to mention that Sindh was the first to collect the sales tax on services in 2011-12, followed by Punjab in 2012-13 and Khyber Pakhtunkhwa in 2013-14. During 2012-13, over all tax revenues increased by 14.1 percent against 12.5 percent in the same period of 2011-12. The increase in tax revenues during 2012-13 is shared by 40.6 percent rise in provincial taxes and 11.5 percent increase in federal transfers.

Consolidated provincial position indicates a significant growth in tax revenues and provincial share in federal revenues over the past five years. It is also notable that provincial surplus has also increased considerably from 2011-12 onwards.

During the first nine months of current fiscal year, provincial taxes stood at Rs.136.2 billion against Rs.109.6 billion in the comparable period of 2012-13 and federal transfers amounted to Rs.1,017.8 billion during July-March, 2013-14 against Rs.893.2 billion in the same period last year. Hence, following a growth of 24.3 percent in provincial tax revenues and 13.9 percent in federal transfers, provincial surplus posted a healthy growth and reached to Rs.257.9 billion during the same period.



On the other hand, expenditures showed sluggish trend as it grew by 9.3 percent during fiscal year 2012-13 against the growth of 25.9 percent in 2011-12. Whereas, during July-March, 2013-14 total expenditures posted a growth of 4.5 percent and reached to Rs.831.4 billion against Rs.766.3 billion in the same period of fiscal year 2012-13.

Medium Term Budgetary Framework (MTBF)

In order to modernize budgetary management system of the federal government, the Finance Division has started an important reform initiative called Medium-Term Budgetary Framework (MTBF). The reform aims at improving fiscal discipline, creating a mechanism through which government's priorities are linked with budgetary allocations and enhancing focus on achievement of results. While important progress has been made in advancing the reform, the Finance Division is taking additional steps to move to the next stage of the reform.

In the first stage, focus was directed towards embedding new processed and improving comprehensiveness of the budget. Budget preparation process now includes development of a medium term macroeconomic and fiscal framework, a Budget Strategy Paper-which is tabled in the Cabinet and performance based budgets. Thus in addition to the traditional budget that provides budget information by 'inputs'(resources), the budget is now also presented by 'output' (services delivered). Each year the Federal government presents 'Federal Medium Term Budget Estimates for Service Delivery (also known as MTBF Green Book) in the Parliament together with other budget books.

In the second stage focus is being enhanced towards improving operational efficiency and laying the foundation of a government–wise monitoring system. The Finance Division has recently compiled a 'Government Performance Monitoring Report' for the year 2012-13. Through this information it will be possible to understand the reasons for variance-budget vs actual, and performance targets achieved as compared to planned. In addition, deliberations are being made to delegate planning and budgeting processes to Principal Accounting Officers and introduce a system of accountability for results. Furthermore, in order to computerize the MTBF processes, work with PIFRA (Project to Improve Financial Reporting and Auditing-a World Bank funded initiative) is at advanced stage. Around fifty software licensed have been procured that will be used by different ministries/divisions for compiling Output-Based Budgets. Over the next few months the first pilot site is likely to be operationalized. Through this software it would be possible to prepare and monitor Output-Based Budgets on regular basis.

Way Forward

Over the years Pakistan's fiscal accounts remained under immense pressure due to expenditure overrun surpassed the revenues on account of high interest payments, untargeted subsidies and less than expected revenues. Present government soon after assuming the charge in June, 2013, took immediate steps to improve the fiscal situation through its reform agenda with an aim to resolve long standing structural issues, particularly in energy sector. Consequently, fiscal accounts started to improve as fiscal deficit reduced to 3.2 percent during first nine months of current fiscal year against 4.7 percent of deficit in the comparable period of last year. This has also resulted in a significant decline in government borrowing for budgetary support.

On revenue side, comprehensive reform strategy with an objective of increasing the tax revenues to 15 percent of GDP over the medium term resulted in significant growth of 15.9 percent during July-April, 2013-14. It is also notable that, in an effort to remove the distortions and increase the tax revenues, government is sternly focused on removing the SRO culture.

Moreover, expenditures have also been contained on account of prudent expenditure management strategy. On the basis of these developments, overall fiscal deficit for fiscal year 2013-14 is expected to remain even less than 6.0 percent of GDP. Over the medium term, with various steps to control the expenditures and to increase the revenues, fiscal deficit will be brought down further to 4.0 percent of GDP.

It is pertinent to mention that IMF has acknowledged all these fiscal developments and explained this improvement as “strong” and agreed that government’s reform program is on right track and economy is moving into right direction.