Fiscal Policy Statement

2012-13

Debt Policy Coordination Office
Ministry of Finance

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Acknowledgements

This Policy Statement has been prepared to fulfil the requirement laid out under Section 6 of the Fiscal Responsibility and Debt Limitation Act 2005. I would like to acknowledge the input of various Ministries, Departments, Divisions and Agencies, particularly, timely data provision by Budget Wing (MoF), Economic Affairs Division. I would like to recognize the effort put in by Dr. Imtiaz Ahmed, Joint Secretary (DPCO), Muhammad Umar Zahid, Financial Analyst (DPCO) and Arsalan Ahmed, Financial Analyst (DPCO) in the realization of this comprehensive document.

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1. Introduction

1.1. Fiscal year 2012 was yet another challenging year for the global economy. The developed economies suffered a downward spiral essentially due to five weaknesses that mutually reinforced each other: (i) sovereign debt crises in euro area; (ii) fiscal cliff in the United States; (iii) fragile banking sector; (iv) weak aggregate demand (associated with high unemployment and fiscal austerity measures) and (v) policy paralysis caused by political gridlock and institutional deficiencies. It decelerated economic growth in developing countries and economies in transition, particularly in the Asian Giants through falling export demand from USA and European Union and declining corporate investment. The impact, however, varied as economic and financial linkages to major developed economies differed across countries. In addition, emerging economies, such as Pakistan, were affected by declining primary commodity prices and had to cope with large financial shocks including sell-off in equity markets and reversal of capital inflows. It is estimated that the U.S. fiscal cliff could entail significantly fiscal tightening (by about 3 percent of GDP) which would mean less aggregate demand and less demand of goods from emerging economies.

1.2. Pakistan is no exception and was impacted by these global trends. Additionally, Pakistan's economy faced various challenges during the last four years: (i) Great floods of 2010, heavy rains in 2011 as well as 2012 cost US$ 13 billion in damages to infrastructure and agriculture and 2 percent of GDP growth; (ii) low external inflows; (iii) continued security situation requiring additional resources; (iv) high oil prices; (v) legacy of energy constraint and (vi) low investment to GDP.

1.3. Notwithstanding these adverse shocks and challenges, Pakistan's economy continued to grow during the last three years. Per Capita income has risen. Real GDP grew by 3.7 percent during 2011-12 compared with 3 percent in 2010-11. The growth was more broad-based as it was evenly distributed across agriculture, industry and the services sector. The growth was driven by private consumption. The agriculture grew by 3.1 percent, industry by 3.4 percent and services by 4.0 percent. Growth in agriculture came from livestock and Kharif crops.

1.4. Remittances remained buoyant and posted yet another year of strong growth. Inflow was US$ 13.2 billion against a forecast of US$ 12.5 billion. The 18 percent growth was realized despite continuing global economic weaknesses as number of Pakistani workers abroad increased by 6.4 percent. This not only helped in narrowing the current account deficit but also contributed to economic activity. Pakistan's exports almost equaled the last year achievement of US$25 billion notwithstanding contraction in our major trading partners such as the United States and euro area.

1.5. Increase in wheat procurement price to Rs.1,050 per 40kg, spillover from agriculture sector combined with strong remittances and income support schemes boosted construction activities and household consumption – which helped the manufacturing sector. There was sharp improvement in financial sector earnings. The private consumption grew by 11.6 percent during 2011-12.Food prices during 2011-12 remained stable which helped bringing down overall inflation to 11 percent–lower than projected 12 percent. By December 2012, all manifestations of inflation–Consumer Price Index, Food Inflation, Non-Food Inflation, Sensitive Price Index and Wholesale Price Index–were in single digit below 10 percent. This decline in inflation allowed the State Bank to reduce the policy rate by 250 bps.

1.6. FBR tax collections (net) recorded a healthy growth of 21.4 percent during 2011-12. With this growth, FBR's tax-to-GDP ratio has increased from 8.6 percent in 2010-11 to 9.1 percent in 2011-12. Direct tax collection improved considerably during 2011-12, with a growth of 23 percent, compared with 12.5 percent in the previous year. The collection of indirect taxes continued to follow its growth momentum, and registered a Year-on-Year increase of 20.3 percent in 2011-12. Sales tax collection showed significant growth of 27.8 percent in 2011-12, compared with 22.6 percent in 2010-11. This was despite a 100 bps reduction in the sales tax rate, and the transition of the sales tax collection on services from the federal to provincial governments. A commodity-wise break-up of sales tax collection suggests that the major contribution to its growth came from domestic sales tax on cement, sugar, natural gas, and fertilizers. While domestic sales tax collection grew by 16 percent, sales tax on imports increased by 40.2 percent, primarily due to the removal of exemptions and higher imports of POL products, edible oil, automobile and machinery. Another factor that contributed to the high growth in sales tax was the increased vigilance by FBR over rebates and refunds.

1.7. The budget deficit for 2011-12 was 8.5 percent of GDP on the back of (i) non-realization of Coalition Support Fund (CSF) and 3G Licenses auction; (ii) below target revenues from FBR collections and Petroleum Development Levy; (iii) Provinces' inability to tax the agriculture and services sectors effectively; (iv) deficit instead of an anticipated provincial surplus; and (v) one-time payment for Power Sector, Trading Corporation of Pakistan (TCP) and Utility Stores Corporation (USC) debt consolidation. The expected revenues from defense services including CSF were Rs.118.7 billion but in absence of any inflows from CSF, only Rs.9.8 billion were received under this head. Similarly, 3G auctions were expected to yield Rs.75 billion but auction could not take place. The Provinces posted a deficit of

Rs.39 billion instead of expected Rs.125 billion surplus. FBR collection, though 21.4 percent higher than the last year, were 96.5 percent of the target. The Petroleum Development Levy was adjusted downward frequently during the year to subsidize the petroleum products prices reducing the revenues from Rs.120 billion to Rs.60 billion. Expenditure increased substantially as a result of debt consolidation of Power Sector, TCP and the USC amounting to Rs.391 billion or 1.9 percent of GDP. The fiscal deficit adjusted for this one-off payment stood at 6.6 percent of GDP.

1.8. Notwithstanding above, the Government continued austerity measures and disciplining the expenditures. The average annual growth in expenditures was 14.7 percent during 2009-2012 compared with 25.5 percent during 2005-2008. The Power sector and associated tariff differential subsidies had been a major challenge and contributed around 1.0 to 1.5 percent of GDP towards the fiscal deficit. Likewise, tax revenues are below the true potential of the economy which could increase by another 2.0 to 2.5 percent of GDP. The Government is taking necessary steps to move towards that direction.

2. Fiscal Policy Statement

2.1. The Fiscal Policy Statement is presented to fulfill the requirement of Section 6 of the Fiscal Responsibility and Debt Limitation (FRDL) Act 2005 which stipulates that:

(1) The Federal Government shall cause to be laid before the National Assembly the Fiscal Policy Statement by the end of January each year.

(2) The Fiscal Policy Statement shall, *inter alia*, analyze the following key Macroeconomic indicators, namely:-

- (a) Total revenues;
- (b) Total expenditures;
- (c) Total fiscal deficit;
- (d) Revenue deficit; and
- (e) Total public debt

(3) The Federal Government shall explain how fiscal indicators accord with the principles of sound fiscal and debt management.

(4) The Fiscal Policy Statement shall also contain:-

- (a) The key measures and rationale for any major deviation in fiscal measures pertaining to taxation, subsidy, expenditure, administrated pricing and borrowing;
- (b) An update on key information regarding macroeconomic indicators;
- (c) The strategic priorities of the Federal Government for the financial year in the fiscal area;
- (d) The analysis to the fullest extent possible of all policy decisions

made by the Federal Government and all other circumstances that may have a material effect on meeting the targets for economic indicators for that fiscal year as specified in the Medium-Term Budgetary Statement; and

(e) An evaluation as to how the current policies of the Federal Government are in conformity with the principle of sound fiscal and debt management and the targets set forth in the Medium-Term Budgetary Statement.

3. Budget Strategy for 2011-12

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

- Containment of overall fiscal deficit to 4 percent of GDP.
- A significant increase in FBR taxes (to Rs.1,952 billion).
- Gradual elimination of tariff differential subsidy.
- Targeted subsidies on food and fertilizer.
- Zero net borrowing from SBP during 2011-12 and in subsequent years.
- Continuation of ban on new recruitments and purchase of durable goods.
- Rationalization of other expenditure.
- Establishment of an independent commission to scrutinize all development and current expenditure with a view to ensuring their necessity, efficacy and value to the public exchequer.
- Establishment of an independent commission to examine structure of pay and allowances across the public services and bring equity and fairness.
- Implementation of New Growth Strategy.

3.2. The hallmark of 2011-12 was the monetization of transport for all civil servants in Basic Pay Scales in grades 20 to 22 effective from January 1, 2012 in accordance with recommendations of the Pay and Pension Commission 2009. Over the period of time, it will help in reducing the expenditures on purchase of new vehicles, repair and maintenance and POL/CNG. The Government has also constituted a committee to examine structure of pay and allowances across the public services to remove discrimination and bring equity and fairness across them. Likewise, a committee was constituted to scrutinize all development and current expenditure as envisaged in the Budget Strategy. However, its report is still awaited.

3.3. The Government introduced various measures to enhance tax revenues including expansion of the GST tax-base by removing a number of exemptions and zero ratings.

4. Historical Perspective on Fiscal Development

4.1. The decade of 1990s experienced high fiscal imbalance (Fig-1). However, the fiscal deficit started declining during the period 2002-03 to 2006-07 primarily because of (i) rescheduling of foreign debt of US$ 12 billion that brought down the debt servicing from 42.4percent in 2000-01 to 22 percent of the revenues in 2005-06 (ii) huge flows of foreign grants that increased non-tax revenues and inflows from CSF. Nevertheless, fiscal deficit moved up to 7.6 percent of GDP during 2007-08 for the reasons: (i) policy inaction of the Government, particularly during the transition, to deal with the rising oil and commodity prices; (ii) decision of the Government to subsidize rising oil and commodity prices; (iii) lower revenues and (iv) higher expenditures because of substantially increased subsidy bill.

Fig-1: Fiscal Deficit (As percent of GDP)

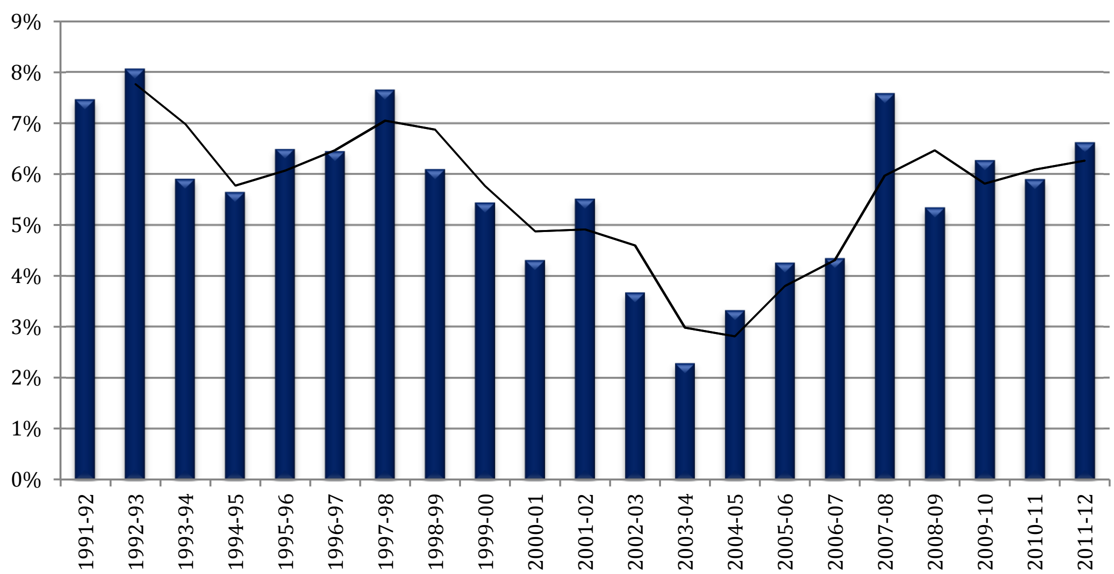


Table-1: Fiscal Indicators (as percent of GDP)

	Real GDP Growth	Overall Fiscal Deficit	Expenditure			Revenue		
			Total	Current	Development	Total	Tax	Non-Tax
1992	7.6	7.5	26.7	19.1	7.6	19.2	13.7	5.5
1993	2.1	8.1	26.2	20.5	5.7	18.1	13.4	4.7
1994	4.4	5.9	23.4	18.8	4.6	17.5	13.4	4.1
1995	5.1	5.6	22.9	18.5	4.4	17.3	13.8	3.5
1996	6.6	6.5	24.4	20.0	4.4	17.9	14.4	3.5
1997	1.7	6.4	22.3	18.8	3.5	15.8	13.4	2.4
1998	3.5	7.7	23.7	19.8	3.9	16.0	13.2	2.8
1999	4.2	6.1	21.9	18.6	3.3	16.0	13.3	2.7
2000	3.9	5.4	18.9	16.4	2.5	13.4	10.6	2.8
2001	2.0	4.3	17.4	15.3	2.1	13.1	10.5	2.6
2002	3.1	5.5	19.6	16.2	3.4	14.2	10.7	3.5
2003	4.7	3.6	18.4	16.0	2.4	14.8	11.4	3.4

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

	Real GDP Growth	Overall Fiscal Deficit	Expenditure			Revenue		
			Total	Current	Development	Total	Tax	Non-Tax
2004	7.5	2.3	16.4	13.8	2.6	14.1	10.8	3.2
2005	9.0	3.3	17.2	14.5	2.7	13.8	10.1	3.7
2006	5.8	4.3	18.4	14.7	3.7	14.1	9.9	4.2
2007	6.8	4.4	19.3	15.9	3.5	15.0	10.3	4.7
2008	3.7	7.6	22.2	18.1	4.1	14.6	10.3	4.4
2009	1.7	5.3	19.9	16.0	3.8	14.5	9.5	5.1.
2010	3.1	6.3	20.3	16.1	4.2	14.0	9.9	4.1
2011	3.0	6.0*	19.1	16.1	3.0	12.5	9.4	3.1
2012	3.7	6.6**	19.1	15.1	3.9	12.4	9.9	2.5
2013(T)	4.3	4.7	19.0	14.5	4.4	14.3	10.9	3.4

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

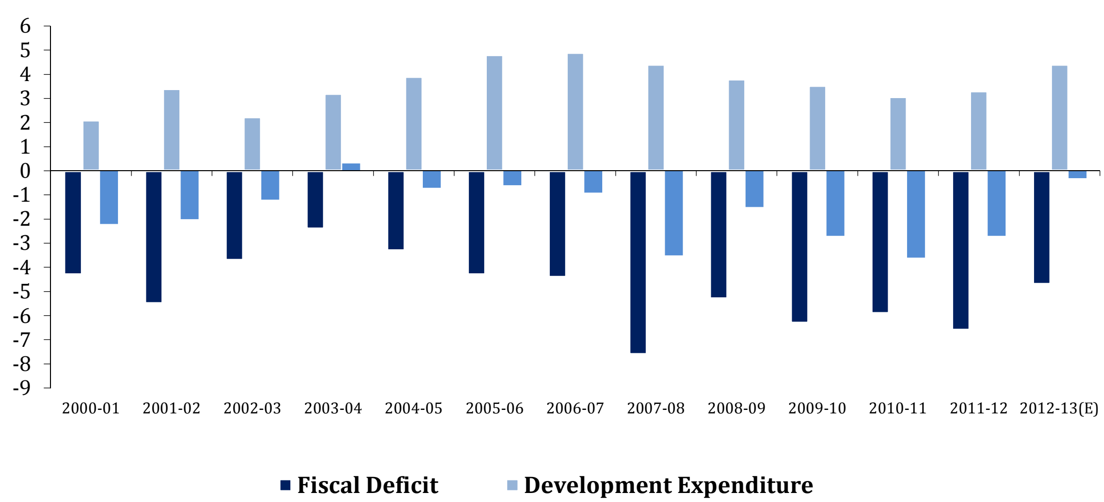
*excludes arrears of electricity subsidies amounting Rs.120 billion, budget deficit including arrears of subsidies works out at 6.6 percent of the GDP

**excludes, "one-off" payment of Rs.391 billion on account of debt consolidation

Source: Debt Policy Coordination Office Staff Calculations

4.2. The trend of revenue balance, development expenditure and fiscal deficit is reflected in Fig-2.

Fig-2: Trend in Fiscal Indicators (As percent of GDP)



5. Fiscal Performance (2011-12)

I. Total Revenue

A. Federal Board of Revenue (FBR) Collection

5.1. The Government has taken several steps to provide relief to the common man. The General Sales Tax on goods was reduced from 17 to 16 percent; abolished regulatory duties on 392 out of 397 items; abolished special excise duties, reduced federal excises on certain items; and enhanced the exemption limit on income tax. Additionally, number of slabs for income tax was reduced from 17 to 6. The revenue foregone on this front has been targeted to be compensated through broadening the tax base and improving tax compliance. At the same time, the government removed exemptions and zero ratings from the GST regime.

5.2. FBR was assigned a revenue target of Rs.1,952 billion for 2011-12, which was higher by Rs.402 billion or 26 percent over the actual collection of Rs.1,550 billion of 2010-11. Despite slow growth in the large manufacturing sector and less tax realization from major sectors like cement, beverages and services, FBR managed to collect Rs.1,881 billion (96.5 percent of the assigned target) showing a healthy growth of 21.4 percent over the actual collection of 2010-11. This growth has increased the FBR tax to GDP ratio from 8.6 percent in 2010-11 to 9.1 percent in 2011-12(Fig-3). However, Rs.1,881 billion does not include Rs.25 billion collected by Sindh Revenue Board (SRB) on account of General Sales Tax on services. To make 2011-12 comparable with 2010-11, Sindh collection need to be added which makes total collection to Rs.1,906 billion showing a growth of 23 percent.

5.3. Refunds by the FBR during 2011-12 were Rs.146 billion, 37.3 percent higher than the 2010-11. The Government is taking measures to enhance revenues by broadening the tax-base, simplifying the tax structure, moving towards two taxes regime, effective monitoring and risk based audit.

Fig-3: Tax Revenue (As percent of GDP)

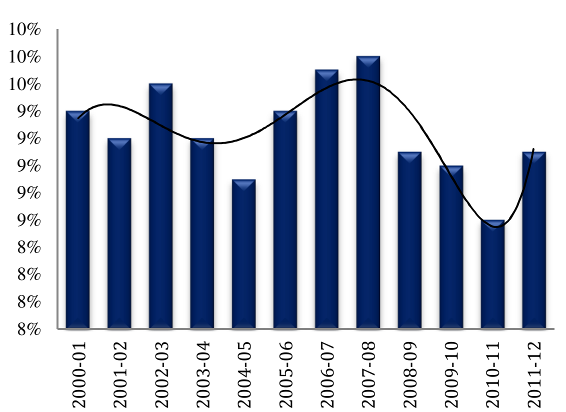
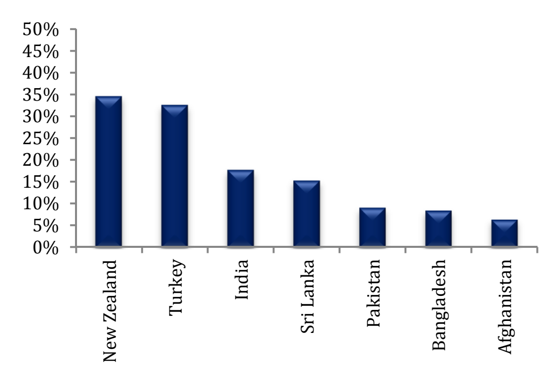


Fig-4: World Comparison - Tax to GDP



5.4. A glimpse at the tax-wise collection and targets (Table-2) shows that customs duty has achieved the allocated target during 2011-12. However, direct taxes and sales tax collection have marginally missed the target. Federal Excise missed the target as well as witnessed a negative growth of 11 percent owing to:

- Abolition of Special Excise Duty (SED) both at import and domestic stages;
- Reduction of FED rates of beverages from 12 percent to 6 percent;
- Reduction of FED rates on cement from Rs.700 per Metric ton to Rs.500 per Metric ton.

Table-2: A Comparison of Collection vis-à-vis Target (2011-12)

(Rs. in billion)

Tax Head	Target	Collection*	Achievement of Target (%)
Direct Taxes	745.0	731.9	98.2
Sales Tax	852.0	809.3	95.0
Federal Excise	140.0	122.0	87.1
Customs Duty	215.0	218.2	101.5
All Taxes	**1,952**	**1,881.4**	**96.5**

* Provisional Source: Federal Board of Revenue

Note:- Rs.25 billion on account of services has been collected by Sindh Revenue Board (SRB) is not included in revenue collection.

B. Tax wise Analysis

Direct Taxes:

5.5. The direct taxes are one of the major sources of federal tax revenues after sales tax. The share of direct taxes in total federal tax receipts has increased from around 32 percent in 2000-01 to 39 percent in 2011-12 owing to improved tax efforts and effective implementation of tax policy and administrative reforms. The collection under direct taxes has been Rs.732 billion which is higher by 23 percent as compared to the last fiscal year. An amount of Rs.92 billion refunds has been paid back to the claimants as against Rs.47 billion during 2010-11.

5.6. The direct taxes includes income tax and other direct taxes i.e. capital gain tax, worker welfare fund and worker profit participatory fund. The structure of income tax is based on withholding taxes (WHT), voluntary payments (VP) and collection on demand (COD) having share of 51 percent, 29 percent and 16 percent respectively in gross collection during 2011-12. The contribution of income tax in total direct taxes has been over 95 percent. Details of these components of income tax are presented in Table-3.

Table-3: Head-wise Performance of Direct Taxes

	Collection (2011-12)*	Collection (2010-11)	Change (%)
(Rs. in billion)			
Voluntary Payments	237.4	196.1	21.1
Collection on Demand	130.0	72.2	80.1
Deductions at Source (WHT)	422.4	357.8	18.1
Miscellaneous	31.0	3.0	933.3
Gross Income Tax	820.8	629.1	30.5
Total Net Direct Taxes	731.9	602.5	21.5

* Provisional Source: Federal Board of Revenue

Analysis of Components of Income Tax

5.7. ***Voluntary Payments (VP):*** This component includes payments with return and advances. Considerable growth of 21.1 percent has been witnessed in collection from this important component i.e. Rs.237 billion have been generated during 2011-12 as compared to Rs.196 billion in the corresponding period last year. Major component of voluntary payment is advance tax where a sum of Rs.222 billion has been collected in 2011-12 against Rs.184 billion last year. The second component of VP is payment with returns which has increased significantly during the period under review. During 2011-12, Rs.15 billion were collected against Rs.12 billion in 2010-11, indicating a growth of 26.1 percent (Table-4).

Table-4: Collection of Income Tax by Voluntary Compliance

(Rs. in billion)

	Collection (2011-12)*	**Collection (2010-11)**	**Change (%)**
Voluntary Payments (A+B)	237.4	196.1	21.1
A) With Returns	15.0	11.9	26.1
B) Advance Tax	222.4	184.2	20.7

* Provisional Source: Federal Board of Revenue

5.8. **Withholding Taxes (WHT):** WHT continues to be the leading source of direct tax receipts with the collection of Rs.422 billion during 2011-12 against Rs.358 billion during the same period last year indicating a healthy growth of 18 percent. The nine major withholding taxes contributed over 90 percent of total WHT collection.

5.9. The growth pattern of various components of WHT has been different i.e. dividend (46.7 percent), bank interest (43.2 percent), salary (25.7 percent), imports (28.5 percent), exports (-3.3 percent), telephone (33.7 percent). The highest growth registered in collection from dividend is due to record growth in respect of disbursement of profits by the companies to their shareholders. The main reason is that the investment opportunities are shrinking down due to economic uncertainty and deteriorating economic indicators. Similarly, the reason of 25.7percent growth in collection from salary is due to increase in the pay package of employees. Likewise, growth of 28.5 percent from imports is mainly on account of increase in the volume of imports. The higher growth of 43.2 percent in bank interest and securities is due to general reluctance in investing in industrial sector/commerce & trade etc.

Table-5: Deductions at Source: A Comparison of Collection

	Collection 2011-12*	Collection 2010-11	Change (%)	Share (%) 2011-12
	(Rs. in billion)			
Contracts	106.5	72.1	47.7	25.2
Imports	85.3	66.4	28.5	20.2
Salary	57.3	45.6	25.7	13.6
Telephone	36.9	27.6	33.7	8.7
Exports	23.3	24.1	-3.3	5.5
Bank Interest	33.8	23.6	43.2	8.0
Cash Withdrawal	12.5	10.6	17.9	3.0
Electricity	14.6	14.3	2.1	3.5
Dividend	17.6	12.0	46.7	4.2
Sub-Total	388.0	323.0	20.1	91.9
Other WHT	34.4	34.9	-1.4	8.1
Total WHT	422.4	357.8	18.1	100.0

* Provisional	Source: Federal Board of Revenue

Indirect Taxes

Sales Tax:

5.10. Sales tax has been leading revenue generating source of federal tax receipts in 2011-12 and constitutes around 43 percent of the total net revenue collection. An amount of Rs.809 billion has been collected under the sales tax head during 2011-12 over the collection of Rs.633 billion in the comparable period of last year indicating a growth of 28 percent. This is partially due to the tax base broadening efforts of the government by removing major sales tax exemptions and zero rating. The collection is realized from two components: i.e. sales tax on imports and sales tax on domestic sector. Sales tax collection from imports has registered a healthy growth of 40.2 percent. Around 16 percent growth has been yielded in sales tax collection from domestic side (Table-6).

Table-6: Collection and Growth of GST

Heads	2011-12*			2010-11			Growth (%)		
	Gross	Refund	Net	Gross	Refund	Net	Gross	Refund	Net
	(Rs. in billion)								
Import	432.7	0.0	432.7	308.7	0.0	308.7	40.2	0.0	40.2
Domestic	421.9	45.3	376.7	375.5	50.8	324.7	12.4	-10.8	16.0
Total	**854.6**	**45.3**	**809.3**	**684.2**	**50.8**	**633.4**	**24.9**	**-10.8**	**27.8**

* Provisional Source: Federal Board of Revenue

5.11. ***Sales Tax Domestic Collection and Major Revenue Spinners:*** The collection of sales tax has been highly concentrated in few commodities. This is confirmed by the fact that only petroleum products and telecom sector contribute more than 50 percent of the total sales tax domestic. Major ten commodities contribute over 80percent of the total net sales tax from domestic. Petroleum has been the top revenue generation source of sales tax domestic and contributed around 40 percent of the total sales tax domestic during 2011-12. Its collection has negatively grown by 1.9 percent. Main reason of negative growth is attributed to decline in international price of oil during 2011-12 as compared to last fiscal year. Besides, 120 percent higher refunds have been paid back to the oil sector which has adversely impacted the net revenues.

Detail of major revenue spinners is presented in Table-7.

Table-7: Comparison of Sales Tax Domestic (Net) Collection by Major Commodity

Major Commodities	Collection (2011-12)*	Collection (2010-11)	Growth (%)	Share (%) 2011-12	Share (%) 2010-11
	(Rs. in billion)				
POL Products	150.4	153.3	-1.9	39.9	47.2
Telecom Sector	49.1	52.7	-6.8	13.0	16.2
Natural Gas	29.2	17.2	69.8	7.8	5.3
Other Services	17.4	20.7	-15.9	4.6	6.4
Fertilizer	13.2	3.8	247.4	3.5	1.2
Sugar	12.7	7.3	74.0	3.4	2.2
Cigarettes	12.5	11.5	8.7	3.3	3.5
Electrical Energy	9.8	8.2	19.5	2.6	2.5
Beverages	8.4	8.3	1.2	2.2	2.6
Cement	8.0	4.9	63.3	2.1	1.5
Sub-Total	**310.9**	**287.8**	**8.0**	**82.5**	**88.6**
Others	65.8	36.9	78.3	17.5	11.4
Total	**376.7**	**324.7**	**16.0**	**100.0**	**100.0**

* Provisional Source: Federal Board of Revenue

5.12. ***Sales Tax at Import Stage****:* Sales tax on imports is a significant component of federal tax receipts. The collection of sales tax has posted an increase of 40.2 percent during 2011-12 mainly due to withdrawal of exemptions on certain commodities and

16 percent growth registered in the value of imports during the year. Major 10 commodities of sales tax import have contributed over 75 percent of the total sales tax collection (Table-8).

5.13. Like sales tax domestic, petroleum is also a leading source of sales tax collection at import stage. The collection of sales tax from petroleum reflected a growth of 42.4 percent. Although imports from petroleum products grew by 31 percent but main driver behind this growth is import of crude oil which is zero rated. Thus, growth in the collection of sales tax from petroleum is not matching with the overall growth in the imports of petroleum products.

Table-8: Collection of Sales Tax (Import) from Major Items

Description	Items	Collection (2011-12)*	Collection (2010-11)	Growth (%)	Share (%) 2011-12	Share (%) 2010-11
	(Rs. in billion)					
POL Products	27	157.3	110.5	42.4	36.4	35.8
Edible Oil	15	34.9	28.6	22.0	8.1	9.3
Plastic	39	26.1	24.6	6.1	6.0	8.0
Vehicles and Parts	87	28.1	19.8	41.9	6.5	6.4
Iron and Steel	72	21.8	19.0	14.7	5.0	6.2
Mechanical Machinery	84	22.6	12.6	79.4	5.2	4.1
Electrical Machinery	85	14.1	9.7	45.4	3.3	3.1
Organic Chemicals	29	9.6	8.4	14.3	2.2	2.7
Paper & P. Board	48	7.4	8.0	-7.5	1.7	2.6
Tea & Coffee	9	5.7	5.9	-3.4	1.3	1.9
Sub Total		**327.5**	**247.0**	**32.6**	**75.7**	**80.0**
Other		105.2	61.7	70.5	24.3	20.0
Gross		432.7	308.7	40.2	100	100
Refund/Rebate		0.0	0.0	84.8		
Net		432.7	308.6	40.2		

* Provisional   Source: Federal Board of Revenue

Customs Duty:

5.14. Customs duty is levied on dutiable imports and contributing around 12percent in federal tax receipts during 2011-12. An amount of Rs.218 billion has been collected during 2011-12, thereby, recorded a growth of 18 percent over the collection of Rs.185 billion in last fiscal year. This achievement has been made despite modest growth of 6 percent in the dutiable import during 2011-12.

5.15. The target allocated to the customs duty for 2011-12 was Rs.215 billion which was surpassed by 1.5percent. There is a considerable degree of concentration of collection of customs duty in few items; only five items i.e. vehicles, petroleum products, edible oils, mechanical machinery and electrical machinery contributed over 44percent of the total collection during 2011-12. Similarly, 58.2 percent of the total collection of customs duty has been realized from 10 major commodities groups. The collection of customs duty from these leading commodities is highlighted in Table-9.

Table-9: Details of Collection of Customs Duty

Description	2011-12*	2010-11	Growth (%)	Share (%)	
				2011-12	2010-11
(Rs. in billion)					
1.Vehicles and Parts (87)	43.1	28.1	53.4	19.0	14.5
2. POL Products (27)	17.6	21.4	-17.8	7.8	11.1
3.Edible Oil (15)	18.4	17.3	6.4	8.1	8.9
4.Mechanical Machinery (84)	11.6	10.9	6.4	5.1	5.6
5.Electrical Machinery (85)	9.9	9.5	4.2	4.4	4.9
6.Plastic (39)	8.8	8.8	0.0	3.9	4.6
7.Iron and steel (72)	7.8	7.6	2.6	3.4	3.9
8..Paper & P. Board (48)	6.6	7.3	-9.6	2.9	3.8
9.Textile material (54)	4.3	4.5	-4.4	1.9	2.3
10.Organic Chemical (29)	3.9	3.9	0.0	1.7	2.0
Sub Total	**132.0**	**134.2**	**-1.6**	**58.2**	**69.4**
Other	94.7	59.1	60.2	41.8	30.6
Gross	226.7	193.4	17.2	100	100
Refund/Rebate	8.5	8.5	0.0		
Net	218.2	184.9	18.0		

* Provisional Source: Federal Board of Revenue

Automobile is the top revenue spinner of customs duty which constituted 19 percent of the total customs duty collected during 2011-12. The collection of automobile grew by 53.4 percent during 2011-12 due to growth of 37.2 percent in the value of dutiable imports. Petroleum products have been the second major revenue source of customs duty.

Federal Excise Duty (FED):

5.16. Federal excise duty is levied at import and domestic stages. The major portion of the receipts emanates from domestic sector. The base of the federal excise duty is quite narrow and is limited to few commodities. Federal excise duty has contributed around 6.5 percent of total tax collection during 2011-12. The tax collection realized has been Rs.122 billion in 2011-12 as compared to Rs.137 billion in 2010-11 yielding a negative growth of 11 percent owing to abolition of Special Excise Duty (SED) both at import and domestic stages, reduction of FED rates of beverages from 12 percent to 6 percent and reduction of FED rates on cement from Rs.700 per Metric ton to Rs.500 per Metric ton.

5.17. Among major items, cigarette has been the top most revenue generator with 44 percent share in FED collection, followed by cement (10 percent), natural gas (10 percent), services (8 percent), beverages (6 percent), POL products (5 percent) and perfumery (2 percent). Only eight major spinners of FED contributed 90 percent of the total FED collection.

Table-10: FED Collection from Major Commodities

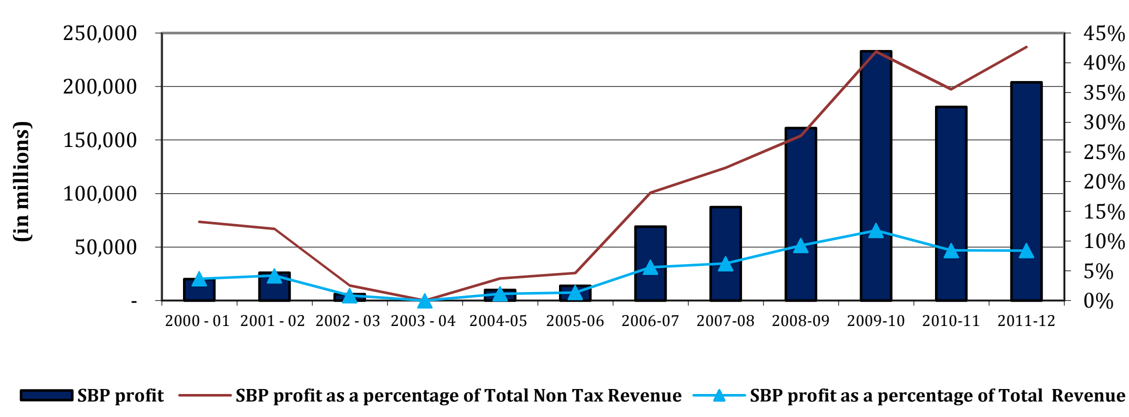
	Collection (2011-12)*	Collection (2010-11)	Growth (%)	Share (%) 2011-12	Share (%) 2010-11
		(Rs. in billion)			
Cigarettes	53.5	47.1	13.6	43.9	34.3
Cement	12.7	15.5	-18.1	10.4	11.3
Natural Gas	12.1	11.7	3.4	9.9	8.5
Services	10.4	11.0	-5.5	8.5	8.0
Beverages	7.9	9.1	-13.2	6.5	6.6
POL Products	5.8	5.1	13.7	4.8	3.7
SED	4.4	24.6	-82.1	3.6	17.9
Perfumery	2.4	2.0	20.0	2.0	1.5
Sub-total	**109.2**	**126.1**	**-13.4**	**89.5**	**91.8**
Others	12.8	11.2	14.3	10.5	8.2
Grand total	**122.0**	**137.4**	**-11.2**	**100**	**100**

* Provisional
Source: Federal Board of Revenue

C. Non Tax Revenue

5.18. Non tax revenue in 2011-12 reached Rs.514 billion. SBP profit contributed Rs.204 billion (39.7 percent in non-tax revenue) or around 8 percent in total revenue (Fig-5). Receipts under the head of defense were budgeted at Rs.119 billion during 2011-12 originating mainly from logistic support services provided to the coalition forces. However, around Rs.10 billion could be realized under this head leaving the receipts under the head of defense below the target by Rs.109 billion. The dividends receipts from financial and non-financial institutions remained below the budget target by Rs.14.7 billion. Government allocated Rs.75 billion receipts from sale of 3G licenses, however, it could not be materialized.

Fig-5: Profit receipts from SBP



II. Total Expenditures

5.19. The overall expenditure of the (consolidated) government was projected to increase by 12 percent from actual spending– adjusted for one-off payment of Rs.120 billion – during 2010-11. This was majorly due to a 46 percent increase in development spending. The overall recurrent expenditure of the government was expected to increase by 7 percent. The recurrent expenditure of the provincial governments was budgeted to increase by 18 percent, while federal government's recurrent expenditure was projected to increase by 2.4 percent. The amount paid against subsidies was projected to decline by 31 percent. In particular, power sector subsidies were expected to decline from Rs.214.8 billion in 2010-11 to Rs.147.3 billion in 2011-12.

5.20. The large increase in development spending was due to: (i) 38 percent increase in development spending of the provinces reflecting both an improvement in provinces' financial situation due to larger transfer of revenue from the federal government and passing down of additional responsibility due to the 18th Constitutional Amendment; (ii) 39 percent increase in the size of Public Sector Development Programme(PSDP), which reflected an attempt to provide funding for the projects and program for which the funding was reduced in 2010-11 due to shortage of finances.

5.21. Total expenditure for 2011-12 approximated to Rs.3,936 billion; Rs.215 billion above the spending targets while the growth over the previous fiscal year was 18.3 percent. The current expenditure exceeded the target by 5 percent mainly due to higher than budgeted expenditure on interest servicing and salaries & pension. The development expenditure witnessed a significant upward adjustment, which was 44.6 percent higher than 2010-11.

Table-11: Consolidated Expenditure, 2011-12 (Rs. in billion)

	Budget Estimate	Prov. Actual July-June	Variance
Federal	**2,016.3**	**2,154.7**	**138.4**
General Public Service	**1,361.4**	**1,472.4**	**111.0**
Servicing of Domestic Debt	714.7	821.1	106.4
Servicing of Foreign Debt	76.3	67.9	(8.4)
Superannuation Allowances & Pension	96.1	140.4	44.3
Grants to Others	239.6	224.3	(15.3)
Others General Public Services	234.7	218.6	(16.1)
Defence Affairs and Services	**495.2**	**507.2**	**12.0**
Public Order and Safety Affairs	**59.6**	**70.8**	**11.2**
Economic Affairs	**50.3**	**41.0**	**(9.3)**

Table-11: Consolidated Expenditure, 2011-12 (Rs. in billion)

	Budget Estimate	Prov. Actual July-June	Variance
Others	**49.7**	**63.4**	**13.7**
Provincial	**960.0**	**967.8**	**7.8**
Current Expenditure	**2,976.3**	**3,122.5**	**146.2**
PSDP	**640.0**	**664.7**	**24.7**
Federal	300.0	289.3	(10.7)
Provincial	340.0	375.4	35.4
Other Development Expenditure	**97.1**	**67.1**	**(30.0)**
Development Expenditure	**737.0**	**731.9**	**(5.1)**
Net Lending	**7.9**	**12.0**	**4.1**
Total Expenditure	**3,721.2**	**3,936.2**	**215.0**

Source: Budget Wing, Finance Division

Table-12: Consolidated Budgetary Position of the Government (Rs. in billion)

	Prov.Actual July-June 2010-11	Budget Estimate 2011-12	Prov.Actual July-June 2011-12	Variance B.E.vs. Actual 2011-12
A. Total Revenue	**2,252.9**	**2,870.5**	**2,566.5**	**(304.0)**
a) Tax Revenue	**1,699.3**	**2,151.2**	**2,052.9**	**(98.3)**
- Federal	**1,634.8**	**2,074.2**	**1,945.7**	**(128.5)**
of which FBR Revenue	1,550.2	1,952.3	1,881.5	(70.8)
- Provincial	64.6	77.0	107.2	30.2
b) Non-Tax Revenue	**553.5**	**719.3**	**513.6**	**(205.7)**
- Federal	491.2	642.3	465.6	(176.7)
- Provincial	62.3	77.0	48.0	(29.0)
B. Total Expenditure	**3,447.3**	**3,721.2**	**3,936.2**	**215.0**
a) Current Expenditure	**2,900.8**	**2,976.3**	**3,122.5**	**146.2**
- Federal	**2,088.1**	**2,016.3**	**2,154.7**	**138.4**
of which: **Interest Payments**	**698.1**	**791.0**	**889.0**	**98.0**
- Domestic	629.7	714.7	821.1	106.4
- Foreign	68.4	76.3	67.9	(8.4)
Defense Expenditure	**450.6**	**495.2**	**507.2**	**12.0**
- Provincial	**812.7**	**960.0**	**967.8**	**7.8**
b) Development Exp	**506.1**	**737.0**	**731.9**	**(5.1)**
- PSDP	**461.5**	**640.0**	**664.8**	**24.8**
Federal	215.9	300.0	289.3	(10.7)
Provincial	245.6	340.0	375.4	35.4
- Other Development Exp	**44.6**	**97.1**	**67.1**	**(30.0)**
c) Net Lending	**7.9**	**7.9**	**12.0**	**4.1**
d) Unidentified Exp	**32.5**	**-**	**69.8**	**69.8**
C. Overall Fiscal Balance	**(1,194.4)**	**(850.6)**	**(1,369.7)**	**(519.1)**
- As % of GDP	*(6.0)**	*(4.0)*	*(6.6)***	-
D. Financing of Fiscal Balance	**1,194.4**	**850.6**	**1,369.7**	**519.1**
a) External Sources	107.7	134.5	128.7	(5.8)

Table-12: Consolidated Budgetary Position of the Government (Rs. in billion)	Prov.Actual	Budget	Prov.Actual	Variance
	July-June	Estimate	July-June	B.E.vs. Actual
	2010-11	2011-12	2011-12	2011-12
b) Domestic	**1,086.7**	**716.1**	**1,241.1**	**525.0**
- Non-Bank	471.6	412.6	529.4	116.8
- Bank	615.1	303.5	711.7	408.2
E. GDP at Market Prices	18,062.9	21,041.5	20,654.0	(387.5)
Memo Items:				
Revenue Balance	**(602.4)**	**(105.7)**	**(521.0)*** **	**(415.3)**
- *As % of GDP*	*(3.3)*	*(0.5)*	*(2.5)*	-
Primary Balance	**(450.8)**	**(59.7)**	**(445.8)*** **	**(386.1)**
- *As % of GDP*	*(2.5)*	*(0.3)*	*(2.2)*	-

*excludes arrears of electricity subsidies amounting Rs.120 billion, budget deficit including arrears works out at 6.6 percent of GDP
excludes, "one-off" payment of Rs.391 billion on account of debt consolidation* Adjusted for grants

A. Current Expenditure

5.22. Current expenditures showed a growth of 12.3 percent in 2011-12 (adjusted for one-off payment of Rs.120 billion), compared with 21.6 percent in 2010-11. However, within current expenditure, domestic debt servicing and pensions increased significantly – by more than 28 percent during the year. While the increase in debt servicing is the result of excessive borrowing from banks, pension increases of 15 to 20 percent, was announced in the 2011-12budget to give relief to retired civil and military employees.

5.23. Total interest payments (domestic plus foreign), having a share of 28.5 percent in current expenditure, increased by 27.3 percent in 2011-12, compared to 8.7 percent in the previous year. The rise in interest payment was entirely driven by a surge in interest paid on the country's domestic debt while interest payments on foreign debt remained at the same level as in 2010-11. On the other hand, defence expenditure – another major head of current expenditure with a share of 16.2 percent in current expenditure – increased by 12.6 percent during the year, which is lower than 20.2 percent in 2010-11.

5.24. Subsidies became the second largest item in current expenditures after debt servicing; the total volume of subsidies in 2011-12 surpassed the defense budget. It also included one-off payment of Rs.391 billion against power and commodity sector as discussed earlier. During 2011-12, total subsidies were Rs.557.9 billion, of which 83.2 percent went to power sector and the rest to fertilizer and agriculture commodities.

General Public Service

5.25. Originally, expenses with regards to general public service were budgeted at Rs.1,361 billion for 2011-12. However, this category ended up with an increase of Rs.111 billion mainly on account of servicing of domestic debt. The impact of increased salaries and relief to pensioners also contributed towards the increased public service expenditure.

a. ***Interest Payments:***

5.26. Fiscal deficit including one-off debt consolidation required higher borrowings that increased the debt servicing during the course of the year. Moreover, owing to the non-availability of external proceeds, government had to shift to domestic financing during past few years. Interest payments accounted for 34.6 percent of total revenues in 2011-12 against 31 percent in 2010-11. Domestic interest servicing accounted for 92.4 percent of the total interest payments during 2011-12.

b. Subsidies:

5.27. During 2011-12, government paid subsidies for the amount of Rs.167 billion (excluding one-off payment of Rs.391 billion) against the budget estimate of Rs.166 billion. Government also cleared the unpaid subsidy claims of PEPCO related to past years' amounting to Rs.433 billion (Rs.120 billion in 2010-11 and Rs.313 billion in 2011-12). Furthermore, past years' subsidy claims of Rs.78 billion related to commodity operations were also paid during 2011-12. A considerable drain on government resources has been an increasing burden of contingent liabilities in order to cover the losses incurred by public sector enterprises (PSEs). Accordingly, the contingent responsibility has transformed into government's liability as in case of power and commodity sector.

Table-13: Subsidies: (2008-09 to 2011-12)

	Power Sector	Food & Agriculture	Oil Refineries	Others	Total
		2011-12			
Actual	464.0*	80.3*	6.2	7.5	**557.9***
Share (percent)	*83.2*	*14.4*	*1.1*	*1.3*	*100.0*
Budget Estimate	147.3	11.2	7.9	0.1	166.4
Revised Estimate	464.3	29.6	7.9	10.5	512.3
		2010-11			
Actual	334.8**	29.6	10.8	9.4	**384.6****
Share (percent)	*87.1*	*7.7*	*2.8*	*2.4*	*100.0*
Budget Estimate	87.3	26.1	10.8	2.5	126.7
Revised Estimate	343.1	39.5	10.8	2.3	395.8
		2009-10			
Actual	178.8	30.1	11.2	1.2	**221.3**
Share (percent)	*80.8*	*13.6*	*5.1*	*0.5*	*100.0*
Budget Estimate	66.7	35.6	15.0	2.6	119.9
Revised Estimate	179.5	36.1	11.2	2.1	229.0
		2008-09			

Table-13: Subsidies: (2008-09 to 2011-12)

	Power Sector	Food & Agriculture	Oil Refineries	Others	Total
Actual	109.8	58.6	67.7	6.6	**242.7**
Share (percent)	45.2	24.1	27.9	2.7	100.0
Budget Estimate	88.4	66.7	140.0	0.1	292.4
Revised Estimate	111.6	63.5	70.0	6.9	252.0

*Includes, "one off" payment of Rs.312.8 billion and Rs.78.2 billion against past years' unpaid power sector subsidies and commodity operations respectively

**include arrears of electricity subsidies amounting Rs.120 billion

Source: Budget Wing, Finance Division

B. Provincial Finances

5.28. Provincial expenditures have been growing at an average of 27 percent during the last three years. Nevertheless, their tax effort has not been in line with the understanding reached during the NFC Award. Despite transferring the functions of 17 ministries to provinces, federal expenditure did not fall as: (a) most of the employees of the devolved ministries preferred to stay on the federal payroll rather than opting for the provinces; (b) some new ministries were created in the federal government; and (c) some divisions were upgraded to ministries. Additionally, the federal government agreed to finance the vertical programs over the NFC period.

5.29. As a result, the federal government continued to face pressure on its fiscal balance. The provinces, on the other hand, were unable to support the federal government as had been envisaged in the fiscal devolution process. More specifically, the provinces' share in total expenditure increased from 31.5 percent in 2011 to 34.5 percent in 2011-12, whereas their share in revenue generation remained almost the same at 6 percent of the total (federal plus provincial) revenues.

5.30. The Provinces posted a deficit of Rs.39 billion during 2011-12 as compared to surplus of Rs.134 billion in 2010-11.The surplus in 2010-11 was due to upward revision in the share of provincial governments to 56 percent in divisible pool (a welcome consequence of 7th NFC Award), the deficit in 2011-12 was driven by sharp rise in provincial expenditures. However, putting aside what has happened in the last two years, both the 7th NFC Award and 18th Amendments are considered right steps towards greater accountability and efficient decision making in the provision of local services and financing thereof.

5.31. Amongst the provinces, Punjab has a share of 44.5 percent, both in total provincial revenues and in total provincial expenditures. It is followed by Sindh, with a 28.8 percent share in total provincial revenues and a 30.4 percent share in total expenditures. These two provinces drive the whole outcome of provincial fiscal operations. This is why, despite a budget surplus of Rs.19.1 billion in Balochistan, the overall provincial balance was in deficit due to Sindh and Punjab. Although both Sindh and Punjab displayed efforts to increase revenue, they could not control expenditures. Sindh had to face extra outlays to rehabilitate flood affectees in a large part of the province, while Punjab spent on infrastructure, health, education and food subsidies. Khyber Pakhtunkhwa (KPK) witnessed a budget deficit of Rs.3.7 billon during 2011-12, despite being the largest recipient of federal loans and grants (Rs.34.5 billion). The province's own resources (other than grants and transfers from the divisible pool) shrank (-69.7 percent), while its expenditure growth was 30.2 percent during the year. The performance of Balochistan, did not differ from KPK in revenue mobilization; however, its expenditures were well contained. While all other provinces spent on development programs, Balochistan could not keep pace, and therefore witnessed a budget surplus of Rs.19.1 billion.

C. Development Expenditure

5.32. The amount of Rs.732 billion was spent for development purposes in 2011-12 in comparison to Rs.506 billion during 2010-11. Development spending was enhanced for fiscal year 2011-12 by Rs.226 billion or 44.6 percent as compared to 2010-11. Out of it, PSDP was Rs.665 billion as against a budgeted estimate of Rs.640 billion, while other development expenditures summed to Rs.67 billion and witnessed a cut of 31 percent (in comparison to budget estimates) in the fiscal year 2011-12. Among PSDP, provincial share increased by 10.4 percent in comparison to budgeted outlay, whereas, federal portion was curtailed by 3.6 percent in the period under review. It has been encouraging to witness increased development expenditure in 2011-12 compared to missed targets in past years.

6. Recent Fiscal Policy Development

6.1. During 2011-12, government took various measures to boost economic activities and achieve fiscal consolidation. The fiscal strategy was aimed at expanding the resource envelope by tapping "tax buoyancy" and by containing the current expenditures. The government followed austerity on the expenditure side and notable mobilization of taxes on the revenue side. However, the policy of not passing the entire burden of oil and electricity prices and to preserve the safety nets for vulnerable groups, have added to government expenditures.

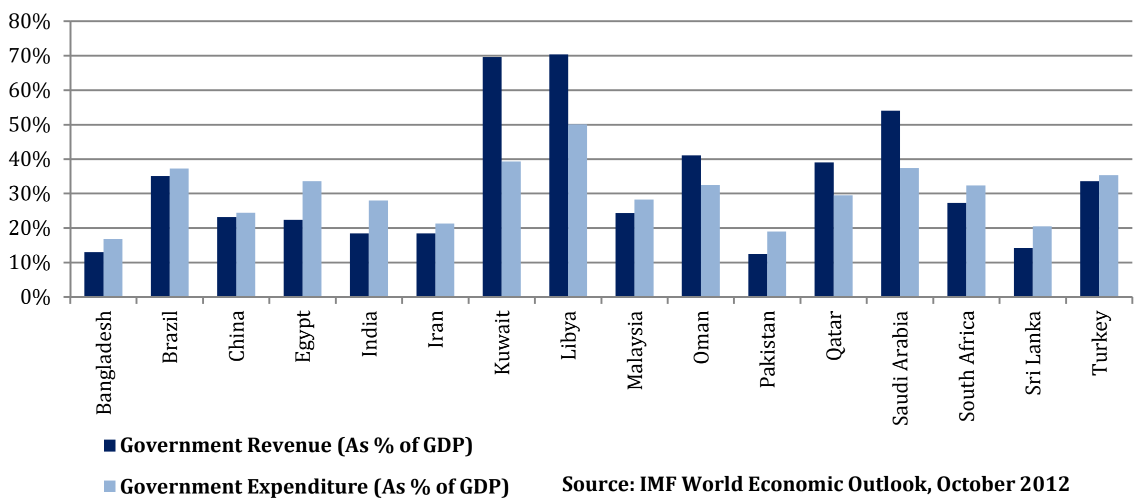
Table-14: Consolidated Revenue & Expenditure of the Government				(Rs. in billion)
	Prov. Actual July-June 2010-11	Budget Estimate 2011-12	Prov. Actual July-June 2011-12	Variance Budget Vs. Actual 2011-12
A. Total Revenue	**2,252.9**	**2,870.5**	**2,566.5**	**(304.0)**
a) Tax Revenue	1,699.3	2,151.2	2,052.9	(98.3)
b) Non-Tax Revenue	553.5	719.3	513.6	(205.7)
B. Total Expenditure	**3,447.3**	**3,721.2**	**3,936.2**	**215.0**
a) Current Expenditure	2,900.8	2,976.3	3,122.5	146.2
b) Development Expenditure	506.1	737.0	731.9	(5.1)
c) Net Lending	7.9	7.9	12.0	4.1
d) Unidentified Expenditure	32.5	-	69.8	69.8
C. Overall Fiscal Balance	**(1,194.4)**	**(850.6)**	**(1,369.7)**	**(519.1)**
- *As % of GDP*	*(6.0)**	*(4.0)*	*(6.6)***	-

*excludes arrears of electricity subsidies amounting Rs.120 billion, budget deficit including arrears works out at 6.6 percent of GDP
**excludes, "one off" payment of Rs.391 billion on account of debt consolidation

Source: Budget Wing, Finance Division

6.2. Total revenues amounted to Rs.2,567 billion with tax revenues stood at Rs.2,053 billion and non-tax revenues recorded at Rs.514 billion in 2011-12. The FBR collection stood at Rs.1,881 billion during 2011-12 against the total collection of Rs.1,550 billion during 2010-11. On non-tax revenue front, SBP remains one of the biggest contributors towards national kitty by contributing Rs.204 billion or 39.7 percent. The total expenditure stood at Rs.3,936 billion with Rs.3,123 billion current expenditure and Rs.744 billion development expenditure and net lending.

Fig-6: Government Revenues and Expenditures (As percent of GDP)



Source: IMF World Economic Outlook, October 2012

6.3. Selected fiscal indicators for the last four years are iterated below:

Table-15: Selected Fiscal Indicators (in percent)

	2008	2009	2010	2011	2012
Real Growth of Public Debt	8.3	5.2	3.9	1.6	7.9
Real Growth of Revenues	(0.6)	2.9	(0.1)	(8.3)	3.9
Real Growth of Tax Revenue	1.6	(4.5)	8.7	(2.4)	10.1
Real Growth in Non-interest Exp.	17.7	(11.7)	11.1	(1.7)	1.1
Real Growth of GDP	3.7	1.7	3.1	3.0	3.7
Primary Balance*	(2.5)	(0.1)	(1.6)	(2.5)**	(2.2)***
Revenue Balance*	(3.2)	(1.2)	(1.7)	(3.3)**	(2.5)***
Public Debt/GDP	59.0	60.0	60.2	59.3	61.3
Public Debt/Revenue	403.1	412.2	428.8	475.0	493.6
Debt Service/Revenue	37.2	46.6	40.4	38.0	39.9

*Adjusted for grants

**excludes arrears of electricity subsidies amounting Rs.120 billion

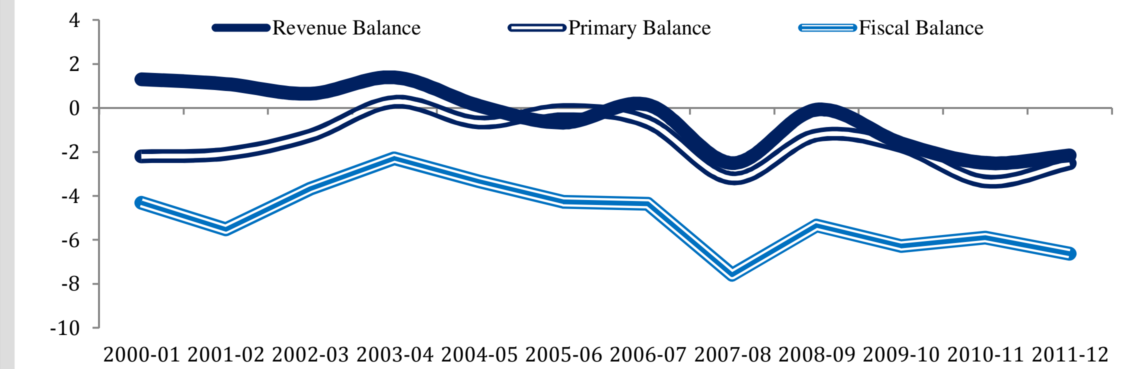
***excludes, "one off" payment of Rs.391 billion on account of debt consolidation

Source: Debt Policy and Coordination Staff Calculations

6.4. The revenue deficit was Rs.328 billion or 3.2 percent of GDP during 2007-08. While the same indicator improved sharply by 200 bps in 2008-09 over 2007-08, the fiscal year 2011 saw a reversal of this declining tendency and recorded a revenue deficit of 602 billion approximating to 3.3 percent of GDP. Revenue deficit stood at Rs.521 billion or 2.5 percent of GDP in 2011-12.

6.5. Primary balance is the total revenue adjusted for non-interest expenditure. A negative primary balance essentially means that the government is borrowing monies to pay interest payment on the debt stock. In line with the revenue deficit, the primary deficit aggregated to Rs.446 billion or 2.2 percent of GDP in 2011-12.

Fig-7: Trends in Fiscal, Revenue and Primary Balance



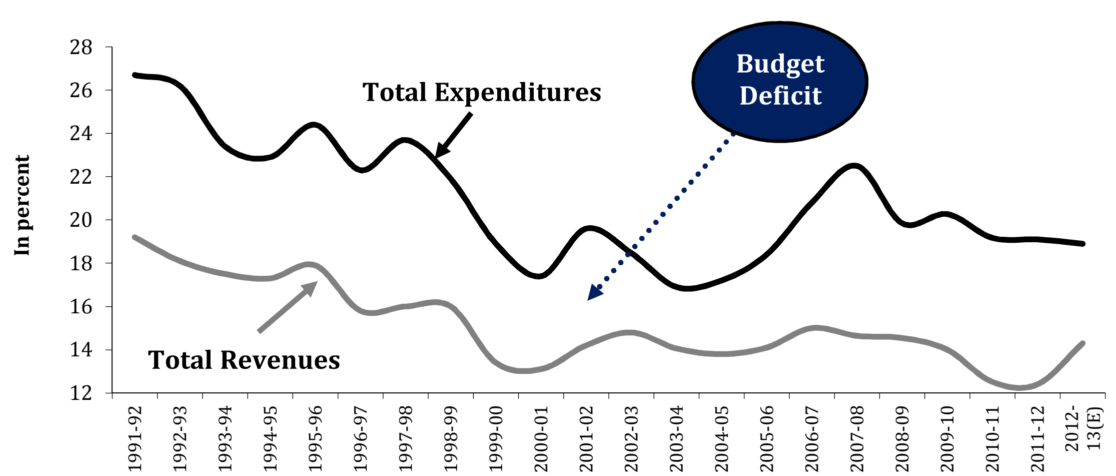
6.6. The government consolidated Rs.391 billion or 1.9 percent into public debt in 2011-12 against outstanding previous years subsidies related to the food and energy sectors due to which Public Debt-to-GDP exceeded the threshold of 60 percent. This one-off settlement was a fiscal reform measure that will yield the government annual savings of Rs.10 billion on interest payments in the medium term and reduce the cost of financing of commodity operations in future. It has also reduced bank's exposure in power sector through the retirement of outstanding circular debt which was previously acted as a disincentive for further bank lending to the sector.

6.7 Government has set an optimistic fiscal deficit target of 4.7 percent for 2012-13. FBR should now push for increasing the tax pie by bringing undocumented sectors into tax bracket along with devising policies that close loopholes for tax evasion.

7. Fiscal Deficit

7.1. Fiscal balance has been under pressure for the last few years due to structural problems. The fiscal deficit during 2011-12 was 8.5 percent including one off payment to consolidate power and commodity sector debt of 1.9 percent of GDP. The sources of fiscal deficit higher than the target were: (i) the provinces posted a deficit of Rs.39.1 billion against an expected surplus of Rs.125 billion; (ii) significant shortfall in non-tax revenues because of non-receipt of CSF and non-auction of 3G License; (iii) payment of Rs.391 billion for PSEs debt consolidation; (iv) lower than target FBR tax revenues and (v) lower than target Petroleum Development Levy as it was adjusted downwards frequently to accommodate rising international oil prices (urged by the Parliamentary Committee). As explained above, the provincial fiscal operation is also contributing to this fiscal deficit.

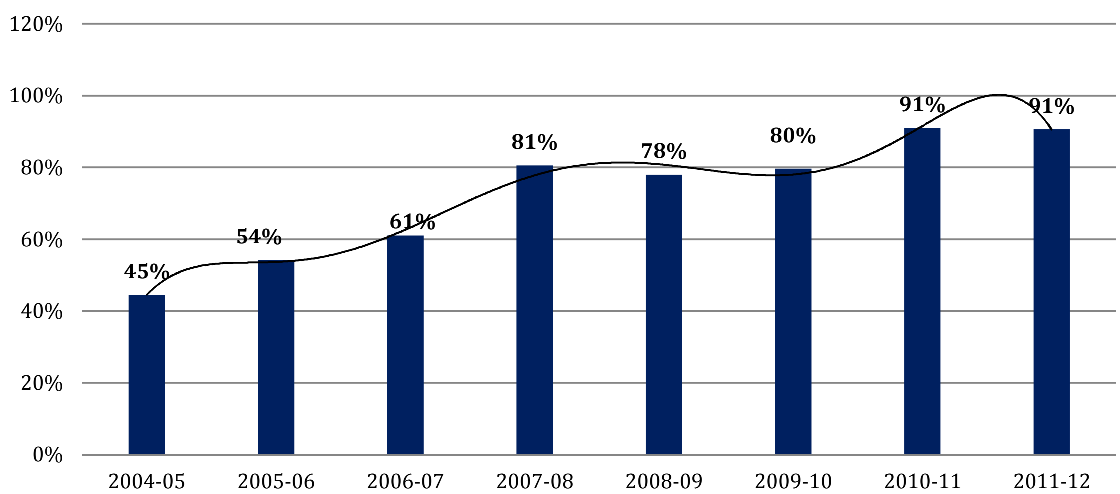
Fig-8: Expenditures and Revenues (As percent of GDP)



8. Financing of Fiscal Deficit

8.1 Declining external inflows due to global recession and financial crisis exacerbated the already weak fiscal performance during the 2011-12. A widening fiscal balance, was, therefore, mainly financed through domestic sources. It moved up the domestic debt substantially. However, it was partially off-set by declining foreign debt which has declined from over 29 percent of GDP in FY2009 to 21 percent of GDP in October 2012.

Fig-9: Domestic Financing of Fiscal Deficit, 2005 - 2012



8.2. In the course of the fiscal year 2011-12, Rs.1,241 billion was generated from internal avenues against a budgeted target of Rs.716 billion. Bulk of the domestic financing came from banking sources (57.3 percent of the domestic borrowing). The non-bank inflows amounted to Rs.529 billion, 28.2 percent higher than the estimated magnitude.

8.3. To check high borrowings, the Government promulgated an amendment in the State Bank of Pakistan Act, whereby it has committed (a) net zero quarterly borrowing from SBP baring ways and means limit and (b) repay SBP outstanding debt as of April 2011 in next 8 years. The government borrowed Rs.507.5 billion from SBP during 2011-12 as compared to retirement of Rs.17 billion during 2010-11. Moreover, total government borrowing from the State Bank stood at Rs.1,662 billion as on June 30, 2012. As required by the SBP Act, an average annual repayment of Rs.238 billion is essential for the next seven years to retire the outstanding debt stock prior to 30th April 2019. This will require higher generation of revenues and/or higher mobilization of external flows.

9. Fiscal Performance July-September 2012-13

9.1 The expenditures are recorded at Rs.976 billion (4.1 percent of the GDP) against the revenue of Rs.692 billion (2.9 per cent of the GDP) thus overall fiscal deficit stood at Rs.284 billion or 1.2 percent of GDP in the first quarter this year against an annual budgetary limit of 4.7 percent of GDP.

Tax Revenue

9.2 Tax revenue as a percentage of GDP remained flat at 1.9 percent of GDP in July-September 2012 as it stood last year. However, non-tax revenue showed improvement on the back of receipt from CSF and stood at 1 percent of GDP in the first quarter this year against 0.6 percent of GDP in the corresponding period of last year.

Table-16: Consolidated Budget, July-Sept 2012 (Rs. in billion)

	Prov. Actual	Prov. Actual
	July-Sept, 2011	**July-Sept, 2012**
A. Total Revenue	**533.6**	**692.1**
a) Tax Revenue	**408.9**	**451.3**
- Federal	389.8	423.1
of which FBR Revenue	373.7	399.7
- Provincial	19.2	28.2
b) Non-Tax Revenue	**124.7**	**240.8**
- Federal	105.9	216.5
- Provincial	18.8	24.4
B. Total Expenditure	**790.9**	**975.9**
a) Current Expenditure	**656.6**	**812.4**
- Federal	436.4	609.7
of which: **Interest Payments**	177.3	312.8
- Domestic	164.8	299.4
- Foreign	12.4	13.4
Defense Expenditure	107.2	117.4
- Provincial	220.2	202.6
b) Development Expenditure	**88.9**	**74.1**
- PSDP	78.9	68.3
Federal	47.3	30.3
Provincial	31.6	38.0
- Other Development Expenditure	10.0	5.8
c) Net Lending	**(1.2)**	**0.8**
d) Unidentified Expenditure	**46.6**	**88.7**
C. Overall Fiscal Balance	**(257.2)**	**(283.8)**
- *As % of GDP*	(1.3)	(1.2)
D. Financing of Fiscal Balance	**257.2**	**283.8**
a) External Sources	(4.4)	(1.6)
b) Domestic	261.6	285.4
- Bank	142.1	151.5

Table-16: Consolidated Budget, July-Sept 2012 (Rs. in billion)

	Prov. Actual July-Sept, 2011	Prov. Actual July-Sept, 2012
- Non-Bank	119.5	133.9
c) Privatization Proceeds	0.0	0.0
E. GDP at Market Prices	**20,654.0**	**23,655.0**
Memo Items		
Revenue Balance	**(120.5)***	**(117.7)**
- *As % of GDP*	*(0.6)*	*(0.5)*
Primary Balance	**(77.5)***	**31.6**
- *As % of GDP*	*(0.4)*	*0.1*

*Adjusted for grants

Non Tax Revenue

9.3 Non tax revenue posted a healthy growth of 100.6 percent (Y/Y) during first quarter of 2012-13 majorly due to realization of US$ 1.12 billion on account of CSF. Other major contributions came from SBP profits and dividends. SBP profits stood at Rs.50 billion during first quarter of 2012-13 against Rs.54 billion in the corresponding period last year.

Table-17: Non-Tax Revenue, July-Sept 2012 (Rs. in billion)

	Prov. Actual July-Sept 2011-12	Prov. Actual July-Sept 2012-13
Non-Tax Revenue	**109.8**	**220.3**
Interest (PSEs & Others)	5.0	4.6
Dividend	13.0	15.0
SBP Profit	54.0	50.0
Defence	1.8	107.3
Citizenship, Naturalization & Passport Fee	1.9	3.1
Development Surcharge on Gas	5.7	3.9
Discount Retained on Crude Oil	4.3	3.3
Royalty on Oil/Gas	15.0	14.8
Others	9.1	18.3

Source: Budget Wing, Finance Division

Expenditure

9.4 Current expenditure soared by 23.7 percent during first quarter of 2012-13 compared to same period last year. Current spending was Rs.812 billion in July-September, 2012 with interest payments increasing to Rs.313 billion. The main contributor has been servicing of domestic debt accounting 95.7 percent of the total interest payments. Spending on PSDP stood at Rs.68billion during first quarter of 2012-13 against Rs.79billion during the corresponding period of last year.

9.5 Government is working for tightening of expenditures along with effective management of financial resources. It remains an uphill task in the presences of tariff anomalies, inefficient operations of public utilities and misallocation of natural resources.

10. Economic Reforms

10.1. The restructuring of Public Sector Enterprises (PSEs) was initiated as a roadmap for improved economic and financial governance. A framework for restructuring was devised for:-

I. Pakistan Steel Mills (PSM)
II. Pakistan Railway (PR)
III. Pakistan International Airlines (PIA)

10.2. Key aspects of restructuring model included (i) restructuring Boards of Directors (BoDs) of PSEs; (ii) inducting professional management including CEOs, CFOs and key managers; (iii) developing viable turn around plans; (iv) ensuring implementation of plans in an independent manner with the support of government under the mandate of Cabinet Committee on Restructuring (CCOR). Details of the restructuring carried out in each of the above three PSEs is summarized below;

I. Pakistan Steel Mills (PSM)

10.3. PSM was in a reasonably strong financial position during 2000-08 as it generated significant profits in this period. Its financial position has deteriorated rapidly since 2008-09. The cost of sales increased by 58 percent in 2008-09 as compared to 2007-08 due to increase in raw material prices, especially coal, and capacity utilization level dropped to 64 percent in 2008-09 from 82 percent in 2007-08. The PSM operated at an average capacity of less than 20 percent.

10.4. Under the restructuring plan for PSM approved by the Cabinet Committee on Restructuring (CCOR), the BoDs of PSM has been reconstituted and a new CEO has also been appointed. Immediate financial needs have been addressed. New business plan of PSM is focused on maximum utilization of capacity and a path of achieving break-even point. Smooth availability of raw materials to PSM is being ensured for future profitability. An inter-ministerial monitoring committee has been constituted to oversee the implementation process of the Business Plan. It is envisioned that PSM will enhance capacity utilization to the agreed level of 50 percent, from current position of 19 percent in 2012-13. PSM is expected to reach break-even in 2013-14 and is projected to make a profit by 2014-15.

II. Pakistan Railways (PR)

10.5. The Government of Pakistan is making sustained efforts to revitalize Pakistan Railways. BoD of PR has been reconstituted with involvement of high caliber professionals. CCOR has finalized a restructuring framework for Pakistan Railways. Repair and addition of locomotives has been prioritized for improving revenue generation and restoration of rail services. Freight operations are being prioritized. Under the Plan, outsourcing of maintenance to reduce cost is being pursued. It is being envisaged that pricing will be determined in future according to market conditions and cost of doing business. Credit line of Pakistan Railways from Pakistan State Oil has been enhanced to ensure smooth supply. An asset management company has been established for optimum utilization of PR's assets. Private Sector involvement is the focus moving forward with trains being run under Public Private Partnership. Financial viability is being pursued through improving revenue and support by the Government both through grant and allocation of Public Sector Development Program.

10.6. Pakistan Railways is presently in the phase of repairing and rehabilitating ageing assets along with procurement of new assets. This formative phase is expected to last for next 3 years i.e. till 2014-15. However, a gradual increase in revenues will start as additional locomotives become available for operations. In medium term, Pakistan Railways focus will be on adding locomotives in its fleet and enhance revenues. In the long run, PR needs to move towards a model of track access for private sector train operating companies. The Government of Pakistan may need to continue support of Pakistan Railways for next 3 to 5 years - through sizable allocation in PSDP - to pay for improving rolling and non-rolling assets.

III. Pakistan International Airlines Corporation (PIAC)

10.7. Under the restructuring strategy for PIAC, a new CEO has been appointed. A Business Plan for PIAC has been developed for the next five years, which envisages the introduction of fuel-efficient aircrafts, route rationalization, separation of core and noncore activities and human resource rationalization with the objective of making PIAC a sustainable and profitable entity in the long run. However, this can only be achieved with continued financial support. Cornerstone of the business plan being put forward is a shift in strategy from high capacity, low frequency operations to high frequency optimum capacity operations. It is expected that PIAC may be out of the red and turn profitable by the year 2018. Success of this business plan depends on lowering the level of liabilities, as high debt cost will continue to pose challenge for operational viability and sustainability.

PSE Reform: Going Forward

10.8. The vision moving forward includes formulation of an objective framework for determining fitness of a PSE for eventual disinvestment. The reform agenda for enterprises to be retained by the government in pursuance of several social objectives should encompass introduction of stand-alone legislation on governance and operation to provide transparent policy guidelines. Hybrid arrangements of establishment of PSEs need to be phased out. PSEs registered under Companies Ordinance 1984 have to adhere to applicable clauses including full autonomy and independence of Boards for policy and oversight otherwise PSEs may be retained as autonomous bodies under Ministries/Divisions. Nomination Commission/ Specialized Unit has to be established for appointment of Directors in PSEs and database for performance and accountability of Directors must be developed. A central oversight mechanism is recommended to be developed for continuous performance monitoring and advisory on management of PSEs. Public Service Obligation and Commercial services may be separated in accounting framework. Lastly, participation of private sector in PSE's operations should be enhanced to make them competitive entities.

Power Sector Reforms

10.9. The Government has pursued structural and policy reforms in power sector focusing on governance and financial sustainability in order to improve performance and service delivery of the power sector. Under policy reforms for the power sector, the government has framed two key Power Sector Reform Plans namely Power Sector Reform Plan 2010 and Power Sector Recovery Plan 2011. Under these reform measures, BoDs of all nine distribution companies (DISCOs) and National Transmission & Dispatch Company (NTDC) has been reconstituted. CEOs of FESCO, LESCO, QESCO, and IESCO have been approved. CEOs of 3 DISCOs (SEPCO, LESCO and MEPCO) have been replaced. GENCO Holding Company has been formed with a new CEO and BODs to improve efficiency of generating companies. Dissolution of PEPCO has been finalized and the Central Power Purchasing Authority (CPPA) has become operational with a new BODs. Regulatory reforms have been undertaken through NEPRA Act amendment to empower NEPRA to directly notify fuel adjustment tariffs to reduce discretion of the Government. Cabinet has in principle given its approval to New Electricity Act, which is a major reform in curbing theft. Cumulative increase in tariff of over 100 percent since March 2008 has been undertaken to meet the lag in increase and reflect true cost.

10.10 New Electricity Act has been approved by the Cabinet to strengthen legal framework for curbing theft and other administrative losses. In order to provide supportive legal framework for power sector, new tariff determination mechanism to ensure financial sustainability of the sector is being drafted. Reforms to make power sector financially sustainable including rationalization of tariff structure, improved efficiency in the system through reduced T&D losses and better fuel mix, automated payment mechanism and improvement in receivables of DISCOs are being pursued.

10.11. Under supply side management, measures are being taken to reduce the demand-supply gap as well is improving the fuel mix. Since 2008, 3,400MW has been added to the system. Lost capacity due to inter-corporate debt, of the existing generating plants has been brought back through improved and optimized financial flow management. Most efficient plants are being dispatched to conserve fuel. In order to decrease dependence on more expensive fuels, there is focus on developing indigenous resources for power generation. Capacity addition of 3,400 MW has been attained since 2008. Mangla raising has been completed and the project inaugurated. Diamer-Bhasha Dam of 4,500MW generation capacity has been inaugurated, while the 1400MW Tarbela 4th extension has been initiated.

10.12. Government of Pakistan aims to phase out subsidies to power sector which have cost over Rs.1.27 trillion in last 5 years. Circular debt issue being handled by improving flow and clearing of stock. Federal Government is facilitating recovery of Provincial and Federal Government Departments through Budget Adjuster. Efforts for 100 percent recovery of current bills are underway along with disconnection of defaulters after 45 days (reduced from 90 days) without any exemption/discrimination. The timely payment of tariff differential subsidy (TDS) is being ensured along with subsidies for KESC and FATA on a monthly basis. Line losses have been reduced from 20.4 percent (2009-10) to 19.6 percent (2010-11) and 19.4 percent (2011-12). Loss mapping in each DISCO is in progress to exactly pin-point source of losses to achieve a target of 18.7 percent losses in 2012-13. Load Management and conservation measures to save about 1000MW put in place.

10.13. In the immediate future, the focus on cost recovery, ensuring recovery of current and past dues; improving tariff structure; improvements in efficiency both in DISCOs and GENCOs, including achieving optimal efficiency for each fuel mix; modernizing key operations (financial and administrative) and addressing technical issues is imperative for ensuring sustainability of the sector. These short-term reform measures will be supported by a strengthened Ministry of Water & Power with a separate Power Directorate supported by professionals inducted from the market to develop policies for power sector.

10.14. Going forward, the medium term emphasis would be towards achieving a less oil dependent power generation mix through development of indigenous energy resources particularly hydel, coal and renewable energy resources for sustainable and affordable energy supply in the country. Rehabilitation/ replacement of GENCOs plants needs to be carried out to increase capacity and efficiency. The LNG infrastructure needs to be developed in order to move towards greater use of gas in the power generation mix. To permanently settle the circular debt problem, the residual stock of 'policy induced' debt (after net-offs, write-offs and re-scheduling) should be shifted to a specifically created government debt holding company. Long-term financing options for power sector projects should be explored to promote investment in the sector.

10.15. On the regulatory side, capacity building of NEPRA is envisaged to strengthen the regulatory framework to meet the current needs and evolving dynamics of the power sector. Moreover, development and effective implementation of energy efficiency codes – legislation to promote energy efficiency in the country will play a critical role towards meeting energy needs in the country.

11. External Sector Assessment

11.1 Current account posted a deficit of US$ 4.6 billion (2 percent of GDP) during 2011-12 against a surplus of US$ 214 million (0.1 percent of GDP) during 2010-11 despite exports remaining at almost same level as 2010-11 and swelling inflows in remittances. Overall balance of external account stood at US$ -3.3 billion (1.4 percent of GDP) in 2011-12 against US$ 2.5 billion (1.2 percent of GDP) in the same period last year.

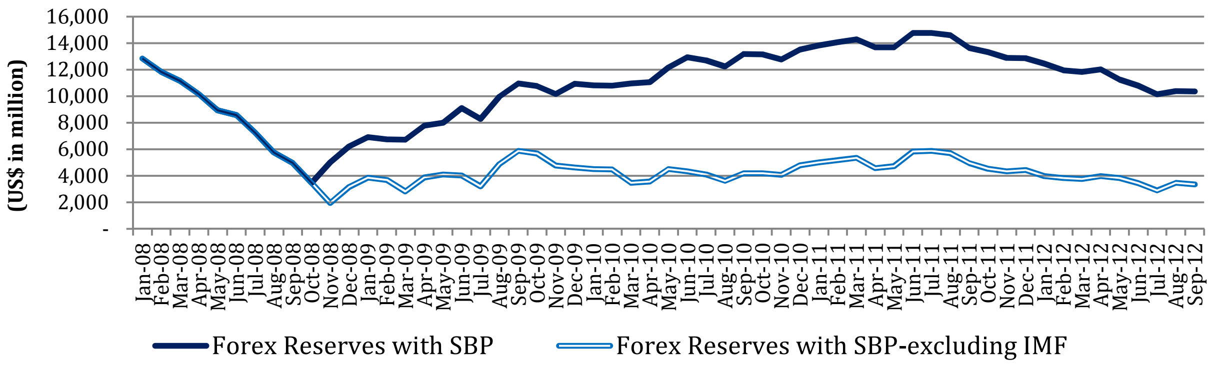
Table-18: Components of Foreign Exchange Earnings & Payments (US Dollar in billion)

	2008	2009	2010	2011	2012
Foreign Exchange Earnings	**37.2**	**35.4**	**38.1**	**47.7**	**47.9**
Goods: Exports f.o.b	20.4	19.1	19.7	25.4	24.7
Services: Credit	3.6	4.1	5.2	5.7	5.0
Income: Credit	1.6	0.9	0.6	0.7	0.8
Current Transfers	11.6	11.3	12.7	15.9	17.4
Of which Workers Remittances	6.5	7.8	8.9	11.2	13.2
Foreign Exchange Payments	**51.1**	**44.6**	**42.1**	**47.4**	**52.4**
Goods: Imports f.o.b	35.4	31.7	31.2	35.9	40.1
Services: Debit	10.0	7.5	6.9	7.7	8.0
Income: Debit	5.5	5.3	3.8	3.7	4.2
Of which Interest Payments	2.2	1.9	1.5	1.5	1.8
Current Transfers: Debit	0.1	0.1	0.1	0.1	0.1

Source: State Bank of Pakistan and Debt Policy Coordination Office Staff Calculations

11.2. The net inflows in financial account continued to fall which was around 5 billion in 2009-10. Net inflows in financial account saw a fall of 29 percent reaching at US$ 1.5 billion in fiscal year 2011-12 against US$ 2.1 billion during the corresponding period last year. Falling disbursements in long term program loans were supplemented by release of project loans during 2011-2012. The overall long term disbursements fell by 10.4 percent during 2011-2012. Net portfolio investments posted an outflow of US$ 133 million during fiscal year 2011-12 against an inflow of US$ 345 million during the corresponding period last year. Foreign direct investment decreased by another 50 percent to US$ 812 million during 2011-2012 owing to deteriorated law and order situation, weak economic activities and energy crises.

Fig-10: Foreign Exchange Reserves



11.3. First quarter of 2012-2013 took a promising start as current account registered a surplus of US$ 435 million mainly due to reimbursement of US$ 1.12 billion by the United States against CSF. Import of goods fell by 6.6 percent while export of goods fell by 2.4 percent. Export of services registered a growth of 78 percent during July-September, 2012 over the corresponding period last year.

Rationalizing prices of crude oil in international market are providing relief to Pakistan's import bill. Meanwhile higher remittances continue to provide boost to current account, as remittances increased by 9 percent during first quarter of 2012-13. Government's strong commitment to route inflows through formal sector has yielded positive and impressive results.

11.4. Financial account witnessed decrease of US$ 33 million during first quarter of 2012-13 on account of subdued foreign direct investment and no disbursements in program loans. FDI continued its slide in first quarter of 2012-13 as it decreased by 55 percent. Foreign exchange reserves continue to slip on back of IMF repayments during July-September, 2012. At the end of first quarter of 2012-13, reserves stood at $14.9 billion.

12. Review of Public Debt

12.1. The total public debt stood at Rs.12,667 billion as on June 30, 2012, an increase of Rs.1,967 billion or 18.4 percent higher than the debt stock at the end of last fiscal year. This rise is mainly attributed to:

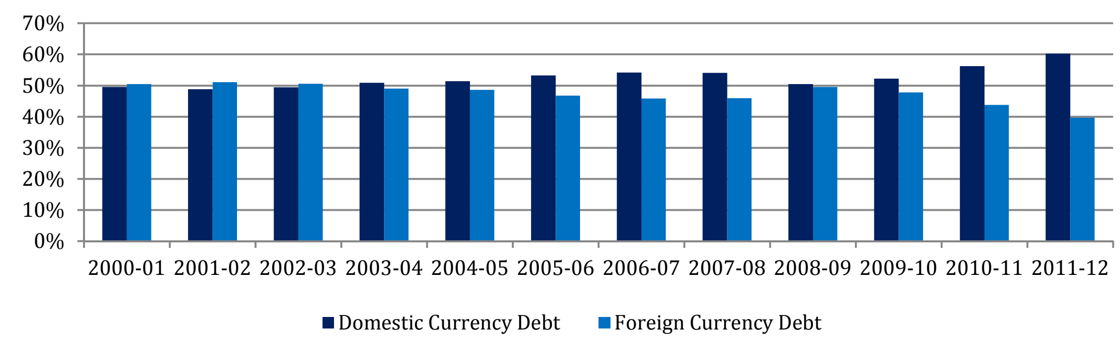
i. Slippages in both revenues and expenditures led to fiscal deficit at 1,370 billion or 6.6 percent of GDP. Increased demands on the government budget for purposes of interest servicing, security and subsidies which constituted 60.9 percent of the revenue meant that expenditure was fairly rigid even in the face of a committed effort to rationalize expenditure and curtail the fiscal deficit. Government borrowed Rs.1,241 billion from domestic sources and Rs.129 billion from external sources to finance its fiscal operations.

ii. In November 2011, government consolidated Rs.391 billion into public debt against the past years' unpaid subsidy claims of power and commodity sector.

iii. The remaining increase in public debt was caused by adverse movement of exchange rate on the external debt.

12.2. The primary source of increase in public debt during 2011-12 has been a rapid increase in local currency component that accounted for 82.4 percent of the total increase in public debt. Historically, public debt stock accounted for almost the same burden from domestic and external sources.

Fig-11: Sources of Public Debt (Percent)



12.3 The external debt component grew by Rs.345 billion or 7.4 percent over last fiscal year. During 2011-12, appreciation of the US Dollar against other major currencies caused the foreign currency component of public debt to decrease by US$ 1,740 million, however, it was subdued by depreciation of Pak Rupee against US Dollar by 10 percent. This capital loss on foreign currency debt, however, is mitigated by the strong concessionality element associated with Pakistan's external loans. The impact of any currency shock should not be looked at in isolation, but rather be analyzed in the context of interest rate differential.

12.4 Total public debt stood at Rs.13,199 billion at the end of first quarter 2012-13, thereby, registered an increase of Rs.532 billion or 4.2 percent in first three months of current fiscal year. The government was able to contain fiscal deficit at 1.2 percent of GDP for July-September, 2012 largely because of Rs.109 billion provincial budget surpluses and US$ 1.12 billion reimbursed by the United States on account of the CSF that helped restricted the growth in public debt. The primary source of increase in public debt during first quarter 2012-13 remained the local currency component that accounted for 91 percent of the total increase in public debt. The first quarter of the current fiscal year noticed a capital loss of US$ 721 million owing to US Dollar depreciation against other major international currencies.

Table-19: Public Debt, 2008-2013*

	2008	2009	2010	2011	2012 (P)	2013*
	(Rs. in billion)					
Domestic Debt	3,266.0	3,852.5	4,651.4	6,015.5	7,637.0	8,120.7
External Debt	2,778.0	3,776.2	4,259.9	4,684.9	5,030.2	5,078.6
Total Public Debt	**6,044.0**	**7,628.6**	**8,911.3**	**10,700.5**	**12,667.2**	**13,199.3**
	(In percent of GDP)					
Domestic Debt	31.9	30.3	31.4	33.4	37.0	34.3
External Debt	27.1	29.7	28.8	26.0	24.4	21.5
Total Public Debt	**59.0**	**60.0**	**60.2**	**59.3**	**61.3**	**55.8**
	(In percent of Revenue)					
Domestic Debt	217.8	208.1	223.8	267.0	297.6	-
External Debt	185.3	204.0	205.0	208.0	196.0	-
Total Public Debt	**403.1**	**412.2**	**428.8**	**475.0**	**493.6**	-
	(In percent of Total Debt)					
Domestic Debt	54.0	50.5	52.2	56.2	60.3	61.5
External Debt	46.0	49.5	47.8	43.8	39.7	38.5
Memo:						
Foreign Currency Debt (US$ in billion)	40.7	46.4	49.8	54.5	53.2	53.6
Exchange Rate (Rs./US$, End of Period)	68.3	81.4	85.5	86.0	94.5	94.8
GDP (Rs. in billion)	10,242.8	12,724.0	14,804.0	18,033.0	20,654.0	23,655.0
Total Revenue (Rs. in billion)	1,499.4	1,850.9	2,078.2	2,252.9	2,566.5	-

P: Provisional
*end-September 2012

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

Note: The Debt to GDP ratio would have been 59.4 percent in 2011-12 had the government not consolidated Rs.391 billion into Public Debt.

13. Servicing of Public Debt

Increase in the outstanding stock of total public debt has implications for the economy in the shape of a greater amount of resource allocation towards debt servicing in future. In order to meet debt servicing obligations, an extra burden is placed on limited government resources and may have costs in the shape of foregone public investment or expenditure in other sectors of the economy.

Table-20: Public Debt Servicing (2011-12)

	Budgeted	Actual	% of Revenue	% of Current Expenditure
	(Rs. in billion)			
Servicing of External Debt	76.3	67.9	2.6	2.2
Repayment of External Loans	243.2	135.3	5.3	4.3
Servicing of Domestic Debt	714.7	821.1	32.0	26.3
Servicing of Public Debt	**1,034.2**	**1,024.3**	**39.9**	**32.8**

Source: Budget Wing & Debt Policy Coordination Office Staff Calculations

In 2011-12, public debt serving stood at Rs.1,024 billion against Rs.856 billion paid during the last fiscal year. Public debt servicing consumed nearly 39.9 percent of total revenues in 2011-12 against a ratio of 38 percent in last fiscal year. Out of total, domestic debt servicing stood at Rs.821 billion against the budgeted estimate of Rs.715 billion.

Table-21: Break-up of Domestic Debt Servicing (2011-12)

	Budgeted	Actual
	(Rs. in billion)	
1- Permanent Debt	**104.9**	**142.8**
- Prize Bonds	24.4	26.9
- Pakistan Investment Bonds	54.9	81.7
- Government Ijara Sukuk	24.1	32.6
- Others	1.5	1.6
2- Floating Debt	**345.9**	**379.5**
- Treasury Bills	195.9	214.5
- Market Related Treasury Bills	150.0	165.0
3- Unfunded Debt	**262.3**	**298.0**
- National Saving Schemes	253.9	298.0
- Others (Postal Life Insurance, Provident Funds)	8.5	0.0
4- Others	**1.5**	**1.5**
Total (1+2+3+4)	**714.7**	**821.1**

Source: Budget Wing, Finance Division

Out of total repayment of foreign loans, government paid Rs.97 billion and 37 billion to multilateral and bilateral donors respectively.

14. Report on Compliance with FRDL Act 2005

The Fiscal Responsibility and Debt Limitation (FRDL) Act, 2005 was approved on 13 June 2005. The FRDL Act, 2005 requires that the federal government take measures to reduce total public debt and maintain it within prudent limits thereof. The following sections identifies the various limits prescribed by the FRDL Act 2005 and reports on progress thereof.

The FRDL Act 2005 requires the following:

(1) Reducing the revenue deficit to nil not later than the thirtieth June, 2008 and thereafter maintaining a revenue surplus

Revenue balance has been in negative since 2006 because of increasing exogenous and endogenous challenges highlight above.

Table-22: Revenue Balance (Percent of GDP)

Revenue Balance*	2006	2007	2008	2009	2010	2011	2012
	-0.1	-0.6	-3.2	-1.2	-1.7	-3.3**	-2.5***

**Adjusted for grants*
***excludes arrears of electricity subsidies amounting Rs.120 billion*
****excludes, "one off" payment of Rs.391 billion on account of debt consolidation*

(2) *Ensure "that within a period of ten financial year, beginning from the first July, 2003 and ending on thirtieth June, 2013, the total public debt at the end of the tenth financial year does not exceed sixty percent of the estimated gross domestic product for that year and thereafter maintaining the total public debt below sixty percent of gross domestic product for any given year."*

The government consolidated Rs.391 billion or 1.9 percent into public debt in 2011-12 against outstanding previous years subsidies related to the food and energy sectors due to which Public Debt to GDP stood at 61.3 percent of GDP at end June 2012. It would have been 59.4 percent of GDP if Rs.391 billion was not consolidated. It is important to note that the Fiscal Responsibility and Debt Limitation Act (FRDLA) - 2005 requires debt ceiling of 60 percent of GDP by end-June 2013.

The public debt also includes loans from IMF amounting to US$7.3 billion or 3.2 percent of the GDP as on June 30, 2012. The borrowing from IMF is only utilized towards Balance of Payment support and is reflected in foreign currency reserves of the country.

(3) *Ensure "that in every financial year, beginning from the first July, 2003, and ending on the thirtieth June 2013, the total public debt is reduced by no less than two and a half percent of the estimated gross domestic product for any given year, provided that social and poverty alleviation related expenditures are not reduced below 4.5 percent of the estimated gross domestic product for any given year and budgetary allocation to education and health, will be doubled from the existing level in terms of percentage of gross domestic product during the next ten years."*

Table-23: Debt to GDP **(Rs. in billion)**

	2006	2007	2008	2009	2010	2011	2012
Domestic Currency Debt	2,321.7	2,600.6	3,266.0	3,852.5	4,651.4	6,015.5	7,637.0
Foreign Currency Debt	2,037.6	2,201.2	2,778.0	3,776.2	4,259.9	4,684.9	5,030.2
Total Public Debt	**4,359.3**	**4801.8**	**6,044.0**	**7,628.6**	**8,911.3**	**10,700.5**	**12,667.2**
GDP	7,623.2	8673.0	10,242.8	12,724.0	14,804.0	18,033.0	20,654.0
Total Public Debt (as percent of GDP)	**57.2**	**55.4**	**59.0**	**60.0**	**60.2**	**59.3**	**61.3**

The condition of reducing debt to GDP by 2.5 percent annually was envisaged in the FRDLA, 2005 to achieve the core objective of reducing Debt to GDP below 60 percent by the end of 2012-13.

Social and poverty alleviation related expenditure (as given by pro-poor budgetary expenditure excluding non-development outlays on law and order) remained at 8.2 percent of GDP. Additionally, expenditure on health and education stood at 0.7 percent and 2.1 percent of GDP. The (FRDLA) - 2005 stipulates that the spending on health and education shall be doubled to 1 percent and 3.2 percent respectively in ten years beginning from 1st July, 2003.

Table-24: Social Sector Expenditure

	2006	2007	2008	2009	2010	2011	2012
Social sector and poverty related expenditure (as percent of GDP)	4.9	4.9	9.3	6.9	6.7	6.0	8.2
Expenditure on education (as percent of GDP)	1.9	1.9	1.8	1.9	1.8	1.8	2.1
Expenditure on health (as percent of GDP)	0.5	0.6	0.6	0.7	0.8	0.6	0.7

(4) *Not issue "new guarantees, including those for rupee lending, bonds, rates of return, output purchase agreements and all other claims and commitments that may be prescribed, from time to time, for any amount exceeding two percent of the estimated gross domestic product in any financial year: Provided that the renewal of existing guarantees shall be considered as issuing a new guarantee."*

New guarantees including rollovers, issued by the government in 2011-12 amounted to Rs.203 billion or 1 percent of GDP. The government also issued additional guarantees equivalent to 0.1 percent of GDP for commodity financing operations.

Table-25: New Guarantees Issued

(Rs. in billion)	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**
New guarantees issued	14.0	140.7	138.8	276.3	224.0	62.4	203.2
(as percent of GDP)	**0.2**	**1.6**	**1.4**	**2.2**	**1.5**	**0.3**	**1.0**

Since last few years, Pakistan is faced with serious challenges both at domestic and international fronts. Higher security related expenditure, energy shortages, higher food and energy subsidies in wake of higher international commodity prices and non-materialization of committed receipts exerted enormous pressure on government's limited resources. Given the severity of these challenges, the government was able to manage fiscal deficits at reasonable levels.

15. Conclusion

The Government remained committed to accomplish objectives outlined in the FRDLA, 2005. Fiscal policy would continue to explore opportunities for augmenting the resource envelop. At the same time, expenditure would be rationalized and non-productive outlays would be curtailed. FBR Tax to GDP Ratio has improved to 9.1 percent in 2011-12 from 8.6 percent in 2010-11 on the back of encouraging growth of 20.8percent in FBR collection over 2010-11. The Government would continue to take efforts to broaden the tax base, removing distortions in the tax structure and use the technology platform effectively to mobilize domestic resources. The fiscal and administrative structure of Pakistan has been considerably decentralized after the 18th Constitutional Amendment and 7th National Finance Commission (NFC) Awards. The fiscal decentralization holds significant promise in achieving better development outcomes through improved resource mobilization, enhanced efficiency in service delivery and better accountability.

Prudent fiscal policy together with strong implementation and accountability is essential for macroeconomic stability. It will help reduce inflation, strengthen economic growth, and mitigate risks of falling foreign reserves and debt burden. By placing a high priority on structural reform and revenue generation, and establishing a comprehensive framework for management of PSEs, the government will be able to finance the envisaged expenditures while containing excessive borrowing and maintaining fiscal sustainability.

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