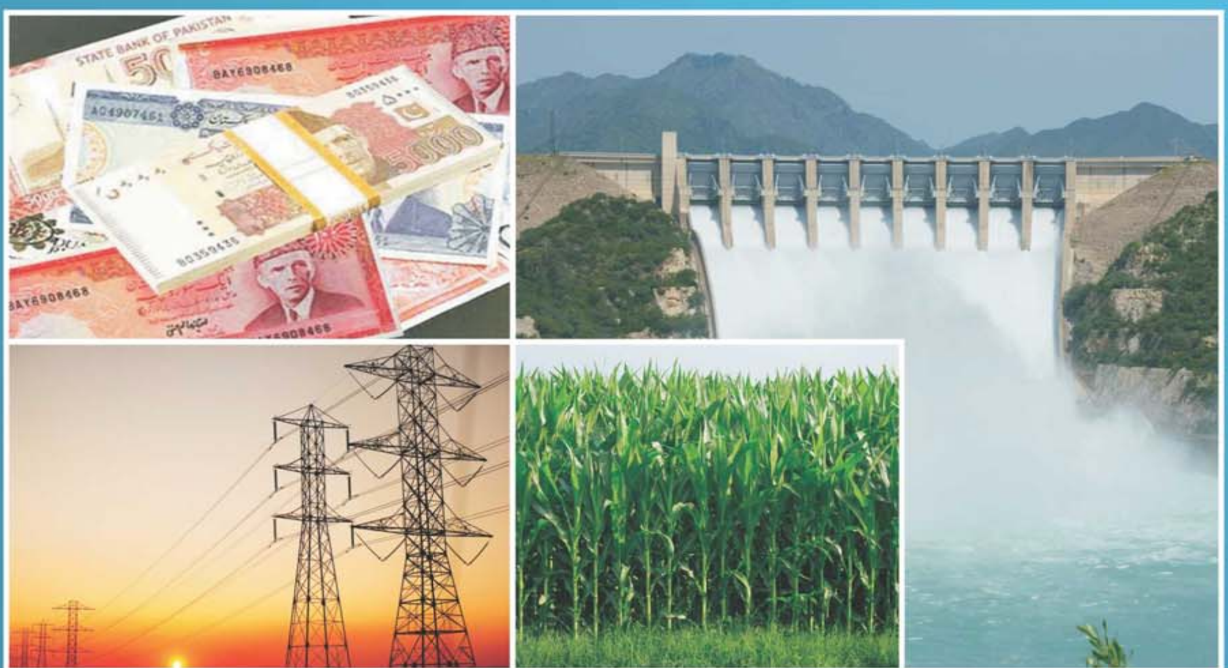
Fiscal Policy Statement
2014-15



Debt Policy Coordination Office
Ministry of Finance

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Acknowledgements

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Ehtesham Rashid
Director General
Debt Policy Coordination Office
Ministry of Finance

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Fiscal Policy Statement 2014-15

1.0 Introduction

1.1 Pakistan's economic growth over the past many years has faced number of challenges mainly emanating from unstable security situation and crippling energy crisis. Besides, a number of deep structural problems that have persisted for decades are also responsible including weak financial position rooted in low tax revenues, limited exports growth, insufficient investment in human capital development, weak infrastructure and low economic activities. External shocks such as volatile commodity prices have also adversely affected the economic performance. However, after a period of slack growth during last few years, GDP posted 4.1 percent growth during 2013-14 against 3.7 percent last year mainly owing to recovery in industrial sector and moderate growths witnessed in services and agriculture sectors.

1.2 During 2013-14, improved macroeconomic stability and reduction in external account vulnerability accounted for broader achievements. These were supported by inflation containment at single digit, improvement in tax collection, reduction in fiscal deficit, growth in exports and imports, improvement in workers' remittances, successful launch of Eurobonds, auction of long pending 3G and 4G licenses, significant improvement in country's foreign exchange reserves, stability in exchange rate, rise in foreign direct investment and improved stock market activities.

1.3 Fiscal performance in 2013-14 improved compared with a pattern of wide slippages experienced over past few years. Overall, fiscal deficit was recorded at 5.5 percent of GDP compared with 8.2 percent a year earlier. Encouragingly, the budget deficit fell well within the target of 6.5 percent set for 2013-14. Improvements on fiscal front included i) growth of 22 percent in total revenues compared to 16 percent last year, stemming from both tax and non-tax revenues; ii) growth in current expenditure fell sharply from 17 percent in 2012-13 to 9 percent in 2013-14, mainly because of reduction in subsidies; iii) development expenditure posted a healthy growth of 46 percent against 6 percent last year; iv) primary deficit narrowed to 0.2 percent of GDP compared with 3.6 percent a year earlier; v) provincial surplus recorded at Rs.150 billion in 2013-14 against its target of Rs.23 billion; and vi) the availability of external financing coupled with reduced fiscal deficit decreased pressure on the banking system.

2.0 Fiscal Policy Statement

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 expenditures;
- (b) total revenues;
- (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.

3.0 Budget Strategy 2013-14

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

- Containment of the fiscal deficit at 6.3 percent of projected GDP;
- Enhancement of federal revenue to Rs.3,420 billion;
- Improvement of tax to GDP ratio from current level of 9 percent to 15 percent by 2018;
- Rationalization of subsidies and discouraging its indiscriminate use;
- Realization of low cost foreign borrowings to finance fiscal deficit and reduce the burden of debt servicing;
- Rationalization of current expenditure to improve efficiency;
- Enhancement of efficiency of the tax machinery and removal of anomalies and distortions in the current tax system;
- Fully reform and restructure public sector entities. All such entities that can be profitably privatized will be put to a credible process of privatization. Wherever privatization is not a possible option, either a management contract will be negotiated or fully independent management will be inducted to run the entities on pure professional grounds.

3.2 Budget 2013-14 focused on key areas of revenue mobilization and curtailment of expenditure. Besides, it stressed on protection of vulnerable groups through a range of measures to minimize the impact of fiscal consolidation policies on such groups. On the expenditure side, the focus was on austerity measures to contain rising current expenditure and target development expenditure in the provinces on an equitable basis. The budget envisaged economic reforms to stabilize the economy and control the rising burden of public debt.

4.0 Historical Perspective on Fiscal Development

4.1 Last couple of decades had been filled with multiple highs and lows in terms of fiscal performance of Pakistan. A comparison over the last two decades is shown in Table-1:

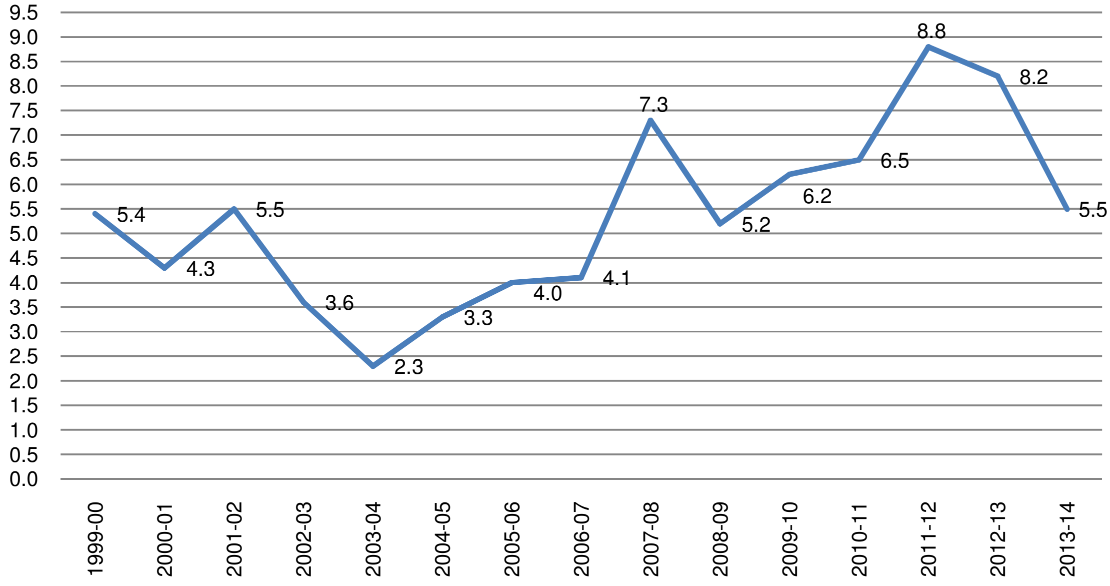
Table-1: Fiscal Indicators (as percentage of GDP)

Year	Real GDP Growth	Fiscal deficit	Expenditure			Revenue		
			Total	Current	Develop-ment	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
2004	7.5	2.3	16.4	13.8	2.6	14.1	10.8	3.3
2005	9.0	3.3	17.2	14.5	2.7	13.8	10.1	3.7
2006	5.5	4.0	17.1	13.6	3.4	13.1	9.2	3.9
2007	6.8	4.1	18.1	14.9	3.2	14.0	9.6	4.4
2008	5.0	7.3	21.4	17.5	3.9	14.1	9.9	4.2
2009	0.4	5.2	19.2	15.5	3.7	14.0	9.1	4.9
2010	2.6	6.2	20.2	16.0	4.2	14.0	9.9	4.1
2011	3.7	6.5	18.9	15.9	3.0	12.3	9.3	3.0
2012	3.8	8.8	19.6	15.6	4.1	12.8	10.2	2.6
2013	3.7	8.2	21.4	16.3	5.1	13.3	9.8	3.5
2014	4.1	5.5	19.8	15.8	4.0	14.3	10.1	4.2

Source: Economic Survey of Pakistan & Debt Policy Coordination Office Staff Calculations, Finance Division

4.2 The decade of 1990's experienced high fiscal imbalances. The fiscal performance of the country saw considerable improvement during the period starting from 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 percent in 2000-01 to 22 percent of the revenue in 2005-06 and (ii) huge flows of foreign grants that increased non-tax revenue and inflows from Coalition Support Fund (CSF). Post 2006-07, fiscal performance declined considerably as the average fiscal deficit remained around 7 percent of GDP during 2008-13. It was mainly due to challenges on internal and external fronts and policy inaction on important matters including adverse security situation, energy shortages, lower tax base, persistent losses posted by the PSEs, flooding and torrential rains, increasing debt servicing requirement, higher than budgeted subsides and gradual dilapidation in the socio-economic infrastructure. Trend analysis of fiscal deficits over the years 2000-14 is depicted in Fig-1.

Fig-1: Trends in Fiscal Deficit
(Percentage of GDP)



4.3 Overall, an analysis of the last two decades of fiscal performance revealed that high subsidies remained a major burden on fiscal account combined with falling tax to GDP ratio. Interestingly, even during the period of fiscal improvement (1999-2004), tax to GDP ratio continued to decline. Tax revenue as percentage of GDP, which stood at an average of 13.7 percent during 1992-96, decreased to an average of 9.7 percent during 2008-2013. Low tax to GDP ratio has also translated into falling total revenue to GDP ratio as it decreased from an average of 18 percent during 1992-96 to 13.4 percent during 2008-13. The fiscal performance improved considerably during 2013-14 both in terms of revenue mobilization and expenditure management. Going forward, both spending and revenue measures have important implications for the economy and these need to be taken into account if the ongoing fiscal consolidation efforts are to be sustainable.

5.0 Fiscal Performance during 2013-14

5(i) Total Revenue

5.1 The total revenue of the government comprises tax revenue and non-tax revenue. Tax revenue includes direct taxes and indirect taxes while non-tax revenue mainly consists of government receipts on its investments and provision of services. Government was able to achieve almost 100 percent of its budget target for the year 2013-14 with the main driver being the non-tax revenue which exceeded the target by 22 percent. Tax revenue also showed significant performance and achieved 92 percent of its annual target.

5.2 Total revenue posted a growth of 22 percent in 2013-14 compared to 16 percent in the previous year based on strong growth in both tax and non-tax revenue. The strong growth in revenues was also supported by number of one-off inflows such as: i) grant under the Pakistan Development Fund; ii) payment of profit arrears from SBP; and iii) utilization of Universal Service Fund.

5(ii) FBR Collection

5.3 FBR collected Rs.2,266 billion against budget target of Rs.2,475 billion for 2013-14. This represented an achievement of around 92 percent of the target compared with only 81 percent last year. FBR tax collection grew by 16 percent during 2013-14. As a result, the tax to GDP ratio improved, which itself is a significant indicator of the government reforms agenda.

Table-2: A Comparison of Tax collection against established targets 2013-14 (Rs. in billion)

Tax Head	Original Budget	Provisional Collection	Achievement of Target (%) 2013-14	Achievement of Target (%) 2012-13
Direct Taxes	975.0	884.1	90.7	78.9
Sales Tax	1,054.1	1,002.1	95.1	78.2
Federal Excise Duty	166.9	139.1	83.3	95.6
Customs Duty	279.0	241.0	86.4	96.8
All Taxes	**2,475.0**	**2,266.3**	**91.6**	**81.3**

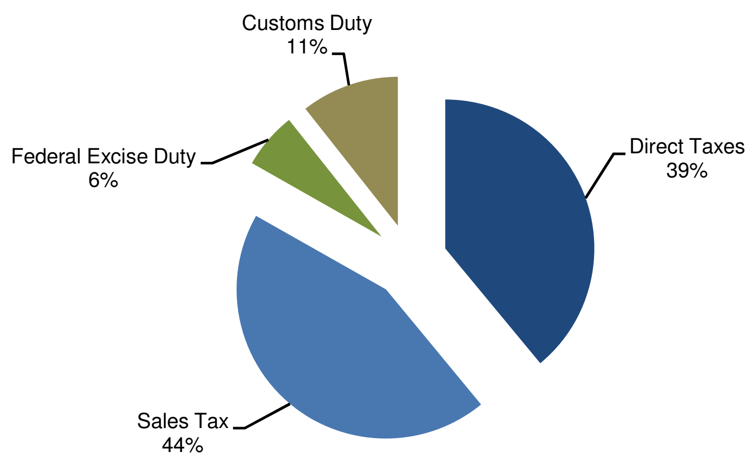
Source: Federal Government Fiscal Operations 2013-14

5.4 FBR was assigned a target of Rs.2,475 billion for 2013-14. The target was based on the assumptions that FBR revenue collection would be Rs.2,050 billion during 2012-13 and high trajectory growth of macroeconomic indicators forecasted for 2013-14. On the contrary, the base year collection stood at Rs.1,946 billion and eroded revenue base by Rs.104 billion. The correction was made accordingly and the target was reduced to Rs.2,345 billion and further corrected to Rs.2,275 billion during the year.

5(iii) Tax wise Analyses

5.5 The FBR tax to GDP ratio in 2013-14 improved to 8.9 percent from 8.7 percent in 2012-13 on the back of improved tax collection. The analysis of taxes collected by FBR in 2013-14 is as follows:

Fig-2: Tax Wise Analysis
(Percentage of Total Tax Collection)



Head Wise Analysis of Direct Taxes

5.6 Direct taxes comprises mainly income tax and other direct taxes including worker welfare fund and worker profit participation fund. The contribution of income tax in total direct taxes was around 97 percent. The income tax is further sub categorized in voluntary payments, collection on demands and withholding taxes (WHT).

5.7 Direct taxes contributed 39 percent in the total tax collected during 2013-14 compared with 38 percent last year and stood at Rs.884 billion. This represented a significant growth of around 20 percent over the previous year's tax collection and was major contributor in total revenue growth. The direct taxes collection achieved 91 percent of the assigned target, which was higher than 79 percent achieved last year. This shows improvement in the estimation, administration and collection of these taxes while leaves space for further improvement. Table below shows the head wise performance of each component of direct taxes.

Table-3: An analysis of Direct Tax Collection (Rs. in billion)

Tax Head	2013-14	2012-13	Growth (%)	% share in 2013-14	% share in 2012-13
Voluntary Payments	262.6	244.9	7.2	27.7	30.7
Collection on Demand	80.6	89.4	(9.9)	8.5	11.2
W.H.T	578.4	436.1	32.6	61.0	54.7
Miscellaneous	26.1	26.4	(1.0)	2.8	3.3
Gross Direct Taxes	**947.7**	**796.8**	**18.9**	**100.0**	**100.0**
Total Net Direct Taxes	**884.1**	**735.8**	**20.2**	**-**	**-**

Source: FBR Biannual Review 2013-14

a - Voluntary payments

5.8 Voluntary payments grew by 7 percent and stood at Rs.263 billion compared with Rs.245 billion last year. The growth in collection stemmed from advance tax which grew by 8.1 percent, however, it was partially offset by the decline in payment with returns by 6.8 percent. Despite this growth, the voluntary payments represented 28 percent of the total direct tax collection in 2013-14 compared with its share of 31 percent in 2012-13. This stresses the need for effective enforcement on part of authorities and requires deterrence by effective audit.

Further, there is a need to increase income tax base and introduce supportive schemes to improve voluntary payments.

b - Collection on Demand

5.9 Collection on demand decreased for another year in a row by around Rs.9 billion or 10 percent compared with its collection of Rs.89 billion in 2012-13. This decline was a result of lack of audit for several years and past cases which were under litigation. The lack of audit also deters fresh demand which could be translated into collection. Until the government improves its audit and administration for tax collection, it is difficult to overturn this declining trend in coming years.

c - Withholding Taxes

5.10 Withholding tax was the main contributor in direct taxes with 61 percent share in 2013-14. The collection of WHT stood at Rs.578 billion with around 33 percent growth from the previous year's collection of Rs.436 billion. The nine major components of withholding taxes contributed around 88 percent of total withholding tax collection. The table below shows the head-wise breakup of the WHT collections during 2013-14.

Table-4: Head Wise Collection of WHT (Rs. in billion)

Collection Head	Collection		Growth %
	2013-14	2012-13	
Contracts	136.6	111.5	22.5
Imports	123.8	103.2	19.9
Salary	64.6	50.1	29.0
Telephone	52.0	27.1	91.8
Bank mark-up	40.5	35.3	14.5
Exports	26.7	23.2	15.2
Dividends	24.2	19.2	26.0
Electric Bills	19.8	16.0	23.3
Cash Withdrawal	19.1	12.4	53.2
Sub total	**507.2**	**398.1**	**27.4**
Share in WHT (%)	87.7	91.3	-
Total WHT	**578.4**	**436.1**	**32.6**
% share In Income tax	61.0	56.5	-

Source: FBR Biannual Review 2013-14

5.11 Government is increasingly relying on withholding taxes to collect direct taxes as taxpayers do not compel to pay under voluntary payments. The scope of withholding tax was further increased by introducing number of measures in 2013-14 such as withholding tax on marriage halls, hotels, restaurants, educational institutions with annual fee above Rs.200,000, foreign-based films and TV dramas and traders. This was further supported by making registered sales taxpayers as withholding tax agents.

5.12 The improved performance in withholding tax collection was led by telephone segment (92 percent), cash withdrawals (53 percent), salary (29 percent), dividends (26 percent) and electric bills (23 percent). The overall growth was attributable to effective monitoring of withholding tax by creating special monitoring units and rationalization of tax rates.

Indirect Taxes

5.13 Indirect taxes mainly include sales tax, federal excise duties and custom duties. Indirect tax constituted 61 percent of the total tax collection during 2013-14.

Sales Tax

5.14 Sales tax was the biggest contributor constituting 44 percent of the total tax revenue. Sales tax grew by 19 percent during 2013-14 with larger contribution from increase in the collection on domestic products. This was primarily because of an across the board increase in sales tax rate from 16 to 17 percent announced in the budget 2013-14. The major impetus came from petroleum products which have a combined share of around 40 percent in total sales tax collection.

Table-5: Sales Tax Collection (Rs. in billion)

Collection Head	2013-14		2012-13		Gross Growth %	Net Growth %
	Gross	Net	Gross	Net		
Sales tax on imports	495.4	495.3	430.4	430.4	15.1	15.1
Sales tax on domestic products	539.1	506.8	440.6	410.9	22.4	23.3
Sub total	**1,034.5**	**1,002.1**	**871.0**	**841.3**	**18.8**	**19.1**

Source: FBR Biannual Review 2013-14

5.15 As a reform agenda, FBR introduced dual sales tax rate for registered and unregistered businesses. An additional sales tax of 5 percent was imposed on unregistered industrial and commercial firms until they formally registered. Further to encourage registration, an additional 2 percent tax was imposed on all taxable supplies to unregistered firms.

a - Sales Tax from Domestic Market

5.16 Sales tax from domestic market made up for around 51 percent of the total sales tax collection with an increase of 23 percent over the last year. The major 10 commodities contributed around 75 percent in the total net sales tax collection in the domestic market as depicted in the table below:

Table-6: Commodity Wise Collection of Sales Tax from Domestic Market (Rs. in billion)

Commodities	Collection			% share 2013-14
	2013-14	2012-13	% growth	
POL Products	231.0	180.6	27.9	45.6
Natural Gas	31.6	36.8	(14.1)	6.2
Fertilizers	24.0	19.9	20.5	4.7
Cement	20.1	11.5	75.5	4.0
Electrical Energy	19.9	10.1	98.2	3.9
Cigarettes	17.7	14.5	21.6	3.5
Aerated Water	13.5	10.7	26.7	2.7
Sugar	9.2	8.5	7.5	1.8
Tea	8.4	5.3	57.5	1.6
Food Products	4.9	3.1	57.3	1.0
Sub Total	**380.4**	**301.1**	**26.3**	**75.1**
Other Sectors	126.4	109.8	13.2	24.9
Sales Tax (Domestic) Net	**506.8**	**410.9**	**22.8**	**100.0**

Source: FBR Biannual Review 2013-14

5.17 The collection of sales tax in domestic market has been highly concentrated in few commodities. This is evident from the fact that only petroleum products and natural gas contributed around 52 percent of the total sales tax from domestic market. The reason for increase in the tax collection from POL products can be traced to the revival of economic activities in the country. A strong collection from the cement sector (growth of 76 percent) was inline with the increased construction activities, of which public sector has also been an active contributor in creating demand for cement and related products. Moreover, fertilizer production increased by 18 percent converting into a healthy sales tax collection growth of 21 percent. Not the least, collection on electrical energy doubled mainly following the tariff increase during the year.

5.18 Other sectors also registered healthy growth of 13 percent and contributed 25 percent in the overall growth in sales tax collections from domestic market. The only exception was in collections from natural gas which exhibited negative growth of 14 percent which could be attributable to comparatively lower gas production and higher refunds of more than Rs.4 billion paid during 2013-14.

b - Sales Tax from Imports

Table-7: Commodity Wise Collection of Sales Tax at Import Stage (Rs. in billion)

Commodities	Collection			% share 2013-14
	2013-14	2012-13	% growth	
POL Products	169.6	156.3	8.5	34.2
Edible Oil	33.9	32.3	4.8	6.8
Plastic Resins	27.8	20.6	35.1	5.6
Iron and Steel	27.6	21.7	26.6	5.6
Machinery and Appliances	26.1	19.5	33.8	5.3
Vehicles	26.0	26.8	(2.9)	5.3
Electric Machinery	18.8	14.5	29.4	3.8
Organic Chemicals	13.3	10.0	33.0	2.7
Fertilizers	12.8	10.6	21.2	2.6
Misc. Chemicals	9.0	6.5	30.6	1.8
Sub Total	**364.9**	**318.8**	**14.3**	**73.7**
Others	130.5	111.6	17.3	26.3
Gross	**495.4**	**430.4**	**15.1**	**100.0**

Source: FBR Biannual Review 2013-14

5.19 The share of sales tax collection on imports constituted 49 percent of total sales tax as against 51 percent last year with growth of 15 percent. Table-7 shows the respective contributions from ten major commodities which contributed around 74 percent in the total sales tax collection from imports. Out of these, six registered growth ranging between 26 percent to 35 percent. More than 50 percent share came from four commodities i.e. POL products, edible oil, plastic resins and iron & steel. Overall, POL products remained the largest contributor with 34 percent share in the total sales tax from import and 45 percent from domestic market.

5.20 The only negative growth was witnessed in the collection from vehicles segment (3 percent) which was insignificant compared with increase witnessed in all major sectors which posted healthy increase compared with the last year. However, the increase in imports and its adequate translation into sales tax collection can only be achieved by improving sales tax collection machinery.

Customs Duty

5.21 Customs duty was once the largest revenue source in the country but faded away on account of trade liberalizations in 1990s. During 2013-14, customs duty imposed on dutiable imports contributed around 17 percent in the indirect taxes and around 11 percent in the total tax collection. Dutiable imports constituted only 38 percent of the total imports during 2013-14 implying high level of exemptions on imports from customs duty. Duty free imports grew by 5.9 percent while dutiable imports grew by 7.6 percent. Customs duty collection grew by only 0.6 percent compared with the previous year and achieved 86 percent of its budget target. One of the major reasons attributed to this low growth was appreciation of Pak Rupee against US Dollar. The following table reveals the head wise collection of the customs duty:

Table-8: Commodity Wise Collection of Customs Duty (Rs. in billion)

Commodities	Budget 2013-14	Collection			% share 2013-14	Target Achieved (%)
		2013-14	2012-13	% growth		
Vehicles	45.6	36.3	42.3	(14.2)	14.5	79.7
Edible Oil	22.6	20.7	20.2	2.0	8.3	91.3
POL Products	18.6	16.8	20.4	(17.8)	6.7	90.1
Mechanical Machinery	12.8	13.7	12.4	11.2	5.5	107.0
Electrical Machinery	10.8	11.3	10.4	8.9	4.5	105.0
Plastic	9.2	11.1	8.8	25.3	4.4	120.2

Table-8: Commodity Wise Collection of Customs Duty (Rs. in billion)

Commodities	Budget 2013-14	Collection			% share 2013-14	Target Achieved (%)
		2013-14	2012-13	% growth		
Paper and Paper Board	5.2	5.9	5.2	14.1	2.4	112.6
Iron and Steel	7.6	5.8	7.1	(17.5)	2.3	76.4
Textile Materials	3.6	4.8	3.4	42.1	1.9	135.3
Organic Chemicals	4.2	4.3	3.9	10.7	1.7	103.0
Sub Total	**140.3**	**130.7**	**134.1**	**(2.5)**	**52.4**	**93.2**
Other Sectors	151.2	119.0	115.8	2.7	47.6	78.7
Gross	**291.4**	**249.7**	**249.9**	**(0.1)**	**100.0**	**85.7**
Refund/Rebate	12.4	8.7	10.4	(15.7)	-	-
Net	**279.0**	**241.0**	**239.6**	**0.6**	**-**	**86.4**

Source: FBR Biannual Review 2013-14

5.22 Customs duty collection was dominated by 10 commodities comprising 52 percent share in the total custom duty collection. The major share came from vehicles (15 percent) followed by edible oil (8 percent), POL products (7 percent), mechanical machinery (6 percent) and electrical machinery (5 percent).

5.23 Vehicles remained the top revenue generator in customs duty despite the fact that the collections from this segment dropped by 14 percent in 2013-14 mainly owing to decline of 7 percent in the value of dutiable imports. Motor car, which had been a main contributor in the vehicles segment, experienced 18 percent decline which adversely affected the collection from this head by 19 percent. Resultantly, the share of collection on vehicles on customs duty dropped to 15 percent of total customs duty collection from 17 percent last year.

5.24 The customs duty collection from POL products decreased by 18 percent as some of the major petroleum items like crude oil, furnace oil and motor spirit were exempted from customs duty. Hence, customs duty from petroleum products mainly depends on the level of contribution by High Speed Diesel (HSD) Oil for which value of dutiable imports decreased by 13 percent. Likewise, the collection on HSD also dropped by 18 percent. Despite the growth and achievement of budget target by over 100 percent in some segments, overall custom duty collections missed the budget target by around 14 percent.

Federal Excise Duty

5.25 Federal Excise Duty (FED) is levied on selected commodities at import and domestic stages. FED contributed around 6 percent in the total tax revenue in 2013-14, which was at the same level as in 2012-13. The bulk of FED collection was from domestic sources. Owing to its narrow base, 5 major commodities including cigarettes, services, natural gas, beverages and cement contributed around 92 percent of the total FED collection. The collection increased by 15 percent and stood at Rs.139 billion in comparison with the previous year's collection of Rs.121 billion. The total FED collection was around 83 percent of the targeted amount of Rs.166 billion. The following table gives a commodity wise break-up of the FED collections:

Table-9: Commodity Wise Collection of FED (Rs. in billion)

Commodities	Budget 2013-14	Collection			% share 2013-14	Target achieved %
		2013-14	2012-13	% growth		
Cigarettes	79.9	72.1	62.0	16.3	51.8	90.2
Services	14.5	20.0	13.3	50.8	14.4	138.5
Beverages	11.1	12.5	9.1	37.2	9.0	112.3
Natural Gas	18.8	12.1	11.4	5.9	8.7	64.6
Cement	16.5	11.2	10.9	2.6	8.1	67.9
Sub Total	**140.8**	**128.0**	**101.2**	**26.5**	**92.0**	**90.9**
All Other	26.0	11.1	19.9	(44.2)	8.0	42.8
Gross Total	**166.8**	**139.1**	**121.1**	**14.8**	**100.0**	**83.4**
Refund/Rebate	-	0.0	0.2	(98.7)	-	-
Net Total	**166.8**	**139.1**	**121.0**	**15.0**	**-**	**83.4**

Source: FBR Biannual Review 2013-14

5.26 Among major items, cigarette was the largest contributor maintaining 52 percent share in the total FED collection followed by services (14 percent), natural gas & beverages (9 percent each) and cement (8 percent). The FED collection from cigarettes showed an increase of 16 percent and stood at Rs.72 billion but missed its target of Rs.80 billion.

5.27 Collection on services exceeded its target by around 39 percent and stood at Rs.20 billion. The collection from beverages registered a growth of 37 percent over the previous year and stood at Rs.13 billion. All major sectors posted growth while other sector, which has only 8 percent share in total collection, posted a significant decline of 44 percent. This allowed the total FED collection to post overall growth of 15 percent.

5.28 Government also relied on other sources of indirect taxes which mainly include petroleum levy, airport taxes and other taxes. During 2013-14, collection from petroleum levy stood at Rs.104 billion against the target of Rs.120 billion and posted a decline of 6 percent on the previous year's collection of Rs.110 billion. The other taxes registered a strong growth of 73 percent owing to small base year collection and stood at Rs.5 billion.

5(iv) Non-Tax Revenue

5.29 Non-tax revenue grew substantially to compensate for the lower than budgetary tax revenues. Non-tax revenue was mainly led by SBP profits and defense receipts. Besides, long pending auction of 3G and 4G licenses materialized and increased mark-up receipts from PSEs and dividends contributed significantly in non-tax revenue. The receipts from non-tax revenue during 2013-14 increased by 43 percent over the last year and stood at Rs.1,038 billion thereby achieved 126 percent of the budget target. The table below shows the main contributions to the government's non-tax revenue and their performance against targets:

Table-10: Sources of Non-Tax Revenue (Rs. in billion)

Sources of Taxation	Budgeted 2013-14	2013-14	2012-13	% growth	% share	Target Achieved %
Profits: Post Office / PTA	134.0	94.8	-	-	9.1	70.8
Mark-up	13.3	14.1	14.8	-5.0	1.4	105.6
Mark-up (PSE's)	23.8	65.8	11.6	468.3	6.3	276.4
Dividends	68.4	65.9	63.5	3.9	6.4	96.4
Defense	112.1	117.2	180.4	(35.0)	11.3	104.5
SBP profits	200.0	326.2	220.0	48.3	31.4	163.1

Table-10: Sources of Non-Tax Revenue (Rs. in billion)

Sources of Taxation	Budgeted 2013-14	2013-14	2012-13	% growth	% share	Target Achieved %
Citizenship & Naturalization	16.5	19.0	16.2	16.8	1.8	115.0
Development Surcharge on Gas	35.3	38.5	32.2	19.8	3.7	109.0
Discount Retained on Crude Price	18.0	40.7	15.5	163.0	3.9	226.1
Royalty on Oil and Gas	72.2	76.4	65.2	17.3	7.4	105.8
Windfall Levy	25.0	14.6	23.8	(38.6)	1.4	58.3
Gas Infrastructure Development Cess	38.0	31.8	33.6	-5.2	3.1	83.7
Foreign Grants	30.0	12.3	-	-	1.2	41.1
C-01010 Others (Profit)	-	67.7	-	-	6.5	-
Others	35.2	52.4	50.1	4.5	5.1	148.8
Gross Receipts	**821.9**	**1,037.5**	**726.8**	**42.8**	**100.0**	**126.2**

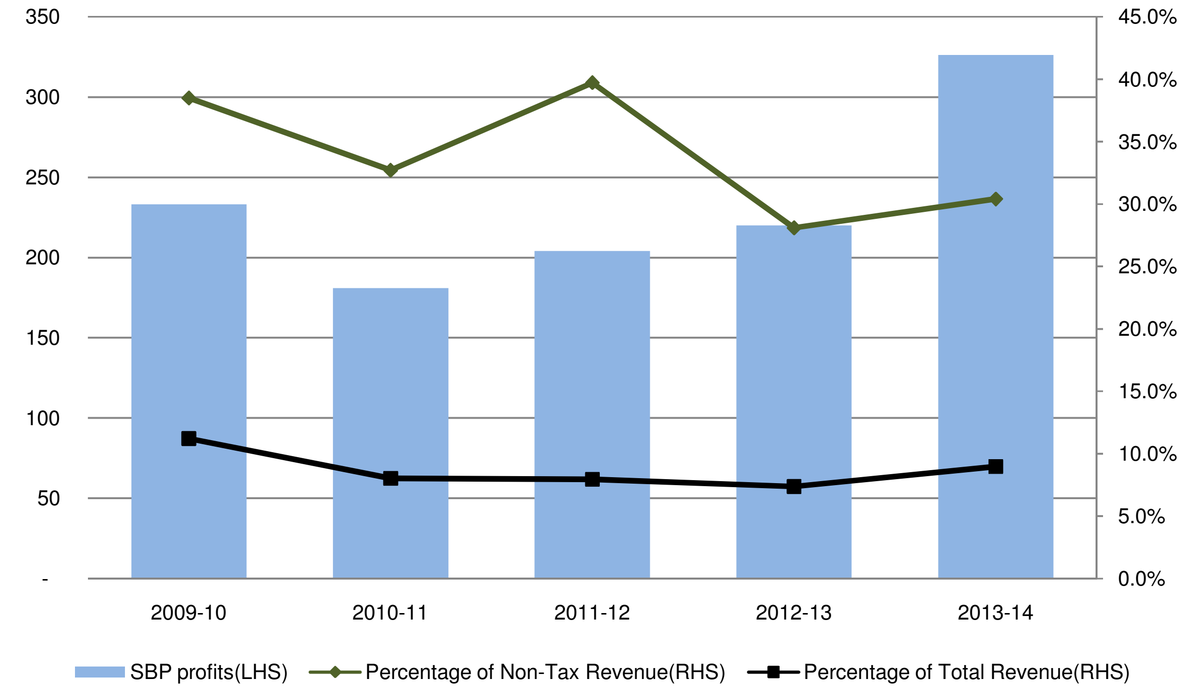
Source: Budget & Federal Government Fiscal Operations 2013-14

5.30 Around 52 percent of non-tax receipts were contributed mainly by SBP profits (31 percent) followed by defense (11 percent) and PTA (9 percent). In addition, the government also utilized Rs.68 billion from Universal Service Fund which was initially not a part of the budget estimates.

5.31 Receipt of Coalition Support Fund (Rs.108 billion) mainly constituted the revenue from the defense sector. Further, mark-up received from PSEs grew significantly and stood at Rs.66 billion, up from only Rs.12 billion last year. Government collected Rs.202 billion from the oil and gas sector on account of i) Gas Development Surcharge; ii) royalties on oil and gas; iii) discount retained on crude oil production; iv) windfall levy against crude oil; and v) Gas Infrastructure Development Cess. These amounts were in addition to sales tax on petroleum products that provided over Rs.400 billion during the year.

5.32 SBP profits increased by 48 percent during 2013-14 compared with last fiscal year and stood at Rs.326 billion surpassing the budget target of Rs.200 billion. These proceeds also included Rs.76 billion as arrears of past years. The graph below shows the historical profits from SBP depicting a gradual increase over past few years.

Fig-3: Profit Receipts from SBP
(Rs. in billion & percentage of Non-Tax Revenue and Total Revenue)



6.0 Total Expenditure

6.1 Government's total expenditure comprises current expenditure and development expenditure. Over 75 percent of total expenditure were current expenditure while remaining constituted development expenditure and net lending. Current expenditure increased by 9 percent whereas direct development expenditure registered a significant increase of 46 percent during 2013-14. The total expenditure during 2013-14 recorded at Rs.5,241 billion against the budgeted amount of Rs.5,297 billion witnessed an increase of only 9 percent over the last year, which was considerably lower than the 24 percent increase recorded in 2012-13. The impetus of total expenditure growth came from development spending as the growth in current expenses slowed down. This outcome was inline with the government's austerity measures announced in budget 2013-14 to curtail current expenditure and increase development expenditure. The consolidated fiscal position of the government in 2013-14 is depicted in the table below:

Table-11: Consolidated fiscal position of the government in the fiscal year 2013-14

	Budgeted 2013-14	Provisional		% growth	% of GDP	% of Budget 2013-14
		2013-14	2012-13			
Total Revenue	**3,646.7**	**3,637.3**	**2,982.3**	**22.0**	**14.3**	**99.7**
Tax Revenue	2,768.1	2,564.5	2,199.2	16.6	10.1	92.6
Non Tax Revenue	878.6	1,072.8	783.1	37.0	4.2	122.1
Total expenditures	**5,297.3**	**5,241.1**	**4,800.3**	**9.2**	**20.6**	**98.9**
a) Current expenditure	**3,963.0**	**4,004.6**	**3,660.4**	**9.4**	**15.8**	**101.0**
of which mark up payments	1,153.5	1,147.8	991.0	15.8	4.5	99.5
Domestic	1,064.5	1,072.8	920.4	16.6	4.2	100.8
Foreign	89.0	75.0	70.6	6.2	0.3	84.2
Provincial current expenditure	1,185.0	1,173.3	1,095.2	7.1	4.6	99.0
Defense expenditure	627.2	623.1	540.6	15.3	2.5	99.3
b) Development expenditure and net lending	**1,334.3**	**1,236.5**	**1,139.9**	**8.5**	**4.9**	**92.7**
Development expenditure	1,326.8	1,135.9	777.1	46.2	4.5	85.6
PSDP	1,155.0	865.5	695.1	24.5	3.4	74.9
Other Development expenditure	171.8	270.5	82.0	229.8	1.1	157.4
Net lending	7.5	100.6	362.8	(72.3)	0.4	1,341.5
c) Unidentified expenditures	-	(215.1)	16.0	(1,444.3)	(0.8)	-
Overall fiscal balance	(1,650.6)	(1,388.7)	(1,833.9)	(24.3)	(5.5)	84.1
% of GDP	(6.3)	(5.5)	(8.2)	(33.0)	-	86.1
Financing of fiscal balance	1,650.6	1,388.7	1,833.9	(24.3)	5.5	84.1
a) External sources	168.7	511.7	(1.7)	(30,201.6)	2.0	303.3
Domestic sources	1,481.8	877.0	1,835.6	(52.2)	3.5	59.2
Non-Bank	506.8	553.3	378.0	46.4	2.2	109.2
Bank	975.0	323.7	1,457.5	(77.8)	1.3	33.2
GDP at market prices	26,001.0	25,401.9	22,489.1	13.0	100.0	97.7

6(i) Current Expenditure

6.2 Current expenditure mainly includes the general public services and defense expenditure. Current expenditure recorded at Rs.4,005 billion in 2013-14 compared with Rs.3,660 billion in the previous year showing an increase of 9 percent. The current expenditure remained within the budget target, showing a decrease in pace of growth in current expenditure.

General Public Services

6.3 The expenditure on general public services comprised around 50 percent of the current expenditure and stood at Rs.1,991 billion in 2013-14. The general public services mainly included the mark-up payments on foreign/domestic debt, pensions and annuities and grants. Mark-up payments on domestic debt solely constituted over 50 percent of these expenditures and 27 percent of the total current expenditure. This was a result of increased reliance on domestic sources to finance fiscal deficit in the past few years. Mark-up payments on domestic and foreign debt comprised 4.5 percent of GDP and consumed 32 percent of the total revenue in 2013-14.

6.4 Superannuation and pension costs were another main component of the general public services. Pension cost witnessed 4 percent growth and stood at Rs.180 billion as compared to Rs.173 billion in the last year. Pension cost remained around 9 percent of these expenditure in 2013-14, compared with same share last year, reflecting an efficient control on the pension and superannuation allowance.

Table-12: Components of General Public Expenditure (Rs. in billion)

Expenditure	2013-14	2012-13	% growth	% share 2013-14
Mark-up on domestic debt	1,072.8	920.4	16.6	53.9
Mark-up on foreign debt	75.0	70.6	6.2	3.8
Superannuation allowances & Pension	180.2	172.6	4.4	9.0
Grants (other than provinces)	283.2	232.7	21.7	14.2
Other general public service	380.1	427.6	(11.1)	19.1
Total	**1,991.3**	**1,823.9**	**9.2**	**100.0**

Source: Fiscal Operations 2013-14

Subsidies

6.5 The total subsidies recorded at Rs.306 billion or 8 percent of the current expenditure during 2013-14 compared with Rs.358 billion. Despite a decline of 15 percent in 2013-14 compared with previous year, subsidies exceeded its budget target by 27 percent. The subsidies to power sector also declined on year-on-year basis mainly owing to increase in power tariffs. The power sector subsidies constituted 96 percent of the total subsidies leaving less room for other vulnerable segments of the economy. The second largest recipient of the subsidies was food and agriculture sector which consumed Rs.13 billion. The amount of subsidies to power sector increased burden on the government's resources and implies the need for macroeconomic restructuring to make the power sector viable, independent and self-sufficient. Government is embarked on the path to economic restructuring to mobilize revenue, consolidate fiscal situation and revive the economy with the expectation to improve the socio-economic outlook and reduce the burden of subsidies to protect the vulnerable groups of the society.

Table-13: Subsidies (2010-2014) - (Rs. in billion)

Subsidies	Power sector	Food and Agriculture	Oil Refineries	Others	Total
2013-14					
Budget estimate	220.1	15.0	4.0	1.3	240.4
Actual subsidies	292.3	12.5	0.0	0.9	305.7
% share	95.6	4.1	0.0	0.3	100.0
2012-13					
Budget estimate	185.3	11.2	7.7	3.4	208.6
Actual subsidies	344.1	8.7	3.4	1.8	357.9
% share	96.1	2.4	1.0	0.5	100.0
2011-12					
Budget estimate	147.3	11.1	7.9	0.1	166.4
Actual subsidies	464.0*	35.3	6.2	7.5	512.9
% share	90.4	6.9	1.2	1.5	100.0
2010-11					
Budget estimate	87.3	27.2	10.8	1.4	126.7
Actual subsidies	334.8**	25.7	10.8	9.3	380.6
% share	88.0	6.8	2.8	2.4	100.0
2009-10					
Budget estimate	66.7	37.9	15.0	0.3	119.9
Actual subsidies	178.8	22.2	11.2	1.3	213.5
% share	83.7	10.4	5.3	0.6	100.0

* Includes one off payments of Rs.312.8 billion and Rs.78.2 billion to the power sector and commodity operations respectively.

** Include electricity subsidies amounting to Rs.120 billion.

Source: Budget Wing, Finance Division

6(ii) Development Expenditure

6.6 Development expenditure and net lending comprised 4.9 percent of total GDP compared with 3.4 percent last year. Development expenditure registered a growth of 9 percent and stood at Rs.1,237 billion in 2013-14 compared with Rs.1,140 billion last year. Development expenditure constituted 24 percent of the total expenditure during 2013-14. Expenditure through Public Sector Development Programs (PSDP) constituted almost 70 percent of the development expenditure and net lending. Out of total PSDP expenditure, around 53 percent was carried out by the provinces. Unlike the past trend, the development expenditure achieved around 93 percent against the budget target of Rs.1,334 billion. The net lending increased to Rs.101 billion against the budget target of Rs.7.5 billion. Moreover, the government also spent on its development programs outside PSDP, like Benazir Income Support Program (BISP), Pakistan Poverty Alleviation Fund, Textile Policy 2009-14, and subsidy to TCP for the import of urea. Going forward, the government needs to invest more resources towards the targeted development expenditure in the wake of the current socio-economic environment which will contribute in economic growth.

7.0 <u>Provincial Fiscal Operations</u>

7.1 Provincial governments posted overall surpluses of around Rs.150 billion in 2013-14 against the budget target of Rs.23 billion. This was an outcome of following factors:

– There is an understanding that provincial governments will support the overall fiscal consolidation efforts by posting surpluses, particularly after 7th NFC Award when provincial shares in divisible pool increased considerably;

– There is a view that transfers from federal government are unpredictable, especially at the end of fiscal year, which dampened PSDP spending by provinces;

– Hard limits on provincial government borrowings from SBP, incentivized provinces to remain conservative in their spending; and

– There are still capacity issues within the provincial governments to take the enhanced fiscal responsibilities after the 18th Constitutional Amendment.

Table-14: Provincial Fiscal Operations (Rs. in billion)

Fiscal Operations	2013-14	2012-13	% growth	% share
Total Revenue*	1,767.4	1,544.4	14.4	48.6
a) Tax Revenue	190.0	150.7	26.1	7.4
b) Non-Tax revenue	49.4	71.3	(30.8)	4.6
Total expenditure	1,617.9	1,481.6	9.2	30.9
a) Current expenditure**	1,187.4	1,110.0	7.0	29.7
b) PSDP	430.5	371.5	15.9	49.7
Fiscal Surplus/ (Deficit)	**149.5**	**62.8**	**138.1**	**10.8**

* Includes Rs.1,214.9 billion and Rs.1,406.3 received from the federal government in 2012-13 and 2013-14 respectively.
**Includes Rs.14.8 billion and Rs.14.1 billion as mark-up paid to federal government in 2012-13 and 2013-14 respectively.

Source: Fiscal Operations 2013-14

7.2 The significant increase in provincial surpluses helped to contain overall fiscal deficit, however, this may not have been the intended policy objective. There is a need to encourage fiscal devolution whereby revenue collection should be increasingly done by the provinces so that a more stable revenue stream would allow the provincial governments to manage their development spending.

7.3 It is encouraging that provinces own revenue generation is gradually gathering pace contributed mainly by GST collection on services. The share of provincial tax collection in total revenue has increased from 5.3 percent in 2010-11 (before 18th Amendment) to 10.7 percent in 2013-14. However, the element of certainty in provincial cash flows needs attention as 80 percent of the provincial revenues still come from their shares in divisible pool, which is dependent upon FBR tax collection. Provinces need to tap the potential area of agriculture income to supplement their revenue collection efforts.

7.4 Province of Punjab generated the largest budget surplus, followed by KPK, Sindh and Balochistan. Punjab and Sindh posted surpluses while increasing their development spending over the previous year. On the other hand, KPK posted surplus compared with a deficit last year while Balochistan's surplus declined by

Rs.5.3 billion compared to last year owing to increase in its current expenditure related to education sector.

7.5 More than 90 percent of total provincial tax collection was contributed by Sindh and Punjab as they strengthened their collection machinery for sales tax on services. KPK has established its own revenue authority following Punjab and Sindh while Balochistan is in process of setting up a similar authority. This is very encouraging as provinces have started exercising their revenue raising powers conferred upon by the Constitution.

7.6 On the expenditure side, provincial expenditure grew by 9 percent in 2013-14, thereby, witnessed almost the same growth last year. The worrying aspect was that the development budgets allocated to the provinces remained underutilized. Against the budget allocation of Rs.615 billion for provincial PSDP, provinces could utilize only Rs.431 billion (70 percent) during 2013-14 owing to the capacity constraints, uncertain inflow of revenue from divisible pool and understanding to show surpluses.

7.7 Expenditure on infrastructure (construction and transport) was given priority in development outlays by all provinces. Besides, Sindh spent around 33 percent of total development expenditure on social protection. Punjab focused more on housing and community amenities with 29 percent allocation, while KPK government allocated around 23 percent on health and education.

8.0 Fiscal, Revenue and Primary Balance

8(i) Fiscal Balance

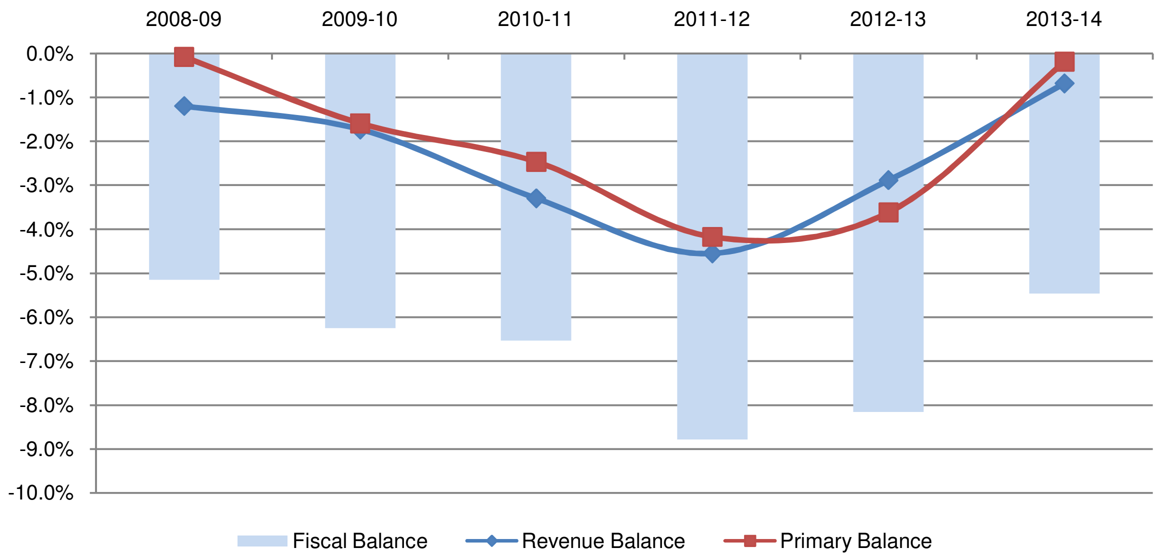
8.1 Fiscal balance witnessed some favorable developments during 2013-14. External financing increased in 2013-14 after declining for past several years. Funding from IFIs increased significantly during the year while the government re-entered the global capital markets after a gap of 7 years and mobilized US$2 billion via Eurobonds.

8.2 The availability of external funding also reduced the government's reliance on domestic sources which improved maturity profile of Pakistan's domestic debt. As a result, the government not only borrowed less from domestic sources in 2013-14 compared to previous year, its borrowings from commercial banks also reduced. The composition of bank lending changed in favor of long term government bonds (PIBs), which reduced the roll-over and interest rate risks.

8(ii) Revenue Balance

8.3 Revenue balance is the total revenues minus current expenditure. The persistence of revenue deficit indicates that the government is not only borrowing to finance its development expenditure, but partially to finance its current expenditure. Revenue deficit was recorded at Rs.173 billion or 0.7 percent of GDP in 2013-14 compared with Rs.649 billion or 2.9 percent in last fiscal year. Despite this significant improvement, there is a need to bring revenue deficit to nil as envisaged under Fiscal Responsibility and Debt Limitation Act, 2005 so that borrowing is used to supplement development activities which will enhance repayment capacity of the country.

Fig-4: Trends in Fiscal, Revenue and Primary Balance (In Percent of GDP)



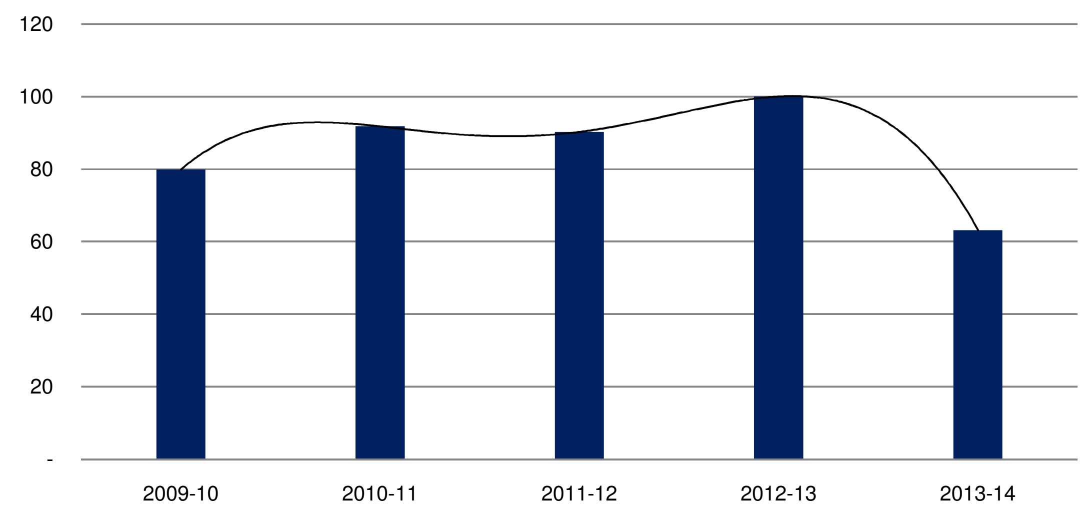
8(iii) Primary Balance

8.4 Primary balance is the total revenues minus non-interest expenditure or fiscal deficit before interest payments. Primary balance is an indicator of current fiscal efforts since interest payments are predetermined by the size of previous deficits. Achieving a primary surplus is normally viewed as important, being usually necessary for reduction in public debt to GDP ratio. Primary deficit improved significantly in 2013-14 and recorded at Rs.47 billion or 0.2 percent of GDP compared with Rs.814 billion or 3.6 percent in last fiscal year.

8(iv) Financing of Fiscal Deficit

8.5 Pakistan's fiscal balance improved significantly in 2013-14 as compared with last fiscal year. The actual fiscal deficit of 5.5 percent was not only lower than 8.2 percent last year but also lower than its budgeted target of 6.5 percent. This improvement in fiscal deficit has slowed down the pace of public debt accumulation. Apart from this reduction in fiscal deficit, another positive development was shift in financing mix of fiscal deficit i.e. around 37 percent of fiscal deficit was financed from external sources which not only reduced the pressure on the banking system, but also left space for commercial banks to finance the private sector.

Fig-5: Domestic Financing of Fiscal Deficit
(Percentage of GDP)



9.0 <u>Fiscal Performance July-September, 2014</u>

9.1 Fiscal deficit was recorded at 1.2 percent of the GDP during July-September 2014 against the budget target of 4.9 percent set for 2014-15. This was mainly driven by increased mark-up payments during July-September, 2014. Total revenue grew by only 1.2 percent on comparable basis and stood at Rs.840

billion while total expenditure recorded at Rs.1,170 billion depicting a growth of 13 percent. A relatively larger primary surplus was recorded in the first quarter, which was inline with the first quarter trends over the past two years. The provincial surplus was recorded at Rs.58 billion down from Rs.122 billion last year due to increased provincial expenditure as well as lower transfers from the divisible pool.

Tax Revenue

9.2 Tax revenue as a percentage of GDP increased to 2.2 percent as compared with 2.1 percent in the corresponding period last year. Although the government managed to raise its total tax revenue in absolute terms but could not keep up the growth pace required to achieve annual target of 24 percent for 2014-15. Accordingly to stimulate the pace of growth in the remaining period of 2014-15, FBR needs to take further improvement measures through enhanced documentation of the economy, simplification of tax procedures and effective enforcement.

Non Tax Revenue

9.3 Non-tax revenue posted 21 percent decline during first quarter of 2014-15 which may be traced to abnormally high one-off inflows witnessed in the comparable period last year. SBP profit stood at Rs.68 billion while some support came from the Coalition Support Fund during the quarter. Royalties on oil & gas and dividends also provided some respite with a collection of Rs.20 billion and Rs.12 billion, respectively.

Expenditure

9.4 Total expenditure were primarily driven by mark-up payments during July-September, 2014. Non mark-up expenditure increased by only 5 percent while mark-up expense grew by 31 percent. Moreover, the expenditure on defense also increased which was expected in light of current security situation of the country. Spending on PSDP stood at Rs.93 billion against Rs.80 billion during the corresponding period last year. Government is committed to curtail the current expenditure with effective management of financial resources.

10.0 Economic Reforms

10.1 Reform strategy is focused on improvement in corporate governance, restructuring of PSEs and Strategic Partnership through Privatization. The updates in terms of restructuring of the three large PSEs – Pakistan Steel Mills (PSM), Pakistan International Airlines (PIA) and Pakistan Railways (PR) are highlighted below:

I. Pakistan Steel Mills

10.2 PSM enjoyed a strong financial and operational status until 2007-08. Subsequently, deterioration in capacity utilization and increase in raw material prices negatively affected its overall functioning and profitability. PSM has posted losses since 2008-09 and operated under its optimal capacity.

10.3 On the direction of Economic Coordination Committee (ECC) meeting held in April 2014, Ministry of Finance finalized month-wise cash disbursement restructuring package of Rs.18.5 billion for PSM. Monthly releases are being made based on achievement of KPIs as agreed in the business plan. An inter-ministerial monitoring committee has been constituted to oversee the implementation process of the business plan. It is envisioned that capacity utilization of PSM will be enhanced to the agreed level of 70 percent to reach break-even capacity by January 2015 and is projected to be profitable by 2015-16. Other planned initiatives include expansion with the support of Russia and taping revenue sources through sale of scrap, IPO and working capital management to revive PSM.

II. Pakistan Railways

10.4 Pakistan Railways (PR) is making steady operational and financial progress which is reflected in PR's financial statements for 2013-14. Revenue for 2013-14 stood at Rs.23.9 billion as compared with Rs.18.1 billion in 2012-13, depicting an annual growth of 33 percent, primarily contributed by tariff and route rationalization as well as removal of cost redundancies in business operations.

10.5 The earnings from the freight business were recorded at Rs.3.5 billion in 2013-14 compared with Rs.1.9 billion a year earlier depicting significant increase of 79 percent. With the additional procurement of 15 locomotives for both freight and passenger business, the performance of PR is expected to improve in 2014-15. This is also evident from the financial results from first quarter 2015 which kept an upward trajectory with revenue of Rs.6.3 billion as compared to that of Rs.5.1 billion during the same quarter last year.

10.6 The re-structuring plan, in consultation with Pakistan Railways, has also been finalized with detailed short, medium and long term initiatives which will provide further guidance to future business strategy for Railways in the following areas:

- Governance
- Internal business process
- Service delivery
- Financial reforms
- Investment planning

10.7 As envisaged under the recent proposed restructuring plan, government will make available Rs.2 - 2.5 billion per month to bridge the revenue expense deficit and subsequently reduce it in the coming years to a manageable level.

III. Pakistan International Airlines (PIA)

10.8 An initial plan for PIA has been developed which envisages the introduction of fuel efficient aircrafts, route rationalization, separation of core and non-core activities and HR rationalization with the objective of making PIA a sustainable and profitable entity in the long run. The plan provides an overall picture of financial position and future prospects based on operational strategies being implemented in these focal areas. 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. Success of this plan depends on lowering the level of liabilities as high debt cost will continue to pose challenges for operational viability and sustainability.

10.9 PIA's restructuring plan revolves around Rs.16 billion approved by ECC in July 2013 out of which around Rs.15 billion was provided in 2013-14. PIA also took various steps like induction of 4 narrow body aircrafts in first 5 months of 2014 and cost cutting measures which include route rationalization and rationalization of manpower at foreign stations etc. These steps resulted in improvement in financial results in the first half of 2014 with after tax losses decreased to Rs.10.8 billion from Rs.18.4 billion in corresponding period last year. PIA's restructuring plan also includes induction of fuel efficient fleet and 18 new aircrafts by December 2015.

IV. Power Sector Reforms

10.10 Energy Sector reform is a key component of the structural reforms agenda of the present government. Government developed a National Power Policy 2013-18 which focuses on improved governance structure, supportive legal framework, financial sustainability, supply-demand side management and promoting private sector participation in the sector. Implementation of this policy will help to improve the governance and financial viability of power sector.

10.11 Implementation of government plans has pushed the structural reforms forward. In an effort to move to full cost recovery, government has rationalized tariffs. The differential, between the NEPRA Determined Tariff (NDT) and proposed tariff for 2013-14, has decreased substantially and subsidies are being phased out except for the vulnerable consumers in the residential and agriculture categories. Further, NDT (cost recovery tariff) is applied to rest of the categories. Government will continue its efforts to rationalize tariff periodically. Besides, timely payment of Tariff Differential Subsidy (TDS) is being ensured on a monthly basis.

10.12 Significant efforts are being made to ensure financial sustainability of the system. Mechanisms are under consideration to cap the overdue payments to a minimum sustainable level. Mechanism of at source deduction of public sector overdue payables is being implemented and a feeder to feeder monitoring to curtail losses is being pursued. New Electricity Act will help improving litigation mechanism for power sector receivables. Revenue based load management is being carried out in order to ensure smooth recovery of payables. An effort is underway to incorporate all costs to reflect in the tariff structure to arrest build-up of circular debt.

10.13 Operations of Central Power Purchase Authority (CPPA), as an effective financial manager of the system, have improved. To increase transparency in the system, monthly due amount and payments by the DISCOs to CPPA, and by CPPA to the generators will be made available on the website of CPPA. Further, overhaul of financial and management system in Distribution Companies (DISCOs) and Generation Companies (GENCOs) is imperative to improve their performance to a sustainable level. In this regard, performance contracts have been signed with DISCOs to tackle losses, raise payment compliance, improve energy efficiency and service delivery. Moreover, professional board members of DISCOs have been appointed to improve corporate governance. In the medium term, disinvestment of DISCOs is also being planned.

10.14 On the regulatory side, capacity building of NEPRA is imperative to strengthen the regulatory framework to meet the current needs and evolving dynamics of the power sector. A diagnostic audit is being carried out to identify areas where reforms are required. NEPRA will effectively oversee the performance of power sector, and publish quarterly performance standards and indicators of the DISCOs on its website. NEPRA has been allowed to pass on Fuel Price Adjustments (FPA) without prior clearance from the government. Entry and middle management positions in NEPRA have been added to strengthen technical capacity of NEPRA. Development and effective implementation of energy efficiency codes – Pakistan Energy Efficiency and Conservation Act to promote energy efficiency in the country shall play a critical role towards meeting energy needs in the country. The overall objective of above reform process is to ensure smooth financial flow in power sector through reduction in build-up of circular debt.

Improved Fuel Mix

10.15 Efforts are underway to improve power sector fuel mix in the country to reduce price of power basket and improve financial viability. Under the reforms, a large capacity addition is planned from wind, solar, nuclear, hydel and coal power projects till 2019-20. The emphasis is 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. Three hydel plants: Tarbela (4th extension), Chashma, Neelum Jehlum and few other small dams are expected to provide additional generation within next three years. IPPs and GENCOs are also being encouraged to covert from oil to coal based power generation. In addition, development of support infrastructure to import 1000MW under CASA is also included in the plan. Power sector has been given priority in terms of allocation of gas for power generation. All these efforts will improve the energy mix thereby reducing dependence on oil and ensure reasonable tariffs for consumers.

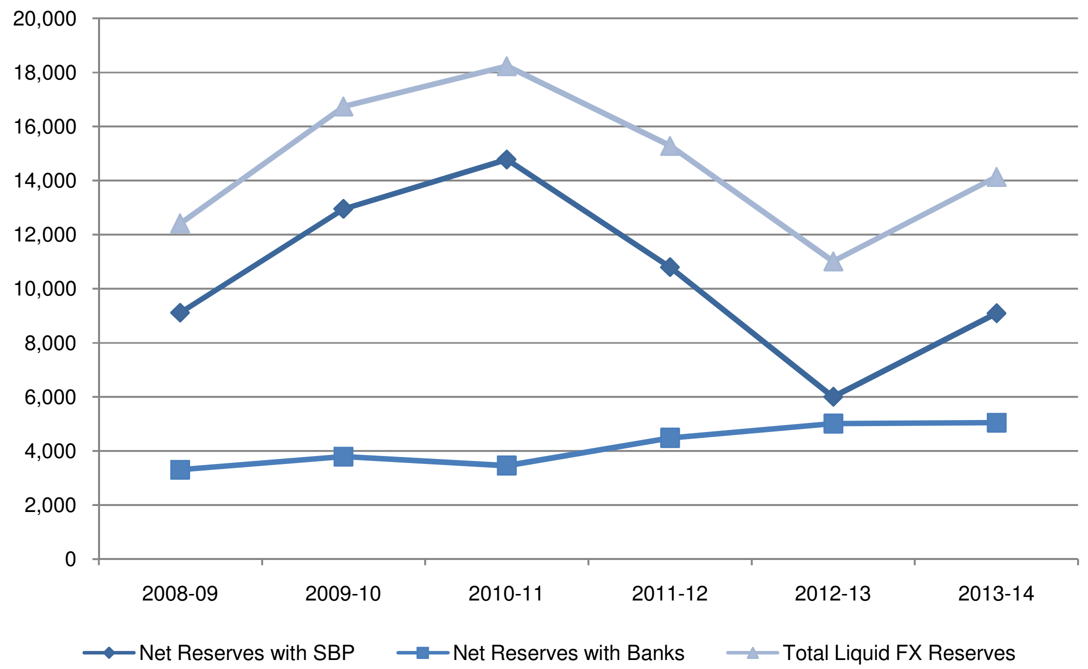
10.16 Going forward, the medium term emphasis will be towards achieving a less oil dependent power generation mix. On the regulatory side, capacity building of NEPRA is envisaged to strengthen the regulatory framework to meet the current needs and evolving dynamics of the power sector. Moreover, development 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.

11.0 <u>External Sector Assessment</u>

11.1 Pakistan's balance of payments position improved significantly in 2013-14. SBP foreign exchange reserves witnessed an increase of US$ 3.1 billion compared with cumulative decline of US$ 8.8 billion during last two fiscal years. Pressure on SBP reserves mainly eased as Pakistan received US$ 1.675 billion from the IMF, US$ 1.5 billion under the Pakistan Development Fund, US$ 2 billion through issuance of Eurobonds, fresh disbursement of US$ 1 billion from World Bank etc.

In addition, proceeds from long awaited 3G/4G licenses auction and UBL divesture helped building the foreign exchange reserves. The increase in external inflows also enabled the government to meet its debt obligations as external debt servicing of around US$ 7 billion was made during 2013-14 which was larger than the size of SBP reserves (US$ 6 billion) at start of the year.

Fig-6: Foreign Exchange Reserves Position (US$ in million)



11.2 The current account deficit recorded at around US$ 3 billion in 2013-14 compared with US$ 2.5 billion during last fiscal year. This increase is mainly attributed to lower inflows under the Coalition Support Fund (CSF). The current account actually improved as compared with last fiscal year, if CSF is not taken into account. The improvement in current account (excluding CSF) is primarily contributed by increase in workers' remittances that reached at record high level of US$ 15.8 billion even surpassing the target of US$ 15.1 billion set for 2013-14. The increase in workers' remittances provided much needed foreign currency respite in past few years. In absolute terms, these remittances have financed 95 percent of the trade deficit, 38 percent of the total imports and contributed 6 percent in Gross National Income in 2013-14.

11.3 Overall trade deficit was recorded at US$ 16.6 billion in 2013-14 compared with US$ 15.4 billion in 2012-13. This increase in trade deficit came primarily from higher imports of machinery, iron, fertilizer and steel, whereas exports posted a nominal growth supported by award of GSP Plus status by the European Union (EU). Services deficit also widened primarily due to lower inflows of CSF and recorded at US$ 2.5 billion compared with US$ 1.5 billion in the last fiscal year. Similarly, primary income account also posted a deficit of US$ 3.9 billion in 2013-14 compared with US$ 3.7 billion in last fiscal year. Together, the deficit in these accounts offset the remarkable improvement in worker remittances and accordingly current account deficit widened in 2013-14 compared with the last fiscal year.

11.4 Pakistan received a grant of US$ 1.5 billion from Saudi Arabia which augmented its capital account surplus. Financial account also improved significantly owing to proceeds from the issuance of Eurobonds, fresh loans from IFIs, sale of 3G/4G licenses auction and proceeds from the UBL divesture. The proceeds from telecommunication sector (auction of 3G/4G licenses) pushed foreign direct investment to surpass last year's level, whereas, growth in other sectors remained subdued. Similarly, increase in foreign portfolio investment was mainly driven by proceeds from the issuance of Eurobonds and UBL divesture.

11.5 The Pak Rupee appreciated by around 0.9 percent during 2013-14. Based on the fiscal year end exchange rate, this was the first year after 2002-03 when Pak rupee posted an appreciation against US Dollar. The effective exchange rate which indicates relative strength of the Pak Rupee compared to basket of other currencies showed a nominal depreciation of 0.3 percent during the year. However, this depreciation could not offset the sharp rise in relative prices (CPI in Pakistan compared to other countries in the trade basket) which lead to an appreciation of 5.5 percent in the Real Effective Exchange Rate (REER).

12.0 <u>Review of Public Debt</u>

12.1 The portion of total debt which has a direct charge on government revenues as well as the debt obtained from the IMF is defined as public debt. Pakistan's public debt has two main components, namely domestic debt (which is incurred principally to finance fiscal deficit) and external debt (which is raised primarily to finance development expenditure).

12.2 The composition of public debt witnessed major changes in the past few years with increased reliance on domestic debt due to persistent large fiscal deficits and unavailability of sufficient external funding. The composition of domestic debt portfolio itself undergone a transformation from a high dominance of unfunded debt to an increasing dependence on short term floating debt which was a source of vulnerability as it entailed high rollover and refinancing risk. Besides, the cost and stock of external public debt increased due to depreciation of Pak Rupee against US Dollar. The present government soon after assuming the charge took measures to manage its public debt portfolio effectively. Some of the significant actions taken by the government are as follow:

- Government developed its first Medium Term Debt Management Strategy (2014-18) that is closely linked to fiscal framework to guide the borrowing activities (Box-1). The focus of the strategy is lengthening the maturity profile to reduce the refinancing risk along with sufficient provision of external inflows in the medium term to reduce the pressure on domestic resources keeping in view cost-risk tradeoffs. Over the medium term, the strategy is expected to result in longer average time to re-fixing due to less exposure to interest rate risk along with reducing the pressure on domestic resources through more external inflows. Accordingly, the composition of public debt improved in 2013-14 mainly due to (a) higher disbursements from International Financial Institutions (IFIs); (b) successful issuance of Eurobonds; and (c) the significant substitution of Treasury bills (T-bills) with Pakistan Investment Bonds (PIBs);
- With increased external inflows, the government was able to boost its foreign exchange reserves vis-a'-vis improving exchange rate of Pak Rupee against major international currencies. This also contributed in reducing external public debt in rupee term;

- To broaden the investor base and have a liquid government securities market, trading of government debt instruments (Treasury Bills, Pakistan Investment Bonds and Government Ijara Sukuk) commenced on the stock exchanges which provided an additional investment channel to retail investors.

12.3 Following an improvement in fiscal deficit, the pace of debt accumulation slowed down in 2013-14. Public debt stock as on June 30, 2014 was recorded at Rs.15,996 billion representing an increase of Rs.1,704 billion or 12 percent higher than the last fiscal year. Unlike last fiscal year, where entire increase in public debt was contributed by domestic debt, external debt contributed around 18 percent of the total increase in public debt in 2013-14. In fact, external public debt recorded an increase of US$ 3.5 billion despite hefty repayments of around US$ 5 billion made during 2013-14 against external public debt. Government decision to re-engage with the IMF facilitated the resumption of inflows from IFIs as evident from increase in multilateral loans by US$ 1.6 billion in 2013-14. Further, Pakistan successfully tapped international capital markets after a gap of 7 years and mobilized US$ 2 billion through the issuance of Eurobonds. The increase in external public debt was also contributed by the translation loss amounting to US$ 571 million on account of depreciation of US Dollar against other major currencies.

12.4 The composition of public debt also improved mainly due to substitution of short term T-bills with medium to long term PIBs in 2013-14. Government mopped up net of retirement Rs.1,902 billion through PIBs which resulted in increase in share of permanent debt to 37 percent of total domestic debt at the end of 2013-14 compared with 23 percent last year. This re-profiling of domestic debt was envisioned in MTDS and accordingly exposure of government to refinancing risk has reduced. However, in terms of cost, the government is required to make more interest payments in future as PIBs carries higher interest rates compared with the shorter maturity T-bills.

Table-15: Public Debt

	2009	2010	2011	2012	2013(P)	2014(P)	2015(P)*
(Rs. in billion)							
Domestic Debt	3,860.4	4,654.3	6,016.7	7,638.1	9,521.9	10,920.0	11,105.6
External Debt	3,871.0	4,351.9	4,750.2	5,057.2	4,771.0	5,076.5	5,129.6
Total Public Debt[(a)]	**7,731.4**	**9,006.2**	**10,766.9**	**12,695.3**	**14,292.9**	**15,996.5**	**16,235.2**
(In percent of GDP)							
Domestic Debt	29.2	31.3	32.9	38.1	42.3	43.0	38.2
External Debt	29.3	29.3	26.0	25.2	21.2	20.0	17.6
Total Public Debt	**58.6**	**60.6**	**58.9**	**63.3**	**63.6**	**63.0**	**55.8**
(In percent of revenues)							
Domestic Debt	208.6	224.0	267.1	297.6	319.3	300.2	---
External Debt	209.1	209.4	210.9	197.0	160.0	139.6	---
Total Public Debt	**417.7**	**433.4**	**477.9**	**494.7**	**479.2**	**439.8**	**---**
(In percent of total debt)							
Domestic Debt	49.9	51.7	55.9	60.2	66.6	68.3	68.4
External Debt	50.1	48.3	44.1	39.8	33.4	31.7	31.6
Memo:							
Foreign Currency Debt (US$ in billion)	47.6	50.9	55.3	53.5	47.9	51.4	50.0
Exchange Rate (Rs./US$, End of Period)	81.4	85.5	86.0	94.5	99.7	98.8	102.6
GDP[(b)] (Rs. in billion)	13,200	14,867	18,276	20,047	22,489	25,402	29,078
Total Revenue (Rs. in billion)	1,851	2,078	2,253	2,567	2,982	3,637	---

P:Provisional *end-September, 2014

[(a)]The public debt amounts are shown in accordance with the revised public debt definition i.e. the portion of total debt which has a direct charge on government revenues as well as the debt obtained from the IMF is defined as public debt

[(b)]The base of Pakistan's GDP has been changed from 1999-00 to 2005-06

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

12.5 Public debt was recorded at Rs.16,235 billion as at end September 2014, registering an increase of Rs.239 billion or 1.5 percent during first quarter of 2014-15. This increase in public debt was almost quarter of the increase seen in the same period last year. The maturity profile of domestic debt further improved as the government was able to mobilize more through PIBs. Despite year-on-year increase in fiscal deficit during first quarter of 2014-15, the net addition to domestic debt stock was actually lower than the budgetary borrowing from domestic sources. This disconnect is attributed to utilization of the government deposits kept with SBP.

12.6 External public debt decreased by US$ 1.4 billion during first quarter of 2014-15 and recorded at US$ 50 billion. This reduction in external public debt was mainly contributed by translational gain of US$ 1.8 billion on account of appreciation of US Dollar against other major currencies. However, despite this translational gain, external public debt increased in Pak Rupee terms by Rs.53 billion and recorded at Rs.5,130 billion owing to depreciation of Pak Rupee against US Dollar by around 4 percent.

13.0 Servicing of Public Debt

13.1 A rising debt burden has implications for the economy in the shape of a greater amount of resource allocation towards debt servicing in the future. Comparing debt service to a country's repayment capacity yields the best indicator for analyzing whether a country is likely to face debt-servicing difficulties in a given period.

13.2 During 2013-14, public debt servicing recorded at Rs.1,460 billion against the budgeted estimate of Rs.1,561 billion. Public debt servicing consumed 40 percent of revenues. Ideally, this ratio should remain below 30 percent to allow the government to allocate more resources towards social and poverty related expenditures.

Table-16: Public Debt Servicing - (2013-14)

	Budgeted	Actual (P)	Percent of Revenue	Percent of Current Expenditure
	(Rs. in billion)			
Servicing of External Debt	89.0	75.0	2.1	1.9
Repayment of External Debt	407.7	312.1	8.6	7.8
Servicing of Domestic Debt	1,064.5	1,072.8	29.5	26.8
Servicing of Public Debt	1,561.2	1,459.9	40.1	36.5

P: Provisional

Source: Budget Wing and Debt Policy Coordination Office Staff Calculations, Finance Division

13.3 The domestic interest payments were recorded at Rs.1,073 billion with an increase of Rs.152 billion as compared with last fiscal year. This increase in domestic interest payments was mainly contributed by the increasing volume of domestic debt, increase in interest rates during first half of the year and an upward adjustment in profit rates on National Savings Schemes (NSS) instruments. Further, weak cash management also contributed towards increase in interest payments as government deposits with State Bank of Pakistan (SBP) witnessed an increase of around Rs.287 billion during the year i.e. if these deposits were utilized towards retirement of some of the borrowing from SBP, net interest payments would have been much lower. Going forward, the need for effective cash management can hardly be overemphasized.

14.0 Report on Compliance with FRDL Act 2005

The Fiscal Responsibility and Debt Limitation (FRDL) Act, 2005 approved on June 13, 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 deficit was recorded at Rs.173 billion or 0.7 percent of GDP in 2013-14 compared with Rs.649 billion or 2.9 percent of GDP in last fiscal year. Although the government was able to reduce the revenue deficit significantly in 2013-14 as compared with previous fiscal year, there is still a need to achieve a revenue surplus so that borrowings are only utilized towards financing the development needs of the country.

Table-17: Revenue Balance (Percent of GDP)

	2009	2010	2011	2012	2013	2014
Revenue Balance*	(1.2)	(1.7)	(3.3) [(a)]	(4.5) [(b)]	(2.9) [(c)]	(0.7)

*Adjusted for grants

[(a)] includes arrears of electricity subsidies amounting Rs.120 billion or 0.7 percent of GDP

[(b)] includes "one off" payment of Rs.391 billion on account of debt consolidation or 2 percent of GDP

[(c)] includes payment for the resolution of the circular debt amounting Rs.322 billion or 1.4 percent of GDP

(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."

Public debt to GDP ratio was recorded at 63.6 percent in 2012-13. Government has brought it down to 63 percent in 2013-14 which was mainly driven by lower fiscal deficit and appreciation of Pak Rupee against US Dollar. Public debt also includes loans from the IMF amounting to US$ 3 billion or 1.2 percent of the GDP as on June 30, 2014. The borrowing from the IMF is only utilized towards balance of payment support and is reflected in foreign currency reserves of the country.

Table-18: Public Debt to GDP (Rs. in billion)

	2009	2010	2011	2012	2013	2014
Domestic Debt	3,860	4,654	6,017	7,638	9,522	10,920
External Debt	3,871	4,352	4,750	5,057	4,771	5,076
Total Public Debt	**7,731**	**9,006**	**10,767**	**12,695**	**14,293**	**15,996**
GDP	13,200	14,867	18,276	20,047	22,489	25,402
Total Public Debt (as percent of GDP)	**58.6**	**60.6**	**58.9**	**63.3**	**63.6**	**63.0**

(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."

The condition of reducing public debt to GDP ratio by 2.5 percent annually was envisaged in the FRDL Act, 2005 to achieve the core objective of reducing Public debt to GDP below 60 percent by end of 2012-13. As the government achieved this landmark in 2005-06, the sub-limit of annual reduction of 2.5 percent was no more applicable.

Social and poverty alleviation related budgetary expenditures remained at 7.6 percent of GDP in 2013-14. Additionally, expenditures on health and education stood at 0.8 percent and 2.1 percent of GDP respectively.

Table-19: Social Sector Expenditure

	2009	2010	2011	2012	2013	2014
Social sector and poverty related expenditure (as percent of GDP)	**7.4**	**7.5**	**6.8**	**9.4**	**8.5**	**7.6**
Expenditure on education (as percent of GDP)	1.8	1.7	1.8	2.2	2.1	2.1
Expenditure on health (as percent of GDP)	0.6	0.6	0.6	0.7	0.7	0.8

(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."

During 2013-14, the government issued new guarantees including rollovers amounted to Rs.106 billion or 0.4 percent of GDP.

Table-20: New Guarantees Issued

(Rs. in billion)	2009	2010	2011	2012	2013	2014
New guarantees issued	276	224	62	203	136	106
(as percent of GDP)	**2.1**	**1.5**	**0.3**	**1.0**	**0.6**	**0.4**

Government is committed to accomplish objectives outlined in Fiscal Responsibility and Debt Limitation Act, 2005. Accordingly, it has taken various corrective measures to effectively manage its public debt portfolio. Government is gradually moving towards achieving revenue surplus and reducing its public debt to GDP below 60 percent to ensure that both the level and rate of growth in public debt is fundamentally sustainable and can be serviced under a wide range of circumstances while meeting cost and risk objectives.

15.0 Conclusion

15.1 After number of years of fiscal slippages, the fiscal deficit reduced and fell within the budget target on the back of strong revenue collection which grew by 19 percent and achieved almost 100 percent of the budget target while expenditure remained within the budget limits. Following this improvement in fiscal deficit, the pace of public debt accumulation slowed down. Other macroeconomic indicators also improved as inflation rate declined, foreign exchange reserves increased, Pak Rupee appreciated against US Dollar and relatively contained current account deficit. The fiscal deficit was not only reduced, there was a shift in financing mix of fiscal deficit as pressure on the domestic sources especially on the banking system reduced which created space for private sector credit.

15.2 Fiscal policy should continue to explore opportunities for augmenting the resource envelop. At the same time, revenue mobilization should be given priority alongwith rationalization of current expenditure as envisaged in budget 2014-15. The elements of the vision presented were: (i) promotion of trade and investment and protection of economic sovereignty; (ii) making the private sector primary engine of economic development; (iii) public investment to build a strong infrastructure of roads, highways, railways, ports, water, hydro-power and related infrastructure; (iv) equitable sharing of development burden by eliminating the culture of tax exemptions and concessions and recovering cost of public services to ensure their sustainable supply; (v) practicing austerity and frugality in public expenditures and containing them within the available resources; and, (vi) protecting the weak and vulnerable segments of population both by insulating them from inflationary pressures as well as giving cash grants to mitigate the adverse impact of economic adjustment and reforms. Moreover, the principles of sound fiscal and debt management as outlined in the FRDL Act, 2005 need to be strengthened during the coming years.

15.3 There is broad agreement that a steady rise in tax to GDP is the best guarantee of viable fiscal adjustments and sound finances, a desired goal that has been missed for decades. Moreover, budgetary borrowing options need to be monitored to ensure that financing of future fiscal deficits does not dilute monetary policy's efforts to keep money supply in check and tackle inflation. In this regard, amplified revenue generation and reduction in primary deficit will also limit the pace of debt creation. By placing a high priority on structural reforms to enhance revenue generation, rationalization of current expenditure and establishment of a comprehensive framework for management of PSEs is a key to ensure fiscal consolidation and sustainability.

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