Fiscal Development

Significance of sound fiscal policies and prudent expenditure management has become an important part of the policy debate in the fallout of the global financial crisis. The prudent expenditure management not only accommodates shortfall in revenues, creates buffers but also help in easing pressures on public finances.

Managing fiscal deficit in Pakistan has always remained a daunting task together with unexpected high government expenditures. Due to unfavorable climatic behavior, along with security situation posed serious threats to fiscal sustainability efforts. Consequently, the economy marked growth at 3.9 percent on average over the past five years.

When the present government came into power in mid-June 2013, it particularly focused to balance the external account, contract the fiscal imbalance, contain the inflationary pressure, revive the economy through short term policy measures by resolving all structural issues. Government’s efforts started to reap the benefits as evidenced from initial gains in macroeconomic recovery. During fiscal year 2013-14, all major indicators showed significant improvement, real GDP grew at 4.03 percent, average CPI inflation remained in single digit, fiscal deficit contained at 5.5 percent and foreign exchange reserves improved significantly. More importantly, fiscal year 2013-14 witnessed considerable decline in government borrowing for budgetary purpose from the banking system which was the evidence of improved fiscal accounts. Better economic performance in the midst of difficult domestic environment on account of security and energy related issues can be credited to commendable efforts of government through better monetary and fiscal policies coordination.

High fiscal deficit since 2009-10, was reduced to 5.5 percent of GDP in 2013-14 if to compare with 8.2 percent of GDP in 2012-13. The deficit was effectively brought down through prudent expenditure management strategy as total expenditures reduced from 21.5 percent of GDP in fiscal year 2012-13 to 20.0 percent of GDP in 2013-14. While total revenues increased to 14.5 percent of GDP in fiscal year 2013-14 from 13.3 percent during 2012-13.Similarly, FBR tax collection posted a growth of 15.8 percent during fiscal year 2013-14 and stood at 9.0 percent of GDP against 8.7 percent of GDP in preceding year.

With the onset of the current fiscal year, the economy faced some headwinds due to political unrest followed by security related operations, legal challenges to privatization, taxation and energy sector reforms. In spite of all these challenges economy showed resilience on account of government’s efforts to contain expenditures through expenditure management strategy and revenue building measures. Furthermore, decline in international oil prices also helped in reducing the pressures on external and fiscal sector.

During July-March 2014-15, fiscal deficit was contained at 3.8* percent against 3.9* percent in the same period of fiscal year 2013-14. Similarly, total expenditures reduced to 13.6 percent of GDP against 13.7 percent of GDP during the period under review. Following the fiscal discipline in the last three quarters, overall fiscal deficit is expected to remain at 5.0 percent of GDP for the entire fiscal year 2014-15.This shows that consolidation efforts of present government are focused on containing expenditure along with broadening the tax base, improving tax collection and strengthening tax administration.

*On the basis of revised GDP

Fiscal Policy Development

Fiscal policy as an important part of economic framework can play an important role in influencing the economic direction of the country as it can bolster economic growth and human development through efficient utilization of resources and prudent expenditure management.

Over the years, Pakistan has faced formidable challenges on fiscal front due to inefficient utilization of resources and ineffective expenditure management strategy in the wake of less efficient tax system and unplanned expenditures.

A review of Table 4.1 suggests fiscal deficit reached to its highest level at 8.2 percent of GDP in 2012-13 from 5.2 percent in 2008-09 owing to delays in implementation of tax reforms and expenditure overrun due to loss making PSEs security related expenditures, untargeted subsidies and higher interest payments.

Due to persistently high fiscal deficits, endeavors to achieve fiscal policy objectives such as sustained economic growth along with declining debt services, alleviating poverty and investing in physical and human infrastructure were severely hampered in the past owing to absence of enough fiscal space to cover the rising public expenditures.

The fiscal deficit which was projected at 8.8 percent of GDP in fiscal year 2012-13 brought down to 8.2 percent. It was further contained at 5.5 percent of GDP in fiscal year 2013-14 through prudent expenditure management and revenue measures.

Table: 4.1 Fiscal Indicators as Percent of GDP

Year	Real GDP Growth	Overall Fiscal Deficit	Expenditure			Revenue		
			Total	Current	Development[/1]	Total Rev.	Tax	Non-Tax
2005-06	5.8	4.0	17.1	12.6	4.5	13.1	9.8	3.3
2006-07	5.5	4.1	18.1	14.9	4.6	14.0	9.6	4.4
2007-08	5.0	7.3	21.4	17.4	4.0	14.1	9.9	4.2
2008-09	0.4	5.2	19.2	15.5	3.7	14.0	9.1	4.9
2009-10	2.6	6.2	20.2	16.0	4.4	14.0	9.9	4.1
2010-11	3.6	6.5	18.9	15.9	2.8	12.3	9.3	3.0
2011-12	3.8	6.8	19.6	15.6	3.7	12.8	10.2	2.6
2012-13	3.7	8.2	21.5	16.4	5.1	13.3	9.8	3.5
2013-14	4.0	5.5	20.0	16.0	4.9	14.5	10.2	4.3
2014-15 (B.E)	5.1	5.0	19.4	15.3	4.1	14.5	11.5	3.0

[/1] including net lending

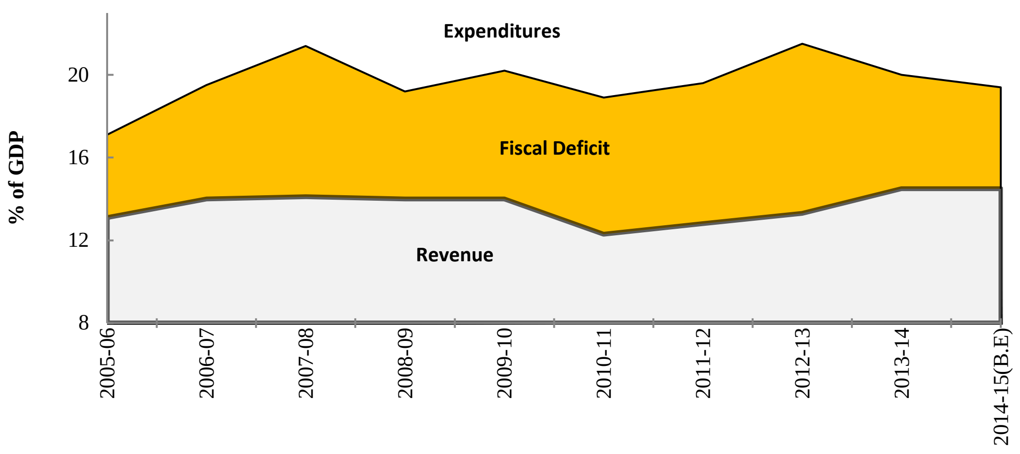
Note: Estimated growth during fiscal year 2014-15 is 4.24 percent.

The government succeeded in reducing the deficit on account of 22.0 percent growth in total revenue in 2013-14 against 16.2 percent increase in 2012-13 on account of increase in tax and non-tax revenues during the same period. While as percent of GDP, it grew by 14.5 percent of GDP in 2013-14 against 13.3 percent of GDP in 2012-13.

On expenditure side, due to prudent expenditure management strategy, growth in total expenditures significantly reduced to 4.4 percent in 2013-14 against 22.4 percent in 2012-13. As percent of GDP it reduced to 20.0 percent of GDP in 2013-14 from 21.5 percent of GDP in 2012-13. Growth in current expenditures reduced to 9.4 percent in 2013-14 against the growth of 17.2 percent in fiscal year 2012-13. While, it reduced to 16.0 percent of GDP in 2013-14 against 16.4 percent of GDP in 2012-13. On the other hand development expenditures which grew at 6.2 percent in 2012-13 increased to 46.2 percent in 2013-14. As percent of GDP it increased by 4.5 percent of GDP in fiscal year 2013-14 against 3.5 percent of GDP in 2012-13[2]

[2] Development expenditures and net lending reduced to 4.9 percent of GDP in 2013-14 from 5.1 percent of GDP in 2012-13

Fig-1 Revenue-Expenditure Gap (% of GDP)



During fiscal year 2013-14, all the four provinces posted a surplus of Rs.196.9 billion against Rs. 52.7 billion in 2012-13. Moreover, availability of enough external resources including CSF worth $1.05 billion in 2013-14 also helped in containing the deficit.

On positive note, fiscal indicators started to improve in fiscal year 2013-14 as evidenced from Table 4.1. The improvement signifies government's commitment to create fiscal buffer through raising tax revenues and expenditure management. Moreover, the present government has identified various areas which needed improvement and embarked on agenda of economic reforms focusing on energy reforms, PSEs reform **(Box-I)**, better resource mobilization, eliminating militancy, bridging fiscal deficits and price stability.

With various steps to control the expenditures and to increase the revenues, fiscal deficit is expected to reduce at 5.0 percent of GDP in fiscal year 2014-15. Total expenditures are expected to remain at 19.4 percent of GDP of which current expenditures are budgeted to reduce at 15.3 percent and development expenditure and net lending at 4.1 percent of GDP. Similarly, total revenues are expected to reach at 14.5 percent of GDP in fiscal year 2014-15 on account of expected increase in tax revenues at 11.5 percent of GDP (12.2 percent on the basis of revised GDP) from the current level of 10.2 percent of GDP while non-tax revenues are budgeted to remain at 3.0 percent of GDP in fiscal year 2014-15. Recently Gas Infrastructure Development Cess (GIDC) bill have been approved. The legislation will not only play a vital role in raising overall revues but will also be important for energy development.

Box: I - Public Sector Enterprise (PSE) Reforms

- To manage the existing PSEs, the government has implemented a holistic PSE Reform Strategy with an aim to improve corporate governance, restructuring of PSEs and Strategic Partnership through Privatization.
- To institutionalize corporate governance initiatives for PSEs, the Public Sector Companies Rules 2013 have been approved by the government. The Rules would help clarify the roles of different stakeholders involved in the management of PSEs.
- Government has embarked on strategic partnership/disinvestment of 31 PSEs representing the most viable transactions. The Strategy involves disinvestment of a mix of PSEs in the oil & gas, banking & finance, power, industrial, transport and real estate sectors.
- Transactions of UBL , PPL and HBL have been completed so far.
- Financial Advisors have been appointed for Islamabad Electric Supply Company (IESCO), Lahore Electric Supply Company (LESCO) and Faisalabad Electric Supply Company (FESCO). FESCO's transaction is planned to be completed by end July 2015, while transaction of IESCO and LESCO are expected to be

completed by end December, 2015.

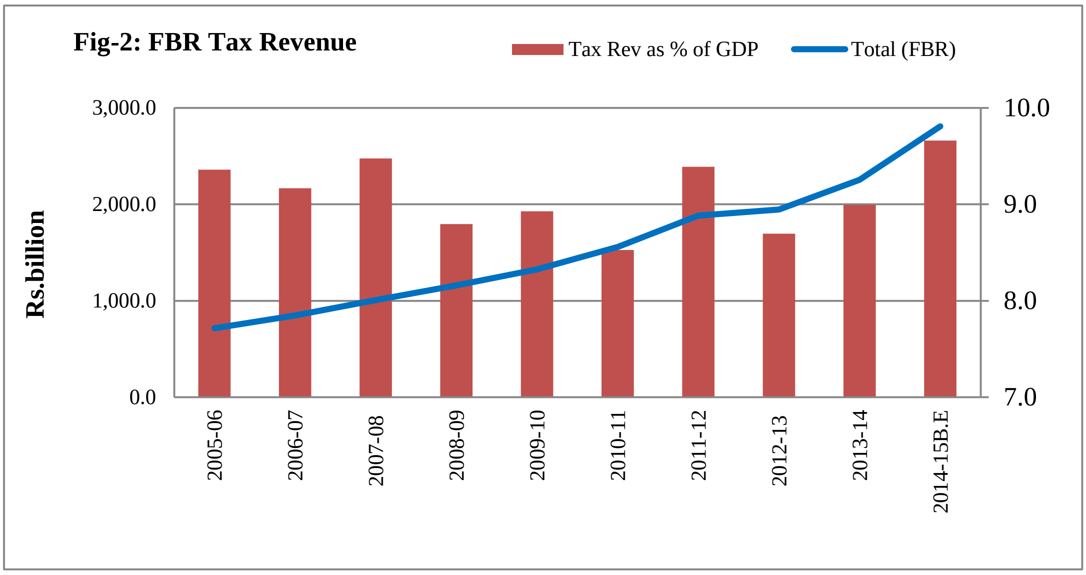
- Financial advisors have been appointed for Pakistan International Airlines (PIA) to seek potential options for restructuring and strategic private sector participation in the core airline business by end December, 2015.
- The Board of Pakistan Steel Mills (PSM) has approved a comprehensive restructuring plan to prepare for potential strategic private sector participation in the company.
- In this regard appointment of financial advisors, which was advertised in January 2015, was disqualified during the evaluation process. It has been re-advertised on February 15, 2015 and the appointment of financial advisors is expected to be completed soon so that the due diligence process can be initiated.
- A comprehensive Railway restructuring plan has been finalized, which envisages improvements in governance and internal business processes, service delivery, financial management and investment planning.
- The roadmap revolves around short, medium and long term reform measures in the above five areas to facilitate achievement of optimum results.

Power Sector Reforms

- National Power Policy 2013-18 focuses on improved governance structure, supportive legal framework, financial stability, supply demand side management and promoting private sector participation in the sector.
- In an effort to move to full cost recovery, the current government has rationalized tariffs.
- The differential, between the NEPRA determined tariff (NDT) and proposed tariff for fiscal year 2013-14 has decreased substantially and subsidies are being targeted to vulnerable consumers in the residential and agriculture categories.
- 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 improve 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 buildup circular debt.
- Operationalization of Central Power Purchase Authority (CPPA) as an effective financial manager of the system is a significant step in this regard.
- To increase transparency in the system, monthly amount due and payment by the DISCOs to CPPA and by CPPA to the generators will be made available on the website of CPPA.
- Efforts are underway to improve power sector fuel mix in the country to reduce the price of power basket and improve financial viability. Under the reforms, large capacity addition is planned from wind, solar, nuclear, hydel and coal power projects in the medium term.
- 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 convert from oil to coal based power generation.
- Development of supportive 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 whereby reducing dependence on oil for power generation and ensure reasonable tariffs for consumers ultimately leading for financial sustainability.

Structure of Tax Revenues

Taxes are the most important source of public revenues and fundamental to strengthen the successful functioning of the government. In this regard strengthening resource mobilization is imperative for designing an efficient tax system which can promote inclusive growth, encourages good governance, ensures the delivery of public services and promotes social justice.



Inefficient tax system in developing countries has long been a major concern. Pakistan has also witnessed numerous tax policy challenges to establish efficient tax system. Resultantly narrow tax base lead not only lower tax to GDP ratio but also posed serious threats to fiscal sustainability. Despite the increase in tax revenues in absolute term, FBR tax to GDP ratio varied between 8.5 to 9.7 percent during the past 10 years.

However to achieve the fiscal sustainability present Government is stringently focusing on wide-ranging resource mobilization strategy with an aim to increase the tax to GDP ratio to 15 percent in next few years (Box-II).

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

Year	Total (FBR)	Tax Rev as % of GDP	Direct Taxes	Indirect Taxes			
				Customs	Sales	Excise	Total
2005-06	713.5	9.4	225.0	138.4	294.8	55.3	488.5
			[31.5]	{28.3}	{60.3}	{11.3}	[68.5]
2006-07	847.2	9.2	333.7	132.3	309.4	71.8	513.5
			[39.4]	{25.8}	{60.3}	{14.0}	[60.6]
2007-08	1,008.1	9.5	387.9	150.7	377.4	92.1	620.2
			[38.5]	{24.3}	{60.9}	{14.9}	[61.5]
2008-09	1,161.1	8.8	443.5	148.4	451.7	117.5	717.6
			[38.2]	{20.7}	{62.9}	{16.4}	[61.8]
2009-10	1,327.4	8.9	526.0	160.3	516.3	124.8	801.4
			[39.6]	{20.0}	{64.4}	{15.6}	[60.4]
2010-11	1,558.2	8.5	602.5	184.9	633.4	137.4	955.7
			[38.7]	{19.3}	{66.3}	{14.4}	[61.3]
2011-12	1,882.7	9.4	738.4	216.9	804.9	122.5	1,144.3
			[39.2]	{19.0}	{70.3}	{10.7}	[60.8]
2012-13	1,946.4	8.7	743.4	239.5	842.5	121.0	1,203.0
			[38.2]	{19.9}	{70.0}	{10.1}	[61.8]

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

Year	Total (FBR)	Tax Rev as % of GDP	Direct Taxes	Indirect Taxes			
				Customs	Sales	Excise	Total
2013-14	2,254.5	9.0	877.3	242.8	996.4	138.1	1,377.3
			[39.0]	{17.6}	{72.3}	{10.0}	[61.1]
2014-15 B.E	2,810.0*	9.7	1,180.0	281.0	1,171.0	178.0	1,630.0
			[42.0]	{17.2}	{71.8}	{10.9}	[58.0]

Source: Source: Federal Board of Revenue

{} as % of indirect taxes. [ ]as % of total taxes

*: Target revised downward at Rs.2605 on account of losses incurred due to decline in International Oil and Commodity Prices.

A brief look at Table 4.2 indicates the significant changes in its tax structure when share of direct tax in total tax collection increased from 31.5 percent in 2005-06 to 39.0 percent in fiscal year 2013-14 and budgeted to reach at 42.0 percent in fiscal year 2014-15. On the other hand share of sales tax in total taxes increased from 41.3 percent in 2005-06 to 44.2 percent in 2013-14 and projected to reduce at 41.7 percent in 2014-15.

Box-II - Major Initiatives taken by FBR

Broadening of Tax Base

- For broadening of tax base several initiatives have been taken and some are in pipeline. Initially the objective is to incorporate 300,000 new taxpayers. In this regard, more than 171,000 notices upto February 2015 have already been issued. Similarly, a detailed plan for outreach program including provisional assessment, collection procedures, penal actions and prosecution proceedings has been chalked out and is being implemented.
- Moreover, a landmark measure to bring a larger number of tax payers into the tax net is the announced merger of the existing database of 3.6 million individuals holding the National Tax Number (NTN) with the Computerized National Identity Card (CNIC) database comprising 150 million.

Withdrawal of Exemptions/Concessions

- In order to remove distortions and discrimination in the income tax structure and to abolish unnecessary concessions a plan for withdrawal of exemptions has been chalked out.
- First tranche has been withdrawn in the Budget 2014-15 and remaining will be withdrawn phase-wise in a couple of years. The FBR has granted no new tax concessions or exemptions through statutory Regulatory Orders (SROs).

Taxpayers Facilitation

- Introduction of an e-filling process accessible to taxpayers for income tax, sales tax and excise at e-FBR portal has been ensrued. Automation of systems has helped in minimizing the contact between taxpayer and tax officers and as a consequence the complaints of harassment have been reduced accordingly.

Strengthening Tax Audit

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

Human Resources Management

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

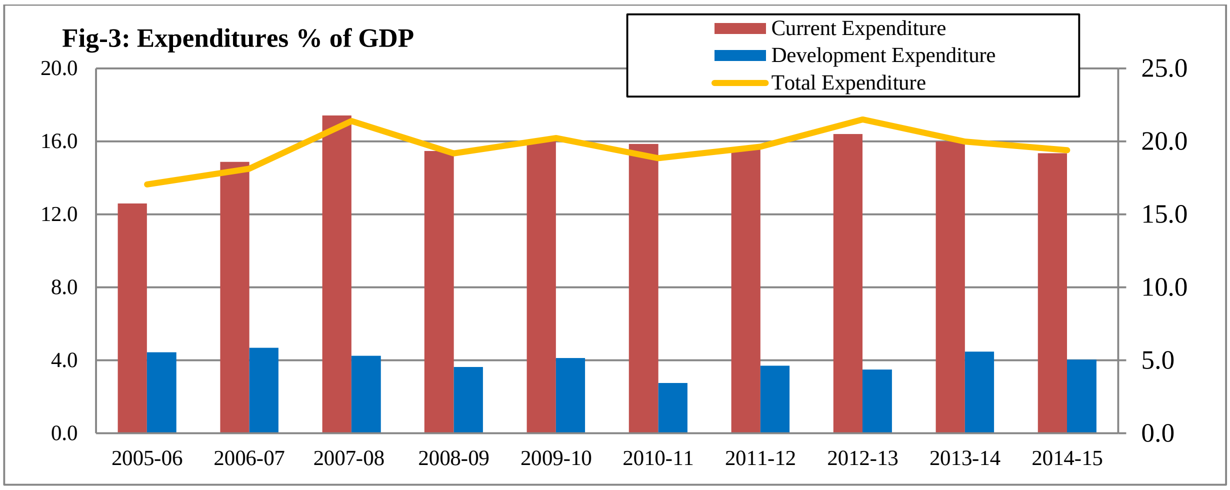
Source: FBR

Custom duty in indirect tax reduced from 28.3 percent in 2005-06 to 17.6 percent in 2013-14 and it is budgeted to reduce further to 17.2 percent in 2014-15. Going forward, share of federal excise in indirect taxes decreased from 11.3 percent in 2005-06 to 10.0 percent in 2013-14 and budgeted to reach at 10.9 percent in 2014-15.

Review of Public Expenditures

Public expenditure management is important for any government to have control over its expenditures particularly when revenue receipts are not enough to cover its development projects. It is therefore imperative to create harmony between revenue receipts and expenditures to help the governments to evade high deficits.

In Pakistan considerably high expenditures on account of unplanned expenditures incurred due to floods, security related issues, high interest payment, untargeted subsidies particularly to loss making PSEs, energy subsidies, non-development projects and less than expected tax collection has dominated the scene of fiscal management. Consequently, fiscal deficit rose by 6.6 percent on average during the past five years.



However, during fiscal year 2013-14 Pakistan has made substantial progress in expenditure management through prudent expenditure management (Box-III). Fiscal year 2013-14 witnessed decline in total expenditure as its growth reduced to 4.4 percent against 22.4 percent in 2012-13. While as percent of GDP it reduced to 20.0 percent in 2013-14 from 21.5 percent recorded in 2012-13 and reached to Rs. 5,026.0 billion in fiscal year 2013-14 from Rs. 4,816.3 billion in 2012-13. During current fiscal year, total expenditures are expected to decline further at 19.4 percent of GDP with an aim to contain the fiscal deficit within reasonable limits.

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

Year	Total Expenditure (A)	Current Expenditure (B)	Interest Payments (C)	Defence (D)	Development Expenditure (E)	Non Interest Non-Defence Exp (A-C-D)	Fiscal Deficit	Revenue Deficit/ Surplus (TR-Total CE)	Primary deficit (TR-NI Exp)
2005-06	17.1	12.6	2.9	2.9	4.4	11.2	4.0	0.5	-1.1
2006-07	18.1	14.9	4.0	2.7	4.7	11.4	4.1	-0.8	-0.1
2007-08	21.4	17.4	4.6	2.6	4.2	14.2	7.3	-3.3	-2.7
2008-09	19.2	15.5	4.8	2.5	3.6	11.8	5.2	-1.4	-0.3
2009-10	20.2	16.0	4.3	2.5	4.1	13.4	6.2	-2.1	-1.9
2010-11	18.9	15.9	3.8	2.5	2.8	12.6	6.5	-3.5	-2.7
2011-12	19.6	15.6	4.4	2.5	3.7	12.7	6.8	-2.8	-2.4
2012-13	21.5	16.4	4.4	2.4	3.5	14.7	8.2	-3.0	-3.8
2013-14	20.0	16.0	4.6	2.5	4.5	13.0	5.5	-1.5	-1.0
2014-15 B.E	19.4	15.3	4.6	2.4	4.0	12.4	5.0	-0.8	-0.3

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

Current expenditure has reduced to 16.0 percent of GDP in 2013-14 from 16.4 percent of GDP in 2012-13. It amounted to Rs. 4,004.6 billion in 2013-14 against Rs. 3,660.4 billion in 2012-13, thus posted a growth of 9.4 percent against the growth of 17.2 percent in preceding year. In fiscal year 2014-15, it is expected to reduce further at 15.3 percent of GDP.

Notwithstanding high growth in interest payments and defense expenditure, reduced growth in current expenditure during fiscal year 2013-14 was achievable due to decline in subsidies. In fiscal year 2013-14, subsidies registered a significant decline and stood at Rs. 305.7 billion against Rs. 358.0 billion in the same period of fiscal year 2012-13 on account of increased power tariffs for all categories of consumers, however subsidies are being targeted to vulnerable consumers in the residential and agriculture categories.

Interest payments increased from Rs.991.0 billion in 2012-13 to Rs.1,147.8 billion in 2013-14. While as percent of GDP it increased to 4.6 percent in fiscal year 2013-14 against 4.4 percent in the comparable period of fiscal year 2012-13. By the end of current fiscal year it is expected to reach at 4.6 percent of GDP.

Defense expenditures witnessed a slight increase of 2.5 percent of GDP in fiscal year 2013-14 against 2.4 percent of GDP in 2012-13 and reached to Rs.623.1billion against Rs. 540.6 billion in fiscal year 2012-13. During current fiscal year, defense expenditures are expected to remain at 2.4 percent of GDP slightly lower than the level witnessed in fiscal year 2013-14.

Despite the fact that government is taking all possible efforts to restrict the non development expenditures to create a fiscal buffer for development spendings, there are some mandatory non development expenditures like interest payments, defence and law and order which cannot be avoided in any circumstances. Therefore government is making its best efforts to manage these expenditures within the available fiscal space.

During fiscal year 2013-14, development expenditures witnessed marked improvement as it grew by 46.2 percent against the growth of 6.2 percent and reached to Rs. 1,135.9 billion in 2013-14 against Rs. 777.1 billion in 2012-13. As percent of GDP it increased to 4.5 percent in 2013-14 from 3.5 percent of GDP in 2012-13. Together with net lending it posted a growth of 8.5 percent to reach at Rs. 1,236.5 billion in fiscal year 2013-14. Development expenditures are expected to reach at Rs.1,172.8 billion in fiscal year 2014-15.

Within development expenditure, Public Sector Development Program (PSDP) increased significantly both at federal as well as provincial level. In absolute term, Federal PSDP increased to Rs. 434.9 billion in 2013-14 against Rs.323.5 billion in 2012-13, thus posted a growth of 34.4 percent. On the other hand Provincial ADP amounted to Rs. 430.5 billion in 2013-14 against Rs. 371.5 in 2012-13 thus witnessed a growth of 15.9 percent. During fiscal year 2014-15, Rs. 1,175 billion have been allocated in the PSDP as compared to Rs.1,155billion in 2013-14.

Fiscal Performance (July-March, 2014-15)

Pakistan's economy remained resilient despite significant challenges at the onset of current fiscal year when political uncertainty due to long march/dharna and floods in September, 2014 undermined the nascent stage of recovery.

Table: 4.4 Consolidated Revenue & Expenditure of the Government

	2014-15 B.E	July-March		Growth
		2014-15	2013-14	
A. Total Revenue	4,220.6	2,682.6	2,477.4	8.3
a) Tax Revenue	3,337.2	2,063.2	1,786.2	15.5
Federal	3,129.2	1,918.0	1,650.0	16.2
of which FBR Revenues	2,810.0	1,775.1	1,574.8	12.7
Provincial Tax Revenue	208.0	145.2	136.2	6.6
b) Non-Tax Revenue	883.3	619.5	691.2	-10.4
B. Total Expenditure	5,642.4	3,731.6	3,446.2	8.3
a) Current Expenditure	4,462.3	3,199.1	2,904.6	10.1
Federal	3,097.3	2,255.8	2,083.2	8.3
Markup Payments	1,325.2	974.5	909.1	7.2
Defence	700.1	485.9	451.7	7.6

Table: 4.4 Consolidated Revenue & Expenditure of the Government

	2014-15 B.E	July-March		Growth
		2014-15	2013-14	
Provincial	1,365.0	943.2	821.4	14.8
b) Development Expenditure & net lending	1,180.1	594.0	555.8	6.9
c) Statistical discrepancy	-	-61.4	-14.1	-
C. Overall Fiscal Deficit	1,421.8	1,048.9	968.9	-
As % of GDP	5.0	3.8	3.9	-
Financing of Fiscal Deficit	1,421.8	1,048.9	968.9	8.3
i) External Sources	508.0	137.8	107.1	28.7
ii) Domestic	913.9	911.1	861.7	5.7
- Bank	227.9	469.4	436.9	7.4
- Non-Bank	686.0	426.5	424.8	0.4
GDP at Market Prices	29,078	27,384	25,068	9.2

Source: Budget Wing, Finance Division

Government's concerted endeavors helped the economy in coming back on track as key macroeconomic indicators have improved during ongoing fiscal year 2014-15. Additionally, favorable decline in international oil prices, private and financial sector developments, improved social protection and revenue mobilization further supported the economic recovery.

On fiscal front, consolidation efforts are on track despite challenges on revenue side, since government has successfully curtailed the fiscal deficit at 3.8 percent of GDP during July-March, 2014-15 against 3.9 percent during the same period last year on account of prudent expenditure management. Furthermore, Pakistan has received $1,452 million under CSF during first and second quarter of current fiscal. These inflows have not only provided further comfort to fiscal accounts but also helped in maintaining the country's reserve position. Moreover, a healthy provincial surplus to the tune of Rs.194.0 billion has also helped in containment of fiscal deficit. Pakistan has not only successfully contained the fiscal deficit but has also met end of March performance criteria on the budget deficit with IMF. Encouragingly, it will help to restrict the overall budget deficit at 5.0 percent of GDP for the entire fiscal year 2014-15.

According to consolidated revenue and expenditure statement of the government, total revenue grew by 8.3 percent during July-March, 2014-15 and stood at Rs. 2,682.6 billion against Rs. 2,477.4 billion in the same period of 2013-14. Within total revenues, total tax collection amounted to Rs. 2,063.2 billion during July-March, 2014-15 against Rs. 1,786.2 billion in the same period of 2013-14, thus posted a growth of 15.5 percent. Tax revenues witnessed a considerable growth on account of 16.2 percent growth in federal tax collection, of which FBR tax collection during the same period grew by 12.7. During first nine months of current fiscal year, FBR tax collection reached to Rs. 1,775.1 billion against Rs. 1,574.8 billion in the comparable period last year. While it stood at 6.5 percent of GDP during July-March 2014-15 against 6.3 percent of GDP in the same period of fiscal year 2013-14.

However, during July- March, 2014-15 non tax revenue witnessed a decline and reached to Rs. 619.5 billion from Rs. 691.2 billion in the comparable period of 2013-14. Of which Rs. 222.5 billion were accumulated as SBP profit followed by Rs. 154.3 billion under defence, Rs. 61.0 billion under royalties on oil/gas, Rs. 54.8 billion as dividend and Rs. 26.7 billion as foreign grants.

On expenditure side, total expenditure amounted to Rs. 3,731.6 billion during July-March, 2014-15 against Rs. 3,446.2 billion. Of which, current expenditure grew by 10.1 percent and amounted to Rs. 3,199.1 billion against Rs. 2,904.6 billion in the comparable period last year. During first nine months of current fiscal year, total expenditure as percent of GDP reduced to 13.6 percent against 13.7 percent of GDP in the same period last year.

Within current expenditure, expenditure on markup payments amounted to Rs.974.5 billion during July-March, 2014-15 against Rs.909.1 billion in the same period last year. While defence expenditure stood at Rs. 485.9 billion against Rs. 451.7 billion during the period under review. Similarly, current subsidies reached to Rs. 185.9 billion during July-March, 2014-15. Of which electricity subsidies stood at Rs.178.7 billion. In this regard it is important to mention that in an effort to move to full cost recovery, the government rationalized the tariffs. The tariff differential between the NEPRA determined tariff (NDT) and proposed tariff for fiscal year 2013-14 decreased substantially and subsidies were targeted to vulnerable consumers in the residential and agriculture categories. The resolve is to continue to protect this group.

Development expenditure and net lending grew by 6.9 percent during July-March, 2014-15 and reached to Rs.594.0 billion against Rs. 555.8 billion in the same period last year. One of the important development is a remarkable increase in PSDP which has witnessed a growth of 27.1 percent and reached at Rs. 499.4 billion against Rs. 393.0 billion in the comparable period of fiscal year 2013-14. Overall development expenditures registered a remarkable growth of 23.4 percent during the same period. Within PSDP, Federal and Provincial ADP grew by 7.6 and 46.0 percent, respectively, during first nine months of current fiscal year against.

Another important development witnessed during the current fiscal year is the improved pattern in financing of fiscal deficit, from domestic non-bank and external resources have been increased. Going forward, the inflows from external resources, particularly, successful issuance of Sukuk, seven tranches from IMF and inflows from other international financial institutions on account of improved economic performance, privatization proceeds of Rs. 15.2 billion has also helped the government in financing the deficit.

FBR Tax Collection (July-April, 2014-15)

During fiscal year 2013-14, FBR has collected Rs. 2,254.5 billion against the target of Rs. 2,275 billion and compared to the collection of Rs. 1,946 billion during 2012-13, thus posted a growth of 15.8 percent. Consequently, the tax GDP ratio has enhanced to 9.0 percent from 8.7 percent which itself a significant indicator of the government reform agenda. During July-April, 2014-15, FBR has collected Rs. 1972.4 billion as provisional tax revenues against Rs.1744.9 billion reflecting a growth of 13.0 percent.

During the current fiscal year, a number of compensatory measures were introduced to maintain the tax revenues at modest level after the significant fall in international oil prices and resultant decline in domestic retail fuel prices which has severely affected the tax revenues, like increase in GST rate on petroleum products from 17 percent to 22 percent and then to 27 percent , introduction of additional revenue measures at federal level to meet the shortfall including levying regulatory duties on imports of more than 300 items and levying a 2 percent withholding tax on non-filers service providers and importers.

Table 4.5: FBR Tax Revenues (Rs. Billion)

Revenue Heads	July-April		% Change
	2013-14	2014-15	
A. DIRECT TAXES			
Gross	708.9	837.5	18.1
Refund/Rebate	50.9	61.5	
Net	**658.1**	**775.9**	17.9
B. INDIRECT TAXES			
Gross	1,125.3	1,245.0	10.6
Refund/Rebate	38.5	48.5	
Net	**1,086.9**	**1,196.5**	10.1
B.1 SALES TAX			
Gross	825.7	882.3	6.9
Refund/Rebate	30.5	40.3	
Net	**795.2**	**842.1**	5.9
B.2 FEDERAL EXCISE			
Gross	104.0	119.6	15.0
Refund/Rebate	0.0	0.0	

Table 4.5: FBR Tax Revenues (Rs. Billion)

Revenue Heads	July-April		% Change
	2013-14	2014-15	
Net	**104.0**	**119.6**	15.0
B.3 CUSTOM			
Gross	195.6	243.0	24.2
Refund/Rebate	8.0	8.2	
Net	**187.7**	**234.8**	25.1
TOTAL TAX COLLECTION			
Gross	1,834.3	2,082.4	13.5
Refund/Rebate	89.4	110.0	
Net	**1,744.9**	**1,972.4**	13.0

Source: Federal Board of Revenue

Direct Taxes

The net collection of direct taxes has registered a growth of 17.9 percent during the first ten months of fiscal year 2014-15. The net collection has increased from Rs. 658.1 billion during July-April, 2013-14 to Rs. 775.9 billion in the same period of current fiscal year. Bulk of the tax revenues of direct taxes is realized from income tax. The components of income tax are withholding tax, voluntary payments and collection on demand.

Indirect Taxes

Sales Tax

Gross and net collection of sales tax has increased from Rs. 825.7 billion and Rs. 795.2 billion to Rs.882.3 billion and Rs. 842.1 billion respectively, thus registered a growth of 6.9 and 5.9 percent, respectively. In fact, 53.1 percent of total sales tax has been contributed by sales tax on import while the rest has been contributed by domestic sector. Within net domestic sales tax collection, the major contribution emanated from POL products, fertilizers, natural gas, cement, electrical energy, beverages, cigarettes, sugar etc. On the other hand, POL products, plastic, edible oil, vehicles, machinery, chemicals, oilseeds etc contributed significantly to the collection of sales tax from imports.

Customs Duty

Customs duty collection has registered growth of 24.2 percent and 25.1 percent in both gross and net terms, respectively. The gross and net collection have increased from Rs.195.6 billion and Rs.187.7 billion during July-April 2013-14 to Rs. 243.0 billion and Rs. 234.8 billion, respectively. The major revenue spinners of custom duty have been vehicles, automobiles, edible oil, petroleum products, machinery, plastic, iron and steel, paper and paperboard etc.

Federal Excise Duty

The collection of Federal Excise Duties (FED) during July-April, 2014-15 has recorded 15.0 percent growth. The net collection stood at Rs. 119.6 billion during July-April, 2014-15 as against Rs. 104.0 billion during the same period last year. The major revenue spinners of FED are cigarettes, cement, beverages, natural gas and international travel.

Provincial Budget

The total outlay of the four provincial budgets for 2014-15 stood at Rs. 2,257.1 billion, 29.9 percent higher than the outlay of Rs. 1,737.7 billion last year.

Table 4.6: Overview of Provincial Budgets (Rs Billion)

Items	Punjab		Sindh		KPK		Baluchistan		Total	
	2013-14 RE	2014-15 BE	2013-14 RE	2014-15 BE	2013-14 RE	2014-15 BE	2013-14 RE	2014-15 BE	2013-14 RE	2014-15 BE
A. Tax Revenue	**746.3**	**968.5**	**387.5**	**488.4**	**217.4**	**273.9**	**127.6**	**146.6**	**1,478.8**	**1,877.4**
Provincial Taxes	96.4	164.7	79.1	107.0	11.7	19.5	2.8	3.5	190.0	**294.7**
GST on Services (transferred by federal govt)	0.0	0.0	0.0	0.0	0.0	0.0	1.5	1.9	1.5	**1.9**
Share in Federal Taxes	649.9	803.8	308.4	381.4	205.7	254.4	123.3	141.2	1,287.3	**1,580.8**
B. Non-Tax Revenue	**34.1**	**32.6**	**77.3**	**101.7**	**46.9**	**82.8**	**17.8**	**22.1**	**176.1**	**239.2**
C. All Others	**42.4**	**35.3**	**19.1**	**36.0**	**36.4**	**17.8**	**36.7**	**31.3**	**134.6**	**120.3**
Total Revenues (A+B+C)	**822.8**	**1,036.4**	**483.9**	**626.1**	**300.7**	**374.5**	**182.1**	**200.0**	**1,789.5**	**2,236.9**
a) Current Expenditure	**569.3**	**699.9**	**328.2**	**436.0**	**187.1**	**249.9**	**120.3**	**120.9**	**1,204.9**	**1,506.7**
b) Development Expenditure	**224.0**	**345.0**	**152.0**	**215.0**	**104.8**	**139.7**	**52.0**	**50.7**	**532.8**	**750.4**
Total Exp (a+b)	**793.3**	**1,044.9**	**480.2**	**651.0**	**291.9**	**389.6**	**172.3**	**171.6**	**1,737.7**	**2,257.1**

Source: Provincial Finance, Finance Division

The total budget outlay of Rs. 2,257.1 billion is shared in the ratio of 66.8 percent and 33.2 percent between current and development expenditures, respectively. The allocation for development expenditure is 40.8 percent higher than last year and current expenditure is higher by 25.0 percent.

Allocation of Revenues between the Federal Government and Provinces

Currently, 7th National Finance Commission (NFC) Award (2009) is operative. Through this Award, the financial autonomy of the provinces has been strengthened by increasing their share in the Divisible Pool (taxes) from 50 percent to 56 percent in fiscal year 2010-11 and to 57.5 percent from fiscal year 2011-12 onwards. Under 7th NFC award, multiple indicators were adopted for distribution of provincial shares in the divisible pool whereas in all the previous awards, population remained as sole criterion for distribution of provincial share in the divisible pool with special grants (subventions) to smaller provinces.

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

	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15 B.E
Divisible Pool	574.1	834.7	1,063.1	1,117.5	1,287.4	1,580.8
Straight Transfer	81.2	163.0	145.6	103.5	124.4	137.5
Special Grants/ Subventions	82.0	54.1	53.9	61.2	53.8	32.7
Project Aid	16.0	21.9	47.8	71.3	85.2	103.6
Program Loans	0.0	0.0	4.6	4.2	59.1	48.1
Japanese Grant	0.0	0.1	0.1	0.0	0.0	0.1
Total Transfer to Province	**753.3**	**1,073.7**	**1,315.0**	**1,441.5**	**1,611.5**	**1,904.7**
Interest Payment	18.7	18.5	12.9	14.8	14.1	13.0
Loan Repayment	24.0	32.4	36.1	32.1	38.7	39.4
Transfer to Province(Net)	**710.6**	**1,022.8**	**1,266.0**	**1,394.5**	**1,558.8**	**1,852.3**

Source: Various issue of Budget in Brief.

During fiscal year 2014-15, net transfers to provinces are projected to increase to Rs. 1,852.3 billion, an increase of 18.8 percent over the revised transfer of Rs. 1,558.8 billion in 2013-14.

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

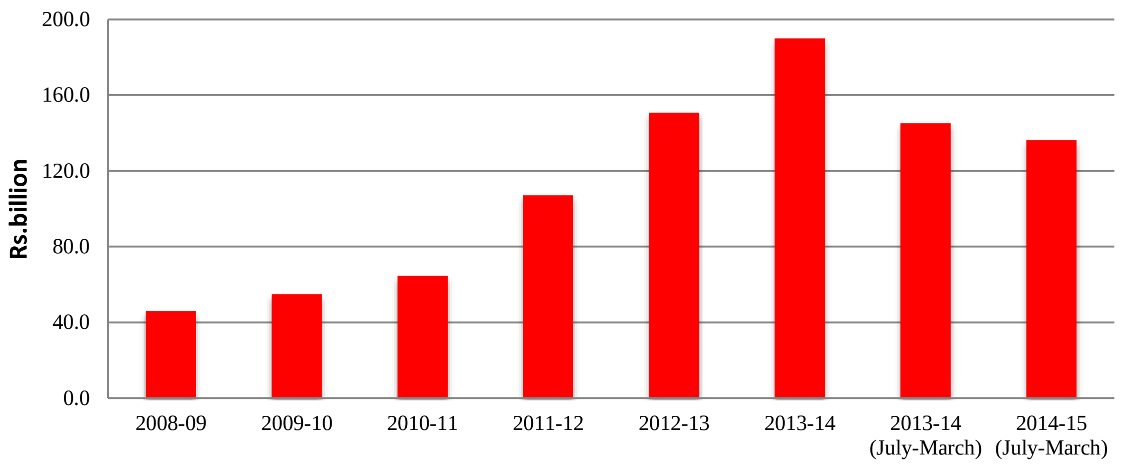
Items	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	July-March	
							2014-15	2013-14
A. Tax Revenue	571.7	688.3	1,063.9	1,197.1	1,365.7	1,596.2	1,252.8	1,153.9
Provincial Taxes	46.1	54.8	64.6	107.2	150.7	190.0	145.2	136.2
Share in Federal Taxes	525.6	633.5	999.3	1,089.9	1,215.0	1,406.3	1,107.6	1,017.8
B. Non-Tax Revenue	83.8	67.9	62.3	48.0	71.3	49.4	36.9	34.7
C. All Others	95.0	120.0	85.1	88.6	107.4	121.8	71.5	59.4
Total Revenues (A+B+C)	750.5	876.2	1,211.3	1,333.7	1,544.4	1,767.4	1,361.2	1,248.0
a) Current Expenditure	564.2	646.2	831.2	980.6	1,110.0	1,187.4	953.0	831.4
b) Development Expenditure	201.8	258.4	245.6	375.4	371.5	430.5	291.5	199.7
Total Exp (a+b)	766.0	904.6	1,076.8	1,356.0	1,481.6	1,617.9	1,244.4	1,031.1

Source: Fiscal Operations (various issues), Budget Wing

A cursory look at Table 4.8 reveals that provincial tax revenues shows significant growth in post devolution period. During 2013-14, overall tax revenues increased by 16.9 percent against 14.1 percent in 2012-13. The increase in tax revenue during 2013-14 was shared by 26.1 percent rise in provincial taxes and 15.7 percent increase in federal transfers. About 80 percent of provincial revenues came from their shares in the divisible pool during fiscal year 2013-14. However, provinces' own revenue receipts are also on continuous rise mainly due to GST collection on services. The share of provincial tax collection in total revenues has increased from 5.3 percent in fiscal year 2010-11 (before the 18th Amendment), to 10.8 percent during fiscal year 2013-14.

During July-March, 2014-15, tax collection witnessed modest increase as provincial taxes stood at Rs.1,252.8 billion against Rs.1,153.9 billion in the comparable period of 2013-14, while federal transfers to provinces reached to Rs.1,107.6 billion against Rs.1,017.8 billion during the same period under review. Hence, following a growth of 8.6 percent in provincial taxes and 8.8 percent in federal transfers, provincial surplus amounted to Rs.194.0 billion.

Fig-4: Provincial Taxes



On the other hand expenditure witnessed sharp rise as it posted a growth of 20.7 percent and reached to Rs.1,244.4 billion during the first nine months of current fiscal year against Rs.1,031.1 billion in the same period of fiscal year 2013-14. Increase in total expenditures was mainly driven by higher growth in the development expenditures as it grew by 46.0 percent during the period under review.

Medium Term Budgetary Framework (MTBF)

The annual budget of the federal government is based on a Medium Term Budgetary Framework (MTBF). The MTBF is an approach to budgeting that integrates policy-making, planning and budgeting within a medium-term framework.

The MTBF has provided the framework for budget preparation in all ministries/division and departments of the federal government since 2009. The MTBF has introduced three innovations:

- The Budget Strategy Paper
- Performance Based Budget (also known as MTBF Green Book) and
- Government Performance Monitoring Report

Through the MTBF reform, the budget preparation and monitoring processes have been strengthened. The MTBF Green Book is the key mechanism of the government to define performance (goals, outcomes, outputs etc) in the shape of performance indicators and targets. Processes are being put in place to monitor service delivery of ministries on regular basis.

For the next year, the Finance Division plans to work on Result Based Management (RBM) system in consultation with the Planning Commission. The RBM system will align planning, budget preparation, budget implementation with execution and monitoring processes to focus on achievement of result. In addition, the Finance Division is planning to start work on development of a comprehensive Public Financial Management reforms strategy to strengthen further fiscal reforms.

Way Forward:

Despite the headwinds at the onset of new fiscal year due to political unrest, security related operations, legal challenges to privatization; taxation and energy sector reform Pakistan's economy remained resilient. Particularly, economy has successfully followed the path of fiscal discipline due to strenuous efforts by the government in order to contain expenditures through expenditure management strategy and revenue building measures. Furthermore decline in international oil prices also helped in reducing the pressures on external and fiscal sector.

Fiscal development during the first nine months of current fiscal year has laid down the foundation of long term economic growth. Fiscal deficit has been successfully curtailed to 3.8 percent of GDP during July-March, 2014-15 from 3.9 percent of GDP in the comparable period last year. Pakistan has not only successfully contained the fiscal deficit but has also met end March performance criteria on the budget deficit with IMF. Encouragingly, it will help to restrict the overall budget deficit at 5.0 percent of GDP for the entire fiscal year 2014-15.