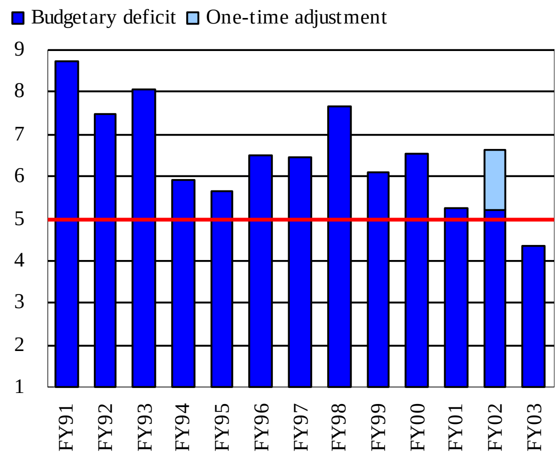
4 Public Finance and Fiscal Policy

4.1 Overview

Quite unlike FY02, when a one-time expenditure jump had reversed the fiscal consolidation, FY03 saw a decisive fall in the fiscal deficit to 4.4 percent of GDP. The year therefore marks an important watershed in the government's efforts to cut the fiscal deficit, in that: (1) this is the first time in decades that the annual fiscal deficit target has been met (or exceeded); and also (2) the first time in over 25 years that the fiscal deficit has moved below 5 percent of GDP (see **Figure 4.1**).

Figure 4.1: Budgetary Deficit (percent of GDP)



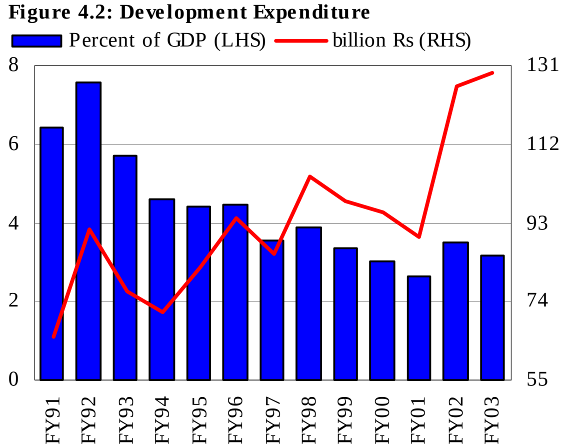
Also, it is quite heartening to note that the greater part of the improvement stems from a sharp jump in revenues - consolidated tax receipts in particular depicted a 16.2 percent YoY increase during FY03, considerably higher than the 8.3 percent growth recorded in FY02.

While the fiscal adjustment efforts deserve credit, there are a couple of issues that merit further consideration:

1) Firstly, a glance at **Figure 4.2** shows that over the years the decline in the fiscal deficit was at least partially due to a reduction in developmental expenditures relative to the economy. The fall in FY03 development expenditures to GDP ratio was therefore particularly disappointing. The government appears to have recognized this problem, as evident in the increased FY04 developmental outlays.
2) Secondly, a significant contribution to the reduction in the fiscal deficit during FY03 is through a strong growth in defense receipts.

   Therefore, at face value it would appear that the reduction in the fiscal deficit might not be sustainable in future, as these non-structural receipts would not flow in the future. To the extent that these receipts financed increased defense spending incurred in providing logistic support etc. to international forces in Afghanistan, there is no cause of concern. But, if for some reason they did set up some recurring demands the domestic receipts would have to foot the bill.

Figure 4.2: Development Expenditure



Notwithstanding the satisfactory fiscal performance witnessed in FY03, it is important to recall that

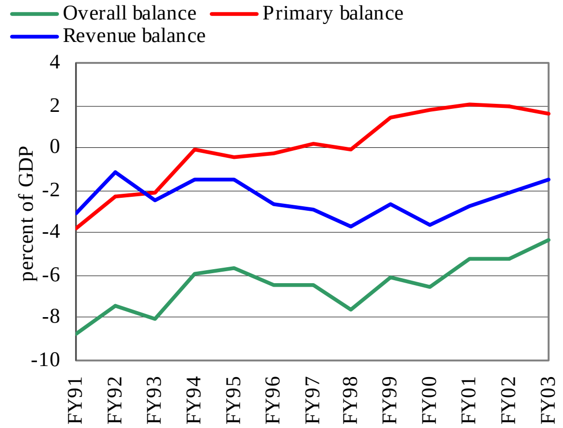
Pakistan still remains heavily burdened by the debt incurred in the past, and needs to generate sustained primary fiscal surpluses for years to come.[1] Moreover, it is imperative that the requisite fiscal prudence be evident in current rather than developmental spending (which needs to accelerate) if the economy's ability to carry debt is to improve.

To this end, therefore, the government should hasten to send a strong signal to investors and businessmen through the passage of the draft Fiscal Responsibility Law. At the same time it must ensure that the resulting fiscal space, in coming years, is used to increase investments in human development and infrastructure.

4.2 Fiscal Performance Indicators

The broad improvement in the Pakistan fiscal profile during FY03 is mirrored in the changes in most of the key fiscal indicators during FY03.

Figure 4.3: Balance Indicators



4.2.1 Fiscal Balance Indicators

In aggregate, fiscal balance indicators show that the broad recovery in Pakistan's fiscal position since FY98 continued into FY03 as well (see **Figure 4.3**). While the overall balance remains negative in FY03 (i.e., the budget deficit persisted), a trend improvement is clearly evident. This not only reflects the FY03 reduction in the budget deficit, in absolute terms, but also the increased capacity of the growing economy to service the debt. However, a large amount of contingent liabilities, both implicit and explicit, remains a matter of concern.[2] In fact, contingent liabilities are estimated to be around Rs 75 billion (1.3 percent of GDP).

The revenue balance, which measures the share of revenues captured by non-development expenditures, also improved in FY03. Here too, the deficit fell from 2.1 percent of GDP in FY02 to 1.6 percent of GDP in FY03 (its lowest level during last five years). The reduction in the revenue deficit was primarily achieved on the back of a strong increase in revenues coupled with a decline in debt servicing costs. It is imperative that the revenue should be able to finance non-development expenditure in totality and borrowed funds are used only for productive development expenditures. Tax revenue to GDP ratio needs to be raised to at least eliminate revenue deficit.

Contrary to the improvement in overall and revenue balances, the primary balance saw a marginal deterioration during FY03 due to a more pronounced decline in interest payment compared to the decline in the budget deficit. Thus, the primary balance fell from 2.0 percent of GDP in FY02 to 1.6 percent of GDP in FY03.

[1] Despite considerable improvement in recent years, Pakistan's aggregate debt to GDP ratio remains amongst the highest in the World.

[2] Explicit liabilities are specific government obligations defined by a contract or a law, in this case the government is legally mandated to settle such an obligation when it becomes due i.e. guarantees for borrowing and obligations of provincial governments and public or private entities. While implicit liabilities are a moral obligation or expected burden for the government not in the legal sense, but based on public expectations and political pressure i.e., liability clean up in entities being privatized and bank failures.

4.2.2 Revenue Indicators

Pakistan's revenue indicators for FY03 depict some modest improvement over the corresponding FY02 figures. The *total-revenue-to-GDP* ratio rose to a ten-year high of 17.7 percent in FY03 compared with 17.2 percent in FY02 **(**see **Table 4.1 & Figure 4.4).**

Table 4.1: Summary of Public Finance- Consolidated Federal and Provincial Governments

billion Rupees

	FY99	FY00	FY01	FY02^{RE}	FY03^{PE}	YoY change (absolute)
1 Revenue receipts (a+b)	468.6	512.5	553.0	624.1	720.7	96.6
a) Tax revenue	390.7	405.6	441.6	478.1	555.8	77.7
b) Non-tax receipts	77.9	106.9	111.4	146.0	164.9	18.9
2 Total expenditure (a+b)	647.8	709.1	717.9	826.2	898.1	71.9
a) Current	547.3	626.4	645.7	700.2	781.9	81.7
b) Development	98.3	95.6	89.8	126.2	129.2	3.0
c) Net lending to PSEs etc.	2.2	-12.9	-17.6	-0.2	-22.7	-22.5
d) Statistical discrepancy	n.a.	9.7	14.8	-13.0	9.8	22.8
3 Revenue surplus/deficit (1-2.a)	-78.7	-113.9	-92.7	-76.1	-61.2	14.9
4 Overall deficit (1-2)	-179.2	-206.3	-179.7	-189.1	-177.4	11.7
5 Financing through:	179.2	206.3	179.7	189.1*	177.4	-11.7
a) External resources (net)	97.1	69.7	120.7	82.8	88.3	5.5
b) Internal resources (i+ii)	82.1	136.6	59.0	106.3	89.1	-17.2
i) Domestic non-bank	155.9	96.7	92.0	85.0	146.8	61.8
ii) Banking system	-73.8	39.9	-33.0	12.9	-69.1	-82.0
iii) Privatization proceeds	n.a.	n.a.	n.a.	8.4	11.3	2.9
As percent of GDP (mp)						
1. Revenue receipts (a+b)	15.9	16.3	16.2	17.2	17.7	0.5
a) Tax revenue	13.3	12.9	12.9	13.2	13.7	0.5
b) Non-tax receipts	2.7	3.4	3.3	4.0	4.1	0.0
2. Total expenditure (a+b)	22.0	22.5	21.0	22.8	22.1	-0.7
a) Current	18.6	19.9	18.9	19.3	19.2	-0.1
b) Development@	3.3	3.0	2.6	3.5	3.2	-0.3
c) Net lending to PSEs etc.	0.1	-0.4	-0.5	0.0	-0.6	-0.6
3. Revenue surplus/deficit (1-2.a)	-2.7	-3.6	-2.7	-2.1	-1.5	0.6
4. Overall deficit (1-2)	-6.1	-6.6	-5.2	-5.2	-4.4	0.8
5. Financing through:	6.1	6.6	5.2	5.2	4.4	-0.8
a) External resources (net)	3.3	2.2	3.5	2.3	2.2	-0.1
b) Internal resources (I+ii)	2.8	4.3	1.7	2.9	2.2	-0.7
i) Domestic non-bank	5.3	3.1	2.7	2.3	3.6	1.3
ii) Banking system	-2.5	1.3	-1.0	0.4	-1.7	-2.1
iii) Privatization proceeds	n.a.	n.a.	n.a.	0.2	0.3	0.0

Source: Budget Wing, Finance Division, Islamabad

R.E: Revised Estimates; P.E: Provisional Estimates

@ From 1998-99 onward, also include lending to PSEs

*:If one-off expenditure of Rs. 52 billion incurred on KESC recapitalization (Rs.32 billion) and CBR bonds (Rs.20 billion), is accounted for the fiscal deficit will be 6.6 percent of GDP.

This improvement, and the related rise in the *tax-to-GDP* ratio primarily reflects the success of the government's efforts to widen the tax base and improve tax administration, due to which tax growth has outstripped the growth in the economy. However, improvement witnessed in *non-tax-revenue to-GDP* ratio in FY03, despite a sharp fall in SBP profits was mainly due to a rise in defense receipts.

4.2.3 Expenditure Indicators

On an aggregate level, the focus on lowering the fiscal deficit through lower development spending over the years is quite evident in **Figure 4.6**.

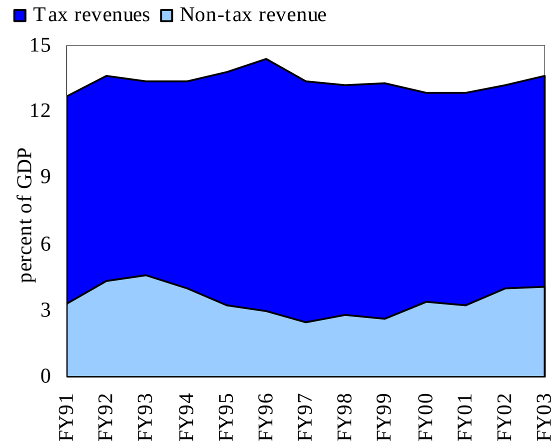


Figure 4.4: Trends in Revenue Receipts

Clearly, there has been an across the board improvement in the current expenditure profile by FY01, with a sharp reduction in interest payments, a decline in defense spending and in general administration. In fact, the only segment that saw an increase in spending was general subsidies, which essentially reflected the impact of the deterioration in the financial position of the two power utilities, WAPDA and KESC.

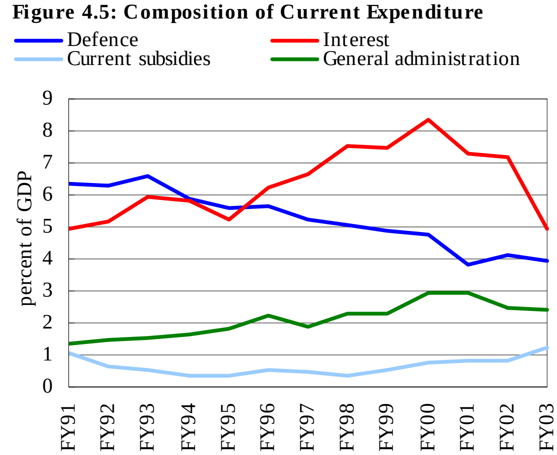


Figure 4.5: Composition of Current Expenditure

The sharp fall in the expenditure share of interest payments and defense is particularly heartening given that these two heads alone had accounted for over two thirds of the government expenditures by FY00 and made the structure of expenditure highly inflexible. So expenditure reduction was achieved in the 1990s at the cost of development expenditure (see **Figure 4.6**).

As government's own investments in infrastructure and human development have an important role in "crowding in" private investments, a sustained reduction in development expenditure is clearly counter-productive.

4.3 Fiscal Developments at Federal Level

The revised federal budget revenue receipts stood at Rs 701.6 billion, up by 13.3 percent during FY03 over FY02. This figure is also 4.0 percent higher than the budget target for the year. The improvement is contributed by, both tax and non-tax revenues (see **Table 4.2**). The revised federal expenditures on the revenue account were Rs 709.2 billion in FY03, 2.1 percent higher than in the previous year. Thus on revenue account, the Federal Government's own budget was almost in balance in FY03. This represents an acceleration of a trend, which began in FY01.

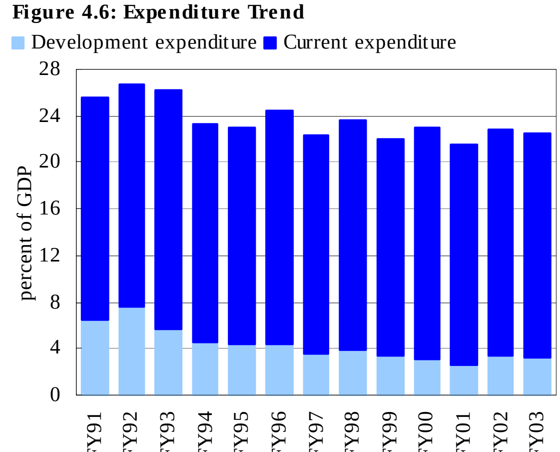


Figure 4.6: Expenditure Trend

4.3.1 CBR Tax Performance

Helped by a realistic tax target, a broad improvement in the economy and rising imports, as well as various administrative measures, the CBR turned in an exceptional performance during FY03, comfortably *exceeding* the annual 13.6 percent target growth for the period (see **Figure 4.7**). The growth represents a significant improvement over the insipid 3 percent increase witnessed in FY02 (see **Table 4.3**).

This the first time in the past 10 years that the annual tax target has been achieved, and it is all the more impressive given that the tax increase target for FY03 was quite robust, in comparison with recent years.

As evident from **Table 4.3**, indirect taxes accounted for approximately 67 percent of the aggregate net tax receipts, with approximately half being accounted for by sales tax alone. However, in terms of the annual target, indirect taxes fell short of the mark due to under performance by both sales tax and excise duty, but this was almost offset by the above-target performance of direct taxes and customs receipts.

Despite the strong FY03 performance, the overall CBR tax to GDP ratio has seen only a small up tick from 11.0 in FY02 to 11.3 percent in FY03. In fact, as seen in **Figure 4.8**, this ratio has remained in the 10.5 percent and 11.5 percent range since FY98, which is lower than average of 11.9 percent for preceding 6 years. Clearly, while the tax reforms have helped raise (and stabilize) direct tax receipts by about 2.0 percent of GDP, the limited revenue yield from indirect taxes continues to be a drag on the aggregate tax performance.

Table 4.2: Federal Government Fiscal Performance

billion Rupees

	FY00	FY01	FY02	FY03
Revenue receipts	531.3	535.1	619.1	701.6
Tax revenue	386.0	422.8	459.1	525.8
Non tax revenue	145.3	112.3	159.9	175.8
Revenue expenditure	604.4	612.7	694.5	709.2
Current expenditures	592.5	593.6	650.4	673.3
Development expenditures	11.8	19.1	44.1	35.9
Balance on revenue account	-73.1	-77.6	-75.4	-7.6
	Percent of GDP			
Revenue receipts	16.9	15.6	17.1	17.3
Tax revenue	12.3	12.4	12.7	12.9
Non tax revenue	4.6	3.3	4.4	4.3
Revenue expenditure	19.2	17.9	19.1	17.5
Current expenditures	18.8	17.3	17.9	16.6
Development expenditures	0.4	0.6	1.2	0.9
Balance on revenue account	-2.3	-2.3	-2.1	-0.2

Source: Annual Budget Statement, Government of Pakistan

Figure 4.7: Growth of CBR Targets and Actual Tax Collections

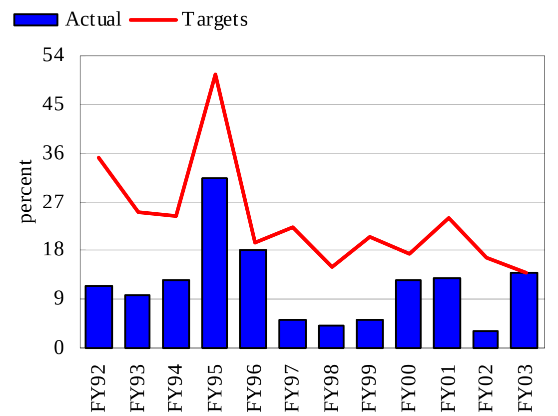


Table 4.3: Actual Tax Collections (Net) by CBR

billions Rupees

	Actual ollections				Target for	Target achievement		Projected	Increase\decrease in percent			
	FY00	FY01	FY02	FY03	FY03	Absolute	Percent	FY04	FY01	FY02	FY03	FY0
Direct taxes	113.0	124.6	142.5	151.3	148.4	2.9	2.0	161.1	10.3	14.4	6.2	6.5
Indirect taxes	234.2	267.7	261.6	308.9	310.5	-1.6	-0.5	348.9	14.3	-2.3	18.1	12.9
Sales tax	116.7	153.6	166.6	194.8	204.0	-9.2	-4.5	223.1	31.6	8.5	17.0	14.5
Central excise	55.8	49.1	47.2	45.0	47.5	-2.5	-5.3	47.7	-12.0	-3.9	-4.6	6.0
Customs	61.7	65.0	47.8	69.1	59.0	10.1	17.1	78.1	5.5	-26.5	44.5	13.0
Total	**347.1**	**392.3**	**404.1**	**460.2**	**458.9**	**1.3**	**0.3**	**510.0**	**13.0**	**3.0**	**13.9**	**10.8**

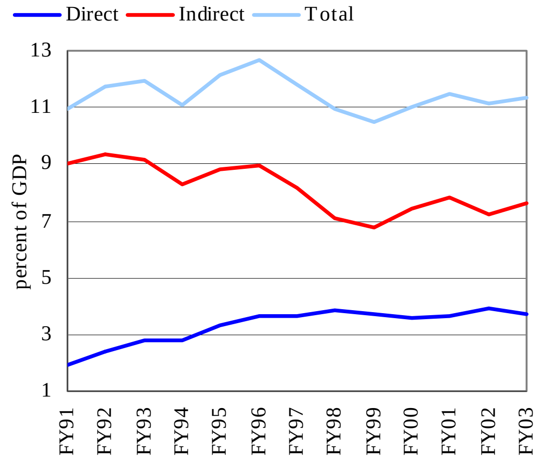
Source: Central Board of Revenue

4.3.2 Refunds and Gross Collections

There have been some views that the strong FY03 net tax receipts may, in part, reflect that accrued tax refunds were withheld to inflate the annual (net) tax collections.

One reason behind this concern is that the 10.9 percent growth in gross tax receipts for FY03 is substantially lower than the 13.9 percent growth in the corresponding net receipts. However, on closer scrutiny this is easily explained by fact that in FY02 exceptionally high refunds were disbursed to clear the accumulated arrears. Thus the FY02 net collections were much lower than trend. Following this large adjustment, the FY03 net collections resumed their normal growth path (see **Table 4.3**).

Figure 4.8: Composition of CBR Taxes



The disbursed refunds declined from Rs 79.3 billion in FY02 to Rs 75.6 billion in FY03, even though exports were higher in the latter year (which would be expected to translate into higher refunds). In fact, the FY03 refunds are only Rs 3.7 billion lower than that paid in FY02 (despite the absence of any arrears and also the fact that the duty drawback rates were cut down). As a result, refunds as a share of tax collected reached 14.1 percent (see **Table 4.4** and **Figure 4.9**). Thus, the unexpectedly strong payments may be attributed to the robust growth in the exports and the greater transparency in the refund repayment system due to the introduction of the Sales and Automated Refund Repository (STARR) network.

Table 4.4: Gross Collections

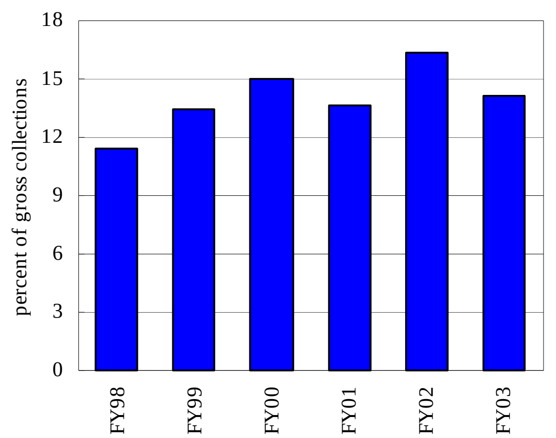
billion Rupees

Year	Gross collections	Refund		Actual collections	YoY percentage change	
		Absolute	Percent		Actual	Gross
FY98	331.1	37.9	11.5	293.1	2.5	n.a.
FY99	356.4	47.9	13.4	308.5	5.1	7.7
FY00	407.6	61.0	15.0	346.6	12.3	14.4
FY01	454.4	62.1	13.7	392.3	13.0	11.5
FY02	483.3	79.3	16.4	404.1	3.0	6.4
FY03	535.8	75.6	14.1	460.2	13.9	10.9

Source: Central Board of Revenue

However, there is a sharp drop in refund payments in the *final* months of FY03 (see **Figure 4.10**). Given that exports usual surge during this period, the decline in refund payments is certainly surprising, particularly given the CBR claim that the time lag between the filing of the refund claim and its payment (after verification) has been sharply curtailed. Interestingly, the fall in refund payments is visible in both July FY02 as well as the corresponding month of FY03, leaving the relative performance in the two years roughly unaffected.

Figure 4.9: Trend of Total Refunds



Direct Taxes

After under-performing on targets during much of FY03, direct taxes surged strongly during Q4-FY03 to reach Rs 151.3 billion by end-June FY03; 2.2 percent over the target and 6.2 percent over the FY02 collections (see **Table 4.3**). The above-target growth of the direct taxes appears to be a result of increasing economic activity as well as growth in the taxpayer base,[3] and withdrawal of exemptions in the FY02 budget

Withholding taxes (WHT) remained the biggest source of direct tax collections, accounting for approximately 76.4 percent of the aggregate direct taxes in FY03. The breakup of the withholding tax receipts (available only for the July-May period), suggest that three of the five major sub-categories: salaries, contracts and imports (all indicating a rise in economic activity) strongly contributed to the FY03 growth in withholding tax receipts.

The fall in the withholding tax receipts from the other two categories, interest income and income from securities probably reflects the steep drop in interest rates in the economy (see **Table 4.5**).

'*Voluntary payments*' and '*collection on demand*' are the other two main components of income tax. The collection on demand posted a small growth, which depicts improvement in the audit, detection and penalty imposition system (see **Table 4.6**). Within voluntary payments, private, public companies, banks and foreign companies, contributed the largest share of around 77 percent, and the individuals contribute the remaining 23 percent.[4] Voluntary payments registered a decline during FY03, largely on account of a sharp reduction in the payments by PTCL (from Rs 6.4 billion in FY02 to Rs 0.1 billion in FY03), and the expiry of the tax amnesty scheme.

Figure 4.10: Monthly Refunds

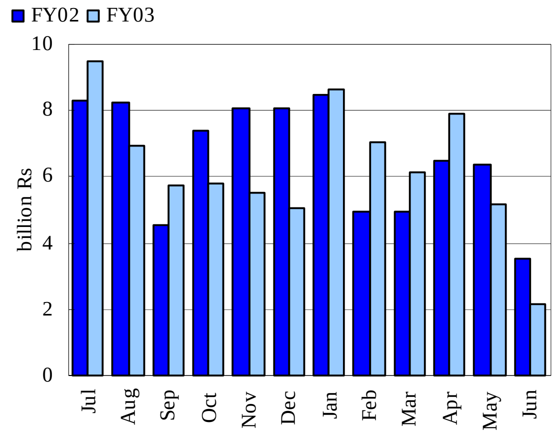


Table 4.5: A Comparison of Withholding Taxes (July-May)

billion Rupees

Collection Heads	FY02	FY03	YoY change Absolute	YoY change Percent
Contracts	16.3	19.5	3.1	19.1
Securities	5.6	4.5	-1.1	-19.8
Imports	17.5	19.2	1.7	9.7
Salary	7.4	8.2	0.8	10.1
Interest	5.6	5.2	-0.4	-7.1
a. Sub-total (five major items)	52.5	56.6	4.1	7.8
Percentage share in total WHT	76.0	76.4	0.4	0.5
b. Other WHT	16.6	17.5	0.9	5.6
c. Total WHT	69.1	74.1	5.0	7.2
Percentage share in gross income tax	54.4	57.1	-	-

Source: Central Board of Revenue

Table 4.6: A Comparison of Voluntary Payments and Collection on Demand (July-May)

billion Rupees

	FY02	FY03	YoY change Absolute	YoY change Percent
Voluntary payments	41.6	39.9	-1.6	-4.0
Collection on demand	15.5	15.7	0.2	1.1
a) Arrears demand	3.8	3.5	-0.3	-7.3
b) Current demand	11.8	12.2	0.5	3.8

Source: Central Board of Revenue

The real test of increased tax effort by administration and compliance would lie in higher share of voluntary payments and collection on demand, as the withholding taxes are captive payments made at the source of income.

[3] The number of individual taxpayers rose from 2.14 million in June FY02 to 2.21 million in March FY03.

[4] This category includes salaried and other individuals, association of persons, and registered and unregistered firms.

Sales Tax

Over the last few years, the government has increasingly focused on the general sales tax (GST) as the key source of tax revenue, and this momentum has continued into FY03 as well. A robust 17 percent growth in GST receipts pushed the FY03 receipts to Rs 194.8 billion, accounting for 42.3 percent of the aggregate CBR tax collections during the period. More importantly, the *incremental* GST receipts during FY03 accounted for a stunning 50 percent of the CBR tax *increase* witnessed during the year. However, despite this performance, the FY03 still fell 4.5 percent short (Rs 9.2 billion) in meeting the target (see **Table 4.3**).

Given the strong import growth, one would have expected the relative share of GST on imports to rise. But in actual fact, the share of GST on imports in total GST receipts declined to 54.1 percent in FY03, from the 55.7 percent recorded in FY02. This phenomenon is explained by: (1) tariff rationalization and (2) the exceptionally strong domestic sales tax collections; while 13.6 percent growth was registered in GST on imports, a far more robust 21.1 percent growth was achieved for domestic GST.

The strong growth in net domestic GST collections was despite the fact that 99.5 percent of the total Rs 43.9 billion FY03 GST refunds were on gross domestic receipts. Interestingly, while export growth has remained strong throughout FY03, the high GST refunds (relative to FY02) is visible mostly in the latter half of FY03.

A sectoral breakup of the GST collections reveals interesting insights (see **Figure 4.11**). While *imports* continue to contribute most of the GST receipts, there is a slow, but quite perceptible increase in the share of *services*. The contribution from *wholesale & retail trade*, in contrast, has shrunk 2.6 percent from its FY01 peak, despite about a 59.4 percent increase in the number of registered taxpayers over the period. However, while the tax receipts from the sector are disappointing, the increased documentation is nonetheless an important pre-requisite for future growth in GST receipts from the sector.

Figure 4.11: Sectoral GST Collection

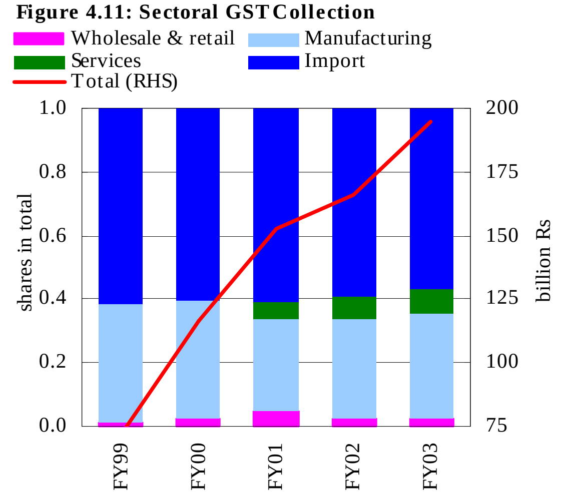
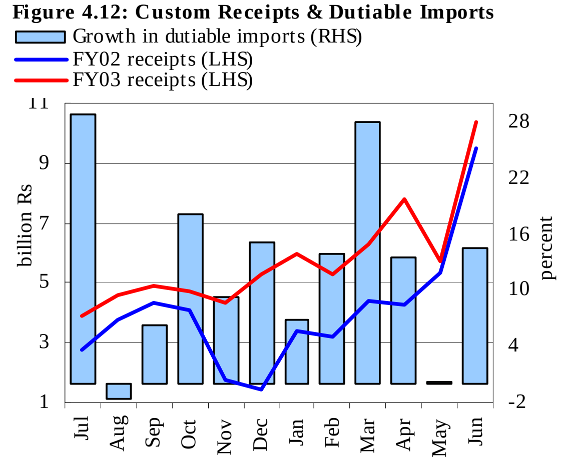


Figure 4.12: Custom Receipts & Dutiable Imports



Customs Duties

The exceptionally strong 44.5 percent increase in customs duty receipts during FY03, resulted in incremental receipts of Rs 10.1 billion over the FY03 target, to Rs 69.1 billion. This outcome eased the significant shortfall in sales tax receipts (see **Table 4.3**) and contributed to the achievement of the overall FY03 tax revenue target.

The higher customs duty collections were driven primarily by a 12.4 percent rise in dutiable imports during FY03, which coincided with a jump in the effective rate from an average of 18.5 percent in FY02 to an average of almost 19 percent during FY03 (see **Figure 4.12**). The rise in the effective duty rate, in turn, was driven by a fall in refunds paid on customs duty receipts, which dropped more than 35 percent, from Rs 26.8 billion in FY02 to Rs 17.2 billion in FY03. This fall in the refunds clearly indicates that a significant portion of the increased imports during the year pertained to goods for domestic consumptions (automobiles), or for investment (machinery imports), as much as intermediate inputs for exports.

In fact, during FY03 considerable increase was witnessed in customs duty collections of *transport and vehicles* (62 percent), *electrical machinery & equipment* (41 percent), *machinery & mechanical appliances* (26 percent) and *organic chemicals* (22 percent).

Central Excise Duty

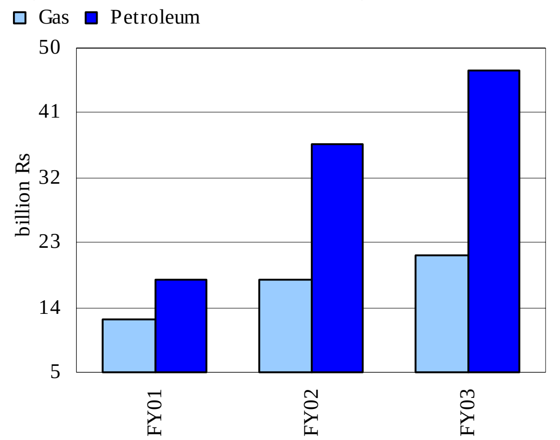
The FY03 CED receipts totaled Rs 45.0 billion, 4.6 percent lower than in FY02, and 5.3 percent lower than the FY03 target (see **Table 4.3**). The central excise duty is considered a dying tax, which is being replaced by the GST. Approximately 86 percent of the CED collections are from just 4 items, cigarettes, cement, beverages & beverage concentrates and natural gas. Not surprisingly, given this shift (e.g. services and sugar to GST and POL to custom duties, during FY03), and the below target collections, the share of CED in total tax collection declined to 9.8 percent in FY03.

4.3.3 Surcharges

The revenue from surcharges rose 21.9 percent to Rs 66.9 billion during FY03. As evident from **Figure 4.13**, most of this increase was due to a considerable growth in petroleum development surcharge collections, which rose 28.1 percent during the period, despite small reductions in the fixed per litre levy.[5]

The FY03 gas development surcharge receipts grew at a more moderate 11.6 percent, on the back of a small rise in the gas prices (as newer, more expensive, gas fields were brought on-line) and higher gas sales volumes.

Figure 4.13: The Pattern of Surcharges



4.3.4 Non-Tax Revenues

The non-tax revenue receipts in the consolidated government accounts stood at Rs 164.9 billion or 4.1 percent of GDP (see **Table 4.1** & **Figure 4.4**), these have posted a 13.0 percent growth in FY03 over FY02. Although, there were some setbacks on account of some heads like SBP profits (which were Rs 20 billion below budgetary target), WAPDA and NHA receipts, but this was largely compensated by income receipts from *civil administration*, and *dividend income* (Rs 9.9 billion from OGDC and Rs 12.3 billion from PTCL).[6] The higher share of civil administration reflects higher receipts under the sub-head of *defense*, due to logistic supports provided to the international forces.

[5] The growth in FY02 receipts had been much stronger due to the increased in the levy as well as rising volumes of petroleum product sales. While the levy had been declining in FY03, the average incidence was higher.

[6] As a result, the share of *civil administration*, *dividend income* and *interest income* in total non-tax revenues reached 32.6 percent, 16.1 percent and 15.9 percent respectively during FY03.

4.3.5 Federal Expenditures

The federal expenditures recorded an increase of Rs 11.7 billion over the previous year (see **Table 4.7**). While, current expenditures recorded a 10.7 percent rise as compared to FY03 budget estimates, developmental expenditures fell by 8.9 percent. The shortfall in revenue developmental expenditures is a matter of concern; it is an indicator of less spending on maintenance and provision of various social services. In contrast, capital developmental expenditures recorded a marginal increase of 1.7 percent in FY03 over budget estimates of FY03, and 9.5 percent over actual of FY02, even this increase is apparently due to a base effect as FY02 itself had shown a decline of 1.8 percent.

Table 4.7: Federal Government Expenditure
billion Rupees

						Excess/shortfall over			Change over FY03^BE	
Head	**FY00**	**FY01**	**FY02^PA**	**FY03^BE**	**FY03^RE**	**FY03^BE**	**FY02^PA**	**FY04^BE**	**Absolute**	**Percent**
I. Revenue expenditure (A+B)	604.4	612.7	694.5	647.3	709.2	9.6	2.1	704.5	-4.7	-0.7
A. Current expenditure	592.5	593.6	650.4	608.0	673.3	10.7	3.5	645.2	-28.1	-4.2
(i) Debt servicing	330.6	312.7	318.7	289.7	257.4	-11.1	-19.2	256.0	-1.5	-0.6
(ii) Defence	152.8	131.1	149.3	146.0	160.1	9.7	7.3	160.3	0.1	0.1
(iii) General administration	19.6	50.8	54.1	54.9	55.1	0.4	2.0	58.6	3.5	6.3
(iv) Grants and subventions	33.3	36.9	66.7	56.3	55.6	-1.3	-16.7	62.1	6.5	11.6
(v) Social services	10.5	9.9	13.2	13.9	13.6	-1.8	3.0	16.4	2.8	20.4
(vi) Law and order	9.0	10.1	10.8	11.6	11.7	0.1	8.1	12.3	0.7	5.9
(vii) Community services	5.8	6.5	7.9	8.2	8.1	-0.2	3.4	8.6	0.4	5.3
(viii) Subsidies	20.4	20.4	25.5	20.8	49.8	139.4	95.3	64.5	14.7	29.6
(ix) Economic services	3.0	5.9	3.9	4.1	4.1	-0.2	4.2	4.7	0.6	14.5
(x) Unallowable	7.5	9.2	0.3	2.5	57.7	2253.6	19946.5	1.9	-55.9	-96.8
B. Development expenditure	11.8	19.1	44.1	39.4	35.9	-8.9	-18.7	59.2	23.4	65.2
II. Capital disbursements (A+B)	137.1	95.4	254.3	121.5	152.0	25.2	-40.2	123.3	-28.7	-18.9
A. Current expenditure	59.6	30.8	193.0	55.5	84.9	53.0	-56.0	52.5	-32.4	-38.2
B. Development expenditure	77.5	64.5	61.3	65.9	67.1	1.7	9.5	70.8	3.7	5.5
Total expenditure (I+II)	741.4	708.1	948.7	768.8	861.2	12.0	-9.2	827.7	-33.5	-3.9

Source: Annual Budget Statement, Government of Pakistan
PA: Provisional Actual, BE: Budget Estimates, RE: Revised Estimates

The break up of current expenditures (revenue component) reveals that a substantial jump in unallocable spending (from Rs 0.3 billion in FY02 and budgetary estimates of Rs 2.5 billion to Rs 57.7 billion in FY03), that accounts largely for this overall rise, is the result of government's equity injection in KESC.

Similarly, defense expenditures witnessed a 7.3 percent rise due to troops demobilization from the eastern border and higher troop activities on the North Western border.

The other component of current expenditures, *subsidies* recorded substantial increase both as compared to budgetary estimates of FY03, and actual FY02 figures. This surge in subsides is largely attributed to WAPDA.

The above-mentioned spending increase comprising subsidies to WAPDA, addition to equity of KESC and higher defense expenditures were partially offset by a significant decline in debt servicing payments of Rs 32.3 billion. The gain in debt servicing was realized on the back of declining domestic & international interest rates and improvement in debt profile. The grants & subventions also recorded a fall as compared to budgetary estimates for FY03 and actual FY02 figures.

The aggregate development expenditures witnessed a fall as compared to both, budgetary estimates of FY03 and FY02 actual. It is largely attributed to a transitory period effect of change in the government in the first half of FY03. However, the issue of poor monitoring could not be ruled out.

4.4 The Budget-FY04

The federal budget for FY04 marks the continuation of fiscal consolidation seen in recent years, as the government has planned to reduce the budget deficit to 4.0 percent of GDP, down from the 4.4 percent recorded in FY03. The reduction in FY04 fiscal deficit is envisaged to come from a stricter control over current expenditures and higher revenues. Specifically, declining debt servicing charges and a reduction in unallocable expenditures are expected to play an important role in curtailing current expenditures. Developmental expenditures, which witnessed a below-target growth in FY03, are budgeted to increase by 65.2 percent (see **Table 4.7**).[7]

On the revenue side, an increase of 3.8 percent is expected during FY04 as compared to a 4.0 percent rise in FY03. Total revenue is expected to increase by 8.6 percent; solely on the back of tax receipts as both surcharges and non-tax receipts are estimated to decline in FY04. Within tax receipts, both direct and indirect taxes would be estimated to grow strongly (see **Table 4.8**).

Table 4.8: Federal Government Revenue Receipts

billion Rupees

					Excess/shortfall over			Excess over $FY03^{RE}$	
Head	**FY01**	**$FY02^{PA}$**	**$FY03^{BE}$**	**$FY03^{RE}$**	**$FY03^{RE}$**	**$FY02^{PA}$**	**$FY04^{BE}$**	**Absolute**	**Percent**
1. Revenue receipts (II+III+IV)	535.1	619.1	674.9	701.6	4.0	13.3	728.4	26.8	3.8
I. Total taxes and surcharges (II+III)	422.8	459.1	521.1	525.8	0.9	14.5	571.1	45.4	8.6
II. Total taxes (i+ii)	392.3	404.3	460.6	458.9	-0.4	13.5	510.0	51.1	11.1
(i) Direct taxes	124.6	142.6	148.4	145.0	-2.3	1.6	161.1	16.1	11.1
a) Taxes on income	117.5	136.6	143.2	138.8	-3.1	1.6	154.2	15.4	11.1
b) Wealth tax	1.5	0.5	0.0	0.0				0.0	
c) Workers welfare tax	5.0	5.0	4.3	5.6	30.2	13.0	6.2	0.6	10.7
d) Capital value tax	0.6	0.6	0.9	0.6	-33.3	-0.2	0.7	0.1	16.7
(ii) Indirect taxes	267.7	261.6	312.2	313.9	0.5	20.0	348.9	35.0	11.2
a) Customs	65.0	47.8	56.5	69.6	23.2	45.6	78.1	8.5	12.2
b) Central excise	49.1	47.2	50.0	46.5	-7.0	-1.5	47.7	1.2	2.6
c) Sales tax	153.6	166.6	205.7	197.8	-3.8	18.7	223.1	25.3	12.8
III. Surcharges	30.5	54.9	60.5	66.9	10.5	21.9	61.1	-5.7	-8.6
a) Petroleum	17.9	36.0	45.5	45.8	0.7	27.4	46.1	0.3	0.7
b) Natural gas	12.6	18.9	15.0	21.0	40.3	11.6	15.0	-6.0	-28.7
IV. Non-tax revenue	112.3	159.9	153.8	175.8	14.3	9.9	157.2	-18.6	-10.6
a) Property & enterprises	67.6	83.7	79.5	82.5	3.8	-1.4	92.4	9.9	12.0
b) Civil administration	23.2	48.4	50.3	66.0	31.1	36.3	35.0	-31.0	-47.0
c) Miscellaneous	21.5	27.8	24.0	27.3	14.0	-1.9	29.8	2.5	9.1
2. Less transfers to provinces	163.1	171.5	193.5	192.8	-0.4	12.5	214.8	22.0	11.4
Revenue receipts (net) (1-2)	372.0	447.6	481.4	508.8	5.7	13.7	513.5	4.8	0.9

Source: Annual Budget Statement

PA: Provisional Actual, BE: Budget Estimates, RE: Revised Estimates

[7] As regards the developmental expenditures, in FY03 both the federal and provincial governments did not fully utilize the allocations made, which is a source of concern. But this year, the developmental expenditures should be properly monitored on quarterly basis, so that the sustainability of future growth could be ensured.

The total revenue receipts, which are 62 percent of the total financing requirements, are expected to be 0.9 percent higher in FY04 in comparison with the FY03 figure. This is envisaged to reduce the overall internal and external financing requirements by 53 percent and 5.8 percent respectively. The target for the privatization receipts in FY04 has remained unchanged at the FY03 level (see **Table 4.9**).[8] As a result, government is expected to borrow Rs 27.9 billion from the banking system in FY04 as against a retirement of Rs 33.0 billion in FY03.

Table **4.9**: **Financing of the Federal Government Expenditures**

billion Rupees

HEAD	FY00	FY01	FY02^{PA}	FY03^{BE}	FY03^{RE}	Change in FY03^{RE} over FY03^{BE}	FY04^{BE}	Change over FY03^{RE} Absolute	Change over FY03^{RE} Percent
I. Revenue receipts (net)	387.7	372.0	447.6	481.4	508.8	5.7	513.5	4.8	0.9
II. Internal resources (i+ii)	144.2	135.0	163.4	91.4	189.9	107.6	89.2	-100.7	-53.0
i) Capital receipts	53.0	93.3	68.0	44.2	100.8	128.1	35.5	-65.3	-64.8
ii) Public account	91.1	41.7	95.4	47.3	89.1	88.5	53.7	-35.4	-39.8
III. External resources (1+2+3)	164.8	209.3	291.1	198.1	169.0	-14.7	159.1	-9.9	-5.8
i). Plan resources	99.3	170.3	225.5	188.7	160.3	-15.0	159.1	-1.2	-0.7
ii). Debt rescheduling	64.3	34.4	65.7	9.4	8.7	-7.5	0.0	-8.7	-100.0
iii). Non-plan resources	1.2	4.5	0.0	0.0	0.0	0.0	0.0	0.0	
IV. Total receipts (I+II+III)	696.7	716.3	902.2	770.9	867.6	12.5	761.8	-105.8	-12.2
V. Change in provincial cash balance	4.8	24.7	25.8	17.0	16.6	-2.7	28.0	11.4	68.7
VI. Privatization proceeds	0.0	0.0	8.4	12.0	10.0	-16.9	10.0	0.0	0.3
VII. Credit from banking system	40.0	-33.0	12.5	-31.1	-33.0	5.9	27.9	60.9	-184.7
Total resources (IV+V+VI+VII)	741.4	708.1	948.7	768.8	861.2	12.0	827.7	-33.5	-3.9

Source: Annual Budget Statement, Government of Pakistan

4.5 Regional Comparison

To have a better view of the fiscal position of the county, it would be useful to look at comparative indicators of fiscal policy in South Asian countries. The data reveals that Pakistan is performing better in terms of containing the deficit along with Bangladesh (see **Table 4.10**), while India and Sri Lanka still have higher deficits. Interestingly, Pakistan is the only country in the region which has started producing primary surplus during last few years, which is pre-requisite for the longer-term debt sustainability.[9]

In terms of revenues, India is in the leading position while performance of Bangladesh is among the lowest for all revenue indicators. After India, Pakistan has better revenue generation capacity and Sri Lanka stands at the third position in terms of revenue collection. On the expenditures front, Pakistan and Bangladesh appears to be more disciplined as compared to Sri Lanka and India. The debt to GDP ratio is higher in case of Sri Lanka and Pakistan.

Table 4.11 extends the sub-regional analysis of South Asia and compares it with East and Southeast regions. It suggests that in terms of revenues, expenditures and their residual fiscal balance South and East Asian regions have rising trend in revenues; the Southeast Asian region is experiencing a fall in revenues. In the case of South and East Asian regions, the rising trend in revenues may be attributed to widening of the tax bases and reforms in their taxation system. The Southeast Asian countries

[8] The privatization drive has been slowed due to limited interest of investors, weak global equity markets and regional political uncertainties. The privatization of PSO, Habib Bank, has been delayed, while in the case of HBL privatization, government intends to re invite the EOI for ensuring transparency and better assets price sale.

[9] It may be noted that Pakistan has rescheduled its major part of external debt in the last three years, which has also helped the government in improving the deficit position and creating the fiscal space in the economy by reducing debt servicing.

downward trend in revenues may be ascribed to their attempt to keep a low incidence of taxes to attract more investment.

Table 4.10: South Asian Countries Key Fiscal Policy Indicators [1]

percent of GDP

	Pakistan				India			Sri Lanka				Bangladesh		
	1991	**2001**	**2002**	**2003**	**1991**	**2002**	**2003**	**1990**	**2001**	**2002**	**2003**	**1991**	**2001**	**2002**
Balance indicators														
Gross fiscal deficit	-8.8	-5.2	-5.2	-4.4	-9.4	-9.9	-10.1	-9.9	-10.8	-8.9	-7.5	-6.0	-5.5	-4.4
Revenue deficit	-3.1	-2.7	-2.1	-1.5	-4.2	-6.9	-6.7	-1.2	-4.9	-4.4	-2.3	0.9	1.2	1.9
Primary deficit	-3.8	2.0	2.0	1.6	-5.0	-3.7	-3.6	-3.5	-4.1	-1.6	-0.2	n.a.	n.a.	n.a.
Other indicators														
Revenue receipts	16.9	16.2	17.2	17.7	18.6	17.4	19.1	21.1	16.7	16.5	16.7	7.6	9.3	9.8
Tax revenue	12.7	12.9	13.2	13.7	15.4	13.7	14.9	n.a.	14.8	14.0	14.9	n.a.	n.a.	n.a.
Direct taxes	2.0	3.6	3.9	3.7	2.5	3.6	4.2	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Indirect taxes	10.7	7.8	7.2	7.6	12.9	10.1	10.7	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Total expenditure	25.7	20.9	22.8	22.1	28.8	28.5	30.4	31.0	27.5	25.4	24.6	13.6	14.8	14.2
Developmental	6.4	2.6	3.5	3.2	17.4	14.3	15.4	8.3	5.9	4.6	5.3	4.4	6.3	5.8
Non-developmental	19.3	18.9	19.3	19.2	11.4	14.1	15.1	22.3	21.6	20.8	19.3	6.7	8.1	7.9
Interest payments	4.9	9.1	8.8	6.3	4.4	6.2	6.5	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Debt	91.3	109.7	101.8	90.7*	61.7	71.1	75.5	96.5	103.2	105.3	103.0	n.a.	n.a.	n.a.

Source: Annual Report of RBI FY03, Annual Report of Bank of Bangladesh FY02, Central Bank of Sri Lanka Annual Report - 2002, Pakistan Economic Survey 2003

*End March Figure, n.a.: Not Available; [1] Consolidated basis.

On the expenditures side, the situation is different, as the East and Southeast Asian countries look more disciplined while on average South Asian countries are less prudent. Finally, the South Asian countries have much higher, although declining, fiscal deficit in contrast to the other Asian countries. The expenditure to GDP ratios in the case of East Asia and Southeast Asia are lower as compared to the South Asian countries and the major reason could be that their governments have shifted some activities to the private sector in these countries.

Table 4.11: Fiscal Operations in East, Southeast and South Asian Regions*

percent of GDP

	Total revenue				Total expenditure				Fiscal balance			
	1990	**1995**	**2000**	**2002**	**1990**	**1995**	**2000**	**2002**	**1990**	**1995**	**2000**	**2002**
South Asia	17.2	18.7	19.7	19.8	27.7	28.6	28.4	28.5	-8.1	-6.2	-6.3	-6.6
East Asia	17	15	19.5	19.6	16.1	16.1	20.2	21.2	0.3	0.1	-1.7	-1.6
Southeast Asia	21	22.9	19.1	18	20.8	18.5	19.4	21.5	0.2	3.4	-0.6	-3.5

Sources: Asian Development Bank, http://www.adb.org/Documents/Books/Key_Indicators/2003/default.asp

*: Un-weighted average