3 Fiscal Developments

Revised budgetary estimates for the federal government indicate that fiscal discipline remained strong in FY04. Overall revenue receipts rose by a robust 8.7 percent, largely supported by the CBR tax collections,[1] even as expenditure growth (excluding repayment of external debt) remained subdued.

The rise in revenue receipts and lower expenditure growth in turn, underpinned a significant progress towards fiscal consolidation. Specifically, consolidated FY04 budgetary deficit of the federal and provincial governments not only saw a reduction of Rs 3.2 billion to Rs 177.4 billion compared with that in the preceding year, but also remained below the target for the year.

Despite the visible improvement in the overall budgetary position, the decline in the consolidated development expenditures of the federal and provincial government remained a source of concern. A revised figure of Rs 154.4 billion for FY04, although substantially higher as compared to the preceding year, fell short of target by Rs 5.6 billion.

3.1 Revenue Receipts

The rise in overall revenue receipts is primarily driven by strong tax receipts while the non-tax revenue recorded relatively lower growth (see **Table 3.1**). However, while the rise in aggregate tax revenue is largely in line with targets, the growth in non-tax revenues contributed significantly above the target by Rs 30.1 billion. In fact, it is about entirely the exceptional rise in the non-tax revenues that allowed overall revenues to substantially exceed the FY04 target. This rise in federal non

Table 3.1: Federal Government Revenue Receipts

billion Rupees

		FY04		Changes over FY03	
	FY03	**BE**	**RE**	**Absolute**	**Percent**
a) Tax revenue (CBR)	460.0	510.0	510.0	50.0	10.9
b) Tax revenue (other than CBR)	68.2	67.6	70.1	1.9	2.8
c) Non-tax revenue	171.8	150.8	180.9	9.1	5.3
Overall revenue receipts (a+b+c)	700.0	728.4	761.0	61.0	8.7
Less provincial share in taxes	196.0	214.8	211.4	15.5	7.9
Net revenue receipts	**504.0**	**513.5**	**549.6**	**45.5**	**9.0**

Source: Federal Budget in Brief, Government of Pakistan
BE: Budget estimates, RE: Revised estimates

[1] The realized 8.7 percent rise in overall revenue receipts is well above the original estimated target growth of 4.1 percent during FY04.

tax revenues was mainly due to higher defense receipts (comprising payments for logistic support) and increased dividend receipts (on account of the government's holdings in public sector enterprises).[2]

3.2 Expenditures

The revised Federal expenditures for FY04 are estimated at Rs 868.4 billion, depicting a rise of Rs 63.2 billion over the budgetary target for the year (see **Table 3.2**). This rise stems from a surge in expenditures on general public services and defense. The Rs 70.5 billion rise in the former can be explained by the pre-payment of expensive foreign debt. Specifically, foreign loan pre-payment (principal) surged to Rs 111.3 billion as compared to the budgeted amount of Rs 46.0 billion. Furthermore, the debt servicing on the foreign debt also climbed to Rs 45.0 billion against the envisaged target of Rs 39.5 billion. On the other hand, interest payments on domestic debt continued to benefit from low interest rate regime and it remained Rs 9.3 billion lower as compared to the original target of Rs 170.0 billion.

Table 3.2: Expenditures During FY04

billion Rupees

	FY04		Changes over BE	
	BE	**RE**	**Absolute**	**Percent**
Current expenditures	645.2	714.0	68.79	10.66
Of which				
General public services	377.9	448.4	70.50	18.66
Defense affairs & services	160.3	180.5	20.29	12.66
Economic affairs	78.2	54.8	-23.41	-29.95
Developmental expenditures	**160.0**	**154.4**	-5.63	-3.52
Federal government	113.0	106.9	-6.14	-5.43
Provincial government	47.0	47.5	0.51	1.09
Total expenditures (A+B)	**805.2**	**868.4**	63.2	7.8

Source: Federal Budget in Brief, Government of Pakistan
BE: Budget estimates, RE: Revised estimates

Defense spending, the second largest component in the current expenditures, also saw a significant rise of Rs 20.3 billion over the original FY04 budget target (see **Table 3.2**). This increase is largely attributed to the larger troop movement along the Western borders and this rise could also be related to the assistance provided against payments for logistic support (recorded as "*defense receipts*" in non-tax

[2] Dividend income exceeded the budget target by Rs 9.6 billion, largely due to higher dividend payments by OGDCL, PTCL and Pakistan Petroleum product limited.

revenues). The netting off the rise in defense spending and increase in defense receipts may leave the overall budgetary position of the government unchanged.

The lower than targeted growth in *developmental* expenditures of the federal government is a little troubling. Although revised budgetary estimates show a significant improvement in development spending compared to the preceding year, however, it is Rs 5.6 billion lower than the FY04 budgetary target. While there are clearly quite valid reasons for many of the delays,[3] but the point remains that this shortfall nonetheless reflect badly on the government's commitment to implement development programs, especially given that it is the government itself that made the budgetary allocations after examining the feasibility of the projects (and associated problems). In particular, these reasons become increasingly meaningless unless there is clear evidence of efforts to remove these bottlenecks for succeeding years.

3.3 Financing of the Budgetary Outlay

Looking at **Table 3.3**, considerable variation is visible between the envisaged and revised estimates for the financing of the budgetary expenditures. The revised estimates show a sharp decline in external financing and net position of provincial cash balances. As a result, the government's borrowings from the banking system witnessed exceptional growth during the period.

Table 3.3: Financing of Federal Budgetary Outlay

billion Rupees

	FY04		Changes over BE	
	BE	**RE**	**Absolute**	**Percent**
Net revenue receipts	513.5	549.6	36.0	7.0
Net capital receipts	36.7	39.8	3.1	8.5
External receipts	159.1	144.8	-14.3	-9.0
Self financing of PSDP by provinces	30.0	34.8	4.9	16.2
Change in provincial cash balance	28.0	14.3	-13.6	-48.8
Privatization proceeds	10.0	11.0	1.0	10.0
Bank borrowing	27.9	74.0	46.1	165.0
Total resources	805.2	868.4	63.2	7.8

Source: Federal Budget in Brief, Government of Pakistan
BE: Budget estimates, RE: Revised estimates

[3] The lower utilization of funds is attributed to following reasons; (1) weak systems and processes of planning, approval and execution of the development projects; (2) inefficiency in respective departments who execute infrastructure projects; (3) the cumbersome procedure of the federal government to release funds; and (4) the conflicts between provincial and district governments.

The decline in net external receipts reflects a number of factors including a small fall in project financing, termination of the Saudi Oil Facility, and the government's decision to pre-pay a portion of its expensive external debt. The resulting sharp decline in net external receipts was only partially offset by the proceeds from Pakistan's US$ 500 million sovereign Eurobond issue in January 2004.

3.4 CBR Tax Collections

As in the preceding year, CBR tax revenues witnessed robust growth during Jul-Apr FY04 (see **Table 3.4**), climbing Rs 8.4 billion above the target for the period. The above-target aggregate collections were due entirely to strong receipts of customs duty and sales tax, as direct taxes and CED receipts under performed on the respective targets.[4]

Table 3.4: Total CBR Receipts
billion Rupees

			YoY change	
	FY03	**FY04**	**FY03**	**FY04**
Q1	***90.4***	***94.1***	***16.6***	***4.1***
Q2	***111.1***	***136.4***	***14.4***	***22.8***
Jan	37.2	43.7	13.5	17.6
Feb	33.1	39.3	19.8	18.7
Mar	38.6	40.0	10.6	3.6
Q3	***108.9***	***123.0***	***14.2***	***13.0***
Apr	41.8	43.9	15.2	4.9
Jul-Apr	**352.1**	**397.2**	**15.0**	**12.8**

While the above-target receipts are certainly a welcome development, the CBR tax collections should have responded to the higher nominal GDP growth proportionally. Specifically, the FY04 initial CBR tax projections were computed assuming real GDP growth of 5.3 percent, and inflation at 3.9 percent. In the event, not only is the FY04 real GDP growth projected to reach 6.4 percent, average inflation too is expected to reach the 4.5-4.6 percent range. Keeping the same buoyancy measure, the CBR tax collection should have reflected further improvement over the initial projections.

3.4.1 Analysis of Major Taxes

Direct Taxes

As shown in **Table 3.5**, cumulative direct tax receipts during Jul-Apr FY04 fell short of target despite the impact of an exceptional jump in Q2-FY04 collections stemming from strong receipts from corporations. The rise in voluntary payments appears to reflect the increasing profitability of domestic businesses, and to some extent indicate that the government's tax reforms may be beginning to bear fruit.

[4] The shortfall in direct taxes may partially be ascribed to the higher refunds made during the Q3-FY04.

Table 3.5: CBR Tax Collections and Targets (Jul-Apr)
billion Rupees

Heads	Target FY04	Target Jul-Apr	Net collection FY02	Net collection FY03	Net collection FY04	YoY change Absolute	YoY change Percent	Absolute difference with Jul-Apr target	Absolute difference with Jul-Apr FY03
Direct taxes	161.1	121.1	108.5	109.5	118.7	9.2	8.4	-2.4	9.2
Indirect taxes	348.9	267.7	197.6	242.6	278.5	35.9	14.8	10.8	35.9
Sales tax	223.1	169.3	128.5	154.1	173.0	18.9	12.3	3.7	18.9
Central excise	47.7	35.8	35.89	35.46	35.3	-0.2	-0.5	-0.5	-0.2
Customs	78.1	62.6	33.25	53.01	70.22	17.2	32.5	7.6	17.2
Total	510.0	388.8	306.1	352.1	397.2	45.1	12.8	8.4	45.1

Source: Central Board of Revenue

The Jul-Mar FY04 break up of the income tax[5] indicate an overall increase of 10 percent in gross collections, mainly on the back of higher contributions from voluntary payments (payments through return submission) of Rs 7.4 billion, and withholding taxes of Rs 3.5 billion, while collections on demand witnessed a decline over the preceding year.

The analyses of the sub components of withholding taxes, which accounts for approximately 56 percent of total income tax receipts, shows that the significant boost to direct tax receipts was from salaries, contracts, imports and exports, which are clearly linked with the rising economic activity, as is the strong contribution from advance taxes on electricity and telephone bills.

Indirect Taxes

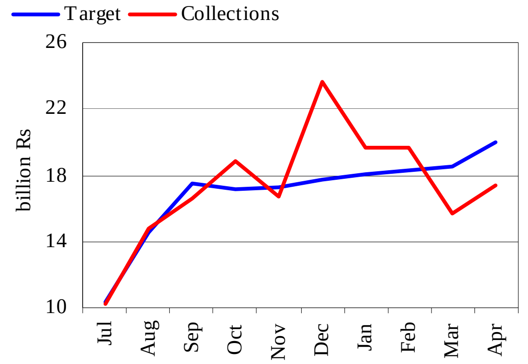
Sales Tax

The sales tax performance during Jul-Apr FY04 is impressive and it contributed a sum of Rs 173 billion, which is Rs 3.7 billion more than the target (see **Table 3.5**). Sales tax receipts grew strongly during Jul-Apr FY04, mainly due to strong rise in imports; particularly the GST on imports rose by 17.7 percent YoY, while those on domestic items registered a 5.1 percent growth. The latter may partially be explained by a jump in refunds stemming from rising exports.[6]

[5] This analysis is based on the latest available data.
[6] In order to improve sales tax collections, Medium Tax payers Units are to be established soon in other parts of the country for the benefit of the people. In this regard, GST refund system and export duty drawback are also being computerized and strengthened to avoid delays, which invite corruption. All these drastic measures underway are part of reforms introduced in the CBR tax collection machinery, which are meant to minimize human contact between CBR tax officials and taxpayers.

The monthly comparison with the targets indicates that monthly sales tax collections remained above the targets throughout Jul-Apr FY04, other than March and April 2004 (see **Figure 3.1**). The annual FY04 collections are expected to comfortably exceed the annual target.

Figure 3.1: Sales Tax during Jul-Apr FY04



Central Excise Duty

Central Excise duties witnessed a small shortfall of Rs 0.5 billion against the Jul-Apr FY04 target to stand at Rs 35.3 billion; these receipts are also 0.5 percent less than that in the corresponding period of FY03 (see **Table 3.5**).[7] The detailed break down of the collections shows that three major contributors beverages, cigarettes and natural gas (that account for 60 percent of the total CED collection) saw an increase in collections, but this was more than offset by a fall in CED receipts from cement and POL products.[8]

Customs Duty

Customs duty receipts consistently registered a substantial growth of 32.5 percent during Jul-Apr FY04 to reaching Rs 70.2 billion i.e. Rs 7.6 billion above the target for the period. It is heartening to note that this remarkable rise is in on top of the 59.4 percent increase during the same period of FY03 (see **Table 3.5**).

However, this surge is consonant with the 16.3 percent YoY rise in import value during the Jul-Mar FY04. A notable thing is the rise in dutiable imports, which has increased average effective tariff rate to 9.9 percent in Jul-Mar FY04 from 9.1 during the same period of the last year. The rise in effective tariff is larger due to higher imports of iron & steel products, vehicles and edible oil which fall in higher tariff categories.

[7] CED is leviable on limited number of goods produced or manufactured, and services provided or rendered domestically. On most of the items CED is charged on the basis of the value/quantity or retail price.

[8] The rate on cement was declined as a part of last year budgetary measures. In addition, a part of the domestic cement production is also being exported to Afghanistan and is therefore not taxable.

Although, an across-the-board rise was observed in all the major contributors to customs duty receipts (other than coffee and tea), the leading sources were autos, machinery & mechanical appliances, iron & steel and POL products.[9]

[9]The duty rates on the coffee and tea were reduced in the last year budget.