5 Fiscal Developments

5.1 Overview

Data for Q1-FY10 shows the fiscal deficit at 1.5 percent of projected annual GDP compared to 1.1 percent in Q1-FY09, raising concerns over the ability of the government to meet the annual target of 4.9 percent of GDP. It is claimed that a significant part of the slippage owes to an unexpected rise in spending (e.g., increase in government spending related to the anti-terrorist operations, etc.) and delays in some revenue receipts into the next quarter. If this is correct, then the fiscal deficit trend should become consistent with the annual target by the end of the next quarter.

One concern, however, is the higher contribution of non-tax revenue within the marginal increase in overall revenue during Q1-FY10. This is because jumps in non-tax revenue are unpredictable, and are often not sustained in each quarter of the fiscal year. For example, non-tax revenue would have fallen to Rs 58.5 billion had there not been a Rs 70.0 billion transfer from SBP profits to the government.

Despite the sharp growth in fiscal deficit in rupee terms, financing from domestic sources has grown only moderately, because of the significant rise in net external financing. Also, quite encouragingly, the government has been successful in reducing reliance on the extremely inflationary borrowing from the central bank.

The government faces very difficult choices, with considerable pressure to increase social sector spending, and to build infrastructure, even as the costs of the anti-militancy campaign continue to mount. At the same time, the weak economy constrains its ability to raise revenue from the same tax base. This suggests the need to urgently work towards broadening the tax base to provide needed essential services and public goods.

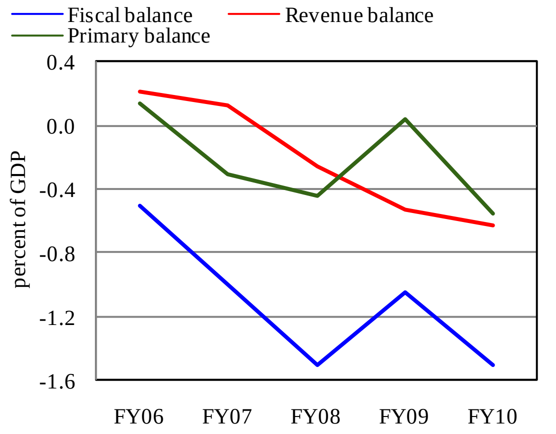
It must be kept in mind that the government's ability to heavily fund the fiscal deficit from the domestic banks in FY09 and FY10 has been helped by the sharp decline in net credit to the private sector. This is not a sustainable position, and points to the need for developing domestic savings, and domestic debt market.

In the medium-term, given the rigidities in the structure of government expenditure, revenue enhancement through tax reforms will be a key to fiscal consolidation. However, one very important development in fiscal policy is the recent agreement between the federal and provincial governments on the 7th National Finance Commission Award (see **Special Section 2** for details).

5.2 Fiscal Performance Indicators

After improvement in the fiscal performance during FY09, the key fiscal indicators deteriorated significantly in Q1-FY10. Deficit in the revenue balance as percent of GDP,[1] has been deteriorating since FY05, touching 0.6 percent in Q1-FY10 – the highest level since quarterly data was made available in FY02 (see **Figure 5.1**). This rise would be even higher if Rs 14.2 billion in *unidentified expenditure* is recorded in the current expenditure. Deterioration in revenue balance is troubling, as it entails borrowings to meet current expenditure that, unlike development spending, do not add to the repayment capacity of the economy. This is why the Fiscal Responsibility and Debt Limitation Act 2005 (FRDL) required the generation of revenue surpluses from FY08 onwards.

Figure 5.1: Fiscal Performance Indicators (Q1)



Similarly, the primary balance as percent of GDP,[2] also turned into deficit from zero in the same period last year to 0.6 percent in Q1-FY10. This is a reflection of expansionary fiscal policy, i.e., increase in government expenditure net of interest payments. As a result, stock of public debt in relation to the gross domestic output is likely to increase. It may be added here that persistent primary deficits create problem of debt sustainability.

5.3 Revenue

Total revenue stood at Rs 427.3 billion in Q1-FY10, registering a growth of 11.0 percent compared to 23.1 percent in the same period last year (see **Table 5.1**). The weaker growth in revenue receipts was largely due to deceleration in tax

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[1] Revenue balance measures the saving capacity of the government and is calculated as the difference between total revenues and current expenditures.

[2] Primary balance helps assess the sustainability of fiscal deficit. It highlights the current discretionary budgetary stance by excluding the impact of interest payments.

revenue growth. On the other hand, non-tax revenue witnessed a strong growth, but this was not enough to neutralize the impact of deceleration in the tax revenue growth.

Table 5.1: Summary of Consolidated Public Finance
billion rupees

	Jul-Sep				YoY change (%)	
	FY07	**FY08**	**FY09**	**FY10**	**FY09**	**FY10**
Total revenue	255.7	312.6	385.0	427.3	23.1	11.0
Tax revenue[3]	199.2	219.7	278.7	298.8	26.8	7.2
Non-tax revenue	56.5	92.9	106.3	128.5	14.5	20.9
Total expenditure	342.4	470.7	522.8	650.9	11.1	24.5
Current	244.2	340.0	456.1	521.0	34.2	14.2
Development and net lending	65.2	112.9	57.6	115.7	-55.6	100.8
Unidentified expenditure	33.0	17.8	9.1	14.2	-49.0	56.3
Fiscal balance	-86.7	-158.1	-137.7	-223.7	-12.8	62.4
As percent of GDP[4]						
Total revenue	2.9	3.0	2.9	2.9	--	--
Tax revenue	2.3	2.1	2.1	2.0	--	--
Non-tax revenue	0.6	0.9	0.8	0.9	--	--
Total expenditure	3.9	4.5	4.0	4.4	--	--
Current	2.8	3.2	3.5	3.5	--	--
Development and net lending	0.7	1.1	0.4	0.8	--	--
Unidentified expenditure	0.4	0.2	0.1	0.1	--	--
Fiscal balance	-1.0	-1.5	-1.1	-1.5	--	--
Primary balance	-0.3	-0.4	0.0	-0.6	--	--
Revenue balance	0.1	-0.3	-0.5	-0.6	--	--

Source: Ministry of Finance

Relatively strong growth in non-tax revenue (against tax revenue) pushed its share in total revenue to 30.1 percent in Q1-FY10 compared to 27.6 percent in the same quarter last year. This increased share of non-tax revenue in total revenue can hardly be termed a welcome development due to its unpredictable nature.

Tax revenue recorded an increase of 7.2 percent in Q1-FY10, much lower than the 26.8 percent realized in the corresponding period last year (see **Table 5.2**). Compositional break-up of tax revenue shows that all major tax-heads except 'petroleum levy' contributed to the deceleration. Specifically, petroleum levy contributed Rs 24.1 billion in tax revenue during Q1-FY10 against Rs 1.8 billion in the same period last year. It is pertinent to note here that petroleum levy was imposed as fixed consumption tax from the start of the current fiscal year. Also, the surcharges on POL have been replaced with petroleum levy and are now considered part of tax revenue. On the other hand, taxes on goods and services showed signs of weakening due to slowdown in the domestic demand. Similarly, taxes on international trade also declined due to fall in the volume of imports and relatively lower international commodity prices. The decline would have been greater, were it not for the substantial weakening of the rupee over the year.

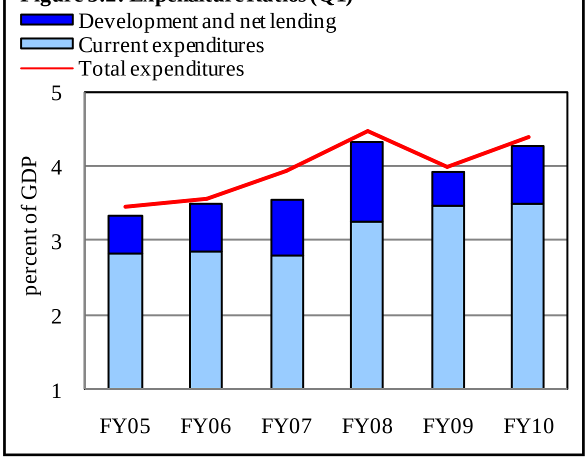
Table 5.2: Composition of Tax and Non-tax Revenue
billion rupees

	Jul-Sep			YoY change (%)	
	FY08	**FY09**	**FY10**	**FY09**	**FY10**
Tax revenue	**219.7**	**278.7**	**298.8**	**26.8**	**7.2**
Direct taxes	79.2	89.7	84.1	13.3	-6.3
Taxes on property	1.0	1.8	1.7	73.1	-9.1
Taxes on goods and services	98.0	136.6	146.1	39.4	7.0
Taxes on international trade	29.1	38.2	33.1	31.0	-13.4
Petroleum levy	4.2	1.8	24.1	-55.6	1206.1
Other taxes	8.2	10.5	9.9	28.2	-6.5
Non-tax revenue	**92.9**	**106.3**	**128.5**	**14.5**	**20.9**
Profits from PTA/Post office dept	0.0	0.0	0.0	--	--
Interest (PSE and others)	12.6	1.6	0.1	-87.1	-93.5
Dividends	2.0	9.5	18.9	372.2	98.7
SBP profits	47.3	28.0	70.0	-40.8	150.0
Defence	1.3	29.2	1.9	2070.2	-93.4
Development surcharges on gas	4.6	6.4	5.7	37.4	-9.9
Discount retained on crude oil	--	4.0	0.0	--	--
Royalty on oil/gas	11.3	10.4	9.2	-7.8	-10.9
Others	13.7	17.1	22.6	24.7	31.9
Total revenue	**312.6**	**385.0**	**427.3**	**23.1**	**11.0**

Source: Ministry of Finance

Non-tax revenue added Rs 128.5 billion in Q1-FY10 compared to Rs 106.3 billion in the same period last year, registering strong growth of 20.9 percent. The acceleration in the non-tax revenue receipts is largely attributable to: a) strong inflows received in the form of dividends, and b) sharp increase in the transfer of SBP profit to the government. The increase in the latter was primarily attributed to huge stock of government debt held by the central bank. The rise in the transfer of SBP profit and increased dividend income both helped to compensate for the deceleration in the other heads of non-tax revenue.

Figure 5.2: Expenditure Ratios (Q1)



5.4 Expenditure

Total expenditure grew by 24.5 percent during Q1-FY10, significantly higher than 11.1 percent recorded in the same period last year. Compositional break-down of total spending shows that growth in expenditure was contributed by increase in current expenditure as well as development expenditure. The latter showed an exceptional YoY increase of 92.1 percent in Q1-FY10, compared to 48.9 percent decline during the same period last year. The large growth in total expenditure is also evident from increased total expenditure to GDP ratio to 4.4 percent in Q1-FY10 from 4.0 percent in the same period last year (see **Figure 5.2**).

Table 5.3: Composition of Current Expenditure

billion rupees

	Jul-Sep			YoY change (%)	
	FY08	**FY09**	**FY10**	**FY09**	**FY10**
Current expenditure	**340.0**	**456.1**	**521.0**	**34.2**	**14.2**
of which					
Interest payments	111.1	142.3	141.5	28.1	-0.6
Domestic	98.5	128.1	129.3	30.0	0.9
Foreign	12.6	14.2	12.2	12.8	-14.2
Grants (other than provinces)	7.7	16.4	60.1	112.1	266.0
Defence	57.5	82.2	86.2	42.8	4.9
Economic affairs	25.6	50.6	11.0	97.7	-78.2
Health	1.1	1.1	1.4	-0.2	22.0
Education affairs and services	5.0	5.3	6.8	6.3	28.8
Provincial	102.6	115.1	139.6	12.2	21.3

Source: Ministry of Finance

Within total expenditure, current expenditure increased by 14.2 percent to reach Rs 521.0 billion in Q1-FY10 (see **Table 5.3**), which are 3.5 percent of GDP. Further analysis reveals that the current expenditure of the provinces increased by 21.3 percent in Q1-FY10, compared to 12.2 percent rise recorded in the first quarter of the last fiscal year.

Furthermore, surge in the current expenditure of the federal government reflects: a) acceleration in the defense expenditure on account of continued military operations against militants in some areas in the north of Pakistan, and b) rise in grants to the non-government entities. Increase in the latter is attributable to the support programs for poor and payments to internally displaced people (IDPs). On the other hand, the government spending on interest payments remained almost unchanged at Rs 141.5 billion in Q1-FY10 compared to Rs 142.3 billion in the same period last year. Additionally, sharp fall in the expenditure under 'economic affairs' probably reflects a decline in subsidies provided by the government to various sectors in the preceding year.

Government development spending increased to Rs 109.0 billion in Q1-FY10 from Rs 56.8 billion in the same period last year. Further break-up of data reveals that increase was largely on account of provincial governments whose share in total PSDP spending has increased to 46.3 percent in Q1-FY10 from 37.0 percent during Q1-FY09.

5.5 Domestic Budgetary Financing[7]

A higher than projected fiscal deficit in Q1-FY10 has placed pressures on both external and domestic sources of financing. Of the total financing requirement, approximately one-third was met through external sources compared to only 4.5 percent in Q1-FY09. The sharp increase in the external financing mainly reflects inflows under bridge financing[8] provided by the IMF in August 2009. Despite this sharp increase in the net external financing, budgetary financing from domestic sources also continued to rise, touching Rs 146.6 billion in Q1-FY10 (see **Table 5.4**).

[7] Budgetary financing from the banking system is worked out on cash basis and hence, this will differ from government borrowing numbers reported in **Table 4.1** where data is measured on accrual basis.
[8] Bridge financing is temporary financing and is used as a bridge to maintain liquidity while waiting for expected cash inflow.

Table 5.4: Sources of Financing
billion rupees

	Jul-Sep			Growth (%)		Percent share[1]	
	FY08	**FY09**	**FY10**	**FY09**	**FY10**	**FY09**	**FY10**
Total financing of budget	**158.1**	**137.7**	**223.7**	**-12.9**	**62.5**	**100.0**	**100.0**
External resources (net)	36.8	6.2	77.1	-83.3	1151.2	4.5	34.5
Internal resources (net)	121.3	131.7	146.6	8.6	11.3	95.5	65.5
Banking system	69.9	104.6	39.0	49.8	-62.7	(79.4)	(26.6)
Non-bank	51.4	27.1	107.6	-47.3	297.3	(20.6)	(73.4)

Source: Ministry of Finance

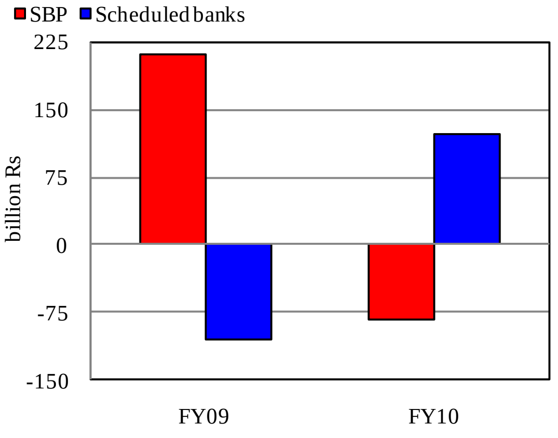
[1] Numbers in parenthesis represent share in internal source of financing

Within domestic sources of budgetary finance, non-bank's contribution witnessed a strong expansion. As a result, the share of non-bank in domestic source of financing jumped to 73.4 percent compared to 20.6 percent in the same period last year. Financing from the banking system also witnessed significant change during Q1-FY10.

Financing from the Banking Sector

Net budgetary financing from the banking system was Rs 39.0 billion in Q1-FY10, compared to Rs 104.6 billion in the same period last year. However, the financing structure from the banking system changed, as the government borrowings from the scheduled banks increased significantly in the period under discussion. On the other hand, the financing from the central bank saw net retirement of Rs 82.6 billion in Q1-FY10 (see **Figure 5.3**), reflecting successful implementation of the limit on government borrowings from the central bank imposed under Stand-By Arrangement with IMF. While a reduction in deficit monetization would help contain inflationary pressures somewhat, a rise in government borrowings from the scheduled banks will have consequences on liquidity and interest rates.

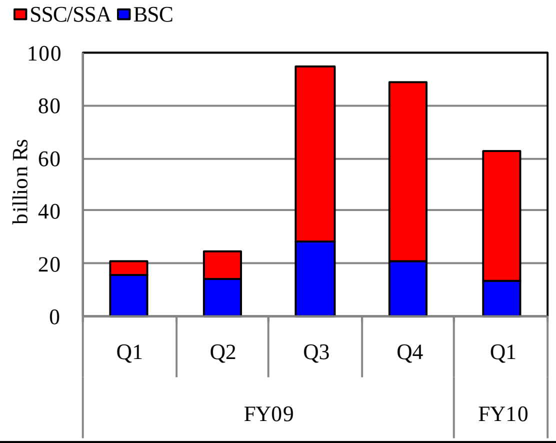
Figure 5.3: Financing from Banking Sector (Q1)



Financing from the Non-bank Sources

Non-bank borrowings stood at Rs 107.6 billion in Q1-FY10, compared with Rs 27.1 billion in the corresponding period of the previous year. NSS with Rs 53.0 billion addition was the largest contributor in the total financing received from non-bank sources in Q1-FY10. Within NSS, net investment in Behbood Saving Certificates (BSC), Special Saving Certificates (SSC) and Special Saving Accounts (SSA) increased significantly. These three instruments contributed Rs 62.7 billion in total NSS financing, but the net retirement of other instruments has reduced the net inflows through NSS (see **Figure 5.4**). It is worth noting that the performance of NSS instruments is dwindling after large jump in the second half of FY09. A part of this weakness probably owed to recent cuts in profit rates on major NSS instruments in line with the fall in the interest rates on long-term government papers.

Figure 5.4: Net Financing through BSC, SSC and SSA



5.6 FBR Tax Collection

Total tax collection reached Rs 263.7 billion during Q1-FY10 against Rs 262.1 billion in the corresponding period a year earlier (see **Table 5.5**). The amount collected portrays poor performance of all the four major heads of the FBR taxes.

Table 5.5: FBR Tax Collection (net) (Jul-Sep)

billion rupees

	Annual target		Net collection		% of annual target		YoY change (%)	
	FY09	FY10	FY09	FY10	FY09	FY10	FY09	FY10
Direct taxes	498.9	565.6	88.2	85.2	17.7	15.1	13.8	-3.5
Indirect taxes	751.1	751.1	173.9	178.5	23.2	23.8	36.1	2.7
Sales tax	469.9	499.4	110.2	117.1	23.5	23.4	33.2	6.2
FED	112.0	152.8	25.5	28.4	23.4	18.6	58.9	11.5
Customs	169.2	162.2	38.2	33.1	22.6	20.4	31.7	-13.4
Total collection	**1,250.0**	**1,380.0**	**262.1**	**263.7**	**21.0**	**19.1**	**27.7**	**0.6**

Source: Federal Board of Revenue

Direct taxes registered a decline, while indirect taxes on the whole grew by only 2.7 percent.

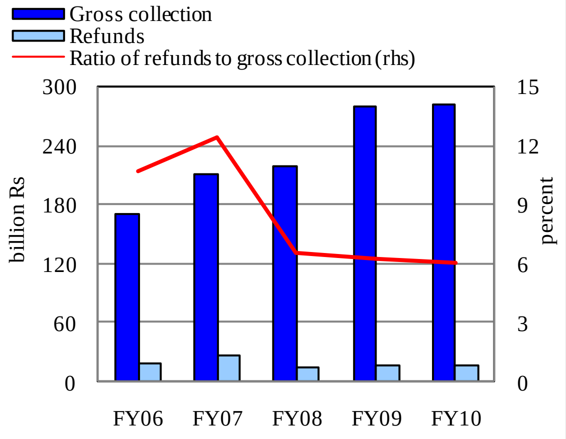
Deceleration in the FBR tax receipts is a reflection of overall weak economic activities. Specifically, low expected earnings of the corporate sector and decline in imports translated into below expected performance of the tax collection. Further, production in large scale manufacturing sector has declined during Q1-FY10 on top of a substantial 6.0 percent fall in Q1-FY09, which continued to drag tax receipts.

An analysis of the FBR tax performances with respect to the annual target reveals that only 19.1 percent of the annual target has been achieved compared with 21.0 percent in Q1-FY09. The FBR has to collect over Rs 124.0 billion per month on average during the remaining nine months of the fiscal year to meet annual target of FY10. Last year average monthly tax collection stood at Rs 96.4 billion which also remained the highest so far. Given these facts and weak economic activities, the target for FY10 clearly looks ambitious.

Refunds

The gross tax collection has recorded 0.5 percent growth during the first quarter of FY10 compared to 27.2 percent increase during the comparable period last year. The ratio of refund to gross collection has remained stagnant for the last three years (see **Figure 5.5**). This indicates that the government is not trying to hold refunds to meet its budgetary needs and to show increase in net receipts.

Figure 5.5: Refunds and Gross Collection (Q1)

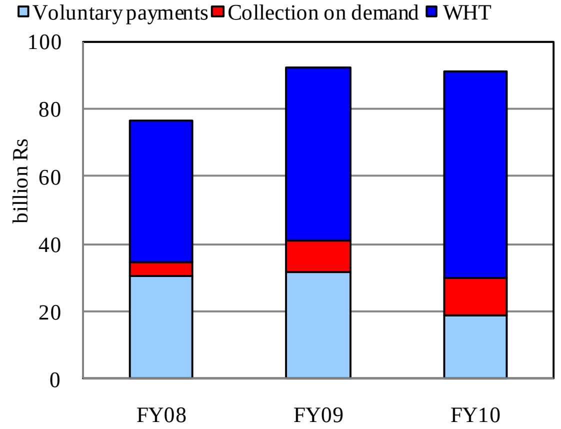


Direct Tax Collection

Collection from direct taxes registered negative growth of 3.5 percent during Q1-FY10 to Rs 85.2 billion. As gross income tax accounts for 97.0 percent of the gross direct taxes, a compositional break-down of gross income tax will help to trace out the reasons behind the fall in direct tax receipts.

During Q1-FY10, gross income tax collection was only Rs 91.1 billion compared to Rs 92.5 billion collected during the corresponding period a year earlier. A major setback to the gross income tax came from short fall in voluntary payments (VP). Revenue from the voluntary component was Rs 19.0 billion during the period under discussion against Rs 31.8 billion during the same period last year (see **Figure 5.6)**.

Figure 5.6: Major Components of Gross Income Tax (Q1)



A break-down of VP, which comprises payments with returns and advance tax payments, shows that payments with return contributed Rs 3.6 billion to the total voluntary receipts compared to Rs 2.2 billion a year earlier. However, advance tax payments were only Rs 15.3 billion during Q1-FY10 compared to Rs 29.6 billion in the corresponding period a year earlier. Consequently, the reason of the short fall in direct taxes during Q1-FY10 can be narrowed down to the dismal performance of advance tax payments. The advance tax is paid by corporate sector on the basis of expected profitability. The decline in this component thus shows that the corporate sector was expecting a lower profit during Q1-FY10.

Table 5.6: Withholding Tax Collection

billion rupees

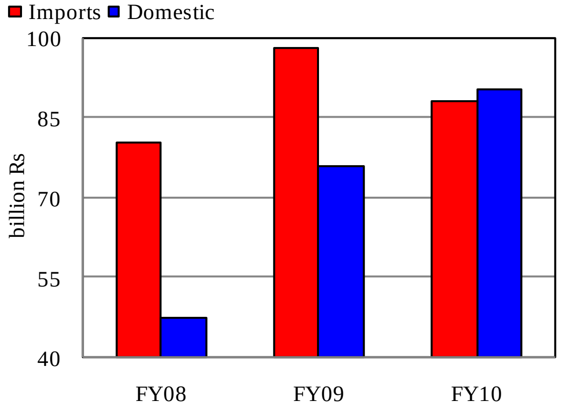
	Jul-Sep			Absolute difference	
	FY08	**FY09**	**FY10**	**FY09**	**FY10**
Imports	6.4	8.0	10.4	1.5	2.4
Salaries	4.3	5.4	7.1	1.1	1.8
Dividends	1.1	1.6	1.3	0.5	-0.3
Securities	3.3	3.2	4.5	0.0	1.3
Contracts	13.9	17.2	18.0	3.2	0.8
Exports	2.3	3.6	3.7	1.3	0.1
Cash withdrawal	1.3	2.2	2.8	0.9	0.6
Electricity bills	1.3	1.6	3.4	0.3	1.8
Telephone	4.4	4.9	5.1	0.6	0.2
Others	4.1	4.1	5.1	0.0	1.0
Total (gross)	**42.3**	**51.7**	**61.5**	**9.4**	**9.7**

Source: Federal Board of Revenue

The collection on demand, which is a major component of gross income tax, grew by 19.1 percent in Q1-FY10 (YoY), but this rise was not sufficient to make up for the fall in advance tax payments. Last year, the FBR fully utilized the system for audit and assessment of the tax returns resulting in 118.0 percent YoY growth for collection under demand.

The third major component of the income tax, i.e., withholding tax (WHT) grew by 18.8 percent in Q1-FY10 compared to 22.3 percent increase during the same period a year earlier (see **Table 5.6**). Collection from imports and electricity bills remained the top most contributors in terms of total addition to the WHT collection during the quarter. Increased contribution under the head of electricity bills despite power outages across the country owed to rise in electricity charges. Collection under the head of salaries also stood higher than the previous year. This reflects rise in salaries by the employers to compensate the historic high inflation. Receipts from exports could add only Rs 0.1 billion due to 4.0 percent decline in exports during Q1-FY10 over the corresponding period of the previous year.

Figure 5.7: Import and Domestic Sources of Net Indirect Taxes (Q1)



Indirect Taxes

Net collection from indirect taxes grew by only 2.7 percent in Q1-FY10 compared to 36.1 percent in the corresponding period of the previous year. In absolute terms, indirect tax collection was Rs 178.5 billion in Q1-FY10 compared to Rs 173.9 billion during Q1-FY09. A detailed data of indirect taxes shows that major setback came from the imports. Import related indirect taxes declined by 10.2 percent over the previous year (see **Figure 5.7**). This was mainly on account of 21.0 percent decline in the rupee value of imports.

Growth in indirect tax collection from domestic source decelerated to 19.3 percent during the period under discussion compared to 60.0 percent increase a year earlier. The considerable growth in Q1-FY09 in indirect tax collection from domestic sources was helped by the hefty increase in tax receipts from POL products due to increase in international prices.

Commodity-wise analysis shows that major shortfall came from POL products as collection from POL products remained below the previous year collection by Rs 6.0 billion (see **Table 5.7**). This was mainly due to 46.0 percent decline in the dutiable import value of the POL products. Collection under the head of services

Table 5.7: Indirect Tax Collection from Major Commodities (Domestic + Imports)

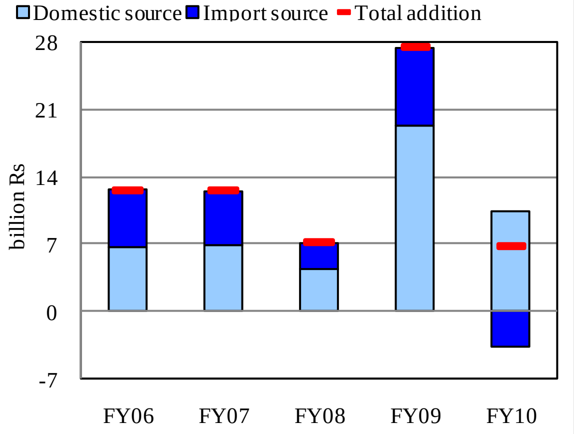
billion rupees

	Jul-Sep			Absolute difference		Share in total (%)		
	FY08	FY09	FY10	FY09	FY10	FY08	FY09	FY10
Total indirect tax collection	**127.8**	**173.9**	**178.5**	**46.1**	**4.6**	**100.0**	**100.0**	**100.0**
of which								
POL products	31.1	59.1	53.1	28.1	-6.0	24.3	34.0	29.8
Edible oil	8.3	8.4	6.9	0.2	-1.6	6.5	4.9	3.9
Vehicles (non-railway)	9.5	9.4	7.3	0.0	-2.1	7.4	5.4	4.1
Iron and steel	3.9	4.1	4.6	0.1	0.5	3.1	2.3	2.6
Electric machinery	4.5	5.7	4.0	1.2	-1.7	3.5	3.3	2.3
Tea and coffee	0.9	1.6	1.8	0.7	0.2	0.7	0.9	1.0
Machinery & mechanical appliances	4.1	5.0	4.2	0.9	-0.7	3.2	2.9	2.4
Plastic resins etc	4.8	6.6	5.4	1.8	-1.2	3.7	3.8	3.0
Cigarettes & tobacco	5.9	8.9	9.6	3.1	0.7	4.6	5.1	5.4
Cement	3.7	5.3	5.6	1.6	0.4	2.9	3.0	3.1
Services	3.3	5.0	8.3	1.8	3.2	2.6	2.9	4.6
Sub-total	**79.8**	**119.1**	**110.7**	**39.3**	**-8.4**	**62.4**	**68.5**	**62.0**

Source :Federal Board of Revenue

and iron & steel generated higher revenue when compared to their contributions during Q1-FY09. The dutiable import value of the iron & steel grew by 24.2 percent during Q1-FY10 as against 18.3 percent decline in the corresponding period a year earlier. Increased contributions in terms of domestic source mainly came from: a) cement b) cigarettes and tobacco, c) electrical energy, d) natural gas, and e) services.

Figure 5.8: Year-wise Addition in Sales Tax Collection (Q1)



Sales Tax

Net collection from sales tax stood at Rs 117.1 billion during Q1-FY10 higher by Rs 6.8 billion from the corresponding period a year earlier. Of the total addition in the sales tax, Rs 10.4 billion came from domestic source which implies that collection of sales tax from import source fell below the previous year amount by Rs

3.6 billion (see **Figure 5.8**).

A break-up of the domestic related sales tax shows that collection under the head of: a) natural gas, b) electric energy, c) beverages, d) cement, e) motor cars, f) sugar, and g) services exceeded that of the comparable period last year. Collection from the import source declined by 6.5 percent compared to the corresponding period of the previous year. Of this, collection under the head of iron & steel exceeds that of the comparable period of the last year. The decline in the import related sales tax is aligned with the decline in the rupee value of the imports.

Federal Excise Duty (FED)

Q1-FY10 collection from FED stood at Rs 28.4 billion compared to Rs 25.5 billion collected during the first quarter of the previous year. A break-up of

Table 5.8: Summary of Consolidated Provincial Finance
billion rupees

	Jul-Sep				YoY change (%)	
	FY07	**FY08**	**FY09**	**FY10**	**FY09**	**FY10**
Total revenue	**98.7**	**142.0**	**160.2**	**173.2**	**12.8**	**8.1**
Provincial share in federal revenue	78.5	90.9	124.4	132.1	36.9	6.2
Provincial taxes	9.9	9.4	12.6	11.2	34.0	-10.7
Property taxes	1.5	1.0	1.8	1.7	80.0	-8.3
Excise duties	0.5	0.6	0.6	0.6	0.0	4.8
Stamp duties	2.4	2.7	2.6	2.3	-3.7	-10.8
Motor vehicle tax	2.0	2.3	2.1	2.5	-8.7	18.6
Other	3.5	2.8	5.5	4.2	96.4	-24.4
Provincial non-tax	4.9	18.3	8.4	10.0	-54.1	19.4
Interest	0.0	9.5	0.0	0.0	-	-
Irrigation	0.5	0.5	0.4	0.4	-20.0	-10.5
Others	4.4	8.3	8.0	9.7	-3.6	20.8
Federal loans and transfers/grants	5.4	23.4	14.8	19.7	-36.7	33.3
Loans (net)	-1.5	1.3	1.5	0.1	11.8	-91.1
Grants	6.9	22.0	13.3	19.6	-39.6	47.4
Total expenditure	**111.7**	**167.7**	**140.1**	**183.2**	**-16.5**	**30.8**
Current expenditure	88.2	107.0	119.3	143.8	11.5	20.5
Interest payments to federal govt	5.1	4.4	4.2	4.2	-4.5	0.1
Other current expenditure	83.1	102.6	115.1	139.6	12.2	21.3
Development expenditure	23.5	60.7	20.8	39.4	-65.7	89.6
Overall balance	**-13.0**	**-25.7**	**20.1**	**-10.1**	**-178.1**	**-150.1**

Source: Ministry of Finance

collection from FED into import and domestic sources reveals that collection from the import related FED declined by 31.1 percent and stood at Rs 2.8 billion. Domestic source generated Rs 25.6 billion during Q1-FY10 compared to Rs 21.5 billion a year earlier. A break-up of FED collected from domestic source reveals that tax receipts from beverages and cigarettes & tobacco were higher than in the corresponding period a year earlier.

Custom Duty (CD)

The net collection realized under the head of custom duty during Q1-FY10 has been Rs 33.1 billion, entailing negative growth of 13.4 percent over the corresponding period of the previous year. Collection from custom duty moves in tandem with the rupee value of imports.

5.7 Provincial Fiscal Operations

Provincial public finances indicate noticeable deterioration in Q1-FY10, as total expenditure witnessed considerable acceleration coupled with fall in the revenue receipts (see **Table 5.8**). Consequently, the overall balance turned into Rs 10.1 billion deficit compared to a surplus of Rs 20.1 billion during Q1-FY09.

Table 5.9: Provincial Finance during Jul-Sep

billion rupees

	Punjab		Sindh		NWFP		Baluchistan	
	FY09	**FY10**	**FY09**	**FY10**	**FY09**	**FY10**	**FY09**	**FY10**
Total revenue	**72.6**	**73.8**	**47.1**	**48.0**	**21.7**	**32.7**	**18.8**	**18.7**
Provincial share in federal revenue	59.8	65	37.4	40.1	15.5	15.7	11.7	11.4
Provincial taxes	5.7	6.1	6.2	4.4	0.6	0.5	0.2	0.2
Provincial non-tax	5.4	3.1	0.8	1.0	1.8	5.7	0.4	0.2
Federal loans and transfers/grants	1.8	-0.4	2.7	2.4	3.9	10.8	6.5	6.9
Total expenditure	**68.1**	**105.5**	**46.6**	**35.0**	**17.0**	**30.9**	**8.4**	**11.8**
Current expenditure	56.8	81.0	41.3	31.5	14.5	20.4	6.9	10.9
Development expenditure	11.3	24.5	5.4	3.6	2.5	10.4	1.5	0.9
Overall balance	**4.5**	**-31.7**	**0.5**	**13.0**	**4.8**	**1.8**	**10.4**	**6.9**

Source: Ministry of Finance

Revenue receipts of all provinces stood at Rs 173.2 billion, registering a growth of 8.1 percent in Q1-FY10 against 12.8 percent rise last year. Federal tax assignments to provinces increased marginally in Q1-FY10 due to small expansion in the divisible poll (also visible from deceleration in the growth of the FBR tax collection).

Province-wise details show that Punjab experienced enormous deterioration in the overall balance, turning from surplus into deficit in Q1-FY10. Sindh recorded improvement in the overall surplus; while Baluchistan and NWFP recorded reduction in the surpluses in overall balance (see **Table 5.9**).

5.8 Domestic Debt

Pakistan's domestic debt stood at Rs 4.1 trillion at end-October 2009, registering a growth of 5.7 percent in Jul-Oct FY10 compared to 6.3 percent rise in the same period last year (see **Table 5.10**). This deceleration in the growth of domestic debt in the presence of increased fiscal deficit for Q1-FY10 reflects relatively higher availability of external resources to finance the budget deficit.

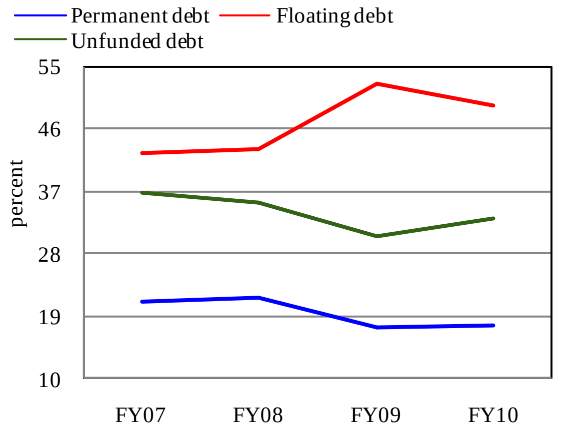
Table5.10 : Key Developments of Domestic Debt

	Jul-Oct	
	FY09	**FY10**
Growth in domestic debt (percent)	6.3	5.7
Contribution of LT debt (billion Rs)	25.8	116.5
Contribution of ST debt (billion Rs)	179.3	103.0
Domestic debt (billion Rs)	205.0	219.5
Domestic debt stock (end-Oct; billion Rs)	3471.1	4072.1

Composition of Domestic Debt

Compositional break-up of domestic debt indicates that the floating debt grew by 5.4 percent during Jul-Oct FY10, compared to 10.9 percent increase in the same period last year. Despite this decline, floating debt remained the largest component of domestic debt (see **Figure 5.9**). The government was able to mobilize substantial amount from non-bank sources in Jul-Oct FY10. As a result, the share of unfunded debt in total domestic debt increased to 33.0 percent by end-October 2009 from 30.4 percent by end-October 2008. On the other hand, the share of permanent debt in total domestic debt observed a marginal increase to reach 17.7 percent by end-October 2009.

Figure 5.9: Share in Total Domestic Debt (end-Oct)



The break-up of domestic debt reveals that the outstanding stock of permanent debt rose by Rs 42.1 billion in Jul-Oct FY10 compared to a net retirement of Rs 8.1 billion in the same period last year (see **Table 5.11**). Within the permanent debt, PIB retained its dominant share by contributing Rs 15.7 billion in Jul-Oct FY10. The government was able to borrow Rs 14.4 billion through single auction of Ijara Sukuk Bond in September 2009. Additionally, mobilization through prize bonds saw a significant improvement, adding Rs 13.0 billion in Jul-Oct FY10. This was mainly due to the decision of the government to increase the amount of prizes on different denominations in February 2009.

Table 5.11 : Profile of Permanent Debt (Jul-Oct)
billion rupees

	FY09		FY10	
	Net receipts	Debt (end-Oct)	Net receipts	Debt (end-Oct)
PIBs	-12.5	399.1	15.7	456.7
Ijara sukuk	6.5	6.5	14.4	42.2
Prize bonds	-2.1	180.7	13.0	210.4
Others	0.0	14.0	-1.0	10.8
Total	**-8.1**	**600.3**	**42.1**	**720.1**

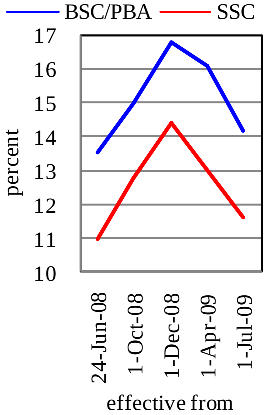
Growth in the floating debt went down by 5.5 percentage points to 5.4 percent in Jul-Oct FY10, compared to corresponding period last year. The sharp deceleration in the growth of floating debt largely stemmed from lower government borrowings through treasury bills for replenishment, which recorded a net retirement of Rs 81.9 billion in Jul-Oct FY10; against an addition of Rs 273.5 billion in the same period last year (see **Table 5.12**). The outstanding stock of t-bills (auction) increased by 23.2 percent in Jul-Oct FY10 compared to a decline of 17.6 percent in the same period last year. The reversal resulted from increased participation of the commercial banks in the t-bills auctions due to: a) expectations of downward

Table 5.12 : Net Flows Through T-bills (Jul-Oct)
billion rupees

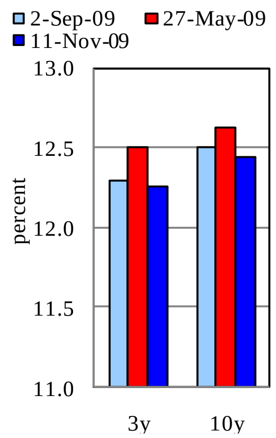
	FY08	FY09	FY10
MTBs	108.2	-94.3	184.9
MRTBs*	-46.7	273.5	-81.9
Total	61.6	179.3	103.0

*inclusive of outright sale of MTBs to commercial banks

Figure 5.10: Rate of Return on Major NSS Instruments

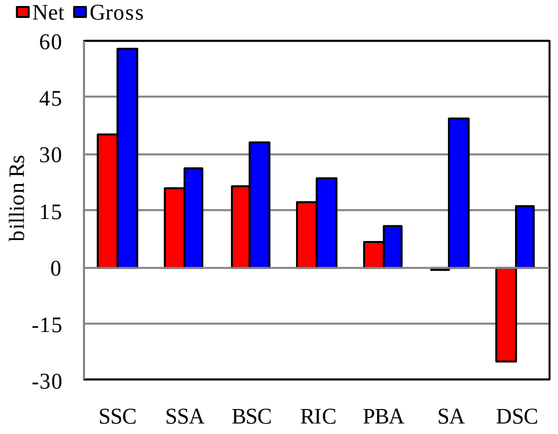


Rate of Return on PIBs



movement in policy rate due to easing inflation, and b) slowdown in the demand for credit from the private sector. Unfunded debt, mainly comprising national savings schemes saw an increase of Rs 74.5 billion in Jul-Oct FY10 compared to increase of Rs 33.8 billion in the corresponding period last year. This increase was mainly on account of investors' expectations about further reduction in the rate of returns on NSS. Despite this increase in Jul-Oct FY10, the government may have difficulty in mobilizing funds through NSS in the coming months, as average monthly flows observed declining trend. Gradual fall in the net mobilization through NSS was mainly due to the government's decision to lower the profit rate on the major NSS instruments since April 2009. The persistent fall in the yield of PIBs could result in further cut in the profit rates on NSS instruments (see **Figure 5.10**).[9]

Figure 5.11: Gross & Net Flows through NSS (Jul-Oct)



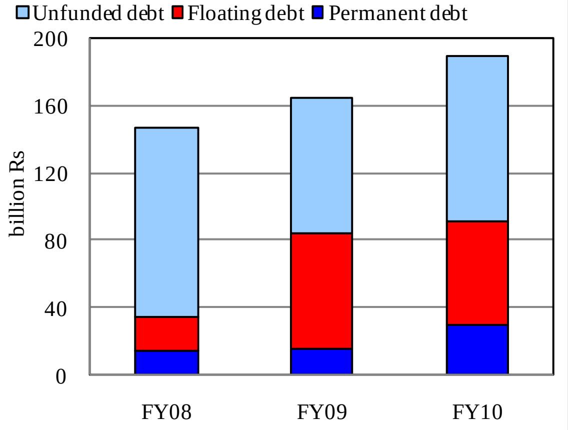
Gross sales of NSS instruments rose significantly to Rs 207.6 billion during Jul-Oct FY10 (see **Figure 5.11**). However massive encashment of these instruments coupled with the larger maturities of Defense Saving Certificates (DSC) has lowered the net receipts in the same period. Despite the higher interest rate offered by BSC and PBA, SSC and SSA remained the attractive instruments for the investor. This was probably due to: a) free encashment facility on these schemes at any time after one month of the date of purchase, and b) exemption from withholding tax, if the profit earned on these schemes remains in specified limit. Additionally, the investment scope is quite high as institutional investors are also eligible to invest in these instruments.

Interest Payments on Domestic Debt

Interest payments on domestic debt increased by 14.9 percent to Rs 189.4 billion in Jul-Oct FY10 compared to Rs 164.8 billion in the same period last year (see **Figure 5.12**). The break-up of domestic debt servicing data reveals that interest

[9] The tenor of BSC and PBA is ten years, while that of SSC is three years.

Figure 5.12: Interest Payments on Domestic Debt (Jul-Oct)



payments on permanent debt increased significantly during Jul-Oct FY10 compared to the same period last year. This increase largely stemmed from the interest payments on 10 year PIBs, consistent with its increasing share in outstanding stock of PIBs. In contrast, interest payments on floating debt decreased moderately in Jul-Oct FY10 compared to the same period last year. This decrease is largely due to lesser maturities of the t-bills (auction), as banks were reluctant to participate in the 12 months t-bills auctions during Jul-Oct FY09. However, the decrease in interest payments to commercial banks is largely compensated by rise in the interest payments on MRTBs, with its more than Rs 1 trillion debt stock as on October 30, 2009. The debt servicing cost on unfunded debt stood at Rs 98.7 billion registering a growth of 23.0 percent in Jul-Oct FY10. The interest payments on the matured stock of DSCs still constitute a major share in the total interest payments on unfunded debt. On the other hand, the interest payments on SSC and BSC also increased significantly in Jul-Oct FY10. This seems to be consistent with their rising share in total unfunded debt.