4 Public Finance and Fiscal Policy

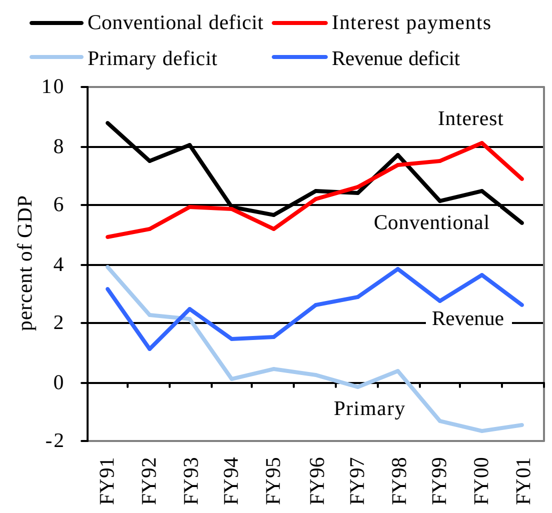
4.1 Introduction

FY01 witnessed the implementation of strong fiscal management along with structural reforms in almost all key sectors of the economy. The reforms were focused on documentation aimed at improving tax compliance. Other measures included a tax amnesty scheme, the extension of GST to services, fiscal transparency, measures to arrest the overrun of expenditures, and several other steps intended to promote fiscal discipline and correct macroeconomic imbalances. Despite weaker than expected economic growth on account of the drought, these measures helped the government realize a significant increase in tax revenue and contain expenditure growth. This jointly resulted in an impressive reduction of 1.1 percent in the budget deficit to 5.3 percent of GDP in FY01.

4.2 Consolidated Fiscal Developments in FY01[1]

Fiscal consolidation is visible in all three measures of the budget deficits (see **Figure 4.1**). Since there was a revenue shortfall this year, the decline in the overall budget deficit, indicates government efforts towards greater budgetary discipline. The primary balance has remained in surplus for the last three years in a row, showing that the fiscal deficit is primarily driven by interest payments. Another measure of the fiscal position is the revenue deficit, which also shows signs of improvement in FY01; this was the outcome of exerted efforts to control government spending, which was sharply curtailed by 1.7 percent of GDP over the last year (see **Table 4.1**). This was mainly on account of lower interest payments, reduction in other expenditures and a cut in the public sector development program of provincial governments.[3] Moreover, higher tax collection also contributed to a reduction in the budget deficit.

Figure 4.1: Trends in Key Indicators[2]



Despite lower than anticipated economic growth, consolidated tax revenues recorded healthy growth of 13.8 percent over FY00, mainly on account of higher tax collection by CBR. However, this increase was eclipsed by lower non-tax revenues (consolidated), which slowed the overall growth in revenues to 4.7 percent in FY01, from 15.6 percent last year. On the expenditure side, a deteriorating balance between productive and current spending over the past decade has continued to exacerbate the composition of the fiscal balance. Government borrowing to finance current expenditures has not increased the productive capacity of the economy. As depicted in **Figure 4.1**, the revenue balance has

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[1] The discussion in this section is based on revised estimates for FY01, targets for FY01 and provisional actual data of FY00.

[2] The conventional balance is the gap between total revenue receipts and expenditure, whereas the primary balance is the gap between revenue and non-interest expenditure. The revenue balance, on other hand, is the difference of revenue receipts and current expenditures.

[3] Revised public sector development expenditures of provincial governments stood at Rs 28.8 billion, which not only fell short of budget target (Rs 44.7 billion) but also from the provisional actual (Rs 36.3 billion) of FY00. However, this apparent decline is deceptive, when seen in the context of consolidated PSDP that showed an increase of Rs 14.4 billion over FY00. This point shows that the federal government has spent more (although lower than budgeted) on PSDP compared to FY00.

remained in deficit, indicating that the government is not only borrowing to finance development but also current expenditure.[4] This has enhanced indebtedness of the country and stilted productive capacity.

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

billion Rupees

	FY99	FY00^{PA}	FY01^{BE}	FY01^{RE}	FY02^{BE}
1. Revenue receipts	**468.6**	**541.6**	**608.6**	**566.9**	**657.9**
Tax revenue	390.7	405.8	497.8	461.7	528.2
Non-tax receipts	77.9	135.8	110.8	105.2	129.8
2. Total expenditure	**647.8**	**745.7**	**770.7**	**752.5**	**844.8**
Current	547.3	655.0	658.5	656.4	714.6
Development	98.3	87.7	120.4	102.1	130.0
Net lending to PSEs etc.	2.2	3.0	-8.2	-6.0	0.2
3. Revenue surplus/deficit	**-78.7**	**-113.4**	**-49.9**	**-89.6**	**-56.6**
4. Overall deficit (1-2)	**-179.2**	**-204.1**	**-162.1**	**-185.6**	**-186.9**
5. Financing through:	**179.2**	**204.1**	**162.1**	**185.6**	**186.9**
External resources (net)	97.1	66.5	90.9	128.8	121.6
Internal resources	82.1	137.6	71.2	56.8	65.3
Domestic non-bank	155.9	97.7	73.4	96.3	54.8
Banking system	-73.8	40.0	-2.3	-39.4	10.5
As per cent of GDP (mp)					
1. Revenue receipts	**15.9**	**17.0**	**17.3**	**16.3**	**17.3**
Tax revenue	13.3	12.7	14.2	13.3	13.9
Non-tax receipts	2.7	4.3	3.2	3.0	3.4
2. Total expenditure	**22.0**	**23.4**	**22.0**	**21.7**	**22.3**
Current	18.6	20.6	18.8	18.9	18.8
Development	3.3	2.8	3.4	2.9	3.4
Net lending to PSEs etc.	0.1	0.1	-0.2	-0.2	0.0
3. Revenue surplus/deficit	**-2.7**	**-3.6**	**-1.4**	**-2.6**	**-1.5**
4. Overall deficit (1-2)	**-6.1**	**-6.4**	**-4.6**	**-5.3**	**-4.9**
5. Financing through:	**6.1**	**6.4**	**4.6**	**5.3**	**4.9**
External resources (Net)	3.3	2.1	2.6	3.7	3.2
Internal resources	2.8	4.3	2.0	1.6	1.7
Domestic non-bank	5.3	3.1	2.1	2.8	1.4
Banking system	-2.5	1.3	-0.1	-1.1	0.3

^{RE} Revised estimates ^{PA} Provisional actual ^{BE} Budget estimates

Source: Ministry of Finance

The pattern of key expenditures as a percent of GDP is shown in **Figure 4.2**. The fall in debt servicing and defense expenditures is visible during FY01. An interesting feature this year, was the reduction in interest payments, realized primarily on account of lower T-bills rates, lower returns on NSS, and smaller amounts of prize money carried by Prize Bonds.[5] Defense expenditure has continued to record a significant decline since FY93. In FY02, it estimated at 3.5 percent of GDP compared to 6.5 percent in FY93. Contrary to this decline, expenditures on the running of civil government increased mainly on account of military pensions that were reclassified and transferred to

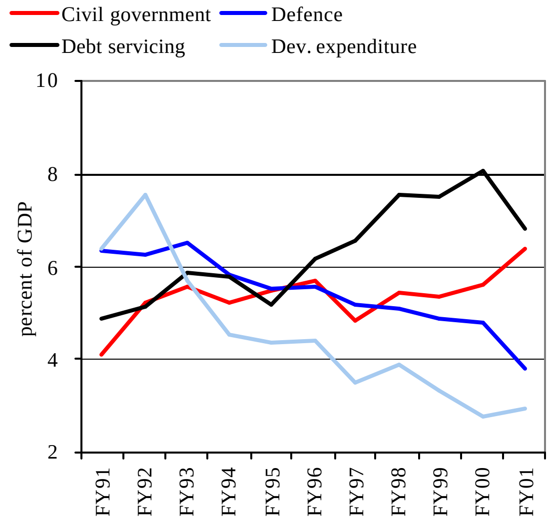
[4] Pakistan is running revenue deficit since FY85.

[5] The weight average yield on T-Bill rates declined from 10.6 percent in FY99 to 7.2 percent in FY00 on account of an easing of monetary policy. Profit rates on National Saving Schemes were adjusted downward on May 14, 1999, January 1, 2000 and on July 1, 2000.The prize money paid on National prize Bonds was reduced from 12 percent to 6 percent on January 1, 2000.

general administration.[6] Spending on social and economic services also declined, which may be the upshot of better accountability and improved governance. Despite a significant decline in overall expenditures, development spending (consolidated) recorded a healthy increase of 16.4 percent over FY00, indicating government efforts to reprioritize such spending.

The composition of deficit financing during FY01, marked a significant shift from domestic to external sources, as external financing stood at Rs 128.8 billion against Rs 66.5 billion in FY00 (see **Table 4.1**). This change is the result of higher inflows from international financial institutions (IFIs) as a result of the SBA, which in turn allowed the government to reduce its dependence on bank borrowings.

Figure 4.2: Pattern of Key Expenditures



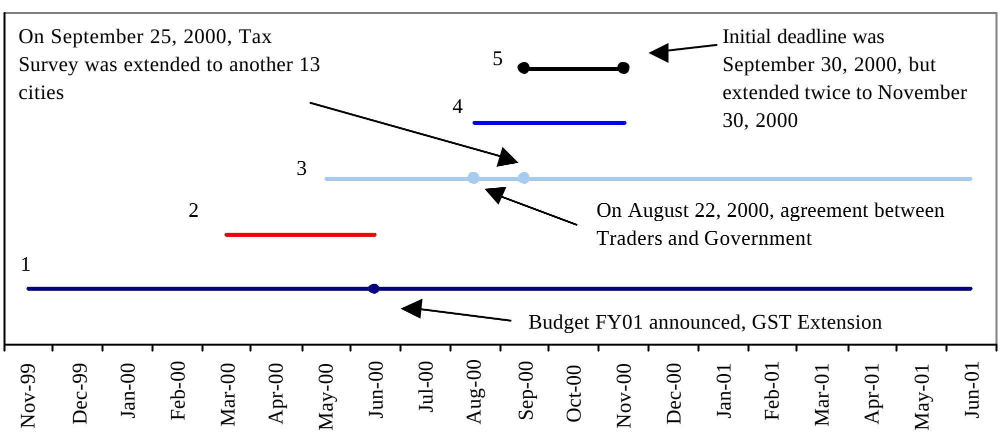
4.3 Fiscal Operations of Federal Government in FY01

4.3.1 Recap of Major Fiscal Policy Measures

The existing fiscal reforms date back to mid-December 1999, when the government announced its Economic Revival Program (ERP), which envisaged a self-reliant economy. Besides suggesting structural reforms in key sectors, the ERP announced a series of interrelated fiscal and legal reforms to correct macroeconomic imbalances in the economy (see **Figure 4.3**). Initially, measures like the

Figure 4.3: Recap of Fiscal Reforms

1. Three-year Economic Revival Program announced on December 15, 1999
2. Tax Amnesty Scheme (I) from March 1 to June 30, 2000
3. Tax Survey and Documentation Exercise, started from May 27, 2000 and still in progress
4. Tax Amnesty Scheme (II) from August 3, 2000 to November 30, 2000
5. Self Assessment Scheme announced in September to November 30, 2000



[6] Expenditure on running of the civil government includes spending on general administration, law and order, social,

accountability drive and tax survey were a source of public anxiety. However, these were precursors to the government's commitment to institutionalize accountability and lay down the foundation of a fully documented economy. To appease public concerns related to these issues, the government announced a Tax Amnesty Scheme (TAS) in December 1999, to facilitate those who want to break away from past practices and pay their tax liabilities.

The second amnesty scheme (TAS-II) contributed only Rs 1.1 billion to the government exchequer as most people had already availed TAS-I, while traders were able to avail special concessions in their agreement with the government. CBR also announced a Self Assessment Scheme (SAS) to file income and wealth tax returns for FY00. The deadline of SAS was extended to end-November, as traders were allowed to avail TAS-II to declare their assets.

4.3.2 Tax Survey and Registration Scheme

The Tax Survey and Registration Scheme was launched on May 27, 2000, in an effort to document the economy, widen the tax base and add to tax revenue. The overall survey work was divided into three phases. In its first Phase, the survey was launched in select areas of13 big cities and was extended to remaining areas in addition to another 13 cities in Phase-II. In Phase-III, the tax survey will cover the remaining cities with revenue potential. Three types of survey forms were designed to collect comprehensive information from business units, tenants and property owners. The process of information collection and analysis was to be completed in three visits to businesses and households. In the first visit, survey forms were distributed, which were collected after a pre-specified period of two weeks. The analysis of information provided in the survey and its comparison with data from other sources (like telephone, gas and electricity bills) was a key element to cross check information provided in the tax survey. After a careful analysis and comparison, a third visit to businesses, known as 'on the spot assessment' was made to assess the final liability of a taxpayer and to remove any anomalies. The following benefits have been realized up to June 30, 2001:

- Total number of forms distributed in Phase-1 were 773.7 thousand, of which 679.1 thousand were retrieved, showing retrieval turnout of 87.8 percent. The progress in Phase-II shows that 1,068.4 thousand forms were distributed and 901.6 thousand retrieved. In total, 1,842.1 thousand forms were distributed in both phases and retrieval turnout was 85.8 percent.

- The number of spot visits, a key element of the tax survey, conducted in Phase-I were 90.2 thousand and the resultant increase in declared turnover was 51.7 percent compared with the turnover declared in survey forms. Spot visits for Phase-II have not started yet.

- 63.3 thousands new sales taxpayers registered/enrolled/enlisted.

- An additional 172.1 thousand income taxpayers have registered themselves voluntarily ; and

- An increase of 30 percent was realized in tax payments via income tax returns in FY01 compared to FY00.

Despite these encouraging developments, the direct contribution from the tax survey in terms of revenue collections has been far lower than anticipated, primarily because of its medium-term nature and strong resistance by traders in the first quarter of the year. However, an enormous amount of data has been collected, which should help CBR realize higher tax collections in future.

economic and community services.

4.3.3 CBR Tax Collections[7]

One of the major challenges faced by Pakistan's fiscal authorities is the matching of revenues with expenditures. Historically, CBR tax collections to GDP ratio, which is an indicator of tax effort, remained within a tight range of 10.5 to 12.5 over the last decade (see **Figure 4.4**). Although, this ratio has witnessed a marginal improvement in FY01 on account of buoyant tax collections, it is still lagging behind the peak achieved in FY96. This low tax to GDP ratio can be traced to the existence of a large undocumented economy, extensive exemptions, a narrow tax base, reduction in import related taxes and the absence of a tax culture in the country.

Figure 4.4: CBR Tax Collections to GDP Ratio

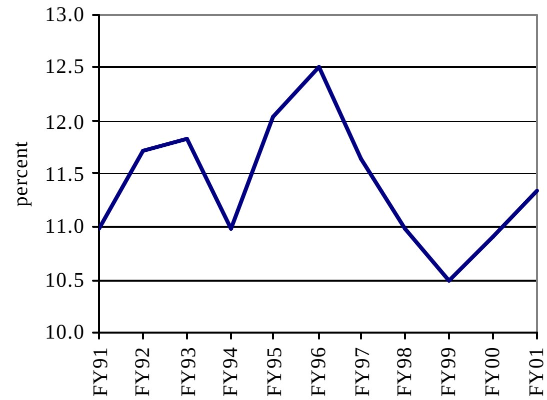
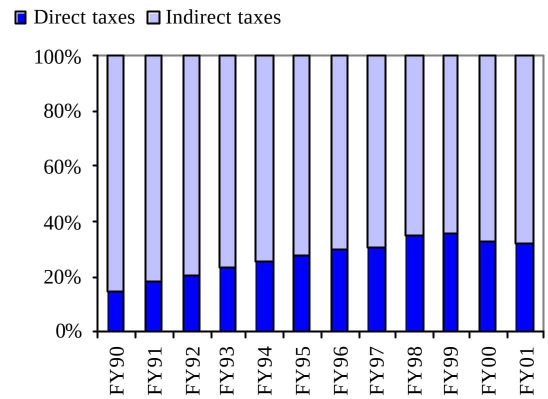


Figure 4.5: Share in Tax Revenue



To enhance the mobilization of tax revenues, successive governments have undertaken wide-ranging tax and tariff reforms in the 1990s that marked a shift in the composition of tax revenue. The share of direct taxes has approximately doubled from FY90 to FY01 (see **Figure 4.5**), which is largely due to an increase in withholding taxes that account for almost two-thirds of total income tax revenue.[8] However, after peaking in FY99, the share of direct taxes has marginally declined in subsequent years.

More specifically, the slower growth of direct taxes and a decline in its share of total taxes was the result of lower T-bills rates and a shift in government borrowing from commercial banks to SBP. This resulted in a sharp reduction in tax revenues from interest income, as returns to SBP from T-bills are not taxed. Furthermore, since witnessed retirement to the banking sector, this also led to lower revenues from interest income. The decline in the share of direct taxes can also be attributed to government effort to broaden the sales tax net. Consequently, sales tax collection has out performed all other revenue heads. Moreover, the on-going documentation drive and the extension of GST to services, has had an immediate impact on indirect tax collection, while the impact on direct taxes will emerge after a lag.

The composition of indirect taxes witnessed a sharp swing in the late 1990s (see **Figure 4.6**). The share of central excise duty (CED) in total indirect taxes has remained stable (except for the last two years) compared to sales tax and custom duties. As shown, the share of custom duties continued to decline over the last decade, largely due to tariff reforms and trade liberalization measures adopted by

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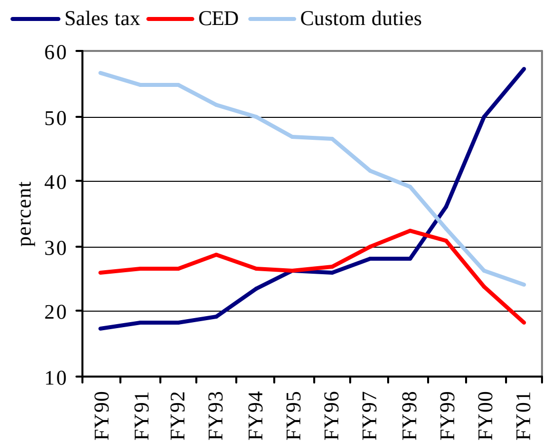
[7] Data on actual tax collection are utilized to gauge the performance of CBR, which are different from revised data reported in **Table 4.4**.

[8] Withholding tax is subject to criticism because of its indirect nature; generally, this tax is adjustable toward the final liability of a taxpayer, but some (turnover tax, import levies etc.) are not adjustable and treated as the final liability, and may have a cascading effect. A classic example of cascading is the multistage retail turnover tax, applied to all sales in a production or distribution process, this does not take into account tax paid on inputs at earlier stages. However, in order to simplify the tax structure, the government has abolished five types of withholding tax in the budget for FY02.

Pakistan. The share of sales tax posted a steep increase in late 1990s, mainly on account of its extension to various sectors and government efforts to replace central excise duty with sales tax. This is obvious in last two years (see **Figure 4.6**).

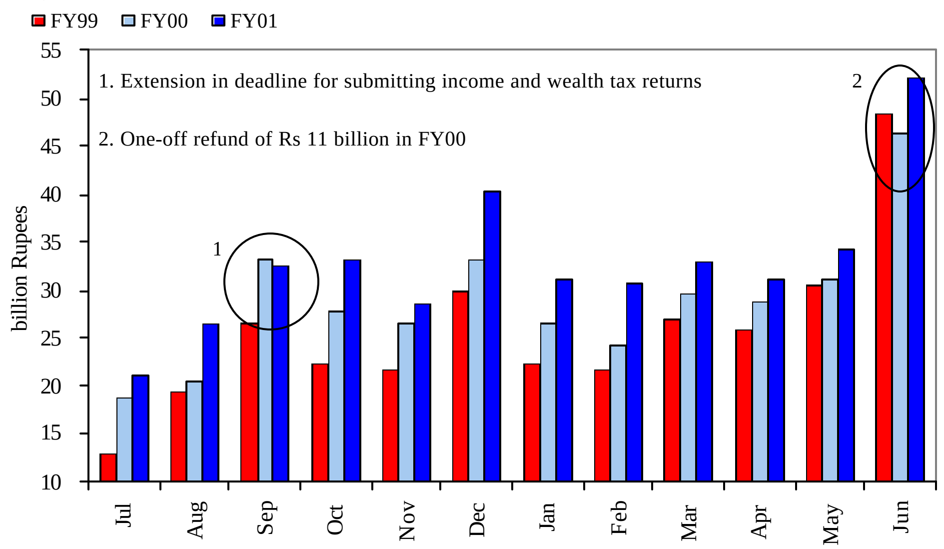
Figure 4.6: Shares in Indirect Taxes



Seasonality in Tax Collections

A persisting seasonal pattern is clearly visible in monthly tax collections over the last three years (see **Figure 4.7)**. Lower tax collection in September 2000 compared to September last year was because the deadlines for submitting income and wealth tax returns was extended, which partially shifted the revenue impact to October 2000. Similarly, the change in pattern in June 2000 was the result of a one-time refund of Rs 11.0 billion, which led to lower net tax collections last year (see **Figure 4.7**). Except these two points, a seasonality of peaks is realized at quarter ends, reflecting special efforts by CBR to meet revenue targets, and seasonal behavior of business activities in the economy. Tax collection in September largely includes the revenue impact of the Self Assessment Scheme (SAS), while December is the year end for financial institutions.

Figure 4.7: Seasonality in Tax Collections



Actual Tax Collections in FY01

As opposed to single digit growth of federal tax collections in the pervious decade, CBR revenues recorded double-digit growth for the second year in a row in FY01. In the preceding three years FY96-FY99, the actual tax collection increased by Rs 40.5 billion or cumulative growth of 15.1 percent. In the next two years FY99-FY01, tax collection rose by Rs 85.4 billion or almost 27.7 percent. A healthy growth of 13.5 percent in FY01 over actual collections in FY00, was the result of tax reforms during the year. The break up of revenues collected reveals that direct taxes increased by

12.8 percent over actual collection in FY00 (see **Table 4.2**). This buoyant growth, although lower than projected, was on account of the revised SAS, the one-off nature of tax amnesty (TAS-II), and the on-going tax survey. The direct tax base has also been expanded through reforms of agricultural income and wealth tax; in addition, exemptions have also been curtailed. A massive increase in workers welfare tax due to the realization of arrears also contributed to this increase in direct taxes.

Table 4.2: Actual Tax Collections by CBR
billion Rupees

	FY98	FY99	FY00	FY01	Percentage change			
	1	2	3	4	2 over 1	4 over 2	3 over 2	4 over 3
Direct taxes	78.2	110.2	113.0	127.4	41.0	15.6	2.5	12.8
Indirect taxes	189.9	198.3	234.2	266.5	4.4	34.4	18.1	13.8
Sales tax	49.8	72.1	116.7	152.8	44.7	111.9	61.9	30.9
Central excise	51.1	60.9	55.8	49.2	19.2	-19.2	-8.4	-11.8
Customs	88.9	65.3	61.7	64.5	-26.6	-1.3	-5.6	4.6
Total	**268.0**	**308.5**	**347.1**	**393.9**	**15.1**	**27.7**	**12.5**	**13.5**

The growth of indirect taxes also remained buoyant on account of sales tax. During the year, monthly sales tax growth ranged from 30.7 to 77.0 percent, with an average increase of 48.7 percent over actual collections in FY00. These increases were primarily due to the full year impact of GST extension to the energy sector and several other discretionary measures, which include extension of GST to pesticides and fertilizers, and to services that was previously subject to CED. In addition, higher GST collection also benefited from improving tax compliance, a wider tax base and increasing documentation due to the on-going tax survey. While sales tax revenue grew significantly, revenue from customs and CED recorded negative growth during most of this year. As mentioned earlier, the government has been substituting CED with GST, therefore the negative growth in CED is not surprising. Custom duties were not able to meet the budget target primarily due to lower than anticipated increase in dutiable imports.

Budget Targets and Actual Outcome

Despite significant growth, CBR tax collections not only fell short of the budget target, but also the revised targets (see **Table 4.3**). Over-ambitious CBR revenue targets (performance criterion under the SBA) experienced frequent revisions during the course of the year, which forced the government to request a waiver in each review meeting for its non-observance. Realized tax collections were at Rs 41.8 billion short of the budget estimates and Rs 12.6 billion lower than the last revised target. These projection errors had serious implications for the actual deficit, expenditure adjustments and borrowing requirements during the year.

Table 4.3: CBR Targets during FY01
billion Rupees

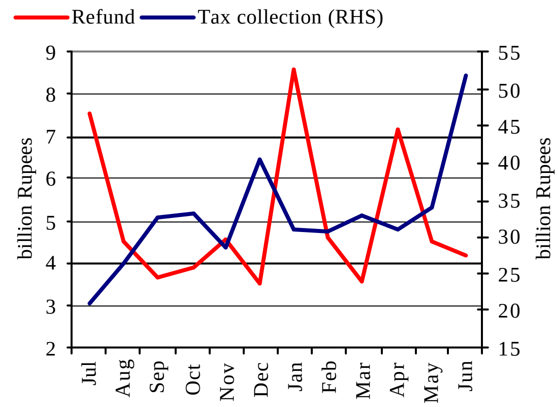
	Direct taxes	Indirect taxes				Total taxes
		Sale tax	CED	Customs	Total	
Budget	137.1	172.0	53.4	73.2	298.6	435.7
First revision[1]	138.4	176.7	50.3	64.6	291.6	430.0
Second revision[2]	133.9	166.2	52.5	64.6	283.3	417.2
Third revision[3]	133.9	155.8	52.2	64.6	272.6	406.5
Actual	127.4	152.8	49.2	64.5	266.5	393.9
Budt target achieved (%)	92.9	88.8	92.1	88.1	89.2	90.4

[1] November 4, 2000 [2] March 18, 2001 [3] May 25, 2001

Source: Annual Budget Statement and IMF Review Reports

During FY01, the revisions and shortfalls were largely attributed to lower GDP growth, postponement of taxation measures due to prolonged negotiations with traders, displacement of CBR officials from regular duties to the tax survey, lower than expected growth in dutiable imports in the first half of FY01 and concessions granted to traders/retailers in the on-going tax survey. Although most of these factors were beyond the control of CBR, the government should categorize shortfalls according to technical, policy and exogenous economic factors.

Figure 4.8: Tax Collection and Refund



In addition to frequent revisions, another interesting point related to CBR is the refund/rebate system. Traders claim that CBR holds on to refund amounts to boost revenue collection at quarter ends, while CBR officials claim that the fall in refunds is the result of incomplete documentation and the consequent delays in finalizing these cases. To illustrate this issue, monthly tax collections and refund/rebate amounts are plotted in **Figure 4.8**. Recognizing the severity of this problem, the present government has replaced "No Duty No Drawback Rules 1998" with a simplified "Duty and Tax Remission for Export Rules, 2001" with effect from March 22, 2001. In addition, a Task Force on Reforms in Tax Administration was constituted to review existing management and policies of CBR, recommend measures to improve the ability of CBR tax machinery, and steps to collect taxes without creating bureaucratic obstacles for taxpayers. The Task Force has submitted its comprehensive report and the government has decided to implement its recommendations to simplify tax processes and almost eliminate contact between taxpayers and officials. Furthermore, the reorganization of CBR and intensive use of technology in tax assessment will reduce the element of discretionary powers.

4.3.4 Surcharges

Revised receipts from surcharges not only fell short of budget target, but also registered negative growth over actual receipts in FY00. Revenues from development surcharge on natural gas were in line with the budget target and recorded a healthy growth of 11.0 percent (over actual collections in FY00). This was largely on account of the full year impact of increase in gas prices with effect from August 16, 1999 (see **Table 4.4**). The entire shortfall in FY01 is therefore attributed to lower revenue from petroleum surcharges due to the payment of accumulated arrears to oil refineries. Moreover, higher international oil prices that were not fully passed on to consumers, also dampened oil surcharge revenue.[9]

Surcharges are considered a volatile revenue source because of the fluctuations in international prices (see **Figure 4.9**).[10] As retail prices were administered by the government and the effect of changes in international prices was not fully passed on to consumers, the result was an unanticipated fall in surcharges. Higher surcharge revenues in FY98 and FY99 were the windfall effect of lower international prices, which has reversed itself in the last two years.[11] The new petroleum pricing

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[9] Despite the volatility of prices, the average price of Brent crude oil increased by 14.3 percent in FY01.
[10] Petroleum development surcharge represents the difference between average import price and sale price of locally manufactured petroleum products.
[11] On August 29, 1997, the price of Brent crude oil was US$ 18.0 per barrel, which continued to decline with some fluctuations and touched lower limit of US$ 9.3 per barrel on December 11, 1998.

policy links end-use prices to the international prices and the government no longer administrates or fixes petroleum product prices. They are announced every fortnight by the oil companies themselves.

Table 4.4: Federal Government Revenue Receipts

billion Rupees

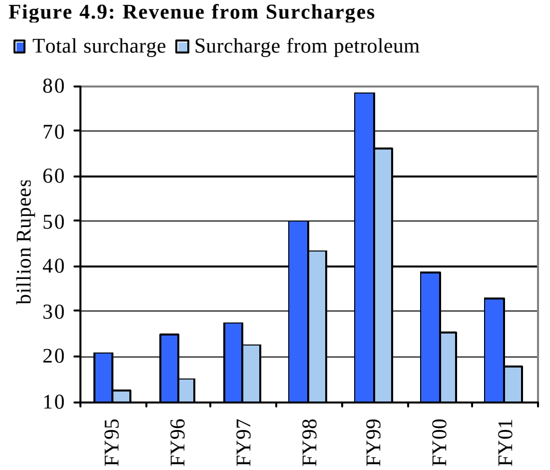
	FY00	FY01				FY02	
				Excess/shortfall from			
	Actual	Target	Revised	Target	Last year	Target	Excess over last year
1. Revenue receipts (II+III+IV)	531.3	594.6	558.0	-36.7	26.7	643.8	85.9
I. Total taxes and surcharges	386.0	473.7	439.5	-34.2	53.5	504.7	65.2
II. Total taxes	347.1	435.7	406.5	-29.2	59.4	457.7	51.2
Direct taxes	113.0	137.1	133.9	-3.2	21.0	149.8	15.9
Taxes on income	105.4	132.6	125.8	-6.9	20.4	144.2	18.4
Wealth tax	3.9	1.1	1.8	0.8	-2.1	0.2	-1.6
Workers welfare tax	3.0	2.9	5.6	2.7	2.6	4.6	-0.9
Capital value tax	0.7	0.6	0.8	0.2	0.1	0.8	0.0
Indirect taxes	234.1	298.6	272.6	-26.0	38.5	307.9	35.3
Customs	61.7	73.2	64.6	-8.6	2.9	69.6	5.0
Central excise	55.8	53.4	52.2	-1.2	-3.6	53.1	0.9
Sales tax	116.7	172.0	155.8	-16.2	39.1	185.2	29.4
III. Surcharges	38.9	38.0	33.0	-5.0	-5.9	47.0	14.0
Petroleum	25.4	23.0	18.0	-5.0	-7.4	32.0	14.0
Natural gas	13.5	15.0	15.0	0.0	1.5	15.0	0.0
IV. Non-tax revenue	145.3	120.9	118.5	-2.4	-26.8	139.1	20.7
Property and enterprises	91.6	71.1	67.7	-3.4	-24.0	81.5	13.8
Civil administration	34.9	27.6	23.9	-3.7	-11.1	28.6	4.8
Miscellaneous	18.7	22.2	26.9	4.7	8.2	29.0	2.1
2. Less: Transfers to provinces	143.6	182.5	169.8	-12.6	26.3	190.0	20.1
Revenue receipts (net) (1-2)	387.7	412.1	388.1	-24.0	0.4	453.8	65.7

Source: Annual Budget Statement of the Federal Government.

4.3.5 Non-Tax Revenue

Receipts from non-tax revenue missed the budget target because of lower than projected receipts from property and enterprises, as well as civil administration (see **Table 4.5)**. Income from property and enterprises is the prime contributor with a share of 57.1 percent in FY01. However, non-tax revenues lagged behind the target due to reduced interest payments from public sector enterprises. The shortage was not even covered by higher interest income from provinces, financial institutions, dividends and profits from Pakistan's post offices.[12] Similarly, revenue

Figure 4.9: Revenue from Surcharges



[12] Revised interest income from financial institutions was higher on account of more receipts from banks/DFIs due to retained amount of Rupee counterpart of Special U.S. Dollar Bonds. In budget FY01, Rs 275 million loss was projected from post office department, but now it is expected to earn profit of Rs 198 million, primarily credited to upward revision in postal tariff rates approved in March 2001.

from civil administration, holding 20.2 percent share in non-tax revenue, also fell short of targets mainly on account of lower than budgeted SBP profits. In addition, lower than budgeted defense, social and economic service receipts, also dampened such receipts.[13]

Contrary to the shortfalls in the above two heads, revised miscellaneous receipts were higher by Rs 4.7 billion over budget target, largely because of higher worker participation fund, passport fees, royalties and sale proceeds from oil and gas (see **Table 4.5)**.

Table 4.5: Federal Government Non-Tax Receipts
million Rupees

	FY00	FY01		FY02
	Receipts R	Target B	Receipts R	Target B
1 Property and enterprises (I+II+III)	74,276.8	71,110.2	67,672.5	81,474.8
I. Interest Income	61,672.0	56,935.0	51,444.1	65,234.3
Provinces	28,270.0	28,986.8	29,370.1	29,543.5
Punjab	12,609.7	13,314.0	13,402.7	13,440.6
Sindh	7,967.7	7,461.4	7,528.3	7,581.2
NWFP	5,209.8	5,575.3	5,765.3	5,809.7
Balochistan	2,482.8	2,636.2	2,673.8	2,712.0
Institutions	33,402.0	27,948.2	22,074.0	35,690.9
II. Dividend income	12,781.8	14,450.4	16,030.4	16,002.4
PTCL	8,994.2	10,000.0	10,118.4	10,118.4
OGDC	2,000.0	2,500.0	3,763.3	3,763.3
PARL	466.6	500.0	466.6	500.0
PSO	400.0	400.0	511.3	400.0
NIC	320.0	350.0	400.0	400.0
Others receipts	601.0	700.4	770.8	820.7
III. Railways & post offices	-177.0	-275.2	198.0	238.0
2 Civil administration	33,759.5	27,589.1	23,879.0	28,641.0
Transfer from SBP	30,000.0	23,000.0	20,000.0	23,000.0
Other receipts	3,759.5	4,589.1	3,879.0	5,641.0
3 Miscellaneous	23,084.4	22,185.8	26,898.0	28,988.0
Royalty on oil and gas	7,965.7	7,535.2	9,127.0	10,437.0
Sale proceeds of oil and gas	6,017.6	5,230.7	6,346.0	7,618.0
Workers profit participation fund	1,800.0	1,900.0	2,700.0	2,800.0
Foreign travel tax	1,700.0	1,800.0	1,700.0	1,730.0
Passport & copyright fee	2,930.0	2,980.0	3,270.0	3,320.0
Other receipts	2,671.1	2,739.9	3,755.0	3,083.0
Total (1+2+3)	131,120.7	120,885.1	118,449.5	139,103.8

R Revised, B Budget.

Source: Explanatory Memorandum on Federal Receipts

4.3.6 Provincial Share in Federal Taxes

Provincial governments receive revenue from the divisible pool of taxes under the National Finance Commission (NFC) Award 1996, which has been effective since July 1, 1997.[14] The share of the federal government in divisible pool is 62.5 percent and the remaining 37.5 percent is divided among provincial governments according to percentages fixed in the NFC Award. Revised transfers to provincial governments during FY01 stood at Rs 169.8 billion, representing a shortfall of Rs 12.6

[13] Defense receipts are realized because of service charges in accordance with protocol agreements, dues from civil agencies, sale and auction of obsolete stores, and charges of army aviation facilities.

[14] The divisible pool includes income tax, wealth tax, capital value tax, export duties on cotton, custom duties, taxes on sales and purchase, federal excise duties (excluding excise duty on gas charged at well-head) and any other tax that may be levied by the federal government. The net amount of divisible pool is calculated by deducting 5 percent collection charges, while an additional one percent from income tax is deducted on account of the amount collected from federal areas.

billion compared to budget estimates. In addition to a lower than projected divisible pool, less collected form GST on services and custom duties, also contributed to this fall (see **Table 4.4**).

4.3.7 Federal Government Expenditure

Revised expenditures on revenue and capital account stood at Rs 697.8 billion, which were significantly lower than actual expenditure in FY00. In terms of GDP, revised expenditure declined by 3.2 percent during FY01 compared to the year before. This clearly shows that fiscal austerity remained a key element in this year. The largest reduction was realized on account of lower debt servicing and defense expenditures. A detailed appraisal of expenditures will help provide more insights.

Revised expenditures on debt servicing, the largest component of current expenditures, registered a sharp decline of Rs 22.5 billion during FY01 over the previous year, but was still marginally higher than anticipated in the FY01 budget (see **Table 4.6**). The main impetus for this decrease came from lower interest payments on permanent, floating and unfunded debt. In addition to this, less than budgeted repayment of principal, despite higher interest payments on foreign debt (by 5.6 billion over FY00), also helped reduce this expense. The fall in interest payments on permanent debt was brought about by lower interest payments on SLIC bonds and prize money on National Prize Bonds.

Defense expenditures in the revised FY01 budget, recorded an impressive decline over actual spending last year and remained lower than budgeted (see **Table 4.6**). This was the result of tight monitoring and efficient use of defense spending. Interestingly, the massive decline in defense spending over FY00 and the steep increase in expenditure on general administration, were attributed to military pensions, which have been reclassified and transferred to the general administration head.

Table 4.6: Federal Government Expenditure
billion Rupees

	FY00	FY01				FY02	
				Excess/shortfall from			
	Actual	Target	Revised	Target	Last year	Target	Excess over last year
1. Revenue expenditure (A+B)	**604.4**	**604.0**	**601.7**	**-2.3**	**-2.7**	**662.6**	**61.3**
A. Current expenditure	592.5	577.6	579.7	2.1	-12.9	621.7	42.5
Debt servicing	330.6	305.6	308.1	2.5	-22.5	329.2	21.1
Interest on domestic debt	207.1	175.4	185.5	10.1	-21.6	197.9	12.4
Interest on foreign debt	44.9	55.0	50.5	-4.5	5.6	62.3	11.7
Repayment of foreign debt	78.6	75.2	72.1	-3.1	-6.6	69.1	-3.0
Defense	152.8	133.5	131.6	-1.9	-21.2	131.6	0.0
Civil government	47.9	80.2	80.2	0.0	32.3	80.6	0.4
General administration	19.6	48.1	49.7	1.7	30.1	47.6	-2.2
Law and order	9.0	10.1	10.1	-0.1	1.0	10.2	0.2
Social services	10.5	11.8	10.4	-1.4	-0.1	12.3	1.9
Economic services	3.0	3.2	3.1	-0.2	0.1	3.4	0.3
Community services	5.8	7.0	6.9	0.0	1.1	7.1	0.2
Grants and subventions	33.3	44.2	36.8	-7.4	3.5	49.3	12.5
Subsidies	20.4	11.8	22.7	10.9	2.3	20.7	-2.0
Un-allocable	7.5	2.3	0.3	-2.0	-7.2	10.3	10.0
B. Development expenditure	11.8	26.4	22.0	-4.4	10.2	40.9	18.9
2. Capital disbursements	**137.1**	**90.3**	**96.1**	**5.8**	**-40.9**	**173.5**	**77.3**
Current expenditure	59.6	20.4	31.7	11.4	-27.9	99.8	68.1
Development expenditure	77.5	70.0	64.4	-5.6	-13.1	73.7	9.3
Total expenditure (1+2)	**741.4**	**694.3**	**697.8**	**3.5**	**-43.6**	**836.1**	**138.7**

Source: Annual Budget Statement of the Federal Government.

Current expenditure on the remaining heads (except subsidy) stayed within budget targets and recorded marginal increases over actual spending in FY00. Although expense on subsidy registered a nominal increase of Rs 2.3 billion over the last year, it was almost double the envisaged amount in the FY01 budget. This upsurge in subsidy expense was largely on account of one-off arrear payments of Rs 10.4 billion to WAPDA, on behalf of the four provinces, AJK and FATA.

During FY01, revised development expenditures were not only lower than anticipated, but also fell short of actual development spending in FY00. Lower development expenditures on the capital account were due to lower disbursements to the provincial governments, AJK, financial and non-financial institutions, local bodies and various other agencies/institutions for carrying out their development efforts.[15]

Although lower than budgeted, higher development expenditures (on the revenue account) over FY00 was primarily the result of increased spending on community and economic services. Also, higher expenditure on training and research (in law and order), and social services added to this rise.

4.3.8 Financing of Federal Government Expenditure

Revised data on the financing of federal government expenditures witnessed sizeable changes over actual financing in FY00 and budget estimates for FY01. Capital receipts (net) mounted to Rs 94.4 billion on account of higher proceeds from prize bonds and the Pakistan Investment Bond (PIBs - see **Table 4.7**). Receipts from public accounts, not only fell short of actual receipts in FY00, but were also lower than those envisaged in the FY01 budget. This was mainly due to lower receipts from NSS instruments, as rates were rationalized and incremental investment by institutions was banned. Another major development was in the availability of external resources, which not only exceeded actual receipts in FY00, but also the budget target for FY01. Compared to last year, the driving force largely came from higher project/commodity aid and from non-planned sources. Credit from banking sector also witnessed a sharp reversal, as the government *retired* Rs 39.4 billion in FY01, against borrowing of Rs 40.0 billion during FY00.[16]

4.4 The Consolidated Budget FY02[17]

The types of fiscal efforts undertaken this year are expected to reduce the budget deficit from 5.3 percent of GDP in FY01 to 4.9 percent in FY02. This target is likely to be achieved primarily through higher growth in tax collection. The surge in tax revenue is expected on the back of higher projected tax collections by the CBR, largely due to efficient tax administration and other discretionary measures announced in the federal budget for FY02. To this end, additional support from provincial governments is also expected, as provincial tax revenues are likely to increase. Moreover, healthy growth in non-tax receipts is envisaged, largely on account of higher receipts from civil administration, interest and dividends (see **Table 4.1)**.

On the expenditure side, an increase of 0.6 percent of GDP is anticipated in the (consolidated) budget for FY02, due to higher projected development expenditure (see **Table 4.1**). Compositional breakdown of expenditure shows that current expenditures likely to decline slightly in terms of GDP, while an increase of Rs 58.2 billion n is anticipated in absolute terms. This projected increase is

[15] Development expenditures on revenue accounts include purchase of such assets, which can be used for more than a year. While investible funds and loans transferred to provincial governments, AJK, and various agencies/institutions for investment requirements are treated as development expenditures on capital account.
[16] For detail discussion on Credit from banking system, see **Chapter 5**, Money and Credit. These figures may not tally with the one reported in that chapter.
[17] The brief discussion in this section is based on consolidated budget for FY02.

primarily attributed higher debt servicing and two *one-off* spending programs related to the banking sector and NADRA.[18]

Table 4.7: Financing of the Federal Government Expenditures

billion Rupees

	FY00	FY01				FY02	
	Actual	Target	Revised	Excess/shortfall from		Target	Excess over last year
				Target	Last year		
1. Revenue receipts (net)	387.7	412.1	388.1	-24.0	0.4	453.8	65.7
2. Internal resources	144.2	98.9	127.6	28.8	-16.5	94.5	-33.1
Capital receipts	53.0	42.5	94.4	51.9	41.4	57.4	-37.0
Public account	91.1	56.3	33.2	-23.1	-57.9	37.0	3.8
3. External resources	164.8	185.6	221.1	35.5	56.3	262.1	41.0
Plan resources	99.3	146.6	163.9	17.3	64.6	239.3	75.4
Debt rescheduling	64.3	31.9	52.9	20.9	-11.4	21.8	-31.0
Non-plan resources	1.2	7.1	4.4	-2.7	3.1	1.0	-3.4
4. Total receipt (1+2+3)	696.7	696.6	736.9	40.3	40.2	810.4	73.5
5. Credit from banking system	40.0	-2.3	-39.4	-37.2	-79.4	10.5	49.9
6. Provincial surplus (+)/deficit (-)	4.8	0.0	0.4	0.4	-4.4	15.2	14.8
Total resources (4+5+6)	**741.4**	**694.3**	**697.8**	**3.5**	**-43.6**	**836.1**	**138.2**

Source: Annual Budget Statement of the Federal Government

A strong increase of 27.3 percent in development expenditures is projected over the revised estimates for FY01 (see **Table 4.1**). Since the government has already identified four sectors to boost economic growth, the bulk of development spending is likely to target areas.[19] In addition, the allocation for Special Programs and the Social Action Programs are also likely to be higher compared to last year.[20] Furthermore, a strong revival in the public sector development program of provincial governments is envisaged in the consolidated budget for FY02.

As mentioned earlier, the government's financing of the budget deficit has tilted toward external sources. Following the same pattern as this year, around two-third of the deficit is expected to be financed through external receipts, while the remaining component will be financed locally (see **Table 4.1**).

4.5 Federal Government Budget FY02

The thrust of the FY02 federal budget is on the growth of revenue receipts along with tight control over expenditures. The salient features are briefly discussed below.

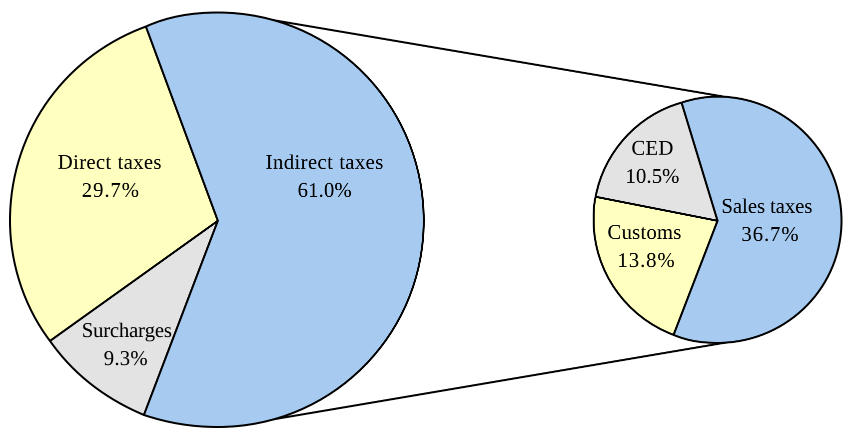
- On the revenue side, despite lowering of import tariffs, the rationalization of personal, corporate, and withholding taxes, an improvement in both tax and non-tax revenue is envisaged. This is largely expected to come from strengthening tax administration, increasing documentation, and broadening the sales tax base, rather than imposing new taxes and increasing existing tax rates. A compositional breakdown of tax revenue is provided in **Figure 4.10**, while budget targets in comparison with revised estimates for FY01, are reported in **Table 4.4.**

[18] Debt servicing are expected to increase by Rs 24.2 billion, while Rs 11.4 billion are reserved for banking sector reforms and for NADRA. In addition, Rs 6.4 billion increase in expenditure on social services is projected.

[19] Four sectors include agriculture, small and medium industry, information technology, and oil, gas and mineral sector.

[20] Special programs include Khushal Pakistan, the Drought Relief Program and Devolution Plan. While, expenditures on the social action program aims at improving social services in select areas, which include primary education, nutrition, health, population welfare, water supply and sanitation.

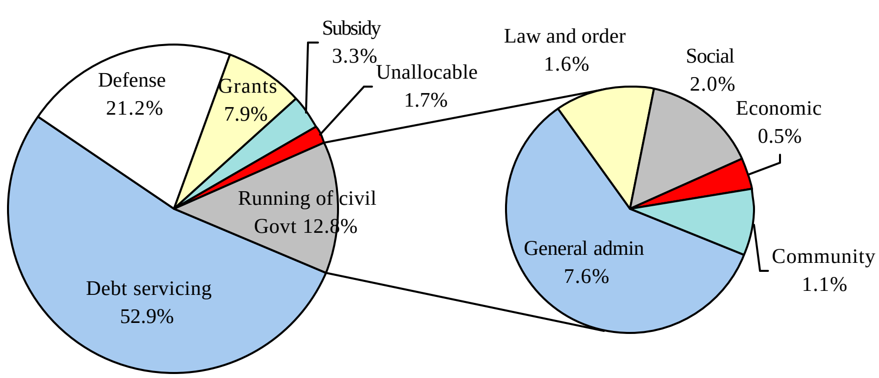
Figure 4.10: Tax Revenue Targets for FY02



?? Revenue from surcharges is projected at Rs 47.0 billion, indicating an increase of Rs 14.0 billion over the revised target for FY01 (see **Table 4.4 & Figure 4.10**). As revenue from development surcharges on natural gas has been frozen at the revised estimates level for FY01, the entire increase is envisaged from the levy on petroleum products.[21]

?? An improvement in non-tax revenue collection is projected over the revised FY01 target, which is mainly expected to come on higher revenues from property and enterprises (see **Table 4.4**). Although a supplementary push will also come from higher civil administration and miscellaneous receipts, their role in the projected increase will remain somewhat limited. Higher receipts from property and enterprises are also expected due to higher profits from post offices.

Figure 4.11: Distribution of Current Expenditure FY02



[21] In recent budget FY02, with the complete deregulation of prices of petroleum products, the mechanism of fixed levy is being laid down. The levy is being imposed through the Finance Ordinance 2001 at the per liter price of various petroleum products, which will be notified by the government from time to time.

?? Prudent fiscal management coupled with tight control over government spending, will remain the hallmark of FY02. However, in terms of GDP, current and development expenditures on the revenue account are expected to be marginally higher than FY01. A compositional breakdown of current expenditures is provided in **Figure 4.11** and **Table 4.6**.

?? Net revenue receipts will remain the prime source of financing, with the Rs 65.7 billion increase expected over the revised estimates for FY01 (**Table 4.7**). Proceeds from internal resources are projected to decline compared to this year, largely on account of lower capital receipts, while the decline in capital receipts cab be traced to the Special US Dollar Bond.