4 Public Finance and Fiscal Policy

4.1 Overview

The robust growth in revenues and moderate rise in expenditures[1] contributed significantly towards the fiscal consolidation drive of the government during FY04. As a result, the overall budgetary deficit declined for a second successive year in absolute terms, dropping from Rs 184.6 billion in FY03 to Rs 173.9 billion in FY04. Moreover, due to the strong growth in the economy, as a percentage of GDP the budgetary deficit dropped even faster, from 4.5 percent of GDP in FY03 to 3.9 percent in FY04, lower than the target for the year (see **Table 4.1**).[2]

The consolidated revenue receipts in FY04 recorded a strong 11.4 percent rise, which emanated from a surge in both, tax collections and non-tax receipts. While the bulk of the tax revenue growth was from CBR taxes, led by strong growth in trade-related taxes,[3] the rise in non-tax revenues was mainly due to higher *logistic support* receipts as well as larger dividends from PTCL and OGDCL.

The rise in consolidated expenditures however, moderated to 7.9 percent YoY in FY04 compared to 9.2 percent YoY in the preceding year. This is attributed to the decline in current expenditures (2.6 percent) on the back of sharp drops in *unallocable expenses*,[4] *grants*, *social services* and *subsidies*.[5] This helped in offsetting the increase witnessed in *defense*, *law & order* and *debt servicing*.[6] However, the existence of sizable contingent liabilities (Rs 75.9 billion in FY04), largely owed to the two power sector utilities, is matter of concern.[7]

An interesting development is the 3.8 percent YoY decline in federal expenditures (in the consolidated accounts), even as the corresponding *provincial expenditure* and *net lending to PSEs* grew strongly.

It appears that the improved health of WAPDA[8] and KESC, and equity injections in the shape of *net lending to PSE*s, led to a sharp YoY decline in *unallocable* and *subsidy* costs (in the current expenses of the federal government) during FY04. The rise in provincial spending is probably due to the increased cost of provincial authorities on *law & order*, higher debt servicing, and partly a shifting of the responsibilities from the federal to provincial governments.

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[1] It is hoped that the improvement would be sustained by the ongoing fiscal reforms. In particular, the FY04 the government has introduced new accounting methodology and established debt policy coordination office to make the spending more transparent and efficient. Moreover, the Fiscal Responsibility and Debt Limitation Law (FRDLL) have already been presented in the national assembly; the enactment of this law is expected to help maintain fiscal discipline and bring the debt burden within sustainable limits.

[2] The GDP has been rebased from FY00 and onwards by including some new sectors; however, in order to make the data consistent and comparable, the indicators used in the chapter have been calculated in terms of GDP on FY80 basis. Using the re-based GDP (i.e. Rs 5458 billion) the fiscal deficit drops to 3.2 percent of GDP.

[3] While the resulting achievement of the tax revenue target is appreciable, the decline in tax buoyancy from 1.6 percent in FY03 to 0.8 percent in FY04 could be a matter of some disquiet.

[4] The substantial jump of Rs 57.7 billion in unallocable expenses during FY03 is largely attributed to the government's equity injection into the KESC.

[5] The major portion of subsidies is still laid for energy sector which includes WAPDA, KESC, PARCO etc and some to PASSCO.

[6] The rise in expenditure on law & order is mainly engendered by the higher provincial spending, while the federal spending rose marginally over FY03.

[7] Please see the contingent liabilities detail in Economic Survey, 2003-04.

[8] The improvement in the WAPDA's condition is linked with the improved utilization of thermal power stations and the larger availability of the hydel power due to the increased water availability during FY04.

Table 4.1: Summary of Public Finance (Consolidated Federal and Provincial Governments)
billion Rupees

	FY00	FY01	FY02		FY03	FY 04	YoY change		FY05	
					PA	RE	Absolute	Percent	BE	
1 Revenue receipts (a+b)	512.5	553.0	624.1		717.2	798.8	81.5	11.4	841.9	
a) Tax revenue	405.6	441.6	478.1		554.1	610.5	56.4	10.2	687.4	
of which CBR revenues	347.1	392.3	404.1		460.6	518.8	58.2	12.6	580	
b) Non-tax receipts	106.9	111.4	146.0		163.1	188.3	25.2	15.4	154.5	
2 Total expenditure	709.1	717.9	826.2		901.8	972.6	70.8	7.9	1,040.9	
a) Current	626.4	645.7	700.2		806.1	785.5	-20.6	-2.6	856.5	
b) Development	95.6	89.8	126.2		129.2	154.4	25.2	19.5	188.0	**
c) Net lending to PSEs etc.	-12.9	-17.6	-0.2		-33.5	32.8	66.3	-198.0	-3.6	
d) Statistical discrepancy	9.7	14.8	-13.0		…	…	…	…	…	
3 Revenue surplus/deficit (1-2.a)	-113.9	-92.7	-76.1		-88.8	13.3	102.1	-115.0	-14.6	
4 Overall deficit (1-2)	-206.3	-179.7	-189.1	*	-184.6	-173.9	10.7	-5.8	-199.0	
5 Financing through:	206.3	179.7	189.1		184.6	173.9	-10.7	-5.8	199.0	
a) External resources (Net)	69.7	120.7	82.8		87.5	15.8	-71.7	-81.9	78.2	
b) Internal resources (i+ii+iii	136.6	59.0	106.3		85.7	147.1	61.3	71.5	105.8	
i) Domestic non-bank	96.7	92.0	85.0		141.6	73.0	-68.6	-48.4	74.7	
ii) Banking system	39.9	-33.0	12.9		-55.9	74.0	129.9	-232.5	31.2	
iii)Privatization proceeds	…	…	8.4		11.3	11.0	-0.3	-2.9	15.0	
As percent of GDP (mp)										
1. Revenue receipts (a+b)	16.3	16.2	17.2		17.7	18.0	0.3	…	17.1	
a) Tax revenue	12.9	12.9	13.2		13.6	13.7	0.1	…	13.9	
of which CBR revenue	11.0	11.5	11.1		11.3	11.7	0.3	…	11.7	
b) Non-tax receipts	3.4	3.3	4.0		4.0	4.2	0.2	…	3.1	
2. Total expenditure	22.5	21.0	22.8		22.2	21.9	-0.3	…	21.1	
a) Current	19.9	18.9	19.3		19.8	17.7	-2.1	…	17.3	
b) Development	3.0	2.6	3.5		3.2	3.5	0.3	…	3.8	
c) Net lending to PSEs etc.	-0.4	-0.5	0.0		-0.8	0.7	1.6	…	-0.1	
3. Revenue surplus/deficit (1-2.a)	-3.6	-2.7	-2.1		-2.2	0.3	2.5	…	-0.3	
4. Overall deficit (1-2)	-6.6	-5.2	-5.2	*	-4.5	-3.9	0.6	…	-4.0	
5. Financing through:	6.6	5.2	5.2		4.5	3.9	-0.6	…	4.0	
a) External resources (Net)	2.2	3.5	2.3		2.2	0.4	-1.8	…	1.6	
b) Internal resources (i+ii+iii)	4.3	1.7	2.9		2.1	3.3	1.2	…	2.1	
i) Domestic non-bank	3.1	2.7	2.3		3.5	1.6	-1.8	…	1.5	
ii) Banking system	1.3	-1.0	0.4		-1.4	1.7	3.0	…	0.6	
iii) Privatization proceeds	…	…	0.2		0.3	0.2	0.0	…	0.3	

Source: Budget Wing, Finance Division, Islamabad/ Economic Survey 2003-04, Ministry of Finance
PA: Provisional Actual, R.E: Revised Estimates, B.E: Budget Estimates, " …" not available
* If one-off expenditure of Rs. 52 billion incurred on KESC recapitalization (Rs.32 billion) and CBR bonds (Rs.20 billion) is accounted for; the fiscal deficit will be 6.6 percent of GDP.
** Developmental Expenditures are adjusted by operational shortfall of Rs. 14 billion

Developmental expenditures during FY04 stood at Rs 154.4 billion against the budgeted Rs 160 billion – an under utilization of Rs 5.6 billion. Although, these expenditures are higher than FY03 but it would clearly be more desirable to fully meet developmental spending targets.[9]

Although, the financing requirements have been declining over time, yet a significant shift was witnessed in the financing profile during FY04. The notable decline was observed in (net) external financing and borrowing from non-bank sources. The decline in the former is attributed to the end of the Saudi Oil Facility and repayments of costly external debts that were partially financed through the Euro Bond inflows. The drop in financing from domestic non-bank sources represents the negative

[9] However, if the operational shortfall of Rs 8.0 billion is taken into account, the FY04 development expenditures exceeded the target by 1.6 percent.

net receipts from the National Savings Schemes. Consequently, the borrowing from the banking sector surged as compared to the net retirement in recent years.

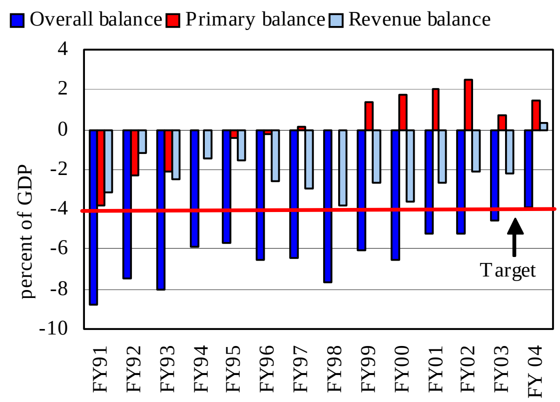
4. 2 Fiscal Performance Indicators

The underlying improvement in the fiscal discipline during FY04 can be gauged by the positive movements in key fiscal indicators.

4. 2.1 Balance Indicators

Significant improvement is visible in all key balance indicators during FY04. The ***overall balance*** is an important indicator to assess the performance of the fiscal authorities, and a key measure of macroeconomic stability. The performance of overall balance is quite satisfactory in FY04, as it continued a trend decline, falling to a historical low at 3.9 percent of GDP (see **Figure 4.1**).

Figure 4.1: Balance Indicators



Although this achievement is somewhat tarnished by the presence of sizable amount of contingent liabilities (that reached 1.7 percent of GDP[10] in FY04), it is encouraging to note that the government is trying to address this problem. It is expected that the anticipated promulgation of the fiscal responsibility law will limit the scope and amount of the contingent liabilities in coming years.[11]

The ***revenue balance*** too saw striking improvement in FY04, moving into surplus for the first time in 20 years.[12] A trend decline in revenue deficit (or sustained generation of surpluses) is a welcome indicator of the availability of fiscal space to increase development expenditures. Unfortunately, it seems that the FY04 surplus may not be sustainable as FY05 budget estimates project that the indicator will slip back into deficit.

The ***primary balance***, an indicator of solvency and debt repayment position of the economy has been in surplus since FY98. In FY04, the primary surplus rose to 0.8 percent of GDP due to better revenue receipts. The continued generation of primary surpluses, together with the growth in GDP in excess of the average interest on the public debt (as seen in recent years) has raised the possibility that the country's debt burden could be reduced to the 'safe limits' set in FRDLL earlier than planned, particularly if the impressive performance of FY04 is sustained.

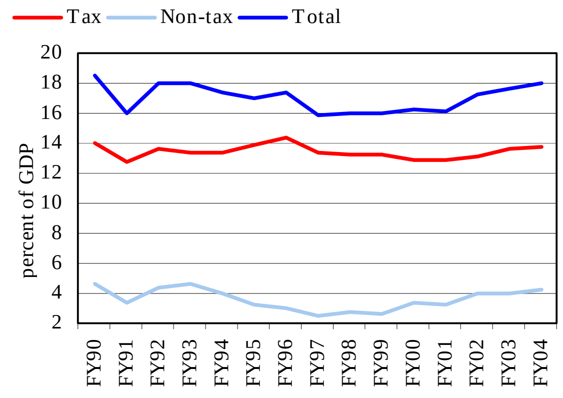
4.2.2 Revenue Indicators

The robust 11.4 percent revenue growth in FY04 pushed up the *revenue to GDP* ratio for the fourth successive year from 17.7 percent in FY03 to 18.0 percent in FY04; the highest for the last 10 years (see **Figure 4.2**). While the steady improvement in this indicator in recent years suggests the influence of the more recent tax reforms that increase the buoyancy and elasticity of the tax system, the FY04 specific factors probably include the strong contribution from oil & gas surcharges, and the exceptionally strong non-tax receipts.

[10] GDP is at 1980 basis.
[11] The Fiscal Responsibility and Debt Limitation Law proposes to limit explicit contingent liabilities in rupee lending, bonds, rates of return, output purchase agreements, and other claims that may endanger the fiscal policy of the government.
[12] The revenue balance used to record surpluses prior to FY85, but had remained in deficit thereafter.

The role of the exceptional flows in improving the *revenue to GDP ratio* however suggests that a part of the improvement in FY04 may not be sustained in coming years. In particular, logistic support payments, and the petroleum oil development surcharge could vary significantly over years as a result of exogenous factors. This suggests the need to further improve on the gains in the tax buoyancy by widening the tax base.

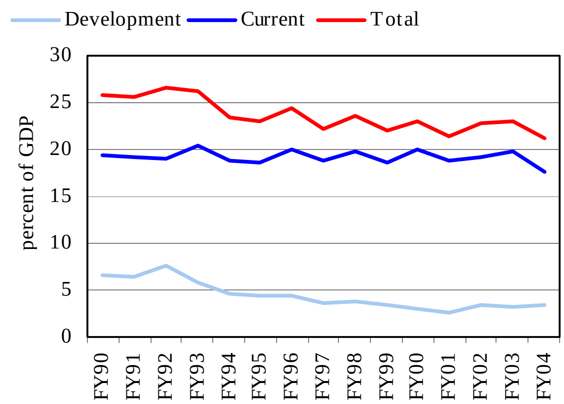
Figure 4.2: Trend in Revenues



4.2.3 Expenditure Indicators

iThe expenditure indicators show a distinct improvement in FY04 compared to the previous years, with the *total expenditure to GDP* ratio dropping to the lowest value since the 1990s. Even more encouragingly, the dip was caused by a deceleration in current spending rather than development spending (see **Figure 4.3**).

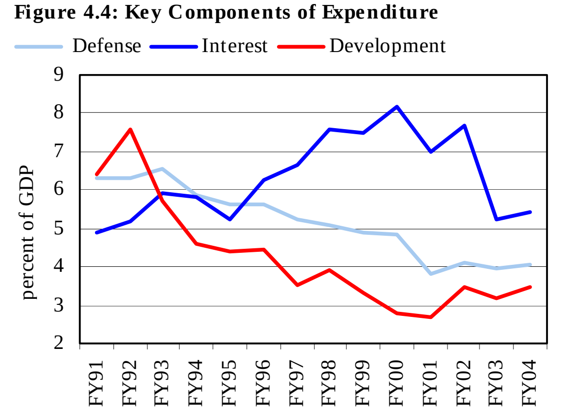
Figure 4.3: Expenditure Trends



In fact, *the current expenditure to GDP* ratio fell below the 18 percent mark for the first time since the 1990s. The decline in current expenditures together with the concomitant increase in the revenue ratios clearly shows the increasing availability of fiscal space to increase development spending that will emerge with the continuation of fiscal discipline.

Interestingly, the FY04 fall in the *current expenditure to GDP* ratio took place in the face of a small rise in the ratios of defense and interest payments to GDP (see **Figure 4.4**). This is because a large part of the year-on-year fall in current spending is caused by the absence of the FY03 equity injections into KESC; which clearly indicates how critical the successful restructuring of the power utilities or privatization is to the fiscal health of the GoP.

Figure 4.4: Key Components of Expenditure



The developmental expenditures, which are important for generating future economic growth and employment, have not so far been able to attain the peak level of FY92 (7.6 percent of GDP). After touching the lowest level (2.7 percent of GDP) in FY01, they rebounded and stood at 3.5 percent of GDP in FY04.

4.3 Fiscal Developments at the Federal Level

The revised Federal receipts for FY04 stood at Rs 761 billion against the targeted Rs 728.4 billion, a rise of 4.5 percent over the budgeted amount and 8.5 percent over corresponding year of FY03. This rise largely stemmed from the 10.3 percent YoY rise in total tax receipts and the exceptional rise in the non-tax revenues of 15 percent YoY to Rs 180.9 billion (as against the budgeted Rs 157.2 billion).

4.3.1 CBR Tax Performance

The revenue receipts from CBR, which contributes approximately 68 percent in the federal receipts, surpassed the set target by Rs 8.8 billion and reached Rs 518.8 billion in FY04 as compared to Rs 460.6 billion in FY03 (see **Table 4.2**). This exceptional performance is a continuation of the trend observed in FY03 when CBR marginally over achieved targets after a prolonged period. However, the increase in tax revenues was not proportionate to the rise in rebased GDP in FY04.

During the 90s, government broadly introduced two phases of reforms in the tax system for collecting the potential revenues and to counter the prevailing rigidities in the tax system. The first phase of reforms included; (1) tariff reduction and rationalization; (2) introduction of GST (VAT mode) and expansion of its base; (3) reducing the roles of central excise duties; and (4) increasing the range and scope of direct taxes. The second phase of the reforms was largely directed towards the expansion of the tax base and to improve the human resource (HR) conditions of the tax collection machinery.

These included: (1) automation of the sales tax and customs clearing system; (2) introduction of Large Taxpayer Units (LTUs) and Medium Taxpayer Units (MTUs); (3) introduction of self-assessment system; (4) abolishing the wealth tax; and (5) tax survey and documentation drive. As a result of these reforms, the structure of both direct and indirect taxes has changed drastically and now the CBR taxes are more buoyant. However, in order to judge the performance of CBR individual taxes, it would be appropriate to look at the major tax components of direct and indirect taxes.

Tax Analysis by Components

Direct Taxes

Growth in direct taxes accelerated to 8.8 percent YoY in FY04 from 6.6 percent in FY03, comfortably exceeding the annual target (see **Table 4.2**). This reflects a number of developments including rising corporate profitability stemming from increased economic activity, as well as result of efforts to expand the tax base, introduction of self-assessment schemes, enforcement of risk-based audit, and growing tax compliance.

Table 4.2: Tax Collections (Net) by CBR
billions Rupees

	Targets for	Actual collections				Absolute difference with		Targets for	Difference with (percent)
	FY04	FY01	FY02	FY03	FY 04	Target	FY03	FY05	FY04
Direct taxes	161.1	124.6	142.5	151.9	165.3	4.2	13.4	181.9	10.0
Indirect taxes	348.9	267.7	261.6	308.7	353.5	4.6	44.8	398.1	12.6
Sales tax	223.1	153.6	166.6	195.1	219.1	-4.0	23.9	249.2	13.8
Central excise	47.7	49.1	47.2	44.8	44.6	-3.2	-0.2	45.7	2.6
Customs	78.1	65.0	47.8	68.8	89.9	11.8	21.1	103.2	14.8
Total	510.0	392.3	404.1	460.6	518.8	8.8	58.2	580.0	11.8

Source: Central Board of Revenue

The encouraging increase in tax compliance is particularly evident in the rise in *voluntary payments*, which surged by 23.5 percent YoY to Rs 66.5 billion in FY04.

Similarly, withholding taxes, which are deducted at source, rose 9.9 percent YoY in FY04. These stood at Rs 66.5 in FY04 compared to the Rs 53.8 billion in FY03. The bulk of the growth came from contracts (13.4 percent), imports (9.8 percent), exports (13.5 percent), salaries (21.1 percent), securities, interest income and electricity (14 percent) & telephone bills (53.1 percent).

Indirect Taxes

General Sales Tax (GST)

After the first generation reforms that were pursued in the last decade, the GST has emerged as the single largest revenue source (see **Figure 4.5**). Revenue collection from GST constituted 42.0 percent of the total CBR revenues during FY04.

Figure 4.5: Structure of CBR Revenue

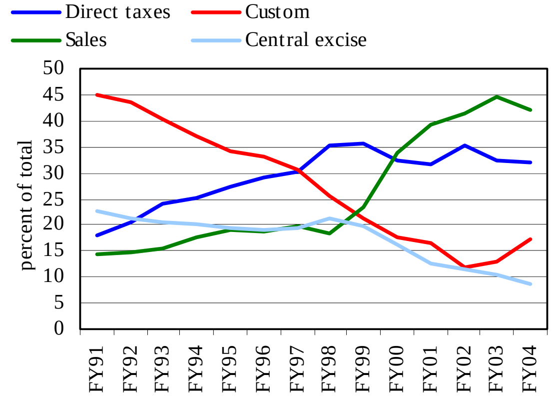
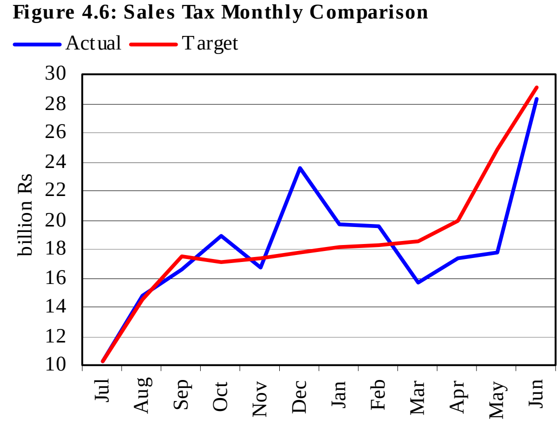


Figure 4.6: Sales Tax Monthly Comparison



The receipts from GST registered a growth of 12.3 percent YoY in FY04 to Rs 219.1 billion, but fell 1.8 percent short of the annual target (see **Table 4.2**). As evident from **Figure 4.6**, collections during the first three quarters either met or exceeded the target, before falling well below the monthly projections during the fourth quarter. The larger contribution to the GST collections in FY04 was from imports, as the GST on imports rose 20.3 percent YoY to reach Rs 172 billion. By contrast, the GST on domestic production grew only by a meager 2.8 percent YoY in the same period, the weakness in these receipts contributed significantly to the below target aggregate GST receipts in Q4-FY04.

The strong growth in the GST on imports is consistent with rising imports in the economy in FY04, while the low growth in sales tax on domestic component probably reflects (1) the adjustment of advance payments of arrears collected under electricity charges, and (2) a large rise (19.2 percent YoY) in the refund payments, largely due to an upswing in exports.

Custom Duties

The performance of the custom duties has been exceptional during the last two years, recording growth of 44 percent YoY in FY03 and 30.6 percent in FY04 (see **Table 4.2**). This exceptional rise in custom duties demonstrates that lowering of tariff rates had positive impact on the revenue yield as previously smuggled goods were diverted to official imports. Increase in the value and volume of imports also played a key role in this upsurge.

A further analysis suggests that this surge is originating from the major items like CKD vehicles, iron and steel scrap and products, edible oil, POL, and machinery and mechanical appliances. The rise in the imports and custom receipts from these items is consistent with the ongoing domestic economic recovery. In this regard, the rise in the import of iron & steel products is an indication of the rising construction activity, while the higher textile machinery imports is aligned with the continuing BMR activity in the textile sector. Similarly, the rise in the custom revenues from the motor vehicles can be linked with the surging demand in the auto sector due to greater access to cheaper loans.

Central Excise Duty (CED)

The CED is being gradually phased out by shifting the majority of the items under the ambit of sales tax or custom duties. This is evident in **Figure 4.5**, which shows a drastic reduction in the CED share from 22.5 percent in FY91 to 8.6 percent in FY04.

CED collections fell short of the target for FY04 by 3.2 billion and stood at Rs 44.6 billion against the Rs 44.8 billion collected in FY03 (see **Table 4.2**). However, given that this is inline with policy i.e., CED is to be gradually phased out and substituted by sales tax, there is no cause of alarm.[13] A break-up of the CED receipts shows that 82 percent of the revenues originated from five major items, i.e., cigarettes, cement, beverages & beverage concentrates, POL, and natural gas products. The collection from the cigarettes, beverages, and natural gas has shown increases while the collection from the cement has declined due to reduction of CED rates by 25 percent.[14]

4.3.2 Surcharges

At Rs 70.1 billion, the FY04 surcharges and other receipts were comfortably above the Rs 67.6 billion annual targets. However, receipts from the two components, gas and oil development surcharge saw a YoY decline of 9.4 percent[15]. This probably represented an increase in the cost of both petroleum as well as gas (since well head prices is linked to international oil prices), which was not passed on proportionately to consumers.

The Gas Development Surcharge (GDS) had also been expected to fall due to the increase in the rates offered to older fields (e.g., Sui). This appears to explain the lower target set for FY04 (Rs 15 billion), relative to the actual receipts of Rs 21.4 billion in FY03. In the event, the FY04 receipts nonetheless exceeded the target due to a strong 21.2 percent rise in gas production during the year.

4.3.3 Non-Tax Revenues

The consolidated non-tax revenues depicted exceptional performance and surged to Rs 182.7 billion in FY04, as compared to the set targets of Rs 156.2 billion (see **Table 4.1**). The impressive growth in the non-tax receipts resulted from higher dividend income from PTCL[16] and OGDCL, interest income, logistic support that come under *civil administration*, and miscellaneous receipts.[17] The rise in miscellaneous income is mainly due to larger receipts from UN, non-project grants, auction of textile quota, and citizenship & naturalization, etc.

4.3.4 Federal Expenditures[18]

The expenditures on revenue account witnessed 9.0 percent rise as compared to the budgeted negative growth of 0.7 percent over FY03. As a result, the federal expenditures on revenue account stood at Rs 773.2 billion in FY04, as compared to the budgeted Rs 704.5 billion, a rise of Rs 68.7 billion in

[13] The CED on cement and paper & paper board was reduced in the federal budget of FY04; the reduction of duty on cement is a step to boost the construction activity in the economy. The reduction of duty on paper & paper board is meant for reducing the cost of text and general stationary for the masses.

[14] As regard the cement demand, it increased 17 percent during FY04 owing to larger PSDP spending, surging exports and rising construction activity in the housing sector.

[15] The revenues from oil surcharges more or less matched the targets while they exceeded the target by Rs 3 billion in the case of gas.

[16] PTCL has experienced a 26.4 percent rise in profits in FY04 as compare to FY03, which is primarily driven by increase in call traffic. The surge in traffic is attributed to the rise in Access Lines in Service (ALIS) and reduction in NWD and international calling rates. In addition, the enormous growth in mobile communication and data network operations during FY04 has also supplemented the earnings.

[17] The miscellaneous receipts include income from sale proceeds, royalty on oil and gas, passport fee, workers profit participation tax, foreign travel tax, airport tax and others.

[18] As a part of reform process and improving the country's Financial Accounting and Budgeting System (FABS), government has introduced New Accounting Model (NAM) to initially operate on cash basis and eventually move towards the accrual basis of accounting standards. Due to this, the government has changed the definition and reporting of a number of variables. As a result comparison with data for preceding years is not meaningful.

absolute terms (see **Table 4.3**). The main source of this variance is the pre-payment of $1.1 billion of loan to ADB and hence actual debt servicing payments were higher by Rs 61.8 billion compared to the FY04 budget estimates.

Table 4.3: Federal Government Expenditures
billion Rupees

	FY01	FY02	FY03	FY04	FY04	Change over (%)		FY05	Change over FY04	
			PA	BE	RE	FY04 BE	FY03 PA	BE	Absolute	Percent
I. Revenue expenditure (A+B)	611.7	694.5	709.2	704.5	773.2	9.8	9.0	786.2	13.1	1.7
A. Current expenditure	592.6	650.4	673.3	645.2	714.0	10.7	6.0	700.8	-13.2	-1.9
General public service	-	-	-	377.9	448.4	18.7	…	423.8	-24.6	-5.5
Defense affairs and services	131.1	149.3	160.1	160.3	180.5	12.7	12.7	193.9	13.4	7.4
Public order and safety affairs	…	…	…	13.0	14.0	8.4	…	15.1	1.0	7.3
Economic affairs	…	…	…	78.2	54.8	-29.9	…	48.8	-6.0	-10.9
Environment protection	…	…	…	0.1	0.1	0.0	…	0.1	0.0	3.0
Housing and community amenities	…	…	…	0.8	0.9	12.8	…	0.8	-0.1	-10.2
Health services	…	…	…	2.8	2.8	0.2	…	3.3	0.4	15.8
Recreation, culture and religion	…	…	…	2.0	2.0	0.0	…	2.2	0.2	9.7
Education affairs and services	…	…	…	9.6	9.6	-0.1	…	12.2	2.6	26.7
Social protection	…	…	…	0.5	0.7	37.8	…	0.5	-0.2	-26.9
Old Classification										
Debt servicing	312.7	318.7	257.4	255.9*	317.7*	24.2	23.4	265.3*	-52.4	-16.5
General administration	50.8	54.1	55.1	…	…	…	…	…	…	…
Grants and subventions	36.9	66.7	55.6	…	…	…	…	…	…	…
Social services	9.9	13.2	13.6	…	…	…	…	…	…	…
Law and order	10.1	10.8	11.7	…	…	…	…	…	…	…
Community services	6.5	7.9	8.1	…	…	…	…	…	…	…
Subsidies	20.4	25.5	49.8	…	…	…	…	…	…	…
Economic services	5.9	3.9	4.1	…	…	…	…	…	…	…
Unallocable	9.2	0.3	57.7	…	…	…	…	…	…	…
B. Development expenditure	19.1	44.1	35.9	59.2	59.1	-0.2	64.9	85.5	26.3	44.5
II. Capital disbursements (A+B)	95.4	254.3	152.0	123.3	125.3	1.7	-17.5	122.1	-3.2	-2.6
A. Current expenditure	30.8	193.0	84.9	52.5	65.0	23.8	-23.5	38.7	-26.2	-40.4
B. Development expenditure	64.5	61.3	67.1	70.8	60.4	-14.7	-10.0	83.4	23.0	38.1
Total expenditure (I+II)	708.1	948.7	861.2	827.7	898.5	8.6	4.3	908.4	9.9	1.1

Source: Annual Budget Statement, Government of Pakistan

* Included in General Public Service under current expenditure on revenue account

Note: The Federal budget for FY05 has been prepared according to new accounting model that is different from the previous system. The exact correspondence between historical data available on old classification system and estimates developed on the new system is not technically feasible.

PA: Provisional Actual, BE: Budget Estimates, RE: Revised Estimates, …= data not available

Other increases took place in *defense* expenditures, which stood at Rs 180.5 billion against the FY04 budget target of Rs 160.3 billion. This sizable increase in the defense spending is attributed to the continued troops operations on the Western borders.[19]

These increases were offset to some extent, by a reduction in subsidies. The improved financial position of WAPDA and KESC, as well as the capital injections into these utilities[20] led an 11.3 percent YoY reduction in subsides in FY04. Nonetheless, the energy sector still received almost 70

[19] Defense expenditures had reached Rs 160.1 billion in FY03, approximately Rs 14 billion above the budget target. This had been thought to represent a one-off increase related to the troop movements on the Eastern border. The FY04 expenditure is thus Rs 20.3 billion higher, due to activities on Pakistan's Western border.

[20] In FY03 the capital injection into KESC had been through current expenditures (under *unallocable* spending). In FY04, the continued capital injections are part of the net lending to PSE (which does not form part of current expenditures).

percent of the total subsidies, with the remainder being accounted for mainly by Pakistan Railways and Pakistan Agricultural Storage and Services Corporation (PASSCO).

4.3.5 Financing of Federal Budget

Although the reduction in the budgetary deficit significantly reduced the governments funding requirements during FY04, government borrowings from the banking system increased significantly during the period (see **Table 4.4**). This was principally due to the lower availability of external financing as well as the reduced availability of non-bank financing.

The former declined by 3.1 percent YoY during FY04 (largely due to the termination of the Saudi Oil Facility). The consequent decline in net external receipts was only partially offset by the Rs 28.8 billion proceeds from the sovereign Eurobond issue in February 2004.

Table 4.4: Financing of the Federal Government Expenditures
billion Rupees

		FY00	FY01	FY02	FY03	FY04	FY04	Change over (%)		FY05
				PA	RE	BE	RE	FY04 BE	FY03 RE	BE
I.	Revenue receipts (net)	387.7	372.0	447.6	508.8	513.5	549.6	7.0	8.0	557.2
II.	Internal Resources (i+ii)	144.2	135.0	163.4	189.9	89.2	104.8	17.5	-44.8	103.2
	i Capital receipts	53.0	93.3	68.0	100.8	35.5	116.1	227.0	15.2	102.7
	ii Public account	91.1	41.7	95.4	89.1	53.7	-11.4	-121.2	-112.8	0.5
III.	External resources (i+ii+iii)	164.8	209.3	291.1	169.0	159.1	144.8	-9.0	-14.3	156.4
	i. Plan resources	99.3	170.3	225.5	160.3	159.1	144.8	-9.0	-9.7	156.4
	ii. Debt rescheduling	64.3	34.4	65.7	8.7	0.0	0.0		-100.0	0.0
	iii Non-plan resources	1.2	4.5	0.0	0.0	0.0	0.0			0.0
IV.	Total receipts (I+II+III)	696.7	716.3	902.2	867.6	761.8	799.1	4.9	-7.9	816.7
V.	Change in provincial cash balance	4.8	24.7	25.8	16.6	28.0	14.3	-48.8	-13.5	31.6
VI.	Privatization proceeds	0.0	0.0	8.4	10.0	10.0	11.0	10.0	10.3	15.0
VII.	Credit from banking system	40.0	-33.0	12.5	-33.0	27.9	74.0	165.0	-324.5	45.2
Total resources (IV+V+VI+VII)		741.4	708.1	948.7	861.2	827.7	898.5	8.6	4.3	908.4

Source: Annual Budget Statement, Government of Pakistan
PA: Provisional Actual, BE: Budget Estimates, RE: Revised Estimates, …= data not available

The 48.4 percent YOY decline in non-bank financing is due to the sharp fall in net NSS receipts during the period (see **Section on Domestic Debt** for details). As a result, the government's financing from the banking system increased to Rs 74 billion in FY04, as compared to the budgetary estimates of Rs 27.9 billion.

4.4 The Budget - FY05

The FY05 budget is a part of medium term framework presented by the government to project the evolution of the various macro indicators. In this regard, the FY05 budget represents a significant departure from past trends as it does not seek to further compress the fiscal deficit; in fact, the FY05 fiscal deficit, is budgeted to rise to Rs 199 billion or 4.0 percent of (projected) GDP. This stems from the government's increased focus on raising the poverty related spending as well as public investment to improve infrastructure, in order to sustain high growth rates in the long-term.

Moreover, in order to create greater fiscal space to expand such expenditures, the government plans to reduce the debt below 80 percent of GDP, earlier than originally anticipated through the Fiscal Responsibility and the Debt Limitation Law (FRDLL).[21]

[21] The proposed law is yet to be approved by the Parliament.

4.5: Federal Government Revenue Receipts
billion Rupees

`	FY01	FY02	FY03	FY04	FY04	Change over		FY05	Change over FY04	
Head			RE	BE	RE	FY04 BE	FY03 RE	BE	Absolute	Percent
1.Revenue receipts (II+III+IV)	535.1	619.1	701.6	728.4	761.0	32.6	59.4	796.3	35.3	4.6
I. Total taxes and surcharges	422.8	459.1	525.8	577.6	580.1	2.5	54.3	654.8	74.7	12.9
II. Total taxes	392.3	404.3	458.9	510.0	510.0	0.0	51.1	580.0	70.0	13.7
Direct taxes	124.6	142.6	145.0	161.1	161.5	0.4	16.5	181.9	20.4	12.6
Taxes on income	117.5	136.6	138.8	154.2	154.6	0.4	15.8	174.4	19.7	12.8
Wealth tax	1.5	0.5	0.0	…..	…..	…..	…..	….	…..	
Workers welfare tax	5.0	5.0	5.6	6.2	6.3	0.1	0.7	6.9	0.6	10.0
Capital value tax	0.6	0.6	0.6	0.7	0.6	-0.1	0.0	0.7	0.1	8.3
Indirect taxes	267.7	261.6	313.9	348.9	348.5	-0.4	34.6	398.1	49.6	14.2
Customs	65.0	47.8	69.6	78.1	86.6	8.5	17.0	103.2	16.6	19.2
Central excise	49.1	47.2	46.5	47.7	43.5	-4.2	-3.0	45.7	2.2	5.1
Sales tax	153.6	166.6	197.8	223.1	218.4	-4.7	20.6	249.2	30.8	14.1
III. Surcharges & others	30.5	54.9	66.9	67.6	70.1	2.5	3.2	74.8	4.7	6.7
Petroleum	17.9	36.0	45.8	46.1	46.4	0.3	0.6	47.5	1.1	2.4
Natural gas	12.6	18.9	21.0	15.0	14.2	-0.8	-6.8	15.0	0.8	5.6
Others				6.4	9.5	3.1	9.5	12.3	2.8	29.5
IV. Non-tax revenue	112.3	159.9	175.8	150.8	180.9	30.1	5.1	141.5	-39.4	-21.8
Property and enterprises	67.6	83.7	82.5	92.4	101.4	8.9	18.8	95.3	-6.0	-6.0
Civil administration	23.2	48.4	66.0	33.1	45.3	12.2	-20.6	15.3	-30.0	-66.2
Miscellaneous	21.5	27.8	27.3	25.2	34.2	9.0	6.9	30.9	-3.3	-9.8
2.Less transfers to provinces	163.1	171.5	192.8	214.8	211.4	-3.4	18.6	239.2	27.7	13.1
Revenue receipts (Net) (1-2)	372.0	447.6	508.8	513.5	549.6	36.0	40.8	557.2	7.6	1.4

Source : Annual Budget Statement
PA: Provincial Actual, BE: Budget Estimates, RE: Revised Estimates

4.4.1 Federal Revenues for FY05

On the revenue side, gross revenue receipts are estimated at Rs 796.3 billion, a growth of 4.6 percent over the revised estimates of FY04 (see **Table 4.5**). The net revenue receipts (Rs 557.2 billion) are expected to increase by only 1.4 percent largely due to higher disbursements to the provinces. The transfer to provinces is estimated at Rs 239.2 billion in FY05, a growth of 13.1 percent YoY as compared to 9.6 percent YoY in FY04. The gross revenue receipts are estimated to be boosted by a 12.9 percent rise in *tax revenues* (revenue from CBR and surcharges), while the non-tax revenues are expected to decline by 21.8 percent (this reflects conservative estimates) largely on account of cautious projections for the US logistic support inflows.

The break up of the federal revenues for FY05, indicates that the bulk of the revenues is expected from the CBR revenues, which hopefully will remain buoyant during FY05 (see **Table 4.2**).[22] The CBR revenues for FY05 are expected at Rs 580 billion,[23] 11.8 percent higher than the realized revenues of Rs 518.8 billion during FY04.

The revenues from surcharges are budgeted to rise 3.1 percent YoY in FY05. This seems to suggest the government will continue to partially insulate the domestic economy from the direct impact of the

[22] The new tax measures in the budget are as follows (1) streamline the sales tax regime by enforcing the most effective tax rate at rate of 15 percent (2) exclude all plant, machinery, and equipment from sales and withholding taxes (3) to significantly to reduce the import duties on cars. However, it is expected that these would have meager negative impact.
[23] Reports indicate that this figure has been revised upwards to Rs 590 billion. However, there is no official notification to this effect.

large rise in international POL prices. However, given the strength of the oil prices hike, this is unlikely to be sustained for long.

Non-tax revenues are projected to decline by 21.8 percent, from Rs 181 billion in FY04 to Rs 142 billion in FY05. This sizable reduction is originating largely from dwindling defense receipts (logistic support from US) and expected marginal drop in interest receipts from the public enterprises and provinces. However, the projected dividend income from the enterprises such as PTCL and OGDCL may rise above the budgeted targets[24].

4.4.2 Federal Expenditures for FY05

In FY05, the total budgetary outlay has been estimated at Rs 908.4 billion which includes Rs 786.2 billion for *revenue expenditures* and Rs 122.1 billion for *capital expenditures* (see **Table 4.3**). The total expenditures (revenue and capital account) are expected to grow by 1.1 percent over revised FY04 estimates. Within the total, the revenue component is expected to grow by 1.7 percent, while capital expenditures shows a decline of 2.6 percent over revised estimates of FY04. Encouragingly, the government plans to spend more on *consolidated developmental* expenditures to the tune of Rs 202 billion in FY05, which are 30.8 percent more than the Rs 154.4 billion in FY04.

Current expenditures will fall by 1.9 percent in FY05 compared to FY04.[25] Within current expenditures, the defense, public order and safety affairs, health affairs (marginal rise), education affairs and services are expected to rise, while the government intends to contain the expenditures on general public service, economic affairs and social protection accounts.

The notable increase of Rs 13.4 billion is envisaged in defense spending, which is estimated to increase from Rs 180 billion in FY04 to Rs 193.9 billion in FY05. This rise is stemming mainly from the two sources; (1) the continued security forces actions on Western borders; and (2) from the expenditures needed for the modernization of the armed forces. The higher allocation for education (Rs 12.2 billion) in FY05 as compared to the Rs 9.6 billion in FY04 is particularly welcome. The Government has also decided to set aside increased funds to improve the law and order.

The other major component of expenditure, debt servicing is budgeted to decline by Rs 52.4 billion as a result of lower debt repayments in FY05. Interest payments on external debt will remain at the FY04 level while those on domestic debt will rise marginally.

Development expenditures (revenue account) for FY05 will overtake defense expenditure after a long time. Even assuming that the entire allocation of Rs 202 billion (excluding the operational shortfall the target is Rs 188 billion) is not fully utilized the overall growth over the previous year's actual outlay is likely to be above 20 percent. Water resource development, transport and Communications and Education (including higher education) account for the bulk of the development expenditure allocations. The share of Federal Ministries and Corporations is almost two-third while the Provincial Governments account for the remaining one-third of the total development budget. This relative share has to be gradually reversed as most poverty-related expenditures are transferred to the provincial and local governments. The impact of every rupee spent directly at the district level is likely to be higher as the ownership of the projects by the local population leads to better effectiveness of resources used.

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[24] In October 2004 PTCL announced dividends that were substantially higher than in the previous year. It is thought that other PSEs may also follow this trend.

[25] There are problems in the analysis of the expenditures due to introduction of NAM, now, the definition and the construction of the most of the expenditures component has been changed and there is no comparable series exist for the preceding years.

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