Chapter 4

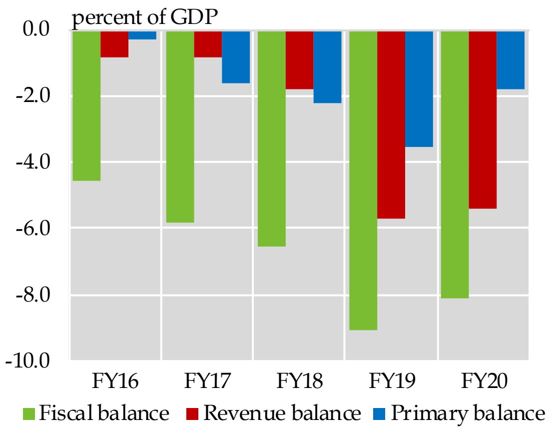
Fiscal Policy

Controlled expenditures, along with a pick-up in revenue growth, yielded a visible improvement in the fiscal position in the first eight months of FY20. The steady improvements were, however, challenged by the outbreak of Covid-19 in the last four months of the year. The response to the outbreak led to a doubling of the fiscal deficit in Q4 alone undermining the gains of the first three quarters. The pressures emerged simultaneously on both expenditure and revenue sides, as the fiscal stimulus package entailed cash transfers to the vulnerable population and efforts to shore up healthcare facilities, just as revenues shrank considerably amid the lockdowns. Nevertheless, the earlier gains had created the fiscal space to tackle the Covid-19 shock, and kept the full-year budget deficit lower than last year. That said, the budget deficit was still high from a sustainability standpoint. Also, revenue growth was driven partly by the withdrawal of some earlier tax concessions and increase in tax rates, and by substantial contributions from one-off factors like non-tax revenues, especially SBP profits and GSM license renewal fees. Therefore, renewed strong commitment to revenue and expenditure reforms would be needed once the economy recovers from the pandemic's fallout.

4.1 Major Fiscal Indicators

The fiscal consolidation efforts to reduce the deficit during the first quarters of the year largely paid off, as, despite the Covid-19 shock, the budget deficit declined from 9.1 percent of GDP in FY19 to 8.1 percent in FY20. This performance owes to multiple policy measures to enhance the FBR's tax collection, along with *one-off* gains from non-tax revenues and prudent management of expenditures in the first 8 months of FY20. In effect, the primary surpluses accumulated during this period largely compensated for the adverse impact of Covid-related additional expenditure on health and cash transfers, and resulted in relatively better fiscal outcomes than FY19 **(Figure 4.1)**.

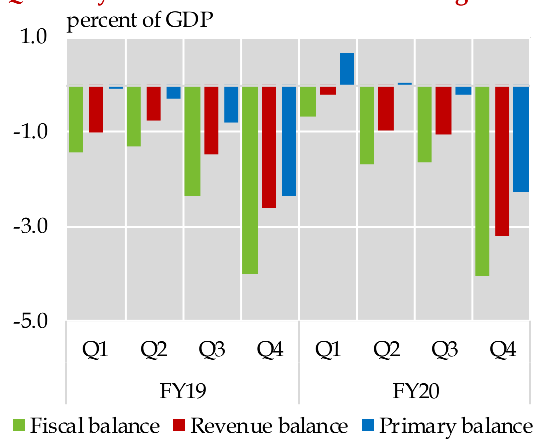
Fiscal Indicators **Figure 4.1**



Source: Ministry of Finance

The government rolled out a number of tax and administrative measures in the budget 2019-20 to enhance revenue mobilization. These included reversal of earlier tax exemptions to certain sectors, increasing slab-wise income tax rates, and upward revision in sales tax and FED rates on selected items. On the administrative front, e-filing and refund systems were improved to facilitate businesses and other taxpayers and promote the filing culture. Importantly also, the government took measures to enhance documentation in the economy and reduce informality; notable measures included the implementation of the CNIC condition for high-value purchases, and the introduction of Point of Sales Integration System for retailers across the country. Meanwhile, non-tax revenues posted a substantial increase following increased transfer of SBP profits and payments of GSM license renewal fee.

Quarterly State of Fiscal Indicators **Figure 4.2**



Source: Ministry of Finance

On the expenditure side, sizable efforts were taken to control the growth in current spending. Development expenditures also remained subdued, as the relevant government departments – that were delegated the responsibility to execute PSDP spending as part of the public financial management reforms – could not initiate the committed projects in the earlier part of the year. Later on, when Covid-19 hit, these projects were delayed further. As a result, the government was able to record a cumulative primary surplus of Rs 193.5 billion in the first three quarters of the year. Although Q3 witnessed a slight primary deficit, the fiscal and revenue deficits remained largely within the contours of the IMF program. By that point, the fiscal position seemed well positioned to achieve the full-year targets. In particular, the revised FBR tax revenue target of Rs 4,803 billion was within reach, given the high growth in major revenue categories in the first eight months. However, with domestic outbreak of Covid-19, the trend in both revenue generation and expenditures turned unfavorable **(Figure 4.2).**

The FBR's tax collection weakened from March-2020 onwards, with all the major revenue categories reporting YoY declines during Mar-Jun FY20 **(Table 4.1)**. As the bulk of revenue collection typically occurs at quarter-ends, even Q3 witnessed a substantial fall in revenue growth, whereas the revenue growth in Q4 plummeted into negative territory.

FBR Tax Collection in FY20 **Table 4.1**

billion Rupees; growth in percent

	Pre-Covid-19	Covid-19
	Jul-Feb	Mar-Jun
Direct taxes	1,005.1	517.9
growth	***19.8***	***-13.1***
FED	163.0	87.5
growth	***17.9***	***-14.7***
Customs	433.3	193.1
growth	***-2.4***	***-19.7***
Sales tax	1134.1	462.7
growth	***24.6***	***-15.6***
Total	2,735.5	1,261.2
growth	***17.3***	***-15.2***

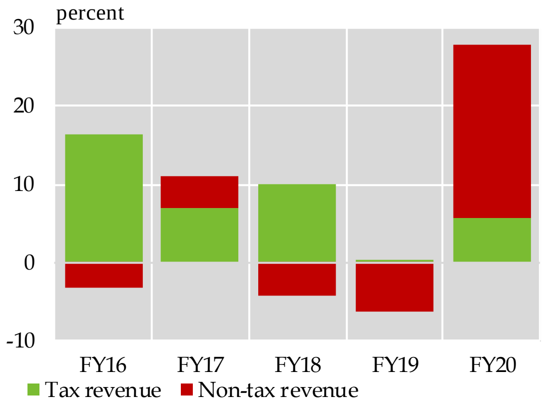
Source: Federal Board of Revenue

In overall terms, Covid-19 resulted in an estimated loss of about Rs 1 trillion in tax revenue, as the full year collection stood at Rs 3,996.7 billion. The expenditure side also took a similar hit, as the government spent heavily on health and cash transfers in Q4 to control the disease spread and alleviate unfavorable social outcomes. Current expenditures in Q4 were Rs 1 trillion higher than the average spending in the first three quarters. Thus, if it were not for the fiscal efforts of the first eight months and the windfall gains from non-tax revenues, the overall fiscal outcome could have deteriorated sharply.

4.2 Revenues

The total revenues grew by a sizable 28.0 precent during FY20, as compared to a decline of 6.3 percent last year. While tax revenues grew modestly, the major contribution to this growth came from higher SBP profits and submission of GSM license fees, which led to a sharp rise in non-tax revenues for the government **(Figure 4.3)**.

Growth Contribution in Total Revenue **Figure 4.3**



Source: Ministry of Finance

FBR Taxes

The FBR tax revenue grew by 4.4 percent, compared to a decline of 0.4 percent last year **(Table 4.2)**. The tax revenue growth recorded during Jul-Feb mainly resulted from the measures announced in the FY20 budget. As discussed earlier, revenue mobilization rose following the elimination of the preferential tax treatment for certain sectors (e.g. sugar, steel and edible oil), and withdrawal of the zero-rating regime for five export-oriented sectors (textile, leather, carpets, sports goods and surgical goods).

FBR Tax Collection **Table 4.2**

billion Rupees; growth in percent

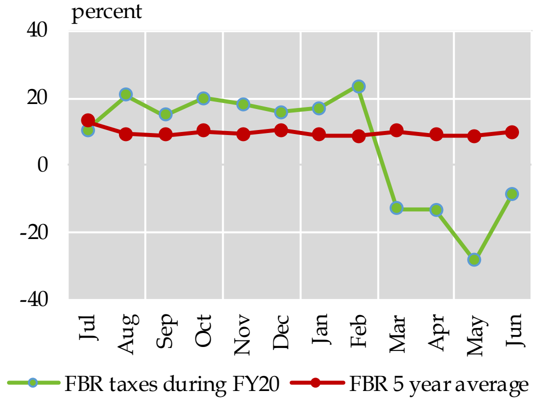
			Growth	
	FY19	**FY20**	**FY19**	**FY20**
Direct taxes	1,445.5	1,523.1	-5.9	5.4
Indirect taxes	2,383.0	2,473.7	3.3	3.8
Customs	685.6	626.4	12.7	-8.6
Sales tax	1,459.2	1,596.8	-1.8	9.4
FED	238.2	250.5	11.6	5.2
Total FBR	**3,828.5**	**3,996.7**	**-0.4**	**4.4**

Source: Federal Board of Revenue

Similarly, measures such as the increase in sales tax rates, especially on petroleum products and sugar; upward revision in income tax rates for both salaried and non-salaried persons; reinstatement of withholding tax and sales tax on mobile top-ups; increased excise duty on cement and cigarettes; and upward adjustment in power tariffs, supported the revenue collection. These measures helped domestic taxes (62.2 percent of FBR taxes) grow by 7.2 percent in FY20, as compared to a decline of 3.1 percent last year.

Keeping in view the encouraging growth in tax revenues during Jul-Feb FY20 – with monthly growth exceeding the 5-year average – it was expected that the FBR would meet its revised revenue target of Rs 4,803 billion.[1] However, the target had to be substantially revised down to Rs 3,907 billion because of Covid-related developments, and the FBR was able to achieve this target. The overall collections also recovered slightly in June 2020 following the ease in countrywide lockdowns. However, this performance could not continue after the Covid-19 outbreak in the country.

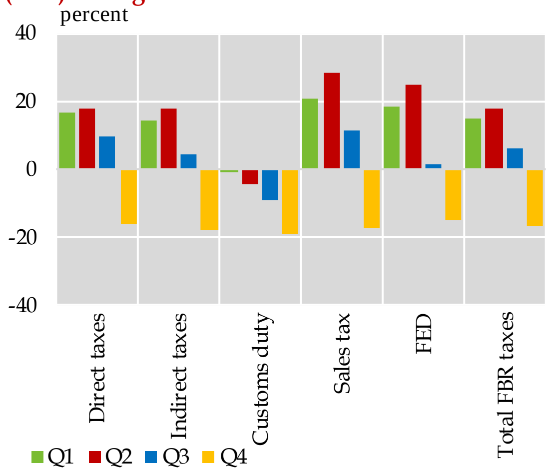
Monthly Growth in FBR Taxes during FY20 (YoY) **Figure 4.4**



Source: Federal Board of Revenue

With the imposition of lockdowns around the last week of March-2020, the growth in FBR taxes fell by 13.2 percent in that month **(Figure 4.4)**. Customs and FED declined the most in the month (22.7 and 16.7 percent, respectively), followed by direct taxes and sales tax (11.1 and 10.4 percent). This was particularly worrying, given that the bulk of collections are usually concentrated at quarter-end. Consequently, the growth in FBR taxes deteriorated in Q3-FY20 **(Figure 4.5)**. Importantly also, import-related taxes, constituting around 40 percent of the FBR taxes, continued to remain under stress throughout the year due to the declining trend in imports.

Quarterly Growth in FBR Taxes (YoY) during FY20 **Figure 4.5**



Source: Federal Board of Revenue

Direct Taxes

Direct taxes increased by 5.4 percent during FY20, as compared to a decline of 5.9 percent in FY19. This mainly emanated from higher growth in withholding taxes (WHT), which offset the declining impact from voluntary payments and collection on demand.

WHT, having a share of more than 70 percent in direct taxes, recorded a double-digit growth in FY20, as compared to a decline of 8.3 percent during FY19. This rise came mainly from a noticeable surge in the collection from salaries, interest & securities, and telephone. Tax measures taken in the FY20 budget, such as the upward revision in tax rates on various salary slabs, increase in tax rates on profit on debt, and the re-enactment of WHT on mobile phone top-ups, all improved the collection from these heads (**Table 4.3**). In contrast, WHT collection on imports declined by 10.0 percent during FY20, primarily due to a decline in import values even in Pak Rupee terms.[2] Collection from contracts during FY20 were almost at last year's level, as the PSDP - the major contrubutor to collection from

[1] The budgeted FBR revenue target was set at Rs. 5,555 billion.
[2] The import value declined by 5.5 percent on YoY basis as compared to 11.3 percent positive growth last year.

contracts - slightly increased by Rs 81.5 billion during FY20.

Voluntary payments, having a share of around 26 percent in the overall direct taxes, declined 11.0 percent in FY20, as compared to a decline of 1.0 percent in FY19. This was mainly due to negative growths of 10.2 and 48.7 percent in collection from returns during FY19 and FY20, respectively. It may be recalled that tax amnesty schemes were announced in the last two fiscal years, and the response in FY18 was overwhelming, given that the collection from returns had grown by a substantial 189.1 percent. The high base effect of FY18 would have affected the growth in collection from returns both in FY19 and FY20 – more so in the current year, as no such scheme was announced in FY20. A similar trend was visible in the collection on demand, which declined by 40.8 in FY20, as compared to a 0.2 percent decline in FY19.

Break-up of Direct Taxes **Table 4.3**

billion Rupees; growth in percent

			Growth	
	FY19	FY20	FY19	FY20
Voluntary payments	**462.2**	**411.1**	**-1.0**	**-11.0**
Collection on demand	**102.6**	**60.8**	**-0.2**	**-40.8**
Withholding taxes	**960.2**	**1091.9**	**-8.3**	**13.7**
of which				
Imports	221.8	199.7	1.4	-10.0
Exports	34.4	38.4	21.7	11.6
Contracts	234.7	237.4	-17.0	1.1
Salary	76.4	129.4	-42.7	69.4
Interest & securities	58.1	128.3	27.5	120.7
Cash withdrawal	32.1	15.3	-5.5	-52.3
Dividends	57.2	55.1	-1.1	-3.6
Electric bills	35.6	45.4	5.2	27.8
Telephone	17.2	54.6	-63.7	217.9

Source: Federal Board of Revenue

Indirect Taxes

Indirect taxes, constituting more than 60 percent of the overall FBR taxes, grew by 3.8 percent during FY20, as compared to a 3.3 percent increase last year. After recording a double-digit growth in Q1 and Q2 of FY20, the growth deteriorated in Q3 because of the Covid-related developments. Futhermore, disaggregated data reveals that the monthly collections of indirect taxes remained around 16 percent lower YoY during the last four months of FY20.

Sales Tax on Domestic & Import Stage Table 4.4

billion Rupees; growth in percent

			Growth	
	FY19	FY20	FY19	FY20
Domestic				
of which				
POL products	248.5	234.6	-16.9	-5.6
Electrical energy	51.4	91.8	5.8	78.8
Cement	21.6	21.2	-10.2	-1.8
Sugar	26.6	41.2	31.8	54.9
Textile sector		61.2		
Sales tax (domestic)	**669.9**	**813.1**	**-8.4**	**11.0**
Imports				
of which				
POL products	221.3	231.3	-16.2	4.5
Iron and steel	69.6	82.9	1.8	19.2
Vehicles	63.0	42.9	-5.6	-31.8
Plastic resins etc.	52.1	55.2	15.4	5.9
Organic chemicals	20.2	31.2	14.9	54.9
Sales tax (imports)	**810.4**	**876.3**	**-1.7**	**8.1**
Gross sales tax	**1,480.4**	**1,689.4**	**-4.8**	**14.1**
Net sales tax	**1,459.2**	**1,596.8**	**-1.8**	**9.4**

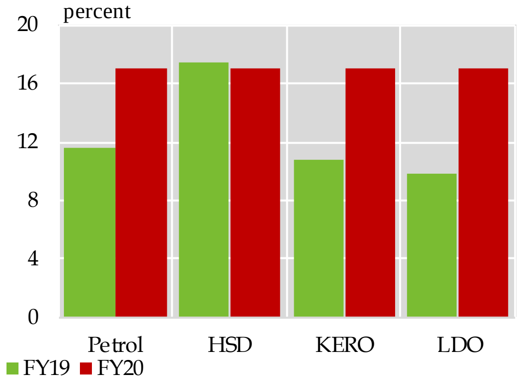
Source: Federal Board of Revenue

Sales tax

Sales tax collection increased by 9.4 percent during FY20, as compared to a decline of 1.8 percent during FY19 **(Table 4.4)**. During Jul-Feb FY20, the sales tax collection posted a YoY growth of 24.6 percent, mainly due to the upward price adjustments in power tariffs, which led to a significant rise in collection from electrical energy (Discos). Moreover, collection from the textile sector also added a substantial amount to the sales tax collection after the abolishment of the zero-rating regime for the sector. Furthermore, sales tax collection on sugar increased due to the elimination of preferantial treatment for the sugar sector.

Similar to other categories, collections from POL products also remained subdued during the Covid period. This mainly came from the domestic stage, following the lockdowns and mobility restrictions and reduced economic activity in general. However, before the Covid outbreak and until Q3, the POL products were the main contributor to the overall sales tax collection on account of the rise in sales tax rate **(Figure 4.6)**. Meanwhile, collection from the cement sector and motor vehicles declined during FY20. The drop in cement is explained by the lower construction activity **(Chapter 2)**, whereas collection from vehicles declined primarily due to the continuation of import compression policies and lower production of cars.

Sales Tax Rates on POL Products **Figure 4.6**



Note: Sales tax rates for FY20 are calculated on basis of weighted average formula.
Source: Federal Board of Revenue

Customs and Federal Excise Duties

There has been a declining trend in the collection from customs duty since May 2019, as imports have contracted sharply following the exchange rate adjustment, along with the imposition of import compression measures like regulatory duties and additional customs duty (ACD). The ACD was increased from 1.0 to 2.0 percent in the FY19 budget; whereas in the FY20 budget, concessions on customs duty on plants, machinery, equipment & apparatus were withdrawn, and 5.0 percent customs duty on natural gas was restored. The drop in collection from customs duty deepened in Q4 on account of Covid-19. In overall terms, the collection from customs duty declined by 8.6 percent in FY20, as compared to a growth of 12.7 percent last year **(Table 4.5)**. Almost all the categories of custom duty declined during FY20 besides collection from POL. Meanwhile, FED collection grew by a relatively subdued 5.2 percent in FY20, as compared to an increase of 11.6 percent recorded last year.

Major Revenue Spinners of Excise and Custom Duty **Table 4.5**

billion Rupees; growth in percent

			Growth	
	FY19	**FY20**	**FY19**	**FY20**
Custom duty	**685.6**	**626.4**	**12.7**	**-8.6**
POL products	79.4	83.2	12.3	4.9
Vehicles	81.5	56.9	-16.1	-30.2
Iron and steel	47.2	45.4	13.9	-3.7
Other	477.6	440.9	19.7	-7.7
FED	**238.2**	**250.5**	**11.6**	**5.2**
Cigarettes & tobacco	91.0	88.6	35.5	-2.6
Cement	57.6	71.5	6.7	24.1
Concentrate/ water/beverage	23.0	24.1	2.9	5.0
Indirect tax	**2,383.0**	**2,473.7**	**3.3**	**3.8**

Source: Federal Board of Revenue

This increase was mainly backed by a 24.1 percent growth in cement due to the upward revision in FED rates.[3] However, the growth in collection from cement was offset by hits to FED collection from cigarettes and tobacco **(Table 4.5).** The upward revision in FED rates on cigarettes and tobacco negatively affected the growth in FED collection from the formal cigarette industry, as many consumers likely shifted towards cheaper and smuggled products **(Chapter 2)**.

4.3 Non-tax Revenues

Non-tax revenues rose significantly in FY20, on the back of higher SBP profits and the GSM license renewal fee **(Table 4.6).** Mark-up payments from PSEs also increased on account of higher interest rates, which added Rs 69.5 billion to the non-tax revenue. Profits from the SBP and the PTA, and the mark-up income from PSEs, contributed the most to the non-tax revenue growth in FY20.

Compared to an average of Rs 226.5 billion during the last 10 years, the SBP transferred Rs 935.5 billion in profit during FY20 **(Figure 4.7).** These transfers stemmed primarily from higher interest earnings on the existing debt stock and revaluation gains **(Chapter 5)**.

[3] The FED rate for beverages was increased to 13.0 percent from 11.5 percent, while that on cigarettes and cement was increased by Rs 700 per 1,000 sticks and Rs 0.5 per kg, respectively.

Non-Tax Revenues **Table 4.6**

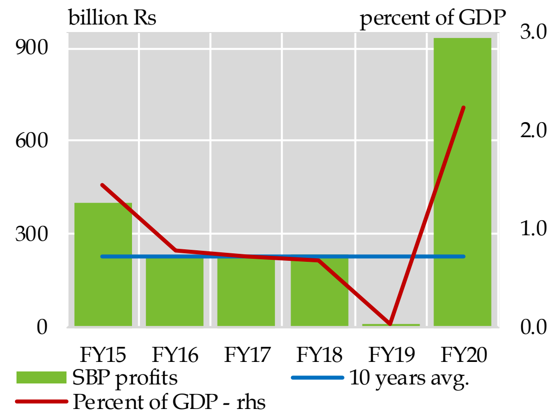
billion Rupees

			Abs. Change	
	FY19	FY20	FY19	FY20
Mark-up (PSEs & others)	35.7	105.2	-52.1	69.5
Dividends	60.2	40.1	2.7	-20.1
SBP profits	12.5	935.5	-220.7	923.0
Defence	15.6	14.4	2.9	-1.2
Royalties on gas & oil	87.9	79.4	29.7	-8.5
Profits post office dept./PTA	18.2	127.0	2.3	108.8
Passport & other fees	23.0	17.7	7.1	-5.3
Discount retained on crude oil	14.0	13.0	4.9	-1.0
Windfall levy against crude oil	7.7	5.2	3.8	-2.5
Petroleum levy on LPG	3.7	3.2	1.6	-0.5
Other	148.7	183.7	-115.8	35.0
Total non-tax revenue	**427.3**	**1,524.4**	**-333.6**	**1,097.1**

Source: Ministry of Finance

Furthermore, PTA profit was mainly driven by GSM licence renewal fee which contributed Rs 127.0 billion to the non-tax revenue. Also, the higher interest earnings from the government's lending to PSEs added Rs 105.2 billion to the non-tax revenue in FY20 because of the higher interest rates. Mark-up receipts mainly came from coporations such as WAPDA and NHA. Profits from hydro-electricity increased by Rs 4.7 billion to Rs 25.7 billion during the review period. Moreover, Rs 26.9 billion were received against the services provided by Pakistani troops in various international peacekeeping missions.

Trend in SBP Profits **Figure 4.7**



Source: Ministry of Finance

In contrast, dividends on the government's shareholding in commercial enterprises, declined by Rs 20.1 billion during FY20, after rising by Rs 2.7 billion last year. In fact, dividends remained below their five-year average. This decline was attributed to the lower profitablity of various PSEs, such as OGDCL, PTCL and Pak Arab Refinery, which led to a decline in reported dividends by these entities.

Furthermoe, the collection from passport & other fees eclined Rs 5.3 billion in FY20, possibly due to the closure of passport offices following the Covid-19 outbreak. Royalties on gas and oil declined by Rs 8.5 billion in FY20 as compared to an increase of Rs 27.9 billion last year. This decline was concentrated in Q4 amid Covid-19, as the royalties had actually increased by Rs 3.8 billion until Q3.[4] Windfall levy against crude oil declined by Rs 2.5 billion during FY20, as compared to a rise of Rs 2.7 billion recorded last year.

4.4 Expenditures

Despite a decline in the development spending, total expenditures grew by a sizable 17.0 percent during FY20, as compared to an 11.3 percent increase last year **(Table 4.7)**. This was mainly due to a higher, Covid-related growth in current expenditures. Although a better fiscal performance was seen in the first nine months of FY20, the last quarter saw pressures on public finances due to higher Covid-19 related expenditures on health and social transfers. Total expenditures constituted around 23.3 percent of GDP, the FY20. The current expenditures surged in Q4-highest since FY98.[5] As a result, the fiscal deficit increased in the last quarter of FY20 to reach 4.1 percent of GDP.

Current Expenditures

Expenditure-control efforts in the first three quarters were reversed in the fourth quarter of

[4] According to Exploration and Prduction Policy (2012), oil exploration and production companies pay 12.5 percent of the value of petroleum as royalty.

[5] Fiscal Policy Statement of Pakistan (2019-20), Ministry of Finance.

Analysis of Fiscal Spending **Table 4.7**

billion Rupees

	Jul-Jun		Absolute change		Growth	
	FY19	FY20	FY19	FY20	FY19	FY20
Current expenditures	**7,104.0**	**8,532.0**	**1,249.8**	**1,428.0**	**21.3**	**20.1**
Federal	4,776.2	6,016.2	986.4	1,240.0	26.0	26.0
of which						
Interest payments (i+ii)	2,091.1	2,619.7	591.2	528.6	39.4	25.3
(i) Domestic	1,820.8	2313.1	498.2	492.3	37.7	27.0
(ii) Foreign	270.3	306.6	93.0	36.3	52.5	13.4
Defense	1,146.8	1,213.3	116.4	66.5	11.3	5.8
Public order and safety	171.6	176.3	46.9	4.7	37.6	2.7
Others	1366.6	2,006.9	231.9	640.2	20.4	46.8
Provincial	2,327.9	2515.8	263.4	187.9	12.8	8.1
Development expenditures	**1,178.4**	**1,155.2**	**-405.6**	**-23.2**	**-25.6**	**-2.0**
PSDP	1,008.2	1,089.7	-448.0	81.5	-30.8	8.1
Federal	502.1	467.7	-74.0	-34.3	-12.9	-6.8
Provincial	506.2	622.0	-374.0	115.8	-42.5	22.9
Others (including BISP)	170.2	65.5	42.4	-104.7	33.2	-61.5
Net lending	40.8	48.5	3.1	7.8	8.3	19.1
Total expenditure*	**8323.2**	**9,735.8**	**847.3**	**1,412.5**	**11.3**	**17.0**

* Excluding statistical discrepancy

Source: Ministry of Finance

FY20 due to additional spending requirements following the Covid-19 outbreak for healthcare, social transfers and grants.

That said, for the full year, the growth in current expenditures was mainly led by interest payments, which grew by 25.3 percent during FY20, as compared to 39.4 percent last year. This mainly emanated from higher payments on domestic debt in the wake of higher interest rates during FY19 and most of FY20. Another factor was the substantial increase in grants for spending on social fronts, such as the Benazir Income Support Program (BISP) under the umbrella of the *Ehsaas* Program. In addition, the government announced a fiscal stimulus package worth Rs 1.2 trillion amid Covid-19. The package aimed to provide relief to the small businesses, and the economically vulnerable low-income groups whose livelihood was badly affected by the pandemic-related lockdowns. First, about Rs 570 billion were allocated to support the public; this included funding for the Utility Stores; power and gas subsidy for bill deferrals; sizable reduction in petrol and diesel prices; support for daily wage workers and the poor; and *panahgahs.*

Second, Rs 480 billion were kept for the business sector and to support SMEs, agriculture, exporters, and to pay wheat farmers. Third, emergency measures of Rs 190 billion were taken, which included tax relief on food and health items, incentives for medical equipment, and emergency funding (including for the National Disaster Management Authority).

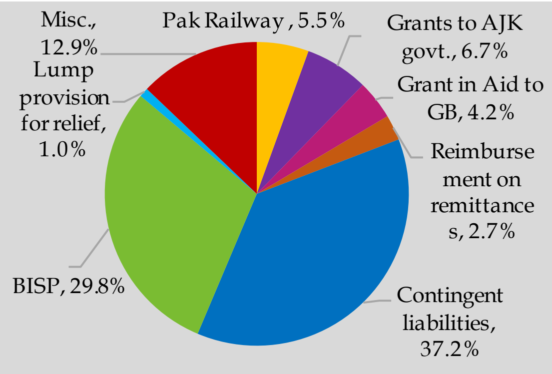
The government also launched the "Ehsaas Emergency Cash Program", with an allocation of Rs 144 billion. This program aims to distribute Rs 12,000 among 12 million poor families of daily wage earners. Around Rs 160.5 billion was already distributed among 13.3 million beneficiaries till July 27.[6] Contributing around 2.0 percent of GDP in FY20, the grants included support for Pakistan Railway, AJK and Giglit Baltistan, and also for contingent liabilities **(Figure 4.8)**. Furthermore, the spending in this category registered Rs 813.4 billion, which exceeded the target of Rs 734.7 billion.

[6] Source: Pakistan Economic Update for July 2020, Ministry of Finance.

Subsidies are estimated to have recorded a significant increase during FY20. Major contribution came from power, food & agriculture sectors; moreover, the share of petroleum revved up during the year which included subsidies to the LNG sector and oil marketing companies **(Figure 4.9)**.

Dissection of Grants for FY20* **Figure 4.8**

(share in percent)



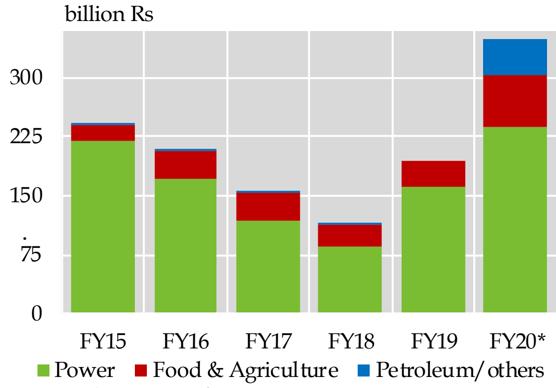
* Revised estimates for FY20

Source: Budget in Brief (FY21)

In the power sector, subsidies were granted to Wapda, Pepco and K-Electric. The subsidies to Wapda/Pepco constituted the major share of Rs 201 billion in the budget and increased to Rs 211 billion, mainly due to inter-Disco tariff differential as well as electricity bill deferment following Covid-19.

Within food & agriculture sector, the Pakistan Agricultural Storage and Services Corporation (PASSCO) received subsidies for wheat operations, and the Utility Stores Corporation for Ramzan and Covid-related stimulus packages; whereas fertilizer plants also received subsidies. Subsidy expenditure on Utility Stores rose to Rs 43.5 billion against the targeted Rs 5.5 billion during FY20, owing to sales of essential items, including under the Covid stimulus package. In the energy sector, subsidies were granted to the gas companies to supply imported LNG to the industries at reduced rates. Besides, oil marketing companies also received a significant share. As a result, the petroleum-related subsidies reached Rs 47 billion, and exceeded their target by Rs 23 billion.

Subsidies by Major Sectors **Figure 4.9**



* Revised estimates for FY20

Sources: Fiscal Policy Statement FY20; Budget in Brief (FY21)

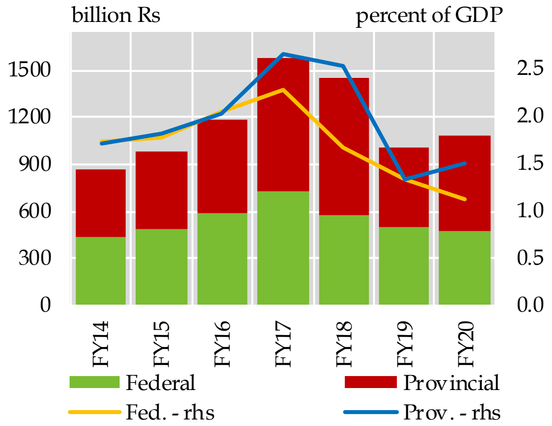
Development Expenditures

Development expenditures declined by 2.0 percent in FY20 as compared to a decline of 25.6 percent during FY19. This is the third consecutive year that the development expenditures have declined. The federal development expenditures, which reduced by 6.8 percent in FY20 as compared to a decline of 12.9 percent last year, were mainly responsible for the overall lower development spending.

The PSDP spending has been shrinking over the last few years, whereas the shares of federal and provincial governments have also changed. Specifically, the budgetary outlay for federal development expenditures has been decreasing. In terms of GDP, both federal and provincial PSDP expenditures have showed a declining trend since FY17 **(Figure 4.10)**. This may be explained by the lower fiscal space available for development spending, given that the federal government's expenditures are constrained by interest payments, defence expenditures, and grants.

According to a World Bank study, the main bottleneck was effective public financial management (PFM), which encompasses issues like the timely release of funds, transparent and efficient procurement, and federal-provincial coordination.

Trends in PSDP **Figure 4.10**



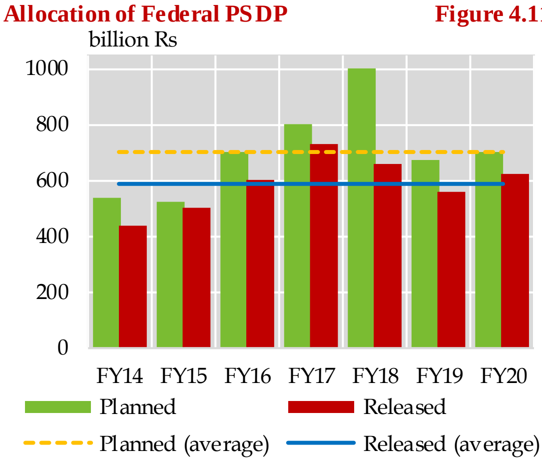
Source: Ministry of Finance

These bottlenecks can be addressed by enhancing the capacity of the PFM institutions, such as the Pakistan Audit and Accounts Academy (PAAA) and the Public Procurement Authority across various government departments.[7] With the enactment of the Public Financial Management (PFM) Act in FY19, the respective divisions and departments were made responsible for executing the sectoral PSDP projects.[8] However, anecdotal evidence suggests that the institutions have struggled with administrative and capacity constraints in executing projects in the earlier part of FY20.

In addition, the budgeted and actual PSDP spending may also be an indicator of the capacity to spend the budgeted funds. On average since FY14, the planned federal PSDP expenditure continued to remain around Rs 700 billion, out of which about Rs 600 billion were actually spent. This was particularly evident in FY18, when the actual spending was far lower than the federal budget outlay for the year **(Figure 4.11)**.

The federal divisible pool is distributed among the provinces according to the budgeted target at the beginning of the year, as per the NFC (2009) award. The federal PSDP was significantly compromised due to the shortfall of more than Rs 1,500 billion in FBR taxes as compared to the budgeted target, along with urgent, additional expenditures incurred amid the Covid-19 pandemic.

Allocation of Federal PSDP **Figure 4.11**



Source: Ministry of Finance

Encouragingly, the actual PSDP released for federal was about 89 percent of the budgeted target set in the beginning. About 30 percent of the release was dedicated to infrastructure and power-related spending, such as those pertaining to the National Highway Authority (NHA), Pakistan Electric Power Company (PEPCO), and the National Transmission and Dispatch Company (NTDC). Some of the special projects (mostly managed by the Finance Division) were nearly aligned with the budget targets, such as the Special Federal Development Program for temporarily displaced persons (TDPs) and security-related projects. About half of the releases were disbursed for projects like the PM Youth Hunarmand Program, Gas Infrastructure Cess, and the Merged Areas 10-year KP development programs.

Within federal ministries, the water resource and cabinet divisions, and the Higher Education Commission (HEC) received major shares. Importantly, construction of dams in Balochistan and the Diamer Bhasha Dam (in KP and Gilgit Baltistan) received major allocations under the water resources division.

[7] Cole, W. P. O. (2016). *Pakistan-Public Financial Management and Accountability to Support Service Delivery Project No. 109788*. Washington, DC: World Bank.
[8] Source: Public Financial Management Act 2019 for Pakistan, Ministry of Finance.

Meanwhile, the cabinet division's major expenditure components included allocations for the SDGs Achievement Program and the Greenline Bus Rapid Transit System (BRTS) for Karachi. The HEC's major projects included the establishment of a NUST campus in Quetta, and the initiative of MS leading to Ph.D. program of faculty development for engineering universities, and other projects comprising various foreign scholarships and fellowships.

4.5 Provincial Fiscal Operations

The provinces remained committed to the objective of fiscal consolidation and posted a combined surplus of Rs 224.9 billion during FY20 **(Table 4.8)**. However, this surplus was only 53 percent of the target (Rs 423 billion) set for the year. Balochistan (Rs 74.8 billion) contributed the most, followed by Sindh (Rs 70.9 billion) and KP (Rs 66.4 billion) to the overall surplus yielded by the provinces.

Provincial Fiscal Operations **Table 4.8**

billion Rupees

	Total		Growth	
	FY19	**FY20**	**FY19**	**FY20**
A. Total revenue	2,995.9	3241.0	2.0	8.2
Provincial share in fed. revenue	2,397.8	2504.0	8.1	4.4
Provincial own revenue	488.1	516.0	-10.9	5.7
Taxes	401.8	413.6	0.1	2.9
Non-tax revenue	86.3	102.4	-41.2	18.6
Fed loans and transfers	110.0	221.0	-36.4	100.9
B. Total expenditure	2857.0	3163.9	-3.5	10.7
Current**	2350.8	2541.9	13.0	8.1
Development	506.2	622.0	-42.5	22.9
Gap (A-B)	138.9	77.1	-720.8	-44.5
Financing* (overall balance)	**-190.0**	**-224.9**	**-1183.8**	**18.4**

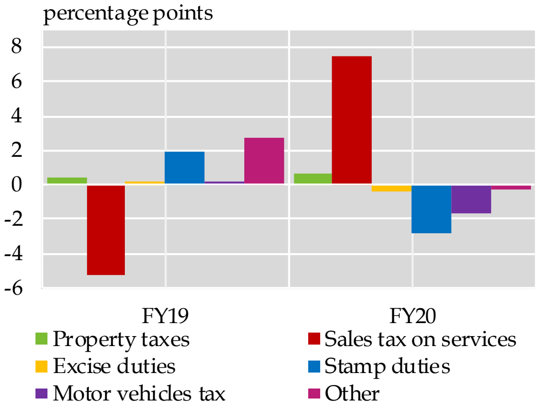
*Negative sign in financing means surplus. ** Current expenditure data may not match with those given in Table 4.7 as numbers reported here includes the markup payments to federal government.

Source: Ministry of Finance

Provincial Revenue

Total provincial revenues grew by 8.2 percent during FY20 as compared to 2.0 percent last year. The provincial share in federal revenue, which covers almost 79 percent of the total provincial revenue, grew by 4.4 percent during FY20 as compared to 8.1 percent last year. However, *provincial own tax revenue* grew by 5.7 percent during FY20, in contrast to a decline of 10.9 percent last year. Sales tax on services (GSTS), having a share of around 56 percent in provincial tax collection, contributed the most **(Figure 4.12)**.

Contribution of Provincial Tax Revenue Spinners **Figure 4.12**



Source: Ministry of Finance

Moreover, the higher collection from GSTS also came from a revoke of the ban on collection of sales tax on mobile top-ups in FY19.[9] The property tax is usually considered to be the potential source for extracting revenue, but its share in the overall provincial revenue is quite low. Despite its growth, it contributed only Rs 9.6 billion during FY20. There are various tax administration and coverage issues that hinder the property tax collection in Pakistan.[10]

That said, the provincial tax and non-tax collection were both affected by the Covid-19, which slowed down the pace of economic

[9] As per the Human Rights Case No. 18877 of 2018, there was a ban on collection of sales tax on mobile top-ups that was applicable to all the provinces. Since telecom services make as significant share of taxable services, the collection was lower in FY19. GSTS for provinces increased in FY20 with the revoke of the ban.

[10] Nabi, I., and H. Shaikh (2011). *Reforming the Urban Property Tax in Pakistan's Punjab*. Policy Brief PB1301. Lahore: Lahore University of Management Sciences. For more details on the topic, also see Special Section 1 of the SBP's State of the Economy Report for Q1-FY19.

activity. As a result, excise and stamp duties and motor vehicle tax declined. This also reflected the impact of lower production and sales of cars and motorcycles, amid the import-compression measures adopted earlier; the trend was further aggravated by Covid-19. Non-tax revenues, constituting around 20 percent of provincial own revenue collection, grew by 18.6 percent during FY20, against a decline of 41.2 percent in FY19. Profit from hydroelectricity increased to Rs 25.7 billion from Rs 21.1 billion last year. Most of this came from KP (Rs 18.7 billion) and Punjab (Rs 7.0 billion). Moreover, irrigation receipts of Rs 3.8 billion were collected during FY20, as compared to Rs 2.4 billion last year. Punjab contributed the most by reporting Rs 3.2 billion under this head.

It is important to note that federal loans and transfers reached Rs 220.9 billion in FY20, almost double the amount reported in FY19 – and about 62 percent of these transfers went to KP. These transfers mainly represent the funds allocated under the 10-year development program for the merged areas.[11] The development and uplift of the Federally Administered Tribal Areas remained a priority for both the federal and KP governments. The primary focus is to upgrade the health, education, and social protection framework, whereas the secondary focus would to improve infrastructure, including the construction of roads and provision of electricity. [12]

Provincial Expenditures

The total provincial expenditures grew by 10.7 percent during FY20, after declining by 3.5 percent last year. Since both current and development expenditures grew in FY20, the provinces could only achieve about half of the targeted annual provincial surplus. The provincial development expenditures rebounded in FY20, rising by 22.9 percent during the year, after dropping 42.5 percent last year.

Heat Map Showing Provincial Current Expenditure Preferences **Table 4.9**

Average shares in total current expenditure since FY16 (percent)

	Punjab	Sindh	KP	Balochistan
Admin affairs*	21.6	21.7	19.2	21.1
Transfers to districts	34.7	10.1	41.0	1.8
General services	0.7	0.7	0.5	1.7
Public order	14.3	14.9	14.9	16.6
General affairs**	0.1	0.3	0.1	0.6
Food and agri***	6.3	5.8	3.6	8.4
Fuel and energy	0.1	3.5	0.0	4.9
Mining and manufacturing	0.9	0.2	0.2	1.3
Construction and transport	2.5	2.1	1.5	4.6
Other industries	0.0	0.1	0.0	0.0
Housing and community	1.2	0.6	1.1	4.2
Health	10.1	12.7	7.7	9.1
Recreation and cul	0.3	1.1	0.3	1.1
Education	5.7	24.9	7.7	23.3
Social protection	1.4	1.3	2.1	1.3

Key: Lowest to highest

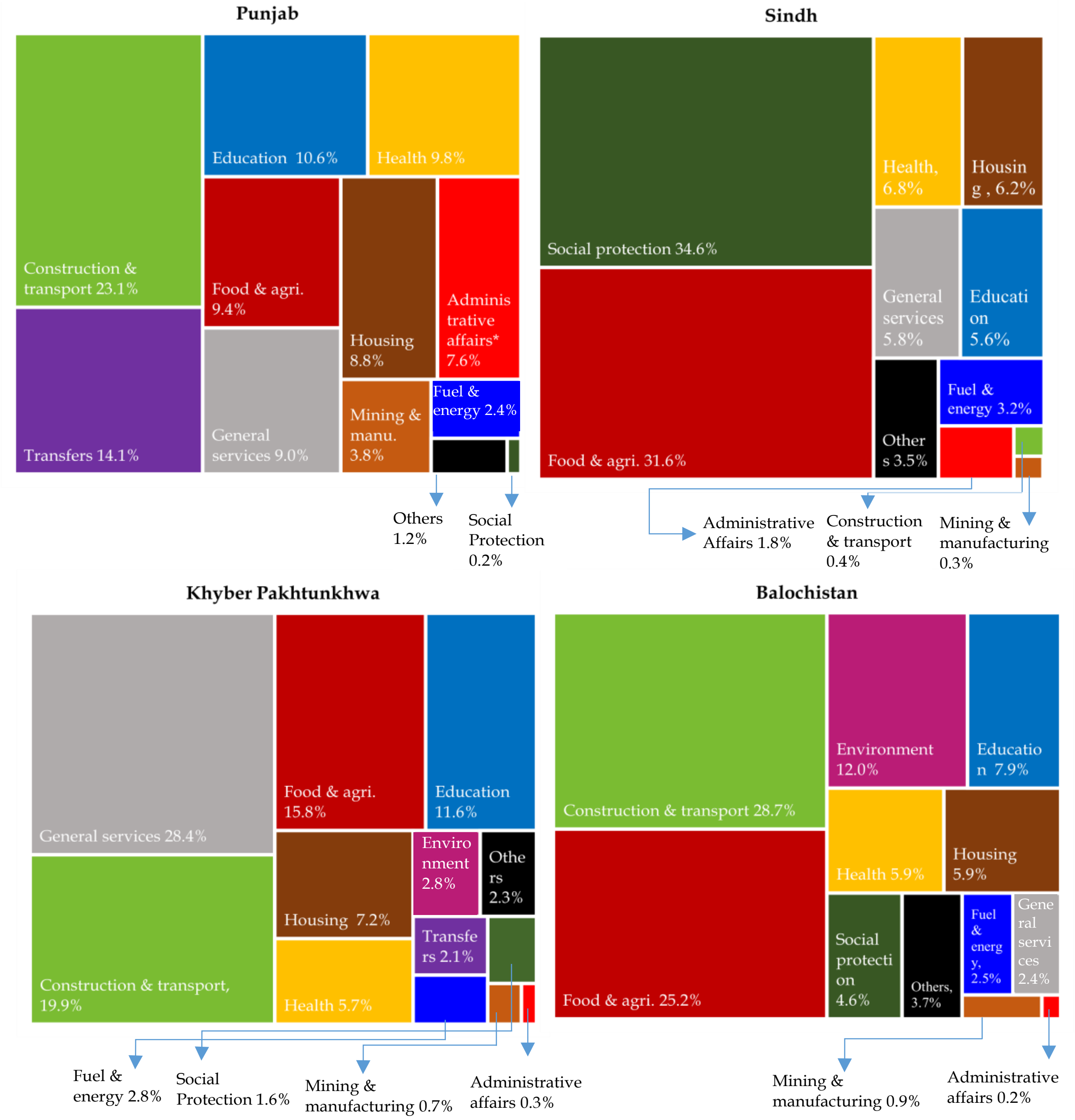
* This term includes Executive & Legislative Organs, Financial and Fiscal Affairs; ** General Economic, Commercial & Labor Affairs
*** Agriculture, Food, Irrigation, Forestry, and Fishing

Source: Ministry of Finance

However, current expenditures slowed down to 8.1 percent in comparison with the 13.0 percent growth last year. Province-wise analysis reveals that over the last five years, the trend in provincial current expenditures is tilted towards administrative affairs of the provincial governments, followed by public order, health, and food-related spending. Encouragingly, Sindh and Balochistan invested more in education, while Punjab and KP transferred the funds to district authorities for providing services to the general public **(Table 4.9)**. Although the provincial development expenditures rebounded from last year, there remain gaps in the budgeted estimates and the actual spending. For example, Punjab spent about 76 percent, Balochistan 86 percent, and KP 50 percent, of their respective budget allocations. Sindh, on

[11] Under the 25th amendment in 2018, the Federally Administered Tribal Areas (FATA) region was officially merged with Khyber Pakhtunkhwa.
[12] KP White Paper for FY21 (source: https://www.pakp.gov.pk/wp-content/uploads/White-Paper-2020-21.pdf).

Composition of Provincial Development Expenditure during FY20 **Figure 4.13**



* This term includes Executive & Legislative Organs, Financial and Fiscal Affairs;
Source: Ministry of Finance

the other hand, spent only 34 percent of the budget outlay, which is reflected in the decline of the province's development expenditure during the year. The provincial spending varied in different sectors during the year. For instance, the major preference points for Punjab remained construction and transport, transfers to district, health, and education. Likewise, KP and Balochistan focused their spending on construction, and food and agriculture, whereas Sindh spent largely on social protection and food and agriculture **(Figure 4.13)**. In overall terms, food and agriculture, construction, education, health, and housing remained the provincial priorities during FY20. These developments will help the provinces to invest in more productive areas, such as education, health, and infrastructure, to achieving the Sustainable Development Goals (SDGs) objective, and to impart social development. .