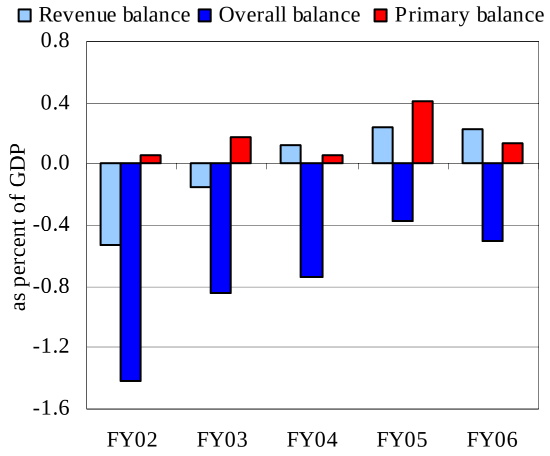
5 Fiscal Developments

5.1 Overview

Figure 5.1: Fiscal Balance Indicators-Q1



The fiscal deficit widened marginally during Q1-FY06, rising to 0.5 percent of (estimated) GDP, as compared to approximately 0.4 percent of GDP in Q1-FY05. This rise is not a concern, as the increase is small, revenue growth appears reasonably strong, net lending to PSEs has remained negative,[1] and given that the higher growth in expenditure is driven primarily by a 58.6 percent YoY increase in development expenditure. This is clearly evident in the fiscal balance indicators, where the revenue balance for Q1-FY06 is practically unchanged from the previous year. Similarly, the primary surplus has dropped 0.1 percent of GDP against the 0.4 percent of GDP in FY05 (see **Figure 5.1**). This too is not worrisome considering that interest payments have declined, and given that the remaining deterioration is principally caused by higher developmental expenditure; which have risen from 0.5 percent of GDP in Q1-FY05 to 0.7 percent of GDP in Q1-FY06.

However, given that fiscal performance post-Q1-FY06 is likely to deteriorate due to a possible rise in expenditures in the aftermath of the October 2005 earthquake, there is a need for greater vigilance in sustaining (and improving) revenue growth. Specifically, the appreciable 21.0 percent YoY growth in CBR revenues in the first quarter is mainly due to the unexpectedly large rise in international trade taxes; these taxes accounted approximately 76.5 percent of the total increase in CBR tax collections during the period. This suggests the need for the CBR to increase focus on tax compliance and expanding the tax net.

[1] This improved position was primarily attributable to Pakistan Steel, while the other PSEs did not perform well during the quarter.

5.2 Revenues

Revenue receipts increased to Rs 236.6 billion in Q1-FY06; this represents a growth of 17.0 percent YoY, which is sharply lower than the 22.2 percent YoY rise in Q1-FY05. In absolute terms however, the Rs 34.4 billion increase in Q1-FY06, is only a little lower than the Rs 36.7 billion increase recorded in Q1-FY05. Indeed, when seen as a percentage of GDP, revenues increased marginally from 3.1 percent in Q1-FY05 to 3.2 percent during Q1-FY06 (see **Table 5.1**).

Table 5.1: Consolidated Federal and Provincial Government

billion Rupees

								YoY change	
			FY02	FY03	FY04	FY05	FY06	abs.	percent
1	Revenue Receipts		115.3	153.5	165.5	202.2	236.6	34.3	17.0
	a)	Tax Revenue	94.4	115.6	119.7	142.5	164.9	22.3	15.7
	b)	Non-Tax Revenue	20.9	38.0	45.8	59.7	71.7	12.0	20.1
2	Total Expenditures		178.0	194.5	206.5	227.1	274.3	47.1	20.8
	a)	Current	138.8	161.2	158.9	186.9	219.8	32.9	17.6
	b)	Developmental	13.5	21.7	24.9	32.0	50.7	18.8	58.6
	c)	Net Lending to PSEs etc.	5.7	-0.6	8.3	1.5	-0.1	-1.6	-110.0
	d)	Unidentified	20.0	12.3	14.5	6.8	3.9	-2.9	-43.1
3	Revenue Balance (1-2.a)		-23.5	-7.6	6.6	15.4	16.8	1.4	9.1
4	Overall Balance (1-2)		-62.7	-41.0	-41.0	-24.9	-37.7	-12.8	51.5
As percentage of GDP									
1	Revenue Receipts		2.6	3.2	3.0	3.1	3.2	0.1	2.6
	a)	Tax Revenue	2.1	2.4	2.2	2.2	2.2	0.0	1.5
	b)	Non-Tax Revenue	0.5	0.8	0.8	0.9	1.0	0.0	5.3
2	Total Expenditures		4.0	4.0	3.7	3.5	3.7	0.2	5.9
	a)	Current	3.2	3.3	2.9	2.9	2.9	0.1	3.2
	b)	Developmental	0.3	0.4	0.5	0.5	0.7	0.2	39.2
	c)	Net Lending to PSEs etc.	0.1	0.0	0.2	0.0	0.0	0.0	-108.8
	d)	Unidentified	0.5	0.3	0.3	0.1	0.1	-0.1	-50.1
3	Revenue Balance (1-2.a)		-0.5	-0.2	0.1	0.2	0.2	0.0	-4.3
4	Overall Balance (1-2)		-1.4	-0.8	-0.7	-0.4	-0.5	-0.1	32.9

Source: Ministry of Finance

In Q1-FY06, tax revenues stood at Rs164.9 billion, up 15.7 YoY, compared to a rise 19.1 percent YoY during Q1-FY05. The deceleration in the growth of tax revenues owes to both, a relatively slower rise in CBR taxes,[2] as well as a drastic decline in Petroleum Development Levy[3] (that decreased from Rs 3.6 billion in Q1-FY05 to Rs 1.2 billion in Q1-FY06).

While non-tax revenues also saw growth decelerate from 30.4 percent YoY in Q1-FY05 to 20.1 percent in Q1-FY06, the growth was nonetheless high, pushing the receipts to Rs 71.7 billion. Key contributions to this included defence receipts (Rs 28.9 billion), profits from PTA (Rs 10.2 billion), and SBP profits (Rs 3.6 billion) and dividends (Rs 7.6 billion).

5.3 Expenditure

The consolidated expenditure during the first quarter of FY06 rose to Rs 274.3 billion, up 20.8 percent YoY, as compared to a rise of 10 percent YoY in Q1-FY05. This acceleration in expenditure is principally due to a substantial increase in development spending. The rise on current expenditure during Q1-FY06 was held steady at 17.6 percent YoY, and therefore current expenditure as a share of GDP remains at 2.9 percent of GDP (see **Table 5.1**). Encouragingly, interest payments declined by 6.7 percent during the quarter, although the impact of this was offset by a 21.4 percent YoY increase in defence expenditure (see **Table 5.2**). Nonetheless, the aggregate share of defence and interest payments in total current expenditure dropped from 52.2 percent in Q1-FY05 to 47.3 percent in Q1-FY06.

Table 5.2: Composition of Current Expenditure during Q1

billion Rupees

			YoY change	
	FY05	**FY06**	**absolute**	**percent**
Current expenditures	186.9	219.8	32.9	17.6
Of which				
Interest payments	51.5	48.0	-3.5	-6.7
Domestic	42.4	39.8	-2.7	-6.3
Foreign	9.0	8.2	-0.8	-8.9
Defense	46.1	55.9	9.9	21.4
Provincial	52.7	67.0	14.3	27.1

Source: Ministry of Finance

The sharp increase in total expenditure mainly came from an increase in the development expenditure that rose form 0.5 percent of GDP to 0.7 percent of GDP. It is noteworthy that of the development expenditure of Rs 50.7 billion, a net profit of Rs 146 million from public sector enterprises also helped contain fiscal balances in this regard.

[2] For details please see **Section 5.5**

[3] Petroleum development levy remained almost zero on major products during the comparable period.

Finally, net lending to PSEs was negative during the first quarter of FY06, as compared to the 1.5 billion lending in the comparable period last year. This is primarily because of high profits of Pak Steel.

5.4 Financing

The budgetary financing requirements increased to Rs 37.7 billion in Q1-FY06 as compared to the Rs 24.9 billion during the corresponding period of FY05.

Table 5.3: Financing of Budget Deficit during Q1
billion Rupees

			Percent share	
	FY05	**FY06**	**FY05**	**FY06**
Financing through	24.9	37.7	100.0	100.0
External resources(net)	19.6	5.0	78.6	13.3
Internal resources	5.3	32.7	21.4	86.7
Domestic non-bank	19.1	14.3	76.8	38.0
Banking system	-19.9	14.9	-79.9	39.4
Privatization proceeds	6.1	3.5	24.5	9.3

Source: Ministry of Finance

Unlike the previous year, the financing requirements were largely met though the domestic resources (86.7 per cent) (see **Table 5.3**).

To finance its budget, the Government raised Rs 14.9 billion through bank borrowing and Rs 14.3 billion from the non-bank. Of the non-bank borrowing, the major chunk came from the public debt, especially T-Bills auction, while Rs 3.2 billion were also raised from saving schemes. Moreover, privatisation proceeds of Rs 3.5 billion also helped in financing the fiscal deficit.

5.5 CBR Tax Collection

CBR tax receipts surpassed the Rs 145.5 billion target for Q1-FY06 by 4.5 percent. Details of monthly tax collection reveal that CBR met all its monthly targets with an overall growth of 21 percent over the last year; however, progress during the month of August was exceptionally good as total revenue collection surpassed the target by 8.3 percent. This was mainly due to sales tax collection that exceeded the monthly target by 16.2 percent (see **Table 5.4**).

Table5.4: Monthly Tax Collections (Net)
billion Rupees

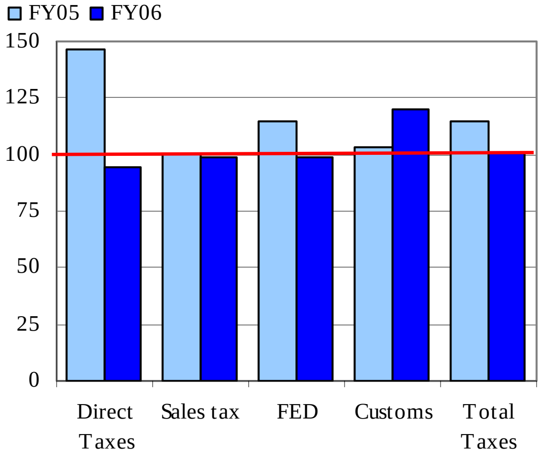
				Growth rates	
	FY04	**FY05**	**FY06**	**FY05**	**FY06**
Jul	23.4	30.7	34.6	31.3	12.8
Aug	30.1	34.2	44.9	13.5	31.4
Sep	40.6	60.8	72.5	50.0	19.2
Q1	**94.1**	**125.7**	**152.1**	**33.6**	**21.0**

Source: Central Board of Revenue

Although the individual targets of all domestic taxes (income tax, sales tax - domestic and federal excise duty) could not be met during the quarter, it was mainly due to the ambitious targets set for the quarter. However, their YoY growth performance was not impressive relative to the last year (see **Figure 5.2**).

Looking to the performance of the first quarter, the CBR will have to gear up its efforts in the remaining months of the current year to meet it annual target of Rs 690 billion.

Figure 5.2: Q1 Revenue Collection as % of Targets



5.5.1 Refunds and Gross Collection

The 15 percent YoY growth in gross collection, (from Rs 148.3 billion in Q1 FY05 to Rs 170.3 billion in Q1 in FY06) and fall of YoY 19.4 percent in refunds (from Rs 22.6 billion to Rs 18.2 billion) made the achievement of tax revenue target possible during the quarter (see **Figure 5.3**).

The decline in tax refunds is basically due to a fall in sales tax refunds, principally owing to zero tax rating on export-oriented products.

5.5.2 Analysis by Tax Components

Direct Taxes

Growth in direct tax collections decelerated to 15.5 percent YoY during Q1-FY06 from 63.2 percent in Q1-FY05. As a result, the collections totalled only Rs 48.2 billion, slightly lower than the Rs 48.8 billion target for the period (see **Table 5.5**).

Figure 5.3: Refund and Gross Collection (Q1)

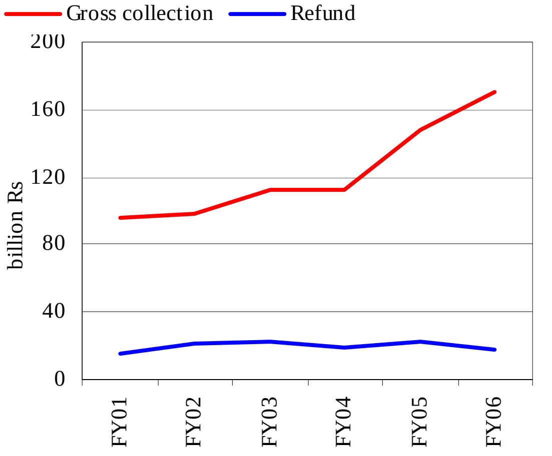


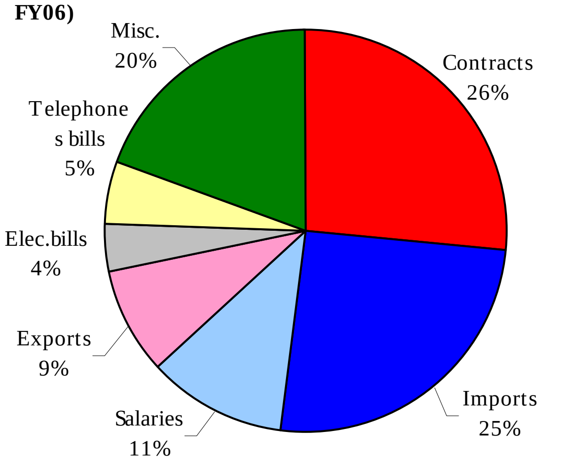
Table 5.5: Tax Collection in Q1
billion Rupees

	Targets FY06		Net Tax Collection			As % of target		YoY change	
	Annual	**Q1**	**FY04**	**FY05**	**FY06**	**Annual**	**Q1**	**Abs.**	**Percent**
Direct Taxes	215.4	48.8	25.6	41.7	48.2	22.4	98.7	6.5	15.5
Indirect Taxes	474.6	96.7	68.5	84.0	103.9	21.9	107.4	19.9	23.7
Sales tax	294.0	57.1	41.6	50.4	63.0	21.4	110.3	12.6	25.1
FED	59.4	12.7	9.0	11.2	12.2	20.6	96.4	1.0	9.0
Customs	121.2	26.9	17.9	22.4	28.6	23.6	106.5	6.3	27.9
Total Taxes	**690.0**	**145.5**	**94.1**	**125.7**	**152.1**	**22.0**	**104.5**	26.3	21.0

Source: Central Board of Revenue

A break-up of income tax collections does not exhibit any notable improvements in voluntary payments and collection on demand, and the main source of the growth in collections remains withholding taxes, which rose 18.2 percent YoY to Rs 26.6 billion, which is attributable to the increased economic activity in the country. The main sources of withholding tax receipts were contracts (Rs 7.1 billion), imports (Rs 6.7 billion) and salaries (Rs 3.0 billion) – (see **Figure 5.4**).

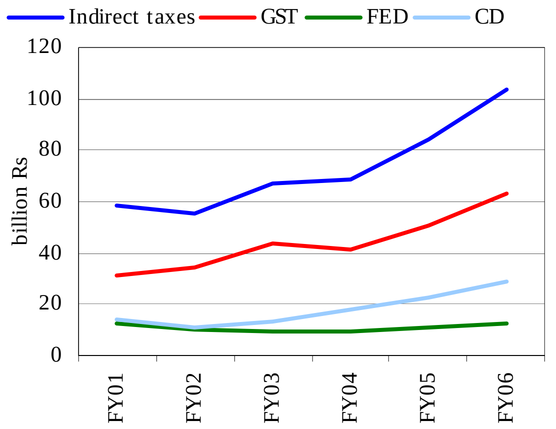
Figure 5.4: Composition of Withholding Tax (Q1-FY06)



Indirect Taxes

During Q1-FY06, indirect taxes amounted to Rs 103.9 billion, up 23.7 percent YoY compared to a 22.6 percent YoY rise in Q1-FY05 (see **Figure 5.5**). This strong rise in indirect tax receipts is entirely due to acceleration in both sales tax and customs duty receipts, due to the exceptional rise in the

Figure 5.5: Trend in Indirect Taxes during Q1



country's import bill, and a fall in claims of refunds.

Sales Tax

Sales tax receipts witnessed a robust increase 25.1 percent YoY during Q1-FY06, as compared to the 21.0 percent YoY during Q1-FY05 (see **Table 5.5**). In contrast to recent years, this was achieved principally due to an exceptional 39.5 percent YoY rise in receipts from domestic sources, which outstripped even the strong YoY rise of 17.6 percent in the sales tax on imports. The biggest contribution to this sharp rise was from the decline in sales tax refunds, following the zero rating of exports oriented industries. (see **Table 5.6**)

Table 5.6: Major Revenue Spinners of GST (Domestic)

billion Rupees

			YoY change	
	FY05	**FY06**	**absolute**	**percent**
POL Products	5.9	5.4	-0.5	-8.2
Services (telecom)	4.1	5.3	1.1	27.3
Natural Gas	2.6	2.9	0.3	11.2
Sugar	1.7	2.0	0.3	16.3
Cement	0.9	1.2	0.2	23.6
Sub total	15.3	16.8	1.4	9.4
Others	17.7	14.7	-3.0	-16.8
All Commodities	**33.0**	**31.5**	**-1.5**	**-4.6**
Refund/ Rebate	15.2	7.5	-7.6	-50.3
GST Net	**17.9**	**24.0**	**6.1**	**34.1**

Source: Central Board of Revenue

Federal Excise

Federal excise contributed around Rs 12.2 billion to the exchequer during Q1-FY06 showing an increase of 9 percent YoY, as compared to the 24.8 percent YoY rise in Q1-FY05.

The increase in FED receipts essentially mirrors the increasing production in key industries, particularly cigarettes, cement and beverages. However, it is surprising that despite a growth of 1.3 percent in POL products, the FED collection declined by 8.3 percent YoY in the first quarter of FY06 as compared to the same period of the preceding year. (see **Table 5.7**)

Table 5.7: Gross Federal Excise Collection in Q1 (gross)

billion Rupees

			YoY change	
	FY05	**FY06**	**absolute**	**percent**
Cigarettes	4.0	4.5	0.6	14.6
Cement	2.6	2.8	0.2	6.5
POL	1.1	1.0	-0.1	-8.3
Natural gas	1.3	1.3	0.0	-3.0
Beverages	1.1	1.4	0.3	23.7
Sub total	10.2	11.1	0.9	8.7
Others	1.0	1.1	0.1	11.8
Total FED	**11.2**	**12.2**	1.0	9.0

Source: Central Board of Revenue

Customs Duty

Collection from customs duty amounted to Rs 28.6 billion, up 27.9 percent YoY as compared to the rise of 25.2 percent YoY during Q1-FY05. This rise simply reflects the increase in the country's import bill during the period.

Table 5.8: Major Revenue Spinners of customs duty (Q1)
billion Rupees

			YoY change	
	FY05	**FY06**	**absolute**	**percent**
Vehicles	4.6	7.1	2.5	55.2
Edible Oil	3.6	4.1	0.4	12.0
Mech. Appliances	2.0	2.4	0.3	16.0
Elec. Machinery	1.5	1.7	0.2	13.5
Iron and Steel	1.5	1.5	0.0	1.3
POL	1.7	1.1	-0.6	-34.0
Sub total	14.9	17.8	2.9	19.6
Others	11.7	16.1	4.5	38.3
Gross collection	26.5	33.9	7.4	27.8
Refunds/rebate	4.2	5.3	1.1	27.2
Net Collection	22.4	28.6	6.2	27.9

Source: Central Board of Revenue

A break-up of the collections shows that motor vehicles continued to remain a major revenue spinner, followed by edible oils, mechanical appliances, and electrical machinery. Unlike previous years, however, the revenue from POL products has declined (see **Table 5.8**).