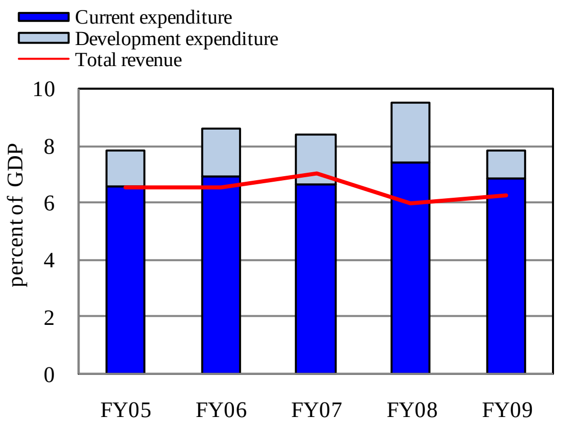
5 Fiscal Developments

5.1 Overview

Fiscal consolidation has been a major priority under the macroeconomic stabilization agenda for FY09. This seems to be bearing fruits, as data for first six months of FY09 estimate overall fiscal deficit to have dropped to 1.9 percent of projected annual GDP compared to 3.4 percent in H1-FY08. The fiscal deficit for H1-FY09 thus appears to be in line with the annual target set in the budget FY09 as well as that agreed with IMF under Stand-by Arrangement (SBA).

Figure 5.1: Total Revenues and Expenditures Booked (H1)



Understandably, the fiscal improvement thus far has largely been brought about by elimination of oil subsidies and a cut in development spending (see **Figure 5.1**). Total revenues, as percent of GDP, recovered slightly during H1-FY09 after the sharp decline witnessed in H1-FY08. The marginal improvement came exclusively from increase in non-tax revenues (see **Table 5.1**). Stagnation of tax revenues, as percent of GDP, yet again underscores the significance of fiscal prudence. While there is need for a line-by-line review of government budget outlays, long term sustainability of fiscal accounts would require expansion in total revenues, particularly by broadening the tax base.

Broadening the tax base is key to a sustainable macroeconomic framework, particularly as access to external financing is increasingly difficult. This forces greater reliance on domestic financing, with a concomitant high risk of crowding out of private investment.

5.2 Fiscal Performance Indicators

All key fiscal performance indicators showed significant improvement in H1-FY09 (see **Figure 5.2**). Consistent with annual target for FY09, overall fiscal deficit, as a share of GDP, recovered to the H1-FY07 level. The large fiscal

Table 5.1: Summary of Consolidated Public Finance

billion Rupees

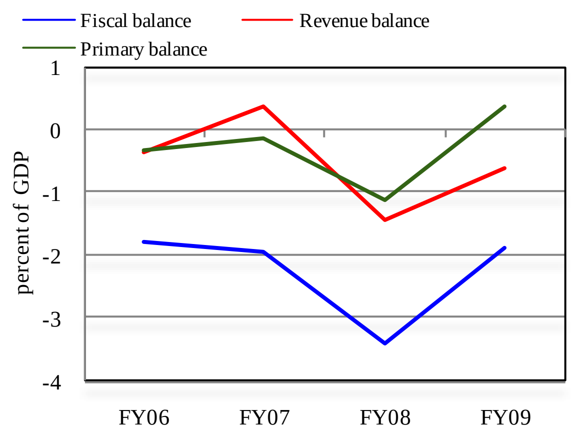
	Jul-Dec				YoY change (%)	
	FY06	**FY07**	**FY08**	**FY09**	**FY08**	**FY09**
Total revenue	497.8	614.8	625.6	834.5	1.8	33.4
Tax revenue	343.3	433.4	450.7	578.0	4.0	28.2
Non-tax revenue	154.6	181.3	174.9	256.5	-3.6	46.7
Total expenditure	634.5	783.8	981.9	1,085.0	25.3	10.5
Current	525.3	581.4	775.1	916.8	33.3	18.3
Development and net lending	127.8	147.9	225.8	133.0	52.6	-41.1
Unidentified expenditure	-18.6	54.4	-18.9	35.3	--	--
Budget balance	-136.7	-169.0	-356.3	-250.6	--	--
	as percent of GDP					
Total revenue	6.5	7.0	6.0	6.2	--	--
Tax revenue	4.5	5.0	4.3	4.3	--	--
Non-tax revenue	2.0	2.1	1.7	1.9	--	--
Total expenditure	8.3	9.0	9.4	8.1	--	--
Current	6.9	6.7	7.4	6.8	--	--
Development and net lending	1.7	1.7	2.2	1.0	--	--
Unidentified expenditure	-0.2	0.6	-0.2	0.3	--	--
Budget balance	-1.8	-1.9	-3.4	-1.9	--	--

Source: Ministry of Finance

slippage in FY08 resulted mainly from substantial deceleration in total revenues and unusually high subsidies, especially on petroleum products. Consequently, rationalization of subsidies has been an important ingredient of fiscal consolidation plan for the current fiscal year. Given fiscal rigidities in current expenditures and only slight improvement in total revenues, as percent of GDP, the government had to curtail its development spending during Jul-Dec FY09.

Encouragingly, primary balance (total revenues less total expenditures excluding interest payment) moved into

Figure 5.2: Fiscal Performance Indicators (Jul-Dec)



surplus during H1-FY09, the first such instance since H1-FY05. The emerging surplus in primary balance reflects the viability of current level of non-interest expenditures compared to total government resources, which could potentially lead to reduction in total debt stock. While the improvement in primary balance during H1-FY09 is considerable, the continued deficit in revenue balance suggests a still large growth of current expenditures compared to government's resource envelope. Additionally, even though the deficit in revenue balance recorded a decline, this apparent improvement in revenue balance is unclear given the presence of large 'unidentified expenditures.'

5.3 Revenues

The strong growth in total revenues recorded in Q1-FY09 further consolidated during second quarter of the current fiscal year. Specifically, total revenues rose to Rs 834.5 billion, registering an impressive YoY growth of 33.4 percent during H1-FY09 as compared to only 1.8 percent growth in H1-FY08. While this large acceleration in total revenues is due to substantial rises in both tax and non-tax revenues, the increase in tax receipts is just enough to keep these, as a share of GDP, unchanged at H1-FY08 level.

Category-wise performance of tax receipts reveals a large shortfall in collection of direct taxes for the second consecutive year. It is to be noted that direct tax receipts, contributing nearly 40 percent to the FBR tax revenues, play a key role in revenue trends. While the entire shortfall will be hard to replenish in the remaining months of FY09, the feared deceleration in direct tax receipts due to likely fall in corporate earnings, on account of realization of impairment losses arising from decline in value of financial assets, will now be staggered up to Q2-FY10, following the relaxation in IAS39 by SECP and SBP.[1] Furthermore, consumption taxes and custom duties, which produced the strong rise in Q1-FY09 tax receipts, have started to weaken following a decline in international prices of POL inputs such as POL products.

[1] The international accounting standard (IAS) 39 requires valuation of all financial assets and liabilities according to market price as on that day and recognition of any profit and loss arising from such valuation into the income statement. Realizing the unprecedented decline in market value of the stock exchanges and the fact that the market was effectively closed for nearly four months through imposition of price floor, SECP and SBP allowed all companies to defer the recognition of impairment loss as on 31st December 2008, if any, due to valuation of listed equity investment held as 'available for sale' to quoted market price on that day. Companies opting for this allowance are asked to show the impairment loss under equity. However, any such amount taken to equity will be routed to income statement on quarterly basis during the calendar year ending on 31st December 2009, provided the said decline in share prices is not reversed in coming quarters.

Non-tax revenues added Rs 148.3 billion to total revenues during Oct-Dec FY09 compared to Rs 77.8 billion in the corresponding period last year, registering an exceptionally strong YoY growth of 90.5 percent. This second-quarter large rise in non-tax revenues is in sharp contrast to a big deceleration witnessed in the growth of non-tax revenues during Q1-FY09, despite substantial inflows on account of logistic support reimbursements. The extraordinarily strong performance of non-tax revenues in Q2-FY09 is mainly attributable to a sharp increase in transfer of SBP profits and large collection of surcharge on petroleum products (see **Table 5.2**).

Table 5.2: Composition of Tax and Non-Tax Revenues

billion Rupees

	Jul-Sep		Oct-Dec	
	FY08	**FY09**	**FY08**	**FY09**
Tax revenues	**215.6**	**276.8**	**235.1**	**301.2**
Direct taxes	79.2	89.7	85.2	121.1
Taxes on property	1.0	1.8	1.0	0.7
Taxes on goods & services	98.0	136.6	109.2	136.0
Taxes on international trade	29.1	38.2	32.4	35.3
Other taxes	8.2	10.5	7.4	8.1
Non-tax revenues	**97.0**	**108.1**	**77.8**	**148.3**
Profits from PTA/PO	0.0	0.0	0.0	0.0
Interest (PSE and others)	12.6	1.6	2.2	2.0
Dividends	2.0	9.5	30.3	24.9
SBP profits	47.3	28.0	0.0	43.9
Defence	1.3	29.2	0.9	1.0
Surcharges	**8.8**	**8.2**	**10.7**	**29.2**
Petroleum	4.2	1.8	3.2	27.0
Gas	4.6	6.4	7.5	2.2
Discount retained on crude oil		4.1		1.9
Royalty on oil/gas	11.3	10.4	10.2	15.4
Others	13.7	17.1	23.4	30.1
Total revenue	**312.6**	**385.0**	**313.0**	**449.5**

Source: Ministry of Finance

The ongoing large spread between international oil prices and domestic POL products prices has helped the government curtail its budgetary financing requirements. However, this needs to be a short term practice, as permanent reliance on such receipts to finance government expenditures is not without risks given the volatility in energy prices. Moreover, the failure to pass on the decline in energy prices raises the production costs. Also, SBP passed on another Rs 43.9 billion to the government during Q2-FY09, making its profit transfer to the government a cumulative Rs 71.9 billion in first six months of FY09. While this helped reduce H1-FY09 fiscal deficit, the government will now need to generate additional revenues or make further expenditure rationalization to meet its annual fiscal deficit target.

5.4 Expenditures

Elimination of oil subsidies and a pronounced absolute decline in development spending produced significant deceleration in growth of public expenditures during first six months of FY09. Specifically, consolidated public expenditure rose to Rs 1085.0 billion during H1-FY09, up by 10.5 percent as compared to 25.3 percent rise in the corresponding period last year. During H1-FY09, development expenditures experienced a 41.1 percent YoY decline. Consequently, as a share of GDP, development spending dropped to 1.0 percent in H1-FY09, compared to 2.1 percent in H1-FY08.

Meanwhile current expenditures witnessed a particular deceleration in second quarter of FY09 (12.4 percent YoY in Q2-FY09 compared to 25.8 percent YoY in Q1-FY09), despite a significant increase in interest payments. As a result, current expenditures grew by 18.3 percent YoY during H1-FY09 compared to 33.3 percent in H1-FY08. The second quarter deceleration was made possible by declines in non-government grants and, surprisingly, in defense spending (see **Table 5.3**).

Table 5.3: Composition of Current Expenditures
billion Rupees

	Jul-Sep		Oct-Dec	
	FY08	**FY09**	**FY08**	**FY09**
Current expenditures	**340.0**	**427.8**	**435.1**	**488.9**
of which				
Interest payments	111.1	115.0	126.6	184.9
Domestic	98.5	101.0	110.2	164.9
Foreign	12.6	14.0	16.3	19.9
Superannuation allowance	10.5	9.2	12.3	21.6
Grants (other than provinces)	7.7	15.8	37.5	21.9
Defence	57.5	82.2	74.3	65.6
Economic affairs	25.6	50.6	25.4	23.9
Health	1.1	1.1	1.6	1.2
Education affairs and services	5.0	5.3	5.6	2.4
Provincial	102.6	115.1	107.4	121.4

Source: Ministry of Finance

Although the strong YoY growth in current expenditures seen last year has decelerated, the H1-FY09 current expenditure growth is still quite strong and needs to be brought down for sustained fiscal consolidation. This becomes more important considering the expected rise in domestic interest payments in coming months on account of very high government borrowing from SBP. Additionally, H1superannuation allowances and pensions have increased strongly for the second consecutive year following 20 percent rise in pensions in each of last two budgets. Finally, subsidy to oil refineries/OMCs in H1-FY09 on account of outstanding price differential claims from preceding year still constitute more than half of total current subsidies, reflecting on the grave consequences of one ill-advised decision.

Moreover, reducing development spending cannot be a sustainable feature of fiscal consolidation, particularly given the need to invest in infrastructure and building human capital. While private-public partnership can be an important supplement here, the role of the government cannot be supplanted. Also, it can hardly be overemphasized that increasing development expenditures would be crucial in dampening the negative effect of the global recession on Pakistan.

5.5 Budgetary Financing[2]

The large drop in H1-FY09 fiscal deficit is clearly reflected in the negative growth of the sources of budgetary financing (see **Table 5.4**). The government received Rs 141.1 billion in gross external inflows in H1-FY09. However, Rs 104.1 billion external outflows on account of repayment of external debt left only Rs 37.0 billion, in net terms, for financing the budget deficit. With lesser availability of budgetary financing through external sources, government's reliance on domestic financing increased sharply.

Table 5.4: Sources of Financing (Jul-Dec)

billion Rupees

	Jul-Dec			Growth (%)		Percent share[1]	
	FY07	FY08	FY09	FY08	FY09	FY08	FY09
Total financing of budget	**169.0**	**356.3**	**250.6**	**110.9**	**-29.7**	**100.0**	**100.0**
External resources (net)	96.2	68.0	37.0	-29.3	-45.6	19.1	14.8
Internal resources (net)	72.7	288.3	213.6	296.4	-25.9	80.9	85.2
Banking system	31.5	228.6	181.0	626.4	-20.8	(79.3)	(84.7)
Non-bank	25.3	58.0	31.3	129.0	-46.1	(20.1)	(14.7)
Privatization proceeds	15.9	1.7	1.3	-89.6	-21.8	(0.6)	(0.6)

Source: Ministry of Finance

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

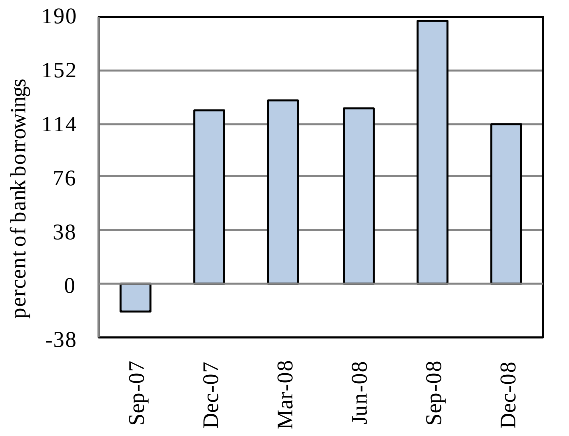
Within domestic sources of budgetary financing, non-bank's contribution also witnessed a strong contraction. Consequently, banking system had to meet much of the government's budgetary requirements during H1-FY09. Thus, despite a 20.8 percent YoY decline in H1-FY09, the share of banking system in domestic sources of financing rose to 85.2 percent compared to 80.9 percent in the corresponding period last year.

Notwithstanding the continued pressure on the banking sector to finance the budget deficit, there is marked improvement in the composition of budgetary financing from the banking system in recent months. The share of SBP financing in total budgetary borrowing from the banking system fell to 114.1 percent at end-Dec 2008 compared to 187.0 percent in Q1-FY09 (see **Figure 5.3**). Government budgetary requirements from the central bank fell off as scheduled banks, being

[2] Budgetary financing from the banking system is worked out on cash basis and hence, these will differ from government borrowing numbers reported in the section on Money and Credit where data is measured on accrual basis.

hit by slow private credit demand and increased NPLs, were attracted towards risk-free government securities.

Figure 5.3: Govt Borrowings from SBP (cumulative)



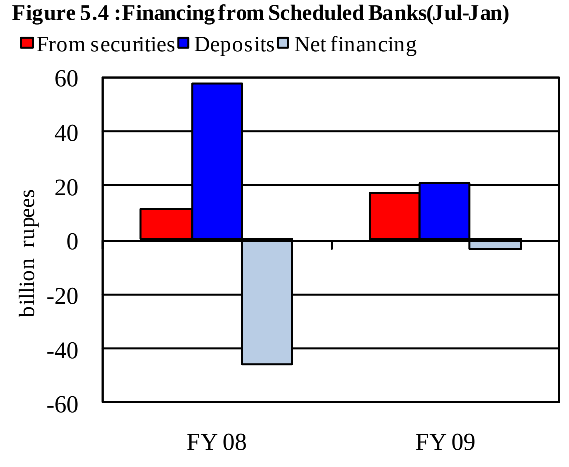
Financing from the Banking sector

January data on government borrowing reveal an expansion of Rs 51.6 billion in net budgetary financing from the banking sector. As a result, budgetary financing availed from the banking sector reached Rs 232.6 billion during Jul-Jan FY09 compared to Rs 188.8 billion in the same period of the preceding year.

During the first seven months of FY09, SBP provided Rs 249.5 billion, through issuance of fresh MRTBs, to the government for budgetary support. At the same time, government deposits with SBP (including other deposits) increased by Rs 13.0 billion that has pushed back the net budgetary financing in Jul-Jan FY09 to Rs 236 billion.

During Jul-Jan FY08, net financing from scheduled banks amounted to retirement of Rs 46.1 billion due to weak participation of the banks in government securities auction and expansion of government deposits with the banks. With perceived risks associated with credit to private sector during economic slowdown, banks' interest in relatively risk-free government T-Bills has renewed since mid-November 2008. At the same time, government drew down a large part of its deposits held with scheduled banks during Jul-Jan FY09. As a result, net retirement from scheduled banks reduced to Rs 3.4 billion during Jul-Jan FY09 (see **Figure 5.4)**.

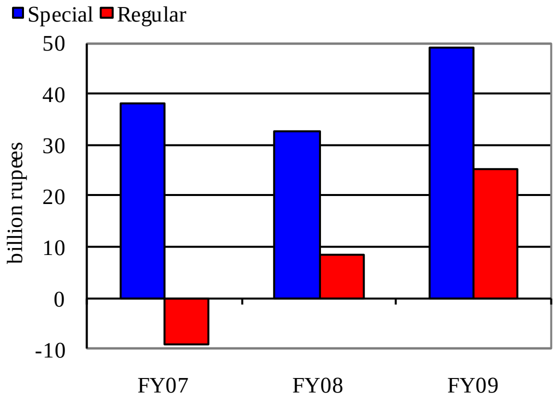
Figure 5.4 :Financing from Scheduled Banks(Jul-Jan)



Financing from the Non Banks

NSS, with net receipts of Rs 74.9 billion, remained the largest contributor in non bank sources of deficit financing. In an attempt to attract more resources through non-bank, the government revised the rate of return twice on some NSS instruments during the period under discussion. As a result, net receipts in NSS instruments grew at relatively faster pace in Jul-Jan FY09 compared to the same period last year. It is important to note that the Behbood Saving Certificate (BSC) and Pensioner Benefit Account (PBA) are called specialized investment instruments as these target the widows and pensioners and hence offer higher rates of return compared to other NSS instruments. Together these two instruments fetched Rs 49 billion for budgetary financing in Jul-JanFY09 (See **Figure 5.5)**. The performance of other regular NSS instrument also improved in Jul-Jan FY09.

Figuer 5.5:Financing Through Regular and Special NSS Instruments (Jul-Jan)



5.6 FBR Tax Collection

Growth in net tax collection during Jul-Jan FY09 accelerated to 23.0 percent against 10.8 percent during the same period last fiscal year (see **Table 5.5**). A break up of total tax collection shows that the double digit growth in all the four

Table 5.5: FBR Tax Collection

billion Rupees

	Net collection (Jul-Jan)			YoY change (%)		Collection as % of annual budget target		
	FY07	FY08	FY09	FY08	FY09	FY07	FY08	FY09
Direct taxes	185.2	191.7	235.3	3.5	22.8	69.9	47.3	47.2
Indirect taxes	277.5	321.0	395.1	15.7	23.1	48.7	51.8	52.6
Sales tax	171.0	199.2	250.0	16.5	25.5	49.7	53.1	53.2
FED	36.2	46.3	61.7	28.1	33.2	52.4	50.9	55.0
Customs	70.3	75.4	83.4	7.2	10.6	44.7	49.0	49.4
Total	**462.7**	**512.6**	**630.5**	**10.8**	**23.0**	**55.4**	**50.0**	**50.4**

Source: Federal Board of Revenue

taxes have helped accelerate this YoY growth in net tax collection.

Despite this strong growth, seven months tax collections for FY09 indicate a large shortfall in direct tax receipts. Though strong indirect tax collection during initial months of FY09 pull up the growth statistic for Jul-Jan FY09, monthly data show that receipts under sales tax and FED have started to weaken. Total tax collections (net) by FBR till January 2009 constitute 50.4 percent of Rs 1250 billion annual budget target and 48.5 percent of Rs 1300 billion revised IMF projections for FY09. At current levels of revenue collection, and given the severe economic slowdown in the country, FBR is likely to have hard time achieving even the Rs 1250 billion annual budget target for FY09.

Direct Tax Collection

Direct tax collection stood at Rs 235.3 billion during Jul-Jan FY09 against the FY09 annual budget target of Rs 499.0 billion. Although Jul-Jan FY09 direct tax receipts represent a growth of 22.8 percent YoY compared to 3.5 percent YoY in the same period last year, the increase is lower than the 28.7 percent YoY increase needed to achieve the annual budget target. Given that estimates for real GDP growth for FY09 indicate a big deceleration, the direct tax budget target for FY09 will be hard to achieve.

A break up of the direct tax collection, available for H1-FY09, reveals that more than half of net income tax came from "withholding taxes" followed by voluntary payments. The deceleration in advance tax payments witnessed in Q1-FY09 further deepened in Q2-FY09 reflecting weakening profitability of the corporate sector. With increased focus on audit and assessment of tax returns, FBR was able to collect a handsome Rs 29.9 billion on account of demand creation (see **Table 5.6**).

Table 5.6 : Major Components of Income Tax

billion Rupees

	Jul-Dec		YoY % change		Share in Total	
	FY08	**FY09**	**FY08**	**FY09**	**FY08**	**FY09**
Voluntary payments	67.5	79.8	-35.8	18.2	42.8	38.6
Collection on demand	11.3	29.9	150.4	165.6	7.1	14.5
Withholding taxes	92.1	112.8	19.6	22.5	58.4	54.6
Others	0.1	0.2	-13.6	159.3	0.1	0.1
Gross collection	170.9	222.7	-8.4	30.3	108.4	107.9
Refund	13.2	16.3	-32.5	23.0	8.4	7.9
Total net	**157.7**	**206.4**	**-5.6**	**30.9**	**100.0**	**100.0**

Source: Federal Board of Revenue

Withholding tax (WHT) receipts grew by Rs 20.7 billion to reach Rs 112.8 billion during the first half of FY09, reflecting a YoY growth of 22.5 percent (see **Table 5.7**). Major heads contributing to withholding tax receipts were contracts (Rs 38.7 billion, up 23.4 percent YoY), imports (Rs 15 billion, up 19 percent) and salaries (Rs 12.0 billion, up 33.4 percent).

Table 5.7: Withholding Tax Collection (Jul-Dec)
value in billion Rupees, change & share in percent

	FY08	FY09	change	Share in total FY08	Share in total FY09
Imports	12.6	15.0	19.0	13.7	13.3
Salaries	9.0	12.0	33.4	9.8	10.7
Dividends	3.1	4.2	35.1	3.4	3.7
securities	8.2	6.7	-18.5	8.9	6.0
Contracts	31.4	38.7	23.4	34.1	34.3
Exports	5.0	7.2	43.6	5.5	6.4
Cash withdrawal from banks	2.8	5.2	86.3	3.0	4.6
Electricity bills	3.0	5.6	86.0	3.3	5.0
Telephone	8.7	10.4	19.3	9.4	9.2
sub total	83.9	105.1	25.2	91.1	93.2
Others	8.2	7.7	-5.7	8.9	6.8
Gross total	**92.1**	**112.8**	**22.5**	**100.0**	**100.0**

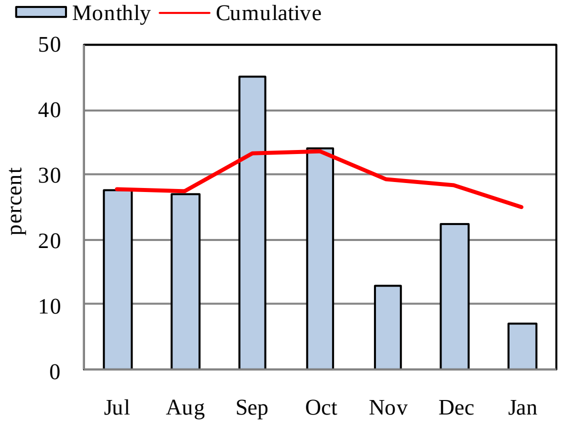
Source: Federal Board of Revenue

Indirect Taxes

Feeding on high international commodity prices and steep depreciation of Pak rupee, indirect taxes grew very strongly during the initial months of FY09, making up part of the shortfall in direct taxes. However, with sharp decline in world commodity prices and, consequently, in import growth, indirect tax receipts have started to weaken. Thus while Jul-Oct FY09 indirect tax receipts grew by 35.7 percent, the increase reduced to merely 7.4 percent YoY for Nov-Jan FY09. As a matter of fact, January 2009 receipts for the indirect taxes are Rs 0.9 billion less than January 2008 receipts, reflecting a contraction of 1.2 percent.

Sales tax receipts spearheaded the revenue effort during Jul-Jan FY09. During this period, net collections under sales tax grew by 25.5 percent YoY to reach Rs 250.0 billion, against annual budget target of Rs 470.0 billion. However, sales tax collections in recent months reveal a particular deceleration (see **Figure 5.6**). Detailed data related to the domestic source of sales tax, available for Jul-Dec FY09, depicts that POL products, telecom, natural gas and sugar were the main

Figure 5.6: YoY Growth in Monthly Sales Tax



domestic sources of revenue (see **Table 5.8**).

Table 5.8:Major Revenue Spinners of Sales Tax (domestic) (Jul-Dec)
billion Rupees

	FY08	FY09	% change	Share in total FY08	Share in total FY09
Telecom services	21.8	23.5	7.9	24.6	18.7
POL products	9.2	39.6	331.7	10.4	31.4
Natural gas	8.1	10.0	23.1	9.1	7.9
Sugar	5.1	4.5	-11.1	5.8	3.6
Cigarettes	4.0	4.0	1.1	4.5	3.2
Cement	1.7	1.8	4.7	2.0	1.4
Tea	1.3	1.6	17.9	1.5	1.2
Beverages	1.8	1.6	-14.2	2.0	1.2
Auto parts	1.0	0.7	-26.1	1.1	0.6
Food products	0.5	0.7	43.1	0.6	0.6
Sub total	54.5	88.1	61.5	61.5	69.9
Others	34.1	38.0	11.4	38.5	30.1
Total (gross)	**88.6**	**126.1**	**42.3**	**100.0**	**100.0**

Source: Federal Board of Revenue

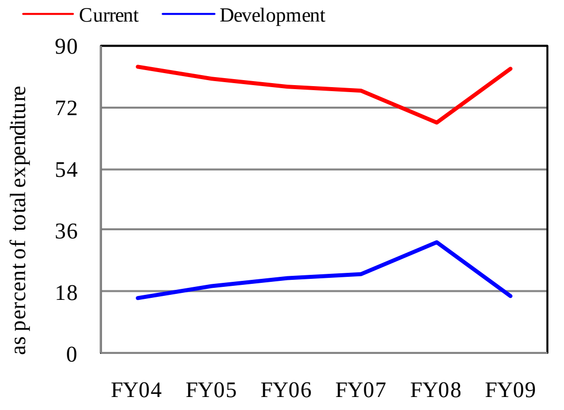
Federal excise duty stood at Rs 61.7 billion during first seven months of current fiscal year showing a YoY growth of 33.1 percent. A break up of the FED, available for Jul-Dec FY09 shows that the major revenue came from the cigarettes (Rs 15.5 billion) followed by cement (Rs 8.6 billion) . FED receipts from beverages were Rs 5.5 billion and that of natural gas stood at Rs 3 billion during H1-FY09. The collection of FED from services stood at Rs 8.2 billion during July-Dec FY09 against Rs 5.1 billion in the same period last fiscal year.

Adding Rs 7.9 billion more during Jul-Jan FY09 than the corresponding period a year earlier, net collections from custom duty reached Rs 83.4 billion against the annual budget target of Rs 169.0 billion.

5.7 Provincial Fiscal Operations

Notwithstanding the apparent deceleration in total revenues, consolidated provincial public finance recorded a substantial surplus in overall balance during H1-FY09 as total expenditures witnessed 8.7 percent YoY decline to reach Rs 294.4 billion (see **Table 5.9**). Province-wise details show that while the other three provinces recorded surpluses in their respective overall balance Sindh experienced a deficit in H1-FY09 (see **Table 5.10**). However, the large

Figure 5.7: Composition of Total Expenditures (Jul-Dec)



overall balance in H1-FY09 does not necessarily indicate an improvement in fiscal performance of the provinces as the decline in total expenditures was produced mainly through 52.6 percent cut in development spending. As a result, the share of development spending in total expenditures nearly halved from the H1-FY08 level (see **Figure 5.7**).

On the other hand, current expenditures registered only a slight deceleration during H1-FY09. Specifically, current expenditures stood at Rs 245.0 billion during H1-FY09, with an increase of 12.2 percent compared to a rise of 16.6 percent in the corresponding period last year.

Table 5.9: Summary of Consolidated Provincial Finance
billion Rupees

	Jul-Dec		
	FY07	**FY08**	**FY09**
Total revenue	**215.7**	**285.2**	**326.4**
Provincial share in federal revenue	170.2	187.4	250.6
Provincial taxes	17.0	18.2	22.0
Property taxes	1.7	2.0	2.5
Excise duties	1.0	1.3	1.5
Stamp duties	4.7	5.3	5.0
Motor vehicle tax	3.9	3.9	3.5
Others	5.8	5.8	9.4
Provincial non-tax	18.3	34.2	24.7
Interest	0.1	9.8	0.1
Irrigation	0.9	1.0	1.2
Others	17.3	23.1	23.5
Federal loans and transfers/grants	10.3	45.4	29.2
Loans (net)	-4.4	3.7	1.8
Grants	14.7	16.3	19.2
Grant for dev. expenditure	0.0	25.4	8.2
Total expenditure	**242.7**	**322.4**	**294.4**
Current expenditure	187.2	218.3	245.0
Development expenditure	55.4	104.2	49.4
Overall balance	**-26.9**	**-37.2**	**32.1**

Source: Ministry of Finance

Table 5.10: Provincial Finance during Jul-Dec
billion Rs

	Punjab		Sindh		NWFP		Balochistan	
	FY08	**FY09**	**FY08**	**FY09**	**FY08**	**FY09**	**FY08**	**FY09**
Total revenue	**144.1**	**159.8**	**78.4**	**89.9**	**39.3**	**44.0**	**23.4**	**32.7**
Provincial share in federal revenue	94.2	124.0	56.8	76.7	23.0	31.4	13.4	18.5
Provincial taxes	9.8	10.2	7.0	10.4	1.0	1.1	0.4	0.3
Provincial non-tax	22.8	19.7	3.9	1.8	6.8	2.3	0.7	1.0
Federal loans and transfers/grants	17.3	6.0	10.6	1.0	8.6	9.3	8.9	12.9
Total Expenditure	**173.9**	**148.9**	**86.1**	**94.0**	**38.6**	**29.1**	**23.9**	**22.3**
Current expenditure	102.3	120.2	71.9	83.1	25.6	23.5	18.5	18.2
Development expenditure	71.6	28.7	14.2	11.0	12.9	5.6	5.4	4.1
Overall balance	**-29.8**	**10.8**	**-7.7**	**-4.1**	**0.8**	**14.9**	**-0.5**	**10.4**

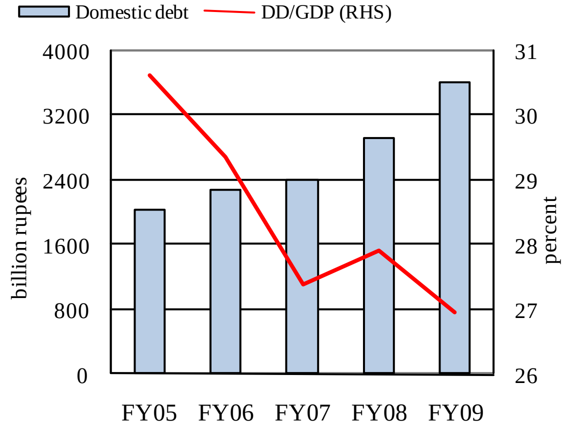
Source: Ministry of Finance

Growth in total revenues decelerated during H1-FY09 due to declines in both non-tax revenues and federal government loans and grants to the provinces. However, this was more than offset by Rs 63.1 billion increase in federal tax assignments to the provinces during H1-FY09. The high growth in provincial share in federal revenues during H1-FY09 was caused by larger divisible pool following strong growth in indirect taxes.

5.7 Domestic Debt

Despite sizeable reduction in fiscal deficit in H1-FY09, domestic debt recorded net addition of Rs 341.0 billion till January 2009. This strong growth in domestic debt reflects non-realization of privatization proceeds and reduced availability of net external financing due to increase in external debt repayments on maturing stock of foreign currency bonds. Notwithstanding the large increase in domestic debt, and the stock of domestic debt at Rs 3.6 trillion, the ratio of domestic debt to estimated FY09 GDP declined to 27.0 percent after rising slightly in FY08 (see **Figure 5.8**).

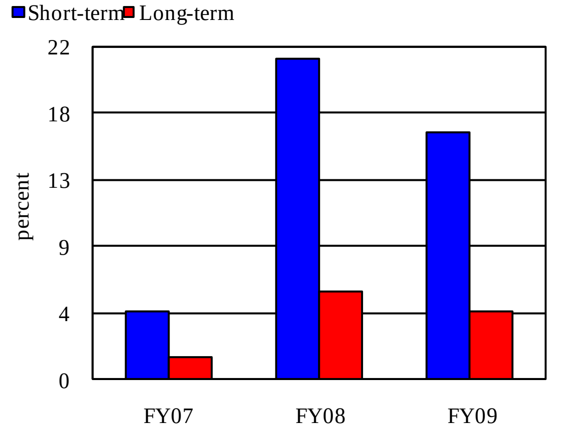
Figure 5.8: Domestic Debt Outstanding (end-Jan)



Composition of Domestic Debt

Although growth in short term debt decelerated during Jul-Jan FY09, the increase of 16.3 percent in the outstanding stock of short term debt is still quite strong (see **Figure 5.9**). As a result, despite the deceleration, the share of short term debt in total domestic debt strengthened by 6.9 percentage point to reach 52.8 percent due to an even weaker growth in long term debt.

Figure 5.9: Growth in Domestic Debt (Jul-Jan)



The breakup of the domestic debt data reveals that the outstanding stock of permanent debt stood at Rs 609.1 billion at the end of January 2009 (see **Table 5.11)**. In contrast to a substantial rise of Rs 44.5 billion during Jul-Jan FY08, the stock of PIBs depleted by Rs 12.5 billion during H1-FY09. With short term interest rates on the rise during Jul-Jan FY09, only Rs 3.6 billion (gross) were collected in the single PIB auction held during the current fiscal year. In the meantime, maturities of Rs 16.1 billion during this period resulted in contraction of PIB stock as on January 2009. On the other hand, the government fetched Rs 12.5 billion through two successful GoP Ijara Sukuk bond auction during Jul-Jan FY09. The inflows through Ijara Sukuk bond offset the repayment on the matured stock of PIB, leaving the overall stock of permanent debt almost unchanged.

Table 5.11: Gross Receipts and Payments (Jul-Jan)

billion Rupees

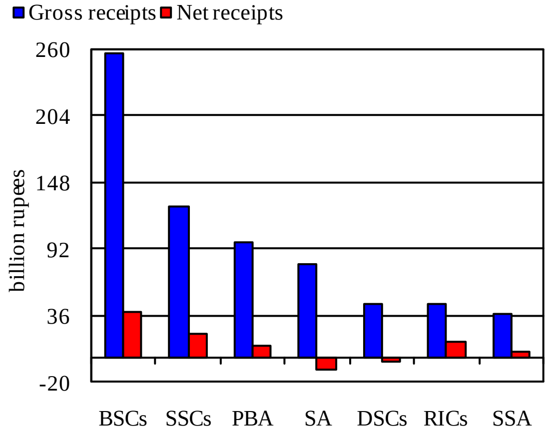
	FY08			FY09		
	Gross receipts	**Repayments**	**Debt (end Jan)**	**Gross receipts**	**Repayments**	**Debt (end Jan)**
Permanent	123.3	75.7	600.6	72.5	71.8	609.1
of which						
PIB	54.6	10.1	405.8	3.6	16.1	399.1
Ijara Sukuk	0.0		0.0	12.5	0.0	12.5
Floating	1170.9	935.9	1342.7	2558.8	2291.5	1904.7
of which						
MTBs	351.7	370.8	637	943.5	877.9	602.6
MRTBs*	819.2	565.1	705.7	1615.3	1413.6	1302.1
Unfunded	257.5	216.5	979.8	687	612.8	1093.3
Total	1551.7	1228.1	2923.1	3318.3	2976	3607.1

* Inclusive of outright sale of MTBs to commercial banks

Floating debt rose by 16.3 percent in Jul-Jan FY09, compared to 21.2 percent in corresponding period last year. The stock of T-bill holdings by SBP still constitute a major share in floating debt, reflecting government's heavy reliance, in the past 16 months, on the central bank to finance the budget deficit. The outstanding stock of MRTBs went up by 18.3 percent in Jul-Jan FY09 compared to a rise of 56.3 percent in the same period last year. However a notable development was seen when the government retired MRTBs of worth Rs 80.8 billion in December 2008. This was made possible by renewed interest of commercial banks in T-bill auctions.

Unfunded debt showed increase of 7.2 percent to reach Rs 72.9 billion during Jul-Jan FY09. Gross receipts from sale of NSS instruments stood at Rs 687.0 billion in the period under discussion (see **Figure 5.10**). Gross sales of major NSS instruments, i.e., Behbood Saving Certificate (BSC), Special Saving Certificate (SSC) and Pensioner Benefit Account (PBA) went up significantly during the period. However, massive encashment of these instruments (including early encashment) has pushed the net receipts to a much lower level. The less than expected inflow through NSS instruments has forced the government to twice revise upwards the rate of return on major NSS instruments, in a span of three months. Recently, the government has provided the facility of free conversion toward higher rate of return for existing holder of the BSC and PBA. These steps are expected to help the government in mobilizing more funds through NSS instruments in the remaining months of the current fiscal year.

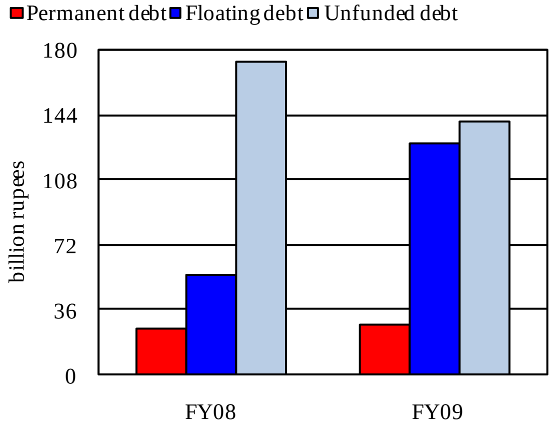
Figure 5.10:Gross & Net Reciepts of NSS (Jul-Jan)



Domestic Debt Servicing

During Jul-Jan FY09, the debt servicing cost of the domestic debt increased to Rs 288.2 billion (see **Figure 5.11**). The breakup of domestic debt servicing data reveals that there is a sharp increase in floating debt servicing cost. The surge in the floating debt stock to finance the large budget deficit in FY08, coupled with the hikes in the interest rates, pushed the share of interest payment on floating debt in total domestic debt servicing to 44.4 percent in Jul-Jan FY09 from 22.4 percent in the same period of the preceding year. Even as interest payments on unfunded debt declined during Jul-Jan FY09 compared to the same period last year, debt servicing cost of the unfunded debt still constitutes a major share in total domestic debt servicing.

Figure 5.11: Domestic Debt Servicing (Jul-Jan)



The recent decline in interest payments on unfunded debt indicates easing of payment pressure on account of maturities of high-interest rate DSCs of late 1990s. On the other hand the debt servicing cost of BSC and PBA is expected to increase in future due to their nature of coupon payments and relatively better interest rate structure among others schemes.