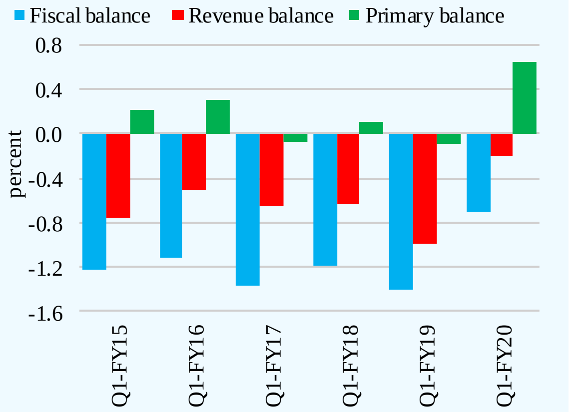
4 Fiscal Policy and Public Debt

4.1 Overview

All the fiscal indicators improved at the beginning of FY20. The fiscal deficit reached 0.7 percent of GDP in Q1-FY20, the lowest in 15 quarters. A remarkable turnaround was visible in the primary balance, which posted a surplus, whereas the revenue deficit became almost negligible (**Figure 4.1**). This improvement was made possible through both revenue-enhancing and expenditure-control measures.

Figure 4.1: Fiscal Indicators (percent of GDP)



Data source: Ministry of Finance

On the revenue side, the major thrust came from the reversal of some of the tax concessions given last year. These concessions had included the slash in general sales tax (GST) rates on petroleum products; suspension of taxes on telecom services; increase in the income threshold for income tax collection; and lowering of income tax rates for both salaried and non-salaried persons. Besides, increased excise duty on cement and cigarettes and the upward adjustment in power tariffs were also major contributing factors to the higher revenue collection during Q1-FY20. Further impetus came from the end of the preferential tax treatment for certain sectors (e.g. sugar, steel and edible oil) and the zero-rating regime for five export-oriented sectors (textile, leather, carpets, sports goods and surgical goods). At the same time, non-tax revenues also grew strongly on the back of higher SBP profit and partial realization of the much-awaited renewal fees for GSM licenses.

The government also actively pursued documentation efforts (especially related to asset revaluations), increased financial scrutiny, and introduced structured mechanisms to register businesses' value-chains and curb smuggling practices. All these efforts would be instrumental in attaining the high and sustainable tax revenue growth. As for the current year, the first quarter revenue growth lagged behind the target as revenue collection from imports remained subdued.

On the expenditure side, a broad-based containment in current spending was witnessed during Q1-FY20 (**Table 4.1**). A sharp contraction was visible in *other expenditures*, such as education, economic affairs, health, housing, environment, recreation and culture. Furthermore, interest payments, defence expenditures, public order and safety and provincial current spending all decelerated from last year. Importantly, the government did not resort to the usual practice of cutting development expenditures to achieve fiscal consolidation, as these recorded a sharp rise in Q1-FY20.

Table 4.1: Summary of Fiscal Operations
billion rupees

	Actual			Growth	
	Q1-FY18	**Q1-FY19**	**Q1-FY20**	**Q1-FY19**	**Q1-FY20**
A. Total revenue	**1,025.1**	**1,102.1**	**1,489.1**	**7.5**	**35.1**
Tax revenue	911.4	975.2	1,142.9	7.0	17.2
Non-tax revenue	113.7	126.9	346.1	11.6	172.8
B. Total expenditure	**1,465.9**	**1,643.8**	**1,775.1**	**12.1**	**8.0**
Current	1,240.5	1,479.9	1,582.2	19.3	6.9
Interest payments	*445.4*	*507.1*	*571.7*	13.9	12.7
Development	189.9	109.2	142.5	-42.5	30.5
Net lending	0.9	-0.3	4.7		
C. Statistical discrepancy	**34.6**	**54.9**	**45.8**		
Fiscal balance (A-B-C)	**-440.8**	**-541.7**	**-286.0**		
Revenue balance*	-215.4	-377.8	-93.1		
Primary balance**	4.6	-34.6	285.7		
Financing	440.8	541.7	286.0		
External sources	7.9	210.8	166.5		
Domestic sources	432.9	330.9	119.5		
Banks	408.1	92.5	-123.0		
Non-bank	24.5	238.4	242.5		
As percent of GDP					
Total revenue	3.0	2.9	3.4		
Tax revenue	2.6	2.5	2.6		
Non-tax revenue	0.3	0.3	0.8		
Total expenditure	4.3	4.3	4.0		
Current	3.6	3.9	3.6		
Development	0.6	0.3	0.3		

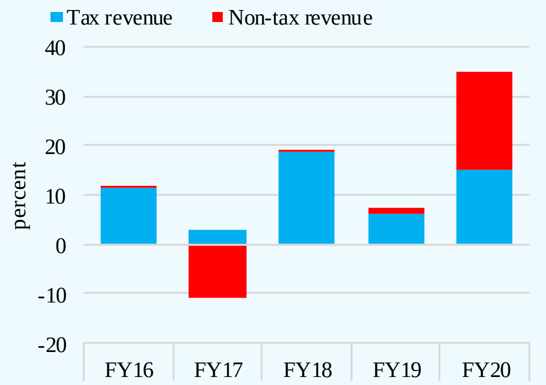
*Revenue balance is total revenue less current expenditures. **Primary balance is fiscal balance excluding interest payments.
Data source: Ministry of Finance

Despite lower financing needs and the appreciation of Pak rupee against the US dollar, the pace of public debt accumulation increased in Q1-FY20. While the government adhered to zero borrowing from the central bank, it continued to strategically build up its deposits with the banking system to create cash buffers for managing the revenue-expenditure gap in the absence of a major and residual source of financing. The resultant rise in the domestic debt was large enough to offset the decline in the rupee value of the government's external debt. The dollar value of external debt in Q1-FY20, on the other hand, grew at a slower pace as compared to the same period last year. This deceleration was largely attributed to the revaluation gains due to depreciation of other currencies against the US dollar and higher debt repayments.

4.2 Revenues

Total revenue collection recorded an impressive increase of 35.1 percent in Q1-FY20 against the 7.5 percent growth observed in Q1-FY19. Tax and non-tax revenues contributed almost equally to this growth **(Figure 4.2)**.

Figure 4.2: Growth Contribution in Total Revenue in Q1



Data source: Ministry of Finance

FBR taxes[1]

The overall FBR taxes grew 15.2 percent in Q1-FY20, compared to the 8.8 percent rise noted in Q1-FY19 **(Table 4.2)**.[2] This higher growth can be attributed to: (i) an increase in sales tax rates; (ii) reinstatement of taxes on telecom services; (iii) an upward revision of tax rates on various salary slabs; (iv) increase in interest rates and higher tax on profit on debt;[3] (v) upward revision in the federal excise duty (FED) rates; and (vi) the abolishment of the zero rating regime on five export-oriented sectors. In addition to these measures, the impact of higher inflation also boosted revenue mobilization.

Despite this improvement, the FBR managed to achieve only 17.3 percent of the annual target of Rs 5,555.0 billion for FY20.[4] This means that tax revenues

[1] The analysis in this section is based on data received from FBR.
[2] The latest data on fiscal operations released by MoF depicts a growth of 15.9 percent in FBR tax revenue.
[3] Tax rates (in percentage terms) on three slabs of income from profit on debt were raised from 10, 12.5 and 15.0 percent to 15.0, 17.5 and 20.0 percent, respectively, in the FY20 budget.
[4] Note that the indicative target for FBR taxes has been revised down to Rs 5,238.0 billion for FY20 (source: IMF Country Report No. 19/380, December 2019).

would require a substantially higher growth in the remaining 9 months of the year to achieve the full year target.[5] Moreover, import-related taxes, representing nearly half of FBR taxes, would remain under stress due to the ongoing declining trend in imports. Dutiable imports, in particular, declined sharply in Q1-FY20.

Table 4.2: FBR Tax Collection
billion rupees

	Budget FY20*	Q1			Growth (%)		
		FY18	FY19	FY20	Q1-FY18	Q1-FY19	Q1-FY20
Direct taxes	2,081.9	282.9	298.5	349.2	21	5.5	17
Indirect taxes	3,473.1	482.1	533.8	609.9	22.5	10.7	14.3
Customs duty	1,000.5	128.9	156.5	155.2	27.8	21.5	-0.8
Sales tax	2,107.7	314.4	335.1	404.7	20.2	6.6	20.7
FED	364.8	38.8	42.1	50	25	8.5	18.7
Total taxes	**5,555.0**	**765**	**832.3**	**959.1**	**22**	**8.8**	**15.2**
Percent of GDP	**12.6**	**2.2**	**2.2**	**2.2**			

* Budget in Brief, Ministry of Finance
Data source: Federal Board of Revenue and Ministry of Finance

Encouragingly, the fiscal authorities have introduced some initiatives to facilitate business and individual tax payers and to broaden the tax base. For instance, in order to provide hassle-free refunds to exporters, the FBR has introduced the Fully Automated Sales Tax e-Refund (FASTER) system for tackling refund claims within 72 hours. The FBR has also launched a mobile application, "FBR Tax Asaan," to facilitate taxpayers in paying sales tax and claiming refunds. In addition, video tutorials are prepared and uploaded online to guide taxpayers in filing their income tax returns. These efforts to simplify and streamline the taxation mechanism have also contributed to the improvement in Pakistan's ranking in the World Bank's Ease of Doing Business: the digitization of tax collecting procedures was cited as one of the drivers of the improvement in the country's ranking. In addition, the government has continued its drive to increase documentation in the economy. However, businesses are resisting some of these documentation measures, such as the CNIC condition on business-to-business (B2B) and business-to-consumer (B2C) transactions.

Direct Taxes

Direct taxes, having a share of 36.4 percent in FBR taxes, recorded a sizeable growth of 17.0 percent in Q1-FY20, compared to the rise of 5.5 percent in the

[5] Given the revised target of Rs 5,238.0 billion, a collection of around Rs 475.0 billion would be required in each month of the remaining FY20. This does not compare favorably with the average 5-year monthly collection of around Rs 300 billion in the last 9 months of a fiscal year.

same period last year. Withholding taxes (WHT), having a major share in direct taxes, grew by 19.8 percent to Rs 256.5 billion during the quarter, in contrast to a decline of 4.6 percent last year **(Table 4.3)**. [6]

In addition, an increase of Rs 44.6 billion in voluntary payments was also noted, owing to an increase of Rs 24.8 billion in advance taxes. Some of the rise in voluntary payments may also be attributed to the Amnesty Scheme announced in FY19. However, collection on demand contracted by 48.2 percent to Rs 5.8 billion in Q1-FY20 compared to 11.3 billion last year. The rise in withholding taxes mainly came from the increase in collection following the upward revision in salary slabs, which added Rs 10.0 billion to the withholding taxes.[7]

Table 4.3: Break-up of Direct Tax Collection during Q1
billion rupees

			Abs. Change	
	FY19	**FY20**	**FY19**	**FY20**
I. Collection on demand	**11.3**	**5.8**	**-0.1**	**-5.4**
II. Voluntary payments	**64.8**	**109.4**	**-1.4**	**44.6**
III. Withholding taxes	**214.2**	**256.5**	**-10.4**	**42.3**
Imports	57.3	50.7	**6.3**	**-6.6**
Exports	7.4	9.6	**1.1**	**2.3**
Contracts	49.2	51.0	**-7.8**	**1.8**
Salary	15.4	25.4	**-11.3**	**10.0**
Interest & securities	14.0	29.8	**1.9**	**15.8**
Cash withdrawal	8.9	4.3	**1.8**	**-4.6**
Dividends	8.6	13.0	**-1.2**	**4.4**
Electric bills	9.3	11.4	**3.4**	**2.1**
Telephone	1.9	12.6	**-10.2**	**10.7**
Others	42.2	48.8	**5.7**	**6.6**
Net direct taxes	**298.5**	**349.2**	**15.7**	**50.7**

Data source: Federal Board of Revenue

The collection from interest and securities in withholding taxes increased to Rs 29.8 billion during Q1-FY20 from Rs 14.0 billion in Q1-FY19, as interest rates and tax rates on profit on debt both increased. The reinstatement of taxes on telecom services led to a higher tax collection of Rs 12.6 billion in Q1-FY20.[8] With filers getting exemption, the withholding tax on cash withdrawals dropped sharply to almost half of the amount collected last year.

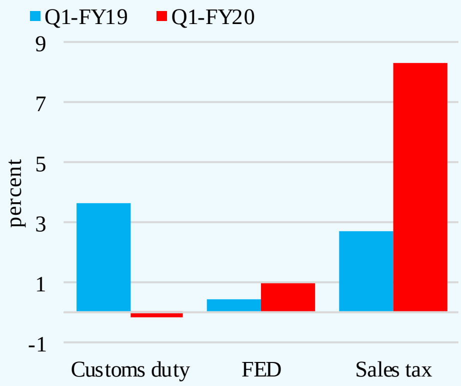
<u>Indirect taxes</u>

Indirect taxes, having a share of 63.6 percent in FBR taxes, grew by 14.3 percent during Q1-FY20 on top of the 10.7 percent growth observed during Q1-FY19.

[6] Withholding taxes had a 73.4 percent share in overall direct taxes in Q1-FY20.
[7] Collection from salaries grew 64.7 percent in Q1-FY20, as compared to a decline of 42.3 percent recorded last year.
[8] Salaries, interest and securities, and telephone together contributed 26.4 percent to the overall withholding taxes.

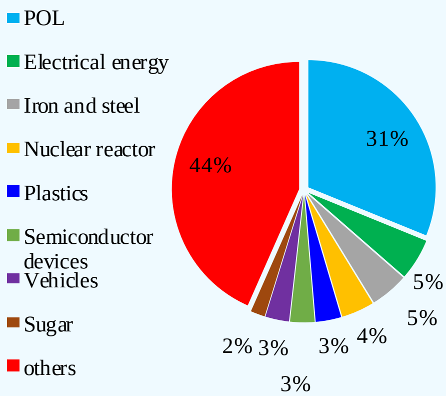
This was primarily owing to the 20.7 percent growth in sales tax to Rs 404.0 billion, as compared to the 6.6 percent growth recorded last year. Sales tax, constituting around 66.0 percent of indirect taxes, contributed 8.4 percent out of the 15.2 percent growth in the FBR taxes **(Figure 4.3)**.

Figure 4.3: Growth Contribution of FBR's Indirect Taxes



Data source: Federal Board of Revenue

Figure 4.4: Contribution in Sales Tax during Q1-FY20



Data source: Federal Board of Revenue

The major contribution to the increase in sales tax came from POL products **(Figure 4.4)**. This is explained by the hike in prices and sales tax rates on most of the petroleum products **(Table 4.4)**.[9] The increased sales tax rate on motor spirit (petrol), contributed the most to the rise in collection from POL products. Without POL, the indirect taxes recorded a growth of 12.9 percent in Q1-FY20 as compared to 16.7 percent last year.

Table 4.4: Sales Tax Rates on POL (percent)

	Q1-FY19*	Q1-FY20
Petrol	11	17
High speed diesel	23	17
Kerosene	8	17
Light diesel oil	4	17

*Effective rates for Q1-FY19, calculated on basis of weighted average formula
Data source: Federal Board of Revenue

Another major contributor to the higher sales tax was electrical energy; collection from this segment grew 69.3 percent to Rs 22.0 billion, as compared to a decline of 1.3 percent in the corresponding period of last year. This was due to the upward price adjustments in tariffs during Q1-FY20. Furthermore, with the abolishment of preferential treatment for the sugar industry, collections from this

[9] The prescribed (exclusive of sales taxes) prices of petrol and high speed diesel increased from Rs 84.8 and Rs 85.9 per liter in Q1-FY19 to Rs 95.1 and Rs 106.9 in Q1-FY20, respectively.

sector also recorded an increase of Rs 7.7 billion from Rs 3.9 billion during Q1-FY19. Similarly, the collection from sales tax on textile products also increased to Rs 2.1 billion as compared to Rs 0.6 billion last year, on back of the elimination of zero-rating regime for the sector.

In contrast to sales tax, collections from customs duty, the second major component of indirect taxes, declined by 0.8 percent in Q1-FY20, as compared to the 5-year average growth of 19.7 percent. This decline was attributed primarily to a sharp contraction in imports during the quarter. Specifically, the dutiable imports (in rupee terms) declined by 6.8 percent during Q1-FY20, against a rise of 23 percent in the corresponding period of last year. The collection from vehicles declined by 32.0 percent to Rs 16.8 billion in Q1-FY20 against 0.8 percent rise in Q1-FY19. The demand for imported vehicles was affected by higher prices and stringent documentation requirements that raised the transaction costs. Meanwhile, the growth in duty-free imports (in rupee terms) almost doubled in Q1-FY20.

Table 4.5: Upward Revision in FED in Budget 2019-20

	Q1-FY19	**Q1-FY20**
Beverages/Aerated waters	11.5%	13.0%
Cement	Rs 1.5 per kg	Rs 2 per kg
Cigarettes	Rs 4,500 per 1,000 sticks	Rs 5,200 per 1,000 sticks
Natural gas	Rs 4.9 per MMBTU	Rs 10 per MMBTU

Data source: Budget Speech 2019-20

On the other hand, the collection from FED improved due to the upward revision in the excise duty rate **(Table 4.5)**. Overall FED collections increased by 18.7 percent to Rs 50 billion in Q1-FY20, compared with a rise of 8.5 percent last year. Collections from cement, cigarettes and beverages contributed to the higher growth in FED this year.

Table 4.6: Non-tax Revenues (consolidated)
billion rupees

	Q1-FY19	**Q1-FY20**
Mark-up (PSEs and others)	1.2	3.3
Dividends	4.5	1.7
SBP profit	50.7	185.0
Defence	2.4	2.6
Profits PTA/post office	6.1	71.8
of which GSM renewal fee	-	70.0
Royalties on gas and oil	23.6	23.8
Passport and other fees	3.3	6.2
Discount retained on crude oil	3.1	3.7
Windfall levy against crude oil	2.1	2.0
Others	29.9	46.0
Total non-tax revenue	**126.9**	**346.1**

Data source: Ministry of Finance

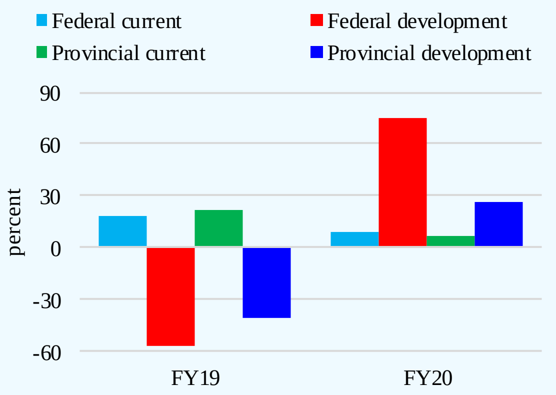
Non-tax revenues

Non-tax revenues grew by a significant 172.8 percent to Rs 346.1 billion during Q1-FY20, as compared to an increase of 11.6 percent recorded in the same period last year (**Table 4.6**). The major contributors to the higher non-tax revenue were SBP profit (Rs 185 billion) and partial realization of the GSM license renewal fees (amounting to Rs 70.0 billion).[10] The SBP accrued higher profit this year primarily on account of both higher stock of government securities and interest rates, apart from the appreciation of the Pak rupee in Q1-FY20.

4.3 Expenditures

Total expenditures decelerated to 8.8 percent during Q1-FY20 as compared to 11.0 percent in Q1-FY19. This was largely achieved by a containment in current expenditures, both at the federal and provincial levels **(Figure 4.5)**. In particular, provincial current spending and defence expenditures both slowed down. In addition, a decline was also seen in *other expenditures*, such as education, economic affairs, health, housing, environment, recreation and culture.

Figure 4.5: Growth in Expenditures during Q1



Data source: Ministry of Finance

The growth in defence spending and public order decelerated substantially during Q1-FY20, reflecting improved security conditions in the country. In addition, there was a slight decline in the growth of interest payments, despite growing debt levels and higher interest rates. This slowdown can be explained by the change in the payment structure of central bank debt that was re-profiled to longer maturities; thus, a part of the payments accrued in Q1-FY20 will be paid over the next quarters.[11]

In contrast to large cuts in development expenditure last year, these expenditures witnessed a sharp rise in Q1-FY20, which is partly explained by decelerating current expenditures and partly motivated by government's preference to support growth and employment in the country. Importantly, the contributions were made by both the federal and provincial governments **(Table 4.7** and **Figure 4.5)**.

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[10] Source: Pakistan Telecommunication Authority (https://www.pta.gov.pk/en/media-center/single-media/pta-receives-over-rs-70-billion-against-license-renewal-fee-040919).

[11] In June 2019, the government converted the stock of short-term MRTBs held by the SBP into long-term PIBs of various maturities. Since 70 percent of the MRTBs were converted into 10-year PIBs with floating rates (benchmarked with the 6-month T-bill rate), the coupon payments would be made bi-annually.

Table 4.7: Analysis of Fiscal Spending
billion rupees, growth in percent

	Q1				Growth		
	FY18	**FY19**	**FY20**	**Abs. change**	**FY18**	**FY19**	**FY20**
Current expenditures	**1,240.5**	**1,479.9**	**1,582.2**	**102.2**	**15.9**	**19.3**	**6.9**
Federal o/w	846.4	999.3	1,069.7	70.5	11.7	18.1	7.1
Interest payment	445.4	507.1	571.7	64.6	7.5	13.9	12.7
Defence	181.9	219.4	242.6	23.2	20.1	20.6	10.6
Public order and safety	27.9	32.7	33.3	0.6	16.2	17.1	1.9
Others	191.2	240.1	222.1	-18.0	13.8	25.5	-7.5
Provincial	394.1	480.7	512.4	31.8	25.9	22.0	6.6
Development expenditures	**189.9**	**109.2**	**142.5**	**33.3**	**-0.6**	**-42.5**	**30.5**
PSDP	165.0	106.6	142.4	35.8	-1.3	-35.4	33.6
Federal	69.5	50.9	71.8	20.9	8.4	-26.8	41.1
Provincial	95.4	55.7	70.6	14.9	-7.4	-41.6	26.7
Others (including BISP)	24.9	2.6	0.1	-2.5	3.9	-89.5	-96.0
Net lending	**0.9**	**-0.3**	**4.7**	**4.9**	**-**	**-**	**-**
Total expenditure*	**1,431.3**	**1,588.9**	**1,729.3**	**140.4**	**13.5**	**11.0**	**8.8**

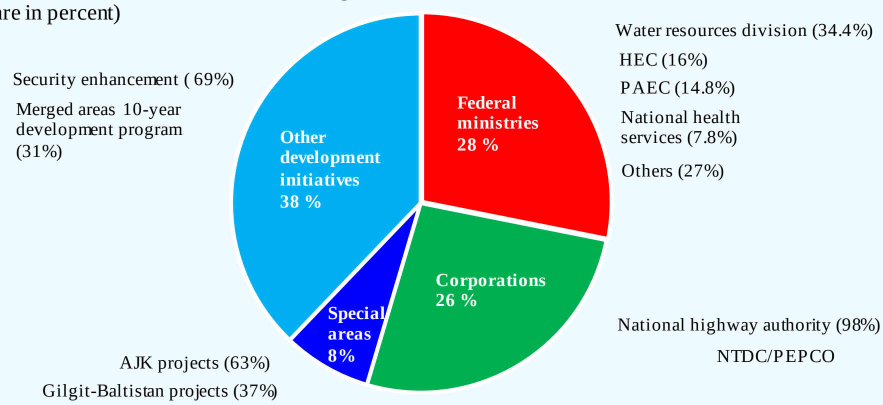
* Excluding statistical discrepancy
Data source: Ministry of Finance

Within the federal PSDP, the ministries received the highest share (28 percent) followed by corporations (26 percent) such as the National Highway Authority (NHA), National Transmission and Dispatch Company (NTDC), and Pakistan Electric Power Company (PEPCO); this shows that development concerns were tilted towards infrastructure and energy-related spending. In addition to the usual projects, the budget FY20 also emphasized welfare and tourism projects, and the 10-year development plan for the former FATA, which was merged with KP under the 25th amendment **(Figure 4.6)**.

In July 2019, the government announced a strategy for release of funds for FY20.[12] In order to achieve better public financial management, the government allocated a fixed percentage of releases for both current and development expenditure in a quarter-wise release plan. Accordingly, it was decided that 20 percent of the funds would be released in Q1 and Q2 each, and the remaining would be equally divided in Q3 and Q4. Despite a substantial rise in development expenditure during Q1-FY20, the federal PSDP expenditures were recorded at 13.3 percent of the overall annual budgeted PSDP.

[12] For details, see the Office Memorandum No. F.4 (I), B&A/ 2019-20 (Ways and Means)/35 dated 15th July 2019, Government of Pakistan, Finance Division on subject Policy/strategy for release of funds – financial year 2019-20 (https://www.pc.gov.pk/uploads/psdp/Release2019-20.pdf).

Figure 4.6: Federal PSDP releases during Q1-FY20
(share in percent)



Data source: PSDP releases as on 27-09-2019, Ministry of Planning, Development and Reform

4.4 Provincial Fiscal Operations

The total provincial revenues (including federal transfers) grew by a slight 0.5 percent during Q1-FY20, against a 36.9 percent growth recorded last year **(Table 4.8)**. The provinces' own revenues posted an impressive growth of 31.3 percent as compared to a decline of 9.7 percent in Q1-FY19. This improvement mainly came from the non-tax revenues, which grew by 111.8 percent to Rs 30.9 billion during the period; provincial tax revenues also increased by 17.9 percent, compared to a meagre 2.0 percent growth last year.

Further analysis shows that both direct and indirect sources of provincial taxes accounted for this growth during Q1-FY20. The biggest collection was from the general sales tax on services, followed by stamp duties, property tax, and motor vehicles. Moreover, the increase in non-tax revenue was mainly on the back of *profits from hydroelectricity* from KP and Punjab.

Despite higher growth in federal revenues, the NFC transfers to the provinces declined to Rs 612.5 billion during Q1-FY20 from Rs 662.9 billion last year. However, federal loans and grants, especially for development purposes, rose to Rs 43.2 billion, almost double from last year's level of Rs 21.1 billion.
The annual target of provincial surplus was set at Rs 423.0 billion for FY20; the provinces achieved 44.7 percent of this target by posting a combined surplus of Rs 189.0 billion during Q1-FY20. KP registered the highest surplus, followed by

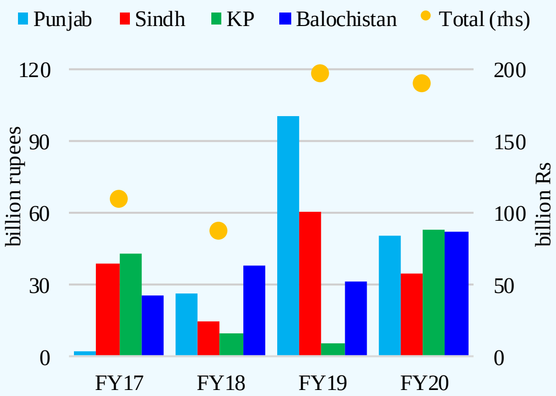
Table 4.8: Provincial Fiscal Operations during Q1
billion rupees and growth in percent

	Punjab	Sindh	KP	Balochistan	Total	Growth
FY20						
A. Total revenue	365.8	198.6	140.8	85.9	791.1	0.5
Provincial share in federal revenue	293.5	145.0	97.0	76.9	612.5	-7.6
Provincial revenue (I+II)	71.9	46.2	13.4	4.0	135.5	31.3
I. Taxes	52.1	43.7	5.5	3.2	104.5	17.9
II. Non-tax revenue	19.8	2.4	7.9	0.8	30.9	111.8
Fed loans and transfers	0.4	7.4	30.4	5.0	43.2	104.4
B. Total expenditure	290.4	163.0	87.1	48.6	589.1	9.0
Current**	247.7	147.3	78.7	44.9	518.5	6.9
Development	42.7	15.8	8.4	3.7	70.6	26.7
Gap (A-B)	75.4	35.5	53.7	37.3	202.0	-18.1
Financing* (overall balance)	**-49.9**	**-34.5**	**-52.7**	**-51.8**	**-189.0**	**-4.0**
FY19						
A. Total revenue	390.6	209.4	116.0	71.2	787.2	36.9
Provincial share in federal revenue	325.8	163.4	107.7	65.9	662.9	54.6
Provincial revenue (I+II)	51.0	43.0	5.9	3.2	103.2	-9.7
I. Taxes	42.6	39.9	4.1	2.0	88.6	2.0
II. Non-tax revenue	8.5	3.1	1.8	1.3	14.6	-46.7
Fed loans and transfers	13.7	3.0	2.3	2.1	21.1	-34.6
B. Total expenditure	264.1	145.3	86.6	44.6	540.6	9.7
Current**	233.8	132.2	75.8	43.1	484.9	21.9
Development	30.3	13.1	10.8	1.5	55.7	-41.6
Gap (A-B)	126.5	64.1	29.4	26.7	246.6	200.4
Financing* (overall balance)	**-100.0**	**-60.5**	**-4.9**	**-31.4**	**-196.7**	**128.2**

*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.
Data source: Ministry of Finance and SBP calculations

Balochistan; the surpluses of both these provinces grew sharply from the corresponding period last year. However, the surplus recorded by Punjab halved from last year, whereas that of Sindh was also lower as compared to Q1-FY19; this was due to lower revenue collection in both provinces, along with a relatively higher growth in expenditures during the period **(Figure 4.7)**.

Figure 4.7: Provincial Surplus during Q1

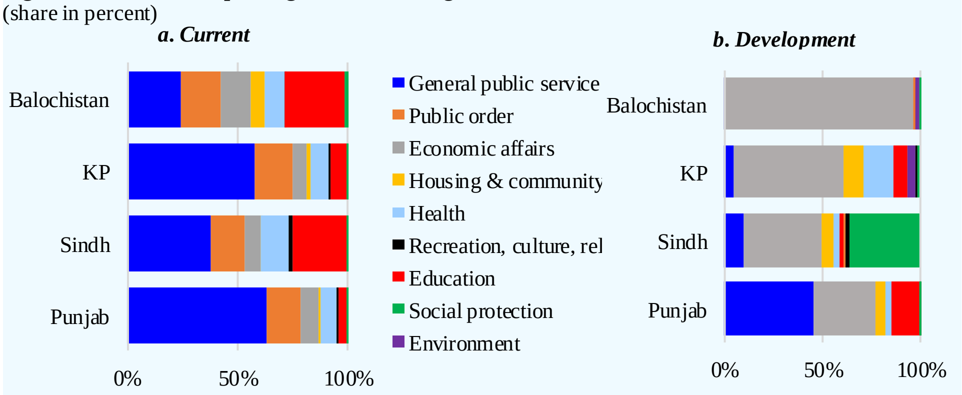


Data source: Ministry of Finance

Provincial expenditures

The total provincial spending growth decelerated to 9.0 percent during Q1-FY20 as compared to 9.7 percent growth last year, with current expenditures playing a major role. The current provincial spending grew by 6.9 percent as compared to the 21.9 percent growth recorded in the previous year, and remained skewed towards general public service, public order, health and education **(Figure 4.8a)**. The deceleration in current expenditures created some fiscal space for the provincial development expenditures, which increased by 26.7 percent during Q1-FY20 in contrast to a decline of 41.6 percent last year. The higher spending was mainly recorded for economic affairs, which includes agriculture, food, construction, and transport **(Figure 4.8b)**.

Figure 4.8: Provincial Spending Priorities during Q1-FY20
(share in percent)

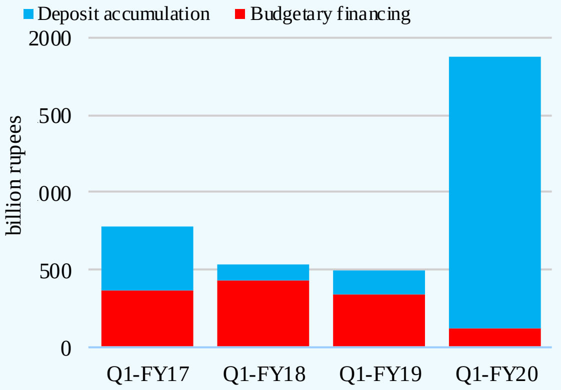


Data source: Ministry of Finance

4.5 Public debt

Public debt increased by Rs 1.5 trillion during Q1-FY20, as compared to an increase of Rs 0.8 trillion in the same period last year (**Table 4.9**). This rise was mainly attributed to an increase in the domestic debt, which more than offset the decline in the rupee value of external debt.

Figure 4.9: Change in Domestic Debt



Data source: State Bank of Pakistan

Domestic debt

The pace of domestic debt accumulation accelerated sharply during Q1-FY20 – to Rs 1.9 trillion – and was almost four times higher than in Q1-FY19. Although the financing needs were lower than last year, the government continued to build up strategic cash buffers in the form of deposit accumulation (**Figure 4.9**). The need for these cash buffers emerged as the government adhered to zero fresh borrowing from the central bank. These deposits would facilitate the government to manage its debt obligations more smoothly in the absence of a major source of financing**.**

Table 4.9: Pakistan's Public Debt Profile

billion rupees

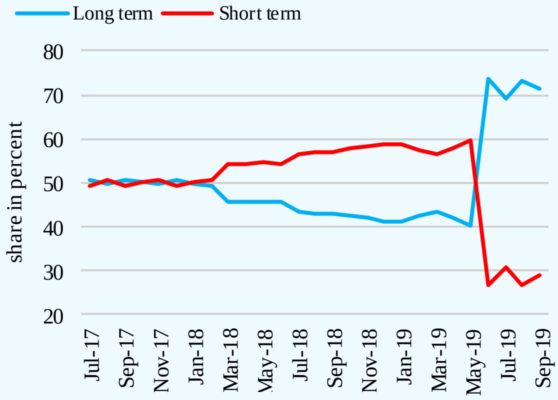
	Stocks				Flows	
	June-2018	**Sep-2018**	**June-2019**	**Sep-2019**	**Q1-FY19**	**Q1-FY20**
Public debt	**24,952.90**	**25,783.40**	**32.707.9**	**34,240.60**	**830.6**	**1,532.70**
Government domestic debt	16,416.30	16,919.80	20,731.80	22,649.90	503.6	1,918.10
Government external debt	7,795.80	8,122.90	11,055.10	10,598.00	327.1	-457.1
Debt from the IMF	740.8	740.7	921	992.7	-0.1	71.7
Memorandum Items						
Total debt of the government*	23,024.0	23,692.0	29,520.7	29,300.0	668.0	-220.7
Govt. deposits with banking system	1,928.9	2,091.4	3,187.2	4,940.6	162.5	1,753.4

* FRDLA definition

Data source: State Bank of Pakistan

The maturity structure of the additional domestic debt was almost equally balanced between short-term and long-term securities during Q1-FY20. It is important to highlight that the overall share of short-term debt has declined substantially since June 2019, when the government re-profiled its short-term debt into long-term debt (**Figure 4.10)**. Consequently, the re-pricing and roll-over risks have also significantly declined.

Figure 4.10: Tenor-wise Composition of Domestic Debt



Data source: State Bank of Pakistan

The government's borrowing from non-bank sources amounted to Rs 342.8 billion in Q1-FY20, compared to Rs 242.0 billion during the same period last year (**Table**

4.10). Non-banks preferred investing in T-bills and also PIBs. Net mobilization from National Saving Schemes (NSS) also increased significantly during the period under review, due to higher profit rates and some possible switchover from the discontinued Rs 40,000 denomination prize bonds towards various NSS instruments.[13]

Table 4.10: Non-bank Holding of Domestic Debt

flow in billion rupees

	Q1-FY19	Q1-FY20
T-bills	146.4	204.3
Other securities	38.7	154.8
Prize bond	42.1	-152.3
NSS	10.5	137.7
Total	**242.0**	**342.8**

Data source: State Bank of Pakistan

External debt & liabilities

The external debt & liabilities increased by US$ 0.5 billion compared to an increase of US$ 0.9 billion during the same period last year (**Table 4.11**). The improvement in the current account balance, revaluation gains due to the depreciation of major currencies against the US dollar, and higher external debt servicing (both principal and interest payments) are major factors which explain the slowdown in accumulation of the external debt. Nonetheless, the first IMF tranche of almost US$ 1 billion, and fresh disbursements of bilateral loans by China and multilateral loans by the ADB and the IDB, increased the stock of external debt during the period under review.

Meanwhile, revaluation gains due to the depreciation of major currencies against the US dollar reduced the dollar value of the country's external debt by roughly US$ 0.7 billion during Q1-FY20. More than one half of these gains were due to the US dollar's appreciation against the Special Drawing Rights (SDR) during the period.[14]

Foreign investors (mainly from the US and the UK) took keen interest in government securities during Q1-FY20, as they made investments worth US$ 0.3 billion in T-bills (**Figure 4.11**). This investment was an outcome of the continued

[13] It must be recalled that to enhance documentation of the economy, the government notified the withdrawal of Rs 40,000 denomination national prize bonds from circulation on 24th June 2019. The holders of these prize bonds were given three options: (i) conversion to premium prize bonds; (ii) replacement with special savings certificate/defense savings certificates; or (iii) encashment at face value (transfer of proceeds to the bond-holder's bank account). As highlighted in SBP's Annual Report of FY19, evidence suggests that many bond-holders preferred to substitute these bonds with NSS.

[14] External debt denominated in SDR constitutes around 27 percent of the country's external debt stock. The SDR depreciated by 1.9 percent against the US dollar in Q1-FY20.

Table 4.11: Pakistan's External Debt and Liabilities
billion US$

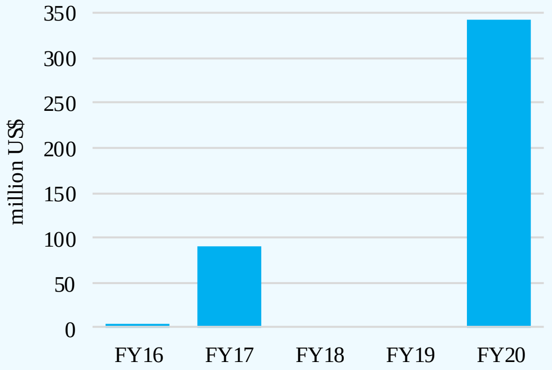
	Stock				Flow	
	June-18	**Sep-18**	**June-19**	**Sep-19**	**Q1-FY19**	**Q1-FY20**
A. Government debt	64.1	65.4	67.8	67.8	1.3	0.0
Of which						
Paris club	11.6	11.5	11.2	11	-0.1	-0.2
Multilateral	28.1	27.6	27.8	28	-0.5	0.2
Other bilateral	8.7	10.8	12.7	12.8	2.1	0.1
Bonds	7.3	7.3	6.3	6.3	0	0
Commercial loans	7.5	7.2	9	8.3	-0.3	-0.7
Multilateral (ST)	1	0.9	0.8	0.9	-0.1	0.1
B. Debt from IMF	6.1	6	5.6	6.4	-0.1	0.8
C. Foreign exch. liabilities	5.1	5	10.5	10.4	-0.1	-0.1
1. Public external debt	75.4	76.3	83.9	84.5	0.9	0.6
2. PSEs debt	2.7	2.7	4	3.8	0	-0.2
3. Banks debt	4.4	4.5	4.7	4.5	0.1	-0.2
4. Private sector debt	9.2	9.3	10.4	10.8	0.1	0.4
5. Intercompany debt	3.6	3.3	3.3	3.3	-0.3	0.0
External debt & liabilities	95.2	96.1	106.3	106.9	0.9	0.6

Data source: State Bank of Pakistan and Economic Affairs Division

improvement in the country's BoP position and reserve buffers; sustainability of the exchange rate regime; and the comfort offered by the inception of the IMF program (**Chapter 5**).

External loan disbursements more than doubled in Q1-FY20 over the same period last year. Specifically, disbursements from commercial banks, ADB and IDB increased considerably. Most of these disbursements were for financing purposes (non-project based).

Figure 4.11: Foriegn Investment in Government Securities during Q1



Data source: State Bank of Pakistan

Pakistan's external debt servicing amounted to US$ 3.0 billion during Q1-FY20, up from US$ 2.5 billion during Q1-FY19. Principal and interest payments were both higher during the period under review, with debt servicing of commercial loans almost five times higher as compared to last year. Similarly, interest payments on bilateral and commercial loans increased considerably in Q1-FY20 over the corresponding period of last year (**Table 4.12**).

Table 4.12: Public External Debt Servicing during Q1
million US$

	FY19	FY20	Change
Principal			
I. Total debt (a+b+c+d)	1,902.1	2,275.3	373.2
a. Government debt	1,374.5	1,923.9	549.4
Paris club	25.1	28.2	3.2
Multilateral	412.2	420.1	7.9
Other bilateral	139.8	174.3	34.5
Commercial loans/credits (LT)	200.0	945.0	745.0
Short term	597.5	356.3	-241.2
b. IMF	83.9	164.8	80.9
c. PSEs debt	90.1	54.2	-35.9
d. Private debt	352.6	131.0	-221.6
Interest			
II. Total debt (a+b+c+d)	552.0	798.0	246.0
a. Government debt	360.2	482.6	122.4
Paris club	6.3	6.7	0.4
Multilateral	113.9	120.8	7.0
Other bilateral	98.9	163.5	64.4
Euro/Sukuk bonds	32.7	32.7	0.0
Commercial loans /credits(LT)	90.2	141.6	51.4
Multilateral (ST)	13.6	8.0	-5.6
b. IMF	35.7	43.7	8.0
c. PSEs debt	44.5	50.4	5.9
d. Private debt	58.9	151.0	92.1
Total (I+II)	**2,454.1**	**3,073.7**	**619.2**

Data source: State Bank of Pakistan