STATE OF THE ECONOMY

Research Report No.95
June 2015

An Evaluation of the Federal Budget 2015-16

SPDC

SOCIAL POLICY AND DEVELOPMENT CENTRE

Research Report No.95

An Evaluation of the Federal Budget 2015-16

July 2015

SOCIAL POLICY AND DEVELOPMENT CENTRE

Editing Support
Aasiya Kazi

Graphics and Design
Muhammad Rizwanullah Khan

FOREWORD

The Social Policy and Development Centre (SPDC) is pleased to present its research report on the state of the economy in the light of the Pakistan Economic Survey 2014-15, and the Federal Budget for fiscal year 2015-16.

The report is an effort to objectively present the situation with respect to the state of the economy. It highlights the issues related to economic growth, fiscal challenges and development priorities of the government. It acknowledges the gains made over the past year, but also identifies the areas where weaknesses are pronounced and where policy shifts are needed so that the momentum of economic revival can be generated and sustained. The report contains 8 articles on various aspects of the budget written by staff members of SPDC. We are grateful to Dr. Hafiz A. Pasha for providing guidance to the team.

We hope that all stakeholders including parliamentarians, policy makers, academicians, development practitioners, researchers, civil society activists, donors and the business community will benefit from this report.

Prof. Dr. Khalida Ghaus
Managing Director

CONTENTS

Pages

1. Achieving Macroeconomic Targets 1
   By Naveed Aamir

2. Overstated GDP Growth.. 5
   By Nadeem Ahmed

3. Performance of the External Sector 13
   By Iffat Ara

4. An Overview of External Debt and Foreign Exchange Reserves 19
   By Iffat Ara

5. Federal Budget 2015-16: An Exercise in Deception 22
   By Muhammad Sabir

6. Understanding Tax Expenditure 29
   By Muhammad Sabir

7. The Tale of Tax-to-GDP Growth 32
   By Muhammad Sabir

8. Development Priorities of the Federal Government 38
   By Muhammad Asif Iqbal

List of Tables

Table 1.1: GDP Growth Rate in 2014-15 ... 3
Table 2.1: Agriculture Sector ... 6
Table 2.2: Industrial Sector ... 8
Table 2.3: Services Sector ... 10
Table 3.1: Composition of the Current Account ... 14
Table 3.2: Major Exports ... 15
Table 3.3: Source of Change in Major Exports ... 16
Table 3.4: Major Imports ... 18
Table 4.1: Level of External Borrowing and Debt of the GoP ... 19
Table 4.2: Composition of External Debt ... 20
Table 5.1: Composition of Gross Revenue Receipts ... 23
Table 5.2: Federal Current Expenditure ... 25
Table 5.3: Federal Current Expenditure ... 26
Table 5.4: Computation of Overall Budget Deficit ... 27
Table 7.1: Tax-To-GDP Ratio (%), 2005-06 to 2014-15 ... 32
Table 7.2: Buoyancy of Direct Taxes: 2005-06 to 2014-15 ... 33
Table 7.3: Buoyancy of Excise Duty: 2005-06 to 2014-15 ... 34
Table 7.4: Buoyancy of Customs Duty: 2005-06 to 2014-15 ... 34
Table 7.5: Buoyancy of Sales Tax: 2005-06 to 2014-15 ... 35
Table 7.6: Decomposition of the Changes in Tax-To-GDP Ratio ... 36
Table 8.1: Analysis of Federal Public Sector Development Programme ... 39

ACRONYMS

AJ&K	Azad Jammu and Kashmir
BOP	Balance of Payment
CCI	Council of Common Interests
CPEC	China-Pakistan Economic Corridor
CSF	Coalition Support Fund
EU	European Union
FATA	Federally Administered Tribal Areas
FBR	Federal Board of Revenue
FDI	Foreign Direct Investment
FY	Fiscal Year
GB	Gilgit Baltistan
GDP	Gross Domestic Product
GDS	Gas Development Surcharge
GIDC	Gas Infrastructure Development Cess
GoP	Government of Pakistan
GRR	Gross Revenue Receipts
HBL	Habib Bank Limited
ICT	Islamabad Capital Territory
IMF	International Monetary Fund
IPPs	Independent Power Producers
ITO	Income Tax Ordinance
KESC	Karachi Electric Supply Company
LNG	Liquefied Natural Gas
LPG	Liquefied Petroleum Gas
LSM	Large Scale Manufacturing
MDG	Millennium Development Goal
MW	Mega Watt
NFC	National Finance Commission
NHA	National Highway Authority
NTDC	National Transmission and Dispatch Company
PAEC	Pakistan Atomic Energy Commission
PDL	Petroleum Development Levy
PEPCO	Pakistan Electric Power Company
PEPCO	Pakistan Electric Power Company
PES	Pakistan Economic Survey
POL	Pakistan Oil and Lubricant
PSDP	Public Sector Development Programme
SBP	State Bank of Pakistan
SPDC	Social Policy and Development Centre
SROs	Statutory Regulatory Orders
SSM	Small Scale Manufacturing
TAPI	Turkmenistan-Afghanistan-Pakistan-India
TDPs	Temporarily Dislocated Persons
WAPDA	Water and Power Development Authority

1 ACHIEVING MACROECONOMIC TARGETS

The Federal Budget for the year 2015-16 has been announced at a time when the country is facing multi-dimensional issues. The impact of which emerged in the failure of the government to cope up with the necessary pace of growth required to maintain the targets set forth for various sectors of the economy stated in the Annual Plan 2014-15. The real growth in GDP during the fiscal 2014-15 remained only 4.2 percent against the target of 5.1 percent. Similarly, targets of export growth and level of foreign direct investment have been missed. Nevertheless, significant achievement has been made in reducing the rate of inflation, current account deficit and import growth, which is probably a sign that there is still ample room for acquiring the desired level of growth and development in the economy provided proper strategic measures are taken along with sound planning required for the execution.

Reasonable performance of some macroeconomic indicators has contributed to stabilising the economy to a certain extent. The rate of inflation during the fiscal year 2014-15 is recorded to be 4.8 percent against the projected rate of 8 percent. This is the outcome of reduced international oil prices and also the prices of certain food items which remained moderate.

Current account deficit has been contained below one percent of the GDP against the target of 1.1 percent. This is mainly driven by restricting the trade deficit through a decline in growth of imports as well of exports, which fell by 1.6 percent and 3.2 percent respectively (July 2014- to April 2015). Workers' remittances show an increase from $12,898 million in 2013-14 to $14,970 million during 2014-15. Although the target set forth was $16673 million but still an increase of 16.1 percent is realised.

The target set for the level of National Savings (14.6 percent) has almost been met. The inflow of net foreign resources was instrumental in bridging the gap between saving and investment. The result appeared in the form of increased national savings of 14.5 percent of GDP compared to 13.7 percent during 2013-14.

Total investment as percentage of GDP in 2014-15 remained almost at the same level of previous year – 15 percent against the target of 15.7 percent. Public investment has taken an upward shift from Rs842 billion in 2013-14 to Rs1,057 billion in 2014-15, indicating a considerable growth of 25.6 percent which was merely 6.8 percent during the previous fiscal year. Thus the level of public investment as a percentage of GDP increased from 3.36 to 3.86 percent. On the other hand, private investment slightly fell short, which remained at 9.66 percent of GDP against the target of 10.3 percent.

As mentioned earlier, several targets including export growth, level of foreign direct investment and GDP growth (overall and sectoral) have been not been achieved. The target for export growth for 2014-15 was set at 5.8 percent but exports have actually witnessed negative growth. This is primarily due to the reduction in the export growth of textiles as well as of rice. Although, exports to the EU increased but overall there is a decline because in 2014-15 it stood at $20,176 million against $20,834 million in 2013-14.

Foreign direct investment (FDI) has been at a miserably low level perhaps owing to the energy crisis and political unrest. As per the latest figures provided by the State Bank of Pakistan, FDI witnessed a decline of 46.8 percent during the first eleven months of fiscal year 2014-15 where it remained at $803 billion as compared to $1,509 during the same period in 2013-14. The target set for 2014-15 was $4,317, which is highly unlikely to be met.

As shown in Table 1.1, majority of sectoral growth targets have not been met during 2014-15 while the major setback appears to be the large scale manufacturing sector. The only sub-sector where massive growth has been observed is General Government Services, which grew by 9.4 percent against the target of 4.3 percent.

The agriculture sector which is considered to be the backbone of a country's economy indicates a growth rate of only 2.9 percent whereas the target for the fiscal year 2014-15 was set at 3.3 percent. The onset of natural calamities during sowing time and hindrances in the marketing of the harvest both had negative impact on the growth in agriculture. Among the important crops, production of wheat and sugarcane decreased by 1.9 percent and 7.1 percent respectively during 2014-15 compared to last year. The target set for wheat production was 25.8 million tonnes whereas production remained at 25.5 million tonnes. Similarly, 62.6 million tonnes of sugarcane was produced during fiscal year 2014-15 whereas the target fixed was 65.5 million tonnes. On the other hand, production of cotton and rice showed an upward shift by 9.5 percent and 3.0 percent respectively. The growth in livestock remained slightly above the target.

Table 1.1
GDP Growth Rate in 2014-15

(%)

	Target	Achieved	Difference
GDP Growth	**5.00**	**4.24**	-0.76
A. AGRICULTURE	**3.30**	**2.88**	-0.42
1. Crops	1.50	1.00	-0.50
2. Livestock	3.80	4.12	0.32
B. INDUSTRIAL SECTOR	**6.80**	**3.62**	-3.18
1. Mining and Quarrying	6.50	3.84	-2.66
2. Manufacturing	6.90	3.17	-3.73
Large Scale	7.00	2.38	-4.62
Small Scale	8.40	8.24	-0.16
Construction	7.50	7.05	-0.45
Electricity Generation & Gas Distribution	5.50	1.94	-3.56
COMMODITY PRODUCING SECTOR (A+B)	**5.00**	**3.24**	-1.76
C. SERVICES SECTOR	**5.20**	**4.95**	**-0.25**
1. Wholesale and Retail Trade	6.10	3.38	-2.72
2. Transport, Storage and Communication	4.50	4.21	-0.29
3. Finance and Insurance	5.80	6.18	0.38
4. Housing Services *(Ownership of Dwellings)*	4.00	4.00	0.00
5. General Government Services	4.30	9.44	5.14

Source: Pakistan Economic Survey 2014-15.

The industrial sector could not keep up the growth path at the desired level. Instead of the 6.8 percent growth target only 3.6 percent was achieved. The growth in the large scale manufacturing (LSM) sector having a share of 11 percent in the industry and 80 percent in manufacturing is far from satisfactory. The growth target for LSM during the fiscal year 2014-15 was 7 percent, however, only 2.5 percent growth is seen in this sector which is even lower than 4.6 percent in 2013-14. On the other hand, the small scale manufacturing (SSM) sector grew at a steady rate of 8.2 percent. Since the share of SSM in total manufacturing sector is less than 15 percent, it has smaller effect on the overall growth rate of the manufacturing sector. However, growth of SSM is important in the context of employment generation as well as its contribution to the production of certain exportable items.

Moderate growth is seen in mining and quarrying while the power sector could not grow at the desired level too. Growth in Electricity Generation and Gas Distribution remained merely 1.94 percent, much lower than 5.57 percent during 2013-14. Reduced growth is observed in wood products as they declined considerably by 78 percent during the year, while production of paper and board, engineering products and rubber products also showed a declining trend.

The Services Sector has mainly contributed to the overall GDP growth. Within this sector, General Government Services grew considerably followed by Finance and Insurance. The growth in the former appears to be the resultant impact of increase in pay and pension allowance of government servants while growth in finance and insurance owes to huge profits of the banks. The wholesale and retail trade sector did not perform well during the period 2014-15 largely due to the weak performance of industrial and agriculture sectors. In 2014-15, growth in this sector remained at 3.4 percent while the target was set at 6.1 percent.

The above analysis clearly indicates that performance in achieving the macroeconomic target has been mixed and the government needs to take stringent measures to meet various targets set for different sectors of the economy. Although GDP growth has slightly improved as compared to the previous fiscal year, commodity producing sectors have not performed well and the growth is mainly driven by the services sector. In order to improve and sustain the level of GDP growth, greater focus needs to be placed on industrial and agriculture sectors.

2 OVERSTATED GDP GROWTH

It is commonly believed that the economy of Pakistan has immense potential that has not been systematically tapped by successive governments and policy makers. The fundamental question is why Pakistan is lagging behind in terms of economic growth in the last couple of years during a period when the economic performance of neighboring economies such as India, Bangladesh and Sri Lanka is exceptionally good. The answer of this question is that the government consistently overstates the growth rates – a practice that impedes them to revisit the policy options available to foster growth. Higher growth rhetoric, bandied around as 'good' news, has political implications as it gives extra mileage to the ruling government. But the fact of the matter is hiding the reality is not a public service; it has spillover effects that a country and its population have to bear in the long run.

The purpose of this article is to identify the missing linkages in the growth rates between three main sectors i.e. agriculture, industry and services sectors and its sub-sectors. The numbers published in the recent Pakistan Economic Survey 2014-15 are creating doubts of its plausibility and precision because the corresponding sub-sectors are telling a different story. For the performance analysis of value-added GDP and its different components, an evaluation criterion has been established. The analysis is based on "difference approach" both for real GDP growth and share in GDP. Following are the four scenarios of performance evaluation.

Scenario 1: If the growth difference in the current and previous year is positive and the share difference in the current and previous year is also positive then the sector's performance is positive.

Scenario 2: If the growth difference in the current and previous year is positive and the share difference in the current and previous year is negative then the other sector's performance is better than this sector.

Scenario 3: If the growth difference in the current and previous year is negative and the share difference in the current and previous year is positive then this sector's performance is better than other sectors.

Scenario 4: If the growth difference in the current and previous year is negative and the share difference in the current and previous year is also negative then the sector's performance is negative.

In addition to the performance evaluation of the value added sectors, an analysis of aggregate demand will be conducted to see the negative or positive impact of the value added output.

AGRICULTURE SECTOR

Pakistan agriculture performance is continuously declining since 2006-07. It reached its lowest 0.2 percent in 2009-10 due to the devastating flood of 2010. The highest of the period (2006-07 to 2014-15) was 3.6 percent in 2011-12. Agriculture's share in total GDP has also been declining – it was 50 percent in 1949-50 and only 20.88 percent in 2014-15. In the recent Economic Survey of Pakistan 2014-15, the growth in agriculture is estimated to be 2.88 percent – 0.18 percent higher than the previous year. But the growth in crops and important crops shows negative growth from last year. The 'important crops' which have the highest weight in the crop sub-sector have shown a decline in the production of sugarcane by 7.1 percent, wheat by 1.9 percent and maize by 5.0 percent. Cotton has shown production surplus of 9.5 from last year with 13.98 million of bales. It is the main agriculture crop for the domestic industry and foreign exchange earnings. Ironically, the sub-sectors of cotton have not shown any growth that could justify the production surplus of 9.5 percent. For instance, the production of cotton yarn increased by 0.49 percent and export of raw cotton, cotton yarn

Table 2.1
Agriculture Sector

	FY-13 to FY-14	FY-14 to FY-15
	Difference in Growth Rates	
OVERALL	0.02	0.18
1. Crops	1.67	-2.20
Important Crops	7.79	-7.67
Other Crops	-10.95	6.47
Cotton Ginning	1.57	8.71
2. Livestock	-0.69	1.36
3. Forestry	-13.32	9.88
4. Fishing	0.33	4.77
	Difference in Percentage Share	
OVERALL	-0.27	-0.28
1. Crops	-0.07	-0.26
Important Crops	0.20	-0.21
Other Crops	-0.24	-0.07
Cotton Ginning	-0.03	0.02
2. Livestock	-0.15	-0.01
3. Forestry	-0.05	0.00
4. Fishing	-0.01	0.01

Source: Pakistan Economic Survey, 2014-15.

and cotton cloth decreased by 26.2, 7.5 and 11.0 percent respectively. One may ask the question: where did the cotton go?

Despite having significant growth in 2014-15 in other crops and cotton ginning sub-sectors, their share in GDP has not shown any substantial increase because of their relatively less weight in total agriculture production. The share of other crops and cotton ginning is 28.1 and 7.4 percent respectively.

The real growth rate in the livestock sub-sector was 4.12 in 2014-15 that is 1.36 percent higher than the previous year, but its share in GDP has decreased by 0.01 percent. The growth rate of the livestock sub-sector does not correspond with the growth in production of livestock and other products. For instance, growth in the production of livestock (animals) was only 2.7 percent. Similarly, growth in milk production, which constitutes about half of the livestock sector, was only 3.2 percent.

The growth difference in the forestry sub-sector in 2014-15 was 9.88 percent owing to the negative growth of 6.74 percent in 2013-14. It is surprising that high real growth in forestry does not correspond with growth in wood industry where production has declined by 78.5 percent.

The growth difference in the fishing sub-sector in 2014-15 was 4.77 percent that increased its share in total GDP by 0.01 percent. However, the real growth of 5.75 percent in the fishing sub-sector has not translated into export of fish and fish products that has declined by 2.4 percent in 2014-15.

The analysis of growth rates in the agriculture sector has revealed that despite the growth difference in 2014-15 its share in GDP has not increased. According to the performance evaluation criterion, the agriculture sector falls in scenario 2 which highlighted the fact that the performance of other sectors is better than agriculture. The growth track approach raised questions about the accuracy of numbers as most of the corresponding sectors have not shown positive growth rates.

INDUSTRIAL SECTOR

Over the years, the industrial growth performance declined substantially owing to the energy shortage and low growth in the agriculture sector and raw material production industry. The growth difference in the industrial sector in 2014-15 was -0.84 percent that resulted in the decline of its share in total GDP by 0.12 percent. Mining and Quarrying shows 3.84 percent real growth that corresponds to 4.12 percent increase in coal, 3.73 percent increase in limestone and 14.03 in crude oil extraction. However, out of 17 principal minerals 10 show negative growth in which natural gas extraction has declined by 2.32 percent and marble declined by 8.48 percent.

Manufacturing sector growth has declined in two consecutive years by 0.16 percent (2013-14) and 1.29 percent (2014-15). Large scale manufacturing that contributes 80 percent of the value added in manufacturing sector has also shown a 1.61 percent decline from FY-14 to FY-15. Their share in GDP has gone down by 0.14 percent and 0.19 percent respectively. The manufacturing sector low growth of 3.17 percent in 2014-15 was mainly because of the sluggish growth of large scale manufacturing sector particularly in high weight items such as textile, food, beverages & tobacco and fertilizer that shows growth of 0.50 percent, -1.03 percent and 0.95 percent respectively. Similarly, the incremental production of high value items such as cotton cloths and cotton yarn was close to zero in 2014-15. The collapse of large scale manufacturing sector caused exports to fall by 5.0 in 2014-15. Pakistan will not be able to take advantage of low oil prices and GSP plus status without revamping manufacturing sector policies, particularly large scale manufacturing sector.

Table 2.2
Industrial Sector

	FY-13 to FY-14	FY-14 to FY-15
	Difference in Growth Rates	
OVERALL	3.85	-0.84
1. Mining & Quarrying	-2.23	2.19
2. Manufacturing	-0.16	-1.29
Large Scale	-0.19	-1.61
Small Scale	0.01	-0.05
Slaughtering	-0.23	-0.08
3. Electricity Generation & Distribution & Gas Distribution	31.95	-3.63
4. Construction	6.17	-0.20
	Difference in Percentage Share	
OVERALL	0.08	-0.12
1. Mining & Quarrying	-0.07	-0.01
2. Manufacturing	0.06	-0.14
Large Scale	0.00	-0.19
Small Scale	0.07	0.06
Slaughtering	-0.01	-0.01
3. Electricity Generation & Distribution & Gas Distribution	0.02	-0.04
4. Construction	0.07	0.06

Source: Pakistan Economic Survey, 2014-15.

The energy crisis is threatening the economy of Pakistan since the last 10 years. The volatility in the growth of electricity generation and distribution and gas distribution sub-sector is because of inconsistent energy policies of the government that focus more on capital intensive projects to increase installed capacity rather than on the improvement in the existing generation capacity. The installed capacity of electricity in Pakistan is 23,000 MW and domestic demand of electricity (peak months) is nearly 19,000 to 20,000 MW that provided a space of 3,000 MW as a buffer. The growth of 1.94 percent in electricity generation and distribution and gas distribution sub-sector looks inconsistent as overall electricity generation has declined by 2.3 percent with all the sources of power generation hydro by 2.0 percent, thermal by 2.8 percent and nuclear by 1.3 percent. A similar trend is observed in gas distribution that decreased by 2.3 percent in 2014-15.

The growth difference in the construction industry was negative in 2014-15 with an increase in the share of GDP that indicated a relatively better performance of this sub-sector. However, the real growth of 7.05 percent did not match the growth in the cement industry that stood at 2.74 percent. Similarly, the construction industry is heavily dependent on private sector investment which also shows meager growth of 3.21 percent in 2014-15.

The analysis of growth rates in the industrial sector has revealed that both growth and share difference is negative in 2014-15. According to the performance evaluation criterion, industrial sector performance is poor in comparison with other sectors as both growth and share difference is negative (scenario 4).

SERVICES SECTOR

The services sector is the highest growing sector in Pakistan as its share in GDP was 42.0 percent in 1975-76 that increased to 58.8 percent in 2014-15. This sector is dominated by wholesale and retail trade (31.0 percent) followed by transport, storage and communication (22.7 percent) and other private services (16.8 percent). The share of finance and insurance, housing and general government is 5.3 percent, 11.5 percent and 12.6 percent respectively.

The growth difference in services sector was positive by 0.58 percent with incremental share of 0.40 percent in GDP. Ironically, both dominant sub-sectors i.e. wholesale and retail and transport & communication sectors have shown negative growth by 0.60 percent and 0.35 percent respectively. It is also noted that household final consumption expenditures have declined by 1.8 percent from 2013-14. With the meager growth in agriculture and industrial sector output, the economic activity in wholesale and retail trade and transport & communication has also slowed down which signifies the moderate recession tendency in the economy. The government claimed that due to the 'dharna' in

Islamabad, the growth and economic activity in transport and communication sector was hampered. But the ‘dharna’ started in the month of August 2014 and ended in December 2014 that is not the period of Kharif crop transportation as harvesting of Kharif crop usually finishes in the months of April-May. Similarly, the industrial production on average was below 2 percent in first six months of year 2014 except in January 2014 when industrial production was 11.19 percent that means there was not enough production that needs to be transported from August 2014 to December 2014. Undoubtedly, the ‘dharna’ slowed down the economic activity in the country but it did not have a substantial impact on the two important sectors of the economy.

Table 2.3
Services Sector

	FY-13 to FY-14	FY-14 to FY-15
	Difference in Growth Rates	
OVERALL	-0.76	0.58
1. Wholesale & Retail Trade	0.45	-0.60
2. Transport, Storage & Comm.	0.53	-0.35
3. Finance & Insurance	-4.14	2.00
4. Housing Services	0.00	0.00
5. General Government Services	-8.47	6.59
6. Other Private Services	1.07	-0.38
	Difference in Percentage Share	
OVERALL	0.19	0.40
1. Wholesale & Retail Trade	-0.01	-0.15
2. Transport, Storage & Comm.	0.07	0.00
3. Finance & Insurance	0.00	0.06
4. Housing	0.00	-0.02
5. General Government Services	-0.08	0.35
6. Other Private Services	0.21	0.16

Source: Pakistan Economic Survey, 2014-15.

The sub-sectors of finance and insurance and general government services have shown exceptional growth of 6.18 and 9.44 percent respectively. By analysing from a growth difference perspective, the general government services increased by 6.59 percent that is somewhat inconsistent if we take figures provided on the website of the Finance Ministry under Pakistan’s Fiscal Operations. The alternative methodology to arrive on general government services is to deduct total debt servicing from total current expenditures. From this methodology the real growth in general government services was 1.25 percent instead of 9.44 percent reported by government. The analysis of growth rates of services sector has revealed that growth difference is negative and share difference is positive in 2014-15. According to the performance evaluation criterion, services sector performance is better in comparison with other two sectors as it represents scenario 3.

The following section presents the estimated growth rates of some sectors of GDP by analysing the growth patterns of the corresponding sectors.

CONCLUSION

In the above sections, ample evidence is found that creates doubts about the plausibility of the GDP numbers. In agriculture, important crops and livestock sectors are those where the growth numbers do not reflect the performance of its sub-sectors. In important crops, sugarcane and wheat production have the highest share and both have shown negative growth in production in 2014-15 (-7.1 and -1.9 percent respectively). The cumulative impact of the negative growth of sugarcane and wheat and maize is around 0.12 percent. Similarly, real growth rate on livestock sector was 4.12 percent in 2014-15 that looks higher for two reasons. Firstly, milk production, which represents 50 percent of the livestock sector, has not shown higher growth rate. Instead it remained at 3.2 percent both in 2013-14 and 2014-15. In 2013-14, when animal production was 2.5 percent, milk production was 3.2 percent and meat production was 4.5 percent, the growth rate of livestock sector was 2.76 percent. These ratios have not changed in 2014-15 that means the livestock growth is overstated by 1.4 percent.

In the industrial sector, the growth of 1.94 percent in electricity generation & distribution and gas distribution sector is in contradiction with the growth in electricity and gas generation figures in 2014-15. The overall electricity generation has come down by 2.3 percent in which hydro declined by 2.0 percent, thermal by 2.8 percent and nuclear by 1.3 percent. When the production of both electricity and gas has declined by more than 2 percent in 2014-15, the growth in this sector is largely based on the distribution aspects. Therefore, the growth rate of 1.94 percent in 2014-15 appears to be overstated by 1 percent.

In the services sector, the general government services growth rate of 9.44 percent seems unusual keeping in view its historical growth trend. As stated above, alternative methodology has been used to verify the growth numbers. The growth rate in general government services appears to be 8.19 percent less than the reported one.

In the view of above, the real GDP growth in 2014-15 does not appear to be more than 3.5 percent. The poor performance of the agriculture sector, particularly in the important crops sector, was the main driving force behind this decline. Large scale manufacturing sector was also not performing well which again has a spillover impact on the performance of others sectors of the economy. The economy of Pakistan is based on the higher growth of important crops and large scale manufacturing sectors. These two sectors are feeding sectors of the economy particularly for services sector performance. The government has to prioritise these two important sectors of the economy for higher sustainable growth in the future. Lastly, we as nation have to be brave enough to face the reality – higher economic growth is not the ultimate goal, an egalitarian society is.

3 PERFORMANCE OF THE EXTERNAL SECTOR

The year 2014-15 depicts an uneven picture of the external sector – while the external factors exert positive effects, the internal factors serve to neutralise the said positive effects.

The healthy part is the reduction in the growth of the trade deficit as can be seen in the composition of the current account (Table 3.1). During July 2014 and April 2015, exports stood at $20.2 billion and imports at $34.1 billion resulting in a trade deficit of $13.9 billion, up by 0.7 percent compared to the same period a year ago. A slower growth in trade deficit on account of the decline in imports and/or increase in exports is appreciable. However, the picture during July 2014 and April 2015 is somewhat exceptional where the growth in the trade deficit has been contained by the twin effects of declines – in imports as well as in exports. Although imports declined by 1.6 percent, exports declined by 3.2 percent (twice the rate of decline in imports) which prevented a decline in the trade balance. Negative growth in imports is largely a result of the fall in international oil prices that contributed to the decline of petroleum exports and freight charges. It is also noticeable that in 2013-14, exports increased only by one percent. This is an indication of the fact that the exports appear to be stagnant in the last few years which raises serious questions on the productive capacity of the economy.

The services deficit narrowed to $1.6 billion during July 2014 to April 2015 from $2.4 billion over the same period a year ago, registering a decline of 30 percent. This decline is a result of an inflow of $1.5 billion under the Coalition Support Fund (CSF) during this period (Economic Survey 2014-15). This improvement, however, is not sustainable. Had this amount not been added to the receipt part of the services balance, the services deficit would have been over $3 billion (over one percent of GDP). The deficit in the income account has worsened by 12 percent primarily because of higher interest payments and increase in income payable abroad. On the other hand, net current transfers increased by 8 percent of which workers' remittances, which constitute a major part (84 percent) of the former, increased by over 16 percent. Nevertheless, all these factors, contributed in reducing the current account deficit to $1.4 billion in the first ten months of FY14 compared to $2.9 billion in the corresponding period of FY13 (a decline of 54 percent). In relative terms, it is 0.5 percent of GDP, which is half compared to the same period a year ago.

Table 3.1
Composition of the Current Account

(US $ Million)

	2012-13	2013-14	Growth (%)	2013-14 July-April	2014-15 July-April	Growth (%)
Trade Balance	**-15,431**	**-16,701**	**0.8**	**-13,811**	**-13,910**	**0.7**
Exports (f.o.b)	24,795	25,068	1.1	20,834	20,176	-3.2
Imports (f.o.b)	40,226	41,769	3.8	34,645	34,086	-1.6
Services Balance	**-1,472**	**-2,551**	**73.3**	**-2,349**	**-1,632**	**-30.5**
Receipts	6,733	5,322	-21.0	4,197	5,026	19.8
Payments	8,205	7,873	-4.0	6,546	6,658	1.7
Income Balance	**-3,685**	**-3,943**	**7.0**	**-3,169**	**-3,576**	**12.8**
income credit	488	541	10.9	453	476	5.1
income debit	4,173	4,484	7.5	3,622	4,052	11.9
Current Transfers (net)	**18,092**	**20,065**	**10.9**	**16,398**	**17,754**	**8.3**
(Workers' Remittances)	13,922	15,837	13.8	12,898	14,970	16.1
Current Account Balance	**-2,496**	**-3,130.0**	**25.4**	**-2,931.0**	**-1,364.0**	**-53.5**
Trade Balance as % of GDP	**-8.8**	**-8.2**		**-5.7**	**-5.9**	
Current Account Balance as % of GDP	**-1.1**	**-1.3**		**-1.0**	**-0.5**	

Source: Pakistan Economic Survey 2014-15

The unhealthy part is an almost across-the-board decline in exports, which is a matter of serious concern (Table 3.2). Total exports stood at $20 billion during July 2014 and April 2015 that were 5 percent lower than the exports during July 2013 and April 2014. Declines are reported in a wide range of commodities, including major products. Textile sector's exports that constitutes more than 57 percent of total exports showed depressed performance with an overall decline of 1.2 percent during first ten months of 2014-15 over the same months of 2013-14. Within textiles, exports of cotton yarn and cotton cloth depicted a decline of 7.5 percent and 11 percent respectively. A decline of 5.4 percent is also reported in rice, which is another major export. Non-traditional exports such as carpets and rugs, sports goods, leather tanned and manufactures, surgical goods and instruments, chemicals and pharmaceuticals, engineering goods, gems and jewelry and cement have also dropped by 18 percent altogether.

Table 3.2
Major Exports

(US$ Million)

Commodities	2012-13		2013-14		Growth %	2013-14*		2014-15*		Growth %
	Value	Share %	Value	Share %		Value	Share %	Value	Share %	
Food Group	**4,762**	**19.5**	**4,625**	**18.4**	**-2.9**	**3,943**	**18.8**	**3,862**	**19.4**	**-2.1**
Rice	1,922		2,163		12.5	1,850		1,750		-5.4
Fish & Fish Preparation	318		369		16.3	294		287		-2.4
Fruits	392		435		11.0	398		400		0.5
Vegetables	247		209		-15.3	187		196		5.0
Wheat	54		7		-86.9	7		3		-57.1
Spices	68		57		-16.8	45		54		19.7
Oil seeds and nuts	36		82		128.0	77		62		-20.0
Meat & Meat Preparation	211		230		8.9	192		202		5.5
Other food items	1,514		1,073		-29.1	893		909		1.7
Textile Group	**13,048**	**53.3**	**13720**	**54.6**	**5.2**	**11,420**	**54.4**	**11,282**	**56.6**	**-1.2**
Raw cotton	154		205		33.3	196		145		-26.2
Cotton Yarn	2,253		1,997		-11.3	1,716		1,587		-7.5
Cotton Cloth	2,690		2,770		3.0	2,346		2,088		-11.0
Knitwear	2,043		2,294		12.3	1,839		1,982		7.8
Bedwear	1,785		2,138		19.7	1,767		1,747		-1.1
Towels	770		767		-0.3	630		650		3.2
Readymade Garments	1,800		1,909		6.1	1,578		1,722		9.1
Synthetic Textile	406		385		-5.1	319		280		-12.3
Made up Articles	406		385			542		543		0.1
Others	742		870		17.2	487		538		10.4
Petroleum Group	**28**	**0.1**	**721**	**2.9**	**2446.4**	**601**	**2.9**	**539**	**2.7**	**-10.4**
Other Manufactures	**4,754**	**19.4**	**4,341**	**17.3**	**-8.7**	**3,598**	**17.2**	**2,951**	**14.8**	**-18.0**
Carpets, Rugs & Mats	122		125		2.3	107		103		-3.7
Sports Goods	334		364		9.0	290		272		-6.4
Leather Tanned	500		551		10.3	439		408		-7.1
Leather Manufactures	569		625		9.8	521		498		-4.3
Surgical Goods & Instruments	304		338		11.3	285		284		-0.3
Chemicals & Pharmaceuticals	874		1,171		34.0	969		809		-16.5
Engineering Goods	290		327		12.5	256		189		-26.2
Gems & Jewelry	1,182		330		-72.1	318		6		-98.2
Cement	577		508		-12.0	414		382		-7.6
Others	**1,869**	**7.6**	**1,702**	**6.8**	**-8.9**	**1,417**	**6.8**	**1,289**	**6.5**	**-9.0**
Total	**24,460**	100.0	**25,110**	100.0	**2.7**	**20,979**	100.0	**19,922**	100.0	**-5.0**

* July to April
Source: Pakistan Economic Survey 2014-15 and Statistical Bulletin, SBP

Table 3.3
Source of Change in Major Exports

(%)

	Share in total Exports	Un-weighted growth in $ Value of exports	Weighted growth in $ Value of exports	Decomposition of weighted	
				Price Effect	Quantity Effect
Primary Commodities	**23.3**		**-0.82**	**-0.46**	**-0.36**
Rice	8.8	-5.4	-0.47	-0.66	0.18
a) Basmati	2.5	-18.5	-0.46	0.12	-0.58
b) Others	6.3	1.1	0.06	-0.36	0.42
Fish &Fish preparations	1.4	-2.4	-0.03	0.02	-0.05
Fruits	2.0	0.5	0.01	0.32	-0.31
Sugar	1.3	1.6	0.02	0.05	-0.03
Meat and Meat preparations	1.0	5.5	0.06	0.05	0.00
Textiles and Apparel	**49.8**		**-0.37**	**1.55**	**-1.92**
Raw Cotton	0.7	-26.2	-0.19	-0.09	-0.10
Cotton Yarn	8.0	-7.5	-0.60	-0.66	0.06
Cotton Cloth	10.5	-11.0	-1.15	1.46	-2.61
Knitwear	10.0	7.8	0.78	0.63	0.15
Bed wear	8.8	-1.1	-0.10	-0.19	0.10
Towels	3.3	3.2	0.10	0.14	-0.03
Readymade Garments	8.6	9.1	0.79	0.28	0.51
Other Manufactures	**7.1**	-3.7	**-0.41**	**1.13**	**-1.53**
Carpets, Rugs & Mats	0.5	-6.4	-0.02	0.11	-0.12
Leather Tanned	2.1	-7.2	-0.15	0.40	-0.54
Leather Garments	1.6	9.2	-0.14	0.38	-0.52
Leather Gloves	0.9	6.9	0.06	0.23	-0.17
Electric Fans	0.1	-8.5	-0.01	0.02	-0.03
Cement	1.9	-7.6	-0.15	0.00	-0.15
Joint impact of 80% Exports	**80.2**		**-2.80**	**3.30**	**-6.09**

Source: SPDC estimates based on Pakistan Economic Survey 2014-15 and Statistical Bulletin, SBP

The Finance Minister has attributed this fall in exports to the decline in international prices. The Economic Survey 2014-15 decomposes the sources of decline in the value of 80 percent of total exports into price and quantity effects. While it appears at first glance that the decline in exports is due to the fall in international prices, a detailed analysis shows that this is not the case. Given that different export items have different shares in total export, different items thus command different weights. It is important to look at the weighted growth rate of the same selected items, constituting 80 percent of total exports, by weighting the growth rate of each item with its respective share in exports. As shown in Table 3.3, rice exports declined by a weighted rate of 0.47 percent. These exports declined as a result of the decline in price by 0.66 percent and increased due to increase in quantity by 0.18 percent hence the net effect is 0.47 percent.

Analysing other items in a similar manner, it is observed that in many items the decline in quantity has outweighed the impact of increase in prices. For example, the highest decline in terms of weighted rate is seen in cotton cloth (-1.2 percent), constituting 10.5 percent of total exports, which is a result of decline in quantity not in prices. Knitwear constituting 10 percent of total exports increased by a weighted rate of 0.78 percent of which the increase due to price effect is higher than that of quantity effect. In case of all other non-traditional manufacturing items, the price effect is positive while quantity effect is negative.

Overall these 80 percent exports declined by 6 percent due to decline in quantity and increased by 3.3 percent due to increase in quantity that causes a net effect of decline by 2.8 percent. In other words, by weighting each item with its respective share indicates that about 64 percent of decline is due to the price effect and 36 percent due to quantity effect. This indicates that the decline in exports is largely due to the quantity effect and reflects the supply constraints that the export sector faces on account of a host of domestic factors like energy crisis, slowing down in investment and law and order condition.

Imports amounting to $37.7 billion during July 2014 and April 2015 registered an increase of 1.8 percent over the same period a year ago ($37.1 billion). It shows that the import bill is almost constant, despite the fact that imports of items in the food, machinery and metal categories have recorded increases of over 22 percent and in the chemical group of over 11 percent (Table 3.4). These increases have been neutralised by the sharp decline in international oil prices, which has reduced the oil import bill by about $2.3 billion. Comments are also in order on the healthy increases in machinery, metal and chemical imports, which could be reflective of robust economic activity. But, the fact that import growth is not reflected in corresponding export growth is indicative of the growth of high import-content for production of domestic consumption in the country.

To conclude, the external sector secured its health due to exogenous factor rather than the strength of the economy. A sharp drop in international oil process has saved almost $2.4 billion (constituting nearly 80 percent of total foreign loan repayment in 2014-15) that helped out in reducing the growth in the trade deficit. And this combined with $15 billion foreign remittances (that grew by 16 percent) and $1.5 billion under CSF have contributed in a reduction in the current account deficit by 54 percent.

Table 3.4
Major Imports

(US$ Million)

Commodities	2012-13		2013-14		Growth %	2013-14*		2014-15*		Growth %
	Value	% Share	Value	% Share		Value	% Share	Value	% Share	
Food Group	**4,188**	**9.3**	**4,244**	**9.4**	**1.3**	**3,454**	**9.3**	**4,205**	**11.1**	**21.8**
Milk/cream & infants food	137		163		19.1	134		219		62.8
Wheat Un-milled	7		107		1468.9	107		185		72.9
Tea	368		300		-18.5	248		291		17.3
Spices	67		93		37.6	72		87		21.9
Edible Oil (Soyabean & Palm)	2,037		2,019		-0.9	1,609		1,495		-7.1
Pulses	327		308		-5.7	240		322		34.3
Others	1,244		1,253		0.7	1,045		1,606		53.8
Machinery Group	**5,705**	**12.7**	**6,458**	**14.3**	**13.2**	**6,753**	**18.2**	**8,247**	**21.8**	**22.1**
Power Generating	959		1,081		12.8	873		1,098		25.8
Textile	388		600		54.4	493		368		-25.5
Construction & Mining	162		261		61.0	230		220		-4.4
Electrical & apparatus	844		1,117		32.4	920		958		4.2
Telecom	1,494		1,346		-10.0	1,027		1,180		14.9
Road Motor Vehicles	1,450		1,249		-13.9	1,031		1,281		24.2
Others	408		805		97.3	2,178		3,142		44.2
Petroleum Group	**14,973**	**33.3**	**14,861**	**33.0**	**-0.8**	**12,221**	**33.0**	**9,855**	**26.1**	**-19.4**
Petroleum Products	9,529		9,085		-4.7	7,482		6,267		-16.2
Petroleum Crude	5,444		5,776		6.1	4,739		3,588		-24.3
Textile Group	**2,612**	**5.8**	**2,677**	**5.9**	**2.5**	**2,245**	**6.1**	**2,092**	**5.5**	**-6.8**
Agriculture/ Chemical Group	**6,416**	**14.3**	**6,706**	**14.9**	**4.5**	**5,488**	**14.8**	**6,126**	**16.2**	**11.6**
Fertilizer	659		700		6.3	595		743		24.8
Insecticides	88		123		40.4	96		114		18.9
Plastic Material	1,425		1,679		17.8	1,357		1,469		8.2
Medicinal Products	833		791		-5.0	675		800		18.5
Others	3,412		3,414		0.0	2,764		3,000		8.5
Metal Group	**3,337**	**7.4**	**3,081**	**6.8**	**-7.7**	**2,448**	**6.6**	**3,025**	**8.0**	**23.6**
Iron & Steel	1,611		1,428		-11.4	1,123		1,488		32.5
Others	1,726		1,653		-4.2	1,325		1,537		16.0
Others	**7,719**	**17.2**	**7,047**	**15.6**	**-8.7**	**4,476**	**12.1**	**4,214**	**11.2**	**-5.9**
Total	**44,950**	**100**	**45,073**	**100**	**0.3**	**37,085**	**100**	**37,763**	**100**	**1.8**

* July to April

Source: Pakistan Economic Survey 2014-15 and Statistical Bulletin, SBP

4 AN OVERVIEW OF EXTERNAL DEBT AND FOREIGN EXCHANGE RESERVES

At the start of 2014-15, the external debt of the Government of Pakistan stood at $ 54.8 billion (i.e. on the 30th of June 2014), which was equivalent to 22.5 percent of the GDP and constituted about 84 percent of the total external public debt. The Budget 2014-15 envisaged a gross inflow of $6.2 billion consisting of project loans of $1.7 billion; program loans of $2 billion and other inflows of $2.4 billion (including Euro and Ijara Sukuk bonds). With debt repayment of $3.3 billion, the net inflow was expected to be about $3 billion. However, the revised estimates reveal an external borrowing of $6.5 billion in 2014-15, up by 6 percent than that originally anticipated. The highest increase of 27 percent took place in project loans while the programme loans declined by over 7.5 percent. Other inflows also increased due to the receipt from flotation of Sukuk bonds and borrowing from Islamic Development Bank amounting $1 billion and $0.9 billion respectively, both doubled compared to their budgeted amount.

Table 4.1
Level of External Borrowing and Debt of the GoP
(US$ Billions)

	Revised Estimates 2013-14	Budget Estimates 2014-15	Revised Estimates 2014-15	Budget Estimates 2015-16
Gross Inflow	**6.6**	**6.2**	**6.5**	**7.2**
Project Loans	1.6	1.7	2.2	2.1
Program Loans	2.4	2.0	1.8	1.9
Other Inflows	2.0	2.4	2.5	3.3
Debt Repayment	2.6	3.3	2.9	3.1
Net Inflow	**4.0**	**2.9**	**3.6**	**4.1**
External Debt *(at end of FY)*	**54.8**	**57.7**	**58.4**	**56.4**
External Debt as % of GDP	21.9	19.8	21.6	20.8

Source: Based on Budget in Brief 2015-16, GoP

Focusing on the repayment of external debt, the budget estimated $3.3 billion to be retired during 2014-15 but the revised estimates show that government retired $2.9 billion (lower by $0.4 billion than the projected amount). As a result, the net inflow of external borrowing increased by $0.7 billion (26 percent) more than the budgeted amount and stood at $3.6 billion in 2014-15. This indicates that the government opted for external borrowing in order to build up the level of foreign exchange reserves.

Given this, the external debt of the government stood at $58.4 billion by the end of June 2015 as per revised estimates. Though the government's external debt-to-GDP ratio declined slightly (0.3 percentage points) during 2014-15 compared to that in 2013-14, it increased by 1.7 percentage points compared to that expected in the budget.

An important indicator of external debt sustainability is the ratio of external debt to exports of goods and non-factor services. In the context of the external debt of the GoP, this ratio stands at 180 percent in 2013-14 and is expected to increase to up to 200 percent in 2015-16.

The current Budget of 2015-16 envisages gross inflow of external borrowing at $7.2 billion up by $0.7 billion compared to that in 2014-15. This increase is anticipated by relying largely on other loans category that includes floating of Euro bonds and China Safe Deposits each worth one billion dollars. Debt repayment is expected to be at $3.1 billion, which is only $0.2 billion (21 percent) higher than the revised estimates. This creates a net inflow of $4.1 billion. If external borrowings are restricted to the budgeted level then the government external debt-to-GDP ratio will stand at 20.8 percent at the end of 2015-16, which is 0.8 percentage points less than that at the end of 2014-15.

The composition of debt which the government claims is disbursed or credited in its accounts during July-March as per Economic Survey 2014-15 is shown in Table 4.2. Total amount disbursed was $4 billion comprising project aid, non-food aid, BOP/budgetary support (including loan from IMF of $1.04 billion) and relief. Debt servicing during that period was $2.34 billion resulting in a net inflow of $1.66 billion. In addition, the government also claims the inflow of foreign exchange from floating Ijara Sukuk bonds of worth $1 billion and proceeds from privatisation of HBL amounting $0.76 billion. This results in an overall net inflow of $3.43 billion. However, the amount of foreign exchange reserves acquired during July-May 2014-15, amounts to $2.82 billion by government (SBP) and $0.06 billion by private sector (commercial banks). This indicates a difference of $612 million. It is likely that some of the amount under privatisation proceeds of HBL might not yet have been credited.

Table 4.2
Composition of External Debt
(US$ Billions)

	2014-15 (Jul-Mar)
Project Aid	1.76
Non-Food Aid	0.01
BOP (incl. IMF loan)	2.13
Relief	0.11
Total	**4.00**
Debt Servicing	2.34
Net Inflow	**1.66**
Ijara/Sukuk	1.00
Privatisation proceeds (HBL)	0.76
Total Inflow	**3.43**

Source: SBP

This is important to mention that the current account shows a deficit of $1.5 billion during July-March 2014-15 and hence did not contribute in building up foreign exchange reserves. As a result, the existing reserves with SBP are primarily attained through external borrowing largely from project aid, loan from IMF and Sukuk bonds. Thus, the inflows of foreign exchange resources or reserves held with the government are in fact liabilities to the government that have to be paid back when they get matured (usually in a period of 3 to 4 years).

5 FEDERAL BUDGET 2015-16: AN EXERCISE IN DECEPTION

At first blush, the statistics presented in the federal budget 2015-16 sound good, but looking closer reveals a number of inconsistencies. For instance, as per revised estimates gross revenue receipts in 2014-15 exceed the target by Rs7 billion, despite the fact that the FBR missed its target by more than Rs200 billion. Similarly, there is a decline in federal transfers to provinces of more than Rs145 billion, while net revenue receipts of the federal government increased by Rs152 billion. This implies that only those tax and non-tax targets were missed which have share of provinces. On the expenditure side, there is not much deviation in the budget and revised estimates of total current expenditures in 2014-15 largely due to savings of Rs93 billion in debt servicing despite a massive increase in state bank profits. Consequently, federal fiscal deficit declined by roughly Rs187 billion in 2014-15 compared to budget estimates. Similar, statistics are presented for the fiscal year 2015-16 including projected growth of 19 percent in FBR taxes, zero percent growth in current expenditure, decline in domestic debt servicing and subsidies, massive increase in development expenditure and provincial surplus. All these statistics requires consistency checks.

GROWTH IN FEDERAL TAXES

The FBR is the largest tax collecting authority in Pakistan, which collects 90 percent of the federal taxes. In 2014-15, due to a sharp decline in POL prices and negative nominal growth in Large Scale Manufacturing, it was expected that the FBR will miss its targets by a big margin. However, revised estimates published in budget documents showed a growth of 14.5 percent in FBR revenues (see Table 5.1), which is commendable. There are a couple of reasons for this performance. First of all, direct taxes showed a phenomenal growth of 24.5 percent in 2014-15 compared to revised estimates of 2013-14. This is attributed to Rs144 billion discretionary changes or additional revenue measures announced in the 2014-15 budget. This implies that only Rs74 billion is collected through nominal growth. Second, in order to avoid the impact of the fall in POL prices, the rate of sales tax of petroleum products was upward revised during the year, which nullified the impact of falling prices on FBR revenues.

For 2015-16, the government announced a growth of more than 19 percent in FBR revenues. This growth largely hinges on revenue measures of Rs238 billion announced by the FBR for 2015-16. The addition revenues from growth in tax bases is hardly Rs200 billion. It seems the government strategy for resource mobilisation is not based on expansion in tax bases. Instead, it is based on additional resource mobilisation measures, which have negative implication on tax bases.

In addition to FBR taxes, there is a growing category of other than FBR taxes. Three taxes namely Petroleum Development Levy (PDL), Gas Development Surcharge (GDS) and Gas Infrastructure Development Cess (GIDC) were brought in the category of tax revenues in 2009-10, 2013-14 and 2014-15 respectively. These taxes were expected to contribute more than Rs300 billion to tax revenues in 2014-15. There is a 17 percent and 65 percent growth in PDL and GIDC in 2014-15 compared to revised estimates of 2013-14. The growth in PDL is understandable. Given the decline in international POL prices, which caused an increase in the consumption of POL products, if the per unit rate of PDL is unchanged then revenues from PDL would increase in line with the increase in demand.

Table 5.1
Composition of Gross Revenue Receipts

Rs. in Billion

	2013-14	2014-15		2015-16	Growth Rate (%)	
	Revised	Budgeted	Revised	Budgeted	RE14-RE15	RE15-BE16
Gross Revenue Receipts	**3,597**	**3,946**	**3,952**	**4,313**	**9.9**	**9.1**
Tax Revenue (FBR and Others)	**2,514**	**3,129**	**2,910**	**3,418**	**15.8**	**17.5**
Tax Revenue (FBR)	**2,275**	**2,810**	**2,605**	**3,104**	**14.5**	**19.1**
Direct Taxes	**891**	**1,180**	**1,109**	**1,348**	**24.5**	**21.5**
Indirect Taxes	**1,384**	**1,630**	**1,496**	**1,756**	**8.1**	**17.4**
Custom Duties	241	281	255	299	5.8	17.3
Sales Tax	1,005	1,171	1,082	1,250	7.7	15.6
Federal Excise	138	178	159	206	15.2	29.8
Tax Revenue (Other than FBR)	**239**	**319**	**305**	**315**	**27.7**	**3.1**
Petrolium Development Levy	108	123	126	135	16.7	7.1
Gas Infrastructure Dev. Cess	88	145	145	145	64.8	0.0
Gas Development Surcharge	39	46	30	30	-23.1	0.0
Other Taxes (ICT + Airport tax)	4	5	4	5	5.0	9.5
Non-Tax Revenues	**1,083**	**816**	**1,042**	**895**	**-3.8**	**-14.2**
Income from Property and Enterprise	321	192	221	228	-31.2	3.0
SBP Profits	260	270	399	280	53.5	-29.8
Defence	119	140	204	154	72.1	-24.5
Others	383	214	218	233	-43.1	6.7

Source: Federal Budget in Brief 2015-16

However, growth in GIDC is difficult to digest due to a couple of reasons. First of all, GIDC is a tax on gas and revenues from various heads of gas like GDS and royalty declined by 23 and 12 percent respectively in 2014-15, how GIDC can grow massively. Second, there were legal issues in GIDC, therefore, the present government presented GIDC Bill 2015 in the National Assembly, which passed in 2015. It is difficult to understand how the federal government was able to meet full year targets in less than 6 months. In addition, there is a debate whether GIDC is a tax or non-tax/earmarked revenue. As per GIDC Act 2015, the receipt under GIDC is earmarked revenues for Iran-Pakistan gas pipeline project, Turkmenistan-Afghanistan-Pakistan-India (TAPI) pipeline project, and other infrastructural projects like construction of an LNG terminal and LPG supply enhancement project. The earmarked revenues should be kept separate and not be included in the federal consolidated fund instead the government is treating GIDC as tax revenues, which is against the ruling of Supreme Court.

In addition to taxes, non-tax revenues played an important role in achieving the target of Gross Revenue Receipts (GRR). In 2014-15, a target of Rs816 billion was set for non-tax revenues, while revised estimates show collection of more than trillion rupees. The State Bank of Pakistan's Profit and Defence receipts are the major contributors in over passing the non-tax revenues targets. However, there is an anomaly in SBP profit, which shows an amount of Rs399 billion in Table 5.1 of Explanatory Memorandum of Federal Receipts, while Table 11 of the same document shows an amount of Rs296 billion under revised estimates for 2014-15. The anomaly of Rs103 billion is simply a reflection of privatisation proceeds from HBL, which is not mentioned separately in any documents of the federal budget. This creative accounting has two advantages: (1) it reduces the budget deficit by Rs103 billion and (2) Section 16(2) of the Privatisation Commission Ordinance, 2000 said that "ten percent shall be used for poverty alleviation programmes" and "the remaining ninety percent for retirement of the Federal Government debt," showing privatisation proceeds under SBP profits allow the government to use this amount for financing of government expenditures.

UNDERESTIMATION OF CURRENT EXPENDITURES

The Budget 2015-16 shows a nominal growth of zero percent in the overall current expenditures. Given that the Budget 2015-16 has announced an increase of seven and half percent in the salaries and pensions, increase in both domestic and foreign debt, continuation of Operation Zarb-e-Azb and given that no cost cutting measures have been announced, this seems an underestimation in the current expenditures. We suspect this underestimation specifically in four areas namely salaries, pensions, debt servicing and subsidies.

Table 5.2
Federal Current Expenditure

Rs. in Billion

	2013-14	2014-15		2015-16	Growth Rate	
	Revised	Budget	Revised	Budget	RE14-RE15	RE15-BE16
FEDERAL CURRENT EXPENDITURE	**3,198.6**	**3,463.2**	**3,480.8**	**3,482.2**	**8.8**	**0.0**
General Public Services	2,364.9	2,543.3	2,530.4	2,446.6	7.0	-3.3
Defence Affairs and Services	629.8	700.1	720.0	781.2	14.3	8.5
Public Order and Safety Affairs	77.0	86.5	87.6	94.9	13.7	8.3
Economic Affairs	43.0	47.6	55.3	60.2	28.6	8.9
Health Affairs and Services	9.4	10.0	10.1	11.0	7.3	8.8
Education Affairs and Services	63.4	64.0	64.5	75.6	1.7	17.1
Other Current Expenditures	11.0	11.7	12.9	12.8	16.7	-0.9

Source: Federal Budget in Brief 2015-16

A look into civil and military pension – which are part of General Public Services – indicates a less than 4 percent growth in military pension while almost 9 percent growth in civil pensions. Given that the rate of increase in both pensions is the same, this difference either shows an estimation error or deliberate understatement of military pension.

Similarly, the nominal growth of over 2 percent in debt servicing (largely interest payment) in Budget 2015-16 against revised estimates of 2014-15 is an indication that the government has not incorporated the full year impact of previous debt as well as the impact of financing of budget deficit through domestic sources. It appears that the federal government is under-estimating the debt servicing obligations, particularly, domestic debt. While the decline in the interest rate provided some savings in 2014-15 in domestic debt servicing as revised estimates are lower than budget estimates, it is likely to increase due to the increase in stock of domestic debt.

The striking feature of the budget 2015-16 is a sharp reduction of more than 40 percent in subsidies. This was expected given that Pakistan is following an IMF stabilisation program and is under substantial pressure to cut current expenditures. It is important to analyse how much this cut can be exercised. Table 5.3 presents the subsidy levels proposed for 2015-16, and budget and revised estimates for 2014-15. It shows the government proposes to reduce subsidy to WAPDA/PEPCO from Rs185 billion to Rs98 billion, a decline of 47 percent. The other major decline occurs in subsidies to KESC/K-Electric. In the presence of large duration of load shedding hours and deaths of more than 1200 persons due to heat and electricity outages, this decline would likely increase per unit consumer price of electricity.

Table 5.3
Federal Current Expenditure

Rs. in Billion

	2013-14	2014-15		2015-16	Growth Rate (%)	
	Revised	Budget	Revised	Budget	RE14-RE15	RE15-BE16
SALARY AND PENSION						
Civil Government Salary	***148.4***	***175.0***	***175.9***	***193.9***	***18.6***	***10.2***
Superannuation Allowance & Pension	***187.7***	***215.0***	***220.0***	***231.0***	***17.2***	***5.0***
Pension Military	142.4	163.4	167.9	174.3	17.9	3.8
Pension Civil	45.3	51.6	52.1	56.7	15.1	8.9
Total Salary and Pension	**523.7**	**605.0**	**615.8**	**655.9**	**17.6**	**6.5**
DEBT SERVICING						
Interest on Foreign Debt	*78.5*	*100.6*	*100.5*	*111.2*	28.0	10.7
Repayment of Foreign Debt	*263.6*	*333.2*	*295.6*	*316.4*	12.1	7.0
Interest on Domestic Debt	*1,108.8*	*1,224.6*	*1,169.5*	*1,168.7*	5.5	-0.1
Total Debt Servicing	***1,450.9***	***1,658.4***	***1,565.6***	***1,596.3***	***7.9***	***2.0***
SUBSIDIES						
Subsidy to WAPDA/PEPCO	*245.0*	*156.1*	*185.0*	*98.0*	-24.5	-47.0
Subsidy to KESC	*64.3*	29	36	20	-44.0	-44.4
Subsidy to Others	13.7	18.1	22.2	19.6	62.4	-11.9
Total Subsidy	***323.0***	***203.2***	***243.2***	***137.6***	***-24.7***	***-43.4***

Source: Federal Budget in Brief 2015-16

UNPLEASANT BUDGETARY ARITHMETIC

According to the budget documents, revised estimates for 2014-15 indicate that in absolute terms the budget deficit was much lower compared to what was envisaged at the time of budget making. At the time of budget making, authorities estimated a budget deficit of Rs1.42 trillion, while as per revised estimates the overall budget deficit is likely to be Rs1.38 trillion in 2014-15, a decline of more than Rs39 billion. Pakistan's authorities believe that this positive deviation is the result of their stabilisation and austerity efforts. This sub-section reviews whether this deviation is an outcome of sound macroeconomic policies or creative accounting during the budget making exercise.

Conceptually, a budget deficit is simply the difference between total revenues and total expenditure. The former includes both tax and non-tax revenues and the latter includes both current and development expenditures. In reality, the computation of the budget deficit is slightly more complicated due to allocations made to repayment of foreign debt, different tiers of governments and lending to autonomous bodies.

Table 5.4
Computation of Overall Budget Deficit

(Rs in Billion)

	Heads	2014-15 Budget	2014-15 Revised	2015-16 Budget
REVENUE RECEIPTS				
	GROSS REVENUE RECEIPTS	**3,945.5**	**3,952.5**	**4,312.7**
Minus	*Transfer to Provinces*	*1,720.2*	*1,574.7*	*1,849.4*
Minus	*HBL Privatisation Proceeds*	*0.0*	*102.0*	*0.0*
Plus	Net Lending to Provinces and others	32.1	37.5	46.2
A	**NET REVENUE RECEIPTS & LENDING**	**2,257.4**	**2,313.2**	**2,509.6**
FEDERAL EXPENDITURE				
	Current Expenditures	3,463.2	3,480.8	3,482.2
Minus	*Repayment of Foreign Loans*	*333.2*	*295.6*	*316.4*
Plus	Federal Development Expenditures	838.5	754.3	969.0
B	**NET FEDERAL EXPENDITURE**	**3,968.6**	**3,939.5**	**4,134.9**
BUDGET SURPLUS(+)/DEFICIT (-)				
Federal (A-B)		***-1,711.1***	***-1,626.3***	***-1,625.3***
Provincial		**289.3**	**141.6**	**297.2**
Overall		***-1,421.8***	***-1,484.7***	***-1,328.1***
GDP (MP)		**29,078**	**27,384**	**30,672**
BUDGET DEFICIT (As % of GDP)				
Federal Budget Deficit		***-5.9***	***-5.9***	***-5.3***
Overall Budget Deficit		***-4.9***	***-5.4***	***-4.3***

Source: SPDC's Estimates based on Federal Budget in Brief 2015-16

Table 5.4 highlights that the net revenue receipts and lending – sum of both tax and non-tax revenues after excluding the provincial share in revenues and adding net lending – surpasses the budget estimates for 2014-15 by 6.9 percent as per revised estimates. Given sluggish economic activity and ongoing security challenges and threats, apparently, this increase is commendable. However, a scrutiny of various components of net revenue receipts indicates that it is not due to taxation efforts of the federal government. In fact, once again the federal government has failed to achieve its tax target for 2014-15 even after including Rs145 billion from GIDC. The increase in net revenue receipts is derived by tremendous growth in non-tax revenues. State Bank profit, which was revised upward from Rs270 billion to Rs399 billion is the largest contributor in this growth. SBP profit is largely the interest payment received from government on federal debt. Given that the interest rate is declining and the government retired

SBP debt, this increase is unexplainable. The only valid explanation is that proceeds from privatisation of HBL is shown under SBP profits. Conceptually, proceeds from privatisation should not be included in the gross/net revenue receipts. Therefore, we subtracted this amount from gross revenue receipts.

Despite the reservations expressed above on various heads of revenues and current expenditures assuming the statistics presented in the federal budget documents are correct except SBP profit, estimation shows a federal budget deficit of Rs1.7 trillion and Rs1.6 trillion as per budget and revised estimates of 2014-15 respectively, which is roughly 5.9 percent of the GDP.

In order to lower the overall budget deficit, the federal budget documents show provincial surpluses. In 2014-15, it was budgeted more than Rs289 billion and revised downward to Rs141 billion. As a result, overall budget deficit in 2014 -15 declines to Rs1.48 trillion from Rs1.63 trillion, which is 5.4 percent of the GDP and not 4.9 percent of the GDP. If the monetary impact of overestimation in revenues and underestimation in current expenditures of the federal government taken into account, the overall budget deficit is likely to cross 5.5 percent of GDP in 2014-15 and reach to 5 percent of GDP in 2015-16.

Based on these estimates, it can be inferred that the large deviation in budgeted and revised estimates of budget deficit pertains to systematic errors, which may have been made intentionally to show a lower deficit within the prescribed limits of IMF.

If such budgeting practices continue then it would further erode the credibility of the government among people, donor agencies and in the eyes of IMF. Moreover, it creates uncertainty in federal and provincial fiscal planning, which is a potential harbinger of negative implication for development.

6 UNDERSTATING TAX EXPENDITURE

Tax expenditure is the revenue foregone due to exemptions and concessions, which are deviations from a normal tax regime. They are also referred to as tax loopholes. Tax expenditures are either embodied in the tax laws or promulgated through SROs in Pakistan. They have the same impact on the budget deficit as higher expenditure and are named 'tax expenditure'. There is a strong perception that one of the major reasons for the low tax-to-GDP ratio in Pakistan is the high level of tax expenditure.

Every year Pakistan Economic Survey (PES) publishes the estimates of tax expenditures in the federal tax system. As per PES for the year 2014-15, the size of tax expenditure is around Rs665 billion, which accounts for 2.4 percent of the GDP. The tax-wise estimates show that tax expenditures in sales tax, customs and income tax are Rs478 billion, Rs103 billion and Rs84 billion respectively. These estimates suggest that tax expenditure in income tax is only 12.5 percent of total tax expenditures or 0.3 percent of GDP. In contrast to the general perception, this implies that the rich and powerful are not the major beneficiaries of tax exemptions and concessions in Pakistan. SPDC reviewed the various exemptions in direct taxes to analyse the extent of the veracity of government estimates of tax expenditure.

A look into categories of direct tax expenditure indicates both exclusion and understatement of a number of tax breaks to both corporate and personal income tax payers. For example, PES shows the tax expenditure on capital gains of only Rs2.5 billion. Under Section 37 of the Income Tax Ordinance (ITO) capital gains on property are taxable, if the property is disposed of within two years of purchase. In this way, the law only covers short-term capital gains. In India and some other countries, long-term capital gains, adjusted by inflation, are also subject to taxation. The absence of this provision in Pakistan implies a revenue loss annually of over Rs 25 billion.

Other tax benefits to personal tax payers not mentioned in PES include investment allowance, exemptions of income from some saving schemes and bonds, tax credit on provident fund contribution, etc.

For corporate tax payers, there are also a number of tax benefits which have not been included in the PES estimates. The first is accelerated depreciation allowance, with a revenue loss of Rs30 billion. Similarly, lower presumptive taxes on exporters of goods and services cost over Rs35 billion. In addition, there is a tax holiday (lifetime) to Independent Power Producers (IPPs), which costs more than Rs50 billion each year. Likewise, tax deduction on provisioning for bad debts by banks is costing Rs25 billion.

Interestingly, the pension of the executives of large corporations is also exempted from tax. While only Rs400,000 is exempted from the income of a common person, the exemption of pension of corporate executives is inconsistent with the law and should be treated as tax expenditure.

In addition, the personal benefits of the President, Prime Minister, Ministers, Supreme Court Judges, Chiefs of the Army, Navy and Air Force and Corp Commanders are also exempted in the second schedule of the income tax ordinance. Recently, the government monetized the perquisites and added a token tax of 5 percent on the additional income. Although, these tax expenditures are not in billions of rupees, they do give a wrong signal to society regarding equity in the tax system.

There is a negative impact of present trade regime on tax revenues as it contains both under-invoicing and transfer pricing. Through under-invoicing both custom duty and sales tax are evaded. On the other hand, those pharmaceuticals or chemicals used in pharmaceuticals, which have tax exemption or lower custom duty, contain transfer pricing, which increase their cost and under report corporate profits and thus evade taxes.

Finally, Pakistani citizens have property as well as other sources of income in foreign countries, which is called global income. Pakistan has double taxation treaties with many countries to avoid double taxation on global income. However, these global incomes are not subject to any tax whether Pakistan has double taxation treaty with the income generating countries or income tax rate in income generating country is less than the income tax in Pakistan. There are various estimates of global income circulating in Pakistan that range from $200 billion to $600 billion. If we apply a minimum tax of 5 percent on global income of $200 billion, it yields $10 billion or one trillion rupees.

Overall, estimate of the tax expenditure largely in direct taxes is close to Rs600 billion excluding tax expenditure on global income. This is equivalent to 2.2

percent of the GDP. As opposed to the estimates of the PES (12.5 percent), the major share of tax expenditure is in direct taxes of almost 53 percent.

The budget of 2015-16 hardly makes any attempt to eliminate or reduce the above mentioned tax breaks for the big corporate and rich individual taxpayers. In conclusion, the quantification of tax expenditure by PES grossly understates the exemptions and concessions in direct taxes to the richer segments of society. In fact, the major share of tax expenditure is in direct taxes both at the federal and provincial levels. If the tax-to-GDP is to be raised and the tax system made more equitable then many of the direct tax expenditures will have to be phased out.

7 THE TALE OF TAX-TO-GDP GROWTH

The revised estimates for 2014-15 show an increase in the tax-to-GDP ratio. While the Federal Board of Revenue (FBR) is a major contributor in tax revenues, contribution of taxes other than FBR has exceeded 10 percent of total federal tax revenues. The growth in tax revenue other than the FBR's is an outcome of inclusion of Gas Infrastructure Development Cess (GIDC), petroleum development levy and Gas Development Surcharge (GDS) in tax revenues. Previously both GIDC and GDS were part of non-tax revenues. Given that GDS, GIDC and Petroleum Development Levy have been gradually transferred from non-tax revenues to the tax revenues, Petroleum levy on LPG still being part of the non-tax revenues is enigmatic. In order to avoid impact of definitional changes on tax-to GDP ratio, the analysis in this section focuses only on FBR taxes.

It is important to discuss the overall and specific tax-to-GDP ratios of federal taxes collected by FBR. Table 7.1 reveals that there has been a lack of elasticity in the FBR's taxes during 2005-06 to 2014-15. On average, the tax-to-GDP ratios of income tax and sales tax have been hovering around 3.5 percent while that of excise and customs duties have either stagnant or fallen. A marginal increase of 0.3 and 0.5 percentage points in the tax-to-GDP ratio in 2013-14 and 2014-15 came as a bolt from the blue after a sharp decline of 0.7 percentage points in 2012-13. Hence, there is a need to understand these changes. The rest of analysis throws light on these changes by decomposing the tax-to-GDP ratio into its two key components – tax-to-base and base-to-GDP ratios.

Table 7.1
Tax-To-GDP Ratio (%), 2005-06 to 2014-15

Year	Direct Taxes	Excise Duties	Customs Duties	Sales Tax	Total Indirect Taxes	Total Taxes
2005-06	2.7	0.7	1.7	3.6	5.9	8.7
2006-07	3.6	0.8	1.4	3.3	5.6	9.2
2007-08	3.6	0.9	1.4	3.5	5.8	9.5
2008-09	3.4	0.9	1.1	3.4	5.4	8.8
2009-10	3.5	0.8	1.1	3.5	5.4	8.9
2010-11	3.3	0.8	1.0	3.5	5.2	8.5
2011-12	3.7	0.6	1.1	4.0	5.7	9.4
2012-13	3.3	0.5	1.1	3.8	5.4	8.7
2013-14	3.5	0.6	1.0	4.0	5.5	9.0
2014-15RE	4.0	0.6	0.9	4.0	5.5	9.5

Source: Estimates Based on Taxes Data from FBR Bi-annual reports and GDP data from Economic Survey 2014-15.
RE=Based on Revised Estimates from Federal Budget in Brief 2015-16

DIRECT TAXES

Years	Tax-to-GDP Ratio	Tax Base-to-GDP Ratio	Effective Tax Rate
2005-06	2.7	72.3	3.8
2006-07	3.6	72.7	5.0
2007-08	3.6	74.8	4.9
2008-09	3.4	72.3	4.6
2009-10	3.5	72.6	4.9
2010-11	3.3	71.4	4.6
2011-12	3.7	72.9	5.1
2012-13	3.3	72.2	4.6
2013-14	3.5	71.5	4.9
2014-15RE	4.0	70.3	5.8

Table 7.2
Buoyancy of Direct Taxes: 2005-06 to 2014-15
(%)

Source: Estimates Based on Taxes Data from FBR Bi-annual reports and GDP data from Economic Survey 2014-15.
RE= Based on Revised Estimates from Federal Budget in Brief 2015-16

Using non-agricultural GDP as the tax base, we have decomposed the buoyancy of direct taxes into its components (Table 7.2). The initial rise in the tax-to-GDP ratio is a combined consequence of both a rise in tax-to-tax base and effective tax rate. The decline in tax-to-GDP ratio of direct taxes in 2012-13 is a combined consequence of both a decline in effective tax rate and base-to GDP ratios. However, in both 2013-14 and 2014-15 direct tax to GDP ratio marginally increased by 0.2 and 0.5 percentage points of GDP respectively. In both years, while tax-base-to-GDP ratio has declined, effective tax rate has increased. Therefore, it can be gauged that increase in effective tax rate dominates the decrease in tax base to GDP ratio which has finally resulted in an overall increase in tax-GPD ratio.

What explains the increase in the effective rate of direct taxes in 2013-14 and 2014-15? The answer is fairly apparent in the movement of statutory rates and withdrawing exemptions. In 2013-14, income tax rates for both salaried and non-salaried were revised. In 2014-15 as per estimates of FBR Rs144 Billion new tax measures were introduced. For instance, an advance tax was introduced on purchase of immovable property and high end domestic electricity bills and increase in advance tax rate on purchase/registration of new private vehicles. Moreover, new withholding taxes were introduced in both years (Minimum Tax on builders and developers, and withholding tax on cable operators and other electronic media and the like) and tax rates of few existing withholding taxes including withholding tax on cash withdrawals were revised upwards.

EXCISE DUTY

The tax base of excise duty consists primarily of value added in large-scale manufacturing. Major revenue contributors include petroleum products, cigarettes, sugar, cement, etc. In the early nineties, the tax net of excise duty was extended to cover services like banking, telephones, electricity and professional services. Consequently, the tax base for excise duty has been extended to include value added in finance and insurance, and transport and communications.

The tax base for excise duties is not very large and has been declined by more than 4.4 percentage points since 2008-09 and unchanged in 2014-15 as shown in Table 7.3. However, the sluggish growth in revenues, particularly in 2012-13 is mainly explained by the declining effective tax rate compared to 2011-12. In 2013-14 and 2014-15 the effective tax rate marginally increased by 0.1 percentage point. However, the stagnation in tax-to-GDP ratio of excise duty is essentially a reflection of incomplete adjustment of the tax rates to inflation, as the duty continues to be levied at specific rates on certain items; secondly, this is also a result of gradual replacement of excise duties by sales tax and transfer to sales tax on services to provinces after the 7th NFC Award. In essence, the marginal increase in the effective tax rate is an outcome of the increase in the statutory rate of excise duty on cigarettes.

Table 7.3
Buoyancy of Excise Duty: 2005-06 to 2014-15
(%)

Years	Tax-to-GDP Ratio	Tax Base-to-GDP Ratio	Effective Tax Rate
2005-06	0.7	26.1	2.6
2006-07	0.8	26.7	2.9
2007-08	0.9	26.6	3.3
2008-09	0.9	27.3	3.3
2009-10	0.8	26.6	3.2
2010-11	0.8	25.2	3.0
2011-12	0.6	24.1	2.5
2012-13	0.5	23.9	2.3
2013-14	0.6	23.3	2.4
2014-15RE	0.6	23.3	2.5

Source: Estimates Based on Taxes Data from FBR Bi-annual reports and GDP data from Economic Survey 2014-15.
RE= Based on Revised Estimates from Federal Budget in Brief 2015-16

CUSTOMS DUTY

The tax base for customs duty is the value of dutiable imports which is the total value of imports minus the value of exempt items like food, fertiliser and pharmaceuticals. Since 2010-11 tax-base-to-GDP ratio is hovering around 11 percent; however, the decline from 14 percent to 11 percent during 2005-2006 to 2010-11 is noteworthy (Table 7.4). The relatively higher tax to GDP ratio during 2005-06 to 2007-08 reflects

Table 7.4
Buoyancy of Customs Duty: 2005-06 to 2014-15
(%)

Years	Tax-to-GDP Ratio	Tax Base-to-GDP Ratio	Effective Tax Rate
2005-06	1.7	14.0	12.1
2006-07	1.4	13.7	10.5
2007-08	1.4	14.3	9.9
2008-09	1.1	12.7	8.9
2009-10	1.1	11.8	9.1
2010-11	1.0	11.1	9.1
2011-12	1.1	11.0	9.8
2012-13	1.1	11.2	9.5
2013-14	1.0	10.7	9.0
2014-15RE	0.9	10.8	8.6

Source: Estimates Based on Taxes Data from FBR Bi-annual reports and GDP data from Economic Survey 2014-15.
RE= Based on Revised Estimates from Federal Budget in Brief 2015-16

the higher demand for imports of consumer durables like automobiles, electronic home appliances and capital goods. This was the result of boom in the economy and greater buoyancy in the manufacturing sector during that period.

Since 2012-13, tax-to-GDP ratio shows a continuous decline of 0.1 percentage point in each year. This decline is partly explained by the initial decline in tax-base-to-GDP ratio and mainly by the decline in the effective tax rate, which gradually declined to 8.6 percent in 2014-15 from 9.8 percent in 2011-12. While the base effect is positive in 2014-15, it declined in tax rate that caused a reduction of 0.1 percentage points in tax-to-GDP ratio. The decline in effective tax rate is primarily a consequence of the cascading down of import tariffs in an effort to liberalise trade in the country.

SALES TAX

Sales tax is levied at two stages in Pakistan – import and domestic production. During the nineties, it acquired the characteristics of a value added tax. Therefore, the tax base for the tax is the value of dutiable imports plus revenue from import duty plus value added in large-scale manufacturing. In recent years, there has been a major broad basing of the tax, which has increasingly been substituted for customs duty, excise duty and the petroleum development surcharge. The size of the tax base has, therefore, been accordingly extended.

Table 7.5
Buoyancy of Sales Tax: 2005-06 to 2014-15
(%)

Years	Tax-to-GDP Ratio	Tax Base-to-GDP Ratio	Effective Tax Rate
2005-06	3.6	32.9	10.9
2006-07	3.3	32.3	10.4
2007-08	3.5	36.7	9.7
2008-09	3.4	31.3	10.9
2009-10	3.5	31.0	11.2
2010-11	3.5	31.8	10.9
2011-12	4.0	32.9	12.2
2012-13	3.8	31.7	11.9
2013-14	4.0	30.5	13.1
2014-15RE	4.0	27.1	14.6

Source: Estimates Based on Taxes Data from FBR Bi-annual reports and GDP data from Economic Survey 2014-15.
RE= Based on Revised Estimates from Federal Budget in Brief 2015-16

Table 7.5 shows that the tax base-to-GDP ratio varies from year to year. The tax-to-GDP ratio has hovering around was 4 percent, since 2011-12 and stagnant during 2014-15. Since 2011-12, tax-base-to GDP ratio has been consistently declining and reached 27 percent in 2014-15. Consequently, in 2012-13, 2013-14 and 2014-15 base effect is negative. This decline is mainly caused by decline in international prices and sluggish growth in large scale manufacturing. Even in 2014-15, the growth in large scale manufacturing at current prices is negative. On the other hand, effective tax rate is increased from 11.9 percent in 2012-13 to gradually 14.6 percent in 2014-15. In 2013-14, effective tax rate increase due to increase in statutory rate from 16 percent to 17 percent. In 2014-15, increase in effective tax rate is due to increase in rate on POL products from 17 percent to gradually 32 percent and sales tax on retailer based on electricity bills. Despite, increase in effective tax rate, the tax-to-GDP ratio was unchanged due to negative base effect.

WHAT CAN EXPLAIN THE CHANGE IN TAX-TO-GDP RATIO?

The result of decomposition for 2005-06 to 2011-12 and afterward for each year indicates that during 2005-06 to 2012-12, there was an increase in the tax-to-GDP ratio of more 0.7 percentage points (Table 7.6). Although there is a negative base effect of 0.28 percentage points, the rate effect shows an improvement of roughly 1 percentage point, which contributed to increasing the tax-to GDP ratio. Similarly, in 2012-13, 2013-14 and 2014-15 base effect is negative and rate effect is positive except 2012-13, whereas rate effect is also negative. The positive rate effect is a reflection of the increase in statutory rates in both 2013-4 and 2014-15. Precisely, this analysis clearly indicates that the resource mobilisation strategy of the present government hinges on the increase in statutory tax rates of sales tax, excise duty, and income tax, while the statutory rate of custom duty declined. Given that economic growth is not picking up, increasing the tax rate is the wrong strategy and if it continues it is likely to further squeeze the tax bases.

Table 7.6
Decomposition of the Changes in Tax-To-GDP Ratio
(% of GDP)

Tax	FY06 to FY12	2012-13	2013-14	2014-15 RE
Base Effect				
Direct Taxes	0.021	-0.033	-0.034	-0.059
Excise Duty	-0.064	-0.006	-0.014	0.000
Customs Duty	-0.282	0.022	-0.049	0.010
Sales Tax	0.046	-0.102	-0.142	-0.441
Total Taxes	**-0.279**	**-0.119**	**-0.239**	**-0.491**
Rate Effect				
Direct Taxes	0.925	-0.329	0.239	0.582
Excise Duty	0.002	-0.064	0.028	0.026
Customs Duty	-0.321	-0.034	-0.059	-0.040
Sales Tax	0.381	-0.102	0.375	0.395
Total Taxes	**0.987**	**-0.529**	**0.583**	**0.964**
Change in Tax-to-GDP Ratio				
Direct Taxes	0.945	-0.362	0.205	0.523
Excise Duty	-0.062	-0.070	0.014	0.026
Customs Duty	-0.602	-0.012	-0.109	-0.030
Sales Tax	0.427	-0.203	0.233	-0.046
Total Taxes	**0.708**	**-0.647**	**0.343**	**0.472**

Source: Estimates Based on Taxes Data from FBR Bi-annual reports and GDP data from Economic Survey 2014-15.

RE= Based on Revised Estimates from Federal Budget in Brief 2015-16

The increase in the tax rate of sales tax has a regressive impact as it disproportionately affects the poor, discourages domestic production and increases smuggling. No wonder high statutory rate of sales tax on POL products increases incentive to smuggle Iranian petrol, which is openly available in Karachi. On the other hand, the positive rate effect of direct taxes is an outcome of over reliance on withholding taxes along with the cumbersome process of registration and rebate. There is a need that the government should shift the focus of resource mobilisation strategy towards broadening the tax base, which has other benefits including job creation.

8 DEVELOPMENT PRIORITIES OF THE FEDERAL GOVERNMENT

The Public Sector Development Programme (PSDP) of 2015-16 clearly manifests the development priorities of the federal government where physical infrastructure, particularly road transport, continues to be the main development concern. The size of the PSDP is planned to be Rs 700 billion reflecting a sizable increase of 29 percent over last year's revised budget of Rs 542 billion. However, the actual releases for 2014-15 on June 6, 2015 stand at Rs 426 billion suggesting that Rs 116 or 21 percent of the total PSDP has to be spent in just three weeks if no cuts are to be made in the revised outlay.

As shown in Table 8.1, 58 percent of total development allocation has been devoted to physical infrastructure where transport and communication attracted a large chunk of Rs 220 billion – a 39 percent increase from the previous fiscal year. A major proportion of this sector is provided for the National Highway Authority (NHA). Allocations of Rs 160 billion to the NHA also include Rs 58 billion for projects related to the China-Pakistan Economic Corridor (CPEC). The power sector has also received a significant increase of 31 percent with an allocated amount of Rs 143 billion. The other sector to benefit from enhanced allocations is 'special programmes'. The total amount of Rs 168 billion allocated for these programmes also includes Rs 100 billion for Temporarily Dislocated Persons (TDPs). However, even by excluding allocation for TDPs, the provision for special programmes has been more than doubled – from Rs 30 to Rs 68 billion. These programmes include MDGs and Community Development Programme, Special Federal Development Programme and Prime Minister's Youth Programme. In this way, a significant proportion of the PSDP has been made subject to the discretion of Prime Minister/federal government and no details of development schemes under this category are provided. Altogether, about 30 percent of the PSDP remains unexplained if allocations to both special areas and special programmes are taken into account.

The axe has fallen on water and social sectors where allocations have shrunk by over 30 percent. The amount provided for conservation and augmentation of water resources has declined from Rs 46 billion in 2014-15 to Rs 31 billion in 2015-16. Similarly, allocations to social sectors, which mainly include education and health, decreased from Rs 81 billion to Rs 61 billion.

Table 8.1
Analysis of Federal Public Sector Development Programme

(Rs in Billion)

	2014-15	2015-16	Increase (%)	Share (%) 2015-16
Allocations by Sector				
Infrastructure	323	406	25.8	58
Power	109	143	31.2	20
Transport and Communication	158	220	39.1	31
Water	46	31	-33.5	4
Social Sector	88	61	-30.9	9
Special Areas (AJ&K, GB, FATA)	38	39	1.8	6
Special Programmes	30	168	460.0	24
Others	63	26	-58.3	4
Total	542	700	29.2	100
Allocations by Agency				
Ministries	304	253	-16.7	36.2
Corporations (NHA, WAPDA)	159	272	71.3	38.8
Special Programmes	80	175	120.1	25.0

Sources: PSDP 2015-16; Annual Plan 2015-16

There is an interesting shift in terms of the execution of development schemes. The amount allocated to ministries has declined from Rs 304 billion to Rs 253 billion. In this way, the share of ministries in total PSDP has gone down from 58 percent in 2014-15 to only 36 percent in 2015-16. On the other hand, the shares of corporations (WAPDA and NHA) and special programmes have increased to 39 percent and 25 percent respectively.

Nonetheless, it is heartening to observe that the government has shown its commitment toward CPEC-related projects, which altogether received an allocation of Rs 80 million in the PSDP 2015-16. The total cost of the CPEC development scheme included in the current PSDP is Rs 423 billion (including foreign loans of Rs 69 billion). These include 11 ongoing and 20 new schemes. Sector-wise breakdown of CPEC allocations in 2015-16 indicates that Rs 58 billion and Rs 11 billion have been provided for Transport & Communication and Ports and Shipping respectively. Rs 5 billion have been allocated to the Power sector while the rest is provided for Aviation and Railways. Overall, projects of western alignment are being financed on a priority basis.

Given the current situation of the energy crisis and its implications for economic development, the importance of the power sector cannot be overemphasised.

Development allocations to the power sector have increased from Rs 109 billion to Rs 142 billion. This includes Rs 112 billion for the Water and Power Development Authority (WAPDA) and Rs 30 billion for the Pakistan Atomic Energy Commission (PAEC). In addition to PSDP funds, self-financing schemes of WAPDA, the National Transmission & Despatch Company (NTDC) and Pakistan Electric Power Company (PEPCO) amount to Rs 175 billion. In this way, altogether planned investment in the power sector would be Rs 317 billion. Within the PSDP budget of WAPDA, thermal power has been given more priority with a share of 47 percent while 24 percent is allocated for hydel power and the rest for system enhancement and transmission, etc.

The power sector has also attracted a large chunk of foreign aid. Out of Rs 146 billion of foreign aid in the PSDP 2015-16, almost half (Rs 72 billion) is planned to be invested in the power sector. However, despite heavy investment, no major hydel power project seems likely to be completed in the next couple of years or so, which implies that increased allocations are less likely to make a significant contribution in tackling the existing energy crisis, at least in the short run. Keeping aside public investment for a moment, the level of private sector investment in the power sector is quite depressing. The Pakistan Economic Survey 2014-15 shows that private investment in electricity generation distribution (combined with gas distribution) has almost collapsed. The level of gross fixed capital formation in the sector remained at Rs 11 billion as compared to Rs 23 billion in 2013-14 (at current market prices). It is, therefore, imperative for the government to focus on developing an integrated energy policy to break the chain of living from one crisis to another.

The resource allocation strategy given in the Annual Plan 2015-16 states that ongoing projects were protected for an early completion to avoid further cost and time overruns. However, the state of affairs that emerges from an analysis of allocations to ongoing and new schemes is not that encouraging. Out of total Rs 700 billion, the allocable amount is about Rs 496 billion for which scheme-wise details are provided in the PSDP document. Analysis of these schemes reveals that 47 percent of the total allocable PSDP is devoted to new schemes. For example, in NHA's budget, only Rs 22 billion have been allocated for ongoing schemes while Rs 137 have been provided for new schemes. If CPEC projects are excluded, development allocations for NHA become Rs 15 billion for ongoing and Rs 87 billion for new schemes. In this way, excluding CPEC, new schemes with the estimated cost of Rs 727 billion have been introduced for NHA in the presence of a large number of ongoing schemes.

Over the years, the practice of introducing new schemes at the cost of completing ongoing schemes has resulted in a very large size of the PSDP portfolio in relation to the available resources. According to the Annual Plan, a total of 936 projects and programmes, costing Rs 5.3 trillion, will be financed under the PSDP during 2015-16 with an estimated expenditure of Rs 1.5 trillion up to June 30, 2015. This leaves a throw-forward of Rs 3.9 trillion. By adding Rs 1.7 trillion of the cost of new projects introduced in PSDP 2015-16, the total portfolio becomes Rs 5.6 trillion. Therefore, if no new scheme is added, it will take around 11 years for completion of these development projects given the current level of resource allocation. In addition, a number of projects relating to the power sector are being self-financed by the WAPDA, PEPCO and NTDC, having a total portfolio of about Rs 2.5 trillion.

What is more disturbing is that more than 190 new projects for financing have been included in the PSDP that currently have 'unapproved status'. This is a serious violation of the procedure for appraisal and approval of projects. The total allocation for these unapproved schemes is Rs 84 billion, which accounts for 36 percent of the total allocations to new schemes. It is important to note that the amount of Rs 84 billion does not include allocations to vertical programmes in the health sector, which understandably have remained unapproved due to the delay in the new NFC award since these programmes were to be transferred to the provinces in 2015-16 as per the decision of Council of Common Interests (CCI) on April 28, 2011.

Almost half of the unapproved allocations are made in three sectors: NHA, Water and Railways. In the development budget of NHA, a portfolio of 29 new schemes has been included which contains 23 unapproved schemes. Similarly, in Water and Railways respectively, 14 out of 16 and 11 out of 19 new schemes are classified as unapproved schemes.

Overall, the PSDP of 2015-16 reflects a greater focus on development of physical infrastructure. There are no two opinions about the importance of investing in power and communication sectors since they will contribute to achieving the long-term objective of economic growth. However, this should not be attempted at the cost of investing in social sectors such as higher education, health and conservation and augmentation of water resources. Moreover, the practice of ad hoc inclusion of a large number of projects needs to be done away with and due process of appraisal and approval should be adopted.

Social Policy and Development Centre
15-Maqbool Co-operative Housing Society
Block 7 & 8, Karachi 75350, Pakistan
Tel: (92-21) 111-113-113
Fax: (92-21) 3453-4285
E-mail: spdc@spdc.org.pk

www.spdc.org.pk