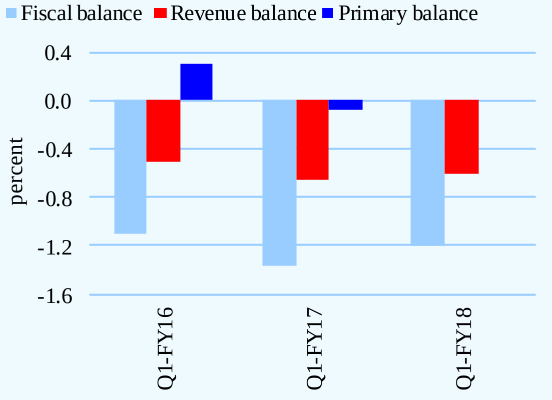
# 4 Fiscal Policy and Public Debt

## 4.1 Overview

A sharp rebound in tax collection helped in containing fiscal deficit in the first quarter of FY18. The fiscal deficit was recorded at 1.2 percent of GDP in Q1-FY18, lower than 1.4 percent in FY17 (**Figure 4.1**). The primary balance, which excludes interest payments, improved from a deficit of 0.1 percent in Q1-FY17 to a marginal surplus in Q1-FY18. The revenue balance, the gap between total revenue and current expenditure, also shrank to 0.6 percent of the GDP in Q1-FY18 from 0.7 percent realized in Q1-FY17. The improvement in primary balance indicates government's capacity to manage its debt, while lower revenue balance shows the government's ability to finance its operational expenses. The latter also reflects that growth in revenue collection outpaced the growth in current expenditures.

**Figure 4.1: Fiscal Balance Indicators (percent of GDP)**




Data Source: Ministry of Finance

The revenue collection grew by 18.9 percent during Q1-FY18, against a decline of 8.0 percent last year (**Table 4.1**). This recovery in revenue collection was spearheaded by 22.0 percent increase in FBR tax collection. The growth in FBR tax collection in Q1-FY18 was not only the highest during the last five years, but was also broad-based. Both the direct and indirect tax collection recorded over 20 percent rise. This rebound in tax collection allowed FBR to double the amount of refunds to Rs 51.4 billion during Q1-FY18, compared to only Rs 25.9 billion in the corresponding period of last year.

Though growth in expenditure was slower than that of revenue collection, it was significantly higher than that of last year. Not surprisingly, current expenditures grew much sharply on account of higher spending on defence, maintaining public order and safety, interest payments, environment protection, etc. The experience of previous election years shows that current expenditures typically jump in the election year (**Figure 4.2**). The development expenditure, on the other hand, gains some momentum in pre and post election years. This year, however, development expenditure is expected to grow further from FY17, given the budgetary target set for FY18. The Q1-FY18 data shows trends in development expenditure strengthened further, growing by 15.6 percent on top of 12.4 percent growth registered in the same period of FY17.

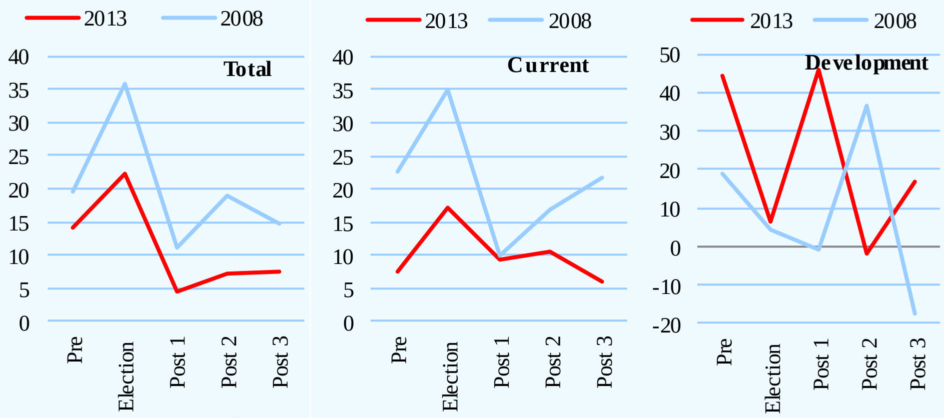
**Table 4.1: Summary of Fiscal Operations**
billion rupees

| | | Actual | | % of GDP | |
|---|---|---|---|---|---|
| | **Budget FY18** | **Q1-FY17** | **Q1-FY18** | **Q1-FY17** | **Q1-FY18** |
| A. Total revenue | 6,167.2 | 862.2 | 1,025.0 | 2.7 | 2.9 |
| Tax revenue | 4,912.5 | 750.7 | 911.0 | 2.4 | 2.5 |
| Non-tax revenue | 1,254.7 | 111.6 | 113.7 | 0.4 | 0.3 |
| B. Total expenditure | 7,646.8 | 1,300.1 | 1,465.9 | 4.1 | 4.1 |
| Current | 5,393.9 | 1,070.7 | 1,240.5 | 3.4 | 3.5 |
| *Interest Payments* | *1,363.0* | *414.3* | *445.4* | 1.3 | 1.2 |
| Development | 2,265.2 | 191.1 | 220.5 | 0.6 | 0.6 |
| Net lending | -12.3 | -0.3 | 0.9 | 0.0 | 0.0 |
| C. Statistical discrepancy | 0.0 | 38.6 | 4.0 | 0.1 | 0.0 |
| Fiscal balance (A-B-C) | -1,479.6 | -437.9 | -440.9 | -1.4 | -1.2 |
| Revenue balance | 773.3 | -208.5 | -215.5 | -0.7 | -0.6 |
| Primary balance | -116.6 | -23.6 | 4.4 | -0.1 | 0.0 |
| *Financing* | 1,479.5 | 437.9 | 440.8 | 1.4 | 1.2 |
| External sources | 511.4 | 68.8 | 7.9 | 0.2 | 0.0 |
| Domestic sources | 968.1 | 369.1 | 432.9 | 1.2 | 1.2 |
| Banks | 390.1 | 299.7 | 408.0 | 0.9 | 1.1 |
| Non-bank | 528.0 | 69.3 | 24.5 | 0.2 | 0.1 |
| Privatization | 50.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| ***Growth*** | | | | | |
| Total Revenue | | -8.0 | 18.9 | | |
| Tax revenue | | 3.8 | 21.4 | | |
| Non-tax revenue | | -47.7 | 1.9 | | |
| Total expenditure | | 2.8 | 12.8 | | |
| Current | | -1.3 | 15.9 | | |
| Development | | 12.4 | 15.4 | | |

Data source: Ministry of Finance

For financing of the fiscal deficit, the government relied heavily on bank borrowing, which financed about 93 percent of the fiscal deficit in Q1-FY18. There was also a stark contrast in bank borrowing that was evenly distributed between SBP and scheduled banks in Q1-FY18. The situation was different last year when the government borrowed from SBP not only to finance the fiscal deficit, but also to retire its borrowing from the scheduled banks. The non-bank financing declined to Rs 24.5 billion in Q1-FY18, while the same was Rs 69.3 billion in Q1-FY17. Similarly, external finance was only Rs 7.9 billion, against Rs 68.8 billion in Q1-FY17.

**Figure 4.2: Impact of Election on Fiscal Expenditure Growth (in percent)**




Data Source: Ministry of Finance

Accordingly, the debt accumulation in Q1-FY17 was mostly due to an increase in domestic debt, while external debt also increased notwithstanding the decline in external finance. This increase in external debt was also due to appreciation of international currencies against US Dollar.

## 4.2 Revenues

The consolidated revenue collection rebounded sharply with 18.9 percent growth in Q1-FY18 against a decline of 8.0 percent in the corresponding period of the last year. This rebound was mainly led by a sharp recovery in tax revenues, boosted by enhanced focus on withholding and trade related taxes and rationalization of tax incentives/concessions that had affected revenue collection in the last year.[1] The non-tax revenues also posted a modest recovery.

### *FBR taxes*

The tax collection in Q1-FY18 was mainly boosted by 22.0 percent increase in FBR tax collection, which constitutes around 84 percent of the total (federal and

[1] In order to retrieve revenue performance FBR rationalized some of the tax incentives such as: (i) sales tax on retail sales of five export oriented sectors was increased from 5 percent to 6 Percent; (ii) import of commercial fabrics was subjected to 6 percent sales tax from previous zero rated status; (iii) a concessionary duty on hybrid electric vehicles above 2500 cc was withdrawn; and (iv) a 3 percent tax credit to manufacturers making sales to registered sales persons was also withdrawn.

provincial) tax collection, compared to a growth of 6.3 percent during the same period last year (**Table 4.2**). This sharp increase in FBR tax collection was also broad-based with over 20 percent increase in both direct and indirect taxes. The robust growth enabled the FBR to settle even higher refunds, which almost doubled to Rs 51.4 billion during Q1-FY18, compared to only Rs 26 billion in the corresponding period of last year.

**Table 4.2: FBR Tax Collection**
billion rupees

| | billion rupees | | | percent growth | |
|---|---|---|---|---|---|
| | **Budget FY18** | **Q1-FY17** | **Q1-FY18** | **Q1-FY17** | **Q1-FY18** |
| Direct taxes | 1594.9 | 233.7 | 282.9 | -2.5 | 21.0 |
| Indirect taxes | 2418.1 | 393.4 | 482.1 | 12.2 | 22.5 |
| Customs duty | 581.4 | 100.9 | 128.9 | 26.7 | 27.8 |
| Sales tax | 1605.2 | 261.5 | 314.4 | 7.4 | 20.2 |
| FED | 231.5 | 31.1 | 38.8 | 13.0 | 25.0 |
| Total taxes | **4013.0** | **627.1** | **765.0** | **6.3** | **22.0** |

Data source: Federal Board of Revenue

Within direct taxes, voluntary payments (VP) having a share of 22 percent, grew by 16.9 percent. This increase is noteworthy despite reduction in corporate income tax rate from 31 percent to 30 percent and a decline in bank profitability, which was lower by 36.6 percent, during FY18.[2] It suggests that corporate profitability, other than banking sector, might have improved considerably during Q1-FY18. Collection on demand (CoD) grew by around 40 percent, largely reflecting results of risk based audit introduced during FY17 (**Table 4.3**).[3]

**Table 4.3: Break-up of Direct Taxes**
billion rupees

| | billion rupees | | |
|---|---|---|---|
| | **Q1-FY17** | **Q1-FY18** | **Growth (%)** |
| **I. Collection on demand** | **8.2** | **11.4** | **39.4** |
| **II. Voluntary payments** | **56.7** | **66.3** | **16.9** |
| **III. Withholding taxes** | **190.3** | **224.6** | **18.0** |
| Imports and exports | 49.9 | 57.3 | 14.8 |
| Contracts | 45.4 | 57.0 | 25.7 |
| Salary | 20.8 | 26.7 | 28.5 |
| Interest & securities | 10.8 | 9.8 | -9.1 |
| Cash withdrawal | 6.8 | 7.1 | 5.6 |
| Dividends | 6.4 | 9.8 | 53.9 |
| Electric bills | 5.4 | 5.9 | 9.4 |
| Telephone | 12.2 | 12.1 | -1.0 |
| Others | 32.7 | 36.5 | 11.8 |
| **Gross (I+II+III)** | **255.1** | **300.0** | **17.6** |
| Refund | 19.1 | 19.9 | 4.5 |
| **Total direct taxes** | **233.7** | **282.9** | **21.0** |

*: Break-up is based on provisional data; numbers may not tally with Table 4.2.
Data source: Federal Board of Revenue

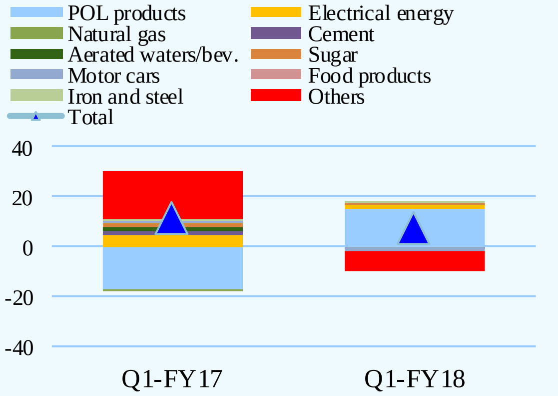
[2] The banking sector profits were down from Rs 71 billion in Q1-FY17 to Rs 45 billion in Q1-FY18. This was largely due to one-off settlement payment made by a large bank to a foreign regulator.
[3] FBR has introduced Risk based audit through its revised audit policy available at the following link: http://download1.fbr.gov.pk/Docs/201713151156763TaxpayersAuditPolicy2016.pdf

Withholding taxes (WHTs), having 74 percent share in direct taxes, grew by 18.0 percent during Q1-FY18. This growth was largely contributed by 25.0 percent increase in collection from contracts, which reflects increased pace of development projects and their onward delegation to private contractors.[4] Second major push to WHT came from 14.8 percent increase in collection from external trade, primarily on the back of surge in imports by 25.0 percent during Q1-FY18. Moreover, owing to upward revision in tax rate from 12.5 percent to 15 percent in FY18 budget, collection from dividend income increased by 25.7 percent in Q1-FY18.

It is worth highlighting here that the efforts to enhance tax base through increase in documentation and expansion in the scope of differential taxation did have an impact on raising tax revenue. These efforts can be complemented by utilizing behavioral insights to encourage voluntary income tax return filing and thus tax payments. In this regard, Pakistan can learn from recent experiences of advanced and emerging economies (**Special Section 3**).

As mentioned earlier, the indirect taxes also recovered sharply, growing by 22.5 percent in Q1-FY18 compared to 3.6 percent increase in the same period last year. All the three components of indirect taxes – sales tax, custom duty, and FED – have contributed to this remarkable growth in indirect taxes. Specifically, sales tax, with a share of 74 percent in indirect taxes and 41 percent in overall FBR taxes, recorded a strong growth on the back of pass through of higher oil prices in the international market to domestic prices.

**Figure 4.3: Contribution to Growth in Domestic Sales Tax Collection**

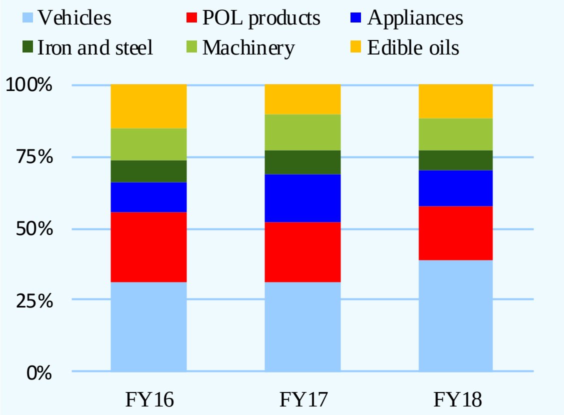



Data Source: Federal Board of Revenue

[4] The on-going momentum of CPEC and infrastructure related projects also explain this trend.

Sales tax from POL items grew by 43.6 percent with significant contribution at both import and domestic stage amid ad-valorem tax structure (**Figure 4.3**).[5,6] POL remained a dominant source of sales tax collection in Q1-FY18 with a share of around 36 percent in overall sales tax revenues. Electric energy was the other major contributor to domestic sales tax collection, both due to better availability of energy supply and higher revenues from iron and steel sector, which is liable to pay sales tax on the basis of electricity it consumes.[7]

**Figure 4.4: Custom Duty Collection during Q1**




Data Source: Federal Board of Revenue

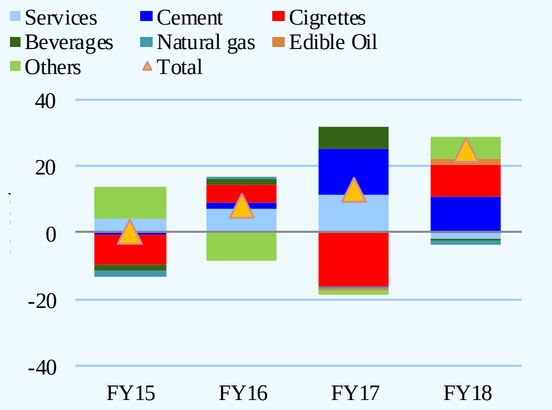
Likewise, customs duty collection witnessed a sharp increase of 27.8 percent during Q1-FY18, on top of 26.7 percent increase observed in the same period of last year. This can be attributed to a continued surge in import of capital and consumer goods in view of the ongoing work on power and infrastructure projects and rising income levels in an expanding economy. In addition, increase in regulatory duties on import of a range of non-essential items in the Finance Act 2017-18 also contributed to higher custom duty collection (**Figure 4.4**).[8,9]

In particular, collection of duty from vehicles, which constitutes around 54 percent of total custom duty collection, surged by 57.7 percent both due to higher import as well as revision in duty structure on import of vehicles.[10] Moreover, in October 2017, the government further increased regulatory duties on non-essential items

[5] Ad-valorem tax is based on the given value of a commodity; thus, a higher value means higher tax collection.
[6] In FY17, increase in international petroleum prices were mostly absorbed to keep domestic prices stable and to provide relief to agriculture and exporting industries.
[7] For FY18 the sales tax rate for iron and steel was revised upward to Rs 10.5 of electricity consumed from previously applicable rate of Rs 9 per unit.
[8] The value of imports has grown by 25 percent during Q1-FY18.
[9] Effective 1st July 2017, a regulatory duty levied /increased in the range of 5-15 percent on 565 non-essential items through Finance bill FY18.
[10] In addition to imposition of regulatory duty on the import of luxury vehicles, the concessional duty on the import of hybrid vehicles above 2500 cc was also withdrawn in budget FY18.

with a dual objective to protect local industry and to correct the external sector imbalance.[11] It is expected that the initiative may somewhat discourage imports of non-essential items and may generate additional revenues.[12]

**Figure 4.5: Contribution to the Growth of FED during Q1**




Data Source: Federal Board of Revenue

Higher FED collection benefited from ongoing infrastructure products and rise in domestic consumption for durables. Particularly, FED collection from cement sector, which constitutes around one fourth of total FED collection, surged amid high demand from construction and work on power and infrastructure projects under CPEC. Upward revision in duty on cement provided an additional impetus (**Figure 4.5**).[13] Moreover, FED collection from cigarettes increased sharply in Q1-FY18 as its production recovered after revision in duty structure along with administrative measures to cut back availability of smuggled and counterfeit brands.[14] Likewise, increase in production of edible oil also contributed positively.

***Non-tax revenues***

The non-tax revenues grew marginally by 1.9 percent during Q1-FY18 compared to a decline of 47.7 percent in Q1-FY17. The profits from SBP, PTA and receipts from passport fees largely supported non-tax revenues in the absence of Coalition Support Fund (CSF) receipts (**Table 4.4**). The discount retained on crude oil and

[11] FBR vide SRO 1035(I) 2017 dated 16th October 2017 levied/increased regulatory duty on a number of non-essential items.

[12] The government has withdrawn some of the available concessions/exemptions in the federal budget FY18. Moreover, the regulatory duty on a number of non-essential items has been increased to check their imports.

[13] Effective from 1st July 2018 FED on cement production was revised upward from Rs 1 per kg to Rs. 1.25 per kg, finance bill FY18. Moreover, cement production increased by over 20 percent during Q1-FY18.

[14] Effective 1st July 2017, FBR introduced three tiers of duty structure for a pack of thousand cigarettes: (i) Rs 3740, if price exceeds Rs 4500; (ii) Rs 1670, if price between Rs 2900 to Rs 4500; and (iii) Rs 800, if on price is less than Rs 2900. Moreover, FBR improved documentation by introducing a withholding tax at 5 percent of the value on tobacco sale to the manufacturers.

windfall levy against crude oil remained close to last year's level, as the uptick in the international oil prices offset somewhat lower production. However, dividend income maintained its downward trajectory on account of losses incurred by Public Sector Enterprises (PSEs). Royalties on oil and gas also declined despite increase in production/exploration of new oil and gas reserves.

**Table 4.4: Non-tax Revenues**
billion rupees

| | Budget FY18 | Actual Q1-FY17 | Actual Q1-FY18 |
|---|---|---|---|
| Mark-up (PSEs and others) | 96.0 | 0.8 | 0.6 |
| Dividends | 93.3 | 5.0 | 0.4 |
| SBP profits | 260.0 | 39.4 | 45.0 |
| Defence (including CSF) | 141.8 | 1.7 | 2.7 |
| Post office/PTA profits | 11.3 | 0.1 | 5.4 |
| Royalties on gas and oil | 58.5 | 14.3 | 13.0 |
| Passport and other fees | 28.0 | 2.7 | 4.2 |
| Discount retained on crude oil | 10.0 | 2.1 | 2.1 |
| Windfall levy against crude oil | 8.0 | 0.3 | 0.4 |
| Others* | 547.8 | 45.4 | 40.0 |
| **Total non-tax revenue** | **1254.7** | **111.6** | **113.7** |

*Others include non-tax receipts by federal and provincial government. For instance Non- tax receipts of Rs 40.0 billion during Q1-FY18 includes Rs 27.3 billion by provinces and Rs 12.7 billion by the Federal Government.
Data source: Ministry of Finance

## 4.3 Expenditures

The consolidated fiscal spending increased by 15.9 percent in Q1-FY18, compared to a marginal increase of 0.6 percent last year.[15] The current and development expenditure grew by 15.9 percent and 15.4 percent respectively, in Q1-FY18. The federal current expenditure grew by 11.7 percent, while the provincial current expenditure rose much sharply by 25.9 percent (**Table 4.5**).

Within the federal current expenditure, defense spending rose by 20.1 percent in Q1-FY18 compared to 4.0 percent increase in the same period of last year. This increase is attributed to expenses on security related to CPEC and various other operations aimed at improving the security situation in the country.

Besides, interest payments were also higher by 7.5 percent in Q1-FY18 against a marginal decline of 0.4 percent in first quarter of the last year. In terms of GDP, however, interest payments declined from 1.3 percent in Q1-FY17 to 1.2 percent in Q1-FY18.

Increase in interest payments is explained by reversal in two factors, which subdued the mark up payments last year. First, the benefit of declining interest rates is no longer available, as the interest rates remained broadly stable around

[15] Including the statistical discrepancy in the total expenditure moderates the expenditure growth to 12.8 percent for Q1-FY18, as reported in Section 4.1, due to low discrepancy reported this year.

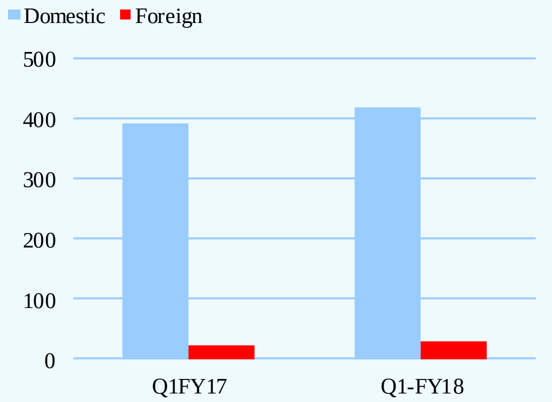
**Table 4.5: Analysis of Fiscal Spending**
billion rupees

| | Actual | | Growth | |
|---|---|---|---|---|
| | **Q1-Y17** | **Q1-Y18** | **FY17** | **FY18** |
| **Current expenditures** | **1,070.7** | **1,240.5** | **-1.3** | **15.9** |
| Federal | 757.8 | 846.4 | -1.4 | 11.7 |
| *of which* | | | | |
| Interest payment | 414.3 | 445.4 | -0.4 | 7.5 |
| Defense | 151.5 | 181.9 | 4.0 | 20.1 |
| Public order and safety | 24.0 | 27.9 | 10.5 | 16.2 |
| Others | 168.0 | 191.2 | -9.1 | 13.8 |
| Provincial | 312.9 | 394.1 | -1.3 | 25.9 |
| **Development expenditures** | **191.1** | **220.5** | **12.4** | **15.4** |
| PSDP | 167.1 | 195.6 | 14.2 | 17.0 |
| Federal | 64.1 | 100.2 | -10.1 | 56.3 |
| Provincial | 103.0 | 95.4 | 37.2 | -7.4 |
| Others (including BISP) | 24.0 | 24.9 | 1.6 | 3.9 |
| **Net lending** | -0.3 | 0.9 | -77.2 | -454.4 |
| **Total** (excl. statistical discrepancy) | **1261.6** | **1461.9** | **0.6** | **15.9** |

Data source: Ministry of Finance

last year's level. However, domestic debt continued to accumulate. As a result, the government had to pay Rs 24.9 billion more in mark up payments (**Figure 4.6**).

**Figure 4.6: Mark up Payments**




Data Source: Ministry of Finance

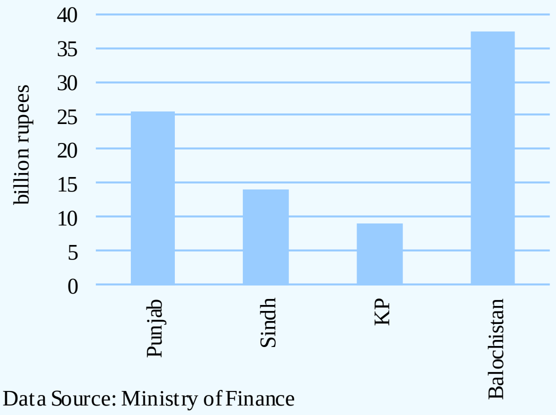
Second, strengthening of currencies against US dollar, particularly against Japanese Yen, benefitted on mark up payments on external debt last year. However, the currency dynamics changed this year. In particular, dollar weakened against SDR and Euro. Moreover, interest payment on foreign commercial loans increased. Thus, mark up payment on the external debt increased by Rs 6.2 billion (28.8 percent) in Q1-FY18.

The growth in consolidated federal and provincial development expenditure was largely driven by federal Public Sector Development Program, which increased by 56.3 percent in Q1-FY18. The disbursement under federal PSDP reached Rs 100.2 billion in Q1-FY18 against Rs 64.1 billion in the same period of last year. On the contrary, provincial development expenditure declined by 7.4 percent to Rs 95.4 billion in Q1-FY18 from Rs 103.0 billion in Q1-FY17.

## 4.4 Provincial fiscal operations

The provinces posted a combined surplus of Rs 86.2 billion during Q1-FY18, down from Rs 108.5 billion in the corresponding period of last year. This surplus in Q1-FY18, which was one fourth of the annual target of Rs 347.3 billion, primarily came from Balochistan followed by Punjab (**Figure 4.7**). Both, slower growth in provincial revenues and a surge in provincial expenditures, contributed to a lower surplus during Q1-FY18 (**Table 4.6**).

**Figure 4.7: Provincial Surplus during Q1-FY18**



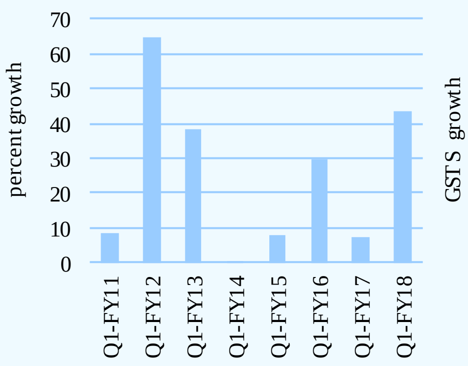

Data Source: Ministry of Finance

**Table 4.6: Provincial Fiscal Operations during Jul-Sept**
billion rupees

| | Punjab | Sindh | KP | Balochistan | Total | Growth |
|---|---|---|---|---|---|---|
| ***FY18*** | | | | | | |
| A. Total Revenue | 254.3 | 153.1 | 72.1 | 65.1 | 544.6 | 9.0 |
| Provincial share in federal revenue | 200.7 | 106.2 | 66.3 | 55.5 | 428.7 | 2.9 |
| Provincial Revenue (I+II) | 58.0 | 41.8 | 6.5 | 7.9 | 114.2 | 43.7 |
| I. Taxes | 45.0 | 36.0 | 4.0 | 1.8 | 86.9 | 34.9 |
| II. Non-tax revenue | 13.0 | 5.8 | 2.5 | 6.1 | 27.4 | 81.8 |
| Fed loans and transfers | -4.4 | 5.0 | -0.7 | 1.7 | 1.7 | -53.8 |
| B. Total expenditure | 248.6 | 139.2 | 66.6 | 38.7 | 493.0 | 17.6 |
| Current | 182.9 | 119.9 | 56.8 | 38.0 | 397.6 | 25.8 |
| Development | 65.7 | 19.3 | 9.8 | 0.7 | 95.4 | -7.4 |
| Gap (A-B) | 5.7 | 13.9 | 5.6 | 26.5 | 51.6 | -35.9 |
| **Financing* (overall balance)** | **-25.7** | **-14.1** | **-9.1** | **-37.4** | **-86.2** | **-20.6** |
| ***FY17*** | | | | | | |
| A. Total Revenue | 242.4 | 134.6 | 66.9 | 55.8 | 499.7 | 36.5 |
| Provincial share in federal revenue | 194.5 | 104.7 | 65.2 | 52.0 | 416.5 | 44.2 |
| Provincial Revenue (I+II) | 46.9 | 27.2 | 3.1 | 2.3 | 79.4 | 7.2 |
| I. Taxes | 36.0 | 25.8 | 1.4 | 1.3 | 64.4 | 8.8 |
| II. Non-tax revenue | 10.9 | 1.4 | 1.7 | 1.0 | 15.0 | 1.0 |
| Fed loans and transfers | 1.0 | 2.5 | -1.4 | 1.5 | 3.7 | 23.1 |
| B. Total expenditure | 192.9 | 102.7 | 92.5 | 31.1 | 419.2 | 6.1 |
| Current | 139.4 | 78.7 | 68.3 | 29.7 | 316.2 | -1.2 |
| Development | 53.5 | 23.9 | 24.2 | 1.4 | 103.0 | 37.2 |
| Gap (A-B) | 49.4 | 31.9 | -25.6 | 24.7 | 80.5 | -377.3 |
| **Financing* (overall balance)** | **-2.2** | **-38.8** | **-42.8** | **-24.9** | **-108.5** | **1369.9** |

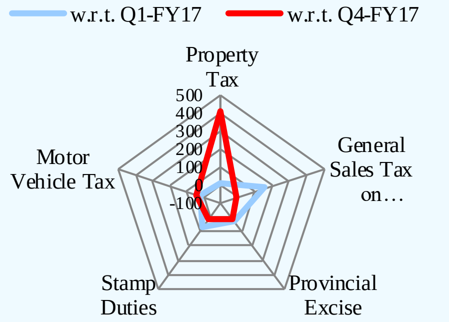
* Negative sign in financing means surplus.
Data source: Ministry of Finance and SBP Calculations

**Figure 4.8: Growth in Provincial Own Revenue**




Data Source: Ministry of Finance

**Figure 4.9: Growth of Provincial Tax Revenue Spinners in Q1-FY18 (in percent)**




Data Source: Ministry of Finance

***Provincial revenue***

The overall provincial revenue grew at a slower pace of 9.0 percent in Q1-FY18 compared to 36.5 percent increase in the corresponding period of last year. This slowdown is attributed to the sluggish growth in *provincial share in federal revenue* and decline in *federal loans and transfers,* respectively (**Table 4.6**).

Nonetheless, *provincial own revenue collection* reported a significant improvement in Q1-FY18; showing a 43.7 percent growth as compared to the previous corresponding period. The quarter-wise analysis shows General Sales Tax on Services (GSTS) and property taxes were the major revenue spinners (**Figure 4.8 and 4.9**).[16] The provincial non-tax revenue, however, rebounded from the slow growth reported in the corresponding period of last year.

***Provincial expenditure***

The provincial expenditure surged by 17.6 percent in Q1FY18 compared to 6.1 percent in the corresponding period last year. This was mainly driven by 25.7 percent increase in the current expenditures. On the other hand, development expenditure declined by 7.4 percent, against persistent increase recorded during three previous years.

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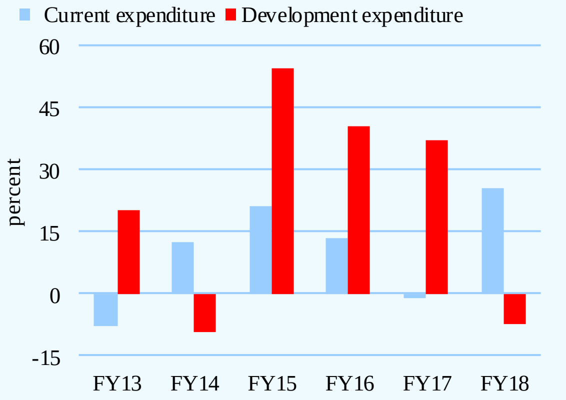
[16] Basically, the Capital Value Tax (CVT) [2 percent] and the Property Registration Tax (3 percent) in Punjab have been merged w.e.f. July 1st, 2017 except Lahore. This has helped the property taxation to be improved in Punjab especially in Q1-FY18.
Reference: Notification No. 3839-2017/1000 ST (I) issued on June 22nd, 2017.

In contrast to the trends in recent years, provincial current expenditures increased while development spending declined (**Figure 4.10**). Probably, lower receipts from federal revenue might have affected provincial development spending.

**Figure 4.10: Growth in Provincial Expenditure during Q1**




Data Source: Ministry of Finance and SBP Calculations

The province-wise analysis shows that within current expenditures, against the past pattern, provinces spent relatively more on environment protection, public order and safety affairs, recreation, culture, housing and community amenities and general public service.

### 4.5 Public debt

The pace of public debt accumulation slowed down during Q1-FY18, registering 3.0 percent growth compared with 4.4 percent increase in the same period last year. In absolute terms, the public debt stock reached Rs 22.0 trillion by end-September 2017, up from Rs 21.4 trillion by end-June 2017 (**Table 4.8**). Within the public debt, government debt rose to Rs 20.2 trillion at end-September 2017 from 19.6 trillion as of end-June 2017. Though external debt also increased, major contribution came from domestic borrowings.

The increase in external debt, notwithstanding low net external financing during the quarter, was due to revaluation losses of around US$ 438.4 million. In addition, this increase was mainly driven by government borrowing from China, and the disbursement by multilateral donors. In case of domestic debt, the growth was driven by government borrowing from both SBP and commercial banks.

**Table 4.8: Pakistan's Public Debt Profile**

billion Rupees

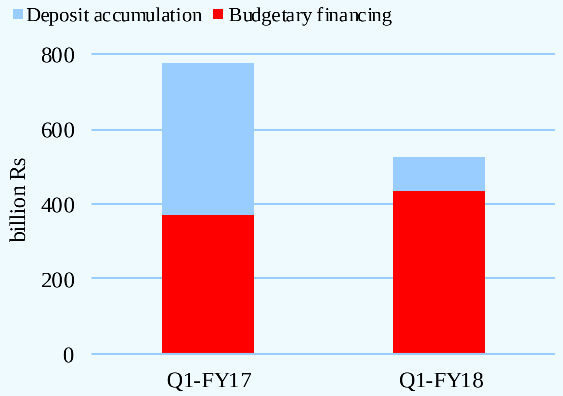
| | Stocks | | | | Flows | |
|---|---|---|---|---|---|---|
| | **Jun-16** | **Sep-16** | **Jun-17** | **Sep-17** | **FY17** | **FY18** |
| **Public debt** | **19,676.6** | **20,542.9** | **21,408.7** | **22,059.8** | **866.3** | **651.2** |
| Domestic debt | 13,625.9 | 14,385.8 | 14,849.2 | 15,375.5 | 759.8 | 526.3 |
| Government external debt | 5,417.6 | 5,515.2 | 5,918.7 | 6,029.8 | 97.5 | 111.1 |
| Debt from the IMF | 633.1 | 642.0 | 640.8 | 654.5 | 8.9 | 13.8 |

Data source: State Bank of Pakistan

**Domestic debt**

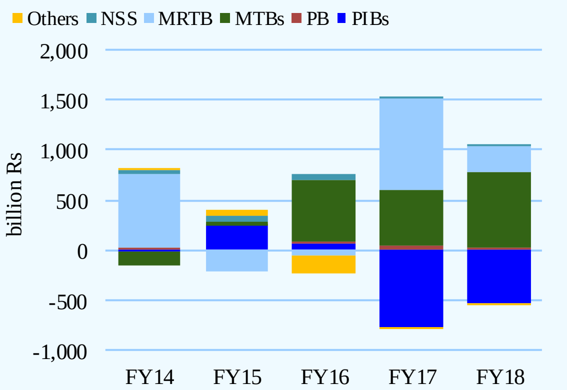
Unlike in Q1-FY17, when a part of fiscal deficit was financed from external borrowings, the financing burden entirely fell on domestic sources during Q1-FY18. Besides, the budget deficit (in nominal terms) was also higher. Yet the pace of domestic debt accumulation slowed down: expanded by Rs 526.3 billion in Q1-FY18, compared to an increase of Rs 759.8 billion in the previous year. This is because the government borrowed more than its financing requirement and kept it as deposits with the banking system during Q1-FY17 (**Figure 4.11**).

**Figure 4.11: Change in Domestic Debt**




Data Source: State Bank of Pakistan

**Figure 4.12: Composition of Domestic Debt during Q1(Flow)**




In term of maturity structure, the government met its borrowing requirements mainly through short-term instruments (both SBP and scheduled banks), which helped to retire maturing PIBs during Q1-FY18 (**Figure 4.12**).[17] In fact, the government borrowing through floating debt instruments crossed Rs 1.0 trillion, almost double the overall increase seen in domestic debt. Within that, government borrowing from scheduled banks through T-bills stood at Rs 745.9 billion, while the borrowing from SBP was at Rs 271.9 billion.

[17] Total PIBs maturities stood at RS 596.6 billion during Q1-FY18 compared to Rs 1.4 trillion in the same period last year.

From the commercial banks' standpoint, short-term debt securities were attractive, as they were not expecting any further fall in the policy rate. The banks, therefore, were reluctant in participating in PIB auctions and instead participated in T- bills auctions aggressively. Within T-bills, bulk of the offers was made in 3 and 6 month tenor. In overall terms, the commercial banks offered much higher amount in T-bills relative to PIBs (**Table 4.9**).

**Table 4.9: Auction Profile of Government Securities (Face Value)**

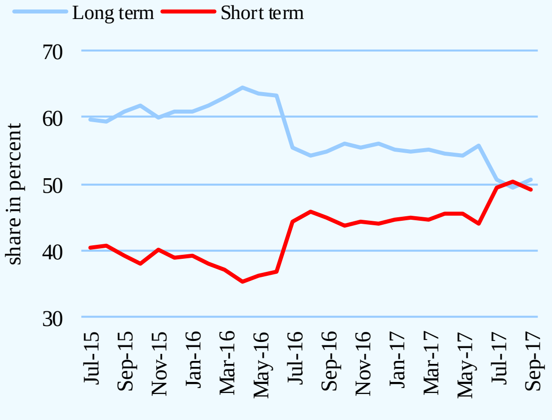
billion Rs

| | Q1-FY17 | | | | Q1-FY18 | | | |
|---|---|---|---|---|---|---|---|---|
| | Offer (competitive) | Maturity | Accepted | Accepted net of maturity | Offer (competitive) | Maturity | Accepted | Accepted net of maturity |
| ***MTBs*** | | | | | | | | |
| 3-M | 814.5 | 267.1 | 410.5 | 143.4 | 3,501.6 | 1,800.4 | 3,463.1 | 1,662.7 |
| 6-M | 1,378.4 | 400.6 | 863.4 | 462.8 | 942.8 | 1,391.0 | 895.5 | (495.5) |
| 12-M | 873.1 | 510.3 | 490.1 | (20.3) | 66.8 | 490.1 | 47.7 | (442.4) |
| **Total** | **3,066.0** | **1,178.0** | **1,763.9** | **585.9** | **4,511.2** | **3,681.5** | **4,406.3** | **724.8** |
| ***PIBs*** | | | | | | | | |
| 3 Years | 497.5 | 1,170.8 | 305.3 | (865.6) | 60.4 | 376.3 | 23.4 | (353.0) |
| 5 Years | 299.7 | 254.3 | 217.1 | (37.2) | 18.4 | 196.4 | 10.2 | (186.2) |
| 7-Years | 195.7 | 2.2 | - | (2.2) | - | - | - | - |
| 10 Years | | - | 124.0 | 124.0 | 28.5 | 23.9 | 22.1 | (1.8) |
| 20 Years | 2.5 | | | | | | | |
| **Total** | **995.4** | **1,427.3** | **646.3** | **(781.0)** | **107.3** | **596.6** | **55.6** | **(541.0)** |

Data source: State Bank of Pakistan

The government accepted an amount well-above the maturity and pre-auction target during Q1-FY18 (**Table 4.9**). In case of PIB auctions, both offered and accepted amount in PIB auctions fell short of both the maturity and the target for the quarter.

**Figure 4.13: Tenor-wise Composition of Domestic Debt**




With these developments, the share of floating debt has increased to 49.2 percent by end- September 2017 from 44.1 percent in June 2017 (**Figure 4.13**). Consequently, the re-pricing and roll-over risks have somewhat increased.

The data on risk indicators for end-June 2017 show that debt re-fixing in one year and debt maturing in one year has already increased compared with end-June 2016. However, it is important to note here that these remain within the indicative range prescribed by the Medium-term Debt Strategy (MTDS) 2016-2019.[18]

**Table 4.10: Change in Non-bank Holding of Domestic Debt**
billion Rs

| | FY16 | FY17 | FY18 |
|---|---|---|---|
| T-bills | 16.6 | 156.0 | 111.1 |
| Other securities | 23.0 | -153.9 | -143.0 |
| NSS (including prize bonds) | 88.9 | 60.8 | 49.5 |
| *of which* | | | |
| DSC | 0.6 | 4.3 | 0.9 |
| SSC | 7.3 | -0.7 | -11.7 |
| BSC | 22.6 | 18.6 | 12.8 |
| SSA | 19.7 | 8.3 | 18.5 |
| Prize bond | 35.2 | 34.8 | 30.4 |
| Total | 128.4 | 62.8 | 17.5 |

Data source: State Bank of Pakistan

Government borrowing from non-bank remained lower than last year at Rs 17.5 billion during Q1-FY18 compared with Rs 62.8 billion last year.

**Table 4.11: Public External Debt and Liabilities**
billion US$

| | **Jun-17** | **Sep-17** | **Change** |
|---|---|---|---|
| A. Government debt | 56.4 | 57.2 | 0.8 |
| *Of which* | | | |
| Paris club | 12.0 | 12.1 | 0.1 |
| Multilateral | 27.6 | 27.9 | 0.3 |
| Other bilateral | 5.8 | 6.3 | 0.4 |
| Bonds | 4.8 | 4.8 | 0.0 |
| Commercial loans | 4.8 | 4.9 | 0.1 |
| Multilateral (ST) | 0.8 | 0.7 | -0.1 |
| B. Debt from IMF | 6.1 | 6.2 | 0.1 |
| C. External Liabilities | 3.6 | 3.6 | 0.0 |
| Total | 66.1 | 67.0 | 0.9 |

Data source: State Bank of Pakistan

Similar to commercial banks, non-bank also preferred investing in T-bills to replace the maturing PIBs (**Table 4.10**). Net mobilization from National Saving Schemes (NSS) also continued to decline due to downward revision in rates on different instruments, following reduction in the policy rate during last few years. Mobilization from all major schemes, except for Special Saving Accounts (SSA), declined.

[18] Domestic debt re-fixing in one year rose from 52.8 percent at end-June 2016 to 56.4 percent at end-June 2017, while debt maturing in one year rose from 51.9 percent at end-June 2016 to 55.6 percent at end-June 2017. The MTDS 16-19 indicative ranges for both indicators are between 50 to 65 percent. ( Source: http://finance.gov.pk/Quarterly_Risk_Report_End_June_2017.pdf and http://finance.gov.pk/Quarterly_Risk_Report_June_30_2016.pdf)

## Public external debt and liabilities

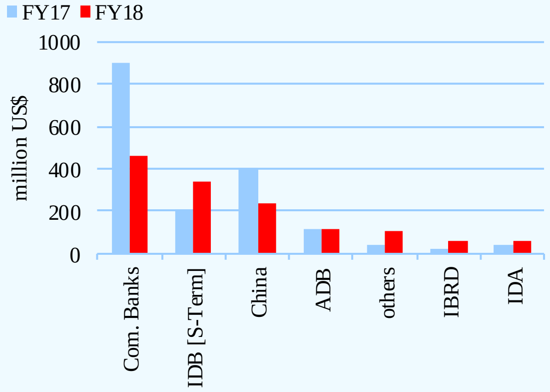
The stock of public external debt and liabilities rose by US$ 0.9 billion during Q1-FY18, reaching US$ 67.0 billion as of end-September 2017 (**Table 4.11**). This largely stemmed from government borrowings from China, multilateral donors and foreign commercial banks. Moreover, revaluation losses of around US$ 438.2 million also inflated the public debt stock during the period. Specifically, US dollar depreciated against Euro and Special Drawing Rights (SDR) by 3.5 and 1.6 percent respectively, which led to an increase in the dollar value of external debt denominated in Euro and SDR.[19]

Looking at the composition of public external debt, the government debt amounted to US$ 57.2 billion as of September 2017. Out of this, long-term debt (mainly multilateral and Paris club) stood at US$ 56.2 billion, whereas short term debt was only US$ 1.0 billion. It is important to note here that short term debt declined by around US$ 778 million YoY in September 2017. Consequently, the FX risk-gauged by short-term debt-to-official liquid reserves reduced during Q1-FY18.[20]

### *Gross inflows declined*

Gross external disbursements declined by 20.6 percent in Q1-FY18 over last year.[21] Meanwhile, the loan from the IFIs came as project financing primarily in the areas of education, energy, infrastructure and social sector development. By summing-up, total inflows during the quarter

**Figure 4.14: Gross Loan Disbursment during Jul-Sep**




Data Source: Economic Affairs Division

[19] Debt denominated in Euro and SDR constituted around 36 percent of external debt stock at end September 2017.
[20] The ratio of short-term debt-to-official liquid reserves went down to 27.7 percent as of June 2017 from 31.9 percent in June 2016 (Source: http://finance.gov.pk/Quarterly_Risk_Report_End_June_2017.pdf and http://finance.gov.pk/Quarterly_Risk_Report_June_30_2016.pdf).
[21] This discussion excludes IMF inflows and is based on data available on Economic Affairs Division website (http://www.ead.gov.pk/pubDetails.aspx).

constitute only 18 percent of the full year target for FY18.[22] Purpose-wise detail shows that the inflows from commercial banks largely came for budgetary support, while China made disbursement for the various infrastructure projects under CPEC (**Figure 4.14**).

### External debt servicing

Pakistan's external debt servicing grew by around 60 percent during Q1-FY18 over the same period last year. Both principal and interest payments were higher during the quarter (**Table 4.12**). This was largely due to higher repayment of multilateral and commercial loans, which accounted for 80 percent of the debt servicing.

In contrast to principal, increase in interest payment was much lower. This was because government external borrowings during the recent years were at low rates. This, along with some recovery in exports and remittances, is expected to improve government's servicing capacity going forward.[23]

**Table 4.12: Public External Debt Servicing during Jul-Sep**
(million US $ )

| | FY17 | FY18 |
|---|---|---|
| ***Principal*** | | |
| Public debt(a+b+c) | 510.6 | 904.0 |
| a. Government debt | 510.6 | 904.0 |
| Paris club | 27.4 | 25.2 |
| Multilateral | 377.4 | 392.8 |
| Other bilateral | 105.8 | 78.1 |
| Commercial loans/credits | 0.0 | 408.0 |
| b. IMF | 0.0 | 0.0 |
| c) Foreign exchange liabilities | 0.0 | 0.0 |
| ***Interest*** | | |
| Public debt (a+b+c) | 246.3 | 300.0 |
| a. Government debt | 206.0 | 260.2 |
| Paris club | 8.7 | 8.0 |
| Multilateral | 79.9 | 89.7 |
| Other bilateral | 64.0 | 79.4 |
| Euro/Sukuk global bonds | 32.4 | 0.1 |
| Commercial loans /credits(LT) | 6.8 | 55.7 |
| Multilateral (ST) | 6.9 | 27.3 |
| b. IMF | 17.3 | 30.9 |
| c. Foreign exchange liabilities | 23.0 | 8.9 |
| **Total (P+I)** | **757.0** | **1204.0** |
| ***Memorandum Items*** | | |
| Short term government debt servicing - principal | 566.7 | 445.1 |

Data source: State Bank of Pakistan

[22] Budget 2017-18 also aims at raising US$ 1 billion through issuance of Euro/Sukuk bond in the international capital market. However, in November 2017, Pakistan issued US$ 1.0 billion five years Sukuk and US$ 1.5 billion ten years Eurobond at a profit rate of 5.625 percent and 6.875 percent respectively.

[23] The exports of goods and services recorded 10.9 percent YOY growth during Jul-Sep FY18, while FEE increased by 6.1 percent over last year