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Proposals to Address the Short-Term Challenges to the Economy

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Foreword

This document is a summarized version of a report being prepared by the Beaconhouse Centre for Policy Research on the nature of the central immediate to short-term challenges that lie ahead for the country and the potential policy actions that would be required to attend to them.

It confines itself to three areas that in our opinion are critical to the financial and economic management of the Pakistan Economy. That the paper focuses on the short-term should not be construed as a dilution of the importance of instituting long overdue structural reforms. These are required, but given the lingering history of such neglect and poor quality of governance the road to reform looks dauntingly long.

Using a carefully crafted, rigorous Macro-economic model developed at the Centre (the underlying technical analysis will be presented in the Report) it assesses the impact of the suggested measures on the key economic indicators.

We hope that this modest submission will help initiate a debate on the nature and scale of the issues at hand and the initiatives required to address them.

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Chapter I: Agenda of Tax Reforms

1.1 Introduction

Pakistan today faces an incipient financial crisis. This is manifest in the rise in the size of the 'twin' deficits- the current account deficit and the fiscal deficit respectively. The former was recorded at 5.8 percent of the GDP and the latter at 6.6 percent of the GDP for the fiscal year just ended, as shown in Table 1 in the Statistical Appendix.. The foreign exchange reserves of the SBP, net of swap funds, are down to $4 billion, not even enough to finance one month of imports.

The public finances of Pakistan have worsened substantially since 2015-16. The last two years have witnessed a burgeoning fiscal deficit. This is the outcome of a flat tax to GDP ratio, falling non-tax to GDP ratio and a growing current expenditure to GDP ratio, also shown in Table 1. There has consequently been an increasing resort to inflationary borrowing from the SBP and to high cost, largely short-term, external commercial loans.

Our Report on the reform proposals to attend to the immediate to short-term challenges comprises two parts. The first deals with public finances, further sub-divided into two sections- the first highlighting the agenda of tax reforms and the second the measures required to enforce economy in expenditure. The second carries our analysis and proposals to tackle the issues concerned with the precariously placed external account. A summarized version of this Report will accordingly be printed in these columns in three installments.

The implications of the poor state of public finances are manifold. First, a larger fiscal deficit contributes to a bigger current account deficit. The associated increase in aggregate demand leads to an upsurge in imports. The BNU Macroeconomic Model estimates that for a Rs.100 billion increase in the budget deficit leads to larger imports of roughly $400 million. We, therefore, focus first on reforms in public finances. Our reasons for doing so are the urgency to address the fiscal recklessness of the Budget for 2018/19 year presented by the PML (N) Government in its last days, already commented upon at length by the authors and that the new Government may just have to revise the Budget to reflect the priorities that it has pronounced for its term of office.

1.2 Tax Reforms

The overall performance and of individual taxes of FBR over the last five years reveals first a rise of 1.2 percent of the GDP in income tax revenues, as shown in Table 2. This is due primarily due to a proliferation in the number of withholding taxes and at increased rates, which are even higher for "non-filers". Second, sales tax revenues reached a peak of 4.6 percent of the GDP in 2015-16, as shown in Table 2. This happened at a time when oil prices had tumbled sharply and it was possible to reap a '*wind fall*' by big enhancements in sales tax rates.

The tenure of the IMF Program from 2013 to 2016 witnessed a process of trade liberalization and the maximum tariff rate was reduced from 30 percent to 20 percent, as shown in Table 9.. Simultaneously, other tariff slabs were cascaded down. This is one factor which has contributed to the fast growth in imports in recent years. However, more recently, zero duty items earlier have been subjected to a minimum tariff of 3 percent and tariffs on POL products have been increased as shown in Table 10. This explains the rise in import duty revenues as a percentage of the GDP, despite the decline in the maximum tariff.

Excise duties have now become the smallest source of FBR revenues. Revenues have stayed at close to 0.6 percent of the GDP throughout the period, as shown in Table1.

The following implications follow from the trends revealed above.

A. There is a need to focus more on a return and documentation based income tax system, thereby reducing reliance on withholding taxes, many of which are indirect and regressive in nature.
B. Examine the case for partial or full restoration in personal income tax rates brought down sharply in the budget of 2018-19.
C. Analyze if there is need to rationalize the import tariff structure in the light of the continuing rapid growth in imports.
D. Explore the potential for broad-basing the sales tax and bring it closer to being a value added tax.

The reforms proposed are aimed at achieving the following objectives:

a) Move to a higher revenue-yielding and more buoyant tax system.
b) Make the tax burden more equitable across income groups.

c) Achieve a more balanced sectoral tax incidence.

d) Promote investment, savings, exports, employment and more balanced regional development.

e) Minimize multiplicity of taxation, escalation in tax rates and focus on gradual rationalization of rates with broad-basing of revenue sources.

f) Build in mechanisms, laws and institutional processes to check tax evasion and corruption.

g) Promote integration and cooperation between the Federal and Provincial tax systems.

h) Lead to a simpler, transparent and a more friendly tax system, presently unwieldy and complex.

i) Create a more modern, autonomous and functional tax administration.

j) Formulate tax policy that is more evidence-based and consistent.

1.2.1 Income Tax

1.2.1.1 Partial Restoration of the previous Income Tax Regime

This year's Federal Budget contains an inexplicable and utterly unjustified reduction in the tax rates of personal income tax. The exemption limit has been trebled from Rs 400,000 to Rs 1,200,000 in one go, while the maximum tax rate has been halved from 30 percent to 15 percent.

The exemption limit is equivalent to $9,677, which is almost six times our per capita income. The corresponding exemption limit in India is Rs 250,000, equivalent to $3,576 and just over two times the per capita income. Similarly, in Bangladesh the exemption limit is equivalent to $3,578 and about two and half times the per capita income. In comparison, therefore, the exemption limit has been raised far too high in Pakistan. A reasonable level would be Rs 800,000, twice the previous exemption limit.

The tax reduction disproportionately benefits individuals with higher incomes. For example, an individual earning an annual income of Rs 2 million faces a tax deduction of Rs 40,000 as compared to Rs 244,000 in the old system. There is a large saving in the tax liability of Rs 204,000. The reduction rises exponentially and reaches Rs 690,000 in the case of a person with an annual income of Rs 5 million and so on.

The reform proposed is to move to a tax structure which is intermediate between the old and the new structures. The exemption limit proposed, as identified above, is Rs 800,000, equivalent to $6,451 and four times the per capita income, while the number of slabs is proposed to be increased from four to six, with the two additional slabs having marginal tax rates of 20 percent and 25 percent.

The recommended personal income tax structure is given below:

Recommended personal Income Tax Structure	
Income Slab	Proposed Rate (%)
< 800,000	0%
800,000 – 1,600,000	5%
1,600,000 – 2,400,000	40,000 + 10%
2,400,000 – 3,200,000	120,000 + 15%
3,200,000 – 4,000,000	240,000 + 20%
4,000,000 and above	400,000 + 25%

The currently operative income tax regime implies a heavy loss of over Rs 90 billion. Implementation of the tax structure proposed above will bring back over half the loss of revenues.

1.2.1.2 Rationalizing the Withholding Tax Regime

Pakistan today has one of the most elaborate withholding tax regimes in the world. Revenues are collected at source either in the form of advance taxes against any income tax liability or as fixed taxes. In particular, many of the fixed taxes have acquired the character of indirect taxes and in some cases are clearly regressive in incidence.

Today, almost three-fourths of the total revenues from direct taxes come from the withholding tax regime. The remainder, one fourth, is in the nature of advance taxes paid by tax filers along with their returns. Revenues, following the audit of returns, provide even less than 10 percent of the total revenue collected from the income tax.

The unbridled expansion of the withholding tax regime is a tacit acceptance by FBR that is unable to develop a modern tax filing and documentation based system. The former system was originally developed in the 90s and unearned capital incomes were primarily subjected to taxation at source like dividends, interest income on bank deposits and return on national saving. The system was relatively easy to administer with standard rates and very few withholding tax agents like banks and the corporate sector. It also made the tax system made more progressive.

However, the regime has been extended to sales transactions, utility bills, transport, imports, exports, provision of services like education, contracts, etc. In many cases the system has become predatory, is cumbersome, hard to administer with significant costs to withholding agents and with the burden falling on the majority of the population, many of whom have incomes below the income tax exemption limit.

In 2016/17 there were 64 sections / sub-sections in Income Tax relating to levy of withholding taxes, as shown in Table 27[1]. An additional complication is the need for the withholding agent to distinguish between filers and non-filers, with the latter having higher rates. Presumably the intention is to induce more filing of returns. However, there is the danger and the inherent inequity in that the non-filer may be a genuinely exempt person with low income, who is not required to file a return.

The distribution of revenue from these different withholding taxes is extremely skewed. The top 23 sources contribute 97.7 percent of the tax collection, while the remaining 41 sources have an extremely small share of just 2.3 percent, as shown in Tables 3, 4and 5. This makes a strong case for rationalizing the withholding tax regime by eliminating many of the small sources. This will contribute to a less cumbersome, more transparent and progressive tax system.

The following reforms are suggested in the withholding tax regime:

A. Among the 41 small withholding tax sources retain only these which satisfy the following criteria:
    a. number of withholding tax agents is small

[1] The current number, after the Budget of 2018/19 is 68.

b. limited scope for forward shifting
c. clearly progressive incidence
d. no double taxation of the tax base with provincial/local taxes.

There is need also to examine the large withholding taxes from the viewpoint of the above criteria and identify if, given their size, they are creating distortions in the economy. This leads also to the following recommendations:

a) The levy of a withholding tax on cash withdrawals and other banking transactions has retarded the development of the banking system and financial intermediation by leading to lower deposits and more cash transactions outside the banking system. This levy needs to be withdrawn. Instead, an advance tax may be introduced on credit card charges. The incidence of this levy will be progressive.
b) The fixed tax on mobile phone cards is tantamount to double taxation as the Provincial sales tax on services is also collected from the telecom sector. The combined tax rate exceeds33 percent. Also, given the very broad-based ownership of mobile phones, there are millions of people who have incomes below the income tax limit and yet are compelled to pay the fixed tax. The Supreme Court has already given a ruling on the oppressive taxation of mobile phone cards. As such, the fixed income tax rate should be brought down drastically to 5 percent.
c) The advance tax on electricity bills of industrial consumers should be reduced. This is one more factor contributing to the loss of competitiveness. The corresponding tax on commercial and large domestic consumers may be enhanced.
d) The presumptive income tax on exports of 1 percent may be withdrawn. Accordingly, the export incentive rates may be reduced by one percentage point. This should also improve the liquidity of exporters.

The above proposals may affect the revenues derived from the withholding tax regime. This should be compensated by a drive for detecting more tax evaders through collateral evidence. The target must be to double the number of tax return filers in the next three years. Simultaneously, the target should also be raise additional revenues from the assessment process to 15 percent of total income tax revenues.

1.2.1.3 Taxation of Capital Gains

There is a need to comprehensively reform taxation of capital gains on properties as follows:

a) The tax should be levied on real and not nominal capital gains. The Income Tax Ordinance should present the rental values inflation index with respect to the holding period. This index should be applied to the original cost and the difference with respect to the disposal value be taken as the capital gain.
b) There should be no upper limit for the holding period in terms of application of the tax on capital gains.

For a holding period of up to five years the tax rate should be 15 percent and thereafter 10 percent.

1.2.1.4 Withdrawal of Tax Expenditures

There is a case for withdrawing the exemption or concession in the following cases, in the manner proposed:

a) Business income of trusts/foundations which are not operating in the area of education or health should be subjected to a fixed tax of 5 percent.
b) Any donation paid to recognized institutions other than those operating in education and health should be given a tax credit at a fixed rate of 10 percent.
c) Following the reduction in personal income tax rates, all concessionary tax rates applicable or tax deductions in special cases in the Third Schedule of the ITO 2001 on individuals should be withdrawn.

1.2.1.5 An Excess Profits Tax

Pakistan has a Super tax on companies. This was reduced somewhat in the Budget for 2018-19 to 3 percent in the case of banking companies and to 2 percent for non-banking companies having income greater than Rs 500 million.

The problem is the arbitrary nature of the Super Tax. There is a need to design a more objective basis for additional taxation of companies. As such, the proposal is to withdraw the Super tax and substitute it with an Excess Profits Tax. This makes the tax system more equitable and linked to the ability to pay more.

The rate of the Excess Profits Tax proposed is 10 percent. This will be levied in addition to the normal corporate income tax only on profits exceeding the return on equity plus reserves of 30 percent. Of course, if the return is lower than 30 percent then there will be no Excess Profits Tax on the company.

This proposal has the merit that the tax gets linked to higher profits and not just to turnover. A company with high turnover may not necessarily be making larger profits. Companies which enjoy special advantages or quasi-monopoly power will be the more likely candidates for payment of the Excess Profits Tax.

The rate of 30 percent of profit on equity and reserves is linked to observed rates of profitability of companies quoted in the Pakistan Stock Exchange. This rate is substantially higher than the average for all years from 2010 to 2015, as shown in Table 6.

1.2.1.6 Compulsory Filing of Returns

The Budget of 2018-19 has introduced the compulsory filing of returns for engaging in a property transaction of Rs.4 million or more and for purchase of a car. A similar pre-condition may be also introduced in the following cases:

a) Continuation of registration of a company with SECP.
b) Continuation of an industrial or commercial connection of electricity where the annual consumption exceeds 500,000 kilowatt hours.
c) Membership of any Chamber of Commerce, Trade Association or any professional body and its continuation.

1.2.1.7 Transfer Pricing

The issue of transfer pricing is important as it reduces the corporate income tax base due to shifting of profits outside Pakistan via higher prices of imports by multinational companies. Industries that are more vulnerable to this practice include automobiles, pharmaceuticals, aerated waters/beverages and chemicals.

A section on transfer pricing needs to be included in the ITO 2001. Section 92 of the Income Tax Act 1961 of India contains one of the methods for detecting transfer pricing via computation of the '*arms length price*'. We should adopt the same methodology, with supporting legislative amendments.

1.2.1.8 Changes in Audit Policy

The following proposals are being tabled for improvement in the audit system:

a) Within the next three years, increase the percentage of returns audited to 10 percent.
b) Develop a risk-based audit policy. The parameters should be identified on the basis of research on demands raised following audit of different types of taxpayers.

c) A new taxpayer may be exempted from audit for the first three years, in order to promote compliance. This should apply only in the case of individual taxpayers and not companies or AOPs.

The time has also come for moving to composite audit of income and sales tax returns, under the IRS.

1.2.1.9 Reduction in the Minimum Income Tax

We have the concept of a minimum income tax. This is levied at 1½ percent of the turnover of a company if it is in a loss or 30 percent of the net profit if the income tax is less than the minimum tax. Of course, there are the usual carry-forward provisions on the tax paid.

There is a degree of inequity in levying this minimum tax on a company suffering a loss in any particular year. It is, of course, possible that the company is characterized by cyclical fluctuations in output. In this case the minimum tax reduces the annual variation in taxes paid.

However, in view of the inequity, we propose that the present tax levy be replaced by a tax at"one percent of turnover (excluding exports) or of 0.5 percent of fixed assets, whichever is lower".

This amendment will help achieve two objectives. First, it will lead to a reduction in the rate of turnover tax by half a percentage point. Second, it will favor less capital-intensive industries and promote more labor-intensive activities.

1.2.1.10 Tax Incentives and Reliefs

The following incentives or reliefs in the income tax system are suggested including the ones identified above:

a) The Accelerated Depreciation Allowance may be raised from 25 percent back to 50 percent.
b) The tax credit on Balancing, Modernization and Replacement (BMR) may be doubled.
c) Same incentives in the same sectors to Pakistani companies as to Chinese companies.
d) The tax on Banking Transactions should be withdrawn.
e) Reduction in Withholding Tax Rate on mobile telephone and pre-paid card to 5 percent.

f) Halve the withholding tax on industrial electricity consumers.

g) Withdrawal of tax on undistributed Profits.

h) Reduction in Minimum Income Tax.

1.2.2. The General Sales Tax

The General Sales Tax (GST) is now levied on both goods and services in Pakistan. The former tax base is with the Federal Government and the latter with the Provincial Governments, following the 18th Amendment.

The revenue from the sales tax on goods was 4.3 percent of the GDP in 2017-18, as shown in Table 2. It has, however, fallen from the peak of 4.6 percent of the GDP in 2015-16. The Provincial variant has grown very rapidly following its introduction in 2012. By now, it has reached the yield annually of almost 0.7 percent of the GDP.

The reforms proposals given below are an attempt to develop the GST into a comprehensive Value Added Tax (VAT), to broad-base the coverage and to increase the overall revenue yield.

1.2.2.1 Harmonization of Tax Rates

There is growing variation in the sales tax rates as follows:

- Sind Revenue Board (SRB): 13% or 19½% on services
- Punjab Revenue Authority (PRA): 16% or 19½% or specific rates on services
- Federal Board of Revenue: 17% on goods

There are input-invoicing provisions in both the Federal and Provincial taxes. However, the variation in rates on different inputs leads to a divergence from the features of a VAT.

The Provincial Governments are effectively engaged in a '*race to the bottom*', with competition for tax bases by bringing down tax rates, especially in the case of SRB. This must be avoided.

Therefore, the proposed reform is to have a uniform rate across jurisdictions and the same rate on goods and services to give the GST the features of a comprehensive VAT. The suggested uniform rate initially is 17 percent, to avoid any loss of revenues in the short-run. Issues with and among the Provinces may be resolved in the CCI. Over time the standard tax rate may be brought down to 15 percent.

1.2.2.2 Sales Tax on Imports of Services

The Provincial Governments currently collect the sales tax on domestically provided services. There is, however, a potential tax base of import of services, as in the case of goods.

India and Philippines have developed the '*reverse charge principle*' on taxation of imported services, whereby the tax payment is made by the domestic recipient of a service and charged accordingly from the foreign provider of the service.

There are a number of imported services which could be charged the sales tax on services, including the following:

- Life Insurance Services
- Reinsurance
- Financial Services
- Computer and Information Services
- Business Services

There is need to develop appropriate rules and procedures for tapping the full potential of the sales tax on import of services.

1.2.2.3 Broadening the Tax Base

The Third Schedule of the Sales Tax Act of 1990 includes goods which are subject to sales tax payment by manufacturers on notified retail prices. This has been provided for under clause (a) of sub-section (2) of section 3 of the Act. Currently, 17 items have been brought under the purview of this clause.

This provision has enabled the coverage of value added at the wholesale and retail stage. As such, it represents an important broad-basing of the sales tax system of Pakistan.

The proposal is to extend the taxation on the retail price to other consumer goods and consumer durables. Candidates for inclusion are the following: vegetable ghee, paints, motor cars, TV sets, air conditioners, etc.

1.2.2.4 Sales Tax on POL Products

The sales tax rates on products like motor spirit, HSD oil, kerosene oil have been varied, more or less, monthly in the process of fixation of the retail prices by the Government, as shown in Table 7. This is the consequence of the policy of reducing the monthly fluctuation in prices. Therefore, when the import price was falling, as in 2015-16, the tax rates were

enhanced. Alternatively, when they are rising, as in 2017 and 2018, the rates are being brought down.
The first problem is the large variation in the tax rate between motor spirit and HSD oil. The policy in Pakistan is to keep the rate on HSD oil relatively high and thereby to ensure that it is priced higher than motor spirit. This is contrary to common international practice, as shown in Table 8.

Therefore, the time has come to narrow the price differential between motor spirit and HSD oil. This is justified as the tax burden of motor spirit is more progressive, with its use in private cars. HSD oil and LDO are inputs for agricultural tube-wells and public transport and HSD is used in the movement of basic goods, like food items.

The proposal is that henceforth both motor spirit and HSD oil should be subjected to the standard sales tax rate of 17 percent. Any desired increase in revenues should come from an adjustment in the rates of petroleum levy. This will also ensure that a higher proportion of revenues accrue to the Federal Government.

1.2. 3 Import Duties

Import duties constituted the principal source of tax revenue for the Federal Government for a long time right up to the late 90s. Their contribution at that time was almost 5 percent of the GDP. Pakistan had created a high tariff wall to promote the process of import substitution within the domestic economy.

Trade liberalization has now been on-going for the last two decades. The maximum tariff has been drastically scaled down to 20 percent, as shown in Table 9. The revenue yield from import duties is down to 1.8 percent of the GDP, as shown in Table 2. Today, the average MFN tariff at the six digit level of the harmonized code is, according to the WTO, lower in Pakistan than that in India or Bangladesh,

The process of trade liberalization had gone far by 2007-08. The number of tariff slabs was brought down to six and the maximum tariff set at 25 percent as shown in Table 9.The year, 2007-08, saw the largest current account deficit in the history of Pakistan of over 9 percent of the GDP. Consequently, the next year, 2008-09, witnessed a retreat in the tariff reform process. The maximum rate was raised to 35 percent as shown in Table 9.

The last two IMF Programs promoted once again the process of trade liberalization. By 2017-18, the maximum tariff was brought down to 20 percent and the number of slabs was reduced to four only. A minimum tariff of 3 percent has since been introduced. Consequently, there are no zero duty / exempt imports now.

Despite the scaling down of tariffs, there has been a rise in the ratio of import duty revenues to the value of imports. This was 6 percent in 2007-08 and is almost 9 percent in 2017-18. POL products are now the primary source, along with vehicles and edible oil, of revenue from import duties. One of the main factors for the increased yield of import duties is the hike in tariffs on POL products and crude oil.

Based on the above trends, reforms for early implementation are described below.

1.2.3.1 Tariff Reforms

The upsurge in imports is attributable to a combination of on overvalued exchange rate and lower import tariffs, both of which have made imports cheaper and more competitive with domestic products. Therefore, as in 2008-09, following a large trade deficit, there is an urgent need, at least temporarily, to partially reverse the process of trade liberalization. The recent introduction of big regulatory duties on selected items has proved to be counterproductive. It has led to under invoicing and more smuggling. As such, the maximum regulatory duty which is 80 percent currently, should initially be limited to a maximum of 30 percent and gradually phased out. Hence, our strategy is to opt for a more broad-based small increase in tariffs.

We propose the following import tariff structure.

Proposed New Import Tariff Structure *(%)*		
	Present	Proposed
1st Slab	3	5
2nd Slab	11	10 or 15
3rd Slab	16	20
4th Slab	20	25

This will provide somewhat more protection to domestic industry. The overall increase in tax revenues, including the consequential effect on the sales tax and the presumptive income tax is in the region of almost Rs 150 billion. This will make a significant contribution to the realization of the FBR revenue target for 2018-19.

The rise in tariffs on imported inputs used in exports should be countered by a one percentage point increase in the rate of duty drawback / export incentive.

1.2.3.2 Import Tariffs on POL Products

The import tariff on the three major POL products is proposed as follows:

	Present (%)	Proposed (%)
Motor Spirit	3	10
HSD Oil	11	5
Furnace Oil	11	5

The objective of reducing the import tariff on furnace oil is to bring down the cost of fuel input into electricity. Any reduction in revenue will be more than compensated by the rise in the duty on motor spirit. The rise in tariff on motor spirit will bring its price closer to HSD oil. Any loss of revenues can be compensated for a rise in the Petroleum Levy.

1.2.4 Excise Duties

Excise duties are the smallest source of FBR revenues. Their share currently is below 6 percent, as shown in Table 2. The tax base is also very narrow. Almost two-thirds of the revenues are from cigarettes. The remaining one-third is contributed mostly by beverages, cement and air travel.

There are three reforms proposed in excise duties, as follows:

1.2.4.1 Phasing Out Excise Duty on Cement

The construction industry and housing can be given a fillip by withdrawal of excise duties on one of the key inputs, cement. The tax rate is Rs 1250 per ton. This should be eliminated in two steps.

1.2.4.2 Excise Duty as a 'Clean Air' Tax

There is a need to charge an excise duty on industries which pollute the environment like leather tanning, chemical or acid making, brick production, etc.

1.2.4.3 Withdrawal of Excise Duty on Services

The remaining excise duty on services needs to be withdrawn as this is stepping into the fiscal powers of Provincial Governments.

The approach should now be to set FBR revenue targets in gross terms. This will remove the incentive to hold back refunds.

The overall revenue yield from the above tax reform package is estimated at Rs 300 billion in 2018-19. This includes an additional Rs 100 billion from import duty, Rs 125 billion from income tax and Rs 75 billion from sales tax. The higher FBR revenues will help significantly in reducing the fiscal deficit in 2018-19. We are, however, mindful that the revenue gain may be limited if the GDP growth slows down somewhat due to the implementation of the necessary wide-ranging reforms to stabilize the economy.

In our opinion, the implementation of the above proposed reforms will lead to a more buoyant and progressive tax system along with lower compliance costs and propensities for evasion.

Chapter II: Economy in Expenditure

2.1 Introduction

The objective of this part of the report is to identify major areas in which economy can be achieved in public expenditure. This is expenditure directly incurred by the Federal and the Provincial Governments.

We start first with a review of trends:

Public expenditure had approached Rs 7.5 trillion by 2017-18, as shown in Table 11. This is equivalent to 21.8 percent of the GDP as against 19.9 percent of the GDP in 2012-13, excluding the retirement of circular debt that year, suggesting that public expenditure is now taking up a larger share of the national economy.

Two sub-periods can be distinguished within the tenure of the PML (N) Government. During the operation of the IMF Program from 2013-14 to 2015-16 serious efforts were made to restrict the annual growth in expenditure to a single-digit rate of 5 percent to 8 percent. However, fiscal discipline was largely sacrificed after the end of the Program. The annual rate of growth in public expenditure during the last two years was around 13 percent, also shown in Table 11.

Current expenditure currently accounts for 78 percent of total expenditure, as shown in Table 12, The remainder, 22 percent, is in the form of development expenditure, especially through the national PSDP. Efforts have been made to reduce the budgetary share of current expenditure. Consequently, it has grown at 9 percent annually since 2012-13.

In the Federal Government's current expenditure, the two major components are debt servicing and defense, with current shares of 39 percent and 27 percent respectively. The growth rate of debt servicing has been 8 percent annually and that of defense, 13 percent, as shown in Table 13.

The cost of administering the Federal Government consists of salaries and allowances, pensions and non-salary operating costs. These costs have risen from Rs 419 billion in 2012-13 to Rs 805 billion by 2017-18, with an annual average growth rate of over 11 percent, as

shown in Table 16. The share in the GDP of these costs has risen to 2.1 percent of the GDP, highlighting no achievement in economies of scale in overhead costs.

Over 61 percent of total public expenditure is incurred by the Federal Government with the remainder 39 percent by the four Provincial Governments combined as shown in Table 14. However, the latter have shown a substantially higher growth rate in spending of 14 percent as compared to 7 percent in the case of the Federal Government.

The above analysis of trends in different components of public expenditure enables the identification of areas of focus for achieving greater economy in expenditure, as follows:

a) The Federal and Provincial Governments will have to restrict the growth in their expenditures in 2018-19 to a single-digit rate, as was achieved from 2013-14 to 2015-16. Even more than the Federal Government, the Provincial Governments will need to implement strong controls to check duplication of functions and the growth in lower priority expenditures. This must start in the Provinces where the Government of Tehrik-e- Insaf has been set up.

b) The size of the PSDP has been augmented rapidly through the incorporation of several new projects every year. Currently, the Federal PSDP has as many as 1,148 projects under implementation. There is a need to urgently initiate efforts to improve the quality of development spending. The portfolio of projects has become too bloated resulting in major completion time and cost overruns.

c) Salaries, allowances and pensions at both levels of Government have generally risen annually at a rate higher than the increase in the cost of living. During the last decade the pay package of Government employees has increased cumulatively in real terms by over 40 percent. This increase is actually larger than the rise of emoluments in the private sector. There is a need to develop an appropriate remuneration policy in the public sector.

d) Operating costs are non-salary costs which include expenditures on utilities, running of vehicles, stationery, acquisition of physical assets, civil works, repair and maintenance, etc. These costs aggregate to over Rs 750 billion at the Federal level.

This is the area in which there is maximum scope for economy. The new Government has already begun to define standards and rules for achieving a sizeable reduction in various operating costs.

We turn to detailed proposals for achieving greater economy of expenditure in 2018-19.

2.2 CURRENT EXPENDITURE

2.2.1 'Rightsizing' of the Federal Government

There was a general expectation that following the 18th Amendment and the transfer of Concurrent List Functions there would be a sizeable trimming of the Federal Government. However, there has been a 'Division Creep' over the last five years. Today, there are as many as 40 Divisions, as shown in Table 28, and over 200 attached departments and autonomous organizations in Islamabad.

The various Divisions vary greatly in size, as measured by the current expenditure budget, consisting of salary and non-salary costs. There are four big Divisions, namely, Cabinet, Capital Administration and Development, Communications and Economic Affairs Division, which have annual recurring budgets above Rs 5 billion, as shown in Table 15. 13 Divisions are medium-sized with budgets ranging from Rs 1 to Rs 5 billion. There are as many as 23 small Divisions with allocations of less than Rs 1 billion. These Divisions are the prime candidates for rationalization of the Federal Government.

We propose the establishment of a Rightsizing Committee, headed by the Advisor on Institutional Reforms, to identify the architecture of a lean and efficient Federal Administration. This Committee should explore a variety of options to achieve this objective, including the winding down of Divisions whose functions have essentially been mandated to Provincial governments, the consolidation of Divisions to curb duplication of activities, etc. A casual look at the list of Divisions reveals cases where there is a strong rationale for clustering into one Division, thereby moderating overhead costs. This will also provide for greater synergy among functions. Some readymade cases are presented below

As a starting point to attain the goal of a slender and well-knit Federal Government all sanctioned positions presently vacant or are rendered vacant by the process of attrition/retirement of an incumbent should be surrendered immediately.

This Commission could also be assigned the task of initiating '*zero base*' budgeting of the Divisions and the multitude of attached departments and autonomous bodies that it recommends for retention, considering that some of the latter entities also have the potential to become more self-financing. .

2.2.2 Voluntary Economy in Defense Expenditure

The Defense budget is not subjected to detailed scrutiny. The share of the Defense budget in Federal current expenditure has increased from 21 percent in 2012-13 to 27 percent in 2017. As such, the Ministry of Defense may seek a voluntary cut in their budget by the Armed Forces, if possible, as part of the national effort to practice austerity.

2.2.3 Ceiling on 'Charged Expenditure'

Charged expenditure is the category of expenditure which is not voted upon by the National Assembly. This includes the expenditure on the operations of the National Assembly itself, the Senate, President's Office and Household, Supreme Court, etc. the total charged expenditure of these entities, according to the Revised Estimates for 2017-18, is Rs 10.3 billion.

Big cumulative increases over the last five years in charged expenditure have been seen in the National Assembly of 84 percent, the Senate of 96 percent and the Supreme Court of 75 percent, as shown in Table 18. More moderate increases are observed in the case of the Office of President of 56 percent and by the Islamabad High Court of 37 percent.

The costs of the Prime Minister's Office are, in fact, not in the nature of charged expenditure. They have shown a relatively smaller increase of 38 percent over the previous five years, also shown in Table 17. There is a need to urge the various Institutions to also voluntarily ensure a noteworthy cutback in expenditure in 2018-19. This will have a pronounced symbolic value.

2.2.4 Transparency and Reduction in Contingent Liabilities

There is a lumpy expenditure head referred cryptically as '*Grants to Others*' or as '*Contingent Liabilities*'. In addition, there are unspecified '*miscellaneous grants*'. These heads combined accounted for grants of Rs 275 billion in 2017-18, as per the revised estimates, as shown in Table 18. They are equivalent to almost 60 percent of the outlay on grants by the Federal Government.

These grants, over the five years of the PML (N) Government, have added up to a massive Rs 1.2 trillion. There is a serious problem of lack of transparency relating to the recipients of these large grants. The nature of grants which are classified as contingent liabilities is also an issue.

The Pakistan Economic Survey has an Annex on Contingent Liabilities. Presumably these are the liabilities that are catered for by the above-mentioned grants. These are sovereign guarantees issued on behalf of Public Sector Enterprises-covering both rupee and foreign exchange guarantees against borrowings by PSEs.

The outstanding guarantees have exceeded Rs 1 trillion by December 2017, of which 8 percent cover foreign currency guarantees and the remainder domestic currency. The stock of guarantees has grown annually at the rate of almost 10 percent. The high ratio of the grants to the value of guarantees is high, at almost 20 percent. This suggests that grants cover both debt repayment and interest charges.

The picture that emerges is of the poor overall state of PSEs in Pakistan. Therefore, the Budget documents should include a statement that identifies the PSE and the amount and purpose of the grant bestowed. There is also a case for including these grants in the total cost of debt servicing.

The new Government has made a strong commitment to improve the workings of PSEs. Efforts must be made to reduce the burden on the Budget by ensuring that in future the revenues of PSEs are able to at least cover their debt servicing liabilities.

2.2.5 Reduced Commitments to Provincial Governments

The policy in future, starting in 2018-19, must be to avoid ad-hoc grants to the Provincial Governments. These Governments have received a favorable dispensation under the 7th NFC Award. As such, only NFC mandated grants should be made to Provincial Governments.

There is, in fact, only one grant specified by the 7th NFC. This is the grant to the Government of Sindh in lieu of the abolition of the Octroi and Zila tax. It is equivalent to 0.66 percent of the provincial share in the net proceeds of the Divisible Pool.

The cumulative magnitude of the grants to the four Provinces combined is Rs 170 billion over the last five years. The budget of 2018-19 must ensure that only the mandated grant is given to the Government of Sindh and no ad-hoc grants are made to other Provinces.

There is another issue with regarding to pending implementation of the 18th Amendment. The Concurrent List of functions which has been transferred to the Provincial Governments and the Federal List-Part-I imply that the day-to-day running of universities is the joint responsibility of the Federation and Provinces. In fact, while there is a Federal HEC there are also HECs in at least two Provinces.

Therefore, there is a case for, more or less, 50:50 sharing in the costs of higher education by the two levels of Government. The recurring allocation for HEC is Rs 65 billion and Rs 35.8 billion for development for 2018-19. If agreement can be reached on equal sharing, probably through the CCI, then the Federal Government could save over Rs 50 billion in 2018-19.

Similarly, the functions of health and population planning have also been transferred to the Provincial Governments. However, the Federal PSDP still contains vertical programs in these two areas. The total allocation for 2018-19 is Rs 25 billion. These programs should be gradually transferred to the Provincial Governments and in the transition phase the costs could be shared equally.

There is a need to remind ourselves that the five years of the 7th NFC Award ended in 2014-15. A new Award has been pending for over three years. The new Government should start deliberations on the 8th NFC Award.

2.2.6 Reduction in Subsidies

The largest component of subsidy borne by the Federal Government is the Tariff Differential Subsidy (TDS) of the power sector. The total subsidy paid to WAPDA/PEPCO and K-Electric in 2017/18 was Rs 114 billion, as shown in Table 20. This is equivalent to 77 percent of the total subsidy bill for the year.

The TDS has fortunately been falling sharply. The subsidy was Rs 349 billion in 2012-13 which has been progressively trimmed to Rs 114 billion by 2017-18. However, it is expected to increase to Rs 149 billion in 2018-19.There has possibly been some under provisioning of the TDS to reduce the fiscal deficit. This may be one of the factors contributing to the big increase in the circular debt in the power sector.

The new Government will need to investigate the size of the TDS. Also, there is the risk that in the event of an IMF Program there may be a condition on the removal of the TDS. In the short-run, this will require an average increase in the electricity tariff of at least 15 percent. Of course, this eventuality needs to be avoided if domestic industry is not to be rendered even less competitive.

We come now to an in-depth examination of the largest head in the expenditure budget of the Federal Government, the cost of domestic and external debt servicing.

2.2.7 Cost of Debt Servicing

The combined cost of servicing of domestic and external debt is the largest single expenditure head in the Federal Budget. The total cost of debt servicing was Rs 1500 billion, equivalent to 39 percent of total current expenditure as shown in Table 20. The dominant part is the mark-up on domestic debt with a share of 88 percent in total debt servicing. Also, the total cost is almost Rs 163 billion higher than the original budget estimate for 2017-18.The rise in domestic debt servicing has been moderate over the last five years with a growth rate of about 7 percent. As opposed to this, external debt servicing costs have risen sharply by over 18 percent.

The explanation behind the contrasting trend lies in the movement of the average interest rate. This has actually fallen significantly in the case of domestic debt from almost 10 percent

in 2012-13 to near 8 percent by 2017-18. However, the effective interest rate on external debt has risen from 1.6 percent to 2.3 percent also shown in Table 20.

The fall in the average interest rate on domestic debt is due, first, to an overall decline in interest rates in the economy due to lower inflation and the shift in the composition of this debt from medium-to-long-term PIBs to short-term MTBs, especially after 2015-16, as shown in Table 21.

The rise in the effective interest rate of foreign debt is the result of increased resort to the flotation of relatively high cost Sukuk/Euro bonds and to commercial loans from international commercial banks, especially of China. Consequently, the share of concessional loans from multilateral agencies has declined. Also, the recent depreciation of the rupee has increased the cost.

Ex post, it appears there was a serious error in debt management in the earlier part of the IMF Program. There was a big increase in the debt stock of PIBs in 2013-14 of almost Rs 2 trillion, as shown in Table 21, at a time when interest rates reached the peak and fell sharply thereafter. This policy was adopted at the urging of the IMF. Consequently, the debt servicing cost remained high despite the fall in interest rates due to the 'lock in' effect of carrying PIBs.

After 2015-16, there has been a wholesale shift towards MTBs. This has reduced the cost of incremental debt with interest rates falling sharply. The mix between domestic and external borrowing has also been changing. The share of external borrowing to finance the budget deficit has increased from 14 percent in 2014-15 to over 35 percent in 2017-18. This is due more to the compulsion to meet the rising external financing requirement of the balance of payments.

The problem currently is that there is now a large stock of almost Rs 9 trillion MTBs, with a maturity period of up to one year, waiting to be refinanced mostly in 2018-19, at a time when interest rates are expected to rise, which may well put heavy pressure on the capital market. The policy during a period of rising interest rates should have been to '*lock-in*' investors on a more long term basis. As such, the emphasis should be on the flotation of PIBs at more attractive rates.

A key factor in determining the state of finances in 2018-19 will be the quality of debt management in a year of rising interest rates and a falling rupee. The capacity of the Debt Policy Coordination Office in the Federal Ministry of finance will need to be rapidly augmented.

2.2.8 Borrowing from SBP

There has been a dramatic reversal in the policy of borrowing from the SBP for financing part of the budget. During the tenure of the IMF Program there was minimal resort to the Central Bank and bulk of the bank borrowing was from commercial banks.

Following the Departure of the IMF, a record level of reliance has been placed on borrowing from the SBP. At one stage in 2018 the flow actually exceeded the stock of debt with the SBP. The motivation for the Government is that this form of borrowing effectively has a zero cost. The interest paid reverts back to the Government in the form of higher SBP profits. However, deficit financing through the SBP has strong inflationary implications.

The recommended level of borrowing from the SBP should be determined by the extent of '*seignorage*' in the economy. This corresponds to the increase in the demand for money and has been estimated at about 1.5 percent of the GDP. Therefore, given the projected size of the national economy of over Rs 38 trillion in 2018-19, Government borrowing from the SBP should be restricted to Rs 570 billion this year. Of course, if Pakistan enters into an IMF program, then any borrowing from the SBP will be strongly discouraged.
We turn finally to an assessment of the Federal PSDP for 2018-19.

2.3 The Federal PSDP

The Federal PSDP and the portfolio of projects included in it are the principal means by which the Federal Government expands the productive capacity of the economy. The other part of the national PSDP is that executed by the four Provincial Governments of Pakistan.

The size of the Federal PSDP was 324 billion in 2012-13, equivalent to 1.4 percent of the GDP as shown in Table 23. Despite expenditure constraints during the period of the IMF Program, there was an increase in the size of the PSDP to 2 percent of the GDP by 2015-16. Simultaneously, despite this increase, there was success in bringing down the size of the fiscal deficit. However, 2017-18 is the first year when the big increase in the budget deficit

has compelled some reduction in the size of the Federal PSDP as a percent of the GDP to 1.9 percent. This is likely to also continue in 2018-19.

The implementation of PSDP projects is by a large number of entities including the various Ministries, Corporation, Governments in special areas like AJ&K and Gilgit - Baltistan. In addition, special programs are delivered by Specialized Agencies like the ERRA. The time has come to completely avoid any form of pork barreling with special programs.

Historically, the Ministries have been responsible for spending about half the funds in the PSDP, as shown in Table 24. However, given the strong preference for highway projects of the PML (N) Government and commencement of the work on the CPEC corridor, the National Highways Authority has emerged as the largest executing agency, especially after 2015-16. The share of special areas financed by the Federal Government has remained below 10 percent.

The number of projects under execution in 2018-19 is as large as 1,148. The total cost of these projects is over Rs 9 trillion, especially concentrated in the highway and water resources sectors, as shown in Table 25.About 27 percent of the cost had been incurred by 2017-18 on the projects combined. As such, the throw forward is very large at Rs 6.7 trillion. The total size of allocation to the projects In the PSDP is Rs 765 billion in 2018-19. This implies that a typical project may take as much as another nine years to complete.

The area of great concern is the small share in the PSDP of two key sectors – Water and Power – as shown in Table 26. Projects, including dams and reservoirs, in the Water Sector need to be accorded substantially higher priority if Pakistan is not to become a severely '*Water-stressed*' country by 2025. Similarly, transmission and distribution projects in the power sector need to be completed faster if the new generation capacity is to be fully used. A big reallocation to these sectors is recommended by reducing the allocation to NHA.

2.3.1 Pruning the PSDP

With a portfolio of 1148 projects, as highlighted earlier, the Federal PSDP is overloaded. This has stretched the implementation capacity of executing agencies to the limits. Further, delay incompletion of projects is leading to big cost overruns and staggering of the developmental impact.

The new Government should undertake a comprehensive and in-depth review of the Federal PSDP of 2018-19, both at the sector /area level and down to individual projects.

A methodology is described below for undertaking an assessment of the Development Program. The prime objective is to see which projects can be shelved, deferred and resources released thereby for priority sectors like Water Resources and Power.

The first step should be to reach an understanding with the provinces on the transfer/sharing of costs of intra-provincial projects.
The next step should be to distinguish between on-going projects and new projects of a particular implementing agency. This methodology has been applied below on the project portfolio of NHA as a case study.
A new project when subjected to scrutiny should be retained in the 2018-19 PSDP if either it is a CPEC project or it has commitment for foreign assistance from, say, a multilateral agency.

On-going projects should continue to be implemented if they are part of CPEC. If not included in CPEC the project must pass the following criteria for continuation: Either (i) 80 percent or more of the cost has already been incurred and/or (ii) it has received foreign assistance and with more funds forthcoming.

The above methodology has been implemented on the portfolio of 112 projects in the PSDP of NHA of 2018-19. 43 projects are on-going and 79 are new.

The results are as follows:

a) Only one new project meets the criteria. It has an allocation of Rs 2 billion. The total allocation for new projects is Rs 65 billion. Therefore, Rs 63 billion can be withdrawn from the PSDP for NHA.
b) 26 out of the 43 on-going projects pass the test. This leads to the inclusion of Rs 205 billion of allocation.

Overall, out of the PSDP of Rs 302 billion, including self-financing by NHA, Rs 207 billion stay in the PSDP.

The proposal is that the resulting funds released should be allocated to the Water and Power Sectors by increasing the funding for mature on-going projects, in order to facilitate earlier completion.

2.4 Proposal for a Possible 'Water Resources' Cess

Given the top-most priority for implementing projects and programs for improving the water resources position of the country, more development funds need to be allocated to the sector. To supplement allocations for the water sector a levy of a special WATER RESOURCES CESS at the rate of 2 percent on all taxes paid by taxpayers to the Federal Government (to be levied on both direct and indirect taxes) may also considered as an option.

Revenues from the Cess could be explicitly earmarked for transfer to the Diamer Basha and Mohmand Dam Fund. More than Rs 80 billion would accrue annually from the Cess to the Fund.

Overall, there is substantial scope for economy in public expenditure. The above analysis has revealed that operating costs can be significantly reduced. Institutions, which enjoy the privilege of having 'charged' expenditure not voted upon by the National Assembly, must begin to exercise voluntary expenditure restraint. Defense Services may also try and achieve a similar voluntary cut in their budget. Also, Provincial Governments should put in place strong mechanisms for achieving greater austerity.

The policy of ad-hoc increases in salaries, allowances and pensions must be avoided. A proper remuneration policy must be put in place which limits the maximum rate of increase to the rate of inflation. A moratorium may be imposed over the next two years on the increase in salaries and allowances of Government employees above BPS Grade 17.

Provincial transfers must be limited only to those provided for in the 7th NFC Award and efforts made to share the cost of joint functions like higher education, population planning and health. The process of discussion on the next NFC Award may also be initiated.

The quality of public debt management has to be substantially improved with a clear statement of policies to be followed during a period of rising interest rates.

The Federal PSDP needs to be reviewed in-depth to divert more funds to the CPEC, Water and Power Sectors. New projects in the Federal PSDP of 2018-19 may largely be postponed for implementation unless they fulfill certain special criteria.

Overall, the target must be to achieve a cut in total public expenditure of one percent of the GDP. Along with implementation of the agenda of tax reforms it should be possible to bring down the fiscal deficit to 5 percent of the GDP in 2018-19.

Chapter III: Managing the Balance of Payments

3.1 Introduction

The external balance of payments of Pakistan worsened in 2016/17 crossing $12 billion, from a relatively safe level of below $5 billion in 2015-16. The year, 2017-18 saw a further deterioration and the current account deficit rose further to $18 billion, equivalent to 5.8 percent of the GDP. This puts us in the list of countries vulnerable to complications in discharging external debt obligations. Countries like Egypt and Turkey also have current deficits in the range of 5.5 to 6.5 percent of their GDP. These countries have witnessed substantial depreciation in the value of their respective currencies, ranging from 50 percent to 60 percent, over the last two years.

Why has the current account deficit become so large? And has this deficit acquired a deeper, protracted and structural character? There are a number of explanations for its growing level. First, the policy preference from 2014 onwards was to maintain the nominal value of the rupee. This resulted in the appreciation of the real effective exchange rate (REER), by as much as 24 percent by mid-2017. This rise in the value of the currency affected the competitiveness of our exports and made imports cheap relative to domestically produced goods. Consequently, exports plummeted by 12 percent between 2013-14 and 2016-17, while imports continued to grow at an accelerated rate.

Secondly, the IMF Program bound us to further liberalize the trade regime, requiring the scaling down of the import tariff walls, resulting in the maximum tariff being brought down from 30 percent to 20 percent. The lower tariff slabs were also cascaded down accordingly.

Thirdly, a number of other special factors were also in operation. The launching of power generation and other infrastructure projects under CPEC induced a sharp increase in imports of machinery by almost 23 percent between 2015-16 and 2017-18. Furthermore, the oil price which had fallen to below US$ 50 per barrel in 2015 started rising, especially in 2016-17. As a result, from 2015-16 to 2017-18 the oil import bill increased by 59 percent.

Exports have also been rendered more uncompetitive by some other factors. The zero-rating of exports should have implied, more or less, automatic payment of refunds. But this has not

transpired. Currently, over Rs 200 billion of outstanding refund claims have piled up, adversely affecting the liquidity of exporters.

The cost disadvantage of exporters has been worsened by the relatively high price of electricity in Pakistan, partly owing to large inefficiencies in generation, transmission and distribution, partly to a continuing low recovery rate of bills and theft. System losses approach 30 percent. Also, until recently there was heavy dependence on a relatively expensive fuel source, furnace oil.

Our vulnerability to a financial crisis is highlighted by the perilously low level of foreign exchange reserves with the SBP. Currently, they stand at just above $10 billion, not even enough to provide an import cover of two months. Further, if the 'swap' funds with the SBP are excluded net reserves are down to a precarious level of less than $ 4 billion.

3.2 Factors Affecting Competitiveness

In the last five years the competitiveness of the real sectors in particular and the economy in general has been increasingly compromised. Two inextricably linked policy distortions and poor governance have impacted the competitiveness of the economy, creating and reinforcing potentially grim challenges in the not too distant future to the financing of our external bills.

These relate to:

a) An increasingly slanted tax structure conjoined with the unpredictable interpretation of the governing laws that incentivizes movement of investable funds into either unproductive sectors of the economy (like real estate, speculative activities, etc.) or sub-sectors of a 'rentier' nature involving heavy protection against global competitors. The complex system has simultaneously raised for all businesses the cost of compliance with tax regulations;
b) As mentioned above an overvalued exchange rate and other policies pertaining to taxation in general, and long delays in processing tax refunds, in particular of exported products and higher input costs due to relatively large energy tariffs and transportation costs (owing to a heavy reliance on taxes on diesel for tax revenues-the mainstay of industry, transport and agriculture). This is the consequence of complex and high rates of import duties on raw materials and intermediate goods used in manufacturing and a dysfunctional system for GST and customs duty refunds. These

factors induced a higher rate of our domestic inflation compared with our competitors or trading partners, gravely impairing the competitiveness of the economy.

c) Since we have been running large budget deficits (with their spill-over effects on the balance of payments) and a higher rate of inflation than our trading partners it has been difficult to ensure stability in the value of the rupee. A high rate of inflation within the country with an un-adjusted rupee raises the cost of production, making imports cheaper and exports less competitive internationally.

Furthermore, we have to compete in a global trading system where increasingly stringent requirements apply with regard to product quality, safety, health and environmental impact. Hence, exporters need certificates from internationally recognized institutions that their products conform to these requirements.

Today, non-tariff trade costs (freight, insurance, and other cross-border-related fees) tend to be much larger than any remaining import tariffs. Those trade costs also have a more intangible dimension that encompasses information costs, non-monetary barriers (regulation, licensing, and so on), insecure contracts, and weak trade governance leading to uncertainty.
The discussion above underscores the complexity of designing trade policy, since it requires grappling with a large array of overlapping objectives, in a system where policy making is highly fragmented. In Pakistan historically, the destiny of our economy has been critically dependent upon external capital inflows because the level of our domestic savings has been inadequate to finance the combined investments of the public and private sectors.

Hitherto our style of governance has been to look towards the international community for handouts to pay our bills, as if we have an open-ended license fiscal profligacy and to mismanage our affairs. Official efforts have been geared to simply winkle the next tranche from the granted loans rather than as temporary relief measures, as efforts are launched for fiscal rectitude and encourage and solicit domestic and foreign investment to drive growth. And foreign investors follow a boom, they cannot create a boom. Foreign investment only supplements and complements domestic investment. The experiences of SE Asia and China bear testimony to this. Foreign investment in China is high because domestic investment is high and not vice versa. There are no examples in the world of accelerated economic growth based largely on foreign capital.

Therefore, going forward we will have to look at domestic sources to meet our growing investment requirement, since international capital flows are destined to become more volatile, while the poor country image and the fragility of the external account will make it more difficult to access such funds at affordable rates. This will require more savings, both ‘public’ and private, which will have to be anchored in fundamental structural reforms.

3.3 Reforms

While acknowledging that the structural vulnerabilities of the external account can be dealt with comprehensively only in the medium-term (there being no quick fixes) some strong multiple actions are needed urgently on both the export and import fronts because, as already argued above, the foundations of our balance of payments are wobbly and the foreign exchange reserves are under severe stress.
These measures should be aimed at bringing the current account deficit down to around 2.5 percent of GDP, corresponding to a gap that can be financed from normal and regular capital flows. Some of these transitional interventions will have to be phased out in the medium to long term to address the structural issues affecting our competitiveness.

Emergency provisions of GATT may also have to be invoked by introducing a regime of minimum import prices (admittedly a non-tariff barrier) not entirely because of balance of payment financing reasons but for administrative reasons as well, to check under-invoicing.

The import bill could also be controlled by a wider system of cash margins for various categories of imported items. The cash margin could range from 10 percent to 100 percent, depending on the nature of the good imported.

For reducing the high cost of doing business for exports we propose the following measures[2]:

a) Removal of regulatory duties on all raw materials to reduce the high cost of domestic production to compete with imports and help exports.
b) Levy of import duties on machinery and spare parts to 5% and removal of GST on machinery, whether imported by manufacturer or commercial importers, to reduce the cost of investment for modernization and to keep up with new trends in the export market. Simultaneously, there is need to minimize the number of SROs.

[2] These proposals have been crafted benefiting from the recommendations in Dr. M. Zubair Khan’s report for Asian Development Bank, “Analysis of Pakistan’s Export Performance Main Challenges and Issues”

c) Five exporting sectors zero rated by FBR should also be zero rated for power surcharges on energy to bring the tariff in line with regional competitors. The export incentive scheme should be extended to cover more emerging exports.
d) As starting points for achieving timely refunds, FBR revenue targets should be set in gross terms to reduce the incentive to withhold refunds and the previous system of automatic refunds is reintroduced for matching transactions/invoices filed by the seller and buyer.
e) A mechanism needs to be put in place to provide duty drawbacks on locally manufactured raw materials to support the entire value chain.
f) Indirect exports should be made eligible for support under the LTFF scheme.
g) The LTFF facility should also cover investment on infrastructure of garment plants.
h) Manufacturers-cum-Exporters who do not have composite units but get the work done by vendors are not allowed facilitation under the DTRE scheme. The facility of import of yarn, fabric and other raw materials under the DTRE scheme is only allowed to composite units. It should be extended to Manufacturers-cum-Exporters who do not have composite units are now allowed.
i) To improve the liquidity of exporters and reduce their cost of doing business we should consider an Indian type instrument (*its Merchandize Exports from India Scheme*) whereby *Duty Credit Scrip's* are issued automatically against actual export receipts (as a percentage of the FOB value), which can then be used for paying customs duties and GST, instead of the present system of processing these claims through long winded procedures lacking transparency.
j) Alternatively, a cash incentive type scheme followed by Bangladesh may be adopted. This will require payment of the export rebate / duty drawback along with the export receipts by commercial banks and reimbursement by the SBP.

Furthermore, whilst the bigger exporters in the country have the resources to participate in these regional chains and replace say the Chinese suppliers as the move up the up the value chain, the SME sector, which provides jobs to 80 percent of the manufacturing labor force, will need government support to benefit from such opportunities. Recommendations on credit to SME exporters are:

a) More than 70 percent of the credit lines under the EFS are utilized by the 100 largest exporters. Hence a separate and dedicated component of EFS and LTTF financing should be established for SMEs.
b) Since energy is a key issue, the government can help SMEs by conducting and subsidizing their energy audits to make their processes more energy efficient;
c) Existing vocational and technical training centers for sub-sectors in which we have a comparative advantage should be transferred to a foreign partner to produce internationally certified skilled workers. Bilateral donors can be persuaded to divert their funding for setting up state of the art institutions and become partners in financing technical assistance and managing such centers-because their present grants tend to be relatively small and thinly spread across different agencies and programs, with limited societal and economic impact.

Moreover, with the change in currency of power – from 'hard' to 'soft' other opportunities are being generated with creative industries becoming an important source of not just the badly needed 'soft image' of the country but also a source of growth and trade. Our bright young designers, singers and musicians (many of whom are women) can help change the country image. They should be supported to enable them to realize their potential and. This will not require large volumes of funds.

3.4 Meeting the Financing Requirement

As highlighted above, there is the risk that the external financing requirement could reach an even higher level of $29 billion in 2018-19. Last year, even with a significantly lower requirement of $24 billion, almost $6.3 billion of reserves were consumed to finance the gap. And this year such a cushion of reserves does not exist, presenting a more formidable challenge.

There are two potential options. If we enter into negotiations with the IMF and unacceptable non-economic conditions are imposed then several strong domestic measures will have to be implemented to achieve a measure of self-reliance.
This will involve reducing imports by over 15 percent in relation to last year's imports of $56 billion to achieve which there will be a need to simultaneously apply a variety of reforms to contain imports. This will include a general enhancement in import tariffs (and possible tariff quotas on competitive imports from China), across-the-board application of cash margins up

to 30 percent and significant further depreciation of the rupee (such that the REER is brought down from 111 to 100).

The pressure on the rupee and the foreign exchange reserves is not likely to subside anytime soon following the initiation of 'global currency wars' as one outcome of the trade wars. This depreciation (along with the increase in interest rates-see below) will address the issue of creeping speculation against the rupee, while discouraging imports and improving the competitiveness of our exports.

Direct attempts to narrow the trade deficit will have to be supported by fiscal and monetary policies so as to manage the overall level of aggregate demand in the economy, thereby restricting the volume of import.

This will include a reduction in the size the PSDP by up to Rs 200 billion. The policy rate of the SBP (hitherto benign in nature) may have to reach a double-digit rate and government borrowing from the SBP will have to be limited to below 1.5 percent of the GDP to ensure relatively low growth in money supply.

On the fiscal policy front, the proposals contained in the earlier articles on the agenda of tax reforms and on economy in expenditure will need to be implemented. The fiscal deficit for 2018/19 will have to be brought down to near 5 percent of GDP.

The above set of measures should halve the deficit of 2017/18 of $18 billion to $9 billion in 2018-19. With external debt repayments of around $9 billion this year, the gross financing requirement will be $18 billion following the stabilization measures mentioned above.

The problem is that even with this lower requirement the financing of such a gap will be tough. With less than two months import cover of reserves, multilaterals like the World Bank and ADB may slow down, if not stop, the flow of funds to Pakistan. Also, it will not be possible to float bonds internationally except at interest rates carrying a high risk premium. The country will then have to rely on increased support from friendly countries like China and Saudi Arabia and place hope on increased investment by the diaspora.

Based on the above referred measures to stabilize the economy, without an IMF Program, the BNU Macro Econometric Model makes the following projections for 2018-19:

- Current Account Deficit: $ 9 billion

- GDP Growth Rate: 4.4 %
- Private Investment Growth Rate: -5.5%
- Increase in Employment: less than 1/4th of the annual addition to labour force
- Rate of Inflation: 10.5%
- Budget Deficit: 5.2% of the GDP

Therefore 2018-19 is likely to be a year characterized by a decline in the growth rate from 5.8% in 2017-18 to 4.4%, a rise in the rate of inflation from about 4% to over 10% and a nominal increase in employment opportunities.

The slowing down of the growth rate following the squeezing of imports can be less harsh as a consequence of CPEC related investments and a faster rate of growth of exports, assisted by timely payments of duty drawbacks and tax and GST refunds at the time of export receipts.

The inflationary impact of the measures can partly be moderated by the utilization of cheaper sources of energy through an improvement in the fuel mix and by adjusting downward the support and procurement prices of sugar and wheat to reflect the decline in international commodity prices.

From the discussion above and the estimates of the gross financing requirement of US$18 billion for this year-even after the proposed stringent measures-it should be apparent that no amount of external flows from friendly countries and bonds taken up by our diaspora will be able to meet plug this gap, suggesting that an IMF program may be unavoidable.

Contrary to common perceptions, entering into a Program with the IMF will ease the pain of correction; it will actually provide some ‘breathing space’ to the process of reduction in the current account deficit. This can then be spread over two to three years. Perhaps surprisingly, this should be the chosen path if the Fund behaves as the global lender of the last resort and no non-economic conditions are introduced, since it will enable a gradual and less painful path for undertaking the long delayed essential external and internal adjustments.

Entry into a Program with the IMF will mean that a current account deficit of up to $12 billion can be financed, more or less, comfortably in 2018-19. First, the IMF could make available up to $4 billion in the first year of the Program. Also, the multilateral agencies will be back to support Pakistan and it will also be possible then to float Euro/Sukuk bonds. The second and third year of the Program should witness the completion of structural reforms to put the country back on the path of high and sustainable growth.

The external financing requirements and potential financing in 2018-19 under the two scenarios - 'Without IMF' and 'With IMF'- respectively are presented in the Table below:

External Financing Requirements And Sources of Financing[a]

($ billion)

	Without IMF	With IMF
External Financing Requirements	18.0	23.5
Current Account Deficit	9.0[b]	12.0[c]
External Debt Repayment	9.0	9.0
Build up of FE Reserves	-	2.5[d]
B. Financing	18.0	23.5
FDI/FPI	2.5	3.0
Government Borrowing	10.0	13.0
Bilaterals[e]	3.0	2.5
Multilaterals	1.5[f]	3.5[g]
Bonds	-	2.5
Commercial Loans	4.0	3.0
Other Support	1.5[h]	1.5[h]
Private Borrowing	3.0	3.5
Higher Support from Friendly Countries[i]	2.5	-
From IMF[j]	-	4.0

Notes

a Approximate estimates to the nearest $ 0.5 billion

b Half the deficit of 2017-18

c Two-thirds of the deficit of 2017-18

d For building up reserves to above two months import cover

e Mostly from China for CPEC

f From IDB only

g Also from World Bank and ADB

h Swap funds already received from China

i From countries like Saudi Arabia and from Pakistani diaspora

j Program size of $ 7.5 billion, with $ 4 billion in first year

The new Government has assumed power at a time of incipient financial crisis. The quality of economic management by the new team will be tested. Also, the promises in the manifesto of the ruling party can now only become a reality once the crisis is averted and stabilization of the economy is achieved. We wish the Government every success in its efforts.

STATISTICAL APPENDIX

Table 1: The State of Public Finances – 2012-13 to 2017-18 *(% of GDP)*

	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18(E)
A. TOTAL REVENUES (NET)	7.0	8.0	7.7	7.6	8.1	7.2
A.1. Tax Revenues	*9.1*	*9.4*	*10.*	*11.6*	*11.6*	*11.8*
FBR Revenues	8.6	9.0	9.4	10.7	10.5	11.2
Other Taxes	0.5	0.4	0.8	0.9	0.9	0.6
A.2. Non-Tax Revenues	*3.3*	*4.1*	*3.1*	*2.4*	*2.8*	*1.8*
Defence Receipts*	0.8	0.5	0.6	0.4	0.2	
Other Sources	2.5	3.6	2.5	2.0	2.6	
A.3. Transfers	*-5.4*	*-5.5*	*-5.6*	*-6.4*	*-6.2*	*-6.4*
B. TOTAL EXPENDITURE	15.4	14.9	13.7	13.5	13.6	13.7
B.1. Current Expenditure	*11.7*	*11.5*	*11.2*	*10.9*	*10.9*	*11.1*
Debt Servicing	4.4	4.6	4.8	4.3	4.2	
Defence	2.4	2.5	2.5	2.6	2.8	
Pensions	0.8	0.7	0.7	0.8	0.9	
Grants / Subsidies	3.2	2.8	2.4	2.2	2.0	
Other	0.9	0.9	0.8	1.0	1.0	
B.2. Development Exp.	*3.7*	*3.4*	*2.5*	*2.6*	*2.7*	*2.6*
PSDP	1.6	1.7	1.8	2.1	2.3	
Other Development Exp.	0.4	1.0	0.5	0.4	0.4	
Net Lending	1.7	0.7	0.2	0.1	0.0	
C.STATISTICAL DISCREPANCY	0.0	-0.6	-0.4	-0.5	0.2	-
Federal Fiscal Deficit	*-8.4*	*-6.3*	*-5.6*		*-5.7*	*-6.5*
Provincial Cash Surplus/Deficit	*0.2*	*0.8*	*0.3*	*0.7*	*-0.1*	*-0.1*
Consolidated Fiscal Deficit	*-8.2**	*-5.5*	*-5.3*	*-4.6*	*-5.8*	*-6.6*

Source: MOF, Fiscal Operations | Estimated for 2017-18

Table 2: Trend in FBR Tax Revenues *(% of GDP)*

	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18
Income Tax	3.3	3.5	3.7	4.1	4.2	4.5 (4.2)**
Sales Tax	3.8	4.0	4.0	4.6	4.1	4.3
Customs Duty	1.1	1.0	1.1	1.4	1.6	1.8
Excise Duty	0.5	0.5	0.6	0.6	0.6	0.6
TOTAL*	8.6	9.0	9.4	10.7	10.5	11.2 (10.9)**

*Including revenues from the Amnesty Scheme | **Excluding revenues from the Amnesty Scheme.

Source: MOF, Fiscal Operations | Estimated for 2017-18

Table 3: Distribution of Revenue from Withholding Taxes

	No	Share in Revenue (%)
Large Withholding Taxes *(20 billion or above from the source)*	12	86.8
Medium-Sized Withholding Taxes *(above Rs 5 billion-less than Rs 20 billion)*	11	10.9
Small Withholding Taxes *(below Rs 5 billion)*	41	2.3
TOTAL	64	100.0

Source: FBR Year Book, 2015-16

Table 4: Revenue from Top Withholding Taxes (> 20,000 Million Rs), *(Rs in Million)*

Serial No.	Section of ITO	Description	2015-16 Revenue
4	148	Import	179,728
5	149	Salaries	92,252
6	150	Dividends	42,042
8	151(1) (b)	Profit on Bank Deposits	26,745
17	153(1) (a)	Sale of Other Goods	63,183
18	153(1) (b)	Services	70,714
19	153(1) (c)	Other Contracts	79,746
21	154(1)	Exports	
28	231A	Cash Withdrawal from Banks	28,619
41	235	Electricity Bills	25,526
45	236	Mobile Phone Subscribers	41,653
60	236P	Advance Tax on Bank Transactions not by cash	21,608
		TOTAL	696,714
		Share (%)	86.8

Source: FBR Year Book, 2015-16

Table 5: Revenue from Medium-Sized Withholding Taxes (Rs 5000 - < 20,000 Million), *(Rs in Million)*

Serial No.	Section of ITO	Description	2015-16 Revenue
7	151(1) (a)	Profit on NSC / PO	13,964
11	152(1)	Royalty / Fee for Technical Services	9,626
14	152(2)	Others at 20 percent	5,414

16	153(1) (a)	Sale of Rice, Cotton Etc,	6,041
24	155	Income from Property	10,923
25	156	Prizes	7,921
26	156A	Petroleum Products	5,334
30	231B	Registration of New Cars	7,553
32	233	Commission of Others	8,058
44	236	Telephone Subscribers	6,330
56	236K	Advance Tax on Sale of Properties	6,222
		TOTAL	87,836
		Share (%)	10.9

Source: FBR Year Book, 2015-16

Table 6: Actual Profit as % of Equity and Reserves of Companies Quoted in the PSX

Year*	Return (%)
2010	15.4
2011	18.8
2012	13.4
2013	20.8
2014	16.7
2015	20.6

*More recent data is not available.

Source: SBP, Financial Statements Analysis of Companies in PSX.

Table 7: Sales Tax Rates for August *(%)*

	2015	2016	2017	2018
Motor Spirit	19.0	17.0	23.5	9.5
HSD Oil	28.0	28.0	40.0	22.0
Kerosene Oil	16.0	5.0	0.0	6.0
Light Diesel Oil	17.0	8.5	0.0	1.0

Source: FBR

Table 8: Petrol Prices in Selected Countries ($ per liter)

	Motor Spirit	HSD Oil	Ratio
Pakistan	0.77	0.92	0.92
Sri Lanka	0.97	0.74	1.31
Nepal	1.00	0.85	1.18
Philippines	1.06	0.84	1.26
China	1.11	0.99	1.12
India	1.17	1.04	1.13
Turkey	1.19	1.08	1.10

Source: www.globalpetrolprice.com

Table 9: Structure of Import Duties

	Regular Slabs* (%)	No of Slabs	Max Duty
2007-08:	0, 5, 10, 15, 20, 25	0.92	25
2008-09:	0, 5, 10, 15, 20, 25, 35	7	35
2012-13:	0, 5, 10, 15, 20, 25, 30	7	30
2017-18:	3, 11, 16, 20	4	20

*ignoring tariff peak

Source: FBR

Table 10: Import Duty on Petroleum Products *(%)*

	2007-08	2012-13	2017-18
Motor Spirit	0	0	3
HSD Oil	10	10	11
Furnace Oil	0	0	11
LDO	5	0	3
Crude Oil	0	0	3

Source: FBR

Table 11: Level of Growth of Public Expenditure* ***(Rs in Billion)***

	Level	Growth Rate (%)
2012-13	4816	-
2013-14	5026	4.4
2014-15	5388	7.2
2015-16	5796	7.6
2016-17	6801	17.3
2017-18 (E)	7488	10.1
Average Growth Rate (%)	8.8	

Source: MOF, Fiscal Operations

Table 12: Level of Growth of Current and Development Expenditure ***(Rs in Billion)***

	Current Expenditure		Development Expenditure		Share of Current Expenditure in Total Expenditure (%)
	Level	Growth Rate (%)	Level	Growth Rate (%)	
2012-13	3671	-	1145	-	16.2
2013-14	3839	4.5	1187	-3.7	76.3
2014-15	4282	11.5	1106	-6.8	79.5
2015-16	4543	6.1	1252	13.2	78.4
2016-17	5140	13.1	1661	32.7	75.6
2017-18	5854	13.9	1622	-2.3	78.3

Average Growth* Rate (%)		9.3		7.0	
Source: MOF, Fiscal Operations					

Table 13: Growth of Major Components of Current Expenditure ***(Rs in Billion)***

	Debt Servicing	Growth Rate (%)	Defence Expenditure	Growth Rate (%)
2012-13	990	-	540	-
2013-14	1147	15.9	623	15.4
2014-15	1303	13.6	697	11.9
2015-16	1263	-3.1	758	8.8
2016-17	1348	6.7	888	17.2
2017-18	1500	11.3	1030	16.0
Average Growth Rate* (%)		8.3		12.9

Source: MOF, Fiscal Operations

Table 14: Growth of Federal and Provincial Expenditures *(Rs in Billion)*				
	Total Federal Expenditure	Growth Rate (%)	Total Provincial Expenditure	Growth Rate (%)
2012-13	3345		1471	
2013-14	3489	4.3	1537	4.5
2014-15	3563	2.1	1825	18.7
2015-16	3729	4.7	2067	13.3
2016-17	4253	14.1	2548	23.3
2017-18	4704	10.6	2960	16.2
Average Growth Rate (%)	6.8		14.0	
Source: MOF, Fiscal Operations				

Table 15: Distribution of Division by Size, 2018-19 Budget Estimates		
Size (Rs)	No. of Divisions	Share of Expenditure (%)
> 5 billion	4	50.0
1 – 5 billion Rs	13	38.7
< 1 billion Rs	23	11.3
TOTAL	40	100.0 (Rs 81 billion)
Source: MOF, Fiscal Operations		

Table 16: Costs of Administration* of the Federal Government, *(Rs in Billion)*

	Salaries Allowances & Non-Salary Costs	Growth Rate (%)	Pensions	Growth Rate (%)	Total cost of Admin	Growth Rate (%)	Costs of Admin as % of GDP
2001-12	215.6		135.4		351.0		1.7
2012-13	251.2	16.5	167.4	23.6	418.6	19.3	1.9
2013-14	271.3	8.0	187.7	12.1	459.0	9.7	1.8
2014-15	313.3	15.5	220.0	17.2	533.0	16.1	1.9
2015-16	340.0	8.5	236.0	7.3	576.0	8.1	2.0
2016-17	398.2	17.1	245.0	3.8	643.2	11.7	--.0
2017-18	402.1	1.0	333.3**	36.0	735.4	14.3	2.1
2017-18 (R.E)	463.4	15.2	342.0	2.6	805.4	9.5	
Average Growth Rate (%)	9.4		13.8		11.3		

*According to Revised Estimates presented in the Budget Documents

**Big jump in military pensions of 41 percent over the Budget Estimate for the year

Source: MOF, Budget-in-Brief,(various years)

Table 17: Trend in 'Charged'* Expenditures, *(Rs in Million)*

'Charged' Expenditure	2012-13	2017-18 (R.E)	Cumulative Growth (%)
National Assembly	2073	3820	84
The Senate	1206	2359	96
Presidents Office and Households	617	963	56
Supreme Court	1038	1817	75
Islamabad High Court	355	486	37
Wafaqi Mohtasib	300	670	123
Federal Tax Ombudsman	100	147	47
Total of Above	5689	10262	80
Total Current Expenditure			50
Voted Expenditure	**2012-13**	**2017-18**	
PM's Office	702	968	38

Source: MOF, Demand for Grants and Appropriations

Table 18: Grants for Meeting Contingent Liabilities, *(Rs in Billion)*

	Contingent Liabilities	Miscellaneous Grants	Total
2013-14	150	46	196
2014-15	200	56	256
2015-16	180	62	242
2016-17	165	68	233

2017-18 (R.E.)	195	80	275
Cumulative	890	312	1202

Source: MOF, Budget-in-Brief

Table 19: Trend in the Tariff Differential Subsidy to the Power Sector, *(Rs in Billion)*

	WAPDA/ PEPCO	K-Electric	Total
2012-13	265	84	349
2013-14	245	64	309
2014-15	185	36	221
2015-16	118	53	171
2016-17	103	15	118
2017-18	81	33	114
2018-19 (*B.E)	134	15	149

Source: MOF, Budget-in-Brief

Table 20: Evolution and Break-Up of Cost of Debt Servicing, *(Rs in Billion)*

	Domestic Debt			External Debt		
	Interest Cost	Domestic* Debt	Average Interest Rate	Interest Cost	External* Debt	Average Interest Rate
2012-13	920	9520	9.66	71	4487	1.58
2013-14	1073	10906	9.83	75	4877	1.54
2014-15	1208	12192	9.90	96	4775	2.01
2015-16	1150	13625	8.44	113	5418	2.09
2016-17	1220	14849	8.22	128	5918	2.16
2017-18	1322	16415	8.05	177	7796	2.27
Annual Growth Rate (%)	7.3	10.9		18.3	11.0	

Source: MOF, Budget-in-Brief

Table 21: Composition of Domestic Debt, *(Rs in Billion)*

	Long Term			Short Term		
	Debt	Change	Share (%)	Debt	Change	Share (%)
2012-13	4325		45.4	5195	4487	54.6
2013-14	6307	1982	57.8	4599	-596	42.2
2014-15	7583	1276	62.2	4609	10	37.8
2015-16	8624	1041	63.3	5001	392	36.7
2016-17	8298	-326	55.9	6551	1550	44.1
2017-18	7526	-772	45.8	8889	2338	54.2

Table 22: Yield on 5 year PIBs and 6 month MTBs *(%)*

	Yield on 5 year PIBS		Yield on 6 Month MTBs		Inflation Rate (%)
	December	June	December	June	
2012-13	10.93	10.05	9.28	9.22	7.4
2013-14	12.56	12.54	9.98	9.96	8.6
2014-15	10.75	8.88	9.47	6.75	4.5
2015-16	7.99	6.88	6.39	5.95	2.9
2016-17	-	6.90	5.90	-	4.2
2017-18	-	8.48 (9.25)*	-	- (7.73)*	3.9

*August 2018

Table 23: Size of the Federal PSDP *(Rs in Billion)*

	Expenditure on Federal PSDP	Growth Rate (%)	% of GDP
2012-13	324	-	1.45
2013-14	435	34.2	1.74
2014-15	489	12.4	1.78
2015-16	593	21.3	2.04
2016-17	726	22.4	2.27
2017-18 (R.E)	661	-9.0	1.92
2018-19 (B.E)			

Actual Growth Rate (%)	14.3		
Source: MOF, Budget-in-Brief			

Table 24: Distribution of PSDP* among Implementing Agencies *(%)*

	Ministries	Corporations	Special Areas	Special Programs	Total
2013-14	50.6	37.3	9.6	2.5	100.0
2014-15	52.4	32.8	9.1	5.7	100.0
2015-16	31.1	35.9	7.3	25.7	100.0
2016-17	27.6	51.1	6.4	14.9	100.0
2017-18	23.4	48.8	7.1	20.7	100.0

*On the basis of releases. Source: Planning Commission

Table 25: The Key Facts on PSDP[a] (Federal) for 2018-19, ***(Rs in Billion)***

Sector	Total Cost of Projects	Cost Incurred Already	Throw-forward	Allocation for 2018-19		
				F.E.	Rupee	Total
National Highways Authority	2923	755	2168	96	206	302*
Water Resources	2736	1096	1640	14	186	200**
Railway	639	105	534	4	36	40
NTDC / PEPCO	593	120	473	32	40	72***
Pakistan Atomic Energy Commission	1052	107	945	0	30	30
Higher Education Commission	310	86	224	0	46	46
Capital Administration Division	124	6	118	0	15	15
Finance Division	157	54	93	2	16	18
National Health Services	176	90	86	2	23	25
Others	485	97	388	7	10	97
TOTAL***	9195	2516	6679	157	608	765

Almost 9 years on average to complete projects | 27% Completed

[a] Excluding Special Program, only Ministries and Corporations

*Includes Rs 100 billion in PPP Mode financing | **Includes WAPDA Self-Financing

***Including self-financing by PEPCO | ***Number of projects under execution is 1148

Table 26: Development Priorities in the Federal PSDP ***(% of the PSDP)***

Development Priorities	2017-18	2018-19
Water	4.2	9.4
Power	7.5	7.8
Highways	42.6	23.7
Other Physical Infrastructure	5.8	6.9

Social Sectors	6.0	8.5
Special Areas	8.3	9.3
IDPs and Security	8.0	10.6
Other Special Programs	11.4	5.1
Others	6.2	18.7
TOTAL	100.0	100.0

Source: MOF, Fiscal Operations

Table 27: Distribution of Revenues from Withholding Taxes 2015-16, *(Rs in Million)*

Serial No.	Section of ITO		Revenue
		Total Withholding Taxes	803,116
1	4A	Surcharge on Income Tax @ 15%	3
2	7	Non-Residents Operating Ships @ ---%	45
3	7	Non-Residential Operating Aircraft @ 3%	54
4	148	Imports	179,728
5	149	Salaries	92,252
6	150	Dividends	42,042
7	151(1) (a)	Profit on NSC / PO	13,964
8	151(1) (b)	Profit on Bank Deposit	26,745
9	151(1) (c)	Profit on government Securities	4,760
10	151(1) (d)	Profit on Other Securities	2,730
11	152(1)	Royalty / Fee for Technical Services	9,626
12	152(1) (A)	Non-Resident Contractor	4,925
13	152(1)(AA)	Payment of Insec / Re-Insec Premium	-
14	152(2)	Others at 20 percent	5,414
15	153(1) (b)	On Transport Services	334
16	153(1) (a)	Sale of Rice, Cotton, Seed or Edible Oil	6,041

17	153(1) (a)	Sale of Other Goods	63,183
18	153(1) (b)	Services	70,714
19	153(1) ©	Other Contracts	79,746
20	153(1) (d)	-	42
21	154(1)	Exports	24,898
22	154(2)	Indenting Commission on Foreign Exchange	664
23	154(3C)		58
24	155	Income from Property	10,923
25	156	Prizes	7,921
26	156A	Petroleum Products	5,334
27	156B	Withdrawal from Pension Fund	144
28	231A	Cash Withdrawal from Banks	28,619
29	231AA	(DD, DDC, etc.)	916
30	231B	Registration of New Cars	7,553
31	233	Commission from Advertising Agents	3,562
32	233	Commission Others	8,058
33	233A (1) (a)	On purchase / sale of shares	993
34	233A (1) (b)	Commission on Trading of Shares	-
35	233A (1) (c)	On trading of shares	400
36	233A (1) (d)	On Financing of Carry over Shares Trades	32
37	234	On Goods Transport Vehicles	3,735
38	234	On Passenger Transport Vehicles	1,917
39	234	On Private Motor Cars	3,304
40	234A	On CNG Stations	1,763

Table 27 *(…Contd.)*: Distribution of Revenues from Withholding Taxes 2015-16, *(Rs in Million)*

Serial No.	Section of ITO		Revenue
		Total Withholding Taxes	803,116
41	235	Electricity Bills	25,526
42	235A	Advance Tax on Domestic Electricity Consumption	269
43	235B	Tax on Steel Melters, Re-rollers	466
44	236	Telephone Subscribers Other than Mobile Phones	6,330
45	236	Mobile Phone Subscribers – Pre-Paid Cards	41,653
46	236A	Advance Tax on Sales through Auction	3,612
47	236B	Purchase of Domestic Air Ticket	478
48	236C	Advance Tax on Sales / Transfer of Immoveable Property	2,164
49	236D	Advance Tax on Functions / Gathering	733
50	236E	Advance on foreign Produced TV Plays and Serials	1
51	236F	Advance Tax on Cable Operators / Electronic Media	23
52	236G	Advance Tax on Distributors / Wholesalers	3,392
53	236H	Advance Tax on Sales to Retailers	1,836
54	236I	Advance Tax on Educational Institutions	2,520
55	236J	Advance Tax on Dealers/Commission Agents/Arthis	135
56	236K	Advance Tax on Purchaser on transfer of immoveable properties	6,222
57	236L	Advance Tax on purchaser of international air ticket	948
58	236M	Bonus Shares Issued by Companies in Stock	529

		Exchange	
59	236N	Bonus Shares Issued by Companies not in Stock Exchange	52
60	236P	Advance Tax on Banking Transactions Otherwise than through cash	21,608
61	236Q	Payment to Residents for Use of Machinery and Equipment	102
62	236R	Collection of Advance Tax on Education Expenses Remitted Abroad	280
63	236S	Dividend in specie	543
64	236T	Collection by PMEX	107

Table 28: List and Current Budget of divisions 2018-19

1	Cabinet Division	6343	21	Information & Casting Division	735
2	Aviation Division	97	22	National Heritage Division	1085
3	Capital Admin & Development	21294	23	ICT & Telecom Division	4075
4	Establishment Division	2734	24	Interior Division	831
5	National Security Division	51	25	IPC Division	1907
6	Climate Change Division	614	26	Kashmir & G-B Division	371
7	Commerce Division	4912	27	Law and Justice Division	555
8	Textile Division	432	28	Maritime Affair Division	782
9	Communication Division	7663	29	Narcotics Control Division	2672

10	Defence Division	1687	30	National Food Sec Division	4176
11	Defence Production Division	698	31	Overseas Pakistani Division	1341
12	Power Division	245	32	Parliamentary Affair Division	395
13	Petroleum Division	377	33	Planning and Development Division	1110
14	Finance Division	1809	34	Postal Services Division	58
15	Economic Affair Division	5296	35	Privatization Division	166
16	Revenue Division	378	36	Religious Affair Division	503
17	Foreign Affairs Division	1524	37	Science and Technology Division	127
18	Housing & Works Division	160	38	States and Frontier Reg. Division	2357
19	Human Rights Division	438	39	Statistics Division	2357
20	Industries and Prod. Division	331	40	Water Resources Division	236
				TOTAL	81055
Over 200 Attached Departments and Autonomous Bodies					