



*Research Report No. 1*

## **Fiscal Policy in Pakistan**

**SOCIAL POLICY AND DEVELOPMENT CENTRE**

# Fiscal Policy in Pakistan

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## THE RESEARCH TEAM

1. Dr. Hafiz A. Pasha – Team leader
2. Dr. A. F. Aisha Ghaus
3. Rafia Ghaus
4. Rizwanullah Khan

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## EXECUTIVE SUMMARY

### 1. Trends in Public Finance

- 1.1. The fiscal status of the federal government has deteriorated significantly over time from a surplus on the revenue account to a deficit of over Rs.21 billion in 1990-91. On the whole, the overall budgetary deficit has increased from about 13 billion in 1977-78 to almost Rs.60 billion in 1990-91, showing a growth of over 12 percent per annum. The revenue deficit is equivalent to 2.1 percent of the GDP while the overall budgetary deficit is higher at about 5.9 percent.
- 1.2. This deterioration in public finances is the consequence, first of the rapid growth of over 18 percent per annum in current expenditure. Between 1977-78 and 1989-90 the share of current expenditure in the GDP increased by over 7.7 percentage points. Since then there has been some moderation and the share has declined to about 17 percent. The two large components of current expenditure are defence expenditure and debt servicing (combined share of 80 percent). Second, revenue receipts of GOP have been characterized by a relative lack of buoyancy. The annual growth rate of tax revenue is about 15 percent. The tax/GDP ratio has risen by only one percentage point during the last fourteen years.
- 1.3. The last two decades have also witnessed a relatively slow growth, of about 12 percent per annum, in revenue receipts (from own sources) of the provincial governments in Pakistan during a period when expenditures have grown

rapidly, at an annual rate of about 20 percent. Consequently, the dependence of the provincial governments on the federal government has increased substantially. Federal transfers constituted 39 percent of provincial revenue receipts in 1972-73. This share has increased to over 77 percent by 1989-90. The rapid growth in non-development (deficit) grants, in particular, has imposed additional budgetary strains on the federal government.

- 1.4. Despite the high level of support provided by the GOP the combined financial position of the four provinces has declined significantly. In 1989-90, the latter had combined revenue deficit of over Rs.4.5 billion, equivalent to 8.7 percent of their expenditure. Provincial own receipts as a percentage of current expenditure liabilities have fallen from 60 to 24 percent during the decade of the 80s. This clearly highlights the slackening of the provincial effort, on one hand, and the growing financial dependence on the federal government on the other.
- 1.5. The trend in the budgetary magnitudes of the federal government reveals a lack of success in meeting the IMF conditionalities. GOP has not been successful in containing the budgetary deficit to within IMF imposed ceilings. In addition, the SAP required that the reduction be achieved while protecting government development spending at around 7 percent of GDP. The actual size of the ADP is closer to 6 percent of the GOP. Some, significant adjustments have, however, been made in the public finances of the country in response to these conditionalities primarily in the form of reduction in

costs of general administration and in grants to provinces.

## **2. The Current Situation**

- 2.1. Elements in the macro economic environment, both domestic and international, and the overall mix of economic policies adopted by the GOP have a bearing both in the short run and in the medium run on the budgetary position. These include, first, the recent Gulf Crises. The budget was impacted upon last year by the reduction in the margin between POL import and domestic prices and the resulting losses in revenues from the POL development surcharge. Higher subsidies had to be given for crude oil purchases, while the significant shortfall in customs duty revenues is also partially attributable to the Gulf Crisis. Second, the NFC Award of 1991 has increased significantly revenue-sharing transfers to the provinces. On the whole, such transfers to the provinces in 1991-92 will increase by Rs.25 billion in relation to the level in the absence of the award, equivalent to 2.1 percentage points of the GDP.
- 2.2. Third, conversion of T&T into an autonomous corporation in 1990-91, has resulted in a sizeable loss in non-tax revenues to the GOP. Fourth, the financial sector reforms have restricted access and increased cost of borrowing at a time when the GOP is under pressure to service debts. Fifth, the international aid environment is not very favourable and the prospects for large foreign aid inflows in the medium run do not look good.

- 2.3. Sixth, despite the resource constraints, GOP has announced the pay committee award. The additional wage bill to the GOP due to this increase for civilian employees and army personnel is estimated at Rs.6 billion. Altogether most of the factors operating currently are unfavourable, except for the privatization program which could increase income from sale of assets.

### 3. **The Budget of 1991-92**

- 3.1. The federal Budget of 1991-92 is of special significance as it; includes a major package of tax reforms. Major elements of the tax reforms package in the Budget are as follows:

Conversion of withholding to fixed taxes, use of valuation manual (with fixed prices) for import duty purposes, introduction of capacity taxation in excise duty and switch-over to self-clearance, levy of sales tax by resort to the forfeit system (Shoorai Tashkees), scheduler income taxation of unearned income (interest, dividends), imposition of *m* minimum rate of corporate income tax on turnover, reduction in maximum income tax rates on individuals and registered firms, etc. These measures are expected to simplify the tax system and reduce evasion and corruption.

Revenue generation proposals include the levy of an export duty on cotton yarn, a 1 percent warehousing surcharge on imports, increase in excise duty on cotton yarn, imposition of an excise duty (at 25 percent) on telephone services and (at 1 percent) on bank advances, partial extension of sales tax to wholesalers and commercial importers, etc.

- 3.2. The development strategy of the federal government has become more sectorally concentrated in 1991-92. Sectors which show a significant increase in allocation include energy, 51 percent, transport and communication, 62 percent, and agriculture, 28 percent. Important sectors where the 1991-92 allocations are lower than the previous year include education, health, science and technology and other social sectors. As far as provincial ADP are concerned, major sectors of investment include housing and physical planning, 18 percent, education, 14 percent, health, 12 percent, and agriculture 10 percent.
- 3.3. The budget of 1991-92 proposes three distinct measures aimed at reducing inter-personal and inter-regional inequalities in the country. These include, first, the formation of a welfare fund, bait-ul-mal, second, through public works under the tamir-e-watan programme and, third, introduction of a matchings grant scheme for the uplift of the deprived communities. Also, recognition has been given for the first time to community development organization with grass root representation as participants in the development process.

#### **4. Future Possibilities.**

- 4.1. The basic strategy of resource mobilization will probably consist of generating the largest component (in proportionate terms) of additional revenue from direct taxes like income and wealth tax. Not only is the revenue-raising potential highest in these taxes but this will also provide for a more balanced, progressive and elastic tax structure. Within indirect taxes, the strategy will involve a shift in composition away from



taxes on international trade to those on domestic production and sales.

- 4.2. Some of the possible areas of reform in income taxation include removal of exemptions, taxation of unearned income, introduction of presumptive income taxation, minimum taxation on registered firms and individuals, fixation of corporate norms and rationalization of tax rates. In the case of wealth tax, potential areas of reform include updating of valuation Lists, introduction of an agricultural wealth tax and withholding tax provisions
- 4.3. In the case of indirect taxes, cornerstones of the likely resource mobilization strategy are extension of excise duty to services and the general sales tax to wholesale level, broadbasing of customs duties, and improvements in the system of export rebates.
- 4.4. Significant scope exists for mobilizing additional revenues from provincial sources. Potential area include; switchover from specific to ad valorem registration fee in the case of motor vehicle tax, reassessment of rental values and scaling down of exemptions in the case of property tax, introduction of new and buoyant sources of revenues like The capital gains tax and vacant plots tax, and development of a presumptive agricultural income tax.
- 4.5. Also, greater economy in expenditure will have to be achieved. This will include, first, the handing back to the provinces of functions (in the concurrent list) which had earlier been federalized due to the paucity of

resources at the provincial level, Second, winding down ministries performing a role of coordinating essentially provincial functions, Third, adopting a more efficient policy of public debt management, which seeks in particular to raise the period of repayment of domestic borrowing. Fourth, freezing the real level of defence expenditure. Fifth, in the area of social sector investments, innovative delivery mechanisms will have to be evolved which are cost effective and involve a greater degree of community involvement in the choice, execution, financing and management of services.

## **5. Strategic Choices**

- 5.1. If no major changes are made in the fiscal policy in the next few years net revenue receipts of GOP are likely to decline from 14.4 percent to 13.6 percent of GDP by 1995-96. Current expenditure will increase from 15 percent to 16.3 percent. As a consequence, the budgetary deficit will use once again to 7.7 percent of GDP, back to the high levels of mid-80s.
  
- 5.2. It is, expected, however, that GOP will increase its fiscal effort. The targeted increase in revenues is about 1.4 percent of GDP in the next four years. Some expenditure cut backs are expected in general administration and subsidies. Debt servicing is also likely to be lower with a higher self-financing of development expenditure by the provinces and autonomous corporations. As such, In this scenario, net revenue receipts could rise to over 16 percent of the GDP by 1995-96. Growth in current expenditure is likely to be lower as a consequence and it is possible that by 1994-95

a small surplus could be achieved in the revenue account. Subject to these achievements, the overall budgetary deficit could fall to about five percent, close to the level required by the IMF. This will, however, require the political will on the part of GOP to successively add to the tax burden and restrict public sector employment.

## **6. Implications for Donors**

- 6.1. Analysis undertaken above leads to certain basic implications for donor agencies. First, it appears on the basis of budgetary projections, that the credit risk of extending loans to Pakistan is unlikely to alter dramatically in the next few years. Given continued growth in exports, the ability to service external debt is likely to be sustained. The problem appears to be more internal in nature, resulting from the fast growth in domestic debt and rising costs of borrowings.
- 6.2. We have demonstrated the lack of success of GOP in meeting the IMF conditionalities. Future SAP lending may be based on conditionalities which ensure commitment to a strategy that will bring down the budgetary deficit to acceptable levels. These could include explicit targets for the tax/GDP ratio and level of development expenditure. In addition, the level of defence expenditure and the share of social sectors in development expenditure must remain on the agenda for discussion.
- 6.3. The strong commitment of GOP to the process of privatization implies a potentially important role for donor agencies in the development of the private sector

## **FISCAL POLICY IN PAKISTAN**

This report presents an analysis of fiscal policy in Pakistan. *The* format of the report is as follows: Chapter 1 highlights the long-term evolution of public finances in Pakistan. It describes, in particular, the elasticity and buoyancy of tax revenues, growth in debt servicing, size and composition of the public sector development program and the more recent adjustment to IMF conditionalities imposed as part of the Structural Adjustment Facility (SAF).

Chapter Two deals with elements in the current situation which have an important bearing on the fiscal status of GOP and represent the backdrop to the framing of the current Budget. This includes impact of the Gulf Crisis, the National Finance Commission (NFC) award, The conversion of the Telephone and Telegraph Department into an autonomous corporation, reforms in the financial sector, the Pay Committee award and consequences of the privatisation program.

Chapter Three highlights the salient features of the GOP and provincial budgets for the current fiscal year, 1991-92. Special emphasis is given to the package of tax reforms and resource mobilisation, to the ADP size and priorities, to poverty alleviation efforts and new financing initiatives.

Chapter Four speculates on the possibilities that exist in the medium and long run regarding the level and strategy of resource mobilisation and for achieving control over expenditures.

Chapter Five highlights the likely strategic choices within this range of possibilities.

Chapter Six brings out the implications of the likely developments in fiscal policy in Pakistan on donor agencies. This includes a judgement on the future credit worthiness of Pakistan, the implications for donor lending in terms of choice of sectors and executing agencies and the nature of requirements for technical assistance in the area of fiscal policy.

## CHAPTER ONE TRENDS IN PUBLIC FINANCES

### TREND IN FINANCES OF GOP

The evolution of budgetary magnitudes of the federal government, over the period 1977-78 to 1990-91, is presented in Table 1.1. Receipts have not increased in line with its expenditure liabilities, thereby resulting in large and growing budgetary imbalances. Net revenue receipts (both tax and non-tax) have increased at an annual rate of about 16 percent, from Rs.22 billion in 1977-78 to Rs.150.5 billion in 1990-91. Compared to this the annual growth in current expenditure has been 17.4 percent.. As a consequence, the fiscal state of the federal government has deteriorated significantly over time from a surplus of Rs.1.8 billion on the revenue account to a deficit of over Rs.21 billion in 1990-91. On whole, the overall budgetary deficit has increased from Rs.13.4 billion in 1977-78 to Rs.59.9 billion in 1990-91, showing a growth of over 12 percent per annum.

The anatomy of the emerging fiscal crisis confronting the GOP is highlighted by the financial ratios presented in Table 1.2 and 1.3. Table 1.2 shows that in 1981-82 the federal government had a revenue surplus equivalent to over 11 percent of its current Liabilities. Since then the situation has reversed and currently GOP is facing a shortfall of 13 percent in its current expenditure. Almost 25 to 30 percent of the total expenditure, current and development, has been financed by borrowings or use of cash balances. Currently, the GOP has a revenue deficit equivalent to 2.1 percent of the GDP while the overall budgetary

**TABLE-1.1**  
**TREND IN THE FINANCES OF THE FEDERAL GOVERNMENT OF PAKISTAN**

(Rs in Billion)

	1977-78	1981-82	1984-85	1987-88	1988-89	1989-90	1990-91 (R)	ACGR (%)
<b>A. NET REVENUE RECEIPTS</b>	<u>22.0</u>	<u>42.0</u>	<u>66.1</u>	<u>105.0</u>	<u>120.0</u>	<u>130.2</u>	<u>150.5</u>	<u>15.9</u>
A. 1. <u>Tax Receipts</u>	<u>19.2</u>	<u>38.6</u>	<u>52.7</u>	<u>75.9</u>	<u>91.6</u>	<u>106.7</u>	<u>120.6</u>	<u>15.1</u>
A.1.1. Taxes on Income & Wealth	2.9	8.5	9.3	12.1	14.3	16.5	20.0	16.0
A.1.2. Taxes on Commodities & Transaction	16.3	30.1	43.4	63.8	77.3	90.2	100.6	15.0
A. 2. <u>Non-Tax Receipts</u>	<u>6.3</u>	<u>12.6</u>	<u>25.3</u>	<u>45.3</u>	<u>52.0</u>	<u>54.4</u>	<u>63.7</u>	<u>19.4</u>
A.2.1. Income from Property & Enterprise	3.7	7.6	12.3	21.0	25.8	29.8	30.5	17.6
A.2.2. Receipts from Civil Administration	1.0	1.7	4.6	4.4	3.9	3.8	2.0	7.9
A.2.3. Miscellaneous Receipts	1.6	3.3	8.4	19.9	22.2	19.8	31.2	27.2
A. 3. <u>Divisible Pool Transfers</u>	<u>2.5</u>	<u>9.2</u>	<u>11.9</u>	<u>16.2</u>	<u>23.9</u>	<u>30.0</u>	<u>33.8</u>	<u>22.1</u>
<b>B. CURRENT EXPENDITURE</b>	<u>18.9</u>	<u>36.3</u>	<u>68.1</u>	<u>104.9</u>	<u>125.0</u>	<u>153.0</u>	<u>162.8</u>	<u>18.0</u>
B. 1. General Administration	1.1	2.1	4.1	5.2	5.6	5.9	7.2	15.5
B. 2. Defence	9.7	18.6	31.9	45.3	51.1	61.9	63.6	15.5
B. 3. Services (Comm, Social, Economic)	2.1	3.5	5.6	7.6	8.7	8.0	12.4	14.6
B. 4. Subsidies	1.1	1.3	3.8	4.0	8.2	8.6	8.2	16.7
B. 5. Debt Servicing	4.1	9.7	21.2	39.4	47.9	60.3	63.8	23.5
B. 6. Others	0.8	1.1	1.5	3.4	3.4	8.3	7.6	7.2
<b>C. NON-OBLIGATORY GRANTS TO PROVINCES</b>	<u>1.3</u>	<u>1.6</u>	<u>9.1</u>	<u>15.7</u>	<u>10.0</u>	<u>6.9</u>	<u>8.9</u>	<u>15.9</u>
<b>D. REVENUE SURPLUS/DEFICIT (B+C-A)</b>	<u>+1.8</u>	<u>+4.1</u>	<u>-11.1</u>	<u>-15.6</u>	<u>-15.3</u>	<u>-29.7</u>	<u>-21.2</u>	<u>20.8</u>
<b>E. DEVELOPMENT EXPENDITURE</b>	<u>17.5</u>	<u>27.9</u>	<u>36.8</u>	<u>54.8</u>	<u>55.7</u>	<u>55.0</u>	<u>63.0</u>	<u>10.3</u>
<b>F. SELF-FINANCING BY AUTONOMOUS CORPNS</b>	<u>1.1</u>	<u>1.9</u>	<u>2.6</u>	<u>6.0</u>	<u>5.4</u>	<u>5.6</u>	<u>7.9</u>	<u>16.7</u>
<b>G. BUDGETARY DEFICIT*</b>	<u>13.4</u>	<u>16.2</u>	<u>35.9</u>	<u>50.9</u>	<u>46.9</u>	<u>65.4</u>	<u>59.9</u>	<u>12.2</u>
<b>H. GDP AT MARKET PRICES</b>	<u>176.3</u>	<u>324.2</u>	<u>472.2</u>	<u>675.4</u>	<u>773.0</u>	<u>862.5</u>	<u>1016.7</u>	<u>14.4</u>
<b>I. DEFICIT AS % OF GDP</b>	<u>7.6</u>	<u>5.0</u>	<u>7.6</u>	<u>7.5</u>	<u>6.1</u>	<u>7.6</u>	<u>5.9</u>	<u>-</u>

Sources: Pakistan Economic Survey, Finance Division, GOP.  
Budget in Brief, 1991-92, Finance Division, GOP.

ACGR = Annual Cumulative growth rate.

\* The budgetary deficit is computed as follows:

Budgetary deficit = Current Expenditure + Development Expenditure + Non-Obligatory Grants to Province  
- Net Revenue Receipts - Self Financing by Autonomous Corporations - Debt Repayment

TABLE-1.2

## KEY FISCAL RATIOS OF THE FEDERAL GOVERNMENT OF PAKISTAN

	Percentages						
	1977-78	1981-82	1984-85	1987-88	1988-89	1989-90	1990-91 (R)
Current Surplus(+)/Deficit(-) as percentage of Current Expenditure	+9.5	+11.3	-16.3	-14.9	-12.2	-19.4	-13.0
Debt Servicing as % of Current Expenditure	24.3	25.6	27.5	37.5	39.9	39.4	39.2
Development Expenditure as % of Total Exp.	46.4	42.4	32.2	31.2	29.2	25.6	26.8
Budgetary Deficit as % of Total Expenditure	35.5	24.6	31.5	29.0	24.6	30.4	25.5

Sources: Pakistan Economic Survey, Finance Division, GOP.  
Budget in Brief, 1991-92, Finance Division, GOP.



TABLE-1.3

## KEY BUDGETARY MAGNITUDES OF THE GOP AS % OF GDP

	1977-78	1981-82	1984-85	1987-88	1988-89	1989-90	1990-91 (R)
Total Resources	13.1	13.6	14.6	16.4	16.2	15.7	15.6
Development Expenditure	9.9	8.6	7.8	8.1	7.2	6.4	6.2
Current Expenditure*	10.8	11.1	14.4	17.8	17.5	17.7	16.0
Debt Servicing	2.3	3.0	4.5	5.8	6.2	7.0	6.3
Total Expenditure	20.7	19.7	22.2	26.0	24.1	24.1	22.2
Current Surplus(+)/Deficit (-)	+1.0	+1.3	-2.4	-2.3	-2.0	-3.4	-2.1
Budgetary Deficit	-7.6	-5.0	-7.6	-7.5	-6.1	-7.7	-5.9

Sources: Pakistan Economic Survey, Finance Division, GOP.  
Budget in Brief, 1991-92, Finance Division, GOP.

\* Includes Non-Obligatory grants to provinces.

deficit is higher at about 5.9 percent<sup>1</sup> (see table 1.3). The latter has declined somewhat from the peak levels approaching 8 percent in the mid-80s.

The deteriorating fiscal state of the GOP has had adverse implications on the share of its resources devoted to development. Development expenditure has fallen from 46 percent of the total expenditure in 1977-78 to about 27 percent in 1990-91. In relation to the GDP, the decline has been of 3.7 percentage points, from about 10 percent in 1977-78 to only 6 percent in 1990-91. Details of the sectoral composition of the ADP are given in Appendix I.

Rapid growth of over 18 percent per annum has taken place in current expenditure. Between 1977-78 and 1989-90 the share of current expenditure in the GDP increased by over 7.7 percentage points. Since then there has been some moderation and the share has declined to about 17 percent. The two large components of current expenditure are defence expenditure and debt servicing (combined share of 80 percent). The latter has grown at the annual rate of 23.5 percent and the former at 15.5 percent. The growing burden of debt servicing can be judged by the fact that while it represented 19 percent of net revenue receipts of GOP in 1977-78 it now consumes over 42 percent (see Appendix II for details) .

<sup>1</sup>Current indications are that the budget deficit has exceeded 8 percent of the GDP in 1990-91. Reasons are, first, that the actual revenue figures are lower than the revised estimates by about Rs.10 to 12 billion. This is due to some speculative behavior on the part of traders and industrialists during the month of June in response to the budgetary proposals for 1991-92. In addition, the budget deficit has increased by the provinces to the tax of Rs.7 billion.

Revenue receipts of GOP have been characterized by a relative lack of buoyancy. The annual growth rate of tax revenues is about 15 percent while that of non-tax revenues is 19.5 percent. The tax/GDP ratio has risen by only one percentage point during the last fourteen years. The basic reason for this is that individual tax sources are inelastic and generally do not grow in line with the increase in the size of the national economy. A detailed analysis of the elasticity and buoyancy of federal taxes is given in Appendix III.

Within tax revenues, the share of indirect taxes is very large, at over 83 percent in 1990-91. Income and wealth taxes currently constitute only 2 percent of the GDI<sup>1</sup>. This is low in comparison to other countries at a comparable stage of development and highlights the large-scale exemptions and evasion, which characterize Pakistan's income tax system.

**1.2. TRENDS IN FINANCES OF PROVINCIAL GOVERNMENTS** The last two decades have witnessed relatively slow growth, of about 12 percent per annum, in revenue receipts (from own sources) of the provincial governments in Pakistan during a period when expenditures have grown rapidly, at an annual rate of about 20 percent (see table 1.4). Consequently, the dependence of the provincial governments on the federal government has increased substantially. In 1972-73, transfers by the federal government in the form of revenue share in divisible pool taxes and non-development grants (these are primarily given to finance current account deficits of the provinces) constituted 39 percent of provincial revenue receipts. By 1989-90 this has increased to over 77 percent. The rapid growth in non-development (deficit) grants, in particular, has imposed additional budgetary strains on the federal government.

**TABLE-1.4**  
**KEY PUBLIC FINANCE MAGNITUDES OF THE**  
**PROVINCIAL GOVERNMENTS OF PAKISTAN**

Rs in Million

	1972-73	1984-85	1989-90	Annual Growth Rate (%)
<b>A. GENERAL REVENUE RECEIPTS</b>	<u>2428</u>	<u>25960</u>	<u>48691</u>	<u>36.6</u>
Federal Tax Assignments	860	11064	30649	25.9
Provincial Tax Assignments	725	3206	5022	12.1
Provincial Non-Tax Receipts	747	2982	5741	12.7
Federal Non-Development Grants	97	8708	7087	28.7
<b>B. DEVELOPMENT REVENUE RECEIPTS</b>	<u>24</u>	<u>616</u>	<u>2944</u>	<u>32.6</u>
Federal & Foreign Development Grants	24	616	2944	32.6
<b>C. CURRENT EXPENDITURE</b>	<u>2441</u>	<u>25888</u>	<u>52027</u>	<u>19.7</u>
General Administration	143	2398	5721	24.2
Law and Order	263	2464	4384	17.9
Community Services	585	8920	2930	9.9
Social Services	802	7656	17325	19.8
Economic Services	582	3939	6275	15.0
Subsidies	242	1588	2993	15.9
Debt Servicing	321	2936	11816	23.6
<b>D. DEVELOPMENT REVENUE EXPENDITURE</b>	<u>801</u>	<u>2321</u>	<u>5561</u>	<u>12.0</u>
<b>E. REVENUE SURPLUS (+)/DEFICIT (-)</b>	<u>-790</u>	<u>-1788</u>	<u>-4552</u>	<u>10.3</u>
<b>F. NET CAPITAL RECEIPTS</b>	<u>2088</u>	<u>7172</u>	<u>13360</u>	<u>11.5</u>
Development Capital Receipts	1534	7050	10531	11.9
Others	554	122	3521	11.4
<b>G. DEVELOPMENT CAPITAL EXPENDITURE</b>	<u>1533</u>	<u>5795</u>	<u>11142</u>	<u>12.3</u>
<b>H. USE OF CASH BALANCES</b>	<u>-235</u>	<u>256</u>	<u>3735</u>	<u>17.6</u>

Sources: Annual Budget Statements of the provincial Governments.  
Public Finance Statistics.

Despite the high level of support provided by the GOP the combined financial position of the four provinces has declined significantly. In 1989-90, the latter had revenue deficit of over Rs. 4.5 billion, equivalent to 8.7 percent of their expenditure. The overall shortfall in resources resulted in a draw down in cash balances (overdraft, facility with SBP) of over Ra.3.4 billion in 1989-90. First indications are that this has increased to Rs.7 billion in 1990-91.

Provincial own receipts as a percentage of their current expenditure liabilities have fallen from 60 to 24 percent during the decade of the 80s (see Table 1.5). This clearly highlights the slackening of the provincial effort, on one hand, and the growing financial dependence on the federal government on the other. It may be mentioned here that this is happening at a period when GOP itself is confronted with high and growing budgetary deficits.

**TABLE-1.5**  
**KEY FISCAL RATIOS OF THE FOUR**  
**PROVINCIAL GOVERNMENTS**  
**(COMBINED)**

	(Percentage)		
	1972-73	1984-85	1989-90
Provincial Receipts as % of Current Expenditure	60.3	23.9	20.7
Federal Tax Assignments as % of Current Expenditure	35.2	42.7	58.9
Debt Servicing as % of Provincial Receipts	21.8	47.4	109.8
Debt Servicing as % of Total Revenue Receipts	13.2	11.3	24.2
Revenue deficit as % of Current Expenditure	32.3	6.9	8.7
Use of Cash Balance as % of Total Expenditure	5.9	1.2	5.8

Sources: Annual Budget Statements of the provincial Governments.  
 Public Finance Statistics.

The development program of the provinces is financed largely by loans and grants from GOP. There is very little domestic or external borrowing undertaken directly. The burden of debt servicing has risen rapidly, at the annual rate of 32 percent, for example, during the last five years. By 1989-90 debt servicing consumed nearly 29 percent of the revenue receipts (excluding deficit grants) of the provinces.

A comparative analysis of the four provincial governments reveal that the most severe liquidity problems in 1990-91 have been

experienced by the governments of Sindh and Baluchistan. However, in terms of the ratio of provincial own receipts as a percentage of revenue receipts these ratios are the highest in these two provinces at 27 percent and 26 percent respectively. The share of capital expenditure is the highest for the government of Baluchistan, 33 percent.

1.3. STRUCTURAL ADJUSTMENT TO IMF CONDITIONALITIES The IMF has imposed conditionalities on GOP in 1988 as part of the medium-term Structural Adjustment Program. The basic objective of these conditionalities is to bring down the size of the budgetary deficit as a percentage of the GDP. The preamble of the agreement states:

'if the large and growing overall fiscal deficits were allowed to persist, they would have continued to absorb domestic and foreign savings, which would have led to increased domestic financial instability and possible crowding out of private sector investments and would also have added to potential difficulties in servicing both domestic and external debt. There was, therefore, an urgent need to lower the fiscal deficit. For the improvement in the fiscal position to be sustainable, however, it is crucial for major structural weaknesses in the fiscal system to be corrected, these include the narrow and inequitable tax base and the low elasticity of tax system. It will also be essential to strengthen expenditure control measures. Such a fiscal adjustment was necessary to improve national savings performance and to permit adequate levels of investment in key sectors, so that satisfactory growth performance could be maintained in the future. It would also help to minimize the degree of build-up of inflationary pressures'.

Analysis of the trend in the degree of success in meeting type of adjustments that have success in containing the size budgetary magnitudes reveals the IMF conditionalities and the been made. We first review the of the budgetary deficit below,

**TABLE-1.6**  
**COMPARISON OF THE ACTUAL WITH STIPULATED TARGET BUDGET**  
**DEFICIT AS PER THE IMF SAF**

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	Size of Budgetary Deficit* According To SAF	Actual Size of Budgetary Deficit	Divergence
	(% of GDP)		
1988-89	6.5	7.4	0.9
1989-90	5.5	6.7	1.2
1990-91	4.8	8.0	1.1
1991-92 (B)	4.5	5.5	1.0

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Source: Ministry of Finance, Government of Pakistan.

\* for the federal and provincial governments combined

Therefore, GOP has not been successful in containing the budgetary deficit to within IMF imposed ceilings. In addition the SAP required that the reduction be achieved while protecting government development spending at around 7 percent of GDP. The actual size of the ADP is closer to 6 percent of the GDP.

However, although GOP has not been successful in achieving the SAF targets, significant adjustments have been made in the public finances of the country. Analysis of trends upto 1990-91 reveals the following:



- i) Bulk of the adjustment has been made on the expenditure side, as a result of which a rising trend prior to 1988-89 has been converted into a declining trend from 1988-89 onwards. A significant once-and-for-all cut has been imposed in general administration as a percentage of the GDP. The largest reduction over the last two years is in deficit grants to the provinces. Smaller adjustments have been made in expenditure on subsidies and on law and order. The ADP/GDP ratio is also significantly below pre-SAP levels.
- ii) Little or no effort has been made for additional resource mobilization. The tax and non-tax GDP ratios remain largely unchanged. In fact, net revenue receipts have been lower than projected levels because of higher divisible pool transfers.
- iii) Some of the burden of structural adjustment has been forced on the provinces. The rapid decline in revenue deficit grants exceeds the rise in divisible pool transfers. This situation has, of course, altered after the recent NFC award.

## CHAPTER TWO THE CURRENT

### SITUATION

There are major elements in the current situation either in terms of the nature of the macro economic environment, both domestic and international, or in terms of the overall mix of economic policies adopted by the GOP which have an important bearing both in the short run and in the medium run on the budgetary position.

#### 2.1. THE GULF CRISIS

During the Gulf Crisis, which erupted in the last fiscal year, both the balance of payments and the budget come under severe strain. The former was affected by the rise in the oil import bill (over \$ 600 million), decline in home remittances from Kuwait and Iraq (about \$ 180 million) and the fall in exports to the Middle East. The budget was impacted upon by the reduction in the margin between POL import and domestic prices and the resulting potential losses in revenues from the POL development surcharge. This necessitated a drastic upward revision (average of 41 percent) in consumer prices of POL products. Simultaneously, higher subsidies had to be given for crude oil purchases in spot markets by domestic refineries. It is estimated that this cost the federal government over Rs 3 billion in 1990-91, and represents the biggest (though not so well known) impact of the Gulf Crisis on the federal budget. In addition some costs (approximately Rs. 0.4 billion) had to be incurred on the repatriation of workers.

The significant shortfall in customs duty revenues of about Rs 2 billion is also partially attributable to the Gulf Crisis. The major upsurge in the rate of inflation (from 6 percent to 13 percent) caused by the cost-push pressures of higher oil and

energy prices raised the level of current expenditure and exacerbated expectations about wage increases in the public sector.

The subsequent decline in oil prices after the liberation of Kuwait has considerably softened the impact. During the current fiscal year the GOP actually expects substantial windfall gains in revenue from the petroleum development surcharge. This is budgeted at Rs 13.8 billion, as compared to Rs 7.7 billion realised last year, a jump of over Rs 6 billion. Clearly, the government has no plans to transfer fully the benefit of the fall in international prices (projected at \$ 17 per barrel in 91-92) to consumers and, thereby, force down the domestic price level. Revenue considerations appear to be dominating over anti-inflationary policies.

## 2.2. THE NFC AWARD

The May 1991 NFC<sup>2</sup> award has come after a gap of many years (due since 1979)<sup>3</sup> and some abortive attempts earlier. Meanwhile the provinces had run into large, chronic deficits on the revenue account necessitating the ad-hoc provision of federal revenue deficit grants. Chapter One has highlighted that over time the reliance of the provinces on these grants had increased significantly. At their peak, in 1987-88 these grants were Rs.12 billion, financing over one-fourth of the provincial current expenditure. It needs, however, to be noted that access to such revenue deficit grants on one hand mitigated against provincial

<sup>2</sup>The National Finance Commission (NFC) is a constitutional body, constituted by the President of Pakistan, every five years, to make recommendations on the distribution between the federation and provinces of the net proceeds of divisible pool taxes (as specified by the President), the making of grants-in-aid, and exercise of borrowing powers by the provinces.

<sup>3</sup>The last NFC Award was announced in 1974.

financial autonomy and, on the other hand, left provinces with little incentive either to mobilise their own revenues or to economise on their expenditure. In the context of the current macro resource constraint a change in the pattern of intergovernmental fiscal, relations was, therefore, long over due.

The NFC Award of 1991 significantly increases revenue-sharing transfers to the provinces. The increase is because of the inclusion of excise duties on tobacco and tobacco manufacturers and sugar in the divisible pool of taxes (see table 2.1). In terms of distribution, however, the NFC has essentially opted for the same formula as contained in the 1974 Award. Divisible pool taxes (rx't. of costs of collection) are to be generally shared on the same basis of 20:80 between the federation and provinces, while the latter share will continue to be distributed among the provinces on the basis of population. The special feature of the 1991 award, however, is the large increase in the quantum of revenues to be shared on the basis of collection. In addition, the discretionary element in grants has been eliminated and a system of fixed, special grants to each province has been instituted.

On the whole, the NFC award will increase total federal transfers to the provinces in 1991-92 by Rs 25 billion in relation to the level in the absence of the award. In proportion to GDP, the increase is of 2.1 percentage points. It, therefore, appears that an important part of the increase in federal revenue account deficit (from Rs 21 billion in 1990-91 to Rs 32 billion in 1991-92) can be attributed to the increased flow of federal transfers to the provinces, as a consequence of the NFC award.

**TABLE-2.1**  
**REVENUE SOURCES AND MAGNITUDE OF TRANSFERS**  
**TO PROVINCES WITH AND WITHOUT NFC AWARD OF 1991**  
**IN 1991-92**

(Rs in Billion)

	WITHOUT 1991 NFC AWARD		WITH 1991 NFC AWARD	
	TRANSFER	SHARE (%)	TRANSFER	SHARE (%)
<b>A. REVENUE SOURCES SHARED ON THE BASIS OF POPULATION</b>	<u>38.3</u>	<u>95.5</u>	<u>48.6</u>	<u>74.7</u>
Income Tax	17.6	43.9	17.6	27.0
Sales Tax	18.3	45.6	18.3	28.1
Export Duty on Cotton	2.4	6.0	2.4	3.7
Excise Duty on Tobacco Manf.	-	-	7.3	11.2
Excise Duty on Sugar	-	-	3.0	4.6
<b>B. REVENUE SOURCES SHARED ON THE BASIS OF COLLECTION</b>	<u>1.8</u>	<u>4.5</u>	<u>16.5</u>	<u>25.3</u>
Excise Duty & Royalty on Gas	1.8	4.5	1.8	2.8
Surcharge on Gas	-	-	7.4	11.4
Royalty on Crude Oil	-	-	1.3	2.0
Profits on Hydroelectricity*	-	-	6.0	9.2
<b><u>TOTAL</u></b>	<u>40.1</u>	<u>100.0</u>	<u>65.1</u>	<u>100.0</u>
TRANSFERS AS % OF GDP (AT MARKET PRICES)	<u>3.4</u>	-	<u>5.5</u>	-

Source: Explanatory Memorandum of the Budget, 1991-92, Ministry of Finance, GOP.

The original expectation was that this transfer would not be made out of the federal consolidated fund, but directly by WAPDA. Recent indications, however, are that WAPDA is not in a position to make such a large transfer. Therefore, at least part of the liability is likely to fall directly on GOP.

The NFC award promises considerable improvement in the financial state of the provinces. Table 2.2 shows that from a current account deficit of Rs 5 billion in 1990-91, the provinces are likely to be able to generate a current surplus of Rs 7 billion in 1991-92. This implies that the provinces can potentially self finance a significant (30 to 40 percent) part of their development plans. As such, the NFC award represents a big step forward in the process of decentralisation in Pakistan. By expanding substantially the availability of resources to all four provinces, it places them in a position to independently frame their budgets and development plans without depending on discretionary grants from the federal government.

The large flow of revenue transfers to the provinces, with no effort on their part, alongwith continued and increased growth because of federal fiscal effort in divisible pool taxes, however, has the danger that the provinces may slacken further their fiscal effort and increase their current expenditures more rapidly to absorb the short run surpluses that they will enjoy. This can occur despite the change in the pattern of intergovernmental fiscal relations (with no access to deficit grants) .

Research<sup>4</sup> on the impact of federal transfer on provincial finances shows that for every one rupee increase in transfers from the federal government, provincial own revenues decline by 20 to 30 paisas and their current expenditures increase by as much 90 paisas. In fact, with the exception of Punjab, the provincial governments have indeed set a precedent in this regard

<sup>4</sup>See Pasha, H.A and Ghaus, A "Provincial Fiscal Response to Federal Transfers" A.E.R.C. Working Paper, 1991.

by announcing tax free budgets of 1991-92. Also, the 1991-92 provincial budgets reveal that current expenditure will rise rapidly during the current fiscal year by 16 percent in Punjab, 26 percent in Sind, 24 percent in NWFP and 29 percent in Baluchistan. The actual increase could be even higher given the impact of the Pay Committee Award. As such, it is

**TABLE-2.2**  
**TRANSFER TO PROVINCES, 1990-91 AND 1991-92**

(Rs in Billion)

	PUNJAB**	SIND**	NWFP	BALUCHISTAN	TOTAL
<u>1990-91</u>	21.4	9.7	7.8	3.6	<u>45.2</u>
<u>1991-92</u>					
Without Tax Proposals	30.3	15.3	12.7	8.7	<u>67.1</u>
With Tax Proposals*	32.2	16.0	13.1	8.9	<u>70.3</u>

**CURRENT ACCOUNT DEFICIT/SURPLUS OF THE PROVINCES**

(Rs in Billion)

	PUNJAB**	SIND**	NWFP	BALUCHISTAN	TOTAL
<u>1990-91</u>	-1.9	-3.3	-1.7	-1.3	<u>-5.0</u>
<u>1991-92</u>					
Without Tax Proposals	+2.1	+0.4	+1.5	+3.0	<u>+7.0</u>
With Tax Proposals*	+4.0	+1.1	+1.9	+3.2	<u>+10.2</u>

Sources: Aisha Ghaus, Impact of the NFC Award, 1991, AERC Working Paper, 1991.

\* Including the revenue impact of federal taxation proposals of 1991-92

\*\* Based on the Revised Estimates of 1990-91

important that certain regulatory measures and/or appropriate changes in the incentive environment should be introduced that will induce/encourage the provincial governments to mobilise additional revenues and economise on expenditure. The federal government has announced an incentive mechanism according to which the provincial government will receive matching development grants equal to the additional revenue generated from own sources. It is too early to speculate on the likely consequences of the matching grants scheme on the federal budget deficit. However, it is possible that in the event the provinces do launch a significant fiscal effort then the matching grants will at least partially substitute for regular development allocations to the provinces from the ADP. This implies that the overall flow of development funds to the provinces may not necessarily increase significantly. However, due to a large grant component the debt servicing obligation would be reduced.

In terms of development expenditure, the current fiscal year is likely to witness significant increases in all provinces except Sindh, despite the fact this province has been given a special development grant of Rs.2.5 billion. This highlights the severe problems GOS is facing in utilizing its development funds given the troubled law and order situation in the province. As far as the other provinces are concerned there are likely to be similar problems of implementation capacity, if not of the same degree. This has already been highlighted earlier during the period of the Five Point programme from 1986-87 to 1988-89.

Another, possible mechanism which will perhaps restrict casual use of public funds and will further the process of decentralisation is to transfer back functions that can



potentially be performed by the provincial governments but are currently a responsibility of the federal government because of the resource crunch at the provincial level. These include functions like university education, fertiliser subsidy, flood control, highways etc.

2.3. CONVERSION OF T&T INTO AUTONOMOUS CORPORATION The Telegraph and Telephone Department had traditionally been one of the most profitable state monopolies, generating large surpluses for the federal exchequer. In 1989-90 the contribution was over Rs 7 billion, representing almost 74 percent of the total income of GOP from property and enterprise (excluding interest income from the provinces). In 1990-91 the budgeted level of profits was in excess of Rs 9 billion. However, following the conversion into an autonomous corporation in 1990-91, the realised level is Rs 4.9 billion. This source will dry up completely in 1991-92. There will, ofcourse, be some savings due to the reduction in expenditure (both recurring and development) on the T&T department from the budget and return from investments of GOP in T&T. However, there is still a sizeable loss of about Rs 4 to 5 billion.

Potentially, this loss could have been minimized if the autonomous T&T corporation was subject to corporate income tax (at 45 percent) like the nationalised commercial banks and public enterprises. Unfortunately, this possibility does not exist in the short run as the new corporation has been given a special exemption from payment of income tax for the first three years by a special Cabinet decision.

#### **2.4. IMPLICATIONS OF FINANCIAL SECTOR REFORM**

Major changes have been taking place in the financial sector of Pakistan in response to the perception that this sector is "repressed" and financial intermediation has become a barrier especially for private investment. The IMF and World Bank have been actively promoting structural adjustment in the sector through policy conditionalities. The basic objective of these reforms is to equalise the access to capital markets of both of the public and private sectors and to force the former to borrow (both short and long term) at near market rates. Consequently, participation in small savings schemes (special savings certificates, etc.) has been limited only to households (ban on institutional purchases), treasury bills are to be floated at higher rates and the major new financial instrument for medium to long term borrowing that has been introduced by the GOP is the Federal Investment Bond (FIB). This bond carries relatively attractive rates of return, ranging from 12 percent to 15 percent, for periods of investment from three to ten years. In addition, no compulsory income tax or Zakat deduction is envisaged. It is expected that a secondary market (with discounting) will develop over time for these bonds. During 1990-91 over Rs.19 billion worth of these bonds were sold, primarily to the commercial banks.

These financial sector reforms, which have restricted access and increased cost of borrowing, have come at a time when the GOP is under pressure to honor debt repayment obligations against bonds and certificates floated earlier like the Khas Deposit certificates (which were replaced by Special Savings certificates) and bearer bonds. The quantum of payment at redemption is estimated at Rs.18 Billion in 1990-91. This is expected to rise sharply to over Rs 27 billion in 1991-92. This highlights the very serious cash flow problem that the GOP finds

itself confronted with currently. Not only is new domestic borrowing becoming more difficult and expensive but also large outflows are taking place as bonds and debentures floated in previous years mature. This highlights the inherent risk that, in the face of a liquidity squeeze, the GOP will have no option but to go in for deficit financing (by printing money) to avoid a potential domestic default situation. This structural problem of federal finances has seldom been highlighted in the public debate.

In the 1991-92 budget, gross domestic capital receipts are budgeted at Rs 68 billion, with over Rs 54 billion coming from new flotations of FIBs. The big question is whether the domestic capital market has the capacity to absorb this large additional volume of FIBs or whether by the end of the fiscal year substantial discounting will have to be resorted to, thereby raising the effective cost of borrowings further. In addition, interest payments on domestic debt are expected to reach the level of Rs 47 billion, with a growth rate of almost 40 percent over the previous years level. Part of this extraordinarily rapid increase is due to the higher cost of short term borrowings (through treasury bills). However, this will contribute to higher profits of SBP, which are projected to increase by as much as Rs 5 billion next year. These profits will accrue to the GOP and will thereby, at least, partially compensate for the higher cost of domestic borrowings.

**2.5. THE INTERNATIONAL AID ENVIRONMENT** During 1990-91, the USA announced a cessation of new bilateral assistance to Pakistan as a consequence of the Pressler Amendment. The Aid-to-Pakistan consortium has emphasised in its last meeting the need for Pakistan to change its expenditure priorities in favour of the social sectors. More recently, the

IMF has expressed its reservations about revenue forecasts in the 1991-92 Budget and about the size of the projected budgetary deficit.

At the more global level, demand for credit is likely to be strong in coming years as the process of reconstruction commences in the USSR and Eastern Europe and the US budget deficit continues to be large. As opposed to this, the supply of credit will be limited by the inability of OPEC countries and Germany to generate larger surpluses. Therefore, the international capital market is likely to be tight and interest rates may rise. Consequently, international agencies are likely to be more selective and less induced to make concessional loans. For Pakistan, it is clear that there has been a qualitative change in the international aid environment (from the favourable period of early and mid 80s) and increased reliance will have to be placed over time on domestic resource mobilisation and cut backs in expenditure.

During this year, however, contrary to the emerging trends, a significantly higher level of foreign assistance has been projected in the GOP Budget. The gross inflow is projected at Rs 48 billion, an increase of Rs 10 billion over last year. Bulk of the increase is expected in project aid, with substantial decline in food aid. The optimistic expectations about the inflow of foreign aid are based on the fact that currently commitments substantially exceed disbursements. As of June 30, 1990, almost \$ 8.5 billion<sup>5</sup> of committed debt remained undisbursed. This is equivalent to over four years of the annual flow. Therefore, if the GOP can concentrate on faster utilisation of committed funds,

<sup>5</sup>Bulk, almost 89 percent, of the undisbursed aid is by the Consortium. Almost \$ 2.7 billion is with the ADB, \$ 1.8 billion with IBRD and \$ 0.7 billion with the Japanese government.

it can, at least, temporarily postpone the decline in aid inflows as the rate of new commitments decreases.

2.6. **THE PAY COMMITTEE AWARD** The last upward revision in pay scales of government employees was in 1987. Since then the cumulative increase in the cost of living index (as estimated by the FBS) has been almost 45 percent. In recent months, in the wake of the Gulf Crisis and increased rate of monetary expansion, the rate of inflation has reached the double-digit level (13 percent to 15 percent). Consequently, there has been pressure for another escalation in salary levels in the public sector to atleast partially restore the level of real wages. The Pay Committee constituted for this purpose has already announced the award. The average increase in emoluments (basic pay plus allowances) ranges from 15 percent to 17 percent.<sup>6</sup> The additional wage bill to the GOP due to this increase for civilian employees and army personnel is estimated at Rs 6 billion. The Finance Minister has indicated that this will add to the budgetary deficit and be financed by use of cash balances (deficit financing).

2.7. **CONSEQUENCES OF THE PRIVATISATION PROGRAM** During the last financial year, the dividend income from GOP investments in financial institutions (NIT, NDFC, etc.) was Rs 29 million, from nationalised banks, Rs 6 million, and from the public enterprises (mostly industrial or utility related), Rs 657 million. Most of the banks and public enterprises are expected to be privatised. However, while loss of dividend income is not likely to be substantial there will be large once-and-for-all

<sup>6</sup> This is over and above the adhoc increases granted in dearness and other allowances periodically.

increase in resources due to the sale of assets. Already, the sale of MCB has contributed over Rs 0.8 billion in 1990-91. It is too early to say what will be the total quantum of additional resources generated by the privatisation program. Success in the handing over of the banks and the telecommunications corporation, in particular, could lead to the inflow of very sizeable funds. GOP has indicated that these funds will be used for social sector programs, especially in the backward areas, over and above the regular ADP. It is perhaps more realistic to assume that the funds will largely substitute for borrowings and not add significantly to development outlays.

Altogether most of the factors operating currently are unfavourable, except for the privatisation program and aid inflows. These factors represent the back drop to the 1991-92 Budget and have greatly restricted the ability of GOP to achieve a large improvement in its budgetary position in the short-run. It is possible, however, that the impact of the financial sector reforms may be favourable in the medium-run, especially if the composition of public debt is altered towards bonds with longer maturity periods.

## CHAPTER THREE THE BUDGET OF

### 1991-92

The federal budget of 1991-92 has been announced at a time when the public finances in the country are under severe strain. The federal government is faced with a previous year's budgetary deficit equivalent to 5.9 percent of the GDP. The NFC award entailing significant enhancement in transfers to provinces has been announced and the overall macro-environment both internal and external is not very favourable. As mentioned in Chapter One major causes of the unsustainable stress on public finances are structural problems like the high growth rate of current expenditure, and relatively slow growth in revenues. Therefore, it is essential that the budget of 1991-92, which is the principal fiscal policy tool of the government, makes an attempt to address some of these structural issues and takes major reformatory steps forward.

#### 3.1. KEY MAGNITUDES

The key magnitudes of the federal budget of 1991-92, alongwith the impact of proposed budgetary measures, are presented in Table 3.1. It appears that the budget does depart, in some ways, from the traditional pattern and makes an attempt to address some of the key issues, though in a limited manner. For example, an attempt has been made to increase the level of federal resource mobilisation and to enhance the long run buoyancy of federal taxes. Measures to this effect include, taxation proposals of Rs.18.5 billion. This constitutes by far the highest level of fiscal effort by the federal government historically. Compared to the 1990-91 budget this year's budget proposes more than

**TABLE-3.1**  
**TREND IN THE FINANCES OF THE FEDERAL GOVERNMENT**  
**KEY BUDGETARY MAGNITUDES IN 1990-91 OF GDP**

(Rs in Billion)

	1990-91	1991-92 (B)	1991-92 (B+T)*	Impact of Budgetary Proposals
<b>A. NET REVENUE RECEIPTS</b>	<u>150.5</u>	<u>153.5</u>	<u>169.7</u>	<u>16.2</u>
A. 1. <u>Tax Receipts</u>	<u>120.6</u>	<u>136.6</u>	<u>156.4</u>	<u>19.8</u>
A.1.1. Taxes on Income & Wealth	20.0	24.5	27.8	3.3
A.1.2. Taxes on Commodities & Transaction	100.6	112.1	128.6	16.5
A. 2. <u>Non-Tax Receipts</u>	<u>63.7</u>	<u>76.1</u>	<u>76.1</u>	0
A.2.1. Income from Property & Enterprise	30.5	32.4	32.4	0
A.2.2. Receipts from Civil Administration	2.7	7.1	7.1	0
A.2.3. Miscellaneous Receipts	36.6	36.6	36.6	0
A. 3. <u>Divisible Pool Transfers</u>	<u>33.8</u>	<u>59.2</u>	<u>62.8</u>	<u>3.6</u>
<b>B. CURRENT EXPENDITURES</b>	<u>162.8</u>	<u>185.7</u>	<u>194.7</u>	<u>9.0</u>
B. 1. General Administration	7.2	8.3	8.3	0
B. 2. Defence	63.6	71.0	71.0	0
B. 3. Services (Comm, Social, Economic)	12.4	9.3	9.3	0
B. 4. Subsidies	8.2	5.5	8.5	3.0
B. 5. Debt Servicing	63.8	80.7	80.7	0
B. 6. Others	7.6	10.9	16.9	6.0
<b>C. NON-OBLIGATORY GRANTS TO PROVINCES</b>	<u>8.9</u>	-	-	0
<b>D. REVENUE ACCOUNT SURPLUS/DEFICIT</b>	<u>-21.2</u>	<u>-32.2</u>	<u>-25.0</u>	<u>-7.2</u>
<b>E. DEVELOPMENT EXPENDITURE</b>	<u>63.0</u>	<u>72.7</u>	<u>72.7</u>	0
<b>F. SELF-FINANCING BY AUTONOMOUS CORPNS</b>	<u>7.9</u>	<u>14.3</u>	<u>14.3</u>	0
<b>G. BUDGETARY DEFICIT</b>	<u>59.9</u>	<u>72.3</u>	<u>65.1</u>	<u>-7.2</u>
<b>H. GDP AT MARKET PRICES</b>	<u>1016.7</u>	<u>1179.4</u>	<u>1179.4</u>	0
<b>I. DEFICIT AS % OF GDP</b>	<u>5.9</u>	<u>6.1</u>	<u>5.5</u>	<u>-0.6</u>

Sources: Budget in Brief, 1991-92, Ministry of Finance, GOP.

\* Inclusive of the impact of budgetary proposals

(B) = Budget estimates

B+T = Budget estimates + revenues from taxation proposals



40 percent higher additional revenue generation.<sup>7</sup> Also, the budget proposes a structurally different package of proposals compared to the previous years. Instead of relying on enhancement in tax rates/levies, additional resource mobilisation will be achieved by tax reforms aimed at simplification of tax structure, removal of exemptions and broadening the tax base by bringing some of the relatively undertaxed sectors in the tax net. Simultaneously, the tax net is being extended to some of the fast growing sectors of the economy thereby enhancing the long run buoyancy of the tax structure. Mobilisation through non-tax sources has, however, not been proposed. However, the tax base re-mains to be expanded to cover agricultural income, income from capital gains on financial assets, income from government bonds, etc. The scope for mobilizing additional revenues from non tax sources of the federal government is limited as most of the important user charges on irrigation, education, health, etc are levied by the provincial governments. However, scope exists for generating higher revenue from state trading, levy of higher tolls on national highways, higher postal charges for services like UMS, etc.

The major area where the budget of 1991-92 is largely silent is on the expenditure side. No attempt has been made to economise on non-development expenditure, which is budgeted to increase by 19.5 percent over the 1990-91 level, after allowing for the impact of the Pay Committees award. Some of the other special features of the federal budget are discussed in the subsequent sections.

<sup>7</sup>The 1990-91 budget included taxation proposals of Rs.12.9 billion.

On the whole, the federal budget of 1991-92 shows an overall budgetary deficit of Rs 72.3 billion. Equivalent to 6.1 percent of the GDP, the overall budgetary deficit is proposed to be financed through external resources, Rs 29.7 billion, internal net capital receipts, Rs 0.4 billion and deficit financing of Rs 25.6 billion. It may, however, be mentioned here that the GOP has been unable to meet the IMF conditionality of restricting its budgetary deficit for the third consecutive year.

Turning to the provincial budgets of 1991-92, the NFC award has dramatically improved the budgetary position. Compared to draw down of cash balances equal to Rs '1 .5 billion in 1990-91 the provinces of Punjab and Sindh together will be able to accumulate cash balances of over Rs 2 billion in 1991-92. Similarly, their revenue accounts also show significant improvement with a decline in the deficit of about 88 percent.

However, as far as their own fiscal effort is concerned the provincial budgets of 1991-92 do not have much to offer. With the exception of Punjab, which proposes additional revenue generation of Rs 700 million, primarily through stamp duties, the provincial governments have neither made an attempt to enhance own revenues nor to economise on expenditures. It may be pointed out that if this pattern continues the revenue gains from the NFC award will soon be exhausted and the provinces may end up in severe fiscal strains once again in the next few years.

**TABLE-3.2**  
**KEY PUBLIC FINANCE MAGNITUDES OF THE**  
**PROVINCIAL GOVERNMENTS OF PAKISTAN**

(Rs in Million)

	1990-91*	1991-92*
<b>A. <u>GENERAL REVENUE RECEIPTS</u></b>	<b>42324</b>	<b>57286</b>
Federal Tax Assignments	26589	41075
Provincial Tax Assignments	6212	6628
Provincial Non-Tax Receipts	5217	5221
Federal Non-Development Grants	4306	4310
<b>B. <u>DEVELOPMENT REVENUE RECEIPTS</u></b>	<b>4925</b>	<b>2577</b>
Federal & Foreign Development Grants	4925	2577
<b>C. <u>CURRENT EXPENDITURE</u></b>	<b>47662</b>	<b>54991</b>
General Administration	4702	5153
Law and Order	5037	5063
Community Services	1902	2289
Social Services	17778	21021
Economic Services	5823	6558
Subsidies	1146	1437
Debt Servicing	11274	12511
<b>D. <u>DEVELOPMENT REVENUE EXPENDITURE</u></b>	<b>8071</b>	<b>5093</b>
<b>E. <u>REVENUE SURPLUS (+)/DEFICIT (-)</u></b>	<b>-8484</b>	<b>-1031</b>
<b>F. <u>NET CAPITAL RECEIPTS</u></b>	<b>12388</b>	<b>12106</b>
Development Capital Receipts	10706	10832
Others	1682	1274
<b>G. <u>DEVELOPMENT CAPITAL EXPENDITURE</u></b>	<b>8640</b>	<b>9042</b>
<b>H. <u>USE OF CASH BALANCES</u></b>	<b>-4736</b>	<b>+1943</b>

Sources: Annual Budget Statements of Provincial Governments, 1991-92.

\* Includes the provinces of Punjab and Sind only.

40 percent higher additional revenue generation.<sup>7</sup> Also, the budget proposes a structurally different package of proposals compared to the previous years. Instead of relying on enhancement in tax rates/levies, additional resource mobilisation will be achieved by tax reforms aimed at simplification of tax structure, removal of exemptions and broadening the tax base by bringing some of the relatively undertaxed sectors in the tax net. Simultaneously, the tax net is being extended to some of the fast growing sectors of the economy thereby enhancing the long run buoyancy of the tax structure. Mobilisation through non-tax sources has, however, not been proposed. However, the tax base remains to be expanded to cover agricultural income, income from capital gains on financial assets, income from government bonds, etc. The scope for mobilizing additional revenues from non tax sources of the federal government is limited as most of the important user charges on irrigation, education, health, etc are levied by the provincial governments. However, scope exists for generating higher revenue from state trading, levy of higher tolls on national highways, higher postal charges for services like UMS, etc.

The major area where the budget of 1991-92 is largely silent is on the expenditure side. No attempt has been made to economise on non-development expenditure which is budgeted to increase by 19.5 percent over the 1990-91 level, after allowing for the impact of the Pay Committees award. Some of the other special features of the federal budget are discussed in the subsequent sections.

<sup>7</sup>The 1990-91 budget included taxation proposals of Rs.12.9 billion.

On the whole, the federal budget of 1991-92 shows an overall budgetary deficit of Rs 72.3 billion. Equivalent to 6.1 percent of the GDP, the overall budgetary deficit is proposed to be financed through external resources, Rs 29.7 billion, internal net capital receipts, Rs 0.4 billion and deficit financing of Rs 25.6 billion. It may, however, be mentioned here that the GOP has been unable to meet the IMF conditionality of restricting its budgetary deficit for the third consecutive year.

Turning to the provincial budgets of 1991-92, the NFC award has dramatically improved the budgetary position. Compared to draw down of cash balances equal to Rs1.5 billion in 1990-91 the provinces of Punjab and Sindh together will be able to accumulate cash balances of over Rs 2 billion in 1991-92. Similarly, their revenue accounts also show significant improvement with a decline in the deficit of about 88 percent.

However, as far as their own fiscal effort is concerned the provincial budgets of 1991-92 do not have much to offer. With the exception of Punjab, which proposes additional revenue generation of Rs 700 million, primarily through stamp duties, the provincial governments have neither made an attempt to enhance own revenues nor to economise on expenditures. It may be pointed out that if this pattern continues the revenue gains from the NFC award will soon be exhausted and the provinces may end up in severe fiscal strains once again in the next few years.

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Sources: Annual Budget Statements of Provincial Government, 1991-92

\* Includes the provinces of Punjab and Sind only

### 3.2. PACKAGE OF TAX REFORMS

The Federal Budget of 1991-92 is of special significance as it includes a major package of tax reforms. Many of these reforms have been proposed by the Tax Reforms Committee (TRC) constituted by the Prime Minister. The Committee's report was submitted to GOP in January 91. Subsequently, a Resource Mobilisation and Tax Reforms Commission was constituted with the mandate not only of assisting in the implementation of the recommendations of the TRC but also of suggesting major structural reforms like a workable capacity taxation in the field of central excise, institution of a fixed or presumptive tax system in direct taxes and improvements in the customs duty collection system.

The Commission has also been asked to identify proposals for improving the tax administration system with a view to minimising discretion (thereby reducing collusive evasion), for comprehensive computerisation, developing a database and for restoring the dignity of the tax payer. In the area of resource mobilisation, the Commission is expected to recommend measures that would improve the resources of the federal and provincial governments, especially by broadening the tax base and increasing the proportion of direct taxes.

Major elements of the tax reforms package in the Budget are as follows:

#### INCOME TAX

Withholding taxes on certain categories of tax payers like contractors, importers and suppliers have been converted into fixed taxes. In the event there is no other income, payment of the fixed tax will be deemed to be the final discharge of the tax liability and return of total income will not have to be filed

(under Section 55 of the ITO). The fixed tax rates are 3 percent for payments made to contractors, 2 percent for importers and 2 1/2 percent for suppliers.

The transition to fixed taxes is largely to simplify the system of tax payments in the case of tax payers where there is greater documentation of transactions. This measure also eliminates the problem of obtaining refunds against payment of withholding taxes, which had led to corruption and caused inconvenience. It is estimated that saving in refunds will yield significant additional revenues of about 0.65 billion.

#### CUSTOM DUTIES

Major problems in tax administration in this area relate to valuation, warehousing and transportation to inland customs stations (dry ports). Given high effective rates of taxation (import duty + sales tax + import surcharge + iqra surcharge + import licence fee) of imports, there is a tendency to either underinvoice the c.i.f. value of consignments or to change the commodity classification so as to pay lower rates of duty. The Customs Department has faced great difficulties in valuing items, which are prone to fluctuations in prices or where variations in prices by source are quite pronounced. Consequently, it is not uncommon for different values to be assigned at, more or less, the same time for the same good from the same source in different Collectorates. The presence of COTECHNA has apparently not had the desired impact.

The 1991-92 Budget introduces a major change in the valuation system. It bases assessment of duty on standardised ITPs (International Trade Prices) which are to be fixed quarterly and published in a Valuation Manual prepared by the Appraisement Collectorate, Customs House, Karachi. In effect, the assessment



is delinked from the reported bill of entry values, thereby largely eliminating the revenue losses due to underinvoicing or underassessment. The first Valuation Manual has become operative from the 1st August to 31st of October. It has been prepared with the help of the major trade associations, and has generally been well received by trade and industry. ITPs have been specified for 9637 items distinguished by number in the First Schedule of the Customs Act, 1969 and by major country of origin. ITP values are given in the currency of the country of origin, and, therefore, have built in provision for increase in revenues as the rupee depreciates.

The change in valuation system is expected to fetch additional customs duty revenues of Rs 1 billion in 1991-92. The revenue expectation is essentially a value judgment and its realisation will depend upon the extent of underinvoicing prior to the change, the ability of the ITPs to capture true trade values and success in implementing the new system. However, the ITPs apparently, on the average, are about 5 percent to 10 percent higher than recent c.i.f. prices in the case of some major commodities. Therefore, the switchover to the new valuation system has been accompanied by a back-door enhancement in the effective rate of import duties. If widespread valuation disputes do not arise subsequently, then this measure could yield Rs 2 to 3 billion extra, well in excess of the revenue target.

The other major area of reform is warehousing. The system currently in operation is extremely cumbersome and involves manual entries in ledgers. Consequently, it is extremely difficult to keep track of consignments resulting in inefficient utilisation of bonded warehouse space and in revenue leakages. This is obviously an area where a computerised system would greatly facilitate documentation and control over movement of

goods. This is the basic improvement proposed in the warehousing system. However, the implementation of a decentralised computer-based information system for warehousing is a complex process and will take time to become operational. As such, the revenue expected from improvement in the warehousing system of Rs 1.5 billion is optimistic and unlikely to be achieved in 1991-92. This is also the view of the IMF mission.

Other areas where improvements are proposed are in transportation of dutiable goods to inland customs stations (dry ports) and in the auction system. The former will also require a regionally (between collectorfites ) integrated computer system to track the movement of consignments. Combined yield expected is Rs 1 billion. This is again a subjective estimate and unlikely to be achieved in 1991-92. Altogether, given the wide ranging nature of reforms proposed in import duty collection and the need generally to switchover to sophisticated computer based systems within one year, it is unlikely that the Customs Department, as it is currently staffed, will be able to fully implement these reforms. Understandably, the IMF is pessimistic about GOP's ability to bring in the additional Rs 4.5 billion revenues from reforms in customs duties in 1991-92. However, some cushion has been provided by the effective escalation in import duties implied by the new ITPs.

#### CENTRAL EXCISE DUTIES

The major reform proposed in central excise duties is the switchover to capacity taxation in selective items like tobacco manufactures, cement, sugar, yarn (of all types), etc. Collectively, these industries account for over 80 percent of the revenue from this source. As an initial step, excise staff has been withdrawn generally and the system of self-clearance introduced. The basic motivations behind the switchover to

capacity taxation are, first, to eliminate corruption and evasion at the stage of clearance from the factory premises, second, to simplify the tax system and reduce the compliance cost and, third, to provide incentive for higher production in view of zero taxation at the margin.

Capacity taxation had been in existence in Pakistan in the 70s but was abandoned in view of the wide spread litigation arising from 'abatement' claims for factory closures and the resulting lack of utilisation of capacity due to abnormal factors like load shedding, strikes, etc. As such, the pure form of capacity taxation has not been reintroduced. Instead, the proposed system is really a form of taxation of 'presumed' production or potential output, allowing for the impact on average of various factors which affect utilisation of capacity. Consequently, the system potentially rewards firms which are more efficient or evade less and penalises those which are relatively inefficient or are more prone to underdeclaration historically.

Although, the switchover essentially represents a change in the assessment basis and is, therefore, inherently not a revenue-generating measure, additional revenues of as much as Rs 2.5 billion are expected in the 1991-92 Budget from this reform. It is envisaged that in the process of change, known pockets of evasion can be mopped up. The best example of this is in tobacco manufactures where there is strong collateral evidence of substantial evasion by the smaller manufacturers, generally located in Mardan district. These manufacturers collectively have about 1/4 ths of the capacity (as measured by the number of cigarette machine makers) but contribute only about 2 percent to the total revenue. Evasion to the tune of Rs 1.5 billion is estimated.

The GOP has constituted a high-powered Capacity Taxation Committee under the Chairmanship of MR. A.G.N. Kazi with representatives from industry, Resource Mobilisation and Tax Reforms Commission, CBR and the ministry of industries. The task of the Committee is to develop workable capacity taxation formula for each industry and to make assessments thereof. The target is for full implementation of the capacity taxation system by the 1st of September. The Committee appears to have had limited success to date. The new system has been successfully implemented for the cement industry, the same tax system has been retained for sugar while the formula for yarn units is close to being finalised. Altogether, at this stage, it is expected that over Rs 1 billion of additional revenue will be generated. But the major area where a workable formula remains to be evolved is in cigarettes and negotiations with industry have broken down. The small-scale manufacturers have resisted attempts to enhance substantially the tax burden on them, given the high level of evasion. It is unlikely, as such, that capacity taxation of cigarettes will yield significant additional revenues. An overall shortfall of upto Rs 1 billion is likely in attainment of the revenue target.

The other reform in the regime of excise duties is the introduction of the Shoorai Tashkees (taxation by consensus) system in industries which currently do not yield large revenues. The approach here is to negotiate directly with industry associations on a regional basis and to arrive essentially at a group assessment, with the assurance thereafter of no physical checks by the excise department. The response to date to this system has been extremely encouraging. Given the existing high levels of evasion, the prospect of reduction in compliance costs and in illicit payments, industry associations have offered sizeable increases in revenues, in some cases from 300 to 500

percent. It is likely, as such, that the overall target of additional revenue from this system of Rs 500 million will be exceeded. This will, at least, partially compensate for the shortfall in revenues from the switch-over to capacity taxation.

Data on tax revenues at the federal level have become available for the period, July to November, 1991. The respective growth rates are as follows:

Revenue (Ra. in Million)			
[-----],	July to November 1990	July to November 1991	Growth Rate (%)
Income & Corporation Tax	6842	4391	55.8
Wealth Tax	305	113	169.9
Customs Duties	23535	19621	19.9
Central Excise	11423	9284	23.0
Sales Tax	8104	7653	5.9
TOTAL	50209	41062	22.3

High growth has been achieved particularly in direct taxes. It appears that the taxation proposals and reforms in the area proposed in the 1991-92 Budget have already started yielding returns. The performance of customs and excise duties is satisfactory. The major problem area appears to be the sales tax. The transaction to a VAT has created difficulties.

**3.3. PROPOSALS FOR RESOURCE MOBILISATION** Alongwith the major attempt at tax reform, the 1991-92 Budget includes a sizeable package of resource mobilisation proposals. These proposals are expected to yield Rs.11.8 billion (see table 3.3), equivalent to about 1 percent of the GDP. Over 60 percent of the additional revenues will come from excise duties, 25

**TABLE-3.3**  
**GOP TAXATION PROPOSALS AND THEIR REVENUE EFFECT**  
**IN THE BUDGET OF 1991-92**

TAX/PROPOSAL	REVENUE EFFECT (Rs in Million)
<b>A. INCOME TAX</b>	
1. Flat-rate Income Tax at 10% on dividends and profits/interest on bank deposits, etc.	1500
2. Introduction of Presumptive Tax on contractors, suppliers and commercial importers	650
3. (a) Abolition of monetary threshold for withholding tax (b) Increase in withholding tax rates	500
4. Introduction of Minimum Tax at 0.5% of total	900
5. Reduction of Income tax rates on individuals and registered firms, raising of exemption limit, with drawal of investment allowance	-115
6. Liberalisation of upper limit on salaries of directors	-100
<b>TOTAL</b>	<b>3335</b>
<b>B. CUSTOMS DUTIES</b>	
1. Concessions	-178
2. Rationalisation Measures	-407
3. Reforms Measures:	4500
a) Improvement in Valuation System	(1000)
b) Safe Transportation of Dutiable Goods	(500)
c) Improvement in the Warehousing System	(1500)
d) Improvement in the Auction System	(500)
e) Recovery of Arrears	(1000)
4. Revenues Measures	1340
a) Export Duty on Cotton Yarn	(1360)
b) Levy of 1% Warehousing Surcharge	(400)
c) Export Rebate on Cotton Fabrics	(-770)
d) Withdrawal of Exemption for Gadoon	(350)
<b>TOTAL</b>	<b>5255</b>

percent from income tax, 11 percent from customs duties and the remainder, 4 percent, from sales tax. The concentration of the incremental fiscal effort in excise duties is partly the consequence of the NFC Award. Since 80 percent of the revenues from income tax and sales tax are transferred to the provinces, the federal government is trying to develop sources which are exclusively its own, like excise duties<sup>8</sup> and import duties, so as to get the maximum increase in its receipts.

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<sup>8</sup>excluding tobacco and sugar

TAX/PROPOSAL	REVENUE EFFECT (Rs in Million)
<b>C. CENTRAL EXCISE DUTIES</b>	
1 . Switch-over to Capacity Taxation on Selective items	2500
2 . Fixation of Duty under Shoorai Tashkees System	500
3 . Audit by Valuation Committees	400
4 . Increase on Cotton Yarn	960
5 . Increase on Man-Made Yarn	240
6 . Increase on Bank Cheques	50
7 . Levy of Excise Duty on Telephone Services*	3000
8 . Levy of Excise Duty on Bank Advances*	2000
TOTAL	9650
<b>D. SALES TAX</b>	
1 . Extension of sales tax coverage to wholesale stage	50
2 . Extension of sales tax to commercial importers	25
3 . Withdrawal of exemptions from sales tax	93
4 . Increase in rate on processed fabrics	160
5 . Levy of Sales Tax under Shoorai Tashkees system	50
6 . Consequential effect of increase in other taxes	300
TOTAL	683
OVERALL TOTAL	18923

Source : Budget Speech of Federal Minister of Finance 1991-92.

\* Not Included in the package of taxation proposals Mentioned by GDP



The major taxation proposals in 1991-92 consist either of broadening of the tax base or removal of exemptions. As mentioned earlier, the conventional approach of raising tax rates has not been used to the same extent. The major proposals are discussed below.

#### INCOME TAX

The 1991-92 Budget introduces a schedular income tax at the flat rate of 10 percent on dividends and profits/interest on bank deposits (except inter-bank deposits), bonds, certificates, debentures, securities and instruments of every kind payable after June 30, 1991, by any banking company, corporate body, financial institution, local authority or finance co-operative society. This proposal is expected to yield revenue of Rs. 1.5 billion.

The primary motivation behind the introduction of the schedular taxation of capital income is to remove the rampant evasion in declaration of such income. Unearned income constitutes only about 3 percent to 4 percent of declared income in Pakistan, whereas estimates are that it should range from 10 percent to 12 percent. The old withholding tax regime for dividends and interest income had failed because, given the exemptions, tax payers had avoided payment by maintaining multiple accounts. The absence of any exemption in the flat rate tax is primarily to discourage the tendency towards splintering. There is, however, some concern about the equity implications of the proposals. Widows, orphans, etc., who are currently maintaining small accounts are also liable to pay the tax.

It is significant to note that government instruments like FEBCs, bearer bonds, FIBs, special savings certificates, etc., have not been subject to the flat-rate tax. Clearly, the GOP does not

want to discourage households from investing in these instruments which contribute to its capital receipts. Portfolio changes are likely in response to this tax with part of the time deposits of the banks shifting to government savings schemes or to physical assets. The revenue yield is clearly a function of the extent to which taxed financial assets are substituted by untaxed assets or by greater consumption.

The second proposal in income tax for generating higher revenues is the abolition of monetary threshold for withholding tax in respect of contracts and commission/brokerage and its extension to all companies and registered firms. Simultaneously, there is an increase in withholding tax rates from 2 percent to 2.5 percent for general suppliers, from 1 percent to 1.5 percent for suppliers of rice and cotton, from 1.5 percent to 2 percent for importers and from 3 percent to 5 percent for services rendered. Following the Budget, however, given the protest by businessmen on the widespread extension of the withholding tax regime, the possibility of double taxation and 'cascading' of the tax, the Government has largely withdrawn its proposal for abolition of the threshold. The higher tax rates, however, are operative and part of the revenue target of Rs 0.5 billion from this proposal will be achieved.

Another major innovation in the income tax system in 1991-92 is introduction of the concept of minimum taxation. The base of corporate profits had been considerably eroded by the regime of income tax holidays and by provisions of accelerated depreciation, carry forward of losses, tax credit for BMR, etc. Consequently, out of the approximately 12000 companies on the tax rolls of CBR only about half paid any tax. What is perhaps more striking is that out of the 440 public quoted companies in the Karachi Stock Exchange, only 112 paid any income tax in 1988-89.

The erosion of the tax base is most pronounced in the textile sector.

The large-scale concessions and exemptions given periodically have drastically reduced the income tax base and greatly diminished its revenue contribution. Minimum taxation ensures that all companies pay at least some tax. This widens the tax net and provides for a degree of horizontal equity in the system.<sup>9</sup> The 1991-92 Budget introduces a minimum tax at 0.5 percent of the total turnover of every company which pays no tax or pays lesser amount of tax. Additional revenues of Rs.0.9 billion are anticipated.

The Finance Bill also contains a provision (in Section 59C) for introduction of fixed tax on establishment whereunder an assessee may opt to pay a fixed amount of tax without being required to furnish a return of his total income. The intent primarily is to bring shops into the tax net. Initially, it is proposed to charge Rs 600 annually from establishments (which are currently not paying income tax) located in towns with town committee status and Rs 900 from those located within municipal/metropolitan corporation areas. Tokens will be issued against payments by banks, post offices, etc. Given the low rates and voluntary nature of this scheme, it is not expected to yield more than Rs.0.2 billion initially.

#### CUSTOMS DUTIES

Primarily to encourage greater value added in the export of textiles, the Budget increases the export duty on cotton yarn from Rs 4 to Rs 6 per kg and proposes enhancement in export

however, there is some loss of equity due to taxation of genuine loss-making companies.

rebate on cotton fabrics. The net revenue yield is about Rs 0.6 billion. In addition, a 1 percent warehousing surcharge is proposed to encourage faster clearance and provide for some cost recovery. The earlier withdrawal of exemptions on import duty on raw materials imported for the Gadoon-Amazai Industrial Estate is also expected to lead to some additional revenues (Rs 0.35 billion) .

#### **EXCISE DUTIES**

The Budget proposes increases in excise duty rates on cotton and man-made yarn and on bank cheques, with the collective yield of Rs 1.25 billion. In addition, there are two major proposals for base broadening. The first is the levy of an excise duty on telephone services at the rate of 25 percent<sup>10</sup> of billing. The primary reason for this levy is to generate revenues from the telecommunications sector following the conversion of T&T Department into an autonomous corporation and the resulting loss of profit income. Revenue from this proposal could be over Rs 3 billion.

Another major proposals is the introduction of the 1 percent excise duty on bank advances. Revenues from this source are earmarked for the Bait-ul-Maal, a special welfare fund created in 1991-92. Small loans (of upto Rs 50,000), agricultural, export and investment loans are exempted from this tax. The tax base will consist primarily of working capital advances made to the corporate sector. The primary justification for this tax is that institutional credit remains subsidised in Pakistan and given rationing of credit (according to the national credit plan) it is assumed that the burden of the tax will largely fall on corporate

"Implementation of this proposal has been delayed in view of the pending privatisation of the PTC.

profits and not be passed on to consumers. The revenue expectation is almost Rs 2 billion.

#### SALES TAX

Given the recent introduction of the general sales tax (with characteristics of a VAT) in Pakistan, the Budget does not propose to generate substantial revenues from this source. However, some initial attempts have been made to widen the tax base, as pointers for coming years. Exemptions on a number of items has been withdrawn. Commercial importers have been brought into the tax net and the GST has been extended to the wholesale <sup>^</sup>age *in respect of* nine *locally* produced items.

In addition, a Shoorai Tashkees scheme has also been introduced in Sales Tax. Initial reports are that this scheme is yielding substantial additional revenues. For example, in the case of textile processors, negotiations have led to additional revenue commitment of Rs 290 million.

#### SUMMARY

The July IMF Mission to Pakistan has expressed some reservations about the quantum of additional revenues of about Rs.19 billion anticipated from the proposals contained in the 1991-92 Budget. Clearly, as emphasised earlier, there is an element of value judgment about the gains from tax reform especially in the area of indirect taxes. For example, the revenue target of Rs 4.5 billion from reforms in customs duties is ambitious and requires a number of improvements in tax administration, which will be difficult to implement in the short run. However, the implicit escalation in import tariffs following the shift to ITPs

contained in the new valuation manual will provide a cushion to revenues. Similarly, the switchover to capacity taxation in excise duties should have been seen as a revenue-neutral measure, at least in the short-run, and not as a proposal that could yield as much as Rs 2.5 billion. However, the apparent success of the Shoorai Tashkees system will at least partially compensate for the short fall.

The real potential for exceeding revenue expectations exists in the income tax proposals. Despite the GOPs retreat on the withholding tax front, it appears that the revenues anticipated from various proposals has been understated. This is especially the case with the revenue yield from the 10 percent flat-rate tax on capital income, the presumptive tax on contractors, importers, etc., and the 1/2 percent minimum tax. Altogether, while there may be significant shortfalls in the case of revenue yield from some proposals, as a whole the overall divergence is not likely to be large. The precise position will, of course, become clear only as the year proceeds.

#### **3.4. ADP SIZE AND PRIORITIES.**

The 1991-92 budget earmarks approximately Rs 73 billion for the ADP, showing an increase of about 15.4 percent over the previous year. An analysis of the composition of the ADP shows that out of the nineteen major sectors, there is an increase in six sectors while in the remaining thirteen sectors allocations are lower compared to 1990-91. It, therefore, appears that the development strategy of the federal government has become more sectorally concentrated in 1991-92 and priorities are being changed sharply.

Sectors which show a significant increase in allocation include energy, 51 percent, transport and communication, 62 percent, and agriculture, 28 percent. Increase in the social welfare sector is also significant, 68 percent, through much of it, can be attributed to the relatively low base.

TABLE-3.4 ANNUAL DEVELOPMENT PLAN OF THE FEDERAL GOVERNMENT  
(Rs in Million)

	1991-92
Agriculture	1673.8
Industry	121.5
Minerals	389.9
Water	3516.7
Power	28104.9
Transport & Communication	13264.2
Physical Planning & Housing	707.2
Rural Roads & Model Villages	593.6
Education & Training	682.5
Health & Nutrition	1133
Social Welfare	88.8
Special Development	64.8
Others	5122
Total	<u>56861.1</u>

Source: Budget-in-Brief, Ministry of Finance, GOP, 1991-92.

Important sectors where the 1991-92 allocations are lower than the previous year include education, health, science and technology and other social sectors. It appears, therefore, that the prime victims of the current financial malaise at the federal level are the social sectors. Given the pattern of short-run, explicit returns from investment the federal government has clearly shifted its priorities from social to physical infrastructure. As such it becomes essential that the provincial governments, which are constitutionally responsible for some of these services, give more priority to these sectors, particularly after the improvement of their fiscal status following the NFC award.

An analysis of the 1991-92 development plans of the provincial government of Sindh and Punjab, however, does not show a significant increase in the sectoral priority of these sectors. Compared to 1989-90 level the budgetary allocations to these sectors are higher by less than 1 percent. Table 3.5 presents the composition of the Annual Development Programmes of Punjab and Sindh. The total development outlay of these two provinces combined is Rs 14.9 billion, 33 percent higher than 1989-90 level. Major sectors of investment include housing and physical planning, education, health, and agriculture, with shares in the provincial ADPs of 18,14,12 and 10 percent respectively. A detailed analysis of trend in the size and composition of the provincial ADPs is presented in Appendix I.

### 3.5. POVERTY ALLEVIATION EFFORTS

The budget of 1991-92 proposes three distinct measures aimed at reducing inter-personal and inter-regional inequalities in the country. These include, first, the formation of a welfare fund, 'bait-ul-maal', second, through public works under the 'tamir-e-watan' programme and, finally, through 'Matchings Grant Scheme' for the uplift of the deprived communities.

'Bait-ul-Maal' has been created as a multi-purpose fund to be used for the welfare of the poor and needy. The government has allocated Rs 3.0 billion as the opening amount of the fund which will be used in 1991-92 to, first, subsidize the prices of basic food items like flour, pulses, and vegetable ghee. It is estimated that more than 50 percent of the initial allocation will be utilized for these subsidies. Second, the fund will be used to pay stipends to the poor, orphans, widows and old-aged or people who do not have any other source of income. Moreover, the fund can also be used for providing dowry to poor and needy ladies, artificial limbs to the disabled and houses to the deserving people. Financing of the 'bait-ul-maal') will be by revenues from the 1% tax on bank advances. For 1991-92 only, a special capital assets tax has also been levied.



TABLE-3.5 PROVINCIAL ANNUAL DEVELOPMENT PROGRAMME

	(Rs in Million)
	1991-92
AGRICULTURE	1520.2
Agriculture	443.7
Animal Husbandry	82.4
Forestry	146.7
Fisheries	28.2
Others	819.0
IRRIGATION	894.0
INDUSTRY	267.0
MINERALS	55.7
POWER	36.0
TRANSPORT & COMMUNICATIONS	1147.0
PHYSICAL PLANNING ft HOUSING	2623.1
Rural Water Supply/Sanitation	444.0
Urban Water Supply/Sanitation	418.0
Others	1927.1
RURAL DEVELOPMENT	789.4
EDUCATION & TRAINING	2084.6
Primary Education	509.0
Secondary Education	708.9
Technical Education	116.1
Others	750.7
HEALTH ft NUTRITION	1831.0
Hospital Beds	319.0
Rural Health Program	592.5
Others	407.5
MANPOWER ft EMPLOYMENT	35.0
SOCIAL WELFARE	21.0
OTHERS	462.0
TOTAL ADP (Excluding SDP)	11766
SPECIAL DEVELOPMENT PROGRAM	3180.0
Total	14945.8

Includes Punjab and Sindh only.

Source: Provincial Annual Development Programme as, 1991-92

The mechanisms for utilisation or administration of the fund are still fraught with ambiguity. However, in principle the fund could be instrumental in protecting the living standards of poorer segments of society. The emphasis is, however, on subsidising consumption. Instead, higher allocations may have been given for generation of employment opportunities and for development of training facilities.

Under the tamir-e-watan programme, the budget proposes to finance the provision of services like roads, electricity, health, education and other amenities (including the 3 and 7 maria housing in the rural areas of the country). Schemes under this program are to be implemented by the provincial governments and district committees. The district committees will consist of elected representatives. It is, however, felt that the involvement of the lower level local government, the district council, would perhaps have encouraged development at the grassroots level and ensured a degree of sustainability of the investments.

Along with the programmes mentioned above the budget proposes the establishment of a Fund for the uplift of the deprived. The Fund will be financed from the proceeds of privatization. For this purpose, target areas will be identified at the community level i.e. village, mohallah and urban slums to undertake the following activities through their own organizations; (i) population, nutrition and health; (ii) primary and middle education; and (iii) community infrastructure. For each community a Community Development Organization with grass root representation will be created as non-governmental organizations. It will be responsible for identifying the community needs and securing allocations from the proposed Fund. It will take steps to increase the enrollment of children and to provide funding for

community infrastructure projects. Matching grants will be made from the proposed Fund to promote these activities.

### 3.6. NKW **FINANCING INITIATIVES**

Given the overall resource constraint in the public sector, the GOP has made an attempt to encourage private sector participation in important social sectors like education and health. The budget proposes a matching grant scheme for all private investments in primary and secondary education and health. According to the scheme the government will give a matching grant to any private sector investment in the aforesaid sectors, 25 percent by the local and federal governments respectively and the remaining 50 percent by the provincial government.

Proposed to be financed by income raised through privatization the introduction of the matching grant scheme is an innovative financing mechanism which will not only reduce the burden on the public exchequer but will also mitigate against stagnation of development activities in these sectors in periods of resource constraints. It could lead to significant changes in the service delivery mechanisms by greater involvement of the community. This will contribute to more cost-effective and sustainable provision of services.

## CHAPTER FOUR FUTURE POSSIBILITIES

We speculate in this chapter on the likely steps that will be adopted by the GOP in the next few years to contain the size of the budgetary deficit. This include a description of the likely strategy of resource mobilization and areas of expenditure control.

**4.1. STRATEGY OF RESOURCE MOBILIZATION** The next few years will witness attempts by the GOP to raise the tax/GDP ratio in the economy in order to contain the budgetary deficit and thereby reduce the level of borrowings. A significant beginning has already been made in the 1991-92 Budget. If there is not a major shortfall in the revenue projections, then the federal tax/GDP ratio could go up from 13.2 percent in 1990-91 to 14.7 percent in 1991-92, an increase of almost 1 1/2 percentage points in one year.

The basic strategy of resource mobilization will consist of generating the largest component (in proportionate terms) of additional revenues from direct taxes like income and wealth tax. Not only is the revenue-raising potential highest in these taxes but this will also provide for a more balanced, progressive and elastic tax structure. A target of doubling the share of direct taxes from about 15 percent currently to 30 percent in the next five years is probably feasible.

Within indirect taxes, the strategy will also involve a shift in composition away from taxes on international trade to those on domestic production and sales. This will be achieved by a major broadbasing of the tax bases for sales tax and excise duties (especially to cover the service sectors of the economy) and by

reduction simultaneously in the rate of import tariffs (partly in response to IMF conditionalities). Specifically, the proposals for resource mobilization in the next few years could include the following :

#### Income Tax

- 1) **Removal of Exemptions:** Successively, exemptions in the First and Second Schedule of the ITO are likely to be withdrawn. This will bring into the tax net components of income like capital gains on financial assets, perquisites and allowances, commercial income of foundations, interest income from government bonds and savings schemes, etc. There will be increasing debate on the need for introduction of an agricultural income tax. While this will continue to be resisted by the powerful feudal lobby, it is possible that partial success will be achieved through taxation of non-crop income from orchards, etc.
- ii) **Taxation of Unearned Income:** The 1991-92 Budget, as mentioned earlier, makes a major attempt at bringing capital income more effectively into the tax net by deduction at source of the flat-rate (10 percent) tax. One major source of capital income which continues to be characterized by rampant evasion is rental income from property. The potential tax base is large at over Rs, 30 billion. It is likely that by coordinating collection with the Provincial Excise and Taxation Departments, which are responsible for collection of property tax, leakage in revenues can be reduced.
- iii) **Introduction of Presumptive Income Taxation:** PIT has been introduced in the case of contractors, suppliers and

commercial importers in the 1991-92 Budget. Following surveys, this regime is likely to be extended to wholesale and retail trade establishments and various professions also. Large-scale evasion exists in both categories and the levy of PIT could yield significant additional tax revenues. In addition, a PIT already exists in the road transport sector. However, the flat rates are very low and there is little correlation with the income generating capacity of different types of vehicles. The rates will have to be enhanced substantially.

- iv) Minimum Taxation: Companies have been subject to a minimum tax of 1/2 percent of turnover this year. The next step may be the introduction of minimum taxes in the case of registered firms and individual tax payers.

Fixation of Corporate Norms: Attempts may be made in future years to specify norms of corporate profitability for tax purposes. Firm's declaring above the norm could be given preferential treatment in the assessment process and be subject to lower tax rates on declared income above the norm. Such schemes will be developed to induce higher profit declaration by companies.

- i) Rationalization of Tax Rates: There is a perception that tax rates are too high in Pakistan, which has encouraged evasion. Tax rates have been brought down this year to a maximum of 35 percent in the case of registered firms and individuals. The Tax Reforms Committee had recommended that the tax rate for companies should also be brought down from 45 percent to 35 percent . This was not implemented this year because of the fear of significant

revenue losses (of almost Rs. 3.5 billion) in the short run. However, as the income tax base is broadened and exemptions are withdrawn, there will be a tendency to bring down tax rates. In addition, the tax rate on commercial banks is very high at 65 percent. As banks get privatised there will be strong pressure to remove this differential.

#### TOALTH TAX

Wealth tax collections are extremely low in Pakistan at about Rs.0.6 billion only. This bears no relation with the value of financial and physical assets in the economy. A number of possibilities exist for raising additional revenues.

- i) Updating of Valuation Lists: Values of properties declared for wealth taxes currently are very low in relation to market values. Valuation boards will need to be set up in different cities to develop a set of tables which can be used for assessment purposes. This is required because of the high component (over 80 percent) of owner-occupied properties in the country.
- ii) Agricultural Wealth Tax: The conditions that owners of agricultural land pay wealth tax only if they are liable to income tax and that their non-agricultural assets are at the same time independently chargeable to wealth tax are likely to be removed in the next few years. In addition, the capital value of a produce index unit (PIU) has been fixed at only Rs. 100 for wealth tax purposes. This has effectively exempted bulk of agricultural land from the tax. As compared to this, the value per PIU for credit purposes has been fixed at Rs. 400. If there is a corresponding enhancement in the rate for tax purposes

then additional revenues of upto Rs.1 billion could be generated.

- iii) Withholding Wealth Tax: Withholding taxes have been used hitherto for broadening the base of income tax and reducing evasion. The same approach may be applied for wealth tax. Investment in physical assets, in particular, is more visible. The Provincial Excise and Taxation Departments could act as the collection agency, at the time of collection of property and motor vehicle tax. An appropriate withholding tax could be charged from owners of properties situated on large plots (above 240 square yards) and large vehicles (above 1000 c.c). Given the problems associated with establishing the sources of income, tax payers are likely to adopt a passive attitude to payment of such a withholding tax. If implemented, the potential revenue from this proposal is substantial.

Altogether, it is likely that in coming years major efforts will be made to develop direct taxes in Pakistan by broadening the tax base, removal of exemption and simplification of the tax system by introduction of presumptive and minimum taxes.

#### EXCISE DUTIES

- vi) Excise Duty on Services: A major step forward has been made this year by the levy of an excise duty on telephone services and on bank advances, with the combined yield of over Rs.5 billion. GOP will search for new tax bases consisting of fast growing services, which are, consumed more by the upper income groups or by the corporate sector. Candidate services for levy of excise duty



include electricity consumption by domestic and commercial consumers (above a certain minimum level to protect small consumers), air-conditioned railway travel, port services to general cargo, urgent mail services of the Post Office, etc.

### **GENERAL SALES TAX**

i) Extension to Wholesale and Retail Trades: The big area for raising additional revenues from this tax is to take it beyond the manufacturing stage to distribution. A small step in this direction has already been taken in the 1991-92 Budget. The next phase will be extension of GST to arf-aa where established dealerships exist. The retail sector will be difficult to cover because of the problem of documentation. Initially, an attempt may be made to subject sales of consumer durables to GST.

### **CUSTOMS DUTIES**

Import Tariffs have generally been very high in Pakistan. Recently, attempts have been made to decrease these rates, as in the 1991-92 Budget, in which rates on 1321 commodities have been brought down to a maximum of 90 percent. High tariffs traditionally have conferred too high a level of effective protection to domestic industry and subsidized inefficiency. They have also encouraged under invoicing and smuggling. In coming years, tariff rates may be brought down further to a maximum of about 60 percent. Simultaneously, effort will be made to protect revenues in the following ways:

i) Rationalization of the Rate Structure: There is a myriad of exemptions and special treatment currently in the duty structure. This multiplicity of tariffs for the same commodity has led to distortions and revenue losses. For

example, rates vary among industrial and commercial importers and between public sector and private sector importers. Rationalisation of the rate structure has become essential.

- ii) Improvements in the System of Export Rebates: Pakistan is currently operating a very complex system of export rebates. These rebates have been pitched at high levels with the objective of stimulating exports. The exchange rate will have to be used more to provide a general incentive to export promotion. In addition, there is large-scale abuse and corruption in the system of duty drawbacks. This system will have to be streamlined in coming years to prevent excessive revenue leakages. In the context of indirect taxes, the strategy will consist largely of spreading the tax net, reducing reliance on taxes on international trade and raising higher revenues by taxes on domestic production and sales.

### **PROVINCIAL REVENUE SOURCES**

Provincial taxes have generally remained underdeveloped for reasons highlighted earlier. Currently, they contribute less than 5 percent to national revenues. Significant scope exists for mobilizing additional revenues as follows:

- (i) Motor Vehicle Tax: The MVT is the second largest source of revenue for the provinces. It is characterized by low elasticity because of specific rates. Revenues can be enhanced by making registration fees ad valorem (about 1%) in character.

- (ii) Property Tax: The most under exploited source of revenue of the provincial (and local) governments currently is the property tax. It is estimated that revenues could be ten times the existing level. This will require reassessment of rental values, scaling down of exemptions to owner-occupied properties, etc.
- (iii) New Taxes: The Capital Gains Tax on properties was abolished in 1985-86. At the time, it was a very buoyant source of revenue. This tax needs to be reintroduced once again, and the rates of stamp duty brought down correspondingly. Simultaneously, there is a case for introduction of a vacant plots tax. Both taxes will be instrumental in curbing the rampant speculation in urban land.
- (iv) User Charges: Rates of cost recovery in provincial services are very low. Significant additional revenues could be generated by raising irrigation charges, fees for secondary and college education, etc.

The key element of the strategy in the area of provincial revenue sources will be to raise the buoyancy of provincial taxes by structural changes in the tax system.

## **1.2 EXPENDITURE CONTROL**

As the process of resource mobilization runs increasingly into limits imposed by class interests and powerful lobbies, the Government will have to adopt a two-pronged approach to solve the problem of a large and growing budget deficit. This will not only involve generation of additional resources but also a contraction in the size of the public sector and greater economy in expenditures.

Within the sphere of civil administration and provision of services, fundamental changes are likely to follow gradually in the aftermath of the NFC Award. This will include, first, the handing back to the provinces of functions (in the concurrent list) which had earlier been 'federalized' due to the paucity of resources at the provincial level. This includes the SCARPS, flood control, universities, fertilizer subsidy and roads of national importance. In 1990-91, total federal expenditure (current and development) on these functions was about Rs. 5 billion. Expenditure on the fertilizer subsidy is already expected to be reduced by 53 percent in 1991-92. As far as universities and roads of national importance are concerned, in view of their potential role in the process of national integration, special arrangements may be evolved whereby joint funding, according to predetermined shares, will take place by the federation and the provinces. These functions could then be performed by autonomous agencies like the University Grants Commission and the National Highways Board.

The next area where GOP may trim its role over time is by winding down ministries performing a role of coordinating essentially provincial functions. This includes the ministries of education, health, food and agriculture, local government and rural development, housing, etc. Running these ministries currently costs GOP about Rs.1 billion. Some of this expenditure could be saved by creating one umbrella ministry for inter-provincial coordination and transferring the surplus personnel to their province of origin. Also, as the process of privatisation proceeds, the Ministry of Production will become largely redundant.

Within the current budget of the GOP, the two dominant heads of expenditure are debt servicing and defence. The former, as

highlighted earlier, has demonstrated explosive growth due to the rapid increase in the level of outstanding debt (both domestic and external) and higher marginal cost of borrowing. Clearly, growth in cost of debt servicing can only be contained by restricting the size of the overall budgetary deficit and by adopting a more efficient policy of public debt management, which seeks in particular to raise the period of repayment of domestic borrowing (as is being attempted with the FIBs).

Defence expenditure has largely remained outside the ambit of public discussion (including the parliament) due to strategic *considerations and the powerful vested interest of the military* establishment. Details of the break up to defence expenditure are not included in the budget statements and, therefore, it is not possible to identify the scope which exists for achieving some economy in this expenditure. It is necessary, however, for a balanced 'austerity' program that not only civilian but also military expenditure in the country be controlled. The latter has grown in real terms at the rate of about 10 percent annually during the 80s. Perhaps, a feasible target is to freeze the real level of defence expenditure. Budgetary provisions in future years will then involve only inflation indexation.

Subsidies are an area where strong pressures (including these of IMF) have been exerted to bring down expenditure. But, increasingly, as the rate of inflation rises in the country, consumer subsidies have become essential to protect the living standards of the poorer segments of society. This is indicated by the fact that in the 1991-92 Budget additional expenditure of over Rs.1.5 billion through the Bait-ul-Maal is proposed to bring down the prices of atta, daal (pulses) and ghee. Therefore, success in limiting the subsidy bill is closely linked to the success of anti-inflationary policies of GOP. However, ways will

uncontrolled population growth makes it difficult to improve levels of service coverage. Innovative delivery mechanisms will have to be evolved which are cost effective and involve a greater degree of community involvement in the choice, execution, financing and management of services. The CIDA - World Bank assisted Rural Water Supply and Sanitation Program is one area where it is hoped that these concepts will be tried successfully in coming years .

Turning to expenditure control by the provinces, this has historically been an area of some concern. In the absence of the NFC Award and given the access to residual deficit grants, provinces have been profligate spenders. Since 1988-89, the ceiling on these grants has exercised a major restraining effect on provincial expenditures. The 1991 NFC Award was meant to change all this, by putting the burden on the provinces of financing their own deficits. However, in the short run, given the somewhat generous nature of the award (see Chapter Two) and the pent-up pressures for spending, the provinces are likely to increase their current expenditures dramatically in 1991-92. It is not surprising that the greatest pressure for lifting the ban on fresh recruitment has come from the provinces. This tendency will eat into any revenue surpluses, especially if the provincial governments pick up the full cost of the Pay Committee Award from their own resources. Simultaneously, development transfers (ADP + SDP) from the federal government are being cut back (by about Rs.2 billion in 1991-92). There is danger that if the provincial governments do not restrict growth in their current expenditures that in the next few years their development activity will also contract severely.

Altogether, as the government runs into political and institutional limits of higher taxation it will be compelled to

out back on expenditures to curtail the size of the budgetary deficit. Given the rigidity in major expenditure heads like defence and debt servicing the flexibility in these areas is limited and there is the danger that development expenditure and expenditures on social sectors will be cut further, thereby affecting the long-term growth potential of the economy.

## **CHAPTER FIVE STRATEGIC**

### **CHOICES**

The previous chapter has highlighted the possibilities that exist for mobilizing additional resources or for controlling expenditures. The GOP is going to remain under pressure to bring down the size of the budgetary deficit in order to maintain its credit worthiness, both internationally and domestically, and to restrict the rate of inflation within politically acceptable limits. Tackling the structural problems of fiscal policy will remain high on the agenda of GOP.

The objective of this Chapter is to identify the likely strategic choices within the range of possibilities indicated by us earlier. These choices will clearly be determined by political and economic considerations and limits of administrative feasibility. Initially, we develop a scenario based essentially on continuation of previous trends. This will indicate the size of the budgetary deficit in the absence of major changes in fiscal policy. This is followed by a description of the strategy that is likely to be followed to remove the imbalance in public finances.

### 5.1 UNCHANGED TRENDS SCENARIO

An econometric model<sup>1</sup> has been constructed to project key budgetary magnitudes on the basis of relationships observed during the period, 1977-78 to 1990-91. This model projects revenues upto 1995-96 with the help of individual tax buoyancy coefficients (see Appendix III) and growth of the tax bases. Expenditures are projected on the basis of the historically observed relationship with GDP and in the case of debt servicing by quantifying the future level of domestic and foreign debt and the effective interest cost of servicing this debt.

Results of the projection of budgetary magnitudes on the basis of unchanged trends are given in Table 5.1. Net revenue receipts are likely to decline in this scenario from 14.4 percent to 13.6 percent of the GDP. Current expenditure (excluding debt repayment) share of the GDP will increase from 15 percent to 16.3 percent, with fastest growth in the interest cost of debt. The share of this head in total expenditure will increase from 35 percent to over 41 percent. If debt repayment is added to the interest cost then debt servicing will approach 50 percent of current expenditure and consume almost 62 percent of revenue receipts.

This result is that unless major changes are made in fiscal policy, the budgetary deficit will rise rapidly once again, at the annual rate of almost 26 percent. The consequence is that the budget deficit as a percentage of the GDP will rise from the anticipated level of 5.5 percent in 1990-91 to almost 7.7 percent in 1995-96. In other words, there is a danger that the fiscal

<sup>1</sup>Details of the specification of the model are given in Appendix IV.



imbalance will approach the high level of the mid-SOs, prior to the launching of IMF structural adjustment program.

## 5.2 STRATEGIC CHOICES

Clearly, GOP will have to make major changes in its fiscal policy if it is to bring the budget deficit down to acceptable levels. We have demonstrated in Section 1.3 that much of the adjustment

TABLE 5.1  
PROJECTED FISCAL SHTOS OF GOP  
(On the Basis of Uncharged Trends) (Rs in Billion)

	1991-92	1992-93	1993-94	1994-95	1995-96	ACGR (X)
A. NET REVENUE RECEIPTS	169.7	193.3	219.8	250.1	284.6	13.8
A.1 Tax Revenues	156.4	180.6	208.6	241.0	278.3	15.5
A.2 Non-Tax Revenues	76.1	84.9	94.6	105.5	117.6	11.5
A.3 Divisible Pool Transfers	62.8	72.2	83.4	96.4	111.3	15.5
B. CURRENT EXPENDITURE	176.1	207.5	244.7	289.0	341.9	18.0
B.1 General Administration	8.3	9.6	11.2	13.0	15.1	16.1
B.2 Defence	71.0	82.0	94.7	109.4	126.4	15.5
B.3 Services	9.3	10.7	12.4	14.3	16.6	15.5
B.4 Subsidies	8.5	9.8	11.3	13.1	15.1	15.5
B.5 Interest on Debt	62.1	76.3	93.5	114.8	141.1	22.6
B.6 Others	16.9	19.1	21.6	24.4	27.6	15.5
C CURRENT ACCOUNT SURPLUS/DEFICIT	-6.7	-14.2	-24.9	-38.9	-57.3	
D. DEVELOPMENT EXPENDITURE	72.7	84.0	97.0	112.0	129.4	15.5
E. SELF FINANCING BY AUTONOMOUS CORP COUP.	14.3	16.4	18.9	21.6	24.8	14.8
F, BUDGETARY DEFICIT	65.1	81.8	103.0	129.3	161.9	25.6
G.GDP	1111	1362	1573.	1817	2098	15.5
H. BODCKT DEFICIT AS % OF GDP	5.5%	6.0%	6.5%	7.1%	7.7%	

made by the GOP, as part of the SAP, has been on the expenditure side. Excluding defence, the scope, therefore, for large quantitative improvements in the budget deficit by further cutbacks in expenditure is limited. The focus clearly has to be . on the resources side.

A major effort for mobilizing additional resources has, in fact, , been made in the 1991-92 budget. Given the slack in the J utilization of revenue raising potential of federal taxes like ? income and wealth taxes and in property-related provincial taxes, highlighted in Chapter Four, it can be expected that bulk of the adjustment will be on the resources side. As far as expenditures are concerned some economy will be exorcised in expenditure on general administration *and* subsidies. The big question is whether a similar control can be exercised on the growth of defence expenditure. Development expenditures have already been curtailed in the last few years, especially in the last few years, and any further cutbacks will mean sacrificing economic growth and Jeopardizing a strong private sector investment response (in the presence of infrastructural bottlenecks) on which this government has pinned most of its hopes for restoring economic buoyancy.

Based on the above, we expect the following strategic choices:

- (i) The resource mobilization effort will remain pitched at this years level. The total yield from taxation proposals (including both reforms and tax rate hikes) in 1991-92 is equivalent to about 1.4 percent of the GDP. We expect that the government will target for, more or

less, the same yield from taxation proposals in the next four years, upto 1995-96. The additional revenue generation will have to rise to about Rs.28 billion annually by 1995-96.

ii) Given varying priorities, we expect that different components of expenditure will have growth rates corresponding, more or less, to the following:

Expenditure	Component	Basis for determining Future growth rate	Implied Growth	Annual Rate 10%
General Administration		Constant in real terms		
Defence		Constant share of GDP		15.5%
Services		Constant share of GDP		15.5%
Subsidies		Constant in real per capita terms		13%
Others		Constant in real per capita terms		13%
Development Expenditure	Constant share of GDP			15.5%

The implied growth rates are derived on the basis of the assumptions that the inflation rate between 1991-92 and 1995-96 will be 10%, the real GDP growth rate will be 5.5% and population growth will continue at about 3% per annum.

The above strategic choices imply a significant cut back in expenditure on general administration and subsidies. Debt servicing is also likely to be lower because of lower budgetary deficits.

- (iii) Self financing of development expenditure is also likely to be higher. In particular, as provinces launch their own resource mobilization effort they should be able to finance part of their development program from their own resources. As such, it is possible that the component of self-financing by autonomous corporations and provinces will be significantly higher than in the unchanged trends scenario.

The resulting projections of public finances of GOP with higher level of resource mobilization and some expenditure control are given in Table 5.2. In this scenario, not revenue receipts rise as a percentage of GDP from 14.4 percent to 16.1 percent by 1995-96. Tax revenues in particular will demonstrate a high level of buoyancy, with an annual growth rate approaching 23 percent. This will lead to an increase in the tax/GDP ratio from 13.3 percent to 16.9 percent. Current expenditure will also rise as a percentage of GDP, due to the relatively rapid growth in debt servicing of about 21 percent per annum.<sup>12</sup> However, the increase will be less than that in revenue receipts. Consequently, it is possible that by 1994-95 a small surplus could be achieved in the current budget. This will mean that borrowings are used for financing development and not to meet the needs of current consumption.

The consequence of the above type of structural adjustments will be success in bringing down the budget deficit from 5.5 percent

<sup>12</sup> It is estimated that outstanding domestic debt will approach Rs.700 billion by 1995-96 while outstanding external debt will exceed Rs.550 billion. In the surcharged trends scenarios, the former will be even larger at about Rs.850 billion.

of the GDP in 1991-92 to 4.5 percent in 1995-96. This is the level required by the IMF. It is also a safe level and will imply a major moderation of inflationary pressures.

Our analysis reveals that most of the future adjustment in the size of the budgetary deficit (from the level likely to be attained if past trends continue) will come from the resources side. This is in contrast to the policy followed between 1988-89 and 1990-91 of bringing about improvements in the budgetary situation by cut backs in expenditure, especially on development. Almost 75 percent of the adjustment will be made by mobilizing higher resources, 10 percent by raising the component of self-financing and the remainder, 15 percent, by economizing on different components of current expenditure.

TABLE 5.2

**PROJECTED FISCAL STATUS OF GOP**  
**(With Higher Level of Resource Mobilization and Economy in Expenditure)**

(Rs in Billion)

	1991-92	1992-93	1993-94	1994-95	1995-96	ACGR (%)
<b>A. NET REVENUE RECEIPTS</b>	<u>169.7</u>	<u>202.1</u>	<u>240.1</u>	<u>285.2</u>	<u>338.3</u>	<u>18.8</u>
A.1 Tax Revenues	<u>156.4</u>	<u>193.6</u>	<u>238.0</u>	<u>291.1</u>	<u>354.3</u>	<u>22.7</u>
Without Discretionary Changes	<u>140.4</u>	<u>175.2</u>	<u>216.8</u>	<u>266.6</u>	<u>326.0</u>	
Revenue from Proposals	<u>16.0</u>	<u>18.4</u>	<u>21.2</u>	<u>24.5</u>	<u>28.3</u>	
A.2 Non-Tax Revenues	<u>76.1</u>	<u>85.9</u>	<u>97.3</u>	<u>110.5</u>	<u>125.7</u>	<u>13.4</u>
Without Discretionary Changes	<u>76.1</u>	<u>84.9</u>	<u>95.8</u>	<u>108.5</u>	<u>123.2</u>	
Revenue from Proposals	<u>-</u>	<u>1.0</u>	<u>1.5</u>	<u>2.0</u>	<u>2.5</u>	
A.3 Divisible Pool Transfers	<u>62.8</u>	<u>77.4</u>	<u>95.2</u>	<u>116.4</u>	<u>141.7</u>	<u>22.7</u>
Without Discretionary Changes	<u>59.2</u>	<u>70.1</u>	<u>86.7</u>	<u>106.6</u>	<u>130.4</u>	
Revenue from Proposals	<u>3.6</u>	<u>7.3</u>	<u>8.5</u>	<u>9.8</u>	<u>11.3</u>	
<b>B. CURRENT EXPENDITURE</b>	<u>176.4</u>	<u>206.8</u>	<u>242.3</u>	<u>283.7</u>	<u>332.2</u>	<u>17.1</u>
B.1 General Administration	<u>8.3</u>	<u>9.1</u>	<u>10.0</u>	<u>11.0</u>	<u>12.2</u>	<u>10.0</u>
B.2 Defence	<u>71.0</u>	<u>82.0</u>	<u>94.7</u>	<u>109.4</u>	<u>126.4</u>	<u>15.5</u>
B.3 Services	<u>9.3</u>	<u>10.7</u>	<u>12.4</u>	<u>14.3</u>	<u>16.6</u>	<u>15.5</u>
B.4 Subsidies	<u>8.5</u>	<u>9.6</u>	<u>10.9</u>	<u>12.3</u>	<u>13.9</u>	<u>13.0</u>
B.5 Interest on Debt	<u>62.4</u>	<u>76.3</u>	<u>92.7</u>	<u>112.3</u>	<u>135.5</u>	<u>21.1</u>
B.6 Others	<u>16.9</u>	<u>19.1</u>	<u>21.6</u>	<u>24.4</u>	<u>27.6</u>	<u>13.0</u>
<b>C. CURRENT ACCOUNT SURPLUS/DEFICIT</b>	<u>-6.7</u>	<u>-4.7</u>	<u>-2.2</u>	<u>+1.5</u>	<u>+6.1</u>	<u>-</u>
<b>D. DEVELOPMENT EXPENDITURE</b>	<u>72.7</u>	<u>84.0</u>	<u>97.0</u>	<u>112.0</u>	<u>129.4</u>	<u>15.5</u>
<b>E. SELF FINANCING BY AUTONOMOUS CORP.</b>	<u>14.3</u>	<u>18.9</u>	<u>21.9</u>	<u>25.1</u>	<u>28.8</u>	<u>19.1</u>
<b>F. BUDGETARY DEFICIT</b>	<u>65.1</u>	<u>69.8</u>	<u>77.3</u>	<u>85.4</u>	<u>94.5</u>	<u>9.8</u>
<b>G. GDP</b>	<u>1179</u>	<u>1362</u>	<u>1573</u>	<u>1817</u>	<u>2098</u>	<u>15.5</u>
<b>H. BUDGET DEFICIT AS % OF GDP</b>	<u>5.5%</u>	<u>5.1%</u>	<u>4.9%</u>	<u>4.7%</u>	<u>4.5%</u>	<u>-</u>

The continuously increasing level of resource mobilization during the next five years will, of course, require a high degree of political will on the part of the GOP. Administrative measures and other reforms will have to be instituted to check the problem of large-scale tax evasion. The quality of tax administration, both at the federal and provincial level, will have to be vastly improved. The tax departments will have to be purged of corrupt and inefficient officials and greater reliance placed on data base development and on deterrent punishments to evaders. It will also be necessary to broad-base the tax structure, to withdraw the tax privileges to powerful interest groups and to roll back exemptions. Unless all this is done, it is unlikely that the structural problems of fiscal policy will be solved.

## **CHAPTER SIX**

### **IMPLICATIONS FOR THE DONORS**

We have identified in the first five chapters of this report the long-term developments in fiscal policy in Pakistan, the current prospects, the possibilities that exist in coming years and the likely strategic choices that will be made by GOP in performing its task of fiscal management. In the process, the contours of the future resource mobilisation strategy have been identified and an attempt made to indicate likely expenditure priorities and possible arena of economy. Many of the changes that are likely to occur are structural in character and have basic implications on the activities of the donors in Pakistan in terms of the level and composition of lending. This Chapter outlines some of these implications.

#### **6.1. CREDIT WORTHINESS OF PAKISTAN**

The basic question which perhaps arises from the viewpoint of both bilateral and multilateral donors is the ability of GOP in coming years to service its foreign debt obligations. The Appendix on Debt Servicing has analysed in detail the trends in the volume of outstanding debt, both external and internal, and the cost of interest and repayment of debt. By 1989-1990, servicing of external debt had reached the level of 23 percent of the foreign exchange earnings (exports + remittances) of the country. During 1990-91, this share has, in fact, declined to 18 percent due to the extra ordinary growth in exports of 22 percent and the fact that home remittances have not declined significantly despite the Gulf Crisis. GOP is placing a lot of emphasis on promotion of exports. The target for 1991-92 has been fixed at \$ 8 billion, compared to the level achieved in 1990-91 of about \$ 6 billion. It is also likely that home



76.

remittances will pick up again as Pakistani workers return to Kuwait.

Based on the likely trends in foreign exchange earnings and level of external assistance we do not expect the ratio of debt servicing of external debt to foreign exchange earnings to exceed 25 percent by 1995-96. Therefore, in this narrow sense the international credit rating of Pakistan is not likely to be affected in any dramatic way. The problem seems to be more of an internal nature. Given the declining value of the rupee and growth in the interest and repayment of debt, the rupee costs of external debt servicing are expected to increase rapidly and, alongwith the interest on domestic debt, place a heavy burden on the budgetary resources of GOP. In the unchanged trends scenerio (presented in Section 5.1) we project that debt servicing will consume over 62 percent of the net revenue receipts of GOP and constitute almost 50 percent of current expenditure. This will contribute to a further deterioration in the budgetary situation and necessitate additional borrowing. The government will essentially be caught in a debt trap whereby it will have to borrow more to meet its debt obligations and this will contribute to an increase in the debt servicing burden which will imply further borrowing. Clearly, the only way to get out of the trap will be to make strategic choices (of the type described in Chapter 5) to bring down the budget deficit. If not, then the prospect of either a general debt default cannot be ruled out or of runaway inflation caused by excessively high levels of deficit financing.

## **6.2. STRUCTURAL CONDITIONALITIKS**

GOP does not have an enviable record to date in fulfilling the conditionalities in its agreement with the IMF as part of the ongoing SAP. As demonstrated in Section 1.3, budget deficit

ceilings have been violated every year. Some adjustments no doubt have been made, but these have consisted primarily of cutbacks in development expenditure and of passing the burden of adjustment on the provinces (prior to the 1991 NFC Award). Clearly, there is need for continuation of the structural conditional ties to ensure that fiscal policy remains on track and there is a commitment to bringing down the size of the budgetary deficit. We have indicated in Chapter 5 that subject to an aggressive policy of resource mobilisation and some expenditure control it is possible for GOP to bring about a reduction in the budgetary deficit from the level projected in the current fiscal year of 5.5 percent of GDP to 4.5 percent of GDP by 1995-96. The key elements of the strategy could be explicitly incorporated into conditionalities.

These could consist of the following:

- i) The budget deficit be reduced in a continuous fashion to 4.5 percent of GDP by 1995-96.
- ii) The quantum of additional resources realised from taxation proposals (both from administrative improvements and rate enhancements) in the Budgets should be 1.5 percent of the GDP each year from 1992-93 to 1995-96. The share of direct taxes in total tax revenue of GOP should increase to 30 percent by 1995-96.
- iii) Development expenditure in the public sector should not fall below 6 percent of the GDP.

In addition there could be covenants relating to the share of social sector *allocations* in the national *ADP* and to continued financial sector reform. The question of whether defence

expenditure can be limited to a certain percentage of GDP remains a very sensitive issue and subject to negotiations between GOP and the donor agencies.

6.3. PROMOTION OF THE PRIVATE SECTOR The present government is strongly committed to the process of privatisation of all existing public enterprises, including the commercial banks. In addition, private sector participation has been invited in major infrastructure investments like power, highways, telecommunications, etc. There are two ways in which this effort of limiting the size of the public sector and expanding the role of the private sector can be promoted by donor agencies. The first is the funding of special credit lines through development finance institutions (DFIs) for providing debt financing to entrepreneurs. The second is the promotion of the transfer of technology through the establishment of joint venture arrangements between multinational and local parties. The most promising areas for this appear to be a high tech sectors like power, telecommunications, electronics, etc., and export oriented activities like garment and leather manufacture.

Donor agencies have hitherto been used customarily to working with government and public sector entities. Increasingly, during the 90s, they will have to orient their operations towards commercial activities relating to the identification of attractive business opportunities in Pakistan and developing institutional arrangements for collaboration between foreign and local investors. To the extent that the financing of infrastructure investments can be taken over by the private sector this will reduce the burden on GOP resources and help in reducing the size of the budgetary deficit without sacrifice of economic growth.

6.4. **SECTORAL PRIORITIES FOR LENDING** Clearly, the sectoral composition of individual donor lending is a function of its goals and priorities. Given the constraints on public sector development expenditure in coming years there will be greater absorption capacity given the likely slack in the utilisation of existing institutional resources for implementing projects. This is especially likely to be the case with executing agencies in the social sectors like the education, health, public health engineering, social welfare departments. Therefore, this gap can be effectively utilised by donor agencies for channelling funds into different sectors without requiring substantial investments initially in institutional and human resource development, and additional staffing.

6.5. **IMPLICATIONS OF PROCESS OF DECENTRALISATION** We have highlighted in the previous chapters that the NFC Award of 1991 represents a major step in the process of decentralisation in Pakistan. Provincial governments will increasingly play a more pivotal role following transfer of substantial additional resources and the prospect that a number of concurrent list (from the Constitution) functions will be handed back to them. Given this enhancement in the role of the provinces and the likely contraction in the role of GOP, donor agencies will increasingly have to work with provincial governments, especially in the design, co-financing and execution of social sector programs. For donor agencies with large involvement in sectors like education and health this may even mean the establishment of regional offices at the provincial headquarters level for project preparation and monitoring.

Over time, it is likely that the process of decentralisation will be carried further down to the local and community level. The federal budget of 1991-92 contains the first explicit recognition

by GOP of the need for involvement of community based organisations in the financing (through matching contributions) and delivery of basic services. This also implies a greater utilisation of NGOs for promoting community development. Traditionally, GOP and the provincial governments have essentially worked through line departments with a strong engineering orientation and a supply-driven approach. There is very little experience of working with NGOs/CBOs.

This is an area in which donor agencies could make a major contribution. CIDA, for example, has considerable experience in the area of community development and it could promote new and innovative implementation methodologies through pilot projects which could subsequently be replicated in the regular ADP. It could also provide technical expertise for training and organisation of NGOs.

Provincial Education Foundations have already been formed in the provinces of Punjab and Sind. These could be targeted for, greater NGO involvement through the mechanism of development grants. Another opportunity is the Tameer-e-Watan program. It is, of course, a program with political objectives. However, the potential for community involvement exists in this program if it is suitably designed and executed.

The CIDA - World Bank assisted Rural Water Supply and Sanitation Strategic Investment Plan for Pakistan is about to reach the stage of project implementation with donor funding (primarily from the World Bank at this stage). This plan embodies fundamental changes in the delivery mechanism to ensure, sustainability in the provision of services by greater involvement of the community at all stages in the design, execution, maintenance and financing of schemes. Success in this

area will provide the justification for replication of this approach in the rest of the sector and other sectors.

**6.6. ADDITIONALITY OF DONOR FUNDING** One of the basic problems in the development of projects for donor funding at the provincial level has been the problem of additionality in the provincial ADP. Given that provincial allocations from the national ADP are largely population driven, provincial governments have not been aggressive in mobilising donor assistance because of the likelihood that additional assistance would largely substitute for ADP allocations given the overall ceiling on development transfers from ROP. The greater autonomy granted to the provinces, as embodied in the NFC Award, may change this. Provinces are more likely to be allowed to increase their ADPs by borrowings from domestic and foreign capital markets. To the extent, therefore, that regional equity considerations will not completely dominate the allocation of development funds, resources made available by donors are likely to be more efficiently utilised.

However, while there is a greater prospect for additionality of donor funds at the provincial level the opposite may well be the case at the federal level. In the event greater external assistance is secured for development of a particular sector then this will not necessarily be translated into a corresponding increase in the overall sectoral allocation. Given the paucity of resources, funds may well be diverted to other sectors.

**6.7. TYPES OF TECHNICAL ASSISTANCE** We have suggested earlier that GOP will have to launch a major resource mobilisation effort during the first half of the 90s if the structural imbalance in public finances is to be removed. Direct taxes, in particular, like the income and wealth taxes

will have to be developed. Increasing reliance will have to be placed on documentation and data base development if the full tax base is to be exploited. This will require the establishment of integrated, computer-based information systems. The quality of federal (Central Board of Revenue) and provincial (Excise and Taxation Departments, Boards of Revenue) will clearly determine the degree of success of the resource mobilisation effort. Currently, a large number of the tax officials are either corrupt, inefficient or lack motivation and there is hardly any capacity for training and human resource development at all levels in the hierarchy.

Technical assistance by donor agencies in the area of tax policy and administration could potentially make a significant contribution to the generation of additional resources both at the federal and provincial levels. In the short run there is need for inputs by foreign experts in implementation of the taxation reforms and, in particular, in aiding the process of computerisation of major departments like customs and income tax. Over time, donor assistance will be required for strengthening the training capability. A specific proposal which has been put forward by the Resource Mobilisation and Tax Reforms Commission is the setting up of an Institute of Public Finances and Policy in the country. This institute will be given the mandate of not only undertaking research in the area of fiscal policy but also with the task of whetting SROs prepared by CBR prior to their promulgation. It will also have the responsibility of coordinating and organising training programs for tax officials of the federal, provincial and local governments. Donor assistance in the form of partial financing, fellowships and visiting faculty could potentially be vital in getting this Institute launched. GOP is likely to finalise this proposal by the end of this fiscal year.

## APPENDIX I

### SIZE AND COMPOSITION OF ADP

The sectoral composition and trend in the public sector development program is presented in Table A-1. On the whole, the development expenditure of the federal and provincial governments have increased at an annual rate of about 10 percent from Rs 20 billion in 1978-79 to about Rs 25 billion in 1989-90. Sectors which show a high growth in allocations are power, transport and communications and education. Other sectors generally show a slow-growth in development expenditures while the industries sector actually shows a decline in allocations over the period of analysis.

Table A-2 highlights the changes in the sectoral priorities of the public sector development plan over the period 1978-79 to 1991-92. It appears that compared to 1978-79 higher priority was attached to power, water, education, health and social development in 1989-90. Conversely, sectors which reflect a lower priority include industry, agriculture, physical planning and housing and transport and communications. The budgets of 1991-92 shows a further change, and perhaps concentration, in the priorities of the government in Pakistan. The increase in the sectoral allocations is restricted to physical infrastructure, primarily power and transport and communication while other sectors, particularly the social sectors, show a significant decline.



**TABLE-A-1**  
**SECTORAL COMPOSITION AND TRENDS IN PUBLIC SECTOR**  
**DEVELOPMENT PROGRAM**

(Rs in Million)

	1978-79	1983-84	1986-87	1989-90 (R.E)	1991-92*
Agriculture	2041	2798	3346	3012	3194.0
Water	1748	3381	5155	5440	4410.7
Power	2935	5115	10477	16399	28140.9
Industry	4608	2286	404	166	388.5
Fuels & Minerals	664	2003	2631	2347	446
Transport & Communication	4026	5024	5823	8158	14411.2
Physical Planning & Housing	1534	2612	4333	3813	3330.3
Education & Training	772	1548	3719	4627	2767.1
Health & Nutrition	648	1563	2527	2668	2964.0
Social Welfare	132	260	633	594	85.8
Work Prog./Rural Development	214	952	1956	2432	1383.0
Others	1257	1240	2484	4684	2351.0
Special Development Program**	-	366	653	3528	8302
Total (Net)	20579	29148	44141	57868	71807.1
Total (Federal)	16540	21738	31523	41657	58
Total (Provincial)	4039	7044	11956	12683	14945
Total (SDP)	-	366	653	3528	1860.2

Source: Pakistan Economic Survey, 1990-91, Budget-in-Brief,  
 Ministry of Finance, GOP, 1991-92.

\* Includes the budget estimates of GOP and the Provincial Governments of Punjab & Sindh

\*\* Also, includes allocations to special programmes like the MNA/MPA Programme, the People's Works Programmes, Tameer-e-Watan Programme etc.

TABLE-A-2

## SECTORAL PRIORITIES OF THE PUBLIC SECTOR DEVELOPMENT PLAN

(Percentage)

Sectoral Shares in Development Outlay

	1978-79	1989-90 (R.E)	1991-92*
Agriculture	9.9	5.2	4.4
Water	8.5	9.4	6.1
Power	14.3	28.3	39.2
Industry	22.4	0.3	0.5
Fuels & Minerals	3.2	4.0	0.6
Transport & Communication	19.6	14.1	20.1
Physical Planning & Housing	7.4	6.6	4.6
Education & Training	3.7	8.0	3.8
Health & Nutrition	3.1	4.6	4.1
Social Welfare	0.6	1.0	0.1
Rural Development	1.0	4.2	1.9
Others	6.3	8.2	3.0
Special Development Programs	0.0	6.1	11.6
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
Share in Total of:			
Federal Government	80.4	72.0	67.6
Provincial Government	19.6	21.9	20.8
SDP	0.0	6.1	11.6

Source: Pakistan Economic Survey, 1990-91, Budget-in-Brief,  
 Ministry of Finance, GOP, 1991-92.

\* The development outlays of NWFP and Baluchistan are not included.

In terms of inter-governmental allocations of development expenditures, the federal government has the highest share, through declining significantly overtime. In 1978-79, more than 80 percent of the total development expenditure was incurred by the federal government. By 1989-90 this share has declined to 72 percent. Much of the decrease has been because of the increasing significance of SDPs, mostly implemented by the provincial governments and local agencies.

Tables A-3 and A-4 present the sectoral development priorities of the federal and provincial governments respectively. A number of important conclusions emerge from the analysis of these tables. First, there appears to be a shifting of sectoral priorities between levels of government over the period 1978-79 to 1991-92. That is, there are a few sectors where the share of federal development expenditure has declined overtime but the priority given by the provincial governments has increased and vice versa. Major sectors in the former category include agriculture, education and training (though the share of provincial government expenditure has not increased very significantly) health and industry. On the other hand major sectors where the relative share of provincial development expenditure has declined while that of the federal government has increased include power and transport and communications.

Second, there are some important sectors where the relative shares of both the federal and provincial governments have declined during the period of analysis. These include physical planning and housing, water, social welfare, and manpower and employment. Third, the increasing share of SDPs, both in federal and provincial development plans is significant more so in the case of the latter. In recent years the federal government has

TABLE-A-3

## SECTORAL PRIORITIES OF THE DEVELOPMENT

## PLAN OF THE FEDERAL GOVERNMENT

(PERCENTAGE)

SHARE IN DEVELOPMENT OUTLAY

	1982-83	1986-87	1989-90	1991-92
Agriculture	3.6	5.2	3.1	3.0
Industry	12.1	1.4	0.4	0.2
Minerals	0.6	0.8	0.7	0.7
Water	14.5	17.7	7.9	6.2
Power	31.9	3.9	47.0	49.4
Transport & Communication	20.5	17.7	15.3	23.3
Housing & Physical Planning	3.4	15.2	1.9	1.2
Rural Development	0.3	4.5	0.7	1.0
Education & Training	2.6	11.0	2.9	1.2
Health	1.8	8.8	3.2	2.0
Manpower & Employment	0.6	0.4	0.5	0.2
Social Welfare	0.1	0.4	0.3	0.1
Others	8.0	6.4	7.1	2.5
SDP	-	6.6	9.0	9.0
<b>Total</b>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>

Sources: Pakistan Economics Survey, 1990-91  
Budget-in-Brief, Ministry of Finance, GOP, 1991-92

**TABLE-A-4**  
**SECTORAL PRIORITIES OF THE DEVELOPMENT**  
**PLAN OF THE PROVINCIAL GOVERNMENTS**  
**(PERCENTAGE)**

SHARE IN DEVELOPMENT OUTLAY				
	1982-83	1986-87	1989-90	1991-92*
Agriculture	8.6	6.5	4.2	10.2
Industry	0.8	1.1	0.8	1.8
Minerals	0.4	0.4	0.4	0.4
Water	11.4	10.9	6.9	5.9
Power	0.5	0.2	0.3	0.2
Transport & Communication	12.2	7.1	9.7	7.7
Housing & Physical Planning	23.8	22.5	16.8	17.6
Rural Development	11.9	12.9	9.3	5.3
Education & Training	12.7	18.2	13.6	13.9
Health	11.0	13.7	11.6	12.3
Manpower & Employment	0.7	0.5	0.3	0.2
Social Welfare	0.6	0.6	0.3	0.1
Others	0.8	0.4	8.9	3.1
SDP*	4.6	5.0	16.9	21.3
<b>Total</b>	100.0	100.0	100.0	100.0

Sources: Pakistan Economic Survey, 1990-91.  
Provincial ADPs, 1991-92.

\* The Budgetted Development Outlays of the Provincial Governments of NWFP and Baluchistan are not Included.

developed a tendency of launching special development programmes, outside the framework of the regular ADP, which primarily consist of block allocations to the provinces. Example of such programmes include the MNA/MPA schemes launched under the Five Point Programme, Peoples Works Programme and now the Tamir-e-Watan programme. Such schemes, though have the primary motive of development are usually used with political objectives. Furthermore, the efficiency in the utilisation of funds is generally lower.

## APPENDIX II

## DEBT SERVICING OF GOP

The structural imbalance in public finances, discussed in Chapter One, has forced the country to indulge in heavy and increasing borrowing, both from the domestic and international capital markets. In recent years the government has not only borrowed to finance its development plans but also to operate and maintain its activities at the existing level. As a consequence there has been substantial increase in the debt servicing burden in relation to revenue during the last decade.

Table A-5 presents the composition and growth in public debt. A number of important conclusions emerge from an analysis of this table. First, public debt, both domestic and foreign, has increased at a high rate of 19 percent per annum. In 1980-81, total public debt was Rs 146 billion. This has increased to Rs 803 billion by 1990-91. Second, the component of domestic debt has increased more rapidly, at an annual rate of 21 percent, from Rs 58 billion to Rs 414 billion by 1990-91. As such, the 80s have been a change in the structure of public debt in Pakistan. In 1980-81, 58 percent of public debt was foreign. By 1990-91 this share declined to 48 percent. Third, the ratio of public debt to GNP has increased from 49 percent in 1980-81 to 80 percent in 1990-91. This indicates that the debt carrying capacity of the economy has not grown in line with the volume of outstanding debt.

#### Foreign Debt

Table A-6 presents trend in the flow of external capital to Pakistan. During the 7th plan period total foreign aid commitment to the country is of over US \$ 3 billion annually.

**TABLE-A-5**  
**GROWTH AND COMPOSITION OF PUBLIC DEBT**

(Rs in Millions)

Year	Foreign Debt	Percent Share	Domestic Debt	Percent Share in Total	Total Public Debt	As Percent of GNP
1980-81	87,650	58	58,087	42	145,737	49
1981-82	96,798	55	79,087	45	175,887	51
1982-83	118,318	54	101,727	46	220,045	55
1983-84	127,642	51	122,682	49	250,325	54
1984-85	147,440	50	149,946	50	297,356	57
1985-86	179,283	47	203,119	53	382,402	68
1986-87	206,435	45	248,477	55	454,912	75
1987-88	227,269	44	290,097	56	517,366	74
1988-89	272,732	45	333,210	55	605,942	76
1989-90	323,917	46	380,884	54	704,801	80
1990-91	388,809	48	413,996	52	802,805	80

Sources: Ministry of Finance, GOP.



The share of grants in the total commitment, however, shows a significant decline over time. During the 1st plan, 80 percent ^ of the total commitment was in the form of grants. This share has declined to 10 percent by 1990-91. Also, the table highlights the low and somewhat declining share of disbursements to commitment, over time.

The decline in the grant component in the capital inflow, implying higher repayment costs, has placed an increasing burden on the overall resources. This situation has been exacerbated by the inability of country's productive capacity or debt sustaining capacity to increase according. This is demonstrated by table A-7 which shows that debt servicing is an increasing proportion of the country's GNP and foreign exchange earnings.

Another evidence of the increasing strain on the country's debt servicing capacity is the sharp decline in net foreign service transfers over the years. Table A-8 shows that net transfers (gross disbursement - debt servicing) has declined from 77 percent in 1974-75 to 20 percent in 1990-91. This implies that currently 80 percent of the external funds received (primarily as loans) are used to service previous borrowing. As such, the country is nearing a potentially serious situation when debt default may be possible if fundamental restructuring of both the external financial management and the economy is not undertaken.

### **Domestic Debt**

As highlighted earlier the structure of country's public borrowing has shifted in the last decade with domestic borrowing constituting an increasing share. Table A-9 presents the composition of domestic debt. The table shows a change in the internal borrowing pattern of the government. A clear shift away from floating to unfunded debt is indicated during the period 1980-81 to 1989-90, some change in the policy is, however, apparent in 1991-92.

**TABLE-A-6**  
**GROSS CAPITAL INFLOWS**

(US \$ MILLIONS)

Period	Commitments	Share of Grants	Disbursements	Disb. as % of Commitments
Pre Plan	337	70	-	-
1st Plan	1,075	80	842	60
2nd Plan	2,911	46	2,394	82
3rd Plan	2,937	31	3,043	104
Non-Plan	6,967	12	5,730	82
5th Plan	7,233	22	5,793	80
6th Plan	11,907	23	7,184	60
<u>7th Plan</u>				
1988-89	3,313	18	2,619	79
1989-90	3,424	19	2,342	68
1990-91	3,221	10	2,105	65

Sources: Economic Affairs Division, GOP.

**TABLE-A-7**  
**DEBT AND DEBT BURDEN**

	1974-75	1979-80	1984-85	1989-90
Debt Disbursed/Outstanding as % of GNP	42.3	34.0	30.5	37.2
Debt Servicing as % of GNP	2.3	3.1	3.7	4.3
<b><u>Total</u></b>	<b><u>44.6</u></b>	<b><u>37.1</u></b>	<b><u>34.2</u></b>	<b><u>41.5</u></b>
Debt Servicing as % of Foreign Exchange Earnings	17	18	21	23

Sources: Pakistan Economic Survey, 1990-91.

**TABLE-A-8**  
**NET TRANSFER OF RESOURCES**

(US \$ MILLIONS)

Year	Gross Disbursements	Debt Servicing	Net Transfer	Net Transfer As % of Gross Disbursements
1974-75	1,135	259	876	77
1977-78	954	382	572	60
1980-81	1,471	995	476	32
1981-82	1,288	1,148	140	11
1982-83	1,541	1,277	264	17
1983-84	1,357	1,205	152	11
1984-85	1,360	1,254	106	8
1985-86	1,624	1,558	66	4
1986-87	1,511	1,744	(233)	(15)
1987-88	1,965	1,791	174	9
1988-89	2,773	1,862	911	33
1989-90	2,503	1,826	677	27
1990-91	2,244	1,806	438	20

Sources: Economic Affairs Division, Government of Pakistan.

TABLE-A-9  
COMPOSITION OF DOMESTIC DEBT

(Percentage)

	1980-81	1984-85	1989-90	1991-92
Total Internal Debt (Rs in Billion)	58.1	149.9	380.9	472.2
Share of:				
Permanent Debt <sup>a</sup>	23.6	24.5	25.9	42.7
Floating Debt <sup>b</sup>	54.7	48.6	38.2	27.9
Unfunded Debt <sup>c</sup>	21.7	26.9	35.9	29.4
<b><u>Total</u></b>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>	<u>100.0</u>

Sources: Ministry of Finance, GOP.

- a: consist of long term borrowing through market loans, prize bonds, foreign exchange bearer certificates, national bearer bonds and federal investment bonds
- b: largely consists of treasury bills of short duration
- c: largely consists of a variety of saving schemes offered by National Saving Centre such as Khas Deposit Certificates etc.

## **Cost of Borrowing**

The trend in rising costs of borrowing is presented in Table A-10. The table shows that currently interest payments are almost 5 percent of the GDP, growing at an annual rate of about 24 percent. The rising cost of borrowing from 3.86 percent in 1980-81 to 5.26 percent in 1990-91, in particular, needs to be noted. The table clearly shows that this increase in the cost is primarily because of the high growth in the cost of domestic debt. Over the period 1980-81 to 1990-91, cost of domestic debt has increased\*from 5.77 percent to 8.11 percent.'

A number of important issues emerge from the above analysis of the debt management policy of the government. First, that the current level of and the rate of increase in debt is not sustainable. This is further substantiated by table A-10 which indicates that debt servicing costs as percentage of the GDP have risen from about 2 percent in 1980-81 to 4.7 percent in 1990-91, Furthermore, debt servicing consume 23 percent of the total foreign exchange earnings of the country. Therefore, it appears that the county's productive capacity, or its debt carrying capacity has not increased in line with its debts burdens. This perhaps is a consequence of the low yielding, unproductive uses to which borrowed money is put. Second, overtime the government seems to have opted for more expensive borrowings. The share of

higher cost of domestic borrowing is partially offset by higher tax and non-tax receipts. First, there is a 30 percent income tax on the income from securities. Second, profits of the State Bank of Pakistan are higher when the yield on treasury bill rises. This profit accrues to the GOP. In 1991-92 for example SBP is expected to make exceptionally high profits of Rs.5 billion due largely to the increase in interest rates on treasury bills.

domestic debt, the cost of which is 85 percent higher than foreign debt, has increased significantly overtime. Third, within domestic debt, government seems to have increased its use of the higher cost borrowings. Table A-9 shows that the share of short-term, higher cost, unfunded debt has increased overtime.

**TABLE-A-10**  
**INTEREST PAYMENT OF DEBT**

(Rs in Millions)

Year	Total Debt	Interest Payment on Domestic Debt	Interest Payment on Foreign Debt	Interest Payment As Percent of GDP	Interest Payment As Percent of GDP
1980-81	145737	3,351	2,280	2.02	2.06
1981-82	175,887	4,489	2,270	2.09	2.13
1982-83	224,366	6,249	4,374	2.92	2.54
1983-84	250,325	8,443	5,148	3.24	2.91
1984-85	297,356	10,182	5,863	3.40	3.09
1985-86	382,402	12,642	6,377	3.70	3.38
1986-87	454,912	15,817	7,373	4.05	3.80
1987-88	517,366	22,549	8,230	4.56	4.38
1988-89	605,942	33,614	9,432	5.59	5.38
1989-90	704,801	34,775	11,913	5.41	5.30
1990-91	802805	33,562	13,781	4.84	4.70

**EFFECTIVE COST OF BORROWING (%)**

Year	Domestic Cost of Borrowing	Foreign Cost of Borrowing	Weighted Cost
1980-81	5.77	2.60	3.86
1981-82	5.68	2.35	3.84
1982-83	6.14	3.57	4.73
1983-84	6.88	4.03	5.43
1984-85	6.79	3.98	5.40
1985-86	6.22	3.56	4.97
1986-87	6.37	3.57	5.10
1987-88	7.77	3.62	5.95
1988-89	10.09	3.46	7.10
1989-90	9.13	3.68	6.62
1990-91	8.11	2.84	5.26

Source: Explanatory Memorandum on Budget, Ministry of Finance.



Finally, in the case of foreign debt. It appears that the major issues confronting the government include, one, the declining share of grants to total capital inflow. During the first plan period, grants, constituted 80 percent of the total inflow. This proportion has systematically decline overtime and in 1990-91 only 10 percent of the total foreign commitments are in the form of grants. Two, the low share of disbursements to total commitment. In 1990-91, disbursements were only 65 percent of the commitment and this proportions appears to have also declined overtime

**APPENDIX III****ELASTICITY AND BUOYANCY OF TAXES**

Chapter one- has indicated that the relatively slow growth in federal and provincial revenue receipts is a major cause of the high and growing financial strain on public finances in Pakistan. Generally, growth in revenues depends on the level of tax rates, the progressivity of the rate structure, nature of taxation (whether tax rates are specific or valorem in character), the tax collection efficiency (level and extent of evasion and corruption) and the change in the tax base due to changes in income. For the purpose of analysis it is usually possible to identify the causes of slow growth in revenues by decomposing the elasticity/buoyancy\* coefficients into the tax-to-base and base-to-income components.

The former computes the impact of tax rates, progressivity of tax structure, nature of the tax structure and efficiency in tax collection on tax revenue growth while the latter indicates the growth in the base due to changes in income.

Table A-11 presents the elasticity and buoyancy coefficients of major federal taxes. The table shows that the overall elasticity of federal taxes is 0.80. This implies that for every ten percent growth in income, federal tax revenues increase by only eight percent. As such, the federal tax structure is inelastic.

\*The elasticity of a tax system gives the automatic or natural responsiveness of tax yields to changes in national income. The buoyancy coefficient on the other hand not only measures growth in tax revenues that result automatically from increase in the tax base but also from discretionary changes.

TABLE-A-11

**THE TAX-TO-BASE AND BASE-TO-INCOME ELASTICITY AND  
BUOYANCY OF MAJOR FEDERAL TAXES, 1972-73 TO 1989-90**

<b>T A X</b>	<b>TAX BASE</b>	Tax-to Base	Base-to Income	Tax-to Income
<b><u>INCOME TAX</u></b>	Non-Agriculture GDP			
Elasticity		0.88	1.07	0.95
Buoyancy		1.0	1.07	1.07
<b><u>IMPORT DUTIES</u></b>	Value of Imports			
Elasticity		0.67	1.06	0.69
Buoyancy		1.00	1.06	1.06
<b><u>EXCISE DUTIES</u></b>	Value Added in Large Scale Manufacturing			
Elasticity		0.57	1.15	0.66
Buoyancy		0.78	1.15	0.89
<b><u>SALES TAX</u></b>	Value of Imports* + Value of Industrial Production			
Elasticity		0.96	1.05	1.01
Buoyancy		1.20	1.05	1.26
<b><u>TOTAL TAXES</u></b>	Gross Domestic Product			
Elasticity		0.80	1.00	0.80
Buoyancy		1.07	1.00	1.07

Sources: Qazi Massod and Mohammad Akbar, 'Elasticity and Buoyancy of Federal Taxes', AERC Working Paper, 1991.

\* Include the value of Import Duties paid.

The Table also shows that except for sales tax, major federal taxes have a tax-to-income elasticity coefficients of less than one, indicating that these are inelastic. The generally low values of the tax-to-base coefficients further indicates that the overall low elasticity is because of the specific nature of the tax structure and/or generally low level of tax collection efficiency and/or the lack of progressivity in tax structures. The tax bases are otherwise quite elastic (as reflected by the greater than unity value of the base-to-income coefficient).

As compared to the elasticity, the buoyancy coefficient of most of the federal taxes is greater than one, indicating that because of discretionary tax changes, like rate enhancement, improvement in tax administration, withdrawal of exemptions etc, tax revenues have generally been able to grow in line with income. It appears that the fiscal effort of the GOP, particularly in the last few years, has helped increase the growth potential of most tax sources.

Unlike the federal government, the lack of fiscal effort of the provincial governments in Pakistan has resulted in a low (0.62) value of the buoyancy coefficient of provincial taxes. Table A-12 shows that some important provincial taxes like stamp duties, property tax, entertainment tax, lack buoyancy. It is also significant to note that is not due to the stagnant nature of their tax bases, as popularly claimed, but because of problems in exploiting the tax base in an adequate and efficient manner, reflected by the low tax-to-base buoyancy components.

An Exception to this is the motor vehicle tax. the low base-to-income buoyancy coefficient is primarily because the tax is levied on a specific base (number of vehicles) and, therefore, does not increase as rapidly as income in the economy.

TABLE-A-12

**TAX-TO-BASE AND BASE-TO-INCOME BUOYANCY OF MAJOR  
PROVINCIAL TAXES, 1972-73 TO 1987-88**

<u>T A X</u>	<u>TAX BASE</u>	Tax-to Base	Base-to Income	Tax-to Income
Stamp Duty	GDP	0.75	1.05	0.79
Motor Vehicle Tax	National Stock of Vehicles on Road Weighted by tax differentials	1.97	1.51	1.00
Entertainment Tax	National Expenditure on Recreation	0.58	1.04	0.60
Electricity Duty	Total Income from Salce of Electricity	0.70	1.55	0.10
Property Tax	Income generated from the Ownership of Dwellings	-0.31	1.15	-0.35
Professional Tax	Non-Agricultural GDP	1.45	1.07	1.55
<b><u>TOTAL TAXES</u></b>	GDP	0.62	1.00	<u>0.62</u>

Source: Own Estimates.

On the whole, the coefficients of elasticity and buoyancy of federal and provincial taxes indicate that the major reason for the lack of rapid growth in revenues in Pakistan is underexploitation of an otherwise buoyant and elastic tax base. Analysis also shows that the federal government has in recent years made an attempt in this regard but effort on the part of the provincial governments is generally lacking.

## A B B R E V I A T I O N S

ADP	=	ANNUAL DEVELOPMENT PROGRAM
CBO	=	COMMUNITY BASED ORGANISATION
CBR	=	CENTRAL BOARD OF REVENUE
CIDA	=	CANADIAN INTERNATIONAL DEVELOPMENT AGENCY
DFI	=	DEVELOPMENT FINANCE INSTITUTION
FBS	=	FEDERAL BUREAU OF STATISTICS
FEBC	=	FOREIGN EXCHANGE BEARER CERTIFICATES
FIB	=	FEDERAL INVESTMENT BONDS
GDP	=	GROSS DOMESTIC PRODUCT
GNP	=	GROSS NATIONAL PRODUCT
GOP	=	GOVERNMENT OF PAKISTAN
GST	=	GENERAL SALES TAX
IBRD	=	INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
IMF	=	INTERNATIONAL MONETARY FUND
ITO	=	INCOME TAX ORDINANCE
ITP	=	INTERNATIONAL TRADE PRICES
MCB	=	MUSLIM COMMERCIAL BANK
MVT	=	MOTOR VEHICLE TAX
MNA	=	MEMBER OF NATIONAL ASSEMBLY
MPA	=	MEMBER OF PROVINCIAL ASSEMBLY
NDFC	=	NATIONAL DEVELOPMENT FINANCE CORPORATION
NGO	=	NON-GOVERNMENT ORGANISATION
NFC	=	NATIONAL FINANCE COMMISSION
NIT	=	NATIONAL INVESTMENT TRUST
OPEC	=	OIL PRODUCING AND EXPORTING COUNTRIES
PIU	=	PRODUCE INDEX UNIT
POL	=	PETROLEUM, OIL AND LUBRICANTS
PTC	=	PAKISTAN TELECOMMUNICATIONS CORPORATION
SAF	=	STRUCTURAL ADJUSTMENT FACILITY
SBP	=	STATE BANK OF PAKISTAN
SDP	=	SPECIAL DEVELOPMENT PROGRAM
SRO	=	STATUTORY RULES AND ORDERS
T&T	=	TELEGRAPH AND TELEPHONE CORPORATION
TRC	=	TAX REFORMS COMMITTEE
VAT	=	VALUE ADDED TAX