3 Pakistan

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I. Introduction

The Islamic Republic of Pakistan situated in the north-west of South Asian sub-continent emerged as an independent state on 14th of August, 1947. It is bordered by Afghanistan and Iran on the west, India in the east, China in the North and Arabian Sea in the south. The name *Pakistan* is derived from the Urdu words *Pak* (meaning pure) and *stan* (meaning country).

Geography and Climate

Pakistan covers an area of 796,095 sq km lying between latitude 24 degree and 37 degree North and longitude 62 degree and 75 degree East. Total land boundary of Pakistan is 6774 km. Pakistan is a land of many splendors. The scenery changes northward from coastal beaches, lagoons and mangrove swamps in the south to sandy deserts, desolate plateaus, fertile plains, and upland in the middle and high mountains with beautiful valleys, snow-covered peaks and eternal glaciers in the north. The variety of landscape divides Pakistan into six major regions: the North High Mountainous Region, the Western Low Mountainous Region, the Balochistan Plateau, the Potohar Upland, the Punjab and the Sindh Plains.

Stretching to the north, from east to west is a series of high mountain ranges, which separate Pakistan from China, Russia and Afghanistan. They include the Himalayas, the Karakoram and Hindukush. With the assembly of 35 giant peaks over 24,000 ft (7,315 m) high, the region is the climber's paradise. Many peaks are higher than 26,000 ft. The world's second highest peak K 2 (the "K" is the initial letter of the name of mountain Karakoram) tops at 28,250 ft.

Pakistan has a continental type of climate characterized by extreme variations of temperatures. The areas close to the snow-covered mountains are cold. Temperatures on the Balochistan Plateau are comparatively high. Along the coastal strip, the climate is modified by sea breezes. In the rest of the country, temperature rises steeply in the summer and hot winds called "loo" blow across the plains during the day. The temperature soars to 40 degree centigrade and beyond. The highest recorded temperature at Jacobabad is 53 degree centigrade. Winters are cold with average minimum and maximum temperature 4 degree and 18 degree centigrade respectively. Pakistan experiences a general deficiency of rainfall. In the plains the annual average ranges from 13 cm, in the northern parts of the lower Indus Plains to 89 cm in the Himalayan Region. Rains are of monsoon origin and fall late in summer.

People and Culture

The population of the country is 135.28 million (1997 estimates). The current growth rate of 2.82% is the highest among nine most populous countries of the world. Of the four provinces Punjab has 56.5% of the total population, Sindh has 22.6%, NWFP including Federally Administered Tribal Areas (FATA) is 15.7%, and Balochistan has 5.1%. Sindh is the urbanized province with 43% of the people living in urban areas including Karachi. There are about 12 cities with population of 200,000 and above, and about 28 cities with population of 100,000 and above. Karachi is the largest city and Islamabad is the seat of the government.

The people of Pakistan speak many languages and dialects, reflecting the country's ethnic diversity. The main regional languages are Punjabi, Sindhi, Pushto, Balochi and Saraiki. Urdu is a national language and its use is encouraged to foster unity. Main official language is English and is used in government and education. Common dress used in both rural and urban areas is shalwar-qameez. Usually it is made of cotton. It differs for men and women. Men wear solid, plain colors and add a vest or coat for a formal occasion. The women, however, wear bright patterned colors, with more tailoring. Women also wear a dupatta (long scarf). The joint family system is quite common. In a joint family system father, mother, children and their families live together in the same household. The presiding male of the family has significant influence over the lives of all family members. The elder members of the family grandfather and grandmother etc. are highly respected. Arranged marriages are still a standard tradition. Chapati or roti unleavened bread similar to pita bread) is a staple food in Pakistan although rice is also a part of most meals and deserts. The food is generally spicy and oily.

Pakistan has been the cradle of a civilization that dates back more than five millennium. Over the centuries, through successive waves of migrations from the north-west, as well as by internal migrations across the subcontinent, Aryans, Persians, Greeks, Arabs, and Mughals came and settled in this region. However, it was Islam and Islamic traditions that finally took roots and formed the mainspring of Pakistan's cultural heritage.

Muslims from the earliest days, built cities, forts, palaces, mosques, tombs and mausoleums which are marked by simplicity and grandeur, with open spaces and abundance of light. Pakistan therefore, inherits immense treasure of culture

History and Political Structure

Pakistan has its roots into the remote past. Its establishment was the culmination of the long struggle by Muslims of the South-Asian subcontinent for a separate homeland of their own. In 1947 the Indian sub-continent was divided into two independent countries of Pakistan and India by the British. Mohammad Ali Jinnah was the great leader and the father of the nation.

The Constitution of the Islamic Republic of Pakistan provides for a federal parliamentary system of government, with President as Head of State and the popularly elected Prime Minister as Head of Government and the country's Chief Executive. The Parliament of Pakistan consists of the President and two Houses known as the National Assembly and the Senate. The National Assembly is elected for a five-year term on the basis of adult franchise. In a country with 97 per cent Muslim population, and minimum chance of Non-Muslim securing a general seat, 10 seats have been reserved for Non Muslims in a House of 217 seats. The Senate of Pakistan is the Upper House of the Parliament. The Senate derives equal representation from all the four federating units (Punjab, Sindh, Balochistan, NWFP, FATA, and Islamabad being the capital territory) and has total membership of 87. The Provincial Assemblies of the four Provinces elect 19 members each from their respective provinces. Of this, 14 are for general seats and 5 for seats reserved for Ulema (religious scholars), professionals and technocrats. The Federally Administered Tribal Areas (FATA) is represented by 8 members, whereas the Federal Capital has 3 seats in the Upper House of Parliament. To administer the subjects falling within the jurisdiction of the Federation, there are Ministries, Divisions, attached departments, subordinate offices, autonomous and semi-autonomous bodies. A ministry may comprise one or more divisions. There are other statuary bodies having an important role in the affairs of the Federation, such as the Attorney General, the Auditor General, the Election Commission, the Federal Public Service Commission, the Council of Islamic Ideology, and Federal Ombudsman. Judiciary is headed by Chief Justice of the Supreme Court and enjoys independence in dealing with judicial matters.

II. Overview of Macroeconomic activity and Fiscal Position

Table1: Selected Macroeconomic Indicator

	FY02	FY03	FY04	FY05	FY06	FY07
						Growth rates(percent)
Real GDP(at factor cost)	3.1	4.8	7.5	8.6	6.6	7.0
Agriculture	0.1	4.1	2.2	6.7	2.5	4.5
Major crops	-2.5	6.8	1.9	17.8	-3.6	4.3
Manufacturing	4.5	6.9	14	12.	8.6	11.0
Large Scale	3.5	7.2	18.2	15.6	9.0	13.0
Services sector	4.8	5.2	5.9	8.0	8.8	7.1
CPI(FY01=100)	3.5	3.1	4.6	9.3	7.9	6.5
Monetary assets(M2)	15.4	18.0	19.6	19.3	15.2	13.5
Exports(f.o.b.)	-0.7	22.2	10.3	16.9	14.4	13.0
Imports(c.i.f.)	-3.6	18.2	27.6	32.1	38.8	-2
						As percent of GDP
Total Investment	16.8	16.9	17.3	16.8	20.0	
National savings	18.6	20.8	18.7	15.1	16.4	
Tax Revenue	10.9	11.5	11.0	10.0	10.5	
Total revenue	14.2	14.9	14.3	13.7	14.0	
Budgetary expenditure	18.5	18.7	16.7	18.2	18.2	
Budgetary deficit	4.3	3.7	2.4	3.3	4.2	
Domestic debt	39.0	38.4	35.1	32.4	29.7	
Foreign debt	45.6	40.0	35.0	31.0		
Total debt	85.9	79.3	71.4	64.9	58.8	

Figures for FY07 are the projections
Source: State Bank of Pakistan, Annual Report 2005-06.

II.1 Macroeconomic activity:

Pakistan's economy has delivered solid economic growth in the year 2005-06 in the midst of a rise in oil prices and devastating earthquake of October 8, 2005 causing widespread damages. Pakistani corporate and consumers continue to be the bright spot. Consumer spending remained buoyant and investors remained active on the strength and sustainability of the current growth momentum, despite higher energy prices and natural calamities. With economic growth at 6.6 percent in 2005-06, Pakistan's economy has grown at an average rate of almost 7.0 percent per annum during the last four years (2002/03 – 2005/06) and over 7.5 percent in the last three years (2003/04 – 2005/06), thus positioning itself as one of the fastest growing economies of the Asian region. The growth momentum that Pakistan sustained for the last four years is backed by dynamism in industry, agriculture and services, and the emergence of a new investment cycle supported by strong credit growth.

The pre-requisites for a sustained economic growth appear to have gained firm footing during the last four years. The outgoing fiscal year (2005-06) has been an extra-ordinary year for the economy of Pakistan. At the start of the year the economy faced unfavorable conditions from rising oil prices, hovering around $ 70 – 75 per barrel and putting severe strains on the country's trade balance on the one hand and budget on the other, and massive earthquake of October 8, 2005 causing extensive damage to property, infrastructure, school, hospital etc. and loss of over 70,000 human lives. The rescue, relief and reconstruction of earthquake affected areas also put budget under severe stress. Pakistan's economy has proved itself as remarkably resistant in the face of shocks of extra-ordinary proportions. Growth has remained buoyant. Real GDP grew strongly at 6.6 percent in 2005-06 as against the revised estimates of 8.6 percent last year and 7.0 percent growth target for the year.

Key drivers of this year's growth have been service sectors and industry. Large-scale manufacturing grew by 9.0 percent as against 15.6 percent of last year and 14.5 percent target for the year, exhibiting signs of moderation on account of higher capacity utilization .The services sector continued to perform strongly at 8.8 percent. Construction too continued to perform strong showing, partly helped by activity in private housing market, spending on physical infrastructure, and reconstruction activities in earthquake affected areas.

Consumer spending remained strong and investment spending gained further traction.

Pakistan's economy continues to maintain solid pace of expansion since the fiscal year 2002-03 recovery in the economy has been strong, rapid and sustained. During the fiscal year 2005-06, Pakistan's economic fundamentals have gained further strength. Main contribution came from services sector. Within the CPS, agriculture contributed 0.55 percentage points or 8.4 percent to overall growth while industry contributed 1.54 percentage points or 23.3 percent. Within services sector wholesale and retail trade has contributed 27.9 percent or 1.84 percentage points to GDP growth. Pakistan's per capita real GDP has risen at a faster pace during the last three years (5.6% per annum on average in rupee terms) leading to a rise in average income of the people.

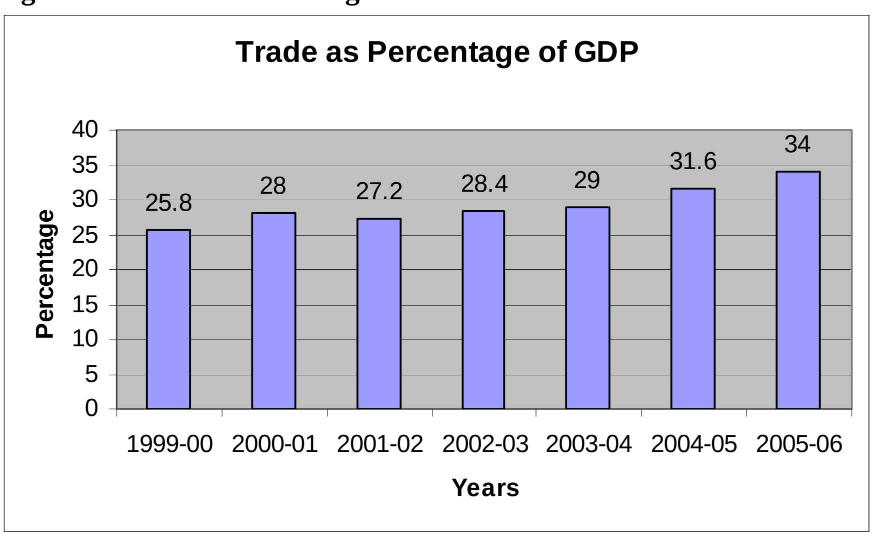
II.1.1 International Environment

Rising imports of petroleum and related products, rise in import of machinery, raw materials and debt servicing have contributed more in widening the gap between imports and exports. However, increasing growth rate of exports and remittance have played an important role in the upward movement of the economy.

(a)Trade Balance

Pakistan's foreign trade sector is being affected both by structural and cyclical factors. On the domestic side, four years of strong economic growth strengthening domestic demand and triggering a consequent pick up in investment spending, has led to a massive surge in imports. On the external side, the global economy continues its strong and broad – based expansion with growth reaching close to 5 percent in 2006 with similar expansion projected for the next year. Like many other developing countries, Pakistan has also benefited from a strong and sustained growth in world economy. Pakistan's exports grew at an average rate of 16.45 percent per annum over the last four years. Notwithstanding global economic expansion, the sound macroeconomic policies that Pakistan pursued coupled with wide – ranging structural reforms, particularly in the areas of trade and tariff that it implemented over the last six or seven years have helped Pakistan doubled its exports in seven years and increased its trade-to-GDP ratio from close to 26 percent in 1999-2000 to estimated 34 percent. The growing trend of trade to GDP ratio can be observed by the following figure.

Figure 1: Trade as Percentage of GDP



Source: Economic Survey of Pakistan 2005-06

Though there is an increasing trend in export but unfortunately the imports are also growing on a trend higher than exports giving rise to trade deficit. The major reason for increase in imports as discussed above are growing domestic demand due to high economic growth and consequent pick up in investment spending. Rising oil prices have also played a major role in raising trade deficits.

The merchandise trade deficit stood at $ 8.62 billion by the end of the third quarter

(July-March) of the fiscal year 2005-06 as against $ 4.3 billion in the same period last year, showing a deterioration of over 100.0 percent. As share of GDP, Pakistan's trade deficit was almost 7.0 percent in 2005-06 as against 4.0 percent last year. With the help of following table we can understand the factors which contributed to the widening of trade deficit.

Table 2: Major Contributors to increase in trade deficit

(Million $)

	Absolute Increase	**% Contribution**
A. Trade Deficit in Jul-March 2004-05	4263.4	-
B. Trade Deficit in Jul-March 2005-06	8620.2	-
Absolute Increase in Trade Deficit (B-A)	4356.8	100.0
Major Contributors		
Petroleum Group	1809.2	41.5
Machinery Group	935.9	21.5
Consumer Durables	400.5	9.2
Raw Materials		
-Iron Steel and Scrap	520.8	12.0
-Fertilizer	213.2	4.9
-Chemical Products	200.1	4.6
-Plastic Materials	170.1	3.9
Other	107.0	2.4

Source: Economic Survey of Pakistan 2005-06

Exports: Although Pakistan exports many products and raw materials but at the same time the exports are highly concentrated to few items which form the major chunk of exports. These are cotton and related products, leather, rice, synthetic textiles and sports goods. These five categories contributed around 74% share in total exports in financial year 2005-06. Cotton manufactures contributed 58% followed by leather and rice at 6.1 and 6.9 percent respectively. This trend of composition continues as it was during last year. The annual export share of major commodities can be observed from the following table.

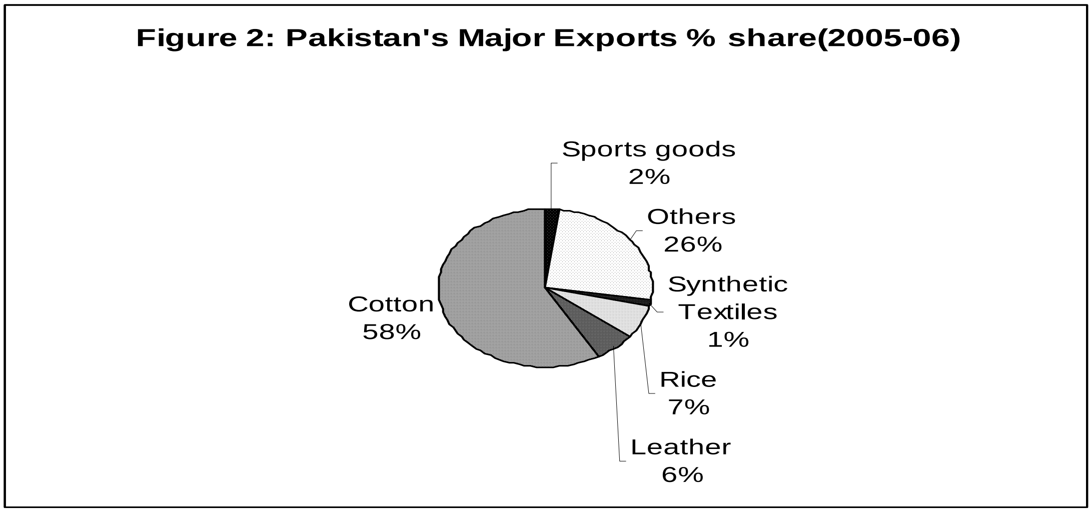
Table 3: Pakistan's Major Exports

Percentage Share

Commodity	92-93	94-95	96-97	98-99	99-00	00-01	01-02	02-03	03-04	04-05	05-06*
Cotton Manufacturers	59.8	58.7	61.3	59.1	61.0	58.9	59.4	63.3	62.3	57.4	58.4
Leather	9.3	8.0	7.7	6.9	6.3	7.5	6.8	6.2	5.4	5.8	6.1
Rice	4.7	5.6	5.6	6.9	6.3	5.7	4.9	5.0	5.2	6.5	6.9
Synthetic Textiles	7.4	7.1	6.1	5.1	5.3	5.9	4.5	5.1	3.8	2.1	1.2
Sports Goods	1.9	3.2	3.7	3.3	3.3	2.9	3.3	3.0	2.6	2.1	1.9
Sub-Total	83.1	82.6	84.4	81.3	82.2	80.9	78.9	82.6	79.3	73.9	74.5
Others	16.9	17.4	15.6	18.7	17.8	19.1	21.1	17.4	20.7	26.1	25.5
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Ministry of Commerce and FB

Figure 2: Pakistan's Major Exports



Source: Economic Survey of Pakistan 2005-06

Pakistan is moving gradually towards higher value added in exports of textile manufacturers. The shares of bed wear, knitwear and towels (value added exports) have increased while those of cotton yarn and synthetic textiles have declined. The shares of other components of textile manufactures either remained constant or fluctuated during the last eight years

However, Pakistan's exports composition has changed significantly during the last decade. A sharp decline has been observed in the share of primary and semi-manufactured exports and increase in manufactured goods. If Semi-Manufactures and Manufactured Goods are taken together, 89 percent of export earnings during 2004-05 originated from Manufactured Exports and only 11 percent came from Primary Commodities. This trend shows that Pakistan does not rely heavily on Primary Commodities for foreign exchange earnings.

Pakistan's exports are highly concentrated in few countries as well. The seven countries, namely USA, Germany, Japan, UK, Hong Kong, Dubai and Saudi Arabia account for 50 percent of its exports. The United States is the single largest export market for Pakistan, accounting for 27 percent of its exports followed by the United Kingdom, Dubai, Germany and Hong Kong. Japan as Pakistan's export destination is fast vanishing as less than one percent of its exports entering Japan. Pakistan needs to diversify its exports not only in terms of commodities but also in terms of markets. Heavy concentration of exports in few commodities and few markets could cause serious export instability.

Table 4: Major Export Markets

(Percentage Share)

Country	**92-93**	**94-95**	**96-97**	**98-99**	**99-00**	**00-01**	**01-02**	**02-03**	**03-04**	**04-05**	**05-06***
USA	13.9	16.2	17.7	21.8	24.8	24.4	24.7	23.5	23.9	23.9	26.9
Germany	7.8	7.0	7.5	6.6	6.0	5.3	4.9	5.2	4.9	4.8	4.6
Japan	6.8	6.7	5.7	3.5	3.1	2.1	1.8	1.3	1.1	1.1	0.8
UK	7.1	7.1	7.2	6.6	6.8	6.3	7.2	7.1	7.6	6.2	6.0
Hong Kong	6.6	6.6	9.4	7.1	6.1	5.5	4.8	4.6	4.7	3.9	3.9
Dubai	5.9	4.0	4.6	5.4	5.7	5.3	7.9	9.0	7.3	3.3	5.3
Saudi Arabia	4.7	2.7	2.6	2.4	2.5	2.9	3.6	4.3	2.8	2.5	2.3
Sub-Total	**52.8**	**50.3**	**54.7**	**53.4**	**55.0**	**51.8**	**54.9**	**55.0**	**52.3**	**45.7**	**49.9**
Other Countries	47.2	49.7	45.3	46.6	45.0	48.2	45.1	45.0	47.7	54.3	50.1
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Economic Survey of Pakistan 2005-06

Imports: Like exports, Pakistan's imports are also highly concentrated in few items like, machinery, petroleum & petroleum products, chemicals, transport equipments, edible oil, iron & steel, fertilizer and tea. These eight categories of imports accounted for 72.5 percent of total imports during 2005-06. Among these categories machinery, petroleum & petroleum products and chemicals accounted for 53.4 percent of total imports. Concentration of imports remained, by and large, unchanged over the last one decade. The composition of Pakistan's imports has not witnessed any appreciable change over the years. The share of raw materials for consumer goods in the total imports continued to be high while that for capital goods remained stagnant. The share of capital goods exhibited upward movement — mainly because of higher level of investment in the country. The share of consumer goods has declined owing to higher domestic production.

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Table 5: Pakistan's Major Imports

(Percentage Share)

Commodities	92-93	94-95	96-97	98-99	99-00	00-01	01-02	02-03	03-04	04-05	05-06*
Machinery * *	24.3	22.8	23.1	17.9	13.9	19.3	17.1	18.5	17.8	22.5	18.0
Petroleum & Products	15.5	15.3	19.0	15.5	27.2	31.3	27.1	25.1	20.3	19.4	22.3
Chemicals @	12.5	14.0	13.4	16.6	17.5	20.0	15.9	15.1	16.1	15.5	13.4
Transport Equipments	12.5	5.9	4.7	5.7	5.5	4.0	4.8	5.6	5.6	6.2	7.7
Edible Oil	5.9	9.6	5.1	8.7	4.0	3.1	3.8	4.8	4.2	3.7	2.7
Iron & Steel	3.2	3.6	3.9	3.1	3.0	2.6	3.3	3.3	3.3	4.3	5.1
Fertilizer	2.5	1.2	3.2	2.8	1.9	1.6	1.7	2.1	1.8	2.0	2.4
Tea	2.1	1.8	1.1	2.4	2.0	1.9	1.5	1.4	1.2	1.1	0.9
Sub-Total	78.5	74.2	73.5	72.7	75.0	83.8	75.2	75.9	70.3	74.7	72.5
Others	21.5	25.8	26.5	27.3	25.0	16.2	24.8	24.1	29.7	25.3	27.5
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Ministry of Commerce and Federal Bureau of Statistics

Pakistan's imports are also highly concentrated in few countries. Over 40 percent of them continue to originate from just seven countries i.e. the USA, Japan, Kuwait, Saudi Arabia, Germany, the UK and Malaysia. Saudi Arabia is emerging as major suppliers to Pakistan followed by the USA and Japan.

(b) Current Account Balance

Pakistan's current account balance that went in negative in 2004-05 after enjoying surpluses for three consecutive years remained in deficit in 2005-06 with gap continued to widen owing to higher oil import bill on the back of high global crude oil prices and sharp rise in non-oil imports backed by strong demand. Apart from further widening of trade deficit, higher freight charges by international shipping lines as a result of sharp increase in global trade and higher fuel cost, and growth in personal travel due to the rising level of income of middle and high income groups have also contributed to the widening of current account gap.

The current account deficit, excluding official transfers was $ 4696 million during first nine months (July-March) of the current fiscal year as compared to $ 1181 million in the same period during previous year. As percentage of projected GDP for the year the current account deficit stood at 3.7 percent as against

1.1 percent in the same period last year Although trade deficit (fob) almost doubled over the last year and services balance deteriorated by 27.5 percent, the strong inflows under private transfers supported by rising workers' remittances and resident foreign currency accounts offset some of the negatives with current account deficit.

Table 6: Balance of Payments

($ Million)

Components	2003-04	2004-05	July-March	
			2004-05	2005-06 (P)
Trade balance	1208	-4352	-3202	-6104
Exports (fob)	12396	14401	10641	11854
Imports (fob)	-13604	-18753	-13843	-17958
Services (net)	-3584	-5841	-4230	-5393
Private transfers (net)	6116	8440	6251	6801
Workers remittances	3871	4168	3050	3228
Current account balance Excluding official transfers	1314	-1753	-1181	4696
Long term capital (net)	-201	2552	1633	3905
Changes in reserves (- ve = Increase)	-826	-372	-510	-124

Source: State Bank of Pakistan

(c) Exchange Rate and Exchange System

The State Bank of Pakistan (The Central Bank) is responsible to keep the exchange rate of the rupee at an appropriate level and prevent it from wide fluctuations in order to maintain competitiveness of exports and maintain stability in the foreign exchange market. To achieve the objective, various exchange policies have been adopted from time to time keeping in view the prevailing circumstances. Pak-rupee remained linked to Pound Sterling till September, 1971 and subsequently to U.S. Dollar. However, it was decided to adopt the managed floating exchange rate system January 1982 under which the value of the rupee was determined on daily basis, with reference to a basket of currencies of Pakistan's major trading partners and competitors.

After nuclear detonation by Pakistan in 1998, a two-tier exchange rate system was introduced from July 1998, with a view to reduce the pressure on official reserves and prevent the economy to some extent from adverse implications of sanctions imposed on Pakistan. However, effective from May 1999, the exchange rate has been unified, with the introduction of market-based floating exchange rate system, under which the exchange rate is determined by the demand and supply positions in the foreign exchange market. The surrender requirement of foreign exchange receipts on account of exports and services, previously required to be made to State Bank through authorized dealers, has now been done away with and the commercial banks and other authorized dealers have been made free to hold and undertake transaction in foreign currencies. As the custodian of country's external reserves, the State Bank is also responsible for the management of the foreign exchange reserves. The task is being performed by an Investment Committee.

Main source of foreign exchange earning and foreign exchange reserves is from exports and remittances from expatriates as well as Foreign Direct Investments. The position of Foreign exchange reserves over the period of years can be observed from the following table.

Table 7: Foreign Exchange Reserves

(Million US $)

End Period	Net Reserves with SBP	Net Reserves with Banks	Total Liquid Reserves
1998-99	1662.7	616.5	2279.2
1999-00	991.0	976.6	1967.6
2000-01	1676.9	1542.6	3219.5
2001-02	4333.4	2098.2	6431.6
2002-03	9525.1	1193.9	10719.0
2003-04	10553.9	1785.3	12339.2
2004-05	9790.7	2832.7	12623.4
2005-06	10760.2	2376.7	13136.9

Source: State Bank of Pakistan.

(d) Foreign Direct Investment

Now a day foreign direct investment has become one of the largest source of private external finance for developing countries. Pakistan has been fortunate to attract a reasonable amount of FDI during the last few years due to its liberal foreign exchange regime, conducive business environment for foreign investors, legal securities and better infrastructure for business.

FDI in 2005-06 has reached $3.5 billion – the highest ever in the country's history, as against $ 1.5 billion in the same period last year, thus registering an increase of 131 percent.

Table 8: Position of Foreign Direct Investment

(Million US $)

Fiscal Year (July-June)	**2000-01**	**2001-02**	**2002-03**	**2003-04**	**2004-05**	**2005-06**
Total Foreign Investment (Mn US$)	182	474.6	820.1	921.7	1,676.60	3,872.50
Of which: Portfolio Investment	-140.4	-10.1	22.1	-27.7	152.6	351.5
Foreign Direct Investment	322.4	484.7	798	949.4	1,524	3,521

Source: Pakistan Board of Investment

Table 9: Major Sectors attracting FDI

(Percentage Share)

Power	12.50%	7.50%	4.10%	-1.49%	4.80%	9.11%
Mining & Quarrying and Oil exp.	26.30%	56.70%	23.60%	21.43%	12.80%	9.08%
Textile	1.40%	3.80%	3.30%	3.73%	2.60%	1.33%
Transport, Storage & Comm.	25.30%	7.30%	14.30%	24.29%	34.90%	55.56%
Electrical Machinery	0.70%	2.20%	1.30%	0.92%	0.20%	0.05%
Financial Business	-10.80%	0.70%	26.00%	25.50%	17.70%	9.35%
Trade	4.10%	7.10%	4.90%	3.75%	3.40%	3.35%

Source: Pakistan Board of Investment

From table 10 we can see that FDI grew on a steady pace from fiscal year 2000-01 to 2005-06. It was more than ten times in the year 2005-06 from that of in year 2000-01. Table 11 shows Sectoral distribution of the FDI. Transport, Storage and communication, financial business, oil exploration and power sectors are the dominant sectors where most of the FDI inflows are concentrated. From table 12 it can be ascertained that UAE and US and UK are the major investor in terms of FDI.

Table 10: Country wise breakup of FDI

(Percent)

Country	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06
USA	28.80%	67.30%	26.50%	25.11%	21.40%	14.70%
United Kingdom	28.10%	6.30%	27.50%	6.84%	11.90%	6.90%
UAE	1.60%	4.40%	15.00%	14.18%	24.10%	40.50%
Germany	4.80%	2.30%	0.50%	0.74%	0.90%	0.80%
France	0.20%	-1.40%	0.30%	-0.59%	-0.20%	0.10%
Hong Kong	1%	0.60%	0.70%	0.66%	2.10%	0.70%
Japan	3%	1.30%	1.80%	1.59%	3.00%	1.60%
Saudi Arabia	17.60%	0.30%	5.50%	0.76%	1.20%	7.90%
Netherlands	1.50%	-1.10%	0.40%	1.48%	2.40%	3.40%
Others	12.00%	19.10%	21.80%	48.88%	33.00%	23.20%

Source: Pakistan Board of Investment

(e) Borrowing from Abroad

Pakistan's total stock of external debt and foreign exchange liabilities grew at an average rate of 7.4 percent per annum during 1990-99 – rising from $ 20.5 billion in 1990 to $ 38.9 billion by end June 1999. Foreign exchange earnings on the other hand, either remained stagnant or increased at a snails pace during the same period. Despite the accumulation of almost $ 18.4 billion debt in the 1990s, foreign exchange earnings rose by only $ 4.0 billion. Consequently the debt burden (external debt and foreign exchange liabilities as a percentage of foreign exchange earnings) rose from 256.6 percent in 1989-90 to 335.4 percent in 1998-99.

Following a credible strategy of debt reduction over the last six years, Pakistan has succeeded in reducing the country's debt burden. External debt and foreign exchange liabilities, instead of growing at the pace of the 1990s, were in fact reduced from U.S. $38.9 billion in 1998-99 to $ 36.5 billion by end-March 2006 — a reduction of $ 2.4 billion in seven years. Most importantly, the burden of the debt has declined substantially during the same period. For example, the external debt and liabilities as a percentage of foreign exchange earnings which stood at 335.4 percent in 1998-99, declined to 127.6 percent by end-March 2006. The external debt and liabilities stood at 64.1 percent of GDP in end-June 1999, declined to 28.3 percent in end-March 2006.

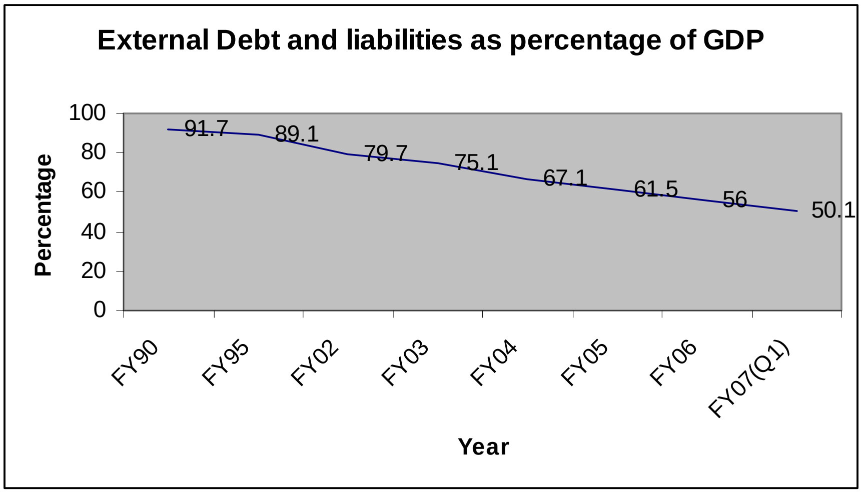
Table 11: External Debt and Foreign Exchange Liabilities

(Billion US $)

Item	1990	1999	2000	End June 2001	2003	2004	2005	End Ma r 2005
1.Public & Publicly Guaranteed Debt	18.2	28.3	27.804	28.165	29.23	29.875	31.084	31.821
A. Medium & long term (Paris Club, Multilateral and Other Bilateral	14.7	25.4	25.301	25.606	28.07	28.627	29.177	29.403
B. Other medium & long term (Bonds, Military & commercial)	2.7	1.6	2.373	2.302	0.976	1.226	1.636	2.210
C. Short Term (IDB)	0.8	1.3	0.13	0.257	0.187	0.022	0.271	0.208
2. Private Non-guarantee- Debt	0.3	3.4	2.842	2.45	2.028	1.67	1.342	1.588
3. IMF	0.7	1.8	1.55	1.529	2.092	1.762	1.611	1.494
Total External Debt (1 through 3)	19.2	33.6	32.196	32.144	33.35	33.307	34.037	34.903
4. Foreign Exchange Liabilities	1.3	5.3	5.664	5.015	2.122	1.951	1.797	1.654
- Foreign Currency Accounts	(1.1)	(1.5)	1.733	1.1	0	0	0	0
Total External Liabilities (1 through 4)	20.9	38.9	37.86	37.16	35.47	35.26	35.834	36.557

Source: State Bank of Pakistan

Figure 3: External Debt and Liabilities as Percentage of GDP



Source: Ministry of Finance Government of Pakistan

The continuous build up in foreign exchange reserves helped Pakistan retire its expensive debt. In 1999-2000, Pakistan paid $ 3.756 billion on account of debt servicing and $ 4.081 billion worth of payments were rolled over. The combination of re-profiling of Paris Club bilateral debt on a long-term horizon, the substantial write-off of the US bilateral debt stock, the prepayment of expensive debt worth $ 1.1 billion and the relative shift in contracting new loans on concessional term has begun to yield dividend. The annual debt servicing payments made during the period 1999-2000 to 2003-04 averaged just above $ 5 billion per annum. This amount has drastically come down to around $ 3 billion in 2004-05

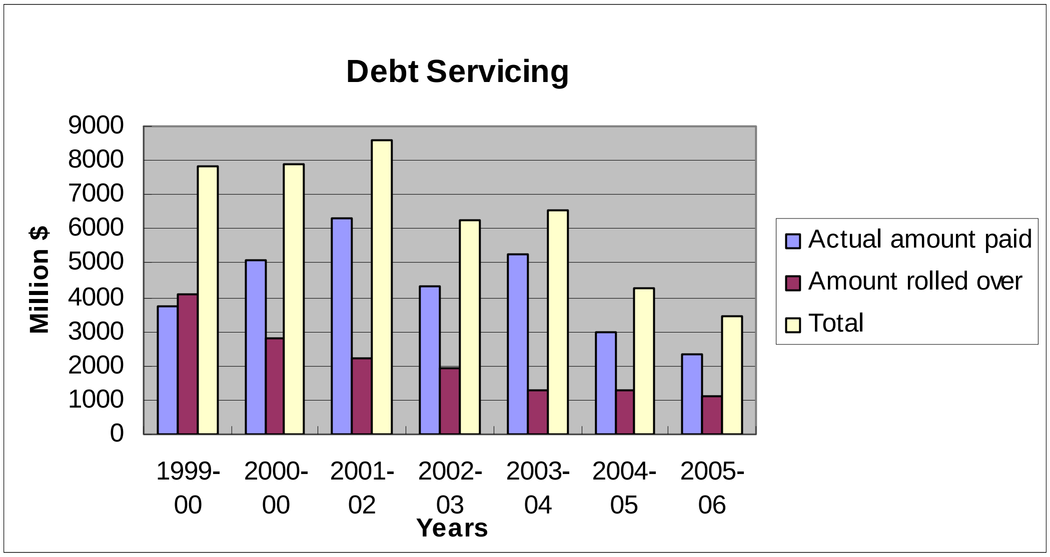
Table 12: Debt Servicing

(US Million $)

Years	Actual amount paid	Amount rolled over	Total
1999-00	3756	4081	7837
2000-00	5101	2795	7896
2001-02	6327	2243	8570
2002-03	4349	1908	6257
2003-04	5274	1300	6574
2004-05	2965	1300	4265
2005-06	2360	1100	3460

Source: State Bank of Pakistan

Figure 4



Source: State Bank of Pakistan

II.1.2 Domestic Environment

(a) Economic Growth Rate

Pakistan's economy overcame adverse pressures to achieve strong growth for the third successive year in FY06. Despite unexpectedly weak harvests of some key crops (cotton, sugarcane and wheat), the impact of the October 2005 earthquake, a tight monetary policy and an unprecedented rise in oil prices, real GDP growth remained strong at 6.6 percent during FY06. However, there was a visible decline in the quality of the economic performance, in the sense that the FY06 growth was more narrowly based as compared to preceding years.

In contrast to a broad based growth in FY05, the stimulus to the high growth in FY06 was principally from the above-target performance of the services sector, as both the key commodity-producing sectors, agriculture and industry saw growth fall well below the respective annual targets.

Table 13: Comparison of GDP growth rate with other countries

(Percentage)

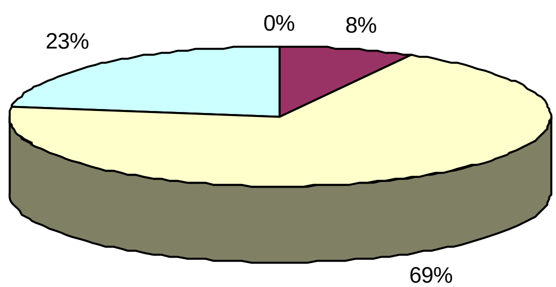
Region/Country	2003-04	2004-05	2005-06
World GDP	4.1	5.3	4.8
Euro Area	0.7	2.1	1.3
United States	2.7	4.2	3.5
Japan	1.8	2.3	2.7
Germany	-0.2	1.6	0.9
Canada	2.0	2.9	2.9
Developing Countries	8.4	8.8	8.6
China	10.0	10.1	9.9
Hong Kong SAR	3.2	8.6	7.3
Korea	3.1	4.6	4.0
Singapore	2.9	8.7	6.4
Vietnam	7.3	7.7	7.5
India	7.2	8.1	8.0
Bangladesh	5.8	5.9	5.8
Sri Lanka	6.0	5.4	5.9
Pakistan	7.5	8.6	6.6

Source: Economic Survey of Pakistan 2005-06

Over the period of years the percentage share of various sectors of the economy has been subject to change. In early 1990's the share of agricultural sector was dominant in GDP. The change in composition started and the share of industrial and services sector grew at a steady pace. The share of Services sector which was at 48% in financial year 2004-05 rose to even more at 69% in the year 2005-06. The share of agriculture has been reduced from eighteen to eight percent in the same period whereas manufacturing sector has also shown decline from 25% to 23%.

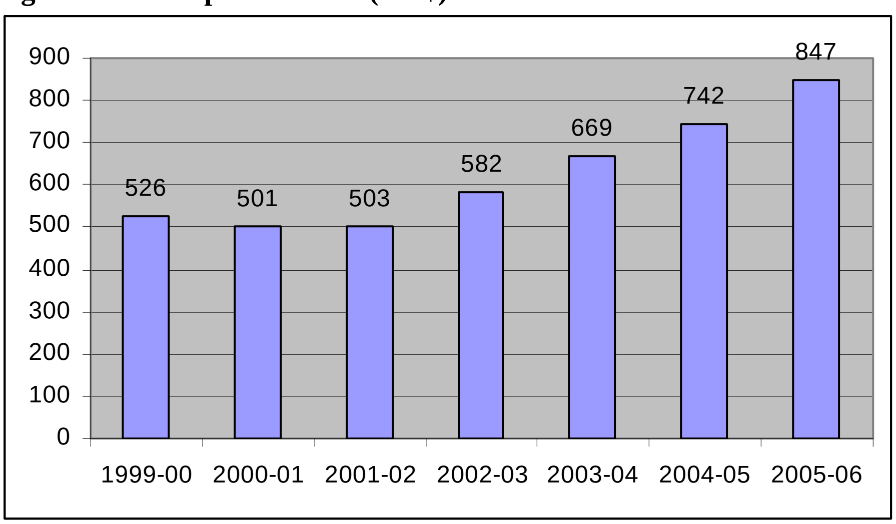
Per capita income, defined as Gross National Product at market price in dollar term divided by the country's population, grew at a much slower pace of 1.4 percent per annum in the 1990s, mainly due to slower economic growth, declining trend in workers' remittances and fast depreciating exchange rate. The pendulum swung to other extreme during the last few years and the per capita income grew at a tremendous pace. The per capita income in dollar term has grown at an average rate of 13.6 percent per annum during the last three years rising from $ 669 in 2003-04 to $ 742 in 2004-05 and further to $ 847 in 2005-06. The main factor responsible for the sharp rise in per capita income include acceleration in real GDP growth, stable or even appreciation in exchange rate and four fold increase in the inflows of workers' remittances. Per capita income in dollar term rose from $ 742 last year to $ 847 in 2005-06, depicting an increase of 13.6 percent. The figure shows the improvement in per capita income during the last six years.

Figure 5: Contribution to Real GDP growth rate 2005-06



Source: Economic Survey of Pakistan 2005-06

Figure 6: Per Capital Income (US $)



Source: Economic Survey of Pakistan 2005-06

(b) Inflation

Inflation seemed to be a chronic problem in Pakistan as in many other parts of the world. There is a wide spread recognition that inflation results in inefficient resource allocation and hence reduces potential economic growth. Inflation imposes high cost on economies and societies; disproportionately hurts the poor and fixed income groups and creates uncertainty throughout the economy and undermines macro economic stability..

High inflation has always penalized the poor more than the rich because the poor are less able to protect themselves against the consequences, and less able to hedge against the risks that high inflation poses Prices remained volatile during the decade of the 1990s, ranging between 5.7 percent and 13.0 percent mainly because of decelerating economic growth, expansionary monetary policies, output set-backs, higher duties and taxes, a depreciating Pak Rupee, frequent adjustments in the administered prices of gas, electricity and POL products, etc. The changes introduced in the economy added a major element of distortion in economic relations with an inevitable pressure on prices, GDP growth and the performance of the large-scale industrial sector. The pressure on prices intensified in 1994-95 when inflation went up to 13 percent. Both the food and non-food inflation contributed to the persistence of double digit inflation, averaging 12.2 and 10.7 percent.

Table 14: Inflation Rates (based on Sensitive, Consumer and Wholesale Price indexes)

Period	SPI	CPI	WPI
1993-1994	11.79	11.27	11.40
1994-1995	15.01	13.02	16.00
1995-1996	10.71	10.79	11.10
1996-1997	12.45	11.80	13.01
1997-1998	7.35	7.81	6.58
1998-1999	6.44	5.74	6.35
1999-2000	1.83	3.58	1.77
2000-2001	4.84	4.41	6.21
2001-2002	3.37	3.54	2.08
2002-2003	3.58	3.10	5.57
2003-2004	6.83	4.57	7.91
2004-2005	11.55	9.28	6.75
2005-2006	7.02	7.92	10.10

Source: Federal Bureau of Statistics

However, the inflation rate has started to decelerate over the last three years (1998-2000) because of an improved supply position, strict budgetary measures and depressed international market prices. The inflation rate which was at 5.7 percent in 1998-99, was reduced to 3.6 percent in 1999-2000 and further to 3.1 percent in 2002-03. This low level of inflation has been achieved as a result of strict fiscal discipline, the lower monetization of the budget deficit, an output recovery, a reduction in duties and taxes, and appreciation of exchange rate. Inflation began to pick up after the first quarter of 2003-04, reaching as high as 8.5 percent in June 2004 for a variety of reasons including the rise in the support price of wheat, shortages of wheat owing to less than the targeted production, mismanagement in wheat operations, and ban on inter-provincial movements of wheat. The rising trend continued in financial year 2005-06 and until latest period due to variety of factors mainly the sharp escalation in oil prices internationally.

(c) Consumption

Consumption as a percentage of GDP has been on decline meaning thereby the increase in saving and resultant increase in the level of investments. The analysis of data shows that total consumption was 83.3% of GDP for fiscal year 2001-02 which was reduced to 80% of GDP in financial year 2005-06.

The contribution of private sector dominated the scene. It was 87.51 % of total consumption in fiscal year 2001-02 and it grew to 92.38% for the period 2005-06. The government or the public sector consumption also has experienced declining trend which has declined from 12.39 % of total consumption in fiscal year 2001-02 to 7.62% for the period 2005-06.

This also indicate increased role of private sector activity over the period of five years.

Table 15: Consumption patterns

(As percentage of GDP)

Financial Year	2001-02	2002-03	2003-04	2004-05	2005-06
Total consumption (as % of GDP)	83.3	83.1	83.4	81.9	80.0
Private sector share out of total (%)	87.51	88.86	87.92	89.53	92.38
Public sector share (%)	12.49	11.14	12.08	10.47	7.62

Source: Economic Survey of Pakistan 2005-06

(d) Investment and saving

Fixed investment is the key to sustain growth momentum. Fixed investment grew by 24.7 percent on average during the last three years (2003-06) while private investment grew by 24.6 percent per annum during this period. In the fiscal year 2005-06, gross fixed capital formation or domestic fixed investment grew by 30.7 percent as against 28.6 percent last year. The composition of investment between private and public sector has changed considerably during the last three years. Private sector investment grew by 31.6 percent this year as against 29.1 percent increase in last year. Public sector investment has also increased by 24.9 percent per annum during the last three years and 28.2 percent during the current fiscal year. Public sector investment has created spillovers for private sector investment through massive rise in public sector development program and infrastructure investment. In other words, the growth in domestic investment in the current year was largely a public-private partnership based growth where both sectors are working in tandem to augment growth spree in the economy. The government has vacated space for the private sector in the past but now the government is active player in infrastructure building and social sector development.

Like growth, private sector investment was highly broad-based. Major growth in investment by private sector is witnessed in agriculture (15.3%), manufacturing (14.4%), mining and quarrying (45.5%), construction (9.5%), transport and communication (20.2%), and wholesale and retail trade (424.5%). As a result of the sharp rise in private sector investment, its share in domestic fixed investment rose by 9.6 percentage points over last six years, that is, from 64.2 percent to 73.8 percent. Public sector investment lost as much ground in favor of private sector. All sectors of the economy witnessed double digit increase in investment. In the public sector investment, only post office and telegraph witnessed negative growth. On the other hand, public sector investment rose sharply by 185.5 percent in electricity and gas distribution. General government investment was however, up by 11.6 percent in 2005-06.

As percentage of GDP, total investment provisionally estimated at 20.0 percent as against 18.1 percent last year. Fixed investment as percentage of GDP is estimated at 18.4 percent as against 16.5 percent last year. Both public sector investment and private sector investment as percentage of GDP have increased to 4.8 percent and 13.6 percent respectively, up from 4.4 percent and 12.1 percent last year. The contribution of national savings to the domestic investment is indirectly the mirror image of foreign savings required to meet investment demand. The requirement for foreign savings simply reflects the current account deficit in the balance of payments. National savings were not able to finance the demand for the growing economy and the recourse to foreign savings to the extent of 3.7 percent of GDP reflects the saving-investment gap. National savings as percentage of GDP stood at 16.4 percent in 2005-06 fractionally lower than last year's level of 16.5 percent

Table 16: Saving and Investment

(As percentage of GDP)

Description	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06 (P)
Total Investment	17.2	16.8	16.9	16.6	18.1	20.0
Changes in Stock	1.4	1.3	1.7	1.6	1.6	1.6
Gross Fixed Investment	15.8	15.5	15.3	15.0	16.5	18.4
- Public Investment	5.7	4.2	4.0	4.0	4.4	4.8
- Private Investment	10.2	11.3	11.3	10.9	12.1	13.6
Foreign Savings	0.7	-1.9	-3.8	-1.3	1.6	3.7
National Savings	16.5	18.6	20.8	17.9	16.5	16.4
Domestic Savings	17.8	18.1	17.6	15.7	14.5	14.4

Source: Economic Advisor's Wing

(e) Capital Stock

The trend of gross fixed capital formation has always been upward in Pakistan. As we can see that the total of around 659 billion rupees rose to around one trillion in the year 2004-05 giving rise of almost 52%. The data also shows that the private sector has maximum share in fixed capital formation during all the years given in table 19 below. large scale manufacturing, electricity & gas, transport & communication, real estate sector and services were the dominant sectors where most of the investment has been made . This also depicts that Pakistan's economy is emerging economy shifting from agro base to industry and services.

Table 17: Gross Fixed Capital Formation (GFCF)

(Million rupees)

Sectors	2000-01	2001-02	2002-3 (F)	2003-04 (P)	2004-05 (P)
Total GFCF(A+B+C)	659325	680373	736433	864701	999306
A. Private Sector	423097	496464	545104	597591	713157
B. Public Sector	169242	113523	104051	142324	141781
C. General Government	66986	70386	87278	124786	144368
Private + Public Sectors	592339	609987	649155	739915	854938
1. Agriculture	67148	69604	75681	78081	86212
2. Mining and quarrying	33693	48995	77430	58812	62484
3. Manufacturing	151020	168055	164920	186772	229770
i) Large-scale	128826	143005	136066	147415	179935
ii) Small-scale	22191	25047	28854	39357	49835
iii) Slaughtering	3	3			
4. Construction	13589	15163	7130	10112	15887
5. Electricity and Gas	67628	56865	57562	44404	46064
6. Transport & Communica.	104679	86360	82864	134109	162204
7. Wholesale&retail trade	8589	10375	12533	14517	18497
8. Finance and Insurance	5104	10158	23366	27224	26937
9. Ownership of Dwellings	87448	87833	91379	111032	115500
10. Services	53441	56579	56290	74852	91383

Source: Federal Bureau of Statistics

(f) Money Supply

M1 consists of the outstanding stock of currency in circulation, the demand deposits of scheduled banks and the other deposits with the State Bank of Pakistan. M2 is M1 plus the outstanding stock of time deposits of scheduled banks and the outstanding stock of the RFCDs. M3 includes: the outstanding stock of the M2, outstanding deposits of the national saving schemes (NSS), and outstanding deposits of the provincial cooperative banks of the Punjab, Sindh, NWFP, Balochistan, AJK and the Northern Areas. During the first nine months of the current fiscal year, M1 increased by 7.9 percent against 16.7 percent last year.

Table 18: Money supply

(Rs. Billions)

End Period Stock	Money Supply & Monetary Assets			(Percentage Change)		
	(M1)	(M2)	(M3)	(M1)	(M2)	(M3)
June 1991	265.1	400.6	569.40	10.4	7.4	12.9
June 1992	302.9	505.6	679.2	14.2	26.2	19.3
June 199	327.8	595.4	777.3	8.2	17.8	14.4
June 1994	358.8	703.4	923.4	9.4	18.1	18.8
June 1995	423.1	824.7	1083.6	17.9	17.2	17.3
June 1996	448.0	938.7	1246.3	5.9	13.8	15.0
June 1997	443.6	1053.2	1430.1	-1.0	12.2	14.8
June 1998	480.3	1206.3	1696.8	8.3	14.5	18.6
June 1999	643.0	1280.5	1913.4	33.9	6.2	12.8
June 2000	739.0	1400.6	2137.2	14.9	9.4	11.7
June 2001	761.4	1526.0	2313.9	3.0	9.0	8.3
June 2002	876.8	1761.4	2640.9	15.2	15.4	14.1
June 2003	1106.2	2078.7	3102.0	26.2	18.0	17.5
June 2004	1371.6	2486.6	3519.4	24.0	19.6	13.5
June 2005	1624.2	2966.4	3975.5	18.4	19.3	13.0
End March	1600.9	2801.9	3785.9	16.7	12.7	7.6
2005 2006	1752.8	3248.2	4267.1	7.9	9.5	7.3

Source: State Bank of Pakistan

M2 has recorded a growth of 9.5 percent compared to 12.7 percent last year. The broadest monetary aggregate, M3, has increased by 7.3 percent during the first 3 quarters of 2005-06, compared to 7.6 percent in the comparable period last year. During July-March 2005-06 M3 increased by Rs 292 billion of which 96.6 percent was contributed by net changes in M2 and only 3.4 percent was contribution by the net accruals of NSS and provincial cooperative banks (Rs 10 billion). During the same period last year the entire growth in M3 was due to M2 as net accrual of NSS and deposits of provincial cooperative banks was negative.

The State Bank of Pakistan has taken a number of proactive and forward looking steps to strengthen the prudential regulations and monitoring framework. These measures are also meant to facilitate the farming community, ensure participation of non-banks in the secondary market for government papers/bonds, induce private sector to invest in the infrastructure development projects, promote consumer and housing finance, SME sector and for improved governance of the financial system.

(g) Employment

Employment share of agricultural and allied activities (43.4%) in 2005-06 levels slightly higher than that of 2003-04 (43.1%). Male employment declines while female’s climbs about 2% up. As for non-agricultural employment, manufacturing and construction scale up respectively from 13.7% and 5.8% in 2003-04 to 13.8% and 6.1% in 2005-06. Community, social & personal services lose a half percentage point from 15% in 2003-04 to 14.4% in 2005-06 while wholesale and retail trade and transport remain unchanged. It seems that employability of secondary and tertiary activities is generally on rise though; the rate of growth has to go a long way to assume sustainable momentum. A comparative picture of the proportions of persons employed in major industry divisions is given in the following table.

Table 19: Distribution of labor employed labor force by sectors.

Major Industry Divisions	2003-04			2005-06		
	Total	Male	Female	Total	Male	Female
Total	100.0	100.0	100.0	100.0	100.0	100.0
Agriculture, Forestry, hunting, and fishing	43.1	38.1	67.3	43.4	37.2	68.8
Manufacturing	13.7	13.5	14.7	13.8	13.7	14.6
Construction	5.8	7.0	0.3	6.1	7.5	0.4
Wholesale and retail trade	14.8	17.5	1.7	14.7	14.5	13.6
Transport, storage and communication	5.7	6.9	0.1	5.7	7.1	0.3
Community, social and personal services	15.0	14.8	15.8	14.4	14.5	13.6
Others(includes mining and quarrying, electricity, gas and water, financing, insurance, real estate, and business services and activities not adequately defined)	1.9	2.2	0.1	1.9	2.3	0.2

Source: Labor Force Survey 2005-06.

Female labor force participation is on the rise for most sectors as seen from the above data especially agriculture, fishery, forestry and hunting sectors. It is important to note that the employment of the rural females increased despite a considerable rise in female Labor Force Participation Rate. The increase in rural female employment was mainly in the category of unpaid family helpers, which may be due to enhanced growth rates in agriculture in recent years or due to the combined efforts of various NGO. The distribution of female labor force by major sectors also supports the view that employment gains are concentrated in female unpaid workers, as the largest increase in the female employment is seen in Agriculture and allied industries.

Since 2003-04 and until December 2005, 5.82 million new jobs have been created reflecting the growing pace of economic activity in the country. In the past the economy use to create about 1 million jobs annually but the capacity to generate more jobs has increased in recent years as a result of strong economic recovery. It is also important to note that out of 5.82 million new jobs, 4.4 million (78%) have been created in rural areas while 1.28 million (22%) have been created in the urban areas. Going forward the challenge faced by the government is to sustain the growth momentum to create more jobs, increase incomes of the people, and reduce unemployment and poverty.

II.2 Fiscal Position

Pakistan has gained further strength on fiscal side. Revenues are buoyant, expenditure is rationalized, fiscal deficit is at sustainable level and revenue deficit has almost been eliminated. Resultantly, Public debt is fast moving towards a sustainable level. Much progress has been made towards fiscal consolidation. The wide-ranging tax and tariff reforms as well as reforms in tax administration have started paying dividends. Tax collection by the Central Board of Revenue (CBR) has picked up. As a result of prudent fiscal management over the last 5 years, the burden of interest payment in domestic budget has declined sharply, thereby, releasing resources for development and social sector program.

Table 20: Fiscal Indicators as Percentage of GDP

Year	GDP Real Growth	Overall Fiscal Deficit	Expenditure			Revenue		
			Total	Current	Development	Total Rev.	Tax	Non-Tax
1990-91	5.4	8.8	25.7	19.3	6.4	16.9	12.7	4.2
1991-92	7.6	7.5	26.7	19.1	7.6	19.2	13.7	5.5
1992-93	2.1	8.1	26.2	20.5	5.7	18.1	13.4	4.7
1993-94	4.4	5.9	23.4	18.8	4.6	17.5	13.4	4.1
1994-95	5.1	5.6	22.9	18.5	4.4	17.3	13.8	3.5
1995-96	6.6	6.5	24.4	20.0	4.4	17.9	14.4	3.5
1996-97	1.7	6.4	22.3	18.8	3.5	15.8	13.4	2.4
1997-98	3.5	7.7	23.7	19.8	3.9	16	13.2	2.8
1998-99	4.2	6.1	22.0	18.6	3.4	15.9	13.3	2.7
1999-00	3.9	5.4	18.7	16.5	2.2	13.5	10.7	2.8
2000-01	1.8	4.3	17.2	15.5	1.7	13.3	10.6	2.7
2001-02	3.1	4.3	18.8	15.9	2.9	14.2	10.9	3.3
2002-03	4.7	3.7	18.6	16.3	2.3	14.9	11.5	3.4
2003-04	7.5	2.4	16.7	13.5	3.2	14.3	11.0	3.3
2004-05	8.6	3.3	18.2	13.1	3.8	13.7	10.0	3.7
2005-06 P	6.6	3.4*	17.6*	13.4	4.2	14.2	10.4	3.8

Source: Economic Survey of Pakistan 2005-06

During the five years from 2000-01 to 2005-06, tax collection by the CBR increased by 81.0%. The Central Board of Revenue (CBR) was targeted to collect Rs.690 billion for financial year 2005-2006 but it actually collected Rs.710 billion – Rs.20 billion more than the target. The total expenditure remains more or less stable in a narrow band of 17 to 18.8 percent of GDP during the last six years. Substantial decline in interest payments from as high as 7.5 percent of GDP in 1998-99 to 3.1 percent of GDP in 2005-06, has provided fiscal space to reorient expenditure in favor of development expenditure. Resultantly the share of current expenditure in total expenditure declined from 89 percent of total expenditure in 1998-99 to 78 percent in 2005-06. In addition, the share of development expenditure doubled from 11 percent to 22 percent in the same period. During the last six years the development expenditure improved from 2.2 percent of GDP in 2000-01 to 4.2 percent of GDP in 2005-06. Second largest component of the current expenditure, namely, defense spending remained stagnant at around 3.1 percent to 3.3 percent of GDP during the last six years. Government is achieving the goal of fiscal stabilization without compromising spending on the social sector. During the last six years the real growth in current expenditure hovered around 3 percent per annum and pace of growth has slowed down. Total expenditure grew by 3.4 percent in the first three years (2000-03) but accelerated to 5.6 percent during the last three years (2003-06). The main contribution is coming from development expenditure which grew by 7.4 percent per annum in first three years (2000-03) and by 23.8 percent in recent three years (2003-06).

Total consolidated revenues are targeted at Rs. 1095.6 billion in 2005-06 compared to Rs. 900.0 billion in 2004-05, an increase of 21.7%. This was primarily due to a rise of 22.2 percent in tax revenue on the back of increases in both federal and provincial tax revenues, which grew by 19.8% and 50.1%, respectively. Non-tax revenue increased by 19.3 percent in 2005-06 but remained stagnant at 3.8 percent of GDP. In 2005-06, Pakistan is likely to face an overall fiscal deficit of Rs. 261.6 billion or 3.4% of GDP excluding earthquake effect and if we include earthquake related spending worth Rs.65.8 billion, the size of the deficit stood at Rs.327.3 billion or 4.2 percent of GDP. This revenue-expenditure gap was financed through external and domestic sources.

Out of the gap of Rs. 327.3 billion, financing from external sources is expected at Rs 118.4 billion. The remaining gap of Rs. 208.9 billion is likely to be financed from domestic sources. Within domestic sources, financing from non-bank sources amounted to Rs. 22.4 billion while Rs. 96.7 billion would be contributed by the Banking sources, and Rs. 90.0 billion is to be financed through privatization proceeds. The public debt- to-GDP ratio, which stood at almost 85 percent in end June 2000, declined substantially to 61.4 percent by the end of June 2005, 23.6 % decline in country's debt burden in 5 years. Following the debt reduction strategy in which raising revenue was one of the key elements, the public debt burden in relation to total revenue has declined substantially from 562.5 percent in 1999-2000 to 448.9 percent by end-June 2005. During the last six years, the debt servicing liabilities have declined sharply from 65.4 percent of revenue in 1999-2000 to 27.8 percent of revenue and from 53.5 percent to 27.8 percent of current expenditure in 2005-06.

The ratios of domestic debt to GDP and to tax revenue both decreased during 2005-06. The stock of domestic debt as Overview of the Economy percent of GDP declined from 35.7 percent in 2003-04 to 32.8 percent in 2004-05 and further to 29.4 percent by end March 2006. As a result of prudent fiscal management over the last 6 years, the burden of interest payments on the domestic budget has declined sharply, thereby, releasing resources for development and social sector programs. Interest payments as a percentage of total revenue have been reduced to one-half (41 percent to 20 percent) over the last six years. Similarly, share in total expenditure declined from 30 percent to 16 percent during the same period. Most importantly, as percentage of GDP, interest payments declined from 6 percent to 2.6 percent in the last six years. Nevertheless, the present state of the economy is far behind to be considered as satisfactory. The economy must grow in faster pace to reduce levels of poverty and to bring the country in the bracket of middle income countries.

II.2.1 Government Expenditure

The total expenditure remains more or less stable in a narrow band of 17 to 18.8 percent of GDP during the last six years. Substantial decline in interest payments from as high as 7.5 percent of GDP in 1998-99 to 3.1 percent of GDP in 2005-06, has provided fiscal space to reorient expenditure in favor of development expenditure. Resultantly the share of current expenditure in total expenditure declined from 89 percent of total expenditure in 1998-99 to 78 percent in 2005-06. In addition, the share of development expenditure doubled from 11 percent to 22 percent in the same period.

The development expenditure bore the brunt of structural adjustment of the 1990s and it was declined from as high as 7.5 percent of GDP in 1991-92 to 2.5 percent of GDP by 1999-2000. During the last six years the development expenditure improved from 2.2 percent of GDP in 2000-01 to 4.2 percent of GDP in 2005-06. Second largest component of the current expenditure, namely, defense spending remained stagnant at around 3.1 percent to 3.3 percent of GDP during the last six years. This shows strong focus of the government on removing infrastructural bottlenecks and building physical assets. The Government is achieving the goal of fiscal stabilization without compromising spending on the social sector. Non defense, non-interest expenditure has improved from 7.8 percent of GDP in 1999-2000 to 11.8 percent of GDP in 2005-06.

Table 21: Federal Government expenditure

(Million Rs.)

HEAD	2003-04	2004-05	2005-06	2006-07	2006-07	2007-08
I. REVENUE EXPENDITURE (A+B)	773,165	866,771	1,072,223	1,115,937	1,234,148	1,353,660
A. CURRENT EXPENDITURE:	714,019	784,680	918,789	879,779	1,033,532	1,056,349
a. General Public Service	448,430	468,974	563,673	504,288	63,4761	641,875
b. Defense Affairs and Services	180,537	216,258	241,062	250,182	252,631	275,000
c. Public Order and Safety Affairs	14,048	17,546	20,362	22,463	22,923	24,540
d. Economic Affairs	54,758	62,172	67,572	74,663	91,222	78,941
e. Environment Protection	132	136	147	167	177	182
f. Housing and Community Amenities	926	866	891	1,040	1,127	1,095
g. Health Services	2,809	3,280	4,361	4,728	4,760	5,240
h. Recreation, Culture and Religion	2,003	2,245	2,442	2,741	2,851	2,929
i. Education Affairs and Services	9,640	12,340	16,747	18,778	21,908	24,147
j. Social Protection	737	863	1,533	728	1,173	2,401
B. DEVELOPMENT EXPENDITURE	59,146	82,091	153,434	236,158	200,616	297,311
II. CAPITAL DISBURSEMENTS (A+B)	125,348	119,672	124,140	137,822	130,334	155,373
A. CURRENT EXPENDITURE:	64,964	52,739	38,519	24,602	31,932	32,117
	-	-		-		
B. DEVELOPMENT EXPENDITURE:	60,384	66,933	85,621	113,220	98,402	123,256
(i) Public Service	610	4,191	8,256	10,352	9,878	13,210
(ii) Economic Affairs	4,287	5,321	4,346	4,260	6,221	12,849
(iii) Transfers	55,487	57,420	73,020	98,609	82,303	97,196
(vi) Block allocation for late NIS	-	-		-		
III ESTIMATED OPERATIONAL SHORT FALL /OTHER ADJUSTMENT INPSDP	-	14,563	-			
TOTAL EXPENDITURE (I+II)	898,513	1,001,006	1,196,364	1,253,758	1,364,482	1,509,032

Source: State Bank of Pakistan

The total outlay of the four provincial budgets for 2005-06 stood at Rs.471.7 billion, which is 8.7 percent higher than the outlay for last year (Rs.434.0 billion). NWFP witnessed the highest increase of 23.3 percent in budgetary outlay followed by the Punjab (5.7%), Sindh (5.5%) and Baluchistan (12.7%). The overall provincial revenue receipts for 2005-06 are estimated at Rs. 506.5 billion, which is 39.4 percent higher than last year. Tax revenue accounting for 64.3 percent of overall revenue receipts, amounted to Rs.325.7 billion which is 16.9 percent higher than last year and non-tax revenue is estimated at Rs.34.9 billion which is 52.4 percent higher than last year

The total budget outlay of Rs. 471.7 billion is shared in the ratio of 77 percent and 23 percent between current and development expenditures, respectively.

Table 22: Consolidated Budget (Federal and Provincial)

(Rs. Billion)

	2002-03	2003-04	2004-05	2005-6	% change
	As % of GDP (mp)				
Total Revenue	14.9	14.3	13.7	14.2	-
- Tax Revenue	11.5	11.0	10.0	10.4	-
- Non-Tax Revenue	3.4	3.3	3.8	3.8	-
Total Expenditure	18.6	16.7	17.0	18.4	-
-Earthquake Spending				0.8	
Current Expenditure	16.4	13.5	14.3	14.2	-
- Interest Payment	4.3	3.5	3.2	3.2	-
- Defense	3.3	3.2	3.2	3.2	-
PSDP	2.2	3.1	3.5	4.2	-
C. Overall Fiscal Deficit					-
- Excl. Earthquake Effect				3.4	-
- Incl. Earthquake Effect	3.7	2.4	3.3	4.2	-
GDP at Market Price (Rs Bln)	4823	5641	6581	7713	16.7

Source: Budget wing, Finance Division.

The allocations for development expenditure are 11.0 percent lower than last year and for current expenditure, they are higher by 16.5 percent. The main components of the Provincial budgets 2005-06 in comparison with revised estimates of last year can be observed from the following table.

Table 23: Provincial Budgets

(Rs. Billion)

Item	Sindh 04-05	05-06	N.W.F.P 04-05	05-06	Punjab 04-05	05-06	Balochistan 04-05	05-06	Total 04-05	05-06
	(R.E)	(B.E)	(R.E)	(B.E)	(R.E)	(B.E)	(R.E)	(B.E)	(R.E)	(B.E)
Provincial Taxes	12.1	13.4	2.3	2.5	19.1	25.8	0.9	0.9	34.4	42.6
Share in Federal Taxes	75.8	86.4	29.2	34.1	122.8	143.6	17.5	20.2	245.3	284.3
All Others	17.3	17.3	15.7	20.9	17.1	24.0	11.9	10.4	62.0	76.8
Total Tax Revenues	87.9	99.8	31.5	36.6	141.9	169.4	18.4	21.1	279.7	326.9
Non-Tax Revenues	4.9	6.6	2.2	2.4	15.0	25.1	0.8	0.8	22.9	34.9
Total Revenues	110.1	127.9	49.4	59.9	174.0	218.5	31.1	32.3	364.6	438.6
a) Current Exp. b)	105.7	118.9	42.6	51.0	136.3	157.5	26.2	34.6	310.8	362.0
Development Exp.	29.7	24.0	15.8	21.0	62.8	53.0	14.9	11.7	123.2	109.7
i) Rev. Account ii)	4.5	2.1	2.5	3.9	38.9	23.3	0.0	0.0	45.9	29.3
Cap. Account Total	25.2	21.9	13.3	17.1	23.9	29.7	14.9	11.7	77.3	80.4
Exp. (a+b)	135.4	142.9	58.4	72.0	199.1	210.5	41.1	46.3	434.0	471.7

Source: Economic survey of Pakistan

II.2.2 Public Borrowings

Pakistan's public debt grew at an average rate of 18 percent and 15 percent per annum during the 1980s and 1990s, respectively – much faster than the growth in nominal GDP (11.9% and 13.9% respectively).

Resultantly, public debt rose from 56 percent of GDP at the end of the 1970s to 92 percent by the end of the 1980s. The root cause of rising debt burden has been the persistence of large fiscal and current account deficits. Pakistan, on average, sustained fiscal and current account deficits of almost 7 percent and 5 percent of GDP, respectively during 1990-99. In many developing countries including Pakistan, the "twin deficits" have been the prime cause of low economic growth. Large fiscal and current account deficits led to the accumulation of domestic and external debt which increased country's vulnerability to external shocks, reduced investment rate, and consequently slowed economic growth. Thus, there exist a strong negative relationship between fiscal deficits and economic growth. When a country like Pakistan sustains such a large fiscal and current account deficits for so long a period is bound to experience decrease in economic growth.

It is in this background that the first and foremost challenge for the government six years ago had been to arrest the rising trends of debt. The government had set-up a high level Debt Committee which examined the root cause of the rising debt burden and suggested debt reduction strategy to stabilize debt situation. The government is following the debt strategy as suggested by the Committee. Reduction in the fiscal and current account deficits, lowering the cost of borrowing, raising revenue and foreign exchange earnings, and debt re-profiling from the Paris Club have been the key features of the debt reduction strategy. To provide legal cover to debt reduction strategy a Fiscal Responsibility and Debt Limitation Act 2005 has been promulgated in June 2005. As a result of the credible strategy being followed by the Government, the public debt- to-GDP ratio, which stood at almost 85 percent in end June 2000, declined substantially to 61.4 percent by the end of June 2005, 23.6 percentage points decline in country's debt burden in 5 years. By end March 2006, public debt further declined to 54.7 percent of the projected GDP for the year.

The rising stock of public debt has had serious implications for debt service obligations during the 1990s. In 1980-81, almost 12 percent of total revenues were consumed for debt servicing and by 1989-90 this increased to almost 39 percent. By end of 1990 (in 1999-2000), almost 69 percent of total revenues were being consumed by one budgetary item, namely, debt servicing, leaving only 31 percent to be spent on development programs, the social sector, civil administration, defence etc. Quite naturally, it was highly inadequate to finance these budgetary items. The development budget faced the burden of adjustment as it continued to shrink from over 9.0 percent of GDP in 1980-81 to 6.5 percent in 1990-91 and further to 2.5 percent by the end of the 1990s. The high and growing public debt burden is the major source of the sharp slowdown in Pakistan's economic growth, to less than 4 percent per annum in the 1990s and the consequent increase in poverty incidence by 1999-2000. Consequently, the Government's annual development budget continued to shrink from 6.4% of GDP to 2.5% of GDP during the same period. Both physical and human capital deteriorated sharply during the period, constraining the country's future growth potential. During the last six years, the debt servicing liabilities have declined sharply from 65.4 percent of revenue in 1999-2000 to 27.8 percent of revenue and from 53.5 percent to 27.8 percent of current expenditure in 2005-06. The subsequent fiscal space created by bridging the revenue-expenditure gap and low debt servicing cost has enabled the Government to increase poverty and social sector related expenditures from Rs. 89.8 billion or 2.2% of GDP in 2000-01 to Rs. 326.7 billion or 4.2% of GDP in 2005-06.

The outstanding stock of domestic debt rose by Rs 108.6 billion during 2005-06, compared to an increase of Rs 146.0 billion in the preceding year – the rise is primarily due to rise in the nominal value of the fiscal deficit. The Government has also showed greater deficit tolerance in terms of its ratio to GDP, mainly because of releasing more resources towards social sector. However, this does not imply fiscal indiscipline, since the budget deficit as a percent of GDP is still targeted at 3.4 percent of GDP during the year 2005-06 which is slightly higher than the actual achievement of 3.3 percent of GDP in 2004-05. The inclusion of earthquake effect give boost to the fiscal deficit for the current year by 0.7 percent of GDP or the deficit would be 4.1 percent of GDP in 2005-06. This has contributed to rise in quantum of domestic debt to some extent. In fact, this moderate growth of domestic debt compared to the trend growth rate of 1990s, together with the increasing revenues and accelerating economic growth, implies that the economy's debt carrying capacity has been improving for the last six years.

Table 24: Composition of Public Borrowing

(Rs. Billion)

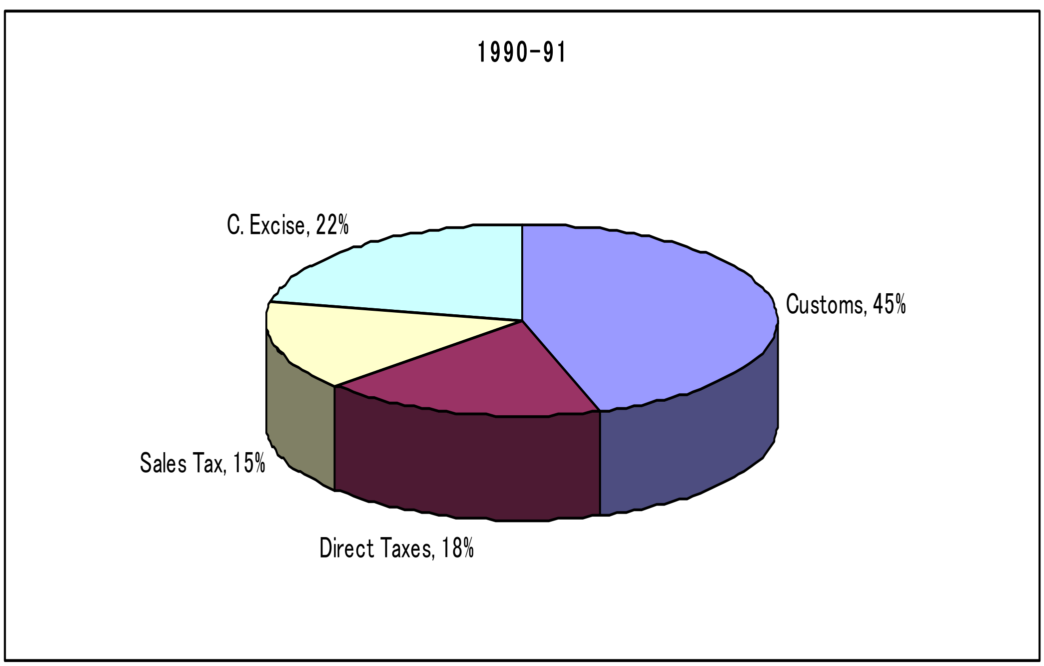
	SBP	Com. Bank	Total	Non-Bank	Total Domestic Debt
1998-99	359.5	314.0	673.5	702.4	1375.9
1999-2000	551.4	213.5	764.9	813.9	1578.8
2000-01	604.6	228.1	832.7	898.3	1731.0
2001-02	326.2	388.5	714.7	1003.2	1717.9
2002-03	110.1	607.6	717.7	1136.0	1853.7
2003-04	133.3	652.3	785.6	1193.9	1979.5
2004-05	324.9	618.1	1109.7	1022.9	2129.1
2005-06	444.5	639.5	1084.0	1164.7	2248.7

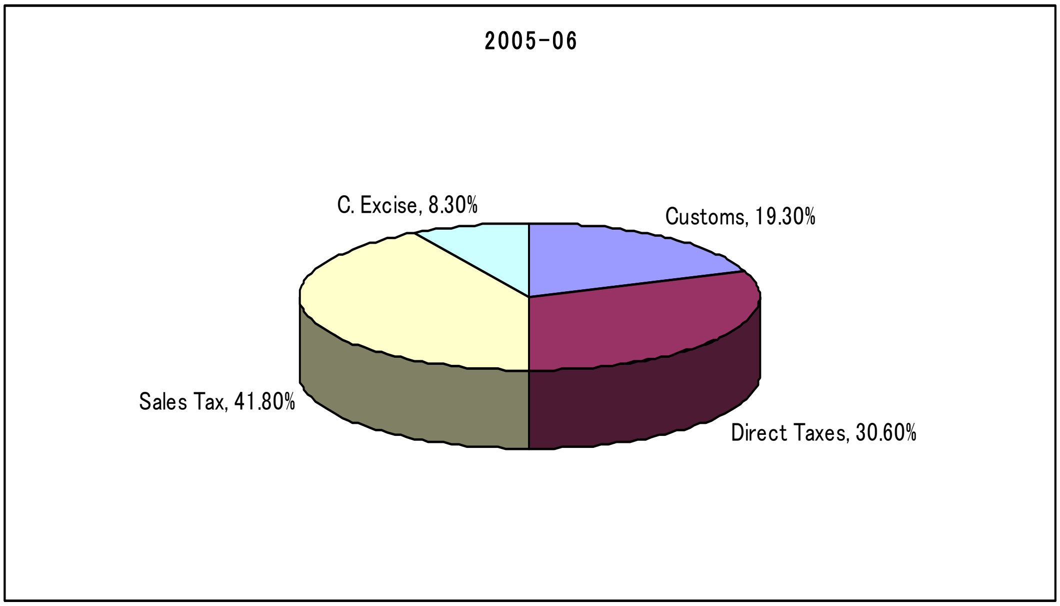
Source: State Bank of Pakistan

II.2.3 Aggregate Tax Revenue

Central Board of Revenue (CBR) is the authority at federal level to collect tax revenues. It is headed by Chairman who is also the Secretary Revenue Division. The structure of Pakistan's taxation changed considerably since the 1990s. The share of direct taxes in tax revenues increased from 18.0% in 1990-91 to 31.0% in 2005-06. The share of indirect taxes in tax revenues declined from 82.0% to 69.0% during the same period. The basic philosophy of tax and tariff reforms has been to move away from investment and production based taxes towards income and consumption based taxes. During the 1990s Pakistan was confronted with lower tax-to-GDP ratio primarily due to the existence of a narrow tax base, over-reliance on taxes on imports, the complexity of the tax regime and weak tax administration. In 2000-01, the Government tightened fiscal management and implemented structural reforms across all major sectors of the economy. Tax administration reforms were focused on improving tax compliance. Improvements in tax collection were sought by implementing a tax amnesty scheme and extending the general sales tax to the services sector. The tax revenue has surpassed the target for the third year in a row but nominal GDP is increasing at a faster pace then tax collections, so tax-to-GDP ratio remained almost stagnant.

Figure 7: Structure of Federal Taxes





Source: Economic Survey of Pakistan 2005-06

Table 25: Trend of Federal Taxes

(Rs. Billion)

YEAR	*COLLECTION*	*% CHANGE*
1	*2*	*3*
1999-00	347	12.5%
2000-01	392	13.0%
2001-02	404	3.0%
2002-03	461	14.0%
2003-04	521	13.1%
2004-05	590	13.2%
2005-06	712	20.7%

Source: Central Board of Revenue

III. Tax Structure: Institutions and the Reality

An efficient tax system should raise enough revenue to finance essential expenditures without excessive public sector borrowing; and raise the revenue in ways that are equitable and that minimize its disincentive effects on economic activities.

In Pakistan, the establishment of effective and efficient tax system faces some serious challenges. The first of these challenges is the structure of the economy that makes it difficult to impose and collect certain taxes. For example, the economy of Pakistan is often characterized by a large share of agriculture in total output and employment; by large informal sector activities and occupations' by many small establishments; by a small share of wages in total national income, and so on. All these factors reduce the possibility of relying on certain modern taxes such as income tax, sales tax etc. The structure of the economy in association with low literacy and low human capital make it difficult to develop a good tax administration. When the officials of tax administration are not well educated and well trained, when resources to pay good salary and to establish necessary infrastructure are limited, when the tax payers have limited ability to keep accounts, when the use IT is limited, it is difficult to collect tax effectively.

As a consequence of all these factors Pakistan, often end up with small tax sources, heavy reliance on custom duties, and not on direct taxes. The non-availability of reliable statistics from the businesses makes it even more difficult for tax administration to assess the potential taxes that need to be collected. As a consequence, marginal changes are often preferred over major structural changes. This perpetuates the inefficient tax structure.

Uneven income distribution is also a major constraint in developing efficient tax system. To generate higher tax revenue, the high income earners are supposed to be taxed significantly more proportionately than the low income group. But the economic and political powers are concentrated in the top brackets which sets the goals of the tax administration rather more difficult to collect taxes from high income earners. This is one of the major reasons that the number of income tax payers in Pakistan is very low.

The above discussed factors and difficulties prevented Pakistan to raise its tax-to-GDP ratio in line with the average of developing countries at 17%. As consequence, Pakistan sustained a large budget deficit throughout the 1990s. Realizing the weaknesses of Pakistan’s tax structure a concerted reform effort was launched in the early 2000. The government began wide-ranging tax and tariff reforms and worked on fiscal transparency, aimed at reducing tax rates, broadening the tax base to hitherto untaxed or under taxed sectors, and shifting the incidence of taxes from imports and investment to consumption and incomes.

The reduction in tax rates was intended to stimulate investment and production and promote voluntary tax compliance. Broadening of the tax base was intended to ensure the fair distribution of the tax burden among various sectors of the economy. Among the various tax policy reforms, the most significant are the continuous raising of the basic threshold of income tax, reduction of corporate rate to ensure parity between the rates applicable to private, public, and banking companies, re-introducing uniformity of GST rate, and continuous reduction and rationalization of tariff rates.

The wide-ranging tax and tariff reforms as well as reforms in the tax administration have started paying dividends. Tax collection by the Central Board of Revenue (CBR) has gone up, the overall budget deficit as percentage of GDP has declined; the revenue deficit has been narrowed. An improved tax structure will reduce the deadweight loss associated with raising a given amount of revenue and a reduction in the relative share of trade taxes and increases in the relative shares of taxes on income and consumption could be an ample evidence of an improvement in the tax system.

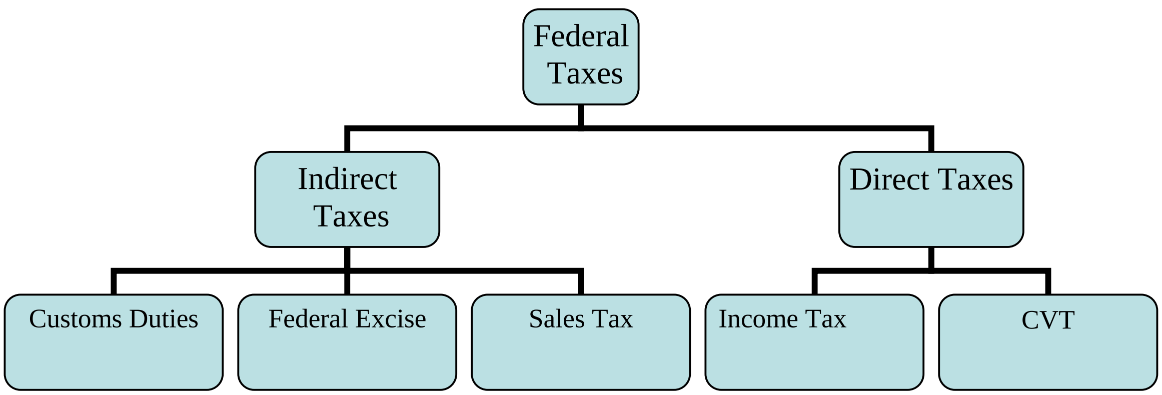
Table 26: Tax -GDP Ratio

Year	Tax Revenue			
	Total (CBR)	As % of GDP	Direct Taxes	Indirect Taxes
1990-91	111.0	11.0	20.0 [18.0] 62.0	91.0 [82.0]
1994-95	226.0	12.0	[27.4] 78.0	164.0 [72.6]
1995-96	268.0	13.0	[29.1] 85.0	190.0 [70.9]
1996-97	282.0	12.0	[30.1] 103.3	197.0 [69.9]
1997-98	293.7	11.0	[35.0] 110.4	190.4 [65.0]
1998-99	308.5	10.0	[35.8] 112.6	198.1 [64.2]
1999-2000	346.6	9.1	[32.5] 124.6	234.0 [67.5]
2000-01	392.3	9.4	[31.8] 142.5	267.7 [68.2]
2001-02	403.9	9.2	[35.3] 148.5	261.6 [64.7]
2002-03	460.6	9.6	[32.2] 165.3	312.2 [67.8]
2003-04	518.8	9.2	[31.9] 176.9	353.6 [68.1]
2004-05	588.4	8.9	[30.1] 217.6	411.4 [68.9]
2005-06 (P)	710.1	9.2	[30.6]	492.5 [69.4]

Source: Central Board of Revenue

The basic principles of tax policy have been set as widening the tax base by reducing exemptions, incentives and concessions, reducing multiplicity of rates, lowering tax rates, shifting the incidence of tax burden from production to consumption, moving away from the excessive reliance on manufacturing and taxing all value additions including services, and re engineering business process of the tax system to overcome the culture of tax avoidance and evasion; introducing business process changes in tax administration to establish an efficient tax system. It is the continuous policy and effort of the Government to implement these principles. But unfortunately despite the recent reforms, the tax effort remained modest in Pakistan on account of various structural problems. The administrative reforms envisaged by the CBR, especially moving toward a functional organizational structure, has helped to enhance tax efficiency, as well as improving the tax climate and governance. However, expanding taxation gradually into the agricultural and service sectors would bring greater yields, as would efforts to reduce evasion.

Figure 8: Federal Taxes



Why tax-to-GDP ratio in Pakistan is low in comparison to many developing countries? Despite better growth performance in recent past Pakistan's tax-to-GDP ratio has fallen in 2004-05. The main reason is that GDP grew at a faster pace than tax revenue. If we analyze the contribution of various sectors of the economy in GDP growth vis-à-vis their share in taxes we can easily get the answer.. Almost three fourth of contribution to growth (22.5%) came from agriculture but its contribution to tax revenue is as low as 1.2 percent whereas the contribution in GDP by manufacturing is 17.9% but its contribution in tax revenue is close to two-third of the total. This uneven incidence of taxation among major sectors tells the reasons of low tax to GDP ratio. Ideally speaking all efforts to enhance tax-to-GDP ratio should begin from equitable distribution of tax burden among various sectors according to their contribution in the economic activity.

III.1 Central Board of Revenue

The Central Board of Revenue (CBR) was created on April 01, 1924 through enactment of the Central Board of Revenue Act, 1924. In 1944, a full-fledged Revenue Division was created under the Ministry of Finance. After independence, this arrangement continued up to 31st August 1960 when on the recommendations of the Administrative Re-organization Committee, CBR was made an attached department of the Ministry of Finance.

In 1974, further changes were made to streamline the organization and its functions. Consequently, the post of Chairman CBR was created with the status of ex-officio Secretary Revenue division and Secretary Finance was relieved of his duties as ex-officio Chairman of the CBR.

III.1.1 Functions

In the existing setup, the Chairman, CBR, being the executive head of the Board as well as Secretary of the Revenue Division1 has the responsibilities of:

- Formulation and administration of taxation policy;
- Levy and collection of federal taxes;
- Quasi-judicial function of hearing of appeals;
- Enter into double-taxation treaties with other countries;
- Liaise with all Ministries as well as Chambers of Trade and Industry; and

• Provide an up-date on CBR activities to the President and the Prime Minister of Pakistan.

III.1.2 Functions of various wings and Members

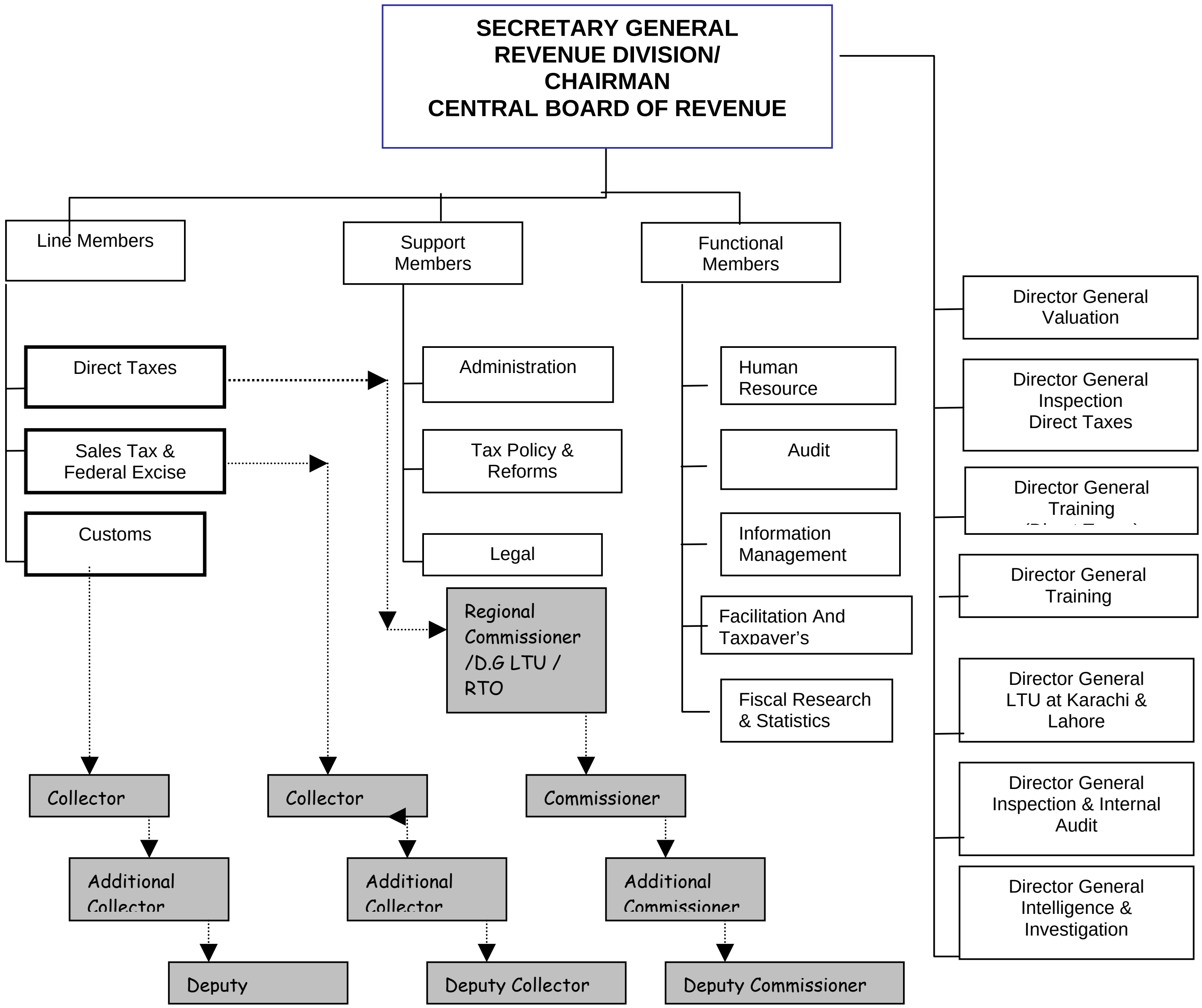
Member (Direct Taxes):is responsible for formulation of policies of Direct Taxes supervision and collection of these taxes. In the headquarters, he is assisted by four Chiefs (BPS-20) and eight Secretaries (BPS-19). In the field, Direct Taxes are administered through five Regional Commissioners of Income Tax. Two of them are based at Karachi and one each at Lahore, Multan and Islamabad. The Regional Commissioners supervise the Zonal Commissioners of Income Tax and Other Direct Taxes, who are directly responsible for collection and administration of Direct Taxes through Additional Commissioners (B-19), Deputy Commissioners (BPS-18), Assistant Commissioners (BPS-17), Income Tax Officers (BPS-16) and Special Officers.

Member (Sales Tax & Central Excise) supervises the collection of Sales tax on domestic goods, services and imports. In the Board, he is assisted by three Chiefs (BPS-20) and five Secretaries, (BPS-19), three Joint Directors (Computer) (BPS-19) and one Cost Accountant (BPS-19). Sales Tax on Imports is collected by nine Customs Collectorates and three composite Collectorates as agency function along with the Customs Duties.

Member (Customs) supervises the collection of Customs Duties by 12 Customs Collectorates in the country. In the Board, he is assisted by two Chiefs (BPS-20) and eight Secretaries (BPS-19) in the discharge of his duties

Besides these line members there are also support and functional members. Support members provide their technical and expert support to the Chairman in discharge of his duties related to the areas of these members. Member Administration and coordination is responsible for all financial and other general administrative matters pertaining to the conduct and discipline of the employees of the CBR. Member Tax Policy and Reforms is looking after and giving his expert advice in policy and reform matters. Whereas Member Legal is entrusted with the job to oversee the pending legal and adjudication matters at the level of High Courts and Supreme Court.

Figure 9: Organizational Structure of Central Board of Revenue



He is also in charge of maintaining updated database of all pending appeals with respect to various criteria's and angles.

On the other hand Functional members are the experts in their respective fields which are the major functions of a tax office. They are hired from private sector on the basis of an open competition on market based attractive packages. They formulate basic policy guide lines in their respective areas which are implemented by the line members after the approval of the Board in its meeting. This is the position after restructuring of the CBR. Previously, there were only line members appointed from the career officers of income tax and customs service. They had to look after all the affairs of their respective wings i.e. Direct Taxes and Indirect Taxes Wings. The situation has changes entirely after the restructuring of the CBR on modern lines.

Various Director General Positions are also there to perform the allied matters like training, valuation, internal inspection system, Intelligence and investigation. These are the external or attached organs of the CBR. They directly report to the Chairman.

During the process of restructuring of CBR a vision and mission statements were also evolved on the pattern of a modern organization to give its staff a clear direction of their duties and also to set the future path of the newly restructured organization. All the officers of the CBR were practically involved in this exercise. Under a systematic plan the member HRM conducted workshops in all over the country in the field offices and obtained the views and feedback of the field formations for the formulation and construction of the vision, mission and values statements as under.

Figure 10

Our Vision

To be Modern, Progressive, Effective, Autonomous and Credible Organization for Optimizing Revenue by Providing Quality Service and Promoting Compliance with Tax and Related Laws.

Our Mission

Enhance the Capacity of the Tax System to Collect Due Taxes through Application of Modern Techniques, Providing Taxpayer Assistance and by Creating a Motivated, Satisfied Dedicated and Professional Workforce.

Our Values

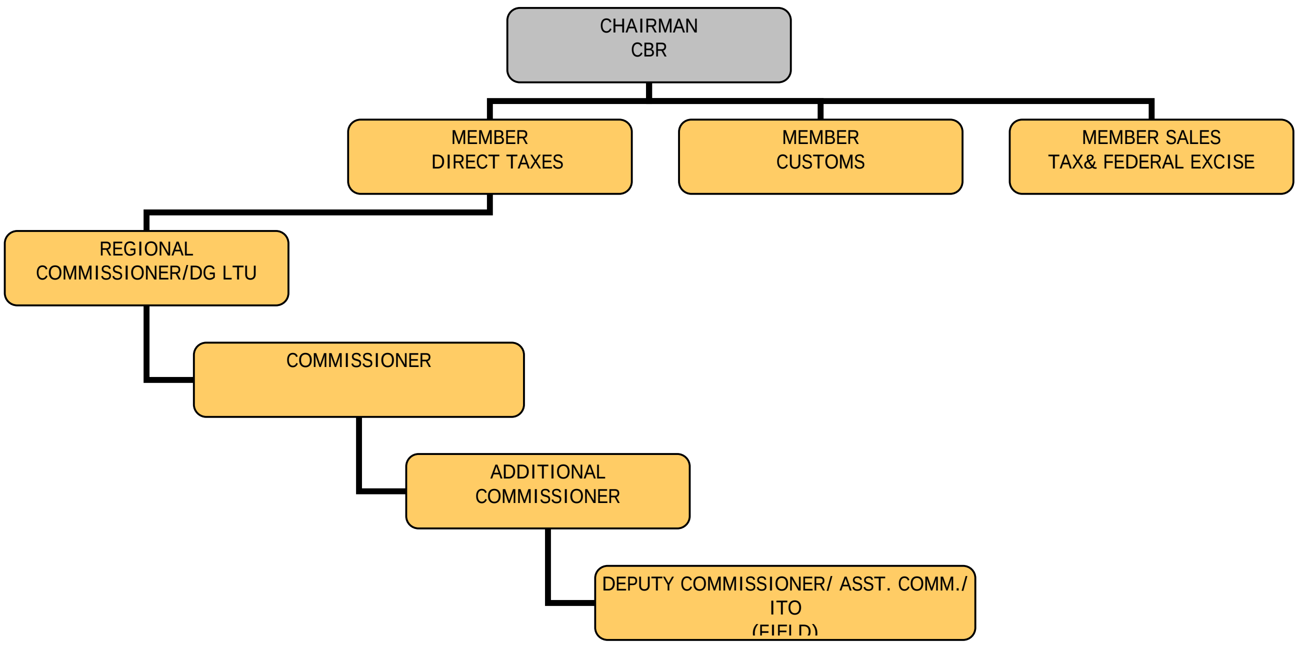
- Integrity
- Professionalism
- Teamwork
- Courtesy
- Fairness
- Transparency
- Responsiveness

III.2 Direct Tax Administration.

As discussed above there are two main wings dealing with the implementation of Taxation laws and collection of due taxes in the country at federal level. One of these is Direct Tax Wing headed by a Member Direct Taxes. There are five Regional Commissioners, Two director generals Large Tax Payers Units each at Karachi and Lahore which cater the taxation matters of large tax payers defined according to turnover threshold. Generally there are five to six zones under a Regional Commissioner headed by a commissioner. Then there are Ranges normally four to five in a zone which constitute five to six circles which is the actual working unit of the taxation matters at gross root level. The circle is normally headed by and ITO, Assistant Commissioner, or a Deputy Commissioner depending on the type and importance of the circle. The details about the types and importance of a circle shall be discussed in the following paras.

As already stated that the CBR now a days passing through a phase of administrative restructuring. The whole set up of the direct taxes is being changed to functional mode from the previous circle based system. In the new setup there would be twelve Regional Tax Offices replacing the Regions and three Large Taxpayers Units each at Karachi, Lahore and Islamabad where almost ninety percent of the head offices of the large and medium size corporations are located. For all other taxpayers twelve Regional Tax Offices are being established at Karachi , Hyderabad, Sukker, Quetta, Multan, Faisalabad, Lahore, Gujranwala, Sialkot, Rawalpindi , Abbottabad and Peshawar. The details of new functional division and their assistance by the Tax Facilitation Centers shall be discussed later in this report. However, the present organizational structure is as under.

Figure 11: Organizational Structure of Direct Taxes



III.2.1 Basic Structure and functions of a tax office

As discussed earlier, the basic structure of an income tax office is based on the concept of one unit performing all basic functions being carried out in a tax office. This basic tax office is called circle. It is headed by a circle office who is either a deputy commissioner, assistant commissioner or and income tax office. This system of administration was inherited from the British India immediately after the independence in 1947. Since than only minor changes have been brought in this basic structure from time to time and according to the need but the basic concept was never changed. The circle is normally staffed by few inspectors, one office superintendent, two or three upper division clerks, two or three lower division clerks, a notice server, a bailiff, a daftari and few peons. The total number of the staff usually remains between 12 to15. Normally following main functions are performed by a circle officer.

1) Receiving of Returns
2) Assessment of the cases selected for audit
3) Collection of raised assessment and other delinquencies.
4) Monitoring of withholding taxes falling in its jurisdiction
5) Appellate issues
6) Expanding the tax base in its area and general guidance of the taxpayers in its territory
7) Reporting to the higher authorities on performance and other information.
8) Human resource management and administrative matters of the circle.

Regarding types of circles, there are normally five types of circles in the department depending on the type of taxpayers it is dealing. The first type is salary circle dealing with the salary cases falling in an income tax zone. There are normally two to three salary circles in a zone. There is specialized circle which normally deals with certain classes of taxpayers. There are also few special circles dealing with corporate cases. They also deal with the salary affairs of the directors of these companies. Then finally all cases which do not fall in any of the above category they fall in territorial circle. Territorial circles consist of a specific territory or area. All the persons doing business activity in there area fall in their jurisdiction unless they fall in the jurisdiction of some other circle mentioned above. There are normally four to five thousand taxpayers in the jurisdiction of a tax circle. Circle offices are monitored and supervised by an Additional Commissioner who is at middle management level heading the range. A range consists of few circles. He is responsible to supervise the work of circle officers. He also provides guidance to them in day to day administrative and legal matters.

Additional Commissioners report to the Commissioner who is in charge of the zone which consists of few ranges. The Commissioner is the head of the zone. He is given a certain target of collection of taxes for a financial year. He normally divides his target to the ranges and also subsequently the range additional commissioners fix the targets of the circles under their jurisdiction. The commissioner also monitors every legal and administrative aspect of circles and ranges in his zone. He is also financial head of the zone and also hire and fire authority for the non-gazetted staff. He recruits the lower staff from the local area on the basis of a standard procedure of open advertisement and an exam to be conducted at local level for final selection of working staff. Five to six zones are monitored by a Regional Commissioner. The Regional Commissioner is assigned a target of tax collection which he divides among the commissioners/zones in his jurisdiction. There are five Regions in the country. With a manifold expansion in population and business activity it was difficult for an officer to handle such a large number of cases efficiently. He also had no support of information technology and other adequate resources to run the affairs. The system had become redundant in view of changed circumstances with the advent of new technologies and business activities. The change was therefore necessary to maintain the credibility of the tax system and to enhance the efficiency of the department. A comprehensive program of tax reform was therefore launched to change the age old system based on single unit performing all the functions to functional divisions in a Regional Tax Office. The process of transformation from the old system to the new one in underway and it is hoped that by the end of year 2009 the task of transformation from old system to new functional system shall be completed.

III.2.3 Large Taxpayers Unit

On the recommendation of the task force constituted to analyze the causes of inefficiencies in the present tax system it was decided to shift the basic working pattern of the tax system from unit based to function based. i.e. at field level one person should be responsible for one function. The first step towards this direction was the establishment of a Large tax payers unit at Karachi being the financial and business capital of the nation. The LTU at Karachi and now at Lahore has started functioning. It is an integrated tax administration, catering for all taxes, such as income tax, sales tax and federal excise duty operating jointly from one location. This interfacing and integration is likely to substantially reduce irritants to taxpayers, smooth-out the tax administration and will also prove a role model for developing the approaches, attitudes and behavior that would be followed by other organs of the CBR. Integrity, transparency, accountability and understanding of problems from taxpayer's point of view are the guiding principles of the workforce. The LTU has the mandate of collection, enforcement and audit of income tax (including the corporate and personal taxes withholding etc.), sales tax and central excise duty of around 300 Large Taxpayers in the Karachi region. While some of the selected taxpayers are liable to pay all the three taxes, the others are required to pay any two or only one of them. Notwithstanding the number of taxes paid by a taxpayer, it is being administered as a single entity by the LTU. There is close liaison between various members of CBR and Director General LTU. The new organizational structure of CBR provides that the functions of LTU will be replicated at other field formations.

Functions of LTU

The major functions of LTU are to:-

- Assist taxpayers through technical advice and taxpayer services;
- Conduct professionally competent audit;

- Assessment of cases;
- Collection of revenue;
- sanctioning and monitoring of refunds/arrears;
- Defense of cases under litigation, appellate tribunal, superior courts and other Forums.

III.2.4 Tax process

The process of tax starts with the filing of returns on or before due date by all the tax payers liable to file a return under the provisions of the Income Tax Ordinance 2001. After the due date the returns and all allied materials is consolidated and sent for the entry of data to the Central Data Entry Centre located in Islamabad. After data entry the returns are received back in the offices. In the meantime when returns are with the data entry centre the tax offices issue delinquency notices to the non-filers of returns and works out the amounts of penalties for non-filing of returns. After receipt back of the returns an exercise of desk audit is conducted to identify the risk areas since all the returns are accepted under universal self assessment system at the time of its filing. As a result of desk audit returns are classified in categories for the purpose of selecting few for detailed audit. A separate criteria is generally announced for selection of cases for audit every year. After completion of audit the taxpayers are served with the demand raised and are asked to pay it within statutory limits failing which entails penalties and additional taxes.

The taxpayer can also avail appellate remedies if he is not satisfied with the assessment raised against him. There are appellate forums starting from commissioner appeals to Supreme Court of Pakistan.

III.3 Taxpayer's rights and obligations

III.3.1 Rights

To be fair, reasonable and courteous

CBR treats the taxpayers fairly and equitably. This includes:-

- Handling of their tax affairs professionally and impartially;
- Paying respect and extending all possible help and assistance.
- Ensuring uniform interpretation and application of law in letter and spirit;
- Requiring the taxpayers to pay what is due under the law.
- Treating the taxpayers as being honest
- The CBR treat the taxpayer and his representative as honest in tax affairs unless proved otherwise.
- Be accountable for what the CBR functionaries do.
- The functionaries of CBR are obliged to act and behave in a professional manner and within the legal framework.

The taxpayers can expect the CBR to:

- Facilitate and educate them.
- Provide information and extend all cooperation to help them to understand and meet their tax obligations.
- Keep the information confidential
- Maintain confidentiality of their tax affairs and any details, documents, or declarations given during the course of any tax proceedings.

Provide access to information. It includes:

- Right to have access to the information or documents about your tax affairs relied upon by the Central Board of Revenue; and
- Right to have access to explanatory circulars and public rulings given by the Central Board of Revenue.

Taxpayers can expect from CBR to allow opportunity of being heard. It includes:

- Allowing reasonable opportunity of being heard before concluding their tax affairs;
- True appreciation of facts and circumstances relevant to your case; and
- Allowing sufficient / reasonable compliance time to respond to queries concerning their tax affairs.

- Accept their right of representation

Taxpayers can expect CBR to:

- Accept your right of appeal, review and alternate dispute resolution

CBR accepts the taxpayer's right to object:

- On disagreements over facts, figures or interpretation of law; or
- For any mistake, error or mal-administration that occurred during the conduct of their tax affairs.

The taxpayers can expect CBR to:

- Minimize their compliance cost

This is ensured by:

- Good governess with a view to facilitate, educate and help the compliant taxpayers in resolving their tax affairs;
- Charging the taxes strictly in accordance with law;
- Simplifying the tax laws and processes and introducing the concepts of self- assessment in its true spirit;
- Conducting meetings with them or their representative at agreed time;
- Finalizing proceedings in minimum possible time;
- Introducing taxpayers friendly, simple and easy to fill tax forms; and
- Providing facilitation and tax education tools (literature, brochures, leaflets, software, website, workshops, seminars, help line etc).

III.3.2 Obligations

The CBR as tax administration organ of the government on the other hand expect from the taxpayers to discharge their tax obligations correctly and faithfully.

The CBR expects from the taxpayers to voluntarily;

- Register themselves
- Comply with tax laws
- File correct, complete and candid returns and statements within the prescribed time;
- Pay due taxes;
- Maintain accounts, documents and records of their transactions;

And;

- Be truthful and honest in their dealings with tax authorities;
- Provide complete and accurate information and records, if required, as per law.

III.4 Appeals and redressal of grievances

A taxpayer aggrieved with the assessment made by the department can choose to prefer for appeal against the treatment by having resort to various options available to him.

1. He can apply to the commissioner to review the order of the subordinate authority. In this case, the Commissioner of Income tax who controls the circle where the original order was made may review the order. In this case, the appellant must waive his further right of appeal and accept the order of the commissioner as final.
2. The taxpayer can file an appeal before Commissioner of Appeals to redress his grievance.
3. If the taxpayer is still unsatisfied with the order passed by the appellant authority, he can choose to appeal against the order of Commissioner Appeals in Income Tax Appellate Tribunal. This appellate authority is independent from the income tax department and is under the Ministry of Law and justice. This is the highest appellate authority to probe the factual matters involved in the issue before it.
4. If the appellant is still aggrieved with the decision of Income Tax Appellate Tribunal, with enough legal ground he can further make a reference to the High and finally if high court feels that the issues still requires to be thrashed out by the Supreme Court It may refer the matter to the Supreme Court of Pakistan. The verdict of the Supreme is final.

5. The taxpayer can also prefer to consult the newly created forum of Alternate Dispute Resolution at the same time even his case is pending before some higher court. This mechanism is governed by the provisions of section 134 of the Income Tax Ordinance 2001.

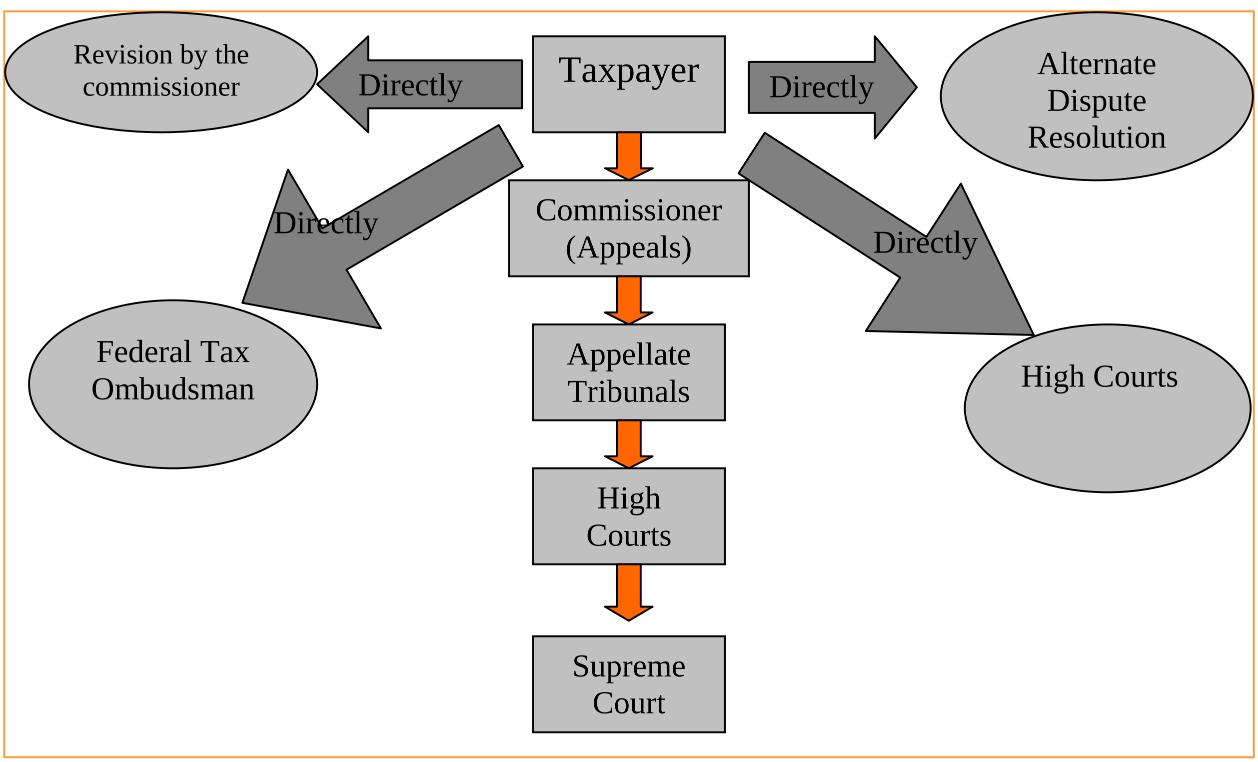
Separate Committees have been created for all major areas of the country. The good thing about these committees is that representatives of business community are also members of these committees. This not only enhances the trust of the taxpayers on the sanctity of the committee but also make him convince to believe in the transparency of the whole process.

6. Few years back the government to improve the business friendly environment and to create a judicious approach in the tax collector's behaviors has created the office of Federal Tax Ombudsman. This office has been very effective and successful since its inception in containing the unbridled use of authority by the tax officers. It has also been able to create an atmosphere of respect for the law among the taxpayers and tax collectors both. A retired judge of Supreme Court is appointed as Tax Ombudsman for tenure of four years. This institution by resorting to the principles of equity, justice, impartiality and speedy trials has gained confidence of the taxpayers. Any taxpayer facing any maltreatment or maladministration by any tax functionary can file an application.

There is no fee of any kind. This has become the cheapest and most reliable forum for the taxpayers. As a matter of policy in the very start of its establishment this institution had a clear tilt and partial approach towards the taxpayers and used to treat the tax collectors more harshly. It also gave some decisions against which the affected staff member even preferred appeals before the office of the President of Pakistan who is the appellate authority against his decisions but now with the passage of time it has attained balance approach and now tries to be impartial and in significant number of case it has given its verdicts in the favor of the department.

Further, with the continuous process of appeals against its decision it has been helpful in distinguishing maladministration from purely legal issues.

Figure 12: Appellate forums in Pakistan



III.5 Latest Income Tax Rates

A system of simplified self assessment has been introduced specially for salary and property income earners with the financial year starting from 1st of July 2006. Most of the exemptions in salary cases and all in the case of property income have been abolished and tax payers have to offer their gross incomes for the purpose of application of tax rates. On the other hand the tax rates have been slashed to minimum and number of progressive slabs have also been revised in such a way that ultimate tax liability has not altered.

But the biggest facility to the taxpayers is that they do not to be involved in lengthy calculation or to have the knowledge of complicated tax provisions to arrive at their taxable income. All they have to do gross up their incomes by whatever name they receive and apply the tax rates to work out the tax payable. This policy has been welcomed by majority of taxpayers especially low income earners from property or salary who could not afford to engage a tax lawyer.

Table 27: Tax Rates for the Individuals Other than Earning Salary Income.

S. No. (1)	**Taxable income (2)**	**Rate of tax. (3)**
1	Where taxable income does not exceed Rs.100,000	0%
2	Where the taxable income exceeds Rs.100,000 but does not exceed Rs.110,000	0.50%
3	Where the taxable income exceeds Rs.110,000 but does not exceed Rs.125,000	1.00%
4	Where the taxable income exceeds Rs.125,000 but does not exceed Rs.150,000	2.00%
5	Where the taxable income exceeds Rs.150,000 but does not exceed Rs.175,000	3.00%
6	Where the taxable income exceeds Rs.175,000 but does not exceed Rs.200,000	4.00%
7	Where the taxable income exceeds Rs.200,000 but does not exceed Rs.300,000	5.00%
8	Where the taxable income exceeds Rs.300,000 but does not exceed Rs.400,000	7.50%
9	Where the taxable income exceeds Rs.400,000 but does not exceed Rs.500,000	10.00%
10	Where the taxable income exceeds Rs.500,000 but does not exceed Rs.600,000	12.50%
11	Where the taxable income exceeds Rs.600,000 but does not exceed Rs.800,000	15.00%
12	Where the taxable income exceeds Rs.800,000 but does not exceed Rs.10,00,000	17.50%
13	Where the taxable income exceeds Rs.10,00,000 but does not exceed Rs.13,00,000	21.00%
14	Where the taxable income exceeds Rs.13,00,000	25.00%

Source: Income Tax Ordinance 2001

Table 28: Tax Rates for Companies

Tax Year (1)	Banking Company (2)	Public company other than a banking company (3)	Private company other than a banking company (4)
2003	47%	35%	43%
2004	44%	35%	41%
2005	41%	35%	39%
2006	38%	35%	37%
2007	35%	35%	35%]

Source: Income Tax Ordinance 2001

Table 29: Rates for the Tax Payers Earning Income from Salary

S. No.	Taxable income	Rate of tax.
(1)	(2)	(3)
1.	Where taxable income does not exceed Rs.150,000	0%
2.	Where the taxable income exceeds Rs.150,000 but does not exceed Rs.200,000	0.25%
3.	Where the taxable income exceeds Rs.200,000 but does not exceed Rs.250,000	0.50%
4.	Where the taxable income exceeds Rs.250,000 but does not exceed Rs.300,000	0.75%
5.	Where the taxable income exceeds Rs.300,000 but does not exceed Rs.350,000	1.50%
6.	Where the taxable income exceeds Rs.350,000 but does not exceed Rs.400,000	2.50%
7.	Where the taxable income exceeds Rs.400,000 but does not exceed Rs.500,000	3.50%
8.	Where the taxable income exceeds Rs.500,000 but does not exceed Rs.600,000,	4.50%
9.	Where the taxable income exceeds Rs.600,000 but does not exceed Rs.700,000,	6.00%
10.	Where the taxable income exceeds Rs.700,000 but does not exceed Rs.850,000,	7.50%
11.	Where the taxable income exceeds Rs.850,000 but does not exceed Rs.950,000,	9.00%
12.	Where the taxable income exceeds Rs.950,000 but does not exceed Rs.1,050,000,	10.00%
13.	Where the taxable income exceeds Rs.1,050,000 but does not exceed Rs.1,200,000,	11.00%
14.	Where the taxable income exceeds Rs.1,200,000 but does not exceed Rs.1,500,000,	12.50%
15.	Where the taxable income exceeds Rs.1,500,000 but does not exceed Rs.1,700,000,	14.00%
16.	Where the taxable income exceeds Rs.1,700,000 but does not exceed Rs.2,000,000,	15.00%
17.	Where the taxable income exceeds Rs.2,000,000 but does not exceed Rs.3,150,000,	16.00%
18.	Where the taxable income exceeds Rs.3,150,000 but does not exceed Rs.3,700,000,	17.50%
19.	Where the taxable income exceeds Rs.3,700,000 but does not exceed Rs.4,450,000,	18.50%
20.	Where the taxable income exceeds Rs.4,450,000 but does not exceed Rs.8,400,000,	19.00%
21.	Where the taxable income exceeds Rs.8,400,000.	20.00%

Source: Income Tax Ordinance 2001

III.6 Withholding Taxes

Like other countries in the world tax at source or withholding tax has also been used as safer and popular mean to collect tax in advance and at source. It becomes a source of irritant for the taxpayers, when it is treated as full and final discharge of their tax liabilities. When the options of adjustment of their tax withheld at source is not provided under the law to certain classes of taxpayers. Some major sectors of the economy at present are covered under presumptive tax regime.

Their receipts are treated as their income under the deeming provisions of law. Government collects almost 70 % of its taxes through withholding activity. Corporations, The federal and provincial governments, local authorities, foreign companies and missions and the persons paying taxable salary are treated as withholding agents under the law. They are obliged to withhold tax from certain payments and deposit it in the government treasury within seven days of deduction.

Table 30: A summary of withholding rates and relevant transactions

From whom	Rate	On
Importers of goods	6%	Value of goods as determined under section 25 of the Customs Act, 1969,
Employee	Annual average rate (to be calculated as per rate card subject to applicable reductions in tax)	Salary chargeable to tax
Shareholders	In case of: Public Company 5%,Insurance Company 5% Any other resident company- 5% Others -10%	Gross amount of dividend
Recipient of yield or profit (profit on debt)	10%	Yield or profit (profit on debt) on an account, deposit or a certificate under the National Savings Scheme or Post Office Savings
Recipient of profit on debt on an account or deposit	10%	Profit on debt on an account or deposit
Recipient of profit on any security (profit on debt)	10%	Profit on debt on any security (

Recipient of Profit on debt	10%	Profit on debt on any bond, certificate, debenture, security or instrument of any kind
Non-Resident Person	15% or lower rate as per agreement for avoidance of double taxation	Gross amount of royalty or fee for technical services
Non-Resident Person	6% or lower rate as per agreement for avoidance of double taxation	Gross amount of payment on account of execution
Non-resident Person	30% or lower rate as per agreement for avoidance of double taxation	Gross amount of any payment chargeable to tax including profit on debts but excluding royalty and fee for technical services
Resident Person Permanent Establishment in Pakistan of a Non-Resident	Sale of: Rice, cottonseed or edible oils 1.5% Any other goods 3.5% Services rendered or provided 6% Execution of contract 6%	-Gross amount of payment on account of: Sale of goods (inclusive of sales tax); -Rendering or providing of services; and -Execution of a contract, other than a contract for the sale of goods or rendering of services.
Exporter of goods Foreign indenting commission agents	Export of goods listed in: Part I of the 7th Schedule -0.75%, Part II of the 7th Schedule-1.00%,Part III of the 7th Schedule -1.25% ,Part IV of the 7thSchedule-1.50%,Foreign indenting commission-5.00%	Foreign Exchange proceeds
Recipient of rent of immovable property	5%	Rent of immovable property (including rent of furniture and fixtures, and amounts for services relating to such property)
Recipient of prize bonds	10% - On prize of a prize bond	Prize on a prize bond;
Every Person making a cash withdrawal exceeding Rs. 25,000 per day	0.2%	Amount withdrawn in excess of Rs. 25,000 per day
Recipient of brokerage or commission	10%	Brokerage and Commission
Members of the stock exchange	0.01%	Purchase and/or sale value of the shares
Owner of motor vehicle	In the case of goods transport vehicles ranging from Rs. 1,200 to Rs. 36,000 per annum In case of passenger transport vehicles plying for hire ranging from Rs. 25 to Rs. 100 per seat per annum Other private motor cars ranging from Rs. 500 to Rs. 3,000 per annum	Registered laden weight of transport vehicles Registered seating capacity of passenger transport vehicles plying for hire Engine capacity of other private motorcars
Commercial and Industrial consumers of electricity	Ranging from Rs. 60 to Rs. 2,000 of the monthly bill	Amount of electricity consumption charges
Telephone subscriber Purchaser of prepaid telephone cards	In the case of telephone subscriber (other than mobile phone) ranging from Rs. 50 to Rs. 300 of the monthly bill In the case of subscriber of mobile telephone and prepaid telephone card - 10% of the amount of bill or sales price of pre-paid telephone card	Amount of bill or sale price of a pre-paid card

III.7 Treaties for Avoidance of Double Taxation

As an active member of various world organizations Pakistan has also entered in to treaties for avoidance of double taxation with fifty four countries until today. The treaties are also re-negotiated regularly in accordance with change in the nature of relations and to respect various protocols entered into. Being the secretary Revenue Division the Chairman CBR has been given complete responsibility to negotiate the treaty with the tax authorities of the foreign governments.

III.8 Advance Ruling

With a view to remove any confusion and to avoid disputes in respect of determination of the income tax liability of a non-resident person, a procedure of Advance Rulings has been brought on statute by way of incorporating Section 206A into the Income Tax Ordinance, 2001, with effect from 1.7.2003. Through this facility non-residents can obtain, in advance, a binding ruling on the issues that could arise in determining their tax liabilities at a later stage. Therefore, time consuming and expensive legal disputes can be avoided. The Centre Board of Revenue is empowered to determine any question of law or of fact as specified in the application made before it in respect of a transaction which has been undertaken or is proposed to be undertaken by a non-resident in Pakistan on its own or in combine with a resident concern. Five rulings have been issued in various cases until now.

III.9 Indirect Tax Administration

Within the Central Board of Revenue there is another wing called Indirect taxes wing. It consists of the administration of Customs duties, Sales tax and excise duties. There are two line members in this wing. The Member Customs is the administrative head of Customs department and Member Sales Tax and Federal Excise is responsible to oversee the work of the sales tax and federal excise departments. These members report to the chairman CBR for their performance. The activities of levying customs duties are carried out within the four walls of Customs Act.1969 as amended from time to time, whereas Sales Tax and Federal Excise are administered through Sales Tax Act.1990 and Federal Excise Act 2005 respectively.

III.9.1 Sales Tax

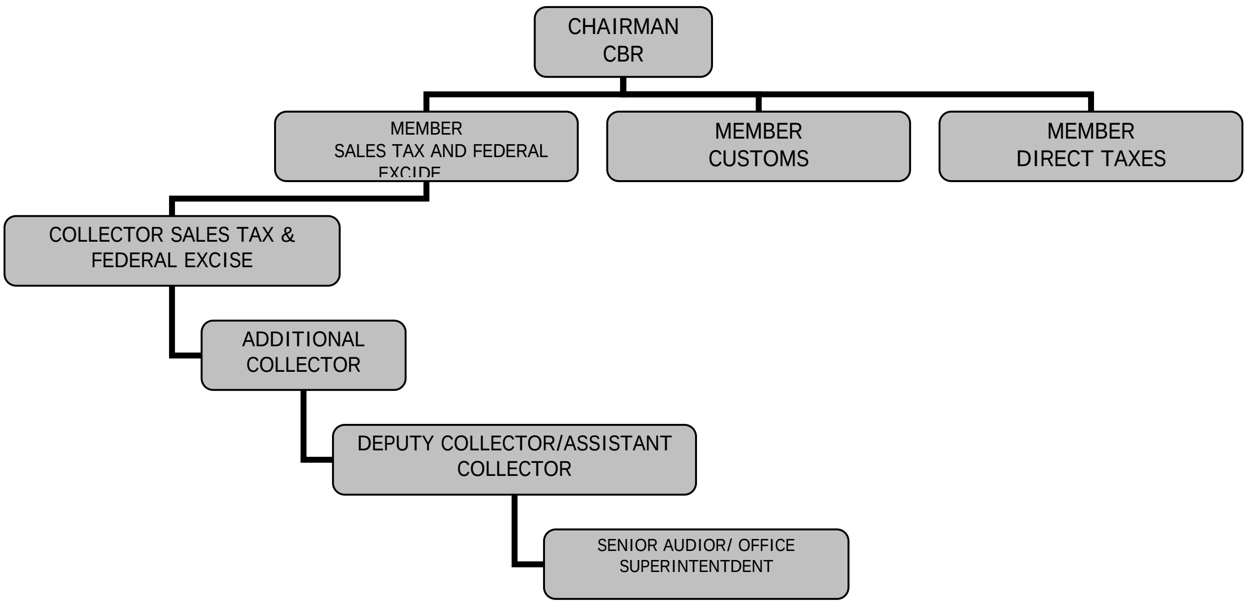
Sales Tax was introduced for the first time in 1949 at a very limited level and on few items. It remained very insignificant until 1990 when in the wake of revenue needs and to transform the taxation system in line with the modern practices in the world a new Sales Tax law was enacted. The sales tax has gradually become the largest single tax of CBR. Many excisable items were replaced by Sales tax gradually. The mechanism of sales tax is the same that of a modern VAT which shall be discussed later in this report.

As stated above A Member Sales Tax & Federal Excise is the overall in charge of these two departments. There are collectors of sales tax and federal excise reporting to him. They head the Collectorates of Sales Tax and Federal Excise. They are assisted by a number of Additional Collectors. The job of these Additional Commissioners is to supervise and guide the Deputy/Assistant Collectors. The Deputy or Assistant Collector is normally the heads of a division in the collectorate. They have a certain number of staff in their subordination that assists him in the discharge of his duties. The staff members normally consist of one senior auditor, a superintendent, few clerks, bailiff, and few peons. Since the Sales Tax department was reorganized in 1990 therefore a system of functional divisions was adopted from the very start. Presently there are Enforcement, Audit, Refunds, Intelligence and investigation, Registration, Legal, HRM and IT divisions in a Sales Tax office.

Sales Tax system in Pakistan functions under the legal framework of Sales Tax Act 1990 and Rules made under Sales Tax Act 1991. As per Sales Tax Act, a flat tax rate of 15% is chargeable on all goods and services at import stage and on all goods and services produced or provided in Pakistan except otherwise provided at every stage when the title of the goods and services of the concerned transaction is transferred.. The exceptions are basic agricultural products, animals and unpacked or processed animal products, education, books, magazines, newspapers, postal services and passengers and goods transportation services etc. Besides, according to the law, any person engaged in selling of goods and services at retail level and subject to sales tax having yearly sale of more than five million rupees has to pay Turn-over Tax at the rate of 2% on the amount of the annual sale. The sales tax collection system in Pakistan is also based on Self Assessment System. Every Taxpayer subject to sales tax has to furnish a monthly return declaring his turnover and showing the difference of input and output tax credits claimed and also declaring other basic information. The returns are processed in elaborate computer software and cases are selected for audit.

Every taxpayer is registered with the Sales Tax Department and allocated a Sales Tax Registration number which the taxpayer has to quote everywhere and also to print on the cash memos and other books. The taxpayer is also required to maintain prescribed books of accounts which should be updated and ready for inspection in case of audit.

Figure 13: Sales Tax Organization



The sales tax has emerged as one of the two main revenue sources of federal tax receipts. Due to its buoyant nature, the reliance on GST has increased manifold over the years. This is evident from the fact that the share of GST has reached 41.4% in the total federal tax collection during FY: 05-06 as against 18.6% in FY: 95-96 when it was transformed into full fledged value added tax. The gross sales tax collection of Rs. 327.1 billion and net collection of Rs. 294.6 billion during FY: 05-06 was higher by 11.5% and 23.5% over the corresponding period of previous financial year. The performance of Sales tax for domestic sector indicates that around 71% of gross collection has been generated by ten major revenue spinners during FY: 05-06 as against 65.4% during PFY. Among the leading resource generators, the shares of telecom and petroleum products have been around 36%. Similarly, the sales tax collection from natural gas and electrical energy was close to 9% each. The reason for this performance has been multi-faceted. For instance, the increase in collection from POL by 16.5% was mainly due to the price factor. It is now common observation that international prices of energy are constantly increasing over the last few years.

III.9.2 Customs

Customs department is headed by a member customs at the level of CBR. It is further divided into Collectorates headed by a Collector and staffed by Additional Collectors and Deputy/Assistant Collectors.

Largest establishment of Customs department is in Karachi which is also the main port and largest business center of the country. There are also dry ports in up country in major cities of Hyderabad, Quetta, Multan, Faisalabad, Lahore, Sambarial, and Peshawar which facilitates the export and import activities. Pakistan Customs is the guardian of Pakistan borders against movement of contra band goods and is facilitator of bona fide trade. It provides a major source of revenue to the Government of Pakistan in the form of taxes levied on the goods traded across the borders. It also helps to protect the domestic industry, discourage consumptions of luxury goods and stimulate development in the under -developed areas. Pakistan became the member of WTO in 1995 as one of its founding members and is following the decisions of the organization. The share of revenue from customs has decrease manifold since 1990. The collection from customs duty used to account for 45 percent of total collection and 55 percent of indirect taxes in 1990-91. Its share has now been reduced to 17 percent and 25 percent, respectively. This is the consequence of the tariff reform implemented by successive governments since 1990-91.

Federal Excise as a tax is loosing its importance and gradually being faded out or being replaced by sales tax. Its share in total and indirect taxes were 22.5 percent and 27.5 percent, respectively, in 1990-91. These have now been reduced to 8.6 percent and 12.6 percent, respectively.
The pace of change in the tax structure, particularly in indirect taxes has gained considerable momentum over the past five years. The share of customs' collection has declined from 33 to 25 percent and the share of central excise has declined from 31 to 13 since 1998-99. The share of sales tax increased from 36% to 62.5%.

Table 31: Composition of Federal Taxes

YEAR	DIRECT TAXES	INDIRECT TAXES
1999-00	32.5%	67.5%
2000-01	31.8%	68.2%
2001-02	35.3%	64.7%
2002-03	33.0%	67.0%
2003-04	31.7%	68.3%
2004-05	33.2%	66.80%
2005-06	34.1%	65.90%

Source: Central Board of Revenue

III.10 Recent Reforms and its impact

The tax administration reforms focus on: management and institutional development; improving revenue operations; strengthening revenue services; tax compliance culture; adopting responsive IT system; infrastructure up-gradation and development, and program management. The tax administration reform strategy is concentrated on policy reforms, administrative reforms and Organizational reforms. The policy reforms cover simplification of laws, introduction of universal self-assessment, elimination of exemptions, reducing dependence on withholding taxes, and effective dispute resolution mechanism. The administrative reforms aim at transforming income tax organization on functional lines, re-engineering of manual processes of all taxes with the aim to reduce face to face contact between taxpayers and tax collectors, increasing effectiveness of CBR, and improving skills and integrity of the workforce. The organizational reforms include re-organization of CBR headquarter on functional lines, reduction in number of tiers, reduction in workforce from existing level with enhanced financial packages. Simultaneously, the Government has constituted a Cabinet Committee for Federal Revenue (CCFR) to provide functional autonomy to CBR. CBR has already re-structured it's headquarter operations.

In the tax administration reform program, substantial investment is being made in infrastructure development, end-to end automation of business processes, and human resource development. Tax administration reforms in the CBR include among others, comprise promulgation of new income tax law, universal self-assessment system for income tax, intensification of GST management, streamlining of refund system of sales tax, introduction of the DTRE Scheme, and establishment of Large Taxpayers Units (LTUs) and Medium Taxpayers Units (MTUs) in the country. Another development that has reduced considerable hassle of the taxpayers is the speedy clearance of goods at Karachi port under the CARE

Project. This project has introduced computerized Processing of Customs documents (PACCS) under which the "Goods Declarations" can be filed by an importer "on line" without physical interaction with customs officials. The processing has reduced the clearance time of goods to few hours from more than ten days.

This step reduced the up-front the cost of doing business considerably. This new system has revolutionized the working of Pakistan customs, which is now at par with the modern set ups.

In the year 2005, the government has launched Tax Administration Reform Project (TARP) at a cost of $149 million with the assistance of World Bank. This program is for five years and aimed at further boosting the ongoing reforms initiatives. Main feature of the TARP is developing an overall human management strategy; promote tax compliance culture, develop a communication program, computerization and appropriate registration system. Thus, the future set up envisages a clear segregation in the operations of domestic and international taxes. Whereas all domestic taxes will operate through Regional Tax Offices (RTOs), the international trade taxes will be handled within a One Window Customs setup. The creation of RTOs will not only lead to co-location of the offices of Income and Sales Taxes (including excise duties), but more so, the strengthening of computerization and networking. The later will thus ensure that sharing of information takes place instantaneously. At the same time, the One-Customs will ensure equal treatment of taxpayers at each entry point, i.e., at sea and dry ports and at airfreight units.

Outcomes of Reforms

Wide-ranging tax and tariff reforms, as well as reforms in tax administration, have been beneficial. During the five years from 2000-01 to 2005-06, tax collection by the CBR increased by 81.0%. The revenue deficit (the difference between total revenue and total current expenditure), a measure of government dis-saving, was at a deficit of 0.7% of

GDP in 2004-05 compared to a deficit of 2.2% in 2000-01. It has further progressed towards almost elimination at 0.03 percent of GDP in 2005-06. Pakistan has attained revenue surplus first time since 1984-85 in 2003-04 when it recorded 0.8 percent of GDP surplus. In the recent two years revenue deficit existed though at an insignificant level as a result of some unavoidable increase in committed expenditure heads.

The primary balance (total revenue minus non-interest total expenditure) was at a surplus from 2000-01 to 2003-04 and only registered a surplus of 0.1% of GDP in 2004-05 due to increased spending on social sector development programs. An unwelcome development of the current year is emergence of primary deficit first time since 1996-97.

Pakistan economy badly need adequate primary surplus at this critical juncture of fiscal stabilization. The positive aspect of reforms is the structural transformation in the structure of taxes which has undergone considerable changes since the 1990s. Firstly, the share of direct taxes in total taxes (collected by the CBR) has increased from 18 percent to over 31.0 percent in 2005-06. The share of indirect taxes declined from 82 percent to 69 percent during the same period. Even within the indirect taxes, dramatic changes have taken place. The collection from custom duty used to account for 45 percent of total tax collection and 55 percent of indirect taxes in 1990-91, its share has now been reduced to 20.2 percent and 26 percent, respectively. This is the consequence of the tariff reform implemented by successive governments since 1990-91. The share of sales tax increased at a tremendous pace from 14.4 percent to 40 percent of total taxes and from 17.6 percent to 62.5 percent of indirect taxes during the same period. Central excise as a tax is loosing its importance and gradually being faded out. Its shares in total taxes and indirect taxes were 22.5 percent and 27.5 percent, respectively in 1990-91. These have now been reduced to 8.4 percent and 11.5 percent, respectively during the same period. The basic philosophy of tax and tariff reforms has been to move away from investment and production-based taxes (indirect taxes) to income (direct taxes) and consumption (sales tax)-based taxes. Pakistan has succeeded in changing the composition of its taxes, but much more efforts will be required to enhance the share of direct taxes in the total taxes which is 32% now when compared with 18% in 1990.

IV. Country Specific Fiscal Issues

Like all other developing countries that are in their take-off stage of economic development, Pakistan is also facing some peculiar fiscal problems and issues which are specific to its history, location, geography and socio-ethnic situation. Although the list can be stretched to many issues directly or indirectly related to the sphere of fiscal activity of the government, but only major and directly related issues to the fiscal policy are discussed in the following.

Debt Servicing

As also discussed in the preceding paras, Pakistan is trapped in the vicious circle of huge debts having both foreign and local origin. 304.8 billion rupees were set apart for debt serving out of total public outlay of 1196 billion rupees which comes to 25.41% of total expenditure in the budget for financial year 2005-06.In 1980-81, almost 12 percent of total revenues were consumed for debt servicing and by 1989-90 this increased to almost 39 percent. By end of 1990 (in 1999-2000), almost 69 percent of total revenues were being consumed by one budgetary item, namely, debt servicing, leaving only 31 percent to be spent on development programs, the social sector, civil administration, defense etc. Quite naturally, it was highly inadequate to finance these budgetary items. The high and growing public debt burden has always been the major source of the sharp slowdown in Pakistan's economic growth, to less than 4 percent per annum in the 1990s and the consequent increase in poverty incidence by 1999-2000. However, due to prudent economic management of debts by paying off costly loans on priority and rescheduling of loans by Paris Club and other international organizations, during the last six years, the debt servicing liabilities have declined sharply from 65.4 percent of revenue in 1999-2000 to 27.8 percent of revenue and from 53.5 percent to 27.8 percent of current expenditure in 2005-06. The subsequent fiscal space created by bridging the revenue-expenditure gap and low debt servicing cost has enabled the Government to increase poverty and social sector related expenditures from Rs. 89.8 billion or 2.2% of GDP in 2000-01 to Rs. 326.7 billion or 4.2% of GDP in 2005-06.

Defense Expenditure

Pakistan's expenditure on defense and related areas has always been very high and disproportionate to its size of economy, area, population and resources. There are many contributing factors to this situation. The very first and most important factor is our relations with our gigantic neighbor India from the very independence of the country from the British rule in 1947. Due to dispute over Kashmir and others areas like Siachin and Sir creak we have been even pushed into war three times by our neighbor. In the wake of this history to incur disproportionately high defense expenditure is an unwanted necessity for a developing country like Pakistan. The result is the slow pace of overall social and economic development. The funds otherwise to be spent on building of infrastructure required for the accelerated growth of society are being diverted to this unproductive area. This situation can be rectified only through a political process and a separate subject. Anyway, this is one of the specific fiscal issues concerning Pakistan.

Conducive environment for investment

As every other developing country in the world Pakistan also aspires for inflow of foreign investment which not only supports the growth of and momentum of economic activities but also helps creation of employment opportunities for the locals. The inflow of investment also improves the position of foreign exchange of a country. Pakistan is a large country with abundant human and natural resources but lacking financial resources. Pakistan is striving hard for creating conducive environment for foreign investors. Pakistan has also introduced many laws guaranteeing security of investments and other rights. Doing business is now very easy in Pakistan. Free mobility of foreign exchange and profits, hundred percent equity owned by foreign investors , creation of Board of Investment are few other important instances which shows the level of seriousness of the government of Pakistan for attracting foreign investment. This is also one of the important issues for my country.

Reform of the Central Board of Revenue and improving tax to GDP ratio

As discussed in earlier topics; the tax system always plays the role of a backbone in the economy of a country. With the changing dynamics of World politics self-reliance is the only way out for poor nations. The taxes are the main source of a country's income and an apparatus for resource mobilization. Central Board of Revenue also requires comprehensive restructuring and administrative overhaul to raise the almost stagnant tax-GDP ratio since late nineties. As discussed the government of Pakistan is working on program named TARP (Tax Administration Reform Project) under the supervision of the World Bank. This project is scheduled to be completed by the end of year 2009. It is hoped that Pakistan will be able to bring its tax-GDP ratio from ten percent to 15% by the year 2015 as planned.

Privatization of state owned enterprises.

Privatization of state owned enterprises is another area where there are challenges and issues both in front of the government of Pakistan. The government in 1973 under the influence of Communist school of thought managed to nationalize many large industrial units, banks and other companies. In early nineties again, with the change in the direction of wind Worldwide, the emergence of Uni-polar World and dominance of capitalist philosophy the government started to privatize the earlier state owned business organizations. For this purpose a separate ministry headed by a federal minister was created. The guiding principle was to give priority to those units which were sick and demanded immediate rehabilitation.

Unfortunately, this has not been strictly adhered to. Many profit making organizations have been privatized first motivated by political affinities and benefits. The element of transparency has also been ignored in most of the cases. Gradually, this issue was noted by the general public on the whole and following severe criticism and even suo-moto interference by the higher courts the government had to follow the rules of transparency of the process but still a sizeable number of people have reservations on the whole process. The spending of privatization proceeds is another issue which often becomes the headline of the newspapers.

Trade gap and Export diversification.

Pakistan's export base is very narrow both in terms of merchandize exported and the countries where they are sent. At the same time the trade gap despite strenuous efforts on the part of government is also beyond manageable limits. For this the government has to encourage the export of value added products instead of semi-finished or raw materials. It also has to diversify in terms of destination of its exports. This area also needs special attention.

V. Conclusion: Where we stand and where we go.

Pakistan is a developing country having better resource base, strategic location thus with promising future but as well as many challenges to face. Pakistan has been suffering from political instabilities right from its creation. All it lacks is a stable and consistent political system otherwise it has all potential to grow at a fast pace and develop itself into a modern country. After nine eleven incident it has even more challenges to face on many fronts especially the rise of domestic extremism. One thing however is sure that these segments are a very negligible part of the whole population. Majority is with moderate approach desirous to live with peace with the World community.

Modernization of revenue authorities is another crucial area which can be the key to success and determine a concrete path to a developed future. As discussed earlier the government is committed to re-organize the CBR on modern footings as a dynamic and effective organization.

Another important area is to cultivate friendly ties with our neighbor by resolving all contentious issues. This will not only ensure political stability but also get the funds spared from defense for the development of infrastructure necessary for rapid growth.

Consistency of economic policies is another area which requires serious attention. This aspect basically ensures the confidence of the investors and thus accelerated growth of the economy. In past every successive regimes introduced their own policies by nullifying the policies and guarantees by their predecessors. This state of affairs shook the confidence of the investors and gave way to the flight of capital from the country. Since year 2000 however, consistency has been observed to some extent in the policies of the government. The continuation of policies in the long run and honoring the commitments will also allow the country to build a strong economy by attracting FDI to a reasonable extent.

Maintenance of law and order should be another priority of the government. Since no one in the world would endanger his life and property for reaping even heavy profits in a high demand market. Unfortunately, government has not been actually successful on this score. The general law and order situation is not so good especially in rural and far flung tribal areas which are also rich in mineral and other resources. This situation not only prevents and discourages the foreign investors to bring their capital to Pakistan but also force the local businessmen to establish their business in neighboring countries especially the UAE. The government should not only take concrete steps to ensure safety of the lives and properties of the people but also should make sincere endeavor to present a better image in front of the world regarding law and order.

Contrary to its growth potential and rich resources Pakistan is facing a serious crisis of energy. It is consuming its own sources of natural gas and petroleum at a fast pace and is not developing other reliable source of energy seriously especially hydel energy for which Pakistan has a great potential because of having many rivers and natural locations for large dams. Unfortunately due to lack of consensus and political harmony among the federating units we have not been able to construct any large dam since late sixties. This situation requires immediate attention and long term planning, because cheap energy can be a crucial factor in keeping the Pakistani products competitive in the world market and also to maintain a high and consistent economic growth rate. Pakistan by realizing the gravity of situation has however initiated few steps which includes starting work on some dams, negotiating cheaper gas import from Iran and start of construction work on a gas pipeline to import natural gas from Turkmenistan in central Asia but Pakistan still needs lot more to do to maintain its high economic growth rate which fortunately has been around seven percent for the last six years.

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