Chapter 14

FISCAL, MONETARY AND CAPITAL MARKET DEVELOPMENT

Major challenges on the fiscal front include an ever-increasing fiscal deficit due to power sector subsidies, expenditure on the loss-making public sector enterprises and declining tax-to-GDP ratio. Thus the fiscal policy has to ensure a sustained fiscal position by having targeted subsidies in all sectors, mobilising domestic resources, broadening the tax base and prioritising the public expenditure in line with the growth and development objectives of the Plan. The monetary policy will supplement the fiscal policy by maintaining price stability, strengthening the financial sector and ensuring availability of credit to the productive sectors of the economy for facilitating their expansion. Ultimately, the aim is to gear up fiscal and monetary policies towards achieving robust growth, while simultaneously ensuring macroeconomic stability.

Situational analysis

Pakistan's fiscal situation is under stress mainly owing to stagnancy in tax mobilisation, declining tax-to-GDP ratio and higher expenditure. During the last five years, the revenue generation has recorded dismal performance, and total revenue has declined from 14 per cent in 2008-09 to 13.3 per cent of the GDP in 2012-13. On the other hand, total expenditure rose from 19.2 per cent in 2008-09 to 21.5 per cent in 2012-13, while the current expenditure remained high at 16.4 per cent as compared to 15.5 per cent in 2008-09. The development expenditure has declined from 3.6 per cent in 2008-09 to 3.5 per cent in 2012-13. Consequently, the fiscal deficit on average stood at 6.6 per cent. In fact, this deficit rose to 8.2 per cent in 2012-13 from 5.2 per cent in 2008-09. (All percentages have been calculated as per the GDP.)

The main reasons for overshooting of the fiscal deficit during 2008-13 have been huge increases in interest payments, higher than budgeted energy and food subsidies, circular debt consolidation, increase in salaries and pensions, rising current expenditure, losses of public sector corporations, cost of the War on Terror, expenditure on rehabilitation and reconstruction of damages caused by the floods of 2010 and 2011, expenditure on the Internally Displaced Persons (IDPs),and tax and non-tax revenue slippages. This persistence of high fiscal deficit has ballooned the public debt by 133.3 per cent, from Rs6,126 billion in June 2008 to Rs14,293 billion in June 2013. It went further up to Rs15,996.5 billion in June 2014 and Rs16,936.5 billion in March 2015.

During 2003-2013, Pakistan's overall tax-to-GDP ratio remained stagnant at about ten per cent on average, whereas India and Sri Lanka have better tax-to-GDP ratios than Pakistan.

Resource mobilisation in developing countries

The need for additional revenue is substantial for many developing countries, but improving revenue mobilisation has more importance. Global experience shows that progress can be made given strong political will since a common element of success-stories is a sustained political commitment at the highest level even when administrative reforms can prompt strong opposition. However, reforms must be entrenched to avoid subsequent slippages.

Empirically, several countries have significantly improved their tax performance in relatively short periods, and analysis (comparing performance of differing countries) suggests that many lower-income countries can increase their tax ratios by two to four per cent of the GDP. While some (such as Egypt and Pakistan) show little or no improvement in tax ratios over extended periods, others have made impressive progress. Peru, for instance, increased its tax ratio from six to 13 per cent over the 1990s and to about 17 per cent now. Some have achieved sustained revenue increases of four to five per cent of the GDP over just a few years. During the last decade, El Salvador, Tanzania and Vietnam made substantial progress on tax mobilisation. Key tax reforms carried out by these countries (strong tax performers) during the 2000s are summarised in the box below.

Strong tax performers of 2000s – case studies

El Salvador

Significant and well-designed base-broadening measures have been adopted for improving both efficiency and fairness. These reforms *inter alia* included: (i) restricting VAT zero-rating to exports, (ii) eliminating exemptions on interest earned in banks licensed abroad and on income from interest and capital gains of individuals, (iii) establishing a tax on registration of new vehicles, and (iv) broadening the income tax withholding base for non-residents.

As a result of these reforms, the tax system is now simpler and the tax laws are of good quality by the international standards. With only a few and largely standard exemptions (financial services, health, education, and imported capital goods) and only one positive rate (13 per cent) the Salvadorian VAT has a good design; at 52 per cent, C-efficiency is among the highest in Latin America.

Reflecting these reforms, the tax revenue increased from 10.9 per cent of the GDP in 2004 to 13.4 per cent in 2010.

Tanzania

Major reforms of policy and administration have been undertaken over the past decade to address low revenue collection. Key reforms included: (i) introduction of a common taxpayer identification number (TIN) for all taxes, (ii) creation of a Large Taxpayers Department and consolidation of the VAT and income tax administration into a single, functionally-structured Domestic Revenue Department, (iii) registration compliance was improved by such measures as allocating geographical groups of taxpayers to a specific team with clear performance targets, and improving assistance to small taxpayers in understanding and complying with their obligations, (iv) a new income tax law (2004) introduced self-assessment and rationalised small taxpayer administration, (v) an increase in the VAT threshold focused on high-yield taxpayers, and (vi) modernisation of the customs department focused on interfacing its operations with domestic revenue operations.

Policy reforms brought significant simplification in the tax system. The number of brackets of the PIT was reduced and the top marginal rate was cut (from 35 to 30 per cent) and aligned with the CIT rate. Consequently, tax revenue increased steadily, that is, from nine per cent of the GDP in 2000 to 15.3 per cent in 2009.

Vietnam

During 2005-10, sweeping reforms have been seen in both policy and administration. The tax policy regime has been considerably rationalised. The CIT has been strengthened by unifying the rate structure (at 25 per cent, rather than 28 and 15) removing some incentives, permitting deductions for reasonable expenses and transferring unincorporated businesses to the PIT. The VAT has been improved by restricting zero-rating to exports, eliminating the discrimination between domestic and imported products and reducing exemptions. The PIT has also undergone comprehensive changes, which included: capital income brought into tax, 30 per cent surcharge eliminated, tax brackets significantly broadened, top marginal rate lowered from 40 per cent to 35 per cent and tax allowances for dependents introduced.

The tax administration has also undergone significant transformation and strengthening. A modern self-assessment system and a supporting set of tax administration procedures have been introduced. All tax offices are now connected via a computer network and a broad range of Information Technology applications has been developed to support core tax administration functions. Steps have also been taken to upgrade staff skills.

Reflecting these reforms, the tax revenue has increased significantly and other important benefits have been realised. As share of the GDP, the tax revenues increased from an average of 19.6 per cent during 2001-04 to an average of 23.7 per cent during 2005-08.

Source: *Revenue Mobilization in Developing Countries (2011), International Monetary Fund (IMF)*

The Pakistan Vision 2025 envisages a framework of growth and development, which comprises seven pillars where monetary and fiscal developments connect to the pillar of ‘Achieving Sustained, Indigenous and Inclusive Growth’. Broadly, the Vision calls for reforms, which catalyse revenue generation and curtail non-development expenditure. This consists of broadening tax base, moving away from across-the-board subsidies to the targeted subsidies, restructuring or privatisation of the selected Public Sector Enterprises (PSEs) and introducing performance-based assessment and strict accountability of the public spending.

Specifically, the Vision stipulates a rise in tax-to-GDP ratio by targeting it to increase from 9.8 per cent in 2012-13 to 16-18 per cent by 2025; thus bringing it at par with countries, like India, Turkey and Thailand.

Plan

The overarching pillars of the Vision, along with its specific targets, serve as the guiding principles of the Plan. It aims at an average growth target of 5.4 per cent per annum in order to achieve a growth rate of seven per cent by the year 2017-18. In order to achieve this target, substantially large allocations of resources are required to strengthen country’s physical and human infrastructure. A right-type of policy mix is required for boosting revenue generation, raising domestic savings and devising a prudent fiscal policy to release maximum funds for development in order to achieve the goals of sustainable and inclusive growth.

The major thrusts of the fiscal policy will be to prioritise government expenditure and curtail the maximum of it without harming the current salaries, allowances and pensions, targeting subsidies, fully or partially privatising and revamping of the loss-making PSEs, limiting government borrowing and also complementing efforts to curtail government's current expenditure, improving governance to eliminate wastage of public funds and optimally allocating development funds to increase the production as well as overall productivity of the real sector. In the area of revenue, tax mobilisation will be focused on broadening tax-base, doing away with exemptions and enhancing tax compliance by streamlining federal and provincial tax machineries.

Consolidated budgetary scenario for the Plan is given below.

Consolidated budgetary projections 2013-18
(As percentage of the GDP)

Items	2009-13 (Average)	2012-13	2013-14	Revised Estimates 2014-15	Budget Estimates 2015-16	Projections	
						2016-17	2017-18
Total revenue	**13.3**	**13.3**	**14.5**	**15.4**	**15.1**	**15**	**15.3**
Tax revenue	9.7	9.8	10.2	11.5	12	12.5	13
FBR tax revenue	8.9	8.7	9	9.5	10.1	10.6	11.3
Non-tax revenue	3.6	3.5	4.3	4	3.1	2.5	2.3
Total expenditure	**19.9**	**21.5**	**20**	**20.4**	**19.4**	**19**	**18.8**
Current	15.9	16.4	16	16.3	14.9	14.6	14.2
Development	3.5	3.5	4.5	4.1	4.5	4.4	4.6
Fiscal balance	**-6.6**	**-8.2**	**-5.5**	**-5.0**	**-4.3**	**-4**	**-3.5**

Source: *Finance Division*

The public debt to the GDP ratio is estimated at 62 per cent for 2015-16 and projected to be 58.8 per cent and 55.2 per cent in 2016-17 and 2017-18 respectively.

Objectives

The main objectives of the Plan are to:

- embark upon wide-ranging tax reforms to develop resilient, broad-based and growth-oriented tax structure that encourages progressive taxation, widens tax net and ultimately increases tax-to-GDP ratio

- curtail the government current expenditure in order to bring fiscal deficit within sustainable limit (as stipulated by the Vision)
- explore avenues for raising fiscal space preferably through indigenous resources mobilisation rather external resources, and
- devise prudent debt management policy that targets lower external debt-export ratio to ensure external credit worthiness and reduce stress on the financial sector

These objectives corroborate with the Vision as these ensure macroeconomic stability through prudent fiscal policy leading to sustainable growth and build investors' confidence in the growth prospects of the country.

Target

For achieving the above-mentioned objectives, the following targets have been envisaged.

- Increasing total revenue from 13.3 per cent of the GDP in 2012-13 to 15.3 per cent in 2017-18
- Enhancing tax revenue from 9.8 per cent of the GDP in 2012-13 to 13 per cent in 2017-18
- Increasing the FBR tax collection from 8.7 per cent of the GDP in 2012-13 to 11.3 per cent in 2017-18
- Curtailing total expenditure from 21.5 per cent of the GDP in 2012-13 to 18.8 per cent in 2017-18
- Curtailing current expenditure from 16.4 per cent of the GDP in 2012-13 to 14.2 per cent in 2017-18
- Increasing development expenditure from 3.5 per cent of the GDP in 2012-13 to 4.6 per cent in 2017-18
- Reducing fiscal deficit from 8.2 per cent of the GDP in 2012-13 to 3.5 per cent by 2017-18

Strategies

In order to achieve the targeted fiscal deficit, the following strategies have been proposed.

- Formulate expenditure policy, which aims at strict control of non-developmental expenditure and is adequately accommodative for meeting pressing social and infrastructure needs of the economy. The first step of this strategy entails a judicious choice between subsidies vis-à-vis development expenditure in the course of resource allocation. The following steps have been taken during 2013-2014:
  - In a bid to curtail the current expenditure by making subsidies more targeted, the National Energy Policy 2013 necessitates periodic increases in average tariff in order to eventually eliminate the Tariff Differential Subsidy (TDS) for all consumers except the most vulnerable ones over the next three years.
  - The first adjustments were made to commercial, industrial, bulk, and large consumer's targets for reducing subsidies by about 0.75 per cent of the GDP on an annualised basis during 2013-14.

- Introduce tax reforms under the aegis of the FBR, which targets simultaneous restructuring, simplification and automation of tax regime whereby restructuring constitutes (but not limited to) broadening tax-base and increasing tax net, rational and affordable rates covering a broad range of sectors and taxpayers. The initial steps to these reforms in the first year of the Plan (2013-2014) comprise:
  - Review of withholding income regime in order to address its regressive nature as it has become a turnover tax, the incidence of which is passed on to the public as price of consumption and income tax refunds are obtained as windfalls.
  - Encouraging and facilitating provincial governments to enhance their own tax revenues by effectively taxing agriculture income and property as well as broadening the sales tax. A simultaneous restructuring of the provincial authorities and boards as well as excise and taxation departments and boards of revenue is in the process for achieving these targets.
  - Publication of tax directories of the parliamentarians and all taxpayers and announcement of tax privilege scheme for top taxpayers. The annual tax directory aims to document and assess tax paid in the preceding three years. The next step to the strategy of publicising tax-payers is launching of an advocacy campaign for promoting the tax culture in the country and recognition of taxpayers' rights.
- Instate fiscal discipline by reining in internal and external debt. The following steps have been taken in the first year of the Plan.
  - Development of the Medium-Term Debt Management Strategy (MTDS) 2014-18, which ensures sustained level and rate of growth of public debt that remains serviceable under varying circumstances. The main objectives of the MTDS are: i) fulfilling financing needs of the government, ii) minimising the cost of debt while maintaining the acceptable level of risks, and iii) facilitating the development of domestic debt market. It focuses on lengthening of maturity profile to reduce the refinancing risk along with sufficient provision of external inflows in the medium-term to reduce the pressure on domestic resources keeping in view cost-risk trade-offs.
  - Facilitating implementation of the debt management strategy by mandating the Debt Policy Coordination Office (under the aegis of Ministry of Finance) to conduct the Debt Sustainability Analysis (DSA) in consultation with the stakeholders
  - Corresponding review and amendment in the provisions of the Fiscal Responsibility and Debt Limitation Act, 2005 for making it more effective to attain fiscal discipline
- Privatisation, divestment and restructuring of loss-making PSEs to increase total government revenue – This strategy is aligned with the objective of curtailing contingent liabilities of the government through implementation of the best practices of corporate governance. The initial steps in this regard for the year 2013-14 are:
  - Setting up of a consortium of Citigroup, Merrill Lynch International, Goldman Sachs and BMA Capital Management as Financial Advisory Consortium (FAC) for divestment of 10 per cent shares of the Oil and Gas Development Company Limited

(OGDCL) by simultaneous international offering through the Global Depositary Receipts (GDR) and a domestic secondary offering

– Curtailing non-development expenditure by following austerity drive by the Prime Minister's Office and House as well as the federal ministries and divisions, and remove discretionary grants of the federal ministers

Provincial revenues

In the 7th National Finance Commission (NFC) Award, the provincial share was substantially increased to 57.5 per cent of the divisible pool. Apart from the larger provincial share, Balochistan and Khyber Pakhtunkhwa were given additional resources – the former for reasons of its largest area and the latter because of the expenditure related to combating terrorism. Resultantly, the net federal receipts in proportion to gross federal receipts have declined to 56.2 per cent in 2012-13 from 67.9 per cent in 2009-10, the year preceding the 7th NFC Award, that is, hardly sufficient to finance interest payments and defence expenditure. The federal government is highly constrained in financing because some of the high priority programmes still remain its responsibility even after the passage of the 18th Constitutional Amendment.

The federal and provincial governments, in the 7th NFC Award, were recommended to streamline their tax collection systems for increasing their revenues in order to achieve 15 per cent of tax-to-GDP ratio by the terminal year, that is, 2014-15. However, the tax-to-GDP ratio remained at 9.3 per cent, 10.2 per cent and 9.8 per cent during 2010-11, 2011-12 and 2012-13 respectively.

The provinces will supplement the federal government's efforts to attain fiscal discipline by exploiting their revenue generating potential through making agriculture income tax more effective, broadening tax net on the services used by the rich, and devising mechanism to tax property at prevailing market rates. Moreover, the provinces will further augment their efforts to enhance outcome and efficiency of the public money. The Punjab, Khyber Pakhtunkhwa and Sindh have established authorities and boards to collect GST on services, while Balochistan is working on it. It will help exploit the potential of this huge sector.

The **Punjab** government, during the last few years, has tried to tap buoyancy of the land revenue by introducing structural reforms, which also included introduction of valuation table to the rural areas for the mutation purpose. The government is considering introduction of further reforms including introduction of e-stamping to land transactions to plug leakages in the tax and ensure greater transparency in the process of transfer of property. The provincial government intends to automate the base of urban immovable property tax plans, and in the medium-term plans to broaden the scope of the GIS mapping project – implemented in Sialkot district – to the entire province, which will help improve property tax collection. The government is also focusing on improving recovery of agriculture income tax and is making certain amendments in the schedule of agriculture income tax. The provincial government made necessary legal and institutional frameworks for the collection of sales tax on services through the Punjab Revenue Authority (PRA), which started working in July 2012. During 2014-15, the government revised stamp duty (on some instruments), Punjab Motor Vehicles Taxation Act 1958 and valuation list of properties as required under the Punjab Urban

Immovable Property Tax Act 1958. Moreover, some improvements were made in the taxation on services. The token tax rates of vehicles on some of the slabs have been revised through the Finance Act 2014. Taxes have been proposed on imported luxury vehicles, and luxurious houses for the purpose of providing cross subsidies. The government followed austerity measures to reduce expenditure on purchase of durable goods.

The **Sindh** government, in its fiscal outlay of 2013-14, reiterated its plan to enhance the base of the sales tax on services by removing anomalies and inequities, reviewing the exemptions to bare minimum and reforming the provincial tax administrations. The provincial government has projected to increase its sales tax collection to Rs100 billion in the next three years. During 2014-15, the government carried out Public Expenditure and Financial Accountability (PEFA) assessment to improve the performance of public financial management. Based on the PEFA assessment, the Sindh Public Sector Management Reform Project has been launched with the objectives of increasing revenue mobilisation, improving performance of the public financial management and procurement, and strengthening management and transparency of the development portfolio. Other initiatives include establishment of the Tax Reform Unit and Debt Management Unit. Moreover, the government has approved the Sindh Tax Revenue Mobilisation Plan 2014-19 and Public Financial Management Strategy, Government of Sindh (2014-15 to 2019-20). The Medium-Term Budgetary Framework (MTBF) has been rolled out in eight provincial departments.

The **Khyber Pakhtunkhwa** government has planned and undertaken an agenda of broad-based reforms, which encompasses good governance, economic growth and development. The provincial government has adopted strategies like Comprehensive Development Strategy (CDS), Post-Crises Need Assessment (PCNA), Economic Growth Strategy (EGS) and sectoral strategies. A Strategic Development Partnership Framework (SDPF) has been agreed with development partners to set top-level strategic priorities and commitments of the partners for accelerating and expanding service delivery in a transparent and accountable manner. The framework will be implemented through measures taken under the Medium-Term Budgetary Framework (MTBF), Output-Based Budgeting (OBB) and Integrated Development Strategy (IDS). Accordingly, the provincial receipts will be enhanced substantially during the Plan period. The provincial tax to the provincial GDP ratio will be increased from 0.4 per cent in 2012-13 to 1.5 per cent in 2017-18. The fiscal space for development will be enhanced through increased tax revenues and curtailed non-development expenditures. The major strategies for the purpose will include: improving tax base, elimination of non-productive expenditures, strengthening of the Khyber Pakhtunkhwa Revenue Authority, gradual broadening of the tax net on services, doubling the collection of infrastructure development cess in the next three years, provincial tax survey, tax policy review, strengthening of revenue collecting departments, harmonisation of agriculture income tax, and computerisation of the land revenue record etc. The provincial revenue will be shared with the local governments through statutory award to be made by the Provincial Finance Commission (PFC). The local governments will levy their own taxes and fees for the service delivery entrusted to them; thus sharing the burden with the provincial exchequer. A number of steps were initiated in 2013-14, while the rest were started in 2014-15 with completion targets by 2017-18. During 2014-15, the government broadened the tax net on services. It revised the rates of taxes on services, urban immovable property, stamp duty, land, agriculture income, and capital value, etc. Moreover, it revised the rates of various non-tax items.

The **Balochistan** government has taken certain measures for enhancement of its own revenue through the Balochistan Finance Act 2013. It mainly focuses on tax on the immoveable property called the Capital Value Tax, which is imposed on property of at least 500 square yards or one kanal. The exemption threshold in the Balochistan Urban Immoveable Property Tax Act 1958 has been reduced through amendment from current residential houses constructed area of 4500 square feet to 2500 sq. ft., whereas the value of immovable property will be calculated according to the valuation table notified by the Deputy Commissioner of the respective area. Similarly, the mutation fee is fixed at a certain percentage of the consideration or value of land and it will be calculated according to the valuation table notified by the collector in respect of the land situated in the locality under the Stamp Act 1899. Under the Balochistan Sales Tax Ordinance 2000, the existing schedule of taxable services has been expanded significantly. To overcome the capacity issues in tax collection, which is presently being carried out by different departments, the provincial government has planned to establish the Balochistan Revenue Authority (BRA). The BRA will improve tax efficiency, prevent tax evasion, broaden the tax-base and settle the issues of the tax compliance. Further strengthening of the revenue mobilisation measures, taken during 2013-14, will help in improving the provincial revenues.

Monetary developments

The overarching monetary and financial framework corroborates the broad objective of public welfare by targeting price stability and wealth creation. In order to catalyse domestic and foreign investment, the Vision 2025 advocates coordination and synchronisation between fiscal, monetary, investment, commercial and industrial policy. Though the Monetary and Fiscal Coordination Board is already established and working under the Ministry of Finance to achieve this end, there is a need for considerably scaling back monetary accommodations of the fiscal deficits.

Additionally, Pakistan's financial services sector needs to be viewed in terms of its predominant role for satisfying the ever-growing needs of the economy on a pattern of the developed countries. Growing financing requirements of the private and public sector investments, particularly in energy and infrastructure development, are likely to remain unmet unless new long-term financing sources are developed.

However, development of the banking system and other financial institutions and markets are limited by shortcomings in the infrastructure for financial services and transactions. Given their central roles in banking and non-banking sectors respectively, the Vision thus emphasises facilitating the State Bank of Pakistan (SBP) and Securities and Exchange Commission of Pakistan (SECP) to continue with their operations efficiently and autonomously.

Plan

The Plan promotes a monetary policy that is coordinated with, but not subservient to the fiscal obligations since an important task of the monetary policy is to anchor expectations of the people in line with the announced targets of inflation and growth.

The Plan also focuses on development of the SMEs and enhancing productivity of the private sector through various measures, including value-addition and import substitution. This will allow resources to be channelised to the private sector, both for investment and consumption, which are the key drivers of growth in the economy.

A broad-based, modernised and developed capital market is considered imperative for macroeconomic stability and economic growth. A developed corporate bond market enables the issuers (corporates, federal government, provincial governments, city governments and municipal corporations) to raise funds against issuance of bonds for financing their projects (dams, motorways, highways, roads, railway lines, airports, high-rise buildings, housing schemes, etc.)

Simultaneously, it enables the investors (mutual funds, employee funds, investment companies and individuals) to invest their surplus funds in these bonds; thereby reducing dependence on the banking sector. This allows banks to provide financing facilities to the marginalised sectors of the economy. However, the corporate bond market is still nascent and needs to be developed to function effectively. Similarly, the diversion of credit away from the manufacturing sector to the presently under-served productive sub-sectors is required for the economic growth.

During the Plan period, the SBP and SECP – being the regulators of the financial sector – will strive to play a facilitating role in enhancing its growth. To adopt the developments in the monetary policy over time and the structural changes taking place in the domestic economy, the SBP has introduced several changes in the process of monetary policy formulation and its implementation.

During the last decade, the SBP has focused on institutionalising the process of policy formulation, stepped towards a more market-based credit allocation mechanism, developed its operational capacity, improved its analytical capabilities to assess future developments to act proactively, and improved upon the communication of the policy stance to the general public.

Additionally, combination of the economic and institutional arrangements will be made to keep inflation under control. Efforts will be made to ensure that the future financial sector growth is based on an enhanced private sector involvement, including banking, equities market and especially the corporate bond private debt markets. Under the concept of the public-private partnership to overcome the trust deficit, the private sector will be given due role in the Public Sector Development Projects, particularly in the implementation of the infrastructure development projects.

Objectives

The key objectives of the Plan are to

- maintain and strengthen autonomy of the SBP for an effective formulation and implementation of monetary policy and strengthen its institutional capacity
- ensure price stability and curb inflationary expectations to promote business activity and encourage economic growth for proper utilisation of resources, capital formation, productive employment and increase in income

- ensure less reliance on the government borrowing from the SBP for budgetary purposes in order to improve the effectiveness of monetary policy

- formulate a workable policy for effective implementation of the public-private partnership

- facilitate risk management and market-based operations of the financial markets, promote competition, diversification and efficiency, curb speculation and ensure financial sector stability via proactive supervision and regulation, and

- promote the culture of savings and investment among masses for broader financial inclusion in the society and promote broader documentation of the economy through corporatisation of the business enterprises and increase public listing at the stock exchange

It outlines that more resources will be mobilised for the formalisation of the informal economy through incentives, such as facilitating documentation, simplifying rules and procedures, easy access to dispute resolution, access to information and generally removing barriers to formalisation.

Strategies

The objective of monetary policy is to achieve and maintain monetary stability in line with the targets of inflation and economic growth set annually by the government. The monetary and credit policies, when coordinated with overall macroeconomic policies, facilitate capacity expansion of the real sectors and ensure soundness of the financial sector, which eventually reflect as increased savings and credit flows. In order to attain these objectives, the following strategies have been envisaged during the Plan period.

- Maintaining zero borrowings from the SBP at the end of each quarter

  – Previously, the SBP pursued an accommodative monetary policy to spur economic growth in the absence of the private investment. In FY13, it continued open market operations and direct financing for the fiscal deficit (approximately 20 present of the reserve money). However, for the Plan period, the SBP intends to refrain from further net direct lending to the government, and limit open market liquidity operations to the extent where they remain within fiscal and monetary targets. The shift in policy is indicated by firm commitment of no further direct financing of the budget, including purchases of the government papers from the primary market and limits on the Net Domestic Assets of the SBP.

- Enhancing independence of the SBP

  – A draft bill, related to the amendments in the SBP Act, is pending before the Parliament for approval. These amendments are envisaged to strengthen the autonomy of the Bank; thus ensuring full operational independence in its pursuit of the price stability.

- Addressing gaps in data collection and reporting mechanism in the financial sector (banking and non-banking) along with dissemination of relevant financial information to stakeholders

  - As the first step towards devising an effective communication strategy, the SBP has already initiated review of its existing communication strategy. It is also consulting financial market analysts to hear their views, and explain the rationale of prevailing monetary policy stance.

- Safeguarding the financial sector from internal and external vicissitudes, where the initial steps comprise the following.

  - A deposit insurance scheme is envisioned by the Ministry of Finance to introduce long-term stability in the banking system. The scheme is to be managed by a Deposit Protection Fund, established as a subsidiary of the SBP with its own governance structure and funded by flat premium payments from banks. The proposed initial coverage limit is Rs100,000 per depositor per bank, covering 72 present of depositors and 40 present of the total insurable deposits. The draft act for the Fund is being finalised, and the scheme is expected to be operational by December 2015.

- Promotion of the financial sector, which provides exhaustive financial service besides stimulating economic growth and contributing to the financial stability. This entails expanding and deepening financial markets (banking and non-banking) whereby the initial steps taken are:

  - Inclusion of non-banking financial institutions and Modarabas in the credit delivery to the SME and export sector in the financing schemes of the SBP, and international donors to ensure effective utilisation of resources by the targeted beneficiaries

  - Developing the Islamic financial market by promoting diversity of the Islamic financial products and services, and creating linkages with the global Islamic financial sector

  - Government bonds like PIBs, T-Bills, Sukuk issued by the government or the public sector companies and corporations [like Pakistan Domestic Sukuk Company Limited (PDSCL), WAPDA, Civil Aviation etc.] to be listed and traded on the stock exchanges

Inflation

In Pakistan, changes in prices are measured by three indices, that is, Consumer Price Index (CPI), Wholesale Price Index (WPI) and Sensitive Price Indicator (SPI), which are compiled with base year of 2007-08. The CPI is an index, which examines the weighted average prices of a basket of consumer goods and services such as food, transportation and medical care, etc. The WPI is an index, which measures and tracks changes in prices of goods in the stages before the retail level; thus showing the average price changes of goods sold in bulk. The SPI is an index through which the prices of essential daily-use items are measured.

The CPI covers the retail prices of 487 items in 76 markets of 40 major cities. The WPI covers the wholesale prices of 463 items prevailing in 21 cities. The SPI covers prices of 53 essential items, which are collected from 17 cities. During the last five years, average rate of inflation remained at 11.8 per cent per annum. In 2012-13, the CPI inflation witnessed a downward trend and stood at 7.4 per cent as compared to 11 per cent in 2011-12. Inflation decelerated to 4.6 per cent in July-May 2014-15 as compared to 8.7 per cent during the corresponding period of the last year. Therefore, inflationary expectations, during the Plan period, are not very high and it is expected that inflation will remain about six per cent during the later period of the Plan.

Financial sector development

Development, integration and deepening of the financial markets are major goals of the long-term economic planning. Fair, efficient and transparent equity and debt markets mobilise savings and provide lucrative investment opportunities through alternate sources of fund-raising. Therefore, the financial sector development is crucial for ensuring proper and full transmission of measures taken by the monetary policy, which entails smooth functioning of both banking and non-banking financial institutions. Pakistan ranks 67th in the financial development pillar of the Global Competitiveness Index (GCI), which shows potential for development of a competitive financial sector.

Accordingly, the Vision 2025 emphasises development of an efficient financial sector, which channels resources to entrepreneurial and investment projects with the highest expected rate of return. It intends to expand the outreach of the capital market beyond stocks by developing secondary market for corporate and government bonds. The Vision, thus, highlights the role of the SECP in developing a capital market, which facilitates efficient fund-raising rather than mere trading.

Plan

The objectives of the Plan resonate with that of the Vision, whereby it aims to develop the financial sector, which is at par with the global capital markets. The Plan focuses on deepening and diversifying the equity and debt markets, and promoting private sector-led economic growth, keeping in view the following objectives:

Objectives

The important objectives are to

- develop a capital market (both primary and secondary), which offers high quality financial products, and is accessible to both national and international investors and traders
- promote efficiency, transparency, integrity and reliability of capital markets to boost investor confidence and curtail capital flight, and
- provide necessary infrastructure to enhance market competitiveness in the international arena

Strategies

In order to achieve these objectives, focus will be on the following main areas.

- Attracting foreign and domestic investment by simplifying rules and procedures of business – In this regard, the SECP has already taken steps to create an enabling environment by promoting the 'ease of business':
  - One of the major initiatives is the signing of a Memorandum of Understanding for the establishment, operation and administration of a virtual 'One-Stop Shop' for company registration among the SECP, FBR and EOBI. Similarly, an MoU for consultation, cooperation, and the exchange of information – related to the supervision of the Alternative Investment Fund Managers (AIFM) entity between the SECP and European Union competent authorities – has also been signed.
- Development of primary, equity and corporate debt market by offering lucrative avenues for investment to the marginalised and untapped economic sectors – The following steps have been envisaged:
  - Launch of the high-yield Sukuk bonds (Pakistan's first Islamic bonds since 2005) is planned to capitalise on the shortage of the global Sukuk supply, which will ultimately cut borrowing costs for the government. The Sukuk sale is aimed to attract investment into the local Islamic finance industry, where excess liquidity in the Islamic capital market will lead to competitive pricing of the Sukuk bonds than the Dollar bonds.
  - In an attempt to facilitate the small and medium enterprises and services sector enterprises, the SECP is promoting the Limited Liability Partnership (LLP). It has developed a concept paper, which elaborates the Partnership in a new corporate structure, which combines the flexibility of a general partnership and the advantages of the limited liability of a company at a low compliance cost. The aim is to attract the SMEs towards the LLP, given its flexibility.
  - Similarly, in order to introduce the concept of the e-IPO, development of the IPO Portal on the SECP website is also in the offing.
  - The government also plans to list Treasury Bills with the Lahore and Islamabad stock exchanges for enabling small investors to invest in the government T-Bills. However, a detailed plan with extensive risk analysis is yet to be devised for this purpose.
- Strengthening the regulatory regime of the SECP – This entails reviewing, improving and amending of the consolidated registration, licensing and capital adequacy requirements for capital market intermediaries. A number of regulatory reforms are being launched to foster growth of a robust corporate sector and broad-based capital markets, which include:
  - Comprehensive review of the existing regulatory framework is in process, which specifically focuses on minimum entry standards, criteria for sponsors, directors and employees, revised risk-based capital adequacy and regular audit of financial position of the broker by independent auditors. This review aims to facilitate compliance of the companies with the relevant principles of the International Organisation of Securities Commissions (IOSCO) for market intermediaries.

- Similarly, the requirement for limiting the aggregate liabilities, maximum exposure to a single person or group, assets under custody, code of conduct, KYC (Know Your Client) policies and customer-due diligence are envisaged to be reviewed keeping the best international practices in view. Detailed guidelines regarding the customer-due diligence and KYC policy to safeguard the Non-Banking Finance Companies (NBFCs) against the abuse of money laundering activities, terrorist financing and other illegal trades have been issued in this regard.

- Following the demutualisation of the stock exchanges (in pursuance of the Stock Exchanges Corporatisation, Demutualisation and Integration Act 2012), a comprehensive plan for segregation of regulatory and commercial functions of stock exchanges has been approved by the government for implementation during the Plan period.

- Introduce reforms in the insurance industry and preclude financial risks and uncertainties keeping in view the global unprecedented challenges to insurers and regulators, which include:

  - The SECP has proposed a roadmap of reform and development for the insurance industry, whereby a strategy has been prepared by a committee with representation of insurance, banking and business segments. The roadmap suggests organisational and operational restructuring, market development, insurance education and technology development in life and non-life insurance.

- The SECP has drafted a new legislation as the Securities Bill 2015 (draft) in order to address deficiencies in the existing law, and incorporate international best practices. The draft bill is in the process of enactment. Similarly, the Futures Trading Bill is to be enforced in order to establish fair, transparent and efficient futures market. Several structural reforms are also in offing, which include:

  - Attainment of the Central Counter Party status by the National Clearing Company
  - Introduction of the revised settlement model for trading in the government debt securities
  - Improvement in the National Custodial Services and Direct Settlement System
  - Introduction of the Settlement Guarantee Fund of appropriate size
  - Development of the Commodities Market
  - Introduction of the single inspection regime in place of multiple inspections

- In order to develop the NBFCs engaged in lending activities (leasing, housing finance, investment finance, etc.), the following changes in the regulatory and structural framework have been envisaged:

  - Reduce equity requirements for non-deposit taking NBFCs
  - Introduce concept of the Islamic NBFCs and microfinance NBFCs

- Incorporate new regulations for discount houses
- Broaden scope of the housing finance companies to undertake commercial housing finance activities
- Revamp investment finance services model specifically focusing on lending

- The mutual fund sector is being developed to add diversity and depth to the financial system and reduce dependence on the banking system. This will promote savings by offering alternative asset classes and fund-raising avenues. A multipronged strategy to incentivise the Asset Management Companies (AMCs) is being considered, which includes:
    - Establishment of the AMCs' own distribution and branch network
    - Amendment in regulatory framework regarding fiduciary responsibilities, corporate governance, employee's trading, internal control and risk management requirements
    - Review of the existing regime to allow for a single entity to undertake all fund management services (asset management, investment advisory, etc.)
    - Introduce concept of the private funds to encourage alternative forms of capital formation