



# ANALYSIS OF BUDGETS AND EXPENDITURES of the Government of Pakistan

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**Pakistan MTBF Project**

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## Executive Summary

This report presents the results of analysis of the budget of the Federal Government of Pakistan (GoP) based on three years of budget data from fiscal year (FY) 2003/4 to FY 2005/06. The aim of the analysis is to identify key issues in budgetary management which should be taken into account in the preparation of a Budget Strategy Paper, which will be produced for the first time under the Pakistan Medium Term Budget Framework (MTBF) Project. A secondary objective is to calculate some key indicators of budgetary performance based on internationally recognised 'PEFA' performance indicators.

### The Federal Budget

The GoP budget has grown significantly in recent years, from R 817Bn in 2003/04 to R 1150Bn in 2005/06, an increase of 41% in nominal terms. The budget is made up of three main types of expenditure – recurrent expenditure (58% of the total in 2005/06, development expenditure (22%) and debt service (21%). The Table below shows the original budget and actual expenditures of GoP over the last three years. The data follows the traditional presentation used by the GoP with some minor modifications to show separately debt servicing and repayment.

Table: Original Budgets and Actual Expenditures, Rupees Bn

EXPENDITURE CATEGORY	2003/04		2004/05		2005/06	
	Original	Actual	Original	Actual	Original	Prelim.
Total Recurrent	543.4	483.7	519.6	597.9	764.0	661.6
Total Development	135.4	128.8	175.7	161.9	235.6	248.8
Charged (debt-service)	210.0	203.3	214.2	216.3	236.0	237.1
Charged (other)	1.2	1.3	1.6	1.7	1.8	2.4
Total	890.0	817.1	911.1	977.8	1237.4	1149.9
Charged (debt repayment)	1146.0	1182.0	1341.1	2131.7	2229.5	2080.3
Grand Total	2035.9	1999.1	2252.2	3109.6	3466.9	3230.2

### Main Trends in Federal Expenditure

- **The development budget has grown significantly in recent years** - up by 93% in nominal terms over the period. By comparison, the recurrent budget has grown by only 36% in nominal terms over the same period. In 2005/06, the development budget accounted for 22% of total expenditures compared with 15% just two years earlier. This trend is even more significant in real terms. Recurrent expenditure increased by less than 5% in real terms during the three year period to 2005/06, compared to a real increase in development expenditure of 55% in real terms over the same period.<sup>1</sup>

<sup>1</sup> General CPI: FY04=4.6, FY05=9.3, FY06=7.9. Source: [www.sbp.org.pk](http://www.sbp.org.pk) (State Bank of Pakistan)

- **There is significant variation between original budgets and actual expenditures.** Actual expenditure is systematically different from original budget estimates for both recurrent and development expenditure. The variance is greater on recurrent expenditures (+/- 15%) than it is on development expenditures (+/- 8%). Debt service on the other hand has been close to original budgets in recent years.
- **Revenue forecasting during budget preparation is particularly weak.** Actual revenue collections have been, on average, more than 10% above the original estimate for the last three years. This has opened the door to systematic use of supplementary appropriations which are now a normal feature of budget execution for most federal ministries.
- **Supplementary budget are used extensively on both recurrent and development budgets.** Amounts equivalent to 10%, 21% and 18% of the originally approved budget were provided in the form of supplementary allocations in 2003/04, 2004/05 and 2005/06 respectively.

In order to put these trends into context, this report calculates several performance indicators for the federal budget using the PEFA Performance Measurement Framework. The PEFA framework provides an internationally recognised set of indicators and benchmarks against which to assess performance in public financial management. In this regard, of particular interest are PEFA Performance Indicators 1 and 2, which measure respectively the ability of the government to implement budgeted expenditure as planned at aggregate and sub-aggregate (i.e. ministerial) level. Where the level and composition of expenditure varies considerably from the original budget, the budget will not be a useful statement of intent or indicator of the government's ability to deliver public services as expressed in policy statements, output commitments and workplans.

**This report shows that, by international standards, the original budget of the government is a poor indication of actual expenditure, in aggregate terms and especially in terms of spending by individual ministries.** The predictability of aggregate spending is slowly improving but at ministry levels predictability is getting significantly worse. It will take several years of sustained improvements in budgetary management before performance against these two particular indicators improves and the federal budget is seen by international standards to a more reliable guide to actual expenditure and, therefore, service delivery.

**These findings are of critical importance for the federal MTBF reform process.** Unless there are improvements in predictability between budgeted and actual expenditures (at both aggregate and ministry levels) investments currently being made by GoP and its development partners in improved budget preparation (through the MTBF project) are unlikely to realise their objectives. This analysis points to the need to improve revenue forecasting during budget preparation. This is an area in which the MTBF project can provide support. If the budget is to become more plausible as a statement of fiscal intent, especially at sector and ministry level, it also points to the need to see a sustained reduction in the use of supplementary appropriations.

## 1. Introduction

This report presents the results of analysis of the budget of the federal Government of Pakistan (GoP) based on three years of budget data - fiscal year 2003/4 to fiscal year 2005/06.<sup>2</sup> The aim of the analysis is to identify key issues in budgetary management which should be taken into account in the preparation of a Budget Strategy Paper, which will be produced for the first time under the Pakistan Medium Term Budgetary Framework (MTBF) Project. A secondary objective of this report is to present estimates for certain PEFA performance indicators as explained below. The report was prepared by the MTBF team in Finance Division.

Under the Pakistan MTBF Project, the second phase of which commenced in October 2006, attention is being paid to the introduction of a strategic (or 'top-down') component to the Federal MTBF process.<sup>3</sup> The top-down component aims to provide strategic guidance for the annual and three-year budget preparation processes which are the core of the MTBF. The top-down component consists of three main elements: a Medium Term Fiscal Framework (MTFF), which provides an overview forecast of the macro-fiscal situation, a Budget Strategy Paper (BSP), which reviews the pressures on the budget and the priorities for public sector spending in the context of the forecast fiscal space, and a set of indicative budget ceilings, which will in future be set to guide the budget preparation process in the federal line ministries. Under the MTBF process work is currently proceeding on the preparation of all these elements.

In the specific context of the MTBF Project, this analysis also addresses an additional requirement. The project document for the MTBF project and in particular the project's logical framework make extensive use of the internationally recognized Public Expenditure and Financial Accountability (PEFA) performance indicators as objectively verifiable indicators for the progress of the federal MTBF in Pakistan.<sup>4</sup>

PEFA assessments have been made in many countries over the past two years. However, none has yet been undertaken at the federal level for Pakistan. Ideally the MTBF process would be rolled out in an environment in which the PEFA ratings for the federal public financial management (PFM) system have already been established, thereby enabling the impact of the MTBF on PFM performance to be monitored from an agreed baseline. The present analysis was undertaken with a view to at least partially addressing this gap. Specifically, this report provides estimates for PEFA indicators 1 and 2, which relate to the divergence of originally budgeted and actual expenditures, since these are of particular relevance to the MTBF process. It also provides a brief analysis of PEFA indicator 3 which measures aggregate revenue performance compared to original budgeted forecasts, since aggregate revenue performance can be an explanatory factor for expenditure performance.

This report is the result of a four week visit to Islamabad by Rachel Wilson, a public expenditure analyst with Oxford Policy Management, during February and March 2007 and

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<sup>2</sup> The fiscal year runs from July to June.

<sup>3</sup> Pakistan MTBF is supported by the UK Department for International Development (DFID). The second phase of implementation of the project started in October 2006 and runs until July 2009.

<sup>4</sup> The PEFA Framework is discussed in more detail in Section 4 of this report.

outlines the key findings of that work. This report was drafted with additional inputs from the MTBF project team in Finance Division and discussions on preliminary findings with the MTBF Secretariat in Finance Division during April and May 2007.

## **Report Structure**

Following this introductory section, the analysis is provided in four sections as follows:

**Section 2** provides definitions of the key terms used in the budget process of the GoP. It identifies the sources of data used for the analysis and summarises issues relating to the data sets drawn on for the preparation of this report.

**Section 3** analyses the budget presented in terms of aggregates and sub-aggregates familiar from the normal practice in official documents of GoP relating to the budget, and presents the main trends in expenditure for the three most recent years for which official data is available, namely fiscal years 2003/04 to 2005/06.

**Section 4** introduces the PEFA framework, which through the calculation of 28 indicators of the quality of PFM is increasingly recognised internationally as the standard assessment system for the high-level monitoring of PFM. This section presents calculations for PEFA Indicators 1, 2 and 3 for the federal budget. Indicators 1 and 2 provide a measure of the extent to which actual expenditure by the Government of Pakistan reflects the budget as passed by the National Assembly over the period studied. Indicator 3 looks specifically at revenue. In order to calculate these indicators expenditure data as presented by GoP has been reformulated so as to be in compliance with the PEFA regulations (insofar as this is possible) so as to allow for international comparisons. This may make comparison with the traditional breakdown of GoP budget data (as provided in the official documents identified in Section 2) difficult. Explanations have been included where necessary to explain the ways in which the data have been rearranged.

**Section 5** builds upon Section 4 by analysing further the differences between original budgets and actual expenditures. It does this by considering the use of supplementary expenditure and revised estimates as defined in the report. Again, the data used for this analysis will not match exactly those shown in the annual budget statements for the corresponding budget years, since they have been reformulated to remove those elements of expenditure over which the GoP has little discretion (in particular, debt-related payments) in accordance with the PEFA methodology.

## 2. Definitions, Sources and Data

The analysis presented in this report is based on a three-year data set, relating to the fiscal years 2003/4, 2004/05 and 2005/06 of the GoP. This period was selected as providing the most recent period for which both budget data (original and supplementary appropriations) and actual expenditures are available. PEFA indicators 1 and 2 both require a three-year period of data for their calculation. It is noted that, while the data for 2003/04 and 2004/05 are final data, actual expenditure data for 2005/06 are preliminary and may therefore be subject to some variation in the future.

### Definitions

The analysis presented in this report centres on the following key budget concepts:

- **‘Demands’** are appropriations made by the National Assembly (the legislature). They define the total amount of money that may be expended for the nominated purpose. The budget is made up of a series of demands; a federal line ministry typically has several ‘demands’ (for example, for recurrent and development expenditure) that are approved by the legislature.
- **‘Original budget’** is the total amount appropriated each year by the National Assembly at the start of the fiscal year. It does not include supplementary appropriations, which occur subsequently;
- **‘Supplementary budget’** refers to the additional budgetary provision appropriated by the National Assembly for a particular budget year. It is noted that supplementary budgets are usually appropriated at the very end of the budgetary year after the expenditure in question has actually been incurred;
- **‘Revised estimates’** are the estimates of the expected budgetary outturn, prepared by the federal ministries during the period of the preparation of the following year’s budget (usually in January or February). Revised estimates are used as a baseline or reference point in the preparation of the next year’s budget. As such, their accuracy is of interest. In practice the revised estimates aim to include both original and supplementary appropriations and to allow for expected surrenders of funds, but since the supplementary appropriation has not necessarily been finalised at the time of the calculation of revised estimates, these two variables can and do differ from one another.
- **‘Charged expenditure’** refers to certain appropriations that are normally made each year but which have no specific demand numbers (in other countries this is often called ‘statutory’ expenditure). In Pakistan, the following items are ‘charges’ on the Federal Consolidated Fund: (i) staff housing and allowances of the President (ii) audit (iii) domestic debt service and repayments (iv) foreign debt service and repayments (v) expenditure on elections and the Supreme Court (vi) Wafaqi Mohtesib Secretariat, and (vii) the Federal Tax Ombudsman. Domestic debt ‘repayment’ (mostly in fact roll-over) is by far the largest of these items in each year of the period studied. Foreign debt repayment and debt servicing are also significant items of charged expenditure.

- **‘Actual expenditure’** refers to the actual expenditure incurred as recorded in the final accounts and reported in the government’s Appropriation Accounts.

## Sources

The subject of this report is the budget of the GoP as reported in official budget documents and publications. Specifically, this report is based on analysis of information on budgets and expenditures presented in the following documents:

- Appropriation Accounts (Civil), Volume I, compiled by the Accountant General Pakistan Revenues - or **‘Yellow Book’**. The Appropriation Accounts present the audited accounts of actual expenditure (based on original budgets and supplementary budgets) incurred from the Federal Consolidated Fund during the year.
- Details of Demands for Grants and Appropriations, compiled by Finance Division, Government of Pakistan – or **‘Pink Book’**. These documents are produced separately for recurrent and development expenditures and provide details of original and revised budget estimates.
- Supplementary Demands for Grants and Appropriations, 2005-06, compiled by Finance Division, Government of Pakistan. Provides information about supplementary expenditures for the most recently completed fiscal year.
- Preliminary information on actual expenditures for 2006-07, as provided by the Accountant General Pakistan Revenues.

## Data

For the purposes of calculation of PEFA indicators and for analysis of the revised estimates and supplementary budgets, specific changes of classification and aggregation have been made to the budget data as published by the GoP. These changes relate to the exclusion of certain budget lines and the recalculation of the associated aggregates so as to conform with the methodology and concepts used for the calculation of the PEFA indicators. Details of these changes are noted in each section below.

The data set required by this analysis is sourced primarily from the Appropriation Accounts for 2003/04 and 2004/05, supplemented with information on revised estimates since these are also of interest. Preliminary data from the Accountant General’s office has been used for information on actual expenditure in 2005/06 because Appropriation Accounts for 2005/06 were not available. This combined data set - showing the original budget, supplementary budget, revised estimate and actual expenditure for each federal ministry and item of charged expenditure for the last three fiscal years - is attached at Annex 1.

The data in Annex 1 is shown at *ministry* level. The data set is also available at the *demand* level (demand level detail is not shown in Annex 1). In 2005/06, for example, there were 170 demands corresponding to 35 ministries and Cabinet Secretariat. Each ministry typically has 2-4 demands for recurrent expenditure (usually corresponding to a Division within a Ministry) and typically one demand for development expenditure. Some ministries have a significantly higher number of recurrent demands, principal among these ministries being Finance and Cabinet Secretariat.

### 3. Breakdown of the Federal Budget

This section presents information on original budgets and actual expenditures of the GoP for each of the last three fiscal years from 2003/04 to 2005/06. It presents a summary of the main expenditure trends in the federal budget and an analysis of the extent to which actual expenditures reflect originally approved budgets.

#### Overall Expenditure Trends

Table 1 below shows the breakdown of the overall budget by recurrent and development expenditure for the three year period of analysis in nominal terms. The data in Table 1 follows the traditional presentation used by the GoP with some minor modifications as follows:

- Items of current expenditure on the capital account have been moved up to sit under items of current expenditure on the revenue account
- Items of charged expenditure which are of a recurrent nature have been presented as part of total expenditure
- Debt servicing (domestic and foreign) is presented separately from debt repayment
- Items of charged expenditure relating to debt repayment (domestic and foreign) have been presented separately from total expenditure.

Table 1: Original Budgets and Actual Expenditures, Rupees Bn

EXPENDITURE CATEGORY		2003/04		2004/05		2005/06	
		Original	Actual	Original	Actual	Original	Prelim.
a	Recurrent Exp. (revenue a/c)	513.3	436.8	507.2	547.2	752.4	645.7
b	Recurrent Exp. (capital a/c)	30.1	46.9	12.4	50.7	11.5	15.9
c=a+b	Total Recurrent	543.4	483.7	519.6	597.9	764.0	661.6
d	Total Development	135.4	128.8	175.7	161.9	235.6	248.8
e	Charged (debt-service)	210.0	203.3	214.2	216.3	236.0	237.1
f	Charged (non-debt related)	1.2	1.3	1.6	1.7	1.8	2.4
g=c+d+e+f	Total	890.0	817.1	911.1	977.8	1237.4	1149.9
h	Charged (debt repayment)	1146.0	1182.0	1341.1	2131.7	2229.5	2080.3
j=g+h	Grand Total	2035.9	1999.1	2252.2	3109.6	3466.9	3230.2

Source: See Annex 1

The following points explain the data shown in Table 1:

- *Recurrent expenditure on the revenue account* - relates to the current expenditure budgets of federal ministries. The number of ministries and demands changes from year to year. In 2005/06 this item related to 35 ministries and Cabinet Secretariat and

- demand numbers 1 (Cabinet division of Cabinet Secretariat) to 118 (Women Development Division of the Ministry of Women Development)
- *Recurrent expenditure on the capital account* - relates to certain recurrent expenditure items categorised as 'development expenditure' in the appropriation accounts. In 2005/06, these items related to six demand numbers – from demand number 119 (Ministry of Food and Agriculture, purchase of food) to demand number 125 (Ministry of Finance, other loans and grants by the Federal Government)
  - *Total development expenditure* – relates to development expenditure of federal ministries. In 2005/06 these items related to demand numbers 126 (Cabinet Division development expenditure) to demand number 170 (Ministry of Water and Power, capital expenditure on irrigation and electricity)
  - *Charged expenditure, debt service* – relates to servicing of domestic and foreign debt
  - *Charged expenditure, non-debt related* – relates to expenditure on the office of the President, audit, Supreme Court and elections, Wafaqi Mohtesib Secretariat (Federal Accountability Bureau) and the Federal Ombudsman
  - *Total* – is the sum of all of the above
  - *Charged, debt repayment* – relates to the repayment of domestic and foreign debt and the repayment of short term foreign credit. The Government is heavily dependent on short term domestic borrowing from the State Bank of Pakistan to meet its budgetary financing requirements. In the appropriation accounts, gross debt repayment both domestic and foreign is shown, confusingly, as an above the line expenditure item. This is in fact mostly rollover of short term debt (with the corresponding inflows shown elsewhere in the accounts) rather than expenditure. Debt repayment is shown separately from total expenditure in this report because it is essentially a below the line financing item.

Table 1 shows that:

- Federal expenditures have grown significantly in the last three years, from R 817 Bn in 2003/04 to R 1150 Bn in 2005/06, an increase of 41% in nominal terms
- The federal budget is made up of three main type of expenditure – recurrent expenditure which in 2005/06 accounted for 58% of the total (R 661.6 Bn), development expenditure (22%) and debt service (21%)
- Federal development expenditure has grown significantly as a proportion of total outlays in recent years (up by 93% in nominal terms between 2003/04 and 2005/06) as GoP has reduced debt and diverted the savings from interest payments towards the Public Sector Development Programme.<sup>5</sup> By comparison the recurrent budget has grown by 36% in nominal terms and debt service by 9% over the same period.

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<sup>5</sup> See *Pakistan Economic Survey*, various editions, Finance Division, Government of Pakistan

- Debt service in 2005/06 consumed a significantly lower proportion of overall expenditure (21%) than it did in 2003/04 (26%), continuing the strong trend in debt reduction by GoP that has been underway since the late 1990s<sup>6</sup>

The main observations to be drawn from Table 1 are that:

- There is a significant variance between the original budgets and actual expenditures. The variance is greater on recurrent expenditures (around 15% in absolute terms) and less so on development expenditures (around 7% in absolute terms). Debt service has been close to original budgets in recent years.
- A greater proportion of total expenditure goes on recurrent spending than on development spending each year but this share is decreasing relatively rapidly. By 2005/06 the share of development expenditure in total expenditure was approximately 22% compared to 15% two years earlier
- In real terms, recurrent expenditure increased by less than 5% between 2003/04 and 2005/06. By comparison, development expenditure increased by 55% in real terms over the same period.<sup>7</sup>

### Original Budgets and Actual Expenditure

Table 2 below provides further analysis of original budget allocations (excluding supplementary appropriations) and actual expenditures.<sup>8</sup> The table shows the original budget and actual expenditure, where actual expenditure is expressed as the difference between actual expenditure and the original budget as a percentage of the original budget.

Table 2: Original Budgets and Actual Expenditures, Rupees Bn

EXPENDITURE CATEGORY	2003/04		2004/05		2005/06	
	Original	Actual	Original	Actual	Original	Prelim.
Total Recurrent (%)	543.4	-15%	519.6	+15%	764.0	-13%
Total Development (%)	135.4	-5%	175.7	-8%	235.6	+6%
Charged (debt-service) (%)	210.0	-3%	214.2	+1%	236.0	0%
Total Expenditure (%)	890.0	-8%	911.1	+7%	1237.4	-7%

Source: Table 1

The main observation to be drawn from Table 2 is that actual expenditure is systematically different from original budget estimates for both recurrent and development expenditure. This is due to overoptimistic budgeting (i.e. budgeting for expenditures in excess of a ministries capacity to spend) and the systematic use of supplementary appropriations. Each year, most ministries are granted a supplementary appropriation on the recurrent budget. In 2005/06, for example, only three ministries did not receive a supplementary appropriation on

<sup>6</sup> See *Debt Policy Statement 2006-07*, Debt Policy Coordination Office, Ministry of Finance, January 2007

<sup>7</sup> General CPI: FY04=4.6, FY05=9.3, FY06=7.9. Source: [www.sbp.org.pk](http://www.sbp.org.pk) (State Bank of Pakistan)

<sup>8</sup> In the case of 2005/06, the preliminary estimate of actual expenditure

the recurrent budget. On the development budget, 24 out of a total of 36 ministries received supplementary appropriations in 2005/06. The use of supplementary appropriations is analysed in more detail in Section 5.

### Revised Estimates and Actual Expenditure

Table 3 below provides a comparison between revised estimates and actual expenditures for each of the three years, 2003/04 to 2005/06. Revised estimates are the expected budgetary outturn prepared by federal ministries during the preparation of the following year's budget – (revised estimates are usually produced in January - February each year). As such, they are a point of reference in the preparation of the budget for the following year. Table 3 looks at whether revised estimates provide a better indication of actual expenditure than the original budget.

Table 3: Revised Estimates and Actual Expenditures, Rupees Bn

EXPENDITURE CATEGORY	2003/04		2004/05		2005/06	
	Actual	Revised (%)	Actual	Revised (%)	Prelim.	Revised (%)
Total Recurrent (%)	483.7	+4	597.9	+24	661.6	+42
Total Development (%)	128.8	-14	161.9	-8	248.8	-2
Charged (debt-service) (%)	203.3	+2	216.3	+2	237.1	+2

Source: Annex 1

Table 3 should be interpreted as follows:

- For each year the table shows actual expenditure (and in the case of 2005/06 the preliminary estimate of actual expenditure) and the revised estimate of expenditure for that year
- For each year, the revised estimate is shown in term of its difference in percent to actual expenditure as a percentage of actual expenditure. Where the difference is positive, the revised estimate is higher than actual expenditure and vice versa. This provides a measure of the accuracy of the revised estimate.

The main observation to be drawn from Table 3 is that revised estimates are not a good forecast of actual expenditures. The data suggests in particular that recurrent expenditures are systematically overestimated when revised estimates are produced. A further analysis of revised estimates is provided in Section 5.

## 4. PEFA Indicators

This section focuses on calculation of PEFA Indicators 1 and 2 for the federal budget. It also looks at PEFA Indicator 3 which looks at revenue performance, since revenue performance can be an important determinant of expenditure performance. Indicators 1 and 2 concentrate on expenditure outturn compared with the original budgets as approved by the National Assembly. PEFA indicator 1 focuses on aggregate expenditure outturn whereas indicator 2 considers the disaggregated (ministerial) level outturn.

### PEFA Performance Indicators for Public Financial Management

In recent years a new framework has been developed for the assessment of the quality of public financial management. This is known as the PEFA framework.<sup>9</sup> The framework operates on the basis of 28 indicators covering six major areas of assessment of PFM systems. An overview of the PEFA framework and indicator set is attached at **Annex 2**.

The PEFA framework is rapidly gaining recognition as the international system for the high-level benchmarking of systems of public financial management. As of October 2006, 33 PEFA assessments had reached report stage, a further 16 assessments were on-going, and 36 had been agreed but had not yet started. By early 2008, it is expected that some 75 countries will have completed a PEFA assessment for central government and repeat assessments will have been performed in about five countries. According to the PEFA Secretariat, the geographic distribution of these assessments is likely to be as follows: 30 in Sub-Saharan Africa; 5 in the Middle East and North Africa; 10 in Eastern Europe and Central Asia; 8 in South Asia; 11 in East Asia; and 14 in Latin America and the Caribbean. In addition, it is expected that assessments at sub-national government level will have been undertaken in 5-10 cases.

The project document for the Pakistan MTBF makes extensive use of PEFA indicators as 'objectively verifiable indicators' of the progress of the MTBF and whether the project is meeting its targets and achieving its purpose and goal. To date, no PEFA assessment has been undertaken at federal level in Pakistan although three province-level PEFA assessments have been conducted for Punjab, Balochistan and North West Frontier Province. At present, therefore, the federal MTBF lacks a set of baseline indicator values against which to set specific targets and assess progress. It is therefore a matter of some urgency that initial estimates be prepared, at least for the most important of the PEFA indicators in respect of the MTBF project.

In this context the budget analysis work covered in this report has as its core element the calculation of baseline estimates for PEFA indicators 1 and 2. Since the PEFA framework provides a set of indicators allowing for comparison across countries, it is important that the indicators are calculated in accordance with the regulations set out by PEFA. Each indicator is assessed on a four point scale from A to D. Guidance has been developed on what

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<sup>9</sup> PEFA ("Public Expenditure & Financial Accountability") is a partnership between the World Bank, the European Commission, the UK Department for International Development, the Swiss State Secretariat for Economic Affairs, the French Ministry of Foreign Affairs, the Royal Norwegian Ministry of Foreign Affairs, the International Monetary Fund and the Strategic Partnership with Africa. The PEFA Secretariat is based at the World Bank in Washington.

performance meets each score. The highest score is warranted for an indicator if the core PFM element meets the relevant objective; 'A' is the highest performance level and 'D' is the lowest performance level. The methodological guidelines for calculating PEFA indicators 1 and 2 which are presented in this report are attached in **Annex 3**.

### Calculation of PEFA PFM Indicators

PEFA Indicators 1 and 2 address the following specific questions:

- Indicator 1 Aggregate expenditure out-turn compared to original budget
- Indicator 2 Composition of expenditure out-turn compared to original budget

Indicator 1 measures total actual expenditure (as defined in government budget documentation and fiscal reports) but excludes two expenditure categories over which the government will have little control. Those categories are (a) debt service payments, which in principle the government cannot alter during the year while they may change due to interest and exchange rate movements, and (b) donor funded project expenditure, the management and reporting of which are typically under the donor agencies control to a high degree. Changes in the overall level of expenditure translate into changes in spending for individual ministries, departments and agencies. Indicator 2 measures the extent to which reallocations between budget lines have contributed to variance in expenditure composition *beyond* the variance resulting from changes in the overall level of expenditure. In order to be compatible with Indicator 1, this indicator should also exclude debt service payments and donor funding from its calculation.

Specifically, the data used for the calculation of PEFA indicators 1 and 2 includes all budgeted expenditure for the years in question other than the following demands:

- Servicing of foreign loans (Ministry of Economic Affairs and Statistics)
- Repayment of foreign loans (- see discussion of debt repayment pp 9-10)
- Servicing of domestic loans (Ministry of Finance and Revenue)
- Repayment of domestic loans (- see pp 9-10)
- Repayment of short term foreign credit (- see pp 9-10)

It has not been possible to separate out donor funding from the analysis of indicators 1 and 2 since the data sources used do not identify donor spending in the final accounts. It is not clear to what extent foreign assistance is shown in budget documents (i.e. the extent it is 'on-budget'). Therefore, donor funded project expenditure has not been subtracted from the calculation of indicators 1 and 2 as recommended by the PEFA methodology.

It should be noted that the items listed above have been removed *both* from the total expenditure figure *and* from the ministry level (i.e. the relevant demands have been removed). This ensures that the percentages calculated for indicators 1 and 2 are accurate and comparable. It does, however, mean that the total expenditure figures used in these calculations will not be exactly the same as those used in the previous section of this report.

Detailed calculations for PEFA Indicators 1 and 2 are shown in **Annex 4**.

**PEFA Indicator 1**

Table 4 below shows the calculation for PEFA indicator 1.

Table 4: PEFA Indicator 1

EXPENDITURE CATEGORY	2003/04			2004/05			2005/06		
	Original	Actual	Diff.	Original	Actual	Diff.	Original	Actual	Diff.
Total Expenditure	680.0	613.7	-9.7%	696.9	761.5	+9.3%	1000.3	913.7	-8.7%

Source: Annex 4

In Table 4, 'Original' refers to the total budget including both recurrent and development spending, but exclusive of those items outlined above. Total expenditure therefore equals total recurrent and developments less all debt related expenditure (servicing and repayment) and less grants in aid and miscellaneous adjustments between federal and provincial government. 'Actual' refers to the total expenditure in that year, following the same definition. 'Diff' refers to the difference between the original estimate and actual expenditure, with the difference expressed as a percentage of the original budget.

**Results:**

- **The rating for PEFA Indicator 1 is B** because actual expenditure has deviated from budgeted expenditure by more than 5% of budgeted expenditure (the benchmark for scoring A) but less than 10% of budgeted expenditure (the minimum performance level for a B) in at least 2 of the last 3 years.
- **PEFA Indicator 1 only just achieves a score of B.** It can be seen that performance against the indicator is improving slowly over time
- Underperforming revenue collection cannot be used to explain the fact that in two of the last three years actual expenditure has fallen short of original budgeted expenditure. Original revenue estimates during the period have been conservatively set, with actual revenue receipts being 9% above the budgeted figure in 2003/04, 13% above the budgeted figure in 2004/05 and 10% above the budgeted figure in 2005/06.<sup>10</sup>
- In order to score an A for this indicator the difference between the original budget and actual total expenditure must be below 5% for the next two fiscal years (2006/07 and 2007/08). To score an 'A' for this indicator actual expenditure must be within 5% of original expenditure for at least two of the last three years.
- The earliest possible date at which the score for this indicator could change is once the accounts for 2007/08 become available (i.e. in the autumn of 2009).

<sup>10</sup> Data for 2005/06 is a preliminary estimate. See Table 6 for further details of original revenue budgets and actual out-turn.

## PEFA Indicator 2

PEFA Indicator 2 makes an empirical assessment of expenditure out-turns against the original budget at the sub-aggregate level (ministry/agency). To make the assessment, the total variance in expenditure composition at this level is calculated and compared to the overall deviation in expenditure for each of the last three fiscal years. Table 5 below shows the calculation for PEFA Indicator 2.

Table 5: Calculation of PEFA Indicator 2

	Sum of absolute deviations at the ministry level (R Bn)	Deviations as a percentage of original allocation	Percentage deviation less overall deviation
<b>2003/04</b>	148.3	22%	12.1%
<b>2004/05</b>	198.3	29%	19.2%
<b>2005/06</b>	335.7	34%	24.9%

Source: Annex 4

Table 5 should be interpreted as follows:

- '*sum of absolute deviations at the ministry level*' refers to the sum of the absolute value of the difference between original and actual for each ministry. The demands that relate to debt (as listed on p13 above) have been removed from the ministry totals, for both originals and actuals
- '*deviations as a percentage of original allocation*' refers to the sum of absolute deviations as a percentage of the sum of all of the original allocations to the ministries. Again, those items listed on page 13 have been removed from ministry totals
- '*deviation less overall deviation*' shows what is left when the overall % deviation found for that budget year (as per PEFA Indicator 1) is deducted from the sum of deviations at the ministry level (expressed as a % of the sum of all of the original allocations). The result shows the extent to which deviations at the ministry level are over and above the overall level of deviation in the budget.

Results:

- **The rating for PEFA Indicator 2 is D** because in at least two of the three years studied, deviation at the ministry level exceeded overall deviation by more than 10%. **By international standards the original budget is an extremely poor indicator of the actual level of expenditure at ministry level.**
- **Performance against PEFA Indicator 2 worsened over the period.** In other words, individual ministry budgets are becoming less predictable at the same time as the predictability of the budget at an aggregate level (as measured by Indicator 1) is improving. The variance between original budget and actual expenditure at ministry

level is significant both in terms of the number of ministries where variance is observed and the average variance observed in those ministries.<sup>11</sup>

- In order to score a 'C' for this indicator, the percentage deviation less overall deviation needs to be below 10% in each of the next two years. The earliest possible date at which this indicator could change is once the accounts for 2007/08 become available (i.e. in the autumn of 2009).

### PEFA Indicator 3

Accurate forecasting of domestic revenue is a critical factor in determining budget performance, since budgeted allocations are based on that forecast. A comparison of budgeted and actual revenue provides an overall indication of the quality of revenue forecasting. This comparison is measured by PEFA Indicator 3.

PEFA Indicator 3 looks at the extent to which actual revenue collections fall short of budgeted revenue collection. To score an 'A' actual revenues must be 97% or more of budgeted revenue collection in at least two of the last three fiscal years; to score 'B' they must be 94% or more of budgeted revenue collection; to score 'C' they must be 92% or more; and performance worse than this scores 'D'. PEFA Indicator 3 is therefore concerned with measuring the extent to which actual revenue collections fall short of original budgeted revenue collection.

In the case of Pakistan, the Government has in recent years of basing its budgets on conservative revenue estimates. Actual revenue collections have outperformed budgeted collections by 9%, 13% and 10% in each of the last three fiscal years 2003/04, 2004/05 and 2005/06 respectively. Table 6 below shows the calculation for PEFA Indicator 3.

Table 6: PEFA Indicator 3

REVENUE CATEGORY	2003/04		2004/05		2005/06	
	Original	Actual	Original	Actual	Original	Rev. Est.
Tax Revenue	577.6	611.5	654.8	659.4	700.1	715.7
Non-Tax Revenue	150.8	182.7	141.5	240.7	227.3	307.0
Revenue (Gross)	728.4	794.2	796.3	900.1	927.4	1022.7
Difference		+9.0%		+13.0%		+10.3%

Source: Ministry of Finance website for actuals for 2003/04 and 2004/05, Annual Budget Statement 2006/07 for revised estimate for 2005/06. Budget documents for originals budgets.

Table 6 should be interpreted as follows:

- Tax revenue comprises direct and indirect taxes

<sup>11</sup> For example, in 2005/06 out of 42 main expenditure heads (of which 38 relate to federal ministries) in only eight cases was actual expenditure within 10% of original budgeted expenditure

- Non-tax revenue comprises income from property and enterprise, receipts from various civil administration functions, and other miscellaneous receipts
- Revenue (gross) refers to total revenue receipts. The Government also receives capital receipts (investments, loans and new debt receipts) each year but these are not included in the table.

Results:

- **The rating for PEFA Indicator 3 is A**, since budgeted revenue has been achieved in each of the last three fiscal years.
- In the particular context of Pakistan, it should be noted that the revenue performance described above is combined with systematic use of supplementary budget appropriations that are only presented to the legislature at the end of the year (after the expenditure has been incurred). Supplementary budgets are considered in the next section.
- Weak control of supplementaries means that the executive has created a situation whereby unappropriated revenues are being used for additional expenditures without prior approval by the legislature. This helps explain the score that emerges for Indicator 1 and, in particular, the low score that emerges for Indicator 2

## 5. Supplementary Budgets and Revised Estimates

This section analyses the extent to which supplementaries are used in the GoP budget process. It also provides further analysis of the revised estimates used by the GoP for the purposes of budget preparation for the forthcoming budget year.

It is recognised that in order for supplementary allocations to be made to some Ministries, surrenders are often made elsewhere. This section does not analyse where these surrenders come from, since it is concerned primarily with the extent to which supplementaries and whether there are any particular ministries that tend to rely on supplementary budgets. This is of interest, since if there are particular ministries that always have high supplementary allocations it would seem prudent to ask why those ministries do not simply receive a higher allocation in the original budget at the start of the budget year.

Ministries prepare revised estimates to try to take account of expenditure performance during the year before preparing the next year's budget (including any supplementary budgets that they may receive). It is recognised that revised estimates may not fully capture all supplementary budgets, which continue to be made after revised estimates have been prepared.

### Data

The same data that was used for the calculation of the PEFA indicators, as described in Section 4, is used here. The interest, as before, is to analyse those areas of expenditure where the government has discretion. There are some items over which the government has relatively little discretion such as supplementaries for loans and interest repayments caused by exchange rate and interest rate movements and these have been removed from the data set. Other items, such as debt repayments, tend to be relatively predictable but because they often represent a large proportion of total expenditure their relative predictability can mask lack of predictability elsewhere in the budget. Therefore, as with Section 4, debt repayment has also been removed from the analysis.

### Supplementary Budgets

Table 7 presents analysis of the use of Supplementary Allocations for the last three fiscal years. It focuses on supplementary budget allocations to recurrent, development, debt service and other non-debt related expenditures. It does not look at the impact of supplementary estimates on total expenditure including debt repayment, for the reasons mentioned above.

Table 7 should be interpreted as follows:

- 'Original' shows original budgeted expenditure as per Table 1.
- 'Supplementary' shows supplementary expenditure against the relevant expenditure category as per Annex 1
- '%' shows the relative magnitude of supplementary expenditure as a percentage of the originally approved budget.

Table 7: Original Budgets and Supplementary Budgets, Rupees Bn

EXPENDITURE CATEGORY	2003/04			2004/05			2005/06		
	Original	Supp.	%	Original	Supp.	%	Original	Supp.	%
Total Recurrent	543.4	70.0	13%	519.6	160.5	31%	764.0	149.1	20%
Total Development	135.4	14.7	11%	175.7	20.4	12%	235.6	56.7	24%
Charged (debt-service)	210.0	7.0	3%	214.2	9.9	5%	236.0	10.4	4%
Charged (non-debt related)	1.2	0.3	25%	1.6	1.0	63%	1.8	0.8	44%
Total	890.0	92.0	10%	911.1	191.8	21%	1237.4	217.0	18%

Source: See Annex 1

#### Results:

- Amounts equivalent to 10%, 21% and 18% of the originally approved budget were provided in the form of supplementary allocations in 2003/04, 2004/05 and 2005/06 respectively. It is understood that these allocations are only approved *ex post facto* (i.e. supplementaries are approved by the legislature at the end of the fiscal year, after the expenditure has taken place)
- Supplementary budget are used extensively on both recurrent and development budgets.
- The overall use of supplementaries follows the same pattern as trends in revenue collection. A comparison of tables 6 and 7 shows that when actual revenue collection most exceeds budgeted revenues, supplementaries are most used (in FY 2004/05 when revenue most overshoot the original budget, supplementaries were most extensively used compared with other years).
- The recent earthquake which hit the northern areas of Pakistan occurred in FY 2005/06. It can therefore be understood that supplementaries would be used during 2005/06, since the earthquake would lead to considerable expenditure that was unforeseeable at the start of the budget year. However, this doesn't explain the larger use of supplementary appropriation in 2004/05

#### Revised Estimates

Table 8 provides a summary of actual expenditure, as per Table 1, and revised estimates. For each year the revised estimate is shown for each main category of expenditure alongside the actual level of expenditure for that category. The difference between revised and actual expenditure is shown as a percentage of actual expenditure.

Table 8: Revised Estimates and Actual Expenditures, Rupees Bn

EXPENDITURE CATEGORY	2003/04			2004/05			2005/06		
	Revised	Actual	%	Revised	Actual	%	Revised	Prelim.	%
Total Recurrent	504.6	483.7	+4%	738.8	597.9	+24%	937.5	661.6	+42%
Total Development	110.8	128.8	-14%	149.3	161.9	-8%	243.1	248.8	-2%
Charged (debt-service)	208.0	203.3	+2%	220.5	216.3	+2%	241.2	237.1	+2%
Charged (non-debt)	1.2	1.3	+8%	2.4	1.7	+41%	1.8	2.4	-29%
Total	824.6	817.1	+1%	1111.0	977.8	+14%	1423.6	1149.9	+24%

Source: See Annex 1

#### Results:

- Revised estimates are an unreliable guide to actual expenditure.
- Revised estimates tend to overestimate actual expenditure - in the case of the recurrent budget, significantly so. The revised estimates for recurrent expenditure are consistently higher than actual expenditure. This trend has become more marked over the period, with the revised estimate for 2005/06 overestimating actual expenditure by some 42%.
- The revised estimates for development expenditure are consistently below actual expenditure, but are more accurate than revised estimates for recurrent expenditure.
- Revised estimates for development expenditure have improved in their accuracy over the period so that by 2005/06 the revised estimate for development expenditure was within 2% of actual expenditure.
- Revised estimates for debt service are reasonably accurate (within 2%)

Table 9 below provides further analysis of Revised Estimates. It shows the difference between revised estimates and actual expenditure as a percentage of revised estimates, measured in three different ways – mean difference, median difference, and analysis of the sum differences;

- Mean percentage difference at the ministry level refers to the difference between actual and revised as a percentage of revised, calculated for each ministry. The figure shown in the table is the mean of this figure across all of the ministries;
- Median percentage difference at the ministry level refers to the difference between actual and revised as a percentage of revised, calculated for each ministry. The figure shown is the median value of this calculation across all of the ministries. This figure has been calculated as well because the mean value is significantly affected by a few ministries for which the difference between actual and revised as a percentage of revised is particularly high (such as the Ministry of Defence Production);

- (iii) Sum of absolute difference at the ministry level as a percentage of total revised has been calculated by working out the difference between actual and revised for each ministry, and adding these figures together. The sum has then been divided by the sum of the revised figures for each ministry;

The mean and median are absolute measures and show the full extent of variation (if the direction of the difference was not taken out, a significant underestimate in one ministry would be offset by a significant over estimate in another Ministry). The sign has been left in for the third measure, which compares only *total* actual and *total* revised therefore the problem described above is not relevant here.

Table 8: Analysis of Revised Estimates

	2003/04	2004/05	2005/06
Mean % difference at ministry level	30%	19%	..
Median % difference at Ministry level	10%	10%	14%
Sum of absolute difference at ministry level (as % of total revised)	13%	25%	32%

Source: See Annex 4. The Mean % difference measure is omitted for 2005/06 as this provides a misleading picture owing to outliers.

## **Annex 1: Expenditure of the Federal Government of Pakistan, 2003/04 to 2005/06**

## **Annex 2: The PEFA Framework**

**Separately Attached:** extracts from the *PEFA PFM Performance Measurement Framework* guidelines. For further information see [www.pefa.org](http://www.pefa.org)

## Annex 3: PEFA Guidelines for Indicators 1 and 2

The following explanations are extracts from the PEFA Methodological Manual (pages 19-20), the full text of which can be found on the internet at [www.pefa.org](http://www.pefa.org).

### PI-1 Aggregate expenditure out-turn compared to original approved budget

The ability to implement the budgeted expenditure is an important factor in supporting the government's ability to deliver the public service for the year as expressed in policy statements, output commitments and work plans. The indicator reflects this by measuring the actual total expenditure compared to the originally budgeted total expenditure (as defined in government budget documentation and fiscal reports, but excludes two expenditure categories over which the government will have little control. These categories are (a) debt service payments which in principle the government cannot alter during the year, while they may change due to interest and exchange rate movements, and (b) donor funded project expenditure, the management and reporting of which are typically under the donor agencies' control to a high degree.

In order to understand the reasons for a deviations from the budgeted expenditure, it is important that the narrative describes the external factors that may have led to the deviation and particularly makes reference to the impact of deviations from budgeted revenue, assessed by indicators PI-3 (domestic revenue) and D-1 (external revenue). It is also important to understand the impact of a total expenditure deviation on the ability to implement the expenditure composition as budgeted, ref also PI-6 and PI-16.

#### Dimensions to be assessed (Scoring Method M1)

- i. The difference between actual primary expenditure and the originally budgeted primary expenditures (i.e. excluding debt service charges, but also excluding externally financed project expenditure).

Score	Minimum Requirements (Scoring Method M1)
<b>A</b>	(i) In no more than one out of the last three years has the actual expenditure deviated from budgeted expenditure by an amount equivalent to more than 5% of budgeted expenditure
<b>B</b>	(i) In no more than one of the last three years has the actual expenditure deviated from the budgeted expenditure by an amount equivalent to more than 10% of budgeted expenditure
<b>C</b>	(i) In no more than one of the last three years has the actual expenditure deviated from the budgeted expenditure by more than an amount equivalent to 15% of budgeted expenditure
<b>D</b>	In two or all of the last three years did the actual expenditure deviate from budgeted expenditure by more than 15% of budgeted expenditure

**PI-2 Composition of expenditure out-turn compared to original approved budget**

Where the composition of expenditure varies considerably from the original budget, the budget will not be a useful statement of policy intent. Measurement against this indicator requires an empirical assessment of expenditure out-turns against the original budget at a sub-aggregate level. As budgets are usually adopted and managed on an administrative (ministry/agency) basis, the administrative basis is preferred for assessment, but a functional basis is an acceptable alternative. At administrative level, variance shall be calculated for the main budgetary heads (votes) of ministries, independent departments and agencies, which are included in the approved budget. If functional classification is used, it should be based on the GFS/COFOG ten main functions.

Changes in overall level of expenditure (assessed in PI-1) will translate into changes in spending for administrative (and functional) budget lines. This indicator (PI-1) measures the extent to which reallocations between budget lines have contributed to variance in expenditure composition beyond the variance resulting from changes in the overall level of expenditure. To make that assessment requires that the total variance in the expenditure composition is calculated and compared to the overall deviation in primary expenditure in each of the past average three years.

Variance is calculated as the weighted average deviation between actual and originally budgeted expenditure calculated as a percent of budgeted expenditure on the basis of administrative or functional classification using the absolute value of deviation. In order to be compatible with the assessment in PI-1, the calculation should exclude debt service and donor funded project expenditure.

**Dimensions to be Assessed (Scoring method M1)**

<b>Score</b>	<b>Minimum Requirements (Scoring method M1)</b>
<b>A</b>	(i) Variance in expenditure composition exceeded overall deviation in primary expenditure by not more than 5 percentage points in any one of the last 3 years
<b>B</b>	(i) Variance in expenditure composition exceeded overall deviation in primary expenditure by 5 percentage points in not more than one of the last 3 years
<b>C</b>	(i) Variance in expenditure composition exceeded overall deviation in primary expenditure by 10 percentage points in no more than one of the last 3 years
<b>D</b>	(i) Variance in expenditure composition exceeded overall deviation in primary expenditure by 10 percentage points in at least two out of the last 3 years

## **Annex 4: Detailed calculations for PEFA Indicators 1 and 2**