PROVINCIAL GOVERNMENT RESOURCE MOBILISATION

By

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L INTRODUCTION

The 1991 NFC award has put the onus on provincial governments of self-financing any revenue deficits during the tenure of the award. Prior to this award, the general practice had been for the federal government to give grants to cover any resource gap in the current account of the provinces. In addition, given the macro-resource constraints confronting the country and the large size of the national budget deficit, the federal government is unlikely to be in a position to increase significantly in real terms the Annual Development Programme allocations to the provinces in coming years. Therefore, resource mobilisation from own revenue sources has assumed greater importance if provincial governments are to continue generating surpluses in their non-development budget and raise the level of their development expenditure primarily from such surpluses.

The objective of this paper is to analyse the scope which exists for higher provincial resource mobilisation, in the context of Punjab. Section 2 of the paper gives the trend in the revenue receipts of the government of Punjab and highlights the changes in the share of provincial own tax and non-tax receipts. Section 3 covers provincial tax revenues and discusses the major issues relating to provincial taxation. It presents a strategy for resource mobilisation, within the context of which some detailed proposals are presented for higher revenue generation. Section 4 analyses non-tax receipts and focuses specifically on user charges. The scope for mobilisation of revenues from such charges is also discussed.

2. COMPOSITION OF REVENUE RECEIPTS Table 1 highlights the composition of revenue receipts of the government of Punjab. The importance of provincial tax and non-tax revenues has been declining over time, from about 29 percent in 1984-85 to 23 percent in 1991-92 after the 1991 NFC award which led to a large increase in divisible pool transfers. Within revenues generated by the Punjab government, the share of taxes is 60 percent and that of non-tax sources,

TABLE 1

COMPOSITION OF REVENUE RECEIPTS

OF GOVERNMENT OF PUNJAB

(Rs in Million)

1984-85		**1990-91**	**1991-92**	**1992-93**	**ACGR****
	(A)	(R)	(R)	(B)	(%)
Provincial Own Tax Receipts	1844	4649	5325	6236	16.4
Provincial Own Non-Tax Receipts	1952	3423	3588	4034	9.1
Divisible Pool Transfers	6308	18673	28721	32339	24.2
Non-Development Grants	3120	2661	1162	2139	-13.2
Total*	13227	29404	38796	44746	16.6
SHARES (%)					
Provincial Own Tax Receipts	13.9	15.8	13.7	13.9	
Provincial Own Non-Tax Receipts	14.8	11.6	9.2	9.0	
Divisible Pool Transfers	47.7	63.5	74.0	72.3	
Non-Development Grants	23.6	9.1	3.0	4.8	
Total*	100.0	100.0	100.0	100.0	

* Totals may not add up due to rounding.

** Annual Compound Growth Rate between 1984-85 and 1991-92
A - Actual, R = Revised, B = Budget.
Source: Annual Budget Statement, Finance Department, Government of Punjab.

40 percent. The former have shown relative dynamism, with an annual growth rate of over 16 percent. Non-tax revenues have experienced only modest growth of about 9 percent per annum. The basic conclusion is one of increased dependence of Punjab government on federal transfers and the need, therefore, to increase the component of financing from own revenue sources.

3. TAX RECEIPTS

3.1 Allocation of Fiscal Powers

Taxes with the federal government have been explicitly specified in the 1973 Constitution. Within these sources certain exceptions have been identified which consequently fall within the purview ol'provincial governments. These include the tax on agricultural income, capital gains tax on immovable property and taxes on the purchase or sale of services (excluding railway, sea or air transport). The 1991 NFC Award (in para 45) explicitly hands over the responsibility of collection of a retail sales tax to the provinces. In addition, provincial governments have retained the power to levy the following taxes: excise duties on alcoholic liquor, opium and narcotics; tax on professions, trades and callings; tax on immovable property; land revenue; tax on motor vehicles; stamp duties; entertainment taxes etc.

It is estimated that in 1990-91, 88 percent of the tax revenues were generated by the federal government and 6 percent each by the provincial and local governments respectively. In terms of the share in expenditure, 68 percent is incurred by the federal government, 28 percent by the provincial governments and 4 percent by the local governments. Therefore, provincial expenditure is almost five times the revenue collected from own sources. This highlights the fundamental imbalance in the allocation of fiscal powers in Pakistan. The resource gap of provincial governments has been covered by the flow of funds from the divisible pool of federal taxes and by revenue-deficit grants.

3.2 Provincial Taxation Structure The primary sources of provincial revenue consist of taxes on physical and financial assets. The largest revenue earner is *stamp duties* which is levied on most civil, judicial and commercial documents. The biggest share of revenue within stamp duties is generated from property transactions (duty rate of 8 percent of sale value). Specific rates of duty are charged generally on affidavits, mortgage deeds, rent agreements, bills of lading, securities, bonds, bills of exchange, promissory notes, debentures, etc. The rates of duty are generally low and have remained unchanged for a long period of time.

The *property tax* is levied by the provincial government of Punjab on urban immovable property. This tax is shared with the local governments, such that only 15 percent of the revenues (net of costs of collection) are retained by the province. The tax is charged on the annual rental value (ARV). As shown in Table 2, the tax rate in Punjab ranges from 20 to 25 percent. Under the rules, the property tax cadastre is expected to be updated every five years. Punjab has been able to adhere to this schedule although the reassessments have not been market-based and generally involve an ad-hoc increase of 5 to 10 percent only in ARVs. As a consequence, the ARVs currently bear little relationship to the market rental values. A study by Ghaus (1991) reveals that only about one-tenths of the values are currently being captured by the provincial excise and taxation department, especially in the case of owner-occupied properties. Numerous exemptions have also been granted by size (plots below 100 sq. yards or threshold level of ARV), or by type of owner (government, widows, orphans, etc.). These have eroded the tax base further, and have meant that only about one-thirds to one-half of the properties assessed actually pay tax.

The other tax on physical assets is the *motor vehicle tax* (MVT). It is levied on owners, largely at specific rates on seating or engine capacity in the case of buses, and laden weight in the case of trucks and other heavy vehicles. Agricultural tractors/trailers, special purpose vellicles (ambulances, school buses, etc.) and the National Logistics Cell (NLC) vehicles are exempt from the MVT. As shown in Table 2, tax rates in Punjab are somewhat below those in NWFP, similar to those in Sindh and higher than rates in Balochistan. Upward adjustments in the rates are infrequent, with the last revision in 1981. In addition to the MVT, the province also levies a registration fee on new vehicles. This is specific in character, and ranges from Rs 200 for motor cycles to Rs 1,500 for buses and trucks.

1 he above three taxes on assets are essentially charged from tax payers in the urban areas. In rural areas, a tax, the *land revenue,* is levied on the owners of agricultural

TABLE 2

PROVINCIAL TAX RATES IN PAKISTAN

	SINDH	**PUNJAB**	**NWFP**	**BALOCHISTAN**
STAMP DUTY				
(on urban property sales)	8%	8%	8%	8%
MOTOR VEHICLE TAX				
Motor Cycle	Rs 52 - 68	Rs 52 - 68	Rs 52 - 80	Rs 25 - 50
Cars/Jeeps/Wagons	Rs 480-600	Rs 384-1000	Rs 400-600	n.a
Rickshaw	Rs 400	Rs 392	Rs 400	Rs 330
Taxi	Rs 520-660	Rs 520	Rs 520	Rs 520
Trucks	Rs 376-2828	Rs 376-2828	Rs 400-3000	Rs 320-1848
Buses (per seat)	Rs 98-150	Rs 88-168	Rs 120-168	Rs 16
REGISTRATION FEE				
(by type of vehicle)	Rs 125-1500	Rs 200-1500	Rs 100-1000	n.a
PROPERTY TAX				
Commercial/Industrial	20% - 25%	20% - 25%	15% - 20%	10%- 15%
EDUCATION CESS				
(per worker)	Rs 100	Rs 100	Rs 100	Rs 100
ENTERTAINMENT TAX				
(on cinema)	75%	65%	50%	n.a
HOTEL TAX				
(per room per day)	Rs10- 50	7.5%	7.5%	n.a
PROFESSIONAL TAX				
(on individuals)	Rs 150	Rs 100	Rs 100	n.a
PADDY FEE				
(per quintal)	Re 1	Rs 1.5	n.a	n.a

Source: Excise and Taxation Departments of Provincial Governments.

land. The tax base, as prescribed in the 1967 Land Revenue Act, is the net produce of land. However, assessment is generally on a presumptive basis. These assessments are very outdated as there has been no primary land settlement survey after 1974. The rate of land revenues varies for barani and irrigated areas, and by size of holding. Exemptions include barren or uncultivated land and small land holdings (12 acres of irrigated and 25 acres of barani land). The tax base has been significantly eroded since 1982 when a blanket tax exemption was accorded to all Sunni Muslims following the introduction of *ushr.*

The next category of provincial taxes consists of taxes which are levied essentially in the nature of excise duties on services (with federal government having fiscal powers in the manufacturing sector). Three taxes fall in this category - the electricity duty, the entertainment tax and the hotel tax. 'the *electricity duty* is levied at varying rates by consumer on an ad valorem basis and is collected by WAPDA. The *entertainment tax* applies to movies« theatrical plays, etc. It was originally in the nature of a (seating) capacity tax and has recently been linked on an ad valorem basis to admission fees. The *hotel tax* is levied on larger hotels, with higher tariffs, on billings at the rate of 7 1/2 percent. The federal government also charges an excise duty on hotel services and this has led to problems of double taxation.

Among the minor taxes, the provincial government also levies the equivalent of a small, flat rate income tax called the *professions, callings and trades tax.* In principle, this tax is applicable to all those engaged in gainful employment, including professionals, traders, factories, commercial establishments and contractors. For professionals, the rate in Punjab is Rs 100 . In the rural areas, potentially significant sources of revenue currently are the *cotton fee* and the *paddy fee.*

As far as the incidence of provincial taxes is concerned, recent estimates by Pasha and Ghaus (1991) are that the burden is, more or less, progressive in character. This can be expected, given the high share of taxation on ownership of physical and financial assets. This has the implication that development of provincial taxes will increase the equity of the tax system as a whole.

3.3 Trends in Revenues

Provincial tax revenues are projected at Rs 6.2 billion during the current financial year, as shown in Table 3. Provincial taxes which are direct in nature like the land revenue, urban immoveable property tax, transfer of property tax and the tax on professions, trades and callings collectively contribute about 17 percent to tax revenues. This share has been falling, from over 26 percent in 1984-85.

As highlighted earlier, the largest provincial tax is stamp duties. Historically, the motor vehicle tax has been the second most important source of revenue. It is expected, however, that in 1992-93 revenues from land revenue will exceed those from the MVT for the first time. This is a reflection not only of the lack of buoyancy in the latter source but also of improved fiscal effort in the former tax. The share of land revenue (largely from mutation fees) at 11 percent in Punjab is significantly higher than that in the other three provinces combined of less than 5 percent. This indicates that the burden of provincial taxes on rural households in Punjab is higher.

The degree of skewness in the provincial taxation structure is demonstrated by the fact that out of the eleven major taxes, the three biggest sources (stamp duties, MVT and land revenue) collectively account for as much as 76 percent of total tax revenues. The two other taxes with a share in excess of 5 percent are electricity duty and cotton fees. Both these taxes have shown relatively fast growth.

Altogether, the annual growth rate of provincial tax revenues is estimated at about 16 percent between 1984-85 and 1991-92. The corresponding growth rate in the Gross Regional Product of the province is also 16 percent. This implies that the provincial tax to GRP ratio has remained stagnant over time.

3.4 Issues in Provincial Taxation

Limitation of Fiscal Powers: It has been argued that there is very little scope for provincial resource mobilisation because taxes, with large and relatively buoyant tax bases, like import duties.income and corporation tax, excise duties and sales tax have been pre-empted by the federal government. The taking over of the sales tax, in particular, by the federation soon after partition has been cited as a major encroachment on provincial fiscal powers.

TABLE 3

TRENDS IN TAX REVENUES OF GOVERNMENT OF PUNJAB

(Rs in Million)

	1984-85 (A)	1990-91 (R)	1991-92 (R)	1992-93 (B)	Share in 1991-92 (%)	ACGR** (%)
DIRECT TAXES*	481	790	926	1000	17	9.8
Land Revenue	166	501	587	641	11	19.8
Capital Gains Tax	129	-	-	-	-	-
Transfer of Property Tax	110	150	170	172	3	6.4
Property Tax	46	99	125	138	2	15.4
Tax on Professions, Trades & Callings	30	40	44	49	1	5.6
INDIRECT TAXES	1363	3859	4399	5236	83	18.2
Stamp Duties	581	1903	2897	3159	54	25.8
Motor Vehicle Tax	301	576	607	628	11	10.5
Electricity Duty	127	839	304	346	6	13.3
Cotton Fee	80	225	240	240	5	17.0
Entertainment Tax	191	169	175	176	3	-1.2
Provincial Excise	25	88	116	124	2	24.5
Tax on Hotels	7	21	29	30	1	22.5
Others	51	38	31	533	1	-8.6
TOTAL***	1844	4649	5325	6236	100	16.4

A = Actual, R - Revised, B - Budget.

* Given in descending order of revenue in 1991-92 by type of tax.

** Annual Compound Growth Rate between 1984-85 and 1991-92.

*** Totals may not add up due to rounding.

Source: Annual Budget Statement, Finance Department, Government of Punjab.

It needs to be emphasised, however, that within existing sources, the scope for generating higher revenues has not been fully exploited by the provinces. The issue of taxation of agricultural income, a provincial subject, remains unresolved. Capital gains tax on immovable property which falls within provincial fiscal powers has been abolished and substituted by a higher stamp duty. This substitution has led to significant revenue losses, created serious distortions in the property market and meant that the provinces have not fully benefited from the tremendous boom in real estate values during the 80s. Also, the federal government has been limited constitutionally to the levy of a sales tax only on goods and not on services. The latter has been left to the provincial governments, who have been slow in exploiting the vast potential that exists in taxation of fast-growing services like telecommunications, banking, insurance, etc. Instead, the federal government has tapped substantial revenues in recent years from these sources by extending the coverage of excise duties.

The 1991 NFC award has also handed over the responsibility of retail sales taxation to the provinces. The federal government has encroached in this area also by recently introducing such a tax on 21 items, primarily consumer durables. The provinces have not yet taken any steps towards implementation of retail sales taxation due perhaps to problems of lack of documentation and high number of small outlets, implying high resulting costs of collection. Altogether, it appears that while provincial governments in Pakistan have been granted limited fiscal powers they have failed to even exploit effectively the sources available to them.

Buoyancy of Revenues: As highlighted earlier, the slow rate of growth of provincial revenues has been attributed to the low elasticity of the provincial tax bases. Akhtar (1990) demonstrates that this is actually not the case. Her estimates of the relevant buoyancy coefficients, as shown in Table 4, highlight the fact that tax base to GDP buoyancy coefficients are in excess of or close to unity in the case of most taxes, except the motor vehicle tax. The basic problem, in fact, appears to be low tax revenue-to-tax base buoyancy coefficients in the case of stamp duty, entertainment tax and property tax. This can be attributed largely to the presence of specific tax rates. In the case of property tax, the statutory rate is ad valorem in character, but has effectively become specific because of lack of proper reassessment ofARVs. Therefore, the buoyancy of the provincial tax system can be enhanced by either making the tax structure ad valorem in nature or by periodically indexing the rates to inflation.

TABLE 4

BUOYANCY OF MAJOR PROVINCIAL TAXES

Tax	Tax Base	Tax Revenue to Tax Base Buoyancy	Tax base to GDP Buoyancy	Tax Revenue to GDP Buoyancy
Stamp Duty	Gross Domestic Product	0.75	1.00	0.75
Motor Vehicle Tax	National Stock of Vehicles Weighted by Tax Rates	1.97	0.51	1.00
Entertainment Tax	Expenditure on Recreation	0.58	1.04	0.60
Electricity Duty	WAPDA & KESC Income from Sale of Electricity	0.70	1.55	1.10
Property Tax	Value Added from Urban Ownership of Dwellings	0.31	1.15	0.35
Tax on Professions and Callings	Non-agricultural GDP	1.45	1.07	1.55
Total Provincial Tax Revenues	Gross Domestic Product			0.62

Source: A study of Provincial Finances by Shamshad Akhter, World Bank Residei it Mission in Pakistan, 1990.

3.5 Resource Mobilisation from Taxes

We have demonstrated above that significant revenue-raising potential exists in the provincial tax system, as the full range of available fiscal powers has not yet been exploited and in the case of many taxes, tax rates are very low and have not been enhanced for a long period of time. We have also concluded that the low buoyancy of provincial taxes is not due to any inherent problem of slow growing tax bases but because of reliance on specific tax rates and inadequate fiscal effort in mobilising more resources.

Therefore, the strategy of resource mobilisation from provincial taxes must attempt to make revenues more dynamic either by reforms leading to a transition from specific to ad valorem taxes or by resort to a policy of indexation of tax rates to inflation. Also, there is clearly a need to develop more revenue sources to broad-base the taxation structure and more effectively link revenues to the growth in the regional economy.

Within the context of this overall strategy, we have identified a number of proposals for mobilising resources which score highly on the following criteria:

Equity; the extent to which the burden of the additional taxation falls on the more well-off households.

Economic Efficiency: the extent to which the proposal distorts behavior and creates dead weight losses.

Simplicity: the degree to which the proposal is easy to administer by the provincial tax departments.

Costs **of compliance:** the extent to which the proposal imposes compliance costs on tax payers.

Elasticity: the extent to which proposal contributes to enhancing the built-in elasticity of the tax system.

Legal Constraints: whether the proposal requires any legislative enactment or changes in existing law.

Scope for Evasion and Corruption: the degree to which revenues from the proposal are vulnerable to evasion and corruption.

Revenue-Raising Potential: the quantum of additional revenues likely to generated by the proposal. These proposals are described below:

Stamp Duty: Examination of the composition of revenues from the tax has revealed some structural problems. There is over-dependence currently on collections from property transactions. This needs to be reduced and a higher proportion of revenues generated from other instruments. In fact, the overall rate (over 10%) of taxation on property sales is too high. The has led to large-scale under reporting and evasion and inhibited proper titling and development of the property market. There is a need for reduction of the rate of stamp duty (from 8% to about 4%)[1].

Simultaneously, to compensate for any loss of revenues, the flat rates on financial instruments should be enhanced, for example, on rental contracts from Rs 10 to Rs 100. Corresponding increases in rates can be achieved for articles of memorandum, partnership deeds, security bonds, share certificates, etc.

Motor Vehicle Tax: The modest growth rate in revenues of about 10 percent can be attributed largely to the specific rates of this tax, which have not been enhanced for some time. Consequently, revenues from this tax currently finance only about half the O&M cost of the inter-urban road network in the province.

We recommend, first, that the registration fee component of the tax be made ad valorem in character and charged at the rate of 1 percent of the landed price of imported vehicles or of the sale price of domestically assembled vehicles. This proposal has a progressive incidence because the additional tax burden will fall largely on owners of vehicles. It is likely to have minimal distortionary effects given the very small tax rate. Also, bills of entry are available for assessment of tax liability on newly imported vehicles and revenues are likely to be buoyant because of the ad valorem nature of the tax and fast growth in the stock of vehicles.

1 . especially after the re-introduction of the capita! gains tax on immovable properties.

Second, Government of Punjab may double on average the flat rates of MVT on existing vehicles over the next five years, with a differentially higher rate of enhancement on trucks with high axle loads. It is necessary, however, that tax rates be harmonized among the provinces, given the mobile nature of the tax base.

Urban Immovable Property Tax: This tax is one of the most underdeveloped sources of revenue in the country. However, higher yields from this tax will mostly benefit local governments. Therefore, proposals for development of this tax are discussed in the paper on Local Government Resource Mobilisation, which is being presented later in the conference.

Electricity Duty: This tax has proved to be one of the more buoyant sources of revenue in the province. It is essentially in the nature of a sales tax. Therefore, an attempt must be made through a policy of gradual escalation of rates to approach the standard general sales tax (GST) rate in Pakistan of 12 1/2 percent. Regressivity of the impact can be limited by exempting smaller consumers.

Tax on Professions, Trades and Callings: This tax is a simple, flat rate provincial equivalent of the federal income tax. Revenues could be increased initially by handing over collection responsibility in the case of individual and corporate taxpayers to the federal income tax department. The provincial excise and taxation department can concentrate on collecting PCT tax from persons outside the income tax net.

We now turn to proposals for new taxes within existing fiscal powers.

Vacant Plot Tax: A significant new source of revenue to provincial governments which is worthy of consideration is vacant plot tax. Currently, it is estimated that over 150,000 developed plots are lying idle in Lahore. This reflects the rampant speculation that is currently taking place, largely with black money. The vacant plot tax will not only discourage this speculation but it may also fetch sizeable revenues. It is proposed to levy this tax on plots above 120 square yards which remain undeveloped after three years of allotment, at rates ranging from Rs 5 to Rs 10 per square yard per annum.

Capital Gains Tax: The capital gains tax on urban immovable property was abolished by the provincial governments in 1985-86. Prior to this, the tax had been the most buoyant and progressive source of revenue. The abolition of this tax was accompanied by an increase in the rate of stamp duty (from 6 percent to 8 percent) on property sales. The basic merit of the capital gains tax, as opposed to the stamp duty, is that it only taxes increments in value resulting from a transaction. As such, we recommend that the capital gains tax be re-introduced. The stamp duty rate on property sales can than be brought down from 8 percent to 4 percent.

Retail Sales Tax: As mentioned earlier, the retail sales tax has been transferred to the provinces in the 1991 NFC award. Given implementation difficulties, the provincial government may, as an initial step, examine the scope for levy of a presumptive sales tax on larger outlets in commercial centres of the bigger cities of the province.

Agricultural Income Tax: Last but not the least, we have to consider the case for introduction of an agricultural income tax. I-Iowever, imposition of such a tax remains a very contentious issue in Pakistan. Arguments in favour and against the levy of the tax have been summarized in Qureshi (1987) and Naseem and Akhiaque (1992). It is clear that an agricultural income tax of the conventional type will be very difficult to administer by the provincial tax administration (Board of Revenue). If the issue of whether the rural sector is undertaxed or overtaxed can be resolved, then the feasible strategy appears to be to use the land revenue system as a surrogate for AIT. This would justify the enhancement of rates of land revenue in the province. However, for this to yield more revenues there will simultaneously have to be more effective collection of *ushr,* to prevent a large-scale erosion of the land revenue base.

4. NON-TAX **RECEIPTS**

Table 5 gives the summary picture of non-tax receipts of the government of Punjab. These are projected at about Rs 4 billion in 1992-93, with modest growth of only 9 percent per annum. Bulk of the contribution is by user charges. Receipts from the economic sectors account for 55 percent and these from the social sectors, 21 percent. The other significant source of income is law and order receipts, with a share of 9 percent. We focus our analysis mostly on user charges.

TABLE 5

NON-TAX RECEIPTS OF GOVERNMENT OF PUNJAB

(Rs in Million)

	1984-85 (A)	1990-91 W	1991-92 (R)	1992-93 (B)	Share in 1991-92 (%)	ACGR (%)
Profit of Electricity	-	-	100	110	3	-
Income from Property & Enterprises	66	241	100	210	3	6.1
Receipts from General Administration	44	83	83	89	2	9.5
Law and Order (receipts	176	295	317	336	9	8.8
Receipts from Economic Sectors*	1211	1794	1967	1985	55	7.2
Receipts from Social Sectors*	337	683	764	1037	21	12.4
Other Receipts	118	326	255	268	7	11.6
TOTAL**	1952	3423	3588	4034	100	9.1

* Based on a reclassification of the following sectors - community services, social services and economic services.

** Totals may not add up due to rounding.

Source: Annual Budget Statement, Finance Department, Government of Punjab.

4.1 Trends in Revenues

Table 6 indicates that, in Punjab, revenue receipts from irrigation services, in absolute nominal terms, dominate the receipts over the other sectors. As far as the trend in the other economic sectors is concerned, revenues from works and agriculture, though relatively small in magnitude when compared to the dominant irrigation service, seem to have grown (on an annual basis) faster than the other remaining sectors. It is important to note that services from forestry also generate relatively large revenue receipts for Punjab but display a slow growing trend in revenue receipts.

Trends in revenue receipts from social services of Punjab are presented in the lower half of Table 6. Social services are divided into four broad categories, namely, public health, health, education and public works. Education services are further subdivided into university/college, professional/technical college, secondary school, primary school and other.

Education services yield the largest revenue receipts among the social sectors and these receipts have been rising rapidly, although the growth rate has moderated somewhat in recent years. The trend in the revenue receipts of all sub-sectors within the education sector has been a rising one as well. Revenues from health services have also shown fair growth.

It is worth noting that the budgeted receipts for the fiscal year 1992-93 from public health services are expected to rise to Rs 241 million which amounts to a tenfold increase from the previous fiscal year, 1991-92. Such a colossal increase in public health receipts is contemplated due to a recent decision by the Punjab government to entrust responsibility for maintaining rural water supply and sanitation schemes to the Public Health Engineering Department (PHED). Through user charges, PHED anticipates generating Rs 102.8 million and Rs 115.8 million respectively from water supply and sanitation schemes. Although the above analysis generally indicates rapid growth in revenue receipts from both the economic and social services, these trends in receipts alone are not adequate to provide enough information to comprehend the extent to which these public revenues finance the expenditures incurred by the provincial government. This is dependent upon the level of user charges and the net balance between revenues and expenditures.

TABLE 6

TRENDS IN REVENUE RECEIPTS FROM USER CHARGES OF

GOVERNMENT OF PUNJAB

(Rs in Million)

Sectors/Years ACGR	1984-85	1990-91	1991-92	1992-93	
	(A)	(R)	(R)	(B)	(%)
ECONOMIC SECTORS					
Agriculture	125	224	241	241	8.6
Animal Husbandry	36	71	83	94	12.7
Forestry	127	209	226	226	7.5
Irrigation	771	985	1087	1087	4.4
Works	63	199	235	241	18.3
Others	89	106	94	96	1.0
Total Economic Sectors*	1211	1794	1967	1985	6.4
SOCIAL SECTORS					
Public Health	21	23	24	241	35.7
Health	45	112	121	127	13.8
Education	149	415	444	494	16.2
University/College	44	81	90	89	9.2
Professional/Technical	3	8	11	10	16.2
Secondary55		111	111	9.2	
Primary	36	75	81	75	9.6
Others	10	147	152	208	46.1
Others	146	133	175	175	2.3
Total Social Sectors**	337	683	764	1037	15.1

* Based on a reclassification of the following sectors - community services, social services and economic services.

** Including Community Services excluding Works.

Source: Annual Budget Statement, Finance Department, Government of Punjab.

4.2 Extent of Cost Recovery

The extent of cost recovery is defined as the ratio of revenue receipts to the recurring expenditure of the government in a given sector. These cost recovery ratios have been calculated for both economic and social services of Punjab and are reported in Table 7.

It is interesting to note that, of all the economic sectors considered, only forestry services show a reasonably high recovery ratio of over 87 percent in 1991-92. In the largest revenue-yielding service, irrigation, the cost recovery ratio is about 39 percent only and has been declining significantly over time. Cost recovery ratios for animal husbandry and works are low.

Cost recovery performance of the social sectors across all services, in general, is very poor. The overall recovery ratio for education is less than five percent. Even in university/colleges and professional/technical institutions, where graduates are expected to get higher future economic returns, cost recovery ratios are no more than twelve percent.

Although the public health sector (e.g., water supply, sanitation, etc.) has shown some increasing trend in the cost recovery ratio, it is at best, still below the thirty percent level during the period considered. This figure, however, is expected to increase to 73 percent in fiscal year 1992-93. The cost recovery ratios for basic health services have remained stagnant at below six percent.

The overall analysis manifests a relatively poor performance of cost recovery. For most of the economic services (e.g., agriculture, animal husbandry and irrigation), where the principle of pay-for-what-you-get is most appropriate, the accomplishment of cost recovery has not been satisfactory. As for the social sectors (e.g., health and education), the situation is even worse. We turn now to a description of some of the reasons for the low cost recovery.

4.3 Causes of Low Cost Recovery

In a recent study on resource mobilisation and taxation reforms, Husaini (1991) has cited the following reasons for low cost recovery in irrigation and agricultural services at the provincial level:

TABLE 7

COST RECOVERY RATIO BY SECTOR IN PUNJAB

Sectors/Years	1984-85	1990-91	1991-92 (R)	1992-93 (B) (%)
ECONOMIC SERVICES				
Agriculture	14.7	27.4	29.8	27.7
Animal Husbandary	23.1	19.7	20.5	21.8
Forestry	90.7	85.5	87.3	84.8
Irrigation	57.0	54.1	38.9	34.8
Works	10.5	16.9	17.5	11.2
SOCIAL SERVICES				
Public Health	58.3	26.1	21.8	73.0
Health	5.7	5.7	5.2	3.9
Education	4.4	4.6	4.2	3.9
University/Col lege	10.0	9.2	11.7	7.4
Professional/ Technical	1.1	2.2	1.6	1.4
Secondary	6.7	4.7	4.3	3.7
Primary	2.2	1.6	1.4	1.1

Source: Derived from Annual Budget Statement.

Absence of a consolidated Agency: One of the major reasons for low cost recovery in the case of irrigation services has been absence of a unified agency for the provision and assessment (or collection) of such services to users. Due to the lack of coordination between the agencies providing the service and those that are assessing and collecting the revenues from the users, there seems to be a practice of concealment, under-booking and underreporting of areas under irrigation by users to Patwaris. This has consequently led to substantial leakages in revenue receipts.

Compliance Laxity: The second important reason for the large divergence between public receipts and revenues is lack of compliance to assessment schedules, supervision, monitoring, accountability and cross-checking practices.

Outdated User Charges: It has been argued that the water rates charged to users are seldom revised to reflect the increasing operation and maintenance (O&M) costs of the service. On many occasions, revisions have been made on an ad-hoc basis.

Besides these three broad reasons, there are other factors which have also contributed to the low cost recovery in the economic services provided by the public sector. For example, there is very little incentive (or, for that matter, in some cases, even a disincentive) for the primary assessor to put a concentrated effort in properly assessing and collecting revenues. It has been noted that, for Patwaris and Tappedars, rewards and remuneration for extra efforts are so small, that is not worth their time.

There are similar explanations for the low degree of cost recovery in social services. First, levels of fees/user charges for services such as education, health and water supply are low and have not been revised upwards frequently. This has perhaps been motivated by the concern, on the part of government, to facilitate access to these services to poorer households. However, given that demand for services like high school and college education is higher among middle and upper income groups, this has meant that payments are considerably below average affordability levels. Also, the very limited degree of cost recovery has reduced the availability of resources for social sector maintenance and development. A better policy might be to raise user charges and thereby increase the level and quality of provision of these services. The resulting increased access would be of greater benefit to low income households.

Second, collection efficiency of charges is poor because of the incentive environment that line departments face. Revenues do not accrue directly to the collecting department but are credited to the general treasury. Departments also believe that if they collect more than the stipulated amount, this will lead to a corresponding cut in their grants, resulting in very little net improvement in their resources. Also, since funding comes from provincial budgets, departments know that they have residual access to this source. They are therefore under no pressure to generate their own resources to self-finance any deficits.

Third, collection mechanisms are crude and underdeveloped. For example, drinking water charges are either flat rate or linked to ferrule size at most locations. There is no link between payments and the level of consumption. In schools and colleges, there is a tendency to demand payment of all the fees up front at beginning of the year. This exacerbates the problem of affordability.

We examine next the scope for resource mobilisation from user charges.

4.4 Resource Mobilisation from User Charges The basic strategy of resource mobilisation from user charges must be to raise levels of cost recovery in economic services, like irrigation, where private rates of return are high, implying potentially high willingness-to-pay of consumers. This will enable diversion of public resources to social services where equity considerations dominate and where subsidies can be justified in the presence of externalities and generally high social returns.

We have evaluated proposals for enhancing user charges in terms of various criteria relating to equity, importance of pricing for allocative efficiency, and level of private and social returns from the service.

Consistent with our earlier conclusions, application of the criteria indicate generally higher rates of cost recovery for economic services, especially for irrigation and forestry. Within social services, we recommend that the degree of cost recovery be highest for water supply followed by secondary and college education and the lowest for health services and primary education. However, cost recovery targets may initially have to be on the conservative side in recognition of the political and administrative limits to the extent to which there can be escalation in user charges.

We also emphasise that from the viewpoint of acceptability by consumers of these increases, there should be a policy of differential rates of enhancement and cross-subsidisation within a particular service to allow for considerations of affordability, equity and the likelihood of resistance. As such, irrigation charges should be increased at different rates by the size of the farms. Within college and high school education, a pragmatic approach would be to enhance fees at the points of entry or exit rather than during the period the education is being received. This strategy will minimize student protest. Accordingly, significant additional revenues could be generated by levy of application fees (none at present), and increase in examination and certificate fees especially in the cases of private students. Increases in tuition fees should be relatively modest initially. Similarly, in the context of health services, the largest increase initially should be attempted in the charges for operations, special tests and for private wards.

Simultaneously, efforts will have to be made to improve collection mechanisms. In water supply and sanitation, tariffs may be linked to annual rental values of properties (especially after a comprehensive market-based reassessment). Ability-to-pay could be enhanced by allowing payments in installments. In addition, line departments may be given a greater incentive to collect user charges by allowing them to retain a portion of the revenues and by ensuring that budgetary allocations do not decline in proportion to the increase in revenues.

5. CONCLUSIONS

Implementation of the above mentioned proposals for resource mobilisation from provincial taxes and user charges could significantly improve own revenues of the government of Punjab in the next few years. We believe that it is realistic to target for generation of additional revenues annually from taxation proposals of Rs 1.5 to Rs 2 billion in the forthcoming provincial budgets. Given the matching grant from the federal government of a corresponding amount, this will generate additional resources annually for the province of Rs 3 to 4 billion. By 1995-96, provincial own revenues will be higher by over Rs 4.5 to Rs 6 billion over projected levels. This will not only avert the possibility of the province going back to a deficit situation but coupled with a strategy ol' restraining growth in current expenditure it could enable a quantum jump in the level of development expenditure.

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