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**PROBLEMS IN RESOURCE MOBILIZATION
IN PUNJAB**

BY

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SUBJECT:- PROBLEMS IN RESOURCE MOBILIZATION IN PUNJAB:

The institutional responsibilities of the Provincial Government have grown in size over the years substantially both in development and maintenance particularly in the social sectors. So much so that over 55% of the development expenditure is borne by the Provincial Governments while 25% is financed by the Federation and 20% through the Local Councils. The problem of the Provincial Government is further aggravated by the fact that recurring expenditure on projects completed through Development Budget is to be borne by the Provincial Government on the non-development side. Thus the overall expenditure of the Provincial Government in Punjab has increased very rapidly while income from different sources has not caught up with this rapid increase. Resultantly the financial position of the Provincial Government has deteriorated over the years. The reasons generally advanced for this deterioration are slow moving receipts from the provincial taxes rising debt service and decline in the share of development expenditure in the total expenditure. Due to these reasons the Provincial Government has faced rapid increase in over-draft from the State Bank of Pakistan during the last couple of years. The situation has, however, changed with the 1991 NFC Award. The NFC Award of 1991 has been acclaimed to be the most historic event in the provincial finances in the last 15 years. It has led to a sizeable jump in provincial revenues in 1991-92 and thereafter. As such it is likely to have a significant bearing on the Provincial Government's financial behaviour. The past behavior- of Provincial Government indicates that higher federal transfers generally had a significant stimulatory effect on provincial expenditure and a negative effect on their fiscal efforts. The increase out of divisible pool of taxes by the Federal Government under the new NFC Award is likely to result in 16% additional funds for the Government of Punjab as a result of expansion in the size of the divisible pool. The amount is expected to be quite substantial resulting in balancing the existing deteriorating financial position but only for a short period of time as withdrawal of non-obligatory grants, requirement of reduction

- 2 -in over-drafts, additional expenditure on pays of large number of employees

and cut-back of development transfers from the Federal Government will eat up most of the additional amount coming from the NFC Award. With the present pace of its own provincial resources, the Punjab Government is likely to be once again in deficit in the next few years. Thus there is urgent need to improving its own resources so that the apprehension of facing greater financial deficit in the coming years can be over-come by the Provincial Government.

The basic object of this Paper is to quantify the level of fiscal efforts by the Provincial Government and to diagnose the problems for low provincial tax receipts. The overall growth in the provincial receipts in the country during the last decade has been of the order of 13%. The growth of revenue receipts in Punjab i.e. 16% is much faster than the other provinces. This is due to relative buoyancy of the provincial economy and higher fiscal efforts by the Provincial Government. But this increase in revenue still falls short of increase in expenditure which has grown at a faster rate of over 18%. There has been a tendency on the part of the Provincial Governments not to make much efforts to mobilise their own resources any further due to fiscal policies of the Federal Government. The major problems of the Provincial Government in improving its resources are due to following main reasons:-

- (i) Nature of Taxation Structure.
- (ii) Existing constitutional allocation of fiscal powers.
- (iii) The impact of Islamization process on the Provincial Taxes.
- (iv) Incentive environment.
- (v) Lack of Buoyancy in Provincial Taxes.

The above problems are discussed in the following paras to identify the reasons and suggest measures to improve the present deteriorating situation.

- i) NATURE OF TAXATION STRUCTURE: The **primary** sources of provincial revenue consists of taxes on physical assets like the Property Tax, Motor Vehicles Tax, Stamp Duty and Land Revenue and of taxes which are essentially levied in the nature of Duty on Services like the Electricity Duty, Entertainments Duty and Hotel Tax. The nature of most of these provincial taxes is quite inelastic hardly admitting for any substantial growth except very few levies like Stamp Duty which has grown at a fast pace during the last 5 years or so but its growth has now been retarded largely due to slump in Real Estate business. It is necessary that not only the present shape of taxes is changed but further avenues are also tapped to mobilise further resources. It is suggested in this regard that taxes on physical assets like **Property Tax** and Motor Tax should be re-designed and rates of Stamp **Duty** should be reviewed to make room for the introduction of Capital Gains Tax. There is vast scope to levy some more taxes in the field of Services which can only be exploited with the prior approval and will of the political level.
- ii) EXISTING CONSTITUTIONAL ALLOCATION OF FISCAL POWERS: Taxes and duties are levied by the Federal and Provincial Governments in accordance with law within their respective spheres as defined in the Constitution. The existing constitutional provisions allocate major and buoyant taxes to the Federal Government like income and corporate taxes, customs duty, excise duties on production of goods and Sales Tax. The residuary fields of taxation are obviously of relatively minor nature which do not admit of much growth or elasticity. In these circumstances the provincial expenditure has outgrown the provincial receipts by a large margin.

This difficulty can be over-come if some taxation field with good potential is allocated to the Provinces. Sales Tax was originally a provincial tax and is still being administered by the State Governments in India, ft would improve the revenue potential of Provinces quite substantially if whole of the levy with its vast potential at import, export, production, whole-sale and retail sale level is transferred to the Provinces.

iii) THE IMPACT OF ISLAMIZATION ON PROVINCIAL TAXES:

The process of Islamization has also adversely affected the provincial tax receipts in a big way. The Provincial Governments have been divested of their authority to levy duty on manufacture and. Sale of liquer in general under the Prohibition Order and also declared Betting Tax as illegal. Both these levies were comparatively of a very buoyant nature and receipts of these levies would have grown at a fast pace by now. Further the introduction of Ushr in the Agriculture sector has also deprived the Provincial Government of its legitimate land revenue. After careful analysis, it is estimated that loss of revenue on account of Islamization process is of the order of 20% of the total tax potential of the Provincial Government.

iv) INCENTIVE ENVIRONMENTS:

Incentive environments have not been conducive to greater physical efforts by the Provinces during the last decade or so. In particular, the adhoc nature of inter-governmental fiscal relations, which have evolved in the absence of NFC Award, whereby the provinces have had, .residual; acces&-,-to-3deficit grants from the Federal Government has led to profligacy in expenditures and slackening of fiscal effort. As a consequence of 1991 NFC Award, this attitude on the part

of the Provincial Government has to be changed. The required change in attitude cannot take place over-night as it will require the full support of political structure and the legislature.

- v) LACK OF BUOYANCY IN PROVINCIAL TAXES The existing provincial taxes lack elasticity and buoyancy primarily due to the reason that there is no linkage between revenues and inflation as these are mostly based on specific rates. There is every justification to fix the rates of such taxes on ad-valorem basis. The classic examples in this regard are the prevailing rates of Cotton Fee and Paddy Husking Tax. The existing rate of Cotton Fee was fixed at Rs.2/- per maund in the year 1973 when the average market rate of cotton was around Rs.70/- per maund. Thus, rate of Cotton Fee at Rs.2/- per maund worked out to around 3% of the market price of cotton. Now, after the lapse of two decades the rate of Cotton Fee is the same which works out to about 0.5% of the prevailing market rate of cotton. Similarly the existing rate of Paddy Husking Tax at Paisas 1½ per Kg has no relevance to the present market price of Paddy. Such specific rates have affected the Provincial Government in two ways (i)the revenue receipts have not grown with the rising prices and (ii)the cost of collection on such levies continues to rise due to increase in pay and allowances and other expenditure on collection. The Cotton Fee and Paddy Husking Tax are levied on the Cotton Ginning Factories and the Paddy Husking Units. There is every reason to review these rates and fix them on ad-valorem basis like 2 to 3% of the market price of the produce. It is, however, widely misunderstood in this regard that revision in rates of Cotton Fee and Paddy Husking Tax will effect the grower and that is the main reason that the proposal to revise these rates has not been

approved for presenting it before the Legislature. The proposal to revise the rates of these two levies has the potential of improving the provincial receipts by a good margin of Rs.400 million per annum. It is high time that the rates of these two levies and possibly certain other items are revised to co-relate them to inflation for the benefit of provincial exchequer.

It is clear from the foregoing, that relatively bigger and more buoyant taxes are with the Federation. Taking over of Sales Tax by the Federal Government soon after partition has affected the provincial resources in a big way over the years, The sales tax in Pakistan is presently being levied at the import or manufacturing stage. There is need to introduce Sales Tax at the whole-sale or retail sale level to be levied and administered by the Provincial Governments. This will certainly become a major source of revenue if properly thought out and implemented. It is also felt in this regard that existing resources available to the Provinces have not been fully exploited. There is need to introduce few new taxes to improve the existing insufficient resources. The item of Sales Tax available to the Federal Government according to the constitutional provisions is restricted to goods. The levy of Sales Tax on Services is, thus, outside the purview of Federal Government The Provincial Government is certainly competent to levy Sales Tax on Services but somehow or the other the Provincial Governments have been slow in moving to introduce such taxes on different services except on Entertainments and Hotels. In the meanwhile the Federal Government has moved ahead and introduced a number of new levies in the fields of Telecommunications, Banking, Insurance, etc. under the cover of Excise Duty but these are essentially in the nature of Sales Tax on Services. This looks to be an encroachment on the Provincial sphere of taxation specifically left open for the Provincial Governments. The difficulty of the Provincial Government in this regard arise from two factors i.e. (i) the major and relatively much

more buoyant taxes are with the Federation and (ii) where the Provincial Government has some major field of taxation reserved for it, the Federal Government has encroached upon it and levied some taxes or duties in the same broader field. It is of vital importance that Federal Government withdraws its taxes which have been levied on items not specifically mentioned in the Federal Legislative List of the Constitution so that the Provincial Government may levy and collect such taxes.

PROBLEMS IN EXPLOITING THE EXISTING

RESOURCES FULLY:_____

Although the existing tax resources of the Province lack elasticity and (to not have a broader base still it is felt that the existing resources have not been fully exploited. This has been primarily due to the reason that provincial tax administration has not received due attention for development because of extreme dependence on federal transfers. Since the collection of taxes is relatively low, therefore, the cost of collection is also comparatively high. The two major departments dealing with the provincial tax receipts are the Excise and Taxation Department and the Board of Revenue. The sphere of Excise and Taxation Department is restricted to mostly taxes of urban nature and an independent Administrative Department has been established for the purpose since last 20 years. The personnel of the Department are not very-well trained professionals as they lack in-depth pre-entry training. Further, Department having some enforcement functions on the Excise side suffers from lack of cohesion between the two wings. It is of utmost importance that the staff allocated on Excise side should not be transferred to Taxation side. This purpose can only be achieved if separate cadre for the Excise Wing is established and staff below the rank of Excise and Taxation Officers are not inter-changeable in the two Wings. The position of Board of Revenue is much worse as due to multiplicity of functions priority given to tax collection by the field organizations under the Board of Revenue is relatively very low. The efforts of the Board of Revenue on the revenue side are mostly restricted

to the rural areas. However, the levy of Stamp Duty and Registration Fee which in most part is urban based is being dealt by personnel who are not at all professionally trained for the purpose. The posting of Extra Assistant Commissioners and Tehsildars as Sub-Registrars on part time basis certainly does not help in good tax administration particularly when record of urban property is not available with them. This has certainly hampered the growth of true potential of the major levy of Stamp Duty and Registration Fee on the sale of immovable property particularly in urban areas. In the changed circumstances where no further financial assistance is expected to come from the Federal Government, the Provincial Government has to fall back on its own resources. It is worthwhile to propose in this regard that a specialised Provincial Taxation Service may be established to look after all the urban as well as rural taxes and duties. The measure is likely to go a long way in improving and exploiting the existing revenue resources of the Province to the maximum possible extent.

The existing level of human resources available to the Tax Departments can be very well imagined by the fact that total strength of the Excise and Taxation Department is of the order of 3,100 personnel out of which only 96 are in BS-17 and above. In the matter of tax assessment and collection it is of utmost importance that relatively senior level officials are entrusted with the job to minimise the chances of connived evasion. In the matter of income-tax and other similar levies, most of the work is handled by the officers in Grade-17 and above. The manpower available to the Federal Government revenue departments is quite large with a very heavy top as compared to the Provincial Tax Departments. It is, thus, important from the revenue and general administration point of view that the number of posts in Grade-17 and above are increased so that the level of responsibility and conduct can be improved for better dealings with the taxpayers. In the matter of exploitation of existing resources it is very

important that the rates and mode of different levies remain under constant review so that these can be brought up to date and the rates can be changed to suit the existing circumstances in respect of each and every levy. Unfortunately this cannot happen unless it has the support of Legislature and political will against the tax-payers who have a growing tendency to agitate against any increase in the existing taxes. In the case of Property Tax for instance the Government of Sindh has not been able to carry out 5 yearly re-assessment operations in Karachi for the last about 25 years. The reassessment operations in Punjab are being carried out in all the Rating Areas after every 5 years by rotation. The levy of Property Tax is essentially a tax of civic nature and it is felt in this regard that every citizen who owns a property in the urban area which may be of a very modest status should pay something to the exchequer for the maintenance of civic amenities available to him. This basic philosophy of the levy has not been accepted in Pakistan where more and more individuals claim exemption on one or the other pretext. Number of exemptions available to assesses of Property Tax are really large and in some cases uncalled for. The existing assessments of the owner-occupied property units are very low and need to be revised. But whenever this proposal is taken up there is great resentment from the vocal urban class of property owners who are not willing to any increase in their assessment or tax burden. ..Similarly most buoyant of the taxes available to the Provincial exchequer i.e. the Capital Gains Tax on the sale of immovable property which was levied under an item specifically excluded from the Federal Legislative List of the constitution could not be sustained and was abolished in 1986 under pressure of the vested interest. In this perspective of things it is of utmost importance that political support is accorded to the exploitation of existing resources fully so that substantial improvement can be made in the existing tax receipts. IMPARTING BUOYANCY TO THE EXISTING LEVIES: The existing provincial levies generally lack buoyancy and elasticity

but there are certain areas where the existing levies can be made more buoyant to improve the receipts quite substantially. Few of the measures proposed in this regard are indicated below:-

- i) Rates of levies may be changed from specific to ad-valorem as far as possible
- ii) Rates of Cotton Fee and Paddy Husking Tax may be reviewed and co-related with the existing market rates of the two items.
- iii) Rates of Motor Registration and Transfers Fees should be co-related with the price of the vehicle.
- iv) Rates of Motor Vehicles Tax may be increased by a margin of atleast 50%
- v) Assessments of owner-occupied properties may be increased by a margin of 50% in general Property Tax may be levied in new Rating Areas and also introduced for Industrial and Commercial Units being built outside the existing Rating Areas.
- vi) Service charges and non-tax receipts in the social sectors like Education, Health, Irrigation etc. may be made reasonable and co-related with the recurring cost which has increased tremendously over the years.

PROBLEMS IN DEVELOPING NEW RESOURCES:

As discussed earlier the Provincial Governments are handicapped in developing new resources as most of the major fields of taxation have been allocated to the Federal Government. Further where certain items fall in the residuary powers of the Provincial Governments but were not fully developed by them, the Federal Government has encroached upon their authority and levied some taxes which do not fall within their specified domain. It is proposed in this regard that Sales Tax on Services like Telecommunications, Banking, Insurance etc, levied by the Federal Government under the cover of Excise Duty may be discontinued and Provincial Governments may be authorised to levy and collect Sales Tax on such services. Similarly Federal Government is competent to levy Excise Duty on manufacturing/production of goods but it has certainly encroached upon the provincial field by levying Excise Duty on services provided in the hotels and restaurants. These hotels and restaurants

are not engaged in the manufacturing of goods. Thus, the levy of any tax on services provided in Hotels under the cover of Central Excise Duty does not have proper legal cover. The difficulties of the Provincial Government have been further aggravated by the Federal Government with the introduction of Advance Income-tax, Wealth Tax and Capital Value Tax on properties and Motor Vehicles as the collection of all these levies has been entrusted to the functionaries of the Provincial Government. Due to increase in the tax burden of the same assesseees it is no more feasible for the Provincial Government to increase the existing tax rates of its taxes on these items. The measure is also likely to discourage the payment of provincial taxes as in some of the cases the burden of the levy introduced by the Federal Government is much more than the basic taxes levied by the Provincial Government. This is certainly going to result in default and avoidance of these taxes due to increased burden. It is necessary that more coordination and exchange of information between the Federal and the Provincial Tax machinery is established to ensure that no potential assessee is allowed to escape the tax net. But at the same time the Provincial Tax Officials should not be over-burdened by entrusting the responsibilities of collecting tax on behalf of the Federal Government. The Federal Government may make its own arrangements for collection of taxes levied on properties and motor vehicles.

The up-short of the above discussion is that the existing resources of the Provincial Government are not only limited but also lack necessary buoyancy and elasticity. The potential of these taxes is certainly insufficient to the ever increasing expenditure of the Provincial Government. There is, however, good potential of improving revenue receipts of the Provincial Government by (a) fully exploiting the existing items of taxation, (b) by imparting buoyancy to the possible extent and (c) developing new avenues of taxation. It is of vital importance in this regard that the Federal Government agrees to restrict itself to the items specifically allocated to it under the Federal

Legislative List and do not encroach upon the provincial spheres of taxation.

Sales Tax at the retail level on selected luxury items may be levied by the Provincial Government: which can be developed into a major tax in the years to come. The difficulties in improving the resources of the Provincial Government can be over-come to a large extent if a specialised tax machinery is established in the Province and entrusted with the exclusive job of assessment and collection of taxes. Functions of general administration, land management and drug enforcement may be entrusted to a separate machinery which may not have anything to do with the assessment and collection of taxes. This will help in improving the professional level of tax administration in the Province which is of paramount importance for resource mobilization in future.