Research Report No. 13

AN EVALUATION OF THE BUDGET 1996-97

SOCIAL POLICY AND DEVELOPMENT CENTRE

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FOREWORD

Budget in Pakistan, constitutes a statement of government's fiscal priorities and policy objectives for the forthcoming year. At times major policy changes are announced which include changes in tariff rates, taxes, incentives etc., that have subsequent impacts on various segments in the economy. Therefore, it generally generates a lot of debate, both within and outside the Assembly. Also, the budget is proceeded by the publication of the Pakistan Economic Survey which enables an assessment of the macro-economic performance alongwith the financial review of government revenues and expenditures presented in the budget.

Social Policy and Development Centre, which focuses on policy analysis in particular social sector policy, has published a number of articles both prior to the announcement of the budget and following it. These articles relate to the state of the economy, the debt trap, the budgetary outcome for 1995-96 the options for the budget, the process of fiscal adjustment and the impact of the budget on poverty social development and the provincial finances. Moreover, an analysis of provincial resource mobilisation and expenditure priorities also is presented.

This report is a compilation of these articles. We hope that our analysis will represent an objective appraisal of the economy and the Budget of 1996-97 and will be of some use to you.

1. MACROECONOMIC BACKDROP TO THE BUDGET

STATE OF THE ECONOMY AND IMPLICATIONS FOR THE FEDERAL BUDGET OF 1996-97

BY

Dr. A.F. Aisha Ghaus

The Federal Budget for 1996-97 is being announced at a juncture when the economy exhibits mixed trends. The GDP growth rate has picked up after a few years of recession. GDP growth for 1995-96 is estimated to be 5.6 percent as opposed to 4.7 percent in the last year. The large-scale manufacturing sector, however, fails to show signs of recovery with a low growth rate of 1.6 percent as opposed to the 6 percent targeted for the year. The price situation has improved somewhat with a projected average increase of 11 percent in the CPI, which is lower than 13 percent registered in 1994-95.

Positive developments have emerged on the fiscal side with a decline the budget deficit which according to initial indications has fallen to 4.6 percent of the GDP from the peak level of about 8 percent in 1992-93. This is a consequence of various resource mobilisation measures introduced during the course of the year including imposition of 10 percent regulatory duty on imports, substantial increase in petroleum prices, withdrawal of sales tax exemptions, and major cut backs in development expenditure.

Unfortunately, the adverse feature emerging this year is a rapidly increasing imbalance in the external sector. The current account deficit during July 1995 to March 1996 is $ 3.2 billion, equivalent to about 5 percent of the GDP. Indications are that the fiscal year will close with a very high current account deficit of 6-7 percent of the GDP. This is a consequence of rapid growth in imports, lower than the target growth in exports and decline in remittances. If left unabated there may be a danger of an impending foreign exchange crisis in the country.

Given this economic background, the budget for 1996-97 should include measures to boost the manufacturing sector, control an upsurge in imports, particularly of consumer goods, encourage exports and be non-inflationary. As such, government should avoid an over zealous development of general sales tax and excise duties, the incidence of which will largely be on the manufacturing sector. In addition, further increases in petroleum and utility prices must be avoided. These measures not only depress the manufacturing sector but are also inflationary, thereby encourage stagflationary tendencies in the economy. Efforts at resource mobilisation should concentrate on removing exemptions and concessions from income tax and import duties. It is also necessary to raise the level of the ADP, to enhance the growth potential of the economy and encourage private investment.

Also, rapid pace of import tariff reduction may not be easily absorbed by the local industry. On top of this, to the extent that imports are price elastic, tariff reductions may encourage imports and further accentuate the severe current account deficit problem which is currently being faced. The problem may be further exacerbate by the imposition of a broad based GST on textiles, which could adversely affect exports, in the event of delays in refunds for achieving zero rating of exports.

Altogether, the economy has had a heavy dose of structural adjustment during the last few years, as a consequence of which the budget deficit problem has largely been controlled. As such, there is less urgency for severe fiscal adjustments in the immediate future and greater need to focus on other objectives of growth and macro economic stability. The budget for 1996-97 should, therefore, aim to slow down the process of further fiscal adjustment, concentrate on giving a boost to the manufacturing and in particular the export sectors and lay the basis for future growth in the economy.

The Numbers Game
By
Asad Sayeed and Nadeem Ahmad

It is not only the heat coupled with frequent power cuts that the people of Pakistan have to endure at this time of the year, every year. They are also subjected to new taxes, further inflation and other subtle and not so subtle measures which see their incomes and potential for income generation being steadily eroded. In the midst of all this rough and tumble, the government, its proponents and its critics alike, subject us with countless numbers to prove their point. What do these numbers mean and what bearing do they have on the state of the economy and on the life and livelihood of a common Pakistani?

Perhaps the most important number that is bandied about is the growth rate of GDP. It is deemed to indicate how much the country at large has materially progressed in the last one year. For many years, a high growth rate of over 6 percentage points in GDP was supposed to provide some solace to an otherwise depressing and bleak scenario that pervades in the month of June. In the last few years - since 1992-93 in particular - this growth rate has slumped below the psychologically comfortable figure of 6 per cent per annum. In the current year, however, the Benazir Bhutto government is credited for reviving the growth rate to near its trend performance after a lag of four years to just over 6 percent (6.1 percent to be precise). The government admits that this performance is due to the unusually high growth in the agricultural sector, with production of cotton registering growth rates of 21.7 per cent as a result of increase in cotton production by 1.89 million bales. But do the numbers still add up to jack up the growth rate over the magic figure of 6%?

The principal component in the growth of GDP has been the large increase in cotton output. There is a general rule of thumb applied by policy makers in Pakistan that an increase of one million bales of cotton increases the GDP growth rate by ½ percentage point. This appears to be largely confirmed as our estimations based on the relative weight of cotton in Gross Domestic Product as well as its impact on other sectors (principally textiles and wholesale and retail trade). Thus an increase in GDP growth from 4.4% in 1994-95 to 5.4% in 1995-96 is explained only by the largely fortuitous increase in the production of cotton.

So far so good. But where does the additional 0.7 to 0.8 percentage points in GDP come from? Two sectors within the GDP - small scale manufacturing and wholesale and retail trade - have been the areas where it seems some overstatement of growth appears to have taken place. Figures for small scale manufacturing growth in Pakistan have always been guesstimates. Up until 1970-71, growth in small scale manufacturing was assumed to increase at the same rate as that of the population of about 3 percent. Since then, growth estimates for this sector are based on periodic surveys carried out by the Federal Bureau of Statistics. From the early 1980s onwards, the *assumed* growth rate is 8.4%. According to the National Income Accounts this growth rate is projected on the basis of growth between 1976-77 and 1983-84 - years when censuses of small scale manufacturing were conducted. Because of this assumption, the growth rate for the manufacturing sector as a whole is overestimated, especially considering the fact that for the last four years, large scale manufacturing has grown at an abysmally low rate annually of 1.9%.

The usual governmental response to this anomaly is that because there is great buoyancy in the small scale sector, this figure is more or less correct. In the absence of hard data all one can do in this regard is to understand the determinants of growth in the small scale sector and then see whether those conditions still prevail which contributed to this growth in the 1977-84 period in the Pakistani economy. A number of studies have attributed three different spurts to growth in the small scale sector. In a nutshell, these spurts have been attributed to; (I) mechanisation in agriculture which led to the growth of small scale industry for services and repair of agricultural implements. (ii) The anti-capitalist policies adopted during the Bhutto regime in the 70s was the second important boost to small scale industry in Pakistan. The most important in this regard has been the disintegration of the textile industry. Whereas yarn production remained in the large scale sector, cloth production went into the small scale sector, where even today 52% of its production is located. (iii) The demand boom in the Pakistani economy through Middle East remittances was the third and perhaps the most important boon for this sector. Not only did the sector launch itself into the consumer non-durable market and in supporting the construction industry but also became important in sub-contracting for large-scale manufacturers in the automobile and other engineering sectors.

With a decline in remittances in the 1980s, the last determinant of its growth has tapered off.

The power loom sector has the highest weight in aggregate small scale industry output. One indicator of growth in this sector is its export performance. Exports of cotton cloth declined by 1% in volume in 1995-96 compared to the previous year. There is, therefore, good reason to believe that small scale manufacturing cannot be the only thriving hub of activity in a generally sluggish growth environment. Since the weight of small scale manufacturing in aggregate GDP is roughly 5%, a variation of 1% point in the growth rate of small scale manufacturing will impact on aggregate GDP growth by .05%. One also wonders whether the figure of 3.1% growth in large scale manufacturing reported for the year 1995-96 will be subsequently revised downwards as it was done last year from 2.7% to a historically low of 0.5%.

The Economic Survey also reports a whopping 8.3% increase in wholesale and retail trade. According to the National Income Accounts methodology, wholesale and retail trade is assumed to grow roughly at the same rate as growth in the commodity producing sectors and imports of goods with a margin for trade mark-up to attain the value-added of wholesale and retail trade. As a result in the past, we see that the growth rate of wholesale and retail trade has increased roughly at the same rate as that of the commodity producing sectors and growth in imports. This year, however, the figures are unusually high as growth in value added in the commodity producing sectors is roughly 6% (even after taking the somewhat inflated figures for growth in manufacturing). Since wholesale and retail trade is roughly 16.5% or one-sixth of the GDP, it implies that if we carry on with convention in previous years and assume growth in this sector to be roughly around 6%, it reduces the previous year's GDP growth by .35 percentage points and down to a psychologically less sanguine and more realistic figure of 5.7%.

Add to this possible the overestimation in the growth rate of manufacturing, GDP growth reduces somewhere between a half and one percentage points, which proves the point that the increase in GDP growth is solely due to the increase in cotton production and not because the country has again launched itself on its historical growth path. The moral of the story is not nitpicking on a few percentage points here and there. Rather, by artificially jacking up its figures the government reduces the credibility of its statistics, which in any case are somewhat dubious. Further, if growth rates are artificially inflated, then in subsequent years when the economy takes a plunge due to factors beyond its control, the government has to face the music for an overestimated dip in growth.

REFLECTIONS ON THE EVE OF THE BUDGET OF 1996-97
BY
Dr. Hafiz A. Pasha

The federal budget of 1996-97 will be announced tomorrow, the 13th of June 1996. This will be followed soon thereafter by the provincial budgets. All kinds of speculation are currently rife about the quantum of taxation proposals in the budget, fuelled at least partly by conflicting government statements, with estimates of additional taxation ranging from Rs 20 billion to Rs 50 billion. This is a crucial magnitude because it will primarily determine the short run economic and political consequences of the budget.

By now, it has become clear under what broadly parameters the budget for 1996-97 has to be framed. First, there are the targets embodied in the agreement with the International Monetary Fund as part of the standby facility relating largely to the size of the budget deficit and the board contours of the strategy to be followed for achieving fiscal deficit reduction. According to statements by the government, including those by the Prime Minister (for example, in her speech at Karachi to the All Pakistan Textile Manufacturers Association [APTMA]), the IMF expects the budget deficit to be brought down to 4 percent of the GDP in 1996-97 and possibly to 3½ percent in 1997-98. Given the projected size of the GDP at current market prices in 1996-97 of about Rs 2500 billion, this implies that the budget deficit cannot exceed Rs 100 billion.

Second, the macroeconomic outcome for 1995-96 will inevitably influence the nature of the budget for 1996-97. The current fiscal year has been a mixed year in terms of economic performance. On the positive side is primarily the strong upsurge in the GDP growth rate from 4.7 percent to 6.1 percent due largely to big increases in production of major crops like cotton and rice. But, the Pakistan Economic Survey for 1995-96 released yesterday, has highlighted a number of major shortcomings and lack of achievement of targets, as follows:

! the budget deficit for 1995-96 which was expected to be brought down to 4.6 percent of the GDP following agreement with IMF and taxation measures during the year, like the imposition of the regulatory import duty and broad basing of GST, is likely to remain above 5 percent of the GDP due to unanticipated increases (at the time of the framing of the budget) in debt servicing, defence expenditure, etc., especially after the devaluation and the apparent inability of CBR to achieve even the reduced target for tax revenues. Therefore, fiscal deficit reduction in 1995-96 will be very limited.

! Earlier this year the government was optimistic that the inflation rate had come down so much that the target of 9.5 percent would be achieved. But due to a noticeable picking up in the rate of inflation in recent months it is now expected to be double-digit, close to 11 percent.

! The balance of trade and current account position have deteriorated considerably over the year. Exports are well below target while imports are substantially above target. Consequently, the year will close with a trade deficit in excess of $ 3 billion and the current account deficit may approach $ 4.5 billion, the highest level since 1992-93 when exchange reserves plummetted to critically low levels. Already, foreign exchange reserves have declined by over $ 1.3 billion this year. There is a strong speculation currently in the open market about a rapid slide of the Pakistani rupee.

! The large-scale manufacturing sector has remained sluggish for two years running. Last year the growth rate was ½ percent and the initial estimate for this year is about 3½ percent which could be revised downwards later to below 2 percent. This sector constitutes the primary tax base and has traditionally represented the main source of growth in the economy.

! The financial sector is increasingly fragile. Emergency action has already been taken in the context of United Bank Limited and similar action may soon be required in the case of Habib Bank Ltd. The poor liquidity and profitability position of the large nationalised banks alongwith the decline in foreign exchange reserves has raised the probability of a run on foreign exchange currency deposits. If this happens, then the rupee could tumble rapidly.

On the political front, the conditions for successfully pushing through a `tough' budget may appear to be more favourable. The opposition seems to be more acquiescent and is lying low. But public resentment against the cumulative increase in prices of basic necessities like food items is rising and could be exacerbated further if there is a heavy dose of indirect taxation in the budget resulting, for example, from the broad-basing of GST. The Federation of the Pakistan Chambers of Commerce and Industry, the apex body of trading and industrial interest groups, has been making frequent statements about the need to reduce the pace of fiscal adjustment and avoid heavy additional taxation, which is seen as stagflationary.

In this environment what will the government do in the budget tomorrow?

It is likely that even though the Prime Minister has exhorted the nation to tighten its belts during the process of fiscal adjustment that the bad news will be administered in small doses. This was also the strategy followed last year. Taxation proposals in the original budget of 1995-96 amounted to less than 1 percent of the GDP but this was virtually doubled later through periodic announcements like the imposition of regulatory duty, increases in administered prices of electricity, POL, gas, etc. and broad-basing of GST.

Based on this strategy, the government may initially announce additional taxation of about 1 percent of the GDP which, other things being equal, is the amount required to bring the budget deficit down to the IMF target of 4 percent. Thereafter, during the fiscal year as more adjustments become necessary then a series of `mini-budgets' may be resorted to.

In this context, the particular issue of importance is the extent of customs tariff reforms which will be announced tomorrow. There are three possible degrees of reform. The first is a policy of no change, including retention of the 10 percent regulatory import duty, which it has been agreed with the IMF will be withdrawn. The government might argue that this will need to be retained for the next few months in order to protect the balance of payments position. The second level of adjustment is for the government to propose tomorrow immediate withdrawal of the regulatory duty but do nothing about further tariff reforms in terms of bringing down the maximum tariff rate further. This will confer a revenue loss of at least ½ percent of the GDP and will require that much more taxation in the budget to achieve the budget deficit target of 4 percent. The third and highest quantum of reform is to bring down the maximum tariff alongwith with withdrawal of the regulatory duty. This is a highly unlikely option given the position of revenues and balance of payments in 1995-96.

If the government decides to spread the process of fiscal adjustment over the year then the most likely scenario is that nothing will be done to import duties tomorrow. Subsequently, at an appropriate time, the regulatory duty will be withdrawn alongwith imposition of taxes to make up the revenue losses.

In this scenario of minimum taxation, the additional revenue to be generated from taxation proposals still remains sizeable at about 1 percent of the GDP or Rs 25 billion. How will this additional revenue be generated? The IMF has laid great emphasis on the need next year to effectively extend the net of GST at the import and manufacturing stage to all industries except food, fertilizer and medicines. Of particular significance in this regard in whether GOP extends tomorrow the GST to cover textiles, the largest industry of Pakistan, accounting for about 40 percent of industrial value added and 60 percent of exports. This will be a major decision with the potential of generating revenues in the short run of over ½ percent of the GDP.

But, there are a number of significant implications and given the sluggishness of manufacturing and exports generally, this may not be the best time to impose a GST on textiles. Also, the textile sector has been facing a problem of getting prompt payment of duty drawbacks and this problem will greatly magnified if exports are to be zero rated from GST. The resulting liquidity squeeze could discourage exports significantly.

The government is also proposing, as part of its understanding with IMF, to withdraw the fixed sales tax system currently in force for the small-scale sector and replace it with a proper documentation based value added tax. Much of the small sector of Pakistan is concentrated in the heartland of Punjab in cities like Lahore, Gujranwala, Sialkot, Gujrat, etc., and any tax revolt against this change could have serious political implications.

The federal government also seems to be more interested in the next fiscal year to ensure that the agricultural income tax [AIT] is more effectively imposed by the provincial governments in their respective budgets for 1996-97. Therefore, it is likely that the government will have to contend with an unusual combination of powerful interest groups, both urban and rural, if it wants to even mobilise additional revenues of Rs 25 billion or 1 percent of the GDP. If the experience of 1994-95 is any guide, when the Government had to retreat from its proposal to extent the GST following a tax revolt, then the likelihood of its success is not very high next year. Also, revenue gains from AIT are likely to be marginal in the short run because of problems of tax administration and tax payer compliance.

The government could alternatively have tried to achieve fiscal deficit reduction in 1996-97 through economy and cut backs in expenditure. However, statements made in the newspapers to date reveal that the expenditure to GDP ratio on defense and development is unlikely to decline significantly in 1996-97 from the 1995-96 level. Debt servicing has its built-in growth momentum in the short run. Therefore, the only option the Government appears to have is to go in for additional resource mobilisation in 1996-97 to bring down the budget deficit to 4 percent.

Given the political and economic constraints is the government likely to go back on its 4 percent budget deficit target commitment with the IMF? This year, the bargaining position in comparison to the last year (when the government moved out of the ESAF) is much worse because of the lower foreign exchange reserves and the overhang of a huge current account deficit. Therefore, the government needs the standby facility and the blessings of the donors to borrow more in the international capital market. It is almost certain that the budget deficit will be set at 4 percent of the GDP even if it is not all achieved tomorrow in one go but in successive doses of mini budgets throughout the year.

Altogether, the government appears to have less options in the next budget than it had last year. It will be extremely interesting to see how far it goes in terms of structural adjustment tomorrow in light of the prevailing economic and political conditions and its understanding with the IMF.

THE DEBT TRAP

BY
Dr. A.F. Aisha Ghaus

One of the key issues confronting budget makers in Pakistan today is the rapidly increasing debt servicing obligations, which pre-empt the largest share of public resources. In 1995-96, debt servicing has reached Rs 160 billion and its share in expenditure has increased rapidly from 15 percent in 1980-81 to over 36 percent by 1995-96. If present trends continue, the share may approach 50 percent by the turn of the century.

The high debt servicing is symptomatic of `the debt trap' the country finds itself in today whereby the high existing level of outstanding debt implies high interest payments that add one-to-one to the budget deficit and have to be financed by incremental borrowing which increases public debt, and so on. The result is potentially explosive growth in budget deficit and debt which creates fundamental macro economic imbalances.

The outstanding public debt of Pakistan stood at Rs 1473 billion at the end of 1994-95, equivalent to 78 percent of the GDP. This is in comparison to 53 percent in India, 67 percent in Phillipines, 35 percent in Turkey and 51 percent in Nepal and 99 percent in Sri Lanka. In particular, the domestic debt to GDP ratio appears to be relatively high. Currently outstanding domestic debt in Pakistan is Rs 805 billion, or 55 percent of the total. The domestic debt to GDP ratio surged very rapidly during the decade of the 80s increasing from 22 percent in 1980-81 to 43 percent by 1986-87, but has moderated since then remaining, more or less, unchanged in the 90s. A similar trend is witnessed in total public debt (domestic plus external) to GDP ratio. The recent moderation is largely a consequence of a decline in the primary budget deficit [tax plus non tax revenues minus total expenditures (excluding interest payments)] particularly in the last two years and the relative stability in the exchange rate in the 90s which minimised capital losses on external debt due to currency depreciation. In 1994-95, there was the largest reduction in the last fifteen years in the public debt to GDP ratio of over six percentage points.

In contrast, interest payments to GDP ratio continues to escalate. This ratio has increased from 2 percent in 1980-81 to the current level of over 5½ percent. This is due to the continuous rise in the interest rates particularly in the aftermath of the financial sector reforms introduced in 1991 and increasing resort to more expensive domestic debt.

Efforts must be made to break out of the debt trap. Focus will have to be on improvements in public debt management. A reduction of only ½ percentage point in interest cost saves as much Rs 8 billion to the exchequer. Both the size of public debt and interest costs will have to be contained. This will involve; (I) continued generation of primary budget surpluses, through proper conduct of fiscal policy; (ii) retirement of high cost debt by the use of privatisation proceeds; (iii) resort to low cost borrowing instruments; (iv) more effective co-ordination between public debt management and monetary policy and (v) moderation in the rate of currency depreciation. The Budget of 1996-97 will indicate the extent to which the growth in debt servicing has been controlled.

2. SALIENT FEATURES OF THE BUDGET

THE BUDGETARY OUTCOME OF 1995-96
BY
Zafar H. Ismail

The Revised Estimates of Revenue and Expenditure 1995-96 presented with the Budget for 1996-97 show that there have been substantial slippages both in achieving the targeted level of revenues and in curtailing expenditure to within the limits specified.

1. RECEIPTS

During 1995-96 revenues from taxes are marginally lower than expected despite series of taxation proposals introduced during the year. The estimated tax revenues were projected at Rs. 270.8 billion in June 1995, the revised estimates presented on 13th June, 1996 indicate these to be Rs. 262.5 billion (see Table 1). This shortfall of Rs. 8.3 billion from target (3.2 percent) is attributable largely to a shortfall of Rs. 5 billion (5.4 percent off target) in import duties with a consequential shortfall of Rs. 0.6 billion in sales tax, Rs 1.6 billion (3.2 percent off target) in federal excise and Rs. 1 billion in income and wealth taxes.

Even though imports were 8.3 percent more than expected levels in dollar terms and there was an official devaluation of 7.7 percent while a regulatory duty of 10 percent was also imposed, the shortfall in customs duty collection needs especially to be explained. Possible factors are the revenues foregone due to the special incentive package for exports and for power sector investments. The upsurge in clearance through dry ports in preference to Karachi may also be a contributing factor towards this slippage. Apparently the appraisement procedures and skills at dry ports are not as well developed as at Karachi. In addition, there is some impact of the tariff reforms in 1995-96 which led to a decline in the maximum tariff from 70 percent to 65 percent. It is also possible that there has been slackening in customs administration.

The shortfall of Rs. 1.6 billion in federal excise is a direct result of a reduction in the production of sugar (by 11 percent), beverages (6 percent) and cotton cloth (2 percent).

The shortfall in tax revenues was offset to a large extent by additional yields from development surcharges of Rs. 1.1 billion from gas following the enhancement in gas prices and Rs. 2.3 billion from petroleum products following the 7.7 percent increase in POL prices alongwith the devaluation.

TABLE 1
FEDERAL TAX RECEIPTS 1995-96

	Estimates	Proposals + Mini	Budget	Revised	Slippage	Achieve-ment
TAX REVENUE AND SURCHARGES	271.7	20.8	292.4	287.6	-4.8	98.3%
TAX REVENUE	259.3	11.4	270.8	262.5	-8.3	96.9%
Income, Corporate & Wealth Tax	69.3	7.0	76.2	75.2	-1.0	98.7%
Import Duties	91.1	1.0	92.1	87.1	-5.0	94.6%
Federal Excise	49.5	2.3	51.7	50.1	-1.6	96.8%
Sales Tax	49.5	1.2	50.7	50.0	-0.6	98.7%
SURCHARGES	12.4	9.3	21.7	25.1	3.4	115.8%
Natural Gas Surcharge	4.2	4.3	8.5	9.6	1.1	112.7%
Petroleum Surcharge	8.2	5.0	13.2	15.5	2.3	117.9%

Estimates of the non-tax receipts presented in June 1995 pegged receipts at Rs. 90.2 billion. The revised estimates of June 1996 indicate that government expects to receive Rs. 4.2 billion higher than target. This is largely due to substantial improvements on the miscellaneous account, an increase of Rs. 8.4 billion over target which was offset be shortfalls from the profits of the State Bank (Rs. 2.7 billion) due to foreign exchange losses associated with devaluation and from interest on loans granted by the government (Rs. 2.5 billion).

The most dramatic slippage in receipts by the federal government is the shortfall of 18 percent in internal capital receipts. In value terms the slippage was Rs. 6.7 percent lower than the target of Rs. 37.1 billion. This was due largely owing to a shortfall of Rs. 3.5 billion (30 percent below target) in the sale of Prize`Bonds, and Rs. 5.7 billion, or 23 percent below target, in the savings schemes operated by the government. These shortfalls were offset by the sale of an additional Rs. 4.0 billion (114 percent over target) of Federal Investment Bonds and of Rs. 4.4 billion worth of Treasury Bills.

On the internal capital expenditure account the government spent 13 percent (Rs. 5.1 billion) more than anticipated. Of this and excess of Rs. 7.1 billion was given out for investment and loans and Rs. 0.7 for retirement of bonds. This was, however, reduced by a reduction in the repayment of short-term credits by Rs. 2.7 billion.

During the year 1996-96, the government was able to attract an additional Rs 11 billion from donors assistance for Pakistan, largely for food and non-project purposes. This was largely the consequence of a higher rupee value of foreign aid due to devaluation.

2. CURRENT EXPENDITURE

In June 1995, the government projected that its current expenditures would be 13.6 percent higher than the revised estimates for the preceding fiscal year at Rs. 334.7 billion. During the fiscal year 1995-96 the government introduced measures which added an extra Rs. 3.5 billion to this estimate. However, when presenting the revised estimates for this year, the current expenditure has risen to Rs. 353.2 billion, that is an additional Rs. 15.1 billion over and above the proposed mid-year increase. The increase in the current expenditure over last year was, therefore, Rs. 58.6 billion which represents an increase of 19.9 percent over last year.

The highest proportionate increase over the year was seen by the growth in the expenditure on subsidies. These increased by Rs 6.8 billion from 1994-95, that is by 183 percent. The estimated expenditure on subsidy was pegged at Rs. 3.5 billion, but are now expected to be Rs. 10.5 billion. This is accounted for by the subsidy on wheat. It would appear that the government has absorbed a much higher proportion of the differential between the purchase and issue price of wheat.

The government professes to allocate substantially higher resources for social development. While this holds true for development expenditure, the recurring expenditure, however, shows a reduction of Rs. 0.2 billion, or 2.3 percent, from last year. This would tend to indicate that improvement in the level of service provided is not a major consideration for the government.

The detailed composition of current expenditure is shown in Table 2.

TABLE 2
FEDERAL CURRENT EXPENDITURE

	1994-95 Revised	1995-96 Estimates	1995-96 Proposals	1995-96 Budget	1995-96 Revised	Growth from 1994-95	Slippage during the Year
FEDERAL CURRENT EXPENDITURE	294.6	334.7	3.5	338.2	353.2	19.9%	4.5%
General Administration	18.5	16.9	0.0	16.9	19.4	4.9%	14.7%
Defence	100.2	115.3	0.0	115.3	115.3	15.0%	0.0%
Law and Order	7.2	7.1	0.0	7.1	7.4	1.8%	3.6%
Community Services	4.8	5.0	0.0	5.0	5.1	6.6%	2.6%
Social Services	8.9	9.0	-0.8	8.2	8.7	-2.3%	6.1%
Economic Services	2.5	2.6	0.0	2.6	3.4	34.9%	28.2%
Subsidies	3.7	3.5	0.0	3.5	10.5	183.2%	195.8%
Debt Servicing of which:	133.1	157.3	0.0	157.3	164.6	23.7%	4.6%
Interest on Domestic Debt	76.4	96.2	0.0	96.2	97.8	28.1%	1.7%
Interest on Foreign Debt	22.8	25.0	0.0	25.0	26.8	17.4%	7.2%
Repayment of Foreign Debt	33.9	36.1	0.0	36.1	40.0	18.0%	10.7%
Grants and Unallocable	15.7	18.0	4.3	22.3	19.1	21.1%	-14.4%

3. DEVELOPMENT EXPENDITURE

The Federal Government each year announces the outlays on development programmes which consist of the projects approved for implementation by its own line departments and includes those which are to implemented by the provincial governments and autonomous agencies of the federal government itself. For 1995-96 the government had allocated Rs. 96.5 billion. This was 7.2 percent higher than the previous year. However, owing to a shortfall in resources and an increase in current expenditure, the government was unable to provide more than Rs. 87.2 billion, that is Rs. 9.3 billion, or 9.6 percent, lower than the amount targeted. Unfortunately, the budget documents do not have a tradition of providing a detailed sectoral break-up of the revised estimates. This, therefore, precludes any comment on which sectors suffered the most as a result of a reduction in the outlay.

4. BUDGET DEFICIT

At the beginning of the year the government had project the budget deficit to be 5.7 percent of the GDP, but proposals at the time and subsequent resource generation proposals were expected to reduce this to 5.1 percent. However, end-of-year estimates indicate that this will be 5.4 percent.

OPTIONS FOR THE BUDGET OF 1996-97

BY

Dr. Hafiz A. Pasha and
Dr. A.F. Aisha Ghaus

The last three years have witnessed a fairly rapid and a moderately successful process of fiscal adjustment in Pakistan. The budget deficit has declined by almost three percentage points of the GDP from 7.9 per cent in 1992-93 to the expected level of less than 5 per cent in 1995-96. But contrary to popular perceptions this has been achieved by a downward adjustment of expenditures and not through enhanced resource mobilisation. Between 1992-93 and 1995-96, development expenditure has declined by over 1 percentage point of GDP to the current level of 4.5 per cent. Current expenditure has fallen by about 2 per cent of the GDP from over 20 per cent to about 18 per cent. The latter has been achieved by a reduction of over 1 per cent of the GDP in defence, over ½ per cent of the GDP in social, economic and community services and in subsidies. Despite the multitude of taxation proposals and heavy new taxation announced every year, total tax revenue to GDP ratio has risen only marginally, which has been more than compensated by the decline in the ratio of non-tax revenues to GDP.

The task of fiscal adjustment, however, remains unfinished. As per the IMF conditionalities the budget deficit has to be reduced to 4 per cent of the GDP, implying a deficit reduction of about ¾ percentage point in 1996-97. This does not look like an impossibly difficult task as it less than to the rate of fiscal adjustment achieved in recent years. However, the task for the next budget has been complicated by a number of factors. First, there are problems in further slashing development expenditures. The ADP is already below 5 per cent. Any further reduction is likely to have adverse implications on GDP growth as government continues to be the prime provider of infrastructure which is a necessary pre-requisite for growth in any economy. Strong evidence exists of `crowding in' of private investment by public investment in economic infrastructure in Pakistan. In fact, the strategy must be to raise the tax to GDP ratio to enlarge the size of the ADP. Second, defence expenditure has already declined by 1 per cent of GDP. The complex regional situation and the likely nature of the new government in India limits the scope of further reduction. At best constancy in real defence expenditures can be targeted.

Third, the impending tariff reforms are likely to lead to a substantial revenue loss in coming years. If the maximum tariff rate is brought down from 65 per cent to 55 per cent in the next budget alongwith the withdrawal of regulatory duty introduced last year, the overall revenue loss may approach 1 per cent GDP (or Rs 25 billion). Finally, the relatively easy phase of tax reforms in Pakistan is, more or less, over. These included reduction of tariffs from very high levels, extension of withholding and presumptive taxes, more effective coverage of general sales tax at import and manufacturing stage and extension of excise duties to services with collection by large public sector entities. These reforms were easy to implement both politically and administratively. Further tax reforms will be politically difficult and administratively more complex.

Given the above constraints the important question is what should be the required level of fiscal adjustment in 1996-97? The government perhaps is confronted with two basic options. In the first option it adheres to the IMF budgetary deficit target of 4 per cent of the GDP. Over and above this it implements the tariff reforms and withdraws the regulatory duty. In this scenario the net fiscal adjustment required in the 1996-97 budget will be of over 2 per cent of the GDP (or Rs 50 billion), consisting of; (a) ½ per cent of GDP to maintain constancy in the tax/GDP ratio (because of the low elasticity of tax revenues, in the absence of tax effort, this ratio will decline); (b) 1 per cent of GDP for the loss of revenue due to withdrawal of regulatory duty and tariff reforms; (c) over ½ per cent of GDP to reduce the budget deficit. This implies that the government will other have to mobilise higher revenue and/or economise on expenditure to the tune of Rs 50 billion in the forthcoming budget.

The magnitude of the fiscal adjustment can be substantially reduced if the government decides to maintain the current level of budget deficit and withdraws excise duty on tobacco and sugar from the divisible pool in the impending NFC award without altering the federal share, thereby lowering transfers to the provincial governments. The increase in net federal revenue receipts due to a contraction in the divisible pool will be about ½ per cent of the GDP. It may however, be pointed out that reduction in transfers to the provinces essentially is only a cosmetic solution to the overall budget deficit problem. The consequent provincial deficits will eventually have to be financed leading to ad-hoc, interim adjustments during the course of the fiscal year. In this scenario the required level of resource mobilisation or expenditure reduction is about 1 per cent of the GDP (or Rs 25 billion).

Given that the economy has already passed through a phase of rapid fiscal adjustment in the last few years and given the constraints to further adjustment discussed above, what is the viable strategy for the 1996-97 budget? First it appears that a prudent policy will perhaps be to slow down the pace of tariff reforms and spread out the decline by restricting it to 5 percentage points next year alongwith the withdrawal of regulatory duty. The imperatives for this are strong as it will not only minimise revenue losses but will also give more time to industry to adjust. Moreover, the potential deterioration in the trade deficit, which has already worsened dramatically in 1995-96, will be restricted. There is the danger that further deterioration can lead to a precarious foreign exchange reserve position and destabilise the exchange rate.

Second, additional resource mobilisation may be achieved by short-run gains through withdrawal of exemptions in income tax, phased transition to a comprehensive value added tax and broad basing of imports by withdrawal of concessionary SROs. The Tariff Reforms Committee constituted by the interim government of Moeen Qureshi had recommended the following strategy for preserving revenue-neutrality of the tariff reforms process; 60 per cent recovery through selective withdrawal of import duty SROs; 25 per cent by broad basing of sales tax at import stage and 15 per cent recovery by withdrawal of exemptions in income tax. Key areas for rationalisation of tax exemptions in direct taxes include agricultural income and wealth, interest income from government savings instruments, salary perquisites and wealth taxation of large owner-occupied properties. Revenue gains from extension of GST to the retail trade sector are likely to accrue with some time lag.

Some scope exists for economising on current expenditures. The key area is improved public debt management, with emphasis on retirement of high cost public debt from privatisation proceeds, reduction in rates of return on government savings instruments with decline in rate of inflation and better coordination between public debt management and monetary policy.

Altogether, the Government may find it difficult in 1996-97 to simultaneously achieve a number of objectives - bringing down the budget deficit, achieving steep import tariff reductions and raising the ADP to accommodate high priority new projects. All this will require additional taxation of almost 2 per cent of the GDP, equivalent to Rs 50 billion. Such heavy taxation may prove to be economically and politically unsustainable.

SALIENT FEATURES OF THE BUDGET 1996-97

BY

Zafar H. Ismail and Naveed Hanif

The federal budget 1996-97 has been framed in an environment of constraints, political, social and economic. Political considerations demanded that the burden of taxation should be distributed more equitably between the haves and the have nots. Social demands require that the creeping incidence of poverty be reduced. Proper economic management requires that inflation be minimised and growth of the economy stimulated. All of these considerations had to be kept in mind while developing the resource mobilisation strategy in the Budget. Simultaneously, the government had to meet the conditionalities which govern releases under the standby arrangement with the IMF.

As it come out, however, the budget for 1996-97 appears essentially to have a single item agenda, namely reduce the budget deficit to 4.0 percent of the GDP to meet one of the IMF's major conditionalities. Even though the budget forecasts expenditure increases of Rs.16 billion (14 percent) for defence, Rs.21.5 billion (13.1 percent) for debt servicing and Rs. 17.6 billion (20.2 percent) for development, the government has been able to curtail the budget deficit to attain the deficit target limit of 4 percent of the GDP. This has been achieved through additional taxation of Rs.41 billion. Therefore, the budget of 1996-97 does not envisage any economy in expenditure and relies solely on additional resource mobilisation to bring down the budget deficit.

The composition of taxes imposed by Benazir this year sends mixed signals to the economy. Of the Rs. 41 billion imposed, only Rs. 2.5 billion is from direct taxes. That is, only 6 percent of the proposals will impact directly on the incomes and wealth of the people and of this the bulk will be from those living in the urban areas. In other words, it appears that the thrust would be to rely heavily on indirect taxes.

The indirect taxes amounting to Rs. 38.3 billion (94 percent of proposed additional taxes) are being raised primarily through the imposition of sales tax on a wide variety of goods, including consumer goods such as the basket of textile products, tea and construction materials, which is expected to fuel inflation. Not only has the tax net been expanded substantially, the basic tax rate has also been increased by 3 percentage points. The implications of the widening means that the small scale industry will now also be brought more effectively into the tax net which may lead to major increases in prices of products consumed by the common man while leading to more evasion and corruption in the tax system.

One positive aspect of the budget is the withdrawal of import duties from machinery used for manufacturing exportable goods and the removal of excise duty from cotton yarn, steel products and tyres and tubes. However, these latter items will now have to pay a sales tax at 18 percent, which will be rebatable on export. The size of the rebate claims will, therefore, increase substantially. This would increase the amount of capital blocked in rebate claims, which would in turn lead to an increase in interest costs and, therefore, the cost of production. This will reduce the competitiveness of our exports.

The underlying reason for reducing the budget deficit is to reduce the level of borrowing, contain inflationary pressures, bring down the growth in public debt and restrict the “crowding out” of the private sector. Last year, the budget deficit was expected to be 5.1 percent of the GDP, but is now estimated to have increased to 5.6 percent of the GDP. The level of bank borrowings, however, increased by 18.6 percent over estimates. This year the government hopes to reduce the budget deficit by 1.4 percent of the GDP and hopes that the bank borrowings will be reduced by 56 percent.

The implications of the proposals to raise substantial resources largely from the urban areas through both direct and indirect taxes would further widen the rift between the ruling elite who hail from the rural areas and the major contributors to revenues - the middle class of the urban areas. The reliance on indirect taxes for the bulk of additional resources would appear to be inequitous as the impact of widening the tax base of the GST coupled to an increase in the basic rate by 3 percentage points would undoubtedly fuel inflation. An increase in the price of fertiliser, cloth and cement would certainly increase the cost of necessities in the consumption basket. Moreover, the increase in the cost of production of export goods resulting from the imposition of the GST and a substantially expanded level of export rebate claims will most probably dampen growth in exports which is contrary to one of the basic goals set by government for improving the growth in the economy and reducing the trade deficit.

THE REALITY OF FISCAL ADJUSTMENT

BY

Dr. A.F. Aisha Ghaus

Even though the Federal Budget of 1996-97 has been announced at a stage when the economy is experiencing a high current account deficit, approaching 6 percent of the GDP, a sluggish growth in manufacturing sector for two years running, and a double digit inflation, largely fueled by cost push factors like increase in administered prices and cost of imported inputs, the focus of the budget is only on reduction in the budget deficit. This, in fact, has been the apex policy objective of the government over the last few years. The overall deficit was brought down from 7.2 percent of the Gross Domestic Product (GDP), in 1992-93 to 5.8 percent in 1993-94, primarily by the tough measures introduced by the Caretaker government of Mr. Moeen Qureshi involving substantial reductions in expenditure and increases in administered prices. In 1994-95, taxation proposals of Rs 45.5 billion were introduced to target for a 4 percent budget deficit. Likewise revenue mobilising measures of over Rs 30 billion were introduced in the budget as well as through proposals announced during the year in an effort to achieve 4.5 percent deficit in 1995-96. This year the story is no different. Rs 41 billion taxation proposals have been proposed to bring the deficit down to 4 percent of the GDP.

Governments over the last three years have had moderate success in bringing down the budget deficit. Table 1 shows that even though the set targets where not achieved, the budget deficit has fallen down to 5.4 percent of the GDP by 1995-96. The present government has, however, been able to bring down the budget deficit by only 0.4 percent of the GDP during the last two years. The key question is whether the government will achieve the 4 percent target for 1996-97? The answer lies not only in the quantum of adjustment proposed but also in the nature of fiscal adjustment proposed to achieve this target.

Table 1 shows that, contrary to popular perception, the decline in budget deficit has to date been achieved not through enhanced resource mobilisation but by a downward adjustment of expenditures. Despite the multitude of taxation proposals and heaving new taxation of about

1.1 percent to 1.7 percent of the GDP announced every year the revenue to GDP ratio has declined from 18.6 percent in 1992-93 to 17.6 percent in 1995-96. This is because the marginal rise in the tax-to-GDP ratio has been more than compensated by the decline in the ratio of non-tax revenues to GDP. Net fiscal adjustment has been achieved by over a one percentage point decline in the development expenditure and a 1½ percentage point decrease in current expenditure to GDP ratio. The latter has been achieved by a reduction of over one percent of GDP in defence and subsidies.

TABLE 1
FISCAL ADJUSTMENT
(As % of Gross Domestic Product)

Heads	1992-93	1993-94	1994-95	1995-96	1996-97 [B]
Gross Revenue	**18.6**	**18.6**	**17.4**	**17.6**	**18.2**
Tax	13.0	13.2	13.2	13.2	14.5
Non-Tax	5.6	5.3	4.2	4.3	3.7
Net-Revenues?	**13.8**	**13.4**	**12.1**	**12.0**	**12.8**
Self Financing by Provinces Corporations and Disinvestment etc.	**0.1**	**0.9**	**0.9**	**1.0**	**1.4**
Total Expenditures	**21.1**	**20.1**	**18.4**	**18.4**	**18.2**
Current??	15.9	15.4	14.0	14.4	14.0
Development	5.2	4.7	4.4	4.0	4.2
Budget Deficit	**7.2**	**5.8**	**5.4**	**5.4**	**4.0**
Targetted Budget Deficit		**6.2**	**4.0**	**4.5**	**4.0**

Source: Federal Budget in Brief, Finance Division GOP.

The strategy of fiscal adjustment proposed in 1996-97 almost solely relies on increasing tax revenues, by over percentage point of GDP, Reduction in current expenditures proposed is only marginal while a slight increase in development expenditure is proposed. At a glance the task or fiscal adjustment next year appears to be sizeable at over 1.4 percent of the GDP. In addition, it has been complicated by a number of factors. First, the relatively easy phase of tax reforms is, more or less, over. This included reduction of tariffs from very high levels, (in fact, there was an increase last year, with the imposition of the regulatory duty), extension of withholding and presumptive taxes, more effective coverage of general sales tax at the import and manufacturing stage and extension of excise duties to services with collection by large public sector entities. These reforms were relatively easy to implement, both politically and administratively. Despite this, we see that the tax-to-GDP ratio has increased only marginally from 13.0 percent in 1992-93 to 13.2 percent in 1995-96. To achieve an increase of 1.3 percent of the GDP in 1996-97 through administratively and politically difficult measures like extension of sales tax net to cover small establishments, higher wealth taxation of properties, withdrawal of exemptions on corporate salary perquisites appears an uphill task.

Second, possibility of substantially economy in current expenditure looks remote. Defence expenditure has already been reduced 1 percent of the GDP. Given the complex regional situation the government proposes to increase defence expenditure rather than bring it down. Expenditure on interest payments in the short run is rigid particularly in the absence of structural changes like a reduction in interest rates and retirement of public debt. Therefore, the task of reducing budget deficit to the proposed level looks difficult. In the event additional tax revenues do not materialise government may have no option but to further slash the ADP, which already is low at only 4 percent of the GDP, as was done in 1995-96 when the ADP was scaled down from Rs 96 billion to Rs 87 billion. Further reduction is likely to have adverse implications on the GDP growth which has only just picked up after three years of recession.

Altogether, the government has targeted for a substantial reduction in the budget deficit by 1.4 percent of the GDP in 1996-97. During the 90s this quantum of adjustment was achieved only once before in 1993-94. In the latter year this was achieved primarily through expenditure cut backs on development and defence. The strategy in 1996-97 is, however, fundamentally different and focuses exclusively on raising the tax-to-GDP ratio through additional taxation. The experience of the last few years indicate that it is extremely difficult to raise the tax-to-GDP ratio substantially in the short run without creating stagflationary tendencies in the economy and jeopardising the achievement of other macro economic targets.

3. IMPACT OF THE BUDGET ON SOCIAL DEVELOPMENT

IMPACT OF THE BUDGET ON POVERTY AND INEQUALITY
BY

Dr. Asad Sayeed and Nazia Bano

The impact on poverty and inequality of the 1996-97 budget cannot be seen in isolation of the general policy climate that pervades in the country since the onset of Structural Adjustment Programme and consequent policies of liberalisation and privatisation. Although Pakistan's record in poverty reduction has been impressive up until the beginning of the 1990s (as stated in the recently published World Bank's report on poverty), indirect evidence suggests that at best the rate of decline in poverty has reduced and at worst poverty might have actually increased. This conjecture is based on the movement of some key indicators which determine the rate of poverty - such as an increase in the rate of inflation, reduction in the trend growth rate of the economy, reduction in consumer subsidies as well as declining public sector development expenditure (from an average of 6% of GDP in the 1980s to 4% in the 1990s). To gauge the impact of the 1996-97 budget on poverty and inequality, one has to see how some of the important determinants of poverty and inequality will be affected by various budgetary proposals.

POVERTY

There are three key determinants of poverty in Pakistan; inflation (through its impact on real wages), the capacity of the economy to generate employment through economic growth and finally the safety nets provided by the government to reduce the incidence of poverty. In the following we assess the manner in which these three indicators are likely to behave in the wake of current budgetary proposals.

Inflation

An important determinant of poverty in the short run is inflation in the price index of the consumption bundle of the poor. In the past, these affects have been indirect, where prices of food, clothing and medicine (which constitute 80 % of the consumption bundle of those earning less than Rs. 1000 per month) have increased as a result of price increases in other sectors . This time, however, by the imposition of sales tax on cloth, an increase in the excise duty on cement from 25% to 35% and a 5% sales tax on medicines, the prices of these essential items will increase in the first round. Our calculations show that the inflationary impact of new taxes on the Consumer Price Index (CPI) is going to be of the order of 2.0%. Because food prices have not been taxed directly, prices of food items are expected to increase by 0.33%. The bulk of the increase in CPI will fall on non-food items which will constitute about 84% of the 2% increase in the CPI. In this category the cost of clothing is expected to increase by 6.9%, housing by 4% and medicines by 1.2%.

In addition to new tax proposals, monetary expansion of the tune of 0.8% of GDP for the year 1996-97 is expected to jack up the CPI by another 7.7% to bring the total inflationary impact of the budget to 2.16%. Given these calculations, we see that the direct inflationary impact of all budgetary proposals is not as severe as is popularly perceived. However, as we know so well for Pakistan and for other countries also, inflationary expectations once fuelled often jack up the price level much further than the one-off increase due to these policy shocks. In the expectation of a 'harsh budget', prices of many essential commodities have already been increased in the market. To what extent this ripple effect unfolds over the course of the next year will depend a great deal on the credibility of the policy environment. Going by recent experience the probability of a credible policy environment is low. We should thus expect, even with no mini budgets, an expectations led increase in the CPI index.

Growth and Employment

A fast growing economy generates higher employment and through increases in labour productivity, real wages also increase. Both these consequences of high growth have a positive impact on poverty alleviation. Although growth in the economy as a whole has been restored to its past levels last year, it has been largely fortuitous - coming as it did from the agricultural sector. One way of determining the impact that the present budget will have on employment and therefore on poverty is by gauging the prospects for growth in employment elastic sectors in light of the budgetary proposals. In terms of employment elasticity, the agricultural, manufacturing (particularly small scale manufacturing) and construction sectors top the list. Although the agricultural sector recorded a giant leap in the preceding year, its long run growth is dependent on good fortune as well as growth in other commodity producing sectors, both from the supply and demand side. On the supply side, growth in the construction sector is going to be adversely affected by the increase in cement prices. More importantly in a contractionary growth environment, it is unlikely that demand for new construction will demonstrate much growth.

Perhaps the most glaring feature of this budget is the lack of any strategic incentives provided to the manufacturing sector. In its obsession to maximise revenues, the government has maintained the status quo in tariffs and thereby kept the level of protection to industry unchanged. To the extent that this is perceived as an 'incentive' it amounts to nothing more than preserving the rate of growth of manufacturing to its historically low level of 4.2% per annum in the 1990s as compared to 8 to 9% in the 1980s. The government has reduced the tariff rate on export oriented and specialised textile machinery and a few other items. But will this be able to compensate for the liquidity crunch of roughly 15 to 20 billion rupees that textile related exports will face because of the GST remains to be seen. As for the small scale sector, the removal of fixed sales tax to the system of direct assessment will - to say the least - not help in the growth of the small scale sector.

The most important growth impetus that the government could have provided for the economy at large and for the manufacturing sector in particular is to have gone for a somewhat less restricted money supply. This would have brought interest rates down from their presently exorbitant rates of 20% and above in nominal terms. But such a policy option is taboo in times when IMF prescripts based on the monetarist doctrine rule the roost in this country. The route to poverty alleviation through growth has thus not been served by the strategy adopted in the 1996-97 budget.

Safety Nets

Expenditures through the Zakat and Ushr Fund as well as the Baitul Maal- the two supposed safety nets in operation- have shown very modest growth in the past. In any case it is generally believed that these funds are poorly targeted and much of the money is siphoned-off by other economically and politically powerful lobbies.

The major safety net is that of food subsidies. In the last fiscal year the government should be credited for increasing the subsidy on imported wheat from an estimated 10 million rupees earmarked in the 1995-96 budget to Rs. 7014 million. For the year 1996-97, wheat subsidies have been earmarked at Rs. 5398.6 million, which amounts to a reduction of 30% in real terms. For the sake of poverty alleviation in the coming year one hopes that the government takes a volte face vis-a-vis the wheat subsidy as it did last year.

INEQUALITY

Just like reduction in poverty, inequality has also consistently declined in the country since the mid 1960s up until the 1980s. The beginning of the present decade however shows a major turn around in this phenomenon also. According to the 1995-96 Economic Survey, the distribution of income in Pakistan is more skewed in 1990-91 (the last year for which data is published) than it was in 1963-64. With ever increasing taxation burdens (particularly those of indirect taxes), increase in utility charges and other market friendly policies pursued, it can be conjectured that the distribution of income would have further deteriorated in the last five years. As for the budget, it will accentuate these inequalities further principally through the imposition of the GST. The share of indirect taxes imposed this year has been the highest in the last three years (as seen in Table 1) and within indirect taxes the share of sales tax -which has the greater bearing on income distribution - this year is also most hefty.

TABLE 1
PERCENTAGE SHARE OF DIRECT AND INDIRECT TAXES IN TAX PROPOSALS

Heads	1994-95		1995-96		1996-97	
	Proposals (Billion)	% Share	Proposals (Billion)	% Share	Proposals (Billion)	% Share
TOTAL TAX	**45.5**	**100.0**	**16.3**	**100.0**	**40.9**	**100.0**
Direct Tax	4.8	10.6	6.9	42.3	2.5	6.1
Indirect Tax	40.7	89.4	4.4	27.0	38.3	93.7
Sales Tax	20.2	44.4	1.2	7.4	25.8	63.2
Surcharge on Petroleum	)	)	5.0	30.7	)	)

Source: Budget Speeches of Finance Minister.

Our estimations show that those in the lowest income bracket (earning less than Rs. 2000) will bear the brunt of the new taxes most severely. The real incomes of the lowest bracket are expected to decline by 2.64% as compared to a reduction of 1.87% in the real incomes of the highest income bracket.

While the above budgetary measures will have a negative impact on the distribution of income in the short run, one indicator of reducing inequality in the medium to long run is improvements in income generating opportunities through access to basic social services. Looking at numbers on this count shows that governmental commitment towards the social sectors, indicated by the share of government expenditure on social services, has increased slightly (Table 2). However since growth in government expenditure itself has decelerated, real growth over the years has slowed down. If the route to reducing inequality through a more widespread provision of social services is the slogan, then a much larger chunk of resources need to be reallocated towards the social sectors. Political compulsions and expediency however make this an unlikely outcome in the near future.

TABLE 2
GOVERNMENT EXPENDITURE ON SOCIAL SECTOR DEVELOPMENT
(Rs in Million)

Heads	1995-96	1996-97	Growth Rate
Total Government Expenditure	633611.0	640686.2	1.12%
Total Government Expenditure on Social Sectors	84046.1	86001.1	2.33%
Share of Social Sector Expenditure in Total Government Expenditure	13.3%	13.4%	)
AVERAGE SHARE OF SOCIAL SECTOR EXPENDITURE IN TOTAL GOVERNMENT EXPENDITURE			
1980-88	11.6%		
1988-96-97	12.7%		

Note: 1996-97 figures are given in 1995-96 prices
Source: 1) Budget Documents of Provincial Governments
2) Budget Documents of Federal Governments

CONCLUSION

The impact of the recently announced budget on poverty and inequality in the economy will not be as severe as is made out by the more impulsive rhetoric of the opposition and the public at large. If efforts to reduce poverty and inequality are to be undertaken, then rather than annual budgets, the focal point for analysis ought to be a critical appraisal of market friendly policies in the wake of the structural adjustment programme and the lack of any initiative for launching the economy on a high growth path.

FEDERAL BUDGET 1996-97: IMPLICATIONS FOR THE PROVINCIAL GOVERNMENTS

BY
Rafia Ghaus and Rauf Khan

While there is generally a lot of debate and discussion on how the federal budget affects various economic agents and entities, one impact which almost always goes either unrecognised or underemphasised is its implications for the provincial governments. Provincial governments in Pakistan play a pivotal role in the delivery of some basic social and economic services which have an impact on the quality of life of the people. Therefore, its implications on provincial finances are likely to trickle down and affect the masses.

The federal budget of 1996-97 is significant as it affects provincial finances in a number of ways. First, provincial governments rely heavily on revenue-sharing transfers from the federal government to finance their on-going operations of the National Finance Commission (NFC) award which according to constitutional provisions is to be announced once every five years. The new award was due before the 1996 budget but because the 1995 NFC has not been successful in finalising its recommendations, transfers continue to take place according to the provisions of the 1990 NFC award. According to this 80 percent of the proceeds of income tax, sales tax, excise duty on sugar and tobacco and tobacco manufactures is shared with the provinces. Therefore, the level of federal fiscal effort in these taxes has a direct bearing on the provincial governments.

Federal transfers to the provincial governments are budgeted to be Rs 133 billion in the absence of taxation proposals showing an increase of about 10 percent over 1995-96 level (see Table 1). Bulk of this increase is attributable to the elasticity of income and sales tax. Straight transfers which include Royalty, excise duty and surcharge on gas, royalty on crude oil, and profits from hydro electricity, show a decline of 7 percent from Rs 24 billion in 1995-96 to Rs 22 billion in 1996-97 primarily due to contraction in development surcharge on gas. On the whole the federal government in 1996-97 will transfer 41 percent of it tax revenues to the provinces.

TABLE 1

FEDERAL TRANSFER TO THE PROVINCES

[Rs in Billion]

Source	**1995-96 [R]**	**1996-97**		**PERCENTAGE CHANGE [1995-96 TO 1996-97]**	
		Without Proposals [B]	**With Proposals [E]**	**Without Proposals**	**With Proposals**
Taxes on Income	54.6	62.6	63.9	14.7	16.9
Taxes on Sales	38.0	43.1	62.7	13.3	64.9
Sugar	4.2	4.3	4.3	1.8	1.8
Tobacco	9.1	9.9	9.9	8.3	8.5
Straight Transfers	23.7	22.0	22.0	-7.1	-7.1
TOTAL	**129.6**	**141.9**	**162.7**	**9.4**	**25.5**

Source: Explanatory Memorandum of the Budget, 1996-97

Note: Straight transfers includes profit from hydro-electricity.

In the federal budget of 1996-97 the government has announced taxation proposals of Rs 40.8 billion, largely to be mobilised by the general sales tax and income tax, both of which are shared with the provinces. The government proposes to mobilise Rs 25.8 billion and Rs 1.6 billion respectively from sales and income taxes, thereby increasing the federal transfer to the provinces by about Rs 20.9 billion. This implies that provincial governments will get a 27 percent higher federal transfers in 1996-97 compared to 1995-96 if the taxation proposals are successfully implemented. This is a sizable increase and will lead to a substantial improvement in the financial position of the provincial governments in the country. Therefore, the federal budget of 1996-97 is very favourable from the provincial government's perspective.

The distribution of the revenues gains resulting from the federal budget of 1996-97, however, are not equal across provinces. Since both income and sales tax are distributed among the provinces on the basis of population, the largest province, namely Punjab is the main beneficiary of the budget. As shown in Table 2, the share of Punjab in federal transfers (inclusive of taxation proposals) increases to 51.2 percent. Balochistan accommodates the lowest number of people and thereby gets the least benefit, Its share in total federal transfers actually declines to 7.6 percent.

TABLE 2

SHARE OF PROVINCES IN FEDERAL TRANSFER [PERCENT]

Heads	1995-96 [R]	1996-97	
		Without Proposals [B]	With Proposals [E]
Punjab	48.9	50.3	51.2
Sindh	24.4	24.3	24.2
NWFP	17.2	17.4	16.9
Balochistan	9.4	8.0	7.6
TOTAL	**100**	**100**	**100**

On the negative side, the 1996-97 Budget incorporates on optimistic target of provincial self financing of the Annual Development Program (ADP). The federal budget 1996-97 envisages a generation of a Rs 16 billion revenue surplus by the provinces in the absence of receipts from the taxation proposals. This is not consistent with the revenue surplus reported by the provinces in their budget for 1996-97. According to the provincial budgets the total surplus generated by the provinces will be only Rs 8.9 billion in 1996-97. This assumes an underlying growth rate of 11 percent in provincial own revenue receipts and 13 percent in provincial current expenditures. To achieve the Rs 16 billion revenue surplus targetted the federal government, given the current resource base, growth in provincial current expenditures would have to be restricted to only 8 percent during 1996-97. This is an unrealistically low level and can severely affect the efficiency of service provision by the provincial governments. Even if the provincial resource base is expanded to include revenue gains from taxation proposals announced by the four provincial governments in 1996-97, which are equivalent to Rs 1.2 billion, (implying a 15½ percent increase in provincial own receipts) the target of self financing is unattainable. Also, provincial governments continue to depend on federal development transfers to partly finance their development outlays. Over the last few years their had been a reduction in the provincial share in the Annual Development Program (ADP). Like last year, development transfers of Rs 25 billion (inclusive of SAP tied loans) have been allocated to the provinces. The consequence of these measures is that the completion of provincial development projects may be delayed with implications on the provision of basic services. However, if the additional transfer of Rs 20.9 billion to the provinces materialises due to the federal taxation proposals then the provinces will not only be to achieve the self-financing targets but also increase their ADPs.

Also, the federal government over the years has shown a tendency of encroaching on tax bases which fall under the domain of the provincial governments. For example, sales taxation of services has been included in provincial fiscal powers. However, the federal government has found alternative route of levying excise duties on services. Initially it introduced an excise duty on telephones and then slowly net was extended to include bank advances, travel agents, doctors, advertising agents etc. Also, it has levied capital value tax on essentially provincial tax bases like motor vehicles and properties which tantamounts to double taxation and thereby reduces tax compliance. This may lead to erosion in stamp duty.

Since the announcement of the 1990 NFC award which has made the provincial governments responsible for their deficits and surpluses, all four governments have made an effort to mobilise higher revenues. Therefore, given that the federal government has already pre-empted the broad based and buoyant taxes like income tax, sales tax etc., whatever remaining tax bases fall under the purview of the provincial governments should, in principle, not be encroached upon by the federal government. This is important for the financial autonomy and long run sustainability of the provincial governments in the country.

On the whole, it appears that the federal budget of 1996-97 has favourable implications for the provinces. The resource mobilisation strategy adopted by the federal government will expand the provincial revenue base substantially. However, the absence of any growth in federal revenue transfers and the optimistic self-financing targets may constrain financial outlays on development projects particularly if the additional transfers to the provinces do not materialise.

BUDGET 1996-97: RESOURCE MOBILISATION BY THE PROVINCIAL GOVERNMENTS

BY

Rafia Ghaus and Rauf Khan

The last few years have witnessed a significant increase in the level of fiscal effort by provincial governments in Pakistan. This is largely a consequence of a change in the structure of inter-government fiscal relations between the federal and the provincial governments whereby provinces have to self-finance part of the *Public Sector Development Programme (PSDP)* and have limited access to federal grants and loans. During 1996-97, for example, 64 percent of the *PSDP* is to be financed by provincial governments as compared to 37 percent last year.

Provincial governments propose to generate an additional Rs 2 billion in 1996-97 which is equivalent to 16 percent of their current tax revenues. This is perhaps the highest effort by provincial governments in recent years. Out of this, Punjab proposes to generate Rs 560 million, Sindh, Rs 1200 million, NWFP Rs 147 million and Balochistan Rs 80 million. If realised, it will increase overall provincial tax revenue by 28 percent in 1996-97 as compared to the 12 percent average annual growth during the 90s. Besides, the high quantum of additional revenue generation the key features of the provincial resource mobilisation include, first, the relatively high level of fiscal effort by the smaller provinces, particularly Balochistan. In previous years high effort was limited to the bigger provinces, particularly Punjab. Second, effort has been made to mobilise revenue in un-traditional and innovative ways which include taxation of sensitive areas like agriculture, services, and business. Finally, the incidence of most of the taxation proposals appears to be on the urban areas. Exception exists in the case of Sindh where a graduated fixed agricultural income tax is imposed and the Abiana rate is enhanced. Otherwise bulk of the incidence of almost all the proposals is likely to be on urban based population.

While looking at the taxation measures adopted by the individual provinces it is interesting to note that effort has been made in the last couple of years to mobilise higher revenues from stamp duty, tax rate of which remained, by and large, unchanged for last two decade. In the current budget, NWFP followed the path of Sindh and Punjab by introducing changes in about

32 articles of stamp duty generating an additional revenue of Rs 51 million. Key changes made in Punjab include increase in the rates of stamp duty on insurance and judicial stamps and levy on cheques, pay orders etc. Sindh has introduced a couple of new heads if the stamp act which include "Contract" (article 22a) and "New Issues of Shares" floated by companies listed in Karachi stock exchange and has brought some changes in articles related to shipping transactions. It is encouraging to note that Balochistan also proposes major changes in the financial instruments of stamp duty (see Table 1).

Sales taxation of service is constitutionally under the domain of provincial governments. However, over the last few years the federal government has encroached in this area via a levy of excise duty on service. In the current budget all the provincial governments have taken a bold step by either enhancing or introducing tax on professionals and services. Tax on telephone charges, advertisements, courier charges and business/services has been introduced by Balochistan government. Similarly, Sindh has imposed a tax on sale of services rendered by travel agents, courier, caters, restaurants, chartered accountants, surveyors, architect, banks, modarbas, leasing companies, investment banks, stock brokers, etc. Besides, Sindh has also taken the initiative of taxing agriculture income. NWFP introduced this tax is 1995-96. The structure of tax in the two provinces is, however, quite different. In NWFP the tax is assessed on the basis of production index units, while in Sindh it is linked to acreage. In an effort to tax trade/business Punjab has introduced a tax on petrol pumps, small hotels, marriage halls, restaurants, etc. and has enhanced hotel tax rate.

Some effort is also made by the provinces to enhance taxation of physical assets. Sindh has made enhancement in the rental value of properties for the assessment of property taxation. The second major source of income of the provincial governments motor vehicle tax, has been enhanced by NWFP and Punjab. In addition, Balochistan government has also levied a surcharge on octroi contract at the rate of 5 percent of the contract amount. NWFP already levies a development cess on octroi and so does Sindh. As such, the tendency to encroach on a lower tier revenue source is not only limited to the federal government. The provincial

TABLE 1 TAX PROPOSALS UNDER STAMP DUTY, 1996-97					
S. No.	**Article**	**Province**	**S. No.**	**Article**	**Province**
1	Judicial ! Court Fees ! Penalties (Section 62A) ! Reduction in the exemption limit	Punjab	22	Debenture (Article 27)	Balochistan
			23	Delivery order in Respect of Goods (Article 28)	NWFP
			24	Divorce (Article 29)	NWFP
2	Allotment letter issued in respect of: ! Residential Plots ! Commercial Plots	Sindh	25	Gifts (Article 33)	Sindh
			26	Letter of credit (Article 37)	Sindh, NWFP
3	Acknowledgment and receipts (Article 1)	Sindh, NWFP	27	Letter of Licence (Article 38)	NWFP
4	Administration Bond (Article 2) clause `b'	NWFP	28	Memorandum of association (Article 39)	Sindh, Balochistan
5	Adoption Deed (Article 3)	NWFP	29	Note or Memorandum (Article 43)	NWFP, Balochistan
6	Agreement or Its Memorandum (Article 5)	NWFP, Balochistan	30	Note or Protest by The Master of a Ship (Article 44)	NWFP
7	Agreement related to deposit & title deeds (Article 6)	Sindh	31	Partnership (Article 46)	NWFP, Balochistan
8	Appointment in Execution of a Power (Article 7)	NWFP	32	Insurance (Article 47)	Punjab
9	Appraisement or Valuation (Article 8)	NWFP	33	Power of Attorney (Article 48)	Sindh, Balochistan
10	Apprenticeship Deed (Article 9)	NWFP	34	Promissory Note (Article 49) Clause `a', sub-clause `V'	NWFP
11	Article of association of a company (Article 10)	Sindh, Balochistan	35	Protest of Bill or Note (Article 50)	NWFP
12	Bill of Lading (Article 14)	NWFP	36	Protest by The Master of Ship (Article 51)	NWFP
13	Certificate (Article 18)	Sindh	37	Proxy (Article 52)	Sindh, NWFP
14	Certificate of Other Documents (Article 19)	NWFP	38	Receipts (Article 53)	Sindh, NWFP
			39	Re-Conveyance of Mortgaged Property (Article 54)	NWFP, Balochistan
15	Charter Party (Article 20)	NWFP	40	Release (Article 55)	Sindh
16	Cheques, pay order and bank drafts etc. (Article 21)	Punjab, Sindh, NWFP, Balochistan	41	Security Bond or Mortgage Deed (Article 57)	Sindh, NWFP, Balochistan
17	Composition-Deed (Article 22)	NWFP	42	Settlement (Article 58)	NWFP
18	Contract (Article 22a)	Sindh	43	Shipping Order (Article 60)	NWFP
19	Copy or Extract (Article 24)	NWFP	44	Surrender of Lease (Article 61)	NWFP
20	Counterpart or Duplicate (Article 25)	NWFP	45	Share transfer fee (Article 62)	Sindh
21	Custom Bond (Article 26)	NWFP	46	New issues of share floated by companies listed on KSE	Sindh

governments take the tradition one step ahead and an attempt is made to ride on the backs of local governments.

An analysis of the proposals shows that these are likely to be progressive, buoyant and non-distortionary in character. Since the proposals mostly relate to taxation of physical assets, professional services and transactions generally undertaken by upper to upper-middle sections of population, their incidence is likely to be progressive. In addition, the proposals will not only increase revenues for the public exchequer but will also make the taxation structure more buoyant and broad-based as some the untapped, fast growing sectors come under provincial tax net. Needless to say, if agricultural incomes would have been taxed adequately, the structure would have become more efficient and regionally balanced.

OTHER BUDGETARY PROPOSAL, 1996-97		
S.No.	**Tax**	**Province**
1	Levy of Agriculture Income Tax	Sindh
2	Increase in Abiana Rate	Sindh
3	Increase in Property Tax (ARV) and Withdrawal of Rebate of Owners-occupied Properties	Sindh
4	Tax on Sale of Services/Business: Travel Agents, Courier, Caters, Restaurants, Chartered Accountant, Surveyors, Architect, Builders, Banks, Modarbas, Leasing Companies, Investment Banks, Stock Brokers, etc.	Sindh, Balochistan
5	Increase in Rates on Profession, Trade and Callings	Punjab
6	Increase in Rates of Entertainment Duty	NWFP
7	Increase in Registration Fees and Motor Vehicle Tax	Punjab, NWFP
8	Doubling of Rates on Development and Maintenance Infrastructure Fee	Sindh
9	Increase in Rates of Development Cess on Octroi and levied of cess on tobacco buyers	NWFP
10	Levy of a Surcharge on Octroi Contract	Balochistan
11	Increase in Rates of Tax on Advertisements	NWFP, Balochistan
12	Levy of Duty on Telephone Consumption Charges	Balochistan
13	Increase in the Rates of Hotel Tax	Punjab
14	Increase in the Rate of Bank Cheques Book	Punjab, Balochistan
15	Tax on Room Rent of Private Hospital	Punjab
16	Tax on Hotels, Restaurants, Marriage and Banquet Hall	Punjab
17	Tax on Persons Owing a Petrol Pump on National Highway	Punjab
18	Levy of Tax on Mobile Phone	NWFP
19	Trade Tax on Business/Services	Balochistan
20	Tax on Registration of Business Hours/Firms	Balochistan
21	Registration fees and annual tax Video Cassettes (Wholesaler, Retailer or Lender)	Balochistan
22	Registration fees and annual tax Motor Vehicle Dealer or Real Estate Agent	Balochistan

BUDGET 1996-97: PROVINCIAL EXPENDITURE PRIORITIES
BY
Mohammad Asif Iqbal and Abu Nasar

Provincial governments' expenditures have shown significant growth in the last few years. The fast growth may partially be attributed to first, the implementation of the Social Action Programme which priortises financial commitment to social sector development and second, the improvement in provincial resource position in the aftermath of the 1990 National Finance Commission Award. The objective of this paper is to highlight the overall role of provincial governments in public expenditure and to analyse the differences among four provinces in level, composition and growth of expenditures with special reference of allocations to the social sectors.

SIZE OF PROVINCIAL BUDGETS

Total expenditure of four provincial governments combined, both current and development expenditure, is estimated at Rs 202 billion for the year 1996-97 which is about 11 per cent higher than the last fiscal year (see Table 1). The corresponding estimate for the federal government is about 558 billion. Therefore, provincial governments have a share of 27 per cent in public expenditures. During the period 1993-94 to 1995-96 the average growth in total expenditure is about 21 per cent per annum. This is much higher than the increase budgeted for 1996-97 and, therefore, raises doubt about the feasibility of the expenditure targets. Development expenditures are budgeted to increase by about 10 per cent while an increase of only 11 per

TABLE 1
TOTAL EXPENDITURE BY PROVINCIAL GOVERNMENTS
(Four Provinces Combined)

[Rs in Billion]

	1993-94	1994-95	1995-96	1996-97	ACGR (%)
Current Expenditure	**100.3**	**116.7**	**141.9**	**157.4**	**16.2**
General Admin. & Debt Servicing etc.	50.5	55.8	69.2	72.6	12.9
Social Services	35.8	43.5	52.1	61.7	19.9
Economic Services	14.0	17.3	20.7	23.2	18.2
Development Expenditure (Budget Estimates)	**23.5**	**32.4**	**40.7**	**44.7**	**24.0**
Social Services	12.1	16.2	20.0	21.6	21.1
Economic Services	11.3	16.2	20.7	23.2	26.9
Total Expenditure	**123.8**	**149.1**	**182.6**	**202.1**	**17.7**

Sources: I) Annual Budget Statements of Provincial Governments.
ii) Annual Development Programs of Provincial Governments. (Budget estimates)

cent is budgeted in current expenditure. Compared to this, growth in development and current expenditure during the last three years has been 31 % and 19 % respectively. The sizeable growth in provincial development expenditures is primarily due to increased foreign project assistance provided by donor agencies to finance provincial Annual Development Programs. The share of current and development expenditures in total provincial expenditure is 78 per cent and 22 per cent respectively in 1996-97. These have remained more or less constant since 1994-95. The share of development expenditure in the total budget was about 20 per cent in 1993-94.

TABLE 2
SECTORAL SHARES OF RECURRING EXPENDITURES OF THE PROVINCIAL GOVERNMENTS
(Four Provinces Combined)

[%]

	1993-94	1994-95	1995-96	1996-97
General Administration	10.3	11.3	15.8	14.0
Law and Order	10.8	11.0	9.8	9.1
Debt Servicing	25.8	22.9	20.2	19.7
Subsidies etc.	3.4	2.7	3.0	3.4
Sub-Total	**50.3**	**47.9**	**48.8**	**46.1**
Social Services	**35.7**	**37.3**	**36.7**	**39.2**
Education	26.5	28.6	28.0	29.7
Health	6.7	6.4	6.4	6.8
Other Social Services	2.4	2.2	2.2	2.6
Economic Services	**14.0**	**14.9**	**14.6**	**14.7**
Agriculture	4.4	4.4	4.2	4.0
Irrigation	4.0	5.1	4.5	4.7
Works	3.8	3.6	3.5	4.0
Other Economic Services	1.8	1.8	2.4	2.0
Total	**100.0**	**100.0**	**100.0**	**100.0**

Source: I) Annual Budget Statements of Provincial Governments.

COMPOSITION OF PROVINCIAL EXPENDITURE

Current Expenditure: In 1996-97, Education has the highest share in provincial current expenditure due to its labour-intensive nature, of about 30 per cent in total current expenditure as shown in Table 2. Next in importance is debt servicing, 20 per cent, and general administration, 14 per cent. The share of general administration in provincial current budget has increased rapidly from 10 % in 1993-94 to 14 % in 1996-97 increasing at the rate of about 29 per cent. Despite the generally troubled law and order situation particularly in the provinces of Sindh and Punjab expenditure on this head has increased by less than 10 % per annum.

Even though provinces are involved in the provision of some key economic services like irrigation, agriculture, animal husbandry, forestry, works, etc., the share of these services together is almost the same as on general administration. Overtime this has remained more or less stagnant.

Development Expenditure: In 1996-97, provincial governments allocated 52 per cent of their development resources to economic sector and 48 per cent to the social sector. Following implementation of Social Action Program in 1992-93, it was expected that social sector would be given higher priority in the allocation of development expenditures by the provinces. However, Table 3 shows a declining trend in the share of development expenditure on social sector during the last four years. Social sector received a share of about 52 per cent in 1993-94 which has come down to 49 per cent in 1995-96. A further decline is envisaged in 1996-97. Within the social sector, education shows a modest increase while the share of health and physical planning and housing shows a decline.

In economic sectors, a high priority for water and power is indicated by the increase in its share in total development expenditure from 9 per cent in 1993-94 to over 14 per cent in 1996-97. This is mainly due to massive thrust in the development expenditure of water and power sector in the province of Punjab where an allocation of Rs 1.6 billion has been made for this sector in 1996-97 as compared to Rs 0.4 billion in the previous year . The share of other economic sectors like agriculture, transport and communications and rural development registered a decline.

TABLE 3
SECTORAL SHARE OF DEVELOPMENT EXPENDITURES OF THE PROVINCIAL GOVERNMENTS
(Four Provinces Combined)

[%]

	1993-94	1994-95	1995-96	1996-97
Social Sectors	**51.7**	**50.0**	**49.1**	**48.2**
Education	18.5	19.7	19.0	19.9
Health	10.2	9.4	8.8	7.2
Physical Planning & Housing	20.5	18.5	19.2	18.8
Other Social Services	2.6	2.4	2.2	2.4
Economic Sectors	**48.3**	**50.0**	**50.9**	**51.8**
Agriculture	8.5	9.4	8.8	8.2
Rural Development	16.7	13.6	16.7	15.1
Water and Power	9.2	13.0	10.5	14.2
Transport and Communications	9.9	6.7	8.3	8.6
Other Economic Services	4.1	7.3	6.5	5.7
Total	**100.0**	**100.0**	**100.0**	**100.0**

Source: I) Annual Development Programs of Provincial Governments.

INTER-PROVINCIAL COMPARISON

Table 4 highlights the differences in growth of current and development expenditure among the four provinces. Growth rates have been computed for two periods, from

1993-94 to 1995-96 and from 1995-96 to 1996-97, to highlight changes in priorities in the budget of 1996-97. The table clearly indicates that the growth of both current and development expenditures in all the provinces is very low compared to the previous period with the exception of Balochistan. Punjab has shown the highest increase of about 17 per cent in 1996-97 while Sindh has budgeted a nominal increase of merely 3 per cent over the last year. Within development expenditure, a sharp decline in allocations to the social sector is visible, in particular in the provinces of Sindh and NWFP. In contrast, growth in current expenditure on social sector has been slightly higher in Punjab and NWFP.

Inter-sectoral priorities of provincial governments in current and development expenditures for the year of 1996-97 are presented Table 5. Punjab and NWFP have devoted highest share of current expenditure, of 41 per cent, to social sectors followed by Sindh (36 %) and Balcohistan (34 %). Within social sectors education claims the highest share of 32 % and 31 % in Punjab and NWFP respectively. Share of economic services ranges from 14 to 18 per cent of total current expenditure, the highest being in Balochistan. The share of general administration in total recurring budget is the highest in the province of Punjab implying the absence of economies of scale in management function. Burden of debt servicing is larger in NWFP in relation to the other provinces which is a consequence of relatively high level of borrowing in the past from federal government.

Physical planning and housing has the largest share (about 28 %) in the development outlay in Punjab in 1996-97. In Balochistan and NWFP education is the largest sector while in Sindh rural development and water and power has the highest share of 21 % each. Overall, social sectors claim higher shares (57% in NWFP and Balochistan and 53 % in Punjab) in development expenditure in relation to economic sectors. Exception exists in the case of Sindh where social sectors seems to be given a lower importance with a modest share of 35 per cent.

Overall, the size of provincial governments budget has expanded during the last few years due to increased responsibility of delivery of services in particular, labour intensive social services. In comparison to historical level, the budgeted expenditures for 1996-97 appears to be on the

TABLE 4
GROWTH IN RECURRING AND DEVELOPMENT EXPENDITURES OF PROVINCIAL GOVERNMENTS

[%]

	PUNJAB		SINDH		NWFP		BALOCHISTAN	
	1993-94 to 1995-96	*1995-96 to 1996-97*	*1993-94 to 1995-96*	*1995-96 to 1996-97*	*1993-94 to 1995-96*	*1995-96 to 1996-97*	*1993-94 to 1995-96*	*1995-96 to 1996-97*
Recurring Expenditure	**19.4**	**10.0**	**19.6**	**11.7**	**19.0**	**14.0**	**14.2**	**7.8**
Social Sectors	18.9	19.4	25.1	14.3	22.2	24.4	15.3	11.8
Economic Sectors	16.7	17.7	31.0	3.4	28.2	12.6	12.7	6.3
General Administration & Debt Servicing etc.	20.7	0.4	13.6	12.3	14.3	6.2	14.1	5.7
Development Expenditure	**22.5**	**16.7**	**69.7**	**2.7**	**25.9**	**10.8**	**4.3**	**11.7**
Social Sectors	29.8	11.8	37.6	5.8	35.7	7.2	7.2	2.8
Economic Sectors	14.8	22.7	97.7	1.1	15.1	15.8	0.1	26.1

Sources: I) Annual Budget Statements of Provincial Governments.
ii) Annual Development Programs of Provincial Governments.

lower side. This raises doubts about the feasibility of budgetary estimates. As far as the expenditure priorities are concerned, the budget estimates show a tilt towards social sectors, particularly in the province of Punjab, NWFP and Balochistan. Also, provincial governments should also make conscious effort of achieving greater level of self-reliance in development budget in order to avoid burden of debt servicing in the future.

TABLE 5
INTER-SECTORAL PRIORITIES IN EXPENDITURES OF THE PROVINCIAL GOVERNMENTS
1996-97

[%]

	PUNJAB	SINDH	NWFP	BALOCHISTAN
CURRENT EXPENDITURE				
General Administration	15.3	13.9	10.1	13.9
Law and Order	7.9	12.7	6.4	10.1
Debt Servicing	18.6	19.3	23.5	19.3
Subsidies etc.	2.2	4.5	4.5	5.0
Sub-Total	**44.1**	**50.4**	**44.4**	**48.3**
Social Sectors	**41.1**	**36.0**	**41.0**	**33.8**
Education	32.1	27.2	30.8	21.3
Health	6.6	6.2	7.9	7.8
Other Social Services	2.4	2.7	2.3	4.6
Economic Sectors	**14.9**	**13.5**	**14.6**	**18.0**
Total Current Expenditure	**100.0**	**100.0**	**100.0**	**100.0**
DEVELOPMENT EXPENDITURE				
Social Sectors	**53.3**	**34.6**	**56.9**	**56.6**
Education	17.3	16.9	25.2	26.7
Health	8.0	6.1	7.1	8.0
Physical Planning and Housing	27.6	10.6	20.0	13.4
Other Social Services	0.4	0.9	4.5	8.5
Economic Sectors	**46.7**	**65.4**	**43.1**	**43.4**
Agriculture	11.0	5.2	7.6	9.2
Rural Development	18.8	20.9	7.5	1.3
Water and Power	10.2	20.5	11.2	13.8
Transport and Communications	5.9	7.6	9.1	17.8
Other Economic Services	0.9	11.2	7.7	1.3
Total Development Expenditure	**100.0**	**100.0**	**100.0**	**100.0**

Source: I) Annual Development Programs of Provincial Governments.
ii) Annual Budget Statements of Provincial Governments.

THE MYTHICAL NUMBERS OF SAP ACHIEVEMENTS
BY
Zafar H. Ismail

Pakistan's economic performance over the last thirty years or more has been substantially better than that of most developing countries. The quality of life of its people has not matched with the improvements in their economic well-being. This has improved only marginally. Today the infant mortality rate of 102 is well over the developing world's average of 60 per 1,000 live births, the population growth rate, officially claimed to be 2.86% per year but accepted generally to be 3.1% annually, is perhaps the highest in the world, and the adult literacy rate, 37.9% is well below the region's average of 45.5%. To improve the social development of its people, governments in Pakistan prepared the Social Action Programme with the help of the United Nations Development Programme, first as a three year effort from 1992 to 1995 and subsequently extended this to a five-year programme from 1993 to 1998.

The primary objective of the SAP is to overcome these shortcomings in the shortest span of time. The Programme is designed, therefore, to undertake an accelerated programme of constructing primary schools, particularly for girls in the rural areas, improve the availability of primary health care through a network of outreach and in-situ programmes, and substantially improve access to safe drinking water and sanitation in the rural areas. The targets set for achieving the objectives require a level of effort and dedication of resources which appear to be beyond the capacity of the departments concerned and of the government. Therefore, to claim achievements which compare favourably with targets and objectives, statistics need to be produced to maintain the myth that "all's well".

Since 1992-93, the commencement year for SAP, the Economic Survey contains a special section "Programmes for Balanced Social Development" which is the brainchild of the Planning Division. This contains information on the achievements of SAP during the year. The data source is stated to be "Planning & Development Division" itself. The Division has no capability to generate numbers on its own and it is presumed that it relies on feedback from relevant sections of the provincial Planning & Development Departments. Invariably the numbers given in this section vary from those contained in other parts of the Survey, particularly the narrative sections on Human Development, Chapters 13 and 14 on Education, Health and Nutrition respectively, and the data presented in the Statistical Appendix. These latter are based on information provided by the relevant Ministry and the Federal Bureau of Statistics. Once again this year the Division has produced a set of numbers which do not reconcile and the claims cross the boundaries of acceptability by a wide margin.

The Division's targets and claims for achievement are taken from Table 16.1 of the Economic Survey 1995-96. The values for actual outputs have been taken from a variety of Tables in the same Economic Survey both in the body of the text of the Survey as well as from the Tables in the Statistical Appendix.

Table 1 compares information on primary education from the two sources, namely, the Planning and Development Division and the Ministry of Education. In 1994-95 the Planning Division claims that construction of new primary schools (7175) exceeded the target (6611) by a margin of 16 percent and in the subsequent year was bang on target (7195). The Ministry of Education says that only about 721 new primary schools were constructed in each of these years. The output claimed by the Planning Division is nearly ten times that of the Ministry. Who does one believe? The Ministry obviously. Their numbers are in keeping with historical trends. The largest number of new primary schools that have ever been opened in Pakistan was under the Nai Roshni Programme in 1986-87 when over 20,000 mosque schools were integrated into the mainstream of the primary school system. The historical level of construction has ranged from about 750 in lean years to a maximum of about 2,200 schools in years when funds were released in abundance. The provincial Education Departments themselves agree that they will never be able to handle construction contracts for more than 4,000 to 4,500 schools in any one year - that is a 2-year cycle of starts.

The numbers begin to look even more suspect when one compares the increase in enrollments. The Planning Division claims it has achieved over 96% of target enrollments in 1994-95 and 100% the next year and the growth in enrollment between these two years has been of the order of 1.4 million children. The Ministry and the FBS claim a much lower level - a gross enrollment of 11.5 million in 1995-96 compared to the Planning Division's estimated 14.3

million. The growth of enrollment in absolute terms was about 150,000 and not the 1.4 million shown by the Division (a factor of 10 times). It would also appear that in the hurry to lay claim to very high levels of achievement care has not been taken to add 2 and 2 and ensure that the answer is 4. Add 8.132 million (boys enrollment) to 5.041 million (girls enrollment) and the total should be 13.173 million and not the 12.825 million claimed by the Division for 1994-95.

Table 1
Primary Education

	1994-95			1995-96		
	Planning Division		Ministry	Planning Division		Ministry
	Target	Achieved		Target	Achieved	
New Primary Schools (Nos.)	6611	7175	721	7195	7195	721
Total Enrollment (000)	13323	12825	11338	14284	14284	11484
% of children of 5-9 years	72.1	69.5	60.2	77.3	77.3	59.3
Boys (000)	8178	8132	6960	8451	8451	6918
% of boys aged 5-9 years	86.8	86.4	72.8	89.9	89.9	70.4
Girls (000)	5145	5041	4378	5835	5835	4566
% of girls aged 5-9 years	58.2	57.0	47.2	66.0	66.0	47.9

Source: Economic Survey 1995-96 : Table 16.1 claiming to be from Planning & Development Division
Economic Survey 1995-96 : Statistical Appendix Table 13.1 for Schools, Table 13.2 for Enrollment
Actual Enrollment Rate based on Estimated Cohort Population derived from Table 3.1 of "Social Action Programme : Report to the Donors Meeting" prepared by the Planning Commission, September 1993

The enrollment rate is defined as the ratio of total enrollment to number of children in the relevant school going age cohort (here 5-9 years). The estimates of the denominator used by the Planning Division apparently vary for each calculation. The Division estimates that the overall cohort population in both years is 18.5 million. That is the population rate between the two years was zero percent. Once again the Division's arithmetic fails. The aggregate of the boys' and girls' cohorts (9.4 million + 8.8 million respectively) does not match with the estimated total (18.5 million).

The Division claims that adult literacy has increased from 37% in 1994-95 to 38.6 % in 1995-96, that is bang on target. In the same period male literacy is claimed to have increased from 55% to 58.7% and female literacy from 28% to 31.7%. The change in each of these cases is 3.7% over the two year period. The Ministry however claims that adult literacy in 1995-96 was 37.9%, male literacy was 50% and female literacy was 25.3%. The claims by the Division become doubtful when the weighted average of male and female literacy is computed. The male; female ratio in Pakistan is estimated to be 52:48, and if we weight the literacy levels by these, then the adult literacy rate for 1994-95 works out to be 42% and for 1995-96 to be 49.1% both of which are substantially higher than the rates claimed by the Division for the adult population. Therefore, either the overall literacy rate is incorrect or the values for males and females are fictitious or at best guesstimates.

Table 2
Adult Literacy

	1994-95			1995-96		
	Planning Division		Ministry	Planning Division		Ministry
	Target	Achieved		Target	Achieved	
Adult Literacy (%)	36.8	37.0	37.0	38.6	38.6	37.9
Male Literacy (%)	53.0	55.0	49.0	58.7	58.7	50.0
Female Literacy (%)	27.0	28.0	24.0	31.7	31.7	25.3

Source : Economic Survey 1995-96 : Table 16.1 claiming to be from Planning & Development Division
Economic Survey 1995-96 : Statistical Appendix Table on Economic and social Indicators, pp 6 and 7

Similarly the claims of achievement in the Health Sector appear to be overstated. Immunisation target is claimed to have been exceeded by 20.5% in 1995-96. The Ministry of Health lays claim to an achievement of 67% of targets. The estimated output in the training of Dais (TBAs) in 1995-96 was as targeted, says the Division. The Ministry states that the output was only 67.1% of target. It is only in the construction of Basic Health Units and Rural Health Centres in 1995-96 that claims by the Division are more moderate than the reported actuals by the Ministry.

Table 3
Primary Health Care Outputs

	1994-95			1995-96		
	Planning Division		Ministry	Planning Division		Ministry
	Target	Achieved		Target	Achieved	
Immunization (Million Children)	4.10	3.50	3.45	4.40	5.30	2.95
TBA Training (Nos.)	8175	9735	7088	11185	11185	7500
New Basic Health Units (Nos.)	94	75	69	84	84	90
New Rural Health Centres (Nos.)	23	19	10	20	20	21
Upgradation of BHUs (Nos.)	239	273	250	285	300	200
Upgradition of RHCs (Nos.)	92	98	93	100	100	90

Source: Economic Survey 1995-96 : Table 16.1 claiming to be from Planning & Development Division
Immunisation (Ministry) : Economic Survey 1995-96 Statistical Appendix Table 13.6
TBA Training (Ministry) : Economic Survey 1994-95 and 1995-96 Tables 15.5 and 14.3 respectively
BHUs and RHCs : Economic Survey 1994-95 and 1995-96 Tables 15.5 and 14.3 respectively

The implications of wrong numbers are serious. This tends to lead to a sense of complacency and if repeated often enough will imbue the reader with a false sense of achievement. The Division also lays claim to a fund utilisation rate of nearly 97%. Throughout the year we read in newspaper reports that Punjab which accounts for nearly 62% of allocations has not been implementing the SAP. These are borne out by reports of various donors' SAP Review Missions that performance is generally poor in the country as a whole and that achievements are far behind targets, with Punjab lagging far behind the others. The SAP Annual Operations Plan for each province identifies that disbursal of funds is a major impediment to achieving targets - yet the Division claims a disbursal ratio of 97%!!!