RESEARCH REPORT

ANALYSIS OF PROVINCIAL BUDGETS, 1999-2000

August, 1999

SOCIAL POLICY AND DEVELOPMENT CENTRE

FOREWORD

The Social Policy and Development Centre (SPDC) has a tradition of bringing out a Research Report every year containing analysis of the proposals for expenditure and taxation in the provincial budgets from the viewpoint of their impact on the economy and people of Pakistan. This year's report contains nine articles on various aspects of the Budgets of the four provincial governments in 999-2000, written by staff members of SPDC. We hope that government officials, private sector, members of NGOs and civil society at large will find this report useful in understanding the implications of the Budget.

Dr. Hafiz A. Pasha
Managing Director

CONTENTS

Page #s

<u>OVERALL BUDGETARY POSITION</u>

! What Explains the Shortfall in Federal Transfers to Provinces? 1
Aisha Ghaus-Pasha and Hari Ram Lohano

! Financial Policies of the Provincial Governments 5
Hafiz A. Pasha and Aisha Ghaus-Pasha

! Provincial Governments and the Budget Deficit 9
Sajjad Akhtar

! The Financial Outlook for Provincial Governments in 1999-2000 12
Hafiz A. Pasha and Aisha Ghaus-Pasha

<u>PROVINCIAL TAXATION</u>

! The Buoyancy in Provincial Tax Revenues 16
Hafiz A. Pasha and Mohammad Sabir

! Multiplicity of Taxes: A Critical but Pending Issue 20
Aisha Ghaus-Pasha, Nadeem Ahmed and Fauzia Mukarram

<u>PROVINCIAL EXPENDITURES</u>

! The Resource Crunch and Social Sector Expenditures 25
Zafar Ismail and Naveed Aamir

! Whither Education Policy? 30
Sajjad Akhtar and Abu Nasar

! Provincial Development Program and Rural Development 35
Naeem Ahmed and Imran Ashraf Toor

OVERALL BUDGETARY POSITION

WHAT EXPLAINS THE SHORTFALL IN FEDERAL TRANSFERS TO PROVINCES?

by
Aisha Ghaus-Pasha and
Hari Ram Lohano

The provincial governments claim that stagnation in intergovernmental fiscal transfers is directly responsible for the current malaise in their finances. What has been the magnitude of decline in federal transfers? Is this due to changes in the design of the 1996 NFC award? Or can it be attributed to tax reforms (e.g. reduction in import tariffs) and fall in nominal GDP growth? What compensatory mechanisms have been put in place? Have all provinces been worse off or has the outcome been different among the provinces? This article addresses these questions.

Decline in Federal Transfers

There has been a decline in federal transfers since 1996-97, the first year following the implementation of the 1996 NFC award. Total federal transfers to the provinces were lower by almost 5 per cent (by over Rs 6 billion) in 1997-98 compared to the 1996-97 level (see Table 1). Bulk of the decline was in divisible pool transfers, which declined from Rs 119 billion in 1996-97 to Rs 104 billion in 1997-98.

TABLE 1
FEDERAL TRANSFERS TO THE PROVINCES

(Rs in Billion)

	1996-97	**1997-98**	**1998-99**	**1999-2000**
DIVISIBLE POOL TRANSFERS	119.2	104.0	107.7	124.6
STRAIGHT TRANSFERS	18.6	20.5	20.0	25.3
SPECIAL GRANTS	0.7	7.4	8.2	9.1
TOTAL TRANSFERS	138.5	131.9	135.9	159.0

Sources: Federal Budgets in Brief
Provincial Annual Budget Statements

Straight transfers, already on a declining trend, increased slightly. In contrast, special mandatory grants to the provinces showed a big jump, of almost Rs 7 billion, increasing from Rs 0.7 billion to over Rs

7 billion in 1997-98. This pattern of variation in the various components of federal transfers has a substantial bearing on the revenue loss experienced by each province. Those provinces which have a major share in the divisible pool, that is the two larger provinces of Punjab and Sindh, have borne the brunt of the decline, while revenue losses of the recipients of special grants (the two smaller provinces) have been relatively marginal.

Causes of a Decline in Federal Transfers

The provinces attribute the decline in federal transfers solely to the design of the 1996 NFC award. Is this true or can the decline be attributed to other factors like the tax reforms implemented in the country resulting in revenue losses and the tapering off of the growth momentum of the economy? The provincial allegation, though holds some merit, is not entirely valid simply because the provinces have not received the revenue transfers envisaged in the 1996 NFC award. Table 2 clearly demonstrate that, in 1998-99 for example, provinces combined have received only 68 per cent of the revenue transfers projected by the 1996 NFC. This implies a shortfall in transfers of about Rs 65 billion. As such the real cause of grievance to the provinces is in fact the causative factors behind the shortfall in federal transfers within the context of the current award. What are these causative factors?

TABLE 2
ACTUALS AS % OF PROJECTED NFC MAGNITUDES, 1998-99

(%)

	Punjab	Sindh	NWFP	Balochistan	Combined
FEDERAL TRANSFERS	65.2	67.7	66.5	83.0	67.8
Divisible Pool Transfers	65.2	65.2	65.2	65.2	65.2
Straight Transfers	64.1	79.1	57.3	95.8	73.2
Special Grants	N.A	N.A	100.0	100.0	100.0
OWN REVENUES?	115.7	99.0	121.1	522.7	117.7
CURRENT EXPENDITURE	80.8	88.6	91.1	79.9	84.4
DEVELOPMENT EXPENDITURE (Rupee Component)	81.7	70.0	159.9	65.7	91.1

? inclusive of net capital receipts N.A. = not applicable

Sources:
National finance Commission; Annual Budget Statements; Federal Budget-in-Brief
SPDC estimates.

Table 2 shows that bulk of the shortfall in federal transfers has occurred due to lower divisible pool transfers. According to the provisions of the 1996 NFC award, 37½ per cent of proceeds (net of collection charges) of all federal taxes (including direct taxes, customs and excise duties and sales tax) is transferred to the provinces. The basic problem is that federal tax revenue realisation has been far below the NFC projections in 1997-98 and 1998-99.

Only 65 per cent of tax revenues projected by the NFC have materialised in 1998-99 resulting in a corresponding contraction in the divisible pool. The NFC had projected federal tax revenues of Rs 470 billion in 1998-99, whereas the actual revenue is Rs 308 billion, a shortfall of Rs 162 billion. All taxes, in particular, customs duty and sales tax fell far short of target by 58 per cent and 37 per cent respectively. The question thus arises as to why are the NFC tax projections so out of line? Was it because of faulty projection techniques or did the tax system undergo unanticipated structural changes which dramatically altered the revenue level and pattern? The answer is the latter. The newly elected Nawaz Sharif government brought in a spate of tax reforms in March 1997 soon after succession to power which were wide-ranging and structural in nature. These included massive rate cuts of taxes like income tax and sales tax and implementation of steep import tariff reforms. The consequence was a dramatic reduction in the tax-to-GDP Ratio, which fell down to 10.2 per cent as compared to the NFC projected ratio of 13.9 per cent. The NFC projection is not out of line with historical trends as the tax-to-GDP ratio in 1995-96 stood at 12.3 per cent and had been rising gradually.

The tax reforms, however, were not successful in providing the much hoped for supply-side stimulus to the economy to substantially increase its growth rate and thereby generate additional tax revenues. The actual nominal GDP was less than 90 per cent of the GDP projected by the NFC due both to a lower real growth and lower rate of inflation. Therefore, not only did we witness a decline in government revenues due to tax cuts but also due to a loss in the growth momentum of the key tax bases (especially imports and large scale manufacturing), with both factors reinforcing each other. A decomposition of the impact of the two factors indicates that 70 per cent of the decline in revenues in relation to NFC projections is due to the lower tax-to-GDP ratio while the remaining 30 per cent is due to lower GDP. As such, contrary to popular claims the real reasons for the big reduction in federal transfers to the provinces are the structural tax reforms and the lack of revival of economic growth in the country due especially to the contagion effects of the Asian financial crisis in 1997-98 and the adverse effects of the sanctions imposed on Pakistan in 1998-99 following the nuclear blasts.

The Compensatory Mechanisms

How have the provinces adjusted to the Rs 65 billion shortfall in federal transfers? Again, contrary to common perceptions, it has not been primarily by a cutback in development activities in the provinces. Interestingly, almost half of the adjustment of Rs 32 billion has been through a cutback in current expenditure as compared to the NFC projections followed by higher resort to borrowings of Rs 18 billion. Non-development grants and development receipts from the federal government have additionally contributed Rs 8 billion. Finally, provinces have mobilised higher own revenues of about Rs 5 billion and there has been only residual resort to cutback in development expenditure of Rs 2 billion.

In conclusion, there has been a significant decline in federal transfers to the provinces following the institution of the 1996 NFC award. However, it does not appear to be due to the design of the NFC award but because of large revenue losses arising from the tax reforms implemented in the country during the last two years and the lack of revival of the growth of the economy. However, the provinces have not been forced to contract their expenditures in proportion to the shortfall in revenues due to the cushion provided in the short run by higher borrowings.

FINANCIAL POLICIES OF THE PROVINCIAL GOVERNMENTS

by
Hafiz A. Pasha
and
Aisha Ghaus-Pasha

The objective of this paper is to identify what financial policies have been followed by the provinces to tackle the problem of the growing resource crunch caused by the lack of growth in federal transfers? A priori, it can be expected that faced with this situation the provinces would probably have tried to mobilise more resources from their own revenue sources and cut back on expenditure, wherever possible. But it is important to remember that a new elected government came into office in early 97 on the agenda of faster development and improvement in the quality of life of the people. Provincial governments are at the forefront in terms of delivery of basic social and economic services like education, health, water supply and sanitation, roads, irrigation, etc. and the presence of severe resource constraints had the potential of jeopardising implementation of the political agenda.

Inevitably, therefore, there have been major differences in the financial policies followed by the various provincial governments during the last two years. In Punjab, which is the heartland of support for the ruling Pakistan Muslim League and has an influential and aggressive Chief Minister, the resource constraint imposed by declining federal transfers has been broken by, first, resorting to a mixture of additional taxation, levy of AIT and improved tax administration which has led to an increase of over 41 per cent in own revenues since 1996-97 (see Table), second, by cutting back on the growth of current expenditure, which has been restricted to less than 10 per cent cumulatively in the last two years, and, third, by substantially greater resort to borrowings (federal loans plus use of overdraft facilities with SBP) which have risen from just over Rs 2 billion in 1996-97 to over Rs 14 billion in 1998-99. All this has enabled the province to implement a much larger development program which has increased by almost Rs 5 billion, from the level of below Rs 11 billion in 1996-97.

The strategy followed by the government of Punjab is strongly reminiscent of the policies followed by the first Nawaz Sharif government at the federal level during the first two years of its tenure (1990-91

TABLE 1
GROWTH IN KEY PUBLIC FINANCE INDICATORS
OF PROVINCIAL GOVERNMENTS

	CUMULATIVE GROWTH (%) 1996-97 TO 1998-99				COMBINED
	PUNJAB	SINDH	NWFP	BALOCH-ISTAN	
TOTAL REVENUES	-2.1	-0.3	18.1	21.8	3.6
Own Revenues	41.5	42.5	42.4	-42.2	40.5
Federal Transfers	-10.5	-9.6	15.6	27.4	-2.4
CURRENT EXPENDITURE	9.7	16.3	24.0	11.7	14.0
DEVELOPMENT EXPENDITURE	45.3	21.5	44.8	-3.7	32.0
TOTAL BORROWINGS	509.1	240.0	91.3	-118.6	154.8

Source: Annual Budget Statements
SPDC estimates

and 1991-92) when the budget deficit increased significantly as the development program was scaled up. The economy did respond positively in the short run when the growth rate in 1991-92 went up to almost 8 per cent but the underlying macro-economic imbalance was one of the major factors responsible for the subsequent balance of payments crisis of 1992-93 and the depletion of foreign exchange reserves.

The stimulus provided by the government of Punjab to its regional economy via the push on the development front is unlikely, however, to have the same impact for two reasons. First, provincial expenditures are small in relation to federal expenditures and the multiplier impact is likely, therefore, to be less. Second, the provincial stimulus has come at a time when at the federal level the primary emphasis is on the process of macroeconomic stabilisation as part of an on-going IMF program. Efforts are being made to reduce the budget deficit largely by containment of federal expenditures, especially on development.

What implication does the policy being followed by the government of Punjab of financing development through borrowings have on its future fiscal position? Will it lead to a runaway growth in debt servicing (of the type, observed already in the case of the federal government during the 90's) and impair its future capacity to operate, maintain and expand services? The answer is, probably not. Most of the borrowing in the last two years has been in the form of soft federal loans or foreign assistance. Incremental use of cash balances remains limited at less than Rs 2 billion annually. However, the ability of the government of Punjab to push for further augmentation of its development activities is likely to be increasingly limited. In the current budget of 1999-2000 an increase of only about 3 per cent has been targeted for in development expenditure.

Turning to the government of Sindh we have a somewhat different story to that of Punjab. The story is similar in that both governments faced with a decline in transfers have opted for higher own resource mobilisation and increased resort to borrowings. Sindh has been able to increase its revenues by over 50 per cent in two years, the best performance among the four provinces, despite lack of effective legislation on levy of AIT, and also raised its borrowings from Rs 2½ billion in 1996-97 to Rs 8½ billion in 1998-99. However, Sindh has not opted for the same big push in development expenditure and has been relatively unsuccessful in controlling its current expenditure. Consequently, there is not much divergence between the cumulative growth rates of current and development expenditures respectively since 1996-97.

Moreover, Sindh appears to be in a precarious financial position. The inability to limit the growth in current expenditure (due to the difficult law and order situation and the presence initially of a weak coalition government which had to buy political favours) has implied that the government has run into a large deficit in its current budget, projected at over Rs 4 billion in 1999-2000. Consequently, almost half of the borrowings are being used to finance current expenditure, which is unlikely to expand the future debt repayment capacity of the province. Further, a larger share of the borrowing is in the form of relatively high cost overdraft facility with the SBP. The deterioration is Sindh's financial position explains why it has been the most vociferous about the inequitous nature of the 1996 NFC award.

The government of NWFP did not suffer any decline in federal transfers. On the contrary these transfers have increased by 16 per cent during the last two years, despite the lack of growth in hydro-electricity profits. The basic reason for the jump in transfers is the introduction of a large special grant for NWFP by the 1996 NFC, with the magnitude of Rs 3.3 billion in the first year (1997-98) and rising at 11 per cent annually.

What has been the financial policy adopted by the government of NWFP in the presence of a relatively favourable resource position? Has it gone for a splurge in expenditures and slackened on its own resource mobilisation effort? On the whole, the government of NWFP has behaved prudently initially. In the first year, 1997-98, it reduced its borrowings and brought down its overdraft with the SBP by over one billion rupees while reducing its development expenditure. In 1998-99, however, it has adopted a Punjab-like strategy of aggressive resource mobilisation (with 27 per cent growth in own revenues) and raised development expenditure by almost Rs 3 billion from the level of about Rs 6 billion in 1997-98. This has required access to substantial higher borrowings which have risen from about Rs 3 billion to almost Rs 5 billion.

Balochistan has followed radically different policies from the other three provinces. It was also a major beneficiary of the 1996 NFC award, with a large special grant in the first year of Rs 4.1 billion, rising also by 11 per cent annually. During the last two years it has experienced the fastest growth in federal transfers of 27 per cent. Here again, the evidence is one of fiscal prudence. Current expenditure growth during the last two years has been limited to 12 per cent and there has actually been a minor drop in development expenditure. The province has opted to reduce its outstanding overdraft with the SBP by a much as Rs 6 billion over the last two years. This will lay the basis for greater financial sustainability in come years.

Overall, the financial behaviour of the four provincial governments during the last two years reveals interesting contradictions. The two provinces, Punjab and Sindh, which have experienced declines in federal transfers have shown a degree of profligacy and populism in their expenditures which has necessitated substantially higher levels of borrowing. As opposed to this, the two provinces, Balochistan and NWFP, which have been the recipient of growing transfers, due primarily to the institution of special grants by the 1996 NFC, have demonstrated a degree of financial restraint and cut back on their overdrafts with the SBP. The big question is whether these patterns of financial behaviour will continue in 1999-2000.

PROVINCIAL GOVERNMENTS AND THE BUDGET DEFICIT

by
Sajjad Akhtar

Inter-governmental fiscal relations is a two-way street. Not only do the different tiers of the government share revenues as per some agreed formula but are also liable for and contribute towards the overall budget deficits. Since 1997 there is a some evidence that revenue transfers from the Federal Government to the provinces have declined due to the sharing formula agreed in the NFC Award 1997. However the other side of the coin is that the Federal Government is now increasingly picking the tab on development expenditures of the four provinces, and consequently the share of the provinces in the overall budget deficit has gone up. In this article we discuss the just mentioned latter dimension of the Fiscal Federalism in Pakistan.

Under the current budgetary accounting practice overall budget deficit is composed of two parts:- In Part A development expenditure by the two government tiers plus the current expenditure of the federal government(excluding debt repayment) are deducted from the net revenue receipts (excluding transfers to the provinces) to arrive at the federal budget deficit. Part B represents the Revenue Surplus/Deficit of the provincial governments. As the name implies it is the amount left after the deduction of current expenditure from the total revenues of the provincial governments. The latter is the sum of transfers from the federal government and own fiscal effort. In other words the fiscal deficit of the provincial governments is under-stated by the extent of provincial development expenditure borne by the central government. In Table 1 we track the last 3 year evolution of the revenue surplus/deficit of the provinces under this conventional definition. Note that under this conventional definition revenue surplus/deficit of the provinces are minuscule of GDP and negligible contributors to the consolidated budget deficit. While overall budget deficit as a percentage of GDP ranged from approximately 4 to 6½ the provincial governments generated revenue surpluses or deficits ranging from -0.3 billion to surplus of 16 billion. Interestingly it appears that in 1996-97 the provincial government surplus contributed in lowering consolidated budget deficit by 2/3rds of a percentage point. It is also important to note that there was only a nominal surplus of Rs 1 billion in the current budget of the four provincial governments in 1998-

99. The federal government has stated that this amount is over Rs 3 billion, implying an overstatement of Rs 2 billion and an increase in the overall budget deficit of this magnitude.

TABLE 1
PROVINCIAL REVENUE SURPLUSES/DEFICITS AND THE CONSOLIDATED BUDGET DEFICIT

(Rs in Billion)

Year	Revenue Surplus (+)/ Deficit (-) of Provincial Governments	% of GDP	Consolidated Budget Deficit	% of GDP
1996-97	16.2	0.7	-156.6	-6.3
1997-98	-0.3	0.0	-147.4	-5.4
1998-99	1.1	0.0	-114.3	-3.4

A more transparent and equitable budgetary accounting framework would suggest that the development expenditures undertaken by the provinces should form a part of provincial financial accounting identities and the scope of their revenue surplus/deficit calculations be enlarged to the concept of provincial

TABLE 2
CONTRIBUTION OF PROVINCIAL AND FEDERAL GOVERNMENTS TO THE CONSOLIDATED BUDGET DEFICIT

Year	PROVINCIAL GOVERNMENTS				FEDERAL GOVERNMENT		Share of Provincial Governments in Consolidated Budget Deficit (%)
	Revenue Surplus (+)/ Deficit (-)	Development Expenditure	Budget Deficit	% of GDP	Budget Deficit	% of GDP	
1996-97	16.2	-26.3	-10.1	-0.4	-146.5	-6.0	6.5
1997-98	-0.3	-31.1	-31.4	-1.1	-116.0	-4.2	21.3
1998-99	1.1	-34.7	-33.6	-1.1	-80.7	-2.3	21.4

budget deficits. Implicitly it also implies that provinces be held accountable for their development expenditures and given more autonomy in their fiscal effort for meeting development expenditures. Table 2 gives the impact of provincial finances on the overall budget deficit for the last 3 years under the alternate definition. Making provincial governments liable for development expenditures pushes up their contribution to the overall budget deficit substantially. In nominal terms the combined budget deficit of all the provinces has gone up from Rs.10 billion to Rs.34 billion during 1997/99. As a share of GDP it has gone up from 0.41 in 1996-97 to 1.11 percent in 1998-99, thereby contributing almost 30 per cent to the overall budget deficit. Note also that inspite of slashing of Federal PSDP in the last years, the development expenditures of the provinces have shown a steady increase, partly because of 'priority' expenditures in education and health as defined by SAPII. Given the increasing contribution of the provincial governments to the consolidated budget, greater emphasis must now be placed on ensuring that there is better monitoring of trends in provincial revenues, expenditures and borrowings.

An interesting issue that arises with respect to the health of provincial finances and under a 'circular' flow of inter-governmental transfers is that were the provinces better off during the last 'generous' NFC award when revenue surpluses were being generated and ploughed back in development expenditures (as in 1996-97) or under the present award when the surpluses have dwindled and the federal government is picking the tab? In the short run and from last 3 years evidence it is apparent that major brunt of deficit reduction has been borne by the federal development expenditures. In the long-run the above trends are dis-quieting. If the Federal recurring expenditures do not stabilize, the imposed overall budget deficit targets may cut into the provincial development expenditures thus hurting social sectors. Secondly it erodes the provincial autonomy in decision-making, planning and executing the development projects as most will increasingly be financed by borrowings from the federal government or the SBP. Thus lack of 'provincial ownership' could further reduce the 'bang for development bucks'.

THE FINANCIAL OUTLOOK FOR PROVINCIAL GOVERNMENTS IN 1999-2000

by
Hafiz A. Pasha
and
Aisha Ghaus-Pasha

The current fiscal year promises to be an eventful year for provincial governments when their financial position could change dramatically. On the one hand there are prospects for some positive developments like the restoration of buoyancy in fiscal transfers due to faster growth in federal tax revenues and a major windfall from the broad-basing of GST to POL products, electricity and gas. On the other hand the budgetary position could worsen significantly if the salary award announced by the federal government also has to be implemented at the provincial level, if payables to WAPDA have to be increasingly settled and ways and means have to be found for sustaining the operations of local councils following the abolition of octroi and zila tax in the absence of a full compensatory grant by the federal government.

We first analyse the budgetary projections made by the provincial governments for 1999-2000 and then superimpose upon these the impact of the above-mentioned events. A glance at Table 1 reveals that

TABLE 1
BUDGET ESTIMATES FOR THE FOUR PROVINCIAL GOVERNMENTS COMBINED

(Rs in Billion)

	1998-99 (Revised Estimates)	1999-2000 (Budget Estimates)
TOTAL REVENUES	173.3	194.7
Own Revenues	33.1	36.6
Federal Transfers ?	140.2	158.1
CURRENT EXPENDITURE	172.1	193.8
REVENUE SURPLUS (+) / DEFICIT (-)	1.2	0.9
Net Capital Receipts	-0.1	-3.5
Development Receipts	3.8	2.4
Federal Loans	30.2	27.4
DEVELOPMENT EXPENDITURE	34.7	33.4
USE OF CASH BALANCES	-0.4	6.2

? inclusive of discretionary grants

Sources: Annual Budget Statements
SPDC Estimates

after two years of decline in federal transfers, since the promulgation of the latest NFC award, there is the expectation of a significant increase in these transfers of almost Rs 18 billion, from the last year's level of Rs 140 billion. This increase is based on the assumption that federal tax revenues, which form part of the divisible pool, will increase by Rs 48 billion to reach the figure of Rs 356 billion in 1999-2000. With own revenues at about Rs 37 billion, the total availability of resources in the current budget for the four provinces combined is expected to increase by about Rs 21 billion, to Rs 195 billion.

The increase in current expenditure was restricted to Rs 8 billion last year. In 1999-2000 the provinces have projected a much larger increase in current expenditure of over Rs 21 billion, presumably in part to take care of pending WAPDA liabilities. Consequently, the entire increase in resources will be consumed by higher current expenditure leaving the overall revenue surplus position unchanged. In fact, the current budget of the four provinces is expected to show little or no surplus in 1999-2000 as in the previous year. This implies that development expenditure will largely have to be financed through borrowing.

As opposed to the rapid growth in current expenditure, the provinces have actually projected a fall in development expenditure for 1999-2000. The total development outlay proposed is about Rs 33 billion while the availability of funds for development, consisting mostly of federal loans, is estimated at Rs 27 billion. The residual gap of Rs 6 billion will be covered through use of cash balances (increased overdraft) with the State Bank of Pakistan. A deterioration in the financial position is indicated by the fact that in 1998-99 there was no residual gap and the overdraft level of the four provinces with SBP remained, more or less, unchanged.

Given the high level of dependence of the provinces on federal transfers it is clear that the budgetary projections hinge on the realisation of the expected magnitude of these transfers. The last two year's experience has been one of large shortfalls. In 1997-98 federal transfers fell short by over Rs 6 billion while in 1998-99 they were Rs 13 billion less than anticipated. These shortfalls were the consequence of the inability of the federal government to meet its tax revenue targets. This year CBR is expected to increase its revenues by as much as 16 per cent in the face of a continuing recession in the economy and the full-year impact of the large cut in import tariffs announced in March 99. The general perception is that the federal tax revenue target has been significantly over-pitched. Underachievement of the target by about Rs 20 billion would imply lower transfers to the provinces of Rs 7½ billion. This will cut significantly into the financing available for development by the provinces.

Fortunately, there is an upside to the risks in 1999-2000 which arises from the perhaps unintended favourable consequences on the provincial governments of the tax reforms involving broad-basing of the GST. Following a recent cabinet decision and in line with the conditionalities embodied in the ESAF/EFF program with the IMF the tax base of GST has been extended substantially to include POL products, gas and electricity. It is proposed to make the reform broadly revenue-neutral in character by substituting the surcharges for the GST in the case of POL products and electricity. It is important to note that the surcharges did not form part of the divisible pool of taxes while the GST does. Therefore, this reform will lead to an expansion in the divisible pool from which the provinces will get their mandatory share of 37½ per cent as per the 1996 NFC award.

At this stage it is not possible to quantify the increase in transfers, because the full details of the reforms have not yet been announced. However, there is no doubt that this will lead to a significant increase in transfers of upto Rs 9 billion. These could compensate for any under-performance by CBR in 1999-2000. Therefore, in view of these reforms, it seems likely that federal transfers to the four provinces will approach the projected level of Rs 158 billion.

Beyond this positive impact, there are a number of possibilities which could have negative consequences on the budgetary projections for 1999-2000. The first is the implementation by the provincial governments of the salary award announced by the federal government in the budget for its employees, involving the granting of a special allowance of 20 per cent to 25 per cent in the initial basic pay. Historically, federal announcements on salary increases have been followed, more or less, automatically by provincial governments, especially since the latter have a significant proportion of senior employees on deputation from the federal government. The government of NWFP has already announced that it will give the same increase to its employees and the other three governments are also likely to do so. What is the cost of the salary increase to the four provincial governments? Conservative estimates made by the Social Policy and Development Centre suggest that this would be of the order of Rs 12 to Rs 13 billion. This would represent an increase of 7 per cent over the projected level of current expenditure in 1999-2000, and cut severely into funds available for development.

Another negative factor is the incomplete compensation by the federal government for the abolition of octroi and zila tax, two major sources of revenue of local governments. The revenue foregone is about Rs 19 billion while the federal government proposes to make a grant of Rs 13 billion. The remaining liability of Rs 6 billion is assumed to be the liability of the provincial governments.

The financial outlook for individual provinces differs widely in 1999-2000. As per the budget estimates, the province of Sindh is in the most precarious financial position. It is expected to have a large revenue deficit of over Rs 4 billion in 1999-2000 while the other three provinces will carry revenue surpluses ranging from approximately Rs 1 billion in the case of NWFP, Rs 1.6 billion in Balochistan to Rs 2.2 billion in Punjab. It is not surprising, therefore, that the need for higher overdrafts (by Rs 2.5 billion) is also highest in the case of Sindh in relation to its total expenditure.

The individual projections change dramatically if allowance is made for implementation of the salary award and for grants from provincial resources to local councils. Except Balochistan, which continues to enjoy a small revenue surplus, the other three provinces are likely to incur large revenue deficits in 1999-2000. The magnitude of the deficit ranges from Rs 1.7 billion in NWFP, Rs 7.7 billion in Punjab to almost Rs 10 billion in Sindh. The need for overdrafts from the SBP rises sharply for all four provinces if the projected level of development expenditure is to be maintained. Use of cash balances in this scenario is the highest for Punjab at close to Rs 10 billion followed by Rs 8 billion for Sindh Rs 4 billion for NWFP and Rs 3 billion for Balochistan.

Will the SBP be willing to increase substantially its overdraft facilities to the provincial governments and thereby jeopardise the implementation of its monetary policy? Probably not. The provinces will, therefore, be compelled to find other solutions including deferment of the salary award or cut back in grants to local councils and face up to the adverse political implications of such decisions. Alternatively, the federal government may once again, like the last two years, bail out the provinces by giving enough soft development loans to close the financing gap.. This depends upon how much fiscal space it has, given the tough budget deficit target of 3.3 per cent of the GDP for 1999-2000 and the continuing strict vigilance by the IMF.

PROVINCIAL

TAXATION

THE BUOYANCY IN PROVINCIAL TAX REVENUES

by
Hafiz A. Pasha
and
Mohmmad Sabir

Amidst all the despair and gloom about the stagnation in federal tax revenues, there is some good news from the provincial governments. During the last two years, tax revenues of the four provincial governments combined have increased cumulatively by as much as 38 per cent as compared to only 10 per cent in CBR revenues. Although the provinces collect only about 6 per cent of the national tax revenues, this performance comes in sharp contrast to the earlier experience. Traditionally provincial tax revenues have been relatively slow growing. For example, the provincial tax-to-GDP ratio had fallen from 1.2 per cent in 1972-73 to less than 0.6 per cent in 1996-97.

The resurgence in the provincial fiscal effort can fundamentally be attributed to the lack of growth in federal transfers after the 1996 NFC award. Total transfers have still not yet recovered to the pre-award level in 1996-97. Faced with a growing resource crunch the provinces have had no other option but to mobilise more from their own revenue sources. This has begun to question the view that the provinces are endowed with only limited fiscal powers which cannot be exploited to yield higher revenues.

Analysis of the performance of each provincial government reveals an interesting inverse correlation between the growth in federal transfers and the growth in own tax revenues. Punjab and Sindh experienced significant declines in federal transfers during the last two years, of about 11 per cent and 10 per cent respectively. They have raised their combined tax revenues by 39 per cent during the period. As opposed to this, the two smaller provinces of NWFP and Balochistan witnessed 16 per cent and 27 per cent growth in transfers respectively, due primarily to the institution of large special grants by the 1996 NFC. It is not surprising, therefore, that their combined resource mobilisation has slackened somewhat and they have been able to show less increase in tax revenues of 30 per cent.

The basic question is whether the unprecedented rate of increase in provincial tax revenues is due to broadening of the tax base or due to enhancements in tax rates and withdrawal of exemptions or is it the result of an overall improvement in the quality of provincial tax administration. The advent of the agricultural income tax is, no doubt, a major milestone in the development of provincial tax system, with the potential of substantially augmenting revenues. Punjab and NWFP have made some effort in recent years to exploit this source. The tax has been legislated by the respective provincial assemblies and collection has been underway for sometime, although the coverage and effective tax rates still remain low. Sindh and Balochistan have yet to give the tax a proper legal cover and limited collections are on ad-hoc basis. For the four provinces combined, if revised estimates are accepted as close to actuals, revenues from AIT have increased from Rs 1.5 billion in 1996-97 to Rs 2.3 billion in 1998-99 (see Table 1). This accounts for 15 per cent of the overall increase in tax revenues. Therefore, although the agricultural income tax has made some contribution to the enhanced buoyancy of provincial tax revenues, explanations for the exceptional performance during the last two years lie elsewhere.

TABLE 1
GROWTH IN TAX REVENUES
OF PROVINCIAL GOVERNMENTS

(Rs in Million)

	1996-97	**1997-98**	**1998-99**	**Cumulative Growth (%)**
EXISTING TAXES	12787	14735	17419	36.2
Stamp Duties	4497	5288	6035	34.2
Motor Vehicle Tax	1934	2186	2772	43.3
Land Revenue	1576	1757	2208	40.0
Electricity Duty	1241	1300	1330	7.2
Provincial Excise	877	1128	1239	41.3
Others	2662	3076	3835	44.1
AGRICULTURAL INCOME TAX	1485	1970	2335	57.2
TOTAL TAX REVENUES	14272	16705	19754	38.4

Source: SPDC Estimates
Annual Budget Statements

How have the traditional sources of revenue like stamp duty and motor vehicle tax performed? Revenues from stamp duties have shown a fairly rapid increase of 34 per cent during the last two years. Some of the increase is attributable to increases in rates, especially on financial documents, and to some base-broadening like levy of stamp duty on airline tickets in Punjab. But the property market has been in a state of recession during the last two years and the quantum of increase in stamp duty revenues is unexpectedly high. Much of it is probably due to improved tax administration leading to better coverage of transactions and updating of valuation lists to more adequately capture property values.

Revenues from the motor vehicle tax have also been buoyant during the last two years, with a cumulative increase of over 43 per cent. In particular, revenues have shown exceptional growth of 65 per cent in the province of Punjab due partly to the introduction of a large lump sum tax on luxury vehicles. Rates have also been revised upwards and the provincial excise and taxation department has had more success in registration of smuggled vehicles. Other taxes which have performed well include land revenue and provincial excise duties. It is reassuring to note that the former has yielded more at a time when the focus of the provincial governments has been on development of the agricultural income tax.

However, the special fiscal effort made by the provinces in 1997-98 and 1998-99 does not appear to have been sustained in 1999-2000. In the latest budgets, provincial governments of Punjab, Sindh and Balochistan have announced no new taxes. This represents a reversion to old practices and does not auger well for future growth of revenue. NWFP is the solitary exception where some minor increases have been proposed in the urban immoveable property tax and motor vehicle tax.

This softening in provincial resource mobilisation in 1999-2000 is probably attributable to improved prospects for federal transfers, which are expected to grow by 13 per cent during the current fiscal year. But one lesson the provinces must have learnt over the last two years is not to rely on over-optimistic projections of federal tax revenues (and of divisible pool transfers thereof). If the degree of uncertainty in budgeting of expenditures, especially on the development side, is to be reduced then the provincial governments will have to increasingly rely on their own revenue sources.

The last two years have also demonstrated that if there is the political and bureaucratic will then provincial revenues can be increased rapidly. Major potential areas still exist which can yield substantial additional revenues. The first is the agricultural income tax which currently yields about Rs 2 billion. Conservative estimates are that if the tax is effectively levied and collected then it can yield upto ½ per cent of the GDP, equivalent to about Rs 16 billion, eight times the present level. Similarly, the urban immovable property tax generates revenue of less than Rs ½ billion. Here again, the estimate is that if the assessed rental values could be brought closer to the market values, then revenues could rise over ten times to almost Rs 5 billion at the present tax rates. The issue is not one of the revenue potential of provincial taxes but one of the political will of the provincial governments to tax the rural and urban elites in order to provide better services to bulk of the population.

MULTIPLICITY OF TAXES: A CRITICAL BUT PENDING ISSUE

by
Aisha Ghaus-Pasha
Nadeem Ahmed and Fauzia Mukarram

Federal government has constituted a committee for reduction in the multiplicity of taxes. Earlier last year, the NFC Award Monitoring Committee constituted a sub-committee to look into the same issue, under Dr. Hafiz A. Pasha, the then Deputy Chairman of the Planning commission, of which one of the authors was a member. One of the key recommendations relating to the abolition of octroi and zila tax has been implemented, although some of the other proposals relating to 'piggy backing' on a federal revenue source (the GST), increasing the fiscal powers of local councils (transfer of property and other taxes) and setting up of Provincial Financial Commissions have not been included in the reforms package. The abolition of octroi and zila tax is a major step forward in reducing multiplicity of taxes, but a lot more needs to be done. This papers identifies the major reforms in this area.

At present there are over 30 different levies on business establishments and other tax payers by different levels of government and parastatal agencies. This has led to high nominal incidence of taxes, affected cost of production and increased costs of compliance for tax payers. It has encouraged evasion and corruption and thereby eroded tax revenues. Also, multiplicity of taxes has become a source of inconvenience and harassment and has discouraged economic activity.

Multiplicity of taxation is a consequence of either double taxation by the same tier of government or taxation by multiple tiers of government. Taxation of property transactions is a good illustration of both. Until recently, there were four levies on property transactions. One by the federal government (capital value tax, abolished last year), two by the provincial government (stamp duty and registration fee) and one by the local government (tax on transfer of property). The cumulative nominal incidence of all these, in some instances, added up to 20 per cent. Table 1 below, gives examples of tax bases which currently are subjected to multiple taxation. It appears that in an effort to mobilize higher revenue to reduce fiscal deficits, different levels of government have moved into territories which do not clearly fall within their fiscal domain. The federal government has moved into the area of taxation of physical assets and services, which essentially fall in the fiscal jurisdiction of provincial governments. The provincial governments have extended their tax system to tax bases like imports which have traditionally been the exclusive area for federal taxation.

TABLE 1
EXAMPLES OF MULTIPLE TAXATION OF TAX BASES

Tax Base	Tax	Level of Government
Tax on Property	Advance Wealth Tax	Federal
	Property Tax	Provincial
Tax on Property Transactions	Capital Value Tax (withdrawn)	Federal
	Stamp Duty	Provincial
	Registration Fee	Provincial
	Tax on Transfer of Property	Local
Tax on Purchase of Motor Vehicle	Capital Value Tax (withdrawn)	Federal
	Advance Income Tax	Federal
	Registration Fee	Provincial
	Token Tax	Provincial
Tax on Transfer of Motor Vehicle	Capital Value Tax (withdrawn)	Federal
	Transfer Fee	Provincial
Tax on Hotels	Excise Duty	Federal
	Bed Tax	Provincial
Tax on Company Shares	Capital Value Tax (withdrawn)	Federal
	Stamp Duty	Provincial
Tax on Labour	Professional, trade and Calling Tax	Provincial
	Social Security Contribution	Provincial
	EOBI Contribution	Provincial
	Education Cess	Provincial
	Worker Welfare Fund	Federal
	Worker Participation Tax	Provincial

Source: SPDC

There is need for simplification of the tax structure such that not only the high tax rate is reduced, but also the tax payer does not have to deal with multiple agencies/departments and maintain multiple complex records. As such, the criteria for rationalisation should be as follows:

1. Where more than one level of government levies a tax on a particular tax base:
   (a) Examine the legal validity of imposition of a tax on the base by each level of government.

(b) If the combined tax incidence has become too high, retain the tax and/or reduce the rate of the particular level of government which has the 'natural' (in legal and economic terms) right to collect the tax and is better equipped to do so, and withdraw/abolish the tax of the other level of government.

(c) If the combined tax incidence is reasonable, merge the taxes into one tax and let one government collect the tax, following which revenues can be shared.

2. Where a particular level of government imposes a number of levies on a particular tax base, then these taxes should be consolidated into one levy and responsibility of collection assigned to one agency (either of that level of government of another level of government), following which respective revenue shares may be reverted to different departments.

3. Wherever possible, efforts should be made to introduce a self-assessment regime to facilitate the tax payer and these returns (which should be in simplified form) may be audited randomly by the nominated collection agency.

4. 5 per cent of revenue as collection charges may be given to the level of government which collect a particular tax on behalf of another level of government.

Based on the above criteria, the tax system can potentially be rationalised as follows:

Property Transactions

As mentioned earlier, multiple taxation of property transactions has led to the overall high incidence of the tax. This has impeded the development of the property market and led to under declaration of values and corruption. There is need to drastically reduce the overall tax incidence and broaden the tax base to prevent any significant losses in revenue, as the stamp duty is the principal provincial source of revenue. This involves:

(i) overall halving of provincial and local taxes. This has been done as a special case for the Prime Ministers Housing Scheme. Federal CVT has already been withdrawn.

(ii) the tax base should be enhanced simultaneously by updating the valuation tables in the major cities, adoption of a presumptive basis for valuation for super-structures and more effective coverage of property transactions in the outer limits of metropolitan areas.

Hotels

There are a large number of taxes currently levied on hotels, with the overall incidence approaching 25 percent. It is suggested that:

(i) Since the tax base falls within the domain of services, the federal government withdraws federal excise duty from this area.

(ii) All provincial and other levies should be consolidated into one tax, with a rate which does not exceed 15 percent.

(iii) One agency/department should be responsible for the collection of this, with revenue sharing with other departments.

Services

The federal government levies excise duty on a number of services like hair dressers, accountants, architects, stevedores etc., while the provinces levy a professional, callings and trade tax. It is suggested that the federal tax be withdrawn and the provinces suitably enhance their taxation of such services.

Labour Related Taxes

A large number of minor taxes and charges are being collected by different agencies like social security institution, labor department, industries department etc from business establishments. This has led to a lot of harassment, especially of small and medium-scale units. Most taxes are linked to number of employees, wage bill etc.

It is suggested that:

(i) The number of levies be merged into one tax and the basis of determination of the tax liability be simplified. A simple tax return be developed so that payment can be made by units on a self-assessment basis. The provincial Labour Department can then conduct an audit of a pre-specified percentage of establishments on a random basis.

(ii) revenue share of each agency be specified and revenue receipts be distributed accordingly.

The implementation of the above proposals will substantially simplify the taxation structure and increase tax compliance without leading to dramatic falls in revenues. The federal revenue losses can be compensated by a more efficient exploitation of traditional tax bases.

PROVINCIAL EXPENDITURE

THE RESOURCE CRUNCH AND SOCIAL SECTOR EXPENDITURES

by
Zafar H. Ismail and Naveed Aamir

Social development in Pakistan has been lagging far behind other developing countries. The United Nations Development Programme continues to rank Pakistan among the least well endowed countries in this respect. The Human Development Index for 1999 ranks Pakistan as 138th among 174 countries, down six places in the last six years. This clearly indicates that Pakistan's position in the world has been declining steadily each year. Social scientists and civil society at large have for a number of years been advocating an increase in the allocations to the social sectors to redress this slide. The provincial governments who have traditionally accounted for over 90 percent of expenditures on the social sectors have argued that they cannot do so, because they are faced with severe constraints of resources, particularly after the recent (1996) National Finance Commission Award. Antagonists of the provincial governments would argue that the resource crunch is the direct result of apathy and mal-administration, on the one part, and populism (as expressed by massive over-employment), on the other part. Proponents of these governments, however, argue that this is the result of the step-motherly treatment meted out by the Federal Government. The likelihood is that the apathy towards the development of the social sectors is a result of both sets of factors and is also a reflection of the development priorities of government.

Total expenditures by the four provincial governments combined have increased from a revised estimate of Rs. 177 billion in the first year after the NFC Award (1996-97) to Rs 227 billion budgeted for the current year. This shows that the annual increase is 8.6 percent only. Discounting for inflation during this period, the real growth is only at 1.6 percent annually. Of immense interest to civil society is what has been happening to the social sectors during this period, when provincial governments have been vociferously lamenting a drop in the resources available from the divisible pool of taxes. The share of total social sector expenditures, see Table 1, has decreased from their base level in 1996-97 (38.6%) each year to 37.6% in 1997-98 and 36.6% in 1998-99. Thus, as resources shrink, the social sector expenditures have been clawed back at a disproportionately higher rate than expenditures on the other sectors. The experience of budget utilisation in the social sectors by the provincial governments during this period indicates that they are unable to spend the budgetary allocations. This is due to a variety of reasons, the most oft cited being the non-release of allocations due to shortage of funds. For instance in 1996-97, when the resource crunch was only just beginning to be felt, these were 98.2 percent of the budgeted amount. These fell to just over 92 percent the next year. In 1998-99 the crunch was really severe and the claw-back in expenditures was even more acute, down to only 86.6 percent. Some officials in the line departments argue that even this is on the high side and the cut-back was much more than has been indicated. It is expected that the shortfall in revenue transfers to the provinces during 1999-2000 may be even more severe as the Federal Government's estimate of revenues are overly optimistic. If 1998-99 is any indicator, when the budgetary allocation for the social sectors was 39.1 percent instead of the 36.6 percent revised estimate, then one can expect a similar repetition this year, that is no improvement - perhaps even a retrogression.

TABLE 1
EXPENDITURE ON SOCIAL SECTORS BY THE PROVINCIAL GOVERNMENTS

(Rs in Billion)

	1996-97 (RE)	**1997-98 (RE)**	**1998-99 (RE)**	**1999-2000 (BE)**
Total Expenditure	**177.3**	**195.3**	**206.8**	**227.2**
Total Social Sectors	68	73.4	75.6	87.6
(as % of total expenditure)	*38.4*	*37.6*	*36.6*	*38.6*
Social Action Programme (SAP)	37.7	44.2	44.8	53.6
(as % of total social sectors)	*55.3*	*60.2*	*59.3*	*61.1*

Source: Annual Budget Statement of Provincial Governments and SPDC Data Bank

Another major phenomenon of the vagaries in social sector expenditures is its changing composition. Recurring expenditures, the cost of running the departments and providing social services, have always accounted for more than 80 per cent of the expenditures. Over the last four years, however, their share has increased to over 85 percent. In the event of resource crunch, the development expenditures suffer claw-backs more severely than these recurring expenditures on the plea that salaries must be paid and that at the very least a bare modicum of service must be provided. Never is a claw-back on the over employment even considered as this is an avenue through which political patronage is exercised.

What is planned for 1999-2000? Total allocations have been increased and the share of expenditure on the social sectors in total expenditure has once again been restored to its base level. The increase in this year's allocation for social sector expenditures to a share marginally beyond the base in 1996-97 is perhaps indicative of the pressures on government under the Social Action Programme (SAP). One of the several conditionalities governing release of donor contributions is that governments allocate more funds for improving the quality of the service delivered, and therefore, the need to provide for the purchase of books, medicines, teaching supplies and medical/surgical supplies.

Expenditures on SAP have, however, had a chequered history. The share of SAP within the overall social sectors increased from 55.3 percent in 1996-97 to 60.2 percent in 1997-98. However, there was a cut-back to 59.3 percent in 1998-99. The expenditure of Rs. 44.8 billion on SAP during 1998-99 was substantially below the commitment made to the IMF for its agreeing to the ESAF/EFF programme for Pakistan. This shortfall on the part of the provinces is estimated to be about Rs. 6 billion. Expenditure on SAP by the provinces as a proportion of the GDP reached a peak in 1997-98 of 1.61 per cent and has fallen to 1.48 per cent in 1998-99. The SAP share has now been increased to 61.1 percent in 1999-2000. This sudden upsurge in allocations may be reflective of two factors, one the pressure to increase expenditure on non-salary items (quality enhancing inputs) to meet the conditionalities imposed by donors for reimbursement and the increase in employment resulting from the commissioning of built infrastructure.

There is a fear that two recent diktats of the Federal Government will impose substantial strains on the meagre resources of the provincial governments. It is estimated that the recently announced salary increases will require provincial governments to allocate an additional Rs. 13 billion if they also implement this award. As if this were not enough, the Federal Government has abolished Octroi and Export Tax as a resource available to local governments and has instructed the provincial governments to meet a third of the expected shortfall of Rs. 19 billion. That is, provincial governments are now required to give local governments grants aggregating to over Rs 6 billion to make up this shortfall in their revenues.

Neither of these unforeseen expenditures were planned. Adding up, this means that the provinces are expected to incur additional expenditure of over Rs. 19 billion. There appear to be no plans to meet this enormous hole in the budget. History indicates that the claw-back to meeting resource shortfalls have always fallen on social sector expenditures. If this path is adopted, then there is a real fear that the social sector development budget of Rs 11 billion could be sacrificed, more or less, in its entirety, notwithstanding any commitments to the donors and that further cuts will be made in education and health non-salary heads. The beginnings of this crisis are already being seen. Hospitals have been asked to cut back on medication and supplies and education departments have indicated that they are unable to order supplies and needed inputs because of non-release of allocations.

Within the social sectors what are the priorities? An analysis of Table 2 indicates the relative priority allocated to each of the sub-sectors. Education accounts for the bulk, about 70 percent of total social sector expenditures. Education sector expenditures have increased from 1996-97 annually by about

TABLE 2
COMPOSITION OF SOCIAL SECTOR EXPENDITURE BY PROVINCIAL GOVERNMENTS

(%)

	1996-97 (RE)	1997-98 (RE)	1998-99 (RE)	1999-2000 (BE)
Education	69.9	68.8	70.1	70.8
Health	18.9	19.3	19	18.9
Water Supply and Sanitation	8.2	8.8	8.1	7.5
Others	3	4.1	2.8	2.8
Total	**100**	**100**	**100**	**100**

9.3 percent, that is in real terms they have increased by over 2.3 percent per year. Expenditure on health have accounted for about 19 percent each year. Expenditures have been rising annually by 8.7 percent, substantially lower than that for education. Public Health Services (water supply, sewerage and drainage) have been the third most important segment of the social sectors. These have been traditionally allocated between 8 and 9 percent of social sector expenditures. This year, there appears to have been a cut-back to only 7.5 percent, largely reflecting the Uniform Policy adopted by provincial governments for the sector. The Policy advocates that no new water supply scheme will be initiated unless communities agree to share up-front at least part of the capital costs and the full operating and maintenance costs of these schemes. Moreover, there is a growing realisation that the Public Health Engineering Departments are over-designing schemes. The Population Planning Programme is a federal programme and the provinces play only a minor role. The other segments are minuscular in size and content.

Overall, the last two years have witnessed no real growth in social sector expenditures by the provinces. The outlook for 1999-2000 does not look too promising in view of unforeseen liabilities which could cut significantly into development allocations in particular. Despite the rhetoric, there is no evidence of a growing commitment to human development. Pakistan is faced with the prospect of entering the next millenium as one of the most impoverished and illiterate nations of the world.

WHITHER EDUCATION POLICY?

by
Sajjad Akhtar
and
Abu Nasar

The announcement of provincial budgets every year provides the analyst the opportunity to assess the trends in social sector i.e., basic education, primary health care etc, spending, as outlays on these heads mostly fall in the domain of provincial governments. However in spite of their classification as 'priority' or 'core' expenditures, actual allocations are determined largely by inter-governmental fiscal transfers which in turn depend on overall revenue performance and fiscal policy at the macro level. Budget deficit targets, reduction in the size of PSDP and lower revenue transfers due to recession and trade liberalization in the last two years have effectively constrained the capacity of provincial governments to fulfill budgetary targets for outlays in nearly all the sectors of economic activity. Fiscal policy outlined in the Federal Budget 1999-2000 will effectively further squeeze the ability of the provincial governments to independently generate more resources for the social sector expenditures. Under this proviso one may also question whether it makes sense to evaluate the fulfilment of financial expenditure targets set in the National Education Policy (NEP) for 1998-2010. A priori these were based on highly optimistic assumptions about resource availability and 6 percent growth scenario of the economy for the period till 2010. Consequently the shortfall in expenditures is a foregone conclusion. However a rudimentary and modest analysis of inter-provincial and inter-level trends in outlays is still illuminating for the following reasons:- a) It will quantify the extent of deviations from the expenditure targets set in the NEP document, b) It will act as a signaling device to rectify the lapses in the expenditure priorities in future budgetary exercises.

A comparison of revised (for year 1998-99) and budgetary (1999-2000) outlays with those laid out in the NEP document is challenging and approximate in few respects. First, the formats of education budgets in the provincial documents are in much greater detail than the aggregate classification given in the NEP document. Probably the compilation and publication of aggregate tables consistent with any policy or planning documents (and specifically NEP document in the present case) is not purposely undertaken as it would facilitate the researchers in tracking the year to year implementation of the NEP budgetary targets and question the government claims of priority to social development. In absence of any comparable tables in the budgetary documents a fair amount of time has been spent in extracting, classifying and aggregating the line items in provincial 'Demand for Grants' documents to ensure comparability and consistency with the heads of NEP documents. Second, there is also considerable inter-provincial variation in the structure of budget formats, underlying the need for uniformity and standardization for comparison purposes. Consequently we have focused on three levels i.e., elementary, secondary and Professional/technical/University/college/institutes whose expenditures are relatively better delineated in the budget documents. However some margin of error may still exist. Let us note that margin of error in computing level-wise development expenditures may be less than in computing recurring expenditures as the former expenditures are more clearly delineated in the budgetary documents than the latter. Third, the NEP published document does not give year-wise break-up of recurring and development expenditures by province and level. Only aggregate outlays by province and by education levels are given for years 1998-2003. Consequently for yearly comparison we have taken simple five year average of the aggregate outlays. Only study of detailed documents can reveal whether the timings of these outlays are back or front loaded.

Revised estimates at a macro level indicate that in 1998-99 total expenditures on education were 1.97 percent of GDP. The budgeted figures for 1999-2000 are 2.04 percent of GDP under an 11 percent growth (5 percent real and 6 percent inflation) assumed in nominal GDP. The target in NEP for these two years were 2.5 and 2.8 percent respectively. In other words the expenditure on education are

TABLE 1
REVISED AND PROPOSED EXPENDITURE OUTLAYS
AS PERCENTAGE OF TARGET IN EDUCATION POLICY
[Development Budget]

(%)

	PUNJAB		SINDH		NWFP		BALOCHISTA N	
	FY 99	FY 2000	FY 99	FY 2000	FY 99	FY 2000	FY 99	FY 2000
Elementary Education	36.6	22.0	20.1	14.3	54.8	42.0	27.2	119.5
Secondary Education	2.7	7.1	7.6	8.1	12.5	9.3	14.0	8.9
Professiona/Technical/ Universities/Colleges/ Institutes	31.1	32.8	46.2	54.9	15.1	11.5	8.8	9.2

almost static with serious implications for realization of output targets down the road. With the above qualifications we summarize the results of our consistency exercise in Table 1.

As regards the total development expenditures on education in the year 1998-99, the performance of all provinces is dismal. Actual expenditures as percentage of expenditures planned in the NEP document have ranged from 18.4 percent for Sindh to 36.7 percent for NWFP. Combining the expenditures by the federal government the corresponding ratio comes to 26 percent in 1998-99 and 29.3 percent for 1999-2000. The province wise allocations for year 1999-2000 looks equally bleak as the allocations except Balochistan range from 17.9 percent to 27.1 percent of the NEP allocations. Expectations of unusually high inflow of foreign funds in the elementary sector pushes up the Balochistan share to 75 percent of the NEP document. One can speculate that most of the development expenditures in elementary education may have been channelized in increasing access to the 'middle' component of elementary education under the focus of SAP II rather than providing access to primary education in very poor or relatively inaccessible areas. Apparently the secondary component of development expenditures is not expected to be realized at all in the first two years as outlays hardly exceed the 10 percent of NEP planned outlays. Only in NWFP and Balochistan the ratios were 12.5 and 14 percent of numbers targeted for 1998-99. From the allocation behavior one can also infer that there is some emphasis on improving quality of education at pre-graduate level compared to pre-matric levels. It is surprising that Punjab and Sindh have performed consistently poorer than Balochistan in secondary education expenditures in the first two years of the education policy. As a percentage of planned outlays in "Professional' category the actual expenditure in 1998-99 range from 46.2 percent for Sindh to 8.8 percent for Balochistan. Given sparse population and very poor female enrolment ratios, Balochistan's low ratio in relation to targeted amounts is understandable. However in planning exercises it raises another set of questions. Why were the set targets not more realistic given the low absorption capacity of funds for "Professional" category in Balochistan and NWFP?

Table 2 gives the performance of recurring expenditures in relation to first two year expenditure profile given in the NEP document. The deviations in this expenditure is far less. For the provinces the total

TABLE 2
REVISED AND PROPOSED EXPENDITURE OUTLAYS
AS PERCENTAGE OF TARGET IN EDUCATION POLICY
(Recurring Budget)

	PUNJAB		SINDH		NWFP		BALOCHISTAN	
	FY 99	**FY 2000**	**FY 99**	**FY 2000**	**FY 99**	**FY 2000**	**FY 99**	**FY 2000**
Elementary Education	79.0	97.7	62.6	74.6	78.8	90.7	36.8	47.9
Secondary Education	41.4	47.7	48.5	59.2	72.9	67.1	37.7	54.4
Professional/Technical/Universities Colleges/institutes	67.5	74.1	75.9	93.4	93.2	94.6	53.8	76.4
Libraries and Text Books	15.4	17.4	38.7	52.2	29.2	30.4	7.2	11.2
TOTAL	**64.7**	**77.4**	**59.2**	**72.6**	**83.5**	**88.3**	**41.2**	**50.9**

recurring expenditures on education in 98-99 as a percentage of NEP targets range from 41.2 percent in Balochistan to 83.5 percent for NWFP. In 1998-99 Punjab and NWFP achieved nearly 80 percent of the targets set in the NEP document. Sindh at 63 percent followed closely with Balochistan lagging behind at 37 percent. Incorporating the federal expenditures in provincial totals, the corresponding percentages are 60 and 69 percent for the two years respectively. Unlike development expenditures the outlays for each of the provinces is higher in 1999-00, ranging from 51 percent to 88 percent The budgeted expenditures at elementary level will almost be approaching the planned targets in NEP for the province of Punjab and NWFP, while for Sindh they will be 75 percent of planned target for the year 99-2000. As compared to development, deviations in recurring expenditures at secondary level are far less and in all provinces touching the 50 percent of NEP targets. However they are nowhere close to the percentages attained in the case of elementary education. In comparison to the NEP targets, the actual (1998-99) and planned (99-2000) outlays of the 'Professional/Universities\colleges' is the best. It even surpasses the achievements in elementary education. Either the performance at this level reflects the compensation for neglect in the recent past, or response to the presence of a vocal lobby or political benefits (reduction in educated unemployment) of investments in improving technical education standards. The low priority to investment in quality is reflected in the proxy expenditure head 'Libraries and Text books' Except in Sindh where it approaches 50 percent of NEP targets, the record in other provinces is dismal, with poorest in Balochistan followed by Punjab.

The above modest analysis reveals the following pointers for policy makers and next year budget makers:- a) Under the development head secondary education considerably lags behind other levels. Unless we increase access (ignoring quality aspects for the moment) at this level, human resources for basic skill (post-matriculate) training may be unavailable in sufficient quantities to adapt to technology advancement. b) In a resource constrained environment and SAP II framework the benefits of diversion of resources to secondary level has to be traded off with improving access to 'middle' component of elementary education. Unless the performance ratios improve dramatically in the next two years the donors may seriously think of withdrawing support in SAP II. C) Punjab as the most populated province has to quickly close the gap between NEP targets and budgetary allocations (especially secondary education and Libraries and text books) or at least perform better than other provinces in order to have significant impact on the overall literacy targets set in NEP document. In summary the above analysis provide sufficient evidence to rectify the imbalances between the NEP document and actual allocations in order to save the NEP 1998-2010 from joining previous policy documents gathering dust on the shelves of the education ministry.

PROVINCIAL DEVELOPMENT PROGRAM AND RURAL DEVELOPMENT

by

Naeem Ahmed and Imran Ashraf Toor

Rural development, of late, has become a global concern, though issues involved in it continue to suffer from ambiguity and lack of direction. It is the current rage among planning experts and policy makers as a solution to the problems of poverty and unemployment. Given the prospects of rising rural poverty in the short-term in Pakistan, it is imperative to allocate budgetary expenditure towards programs for specific target groups/areas for income generation and employment creation. Identifying 'rural' with 'agricultural' does not describe the entire rural economy. Rural development, though primarily dependent on small-farmer agricultural progress, implies much more. It consists of many other economic activities-small and cottage industries, trade, shop-keeping, services and the like.

For the sustainable and balanced rural development, provincial governments through budgetary allocations should achieve the following objectives: (a) efforts to raise both farm and non-farm rural incomes through job creation, rural industrialization, and the increased provision of education, health nutrition, housing, and a variety of related social and welfare services; As a by-product (I) it will lead to reduced urban-rural and intra-rural income and welfare disparities. (ii) also reduce out-migration from rural areas and (b) the capacity of the rural sector to achieve long-run sustainability in terms of resource generation and cost-effective expenditures.

The government is facing serious resource constraints during the last few years due to stagnant tax revenue collection and meager growth in GDP. On the other hand expenditures are rising faster every year due to hefty increase in debt servicing obligations. At the federal level it has become imperative to keep the budget deficits at manageable level. Consequently development expenditures are bearing the brunt of deficit reduction. This trend can also be observed in recently announced provincial budgets for the financial year 1999-2000. As shown in table 1, the development budget of all provinces combined has been reduced by 10.7 per cent from Rs 36.2 billion in 1998-99 to Rs 32.3 billion in 1999-2000. It is even lower than the revised

TABLE 1
RURAL DEVELOPMENT ALLOCATIONS IN
THE ANNUAL DEVELOPMENT PROGRAM OF FOUR PROVINCES COMBINED

(Percentage share %)

	1996-97 (R)	1997-98 (R)	1998-99 (R)	1999-2000 (B)
Total Development Expenditures (Billion)	**31.1**	**34.3 (10.2)**	**36.2 (5.4)**	**32.3 (-10.7)**
Public Health Engineering	12.6	12.0 (4.7)	9.8 (-13.7)	12.0 (9.0)
Transport and communication	12.1	12.8 (16.7)	14.5 (19.6)	13.3 (-18.1)
Rural Development	3.0	2.9 (5.4)	7.2 (163.6)	2.0 (-75.6)
Water, Power and Irrigation	9.0	8.3 (2.5)	11.5 (45.9)	11.4 (-11.7)
Agriculture	3.7	3.6 (5.6)	5.9 (75.9)	6.2 (-6.2)
Forestry and Wildlife	1.0	1.3 (39.5)	0.8 (-32.2)	1.1 (13.0)
Industries and Minerals	0.3	0.4 (40.8)	0.2 (-52.0)	0.8 (318.9)
Others	58.2	58.7 (11.1)	49.9 (-10.4)	53.1 (-5.0)

Data source: Provincial Annual Budget Statements
Note: Figures in the parenthesis are growth rates from the previous year

estimates Rs 34.3 billion of 1997-98. In this article we explore the implications of provincial budgetary allocations on the attainment of the above stated objectives of rural development.

Let us first detail the profile of sectoral allocations by combining annual development programs of all the four provinces. Since the development and execution of social sector infrastructure remains the responsibility of the provinces, a little over half of the development expenditures are allocated under this head. In table 1 it is classified under 'Other' and its share has fluctuated between 50 and 59 per cent during the last four years. Within the economic infrastructure, Transport and Communications occupies the largest share closely followed by the Public Health Engineering sector. The share and impact of the former on the rural economy is highly understated in the provincial budgets of this year as major expenditure on this head will be incurred at the federal level by PM's Economic Revival Program. It is planned to construct 5000 km of farm to market roads. Historically the sector termed as 'Rural Development' largely consists of programs and projects initiated by the political party in power. Its share in the budget has fallen notably from 7.2 per cent last year to 2.0 per cent slightly below its historical average. The just mentioned 3 sectors plus Water, Power and Irrigation sectors can be classified as short-to medium run employment generating sectors. Their impact on rural development is complementary/supportive rather than directly productive. Together the four sectors will consume 39 per cent of the proposed allocations. Expenditure in agriculture sector is allocated mainly to on-going and/or new projects and programs in Research and Development of agriculture inputs (e.g., seed variety) or outputs (e.g., disease resistant or hybrid variety). In the last two years provincial allocations in these activities have steadily moved from 4 per cent range to 6 per cent range. In keeping with the overall strategy of less governmental involvement in directly productive activities industries and minerals have been allocated a paltry less than 1 per cent in the provincial budgets although in growth terms it is almost 3 times more than last year. Again the contribution of these investment in rural development is indirect, complementary and staggered rather than direct and immediate improvement in the income level.

Is there considerable inter-provincial variation in the sectoral allocation of development expenditure? Are the provinces following a mutually consistent rural development strategy? Table 2 gives the province-wise sectoral share in development expenditures for the outgoing and the coming year. The sectors subsumed in 'Others' claim the highest share n the Sindh province with almost 72 per cent of its development outlays going to social sectors. Thus in Sindh only 28 per cent of development expenditures are left for investment in economic infrastructure. In NWFP the share as per budgeted figures is 39 per cent against the 48 per cent last year. Among the economic sectors Water, Power and Irrigation tops the list in sectoral allocations in NWFP and Balochistan. In Sindh it is the Transport and Communication and in Punjab it is the share of Public Health Engineering which are the highest. Population pressures in small towns in the Punjab province dictate the need to spend more on sewerage and clean water supply schemes. Except in NWFP the politically driven allocations for rural development have been phased out all other provinces. The province of Sindh stands out in only a insignificant and nil allocation to the agriculture and industry sector respectively.

TABLE 2
RURAL DEVELOPMENT ALLOCATIONS IN
ANNUAL DEVELOPMENT PROGRAM OF PROVINCES

Percentage share (%)

	PUNJAB		SINDH		N.W.F.P		BALOCHISTAN	
	1998-99 (R)	1999-20 (B)	1998-99 (R)	1999-20 (B)	1998-99 (R)	1999-20 (B)	1998-99 (R)	1999-20 (B)
Total Development Expenditure (Rs. Billion)	14.9	13.1	8.3	7.9	8.5	5.7	4.5	5.5
Public Health Engineering	11.7	15.2	5.5	7.5^	10.0	14.4	11.1	8.2
Transport and Communication	14.6	13.1	11.6	12.1	11.0	9.0	26.3	20.1
Rural Development	12.7	0.0	0.7	0.9	4.1	9.1	6.9	0.7
Water, Power and Irrigation	8.7	8.3	4.6	5.4	19.1	20.3	19.7	18.3
Agriculture	9.1	10.3	0.9	1.0	4.8	4.7	6.9	5.7
Forestry and Wildlife	0.5	0.5	0.6	0.6	2.2	3.9	0.1	0.1
Industries and Minerals	0.1	1.7	0.1	0.0	0.4	0.3	0.1	0.5
Other	42.6	50.8	76.0	72.4	48.3	38.4	28.8	46.3

Date Source: Provincial Annual Budget Statements

In summary the provincial budgets do not reflect a significant departure from the historical trends of the last four years. The impact of provincial economic ADPs is complementary and short to medium term employment generation rather than raising incomes through direct investment in productive activities. No doubt the allocations in economic infrastructure are consistent with the current thinking of dependence on market forces rather than on government initiatives, but if the objective is to pursue a broad based labor intensive industrialization and reduce urban-rural income and welfare disparities it is high time for the policy makers to re-think this approach for a more meaningful approach to rural economic development.