Intergovernmental Finance Assessment

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CONTENTS

LIST OF TABLES

LIST OF BOXES

LIST OF CHARTS

ANNEXURES

EXECUTIVE SUMMARY

Assessment of Pre and Post 18th Amendments Structures

Pakistan has witnessed hallmark developments in the last two years which will enhance provincial autonomy and strengthen the federation. The first of these developments was the signing of the 7th National Finance Commission (NFC) Award which increases significantly the share of the provinces in national resources. The other development is the signing of the 18th Amendment to the Constitution. This significantly broadens the range of functional responsibilities of provincial governments.

The 18th Amendment has abolished the Concurrent Legislative List of the Constitution and has made changes in the Federal Legislative List, Parts I and II. The Concurrent List functions have been devolved to the provinces, with the exception of electricity. It has also transferred subjects from the Federal Legislative List Part I, which defines the functions allocated to the federal government, to Part II, making them a joint provincial and federal responsibility under the CCI. Consequently, the structure of government has changed quite substantively. Fifteen ministries/eighteen divisions stand devolved to the provinces. In addition to the ministries earmarked for complete devolution, some subjects of the ministries which continue to function at the federal level have also been selected for devolution. Overall, following the 18th Amendment there is a more rational and balanced distribution of functions between the federal and provincial governments leading to greater empowerment of the latter.

The 18th Amendment also explicitly recognizes sales tax on services and capital value tax on immovable property as provincial subjects. Beside, amending the allocation of functional responsibilities and fiscal powers, the 18th Amendment, also significantly strengthens the Council of Common Interests (CCI) and National Economic Council (NEC). These two Councils have not been very active in the past, with the CCI playing largely a conflict resolution role between the federation and federating units or among the federating units. Following the 18th Amendment the two Councils are to play a major role in economic planning and management. Simultaneously, there is also the strengthening of the office of the Auditor-General of Pakistan.

Assessment of the Pre and Post 7th NFC Award Structures

As mentioned earlier, consensus on the 7th NFC Award is also a major achievement of the present government. Inter-governmental revenue transfers are the lifeline of provincial governments in Pakistan. This dependence is a consequence of the imbalance in the allocation of functional responsibilities and fiscal powers between the federal and provincial governments. The federal government collects as much as 92 percent of tax revenues while federal share in public expenditure is 72 percent. Compared internationally, the extent of vertical imbalance is on the higher side in Pakistan, strengthening the case for decentralization from the federal to the provincial governments of both functions and fiscal powers.

The recently announced 7th NFC award is different from the previous revenue sharing arrangement (the Presidential Order 1, 2006) in the following important ways: the net divisible pool of taxes is larger; the share of the provinces in the divisible pool is higher, the provincial share is divided among the provinces on the basis of multiple criteria with special

development needs of the smaller provinces of Khyber-Pakhtunkhwa(K-PK) and Balochistan also being taken into account; straight transfers have increased and, finally, all taxes on services have been recognized to be a provincial subject (implying abolition of the federal excise duty levied on services).

All in all, the report concludes that over time, intergovernmental transfers between the federation and federating units have evolved within the broad and progressive overriding philosophy of promoting decentralization and fiscally strengthening the provincial governments, which have over the years, and now more so, are expected to play a very important role in the provision of basic social and economic services. The budgeted increase in revenue transfers to provinces due to the 7th NFC Award in relation to the previous arrangements (Presidential Order) is Rs. 222 billion in 2010-11. However, an important emerging issue is the actual realization of this budgeted gain. Indications after the first nine months in the current year are that the level of transfers will be about Rs 75 billion less than the amount budgeted.

Turning next to an important question regarding the extent of fiscal equalization achieved by revenue sharing transfers in Pakistan, the report demonstrates that there was a breakdown in fiscal equalization prior to the 2009 NFC Award. The adhoc arrangements of 2006 announced by the then President clearly failed to improve equity in intergovernmental revenue transfers, However, the 1991 NFC award followed by the 1996 and the 2009 NFC awards have contributed to fiscal equalization. The analysis also shows that fiscal equalization significantly dampens towards the end of the tenure of a particularly award, highlighting the need for timely announcement of awards. It is important that consensus is developed among the federation and the four federating units so that an agreement can be reached in a timely manner. This can be facilitated by better and more accurate data bases and analysis of indicators, which should be the mandate of a substantially strengthened NFC Secretariat in the Ministry of Finance.

The report also undertakes an analysis of the financial implications of the 7th NFC Award. Results of the empirical analysis of past fiscal behaviour indicate that in the aftermath of an Award which expands the share of provinces, the consolidated fiscal deficit tends to rise because there is, first, no corresponding cutback in federal current expenditure, second, the fall in the size of the PSDP is accomplished with some time lag, and third, provincial current expenditure rises rapidly in response to larger transfers. This impact is somewhat moderated by the launching of a more intensive fiscal effort through tax reforms by the federal government to at least partially make up for the loss in net revenue receipts. Also, provincial ADPs take some time to fully adjust upwards. The net impact on the overall fiscal deficit of the 7th NFC Award has been projected to be Rs 48 billion. That is, the fiscal deficit in 2010-11 is likely to be 0.3 percent of the GDP higher than it would have been in the absence of the 7th NFC award.

One way in which these negative implications of higher intergovernmental transfers can be partially mitigated is to provide an incentive to provincial governments as part of the Award in the form of a matching grant linked to increase in self-financing of provincial governments.

The report concludes that the 7th NFC Award is likely to have a number of longer term implications as follows:

- There will be a shift of development focus from the federal government to the provinces. The fast growth in development spending by provinces will require enhancement in capacity to design, execute and manage a larger portfolio of projects. The absorption capacity of the provinces, particularly the smaller provinces, is likely to become an important issue.

- It is important that given the higher transfers from the federal government, provinces do not slacken their own fiscal effort. Proper exploitation of sources in provincial domain is essential not only to enhance the overall federal and provincial consolidated tax-to-GDP ratio but also to make the tax burden more equitable.

- Provinces must avoid profligacy in current expenditures. Additional resources should increasingly be used for development and largely routed towards backward regions and pro-poor sectors.
- The provinces should develop Medium Term Development Framework (MTDFs), taking into account the additional funding available. These will help the provinces strategize and prioritize their development priorities, facilitate proper planning and management of spending in accordance to the development needs of their provinces, thereby avoiding adhocism and populism.

The 7th NFC Award also has significant implications for the federal government which include: economy in non-productive expenditure to reduce the fiscal deficit, sharper prioritization of the federal PSDP and enhancement in the level of resource mobilization. The country is stuck at a low tax-to-GDP ratio making its financial position unsustainable.

Overview of Progress

Devolution under, the 18th Amendment is planned in three phases. Phase I was completed in December 2010 under which Ministries of Special Initiatives , Zakat and Ushr, Youth Affairs, Population Planning and Local Government and Rural Development were devolved to the provinces. In the second phase, completed in April 2011, five more ministries: Education, Social Welfare and Special Welfare, Livestock and Dairy Development, Culture, Tourism have been devolved while the remaining Ministries/divisions will be devolved by June 2011. These include Food and Agriculture, Health, Labour and Manpower, Woman Development, Sports, Statistics Division, Environment and Minorities Affairs The size of the federal secretariat would be reduced by 15 ministries/18 Divisions by the end of June this year, thus reducing the number of federal divisions from 50 to 32.

Devolution of the selected subjects is a complex task. A number of decisions have to be taken for smooth transfers and subsequent smooth functioning of the subjects. In each case a number of questions have to be answered: how will the function be managed? How will it be financed? Does the enabling legislation exist? What changes in laws and procedures are involved? What will be the human resource requirements for providing uninterrupted service at the provincial level? How will any assets and liabilities be shared? These issues are complicated but need resolution. To illustrate an emerging issue with the devolution of Ministry of Labour and Manpower is that the federal and provincial governments differ over

distribution of assets owned by the Workers Welfare Fund (WWF) and Employees Old Age Benefits Institution (EOBI).

Another important question that arises in the process of devolution relates to the autonomous bodies and attached departments under ministries/divisions. Autonomous bodies such as PTDC are likely to be contentious as provinces are demanding equitable distribution of assets.

To facilitate the implementation of the devolution process and address such issues an Implementation Commission (IC) has been established under Senator Raza Rabbani. The IC has formed committees to support the work on different aspects. IC will have to resolve the issues arising in the context of each subject on a case to case basis. In the case of ten ministries devolved so far, certain functions have been relocated at the federal level. For example, in the second phase a wide range of functions (including film censor, education, health, livestock) has been devolved to the new Central Administration and Development Division, which will, it appears, function like a mini government. There is need for proper identification of principles to decide on the location of particular subjects. The principles have to be based on economic and administrative criteria, should ensure efficient delivery of functions, be transparent and ensure cost effectiveness.

Another issue that need to be resolved prior to devolution is the financing of the devolved subjects. Overall, if all Ministries/Divisions are devolved to the provinces as they are operating at the federal level, the additional current expenditure liability on the provinces will be Rs. 45.6 billion- Rs 7.3 billion on account of employee related expenses and Rs. 38.3 billion on other operating expenses. Given the current regional distribution of these expenditures, about 52 percent is in the domain of the federal government 17 percent is in the province of Punjab, 20 percent in Sindh, 8 percent in K-PK and 2 percent in Balochistan.

The federal government is making the point that since the recently promulgated 7th NFC Award has significantly enhanced the share of provinces in the national divisible pool, the devolved subjects should be funded through the additional revenues received by the provinces because of the 7th NFC Award. The provinces, on the other hand, are making three important points in response. First, the 7th NFC Award preceded the 18th Amendment. Because additional functional allocations to provinces were not decided, it could not have influenced the resource allocation decisions in the 7th NFC Award. Second, the provinces are actually not receiving as big a bonanza of additional revenues as was originally claimed. This is due to the shortfall in federal tax collection. Third, the federal government in the budget of 2010-11 unilaterally announced a 50 percent increase in salary and allowances for all government employees which will pre-empt a substantial proportion of the revenue gain to the provinces. Therefore, devolution of functions under the 18th Amendment should be accompanied with devolution of funding from the federal government.

Turning next to the development side, currently there are 232 projects which are being implemented at the federal level by the devolved ministries in all the provinces. 166 projects can be clearly devolved to the provinces concerned. The throwforward liability of such projects is Rs 67 billion. In addition, 66 vertical projects are also being implemented in the provinces. The liability of these projects is Rs 202 billion. Projects of higher education (largely HEC) create a further development liability of Rs 48 billion which can be allocated to the provinces. Therefore, according to first estimates, obtained from the Planning

Commission, the development expenditure liability on-going projects that can be devolved to the provinces following full implementation of the 18th Amendment is Rs 317 billion. Out of these Rs 151 billion is in Punjab, Rs 86 billion in Sindh, Rs 52 billion in Khyber-Pakhtunkhwa and Rs 26 billion in Balochistan (based on the assumption that the cost of vertical projects is distributed among the provinces on the basis of population shares). The outlay in 2010-11 on projects / programs that can be devolved for the four provinces combined is Rs 41.3 billion.

To sum up, we have at the extreme that if the Provincial governments have to, more or less, immediately finance the recurrent and development costs of functions transferred to them then this will lead to an almost 10 percent increase in the level of expenditure incurred last year. Given that the additional transfers envisaged under the 7th NFC Award are unlikely to materialize fully and have been largely per-empted by the 50 percent salary hike, it is clear that the Provincial governments, with Punjab in particular, will have serious problems in self-financing the devolved functions.

Assessment of Provincial Resource Mobilization Capacity

Clearly, provincial resources will have to be augmented. Since the provinces depend on fiscal transfers in a significant way, resource augmentation partially will have to take place through better fiscal effort by the federal government, at least to the extent stated in the Federal Budget Strategy Paper, 2010-2013. On top to this, provincial governments will have to enhance their own level of fiscal effort.

The overall level of resource mobilization by the four provincial governments of Pakistan from their own tax and non-tax revenue sources has fallen from over 1 percent of GDP in the early 90s to below 0.8 percent of GDP in 2009-10. The provinces will have to improve collection from potentially buoyant taxes in their fiscal domain. The NFC document clearly states that the “provinces would initiate steps to effectively tax the agriculture and real estate sectors. Federal government and Provincial governments may take necessary administrative and legislative steps accordingly.”

Currently, the four provinces combined are generating Rs. 287 billion from own sources, Rs. 63 billion through tax sources and Rs. 224 billion as non-tax revenues (including straight transfers). Overall, the provincial tax-to-GDP has declined from 0.50 percent in 2000-01 to 0.46 percent in 2009-10. Similarly, the share of provincial own non-tax revenues in total revenue receipts is very low and appears to have shown modest improvement over time. Among the provinces, Punjab has the highest fiscal effort which has gradually improved since 2000-01.

There is a strong case for higher provincial effort to mobilize own revenues, both tax and non-tax. Candidate tax sources with high potential in Punjab and Sindh are discussed in detail in the report. An important potential source is the Agriculture Income Tax (AIT). It currently yields only about Rs 1 billion in Punjab and less than Rs 2 billion in the whole of Pakistan. But legislation for levy of AIT exists since 1996 and there have been a number of amendments since then. If changes of the type identified in the report are brought in the Acts and collection efficiency is improved, then the tax could yield nationally Rs 10 billion to Rs 15 billion. From the viewpoint of improving taxpayer compliance, 50 % of the tax collected from a tax payer could be reverted to the Zila Council of the district in which he/she is located.

The second area of taxation which the provincial governments are committed to develop as per the 7th NFC Award is property-related taxes, which include stamp duty, tax on transfer of property, capital value tax (CVT) on immovable property and Urban Immoveable Tax (UIPT). The taxes which have the highest potential are UIPT and CVT. The report concludes that the presence of multiple taxes on properties needs to be rationalized and taxes with maximum potential developed. The report presents proposals to do so which focus on broadening the tax base and rationalizing the tax structure.

The report also focuses on General Sales Tax (GST) on services. The tax has the potential to be a major contributor to the provincial exchequer. Finally, non-taxes especially, user charges on economic and community services need be enhanced to ensure proper Q & M of the infrastructure. In particular, Abiana (Irrigation Charges) should be streamlined rationalized to promote efficiency in water use.

In summary, implementation of the proposals presented in the report for development of provincial taxes on agriculture, real estate and services could yield additional revenue of up to 0.8 percent of the GDP, equivalent to almost Rs. 126 billion on the current tax base. Over and above these, the provinces will also have to enhance the level of cost recovery, in particular, in economic and community services. These measures will contribute not only to significant enhancement in the national tax-to-GDP ratio but also enable the provincial governments to expand the coverage and quality of basic services.

Budgetary Process

The Report describes the existing process followed by the provincial governments for preparation of budget. It throws light on process followed for estimation of receipts, estimation of current expenditure and preparation of development budget. While discussing the development budget, a description of the process of planning, approval and execution of development schemes has also been provided. Proposals are formulated for greater involvement of other stakeholders, especially representatives of the private sector, academia and civil society, in the determination of development priorities and allocations.

Detailed analysis of the accuracy of budget estimates prepared by the Punjab Government during the last three financial years is also presented. The accuracy of budget estimates is undertaken by comparing the budget estimates with accounts / actual expenditure. The report concludes that the estimation of current budget is reasonably accurate as there is variation of less than 10 percent between budget estimates and actual expenditure. Under-provisioning for charged expenditure such as “Employee Retirement Benefits” has, however, prominent. Also, higher expenditure on physical assets and civil works compared to that budgeted is revealed by the Object wise analysis of expenditure.

Large downward revisions (up to almost 30 percent) have been made in the size of the development expenditure. These cuts were mandated by resource shortfalls. It is, therefore, extremely important that the Government develops its capacity to accurately estimate its resources so as to enhance predictability of the revenue surplus for financing development. Finally, recommendations have been made for improving the accuracy of budget and efficiency of utilization.

Ensuring an Orderly Transition

The previous chapters have brought to the forefront a number of issues emerging in the process of devolution which need, more or less, immediate policy attention. On the financial side, these issues largely pertain to the financing of devolved subjects and the sharing of assets and liabilities. The former is largely a consequence of the sequencing of the devolution process whereby financial resources were transferred prior to the decision on reallocation of functional responsibilities.

The report presents the points of view of both the provincial and federal governments. It appears that additional revenue transfers due to the 7th NFC award are not enough to finance the additional liability arising from the transfer of functions of the 18th Amendment, of Rs 45 billion on the recurrent side and Rs 41 billion on development outlays annually on on-going projects in devolved functions. Clearly, the larger provinces, particularly Punjab, do not have the fiscal space to take on the new responsibilities. The position with the smaller two provinces, however, is somewhat different. It appears that given the proportionately higher transfers (NFC mandated plus payment of arrears on account of hydel profits to K-PK and a minimum guaranteed level of transfers to Balochistan) the binding constraint in their case is more institutional than financial.

There is a range of options varying from the federal position of full administrative devolution of functions without any further fiscal transfers over and above that envisaged in the 7th NFC award to the provincial position of full financing from federal government with truncated administrative devolution (without transfer of federal staff). What perhaps is required is enunciation of some guiding principles which can be laid down to determine the nature of resolution of each issue on a case to case basis. These principles should be based on the overall strategy of incentivizing the environment for the provinces guiding them towards efficient and cost effective options. Some such principles are presents in the report which may prove handy to the federal and provincial governments for ensuring the financing of the devolved subjects.

Longer Terms Implications: Potential Role of Donors

While we have focused on the benefits of the 18th Amendment in terms of bringing the government closer to people, thus making public policy more responsive, accountable and transparent, a number of potential dangers also need to be identified and counter strategies devised to ensure the success of this flagship initiative of the democratically elected government. Countering the possible longer term adverse implications of the 18th Amendment is also an area where the donor community can assist and thus contribute to the success of a major home grown reform effort. Some such implications are as follows:

Implications for Equalization: Currently fiscal equalisation is also taking place directly through federal expenditures. With devolution of the functions to the provinces following the 18th Amendment, there is the danger that regional inequity may be aggravated as fiscal equalization now will be achieved through revenue transfers only. Higher expenditures have also to be routed to the backward provinces to avoid adverse equity implications.

Change in Priority to the Devolved Subjects: Following devolution, the provinces may choose not to continue the funding levels maintained by the federal government to a

particular project/program. There is the danger that in the case of public goods with negative externalities and spill over effects provincial priorities may go counter to national priorities. What perhaps is required in such cases is some incentivization of the programs/projects to motivate continued priority. A matching grant scheme can perhaps be such an mechanism.

Decline in the Quality of Service Provision: There also exists a real danger that the smaller provinces, in particular, may not be able to maintain the quality of service provision due to capacity constraints. Capacity building in such cases will be a pre-requisite for success.

Monitoring of the Implementation of the Devolution Process: The success of devolution crucially hinges on proper implementation of the reform program, with adequate and timely resolution of emerging issues. Pakistan will need to develop a proper monitoring mechanism of the devolution process which should be capable of highlighting interprovincial differences to ensure timely redressal of any decline in quality of service that may emerge in the transitional stage. Learning from good practices both international and in other provinces and information sharing should be institutionalized through appropriate mechanisms.

The donor agencies can assist the decentralization process not only by providing financial resources to remove any constraints for financing of projects in individual provinces but also provide technical assistance for capacity building, influence the allocation of resources to high priority services through matching forms of support and assist in the development of monitoring mechanisms while providing examples of international best practice, especially in the delivery of services and establishment of regulatory frameworks.

CHAPTER 1
ASSESSMENT OF STRUCTURE OF GOVERNMENT: PRE AND POST 18th AMENDMENT

Pakistan has witnessed some hallmark developments in the last two years. These developments constitute 'opportunities' which, if implemented, in letter and spirit, will lead to a quantum leap in the extent of fiscal devolution in Pakistan, thereby enhancing provincial autonomy and strengthening the federation. The first of these developments was the signing of the 7th National Finance Commission (NFC) Award by the members of the NFC in the presence of the Chief Ministers of the four provinces and the Prime Minister on the 30th of December 2009. Agreement on this award was reached at the sixth meeting of the NFC held in Lahore earlier in December. The award came into force on 1st July 2010. It has been rightly acclaimed as a great achievement. It enhances significantly the share of the provinces in the federal divisible pool (federal tax revenues shared with the provinces) from 46.75 percent to 56 percent in the first year and to 57.5 percent in the remaining years of the award. Punjab, in particular showed great accommodation by accepting multiple indicators beyond population for distribution of resources among the four provinces, primarily for the benefit of the smaller provinces.

The other major development is the passage and signing into law on 9th April 2010 of the 18th Amendment to the Constitution by the President of Pakistan. With this Amendment the Concurrent List of functions in the Constitution stands abolished, devolving the functions contained in this list to the provincial governments. This significantly enhances the range of functional responsibilities of provincial governments and constitutes an important step in bringing the government closer to the people. The subsequent sections trace the changes in the structure of the government following the 18th Amendment.

1.1 Allocation of Functions

Allocation of functions between different tiers of government is defined in the Fourth schedule of the Constitution of Pakistan. Prior to the 18th Amendment, the Fourth Schedule contained the Federal Legislative List (FLL) (Part I and Part II) and the Concurrent Legislative List. The functions performed by the federal government were included in the Federal Legislative List while the Concurrent Legislative List listed functions that could be performed by either level of government. In practice, most of the functions were performed by the federal government. Functions not mentioned in either list are the responsibility of sub-national governments.

The 18th Amendment has abolished the Concurrent Legislative List of the Constitution (that is, entries 1-47 of the Fourth Schedule of the Constitution have been omitted) and has made changes in the Federal Legislative List, Parts I and II. Consequently, the structure of government has changed quite substantively. The Concurrent List subjects are transferred to the provinces, the only exception is electricity, which now falls into Part II of the Federal Legislative List.

The 18th Amendment has made five deletions from the Federal Legislative List Part I. Box 1.1 presents changes in the Federal Legislative Lists Part I and Part II respectively. Ports, national planning and national economic coordination along with census and extension of powers and jurisdiction of members of police have been made a joint responsibility of the

federal and provincial governments though the Council of Common Interests (CCI). According to the 18th Amendment, clause 154(1), "the council shall formulate and regulate policies in relation to matters in Part II of the Federal Legislative List and shall exercise supervision and control over related institutions".

Box 1.1
Changes in the Federal Legislative List (FLL) after the 18th Amendment

Part I			
No.	**Subject**	**Status**	**Transferred To**
21	Major Ports	Deleted	FLL - Part II
32	National planning and national economic coordination including planning and coordination of scientific and technological research	Deleted	FLL - Part II
33	State Lotteries	Deleted	Provinces
38	Census	Deleted	FLL – Part II
40	Extension of powers and jurisdiction of members of police force belonging to any province to any area in another province, but not so as to enable the police of one province to exercise powers and jurisdiction in another province without the consent of the government of that province; extensions of the powers and jurisdiction of the members of a police force belonging to any province to railway areas outside that province.	Deleted	FLL – Part II
Part II			
No.	**Subject**	**Status**	**Transferred From**
4	Electricity	Inserted	Concurrent List
5	Major Ports	Inserted	FLL - Part I
6	All regulatory authorities established under a federal law	Inserted	
7	National planning and national economic coordination including planning and coordination of scientific and technological research	Inserted	FLL - Part I
8	Supervision and management of Public Debt	Inserted	
9	Census	Inserted	FLL - Part I
10	Extension of powers and jurisdiction of members of police force belonging to any province to any area in another province, but not so as to enable the police of one province to exercise powers and jurisdiction in another province without the consent of the government of that province; extension of the powers and jurisdiction of the members of a police force belonging to any province to railway areas outside that province.	Inserted	FLL - Part I
11	Legal, medical and other professions	Inserted	
12	Standard in institutions for higher education and research, scientific and technical institutions	inserted	
13	Inter-provincial matters and coordination	Inserted	

The resulting distribution of functional responsibilities between the two tiers of government has altered significantly. Evolution of functions among different levels of government is presented in Box 1.2, which gives the allocation of functional responsibility before and after the 18th Amendment, 2010 and the Devolution Plan, 2001(which allocated functions to local governments). It may be mentioned here that the local government system is in hiatus in three out of four provinces with the new Local Government Acts awaiting legislative approval. The key conclusion that emerges from Box 1.2 is that following the 18th Amendment there is a more rational and balanced distribution of functions between the federal and provincial governments leading to greater empowerment of the latter. The following fifteen ministries (equivalent to eighteen divisions) stand devolved to the provinces:

1. Culture
2. Education
3. Food and Agriculture
4. Health
5. Labour and Manpower
6. Livestock and Dairy Development
7. Local Government and Rural Development
8. Population Welfare
9. Social Welfare and Special Welfare
10. Special Initiatives
11. Sports
12. Tourism
13. Woman Development
14. Youth Affairs
15. Zakat and Ushr

Box 1.2
Changes in the Allocation of Functions among Different Levels of Government*

Service	According to 1973 and 2001 Devolution Plan	After 18th Amendment 2010 and 2001 Devolution
Defence	F	F
International Trade	F	F
External Affairs	F	F
Census	F	F/P
Nationality, Citizenship	F	F
Posts and Telegrams	F	F
Currency Foreign Exchange	F	F
Public Debt	F	F/P
Telecommunications	F	F
Railways	F	F/P
National Highways	F	F
Major Ports	F	F/P
Electricity	F	F/P
Irrigation	P	P
Distribution of Inputs	P	P
Agriculture Extension	P/L	P/L
Higher Education (University)	F	F/P
Higher Education (Colleges)	P/L	P/L
School Education (Secondary)	L	L
School Education (Primary)	L	L
Preventive Health	L	L
Curative Health	L	L
Farm-to-Market Roads	L	L
Water Supply	L	L
Sanitation	L	L
Drainage	L	L
Solid Waste Management	L	L
Fire Fighting	L	L
Parks and Playgrounds	L	L

* F = Federal, P = Provincial, L = Local

In addition to the ministries earmarked for complete devolution, some subjects (selected functions within ministries that will continue to exist at federal level) have also been selected for devolution. 32 ministries will be retained at the federal level after the implementation of the 18th Amendment, as described in the next chapter.

1.2 Allocation of Fiscal Powers

The thrust of the changes made in the 18th Amendment is on the functional side and amendments on the fiscal side are relatively minor as presented in Box 1.3. This includes the explicit recognition of sales tax on services and capital value tax on immovable property as within the domain of provincial fiscal powers. These powers were implicit prior the 18th Amendment, although the Federal government had been levying an excise duty on services and collecting the CVT on property.

Box 1.3
Fiscal Powers - Amendments in Federal Legislative List - Part I

45. Duties in respect of succession to property – Deleted
46. Estate duty in respect of property – Deleted
49. Taxes on the sale and purchase of goods imported, exported, produced, manufactured or consumed – (except sales tax on services – Inserted)
50. Taxes on the capital value of the assets not including taxes (on immovable property – Inserted)

1.3 Special Provisions

Besides the changes in the allocation of functional responsibilities and fiscal powers, the 18th Amendment has also made changes in Special Provisions of the Constitution. Box 1.4 presents the Special Provisions pre and post 18th Amendment. The most important change relates to the composition and functioning of the Council of Common Interests (CCI), following the 18th Amendment. As shown in the box, the CCI has been greatly strengthened. It shall now be chaired by the Prime Minister and shall meet once a quarter. It will have a permanent secretariat. It shall comprise of the Prime Minister, three Federal Ministers and the four Chief Ministers. The list of subjects on which the CCI will have jurisdiction are mentioned in FLL – Part-II. As highlighted earlier, this has been substantially increased by transfer of some of the subjects from the omitted Concurrent List, and some of the subjects from Part-I of the Federal Legislative List. These include major ports, electricity, all regulatory authorities, national planning, public debt, census, legal, medical and other professions, standards of higher education and interprovincial matters and coordination. CCI will also have jurisdiction over reservoirs in addition to natural sources of water supply. The CCI is expected to present an annual report to the Parliament.

Box 1.4
Changes in the Special Provisions of the Constitution

Article	Pre 18th Amendment	Post 18th Amendment
	Council of Common Interests	
153	Composition: 2(a) Chief Ministers of provinces 2(b) An equal number of the federal government to be nominated by the Prime Minister from time to time 3. The Prime Minister, if he is a member of the Council shall be the Chairman of the Council but, if at any time he is not a member, the President may nominate a Federal Minister who is a member of the council to be its Chairman 4. The Council should be responsible to Majlis-e-Shoora (Parliament)	Composition: 2(a) Prime Minister 2(b) Chief Ministers of provinces 2(c) Three members from the federal government to be nominated by the Prime Minister from time to time 3. deleted 4. The Council shall be responsible to Majlis-e-Shoora (Parliament) and shall submit an Annual Report to both Houses of Majlis-e-Shoora (Parliament)
	Functions and Rules of Procedures	
154	1.The Council shall formulate and regulate policies in relation to matters in Part II of the Federal Legislative List and, in so far as it is in relation to the affairs of the Federation, the matter in entry 34 (electricity) in the Concurrent Legislative List, and shall exercise supervision and control over related institutions	1. The Council shall formulate and regulate policies in relation to matters in Part II of the Federal Legislative List and shall exercise supervision and control over related institutions 2. The Council shall be constituted within thirty days of Prime Minister taking oath of office 3. The Council shall have a permanent secretariat and shall meet at least once in ninety days
	National Economic Council	
156	1.The President shall constitute a National Economic Council consisting of the Prime Minister, who shall be its Chairman, and such other members as the President may determine	1.The President shall constitute a National Economic Council which shall consist of: a) the Prime Minister, who shall be the Chairman of the Council b) the Chief Minister and one member from each province to be nominated by the Chief Minister and c) four other members as the Prime Minister may nominate from time to time 2. The meetings of the Council shall be summoned by the Chairman or on a requisition made by one-half of the members of the Council 3. The Council shall meet at least twice in a year and the quorum for a meeting of the Council shall be one-half of its total membership 4. The Council shall be responsible to the Majlis-e-Shoora (Parliament) and shall submit an Annual Report to each House of Majlis-e-Shoora (Parliament).
	Functions of NEC	
156	(2) The National Economic Council shall review the overall economic condition of the country and shall, for advising the Federal Government and the Provincial Governments, formulate plans in respect of financial, commercial, social and economic policies; and in formulating such plans, it shall, amongst other factors, ensure balanced development and regional equity and shall also be guided by the Principles of Policy set-out in Chapter 2 of Part II.	No Change

Likewise, the role of the National Economic Council (NEC) has also been strengthened, and provincial representation on it has been increased. It will meet at least twice a year and will also submit a report annually to the Parliament. These two Councils have not been very active in the past, with the CCI expected to play largely a conflict resolution role between the federation and federating units or among the federating units.

1.4 Provisions with Regard to Finance, Borrowing and Audit

Article 160 of the Constitution which relates to the National Finance Commission has also been amended with the addition of two clauses-(3A) and (3B)- which basically state that future National Finance Commission shall not reduce the share of resources allocated to the provinces by a previous Commission and there will be monitoring of the implementation of the Award. Also, provinces have become entitled, as of right, to the entire proceeds of the excise duty on oil (in addition to the excise duty on natural gas).

Provinces have also been given powers to raise domestic or foreign loans with conditions as indicated in clauses (3) and (4) of Article 167 given below:

> (3) A Province may not, without the consent of the Federal government, raise any loan if there is still outstanding any part of a loan made to the Province by the Federal government, or in respect of which guarantee has been given by the Federal government; and consent under this clause may be granted subject to such conditions, if any, as the Federal government may think fit to impose.
>
> (4) A Province may raise domestic or international loan, or given guarantees on the security of the Provincial Consolidated Fund within such limits and subject to such conditions as may be specified by the National Economic Council.]

Also, the office of the Auditor-General of Pakistan has been strengthened. The Auditor General of Pakistan has been given a constitutional four year term of office and has also been empowered to audit the accounts of the federal and provincial governments and all their bodies, corporations and authorities through the insertion of clause 170(2), which states "The audit of the accounts of the Federal and of the Provincial Governments and the accounts of any authority or body established by, or under the control of, the Federal or a Provincial Government shall be conducted by the Auditor-General, who shall determine the extent and nature of such audit."

In conclusion, the 18th Amendment is far-reaching in its impact as it not only attempts to remove the original Constitution of the many distortions introduced into it by a succession of leaders that governed the country after its promulgation in 1973 but it also sets in place a different structure of governance, which is more balanced and devolved, bringing governance closer to people.

CHAPTER 2
ASSESSMENT OF PRE AND POST 7th NFC AWARD STRUCTURE

2.1 Vertical Transfers

Inter-governmental revenue transfers are the lifeline of provincial governments in Pakistan. These transfers account for over 80 percent of provincial revenues. This dependence is a consequence of the imbalance in the allocation of functional responsibilities and fiscal powers between the federal and provincial governments in Pakistan, which has given rise to large vertical imbalances. Such vertical imbalances exist in other federations also, as shown in Table 2.1. These are on the higher side in Pakistan. The federal government collects as much as 92 percent of tax revenues and the provinces, only 8 percent. Also, there is relatively greater centralization of functions and the share of the federal government in public expenditure is one of the highest in Pakistan, at 72 percent. *Prima facie*, there appears to be a case for decentralization from the federal to the provincial governments in Pakistan of both functions and fiscal powers.

Table 2.1
Imbalance between Revenues and Expenditures in Countries, 2000-2001
(Before Transfers)

	Revenue Share (percent)	Expenditure Share (percent)	Surplus (+)/ Deficit (-)
AUSTRALIA			
National Government	69	54	+15
Sub-National Governments	31	46	-15
BRAZIL			
National Government	69	54	+15
Sub-National Governments	31	46	-15
CANADA			
National Government	44	37	+7
Sub-National Governments	56	63	-7
INDIA			
National Government	66	45	+21
Sub-National Governments	34	55	-21
SOUTH AFRICA			
National Government	95	50	+45
Sub-National Governments	5	50	-45
GERMANY			
National Government	65	37	+27
Sub-National Governments	35	63	-27
PAKISTAN			
National Government	92	72	+20
Sub-National Governments	8	28	-20

Source: Adopted from Watts (2005).

As highlighted earlier, the 18th Amendment has made modest changes in the allocation of fiscal powers between the two different levels of government. As such, the high dependence of provincial governments on federal transfers is likely to continue in the foreseeable future. It is important that the transfers are designed not only to remove the vertical imbalance but also to be horizontally equitable. We start with an assessment of the 7th NFC Award by highlighting the differences in the revenue sharing arrangements due to the award, quantify revenue gain to the provinces due to the award and examine whether or not it is fiscally equalizing. This will be followed by an analysis of the implications of the award on provincial and federal finances.

2.2 Evolution of Revenue Sharing in Pakistan

The history of revenue sharing in the sub-continent can be traced back to pre-partition days. Since partition, eight revenue-sharing awards have been announced in Pakistan. The first award was the Raisman award of 1951. This was followed by National Finance Commission awards in 1961-62, 1964, 1970, 1974, 1991, 1996 and 2009. Prior to the 7th NFC Award of

2009, revenue sharing was taking place according to the provisions of the Presidential Order No. 1 of 2006, which made amendments in the Distribution of Revenues and Grant-in-Aid Order, 1997. The Presidential Order was promulgated because the provinces failed to evolve a consensus in the NFCs constituted for the purpose in 2000 and 2005.

Intergovernmental transfers have historically taken three forms; "divisible pool" transfers, straight transfers and grants and subventions. Table 2.2 gives the composition of the divisible pool of taxes in terms of which taxes were shared and the proportion in which these were shared between the federation and the provinces combined in the last four Awards. The trend has been initially to increase the size of the divisible pool and subsequently to increase the share of the provinces in the pool.

Table 2.2
Evolution of Divisible Pool in Various Awards

Divisible Pool		SHARED REVENUE SOURCES[a]			
		NFC 1990	NFC 1996	Presidential Order 2006[c]	NFC 2009
A.	**INCOME TAX[b]**				
	Personal	80%	37.5%	45%-50%	56%-57 ½%
	Corporate	80%	37.5%	45%-50%	56%-57 ½%
	Wealth Tax	-	87.5%	45%-50%	56%-57 ½%
B.	**SALES TAX**	**80%**	**37.5%**	**45%-50%[d]**	**56%-57½%[e]**
C.	**EXCISE DUTIES**				
	Tea	-	37.5	45%-50%	56%-57 ½%
	Tobacco	80%	37.5%	45%-50%	56%-57 ½%
	Sugar	80%	37.5%	45%-50%	56%-57 ½%
	Betel nut	-	37.5%	45%-50%	56%-57 ½%
	All excise duties (Excluding GST)	-	37.5%	45%-50%	56%-57 ½%
D.	**EXPORT DUTIES**				
	Cotton	80%	37.5%	45%-50%	-
	Jute	-	-	45%-50%	-
F.	**ESTATE AND SUCCESSION DUTIES**	**-**	**-**	**-**	**-**
G.	**CAPITAL VALUE TAX ON IMMOVABLE PROPERTIES**	**-**	**37.5%**	**45%-50%**	**devolved to provinces**

a. Share of the provinces combined.
b. Excluding taxes on income consisting of remuneration paid out of Federal Consolidated Fund.
c. Provincial share was decided to be 45% for the first financial year and would reach 50% with subsequent increase of 1% per annum.
d. Other than 1/6th of sales tax collected in lieu of zila/octroi taxes to be transferred to the province of origin.
e. Sales Tax on services devolved to provinces

As far as the revenue sharing formula between the provinces is concerned, revenues from the divisible pool of taxes have essentially been distributed among provinces on the basis of their population. The exception has been one-sixths of the sales tax, which was transferred in lieu of octroi/ zila tax (a local government tax abolished in the 90s). This formula has been fundamentally changed in the NFC Award of 2009, with provincial shares

Table 2.3
Revenue Sharing Formula among Federating Units

Award	Tax	Sharing Criteria (Weight)
NFC 1991	Divisible Taxes	Population (100%)
NFC 1996	Divisible Taxes	Population (100%)
Presidential Order 2006	Divisible Taxes	Population (100%)
NFC 2009	Divisible Taxes	Population (82%) Poverty (10.3%) Revenue (5%) IPD* (2.7%)

*Inverse Population Density

computed on the basis of multiple criteria of population, poverty/ backwardness, inverse population density (IPD) and revenue generation/ collection (see Table 2.3). In addition, the province of Khyber-Pakhtunkhwa (K-PK) has been given a 1 percent share in the divisible pool prior to distribution as compensation for costs of the War on Terror. For the first time, revenue sharing formula in the divisible pool is being used to ensure explicitly a degree of fiscal equalization through the inclusion of indicators like backwardness/ poverty and IPD, although the criterion of revenue generation/ collection mitigates somewhat against this. The derived shares of the provinces are presented in Table 2.4.

Table 2.4
Shares of Provinces from the Divisible Pool in Various Awards

(*Percent*)

Province	NFC 1991	NFC 1996	Presidential Order 2006	NFC 2009
Punjab	57.87 (57.87)	57.37 (57.87)	57.37 (57.36)	51.74 (57.36)
Sindh	23.29 (23.29)	23.29 (23.29)	23.71 (23.71)	24.55 (23.71)
KPK	13.54 (13.54)	13.54 (13.54)	13.82 (13.82)	14.62 (13.82)
Balochistan	5.30 (5.30)	5.30 (5.30)	5.11 (5.11)	9.09 (5.11)
TOTAL	**100.00**	**100.0**	**100.0**	**100.0**

Besides divisible pool transfers, the federal government also makes straight transfers to the provinces. Development surcharge, excise duty and royalty on gas and crude oil, and net hydel profits are reverted to the provinces on the basis of collection. The 2009 NFC resolved the outstanding issue of arrears of net hydel profits and development surcharge on gas. It also altered the basis of calculating straight transfers. As a proportion of inter-governmental transfers, straight transfers show a significant increase (see Table 2.5).

Table 2.5
Composition of Transfers from Federal to Provincial Governments

(*Rs in billion*)

	Divisible Pool Transfers	Straight Transfers	Special Grants	Total
1990-91	32.1 (95.0)	1.7 (5.0)	- (-)	33.8 (100.0)
1991-92	47.5 (72.2)	16.3 (24.8)	2.0 (3.0)	65.8 (100.0)
1996-97	119.2 (85.5)	18.2 (13.1)	2.0 (3.0)	139.4 (100.0)
1997-98	104.0 (79.0)	20.3 (15.4)	7.4 (5.6)	131.7 (100.0)
2005-06	244.6 (77.4)	62.8 (19.9)	8.7 (2.7)	316.0 (100.0)
2007-08	403.1 (79.6)	70.6 (13.9)	33.0 (6.5)	506.7 (100.0)
2009-10	574.1 (80.0)	87.2 (12.1)	57.8 (7.9)	689.0 (100.0)
2010-11 (BE)	865.8 (81.0)	197.0* (18.4)	6.0 (0.6)	1068.7 (100.0)

Figures in parenthesis give share in total transfers.
*Inclusive of arrears and the sales tax on services like telecommunications.

Inter-governmental transfers have also taken the form of unconditional grants in Pakistan. The 1990 NFC Award gave grants to the provinces to finance their revenue deficits. This created an incentive for provinces to increase their revenue deficits, undermining key principles of financial responsibility and fiscal prudence. The 1996 NFC award promoted the concept of grants/subventions for fiscal equalization to smaller provinces. Special grants were given to the two smaller provinces equivalent to Rs 3.3 billion for K-PK and Rs 4 billion for Balochistan. These grants, which were inflation indexed, were given for five years. In the 2006 Presidential Order, total subvention/grants for provinces were enhanced from Rs 8.7 billion to Rs 27.7 billion, with the provision for further increases linked to growth of net proceeds in the divisible pool. The 2009 NFC has discontinued the use of grants/ subventions as a mechanism of transfers. Only Sindh is getting a Rs. 6 billion grant in lieu of abolition of octroi/ zila tax grant.

To sum up, the 7th NFC award is different from the previous revenue sharing arrangement (the Presidential Order 1, 2006) in the following important ways: the net divisible pool of taxes is larger; the share of the provinces in the divisible pool is higher; the provincial share is divided among the provinces on the basis of multiple criteria with special developments needs of the smaller provinces of K-PK and Balochistan also being taken into account; enhancement in straight transfers; and, finally, all taxes on services have been recognized to be a provincial subject (implying abolition of the federal excise duty levied on services).

Table 2.6
Budgeted Increase in Revenue Transfer to The Provinces due to The 7th NFC Award
(*Rs in million*)

	2010-11
Transfer to Provinces	
Under Previous Revenue Sharing Arrangements (Ad-hoc Presidential Order)	811.6
Under 7th NFC Award	1033.6
Increase	222.0
% Increase	27.3%

To conclude, by and large, intergovernmental transfers between the federation and federating units have evolved within the broad and progressive overriding philosophy of promoting decentralization and fiscally strengthening the provincial governments, which have over the years, and now more so, are expected to play a very important role in the provision of basic social and economic services. The budgeted increase in revenue transfers to provinces due to the 7th NFC Award is presented in Table 2.6. These are budgeted to be higher by Rs. 222 billion in 2010-11 because of the 7th NFC Award. In other words, transfers would have been lower by over 27 percent if revenue sharing in 2010-11 had continued to take place according to the previous revenue sharing arrangement. However, the revenue gains presented in Table 2.5 are those budgeted at the start of the fiscal year 2010-11. An important emerging issue is the actual realization of the gain. Indications after the first eight months in the current year are that the level of transfers will be about Rs 75 billion less than the amount budgeted.

While the new revenue sharing arrangements have transferred more revenues to the provinces, an important question that remains to be answered is the extent to which these will reduce fiscal disparities across provinces.

2.3 Extent of Fiscal Equalization

The Provincial shares in total federal transfers are presented in Table 2.7 in the last four NFC awards, for years just before and after a particular award. Clear patterns emerge from the Table. First, the share of the largest province, Punjab has declined over time. Punjab received over 55 percent of federal transfers just prior to the 1991 NFC award. Thereafter its share has declined, showing a temporary recovery prior to the 1996 NFC award. The share of Sindh has increased significantly in the late 90s and in the earlier part of last decade. K-PK's share in transfers peaked after to the 1991 NFC award, increasing to 19 percent, and has declined thereafter. The 1996 NFC did attempt to restore the province's share but the 2006 arrangements further lowered it. The 2009 NFC attempts to redress this. As far as Balochistan is concerned, both the NFCs of 1991 and 1996 had enhanced the share in federal transfers to above 11 percent but this trend has not been maintained subsequently.

Table 2.7
Share in Total Transfers by Province

(*percent*)

	1990-91 Pre-1991 Award	1991-92 Post-1991 Award	1996-97 Pre-1996 Award	1997-98 Post-1996 Award	2005-06 Pre-2006 Order	2007-08 Post-2006 Order	2009-10 Pre-2009 Award	2010-11 Post-2009 Award [BE]
Total Federal Transfers *(Rs in Billion)*	33.8	65.8	139.4	131.7	316.0	506.7	718.3	1068.7
Punjab	55.3	45.1	51.3	47.0	47.1	47.3	47.2	46.7
Sindh	24.0	23.9	24.9	23.8	30.1	29.8	29.3	26.7
KPK	12.7	19.0	15.9	17.8	14.4	14.8	15.2	17.1
Balochistan	7.9	12.0	7.9	11.4	8.4	8.0	8.3	9.5
Pakistan	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Box 2.1
Have Intergovernmental Fiscal Transfers been Fiscally Equalizing in Pakistan?

	Divisible Pool Transfers	Straight Transfers	Grants	Total Transfers
NFC Award, 1990	Neutral	Yes	No	Yes
NFC Award, 1996	Neutral	Yes	Yes	Yes
Presidential Order, 2006	No	No	No	No
NFC Award, 2009	Yes	No	Yes	Yes

To answer the question as to whether intergovernmental fiscal transfers have been instrumental in removing fiscal disparities across provinces, Pasha & Pasha (2010) estimate the extent of fiscal equalization in different awards. Box 2.1 presents the basic finding of the studies. The authors conclude that there was a breakdown in fiscal equalization in Pakistan prior to the 2009 NFC Award. The adhoc arrangements of 2006 announced by the then President had clearly failed to improve equity in intergovernmental revenue transfers and had, therefore, been unsuccessful in achieving its basic objective. The 1991 NFC award followed by the 1996 and the 2009 NFC awards, have, however, contributed to fiscal equalization. They also conclude that fiscal equalization significantly dampens towards the end of the tenure of a particularly award, highlighting the need for timely announcement of awards. It is important that consensus is developed among the federation and the four federating units so that an agreement can be reached. This can be facilitated by better and more accurate data bases and analysis of indicators and on

incidence of the federal taxes. This requires substantial strengthening of the NFC secretariat in the Ministry of Finance.

2.4 Financial Implications of the 7th NFC Award

As highlighted above, the 7th NFC Award of 2009 envisages substantial enhancement in the transfers to the provinces. It is bound to have a significant effect on the finances of both levels of government. The first set of post-NFC budgets have been announced for 2010-11. Some of the consequences of the Award have become visible. The federal government is pushing for a strong fiscal adjustment by reducing the target for the consolidated fiscal deficit from 6.3 percent of the GDP in 2009-10 to 4 percent originally in 2010-11, as part of the agreement in the on-going SBA with the IMF. This is predicated, first, on a virtually zero growth in federal current expenditure and a modest growth in development expenditure coupled with a relatively strong fiscal effort and, second, on the inability of the provinces to absorb fully the large post-NFC increase in transfers in the short run, thereby leading to a large build up in cash balances of upto one percent of the GDP.

But, a number of questions have risen already with regard to the implications of the radical change in inter-governmental relations after the 7th NFC Award. Has the underlying structural fiscal deficit been raised once-and-for-all by the Award? What is the incentive for the federal government in a democratic dispensation to raise the tax burden and incur the political costs thereof while transferring a major part of the additional revenues to the provincial governments, which may be on the other side of the political divide as is the case currently in the largest province, Punjab? Given the quantum jump in transfers, are the provinces likely to show financial discipline or engage in runaway spending and waste scarce public resources? Should incentives be put in place on top of the Award to promote greater fiscal effort and economy in current expenditure by provincial governments?

Pasha et al (2010) have developed a theoretical framework to attempt an answer to these questions. The key conclusions are:

Federal Governments

- Tax revenues of the federal government have a negative relationship with the share of revenues retained from the divisible pool. Therefore, historically the federal government has tended to enhance its fiscal effort in the aftermath of awards which mandated larger transfers to the provinces. A similar response can also be expected after the 7th NFC Award, which has led to a big decline in retained revenues.
- Current expenditure of the federal government appears to be largely invariant with respect to the share of retained revenues in the divisible pool. There are strong downward rigidities with respect to expenditures on debt servicing, defence and general administration.
- The inability of the federal government to cutback current expenditure, following an Award which transfers more resources to the provinces, is the basic behavioural assymetry which could lead to an increase in the underlying structural fiscal deficit. The other part of this asymmetry is the likely rapid expansion in provincial budgets following the receipt of larger transfers.

- Development expenditure of the federal government does appear to be responsive to the availability of resources. However, there is a process of lagged adjustment here. This implies that the federal PSDP will take some time to come down to the desired size given the fall in growth of net revenue receipts in the first year after the 7th NFC Award.

Provincial Governments

- There is a negative relationship, between provincial own tax revenues and the level of transfers from the divisible pool. The provinces are inclined to slacken their fiscal effort in the event of a favourable award, like the latest dispensation. This is another factor which contributes to an increase in the consolidated fiscal deficit. However, the magnitude of the behavioural response is small. A one-rupee increase in transfers leads to a five-paisa fall in provincial tax revenues.
- Current expenditure of provincial governments appears to respond quickly and strongly to larger transfers. A one-rupee increase in transfers leads to a more than 40 paisa rise in current expenditure.
- The combined ADP of the provincial governments also appears to be linked to the size of the revenue surplus, which is likely to be larger when transfers increase. However, there is a process of lagged adjustment here indicating that, especially in the case of the smaller provincial governments, there are short-run limits to absorption capacity, in terms of implementation of a larger portfolio of projects.

Results of the empirical analysis of past fiscal behaviour indicate that in the aftermath of an Award which expands the share of provinces, the consolidated fiscal deficit tends to rise because there is, first, no corresponding cutback in federal current expenditure, second, the fall in the size of the PSDP is accomplished with some time lag, and third, provincial current expenditure rises rapidly in response to larger transfers. This impact is somewhat moderated by the launching of a more intensive fiscal effort through tax reforms by the federal government to at least partially make up for the loss in net revenue receipts. Also, provincial ADPs take some time to fully adjust upwards. The net impact on the overall fiscal deficit of the Award has been projected to be Rs 48 billion. That is, the fiscal deficit in 2010-11 is likely to be 0.3 percent of the GDP higher than it would have been in the absence of the 7th NFC Award.

Incentive Scheme for Provincial Government

The basic factors contributing to increase in the fiscal deficit are the decline in the fiscal effort of provincial governments and a big increase in expenditure in the anticipation of larger transfers mandated by the NFC Award. One way in which this tendency can be mitigated is to provide an incentive to provincial governments as part of the Award in the form of a matching grant equal to the increase in self-financing of expenditure in relation to some minimum benchmark level, which will, of course, depend on the fiscal capacity of a particular provincial government. The theoretical framework developed by Pasha & Pasha (2010) undertakes an analysis of such an incentive package on the fiscal behaviour of the provincial governments.

The authors conclude that a matching grant linked to increase in self-financing will reduce the negative effects of the increase in transfers following an Award. It is recommended that such a scheme be put in place as part of the NFC Award, if not in the present award then in

the next Award. The 11th Finance Commission of India has incorporated the same type of incentive with a view to provide for better financial management and greater fiscal discipline. As such, 7.5 percent of the revenues to the states is to be shared on the basis of the measure of financial discipline corresponding to the ratio of own revenue receipts to total revenue expenditure.

2.5 Conclusions and Policy Implications

Clearly the nature of public finances of Pakistan has changed substantially due to the 7th NFC Award. It constitutes a level of fiscal decentralization which can be viewed as a great 'opportunity' for the provinces to improve the well-being of their residents. However, it is important to realize that this opportunity has been created by the federal government at some cost to its own finances. Therefore, it is essential that this 'opportunity' really gets translated into welfare gains and is not wasted. For this to be achieved, the onus is on the four provincial governments. Behavioural consequences over time are likely to be the following:

1. There will be a shift of development focus from the federal government to the provinces. The provinces combined are budgeted to carry out development programme approaching Rs 340 billion in 2010-11, exceeding significantly the federal PSDP budgeted at Rs 280 billion, and recently brought down to Rs 180 billion. The fast growth in development spending by provinces will require enhancement in capacity to design, execute and manage a larger portfolio of projects. The absorption capacity of the provinces, particularly the smaller provinces, will need to be significantly strengthened. Also, given that social services are mostly in the provincial domain, prospects for higher outlays on education and health have improved. This could confer more direct benefits to the people.
2. For the medium term consequences to be favourable, the following conditions need to be fulfilled:
   - It is important that given the higher transfers from the federal government, provinces do not slacken their own fiscal effort. The additional transfers should essentially supplement and not substitute for provincial own revenues. Provinces, particularly the bigger provinces, have two large and buoyant tax bases under their fiscal jurisdiction, real estate and agricultural income. Proper exploitation is essential not only to enhance the overall federal and provincial consolidated tax-to-GDP ratio but also to make the burden of tax system more equitable. This subject will be taken up in the subsequent section.
   - Provinces must avoid profligacy in current expenditures. Prudent spending strategy is an important pre-requisite for the realization of the 'opportunity' that the 7th NFC has opened up. Additional resources should increasingly be used for development and largely routed towards backward regions and pro-poor sectors.
   - The provinces may develop MTDFs, taking into account the additional funding available. These will help the provinces strategize and prioritise their development priorities, facilitate proper planning and management of spending and, very importantly, route spending in accordance to the development needs of their province thereby avoiding ad-hocism and populism. Also, the MTDF's should feed into the 10th Five Year Plan which the Planning Commission is in the process of preparing. Proper dovetailing of the planning exercises at the federal and provincial level will

enhance the credibility of the exercise and ensure development outlays which are essential to enhance the growth potential of the country.

The 7th NFC Award also has significant implications for the federal government, which are as follows:

- It is clear that following transfer to the provinces, the federal fiscal position has deteriorated. The increase in the underlying structural deficit by 1.4 percent to 6 percent of GDP is clearly untenable. The structural deficit has to be brought down. The first thing that has to be done is to cutback federal current expenditures. There is, of course, a non-discretionary component in the federal current spending like debt servicing and defence. The federal government will have to focus on how best to achieve some savings in federal spending?
- Sharper prioritization of the federal PSDP has become indispensible. Considering that the focus for development has largely shifted to the provinces, pruning of development programme at the federal level is essential. Currently, the throw-forward of federal projects is over Rs 3 trillion. With an annual PSDP of less than Rs 200 billion, projects on an average will take fifteen years to complete. Approval of New projects in CDWP/ECNEC should be stopped for some time unless such projects have very high priority.
- The linchpin in the strategy to keep the federal fiscal position sustainable is to enhance the level of resource mobilization. The country is stuck at a tax-to-GDP ratio of less than 10 percent, even at times when the tax bases grew in real terms in excess of 7 percent. In fact, the tax-to-GDP ratio has shown a tendency to decline in recent years. The strategy of resource mobilization has to focus on base broadening and improvements in tax administration.
- Effective functioning of the NFC Secretariat is also necessary. The provinces now have to play a very strong role in the national development scenario. The NFC Secretariat will not only have to keep a database of provincial finances but be pro-active in communicating best practices, special policies and innovations taken by state governments both nationally and internationally. The purpose is, of course, not to step in on provincial autonomy but to support and strengthen the federating units. The NFC Secretariat has to play a supportive role to the NFC Committee, with the Federal Finance Minister and the four provincial Finance Ministers.

CHAPTER 3
OVERVIEW OF PROGRESS

3.1 Timeline of Devolution

Devolution under the 18th Amendment is planned in three phases. Phase I was completed in December 2010; Phase II is to be completed in April 2011. Phase III is underway and is due to be completed by June 2011. In the first phase, five ministries/divisions were devolved, in the second phase another five will be devolved, while the remaining eight divisions are expected to be devolved in the third phase as indicated below:

Phase I	Phase II	Phase III
1. Ministry of Special Initiatives	6. Education	11. Food and Agriculture
2. Zakat and Ushr	7. Social Welfare and Special Welfare	12. Health
3. Youth Affairs	8. Livestock and Dairy Development	13. Labour and Manpower
4. Population Welfare	9. Culture	14. Woman Development
5. Local Government and Rural Development	10. Tourism	15. Sports
		16. Statistics Division
		17. Environment
		18. Minorities Affairs

In addition to the Ministries/ Divisions earmarked for transfer to Provincial governments some subjects (selected functions within Ministries that will continue to exist at federal level) have also been selected for devolution. These include the following:

- Phase II: Ministry of Interior (Arms, Act), Ministry of Law and Justice, Ports and Shipping (inland waterways), Communication, Finance (State lottery), etc.
- Phase III: Initiatives that have a trans-provincial nature

The size of the federal secretariat would be reduced by 15 ministries/18 federal divisions, by the end of June this year, thus reducing the number of federal divisions from 50 to 32 (See Box 3.1).

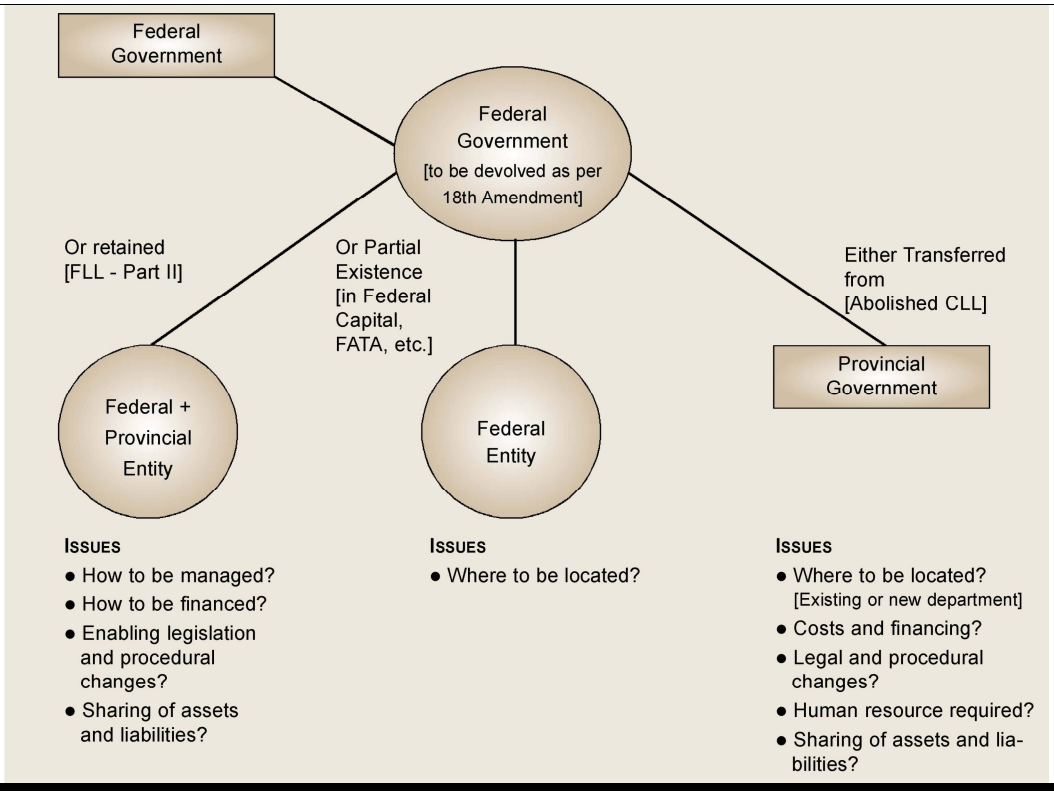
3.2 Emerging Issues

Devolution of the selected subjects is a complex task. A number of decisions have to be taken for smooth transfer and subsequent smooth functioning of the subjects. This is extremely important if quality of service delivery is not to be compromised in the post 18th Amendment era. Chart 3.1 presents the flow chart of some of the key decisions to be taken in the process of devolution. The 18th amendment has decreed that the devolved subjects are: (i) joint responsibility of the federal and provincial governments, (ii) partially retained at the federal level (as in the case of Islamabad, FATA etc), or (iii) devolved to the provinces. In each of the above cases a number of questions have to be answered, such as, how will the function be managed? How will it be financed? Does the enabling legislation exist? What changes in laws and procedures are involved? What will be the human resource requirements for providing uninterrupted service at the provincial level? How will any assets and liabilities be shared?

Box 3.1
Federal Ministries and Divisions Pre and Post 18th Amendment

Pre 18th Amendment	Post 18th Amendment		
	Phase I	Phase II	Phase III
1. Cabinet Secretariat	✓	✓	✓
- Cabinet Division	✓	✓	✓
- Establishment Division	✓	✓	✓
2. Planning and Development	✓	✓	✓
3. Commerce	✓	✓	✓
4. Culture	✓	×	×
5. Defence	✓	✓	✓
6. Defence Production	✓	✓	✓
7. Economic Affairs & Statistics			
- Economic Affairs Division	✓	✓	✓
- Statistics Division	✓	✓	×
8. Education	✓	×	×
9. Environment	✓	✓	×
10. Finance & Revenues			
- Finance Division	✓	✓	✓
- Revenue Division	✓	✓	✓
11. Food & Agriculture	✓	✓	×
12. Foreign Affairs	✓	✓	✓
13. Health	✓	✓	×
14. Human Rights	✓	✓	✓
15. Housing & Works	✓	✓	✓
16. Industries & Production	✓	✓	✓
17. Information and Broadcasting	✓	✓	✓
18. Information Technology	✓	✓	✓
19. Inter-Provincial Coordination	✓	✓	✓
20. Interior*	✓	✓	✓
21. Kashmir Affairs & Gilgit Baltistan	✓	✓	✓
22. Labour & Manpower	✓	✓	×
23. Law, Justice & Parliamentary Affairs	✓	✓	✓
24. Labour and Manpower	×	×	×
25. Livestock & Dairy Development	✓	×	×
26. Minorities	✓	✓	×
27. Narcotics Control	✓	✓	✓
28. Overseas Pakistanis	✓	✓	✓
29. Petroleum & Natural Resources	✓	✓	✓
30. Population Welfare	×	×	×
31. Post	✓	✓	✓
32. Ports & shipping	✓	✓	✓
33. Privatization			
- Privatization Division	✓	✓	✓
- Board of Investment	✓	✓	✓
34. Railways	✓	✓	✓
35. Religious Affairs	✓	✓	✓
36. Science & Technology	✓	✓	✓
37. Social Welfare & Special Education	✓	×	×
38. Sports	✓	✓	×
39. Special Initiatives	×	×	×
40. States & Frontier Affairs	✓	✓	✓
41. Textile	✓	✓	✓
42. Tourism	✓	×	×
43. Water & Power*	✓	✓	✓
44. Woman Development	✓	✓	×
45. Youth Affairs	×	×	×
46. Zakat and Ushr	×	×	×
Total 50	**45**	**40**	**32**

Chart 3.1
Flow Chart of Decisions to be taken in the Process of Devolution



These issues are complicated but need resolution. As an example, we cite the case of Ministry of Labour and Manpower. An emerging issue in the devolution of this Ministry is that federal and provincial governments differ over distribution of assets owned by the Worker Welfare Fund (WWF) and the Employees Old-Age Benefits Institution (EOBI). Financial deposits of WWF were estimated at Rs. 81 billion, while EOBI has assets worth Rs. 148 billion. These two institutions come under the Ministry of Labour and Manpower. The transfer of the ministry to the provinces is scheduled to take place by the end of March, but the issue is likely to drag on till June. Subjects such as labour welfare, provident funds, health insurance and old-age pensions are scheduled to be shifted to all provinces by June this year.

WWF provides grants to worker welfare boards, constituted in each province, to execute welfare projects. The Federal Board of Revenue (FBR) annually deducts two per cent of total income of all registered industrial units, whose income exceeds Rs. 500,000; the deducted amount is placed at the disposal of WWF for utilization. Similarly, FBR collects five percent of worker wages in an industry, to be paid by the employer, and one percent of wages, to be paid by the worker. These funds are placed at the disposal of EOBI which utilizes these funds for payments such as old-age pension, old-age grant and invalidity pension.

Since the adoption of 18th Amendment, discussions have been under way to decide on the devolution of organizational structure of WWF and EOBI, with allocation of their human resources and funds as well as distribution of existing assets to the provinces. As discussions are taking place over distribution of moveable and immovable assets, the Punjab government advocates distribution based on the location of registered industrial units

and workers. On the other hand, the Sindh government is making the case for distribution to be based on source of collection and deduction of welfare fund and pension, as head offices of most of the industrial units registered under the two organizations – WWF and EOBI – are located in Karachi. Khyber-Pakhtunkhwa and Balochistan governments have preference to continue with the use of the existing formula, under which both provinces are receiving comparatively higher funds.

Box 3.2
Departments Attached to the Devolved Ministries/ Divisions

Ministry of Youth Affairs
- National Internship Program
- National Volunteer Movement

Ministry of Labor and Human Resource
- Central Inspectorate of Mines (CIM)
- Directorate of Dock Workers Safety (DDWS)
- Directorate of Workers Education (DWE)
- Implementation Tribunal for Newspaper Employee (ITNE)
- Labour Market Information System and Analysis Unit
- National Institute of Labour Administration Training (NILAT)
- National Talent Pool (NTP)
- National Training Bureau (NTB)
- Overseas Pakistanis Foundation
- Pakistan Manpower Institute (PMI)
- Workers Welfare Fund (WWF)
- Employees Old Age Benefit (EOBI)

Ministry of Tourism
- Pakistan Tourism Development Corporation

Ministry of Social Welfare
- Directorate General of Special Education
- National Council for Rehabilitation of Disabled Persons
- National Council of Social Welfare
- National Trust For Disabled
- Trust for Voluntary Organizations (TVO)

Ministry of Environment
- National Energy Conservation Centre (ENERCON)
- Pakistan Environmental Protection Agency (Pak EPA)
- Pakistan Forest Institute (PFI) Peshawar.
- Zoological Survey Department (ZSD)

Ministry of Health
- Central Health Establishment
- Directorate of Malaria Control, Islamabad
- Federal Government Services Hospital, Islamabad
- Jinnah Postgraduate Medical Center, Karachi
- National Institute of Child Health, Karachi
- Pakistan Institute of Medical Sciences, Islamabad

Ministry of Education
- Federal Directorate of Education (FDE), Islamabad
- Department of Libraries, Islamabad

Ministry of Agriculture
- Agricultural and Livestock Products Marketing and Grading Department (ALPMGD)
- Agriculture Policy Institute (API)
- Department of Plant Protection (DPP)
- Directorate General of Food
- Directorate of Food Accounts
- Federal Seed Certification and Registration Department (FSC&RD)
- Pakistan Agricultural Storage and Services Corporation (PASSCO)
- Pakistan Agriculture Research Council (PARC)
- Pakistan Central Cotton Committee (PCCC)
- Pakistan Oil Seed Development Board (PODB)
- Soil Survey of Pakistan (SOP)

Another important question that arises in the process of devolution relates to the autonomous bodies and attached departments under ministries/divisions. Box 3.2 presents the list of departments/autonomous bodies affiliated with the devolved ministries. Devolution of the ministries will require decisions regarding the location of these bodies as well. Autonomous bodies such as PTDC are likely to be contentious as provinces are demanding equitable distribution of assets.

Box 3.3
Functions (Earlier Allocated to The Devolved Ministries/Division)
Relocated at The Federal Level

	Transferred From	Functions	Transferred to
1	Local Government and Rural Development Division	I. Akhter Hameed Khan National Centre for Rural Development, Islamabad	Establishment Division
		II. People Work Program (Rural Development Program)	Cabinet Division
2	Population Welfare Division	I. Planning and Development	Planning and Development Division
		II. Dealing and Agreement with other countries and international organizations in matters relevant to population planning program	Economic Affairs Division
		III. Collection maintenance and other analysis of demographic and population statistics.	Statistics Division (Federal Bureau of Statistics)
		IV. Mainstreaming population factor in development planning process in ICT, GB,AJK and FATA	Interior Division KA&GB Division , SAFRON Division
		V. Matters relating to national interest for population welfare and National Institute of Population Studies	Planning and Development Division
		VI. Directorate of central warehouse and supplies Karachi.	Planning and Development Division
3	Special Initiative Division	I. Pakistan Dairy Development Company (PDDC)	Food and Agriculture Division
		II. Federal Project Management Unit (PMU) of Clean Drinking Water initiative	Planning and Development Division
4	Youth Affairs Division	I. All international aspects of youth affairs including negotiations for bilateral and multi-lateral agreements for mutual assistance, and	Economic Affairs Division
		II. Cooperation in this field and coordination of aid and assistance from foreign countries for youth affairs	Economic Affairs Division
		III. Youth Centers /Hotels located in federal capital	ICT Administration /Interior Division
		IV. National Internship program	Establishment Division
		V. National Volunteer Movement	Establishment Division
		VI. Youth Centers and Hotels in Islamabad	Central Administration and Development Division
5	Zakat and Ushr Division	I. Collection of Zakat and Ushr Disbursement of Zakat and Ushr to provinces and other areas as per formula approved by CCI	Religious Affairs Division
		II. Management and Distribution of Zakat and Ushr in the ICT, GB, AJK and FATA and the related/ancillary matters including distribution setup and monitoring/ auditing thereof	Interior division KA&GB Division SAFRON Division
		III. Management and Distribution of Zakat and Ushr in Islamabad	Central Administration and Development Division
6	Culture	I. Lok Virsa and Pakistan National Council of Arts, Texila Museum	Ministry of Information and Broadcasting
		II. Texila Museum, National Museum Karachi, Flagstaff House Karachi	Islamabad Capital Territory Division
		III. Pak-China Cultural Centre at Islamabad, National Monument and adjoining museums at Shakarprian	Capital Development Authority
		IV. Central Board of Film Censors, Islamabad	Central Administration and Development Division
		V. Department of Archaeology and Museums, Islamabad	Central Administration and Development Division
7	Education	I. Aiwan-e-Iqbal Lahore, Iqbal Academy and Quaid-i-Azam Academy, Quaid-i-Azam Papers Cell	Cabinet Divison
		II. All federal schools and colleges, Islamabad	Islamabad Capital Territory
		III. Academy of Education Planning and Management, Islamabad	Central Administration and Development Division
		IV. Department of Libraries	Central Administration and Development Division
		V. Federal Board of Intermediate and Secondary Education, Islamabad	Central Administration and Development Division
		VI. Federal Directorate of Education and Education in the Capital	Central Administration and Development Division
		VII. FG Polytechnic Institute of Women, Islamabad	Central Administration and Development Division
		VIII. National Education Assessment Centre, Islamabad	Central Administration and Development Division
		IX. National Institute of Science and Technical Education (NISTE), Islamabad	Central Administration and Development Division
		X. Private Education Institutions Regulatory Authority	Central Administration and Development Division
8	Health	PIMS and Policlinic, Islamabad	Central Administration and Development Division
9.	Livestock and Dairy Development	I. Animal Quarantine Department /Stations/Facilities, in Islamabad	Islamabad Capital Territory Division
		II. National Veterinary Laboratory, Islamabad	Central Administration and Development Division
10.	Social Welfare and Special Education	I. Charitable endowments for Federal Area	Central Administration and Development Division
		II. Directorate General of Special Education, Social Welfare, Child Welfare and Development, Islamabad	Central Administration and Development Division
		III. Training and education and rehabilitation of disabled in Islamabad	Central Administration and Development Division
11	Tourism	Department of Tourist Services in Islamabad	Central Administration and Development Division

To facilitate the implementation of the devolution process and address such issues an Implementation Commission (IC) has been established. The IC is chaired by Senator Raza Rabbani and comprises eight members from different political parties. In total, 42 meetings of the IC have been held, four of which were directly chaired by the Prime Minister. The IC will function till June 30, 2011. To facilitate its working, IC has formed committees to support the work on different aspects, for example, there is a Finance Committee headed by Senator Ishaq Dar which has three members. IC will have to resolve the issues arising in the context of each subject on a case to case basis. In the case of ten ministries devolved so far, certain functions have been relocated at the federal level as presented in Box 3.3. The location has to be thought through. For example, in the second phase a wide range of functions (including film censor, education, health, livestock) has been devolved to the Central Administration and Development Division, which will, it appears, function like a mini government. There is need for proper specification of principles to decide on the location of particular subjects. The principles have to be based on economic and administrative criteria, and should ensure efficient delivery of functions, be transparent and ensure cost effectiveness.

The provincial governments have also formed their own committees to work out the absorption strategy of the devolved subjects. Punjab appears to be somewhat ahead of the other provinces. The province has made the strategic decision to locate 47 devolved subjects to 21 provincial departments (see Box 3.4); identified federal laws with major/ minor amendments or new enactments required to be adopted by provincial governments for the devolved subjects; out of 72 laws that needed to be modified, 42 have been changed, and of these 27 laws have been approved by the cabinet. Rules of business, 2011 have been framed in the light of the 18th Amendment and have also been approved by the cabinet.

3.3 Financing of New Responsibilities

As identified in the earlier section, financing of the devolved subjects is an important issue that needs to be resolved. A number of questions arise in this context: what will be the additional recurrent expenditure requirement of the provincial governments to perform these functions? How will the provinces finance these additional expenditures? What is the throw-forward or additional development expenditure liability in the case of schemes/ project underway in the devolved subjects? Do the provinces have the resource surpluses to finance these on-going projects/programs? If not, what options exist to ensure completion of the development schemes/projects? Should indeed all development schemes initiated by the federal government be taken on by the provincial governments?

Answers to the above questions have to be agreed upon by both the federal and provincial governments prior to the devolution. If this is not done, the danger is that the quality of service provision will fall, directly affecting the people in the process of implementation of the 18th amendment.

Current Expenditure

What will be the additional recurrent expenditure requirement of the provincial governments to perform the devolved functions? The way to assess this is to see what was budgeted for the devolved subjects at the federal level in 2010-11, prior to their devolution. Table 3.1 presents the current expenditure budgeted in 2010-11 for the devolved ministries. The five ministries already devolved are budgeted to incur current expenditure of Rs. 4.2 billion in 2010-11, Rs. 0.3 billion of which is employee related while the remaining, Rs. 3.9 billion is on other operating expenses. For these five devolved subjects, employee related expenditure is

only 6.5 percent of the additional recurrent liability. Largest recurrent liability is associated with the second phase of devolution. The current expenditure on the five ministries to be devolved in this phase is budgeted at Rs 31.5 billion in 2010-11. For these ministries, the employee related expenses are somewhat higher in proportionate terms (11 percent of total) compared to the ministries devolved in the first phase. The highest recurrent expenditures is by Higher Education Commission (HEC) accounting for over Rs. 23 billion.

Box 3.4
Subjects transferred to departments in Punjab in the wake of the 18th amendment, Punjab

Sr. #	Name of the Department	Subjects transferred
1	Population Welfare	Population Planning
2	Information, Culture & Youth Affairs	I. Newspapers, books and printing presses
		II. Ancient and historical monuments, archaeological sites and remains.
3	Labour & Human Resources	I. Welfare of labour; condition of labour, provident fund, employer's liability and workmen compensation, health insurance including invalidity pensions, old age pensions.
		II. Trade Union, industrial and labour disputes
		III. Setting up and carrying on of labour exchanges, employment information bureaus and training establishments
		IV. Regulation of labour and safety in mines, factories and oil fields
4	Literacy & Non-Formal Basic Education	Curriculum, syllabus, planning, policy, centers of excellence and standards of education except standards in institutions for higher education and research, scientific and technical institutions
5	Tourism	Tourism
6	Board of Revenue	I. Bankruptcy and insolvency II. Trusts and trustees III. Transfer of property IV. Evacuee property V. Duties in respect of succession to property VI. Estate duty in respect of property VII. Capital gains on immovable property
7	Auqaf	I. Islamic education II. Auqaf
8	Excise &Taxation	I. Opium, so far as regards cultivation and manufacture II. Poisons and dangerous drugs
9	Zakat & Ushr	Zakat
10	Transport	I. Shipping and navigation on inland waterways as regards mechanically propelled vessels, and the rule of the road on such waterways; carriage of passengers and goods on inland waterways; and II. Mechanically propelled vehicles
11	Social Welfare & Women Dev.	I. Social Welfare II. Infants and minors adoption III. Unemployment insurance
12.	Livestock & Dairy Dev.	Prevention of the extension from one province to another of infectious or contagious diseases or pests affecting animals
13.	Agriculture	Prevention of the extension from one province to another of infectious or contagious diseases or pest affecting plants
14.	Higher Education	Curriculum, syllabus, planning, policy, centers of excellence and standards of education except standards in institutions for higher education and research, scientific and technical institutions.
15.	School Education	Curriculum, syllabus, planning, policy, centers of excellence and standards of education except standards in institutions for higher education and research, scientific and technical institutions.
16.	Special Education	Curriculum, syllabus, planning, policy, centers of excellence and standards of education except standards in institutions for higher education and research, scientific and technical institutions.
17.	Environment	Environmental pollution and ecology
18.	Health	I. Drugs and medicines II. Prevention of the extension from one province to another of infectious or contagious diseases or pests affecting men III. Mental illness and mental retardation, including places for the reception or treatment of the mentally ill and mentally retarded
19.	Home	I. Arms, firearms and ammunition II. Explosives III. Removal of prisoners and accused persons from one province to another province IV. Preventive detention V. Measures to combat certain offences committed in connection with matters concerning the federal & provincial governments and the establishment of a police force for that purpose. VI. Production, censorship and exhibition of cinematograph films
20.	Law & PA	I. Civil procedure II. Law of Limitation III. Arbitration; IV. Actionable Wrongs (torts) V. Administrator-general VI. Official trustee VII.Contracts
21.	LG&CD	Marriage and divorce

Table 3.1
Current Expenditure on Devolved Ministries / Divisions, 2010-11 (BE)
(*Rs in million*)

S.No	Ministry	Total	Employment Related	Others
	FIRST PHASE			
1	Local Government and Rural Development	143.7	81.7	62.0
2	Population Welfare	242.5	113.9	128.6
3	Special Initiatives	56.0	28.2	27.8
4	Youth Affairs	3707.7	19.9	3687.8
5	Zakat and Ushr	90.0	32.1	57.9
	Sub Total	**4239.9**	**275.7**	**3964.1**
	SECOND PHASE			
6	Culture	649.0	202.4	446.6
7	Education	4316.2	2649.9	1666.2
	(HEC)	23220.0	-	23220.0
	Total Education	27536.2	2649.9	24886.2
8	Livestock and Dairy Development	213.8	103.1	110.6
9	Social Welfare & Special Education	2840.5	449.8	2390.7
10	Tourism	238.3	55.2	183.1
	Sub Total	**31477.8**	**3460.5**	**28017.4**
	THIRD PHASE			
11	Environment	325.4	177.2	148.3
12	Food and Agriculture	1959.3	496.2	1463.1
13	Health	5435.5	1943.2	3492.3
14	Labour and Manpower	396.4	261.7	134.7
15	Minorities Affairs	237.3	22.1	215.2
16	Statistics Division	868.0	591.5	276.4
17	Sports	548.7	20.7	527.9
18	Women Development	99.8	42.1	57.7
	Sub Total	**9870.4**	**3554.7**	**6315.7**
	Grand Total	**45588.1**	**7290.9**	**38297.2**

Subjects scheduled to be devolved in the third phase have budgeted current expenditure of about Rs. 9.9 billion in 2010-11. In this case employee related expenses are budgeted at Rs. 3.5 billion, 35 percent of total current expenditure. Health and Food and Agriculture are the big sectors in this devolution phase. It is important to realize that many of the Ministries/ Divisions which are to be devolved post - 18th Amendment are employment intensive, like education and health and, therefore, will lead to an increase in the non-discretionary component of provincial expenditures.

Overall, if all Ministries/Divisions are devolved to the provinces as they are operating at the federal level, the additional current expenditure liability on the provinces will be Rs. 45.6

billion- Rs 7.3 billion on account of employee related expenses and Rs. 38.3 billion on other operating expenses.

Table 3.2
Province Wise Current Expenditure on Devolved Ministries by the Federal Government 2010-11 (BE)

(*Rs in million*)

	Ministry	Federal	Punjab	Sindh	KPK	Balochistan
	FIRST PHASE					
1	Local Government and Rural Development	130.3	-	13.4	-	-
2	Population Welfare	210.0	15.9	16.7	-	-
3	Special Initiatives	56.0	-	-	-	-
4	Youth Affairs	1966.7	800.0	450.0	480.0	11.0
5	Zakat and Ushr	90.0	-	-	-	-
Sub Total		**2452.9**	**815.9**	**480.1**	**480.0**	**11.0**
	SECOND PHASE					
6	Culture	418.6	68.7	134.4	19.6	7.7
7	Education	11092.1	6435.9	6178.9	2974.5	854.8
	(HEC)	6984.1	6395.1	6011.5	2974.5	854.8
8	Livestock and Dairy Development	98.6	9.1	97.7	4.1	4.3
9	Social Welfare & Special Education	2563.0	124.1	76.3	55.7	21.4
10	Tourism	202.7	8.2	13.8	10.8	2.8
Sub Total		**14375.0**	**6646.0**	**6501.1**	**3064.7**	**891.1**
	THIRD PHASE					
11	Environment	188.4	-	48.2	88.8	**-**
12	Food and Agriculture	1711.0	42.0	207.3	-	**-**
13	Health	3506.9	62.3	1819.0	25.5	**21.8**
14	Labour and Manpower	292.1	33.3	43.7	15.9	**11.4**
15	Minorities Affairs	232.3	1.3	1.2	1.2	**1.3**
16	Statistics Division	365.3	222.4	185.2	61.0	**34.0**
17	Sports	548.7	-	-	-	**-**
18	Women Development	99.8	-	-	-	**-**
Sub Total		**6944.5**	**360.3**	**2304.8**	**192.4**	**68.4**
Grand Total		**23772.4**	**7822.2**	**9286.0**	**3737.0**	**970.5**
% of Total		**52.1**	**17.2**	**20.4**	**8.2**	**2.1**

Given the current regional distribution of these expenditures, about 52 percent is in the domain of the federal government (Islamabad, FATA, Gilgit etc), 17 percent is in the province of Punjab, 20 percent in Sindh, 8 percent in Khyber-Pakhtunkhwa and 2 percent in Balochistan (See Table 3.2). The federal part of expenditure includes costs of running the ministry/division out of Islamabad which will also be devolved. There is of course the possibility that once devolved the expenditure levels change. On the one hand, the provinces could and should attempt to economize on these expenditures by improving the efficiency of spending, thereby maintaining provision with lower expenditures by realizing economies of scale, wherever possible. On the other hand, there may be some loss of spending efficiency in the transition stage and expenditure levels for current levels of service may actually go up. For example, fixed costs of administration due to the presence in each province. At this stage it is very difficult to quantify such possibilities or even assume them. One danger that, however, should be taken into account is that the provinces may cutback on expenditures because of funding constraints, thereby compromising on service levels. This takes us to the question raised earlier, how will the provinces finance these additional recurrent expenditures?

The federal government is making the point that since the recently promulgated 7th NFC Award has significantly enhanced the share of provinces in the national divisible pool, the provinces have got a revenue bonanza and, therefore, should finance the additional recurrent liabilities from the higher revenue transfers.

The provinces on the other hand are making three important points in response. First, the 7th NFC Award preceded the 18th Amendment. The provinces' case of higher vertical transfers from the federal government was based on the higher resource requirement to meet provinces' development targets for existing functional responsibilities. The case made by Punjab, for example, was on the grounds that the province cannot meet its Medium Term Development Framework (MTDF) targets, which are based on international commitments like the Millennium Development Goals (MDGs), given the revenue transfers the province receives as per the previous Award. There is some merit in their argument. Because additional functional allocations to provinces had not been decided, therefore, they could not have influenced the resource allocation decisions in the 7th NFC Award.

Second, the provinces are actually not receiving as big a bonanza of additional revenues as was originally claimed. This is due to the shortfall in federal tax collections during the course of the current year. As the size of pie is smaller, the share going to the provinces' is smaller. Third, the federal government in the budget of 2010-11 unilaterally announced a 50 percent increase in salary and allowances for all government employees. The provinces were not taken into confidence prior to the announcement. Since more than three-fourths of government sector employment is in the provinces, this decision has enhanced provincial current expenditure substantially by over Rs 120 billion annually, thereby, eroding significantly the revenue gains to the provinces in the aftermath of the 7th NFC Award. Therefore, the provinces have made the case that the federal government fully fund the expenditure liabilities created by the devolution of Ministries/Divisions. The precedence

Development Expenditure

Turning next to the development side, currently there are 232 projects which are being implemented at the federal level by the devolved ministries in all the provinces. Out of these, 166 projects can be clearly devolved to the provinces concerned. The throwforward liability of such projects is Rs 67 billion. In addition, 67 vertical projects are also being implemented in the provinces. The liability of these projects is Rs 202 billion. Projects of higher education (including HEC) create a further development liability of Rs 48 billion which can be allocated to the provinces. Therefore, according to first estimates obtained from the Planning Commission, the development expenditure liability on on-going projects that can be devolved to the provinces following full implementation of the 18th Amendment is Rs 317 billion. Out of these Rs 151 billion is in Punjab, Rs 86 billion in Sindh, Rs 52 billion in Khyber-Pakhtunkhwa and Rs 26 billion in Balochistan (See Table 3.3), based on the assumption that the cost of vertical projects is distributed among the provinces on the basis of population shares. The outlay in 2010-11 on projects / programs that can be devolved for the four provinces combined is Rs 41.3 billion.

Table 3.3
Province Wise Summary of Projects/ Vertical Programs in the Devolved Ministries
(*Rs million*)

Province	No. of Projects	Cost	Expenditure	Throw-Forward	Allocation 2010-11	Planned Financing					Total
						2011-12	2012-13	2013-14	2014-15	2015-16	
Punjab	52	33500.1	11062.7	22439.5	3214.8	6166.2	5731.3	4810.5	2865.8	2865.8	22439.6
Sindh	48	29349.0	7997.3	21387.3	2456.4	5694.3	5311.9	4149	3316.4	2915.8	21387.4
Khyber-Pukhtumkhwa	27	18740.3	5663.1	13102.3	1181.3	3766.5	2930.9	3623.9	1908.9	872.0	13102.2
Balochistan	39	14867.1	4963.1	10056.6	1915.4	3439.0	2624.8	2312.8	1680.1	0.0	10056.7
Total	**166**	**96456.5**	**29686.2**	**66985.7**	**8767.9**	**19066.0**	**16598.9**	**14896.2**	**9771.2**	**6653.6**	**66985.9**
VERTICAL PROJECTS*											
Punjab	63	144728.4	32642.4	112086.0	13823.2	26397.8	23571.7	33605.4	28511.1	0.0	112086.0
Sindh	66	63144.7	13155.5	49989.1	6028.5	12161.9	10476.0	14917.2	12434.1	0.0	49989.2
Khyber-Pukhtumkhwa	64	35515.3	7248.1	28268.2	3401.1	7077.2	5846.0	8330.1	7014.9	0.0	28268.2
Balochistan	64	13378.3	1451.5	11924.8	1284.5	3038.4	2586.3	3650.7	2649.4	0.0	11924.8
Total	**257**	**256766.7**	**54497.6**	**202268.1**	**24537.2**	**48675.3**	**42480.0**	**60503.4**	**50609.5**	**0.0**	**202268.2**
TOTAL											
Punjab		178228.5	43705.1	134525.5	17038.0	32564.0	29303.0	38415.9	31376.9	2865.8	134525.6
Sindh		92493.7	21152.8	71376.4	8484.9	17856.2	15787.9	19066.2	15750.5	2915.8	71376.6
Khyber-Pukhtumkhwa		54255.6	12911.2	41370.5	4582.4	10843.7	8776.9	11954.0	8923.8	872.0	41370.4
Balochistan		28245.4	6414.6	21981.4	3199.9	6477.4	5211.1	5963.5	4329.5	0.0	21981.5
Total		**353223.2**	**84183.8**	**269253.8**	**33305.1**	**67741.3**	**59078.9**	**75399.6**	**60380.7**	**6653.6**	**269254.1**
HIGHER EDUCATION											
Punjab	55	25947.7	9144.3	16803.4	3227.9	3360.7	3360.7	3360.7	3360.7	3360.7	16803.5
Sindh	38	22627.2	7429.8	15197.5	2209.1	3039.5	3039.5	3039.5	3039.5	3039.6	15197.6
Khyber-Pukhtumkhwa	32	18041.6	6473.1	11568.5	2001.3	3470.5	3470.5	2313.7	2313.7	0.0	11568.4
Balochistan	12	5441.9	1263.6	4178.3	511.7	1253.5	1253.5	835.7	835.7	0.0	4178.4
Total	**137**	**72058.4**	**24310.8**	**47747.7**	**7950.0**	**11124.2**	**11124.2**	**9549.6**	**9549.6**	**6400.3**	**47747.9**
ICT/ Special Areas	31	23073.7	8612.3	14461.4	2142.3	2892.3	2892.3	2892.3	2892.3	2892.3	14461.5
All Pakistan (Vertical Programmes)	37	54925.8	23161.6	31764.2	5670.2	6352.8	6352.8	6352.8	6352.8	6352.6	31763.8
Grand Total	**205**	**150057.9**	**56084.7**	**93973.3**	**15762.5**	**20369.3**	**20369.3**	**18794.7**	**18794.7**	**15645.2**	**93973.2**
TOTAL INCLUDING HIGHER EDUCATION											
Punjab		204176.2	52849.4	151328.9	20265.9	35924.6	32663.7	41776.5	34737.5	6226.5	151328.9
Sindh		115120.9	28582.5	86574.0	10693.9	20895.6	18827.4	22105.7	18790.0	5955.3	86574.0
Khyber-Pukhtumkhwa		72298.1	19384.4	52939.0	6583.7	14314.3	12247.4	14267.7	11237.6	872.0	52939.0
Balochistan		33685.4	7678.2	26159.7	3711.6	7730.8	6464.5	6799.1	5165.2	0.0	26159.7
Total		**425280.6**	**108494.5**	**317001.6**	**41255.1**	**78865.3**	**70203.0**	**84949.0**	**69930.3**	**13053.8**	**317001.6**

* share of provinces determined by the population ratio.
Source: Planning Commission, Government of Pakistan

Taking a deeper look, for example, into the province of Punjab, the provinces' total ADP was budgeted at Rs. 193 Billion in 2010-11. However, taking into account short fall in federal revenues and thereby revenue transfers to the province and diversion of resources to flood relief, the expected releases for ADP is around Rs 128 billion. The provinces' existing throw forward as of June 2010 was Rs. 639 billion. Following devolution of Ministries/Divisions, the throw forward will further increase. Given the current size of the provincial ADP, this implies that the provinces' development outlays have been pre-empted for about six years. This is a very large commitment. The province has already initiated prioritization of schemes, with emphasis on on-going projects and reduction in the throw forward. In the existing ADP, 2049 out of 3081, (almost 67 percent,) are on-going schemes which are to be completed in 2010-11. Also, the stress is on undertaking projects that can be completed within a year to control the throw forward. Given this, will the province give full priority to devolved projects of recent

vintage? To the extent that these are vertical projects which have a foreign component, the province will perhaps have to carry on with the commitment. But in cases where there is no foreign component, the province should perhaps have the option to evaluate the project and choose its continuation. This will become imminent, particularly, if federal funding is not committed for the project.

In conclusion, we have at the extreme that if the Provincial governments have to, more or less, immediately finance the recurrent and development costs of functions transferred to them then this will lead to an almost 10 percent increase in the level of expenditure incurred last year, as shown in Table 3.4. Given that the additional transfers envisaged under the 7th NFC Award are unlikely to materialize fully and have been largely per-empted by the 50 percent salary hike, it is clear that the Provincial governments will have serious problems in self-financing the devolved functions.

Table 3.4
Impact of Costs of Transferred Functions on the Four Provincial Governments Combined
(*Rs in billion*)

	2009-10	Cost of Transferred Functions, 2010-11	Percentage
Current Expenditure	646.2	45.6 [a]	7
Development Expenditure	258.4	41.3	16
Total	904.6	86.9	10

[a] on the assumption, that there is no change in expenditure
Source: Fiscal Operations, MOF, GoP

CHAPTER 4
AN ASSESSMENT OF
PROVINCIAL RESOURCE MOBILIZATION CAPACITY

The previous chapter has demonstrated that provincial fiscal needs will increase significantly in the aftermath of the 18th Amendment. Clearly, provincial resources will have to be augmented. Since the provinces depend on fiscal transfers in a significant way, resource augmentation partially will have to take place through better fiscal effort by the federal government, at least to the extent stated in the Federal Budget Strategy Paper, 2010-2013. The Paper presents proposals to enhance the tax-to GDP ratio from 9.1 percent in 2009-10 to about 11 percent by 2012-13. Simultaneously, the provinces will also have to enhance revenue mobilization from own sources under their own fiscal jurisdiction. This is absolutely essential in the post devolution structure, whereby provinces have been made prime entities of development in the country and if Pakistan is to get out of the low tax-to-GDP trap.

The overall level of resource mobilization by the four provincial governments of Pakistan from their own tax and non-tax revenue sources has fallen sharply from over 1 percent of the GDP in the early 90s to below 0.8 percent of the GDP in 2009-10. This decline can be attributed to a number of factors. The first is the relatively low revenue potential and/or low elasticity of some revenue sources due either to relatively small and /or slow growing tax bases or because of specific rates of taxes, fees and charges which have not been indexed to inflation. Second, the large transfers from the federal government, which accounted for over 80 to 90 percent of total provincial revenues in 2009-10, have created a 'dependency syndrome' whereby the Provincial governments have been reluctant to incur the political costs of additional taxation, as shown by the tax-free budgets in 2010-11.

The previous section has demonstrated that there is a risk that the fiscal effort of the provincial governments will slacken even more in the presence of the large transfers following the 7th NFC Award. However, the authors of the Award appear to have been cognizant of this risk and were able to get the provincial representatives in the NFC to agree to the following clause:

> 'The NFC recommended that the federal government and the provincial governments should streamline their taxation in order to achieve a 15 percent tax to GDP ratio by the terminal year, 2014-15. Provinces would initiate steps to effectively tax the agriculture and real estate sectors. Federal government and Provincial governments may take necessary administrative and legislative steps accordingly'.

In addition, the 18th Amendment to the Constitution has explicitly transferred the sales tax on services to the provincial governments. Any effort at development of this tax will involve the promulgation of provincial legislation even though the process of collection may remain centralized with the Federal Board of Revenue or be undertaken directly by the provinces.

The objective of this section is to identify the key elements of a provincial resource mobilization strategy which can help raise the consolidated (federal + provincial) revenue to GDP ratio above the currently low level of about 14 percent. This will contribute not only to

overall deficit reduction, but since the provincial governments are the prime agents for delivery of social services, (even more so after the 18th Amendment) it could also lead to higher levels of expenditure on education and health and thereby improve the prospects for attainment of the Millennium Development Goals.

4.1 Provincial Own-Revenue

The four provinces combined are generating Rs. 287 billion from own sources, Rs. 63 billion through tax sources and Rs. 224 billion as non-tax revenues. The growth in tax revenues over the last decade has been moderate, at about 12 percent. (see Table 4.1). Overall, the provincial tax revenue to GDP has declined from 0.55percent in 2000-01 to 0.46 percent in 2009-10. Similarly, the share of provincial own non-tax revenues in total revenue receipts is very low and appears to have shown modest improvement over time. Smaller provinces appear to rely more on non-tax revenues.

Table 4.1
Summary of Provincial Own Revenue Receipts

(*Rs billions*)

	Total Revenue Receipts	Provincial Own Tax Revenue	Share (%)	Provincial Own Non-Tax Revenue	Share (%)
PUNJAB					
2000	98.6	12.1	12.3	13.1	13.3
2005	181.3	19.1	10.6	37.6	20.7
2010	436.5	36.8	8.4	76.2	17.5
Average Annual Growth (%)	16.0	11.8		19.3	
SINDH					
2000	55.9	5.3	9.6	10.8	19.4
2005	102.6	10.6	10.3	16.2	15.8
2010	240.5	22.1	9.2	93.2	38.8
Average Annual Growth (%)	15.7	15.3		24.0	
KHYBER PAKHTUNKHWA					
2000	36.2	1.6	4.4	18.0	49.7
2005	45.3	2.3	5.2	12.7	28.1
2010	133.4	3.5	2.6	53.7	40.3
Average Annual Growth (%)	13.9	8.2		11.5	
BALOCHISTAN					
2000	19.7	0.4	2.3	5.7	29.1
2005	29.0	0.8	2.6	7.7	26.5
2010	44.8	1.1	2.5	1.3	2.9
Average Annual Growth (%)	8.6	9.4		-13.8	
TOTAL					
2000	210.4	19.5	9.3	47.7	22.7
2005	358.2	32.8	9.2	74.2	20.7
2010	855.2	63.5	7.4	224.4	26.2
Average Annual Growth (%)	15.1	12.6	-2.2		

Source: Annual Budget Statements, (various years), Finance Department, Provincial Governments.

Revenues from individual provincial taxes for 2010-11 are presented in Table 4.2.

Table 4.2
Revenues from Individual Taxes in 2010-11

(*Rs billions*)

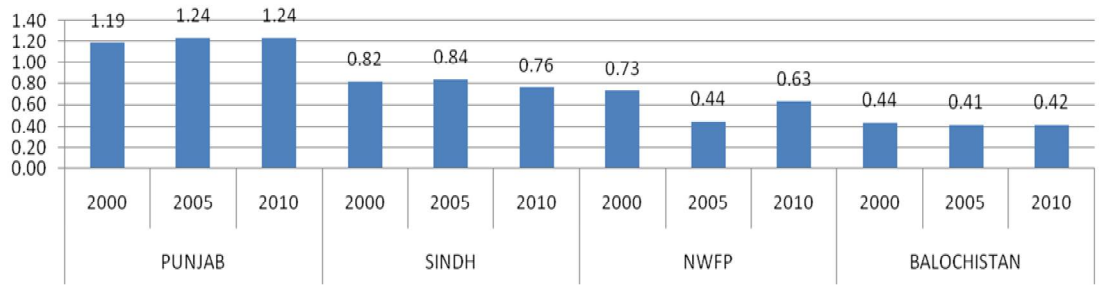
	Punjab	Sindh	KPK	Balochistan	Combined
Direct Taxes	**17.8**	**4.15**	**1.04**	**0.25**	**23.2**
AIT	1.2	0.22	0.02	-	1.4
UIPT	4.4	-	0.08	0.07	4.6
Land Revenues	6.9	0.25	0.76	0.1	8
Registration	3.3	0.9	0.07	0.08	4.4
Tax on PCT	0.5	0.28	0.11	0.001	0.9
Capital Value Tax	1.5	2.5	-	0.001	4
Indirect Taxes	**73.8**	**52.4**	**2.17**	**0.98**	**129.3**
GST on Services	51.2	25	-	-	76.2
Motor Vehicle Tax	6.5	3.8	0.98	0.37	11.6
Stamp Duties	10.2	6.6	0.55	0.16	17.5
Electricity Duty	4	0.6	0.34	-	4.9
Others*	1.9	16.4	0.39	0.45	19.1
Total	**91.6**	**56.5**	**3.21**	**1.23**	**152.5**

Source: Provincial Budget Documents
* Include tax on opium, provincial excise, entertainment tax, development cess on hotels and cotton fee

4.2 Relative Fiscal Effort by Provincial Governments

Punjab has the highest fiscal effort among the provinces which has gradually improved over time (see Chart 4.1). The fiscal effort of other provinces including Sindh has been much lower. Sindh has been successful in maintaining an overall revenue growth of 24 percent primarily through imposition of a sizable infrastructure maintenance fees (Rs.13 billion in 2010-11) that it charges from the users of Karachi Port. This implies a degree of 'tax exporting' to other provinces. Overall index for fiscal effort of Sindh has dropped to 0.76 in 2010. Fiscal effort of Khyber-Pakhtunkhwa has also tended to decline, probably due to military operations on account of insurgency and war on terrorism. Balochistan has shown no improvement in its fiscal effort.

Chart 4.1
Overall Index for Fiscal Effort (IFE)



Source: Calculated using the Representative Tax approach by Hussain,E(2010).

Turning to non-taxes, the level of cost recovery, even in the case of economic services is abysmally low as shown by Table 4.3 (Hussain (2010)). Overall provinces recover less than 5 percent of the recurring expenditures on service. The highest level of recurrent cost recovery is for community services and irrigation. In these cases also the extent of recovery of costs is less than one-fourths. There is clearly a case for enhancing cost recovery in all the provinces.

The provinces will have to embark on a strategy to mobilize higher own revenues. Candidate tax sources with high potential in Punjab and Sindh are discussed below.

Table 4.3
Cost Recovery Index*

(*percent*)

	PUNJAB		SINDH		KHYBER PAKHTUNKHWA		BALOCHISTAN		TOTAL	
	2000	2010	2000	2010	2000	2010	2000	2010	2000	2010
General administration	2.0	0.4	1.3	0.5	3.0	0.3	0.1	0.1	1.7	0.4
Law and order	8.2	4.4	7.2	4.2	7.9	2.3	2.5	2.8	7.3	3.9
Community services	14.5	54.9	3.6	10.7	13.5	46.0	1.7	1.9	9.6	24.4
Social services	2.9	2.5	2.1	1.7	4.0	6.3	0.5	1.6	2.7	2.4
i) Education	2.3	3.5	2.0	2.5	3.5	2.1	0.3	0.3	2.3	2.8
ii) Health	2.6	1.9	2.4	0.8	6.3	5.0	1.3	2.8	3.1	2.0
Economic service	33.8	13.1	22.3	5.5	22.3	22.0	13.3	22.7	27.4	12.8
i) Agriculture	10.2	7.7	6.2	1.8	13.0	10.8	18.4	6.7	10.5	5.4
ii) Irrigation	47.4	40.1	49.0	10.9	22.5	19.2	17.0	2.8	43.2	22.2
OVERALL	**8.2**	**5.8**	**5.5**	**2.9**	**6.9**	**4.8**	**2.7**	**5.4**	**6.8**	**4.8**

Source: Hussian, E.(2010)
* Non-Tax Revenue Receipts /Current Expenditure

4.3 Development of Taxes on Agriculture

As highlighted above, the provincial governments are expected to effectively tax agriculture as per the relevant clause in the 7th NFC Award. Currently, there are various levies on agriculture including land revenue (on land ownership), stamp duty and CVT (on land transactions), agricultural income tax (AIT) and a cotton fee (in Punjab). It is difficult to allocate stamp duties to transactions in agricultural land. But it is clear that provincial taxes on agriculture today account for less than one percent of the value added by the sector in Pakistan.

The popular demand currently is for the effective imposition of the agricultural income tax, the absence of which is seen as a violation of the principle of horizontal equity in taxation. Some political parties have argued that imposition of the RGST should be preceded by development of the AIT. Therefore, one of the imperatives for development of AIT is that this has become necessary to improve the overall level of tax compliance in the country. Second, due to the jump in international commodity prices and domestic support/procurement prices, agricultural incomes have risen rapidly implying now greater ability to pay taxes.

The first attempt to levy an AIT was made by the Caretaker Government of Mr. Moeen Qureshi in 1993 under an Ordinance. The tax was linked to the Produce Index Units (PIUs) of land and was, therefore, presumptive in nature. However, the Ordinance was not ratified by the successor elected government and lapsed after 120 days.

The legislative enactment of AIT was undertaken in 1996-97 when the provincial governments promulgated the AIT Act. Some provisions of the Punjab version of this Act (with subsequent amendments after 1997) are presented in Box 4.1.

Box 4.1
Provisions of Punjab AIT Act

1. Imposition of the tax is justified in the preamble on the grounds that the Constitution of Pakistan envisages the creation of an egalitarian society based on the Islamic principles of social justice.
2. The Act is in twelve sections and has two schedules.
3. 'Agricultural income' means any rent or revenue derived from any land which is used for agricultural purposes.
4. The charge of AIT is determined either on the basis of the presumed income as per the First Schedule or assessed net income as per the Second Schedule, whichever is greater.
5. The exemption limit in the first schedule is $12\frac{1}{2}$ acres of agricultural land cultivated or 25 acres of unirrigated land. The exemption limit in the second schedule is Rs 100,000 of total income.
6. A person who has cultivated land measuring either fifty acres or more of irrigated land or one hundred or more acres of unirrigated land or irrigated and unirrigated land the aggregate area of which is equal to or more than fifty acres of irrigated land (one acre of irrigated land being reckoned as equivalent to two acres of unirrigated land) must file a return of agricultural income.
7. In computation of agricultural income, a number of allowances and deductions are admissible including labor cost, costs of inputs, hiring of equipment, costs of harvesting and marketing, payment of utility bills, mark up on loans, local taxes, cesses and rates, depreciation and capital expenditure.
8. Failure to file a return carries a maximum penalty of Rs 1000. The penalty on concealed income is 100%. The penalty for default in payment is 5 percent per annum.
9. No civil court shall have the jurisdiction in any manner relating to the assessment or collection of the tax leviable under this Act.

The implications of the provisions in the Act are as follows:

- Currently the net income per irrigated acre of cultivated land is between Rs 25000 to Rs 30000. Therefore, if the principle is to apply the same exemption limit of Rs 300,000 (as in the Federal Income Tax Act) to all types of income, then the exemption limit in the first schedule looks reasonable whereas the exemption limit in the second schedule will have to be enhanced from Rs 100,000 to Rs 300,000.
- The AIT appears to be presumptive in nature for persons cultivating land equivalent to a minimum of 12 acres to a maximum 50 acres of irrigated land. For such persons, the first schedule applies. For persons cultivating land in excess of 50 acres of (equivalent) irrigated land, either the first or the second schedule applies, whichever implies a higher tax payment.
- The presumptive tax rates per acre in the first schedule are very low at Rs 150 to Rs 250 per acre. They are equivalent to less than one percent of the average net agricultural income per acre. They have also remained unchanged since 2003.
- There is a case for their enhancement to Rs 750 per acre upto 25 acres and to Rs 1250 per acres beyond 25 acres, with the proviso that the tax is only applied on acreage in excess of 12 acres.
- The penalties are remarkably small. For example, the penalty for non-filing of a return is only up to a maximum of Rs 1000. This needs to be substantially raised to, say, Rs

10000 or so. Also, the penalty for default in payment should be changed at, say, 15% per annum. Further, the tax liability under AIT may be made chargeable as arrears of land revenue.

Overall, the AIT yields only about Rs 1 billion in Punjab and less than Rs 2 billion in the whole of Pakistan. But legislation for levy of AIT exists since 1996 and there have been a number of amendments since then. If changes of the type identified above are brought in the Acts and collection efficiency is improved, then the tax could yield nationally Rs 10 billion to Rs 15 billion. From the viewpoint of improving taxpayer compliance, 50 % of the tax collected from a person could be reverted to the Zila Council of the district in which he/she is located.

4.4 Development of Taxes on Real Estate

This is the second area of taxation which the provincial governments are committed to develop as per the 7th NFC Award. Provincial taxes on real estate currently include the stamp duty, tax on transfer of property, the capital value tax (on property transactions) and the urban immovable property tax (on rental values). Development of taxes on real estate is likely to contribute to greater progressivity of the tax system.

Within property-related taxes, the taxes which are considered as having the maximum revenue-yielding potential are the urban immovable property tax and the capital value tax. But two basic changes are required initially. First, there is a multiplicity of taxes on property transactions. This need to be rationalized. Second, the capital value tax on property currently replicates the stamp duty and needs to be replaced by a capital gains tax on property.

The CVT on immovable property was first levied by the federal government in the Finance Act of 1989. The capital value corresponded to the value in the standard valuation tables of immovable properties or the value specified by the District Collector for the purposes of stamp duty. The standard CVT rate was set at 2 percent. In the Finance Act of 2009 the rate was enhanced to 4 percent. Following the reallocation of fiscal powers in the 18th Amendment, the CVT on immovable properties has been transferred to the provinces and the rate brought down to 2%. The provinces will have to focus on the development of appropriate collection machinery for this tax.

The basic issue is whether in the presence of multiple taxes there is over taxation of property transactions which is likely to hinder the development of the real estate market. Currently, the incidence is as follows:

Stamp Duty	3% of value
Capital Value Tax	2% of value
Registration Fee	1% of value
Tax on Transfer of Property (Town Tax)	1% of value
Total	7% of value

Although the incidence has been brought down from 9 percent to 7 percent, following the reduction in CVT rate from 4 percent to 2 percent, it still remains too high. There is a strong case for withdrawal of the tax on transfer of property and conversion of the registration fee into a graduated flat amount. Beyond this, the CVT needs to be converted into a capital gains tax (CGT) in a manner similar to that done in the case of shares traded in the stock market.

The proposal for development of the CGT is justified on the grounds that part of the capital gains in immovable properties is due to the provision of public infrastructure and services. Therefore, there is a case for levying a tax on these gains. Consistent with this principle, only real and not nominal capital gains should be taxed. The Indian Income Tax Laws have developed a formula for computing real capital gains based on a Cost Inflation Index. The increase in nominal value is reduced by the extent to which the value would have risen due to rise in cost of construction as indicated by the index. A rate of 15 percent could be applied if the gains are over a relatively short period of three years and 10 percent on term gains in excess of three years.

Beyond the development of the tax collection machinery for the CGT on immoveable properties, there is a need for developing a mechanism for checking the substantial under-declaration of property values for tax purposes. For this purpose, the Valuation Tables (containing values specified by the District Collector) for different localities will have to be updated periodically on the basis of market surveys. These values will then represent the minimum values used for assessing both the liability of stamp duty and CGT.

The transition from CVT to CGT on immovable properties is likely to avoid distortions in the real estate market and be considered an altogether more equitable form of taxation. National revenue in 2009-10 from the CVT on properties was about Rs 3 billion. A rational and properly administered tax by the provincial governments could yield three to four times as much over the next two to three years.

Turning to the Urban Immovable Property Tax (UIPT), it is a tax collected by the Provincial Excise and Taxation department and reverted to the local governments. A case study of the tax in the province of Sindh is presented in Box 4.2.

Box 4.2
Urban Immovable Property Tax (UIPT) in Sindh

A case study of the tax in the province of Sindh reveals the following:

1. The Property Tax is levied and collected under the Sindh Urban Immovable Property Tax Act, 1958 and Rules framed there under.
2. The Property Tax is levied under Section 3 of the above mentioned Act, by estimating gross annual rent, which is determined under Section 6 of the Act.
3. After devolution under Sindh Local Govt. Ordinance 2002 (3rd amendment) every Taluka/Town shall be rating area within the meaning of Sindh Urban Immoveable Property Tax Act, 1958, and shall determine the rate of assessment in an area and communicate such rates to respective Executive District Office (Revenue), CDG Karachi for collection by the Excise & Taxation Department.
4. To ascertain the Annual Value of property, the Government of Sindh has rationalized and simplified the system by notifying a valuation table for different localities under Section 5-A of the Sindh Urban Immovable Property Tax Act, 1958 (copy enclosed). For this purpose all the rities (notified as rating areas) of the province of Sindh have been divided into five groups and these groups are further bifurcated into four zones according to the social-economic condition of the localities.
5. The category wise different rates have been specified for each zone of every Group, for the size of Plot in sq.yard and covered area in sq.feet of the Property Unit.
6. The tax is charged and levied at 20% of the annual value of the lands and buildings.
7. Under Section 4 of the Sindh Urban Immovable Property Tax Act, 1958 various property units have been exempted from the Property Tax including the following:
   - Building and lands owned by federal govt, provincial govt. and local govt. for public purpose.
   - A building or land the annual value of which does not exceed eight hundred sixty four rupees.
   - Building used for residential purposes built on a plot not more than 120 sq.yds.

It is clear from the Box that the UIPT is based on presumed/assessed rental values and not on declared values. This practice has been adopted in view of low rents especially in central

cities and because rental values have to be imputed in the case of owner-occupied properties.

Total collection nationally from the UIPT is less than Rs 8 billion. The revenue potential of this tax has been substantially underexploited for a number of reasons:

- Due to absence of regular reassessments, the assessed annual rental values are currently about one third or one fourth of the market rental values
- Differential treatment in favour of owner-occupied properties
- Underassessment of commercial and industrial properties
- Lack of expansion in rating areas in line with the spatial growth of metropolitan cities and lack of notification of new towns as rating areas
- Defects in the assessment formula, especially in the case of luxury properties.

In the short run there is a case for adhoc enhancement of 150 percent to 200 percent in the case of assessed rental values, with a bigger increase in the case of larger properties. This should then be followed by a comprehensive market survey of rents to update the assessment formula.

There is a need to emphasize the fact that in most countries the property tax is the mainstay for financing provision of local services, therefore, development of the UIPT must be given high priority for development as part of the strategy for progressive taxation of real estate.

4.5 Development of GST of Services

In accordance with the provisions of the 7th NFC Award, progress has been made to operationalize the devolution of GST on services to the provincial governments. Effort is also under way to broaden the tax base by extending the tax net to hitherto untaxed or undertaxed services. The latter is a key conditionality of the Standby Facility (SBA) signed with the IMF. One of the key structural reforms was to replace the existing GST with a comprehensive VAT on goods and services. The VAT is expected not only to raise substantial additional revenues but also distribute the tax burden more evenly across sectors and contribute towards greater progressivity of the tax system of Pakistan. The government has preferred to refer to the VAT as Reformed GST (RGST).

Historically, due to constitutional provisions which restrict the federal government to levy a sales tax on “the sale and purchase of goods imported, exported, produced, manufactured or consumed”, the federal government had found it expedient to levy an excise duty on services, effectively in the GST mode. Federal Excise Duty (FED) was levied on TV/cable, insurance, non-fund services, air travel tax and property developers. Beyond this, sales taxable services (in FED-VAT mode) included telecommunications, facilities for travel inland carriage of goods by air and shipping agents.

In 2000, provincial ordinances were promulgated authorizing the federal government to collect sales tax on services at the standard rate on hotels, marriage halls, lawns/clubs/caterers, advertisements on radio/TV, customs agents, ship chandlers, stevedores, shipping agents, courier services, beauty parlours, beauty clinics, slimming clinics, laundries and dry cleaners, caterers and travel agents.

Through the above, however, the government is able to mobilize only a fraction of revenues that can potentially be generated from the large and buoyant services sector. Initial estimates reveal that the services sector combined generate less than one-fourth of FBR[1] revenues while their share in the national economy is more than half. Clearly, significant potential exists for raising more revenues from this sector. Research undertaken for the Federal Board of Revenue (FBR) demonstrates that indeed there exists substantial untapped potential. Net revenues (net of input invoicing of output in intermediate use) from RGST (with 2010-11 tax base) are estimated to be Rs. 158 billion (see Table 4.4). Revenues do not cover education and health care sectors, which as per the recommendations of the Revenue Advisory Council (RAC) are to be exempted from taxation.

Table 4.4
Estimated Net Revenue from Services (With Tax Base of 2010-11)
(*Rs in Billion*)

Sector/Sub-Sector	Revenue
Wholesale and Retail Trade and Hotels and Restaurants	39.7
Transport Storage and Communication	73.1
Banking, Finance and Insurance	29.4
Social Community and Personal Services	15.7
Total	**158.0**

*The following services are exempt: central monetary authority, health and education

Services contributed Rs. 64.5 billion to the exchequer in 2009-10. These revenues are projected at Rs. 76 billion in 2010-11, at a growth rate of 18 percent. As such, additional revenues from replacement of GST and an expansion of RGST to sectors not covered under the GST regime could yield an additional Rs. 82 billion, in 2010-11 equivalent to 0.5 percent of the GDP.

Since GST on services is a provincial tax, revenue will not be shared between the federal and provincial governments but will be reverted back to provinces. The federal government has constituted a committee to decide on the allocation formula, as the NFC did not explicitly consider this matter in its deliberations. Deliberations of the committee are still on-going, see Box 4.3.

4.6 Development of Abiana(Irrigation Charges)

Turning to non-tax revenues, as highlighted above, a major source is abiana. In 2009-10 the collection from abiana was Rs 2.7 billion in Punjab as compared to the direct costs of operations and maintenance of the irrigation system of Rs 6.7 billion. Therefore, the extent of cost recovery is only about 40 percent. The government of Punjab may announce a policy of raising the rates by, say, 20 percent annually, over the next five years so that, more or less, full cost recovery is achieved by the end of the period.

Currently, the *abiana* is collected by season on a flat rate basis per acre of cropped area. The rate is Rs 145 per acre for the *Kharif* season and Rs 85 per acre for the *Rabi Season*. There is no variation in the rate by crop. Earlier, higher rates were charged for water-intensive crops like sugar cane and rice, but this system was abandoned due to rent seeking behaviour by revenue collectors. In the short run, the assessment of *abiana* may be linked to farm area and not to cropped area as this policy discriminates against the small farmer. Also, there is a proposal for making the rate progressive with respect to farm size, as a higher

[1] The Vat on Services, Institute of Public Policy, Beaconhouse National University, June 2010.

proportion of large farmers are located at the beginning of a watercourse. In the long run, the scope for water metering will need to be examined.

Box 4.3
Government Committee on RGST

The Committee has identified the following three groups of services.

Group-I: Stand alone services.

- Group-I services shall include such services that neither involve transactions across the province nor contribute a significant proportion as inputs into other supplies. These services shall be deemed to be of a 'standalone' nature and neither input/output adjustments nor refunds will be provided for such services. Services to be included in this category are to be decided by a technical committee comprising representatives of the federal Finance Division, all the provinces and the FBR.
- Group I Services may be levied and collected by provincial governments, if they so desire. Conversely, any province may delegate collection of taxes under Group-I services to FBR. The proceeds of these taxes shall be credited to each province on the basis of collection from each province. In case where point collection is not clearly identifiable, these provinces will devise a distribution formula for such amounts as are not clearly identifiable.

Group II: Telecom services (origin of service clearly identifiable).

Group II shall include telecommunication services, given that the origin of these services is clearly identifiable. The proceeds of GST on telecom services shall be credited directly to the provinces on the basis of origin of service in each province.

- Other services currently placed in group I but where the service constitute a significant proportion as inputs into other supplies and the origin of the services are found to be clearly identifiable for services in Group II. After mutual agreement between FBR and the provincial governments on the input/ output adjustment and refunds provided, FBR will intimate Finance Division, which will deduct the specified amount from provinces' respective share of their future proceeds

Group III: Services requiring input/ output adjustment.

- Group III shall include Services that constitute a significant proportion as inputs into other supplies or involve transactions across provinces, shall be delegated by the province (s) to FBR for collection. Currently, these could include:
  (a) Financial services, including banking, insurance, stock market operations, etc.
  (b) Advertising services
  (c) Construction services
  (d) Franchising services
  (e) Other services that constitute a significant proportion as inputs into other supplies and involve transactions across provinces
- FBR will provide input/ output adjustment and refunds for services in Group III. Net tax proceeds from services in Group III will be placed in a separate fund which will be distributed among provinces, as an interim measure by accepting provisionally for one year the stated position of each province given below and the federal government picking up the differential to make up for the demand of each province, as indicated below:

Punjab	Sindh	Khyber-Pakhtunkhwa	Baluchistan	Total
60.39%	50.00%	15.62%	10.00%	136.01%

- For FY 2011-12, the federal government and the provinces would evolve a formula that is mutually acceptable to all provinces.

In summary, implementation of the above-mentioned proposals for development of provincial taxes on agriculture, real estate and services could yield additional revenue of up to 0.8 percent of the GDP, equivalent to almost Rs. 126 billion on the current tax base. Over and above these, the provinces will also have to enhance the level of cost recovery, particularly in economic and community services. These measures will contribute not only to significant enhancement in the national tax-to-GDP ratio but also enable the provincial governments to expand the coverage and quality of basic services.

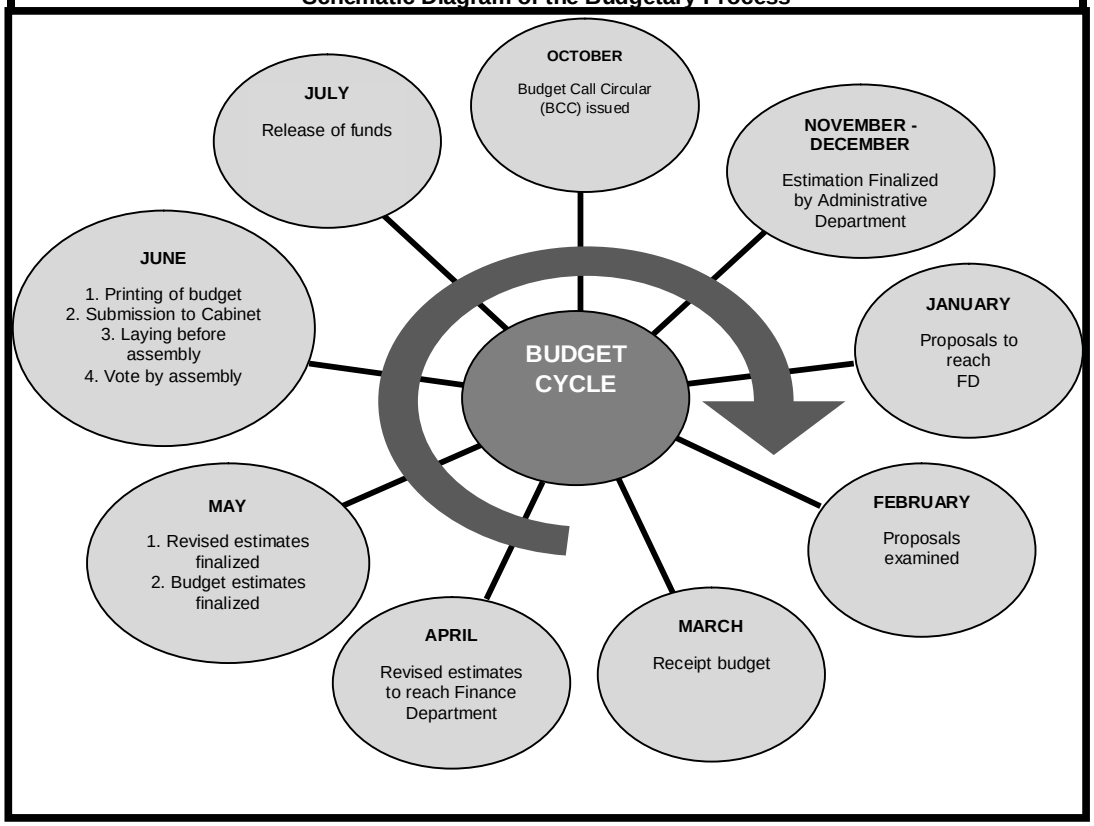
CHAPTER 5
BUDGETARY PROCESS

Budget is not only an exercise of numbers or a statement showing income and expenditure of the Government. In fact, it is a plan for implementation of economic and social vision of the government. In a democratic system of governance, the government is required to meet aspirations of the people. This goal can only be achieved by creating a relationship between resource allocation and effective service delivery. Therefore, budget preparation is one of the most important annual activities completed by every government. Success of a budget relies heavily on accuracy and efficiency of the processes being followed to develop the budget. The following paragraphs provide a brief overview of the budget processes of Punjab Government. The processes followed in Sindh Government are identical. These processes have remained unchanged in the aftermath of the 18th Amendment.

5.1 Schematic Diagram of Budgetary Process

Budget making process for provinces is laid down in Articles 118 to 124 of the Constitution. Chart 5.1 shows different activities undertaken by the Government in connection with budget making along with their sequence during a financial year (July to June):

Chart 5.1
Schematic Diagram of the Budgetary Process

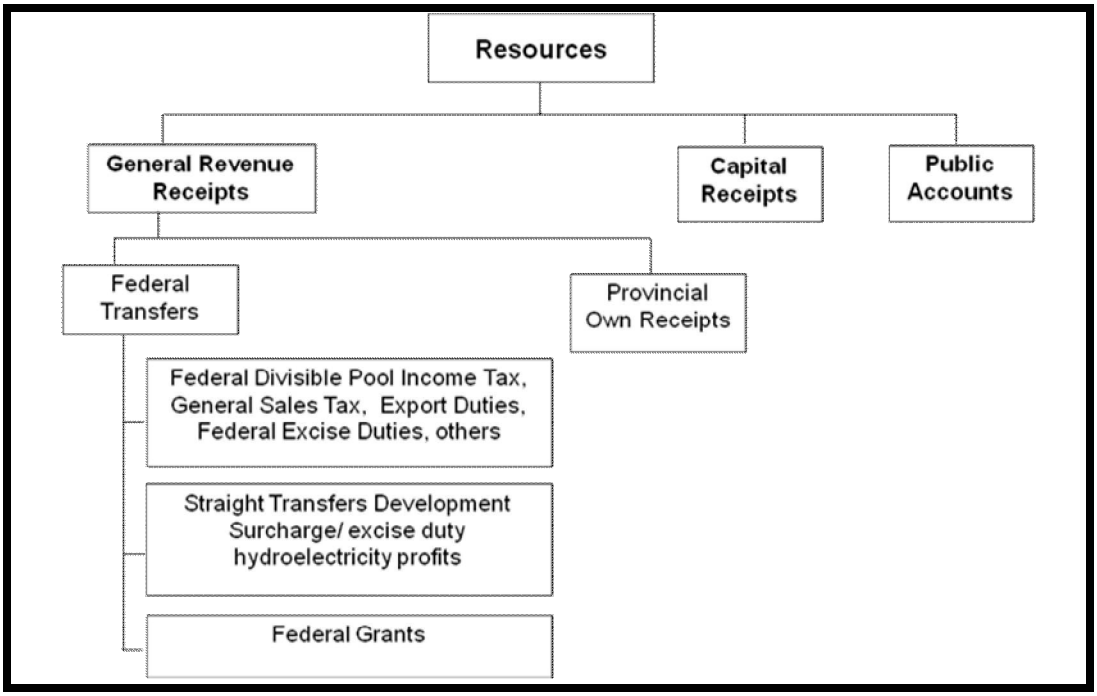


The whole budget making exercise can be divided into following three parts:

i. Estimation of receipts;
ii. Estimation of current expenditure;
iii. Preparation of Annual Development Program

Estimation of Receipts

The schematic diagram below shows different types of receipts of the Government.



Receipts of the government are categorized into General Revenue Receipts and Capital Receipts. As highlighted above, general revenue receipts can further be classified into two categories – federal transfers and provincial own receipts. Federal transfers comprise divisible pool transfers under the National Finance Commission Award, straight transfers and grants from the Federal Government. The components of provincial own receipts include provincial taxes, fees from services rendered / user fees, receipts from Government estates and other miscellaneous receipts. Capital receipts, which constitute comparatively a minor share of total, comprise extraordinary receipts (from privatization of Government assets) and loans from the Federal Government and multilateral agencies. The estimates of receipts are compiled in the budget publication entitled "Estimates of Receipts", which is submitted to the provincial legislature every year for approval as part of the annual budget.

A good budget requires reliable estimation of revenues of Government. The process of estimation of receipts has been provided in Chapter 5 of the “Budget Manual”. No other document of the government discusses the process of estimation of receipts. The process of estimation of receipts has been explained below:

a) Federal Transfers

Provisional estimates of federal transfers i.e. divisible pool transfers, straight transfers and grants are provided to the Government by the Federal Ministry of Finance in the month of May. These estimates are used by Finance Department to prepare the annual budget. The provisional estimates are, however, subject to revision later during the year, which at times is pretty drastic and can potentially cause a serious problem in budget making by the provincial governments as the estimates are finalized by the Federal Government just before presentation of Federal Budget when there is little time left for provincial governments to

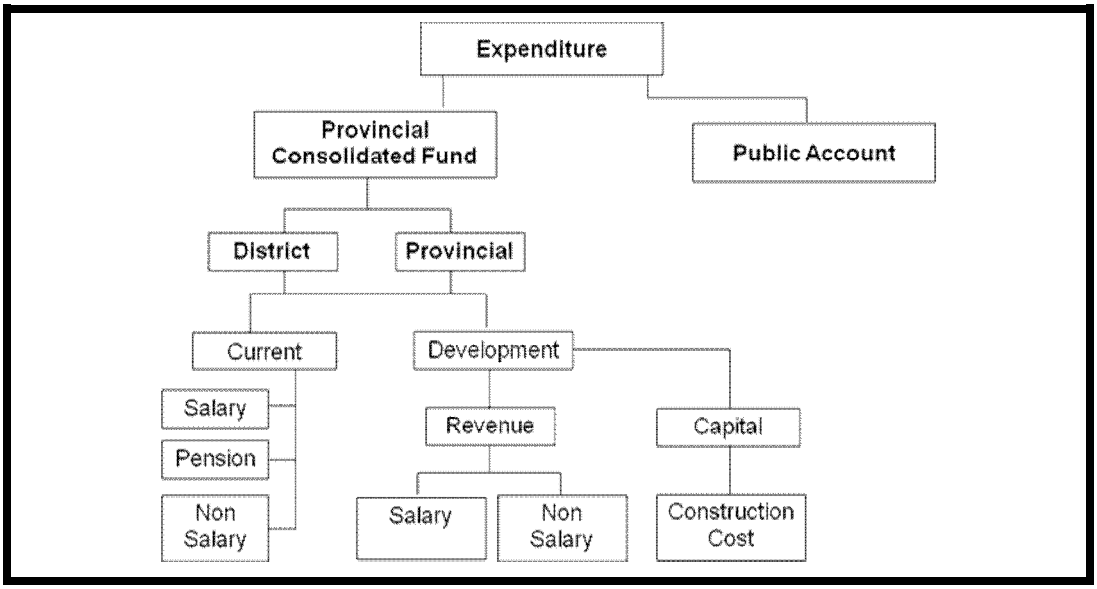
revise its budget estimates. Federal transfers constitute over 85% of the total resources of all provincial governments. Therefore, it is extremely important for the provincial government also to estimate federal transfers itself to be sure of the reliability of estimates.

b) Provincial Own Revenue

The estimates of provincial receipts are prepared by the Finance Department on the basis of the information furnished by the various estimating officers, namely Collecting Officers, Controlling Officers, Regional Heads where they exist and Heads of Departments. This multi-layer system has been laid down in detail in the Budget Manual. The manual provides a bottom up approach for estimating Government receipts. The process is initiated by Finance Department when it circulates relevant forms to heads of collecting departments. The heads are required to distribute these forms among the regional heads, collecting / controlling officers. The collecting officers / controlling officers prepare estimates of revenue collection from the areas of their jurisdiction on the basis of historical trends and actual collection during the ongoing financial year. These officers are also required to prepare a justification for the projection. The estimation done by the different collection / controlling officers is reviewed at the regional level or by the heads of the Departments. At this stage the estimates prepared by the field staff are consolidated and reviewed. The heads are required to review these estimates on the basis of actual collection during the last few financial years and revised estimate of the ongoing financial year. It is also the responsibility of departmental heads to review economic changes that might affect their revenue collection and make necessary changes in the estimates for the next financial year. Finally, the estimates are forwarded to Finance Department by the heads of departments. These estimates are again reviewed by Finance Department in the light of past trends and revised estimates of the ongoing financial year. Finance Department again has the role to increase or decrease the estimates forwarded by heads of departments in the light of past trends of revenue collection and economic factors.

Estimation of Expenditures

The following diagram shows the different types of expenditure of the Government.



a) Estimation of Revenue/Current Expenditure

The process for preparation of non-development / current budget kicks off with the issuance of a Budget Call Circular in the month of October. The circular provides guidance to field offices on budget making along with the target dates (Budget Calendar) for different steps. The circular also contains different forms and formats for provision of information to the heads of respective departments. The forms have been provided to standardize the information provided by different offices. The departmental information on estimates of non-development budget for the next financial year is consolidated by the respective department heads and is communicated to Finance Department by the month of January. These proposals are examined in Finance Department during the month of February. Month of April is the deadline for provision of revised estimates for the ongoing financial year to Finance Department. The departments are, therefore, required to provide second statements of excesses and surrenders, which form the basis for preparation of the revised estimates. Revised estimates for current financial year and budget estimates for the next financial year are finalized by Finance Department in the month of May. This is followed by presentation of budget before the provincial assembly during the month of June. In this way the budget making process starts in the month of October and concludes in the month of June after approval by the Provincial Assembly in accordance with the constitutional provisions mentioned above.

The first one is called the permanent budget whereas the second is commonly referred to as new expenditure. The permanent budget and Schedule of New Expenditures (SNE) are submitted separately by Administrative Department to Finance Department for scrutiny before inclusion in budget estimates. The schedule of new expenditure mainly relates to development schemes which have been completed and, therefore, their running expenditures are meant to be shifted from development budget to non-development. At present the process of estimating recurrent implications of development has some weaknesses due to which the SNEs do not provide the real estimate of this liability. Estimates of recurrent implication provided in the PC-1 of the project are at best incomplete, if provided. In most cases, though, such estimates are not made part of the planning documents. Posts resulting from development schemes are included and cleared by the competent authority but other components of the recurrent liability (operating expenses) are not estimated at the planning stage. Further, no system is in place to systematically record the liability arising out of development schemes. Consequently, there is no way for Finance Department to accurately assess the current expenditure. In this way, the discrepancy in estimating recurrent liability raises the risk element of Government's financial management. This risk usually manifests itself in the form of supplementary grants which is required to be released when a recurrent liability of development schemes is discovered during the course of a year. The need for a supplementary grant, especially at a time of financial crunch, causes delay in operationalization of new facilities.

5.2 Development Planning, Approval and Execution

The development expenditure has been defined in the Punjab Budget Manual 2008 as the expenditure having the following characteristics:-

i. It is designed to keep intact, enlarge and improve the physical resources of the country;
ii. It improves the knowledge, skill, and productivity of the people; and
iii. It encourages efficiency with which available resources are used.

The only exception to the above is the investment in human resource by the Departments of Health and Education, which despite having the above features, is categorized as non-development expenditure. This exception is, however, made because expenditure by these two departments is of permanent nature and should, therefore, be met from permanent resources rather than from loan or aid. In this way the source of funding also plays some part in determining the type of expenditure.

Following the above mentioned principles the expenditure in important sectors such as Irrigation, Power, Communication and Transport etc. on replacement or expansion of existing capacity, or for creation of new physical capacity is treated as development expenditure. In respect of civil works, investment in building and roads are categorized as development expenditure. Similarly, the non-recurring expenditure on housing and settlement projects and ancillary services such as water supply, sewerage, electrification etc. is also part of the development expenditure.

Annual Development Plan (ADP)

Development expenditure is provided for according to plans each of which is intended to cover a period of one year in case of short term, and about 3-6 years in case of medium term plans. Annual Development Program, for a financial year is the statement showing the details of total development expenditure proposed for various development schemes in different sectors / sub-sector for a year.

Development Planning Process

Development budget involves three main parts: the identification of schemes, the approval and budgeting of schemes and the execution of schemes.

Identification of Schemes

Government departments are responsible for identification of development schemes. In this quest, the departments are guided by Government's vision, communicated through policy documents such as Poverty Reduction Strategy Paper (PRSP) or Vision 2020. Ideally, a Government at the start of its tenure in office should come up with its development priorities which should preferably be integrated with national development strategy. The policy document also provides sectoral outcomes for implementation of the development vision. These outcomes in turn provide direction and targets to individual departments to form their respective development programs. In order to have a predictable, well defined and clear planning process, the Departments need to come up with medium and long term sector plans, clearly setting targets for each year. The annual development plan should, therefore, flow from such sectoral / departmental plans of all departments keeping in view the availability of resources.

Being need based is the other important characteristic of a good development program. In the developed countries the research by academia and professional bodies provide justification for various development initiatives. In developing countries this 'luxury' is seldom available. Therefore, the development process is ad-hoc in nature. In Punjab, a Multiple Indicator Cluster Survey (MICS) was conducted in 2007 with the assistance of international development partners to identify need for development initiatives in various districts of the province. However, the survey has not been properly utilized in development planning.

The Budget Manual, despite being a very elaborate document, does not provide specific steps which need to be taken by the Provincial Government for identification of schemes. One, however, feels that the Department Heads must consult surveys such as MICS and hold consultations with public representatives, academia and other stakeholders to identify development schemes for their sectors. Public representatives need to be given special importance in this process as they have the knowledge of local needs. Recently need was felt to hold more consultation with elected leadership of the Province for identification of development initiatives. Therefore, Punjab Government initiated the process of holding pre-budget sessions of the Punjab Assembly. Through this session, Government departments seek input of legislators on prospective development schemes. It is, however, worth mentioning that the process of consultation needs to be further institutionalized as presently many MPAs have been complaining that their input in the pre-budget sessions was not given due importance in framing the development program for the province. In addition, there is great need that the legislators are educated to play the role expected of them which entails providing guidance to bureaucracy on setting development priorities, sector ceilings and monitoring effective use of development funds in whole of the province. At present the legislators only seem to be worried about development schemes for their respective constituencies. In this regard, orientation of the members of legislature is definitely required to apprise them of their true role in the development planning process.

Approval of Annual Development Program

The development budget estimates for the proposed new projects, together with the project documents are submitted to the Planning and Development Board for appraisal. Each scheme or project that is proposed under development allocations is put forth for appraisal using the Federal Planning Commission (PC) forms. The PC-I form contains details about the project scope, location, implementing authority, objectives, cost estimates, and a benefit analysis. At present the Planning Commission has developed 14 different PC-1 forms for different sectors.

The departments must select individual schemes with a view to maximize national economic growth, social development, generation of greater resources and meeting sectoral outcomes determined by Government's vision. However, due to competing demands of different sectors, the decision for inclusion of a development scheme in the ADP hinges on project appraisal which includes technical, social, commercial, financial and economic analysis/appraisal of a project. Project appraisal is important to determine the most beneficial projects due to limited availability of resources for development purpose.

Box 5.1 provides a brief description of steps carried out for formulation of Annual Development Program with target dates:

The composition and competence of different forums responsible for approval of development schemes for inclusion in Annual Development Program subject to availability of resources is given in Box 5.2. It is important to point out that appraisal and scrutiny of proposed projects require that the forums / authorities examining different schemes have the capacity to examine technical and financial aspects of respective projects. PDWP, despite being the highest forum for approval of development schemes, is sometimes criticized for its ability to effectively appraise schemes, simply because it is very difficult for a single body to

review such a large number of schemes. The meetings of this committee are convened at a very short notice which does not allow enough time to members to examine the proposals before attending the meeting. Asymmetry in availability of technical information between line departments and the approving authority (PDWP) is another reason for criticism of the working of PDWP. This asymmetry provides incentives for line departments to over-estimate the costs of projects. In order to curb this tendency, the Government has recently embarked upon the idea of standardizing technical designs of different types of infrastructures. There is still need for the Government to control asymmetry of information between its different agencies to ensure that there are no over-estimation of costs at the planning stage. One option for this is to get the estimates and technical designs prepared by Government departments cross checked by independent experts.

Box 5.1 ADP Calendar	
Early December	Copies of BM-12 form supplied by Finance Department to Administrative Departments for furnishing information relating to development schemes proposed to be included in the ADP
20th December	Administrative Departments return BM-12 form duly filled.
10th January to 15th February	Meetings of competent forums / committees held in P&D Department for consideration of schemes identified by the Administrative Departments.
20th February	First draft of ADP prepared by Finance Department and provided to Administrative Departments for scrutiny of schemes included in the first draft
20th February to 10th March	Administrative Departments complete scrutiny of relevant part of development program and submit plan to P&D. Another round of meetings is held to determine the allocations for each scheme
10th March	Ministry of Finance in consultation with Provincial Government determines the size of resource transfers to provinces and resources available for development. On the basis of this information Planning Commission fixes size of ADP for provinces.
End April	Approval of size of ADP by National Economic Council
End May	Submission of ADP to Cabinet for approval
Early June	ADP submitted to Provincial Assembly for approval as part of budget.

Determination of the size of Annual Development Program is also a contentious issue these days particularly due to the present trend to announce a development budget significantly higher than the last financial year for popular / political reasons even if this means over stretching the financial capacity of the Government. In case of Punjab, this tendency has become more and more visible during the last 5 years. This over-stretching of resources could undermine the whole development process as the payments could get stuck during implementation. It is, therefore, important that the role of Planning Commission and Finance Department is strengthened and insulated from political pressures to determine the sustainable size of development program for respective provinces.

The last step in preparation of ADP is its submission to Provincial Assembly as part of the budget. The Assembly debates the schemes included in the ADP. The members can bring to the attention of the house a certain project proposed to by the government using a cut motion. The cut motion creates occasion for debate in the Assembly regarding a specific allocation and government policy. After the debate the bill upon receiving a simple majority gets approved. Schemes thus approved by the Provincial Assembly form part of the ADP.

Box 5.2 Competence Of Approving Authorities	
DEVELOPMENT FORUM	**APPROVING AUTHORITY**
Category-I Officer (Officers specified in Delegation of Financial Powers Rules)	Upto Rs.2 million
Departmental Development Sub-Committee (A Committee comprising the concerned Administrative Department and a representative each of Finance Department and Planning & Development Department not below the rank of a Deputy Secretary)	Rs.2 million - Rs.200 million
Provincial Development Working Party (A Committee comprising members from the Planning and Development Board including Chairman, Members / sector heads in P&D Department and Chief Economist, Finance Department, and the relevant department sponsoring the scheme not below the rank of an Additional Secretary	Rs.200 million - Rs.5,000 million
Executive Committee of National Economic Council (ECNEC) Finance Minister heads ECNEC. The members include Federal Ministers incharge of economic ministries, the Deputy Chairman Planning Commission, Chief Ministers and Provincial Ministers of concerned departments)	More than Rs.5,000 million

Execution of Schemes

After approval of the budget, funds for development schemes are released by Finance Department in respect of approved schemes. Usually these funds are released in quarterly installments. This allows Finance Department to match its expenditures with the available resources and provides room for it to make necessary adjustments in the development budget during the course of the year in case of any shortfall in the projected receipts. Thus the arrangement provides some flexibility to manage finances of the Government but this practice is termed by many as a reason for slow implementation in the public sector. During the 2009-10, Punjab Government had to adjust the size of its Annual Development Program from Rs.172.0 billion to approximately Rs.135.0 billion, mainly on account of shortfalls in revenue. Such adjustments during the course of financial year create distortions in the overall direction and priorities of the development spending as the adjustment are usually carried out in an ad-hoc fashion.

The execution of schemes is undertaken by the departments once the budget has been approved by the Provincial Assembly. Officials are empowered to carry out expenditures in accordance with the powers granted to them in the Delegation of Financial Powers. As long as the schemes have been approved and there are resources available, the funds are released to the departments at their request. However in case of shortfalls in revenue, cuts are imposed across the sectors. As noted above, this is likely to create distortions in the development plan. Similar distortion is created by intra-sector and inter-sector re-appropriations. It is extremely important that such re-allocations are minimized at the execution stage as these have the potential to change the complexion and direction of the development program authorized by the legislature.

During the execution phase there are three project related PC forms that are used to keep track of the implementation status of projects: the PC-III Form to be furnished by the 5th day of each month to the Planning and Development Board, the PC-IV Form, and the PC- V Form. These forms record the allocations, releases, expenditures, outputs indicators, achievements, and issues in implementation of the schemes.

Accounts are maintained by each department in either a manual format or a computerized format as per the accounting practices being followed in the department. After the completion of the budget cycle, post audit of accounts is carried out by independent auditors, and the audit reports are placed before the Public Accounts Committee of the Provincial Assembly that takes up irregularities on a case by case basis.

Further details on the financial management system, as required by CSF, are presented in Annexure 1.

5.3 Accuracy of Budget Estimates

Current Expenditure

Table 5.1 shows the overall accuracy of the budget estimates of current expenditure during the last three financial years i.e. from 2007-08 to 2009-10.

Table 5.1
Accuracy of Current Expenditure

(*Rs million*)

Current Expenditure	2007-08	2008-09	2009-10
Budget Estimates	243,487	256,948	314,873
Actual Expenditure	226,270	276,533	303,208
Absolute Variation	17,216	19,585	11,664
% Variation	7.1	-7.6	3.7

The table shows that the actual expenditure of the government was 7.1 percent lower compared to the budget estimates for 2007-08. In the next financial year the actual expenditure was 7.6 percent higher than the budget estimates. The budgeting seems to be much more accurate during the 2009-10 as is obvious from only 3.7 percent variation between the budget estimates and the actual expenditure.

Table 5.2
Current Expenditure (by Major Functions)

(*Rs million*)

Major Function	2007-08			2008-09			2009-10		
	Budget	Expenditure	% variation	Budget	Expenditure	% variation	Budget	Expenditure	% variation
01-General Public Service	149,797	144,503	3.5	140,375	150,133	-6.9	159,774	180,167	-12.8
03-Public Order and Safety Affairs	34,713	36,420	-4.9	37,052	46,432	-25.3	54,524	58,485	-7.3
04-Economic Affairs	23,182	17,452	24.7	38,510	34,717	9.9	51,827	22,826	55.9
05-Environment Protection	27	30	-13.6	34	37	-10.5	45	53	-16.2
06-Housing and Community Amenities	2,484	1,222	50.8	2,625	1,574	40.0	2,271	1,538	32.3
07-Health	8,471	9,623	-13.6	12,935	15,300	-18.3	21,771	17,438	19.9
08-Recreational, Culture and Religion	618	2,794	-351.9	629	1,093	-73. 9	739	897	-21.3
09-Education Affairs and Services	22,469	11,824	47.4	23,361	25,475	-9.1	22,466	20,281	9.7
10-Social Protection	1,723	2,397	-39.2	1,426	1,767	-23.9	1,451	1,519	-4.7
Grand Total	**243,487**	**226,270**	**7.1**	**256,948**	**276,533**	**-7.6**	**314,873**	**303,208**	**3.7**

Table 5.3
Current Expenditure (by Minor Functions)

(*Rs million*)

Major Function	2007-08			2008-09			2009-10		
	Budget	Expenditure	% variation	Budget	Expenditure	% variation	Budget	Expenditure	% variation
011 - Executive & legislative organs, financial	44,726	37,195	16.8	33,030	40,800	-23.5	39,249	54,813	-39.7
014 – Transfers	104,265	105,291	-0.9	106,483	108,084	-1.5	119,420	123,790	-3.7
015 - General Services	803	2,014	-150.8	859	1,247	-45.1	1,101	1,563	-41.9
019 - Gen. public services not elsewhere define	1	1	2.7	1	1	1.5	1	0	90.5
031 - Law Courts	2,353	2,272	3.5	2,885	4,178	-44.8	5,302	5,751	-8.5
032 - Police	29,449	31,048	-5.4	30,791	38,167	-23.9	43,600	47,547	-9.1
033 - Fire protection	25	23	10.0	27	26	1.7	41	33	19.5
034 - Prison administration and operation	1,905	2,022	-6.1	2,227	2,898	-30.1	3,395	3,417	-0.7
036 - Administration of Public Order	980	1,054	-7.6	1,120	1,161	-3.7	2,184	1,735	20.6
041 - Gen. economic, commercial & labor affairs	114	316	-175.9	121	130	-7.3	184	310	-68.6
042 - Agri, Food, Irrigation, Forestry & Fishing	16,578	10,130	38.9	30,445	15,922	47.7	43,038	13,582	68.4
044 - Mining and Manufacturing	2,417	3,075	-27.2	3,347	13,791	-312.0	3,525	4,476	-26.9
045 - Construction and Transport	4,058	3,920	3.4	4,583	4,860	-6.0	5,064	4,439	12.3
047 - Other industries	12	10	18.8	12	13	-5.1	15	17	-13.2
053 - Pollution Abatement	27	30	-13.5	34	37	-10.5	45	53	-16.2
061 - Housing development	1,788	504	71.8	1,802	621	65.5	1,215	185	84.8
062 - Community Development	178	167	6.3	252	321	-27.3	290	511	-76.1
063 - Water supply	517	550	-6.3	569	631	-10.8	766	841	-9.9
072 - Outpatients Services	-	-		-	-		-	56	-
073 - Hospital Services	7,886	8,907	-12.9	12,315	14,349	-16.5	17,072	16,708	2.1
074 - Public Health Services	72	70	3.2	79	79	0.2	70	74	-6.8
076 - Health Administration	511	645	-26.2	540	871	-61.4	4,629	598	87.0
081 - Recreational and sporting services	74	215	-189.5	105	88	15.8	114	174	-52.3
082 - Cultural Services	162	169	-4.7	150	292	-94.3	159	307	-93.4
083 - Broadcasting and Publishing	288	2,312	-701.8	269	607	-125.6	338	318	5.9
084 - Religious affairs	76	77	-2.5	84	80	4.5	107	72	32.1
086 - Admin. of Info., Recreation & culture	17	18	-8.6	20	24	-24.5	21	24	-14.9
091 - Pre.& primary education affair & service	4	-	100.0	-	-	-	-	489	
092 - Secondary education affairs and services	19	15	21.9	-	12	-	15	2,752	-17306.7
093 - Tertiary education affairs and services	15,690	7,794	50.3	18,048	15,102	16.3	15,415	11,534	25.2
094 - Education services non definable by level	109	70	35.1	87	94	-7.5	103	152	-47.7
095 - Subsidiary services to education	107	76	29.3	109	106	2.6	123	226	-83.2
096 - Administration	-	-		-	-		-	0	
097 - Education affairs, services not elsewhere	6,538	3,868	40.8	5,115	10,160	-98.6	6,808	5,125	24.7
107 - Administration	1,065	1,051	1.3	1,147	1,384	-20.7	1,202	1,192	0.8
108 - Others	657	1,346	-104.8	278	382	-37.5	248	327	-31.8
Grand Total	**243,487**	**226,270**	**7.1**	**256,948**	**276,533**	**-7.6**	**314,873**	**303,208**	**3.7**

Table 5.2 and 5.3 provide the details of expenditure by major and minor functions respectively. It may be added that Function element (as described in the Chart of Accounts) provides reporting of transactions by economic function and program. It is divided into five sub-elements i.e. Major Function, Minor Function, Detailed, Sub-Detailed Function and Program. Some conclusions emerging from the Tables are as follows:

(i) There was under-provisioning for "General Public Service" in the last two financial years due to which the actual expenditure was almost 7 percent and 13 percent higher in the last two years of the period. A review of relevant part of table 5.3 reveals that the variation was mainly on account of less than actual requirement for "011-Executive & legislative organs, financial and fiscal affairs";

(ii) The budget for "Public Order and Safety" was well below the actual expenditure in all three years. The under provision by much more stark in financial 2008-09 was due to middle of the year grant of "Risk Allowance" to employees of police department equal to their basic pay as is obvious from table 5.3;

(iii) The allocations made for "Economic Services" was high as compared to actual expenditure. This variation was on account of poor expenditure by the Food Department as is obvious from table 5.4 showing budget allocations and expenditure by departments. In fact the budget allocation for the Food Department was made for subsidy programs but payment was deferred in the period under review;

(iv) There was a significant saving from the budget allocations for "Housing & Community Amenities" in all years under review as the allocations for "061-Housing development" remained under-utilized;

(v) The Function "Health Services" experienced under budgeting in the first two years of the period whereas the allocation was found to be pretty close to accurate in the last financial year.

(vi) Tertiary Affairs is major area of investment for the provincial government after promulgation of Punjab Local Government Ordinance 2001 under which primary and secondary education was devolved to the district governments. The budget allocation for this major category was way more than the actual expenditure made in FY2007-08. The next year though the actual expenditure was almost 9 percent higher than the budget allocation. This trend got reversed in the subsequent financial year;

(vii) Similarly, under-budgeting was witnessed in all three financial years for "Social Protection";

(viii) It can also be ascertained that usually under estimation is done in the expenditure which is in the nature of charged expenditure e.g. Employee Retirement Benefits. This is perhaps due to the fact that these expenditures are not subject to voting by the legislature. Therefore, even in case of excess expenditure the legislature may not be able to stop such expenditures. However, this creates an issue of mismatch of resource and expenditure.

Object wise divergence in current expenditure is given in Table 5.4. Under-provisioning for charged expenditure such as "Employee Retirement Benefits" is prominent with some excess in expenditure on physical assets and civil works.

Table 5.4
Current Expenditure (by Major Objects)

(*Rs million*)

Major Function	2007-08			2008-09			2009-10		
	Budget	Expenditure	% variation	Budget	Expenditure	% variation	Budget	Expenditure	% variation
A01-Employee Related Expenses	49,824	49,633	0.4	60,036	66,571	-10.9	86,345	83,977	2.7
A02-Interest Payment	-	-		-	0		-	-	
A02-Project Pre-investment Analysis	3	2	32.9	4	8	-83.2	10	5	45.5
A03-Operating Expenses	28,208	16,744	40.6	17,668	20,566	-16.4	24,267	23,805	1.9
A04-Employees Retirement Benefits	12,653	16,609	-31.3	13,831	24,066	-74.0	19,037	31,549	-65.7
A05-Grants, Subsidies and Write-offs of Loans/Advances/Others	132,664	112,538	15.2	137,179	135,379	1.3	156,145	130,068	16.7
A06-Transfers	1,245	4,951	-297.5	4,930	5,695	-15.5	5,677	6,501	-14.5
A07-Interest Payment	12,400	14,924	-20.4	13,841	13,477	2.6	13,800	18,359	-33.0
A08-Loans and Advances	-	-		2	1	53.8	0	0.	350.7
A09-Expenditure on Acquiring of Physical Assets	426	1,866	-338.1	1,381	3,344	-142.2	1,816	2,532	-39.4
A11-Investments	-	3,200		-	-		-	0	
A12-Civil Works	3	63	-1596.9	51	272	-434.2	7	105	-1355.8
A13-Repairs and Maintenance	6,057	5,736	5.3	8,022	7,149	10.9	7,765	6,301	18.9
Grand Total	**243,487**	**226,270**	**7.1**	**256,948**	**276,533**	**-7.6**	**314,873**	**303,208**	**3.7**

Development Budget

Table 5.5 shows the development budget estimates and actual expenditure during the last three financial years. It is obvious from the table that the actual expenditure has consistently been lower than the budget estimates. This variation has almost been one-third of the budgeted size of the development budget. It may be added that the current expenditure is believed to have the first charge on resources. Such high variation indicates serious deficiencies in the estimation of receipts and inflexibility current expenditure. During the last three financial years the country has been passing through a financial crunch due to which the revenue collection both at provincial and federal level is lower than budgetted. This is also evident from the negative real growth in revenue collection by the public sector in the country. Due to these two issues it has now become a regular feature to cut the size of development budget.

Table 5.5
Accuracy of Development Expenditure

(*Rs million*)

Current Expenditure	2007-08	2008-09	2009-10
Budget Estimates	167, 094	165,382	188,248
Actual Expenditure	120,138	146,811	132,288
Absolute Variation	46,956	18,570	55,960
% Variation	28.1	11.2	29.7

The details of the development expenditure can be seen in Table 5.6 below which shows development budget estimates and actual expenditure by departments.

Table 5.6
Development Expenditure (by Departments)

(*Rs million*)

Departments	2007-08			2008-09			2009-10		
	Budget	Expenditure	% variation	Budget	Expenditure	% variation	Budget	Expenditure	% variation
P50 – Agriculture	3,220	1,172	63.6	2,915	1,611	44.7	3,061	1,689	44.8
P54 - Communication and Works	73,91	45,984	37.8	68,337	53,852	21.2	80,250	56,107	30.1
P57 – Education	17,111	2,150	87.4	21,732	5,606	74.2	19,296	5,762	70.1
P58 - Environment Protection	764	88	88.5	309	229	25.9	-	76	
P59 – Excise & Taxation	-	18		-	-		-	-	
P60 – Finance	14,000	32,403	-131.5	12,000	45,036	-275.3	19,900	29,827	-49.9
P61 – Food	127	36	71.2	70	12	82.8	-	20	
P62 - Forestry Wildlife & Fisheries	7,524	1,099	85.4	664	1,740	-161.8	684	357	47.8
P63 – Governor's Secretariat	-	8		-	-		-	-	
P64 – Health	3,775	2,557	32.3	5,341	4,374	18.1	6,956	2,445	64.8
P65 – Home	39	71	-84.4	554	1,341	-142.2	1,811	2,172	-19.9
P66 - Housing Urban Development Public Health Eng	13,059	10,853	16.9	18,199	17,285	5.0	21,500	17,067	20.6
P67 - Industries and Mineral Development	1,544	545	64.7	2,773	723	73.9	1,413	1,809	-28.0
P68 - Information Technology	440	529	-20.4	122	172	-41.1	1,720	136	92.1
P69 - Information Culture and Youth Affairs	242	23	90.4	198	84	57.5	223	141	36.6
P70 - Irrigation and Power	11,150	8,503	23.7	11,302	6,149	45.6	10,003	5,055	49.5
P71 - Labour and Human Resource	72	7	89.8	85	36	56.8	70	49	29.3
P72 - Law and Parliamentary Affairs	1	-	100.0	-	-		-	-	
P74 - Livestock and Dairy Development	1,013	865	14.6	1,240	752	39.3	1,625	809	50.2
P75 - Local Government and Rural Development	9,923	7,739	22.0	8,210	4,754	42.1	7,700	5,000	35.1
P77 - Mines and Minerals	113	65	42.3	130	98	24.9	150	55	63.4
P78 - Planning and Development	6,797	2,370	65.1	8,021	964	87.9	9,056	691	92.4
P79 - Population Welfare	1,890	1,624	14.0	1,688	1,380	18.3	1,628	1,574	3.3
P82 - Religious Affairs and Auqaf Dept	15	6	56.9	15	7	50.4	20	23	-17.6
P83 - Revenue	-	-		-	1		37	6	82.7
P84 - Services and General Administration	-	-		2	6	-201.3	-	94	
P85 - Social Welfare (W) Development & Bait ul Mal	140	297	-112.3	313	103	66.9	636	207	67.4
P87 – Sports	40	14	64.9	-	14		67	-	100.0
P88 - Transport	177	1,101	-520.9	1,154	313	72.8	436	1,106	-153.9
P89 - Zakat and Ushr	-	-		-	158		-	-	
Grand Total	**167,094**	**120,138**	**28.1**	**165,382**	**146,811**	**11.2**	**188,24**	**132,288**	**29.7**

Following important observations can be made from the Table:

(i) Government of the Punjab seems to have a liking for infrastructure project. These projects are mainly executed by the Communications and Works Department. This sector gets the lion's share from the development budget and comparatively smaller cuts are imposed on this sector.
(ii) Education sector's development expenditure has only been around 30 percent of the budget allocation as is obvious from a variation of almost 70 percent. This is partly due to utilization capacity of the Education Department and partly due to non-availability of resources;
(iii) The allocation against Finance Department represents the transfers to local governments for execution of various schemes. The actual expenditure of Finance Department is always higher than its budget estimates as funds are re-appropriated from other departments and transferred to local governments. Most of the times this is due to non-lapsability of funds that are transferred to District Government in their respective accounts. Due to this aspect public representatives prefer to execute their schemes through the local governments rather than provincial executing agencies;
(iv) There has been comparatively little variation in the budget estimates and actual expenditure of Housing, Urban Development and Public Health Engineering Department. Most of their schemes are usually related to water supply schemes;
(v) The budget expenditure for Forestry, Wildlife & Fisheries Department. Health and Home Department has usually been much higher than their actual expenditure.
(vi) Similarly, Irrigation & Power Sector shows comparatively smaller variation.

More detailed break-up of expenditure is presented in Annexure 2.

Receipt Budget

The accuracy of the receipt budget can be ascertained from Table 5.7.
Following major observations can be made from the Table:

(i) The total receipts of the Government consistently have been below the budget estimates;
(ii) The budget for tax receipts has been consistently over estimated;
(iii) The budget for non-tax receipts seems to be under-estimated. This impression is, however, incorrect due to following:
    a. The collection includes some notional receipts which are entered in the accounts as a result of book adjustments due to surrenders received in the accounts from different projects, revenue deposits etc.
    b. The collection also includes development receipts from the Federal Government which are received only for execution of federal development projects.
(iv) Both the above receipts form part of the Miscellaneous Non-Tax receipts.
(v) The Capital Receipts of the Government were also consistently over-estimated at the time of budget making.

Due to limited flexibility available in the revenue / current budget, the Government usually adjusts the size of its Annual Development Program / development spending. For the sake of predictable flow of development funds it is extremely important that the Government improves the quality of estimation of receipts.

Table 5.7
Accuracy of Receipts

(*Rs million*)

Minor Object Description	2007-08			2008-09			2009-10		
	Budget Estimate	Actual Receipt	% variation	Budget Estimate	Actual Receipt	% variation	Budget Estimate	Actual Receipt	% variation
Tax Collection (including Federal & Provincial Tax Collection)	-	-	-	-	-	-	-	-	-
B011-TAXES ON INCOME	88,911	82,772	6.9	112,521	95,759	14.9	130,107	128,308	1.4
B018-CAPITAL VALUE TAX ON MOVEABLE PROPERTY	-	-	-	1,550	607	60.9	1,768	1,023	42.1
B021-LAND CUSTOMS	35,665	33,821	5.	39,754	34,629	12.9	40,287	40,050	0.6
B023-SALES TAX	74,292	70,575	5.	93,590	90,808	3.0	116,785	120,210	-2.9
B024-FEDERAL EXCISE	19,613	20,044	-2.	25,072	25,930	-3.4	32,076	28,495	11.2
B025-FEDERAL EXCISE ON NATURAL GAS	315	(452)	243.	367	283	22.8	351	292	16.6
B011-TAXES ON INCOME	1,762	674	61.7	1,000	791	20.9	1,100	771	29.9
B012-WEALTH TAX	-	24	-	-	25	-	-	5	-
B013-PROPERTY TAX	6,136	2,131	65.3	9,500	2,900	69.5	10,450	4,074	61.0
B014-LAND REVENUE	4,850	4,212	13.1	4,600	4,646	-1.0	5,060	6,718	-32.8
B016-TAX ON PROFESSION, TRADES AND CALLINGS	370	266	28.0	370	345	6.8	480	406	15.4
B017-CAPITAL VALUE TAX ON IMMOVEABLE PROPERTY	-	6	-	-	0	-	-	0	-
B018-CAPITAL VALUE TAX ON MOVEABLE PROPERTY	1,505	1,649	-9.5	-	0	-	-	0	-
B019-OTHER DIRECT TAXES	-	-	-	-	-	-	-	-	-
B021-LAND CUSTOMS	-	-	-	-	0	-	-	0	-
B023-SALES TAX	10,110	13,514	-33.7	15,334	12,964	15.5	8,759	2,683	69.4
B024-FEDERAL EXCISE	3,237	0	100.0	-	1	-	-	0	-
B025-FEDERAL EXCISE ON NATURAL GAS	1,230	-	100.0	-	1	-	-	0	-
B026-PROVINCIAL EXCISE	1,216	942	22.5	1,319	1,040	21.1	1,450	1,046	27.9
B027-STAMP DUTY	10,034	6,546	34.8	10,000	6,845	31.6	11,000	7,608	30.8
B028-MOTOR VEHICLES	6,331	4,558	28.0	6,931	4,393	36.6	7,624	6,129	19.6
B029-SALE OF OPIUM	14	113	-690.4	15	16	-2.0	17	24	-42.0
B030-OTHER INDIRECT TAXES	4,801	1,110	76.9	3,446	1,086	68.5	3,707	3,132	15.5
Total	**270,392**	**242,505**	**10.31**	**325,369**	**283,069**	**13.00**	**371,021**	**350,974**	**5.40**
Provincial Non Tax Revenue	-	-	-	-	-	-	-	-	-
C01-INCOME FROM PROPERTY AND ENTERPRISE	29,017	9,411	67.6	6,235	11	99.8	6,295	14,548	-131.1
C02-RECEIPTS FROM CIVIL ADMIN. AND OTHER FUNC	4,276	4,924	-15.2	5,792	5,610	3.1	7,702	4,529	41.2
C03-MISCELLANEOUS RECEIPTS	52,532	47,767	9.1	53,719	64,343	-19.8	39,504	47,811	-21.0
Total	**85,825**	**62,102**	**27.6**	**65,746**	**69,964**	**-6.4**	**53,501**	**66,888**	**-25.0**
Capital Receipts	-	-	-	-	-	-	-	-	-
E011-IRRIGATION RECEIPTS	-	0	-	-	0	-	-	(0)	-
E013-INVESTMENT RECEIPTS	-	-	-	-	-	-	-	13	-
E021-FROM PROVINCES	-	0	-	-	-	-	-	0	-
E022-FROM DISTRICT GOVERNMENT /TMAS	585	-	100.0	293	-	100.0	74	125	-69.2
E023-From Financial Institutions	-	-	-	-	-	-	16,900	1,962	88.39
E024-FROM NON FINANCIAL INSTITUTIONS	-	66	-	6	37	-514.4	227	359	-58.5
E025-FROM GOVERNMENT SERVANTS	84	69	18.2	70	120	-71.3	80	55	30.7
E026-FROM PRIVATE SECTOR	-	1	-	1	4	-656.4	1	1	15.5
E027-FROM OTHERS	-	0	-	-	0	-	-	0	-
E031-Permanent Debt-Domestic	0	774	-178310.1	455	227	50.0	0	145	-33250.8
E033-PERMANENT DEBT - FOREIGN	47,646	29,856	37.3	34,533	25,779	25.3	45,111	36,563	18.9
Total	**48,316**	**30,766**	**36.3**	**35,358**	**26,168**	**26.0**	**62,392**	**39,223**	**37.14**
Grand Total	**404,532**	**335,374**	**17.1**	**426,471**	**379,197**	**11.1**	**486,914**	**457,085**	**6.13**

5.4 Summary of Recommendations

Following recommendations are made to improve budgeting, planning and execution at the provincial level:

(i) The Government needs to enhance accuracy of estimation of receipts to ensure predictability of resource availability for the next financial year. In this regard there is need to establish a macro fiscal forecasting unit in the Government. Further, the Government needs to separate the estimation and collection function;

(ii) The quality of current expenditure estimation can be enhanced by streamlining the process of estimating impact of development budget on current expenditure. The deficiency in the existing process results in issuance of supplementary grants when it is

discovered in the middle of a financial year that newly created facilities have to be financed from the current budget;

(iii) Another important aspect of development programs is inclusion of un-approved schemes and block allocations in the development plan. These schemes/allocations are released on completion of the approval process. However, due to a number of steps involved in the approval process the execution of these schemes is usually delayed. It may be worthwhile mentioning here that a number of agencies i.e. sponsoring agency, P&D, Finance Department and executing agencies are involved in this process. Implementation process gets delayed if the case for approval / release of funds gets stuck in anyone of the above mentioned offices. Therefore, there is a clear need to discourage inclusion of unapproved schemes/blocks in the ADP.

(iv) Size of the development budget is increased for political purposes. In order to do this the current expenditure is sometimes under-estimated whereas receipts are over-estimated. This contributes to mismatch of resources and expenditure. Therefore, it is extremely important that the size of development budget is set strictly in accordance with the available resources for development;

(v) At the execution stage the Government's ability to monitor quality of execution is the biggest question mark on the development process as the Government implements most of its projects through private contractors. These contractors have an obvious incentive to make use of this inability to their personal gains. It is important that the Government builds this capacity and develops deterrence in the minds of contractors so that they produce the quality of work which matches the price that they charge the Government. It is also important that the Government creates incentive for technical staff to abstain from collusion with contractors for personal gratification. According to many the efficiency of utilization of public money and poor quality of development works is one of the biggest problem faced by Government. Due to this a large portion of development funds is never used for producing public goods. In order to avoid such colossal loss of public money, the Government needs to streamline its procurement processes, automate release and payment procedures and enhance its monitoring capacity by ensuring availability of information and greater community participation in public sector development works.

The quality of project execution is closely related to input rates for infrastructure projects which form the basis of payments to contractors. Earlier Composite Schedule Rate (CSR) was followed. This system provided input rates, subject to revision annually or bi-annually, based on cost of machinery, equipment and labor. Due to delay in revision of rates, CSR did not reflect the market prices of inputs. Hence, this system was replaced with Market Rate System (MRS) in 2004. Under this system, the input rates are revised every month by Finance Department in consultation with engineering departments of the Government. The switch to MRS was motivated with a view to pay the actual input costs (with reasonable profit) to contractors to get quality output. This system, however, has its own demerits. The biggest and most serious one is the inflationary impact, pushing up input rates manifold since its introduction. Some experts also believe that MRS provides opportunity to contractors to make additional profits if they can observe the direction of change in input costs. Therefore, there is a debate that the Government needs to shift to Engage Procure Construct (EPC) or Turnkey mode of contracting to protect its financial interest as this type of contracts protect interest of both the Government and the contractor. Government does not have to face the risk of increase in cost as in case of MRS and contractors can internalize the risk of inflation in their cost estimates.

CHAPTER 6
ENSURING AN ORDERLY TRANSITION

6.1 Financial Aspects

The previous chapters have brought to the forefront a number of issues emerging in the process of devolution which need, more or less, immediate policy attention. On the financial side, these issues largely pertain to the financing of devolved subjects and the sharing of assets and liabilities. The former is largely a consequence of the sequencing of the devolution process whereby financial resources were transferred prior to the decision on reallocation of functional responsibilities. As highlighted earlier in chapter three, the federal and provincial positions vary on this issue. While the former argues that additional revenues transferred under the 7th NFC Award should finance the additional functions devolved through the 18th Amendment, the provincial view is that they, in effect, do not have the fiscal space to do so for the following reasons:

a) The NFC Award, though it significantly increases the share of provinces in the national resource pool, does not confer as big a bonanza of revenue transfer to provinces as originally claimed because of the likely shortfall in FBR tax collection in 2010-11, the first year of the Award. The budgetary magnitude of transfers is based on tax collection by FBR of Rs. 1667 billion in 2010-11, increasing at a rate of 26 percent. After a lapse of nine months in the fiscal year, the revenue growth is only about 12 percent. Punjab province has received Rs 232 billion in transfers for this period, as opposed to Rs 254 billion, revealing a shortfall of Rs 22 billion. Overall, if current trends prevail, shortfall to the four provinces combined in Divisible Pool transfers could be close to Rs 75 billion in 2010-11.

b) It needs to be remembered that while the 7th NFC increases transfers from the Divisible Pool, other federal transfers, in particular grants to provinces have been discontinued. The exception is Sindh.

c) The revenue gains transferred to the provinces have been significantly eroded because of the federal decision to enhance salaries and allowances of government employees by 50 percent in the Budget of 2010-11. The expenditure impact on Punjab of the salary increase is Rs 54 billion, while on Sindh, it is Rs. 33 billion. Overall, the cost of salary increase is about Rs 120 billion for the four provincial governments combined.

d) The devastating floods, experienced in the summer of 2010, have caused heavy and widespread damages which include losses to private housing, standing crops and public infrastructure. The government provided cash assistance and support to the affectees for the first two losses while the third is the provincial government's responsibility. Punjab and Sindh governments have had to divert Rs. 10 billion and Rs 20 billion respectively on this account from other budgetary heads.

e) Floods have not only led to a diversion of resources away from other expenditures but also a reduction in the flow of own revenues. According to IPP estimates, floods will result in a 2 - 2.5 percent decline in the growth rate of economy in 2010-11. Correspondingly, growth in federal and provincial tax bases will be less than projected, leading to a likely reduction in the growth rate of revenues.

f) In the case of Punjab, an added demand on existing resources is the need to bring down the overdraft / loans acquired in previous years to improve the financial solvency of the province and also possibly to build up some surplus in case of delays in releases by the federal government. Also, there is an expectation that in order to contain the consolidated fiscal deficit all provinces will build up cash surpluses in 2010-11.

The above factors have, as it is, led to a large reduction in the provincial ADPs in comparison to that budgeted at the beginning of 2010-11. In the case of Punjab, the budgeted ADP for 2010-11 was Rs 193 billion. The releases expected to be made in the year are Rs 128 billion, lower than last year's ADP of Rs 133 billion. In the case of Sindh also, the projected ADP is not likely to be more than Rs 82 billion, 70 percent of the budgeted amount for 2010-11. Initial estimates indicate that the erosion of the gains in transfers following 7th NFC Award due to two factors (shortfall in FBR revenue collection and salary hike) will erode about Rs 180 billion of the Rs 222 billion revenue gain budgeted for 2010-11. This implies that additional revenue transfers due to the 7th NFC award are not enough to finance the additional recurrent liability arising from the transfer of functions of the 18th Amendment, of Rs 45 billion, leave alone the development outlays annually on on-going projects in devolved functions of over Rs 41 billion.

Clearly, the larger provinces, particularly Punjab, do not have the fiscal space to take on the new responsibilities. The position with the smaller two provinces, however, is likely to be somewhat different. It appears that given the proportionately higher transfers (NFC mandated plus payment of arrears on account of hydel profits) the binding constraint in their case is likely to be more institutional than financial.

The financial issues arising from the 18th Amendment are complicated and wide ranging and will require detailed workings on different issues for resolution. There is a range of options varying from the federal position of full administrative devolution of functions without any further fiscal transfers over and above that envisaged in the 7th NFC Award to the provincial position of full financing from federal government with truncated administrative devolution (without transfer of federal staff). What perhaps is required is enunciation of some guiding principles which can be laid down to determine the nature of resolution of each issue on a case to case basis. These principles should be based on the overall strategy of incentivizing the environment for the provinces guiding them towards efficient and cost effective options. What is not required is replacement of one structure at the federal level by four structures in the provinces. This will be cost ineffective. Some such principles are illustrated below:

1. All functions that have been devolved to the provinces following the abolition of the Concurrent Legislative List are a provincial responsibility and therefore, policy making, regulation and management should be provincial responsibility.
2. The functions shifted to Part II of the Federal Legislative List and made a joint federal and provincial responsibility should continue to be financed and managed by the federal government while policy making and supervision should be jointly done through the CCI.
3. Given the overall fiscal state of governments in Pakistan, the absorption of functions devolved should be achieved in as cost effective a manner as possible, without compromising on quality of service provision. This requires an approach, already initiated in the case of five devolved ministries, of absorption of most of the additional

functions into already existing departments in the provinces. Setting up of new departments should be limited and based on very strong justification.

4. To the extent that there is need for an expansion in employment, first priority should be given to federal employees already working in the devolved divisions. Such federal employees should continue to be funded by the federal government. If, however, the provincial governments want to hire their own employees, the costs should be borne by them. This will provide an incentive for retaining the human capital that has been developed for the management of the devolved services.
5. A moratorium should be placed on new federal recruitment in order to absorb the federal staff dislocated due to the devolution of the 18 Divisions/Ministries.
6. In the case of attached departments/autonomous bodies that perform functions which are of a national public good nature(with exernalities and spill over effects) the recurrent cost of operations should be funded by the federal government while management should be joint federal and provincial responsibility.
7. Throw-forward of mature on-going projects/ programs devolved to the province should be financed by the federal government upto to the end of the tenure of the present NFC Award. For new schemes or for recent vintage of projects/ programs the choice to carry-on should be with the provincial government. For such schemes, the provincial government should demonstrate some ownership and commitment and finance 50 percent of the cost while the remaining should be financed by the federal government.
8. Provinces have under exploited tax bases in their fiscal jurisdiction as demonstrated in Chapter Five. There is need for provinces to exploit their revenue potential and also to avoid profligacy in unproductive spending. The standing committee of the NFC should decide on an incentive scheme, such as matching federal grant for higher resource mobilization or higher self-financing ratio, to motivate the provinces to have greater ability over time to finance the expansion of devolved services.
9. The 18th Amendment, while devolving ministries /divisions to the provinces, has also in effect devolved the assets and liabilities of the Ministries/Divisions. This implies devolution of income from sources like Worker Welfare Fund (WWF), Workers Profit Participation Fund (WPPF) to the provinces following the transfer of labor-related functions. Likewise Article 172 (3), while providing for equal ownership of federal and provincial governments of minerals, also implies sharing of incomes from these natural resources on a 50:50 basis. Essentially, non-tax receipts of dividends, profits etc of corporations like OGDC operating in the field of natural resources will thus be shared by the federal and provincial governments. If a decision on the sharing formula is agreed upon, then the additional funding requirements of the 18th Amendment can be financed partially through these non-tax revenue sources. The initial estimates indicate that such funding can contribute about Rs 36 billion annually to the four provincial exchequers combined. This, alongwith higher federal and provincial tax mobilization, can finance the additional resource requirements of the provincial government to manage the devolved functions.

CHAPTER 7
LONGER TERM IMPLICATIONS OF THE 18th AMENDMENT: POTENTIAL ROLE OF DONORS

While we have focused on the benefits of the 18th Amendment in terms of bringing the government closer to people, thus making public policy more responsive, accountable and transparent, a number of potential dangers also need to be identified and counter strategies devised to ensure the success of this flagship initiative of the democratically elected government. Countering the longer term adverse implications of the 18th Amendment is also an area where the donor community can assist and thus contribute to the success of a home grown reform effort. Some such implications are as follows:

Implications for Equalization: A regional break-up of federal development expenditure on the devolved functions indicates that the federal government has paid more attention to the backward provinces by choosing to locate more of its development projects in these provinces. As such, fiscal equalisation has taken place directly through federal expenditures also. With devolution of these functions to the provinces, there is the danger that regional inequity may be aggravated as fiscal equalization now will be achieved through revenue transfers only. Provincial shares in revenues are determined by the NFC for five years. Since we have just had an NFC award, changing provincial revenue share is not a plausible option in the next few years. Higher expenditures have also to be routed to the backward provinces to avoid adverse equity implications.

Change in Priority to the Devolved Subjects: Following devolution, the provinces may choose not to continue the funding levels maintained by the federal government to a particular project/program. While reallocation of function enhances the allocative efficiency of public spending in sub-national jurisdictions, the danger is that in the case of public goods with negative externalities and spill over effects, provincial priorities may go counter to national priorities. To illustrate, while population planning in a low population density province like Balochistan may not be high on the provincial development agenda, it is a high priority subject for the country as a whole. The country certainly cannot afford to slide in its population planning projects and thereby on its population control targets. What perhaps is required in such cases is some incentivization of the programs/projects to motivate continued priority. A matching grant scheme can perhaps be such an mechanism.

Decline in the Quality of Service Provision: There also exists a real danger that the smaller provinces, in particular, may not be able to maintain the quality of service provision due to capacity constraints like in the case of sophisticated, technology oriented services or services which require proper regulatory frameworks. Illustrative examples would be university education, drug control or environmental protection. Capacity building in such cases will be a pre-requisite for success.

Monitoring of the Implementation of the Devolution Process: The success of devolution crucially hinges on proper implementation of the reform program, with adequate and timely resolution of emerging administrative/institutional issues, adequate funding arrangements, amicable and equitable settlement of issues like sharing of assets and liabilities etc. Surely Pakistan is not the only country in the world which has undertaken devolution in a major way. India, for example, is ahead in this process. Pakistan needs to learn from the

experience of other countries, especially India as the institutional and financial history and structures of the two countries are very similar. Also, Pakistan will need to develop proper monitoring mechanism of the devolution process which should be capable of highlighting interprovincial differences to ensure timely redressal of any decline in quality of service that may emerge in the transitional stage. Learning from good practices in other provinces and information sharing should not remain informal but should be institutionalized through appropriate mechanism.

Therefore, donor agencies can assist the decentralization process not only by providing financial resources to remove any constraints to financing of projects in individual provinces but also provide technical assistance for capacity building, influence the allocation of resources to high priority services through matching forms of support and assist in the development of monitoring while providing examples of international best practice, especially in the delivery of services and establishment of regulatory frameworks.

ANNEXURE 1
QUESTIONS FORWARDED BY CSF

An attempt has been made to cover the questions raised by CSF in the report. Those which did not fit in the main text or which needed further elaboration are addressed below:

The budget formulation process allows the respective governments to become more proficient at identifying, formalizing and executing their strategic priorities
Punjab Government has a well defined and elaborate budget formulation process. Punjab's budget formulation flows from the strategic vision of the Government. In the past Punjab had documents such as vision 2020 that presented a vision for the future development of the province. In the recent times there has been little work done to update such documents or to develop new ones. The only exception is the "Strategy for Accelerating Economic Growth and Improving Service Delivery". The document provides a broad framework for economic growth of the province and sets service delivery targets.

Notwithstanding the lack of a specific vision document, Punjab's policy makers seems to be doing pretty well in developing medium term development frameworks (MTDFs) for various sectors. For each sector, the framework provides a vision along with policy goals. Accordingly strategic interventions have been developed and key areas have been identified to achieve those policy goals. In line with these strategic interventions, individual schemes have been identified in the MTDF 2010-11. Comparatively speaking, Punjab's development planning is clearly ahead of other provinces in the country. This however, seems to miss out on developing outcomes to achieve the policy goals as the development frameworks jumps from policies to interventions, thus missing out on the intermediate step of developing outcomes which would lead to interventions.

In a way it can be commented that there is nothing in the budgetary processes that bars the Government from developing, formalizing or executing its strategic priorities/development vision. At the same time there are no requirements / procedures which would compel the Government to develop its strategic priorities and align its development programs with it. Simply speaking, the budgetary processes are silent about this aspect of developing strategic priorities.

The annual budget planning and development process are developed within a Medium Term Expenditure Framework and align with its priorities
The Government more recently has been developing a Medium Term Fiscal Framework (MTFF) which lays down the resource envelop and tentative resource allocations for recurrent and development parts of the budget in the medium term i.e. three years. The framework provides the basis of annual budget planning. Strangely though, the Medium Term Development Framework (MTDF) is not always in line with the resources provided for development in the MTFF. Therefore, there is a need to improve coordination / synchronization between the MTFF and MTDF documents. In this regard, it would be advisable to the Government to align the size of its tentative medium term development outlays with the MTFF.

The annual budgets are sufficiently clear and informative to facilitate legislative adoption of the budget and its execution

This is covered in Chapter 5. Annual Budget Statement is the main document which is laid before the Provincial Assembly in accordance with the constitutional requirements. This statement comprises the following:-

(i) Estimates of General Revenue Receipts and Capital Receipts.

(ii) Estimates of Current Revenue Expenditure and Capital Expenditures.

(iii) Estimates of Development Expenditures

(iv) Estimates of Public Account

(v) ADP Resources (A table showing sources of ADP financing)

The statement is prepared in accordance with the Chart of Accounts (CoA) under the New Accounting Module (NAM). Annual Budget Statement summarizes the whole budget. Each of the above mentioned parts of the statement is divided into major functional classifications. Each class is subdivided into a number of sub categories. The total budget of different offices of the Government under each sub category is listed in the annual budget statement. The statement provides the budget estimates of the next financial year in comparison with the budget estimates and revised estimates of the current / ongoing financial year and the actual expenditure / accounts of the previous financial year. In this way the annual budget statement has been structured to allow legislators to compare the proposed estimates with the allocations and accounts of previous financial year and formulate questions / queries to be put forward in the legislature at the time of discussion.

In addition to the above statement documents providing details of receipts and expenditures are also traditionally submitted for the information of the legislators. Due to sheer size of the information, it is not easy for legislators to go through all information provided in the Annual Budget Statement and supporting documents. Therefore, the Government in Punjab has also been preparing and submitting a White Paper on Budget. This document provides analysis of the budget proposals and summarizes information through tables and graphs to facilitate legislators in forming opinions on budget making process.

Despite all the above efforts, very few legislators are able to put forward objective queries to the treasury benches as would be obvious from the proceedings of the budgetary session. The most obvious reason for the above is the capacity of legislators. Realizing this gap there have been some interventions to build the capacity of legislators for example annual seminars conducted by Pakistan Institute of Legislatives Development and Transparency (PILDAT). These efforts have, however, been few and far between.

- **Activity based budgeting is in use**

  Punjab Government is still using input based budgeting in most of its departments. This type of budgeting raises issues of departmental accountability as it has no direct link with policy outcomes. Viewing this as a serious problem, the Government has been making efforts to shift to output based budgeting / activity based budgeting in which activities are budgeted to achieve activities and outputs, which are linked to policy outcomes and goals. The shift is, however, taking place in a phased manner. For FY2009-10, output based budget was prepared for Health and Irrigation & Power Department. Three more departments i.e. Livestock & Dairy Development, Excise & Taxation Department and Higher Education Department were added to this list for FY 2010-11. This coverage of output based budgeting will further be enhanced for FY 2011-12.

- **Cadres of well trained staff will form a ground-up approach to improve budget formulation and execution**

  Submission of proposed budget estimates to Finance Department is the responsibility of the head of every department. These budgets are, however, framed using a bottom up approach although more recently a top down approach is also being used by conveying budget ceilings from top to bottom. The staff actually

working on budget making is used to preparing budget estimates on the input based budgeting method. Therefore, in order to shift to output based budgeting the Government has engaged services of a consulting firm to train the staff of line departments to prepare their budgets on MTBF format. Through this training the capacity of staff is being developed to prepare the budget in an accurate and efficient way.

- **Safeguards must be instituted to prevent abuses, improve payment processes, cash management and expenditure tracking**

  The aspects of expenditure tracking and cash management have been explained below. With regard to payment processes, the Government is considering implementation of the Single Treasury Account system. The system is designed to control issues such as withdrawal of funds before they are required for disbursement.

- **Budget and expenditure institutions are organized along functional lines**

  The budget and expenditure of the Government of the Punjab is organized on functional lines. The whole expenditure of the Government is divided into following 10 major functional categories:

  - General Public Service
  - Public Order and Safety Affairs
  - Economic Affairs
  - Environment Protection
  - Housing and Community Amenities
  - Health
  - Recreational, Culture and Religion
  - Education Affairs and Services
  - Social Protection

  Each of the above functional categories is divided into a number of minor and detailed sub-categories down to the level of an expenditure unit.

- **Needed functions are adequately described by job description**

  Functions of the departments and job description of the officers / officials have been described in detail in different documents. For example the functions of departments have been provided in a schedule of the Rules of Business, 1974. Departments frame the functions of the officers / official in accordance with the internal distribution of work. Since last couple of years the Punjab Government is also working on a project to development Work Breakdown Structures (WBS) of different departments to be able to identify Key Performance Indicators (KPIs) of different functionaries and offices. The work in this regard is in an advanced stage. In this regard a link is also being developed between the budgets / activities of the departments and their KPIs. In this regard Government is also customizing Financial Management Applications software (obtained from Federal Government) that would make it easier for the Finance Department and respective departmental heads to track financial progress and outcomes while reviewing the progress of budget.

- **Human skills are present which match qualifications described in job description in budget and expenditure organizations**

  Individuals are recruited on the basis of their skills and qualification required under the job description. The performance of the civil service is, however, below par due to absence of proper incentives and lack of accountability. The unified pay scale system means that no incentive in the salary / remuneration of a civil servant is linked to his/her performance. This works as a disincentive to work hard, perform well achieve excellence.

- **Controls over expenditure ensure integrity of appropriations**

  The sanctity of any budget depends upon safeguarding integrity of individual budgetary allocations / appropriations. In order to ensure that appropriations are observed, Punjab Government has put an elaborate system in place. Some of these systems are manual whereas others are electronic / computerized.

  At the outset of the financial year, budgetary allocations / appropriations are conveyed to all departmental heads from where these are passed on to individual office heads. Each office is required to keep a record of disbursements made / expenditure incurred by it from various heads of expenditure. On the other hand the office of Accountant General (assisted by District Accounts Offices located in all Districts of Punjab) keeps track of the available allocations from the budget before making any payment. In case of non-availability of budget allocations, payments are not made. In order to support these practices, Government under Project for Improvement of Financial Reporting and Auditing (PIFRA) has developed a SAP R/3 based database which contains information of budget allocations, expenditure made and balance of budget allocations available to every Drawing and Disbursement Officer. Budgets are made with the help of this automated system and every release of funds by the Finance Department is entered into this system. The releases made by the Finance Department, in accordance with the appropriations, are available to all departments and the office of Accountant General through this online system. Similarly the office of Accountant General is required to enter the transaction of every payment made by it in this system. In this way there is little chance that the appropriations would be violated by any Government agency because the system does not allow any release of funds or payment unless budgetary provision / outstanding balance is available for it.

  The expenditure incurred by every office is regularly audited by a constitutional institution i.e. the office of Auditor General of Accounts. This also creates deterrence against any overruns in the expenditure.

- **Commitment controls exist, and if so, manually or electronically**

  Commitment control is done by the Government of the Punjab through its SAP/R3 database established under the World Bank funded Project for Improvement in Financial Reporting and Auditing (PIFRA). Under this system, the departmental heads / Principal Accounting Offices have been given the authority to record the allocations, amount disbursed, committed amount etc. These commitments of different departments can now be considered by the Finance Department while preparing the draft budget estimates for the next financial year. Commitment control

is expected to improve accuracy of the budget estimates and reduce supplementary grants.

- **Basic cash management functions are in place for rationing expenditures so that expenditure accounts are not overdrawn, particularly in the provinces**

  Punjab Government exhibited weak cash management in financial years 2005-06 to 2008-09. In the first three financial years of this period, the Government availed a huge financing from its trust funds for the purpose of meeting its current and development expenditure needs. This resulted in erosion of cash balance accumulated by the Government in the past due to the fact that Government had a common cash account for its own income / receipts and the receipts of trust funds. In the last financial year of this period, the economy was showing a sluggish trend due to global economic recession and a host of domestic issues due to which the revenues were not forthcoming. This required middle of the year adjustment in the expenditure of the Government. Due to lack of these adjustments the Government's cash management suffered a big blow and the financial year ended with an overdraft of approximately Rs.43.000 billion. Consequently, the Government has been focusing more on cash management. Cash plans are developed showing the expected income of the Government, current expenditure and the likely surplus available to the Government without overdrawing the cash resources and development funds are released accordingly. This has led to improvement in the cash management.

  A daily cash balance statement showing the opening balance of the day, receipts and expenditure during the day and the closing balance is received in the Finance Department from the State Bank of Pakistan which performs the banking function of the Government.

  The SAP R/3 database still does not provide a live reporting of cash disbursement from the Government's central account because one part of this system known as the banking module is still not operational. Therefore, the Government is now working to operationalize the banking module. On completion it will provide a robust system for cash balance management. In this system the liability of the Government would be monitor at three stages i.e. bill generation / receipt of cheques in treasury offices, authorization/withdrawal of cash from Government account. In this regard the Government is coordinating with PIFRA to activate banking reconciliation module at the earliest wherein, the actual disbursement against the valid authorizations would also be reported with accuracy and without any delay.

- **The federal level has the ability to produce budget reports across different sectors and provinces, by budget code**

  Producing budget reports across different sectors and provinces by budget code was a cumbersome task before the emergence of SAP R/3 based software produced by PIFRA. New accounting model has been introduced which has been implemented at federal, provincial and district levels. All Governments prepare their budgets in accordance with this new accounting model. All these levels of Government have

also been connected through SAP R/3 system explained above. Due to this system producing various types of budget reports has become easy and accurate.

- **Relational databases are used in budget formulation**

  Government is using SAP/R3 application software which uses Oracle Relational Database Management System (RDBMS) to prepare its budget, accounts. The system was prepared under the Project for Improvement of Financial Reporting & Auditing (PIFRA). This system uses information in different tables to retrieve

  Expenditure reporting occurs at the Provincial level and is results are communicated in a standardized format to the Federal level in a format stipulated and agreed up on by both levels of government, by spending unit and by activity

  As explained above, expenditure reporting has been standardized through introduction of the New Accounting Model (NAM) and made easy by the use of modern computing tools. Every province can now generate its own reports to see its expenditure trends and receipts at all levels i.e. major functional category, minor functional category, sub-detailed functional category and detailed functional categories. Similarly reports can be generated to view department-wise and office-wise expenditure. Likewise, details of object-wise expenditure at various levels can also be retrieved from the database.

- **A common chart of accounts exists at the Federal and Provincial levels of government**

  Yes, a New Accounting Model based on a chart of accounts is used by the Federal Government, Provincial and District Governments in the country. The model provides for a framework for organizing accounting transactions to provide a number of views of these transactions. These views are provided by the elements contained in the chart of accounts. Each element contains a logical structure, which drills down to different levels of detail. This therefore provides both summary and detailed view of accounting transactions. The budgets of all the governments are also prepared on new Chart of Accounts. The Chart of Accounts contains five elements. These are as follows:

  1. **Entity**: Entity element enables reporting of transactions by the organizational structure or in other words by organizational unit, which is making the transaction. The alpha-numeric codes of entity element allow recognition of the entity making any expenditure such as government, ministry / department, attached department, district and drawing and disbursing officer.
  2. **Object**: The object element enables the collection and classification of transactions into expenditure and receipts and also to facilitate recording of financial information about assets, liabilities and equity.
  3. **Fund**: Fund element is a one alpha character that identifies the fund as being the Consolidated Fund or Public Account. There are three sub elements of Fund i.e. Source, Sub-Fund and Grant / Public

Account Number.

4. **Function**: The Function element provides reporting of transactions by economic function and program. The Function element is divided into five sub-elements i.e. Major Function, Minor Function, Detailed, Sub-Detailed Function and Program.
5. **Project**: The Project element enables transactions to be aggregated and reported at a project level (used for development programs).

The accounting model allows organization of fiscal data in accordance with International Public Accounting Standards (IPSAS).

Expenditure tracking tools exist at both levels of government and are expenditure tracking surveys are conducted regularly

It has already been clarified that a robust integrated computer based system has been established which encompasses different levels of Government due to which expenditure tracking is greatly facilitated. Civil Accounts are generated by the office of Accountant General on monthly basis. The respective offices can also generate reports to track their own expenditures. Similarly, Finance Department has been given an access to review expenditure of the Government.

- **Expenditure reporting occurs in a systematic way**

  It is clear from the above that the budgeting and expenditure reporting is done in the light of the new accounting model and the software developed by PIFRA. Periodic reports can be generated from the electronic system/database referred to above which makes the expenditure reporting very systemic and reliable.

- **An integrated approach to training exists which instantiates common practices, procedures and systems at each of the Provinces and at the Federal level**

  Promotion of civil servants is linked to successful completion of training courses designed to enhance their performance. A number of training courses provide an opportunity to Federal and Provincial civil servants to training together e.g. the Mid Career Management Course for promotion from BS-18 to BS-19, National Institute of Public Administration Course for promotion from BS-19 to BS-20 etc. Such training courses provide an important opportunity to learn from each other's experience in addition to other benefits of training.

b) INSTITUTIONAL STRUCTURE AND CAPACITY

(Revenue) At the Provincial level and the Federal level, whether

- **Revenue collection functions (Customs and Tax Administration) operate with a high degree of independence, fair to all tax payers, and has a computerized revenue management system**

The main tax collection agency in Pakistan is the Federal Board of Revenue (FBR). At provincial level in Punjab, tax collection is done by Excise & Taxation Department and Board of Revenue.

FBR is an attached department of the Ministry of Finance / Revenue Division. In this way, it cannot be said that FBR enjoys a very high degree of independence. The revenue collectors in FBR belong to Federal Revenue service. The Chairman FBR is appointed by the Government and is an ex-officio Additional Finance Secretary.

Fairness is a big issue in the tax system of the country. Due to lack of documentation of economy a large section of society is able to evade all taxes. Further, the system is practically not taxing one major type of income i.e. agricultural / farm income at all. Federal Government is making efforts to tax agricultural income in order to address the issue of fairness of the taxation. The political elite of the country, with predominant majority of agriculturists / farms owners / landlords, are resisting this change. Similarly, the Government, through its efforts to levy integrated Value Added Tax / Reformed General Sales Tax, is trying to document the economy to be able enhance its coverage of Sales Tax and Income Tax.

At present bulk of the revenue is generated through Withholding Taxes and indirect taxes such as Sales Tax. Being a regressive tax, Sales Tax puts greater burden on poor as a proportion of their income compared to rich. Hence, it raises the issue of vertical equity which demands that the rich should pay greater percentage of their income compared to poor.

- **A revenue policy unit, separate from revenue collecting functions, is responsible for analyzing and proposing revenue policy**

  Both at the Federal and provincial level revenue policy is mainly proposed by the revenue collecting agencies and finalized with the input of Revenue Division. There is need that revenue policy unit is established separately from the revenue collecting agencies both at the Federal and provincial level.

- **Revenues collected using payment agencies, such as banks (to avoid public servants handling cash) are transferred to the TSA**

  At both provincial and federal, revenues are collected mainly through the State Bank of Pakistan. National Bank of Pakistan also collects revenue as the agent of the State Bank of Pakistan due to absence of the offices of central bank in many districts. The wide network of National Bank of Pakistan is extremely useful in this context. The revenue collected by these agencies is credited immediately to the central account of the respective Governments.

  It may, however, be added that some part of the provincial / federal revenue is also collected through Government treasuries and Post Offices, again due to their location across the country. Post offices and National Bank of Pakistan have not kept pace with the improving reporting technology. Therefore, it takes extra time in reconciliation of receipts through these agencies. In some cases there have also been complaints of revenue loss to Government due to collection agencies such as Post Office.

- **Revenue is allocated efficiently between various levels of Government, avoiding duplication of revenue types**

  One feels that the present tax assignment is quite efficient. Income Tax except on agricultural income is taxed by the Federal Government. Agriculture Income Tax has been assigned to provinces due to natural synergy of this tax with the land revenue record which is maintained by the provinces. Similarly Sales Tax on Goods and Services is collected by the Federal Government despite the fact that Sales Tax on Services is a provincial levy. The federal collection of this tax allows significant efficiency as the Federal Board of Revenue is able to provide input tax adjustment of goods and services. If this tax was collected by the provinces themselves, it would be difficult to allow input tax adjustments thereby causing inefficiencies in the taxation system. A number of other examples of tax efficiency exist in the provincial and federal tax collection. For example, provincial government collects withholding tax on vehicles from the owners along with the Token Tax. We have already mentioned that Federal Government collects GST on Services on behalf of provinces. Many other such examples exist in the system. The main challenge for the Government is to try to increase coverage of economy to enhance its tax to GDP ratio.

(Budget) At the Provincial level and the Federal level, whether

- **The budget process is based on the Medium Term Expenditure Framework (MTEF) approach, including sound analyses of domestic, regional and international economic conditions, which is multi-year in nature, and where resource allocation decisions are closely linked to policy priorities**

  As noted above a Medium Term Fiscal Framework (MTFF) is prepared by the Government these days. This is a document which provides rolling estimates of Government's income and expenditures in the medium term. While making these estimates a detailed review of multi year trends of Federal and Provincial revenue collection is done. Similarly, the past trend of expenditure of the Government is also reviewed to develop the assumptions for forecasting expenditures in the medium term. In this regard the policy priorities also play an important role. More recently the Government has also tried to estimate the linkage between the current and development expenditure i.e. the impact of development expenditure (in various sectors) on the recurrent expenditure of the Government. This also provides an important piece of information to Government to enable it to forecast its expenditure more accurately.

- **Comprehensive budget documents assist the Parliament in their deliberations and the citizens in their understanding of the budget**

  Budget documents prepared by Punjab, like the other Governments, are pretty comprehensive and provide great detail of the budget. The budget documents provide head-wise/object-wise detail of the proposed budget allocations in comparison with the budget allocations of the on going financial year and the

accounts of the last financial year. The office-wise budgets are consolidated to form departmental budgets which are further consolidated among various functional categories of the expenditure.

Recently the Government has started to upload all its budgetary documents on the official website. Therefore, the general public now has access to all these documents. In this way it is possible for the general public to check the budget allocations for their accuracy in comparison with the passed expenditure. However, commenting on the budget requires investing significant amount of energies to develop understanding of the budget.

- **Disciplines government decision making so that decisions involving expenditure are made in the context of the budget process**

  Budget making plays an important role in disciplining decisions involving expenditure as little can be achieve by the Government in specific sectors without availability of resources in the budget. The budgetary processes, however, provide scope for the Government to make available resources for emergent / unforeseen expenditure needs through Supplementary Grants and re-appropriations in the budget. These actions of the Government are, however, subject to approval by the legislature at the close of the financial year. The rules governing the issuance of Supplementary Grant and re-appropriations have been defined. These rules need to be strictly implemented to ensure that the direction of budgets approved by the legislature is not changed during the course of the year through Supplementary Grants and re appropriations in the budget.

(Economic Policy) at the Provincial level and the Federal level, whether

- **An economic policy unit that is staffed by well trained economists that are capable of providing meaningful policy advice on issues of fiscal sustainability, macroeconomic stability and growth**

  Economic policy unit is functional at the federal level in the Ministry of Finance. This unit is staffed by trained economists who are capable of advising on fiscal sustainability, macroeconomic stability and growth related issues. In addition, the Government utilizes the services of an Economic Advisory Council comprising eminent economists of the country. This Council also renders advice to Government on revenue generation measures and fiscal sustainability issues. The Council also comprises the experts in the area of economic planning who, in collaboration with the economists, advise the Government on growth strategy and proposed policy initiatives to implement it. The State Bank of Pakistan is mandated to devise monetary policy to ensure macroeconomic stability. The Board of Directors of the bank also comprises experts from the field of economics, business, finance etc. and approves monetary policy initiatives proposed by the central bank. State Bank is usually headed by a renowned economist, who is supported by well trained staff that maintains economic data and carries out research to assist the Board of Directors and Governor State Bank.

Economic Coordination Committee of the Cabinet is also important body in the context of economic policy. The Committee is headed by country's Finance Minister, representative of relevant Federal Ministries, Governor State Bank and representatives of the provincial governments. This Committee with wide representation from the various levels of the Government not only facilitates decision making on economic policy initiatives but also ensures coordination among Federal and Provincial Governments.

Provinces mainly play their role in implementation of economic policy. Nonetheless, there are departments such as Punjab Economic Research Institute (PERI), functioning under Chief Economist, Planning & Development Board, that assist provincial government in economic policy making. In fact greater role in economic policy development at the provincial level is played by the Finance Department. The department, however, does not have the support of full time economists available to it at present. The need is presently being felt at the provincial level to strengthen its capacity to affect economic policy making through establishment of specialized unit such as Tax Policy Unit and Macro-Fiscal Forecasting Unit etc.

ANNEXURE 2
DETAILED BREAK-UP OF EXPENDITURE

Current Expenditure (By Minor Object)

(Rs in Million)

Minor Object	2007-08			2008-09			2009-10		
	Budget	Expenditure	% variation	Budget	Expenditure	% variation	Budget	Expenditure	% variation
A011-Pay	22,155.2	24,569.9	-10.90%	28,935.8	32,018.9	-10.66%	36,652.5	33,801.7	7.78%
A012-Allowances	27,668.8	25,063.9	9.41%	31,100.9	34,552.7	-11.10%	49,692.8	50,175.8	-0.97%
A022-Reaserch, Surveys and Exploratory Operations	3.6	2.4	32.85%	4.6	8.9	-91.23%	10.8	5.9	45.47%
A031-Fees	-	-		0.3	0.6	-101.14%	1.2	5.7	-386.11%
A032-Communication	585.4	528.6	9.71%	614.4	544.5	11.38%	665.8	547.5	17.77%
A033-Utilities	1,251.8	1,532.6	-22.43%	2,025.8	2,140.4	-5.66%	2,613.6	4,289.2	-64.11%
A034-Occupancy Costs	251.9	240.8	4.40%	332.0	283.2	14.68%	429.7	309.0	28.10%
A035-Operating Leases	-	0.0		0.9	-	100.00%	-	-	
A036-Motor Vehicles	0.2	0.1	58.16%	3.1	1.7	45.78%	1.5	0.5	64.49%
A037-Consultancy and Contractual Work	-	0.5		0.7	4.3	-479.54%	0.3	0.1	75.00%
A038-Travel & Transportation	3,908.2	5,193.5	-32.89%	4,370.7	5,931.8	-35.72%	5,155.5	4,818.1	6.54%
A039-General	22,211.1	9,248.4	58.36%	10,320.3	11,659.6	-12.98%	15,399.4	13,835.4	10.16%
A041-Pension	12,653.3	16,609.6	-31.27%	13,831.0	24,066.9	-74.01%	19,037.4	31,549.3	-65.72%
A051-Subsidies	5,850.0	411.9	92.96%	17,000.0	3,056.3	82.02%	26,700.0	607.3	97.73%
A052-Grants Domestic	126,814.6	112,126.3	11.58%	120,179.6	132,323.5	-10.10%	129,445.9	129,461.3	-0.01%
A061-Scholarships, Bonuses and Other Awards	1,081.8	286.1	73.55%	1,258.5	611.7	51.40%	1,032.8	1,222.5	-18.37%
A062-Technical Assistance	18.9	0.9	95.44%	12.6	11.5	8.74%	12.5	36.5	-192.08%
A063-Entertainments and Gifts	49.4	76.4	-54.71%	34.7	80.8	-132.92%	72.4	121.4	-67.85%
A064-Other Transfer Payments	95.6	4,588.2	-4700.41%	3,624.4	4,992.0	-37.73%	4,559.9	1,121.0	75.42%
A065-Public Private Partnership	-	-		-	-		-	4,000.0	
A071-Interest – Domestic	12,400.1	14,924.3	-20.36%	13,841.7	13,477.4	2.63%	13,800.0	18,359.8	-33.04%
A073-Others	0.0	0.0	14.54%	0.0	0.0	14.47%	0.0	0.0	94.13%
A081-Advances to Government Servants	-	-		2.1	1.0	54.14%	0.0	(0.0)	350.70%
A083-District Govt/TMAs	-	-		-	0.0		-	-	
A091-Purchase of Building	193.2	91.5	52.66%	14.6	41.1	-181.52%	5.0	55.6	-1005.80%
A092-Computer Equipment	13.3	13.7	-3.24%	41.1	57.0	-38.67%	62.8	70.5	-12.30%
A093-Commodity Purhases (Cost of State Trading)	13.0	14.0	-7.73%	14.8	151.9	-928.08%	17.0	17.2	-1.15%
A094-Other Stores and Stocks	17.1	141.9	-729.06%	99.3	178.1	-79.48%	81.5	38.1	53.27%
A095-Purchase of Transport	49.8	773.5	-1454.73%	746.4	940.7	-26.04%	943.7	1,176.4	-24.66%
A096-Purchase of Plant & Machinery	110.9	682.3	-515.00%	406.9	1,836.4	-351.36%	534.2	923.4	-72.85%

Current Expenditure (By Minor Object)

(Rs in Million)

Minor Object	2007-08			2008-09			2009-10		
	Budget	Expenditure	% variation	Budget	Expenditure	% variation	Budget	Expenditure	% variation
A097-Purchase of Furniture & Fixture	28.7	149.5	-419.96%	55.8	107.3	-92.42%	169.3	183.2	-8.22%
A098-Purchase of Other Assets	-	-		2.3	31.8	-1285.82%	3.1	68.4	-2100.54%
A111-Investment – Domestic	-	3,200.4		-	-		-	-	
A113-Investment – Others	-	-		-	-		-	0.0	
A121-Roads, Highways and Bridges	-	-		-	1.2		-	0.0	
A122-Irrigation Works	-	0.6		-	-		-	0.1	
A123-Embankments and Drainage Works	0.2	0.5	-160.65%	0.2	0.2	14.36%	0.7	0.2	70.44%
A124-Building and Structures	3.5	60.8	-1635.98%	50.8	239.0	-370.80%	6.6	105.2	-1503.24%
A125-Other Works	-	-		-	32.0		-	0.1	
A127-Drought Emergency Relief Assistance	-	1.1		0.0	-	100.00%	0.0	-	100.00%
A130-Transport	385.3	590.9	-53.38%	453.8	516.0	-13.71%	602.9	647.8	-7.44%
A131-Machinery and Equipment	155.8	190.8	-22.52%	290.4	242.5	16.50%	315.6	309.0	2.07%
A132-Furniture and Fixture (R&M)	56.0	16.0	71.39%	67.8	56.4	16.84%	80.0	61.1	23.68%
A133-Buildings and Structure	1,923.3	1,865.4	3.01%	2,674.1	2,352.9	12.01%	2,382.2	2,061.0	13.49%
A134-Irrigation	1,488.5	1,113.8	25.17%	1,901.5	1,610.4	15.31%	1,898.2	1,441.7	24.05%
A135-Embankment and Drainage	691.3	637.5	7.78%	756.2	642.3	15.06%	730.3	605.3	17.12%
A136-Roads, Highways and Bridges	1,348.6	1,318.0	2.27%	1,866.6	1,724.3	7.62%	1,734.6	1,167.4	32.70%
A137-Computer Equipment	7.5	2.6	64.99%	10.0	3.2	68.45%	19.9	6.6	66.94%
A138-General	1.4	1.1	20.17%	1.5	1.6	-5.12%	1.7	2.0	-17.35%
A139-Telecommunication Works	0.0	-	100.00%	0.8	-	100.00%	0.1	-	100.00%
Grand Total	**243,487.3**	**226,270.4**	**7.07%**	**256,948.7**	**276,533.8**	**-7.62%**	**314,873.1**	**303,208.5**	**3.70%**

Current Expenditure (By Departments)

(Rs in Million)

Department	2007-08			2008-09			2009-10		
	Budget	Expenditure	% variation	Budget	Expenditure	% variation	Budget	Expenditure	% variation
P50 – Agriculture	2,721.4	23,324.5	-757.09%	4,295.6	5,093.0	-18.56%	5,466.9	4,584.6	16.14%
P51 – C.M. Secretariat	233.1	703.2	-201.74%	182.5	279.2	-52.95%	221.1	297.0	-34.32%
P52 - Chief Ministries Inspection Team	28.4	-	100.00%	31.5	27.4	12.96%	37.5	81.5	-117.43%
P53 - Colonies Department	-	-		-	-		-	19.9	
P54 - Communication and Works	4,069.3	37,264.2	-815.74%	4,600.2	4,712.3	-2.44%	5,070.2	4,265.9	15.86%
P55 - Consolidation of Holdings	-	129.1		-	-		-	6.8	
P56 – Cooperatives	76.4	42.8	43.96%	74.8	92.5	-23.53%	99.2	107.1	-8.04%
P57 – Education	21,759.1	803.6	96.31%	22,557.4	24,658.7	-9.32%	21,310.6	19,234.4	9.74%
P58 - Environment Protection	34.8	54.6	-56.85%	42.7	48.0	-12.37%	56.6	65.0	-14.84%
P59 – Excise & Taxation	63.5	4,302.1	-6674.38%	61.7	70.7	-14.62%	187.4	245.4	-30.99%
P60 – Finance	147,312.9	569.0*	99.61%	137,697.7	146,863.3	-6.66%	156,365.5	169,174.3	-8.19%
P61 – Food	5,875.1	63.9	98.91%	17,023.9	1,959.6	88.49%	26,730.2	543.3	97.97%
P62 - Forestry Wildlife & Fisheries	1,254.7	104,145.8**	-8200.55%	1,354.2	1,556.4	-14.93%	1,608.3	860.0	46.53%
P63 – Governor's Secretariat	133.0	876.6	-558.93%	148.2	142.2	4.10%	120.3	137.8	-14.48%
P64 – Health	8,930.0	1,828.2	79.53%	13,503.2	15,873.1	-17.55%	21,969.1	17,670.6	19.57%
P65 – Home	32,020.1	5,415.4	83.09%	33,811.6	41,924.0	-23.99%	48,849.6	52,047.5	-6.55%
P66 - Housing Urban Development Public Health Eng	2,304.5	1,000.9	56.57%	2,369.4	1,336.8	43.58%	1,976.9	1,225.1	38.03%
P67 - Industries and Mineral Development	2,398.0	12,426.0	-418.18%	3,328.9	13,753.8	-313.16%	3,462.3	4,458.8	-28.78%
P68 - Information Technology	32.0	239.1	-646.02%	34.8	48.4	-39.37%	64.9	53.3	17.87%
P69 – Information Culture and Youth Affairs	426.6	752.9	-76.48%	388.3	856.7	-120.64%	458.7	677.9	-47.80%
P70 - Irrigation and Power	6,892.2	12,315.3	-78.68%	7,522.0	7,257.3	3.52%	8,723.1	7,349.4	15.75%
P71 - Labour and Human Resource	73.2	626.3	-755.18%	78.1	97.2	-24.52%	114.0	107.3	5.87%
P72 - Law and Parliamentary Affairs	439.6	1,493.7	-239.81%	475.0	469.7	1.13%	1,076.8	870.6	19.15%
P73 - Literacy and Non-formal Basic Education	12.2	955.9	-7710.16%	12.2	11.9	2.31%	15.4	14.7	4.57%
P74 - Livestock and Dairy Development	974.0	5,634.8	-478.52%	1,481.0	1,193.4	19.42%	1,793.6	1,346.2	24.94%
P75 - Local Government and Rural Development	271.1	95.6	64.74%	351.8	330.0	6.20%	400.4	7,250.4	-1710.99%
P76 - Management and Professional Development	31.2	-	100.00%	32.0	34.4	-7.34%	37.5	41.1	-9.64%
P77 - Mines and Minerals	108.3	29.2	73.05%	111.3	134.6	-20.90%	169.6	135.9	19.89%
P78 - Planning and Development	231.0	167.4	27.53%	278.4	283.7	-1.89%	234.5	483.8	-106.33%
P79 - Population Welfare	20.1	-	100.00%	21.3	21.8	-2.06%	22.8	575.3	-2425.93%
P80 - Provincial Assembly	427.2	560.0	-31.09%	535.1	533.4	0.31%	698.4	604.0	13.51%
P81 – Relief	29.0	514.2	-1673.27%	30.7	368.4	-1100.32%	23.9	210.1	-777.74%
P82 - Religious Affairs and Auqaf Dept	19.5	49.8	-155.67%	20.3	15.5	23.27%	19.1	20.4	-6.49%

Current Expenditure (By Departments)

(Rs in Million)

Department	2007-08			2008-09			2009-10		
	Budget	Expenditure	% variation	Budget	Expenditure	% variation	Budget	Expenditure	% variation
P83 – Revenue	243.7	256.3	-5.15%	251.7	414.1	-64.53%	592.7	512.7	13.50%
P84 - Services and General Administration	3,094.5	2,537.5	18.00%	3,651.9	5,229.6	-43.20%	6,220.6	6,627.4	-6.54%
P85 - Social Welfare (W) Development & Bait ul Mal	684.4	52.9	92.27%	307.1	409.4	-33.32%	279.4	337.6	-20.84%
P86 - Special Education	109.1	36.5	66.53%	87.9	94.5	-7.53%	103.5	152.8	-47.71%
P87 – Sports	62.2	5.4	91.26%	92.1	71.6	22.24%	99.8	157.7	-58.03%
P88 – Transport	25.5	40.1	-57.06%	26.9	190.7	-609.81%	63.3	169.5	-167.75%
P89 – Zakat and Ushr	66.3	3.0	95.43%	75.2	75.5	-0.28%	101.5	82.8	18.43%
P90 – Tourism Resort Development Dept	-	26.8		-	-		-	13.9	
P91 - Commerce & Investment Department	-	-		-	1.1		28.1	53.8	-91.32%
P92 – PRNCPL G PLYTCH INST G.CERMAIC SHDARA	-	-		-	-		-	335.0	
Unidentified		6,927.9							
Grand Total	**243,487**	**226,270**	**7.07%**	**256,949**	**276,534**	**-7.62%**	**314,873**	**303,208**	**3.70%**

* There seems to be wrong booking of expenditure in case of Finance and Forest, Wildlife & Fisheries Departments during the financial year. This was the first financial year for which budget & expenditure data was entered in the SAP / R3 based software being used by the Government of the Punjab. The problem of wrong booking has now been completely addressed.

Development Expenditure (By Major Functions)

(Rs. in Million)

Major Function	2007-08			2008-09			2009-10		
	Budget	Expenditure	% variation	Budget	Expenditure	% variation	Budget	Expenditure	% variation
01-General Public Service	35,184.4	37,750.7	-7.29%	23,432.3	50,492.3	-115.48%	30,769.3	31,750.0	-3.19%
03-Public Order and Safety Affairs	39.0	71.9	-84.42%	556.0	1,347.5	-142.37%	1,811.8	2,172.7	-19.92%
04-Economic Affairs	86,149.0	56,529.7	34.38%	87,366.1	61,795.1	29.27%	94,447.1	64,850.9	31.34%
05-Environment Protection	764.3	88.0	88.48%	309.4	229.4	25.85%	-	76.5	
06-Housing and Community Amenities	20,028.1	17,042.8	14.91%	23,429.5	19,408.2	17.16%	28,200.0	22,047.8	21.82%
07-Health	5,646.3	3,997.8	29.20%	7,025.5	5,734.6	18.37%	8,576.1	4,016.9	53.16%
08-Recreational, Culture and Religion	738.3	148.9	79.83%	336.5	257.5	23.48%	2,030.8	301.1	85.17%
09-Education Affairs and Services	17,088.0	2,175.6	87.27%	21,746.9	5,599.1	74.25%	19,315.2	5,764.2	70.16%
10-Social Protection	1,456.8	2,332.6	-60.12%	1,180.0	1,948.1	-65.09%	3,098.1	1,307.8	57.79%
Grand Total	**167,094.3**	**120,138.1**	**28.10%**	**165,382.2**	**146,811.8**	**11.23%**	**188,248.4**	**132,288.0**	**29.73%**

Development Expenditure (By Minor Functions)

(Rs. in Million)

Minor Function	2007-08			2008-09			2009-10		
	Budget	Expenditure	% variation	Budget	Expenditure	% variation	Budget	Expenditure	% variation
011 - Executive & legislative organs, financial	2.0	26.9	-1244.89%	1.0	19.9	-1888.62%	37.7	100.4	-166.63%
014 – Transfers	30,130.3	36,029.9	-19.58%	17,336.0	50,052.1	-188.72%	24,054.0	31,339.3	-30.29%
015 - General Services	5,052.1	1,693.9	66.47%	6,095.3	420.3	93.10%	6,677.6	310.2	95.35%
031 - Law Courtser	-	-		2.0	6.0	-201.34%	-	-	
032 – Police	10.0	65.0	-550.48%	4.0	4.1	-2.65%	-	5.8	
034 - Prison administration and operation	-	-		400.0	-	100.00%	-	-	
036 - Administration of Public Order	29.0	6.9	76.30%	150.0	1,337.3	-791.85%	1,811.8	2,166.9	-19.60%
041 - Gen. economic, commercial & labor affairs	612.9	28.8	95.30%	453.6	53.2	88.27%	235.0	97.9	58.34%
042 - Agri, Food, Irrigation, Forestry & Fishing	13,931.0	9,185.4	34.06%	14,439.4	7,315.4	49.34%	12,658.5	6,656.6	47.41%
043 - Fuel and Energy	820.8	2.7	99.67%	806.5	5.0	99.38%	113.3	5.9	94.79%
044 - Mining and Manufacturing	1,048.2	475.2	54.66%	2,447.0	586.8	76.02%	962.7	1,636.8	-70.02%
045 - Construction and Transport	69,715.8	46,209.5	33.72%	69,148.7	53,832.7	22.15%	80,337.1	56,426.1	29.76%
047 - Other industries	20.3	628.0	-2991.23%	71.0	1.9	97.26%	140.5	27.5	80.39%
055 - Administration of Environment Protection	764.3	88.0	88.48%	309.4	229.4	25.85%	-	76.5	
061 - Housing development	600.0	88.8	85.21%	1,700.0	32.5	98.09%	2,500.0	675.4	72.98%
062 - Community Development	12,928.1	11,618.1	10.13%	13,729.5	11,687.1	14.88%	17,200.0	13,389.9	22.15%
063 - Water supply	6,500.0	5,336.0	17.91%	8,000.0	7,688.7	3.89%	8,500.0	7,982.4	6.09%
073 - Hospital Services	3,606.2	2,369.4	34.30%	5,100.2	4,342.5	14.86%	6,737.3	2,338.5	65.29%
074 - Public Health Services	2,040.2	1,628.4	20.18%	1,925.3	1,392.1	27.69%	1,838.8	1,678.4	8.72%
081 - Recreational and sporting services	40.0	14.1	64.86%	-	14.0		67.5	-	100.00%
082 - Cultural Services	242.8	23.4	90.38%	198.8	84.6	57.47%	223.0	141.5	36.55%
084 - Religious affairs	15.4	6.6	56.94%	15.7	7.8	50.43%	20.0	23.5	-17.56%
086 - Admin.of Info., Recreation & culture	440.0	104.9	76.16%	122.0	151.1	-23.86%	1,720.3	136.2	92.09%
091 - Pre.& primary education affair & service	2,389.2	421.7	82.35%	1,385.0	358.4	74.12%	3,643.8	369.7	89.85%
092 - Secondary education affairs and services	3,297.0	5.5	99.83%	16,211.7	3,567.4	78.00%	13,542.9	3,814.3	71.84%
093 - Tertiary education affairs and services	7,532.3	1,632.7	78.32%	3,676.2	1,636.6	55.48%	1,969.1	1,525.4	22.53%
094 - Education services nondefinable by level	302.5	86.4	71.43%	406.5	36.8	90.95%	73.0	54.8	24.86%
095 - Subsidiary services to education	-	-		-	-		-	-	
097 – Education affairs, services not elsewhere	3,567.1	29.4	99.18%	67.5	-	100.00%	86.4	-	100.00%
107 – Administration	1,316.8	2,035.4	-54.57%	866.9	1,686.4	-94.52%	2,462.1	1,099.7	55.33%
108 – Others	140.0	297.2	-112.30%	313.1	261.7	16.40%	636.1	208.1	67.28%
Grand Total	**167,094.3**	**120,138.1**	**28.10%**	**165,382.2**	**146,811.8**	**11.23%**	**188,248.4**	**132,288.0**	**29.73%**

Development Expenditure (By Major Object)

(Rs. in Million)

Major Object	2007-08			2008-09			2009-10		
	Budget	Expenditure	% variation	Budget	Expenditure	% variation	Budget	Expenditure	% variation
A01-Employee Related Expenses	921.9	1,833.8	-98.92%	1,187.8	2,267.8	-90.93%	963.2	2,288.5	-137.60%
A02-Project Pre-investment Analysis	242.5	876.6	-261.55%	301.5	16.6	94.51%	210.9	388.7	-84.31%
A03-Operating Expenses	9,703.2	3,390.1	65.06%	8,672.0	2,428.5	72.00%	10,758.1	2,825.8	73.73%
A04-Employees Retirement Benefits	84.8	60.0	29.22%	-	0.3		-	1.4	
A05-Grants, Subsidies and Write offs of Loans/Advances/Others	26,407.1	36,298.0	-37.46%	21,184.8	40,379.0	-90.60%	34,873.9	35,181.1	-0.88%
A06-Transfers	21,547.8	7,917.0	63.26%	30,760.2	6,710.1	78.19%	23,726.4	22,106.7	6.83%
A07-Interest Payment	-	9.6		-	-		-	-	
A08-Loans and Advances	14,281.4	3,624.0	74.62%	3,322.0	4,521.8	-36.12%	4,714.0	2,779.1	41.05%
A09-Expenditure on Acquiring of Physical Assets	3,978.0	3,511.8	11.72%	5,162.5	6,060.3	-17.39%	4,254.7	6,193.1	-45.56%
A11-Investments	-	-		-	10,000.0		4,900.0	-	100.00%
A12-Civil Works	89,791.5	62,484.0	30.41%	94,459.8	74,039.5	21.62%	103,609.8	60,204.5	41.89%
A13-Repairs and Maintenance	136.1	133.3	2.12%	331.6	387.9	-16.99%	237.4	319.1	-34.41%
Grand Total	**167,094.3**	**120,138.1**	**28.10%**	**165,382.2**	**146,811.8**	**11.23%**	**188,248.4**	**132,288.0**	**29.73%**

Development Expenditure (By Minor Objects)

(Rs. in Million)

.	2007-08			2008-09			2009-10		
	Budget	Expenditure	% variation	Budget	Expenditure	% variation	Budget	Expenditure	% variation
A011-Pay	531.5	993.8	-86.97%	530.6	1,183.0	-122.96%	395.5	1,259.3	-218.42%
A012-Allowances	390.3	840.0	-115.18%	657.2	1,084.8	-65.07%	567.7	1,029.2	-81.30%
A021-Feasibility Studies	242.0	874.6	-261.47%	290.2	13.9	95.20%	210.9	387.9	-83.95%
A022-Reaserch, Surveys and Exploratory Operations	0.5	2.0	-300.00%	11.2	2.5	77.97%	0.0	0.8	-75900.00%
A022-Research and Service and Exploratory Operations	-	-		-	0.2		-	-	
A031-Fees	7.4	0.0	99.93%	7.8	0.0	99.72%	-	0.0	
A032-Communication	15.7	853.8	-5333.22%	39.0	198.5	-408.94%	14.0	34.5	-146.47%
A033-Utilities	22.2	45.9	-106.95%	40.7	144.5	-254.90%	18.9	49.1	-159.43%
A034-Occupancy Costs	26.5	121.4	-358.37%	40.0	109.3	-173.10%	15.2	144.5	-850.97%
A035-Operating Leases	7.5	2.9	62.10%	2.0	2.0	1.43%	-	-	
A036-Motor Vehicles	2.5	1.5	39.85%	1.1	2.4	-122.53%	0.3	1.1	-221.79%
A037-Consultancy and Contractual Work	1.8	11.9	-559.71%	12.9	9.0	30.63%	6.3	28.0	-347.59%
A038-Travel & Transportation	723.9	360.7	50.17%	239.6	324.3	-35.32%	204.0	291.4	-42.81%
A039-General	8,895.7	1,992.0	77.61%	8,288.8	1,638.5	80.23%	10,499.4	2,277.2	78.31%
A041-Pension	84.8	60.0	29.22%	-	0.3		-	1.4	
A051-Subsidies	-	3.5		-	-		-	1.1	
A052-Grants Domestic	26,407.1	36,294.5	-37.44%	21,184.8	40,379.0	-90.60%	34,873.9	35,180.0	-0.88%
A061-Scholarships, Bonuses and Other Awards	650.1	62.4	90.41%	139.2	62.7	54.95%	507.9	304.1	40.13%
A062-Technical Assistance	-	0.1		-	1.4		-	0.4	
A063-Entertainments and Gifts	3.5	2.1	42.22%	3.9	5.7	-45.90%	4.7	4.0	14.91%
A064-Other Transfer Payments	20,894.2	7,852.5	62.42%	30,617.0	6,640.2	78.31%	23,213.9	21,798.2	6.10%
A072-Interest - Foreign	-	8.9		-	-		-	-	
A073-Others	-	0.6		-	-		-	-	
A084-Loans to Financial Institutions	-	-		-	-		3,000.0	1,650.0	45.00%
A085-Loans to Non Financial Instituiions	14,281.4	3,624.0	74.62%	3,322.0	4,521.8	-36.12%	1,714.0	1,129.1	34.13%
A086-Loans to Others	0.0	-	100.00%	0.0	-	100.00%	0.0	-	100.00%
A091-Purchase of Building	28.9	27.2	5.76%	166.0	114.2	31.23%	226.3	782.0	-245.56%
A092-Computer Equipment	358.6	120.0	66.53%	224.2	185.4	17.32%	141.1	173.1	-22.63%
A093-Commodity Purhases (Cost of State Trading)	2.5	5.1	-100.04%	9.3	23.3	-152.00%	1.4	14.5	-913.61%
A094-Other Stores and Stocks	1,506.6	723.9	51.95%	2,717.0	1,821.9	32.94%	1,430.7	489.4	65.80%
A095-Purchase of Transport	664.0	888.8	-33.86%	553.3	1,075.0	-94.31%	730.8	924.9	-26.57%
A096-Purchase of Plant & Machinery	599.5	1,500.6	-150.31%	1,058.9	2,456.8	-132.00%	844.9	3,554.4	-320.70%
A097-Purchase of Furniture & Fixture	668.9	196.2	70.68%	297.7	344.3	-15.65%	464.2	215.9	53.48%

Development Expenditure (By Minor Objects)

(Rs. in Million)

.	2007-08			2008-09			2009-10		
	Budget	Expenditure	% variation	Budget	Expenditure	% variation	Budget	Expenditure	% variation
A098-Purchase of Other Assets	149.0	50.1	66.39%	136.1	39.4	71.07%	415.3	39.0	90.62%
A111-Investment – Domestic	-	-		-	10,000.0		4,900.0	-	100.00%
A121-Roads, Highways and Bridges	54,597.3	38,522.1	29.44%	45,635.5	46,954.0	-2.89%	52,475.0	27,949.3	46.74%
A122-Irrigation Works	6,899.2	4,296.4	37.73%	7,153.5	2,754.6	61.49%	5,155.5	1,594.9	69.06%
A123-Embankments and Drainage Works	1,342.5	3,460.4	-157.75%	3,046.9	3,505.3	-15.04%	4,250.8	3,569.6	16.03%
A124-Building and Structures	19,016.9	9,474.1	50.18%	26,105.9	10,925.9	58.15%	31,087.8	14,669.9	52.81%
A125-Other Works	7,935.5	6,708.8	15.46%	12,511.3	9,828.3	21.44%	10,620.7	12,357.1	-16.35%
A126-Telecommunication Works	-	-		0.1	0.1	32.67%	-	0.0	
A127-Drought Emergency Relief Assistance	-	22.1		6.7	71.4	-967.19%	19.9	63.7	-220.11%
A130-Transport	24.8	42.4	-70.97%	20.9	45.0	-115.27%	12.4	52.8	-325.78%
A131-Machinery and Equipment	29.5	18.1	38.64%	38.7	42.3	-9.30%	6.7	18.3	-174.20%
A132-Furniture and Fixture (R&M)	1.5	17.5	-1105.67%	5.0	5.6	-13.36%	2.6	6.8	-159.83%
A133-Buildings and Structure	77.4	52.8	31.75%	263.1	290.4	-10.39%	214.4	239.0	-11.47%
A136-Roads, Highways and Bridges	0.7	1.2	-77.93%	0.5	3.6	-629.48%	-	-	
A137-Computer Equipment	2.3	1.2	47.67%	3.4	0.9	72.43%	1.3	2.2	-68.36%
A138-General	-	-		-	0.0		-	0.0	
Grand Total	**167,094.3**	**120,138.1**	**28.10%**	**165,382.2**	**146,811.8**	**11.23%**	**188,248.4**	**132,288.0**	**29.73%**