IPP Policy Paper Series

PUNJAB BUDGET 2008-09:

PROGRESSIVE BUT FRAGILE

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The economy of Punjab has performed relatively well over the last two decades, with a growth rate about 0.5 percentage point above that for the country as a whole. During the 90s, the engine of growth of the regional economy was agriculture. In the last few years a loss of dynamism in this sector has been compensated for by fast growth in services and manufacturing. Today the province has a per capita income about 4 percent above the national average and contributes to federal revenues from apportionable taxes almost as much as its share in population.

But this growth has been accompanied, especially during the current decade, by rising inequality both among households and between different parts of the province. Incomes of the top 20 percent of households have risen twice as fast as the poorest 20 percent. Southern Punjab has fallen further behind Northern and Central Punjab. While there has been some progress in the social indicators, 45 percent of the adult population remains illiterate and the net enrolment rate at primary level remains low at below two-thirds.

The absence of inclusive growth coupled with high food inflation in recent years has meant that progress in poverty reduction has been limited. Even now, almost one-thirds of Punjab’s population remains poor with the highest incidence of poverty in relatively small cities and towns, even more than in the rural areas.

The Punjab Budget of 2008-09 is the first budget of the democratically elected coalition government of the province. It comes at a time of worsening economic conditions, with stagnation in agriculture, rising food and fuel prices and growing poverty. Alongwith the federal budget, there are expectations that some relief will be provided, especially to the poor.

BUDGET ESTIMATES

We discuss first the estimates of revenue receipts and expenditure in the Punjab Budget for 2008-09.

Revenue Receipts

Revenue receipts of the province are expected to increase from Rs. 315.6 billion to Rs. 389.9 billion, showing a growth of 24 per cent. Federal transfers are the largest source accounting for 77 per cent of these receipts. Within these transfers, the bulk is transfers from the federal divisible pool, which are expected to increase significantly from Rs 220.1 billion in 2007-08 to Rs 284.6 billion in 2008-09, a growth of over 29 percent. This is due not only to increase in the share of the provinces (from 42.5 percent to 43.75 percent) in the divisible pool but also because of expected fast growth of 25 percent in federal tax revenues, despite an economy which is visibly slowing down. The extent of overestimation, therefore, in transfers could be in excess of Rs 15 billion.

Under the head of federal grants, budgetary support of Rs 6.5 billion for poverty reduction is indicated. This is grant assistance by DFID which was discontinued in 2007-08. It is not clear whether such support will be resumed in 2008-09.

Provincial own tax receipts are expected to also show rapid growth of almost 32 percent, rising from Rs 30.6 billion to Rs 40.4 billion. This includes extraordinary growth of almost 50 percent in stamp duty revenue at a time when the property market is in a slump and the number of transactions is low. Similarly, motor vehicle tax revenue is expected to increase by 38 percent in a period when new car sales are down. Altogether, the extent of overstatement in own tax revenues in 2008-09 could be as much Rs 5 billion.

Within non-tax revenues, extraordinary receipts are pitched at over Rs 17 billion. This includes disinvestment of shares of the Bank of Punjab, which is expected to yield receipts from privatization of Rs 12 billion. The Bank has already suffered considerable loss of confidence following actions by the new government. Sale of shares at this time may lead to a run against the Bank. These receipts should anyway be shown as a financing item in the budget and not as a part of revenue receipts.

Overall, revenue receipts of the Government of Punjab in 2008-09 may have been overstated by about Rs 38.5 billion as follows:

Overstatement of Federal D.P. Transfers	Rs 15 billion
Overstatement of Federal Grants	Rs 6.5 billion
Overstatement of Provincial Tax Receipts	Rs 5 billion
Receipts from Privatisation	Rs 12 billion
Total	**Rs 38.5 billion**

In 2007-08, there was an overstatement of revenue receipts by a similar amount of over Rs 40 billion. This shortfall in revenue will necessitate a cut back in expenditure, especially in the size of the ADP, and/or enhanced cash credit accommodation with the SBP.

Revenue Expenditure

Revenue expenditure, inclusive of an expanded relief program for the poor, is expected to show modest growth of 11 percent from Rs 232.2 billion in 2007-08 to Rs 256.9 billion in 2008-09. A reduction of about Rs 7 billion is actually proposed in general public services (including transfers to local governments) while the outlay on economic affairs (including the relief program) has been raised by Rs 20 billion and on education by Rs 9 billion.

It is commendable that at a time of high inflation restraint is being exercised in budgeting revenue expenditure, which had grown rapidly by almost 17 percent per annum and more than doubled in nominal terms over the last five years. This was a reflection of the growing extravagance in public expenditure at the provincial level by the previous administration.

The decline in expenditure on general public services is predicated on economy in expenditure on executive and legislative organs, financial and fiscal affairs. In particular, interest payments on debt are expected to decline despite past accumulation of provincial debt and rising interest rates in the economy.

The major economy proposed is in transfers to local governments. These are expected to remain virtually flat at just over Rs 106 billion in 2008-09. This is despite the expected rapid growth in federal transfers (including the district support grant) to the province. The new Government of Punjab is demonstrating a degree of hostility to the local governments set up in the province under the Devolution Plan. While this may be politically motivated, it implies that limits have been placed on the provision of basic municipal and social services, which have an important bearing on the quality of life of the people of Punjab.

The revenue expenditure projections also do not factor in the 20 percent increase in salaries and pensions announced by the federal government and major enhancements in allowances, especially for lower level employees. The provincial government is expected to follow suit with an additional cost approaching Rs 15 billion. It will become essential to increase the grant to local governments to avoid any disruption in the provision of basic services.

In the head of public order and safety affairs, the provincial government is also proposing to exercise economy and the allocation has been kept, more or less, constant at Rs 37 billion. But given the deteriorating security situation, with more frequent acts of terrorism, there is a strong likelihood that more protective measures will have to be taken to preserve law and order in the province. Also, there is the threat of strikes and protests against the rapidly increasing food, fuel, electricity and gas prices.

Within economic affairs, the big jump in expenditure is in the relief program for the poor of Rs 17 billion. The provincial government is expected to set up a program of food stamps. The federal government has already announced a national Benazir Income Support Program of Rs 34 billion initially, involving an income supplement of Rs 1000 per month to over 3 million households. For Punjab, the proposed relief program by the provincial government is almost as large as the federal initiative. It remains to be seen how the two programs will be implemented and coordinated and whether targeting of the poor will be effective. Nevertheless, the effort to extend relief by the Government of Punjab needs to be appreciated. No other province has announced such a program.

Overall, the conservatism in expenditure on public order and safety affairs in light of the prevailing security situation, the prospect of higher interest payments and the additional salary bill indicate that revenue expenditure in 2008-09 could be upto Rs 30 billion higher than budgeted. This will put further pressure on borrowings from SBP and/or require large cuts in the ADP.

The Budget is based on a revenue surplus of Rs 133 billion for financing of a provincial ADP of Rs 160 billion. The resource gap of Rs 27 billion is proposed to be met by capital receipts and foreign project assistance. But the gap could be substantially larger in view of the revenue shortfalls and current expenditure spillovers described above and approach Rs 95 billion. In view of the pressure on the SBP to maintain a very tight stance of monetary policy to contain inflation it is unlikely that overdraft limits will be raised. The government of Punjab, alongwith other provincial governments, is likely to face a hard budget constraint in 2008-09.

TAXATION PROPOSALS

Another area in which the government of Punjab needs to be commended is the effort to raise revenues from provincial taxes. Tax revenues are proposed to increase by 32 percent in the coming year as compared to 18 percent annually over the last five years. This demonstrates not only a change in trend in the province but is aso unique among provinces, as the other provinces have all announced tax-free budgets.

The Punjab bill 2008 envisages to raise additional revenues through the following:

- Levy a tax on imported luxury motor cars: a tax of Rs 200,000 on imported cars with engine capacity from 2000 to 3000 cc and Rs. 300,000 on cars exceeding 3000 cc.
- stamp duty of 2 per cent of property value on both new documents of consent decree and transfer of property: the bill proposes to broaden the base of stamp duty by levy on new documents of consent decree and transfer of rights or interest relating to immoveable property by a development authority,

housing authority, statutory body, co-operative housing society, company or a developer.

- increase of one per cent on sales tax on services from 15 to 16 per cent.

In addition, the government of Punjab proposes certain measures to improve tax administration. In the area of property taxation, the valuation tables are being updated and new rating areas notified. The rates of professions, callings and trade tax are being enhanced. Aso, it is proposed to computerize land records for land revenue purposes and rationalize rates of stamp duty on financial instruments.

Positive elements in the resource mobilization strategy include, first, the burden of additional taxation is mostly on the upper income groups and is therefore progressive in character. Second, the additional tax mobilization is more through direct taxes and is therefore unlikely to be inflationary. Three, an attempt has been made to tax hitherto undertaxed sectors, like real estate and services and is, therefore more in the nature of broadening of the tax base. This contrasts with the federal resource mobilization strategy in 2008-09 which relies more on higher taxation of existing tax bases.

DEVELOPMENT PROGRAM

Ambitious plans have been made by the Government of Punjab to expand the development program from Rs 121 billion to Rs 160 billion in 2008-09, a growth of over 31 percent. This continues the past trend of rapid increases in provincial PSDP, by over ten times in size over the last seven years. This has been one factor, which may have contributed to faster growth of the regional economy of Punjab.

However, the stagnation of agriculture meant that development priorities needed to be shifted decisively towards this sector, especially at a time of rising food prices. But the share of the provincial development program going directly into agriculture and rural development remains low at about 12 percent only. In particular, alongwith larger public investments in rural infrastructure, the provincial government ought to have focused more on expanding agricultural research and extension for achieving higher yields. Instead, there continues to be an 'urban bias', with substantially larger allocation of Rs 29 billion proposed for special infrastructure, primarily in the metropolitan city of Lahore like the Ring Road and the Rapid Mass Transit Projects. Also, the allocation for urban development is up by as much as 86 percent. Given high levels of poverty, most of these resources ought to go towards provision of basic municipal facilities in the smaller cities and towns of the province.

The overall allocation for social sectors is up significantly from Rs 47 billion to Rs 59 billion, with important changes in priorities. Within education, the priority is shifting from higher education, emphasized by the previous government, towards school education. Similarly, within health, the focus is more on preventive care and public health. These changes are more pro-poor in character.

In line with the new Punjab's government's negative perception about local governments, there is no increase proposed, in relation to last year's development allocation of Rs 12 billion, to district governments and TMAs. This has negative implications for the rate of expansion in basic municipal and social services. Also, the local government program executed by the provincial government has been phased out.

Perhaps the biggest disappointment is in the lack of increase in the already meager allocation of about Rs 2 billion only for area development programs in backward parts of the province like the Barani areas, Cholistan and Southern Punjab. The public sector will clearly have to play a leading role in arresting the growing regional inequality in the province and allocations for regional planning for balanced development will have to be enhanced substantially in coming years.

CONCLUSION

Given the uncertainty surrounding the optimistic growth projections for revenue receipts and in the ability to restrict current expenditure in a high inflation period and a risky situation from the security point of view, the provincial government may be faced with difficult policy choices during 2008-09. The presence of a hard budget constraint implies that if the resource gap is larger then either the relief program for the poor and/or the development program will have to be cut back. The new Punjab government has demonstrated a commitment to progressivity both on the taxation and the expenditure side in the Budget of 2008-09 but whether it will be able to realize its intentions, given the frailty of the budget estimates in a deteriorating economic environment, remains to be seen.