

**CONFERENCE
ON
RESOURCE MOBILISATION AND
EXPENDITURE PLANNING**

**PROSPECTS OF RESOURCE MOBILIZATION
BY THE
PROVINCIAL GOVERNMENTS**

by

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SPONSORED

by

CANADIAN INTERNATIONAL DEVELOPMENT AGENCY

and

GOVERNMENT OF THE PUNJAB

**March 11-13,1995
Avari Hotel, Lahore**

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INTRODUCTION;

1.1 It is a well known feature of the Federation in Pakistan that the responsibilities of the Provincial Governments have grown at faster pace over the years both on development and maintenance sides particularly in the social sectors. So much so that over 55% of the development expenditure is borne by the Provincial Governments while 25% is financed by the Federal Government and 20% through the Local Councils. The recurring expenditure on projects completed through development budget is shifted to the non-development side as soon as the project is completed resulting in more burden on the regular or non-development budget of the Provincial Governments. Thus, the overall expenditure of the Provincial Governments has increased rapidly while income from different sources has not caught up with this rapid increase. Resultantly the financial position of the Provincial Governments has deteriorated over the years. The NFC Award of 1991 has put more onus on Provincial Governments of self-financing any revenue deficit during the tenure of the Award. Prior to this Award the general practice for the Federal Government was to allow grants to cover any resource gap in the current account of the Provinces. With the passage of time resource mobilization by the Provincial Governments from their own resources has assumed greater importance. The Provincial Governments are expected to continue generating surplus in their non-development budget and raise the level of development expenditure primarily from the surplus resources.

1.2 The reasons for continuing deterioration in the financial resources of the Provinces *arc* slow moving receipts from the provincial taxes, rising debt service and decline in the share of development expenditure in the total expenditure. There was sizeable jump in the Provincial finances after the 1991 Award but thereafter the Provincial Governments are facing more difficulties in balancing their budgets. The past behaviour of Provincial Governments indicates that higher federal transfers generally had significant stimulatory effect on provincial expenditure and a negative effect on their fiscal efforts. The anticipated increase out of divisible pool of taxes by the Federal Government is not forthcoming due to substantial shift in the fiscal policy of the Federal Government. Thus, the NFC Award which was acclaimed to be historical for Provinces did not have the desired results and the Provincial Governments are likely to face more difficulties in years to come.

OBJECTIVE/THEME OF THE PAPER:

2.1 The basic aim of this paper is to quantify the level of fiscal efforts by the Provincial Governments and indicate the possible areas where provincial receipts can be substantially improved so that the financial conditions of the Provincial Governments are further strengthened for more development activity in the field of social sector. The overall growth in the provincial receipts in the country during the last decade has been of the order of 13%. The growth of revenue receipts in the Punjab which is about 16% is much faster than the other Provinces. This is due to the relative buoyancy of the Provincial Economy and higher fiscal effort by the Provincial Government. But even this increase in revenue still falls short of increase in expenditure which has grown at a faster pace of 18%. There has been a tendency on the

part of Provincial Governments not to make much efforts to mobilise their own resources any further due to fiscal policies of the then Federal Government. This has resulted in a stagnation of efforts on the part of Provincial Governments themselves and it is becoming day by day difficult to change this rather regressive approach towards resource mobilization. Prospects for further revenue generation by the Provincial Governments may be broadly categorised as: -

- i) improvements in the existing revenue resources.
- ii) additional receipts from new avenues of taxation; and
- iii) re-allocation of revenue items among the Federation and the Provinces, including enlargement of divisible pool.

IMPROVEMENT IN THE EXISTING RESOURCES:

3.1 Taxes and duties in the country are levied by the Federal and Provincial Governments in accordance with the Constitutional provisions in the respective fields. A List of Federal and Concurrent Items is appended with the Constitution, perusal of which would show that major items of taxation are reserved for the Federal Government. There is very little scope for the Provincial Governments to levy any major tax on residuary items. The primary source of provincial revenue consists of

- (i) taxes on physical assets like the Property Tax, Motor Vehicles Tax, Stamp Duty and Land Revenue; and
- (ii) taxes which are essentially levied in the nature of duty on services Like Electricity Duty, Entertainments Duty and Hotel Tax.

The nature of most of these provincial taxes is quite inelastic. It is due to this basic reason that the provincial taxes have generally increased at a low pace. Exception exists in the case of a few levies like Stamp Duty which has increased at a faster pace upto late 80's but its growth has also been retarded recently due

to slump in Real Estate business. But even in items available to the Provincial Governments, the effort has not been enough on the part of the Provincial Governments to exploit these sources fully. Incentive environments have not been conducive to greater fiscal efforts by the Provinces due to adhoc nature of inter-governmental fiscal relations whereby the Provinces had residual access to deficit grants from the Federal Government which has led to profligacy in expenditures and slackening of fiscal efforts. This attitude on the part of the Provincial Governments has to be changed which cannot happen unless it has the full support of political structure and the legislature. To exploit the existing resource fully, it is of basic importance that the Provincial Tax Administration *is* given due attention and brought at par with the Federal Revenue machinery. The Provincial Tax Administration has not received due attention for development because of extreme dependence on federal transfers. Since the collection of taxes is relatively small, the cost of collection is also comparatively higher for the Provincial Governments. The two major Departments administering the Provincial Tax Receipts are the Excise & Taxation Department and the Board of Revenue. The sphere of E&T Department is restricted to mostly taxes of urban nature and its personnels are not very-well trained professionals as they lack indepth preentry training in the field of assessment and collection of taxes. The position of Board of Revenue is much worse as due to multiplicity of functions priority given to tax collection by the field organization under the Board of Revenue is relatively very low. The efforts of Board of Revenue on the revenue side are mostly restricted to rural areas. However, the levy of stamp duty and registration fee which in part is urban based is being dealt with by personnel who are not at all professionally trained for the purpose. The posting of Extra Assistant Commissioners and Tehsildars as Sub-Registrar on part-time basis certainly does not help in good

tax administration particularly when record of urban property is not available with them. This has certainly hampered the growth of true potential of the major levy. It is of great importance for improvement in the revenue potential of the Provincial Governments that a specialised Provincial Taxation Service is established to look after all the urban as well as rural taxes and duties. The measure is likely to go a long way in improving and exploiting the existing revenue resources to the maximum possible extent.

3.2 In the matter of exploitation of existing resources it is quite important that the mode and format of assessment of different levies remains under constant review so that these can be brought up-to-date and rates changed to commensurate with the prevailing conditions in respect of each and every levy. Unfortunately this cannot happen unless it has the support of the legislature and political will to overcome the tax payers who have a growing tendency to agitate against any increase in the existing taxes. Another salient feature of the existing revenue structure is that service charges and non-tax receipts in the social sector like Education, Health, Irrigation etc. are unreasonably low and have not been co-related with the recurring cost which has increased tremendously over the years.

3.3 The up-shot of the above discussion is that the Provincial Governments have to make a major effort in improving the existing receipts for which following points are of vital importance: -

- i) a Specialised Provincial Taxation Service may be established to look after all Provincial Taxes and Duties;
- ii) the rates of existing levies may be kept under constant review and where-over feasible may be changed from specific to ad-valorem; and
- iii) service charges and non-tax receipts may be revised upward and made reasonable. The rates of such charges and receipts should be co-related with the recurring cost.

ADDITIONAL RECEIPTS FROM NEW AVENUES OF TAXATION:

4.1 It is generally argued that there is very little scope for additional provincial resource mobilization because taxes with large and relatively buoyant tax base like Customs Duties, Income Tax, Excise Duties, Sales Tax etc. are levied by the Federal Government. The taking over of Sales Tax by the Federation immediately after Independence is cited as a major encroachment on provincial fiscal powers. Retail Sales Tax almost throughout the known economies of the world is administered by the provincial or state governments. The field of taxation left for the Provincial Governments in Pakistan is no doubt very narrow and generally of inelastic nature. It however, remains a fact that the scope of generating revenues even within the existing sources has not been fully exploited by the Provinces. The issue of Agricultural Income Tax which has been specifically assigned to the Provinces still remains largely unresolved. Capital Gains Tax on immovable property which falls within the provincial domain has been abolished and substituted by a higher Stamp Duty. This substitution has led to significant losses as it has created serious distortions in the property market and also implies that the Provinces have not fully benefited from the tremendous boom in real estate business during the last decade. It is also observed from the constitutional provisions that the Federal Government has been limited to the levy of Sales Tax on goods but are not competent to levy any tax of similar nature on services. The latter field has been left to the Provincial Governments who have been slow in exploiting the vast potential that exists in the taxation of fast growing services in the fields of communication, banking, insurance and the like. Instead, the Federal Government has tapped substantial revenues in recent years from these sources under the cover of Excise Duties which certainly looks to be an over-stepping. The NEC Award of 1991 had also specifically indicated to transfer the responsibility of collection

of retail sales taxation to the Provinces. The Provinces have failed to take any concrete steps to finalise the arrangements to levy and collect the retail Sales Tax that has very large potential as a major source of revenue. On the other hand the Federal Government has again encroached in this area by introducing sales tax on a large number of items during the last couple of years. Altogether it appears that while Provincial Governments have been granted limited fiscal powers, they have failed to even exploit effectively the sources available to them.

4.2 In view of the above, there is a strong case for the Provincial Governments to introduce new taxes within its existing fiscal powers to improve their resource position to a large extent in the years to come. It is of vital importance for the Provinces that they generate more resources to keep their budgets balanced. In the case of Punjab it looks an essential feature for the next few years that additional resources to the extent of around Rs. 1 billion are generated annually to at least match the increasing expenditure on current side. The Provincial Governments may consider to introduce following new taxes as soon as feasible:-

i) TAX ON PURCHASE AND SALE OF SERVICES:

As mentioned earlier the Federal Government is not competent to levy any tax on sale or purchase of services. The area of tax on services has great potential in view of the increasing dependence on services in the information age. The Provincial Governments may start with a Sales Tax on Services rendered in the field of communications banking, tourism, hoteling etc. immediately while other areas may be tapped in the next few year's time. The field has a vast potential for additional receipts for the provincial exchequer.

ii) RETAIL SALES TAX:

The 1991 NFC Award provides for collection of retail sales tax by the Provinces. There are well-known difficulties in implementing the Sales Tax at retail level. These difficulties can be overcome by providing a fool proof discretion tree system of assessment and collection of this **tax** through a fully trained and highly specialised administrative machinery. The Provincial Governments may, as an initial step, examine the scope for levy of a pre-sumptive Sales Tax on larger outlets in commercial centres of the bigger towns in the Provinces.

iii) CAPITAL GAINS TAX:

Capital Gains Tax which started as a minor levy in the early 60s could have taken the shape of a major tax for the Provincial Governments had it not been abolished in the year 1986. It was probably the most buoyant and progressive source of revenue for the Provinces. The tax was abolished on the ground that it has vast discretionary powers for the assessing officers which resulted in large scale connived evasion and avoidance of the tax. Instead of removing the flaws in the existing law which was enacted when the levy had no real impact, the tax was abolished altogether accompanied by an increase in the existing rate of Stamp Duty on transactions. The basic merit of Capital Gains Tax, as opposed to the Stamp Duty, is that it only taxes increments in value resulting from a transaction of property. In view of this position, it is recommended that the Provinces may re-introduce the levy of Capital gains Tax but at the same time reduce the existing rates of Stamp Duty because the present high rates are not only considered regressive but have also proved to be somewhat counter-productive.

iv) AGRICULTURAL INCOME TAX:

The case regarding the desirability or otherwise for the introduction of an agricultural income tax has remained under discussion for a pretty long time. It looks difficult to levy and collect an agricultural income tax of the conventional type in the peculiar circumstances of the Provinces. The issue whether it is desirable to further tax the agricultural sector needs to be finally resolved by explaining whether the rural sector is properly taxed or not and whether the paying capacity of the agricultural sector can permit any such levy. In any case levy of some sort of Income Tax on the feudal elite is desirable due to a number of reasons and should be taken up in the right earnest by the respective Provinces.

v) ADDITIONAL RECEIPTS FROM NON-TAX RESOURCES:

Revenue receipts from economic and social sectors have remained depressed throughout this period while expenditure in these sectors *has* grown tremendously. There is substantial potential in additional receipts in the following non-tax sectors: -

- a) Agriculture.
- b) Forestry.
- c) Irrigation.
- d) Works.
- e) Housing and Public Health.
- f) Education.
- g) Health.
- h) Animal Husbandry and Fisheries.

In Punjab existing annual receipts from all the above departments are of the order of Rs. 3 billion. Receipts from these sources are mostly in the nature of service or user charges and rates in most of these cases are very low and unreasonable even from the standard of cost of maintaining these sectors. The rates of these service and user charges are required to be made reasonable and at least brought at par with the recurring cost of the projects. It is suggested in this regard that existing receipts from these sources may at least be doubled through a phased programme over a period of about 2 to 3 years by revising the rates of these user charges by a reasonable margin.

RE-ALLOCATION OF REVENUE ITEMS BETWEEN THE FEDERATION AND THE PROVINCES.

5.1 This is a basic feature of the Federation that the federating units are allowed financial autonomy and have sufficient fiscal powers to balance their budget. However, in Pakistan the Provinces have not remained autonomous as far as the fiscal authority is concerned because they have always to look towards the federation for more resources to keep the Provinces going. As a matter of fact the situation has deteriorated over the last few decades since independence as some of the tax items entrusted to the Provinces at the time of Independence and then under the 1956 Constitution have been taken away and allocated to the Federal Government. This has naturally affected the financial autonomy of the Provinces in a big way. The most pertinent instance in this regard is divesting the Provinces of their authority to levy the Sales Tax. This was one of the major sources of revenue for the provinces before independence with great potential for improvement over the years. This tax is generally administered by the Provincial or State Governments almost throughout the world and it has been a great blow to the provincial exchequer to divest them from this levy.

Further a number of tax items on the Provincial Legislative List of the 1956 Constitution have been included in the Federal Legislative List of the 1973 Constitution. Following are few of these examples: -

- i) Tax on Capital Value of Agricultural Land.
- ii) Duties in respect of Succession to Agricultural Land.
- iii) Estate Duty in respect of Agricultural Land.
- iv) Taxes on goods and passengers carried by Railway, water ways and roads.
- v) State Lotteries.

5.2 It would be observed that the above listed items which were specifically allocated to the Provinces under the 1956 Constitution have now been transferred to the Federal Legislative List by the 1973 Constitution in a big way. The Federal Government has quite benevolently placed some major taxes in the divisible pool share out of which is transferred to provinces on the basis of agreed formula. Following taxes and duties constitute the divisible pool of taxes: -

- a) Export duty on Cotton.
- b) Sales Tax.
- c) Income and corporate tax excluding tax on income consisting of remuneration paid out of the Federal Consolidated Fund; and
- d) Excise Duty on Tobacco and Sugar.

In addition to the above items, under the 1991 NFC Award the Provincial Governments have also been allowed royalties on natural gas and oil according to production and location of these resources. It is clear from the above that certain major taxes have not been included in divisible pool, thus, depriving the Provinces of their legitimate share out of these major levies like Customs Duty on import and export of goods and Excise Duties on very large number of items. It is therefore, imperative to enlarge the scope of divisible pool by including

the remaining taxes thereon. The Province of Punjab has also been hit by provision of royalties on account of oil and gas as both these items are mostly produced out of this Province but are mainly consumed here.

5.3 In view of the above discussion it is proposed that not only the scope of divisible pool may be enlarged but the following items may be transferred to the Provinces to make them financially viable:

- a) Levy and collection of Sales Tax may be entrusted to the Provinces.
- b) Capital Value Tax on assets, Succession Duty and Estate Duty may be levied by the Provinces.
- c) The Federal Government may abstain to levy any tax on services and existing levies introduced by them on services under the cover of Excise Duty may be transferred to the Provincial Governments.
- d) The scope of divisible taxes may be enlarged to cover all the major taxes collected by the Federal Government.

6. CONCLUSION:

Study of the foregoing submissions would amply establish that presently the Provincial Governments are not financially autonomous and have to largely depend on the Federal Government for their financial needs which is against the basic feature of a true federation. It is, therefore, inevitable that the Provinces not only generate additional resources from their existing tax items but also introduce some other avenues of taxation from where further resources may be generated. The Federal Government can help the Provinces by strictly following the Constitutional provisions and abstain from levying taxes in areas not specifically earmarked for them. The item of retail Sales Tax may be left to the provinces as agreed in the NFC Award of 1991. The focal point for notice is that unless the Provinces are made financially

independent and responsible to generate their own resources it would be difficult to support the recurring expenditure on development as well as on non-development sides.
