Research Report No.12

Resource Mobilization and Expenditure Planning for Social Sectors in Pakistan

June 1996

THE RESEARCH TEAM

Team Leader:	**Dr. A.F. Aisha Ghaus**
Economists:	**Mr. M. Asif Iqbal**
Research Assistant	**Ms Rafia Ghaus**
Computer Operator	**Mr. Rizwanullah Khan**

TABLE OF CONTENTS

	Page Nos.
CHAPTER ONE:	
PERFORMANCE IN SOCIAL INDICATORS	**1**
1.1 INTRODUCTION	1
1.2 KEY SOCIAL INDICATORS	1
1.2.1 Schematic Links Between Social Sector Outputs and Inputs	3
1.3 TRENDS IN KEY SOCIAL INDICATORS	6
1.3.1 Population Growth Rate	6
1.3.2 Literacy Rate	6
1.3.3 Infant Mortality Rate	9
1.4 TRENDS IN SOCIAL SECTORS INPUTS	9
1.4.1 Enrollment Rates	9
1.4.2 Health Inputs	9
1.4.3 Rural Water Supply Coverage	13
1.5 PLANNING TARGETS	13
1.6 INVOLVEMENT OF DONOR AGENCIES	13
1.7 SOCIAL ACTION PROGRAM	17
CHAPTER TWO:	
INSTITUTIONAL RESPONSIBILITIES FOR DELIVERY OF SOCIAL SERVICES	**18**
2.1 ALLOCATION OF FUNCTIONS	18
2.2 INSTITUTIONAL RESPONSIBILITIES IN SOCIAL SERVICES	20
2.3 SOCIAL SECTOR EXPENDITURES BY LEVEL OF GOVERNMENT	24
2.3.1 Development Expenditure	24
2.3.2 Recurring Expenditure	27
2.4 ROLE OF PRIVATE SECTOR	27
2.5 ROLE OF NGOs	27
CHAPTER THREE.	
FISCAL STATUS OF PROVINCIAL GOVERNMENTS IN PAKISTAN	**31**
3.1 TRENDS IN PROVINCIAL FINANCES	31
3.2 KEY FISCAL RATIOS	31

CHAPTER FOUR:
INTERGOVERNMENTAL FISCAL RELATIONS IN PAKISTAN 35

4.1 HISTORICAL EVOLUTION OF REVENUE-SHARING ARRANGEMENTS 35

4.2 GRANTS 35

4.3 DEVELOPMENT TRANSFERS 37

4.4 THE 1990 NEC AWARD 37

CHAPTER FIVE:
PROVINCIAL TAXES IN PAKISTAN 46

5.1 DESCRIPTION OF PROVINCIAL TAXES 46
5.1.1 Stamp Duty 46
5.1.2 Property Tax 46
5.1.3 Motor Vehicle Tax 47
5.1.4 Land Revenue 47
5.1.5 Taxes on Services 47
5.1.6 Other Taxes 47

5.2 LEVEL OF FISCAL EFFORTS 49

5.3 COMPOSITION OF REVENUES 52

5.4 CAUSES OF LOW TAX REVENUES AND BUOYANCY 52

5.5 REVENUE-RAISING POTENTIAL OF PROVINCIAL TAXES 55
5.5.1 Existing Taxes 55
5.5.2 New Taxes 58

CHAPTER SIX:
PROVINCIAL TAX ADMINISTRATION IN PAKISTAN 60

6.1 INSTITUTIONAL STRUCTURE 60
6.1.1 Excise and Taxation Department 61
6.1.2 Board of Revenue 62

6.2 ISSUES IN TAX ADMINISTRATION 63

6.3 LINKAGES BETWEEN PROVINCIAL AND FEDERAL TAXES 66
6.3.1 Property Tax and Income Tax 67
6.3.2 Property Tax and Wealth Tax 67
6.3.3 PTC Tax and Income Tax 67

6.4 COMPUTERISATION AND DATA BASE DEVELOPMENT 68

CHAPTER SEVEN:
PROVINCIAL USER CHARGES IN PAKISTAN 70

7.1 INTRODUCTION 70

7.2 TRENDS IN MAJOR USER CHARGES 71
7.2.1 Economic Services 71
7.2.2 Social Services 73

7.3 LEVELS OF USER CHARGES 75
7.3.1 Education Services 75
7.3.2 Health Services 75

7.4 EXTENT OF COST RECOVERY 78
7.4.1 Economic Services 78
7.4.2 Social Services 78

7.5 CAUSES FOR LOW COST RECOVERY 80
7.5.1 Economic Services 80
7.5.2 Social Services 81

7.6 REVENUE RAISING POTENTIAL OF USER CHARGES 81
7.6.1 Strategy of Cost Recovery 81
7.6.2 Methodology of Scoring and Ranking Procedures 82
7.6.3 Ranking of Services 83
7.6.4 Levels of Cost Recovery 87

CHAPTER EIGHT:
PROVINCIAL EXPENDITURE ALLOCATIONS IN PAKISTAN 89

8.1 INTRODUCTION 89

8.2 COMPOSITION OF AND GROWTH IN CURRENT EXPENDITURE 89

8.3 COMPOSITION OF AND GROWTH IN DEVELOPMENT EXPENDITURE 89

8.4 ADEQUACY OF DEVELOPMENT EXPENDITURE IN RELATION TO TARGETS 92

8.5 EQUITY CONSEQUENCES OF PUBLIC EXPENDITURE
IN SOCIAL SECTORS 94

CHAPTER NINE:
COST EFFECTIVENESS OF EXPENDITURES IN THE SOCIAL SECTORS OF PAKISTAN 95

9.1 COSTS AND OUTPUTS 95
9.2 AREAS OF WASTAGE 95
9.3 PATTERN OF RECURRING EXPENDITURE 99
9.4 PATTERN OF EMPLOYMENT 101
9.5 INVESTMENT PROGRAMMING 103
9.6 THE PROJECT CYCLE 106
9.7 ALTERNATIVE DELIVERY MECHANISMS 108

LIST OF TABLES

Page Nos.

CHAPTER ONE

Table 1.1:	Basic Indicators for Selected Developing Countries	2
Table 1.2:	Basic Social Indicators for Selected Developing Countries, 1993	4
Table 1.3:	Population Growth Rates by Province in Pakistan	7
Table 1.4:	Trends in the Literacy Rate by Province in Pakistan	8
Table 1.5:	Trends in the Infant-Mortality Rate by Province in Pakistan	10
Table 1.6:	Enrollment Rates by Level of Education and by Province in Pakistan, 1993	11
Table 1.7:	Level of Health Inputs by Province in Pakistan, 1994	12
Table 1.8:	Rural Water Supply Coverage by Province, 1993	14
Table 1.9:	National Targets and Bench-Marks for the Eighth Plan	15
Table 1.10:	Involvement of Donor Agencies in the Social Sectors of Pakistan	16

CHAPTER TWO

Table 2.1:	Share of Different Levels of Government in Revenue and Expenditure in Pakistan	21
Table 2.2;	Actual Allocation of Functions between Different Levels of Government in the Social Sectors	22
Table 2.3.	Share of Different Levels of Government in Development Expenditure on Social Sectors in Pakistan, 1993-94	25
Table 2.4:	Shares of Different Levels of Government in Recurring Expenditure on Social Sectors in Pakistan	26
Table 2.5:	Percentage Share of Private Health Institutions by Province in Pakistan, 1989	28

CHAPTER THREE

Table 3.1:	Trends in Finances of Provincial Governments in Pakistan, 1993-94	32
Table 3.2:	Key Fiscal Ratios of Provincial Governments in Pakistan	33

CHAPTER *TEN:*
ROLE OF LOCAL GOVERNMENTS IN PAKISTAN **109**

10.1 INSTITUTIONAL STRUCTURE 109

10.2 EXISTING ALLOCATION OF FISCAL POWERS AND FUNCTIONS 111
10.2.1 Fiscal Powers 111
10.2.2 Functions 111

10.3 FISCAL STATUS OF LOCAL COUNCILS 116

10.4 SOURCES OF REVENUE 116
10.4.1 Urban Councils 119
10.4.2 Rural Councils 120

10.5 ANALYSIS OF THE MAJOR LOCAL TAXES 120
10.5.1 Octroi 120
10.5.2 Urban Immovable Property Tax 122
10.5.3 Export Tax 123
10.5.4 Other Taxes 123

10.6 REVENUE RAISING POTENTIAL OF LOCAL SOURCES 125
10.6.1 Existing Local Sources 126
10.6.2 New Local Sources 129

10.7 EXPENDITURE PATTERNS 131

10.8 INSTITUTIONAL CAPABILITY 134
10.8.1 Organisational Set-up 134
10.8.2 Staffing Levels and Employment 135
10.8.3 Employment Level and Pattern 137
10.8.4 Managing and Financial Reporting System 139

10.9 CASE FOR DECENTRALISATION 139
10.9.1 Cross-country Comparison of Provision of Social Services 140
10.9.2 Economic and Institutional Justification for Decentralisation 140
10.9.3 Political Justifications for Decentralisation 143

10.10 CANDIDATE SERVICES FOR DECENTRALISATION TO LOCAL LEVEL 143

10.11 MODALITIES OF DECENTRALISATION 149
10.11.1 Revenue Sharing 150
10.11.2 Matching Grants 151
10.11.3 Nature of Decentralisation Program 151
10.11.4 Institutional and Personnel Implications 152

CHAPTER FOUR

Table 4.1:	Trends in Inter-governmental Transfers to the Provincial Governments (Combined) of Pakistan	36
Table 4.2:	Revenue Sources and Magnitude of Transfers to Provinces (Combined) With and Without NFC Award of 1990 in 1993-94	39
Table 4.3:	Positive and Negative Aspects of the 1991 NFC Award for Each Province of Pakistan	40
Table 4.4:	Transfers from Divisible Pool by Federal Government to The Provincial Governments of Pakistan	41
Table 4.5:	Change in Federal Transfers due to The 1990 NFC Award, 1990-91	42
Table 4.6:	Summary of Growth Rates of Provincial Finances Pre-and-Post 1990 NFC Award	44

CHAPTER FIVE

Table 5.1:	Provincial Tax Rates in Pakistan, 1993-94	48
Table 5.2:	Level of Fiscal Effort by Provincial Governments in Pakistan	50
Table 5.3:	Composition of and Growth in Provincial Tax Revenues in Pakistan	51
Table 5.4:	Buoyancy of Major Provincial Taxes in Pakistan	54
Table 5.5:	Ranking of Taxation Proposals under Different Criteria	56

CHAPTER SIX

Table 6.1:	Cost of Collection of Tax Departments of Provincial Governments in Pakistan, 1993-94	64

CHAPTER SEVEN

Table 7.1:	Composition and Growth in User Charges by Province, 1994-95	72
Table 7.2:	Composition of User Charges by Province	74
Table 7.3:	Level of Fees for Public Education by Province in Pakistan	76
Table 7.4:	Level of User Charges for Health Services	77
Table 7.5:	Cost Recovery Ratios by Sector and by Provincial Governments in Pakistan	79
Table 7.6:	Revenue Raising Potential Based on Scoring Procedure: Economic Services	84
Table 7.7:	Revenue Raising Potential Based on Scoring Procedure: Social Services	86
Table 7.8:	Proposed Targets for Cost Recovery	88

CHAPTER EIGHT

Table S.I:	Composition of and Growth in Recurring Expenditure on Social Sectors by Province 1994-95	90
Table 8.2:	Composition of and Growth in Development Expenditure on Social Sectors by Province 1994-95	91
Table 8.3:	Adequacy of Development Expenditure by Provincial Governments in Relation to Seventh Plan Targets	93

CHAPTER NINE

Table 9.1:	Ratio of Growth in Enrollments and Real Public Expenditure on Education, 1980-81 to 1992-93	96
Table 9.2:	Net Continuation Ratio at Primary and Secondary Level by Gender and by Province, 1992-93	98
Table 9.3:	Budgeted Recurring Expenditure by Sub-Sectors and by Province, 1991-92	100
Table 9.4:	Employment by Grade in Social Service Departments of Provincial Governments,(1991 -92)	102
Table 9.5:	Share of New and On-Going Schemes in Social Sectors Allocations by Province, 1991-92	104
Table 9.6:	Budgeted Allocations as Percentage of Total Cost of Schemes in the Social Sectors, 1991-92	105

CHAPTER TEN

Table 10.1:	Number and Types of Local Councils by Province	110
Table 10.2:	Taxes of Urban Local Councils	113
Table 10.3:	Taxes of Rural Local Councils	114
Table 10.4:	Key Financial Ratios of the Local Councils by Province	117
Table 10.5:	Composition of Local Council Income by Province, 1991-92	118
Table 10.6:	Potential Property Tax Base by Province	124
Table 10.7:	Ranking of Local Taxation Proposals on Different Criteria	132
Table 10.S:	Level and Pattern of Expenditure of Local Councils by Province, 1991-92	133
Table 10.9:	Status of Heads of Different Departments of Local Councils	136
Table 10.10:	Range of Employment in Different Departments of Local Councils	138
Table 10.11:	Cross Country Comparison of Local Functional Responsibilities	141
Table 10.12:	Ranking of Candidate Services on Criteria for Decentralisation of Services in Large Cities	145

Table 10.13: Ranking of Candidate Services on Criteria for Decentralisation of Services in Small Cities 146

Table 10.14: Ranking of Candidate Services on Criteria for Decentralisation of Services in Rural Areas 147

Table 10.15: Ranking of Services for Decentralisation 148

Table 10.16: Proposed Matching Grants Scheme by Provincial Government 153

LIST OF CHARTS

CHART 1:	Schematic Links Between Social Sector Outputs and Inputs	5
CHART 2.1:	Legislative and Actual Allocation of Function among Different Levels of Government of Pakistan	19
CHART10.1:	Functions that can be Performed by Urban Local Councils in Balochistan	112
CHART 10.2:	Additional Compulsory Functions to be Performed by a Metropolitan Corporation in Sindh	114

Chapter One

PERFORMANCE IN SOCIAL INDICATORS

1.1 INTRODUCTION

In recent years, there seems to be a change in the focus and direction of development economics with respect to important factors that should be considered in the process of formulating economic plans for developing economies The suggestions by many economists has been that a greater emphasis be paid to the social sectors of the economy if a sustained and meaningful economic growth is to be attained. In this context the Ex. Finance Minister Sartaj Aziz (1992) noted:

> *... the complementarity between growth and distribution (has a) mutually reinforcing relationship between economic growth and human resource development Education especially of females health (lower) population growth proved progress in the social sectors is absolutely necessary for ensuring that per capita growth be sustained.*

At a more theoretical level, discussion on the current state of development economics, Naqvi (1992) argued:

> *... that development economics should focus on the ends of development (i.e., improving the welfare of the people) rather than the means of achieving it (i.e., the growth of per capita income) a more comprehensive indicator of development composed of such components as longevity and literacy rather than just per capita income human capital rather than just physical capital to account for the positive contribution of education and health to economic growth.*

In light of these advances in development economics and of course the recent strong commitment on the part of the Government of Pakistan to support and prepare a comprehensive Social Action Program (SAP) the objective of this chapter is to analyse the performance of key social indicators in Pakistan.

In Section 1.2, we compare social Indicators of Pakistan in relation to other comparable countries. Section 1.3 presents the provincial magnitudes of key social indicators. The relationships between social sector inputs and outputs are discussed in Section 1.4. A brief summary of the provincial governments Eighth Plan targets and bench-marks are reviewed in Section 1.5. Section 1.6 highlights the extent of donor agencies involvement in the social sectors while Section 1.6 summarizes the Social Action Program.

1.2 KEY SOCIAL INDICATORS

The relatively better economic performance of Pakistan's economy in recent years has now been widely acknowledged. The per capita GNP and the corresponding growth rate of Pakistan, as shown in Table 1.1. has been impressive and surpasses that of most of its neighbour countries.

TAIM: 1.1

BASIC INDICATORS FOR SELECTED DEVELOPING COUNTRIES

Country	Population [Million] 1993	Population Growth Rate [%] 1980-1993	GNP Per Capita [US $] 1993	Growth Rate of GNP Per Capita [%] 1980-1993
Pakistan	123	28	430	3.1
Bangladesh	115	2 1	220	2.1
Nepal	21	2.6	190	2.0
Nigeria	105	2.9	300	-0 1
India	898	2.0	300	3.0
China	1178	1.4	490	8.2
Sri Lanka	18	1.5	600	27
Indonesia	187	1.7	740	4.2
Egypt	56	2.0	660	2.8
Philippines	65	2.3	850	-06

Source World Development Report, 1995

Despite its rapid economic progress, the performance in the social indicators of Pakistan has been inadequate. In relation to nine other comparable countries considered, Pakistan's population growth rate has been the second highest at 2.8 percent per annum next to only Nigeria (2.9 percent). As shown in Table 1.2, the overall life expectancy at birth is 62 years which is higher than India and Bangladesh, Nepal and Nigeria but lower than countries like China, Indonesia, Sri Lanka and Philippine. The infant mortality rate for Pakistan is significantly higher than other countries in the region (at 88 per thousand) with the exception of Nepal and Bangladesh.

The most discouraging social indicator has been the literacy rate, particularly for females. With the exception of Nepal, Pakistan's female literacy rate of 21 percent is the lowest of all the countries considered. Even countries like Bangladesh and Nigeria, which have a significantly lower per capita GNP than Pakistan, have a higher female literacy rate as indicated as Table 1.2. On the issue of female education, Lawrence Summers (1992) of the World Bank recently pointed out that:

> *... Underinvestment in girls is not an ineluctable consequence of poverty, nor is if made necessary by any religious or cultural tradition. It is an economic problem that results from a vicious cycle caused, by distorted incentives... uneducated women... have few alternatives and so the expectation becomes self-financing, trapping women in a continuous circle of neglect.*

1.2.1 Schematic Links Between Social Sector Outputs and Inputs In their, special report (1991) entitled "Towards a Social Action Programme", the Planning Commission, Government of Pakistan, identified four key social outputs, namely, population growth. literacy rate, infant mortality rate (IMR), and life expectancy rate as critical to the progress in the social sector of the economy. In fact, an improvement in these social factors is considered to be crucial to achieve sustained meaningful economic growth and prosperity.

In order to enhance these social sector outputs, we first need to know the social factor inputs that would help achieve the desired social targets. Secondly, we also need to know the direct or indirect links between the social sector inputs and outputs. In the following, a schematic diagram will identify the direct links between the social sector inputs and outputs.

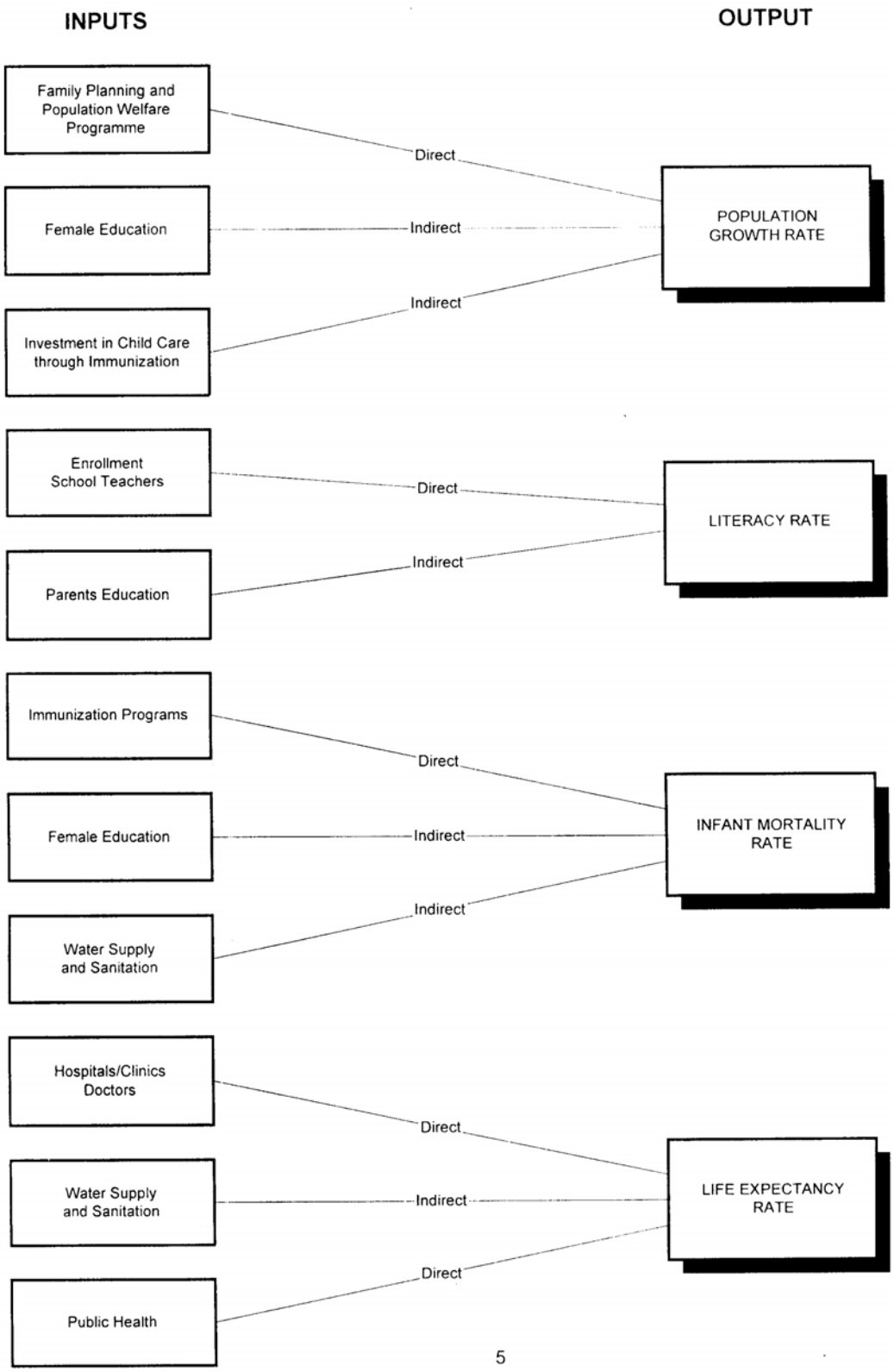
Clearly, population growth rate may be controlled directly by two types of social inputs, e.g., family planning and population welfare programs and female education. Family planning, through contraceptives and other means of medical facilities may directly control the population growth rate. On the other hand, educating mothers (i.e. increasing the female literacy rate), will increase their knowledge on the proper use of contraceptives and other techniques of family planning and this will consequently have a positive effect on reducing the population growth. Finally, immunization programs are expected to reduce infant mortality thereby reducing the incentive for the parents particularly in the rural areas to have large families.

TABLE 1.2
BASIC SOCIAL INDICATORS FOR SELECTED DEVELOPING COUNTRIES, 1993

Country	Life Expectancy at Birth [Year]	Crude Birth Rate [Per 000' pop]	Crude Death Rate [Per 000' pop]	Infant Mortality Rate [Per 000' pop]	Literacy Rate (1990)		
					Male	Female	Total
Pakistan	62	40	9	88	49	21	35
Bangladesh	56	35	11	106	48	22	35
Nepal	54	39	13	96	39	13	26
Nigeria	51	45	15	83	63	39	51
India	61	29	10	80	62	34	48
China	69	19	8	30	84	62	73
Sri Lanka	72	20	6	17	93	83	88
Indonesia	63	24	8	56	86	68	77
Egypt	64	29	8	64	62	34	48
Philippines	67	30	6	42	91	89	90

Source World Development Report, 1995

CHART 1
SCHEMATIC LINKS BETWEEN
SOCIAL SECTOR OUTPUTS AND INPUTS



As for the literacy rate higher enrollment, more schools and teachers will have a direct positive effect on it. At the same time educating mothers will motivate and enlighten them to send their sons and daughters to schools and this again will have a positive impact on the literacy rate.

One of the important effects of immunization programs, of course, will he to reduce the I MR. Educating females will prepare mothers to take better care of their children thereby reducing the 1MR. In addition provision of proper water supply

TABLE 2.2
ACTUAL ALLOCATION OF FUNCTIONS BETWEEN DIFFERENT LEVELS OF GOVERNMENT IN THE SOCIAL SERVICES

	Service	Function	Large Cities	Intermediate Cities	Small Cities	Rural Areas
1	Water Supply Sewerage and Drainage	Development Maintenance	S S	PHE D/I C I C	PHE D I C	PHE D/RDD I C PHE D I C
2	Garbage Collection	Development Maintenance	I C I C	I C I C	I C I C	-
3	Primary Education	Development Maintenance	PE D/I C PE D/I C	PE D PE D	PE D PE D	PE D PE D
4	Secondary and College Education	Development Maintenance	PE D/F E M PE D/F E M	PE D PE D	PE D PE D	- -
5	University Education	Development Maintenance	F E M* F E M*	- -	-	
6	Vocational Training	Development Maintenance	F MM/PE E SD F MM/PE E SD	PE E SD PE E SD	PE E SD PE E SD	
7	Curative Health	Development Maintenance	F HM/PHD/I C F HM/PHD/I C	PHD PHD	PHD PHD	PHD PHD
8	Preventive Health	Development Maintenance	PHD/I C PHD/I C	PHD/I C PHD/I C	PHD/I C PHD/I C	PHD PHD

* University education is funded by the federal government through the Ministry of Education and University Grants Commission However universities are administratively controlled by the provincial government of Punjab

S=Specialised Agency (Development Authority/WASA) I C=Local Council PHE D Provincial Public Health Engineering Department RDD=Provincial Rural Development Department PE D=Provincial Education Department F E M=Federal Education Ministry F MM=Federal Ministry of Manpower PE E SD=Provincial Education Labour and Social Welfare Departments F HM=Federal Health Ministry PHD Provincial Health Department
Source Prepared by Consultants

community hand pumps are provided by the provincial rural development department (RDD). In some areas of the provinces, district councils have devoted a small part of their development expenditure to water supply and sanitation. According to the local government ordinance, maintenance responsibilities in rural areas vest with union councils. However, due to lack of institutional and financial capability the function continues to be performed by PHED.

Garbage Collection: Local councils in the urban areas have specialized in discharging tills basic function.

Primary Education: This is largely the responsibility of the provincial government, although the LGOs contains this as one of the functions to be performed by local governments. It is only in Karachi where the involvement of the metropolitan corporation is significant. Private schools that were nationalised in the early 70s have been made KMC responsibility with the expectation that the recurring expenditure of such schools would he financed by grants from GOS. Such grants have, however, generally not been forthcoming. In large cities, like Lahore, Hyderabad and Karachi, the private sector has taken on a major share in the provision of primary and secondary education.

Secondary and College Education: This is again primarily the responsibility of the provincial education department. The exception is the involvement of the federal education ministry in the funding of special institutions like the Urdu College In Karachi.

University Education: Although university education is in the concurrent list, financing of development and current budgets of universities has been taken over by the federal government due to paucity of resources with the provincial government. However, while funding is through the federal education ministry and University Grants Commission (UGC), administrative control of universities remains with the provincial governments.

Vocational Training: This function is shared between the provincial and federal governments. Within the former, three departments, viz, education, labor and social welfare, share in discharging this responsibilities. Formal training is undertaken by polytechnics run by the education department. At the other end, vocational training facilities, especially for women, are managed by the social welfare department.

Curative ***Health:*** This is again the function primarily of the provincial health departments. In large cities, however, there is multiple provision. For example, the KMC has established the Abbasi Shaheed Hospital and recently a Dental College.

Preventive Health: This is generally a shared responsibility between provincial health department and local councils.

Altogether, it appears that there are significant differences in the distribution of institutional responsibilities depending upon location and size of settlement. In large cities like Lahore. Karachi and Peshawar there has been greater decentralization and local governments (and specialized agencies) have largely taken over of functions of water supply and sanitation Municipal/metropolitan corporations have also moved into the areas of curative health and primary education. This raises the issue of intergovernmental co-ordination and the possibility of over provision.

In medium-sized cities, development responsibilities remain largely with provincial line departments and local governments are involved partially in maintenance, especially in the area of water supply. However, given this institutional allocation, the transition of schemes from the development to the maintenance stage is not always an easy and smooth process.

In rural areas, both development and maintenance responsibilities for provision of social services are generally with provincial line departments. Local council's role is very limited, due both to human and financial resource constraints. Given the substantial outreach capabilities required by the provincial line departments, it is clear that the case for decentralization of the provision of social services is strong in the rural areas, especially of operations and maintenance. This argues not only for a strengthening of local councils but also for the development of community based village level organizations in the provinces.

2.3 SOCIAL SECTOR EXPENDITURES BY LEVEL OF GOVERNMENT Based on the above allocation of institutional responsibilities, we have derived the shares of different levels of government in Pakistan in the development and current expenditure respectively on social services in 1993-94. The resulting estimates are presented in Tables 2.3 and 2.4. These estimates are for the four provinces combined.

2.3.1 Development Expenditure

Overall, the share in development expenditure on the social sectors is 59% by the provincial governments, 14% by the federal government and 28% by all the local councils combined in the country. The share of provincial governments is large in education and training at 85%, health and nutrition at 76% and physical planning and housing (including water supply and sanitation) at 56%. Major federal involvement is in sectors like population welfare and manpower and employment at 94% and 89% respectively. Local councils play a significant role in development of water supply and sanitation and to some extent in health largely preventive. Altogether, our estimate is that in 1993-94 the development outlay by provincial governments was Rs.10.0 billion, by the federal government Rs. 2.4 billion, and by local councils Rs 4.8 billion, thereby yielding an aggregate investment figure of Rs. 17 billion.

TABLE 2.3
SHARES OF DIFFEREENT LEVELS OF GOVERNMENT IN
DEVELOPMENT EXPENDITURE ON SOCIAL SECTORS IN PAKSITAN
1993-94
[Rs in Million]

	Federal	Provincial	Local"	Total
Education & Training	582	4369	216	5167
Percentage Share	11.3	84.6	4.2	100.0
Health & Nutrition	597	2278	115	2989
Percentage Share	20.0	76.2	3.8	100.0
Population Welfare	100.0	65	0	1065
Percentage Share	39.9	6.1	00	100.0
Social Welfare	51	307	0	358
Percentage Share	14.1	85.9	00	100.0
Physical Planning & Housing	12	3034	2420	5467
Percentage Share	0.2	55.5	44.3	100.0
Manpower & Employment	121	15	0	136
Percentage Share	88.9	11.1	00	100.0
Others	18	43	2057	2119
Perentage Share	0.9	2.0	97.1	100.0
Total	2381	10135	4808	17323
Percentage Share	13.7	58.5	27.8	100.0

* Estiamted on the basis of annual growth rate.

Source Annual Budget Statement (Federal)

Annual Budget Statements of the Provincial Governments

TABLE 2.4
SHARES OF DIFFERENT LEVELS OF GOVERNMENT IN
RECURRING EXPENDITURE ON SOCIAL SECTORS IN PAKISTAN
1993-94
[Rs. In Million]

	Federal	Provincial	Local	Total
F ducation & Training	3703	26610	1216	3 1 S29
Percentage Share	1.7	84.4	3.9	100.0
Health & Nutrition	119	6754	781	8654
Percentage Share	12.9	78.0	9.0	100.0
Population Welfare	4	0	0	4
Percentage Share	100.0	0.0	0.0	100.0
Social Welfare	1388	390	0	1779
Percentage Share	78.1	21.9	0.0	100.0
Physical Planning &	9	209	5455	5673
Housing Percentage Share	0.1	3.7	96.2	100.0
Manpower & Employment	163	200		162
Percentage Share	44.9	55.1	00	100.0
Others	1068	340	294.7	4155
Parentage Share	24.9	7.8	677	100.0
Total	7454	34503	10399	52156
Percentage Share	14.2	65.9	19.9	100.0

* Estaimated on the basis of annual growth rate

Source: Annual Budget Statement [Federal].

Annual Budget Statements of the Provincial Governments.

2.3.2 Recurring Expenditure

Turning to recurring expenditure. Table 2.4 demonstrates that the dominance of the role of provincial governments in social sector provision is even more pronounced, The share of these governments combined is 66% as compared to 14% of (he federal government and 20%' of local governments. The-basic reason for this is that two of the more labor-intensive services, viz, education and health, with relatively high O&M costs, are largely the responsibility of provincial governments. 1-edcral shares are significant in sectors like population welfare, social welfare, manpower and employment, while local recurring expenditures are sizeable in health and nutrition and, physical planning and housing (including expenditure by the WASAs). Overall, the total estimated recurring expenditure in 1'W °4 on social sectors by the public sector in Pakistan is Rs. 52.4 billion, with Rs. 34.5 billion by the provincial governments. Rs. 7.5 billion by the federal government and Rs. 10.4 billion by local councils.

2.4 ROLE OF PRIVATE SECTOR

Tlie role of private sector in tlie provision of services like curative health and school education has expanded rapidly during tlie decade of the 80s. Demand for education and medical services has risen substantially with the growth in incomes and the perception of poor quality of service provision by the public sector. Consequently, the demand-supply gap has increasingly been filled by the private sector for the middle to upper income groups especially in the large cities of tlie province like Karachi, and Hyderabad.

Table 2.5 gives the share of private medical institutions in Pakistan. By 1989, 22% of tlie hospital beds were in the private sector. The corresponding percentages for dispensaries and MCH centres are I <S% and 24% respectively. By and large, the role of the private sector is most significant in Sindh followed by Punjab. Private sector involvement in education is also increasing in the larger provinces. Formal estimates of the share of enrollment in private schools are not available. Casual empiricism reveals that this could be as high as 40% in cities like Lahore and Karachi. There is now a growing tendency for private schools to he established in the smaller cities.

The increase in private sector involvement in education and health has clearly relieved the pressure on government. However, it has led to a dualistic market structure with high priced, high quality services being provided by the private sector and highly subsidized, low quality services by the public sector. Also, there has been a drain of scarce human resources like teachers, nurses, etc., from the public to the private sector.

2.5 ROLE OF NGOs

Not much is currently known about the role generally of NGOs in Pakistan and in particular in the social sectors. A recent study by the UNDP, alongwith the Small Projects Office of the CIDA, has however, indicated, perhaps for the first time, the size and nature of involvement of NGOs in Pakistan. The study estimates that there are about 5000 NGOs in Pakistan currently (although almost 40% may

TABLE 2.5
PERCENTAGE SHARE OF PRIVATE HEALTH INSTITUTIONS
BY
PROVINCE IN PAKISTAN, 1989

	Punjab	Sindh	NWFP	Balochistan	Pakistan
Hospitals (Beds)	18	36	6	19	22
Dispensaries (No)	4	"S^	4	-	IS
TB Clinics (No)	39	4	25	-	14
M C H Centres (No)	23	44	20	3	24

Source Statistical Yearbook. 1990. FBS

not be functioning). The study does not present its findings separately for each province. The salient findings of the survey of NGO at the national level are as follows:

- Development of voluntary agencies is basically an urban phenomenon in Pakistan, due to increasing awareness of community development and socio-economic factors less than 30% of the NGOs are in rural areas.

- Most of the NGOs are relatively recent in origin. Only 20% of the NGOs were established before 1972. Over 25% started operating between 19S2 and 19S6.

- Majority of NGOs are local in character Over 55% are operating at the community level. 16% at district level R%) At provincial level and only 5% at national level.

- There is limited human resources capability of NGOs with average of 7 lull-time and 1 part time person. Voluntary workers average at 62 per NGO.

- Major aims of NGOs are women's development (49%). medical care service (43%) and formal education (3S%i). Other social sector objectives include sanitation development (5%,). family planning (3%,) and water supply (2%).

- Prime target groups are women (51%), children (27%,') and patients (2.3%,).

- Major program areas are health (39%i). women's development (39%'). basic education (17%). child development (15%) and adult education (12%.).

- The principal activities are vocational training (31%) for women. Promotion (22%). fund raising (19%o), loans/credit (1S%) and emergency relief (12%.). Major services and facilities include medical aid (40%), vocational skills (40%,), formal education (31%) and adult education (11%).

- Over 65 %i of NGOs have annual beneficiaries of less than 500 people. Only K% have large programs benefiting more than 10.000 people.

- 86% of the NGOs surveyed indicate need for training.

- Achievements include establishment of industrial/vocational centre (39%,), adult education centre (11%i). school (10%). tuition centre (7%i), MCH Centre (6%.). dispensary (6%), hospital (3%), clinic (3%,) and basic health centre (3%.), water tank (2%).

- Annual expenditures are low. Over 53%. of the NGOs have annual budgets less than Rs.50.000.

The overall picture which emerges is that of very limited capability of NGOs currently in Pakistan.

However, it is significant that majority of NGOs are already committed to social sector development goals in the areas of education, health and population planning. There also appears to be a natural complementarily in roles with government. For example, in education there is stronger emphasis by NGOs on female vocational training and adult education.

However, for NGOs to significantly expand their delivery role in the social services, major efforts will have to be launched for human resource and financial strengthening of such organizations. In particular, NGOs will have to be increasingly motivated to take on the task of community development in the rural areas so as to lead to the formation of village level organizations to manage local services. Significant new initiatives in this area will have to he undertaken by government and donor agencies establishment of provincial education and health foundations to strengthen the role of voluntary organisations is a major step in this regard.

Chapter Three

FISCAL STATUS OF PROVINCIAL GOVERNMENTS IN PAKISTAN

3.1 TRENDS IN PROVINCIAL FINANCES The last decade has witnessed relatively slow growth, of about, 11 percent per annum, in revenue receipts (from own sources) of the provincial governments in Pakistan. The provincial government's own revenues have increased from Rs 4.7 billion in 1981-82 to Rs 16.3 billion in 1993-94, with taxes accounting for 54 percent of own revenues (see Table 3.1). As compared to this, provincial current expenditure in 1993-94 was Rs 100.3 billion, showing an annual growth rate of almost 18 percent. Therefore, the provincial governments have had to increasingly rely on fiscal transfers from the federal government to finance their current activities. These transfers largely consist of federal tax assignments and non development grants. In 1990-91 prior to the NPC award, these transfers were Rs 36.8 billion and Rs 10.4 billion respectively accounting for 62 and 17 percent of provincial revenue receipts. In 1993-94, following the '91 NFC award, there has been a change in the pattern of these transfers with federal tax assignments contributing 83 % while non-development grants represent only 2 % of total provincial revenue receipts.

Despite the high level of support provided by the GOP, the financial position of the provincial governments has deteriorated significantly during the decade of the 80s. In 1990-91, the latter had a revenue deficit of about Rs. 2 billion. Furthermore, almost all of the provincial development activity is financed by capital loans or grants from the federal government. In 1990-91, federal loans were Rs 16 billion as compared to about Rs 13 billion of development capital expenditure.

The overall financial position of the provincial governments has, however, improved in 1993-94 due to the significant increase in the flow of funds from the federal government following the NFC award. In 1993-94, the revenue account surplus of the provincial governments combined was Rs. 5 billion with an overall budgetary surplus or build up of cash balances of Rs. 2 billion.

3.2 KEY FISCAL RATIOS

The long-term deterioration in the fiscal status of the provincial governments is further highlighted by the key financial ratios presented in Table 3.2. Provincial own receipts as a percentage of total revenue receipts have declined from 30 percent to 15 percent from 1981-82 to 1993-94. This clearly highlights the slackening of the provincial fiscal effort and the growing financial dependence on the federal government. Furthermore, the ratio of revenue surplus/deficit to revenue expenditure highlights the increasing inability of the provincial governments to adequately finance revenue account liabilities particularly in the 80s. In 1990-91, revenue account deficit of the provincial governments was more than 3 percent of its current expenditure. Similarly, use of cash balances increased over the period of

TABLE 3.1
TRENDS IN FINANCES OF PROVINCIAL GOVERNMENTS IN PAKISTAN

	Punish	Sindh	NWFP	Balochistan	Pakistan
deneral Revenue Receipts	53173	25534	1777	10379	106863
Federal Tax Assignment'	41495	21034	15892	9803	88224
Provincial Tax Receipts	5711	2371	634	142	8858
Non-Tax Receipts	4688	1430	1041	327	7485
I-ed Non-Dev Grants	1279	700	209	107	2296
Current Expenditure	49092	25739	16636	8825	100292
Rev Surplus (+)/Deficit (-)	4081	-205	1141	1554	6571
Debt Servicing	11930	6815	5142	2020	25906
Total Development Expenditure	7793	6418	4348	4366	22925
Development Revenue Expenditure	3486	1585	1888	1318	8276
Development Capital expenditure	4307	4833	2461	3048	14649
Net Capital Receipts	9524	8172	2950	1193	21838
Federal Loans	9019	5685	3121	2042	19868
Others	504	2487	-171	8^0	1971
Development Revenue Receipts	988	1921	760	921	4590

* Including profit from hydro-electricity.

Source Annual Budget Statements of the Provincial Governments

TABLE 3.2
KEY FISCAL RATIOS OF PROVINCIAL GOVERNMENTS IN PAKSITAN

	Provincial Own Rec. as % of Revenue Receipts	Total Revenue Rec. as % of Current Expenditure	Federal Transfers" as % of Total Expenditure	Debt Servicing As % of Rev. Receipts	Development Exp as % of Total Expenditure
Punjab					
1991-92	22.7	104.7	81.8	21.4	23.5
1992-93	19.7	100.0	80.1	25.5	21.3
1993 94	19.6	108.3	92.8	22.4	13.7
Sindh					
1991-92	18.8	101.1	87.1	21.3	23.5
1992-93	15.7	102.5	81.3	25.3	21.4
1993-94	14.9	99.2	91.2	26.7	20.0
NWFP					
1991-92	9.2	111.0	91.6	24.5	30.6
1992-93	9.4	111.4	99.7	27.3	27.0
1993-94	9.4	106.9	95.2	28.9	20.7
Balochistan					
1991-92	3.8	126.5	96.5	15.2	39.5
1992-93	4.5	117.8	93.9	18.9	34.3
1993-94	4.5	117.6	97.6	19.5	33.1
Pakistan					
1991-92	17.5	106.7	86.4	21.3	26.5
1992-93	15.3	104.1	85.3	25.1	23.8
1993-94	15.3	106.6	93.3	24.2	18.6

* Inclusive of transfers both on current and capital account Federal transfers – FTA+DG+FL+DRR

Source Annual Budget Statement of the Provincial Governments

analysis. Therefore, the 80s have witnessed the increasing inability of the provincial government not only to expand but also to sustain its existing level of activity.

The ratio of debt servicing to revenue receipts indicates the extent to which scarce resources were preempted by interest payments and were, therefore, not available for use for expansion of social or economic services. In 1990-91 as much as 26 percent of the total revenue receipts of the provincial governments was pre-empted by debt servicing obligations. The heavy strain of debt servicing on the provinces is also highlighted by the ratio of debt servicing to current expenditures. In 1990-91 debt servicing accounted for almost 25 percent of current expenditure.

As highlighted earlier the situation has improved in 1993-94 following the NFC award. The provincial governments have shown a combined surplus of about Rs 7 billion on the revenue account and there has been a significant draw down of cash balances with SBP. However, there is no evidence of a significantly higher development activity in the provinces because of the improved resource position.

Chapter Four INTERGOVERNMENTAL FISCAL RELATIONS IN PAKISTAN

Our analysis in the previous chapter indicates that the high expenditure levels of the provincial governments and the rapid growth in them has been financed primarily by federal transfers. In 1993-94, for example, federal transfers were equivalent to 93 percent of total expenditure (development + revenue) of the provincial governments (see Table 3.2).

This high dependence on federal support is true both for revenue and capital receipts. In 1993-94 the provincial governments generated only about 15 percent of their revenue receipts through own (tax + non tax) sources. In other words federal government transfers contributed about 85 percent to provincial revenue receipts. These transfers primarily consist of federal tax assignments (see Table 4.1). Similarly, on the capital account a significant component of the provincial development programs are funded by federal transfers coming largely in the form of loans. Given (lie significance of each of these transfers we undertake a brief description of these in the following sections.

4.1 HISTORICAL EVOLUTION OF REVENUE-SHARING ARRANGEMENTS The history of inter-governmental revenue-sharing arrangement between the federation and the federating units (the provinces) goes back to pre-partition times. Since independence there have been five revenue-sharing awards. Starting with the Raisman Award of 1951. Revenue-sharing transfers to the provinces peaked under the 1970 NFC Award which increased the size of the divisible pool by about 40 percent over the Raisman award. The subsequent NFC Award of 1974 reduced the size of the divisible pool by one-fourth (largely due to exclusion of excise duty on tobacco). It included 80 percent of proceeds (net of collection costs) from income tax, sales tax and export duty on cotton to be distributed amongst provinces on the basis of population. In addition, subsequently, excise duty and royalty on natural gas was given to the province of collection.

According to Article 160 of the 1973 Constitution, the President of Pakistan is expected to constitute a NFC every five years to make recommendations on the distribution between the federation and provinces of the net proceeds of divisible pool taxes (as specified by the President), the making of grants-in-aid, and exercise of borrowing powers by the provinces. Two NFCs were constituted in 1979 and 1985 but no consensus could be reached among the provinces on the distribution formula. Meanwhile, the expenditure liabilities of the provincial governments increased rapidly given their service responsibilities in the face of rapid population growth. As a consequence, the provinces ran into high and increasing revenue deficits.

4.2 GRANTS

The emergence of high and growing revenue deficits in provincial finances necessitated the flow of non-development revenue deficits grants from the federal to the provincial governments in the 80s. This

TABLE 4.1
TREND IN INTER-GOVERNMENTAL TRANSFERS TO THE PROVINCIAL GOVERNMENTS (COMBINED) OF PAKISTAN
[Rs in Million]

	1980-81	1988-89	1990-91	1991-92	1992-93	1993-94
Total Federal Transfers	**12989**	**53288**	**66639**	**88659**	**96781**	**114977**
Revenue Transfers	**72.4**	**56.1**	**66.2**	**75.0**	**78.9**	**78.7**
Federal Tax Assignments*	66 4	45 5	50 3	72 3	74 5	76 7
Revenue Deficit Grants	4 4	10 3	15 7	-	-	-
Other	1 6	0 2	0 2	2 7	4 4	2 0
Development Transfers	**27.6**	**43.9**	**33.8**	**21.1**	**25.0**	**21.3**
Grants**	19 1	34 4	9 8	6 7	4 9	4 0
Loans	8 5	9 5	24 0	18 4	16 3	17 3

* Including profit from hydro-electricity
** Includes SDP's
Source Annual Budget Statements of the Provincial Governments

became essential because the provincial governments do not, constitutionally, have the option to deficit finance. Traditionally, non-development grants or subventions were only given to the backward provinces of Balochistan and N.W.F.P and were fixed by the National Finance Commission. The 1974 NFC fixed the subvention level at Rs 50 and Rs 100 million for Balochistan and N.W.F.P respectively.

The phenomena of revenue-deficit grant to the provinces, including the bigger and better-off provinces of Punjab and Sindh, primarily emerged in early 80s and showed rapid expansion till 1991 NFC Award. It needs, however, to be noted that having automatic access to such grants left little incentive for the provinces to either mobilize their own resources or to economize on non development expenditure. Furthermore, it mitigated against provincial financial autonomy and placed severe and sometimes unanticipated strain on the federal government budget. For example, at their peak in 1987-88, 34 percent of the federal government revenue deficit can be attributed to revenue-deficit transfers to the provinces.

The inability of the federal government to act as a residual source of finance to the provincial governments in the face of large and growing budgetary deficits of its own (and the commitment to bring this down as part of the IMF Structural Adjustment Program) led to a change in a policy on grants since 1988-89. Efforts have been made to force a process of structural adjustment also on the provinces by placing a ceiling on deficit grants. As a consequence, the share of revenue deficit grants in total inter-governmental transfers declined by almost 58% (see Table 4.1). However, the figures reveal the inability of the provinces in general to achieve major adjustments in the short run. By 1990-91, the use of cash balances for provincial combined had reached high levels. It stood at almost Rs. 6.8 billion.

4.3 DEVELOPMENT TRANSFERS

The strain on federal finances has also fed to a change in the pattern of inter-governmental transfers over time. In 1990-91, almost 34 percent of the total federal transfers were developmental in nature. By 1993-94, these had declined to only 21 percent. In other words, the federal government primarily concentrated on giving its constitutionally committed transfers to the provinces through federal tax assignments. Because of higher federal fiscal effort in shared taxes, the share of federal tax assignments in total federal transfers has increased, thereby reducing the share of development transfers.

Furthermore, Table 4.1 also reveals a shift in the pattern of development transfers to these provinces. In 1988-89, 77 percent of the total development transfers were in the form of grants. In 1993- 94, the share of grants had fallen to 19 percent only. Therefore, the strain on federal finances has led to lower development grants/higher loans to the provinces. Needless to say, this is to the detriment of the provinces, which will see their already high debt servicing obligations further increase in the future.

4. 4 THE 1990 NFC AWARD

The significant changes in the pattern of inter-governmental transfers in 1991 highlighted by Table 4.1 can primarily be attributed to the announcement of the NFC 1990 award. The NFC Award of 1990,

as already mentioned, has come twelve years late due in 1979. as per constitutional provisions). It has been hailed as a historic achievement by the new government and a major step forward in rationalizing the system of inter-government fiscal relations in the country. The award represents a large expansion in the size of the divisible pool of about Rs. 21 billion (excluding profits from hydro electricity) in 1992-93 as shown in Table 4.2. The total transfer in 1993-94 is estimated at over *W* billion compared to Rs. 61 billion, as per the 1974 NFC provisions.

New revenue sources which have been included in the divisible pool are the excise duty on tobacco and tobacco manufactures and sugar. Surcharge on natural gas and royalty on crude oil are now distributed among the provinces on the basis of collection. Profits from hydro-electricity are remitted directly by WAPDA largely to the N.W.F.P government.

In terms of distribution, however, the NFC has essentially opted for the same formula as contained in the 1974 Award. Divisible pool taxes continue to he shared on the same basis of 20:80 between the federation and the provinces, while the latter share will continue to be distributed on the basis of population. As such as far as the distribution formula is concerned, the NFC continues to favor Punjab. A summary of the major positive and negative aspects of the award for each province is presented in Table 4.3. On the whole, because of the NFC Award, it is estimated that the increase in transfers in 1993-94 will he about 22 percent for Punjab, 45 percent for Sindh, 103 percent for NWFP and 145 percent for Balochistan in relation to transfers according to the previous NFC award (see Table 4.4). Perhaps one of the most important features of the 1991 NFC Award is that the discretionary element in non-development grants like revenue deficit grants has been eliminated and a system of fixed. special grants to each province has been instituted. Special grant of Rs. I billion for Punjab. Rs.200 million for NWF'P and Rs.100 million for Balochistan has been proposed for three years wliile Rs.700 million has been proposed for Sindh for five years. On this basis, the aggregate of divisible pool transfers and grants is expected to increase by 13 percent in 1992-93 over the 1991-92 level.

A number of important questions arise about the NFC Award of 1991 Does it represent too large a concession to the provinces at a time when there is need to reduce the national budgetary deficit'. What are the behavioural consequences that are likely to follow in the immediate aftermath of the Award'.' What are the medium run incentive effects of the Award?. These are valid questions, which we attempt to address in subsequent paragraphs.

In 1991-92, the first year of implementation of the award, for example, revenue sharing transfers to the provinces increased by Rs.25 billion. However, this was partly neutralized by a number of factors over which the provincial governments had little or no control. First, there was a steep decline in other forms of fiscal transfers including non-obligatory grants, development grants etc. This is illustrated by Table 4.5 If revenue sharing had taken place according to the provision of the 1990 NFC' award in 1990-91 even though the gross increase in federal revenue sharing transfers would have been about Rs.23 billion, (lie net increase, after allowing for reduction in grants, would have been much lower at about Rs.7 billion only.

TABLE 4.2
REVENUE SOURCES AND MAGNITUDE OF TRANSFERS TO PROVINCES
(COMBINED) WITH AND WITHOUT NFC AWARD OF 1990
IN 1993-94
(Rs. In Million)

	Without 1990 NFC Award		With 1990 MFC Award	
	Transfers	% Share	Transfers	% Share
Revenue Sources Shared on the Basis of Population	58441	96.1	69366	78.6
Income Tax	33714	55.4	33714	38.2
Sales Tax	24396	40. 1	24396	27.7
Export Duty on Cotton	331	0.5	331	0.4
Excise Duty on Tobacco	-	-	6764	7.7
Manufacturing	-	-	4161	4.7
Excise Duty on Sugar				
Revenue Sources Shared on the Basis of Collection	2370	3.9	18859	21.4
Excise Duty on Gas	1470	2.4	1470	1.7
Surcharge on Gas	-	-	8747	9.9
Royalty on Crude Oil	-		1120	1.3
Profit on Hydro-Electricity	-	-	6621	7.5
Royalty on Natural Gas	900	1.5	900	1.0
Total	60811	100.0	88224	1000

Source: Explanatory Memorandum of the Budget

Annual Budget Statements of the Provincial Governments

TABLE 4.3
POSITIVE AND NEGATIVE ASPECTS OF THE 1991 NFC AWARD
FOR EACH PROVINCE OF PAKISTAN

	Positive	Negative
Punjab	1. Sharing of revenue from Excise Duty on Tobacco and Sugar on the Basis of Population, not Collection 2. Profits from Hydro-electricity generated by Mangia Dam 3. Retention of sharing of population-based formula for Divisible Pool Taxes 4. Increase in grants for three years	1. Sharing of revenues from Development Surcharge on Gas and Royalty on Crude Oil on the basis of collection not population
Sindh	1. Sharing of revenues from Development Surcharge on Gas and Royalty on Oil on the basis of collection, not population 2. Increase in grants for five years 3. Long-run transfer of Retail Sales Tax to Provinces	1. Sharing of revenues from *Excise Duty* on Sugar on the basis of population not collection 2. Lack of inclusion of criteria like collection, rate of urbanization etc in sharing formula for Divisible Pool Taxes
NWFP	1. Sharing of revenue from Excise Duty on Sugar on the basis of population not collection 2. Profits from Hydro-electricity generated by farbela Dam	1. Sharing of revenues from Excise Duty on Tobacco on the basis of population not collection 2. Sharing of Development Surcharge on Gas and Royalty on Oil on the basis of collection not population 3. Lack of inclusion of criteria like backwardness in Divisible Pool Sharing Formula 4. Decrease in Grants
Balochistan	1. Sharing of Excise Duty on Tobacco and Sugar on the basis of population, not collection 2. Sharing of Development Surcharge Gas on the basis of collection, not population	1. Sui charge of Royalty on Guide Oil on the basis of collection not population 2. Decrease in grants 3. Lack of inclusion like 1 and Aica Backwardness in the Divisible Pool Sharing Formula

TABLE 4.4
TRANSFERS FROM DIVISIBLE POOL BY FEDERAL GOVERNMENT TO THE PROVINCIAL GOVERNMENTS OF PAKISTAN

[Rs in Million]

		Punjab	Sindh	NWFP	Balochistan	Pakistan
A	**1992-93 (Revised)**	25505	10938	5966	3461	45986
	Revenues shared on the basis of population	25505	10258	5966	2335	44066
	Revenues shared on the basis of collection	116	679	0	1126	1921
B	**1993-94 (Revised)** *(without NFC Award)*	34037	14474	7913	4387	60811
	Revenues shared on the basis of population	33825	13605	7913	3097	58441
	Revenues shared on the basis of collection	212	869	0	1290	2370
C	**1993-94 (Revised)** *(with NFC Award)*	41373	21035	16013	9804	88225
	Revenues shared on the basis of population	40149	16148	9392	3676	69366
	Revenues shared on the basis of collection	1225	4886	6621	6127	18859
	Percentage Increase					
	C in relation to A	58.2	55.6	57.4	13.5	56.0
	C in relation to B	21.6	45.3	102.3	123.5	145.4

Source: Explanatory Memorandum of the Budget
Annual Budget Statements of the Provincial Governments

TABLE 4.5
CHANGE IN FEDERAL TRANSFERS DUE TO THE
1990 NFC AWARD, 1990-91

Province	Transfer Without The 1990 Award	Transfer With The 1990 Award	Change in Transfers
PUNJAB	24.1	26.3	2.2
Divisible Pool Transfer	18.6	24.2	5. 6
Straight Transfers"	0.1	1.1	1.0
Grants	5.4	1.0	4.4
SINDH	11.9	12.7	0.8
Divisible Pool Transfer	7.5	9.8	2.3
Straight Transfers'	0.6	2.2	1.6
Grants	3.8	0.7	3.1
N.W.F.P.	9.4	11.8	2.4
Divisible Pool Transfer	4.3	5.6	1.3
Straight Transfers"	0.0	6.0	6.0
Grants	5.1	0.2	-4.9
BALOCHISTAN	5.4	7.4	2.0
Divisible Pool Transfer	1.7	2.2	0.5
Straight Transfers"	0.9	5.1	4.2
Grants	2.8	0.1	2.7
TOTAL	50.8	58.2	7.4
Divisible Pool Transfer	32.1	41.8	9.7
Straight Transfers*	1.6	14.4	12 8
Grants	17.1	2.0	15.1

" Includes proceeds from royalty and excise duty on gas surcharge on gas royalty on crude oil and profits from hydro electricity

SOURCE • Explanatory Memorandum of the Budget

• Annual Budget Statements

Second, the federal government announced the Pay Committee awards in June i991 and subsequently there have been two more awards, which have further consumed the potential improvement in the fiscal position of the provinces by increasing their expenditure liabilities. The federal government has had the tendency to unilaterally announce increases in the salaries and benefits of government employees, the incremental expenditure burden of which has to be financed entirely by the provincial governments from their revenues. These measures have a larger financial impact on the provincial governments because of their larger employment in relation to the federal government, finally, on the development account there has been a significant decline in the rate of increase of federal development loans to the provincial governments. During the period 1985-86 to 1990-91, prior to the 1990 NFC award, federal loans to provincial governments increased at an annual rate of almost 14 percent. In the post NFC era this growth rate has declined to about 3 percent only. Therefore, the perception that provinces ha\ e had a big increase of federal transfers in the aftermath of the 1990 NFC award is largely a misnomer.

The 1990 NFC increased the flow of mandatory transfers to the provinces and very importantly removed the distortionary element in grants and substituted it by a system of fixed special grants. 1 lie provinces were made responsible for their own revenue deficits and surpluses. As such the dislortionary incentive environment existing prior to the announcement of the award has been largely eliminated. In addition since tlie award ensured an increase in tlie revenue sharing transfers on the recurring account provincial governments were asked to self-finance a component of their development programs. This has been enforced by a perceptible decline in the How of cash development loans to the provinces. Therefore, a structural change in tlie type of flows between the federal and tlie provincial governments has taken place following the implementation of the 1990 award. Mandatory revenue-sharing transfers on the recurring account have substituted not only for non-development and development grants lint also for federal loans on the development side.

It thus becomes important to see whether or not provincial fiscal management has improved in the post 1990 NFC era? In lieu of the increased federal transfers on the current account, provincial recurring expenditures have tended to grow more rapidly at the annual rate of about 16 percent during tlie last four years as compared to 14 percent during (lie lour years immediately preceding the award (see Table 4.6) However, the higher growth rate reflects, first, the impact of the frequent pay revisions announced b\ (lie federal government and, second, the very rapid growth in expenditures on law and order clover 27 percent per annum by tlie government of Sindh in response to the problems in Karachi. Also the growth rate of current expenditures immediately prior to the award was artificially depressed by the ceiling placed on non-obligatory deficit grants by tlie federal government.

Provincial revenues from own sources have not demonstrated the same buoyancy as in (lie period prior to the announcement of the 1990 NFC award, although the frequency of taxation proposals in provincial finance bills has increase greatly in recent years. Part of the fall in growth rate is due lo tlie poor performance of the largest source of revenue, stamp duties, in Punjab due to the slump in the real estate market in the province. Oilier taxes like motor vehicle tax, tax on professions, trades and callings, etc.

TABLE 4.6
SUMMARY OF GROWTH RATES OF PROVINCIAL FINANCES
PRE-AND POST –1990 NFC AWARD
(Four Provincial Governments Combined)

Annual Growth Rate (%)

Heads	Pre-1990 NEC	Past-1990 NFC
	[1985-86 to 1990-91]	1990-91 to 1994-95]
General Revenue Receipts	11.8	21.7
Federal Tax Assignments	22.2	33.2
Own Tax Revenues	14.9	8.6
Own Non-Tax Revenues	11.0	6.8
Non-Development Grants	-4.5	-32.9
Recurring Expenditure	14.3	16.4
Development Expenditure	14.8	13.7
Development Revenue Receipts	26.1	12.8
Net Capital Receipts	17.2	1.4
Federal Loans	13.7	2.4

excises, have shown greater buoyancy despite the fact that the growth rate of the economy has declined in the 90s and many tax bases have been stagnant, especially in Sindh.

The growth rate of development expenditure has declined somewhat from 15 percent between 1985-86 and 1990-91 to 14 percent after 1990-91. This is, of course, a reflection of the decline in the growth rate of capital transfers from the federal government. However, it is reassuring to note the fact that the provinces have made an appreciable effort to contribute to their development outlays. In the last four years prior to the award, provinces accumulated a revenue deficit of about Rs 12 billion. The situation has been dramatically different in the four year after the award. Over the period 1991-92 to 1994-95 provinces generated a combined revenue surplus of Rs 23 billion which has been diverted to finance development activities in the provinces thereby reducing their dependance on federal development loans.

In summary, the story of provincial fiscal management in the post 1990 NFC era is not one of total success but one in which gradually steps are being initiated in the right directions and provincial finances are being placed on a sounder footing. It is, therefore, important that the signals given and the environment created by the 1990 NFC award remains intact so that desired changes in the structure of provincial finances continue to take place.

Chapter Five

PROVINCIAL TAXES IN PAKISTAN

The objective of this chapter is to describe the provincial taxation structure, to quantity the level of fiscal effort, to diagnose the reasons for the low provincial tax/GDI1 ratio and lo identify areas of resource mobilisation which can generate significant additional revenues, part of which can be used for expanding and maintaining the network of social services in the country.

5.1 DESCRIPTION OF PROVINCIAL TAXES

The primary sources of provincial revenue consist of taxes on physical and financial assets like the stamp duty, property tax, motor vehicle tax and land revenues. We describe each of these taxes below.

5.1.1 Stamp Duty

This tax is levied on most civil, judicial and commercial documents. The biggest share of revenue is generated from property transactions. Specific or ad valorem rates of duty are charged generally on affidavits, mortgage deeds, rent agreements, bills of lading securities, bonds, bills of exchange promissory notes, debentures, etc. For instance, the stamp duty on a letter of credit is Rs 0.50 per document, Rs. 4 per affidavit, etc. The rates of duty on most documents continue to be generally low. Despite attempts in recent years in rate escalation.

5.1.2 Property Tax

Property tax is levied by the provincial governments on urban immovable property. This tax is shared with local governments, such that only 15 percent of the revenues (net of costs of collection) is retained by the provincial governments'. The tax is charged on the annual rental value (offer allowing for rebates). Under the rules, the property tax cadastre is expected to he updated every five years. However, general revaluations of ARVs have either been infrequent or are unrepresentative of true market values. For example, in Sindh the last reassessment of property values was undertaken in 11968-69. Similarly, in Punjab reassessed values for owner occupied properties cannot he more the 10% higher than the previous values. The consequence is that the ARVs currently bear little relationship to the market rental values. A study by Ghaus (1991) reveals that only about one-tenth of (lie values are currently being captured by the provincial excise and taxation department. Numerous exemptions and rebates have also been granted by size plots below 100 sq. yards or a threshold level of ARV) or by type of owner (government, widows, orphans, etc). These have eroded the lax base further and have meant that only about one-third to one-half of properties assessed actually pay tax. In Sindh a 25% tax rebate is also given to owner-occupied properties. Such a rebate is not given in the oilier provinces.

[1] The Share of local governments in Balochistan in however, higher at about 95%.

5.1.3 Motor Vehicle Tax

The other tax on physical assets is the motor vehicle tax. It is levied on owners largely at specific rates on seating or engine capacity, in the case of cars seating capacity, in the case of buses and laden weigh!, in the case of trucks and other heavy vehicles. Special purpose vehicles (ambulances, school buses etc.) and NLC vehicles are exempt from the MVT. Rates vary somewhat among provinces as shown in Table 5.1. Upward adjustments in rates are infrequent. In addition to the MVT, the provinces also levy a registration fee on new vehicles. This is specific in character.

5.1.4 Land Revenue

The above three taxes on assets are essentially charged from tax payers in the urban areas. In the rural areas, a tax, the land revenue, is levied on the owners of agricultural land. The tax base, as prescribed in the 1967 Land Revenue Act, is the net produce of land. However, assessment is generally on a presumptive basis. These assessments are very outdated since a primary land settlement survey has not been undertaken after 1947. The rate of land revenue varies between barani and irrigated areas and by size of holding. Exemptions include barren or uncultivated land and small land holdings (12 '/2 acres of irrigated and 25 acres of barani land). The tax base has been significantly eroded since 1982 when a blanket tax exemption was accorded to all Sunni Muslims following the introduction of Ushr.

5.1.5 Taxes on Services

The next category of provincial taxes consists of taxes which are levied essentially in the nature of excise duties on services (with federal government having fiscal powers in the manufacturing sector). Three taxes fall in this category-the electricity duty, the entertainment tax and the hotel tax. The electricity duty is levied at varying rates by type of consumer on an ad valorem basis and is collected by WAPDA or KESC. The entertainment tax applies to movies, theatrical plays, etc. It was originally in the nature of a (seating) capacity tax and has now been linked on an ad valorem basis to admission fees (25 to 100%). The hotel tax is levied on larger hotels with higher tariffs on the basis of capacity at an ad valorem rate of 20% in Punjab. In other provinces it is linked either to the tariffs or the size of the hotel. The federal government also charges an excise duty on hotel services and this has led to problems of double taxation.

5.1.6 Other Taxes

Among the minor taxes, the provincial governments also charge the equivalent of a small, flat rate income tax called the professions, callings and trades tax. In principle, this tax is applicable to all those engaged in gainful employment, including professionals, traders, factories, commercial establishments and contractors. For professionals, the rate is the highest in Punjab and Sindh at Rs 150 per annum. In addition, provincial excises are charged on alcohol, narcotics, etc.

User is religious tax levied on agricultural output. 47

TABLE 5.1
PROVINCIAL TAX RATES IN PAKISTAN
1993-94

Tax/Province	Punjab	Sindh	NWFP	Balochistan
Stamp Duty [on urban property sales	8.5 - 10%	8.5%	8.5%	5%
Motor Vehicle Tax				
Motor Cycle	Rs 80	Rs 52-80	Rs 52-80	Rs 80
Cars/Jeeps/Wagons	Rs 500-1500	Rs 500-850	Rs 400-600	Rs 600-950
Rickshaw	Rs 392	Rs 400	Rs 400	Rs 400
Taxi	Rs 520	Rs 520-660	Rs 520	Rs 520
Trucks	Rs 500-5000	Rs 376-2828	Rs 400-3000	Rs 952-3080
Buses (per seat)	Rs 88-132	Rs 98-150	Rs 120-168	Rs 80-150
Registration Fee [by type of vehicle]	Rs 200-1500	Rs 125-1500	Rs 100-1000	Rs 650-1250
Property Tax				
Commercial/Industrial	20 - 25%	20 - 25%	15 - 20%	10 - 15%
Education Cess				
(Per worker)	Rs 100	Rs 100	Rs 100	Rs 100
Entertainment Tax				
(On cinema)	50%	100%	100%	25-65%
Hotel Tax				
(Per room per day)	20%	Rs 11-120	Rs 5-100	Rs 20
Profesional Tax				
(On individual)	Rs 150	Rs 150		Rs 50-100
(On companies)		Rs 4000-8000	Rs 1000-5000	
Paddy Fee				
(Per quintal)	Re 1.5	Re 1.25	n.a	n.a

Source: Finance Acts of the Provincial Governments
Excise & Taxation and Board of Revenue Departments

* Owner-occupied property exceeding 600 sq yard additional 25%

** 30% surcharge on residential and commercial properties (assessed during 1-7-68 to 30-6-79) and 15% surcharge on residential and commercial properties (assessed after 30-6-93). Surcharge on all industrial properties at the rate of 30%

The incidence of provincial taxes has recently been derived by Pasha and Ghaus (1991). Their basic conclusion is that the overall burden is, more or less, progressive in character. This can be expected given the high share of taxation on ownership of physical and financial assets. This has the implication that the development of provincial taxes will increase the equity of the tax system as a whole in Pakistan.

5.2 LEVEL OF FISCAL EFFORT

The level of fiscal effort by the provincial governments has been quantified by deriving the magnitude of the provincial tax-to-Gross Regional Product (GRP) ratio. These ratios are presented in Table 5.2. It clearly demonstrates the declining level of fiscal effort by the provincial governments during the last two decades. Not only is the quantum of own revenue generation low at less than one percent of the GRP currently but it has also declined sharply over the last two decades. The decline has been particularly sharp in the case of Sindh and NWFP where the tax-to-GRP ratio has declined from 1.6 percent in 1972-73 to 0.6 and 0.3 percent respectively in 1994-95. Much of the decline, however, has occurred during the period, 1972-73 to 1984-85. During the last few years an attempt has been made to increase the annual growth rate of revenues. This has moderated the decline in the tax/GRP ratio, particularly in Punjab. Part of the reason for this is the restriction placed on the size of deficit grants by the federal government since 1988-89 and the change in the structure of inter-governmental revenue sharing following the 1990 NFC award.

The share of tax revenues and the recent pattern of growth in them is presented in Table 5.3, Highest growth in tax revenues, during the period 1984-85 to 1993-94, has been in Punjab, 12 percent, followed by Balochistan. 11 percent. Revenues have grown relatively slowly in Sindh, at about 9 percent per annum and in some taxes, the property tax and entertainment tax, revenues have been stagnant or actually fallen during the last few years. The relatively poor performance of tax revenues in Sindh is due partly to stagnation in the provincial economy caused by the troubled law and order situation and the poor tax administration.

The fastest growing source of revenue in Punjab is property tax followed by land revenue in Sindh. The high growth in electricity duty is because electricity sales have expanded rapidly and the tax is ad valorem in character. A modest growth rate of about 7 to 9 percent has been demonstrated by the motor vehicle tax primarily because of the specific nature of the tax. Entertainment tax revenues have been stagnant because of the lack of growth in demand for cinemas due to the rapid growth in ownership of VCRs.

A comparison of inter-provincial fiscal effort3 has been made by Ghaus and Khan (1995) by adopting the representative tax system approach first developed by Bahl (1973). For the year 1994-95, Sindh has an intermediate position which is below Punjab and above NWFP and Balochistan.

' Defined as tax revenue to fiscal capacity.

TABLE 5.2
LEVEL OF SICAL EFFORT BY
PROVINCIAL GOVERNMENT IN PAKISTAN
Provincial Tax-to-GRP Ratios

Years	Punjab	Sindh	NWFP	Balocilistan	Pakistan
1972-73	1 0	1 6	1 6	03	1 2
1984-85	08	08	06	03	08
1992-93	08	05	04	0 3	06
1993-94	08	05	04	03	06
1994-95	06	06	03	02	06
ACGR % 1972 to 1995	-2.0	-4.7	-6.7	-1.0	-3.4

Source Annual Budget Statement of the Provincial Governments

Economic Survey

TABLE 5.3
COMPOSITION OF AND GROWTH IN PROVINCIAL TAX REVENUES IN PAKISTAN

Source	Tax Revenues [*Rs in Million*]	SHARE IN TOTAL TAX RECEIPTS (%) [1993-94]					ANNUAL GROWTH RATE (%) [1984-85 TO 1993-94]				
		Punjab	Sindh	NWFP	Balochistan	Pakistan	Punjab	Sindh	NWFP	Balochistan	Pakistan
Stamp Duties	3693	44 8	39 2	28 4	15 5	41 7	16 0	13 0	10 4	10 7	14 8
Motor Vehicle Tax	1523	12 0	23 5	32 4	53 0	17 2	8 6	9 3	6 3	11 6	8 6
Property Tax	220	6 4	5 7	3 5	12 2	6 1	22 9	14 3	16 0	-	20 0
Land Revenue	1030	15 7	1 8	12 3	7 4	11 6	18 4	5 0	12 5	17 0	16 8
Entertainment Tax	239	3 1	2 2	1 1	2 6	2 7	-0 8	-6 4	0 9	3 4	-2 3
Electricity Duty	719	8 4	4 4	19 7	5 6	8 1	14 2	10 1	15 7	8 9	13 7
Others	1117	9 6	23 1	2 6	3 8	12 6	5 4	7 8	-1 1	-3 4	6 3
Total	8858	100 0	100 0	100 0	100 0	100 0	12 0	8 9	9 1	10 8	10 8

Source Annual Budget Statements of the Provincial Governments

5.3 COMPOSITION OF REVENUES

The stamp duty is the largest provincial tax in Punjab and Sindh while motor vehicle tax in the major source of tax revenue in NWFP and Balochistan. In the case of Sindh, next in the ranking in 1993-94 is the Motor Vehicle, 24 percent, (see Table 5.3). Combined together, stamp duty and motor vehicle contribute almost 63 percent of provincial tax revenues in Sindh. The top three revenue sources, which either include stamp duties, motor vehicle tax or land revenue, account for 73 percent of tax revenues in Punjab and NWFP and 76 percent of tax revenues in Balochistan. This highlights the need for diversification of provincial tax base. The shares, in particular, of taxes like the property tax and rural taxes on land are low and need to be enhanced over time alongwith heavier taxation of services.

5.4 CAUSES OF LOW TAX REVENUES AND BUOYANCY

The generally poor performance by the provincial governments in the mobilisation of revenues from different sources has been attributed to a number of factors. First, it is argued that given the existing constitutional allocation of fiscal powers between federal and provincial governments, the latter have been vested essentially with residual sources, which have limited potential for development. Since 1977, the process of Islamization of the fiscal system has further circumscribed these powers. This has included the loss of revenues from excise duty on liquor, abolition of the tax on betting and gambling substitution of land revenue by Ushr, etc. Pasha and Ghaus (1986) estimate that the cumulative loss of revenues of GOS due to Islamization was almost 30 percent of the actual tax revenues in 1984 85.

Second, a view has been put forward that the incentive environment within which the provincial governments operate has not been conducive to greater fiscal effort. In particular, the ad hoc nature of inter-governmental fiscal relations, which had evolved in the absence of NFC Award, whereby the provinces had residual access to deficit grants from the federal government led to profligacy in expenditures and slackening of fiscal effort. In addition, lop- sided revenue sharing arrangements such that the collecting agencies (the provincial governments) get only 15 percent of net revenues has left the substantial revenue-raising potential of the property tax largely unexploited.

Third, the slow growth of provincial tax revenues has been attributed to the low elasticity of the various tax bases with respect to economic growth. In particular, the linkage of revenue to physical entities like stock of motor vehicles, total land under cultivation, total employment, etc., has meant that there is no link between revenues and inflation. Consequently, it is not surprising that the provincial tax/GDP ratio has declined in Pakistan.

We examine the validity of each of these explanations. A diagnosis is essential if proper proposals are to be formulated for provincial resource mobilisation by tackling some of the basic underlying structural problems.

Limitation of Fiscal Powers: There is no doubt that major taxes, with large and relatively buoyant tax bases, like import duties, income and corporation tax, excise duties and sales tax have been pre-empted by the federal government, although historically revenues from some of these taxes have been shared with the provinces. The taking over of the sales tax, in particular, by the federation soon after partition has been cited as a major encroachment on provincial fiscal powers. However, the basic problem with the sales tax in Pakistan is that is levied only at the import and manufacturing stage and not at the wholesale or retail stage. This creates serious problems of apportionment. Given the only port in Karachi, bulk of the revenues from the sales tax on imports will accrue to the government of Sindh. Similarly, given the concentration of industry in the provinces of Sindh and Punjab, a significant component of the tax burden of the manufacturing sales tax is likely to be exported to the smaller provinces. Therefore, handing over of the sales tax to the provinces will have to wait for taxation closer to final consumption. This principle has been recognized in the recent NFC award.

It needs to be emphasised, however, that within existing sources, the scope for generating additional revenues has not been fully exploited by the provinces. The lack of introduction of the agricultural income tax, a provincial subject, is one example of this. The tax base is potentially big [see Coopers, Lybrand (1981)], especially if income from commercial activities like orchards, etc., is included. Also, the federal government has been limited constitutionally to the levy of a sales tax only on goods and not on services. The latter has been left to the provincial governments, who have been slow in exploiting the vast potential that exists in taxation of fast-growing services like telecommunications, banking. insurance, etc. Instead, the federal government has tapped substantial revenues in recent years from these sectors by extending the coverage of excise duties.

Altogether, it appears that while provincial governments in Pakistan have been granted limited fiscal powers they have failed to even exploit effectively the sources available to them.

Incentive Environment: The residual access to deficit grants during the decade of the 80s has increased sharply, as highlighted earlier. Pasha and Ghaus (1986) estimate that a one rupee additional flow of funds to the government of Sindh from the federal government has been absorbed in the form of an increase of about 98 paisas in expenditure and a 2 paisas decrease in own revenues. Consequently, there has been little improvement in the revenue account and higher transfers have not been converted into larger development allocations. More recently there is evidence that the ceiling placed on non-obligatory grants from 1988-89 onwards has stimulated some provincial fiscal effort.

Buoyancy of Revenues: As highlighted earlier, the slow rate of growth of provincial revenues has been attributed to the low elasticity of the provincial tax bases. Akhter (1990) demonstrates that this is actually not the case. Her estimates of the relevant buoyancy coefficients, as shown in Table 5.4, highlight the fact that tax base to GDP buoyancy coefficients are in excess of or close to unity in the case of most taxes, except the motor vehicle tax. The basic problem, in fact, appears to be low tax revenue-to-tax base buoyancy coefficients in the case of stamp duty, entertainment tax and property

TABLE 5.4
BUOYANCY OF MAJOR PROVINCIAL TAXES
IN PAKISTAN

Tax	Tax Base	Tax Revenue to Tax Base Buoyancy	Tax Base to GDP Buoyancy	Tax Revenue to GDP Buoyancy
Stamp Duty	Gross Domestic Product	0.75	1.00	0.75
Motor Vehicle Tax	National Stock of Vehicles Weighted by Tax Rates	1.97	0.51	1.00
Entertainment Tax	Expenditure on Recreation	0.58	1.04	0.60
Electricity Duty	WAPDA and KESC Income from Sale of Electricity	0.70	1.55	1.10
Property Tax	Value Added from Urban Ownership of Dwellings	0.31	1.15	0.35
Tax on Professions and Callings	Non-agricultural GDP	1.45	1.07	1.55
Total Provincial Tax Revenues	Gross Domestic Product			0.62

Source:
i) A Study of Provincial Finances by Shamshad Akhter, World Bank Resident Mission in Pakistan, 1990.
ii) Consultant's estimates.

tax. This can be attributed largely to the presence of specific tax rates. In the case of property tax, the statutory rate is ad valorem in character but has effectively become specific because of the lack of proper reassessment of ARVs. Therefore, the buoyancy of the provincial tax system can be enhanced by either making the tax structure ad valorem in nature or by periodically indexing the rates to inflation.

5.5 **REVENUE-RAISING POTENTIAL OF PROVINCIAL TAXES** We turn now to the scope for additional resource mobilisation in provincial taxes. The basic objective is to bring the provincial tax/GRP ratio level attained in the early 70s. This will require additional revenue generation of close to one percentage point of the GRP, particularly in the case of Sindh and NWFP.

Individual proposals have been assessed on the basis of the extent to which they satisfy the following criteria:

Equity: the extent to which the burden of the additional taxation falls on the more well-off households.

Economic Efficiency: the extent to which the proposal distorts behavior and creates dead weight losses.

Simplicity: the degree to which the proposal is easy to administer by the provincial tax departments. *Costs of compliance:* the extent to which the proposal imposes compliance costs on tax payers. *Buoyancy:* the extent to which proposal contributes to enhancing the built-in elasticity of the tax system. *Level Constraints:* whether the proposal requires any legislative enactment or changes in existing law.

Scope for Evasion and Corruption: the degree to which revenues from the proposal are vulnerable to evasion and corruption.

Revenue-Raising Potential: the quantum of additional revenues likely to generated by the proposal.

Results of assessment of different proposals according to the above criteria are given in Table 5.5. Based on this we present the major proposals which do relatively well in these criteria.

5.5.1 Existing Taxes

Stamp ***Duty:*** Examination of the composition of revenues from the tax has revealed some structural problems. There is over-dependence currently on collections from property transactions. This needs to be reduced and a higher proportion of revenues generated from other instruments. In fact, the overall rate (over 10%) of taxation on property sales is too high. This has led to large-scale under reporting and evasion and inhibited proper titling and development of the property market. There is

TABLE 5.5
RANKING* OF TAXATION PROPOSALS
UNDER DIFFERENT CRITERIA

S.No.	Tax/Proposal	Equity	Economic Efficiency	Simplicity of Administration	Costs of Tax Payer Compliance	Buoyancy	Legal Constraints	Scope for Evasion and Corruption	Revenue Raising Potential	Overall Rating
STAMP DUTY										
1	Updating of Valuation Lists	3	1 5	1	3	3	2	1	3	17 5
2	Removal of Exemption to Co-operative Housing Societies	2	2 5	2	2	2	2	1	2	15 5
3	Enhancement of Rates on Financial Instruments	3	3	3	3	1	3	2	2	20 0
MOTOR VEHICLE TAX										
1	Introduction of Ad Valorem Registration Fee on New Vehicles	2	3	2	1	3	3	3	2	19 0
2	Enhancement of Flat Rate of MVT	2	3	3	3	1	3	2	3	20 0
PROPERTY TAX										
1	Reassessment of ARVs	2	2	1	1	2	3	1	3	15 0
AGRICULTURAL INCOME TAX		2	2	1	1	2	3	1	2	14 0
VACANT PLOT TAX		2	3	2	2	2	1	2	2	16 0
CAPITAL GAINS TAX		3	3	1	1	3	3	1	2	17 0

*The highest score possible is 24 while the lowest is 8

a need for reduction of the rate of stamp duty (from over 8% to about 4%)[4], broadening of the tax base by removal, for example, of the exemption to co-operative societies (as done by the Punjab government in 1991-92) and minimization of evasion by bringing property valuation tables closer to market values.

Simultaneously, the flat rates on financial instruments should be enhanced, for example, on rental contracts to **Rs.** 100. Corresponding increases in rates can be achieved for articles of memorandum. partnership deeds, security bonds, etc. The above proposals have the potential of increasing net revenues to the provincial governments from stamp duty in all the provinces.

Motor Vehicle Tax: The modest growth rate in revenues of about 7 to 10 percent can be attributed largely to the specific rates of this tax, which have not been enhanced for some time. Consequently, revenues from this tax currently finance only about half the O&M cost of the inter-urban road network in the provinces.

We recommend, first, that the registration fee component of the tax be made and ad valorem in character and be charged at the landed price of imported vehicles or of the sale price of domestically assembled vehicles. This proposal has a progressive incidence because the additional tax burden will fall largely on owners of vehicles, and it is likely to have minimal distortionary effects with the very small tax rate. Also, bills of entry are available for assessment of tax liability on newly imported vehicles and revenues are likely to be buoyant because of the ad valorem nature of the tax and fast growth in the stock of vehicles.

Second, the provincial governments may double on average the flat rates of MVT on existing vehicles over the next few years, with a differentially higher rate of enhancement on trucks with high axle loads. It is necessary, however, that tax rates be harmonized among the provinces, given the mobile nature of the tax base. This is an area in which the federal government can provide the necessary coordination. As shown in Table 5.5, this proposal also scores highly on the various criteria.

Urban Immovable Property Tax: We have indicated earlier that the property tax is one of the most under-developed sources of revenue in Pakistan. Since bulk of the revenue from the tax is given to municipal governments, this has adversely affected the resource position at the local level also. We recommend that provincial governments attach high priority to instituting an adequate and representative assessment process as soon as possible. Professional appraisers ought to be involved in this process to ensure accurate and fair assessments. In the interim period, and ad hoc enhancement may be resorted to, with property owners being given the option of subjecting themselves to a formal reassessment or accepting the ad hoc enhancement.

[4] This is the level currently on agricultural properties.

In addition, the property tax net must be extended to fully cover existing rating areas. Rating areas may be expanded in line with the increase in metropolitan areas and, wherever possible, new rating areas be notified. Also, as a tax simplification measure a fixed presumptive tax may be charged from relatively small properties (located on plots below 120 square yards). This will also lead to significant saving in cost-collection. Also, the differential treatment in favour of owner occupied properties needs to be removed. As a first step, the 25% tax rebate given to such properties should be withdrawn. The revenue raising potential of the property tax, even at existing rates, is sizeable.

As highlighted earlier, municipal governments will primary benefit from the improvement in property tax revenues. However, this will increase their ability to manage some of the services currently being provided by the provincial governments like primary education, water supply, etc. This will reduce the expenditure liabilities of the latter and thereby improve their budgetary position.

Ushr: **We** have also examined the burden of provincial taxes in the rural sector. In the absence of an agricultural income tax and following the phasing out of land revenue, the burden is relatively low. As such, we recommend that Ushr be fully developed as a tax on agricultural production to raise revenues for social welfare at the local level. Collection of Ushr is very low currently. In 1990-91 total revenue of ushr collection was Rs 210 million as opposed to the estimated total potential for the tax of Rs 3.7 billion.5 This is due, first, to low presumptive rates of Ushr, second, to high level of exemptions and, third, to low collection efficiency. Estimates are that the potential yield of Ushr is as much as Rs 3000 million, if the tax administration is improved and the tax collected according to true Islamic principles.

There is need to attach high priority in the next few years to development of Ushr as a major fiscal instrument for social welfare. Revenues will, however, not form part of the provincial consolidated fund. Nevertheless, there could be some savings to the provincial governments in social welfare allocation due to substitution by local funds.

5.5.2 New **Taxes**

Vacant Plot Tax: A significant new source of revenue to provincial governments which worthy of consideration is a vacant plot tax. Currently, it is estimated that over 500,000 developed plots are lying idea in large cities like Lahore and Karachi. This reflects the rampant speculation that is currently taking place, largely with black money. The vacant plot tax will not only discourage this speculation but it may also fetch sizeable revenues. The proposal is for this tax to be levied on big plots which remain undeveloped after three years of allotment.

Capital Gains Tax: The capital gains tax on urban immovable property was abolished by the provincial governments in 1985-86. Prior to this, the tax had been the most buoyant and progressive source of revenue particularly in Sindh and NWFP. The abolition of this tax was accompanied by an increase

[5] See Ghaus, Aisha et. al. (1992). 58

in the rate of stamp duty (from 6% to 8%) on property sales. The basic merit of the capital gains tax,, as opposed to the stamp duty, is that it only taxes increments in value resulting from a transaction. As such, we recommened that the capital gains tax be re-introduced by the provincial governments. However, it s emphasized that an attempt should be made to tax only real capital gains and not inflation-linked increases in value. This can be ensured by taxing short-term and long-term capital gains at different rates. Also, as suggested earlier, following re-introduction of CGT the stamp duty rate on property sales should be brought down from 8 percent to 4 percent.

Agricultural Income Tax: Imposition of the agricultural income tax remains a contentious issue in Pakistan. Arguments in favour and against the levy of the tax have been summarised in Qureshi [1992] and Naseem and Akhiaque [1992]. One of the issues relates to the revenue potential of the tax. It is clear that from the view point of simplifying the administration of the tax, it will have to he charged on a presumptive basis, as a tax on land holdings. This will mean development of the existing land revenue structure by the Board of Revenue of the provincial governments. If this is done Khan [1991] estimates that the revenue-raising potential of the tax is Rs 3 billion for Pakistan as a whole.

The additional revenue generation by the provincial governments from implementation of the above proposals can be substantial and can potentially increase the provincial tax to GDP ratio by about one percentage point and restore it to the level prevailing in the early 70s. It will make significant additional resources available for development and maintenance of social and economic infrastructure. Simultaneously, by enabling a greater transfer of resources to the local level, especially by development of the property tax it will promote the process of decentralization of basic social services like water supply and primary education.

Chapter Six PROVINCIAL TAX ADMINISTRATION IN PAKISTAN

Provincial tax administrations in Pakistan have not received much attention for a variety of reasons. First, given the high and growing reliance on federal transfers (from the divisible pool and grants) provincial governments have concentrated on increasing their respective shares in these flows. Consequently, there has been less emphasis on improving collection from own revenue sources. Second, there has been little incentive for and flexibility in changing the provincial tax structure. For example, the property tax remains underdeveloped because provincial governments have to hand over 85 % to 95% of the revenue collected to municipalities. Also, changes in motor vehicle tax are severely constrained by the mobile nature of the tax base. Further, as highlighted in Chapter Six, Islamisation has significantly eroded the fiscal powers of provincial governments, especially in the rural areas. Third, provincial governments have been reluctant to make innovations in their tax systems for political and institutional reasons. The lack of taxation of agricultural incomes and outputs from the service sectors are examples of the absence of such an effort.

The overall consequence is the lack of development of provincial tax administrations in the country. The tax collection system remains fragmented, tax departments have a multiplicity of functions which divert energies from the task of revenue generation, the quality of human resources available is poor and personnel lack specialisation and opportunities for training and upward mobility.

However, following the 1991 **NFC** Award, residual access to federal grants has come to an end and provincial governments will have to use their tax departments more effectively to generate additional resources to preserve their financial status. In addition, there is a growing realisation in Pakistan of the integrated nature of provincial and federal tax administrations. The former are increasingly taking on collection responsibilities for federal income and wealth taxes. This reinforces the need to strengthen provincial tax administrations throughout the country.

The objective of this Chapter is to describe in Section 1 the features of the existing tax departments of the provincial governments. Section 2 of the Chapter gives an inventory of the human resources available to these departments followed by an identification of key issues in provincial tax administration in Section 3. The next two sections highlight the type of linkages that exist among provincial taxes and between provincial and federal taxes. Finally, in Section 6 we discuss the scope for data base development and computerisation of provincial tax departments.

6.1 INSTITUTIONAL STRUCTURE

The provincial tax administration is divided into three departments, as follows:-1. *The Finance Department (FD):* which has overall responsibility for fiscal policy and financial management. It is responsible for preparation of annual budgets of the

provincial governments and its administration. In this connection, it also has the function of preparation of taxation proposals to be incorporated in the Budget Speech of the Provincial Finance Minister. Therefore, the involvement of this department is essentially in the formulation of tax policy.

2. *The Excise and Taxation Department (ETD):* is the major tax collecting agency on behalf of the provincial governments, particularly with respect to the property tax. betterment tax and motor vehicle tax, and its efforts are largely restricted to the urban areas. In Balochistan, this function is performed by a wing within the Board of Revenue.

3. *The Board of (BOR):* the parent department form which (lie two others were carved out. The BOR is responsible for a multitude of functions including land registration, collection of land revenues, maintenance of cadastral registers and land records, the interface of these with shelter related schemes and functions with respect to the collection of stamp duties, registration fees and other levies on land and property transactions. It is also the settlement and rehabilitation organisation and the Court of Wards.

6.1.1 Excise and Taxation Department

The Excise and Taxation Departments (ETD) are the major revenue collection departments of the provincial governments. The departments additionally levy and collect some taxes on behalf of the Federal Government and Local Authorities. Under the 1992-93 Federal Budget this role has been enhanced. These departments have been given the responsibility of collecting withholding wealth tax from large residential and commercial property owners and withholding income tax from motor vehicle owners. This is likely to result in a considerable strain on the already overburdened efficiency of the ETDs.

Functions

The Government Rules of Business of each provincial government defines the business activity assigned to the department which includes, but is not limited to, the following:

(a) Assessment and Collection of Taxes on:

Cinemas and other entertainments
professions buildings
urban immovable property hotels
motor vehicles

(b) Assessment, collection of taxes and control over:
tobacco, opium, narcotics, liquor and intoxicating preparations, import licenses and contracts relating to them.

In addition to the powers given to the departments through the annual Finance Acts/Ordinances approved by the provincial governments, they also draw upon the powers and authority granted to them implicitly from a whole raft of legislation governing the levy of taxes and control of narcotics in the Provinces. The two main Acts relating to current revenue collected are the Motor Vehicles Ordinances and the Urban Immoveable Property Tax Acts.

Organisation
ETD are administratively under the control of the Secretary, Excise and Taxation, and technically under the Director General, Excise and Taxation. In some provinces both functions vest in the same individual. The Secretary is assisted by a small secretariat with the Deputy Secretary at its head. The Director General is assisted by a number of directors, each responsible for a revenue division. The Excise and Taxation Officer is the key official at the district level and combines both the excise and the taxation functions. The latter covers valuation, assessment, billing, collection and also the judicial aspects of appeals. In large cities, like Karachi and Lahore, functions of ETOs are more specialised.

6.1.2 Board of Revenue
The Board of Revenue is the largest and the oldest department of the provincial governments. It dates from the days of the British Raj when it was established primarily as a means for collecting taxes from the local landowners, as a registry of land and as a land colonisation department following the construction of the irrigation network. It is one of two revenue collecting departments of the provincial governments. In its role as a revenue collection agency and that of registering title to land, it is all pervasive. For instance, the record of rights is maintained by the Deputy Registrars for urban properties and the Patwari for agricultural land. In its functions of relief and settlement, the department is primarily concerned with the rural areas.

Functions
The functions of the department include its role as the land commission, colonies department, consolidation of holdings department, relief department besides acting as the revenue department for collection of land revenue, tax on transfer of property etc.

Given the diverse nature of the functions performed by the BOR in the rural areas of the province it has a vast outreach capability extending to individual settlements.

Organisation
The Board is nominally controlled by a Senior Member with the rank of an Additional Chief Secretary. The Board is generally divided into three distinct wings each responsible for particular aspects of the

mandate granted to it. The Senior Member is concurrently the Secretary Revenue, the Chief Land Commissioner and the Relief Commissioner. He is responsible for personnel and administration.

There are ten levels in the hierarchy of the field organisation of BOR. At the intermediate levels of division, district and sub-division, revenue collection responsibilities rest with the Commissioner. Deputy Commissioner and Assistant Commissioner respectively whose prime responsibility is maintenance of law and order. They are also designated as collectors. These functionaries are generally appointed from within the District Management Group (DMG) of the Central Superior Services (CSS) of Pakistan.

Below the level of sub-division are more specialised staff of BOR who perform the functions listed above. At the taluka level in Sindh there is the Mukhtiarkar who has a number of circles. Each circle is headed by an Assistant Mukhtiarkar or Supervising Tapedar who oversees a number of tapas. At the tapa level, there is a Tapedar who controls two or three dehs. The lowest level functionary in a dell is the kofar.

6.2 ISSUES IN TAX ADMINISTRATION In this section we identify some of key issues which arise in provincial tax administration.

Costs of Collection

Given the labor-intensive nature of the collecting machinery for some taxes like land revenue, property tax, professions, callings and trades tax, and the low effective tax rates and wide ranging exemptions. costs of collection as a percentage of revenues generated are relatively high for the provincial tax departments, as shown in Table 6.1. The highest cost of collection ratio is that of rural land related taxes of BOR where costs apparently exceed revenues in the province of Balochistan. However, this ratio is not representative of the true costs because field staff of BOR perform a whole range of functions like land registrations and titling besides revenue collection. Nevertheless, the historical decline in the importance of land revenue as a revenue source, especially after Islamisation. in the presence of the same field deployment of tax personnel has led to an increase in this ratio. More effective involvement in collection of ushr, on the lines suggested in the previous chapter, could bring down the ratio once again.

Excise and Taxation department's costs are equivalent to about 5 to 20 % of revenues generated, being the highest in Balochistan. This is high in relation to the overall federal costs of collection ratio (of about 1 %). In this sense, there is some evidence of over staffing, particularly in the lower grades. The increased involvement of the department, however, in collection of presumptive/withholding income and wealth taxes on behalf of the federal government should bring down this ratio.

TABLK 6.1

COST OF COLLECTION OF TAX DEPARTMENTS

OF PROVINCIAL GOVERNMENTS IN PAKISTAN, 1993-94

Source	COSTOFCOLLFCTTON AS % OF REVENUE				
	Punjab	Sindh	NWFP	Balochistan	Pakistan
Board of Revenue	13.1	15.6	26.8	125.1	15.5
Land Related Taxes	40.5	21.6	71.2	232.2	41.7
Stamps	0.8	1.0	4.7	8.6	1.1
Excise and Taxation Department	4.5	7.8	6.1	20.4	6.3
Total	9.9	11.3	14.9	48.7	11.4

Source Budget Documents of Provincial Governments

Multiplicity of Functions

Officials of E & T department perform both excise and taxation functions. The former is more of a preventive character requiring specialised skills in sleuthing and investigation, the latter is more administrative in character and requires training in both fiscal administration including valuation/ assessment and in legal matters as a result of the judicial powers of "Collectors" vested in the ETOs Similarly, BOR officials perform a wide range of functions including land acquisition, land registration. settlement, etc., as well as collection of land revenue and stamp duties. The non-taxation functions are potentially more important. In the short-run, there exists a case for rationalising the structure of the Excise and Taxation Departments, as has already been done for Karachi Division. This will involve creating a separate Directorate of Excise to cover the divisions like Hyderabad and Sukkur.

Specialization in Taxes

Excise and taxation officers are generally responsible for a number of taxes, many of which make a small revenue contribution. These range from the urban immoveable property lax to the hotel tax. This has restricted the scope for specialisation and development of intensive knowledge of particular taxes. A better approach would, therefore be of creating Directorates with specific tax responsibilities province wide like motor vehicle tax, property tax and other taxes, rather than continue with the practice of Directorates administering all taxes within a division.

Separation of Functions

One of the basic principles of tax administration, that of separation of the functions of assessment, collection and handling of appeals has not been followed in the context of property tax administration by the E & T department. This is essential if accountability is to he preserved in the system and the scope for harassment of taxpayers and corruption minimised. It is suggested that in line with the federal income tax department, a separate appellate machinery be established by the E & T department under the Law Department of the provincial government with no role whatsoever in the assessment and collection of taxes.

Personnel Policies

There are fundamental problems with the personnel policies followed by the provincial tax departments. High-level functionaries (BOS 18 and above) of BOR and E & T Department are drawn from the federal or provincial civil service and generally lack specialised knowledge of tax administration. Also. frequent and unplanned transfers of officers mainly in BPS 18 and above, lead to a situation where officers cannot really come to grips with the issues relating to assessment (expansion of the tax base) and identification of evaders and learning skills in tax administration through a "hands on" process. Further, the resort to senior appointments from outside the departments restricts the upward mobility of lower level personnel and reduces staff motivation levels and the incentive to acquire training.

Given the growing importance of provincial tax administrations, the time has probably come for establishment of a specialised provincial taxation service (PTS) similar to that which already exists at

the federal level. This will provide the requisite base for human resource development and career planning. Officers of the PTS could also be assigned to run the tax departments of local governments. Simultaneously, training capabilities could be developed by the provincial governments. Presently. there is no training institution performing these functions in the provinces.

Decentralisation of Tax Administration

We have highlighted the relatively poor performance of the property tax in the provinces and argued that one of the major reasons for this is that the collecting agency (the provincial governments) retains only 15% of the revenues. Indicators of this poor performance are the slow pace of extension of rating areas, infrequent and inadequate assessments, lack of adequate valuation expertise, use of primitive assessment methods, plethora of exemptions, etc. A logical conclusion is that given the potential importance of property tax revenues to municipal governments, collection of this tax may he decentralised. As a first step, the handing over may first take place in larger cities with the status of metropolitan corporations. Local councils in these cities are likely to have the institutional capability to accept this responsibility and potentially generate more revenues. Any valuation expertise that exists in the E & T Department could be transferred to the local councils. This process of decentralisation will also increase perceptions of the link between taxation and benefits.

Formulation of Tax Policy

In the earlier part of this chapter we had indicated that tax policy functions are performed largely by the finance department and not by the tax departments. It is essential that the prime responsibility for development of proposals for resource mobilisation rest with the latter, given the likelihood of more intensive knowledge of the tax system and the scope for its development. This will require separation of the posts of Secretary and Director General within the E & T department in most provinces, with the former largely involved in the making of tax policy and the latter with administration. The Secretary could have a policy wing staffed by public finance specialists, legal and tax administration experts.

6.3 LINKAGES BETWEEN **PROVINCIAL AND FEDERAL** TAXES *A.* .Strong case exists for the integration of provincial and federal tax administration. Tax departments of the federal governments like the Central Board of Revenue and those of the provincial governments like the Excise and Taxation Departments and the Boards of Revenue have also largely operated independently of each other. However, intrinsically each level of government has a strong interest in the generation of revenues by the other. For the provincial governments, divisible pool transfers from federally collected taxes like the income tax, sales tax, excise duties on tobacco and sugar, etc. are a vital concern. Any enhancement of revenues from such taxes automatically benefits the provincial governments through higher revenue-sharing transfers. For the federal government, any improvement in the resource mobilisation effort of provincial governments, which increases their ability to generate a revenue surplus, implies a lower volume of development transfers and thereby less pressure on the budgetary sources of the federation.

Despite the obvious commonality of interest, there has been very little integration of the two tax administrations. This integration would primarily consist of exchange of relevant information and allocation of overall tax collection responsibilities on the basis of comparative advantage. The integration is meant at no stage to circumvent the provisions of the NFC Award or to lead to loss in the fiscal autonomy of the provincial governments. The objective is to maximize the overall quantum of resources mobilised by both levels of government by a general improvement in the quality of tax administration and exchange of information.

Justification for integration of tax administrations exists when taxes are levied on a more or loss common tax base or when one level of government has access to information which can be of use to another level of government in the collection of its taxes.

6.3.1 Property Tax and Income Tax

The provincial excise the taxation department levies a property tax on rental properties, where the relevant tax base is the rental income as contained in the lease documents. The Income Tax Department of the CBR treats rental income as part of the income of individuals or corporate entities for tax purposes.

Therefore, if the tax administrations of the two departments can be integrated, the possibility of under declaration being detected by each department could be increased. Integration in this tax can he brought about either by exchange of information or if it can be demonstrated that the provincial ETD does an unambiguously better job of taxing rental income, then collection responsibility of income tax on tins type of income may also be handed over to the ETD. This could be in the nature of a withholding tax provision or constitute a final settlement of the tax liability by introduction of the concept of schedular income taxation of rental income.

6.3.2 Property Tax and Wealth Tax

Another important area where integration of tax administration can he of benefit to the public sector is the link between federal wealth tax, collected by CBR, and provincial land revenue and property tax, collected by BOR and ETD respectively. In this case the base of the taxes are the same, that is. wealth tax is levied on immoveable properties above a threshold value (currently Rs 1,000,000). As such. its base potentially includes land and constructed properties both in the urban and rural areas. Detailed records of these are maintained by the ETD in urban and by Board of Revenue (BOR) in (lie rural areas. An exchange of information between the tax departments of these two levels of governments can significantly enhance the collection of wealth tax, the potential of which currently remains significantly under exploited in the country.

6.3.3 PTC Tax and Income Tax

Similarly, the provinces collect a professions, trade and callings tax (PTC), which is essentially in the nature of a small, flat rate tax. Federal income tax department has more information on tax payers.

Such information could be handed over to the provincial excise and taxation departments or indeed the federal income tax department, after deducting some mutually agreed costs of collection, may collect the tax from income tax payers for the provincial governments. Such an arrangement can he of significant advantage to the provincial governments since it not only simplifies tax administration and reduces costs tax collection, but also enhances the overall level of its resource mobilisation.

In short, a strong case exists for vertical integration of tax administrations in the country. We have briefly tried to identify some case where a linkage between tax administrations is clearly justified. In fact. in the 1992-93 Budget some steps have been taken in this direction. Provincial E & T departments have been made responsible for collecting a withholding wealth tax from large properties and withholding income tax from motor vehicle owners.

6.4 COMPUTERISATION AND DATA BASE DEVELOPMENT Information systems available within the finance and tax departments of the provincial governments are rudimentary and in some areas totally inadequate. The information is sometimes inaccurate, incomplete and is available too late to be of real value as a control device. The available data is not analysed and hence its value as a budgeting and planning tool is limited.

There is therefore a need to build a co-ordinated system around three components:-

- Data on the size and characteristics of the tax base.
- Financial transactions
- Information on status of tax payments

Very little use is being made of computer technology. However, the need for its use is well recognised and plans for its introduction are afoot in several functions of each of these departments. In some instances actual efforts have been made to introduce computers, e.g., in the motor vehicle tax department in Karachi and in Punjab.

Excise and Taxation Department

In the ETD records of assessees and of transactions are maintained manually even though the numbers alone would justify computerisation. For example, there are almost 138,000 property tax payers in Lahore and 750,000 registered motor vehicles. This has resulted in the department not having any accurate information as to outstanding arrears, extent of evasion or an estimate of the size of the tax base at any given time. Moreover, there appears to be no coordination or cooperation with the other departments of the provincial governments itself with respect to sharing information on potential tax bases, or with the income tax department of the federal government for cross verification of numbers of tax payers for collection of professional tax, or with ETOs in provinces for cross-verification of tax payments by motor vehicles, or the duplication of vehicle registrations. The maintenance of up to date and cross-verifiable data could be eased by using computer based information and record retrieval systems.

A major initiative in the area of computerisation of the property tax and motor vehicle tax systems had been launched by the Resource Mobilisation and Tax Reforms Commission of the Government of Pakistan.

Chapter Seven PROVINCIAL USER CHARGES IN PAKISTAN

7.1 INTRODUCTION

User pricing (or charge) is an alternative to taxation as a means of financing the supply of public services. It has been argued in the public finance literature [e.g.. Due and Friedlaender (1981), Wagner (1973), Davie and Duncombe (1972), and others] that any governmental services, whether economic or social which provide full or at least partial benefits to the individual, should he financed by user charges rather than taxes. The important reason for adopting such an alternative is that it satisfies the 'excludability' principle, which states that "under such a criterion, there may be a possibility of excluding, from the benefits of the service, an individual who does not wish to pay for the services at the market price. Furthermore, excludability compels an earnest stipulation of the service to individuals rather than jointly to the community at large.

The implementation of user charge pricing system furnishes important benefits, particularly in terms of efficiency (resource allocation) and equity (affordability) considerations. If public services are financed by user fees rather than taxes, then in many cases, this will enable the determination of the quantity of services produced through the market price mechanism instead of the political process or any other non market mechanism. Due and Friedlaender (1981) argued that 'the political process may result in serious resource misallocation because it may fail to interpret preferences (of the individuals) correctly'. On the other hand, if a suitable user pricing mechanism is applied, an efficient resource allocation may be possible. Furthermore, this may also avoid the complexities of the political-process in the determination of public goods and services provided.

On equity grounds there are also benefits of user charges. Of course, with the exception of some public services (i.e., primary education, essential health services in the rural areas, etc.,), equity considerations require that individuals pay-for-what-they-get. This obviously is the dictum of the private free market system, and there is no justifiable reason why it cannot be applied to governmental economic and some social services, particularly in situations where there are direct benefits to individuals and the beneficiaries are easily identifiable. On the other hand, there are other public services which may not be regarded appropriate for sale on a "pay- for-what-you-get' criteria because of social and distributional considerations. These goods are called merit goods and have substantial third party benefits and there is a desire on the part of the society that a large population receive these services as a basic need.

For example, at the national level in Pakistan, the ratio of receipts to all expenditures in the education and health sectors was only 2.5 percent, respectively, in 1990-91. Such a small percentage of recovery ratio of revenue has been labelled "totally out of proportion' by the Planning commission. Government of Pakistan, in their October 28, 1991, Progress Report on SAP to the Donors Dialogue meeting in

Islamabad. In fact, in the same Report (1991), the viewpoint of the Planning commission, with respect to imposing user charges, has been extremely favourable. In this context, the Report (1991) critically noted:

> *There is now no difference of opinion on the need to levy user charges. The internal debate is now focusing on the pace and coverage and the design of implemeniahle proposals. Consultants will be appointed to help the province in these areas. (P. 24)*

On the issue of raising the levels of user charges at the provincial level, the Report (1991) further noted:

> *...it may be useful to have provincial level studies for consideration of the provincial government on potential for increased user charges. The studies must assess willingness-to-pay on the part of the user for higher level services... and consider other linked issues from the perspective of the users. (P. 25)*

In view of these considerations, the objective of this chapter is to review and analyse the prospects and potentials of levying user charges on the economic and social services as an alternative or addition to taxation by the provincial governments. Such a detailed analysis will enable use to identify the sectors where there is a scope for raising the revenue via user charges.

The format of this chapter is as follows. In Section 7.2, we first identify the major sectors, both economic an social, where user charges are levied and then analyse and compare the trends in revenue receipts for these sectors. Levels of user charges and trends in cost recovery ratio by sectors are analysed in Section 7.3 and 7.4 respectively. This will enable us to ascertain the extent of cost recovery over the years. Section 7.5 will briefly discuss the causes of low cost recovery. The revenue raising potential and recommendations, based on various economic and social considerations, for different services of the public sector are discussed in Section 7.6.

7.2 TRENDS IN MAJOR USER CHARGES

Although this report essentially deals with the financing of social sectors, user charges on economic services have also been studies because, the scope of cost recovery in the latter services is generally higher and, secondly, any reduction in the subsidy on economic services will release additional resources for social services.

7.2.1 Economic Services

Five important branches of economic services, namely, agriculture, animal husbandry, forestry, irrigation and works, which generate the bulk of revenue receipts for this sector. A summary of the composition and growth in user charges by province is presented in Table 7.1. The table shows that economic sectors generate over 76 percent of the total user charges in the provinces, the share being higher, about 90 percent in the smaller provinces of NWFP and Balochistan. Income from forestry,

TABLE 7.1

COMPOSITION AND GROWTH IN USER CHARGES BY PROVINCE, 1994-95

[Percent]

Heads	Punjab		Sindh		NWFP		Balochistan		Pakistan	
	Share	ACGR★	Share	ACGR★	Share	ACGR★	Share	ACGR★	Share	ACGR★
Social Sectors	27 9	8 0	25 3	13 8	10 4	13 1	10 4	24 5	23 6	9 5
Economic Sectors	72 1	7 6	74 7	7 6	89 6	13 2	89 6	7 4	76 4	8 5
Total User Charges (Rs in Million)	3218 8	7 7	975 9	8 9	911 4	13 1	222 8	8 5	5354 9	8 7

★ Annual compound growth rate for 1987-88 to 1994-95

Source Annual Budget Statements of Provincial Governments

49%, and agriculture 53%, constitute the largest sources of user charges in NWFP and Balochistan respectively (see Table 7.2). In 1994-95, revenues from agriculture in Balochistan were Rs.131 million which is much higher than the bigger provinces of NWFP and Sindh. In the case of Sindh and Punjab irrigation charges is the highest revenue contributor accounting for 46 and 37 percent of user charge revenues respectively. The relatively high contributing of one source of revenue in all of the four provinces is a clear indication of the skewed nature of user charge structure and the need for diversification of the existing user charge base.

During the period 1987-88 to 1994-95 fastest growth in user charges in economic sectors has been demonstrated by the NWFP over 13% per annum while it is the lowest in the province of Balochistan at about 7% (see Table 7.1). Average growth rate in the two bigger provinces. Punjab and Sindh is also very low at less than 8%.

7.2.2 **Social Services**

Composition and growth of user charges on social services is also presented in Table 7.1. Social services are divided into four broad categories, namely, public health, health, education and social welfare. Currently, the highest share of income from social sectors in user charges is in the province of Punjab, 28 percent, followed by Sindh, about 25 percent. The concept of self-sustained provision of social services is not yet developed in Pakistan, in general, and in the smaller provinces, in particular. Table 7.1 shows that user charges in social sectors account for only 10.4% of user charge revenues in NWFP and Balochistan. As a percentage of provincial own revenue-receipts (tax + nontax). the share is even lower at about 4-5 percent. The corresponding percentages for Punjab and Sindh are also very low at about 6 to 8 percent respectively.

The current level of user charges in social sectors is low, about Rs.l .3 billion in the four provinces combined. Table 7.1 shows that the overall annual growth rate of social service user charges in the provinces combined has been about 10 percent, being the highest in Balochistan 25 percent. The corresponding growth rate in Sindh and NWFP has been 13 to 14 percent. Punjab's performance is relatively poor with the lowest growth rate in user charges in social sectors, if only 8 percent.

On the whole user charges have increased at an average annual growth rate of less than 9 percent in all the provinces. A comparison with the annual growth rate of taxes for the corresponding period (presented in Table 5.3) indicates that user charge revenues have increased faster than tax revenues in NWFP while the growth rate of tax and non tax revenues has been almost identical in Sindh. Punjab and Balochistan, however, put in a relatively higher effort in developing its taxes.

Although the above analysis generally indicates rapid growth in revenue receipts from both the economic and social services, these trends in receipts alone may not he sufficient to provide enough information to comprehend the extent to which these public revenues were adequate to meet the

TABLE 7.2

COMPOSITION OF USER CHARGES BY PROVINCE, 1994-95

(Rs in Million)

Heads	Punjab	Sindh	NWFP	Balochistan	Pakistan
SOCIAL SECTORS					
Education	448	180	29	9	666
Health	172	51	33	6	261
Manpower and Labor	2	1	1	0	4
Public Health	124	10	32	11	176
Housing and Physical Planning	143	0	0	0	143
Social Welfare	8	5	0	0	12
Other Social Services	0	0	0	1	1
Total Social Services	**897**	**247**	**94**	**26**	**1264**
ECONOMIC SECTORS					
Agriculture	278	46	83	131	539
Fisheries	32	8	6	4	49
Animal Husbandary	120	4	9	32	165
Forestry	239	55	448	4	746
Irrigation	1203	445	111	26	1785
Works	343	130	120	20	612
Other Economic Services	106	42	41	6	194
Total Economic Services	**2322**	**729**	**817**	**223**	**4091**
Total User Charges	**3219**	**976**	**911**	**249**	**5355**
SHARE IN TOTAL USER CHARGES (%)					
SOCIAL SECTORS					
Education	13 9	18.5	3 2	3 6	12 4
Health	5.3	5 2	3.6	2 3	4.9
Manpower and Labour	0 1	0.1	0.1	0 0	0 1
Public Health	3.8	1.0	3.5	4 3	3 3
Housing and Physical Planning	4.4	0.0	0.0	0 0	2 7
Social Welfare	0.2	0.5	0.0	0 0	0 2
Other Social Services	0.0	0.0	0.0	0 2	0.0
Total Social Services	**27.9**	**25.3**	**10.4**	**10.4**	**23.6**
ECONOMIC SECTORS					
Agriculture	8.7	4.7	9 1	52 7	10 1
Fisheries	1.0	0.8	0 6	1 5	0 9
Animal Husbandary	3.7	0.4	0.9	13 0	3.1
Forestry	7.4	5.7	49 2	1 8	13 9
Irrigation	37.4	45 6	12.2	10 4	33 3
Works	10.6	13.3	13 2	7 9	11 4
Other Economic Services	3 3	4 3	4.5	2 3	3 6
Total Economic Services	**72.1**	**74.7**	**89.6**	**89.6**	**76.4**

expenditures incurred by the provincial governments. This is dependent upon the level of user charges and the net balance between revenues and expenditures.

7.3 LEVELS OF USER CHARGES

Information on the levels of user charges for public health and education services was gathered through case studies conducted at a major city of each province. In order to see the relative cost differential of these services in each province we examine the data on four major cities, Lahore (Punjab), Karachi (Sindh), Peshawar (NWFP) and Quetta (Balochistan). We will first discuss the levels of user charges for education followed by health.

7.3.1 Education Services

Table 7.3 reports the levels of fees for education at four major cities across the provinces. Fees at (lie primary level are very low across in all four cities. In fact, in Peshawar (NWFP) and Quetta (Balochistan), primary education is provided free of cost. However, fees in Karachi (Rs.21) is somewhat lower than that of Lahore (Rs.30). It should be noted that there is no tuition or admission fee charged for primary schools in these two cities. The relatively big difference in total fees between Karachi and Lahore is due to the "Farogh-e-Taleem Fund" charged by the Directorate of School Education, Lahore. For middle schools, the difference in total fees collected between Karachi (Rs. 134), Lahore (Rs. 138) is marginal. The total high school (9th and 10th classes) or matriculation fees charged in Karachi in both arts and science groups are also lower than in Lahore.

7.3.2 **Health Services**

Data on the levels of user charges for provincial government health institutions at four major cities were collected. The sample institutions are the Karachi Civil Hospital (KCH), Lahore Mayo Hospital (LMH), Peshawar Lady Reading Hospital (PLRH) and Quetta Civil Hospital (QCH). Table 7.4 presents the fees charged for different types of services provided by these institutions across the four provinces.

The OPD charge for each patient is only Rs. 2 for KCH and MHL, Rs. 3 for RCH and a mere Rs. 1 for Lady Reading Hospital Peshawar. Obviously, these rates are extremely low and, may he one of the major reasons for congestion on the outpatient facilities of these hospitals. The low general ward rate of Rs. 4 and Rs. 5 at KCH and QCH respectively or no charges at PLRH and LMH may he justified one equity and social returns grounds. However, the rates for a private room of Rs. 450 at LMH are competitive with private sector while Rs. 100 at PLRH, and QCH and no charges KCH seem to be very low as compared to private hospitals. Even an apparently high fee of Rs. 250-500 at PLRH for major operations may not be based on full cost recovery. The surgery charges of Rs. 1500 by the Professors in teaching hospitals may be slightly higher than other comparable doctors but, nevertheless these rates may be justified on equity and private returns grounds.

TABLE 7.5
LEVEL OF FEES FOR PUBLIC EDUCTION BY PROVINCE IN PAKISTAN

(Rs. Per Annum)

Level of Education	Sindh	Punjab	NWFP	Balochistan
PRIMARY	21	30	0	0
MIDDLE	134	138	70	11
MATRICULATION				
a) Science	394	442	260	177
b) Arts	344	412	237	152
INTERMEDIATE				
a) Science	630	817	958	503
b) Arts	530	667	868	485

Source: Directorates of Education of Provincial Governments

Boards of Intermediate and Secondary Educations.

TABLE 7.4

LEVEL OF USER CHARGES FOR HEALTH SERVICES

(Rupees)

Heads	Civil Hospital Karachi	Mayo Hospital Lahore	Lady Reading Hospital Peshawar	Civil Hospital Quetta
O P D Charges/Patient	2	2	1	3
Admission Fee	0	10	5	0
Ward per Day	4	0	0	5
Private Patient Charges				
Ward per Day	0	110	0	0
Room per Day	0	450	100	100
X-Ray	0	15	25	20
E C G	0	75	40	20
Major Operation	0	1000-1500	250-500	150
Minor Operation	0	400-900	75-250	150

Sources
i) Civil Hospital Karachi
ii) Mayo Hospital Lahore
iii) Lady Reading Hospital Peshawar
iv) Civil Hospital Quetta

7.4 EXTENT OF COST RECOVERY

In this section the extent of cost recovery has been defined as the ratio of revenue receipts to the recurring expenditures of the government in a given sector. These cost recovery ratios are calculated for both economic and social services for the four provinces and are reported in Table 7.5.

7.4.1 Economic Services

It is interesting to note that, of all the economic sectors considered only the forestry service shows a reasonably high recovery ratio of over 80 percent in Punjab and over 150 percent in NWFP (see Table 7.5). In fact, in 1989-90, revenues from forestry were much higher than the recurring expenditure, over 200 percent in NWFP, indicating big revenue surplus in the sector. In Sindh, cost recovery ratio in forestry has declined from over 80 percent in 1989-90 to about 60 percent 1994-95. Irrigation has the second highest cost recovery in the provinces but showed a decline in all the provinces except NWFP. The decline is substantial in the case of Sindh and Punjab of over 120 percent and 27 percent respectively.

It is also worth noting that the economic sectors which generated the largest absolute revenues for the four provinces (e.g., irrigation and agricultural services in Sindh and Punjab) are not necessarily the ones that have the highest cost recovery ratios. In fact the ratio for these services in both the provinces is very low. In Punjab, the current cost recovery rate for irrigation and agriculture is 49 and 32 percent respectively while the corresponding rates for Sindh are 21 and 11 percent. The cost recovery ratios for animal husbandry and works are even lower. By and large the cost recovery ratios for the two smaller provinces have been much lower. Provincial governments in these provinces have generally been unable to recover even one-fourths of the costs of operating and maintaining the services.

7.4.2 **Social Services**

The cost recovery performance of the social sector across all services, in general, has been very poor. The overall recovery ratio for most education services is, less than five percent for the bigger provinces and less than a percentage for the two smaller provinces. Even in the university/college and professional/technical institutions, where graduates are expected to get higher future economic returns. cost recovery ratios are no more than twelve percent.

Punjab health sector (e.g., water supply, sanitation, etc.) has shown tremendous increase in the cost recovery ratio in Punjab. It has increased from 30 percent in 1989-90 to 92 percent in 1993-94. This is due to the charge in collection responsibility, from local governments to provincial government in 1992-93. Sindh's performance in this sector is very poor. Cost recovery ratio in Sindh has declined from 10 percent in 1989-90 to a modest 1.5 percent in 1993-94. In NWFP, it has also declined from 16 percent to 10 percent in the same period. The same ratio for the Balochistan is also lower, at about 5 percent. The cost recovery ratios for basic health services, also are very low and do not show any significant rising trend. In fact, in the province of Sindh. NWFP and Balochistan these have has actually declined over the period of analysis.

TABLE 7.5
COST RECOVERY RATIOS BY SECTOR AND BY PROVINCIAL GOVERNMENTS IN PAKISTAN

[Percent]

Heads	Punjab		Sindh		NWFP		Balochistan	
	1989-90	1993-94	1989-90	1993-94	1989-90	1993-94	1989-90	1993-94
ECONOMIC SERVICES								
Agriculture	25 7	22 2	16 1	10 7	14 3	20 7	36 2	30 6
Animal Husbandry	21 0	21 6	4 5	3 1	42 8	8 1	16 0	16 7
Forestry	77 3	81 3	81 6	59 5	207 2	150 8	17 2	9 0
Irrigation	62 3	49 0	46 9	21 0	14 8	15 1	14 7	12 8
Works	11 7	14 6	7 3	15 7	16 2	15 6	2 2	2 3
SOCIAL SERVICES								
Public Health	30 1	91 9	9 8	1 5	15 5	10 1	1 9	4 6
Health	4 9	6 6	3 5	2 3	3 2	2 5	1 0	0 8
Education	3 3	5 1	3 4	1 5	0 6	0 6	0 4	0 5
University/College	6 5	12 6	12 3	8 2	3 4	2 4	1 1	0 2
Professional/Technical	1 9	4 5	2 6	1 6	0 9	4 9	1 3	1 4
Secondary	4 1	4 6	4 8	2 1	1 3	0 4	0 3	0 1
Primary	1 2	1 1	0 8	0 2	0 0	0 1	0 0	0 0

Sources
i) Annual Budget Statements of Provincial Governments
ii) Budget Documents of Provincial Governments

The overall analysis of this section manifests a relatively poor performance of cost recovery. For most of the economic services (e.g., agriculture, animal husbandry and irrigation), where the principles of equity and pay-for-what-you-get are most appropriate, the accomplishment of cost recovery has not been satisfactory. As for the social sectors (e.g., health and education), the situation is even worse. We (urn now, in the next section, to a description of some of the reasons for the low cost recovery.

7.5 CAUSES **FOR LOW COST RECOVERY** 7.5.1 **Economic Services**

In a recent study on resource mobilisation and taxation reforms, Husaini (1991) cited the following three broad important reasons for low cost recovery in the irrigation and agricultural services at the provincial level:

Absence of a Conslidated Agency: One of the major reasons for low cost recovery in the case of irrigation services has been the absence of a unified agency for the provision and assessment (or collection) of such services to users. Due to the lack of coordination between the agencies providing the service and those that are assessing and collecting the revenues from the users, there seems to he a practice of concealment, under-booking and under-reporting of areas under irrigation by users to Tapedars in rural areas. This has consequently led to substantial leakages in revenue receipts. According to the study by Husaini (p.44), the estimated size of this leakage ranges from eight to ten percent in NWFP and Punjab and as high as thirty-five percent in Sindh.

Compliance Laxity: The second important reason for the large divergence between public receipts and revenues is due to the lack of compliance to assessment schedules, supervision, monitoring accountability and cross-checking practices.

Outdated User Charges: **It** has been argued that the water rates charged to users are seldom revised to reflect the increasing operation and maintenance (O&M) costs of the service. On many occasions, revisions were made on an adhoc basis. For instance, a ten percent increase in the rates was suggested for Sindh in 1984-85 as opposed to a twenty five percent increase for Punjab (1981-82). Balochistan (1985-86) and NWFP (1984-85). These rate escalation were highly inadeauate to cover the increase in O&M costs.

Besides these three broad reasons, there are other factors which may have also contributed to the low cost recovery in the economic services provided by the public sector. For example, there is very little incentive or, for that matter, in some cases, even a disincentive for the primary assessor to put a concentrated effort in property assessing and collecting revenues. It has been noted [e.g.. Husaini (1991, pp.72-73)] that, for Tappedars rewards and remueration for extra efforts are so trivial (e.g.. Rs. 42 per year), that it is not worth their time.

7.5.2 **Social Services**

There are similar explanations, for the low degree of cost recovery in social service. First, as highlighted in Section 7.2, levels of fees/user charges for services such as education, health and water supply are low and have not been revised upwards frequently. This has perhaps been motivated by the concern, on the part of government, to facilitate access to these services to poorer households. However, given that demand for services like high school and college education is higher among middle and upper income groups, this has meant that payments are considerably below average affordability levels. Also, the very limited degree of cost recovery has reduced the availability of resources for social sector maintenance and development. A better policy might be to raise user charges and thereby raise the level and quality of provision of these services. The resulting increase access would be even benefit to low income households.

Second, collection efficiency of charges is poor because of the incentive environment that line departments face. Revenues do not accrue directly to the collecting department but are credited to the general treasury. Departments also believe that if they collect more than the stipulated amount, this will lead to a corresponding cut in their grants, resulting in very little net improvement in their resources. Also, since funding comes from provincial budgets, departments know that they have residual access to this source. They are therefore under no pressure to generate their own resources to self-finance any deficits.

Thirdly, collection mechanisms are crude and underdeveloped. For example, drinking water charges are either flat rate of linked to ferrule size at most locations. There is no link between payments and the level of consumption. In schools and colleges, there is a tendency to demand payment of all the fees up front at beginning of the year. This exacerbates the problem of affordability.

We examine next the revenue raising potential of user charges.

7.6 REVENUE RAISING POTENTIAL OF USER CHARGES 7.6.1 Strategy of Cost Recovery

It has been argued earlier that if user pricing is not based on second economic and social considerations there will be a misallocation or congestion of scarce resources (amongst alternative uses) which, consequently, may lead to immiserizing of the private and social welfare functions of society. We also recognize that there are certain social services, (basic health, primary education, etc.,) which should be encouraged and every effort be made by the state to make these services readily available, particularly in rural areas so as to improve the existing less than desirable state of affairs in many villages in Pakistan.

In order to identify the revenue raising potential of various services (for both the economic and social sectors), we have designed a comprehensive scoring procedure in the follower section which enables

us to rank each service. Based on these rankings, we then make recommendations as to the extent of cost recovery that can be targeted for from each sector.

7.6.2 **Methodology of Scoring and Ranking Procedures** The scoring procedure comprises of the following four important criteria which, we believe, cover a wider spectrum of economic and social consdierations:

a) ***Equity:*** This criterion is expected to capture the affordability aspects of user pricing. In other words, a user who can afford to pay (e.g., private ward, primary education and OPD services in urban areas or irrigation for large farmers, etc.), should be charged for these services to cover the full cost. In view of this, the affordability criterion is, therefore, consistent with the implications of the equity principle, that is, pay-for-what-you-get, as discussed earlier.

b) ***Pricing:*** The purpose of the pricing criterion is to ensure the allocative efficiency dimension of the service. Obviously, the user free for a service priced according to this principle should be able to minimize wastage, misuse and congestion problems and thus allocate the scarce resources to alternative srevices so as to maximize the returns to the society. Thus. for most of the economic and few of the social services (e.g., urban water supply) there should be a full cost recovery pricing based on this criterion.

c) ***Private Returns:*** Under this criterion, the intention is to capture the willingness-to-pay feature of the user fee pricing system. A high score on this count indicates that there is a greater desire on the part of the user to use the services (e.g., higher education and private ward facilities in the urban areas or most of the services in the economic sector) as it entails higher private returns to them.

d) *Social Returns:* The pricing policy, particularly designed for the public services, should also take into account the social considerations. Hence, some public facilities (e.g., primary education, water and sanitation, OPD service, etc.,) which have substantial third party benefits or externalities, should not be priced to cover the full marginal cost. One the oilier hand, the services (such as higher education, private ward hospital facilities, and of course, most of the economic services) where beneficiaries are easily identifiable, a less than full marginal cost pricing policy will create congestion problems and, as a result, even on social and distributional grounds, this would be sub-optimal.

For convenience, we have opted to use numerical values between 0.5 to 3.0 for our scoring procedure for each criterion of a given service. A score of 3 would suggest a full cost recovery on the basis of a given criterion while 0.5 would imply a low cost recovery.

It should also be noted that the four criteria described above may not have equal priority insofar as the public sector's objective function is concerned. We argue that, for a good pricing policy of the public services, the equity (or affordability) and social returns considerations should be the prime concern of the state wliile private returns (willingness to pay) and pricing (allocative efficiency) ought to be of secondary and tertiary importance, respectively. Consequently, we assigned a high weightage of 35 (our of 100) to the equity and social returns criteria respectively, 20 to private returns and only 10 to pricing. Thus, a public service, in principle, can secure a maximum services of 300 [3(35 + 35 +20+ 10)]. Once, these scores are calculated for all the services considered, we then identify the services and propose the extent (on a percentage basis) of cost recovery that can be accomplished from a sector based on the ranking of the scores of these services. Obviously, the sector securing the highest score will be a candidate for, more or less, a full O&M cost recovery while the sector with the least score will be exempted from such a full or even partial recovery proposal.

7.6.3 Ranking of Services

In tills subsection, we identify those economic services, based on the results obtained from the scoring procedure and the ranking of the services, which may have potential for raising revenues for the public sector. This sort of analysis is done separately for economic and social services. We begin with the analysis of the economic sector.

Economic Services: Table 7.6 reports the results of revenue raising potential based on the scoring procedure for the economic services. Both irrigation facilities for large farmers and forest services in the economic sector were assigned the maximum score of 3 for each of the four criteria. The rationale for allocating such high scores on each count for these two services is based on the following reasons. Firstly, on equity or affordahility grounds, large farmers, as compared to the smaller ones, are far more capable of affording the full cost price of irrigation facilities. The same line of argument can also be made for the user of forest services because the major users of this facility are large factories which produce pulp, paper, lumber and other products. Secondly, based on the pricing or allocative efficiency criterion, if these two facilities are underpriced then fanners, both large and small, may change their cropping pattern or may shift to different crops and the user of the forest services may go for the excessive use of scarce forest resources. This excessive use and depletion of forest resources will not only have long-term negative economic consequences (in the form of shortages) but will also have environmental consequences. Thirdly, because of the economic nature of these services, private returns to the users will he quite high and thus they should be priced to the full cost. Finally as for the social returns consideration, society gains nothing by underpricing the irrigation services to the large, or for that matter, small farmers. On the other hand, the below marginal cost pricing for the forest services will create negative externalities to the society be excessive cutting of the scarce forest resources.

Table 7.6 further reveals that both renting of agricultural land services and irrigation facilities to the small farmer also secure the maximum scores of 3 for most of the criteria. It was only on the equity or affordability grounds that these two sectors are marginally short of the maximum score. Since

TABLE 7.6

REVENUE RAISING POTENTIAL BASED ON SCORING PROCEDURE: ECONOMIC SERVICES

Service	CRITERIA				Total Score
	Equity	Pricing	Private Returns	Social Returns	
	WEIGHT				
	35	10	20	35	
IRRIGATION					
Small	2	3	3	3	265
Large	3	3	3	3	300
AGRICULTURE					
Extension	3	1	2	0 5	156 5
Leasing	1	2	3	2	185
Renting Land	2 5	3	3	3	282 5
Forests	3	3	3	3	300
ANIMAL HUSBANDRY	1.5	1	3	1	157 5
COMMUNICATION	2	1	2	3	225

renting of agricultural land is generally done by the big landlords, the score assigned to it on the equity criterion is as high as 2.5. However, on many occasions, small farmers using irrigation services encounter liquidity problems and thus the socre on the affordability criterion is lowered down to 2.

Communications is another economic service where, only on the basis of social returns, one can propose a full cost recovery because it could, otherwise, lead to overuse of congestion problems. However, on equity, pricing and private returns grounds, it would be an imprudent policy choice to suggest a full cost recovery as this service is also used by a large number of poor people.

As for the other three economic services, a full cost recovery can be proposed for agricultural machinery leasing and animal husbandry only on the basis of the private returns criteria and for the extension services only on the grounds of equity considerations.

Social Services: Within the social sector, the sub-categories of three broad services namely, water, education and health are analysed for both rural and urban areas to identify the extent of revenue raising potential. The results, based on the scoring procedure, are reported in Table 7.7. Since the criteria for assigning the scores for a given sector have been discussed in detail earlier, to avoid repetition, we provide a brief discussion of only those social services where there is a potential for raising revenues.

Table 7.7 indicates that the scores on private ward hospitalisation services in both urban and rural areas are the highest as compared to other social services. On equity, pricing and private returns criteria, we assign the maximum score of 3 to each of these two services. The reasons for assigning such high scores to the private ward services are straighforward because the users of these services, in general belong to the relatively upper income group of the society. Therefore, this demographic group of the population, whether living in urban or rural areas, should not only he able to afford (equity consideration) this service but, to them, the private returns of such a service will be much higher as compared to the lower income group. Any underpricing of this social service will thus cause the problem of congestion (allocative inefficiency consideration). On social returns or humanitarain grounds, one can make a case, though a weak one, that the state, perhaps marginally subsidize this service. We, thus, assign a score of 2.5 (rather than 3) on social returns criteria for the private ward service for both urban and rural areas.

As far as the urban higher education (secondary, college level and higher) is concerned, scores assigned are faily high (between 2 and 3) on pricing, private and social returns grounds. However, based on the equity criterion, the scores are slightly lower for these two services for the reason that. for the low income group in urban areas, higher education may not be affordable.

Water supply, general ward and OPD health services in the urban areas and college education in the rural areas were also assigned high scores on equity, pricing, and social returns grounds for reasons that of these services would create congestion problems, misallocation of scares resources, etc. On social

TABLE 7.7

REVENUE RAISING POTENTIAL BASED ON SCORING PROCEDURE: SOCIAL SERVICES

Service	CRITERIA				Total Score
	Equity	Pricing	Private Returns	Social Returns	
	WEIGHT				
	35	10	20	35	
WATER SUPPLY					
• Urban	3	3	3	2	265
• Rural	3	2	2	2	230
EDUCATION					
Primary					
• Urban	3	1	1	1	170
• Rural	2	1	1	1	135
Secondary					
• Urban	2	2	2	3	230
College					
• Urban	1.5	2	3	3	237 5
HEALTH					
O.P.D.					
• Urban	3	3	2	1	210
• Rural	2	3	2	1	175
Maternity					
• Urban	2	2 5	2 5	1 5	197 5
• Rural	1 5	1 5	2 5	1 5	170
General*					
• Urban	1 5	1 5	3.0	2 5	215
• Rural	0 5	1.5	3 0	2 5	180
Private**					
• Urban	3	3	3	2 5	282 5
• Rural	3	3	3	2 5	282 5

* Hospitalisation of general wards.
** Hospitalisation of private wards

returns criterion, however, a very low score of 1 is given to some of these services (e.g.. water supply and OPD health services) because if full cost pricing makes these services unaffordable to the lower income group in the urban areas, then it may generate negative externalities in terms of unhygienic and poor-health conditions.

Other social services such as secondary education, general hospital, OPD, maternity, water supply and primary education in the rural areas and maternity services and primary education in the urban areas are allocated relatively low scores on most counts because these social services are considered to be the basic services. Therefore, it is the responsibility of the state to make them available to most of its citizens at affordable rates.

7.6.4 Levels of Cost Recovery

Based on the above analysis of ranking criteria for levy of user charges and the respective scores of each service, we have formulated our proposals on the achievable and justifiable degree of cost recovery of O&M cost in different economic and social services. The proposed targets for cost recovery are given in Table 7.8.

Consistent with earlier conclusions, generally higher rates of cost recovery are proposed for economic services, especially for irrigation and forestry. Within social services, we recommend that the degree of cost recovery by highest for water supply followed by secondary and college education and the lowest for health services and primary education. Targets are on the conservative side in recognition of the political and administrative limits to the extent to which there can be escalation in user charges.

We also emphasise that from the viewpoint of acceptability by consumers of these increases, there should be a policy of differential rates of enhancement within a particular service to allow for considerations of affordability, equity and the likelihood of resistance. As such, irrigation charges should be increased at different rates by the size of the farms. Within college and high school education, a pragmatic approach would be to enhance fees at the points of entry or exist rather than during the period the education is being received. This strategy will minimize student protest. Accordingly, significant additional revenues could be generated by levy of application fees (none at present), and increase in examination and certificate fees especially in the cases of private students. Increases in tuition fees should be relatively modest. Similarly, in the context of health services, the largest increase initially should be attempted in the charges for operations, special tests and for private wards. Implementation of these cost recovery targets can potentially increase non-tax revenue of provincial governments by over three-fourths.

TABLE 7.8
PROPOSED TARGETS FOR COST RECOVERY

Service	Cost Recovery Target (%)
ECONOMIC SECTOR	
Agriculture	20
Animal Husbandry	5
Forestry	100
Irrigation	75
Works	20
SOCIAL SECTOR	
Public Helath (Water Supply)	50
Health	10
Education	
University/College	10
Professional/Technical	10
Secondary	15
Primary	0

Chapter Eight PROVINCIAL EXPENDITURE ALLOCATIONS IN PAKISTAN

8.1 INTRODUCTION

The purpose of this chapter is to examine the trends in the allocation of public expenditures to the social sectors of the provinces. The analysis of these allocations in relation to the Seventh Five-year Plan (I 988-93) targets in the social sectors will also enable use to shed light on the adequacy of the expenditures as well as to identify the extent to which further allocations are required to meet the plan targets. Section 8.2 analyses the trend in the level and composition of current expenditure allocations to the social sectors in relation to overall expenditures of the provinces. The analysis of development expenditures in (he social sector in relation to the targets is carried out in Section 8.3. equity consequences of public expenditures in the social sector are discussed in Section 8.4.

8.2 **COMPOSITION OF AND GROWTH IN CURRENT EXPENDITURE** Composition of and growth in current expenditure on social services is presented in 1 able 8.1. Current expenditures on the total social services and most of its sub-sectors (e.g. education, health and manpower) have been rising steadily since 1987-88 as shown in Table 8.1. Highest growth in total expenditure on social services has been in Sindh, 18 percent, while the rate of annual increase in the other provinces has been somewhat lower, at about 15 percent. By and large, the rate of increase in expenditure on social sectors has been higher that of total current expenditure. As such, the percentage share of expenditure on social sectors in the overall current expenditure has increased. The highest is in Punjab at about 39 percent and lowest in Balochistan at 31 percent. Rate of increase of this share is also highest in Punjab at about 2 percent per annum. Highest growth sector have been education and social welfare in Punjab and Sindh alongwith health. Physical planning and housing has been the highest growth sector in NWFP and Balochistan.

As far as the allocation among sectors is concerned, the current expenditure share of education is the largest among social services in all the four provinces followed by health service allocations which arc roughly one-fourth or less of the education expenditure with the exception of Balochistan.

8.3 COMPOSITION OF AND GROWTH IN DEVELOPMENT EXPENDITURE Although development expenditures on social sectors have increased over the period 1987-88 to 1994-95 in all the provinces, on a percentage basis, the share of social services in the total development expenditure has exhibited a decline, for the provinces of Punjab and Sindh (sec Table 8.2). It is interesting to note that the share of development expenditure in the social sectors, in general, has been higher than in current expenditure during the period considered. However, in recent years, this gap (between development and current expenditures) has narrowed down substantially. In education sector, growth of development expenditure is highest in NWFP (23%) followed by the Balochistan (20%) and the lowest in Sindh (only 3.8%). NWFP and Balochistan have also shown significantly higher growth in health sector also at about

TABLE 8.1
COMPOSITION OF AND GROWTH IN RECURRING EXPENDITURE ON SOCIAL SECTORS BY PROVINCE
1994-95

Heads	Punjab		Sindh		NWFP		Balochistan		Pakistan	
	Share in Exp. on Social Sectors	Growth Rate*	Share in Exp. on Social Sectors	Growth Rate*	Share in Exp. on Social Sectors	Growth Rate*	Share in Exp. on Social Sectors	Growth Rate*	Share in Exp. on Social Sectors	Growth Rate*
Education	78 9	16 4	78 8	19 2	74 6	14 2	60 7	15 1	76 8	16 6
Health	16 2	12 8	16 1	14 5	19 0	15 3	24 1	13 6	17 2	13 7
Public Health and PPH	2 1	6 0	2 2	18 1	4 8	23 1	9 6	19 1	3 1	13 6
Manpower	0 4	11 7	0 6	14 8	0 0	10 3	2 1	18 0	0 5	14 1
Social Welfare	1 7	21 1	1 2	16 1	0 5	15 4	1 6	18 1	1 4	19 2
Other Social Sectors	0 7	3 2	1 1	8 0	1 0	24 4	1 9	12 4	0 9	8 2
Total Social Sectors *[Rs in Million]*	21859	15 4	11101	18 1	7436	14 8	3099	15 1	43495	15 9
Total Current Expenditure *[Rs in Million]*	56245	13 2	31107	16 6	19405	13 5	9894	14 0	116651	14 2
Share of Social Sectors in Total Current Expenditure [%]	38 9	1 9	35 7	1 2	38 3	1 2	31 3	0 9	37 3	1 5

* Annual compound growth rate for 1987-88 to 1994-95
Sources Annual Budget Statements of Provincial Governments

TABLE 8.2
COMPOSITION OF AND GROWTH IN DEVELOPMENT EXPENDITURE ON SOCIAL SECTORS BY PROVINCE
1994-95

Heads	Punjab		Sindh		NWFP		Balochistan		Pakistan	
	Share in Exp. on Social Sectors	Growth Rate★	Share in Exp. on Social Sectors	Growth Rate★	Share in Exp. on Social Sectors	Growth Rate★	Share in Exp. on Social Sectors	Growth Rate★	Share in Exp. on Social Sectors	Growth Rate★
Education	34 2	9 9	34 7	3 8	50 6	23 0	37 1	20 0	38 9	12 9
Health	16 8	-1 5	19 4	7 3	20 4	12 7	19 8	16 3	18 6	4 9
Public Health and PPH	42 7	3 7	43 6	2 2	25 5	16 3	30 7	20 5	36 7	6 2
Other Social Sectors	6 3	13 5	2 3	21 9	3 4	25 2	12 5	29 1	5 8	19 1
Total Social Sectors *[Rs in Million]*	7069 4	4 8	2756 0	3 9	4142 0	18 6	2445 9	20 2	16413 3	8 7
Total Development Expenditure *[Rs in Million]*	12954 1	5 7	5500 0	5 7	7349 2	16 1	4873 8	14 4	30677 1	8 8
Share of Social Sectors in Total Development Expenditure [%]	54 6	-0 9	50 1	-1 7	56 4	2 1	50 2	5 0	53 5	-0 1

★ Annual compound growth rate for 1987-88 to 1994-95
Sources Annual Budget Statements of Provincial Governments

13 percent and 16 percent respectively. It is important to note that in Punjab, growth in health sector expenditure has been declined. In percentage terms, the share of health sector in total social sector has also been decreased from 30 percent in 1991-92 to 17 percent in 1994-95.

As far as the sectoral allocations are concerned, educ

9.5 INVESTMENT PROGRAMMING

There are certain aspects of investment programming generally and specifically in the social sectors by the provincial governments which mitigate against effective utilization of resources. An in-depth case study has been undertaken by us of the ADP of the provincial governments for 'lie fiscal year. 1991 -92. There were over 2600 schemes being executed in Punjab, 1600 in Sindh and 856 in NWFP in the social sectors. The total capital cost of these schemes was almost Ks 24 billion, 21 billion and 8.7 billion respectively. Given the total ADP allocation of about Rs. 3.3 billion for these schemes in Punjab. 3.8 billion in Sindh and 1.5 billion in NWFP, this implies that the provincial governments are carrying a portfolio of projects equivalent to over 5 1/2 to 8 times the annual allocation (see Table 9.5). In other words a typical scheme-ill the social sectors takes about 5 to 8 years to complete.

The long gestation period of projects is due to the nature of investment programming by the provincial governments. The basic tendency is to approve too many schemes which stretches not only the implementation capacity but also implies dial a given amount of funds is spread over a larger number of projects and, therefore, each project gets a smaller allocation. This tendency can he attributed largely to the politicization of the project approval process. Involvement of elected representatives at me district level and at the provincial level implies that competing claims of different regional Interest and pressure groups can only be reconciled by a larger number of projects being sanctioned, with each project receiving reduced allocations.

The long period taken to complete a typical social sector project is not a reflection of the underlying complexity of construction in most cases, except perhaps for hospitals, high schools, rural health centers or large urban water supply schemes. Primary and secondary schools rural health centers, rural water supply schemes, etc. can generally be executed within one to two years subject to the availability of funds. However, examination of Table 9.6 reveals that the average allocation for schools is only about 7 percent of the total capital requirement in Sindh and NWFP in the case of on-going schemes. This percentage is higher at about 42% in Punjab. It is interesting to note that the average allocation for new schemes in education appears to be higher than on-going schemes. The opposite appears to hold (rue for the other sectors.

There are many deleterious consequences of the over programming of investments by the provincial governments. The need to carry too many schemes in the ADP means that the project preparation, design and execution capacity is stretched to its limits. This inevitably has implications on the quality of implementation. Also, the fact that schemes take live to eight years to complete means that there are significant cost overruns. The inflation in costs of materials and labour in the intervening period implies that the cost estimates in the original PCI are inadequate to complete the schemes. This leads either to revisions in the PCI which causes further delays or to only partial implementation of me schemes, thereby limiting the benefits flowing from the investments. Further, the staggered implementation of projects reduces the present value of benefits.

TABLE 9.5
SHARE OF NEW AND ON-GOING SCHEMES IN SOCIAL SECTORS
ALLOCATIONS BY PROVINCE, 1991-92

Heads	Total Allocation (Rs. *in Million)*	SHARI OF	
		On-going (%)	NEW (%)
PUNJAB	3329	73.6	26.4
Education	1230	47.1	52.9
Health	1135	83.7	16 .3
Public Health	932	96.7	3 .3
Social Welfare	10	70.0	30.0
Manpower and Training	22	59.1	40.9
SINDH	1804	89.1	10.9
Education	857	84.8	15.2
Health	4^1	86.5	13.5
Public Health	4 *b* 9	100.0	0.0
Social Welfare	11	61.6	16.4
Manpower and Training	15	90.0	10.0
N.W.F.P.	1457	68.6	31.4
Education	695	42.4	57.6
Health	448	93.9	6.1
Public Health	289	92.0	8.0
Social Welfare	14	78.6	21.4
Manpower and Training	12	66.7	33.3
BALOCHISTAN	549	80.3	19.7
Education	242	75.6	24.4
Health	68	48 .5	51.5
Public Health	225	95.1	4.9
Social Welfare	3	0.0	100.0
Manpower and Training	11	100.0	0.0

Source Annual Development Programmes of Provincial Governments

TABLE 9.6

BUDGETED ALLOCATIONS AS PERCENTAGE OF TOTAL COST OF SCHEMES IN THE SOCIAL SECTORS, 1991-92

Heads	AVERAGE % OF BUDGETARY ALLOCATIONS TO TOTAL COST OF SCHEMES			
	Punjab	Sindh	N.W.F.P.	Balochistan
Education				
On-going	41 8	6 7	6 6	19 9
New	10 6	9 7	80 3	60 8
Health				
On-going	12 2	13 5	18 3	12 7
New	4 0	5 4	46 2	39 8
Public Health				
On-going	10 8	10 1	25 6	18 7
New	4 2	0 0	13 9	100 0
Manpower and Training				
On-going	15 0	16 9	19 0	20 0
New	16 0	5 0	6 7	0 0
Social Welfare				
On-going	50 0	28 0	15 7	0 0
New	0 0	26 7	21 4	100 0
Total				
On-going	14 2	8 7	12 6	18 5
New	7 7	7 8	57 4	54 3

Source Annual Development Programmes of Provincial Governments 1991-92

Altogether, there are serious problems with investment programming by provincial governments. The tendency to carry too large a portfolio of projects will have to be limited by prescribing the maximum share of the ADP that can be allocated to new schemes in any particular year. In no sector should this share exceed, say, 10%. In 1991-92, the government of Punjab and NWFP allocated as much as 53 to 57% to new schemes in primary education and almost 36% of the social sector allocation in Sindh are to new schemes, in the presence of a large number of unfinished projects.

There is need also to depolitictse the process of approval and allocation of investment funds. '1 his has not only led to a proliferation of schemes but also to investment choices that have not been made on the basis of some efficiency criteria but on considerations of regional equity or lobbying pressures. An intermediate solution would be for the provincial line departments to prepare a portfolio of projects which satisfy certain selection criteria and possess a minimum economic justification. Politicians could then choose from within this short list of projects.

9.6 THE PROJECT CYCLE

The project cycle has five stages-identification, preparation, approval, execution and monitoring. Each stage has a number of problems which affect the degree of cost effectiveness and efficiency in the delivery of services.

Project identification: Identification of individual projects in the social and other sectors is expected to be consistent with the five-year plans. However, these medium term plans are essentially framed at the federal level by the Planning Commission. Provincial governments primarily engage in the preparation of annual development programs within the framework of which individual projects and programs are allocated funds. The five-year plans prescribe broad sectoral allocations at the national level and the identification of individual projects is largely left to the executing agencies, either at the federal or provincial levels. Consistency between project choices and overall sectoral allocations remains an elusive goal.

Basic programmes in the social sectors, especially in the rural areas, relating to primary schools, high schools, rural water supply and drainage schemes, rural health centres, etc. have increasingly been approved by the Provincial Development Working Party (PDWP). The size of individual projects/programs is usually not large enough to warrant further approval by the Central Development Working Party (CDWP) or the ECNEC. The process of project identification has largely been decentralized down to the district level through the involvement of elected representatives.

There is, in fact, a major missing link in the project identification process. This is the lack of medium term sector level investment plans at the provincial level. Such plans could reflect on the one hand the overall development priorities and allocations in the five-year plans and on the other hand define appropriate project selection criteria which could ensure that projects identified possess a minimum justification. As mentioned earlier, this could minimize the problems created by the politicization of the project

identification process. If, in fact, the sector investment plans could generate a short list of projects, then efforts could be made to limit the choice of politicians from among these projects. In the absence of this. project identification will be the consequence largely of lobbying efforts with no guarantee that investments sanctioned are socially or economically justified.

A good example of sector investment planning is the recently prepared Strategic Investment Plans for Rural Water Supply and Sanitation for Sindh. The initiative has come from donor agencies with CIDA providing the funding and the World Bank managing the exercise, 'these strategic plans emphasize sustainability, community involvement, cost recovery and appropriate technology choice and cover the Seventh and Eighth Plan periods, up to 1998. They arc based more on a realistic assessment of future institutional absorptive abilities and financial resources and less on attainment of targets. They also lay down the criteria for selection of schemes. Implementation of these plans could greatly streamline the project identification process and contribute to more effective service delivery.

Project Preparation: This stage of the process usually involves the preparation of PCIs. By now PCI preparation for basic investments in the social sectors has been largely standardized. Given the problems of effective utilization of services like primary schools, rural health centres, etc. in (lie rural areas it is important that the PCIs emphasize the quantification of benefits. The general format of PCTs also docs not enable proper project analysis in specific areas. It is necessary that sub-sector specific PCTs be designed.

Project Approval: Delays are inherent in the project approval process. The planning and development departments of the provincial governments are stretched to their limits because of the preparation of too many new schemes for approval. Consequently, the quality of project appraisal is poor and very little effort is made to optimize the allocation of investments.

Project Execution: The basic problem, referred to earlier, is the phasing of investments. Actual allocation of funds to individual projects/programs is primarily determined by the overall availability of resources and bears little relationship with the scheduling of capital expenditures proposed in the PCTs. This leads to long delays in execution, cost overruns and frequently only partial implementation.

Project Monitoring: This is one of the weakest components of the project cycle. Departments are generally expected to submit project completion reports (PCIV). However, there is no inspection in the field by an independent agency of the quality and degree of implementation. The establishment of independent project monitoring and evaluation units is a pre-requisite for introducing a degree of accountability on the part of the executing agencies. Also, the level and nature of operations of existing schemes/projects is seldom determined. There is a no database relating to performance measures. Consequently, it is generally not known at a centralized place how many tubal water supply schemes are operational, what the enrollment in individual schools is, etc. There is need to establish appropriate management information systems to monitor performance of individual projects. Proposed initiatives like the National education Management

Information System (NEMIS) and Health Information System (HIS) will help greatly in achieving this objective.

Altogether, there is considerable scope for improving the project cycle to enable identification of better projects, improved quality of project preparation, timely and proper approval and efficient implementation. This will require institutional strengthening and technical assistance to the line departments and also to the planning and development departments and development of oilier delivery mechanisms.

9.7 **ALTERNATIVE DELIVERY MECHANISMS** The two main line departments responsible for execution of schemes arc the Works Department and the Public Health Engineering Department of the provincial governments. I lie education and health departments also have an engineering arm. However, there are major limits to the implementation capacity of these departments. A rapidly expanded program of investment in the social sectors runs the risk of running into these limits, leading thereby to delays in implementation and/or higher unit costs. I here is evidence that this happened during the tenure of the Five Point Programme when there was a quantum jump in the allocations for development of the social sectors in the rural areas.

One option which needs to be examined is the involvement of private sector consultants and contractors to take on greater responsibilities for project preparation and execution. Line departments could then play an essentially supervisory and monitoring role. The scale of the work should, however, he large enough and financial attractive to induce private sector participation, especially by reputable firms. As such the development program in a particular sub-sector could be partitioned into district level packages inclusive of schemes for say the next three years and competitive bids invited for these packages. The site of the work then is likely to be sufficient to create economies of scale and the generation of adequate profits. In the short run, involvement of the private sector in the planning, design and implementation of social sector schemes can bring in the badly needed professional expertise for development of the sector.

Finally, we turn to the scope for direct involvement of beneficiary communities in financing, managing and operating schemes. The most promising areas for such involvement arc primary education and water supply and sanitation. The benefits of community participation arc numerous. These include, first, the possibility of contributions both in cash and in kind to capital and recurring costs, thereby reducing the load on the public sector. Second, community involvement in the identification of schemes is likely to make public investments more responsive to demand.

Third, local beneficiary involvement in the management of services could improve the sustainability of investments and ensure proper operations and maintenance. High priority will have to he attached in coming years to development of NGOs and community based organisations to lake on increased responsibilities in the social sectors, especially in the rural areas. Issues related to decentralisation of the provision of social services are taken up in the next chapter.

Chapter Ten

ROLE OF LOCAL GOVERNMENTS IN PAKISTAN

In this Chapter we describe the role of local governments in Pakistan and set up the case Col-decentralization of the provision of social services to this level of government.

10.1 INSTITUTIONAL STRUCTURE

Local governments constitute the third tier of government, after the federal and provincial governments in Pakistan. The provincial governments have delegated some of their functional responsibilities to the local governments through the promulgation of the Local Government Ordinances. As such the latter are not yet a recognised tier of government specified in the constitution of the country. In the urban areas, the structure of the local government consists of a single tier local entity. Depending upon the size of the population, this may be a metropolitan corporation, municipal corporation, municipal committee or town committee (see Table 10.1). However, in Lahore and Karachi there exists a two tier local government system consisting of the metropolitan corporation and eight zonal offices and four zonal municipal committees respectively. The latter, however, do not have separately elected councilors. In tlie case of Lahore the zonal offices have the status of administrative units only. The lands owned by tlie Directorate of Military Lands and Cantonments, however, fall outside the ambit of the local government structure. These come under the cantonment boards and operate under tlie ministry of defence, government of Pakistan, directly. Currently, there are 40 cantonment hoards in the country.

In the rural areas, the structure of local government is based on a two tier system. The upper tier consists of the 97 district councils, the lower tier of union councils. However, there is no vertical integration between union and district councils. In all, there are 4855 local councils in the country. 490 of which arc in the urban areas.

Beside these elected local councils the development requirement of the bigger cities, like Lahore. Peshawar, Faisalabad, Karachi, Hyderabad etc., has necessitated tlie establishment of semi autonomous development authorities (DAs) and water and sanitation agencies/hoards (WASA/KWSB). The former plays an important role in the development of physical infrastructure, particularly land development and sites and services, while the latter have the specific mandate of water supply and sanitation provision in the respective cities. The water agency in Karachi, called the Karachi Water and Sewerage Board (KWSB). works under the Karachi Metropolitan Corporation while water and sanitation agencies (WASAs) in some of the other bigger cities are under the operational control of the Development Authorities (DAs).

TABLE 10.1
NUMBER AND TYPES OF LOCAL COUNCILS
BY PROVINCE

	Punjab	Sindh	NWFP	Balochistan	Total
URBAN AREAS	235	159	56	40	490
Metropolitan Corporation	1	1	-	-	2
Municipal Corporation	8	3	1	1	13
Municipal Committee	70	33	30	13	146
Town Committee	138	114	14	23	289
Cantonment Board	18	8	11	3	40
RURAL AREAS	2511	691	*777*	386	4365
District Councils	35	15	21	26	97
Union Council	2476	676	756	360	4268
TOTAL	2746	850	833	426	4855

10.2 EXISTING ALLOCATION OF FISCAL POWERS AND FUNCTIONS 10.2.1 Fiscal Powers

Fiscal powers of the local bodies are enumerated in the Local Government Ordinances of the respective provinces. By and large the distribution of fiscal powers is heavily influenced by the nature *(if* tile-regional economy. The main revenue source of the district council is a tax on goods (primarily agricultural commodities) 'exported' by the area while the most buoyant revenue generating instrument for the urban councils is a tax on goods 'imported' into the area, octroi. An examination of the tax structure of the local councils also reveals that some of the relatively more buoyant taxes of a local nature, like stamp duty, capital gains tax, motor vehicle tax, property tax and tax on professions, have been pre-empted by the provincial government.

A list of taxes that can he levied by the urban and rural local councils in Pakistan is presented in Tables 10.2 and 10.3 respectively. There are only marginal differences in the local fiscal powers across provinces. Perhaps the only striking difference is that in the province of Sindh, local councils do not have the fiscal powers to tax annual rental value of buildings and land. Local taxes can however, only be levied if prior sanction has been obtained from the provincial government winch has the power to decrease suspend or abolish any tax. Also, proposed changes in tax rates or structure have to he published for public comments. Objection to the proposed tax measures are heard by the Finance Subcommittee of the council in public. This committee then presents its reports to the council for its decision.

10.2.2 Functions

Local councils are responsible for the provision of some basic services in Pakistan. Their functional responsibilities are also enumerated in the LGO. For both urban and rural councils the responsibilities are separated into compulsory and optional functions. The compulsory list covers services that local councils have to provide while the optional list refers to functions that councils may or may not perform. The Sindh LGO carries a separate list of functions to be performed by KMC like provision of trunk infrastructure, sewerage system and treatment plants, storm water drains, etc.

Chart 10.1 presents functions that can be performed by urban local councils. These include water supply, solid water disposal, drainage, fire fighting, roads and street lighting, primary education, health care, etc. The involvement of the local councils in the provision of the latter two services is currently limited because of financial and institutional constraints. As such, these services continue to he the principal responsibility of the provincial governments.

In the case of rural areas, separate legislative allocation of functions is. given for the union and the district councils. A union council may, if directed by the government perform a number of functions. There is an exhaustive list of functions, some of the more important of these are as follows:

1. Provision and maintenance of roads, sanitation, registration of births and deaths:

CHART 10.1

FUNCTIONS THAT CAN BE PERFORMED BY
URBAN LOCAL COUNCILS

REGULATORY	• Insanitary buildings and lands • Infectious diseases • Private sources of water supply* • Drainage and sewerage schemes for commercial and industrial area* • Private market* • Prohibition against keeping and maintaining cattle* • Dangerous animals* • Disposal of carcasses* • Compulsory education • Dangerous and offensive articles and trades* • Site development schemes*	• Regulation of buildings* • Streets* • Traffic control* • Public Vehicles* • Environmental pollution • Bathing and washing places • Dhobi Ghats • Public water courses • Public ferries • Public fisheries • Bye-laws for articles of food and drink • Milk supply • Livestock improvement • Burial and burial places

TABLE 10.3 TAXES ON RURAL LOCAL

COUNCILS

Heads	Sindh	Punjab	NWFP	Balochistan
1. Tax on the export of goods and animals	★	D	D	D
2. Tax on the import of goods and animals for consumption, use or sale	U	U	U	U
3. Tax on the transfer of immovable property	★	D	D	D
4. Fees for licences, sanctions and permission by the council	★	★	★	★
5. Market fees	★	★	★	D
6. Rate on the services like water supply, drainage, lighting provided by the council	★	★	★	D
7. Fees at fairs, agricultural shows, industrial exhibitions, tournaments and other public gatherings	★	★	★	D
8. Fees for specific services rendered by council	★	★	★	U
9. Fees on the slaughter of animals	★	U	U	U
10. Tax on the annual rental value of buildings and lands	★	U	D	-
11. Tools on roads and bridges maintained by the council	★	★	★	D
12. Tax on the construction or maintenance of works of public utility	★	★	★	U
13. Surcharge on any of taxes levied by Government	-	U	U	D
14. Rate for the remuneration of village police	-	-	U	U
15. Tax on vehicles other than motor vehicles, including cars, bicycles and Tongas	★	D	D	
16. Tax on the profession, trades, callings and employment	★	D	U	
17. Tax on advertisement	★	D	-	
18. School fees in respect of schools established or maintained by the council	★	D	-	
19. Tax on lands not subject to local rate	★	-	-	
20. Tax on hearth	★	U	U	U
21. Tax on births, marriages and feasts	★	U	U	U
22. Tax on cinemas, dramatical and the article shows and other amusement	★	U	U	
23. Conservancy rate	★	-	-	
24. Fee on application for erection and re-erection of buildings	★	U	U	U
25. Any other tax which is levied by Government	★		★	
26. Community tax on the adult males for the construction of any work of public utility	★	U	U	-
27. Tax on animals	★	U	U	U
28. Local cess	★	-	★	
29. Fees on sale of cattle at fairs	-	D	-	

★ = Tax can be levied
U = Union Councils only
D = district Councils only

2. Construction and maintenance agency for primary, middle and secondary schools, rural health centres, piped water supply schemes, tube wells, hand pumps, farm-to-market roads.

3. Review the implementation of development projects by line departments:

4. Make recommendations to district councils regarding location of facilities;

5. Identify gaps in facilities and take measures to narrow these gaps in accordance with the priorities laid down by the district council; and

6. Facilitate formation of associations for collective use and maintenance of services.

In addition to these, the district councils may also engage in rural development, agriculture, livestock and dairy development, public health, education, protection from floods and prevention of adulteration, drainage, promotion of culture games and sports, public safety, libraries, regulation of traffic, environmental pollution and social welfare functions.

The actual participation of rural councils in the development and maintenance of services is however, limited. Even though the legislative allocation of functions is wide ranging, financial and institutional constraints have generally limited district councils' involvement to the development and maintenance of link roads, drainage, and partial involvement in preventive and curative health and animal husbandry. The role of the union councils is negligible.

By and large, there appears to be a direct relationship between the level and range of the functions performed by local government agencies and city size. In large cities, considerable diversification is observed in the role of local governments, which in addition to obligatory functions have also taken on some optional functions. The presence of specialised agencies has enhanced local development capacity. Municipal governments in small cities and rural areas have been relegated largely to performing only a few basic functions.

The overall conclusion is that there is a basic imbalance between the range of functions that local governments can perform and the fiscal powers granted to them. The former are very extensive, including social services like primary education and curative health, while the latter are very limited. Consequently, most local councils, especially those in the smaller cities and rural areas discharge only few of the basic functions. Not only have many of the major local taxes been pre-empted by provincial governments but also increasingly most of the local services are being delivered by provincial line departments, especially in the rural areas.

Efforts at decentralization of the provision of some basic social services as part of the SAP are unlikely to he hindered by any legal provisions regarding allocation of functions among different levels of

government in Pakistan. However, the transition can be successfully achieved only if there is simultaneously a significant transfer of resources to the local level either through an expansion in revenue sharing arrangements with the provincial government or by grants.

10.3 FISCAL STATUS OF LOCAL COUNCILS Local councils in Pakistan are largely self financing entities. They generally have no access to capital markets or deficit grants from higher levels of government to finance either recurring or overall budgetary deficits. As such, these governmental units have to generate revenue surpluses to finance development liabilities and balance their books at the end of the fiscal year. Therefore, unlike higher levels of government, local governments are forced to exercise a degree of financial discipline. maximise revenue generation and economise on expenditure. However, in the absence of a well developed grant-in-aid system to equalise differences in fiscal capacity, this requirement puts a tremendous pressure on smaller urban and rural councils which have narrow tax bases and limited fiscal capacity. The consequence is that hulk of the revenues generated are consumed in operating and maintaining existing facilities and, by and large, required increases in service coverage, due to a growth in population, are not achieved. Generally, a relatively smaller proportion of total expenditure of local councils, particularly urban local councils, is devoted to the development of services, (sec Table 10.4). The highest proportion, 29 percent, is incurred by the town committee of Punjab. In rural areas. development expenditures account for about 44 percent and 52 percent of total expenditure in Punjab and NWFP respectively. However, given the tendency to overstate development expenditure, the actual share of this type of expenditure may be much lower. Most of it consists of maintenance works or small schemes. In the case of rural councils in Balochistan expenditure on development activities is almost non existent.

The overall fiscal state of local councils is indicated in Table 10.4. The table shows that local councils in Pakistan generally have a surplus, on their recurring account. Revenue surpluses generally range from 15 to 30 percent of revenue receipts. Also, local councils are able to generate overall budgetary surpluses. However, budgetary surpluses may be more notional than real because of the nature of cash flow accounting adopted by local governments. But, to the extent that these exist, they highlight the limited institutional capability to utilise available resources. Therefore, as far as the current financial position is concerned, local governments show the healthiest fiscal state in the public finance structure in Pakistan. This has been achieved by limiting expenditure to resources available. Consequently, while the municipal books are balanced, the rate of expansion in the coverage of services is very slow.

10.4 SOURCES OF REVENUE

Local governments in Pakistan derive their income from various tax and non-tax sources, legislatively under their fiscal powers. Bulk of the revenues, about 60 percent, are generated through taxes (see Table 10.5). In 1991-92, the estimated share of taxes in urban and rural areas was 44 and 54 percent respectively.

TABLE 10.4
KEY FINANCIAL RATIOS OF THE LOCAL COUNCILS BY PROVINCE

	Urban Councils			Rural Councils
	Metro Politan and Municipal Corporations	Municipal Committees	Town Committees	District Councils
Punjab				
Recurring Expenditure as % of Revenue Receipts	65	64	64	61
Development Expenditure as % of Total Expenditure	26	23	29	44
Budget Surplus/Deficit as % of Total Expenditure	22	35	23	6
Sindh				
Recurring Expenditure as % of Revenue Receipts	142	103	69	89
Development Expenditure as % of Total Expenditure	27	23	9	12
Budget Surplus/Deficit as % of Total Expenditure	-25	26	69	30
NWFP				
Recurring Expenditure as % of Revenue Receipts	78	64	66	41
Development Expenditure as % of Total Expenditure	14	22	28	52
Budget Surplus/Deficit as % of Total Expenditure	16	34	33	27
Balochistan				
Recurring Expenditure as % of Revenue Receipts	73	50	144	82
Development Expenditure as % of Total Expenditure	7	26	7	1
Budget Surplus/Deficit as % of Total Expenditure	57	76	-25	83

Source: NCRD Data Base.

TABLE 10.5
COMPOSITION OF LOCAL COUNCIL INCOME BY PROVINCE, 1991-92
(% Share in Total Receipts)

	Urban Areas					Rural Areas				
	Punjab	Sindh	NWFP	Balochistan	Pakistan	Punjab	Sindh	NWFP	Balochistan	Paksitan
REVENUE RECEIPTS	**89**	**75**	**78**	**69**	**81**	**88**	**81**	**94**	**66**	**87**
Tax Receipts	**55**	**32**	**43**	**54**	**44**	**53**	**45**	**79**	**32**	**54**
Taxon the movement of goods (Octroi/Export Tax)	40	16	30	49	29	28	42	54	13	34
Taxes on Property (Property Tax/Tax on Transfer of Property)	12	7	9	3	9	20	1	14	8	15
Other Taxes	3	10	4	2	6	5	2	12	11	5
Non-Tax Receipts	**34**	**43**	**36**	**15**	**37**	**35**	**36**	**15**	**34**	**33**
Licence & Fees	9	2	13	1	6	10	2	6	8	8
Water Rates	2	1	5	1	2	0	0	0	0	0
Other Non-Tax Receipts	12	15	17	14	14	12	15	9	26	12
CAPITAL RECEIPTS	**11**	**25**	**22**	**31**	**19**	**12**	**19**	**6**	**34**	**13**
Development Grants	1	2	4	5	2	2	7	0	13	3
Others	10	23	18	26	17	10	12	6	22	10
TOTAL RECEIPTS	**5957**	**5517**	**808**	**556**	**12837**	**2502**	**803**	**476**	**52**	**3832**

10.4.1 Urban councils

Analysis of the composition of local council income reveals that octroi tax is the single largest source of revenue for urban local councils. In 1991-92, total collection from octroi was estimated at Rs 5.0 billion, account for about 30 percent of total receipts of urban local councils. It is interesting to note that octroi revenues in Sindh, especially in Karachi, are larger than those from any provincial tax. Other important taxes for urban areas include property related taxes, namely, urban immoveahle property tax and tax on transfer of property (TTP). The former is an annual tax on property rental values while the latter is charged on the total value of the property at the time of sale/transfer. These together account for about 9 percent of total urban receipts with a higher revenue significance in bigger cities which have metropolitan/municipal corporation status.

The revenue contribution of non-tax sources is generally higher in smaller councils (municipal and town committees) where the tax base is relatively narrow and the tax structure underdeveloped. Non tax receipts accounted for 36 percent of total local council income in 1991-92 being the highest 42 percent, in Sindh. Revenue contribution of non-tax receipts for the country as a whole is Rs 8.3 billion.

The generally low level of direct cost recovery of service provision is striking in the case of local councils. The concept of self-sustained provision of municipal services is, by and large, limited to only two services namely, water supply and solid waste. Even these user charges are low and restricted to the larger urban councils only. Water rate is perhaps the only user charge levied by all urban local councils in the country. Water tariffs however, are generally unable to recovery full recurring cost of provision. The tariff rates in smaller cities and towns are either flat levels or are linked to ferrule size. Water rate assessment base in Karachi is the plot size for residential properties, while in Lahore it is the rental values of properties.

In the case of larger cities, as already mentioned, the development capacity of the local councils is supplemented by specialised agencies, namely, the development authorities (DAs) and the water and sanitation agencies (KWSB/WASA). Bulk (75 to 90 percent) of the income of the former is generated through sale of land, which is the primary function performed by these agencies. Similarly, the primary source of income of WASA/KWSB is water rates charged for the provision of water supply. In recent years, water agencies in the country have been able to recovery about 70 to 80 percent of their recurring costs. However, the larger development authorities have run into financial difficulties because of constraints to land development.

10.4.2 Rural Councils

Among the important rural taxes are export tax, TTP, and local rate. Export lax revenues account for almost one - fourth of total receipts of rural local councils in the country. Its revenue contribution in 1990-91 was estimated at over Rs 500 million. Local rate and TTP, mostly on land, are other important sources of revenue for rural councils. The tax structure of rural local councils in some of the provinces is less dependent on single revenue source. Revenues from octroi account for 75 percent of total urban local council tax revenues in Punjab, 83% in Sindh, 76 percent in NWFP and 95% in Balochislan. On the other hand, the relative revenue contribution of the single largest revenue in the case of rural local councils is 50% in Punjab (tax on transfer of property), 73% in Sindh (export tax) and 66% in NWI-'P (export tax). This diversity of revenue structure is particularly true for Punjab and NWFP where the revenue contribution of all these taxes, viz, export tax, TTP and local rate is significant. In Sindh, because of the current low tax rate the revenue potential of some of the taxes like TTP and local rate is largely unexploited. In the case of Punjab, potential exists in increasing revenues from export tax, in particular, which currently has both a low rate and a narrow base.

Non-tax revenues are also of significant importance to district councils with a share of about 34 percent. These revenues are generated from a multitude of smaller sources like licences and fees grants in aid from higher levels of government, etc. Capital receipts account for about 13 percent of total revenues with development grants making only a marginal contribution to total revenues. The share of these in total receipts is the highest for local councils in Balochistan.

As a whole, differences exist in per capita revenue among the different local councils in the country. Urban local councils have much higher per capita revenue compared to rural local councils. Within the former, per capita revenue of metropolitan/municipal corporations are higher than that of municipal/town committees.

10.5 ANALYSIS OF THE MAJOR LOCAL TAXES We now present a description of some of the important local taxes in terms of their coverage, tax rates and structure.

10.5.1 Octroi

Octroi is a tax on goods imported Into the municipal limits for consumption either directly by households, or for processing by industry, with a history which goes hack to the Roman times. It is collected from all posts located at the municipal limits of a city. Originally the tax was collected departmentally by the local councils. During the last decade or so, however, there has generally been a tendency to auction collection responsibilities to private contractors. The basic motivation behind privatisation has been a desire to check evasion through more intensive supervision and reduce corruption. In addition, privatisation has potentially the following advantages, first, for a small municipal government which essentially has to self finance its expenditures, it is a significant advantage from the viewpoint of financial planning to have knowledge of the expected level of major revenues in

advance. Any variation in local economic activity is, as a consequence, less likely to he disruptive to municipal operations. Second, the costs of collection of the local councils are reduced since the contractor has to pay the salaries of the tax collecting staff.

However, privatisation may also have a number of adverse implications. Pasha et al (1989) identify these to be, first, the dead weight losses represented by profits of contractors. A survey shows that these profit margins may he as high as 10 - 15 percent in some jurisdictions. Second, it is also possible that in the process of trying to maximise income, contractors may overcharge or harass tax payers. Considerable time of the local taxation department may then he devoted to the handling of complaints. Third, there have been occasions when contractors have preferred to default on their contract (in the event of a significant decline its the volume of goods entering the municipal area) and forego their deposits rather than continue to make payments to the council at the committed rate. This breakdown in the process of Collection has led to revenue losses.

Finally, and perhaps more importantly, it is necessary to emphasise that privatisation of octroi (or any other tax) works effectively only as long as the bidding process for appointment of contractors remains competitive and corruption does not enter into these appointments. There is some evidence that cartels of contractors have been formed and jurisdictions are being allocated among members of these cartels. This is reflected in the significant slowing down in the growth rate of octroi revenues and the difficulty that many local councils are having in achieving the minimum growth target7 (of about 10 percent) through the auctioning process.

The West Pakistan Municipal Committee Octroi Rules provide guidelines on the basis of which local governments have formed schedules of octroi rates. The rates are specific with respect to the weight of consignments. The specific tax rates are generally low with effective octroi rates. Exception is to he found in the city of Karachi where international imports are taxed on ad valorem rates. The specific tax rates are generally low with effective octroi rates (nominal tax rate as a percentage of wholesale price) generally less than one percent [Pasha et al (1989)].

Pasha et al (1989) and Pasha, Ghaus et al (1990) highlight the existence of significant anamolies in the current octroi rate structure. They show that effective octroi rate (AER) on some basic food items are higher than some consumer durables. For example, AER on the foods and drinks and clothing categories ranges between 0.25 percent to 0.50 percent while for some luxury consumer durables like air conditioners and motor cars it is 0.03 to 0.04 percent only. They conclude that existence of such fiscal anamolies has made the burden of the tax more regressive.

This regressivity of octroi tax is further exacerbated by the fact that in smaller cities, in particular, hulk of octroi revenues accrue from basic items like food and clothing. As such it appears that because of

This growth is a provincial requirement. 121

the current rate structure and the commodity wise contribution, octroi is likely to he regressive in its incidence in general, and perhaps more so in the case of smaller cities.

10.5.2 Urban Immovable Property Tax

The second major contributor to local government revenue in urban areas is the property tax. This tax is one of the oldest known forms of state/local taxation. Unfortunately in Pakistan its revenue contribution is still very low. We first briefly discuss this tax and then present the major causes of its under exploitation in Pakistan.

Property tax is collected from land and buildings located within municipal limits of cities which have been declared as rating areas. It is payable by owners. The tax base is actual annual rental value in the case of rented properties and imputed annual rent in the case of owner - occupied properties. 1'or owner-occupied properties evidence on rents for similar rented properties is used to derive annual values. In Sindh. assessment of imputed rents varies with plot size and locality and the ARV of each room is taken as a function of the quality of construction. Punjab generally ignores the quality of construction. However, research undertaken by Ghaus and Pasha (1986) and Ahmed (1981) indicates that the current assessment formula under-assesses market rental values in the case of residential owner-occupied, large, independent properties located in expensive neighbourhoods. This implies that the formula not only fails to capture true market value but also has a regressivity bias.

According to legislative provisions, reassessment of properties is to be done every five years. Provinces hold variable records in their regularity of reassessment. Sindh's performance is this context is the least impressive where the last comprehensive reassessment of properties was undertaken in 1968 69. Since then there has been considerable inflation in rental values which has remained largely untaxed. In the case of Punjab also, even though there has been regularity in property reassessment, the ceiling placed on the maximum increase in the reassessed value in the case of owner-occupied properties has made the reassessment process inadequate.

The tax rates vary for different types of properties and for different provinces. Highest rate is generally for industrial and commercial properties, from 20 to 25%. Major exemptions from the tax include properties with rental values below a threshold level, government proper-ties and properties owned by widows and orphans. A rebate of 25% is given to owner occupied properties in Sindh.

Immovable property tax was initially collected also by local governments. However, because of underexploitation of its revenue potential, collection was taken over by provincial governments. The tax is essentially a local tax and represents a charge against the local public goods provided. As such. bulk (85 to 95 percent) of the proceeds of property tax (net of collection charges) is transferred to the local councils.

The potential property tax base in Pakistan in 1989 90 has been estimated to be Rs 31.4 billion by Ghaus et al (1991) with almost two thirds of it being residential in nature (see Table 10.6). The share of commercial property in the total base is 18 percent while industrial properties currently constitute 5 percent of the tax base. However, it is interesting to note that the highest growth in the tax base during the latter half of the 1980's has been in the commercial category followed by industrial tax base. As such, it appears that the structure of property tax base is likely to undergo major changes with commercial/industrial components becoming increasingly important.

Ghaus et al (1991) further conclude that currently only about 14 percent of the potential tax base is exploited in the country. Estimating the magnitude of the leakages in the residential tax base in the provinces of Punjab and Sindh, which together account for over 93 percent of total property tax revenues, they show that more than half of the leakage is because of underassessment of rental values by the tax assessing agencies, while 24 to 29 percent is attributable to the inability of the provincial governments to extend rating areas in the face of increased urbanisation. Another 17 percent is because of the various exemptions currently allowed. Leakages due to billing and recovery inefficiencies are estimated to be small resulting in a loss of about 3 to 4 percent.

10.5.3 Export Tax

Export tax is one of the important revenue sources for the district councils in Pakistan. The tax is assessed on the gross weight of a consignment at the point of its exit from the boundaries of a district.

In the late 70s and 80s the base of export tax has been broadened considerably. Initially it was levied on only a few commodities, while currently the export tax list includes 65 commodity groups. The base of the tax is broader in Sindh and NWFP than the other two provinces. Pasha et al (1987) show that the tax rates are generally lower than its urban counterpart, octroi. The logic behind the levy of relatively low rates is the view that the incidence of an export tax tends to fall on other jurisdictions. Therefore, in order to prevent a rate escalation war among jurisdictions the provincial governments keeps a tight check on the level of rates. However, the analysis also shows that tax rates are generally higher in Sindh than in Punjab.

Major exemptions from the tax include, government stock of basic items like sugar, wheat, rice, etc., all goods to be exported out of Pakistan; agricultural inputs like fertiliser, insecticides, etc.

10.5.4 Other Taxes

Some of the other taxes include tax on transfer of property (TTP), local rate etc. The former is levied by the local council at the time of sale of immoveable property both in the urban and rural areas. The tax is generally levied at a low rate and is collected by the Registrar (a provincial government functionary) of Stamp Duty. Local rate is collected from all agricultural land. The tax is again levied at a very low rate and is collected by the Revenue officer (again a provincial government functionary).

TABLE 10.6 POTENTIAL PROPERTY TAX BASE BY PROVINCE

Provinces	Residential	Commercial	Industrial	Total
PUNJAB				
Tax Base (R.s in Billion)	10.8	5.2	0.6	16.7
Share in Tax Base (%)	64.7	31.1	5.2	KIO.O
Growth Rate (%)*	6.4	17.9	11.6	9.5
SINDH				
Tax Base (Rs in Billion)	6.8	31.	0.9	10.8
Share in Tax Base (%)	62.7	28.6	8.9	100.0
Growth Rate (%)*	7.2	8.1	15.9	7.')
NWFP				
Tax Base (Rs in Billion)	1.7	0.5	0.2	2.4
Share in Tax Base (%)	71.1	20.9	7.9	100.0
Growth Rate (%)*	6.1	8.4	17.4	6.5
BALOCHISTAN				
Tax Base (Rs in Billion)	1.3	0.2	0,1	1.6
Share in Tax Base (%)	83.9	12.9	3.2	100.0
Growth Rate (%)*	13.5	12.5	25.7	13.5
PAKISTAN				
Tax Base (Rs in Billion)	20.6	9.0	1.8	31.4
Share in Tax Base (%)	65.5	28.7	5.7	100.0
Growth Rate (%)*	6.5	13.3	14.7	7.7

" Growth rates have been estimated for the period 1984-85 to 1989-90.

SOURCES:

• Ghaus; A. et al "Assessment of Revenue Potential of Property Taxation" Research Report.

Applied Economics Research Centre, 1991.

The other local taxes have a marginal revenue contribution and are generally limited to larger urban local councils. These include advertisement tax, cinema tax, toll taxes etc.

10.6 REVENUE RAISING POTENTIAL OF LOCAL SOURCES Resource mobilisation proposals for the municipal governments must emphasise, first, diversification of and broadening of revenue base, in view of the skewness in the present revenue structure, second make the taxation structure more progressive by tapping the upper income tax payers in the rural areas and the middle-to-upper income group tax payers in the urban areas. Given the present taxation structure, this can be achieved by rationalising the octroi rate structure, which has been indicated to he regressive at least in the smaller cities/towns, and developing property-related taxes which are more progressive in their incidence.

Third, one of the cornerstones of the resource mobilisation strategy should be to introduce the concept of cost recovery, to the extent feasible, in the pricing of municipal services. In fact, in the larger cities land, in particular, should be priced (particularly for the rich) not only to finance direct development costs but also to generate surpluses that can be used for reinvestment in basic social and physical infrastructure by the local agencies.

Development of property related taxes and user charges are probably the limits of the options available in the short run to municipal governments to augment their resources. Beyond this, new arrangements will be required which go beyond the boundaries of current fiscal powers. These will include, first. establishment of more elaborate revenue-sharing schemes initially of taxes which fall within the ambit of common fiscal powers but which have been pre-empted by provincial government, followed by sharing of other taxes of local origin which do not currently fall within the purview of municipal fiscal powers, second, to the extent that larger differentials continue to exist in the per capita revenues of local councils, grants will have to be used to act as a fiscal equalisation device.

A large number of proposals can potentially be made for enhancing municipal revenues. I lowever, these proposals have to be filtered through some criteria to judge the merits and demerits of each proposal. The criteria used for evaluating taxation proposals are as follows: first, burden of incremental taxation should fall, to the extent possible, on the higher income groups, i.e., the incidence of the tax should be progressive; second, the source recommended should be buoyant; third, distortionary effects of additional taxation should be minimal, fourth, proposals should be relatively easy to implement and administer subsequently, and finally, cost of tax collection and compliance should be low.

In addition, for judging proposals related to inter-governmental fiscal transfers (revenue-sharing and grants) we use the following criteria: first, flows from higher levels of government should he fiscally equalising, to the extent possible, among jurisdictions, second, mechanisms which enhance fiscal autonomy of the local governments are to be preferred, third, revenue sharing should relate largely to

taxes of local origin and, lastly, inter-governmental fiscal transfers should not create a disincentive for local fiscal effort but encourage this to the extent possible.

We take up our proposals for higher local resource mobilisation, starting with higher revenue generation from existing revenue sources.

10.6.1 Existing Local Sources

Octroi

As highlighted earlier, a decline in the growth rate of octroi in the 80 s has partially been attributed to the formation of cartels among octroi contractors. To check this tendency it is essential that local councils revert back to departmental collection if the target growth rate is not achieved in the auction. A stimulus may be provided to departmental collection through an incentive scheme, which offers a sizeable bonus to the taxation department staff in the event the target level of revenues is attained. Such a scheme may mitigate against corruption or lack of motivation on the part of (lie department staff.

Also, to maintain the effective octroi rates even in the absence of periodic rate escalations it is suggested that, like in Karachi, partial switch over from specific to ad valorem rates should he introduced in some of the bigger cities on experimental basis. This is recommended only in the case of non-food manufactured items with no seasonal fluctuation in prices which are likely to be shipped in full truckloads and the incidence of which is largely on the upper income groups. This will help in preserving the simplicity and equity of the tax structure.

In the case of such commodities a standard price list [which may be referred to as domestic trade prices (DTP)]8 should be prepared (with the help of trade and industry) at the beginning of each year and used for the valuation of consignments throughout the year. Also. a conscious effort should he made to keep these prices low to minimise complaints of overcharging.

We have also indicated earlier that the average effective rates (AER) of octroi particularly on non-food items are very low. Moreover, analysis shows that AER are frequently higher for basic goods than luxury goods. There is need, therefore, for rate escalation on non food items, and rationalisation of other rates aimed at the removal of rate structure anomalies.

It is therefore, suggested that rates on non food items (excluding commodity groups I and II of the schedule) should be enhanced in such a way that escalations are the highest for luxury items. This will not only increase revenues of the local governments but more importantly make the incidence of the tax progressive.

8 The Customs Department of the Central Board of Revenue operates a similar system called International Trade Prices (ITPs) for valuation of imports. These ITP's are adjusted quarterly.

Also, there is perhaps a case for increase in transit tee. Currently, these arc very low. Higher transit fee is justified on the grounds that transit vehicles contribute significantly to congestion within cities.

Property Tax

Currently 85 to 95 percent of the net property tax revenues collected are transferred to the local authorities by the Provincial E&T departments. As such, the provincial governments do not have the incentive to fully develop the tax which is reflected both in the low assessed to market values and also the reluctance to expand rating areas both within and across cities.

It is, therefore, recommended that decentralization of the collection property tax should he attempted at least in the larger cities with metropolitan/municipal corporation status. If this increases the buoyancy of property tax revenues then other municipal corporations may also be asked to take over tills function. Given the potential importance of this tax, the corporations are likely to have a strong incentive for its development.

As already indicated the process of reassessment of ARVs has either been infrequent, in Sindh or inadequate as in the case of Punjab. To maximise the revenue potential of the tax it is important that proper, unconstrained reassessment of ARVs should be undertaken on priority basis.

Further, the inadequency and regressivity bias inherent in the present property tax assessment formula has been highlighted in the previous sections. It is suggested that assessment methods he refined to include other indicators like plot size, independent bungalow or flat, corner plot. age of the housing unit, etc. It may be stated that these measures are easy to quantify and should not complicate the assessment process significantly.

Property tax rate structure for residential properties has been progressive in all the provinces. However, in 1987. Sindh has standardised the property tax rate for all residential properties. This change will reduce the progressivity of the tax. It is, therefore, recommended that the progressive property tax structure be reintroduced in Sindh.

Over time, as population grows, it is expected that smaller jurisdictions will be declared rating areas and new residential neighbourhoods in existing rating areas included in the tax net. Municipal governments frequently complain that the provincial governments are slow in extension of rating areas implying significant foregone revenues. Our analysis shows that about 20 to 30 percent of the potential tax base lies untapped because of this lack of broadening of the tax base in different provinces. Clearly, an effort must be made by the E&T department, first, to extend the rating area within a city, as well as expand municipal limits and, second, to identify an explicit cutoff point of population (say 10.000) beyond which all cities/towns would be declared as rating areas, without exception. The interference of political factors would thus be minimized.

Also our analysis has shown that 17 percent of the property tax base has been eroded due to various kinds of exemptions given in the provinces of Sindh and Punjab. Therefore, to broaden the tax base need exists for reviewing some of the exemptions currently allowed. One such candidate is the exemption allowed to semi-autonomous bodies like WAPDA, Railways, Telephone and Telegraphs Department, etc. Tax on this is justifiable since properties owned by these agencies also place a demand on municipal services, for which property tax is collected.

Similarly, preferential treatment given to owner-occupied properties in Sindh, [tax is levied at 75% of the applicable annual value) needs to be reviewed. Owner occupied housing already enjoys significant tax benefits in two ways. Imputed rental income is not included as part of income for income tax purposes. Therefore, further preferential treatment to owner-occupied housing appears to he unwarranted.

Export Tax

Since the problems in the administration of export tax are similar to those of octroi, albeit at a smaller scale the recommendations made for the latter also apply to export tax. Further, effective rates of export tax are generally low compared to octroi. Therefore, a case can be made for a selective rate escalation. with a higher rate enhancement for commodities on which the incidence will not be on lower income groups and which are largely local in character. This will imply higher tax rates on items like fruits, sugarcane, tobacco, etc. Also, the export tax can be used as a kind of a royalty through higher levies on minerals.

Water Rates

To make the water tariff structure progressive and to introduce an in-built buoyancy in revenues we recommend that water rates be linked to plot size (also a better proxy for consumption) in the small cities. In cities where property tax exists and regular assessment of ARVs takes place water rates should be linked to the ARVs. Also, in some cities, on a trial basis privatisation of water rate collection could be attempted.

Given the present water tariff rate only a part of the recurring costs of water supply are recovered through water rates. A case, therefore, exists for water rate escalation. This should be implemented in combination with the change recommended earlier in rate bases. The objective must be to recover full costs or at least the O&M costs of water supply, especially in the large cities.

Local Rate

Local rates9 have been shown to be generally very low. It is suggested that for larger land holdings, in particular, the rate should be increased and delinked from the provincially levied land revenue (which

[9] This is the local equivalent of land revenue, shared by the district councils.

has been eroded following the levy of Ushr). This measure will specifically tap the large land owning class in the rural areas, without imposing significant burden or creating any major distorlionary effects.

Licences and Fees

It has been noted earlier that bulk of the revenues from licences and fees accrue from few sources. Rates of those have by and large, remained the same over the past decade or so. It is, therefore recommended that selective rate escalation in major licences and fees like fees on fairs, vehicles and markets, etc. be implemented. Simultaneously, some of the smaller fees, should be phased out

10.6.2 New Local Sources

The resource mobilisation strategy discussed above has highlighted the need for broadening the municipal tax base. This will require greater tapping of sources currently in local government fiscal powers but also introduction of sources, which are local in nature but are presently not contained in the fiscal powers of local government. Suggestions for development of new local sources are presented below.

Presumptive Property tax

Keeping in view the need to make the taxation structure progressive in the smaller cities/towns and to broaden their tax base (beyond octroi) it is suggested that a simple presumptive property tax be introduced in jurisdictions which have not been declared rating areas for property tax. The tax rate may be linked to plot size (with exemption) and construction type (pucca/kaccha) and the collection responsibility allocated to the local council.

Levy of Rates

The need for orienting the revenue structure of local governments toward collection of user charges has been highlighted earlier. In line with this and in view of the untapped provisions in the LGO regarding user charges it is suggested that conservancy, drainage and lighting rates which are currently levied in only a few jurisdictions should be levied by other local councils also.

It is further suggested that the basis of these rates should be the some as property tax. This is the logical choice because the value of the benefits accruing from services can be measured by changes in property values. If recovery of rates is linked to collection of property tax then the additional costs of administration should be low, and the incidence progressive.

Revenue Sharing Arrangements

Limited revenue sharing between the local and higher levels of government is perhaps one of the salient features of local government finance. Given the commonality of fiscal powers of the local and provincial governments, which the latter has pre-empted, and the local nature of some of the taxes collected by the provincial governments, more elaborate revenue sharing arrangements are justified between local and provincial governments.

At the first level, taxes which ought potentially to he shared by provincial governments with “local' governments are taxes which fall within the fiscal powers of both levels of government. This concept has already been accepted in the context of the tax on urban immoveahle property.

At the next level, those taxes which are 'local' in character will have to he shared with the local governments. However, since the provincial governments are also involved in the provision of some local services, this sharing will have to be based on the distribution of functional responsibilities of the provision of local services between the local and provincial government. Also, if some decentralisation of functions to local governments takes place then the case for revenue-sharing could he further extended.

One of the principal candidates for revenue-sharing is motor vehicle tax (MVT). Justification for sharing of MVT is based on the argument that revenues from it are essentially meant to cover costs of road maintenance. Since local governments are largely responsible for the maintenance of intra-city roads the case for sharing of MVT revenues is very strong.

In fact, the provincial government of Balochistan has already set a precedent by sharing half of tills tax with the urban local councils. We recommend that this arrangement be extended in a similar manner to the other provinces. Further, we recommend that half of the share accruing to the local councils he distributed amongst local councils on the basis of population while the other half should be distributed on the basis of collection. Sharing on the basis of population is suggested because car owners in smaller cities have a tendency to register their cars in the bigger cities (in view of a market premium) even though these cars subsequently ply in the smaller cities.

Grants to Local Governments

Variation in the per capita provision of services can to a great extent be attributed to differences in the taxation capacity of the urban and rural local councils. Social equity considerations necessitate that efforts must be made to equalise the level of provision of basic services across jurisdictions. We have identified the above proposals for enhancing revenues through existing and new sources. However, many of the proposals will differentially benefit the larger urban councils more than the smaller urban and rural councils. Therefore, in this section recommendations are made for a system of grants, which must essentially be seen as a fiscal equalisation device.

Our analysis shows that grants currently constitute only a small share of the total income of local councils. Therefore, there is scope for expanding this flow. It is important, however, that this transfer be a reliable source of Income. In the past, the tendency has been to allocate grants on an ad-hoc basis and with political objectives. Unless the flow is assured, councils cannot build up their institutional capabilities on a permanent basis. As such, we recommend that local councils he given a token share say 2 percent, of the national ADP each year. This will not only augment the pool of development funds

in an assured manner hut will also recognize the fact that local governments have a role to play in development.

Also, it is recommended that the highest per capita grant he given to the district councils (which could then pass a share on the union councils) and town committees followed by municipal committees and municipal corporations such that the increase in the revenue receipts as a consequence of the grants is the highest for rural councils. Also the flow of grants should be closely linked to the decentralization programme of the government. More will be said about this in subsequent sections.

On the whole, significant revenue raising potential exists in local sources, especially in property related taxes and user charges, As such, if priority is attached to feasible improvements in tax administration and Justifiable enhancements in rates then a significantly higher level of local resource mobilisation can he achieved. In addition, the establishment of more elaborate revenue-sharing arrangements with the provincial governments as part of a decentralization programme could expand significantly the role of local governments without significantly affecting the budgetary position of the provincial governments. Notice most of the proposal rank well on different criteria presented in Table 10.7 and are therefore unlikely to distort the taxation structure.

10.7 EXPENDITURE PATTERNS

Following a discussion on municipal revenues we turn now to the expenditure side of local councils. Total expenditure incurred by the local councils in Pakistan is estimated at Rs.12.2 billion in 1991-92. In relation to the regional economy, the share of total expenditure is 1.2% percent of the Gross Domestic Product (GDP). Out of this Rs.9 billion or 73 percent is recurring expenditure, indicating that a substantial proportion of total expenditure incurred by these governments is on operating and maintaining the existing network of services.

The pattern of recurring expenditure of local councils is presented in Table 10.8. The table shows that a substantial share, 23%, of total recurring expenditure is on general administration. The highest share 30% is in NWFP followed by Balochistan, 29%. Other important sectors, as reflected by their share in total recurring expenditures, include medical care followed by primary education, and water supply and drainage. 'Others' sectors which include services like social welfare, fire fighting, garden, parks and playgrounds, animal husbandry, etc. together account for about 2^ to 50 percent of total recurring expenditure of local councils. Bulk of the expenditures on primary education and medical care sectors in each of the provinces have largely been incurred by the larger councils like the metropolitan/municipal corporations.

Within development expenditure, the largest sector is sanitation, with an overall share of 21 % . The highest relative expenditure, 41 %, is incurred in NWFP and Balochistan while the share of expenditure on sanitation in Sindh and Punjab is 21 and 17 percent respectively. Next in importance are medical

TABLE 10.7

RANKING OF LOCAL TAXATION PROPOSALS ON DIFFERENT CRITERIA

Tax Proposal	Equity	Buoyancy	Non-Distrotionary	Simplicity of Administ-ration	Collection and Compliance Cost	Overall Ranking
OCTROI						
• Option of Department Collection	1	3	1	2	1	8
• Partial Switchover to Ad-valorem Rates	3	3	2	1	2	11
• Selective Rate Escalation	3	3	2	3	3	14
• Increase in Transit Fees	2	3	3	3	2	13
PROPERTY TAX						
• Decentralisation of Collection	2	3	2	1	2	10
• Reassessment of ARV	3	3	3	1	1	11
• Improvement in Assessment Formula	3	2	3	2	3	13
• Extension of Rating Areas	2	3	2	1	2	10
• Withdrawal of Exemptions	2	2	3	3	3	13
EXPORT TAX						
• Option of Departmental Collection	1	3	1	2	1	8
• Partial Switchover to Ad valorem Rates	3	3	2	1	2	11
• Selective Rate Escalation	3	3	2	3	3	14
• Broadening of Tax Base	2	3	2	2	2	11
LOCAL RATES						
• Enhancement of Rates	3	3	2	3	2	13
WATER RATES						
• Change in Bases	3	3	2	2	2	12
• Rare Escalation	2	3	2	3	2	12
LAND SALES	2	3	2	3	2	12
PRESUMPTIVE PROPERTY TAX	2	2	2	1	2	9
LEVY OF RATES	3	3	2	3	2	13

TABLE 10.8
LEVEL AND PATTERN OF EXPENDITURE OF LOCAL COUNCILS BY PROVINCE, 1991-92
(% Share in Total Expenditure)

	Recurring Expenditure					Development Expenditure				
	Punjab	Sindh	NWFP	Balochistan	Pakistan	Punjab	Sindh	NWFP	Balochistan	Paksitan
General Administration	22.4	22.8	30.2	28.6	23.4	0.0	0.0	0.0	0.0	0.0
Primary Education	10.0	5.5	3.6	0.7	7.3	2.2	5.5	2.3	2.1	3.3
Medical Care	25.6	19.9	19.3	11.1	22.2	16.6	28.1	10.9	17.6	19.7
Sanitation	3.2	1.4	2.7	1.5	2.4	17.3	21.2	40.9	41.0	21.0
Water Supply	6.6	3.0	9.1	6.3	5.4	5.7	21.1	11.2	7.7	10.0
Road and Lighting	4.1	1.9	6.8	1.5	3.3	2.4	0.3	1.1	0.0	1.6
Others	28.1	45.6	28.4	50.2	36.0	55.8	23.8	33.6	31.6	43.4
Total (Rs in Million)	**4365**	**3496**	**688**	**412**	**8961**	**1908**	**1020**	**304**	**41**	**3274**

care and water supply with overall shares 11 % to 20%. The involvement in development of primary education and road lights is limited, with a combined share of less than 5% .

10.8 INSTITUTIONAL CAPABILITY

This section is based on a number of case studies of local councils in Pakistan. The objective is to study their structure and actual working with the view to identify some of the issues relating to institutional capacity to take on additional functions and an expanded delivery role. These councils are discussed in terms of their administrative structure, staffing levels and relationship between the elected and bureaucratic components.

10.8.1 Organisational Set-up

Urban Councils

As already mentioned, urban councils are divided into four categories viz, metropolitan corporation municipal corporation, municipal committee and town committee, depending largely on the site of population.

Each town or city is split into wards and each ward elects a councillor for its representation in the House of the Council. In addition to the directly elected councillors, local councils also elect representatives of special groups like minorities, workers, and women.

The chief executive of a town/municipal committee is called the chairman while the chief executive of a municipal corporation is known as mayor. Each mayor/chairman is assisted by a deputy. Furthermore, each council has a chief operating officer who represents the provincial government and is generally a member of the Local Council Services (LSC) or Sindh Unified Grades (SCUG) Service as the case may be. Each council has a number of functional departments to assist the council in the carrying out of its responsibilities. A typical council has an administration, taxation, finance and an engineering department. As municipal status increases, complexity of the organisational set-up increases with greater specialisation in the performance of functions by individual departments. Also levels in the administrative hierarchy within a department Increase.

In municipal committees/corporations, additional departments which are present are of education and health. Also, the accounts department is usually broken up into separate departments for finance and taxation. By and large, the difference in the structure of a typical municipal committee and a typical corporation is not very pronounced. Bigger municipal corporations like PMC. QMC also perform legal and other functions.

The administrative structure of the metropolitan corporation is substantially more elaborate, with various departments performing specialized functions relating to law, land management, fire brigade service, parks, social welfare, etc. The designation of the Chief Officer also changes to Municipal Commissioner in the case ofKMC.

Rural Councils

The organizational framework of union councils is very simple and consists only of a Chairman and a Secretary. District councils are substantially bigger organizations and have a similar administrative structure to municipal corporations in urban areas. A district council is headed by a Chairman (With a Vice Chairman) and has the standard complement of the following departments - general administration, accounts, taxation, engineering, health and education. Unlike the urban councils, the health department also has a focus towards animal husbandry.

10.8.2. Staffing Levels and Employment

The general pattern is that the level of staffing of different departments varies with the population covered and status of a council. A summary indicator of staffing levels in a department is the status (in terms of BPS grade) of the head. If the grade is high than it can be expected that there is a greater administrative hierarchy of positions under the departmental head.

Table 10.9 gives the status of departmental heads in different types of councils. A number of patterns are revealed by the table. First, grades of heads of departments vary significantly with municipal status and are perhaps higher in the bigger provinces of Sindh and Punjab. For example, in urban councils, the Chief Officer of LMC is in BPS-19, BPS-17 or 16 in municipal committees and BPS-16 or 11 in town committees. Similarly, the chief municipal engineer is in BPS-19 in LMC, BPS-17 to 11 in municipal committees and BPS-16 or 11 in town committees. Similarly, the chief municipal engineer is in BPS-20 in KMC BPS-17 to 11 in municipal committees, and BPS-16 or 11 in town committees. Also, the BPS grade of the Municipal Commissioner in KMC is higher than his counterpart in NWFP and Balochistan.

The same pattern is observed in district councils, with principal officers in larger councils having a somewhat higher status. However, the variation in status of departmental heads with population size is less pronounced than in the urban councils. Union councils have a Secretary only who is either in BPS-5 or 7.

Within a council there is generally little difference in the status of heads of different departments. Usually specialist positions (given higher market value) in departments like engineering and medical are granted higher status. Consequently, heads of these departments usually have the same BPS grade as the Chief Officer. Next in status are Finance/Accounts officers, who are generally one grade below the Chief Officers. It appears that Taxation Officers are frequently granted a lower status than other departmental heads.

A comparison between rural and urban councils reveals that staffing levels in district councils are generally low in comparison to their urban equivalent (are budget size), the municipal corporations. For example, in the latter, chief officers are either in BPS-18 or 19 while in the former they are in BPS-17 or 18. A case exists, therefore, for some elevation of status of principal officers of district councils.

TABLE 10.9

STATUS OF HEADS OF DIFFERENT DEPARTMENTS OF LOCAL COUNCILS [BPS GRADES]

Type of Council	Administration	Finance	Taxation	Engineering	Public Health	Medical	Education
A. URBAN COUNCILS							
Metropolitan Corporation	19 - 20	19	17 - 18	19 - 20	19	19	18
Municipal Corporation	18 - 19	17 - 18	16 - 17	17 - 18	16 - 19	17 - 19	17
Municipal Committee	16 - 17	16	8 - 11	11 - 17	5 - 8	–	–
Town Committee	11 - 16	11	7 - 11	11 - 16	–	–	–
B. RURAL COUNCILS							
District Council	17 - 18	16 - 18	16	17 - 18	–	17 - 18	–
Union Council	5 - 7	–	–	–	–	–	–

SOURCE: Case Studies.

10.8.3. Employment Level and Pattern

Table 10.10 gives the range of employment, overall and by department, in different types of councils as revealed by the case studies. This table demonstrates significant variation in employment with respect to status and population covered by a council. Municipal corporations have total employment ranging from 1500 to 6600: municipal committees from 200 to 900 and town committees from 60 to 160 employees. Variation in employment levels in district councils, however, is more pronounced.

In urban councils, the largest employer is the public health department. This relates primarily to garbage disposal, a highly labour-intensive function. Its share in total employment approaches 50 percent in the case of municipal corporations and 40 percent in municipal committees. In the larger councils, next in importance are the education and engineering departments. Employment in the general administration and finance departments usually accounts for a small share of the total employment, except in the smaller councils.

Significant differences are observed in the pattern of employment of district councils. The primary reason for this is that garbage disposal function is not per-formed in the rural areas. This also explains why overall employment levels are low in comparison to urban councils. The largest department is engineering, with a share in employment approaching one third. This is explained by the dominance of road construction in the development activity of such councils and the moderately high labour-intensity of this sector. Other departments with relatively large employment are taxation and medical, Like the urban councils, the share of administrative staff is small.

The above analysis gives an indication of the level of institutional, capability of local councils. Of particular significance in this regard is the strength of the engineering departments. It is clear that by now the larger urban councils have evolved fairly elaborate administrative structures. The engineering department in such councils compares favourably with the divisional level organization of provincial line departments like the PHED, C & W, etc. Similarly, the finance departments appear to he fairly well staffed. A personnel gap, however, is visible in the taxation departments, which have perhaps not been given the priority they deserve.

The problem of limited institutional capability for undertaking development work appears to he more serious in the case of smaller councils. In town committees, there is frequently only one subengineer (from a polytechnic) in BPS-11. In this case, it is clear that the ability to prepare and implement projects is severely limited. It needs to emphasised that irrespective of status and population size, departmental functions in a council are the same although the scale may be different. Therefore, while there is a case for varying employment in line with the total volume of activities, it is essential that departmental heads in small councils have at least a minimum level of qualifications and status.

TABLE 10.10

RANGE OF EMPLOYMENT IN DIFFERENT DEPARTMENTS OF LOCAL COUNCIL

Department	TYPE OF COUNCIL*			
	Municipal Corporation	Municipal Committee	Town Committee	District Council
Administration	50-250	10-50	5-15	10-50
Finance	15-25	30-80	25 -50	5-15
Taxation	50 - 400			70-300
Engineering	250 - 700	10-30	1 - 15	80 - 500
Public Health	800 - 3200	100-420	25 - 70	-
Medical	50- 180	-	-	25 - 400
Education	100-2300	50 - 250	-	-
Others	40 - 300	10- 100	0- 10	50 - 300
Total	1500 - 6600	200 - 900	60 - 160	250-1500

* A Metropolitan Corporation has much higher-level employment. LMC plus the ZMCs have a total Employment approaching 20,000.

SOURCE: Case Studies.

The engineering strength of the larger district councils is greater. This strength is comparable to the district level set-up of provincial engineering departments. However, the same problem of limited capacity is observed in the smaller district councils.

10.8.4 Managing and Financial Reporting Systems

All the council are require to maintain an elaborate financial reporting system. This has been instituted by the provincial government to ensure that the funds are utilized for the purposes for which these have been allocated. Also. it has been made a requirement to ensure that the grants and funds provided by the provincial government are utilized efficiently. Above all. the formal financial reporting system is needed to fulfill the demands of local audit by the Local Fund Audit Department and also to he ready for any special audits that may be ordered by the province.

10.9 CASE FOR DECENTRALIZATION

The basic pattern which emerges from our earlier discussion of the actual provision of services is that urban local councils have largely restricted their role to the performance of some (or all) compulsory functions. In smaller cities, many of the compulsory functions are outside the capacity (financial/institutional) of municipal governments and this gap has generally been filled by the provincial governments. This is particularly true in the case of the smaller provinces. Estimates show that as much as 40 percent of the expenditure of provincial governments in the country is incurred on the provision of services which are 'local' in character. It is only in the larger cities where attempts have been made, in the presence of specialised agencies, to perform most of the compulsory functions, and in some cases to take on optional functions like schools, clinics/ hospitals, parks, libraries, etc.

The participation of rural local councils in the development and maintenance of services is even more limited. District councils are largely involved only in the development and maintenance of link roads and drainage. Partial involvement in health (human and animal) is observed in the case of the larger district councils while union councils undertake only marginal development and maintenance responsibilities.

Our analysis, however, shows that the generally limited role of the local councils in the country. particularly in the smaller cities and towns is not because of any legislative bindings. The current legislative allocation of functions is, in fact, very liberal and has not restricted any diversification of functions by local governments. Availability of resources, reflecting the allocation of fiscal powers and the pattern of inter-governmental fiscal relations, and institutional capacity for undertaking development work have been the important operative constraints. The basic question is whether the existing delivery mechanism is the best possible structure for the provision of local services in a country like Pakistan? Also, should the status quo be maintained with provincial governments providing services which the LGO specifies as local government responsibility or should in fact there be some change in the existing actual allocation of functional responsibilities? An attempt will he made to answer some of these questions in this section. We start with a cross-country comparison of actual allocation of

responsibilities to see whether or not the actual allocation of functional responsibility in Pakistan is in line with the pattern observed elsewhere. This will be followed by brief discussion of (lie case for decentralization of services in the context of Pakistan.

10.9.1 Cross-country Comparison of Provision of Social Services Table 10.11 presents a cross-country comparison of local functional responsibilities in a sample of large and small cities in the region. By and largem, water supply, sewerage and drainage, primary education. roads and to some extent mass transportation are the primary responsibility of local governments in the cities presented in the table. Major secondary responsibilities include health and law and order. The latter is limited to only a couple of cities analysed.

Local councils in the larger cities of the country have the primary functional responsibility which is consistent with other large cities presented in the table with one major exception - primary education. Primary education is the primary responsibility of local governments in all cities presented in (lie table. In the case of Pakistan, however, the local government plays a secondary role in the sector. Also. local governments are not involved in the mass transportation system in the cities which is a prime local responsibility in a few large cities in India and secondary responsibility in a few others like Jakarta and Bangkok. Similarly, in some cities like Seoul and Bangkok, municipal governments have primary responsibility in curative health, while local governments in Pakistan perform only secondary functions in this area.

In the case of smaller cities in the country, the actual functional responsibility is also not in total harmony with other relatively small cities of the world presented in the Table 10.11. Major areas of difference include primary education and medical health. The former is a principal responsibility of local governments generally in other countries while in the case of Pakistan, local governments in smaller cities do not play any role in health care services whereas in some of the other cities health care is the secondary responsibility of the local governments.

By and large, the above comparison indicates that some scope exists for decentralization of services in Pakistan on the basis of an international cross-country comparison. In the following section we present the case for decentralization of some social/local services on the basis of economic, institutional and political justifications, particularly relevant in the context of Pakistan.

10.9.2 Economic and Institutional Justifications for Decentralization The economic justification offered for decentralization is that it could increase efficiency in me provision of services either by cost reductions or by enhancements in the quality of service (by more effective administration). This argument is particularly true in the case of services which are not characterised by significant economies of scale either at the construction or at the operating stage and the coverage of which is essentially limited to small jurisdictions.

Higher efficiency may arise at the local level because of a greater ability to organise inputs in cash or in kind

TABLE 10.11

CROSS COUNTRY COMPARISON OF LOCAL FUNCTIONAL RESPONSIBILITIES
[In a Sample of Cities]

City/Country	Housing	Water Supply	Sewerage and Drainage	Primary Education	Health (Medical)	Roads	Mass Trans-portation	Law and Order	Electricity
LARGE CITIES									
Bombay - India	P	P	P	P	S	P	P	N	P
Delhi - India	S	P	P	P	S	P	P	N	P
Calcutta - India	S	P	P	P	S	P	N	N	N
Madras - India	S	P	P	P	S	P	N	N	N
Ahmedabad - India	S	P	P	P	P	P	P	N	N
Jakarta - Indonesia	P	P	P	P	S	P	S	S	N
Seoul - Korea	S	P	P	P	P	P	P	N	N
Manila - Philippines	S	P	P	P	S	S	N	N	N
Bangkok - Thailand	N	P	P	P	P	N	S	N	N
Large Cities in Pakistan	**P**	**P**	**P**	**S**	**S**	**P**	**N**	**N**	**N**
SMALL CITIES									
Casablanca - Morocco	N	P	P	N	S	P	P	S	N
Daegu - Korea	S	P	P	P	P	P	N	N	N
Small Cities in Pakistan	N	P	P	N	N	P	N	N	N

P = Primary responsibility, S = Secondary responsibility, N = Not involved in the provision.
SOURCE: World Bank Staff Appraisal Reports on Urban Projects.

of labour, land and materials from beneficiaries through inducing community involvement at all stages of project execution and management. Union councils, for example, are the lowest tier of local government in the rural areas. These councils (through their councillors) are ideally placed to organise village communities to perform the function of a local executing agency.

There are already examples (Orangi Pilot Project, Baldia Soak Pit Programme, etc.). In Pakistan where community based organisations have successfully organised the development of sanitation, sewerage etc. Subject to adequate technical extension services and village level training, rural communities are an organisational and human resource which can be used not only to reduce the costs to the government of service provision, through contributions, but also to ensure sustainability through local management of operations and maintenance.

It has been observed that provincial line departments which are primarily responsible for ihe provision of a range of local services especially in the rural areas, have not involved the beneficiaries In the identification planning and design of schemes. Development costs are high because of the use of inappropriate design standards, corruption (due to lack of accountability) and high overhead and transport costs associated with centralised provision. On top of this, the failure to hand over schemes to local councils has meant an increasing involvement in maintenance. This is not only cutting into institutional capabilities and budgets but especially in rural areas, the provision of maintenance services from district to tehsil headquarters has also meant that the ability to respond quickly to problems and to be cost effective is limited.

Further, it can be argued that if local governments are involved in the provision of services, then the quality of such services is also likely to be higher. This arises from the higher level of accountability. For example, if a primary school is managed by a union council rather than by a district level functionary of the provincial education department then the attendance, quality of instruction, etc.. by teachers can more easily be monitored. This is likely to lead to an improvement in the services provided by teachers. Furthermore, a close link can be established between benefits received by a beneficiary and the cost he/she bears to receive it. This closer link can potentially enhance the willingness of beneficiaries to pay for the cost of its provision. As such, local provision of services can potentially enhance the level of user charge payment in particular, and therefore, can potentially have a positive impact on the level of resource mobilisation.

Altogether, the economic/institutional case of decentralization would argue for the handing over to the lowest tier of government services which are based on relatively simple technology, have high labour inputs both at the development and operating stages, cover relatively small jurisdictions, do not have significant economies of scale, externalities and spillovers and have scope for community participation. Furthermore, given the generally constrained administrative capacity, scope for decentralization exists

for these services which can potentially be handled given the administrative structure of local governments and which the local governments are generally willing to take over in a phased manner.

10.9.3 Political Justifications for Decentralization

The key justification of a political nature for decentralization is that it induces a sense of participation at the grass roots level of people in the provision and management of basic services that are of vital importance in influencing their quality of life. This process of involvement not only creates a sense of greater control and self-reliance but also provides for a clearer articulation of local needs and preferences. The latter is likely to increase the efficiency in the allocation of development resources by identification of areas which are perceived as having the highest priority by beneficiaries.

Perhaps one of the greatest advantages potentially of local councils is the presence of elected representatives from relatively small constituencies. These representatives are therefore, likely to have the greatest knowledge of local problems and priorities. As such if the funding of services is routed through local councils then inter-sectoral allocations and locational choices of schemes may not only he more in line with needs but also be more equitable.

Local councils are the frontline of government. Their accessibility and involvement in day-to-day regulatory and service functions had led to a greater degree of public contact with local representatives and officials. This stands out in contrast to the remoteness of provincial and federal line departments. Therefore, decentralization of functions to local governments is likely to make the overall government system more responsive and sympathetic to the problems of the people.

10.10 CANDIDATE SERVICES FOR DECENTRALIZATION TO LOCAL LEVEL In the previous section we have tried to establish that a case exists for decentralization of the provision of some of local services on economic, institutional and political grounds. However, all these justifications may not hold true for a certain service and a situation may arise where decentralization of a particular service may justified on certain criteria while, on others higher, level provision may he preferred. For example, though a strong case exists for decentralization of water supply and sanitation provision on grounds of accountability, technological complexity of service delivery in the case of a small cities may, in fact, weaken the case for local government provision.

We make an attempt in this section to evaluate the case for decentralization of major local services on certain economic and institutional criteria discussed in the previous section. In addition, since the LGO contains a, more or less, exhaustive list of local services that can be provided by local governments, at this stage, we do not consider it necessary to go beyond the provisions of the ordinance. In the foreseeable future, it is unlikely that local governments will be able to diversify their functions to include those not provided for in the ordinance, given the likely levels of resource availability and institutional capabilities. In fact, we observe currently what while some of the larger municipal governments have started performing their optional functions, most of the smaller councils have had

difficulty in discharging even their basic obligations. Therefore, decentralization is likely to he limited. first, to the larger urban councils undertaking more of their optional functions by substituting for the provincial line departments. Second, the smaller urban and rural councils will first have to demonstrate the capability to discharge their basic (obligatory) functions. It is only after this that further decentralization can be contemplated. Therefore, in our criteria of evaluation, in addition to economic and institutional criteria, we also include legal criteria which basically consider whether or not the service is currently a local government functional responsibility as prescribed in the LGO.

Tables 10.12 to 10.14 present the ranking of services for decentralization in large and small cities and rural areas respectively. We have evaluated a range of services on the basis of our set criteria derived from the previous section. A number of clear patterns emerge from our analysis, first, a strong case exists for local provision of some services which are currently provided by other levels of government either solely or partially. The prime example of this is primary education which has one of the highest scores on the ranking of services for decentralization. This conclusion holds true both for the urban and rural areas of the provinces. Other strong candidate services for decentralization, as revealed by our ranking, include basic health service, water supply, sanitation and drainage and roads. These are services the responsibility for which is either shared between the provincial and local governments or are solely the responsibility of the provincial governments in smaller cities and rural areas.

Second, there are some services, which though are the prime or secondary responsibility of local governments in a few other comparable cities, rank low on our criteria and as such a case for their decentralization does not exist in the context of Pakistan, at least in the near future. Examples of such services are electricity and highways. Finally, there are some services where a not so strong case exists for decentralization as revealed by our ranking. Examples of this include law and order, secondary education and hospitals. These are services which are generally the secondary responsibility of local governments else where in the world.

Table 10.15 summarises our ranking of services for decentralization in the large and small cities and rural areas of the provinces. In the case of large cities, strong candidate services for decentralization include primary education and dispensaries while services that may or may not be decentralised include secondary education, law and order and hospitals. A strong case for decentralization exists for primary education, roads and water supply and sanitation in the case of smaller cities while only a weak case exists for handing over secondary education to local governments. In the case of rural areas a clear case exists for decentralization of primary education, water supply, sanitation and drainage, public health and local roads. Involvement of rural local councils in the running of BHUs could also be considered in the long run. On the whole, principal service related functions, either compulsory or optional, for which a strong case for decentralization to the local level exists include primary education water supply and drainage, dispensaries and roads.

TABLE 10.12

RANKING OF CANDIDATE SERVICES ON CRITERIA FOR DECENTRALISATION OF SERVICES IN LARGE CITIES

[Maximum Score of 27; Minimum Score of 9]

Criteria	Water Supply Sanitation Drainage	EDUCATION			HEALTH			TRANSPORTATION		Housing	Law and Order	Electricity
		Primary	Secondary	College	Public Health	Dispensaries/ BHUs	Hospitals	Roads	Highways			
ECONOMIC												
• Economies of Scale	2	3	2	1	3	2	2	2	1	2	1	1
• Externalities and Spillovers	2	2	2	1	2	2	1	2	1	2	2	2
• Complexity of Technology	1	3	3	1	2	2	1	2	1	2	2	1
• Labour Intensity	2	3	3	3	3	2	2	2	2	2	2	1
INSTITUTIONAL												
• Administrative Capacity	3	3	2	1	3	2	2	3	1	2	2	1
• Accountability	3	3	2	1	3	3	2	2	1	2	3	2
• Scope for Community Participation	2	3	2	1	3	2	2	2	1	2	2	1
• Willingness to accept Responsibility by Local Government	3	2	1	1	3	2	2	3	1	3	2	1
LEGAL												
Within Existing Legislative Allocation of Functions	3	3	1	1	3	3	3	3	1	3	2	1
TOTAL RANKING	**21**	**25**	**18**	**11**	**25**	**20**	**17**	**21**	**10**	**20**	**18**	**11**

The higher the case for decentralisation of the service on a particular criteria, the higher the score it gets.
The scale of ranking is as follows:
High = 3, Medium = 2, Low = 1.

TABLE 10.13

RANKING OF CANDIDATE SERVICES ON CRITERIA FOR DECENTRALISATION OF SERVICES IN SMALL CITIES

Water Supply Sanitation Drainage	EDUCATION			HEALTH			Roads	Housing	Law and Order
	Primary	Secondary	College	Public Health	Dispensaries /BHUs	Hospitals			
2	3	1	1	2	1	1	2	2	1
2	2	1	1	2	1	1	2	2	1
2	3	3	1	2	2	1	2	1	2
2	3	2	2	3	1	1	2	2	2
2	2	1	1	2	1	1	2	1	1
3	3	2	1	3	2	1	2	2	3
2	3	2	1	3	1	1	2	2	2
3	2	1	1	3	1	1	3	1	1
3	3	1	1	3	2	1	3	2	1
21	**24**	**14**	**10**	**23**	**12**	**9**	**20**	**15**	**14**

isation of the service on a particular criteria. the higher the score it gets.
s:

10.11 MODALITIES OF DECENTRALIZATION

We have set up the case for decentralization of social services down to the local level and evaluated various candidate services for decentralization on the basis of a number of criteria. Services which rank high on these criteria have been recommended for decentralization. We now take up the modalities of this process of decentralization.

Clearly, decentralization must proceed in an orderly and phased manner so that the provision of a service is not adversely affected as a result of the transfer. A number of factors must be considered in deciding on the modalities of decentralization. First, the process must be seen as essentially voluntary in character in line with the existing legal allocation of functions among different levels of government. Local councils must be given the option of deciding whether they want to expand their functions or largely continue to discharge their existing functions. Incentive mechanisms can he established to promote such a diversification, but expenditure allocations must rest with local councils, given the preferences of their respective electorates and the quantum of resources available to meet these preferences.

Second, the resource transfer mechanisms established as part of the modalities must not place the larger and richer local councils in the urban areas in an advantageous position relative to those in the smaller towns and villages. Otherwise, there is the danger of further increasing spatial inequalities in the provision of services. Therefore, it may be necessary to have a differentiated scheme of incentives which discriminates in favour of the rural and smaller councils. Third, one of the potential benefits of decentralization is that it can encourage greater local resource mobilisation for financing the provision of services. As such, the modalities must encourage and not impede this process.

Fourth, emphasis must be placed on expanding the coverage of services. If decentralization is promoted at the margin by greater local involvement in increased social sector investments rather than by handing over the existing network of services then it is also less likely to be resisted by provincial politicians and bureaucrats and involve less redeployment of personnel. Further, it will promote competition among provincial and local agencies In the provision of services. However, it will imply a slower process of decentralization and delay the realisation of the full benefits of this program. On balance we consider this a more viable strategy given the political, institutional and inter-governmental structure in the province. Therefore, any proposals for transfer of resources to local councils should he oriented more towards investment rather than recurrent cost financing of existing services. This has the built in advantage of promoting a faster rate of expansion in the coverage of services.

Given the above considerations, we turn to an examination of the pros and cons of different strategies for increasing the availability of resources at the local level so as to promote greater involvement in the provision of social services.

10.11.1 Revenue Sharing

At one extreme, the availability of resources with local councils can be increased significantly by expansion primarily in revenue sharing arrangements, of the type described earlier. In addition, a small share of the national ADP may be earmarked for local councils (o be distributed on a population basis. with larger per capita allocations for the smaller urban and rural local councils.

Expansion of revenue sharing arrangements has a number of advantages. First, it promotes greater fiscal decentralization and autonomy. Second, there is greater certainty of revenues in relation to grant schemes which could be withdrawn by higher levels of government because of resource constraints or political reasons. Third, buoyancy of revenues could be enhanced if there is local sharing in fast growing sources. Fourth, if revenues are shared on the basis on collection, then there is likely to be a greater perception by tax payers of the link between taxation and benefits.

However, revenue sharing schemes also have a number of potential disadvantages. First, flows will exacerbate differences in resource availability, especially if sharing is done on the basis of collection. Jurisdictions with high per capita incomes are likely to preempt a large share of the revenues transferred. We have already highlighted that sharing in taxes like motor vehicle tax, professional tax. etc., will differentially benefit Lahore and other large cities and the share of rural local councils is likely to be marginal. Therefore, revenue sharing schemes can be fiscally equalising only if criteria other than collection are included in the allocation formula. However, consensus on such complex formulae is more difficult to achieve.

Second, revenue sharing arrangements are inherently inflexible. It is not possible to adjust these arrangements in line with changing macro economic conditions. Third, higher transfers of revenues are likely to have a negative impact on the level of fiscal effort of the recipients as well as the level of government which collects the tax. The lack of development of the property tax is attributed to the fact that the provincial governments give away a large (85%) share of the revenue to local governments. Therefore, revenue-sharing may also generally reduce the incentive to mobilise additional resources.

Fourth, there is no guarantee that the additional flow of resources from the expansion in revenue-sharing schemes will be targeted towards the candidate services for decentralization like primary education, preventive and curative health, etc. Local councils may use the funds largely for expanded delivery of services traditionally provided by them. Therefore, while some enlargement in revenue sharing arrangements between the provincial and local governments of Punjab is essential, especially in taxes which are local in origin, this will have to be combined with other mechanisms for increasing the availability of resources with local governments. As such, we analyse the implications of grant schemes, of which the most common form is matching grants.

10.11.2 Matching Grants

Matching grant schemes have the basic advantage of more efficiently targeting the provision of services. By reducing the unit price to local governments of services which are to he decentralised, a strong incentive can be created for increased local involvement in such services. If local governments have a strong willingness to expand their functions in areas like primary education, health, etc. then the presence of matching grants can induce higher levels of fiscal effort, with the additional funds being used to finance investments in services for which matching grants are forthcoming from the higher level of government.

Disadvantages of matching grants schemes, however, are that they also tend to work against the goal of regional equity. Richer local councils are more likely to have the resources required for the matching contributions. As such, the component of the matching grant from the provincial government will have to he larger in the case of poor councils, which are generally in the rural areas and small towns.

Also, matching grant schemes are centrally driven and generally require the establishment of complex approval, regulatory and monitoring arrangements. Also, there is the danger that commitments made may not be honored on a continuing basis. For example, KMC is due a recurring grant from the GOS for running the schools that were nationalised in the early 70s. However, there has been little or no transfer of funds on this account.

Altogether, it appears that while it is essential to design matching grant schemes to promote decentralization and sustain the resource mobilisation effort, it will he essential to build in varying levels of support depending upon the financial strength of the recipients and to ensure that these arrangements are institutionalised and do not remain ad hoc in nature.

10.11.3 Nature of Decentralization Program

Based on the above, we are now in a position to define a short to medium run program for decentralization of provision of services. The emphasis here is on services which form part of the SAP. Candidate services which have been identified with the strongest arguments in favour of decentralization are as follows:

Primary Education: Greater involvement of local councils generally. In rural areas, the primary emphasis is on establishment of community based organisations by union councils to manage primary schools.

Water Supply, Sewerage and drainage: Direct development funding to urban local councils and district councils which may involve the provincial Public Health Engineering Department on a deposit works basis for execution of schemes. Union councils may be assigned the task of establishing community based organisations to manage schemes and arrange for local financing of O&M costs.

Public Health: In the rural areas, immunization and vaccination programs to he run through the district councils in collaboration with union councils.

Dispensaries and Hospitals: Greater involvement of large urban councils, with either metropolitan or municipal corporation status, which have the institutional and financial capability to take on the responsibility for curative health services.

In order to achieve the above, a matching grant scheme of the type outlined in Table 10.16 may he instituted. This will have to be coupled with the expansion in revenue - sharing arrangements, of the type described above, and higher resource mobilisation from existing sources, described in Section 10.6.

The proposed matching grants scheme for promoting decentralization of social services (which are included in the SAP) has a number of features, in light of the considerations mentioned above. First, its coverage is restricted to water supply, sewerage, drainage, primary education and preventive and curative health which have emerged as prime candidates for decentralisation, of varying degree, from our earlier analysis. Second, greater incentives (measured as the extent of the matching contribution by the provincial government) have been provided for new investment rather than the take over of existing facilities. Third, the most favourable arrangements are proposed for the rural councils followed by the smaller urban councils. This reflects differences in resource availability and the need to expand the coverage of basic services at a faster rate in the rural areas. Fourth, targets for local self-financing of operating and maintenance costs are implicit in the matching grants scheme. For example, no matching grants from the provincial government are proposed for financing the operating and maintenance costs of rural water supply and drainage schemes. It is expected that beneficiaries will contribute towards these costs on an on-going basis through an appropriately designed system of user charges. As opposed to this, the recurring costs of rural primary schools will be financed largely by grants-in-aid from the provincial government.

10.11.4 Institutional and Personnel Implications We have emphasised that successful operation of the matching grants scheme will require the establishment of an agency at the provincial level to process and approve applications from local councils and to subsequently regulate and monitor performance. The provincial governments are in the process of establishing Provincial Education and Health Foundations. These foundations could perform such a role. However, currently the coverage is restricted only to voluntary organisations and NGOs which can apply for matching funds. The eligibility for funding will have to be extended to include local councils also. Another option is to entrust the provincial Local Government and Rural Development department with the responsibility of managing the matching grants scheme. Such a scheme is already in operation, on a more modest scale.

TABLE 10.16

PROPOSED MATCHING GRANTS SCHEME BY PROVINCIAL GOVERNMENT

(First Figure is share of Provincial government in cost; Second Figure is share of local council)

	Water Supply Sewerage Drainage	Primary Education	Public Health	Dispensaries and Hospitals
EXISTING SERVICES				
O & M Cost Requirements*				
Metropolitan/Municipal Corporations	-	[⅓ : ⅔]	-	[⅓ : ⅔]
Municipal/Town Committees	-	[½ : ½]	-	-
District Councils	-	-	[1 : 0]	-
Union Councils	-	[1, 0]	-	-
NEW SERVICES				
Development Cost Requirements**				
Metropolitan/Municipal Corporations	-	[⅔ : ⅓]	-	[⅔ : ⅓]
Municipal/Town Committee	[1, 0]	[¾ : ¼]	-	-
District Councils	[1, 0]	-	[1, 0]	-
Union Councils	[1, 0]	[1, 0]	-	-
O & M Cost Requirements**				
Metropolitan/Municipal Corporations	-	[⅔ : ⅓]	-	[⅔ : ⅓]
Municipal/Town Committee	[0, 1]	[¾ : ¼]	-	-
District Councils	[0, 1]	-	[1, 0]	-
Union Councils	[0, 1]	[1, 0]	-	-

* of existing schemes
** of new schemes

Some institutional strengthening of local councils will, also be required. However, we have already highlighted that many of the larger urban councils have a growing involvement in education and health and have established specialised departments to handle the delivery of these services. Therefore, the nucleus already exists to take on an expanded program. For the smaller local councils, greater involvement in the social sectors will require significant enhancement in institutional capability. In the rural areas, the management of primary schools will primarily be placed with community based organisations with local councils will largely act as facilitators and as the channel for funding only. In the context of water supply and drainage significant engineering capability exists with most district councils. If, not then they can fall back on the expertise available with the PHFT) or the private sector. The primary objective here is to facilitate the sense of ownership on the part of local councils so as to enable the transition from the development to the operating stage.

The prospect of a rapid decline in the role of provincial line departments (PHED, PED, PHD) has been minimised by the type of decentralization program that is proposed. The existing network of services will continue to be largely managed by these departments. Therefore, large scale redundancy of personnel is unlikely to result Local councils will potentially take up a role only in the expansion of the services.

On top of this. financial implications of the decentralization program are favourable for the provincial governments. By inducing matching contributions to the capital cost and subsequent local financing of O&M costs the program will reduce the outlays by the provincial governments on the development and maintenance of social services. Therefore, the decentralization program proposed which minimises transitional problems and potentially enhances local resource availability and functions, while reducing financial burden on the provincial governments should be attractive to both levels of government in the provinces.