Within NFC constraints

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IT IS always interesting to read reviews of provincial budgets. The analysis is conducted as if provincial governments in Pakistan have a large degree of freedom to formulate their budgets based on their own priorities. Unfortunately, the reality is just the opposite. Provincial budgets are essentially made in Islamabad, such is the reality of provincial autonomy in the federation of Pakistan, as I proceed to argue below.

Pakistan has a highly centralized tax structure, especially after the introduction of a 15 per cent sales tax in VAT mode under instructions from the IMF. Resultantly, in excess of 80 per cent, and in the case of two provinces close to 90 per cent, of provincial incomes come through statutory transfers from the divisible pool under the NFC Award or in the form of royalties on oil and gas. The centralized tax structure and the limits placed by the Constitution on the taxation powers of lower levels of governments, combined with the demands of debt servicing and the central role in our polity of the military which consumes a significant chunk of internal resources, means that the share of the provinces is limited to 37.5 per cent.

Whereas, in principle, the provinces are the partners of the federal government in the sharing of the divisible pool, and hence have a direct stake in any changes made in the size of this pool, they are never consulted in decisions pertaining to additions to, or reductions in, its volume, despite their heavy dependence on transfers from it for financing their activities.

Although both the multilaterals and the federal government lecture provincial governments ad nauseam on the need to enhance their own revenues through the exploitation and widening of their revenue base, the federal government has simply refused to extend the GST on services to cover professionals like lawyers, accountants, engineers, tax practitioners, etc., although GST on services is a provincial subject under the Constitution. The federal government is reluctant to extend the net to a highly charged and politically vocal community since it would have to face the political flak of taxing them while the revenue benefits would flow to the provinces, as Islamabad would only be entitled to a two per cent collection charge from such a source.

The federal government also controls, preempts and exploits the revenue base of the provinces. For instance, it has levied a withholding tax on motor vehicles, which is a potentially important revenue base/instrument for the provinces. The provinces have limited leeway even in determining expenditure priorities. They are forced to implement national priorities set by Islamabad based on commitments made to donors. There is perfunctory, if any, participation of the provinces in establishing these priorities. Take the recent example of the Poverty Reduction Strategy Paper (PRSP) designed in consultation with the IMF. The provincial governments were hardly involved, even in determining the outcomes and indicators that are being used to judge the country's performance.

Some decisions of the federal government have huge expenditure implications for provincial governments. For instance, the 15 per cent increase in salaries and pensions of civil servants announced in the budget for 2003-04 will unduly burden the budgets of provincial governments. The ripple effect of this decision taken without consulting the provincial and district governments will be devastating for their budgets.

Almost the entire additional revenue transfers to the provinces in 2003-04 will be absorbed by the implementation of this decision. The federal government cannot argue that the provincial and local governments may not give concomitant increases to its employees, if they cannot afford it. It would be politically impossible for provincial and district governments not to enhance the salaries of their own employees as well.

After devolution and the transfer of the operational aspects of delivery of services like education, health and drinking water supply to local governments, the roles and responsibilities of all levels of government, be it federal, provincial, or district, have been fundamentally altered. Resultantly, the historical mandates of the federal and provincial agencies require a shift away from the operational aspects of service provision. Islamabad, however, having introduced a supposedly more effective decentralized framework for delivery of basic social services, continues to function as if business is as usual. It has simply refused to let go by downloading its functions, mandates and responsibilities. How else can one explain federally run health programmes and a Rs. 100 billion education sector reform programme?

It is because of the unfair and highly inequitable distribution arrangement under the 1997 NFC Award that we have the ridiculous situation of Islamabad executing education and health-related programmes, both essentially provincial subjects under the Constitution. Similarly, in complete disregard of local priorities, the federal government is constructing and rehabilitating irrigation channels and intra-provincial roads. A typical example of this anomaly is that when district governments in Sindh requested Wapda that instead of spending money on the rehabilitation of the Rehri canal, funds should be diverted to other projects of greater local priority, they were flatly told by Wapda that the only choice they had was to either accept this project or nothing at all.

We have seen above how the federal government restricts the freedom of provincial governments to mobilize resources either by raising revenues or by reducing expenditures. Another instrument for augmenting resources in the short term is access to credit. Even here the degree of freedom of provincial governments is highly circumscribed.

The provinces cannot raise debt, even in rupees from domestic financial markets, without the prior permission of the federal government, which the latter promptly denies. While expenditure and borrowing-related restrictions are first placed on the provincial governments so that the deficit ceilings prescribed by the IMF are not breached, there is little control over the latter's borrowings other than those covered indirectly by the budget deficit targets laid down by the IMF.

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Contrary to Islamabad's claims of good financial management, the reality is that the bulk of the cost of the structural adjustment programme has been borne by the provinces. This has resulted in outcomes like the decline in net enrolment rates at the primary level, as allocations for social services and essential development expenditure suffered under the IMF programme. Even the benefits of the recent debt relief have not been shared with the provinces. Whereas the federal government was able to get substantial debt relief enabling it to significantly reduce its outflows in the form of debt servicing, the provinces have got nothing of this benefit.

In view of the above facts, it will not be possible for the provinces to effect any increase in pro-poor expenditures to implement the PRSP until the highly iniquitous NFC Award is revised, whereby the provinces are compensated for the loss of almost Rs. 550 billion that they will have suffered by the end of the financial year 2004 from the revision in the sharing of the divisible pool compared with what they would have received under the 1990 NFC Award.

Any reviews of provincial budgets that do not take these limitations and constraints into account are inherently flawed; they tend unjustly to castigate governments that are essentially rubber-stamping what has been handed down to them by the federal government.

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