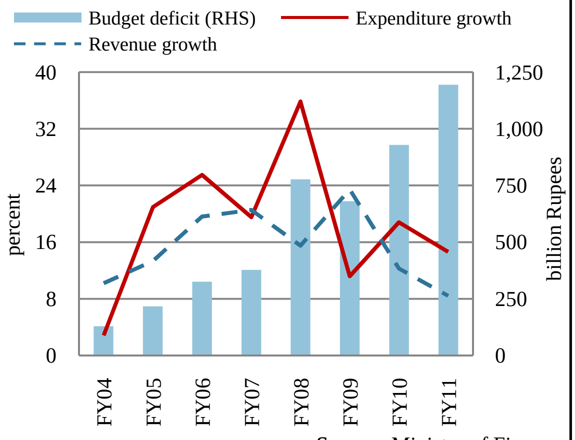
6 Fiscal Policy

6.1 Overview

While the government restricted growth in its total expenditure during FY11, growth in revenues declined more sharply (**Figure 6.1**). Resultantly, the budget deficit to GDP ratio increased to 6.6 percent in FY11 compared with a target of 4 percent.[1]

Figure 6.1: Fiscal Performance



Source: Ministry of Finance

At the time of setting budgetary targets for FY11, the government envisaged not only a considerable containment in its expenditures but also a sharp increase in tax revenues (26.2 percent) on the back of a promising set of tax reforms. However, it faced serious setbacks to its budgetary plans due to two unfavorable events:

a) The Federal Board of Revenue (FBR) could not introduce the Value Added Tax (VAT) due to opposition from the business community, and reservations of the provinces. Later, FBR came up with a new proposal, the Reformed General Sales Tax (RGST); however, this too could not be legislated by the parliament.
b) The country faced unprecedented floods in July and August 2010, which called for unplanned allocation of resources for the rescue and rehabilitation of flood victims.

Moreover, lower than expected inflows under the Coalition Support Fund and lower SBP profit exacerbated the fiscal stress. On the expenditure side, although overall expenditure was controlled, the government was unable to rationalize subsidies as planned in the budget: actual outlays for subsidies were three times higher than the target of Rs 126.7 billion set for FY11. Perhaps even more troubling is the fact that these subsidies primarily compensate the cost of inefficiencies of public sector enterprises, and their beneficiaries are not necessarily the poor. Although the government started raising electricity tariffs, this was not sufficient to bridge the gap between generation cost and revenue from consumers.[2] The process of phasing out subsidies was too slow to have a meaningful impact on the fiscal position.

The fiscal stress was felt throughout the year – even after the introduction of a number of austerity measures and additional revenue generating strategies during Q4-FY11. The budget deficit in the last quarter of FY11 was 2.3 percent of GDP,3 compared with an average of 1.5 percent during the first three quarters.

While a large budget deficit was one issue, its financing was another challenge. The government received Rs 107.7 billion in external financing, but this was only 58 percent of the target of Rs.

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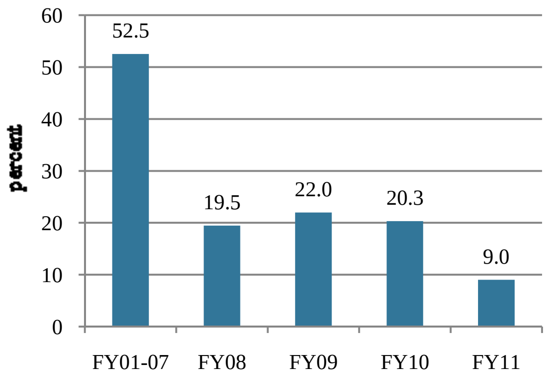
[1] The original target of deficit in the budget was 4 percent of GDP; however, it was subsequently revised upward during the year.
[2] See **Chapter 3** on energy for details.
[3] Budget deficit in Q4-FY11 was also higher than the average deficit of 2 percent in last quarters of past five years.

185.8 billion that had been set for the year. It is interesting to note that before the global financial turmoil of 2007-08, the share of external funds in total deficit financing was more than 50 percent; since then however, this has declined steadily and stood at only 9.0 percent for FY11 (**Figure 6.2**). The onus of budgetary financing thus fell upon domestic sources, particularly the banking system, which accounted for over half of total deficit financing.

It is encouraging to note that within the banking system, budget financing from the central bank was negative during the year, i.e. the government actually retired its earlier debt with SBP. However, heavy borrowing from commercial banks is also undesirable as it not only crowds out private sector borrowing, but has adverse implications for the maturity profile of government debt as banks primarily lacked funds in short-term T-bills (see detail in **Chapter 7** on Domestic and External Debt).

Figure 6.2: Share of External Sources in Budget Financing



* FY04 is excluded from the average as there was negative financig in this year.

Source: Ministry of Finance

Going forward

The government announced fiscal deficit target of 4 percent of GDP in the budget for FY12. However, without credible policy measures to support fiscal consolidation, it seems less likely that budget target would be achieved. The floods in Sindh and a prolonged wave of dengue fever in Punjab have already put pressure on fiscal resources. Moreover, both provincial and federal governments are less likely to be frugal in the year ahead as elections get closer. Also the non-tax revenue are expected to remain below target as: (a) inflows under Coalition Support Fund are uncertain due to strained relations with US; (b) SBP's profit could be lower than expected due to expectation of low discount rate; and (c) no progress on the auction of 3-G licenses.

6.2 Key Features of Fiscal Operations

Key fiscal indicators including the fiscal balance, revenue balance and primary balance, all deteriorated during FY11 (**Table 6.1**). While the overall budget deficit increased to 6.6 percent of GDP during FY11, the revenue deficit, i.e., the gap between current expenditure and total revenue increased sharply from 2.1 percent of GDP in FY10 to 3.6 percent in FY11. This implies that the government had to borrow to finance not only its investment expenditure but also a part of current expenditure. While such excess borrowing adds to the government's debt burden, it contributes nothing to the debt repayment capacity of the economy.[4] It is alarming that the primary balance is also negative, i.e., the government is unable to generate enough revenue to meet its non-interest outlays.[5]

[4] If this continues, Pakistan will be caught in a debt trap.

[5] The primary balance excludes interest payments on loans acquired in the past from the overall balance and thus presents the picture of current fiscal activities.

On the revenue side, both tax and non tax revenues in FY11 were lower than projected. Furthermore, the government was unable to meet even its revised FBR tax collection targets.[6] The outcome for non-tax revenues was similar. While in FY10, the transfer of SBP profits – which were above target – compensated for the shortfall in other non-tax revenues, but this was not the case in FY11 as SBP profit was lower than estimated.

On the expenditure side, flood related expenses at the start of the fiscal year, continued law & order related pressure, and greater than budgeted subsidies, all led to slippages in the targeted budget deficit. The target for subsidies was set at Rs 126.7 billion, while actual disbursement was Rs 395.8 billion.[7]

Table 6.1: Summary of Consolidated Public Finance (billion Rupees)

	FY08	FY09	FY10	FY11	FY11 BE	FY12 BE
Total revenue	**1,499.4**	**1,850.9**	**2,078.2**	**2,252.9**	**2,574.4**	**2,870.5**
Tax revenue	1,065.2	1,316.7	1,472.80	1,699.3	1,858.70	2,151.2
Non-tax receipts	434.2	534.2	605.3	553.5	715.6	719.3
Total expenditure	**2,276.5**	**2,531.3**	**3,007.2**	**3,447.3**	**3,259.3**	**3,721.2**
Current	1,857.6	2,041.6	2,386.0	2,900.8	2,519.1	2,976.3
Development and net lending	423.4	455.7	652.8	514.0	740.1	744.9
Unidentified	-4.4	34.0	-31.6	32.5	0.0	0.0
Overall deficit	**777.2**	**680.4**	**929.1**	**1194.4**	**684.9**	**850.6**
Financing through:						
External resources	151.3	149.7	188.9	107.7	185.8	134.5
Internal resources	624.2	530.2	740.2	1,086.7	499.1	716.1
Banking system	519.9	305.6	304.6	615.1	166.5	303.5
Non-bank	104.3	223.8	435.6	471.6	332.6	412.6
Privatization proceeds	1.7	1.3	-	-	-	-
As % of GDP						
Overall Fiscal Balance	-7.6	-5.3	-6.3	-6.6	-4.0	-4.0
Revenue Balance	-3.5	-1.5	-2.1	-3.6		
Primary Balance	-2.8	-0.3	-2.0	-2.7		

BE: Budget estimate **Source:** Ministry of Finance

In order to curtail the budget deficit, the government announced a large cut in development spending and adopted austerity measures in March 2011 to save Rs 120 billion total expenditure. These measures included fifty percent cut in expenses on stationary, travelling, and POL entitlements; and ban on new recruitments and purchase of durable goods. However, despite these efforts, the fiscal deficit rose to Rs 1,194.4 billion; 74.4 percent higher than the target for the year, and 28.6 percent higher than actual deficit for the last year. The fiscal position has been worsening, and this can only be rectified by taking tough measures to increase revenues through capturing more people in tax net.

6.3 Revenues

In line with the trend in previous years, revenue collection fell short of its target in FY11. The government originally set a revenue target of Rs 1,858.7 billion, 90 percent of which was to be

[6] It has become a regular feature of Pakistan's fiscal operations that at the time of budget planning, quite an ambitious target is set for FBR tax collection; then it is revised several times during the year and at the end of the year, this revised target is also missed.
[7] See Federal Budget in Brief 2011-12, Table 27; column revised 2010-11.

collected by FBR.[8] Even though the target for FBR tax collection was subsequently revised from Rs 1,667.0 billion to Rs 1,588.0 billion, this too could not be met. A comparative analysis with the previous year also portrays a gloomy picture. Last year, the target for tax revenue was missed, while that of the non-tax revenue was successfully met. During FY11, however, both the tax revenue and non-tax revenues were below their targets.

An analysis of tax revenues shows that collection of direct taxes, sales tax and the petroleum development levy (PDL) was lower than initially estimated; with PDL even lower than the previous year's collection (**Table 6.2**). In order to mitigate the effect of a rise in international prices of high speed diesel (HSD) and motor spirit, the government cut the rate of PDL on them during the second half of FY11. While this maintained domestic prices at a lower level, it also slowed growth in PDL collection. In case of income tax and sales tax, a narrow tax base and tax evasion in the country continued to pose challenges for revenue collection. Total tax revenue thus reached Rs 1,699.3 billion with a growth rate of 15.4 percent over the previous year.

Table 6.2: Composition of Tax and Non-Tax Revenue (billion Rupees)

	FY10	FY11				
		Q1	*Q2*	*Q3*	*Q4*	Overall
Tax revenue	**1472.8**	**317.3**	**404.3**	**396.0**	**581.8**	**1699.3**
Direct taxes	528.6	94.4	144.7	135.1	220.5	594.7
Taxes on property	5.7	2.1	1.7	-0.1	0.1	3.8
Taxes on goods and services	641.5	156.9	182.8	178.4	256.3	774.4
Taxes on international trade	161.5	36.5	44.1	47.1	57.8	185.4
Petroleum levy	88.7	15.3	20.1	21.2	26.1	82.7
Other taxes	46.8	12.0	11.0	14.3	20.9	58.2
Non-tax revenue	**605.3**	**82.9**	**185.2**	**109.6**	**175.8**	**553.5**
Interest	10.5	0.5	4.6	1.7	4.6	11.3
Dividend	52.8	0.5	17.0	12.1	21.1	50.6
Transfer of SBP profits	233	40.0	40.0	45.0	56.0	181.0
Defense	115.6	1.4	65.5	1.6	2.2	70.7
Development surcharge on Gas	25.9	5.0	12.3	4.5	8.5	30.4
Discount retained on crude Oil	12.5	3.0	7.5	6.4	19.0	35.9
Royalties on gas and oil	33	19.6	7.0	14.3	18.2	59.1
Miscellaneous	122	12.9	31.2	24.0	46.3	114.4
Total revenue	**2078.2**	**400.1**	**589.5**	**505.6**	**757.6**	**2252.9**

Source: Ministry of Finance

FBR taxes

For the third consecutive year, the FBR failed to achieve its annual tax collection target. The FBR needed a growth of 19.6 percent in tax collection during FY11 to achieve the target; however, actual growth in tax collection was 16.8 percent (**Table 6.3**). It may be noted that this was 6 percentage points lower than nominal GDP growth indicating a low buoyancy of taxes.[9] It implies tax collection during FY11 could not keep pace with the growth in tax base due to large-scale exemptions, leakages, lax enforcement of tax laws, and distrust between the taxation authority and tax payers.

In order to achieve its target, the FBR planned a number of tax reforms including introduction of value added tax (VAT), removing exemptions and increasing documentations. However, due to significant pressure from various interest groups, it had to almost abandon its drive towards tax

[8] Although provinces also have the authority to tax economic activities, especially services, they face serious capacity constraints. Therefore, the country effectively relies on the FBR for tax collection.

[9] There was a unit buoyancy of total FBR taxes (on average) during the previous decade (2000-10), i.e. tax collection was growing with the same rate as that of tax base.

reforms. Although value added tax was rebranded as the Reformed General Sales Tax, it could not be implemented. Faced with a shortfall in revenues, the FBR took some ad hoc measures to raise revenue in the last quarter of the year. Despite these efforts, it failed to achieve year-end tax collection targets.

Table 6.3: FBR Tax Collection (Net) during Jul-Jun (billion Rupees)

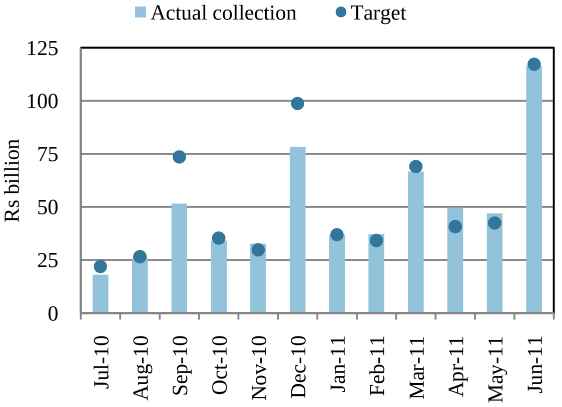
	Annual target		Net collection		% of annual target		% change YoY	
	FY10	FY11R	FY10	FY11	FY10	FY11	FY10	FY11
Direct taxes	565.6	626.9	526.0	602.5	93.0	96.1	19.5	14.5
Indirect taxes	814.4	960.8	801.4	955.6	98.4	99.5	11.6	19.2
Sales tax	499.9	654.6	516.3	633.4	103.4	96.8	14.2	22.7
FED	152.8	132.9	124.8	137.4	81.7	103.4	6.2	10.1
Customs	162.2	173.3	160.3	184.9	98.8	106.7	8.0	15.3
Total collection	**1,380.0**	**1,587.7**	**1,327.4**	**1558.0**	**96.2**	**98.1**	**14.6**	**17.4**

Source: Federal Board of Revenue

Direct tax collection

With the exception of September and December, monthly targets for direct tax collection were successfully achieved during FY11. However, the shortfall in these two months was large enough to cause a slippage in the full year target (**Figure 6.3**). To raise receipts in terms of direct taxes, the FBR administration resorted to frequent postponement of deadlines for income tax returns and introduced a onetime flood surcharge applicable on income and withholding taxes payable at the rate of 15 percent during the March 15 to June 30, 2011 period. Nonetheless, annual collection remained short of target by Rs 24.4 billion.

Figure 6.3: Month-wise Direct Tax Targets and Actual Collection



Source: Ministry of Finance

Indirect tax collection

The annual collection of indirect taxes was Rs 955.6 billion in FY11, which was 19.6 percent higher than the previous year. Although the domestic commodity producing sector remained under stress due to floods and energy constraints, a surge in imports supported growth in indirect tax collection (**Table 6.4**).

While collection under the head of federal excise duty (FED) and customs duty surpassed the target by Rs 16.4 billion, sales tax collection fell short of target by Rs 21.8 billion. However, growth in sales tax for FY11 was higher than that in FY10;

Table 6.4: Indirect Tax Collection (Net) during Jul-Jun
billion Rupees

	Collection		% growth	
	FY10	FY11	FY10	FY11
Imports	**421.1**	**513.0**	**15.0**	**21.8**
Sales tax	247.2	308.6	21.6	24.8
FED	13.6	19.5	-5.7	44.0
Customs duty	160.3	184.9	8.0	15.3
Domestic	**380.3**	**442.5**	**8.0**	**16.4**
Sales tax	269.1	324.7	8.1	20.7
FED	111.2	117.8	7.9	5.9
Total collection	**801.4**	**955.6**	**11.6**	**19.2**

Source: Federal Board of Revenue

it missed the target simply because of too high a target set at the beginning of the year and failure to introduce planned reforms during the year.

The import component of sales tax collection grew by 24.8 percent on the back of stronger growth in the rupee value of imports. Petroleum products and edible oil remained the top revenue source of sales tax on imports. Within the domestic component of sales tax collection, the largest contributions came from POL products, telecom, services, natural gas, sugar and cigarettes. Domestic sales tax collection also benefited from the revenue measures announced in March 2011; when sales tax was applied on the market price of sugar.[10] Moreover, exemptions for sales tax on fertilizers, pesticides and tractors, and zero rating on plants, machinery and equipment including parts were also withdrawn.

Federal excise duty (FED) contributed Rs 137.2 billion which was Rs 4.3 billion above the target. During March 2011, the FBR increased the rate of special excise duty from 1 percent to 2.5 percent; this boosted FED collection. Of the total domestic collection of FED, cigarettes & tobacco, cement and services were the biggest contributors.

The growth in rupee value of imports resulted in above target collection also supported collection under customs duty. In particular, POL Products, edible oil and vehicles (non-railway) stood out as the major heads contributing to collection of customs duty during FY11.

Non-tax revenues, on the other hand, were Rs 553.5 billion in FY11 which was not only less than previous year but also below the target for FY11. The largest component of non-tax revenue is SBP profit which was Rs 4.0 billion less than the target of Rs 185.0 billion for the year. The second major source was Coalition Support Fund (CSF); the receipts under CSF were Rs 70.7 billion against a target of 133.5 billion. Owing to volatility in Pak-US relations and US domestic fiscal constraints, Pakistan did not get a single penny after December 2010 as payments for logistic support provided to coalition forces. The other heads of non-tax revenue, like profits from Pakistan Telecommunication Authority and dividend from OGDCL, Pak Arab Refinery Ltd, and PSO also were less than their target.

6.4 Expenditures

Total expenditure witnessed 14.6 percent growth during FY11, driven exclusively by an increase in the current component. With 21.6 percent growth, consolidated current expenditures surpassed the FY11 target set in the budget by 15.2 percent. Development spending, on the other hand, declined by 21.2 percent over the previous year, and fell short of the budget target by 30 percent (**Table 6.5**).

Within the current expenditure, the largest increase was in subsidies which were 70 percent higher in FY11 than the previous year. The government set a target of total subsidies at Rs 126.7 billion at the beginning of the year. However, actual subsides given were Rs 395.8 billion during the year, i.e., three times higher than the target. More than 80 percent of this subsidy was given to the power sector, which includes a onetime payment of Rs 120 billion in May 2011 to partially settle the circular debt issue.

While subsidies – which are 13.6 percent of the total current expenditures – can potentially be rationalized, other heads of current outlays, including interest payments and expenditure on defense are rigid and hard to adjust. Together, these two capture more than 40 percent of current expenditures in Pakistan. The rigidity in current expenditure renders fiscal consolidation challenging; as a result the burden of adjustment usually falls on development expenditure.

[10] Previously, the sales tax on sugar was applicable at the rate of 8 percent, assuming a price of Rs 28.9 per kg.

Table 6.5: Break-up of Expenditures (billion Rupees)

				Absolute change over	
	FY10	**FY11**	**FY11 BE**	**FY10**	**FY11 BE**
Current	**2,386.0**	**2900.8**	**2519.1**	***514.8***	***381.7***
General public service	1,200.4	1434	1159	233.6	275
Interest payments	642.3	698	698.6	55.7	-0.6
Pension	74.7	106.6	90.7	31.9	15.9
Grants to non-govt.*	250.5	232.1	172.8	-18.4	59.3
Other general public service**	232.9	397.3	196.9	164.4	200.4
Defense	375	451	442.2	75.6	8.4
Public orders & safety affairs	49.5	64.2	51.3	14.7	12.9
Provincial	627.2	812.7	750.0	185.5	62.7
Others	133.9	139.2	116.6	5.3	22.6
Development	**613.4**	**506.1**	**733.5**	**-107.3**	**-227.4**
PSDP	517.9	461.5	610	-56.4	-148.5
Federal***	259.5	215.9	270	-43.6	-54.1
Provincial	258.4	245.6	340	-12.8	-94.4
Others	95.5	44.6	123.5	-50.9	-78.9

*This head also includes expenditure on war-on-terror
**This head includes spending on current subsidies.
***Net excluding development grants to provinces

Source: Ministry of Finance

This was exactly the case in FY11. Since the government lacked the fiscal space to deal with the exogenous shock caused by the floods of 2010, and external support was insufficient, it had to re-allocate funds from development projects to flood related activities. While this strategy helped the government in addressing rehabilitation efforts, development outlays witnessed a sharp reduction of 17.5 percent from Rs 613.4 billion in FY10 to Rs 506.1 billion in FY11.

6.5 Provincial Fiscal Operations

Driven by the acceleration in revenue growth, the consolidated fiscal balance of the provinces registered a surplus of Rs 134.5 billion. This pickup in revenue growth was the result of the 7th NFC award that raised the share of provinces in total revenue from 45 percent in FY10 to 56 percent in FY11. The provinces' own tax revenue also grew 17.9 percent compared with 18.9 percent in the previous year.

Sindh outperformed other provinces in terms of revenue generation, mobilizing Rs 27.5 billion in taxes during FY11 with an addition of Rs 5.9 billion over the previous year. It was followed by Punjab, with additional tax revenue of Rs 2.7 billion.

The growth in provincial expenditures in FY11 was contained to 19.0 percent in FY11, slightly above the previous year. This containment was, however, due to the reduction in development expenditures that showed a negative growth 5.0 percent. Otherwise, growth in current expenditure almost doubled compared with last year.

A province-wise analysis shows that Balochistan experienced the biggest increase in current expenditure in percentage terms; while in absolute terms Punjab stood out. The analysis of development expenditure shows that Khyber Pukhtunkwa (KPK) and Balochistan spent larger amounts than the previous year under this head, while the other two provinces allocated lower funds for development purposes than in the previous year. The devastating floods in Punjab and Sindh during the middle of 2010 forced these provinces to re-allocate development funds to flood related activities.

Table 6.6: Provincial Finance (billion Rupees)

	Punjab		Sind		KP		Balochistan	
	FY10	**FY11**	**FY10**	**FY11**	**FY10**	**FY11**	**FY10**	**FY11**
Total revenue	**401.7**	**531.0**	**241.0**	**330.7**	**152.3**	**223.8**	**81.0**	**125.9**
Provincial share in federal revenue	325.1	460.8	188.4	279.9	80.1	157.9	40.0	100.7
Provincial taxes	29.9	32.6	21.6	27.5	2.3	3.5	1.0	1.0
Provincial nontax	28.3	24.0	13.2	11.5	24.1	25.1	2.3	1.7
Federal loans and transfers	18.4	13.6	17.8	11.9	45.8	37.2	37.8	22.5
Total expenditure	**435.5**	**482.9**	**251.5**	**310.2**	**142.0**	**173.4**	**75.6**	**110.3**
Current expenditure	303.2	375.5	184.6	248.0	102.3	121.7	56.1	85.9
Development expenditure	132.3	107.4	66.9	62.2	39.7	51.7	19.5	24.3
Overall balance	**-33.8**	**48.1**	**-10.5**	**20.5**	**10.3**	**50.3**	**5.4**	**15.6**

Source: Ministry of Finance

Coming to the fiscal balance, KPK ended up with the highest budget surplus among all the provinces, followed by Punjab. The surplus registered by KPK reflects considerable restraint on current expenditure by the provincial government. The current expenditure in KPK increased by 19 percent compared with an average increase of 37.1 percent in other three provinces.

6.6 Devolution of Fiscal Responsibilities to Provinces[11]

The 18th Amendment of the Constitution of Pakistan was passed in April 2010, which entailed that a number of fiscal, administrative and legislative powers were transferred from the federal government to provinces in an attempt to enhance provincial autonomy. Following the passage of the Amendment, multi-party Implementation Commission was formed to plan and implement the devolution of different ministries and department to provinces.

Table 6.7: Distribution of Power between Centre and Provinces

	Federal Legislative List		Concurrent Legislative List
	Part I	**Part II**	
Power to Legislate	Only the Centre is entitled to Legislate	Joint control by the Centre and Provinces	Both Centre and Provinces can legislate but Federal Law Prevails
	Before the 18th Amendment		
Number of Items	59	8	47
	After the 18th Amendment		
Number of Items	53	18	0

Prior to the 18th amendment, the division of legislative powers between the centre and provinces were enshrined in two lists of the 1973 Constitution i.e. the Federal List (Part I and II) and the Concurrent List (**Table 6.7**). Any subject not enumerated in either of these lists was considered a residual subject, and left to the provinces.

The 18th amendment abolished the concurrent list and deleted certain items from the Federal List Part I, making them residuary subjects. Furthermore, it moved some items from Part I to Part II, thereby reducing the number of subjects in the exclusive domain of the central government. The end result is that the provinces now have to deal with more subjects on their own, with the federal government responsible for fewer policy decisions.

This enhanced provincial autonomy is also significant in terms of economic development. The provinces are now in a position to take a lead in growth and stabilization policies. In this context, it is important to understand some details of the devolutionary process, particularly the impact on

[11] ***Disclaimer***: This section reflects views of the Analyst who authored it; and it should not be considered as SBP's point of view.

the financial position of the provinces, as they grapple the responsibilities handed over to them. Some of these are discussed below.

Financial burden on the provinces is expected to increase

With the abolition of the concurrent list, 17 ministries have come under the control of the provinces (**Table 6.8**). Consequently, the provinces would now face higher wage bills, pension liabilities and operations and maintenance costs. The resulting increase in provincial current expenditure may leave ewer resources for developmental projects – at least in the short run.

The Federal government, on the other hand, is left with 31 ministries to run its business, freeing up fiscal space in devising and implanting its budgets. The federal government's actual expenditure on average for the last four years on the devolved ministries amounted to Rs 65.1 billion, against Rs 77.9 billion budget allocation (**Table 6.9**). This implies that the federal government has achieved fiscal space of around Rs 75 billion for the budget 2011-12 due to the transfer of 17 ministries to the provinces.

Table 6.8: List of Ministries Devolved to Provinces

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

Source: Federal Budget documents

The devolved subjects also provide the provinces an opportunity to develop the revenue potential in their areas, as they are empowered to levy any fees for these subjects. Potential revenue sources devolved to the provinces are:

- State lotteries;
- Duties in respect of succession to property;
- Estate duty in respect of property; and
- Taxes on capital value of immovable property

Table 6.9: Federal Government Expenditure* on Devolved Ministries (billion Rupees)

	Current		**Development**		**Total**	
	BE	**RE**	**BE**	**RE**	**BE**	**RE**
FY08	21.6	24.3	49.0	43.1	70.6	67.4
FY09	24.4	19.7	58.5	43.8	82.9	63.5
FY10	24.5	19.9	66.9	50.2	91.4	70.1
FY11	21.5	29.8	45.1	29.6	66.6	59.4
Average	23.0	23.4	54.9	41.7	77.9	65.1

*Expenditure on HEC has not been included.

Source: Federal Budget Documents

In addition, the 18th Amendment has endorsed the right of the provinces to collect GST on services. It would thus put an end to the disagreement between the government of Sindh and the federal government on this issue.

The Amendment further stipulates that Federal Excise Duty levied on the well-heads of both gas and oil shall not form part of the Federal Consolidated Fund, and shall be paid to the province in which the well-head is situated. Previously, the federal government was obliged to give excise duty only on gas, not on oil, to the concerned province. This change is expected to significantly improve provincial revenues. Another important development relates to the ownership of the mineral resources in a province, or in the territorial waters adjacent to the province. Earlier mineral resources in a province were regarded as the property of the federal government. Now the centre and province will enjoy an equal share (50/50).

Regarding the NFC award, the 18th Amendment adds that the share of the provinces in each of the NFC award will not be less than the share of the provinces in the previous award. In addition, the frequency of monitoring of the award will be increased to biannually from the previous once in five years.

Furthermore, provinces are now authorized to borrow directly from development partners against their provincial consolidated fund. This would lower the interest rates they pay, compared to when loans were disbursed by the federal government, and carried a higher interest rate than that decided by the donor agency.

The role of provinces in policy making and national planning stands enhanced

The involvement of provinces in economic and other policy making at national level has been enhanced as Council of Common Interest (CCI) has become more active after the 18th Amendment. CCI is constitutional body consisting of Prime Minister as head, and four chief ministers and three representatives of federal government as members. According to the constitution (section 154), the CCI is not only responsible for formation and regulation of policies in matters coming under its purview but also exercise supervision and control over related institutions.[12]

Furthermore, policymaking in the areas where provinces have gained control such as health, education, population welfare, labor and social safety nets, is now a provincial responsibility. Allocation of development expenditure in these sectors carries significant importance for the development of the economy. Therefore, the provinces, now in a position to steer economic development, are required to distribute the resources for development projects optimally and need to build up their expertise in the field.

Some risks

Although the 18th amendment is an important step towards the devolution of power to the provinces, skeptics warn that the provinces lack the requisite capacity and experience in the subjects devolved upon them. With the devolution of the ministries, the professional competence and institutional memory developed in the federal government may be lost. On the other hand, the provinces would take time to develop the skills required to efficiently run these ministries and divisions. In the interim period, failure in terms of service delivery to the public is possible; it must be avoided if the devolution is to take root.

Another serious downside is that Pakistan may face challenges in the enforcement of international conventions (and treaties) in respect to some economic and social dealings that had been signed with the federal government. For example, in case of labor rights, there is a need to develop some mechanism that all province comply with procedures and principles laid down in different ILO conventions and declarations, to which Pakistan as a federation is a signatory.

Similarly, if federal government enters into some agreement with the IMF, it would be challenging to ensure that IMF conditionalities (like fiscal targets) are met by provinces as well. Experience of the past two years highlights this risk, when the federal government announced a target of budget deficit assuming that provinces would comply to ensure that the consolidated accounts meet the IMF targets, but the actual provincial budgets were not in line.

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[12] Matters mentioned in Part II of Federal Legislative List come under purview of CCI.