

**TAMING THE LEVIATHAN TOWARDS BETTER
PUBLIC SECTOR RESOURCE EFFICIENCY: FISCAL
FEDERALISM OR DECENTRALIZATION IN
PAKISTAN**

Muhammad Ahmad Barula

(CGP #04-097)

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ABSTRACT

Among the backdrop of 18th amendment and devolution of government, this paper examines the effects of fiscal decentralization for the desired objectives of fiscal discipline and better government service delivery. It provides a descriptive and analytical study of fiscal decentralization in light of most recent federal and provincial government expenditure and revenue compositions.

PREFACE

The purpose of this research is review of public expenditure funded by RASTA as part of Research for Social Advancement and Transformations (RASTA). Also would acknowledge support of mentors Dr. Pirzada and Dr. Ather for continued guidance through this research.

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INTRODUCTION

With the advent of liberalized policies worldwide during the 1990's, many countries have shown strong advocacy toward fiscal aspects of decentralization. The fiscal decentralization can be evaluated by examining the revenue and expenditure shares of the sub-national governments (SNG) in comparison to the central government. The major motivation behind fiscal decentralization is to achieve government resource efficiency and improvement in public sector service delivery. However, some mixed results are found in the case of developing countries as against the conventional supporting argument for fiscal decentralization. In case of Pakistan, there is asymmetric decentralization of the fiscal and political institutions (Fayaz Hussain Tunio, 2021) i.e., the political structure is completely decentralized as against the centralized fiscal system. In Pakistan, higher degree of fiscal centralization is observed due to greater share of the federal government in tax autonomy and spending as well as heavy reliance of the federating units on federal transfers.

Fiscal decentralization has been long associated with economic prosperity. Public spending is determined an important link to economic growth in endogenous growth theories (Barro, 1990). Fiscal decentralization basically increase the competition between sub-national governments in provision og public goods leading to economic growth (Bird and Wallick, 1993). In case of Pakistan, a recent research showed how fiscal decentralization can lead to economic growth by improving efficiency of sub-national governments (Ahmed, 2020). This shows how by simply giving more revenue generating responsibilities to sub-national government led to such a considerable impact on economic growth. Following such a positive impact on economy, it is important to explore how a growing economy can progress its public sector efficiency through the process of fiscal decentralization to escape the Leviathan. The objective of this research is to review fiscal decentralization in Pakistan in the context of Leviathan hypothesis. Proponents of this hypothesis (Hobbs) view that national and sub-national government's act to maximize their expenditures when they have to draw resources and compete from a common divisible pool, resulting in rent seeking and inefficiencies. This research examines the effect of decentralization in this context. Major move towards decentralization in Pakistan was through 18th Amendment Act in 2010, which included significant changes like transfer of taxation powers to provinces, increased revenue sharing, increased provincial autonomy and provincial resource mobilization

In the light of 18th Amendment and fiscal decentralisation initiatives, this paper aims to discover why there is continued complete reliance of resource generation placed on the federal government and why the provincial governments have shied away from doing their respective jobs in terms of revenue generation and allocation. Is this because of provinces capacity constraints (tax revenue collection under different departments) or the federations wish to maintain a hegemonic role (control of major tax revenue on sales of goods by federation)? In the light of this inverse political and fiscal relationship (Fayaz Hussain Tunio, 2021) we also see how have things changed since the implementation of the 18th amendment.

Since 18th Amendment Pakistan has gradually decentralized more fiscal responsibilities to the provincial governments through the introduction of federal and concurrent list. The research paper also examines whether government service delivery has increased as result of fiscal decentralization in Pakistan. It is argued that Leviathan can be kept in check by effective decentralization i.e. delegating spending and revenue generation to the local tiers of the government which are better informed on spending requirements. This research sees whether fiscal decentralization measures have been effective in achieving this by examining provincial expenditure.

LITERATURE REVIEW

Theoretical Framework on Economic Efficiency from Fiscal Federalism to Fiscal Decentralization

The classic viewpoint of federalism lays its foundations on the principle of benefit taxation, minimization of horizontal disparities through vertical transfers and fiscal discipline through responsible subnational borrowing. Fiscal federalism is the mechanism of revenue sharing of the center with subnational governments and distribution of resources as per an approved formula. The central government has all power and delegates some public responsibility to the lower tiers. Rodden (2003) argues that government size grows faster when reliance on intergovernmental transfers increases for public expenditures. The soft budget constraints give rise to incentive problem due to common pool resources as competing government tend to overfish.

The Tiebout hypothesis (Tiebout, 1956) of public sector resource allocation justify the decentralization mechanism as an effective way of increasing the efficiency of public sector. Oates (1972) assumes government as 'altruistic agent' and decentralization leads to increased society's welfare resulting from information advantages and flexibility in adapting the local citizen's needs. Brennan-Buchanan hypothesis (1980), under public choice, assumes central government to be monopolist with maximum control over the resources. Thus, centralized system increases the leviathan tendency of the government along with more taxation on citizens. The view is undermined by "race to the bottom" approach under decentralization, resulting from tax competition among subnational governments (Zodrow & Mieszkowski, 1986). Tax competition tames the leviathan but also leads to inefficient public service delivery. Another viewpoint under theory of public choice and political economy debate assumes government to be comprised of self-interested individuals who forcefully do not deviate from good behaviour to preserve the system. Therefore, decentralization prevents the expansion of public sector, and this mechanism is known as 'market-preserving federalism' (McKinnon, 1997).

Tax competition tames the leviathan but also leads to inefficient public service delivery. Another viewpoint under theory of public choice and political economy debate assumes government to be comprised of self-interested individuals who forcefully do not deviate from good behavior to preserve the system. Therefore, decentralization prevents the expansion of public sector, and this mechanism is known as 'market-preserving federalism' (McKinnon, 1997)

Literature shows how fiscal decentralization has increased employment in local economic activities which eventually increases economic growth in Pakistan (Faridi , 2012). Another research by Malik S. et al (2006), confirmed the theory by providing evidence of a positive impact of fiscal decentralization on economic growth using time series data from 1972-2005 for Pakistan.

Padda, Hyder and Akram (2011) discuss how Punjab and Sindh given their huge population has enjoyed highest degree of fiscal decentralization. On the other hand, due to smaller population Khyber Pakhtoonwa and Balochistan are still in control of central government. The paper suggests transferring control of natural resources to provincial government of KP and Balochistan to improve their revenue generation. Iqbal and Nawaz (2010) study the impact of fiscal decentralization on macroeconomic stability. Here they have considered high inflation with high unemployment as a measure for macroeconomic stability. The paper uses a Misery Index to capture the true relationship between fiscal decentralization and macroeconomic stability. The results show a significant positive relationship between fiscal decentralization and macroeconomic stability in Pakistan.

Fiscal decentralization and Pakistan Leviathan

As mentioned above there are contradictory theories as to the effects of decentralization on government size and provision of services. In the case for Pakistan Quartul Ain (QuratulAin, 2020)

tested the common pool hypothesis to see whether intergovernmental transfers from federal to local tiers of government lead to a larger government size or such decentralization was able to keep the Leviathan in check leading to a small size of government. The findings held true with the common pool hypothesis as provincial government's total expenditure as well as expenditures on health, education water supply and sanitation increased. It does not

The data used is of until 2015 and comprises of expenditure on health, education, water and sanitation only. The study using data from expenditure side and does not take revenue generation and composition into account.

Pakistan has undergone many different regimes since the first constitution in 1956. The public sector has experienced decentralization under civilian rule whereas under military rule, centralization was prominent (Adeney and Boni, 2022). Overall, public finances in Pakistan have been plagued by a number of problems. Firstly, the government has been spending more money than it has been taking in, which has led to a buildup of debt. The government has been unable to collect enough taxes to cover its expenses. The federal government has been taking a larger share of the country's resources, leaving the provincial governments with less money to spend. The provincial governments have been spending more money than they have been taking in, which has led to a large gap between their expenditures and own revenues. This gap has been filled by fiscal transfers from the federal government. The government has not been good at managing its finances. This has led to waste, corruption, and mismanagement. The government has not been held accountable for its financial decisions. This has led to a lack of transparency and a culture of impunity.

These problems have had a number of negative consequences for Pakistan, including: economic instability, inequality, poverty and unrest. The high fiscal deficits and poor revenue mobilization have made the Pakistani economy vulnerable to shocks. Moreover, the centralization of resources has led to increased inequality between the provinces. Weak financial management by the government has led to lower investment in social services leading to increased poverty. Lack of accountability has led to unrests and protest. These problems are serious and will need to be addressed if Pakistan is to achieve sustainable economic growth and development.

Given several problems in the public finances in Pakistan, fiscal decentralization will not improve efficiency especially when local governments are still highly dependent on provincial and federal government for financial resources and personnel (Paracha, 2003). Also, there are many expenditure restrictions especially related to personnel hiring and other resources. Moreover, Paracha (2003) discusses how tax sharing between provinces and districts led to inefficiencies in revenue generation. Fiscal decentralization will not be fruitful until all levels of government are accountable for their actions.

Pakistan has decentralized political and centralized fiscal institutions (Fayaz Hussain Tunio, 2021) with the existence of interest groups that interact with each other within such an asymmetric system leading to cultural polarization, and centralization of the taxation system allowing the Leviathan go in check resulting in bad fiscal health and ballooning public debt.

RESEARCH METHODOLOGY

The present research was based on desk-study by collecting data from secondary sources. The main data source used by existing literature is GFS (Government Finance Statistics) by IMF but there is a limitation of non-availability of data for subnational fiscal operations for Pakistan. The current study will utilize various annual reports published by Ministry of Finance, Pakistan Bureau of Statistics and State Bank of Pakistan along with at the sub national level for provincial ministries of finance. The time-period covered is from 2010 till present depending on the availability of data in annual

reports of SBP and statistical supplements. Also FY22 Federal and provincial government annual accounts are used to show current situation.

The research studies below 10 variables classed into three objectives namely Fiscal Federalism and decentralization, fiscal discipline and public sector service delivery.

Fiscal Federalism and Decentralization	Fiscal Discipline	Public Sector Service Delivery
Federal and provincial fiscal operations (breakdown of revenue receipts and expenditures) Federal resource transfers to provinces (taxes and grants) Provincial breakdown of fiscal operations (Punjab, Sindh, KPK and Baluchistan)	Size of government (current and development expenditures) Fiscal balance (federal and provincial) Public debt as percentage of GDP	Health and education outcomes

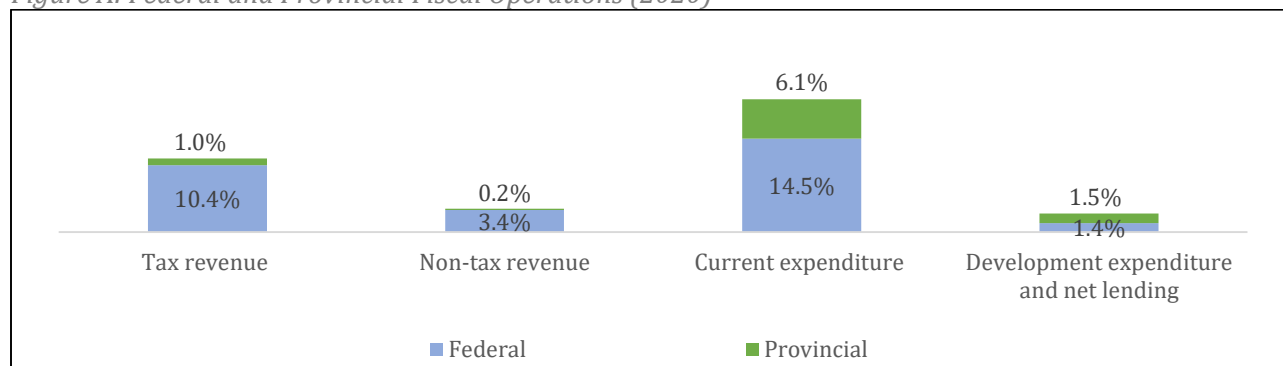
The data sources for above were SBP Annual Reports (various issues), SBP Statistical Supplements (various issues), Economic Survey of Pakistan (various issues), Pakistan Bureau of Statistics, Ministry of Planning Development and Special Initiatives, PSDP reports (various issues), ADP reports (various issues). Outcome is in form of analytical analysis presented through descriptive statistics, graphical illustrations and comparison bar charts on the above variables.

FINDINGS AND DISCUSSION

1. Federal nature of Pakistan's Fiscal operations

The consolidated fiscal operations for Year 2021 are provided in Figure A. The greater federal share in tax revenue, non-tax revenue and current expenditure depicts the federal nature of Pakistan's fiscal operations.

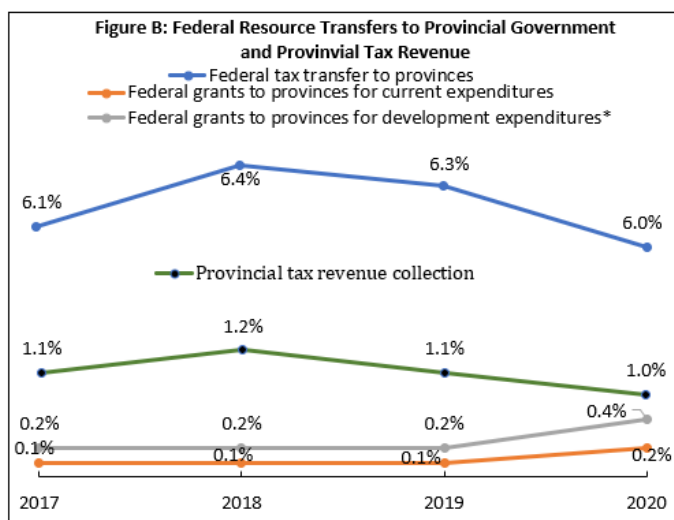
Figure A: Federal and Provincial Fiscal Operations (2020)



Note: All figures are as percentage of GDP

Source: Author's compilation from SBP Annual Report 2021.

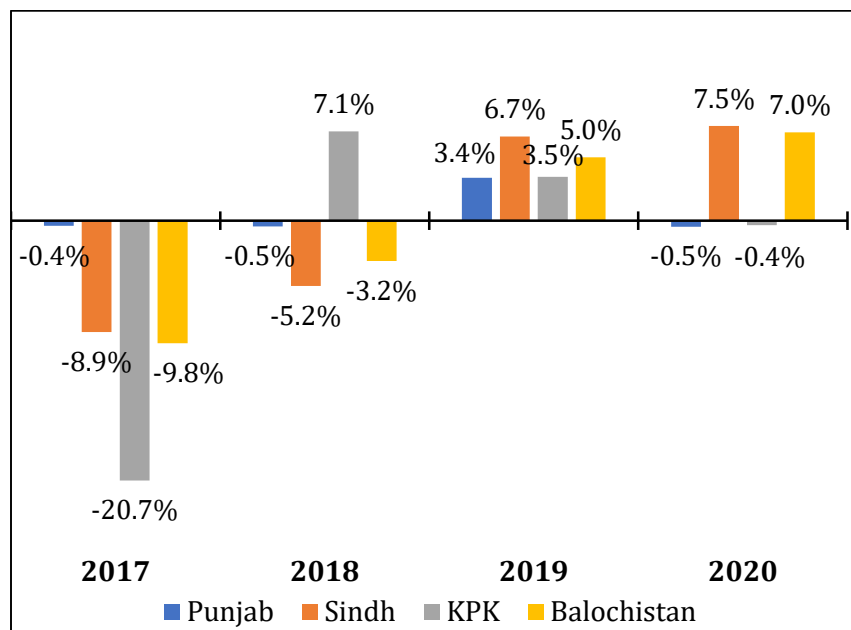
Figure B shows federal resource transfers to provincial government (2017 to 2020). There is a slight increase in federal tax transfers in 2018 with a declining trend in 2019 and 2020. On the other hand, the federal grants remained stagnant from 2017 to 2019 with slight increase in 2020. The provincial tax collection as percentage of GDP is minimal with an average value of 1.1%. Therefore, there is heavy reliance of provincial government on federal resource transfers especially the tax transfers.



Note: *Public Sector Development Program (PSDP). All figures are as percentage of GDP.
Source: Author's compilation from SBP Annual Report 2021.

The provincial fiscal balance (as percentage of total revenue) is given in Figure C. There is an overall provincial deficit in 2017 with KPK facing the highest deficit. In 2018, KPK had the revenue surplus while rest of the provinces were the deficit provinces with highest deficit of Sindh. On the other hand, the following year there was an overall surplus in all provinces with highest surplus in Sindh. Again, in 2020, Punjab and KPK were the deficit provinces but the volume of deficit was relatively small. During Jul-Mar FY2023, all four provinces posted a combined surplus of Rs.456.0 billion against Rs.599.8 billion in the same period of last year (Pakistan, 2023).

Figure C: Provincial Fiscal Balance as percentage of Total Provincial Revenue



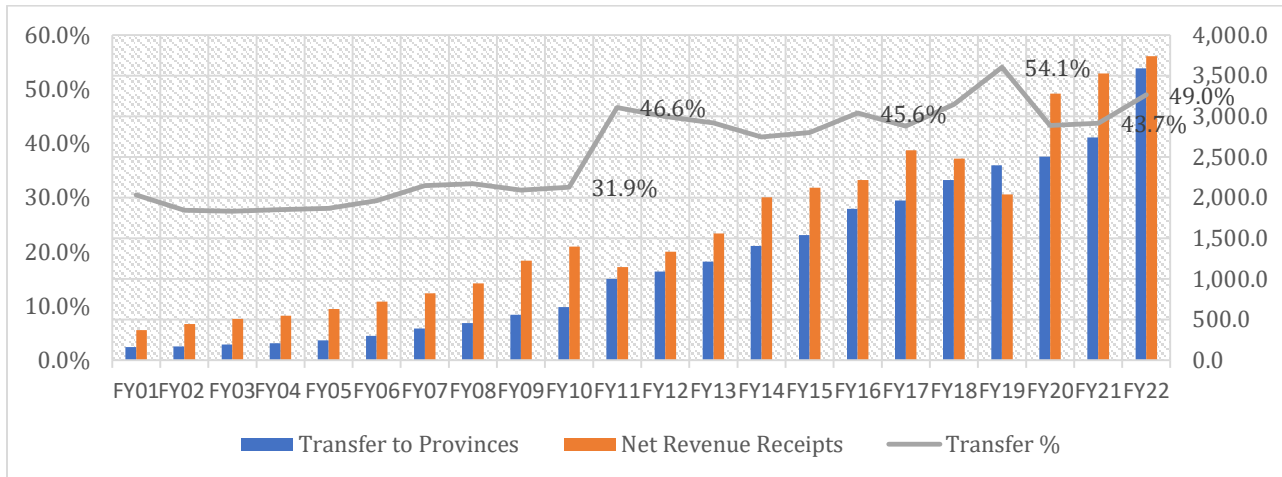
Source: Author's calculation from SBP Annual Report 2021.

2. Fiscal transfers to provinces have increased

As a direct result of new resource sharing formula under the 18th Amendment, total fiscal transfers to provinces increased. The graph shows comparison of federal revenue transfer to provinces and

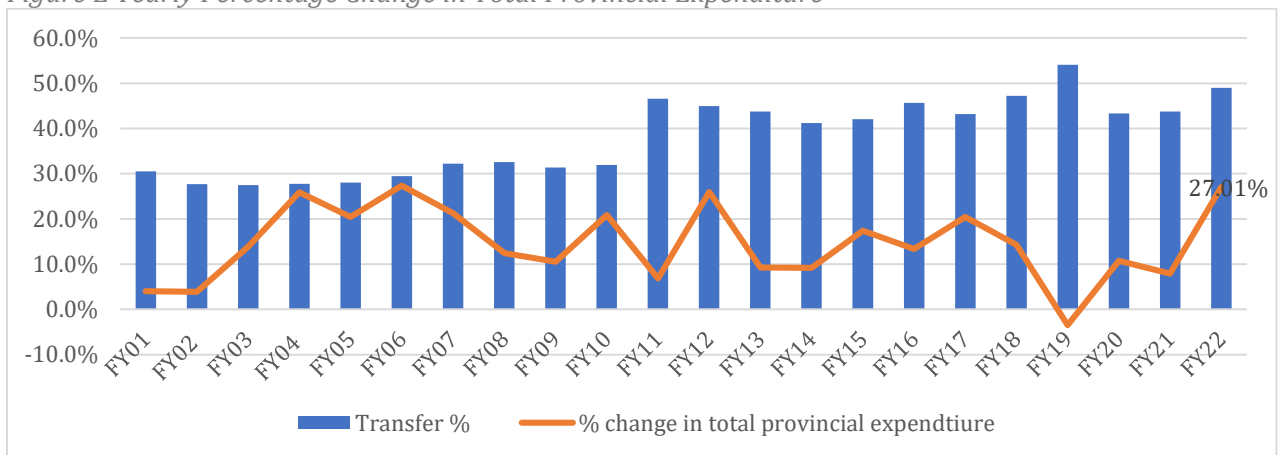
net revenue receipts (total revenue – transfers). In 2010 after fiscal decentralization measures transfer to provinces increased as percentage of total federal gross revenue from 31.9% to 46.6% in FY11 and at the onset of the pandemic in November 2019, transfers had peaked at 54.1% due to which in FY20-FY21 and standing at 49% of total revenue in FY22. As COVID spread economic performance had stalled with the Federal and Provincial Governments introducing relief and refinancing facilities in order to alleviate economic strain on individuals and businesses.

Figure D Federal Transfer to Provinces and Net Revenue Receipts



To see if increased NFC transfers have resulted in increased provincial expenditure in case of fiscal decentralization in Pakistan we can see below diagram that shows change in total provincial expenditure percentage in comparison with NFC transfers. Provinces expenditure has continued to increase as rate between 10-20% with ups and downs.

Figure E Yearly Percentage Change in Total Provincial Expenditure



As the result of increased transfers provincial expenditure increased over the year. Leviathan went unchecked as own sources revenue generation keeps government size in check and transfers tend to do opposite.

3. Vertical Imbalance and Provincial and Federal Government Expenditure

The increase in vertical imbalance shows positive effect on provincial government’s expenditure size and raises the share of education and health spending in the total provincial government’s expenditures (QuratulAIn, 2020).

An increase of fiscal decentralization—linked with democracy lends support to the prediction of a Leviathan-type government (Qiao & Siyinh, 2017). The table below shows federal and provincial government consolidated expenditure (size) and revenue in absolute terms and as percentage of GDP. As of FY20 Pakistan government size stands at 23.1% of GDP.

Figure 3.0 Total Government Consolidated Revenue and Expenditure Absolute and Percentage of GDP

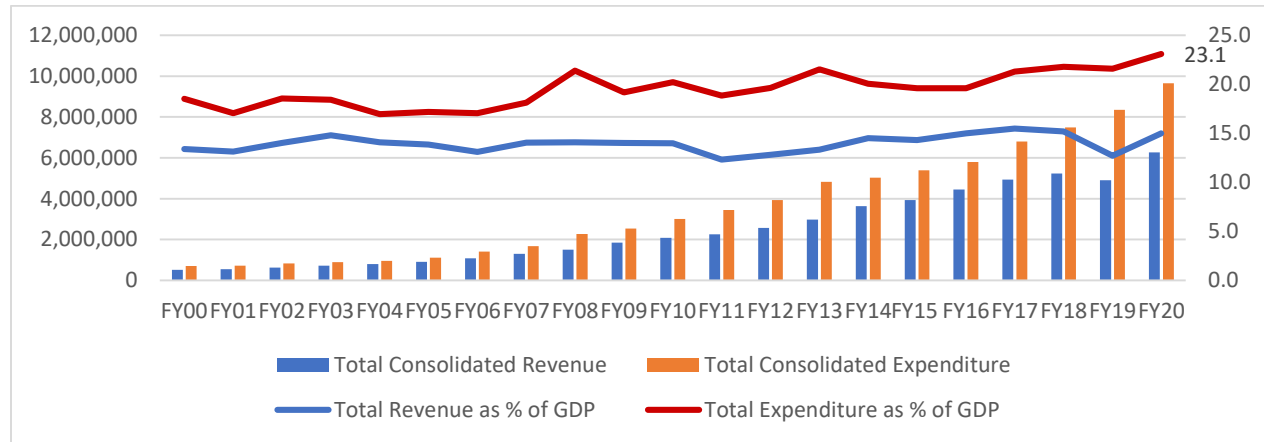
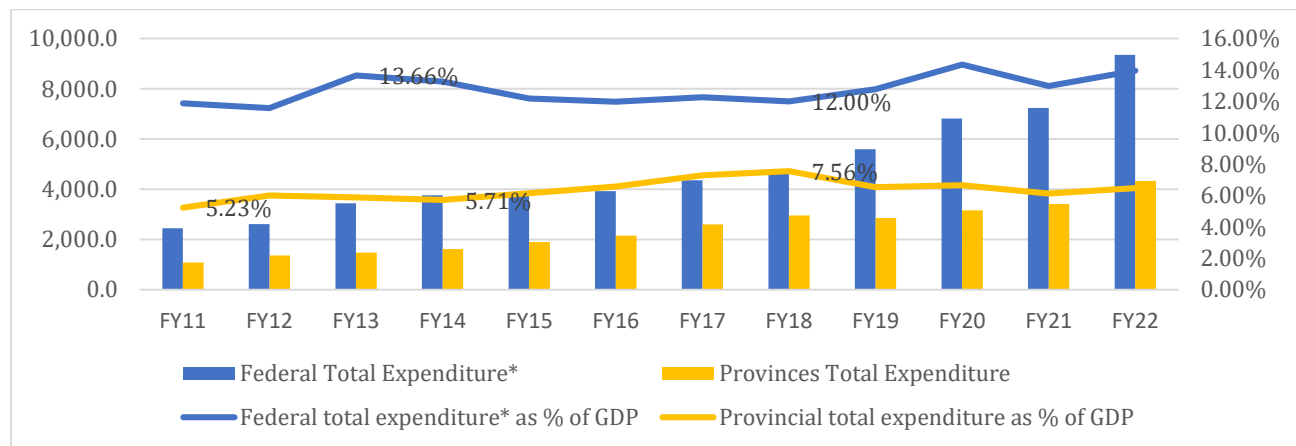
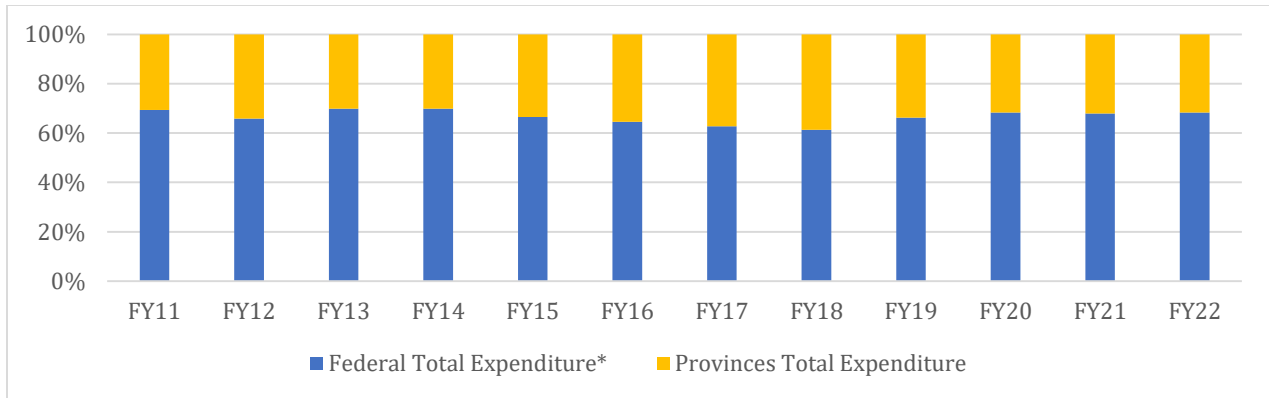


Figure 3.1 Federal and Provincial Government Spending as Percentage of GDP after 2010



Below table shows the size comparison between federal and provincial government, where the provincial government size increased to just under 40% in FY18 from about 30% in FY11. This means that provinces were a bigger part of government service delivery than before.

Figure 3.2 Size comparison between Federal and Provincial Governments post 18th



4. Fiscal Decentralization and Public Service Delivery

(QuratulAIn, 2020) found that spending on health and education increased over the years. As of Fiscal year 2023 spending on health and education is as below.

i. Health

The PSDP allocation for the health sector during FY2023 was Rs.22,356.5 million, which is 2.8% of the total development budget and 0.05% of GDP. The public health expenditure increased by 56.8% during FY2022 from Rs. 586,270 million recorded during FY2021. The expenditure was 1.4% of GDP during FY2022 as compared to 1% during same period of last year (Pakistan, 2023).

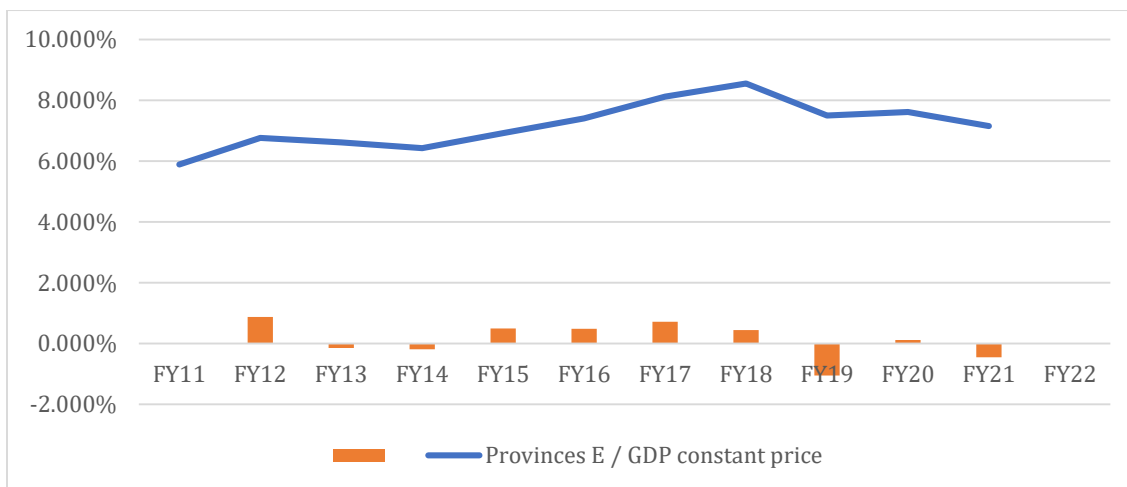
ii. Education

Cumulative education expenditures by Federal and Provincial Governments in FY2022 estimated at 1.7% of GDP. Expenditures on education-related activities during FY2022 witnessed an increase of 37.3%, and reached to Rs. 1,101.7 billion from Rs. 802.2 billion (Pakistan, 2023).

5. Provincial Expenditure and Fiscal Decentralization

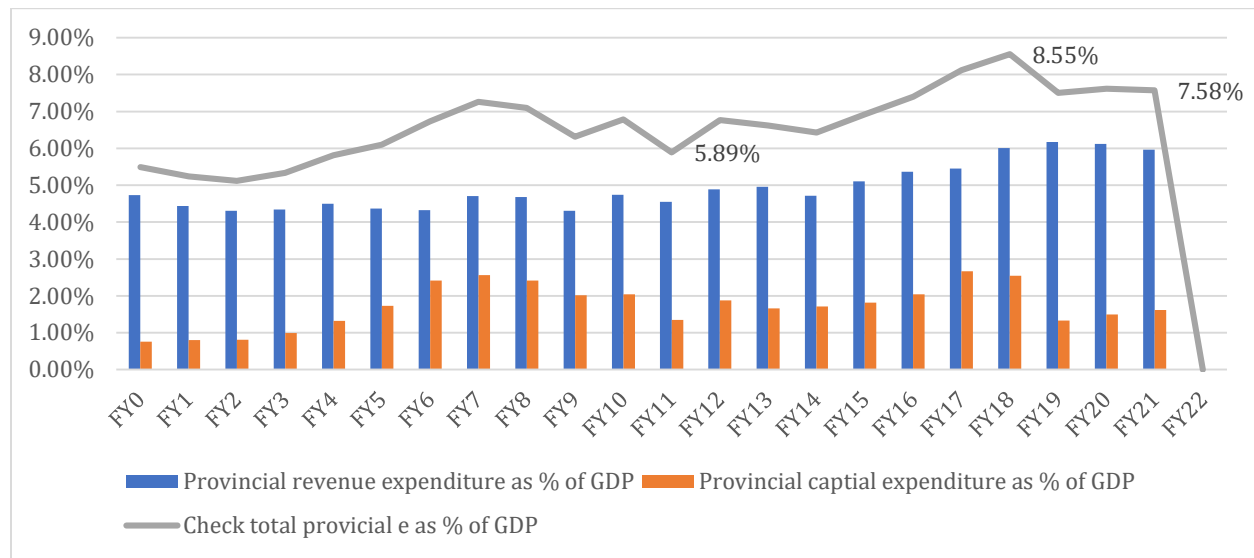
During Jul-Mar FY2023, all four provinces posted a combined surplus of Rs.456.0 billion against Rs.599.8 billion in the same period of last year (Pakistan, 2023).

Figure 5.0 Provincial Expenditure as Percentage of GDP and Yearly Change in Provinces Expenditure



It is important to see how the increased revenue transfers were utilized by the provinces post decentralization initiatives in 2010 and until most recently. Provincial expenditure comprise of revenue and capital expenditure as show in the graph below.

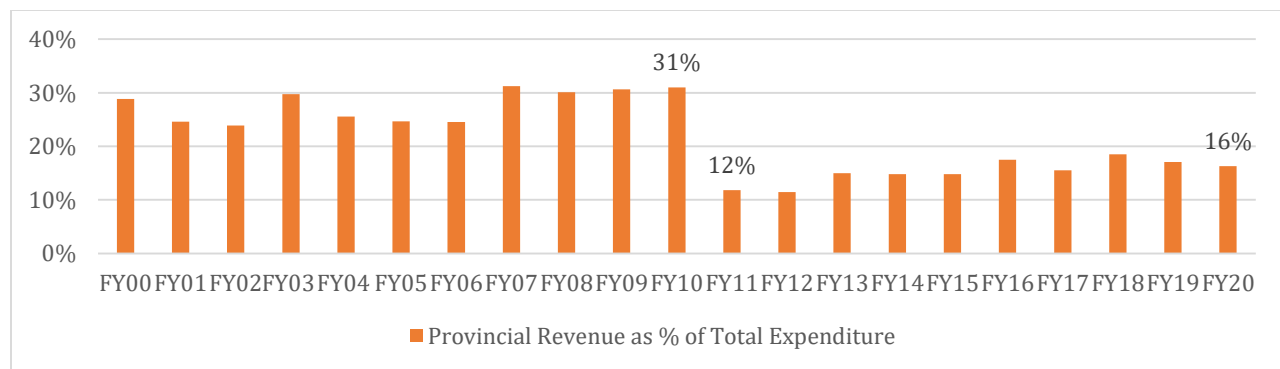
Figure 5.1 Provincial Capital and Revenue Expenditure as Percentage of GDP



6. Provincial Revenue and Fiscal Decentralization

While increased transfers put funds in hand on sub-national government for spending, which proponents of fiscal decentralization argue results in better resources matched spending, it also lets sub national government dependent on common divisible resources with tendency to increase inflate spending requirements to get more resources. However, it is important to note that in FY07-10 own revenue trend is decreasing share and after decentralization in FY11-18 own revenue trend is increasing share up until FY19 (COVID). As a result of increased transfers, provinces own revenue source as percentage of total expenditure decreased as shown in diagram below:

Figure 6.0 Provincial Revenue as Percentage of Total Provincial Expenditure



The table below shows provincial own revenue proportions compared to total provincial revenue. As of FY22 own revenue stood at 15.80% which has been falling overall in the last 5 years. This comprises of tax revenue 13.06% and non-tax revenue 2.74%.

Table 6.1 Provincial Tax and Non-Revenue as Percentage of Total Revenue

	FY18	FY19	FY20	FY21	FY22 P	FY22 P
Provincial own revenue as % of total rev	18.65%	16.29%	15.92%	17.67%	15.80%	740.7
Provincial Taxes	13.66%	13.41%	12.76%	13.64%	13.06%	612.4

Provincial Non-tax	4.99%	2.88%	3.16%	4.03%	2.74%	128.3
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Source: Chapter 4, State Bank of Pakistan.

Province-wise breakdown is in table below. Of the four provinces Sindh leads in own revenue proportion as percentage of total at 22.69% of which provincial taxes account for 21.51% and not tax is only 1.18%. More than half of Sindh's tax revenue is derived from sales tax on services. Punjab has own revenue proportion of 15.48% followed by Baluchistan 10.54% tax revenue of only 4.68% of total as rest is non-tax. KPK own revenue is 9.17% of which tax revenue is 7.71% of total.

Table 6.2 Provinces Tax Revenue as Percentage of Total Revenue

	Punjab	Sindh	Khyber-Pakhtunkhwa	Baluchistan
Provincial own rev % of total rev	15.48%	22.69%	9.17%	10.54%
Provincial Taxes	12.59%	21.51%	4.68%	7.71%
Provincial Non-Tax	2.90%	1.18%	4.48%	2.83%

Source: Author's calculation from Ch4. MOF Govt of Pakistan.

7. Provincial Taxation Capacity

Apart from revenue from federal transfer and non-tax revenue, the provincial governments in Pakistan levy and collect various taxes, including sales tax on services, agriculture income tax, professional tax, property tax, motor vehicle tax, entertainment tax, stamp duties, and other local taxes.

Table below shows consolidated provincial taxes after 2010. While total tax collection is increasing, we have seen that while tax revenue in FY18 was 13.66% it stood at 13.06% in FY22 (table 4.4 above).

Figure 7.0 Provincial Tax Revenue Sources Post 2010

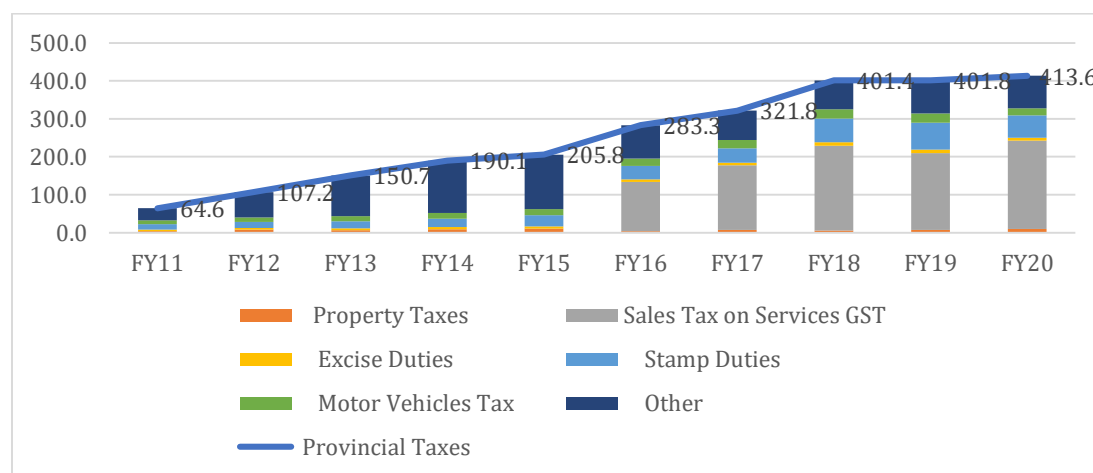


Table 7.1 Consolidated Provincial Revenue Compositions

	FY18	FY19	FY20	FY21	FY22 P	FY22 P
Provincial own revenue as % of total rev	18.65%	16.29%	15.92%	17.67%	15.80%	740.7
Provincial Taxes	13.66%	13.41%	12.76%	13.64%	13.06%	612.4
Property Taxes	0.19%	0.23%	0.30%			-

Sales Tax on Services GST	7.62%	6.77%	7.19%	7.88%	7.59%	355.7
Excise Duties	0.29%	0.31%	0.23%	0.22%	0.19%	8.9
Stamp Duties	2.14%	2.35%	1.82%	1.48%	1.51%	70.9
Motor Vehicles Tax	0.82%	0.83%	0.56%	0.72%	0.77%	36.2
Other	2.60%	2.92%	2.66%	3.34%	3.00%	140.6
Provincial Non-tax	4.99%	2.88%	3.16%	4.03%	2.74%	128.3
Interest	0.04%	0.02%	0.02%	0.08%	0.03%	1.2
Profits from Hydro Electricity	2.09%	0.70%	0.79%	1.40%	0.50%	23.3
Irrigation (Irrigation receipts only)	0.07%	0.08%	0.12%	0.12%	0.10%	4.8
Others	2.79%	2.07%	2.23%	2.43%	2.11%	99.1

Source: Authors calculation from consolidated Provincial Chapter 4, State Bank of Pakistan .

Below table give the province wise breakdown of different tax heads and their contribution to total revenue.

Table 7.2 Province Wise Breakdown of Provincial Revenue Source Tax and Non-Tax

	Punjab	Sindh	Khyber-Pakhtunkhwa	Baluchistan
Provincial own rev % of total rev	15.48%	22.69%	9.17%	10.54%
Provincial Taxes	12.59%	21.51%	4.68%	7.71%
Property Taxes				
Sales Tax on Services GST	7.59%	11.70%	3.08%	4.64%
Excise Duties	0.11%	0.46%	0.00%	0.21%
Stamp Duties	2.29%	1.27%	0.55%	0.13%
Motor Vehicles Tax	0.98%	1.00%	0.17%	0.24%
Other	1.61%	7.08%	0.87%	2.54%
Provincial Non-Tax	2.90%	1.18%	4.48%	2.83%
Interest	0.03%		0.07%	
Profits from Hydro Electricity	0.11%		2.35%	
Irrigation (Irrigation Receipts only)	0.17%	0.02%	0.03%	0.11%
Others	2.59%	1.16%	2.04%	2.70%

Source: Chapter 4, State Bank of Pakistan .

Punjab tax revenue is collected by 5 departments and is classed in 14 heads as shown in table below.

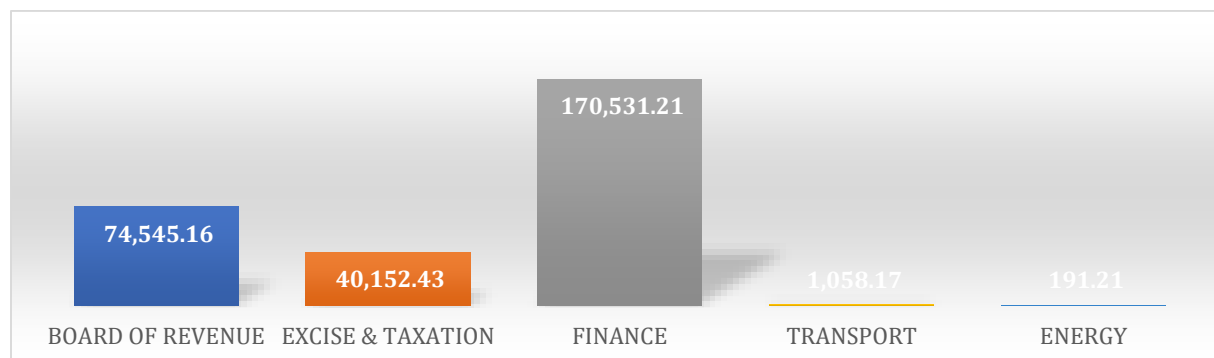
Table 7.3 Punjab Tax Department and Tax Collection Heads

SR	TAX RECIEPTS
I	BOARD OF REVENUE
1	8011 Taxes on Income (Agriculture Income Tax)
2	8013 Property Tax (Transfer of Property)
3	8014 Land Revenue
4	8017 Capital Value Tax on Immoveable Property
5	8027 Stamp Duty

II	EXCISE & TAXATION
6	8013 Property Tax (Transfer of Property)
7	8016 Tax on Profession. Trades and Callings
8	8026 Provincial Excise
9	8028 Motor Vehicles
10	8030 Other Indirect Taxes
III	FINANCE
11	8023 Sales Tax
12	8030 Other Indirect Taxes
IV	TRANSPORT
13	8028 Motor Vehicles
V	ENERGY
14	8030. Other Indirect Taxes

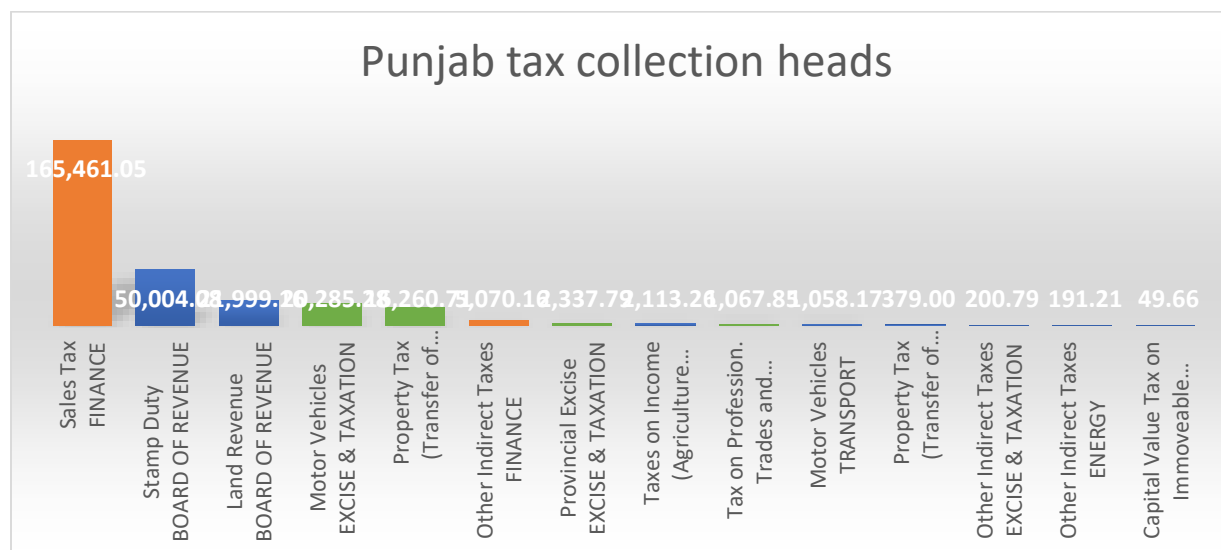
Furthermore, tax collected under these heads shows that most revenue was by Finance department, than board of revenue. Combined these two departments collected the most tax. Excise and Taxation had meagre share of total revenues collected despite having the mandate of tax in its name.

Figure 7.4 Tax Collection by Punjab Departments



Source: Punjab Provincial civil accounts 2022 MOF.

Figure 7.5 Punjab Tax Collection under Different Tax Heads



Source: MOF Government of Punjab.

Sindh Tax is collected under 5 departments and 18 kinds of taxes as shown in table below. Sindh revenue board collects the most tax.

Table 7.6 Sindh Tax Department and Tax Collection Heads

Tax collection departments	No. of Taxes	FY 21	FY22	FY22 %
1-Board of Revenue	5	14,902.50	17,292.90	6.46%
2-Excise & Taxation Department	9	91,678.10	103,313.25	38.58%
3 - Sindh Revenue Board	2	121,729.80	145,796.46	54.45%
4 - Energy and Coal Department	1	1,033.30	1,101.88	0.41%
5 - Transport and Communication	1	298.40	276.45	0.10%
Total	18	229,642.10	267,780.94	100%

Detail of different tax revenue source for Sindh government is in the table below.

Table 7.7 Sindh Tax Collection under Different Tax Heads

Department	Sindh tax	FY22	%
Sindh Revenue Board	Sales Tax on Services (Provincial)	145,796.46	54.45%
E&T	Sindh Development Maintenance of Infra-Structure	83,352.30	31.13%
BOR	Stamp Duties	15,820.02	5.91%
E&T	Motor Vehicles	12,178.47	4.55%
E&T	Provincial Excise	5,741.68	2.14%
E&T	Taxes on Professins, Trades and Callings	1,275.96	0.48%
Energy & coal	Electricity Duty	1,101.88	0.41%
BOR	Tax on Agriculture Income	707.38	0.26%
E&T	Property Tax	560.64	0.21%
BOR	Transfer of Property Tax (Registration)	379.78	0.14%
BOR	Land Revenue	305.53	0.11%
Transport & Comm	Vehicle Fitness and Route Permit	276.45	0.10%
E&T	Cotton Fees	131.58	0.05%
BOR	Capital Value Tax	80.18	0.03%
E&T	Entertainment Tax	57.58	0.02%
E&T	Other Fees (All Types)	15.04	0.01%
Sindh Revenue Board	Worker Welfare Fund	-	0.00%
	Grand Total	267,780.94	1.00

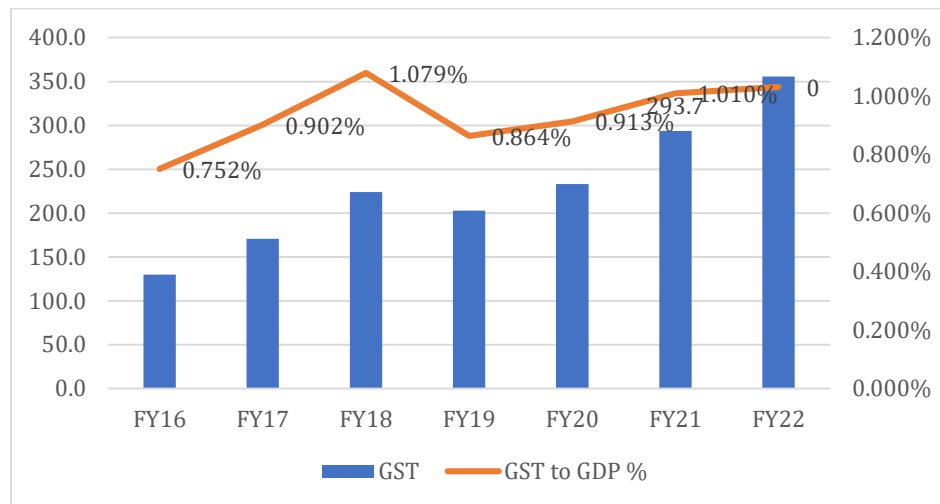
Source: Govt of Sindh, Finance Department.

We can see that GSTS is the main non-tax revenue generator for provincial governments as in FY20 it stood 233 billion which is more than half of a total 413.6 billion. It is important to note that uptill

FY15 sales tax on services was included in other tax revenue as was collected by federal government as provinces set up relevant tax authorities.

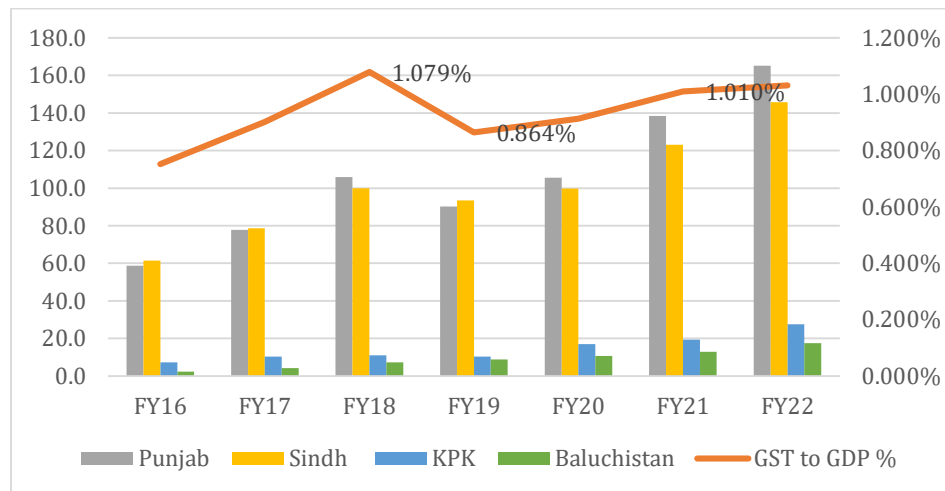
General sales tax on services (GSTS) has become a provincial subject under the Article 8 of the Order, and in 2015 government of Sindh, Punjab and KPK established there on revenue agencies and started collected GSTS while Baluchistan was underway of setting up own authority.

Figure 7.8 GST Collection Trend and GSTS to GDP percentage



GST collection as percentage of sectorial share in GDP increased from .752% in FY16 to 1.079% in FY18. Apart from ratio of collection the overall size of service sector also continued to grow.

Figure 7.9 Provincial Breakdown of GSTS Collection



Provincial breakdown of GSTS collection shows similar trend but we can see that Sindh led in GSTS collection in 3 years FY16, FY17 and again in FY19. Also from the data we can see other province KPK and Baluchistan upward trend in collection over the years.

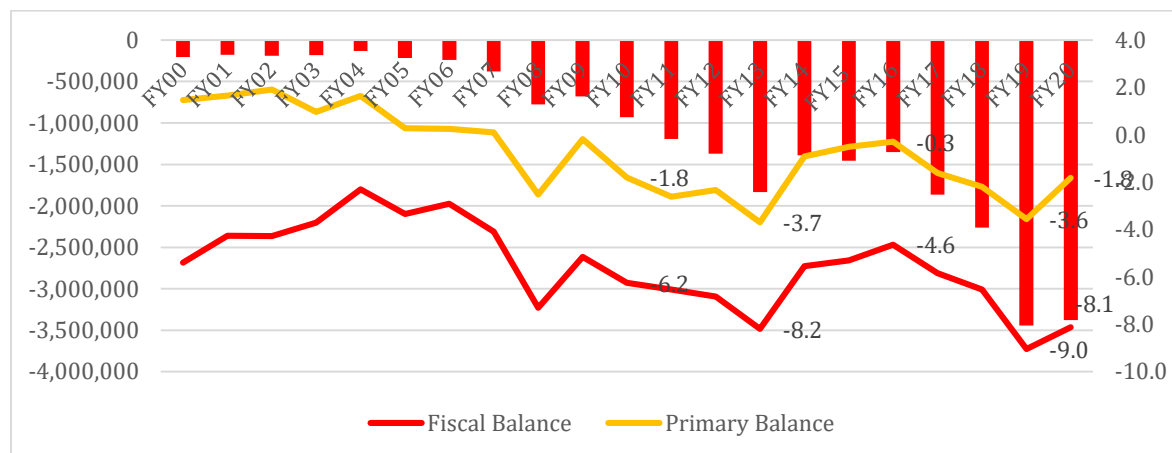
8. Fiscal decentralization and Fiscal Health

As per IMF (IMF Working Paper 2017, 2017) a larger share of decentralized expenditure is associated with a stronger fiscal balance and can lead to more pro-cyclical fiscal policy. However, to effectively achieve this strong accountability and budget management capacity at the local level is also required.

Total public debt was Rs. 59,247 billion at end-March 2023 Domestic debt was Rs. 35,076 billion and external public debt was Rs. 24,171 billion or US\$ 85.2 billion at end March 2023 (Pakistan, 2023).

The table 5.1 below shows fiscal balance absolute and also fiscal and primary balance as percentage of GDP. Primary balance is calculated by subtracting interest payments for the borrowings from the current year's fiscal deficit. The fiscal deficit is calculated by determining the difference between the total income and total expenditure of the government.

Figure 8.0 Fiscal and Primary Balance as Percentage of GDP



Fiscal and Primary balance at the start of 2010 stood at -6.2% and -1.8% (difference being 4.4%) and in 2013 fiscal deficit increased to -8.2% whereas primary balance deficit increased to -3.7% (difference being 4.5%). In FY16 deficit was lowest point for -4.6% and -0.3% (difference being 4.3%) increasing after in FY19 and ending at -8.1% of GDP in FY20 and -1.8% (difference being 6.3%). The largest difference between primary and fiscal deficit is in FY20 of 6.3% (FY19 5.4%) of GDP that means, interest payment by government were the highest as percentage of GDP.

After 2010 fiscal decentralization fiscal and primary balance appear to increase and start to improve from FY13 onwards after which fiscal deficit increases at faster rate than primary deficit meaning interest payment on outstanding debt. Fiscal deficit reduced to 4.6% of GDP (Rs. 3,929.3 billion) during Jul-Apr FY2023 against 4.9% of GDP (Rs.3,275.2 billion) in the same period of last year. Similarly, the primary balance posted a surplus of Rs. 99.1 billion against a deficit of Rs. 890.2 billion during the period under review, reflecting a slowdown in the growth of non-markup expenditures (Pakistan, 2023).

CONCLUSION

As a direct effect of increased revenue transfers after 18th amendment and updated NFC awards, provincial governments have turned into mini-leviathans of their own. The vertical imbalance has increased showing evidence of common pool hypothesis. This also leads us to the conclusion that the budget deficit at the federal level are now lined with fiscal performance at the sub-national level.

Provinces in Pakistan heavily rely on fiscal transfers from the federal government for their revenue needs. The provincial governments have limited control over revenue sources, as the bulk of tax collection is conducted by the federal government. This dependency restricts their ability to generate sufficient revenue independently. Revenue generation capacity at provincial level is limited and draw revenue from one or two major tax sources despite there being large number of tax heads and over five collection departments.

RECOMMENDATION / POLICY IMPLICATIONS

Transfer taxation power to the provinces with the initial plan of equating taxes collected by provinces to match those that need to be transferred through the NFC award. The federal government can begin with end in mind by calculating upcoming transfers and using that magnitude, devise tax policies with provincial governments that enable them to raise tax revenue equating to those that would have otherwise been transferred through NFC.

The government should enhance the capacity and autonomy of local government bodies, such as municipalities and district governments, to manage their own finances. This can be done by providing training, resources, and technical support to local officials.

Addressing challenges requires a multi-faceted approach involving policy reforms, capacity building, improved tax administration, and coordination between the federal and provincial governments. Enhancing the revenue generation capacity at the provincial level is crucial for effective fiscal decentralization, as it allows provinces to have greater fiscal autonomy, make informed policy decisions, and provide essential services to their citizens

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