Budget: wrong framework

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Only fiscally strong provinces and local governments would be able to chalk out a bottom-up process of development that is closer to the aspirations of common masses.

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A select group of people used to think that it was not only the allocations, but a quality spending of those allocated funds that mattered in the public sector development game. It was a pleasant surprise when the minister of state for Finance followed the same line of argument during his budget speech last month.

After informing that the government had allocated an unprecedented amount of Rs520 billion under Public Sector Development Plan (PSDP), he lamented on the low utilisation of PSDP by previous governments (ignoring the fact that current regimes' record of spending the allocated PSDP does not differ much from previous governments) and said that misdeeds and wrong policies of previous regimes had made the people hostage and the country in fact had defaulted.

He also mentioned that 96 per cent of the PSDP had been utilised during 2006-2007: a claim that does not seem to be supported by the Planning Department which reports that during the first nine months of 2006-07, the government could only spend 60 per cent of the proposed development funds amounting to Rs150 billion.

What exactly is the composition of unprecedented allocation of PSDP for 2007-08? Out of Rs520 billion, the federal share is Rs335 billion while the provincial governments are expected to receive Rs150 billion; Rs 35 billion are allocated for earthquake reconstruction. The PSDP/GDP ratio is 4.8 per cent compared to last year's 4.3 per cent. Public sector corporations will invest Rs 204 billion outside the budget increasing the volume of the overall PSDP to Rs724 billion.

Looking at the breakdown of Rs520 billion, one finds that 52 per cent will be spent on infrastructure development and 48 per cent on welfare of people and on social sector. This seems impressive and one hopes that all of this amount is effectively utilised. However, the actual PSDP amount is reduced to Rs427 billion when foreign loans totalling Rs58.6 billion and Rs35 billion earmarked for earthquake reconstruction are deducted (if earthquake related expenses can be deducted while calculating current account deficit then why not deduct them from PSDP as well).

Interestingly education and health continue to be neglected in PSDP and got an embarrassingly low allocation of Rs24 billion and 5 billion respectively. The water and power sector receive the maximum amount of Rs84 billion compared to last year's Rs70 billion. Power sector allocations have been reduced from last year's Rs26 billion to Rs20 billion while the water sector allocation have increased from Rs44 billion to Rs63 billion.

Now the second question arises: Whether this allocation brings any change in the lives of common masses? A layperson's guess would be that the allocation is not bringing much change for common masses. Going by the current PSDP allocations, only 14 per cent is reserved for new high priority projects while 86 per cent of it will be consumed by ongoing development projects (whose cost increases manifold due to inflation and various other factors). It is evident that the government has either been allocating very little amount or the allocated funds lapsed due to non-execution of the projects. It should be kept in mind that Planning Department, in its official documents, states that one of the reasons for non-execution of projects is slow release of funds by the Finance division.

The governance of PSDP is also poor as quite a few projects sponsored by Asian Development Bank got cancelled due to poor delivery. Similarly, governance of spending 'outside the budget' by public sector corporations is not very exemplary and the first audit of the National Commission for Human Development (NCHD) made public recently is a clear example of bad governance. This audit exposes misuse of the Pakistan Human Development Fund (PHDF) to the tune of nearly Rs1.3 billion and a missing Rs338 million from the bank accounts of the NCHD and PHDF.

About the criteria of allocations between centre and provinces. To me, political decentralisation without financial devolution leads to a risky situation where central government shuns its responsibilities and obligations to lower tiers of governments. A classical example is post-rain situation in Karachi, where central government, provincial government, city government, and defence housing authority kept shifting the blame for citizens' miseries on each other.

Is not it strange that the current regime which takes pride in its efforts to strengthen local governments allocates more than double the amount of PSDP funds for central government compared to provincial governments. Can federating governments be strengthened in a federal state where public sector corporations are allocated 25 per cent more amount than the total provincial allocation?

Let us try probing these questions differently. Are allocations and spending the only issues pertaining to PSDP? Perhaps not. There is a major issue of planning paradigm. They say that budget is a planning tool that helps to achieve a vision in a stipulated time by closing the gaps between income and expenditures. This planning tool can't function in a vacuum so it should fit in with given socio-economic and socio-political framework. Unfortunately in our case planning tool (budget) in itself becomes a goal and instead of working within socio-political framework, it tailors its own framework. This new framework is very often far from ground realities. Thus instead of helping us to achieve our broader vision, the budget (the way it is prepared in Pakistan) narrows downs the vision and leads to a situation where one cannot think out of box.

There is another dimension of this issue, which is very rarely discussed in the context of budget and PSDP. To me the fundamental problem with public sector development is the way assignments and the funds to carry out those assignments are distributed between federal and provincial governments.

The constitution of Pakistan defines the functions to be carried out by federal and provincial governments. The federal list functions exclusively belong to federal government and include foreign policy, currency, and defence. The concurrent list deals with subjects that can be dealt with both by federal and provincial governments. Anything that does not fall in either list automatically becomes the responsibility of provincial governments. Many subjects placed in concurrent list were to be handed over to provinces after 10 years of enactment of constitution of 1973. However, it could never happen and many provincial assignments are undertaken by the federal government because it has the fiscal capacity to do so and the latter does not.

No doubt, in Pakistan the federal government has more money as most of the revenue is collected by it. Owing to their peculiar development needs and revenue generation capacities, the provincial governments are dependent on fiscal transfers from federal government. These fiscal transfers are made under the guidance of National Finance Commission (NFC) that was established under Article 160 of the 1973 Constitution. NFC Award comprises of divisible pool (all major federally collected taxes), provincial origin revenue (such as gas or hydro-electric power royalty), and special transfers (grants or loans).

NFC follows article 161 of the 1973 Constitution while distributing provincial origin revenue. Article 161 explicitly stipulates that net proceeds from excise duty and royalties on natural gas collected by the federal government shall be paid to the province in which the well-head of the gas is situated. Likewise, it stipulates that net profit from hydro-power shall be paid to the province in which such power station is situated. This sounds good on paper, but what happens in reality is the opposite and and is perhaps the root cause of reduced fiscal capacity of provincial governments. (see related boxes on natural gas issue in Balochistan and hydro electric power in NWFP).

A related issue of resource distribution that has a direct effect on any development effort in Pakistan is that of inter-provincial (especially between Punjab and Sindh) dispute on water resources (despite the Indus Water Accord of 1991). In my opinion without addressing the resource distribution issues in Pakistan, mere allocation for PSDP by federal governments would not deliver the desired results.

It is about time that efforts are focused on building and strengthening the fiscal capacity of provinces by providing them their due share in resources. Fiscally strong provinces and local governments would be able to chalk out a bottom-up process of development that would be much closer to the aspirations of common masses.

Royalty issue

Balochistan produces almost 40 per cent of the natural gas in Pakistan since 1953. It is on record that Balochistan has received only 12.4 per cent of the royalties due to it from the federal government. The backlog dating back to 1953 runs into tens of billions of rupees. The federal government claims it does not have the funds to pay this back. Effect of nonpayment of royalty on public development in Balochistan might have been compensated by supplying gas to the province. It is an irony that Quetta, the capital city of Balochistan, did not receive gas until 1986 and partially then because a military cantonment had been established there. Even today just four out of 26 districts in Balochistan have gas supply.

Thus Balochistan consumes only 17 per cent of the gas it produces. The province neither receives the due share of gas it produces, nor the royalty. This situation provides the provincial government an excuse not to fulfill its obligations for public development in the province. Hence it is not a big surprise that for the third consecutive year the Balochistan development budget for 2007-08 does not carry any new scheme for want of funds. The Rs13.35 billion development plan for 2007-08 incorporates a foreign funding segment of Rs3.32 billion and an over Rs10 billion local currency component. The local currency component of the PSDP represents the budget deficit remains unfunded.

Balochistan government announced to meet this deficit by way of improving recovery of local taxes, cutting on expenditure and expecting federal straight transfers. In other words PSDP in Balochistan depends on payment of gas royalty.

_Power matters

The story is not very different for hydro-electric power royalty and its crucial role in public development. Most of the hydel power is generated in NWFP. Until 1991, NWFP did not receive any royalty for the hydel power generated in the province. In 1991-92 NWFP government received Rs5.99 billion as net profit for hydro power royalty from federal government. Later on, federal government imposed an annual cap of Rs6 billion on this payment. Now there is a dispute on interpretation of net profit and on the amount of arrears.

More recently an attempt to resolve the dispute between NWFP Government and WAPDA through an arbitration tribunal did not yield any success. As a consequence, NWFP Government is not able to claim and subsequently spend on public development, what is termed in the constitution as provincial origin revenue. Even current NWFP provincial budget has a deficit of almost Rs5.49 billion that provincial government is planning to meet through World Bank funding and expected hydro-power profit payment from federal government.

P.S.

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