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Provinces-IMF meet: anything beyond goodwill?

The provincial finance ministers recently met the IMF. Goodwill messages ensued. If the press releases are any guide, the provincial ministers have assured the fund that they would support the federal government in its attempt to keep the combined fiscal house in order. But not all good wills are meant to morph into reality.

That the provinces should have a balanced budget if not a budget surplus is an old story. The provinces have hardly ever maintained budget surplus; instead post-2010 they have ended up inflating the combined budget deficit. Now that tax revenues are taking a hit – both due to slowing economy and regulatory checks on imports – the divisible pool is shrinking; in such a scenario the provinces can hardly be expected to produce budgetary surpluses.

Or perhaps the goodwill stems from a hopefully strong fiscal coordination committee under the umbrella of the Council of Common Interests, where the federal and provincial finance wonks will arrive at a shared thinking. Given the current scheme of things, this seems wishful thinking.

If media reports are any guide, CM Sindh has categorically disagreed with the federal government's supposed-commitment to the IMF that Pakistan will have single tax collecting agency for sales on goods and services. If anything, as documents available with BR Research reveal, Sindh is very clear that it wants to assign the collection of sales tax on goods to the provinces so they can integrate it with their respective sales tax on services.

In fact, the NFC sub-group-IV that is led by Sindh but has representation from all provinces recently agreed that the matter of delegating the collection powers of the GST on goods to provinces needs to be viewed objectively and dispassionately, "as it promises both the simplification of the taxation system and enhanced revenue generation – a win-win situation for all the stakeholders".

Sindh is proposing a model where in the first year the provinces would collect the GST on goods as per the targets defined by the federal government and collect a fee – say 2 percent of the amount collected as collection charges. Next year, the collection charges shall remain the same for the baseline number but for the incremental amount the charges shall be higher – say 3 percent. And so on in the ensuing years.

In case a province is unable to collect the GST on goods as per the target, then a committee comprising of federal and provincial governments officers shall asses the reasons behind the shortfall. If the shortfall is due to some legitimate reasons such as say draught, or floods, or earthquake or an unfortunate wave of acts of terrorism then, the shortfall may be accepted. Otherwise the shortfall shall be deducted from the federal transfer to the province from the divisible pool.

This seems all hunky dory. Only that in absence of detailed granular data such as provincial GDP, the estimation targets against potential or shortfall against targets will become an affair sorted through political negotiations rather than hard facts. The provincial and federal statistical bodies therefore up their game.

The third possible grounds of goodwill where provinces could support federal government is the latter's demand to allow a 7 percent cut prior to the division of the divisible pool for centre's spending security and federal territories. Provinces have been against that notion for long. Even under the last regime when PML-Nhad power both in the centre and in Punjab, all provinces including Punjab had vehemently opposed the cut.

Now that PTI is in power, certain quarters expect that they will be able to convince Punjab's and KP's finance ministers to agree to the 7 percent cut, or at least a cut of 3-4 percent for security spending. Balochistan too might follow because of coalition of sorts. But Sindh will not – especially given the heated political battle between the PTI and the PPP. Then again, some expect that it is exactly this heightened pressure against top PPP leadership that will perhaps be used as a leverage for them to concede to demands of the pre-divisible pool cut.

If using NAB pressures as leverage against Sindh to give in, is not a part of PTI's plan, then it is very uncertain as to why else will Sindh and other provinces will share centre's fiscal burden. At the end of the day, the discussions will boil down to the expansion of the cake. Even the World Bank's initial latest report on its revenue mobilisation project validates what provinces have been saying for all these years.

"Pakistan has substantial potential to increase tax receipts without imposing new taxes or raising tax rates, which recommends a broad base-low rate approach". A detailed gap analysis "indicates that Pakistan's tax revenue potential would reach 26 percent of GDP, if tax compliance were to be raised to 75 percent, which is a realistic level of compliance for low, middle-income countries," the bank recently said, adding that the tax gap is larger for the GST than for income tax. This only strengthens the case the provinces be allowed to collect GST on goods!

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