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Finance commission: A federation dispute

LAHORE: Provincial budgets have gone awry in the pandemic, as federal government failed to achieve its tax revenue target. The provinces had prepared their budgets on the basis of federal transfers, which they were to get from tax revenue under the National Finance Commission Award.

The pandemic has hit the finances of the federal government badly, but even in pre-pandemic first seven months of this fiscal, tax revenue shortfall was around Rs360 billion after truncating the revenue targets by over Rs300 billion.

That meant even before the pandemic, the provincial shares were already reduced by Rs402 billion. Revenue slippage has remained a hallmark of this regime and in normal circumstances; provinces expect a shortfall of 10 percent.

They are prepared to adjust their budgets accordingly. This time around the provinces have to earmark a large amount of their budget to fight the coronavirus.

All the health facilities are managed by them and they are answerable to the residents of their province in the matters relating to price hike and poverty. In fact, the provinces utilised all available resources to ensure health facilities, provide food ration to the poor, and deploy large police force to ensure that people follow lockdown.

Except for some health gadgets they got no assistance from the federation. The provincial governments were not made even part of the funds distributed to the vulnerable by the federation.

It is next to impossible to take a relief programme of such high magnitude involving over 200 million people federally without involving the provincial or local governments.

On the expected tax revenues of Rs5.5 trillion, provincial share in federal taxes and straight transfers to provinces was estimated at Rs3,254,526 million for fiscal year 2019-20. Punjab was to get Rs1.6 trillion, Sindh Rs815 billion, Khyber Pakhtunkhwa Rs533.26 billion and Balochistan Rs295 billion.

As the revised federal tax revenue projections are only Rs3.9 trillion, the share of provinces being 57.5 percent has automatically declined to Rs2.24 billion.

This is a straight cut of 30 percent for all provinces except Balochistan that is guaranteed the amount given in original revenue collection passed by the National Assembly.

This means Punjab will get Rs480 billion less than what was promised in the original estimates.

Sindh would get Rs244.5 billion less and Khyber Pakhtunkhwa Rs160 billion less.

The federal government is legally right as its tax revenues have nosedived. Even achieving the revised target of Rs3.9 trillion would be an uphill task.

Further, decline in revenue collection would mean further reduction in the share of provinces. But the federal government has somehow been able to get the same resources that it envisaged at the time of presentation of budget.

It is in the form of around Rs533 billion foreign loans that it obtained from multilateral agencies. Its debt servicing cost of around Rs500 billion has been suspended for one year, and the decline in policy rates of the central bank has spared government about Rs500 billion domestic debt servicing cost.

But apart from the last item, the first two would have to be repaid with interest. This amount has simply spared the immediate worries of the federation to enable it to tackle the pandemic.

There has been lot of talk about the skewed distribution of resources between the federation and the provinces.

The federal government tries to generate more resources through indirect taxation that does not fall under income tax, customs duty or sales tax.

The petroleum levy for instance does not fall under the federal divisible pool or the federal excise duty.

These indirect taxes do compensate the federal government to some extent but are implicit tax on the poor. This regime wants to amend the NFC rules, but is facing stiff resistance from the provinces.

It could have created goodwill with provinces by distributing the subsidies as per NFC formula among the provinces from the aid it received from abroad. At the same time, it could have asked them to share the debt servicing burden of this amount when it becomes due in accordance with the amount they received.

This could have paved way for further accords on the loans that federal government receives from abroad and spends around the country.

Moreover, all tax revenue collected by the federal government should come into the federal divisible pool and the share of federal government be increased to a reasonable limit.

Currently, the provinces are at the mercy of federal tax revenues to operate their affairs. The budgets that they prepare have no practical value if they receive fewer amounts. They cannot develop a sustained growth path. The provinces do not exploit their own tax potential because of assured sum from the federal government.