GOVERNMENT OF PAKISTAN

The National School of Public Policy

Report

Public Financial Management–IV

September 9 – 10, 2021

Training Course

Executive Development Institute

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NATIONAL SCHOOL OF PUBLIC POLICY

EXECUTIVE DEVELOPMENT INSTITUTE

The School

The National School of Public Policy is the premier national institution for the training of civil servants in Pakistan. It aims at building their capacity for undertaking tasks of policy formulation and implementation at tactical, operational and strategic levels. The School's training methodology aims at an environment of intellectual freedom amongst participants for investigative analysis, a spirit of rational inquiry, and a genuine desire to seek knowledge. The overarching aim of the NSPP is to improve the quality and effectiveness of public policy its implementation and its management in Pakistan, by improving the quality of in-service training as well as the continuous professional development of officers, executives and associated partners in training.

The Institute

The Executive Development Institute (EDI) is an integral unit of NSPP which provides a platform for the exchange of knowledge and ideas between public and private sectors. The focus of EDI is upon critical policy issues for promoting a better understanding and cooperation between various sectors of the State. The Institute is engaged in the continuous professional development of executives/officers/faculty/ of the public and private sector through training sessions, workshops and policy dialogues. It has also started hosting Webinars on strategic national issues.

The Course

Given the importance of Public Financial Management, EDI has been continuously organizing a series of trainings on topics such as public financial rules, financial policies, programmes, procurements, audit, accounting, and public finances for development. It holds a regular training needs assessment which reinforces the need for a working knowledge of laws, rules, regulations, and processes utilised by the government to mobilize resources, collect revenue and allocate public spending funds for evolving a coherent understanding of the financial matrix of public policy management. PFM is therefore critical for establishing the performance, legitimacy, and accountability of public institutions and private stakeholders engaging in business with the public sector and is therefore a popular Course, generating interest amongst various players of the national political economy.

The Speakers

Due to its popular demand, EDI hosted the 4th consecutive PFM Course on September 9-10, 2021. Seasoned public service practitioners delivered lectures to acquaint participants with contemporary knowledge and essentials of various financial modules pertaining to PFM. The Course attracted a larger number of participants belonging to various ministries/departments/agencies ranging from Ministry of Human Rights, Ministry of Defense Production, Ministry of Railways, National Engineering Service, State Bank of Pakistan, Police Officers from all provinces, Civil Aviation Authority, Solicitor's Department as well as participants from the Academia.

Noteworthy amongst the speakers were:

Mr. Tariq Bajwa:

Former Governor of the State Bank

Chairman FBR

Federal Secretary Finance

Provincial Secretary Finance.

Mr. Hameed Yaqoob Shaikh:

Secretary Planning, Development & Special Initiative Division

Former Chairman Planning and Development Punjab

Mr. Amjad Saleemi:

Legal and Regulatory Reform Expert

Public Financial Management Support Program for Pakistan

Mr. Faisal Rashid:

Senior Consultant PFM Oxford Policy Management

Dr. Hafeez A. Pasha:

Dean of the School of Liberal Arts and Social Sciences, Beaconhouse National University. Former advisor to Prime Minister, Federal Minister for Finance and Economic Affairs, Planning Commission, Education, Commerce, and Trade.

Former Assistant Secretary-General to the United Nations.

Head of the Institute of Business Administration (IBA) Karachi.

Introduction to Public Financial Management

Tariq Bajwa

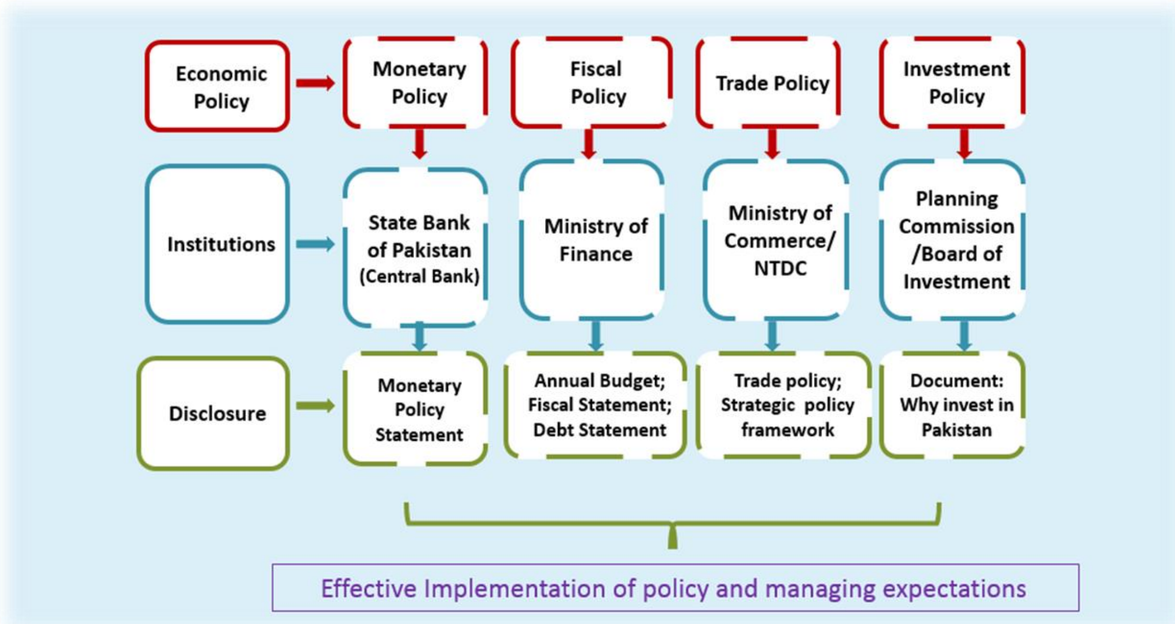
Public Finance Management refers to a set of laws, rules, systems, and processes used by governments to mobilize resources, allocate funds, undertake public spending, account for funds, and audit revenues. A strong, transparent and accountable PFM leads to effective and equitable service delivery and regulates markets more efficiently and fairly. It is important for optimal utilization of public resources, efficient provision of services, getting the most value for money spent, maintaining fiscal discipline, enhancing allocative efficiency, equity and redistribution of wealth in a transparent and accountable manner.

There are five elements of PFM:

Policy formulation involves the special attention of civil service and thinks-tanks to provide policy options to legislators debating policy based on evidence. In Pakistan, there is a paucity of data based decision-making primarily due to the absence of information or unreliable data for making rational decisions. There are five types of polices formulated with relevant institutional support which are listed as follows:

1. Economic Policy
2. Monetary Policy (Interest and Exchange Rate)
3. Fiscal Policy (Budget)
4. Trade Policy (Import and export)
5. Investment Policy (Investment Climate and Regulations)

Figure-1: Institutional arrangements in Policy Formulation



The Budgetary process involves careful deliberations to assess the balance between expenditure and revenue. Third-party evaluations make the systems more efficient and transparent to identify loopholes and plug gaps. Three macroeconomic indicators are important to improve economic processes:

i- Savings Rates

ii- Trade Gap

iii- Direct Investment.

For improving fiscal management, there is a need to cut down expenses and tap the full potential of taxes by increasing the ratio of direct taxes from 46% to 65%. Shrinking of indirect taxes may also be an option requiring careful consideration. The capacity of FBR for imposing taxes on non-revenue taxes requires strengthening. There is also a need for encouraging investment on mega development projects for tax generation and redesigning the process of taxation on the non-traditional sectors of the economy (agriculture sector). It is also necessary that the system of tax collection is kept free from political interference and elite capture.

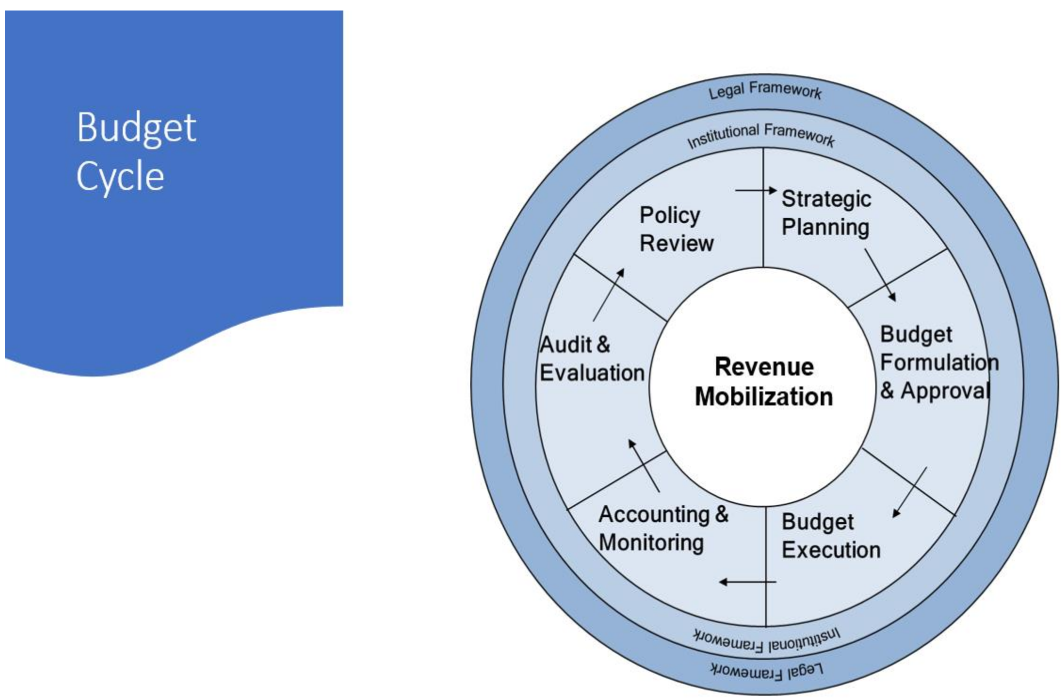
Introduction to Budget

Hamed Yaqoob Sheikh

The annual Budget statement as stipulated in Article 80 of the Constitution which states: '*the Federal Government shall, in respect of every financial year, cause to be laid before the National Assembly a statement of the estimated receipts and expenditure of the Federal Government for that year'*. Whereas Article 118-126 deals with matters related to the presentation and approval of the Budget and Supplementary Budget at the provincial level from the Provincial Consolidated Fund.

The cycle of the Budget entails various processes within a legal and institutional framework. The budget cycle starts from Strategic Planning to a Formulation Process and onto the getting of Approvals. The next step is Execution within Ministries and Line Departments followed by Accounting and Monitoring with Audit and Evaluation which again undergoes a Policy Review for finalization.

Figure-11: Budget Cycle



Budget making involves estimates of expenditure in light of policies of government and guidelines. The estimates of revenues regarding taxes, duties, levies, and other sources of sale and privatization are also important for anticipating the fiscal space for development. Resource mobilization is another important element of Budget where all divisions and departments are issued instructions for reviewing existing revenue streams and finding out ways and new sources for revenue. The Resource Mobilization Committee after extensive consultation presents the Budget to the Cabinet for approval.

Recurrent and Development Budgets are presented to the Assembly after approval of Cabinet for every Financial Year. The Recurrent Budget comprises recurrent and repetitive expenditures with annual increments and inflationary effects. Whereas Development Budget covers estimates of funds proposed to be spent on development projects for improvement in knowledge, skills and physical infrastructure.

For improving fiscal performance, there is a need to explore the optimal potential of non-revenue sectors such as livestock in the Agriculture Sector. There is also a need to fool-proof estimations as well as timely release of funds to avoid overestimation in the Budget which generally occurs due to late release of funds and delays in the execution of projects.

Fiscal Federalism and National Finance Commission Award

Tariq Bajwa

Fiscal Federalism is the theory of relationships between the federal government and provinces. It sets out principles regarding the proper division of taxing and spending powers amongst the federal and provincial governments. The government carries out the distribution of resources according to stipulated law, particularly Article 70 of the Constitution, which restricts the Parliament to subjects mentioned in the Federal Legislative List.

The Federal Consolidated Fund constitutes all revenues collected from the Federal Government, including all loans and their repayment. The distribution of fiscal powers and the distribution of revenues between the federation and the provinces is laid out in Article 160 of the Constitution.

The Divisible Pool refers to the taxes of the Federal Government that it shares with the Provincial Governments as per the recommendations of the NFC Award. All major taxes of the Federal Government except levies and cess are part of the divisible pool. These include taxes on income, wealth tax, capital value tax, taxes on the sale and purchase of goods, exports, Customs and Excise duties and any other tax levied by the Federal Government.

The President constitutes the National Finance Commission (NFC) after every 5 years which includes Federal and Provincial Finance Ministers, and one representative from each Provincial Government. The NFC is responsible for distribution between the Federation and the Provinces of net proceeds of taxes forming the Divisible Pool and the making of Grant-in-Aid to the Provincial Government. It also oversees the exercise of borrowing powers by the Federal and Provincial Governments.

Figure-11I: Layout of NFC

The National Finance Commission (NFC)
• The 7th NFC award was signed in December 2009 and has been in force since FY11. • NFC makes recommendations after every five years in the areas including distribution of the net proceeds of defined taxes, grants by the federal government to the provincial governments, the exercise of the borrowing powers by the federal and provincial governments, etc. • 8th NFC (2010-2015) – No recommendations from the Commission. • 9th NFC (2015-2020) – Few meetings have been held but no consensus on recommendations so far. • 10th NFC (2020-2025) – One meeting has been held so far.

Over the years there is a practise of allocating funds to the federal government for debt servicing. This diverts resources away from development projects especially in the provinces which critically need funds for development particularly in health and education. The graph below reflects the spending of the government on education and health.

Figure-IV: Government Expenditure on Health as percent of GDP

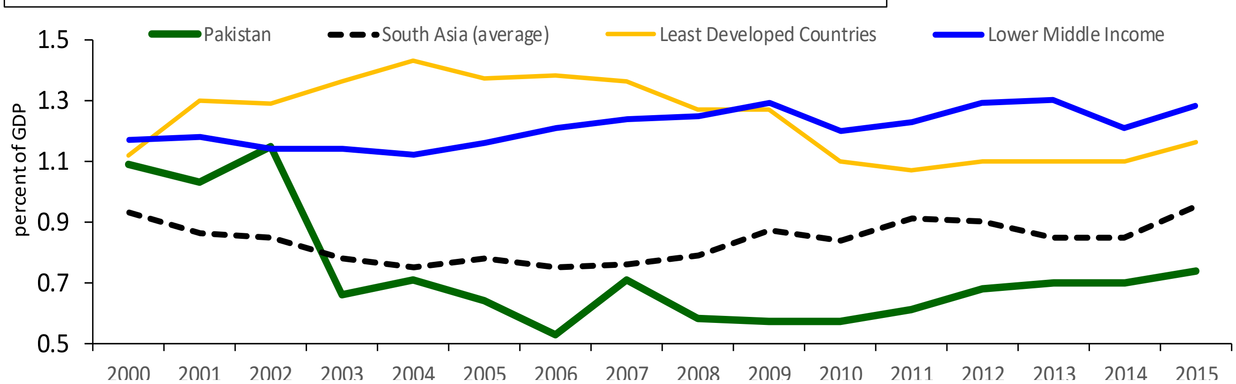
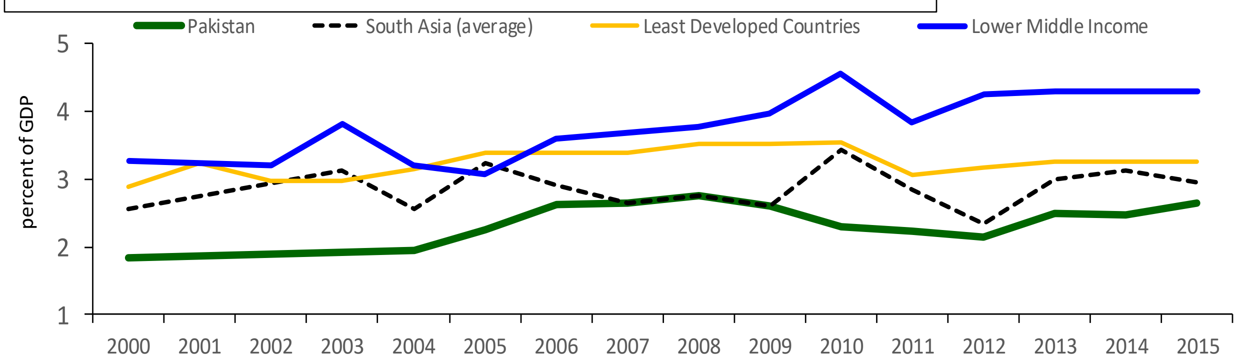


Figure-V: Government Expenditure on Education as percent of GDP



The graph reveals that Pakistan’s spending on education and health is least in the region as compared to the other countries of South Asia. The dismal picture reveals that the spending of Pakistan in health is even less than the spending in the lower middle income and least developed countries.

The same analogy of less spending is depicted on education which is again the lowest in the region as least developed countries spent 3 per cent and lower middle income countries spent 4 per cent in the region during 2015.

There is a need to increase development spending by improving the tax collection mechanism. In this regard removal of tax exemptions and subsidies is necessary. Furthermore, resource mobilization between provinces and federal government can be improved by charging non-tax revenue and exploiting the potential of GST (General Sales Tax) on services. The exercise of running Zero-based budgeting (ZBB) in every year which is a method of budgeting in which all expenses must be justified for each new period can be considered. In this process budgeting starts from a "zero base," and every function within an organization is analyzed for its needs and costs.

Public Procurement

Faisal Rashid

Public procurement is acquisition of goods, services or rendering of works financed wholly or partly out of public funds. It includes disposal of public assets and commercial transactions between the procuring agency and private party in terms of which the private party is allowed to perform a procuring agency's assigned functions including operations and management.

The objectives of procurement are to assure value for money, encourage competition, promote transparency & fairness and strengthen the economy efficiently. The process of procurement follows a cycle that starts from planning in the light of need assessment, budgetary planning and market analysis. The next is the formulation of bidding documents comprising of detailed specifications, a procurement method, and a criterion which furthers tests for prequalification to evaluate the bid in terms of its technicality and financial feasibility. The final stage is contract award and management after the settlement of payment schedule and then pre-shipment inspection, arbitration, and closure.

The procurement process is well-defined, however some challenges arise due to a lack of understanding regarding PPRA rules and regulations. There are also problems regarding negotiation skills, direct contracting, weak monitoring & inventory management, lack of transparency as well as rent seeking behaviour. In such a situation, getting technical expertise from qualified and experienced consultants is important to assure value for money. Furthermore, e-procurement methodology is essential to ensure that the strategy is not limited to only online submissions. It requires complete digitization of the procurement process, end-to-end business process and a single sign-on for suppliers across provincial and federal e-procurement portals for greater supplier efficiency. The e-procurement requires a strong legal framework for the protection of data as well as developing a cadre of procurement professionals.

Exemptions in following a competitive process for procurement are only allowed in emergency cases with a well-defined justification. In case of getting only a single bid, procurement is allowed if pre-set criteria are fulfilled. The economies of scale can be achievable by promoting e-procurement in order to target a larger community.

Audit and Accounting

Amjad Saleemi

Accounting

Accounting is defined as a systematic process of identifying, recording, measuring, classifying, verifying, summarizing, interpreting and communicating financial information. Recording of execution of financial transactions is known as the accounts of an entity. An accounting entity is any unit of Government (e.g. ministry, division, and department) whose principal source of funding is an appropriation from the Federal or Provincial Government. Accounts provide information on the resources available to an entity, the means employed to finance those resources, and the results achieved through their use.

Legal Provisions

Article 170(1) of the Constitution:

"The accounts of the Federation and of the Provinces shall be kept in such form and in accordance with such principles and methods as the Auditor-General may, with the approval of the President, prescribe".

The Auditor General of Pakistan has been assigned the responsibility to decide the form, principles and methods to keep the Accounts.

Appropriation Accounts and Financial Statements, compiled by the Controller General of accounts (CGA) on the basis of the information available in June supplementary accounts, reflect the following entries:

a) Original Budget

b) Supplementary Grant,

c) Revised Estimates

d) Actual Expenditure

The Appropriation Accounts, duly certified by the Auditor General of Pakistan are submitted to the President by the CGA, to be laid before the National Assembly. Likewise, Provincial accounts are submitted to the Governor for submission before the Provincial Assembly.

Auditing

Audit is a systematic and independent examination of data, statements, records, operations, and performance of a government/organization for a stated purpose such as regulatory compliance, operational effectiveness and financial accuracy.

In general terms, "Audit" is an official inspection of an organization's accounts by an independent body. It is a systematic and independent examination of books, accounts, statutory records, documents and vouchers of an organization to ascertain how far the financial statements as well as non-financial disclosures present a true and fair view in the concern.

Constitutional Provisions of Audit

According to the amendment in AGP Ordinance 2001, audit includes regularity audit, information technology audit, environmental audit, forensic audit, performance audit, management audit, special audit and any other kind of audit, report or analysis deemed appropriate by the Auditor-General. The Audit Report containing Audit Paras is placed before the Provincial Assembly and referred to the PAC. The response of the department is considered by the PAC and settled if the response is found satisfactory, otherwise appropriate directions are issued.

The Public Accounts Committee submits its report to the National assembly or Provincial assembly. This is followed by the implementation of PAC recommendations by the Government.

Auditor's General Ordinance, 2001

i. Audit all expenditure from the Consolidated Fund of the Federation and of each Province and to ascertain whether the moneys shown in the accounts as having been disbursed were legally available for, and applicable to, the service or purpose to which they have been applied or charged and whether the expenditure conforms to the authority which governs it;
ii. Audit all transactions of the Federation and of the Provinces relating to Public Accounts;
iii. Audit all trading, manufacturing, profit and loss accounts and balance sheets and other subsidiary accounts kept by Order of the President or of the Governor of a Province in any Federal or Provincial department

iv. Audit, subject to the provisions of this Ordinance, the accounts of any authority or body established by the Federation or a Province, and in each case to report on the expenditure, transactions or accounts so audited by him.

Internal Audit is conducted to ensure compliance with laws and regulations and to help maintain accurate and timely financial reporting and data collection. Internal auditors work for the organization as internal employees to examine records and help improve internal processes such as operations, internal controls, risk management, and governance.

Audit Reports

The Audit Report containing the Audit Para is placed before the Provincial Assembly referred as the PAC. The response of the department is considered by the PAC and settled if it is found satisfactory or otherwise appropriate directions are issued.

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Public Finances for Development

Dr. Hafeez Pasha

Over the last two decades, development budgets have been shrinking although it is an essential variable for the progress and security of the country. The graph of development spending reflects an inverted 'U' shape. It slid to 3% Gross Domestic Product (GDP) in 2001 then rose to 4.8% during 2017-2018 and plummeted to 2.6% subsequently. This has led to a pressing need for improving the efficiency of public spending. Revenues have also indicated an inverted "U" shape trend.

In the two decades efforts to mobilize revenues have not met much success. Increasing the tax-to-GDP ratio and improving non-tax collection remains a formidable challenge. In 2001, tax revenues were less than 10% of GDP and then rose to 17% in 2018 but declined to 11.9% in 2020. There is a continuous rise in spending and decline in revenues leading to a consequent budget deficit which has been spinning out of control. It had been 5% of GDP in 2001 but it hit an all-time high of 9% in 2019. Recently, the government has been able to bring it down to 7% but at the cost of a cut-back in development spending.

Shortage of revenue has severely impacted development spending in Pakistan. It has been consistently axed to control the escalating budget deficit and exponential growth in spending. The share of direct taxes has shrunk from 4.5 to 3.5% from 2018 to 2020. This indicates that the tax system has become regressive. There is a deepening cleft in fiscal balance between the Federal and Provincial governments. The current NFC award has increased the shares of provincial governments in the Divisible Pool taxes from 47.5% to 57.5%. Resultantly provincial current expenditures have gone up from as estimated 3.5% to 6% of GDP from 2018 to 2021.

The faltering state of State-Owned Enterprises is a cause of concern. Some of the SOEs are contributing to rising debts. Despite this, the contingent liability of the government to provide subsidies and debt guarantees to SOEs is very high (approximately 2.4 trillion rupees). Public debt is 83% of GDP (Approx).

Programmes of the International Monetary Fund (IMF) have stringent conditionalities. The government's obligations to follow the guidelines of IMF result in exacerbating fiscal pressures on citizens. The lingering liability of the government to pay pensions and salaries create financial constraints to manage resources optimally.

There is a need to plan Budgets in line with sectoral priorities, where high growth-oriented projects should be allocated a high share of the budget. There is a need to take the growth rate to 6%. For this, the system of taxation needs re-designing and reform to rid it of its structural inefficiencies. The potential of taxes for non-traditional sectors needs to be tapped such as from agriculture and immovable property. Public offices should perform services free from elite capture and political influence. Last but not least, there is a need to increase the capacity of officers to complete projects on time.