

Chapter 2: Background Information on NWFP

2.1 Description of economic situation

2.1.1. NWFP is the third largest province of Pakistan. The province is landlocked and the land routes to the north are few and difficult, passing through hilly terrain. The province itself is largely mountainous, with only 30 percent cultivated land. Nearly 50% of the population lives in the mountainous and arid areas. The province shares a long border with eastern and southern Afghanistan and most of its population has the same ethnic background (Pushtoon) as parts of bordering Afghanistan.

2.1.2. The estimated per capita income of the province is approximately 30% lower than Pakistan's average, with a population share of around 13%. Historically, the provincial economy has been mostly dependent on agriculture (livestock, timber, tobacco, and horticultural production), services, public employment especially in the armed forces, and low skilled workers remittances from inside and outside the country. The province has been growing for a number of years at an economic rate that does not match the population growth rate. This has contributed to under-development and to depleting natural resources in the province.

2.1.3. A powerful earthquake measuring 7.6 on the Richter scale struck the northern areas of Pakistan on October 8, 2005. Five districts in the NWFP – Abbottabad, Batagram, Kohistan, Mansehra, and Shangla – were severely affected. These five districts account for nearly a quarter of the province's geographical area and 17 percent of its population. Reconstruction costs are put at over \$1.5 billion in addition to the costs associated with compensating families for loss and injury and relief for survivors. Even with generous donor support, the bulk of the requirements will have to be met from Pakistan's own resources. Depending on how much of the costs of relief and reconstruction will be borne by the GoNWFP, this would continue to require adjustments in consumption expenditure in the budget, reprioritization of investments and other expenditures, the postponement of some projects, a larger effort at mobilizing resources from within the province, and perhaps additional borrowing from external sources over the next several years.

2.2 Description of Budgetary Outcomes

2.2.1 The revenue and expenditure budgets of NWFP are characterized by sporadic adjustments on a year to year basis due to (a) the high degree of reliance on the federal government for transfers as a result of the NFC Award; (b) the unrealized expectations relating to revenue receipts from the *hydel profits*; (c) the low own-revenue potentials which require proper study with a view to enhancing those potentials through improved tax policies, assessment and collection strategies; (d) reasonable good aggregate out-turns in terms of total budgeted revenues vis-à-vis total actual revenue receipts; and (e) uneven out-turns in terms of composition of budgeted revenues and expenditures vis-à-vis actual receipts and expenditures in any single year as a result of in-year re-allocations between functional classifications. Notwithstanding all these, the province has always strived to maintain its fiscal deficit situation at affordable levels. With annual resource flows from the World Bank and other development partners by way of *Credits and Grants*, the province has been supported in meeting its service delivery needs amidst its continuing overall liquidity constraints.

2.3 Legal and Institutional PFM Framework

2.2.2 As per the Constitution, Federal and Provincial Assemblies authorize expenditures on services to the people that are budgeted to be voted each fiscal year. The range and composition of

the services that will be provided are determined each fiscal year by the respective National and Provincial Assemblies. The Constitution also provides for charged or obligatory expenditures on constitutional positions (such as the President, High Court Judges, Chief Election Commissioner, and the Auditor General) as well as for debt servicing. As for the District Governments, the respective *Zila* Councils are the district equivalents of the federal or provincial Assemblies, and they generally perform the same functions.

2.2.3 Public sector bodies are well defined in the financial system by major type of entities such as (i) Departments of the Government administered directly by the Federal and Provincial Governments; (ii) autonomous bodies that are indirectly administered by their respective governments. Government departments are further divided into centralized accounting agencies and self-accounting agencies. Autonomous bodies are also divided into two categories: (i) statutory bodies established for non-profit objectives; and (ii) public sector enterprises.

2.2.4 The 1973 Constitution was far reaching in its emphasis on financial management and provides (in Articles 79, 166, 168 and 169) for the following three enabling legal frameworks:

- i) On public finance — this law is expected to prescribe how the budgets would be prepared and monitored, and also evaluation mechanisms for assessing the performance of the government vis-à-vis the resources placed at its disposal, and internal controls over finances;
- ii) On public debt management — this law is expected to be designed to prescribe the objective criteria for borrowing (both internally and externally) with a view to minimizing the probability of misuse or waste of borrowed resources, to restrict the quantum of aggregate borrowings both in absolute and relative terms to ensure that debt servicing remains within reasonable limits (sustainability), and to ensure transparency and efficient management of debt; and
- iii) On public sector audit — this law is expected to be structured to provide the basis for independent and competent verification of the truth and fairness of representations of the executive with regard to their stewardship of public funds and achievements concerning the use of allocated resources.

2.2.5 There is no separate Public Finance Law in Pakistan. The Constitutional provisions are, in themselves, quite detailed and provide the enabling operational basis for public finance management in the federation. However, on an annual basis, an Appropriation Law is promulgated to cover aspects relating to public expenditures in pursuance of the annual budget; also a Finance Act that covers public revenues in pursuance of the annual budget is promulgated annually.

2.2.6 In respect of the Public Debt Management Law, the federation has promulgated a Fiscal Responsibility and Debt Limitation Law (FRDL) that covers the thrust of what the Constitution envisaged. This Law is being followed across the federation.

2.2.7 As regards the Public Sector Audit Law, there existed the Pakistan (Audit and Accounts) Order 1973, P.O. 21 of 1973 that was repealed in 2001 and replaced by two sets of legislation that also caused the bifurcation of the audit and accounts - the AGP and CGA Ordinances of May 2001. The foundation for these latter laws is contained in Article 169 of the Constitution and they govern the audit and accounting processes in NWFP as well as the other provinces. The General Financial Rules and the Treasury Rules, which are largely obsolete, require updating for consistency with the renewed GoNWFP's operational accountability practices.

2.2.8 Budget preparation has historically been primarily short-run, input focused, and incremental with little prioritization of expenditures. The use of the budget as a tool for implementing strategies towards achievement of policy goals of the government has been limited.

2.2.9 The basic framework for assignment of fiscal powers and distribution of revenues between the Federation and Provinces (including districts) is laid down in the Constitution. To allow for the distribution of fiscal resources, a divisible pool has been created whereby the net proceeds of specified taxes collected by the Federal Government are pooled and the Federal Government and the Provincial and Local Governments share in the pool. Under the Local Government Ordinance 2001, a number of public service functions have been devolved to local governments elected at the district and sub-district levels. Fiscal Commissions have been established to manage the apportionment of the shares in the divisible pools.

2.2.10 In NWFP, the provincial line departments prepare their respective salary and non-salary budgets. The non-salary is classified as development and non-development. The Finance Department (FD) then compiles the annual budget. The Provincial Planning and Development Department (P&DD) prepares an annual Public Sector Development Program (PSDP) which makes up the total development budget for the province. PSDP planning and execution has not been devolved to the local governments at the district and sub-district (Tehsil) levels. The Provincial Finance Commission (PFC) makes the award for provincial budget transfers to the district governments. The provincial government maintains a provincial consolidated fund account, public account, and food account with the State Bank of Pakistan.

2.2.11 The executive-approved budget is presented to the provincial legislative assembly along with the demands for appropriations. The revised budget (including supplementary appropriations) of the preceding fiscal year is also presented to the assembly. The budget book and supplementary documents are debated by the legislative assembly and approved following the due process. The provincial releases are made directly to the projects and schemes through the executing agencies through their respective 'Budget' Drawing and Disbursement Officers (DDOs). The releases for District Governments are made in accordance with PFC award and the budgets are locally scrutinized and approved by the District Councils following the intimation of projected annual releases.

2.2.12 The DAOs maintain the accounts at the district level for all the funds releases. The provincial Accountant General maintains the appropriation and finance accounts. The reconciliation of fiscal accounts at the provincial and district levels is faced with certain challenges due to the weak capacity at the DAOs as well as the non-compliance of the line departments with the accounting procedures and requirements but the NWFP has been the best performer amongst the four provinces in Pakistan on reconciliation levels over the years. With computerized FMIS under PIFRA having been recently completely rolled out to all districts in the province, the erstwhile problems associated with reconciliations can now be averted.

2.2.13 Audits of regulatory compliance and the annual district and provincial accounts are performed by the Auditor General of Pakistan (AGP) every year. The audit paragraphs (advance audit paras.) making up the audit report are scrutinized by the Departmental Accounts Committees before the adjusted report (draft audit paras.) is forwarded for scrutiny to the Public Accounts Committee (PAC) of the Provincial Legislative Assembly. At the PAC, following due deliberations, the forum can recommend punitive actions such as making recoveries through surcharges, other forms of sanctions, or may drop the audit paragraphs entirely, following justification from the concerned quarters that can convince the committee members. They are also responsible for getting their decisions implemented through the relevant departments although the enforcement mechanism is weak or non-existent.

2.2.14 The Administrative Secretary of the concerned department, as the Principal Accounting Officer, has a mandatory task of properly keeping memorandum accounts, monitoring and

controlling public expenditures in line with the budget, and ensuring proper financial transactions in the department.

2.2.15 With the new devolution of powers promulgated through NWFP Local Government Ordinance (NWFP-LGO 2001), financial management is required to be decentralized to the district, *tehsil* and down to the union council levels. Each government tier is supposed to have its own budget planning, implementation, accounting, and financial reporting, as per the rules. The *Zila* Accounts Committees (ZACs) are being formed at the districts and *tehsils*; however there is little progress in establishing these committees across the province, and neither are the ones established effectively functioning. There is a great confusion over the interpretation of rules, regulations and powers as delegated by the LGO 2001. There is a requirement of great importance to get the district governments report their accounts in a timely and structured manner to the FD. Reconciliation level for expenditures stands at an average of only 97% which is considerably higher than the averages for other provinces.