

**SUB-NATIONAL GOVERNMENT TAXATION:
CASE OF PROPERTY TAXES IN PUNJAB, PAKISTAN**

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August 2016

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Summary

Property taxes tend to be under-used globally, especially in developing countries. This is particularly true in Pakistan. To explore the reasons, I studied policymaking and administration in relation to the recurrent (annual) property tax in Punjab, Pakistan's most populous and urbanised province. I used a mix of research methods, including extensive field observations of how the lower level tax staff of the Excise and Taxation Department go about their work.

I found three major probable explanations for the very low levels of property tax collections:

- Especially after a major decentralisation reform in 2001, responsibilities for collecting the property tax and the revenues it produces are both divided in complex ways between three levels of subnational government. Each level has low incentives to perform its tax collection functions.
- Each level of subnational government obtains most of its income either from transfers from higher levels of government or from loans. It generally seems easier for them to increase their incomes by putting more effort into tapping these sources, rather than trying to improve their own tax collection performance. The lack of strong political pressures to increase spending has a reinforcing effect.
- It has become administratively difficult for senior policymakers to increase property tax revenue collections through mobilising the organisational resources of the Excise and Taxation Department. Property tax collection has become locked into a system that combines (a) a high degree of informality in routine practices, (b) exclusive control of detailed information about tax collection potential and performance by lower level staff and (c) modest rent-taking and responsiveness to local pressures for leniency in tax collection at these lower levels. When higher-level officials in the Department attempt periodically to enforce the achievement of higher tax collection targets, they are mostly frustrated by these informal working practices and relationships.

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Acknowledgements

Perhaps no PhD project goes smoothly without the full support of supervisors. In my case this is especially so. When I started my PhD, after serving fifteen years in the Pakistani civil service, I left behind the creature comforts of the bureaucracy, but brought along the South Asian ‘bureaucratise’ that Mick Moore constantly pointed out and I struggled to shed off. I have probably not been fully successful in doing that, but I would like to record that it was not due lack of persistence on Mick’s part. The biggest contribution to this thesis and my gratitude in the same proportion is for Mick Moore. He not only supervised my academic work but also took charge of my general and physical well-being. I immensely enjoyed cycling to the University and Mick’s walking excursions, exploring the South Downs. Anuradha Joshi’s contribution to my work complemented Mick very well. It was provided at critical junctures, often when Mick and I thought we needed a fresh pair of eyes.

I would not have embarked on my doctorate if Shandana Mohmand had not encouraged me to apply to IDS to work with the Governance Team. Throughout my stay at Brighton, Shandana and Miguel Louriero constantly supported me in multiple ways. I thank them for going out of their way to help me and also for introducing me to Andres Mejia Acosta, my flatmate and my unofficial ‘third supervisor’. Andres was immensely patient with me when I clobbered him with ideas about my work first thing every morning, ‘even before his coffee’, as he often reminds me! The Governance Team generally was very helpful and accommodating. I benefitted from informal discussions with David Leonard and Richard Crook at IDS and others during the reading group get-togethers. I am also grateful for very useful guidance provided by Odd-Helge Fjeldstad and Will Prichard during the formative phases of this work. I would also like to thank Caroline, Adam, Simon and Camilla, of the Governance and ICTD teams for their support; and the dedicated team at the British Library of Development Studies.

I owe a special debt of gratitude to my colleagues in the PhD room. Many faces changed during my four years at IDS but what persisted was the spirit of camaraderie and mutual support readily available both for professional and personal matters. It is an excellent support group, almost an academics’ anonymous! I am indebted to Ricardo Santos for taking the time to help me with some of my quantitative analysis, and to Machiko Tsubura for commenting on some of my draft chapters. I would like to especially thank Shilpi Srivastava, Ana Solerenzio, Marika Djolai, Maisa Shuiqerat, Yashodhan Ghorpade, Alia Aghajanian, Yasamin Alkhansa and many others who made this experience memorable and bearable at the same time. I would specially like to thank Camilla Lindstorm for discussions over our ritual coffee breaks and Mette Hartmeyer for her passionate and insightful views on Pakistan. I would like to acknowledge the support provided by PhD convenors, Linda Waldman and Jeremy Allouche. I am most grateful to Angela Dowman for prompt administrative support and words of encouragement, in moments when they were most needed.

I am grateful to my friends and family in UK for their moral support. They provided me with home(s) away from home during holidays and much needed breaks. Mohsin Shameem, Patrycia and their children were very kind and welcoming. My cousin Dr Salahuddin, his wife Lubna and their children were immensely hospitable. I found Nadir Cheema’s bachelor pad an excellent meeting place for Pakistan scholars in London.

I would like to thank a number of academic colleagues and friends in Pakistan, the UK and the US who I met a number of times over the course of my PhD and discussed my research. Ali

Cheema, Asim Khawaja, Adnan Qadir Khan, Haris Gazdar, Irfan Muzaffar, Omar Masud, Rab Nawaz and Kamran Ali Afzal offered very helpful insights into my project. I would especially like to thank Patrick Doherty, for his very helpful insights into property taxation in Punjab and for sharing his work with me. I am grateful to my sister Dr Rukhsana Zia and my nephew Dr Bilal Ahsan Malik for constant support and guidance throughout my doctorate.

This PhD would not have been possible without numerous colleagues in the Punjab government who helped me collect data. I would like to especially thank Shehreyar Sultan, Muhammad Arshad, Faisal Rasheed, Ahmad Raza Sarwar and Socrat Aman Rana. I would also like to acknowledge Syed Basit Aly and Waqas Ahmad for their promptness in helping collect data from the State Bank of Pakistan. I would also like to thank Imdad Bosal, Zahid Zaman, Khurram Agha and Nadeem Mahboob for hosting during my fieldwork. I would especially like to thank Imdad Bosal for making sure I got extra time from the government to finish writing up my thesis. I am grateful to Dr. Raheal Siddique, Mueed Khan, Salman Humanyun and Huma Ahsan for support and assistance towards the end of this project.

For obvious reasons I cannot name the officers and ranks of the Excise and Taxation Department who hosted me for six months and shared their experiences with me. I only hope I have done justice to the rich information they provided.

I am greatly indebted to the Government of the Punjab and the Planning and Development Department for providing financial support to undertake my PhD, especially Sohail Ahmed for extending my scholarship for the fourth year.

Lastly, I would like to thank my children Myra and Minahil for their love and support, and understanding why I had to spend so much time away from them over the last four years. I would also like to thank their mother, for taking care of them while I was away. I am thankful to my siblings Farzana, Roeeda, Neelofur, Sarah and Seemi, and brothers-in-law, Tauseef, Saleem, Sajjad and Sabahat for always being there for me. I am indebted to my wife Mette Hartmeyer for encouraging me through this tough journey.

I am much obliged to my examiners, Will Prichard and Matthew McCartney for very insightful comments that greatly improved this thesis.

This thesis is dedicated to my children

Myra and Minahil

In the hope that they will one day read it,

And in the loving memory of my parents

Ghulam Murtaza Piracha and Surrayya Jabeen

Who would have been proud to see me get this far.

Abbreviations

AETO	Assistant Excise and Taxation Officer
AIT	Agriculture Income Tax
ETD	Excise and Taxation Department
ETO	Excise and Taxation Officer
FY	Financial Year (1 st July – 30 th June)
GDP	Gross Domestic Product
GIS	Geographic Information Systems
NFC	National Finance Commission
O&M	Operations and Maintenance (costs)
OECD	Organisation for Economic Co-operation and Development
PFC	Provincial Finance Commission
PLGO	Punjab Local Government Ordinance (2001)
TMA	Town/ <i>Tehsil</i> (sub-district) Municipal Administration (Town government)
UNDP	United Nations Development Program
UNICEF	United Nations International Children's Emergency Fund
USD	United States Dollars

Glossary of local terms

<i>Marla</i>	Unit of land; about 25 square yards
<i>Naib-Nazim</i>	Elected vice chairperson at the three levels of local government
<i>Nazim</i>	Elected head/ chairperson of the local government at the District, Town and Union levels
<i>Paisa</i>	Unit of Pakistani currency; 100 <i>paisa</i> = 1 Rupee
<i>Patwari</i>	A lower level official of the Land Revenue Department; he maintains the ownership record of rural properties
<i>Pugree</i>	Lump-sum payment (it is a usual practice when purchasing shops, to give one large upfront payment followed by monthly instalments)
<i>Tehsil</i>	Sub-district jurisdiction; Town (second tier of local government)
<i>Ushr</i>	Islamic tax on farm produce
<i>Zakat</i>	Islamic tax on savings
<i>Zila</i>	District

1 Why is property tax in Punjab so low?

1.1 Introduction

This thesis is concerned with finding reasons for exceptionally low property tax collection in Punjab, Pakistan's most populous and urbanised province. I first got interested in the issue of low property tax as a senior civil servant while heading a provincial public sector reform programme supported by the Asian Development Bank, in 2008. The Punjab Government Efficiency Improvement Programme was initiated in 2002. It partly focused on increasing sub-national¹ tax collection in Punjab. Property tax was high on the reform agenda because it is a local government tax; and Pakistan had a major decentralisation reform in 2001 that substantially increased local government responsibilities for service delivery. Since most property tax functions are performed by the provincial government, extensive policy advice and technical assistance was provided at the provincial level, over the decade of the 2000s. The provincial government repeatedly committed to its aid donors that it will increase property tax collection. Despite this, and all the efforts supported by the aid donors, in real terms, property tax collection declined substantially over the last ten years (see figure 1.1).

When I started investigating the case of property tax in Punjab for my doctoral research, I realized that property tax collection is universally low, compared to its potential. There are a number of reasons cited for low property tax collection all over the world: property tax is unpopular, which can lead to political resistance; since it is a local government tax, higher level governments may oppose increases in the tax; property tax functions are usually divided between different levels of government, the higher level governments may not have incentives to perform these energetically; property revaluations are not conducted as often as they should be, which erodes the basis on which the tax liability is calculated; there can be a number of problems with tax assessment, collection and enforcement; and finally chances of collusion between taxpayers and tax collectors can be relatively high.

¹ In this thesis I use the term '**sub-national**' to denote the provincial government and all the levels of local government below it. '**Local governments**' denote three levels – the district, town and union –under the Punjab Local Government Ordinance (2001). In Punjab province there are 36 district jurisdictions that comprise 144 town jurisdictions, which in turn comprise about 4,000 union jurisdictions. The union level is not concerned with property taxation. Out of the 36 districts, the five (most populous and urbanised) are declared as City Districts.

Given these reasons, Punjab's exceptionally low property tax collection should not be surprising. In the case of property tax in Punjab, experts (mostly aid donor consultants) point out that low collection is due to a number of reasons, including a high level of exemptions; a non-expanding tax base despite rapid urbanisation; failure to revalue properties; remissions for owner-occupied properties; weak administrative and accounting systems; low-skilled tax collectors etc. But these reasons only touch the surface. Low tax collection, as I show through my research has deeper underlying causes, which have largely not captured the attention of scholars of taxation so far.

Thus, in this thesis I ask the question: what are the deeper structural reasons that explain low property taxation in Punjab? Are the factors suggested by the literature simply overwhelmingly present in the Punjab? Or are there other, hitherto unexplored dynamics at play?

To answer my main question, I carried out an in depth study of property taxation in Punjab. In Punjab, there are various kinds of taxes levied on property, including those on its ownership and transfer. This thesis is only concerned with recurrent (annual) property tax in urban areas.² I use the term 'property tax' in its most common sense to mean recurrent (annual) tax on immovable property (land and/ or improvements) in urban areas (Norregaard, 2013).³ I used mixed research methods, that included investigating the question at various levels of government and observation of tax collectors in field offices of the provincial Excise and Tax Department (that collects property tax) over a period of six months out of a full year's fieldwork.

What I found was eye-opening. While the factors mentioned in the literature were no doubt present, on the ground there was a whole set of additional factors that led to perverse performance. Three dynamics stand out. First, especially after a major decentralisation reform in 2001, responsibilities for collecting the property tax and the

² Five separate charges are levied on the formal transfer of ownership of real estate. They are significant to this thesis only to the extent that they (the first four named below) collectively provide more revenue for sub-national governments than does the property tax. The levies are: (i) Stamp Duty on transactions; (ii) Registration Fee for recording changes in property ownership; (iii) Capital Value Tax on transfers; (iv) Transfer Tax on Immoveable Property; and (v) Withholding income tax on real estate transactions, recently introduced by the Federal Government. The first three levies belong to the provincial government while the fourth belongs to the local (town) governments.

³ In Pakistan, recurrent (annual) property tax is formally known as the Urban Immoveable Property Tax (UIPT)

revenues it produces are both divided in complex ways between three levels of sub-national government. Each level has low incentives to perform its tax collection functions. Second, each level of sub-national government obtains most of its income either from transfers from higher levels of government or from loans. It generally seems easier for them to increase their incomes by putting more effort into tapping these sources, rather than trying to improve their own tax collection performance. The lack of strong political pressures to increase spending has a reinforcing effect. Third, property tax collection has become locked into a system that combines (a) a high degree of informality in routine practices, (b) exclusive control of detailed information about tax collection potential and performance by lower level staff and (c) modest rent-taking and responsiveness to local pressures for leniency in tax collection at these lower levels. When higher-level officials in the Excise and Taxation Department attempt periodically to enforce the achievement of higher tax collection targets, they are mostly frustrated by these informal working practices and relationships. These suggest that one needs to understand institutional incentives within local level tax bureaucracies and their relationship with provincial government, higher levels of the tax system as well as elected politicians.

In the next section (1.2) of this introductory chapter, I elaborate my research question. In section 1.3 I present the broader context of taxation in Pakistan and highlight what we already know about property taxation in Punjab. In section 1.4 I review the general literature on property taxation to find some of the common explanations for low property tax collection and discuss the extent to which these are expected to be relevant to my case. I also elaborate on the importance of this study. In section 1.5 I build my research framework and discuss my research approach, and also explain how I investigated my main question including data collection. Lastly, I present my main findings and the chapter outlines, as well as research contribution in section 1.6.

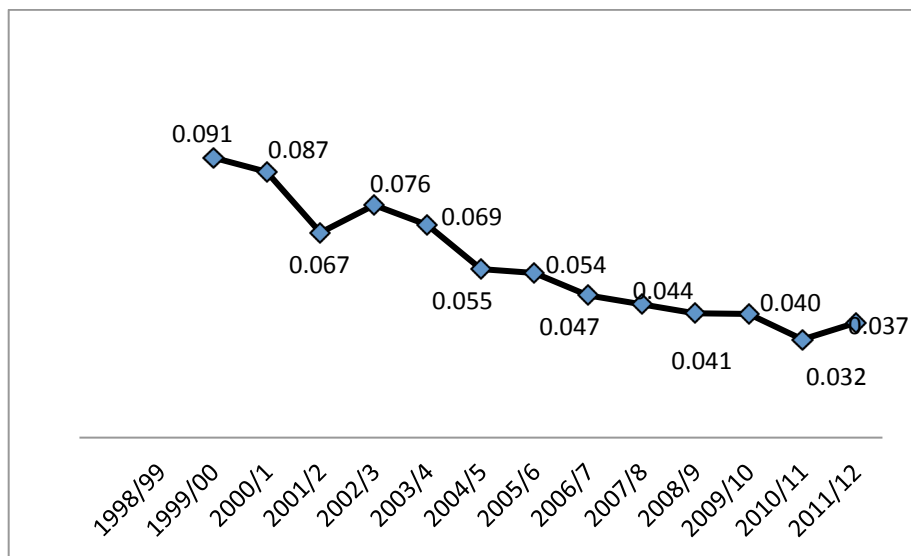
1.2 The research question

This thesis deals with the question, why is property tax collection in Punjab exceptionally low? In Punjab the ratio of property tax to GDP is 0.03%.⁴ This is

⁴ The property tax to GDP ratio for Punjab varies in different studies. This is partly because the Government of Pakistan does not officially publish GDP figures disaggregated by provinces. Bahl and Bird (2008) report the property tax to GDP ratio to be 0.09% for Punjab; according to the World Bank (2009c; p.131) it is about 0.03%. My calculation of

exceptionally low compared to the average of 0.6% in developing countries (Bahl *et al.*, 2008b, World Bank, 2009c). And despite being the most rapidly urbanising country in South Asia with an annual urbanisation rate of 3.1%, Punjab's ratio is also significantly lower than neighbouring India (0.2%), which has many similarities with Pakistan, including a largely common history of taxation and administrative systems (Mathur *et al.*, 2009, Rao, 2013).⁵

Figure 1.1: Punjab property tax to GDP ratio (%)



Source: Author's calculation, based on data from the Finance Department, Punjab and the World Bank (2013).

In many respects, low property tax collection in Punjab is unsurprising. As pointed out in the introduction, tax collection in Pakistan is generally low. In 2010 the ratio of tax to gross domestic product (GDP) was about 10%⁶ while the average of countries with

the ratio for Punjab is based on a recent World Bank (2013) estimation of provincial GDP (see figure 1.1).

⁵ Pakistan is the sixth most populous country in the world with an estimated population of about 185 million in 2012. Six of the most populous cities in Pakistan are in the province of Punjab (Mustafa and Sawas 2013). About 40% of the 90 million people in Punjab live in urban areas, according to the Pakistan Demographic Survey, 2001 and 2007. Source: http://www.statpak.gov.pk/fbs/population_publications. All population figures in Pakistan are based either on estimates or surveys because the 10-yearly population census has not been conducted since 1998.

⁶ Source: International Centre for Tax and Development (ICTD) dataset

comparable income was almost 18%. Pakistan is poor at collecting various types of taxes compared to other low middle-income countries⁷ (LMICs, see table 1.1).

Table 1.1: Comparing tax to GDP ratios (in 2010)

Country/ Group	Government Revenue excluding grants	Government Tax revenue	Direct Taxes	Value added Tax (VAT) Revenue	Trade Taxes
Pakistan	14	10.1	3.5 ⁸	3.5 ⁹	1
LMIC (average)	25.6	17.7	5	5	4.9

Source: ICTD dataset and IMF (2011; p.54)

Compared to the generally positive trend in other countries in the region, with the exception of Sri Lanka, overall tax collection in Pakistan remained fairly static in recent years. It has been around 10% of its GDP, from 2000 to 2010 (figure 1.2), having regressed from almost 12% in 1996-97.¹⁰

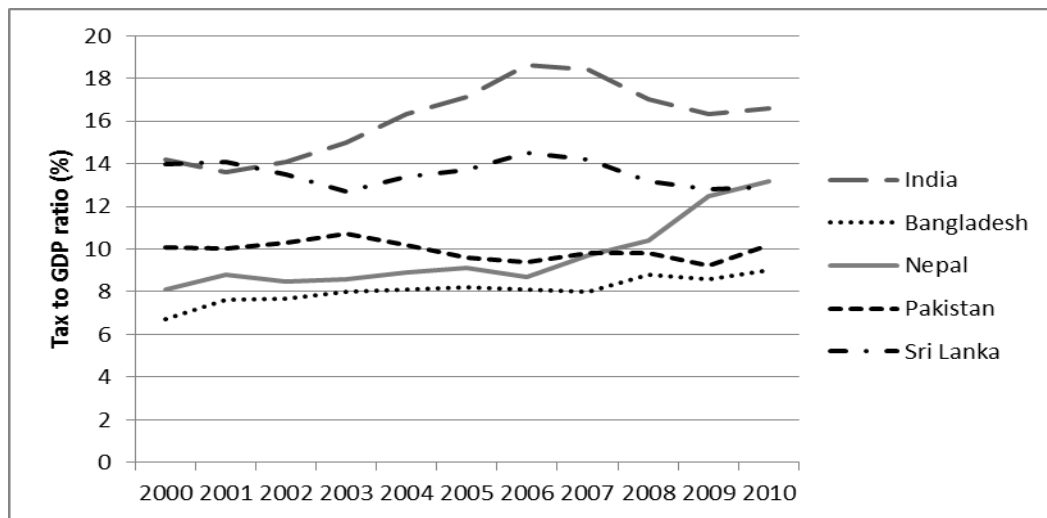
⁷ International Monetary Fund categorises Pakistan as a lower-middle income country (IMF, 2011; p.55)

⁸ Includes only income taxes

⁹ Pakistan has a General Sales Tax (GST) on goods and services in place, which is in essence a destination VAT. Ahmad (2010) provides details of the existing VAT system in Pakistan and its shortcomings. He traces the long history of repeatedly failed reforms to institute a broad-based VAT.

¹⁰ Source: ICTD dataset

Figure 1.2: Regional comparison of tax to GDP ratios (for general government)



Source: ICTD dataset¹¹

Despite this general environment of low tax collection, the case of property taxation in Punjab is puzzling mainly for three reasons. One is that, contrary to expectations that greater decentralisation will lead to increased property tax revenues (Norregaard, 2013) – a major decentralisation reform in 2001, granting local governments unprecedented fiscal and administrative autonomy, has failed to stem the downward slide of property tax to GDP ratio in the Punjab (figure 1.1). The second is that, in order to exploit its potential in Punjab, property taxation has been high on the agenda of various donors supporting fiscal reforms in the province.¹² The downward trend of the property tax to GDP ratio in Punjab continued despite numerous donor-supported initiatives to reform the tax, since 2001.¹³ The third is that, while the overall tax to GDP ratio for Pakistan remained stable (about 10%) over the decade of 2000s, Punjab's property tax to GDP ratio has declined rapidly.

The last point indicates that property taxes in Punjab are probably affected by factors additional to those that impact taxation in Pakistan generally. These are possibly the ones that are specific to property taxation. In the following two sections I explore first

¹¹ Available at, <http://www.ictd.ac/en/about-ictd-government-revenue-dataset>

¹² Nabi and Shaikh (2011) estimate the potential of property tax revenue in Punjab at Rs. 25 billion; about five times the collection in financial year 2011-12.

¹³ Major donors working with the Punjab government that have been involved in property tax reform, include the World Bank, the Asian Development Bank and more recently the Department for International Development, UK.

the context of taxation in Pakistan, and then review the property tax literature to find some common causes of low property taxes.

1.3 The low tax context of Pakistan

In the preceding section I showed that tax collection in Pakistan is low compared to similar countries, and its tax to GDP ratio has been fairly static over the last decade. Most of the donor supported studies attribute low tax collection in Pakistan to some relatively obvious factors, for example, a regime of wide-ranging concessions and exemptions, rampant tax evasion, and inefficient and corrupt tax administration (World Bank, 2009d, 2012a).

Below I outline and discuss the evidence for low tax collection in Pakistan organising the points, starting from more proximate causes to deeper structural ones.

- First, an immediate cause of low tax collection in Pakistan is weak tax administration. It is also *prima facie* evidence that the government gives little priority to taxation. For example, for the year 2004-5, estimated tax gap – difference between estimated potential and actual tax collection – for federal taxes was 69% of actual collections (Ahmed and Rider, 2008). As in most comparable countries, there are large chunks of the economy that are not documented, for example, the small-scale industry.¹⁴ Estimated average tax evasion was about 4% of GDP annually over a forty-year time period (Aslam, 1998).¹⁵ Estimates of the informal economy put it at about 50% of the GDP (Gulzar et al., 2010). The economic and political elite of the country blatantly flouts tax laws. For example, 60% of elected public representatives in national and provincial parliaments do not file any tax returns (Pasha and Pasha, 2013). The Federal Government has taken a number of steps to improve its central tax agency, the Federal Board of Revenue (which includes customs) including converting it into a semi-autonomous tax agency with substantial increase in salaries of its employees. From 2004 to 2011, a major tax administration reform, the Tax Administration Reform Project, was implemented with assistance from aid donors. While some progress was made, for example, reorganisation of the tax agency and introduction of information

¹⁴ Small scale industry is about 7% of the GDP, according to the State Bank of Pakistan (SBP, 2012).

¹⁵ Pakistan ranks high on international corruption indices. For an overview of corruption and governance issues in Pakistan, see Javaid (2010).

technology, which improved databases and some taxpayer services, generally the administrative reforms did not help in improving tax collection. Reforms were not successful for a number of reasons including, tax policy, frequent changes in political and tax agency leadership, implementation capacity, tax staff resistance to change, and generally the government's weak commitment to reform (World Bank, 2012a; p.33). Tax administration remains conspicuously weak in Pakistan: for example, from 2008 to 2012, the average time spent by taxpayers on preparation and filing tax returns and refunds is 560 hours per year. This is the highest in South Asia, where the average time is 331 hours per year (World Bank, 2012a; p.31).

- The second one is another proximate cause: while the Federal Government itself is not a good taxpayer, it has also undermined own source tax revenue generation by sub-national governments. Some experts attribute this to the tendency of the Federal Government to centralize power (Shah, 1996). Sub-national taxation in Pakistan is 0.8% of its GDP. Pakistan's tax system is over-centralized; sub-national government taxes contribute about 5% to the total tax revenue in Pakistan while the comparable figure for India is 35% (Pasha and Pasha, 2013; p.200). In the case of Pakistan, this is partly because the Federal Government abolished some of the sub-national government taxes such as land revenue and octroi without replacing them with any substantive, viable alternatives. Abolition of these taxes was justified by the Federal Government on various pretexts, for example, Islamisation of the economy (e.g. land revenue) and pursuing market liberal policies (e.g. octroi).

Land Revenue was a historical and substantial provincial government tax on agricultural produce. In 1980s it was replaced by Islamic taxes of '*Zakat and Ushr*' – levies on savings and a nominal part of agricultural produce. *Ushr* was augmented by the agriculture income tax (AIT) in 1990s, but low rates and non-enforcement of AIT substantially diluted tax revenue from the agriculture sector which constitutes about 25% of the GDP. Currently Punjab government collects about Rs. 1 billion agriculture income tax; its potential is estimated between Rs. 50-70 billion (Nasim, 2013). Octroi – a tax on movement of goods between districts and their import into municipal jurisdictions – was a substantial revenue source for local governments. It was abolished and replaced by an equivalent grant from the Federal Government in 1990s, because it hampered free flow of goods within the country (Ghaus and Pasha, 1988, World Bank,

1999). Several of these taxes were significant sources of sub-national government revenue.

The rest of the reasons are more structural in nature.

- The third one is foreign aid. Some experts are of the view that Pakistan's continued geo-strategic importance for United States' interests in the area and its role as a front-line state in the Afghan War (1980s) and in the War on Terror (2000s), resulted in large amounts of foreign aid over the last forty years. In particular, experts claim that the intermittent nature of the aid flows to Pakistan helped the government put off the required tax reforms and avoid the political costs of taxation (Ahmad and Mohammed, 2012).¹⁶ However, there is little evidence from cross country statistical analysis that aid – including loans and grants – suppresses tax generation in recipient countries (IMF, 2011, Clist, 2014, Morrissey *et al.*, 2014). In the case of Pakistan specifically, the evidence on this issue is mixed and varies for different time periods. Ahmad (2002) finds that from 1980 to 2000, while loans have had a positive effect on taxation in Pakistan, grants have had a negative effect. Similar work for an earlier period, 1976-95, shows that on the whole foreign assistance enhances taxation efforts (Iqbal, 1997).
- The fourth is political (un)willingness to tax. In theory, the possibility of a premature end to their rule has been cited as one of the reasons why rulers might not be willing to tax the people (Levi, 1988).¹⁷ Pakistan has oscillated between civil and military rule over the seven decades of its existence. When in 1990s the first time four civilian regimes replaced each other in succession, each of them was dismissed suddenly by the President (Ahsan and Desai, 2006).¹⁸ Similarly, there have been numerous disruptions to elected local governments in Pakistan, which might have contributed to unwillingness of local level politicians to raise local taxes. Set up during

¹⁶ Also see proceedings of a seminar, 'Civilian Assistance to Pakistan', held at the London School of Economics (LSE, 2012).

¹⁷ Uncertainty about continuity of rule is expected to affect the 'discount rate' of tax revenues for the ruler (Levi, 1988). Rulers will be less inclined to risk losing political capital and public goodwill by taxing people if they think they will not be in power for long enough to use the money for provision of public services, for example. Olson (1993) develops this concept in terms of 'roving' and 'settled' bandits.

¹⁸ However, since 2002 the country is experiencing its longest uninterrupted democratic spell and national elections are being held regularly.

military regimes – in 1960s by General Ayub Khan; 1980s by General Zia; and by General Musharraf in 2000s – elected local governments were disbanded by provincial governments each time. For long periods of time provincial governments have controlled local governments directly by appointing provincial officials, which is also currently the case, since 2010.

No academic study looks specifically at the connection between political uncertainty and taxation in the case of Pakistan. One might argue that, on the one hand military regimes were not interested in increasing tax collection, while on the other, elected governments were unwilling to tax due to uncertainty about continuity of their rule. Fear of upsetting powerful interests in absence of a wider political support base might have led military regimes to avoid aggressive taxation. In fact, there is some evidence that supports the possibility that, in order to make up for their lack of political legitimacy military regimes wanted to gain support of powerful groups. For example, influential interest groups were the main beneficiaries of tax concessions during General Musharraf's rule from 1999 to 2008 (Pasha and Pasha, 2013).¹⁹

There is a possibility that due to fears of a premature end to their rule, elected civilian governments in Pakistan did not pursue taxation aggressively. Military rulers may have been equally unwilling because of lack of legitimacy of their rule, the higher risk of igniting popular resistance to taxation and their need to appease powerful groups.

- The fifth is people's willingness to pay taxes. There is a large literature on tax compliance, examining people's willingness to pay. Some of the factors that may determine willingness to pay are: attitudes towards authority and the state, expectations of reciprocity by the state, perceptions of other taxpayers' behaviour, experiences with taxpaying and a sense of justice and fairness (Song and Yarbrough, 1978, Fjeldstad, 2004, Oberholzer, 2005). Due to a paucity of evidence, we simply do not know which of these factors shape in willingness to pay taxes in Pakistan. We know though, that tax enforcement is selective and often politically motivated; and the politically well-connected avoid paying taxes. This unequal enforcement may foster a feeling of

¹⁹ Evidence of military regimes trying to gain support of business interests is not limited to General Musharraf's regime. Previous military regimes also followed economic policies which favoured the rich. For example, industrial policies that led to concentration of wealth in the '22 families' in Pakistan in the 1960s during General Ayub's regime; and reversal of Bhutto's populist policies, including de-nationalisation of industries by General Zia in 1980s (Husain, 1999).

injustice on the part of those who are forced to pay. Further, tax collection mechanisms are not transparent or efficient and public service delivery is poor. All these can be reasons for people's resistance towards paying taxes.

- The sixth reason for low tax collection is resistance by powerful groups. Resistance by the elites/ interest groups can take a number of forms, including, influencing tax policy and ensuring that tax collection is not enforced (Eisenstein, 2010). Influence on tax policies in Pakistan is reflected in the arbitrary system of awarding exemptions and concessions in various taxes at both federal and sub-national levels of government. Tax expenditures – *“revenue losses attributed to tax laws which provide for a special exclusion, exemption, deduction, tax credit, preferential rate of tax or a deferral of tax liability”* – have been estimated at about a fourth of total taxes collected by the Federal Government (Pasha and Pasha, 2013; p.207).

Selective enforcement of tax collection by the government and tax evasion by the political and economic elite is a major factor for low tax collection in Pakistan (Husain, 1999). Government's inability to effectively implement agricultural income tax is a case in point. A majority of politicians represent rural constituencies themselves have substantial agricultural landholdings, and have avoided the tax net (World Bank, 1999). Another example of groups successfully resisting taxation is the country-wide bazaar unrest when traders refused to cooperate in VAT registration drive led by the military in 1999 (Ahmad, 2010).

There is little doubt that some of the structural reasons for generally low tax collection in Pakistan discussed above, impact property taxes in Punjab. But, as mentioned earlier, the consistent decline in Punjab's property tax collection in real terms suggests that some additional factors specific to property taxation are at play. In the following section I discuss some of the general reasons for low property tax collection, and specifically on how they might be impacting property taxes in Punjab. I also enumerate the importance of this study.

1.4 Property taxes in the context of taxation

In the theoretical taxation literature, (annual) property tax is considered a 'good' tax for a number of reasons. Since it taxes an immobile base – land alone, and/or improvements

– it is the least distorting of all taxes in terms of impact on economic incentives and does not stimulate much asset flight. It tends to be progressive since it taxes owners of land and capital. It is relatively easy for ‘simple’ tax organisations to collect, if it is being collected locally. Compared to some other taxes it provides relatively stable income through the vagaries of the economic cycle, mostly because property values change slowly. Property tax revenues usually fund municipal services that directly affect the wellbeing of residents and impact house prices positively. It is considered a good way of funding local public services – that cannot be charged to consumers individually. Property taxation is also expected to play an important role in strengthening local level public accountability.

Moreover, property taxation is considered most suitable for collection by sub-national governments (Bird, 2011). In practice as well, in most of the countries around the world, property tax is a local government tax. Although property tax on average accounts for just above 1% of GDP in OECD countries and 0.6% in developing countries, it is considered an important source of funding for local governments. As pointed out earlier there is an expectation that property tax greater decentralisation will lead to increased property tax revenues (Bird and Slack, 2004, Martinez-Vazquez and Timofeev, 2005, Bahl and Bird, 2008, Bahl *et al.*, 2008a, Bird, 2010, Lutz *et al.*, 2011, UN-HABITAT, 2011, Alm, 2013, Cornia, 2013, Kitchen, 2013, Norregaard, 2013).

Importance of this study

Findings from my research about extremely low – about twenty times less than developing country average – urban immovable property tax collection in Punjab paint a bleak picture and could lead one to question the practicality of continuing with the tax. No matter how low it is currently, there are at least three reasons to believe that property tax has a future in Punjab and in similar contexts, and that this research is hence important.

First, the annual tax on urban properties is a relatively progressive tax because it is a levy on the owners of properties; land and capital being indicative of the wealth of a person. Globally inequality is on the rise and there are calls for redistribution of wealth through progressive direct taxation. Public protests like ‘occupy Wall Street’, as well as academic debates, like the one triggered by Piketty (2014) call for a wealth tax to fight inequality. Increased annual property taxes might be a small way of doing this. Since

annual property tax paid by the owners of properties is used to fund public services in the same local jurisdiction, theoretically and practically it does have a redistributive effect, especially if the tax rates are progressive and revenues are expended in the jurisdictions that they are collected from.

To add to the point made above, Pakistan has an exceptionally narrow base of individual income taxpayers, in the sense that less than 1 million people out of a population of about 180 million file income tax returns. ‘Direct taxes’ (see table 1.1 on p.5) comprise income tax collection that is largely based on a ‘withholding’ regime and corporate income tax. Income from agriculture – a fourth of the national GDP – is barely taxed. The government abolished Wealth Tax in early 2000s during the regime of General Musharraf. Experts estimate that the informal economy in Pakistan is almost as large as the formal. In this context, it makes sense for the government to improve property tax policy and administration so that it is able to tax the rich on at least part of their assets that are difficult to hide.

Second, Pakistan is the most rapidly urbanizing country in South Asia; its urban population is growing at a rate of 3% annually. Currently about a third of Pakistan’s population resides in urban areas; this is expected to rise to 50% by 2025. By that year 11 cities in Pakistan will have more than 1 million people living in them. Most of these cities are in Punjab province, which currently has a population of about 90 million. Punjab’s capital city Lahore, currently at 7 million, is expected to be 10 million strong by 2025 (Kugelman, 2014, p.2). These rapidly growing urban concentrations require medium to large-scale public infrastructure, like roads, water supply, sanitation and other municipal services. Most of these are public services that cannot be charged individually. The annual urban property tax is a good way for paying at least the cost of running these services, or even partially funding the capital costs.

Whenever municipal financing mechanism in Pakistan matures – like issuance of municipal bonds, as in some other parts of the world, then local governments with reasonable property tax collections would be considered bankable and will be able to raise their own finances from the market rather than rely on transfers from higher level governments. Presently, the Punjab provincial government is facing immense public and political criticism for spending almost a fourth of its annual development expenditure on just one mass transit project in the city of Lahore. Lahore, the provincial

capital with about 7 million people gets a disproportionate amount of provincial government investment. In some of the years in the recent past this has been in excess of 50% of the annual provincial development expenditure. As mentioned earlier annual property taxes might be low as part of the national tax to GDP ratio, but they are a substantial source of income for local governments globally. If property tax collection in Punjab is closer to international averages, it would enable the fast growing urban centres to at least partly pay for their infrastructure development and maintenance.

Third, ever since the 7th National Finance Commission Award – that distributes tax revenues between the federal and provincial governments – in 2009 and subsequently the 18th Amendment to the Constitution of Pakistan, expenditure responsibilities for the provincial governments have increased substantially. These have not been complemented fully by an increase in the taxes assigned to the provincial governments. The provincial governments are under increased pressure to meet more of their expenditures with their own taxes. Given this scenario the Punjab provincial government can ill-afford to lose out on any subnational government tax base, that funds services in the provincial jurisdiction. Income from annual property tax is almost Rs. 8 billion in financial year 2015-16; there are a number of considerably smaller taxes and levies that the government is still continuing with. The potential for property tax revenues in Punjab has been estimated at about Rs. 25 billion (Nabi and Shaikh, 2011). The potential for improvement in tax policy and administration can also be gauged from the fact that currently property tax collection in Punjab is about 0.03% of its GDP; this ratio for developing countries is about 0.6%, which indicates ample room for improvement.

Given the high revenue potential and relative importance of property tax for sub-national governments, a strong case is made by academics as well as tax practitioners for improvements in property tax policy and administration (Bahl *et al.*, 2008b, Bird, 2010).

Some common explanations for low property tax collection

In order to begin to investigate my question of '*why is property tax so low in Punjab*', it is useful to review broadly six common explanations for low recurrent (annual) property tax that arise from its specific characteristics. I then discuss the extent to which these explanations are relevant in the case of the Punjab.

i. The relative salience of property tax

In the case of recurrent (annual) property tax, its relative salience – visibility compared to some other taxes – makes it unpopular and is considered to be an important external factor that might affect taxpayers' willingness to pay the tax. Although taxpayers bear the burden of other taxes as well, the way property tax is charged and paid makes it relatively unpopular. It is billed annually and paid directly by the taxpayers in periodic lump-sum payments. This is unlike some other taxes, for example, income tax – which is at times withheld at source, and sales tax – usually paid in small amounts with purchases.

There is always a chance that the property taxpayer will feel that his/her property is relatively overvalued for tax purposes, and resist paying it. Individual property tax liability is usually determined on capital or rental value of the property. In absence of actual sale or rent these are usually estimated using various techniques. Property valuation is 'inherently an arguable matter' and may be perceived by taxpayers to be unfair and/ or arbitrary. Additionally if the property is not sold or rented then the tax is actually being charged on an 'unrealized' value. Although an appeals system is expected to rectify over-assessment, appeal processes can be expensive and time consuming (Bird and Slack, 2004; pp.12-13, Cabral and Hoxby, 2012, Slack, 2013).

In the case of the United States where individual property tax liabilities are significantly higher than many other countries, property tax has been identified as the "worst" tax, and is more unpopular than the federal income tax. This is amply demonstrated by caps on property tax rates and property valuation freezes imposed by state legislatures in numerous states (Bahl *et al.*, 2010, p.10). It has been pointed out that, "*there is a well-documented gap between academic studies that support property taxation and the lukewarm or hostile reactions of voters to the property tax*" (Pagano and Jacob, 2010; p.269).

Partly because of its relative salience and the ways in which its liability is estimated, property taxation is unpopular compared to some other taxes. This makes raising revenue from the tax relatively difficult politically.

ii. Institutional arrangements to collect property tax and relatively low political influence of local governments

Most national taxes are collected by one tax agency which is responsible to the beneficiary, mostly the central government. However, in case of property tax, revenue collection and sharing arrangements usually involve different levels of government. Some institutional arrangements to collect property tax among different levels of government involved in collection and sharing of property tax revenue can affect collection. There is a strong theoretical argument for fully decentralizing most policy and administrative functions pertaining to property tax to local governments. However, practice varies widely in how these functions as well as tax revenue is shared between national/ regional and local governments. Experts point out that low property tax revenue due to institutional arrangements, on the one hand, may be due to ‘indifference’ if the higher level of government retains most of these roles, since they usually do not benefit from tax revenues; and on the other hand, from ‘incompetence’ due to capacity issues, as well as low ability to enforce, if local governments are largely responsible for tax collection (Dillinger, 1988, Bird and Slack, 2004, Martinez-Vazquez *et al.*, 2010, Mikesell, 2013, Norregaard, 2013).

Local governments may be constrained by policies regarding property tax set by the higher level of government including capping of tax rates, granting exemptions and not revaluing properties. For example, even in the case of United States, with its long history of local governance, some state legislatures place limits on increases by local governments in property tax rates and/or property revaluations, and have sometimes also granted exemptions and tax reliefs. Similar actions have also been reported in the case of India where state governments grant exemptions from property tax without consulting or compensating the local governments. There can be various reasons for actions by the higher level of government, including unpopularity of the tax and influence of interest groups. Higher level governments may also be driven by political motives and use centralized tax functions to exercise greater fiscal control over local governments. Motivated by multiple factors, such actions can impact property taxes significantly (Bird and Slack, 2004, Shah, 2005, Bahl *et al.*, 2010, Pagano and Jacob, 2010, Boex and Kelly, 2013, Ihlanfeldt, 2013, Rao, 2013, Slack, 2013).

Although considered fit for local governments, for a number of reasons, property tax functions may be divided between various levels of sub-national government. Some of

the reasons for this division are historical and political factors which influence the extent of decentralisation in a country, and the relative autonomy and capacity of local governments. Division of functions between various levels of government to collect property tax can have an impact on actual tax collection.

iii. Once too low, property taxes may be hard to increase substantially

Generally, if revenue from a tax falls too low as a ratio of the government's total income, then for a number of reasons, including political considerations, it might become difficult to raise it substantially (Bird and Smart, 2002). Property tax is likely to fall in this kind of a trap since it is a local government tax and local governments are often reliant (sometimes 'over-reliant') on transfers from higher levels of government. When such transfers are forthcoming local governments may avoid local taxation for a number of reasons, including political expediency. They might also develop expectations to be bailed out by higher level government in times of financial difficulties. Literature on fiscal federalism refers to this as a typical 'common resource' over-exploitation problem. It is expected that sub-national governments may persistently 'raid the fiscal commons' rather than raise revenues from their own taxes (Rodden, 2000, 2002, Oates, 2005, Boadway and Shah, 2009).

In presence of large transfers from higher level of government, property tax revenue may be a relatively insignificant source of sub-national government income. If this is the case, then, the sub-national governments may have low incentives to increase revenue from property taxes substantially.

iv. Property revaluation and political expediency

Property valuations – the current market value of properties or their rental value, the basis on whichever property tax is usually assessed – need to be updated at reasonable intervals. In practice the time gap in revaluations varies widely, from 5 to 10 years or more. Long gaps between revaluations, especially where property values appreciate rapidly or in high inflation countries, may lead to declining property tax assessment in real terms. A large increase in property tax bills that would result from a delayed revaluation is often considered politically unpalatable and risky due to the salience of the tax. Such increases affect property owners who are relatively wealthy and also politically more influential, and hence can effectively oppose revaluations (Slack, 2013).

When properties have not been re-valued for a relatively long time period, it may erode the basis on which property tax is charged. In such cases, given the relative salience of property tax, there might be political resistance to revaluing properties. This could lead property tax revenues to stay low.

v. Property tax administration and collusion

Some property tax systems could raise significant revenues at low costs. However, it is relatively easy for the government to get into a situation of low tax collection, and reluctance to invest in improving tax administration. As in all taxes, effective tax administration is crucial to property tax collection. Property tax administration includes: identification of properties; tax assessment and billing; a mechanism for taxpayers to appeal against assessments; tax collection and enforcement. Property tax in most countries around the world is assessed by tax agencies or professional assessors.²⁰ Property tax collection requires maintaining and updating a cadastre that includes a unique property identification number and its relevant attributes, including dimensions, usage etc. For correct assessments it is important to keep the cadastre constantly updated, which is costly and difficult. Similarly large capital costs may deter the government from investing in improvements, for example, geographic information system (GIS) mapping, digitalising cadastral records and automated billing systems. Reluctance of the government to invest in improving tax administration due to expectations of low returns or benefits that are not immediate may result in continued reliance on manually maintained cadastres. Manual record keeping is not only considered inefficient but may also increase possibility of manipulation and corruption (Dillinger, 1988, Bird and Slack, 2004, Mikesell, 2007).

Property tax collection is especially susceptible to collusion between tax collectors and taxpayers because of their face-to-face interaction. Where properties are not re-valued regularly and tax policy provides for allowances – for example, for use of the property (commercial or residential) and its occupational status (rented or owner-occupied) – the tax collectors also become assessors of individual property tax liability, raising the possibility of collusion (Moore, 2013).

²⁰ Property tax is self-assessed in relatively fewer countries; although it can be cost effective but in the long run the system is expected to lead to under assessment in absence of effective cross-checks (Bird and Slack, 2004; pp. 31-33).

Various elements of property tax administration – for example, manual record-keeping, where tax collectors also assess tax liability, and where tax policy allows use of discretion in assessment – are susceptible to collusion and rent-sharing, which can lead to low tax collection.

vi. Enforcement

Enforcement against non-compliance is immensely important to tax collection, as it helps maintain the credibility of the tax collection system. Property tax enforcement usually involves incentives, sanctions and penalties against taxpayers. Incentives may involve rebates for early payment or instalments. Penalties may be imposed for late payment or interest may be charged on outstanding liabilities. Sanctions may be imposed for recovery of outstanding tax dues, for example, withholding of certain government services (usually registering change of property ownership), and ultimately property seizure and auction to recover tax liabilities. Given the harshness of some of the measures, for example, auction of properties to recover tax liabilities – which might be significantly small compared to the value of the house – the more coercive methods of enforcement are unpopular and politically risky. In countries where the tax administration is generally weak, absence of strict enforcement can lead to significant loss of authority to collect taxes. If taxpayers know that tax collection will not be enforced, they are more likely not to pay taxes. In most developing countries weak enforcement often results in accumulation of large arrears. Experts emphasize the importance of tax collection and enforcement, especially in developing countries, since improvements in assessment alone are not expected to impact tax revenue (Bird and Slack, 2004, Kelly, 2013).

Most of the reasons for low property tax collection are complex and interconnected. Additionally, they are expected to be reinforced by some of the underlying reasons for low tax collection in Pakistan, which I discussed in the previous section. Below, I briefly discuss the extent to which some common reasons identified in the literature are expected to explain exceptionally low property tax collection in Punjab.

I do not expect tax salience to be an immediate significant factor in the case of Punjab. Tax rates and property valuations have remained unchanged since 1999 (Nabi and

Shaikh, 2011).²¹ Individual property tax assessments are grossly low. For example, in 2012, a self-occupied residential property owner in the highest valued neighbourhood typically paid (equivalent of) about 70 USD in annual property tax, an amount comparable to what s/he most probably paid for the monthly electricity bill.²² If the house is rented then the tax bill is ten times more, but still considerably lower compared to tax liability of rented properties prior to changes in property tax policy in 1999. Because of exceptionally low property tax bills the salience factor in Punjab is probably not as significant as the literature points out in the case of some other countries. However, given the relative salience of property tax pointed out in the literature, it cannot be ruled out as a contributing factor when policy decisions on the tax, for example, revaluation of properties, are considered by the government.²³

Institutional arrangements to collect property tax and relatively low political influence of local governments in the case of Punjab are viable explanations for low property tax. After a major decentralisation reform in 2001, property tax revenues and responsibilities were divided between three levels of sub-national government – provincial and local (district and town) levels. In Pakistan, local governments have traditionally been politically quite weak relative to the provincial governments. Thus, an analysis of the complex tax collection mechanism shows how low incentives to collect for each level of government involved, and intergovernmental politics affect property tax collection.

Political expediency and reluctance to increase revenues from relatively small taxes are highly relevant to Punjab. Own source revenues,²⁴ especially from property tax, is

²¹ For example, at the time of my fieldwork in 2011-12, property tax liability for rented properties was usually less than a month's rent. Prior to the changes in 1999 the property tax liability of rented properties was more than two months' rent. Till 1999, property tax was assessed on annual rental value as well but involved complex and differentiated methods of capturing this value for different kinds of properties. These methods provided wide discretion to tax collectors. Rented properties were assessed on actual rent while self-occupied were assessed on number of rooms and some vague notion of rental value, in the absence of standardized rental valuation tables. In 1999 standardized banded annual rental valuation tables were introduced throughout the province.

²² This estimate is based on an average-sized house built on 500 square yards of land. The estimate can vary from 50–100 USD depending on various factors that determine tax liability, including built-up area of the property and remission for older construction.

²³ In 2014 property valuation tables were updated but the tax rate has been reduced substantially, from 20-25% to about 10%. The government has placed a cap on increase of individual liabilities at 150% of the liability under the earlier property valuation.

²⁴ In this thesis I use the term 'own source revenues' in its conventional sense, to mean 'own source tax revenues'.

considerably small compared to transfers from the higher level of government and other sources of revenue available to the sub-national governments.

Issues of tax administration, possibilities of collusion and weak enforcement in the case of property tax collection pointed out in the literature are highly relevant to the Punjab case. However, there is lack of detailed analysis in property tax literature (as well as in the Punjab specific studies, which I refer to below) regarding underlying causes for weak tax administration.

Analysing some of the common reasons for low property tax collection is a good starting point but insufficient to investigate the Punjab case. In the following section I explain the process I followed to research my question.

1.5 Investigating the puzzle: why is annual property tax collection in the Punjab so low?

1.5.1 The research framework

The existing literature offers a number of explanations for low property tax collection that are to an extent relevant to Pakistan. In reviewing this literature on annual urban property taxation in Section 1.4, I noted the relevance of each explanation in the case of Pakistan (Punjab). While this literature on low property tax collection is useful, it is not sufficient to explain the extraordinarily low property tax collection in Punjab. To explain this, it is necessary to cast the net more widely. I offer three additional explanations in this thesis: effects of a dysfunctional decentralization with a history of political rivalry between the provincial and local governments; a low level fiscal equilibrium where the government is locked into a cycle of low tax collection and low political demands for expenditures on public services; and the pervasive and complex informality of local administration that impacts tax collection negatively and creates barriers to reform.

Each of the above three areas of politics in developing countries has not been well addressed in relation to property taxes, but each has been addressed in other domains, and it is thus useful to consider these literatures. Below I discuss these literatures under three broad themes: (1) problems of intergovernmental relations undermining decentralization generally; (2) problems of weak demand for universal public services

in developing countries owing to patronage politics, privatization of services for the relatively well-off, and peculiar issues of budgeting (low operations and maintenance expenditures), that cumulatively lead to low pressures for raising taxes; and (3) corruption and actual working of the state at the local government levels.

1) Intergovernmental politics and decentralization

While empirical evidence is mixed and dependent on the political context, there is a long-standing theoretical argument for decentralization. It is based on the expectation that improved local government accountability to its citizens will lead to improved service delivery, mainly as a result of an increased two-way flow of information between the government and the citizens regarding needs and decision-making. One of the potential problems that can hinder effective decentralization is that, typically subnational governments are weak compared to higher levels of government, which prefer to keep local governments disempowered. It is widely agreed in the literature that control over finances of subnational governments is one way for higher-level governments to do that (Rodden, 2000, Tanzi, 2001, Heller, 2001, Bardhan, 2002, Keefer et al., 2003, Shah, 2004, Smoke et al., 2006, Bahl and Bird, 2008, Bird, 2010, Smoke, 2013, Ghuman and Singh, 2013, Weingast, 2014, Faguet, 2014).

In this thesis I pick on two sub-themes on how the politics of decentralization can impact subnational tax revenues. The first is the literature on the politics of the relationships between different levels of government that impacts tax revenues when tax functions and revenues are divided between two levels of government. I review this literature in Chapter 2 in order to inform my case where actually three levels of government are involved, which is a rarity and not alluded to in the literature. In Chapter 2, based on evidence from Pakistan, I also show the role that bureaucrats play within intergovernmental rivalries, a topic less elaborated in the literature on decentralization and intergovernmental politics.

The second sub-theme within the decentralization literature that I discuss is how transfers from higher levels of government can impact efforts of the recipient government to mobilize tax revenues. In Chapter 3 I review the literature on the intergovernmental transfers and conclude that institutional mechanisms relating to the transfers largely determine the impact of transfers on tax revenues of recipient

governments. I then show that evidence from Pakistan is consistent with the international experience.

2) Weak political demands for public services and low taxation

The second theme that I trace in the literature has to do with political pressures on the government to provide expanded public services that will require it to raise taxes. At the risk of oversimplification, the suggested/alleged causality runs as follows: In a poor country most people who vote are poor, so the poor can effectively demand more universal public services. Pressures for expanded public service therefore force the government to collect more taxes from the rich and spend on the poor. However, in the literature there are a number of explanations for why this might not happen. Here I am concerned with just three explanations: patronage politics, privatization of services for the relatively well off and the way government budgets are made and executed. I use literature on these three topics to understand how the political executive can avoid the potential political costs of taxation, for example losing support of the rich who are politically powerful, while simultaneously aiming to meet its political objective of being re-elected. From a brief review of the literature below I conclude that there is a possibility that in contexts where political patronage is rife and demands for universal services from politically strong (the rich) are weak, peculiar budgeting practices enable the political executive to make do with the available resources and avoid raising more revenues from taxation. In Chapter 4, I show that in the case of Pakistan similar political mechanisms are at work.

Patronage politics

Patronage is defined as an exchange relationship between voters and politicians, where the politicians try to get political support on the basis of exchanging support for clubbed or private goods (individuals or small groups), or for public goods (with large classes/categories of people). Evidence from many poor countries shows that governments prefer to spend more on targeted programs (such as government jobs and infrastructure investment) that reward a selected few rather than improving universal public services. This often results in citizens generally receiving lower levels of or poor quality of public services than would be the case otherwise (Blunt et al. 2012). Often at the cost of universal service provision, politicians service selected groups for a number of reasons: Politicians want to reward their election financiers; politicians want to come

through on campaign promises by providing public projects or programmes/ jobs for which they can claim personal credit rather than focusing on improving provision of public health or education, where credit is difficult to attribute; absence of a strong media and restricted flow of information between citizens and the government can weaken government responsiveness; political fragmentation of voters, amongst other factors (Bardhan and Mookherjee, 2000, Chhibber and Nooruddin, 2004, Keefer and Khemani, 2004, Hasnain, 2008b, Blunt et al., 2012, McCartney and Roy, 2015).

The point that I take from the literature on patronage is that the political elite may not want to invest in expanded public services to get re-elected but can manage it by buying off a smaller section of the electorate by providing targeted services. Hence, despite widespread poverty, elected governments are not inevitably under strong pressures to provide universal services.

Privatization of services for elites

Tax revenues allow states to provide public services to citizens for a better quality of life. However, one of the major constraints to raising taxes is the resistance by the economic and political elites to pay taxes. One of the reasons why the wealthy avoid paying taxes is that they might not rely on public provision of most social services. Especially in most developing countries, the elite live highly privatized lives and therefore have little incentive to pay taxes for something they do not use. Resistance to pay taxes by the elites/ interest groups can take a number of forms, including, influencing tax policy and ensuring that tax collection is not enforced (Eisenstein, 2010). Although not large in numbers, the economic elite are politically powerful and can influence political outcomes in a number of ways, including funding for elections and lobbying for their economic interests. They can also threaten to move their capital out of the country if they find the tax rates too high or other government policies not conducive to capital accumulation. There is some evidence for even the middle classes opting out of public services in developing countries (Singh, 2005, Profeta and Scabrosetti, 2007, Fairfield, 2010, Pasha and Pasha, 2013, Dreze and Sen, 2014, Hassan and Prichard, 2016). The relevant point here is that the relatively rich do not demand expanded public services, which weakens political pressure on the government to provide these.

Budgeting

I link the two sub-themes above with literature on government budgeting practices to demonstrate the possibility of the political executive using available public money to meet their political objectives at the cost of public services and simultaneously avoiding raising taxes. I do so by reviewing the literature on budgeting, especially how operating costs (for maintenance and operations) of public services are a low priority, which practically means that they are estimated on the lower side and then cut further whenever there is a shortage of public funds. In absence of scholarly literature on budgeting in developing country subnational governments, I use literature about central government budgeting as a starting point.

Three shortcomings that usually characterize budgeting in developing²⁵ countries that affect operating cost allocations are: (i) ‘dual’ budgeting - the practice of recurrent (salaries and operating costs) and capital (development) budgets being prepared and executed by two different departments, finance and planning respectively; (ii) ‘incremental’ (historic) budgeting – that partly emanates from inability to correctly estimate departmental service delivery costs due to lack of criteria for judging their adequacy, thus resulting in use of previous year’s costs as a benchmark; and, (iii) annual budgeting, the practice of making annual budgets that have no reference to medium-term fiscal or expenditure framework, and are hence short sighted. In an ideal public financial management world government should be able to predict with reasonable accuracy the incomes and expenditures typically over a three-year time period (Peterson, 1996, Caiden and Wildavsky, 1980)

Various features of budgeting pointed out above create two broad hurdles that may prevent adequate funding of service delivery in some developing countries. Firstly, the fact that traditional budgeting is not performance oriented but input-based makes it difficult for decision-makers to allocate resources or hold spending units (departments) accountable for service delivery targets. Since financial inputs are not related to any outputs it is difficult to measure performance of various departments or functions of

²⁵ As mentioned by some experts the attributes of budgeting and some of the shortcomings discussed are common to most countries around the world. In poor countries some of these issues recur more frequently and are more pronounced, compared to richer countries, due to a number of reasons including greater uncertainties, relatively fewer public resources and weaker budgetary institutions (Caiden and Wildavsky, 1980).

government. To put it in another way, service delivery has no unit cost attached to it, there is no reasonable way of knowing how it will be affected when expenditure cuts are made, which are usually made across the board. Secondly, because of its inability to undertake output oriented 'programme budgeting' (that looks at sector-wide recurrent and capital budgets holistically) rather than stand-alone inputs, the government effectively cannot plan over the medium term due to a lack of measureable objectives. Dual budgeting often restricts the ability of spending units to reallocate resources from capital to recurrent expenditures due to technical rigidities, as well as political interests that prefer availability of funds for development projects (Caiden, 1980; p.164, Peterson, 1996).

Uncertainty of resource availability can impact budgetary outcomes by placing more control over actual resource allocation in the hands of the political executive. For a variety of reasons, developing country governments work under conditions of greater uncertainty where expected resources do not often materialise. For example, some developing countries rely more on sources of government revenue that are less reliable than others, like foreign aid or raw material exports that are vulnerable to international price volatility. Moreover, both revenue and expenditure estimates might be inflated to satisfy multiple interests in the budget planning and approval process, placing the political executive and civil servants in positions of power with unaccountable control over the actual distribution of resources – during the execution of the budget. In countries where patronage politics is rife, unaccountable authority over the public purse is sometimes arrogated by design – by inflating budget estimates to cause a 'shortfall' later - allowing the political executive more space to manoeuvre during budget execution. Alston et al. (2009) find that in the case of presidential system in Brazil there are incentives to overestimate revenues enhancing presidential discretion to cut individual budget items during execution as revenues fall below expectations. Other studies have found wide variation between budget estimates and actual expenditures, for example in Malawi and Mozambique (Rakner et al., 2004, Hodges and Tibana, 2004).

Since the inflow of government resources is unpredictable over the course of the year, the actual budget document approved by the legislature being only an estimation of the annual sum, budgeting in reality is a continuous process - referred to as 'repetitive' budgeting. This implies that just because an allocation has been approved at the beginning of the year it does not necessarily become available to a line department

automatically. The amount will only be 'released' by finance department on a piecemeal basis and that too after scrutiny keeping government's overall resource picture in view. This holds especially for subnational governments that do not have the luxury of deficit financing, like in the case of Pakistan. Even for central governments that can finance deficits, spending priorities are set politically and any additional funding is not shared equally across various expenditure heads. In extreme cases of uncertainty government might resort to cash flow budgeting where scrutiny may take place on a daily basis (Caiden and Wildavsky, 1980; p.72). The ability of government to exercise this level of discretion in allocation of public funds, where, it can pay lip service to certain budget priorities, even reflect them in budget documents but actually spend the money somewhere else makes government policy implementation hard to follow, monitor and influence, especially when comprehensive and timely information on budget execution is not available to legislatures (Caiden and Wildavsky, 1980; p.113).

For a number of reasons including weak legislative oversight, the political executive exercises increased control over decisions regarding use of public resources. Under cabinet style government where executive rules by virtue of its majority in the legislature making approval of budget essential to its continuation, there is very little room available to the legislature to provide any meaningful input into budget planning. Allocation and later availability of constituency development funds budgeted for legislators often become prime focus of their attention (Caiden and Wildavsky, 1980). Generally in developing countries the role of the legislature in the budget process has been found to be marginal (Dabla-Norris et al., 2010; p.26). In their study on institutions and budgetary outcomes Alesina and Perotti (1999) find that democratic accountability of the budgetary process can be diluted in contexts where the political executive is strong in relation to cabinet ministers and legislators.

More recent literature on budgeting in developing countries builds on the work of Caiden and Wildavsky but includes new players, like donors and the civil society. In order to improve service delivery in developing countries, donors push for public financial management reforms, amongst other initiatives, to help improve transparency and accountability of budgeting. For a variety of reasons, including rise of donor financial support, developing country governments are, to some extent, accountable to donors as well (de Renzio, 2007). Simplifying the budget for public scrutiny adds to its legibility for legislators as well (Robinson, 2008; p.11). However, though partly a result

of inertia and capacity issues in developing countries, reform of budgeting systems has proved difficult because of broader institutional and ‘rent-seeking influences’ in these countries (Allen, 2009).

Given various political and bureaucratic interests working formally and informally within the institutional mechanisms – some of which I have described above – most empirical literature finds the fiscal outcomes of the budgeting process prioritise actual expenditures in the following way: civil service salaries are most protected – they are almost a fixed cost for the government, followed by capital (development) budget – due to political patronage, ‘pork-barrel’ politics and visibility of new projects. Operating costs that fund service delivery are estimated on the lower side to begin with, and are at a higher risk of being further slashed during budget execution in periods of fiscal stress (Caiden and Wildavsky, 1980, Peterson, 1996, Alesina and Perotti, 1999). In Chapter 4 I show that fiscal practices in Pakistan are quite similar to those reported in the literature on budgeting. Low political pressure on the government to deliver expanded public services is possibly one of the reasons why tax collection is low.

3) Corruption and actual working of the state

One of the ways of categorizing corruption is: one is ‘grand’ or ‘wholesale’ corruption – cases where mostly senior government officials and politicians are involved in mega corruption, for example, large kick-backs in public procurement or influencing government policy to benefit a few. If found out this kind of corruption is often the subject of public scandals. It is also a large source of funds flowing out of developing countries, into offshore accounts held by political leaders from poor countries or their family members (Siddiqui, 2005). Grand corruption is not the subject of my study.

The second kind of corruption is referred to as ‘petty’ or ‘everyday’ corruption that people in developing countries often come across in their interaction with the state (Witsoe, 2012). This type of corruption often takes the form of ‘speed money’ – to get things done quicker, or pay relatively small amounts of money for government officials to overlook some irregularities in processing a case. Such payments usually become routine and are sometimes referred to as ‘fees’, as in the case of Pakistan. The public generally cannot differentiate (and perhaps does not care to, as long as its work gets done) whether this ‘fee’ is going to the government or into the pockets of the public

functionary. Although petty corruption exists as part of the greater informality in the way the government works, informality does not necessarily imply corruption.

The working of the state, more so in poor countries, is a mixture of formal structures, laws and rules, as well as informal practices often influenced by individual or group networks and at times monetary considerations. As a number of studies on the state in poor countries show, often the boundaries between ‘formal’ and ‘informal’ are ‘blurred’ (Gupta, 1995). Harriss-White (2003) ascribes two meanings to ‘informal economy’: one is the economic activity that is not registered by the state for the purposes of taxation or regulation. The second meaning of ‘informal economy’ is a type of behaviour within the formal economy, which still escapes, partially or fully, taxation or certain kinds of regulation. This kind of practiced informality, within the formal, usually has its own rules and norms that govern it that may find legitimacy within a certain context. This usually gives rise to rents and corruption at the cost of the state. As Harriss-White (2003; p.6) points out that, “the social legitimacy of corrupt and fraudulent activity is less secure than informal economic activity, and it is increasingly contested” – and thus more interesting to study. My study of informality in the collection of property taxes in Punjab lies within this second meaning of the informal economy.

In the case of property taxes, when the taxpayer and the tax collector collude, they both stand to gain and they also know the exact amount of loss to the state. Presumably, how they divide the rent that arises from their collusion is a matter of their respective bargaining positions. As I show later in this thesis (Chapters 5 and 6), the working of the tax department is routinized with deeply ingrained informal practices. In Chapter 5 I review the literature on property tax administration that concerns itself wholly with formal tax collection and its problems. My work does not limit itself to the interaction of the state and the society within the realm of the informal, as the literature reviewed above is concerned with, it also focuses on the internal working of the tax department. There are few studies of the informal working of the state in similar contexts, that I have come across, for example, Wade (1982) and Blundo (2006).

1.5.2 Research strategy and approach

Based on my review of various literatures, when I entered the field to investigate reasons for exceptionally low property tax collection in Punjab, I had some broad ideas

about the explanations that I wanted to investigate. Later in this sub-section, I explain some of the assumptions I started out with and how these developed over the course of my study.

Several donor supported studies provided starting points: a static tax base due to tax exemptions and large newly urbanised areas around cities and towns which are not taxed; the large remissions allowed for owner-occupied residential and commercial properties; and absence of indexation of valuation tables or revaluation of properties in a high inflation economy; use of manual systems to assess and collect property tax; weak enforcement; insufficient and untrained staff, as well as non-availability of resources for effective tax assessment and collection (World Bank, 2000, 2001, 2006, Asian Development Bank, 2009, Bahl and Cyan, 2009, Nabi and Shaikh, 2011, World Bank, 2012b).²⁶

My strategy was to place myself in the provincial Excise and Taxation Department (ETD)²⁷ to get some sense of how property tax is actually collected and what policy issues affect tax collection. Many of the issues that I identified concerned the Punjab Provincial Government. This led me to investigate and gather data initially at the provincial level, primarily the departments of Finance, Excise and Taxation, and Local Government & Community Development, which mostly comprised interviews and financial data. After numerous rounds of interviews and long conversations with provincial level officers of the ETD, I gradually began to observe how the tax collectors actually work, at a local tax office in Lahore. This was logistically convenient since Lahore is the provincial capital where all provincial departments are headquartered. I discuss my fieldwork and data gathering methods in detail in section 1.5.3. But before that, I elaborate my approach that helped me develop some of my ideas about my research.

²⁶ Since late 1990s, the Asian Development Bank and the World Bank have provided technical assistance to the Punjab Provincial Government to assess its property tax policy and administrative setup. They also helped develop recommendations for reform of policies, the organisational structures and business processes for the collection of property tax. Some additional reports are available at:

http://prmp.punjab.gov.pk/Public_financial_management

²⁷ Property tax collection is responsibility of the provincial ETD which has field offices in all the districts. I explain the administrative hierarchy and functioning of the ETD in Chapter 5.

In order to gain a deeper understanding of property taxation in Punjab I explored the broader political and bureaucratic institutional setting – both formal and informal – in which property tax policies are made and the tax is collected. Political and bureaucratic structures, their functioning and incentive mechanisms, which are unique to a country and vary with its level of political and economic development, are important to comprehend tax outcomes (Steinmo, 1989). In Punjab, property tax revenues mostly belong to the local (town) governments while the provincial government controls most of the tax functions. Incentive issues around such arrangements are expected; these are complex due to a history of political competition between the provincial and local governments in Pakistan. As Bird and Vaillancourt (1998; p.2) remark: *“the essence of decentralisation is that it does not occur in general but rather in a particular country – in a country with its own history and traditions and its own specific institutional, political, and economic context.”* Smoke (2013) underscores the importance of taking an ‘inductive approach’ to understand decentralisation in specific contexts, since unique political and bureaucratic state institutions, multiple players and considerations impact property tax policy-making. Similarly, tax administration is better understood if local political, economic and social factors and relationships are considered (Steinmo, 2008). Wade (1982) uses a similar approach to study the irrigation department in India and maps the informal ways of working, channels and relationships that shape organisational outcomes in addition to formal rules and regulations. I was especially motivated by Wade’s work when setting out to understand property tax administration in the Punjab.

To investigate my central question I undertook an empirical, in-depth study using mixed research methods to check for applicability of some of the available explanations provided in the property tax literature. As mentioned earlier, based on the property tax literature, initially I developed some tentative hypotheses that I considered helpful to explore my puzzle. During my research, based on my initial findings, I revisited these hypotheses and refined some of them. This was a gradual process and at times difficult. Throughout my work I was partly guided by my long experience in the civil service, especially of working in the Punjab provincial Finance Department and a donor supported public sector reform programme, as well as a field administrative officer earlier in my career. In the remainder of this sub-section, I briefly outline how my

thinking about the various factors that influence property tax collection in Punjab evolved over the course of this project.

Most property tax policy-making and administrative roles are in practice performed by the provincial government. I started with the assumption that the provincial government is not interested in increasing property tax revenues primarily because these are enjoyed mostly by the local (town) governments. Moreover, it is well known to Pakistan experts, and I have also experienced while working for the government, that provincial level politicians and bureaucracy resent local governments.²⁸ I suspected that intergovernmental political rivalry might be a reason why the provincial government neglected its property tax functions, and that it was not simply a case of ‘indifference’, as asserted by the property tax literature. Taking into account the historic provincial government antagonism towards local governments helped me understand some of the actions of the provincial government, especially after decentralisation reforms in 2001, which impacted property tax collection negatively.

It would be simplistic to attribute the neglect of property tax functions by the provincial government solely to its antagonism towards local governments. The Punjab Provincial Government has historically neglected raising own source revenues. Punjab is highly reliant on transfers from the Federal Government and most of the taxes that the province collects are considerably small compared to its total income. The relative importance of property tax as a source of income for the Punjab Provincial Government was relatively easy to investigate because of the readily available data. A similar exercise for the town governments was not possible because the town government data is not collated at the provincial level. According to the literature property tax revenue is an important source of local government income, so I expected the local (town) governments to be generally more interested in increasing property tax revenues compared to the provincial government.

The non-inclusion of newly urbanized areas to the property tax base, since the decentralisation reforms in 2001, has been pointed out in numerous aid donor reports as

²⁸ I came across evidence of the Punjab Provincial Government constricting flow of resources to local governments while working as Additional Secretary Finance in Punjab, where I dealt with local government financing in 2008. For example, in one instance, the Finance department did not transfer monthly grants to the local governments for three months.

a major reason for low property tax collection in the Punjab. Levy of property tax in newly urbanized areas is the sole responsibility of the town governments in return for a majority share of property tax revenues. It is puzzling then, that the majority of town governments did not. There could be a number of possible reasons for the inaction of the town governments: for example, the town governments might be only partially reliant on property tax revenues or they avoid the political cost of taxing newly urbanised because they do not control any of the tax collection mechanisms.

In the course of investigating these possible explanations some additional questions arose, which I thought were important to investigate. These questions were mostly concerned with the apparent absence of any political pressure on the sub-national governments in the Punjab to raise additional revenues from the taxes assigned to them. Sub-national governments in Pakistan generally do not seem too concerned about changing tax policies or investing in their capacity to increase their own source revenues. Since most property tax functions are provincial government responsibility, I focused on the provincial level mostly to investigate this issue. Since making efforts to increase the government's income and increasing public expenditures are two sides of the same coin, I also investigated the question: what level of political pressures does the provincial government face for increasing its public service delivery expenditures?

The main hypothesis regarding property tax administration that I developed initially was quite general: it was reflective of the literature, as well as widespread perceptions, of tax administration being inefficient and rampantly corrupt. However, during the course of my fieldwork I found that general notions of inefficiency and corruption did not accurately reflect the state of affairs in the Excise and Taxation Department. Annual increases in property tax revenue (in nominal terms), which were mostly incremental but significant in some years did not bear out my initial hypothesis. In absence of property revaluations, non-changing tax rates and non-expanding tax base – to newly urbanised areas, the only two possible ways to increase property tax revenues are by reassessing liabilities of individual properties and collection of arrears. This requires significant administrative work, not typical of a system that is grossly inefficient and rampantly corrupt. While at a systemic level there are a lot of gaps in tax administration, I soon realized that a system where tax collectors do not get any resources from the government (apart from salaries) for their routine work, the notion of efficiency – at least in its basic economic sense – was largely irrelevant. From my initial interaction

with tax staff I got the impression that they use considerable discretion when collecting property tax and that rent-taking in the department was not unbridled, as commonly perceived.

A related hypothesis regarding tax administration pertains to enforcement. According to the property tax literature enforcing tax collection, especially through coercive means, is partly dependent on the government's will to collect taxes. Luckily for me, tax enforcement was unusually aggressive during my fieldwork. This gave me an opportunity to identify various factors that impact enforcement.

Initially I wanted to conduct a survey about taxpayers' willingness to pay property tax; however, I did not undertake this mainly because I got considerable traction in my research on tax administration. My supervisors and I thought I should continue studying the relatively uncharted territory of property tax administration, rather than undertake a perception survey that was expected to give relatively generic results.

1.5.3 Fieldwork and data collection

This doctoral project has been quite challenging. Coming back to academia after two decades, during most of which I worked as a civil servant, was not easy in many ways. My relative strength was my inside knowledge of (parts of) government functioning gained from working in various positions in Pakistan, both at the local and provincial levels of government. More importantly I was fairly confident of accessing relevant civil servants and official data, for example, office files which are not publicly available. I used this advantage fully in investigating my case.

During my fieldwork I effectively played two roles simultaneously. One was that of a senior civil servant who could access government files and data in various departments with relative ease (though not necessarily very expeditious).²⁹ I could rely on colleagues to get officially verified up-to-date financial data from field offices and other sources, which are normally not collated at the provincial level, and which would have been quite challenging for an outsider; collection of the local government financial data and the provincial government cash-balance data from the State Bank of Pakistan, being

²⁹ My request to access and use official files and data for my doctorate, which is sponsored by the Government of Punjab, was granted by the Chief Secretary –the head of the provincial Civil Service – in a letter to provincial Secretaries of the Finance, ETD and Local Government & Community Development Departments.

cases in point. More importantly my position in the civil service gave me ready access to many of the senior civil service informants, some of whom I knew professionally. Most were very forthcoming and I had frank discussions with them about tax policy and how some of the decisions regarding property tax, as well as other provincial taxes, are taken. To my pleasant surprise I found the politicians that I interviewed to be equally open.

My second role was more challenging, and about which I was quite apprehensive; that of a ‘harmless’ researcher mingling with relatively junior tax officials on a daily basis. I had to observe them, discuss sensitive issues like corruption with them, and most of all convince them about my research project so that they opened up to me. For this role, to an extent, I was guided by methodology courses and readings on qualitative data collection,³⁰ and also by reading works on the state mentioned earlier, especially Fuller and Harriss (2001) and Wade (1982), but more importantly by my previous experience as a field officer. I discuss my data collection through observation of tax collectors in more detail later in this section.

I moved back and forth between various departments and levels of government for my data collection. Actual data collection required a lot of persistence and numerous trips and follow-up telephone calls for each piece of information, file and quantitative data. I gathered data using the following:

- Study of official documents and office files concerning property tax policy, annual taxation proposals, specifically exemption-related and legal cases concerning property taxation at the provincial secretariat of the ETD, and the Resource Wing of the Finance Department.
- Participation as an observer in meetings of the ‘Resource Generation Subcommittee of the Punjab Cabinet’, during the 2012-13 budget-making process.
- Semi-structured formal and informal interviews with:
 - High ranking officers of the provincial government including serving and former provincial Chief Secretaries, Ministers and Secretaries of the Finance Department and the ETD.

³⁰ For example, (Van Maanen, 1979, Holy, 1984, Barter and Renold, 1999, Emerson *et al.*, 2011, Bryman, 2012)

- Technical officers of the provincial Finance Department who are concerned with provincial taxation and budgeting. I had multiple rounds of in-depth, issue specific discussions with the relevant officers.
- Former/ retired and serving officers and officials of the ETD including those who headed tax operations and relatively junior officers who have experience in matters regarding property taxation.
- Foreign and local property tax experts and academics with experience of working with the Punjab ETD.

This was augmented by extensive quantitative data gathering in various departments of the provincial government including Finance and ETD, and selected town governments. This included:

- Time series data on:
 - Provincial budget estimates and the actual revenues of all taxes and levies, as well as other sources of income including, transfers from the Federal Government, foreign loans etc.
 - Provincial government transfers to local (town) governments and own-source revenue for selected town governments.³¹
 - Human and financial resources available to the provincial ETD.
- Data on disciplinary cases against tax collectors.

Revenue data for provincial taxes were taken from the province-wide online accounting system maintained by the Accountant General of Punjab. The town level financial data are neither recorded by the Accountant General nor collated at the provincial level. I procured these data through the Provincial Directorate for Local Governments & Community Development, which oversees some broader aspects of local government functioning. Finance officers of the towns that I selected provided authenticated town revenue data. The criterion for my selection of towns for the budget revenue data was guided by the fact that since I was studying a tax applicable to urban areas only. I collected data from all the towns in the seven most populous and urbanized district jurisdictions in the province; these included 49 out of 144 town jurisdictions in Punjab.

³¹ See Annexure 'A' for my selection criteria for the town governments and the map of the Punjab province.

To understand the intricacies of property tax administration I undertook a multi-tiered study of the provincial ETD. This included the offices of: the provincial Secretary, who is the administrative head and advises the government on tax matters, and is ultimately responsible for the tax collection target given to the ETD; the Director General, who heads all taxation operations and field units throughout the province; Regional Directors, who supervise multiple districts; and the Excise and Taxation Officers (ETOs), who are assessing authority for property tax for a whole district (or a Zone in case of larger districts) and directly responsible for property tax collection in their jurisdiction; and the property tax staff below the ETOs.³²

Punjab is divided into nine property tax Regions. I observed the office working of the tax property tax collectors in three Regions. Lahore, the provincial capital, was my primary site where I spent about four months and then a month each in Multan and Rawalpindi.³³ I also conducted interviews with Directors, ETOs and lower level tax staff at four additional sites: Sahiwal – a relatively small Regional headquarter; Khanewal and Sialkot – both relatively small non-regional headquarter districts; and Murree – a small sub-district tax jurisdiction. These four sites were chosen primarily for their size and remoteness from provincial and regional offices – and hence less direct supervision – to account for any variation in behaviour of tax officers and their working when not directly supervised by the Regional Director. Sialkot district was included for the additional reason that an intensive exercise to digitalise the property tax cadastral data was being piloted in Sialkot by the ETD.

Over the six months during which I observed the tax collectors, I limited my observation to the tax office-level and did not accompany lower level tax staff (Inspectors and Constables) on their field visits.³⁴ Since most collusive activities take place while the staff are in the field, my presence would have disrupted their natural environment and not served any purpose. At the office level I observed three levels of

³² In Chapter 5, I explain in detail the hierarchy of the ETD and functions of each level.

³³ The Secretary and Director General of the ETD are based in Lahore. Because of its size it is divided into two property tax Regions, A and B. I chose region B because it collects more property tax. Multan and Rawalpindi districts are City Districts as well but rarely visited by senior departmental officers (also see Annexure 'B' for details of criteria for site selection for observation of tax collectors and a map of Punjab to see where the sites are located).

³⁴ In Multan the Regional Director took me along on some field visits during enforcement, and rounds of inspections to check if properties in some areas were assessed at all. These visits were very insightful.

the ETD: the Director General who heads the province-wide tax operation, three Regional Directors and one associated ETO in each region. The information I gathered through my observations was augmented, explained and enriched through discussions with the officers almost after each interaction with a property taxpayer and other visitors, at an opportune time since I did not disrupt the normal flow of office work. These were complemented with semi-structured interviews and mostly informal discussions with those not being observed directly, including some tax staff and taxpayers that I met in the tax offices and also outside the offices.

I entered the ETD through the bureaucratic hierarchy with the formal permission of the provincial Chief Secretary, which was conveyed to the Secretary and Director General of the ETD. The Director General spoke to the concerned Regional Directors to allow me to sit in their offices and those of their subordinates (the ETOs), and to help me ‘understand’ the working of the department. Officially that was about it. Informally I requested the Additional Director General, a senior official of the ETD cadre, to personally speak to the Regional Directors in order to reassure them that my work was academic in nature and that I was not being sent by the Secretary or the Director General for ‘some kind of an investigation or inspection’. I strategized to have him make these phone calls since, coming from someone from their own cadre,³⁵ his word was expected to be more credible and personal, and not seen as just another routine order from the top. This worked quite well.

Since I am a senior civil servant, working in the same province I was concerned about not being accepted within the lower tiers of the department I was trying to study as a ‘researcher’ or a ‘neutral’ observer. This would have risked my project, by not only being denied correct information but also actively misguided. Once within the lower tiers of the ETD I set about to establish a personal rapport with the tax staff, mostly by using my own experience of working in the lower bureaucracy. Sharing experiences and stories from the remote province I had previously worked in; the difficulties, compromises and practicalities of ‘getting the job done’ not only helped me immerse into the lower tax bureaucracy but also in understanding the complex nature of their socio-political milieu. The tax staff sometimes quipped about me taking time off from my civil service career to do a four-year PhD when I could be a provincial Secretary,

³⁵ As I explain in Chapter 5, the Secretary and DG are usually from general civil service cadres with few personal contacts in the ETD.

heading a department. But that perhaps also convinced them of the sincerity of my task. They would add that I might end up being their boss someday, and that this was a good opportunity to find out how the Department actually worked and the issues that they faced. I usually avoided direct questions on corruption but officers were not shy of talking about their informal practices in generalities. Within the Department, apart from observation and interviews, I took every opportunity to discuss departmental working with all levels of tax staff including the Tax Inspectors, Constables, Clerks and office peons. Earlier discussions about property tax administration with retired officers of the ETD were helpful in gaining initial knowledge of the informal setting.

I have pieced together findings from my continued observation and discussions with various informants at different levels in the government, and in various departments and jurisdictions. I cannot entirely dismiss the possibility that tax staff might have misguided me regarding some issues concerning corruption and the ways in which they operate. I tried to minimize this risk by speaking to a large number of tax staff in different jurisdictions (see Annexure B). Generally, their accounts of the way they worked matched. However, more reassuring of the veracity of what they told me is the fact that their information is largely self-incriminating. None of the staff that I spoke to were defensive about their informal ways of working; they were quite matter of fact about it. At various stages of my fieldwork I discussed my findings with some senior officers with long careers in the ETD; they broadly agreed with the picture that emerged.

1.5.4 Background assumptions

I make two important background assumptions in this thesis.

The first is the poor quality of domestic services in Pakistan. Pakistan has low human development indicators; it ranks 146 out of 187 countries on the HDI scale.³⁶ The fact that Pakistan is nine places lower on the human development index than on its per capita national income ranking reflects the gap in service delivery (UNDP, 2013). Some of the reasons for the failure of successive governments to provide quality public services are:

³⁶ The Human Development Index (HDI) is a composite statistic of life expectancy, education, and per capita income indicators, which is used to rank countries into four tiers of human development.

(a) The government of Pakistan does not invest adequately in the provision of social services. For example, its combined expenditure on health, education and social protection was 1.5% of its GDP, compared to an average of 4.71% for South Asian countries (World Bank, 2012). This is partly because of lack of public resources, but also political expenditure priorities.

(b) Patronage politics and the lack of accountability and transparency in allocation and use of available public funds restrict provision of expanded public services. Experts argue that greater decentralization and accountability puts pressure on the government to allocate resources that are more in line with public needs. However, in the case of Pakistan, successive changes in local government laws and the Constitution devolving expenditure responsibilities to lower levels of government failed to improve service delivery (Ahmad et al., 2005, Hasnain, 2008b, Keefer and Khemani, 2004, Keefer et al., 2003, Mohmand and Cheema, 2007).

(c) The elite do not use most public services; hence they do not exert political pressure for provision of these services. Since they are relatively more influential politically, absence of any political pressure from the elites dilutes the overall political demand for expanded public services (Zaidi, 2011, Andrabi et al., 2002, Asadullah, 2009, Shaikh and Hatcher, 2005). While I discuss some of these factors in various parts of my thesis, in order to remain focused on my research question, I simply assume low levels of quality public service provision in Pakistan and do not go deeply into its reasons.

My second assumption – the extreme reluctance of the Pakistani elites to pay taxes – is clearly an important explanation for low tax collection but it is not the core focus of this thesis. The rich all over the world are reluctant to pay taxes. Governments face a constant risk of the economic elites transferring their wealth abroad. The rich employ all sorts of ways to avoid taxation, including, influencing tax policy and ensuring that tax collection is not enforced (Eisenstein, 2010). Relatively complex and less transparent taxation systems in poor countries make it easier for the elites to manipulate these in their favour. There are also a number of reasons why governments do not make all out efforts to tax the rich; some of these factors are more relevant to developing countries (Profeta and Scabrosetti, 2007, Fairfield, 2010, Pasha and Pasha, 2013, Hassan and Prichard, 2016):

(a) Governments allow the rich various concessions and reductions in the tax rates, in an attempt to gain the political support of these powerful interest groups or as a result of lobbying. The ruling elite bias is found both in tax policy (formal provisions of the tax code) and in tax administration – failure to make much effort to pay what they should be paying in taxes. For example, in the recent past, during the military regime of General Musharraf, tax concessions were granted in an attempt to gain the support of powerful interest groups. These concessions included: Abolition of the wealth tax; exemption granted on capital gains from stock market trading; zero-rating of the domestic sales of major export sectors, such as textiles; exemption from sales tax granted to agricultural inputs, such as fertilizer and pesticides; exemption from sales tax granted to plant and machinery and promulgation of a large number of statutory regulatory orders (SROs) for exemption from or concession in import duties. During Musharraf's regime tax expenditures – revenue losses attributed to tax laws which provide for a special exclusion, exemption, deduction, tax credit, preferential rate of tax or a deferral of tax liability – have been estimated at about a fourth of total taxes collected by the federal government (Pasha and Pasha, 2013).

(b) A large section of the political elite itself has substantial economic interests in retaining a weak tax system. For example, 60% of Pakistan's federal cabinet and two thirds of its federal lawmakers paid no tax in 2010. Thirty-four out of fifty five cabinet members did not file their tax return, and of those who did, most paid negligible taxes (Cheema, 2012). A glaring example of direct economic interests of the political elite in Pakistan is the case of agriculture income tax. Despite contributing about a quarter of Pakistan's GDP, and employing almost a third of the total work force, the agriculture sector accounts for a negligible amount of government income tax revenue (Javid, 2011). Historically, the landed elite in Pakistan has enjoyed political power and has always blocked reform or strict enforcement of the agriculture income tax (Khalilzadeh-Shirazi and Shah, 1991, World Bank, 1999, Manning et al., 2003).

For various reasons, I do not study in detail the impact of elite resistance to property taxes as part of my doctoral research. However, based on their generally successful resistance to taxation in Pakistan, I assume that elites play a significant role that results in low property tax collection.

1.6 Findings, chapter outlines and research contribution

I found a number of reasons for unusually low property tax collection in Punjab that can be categorised under three broad headings. The first is the failure of the sub-national governments to cooperate to collect property tax. The second is the low fiscal equilibrium that results from political disincentives to raise tax revenue as well as low political pressures on government to deliver services. The third is the weak tax administration, mostly due to the predominance of the informal ways in which property tax is assessed, collected and enforced.

These three broad findings are spread over five chapters, as I explain below.

1. Failure of sub-national governments to cooperate

Complex arrangements of collection and division of revenues are frequent in the case of property tax. There are both potential benefits of sharing functions among different levels of government and risk of the potential dysfunctions: ambiguities about responsibilities; muted or perverse incentives to perform well; and the scope for political manoeuvring. I found that after the decentralisation reforms in 2001, these dysfunctions dominate in Punjab, because responsibilities for raising property tax revenue and rights to enjoy those revenues are divided among different levels of government – the province, district and town – in exceptionally complex ways. Revenue raising responsibilities are divided among three levels of government, while revenues are divided only between two levels of government. Town level governments enjoy most of the revenues, the district level governments above them receive none and the remaining revenues accrue to provincial government.

This complex arrangement resulted in disincentives for each level of government involved to cooperate, in order to raise property tax. More specifically three factors impacted property tax revenues: the first deals with organisational disincentives. There is a major mismatch between the efforts that different levels of sub-national government are required to put into property tax collection, and their potential gains. While district governments have no share in revenues they are expected to supervise tax staff, fund their operation costs and review public appeals against assessment. Provincial government exercises most tax collection functions but has a small share of revenues. Town governments receive most of the property tax revenues but have only one significant revenue raising responsibility: declaring newly urbanised areas eligible for

property tax collection. Both provincial and town governments that share tax revenue find that the political cost of raising them is too high compared to their expected returns. Although enjoying majority of revenues from urban property taxes with minimal effort, town governments are reluctant to fulfil their rating responsibilities for electoral reasons. There are a number of possible reasons why elected town government officials failed to rate newly urbanised areas. These include, practically absence of town governments' control over most of the property tax rate-setting and collection functions, as well as tax revenues.

The second is that the current system for property tax collection requires relatively senior public servants who are employed by the provincial government to be accountable for their performance to the lower, district, level of government. This is unpopular and generated resistance, which found ready sympathy within the provincial government, which, for various reasons, was keen to regain control over devolved departments. Resultantly the provincial ETD informally resumed control of its district staff. Thus, in the absence of any share of property tax revenues, the district governments lost administrative control over tax collection as well. Thus there is no incentive for district governments to cooperate over property tax collection that partly explains their failure to provide supervision and funding to local ETD offices – which is their formal role.

The third reason is related, and may indeed in some sense be a major underlying cause for the two factors listed above. There is a long history of rivalry between the provincial level of government, which has the main responsibility for property tax collection, and the levels of sub-national government below it. This rivalry stems in particular from the ways in which military governments have tried to empower local governments and undermine power of provincial governments. The latest (2001) round of local government reform was quite ambitious, devolving provincial authority substantially. Historically, the political and official staff of provincial government seem to have preferred that there should be no elected levels of local government below them, as this reduces their power. If forced to accept the existence of elected local government, they tend to find ways of undermining their authority.

I discuss the above probable causes for low property tax collection in Chapter 2. I explain the formal mechanism of property tax collection and also how it actually works.

I show that revenues and responsibilities of the three levels of sub-national government are mismatched leading to disincentives for each level to cooperate in collecting property tax. Incentive issues existed in the previous system, but I focus on the period since 2001, because the decentralisation reform multiplied these obstacles. I provide evidence that indicates bureaucratic resistance to be accountable to local level of government and how that affected property tax administration. I then trace the history of political rivalry between the provincial and the local governments, which was perhaps an important background reason for provincial government actions that impacted property tax collection negatively.

2. Low fiscal equilibrium: Lack of incentives to raise taxes and expenditures

When own tax revenues are low and political demands for public spending are politically manageable, fiscal politics enters into something of a low level equilibrium – a situation in which sub-national governments neither make the kinds of efforts one might expect to obtain more revenues from own sources, nor appear to be under strong pressure to spend more money. Various factors are at work keeping both sides of the equation – own taxes and expenditures – at low levels, and thus contribute to maintaining this equilibrium; I discuss some probable reasons for low taxes and expenditures in Chapters 3 and 4, respectively. Most of the arguments in these two chapters are largely speculative and based on deduction. The speculation is in turn informed by my field research, extensive work experience in the government as well as my analysis of the relevant academic literature. The evidence I provide for the mechanisms at work that help maintain the low fiscal equilibrium are not cast-iron; at best they are consistent with the arguments that I make.

Low incentives to raise tax revenue

The provincial and town governments share most property tax raising responsibilities. I argue that the provincial and town governments are not strongly motivated to increase tax revenues generally due to their relatively easy access to other sources of revenue, especially transfers from higher levels of government and loans, in the case of provincial governments. More specifically, I found that the fiscal transfer mechanisms – expectations of additional transfers, absence of any attached conditions and unpredictability of the transfer of property tax revenues (in the case of town governments) – did not incentivise sub-national governments to raise property taxes.

The relative insignificance of property tax revenues to the total provincial income led the provincial government to put little effort into maintaining or enhancing its organisational capacity to collect property tax. In the end I begin to link the revenue side of the low fiscal equilibrium with the expenditure side; I found that the sub-national governments rarely run into the kinds of liquidity crises that could force them to increase tax collection.

In Chapter 3 I show that both the provincial and town governments are highly reliant on sources of income other than their own source revenues, especially transfers from higher levels of government and loans. Property taxes are a small proportion of their total incomes, particularly in the case of the provincial government. I show that there is ample evidence from elsewhere that easy access to other sources of income, like loans and transfers, affect the incentives of sub-national governments to raise their own taxes. I provide some evidence that indicates such disincentives to be at work in the case of Punjab. Specifically I discuss: expectations for additional transfers; unconditional transfers; easy access to borrowing by the provincial government; lack of investment by the provincial government in its capacity to collect property tax; and the fact that town governments do not receive their full share of property tax revenues. In the end, I show that generally both the provincial and town governments have enjoyed a relatively comfortable liquidity position reflected by positive cash balances, which indicates absence of sustained fiscal stress.

Low political pressure to spend on public service delivery

For a number of reasons, including the scope of this research, the expenditure side of my 'low fiscal equilibrium' argument concerns the provincial government only, which I discuss in Chapter 4. My arguments in this chapter are generally speculative in nature. The provincial budgets need formally to be balanced at the beginning of the fiscal year and the provincial government is required to maintain a positive liquidity position. But very little effort is put into determining expenditure needs in relation to service delivery projections. Inadequate provision is made for the operations and maintenance costs (non-salary recurrent costs) – including repairs, maintenance, utilities, consumables and other operational necessities critical to effective public service delivery. Because it is able to remain liquid in cash terms normally and to retain unspent balances at the end of the year, the provincial government broadly satisfies the fiscal objectives imposed by

the higher level of government. Additionally, during times of fiscal stress, instead of raising additional taxes, the government resorts to cutting expenditures on operations and maintenance even further, eventually putting the burden of adjustment mainly on service delivery.

I make deductive arguments and provide some evidence that is consistent with them. I argue that there are no pressing internal political pressures to raise additional revenues because the government does not face very strong political pressures to spend on public services, for a number of reasons: the first is that political demands for expanded service delivery are relatively weak, despite appallingly low levels of provision, because of the prevalence of patronage politics, and political dominance of the wealthy who are largely not reliant on publicly provided services. There is weak public and social accountability of the provincial government about the ways in which it spends public resources. The second is that the provincial government is rarely at serious risk of upsetting a powerful interest group – its own employees – because it always prioritizes paying their salaries, by slashing other expenditures if required. The third is that the provincial government can effectively ignore pressures from aid donors to raise expenditures on service delivery without risking its long-term relationship with them.

In Chapter 4, most of the evidence that I provide in support of my arguments above, is based on secondary data and my prior experience of working in the government. I show that despite large gaps in service delivery requirements, government's expenditure priorities are driven by narrow political objectives. I provide some evidence that indicates that mechanisms of political and social accountability of public expenditures are weak. Relatively meagre financial resources are allocated for expenditure on operations and maintenance, which is critical to public service delivery. I also show that during times of fiscal stress the government prioritizes paying salaries to its employees and resorts to cutting its operations and maintenance costs rather than raise more taxes. In order to demonstrate that the government ignores its numerous commitments – about raising certain expenditures – with various aid donors that fund it, I provide an example from a donor-supported programme.

3. Weak tax administration

Although Weberian in form with a clear hierarchy, formal rules, a system of recruitment, postings, promotions and a certain level of answerability, the actual

working of the ETD in Punjab is largely informal that impacts property tax assessment, collection and enforcement. Property tax collection has become locked into a system that combines (a) a high degree of informality, (b) control of detailed information at lower levels that makes it hard for departmental higher level management to change the system or increase collections, (c) modest rent-taking by the local staff who have become very responsive to local pressures for leniency in tax collection. In Chapters 5 and 6, which are based on my field observations, I explore the ways in which property tax is actually administered in Punjab. While in Chapter 5 I discuss normal working of the department, Chapter 6 is concerned with departmental working during a period of unusual pressures to increase tax collection.

Normal working of the ETD

Informality and exercise of discretion by frontline workers is normal occurrence in most organisations. I found that in the case of Punjab property tax policies including large tax rate differentials, for example, those between residential and commercial, owner-occupied and rented properties provide ample opportunities for tax collectors to exercise discretion. Since property tax in Punjab is not self-assessed by the taxpayers – tax collectors assess property tax liability – possibility of collusion is high. This is facilitated by lack of supervision of lower level staff and absence of effective crosschecks on their assessments. I found that for a number of reasons – including manual record keeping, which at times does not represent ground realities truthfully, and weak supervision/ internal audit – higher-level management of the department is not in a position to ensure tax collection effectively. Lower level tax staff monopolise information about properties and often manipulate information they pass on to their seniors in order to avoid demands for higher tax collection. Amongst other information, this is often the case in reporting arrears that are manipulated by lower staff to create a ‘buffer’ for periods when they may face pressures to increase tax collection. I also found that apart from personal gain tax collectors seek and share ‘rents’ from collusive arrangements to fund operational costs of tax collection that are not adequately funded by the government. Although the amount of rent-taking in the department is difficult to estimate, its nature, and the fact that it is embedded and routinized, form a major obstacle to increasing tax collection substantially.

In Chapter 5, I present findings regarding normal departmental working summarised in the preceding paragraph. I explore some of the following questions: what motivates tax collectors, how do they operate in a given environment, why and how administrative discretion exercised, and how it impacts property tax revenue? I explore the incentives that motivate different levels of the ETD in Punjab. I explain formal and informal intra-organizational relationships, and the hoarding and manipulation of information regarding properties and tax arrears by the lower level tax staff. I also show how the higher management of the department uses the middle level management to overcome its lack of detailed information on property tax and pressure them for increased tax collection.

The working of the ETD under unusual pressure to increase property tax collection

I found that even during episodes of strict enforcement, like the one I witnessed, though there are signs of some formal roles and procedures being actualized, these have very little impact on the informal working of the department, especially exercise of discretion by tax staff. Resultantly there is no long-term impact on departmental working or tax collection. Tax staff manage to increase tax collection by leaning into the buffer of tax arrears that they accumulate overtime, but without upsetting too much their local political and social relationships or their collusive arrangements.

In Chapter 6 I analyse tax collectors' behaviour when they are under extraordinary pressures to collect taxes. In this chapter I highlight the tactics used by the supervisory staff during strict enforcement, and those used by the field staff to cope with the situation. I make the point that despite this unusual episode of enforcement there is no long-term change in tax collection or the ways in which local level relationships are configured.

In Chapter 7 I conclude with a recap of the main findings and make comments on an experiment incentivizing tax collectors conducted recently in the Excise and Taxation Department. I then discuss some implications of my study for long-term tax revenue raising in Pakistan, as well as some wider issues of development in the country.

Research Contribution

Based on the review of the various literatures, in this thesis I have made the following original contributions:

1. I have constructed a new framework to answer the question that I set for myself: ‘Why is property tax so low in Punjab?’ After analysing the explanations for low property tax offered by the literature, I cast the net more broadly. I explored probable explanations for low tax collection based on the literatures on public finance, budgeting and the informal working of the state. Since property tax is a subnational tax, I also examined aspects of intergovernmental politics and fiscal transfers to find possible answers to my puzzle. In this process, I developed a useful framework for studying subnational taxation. This framework enabled me to examine the policies and administration relating to a subnational tax in a wider political context. It encompassed politics between different levels of government as well as the relationships between the various levels of the bureaucracy within the tax department. My thesis takes into account various channels of political pressure that may or may not push subnational governments to raise more taxes. It also examines other political aspects such as the respective costs and benefits of the tax revenues and responsibilities when these are divided between various levels of government. Researchers may find this framework helpful when studying subnational taxes.

2. In this thesis I show the practical consequences of rivalries between different levels of government, in this case, neglect of property tax policy and administration that led to exceptionally low levels of property tax collection. The literature predicts the possibility of this sort of an outcome if the incentives to collect taxes are not aligned to the responsibilities assigned to the two levels of government involved. I have added to this literature by presenting a case where three levels of government are involved in property tax collection. This is perhaps an extreme case of a dysfunctional decentralization, where intergovernmental rivalries accentuate the lack of incentives for various levels of government involved to collect the tax effectively.

I also highlight the role that the higher-level officers of the tax department play during the process of decentralization reforms. As expected, they guard and further their own interests, with little regard for overall state functioning, in this case, property tax collection. I show that these higher-level bureaucrats resent reporting to elected officials of the local government and take advantage of political rivalry between the provincial and local governments to restore their provincial status informally, undermining decentralization reforms in the process.

3. Perhaps the most important contribution of this thesis is unpacking the way property tax assessment and collection actually takes place in the context of a poor country. The existing literature on property tax administration is largely theoretical and barring a few exceptions makes largely normative suggestions on how to improve property tax collection. In this thesis, the fine-grained analysis of the informal working of the Excise and Taxation Department in Punjab brings out the political and bureaucratic complexities of tax collection, which has important policy implications.

Although there have been a number of studies about how the state actually functions in poor countries, for example, India, very few of these studies relate to tax collection. Moreover, most of these studies are concerned mainly with analysing the informal interaction between the state and the citizens. This thesis is a significant addition to studies of informal state functioning because of its focus on the internal dynamics the departmental working. Because of issues of access to researchers, this provides a rare opportunity to look into the actual internal working of a tax department in a poor country. Given that for any considerations of reform it is vital to understand the way a tax collection system actually works and to identify all the players involved and their interests, this thesis contributes significantly.

In sum, my overall effort has been to provide probable explanations for unusually low property tax revenues in the Punjab. Given the increased level of interest shown by the international development community, including academics and practitioners, in taxation in poor countries, this research hopes to contribute to the vast and growing body of literature on property taxation through a careful, in depth examination of an extreme case. Taxes are considered important not merely for raising revenue but also as a means to state-building.³⁷ This study is expected to have important policy implications for Pakistan specifically but also more generally for countries with similar context.³⁸

³⁷ For example, see Brautigam *et al.* (2008)

³⁸ For example, Rao (2013) highlights similar issues to those pointed out by donor reports on Pakistan, that he claims result in low property tax collection in India.

2 A cooperation problem: Property tax and inter-governmental politics

2.1 Introduction

Globally, most taxes are collected and spent by national governments. More complex arrangements are however relatively widespread. Different levels of territorial government – national, provincial, regional, district, municipal, etc. – share responsibility for setting tax levels, assessing individual taxpayers and collecting the money owed. They might also share the revenues collected. These more complex arrangements are especially frequent in the case of property taxation. In particular, it is the norm that two adjacent levels of territorial government divide responsibility for the ‘earning’ activities in relation to property taxation: level-setting, assessment and collection. Within the literature on property taxation there are extensive discussions of both the potential benefits of sharing functions among different levels of government in this way and of the potential dysfunctions: ambiguities about responsibilities; muted or perverse incentives to perform well; and the scope for political manoeuvring.

These dysfunctions dominate in Pakistan, because responsibilities for raising property tax revenue and rights to enjoy those revenues are divided among different levels of sub-national government in exceptionally complex ways. Revenue raising responsibilities are divided among three levels of government, while revenues are divided only between two levels of government. Those two levels are not adjacent to one another in the hierarchy: town level governments enjoy most of the revenues, the district level governments above them receive none and the remaining revenues accrue to provincial governments.

I argue in this chapter that one of the reasons for low property tax collection in Punjab is the ways in which the responsibilities and benefits of the property tax system have been interwoven with the structure of sub-national government. Especially since the local government reform of 2001, complex property tax arrangements result in significant obstacles and disincentives to the use of property tax to raise significant revenues. Prior to 2001, while the revenue sharing arrangements were the same as they are currently, all functions – property tax level-setting, assessment and collection – were performed

solely by the provincial government. There were some problems about perverse incentives, but these increased markedly following the reforms in 2001.

The three main components to the argument in this chapter are:

- There is a significant mismatch between the efforts that different levels of sub-national government are required to put into property tax collection, and their potential gains. While district governments have no share in revenues, they are expected to supervise tax staff, fund their operational costs, and adjudicate on public appeals against assessments. The provincial government is responsible for most tax collection functions but enjoys only a small share (about 14%) of total property tax revenues.³⁹ Town governments receive most (about 81%) property tax revenues but have only one significant revenue raising responsibility: to bring newly-urbanised areas into the property tax net by rating them. Practically this involves town governments declaring an area eligible for property tax collection. They are however reluctant to fulfil their rating responsibilities for a number of reasons, including lack of control over property tax collection and revenues. Thus, all three levels of government that have revenue raising responsibilities – the provincial, district and town levels – have incentives not to fulfil these responsibilities energetically.
- The current system for property tax collection requires relatively senior public servants who are employed by the provincial government to be accountable for their performance to a lower level of government, the district. This is unpopular and generated resistance from the officers involved, which found sympathy within the provincial government. For various reasons, the provincial government was keen to regain control over its departments that were devolved under the local government reforms in 2001. Once the provincial government regained control of its field offices (this change was informal and not reflected in local government law), district governments became less cooperative over property tax collection.
- There is a long history of rivalry between the provincial level of government, which has the main responsibility for property tax collection, and the levels of sub-national government below it. This rivalry stems, in particular, from the ways in which

³⁹ After deducting 5% of property tax revenues to cover administrative costs, the provincial government retains 15% (of the remaining 95%) and is legally required to transfer 85% to the respective town governments from where the tax is collected. I use approximate percentage shares in this thesis. For exact shares, see table 2.1.

military governments have tried to empower local governments and undermine the power of provincial governments. The local government reforms in 2001 were quite ambitious, devolving provincial authority substantially. Historically, the political and official staff of provincial government seem to have preferred that there should be no elected levels of local government below them, as this reduces their power. If forced to accept the existence of elected local governments, they tend to find ways of undermining their authority. I argue that a lack of cooperation in the collection of property tax by the provincial government was part of a strategy to curtail the financial resources available to the town governments.

In section 2.2, I review the general literature on the assignment of property tax responsibilities and revenues among different levels of government. Most of the literature I review concerns low-income countries. Among other things, I explore what the literature has to say about the potential advantages and disadvantages of sharing of tax functions among different levels of government. In section 2.3, I begin by explaining in more detail the current arrangement of the property tax functions among the three different levels of sub-national government in the Punjab. I then show that there are disincentives to cooperate over property tax collection for the two levels of sub-national government – the provincial and town – that share revenues from property tax. I show that the provincial government has few incentives to invest in its property tax collection apparatus. I also discuss some probable reasons why the town governments generally failed to extend property tax coverage to newly urbanised areas. In section 2.4, I shift my focus to the third level of government – the district – that has responsibilities of tax collection but does not get a share of its revenues. I give reasons for why the provincial Excise and Taxation Department (ETD) regained control of its field units that had been devolved to district governments under the reforms in 2001. I then explain that the loss of control over the field offices of the ETD led district governments to lose interest in property tax collection, and how this impacted property taxes. In section 2.5, I show that some of the reasons for lack of cooperation over property taxation are embedded in deep historical political rivalries between the provincial and local governments. By comparing some of the actions of the provincial government regarding property taxation before and after local government reforms in 2001, I show that the provincial government may have been trying to restrict the money available to town governments. The last section concludes the discussion.

2.2 Literature review

The literature on property taxation in general highlights the importance of cooperation and getting the incentives right when tax functions are divided between different levels of government. The literature points out that the actual division of responsibilities is usually influenced more by the historical and political factors rather than normative considerations of, for example, efficiency and transparency. It also shows that the ways in which responsibilities are divided can vary greatly among countries.

Experts point out several reasons why property tax responsibilities in developing countries might be divided between different levels of government. Three common reasons are:

- First, because property tax largely benefits small local jurisdictions that may have weak administrative capacity, higher-level governments may take over some functions. Performance of property tax functions by the higher level of government allows certain ‘economies of scale’ to be exploited, for example, hiring skilled professionals and investing in technology – to digitalise property tax cadastre and billing etc. (Ebel and Taliercio, 2005, Weingast, 2006, Mikesell, 2007, Martinez-Vazquez *et al.*, 2010, Mikesell, 2013, Smoke, 2013, Weingast, 2014).
- Second, there can be a sensible case for taking some decisions, especially assessments, out of the hands of organisations especially vulnerable to local (elite) political pressures. This might reduce the chances of a property tax system being used unfairly to penalise or favour certain groups. More generally, property valuation and tax liability assessment activities might be more uniform and effective if they are not undertaken by the same political jurisdiction in which taxes are actually collected.
- Third, getting involved with property tax allows higher-level governments some influence over local government fiscal policy. Control over tax functions of a lower level government may also give the higher-level government an opportunity to exercise more political influence over the local government.

Experts also point out certain disadvantages (some of which, like the one immediately above, might be introduced by design) of property tax collection by the higher level of government. Local governments lose control over flow of tax revenues, since the

higher-level government might not transfer these to lower level governments accurately or punctually. In particular, in the case of taxes that generate low revenues, dependence on higher-level governments might discourage local governments from taking an active interest in ensuring that they receive the correct amount of transfers in a timely way. This may further discourage local governments from making any investments in policies or arrangements that might enhance tax collection (Mikesell, 2013).

Since property tax revenues are generally assigned to local governments, there are some advantages for giving local governments responsibility for some of the tax functions for the purposes of accountability and an increased reliance on own source revenues (Bird, 2010b). Although some experts believe property tax can be collected by relatively simple tax organisations, such as those at the local government level, in practice arrangements for property tax collection can vary among countries and are usually divided between two levels of government (Dillinger, 1991, Bird and Slack, 2004). These arrangements fall into one of the following four categories: central⁴⁰ valuation and central collection; local valuation and local collection, central valuation and local collection, and local valuation and central collection (Mikesell, 2013).

When different levels of government perform property tax functions, it is important that there is some balance between their incentives and their responsibilities. It is possible that, on the one hand, the higher level of government may get very little share of the tax and can become ‘indifferent’ to tax collection, while on the other hand, the local governments that enjoy majority of the tax share may not have the capacity to perform their roles effectively. It has been pointed out that in such situations division of responsibilities for property tax collection between the two levels of government might a trade-off between *“indifference and incompetence”*, since *“the higher level government is capable but not keen while the local government is keen but not capable”* (Dillinger, 1991; p.29). The importance of compensating the higher-level government for the costs it incurs in collecting the tax, perhaps to the extent of a share of the revenues, has been stressed. Without a commensurate share of revenues, there will always be incentive and cost issues faced by the higher level of government when collecting a local government tax. There are examples in the real world, of such tax collection arrangements working quite well. For instance, Canada has one of the highest

⁴⁰ This can also be the provincial government, as it is in the case of Pakistan.

ratios of property tax to GDP in the world. Collection is the joint responsibility of two levels of government (Martinez-Vazquez and Timofeev, 2005, Mikesell, 2007, 2013).

To summarise, property tax functions are usually divided between two levels of government. The functions can be divided in ways that take advantage of the different strengths of these levels of government. For example, the familiarity of lower-level governments with local conditions and the technical capacities of the higher levels (Martinez-Vazquez and Timofeev, 2005; p.37). For such arrangements to work well, the most important factor is to get the incentives right for each level of government to perform its functions effectively.

2.3 Despite getting a share of property tax revenues the provincial and town governments have low incentives to raise property tax

What is unusual about Punjab, and especially since the local government reform in 2001,⁴¹ is the extent of division of both responsibilities and revenues among the sub-national governments. Three levels of sub-national government – the provincial, district and town – now each have responsibilities in the collection process. Yet only two of them – the province and town – share the revenues. In this section I show that despite sharing property tax revenues, the provincial and town governments have low incentives to perform their tax collection roles effectively. The *de facto* division of responsibilities is summarised below (table 2.1).

⁴¹ For a comprehensive description of the Pakistan's local government system prior to 2001, including fiscal relationships between various levels of sub-national government, see Shah (2006); and Dillinger (1991; p.31) for property tax arrangements.

Table 2.1: Property tax: Division of revenues and responsibilities

Government/ Function	Provincial	District	Town
Share from Tax Revenues	5% (collection charges) + 14.25% (provincial share)	0%	80.75%
Tax Policy	Setting tax rates Granting exemptions (tax base)	None	Declaring newly urbanised areas eligible for property tax collection ⁴² (tax base)
Tax Administration	Property tax survey: Revaluation, cadastre maintenance & updating Liability assessment Billing Enforcement	Review appeals against assessment Provision of operational budget to tax offices Administrative supervision and support to tax staff	None

Source: Author; updated from table in Cyan (2007; p.1474)

After 2001, the complex distribution of property tax functions among the three levels of sub-national government was not congruent with the revenue shares accruing to each level. This resulted in low incentives for them to cooperate in raising property tax. The provincial government is responsible for the majority of the property tax collection functions, but is entitled only to about a seventh of the total revenues. The district government has some responsibilities but does not get a share of the revenues. Town governments receive about 81% of property tax revenues although they have only one significant formal responsibility: setting property tax rates (rating) newly urbanised areas, in order to expand the property tax base. In practice, town governments rarely live up even to that responsibility. I now discuss in more detail the financial incentives

⁴² As I explain in section 2.3.2 the formal role of the town governments is to set property tax rates in the newly urbanised areas, eligible for property tax collection.

facing the two levels of sub-national government that receive a share of the property tax revenues: provincial and town governments.

2.3.1 The provincial government

Because it receives a small share of property tax revenues relative to its collection responsibilities, the provincial government puts little effort into tax collection. The money that the provincial government obtains from its 14% share of property tax collections represents an insignificant fraction of its total annual income. In the financial year 2011-12, the provincial government's share of property tax revenues was less than Rs. 1 billion, compared to its total income of Rs. 900 billion. This situation seems to adversely affect the willingness and capacity of the provincial government to collect the property tax through the two following mechanisms in particular.

First, active engagement of the provincial government in trying to increase the yield from property tax would require it to take politically unpopular decisions regarding tax policy and administration. As pointed out in Chapter 1, the property tax is a relatively unpopular tax. The potential political costs of raising property taxes are high for the provincial government. Since it is responsible for majority of the tax collection functions, the public are likely to associate the tax with the provincial government. Changes in tax policy have to be announced in the annual budget speech made by the provincial Finance Minister in the Provincial Assembly. The public generally hold the provincial government responsible for any increases in their property tax bills.

Property tax is politically sensitive. There are currently about 1 million property taxpayers in Punjab. This might seem like a relatively small fraction of the total population of the province, which is about 90 million. But those raw numbers can be misleading. The property tax is payable by the most politically influential fraction of the population: the more wealthy urban dwellers. And the population is urbanising quite fast. Between a third and a half of the population of the province is estimated to be living in urban areas (Ali, 2003, Mustafa and Sawas, 2013). Many people view themselves as potential property taxpayers. The potential political costs of raising property tax are high. This explains why throughout the 2000s the provincial government repeatedly reneged on commitments made to aid donors to take actions to

improve property tax collections,⁴³ included revaluing properties or indexing the property tax valuation table for inflation. Although it is mandatory under the Punjab Urban Immoveable Property Tax Law (1958) to revalue properties every five years, the most recent revaluation in 2014 came after a gap of 16 years. After revaluation, the provincial government imposed a condition that this should not result in an increase in individual property tax bills of more than 50%.

Second, because it receives so little income from the property tax, the provincial government does not find it cost-effective to make the investments in technology and human resources that would enable it to increase its property tax collection capability. Experts have repeatedly recommended that the provincial government needs to invest in well-trained and dedicated staff for property tax collection in all the districts in the province, and digitalise the property tax cadastre, among other improvements. These measures are considered essential if the large property tax potential – estimated to be five times the current level of collection – is to be exploited (World Bank, 2009a, Nabi and Shaikh, 2011, World Bank, 2012b). One of the reasons cited for the repeated unsuccessful attempts to digitalise property tax records in Punjab is the reluctance of the provincial government to commit adequate and sustained resources to these projects (Khan and Inam, 2014).

By contrast, the Punjab Provincial Government has invested in improving its capacity to collect some other provincial taxes – those that generate larger revenues and belong wholly to the provincial government. One example is motor vehicle taxes.⁴⁴ Like the property tax, these are collected by the provincial Excise and Taxation Department. On average, the provincial government earns about Rs. 5 billion from motor vehicle taxes annually. This is slightly less than twice the total property tax collection (see figure 2.1), and about five times more than the provincial share of property taxes. By 2010, the provincial government had successfully installed and is since using a fully computerised and automated motor vehicle registration system operated by trained and dedicated teams in all the 36 districts in the Punjab. The system was initially installed in the

⁴³ For example, under the loan conditionality of the Asian Development Bank (ADB) funded Punjab Government Efficiency Improvement Program (2002-2012); the provincial government repeatedly reneged on mutually agreed policy actions pertaining to property taxes over the course of the ten year programme. Also see Chapter 4.

⁴⁴ These include three kinds of fees levied on motor vehicles: registration, transfer of ownership and annual road tax.

Lahore district in 2006 and rapidly extended to the rest of the province. The total cost of the system was about Rs. 800 million, which is less than a fifth of the annual revenue from motor vehicle taxes. The computerised registration system has improved the efficiency, transparency and credibility of the motor vehicle branch of the ETD, resulting in high levels of client satisfaction (Asian Development Bank, 2009).

The second example is the sales tax (on services), which was handed over to the provincial government for collection by the Federal Government, in 2010. The revenue collected from sales tax alone is almost equal to all other provincial taxes; it was about Rs. 33 billion out of total provincial tax revenue of Rs. 67 billion, in 2011-12. When the collection responsibilities were transferred to the provincial government, it immediately set up a new semi-autonomous tax collection agency, the Punjab Revenue Authority (PRA). The provincial government is considering a number of proposals to build the capacity of the PRA including, establishing regional offices of the PRA and hiring qualified staff on market-based salaries (as opposed to government pay-scales, which are much lower).

For more than a decade now Punjab government's aid donors have consistently pointed out weaknesses in the provincial property tax collection apparatus (World Bank, 1999, 2006, Asian Development Bank, 2009, World Bank, 2009a, 2012b).⁴⁵ In response to these criticisms, the provincial government typically makes slow moving and patchy reform efforts that do little more than provide some misleading reassurance to the donors that their concerns and conditions are being addressed. Numerous false starts to digitalising the property tax cadastre and billing system gave way in 2012 to a new initiative. This was supported of the World Bank and piloted in Sialkot, a medium sized city. Experts who reviewed the progress of this project found it wanting in a number of aspects and narrow in its scope. For example, the project did not include geographic information system (GIS) mapping (Khan and Inam, 2014). Currently (in 2015) the project has been scaled up to include the five City Districts in the Punjab, at an estimated cost of about Rs. 1 billion, which includes GIS mapping. ETD officials told me that the project is slow and it will be some time before it is fully operational in the whole province. It is noteworthy that the estimated cost of this project would be many times the annual provincial share of property tax revenues if it is extended to cover all

⁴⁵ See, http://prmp.pitb.gov.pk/Public_financial_management, for a collection of donor reports on tax reform in Punjab.

the districts. For the provincial government, the cost-benefit ratio of investment in technological improvements is clearly much lower for property taxes collection than for motor vehicle taxes.

The Punjab government has neither increased the human resource available to the ETD nor invested in training the available staff. Although the field staff of the ETD are on the payroll of the district governments, the district governments are wholly reliant on transfers from the provincial government. The ETD has about 3,000 staff, a figure that has remained unchanged for more than a decade. According to the departmental data, 1,396 employees are responsible for property tax assessment and collection in more than 480 property tax circles in the province. By contrast, taxable property units increased from over a million in 2002 to about 1.3 million in 2012. At the provincial level there is an overall shortage of property tax staff. The ETD urgently requires 135 additional positions of property tax Inspectors.⁴⁶ Interestingly, due to a ban on recruitment imposed by the government to cut expenditures, the ETD cannot even hire staff in positions vacated by retiring employees. Provincial level officials of the ETD told me that, they deal with the overall shortage of property tax staff by ensuring that the five City Districts⁴⁷ in the Punjab are well manned. These districts have large numbers of taxable properties and the ETD maintains dedicated property tax staff for their tax offices in these districts.⁴⁸ In most other districts property tax staff are required to collect other minor provincial levies⁴⁹ as well (see figure 2.1). ETD officials told me that the provincial Finance Department refuses to fund staff increases for property tax collection mainly for two reasons. One is that fewer staff will be required once the digitalisation projects are complete. The other is that, on the basis of past annual property tax targets and collection, officials of the Finance Department claim that there is no urgent need to increase in property tax staff.

⁴⁶ I got this information from a proposal initiated by the Secretary of ETD in 2012 for the Chief Minister's approval.

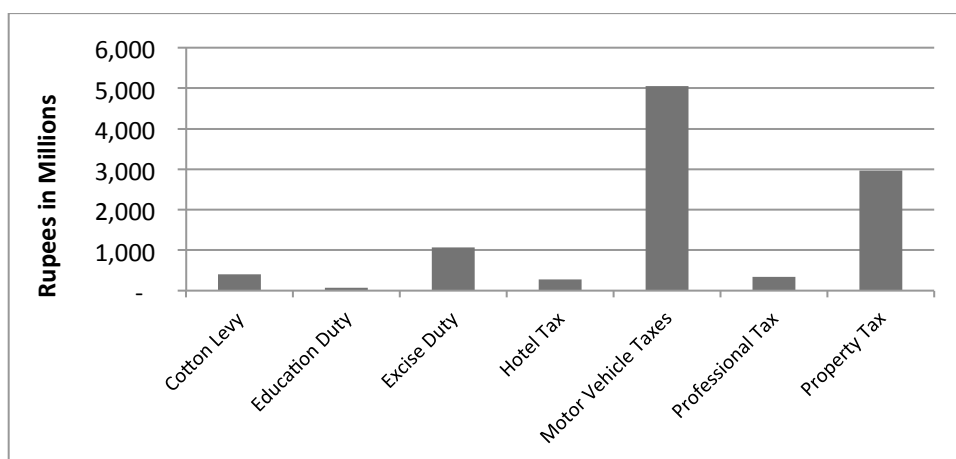
⁴⁷ Out of 36 districts in the Punjab province, 5 most populated (also most urbanised) were declared as City Districts, under the PLGO-2001. I explain their significance to my arguments later in this chapter.

⁴⁸ In Chapter 5, I point out that even in the City Districts that I studied; the tax collectors hire some of the office staff (clerks) privately, at their own expense.

⁴⁹ These include entertainment tax, hotel bed tax, farm house tax, professional tax, cotton levy and some indirect taxes. Tax collection responsibilities of property tax staff vary from district to district.

Generally, the Punjab Provincial Government has not invested in building its capacity for tax collection or even tax policy analysis. As a former Secretary who headed both provincial and federal finance ministries remarked, “...*the provincial government never really developed its tax function... it only concentrated on expenditure management.*” The fact that neither the provincial Finance Department nor any of the provincial tax organisations developed a tax policy analysis capability – a severe shortcoming often pointed out by multilateral agencies – indicates the relative neglect by the government of its tax functions (Asian Development Bank, 2009). Within the Finance Department, a junior officer, a generalist from the civil service, performs the function of provincial tax policy analysis, along with other responsibilities such as general administration of the department.⁵⁰

Figure 2.1: Taxes collected by the ETD (Average for financial years 2006-07 to 2011-12)



Source: Office of Director General, Excise and Taxation, Punjab

⁵⁰ Similarly, over the last 15-20 years, some slow-moving reform initiatives have been on-going in another provincial tax organisation, the Board of Revenue. For example, the Land Records Management and Information System (agriculture land records digitalisation) project – initiated in the late 1990s is still on-going with donor support. Moreover, its primary objective is of ensuring ready availability of authentic property ownership deeds in order to spur economic growth in rural areas, through easing access to credit, expediting change of ownership and minimizing litigation about ownership. For an overview of the land records digitisation project, see: http://www.sbp.org.pk/sbp_bsc/BSC/DFSD/Workshop/Land-Records-Automation-Punjab.pdf <http://www.worldbank.org/projects/P090501/land-records-management-information-systems-program-lrmis-p-province-Punjab?lang=en>.

At the current level of revenue collection and given its small share (14%), the provincial government sees little financial return for the relatively high financial costs it will have to bear to enhance its property tax collection capability. Moreover, the provincial government finds that it will have to bear potentially high political costs of increasing property taxes by performing its property tax functions effectively, in return for relatively small share in its revenues.

2.3.2 Town governments

In this sub-section I explain the lack of cooperation by the town governments, which receive a large share (81%) of tax revenues with the least responsibility. Despite rapid urbanisation in the Punjab and repeated requests by the ETD, the majority of town governments did not rate newly urbanised areas for property taxation. This is the sole responsibility of town governments; it requires passing resolutions by the elected officials of the town governments. Nearly a decade after the implementation of the 2001 reforms, only two town governments in Lahore district – out of 70 towns identified by the ETD all over the province – had passed resolutions rating newly urbanised areas for imposing property tax. Here are four possible reasons:⁵¹

- First, although formally tax rate-setting function is the responsibility of the town governments, in practice the provincial government exercises this power; the town governments are only expected to notify newly urbanised areas eligible for property tax collection. The provincial government ignores the Punjab Local Government Ordinance, 2001, in this regard and sets a uniform property tax rate throughout the province. Town government officials told me that, newly urbanised areas are not as well provided with municipal services as some old municipal areas; hence it is not fair to charge them the same property tax rate. Thus, it is possible that because of their inability to set lower property tax rates for newly urbanised areas, the elected officials of the town governments consider it to be politically unpopular to extend property tax to such areas. As mentioned earlier almost all the property tax functions are performed by the provincial ETD and town governments have no control over tax assessment, collection and enforcement. There is no legal mechanism in place that allows town governments to investigate or provide relief to their residents (who are also their voters)

⁵¹ My findings are based on interviews and discussions with local government officials only during my fieldwork, in 2011-12. Elected local representatives had ceased to hold office in 2010 and were not available for interviews.

regarding complaints against corruption or strict enforcement. Moreover, the town officials have no role in the mechanism of appeals against assessment.

- Second, town level politicians lived in great uncertainty about when elections will be held, or indeed whether they will be held at all. That reduces the incentives to engage in long term political strategies that might involve, for example, raising more money in local taxes and getting the benefits of spending that money. These uncertainties are based on past experience of local governments in Pakistan, which I discuss in section 2.5.⁵² The apprehensions of the local politicians turned out to be true because local government elections have not been held since 2010, and civil servants appointed by the provincial government administer local governments.

- Third, town officials resent the delays in transfers of their property tax revenues from the provincial Finance Department and the deductions that are often made from their shares (see figure 2.2). Town officials usually have to pursue the release of their property tax shares personally with the provincial Finance Department.⁵³ Property tax shares are not released regularly and amounts vary due to unannounced unilateral deductions by the provincial Finance Department. Total disbursement of property tax revenue to all the town governments in Punjab, for the period from July 2003 to June 2012, was Rs. 9.2 billion, while the total collection was Rs. 21.2 billion. Thus, only about 57%⁵⁴ of the property tax revenues collected from town jurisdictions was being channelled back to the town governments, as opposed to their legally prescribed share of 81%. From time to time, the provincial Finance Department makes two types of deductions from the property tax share of the town governments. One is to pay their electricity bills to the utility company.⁵⁵ This deduction is made across the board, for all the town governments in the Punjab. The second deduction is limited to the town

⁵² Since the local government reforms in 2001, only two rounds of local government elections were held, in 2001 and 2005.

⁵³ Property tax revenues are deposited by taxpayers into a centralized account of the provincial government. The provincial Finance Department is responsible for distributing 81% of total property tax collection to respective town jurisdictions. Usually these transfers are delayed. I witnessed this in 2008 while working as Additional Finance Secretary, Punjab where I was in charge of local government finance.

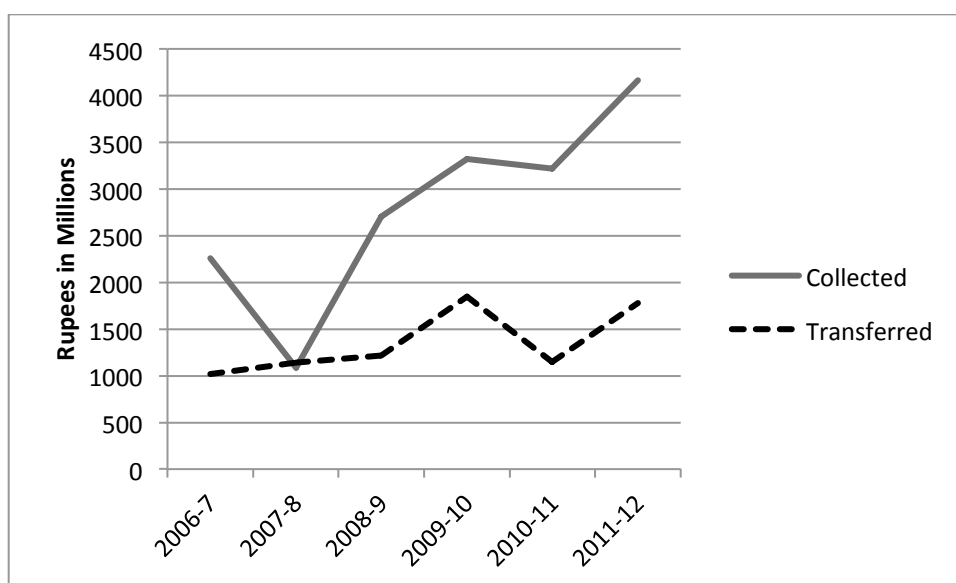
⁵⁴ Author's calculation, based on data provided by the provincial Finance Department

⁵⁵ Public sector consumers of electricity in Pakistan usually do not pay their electricity bills regularly due to lack of funds. Sometimes these accumulate and have to be paid in lump-sum by the provincial government to avoid public inconvenience due to disconnection. In the case of town governments these bills are for street lighting.

(governments) jurisdictions that are located in the five City Districts of Punjab.

Including Lahore, five of the largest urban districts in the Punjab were declared ‘City Districts’ under the Punjab Local Government Ordinance (PLGO), 2001, where the local government set up is different from the other districts. This is especially so with respect to division of responsibilities regarding water supply and sanitation which is generally a town government responsibility; but in the City Districts, existing Water and Sanitation Agencies (WASAs) were allowed to maintain their semi-autonomous status and do not report to the multiple town governments that are part of a City District.⁵⁶ WASAs usually do not recover their operational costs. Since the provincial government normally finances their deficits, it uses property tax share of town governments in these five City Districts to cover part of the deficits. Using property tax share of town governments is an informal practice followed by the provincial Finance Department and contrary to its legal obligations to town governments.

Figure 2.2: Amount of property tax collected and transferred to town governments



Source: Finance Department, Punjab

- The fourth reason for the low level of interest that town governments show in property tax collection is the relatively comfortable financial position of town governments over the last decade. Quite possibly, town governments did not require

⁵⁶ This was mainly because there is one WASA per City District, with centrally managed services. It was not considered technically feasible to break them up according to the multiple town jurisdictions within each City District.

additional money on any urgent basis. In Chapter 3, I explain this in detail and show that, town governments have a number of sources of income. I also show that during the 2000s town governments generally enjoyed a comfortable financial position, reflected in their end-year cash balances.

In this subsection I provided a number of plausible explanations for why town governments did not cooperate over raising property taxes. These range from political uncertainty and the relatively weak political position of town governments, which lack control over policy, administration and transfer of property tax revenues. With relatively little control over property tax collection, town governments are passive recipients of whatever tax revenues are passed down. In the following section I explore additional reasons for the lack of cooperation by the district governments to collect property taxes, apart from the obvious one of having no share in property tax revenues.

2.4 Bureaucratic interests reduce incentives for district governments to cooperate in property tax collection

Because they receive no revenues from the property tax, district governments generally have little direct incentive to cooperate in property tax collection. The information I gained from talking to people in the public services suggests that their willingness to cooperate was further reduced after they lost an intra-bureaucratic tussle for control over the field units of the Excise and Taxation Department (ETD). District governments first obtained this control as a result of the decentralisation reforms of 2001. The new decentralisation arrangements formally subordinated the relatively senior public servants in charge of the district offices of the ETD to elected district level officials. This was very disturbing both for the officers involved and for the provincial government, that naturally wanted to exercise authority over the staff who were responsible for implementing its mandate to collect property taxes. The provincial ETD was eventually able, substantively rather than formally, to regain control over its district level staff. I was told that this generated resentment among the elected officials of district governments, and as further reduced their inclination to cooperate with the provincial government over property tax collection. I explore these processes in more detail in the next two subsections.

2.4.1 Bureaucrats resented the 2001 local government reforms

The 2001 local government reforms in Pakistan reduced the authority of civil servants working at the district level – the ‘district bureaucracy’. They deeply resented this. Prior to 2001 civil administration comprised a hierarchy of regional (divisional) Commissioners, district administrators (Deputy Commissioners/District Magistrates) and sub-divisional administrators (Assistant Commissioners/Sub-divisional Magistrates) who reported to the provincial government. Their tasks included maintaining land ownership records, collecting agricultural land taxes, and maintaining law and order. In addition, the civil administration was required to oversee and coordinate field units of provincial service delivery departments including health, education and civil works. Run by the Indian (later Pakistan) Civil Service and Provincial Civil Service officers, the civil service cadres have been referred to as the ‘steel frame’ through which the colonial state and, after independence, Pakistan, was run. Following independence in 1947, a powerful bureaucracy initially controlled the political processes, especially at the local level in Pakistan, often in collusion with the military (Wilder, 2009).

Prior to 2001, local ‘bodies’⁵⁷ – under both the 1962 and 1979 local government reforms – were mere appendages to the well-established provincial administrative hierarchical system developed under the British Raj. There were separate ‘local bodies’ for urban and rural areas. Both had limited expenditure responsibilities, of municipal service provision in urban areas and some basic infrastructure development in rural areas. They were mostly financed by minor local taxes, user fees, octroi⁵⁸ and discretionary grants from the provincial government (Shah, 1996, 1998). The district and the sub-district administration had an oversight role over the functioning of the local bodies, even when elected officials ran these. During periods when local government elections were not held, the district and sub-district officials administered the local bodies.

There are four main reasons why the relatively senior civil servants working at the district level resented local government reforms that were implemented in 2001.

⁵⁷ Since previous local government systems ran parallel to the district administrative hierarchy, they were referred to local ‘bodies’ rather than ‘governments’.

⁵⁸ As mentioned in Chapter 1, octroi was a distortionary tax and was abolished by the Federal Government throughout Pakistan in 1998. It was replaced by a federal grant: the ‘Octroi and Zila (district) Tax Grant’.

- The first is that, the PLGO-2001 required civil servants working at the district level and below to be directly accountable to the elected local government officials. The historically powerful office of the Deputy Commissioner was abolished and its successor, the District Coordination Officer, reported to the elected chairperson of the district government, the *District Nazim*. Field offices of all the provincial line departments report directly to the District Coordination Officer.⁵⁹ At the town (sub-district) level, the office of the Assistant Commissioner was abolished and the town government⁶⁰ was placed under the control of an elected chairperson, the *Town Nazim*. The annual performance evaluation reports of officers working at the district and town levels were to be initiated (or counter-signed) by the respective *Nazims*. Civil servants resented this loss of status relative to local politicians. For example, previously, under local government system in the 1960s, district officers nominated local politicians for offices within the local bodies.
- Second, abolishing the regional tier of the departmental hierarchy in the province meant the loss of a number of senior positions across all departments. Under the 2001 local government reforms, the regional tier of all the devolved provincial departments were abolished. For all these departments, officers serving at the regional level had to be adjusted down at the district level, which caused them a loss of status.⁶¹ For example, Regional Directors in the ETD who were previously in charge of three to four districts were now limited to overseeing only one district. Severing the hierarchical link (partly a result of abolishing the regional level) between the provincial governments and district offices was a clear move to limit provincial influence over administrative functioning at the district level, thereby ensuring greater administrative autonomy for district governments. In section 2.5, I discuss in detail how the local

⁵⁹ With the exception of the provincial Irrigation Department and the Higher Education Department, all provincial departments were devolved to the district government, and grouped together under 13 district level offices, each headed by an Executive District Officer.

⁶⁰ Town or *Tehsil* Municipal Administration (TMA) is the formal name of this level of local government, for urban and rural areas respectively. For ease of reference, in this thesis I refer to both jointly as 'town governments'.

⁶¹ In 2000-01, while posted as Additional Deputy Commissioner at Quetta, the provincial capital of Baluchistan, I headed the 'District Transition Team' which oversaw the new local government system put into place. For officers of the civil services, it was a time of severe despondency and a sense of loss of power. General Musharraf wrote a demi-official letter to each federal civil service officer (I also received one) eulogizing them for their historic nation-building role and placating their fears about the future of the civil services etc.

government reforms in 2001 reduced the control of the provincial government over the local governments.

- Third, civil officers at the district level resented the new local government system because of the loss of their power and status that they derived from their role as executive magistrates.⁶² The magisterial powers of the district civil officers were reallocated to the *District Nazims* and the district level judiciary. For the officers of the elite federal and provincial civil services, this caused a severe loss of morale as they were especially concerned about the loss of their magisterial powers, which was a source of prestige, especially because it gave them significant authority over the district police. There is a traditional rivalry between the civil servants and police officers. The police service had managed to stay totally unaffected by devolution and retained its regional and district set up intact. Senior police officers had convinced the military – which, some senior civil servants allege was more sympathetic to a fellow uniformed force – that reporting to elected local governments would politicise the police and undermine the public good. Civil and police service officers in Pakistan are inducted through the same competitive examination but historically the civil service officers have always considered themselves a notch above, in status, authority and protocol to their police batch-mates. An inter-service rivalry has traditionally defined the official interaction between these two elite and powerful federal services.

- Fourth, apart from issues of prestige and status, reporting to the local government public representatives was technically problematic for provincial departmental officers. Since they are provincial government employees, matters relating to their career progression – posting and transfers, promotions and disciplinary issues – are decided by the provincial government. Civil servants working at the district level resented the new system partly because they were now subject to two lines of superior authority. Moreover, the provincial and local governments often found themselves in conflict (World Bank, 2009b). Numerous instances of friction and, at times, outright confrontation between newly elected *District Nazims* and senior civil servants were reported from various districts. Contention sometimes surfaced over occupation of office or residential buildings by the newly elected district officials, but a more common reason were matters of professional nature emanating from the duality of control that

⁶² These magisterial powers included the authority to prosecute and adjudicate cases under laws dealing with public order, public health and safety, etc.

the system had created.⁶³ Ways were found to deal with some of these issues, however, district and provincial level public servants were able to make a common cause against the new local government system. The elected officials and the senior civil servants at the provincial level who lost control over field offices and political influence within districts were upset by the local government reforms. Gradually they devised ways of circumventing some of the requirements of the PLGO-2001, especially those pertaining to the devolution of provincial departments and control over civil servants. Since in this thesis I am concerned with property taxes, I discuss below, how the provincial ETD regained control over its field offices.

2.4.2 The provincial government regains control of the devolved ETD field offices

Within a couple of years of the 2001 reforms, the provincial ETD re-established *de facto* control of its field offices. Since the local government law was not amended to reflect this *de facto* re-centralisation, the district governments continue to be formally responsible for the field level tax offices, including their funding and supervision.

The provincial government was motivated to centralise the ETD field offices for three reasons.

- The first is that, the provincial government does not want to lose its power embedded in the capacity to appoint, promote and transfer provincial civil servants, even if they are working at the district level. Commentators consider the decentralisation reforms of 2001 incomplete because a number of the planned reforms were never implemented, including the establishment of a district civil service cadre, for which the district governments would have all the powers pointed out above. Even in the provincial departments which did not centralise their field offices, the provincial government did not fully relinquish control over appointments, transfers and promotions of district staff to the district governments (Manning *et al.*, 2003). As I show in Chapter 5, while explaining tax administration, authority to transfer field officers is the preferred option (and perhaps the only one they can effectively exercise) for higher level officials to control the behaviour of field level public servants.

⁶³ These were often discussed in the provincial secretariat of the Punjab government, where I was working as Deputy Secretary in the Finance Department in 2002. Some issues were more obvious, for example, the *District Nazims* at times refused to allow district officers to attend meetings in the provincial secretariat.

- Second, except property taxes, all the taxes collected by the ETD wholly belong to the provincial government (see figure 2.1). So it made little sense for the field offices of the ETD to report to the *District Nazim* (via the District Coordination Officer). There was the obvious risk that the tax staff would be easily influenced by local political pressures if they are under the overall administrative control of the *District Nazim*. A former provincial Finance Secretary told me that, the Secretary of the ETD at the time, informed the provincial government that without full control over field offices he might not be able to meet provincial revenue targets and honour the provincial government's commitments regarding increased tax revenue generation with its aid donors.
- Third, although property tax is a relatively minor source of income for the provincial government (as I pointed out earlier in this chapter), it is a significant indicator for the ETD's organisational performance. Of all the taxes collected by the ETD (see figure 2.1), motor vehicle and property tax are most important to the department, as they reflect on its functioning and are considered important indicators of the performance of senior career civil servants posted in the department.

Despite initial compliance by the provincial government departments with the organisational changes required under the PLGO-2001, by 2003 the Director General of the ETD had regained control of the ETD field offices, and each of the nine Regional Directors was again in practice overseeing departmental activities in three or four districts. However, the PLGO-2001 was not amended to reflect this centralisation, mainly for two reasons:

- First, it was in the financial interest of the provincial government to keep the district governments responsible for meeting the operational costs of the ETD field offices. As a result of the local government reforms in 2001, approximately 40% of the total provincial income was allocated to local governments. Therefore, there was an incentive for the provincial government to keep the field offices on the budget books of the districts while regaining administrative control over the field offices informally.
- Second, the provincial government was unable to make any changes in the relevant law without the agreement of the Federal Government. But it was very unlikely that this agreement would have been forthcoming. The request would have been directed to the National Reconstruction Bureau, which was headed by a retired army general who had designed the new local government system. He was reported to be very

attached to it, and to suspect that any suggestions for changes were part of a conspiracy by the provinces and the civil service to subvert the new system.

The resultant loss of administrative control over the field offices of the ETD led the district governments to lose any interest in their property tax functions. This had mainly two specific implications for property tax collection:

- First, it led to a weakening of the system of appeals against property tax assessments. As part of the 2001 reforms, a senior district government officer – the Executive District Officer (Finance) who reports to the District Coordination Officer – is formally the second appellate authority for taxpayers who challenge their property tax assessments. Property tax assessment is carried out by the ETD field staff. The first appeal against assessment is adjudicated upon by officers of the ETD. Given the collusive environment within the Excise and Taxation Department (discussed in Chapters 5 and 6), it is possible that an external check on the department by a local authority might have improved accountability and performance in the Department. Due to the informal centralisation of the ETD field offices, the designated district government officers reportedly showed no interest in exercising their authority.
- Second, since the administrative control over field offices was informally assumed by the provincial ETD, the district governments are even less obliged to provide funds for tax collection activities of field offices or supervise them.⁶⁴ Under the Punjab Local Government Ordinance (PLGO), 2001, districts have practically no own source revenues and are wholly reliant on transfers from the provincial government. These regular monthly transfers are formula-based – estimated on a historical expenditure-basis for departments devolved to districts under the 2001 reforms – and unconditional, as I explain in Chapter 3. A large component of the transfers is the salaries of employees. These reflect a national-level pay scale; district authorities have no scope to change remuneration levels. However, operational (non-salary recurrent) costs of the various departments reporting to the districts government are determined by the district government during their annual budget-making. As I explain in Chapter 4, politicians prefer to fund development projects rather than non-salary operational costs of public service departments. The district governments have little incentive to

⁶⁴ In Chapter 5, I point out the non-availability of funds to cover operational costs of the tax staff and how that partly affects their behaviour; tax staff fund tax collection activities from their informal income.

adequately fund the operational costs of the ETD field offices. They obtain no revenues from the property tax and are not in practice held responsible for the performance of the ETD in property tax collections. Resultantly, the district governments are merely conduits for salaries of the ETD field-level employees.

In this section I argued that, in addition to the absence of any financial benefit, loss of administrative control over the field units of the ETD was an important reason for the district governments to not cooperate in property tax collection. The provincial government regained control of the ETD field offices for a number of reasons including: unwillingness of senior provincial civil servants to be accountable to elected district governments; and the fact that the ETD collects mostly provincial taxes and it made no sense to report to the district government. The issues discussed in this section are relatively tangible and visible, at least to someone like me who has good access to the confidential views of relatively senior public servants. But there is another, less tangible reason for this lack of cooperation between the provincial and town governments: the long history of provincial antagonism to local governments in Pakistan.

2.5 Inter-governmental politics and property tax collection

Historically the provincial and local governments have been political rivals. This rivalry has partly emanated from the fact that military governments have tried to empower local governments at the cost of the provincial governments. The latest round of local government reforms instituted by General Musharraf in 2001 seemed to give a lot of power to local governments. He continually supported the local governments during his rule, from 1999 to 2008, and also maneuvered the 17th Amendment to the Constitution of Pakistan, which prevented provincial governments to amend laws concerning local governments. Since, they could not disband the system as they had repeatedly done before, the provincial governments made all possible efforts to thwart this latest round of local government reforms. In this section I argue that property taxation in the Punjab seems to have fallen victim to these developments. There is also a possibility that the interdependence of various levels of subnational government might have been created deliberately leaving them less powerful than it first appears.

2.5.1 A state of rivalry

There is virtually always rivalry between different levels of government. They are often competitors for resources of various kinds. The rivalry is expected to be particularly intense among those levels that are entirely or to a large degree dependent on transfers from higher levels of government. That makes them very direct competitors. So there is nothing unusual about the inter-governmental rivalry in Pakistan. However, this rivalry is especially intense because of the military dimension, which I explain in this subsection.

Local government systems have had a chequered history in Pakistan. The local government systems have been strengthened by military governments and weakened by elected federal and provincial governments. Since independence, in 1947, political developments in Pakistan have been punctuated with episodic experiments of strengthening the local government system during the military regimes of General Ayub (1958-1969), General Zia (1977-1988) and General Musharraf (1999-2008). Experts suggest two main reasons for this. The first is that, local governments are used by military regimes as a means of gaining legitimacy by showcasing ‘grass-roots’ democracy. The second is that, with the objective of creating broader political support, military regimes foster a class of ‘political collaborators’ at the local level. The military expects this support at the local level to help them consolidate power at the centre, and at the same time undermine the power of established political parties and the national and provincial level politicians. General Ayub went to the lengths of having local government councillors (known as Basic Democrats)⁶⁵ declared as the electoral college for his election as President under the 1962 Constitution of Pakistan (Cheema and Mohmand, 2003, Zaidi, 2005, Cheema *et al.*, 2006).

Elected governments in Pakistan have repeatedly either scrapped local government systems instituted by military governments,⁶⁶ hindered them financially, or failed to

⁶⁵ General Ayub’s local government system was called ‘Basic Democracies’. It took Ayub Khan sometime to go to the military option, which was to some significant degree the result of the failure of democratic institutions. But democratic norms were very widespread at the time, and so there were strong pressures to incorporate some element of democracy in the military regime.

⁶⁶ Prime Minister Zulfikar Ali Bhutto scrapped the Basic Democracies System instituted by General Ayub Khan in 1971, branding it corrupt and patronage based (Zaidi, 2005).

hold local government elections. They preferred to administer local governments directly through provincially-appointed bureaucrats. The latest round of decentralisation reforms were undertaken by General Musharraf in 2001. After general elections in 2008 General Musharraf resigned. Local government elections were due in 2010, but as of early 2015 they have not been held in majority of the provinces.⁶⁷ The Constitution of Pakistan (1973) leaves it to the provincial governments to make and implement policy and laws on local governance. In the absence of their military originators, local governments find themselves at the mercy of elected governments. Some of the explanations provided by experts for aversion of national and provincial level politicians to the local government system (Zaidi, 1996, Keefer *et al.*, 2003, Zaidi, 2005, Cheema *et al.*, 2014) are as follows:

- First, new local government systems were instituted by military dictators without consultation with national and provincial parties or politicians. This led to an absence of any broad political support for any of these three local government systems.
- Second, in a political environment where patronage is rife, the provincial and local politicians compete for the same clientele in their constituencies. Elected local governments which can independently decide priorities regarding public expenditures can challenge provincial political influence in the local areas quite effectively.
- Third, the well established political elites are threatened by political competition that results from a well functioning local government system. Local government systems with regular elections constantly spawn new politicians who can graduate to provincial and national politics. In Pakistan, where a political career requires a lot of money, higher (national and provincial) level politics is mostly an exclusive domain of the rich and established political families. Elections for local governments provide an opportunity for a relatively low-cost entry to new aspiring politicians. Thus absence of local governments curtails political competition.

⁶⁷ The provincial government of Baluchistan has only recently held local government elections, in early 2015. The other three provinces are still delaying local government elections despite pressure from the Supreme Court to announce election dates.

2.5.2 Relatively powerful local governments created in 2001

A new local government law was promulgated by the provinces following the ‘Devolution of Power Plan – 2000’⁶⁸ announced by General Musharraf, a year after his military coup. By far the most ambitious local government system, it differed from previous systems substantially, particularly in being protected through a constitutional amendment (Cheema *et al.*, 2006). Some of its features that directly threatened provincial, political and bureaucratic interests emanated from the unprecedented political legitimacy and authority, including relative autonomy in decisions regarding public expenditures, that the PLGO-2001 granted to local governments.

Unlike previous local government systems, the PLGO-2001 created relatively autonomous, multi-tiered local governments that had the final say on matters within their respective mandates. The three levels of local government (the district, town and union) are financially and administratively independent of one another but connected through their elected officials. At the lowest level, union council members and *Union Nazims* (chairpersons) and *Naib Nazims* (vice-chairpersons) are elected directly through popular vote.⁶⁹ The *Union Nazims* and the *Naib Nazims* represent their union councils in the district and town governments respectively. Indirect elections are held for the posts of the *Nazims* and *Naib Nazims* both at the district and town government levels. This is noteworthy since indirect elections led to relatively independent and powerful positions of *Nazims* at the two important levels of local government. Indirect elections for these positions lead to the criticism that this diluted the accountability of the *Nazims* to their electorate, and made the system susceptible to political manoeuvring. Experts point out that the military regime expected the political executive at the local level to be its core supporters, which was allegedly the primary reason for introducing an empowered local government system (Keefer *et al.*, 2003, Cheema *et al.*, 2006).

⁶⁸ General Musharraf’s devolution plan was developed and implemented by a think-tank, the ‘National Reconstruction Bureau’, especially set up for the purpose and headed by a retired army general. Despite the fact that local government is a provincial ‘subject’ under the Constitution of Pakistan (1973), in 2001, a Local Government Ordinance was presented by the Federal Government which all the provincial governments had to promulgate. Since national and provincial assemblies had been disbanded when the military took over and provinces were being run by Governors – mostly retired generals appointed by General Musharraf – the Federal Government faced no resistance in having the devolution plan implemented.

⁶⁹ One-third members in each council were elected indirectly against reserved seats for women, peasants, labour etc.

The authority of the local government *Nazims* at each level was reinforced by severing the bureaucratic hierarchical linkages that ran through the provincial government and the three tiers of local government. The three tiers of the local government were not only independent of each other in terms of their administrative functioning but also of the provincial government (Khan and Ghalib, 2012). They only relied, to varying degrees, on the provincial government for their income, which mostly comprises formula-based transfers under the Provincial Finance Commission award, that I discuss below. The provincial government could not interfere with, or influence, functioning of the local governments at any level. The PLGO-2001 allowed for mechanisms to check any serious irregularities and corruption committed by local governments; however, the provincial government had very little administrative oversight or control over the local governments. Moreover, in order to reinforce local government autonomy in managing public servants working at the local levels, the historical administrative hierarchy of province-division-district was discontinued by abolishing the divisional (regional) Commissioner tier, as pointed out in section 2.4. This further weakened provincial political influence over the local governments.

The PLGO-2001 established a rule-based fiscal transfer mechanism that ensured unhindered flow of financial resources from the provincial to local governments. The transfer mechanism also ensured that the local governments were mostly⁷⁰ free in setting their expenditure priorities. No previous local government system had given this level of expenditure responsibility to the local governments. The size of provincial government transfers to the local governments amounted to almost 40% of the total provincial income. Transfer to each level of local government was made directly by the provincial Finance Department. This was accompanied by the reassignment of a number of expenditure responsibilities from the provincial to local governments, involving the transfer of field offices of most provincial departments (Hasnain, 2008a).

Compared to the district level, the town governments had substantial own source revenues, which might have raised political concerns at the provincial level. Although provincial transfers form a large part of local government income, local governments

⁷⁰ The local governments cannot reallocate resources from heads of employee salaries and allowances.

were also granted some power directly to raise revenues. While the district governments did not raise any own source revenues,⁷¹ the town governments inherited some well-established municipal taxes and fees, including revenues from urban property tax. Additionally, town governments were also assigned a new levy, of one percent on every immovable property transaction within their jurisdiction, both in urban and rural areas (Cyan, 2007).⁷² As I show in Chapter 3, town governments were generally in a comfortable liquidity position over the 2000s. On the expenditure side, the district governments were handed over control of all provincial social and economic service field units operating at the district level including health, education and public works, which carried significant expenditure responsibility. Town governments were given mainly municipal responsibilities, for example, of water supply and sanitation (except in the 5 City Districts) and town planning (Government of Punjab, 2001).

In principle, post-2001 local governments had significant power, and therefore likely to become the focus of considerable political activity. A clear indicator of the political importance of local governments formed in 2001 was the fact that the political elite became interested in contesting for positions in the local government. In the first local government elections held after promulgation of the new law in 2001, many national and provincial-level politicians chose to run for seats of district and town *Nazims*, while others fielded relatives for these powerful positions⁷³ (Manning *et al.*, 2003, World Bank, 2009b). A number of studies have found evidence that after 2001, elected local governments indulged in patronage politics, delivering targeted services and projects, which indicates that the local politicians were consolidating their client-base (Cheema *et al.*, 2006, Mohmand and Cheema, 2007, Hasnain, 2008b). This posed a challenge to the provincial politicians and resulted in a provincial reaction aimed at curtailing the political influence of the local governments.

⁷¹ District governments were empowered to raise new taxes to fund health and education, but these taxes were never levied by any district government in Punjab (Cyan, 2007).

⁷² The provincial government sets a minimum value of land – usually much below its market value – on the basis of which various property transaction levies are charged.

⁷³ Note that general elections in the country were held in 2002, a year after the local government elections. Since the military coup in 1999, till 2002 national and provincial governments were run by unelected officials appointed by General Musharraf.

2.5.3 Provincial reaction

General Musharraf's decentralisation reforms in 2001 were quite ambitious. Restructuring, almost overnight, a local governance structure that had functioned for more than a century was expected to encounter teething problems. While there might anyway have been problems, some or many of those that were observed resulted from the conscious actions of some agents at provincial level, for example, resistance by civil servants that I discussed in section 2.4. In this sub-section I argue that, once elected provincial governments assumed office in 2002, they started hindering the local government reform process without opposing it openly since the military still ruled the country.⁷⁴ Provincial governments had good reason to resist the decentralisation reforms of 2001. One of the reasons was that, General Musharraf reneged on his promise of devolving more authority from the Federal to provincial governments. In the absence of the devolution of powers from the Federal to the provincial governments there was an acute sense of disempowerment at the provincial level. This forced provincial interests to devise ways in which to withhold the transfer of any real authority to local governments (Kaiser, 2005). For example, in the case of tax assignment, the provinces are themselves highly reliant on federal transfers and have very few taxes that they can re-assign to the local governments (Ghaus and Pasha, 1988, Manning *et al.*, 2003, Pasha, 2013).

The traditional provincial-local government rivalry resumed once elected provincial governments came into power after the general elections in 2002. Since General Musharraf stayed in power, the provincial governments could not eliminate elected local governments like they had done earlier. Instead, the provincial governments embarked upon resisting decentralisation by generally decelerating the reform process and flaunting local government law wherever possible. More specifically, provincial governments undermined local government authority by certain actions including: a) denying administrative powers and control over provincial civil servants, such as appointment, promotion and transfers within their jurisdiction; b) placing a ban on recruitment of lower level staff, that was to be undertaken by local governments; c) regaining control of some field offices; d) initiating provincial government-funded

⁷⁴ General Musharraf got himself elected as the President of Pakistan by the National Assembly after the general elections, held in 2002.

development projects – executed by the provincial government directly – in various sectors within local jurisdictions, bypassing local governments (Manning *et al.*, 2003, World Bank, 2004).⁷⁵⁷⁶

In order to exercise greater control over lower levels of government it is not unusual for the higher level to resort to cut-backs, delays and generally making fiscal transfers unpredictable, behaviour which has been referred to as “tragic brilliance” (Weingast, 2006, 2014; pp.19-20). While explaining why the provincial government was so neglectful of property taxation during the 2000s, a former Punjab provincial Finance Secretary summed up the provincial attitude to local governments quite clearly. He recalled that the Punjab Chief Minister (2002-7) was always “*annoyed with the local government system (and) had misgivings about the amount of resources being transferred to them.*” There are good reasons to believe that the provincial government actively denied the transfer of additional financial resources, or the potential of earning these, to the local governments than those mandated under the rule-based mechanism in place. Property tax revenues are a prime example of this strategy.

In Punjab, about 88% of the provincial-local fiscal transfers comprised recurrent costs, mostly salaries of the employees of the provincial departments devolved to local governments. Although 40% of provincial revenue, these transfers to the local governments gave very limited fiscal room for local governments to initiate their own development programmes (Cyan, 2007, Hasnain, 2008a). Assuming that the objective of the provincial government was to curtail the ability of local governments to develop independent development programmes; it would be logical for the provincial government to thwart the chances of earning or transfers of additional revenues to local governments outside of the rule-based transfer mechanism. This may have been a motivating factor behind some of the provincial governments’ (in)actions regarding property tax after 2001.

⁷⁵ Since 1985 members of the national and provincial parliaments are provided with constituency development funds for programmes in their local constituencies with full discretion to identify projects (see Chapter 4 for details).

⁷⁶ Large donor assisted social sector programmes in Punjab. For example, the Punjab Education Sector Reform Program (World Bank) and the Punjab Devolved Social Sector Services Delivery Program (Asian Development Bank).

Although the provincial share of the property tax revenue remained unchanged after 2001, there is a clear difference in the policies followed by the provincial government before and after 2001 local government reforms. It may be reasonable to assume that the change in policies may have resulted from the historic inter-governmental political rivalry. In the rest of this sub-section, I analyse provincial policy changes concerning property taxation before and after 2001, and suggest that regressive tax policies may have been a deliberate attempt to curtail the income of the town governments.

In 1999, the provincial government changed the basis of property tax assessment from area-based⁷⁷ to a system based on the capital value of properties. The broad objective of changing the way property tax was assessed was to improve tax collection, specifically by making assessments uniform and predictable. Three reasons were highlighted by the senior officers of the provincial government who led this change.⁷⁸ The first was, to curtail excessive discretion exercised by the tax collectors who also assessed properties under the existing system. The second was, to increase tax collection in order to overcome significant shortage of finances due to suspension of international aid to Pakistan after it conducted nuclear tests in 1998. This forced the Federal and provincial governments to cut back expenditures and also introduce some tax reforms.⁷⁹ The third was that, the change in property tax assessment was considered necessary since the relatively high incidence of property tax on rented properties was distorting the housing market, which was in need of greater investment.

However, the change to capital value based assessment could not be implemented as it was declared unlawful by the courts on technical grounds. According to the Constitution of Pakistan, only the Federal Government can impose taxes on capital value.⁸⁰ Resultantly, the provincial government was constrained to implement a rental value based assessment system instead. It is noteworthy that, despite the same (14%) share in

⁷⁷ This can be area based or on the capital/ rental value of the property. In Punjab's case the tax before 1999 was a mix of both: a percentage of actual rent if the property was rented and area-based if it was owner-occupied.

⁷⁸ I interviewed the team that implemented this reform, including the Minister, departmental Secretary and the technical staff.

⁷⁹ Austerity measures usually imply cuts on operations and maintenance expenditures. I discuss this in Chapter 4. Also see the discussion on the financial liquidity position of the provincial government in Chapter 3.

⁸⁰ Subsequent amendments to the Constitution in 2010 have enabled provinces to tax capital.

property tax revenues, the provincial government instituted a landmark policy change which was expected to improve property tax assessment and increase collection significantly. In contrast to the above, provincial policies were regressive after the local government reforms in 2001.

Neglect of its property tax policy and administrative functions after 2001 reflects, at best, the provincial government's indifference to the tax, partly due to the incentive structure that I discuss in section 2.3. At worst, this neglect was a deliberate attempt to deny additional resources to a lower level of government. The provincial government neglected most of its property tax functions, some of which it had been performing on a regular basis before 2001. Below I list non-performance of two such functions and one action of the provincial government, which affected property tax collection adversely (World Bank, 2006, Asian Development Bank, 2007, World Bank, 2009a, Nabi and Shaikh, 2011, World Bank, 2012b):

- First, throughout the period of incumbency of elected local governments – the decade of the 2000s – the provincial government did not revalue properties. It had revalued properties earlier, in 1999, when it changed to assessing property tax on the basis on rental value. Under the Punjab Urban Immoveable Property Tax Act (UIPT), 1958, it is mandatory for the provincial ETD to conduct a complete property tax survey every five years to update the cadastre, identify new properties, and update property values.⁸¹ Since the promulgation of the UIPT Act in 1958, these five-yearly surveys had been undertaken by the ETD regularly. After the local government reform in 2001, the mandatory five-yearly property tax survey was not conducted for almost 15 years. This resulted in a large gap between market rental values and the property valuation table. Since the survey is mandatory under the law, the Secretary of the ETD has to seek special permission from the provincial Chief Minister that allows the ETD to continue with the existing property valuations. This affected property tax liability assessments significantly, due to the high rate of inflation and a bouyant property market where, in real terms, rents have gone up manifold since 1999.⁸²

⁸¹ Under the property tax law and rules, most of these activities (except property revaluation) can be carried out by the assessing authority at the local level on a six-monthly basis as well.

⁸² Officers of the ETD refer to this when they (often) state that property tax demand in the Punjab is 'suppressed'.

- Second, in the absence of periodic surveys, the property valuation table was not indexed to cater for inflation since 1999, a gross oversight in a country with an annual rate of inflation of over 10% in most years. The provincial government's reluctance to index valuation tables in the absence of new surveys is remarkable. As a result, the gap in the valuation table and market rental values is now so large that any effort to revalue properties would result in a politically untenable increase in property tax bills. There has been a recommendation to stagger the impact of revaluation over a number of years but was not accepted by the provincial political leadership till very recently.⁸³
- Third, notwithstanding a number of pre-existing exemptions,⁸⁴ after 2001 the provincial government exempted additional categories of properties from the property tax, without the consent of town governments. There may be various reasons for granting exemptions, for example, to gain popularity or due to the influence of interest groups cannot be discounted. But it is noteworthy that exemptions affect town governments disproportionately because majority of the property tax revenues belong to them. During the 2000s there were no exemptions granted for any of the other provincial taxes. In his budget speech in 2006, the Chief Minister exempted residential properties up to five-*marla* (125 square yards) without consulting the provincial Finance Department⁸⁵ or the ETD regarding its impact. Almost a quarter of the provincial property tax base was lost due to this exemption.⁸⁶

⁸³ As mentioned earlier, in 2014, the provincial political executive allowed property revaluations but on the condition that the tax liability of individual properties will not increase more than 50% of its previous annual liability. Also note that since 2010 elected local governments are not in power. The provincial government is in the process of promulgating a new local government law, with the intention of making the local government less powerful than under the PLGO-2001.

⁸⁴ Since long, government-owned properties, residential properties owned by widows and retired government servants are exempt from property tax.

⁸⁵ The then Secretary of the Finance Department told me that this was not even part of the written budget speech of the Chief Minister. Apparently the Chief Minister and his inner coterie of political advisors took this decision without informing or consulting the concerned departments, which they expected to oppose this populist announcement, for a number of reasons, including commitments with donors.

⁸⁶ More recently, during my fieldwork in 2012, the Punjab Chief Minister exempted poultry farms from property tax on the pretext that they were agricultural and hence outside the ambit of urban taxation irrespective of their physical location. The president of the poultry association told me that, after lobbying unsuccessfully for a number of years, the association eventually succeeded in getting poultry farms exempted from property tax, through a direct intervention by the provincial Chief Minister. Reportedly, the Chief Minister's family has large interests in the poultry business.

After the local government reforms in 2001, the provincial government policies regarding property tax became regressive. This was in contrast to at least some efforts by the provincial government to reform property tax collection, prior to 2001. Misusing its authority over tax policy of a tax assigned to a lower level of government – and at no great loss of revenue to itself⁸⁷ – can be attributed to political expediency. However, these actions, when considered with all others discussed in this chapter and given the history of the provincial-local government relationship, appear to be a deliberate attempt to constrain local government finances.

2.6 Conclusion

Sweeping local government reforms in 2001 resulted in complex division of property tax functions, involving three levels of sub-national government, of which only two enjoy a share of the revenues raised. This complexity impacted negatively on property tax collection. For a range of reasons, the various levels of sub-national government were unwilling and unable to cooperate to the degree required to improve the property tax system. In some cases at least, they were more or less consciously undermining one another.

As a result of the mismatch between tax functions and financial rewards, none of the three levels of government performed their respective functions effectively. The provincial government failed to carry out five-yearly property tax surveys after 2001 causing the property valuations to become out-dated. During a period of high inflation, this is significantly depressed the yield from the property tax. The provincial government also granted a major exemption that eroded the property tax base considerably. District governments did not provide the supervisory, administrative and operational support that they were expected to give to property tax collection. The town governments largely failed to extend property taxation to newly urbanised areas – a significant problem in a context of rapid urbanisation. The three main factors that led to low incentives for the three levels of government to cooperate in the collection of property taxes are:

⁸⁷ Similar instances have been reported in other countries, for example, unilateral exemptions from property taxation granted by some state governments in India (Rao, 2013).

- The division of property tax revenues among various levels of government and their responsibilities for property tax collection were not matched appropriately. As the district government receives no revenue share at all, it has no incentive to cooperate. The provincial government receives only a small share of the property tax although it bears the political and most of the organisational burden of collecting it.
- District governments have particular set of reasons for showing no interest in the property tax, in addition to the fact that they receive no revenue from it. They are required to meet some of the operational costs of property tax collection from their own budgets. But they have been losers in a bureaucratic tussle: most of the substantive authority over the local offices of the Excise and Tax Department that was formally assigned to them in 2001 has being re-appropriated by higher-level officials in the Department. The district governments show no interest in fulfilling their formal responsibilities in relation to property tax collection; meeting recurrent costs and acting as appellate authorities.
- The historic political rivalry between provincial and local governments, which has been exacerbated by the fact that military governments have consistently tried to build up the authority of local governments to provide political and bureaucratic competition to provincial governments and provincial level politicians.

3 Low fiscal equilibrium – Income and liquidity of sub-national governments

3.1 Introduction

The arguments in this chapter and the next one are closely interrelated. Both deal with the fiscal position of various levels of sub-national government, principally the Punjab Provincial Government. The material could have been presented in one chapter, but that chapter would have been very long. I have separated out the chapters as best I can. In this chapter I focus on the incomes of sub-national governments and on their liquidity positions. The next chapter deals with their expenditures. The unifying idea is what I have termed *low-level fiscal equilibrium*. I use this term to signify a situation in which sub-national governments neither make the kinds of efforts one might expect to obtain more revenues for themselves nor appear to be under strong pressures to spend more money on public goods. This context of low fiscal equilibrium is important to understanding my core research question because the property tax is a very obvious mechanism through which two levels of sub-national government – the town level, but also the provincial level – could raise additional resources for themselves.

I should explain from the outset that the argument of this chapter is based in part on speculation and deduction. But that speculation is in turn informed by my long experience of working within the system that I describe and by the ideas that I derived from reading the academic literature on decentralisation and fiscal transfers between various levels of government. While I do not have cast-iron evidence for several of the points that I make, I believe that they are at least very plausible. These various sources of ideas and evidence – my field research, my extensive work experience, and the academic literature – seem largely to point in the same directions.

In the next chapter, I argue that the political and institutional pressures on sub-national governments to spend money are less than one might expect in a country that so obviously lacks many public services. In this chapter, I argue four main points – about revenues and fiscal balances within this context of low fiscal equilibrium.

In section 3.2, I show that sub-national governments have relatively easy access to sources of income other than their own locally raised revenues. In particular, they have relatively generous access to fiscal transfers from higher levels of government and to

loans. As a consequence, own revenues in general, and property tax revenues in particular, are not significant sources of income for them. But to provide the facts about the relative insignificance of the property tax for sub-national government revenues does not provide us with an explanation of why they are so low, and why governments do not make greater efforts to increase them.

I begin to move from fact to explanation in section 3.3, where I review the broader academic literature to show that there is considerable evidence that the kind of generous access to fiscal transfers and loans that we find in Pakistan are likely to create disincentives for sub-national governments to put much effort into raising local taxes of any type. In particular, there is evidence that, once local own revenues fall such that they only provide a small portion of the income for sub-national governments, the political incentives are to keep things that way: it makes more sense politically for sub-national governments to try to extract more revenue from other sources than to start a major local revenue raising effort.

In section 3.4, I provide four pieces of evidence that indicate how and to what extent the processes pointed out in section 3.3 are at work in the case of property tax in the Punjab. The first two pieces of evidence are discussed in detail elsewhere in this thesis. The first is concerned with the incentives for the provincial government to invest in its capacity to collect property taxes. The second is about the significance of property tax revenues as income sources for town governments. I summarise them briefly at the beginning of section 3.4. Then:

- In sub-section 3.4.1, I show that the fiscal transfer mechanisms followed in Pakistan discourage sub-national governments from making efforts to increase own source revenues.
- In sub-section 3.4.2, I show that the Punjab Provincial Government has relatively easy access to foreign loans. That likely reduces its incentives to raise its own source revenues. I argue that the Federal Government allows provincial governments to borrow from multilateral agencies because it benefits from the foreign exchange resources generated.

Section 3.5 begins to link the revenue with the expenditure side, by looking at financial balances of the provincial and selected town governments for the decade of the 2000s. I

show that these sub-national governments have generally retained positive cash balances. This decreases pressures to raise additional revenues of any kind.

3.2 From where do sub-national governments get their money?

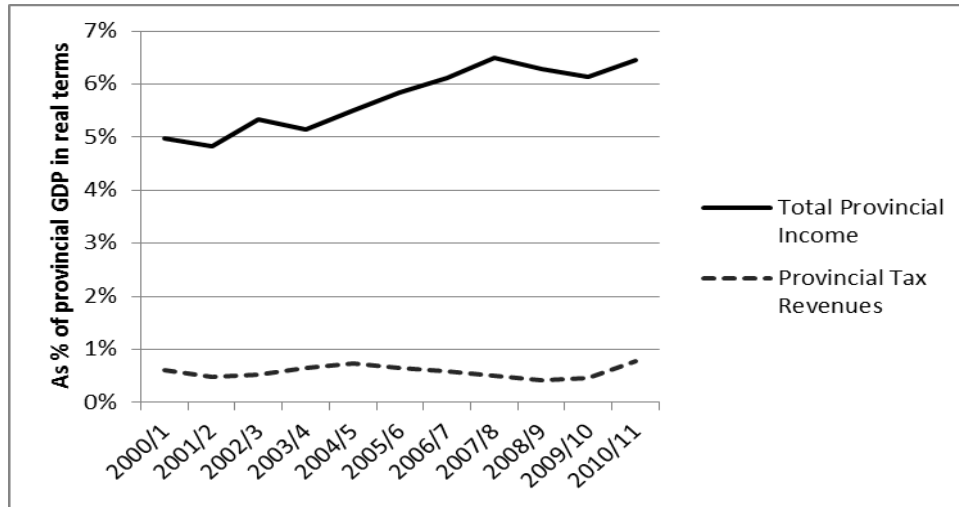
I am not in this section concerned with the district level governments because they do not share in property tax revenues (Chapter 2). The provincial and town governments get their income from different sources. However, both are reliant on transfers from the higher levels of government, and in each case revenues from property tax are a small proportion of total income. Both points are especially true for the provincial government. I deal with the provincial government and town governments separately, in sections 3.2.1 and 3.2.2 respectively. In the case of provincial governments I discuss why transfers and loans are so prevalent.

3.2.1 The provincial government

The Punjab Provincial Government is highly reliant for its income on sources other than tax revenues that it raises itself ('own source revenues'). This reliance has increased over time. Figure 3.1 shows that own tax revenues are a low and generally declining proportion of the total provincial government income over the decade of the 2000s. Over the long term, the ratio of provincial tax revenues to provincial GDP ratio has declined from 1.4% in 1971-72 (Ghaus and Pasha, 1988) to about 1% in the 1990s, and about 0.8% in the 2000s (SBP, 2012).⁸⁸

⁸⁸ Despite this poor performance, Punjab's tax effort is the highest amongst the four provinces in Pakistan (Hussain and Rana, 2010).

Figure 3.1: Punjab Provincial Government own source revenues and total income as % of GDP



Source: Finance Department, Punjab⁸⁹

In Pakistan, the main reason that provincial governments rely on federal transfers is that most of the buoyant taxes belong to the Federal Government.⁹⁰ After Pakistan obtained independence in 1947, for a number of reasons, including imminent bankruptcy and separatist tendencies in various regions, the Federal Government centralised most taxes (Kardar, 1985). The Federal Government collects 92% of the total national tax revenues and the provincial governments collect only 8%, which amounts to less than 1% of GDP. By contrast, the Federal Government is responsible for only 72% of total government expenditures and the provincial governments spend 28% (Pasha, 2013, p.14). The immediate result of this mismatch between expenditure responsibilities and tax assignments of the Federal and provincial governments is that 80% of the income of provincial governments comprises transfers from the Federal Government (Shah, 1996, Bahl *et al.*, 2008b).⁹¹

⁸⁹ Author's calculations using provincial GDP estimates of the World Bank (2013b) and deflator used by the State Bank of Pakistan.

⁹⁰ Federal taxes in Pakistan include the following direct and indirect taxes: All income (except agriculture), corporate taxes and capital value tax; customs, central excise, sales tax (on goods), excise and surcharges on natural resources.

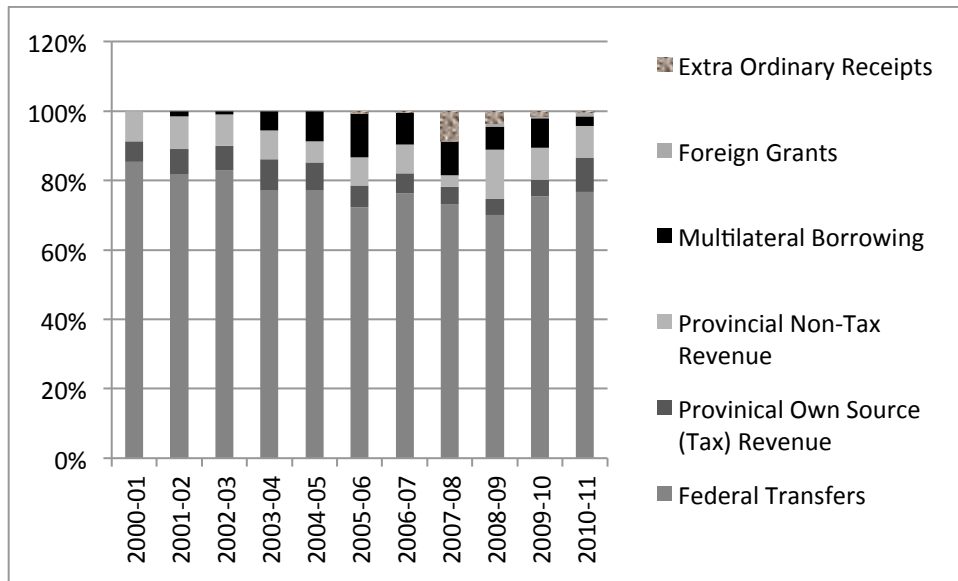
⁹¹ With the 18th Amendment to the Constitution of Pakistan, promulgated in 2010, expenditure responsibilities of the provinces have increased significantly, but have not been fully matched with increased federal transfers. Experts point out that this has increased the gap between provincial expenditure responsibilities and their available resources, and requires significant increase in provincial tax collection (Ahmad, 2013).

Historically, the Punjab Provincial Government (like other provincial governments in Pakistan) has been a net borrower. Earlier it borrowed from the Federal Government to fund part of its annual capital (development) budget. From the 1970s to the 1990s, the Punjab Provincial Government contracted Cash Development Loans (CDLs) from the Federal Government that had a gestation period of 25 years and a grace period of five years. More recently the Punjab Provincial Government borrowed significantly from the World Bank and the Asian Development Bank (Manoel *et al.*, 2012). During the 2000s, budgetary support, a new lending instrument, was introduced by multilateral agencies. These programme-based loans supported the general budgetary operations of the Punjab Provincial Government.⁹² Figure 3.2 shows the high fiscal dependence of the provincial government on federal transfers and loans from multilateral agencies and the low ratio of provincial own source tax revenue to total provincial government income. Between 2000 and 2011, on average, federal transfers constituted 77% of provincial government income and loans accounted for 6%. During this time, on average, the provincial own source revenues constituted 7% of provincial government income, while the provincial share of property tax revenue amounted to 0.08% of its total income.⁹³

⁹² In addition to general budgetary support loans, in the 2000s, the Punjab Provincial Government also contracted sector-specific programme loans from multilateral development banks, for example, the Punjab Education Sector Reform Program (World Bank) and the Punjab Devolved Service Delivery Program (Asian Development Bank). Since sector-specific loans are fungible, they also provide wide leverage to the political executive in how the money is actually spent.

⁹³ Data from the Finance Department, Punjab

Figure 3.2: Income profile of the Punjab Provincial Government⁹⁴



Source: Author's calculations, based on data provided by the Finance Department, Punjab

Property tax revenues are an insignificant source of revenue for the provincial government. The provincial government has good access to other sources of revenue in addition to its own revenues.

3.2.2 Town governments

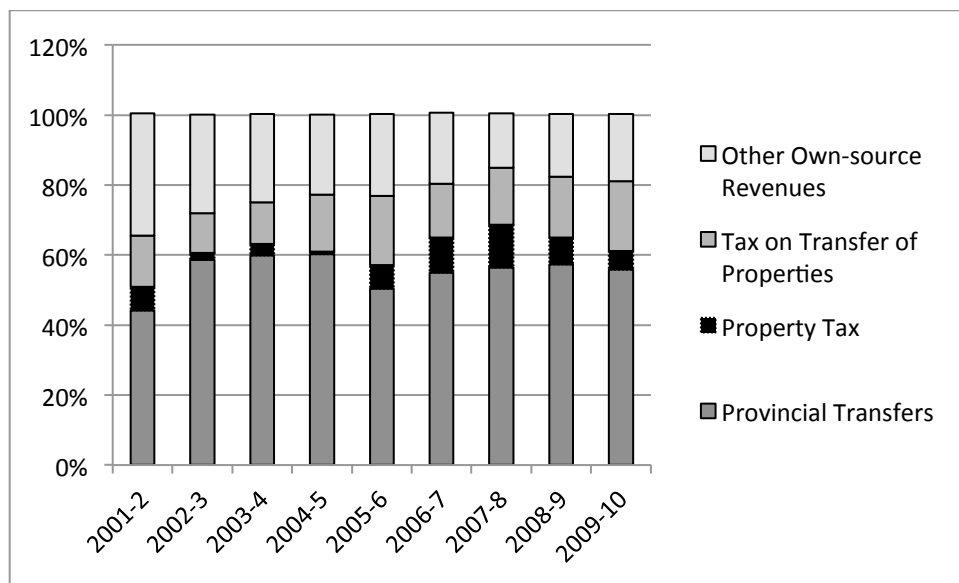
I used financial data from more than a third of the town governments in the Punjab, 49 out of 144 towns. These are spread over 10 out of 36 districts. My sample includes 34 out of 38 towns that constitute the largest (most urbanised) five City Districts, namely, Lahore, Rawalpindi, Gujranwala, Faisalabad and Multan; they together generate about three-fourths of the total property tax revenue in the province. Out of the 49 towns budgetary data from 35 towns covers the time period from 2001 to 2010 while for 14 towns, budgetary data is for the years 2006 to 2010. Thus my sample of town governments is highly representative of urban Punjab that pays property tax.

During the decade of 2000s, on average, property tax constituted about 9% of the total income of the town governments in Punjab.⁹⁵ This might seem very low since town

⁹⁴ 'Extra Ordinary Receipts' refers to one-off revenues like sale of government assets, and sometimes can also reflect an accounting adjustment; these are significant for the financial years: 2007-08 to 2009-10. Foreign grants are a small proportion of Punjab Provincial Government income, and did not exceed 1% of its income during this time period.

governments are the major beneficiaries of property tax revenues. Under the Punjab Local Government Ordinance (PLGO) 2001, the income sources of the town governments include transfers from the provincial government and a number of own sources of revenue, including property tax. Town governments also collect revenues from various traditional municipal levies and fees that they inherited from the municipal authorities that they succeeded.⁹⁶ For the purposes of my analysis, I categorise the income sources of town governments into four main headings. Figure 3.3 shows the relative importance of these sources of income for my sample of town governments.

Figure 3.3: Average income profile of selected town governments



Source: Author's calculations, based on data from the Director General, Local Government and Community Development Department, Punjab

- Provincial transfers

Transfers from the provincial government constitute about 52% of the total income of the town governments. Rule-based financial transfers from provincial to local governments were introduced for the first time in Pakistan under the PLGO-2001 (see

⁹⁵ The town level accounting system is not part of the provincial accounting system maintained by the Accountant General of Punjab. This data is neither readily available at the provincial level nor is it collated by any department. I procured this data officially from town offices through the Director General, Local Government and Community Development Department, Punjab. There is no way of cross-checking this data but it is expected to be reliable since it was officially conveyed to the DG Local Government under the seal and signature of the Town Officer (Finance) in each town government.

⁹⁶ Source: Second Schedule of Punjab Local Government Ordinance, 2001.

Chapter 2 for details). Practically unconditional, these transfers to the town governments are based on a formula involving the total population of the town and its level of urbanisation.⁹⁷

- Tax on transfer of immoveable property (TTIP)

Receipts from the tax on transfer of immoveable properties are significant but quite variable over time. Like all such taxes, receipts depend on property prices and on the level of activity in property markets. Between 2001-02 and 2009-10, TTIP accounted for between 11% and 20% of town government revenues. Prior to the PLGO-2001, only the provincial government collected taxes on transfers of immoveable property.⁹⁸ An additional 1% surcharge on the existing provincial tax on transfer of immoveable property was imposed in 2001, and assigned to town governments. Town governments have to collect this surcharge themselves. They place contractors in the local offices of the District Registrar.

- Other own source revenues

Other sources of town government revenue comprise about 15 traditional municipality fees and levies mostly collected through local contractors appointed by the town governments. These traditional sources of town government revenue declined from almost 40% of total income in 2001-02 to under 20% in 2009-10.

- Property tax

In the decade of 2000s, on average, property tax constituted about 9% of the income of town governments. Although, not insignificant, this is relatively low when compared to other countries. Property tax revenues amount to an average of 19% of the total income for local governments in developing countries (Bird and Slack, 2004; p.6). As explained in Chapter 2, property tax is assessed and collected by the provincial Excise and Taxation Department (ETD). Formally, under the PLGO-2001, the provincial Finance

⁹⁷ This formula only applies to towns in the five City Districts in Punjab; for the rest of the towns in Punjab, the award is based solely on population. The difference in the formula is because more urbanised towns have relatively larger expenditure responsibilities of delivering municipal services.

⁹⁸ The provincial government charges a transfer tax on immoveable properties in addition to various other levies like stamp duty, registration fee and capital value tax. These provincial government levies – based on a basic pre-determined official capital value of urban properties and historical transaction values in cases of rural properties – are collected by the Registrar (of legal deeds) at the district/town level, and amount to about 6% of the official property value.

Department should pass 81% of revenues down to the towns from where the property tax is collected. However, for reasons I discussed in Chapter 2, on average, the town governments received only 57% of the total property taxes collected.

Before going on to analyse the effects on the property tax of the ways of funding sub-national governments, I look at what the academic literature has to say on these issues.

3.3 Review of literature on inter-governmental fiscal transfers

Sub-national governments worldwide rely on fiscal transfers (or ‘grants’) from higher levels of government.⁹⁹ These transfers fund about 60% of sub-national expenditures in developing countries and transition economies, and about a third in OECD countries (Boadway and Shah, 2009; p.351). The most fundamental reason for inter-governmental transfers is that public expenditure functions of sub-national governments are not adequately funded by the taxes, fees and user-charges usually assigned to them.¹⁰⁰

Inter-governmental fiscal transfers are considered to have three inherent, interlinked risks that can lead sub-national governments to indulge in irresponsible fiscal behaviour. First, recipient governments might neglect to raise revenues from taxes assigned to them as they become excessively reliant on transfers from the higher level of government.¹⁰¹ Second, sub-national governments might overspend, expecting to be bailed out by the central government. Central governments can only do this at their own risk. Third, inter-governmental fiscal transfers may weaken the accountability of sub-national governments towards their citizens, because they are less reliant on locally-generated revenues (Gamkhar and Shah, 2007, Weingast, 2009, Scott and Alam, 2011, Muwonge and Ebel, 2014).

Inter-governmental transfers can be designed to mitigate some of these risks. They might also be designed to achieve a number of other national policy objectives: funding centrally-set minimal service delivery standards at sub-national level; addressing issues of equity between sub-national jurisdictions, providing a relatively stable and

⁹⁹ See Bahl and Linn (1994) and Ahmad and Searle (2006) for a taxonomy of how resources are usually divided between central and sub-national governments in developing countries.

¹⁰⁰ See Bird (2010c) for sub-national tax assignment theory and practice.

¹⁰¹ Economists refer to this sort of an easement as a ‘soft-budget constraint’, as opposed to what sub-national governments should be presented with – a ‘hard-budget constraint’, to encourage own-source revenue generation (Kornai et al., 2003).

predictable source of income, amongst others (Tanzi, 2010). Some of these policy objectives conflict with each other. The most significant conflict arises out of the need for the national government to distribute financial resources among sub-national jurisdictions equitably and at the same time avoid the risk of discouraging sub-national governments from raising their own revenues (Bahl and Linn, 1994, Ahmad and Searle, 2006).

Experts state that a ‘good’ transfer design should take into account the fiscal capacity and tax effort of sub-national governments. If it is only their ‘needs’ that are taken into account, then the sub-national government that makes the least effort to raise its own tax revenues will receive a higher share of total transfers. In order to reduce the chances of such perverse incentives from transfers, two conditions are considered necessary. First, transfers need to be designed “*so that the amount received is neither larger when local fiscal effort is lower nor smaller when it is higher*” (Bird and Smart, 2002; p.904). Second, local governments must have the freedom and responsibility to impose some significant taxes of their own. According to some experts, the size of the transfers, compared to sub-national government income, is irrelevant to any incentive or disincentive effects. Provided the grant design is good, perverse incentives that can lead to reduced tax effort by sub-national governments will be minimized. The basic idea is that as long as the recipient sub-national government knows in advance that it will receive only a certain level of resources, even if that covers say 90% or more of its expenditures, it will continue to make the effort to raise the remainder (Bird and Smart, 2002).

However, there are difficulties in implementing these two principles for a good transfer system. First, taxes assigned to sub-national governments might not have the potential to generate revenues that are significant compared to their total income. Second, the transfer system might be under pressure to achieve conflicting objectives: for example, providing extra financial support to poorer sub-national governments while also giving more money to those – usually the richer jurisdictions – that raise relatively more own source revenues. This can complicate the design of transfers considerably. Third, a sophisticated transfer design may require information – about, for example, the fiscal status of subnational governments and human development indicators within their jurisdictions – more accurate and up-to-date and is actually available (Sen and Trebesch (2004). Lastly, political factors, constitutional and legal frameworks, wider inter-

governmental relations, and, in particular, concerns for equity across sub-national regions, impact considerably on the way transfers are distributed among sub-national governments (Ahmad and Searle, 2006, Weingast, 2009).

Not unsurprisingly, there is evidence from low income countries, as well as some high income countries – where sub-national governments generally have significant own source revenues – that sub-national governments prefer to access more transfers from higher levels of government rather than raise additional taxes locally (Caiden and Wildavsky, 1980, Cowan, 2013). There is also evidence of anomalous behaviour by recipient governments. A decrease in own source revenue collection is relatively greater when transfers increase, compared to an increase in revenue collection when transfers are reduced by the same amount (Smart, 1998, Barja Daza *et al.*, 2013, Dash and Raja, 2013). On the whole there is considerable evidence from a wide range of countries that, unless mitigating measures are taken, transfers from higher levels of government lead to irresponsible fiscal behaviour by the recipient governments, including reduced efforts to increase own source revenues (Bird and Smart, 2002, Boex and Kelly, 2013).

Experts believe that, for decentralisation to work effectively and for sub-national governments to be accountable to their citizens, it is important that they are provided with: (i) a clear assignment of expenditure responsibilities, (ii) some own source revenues, (iii) an effective inter-governmental transfer system, and (iv) limits set by higher level government on local government borrowing (Boex and Kelly, 2013; p.261). However, there can be a number of political considerations that prevent the ideal from being achieved. For example, for various political reasons, central governments may transfer some ‘unfunded’ responsibilities to sub-national governments; sub-national governments may not be fully in control of their own source revenues or be able to exploit them; their borrowing abilities may be too low (or high); and there can be numerous issues resulting from inter-governmental transfers. There is also a general issue about uncertainty: the higher-level governments may more or less deliberately keep lower-level governments in a situation of uncertainty, to be better able to influence or control them for electoral or other reasons (Bird and Vaillancourt, 1998b, Rodden, 2000, Boadway and Shah, 2007, Bahl, 2008, Bahl and Martinez-Vazquez, 2008, Weingast, 2009, Boex and Kelly, 2013).

The literature on inter-governmental transfers points out that recipient governments run a high risk of neglecting to raise revenues from taxes assigned to them unless transfers are designed to mitigate this risk. Experts emphasize the need to balance the various objectives of transfers, most importantly the financial needs of sub-national governments and their efforts to raise revenues from taxes assigned to them. For this to work well, the sub-national governments need to have some freedom to impose taxes and the ability to collect them. However, for political reasons and because higher level governments may want to exercise greater control over sub-national governments, transfers do not normally follow the ideals recommended by the experts.

Borrowing allowances to sub-national governments are also expected to impact the tax efforts of sub-national governments. Higher-level governments usually restrict the amount of that sub-national governments can borrow, mainly to avoid usual risks associated with irresponsible fiscal behaviour.

3.4 Effects of sub-national government sources of income on their own tax effort

In this section I provide four pieces of evidence that the intergovernmental fiscal transfer mechanisms in Pakistan have many of the dysfunctional features and effects discussed in the previous section. The first two pieces of evidence have already presented in Chapter 2. I quickly summarise them here.

The first is that the Punjab Provincial Government invests more effort in trying to maintain the infrastructure for collecting the relatively more lucrative provincial taxes than for property taxes. Sub-national governments are more likely to invest in improving the tax collection apparatus where they expect it may pay off in terms of tapping into additional revenue potential. In Chapter 2 (section 2.3.1), I showed that the provincial government readily invested to build its capacity to collect motor vehicle taxes but made relatively low investments in its property tax collection apparatus.

The second is that town governments, which are supposed to receive majority of property tax revenues collected by the provincial government, do not actually receive their shares fully or punctually. As mentioned earlier in this chapter, on average property tax revenues constitute about 9% of the total income of town governments in Punjab. Although this figure is not insignificant, the value of these revenues to the

recipients is reduced because the provincial government makes unannounced and unexplained reductions when it transfers these revenues to town governments. The uncertainty of property tax revenues discourages town governments from making efforts to bring newly urbanised areas into the property tax net (Chapter 2, section 3.2).

My third argument, presented in detail here (sub-section 3.4.1), is that the fiscal transfer mechanisms followed in Pakistan discourage sub-national governments from making efforts to increase own source revenues. The fourth is that the Punjab Provincial Government has relatively easy access to foreign loans. That reduces its incentives to raise its own source revenues (sub-section 3.4.2).

3.4.1 Transfers from the higher level of government

Experts have pointed out that, in Pakistan, historically generous federal transfers have deterred provinces from raising own source revenues (Bahl et al., 2011). According to one estimate, every rupee increase in federal transfers to the Punjab Provincial Government, has led to a decline of five *paisas* in own revenue collection by that government (World Bank, 2013b; p.7). Two features of the system of inter-governmental fiscal transfers in Pakistan discourage sub-national governments from raising more revenues from their own tax bases.

The first reason why, in the case of Pakistan, transfers do not incentivise sub-national efforts to raise taxes assigned to them is the history and availability of additional transfers. The provincial governments can obtain additional transfers during the course of the year, beyond those originally budgeted, by using various kinds of political mechanisms. The Federal tax revenue sharing under the National Finance Commission (NFC) award is not the only resource flow from the Federal to provincial governments. Additional transfers are made under heads of ‘straight transfers’ and ‘grants and subventions’. Straight transfers are largely development surcharges, excise duties and royalties on gas and hydropower profits owed to the provinces by the Federal Government. Special grants and subventions are given to provinces for various purposes such as fiscal equalisation or special development needs, sometimes even to meet fiscal deficits (NFC Secretariat, 2010). Despite being detrimental to fiscal prudence at the sub-national level, such additional transfers are quite common due to political imperatives (Bird and Smart, 2002). Additional transfers are expected to violate a basic rule for good inter-governmental transfers: that the recipient government should know

how much money it has to raise locally, and should not expect additional grants from the higher level government during the course of the financial year. Although, currently the Punjab Provincial Government receives relatively less additional transfers compared to other provinces on a regular bases, these are forthcoming when the need arises, for example, during the relief operations and reconstruction after the extra-ordinary floods in the Punjab in 2010.¹⁰²

The second important feature of fiscal transfers is that they are unconditional. They normally do not involve any conditions on how the money should be spent or how much own source revenues the recipient sub-national governments raise. On rare occasions, some such conditions have been formally introduced. But the conditionality has never been taken seriously. There are understandable political motivations for this lack of conditionality.

As I have explained earlier there are a number of transfers from the Federal Government to the provinces; one of these is rule based. Transfers from the provincial government to local governments are solely rule based. The National and the Provincial Finance Commissions determine these transfers respectively.

Prior to 2010, the National Finance Commission (NFC) awards did not take into account the relative fiscal efforts made by the provincial governments. This changed in principle in 2010, when the criterion for the award was changed to take into account: the population of each province (with an 82% weighting), the provincial poverty index (10.3%), tax revenue generation by the province (5%) and population density of the province (2.7%). However, to date, the condition earmarking 5% of the transfer on provincial tax revenue performance has not been implemented. There is a perception that, due to differences in the potential to raise additional taxes in the various provinces and issues of government capacity, this condition will favour the richer provinces and cause resentment amongst the poorer ones.¹⁰³ Changes in tax policy and administrative improvements in taxation made by the provincial governments are now being regularly monitored and documented in the biannual reports prepared by the federal Ministry of

¹⁰² Most recently, the provinces are pressuring the Federal Government to help them financially to set up power plants to overcome the energy crises. Although electric power is primarily the responsibility of the Federal Government, provincial governments can also invest in power generation up to a certain wattage limit.

¹⁰³ All provinces get the same amount of money under this condition, which basically negates the basic concept of the condition.

Finance (NFC Secretariat, 2010, 2010-13, Pasha, 2013). Similarly, in the case of the Provincial Finance Commission awards, the condition of 5% of transfers to local governments being based on their own source revenue raising effort has not been implemented since 2001.¹⁰⁴

In the rest of this sub-section I explain that politically it is difficult to enforce conditions in the case of transfers in the context of Pakistan. At the Federal level, the transfer mechanisms that developed in Pakistan are primarily shaped by politics. These mechanisms are designed to achieve political consensus over sharing of Federal revenues rather than to incentivise sub-national revenue collection. The transfer mechanisms are designed to primarily promote equity between provinces, and to cater to the needs of the economically weakest province. Since 1951, the Federal Government has distributed federal resources between provinces through a formula-based system; the formula has to be agreed upon by all four provinces. The National Finance Commission (NFC) is constituted by the President of Pakistan to consider the views of all provinces and recommend formulae for sharing federal tax revenues, as mandated by the Constitution of Pakistan¹⁰⁵ (1973).¹⁰⁶ The resultant NFC award governs transfers to provinces for a period of five years. After that, a new commission is formed to reconsider and make a fresh award. The award also governs other federal transfers to provinces and sets borrowing limits for the provincial governments.

Globally, there are four main kinds of institutional arrangements that are used by governments to decide on federal-provincial (state) fiscal transfers: (i) where the Federal Government is solely responsible to design the grant mechanism and distribution criteria, (ii) through a quasi-independent technical commission, (iii) through

¹⁰⁴ Evidence of non-application of this condition is based on my own experience as Additional Secretary, Punjab Finance Department, as in-charge of local government finance. During my fieldwork I also confirmed this fact from colleagues working in the Finance Department, and through analysis of the data on the provincial transfers to town governments.

¹⁰⁵ Article 160 (Government of Pakistan, 1973), available at, http://www.finance.gov.pk/nfc_cons.html

¹⁰⁶ The Federal Government decides the percentage of federal revenues that are to be distributed. Prior to the 7th NFC award (2010) the Federal Government retained about 55% of federal revenues and distributed 45% between the provinces. The 7th NFC award has reduced the retained proportion to about 50% increasing resource transfer to the provinces – referred to as the ‘divisible pool’. However, this has been accompanied by 18th Amendment to the constitution transferring more expenditure responsibilities to the provinces.

federal-provincial committees, (iv) through a variation of an inter-governmental-cum-legislative-cum-civil society committee with equal representation from all constituent units but chaired by the Federal Government. The National Finance Commission in Pakistan is an example of the latter type of arrangement. The commission represents all four provinces equally and the Federal Finance Minister heads it. Each of the four provinces are represented by their finance ministers and by a private individual with relevant technical expertise nominated by provincial government (Boadway and Shah, 2009). There are two characteristics typical of such an inclusive and politically motivated commission, which have also been reported in the case of Pakistan.

- The first is that, though inclusive and transparent, a downside of this model generally is that such a committee can be slow in changing rules and incentive systems that govern transfers, such as those required to encourage sub-national resource generation (Boadway and Shah, 2009; p.387). This is partly because of the dominant role of the representatives from the provinces in this arrangement.
- The second, especially pointed out in the case of Pakistan, is that, political considerations supersede technical ones when it comes to setting or enforcing any conditions within the award that might encourage provinces to increase their own source revenue collection. The award does not impose any conditions on the transfers because of concerns about the fragility of the federation and the history of separatist tendencies. In the interests of national cohesion, the award is normally designed to give special preference to the economically weakest province (Khan, 2006).

From its inception in 1951 until 2010, the NFC award remained unchanged. The membership of the NFC is more political than technical; for example, as compared to India where all the members are technocrats.¹⁰⁷ This partly explains why it has been difficult to change the NFC award for so long. In 2010, the Federal Government was able to convince all the provincial governments to agree to some key changes in the distribution formula, but only after increasing the total share of transfers to the provinces by 5% of total federal financial resources – in order to compensate provincial governments that opposed change because of fear of losing out on revenues.¹⁰⁸ These

¹⁰⁷ In India the Finance Commission is a (non-political) technical body which uses multiple criteria to transfer central resources to state governments (Sen and Trebesch, 2004).

¹⁰⁸ Soon after the NFC award in 2010, the Federal Government passed down a number of additional service delivery responsibilities (through the 18th Amendment to the constitution) to the provincial governments. Experts are of the opinion that the additional

changes basically comprised moving from a population-only criterion to multi-indicator criteria for the distribution of resources among provinces and earmarking 5% of federal transfers to be based on the tax efforts made by the provincial governments. Historically the Punjab government has resisted any change toward multiple criteria for the division of federal transfers among provinces. Being the most populous province, it expected to lose out under any formula not based solely on the population criterion. A formula based partly on indicators of underdevelopment was a longstanding demand by some of the provinces that have relatively smaller populations. Similarly, the less populated and relatively poorer provinces have always resisted any conditions relating to their tax effort, because they argue that their tax bases and level of economic activity are relatively low. Thus historically, while the award mechanism might have managed to meet its objective of political consensus on federal revenue sharing, it has practically not incentivised provinces to increase their own revenue collections.

At the provincial level, although the Provincial Finance Commission members are mostly technocrats and there is only a token representation of local governments. Despite the fact that the PFC award has 5% of the transfer earmarked for local government tax effort since its inception in 2001, the condition has never been applied. This basically reflects that it is politically not viable to base grants on tax efforts of various jurisdictions, both at the provincial and local levels of government.

3.4.2 Borrowing by the provincial government

Earlier in this chapter, I showed that over the 2000s, on average the Punjab Provincial Government borrowed equivalent of about 6% of its total income from multilateral agencies. Easy access to loans reduces incentives for governments to make efforts to raise their own source revenues. In this sub-section I show that the Federal Government allows provincial governments to borrow from abroad because it stands to gain from this, in two ways:¹⁰⁹

transfers to provinces are much less than the expenditures that the additional responsibilities entail. For a detailed analysis of these developments and their potential negative impact on service delivery, if provincial tax revenues are not raised substantially, see Ahmad (2013) and Pasha (2013).

¹⁰⁹ Some senior officers of the Punjab Finance department informed me that the Federal Government usually encourages provincial governments to borrow from multilateral development banks.

First, loans contracted by the provincial governments from multilateral institutions help bolster foreign exchange reserves of the Federal Government. The Federal Government retains the foreign currency in which multilateral loans are disbursed and passes down loans to the provinces in local currency. The Federal Government has historically struggled with fluctuating and mostly low foreign exchange reserves (averaging about US\$ 3.5 billion over the last 30 years)¹¹⁰ due to a chronic external account deficit.¹¹¹ The Federal Government requires foreign exchange for repayment of foreign loans and its large petroleum import bill, amongst other imports. Political commentators and opposition leaders often gauge the Federal Government's economic management and the fiscal stability during different regimes by the amount of foreign exchange reserves. The popular press usually enumerates foreign exchange as the number of days that the country can pay for its oil import.

Second, the Federal Government has for some time now been running a high budget deficit and has been accumulating a large amount of debt. The provincial governments, at least in the case of Punjab, do not have large debts. The Federal Government prefers that provincial governments borrow from abroad and has stopped extending Cash Development Loans to provinces since budgetary support has become available to provinces from multilateral agencies, since early 2000s.

The Federal Government has a wide array of debt raising instruments (see table 3.1), and has historically received foreign aid. Of late the deficit in the Federal Government budget has increased rapidly. Federal deficits averaged over 3% of GDP from 2001 to 2010. In 2011-12, the federal budget deficit increased to 8% of GDP; the debt to GDP ratio was approximately 60%;¹¹² and the debt to revenue ratio was about 500%. This led the State Bank of Pakistan (SBP)¹¹³ to issue warnings about the unsustainability of the Federal Government debt (SBP, 2012).

The Punjab Provincial Government has relatively low debt to GDP ratio and has a wide margin to increase its borrowing. The provincial governments can only borrow from the Federal Government or, with its permission, from multilateral agencies (see table

¹¹⁰ <http://www.theglobaleconomy.com/Pakistan/Reserves/>

¹¹¹ Pakistan has been floating in and out of IMF lending programmes since the 1980s. See, https://www.imf.org/external/np/fin/tad/extrans1.aspx?memberKey1=760&endDate=2015-04-04&finposition_flag=YES, and McCartney (2012).

¹¹² The average debt to GDP ratio for low income countries is about 40% (SBP, 2012, p.75)

¹¹³ Pakistan's central bank

3.1).¹¹⁴ Moreover, the provincial governments can only approve balanced budgets, implying that estimated expenditures should equal estimated income – including federal transfers, borrowing and own source revenues. For short-term cash flow shortages, the provincial governments can also avail an overdraft facility from the State Bank of Pakistan. Despite increased levels of borrowing throughout the 2000s, Punjab government's total outstanding debt in 2011 stood at Rs. 413 billion, about 4% of provincial GDP, while its debt servicing was Rs. 43 billion, 8% of total provincial revenues. The various debt ratios of the Punjab government are relatively low (compared to the Federal Government) and there is a wide scope for the provincial government to borrow. The Federal Government is already strapped for financial resources and readily grants permission to provincial governments to borrow from multilateral agencies, and prefers to avoid sharing additional federal resources with them.

Table 3.1: Sources of credit available to various levels of government in Pakistan

	Foreign	Public Debt ¹¹⁵	Commercial Banking Sector	State Bank of Pakistan	Higher level of government
Federal	Yes ¹¹⁶	Yes	Yes	Yes	-
Provincial ¹¹⁷	Yes ¹¹⁸	No	No ¹¹⁹	No ¹²⁰	Yes
Local ¹²¹ (Town)	No	No	No	No	No ¹²²

¹¹⁴ Clause 3, Article 167 of the Constitution

¹¹⁵ Undertaken by floating bonds, treasury bills and various other instruments in the financial markets

¹¹⁶ Federal Government has also raised credit internationally by floating bonds

¹¹⁷ I have shown the de facto position before 2010. With the passage of 18th Amendment to the Constitution the provinces have acquired the right to borrow from domestic and international lenders, subject to limits and conditions set by the National Economic Council (Manoel *et al.*, 2012).

¹¹⁸ Multi-lateral agencies only

¹¹⁹ Provinces are only allowed to do this when trading commodities, like wheat, when the provincial government buys some stock for strategic purposes and sells it over the year and returns the loan contracted from a consortium of commercial banks.

¹²⁰ Provincial government can only avail a temporary 'overdraft' facility from the State Bank of Pakistan.

¹²¹ The local governments cannot access credit from any source, except from the provincial government, and then only in exceptional circumstances. Section 120 of Punjab Local Government Ordinance prohibits local governments from incurring debt. However, semi-autonomous bodies in large cities like water and sanitation agencies and city development authorities sometimes borrow from the Punjab Provincial Government.

Source: Author¹²³

Although the Federal Government is the ultimate sovereign guarantor for these loans, it does not bear the burden of repayments or other risks – of rupee devaluation, for example – associated with provincial multilateral loans.¹²⁴ This is because the Federal Government deducts loan repayments from federal transfers to the provinces.¹²⁵

3.5 Sub-national government liquidity and the likelihood of increasing own source revenues

This section does not fit too neatly in this chapter and might well be part of the next chapter. Issues of liquidity are intermediate between issues of revenue and expenditure. I include the section on liquidity here for practical reasons of chapter length: Chapter 4 would otherwise be too long. In this section I show that, over the decade of the 2000s, the provincial and the town governments were generally in a relatively comfortable liquidity position, in terms of cash-at-hand. In the case of the provincial government, there is some evidence that during earlier episodes of ‘fiscal stress’, it made efforts to increase its own source revenues. This is normally expected behaviour by governments when faced with sustained periods of ‘fiscal stress’. Diamond defines ‘structural fiscal stress’ as the tendency for government expenditures to grow faster than revenues resulting in a persistent liquidity problem. There is an expectation that a persistent liquidity problem over the medium term will encourage the government to raise more revenues (Diamond, 1996; p. 53). The logical corollary is that, if a government is persistently in a fiscally liquid position in the medium-term, there is a reduced probability that it will increase own revenue collection.¹²⁶ It is likely that absence of efforts to raise additional revenues in the case I am dealing with is partly because of the

¹²² This can happen under exceptional circumstances but did not happen during 2001-10.

¹²³ Collated from the Constitution of the Islamic Republic of Pakistan, 1973, and Punjab Local Government Ordinance, 2001; and discussions with the Finance department officers

¹²⁴ Loan and interest repayments are ‘charged expenditures’ under the Constitution the provincial assembly cannot vote on them when the budget is presented; Articles 73-88 of the Constitution deal with budget and other money matters.

¹²⁵ This is because technically foreign loans are contracted by the Federal Government and loaned on to the provinces.

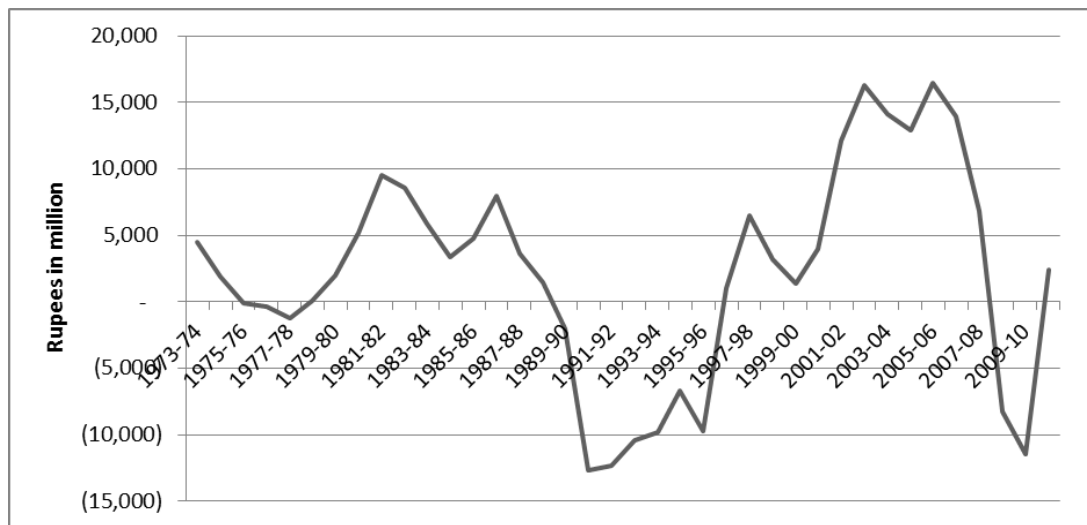
¹²⁶ Others have linked the issue of persistent positive end-year cash balances in a developing country – that appear puzzling since governments of poor country supposedly lack resources for investment and public services and hence require foreign aid – to lack of capacity to spend, underdeveloped budgetary institutions and multiple uncertainties (Caiden and Wildavsky, 1980; p145).

relatively comfortable liquidity position of the Punjab Provincial Government (sub-section 3.5.1) and also of the town governments (sub-section 3.5.2).

3.5.1 The provincial government

For most of the 2000s, the Punjab Provincial Government was fiscally liquid. I use average cash balances over the year as a proxy for liquidity, since government accounting in Pakistan operates on a cash basis and these balances reflect the fiscal position of the government.¹²⁷ In periods where the provincial government has found itself facing persistent negative cash balances, it introduced some tax reforms, which I discuss below; but largely the provincial government relied on implementing strict austerity¹²⁸ measures – a recurrent behaviour, which I discuss in Chapter 4. From 2001 to 2008, the government was flush with cash (see figure 3.4); this is the only time period in recent history when austerity measures were not imposed.

Figure 3.4: Cash balance of the Punjab Provincial Government (Base year: 2001-02)



Source: State Bank of Pakistan¹²⁹

There is some evidence of efforts to increase tax collection by the provincial government during periods of sustained fiscal stress. For example, during the 1990s, the

¹²⁷ The provincial government holds a consolidated account with the State Bank of Pakistan and all its transactions are reported on a daily basis.

¹²⁸ Austerity measures include a 10-15% cut in expenditures, mostly related cutting operational expenditures including repair and maintenance, foreign tours by officials, purchase of vehicles, creation of new public sector jobs and hiring against vacant positions.

¹²⁹ Data procured through the Finance Department, Punjab

government dealt with the negative liquidity position first by declaring austerity measures and eventually making an effort to increase own revenues. In 1997, the Punjab Provincial Government introduced a comprehensive tax reform package; including improving the Stamp Duty Act and imposing the provincial agriculture income tax (World Bank, 1999).¹³⁰ As discussed in Chapter 2, in 1999, the provincial government took a landmark decision to streamline the basis for property tax assessment and introduced standardised valuation tables. This was a substantial policy change that was expected to increase property tax collection. Changes in property tax policies were expected to decrease discretion of tax inspectors (assessors) and bring property valuations closer to market values. From 2008 to 2010 there was again a dip in cash balances. This was partly caused by a newly elected provincial government initiating large food subsidy programmes and more generally due to decreases in transfers from the Federal Government.¹³¹ These food subsidies were scaled down, partly because of cost, and the provincial government returned to a positive cash balance position in 2011-12.¹³² During this period (2008-09) of negative cash balances, the provincial government introduced two new taxes: farm house tax and luxury vehicle tax.¹³³ This move is in line with the expectation that the government is more inclined to make an effort to increase its tax revenues during times of fiscal stress.

3.5.2 The town governments

Under the PLGO-2001, town governments are required to maintain positive cash balance equivalent to 5% of their estimated annual expenditures. Unlike the provincial government, they cannot access short-term overdrafts. One would not expect them to have negative end-year cash balances, and indeed they do not. I found that the aggregate

¹³⁰ However, due to lax enforcement for various reasons revenues from agricultural income tax were barely Rs. 1 billion in 2012. This is considered a huge under exploited provincial tax base given that agriculture amounts to about a quarter of Punjab's GDP. Potential revenue from agriculture income tax for Punjab is estimated to be between 50 to 70 billion rupees (Nasim, 2013).

¹³¹ Largely due to a sharp decline in the federal tax revenues due to increased terrorism in 2007-8, as well as the general unrest and agitation in the country after Benazir Bhutto's assassination.

¹³² I was serving in the provincial Finance Department as Additional Secretary at the time.

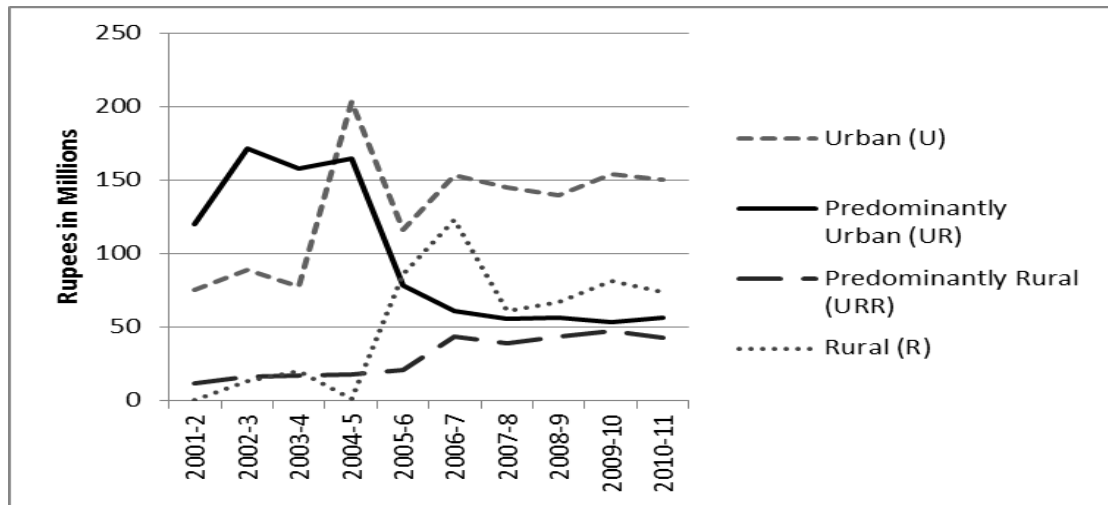
¹³³ In fact the luxury vehicle tax in Punjab was largely counterproductive; after imposition of the tax luxury vehicles are mostly being registered by owners outside Punjab, which makes Punjab lose annual token tax revenues on those vehicles, in addition to registration fees.

year-end real cash balances of selected town governments in the province rose throughout the 2000s. This indicates a comfortable degree of liquidity and, as in the case of the provincial government, no urgent fiscal pressure to raise additional revenues.

I categorise town governments according to their level of urbanisation in order to check if more urbanised towns had a different cash position. I investigate this by analysing time series cash balance data for 49 towns in 10 districts, including the 5 City Districts. The Punjab Provincial Government categorises union councils that constitute town jurisdictions as urban or rural (Government of Punjab, 2012). I denote town governments that consist of only urban or rural union councils as ‘U’ and ‘R’, respectively; town governments that consist of predominantly (more than 50%) urban councils as ‘UR’ and those predominantly comprising (more than 50%) rural union councils as ‘URR’.

On average, except ‘predominantly-urban’ (UR) towns, the rest of the towns in Punjab show (figure 3.5) a trend of increasing cash balances in real terms, from 2001 to 2011. This is partly due to the cumulative effect of non-lapsable cash transfers. Under the PLGO-2001, town governments work outside the government financial accounting system through checking accounts in prescribed local banks, so their cash-at-hand does not lapse into the provincial treasury at the end of the financial year.¹³⁴

¹³⁴ Town governments enjoy a unique accounting status of working outside the normal government accounting system. The provincial and district government levels are part of an online accounting system which has so far not been extended to the town level. The predecessors of the town governments, the municipalities, were also not part of the provincial accounting system. The audit system of the town governments is also separate and run by the Local Fund Audit rather than the Auditor General of Punjab.

Figure 3.5: Town government cash balances (Base year: 2001-02)

Source: Author's calculations; data from Director General, Local Government and Community Development Department, Punjab

Based on my earlier discussion linking cash balances with the probability of increasing tax collection, there is a possibility that, on average, (except predominantly-urban [UR] towns) town governments were in a comfortable liquidity position and had little incentive to raise additional revenue from property taxes, or any other levy for that matter. Even in the case of predominantly urban (UR) towns the cash balance position stabilized after 2005-6.¹³⁵ Positive real cash balances provide a probable explanation for why most town governments did not include newly urbanised areas into the property tax net – the sole responsibility of the town governments regarding property taxation (see Chapter 2).

The foregoing cash-balance analysis of town governments corroborates accounts of some town government officials that I interviewed. They told me that town politicians did not feel any need to increase own source revenues, not even from those sources that the town governments controlled directly.¹³⁶ As reflected in their liquidity position, town governments were not under any sustained fiscal stress that could possibly prompt efforts to increase their revenue collection.

¹³⁵ There is a possibility that these town governments hit their minimum requirement of holding at least 5% of their estimated annual expenditures.

¹³⁶ Town government officials told me that town level politicians were more interested in awarding contracts for collection of municipal levies to people connected to them personally or politically, but that is not my direct concern here.

3.6 Conclusion

My arguments in this chapter are in part speculative and deductive. They are based on my own experience of working in the government, my fieldwork, the relevant literature and a great deal of searching for and analysis of fiscal data from various levels of government in the Punjab. Evidence from elsewhere suggests that when transfers from the higher level of government and other sources of revenue are available to sub-national governments; there is a possibility that the sub-national governments will not make efforts to increase their own source taxation. In the case of Punjab, I found that both the provincial and the town governments are highly reliant on sources of revenue other than their own source taxes generally and property tax specifically. As expected, this leads to a number of disincentives for them to increase revenues from property tax substantially.

There is some evidence of four channels through which the fiscal transfer and loan mechanisms in place in the Punjab discourage provincial and town governments from making more efforts to increase property tax revenues: the provincial government does not expect any significant financial benefit from investing in maintaining or improving its capacity to collect property tax; the town governments are uncertain of financial gains from adding new areas in the property tax net – mainly due to the unreliability of transfers of their share of property tax revenues; transfers from the higher level of government are not conditional to own source tax efforts of the sub-national governments; and the provincial government has easy access to loans.

In the end, I started linking the revenue side of the low fiscal equilibrium to the expenditure side. I showed that the provincial and town governments generally maintained positive cash balances during the 2000s. I argued that a comfortable liquidity position reduced the probability that the governments will make efforts to increase their tax collection. In the next chapter I look at the expenditure side of the low fiscal equilibrium.

4 Low fiscal equilibrium – lack of incentives to spend

4.1 Introduction

Like the previous two chapters, this chapter deals with the reasons why sub-national governments in Pakistan are not very highly motivated to raise additional revenue through the property tax. In Chapter 2, I explained how the division of both responsibilities and revenues between the three levels of sub-national government results in weak incentives for any one of them to put significant effort into improving the performance of the property tax system. The poor design of the property tax collection machinery is, at best, a partial explanation of low efforts to collect property tax. Indeed, one might say that I have done no more than shift the focus of the question. Why is it that sub-national governments have not made more effort to overcome, directly or by pressuring the central government, the various problems with the property tax system set out in Chapter 2? Part of the answer is that, property taxes are not popular with property owners, and governments do not like to become unpopular if they can avoid it, as I explain in Chapter 3. But that is true of all taxes. If governments were to refrain from taxing because of the unpopularity of taxes, they would raise no revenues at all. The unpopularity of taxes is on average counterbalanced politically by the popularity of public spending. Why do the sub-national governments in Punjab – above all the provincial government – not make serious efforts to raise more own revenues to meet the political demands for more spending that one might expect to emanate from (a) the poor, who are grossly underprovided with public services, (b) the people with the most immediate and visible interest in public spending – the public servants and, (c) the aid donors, who fund the provincial government significantly and extract commitments from governments to also spend on public services?

My main argument in this chapter is that provincial government is not under such strong pressures to raise revenue to fund public services as one might believe on the basis of the standard narratives, discourses and procedures through which it conducts its business and represents itself to the outside world. The government normally has enough resources to fund politically prioritised expenditures such as employee-related expenses (salaries, allowances and pensions) and development projects (capital budget). There are no pressing internal political pressures to raise additional revenues because, for a number of reasons, the government is not under strong political pressures to spend

on public services. Firstly, political demands for expanded service delivery are relatively weak, despite appallingly low levels of provision, because of the prevalence of patronage politics; political dominance of the relatively well off who are largely not reliant on publicly provided services; and weak public and social accountability of the provincial government for the ways in which it spends its budget. Secondly, the provincial government is rarely at serious risk of upsetting a powerful interest group, its own employees, because it always prioritises their salaries, even if that means cutting back on expenditure elsewhere. Thirdly, the provincial government can effectively ignore pressure (in terms of conditionality) from aid donors to raise expenditures on service delivery without risking its long-term relationship with them.

In this chapter I use three broad expenditure categories to make my argument. The first two are ‘recurrent’ expenditures. First are the ‘employee related expenditures’ that include salaries, pensions and other benefits of civil servants; second are ‘operations and maintenance costs’ (O&M) that include consumables, repairs, maintenance, utilities and other operational necessities also referred to as ‘non-salary recurrent costs’. The third are capital expenditures that include new development projects.¹³⁷

Budgets need to be formally balanced at the beginning of the fiscal year and the provincial government is required by the Federal Government to maintain a positive liquidity position. However, very little effort is put into funding service delivery. Inadequate provision is made for operations and maintenance costs that are critical to effective public service delivery. Because it is normally able to remain liquid in cash terms and to retain unspent balances at the end of the year, as shown in Chapter 3, the provincial government broadly satisfies the fiscal objectives imposed by the Federal Government.

Note that this chapter focuses almost exclusively on the Punjab Provincial Government. It is the prime actor in respect of the issues discussed here. Since it largely controls the collection and rate setting apparatuses, it is the level of government best placed to change levels of property tax revenues. It is also wholly responsible for funding the

¹³⁷ In the case of loan repayments, the interest payments on loans are reflected in the recurrent budget while the capital repayments are reflected in the capital budget. Loans repayments do not concern me in this analysis for two reasons. First, as I show in Chapter 2, these are not large in the case of Punjab. Second, these are ‘charged expenditures’ of the government which are not controlled by politicians and not voted upon in the Provincial Assembly.

delivery of all the basic social and economic services, for example, primary health, education, local civil works etc.¹³⁸ It both funds and directly manages the provision of higher level (tertiary) services, for example, large hospitals, colleges, large (inter-district) infrastructure etc. Thus, one might expect that there would be strong public pressures on the provincial government to provide and fund public services.¹³⁹

The provincial government seems relatively comfortable, in a political sense, with the current situation in which it (a) depends mainly on federal transfers for revenues and (b) rarely runs into the kinds of liquidity crises that could force it to increase tax collection. One cannot satisfactorily explain this situation without delving deeply into the politics, political economy and public finances of Punjab in particular and Pakistan more generally. For example, Easterly (2003) finds considerable evidence for explanations of ‘elite domination’ and ‘ethnic factionalism’ for poor public service delivery in the case of Pakistan. Though I raise some of these issues in my analysis of the reasons for low pressures to spend on public service delivery, a detailed examination of these issues would go beyond the scope of this thesis. I focus on those elements of the explanation for poor service delivery that became most evident to me in the course of my review of the literature (see section 1.5.1), my fieldwork and my earlier work experience in the Pakistan public service. In the following sections, I provide some evidence that is consistent with my arguments, and therefore renders them at least plausible.

In Section 4.2, I provide evidence that, despite large gaps in service delivery, the government of Pakistan spends much less on key social sectors than other governments in the South Asia. Based on my review of the literature on budgeting (section 1.5.1), I also investigate and show that ‘operations and maintenance costs’ (O&M), which are critical to service delivery, are insufficiently funded. In the three sections that follow, I provide evidence that point to low political pressures on the government to deliver expanded public services, that is consistent with the literature. The kind of evidence I provide in these sections varies. In places I rely on secondary data and in others on my personal impressions and experience while working for the government.

¹³⁸ These funds are given to the district governments that deliver these services. As mentioned in Chapter 2, the district governments have no own source revenues at all and are financially dependent on the provincial government.

¹³⁹ Under the Constitution of Pakistan, it is primarily the responsibility of the provincial government to provide all public services. The provincial government can decide which services to provide directly, and which ones to provide through local governments.

In section 4.3, I discuss, with evidence, three possible reasons for why public service delivery is a low priority for the government. These three explanations are conditional to the broad point about the nature of politics in Pakistan that I mentioned earlier and interact with one another in complex ways and are not separate and distinct causes. They are: (a) politicians prefer to spend on new projects rather than fund operations and maintenance (O&M) costs of service delivery; (b) the relatively well-off do not use most public services; and (c) generally, there is weak social and political accountability of the ways in which the government spends public money. My argument of weak fiscal accountability is mostly deductive in nature and is supported largely by secondary evidence.

In section 4.4, I show that the provincial government does not face any strong pressures from a powerful constituency which has an obvious interest in increased public spending, i.e. the civil service, which is paid its salaries regularly, even when the government is short of funds.

Section 4.5 is largely based on my personal experience of working for a donor-funded public sector reform programme. I use it as an example to argue that the government is not under any strong pressures to expand public services from its aid donors – in the sense that it can effectively ignore any conditionality linked to aid. I conclude the discussion in section 4.6.

4.2 Low levels of service delivery and operations and maintenance costs

The standard of public service delivery to poor people in the Punjab is very low. A major reason is that the budgetary resources allocated for service delivery are very low. This suggests that public service delivery is low priority for the government.

Punjab is the largest province in Pakistan, with more than 50% of the country's population of 180 million. Pakistan has low human development indicators; it ranks 146 out of 187 countries on the HDI scale.¹⁴⁰ The fact that Pakistan is nine places lower on the human development index than on its per capita national income ranking reflects the

¹⁴⁰ The Human Development Index (HDI) is a composite statistic of life expectancy, education, and per capita income indicators, which is used to rank countries into four tiers of human development.

gap in service delivery (UNDP, 2013). Pakistan is one of the few countries in the world to have been unsuccessful in eradicating polio. Experts point out that one of the reasons for Pakistan's low human development is low expenditure on social services (Easterly, 2003).¹⁴¹ Social sector expenditures in Pakistan are considerably lower than the average for countries in South Asia (see table 4.1).

Table 4.1: Public social sector expenditures, as % of GDP

Country/Region	Total government expenditure	Education	Health	Social protection	Total social sector expenditure
Pakistan	16.33	1.05	0.46	0.00	1.50
Average for South Asian countries	18.74	2.66	1.17	0.88	4.71

Source: Adapted from Table 1.2 in World Bank (2012a)

Another reason for the large and increasing gaps in service delivery in Punjab is the rapidly growing population. A joint UNDP-Government of Punjab report on multiple deprivations found that while the overall number of those deprived (of social services) in the province had decreased from 45% in 2003-04 to 43% in 2007-08, there was an increase in the actual number of people classified as deprived from 32 to 33 million, out of a total population of about 90 million. This numerical increase clearly points to a failure of public services to adequately reach and serve more than a third of the population of the province. The report derives a deprivation index based on periodic UNICEF-led Multiple Indicator Cluster Surveys conducted in Punjab. It includes indicators on health, education, water supply and sanitation, amongst others. Though there is wide regional and urban-rural variation within Punjab, in 2008, 20% of the population was deprived in terms of health and education, and 69% were deprived of

¹⁴¹ Easterly (2003) emphasizes Pakistan's low human development in relation to its per capita GDP and in comparison to other countries at the same level of income. He points out reasonable levels of annual growth without corresponding improvements in human development. He also points out that compared to other countries at same level of income Pakistan's defence expenditure as a percentage of GDP is significantly higher, by about 3%, which mirrors its lower social sector spending.

water supply and sanitation services (UNDP and Punjab, 2011). There are complex reasons for gaps in service delivery in Punjab including those of governance, accountability and state capacity.

Amongst other factors responsible for the relatively low human development indicators in Punjab, experts point to low allocations for operations and maintenance costs (O&M) that are critical for service delivery (Easterly, 2003, World Bank, 2013b). Of its recurrent expenditures, the provincial government allocates about 16% for O&M (World Bank, 2013b; p.12).¹⁴² Typically, a scarcity of financial resources at the point of service delivery results in, for example, schools being without teaching material, health care facilities without consumables and medicines, and emergency vehicles without fuel and spare parts.¹⁴³ Since O&M costs also include funds for repairs and maintenance of capital stock, a shortfall results in dilapidated public buildings, equipment in disrepair, and broken down official vehicles that restrict field-staff movement and affect the general functioning of the government. The government does not provide even basic materials like stationery for official work.¹⁴⁴

Similar budgetary issues also persist in the economic sectors. For example, scarce funds for O&M costs lead to a neglect of road and irrigation infrastructure, which at times can lead to disastrous consequences, as experienced in 2010 when massive flooding displaced millions of people.¹⁴⁵ Neglected maintenance of embankments was declared by a floods inquiry committee to be a contributory factor.¹⁴⁶ In the case of irrigation

¹⁴² In stark contrast to this, at the Federal Government level, the military budget has an O&M cost which is more than 50% of its employee related expenditures (PILDAT, 2012b). Over the years, along with other factors, this has resulted in the outcome that, as some have pointed out, the military in Pakistan is the only effective and resourceful institution (Lieven, 2011).

¹⁴³ The press usually reports cases where absence of government funding for delivery of public services can result in disasters. For example, recently deaths of 27 new born children were reported in a government hospital in a major town (Sargodha) because the hospital was reportedly short of oxygen cylinders, amongst other issues. See, <http://www.dawn.com/news/1146780>

¹⁴⁴ I discuss the point about tax collectors bearing the day to day expenditures of tax collection in Chapter 5.

¹⁴⁵ Punjab has one of the largest man-made canal irrigation systems in the world. For a detailed analysis of how low operation and maintenance expenditures have affected the irrigation system, see (Bengali, 2009).

¹⁴⁶ "A Rude Awakening:" Report of the Judicial Flood Inquiry Tribunal on the causes of major breeches in River Indus during the exceptionally high floods in 2010. (Available from Punjab Government) The report points out the issues but does not go into the reasons, apart from lack of supervision and implied corruption.

infrastructure, experts point out that, rather than maintaining its capital assets the government follows a practice of “*build-neglect-rebuild*” (Briscoe and Qamar, 2006; p.8).

The provincial government repeatedly reaffirms its commitment to uplift the provincial population both socially and economically. Despite the political rhetoric,¹⁴⁷ reflected in numerous policy documents,¹⁴⁸ expenditure on public service delivery remains low. In the following three sections, I argue that this is partly because of low political pressures on the government to deliver public services.

4.3 Service delivery to the poor is a low priority for the government

How and why government policies and priorities are set is complex and dependent on a number of interconnected factors. In this section, I suggest three possible reasons why the provincial government does not prioritise public service delivery. My arguments are based on my fieldwork, secondary data, and my prior experience and personal impressions of working for the Punjab Provincial Government in the Finance Department and the Planning and Development Department.

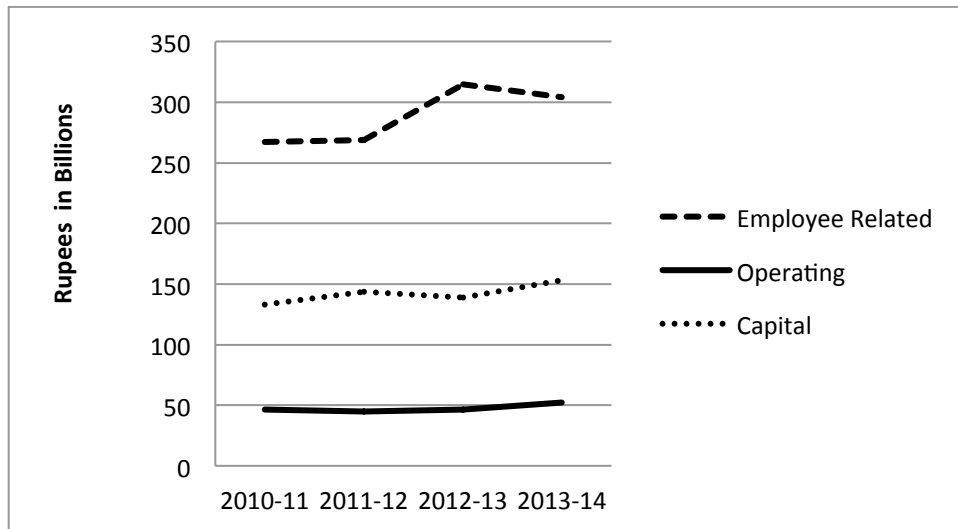
(a) Politicians prefer to fund new projects (mostly civil works) over investing in maintaining existing government capital stock and/or delivering better public services through the existing infrastructure. The annual budget of the Punjab province contains three main expenditure categories: employee-related expenses and O&M costs constitute the recurrent expenditure of the government, while the rest of provincial income is spent on capital (development) expenditure.¹⁴⁹

There are four possible reasons why politicians allocate more resources for capital expenditure than for O&M costs (see figure 4.1).

¹⁴⁷ For example see various reports on “Punjab Development Forum” (PDF) – an annual conference with donors and other stakeholders – held regularly by Punjab government in the 2000’s, at <http://prmp.pitb.gov.pk/prmp1>.

¹⁴⁸ For example, “Vision 2020” (Government of Punjab, 2004); “Poverty focused investment strategy for Punjab” (Government of Punjab, 2006) and “A strategy for accelerating economic growth and improving service delivery” (Government of Punjab, 2009). The latter two are available at <http://prmp.pitb.gov.pk/publications>.

¹⁴⁹ Loan repayments and interest payments are less than 3% of Punjab government’s total annual expenditures. Punjab’s debt burden is less than 4% of its GDP (Manoel *et al.*, 2012).

Figure 4.1: Major provincial expenditures¹⁵⁰

Source: Finance Department, Punjab

Firstly, the provincial political executive uses capital budgets to control provincial and local level politicians. There is a tendency within the political executive to control a greater share of capital funds directly in order to exercise greater leverage over politicians, from both the ruling party and the opposition. For example, the government places large amounts in the capital budget as un-specified ‘block-allocations’ to be used by the political executive for any project they desire during the course of the year.¹⁵¹ Final approval of projects funded by the provincial capital budget and their subsequent cash releases are granted by the Chief Minister’s secretariat, which keeps politicians closely bound to the political executive. Controlling politicians through use of O&M budgets would be relatively difficult, for two reasons: (1) The O&M funds are budgeted (thinly but) more or less evenly for the whole province and are part of the recurrent budget (along with salaries) that are automatically drawn by the provincial line departments through the online budget accounting system run by the Provincial Accountant General. Manipulating these expenditures on a case to case basis or constituency-wise is technically problematic since estimates of recurrent expenditures are approved by the Provincial Assembly in the form of general grants, at the beginning of the financial year. As opposed to this, the political executive for specific

¹⁵⁰ These include actual (as opposed to estimated) combined expenditures of provincial and district governments, in real terms, with 2010 as the base year. The ‘operating’ expenditure in the graph legend stands for ‘operations and maintenance’.

¹⁵¹ This practice persists despite aid donors’ pressure to discontinue it.

constituencies can earmark development projects; (2) As explained in Chapter 2, 40% of the provincial income is transferred to local governments. The majority of this money funds recurrent costs (including O&M) of local government functions, over which the provincial government has very little control.

Secondly, politicians use public resources to strengthen their political position within their constituencies. Capital budgets also include constituency development funds (CDFs)¹⁵² that are at the disposal of elected public representatives and are used for development projects. Politicians reward supporters and deny publicly funded projects to political opponents; a fact fairly well documented in case of Pakistan. At the local level, ruling party politicians reinforce patron-client relationships through new projects. Studies have found a highly unbalanced distribution of resources within jurisdictions, favouring areas where political leaders have a larger support base (Keefer *et al.*, 2003, Mohmand and Cheema, 2007, Hasnain, 2008b, World Bank, 2013b). Politicians cannot manoeuvre O&M expenditures, as easily, for reasons explained in the point above.

Thirdly, politicians encourage greater resources for capital budgets that mostly fund infrastructural projects that are highly visible and give them an opportunity to show tangible development in their constituencies. While professing to pursue development policies that target the poor, capital expenditures are mostly used by politicians to build their image and gain popular support through expensive high-profile infrastructure projects. For example, Easterly (2003) cites the Lahore-Islamabad six-lane expressway built in the 1990s, which, at that time, was used at only 10% of its carriage capacity.¹⁵³ As a senior Finance Department official put it: *“Politicians don’t get any political mileage from funding operational costs.... these are invisible.... they are attracted to new visible things....”*

Lastly, new projects offer greater opportunities for corruption. Politicians and civil servants not only seek commissions from awarding contracts, but politicians get a

¹⁵² For CDF’s in Pakistan, see International Budget Partnership (2010; pp. 45-46)

¹⁵³ A similar recent example is the Metro-bus project in Lahore, built in record time and by diverting major funding from other provincial expenditures. It drew a lot of criticism from various quarters over a number of issues including, absence of proper environmental impact studies and city mass-transit planning. But most importantly for diverting a substantial portion of Punjab’s capital budget, which is meant for 90 million people, spent on one project in a city with a population of 12 million. In my opinion it is not that these projects are not required, but given the availability of resources and other pressing social sector requirements, it is an example of political priorities.

chance to reward business interests and contractors who support their election campaigns, and normally fund their expenses. Corruption in the use of O&M funds is most probably as prevalent as in the capital budget. However, as explained above, O&M funds are usually too widely (and thinly) dispersed making it a less ‘efficient’ way of rent-taking.¹⁵⁴

Given the political preference for greater capital expenditures and employee-related expenditures (which I discuss in section 4.3), the provincial Finance Department faces considerable political pressure to keep low annual budget estimates for O&M costs. During annual budget-making, the Finance Department estimates the resources available for capital expenditures after deducting estimated recurrent costs from expected provincial income, which includes federal transfers and provincial own source revenues. Since other constituents of recurrent costs, such as salaries, pensions and debt (interest) repayments are more or less fixed, political pressure to increase capital expenditures results in the Finance Department giving a low priority to operations and maintenance. As a result the Finance Department is quite stringent when evaluating O&M cost estimates presented by line departments during budget making, partly with the objective of securing more resources for the capital budget.¹⁵⁵

(b) The likelihood of improving public services would be greater if the wealthy, who are relatively more influential politically, were reliant on public services. Their demands for better public services would have a greater possibility of a positive response from the government. In Pakistan, the relatively well off, broadly speaking, those who (would) pay most of the provincial taxes, including property tax, have mostly opted out of using public services including health, education, drinking water and even security.¹⁵⁶

Although I have not come across any academic studies on privatisation of security services in Pakistan, over the last two decades private security companies have

¹⁵⁴ Large O&M contracts, for example, repairs involving large amount in departments like irrigation and civil works, as well as centralised procurement of medicines can be as lucrative as development projects. But such opportunities are relatively few.

¹⁵⁵ For technical details of budget-making in Pakistan, see Bahl *et al.* (2011), Qureshi and Ahmad (1993) and Bengali (2006).

Low provision for O&M costs is observed in other countries as well, for which various reasons have been identified including, absence of setting service delivery targets and costing them realistically, and the practice of annual expenditure estimation rather than over the medium-term (Caiden and Wildavsky, 1980, Peterson, 1996).

¹⁵⁶ Dreze and Sen ([2013] 2014; pg.xi) make a similar argument in the case of India

mushroomed, while gated communities are common and houses of the relatively well off are usually guarded by private security guards.

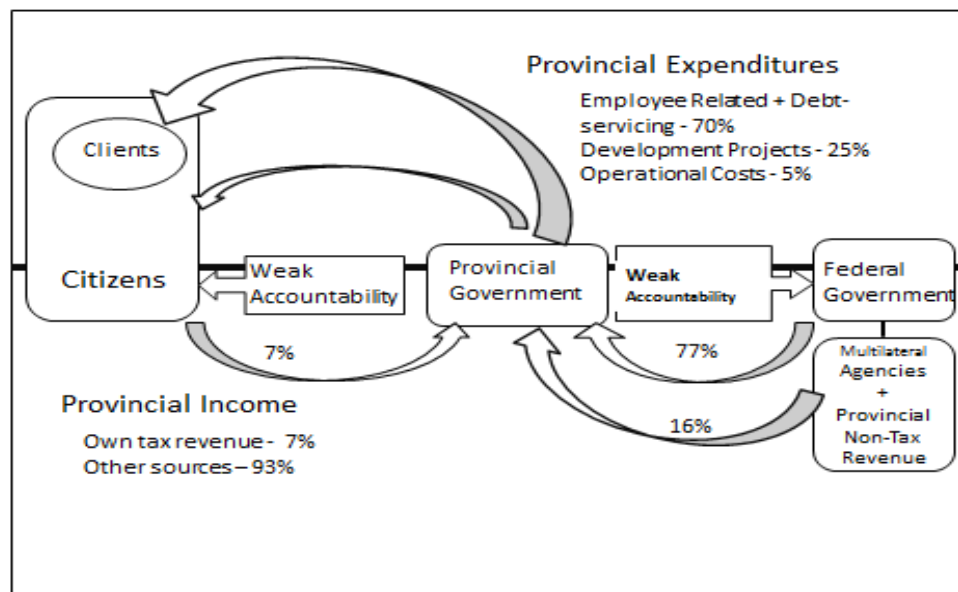
In fact, the phenomenon of accessing alternatives to most public services is not limited to the wealthy. For example, over the last 30 years, the number of private health care and education service providers has vastly increased in urban as well as rural areas. The share of private sector education in Pakistan rose from 3% of total enrolment in 1983 to 36% in 2009 (Salman, 2010). Private social service providers cater to a wide range of income groups, including the middle and low-middle income groups. It is mostly the poor, who cannot even afford the cheapest private clinics or schools, who access government primary social services, or go without any services at all. Furthermore, in terms of quality of service provision, at least in the case of education, studies show that private schools in Punjab provide better quality education than the public schools. This disparity is also partly reflected in the significant wage differential between private and public school graduates. Experts are of the opinion that, while there is a wide gap in the public provision of education, the poor, who cannot afford private education, do not seem to have the political clout required to ensure they receive quality public education (Andrabi *et al.*, 2002, Shaikh and Hatcher, 2005, Andrabi *et al.*, 2008b, Asadullah, 2009).

(c) Social and political accountability regarding the ways in which the provincial government in Punjab spends public resources is generally weak. Experts argue that, generally, greater transparency of the budget and public debate help to create pressures on the government to allocate resources which are more in line with public needs, and that civil society institutions have an important role to play regarding government budgets (Robinson, 2008). However, in the case of Pakistan generally, until very recently, there were no social institutions or mechanisms in place to analyse and inform public opinion on government expenditure priorities. Later in this section, I refer to some of the studies undertaken by the recent civil society initiative for social accountability of the budget, the Pakistan Institute of Legislative Development and Transparency¹⁵⁷ (PILDAT).

¹⁵⁷ PILDAT is a civil society initiative with a 'mission to strengthen democracy and democratic institutions'. Since 2011 PILDAT is publishing reports on budget analysis and

The provincial government is not reliant on its citizens for most of its income, which may be a reason for the provincial government not being accountable to them for the ways in which it spends public resources (see figure 4.2). Political accountability of public expenditures is weak for a number of reasons including the prevalence of patronage-based politics and narrow interests of legislators, which I discussed in the preceding sub-sections.

Figure 4.2: Provincial government: Income, expenditures and accountability



Source: Author; based on data from the Finance Department, Punjab

The provincial government raises very few taxes from its citizens; on average, 7% of its annual income over the last decade. The main source of provincial government income is the Federal Government. However, federal transfers (discussed in Chapter 3) are unconditional in terms of their use. Provincial income from aid donors varies from year to year (see figure 3.2), but in some years it is a significant source of government income. In section 4.6, I argue that pressures – in terms of loan conditionality – on the government from aid donors to increase service delivery are transient and generally not very strong. For a number of reasons, including the fact that funds are fungible, the provincial government is practically free to set its own expenditure priorities.

holding workshops for training of elected representatives, amongst other initiatives. It is the only civil society organisation in my knowledge that is regularly analysing Federal and Provincial budgets. However, PILDAT's analysis is limited to annual budget estimates and does not extend to actual expenditures of the government, which can vary considerably from the budget estimates (www.pildat.org).

Weak political accountability at various levels affects government expenditures as well. At the departmental level, provincial ministers have no objective criteria, for example performance indicators, to review the functioning of their departments or hold bureaucrats accountable for service delivery. Departmental performance is neither measured nor benchmarked. There is no mechanism¹⁵⁸ in place to determine a desirable level of service delivery or costing it, partly due to the practice of input-budgeting (or line-item costing) which has no corresponding link to service delivery outputs or sector policies.¹⁵⁹ Standing Committees of Provincial Assembly (parliament) for oversight of departments are mostly not functional.¹⁶⁰

During the annual budget approval process, the Punjab Provincial Assembly does not hold the political executive accountable for the previous year's expenditures and does not effectively scrutinise or debate the budgetary allocations for the upcoming year. The provincial government's budget has to be approved by the Provincial Assembly before the beginning of every fiscal year. The budgetary documents include not only the upcoming year's income and expenditure estimates, but also the expenditures¹⁶¹ for the previous year. The objective of the Assembly's oversight and approval of the budget is partly to seek a debate amongst public representatives on the expenditure priorities of the government, and to hold it accountable for use of public resources. However, for political reasons, very little time is allocated to the Assembly to hold this debate. This is primarily because in a parliamentary political system the continuity of the government is contingent on the passage of the annual budget. Failure to pass the annual budget shows that the government does not enjoy a majority in the parliament and could lead to

¹⁵⁸ Seven (out of forty) provincial departments for which medium term expenditure budgeting was initiated with technical assistance from the Asian Development Bank (discussed in section 4.6) are an exception to the way expenditure estimates are generally prepared by departments in Punjab. However, various problems regarding these seven departments were reported by experts advising the government on financial reforms. These included inability of the provincial Finance Department to stick to its medium term expenditure framework and make adequate resources available to these seven departments in order for the departments to achieve their service delivery targets.

¹⁵⁹ Input-budgeting is practiced in a large number of countries and is considered by experts to be problematic for service delivery since it is not amenable to performance audits (United Nations, 1986).

¹⁶⁰ Provincial Public Accounts Committee in Punjab is functional, but does not concern us here since it mostly oversees whether fiscal and procurement rules and procedures are being followed by departments and follows up on external audit reports. It is not concerned with departmental performance relating to service delivery.

¹⁶¹ These are called 'revised estimates'. 'Actual' expenditure figures are released later in the year, by the office of the Accountant General of Punjab.

the dissolution of the incumbent government. Thus, the political executive pushes for an expeditious passage of the annual budget. Over the last decade, the average time spent on having general discussions on the annual budget in the Punjab Provincial Assembly was 5.5 days, whereas the previous year's expenditures were not discussed at all. Generally, politicians are more interested in their constituency funds and present and push motions for getting more development projects in their constituencies rather than scrutinising the overall budget or proposals for expenditures presented by the government (PILDAT, 2012a). It is possible that, because the government is not held socially or politically accountable for its expenditures, it continues to be driven by narrow political interests in deciding how to spend public resources.¹⁶²

In this section, I have argued that there are low political pressures on the government for expanded service delivery. The various factors responsible for low pressure to deliver services are both complex and interconnected. Some of the factors that I identified include: the relatively wealthy who are politically influential do not use public services, while due to the nature of politics in Pakistan, the poor, who are most in need of these services, do not have the political clout to apply pressure on the government; political preference for new projects restricts funding for delivery of public services; and, generally the absence of public oversight of government expenditures leaves the political executive free to pursue its expenditure priorities. Below, I discuss why another important constituency, the public servants, who might be expected to have an interest in increased public spending, do not pressure the government to increase financial allocation for O&M costs.

4.4 Low pressure for public service expenditure from public servants

Despite a large wage bill, the government always manages to pay its employees, even during periods when it is relatively short of money. In the absence of any service delivery targets or political pressures for expanded service delivery, public servants are largely satisfied with allocations for recurrent expenditures – employee-related

¹⁶² International Budget Partnership (2012) reports similar findings in the case of Pakistan's Federal Government budget. It finds that legislative oversight of the federal budget is 'moderate' and public engagement is 'weak', with most mechanisms that enable public engagement absent in the budgeting process.

expenditures and O&M costs – providing they get paid and maintain their privileges.¹⁶³ The Punjab government employs about one million people, who hold permanent and pensionable jobs.¹⁶⁴ Employee-related expenditures (salaries, allowances and pensions) that are more or less a fixed cost for the government, take up about 85% of its total recurrent expenditure on average,¹⁶⁵ and even reached 87% in 2012-13. Between 2010 and 2014, real growth in employee-related, O&M and capital expenditure has been 14%, 12% and 15%, respectively. This reflects the relative expenditure priorities of the government, given that O&M expenses are already low, at less than 15% of the recurrent budget. In the preceding section, I explained the political significance and preference for capital expenditures.

There appear to be three reasons for the relatively greater increase in already high employee-related expenditures (see figure 4.1), compared to O&M expenses. First, the provincial government is bound to increase salaries and pensions every year since the public service enjoys a standard countrywide pay scale structure that is set by the Federal Government.¹⁶⁶ Second, the number of government employees rises continuously, as new projects are completed and have to be supported by staff. Politicians are interested in creating new jobs, especially non-skilled jobs, where politicians normally recruit their supporters and clients.¹⁶⁷ Third, the annual pension bill of the Punjab government is growing rapidly.¹⁶⁸

Relatively higher growth rates of employee-related and capital expenditures compared to O&M expenditures point to the low priority given to O&M expenditures. During

¹⁶³ From my experience of working in the Finance Department, senior civil servants normally pursue cases of buying a new official car or a bigger electric generator for their offices more aggressively than for larger financial allocations that could help their department deliver better public services.

¹⁶⁴ An oft quoted quip in the civil service is that, 'it is easier to fire the Prime Minister of Pakistan, than a peon in a government office'.

¹⁶⁵ Also see (World Bank, 2013b)

¹⁶⁶ In order to counter the high rate of inflation, the Federal Government usually increases salaries by 10-15% annually.

¹⁶⁷ Punjab, and Pakistan generally, has a high ratio of unskilled public servants. Hiring of office peons, sweepers, drivers, etc. is usually the prerogative of departmental ministers or local politicians. Since they are pensionable government jobs, normally politicians get their supporters and clients hired to these positions. Reportedly, the going rate to be hired as a sweeper in the Punjab government is equivalent of US\$ 5000.

¹⁶⁸ Actuarial studies show that Punjab's pension liabilities are rising rapidly and increase exponentially in about 10 years' time (Cheema, 2010). To cater for the rising pension liability the Asian Development Bank cajoled the Punjab government to establish and capitalise a pension fund. I discuss its outcome in section 4.5.

periods of fiscal stress, both in the late 1990s and again after 2008 (see figure 3.4) the provincial government imposed austerity measures and cut O&M expenditures across the board.¹⁶⁹ These cuts make more resources available to pay the provincial wage bill. If the provincial income is drastically reduced, capital expenditures are also deferred by withholding contractor payments, amongst other measures.¹⁷⁰ The provincial Finance Department issues austerity notifications that cut O&M expenditures when it faces a shortage of financial resources. The notifications are usually fairly standard and typically direct all departments, irrespective of their service delivery mandate, to cut their O&M expenditures by up to 15%, amongst other measures.¹⁷¹ One of the austerity measures is that all permissions for re-allocation of resources need to be referred to and approved by the office of the Chief Minister, further centralising expenditure decision-making. The decisions are driven by some of the motives I outlined in section 4.3.

Partly because there is little pressure to deliver public services, as discussed in the preceding section, the government can cut O&M expenditures without any immediate political risk. In absence of political pressure to deliver services and because the government so far has been able to pay salaries even during periods of resource shortages, public servants have little reason to pressure the government to increase its income, through increased taxes, for example.

The third possible constituency that can pressure the government to increase public spending on service delivery is the aid donors who give a considerable amount of money to the government in lieu for commitments to increase public spending. In the following section, I show why donor imposed conditions for aid might not be effective by giving an example of a donor-supported programme.

¹⁶⁹ For example: No. FD.SO(G-1)6-40/2009 dated 9th October 2009 and No. FD.SO(Goods)44-4/2011 dated 6th August 2013 (Source: Finance Department, Punjab). Similar notifications were issued after international aid to Pakistan was suspended when Pakistan tested its nuclear capability, in 1997.

¹⁷⁰ As explained in Chapter 3, the Provincial government is highly reliant on federal resources, which are transferred on a monthly basis. Sometimes transfers from the Federal Government are less than expected due to low Federal tax collection, amongst other reasons.

¹⁷¹ The 2013 notification is slightly modified exempting certain procurements meant for health, education and flood protection.

4.5 Ignoring pressures for expanded service delivery from aid donors

The government's ability to satisfy donor conditions for continued financial support without actually changing its expenditure priorities in favour of service delivery is a possible explanatory factor for the overall lack of pressures to deliver services. In this section, I analyse this possibility using, amongst other evidence, the example of a recently concluded donor programme in partnership with the Punjab government that partly involved public spending commitments.¹⁷² My objective is to show how the provincial government can avoid acting on any commitments to donors that involve finances and go against its political priorities. Although it commits to the donors, changes its policies and even passes legislation to satisfy donor aid conditionality, the Punjab government usually ignores all implied expenditure commitments.¹⁷³

Multi and bilateral donor interventions in Punjab increased significantly after 2001. General budgetary and sector specific donor support in terms of loans (see figure 3.2) and grants were complemented by significant technical assistance in the area of public financial management. Monitoring of government policies, budgetary allocations and tracking its expenditure in key service delivery areas by the aid donors, for example, in the health and education sectors accompanied these interventions. Since, financial support is linked to certain donor conditions, periodic public expenditure reviews and monitoring missions by donors have increased considerably (World Bank, 2000, 2001, 2013a).

A recent project completion report¹⁷⁴ produced by the Asian Development Bank (ADB) declared one of its largest public sector reform programmes with the government of Punjab as 'largely unsuccessful'. The Punjab Government Efficiency Improvement Program (Phases I and II), executed between 2002 and 2012, was designed to support the Punjab government to undertake multiple reforms in areas of budgeting and taxation (including property tax), amongst others.¹⁷⁵ The objective of the programme was to make additional resources available over the medium- to long-term in order to fund

¹⁷² I use the example of an Asian Development Bank supported public sector reform programme which I headed as Program Director for two years, prior to my doctorate.

¹⁷³ Some tax reforms were also part of this programme, which were also not undertaken.

¹⁷⁴ The report was shared with me in May 2013 by ADB Manila for comments, since I was the Programme Director for two years, from 2008-10.

¹⁷⁵ The programme reform agenda was wide-ranging including civil service reform and private sector development in addition to public financial management.

expanded service delivery. Over the course of eight years, the programme provided the Punjab government with a general budgetary support loan of US\$ 850 million divided in tranches released every 15 months, subject to the government meeting mutually agreed conditions. With the objective of achieving better service delivery, some of the reform actions included in the programme were to: (i) develop a medium-term framework for expenditure projections and revenues; (ii) establish and capitalise a civil servants' pension fund in view of the exponentially rising pension liability; (iii) undertake medium-term expenditure forecasting in service delivery departments, and build departmental capacity to link financial inputs with planned sector policy outcomes and outputs; (iv) enhance coordination between capital and recurrent budgets, with the objective of allowing more flexibility for departments to deliver services; (v) decrease the number of underfunded projects added to the capital budget every year that spread available resources too thinly, resulting in time and cost overruns;¹⁷⁶ (vi) reform provincial tax departments and change policies, including rationalising exemptions, primarily focused on property tax.¹⁷⁷

I do not intend to examine the causes of the (alleged) failure of this reform programme, which arguably revolve around the incentive structures of both the donor and the recipient. However, it is noteworthy that for eight years the government qualified for numerous loan tranches and ADB quarterly review missions declared the programme as proceeding satisfactorily. A number of programme conditions were process-oriented and revolved around policy changes and, at times, amendments in laws, which the government undertook expeditiously. The ADB expected the government to implement various recommendations made by experts based on the multiple diagnostic studies conducted with ADB assistance. In particular, in the area of public financial management, large teams of consultants were deployed in some departments to build capacity and support them in identifying service delivery outputs and outcomes, for which unit costs were also calculated for the first time. Loan conditions partly comprised the production of documents, such as a medium-term expenditure framework, by the government and their approval from different levels of authority,

¹⁷⁶ Development projects in Punjab normally take twice the amount of time and resources for completion compared to original estimates (World Bank, 2013b).

¹⁷⁷ See <http://prmp.pitb.gov.pk/publications> for various reform areas and related reports etc.

including the Chief Minister, the Cabinet and, in certain cases, new legislation by the Provincial Assembly.

Dealing with donors is primarily the task of senior provincial civil servants who ensure that donor requirements are fulfilled and aid tranches are released on time. The provincial government set up a well-equipped and staffed Program Management Unit for the programme to ensure that donor conditions were fulfilled in coordination with the relevant line departments. A high-level programme steering committee was established under the chairmanship of the Chief Secretary, the head of the provincial civil service, who held regular programme review meetings especially prior to donor review missions. As Program Director, my brief from the government was quite clear: I was to ensure that the loan tranche was delivered on time. I had full access to, and support of, the Chief Secretary as well as the Chief Minister's secretariat, in order to ensure timely issuance of approvals, notifications, presenting policies for Cabinet approval as well as for passing any required legislation by the Provincial Assembly, to fulfil donor conditionality for tranche release.

However, none of the loan conditions had any impact in the long run on the way the government prioritises its expenditures, despite various policies being approved by the political executive. For example, the medium-term expenditure framework, which entailed enhanced financial allocation for O&M expenditures, was never fully implemented. Most reform initiatives were abandoned after the conclusion of the budgetary support programme with the ADB and the government retracted some of its commitments including those with financial implications. For example, in the case of the Punjab Pension Fund, it retrieved billions of rupees it had dispersed to capitalise the Fund, as part of loan conditionality.

Similar programmes in health and education sectors supported by multiple donors have reportedly made some progress in ensuring continued government commitment through close monitoring of budgetary allocations and actual expenditures. Some service delivery and outcome improvements have been achieved through 'ring-fenced'¹⁷⁸ financial donor support. Donor funding for these programmes is sector specific and can

¹⁷⁸ Funding in such programmes is sector specific and can only be spent on certain types of expenditures. Progress and expenditures are closely monitored by donors. Arguably, even in such programmes the government uses its own resources elsewhere, since donor funding is being used in programme sectors.

only be spent on certain types of expenditures. Arguably, even in ‘ring-fenced’ programmes that are closely monitored by donors, political priorities impact on financial allocations. For example, reportedly, in education and health sector programmes, government financing is highly skewed in favour of urban areas and tertiary services (World Bank, 2013b).¹⁷⁹

Donor pressure on government for service delivery is weak and temporary. My main example of the donor supported reform programme mentioned above points to partly process-driven donor conditions that do not require the government to change its expenditure priorities. However, even when they do, these changes may only be temporary, as in the case of the pension fund mentioned earlier. In addition, in the case of health and education programmes, the World Bank (2013b) reports that the government’s political priorities were driving sector expenditures, even though aid donors closely monitored the programmes.

4.6 Conclusion

Explanations based on property tax collection mechanisms and the unpopularity of property tax do not explain low tax collection on their own. Problems in the collection mechanism can be fixed and political resistance to taxation is usually counterbalanced by the popularity of government spending on public services. In the case of Punjab, the provincial government appears to be stuck in a low level fiscal equilibrium; it can sustain itself without taxing its citizens extensively and without providing them with adequate public services. In this chapter, I put forward some reasons for why the provincial government has low political pressure to deliver public services, and provided some evidence that supports my explanations. I found that there are, broadly speaking, three groups that might be expected to pressure the provincial government to increase expenditures on expanded service delivery, which could then perhaps lead to increased taxation.

First, citizens, who are potential users of public services, do not exert pressure on the government to spend more on the provision of public services. I provided some evidence for my argument that the relatively wealthy who are expected to be politically

¹⁷⁹ For an earlier period (1958-1999), Easterly (2003) points out that despite heavy donor involvement and financial support (US\$ 58 billion), social sector performance in Pakistan was disappointing.

influential, have little incentive to pressure the government to increase public services since most do not use these services. The poor, who would certainly use these services, do not have the political clout to pressure the government because of the nature of politics in Pakistan. Politics in Pakistan is largely patronage-based and political priorities for public expenditures favour new projects rather than funding delivery of public services. Moreover, political expenditure priorities persist unchecked possibly because social and political accountability of public expenditures is generally weak.

Second, public servants who have an obvious interest in increasing public expenditures do not pressure the government to increase expenditures for provision of public services. This is possibly because civil servants are not accountable for achieving any service delivery targets and hence are not particularly concerned about low O&M expenditures. Moreover, civil servants do not run the risk of not getting paid by the government. Even when the government is short of resources, it cuts or delays other expenditures in order to pay salaries and pensions.

Third, the provincial government can effectively ignore pressure from its aid donors for increased service delivery (or taxation) by doing enough to broadly satisfy most conditions for aid without changing its expenditure priorities significantly.

5 The Informality of formal tax collection

5.1 Introduction

Although the Excise and Taxation Department (ETD)¹⁸⁰ is Weberian in form – with a clear hierarchy, formal rules, a system of recruitment, postings, promotions and a certain level of institutionalised answerability – its operations in Punjab are mired in informality. That impacts property tax assessment and collection. The system combines, (a) a high degree of informal behaviour, (b) control of detailed information at lower levels that makes it hard for higher level management to change the system or increase collections, (c) modest rent-taking at lower levels, and (d) their responsiveness to local pressures to go easy on tax collection. Informal ways of working and the exercise of discretion by frontline workers are normal within most organisations. But in the ETD case, the ways in which rents are created and shared, and the fact that informal behaviour is embedded and routinized presents a major obstacle to substantially increasing tax collection. One important underlying factor is the very large tax rate differentials between residential and commercial properties and between owner-occupied and rented properties. Since the field level tax collectors themselves assess property tax liabilities, they have ample opportunities to exercise discretion, and therefore to collude with taxpayers. As I mentioned in earlier chapters, the rents that collectors harvest from this collusion serve not only to increase their incomes, but also to fund some of the operational costs of the Department.

There appears to be no in-depth study of a property tax organisation in a developing country that explains how the system actually works in terms of: What motivates tax collectors? How do they operate? Why and how administrative discretion is exercised and how does this impact on property tax revenues? On the basis of my long observation of tax field offices and other fieldwork, I explain the incentives that motivate different levels of the ETD, formal and informal intra-organizational relationships, and the critical role of control and hoarding of information. This chapter deals with the ways in which the department functions under normal circumstances. In Chapter 6, I analyse the behaviour of tax collectors when they are under extraordinary pressures to increase tax collection.

¹⁸⁰ Most of the material in this chapter is common to Piracha and Moore (2015) and Piracha and Moore (2016). The data used in both are from my doctoral fieldwork.

After a brief review of the literature on property tax administration and frontline workers in section 5.2, I outline some important background points about the structure and functioning of the tax department in section 5.3. In section 5.4 I start with reporting a routine office interaction and explain tax collection at the local level. I show that tax collectors have good knowledge of properties in their jurisdiction and use discretion in assessing liabilities. In section 5.5 I analyse relationships between various levels of the department, again beginning with a specific incident. I show, on the one hand, how tax collectors control flows of information to higher levels and insulate themselves from demands of increased tax collection, and on the other, in the absence of information, how higher level management uses its authority to try to enforce greater tax collection. I conclude the discussion in the last section.

5.2 Review of literature on property tax administration and frontline workers

I found very little guidance from the literature on property tax administration on how the tax is actually collected, despite there being ample evidence from elsewhere (and in my own experience of working in Pakistan) that there is lots of informality in government organisations in developing countries. My work on the ways in which property tax collection actually takes place was informed and motivated by literature in similar contexts, of how the state actually works, which I reviewed earlier in section 1.5.1. The literature on recurrent (annual) property taxation underscores tax administration as critical to revenue generation and often uses the aphorism that ‘property tax administration is tax policy’. Surprisingly then, the literature on property tax that deals with its administrative aspects is mostly normative and has limited insight into actual practice. For example, I found that a recent edited volume authored by a number of leading international experts on property taxes in developing countries (Kelly, 2013b) has very little to add to Dillinger (1988) regarding property tax administration in developing countries, despite a gap of three decades. The literature mostly points to weaknesses in the three key steps involved in the property taxation process that can result in low tax collection (Dillinger, 1988, Bird and Slack, 2004, Bahl and Martinez-Vazquez, 2008, Powers, 2008, Bahl and Wallace, 2010, UN-HABITAT, 2011, Kelly, 2013a, 2013b, Kitchen, 2013, Ahmad *et al.*, 2014):

- (i) Property identification: All property units in a jurisdiction, their ownership, description and unique reference number are prerequisites for a cadastre that forms the basis of annual property taxation. This information requires continuous updating which can be costly and at times difficult. In most countries, property records and building permissions are usually not integrated into the cadastre and property transfers may not be reported to the tax department. For a number of reasons, including lack of regular property surveys, coverage of properties in the cadastre may not be complete or accurate.
- (ii) Assessment and appeals: For revenue productivity and fairness to taxpayers, property tax assessments need to be up-to-date and uniform within the same jurisdiction. Absence of regular property revaluations for various reasons, including lack of valuation skills and/or resources, can lead to property taxes that are 'dramatically under-assessed'. Additionally, a system to correct errors in assessments that allows taxpayers to appeal against tax liabilities is also essential for fairness. A cumbersome appeals mechanism may deter some taxpayers from using it, and it may affect their willingness to pay the tax. However, relatively wealthy taxpayers with higher liabilities may consider going through the appeals process worthwhile.
- (iii) Tax collection and arrears: Tax collection involves billing taxpayers, collecting taxes, and ensuring payment. Once the tax is assessed for individual properties, bills are sent to taxpayers. If a taxpayer does not appeal against assessment, s/he is expected to pay within a certain time period. In case of non-payment, tax collectors can enforce compliance through various methods, including sale of property, to clear the tax liability (in cases of long-term delinquency). Non-payment and accumulation of substantial arrears in the absence of enforcing tax collection is a major factor for low property tax collection in developing countries. This is attributed largely to lack of 'political will' to undertake enforcement measures that can be coercive and hence unpopular.

The literature also suggests that, because of the ways in which assessment and collection are undertaken, recurrent property taxation is highly susceptible to collusion between taxpayers and tax collectors. This is mainly because property tax is almost universally assessed by tax staff and is not self-assessed. Regularly updating property records is key to correct assessment. Property tax assessment activities require physical verification. As such, there is greater scope for collusion between the assessor and the

taxpayer than with accounts-based verification, where the assessor has little or no direct interaction with taxpayers. The possibility of collusion is even greater where the tax assessor is also responsible for tax collection activities (Moore, 2013a).

Use of information technology is considered by experts to be an effective way of overcoming some of the shortcomings of property tax administration mentioned above. For example, use of geographic information system (GIS) maps improves the process of property identification and hence coverage. Digitalisation of the property tax cadastre and automation of billing and collection records increases the efficiency of collection processes. Digitalisation also reduces some of the opportunities for tax staff to use their discretion while assessing and collecting property tax. Compared to manual record keeping, it also makes property tax data easily accessible to higher-level management for better oversight and monitoring of tax collectors, strategic management and analysis. However, it is pointed out that technological improvements have only a limited impact on tax collection unless accompanied by wider organisational reforms that influence tax collector incentives. Information technology systems do not completely eliminate tax collector discretion and require continuous data updating. The effectiveness of technology is also limited if the integrity of the data in the system is questionable. Moreover, enforcement, an important collection function, is not directly linked to use of technology (Bird and Zolt, 2008, Bird, 2010a, Kelly, 2013b, Khan and Inam, 2014).

It is well-known that frontline workers or ‘street level bureaucrats’ – i.e. the public service workers that interact directly with the public – often exercise considerable discretion when formally implementing organisational policies; they do not always follow formal rules and standard operating procedures. In some cases, this exercise of discretion may be either inevitable, if the job is to be made manageable, and/or may be desirable (Lipsky, 2010). Informal ways of working along with their well-defined norms are not limited to frontline workers. The prevalence of informality within organisations around the world is well documented (Heclo and Wildavsky, 1981, Wilson, 2000, Grzymala-Busse and Luong, 2002, Colignon and Usui, 2003, Helmke and Levitsky, 2006, Dodson, 2009, Hodder, 2010, Mayo, [1949] 2014). Although there are plenty of studies (see my literature review in section 1.5.1) that deal with the informal working of the state and its interactions with citizens, only a few studies deal with the detailed internal workings of state agencies in developing countries (Dilulio, 1994, Grindle, 1997, Hilderbrand *et al.*, 1997). This is understandably due to the lack of access granted

to outsiders and secrecy about issues that mainly pertain to corruption and illegality. Wade's (1982) work on canal irrigation in India and more recently, a study on taxes on cross-border trade in Africa (Titeca and Kimanuka, 2012) and Blundo (2006) are the only ones that are meaningfully similar to my case.

The personal and group interests of workers, social norms, expediency, compulsions of field-level conditions, or simply the pressure to 'get the job done' might influence the behaviour of frontline workers. But this does not in any significant degree have to be the case with property tax assessment and collection. Tax collectors should stick to the rules and procedures, especially in relation to their key tasks of assessing, billing and collecting.

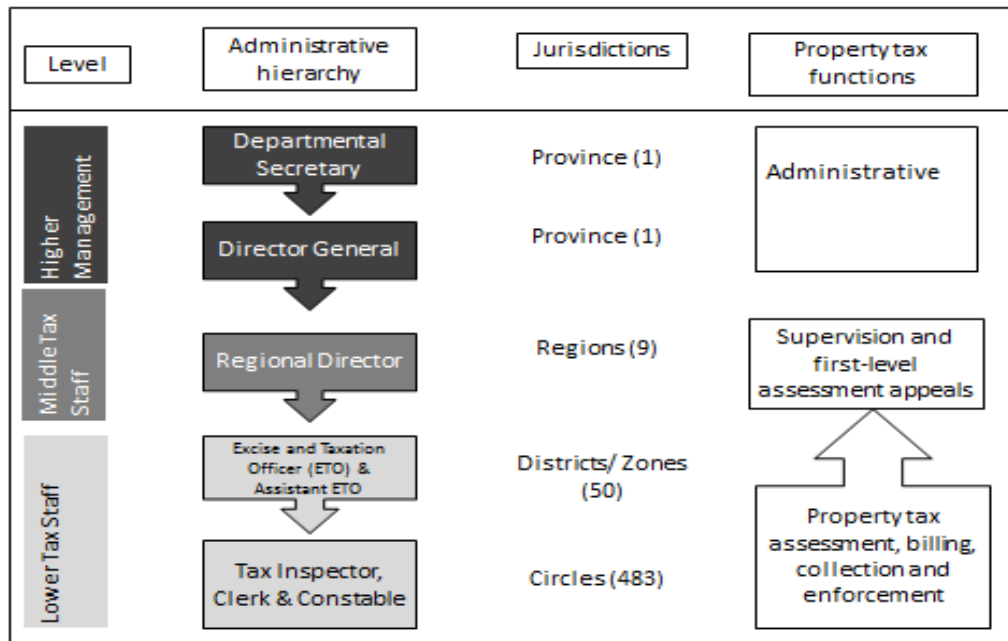
Since the informal ways of working in public bureaucracies is not always in plain view, interventions aimed at improvement that are not informed by an understanding of real organisational workings have lower chances of success (Schick, 1998). Thus, partly to improve chances of success of any interventions to improve the property tax collection system, it is important to find out how the system actually works.

5.3 Property tax administration in Punjab

To make it easier to follow analysis in later sections I first outline the formal hierarchy of the Punjab Excise and Taxation Department (ETD) and the functions performed by its various levels. For simplicity, I refer to three hierarchical levels (see figure 5.1):

- The 'higher level' (or 'higher management') includes: the departmental Secretary, who is responsible for overall target achievement, administration and tax policy work; and the Director General who is responsible for the tax field offices of the whole province. Generalist career civil servants are usually posted to these positions. Usually they have no prior experience of working in the Department, and are posted for relatively short tenures, of about a year or less.
- The 'middle level' comprises Regional Directors who are senior departmental officers responsible for meeting tax collection targets in the 9 property tax Regions. Each Region comprises 3-5 Districts. Mostly recruited as Tax Inspectors or directly as Excise and Taxation Officers (ETOs), Regional Directors have about fifteen or more years of experience in tax collection at various levels and have usually served in various districts. They have a good knowledge of departmental functioning.

Figure 5.1: The ETD hierarchy and functions¹⁸¹



Source: Author

- The 'lower level' includes the Excise and Taxation Officers (ETOs),¹⁸² Assistant Excise and Taxation Officers (AETOs), and Circle staff that comprise a Tax Inspector,¹⁸³ a Clerk and a Constable. The most senior of the field level staff are the Excise and Taxation Officers, who is in-charge of a whole district or a zone in larger districts. There are there are about 50 property tax zones/districts in Punjab province, which in 2011-12, included about 483 property tax Circles. Each Excise and Taxation Officer (ETO) is assisted by an Assistant Excise and Taxation Officer.¹⁸⁴ Each ETO

¹⁸¹ Functions of Regional Directors, ETOs and AETOs vary in Regional headquarter districts and smaller districts, as I explain in this section.

In smaller districts an ETO heads a district. The larger districts are sub-divided into a number of property tax 'Zones', each headed by an ETO.

¹⁸² ETOs are public service grade 17 gazetted officers. A few who are promoted to grade 18 are given the title of Senior ETO. Most ETOs were initially recruited as Inspectors and have since been promoted. Some are directly recruited to the post of ETO through a competitive process conducted by the provincial Public Services Commission.

¹⁸³ Under the Punjab Excise and Taxation Service Rules, 1980, 60% of Tax Inspectors are directly recruited to that post and 40% are promoted from lower ranks, of which 75% are to be from among senior Clerks and 25% from Stenographers. Source: Excise and Taxation Department, Punjab

¹⁸⁴ The role and responsibilities of the AETO varies in large and smaller districts; I explain these later in this section.

supervises about ten Circles. The Circle is the lowest unit in the hierarchy. A Tax Inspector, who is assisted by a Constable and an office Clerk, heads each Circle. Circle staff share the same office buildings as their ETO and the staff of the other Circles in the district or regional tax offices.

In order to grasp the informal working of the department, there are four important things the reader needs to know:

Firstly, under the property tax law, the higher level of the ETD is not directly involved in the assessment or collection of property tax. The higher management has overall responsibility for meeting annual tax collection targets set by the provincial government and recommending tax policy changes to the government. It exercises administrative authority over the lower levels including deciding postings, transfers, and initiating disciplinary action. Higher management can conduct field or record inspections. The latter are mostly carried out on its behalf by a Monitoring Wing (headed by a Director) based at the Director General's office. There are no monitoring cells at the Regional or district levels. Regional Directors and ETOs are expected to undertake inspections personally in their areas of jurisdiction.

Secondly, the lower level performs all property identification, assessment, billing, collection and enforcement tasks. The AETO performs the internal audit function, and is expected to physically crosscheck a certain number of properties and their assessment, as well as audit the records and various registers for each Circle. The AETOs functions are somewhat varied in smaller (non-regional headquarter) districts, where the ETO is the appellate authority and the AETO is the assessing authority. In smaller districts there is no dedicated staff for internal audit. The role of the Circle staff remains unchanged irrespective of the size of the district.¹⁸⁵

Thirdly, taxpayer appeals against assessment are adjudicated by the Regional Directors in large (regional headquarter) districts where the ETOs are assessing authority. In smaller districts, where the AETO is the assessing authority, the ETO performs the appellate function. Thus, the first appeal against assessment in both small and large

¹⁸⁵ Out of 36 districts in Punjab 8 are regional headquarters. Therefore, in 28 districts tax field offices have no internal auditor.

districts lies within the departmental hierarchy, while the second (review) appeal lies outside the departmental hierarchy, that is, with the district government.¹⁸⁶

Lastly, the provincial Auditor General is responsible for the external audit of tax offices. However, external audit is limited to checking for discrepancies within office records. External auditors make no attempt to crosscheck the accuracy of actual property assessments.¹⁸⁷

5.4 Tax collection at the local level

A few weeks into my field research I was sitting in the office of a senior ETO here pseudonymously called Saeen. ETOs are formally responsible for ruling on the property tax assessments for individual properties. As mentioned earlier, they are in charge of about ten Circles, each headed by a Tax Inspector and assisted by one Clerk and one Constable. The Tax Inspector is primarily responsible for initial assessment of properties and updating the property records. The Constable is supposed to report information from the field and go house to house to deliver property tax bills. The staff of a Circle typically operates as a cohesive group. They share a great deal of information and overlap with one another in the tasks they perform. The staff members at the ETO's office and in the circle are localist in orientation. Because they expect to work in the same office for a long time, they are motivated to avoid conflicts with local people and politicians.

As I was sitting in the Saeen's office, a middle-aged woman, whom I will call Mrs Chalak, walked in. She showed Saeen her recent property tax bill, explaining that it related to a residential house owned by her mother-in-law. She complained that the assessment must be wrong, as the bill never used to be this high. Saeen took the bill and asked Mrs Chalak if her mother-in-law was a widow. Mrs Chalak said that she was. Saeen then picked up his cell phone and called the relevant Tax Inspector, telling him

¹⁸⁶ The second (review) appeal, which challenges the outcome of first appeal against assessment is filed with the Executive District Officer (Finance) of the respective District government. For reasons pointed out in Chapter 2, this function is not effectively performed by the district governments. Further appeals can be filed with the provincial High Court and finally the federal Supreme Court.

¹⁸⁷ Various informants reported that these audit teams 'charge them fixed fees per Circle' to produce reports finding only minor discrepancies which are easy to address. External audits seem to be driven more by desires to make claims on informal earnings than a credible crosscheck on tax staff.

the house address and the bill amount, and asking how it was calculated. There followed a three-way conversation as Saeen spoke to his Inspector on the phone and to the lady sitting in front of him.

Saeen (to Mrs Chalak): Your mother-in-law *died* last year.

Mrs Chalak: Ah... yes (slightly embarrassed as her lie is discovered).

Saeen (to Mrs Chalak): You live upstairs and downstairs you have a beauty parlour.

Mrs Chalak: Oh, that is still under construction...

Saeen (to Inspector): Isn't that still under construction?

Saeen (to Mrs Chalak): There is some finishing work going on, but it is functional isn't it?

Satisfied, Saeen puts down his cell phone and addresses Mrs Chalak.

Saeen: So how much rent do you get for the parlour?

Mrs Chalak: It's not on rent; I am running it myself.

Note that the property tax payable would be considerably higher if the premises in question were, first, being used for commercial purposes and, second, rented out by the owner. Saeen did not seem too convinced with Mrs Chalak's answer, but went on to make some calculations on the back of her bill. He kept calculating aloud so that Mrs Chalak could hear what he was doing and object if she did not agree with something. He kept flipping the bill to see the size of the plot and of the constructed area of upper and lower stories of the building. After applying the relevant rates and remissions he came up with a final assessment figure, which he underlined twice. He flipped the bill one last time and read off the figure, which was the same as the one on the bill Mrs Chalak had brought with her. Saeen then explained the classifications he has used: 'self-occupied residential' for the upstairs floor of the building in which Mrs Chalak lives and 'self-commercial' for the beauty parlour on the ground floor. He had treated the car porch area on the ground floor as being in self-residential use and not commercial use, in exactly the same way as his Inspector had when preparing the original bill. Saeen told Mrs Chalak that under the law he is to presume that any property not occupied by the

owner is rented, but he will be lenient in her case. He advised her to get the property transferred in the name of the heir/s of her deceased mother-in-law as this is required under the law. Mrs Chalak did not have anything further to say, but still did not seem very happy with her bill. She went away without saying anything about paying, and Saeen did not ask.

Saeen then turned to me and explained that the increase in the bill was because the property no longer qualified for the reductions granted to widows. He remarked that Mrs Chalak would pay up once that information had sunk in. Saeen did not seem to resent the way in which she had tried to hide the truth about the death of her mother-in-law, the commercial use of the downstairs section as a beauty parlour, or the fact that it was likely rented out. Indeed, he had given her the benefit of the doubt on the latter point. Had he classified the downstairs as rented commercial premises, the tax bill for that part of the property would have increased five-fold. He explained that he had been lenient because he preferred to make a lower assessment and have her pay up rather than assess her strictly and risk non-payment. He added that, *“Even a rupee more in assessment than the ‘fair’ assessment in the mind of the assessee raises the risk of non-payment multiple times”*. That was a lesson he had learned in a quarter century of assessing and collecting property tax.

This routine interaction over Mrs Chalak’s bill is representative of numerous similar issues that regularly came up during my observation of tax offices and discussions with lower level tax staff in three different Regions. Based on this interaction and other ethnographic data, several important dimensions of property tax assessment and collection processes at the local level emerged.

- First, most property tax bills are very low, mostly because the government has not re-valued properties for almost fifteen years. For example, the annual bill that Mrs Chalak disputed was probably about the same as her monthly electricity bill, which she likely pays promptly and without questioning. Typically, the annual property tax billed to an owner-occupied house built on 500 square yards in the highest valued ‘A’ category is only about Rs. 5000, roughly 50 USD.¹⁸⁸

Property tax bills are significant in size only where (a) properties are rented out rather than owner-occupied and/or (b) they are classified as being in commercial rather than

¹⁸⁸ This holds for 2012. Property valuations have been revised recently, in 2014.

residential use. Commercial rented properties are assessed at five times the owner-occupied commercial rate, because they have a higher rental value. The differential for residential properties is ten times (in which case bill would increase from 50 to 500 USD, in the example above). From the economists' perspective, property tax has become very close to an income tax on property that is rented, especially for commercial purposes.

- Second, Circle staff have a deep knowledge of virtually all properties within their jurisdictions, including both those that are registered (on average about 1,100 per staff member)¹⁸⁹ and those that have not been registered and therefore escape payment. The staff maintain a written register of all properties, which contains basic information on assessments, payments, and arrears. But their knowledge is more extensive. When called by his ETO, the Inspector for the Circle in which Mrs Chalak resided immediately recognised her property and knew the relevant recent history: the death of her mother-in-law and the progress in converting the ground floor into a beauty parlour. The Inspector had put an end to the widow's deduction on the property without waiting for Mrs Chalak to formally record the change in ownership of the property with the District Registrar. This was typical of the interactions I observed in various tax offices, reflecting the extensive amount of field information tax staff possesses.

The Constable in particular is constantly out on the streets and haunts the local bazaars. He is supposed to wear the departmental uniform,¹⁹⁰ but almost never does. This is not only to avoid being conspicuous but also to hide the fact that he is a mere Constable. As an ETO remarked, "*in a lot of places the Constable usually introduces himself as a tax officer,*" implying that he is in a decision-making position and can be negotiated with. He is locally referred to by an honorific – *Chaudhri Sahib, Malik Sahib, Mian Sahib, Khan Sahib, Shah Sahib* etc. – according to his caste or lineage. He knows what is going on in the area, both generally and particularly with respect to properties. He has close contacts with local real estate dealers. Typically, the Constable serves his whole career of about thirty years in one Circle. He may see a house being constructed, and knows

¹⁸⁹ However, the range is quite varied. Large cities, particularly Lahore, are very well staffed, while smaller and more remote districts are grossly understaffed. This determines the 'size' (number of properties) of the Circle, which impacts collection. In one of the smaller districts I interviewed an Inspector with 9,000 properties in his Circle. However, this was an extreme case.

¹⁹⁰ Tax inspectors also are required to wear the departmental uniform, but do not. The uniforms have distinctive shoulder ranks for inspectors but none for the constables.

who owns it, what the owner does for a living, when it is occupied and hence becomes liable to be taxed, whether it is owner-occupied or rented out, and whether it is being used for residential or commercial purposes. He also makes it his business to find out the political and social connections of the owner in order to assess their negotiating power.

This valuable unwritten information is monopolized by the permanent Circle staff, and not shared with the office assistants that they typically hire unofficially and privately to do clerical work.¹⁹¹ These are sharp young graduates with good numeracy skills. They are willing to work long hours for a relatively low monthly salary and an occasional ‘bonus’. Their main motivation is the opportunity of being hired permanently if and when formal recruitment takes place.¹⁹² Only then will the permanent staff begin to share the rich informal information about the real property tax base and the associated informal income with them.¹⁹³ As temporary and informal assistants, they are never taken into the field. Further, as one of them described, they have to ‘run out’ of the building if there is an inspection visit by the Director General or some other senior officer.

- Third, detailed information about properties and tax collection is not available to higher levels. Cadastral records along with assessment, billing, collection, and arrears are maintained and updated manually in multiple registers held by the Tax Inspector at the Circle level. Various monthly reports pertaining to any changes in property

¹⁹¹ The work of a Tax Inspector’s office includes: maintaining the cadastre and a number of registers that record assessments, exemptions, appeals, remissions, payments and arrears; issuing tax bills and reminders; issuing notices for enforcements etc., all of which is done manually. The work is routine but large in volume. Apart from the 5 City Districts in Punjab, property tax staff is also responsible for the collection of various other provincial levies. There is a general shortage of clerical staff in the department; out of 483 Circles only 268 have ‘official’ clerks working in them (Source: Excise and Taxation Department). Informal hiring of Circle Clerks is a widespread phenomenon (Khan *et al.*, 2014; p.6).

¹⁹² Mainly due to financial constraints, the government bans recruitment against existing vacancies as well as the creation of new posts for years on end (see Chapter 4). The Chief Minister’s special permission is required to fill any existing departmental vacancies during the ban.

¹⁹³ Retired Circle staff members are never re-hired for these jobs, as they have the knowledge to cut into the informal incomes of their successors. By contrast, in the (agricultural) land revenue department equivalent officers, known locally as *patwaris*, are sometimes re-hired informally after retirement for routine technical work. In this case the main source of informal earnings requires the signature of the incumbent official, for example, on documents transferring property, and so informal hiring of retirees does not threaten informal incomes. (Source: Discussions with District Revenue officers and my own experience as one.)

attributes, assessment, collection, arrears, appeals, remissions etc. are required under property tax rules to be collated at the district level and reported to higher levels. However, this practice has long been discontinued.¹⁹⁴ Currently the only monthly reports generated pertain to aggregated collections. This problem is compounded by the fact that the provincial Accountant General's office does not account for current year and arrears collections under separate accounting heads. As a result, higher level management does not have the information available to cross-check current year and arrear collection figures presented by field tax offices. As I will explain in section 5.5, this information bottleneck is a significant characteristic of the property tax system.¹⁹⁵ Past attempts to digitalise information about the property tax base and tax collection performance, including several supported by aid donors, have come to naught. Senior officers in the department claim that the major reason for repeated failure to digitalise is that the lower level staff members feel threatened, and resist.¹⁹⁶

- Fourth, property tax law and the collection mechanisms in place allow tax collectors ample opportunities to exercise discretion with little fear of being detected. Circle staff are literally 'street-level bureaucrats' (Lipsky, 2010), exercising a considerable amount of discretion. For example, valuation tables categorise blocks of adjacent properties according to estimated rent values, not individual premises. All properties in a block are assigned to a category between A and G and assessed according to their approximate rental value, which is based largely on the extent of infrastructure and service provision in the area.¹⁹⁷ The taxes payable on any individual

¹⁹⁴ Until the 1970s, the Director General's office produced an annual report on property tax (and other taxes) reporting all these changes aggregated for the whole province. The report included about sixteen different tables recording various variables affecting collection.

¹⁹⁵ Khan *et al.* (2014) point out that initially the tax incentive scheme in the Punjab ETD differentiated between current year and arrear collection by tax staff. However, this was discontinued due to non-reliability of the reported figures from field staff, since these could not be effectively crosschecked. The incentive scheme only used aggregate collection data, which are verifiable from the Accountant General's database.

¹⁹⁶ Recently, in 2012, another attempt was made to digitalise data, starting with a pilot medium-sized city, Sialkot, and later expanded to five other cities. The ETD and another provincial agency (the Urban Unit) undertaking this digitalisation claim that it has been relatively successful. However, a recent assessment of the project commissioned by the World Bank (Khan and Inam, 2014) points to serious flaws in the visioning and implementation of the project. It also finds that lower level response to digitalising is not unusually negative for such projects as made out by senior officers.

¹⁹⁷ As discussed in Chapter 2, up till 2014 the property valuation tables drawn up in 1999 were in use. Revaluation is mandatory after every five years under the property tax law.

property within a block are then dependent on its size,¹⁹⁸ whether or not it is deemed to be used for commercial or residential purposes, whether it is owner-occupied or rented out, or whether the owners or occupants merit reductions because they are, for example, widows or retired public servants.¹⁹⁹ The assessing authority (ETO/AETO) can change the basic rating value of a block of properties by reassigning it from category A to B, C to D etc.

Given the incompleteness of property registration systems and records, the complexities of joint family property rights and mostly informal rental arrangements,²⁰⁰ the Circle staff enjoy enormous discretion in making assessments. Since there is a large difference in a property being assessed as commercial or residential, and again within those categories of owner-occupied or rented; most collusion is concentrated in exploiting these shortcomings of tax policy.

Circle staff prepare and deliver the bills, and visit taxpayers repeatedly to follow up on payment until they receive or are shown the bank receipt as evidence that payment has been made.²⁰¹ The billing process is itself complex. Bills are initially prepared on the assumption that they will be paid within the first three²⁰² months of the financial year, and will therefore be eligible for a 5% rebate. Should they not be paid in this time, new bills are prepared. Duplicate bills are anyway delivered regularly as reminders. All these

¹⁹⁸ Tax liability for individual properties is calculated using a complex formula using different rates for size of the plot and built-up area of a property. However, empty land with no improvements is not taxed.

¹⁹⁹ It is possible to assess similar properties or parts of the same property under different bands when being used for residential and commercial purposes. For example, in a highly commercialized 'hot' area, as the staff call it, a commercial property would be assessed in say, band A while its residential part may be assessed in band C.

²⁰⁰ In the case of commercial properties in Pakistan, there is a tradition of giving a large lump-sum payment up-front, called '*pugree*', followed by much smaller monthly 'rent' payments. Such practices, when routine and widespread, can influence rental value estimates even if surveys are carried out regularly.

²⁰¹ Property tax bills are issued in a three-foil format that has to be deposited in branches of the National Bank of Pakistan (or State Bank of Pakistan – Pakistan's central bank) under a designated treasury account. One foil is returned to the taxpayer, stamped by the bank as a receipt. Two are sent to the District Accounts Office. One of the foils is collected by the ETD, which makes an entry of payment in the District/ Region's Central Daily Cash Register. The foil is then sent down through the office of the ETO to the concerned Inspector. The Inspector attaches the receipt to the page in his register (PT-8) that has details of the property.

²⁰² Prior to 2012, the rebate was valid if paid within the first two months of the financial year.

bills are prepared by hand.²⁰³ This intensive personal interaction between tax collector and taxpayer provides the classic breeding ground for collusion between them, to the detriment of the public treasury, as well as scope for coercion on the part of the collector.

Field staff members do not generally use their discretion in ways that generate widespread resentment. Indeed, as the case above illustrates, they tend to make an effort to keep their taxpayers content in order to ensure payment, even at the cost of foregoing some revenue.²⁰⁴ This reflects the interaction of several features of the property tax system examined elsewhere in this chapter: the ability of field level staff to fend off pressures from above to increase collection; the danger of providing opportunities for local politicians to intervene on the side of taxpayers; and the potential costs of disrupting a set of arrangements that provide collectors with reliable revenue streams and most taxpayers with very low property tax bills.

Collusion between tax collectors and property owners to reduce assessments is not the statistical norm. Because rented and commercial properties are assessed relatively highly, it is here that collusive activities are concentrated. Some of the rented shops in a large shopping plaza may be recorded and assessed as owner-occupied. In a multi-storeyed plaza, a whole floor might not be assessed at all. Since there are different tax rates for properties on main roads and off main roads, a corner property may be shown wholly off the main road and charged a lower tax rate. A property being used as an office with no signboards outside may be recorded as residential and charged accordingly. For instance, an official explaining the selective nature of collusion once remarked to me with a smile, *“I do not know why all the petrol stations in my area are*

²⁰³ When the property tax bill is generated, it is supposed to reflect the tax assessment shown in Property Tax Register-8. However, a copy of the actual bill issued is not retained in office records. Neither do the bills have any universal identification number nor are they on officially supplied stationery. Circle staff members normally have to procure office stationery and various forms privately. They sometimes issue inflated bills and then offer to ‘reduce’ taxpayers’ liability in exchange for a bribe, subsequently issuing the correct bill. I was told that this and similar practices of extortion are not encouraged within the informal setting of the department as they are considered risky. The probability of a complaint to higher authorities is greater in such cases compared to collusive practices where the taxpayer also gains financially.

The assessing authority has powers to assess properties on a six-monthly basis, which would require bi-annual billing. However, this is not usually done unless there is a large change in tax liability of a property.

²⁰⁴ For example, tax staff has the legal authority to fine a taxpayer for non-payment, up to the amount of outstanding tax liability. However, this is almost never done.

owner-operated!” He obviously meant that they were not. Since rented commercial properties are taxed five times more, this was where his team was making at least part of its informal earnings.

Blatant misrepresentations run the risk of drawing the attention of the department’s Monitoring Wing. However, the Monitoring Wing is small, with staff based only at the provincial level and none at the regional level. If the Monitoring Wing or a senior officer on inspection unearths irregularities, the staff responsible can offer plausible excuses including that they do not properly understand the rules, they are understaffed and too busy to check on everything, or the property was put to a different use only recently. If disciplinary action is initiated and charges proven, officers normally emerge with minor penalties, which generally do not affect their jobs. While going through records of some of these disciplinary proceedings and summary sheets,²⁰⁵ I found that often the ‘loss to public exchequer’ was made good through payment ‘from the taxpayer’. That restitution was in turn cited as ‘mitigating circumstances’, for lenient decisions by inquiry officers. Since inquiry officers are appointed from within the tax department, they are usually sympathetic colleagues. No departmental staff, including those of the human resources wing in the Director General’s office, could remember anyone being dismissed from service because of ‘under-assessment’.

- Fifth, as mentioned previously, there is a substantial informal economy associated with property tax collection. On the basis of conversations with the staff of six circles, I estimated that the average circle needed to raise about 35,000 Pakistan rupees (350 USD) per month to meet the operational costs not provided for in the official budget: notably informal office assistants, office stationery, fuel for motorcycles and even official vehicles that staff use, as well as other operating costs.²⁰⁶ This kind of ‘living off the land’ is not unusual in the Pakistani bureaucracy. Senior officials justify

²⁰⁵ Performa “B”: Periodic summary report by Excise and Taxation Department giving details of finalized cases under various disciplinary rules including, Punjab Civil Servants’ Efficiency and Disciplinary Rules, 1975, 1999, PROSO-2000 and PEEDA Act, 2006.

²⁰⁶ For the first time, in 2012, the government provided all Inspectors with official motorbikes. However, they are not given any money for the fuel. Prior to that, apart from a vehicle for the Regional Director and a couple of pick-ups limited to Regional headquarters, provided in 2010-11, there was no official transport available for field operations.

In their assessment of the recent digitalisation project for property tax in Punjab, Khan and Inam (2014) point out that tax inspectors have to pay for electric generator fuel to run project computers. Ironically, this was in a project that was supposed to substantially reduce tax collector discretion!

providing inadequate operational budgets to tax offices on the grounds that the staff make a lot of money anyways. This is less true of the offices dealing with property tax than of other offices within the tax department. Positions in offices collecting excise duties on liquor and motor vehicle taxes are more lucrative and eagerly sought. The property tax field staff certainly supplement their salaries significantly with informal earnings. In investigating this, I focused more on the proportional division of these informal earnings than on absolute amounts. There were some variations from office to office, and cases of individual officers who did not participate at all. But the phenomenon is broadly systemic. It is very difficult for individuals to decline participating and continue to have satisfactory relationships with their co-workers. It would also impinge on their ability to run their Circles effectively. Reportedly, on average, about 60-70% of informal earnings are retained at the Circle level, with the Inspector taking more than half, and the Constable and the Clerk sharing the remainder. Operating costs are also met from this share, while the other 30-40% travels to higher levels of the bureaucracy. The bulk of it stays with the ETO and the AETO. I have no clear information on how consistently any of the money travels up to the office of the Regional Director and beyond. The Regional Director also oversees other offices of the ETD that collect the more lucrative excise and motor vehicle taxes. There is a perception that it is more appropriate ('cleaner', more honest) and less risky for the Regional Director to focus his attentions on these other offices than on property tax collection. In talking of informal earnings, staff may use the local term for 'corruption'. But they do not see this as unusual or in any major sense wrong. The words of one officer summarise the general view: *"We are all corrupt. You will not find a single officer in the Department who is honest... it is just that some are more corrupt than others."*

Staff members also insist that the ETD officers do not become very wealthy even after a lifetime of work. Only a handful of officers have made a lot of money and brought a bad name to the department. But these were mostly the 'blue-eyed' favourites of their superiors who remained for long periods in highly lucrative postings, like one of the districts, which is the largest excise earner because of a large brewery located there. The fact that property tax collectors collude directly with taxpayers to share in the money that formally belongs to the public treasury provides a ready legitimisation for their

behaviour: *“the public saves 90 rupees and gives us only 10 rupees, and then they call us corrupt?”* The sense of entitlement to informal earnings is strong.

While there is a great deal of cooperation at the Circle level around informal activities, there is neither total trust nor openness, but rather a degree of individual vigilance and mutual suspicion. If an Inspector is not particularly active in cross-checking information by spending time in the street, the Constable can make additional money for himself by not pooling all ‘deals’ with the rest of the Circle staff. For example, he could keep a few newly constructed properties off the official record, or continue to record properties that have been rented out as owner-occupied. As an informant remarked,

“The Constable always keeps one or two properties out of a hundred for himself... if the Inspector is old or not very vigilant the Constable and Clerk might collude and start running a side-show of their own.”

Lack of external checks and weak monitoring mechanisms have helped a ‘rent-taking’ culture develop within the department where property tax collectors have ample opportunities for low-risk collusion due to tax policy rife with differential tax rates and a manual tax assessment and collection system. The high degree of discretion allowed and exercised, coupled with control of cadastral and tax collection information, is key to the pervasive informality. It is noteworthy that the lower level staff knows that it is necessary that the formal system of tax collection works just well enough that it does not jeopardize their pensionable jobs while they also work the system for personal gain. A distinct characteristic of their incentive structure is guarding their long-term interest of working actively in the Department.

Though collusion is an important factor for low tax collection, a general lack of professionalism and shirking hard work amongst lower staff cannot be discounted. In fact such factors are exacerbated by the lack of routine supervision and inspections due to the pervasive informality in the Department. During my fieldwork, an ETO had given up on his Inspector due to his poor performance, and asked the Director to deal with him. The Director called in the delinquent Inspector, and exasperated by his excuses

said: “*Out of a hundred, it is understandable if you know*²⁰⁷ *five or ten property owners. Why are you not collecting from the rest of them?*”

In the absence of any reliable estimate of the potential property tax revenues in the province, higher-level management resorts to setting arbitrary targets and pressuring Directors to achieve them. In the following section I demonstrate how this is undertaken and how tax collectors respond to these pressures.

5.5 An office meeting, target-setting and managing information

The Secretary of the ETD was chairing the regular monthly meeting in which the nine Regional Directors report on progress regarding their monthly tax collection targets. The Secretary was trying to increase the collection target for the Region for which Nikama was Director. Nikama refused to accept the revised target. He said it was unrealistic and unachievable. The Secretary then asked another Regional Director, Kamu, whether he could do the job if transferred to Nikama’s position. Kamu said that he was willing to try if the target was reduced a little. The Secretary turned to Nikama and asked him if he could try to achieve the reduced target. Nikama still declined. The Secretary had little choice but to replace Nikama with Kamu. He asked Nikama to report to headquarters for further orders.²⁰⁸

²⁰⁷ ‘*Know*’ used by the Director in the sense that the Inspector has collusive arrangements with them.

²⁰⁸ I received a detailed account of this meeting from one of the participants. A new Secretary had recently joined to head the department and was keen to push for higher tax collection. Senior and normally well connected departmental officers are known to ‘test’ the higher level management, confident that their political connections make them ‘untouchable’. Stories of such interactions spread rapidly in the Department after a new Secretary or Director General is posted. They reflect how ‘strong’ (able to resist political pressure) the officer is. The staff usually molds themselves accordingly. In this particular case, a legal and political battle ensued between the Secretary and the displaced Director, which I witnessed in one of my fieldwork sites. The displaced Director was asked to report to head office and an inquiry was initiated against him. However, he filed a petition in a civil court against the order of the Secretary and obtained a ‘stay order’ which, as he interpreted it, allowed him to continue working as Director. Apart from applying political pressure on the Secretary to restore him, he regularly showed up at the Director’s office claiming that he was still the Director. This caused considerable anguish to the new Director since it was eroding his authority over the staff. Eventually, the departmental Secretary approached the local district administration for support and police officers were deployed to the Director’s office. The displaced Director was warned of arrest if he showed up again. After exhausting all his options, he eventually reported to provincial headquarters to face the departmental inquiries initiated against him.

The outcome of this meeting was quite consequential for the individuals involved. For Nikama, it represented a career setback. He had fallen out of favour with the Secretary, and could not expect to get a decent posting as long as this Secretary was in position – unless he could get a politician to intervene on his behalf. For Kamu this was a great opportunity. He was being transferred to a region that was more urbanized, and accordingly had more revenue potential, formally and informally. If he did well there, his next posting could be one of the three most desirable regional directorships in Lahore, the provincial capital.

Aside from the consequences for individual careers, the meeting described above provides insight into some of the higher-level organisational processes around property taxation. I use it as an entry point complemented with additional insights from my fieldwork to further analyse the working of the department. Below I make five broad points.

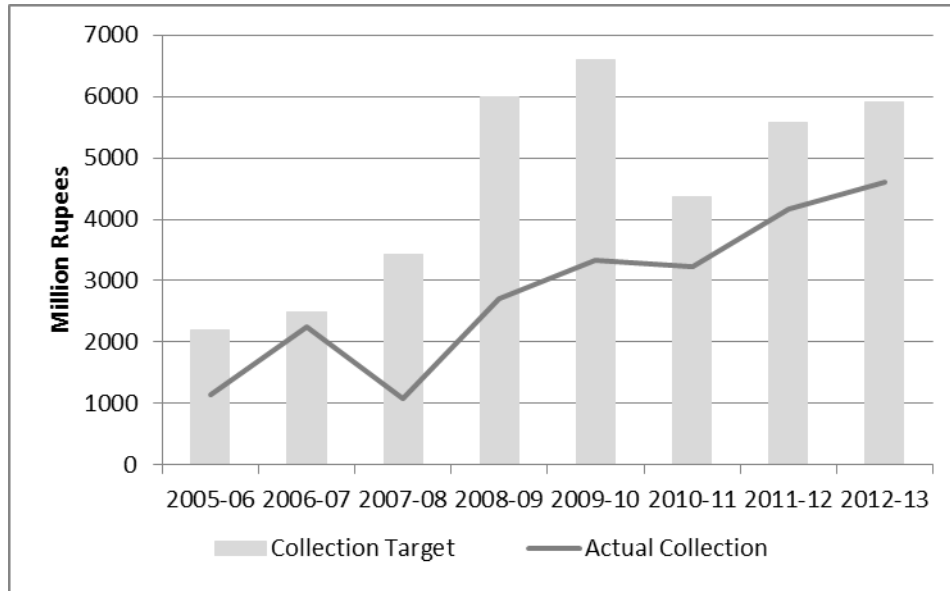
- Firstly, although in broad historical perspective the provincial government does not give priority to property tax collection and fails to exploit its potential, the goals of achieving annual revenue targets – and steadily increasing those targets (in cash terms) – do shape the behaviour of the senior and middle level public servants who oversee the property tax collection apparatus. As in the case of many ‘basic’ taxes levied on a large number of taxpaying entities in low income environments, the objectives set for tax collectors by their superiors are very simple: meet the collection target (Moore, 2013b). Achieving the target is virtually the only performance criterion. As long as revenue collection does not generate political unrest, the senior levels of the bureaucracy are unconcerned about how targets are met, or whether the means used to meet them might have adverse effects on future revenue raising capacity.

The strategy for setting property tax collection targets is ‘incrementalist’. Targets are set in cash terms, initially much higher than the previous year’s collection (see figure 5.2). They are eventually revised down towards the end of the fiscal year.²⁰⁹ Senior officers believe that this is the best way to maintain pressure on subordinates to perform better than the previous year. Incremental target setting by higher level is largely a response to

²⁰⁹ In order to balance the provincial budget, the Finance Department at times sets the tax collection estimates much higher than the previous year’s collection; note the variance in targets and actual collection for financial years 2008-09 and 2009-10, in figure 5.2. However, the ETD has its own internal collection targets which are incrementally higher than the previous year’s collection.

absence of information on the total property tax potential in the province, as well as a credible figure on total outstanding arrears. In essence it really is a shot in the dark.

Figure 5.2: Property tax collection target and actual²¹⁰



Source: Finance Department, Punjab

Target setting alone does not suffice to pressure tax staff. It has to be followed up vigorously by the Secretary and the Director General. They tour districts throughout the province, conduct spot checks, and initiate disciplinary action against lower staff. Disciplinary action takes the form of posting some tax staff to remote districts or initiating inquiries if there is evidence to do so. Clearly, the outcome depends upon how aggressive the higher level is and how effectively it can use its authority. Meanwhile, the middle and lower levels may resort to dragging their feet, protecting each other, or using political influence to neutralize disciplinary action. At one point during my fieldwork, the Director General remarked out of sheer frustration, “*We [Secretary and Director General]²¹¹ are fighting the whole department... it is not an easy task.*”

- Secondly, the higher level is not only handicapped in terms of accurate information but may at times be severely constrained in taking decisions for effective tax collection due to political interference. This interference usually takes the form of

²¹⁰ The sharp decline in financial year 2007-08 is attributed to this being an election year, and a spate of terrorism and political violence including the assassination of Benazir Bhutto, a former Prime Minister of Pakistan and head of one of the largest political parties.

²¹¹ Added by the author

political pressure for transfers and posting of tax collectors at various levels and jurisdictions, as well as when enforcing tax collection – which I discuss in Chapter 6. The political patronage of lower government functionaries is common knowledge in Pakistan. It is not uncommon for lower-level departmental staff to be recruited into government jobs through political connections.²¹² These patronage-based relationships continue through their careers, protecting tax collectors from disciplinary action and helping them in getting ‘better’ (more lucrative) postings. Such relationships between political patrons and tax collectors are largely based on reciprocity, including regular payments and financial support during election campaigns.²¹³

One day during my fieldwork, the Director General and I were discussing management issues that impact property taxation when a ruling party politician walked into his office. After an exchange of pleasantries, he presented a list of three tax officers that he wanted posted to his constituency District claiming there were ‘complaints’ about the incumbents. The Director General promised to accommodate him the best he could. Reportedly, such requests from politicians are routine. Two former departmental Secretaries informed me that they had never been under so much pressure from politicians to post specific people as they experienced in the Punjab ETD. Other informants during the course of my fieldwork also emphasised the factor of political ‘backing’ for tax staff that could be based on arrangements ranging from patronage to kinship. The Secretary and Director General normally do not have strong incentives to disrupt these relationships because they do not want to upset too many politicians and jeopardize their standing with the ruling party. When discussing postings in various offices throughout my fieldwork, tax staff members were quite open about naming officers who managed better postings, as well as politician who were ‘at their back’.

- Thirdly, there is a clear disjuncture, in respect to time horizons, between field-level tax staff and higher-level management. Supervisory staff members, including Regional Directors and ETOs, are usually rotated after two or three years. But the circle staff members are rarely moved out of their circles or districts, except as punishment in

²¹² Gazetted officers (grade 17 and above) are recruited through a competitive process by an autonomous provincial Public Services Commission. Lower ranks like Inspectors, Clerks and Constables can be recruited directly by the Department. Because there is a lot of pressure from politicians pushing their candidates for these jobs, at times the government requests the Commission to recruit Inspector level positions as well.

²¹³ These are not limited to the lower rungs of the civil service.

instances of serious or repeated complaints.²¹⁴ They are concerned about how their behaviour today might affect their capacity to work and earn informally in the future. By contrast, the higher level is strongly present-oriented, as they are in positions that they are unlikely to be occupying in more than a years' time. From their perspective, it is this year's target that matters, hence their focus on monthly and quarterly targets. During the course of my doctorate, from 2010 to 2014, the average tenure of the Secretary and Director General was about a year.

- Fourthly, the disjuncture of time scales between higher and lower levels of the ETD is mirrored in the high level of information inequality between the two levels. Field level staff has rich and detailed information in their heads and in their private records on the actual or potential property tax base. The fraction of the relevant information that is in the official records exists in hand-written ledgers in the Circle offices, as explained in section 5.3. It is not routinely aggregated for transmission upward to higher levels. If higher-level officers want to access that information – or indeed find out almost anything else about the process beyond aggregate collection figures – they have to resort to physical inspections of lower level offices and records. Inspections can be intimidating for those on the receiving end, but they are very inefficient and largely ineffective ways of accessing information that might be useful in gauging the real performance or tax revenue potential of jurisdictions.

The asymmetry of information on property tax arrears is in many respects at the heart of information asymmetry. It is one of the most important instruments used by lower level staff to deal with the performance targets that descend on them from above with much apparent hierarchical force. It would be hard to grasp the informality of property tax collection without understanding what can reasonably be termed as 'the arrears system'.

Property tax arrears are large relative to annual collections. The ETD has no aggregate figures, but knowledgeable people estimate arrears to be upwards of 30% of annual

²¹⁴ Tax staff turnover in smaller districts is lower compared to larger ones. Since smaller districts do not have much potential for informal earnings; there is little political pressure for postings to these districts. It is usually officers that belong to these districts who prefer to stay there.

collections.²¹⁵ Accurate figures are available only locally, and to Circle level staff. A Regional Director described to me how he once summoned a Circle Inspector to ask about the extent of his arrears. The Inspector reported that they amounted to about 20 million rupees (200,000 USD). When asked to bring all his registers to the Regional office for inspection, the Inspector revised that figure to 40 million rupees. By the time he arrived with the registers, his estimate was 50 million. The Director guessed that, had he taken the time to go through the registers, the real figure might have been double that amount, but he did not have the time to check. Written information on arrears exists only in the registers, where it should be recorded property by property. Inspectors should have separate registers that list out all properties in arrears along with sums outstanding. However, supervisors rarely crosscheck these. Similarly, as mentioned earlier, collections of current dues and of arrears are not accounted for separately either by the banks that actually collect the property tax or by the provincial Accountant General. Thus, senior officers only receive aggregate tabulated figures for monthly and annual property tax collection from the Accountant General. They are presented with figures on monthly and annual ‘collections’ disaggregated to ‘arrears’ and ‘current’ by the field staff. Senior officers do not know the quantity of accumulated arrears, nor can they independently verify the disaggregated figures provided to them.

Accumulated arrears are not simply the result of the inability or unwillingness of the Circle staff to persuade property owners to pay on time. They also reflect the fact that Circle staff sometimes actively encourages property owners to accumulate arrears. Why would they do such a thing? There seem to be several interacting reasons. One is that it gives field staff some leverage over the taxpayer concerned. The law gives revenue staff considerable authority to deal with property taxpayers in arrears. Under the provincial revenue collection laws, they can institute legal proceedings for the recovery of ‘outstanding government dues’ and, without court permission, impound moveable property (like vehicles), ‘seal’ (lock up) immovable property to prevent access by the owner, ‘attach’ the rent of the property, or even arrest the owner. These powers are rarely used, but field staff members seem to find it useful to have some of their clients

²¹⁵ Arrears are highly variable and are reportedly much higher in certain regions/ districts compared to others. In my fieldwork sites, officers estimated these to be between 30% and 400% of the current annual demand.

in a position where, in principle, such actions may be taken.²¹⁶ Enforcement and its impact on tax collection are discussed in Chapter 6.

Second, and perhaps more significant, is the scope for staff and property owners to collude to accumulate large arrears on a rented property. After a few years, staff can orchestrate an appeal by the owner on the grounds that the property had been self-occupied the whole time and that he was, for example, living abroad. The appellant authority in such cases is the Regional Director. He is reliant on his local Inspector's field report to decide the case. During my fieldwork I observed a number of such cases presented to the Regional Directors. Most cases were decided in favour of the taxpayers, reducing their liability or arrears. It is hard to say whether the Directors were colluding in such cases but they did not seem to have much evidence apart from the Inspector's report to make their decision.

Third, there is a collective incentive for lower level staff to encourage the accumulation of arrears because it helps them buffer demands from above. This takes us back to the meeting described in the beginning of this section. Revenue targets for property tax do not reflect any sophisticated, informed analysis of changes in underlying revenue bases. They are set by variable combinations of pure incrementalism (last year's figure plus a standard percentage increase) and the kind of strategic games played at that meeting by the Secretary to find out how he could best squeeze out a little more given all the constraints. He may have been assuming that middle level officers (Directors) would have more information than he had available on the real revenue potential of each regional office. In that case, the small bidding war for the Director's post might serve to unearth that information. Alternatively, or equally, he might have been banking on Kamu to be more aggressive than Nikama in badgering and bullying his staff, notably by a blitz of inspections, to suck out a little more money. This makes no difference to the tax officer or staff of the Circle level. They know that these kinds of higher level manoeuvring can at any moment subject them to demands for more money that would be painful if they had to either sacrifice their own informal earnings or upset their taxpayers by renegeing on some collusive assessment deals. The arrears system – and it

²¹⁶ The head of the tax department's monitoring unit informed me that during one of his spot record inspections, he discovered that an inspector had failed to carry forward the record of arrears to the new registers that he had prepared, virtually (officially) wiping off all arrears in his circle. He had moved all arrears in his jurisdiction into the informal zone, thus increasing his personal discretion regarding when and how to use them.

does make sense to term it a ‘system’ – helps them deal with these unpredictable pressures in two ways. First, they can press for payments of arrears when in real need of money, and allow arrears to accumulate again once the pressure is relaxed. Second, the absence of any separate aggregated figures for collections of arrears and of current dues makes it impossible for senior staff to prevent this kind of response.

- Lastly, in order to circumvent information asymmetry, higher-level management creates incentives for the middle level to collaborate to achieve revenue targets. The middle level comprises senior departmental officers who are either close to retirement, having started in relatively junior positions, or relatively younger who were direct recruits as Inspectors or ETOs. During my fieldwork year, higher-level management decided to sideline some of the older officers who were considered ‘incorrigible’ and posted younger ones, who would usually have had to wait longer before occupying important Regional Director positions. Not senior enough to be posted as Directors, some of these officers were granted postings on ‘acting charge’, a tactic normally used to keep the officer on his toes and compliant to his superiors. Officers falling short of expectations can then be returned to positions of their actual seniority. I observed such officers to be quite active and aggressive in pursuing revenue targets by accompanying Circle staff in the field for enforcement and conducting inspections (see Chapter 6).

5.6 Conclusion

The informality of tax collection is systematic and provides tax collectors stable rents through selective collusive arrangements. It is largely non-extortionist, and rents extracted are at the expense of government revenue. These rents are mostly generated from properties that have relatively larger tax liabilities. Current arrangements are the product of repeated interactions, both within the formal boundaries of the property tax system and across them.

In a regime of weak supervision, irregular inspections, almost non-existent external and internal auditing, and manual record keeping, coupled with high level of discretion that Circle staff exercises, rent-taking is an expected outcome. Though it can be considered ‘petty’ corruption at the local level, the systemic nature of the informality has substantial impact on property tax revenues. Although it is selective, mostly exploiting rate differentials and, at times, exemptions allowed under existing tax policy, it has a deep negative impact on the working of the Department. The informal working of the

ETD encroaches on formal roles and responsibilities of the A/ETOs and the Regional Directors who, as part of the 'system', are then constrained in exercising their respective roles effectively. They are mostly content with office-bound management while the lower level staff 'runs' the department. Even when there is pressure to collect more taxes and middle level staff is pushed into action, then, as I discuss in Chapter 6, they focus primarily on enforcing collection of outstanding bills and not re-assessing properties.

The informality of tax collection centres on information asymmetries that exist between the higher and lower levels of the tax department. Lower level staff monopolizes information on tax assessment, collection, and arrears to their benefit over the medium to long term to achieve two primary objectives: Firstly, to earn adequate informal income which is shared throughout the hierarchy of the tax office and to finance the tax functions at the Circle and office levels. Secondly, to maintain an adequate buffer to manage year-on-year incremental increases in tax collection that ensures their continuity in their jobs.

In the absence of accurate information about the tax base, the higher level manipulates and pressures the middle level tax staff to increase tax collection. The incentive mechanism to elicit cooperation from the middle level is based on posting and transfers to what are considered better jurisdictions, and being given charge of 'acting' positions in higher positions to relatively junior tax officers. Given that they have a better sense of the tax potential as well as the informal working of the Department, they are better placed to squeeze more work and tax revenue from the lower level. This is not necessarily at the cost of collusive arrangements. Accumulated arrears and un-assessed pockets of properties provide buffers to resist exactly this sort of pressure. However, the middle level tax officers are also part of the system and know that the following year will have similar pressures from the top. I discuss some of these issues in more detail in the next chapter, which explains departmental functioning during an unusual enforcement drive.

6 Enforcement: The mirage of change

6.1 Introduction

Pervasive informality within the Excise and Taxation Department (ETD), discussed in the previous chapter, creates a range of obstacles to increasing revenue from property tax. One is that tax collectors create a buffer, in the form of tax arrears, which they can use when they come under particularly strong pressure to deliver more revenues. These pressures normally intensify in the last quarter of the financial year, from April to June. Fortunately for me, my fieldwork coincided with an exceptionally intensive drive to raise revenues, in the last quarter of financial year 2011-12. The senior management of the ETD was particularly keen to be seen to be performing well. According to the departmental staff, the level of enforcement activity was significantly greater than normal.

In this chapter, I discuss the working of the ETD under extraordinary pressure to increase tax collection. Most of this pressure was channelled into the collection of arrears, following up on and taking legal action against tax defaulters. Despite a veneer of increased formal working, I find that even during a period of strict enforcement the fundamental working of the department did not change. Pressure for increased tax collection was created by the departmental leadership with support from the political executive. Strict enforcement implies that outstanding dues and arrears are pursued vigorously and collected. The strategies used to enforce follow mostly formal legal procedures that protect tax staff from litigation and complaints. Despite a relatively high level of political support from the top, multiple underlying factors that impact tax collection did not change. These factors are embedded and long-term, including personal and social affiliations that tax staff might have with local politicians. The knowledge that strictness in the Department is only temporary and things can revert to normal rapidly after the end of the financial year or when senior management is changed deter tax collectors from pursuing tax collection aggressively. Tax collectors have instituted a practice of ‘part-payment’, as a way of affecting partial recovery while at the same time responding to ground realities, like political connections, pressures, protecting collusive arrangements or simply taxpayers’ ability to pay. Though strictly not allowed under the property tax rules, part-payment implies payment by the tax defaulter of a portion of his/her outstanding dues or arrears. The exact amount is usually

negotiated between the defaulter and the tax collectors; this adds to the discretion exercised by tax collectors. As discussed in detail in this chapter and the previous one, there are reasons why tax staff might want arrears to remain uncollected.

In section 6.2, I briefly explain why enforcement was exceptionally intense during 2012 when I was doing my doctoral fieldwork and how it changed the way tax staff work. In section 6.3 I highlight the tactics used during enforcement by the supervisory staff. In section 6.4, I show how civil courts can impede tax collection and influence the behaviour of tax collectors. In section 6.5, I show that tax collectors continue to use discretion even during periods of formally strict enforcement. In section 6.6, I explain why despite this unusual episode of enforcement, there was no long-term change in tax collection or the ways in which local level relationships are configured. The last section concludes.

6.2 Enforcement in the last quarter

Part of my fieldwork,²¹⁷ the period from April to June, coincided with the last quarter of the fiscal year. Under pressure from the Finance Department to meet annual collection targets, the ETD usually enforces tax collection in the last quarter. Senior officers of the ETD pressure middle and lower level tax staff to meet targets set for each Region/District. There was a noticeable increase in the activity of tax staff compared to the previous quarters. Tax staff told me that enforcement activity in this particular year was greater than usual.

The driving force behind this unusually aggressive enforcement was the new Secretary, who had been posted to head the ETD earlier that year. He is known for his aggressive and demanding professional nature as well as close personal links to the provincial Chief Minister.²¹⁸ Over the course of the year, strong support from the Chief Minister helped the Secretary to protect the ETD from political interference in the department's administrative matters. The Secretary ensured that postings and transfers of tax staff were not decided on recommendations of politicians but were instead largely

²¹⁷ From September 2011 to September 2012

²¹⁸ The Secretary is quite ambitious and has a reputation for being tough on his subordinates. He was prematurely posted out of two departments he headed earlier because his harsh attitude resulted in departmental staff to go on strike. He probably took his ETD posting as an opportunity to demonstrate to the Chief Minister his ability to deliver on targets.

performance-based. Both the departmental Secretary and the Director General were strict in disciplining staff and conducted random field inspections throughout the province, selectively replacing some of the Regional Directors. To ensure better compliance,²¹⁹ some relatively less senior officers were offered Director level positions in an acting capacity.²²⁰ Gradually, the senior management built pressure for higher revenue collection by signalling to tax staff that they would face sanctions for non-performance. Disciplinary action was initiated against errant staff.²²¹ More importantly, some on-going disciplinary cases were finalized and harsh punishments were delivered to tax officials found guilty, including dismissal from service. Such stiff penalties unsettled tax staff considerably since, as mentioned in Chapter 5, disciplinary cases in the department usually concluded with minor penalties for errant officials. Lighter penalties scarcely impact on careers or posting prospects, and thus provide no incentive for errant officials to alter their behaviour. In addition, senior officers signalled to lower level staff that they would be protected from any political repercussions that might result from enforcing tax collection. Normally, tax staff avoid enforcing collection from influential taxpayers, including ruling party politicians and their supporters, for fear of punitive action, such as being posted to remote districts.

During this period of strict enforcement, some chronic cases of tax default and some politically sensitive cases were vigorously pursued by tax officials. Tax Inspectors and Constables wore their uniforms to work regularly. As mentioned in Chapter 5, this is not the usual practice. Enforcement involved a number of sanctions on taxpayers in arrears, including sealing properties that have outstanding property tax dues – which I discuss in detail in section 6.3. Public visits to the tax office and generally the level of activity in the tax offices increased significantly compared to previous quarters. Tax defaulters eager to avoid enforcement would present their payment receipts, apply for remission or appeal against assessment. Sometimes tax defaulters came in groups: for

²¹⁹ Officers are normally rotated at the beginning of the new fiscal year (in July), so as to have continuity of management through the fiscal year. However, this is not a hard and fast rule. For example, in one of my fieldwork regions the Director was posted just before the beginning of the last quarter of the financial year (consequent to the episode I described in Chapter 5).

²²⁰ 'Acting charge' is the term commonly used when an officer is posted to a position which is above his seniority level in the civil service. As mentioned in Chapter 5, such postings are coveted and fear of reversion makes officers extra compliant to higher management.

²²¹ According to official data from the Director General's office there was an increase of 100% in new disciplinary cases initiated against tax staff by the senior management in FY 2011-12 compared to FY 2010-11.

example, shopkeepers from a market where most shops had been sealed. Local politicians often accompanied them. Defaulters pleaded their cases and requested remissions or more time for payment. Directors and tax officers were inundated with phone calls from ministers, politicians, other civil servants or relatives interceding on behalf of defaulters. The last quarter was hectic for tax staff, who juggled their time between issuing final notices to tax defaulters, following up on individual cases, pursuing cases in civil courts – where taxpayers sometimes file cases against enforcement – and sealing and de-sealing properties.

Sometimes when a defaulter paid up a large overdue tax bill, there was a sense of achievement and pride among tax staff. Expressions such as “*we are the Government... this is our job*” could be heard in staff conversations. As one experienced tax collector remarked, “*we are always ready to do this [enforcement]*”²²² ... *it is the seniors [higher management] who don't want to face the [political] pressures.*”²²³ Notwithstanding these sporadic outbursts of enthusiasm, generally enforcement was a challenging task for supervisory officers.

6.3 How supervisors ensure enforcement

Enforcing tax collection requires the constant support of the political executive. However, that alone is not enough; the senior management has to constantly ensure that tax staff follow rules and procedures stipulated in the tax laws. For much of the year the departmental Secretary attempted to bring the ways in which tax staff conducted their job in line with formal rules. His efforts culminated in the last quarter of the financial year. Regional Directors, motivated by the Secretary to push for greater tax collection (as I showed in Chapter 5), followed the Secretary's lead. Regional Directors are crucial to tax collection both in their supervisory capacity and as appellate authority on tax assessments.²²⁴ As remarked by one Tax Inspector, an information technology expert

²²² Added by author

²²³ Although I don't have any direct evidence to support this but it is generally known that 'strictness' on part of the government or higher management increases the negotiating power of government officials within collusive arrangements – that might partly explain this exuberance.

²²⁴ The effectiveness of Regional Director is mostly limited to the Regional headquarter district that he is located in, which is usually the largest city in the Region. The Director's role requires his physical presence and daily monitoring of staff activities. This is not necessarily replicated in other districts within his jurisdiction, partly because it is physically not possible without neglecting his headquarter city. Large urban centres are an

with a masters' degree in management sciences: *"the culture of the tax office is determined by the Regional Director. He sets our pace of work, through example."*

Regional Directors have sufficient experience of working at junior levels in the ETD to know the nuances of the tax collection business. Even when posted to Regions in which they have not worked previously, Regional Directors can effectively push staff for higher tax collections. Regional Directors cultivate a couple of ETOs and Inspectors in the Regional office. One would see them having tea with the Director once or twice during the course of the day. These collaborators from the local staff are important to the success of the Director. They share vital information about the Region, for example, identifying the tax Circles to which the Director needs to give more attention, or telling on an unusually corrupt Inspector. Some tax staff tend to step forward with such information because they might have been side-lined during the tenure of a previous Director and/or want to earn favour with their present Director.

Generally tax staff are reluctant to change their pace or ways of working. The majority of them require close supervision. The attitude of lower tax staff is similar to Scott's (1985; pp.29-35) depiction of relatively 'powerless' groups whose weapons of resisting authority are,

"... foot dragging, dissimulation, false compliance,they require little or no coordination or planning... and they typically avoid any direct symbolic confrontation with authority... Seen in the light of a supportive subculture and the knowledge that the risk to any single resister is generally reduced to the extent that the whole community is involved...."

Regional Directors constantly pressure lower level tax staff to enforce collection. Below, I enumerate some of the tactics used by Directors that mainly involve emphasising formal roles, following rules and increased supervision.

- First, Inspectors and Constables are obliged to wear their uniforms when on official duty, during the last quarter. No one wore uniforms in previous quarters; this

obvious priority because of the large property tax base. This does not mean absence of enforcement in smaller cities and towns. But I did not find the Directors show too much interest in smaller cities/ districts apart from making a phone call to the ETOs daily to inquire about progress, and occasional short visits.

changed in two out of the three Regions where I witnessed aggressive enforcement.²²⁵

The Directors told me that wearing uniforms has a psychological effect on the officials as well as the taxpayers, sending out a clear signal that it is not business-as-usual. The uniform of the Tax Inspectors and Constables is very similar to that of the police. Only the shoulder straps and caps signify that they belong to the ETD. This subtle difference is not generally evident to the public. The idea is to create a deterrent against attacks by tax defaulters; sealing operations especially can easily get out of hand and people are usually reluctant to assault officials who appear to be the police.

- Second, when enforcing tax collection, teams of tax staff comprising two or three Inspectors and five to six Constables are sent out to a Circle. This is in contrast to earlier quarters where only the Circle field staff – the Inspector and the Constable – collect taxes. Sending out teams is an effective cross-check on the Circle staff, as larger numbers ensure that fewer things stay secret. At times, Inspectors themselves request team visits to their Circles. They use these team visits as an excuse – ‘pressure from above’ and ‘inspection visits by higher officials’ – to pursue tax collection in their Circles more aggressively. Team visits also provide them some face-saving in case they have to renege on some of their collusive agreements. In one instance, prior to the enforcement visit to his Circle, the Circle Inspector requested the Director to instruct the ‘visiting’ Inspector to “*act as his boss*”. Enforcement teams are sent out in one or two vans painted in police colours. An officer pointed out that these vans have a tremendous impact on defaulters, especially in affluent areas. Tax defaulters promise to pay up and request Inspectors to not come to their houses ‘with police’ as it “*dishonours them in the eyes of their neighbours.*”

- Third, at times the Director accompanies enforcement teams, especially to areas considered relatively troublesome. Some markets and congested inner city neighbourhoods are notorious for roughing up and chasing away tax collectors. A Director told me that a certain area was being portrayed by the Circle staff as particularly dangerous and, according to the staff, whenever they go there “*people are ready to bite them!*” The Director made a point to accompany the enforcement team to this area, sealed fifty properties and then gathered the shopkeepers in the bazaar to warn

²²⁵ I observed enforcement in the last quarter in three different Regions. Later I point out why one Region out of these three had relatively weak enforcement.

them to clear their tax dues. He then challenged them, at the same time taunting his own staff and asked, “*so which one of you here bites?*” Another Director (that I accompanied to the field during enforcement) sent out teams every morning and then randomly checked on them in the field personally throughout the day. This prevented staff from going home early as they did not know when he would call their cell phones to locate and meet them.

- Fourth, for effective enforcement, Directors have to convince their staff that they will be protected from any political fall-out of strict enforcement. The following incident is an excellent example of such protection. As I walked into the Director’s office one morning I found a number of ETOs having tea with him. They were discussing a sealing operation from the previous evening that had made headline news in local television. A Tax Inspector had sealed the main city office of a large opposition political party, a move dubbed by media as ‘political victimization’ by the ruling party. Annoyed at this unwanted negative publicity, the ruling party’s leadership asked the departmental Secretary to identify and punish the tax staff responsible for this mischief. The Secretary in turn asked the Director for names of the staff so that he could suspend them from duty. The Director explained to the Secretary that all legal formalities had been followed in the operation. He added that the property owner refused to clear his considerable arrears because he thought the ETD would not enforce collection (by sealing) because such a move would be politically sensitive. However, the Secretary insisted on getting the names of the tax officials involved. The Director, wanting to protect his staff, replied that he had sealed the property personally and was not accompanied by any of his staff. Realising the Director’s firm position, the Secretary assured him that he would deal with the political bosses and that the Director should issue a press release stating the case facts. The incident greatly increased the Director’s standing and reputation with his staff. He had risked his own job to protect the Inspector. Normally, when taking a stand for his subordinates an officer expects them to reciprocate, by working for him sincerely. He expects them to deliver on targets set by superiors and not compromise him professionally.

- Fifth, every morning the Director holds a progress meeting with all tax officers and Inspectors to discuss the recovery of current dues as well as arrears, for each Circle. He asks Inspectors if they need his support for a particularly tough case and if anyone

wants him to come along to a difficult site for sealing properties. Updates on problematic default cases are shared and recovery strategies discussed. According to their performance, tax staff are appreciated, cajoled and at times threatened by the Director. The threat of disciplinary action is used constantly by Directors to keep Inspectors alert. At one of these meetings, the Director, upset with slow progress, warned that if staff did not improve he would “*withdraw his promise of immunity against Tax Inspectors’ past actions.*” He warned that he would start scrutinising their assessments and records more closely and initiate inquiries.

- Sixth, tax collectors find sealing properties to be the most convenient way of enforcing collection. In the case of continued non-payment of government dues, the outstanding amount is declared as arrears under the Land Revenue Act.²²⁶ The land revenue laws from the colonial period are particularly harsh on tax defaulters. They give a wide choice of coercive measures to tax collectors including arrest of defaulter, distress and sale of moveable property, attachment and sale of immoveable property, etc. Any of these actions can be taken once legally prescribed processes of issuing multiple notices are completed. Sealing a property signifies that the government has taken possession²²⁷ of it with the intention of auctioning it in the event that outstanding government dues are not cleared within a certain time period. Previously, the tax staff usually arrested defaulters but that added to administrative costs, amongst other complications, partly because the ETD does not have its own detention facility.²²⁸ For some years now, tax staff have found sealing properties to be a very effective and administratively convenient means of enforcing collection. However, non-observance of prior legal formalities can have repercussions for tax staff and may disrupt the collection process, if defaulters challenge the process or its legality in the civil courts. Sealing commercial properties can be difficult especially when these are a cluster of shops or a whole market. There is always a risk of physical resistance from defaulters. It is generally easier to avoid this by undertaking sealing operations early in the morning, before shops open. Enforcement action against well-organised groups of defaulters located in the same area, like shopkeepers, often elicits political pressure as well. However, once businesses are sealed the negotiating position of defaulters diminishes

²²⁶ Under Sections 74-81 of West Pakistan Land Revenue Act, 1967

²²⁷ The legal term normally used is ‘attaching’ the property.

²²⁸ The department maintains one small lock-up in Lahore.

considerably because their business losses accumulate with each day of closure. Residential properties are relatively easier to seal but, after some instances of being taken to court by residents for being ‘illegally confined’, tax collectors are now very careful when it comes to sealing residential properties. The principle they follow is simple: seal residential property in a way that does not obstruct residents’ movement in or out of the property. The objective is to inconvenience residents and burden them with the social stigma of having their house sealed. Sealing residential properties normally implies locking the main gate so that vehicles cannot be taken out, while leaving a side entrance open. If there is only one entrance to the house then they use a chain and a lock so that the gate opens just enough to let a person through. Once properties are sealed, defaulters usually do not tamper with the locks. Breaking the lock and official seal creates legal complications for the defaulter as the tax staff may register a police case under a criminal act. Though there are exceptions, defaulters are generally aware of this and avoid getting involved in a criminal offence due to the possibility of arrest and extortion by the police.

6.4 Civil courts impede enforcement²²⁹

Despite being legally barred²³⁰ from interfering in tax collection, civil courts²³¹ often halt or reverse enforcement action on applications filed by defaulters. Partly due to the recent wave of judicial activism in Pakistan, civil courts normally entertain cases against enforcement and issue a ‘stay order’ – a judicial order maintaining the status quo, which stops the government from taking any further action to recover tax revenues. Stay is granted despite the fact that it is normally used only where an action by the government is expected to harm the interest of the plaintiff irreversibly, for example, demolishing a building. This is clearly not so in the case of tax recovery since money

²²⁹ See Leiven (2011), Chapter 3 generally and especially pp.107-118, for an illuminating account of how the court system works in Pakistan.

²³⁰ Under various laws civil (lower) courts have no legal authority to entertain cases involving recovery of government dues. For example under, Section 22 of Punjab Urban Immoveable Property Tax Law, 1958; and Land Revenue Act, 1967.

²³¹ Lower courts have no legal role under property tax law. Higher courts have appellate jurisdiction in cases where assessment is challenged by taxpayers. Provincial High Court and the Supreme Court of Pakistan are third and fourth appellate authorities respectively for assessment cases; the first and second being the Regional Director and Executive District Officer (Finance) of the district government. Thus for a case to be taken to a High court the taxpayer should already have appealed (and been rejected) at the first two levels.

can be refunded if at any stage assessment is found to be excessive. Moreover, a stay is normally granted when a case of appeal against assessment, for example, is underway in a court. The logic of such stay orders is that the government should not take any action until the court decides the case. Violation of a stay order can lead to contempt of court proceedings against government functionaries. Normally, tax collectors do not flout court orders.

The tax staff informed me that civil courts entertain cases against tax enforcement on the basis of infringement of human rights. Issuance of stay orders, once these complaints have been accepted for hearing, is routine and an impediment to enforcement. Although the phenomenon is not widespread – one tax officer estimated that it comprises no more than one percent of property tax default for Lahore – it can affect tax collection in a number of ways. First, although the cases are not large in number they usually involve large amounts of outstanding dues, making it more feasible for defaulters to pursue litigation.²³² Second, tax collectors allege that, in a corrupt judicial system, defaulters can bribe court clerks to obtain a stay order. In addition, bribes are made to ensure that once the stay order is granted, the case does not come up for hearing for several months. Stay orders are issued without hearing the tax department's representative. If tax collectors are not given an opportunity to present their case, the stay order can be prolonged indefinitely. Third, in the absence of legal support from the department, tax staff have to pursue court cases themselves, which costs them time and money – an Inspector usually pays out of his own pocket to get legal help in drafting replies to the petition etc. Daily court-case lists are long and reportedly getting a case higher up on the list requires bribing court clerks. A single hearing in court can tie up an Inspector for a whole day. At the end of the day, he usually finds that the hearing has been postponed and is given another date.

For reasons mentioned above, tax collectors try not to encourage defaulters to go to courts, and have low incentives to pursue cases if they do. Only a few high-profile cases are pursued by a small legal team in the Secretary's office.²³³ Cases of property tax arrears that are not recoverable due to on-going cases in courts are estimated to account

²³² For example, semi-autonomous government organisations like power companies and the Pakistan Cricket Board.

²³³ This team normally deals with routine cases against the ETD in the higher courts.

for less than one percent of the total number of defaults.²³⁴ So what about the other ninety nine percent? In the section below I show that continued use of discretion on the part of tax collectors, even during episodes of strict enforcement, may partly explain overall low level of tax collection despite periods when pressure to collect is high.

6.5 Persistent informality

In this section, I show that the tax collectors, including the middle and lower level of the ETD hierarchy, continue using their discretion during periods of strict enforcement, as I witnessed during my fieldwork. Despite the appearance of relatively more formal working practices that I described in section 6.2, in essence there is very little change in the working of the field offices. This is largely because the primary objective of the Regional Directors during these periods of enhanced enforcement is to increase tax collection, and not principally to change the ways through which taxes are collected. My field observations indicated four types of informality that persist even during episodes of strict enforcement.

- First, in order to achieve their objective of increased tax collection, Directors generally allow lower level staff considerable discretion when choosing cases for enforcement. Time and resource constraints during the short enforcement period require that cases for enforcement be prioritised, implying that tax defaulters are pursued selectively. There are good reasons to believe that cases where tax collectors have colluded are lowest on the recovery list, as the following example demonstrates. In one of the morning meetings, the Director, dissatisfied with the progress in the recovery of arrears by one of the Inspectors, asked him to bring his arrears' register, that should contained a full record of all outstanding liabilities in his Circle. It turned out the register in question was a private notebook. The Director showed me the long list of arrears, spread over many pages, and then mentioned that this particular Inspector had won the highest cash award in the province for the last quarter under the on-going tax collectors' incentive scheme.²³⁵ He turned to the Inspector and said, "*you don't deserve*

²³⁴ This is an educated guess based on discussions with some senior ETD officers, and on the fact that stay cases are less than 1% of the total default cases in Lahore, which is the highest ratio for a district in Punjab.

²³⁵ Initiated in the department as part of a study in 2009/10, the scheme was designed and led by a team of economists, Asim Khawaja (Kennedy School of Government, Harvard University), Ben Olken (Massachusetts Institute of Technology) and Adnan Qadir Khan

a bonus that big, just look at your arrears. I should confiscate your award and buy office furniture with it...” He then went on to mark some of the larger amounts with a highlighter and numbered them, giving the Inspector a week to show progress on the highlighted cases or else he would be posted to a part of Punjab where he would almost certainly not be able to earn a bonus.²³⁶ Essentially, the Director was not interested in lists of arrears as long as the Inspectors were showing good progress.

- Second, while Directors threaten lower level staff with disciplinary action and use any available evidence of malpractice to pressure them to increase collection, they rarely initiate disciplinary cases. In one instance, the Director asked an Inspector with a particularly low record of collection to bring and present his assessment registers.²³⁷ Examining the records, the Director was surprised and somewhat amused by the blatant manner in which the Inspector had colluded with taxpayers in his Circle. Literally every third taxpayer had been declared a widow and granted an exemption. Passing the registers for me to see, the Director quipped that the Inspector had *“liberated a third of women in the city from their husbands.”* Even during field visits with the Director in the last quarter, numerous inconsistencies were discovered between official records and actual situation of various properties. The Director made a note of these cases, mentioning them to the Inspector concerned, but did not initiate any disciplinary action.
- Third, in keeping with the current age of news media proliferation in Pakistan, a recent development has been the use of news channels by the Directors. The Directors enlist local newsmen to cover enforcement operations and entertain them in their offices in return for positive press coverage. At times, this might involve extending personal favours to newsmen, like reducing tax assessments for properties of their relatives or friends. This has a two-fold impact: it gets the official version of the story publicised, helping tax collectors avoid risks similar to the incident narrated in section 6.3 – when an Inspector almost got sacked for sealing a political party’s office – and publishing

(International Growth Centre, London School of Economics). Draft paper analysing results at: <http://economics.mit.edu/files/9646>

²³⁶ Larger cities have relatively greater property tax potential – because of large tax base and more commercialization – with greater cushion for manipulating current and arrear collections to show overall improvements.

²³⁷ Property tax register No. 8 (PT-8) is the property-wise record of tax assessments, collections and arrears. One register covers a period of five years after which the record has to be carried on to a new register.

stories about strict enforcement that is expected to encourage taxpayer compliance. I also witnessed some Directors threatening local politicians (who are mostly themselves defaulters) that they would leak names of tax defaulters and their outstanding liabilities to the press. This can lead to embarrassing local newspaper headlines for the politicians and influential people who are named. The threat is used effectively by the Directors to deflect undue pressures, especially from local politicians and public figures that pressure the Directors to ease enforced tax collection.

- Fourth, in certain cases, Directors use discretion with the objective of collecting some tax revenue rather than have a taxpayer not pay at all, by approaching the court for a stay order, for example. During strict enforcement, since the Directors become more directly involved in decisions about individual cases, their own use of discretion becomes more obvious. Either the Regional Directors use discretion themselves or allow lower tax staff to do so. There is a usual practice of allowing part-payment of tax arrears whereby a property is de-sealed after a mutually-agreed partial payment of outstanding property tax dues. Such cases of de-sealing properties always require the approval of the Director. Under tax recovery laws, once a property is sealed, either the defaulter has to pay the outstanding amount in full or the property is auctioned in order to recover the government dues. The part-payment arrangement is convenient – though in contravention of tax recovery laws and rules – to reach a compromise in cases where tax officers face difficulty in collecting full payment. This difficulty can arise mainly because of three reasons: Firstly, the absence of enforcement for a number of years leads to large arrears that make it difficult for tax defaulters to pay in a lump sum. Secondly, the amount of arrears compared to the approximate market value of properties is too disproportionate, and the legal and administrative complexities make auctions impractical.²³⁸ Thirdly, political pressure and the unwillingness of local staff to upset local arrangements and relationships favour a compromise.

In most cases, the use of discretion reduces total tax (arrears) collected. But at the same time ensures at least some collection if the alternative is to collect nothing. I found the

²³⁸ Auctioning a private property to recover government dues can be a long and tedious process. It is even less attractive to tax collectors because arrears, even if relatively large, are usually disproportionately small compared to the market value of properties. This makes auctioning properties to recover property tax dues a bit of an ‘over-kill’. During my fieldwork no tax collector could remember a property being auctioned during his service career.

logic of collecting at least a part of the outstanding dues to be the main motivation behind how tax collectors dealt with various types of tax defaulters.

6.6 Dealing with various types of tax defaulters

During the last quarter of the financial year, I found that tax collectors face, broadly, three types of property tax defaulters. The first are those individuals who do not have the ability to pay. The second are those who do not want to pay because they believe they have been over-assessed. When pushed for payment, they tend to appeal against assessment. The third are politically influential taxpayers, often organised into groups, who simply resist payment and challenge assessment on various grounds in order to reduce their liability. The latter two types impede enforcement either by lodging appeals against assessment with the tax authorities (Regional Directors),²³⁹ applying to civil courts for stay orders, or through involving politicians to mediate with the tax collectors. Below, I cite some examples of each of these three categories of tax defaulters, and show that tax collectors use their discretion when dealing with them. As mentioned earlier, tax collectors do this mainly to recover some tax revenues from defaulters. The amount collected is usually below the originally assessed or potential tax liability.²⁴⁰

- First, throughout my fieldwork I found that tax collectors in all of the three Regions that I studied used their discretion to accommodate cases where they found a genuine inability to pay. While in normal times these arrears would simply be ignored and the liabilities kept pending in the registers, during times of strict enforcement such arrears are either collected or written off the registers. Normally, Tax Inspectors do not want to write off arrears on their own, and prefer ETOs or Directors to make such decisions. Directors and ETOs are satisfied when making remissions in what they perceive to be deserving cases based on information provided mostly by the Circle staff. As elaborated in Chapter 5, Circle staff have excellent on-the-ground information and

²³⁹ Although, legally there is a fixed time period after service of the first tax bill to lodge an appeal regarding assessment, the Regional Directors usually admit appeals for hearing after lapse of the prescribed time-limit as well. Also, under the rules appeals are only to be accepted for hearing by the Director once the taxpayer deposits the outstanding liability. But this rule is almost never followed.

²⁴⁰ This is a broad generalization and I am not discounting the fact that there are cases where reassessment is a genuine requirement.

usually vouch for the weak financial circumstances of a particular household, such as those with an absence of male earners.

On one particular occasion, a woman and her younger brother were shown into the Director's office, accompanied by the Circle Inspector. The Inspector had gone to seal a shop that belonged to their father who had recently passed away, leaving behind eleven children. Over the preceding decade, arrears of almost Rs. 100,000 (1000 USD) had been accumulated by the now deceased father. There was no surviving bread winner in the family and the paltry rent from the shop was their only source of income. The woman, in her early twenties, was the eldest in the family. The Inspector did not want to seal their shop and asked the Director for guidance. The Director went through the case and eventually asked the woman to file an appeal. The Director assured her that he would take care of it. I experienced a number of similar cases brought to the notice of the ETOs or Directors by lower level staff. There seemed to be a consensus amongst tax collectors to use discretion in such cases by either foregoing collections or, preferably, to award a remission. The Circle staff felt safer bringing such cases to the ETOs or the Directors, but, at times, took the decision on their own. An Inspector revealed to me that he had decided to forgo arrears' collection from an old woman who was extremely grateful to him and promised to pray for him. He said soon afterwards his collection rate improved!

However, for obvious reasons, tax collectors are not keen to give such discretionary remissions and are careful when granting them. They do not confuse a person's ability to pay with a person's status. For example, simply being a widow does not mean not having to pay any property tax if tax collectors know she can afford to do so. Such a case came up in the Director's office where an old widow was pleading inability to pay arrears. The Director went through her case. She had already been granted widow's exemption for her residential property, but her commercial property was well-situated and the Director believed she had reasonable earnings. She had been addressing the Director as "brother," so he asked her if she would like her "brother" to be "dishonoured" by his superiors for bad performance. She said no. He told her to pay her dues as he had favoured her as much as he could.

- The second type of tax defaulters are those who are not fully aware of tax laws and current policies related to their liabilities. They normally resist payment because they think they have been over assessed. This lack of taxpayer awareness (genuine or

feigned) reduces compliance generally and hinders collection during enforcement. Lack of awareness of changed tax policies is often compounded by confusion between exemptions granted for property taxes and those given for other taxes, such as income tax, as I show in the example below. In such cases, tax collectors have a broad scope to exercise discretion.

Exemptions granted by the government for other taxes liabilities, such as, by the Federal Government in the case of the federal income tax, can create ambiguities and are usually exploited by property taxpayers. One of these is the income tax exemption granted to organisations registered as charitable trusts with the Federal Board of Revenue. Managers of these organisations claimed that the exemption covered all sorts of taxes, including property tax. The confusion partly emanates from the fact that property tax law also exempts charitable trusts. There is however a proviso that the income from trust properties is spent solely on charitable purposes and that has to be proven to the satisfaction of the assessing authority. As most large charitable trusts have prominent and influential people on their boards, most trust properties were never assessed or pursued for property tax payment prior to this episode of strict enforcement in 2012. Pressures for increased tax collection led the Director in one region to scrutinise some of the exemption cases, and summon board members/ managers of these organisations to provide satisfactory evidence of trust expenditures. In one case, the Director met the finance manager representing a charitable trust run by a scion of an established family of Lahore, famous for his philanthropy and his role in advancing education in the country. The trust had more than a dozen residential houses located in an affluent neighbourhood and mostly rented to foreigners. According to the manager, all rental income was used to fund the charitable activities of the trust. The Director said he would be satisfied with that explanation if evidence of the recipients and audited accounts of charitable expenditures were presented. The manager said the accounts were secret, and could not be divulged. He then listed the great things his boss had done for the country, including the fact that his family had donated millions of rupees to the newly established Government of Pakistan in 1947 when it faced a serious financial crisis. The Director listened patiently and then advised the manager that he had a week to present detailed accounts of the beneficiaries of the trust charity, or be prepared to pay property tax. In another, similar case, the members of the board of a charitable trust that ran a large private university could not present their accounts of charitable

expenditures that would satisfy the Director. The Director had looked up the tuition fees on the university's website, and reminded the board members that their annual property tax bill was less than the annual fees for two students. Irrespective of the trust's status as a non-profit, the board would have to pay property tax. Cases like the two above often end up in higher courts of law. Relatively rich taxpayers can afford to do this, and the amount of money at stake makes it worthwhile.

Confusion, which is not always genuine, over exemptions reduces tax collection and consumes a considerable amount of the tax collectors' time. A large number of property tax defaulters are owners of properties of 125 square yards or less, which, as pointed out in Chapter 2, were exempted from property tax in 2006. At that time, the provincial political leadership verbally directed the ETD not to collect any arrears from the exempted properties. However, for some properties these liabilities lingered in the registers while the owners thought these had been remitted when the exemption was announced. The enforcement drive in 2011-12 brought these outstanding dues to the surface again. Such cases were particularly challenging for tax collectors since some of these small property owners did not have the ability to clear their arrears in full. When some of them came to the tax office to have their final notices withdrawn or properties de-sealed, they maintained that they were exempt. They were told by the tax staff that the exemption did not cover arrears. One of the ETOs would sometimes respond to such tax defaulters that, after 25 years of working for the government, he did not even own an inch of land in Lahore, so they should not expect him to be sympathetic. Nonetheless, in most of these cases, property owners were let off after an agreement over amount of part-payment.

It is noteworthy that, in the instances narrated above, the Director could have exercised his discretion to allow the *de facto* exemptions to continue, possibly motivated either by some personal reward or political pressure. He would have faced little personal risk, but would have lost significant revenues. He chose to do the right thing.

- The third type is defaulters who can mobilize local political pressure. Even during strict enforcement, tax collectors try not to upset their relationships with local politicians and other powerful groups. Almost irrespective of the degree of support for greater tax collection given by the political executive and the senior management of the

ETD, local politicians generally can neutralise these efforts. They can do this in a number of ways:

First, politicians can combine with organised groups of defaulters like trade associations to resist taxation and physically prevent tax collectors from enforcement activities like sealing properties. This happens rarely, as creating a law and order situation can get the politician in trouble with the police. However, in one instance, a local politician asked the Director to have shops in a market de-sealed and promised to make the defaulters pay up. But, once the shops were de-sealed he did not deliver his promise.

Secondly, powerful politicians, especially those belonging to the ruling party, use their influence within provincial government to soften enforcement in their constituencies. This happened in one of the three tax Regions I studied where a senior ruling party politician forbade the ETD to enforce tax collection in his constituency.²⁴¹ The level of enforcement in this region was starkly different to the other two that I studied. This was mostly because the politician in question was politically as powerful within the party as the provincial Chief Minister. The two were also close friends. Therefore, in this Region, the departmental Secretary could not use his influence over the Chief Minister in the same way as he did to isolate the influence of other politicians in his department. Arrears in this District are four times its annual tax collection, which is exceptionally high compared to other Districts.

Thirdly, local politicians fall back on their long-term relationships with tax collectors and make requests at a personal level to show leniency in certain cases. The standing and level of influence that a politician wields both locally and at the provincial level is important, and the tax collectors treat them accordingly. While a local government politician or an elected member of provincial or national parliament whose party is in opposition might not carry much weight in local administrative departments, ruling party politicians can have considerable influence. In addition, some of the tax collectors posted to certain positions on the recommendations of politicians are afraid to refuse them favours.

Irrespective of assurances of protection from political victimisation, local tax staff try not to offend local politicians. Working in a complex socio-political environment, tax

²⁴¹ He has so far successfully opposed inclusion of new rating areas into the property tax net as well.

collectors, who are relatively junior officers in the civil service, run a huge risk of annoying a politician and, potentially, being transferred to remote Districts. During my fieldwork, I was informed by colleagues serving in the field as District or Divisional Commissioners that, every month the Chief Minister holds a meeting that includes party politicians and heads of civil and police administration from each District and Regional government. Among other matters, an important point discussed in these meetings is the level of cooperation and compliance of the civil administration with recommendations of party politicians in various local administrative issues. In an environment where politics is mostly patronage-based, incumbent parties consider it their right to have a say in all kinds of administrative decisions. In these meetings, officers who are pointed out by party politicians to be uncooperative are reprimanded by the Chief Minister and, if complaints persist, are posted out.

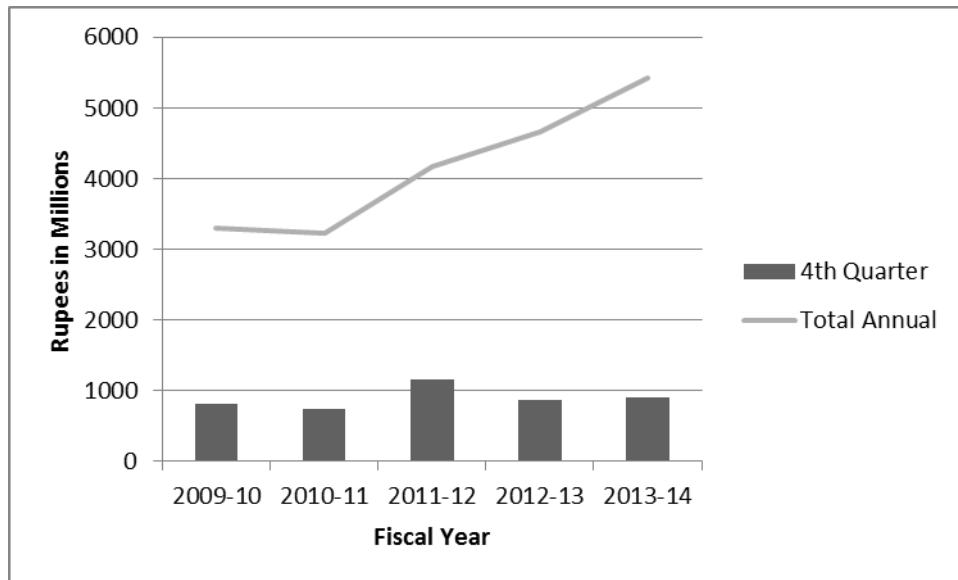
I observed the interaction between politicians and tax collectors in two Regions with strict enforcement on a number of occasions. This was mostly in the offices of the Directors where political representatives would come to ask favours for certain taxpayers. They would often come with large groups, for example with market or traders unions. Directors felt uncomfortable in publicly declining requests made by politicians and, if they did refuse, were very apologetic and blamed pressure from the top to increase collection.

Despite increased support from higher management and the Chief Minister, tax collectors do not fully enforce recovery of arrears. More importantly, tax collectors are mindful of the fact that such enforcement drives and political support from the higher level is transitory. They do not want to upset local politicians too much. Some tax collectors might even want to score personal points by accommodating their requests, especially during strict enforcement.

As mentioned earlier, it is noteworthy that the use of discretion during times of strict enforcement is widespread. A prime example is the withdrawal of enforcement notices and de-sealing properties on part-payment of property tax arrears. Though not legal under the property tax or land revenue recovery laws, this provides relief to the defaulter while the tax collectors can show that they have recovered at least part of the outstanding amount. This arrangement suits all parties concerned, since the outstanding amount is not waived but is instead held in the books and can be liquidated when

another enforcement drive is instituted. In the last quarter of the fiscal year 2011-12 property tax collection crossed the Rs. 1 billion mark, which was unprecedented and has not been surpassed since (see fig. 6.1).

Figure 6.1: Property tax collection in fourth quarter



Source: Office of the Director General, Excise and Taxation, Punjab

As I mentioned at the beginning of this chapter, this was a result of exceptional pressures on tax staff to increase tax collection. However, as I show in the preceding sections, there was neither any change in real terms in the way the department works, nor in the usual pattern of year-on-year nominal increase in tax collection, shown in figure 6.1.

Strict enforcement drives, like the one I witnessed during the last quarter, do not compensate for low tax collection efforts over the previous three quarters and other general shortcomings of property tax administration. A senior tax officer told me that, as an Inspector, he had once managed to double his collection by making a point of visiting defaulters regularly from the second quarter onwards. Every evening, when the probability of finding the head of the household is highest, he showed up at the defaulter's house, reminding him about the property tax bill and asked when it would be paid. The Inspector noted the meeting down in his diary and made sure to return and enquire about payment on the said date, persisting until payment was made. According to the Inspector, property tax collection is a matter of sheer perseverance and hard work

on the part of the Circle team, and matters only come to enforcement if the team is not sufficiently diligent earlier in the year. Another Inspector estimated that in certain cases he makes at least ten visits to a property before they finally pay up. Given the average number of properties per tax Circle staff (more than a thousand)²⁴² a lot of persistence and follow up is required throughout the year rather than relying on strict enforcement drives in the last quarter.

6.7 Conclusion

In this chapter, I discussed the working of the tax department under extraordinary pressure to increase tax collection. Despite appearances of increased formal working, I found that even during a period of strict enforcement the basic ways in which tax staff work did not alter much. The tax collectors both at the lower as well as middle levels exercise discretion. Although the objective of the middle level management is to increase tax collection, their efforts are mostly limited to collection of arrears and not of improving tax assessment. In the following chapter I conclude my thesis and based on my findings discuss some implications of my research apart from some other issues.

²⁴² As mentioned in the previous chapter, this number is quite variable and can be quite high in remote, smaller cities.

7 Conclusion

7.1 Summary of the arguments

The central question that I have tried to answer in this thesis is why property taxes are exceptionally low in Punjab, Pakistan. Many of the points that I have made will be familiar to experts in the field. These include, for example: the unpopularity of such a small tax with taxpayers because it is so visible or salient; the relative ease with which taxpayers with properties in the same locality can organise to oppose payment; the fact that property valuations are not updated at anything like the desirable frequency; the complexities of the procedures for valuing individual properties, which in turn gives considerable discretion to the field level tax collectors; generally weak enforcement; the fact that responsibilities for assessing and collecting property tax – along with the enjoyment of the consequent revenues – are divided among levels of subnational government, reducing the overall incentive for government organisations to focus on this potential source of revenue. My discovery that the property tax system in Pakistan is in many ways very similar to that of other countries has been of great value to me in completing this research. It has enabled me to better understand the Pakistan system. However, the question around which this thesis is focused directs my attention away from the similarities between Pakistan and other countries in respect of property taxes. I have concentrated rather on explaining differences: in particular, the fact that property tax revenues in Pakistan are significantly less than in so many other comparable countries. In this thesis my focus has been the recurrent (annual) tax on properties.

Because I focused very much on obtaining a deeper understanding of how the property tax system works in Pakistan, including considerable fieldwork, I was not able to undertake any rigorous comparisons between Pakistan and any other countries. The answers that I give here to my central question have not been thoroughly tested using comparative data. They must remain tentative. That said, I believe that I have identified three broad explanations for exceptionally low property tax collections in Pakistan.

First, revenues are low because governments are not willing to do the things needed to increase them. Pakistan inherited a property tax system from the colonial era. While governments have made many changes to it, they have overall permitted it to decline in efficacy. There are various dimensions to this story. The most tangible is the factor

discussed in Chapter 2: the fact that roles and responsibilities in the property tax system have been divided in a complex and rather arcane fashion between the three levels of subnational government. To oversimplify: the provincial government bears most of the burden – both organisational and political – in raising property tax revenues, while most of the revenue raised is allocated to the town level governments two tiers below it.

While I have no direct evidence about the options that were considered when the current property tax system was introduced – or about the motivations for the policy choices made – it is very hard to avoid the conclusion that a significant motivating factor was the desire to devolve provincial departments to the local governments, especially the Excise and Taxation Department, since part of its job was to collect property tax, which in any case, belonged to the local government. This resulted in a system where property taxes could not be increased without engaging in complex cooperation across three different tiers of territorial government. The possibility of cooperation was further reduced because of resistance to decentralisation at the provincial government level. Senior civil servants who resented reporting to elected local politicians found a common cause against the decentralisation reforms with the elected provincial government officials who have historically opposed elected local governments.

My second explanation is more tentative; it is based partly on speculation and deduction, and partly my own experience of working in the government. The sub-national governments in the Punjab appear to be in a state of low equilibrium, of low income and low expenditures, where they seem largely to be comfortable in a political sense. They can manage to sustain themselves with the available resources in the absence of any strong political pressures to increase expenditures on public service delivery. One indicator that the sub-national governments in Punjab are not under any immediate pressure to raise additional resources is their relatively comfortable financial liquidity position over the last decade. On the one hand, experience from elsewhere leads us to expect that sub-national governments face disincentives to raise own source taxes. These disincentives are expected to arise particularly when own source taxes become a small source of sub-national governments' total income, and they have easy access to transfers from higher levels of government and loans. As I show in Chapter 3, this is the case in the Punjab. For the Punjab Provincial Government the cost of raising property taxes substantially is relatively high both politically, and financially – as this requires substantial investment in its capacity to collect property taxes. On the other

hand, as I argue in Chapter 4, there are particularly no strong political pressures to expand public service delivery which would require more financial resources and hence possibly more taxation. Political demands for expanded service delivery are relatively weak, despite appallingly low levels of provision, because of the prevalence of patronage politics, and the domination over electoral politics which is exercised by relatively well-off people who are largely not reliant on publicly provided services. In the absence of effective political and social accountability of the ways in which public money is spent, the political executive and the bureaucrats can largely satisfy their own narrow interests – development projects, and salaries and perks, respectively – with the available financial resources. Thus there is no strong internal political pressure on the government to raise more taxes. Moreover, although aid donors routinely attach conditions to their loans that relate to increases in public spending on service delivery, the provincial government can in practice ignore these conditions without impairing its long-term relationships with the aid donors.

Third, I have provided more detailed and tangible evidence for another set of factors that appeared to interact iteratively with the first set listed above. In sum, the staff occupying the lower levels of the property tax collection system have to a large degree taken control of it. The degree of effective monitoring of the system from above has declined over time. In Chapter 5, I show that the basic control technology – hand written records – has not been updated. The financial resources provided by government for meeting basic operational needs to have become less adequate. The field level staff have increasingly been financing their own operational costs – to the extent of actually employing informal assistants. The formal disciplinary procedures of the tax department are still in place and are sometimes used. But they are relatively mild and not imposed with sufficient frequency or severity that they represent a serious disincentive to the misuse of public position. Long-established procedures designed to enable senior staff to control field staff through examination of written records as to a significant degree been neglected. The field level staff maintain a large corpus of information, some unwritten and some located on private records, that is not accessible to their superiors. In particular, field staff are able to both nurture and manipulate a large volume of property tax arrears. To some extent, these arrears are deliberately created. As I show in Chapter 6, during the periods when the senior staff of the tax department try to push and encourage their employees into raising more revenue than

usual – typically in the final quarter of the financial year – two different ways of working coexist within the Department, and within the work routines of many individual officers. On the one hand, the more formal, hierarchical, or Weberian working practices are visibly followed. Uniforms are worn. Senior staff give orders; these orders are obeyed. There is significant visible cooperation between different levels of the hierarchy in trying to achieve the dominant formal goal of the organisation: to collect taxes. However, the senior staff have not penetrated or taken control of the organisation to the extent that one might believe from this kind of evidence. The normal system of operational control by field level staff continues to operate. The field level staff do not disclose the private information they have on collection potential and actual collections. It is at this point that they can make use of the arrears that they have allowed to accumulate. It is much easier for them to deal with collection pressure from above by putting pressure on taxpayers who are in arrears, rather than to take any of the many steps that could be taken to increase collections on a routine basis (e.g. reduce ‘illicit’ exemptions). There is some significant enforcement of formal procedures and tax payers’ obligations at this point, but also much ritualistic enforcement procedure. It is my understanding that this is not just a matter of the senior staff being deluded. To some extent at least, they know what is going on beneath them in the system and are complicit in it. Enforcement rituals do not significantly change the conditions that allow the field level staff to control the property tax system on a day-to-day basis.

7.2 Observations on the tax experiment in Punjab

During my doctoral research, a panel of researchers was conducting an experiment by providing monetary rewards for tax collectors to increase property tax collection. The experiment was conducted in collaboration with the Punjab government.²⁴³ The findings of the tax experiment are published as Khan et al. (2016b).²⁴⁴ During the course of this experiment and my doctoral research, I had a number of mutually beneficial meetings with the tax experiment team since both the studies were investigating the behaviour of

²⁴³ The researchers leading the randomized controlled trial (RCT) were Adnan Qadir Khan (London School of Economics), Asim Khawaja (Harvard Kennedy School of Government) and Ben Olken (Massachusetts Institute of Technology). In my earlier job as Program Director, Punjab Resource Management Program, these researchers approached me with the proposal in 2009/10, and I initiated the concept note for this research collaboration for approval of the Chief Minister, Punjab.

²⁴⁴ There are various versions of the paper cited as Khawaja et al. (2014) in Condition 1. I use the final version of the paper published in the Quarterly Journal of Economics in 2016.

government officials in the same department using different methodologies. Khan et al. conducted econometric analysis of a randomized controlled trial that offered varied incentives to property tax collectors as a group at the circle level, while my work on the property tax collection in Punjab is qualitative, partly based on observations of working of the tax offices. I used qualitative methods single-handedly for about six months' of fieldwork, compared to more than three years' of experimentation undertaken by a panel of researchers with field assistants and the government of Punjab funding the incentive scheme. My research generally complements the findings of Khan et al. (2016b) and goes much further in showing the internal workings of tax office. However, based on my research, I am of the opinion that certain factors like the limited/fixed timeframe of the experiment and the wider social setting in which tax collectors work may have blunted the effectiveness of the incentive scheme, as I discuss later in this section.

Under the tax experiment three incentive schemes were offered to tax staff, in 218 randomly selected property tax circles. The rest of the 264 out of a total of 482 property tax circles in the province were the control group. The first incentive scheme was purely revenue based, where circle staff received a percentage of any increase beyond a historical benchmark level of tax revenue collected. In the second incentive scheme the circle staff were given a reward that was dependent on additional revenue, like in the first scheme, but adjusted for non-revenue outcomes like taxpayer satisfaction and the accuracy of tax assessments, both checked independently through third party surveys of taxpayers. In the third scheme all the circle staff received a bonus based on the circle's performance ranking determined by a performance evaluation committee of the Excise and Taxation Department. The last scheme was based purely on subjective criteria like peer reviews. The experiment results show that on average incentives are effective in increasing revenue and taxpayer satisfaction does not change significantly. The most effective treatment is the pure revenue incentive, while the second one is less effective and the third has no effect. The additional revenues come largely from re-assessment of properties.

Khan et al. report a number of findings, some of which are consistent with my research. I give two examples here. First, most of the revenue increases reported in the experiment are from high-value properties, suggesting that the tax collectors mostly focus their efforts on relatively few properties, reassessing them to increase tax

revenues (Khan et al., 2016b, p.252). These might well be the kind of properties that I highlight in Chapter 5: I report that, to obtain their own informal earnings, tax collectors focus on a small number of properties with high potential for making lucrative deals with taxpayers through using discretion in making assessments. The large difference in assessments between ‘rented’ and ‘self-occupied properties’ provides many such opportunities.

Second, Khan et al. (2016b, p. 262) report that, “...properties newly added to the tax rolls are being systematically targeted, something that would not be feasible unless the tax collector had prior (private) information that is now being revealed.” This echoes one of my key findings about the lower (circle) level tax staff, which is that they have almost perfect information about properties in their circle (see Chapter 5). In addition to the two examples above, Khan et al (2016b; section II.B) borrow from (and cite) my work, and use it to explain some of their findings in their conclusion.

Despite a number of common findings and complementarities, I question the effectiveness of the tax experiment in terms of achieving its stated objective of finding the right ‘incentive’ for tax collectors in order to increase overall tax collection. Based on my research, I point out some factors below that possibly diluted the effectiveness of the incentive scheme, and affect the validity of the policy conclusions drawn from the research.

The first is the limited timeframe, of two years, for which the incentive scheme was executed. Based on my research, I contend that any incentive scheme that has a limited timeframe of x number of years will not be as effective as, say, an on-going incentive scheme. There are two interconnected but separate reasons for this:

(a) The tax collectors are permanent government employees and expect to hold their jobs for most of their working lives; thus they have a much longer time horizon in their minds when making strategic decisions about how much tax collection to aim for in one particular year. In Chapters 5 and 6, I showed that tax collectors are under constant pressure from their superiors to collect more tax revenues compared to the preceding year. Thus, holding everything else (including taxable areas, tax rates and property valuations) constant and given the pressure to increase tax collection every year, I would expect the tax collectors to respond to temporary incentives in a very controlled

fashion.

(b) I would not expect tax collectors to bring to the table all (or even most of) the under assessed and non-assessed properties in their circles in response to a temporary incentive scheme. The reason is that for the tax collectors the trade-off is not directly between bribes and incentive scheme money only. There is a third category: that of properties not on the tax cadastre and from which no rents are being taken by the tax collectors. These unregistered properties are added to the cadastre systematically to partly increase tax collection every successive year. As I explain in Chapter 5, this is one of the ways in which tax collectors deliver annual increases in tax collection and manage to retain their jobs. During my study I found that such properties were important buffers, since taxable urban areas, property valuations and tax rates did not change from 2000 to 2013. In such a context, tax collectors' response to any temporary incentive scheme would be muted and to a large extent, controlled.

Second, the model of collusion that the experiment is based on is that, with the monetary incentive in place, tax collectors can choose to opt out of some of the collusive arrangements, or demand a higher bribe to maintain the arrangements (Khan et al., 2016b; p.229). This model presumes that the tax collectors' decisions to assess the taxpayer correctly or collude with her and under-assess are based on monetary incentives alone. While this might hold true in some of the cases, my study shows that the tax collectors work under a number of political and social constraints and are not totally free to take independent decisions about tax collection solely based on considerations of short-term monetary rewards. As I show in Chapters 5 and 6, the dynamics of the tax office and the local politics of tax collection are complex matters. In the conclusion of their article, Khan et al. allude to this complexity, and find it surprising that no local political resistance accompanied higher tax revenues resulting from their incentive schemes. They expect political opposition to this sort of a drive to collect taxes if it were to carry on for a longer time period. Mascagni (2015) also makes a similar observation about this experiment. In my view, absence of any political fallout and no change in taxpayer satisfaction point towards the fact that the impact of incentives was somewhat blunted, because of the broader social context as well as the limited timeframe of the incentive discussed earlier.

It is noteworthy that the experiment team has recently e-published another study based on an extension to the tax experiment, discussed above. The study is a follow up experiment based on the use of transfers and postings of tax collectors as incentives to increase collection in place of direct monetary incentives. This follow-up study corroborates my findings about how the higher-level management of the Excise and Taxation Department uses postings and transfers as an incentive to get tax collectors to perform better (Chapter 5). Khan et al. (2016a) find transfers and postings to be almost an equally effective way of increasing tax collection as the monetary incentive scheme. This finding in itself also indicates the relative ineffectiveness of the monetary incentive scheme, and might partly explain why the Punjab Excise and Taxation Department did not take it up after the experiment concluded.

7.3 Policy implications for tax reforms in Pakistan

Based on the findings of this thesis, I discuss six broad implications for long-term tax revenue raising in Pakistan. Most of these policy implications are stand-alone but also complement each other, except the third, which is an alternative to the first one.

1. Whenever a level of government collects a tax but does not receive all the revenue collected, then it likely will not make every effort possible to collect the tax. Similarly tax policy tends to be neglected if the government that bears the political cost associated with the tax does not receive a share of the revenues that make the costs bearable. In Chapter 2, I showed such outcomes in the case of annual property taxation in Punjab. The responsibilities for policy-making and collecting property tax and distribution of its revenues are divided between three levels of sub-national government in relatively complex ways. The level of subnational (provincial) government that shoulders the most responsibilities for tax collection receives a relatively small share (15%) of the tax while the district governments receive none, and town governments that receive most of the share (85%) have very few responsibilities. In Pakistan this particular problem is not unique in the case of property taxes. Currently I am working in a provincial tax-collecting agency, the Punjab Revenue Authority that was formed recently to address a similar problem, in the case of sales tax on services.

The Punjab Revenue Authority (PRA) was established in 2012 to collect the sales tax on services, a tax assigned to the provincial governments but collected by the Federal

Board of Revenue up till 2012. In the last year before handing over tax collection to the provinces, the Federal Board of Revenue collected Rs. 22 billion in sales tax on services from 12 taxable services, on behalf of Punjab province. Over the last four years that this tax is being imposed and collected by the Punjab government (through the PRA), tax revenues have gone up to Rs. 60 billion and are being collected from almost 60 services. During the financial year, 2015-16, the tax base increased from 10,000 to almost 22,000 registered sales taxpayers. An obvious reason for this increase in tax revenues is that the tax is being imposed and collected by the level of government (provincial) that also gets to keep all the revenues.

Based on the above example, and on the findings of my thesis, a case can be made for handing over property tax collection to the town governments in Punjab. However, there are a number of counter arguments forwarded by property tax experts and practitioners in Pakistan whenever this proposition is fielded. They make three main arguments. First is the low capacity of local governments to collect all kinds of taxes and fees. Second is the proximity of local level politicians to local businesses and residents that supposedly makes local politicians more susceptible to interest group influences. Third, as discussed in Chapters 3 and 4, if local governments continue to receive transfers from above as at present, they will anyway not take advantage of the opportunities provided to raise their own revenues. In view of this obvious disincentive it is clear that a transfer of property tax functions to the town governments is only viable if accompanied by two measures: (a) building the capacity of town governments to assess and collect property tax, and (b) changing the way money is transferred to local governments in Pakistan.

2. The point ‘b’ above – the way money is transferred to local, and generally subnational governments – is in its own right the second important implication of my thesis for tax revenue raising in Pakistan. Currently subnational taxation (provincial and local governments) is about 0.8% of Pakistan’s tax to GDP ratio. If this is to be raised anywhere close to the levels in comparable countries, the nature and the ways in which transfers from higher level governments to lower levels are made in Pakistan has to be revised substantially. I have discussed the relevant institutions and practices in detail in Chapter 3. Briefly, in the case of Pakistan, intergovernmental transfers – both, from federal to provincial and from provincial to local governments – are governed by formal National and Provincial Finance Commission awards. Unlike India, these finance

awards are made by constitutional bodies led by politicians, rather than technocrats. As a result, the whole award system is politicized and fails to effectively take into account tax efforts made by the recipient governments. Moreover, additional grants from higher level governments, especially in the form of constituency funds and special grants are also forthcoming, which weakens the resolve of the recipient governments to make efforts to raise their own taxes.

According to some experts, subnational governments need to be presented with a ‘hard budget’ constraint, like in the case of local councils in the United Kingdom. The central government in the UK transfers a fixed amount of money to the councils who then have to raise their own resources locally in order to provide an expected level of services. Political pressures for delivering services force local politicians to weigh the relative political costs of increasing taxes or various service charges against the risk to their popularity of providing poor services. (The arrangement is a little more complicated and caps are imposed by the central government on annual increases to the Council Tax, but I use this example to make my point about fixed transfers.) In principle, something similar needs to be implemented in the case of subnational governments in Pakistan. The higher-level governments will have to enforce a ‘hard budget constraint’ on lower level governments, so that the provincial and local governments exert to collect their own taxes. Token incentives in the current scheme of awards that are supposed to incentivize tax collection by subnational governments should also be expanded and implemented more effectively.

3. If the primary objective is to increase property tax revenues in Pakistan and bring them close to developing country averages, then the following suggestion may be considered as an alternative to the first one presented above. Due to longstanding and deep political rivalry between the provincial and local governments in Pakistan (see Chapter 2), it might not be practical to devolve property tax to local governments completely. In that case an alternative could be to have the provincial government appropriate all the revenues from annual property taxation. I propose this because the provincial government makes most of the policies and collects property tax but gets negligible share of the revenues. There are basically two sets of transfers: (a) Local governments are provided money by the provincial governments based on a multiple indicator award designed to fulfil their expenditure requirements, and (b) Revenues from property tax that are over and above this basic transfer. As I show in Chapter 2,

town governments are not reliant on property tax revenue transfers since these are neither regular nor to the full amount due. Reassigning property tax revenues to the provincial government might lead it to invest more in improving tax administration and interventions that are expected to enhance tax collection, including digitization and incentives for tax collectors, as discussed in Chapter 2. The findings of my study imply this to be a practical way of increasing property tax revenues in Punjab, where the potential of annual urban immovable property tax has been estimated at about Rs. 25 billion annually, only about a fourth of which is being collected.

In case both the options of wholly handing over tax functions and revenues to either the town governments or the provincial government are not acceptable, then it would be in order to at least reconsider the provincial share of the property tax revenue. The provincial share should be commensurate with the potential political and financial cost the provincial government is expected to incur in order to improve property tax policy and administration.

4. This implication of my thesis for long-term tax reform in the country concerns tax administration, especially the low capacity of the tax departments and motivations of the tax collectors. Civil servants, including tax collectors, are not only paid salaries that are considerably lower than a ‘living-wage’, but are also not commensurate with the high levels of discretion that they exercise. This creates the need and the opportunity for them to take bribes. Additionally, tax collectors are often not provided the operational costs of tax collection and are expected to ‘live off the land’ while they do their jobs. In the case of property taxes most property circles lack staff, especially tax clerks, that are hired privately by the inspectors. Similarly, costs of stationery, mobility and other tax collection functions are not provided by the state. Land revenue and agriculture income tax collectors face similar conditions. The concept of living off the land often proves to be a slippery slope and reportedly most newly inducted tax collectors soon enough fall in line with the prevailing culture in the tax collecting departments. In my view the tradition of living off the land and low wages perpetually reinforce a culture of corruption in the tax departments, as well as other government departments.

Any meaningful tax administration reform in Pakistan needs to take into account often overlooked factors of low capacity and the low wages of tax collectors. While recent experiments of incentivizing tax collectors in Pakistan have reportedly delivered

encouraging results (see discussion on Khan et al., 2016a/b in section 7.2), previous government experiences (at the Federal Board of Revenue) of doubling wages across the board have not been effective. Based on my study, I suggest that, (a) the case for giving tax collectors ‘living wages’ has to be considered irrespective of any incentive schemes; (b) the tax collectors should be provided full operational costs of collecting taxes, (c) capacity development of tax departments should be an on-going government activity, and (d) incentive schemes should be initiated on an on-going basis in all tax collection departments, and not for a limited timeframe.

5. In order to reform tax administration in Pakistan, it is important to prevent tax collectors from exercising their discretion that results in lower tax collection. This can be done in a number of ways, including:

(a) Limiting the opportunities provided in tax laws and policies that allow exercise of individual discretion. For example, in the case of property tax, rented residential properties are taxed ten times more than the ones occupied by the owners. This gives tax collectors, who also assess the tax liability, an opportunity to collude with the taxpayer at the cost of state revenues. Thus reduction in differential rates of property taxes where property use is unchanged can bring down use of discretion by tax collectors substantially. Using this logic, the Punjab Excise and Taxation Department has recently reduced the differential between self-occupied and rented properties from ten to five times. Similarly simplification of the tax assessment formula can help further reduce discretion exercised during tax liability assessment.

(b) Tax departments in Pakistan need to develop strong audit function that regularly detects cases involving unequal treatment of taxpayers during tax liability assessment or enforcement. Disciplinary procedures against tax staff allegedly involved in corruption need to be revamped. Based on my research, if anti-corruption efforts need to be made effective it is important that prosecution of cases against tax collectors be conducted by a third party and not by the officers of the same department, as practiced currently. Experts are of the view that certainty of punishment if discovered is a more effective deterrent compared to the severity of punishment.

(c) Digitalization and automation of the tax cadastres and notice management systems are helpful in making tax administration relatively transparent and reducing exercise of discretion by lower tax staff. Technology is increasingly being used by tax

departments to minimize physical contact between taxpayers and the assessors/ tax collectors. This is expected to reduce collusion. There has been an uneven progress in this area, among various tax departments in Pakistan. Clearly more needs to be done.

6. The last implication of this thesis is at a much wider political level and is immensely important for tax raising in Pakistan. It has to do with elite taxation and equal application of law. Although not the primary focus of this thesis, in Chapters 1 and 4, I briefly mention the reluctance of the Pakistani elite to pay taxes, for various reasons. Complicity of political and economic elites in Pakistan seems to be of an acute nature, which, does not only affect tax collection directly but also reduces the level of voluntary tax compliance generally. The economic elites in Pakistan, representing both landed or commercial interests, are often themselves political entrepreneurs and leaders with direct control over policy-making. This is true for the leadership of almost all the political parties. The recent Panama Leaks' scandal has exposed ruling party leaders and their families/ supporters of illegally transferring money abroad over the last three decades and evading taxes in Pakistan. There is a lot of public debate on television and newspapers about the elites evading taxes, and the burden of taxes falling on the middle and lower classes, largely through growing indirect taxation.

Part of this debate on tax evasion and avoidance by the elites has been spurred by the public availability of information about taxes paid by elected public representatives. Recently the Election Commission of Pakistan has been making the annual asset returns of elected representatives public. Leaks in the media have also made tax returns of some of the leaders public. This has led to public scrutiny and criticism of tax avoidance/evasion by the political elites. On similar lines, if it is made possible for property taxpayers to access information about what their neighbours and owners of similar properties in their neighbourhood pay in annual property tax, this may lead to pressure for equal treatment, and hence reduced incidence of collusion.

7.4 Some broader implications

In early August 2016 national newspapers ran headlines about Pakistan 'bidding farewell' to the International Monetary Fund (IMF), as another of its loan programmes to Pakistan came to an end. The Finance Minister tried to gain political mileage out of this news, claiming that the government would not need the IMF funding any more.

Various political and economic commentators were, for good reasons, sceptical. Pakistan has been through numerous IMF loan programmes, by many different names – structural adjustment, enhanced growth facility, and the like – but mostly for the same purpose, of filling the fiscal and external account deficits that plague the country. Pakistan experts believe that despite, these programmes and their stringent conditions, over the last more than two decades little has changed in the way the economy is structured and the way the government functions, especially in matters related to tax collection (McCartney, 2012, Zaidi, 2005).

Why, despite almost thirty years of efforts to broaden tax bases, reduce tax rates, improve incentives for tax collectors, increase penalties for taxpayers and improve the technology of tax collection, do tax collections remain so stubbornly low in Pakistan? Why, despite decreases in regulation and quotas, privatization and reductions in tax rates, has corruption seemingly not declined? Why is the level of public service delivery so low? These are complex questions that cannot be explored in depth here. However, a common thread broadly links these questions: weak state capacity and persistent informality in the functioning of the state – important themes of this thesis.

Rooted in Keynesianism and socialist models of development, the role of the state in guiding the economy from the ‘commanding heights’ gained ascendancy in the 1930s. It was consolidated during the post Second World War reconstruction period and remained the dominant development paradigm through the 1970s. Especially highlighted for its relative success in East Asian countries, the ‘developmental state’, with a strong bureaucracy, was expected to lead poor countries toward equitable growth and development. The late 1970s onwards saw a movement towards globalization, market economics and against state intervention in affairs of the economy. Led by Thatcherism and Reaganomics, the developed world generally championed the agenda of ‘rolling back the state’. Also known as the Washington Consensus, the ‘panacea’ for economic problems facing poor countries comprised ten prescriptions including, lowering trade taxes and other barriers to free trade, deregulating economies – for example, loosening capital market and foreign exchange controls, privatizing state-owned enterprises, and cutting fiscal deficits including phasing out state subsidies (Stiglitz, 2002, Williamson, 2009).

Economic liberalization is based on the belief that markets tend to be self-correcting and need only limited state regulation and intervention. Lowering taxes, including income and corporate taxes, was expected to lead to higher capital accumulation and investment in the economy and in turn rapid economic growth. Benefits of growth, primarily through employment generation, were expected to ‘trickle down’ to the poor and hence everyone was expected to be better off. With lower tax rates, individuals and small businesses were expected to register and become part of the formal economy. It was also expected that the rapid growth of the economy would more than offset the decrease in tax rates, resulting in a net increase in tax revenues. These ‘neo-liberal’ policies were implemented in poor countries globally, pushed by the multilateral financial institutions like the World Bank and the International Monetary Fund through lending programmes, like the Structural Adjustment Loans. The changing role of the state and implementation of liberal economic policies in poor countries have largely been a result of the influence of external actors, both intellectually and due to the financial dependence of poor countries on international aid (Lal, 2000, Leftwich, 1995).

At the end of almost three decades of pursuing economic liberalizing policies, some of which are mentioned above, the benefits are not very visible. Amongst other things, there is increasing evidence that inequality has increased globally – both between and within countries – and that ‘trickle down’ does not really work (Piketty, 2014, Stiglitz, 2002). In most poor countries, like Pakistan, a large number of people live below the poverty line and do not have access to basic public services.²⁴⁵ As pointed out earlier in this thesis, although Pakistan is categorized as a low-middle income country, it ranks 146 out of 187 countries on the human development index (UNDP, 2013). A disease like polio, which has been eradicated in almost the whole world, still occurs sporadically in Pakistan. Absence of universal access to state education has provided space for religious seminaries to operate all over the country. Lack of quality public

²⁴⁵ According to a recent government report nearly 39% of Pakistanis live in multidimensional poverty, with the highest rates of poverty in the Federally Administered Tribal Areas (adjacent to Afghanistan) and Baluchistan. Although the multidimensional poverty index showed a strong decline, with national poverty rates falling from 55% to 39% from 2004 to 2015, progress across different regions of Pakistan is uneven. Poverty in urban areas is 9.3 percent as compared to 54.6 percent in rural areas. Disparities also exist across provinces (Report on Multidimensional Poverty, Ministry of Planning, Development and Reform 2016).

education and employment opportunities are considered to be important factors for the rise of religious extremism and militancy in the country (Raja, 2011). The writ of the state in Pakistan is often challenged not only in remote and inaccessible regions, like Baluchistan and the bordering areas with war-torn Afghanistan, but in places like Swat valley, which is just a few hours drive from the national capital, Islamabad. There is also evidence of informal taxation by powerful political groups in the large commercial urban centres, like Karachi. There is an absence of the rule of law and equal treatment for all citizens. On the one hand, all the institutions of the state, including the judiciary are steeped in corruption (Lieven, 2011) – which makes access to justice and to the state generally more difficult for those who cannot afford to pay bribes. On the other hand, as I elaborated in Chapter 4, the rich lead privatized lives and do not demand expanded public services from the state. This puts the poor in a difficult position; they cannot afford private services and, for various reasons like patronage politics, they are not in a position to effectively demand public services from the state.

All of the above does not imply that the Pakistani state was very effective and strong prior to implementation of liberal economic policies or that the present state of affairs is solely because of liberal economic policies. There is no one clear indicator of state capacity, but if the tax to GDP ratio is anything to go by, the capacity of the state in Pakistan has certainly shrunk, clearly in financial terms, over the last couple of decades. The low tax to GDP ratio does not only reflect the diminished capability of the state to tax its citizens but also the size of the state relative to the economy, to which it has to provide multiple public services. From a high point of more than 13% in 1980s, Pakistan's tax to GDP ratio has gradually declined to less than 10% (Marinez-Vazquez and Cyan, 2015; p.10). After fifteen different loan agreements with the International Monetary Fund worth billion of dollars, since 1995, to fix its fiscal deficits and external account deficits, Pakistan has little to show for these loans (McCartney, 2012).

Due to persistent fiscal deficits, running as high as 8% of the annual Federal Government budget in recent years, the Federal Government has been borrowing heavily both from abroad and domestically. According to the Annual Reports of the State Bank of Pakistan, public debt has increased to unsustainable levels. The debt to GDP ratio was 69% in FY15 compared to 65.5% in FY10. Domestic debt increased from 31.4% in FY10 to 44.5% in FY15, while the external debt increased 12%, from

USD 54 billion to 61 billion, during these five years. As a result, interest payments are a large portion of the public expenditure. The domestic interest payments as a percentage of GDP have increased over the years, with 4.3% in FY14 compared to 3.4% in FY11, while interest on foreign loans has been stable at 0.4% since FY11. As a rough estimate, about 9.5% of Pakistan's GDP is collected in tax revenues, out of which 4.7% is spent on debt servicing and about 3.6% is spent on defence – Pakistan Army is one of the largest standing armies in the world.²⁴⁶ It is not surprising then that Pakistan's public social sector expenditure, as a percentage of GDP is 1.5% compared to the average of 4.7% for countries in South Asia (also see Table 4.1).

Despite the rising debt, the government has very little money available to provide expanded public services and build its own capacity. One of the reasons why people do not pay taxes is the absence of public services: they do not feel the state is reciprocating adequately. They might also feel that they should not be paying twice if they access all sorts of private services despite paying taxes. The perception of a dysfunctional and corrupt government at the community level can ease the sense of guilt about not paying taxes and can lead to people readily bribing tax collectors to avoid or totally evade taxes. Narrow tax bases – resulting from non-registration of professionals, businesses, traders and service providers – are probably the biggest challenge for the tax departments in Pakistan. For example, there are only one million registered individual income taxpayers in Pakistan, mostly salaried professionals. Out of this small number, in a country of about 180 million people, only about a fourth usually file their income tax return in a given year. The federal government has launched numerous amnesty schemes for non-income taxpayers to register but has had little success. Those not registered with the tax authorities find it easier to stay out of the reach of a system that is corrupt and wastes their time and money. Thus irrespective of the tax rates, the income taxpayer base might not grow and a large informal sector may persist. Various studies estimate the informal sector in Pakistan between 30% to 50% of the GDP (Gulzar et al., 2010).

But tax collectors (and other public servants) do not have to be corrupt. Irrespective of what people feel about taxes, they can be assessed and made to pay. Obviously, this is

²⁴⁶ According to the World Bank, Pakistan spent 3.6% of its GDP on defence in 2015 (<http://data.worldbank.org/indicator/MS.MIL.XPND.GD.ZS>).

not the case in Pakistan. Corruption amongst public servants in Pakistan is almost a necessity partly because the state runs its core functions, like tax collection, on a shoestring budget. As I have discussed earlier in this thesis, tax collectors, like all other public servants, are not only given salaries much below the living wage, they are also not provided with anything close to adequate funds to bear the operational costs of tax collection. They are basically expected to ‘live off the land’ – bestowed with authority, they are required to fend for themselves, and also in the process collect taxes for the state. In fact, they are modern day versions of ‘tax farmers’. Tax farming is an exploitative way of collecting taxes, which might not make much money for the state, but has ample incentives for tax farmers to be corrupt and usually creates resentment against the state.

Whenever informal sources of income spring up, it also gives rise to a whole political economy of the division of this income. In the context of tax collection in Pakistan, this implies not only sharing informal earnings within the food chain of the tax departments but also with politicians who have the power to affect transfers and postings within the tax departments, or those with power to impact the working of the tax collectors in the field. There often develops an alliance between lower level public servants and tax collectors and local public representatives. Public servants share their informal income with ruling party politicians on a regular basis and fund their election campaigns in return for political patronage, like getting more lucrative postings, and protection against possible disciplinary action by the department. Hurdles to reform that emanate from such complicated and deeply embedded informal relationships are not insurmountable, but will not be easy to overcome even if the ‘political will’ to reform the system develops. Any meaningful reform will have to be a long-term affair and will need to start simultaneously from the top as well as the bottom of the governance structures.

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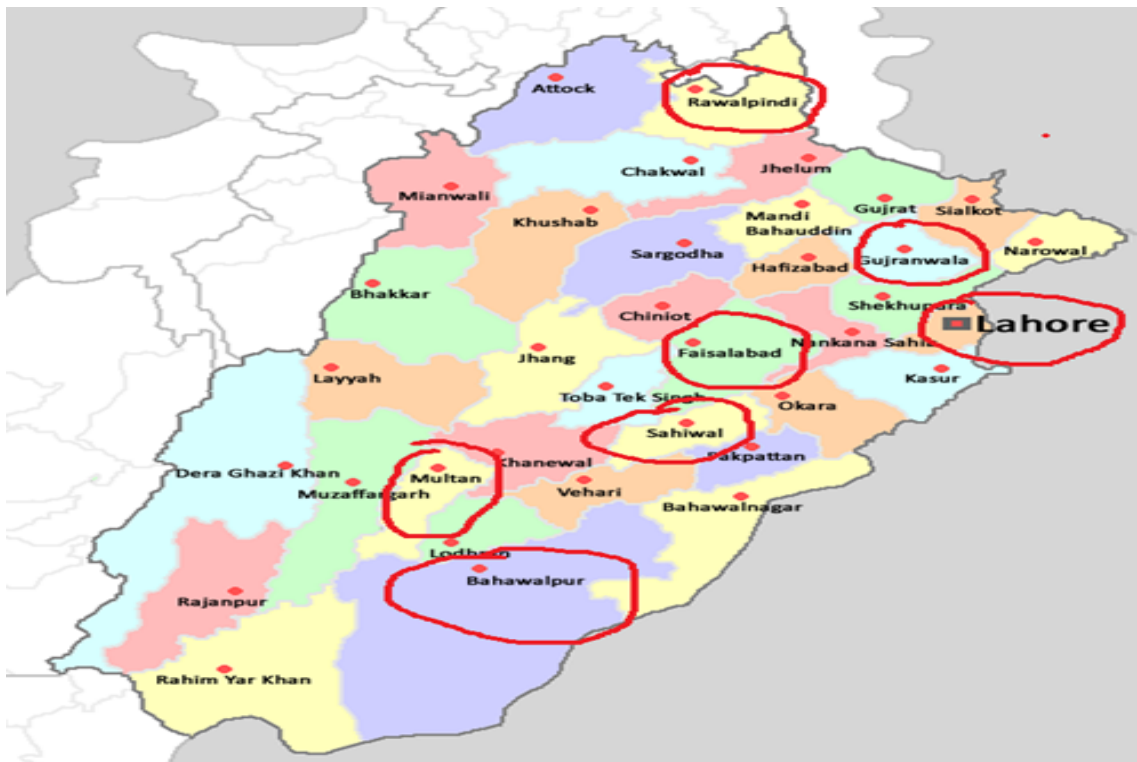
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Annexure A

Selection of local (town) governments for fiscal data

Population-wise seven largest and most urbanised districts in the Punjab province were selected. Each district jurisdiction has 6 to 13 town governments which receive 80% of the property tax collected from their respective jurisdictions. These towns included most of the sites where I observed tax collectors and interviewed tax staff and others.

Figure A.1: Map of Punjab showing districts (circled) from where fiscal data of the town governments was collected



Annexure B

For selection of districts for observing tax collectors I had two criteria:

- The first, was to have a sample of the four largest districts, one from each of the four distinct socio-economic zones of the province, including Lahore:

According to the UNICEF led periodic Multiple Indicator Cluster Survey, Punjab can be divided into four zones in terms of ‘quality of life index’ on the basis of selected socio-economic indicators: north, central and south and west (Andrabi *et al.*, 2008a). I decided not to pick a site from the western zone since the area was recovering from widespread flooding in 2010, and none of the five City Districts of Punjab are located there.

Punjab has a population of about 90 million. Administratively it is divided in 36 districts out of which five are most populous and highly urbanised ‘City Districts’. In descending order of population size, these are Lahore, Faisalabad, Gujranwala, Rawalpindi and Multan. Three large cities, Lahore, Faisalabad and Gujranwala are in central Punjab, while Rawalpindi and Multan are in north and south Punjab respectively.

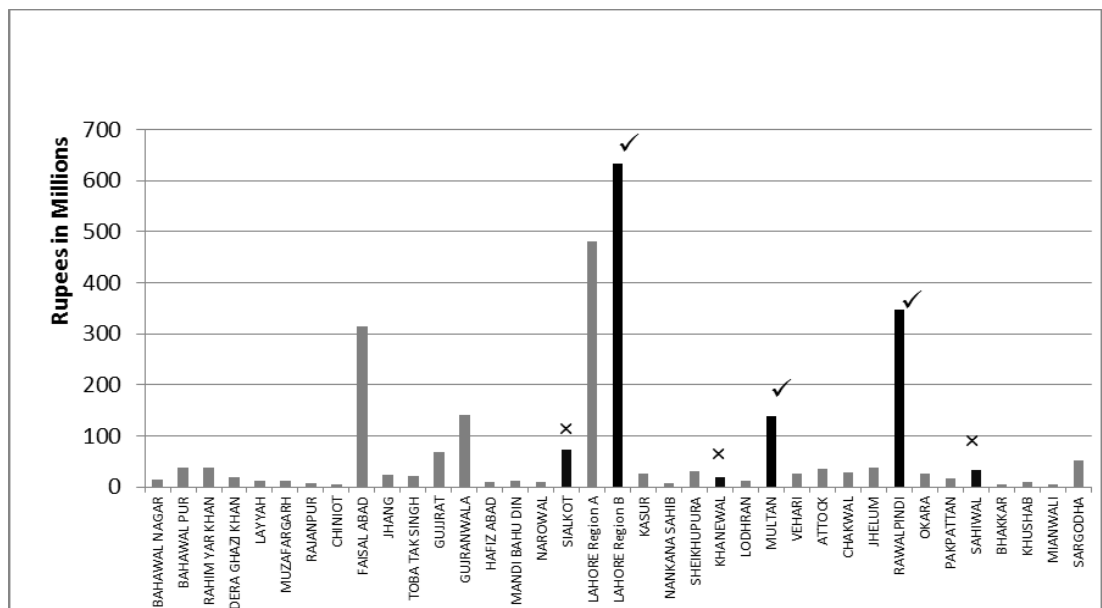
- The second criterion was to select observation sites (property tax jurisdictions) with highest property tax collection in their respective zones, and which were farthest from the provincial capital, Lahore:

Lahore is divided in two property tax Regions. As shown in figure B.1, Lahore- Region B is the highest property tax collector. Faisalabad and Gujranwala were not selected because they are located in central Punjab. Multan and Rawalpindi meet the criterion of being highest property taxers in north and south Punjab respectively, and also happen to be farthest (see figure B.2) from Lahore. The distance from the provincial capital was an important criterion, because greater distance implies less direct supervision by the higher level officers of the ETD including the Secretary and the Director General, who are based in Lahore.

Additional sites for Interviews

In addition to interviews at my observation sites, I interviewed tax collectors and other public servants at Sialkot, Sahiwal, Khanewal and Murree. This was primarily a convenience sample but each site had unique characteristics in terms of level of local supervision. Sahiwal is a small regional headquarter; Khanewal is a small district headquarter reporting to Multan region; Murree is a small sub-district jurisdiction reporting to Rawalpindi; Sialkot is a medium-sized district headquarter where a digitalisation pilot project was being implemented by the ETD during my fieldwork. The main reason for choosing a variety of jurisdictions was to investigate whether there was any fundamental difference in the way the lower level staff functions in remoter districts, with reduced direct supervision of middle and higher level superiors.

Figure B.1: District-wise property tax collection in Punjab (average for 5 years: FY2006-7 to FY2010-11)



Source: Director General's office, Excise and Taxation Department, Punjab

Legend: Interview sites: x + ✓ ; Observation sites: ✓

