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Raising Domestic Resources for Equitable Education in Pakistan

Faisal Bari and Rabea Malik*

Introduction

Pakistan has made progress towards the goal of achieving universal primary education for all, raising the number of children in primary schools, including the number of girls. The proportion of female enrollment in primary schools has gone up from 40% in 2000 to 45% in 2014 (UNESCO Institutes for Statistics database). Despite these positive developments, the pace of progress has been slow and the scale of the remaining challenges is formidable. In 2014, 5.6 million children are out of school at the primary level (UNESCO Institute for Statistics database).

Furthermore, these gains and deprivations are very unequally distributed. Inequality starts at primary schools: only 43% of the poorest families are in primary schools, and only 27% of the poorest complete primary schooling (PDHS, 2013). Regional location impacts access to education and trajectory through school: children in Balochistan are twice as likely to have never been to school compared with children in Punjab (47% and 24% respectively), and similar disparities evident for rural (37%) and urban areas (19%) (Malik and Rose, 2015). Gender inequalities intersect with wealth inequalities to worsen the scale of exclusion: among poor children in rural areas 74% of the girls had never been to school, compared with 55% of boys when in comparison the gender gap in urban areas is zero (ibid).

In 2012, the parliament approved the Right to Education Act, making free education for all up to age 16 a constitutionally protected right, and a responsibility of the state. These commitments indicate a political resolve to end challenges associated with deprivations and inequalities in education. Yet, the country has not kept pace with other countries and continues to rank amongst the world's worst performing in education.

In light of the scale of the challenge, resources available for tackling the issues are low. Fiscal space for funding social development in Pakistan has always been constricted, competing for prioritization with military spending and debt servicing. Low tax revenues have been a chronic policy issue. Growth in tax revenues has not kept pace with rising populations, compromising state's capacity to provide basic services. Additionally, and related to this, centralization of planning and financing functions for many decades has blunted state's ability to target resources based on need. Changes in fiscal relations between the Centre and the provinces in 2010 and a move towards decentralization of planning and delivery of social services including education have been positive developments. However, the resource envelopes of provincial governments remain small, and capacity building for effective planning and governance at the provincial level is a long term exercise. And, importantly, there is little evidence that policy making on financing or service delivery is actively taking equity concerns into consideration.

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* Corresponding author.

Pakistan is an interesting case of contrasts. While the country has made progress on some of the key education goals, it remains a very long way from achieving targets of primary school completion. While there is considerable political support for allocating maximum resources to education – domestic and external – resources made available for social development remain low. At the policy level, there is recognition of diverse regional needs, and domestic financing mechanisms have evolved over the years to reflect these needs in principle. Yet, there are wide variations in practice, and lack of clarity about whether equity principles are followed in distributing resources.

The background paper on Pakistan for the 2015 Oslo Summit on Education and Development began by exploring and detailing some of these contrasts (Malik and Rose, 2015). This paper takes that analysis forward and delves deeper into analyzing the potential for domestic resource generation, and the rigidities in the planning and financing mechanisms which compromise effectiveness of public financing for education.

Past trends, current practices, and future progress on domestic resource availability and utilization, and education outcomes has to be understood in the context of an aspirational but weak state. The political commitment to raising resources for education has often been reduced to rhetoric in the face of resistance from powerful lobbies to tax reform.

This paper collates information from available reports and data, and from conversations with senior economists, policy advisors and academic researchers to answer the following: how can domestic finances/resources for education be increased; how can the efficiency and effectiveness of current resources be improved; what can be done to link budgeting and planning with outcomes. In addressing each of these, the paper reviews the current state of financing, mechanisms for revenue generation and policy planning and decision-making mechanisms, before outlining strategies for reform.

For understanding how domestic finances for education can be improved, we review the current state of knowledge on the tax revenues, the potential for increased revenue generation, and strategies for improving revenue collection. Improving efficiency and effectiveness of current resources addresses questions of targeting resources to areas and schools that need them most. For this we use EMIS data, survey data and budgetary data track resources and outcomes at the district level. Third, we provide examples of steps taken by various provincial governments to link planning and budgeting to outcomes. We conclude with general recommendations. [2]

Current state of financing for education

Pakistan's aspirations for financing education are reflected in its longstanding target of 4% of GDP on education. The target was set in 1992 and the pledge has been repeated at the highest levels of government in policies and education sector plans since then (Government of Pakistan, 1992, 2008). However, spending has so far fallen short of this target. In recent years, the allocation has

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been no more than 2.5% and only reached 2% of GDP in 2013-14 (Government of Pakistan, 2013-14; I-SAPS 2014). The low allocation is due both to very poor tax collection, as well as how the scarce resources available to government are allocated. Historically, social services (education and health) have competed with military spending and debt servicing for attention/priority in the resource allocation calculus (education and health together claimed 2.83% of the GDP in 2014, compared with 7.1% for defense and interest payments) (Government of Pakistan, 2014). In absolute terms, in 2013-14 Pakistan spent $5.3 billion on education.

In recent years, spending on education as a proportion of total budgets has increased. Analysis by Malik and Rose (2015) showed that provinces increased allocations to education in response to expanded fiscal space made available by larger transfers from the federal government.[3] Each of the provinces is spending close to 20% of their total budgets on education. Per capita spending on education in all four provinces has also increased (**Table 1**).

Table 1: Distribution of population and resources across provinces

	Province			
	Punjab	**Sindh**	**KPK**	**Balochistan**
Population* (000)	73,621	30,440	17,744	6,566
Population share (%)Other 2 %	56	23	14	5
Share of NFCA** 2006	56	26	13	5
Share of NFCA** 2009	52	25	15	9
Total Budget 2014-15 USD Billion	10.95	6.86	4.05	2.16
Real per capita exp USD Billion (2007-08)	36.5	54.4	37.2	76.1
Real per capita USD Billion exp (2014-15)	64.3	106.1	101.6	151.3

*1998 Census; **National Finance Commission Award; *** population shares applied to total population estimates from National Institute for Population Studies (NIPS).
Source: Malik and Rose (2015) based on PES 2013-14; I-SAPS (2014); Mustafa (2011); National Plan of Action 2013-16 by Ministry of Education, Trainings and Standards in Higher Education (2013)

However, these positive developments have caveats. One, higher spending at the provincial level is still a proportion of a very small resource envelope. Provincial budgets in comparison to the federal budget and the overall GDP of the country are small, primarily because the very big ticket items like defense and debt servicing are part of the federal government's budgets, and not provincial responsibility.[4] Resources made available to provinces are a function of tax revenues (federal via transfers, and provincial through direct collection) – which despite improvements remain stuck at a low level (more on this in sections below). Second, while per capita income has increased, and by a comparatively higher amount in the less developed provinces (Balochistan and KP), it falls short of what is needed if the country is to achieve goals. Calculations reported in the 2015 EFA Global Monitoring Report estimate that in order to meet post-2015 education goals by 2030, Pakistan would need to increase per pupil expenditure by 10 times its current expenditure at the pre-primary

[3] See Appendix A for a detailed description of recent fiscal and administrative decentralization. Briefly, responsibility for planning and undertaking of basic social services, including education has been devolved to the provinces. Accompanying this administrative decentralization, the federal government increased provincial shares of the total resource pool to make more resources available to undertake the newly devolved functions.
[4] Components of federal expenditure expressed as a percentage of GDP in 2013-14: Defence expenditure - 2.5%; Debt servicing/interest payments 4.6% (Economic Survey 2014-15).

level, by 6 times at the primary level, and by 4 times at the lower-secondary level. The report also estimates that Pakistan is amongst the minority countries that will need to roughly double relative spending on basic education to reach goals by 2030, and will need to increase proportion of GDP allocations to basic education by almost 3 times.

In terms of sub-sectoral breakdown of the 20% of budgetary allocations to education by the provinces, Malik and Rose (2015) found that primary education receives the largest share of spending: 43% in Punjab, 47% in Sindh, 44% in KPK. However, Balochistan allocates just 28% to primary schooling despite having low enrolment at this level.

So while the volume of resources going to education has increased, more resources are needed. Furthermore, these increases may not yield the desired impact if the spending is not targeted to support the most deprived regions and groups.

Raising revenues in a broken tax system

A major challenge facing Pakistan is the need to mobilise resources through a functioning tax system, and to avoid collecting these through regressive taxes. As a result of low tax collection, government expenditure commitments have outstripped revenues and the government has borrowed to sustain its spending. Pakistan's fiscal debt was 5.5% of its GDP in 2013-14 (Government of Pakistan, 2014).

While the Federal Board of Revenue's tax collection has increased in absolute amounts, it remains at 8.7% of the GDP (amongst the lowest levels in the world) (**Table 2**). The tax to GDP ratio in Pakistan has been stagnant between 10 – 11% for the past decade and more. The country ranks 23rd from the bottom in a list of 176 countries on this measure (Rashid et. al, 2013).

Table 2: Tax to GDP ratios (%)

Pakistan	10.0
Sri Lanka	12.9
Malaysia	13.8
Egypt	14.1
India	15.0
Zambia	16.6
Australia	20.7
United Kingdom	26.7

Source: Rashid et al, 2013

Pakistan collects far less tax than it has the potential to, both at the provincial and federal level. In the fiscal year 2013-14, tax revenue by the Federal Board of Revenue (FBR) amounted to 10% of the GDP. Its tax capacity is estimated to be 22.3 percent of GDP, which implies a tax revenue gap of more than 11 percent of GDP.[5] Although its estimated tax effort—the ratio between actual revenue and tax capacity—improved from 0.43 in 2011 to 0.49 in 2015, Pakistan is still significantly below the average of comparator developing countries (0.64) and high-income countries (0.76) (Fenochietto and Pessino, 2013).

Under the current constitutional structure, federal taxes (collected and redistributed by the federal government) include: income tax (individual and corporate); withholding taxes (on various transactions including bank transactions); sales tax on goods; excise duty and surcharges on gas and petroleum. Provincial taxes include agricultural tax, urban immovable property tax, sales tax on services and tax on motor vehicles. Federal taxes make up 90% of tax revenue collected (with the remainder collected through provincial taxes).

In 2010-11 income taxes and sales tax were the biggest contributors to government revenue, and the contribution of both of these taxes has increased substantially since 1989-90. By contrast, customs duties have declined considerably, as has excise duty to a lesser degree (**Table 3**). These duties have declined as part of the requirements of trade liberalization and many products have become tax free. The policy thinking has been to compensate by raising revenues from income and sales tax. However, overall while the shift in the type of taxes collected is apparent, there's been little impact on the overall tax base.

Table 3: Major taxes federal, % of GDP

	1989-90	2010-11
Income tax	1.67	3.2
Customs duties	5.9	1.03
Sales Tax	1.8	3.5
Excise Duty	2.7	0.79
Petroleum & gas surcharges	1.1	0.63
Others	na	0.9
Total	13.2	10

Source: Nasim (2013)

Income tax's contribution to revenues has doubled from 1.6% of GDP in 1989-90 to 3.2 in 2010-11 (**Table 3**). However, this increase has come from increases in withholding taxes (deductions at source). Withholding taxes – which are taxes levied on salaries, dividends, imports, exports, telephone and electricity bills, bank interests, securities and cash withdrawals - 57% in 2010-11 (Nasim, 2013). This means businesses that are documented/registered and salaried employees in the formal sector, and formal financial transactions in banks are taxed. This structure is distortionary, creating incentives for businesses to remain unregistered in the informal market, and for individuals to make transactions off-book to avoid taxes. The structure is inequitable in that the burden of taxes falls on a very small proportion of taxpayers (the salaried group and registered businesses).

[5] Fenochietto and Pessino (2013), estimate tax capacity—the maximum level of tax revenue that a country can collect—and tax effort with a stochastic frontier function, based on a panel of 113 countries, using economic, demographic and institutional characteristics as explanatory variables.

The tax base in Pakistan is narrow, an outcome of: a) undocumented income by individuals and corporations (traders that are part of the informal market, agriculturalists); b) exemptions given to incomes and economic activities (Nasim, 2013; Rashid et. al, 2013).

Table 4: Percentage of Population that filed for taxes 2010-11

Country	
Pakistan	0.9
India	4.7
Argentina	16.5
France	58
Canada	89

Source: Rashid et al (2013)

An extremely small proportion of the registered tax payers is actually filing taxes (**Table 4**). In 2010/11 the population registered for paying taxes was 3.1 million. The number actually filing taxes was 758,368 (Rashid et al, 2013). The percentage of population that files taxes in Pakistan is one of the lowest in the world, at about 0.9% compared with 4.7% in India. Moreover, many potential taxpayers and economic activities are likely to be undocumented. To get a sense of number of people who should be filing taxes, consider the following: the country has a population of 200 million people. With an estimated 30 million households and assuming an average of 1.2 person earning per household (Labour Force Survey 2013), 33 million people are earning. Accounting for the fact that 30% are living below the poverty line, 20 million people should be registered and filing – however, less than 1 million are doing so.

Expanding the tax base involves: documenting incomes and economic activity, increasing voluntary tax compliance, removing exemptions given to various incomes and economic activities.

Currently the tax machinery in Pakistan lacks the capacity to document all income and economic activity. Large informal economies with limited digital coverage of financial transactions make monitoring, verifying and enforcement difficult. The tax collection infrastructure – the federal and provincial boards of revenue – need to be reformed (Shirani, 2016). As developing economies grow and more transactions are digitized, the detailed information trails needed to be able to enforce tax compliance will improve. It will be important to have an evolved and empowered tax collection infrastructure with the ability to use technology to document information needed to enforce tax rules (Kleven et.al. 2016).

Businesses and traders have to be incentivized to register themselves. This will happen through rationalized tax rates (Rashid et. al. 2013), but it also requires a cultural shift in attitudes towards paying taxes. Tax morale in Pakistan is low, and in the absence of enforcement, results in very little tax being collected. Tax morale and voluntary tax compliance are linked. Citizens pay taxes because in return they receive from the government essential services such as social security, education, healthcare, sanitation (Kleven et.al. 2016). In Pakistan, the state provides these services but for some – such as social security - the coverage is very small, and other services like education declining quality of public service delivery has pushed citizens to opt private provision. The proportion of the population utilizing private services is on the rise. People are paying for education, healthcare, water, security.

Income tax exemptions on pension income, incomes from federal securities, mutual funds and capital gains constrict the tax base and reduce revenues. Nabi (2008) estimated lost revenues to be Rs. 230 billion ($2.19 billion) (3% of the GDP) in 2008 - the lost revenue estimate based on taxing income at the regular income tax rate.

The tax structure is disproportionately heavily reliant on indirect taxes: 61% of total federal tax revenue is from indirect taxes, and 39% is direct taxes (Government of Pakistan, 2014). "Since the government lacks the capacity to tax directly from earned incomes, it resorts to indirect taxation that does not differentiate between the rich and the poor" (Rashid et al, 2013). This makes the tax structure regressive at an individual level. It may not be that the tax rates are particularly high than comparable contexts (ibid). Rather the narrow tax bases for direct taxes – individual and corporate income tax – and the voluntary non-compliance, mean the effective burden of taxation falls on a much smaller proportion of the population.

Income tax has the greatest potential to generate substantial tax revenue. It is crucial that reforms undertaken to increase revenues from direct income taxation do so in a progressive way.

Provincial taxes

There are two sources of revenues for the provinces: a) transfers to the provinces from the federal divisible pool based on the National Finance Commission Award (NFCA)[6]; b) tax revenue raised through taxes collected and retained by them (including agricultural tax, immovable urban property tax, sales tax on services and tax on motor vehicles). Only 10% of tax revenue is raised through the four taxes assigned to provinces. The proportion varies for each of the provinces depending on their capacity. In 2014-15 Punjab raised 13% in own taxes; by contrast, Balochistan was able to raise only 2% in its own taxes on average (**Table 5**).

[6] Taxes that become part of the total divisible pool are collected by the Federal Board of Revenue, and redistributed between provinces as federal transfers. The National Finance Commission Awards (NFCA) contains the terms of redistribution of the resource pool that comprises the federal government's tax revenue.

Table 5: Provincial revenue structure and scale

	Tax Revenue Provincial (USD billions)	Total Revenue Receipts* Provincial (USD billions)	Tax Revenue as a Proportion of Total Revenue Provincial	Tax Revenue Provincial as a proportion of national GDP
KP	0.12	2.8	4.3	0.05
Punjab	1	8	13.2	0.43
Sindh	0.3	4.8	7.7	0.15
Balochistan	0.03	1.8	1.6	0.01
Federal				9.99

* Total General revenue receipts consist of Federal Divisible pool taxes, provincial tax revenue, provincial non tax revenue, straight transfers and Federal Grants.
Note: Figures for Provincial Tax Revenue and Total General Revenue Receipts have been taken from White Papers of Budget 2014-15 of provincial governments. Figures for Federal tax and GDP are obtained from Pakistan Economic Survey 2013-14, Chapter 4 Fiscal Development. Source: Govt. of Sindh (2015); Govt. of Punjab (2014); Govt of KP (2014); Govt of Balochistan (2014)

There is considerable potential for increased tax revenue at the provincial level. Table 6 summarizes this potential for various tax categories, including those under provincial purview. Details follow in the sections below.

Table 6: Potential and progressivity of taxes: provincial and federal

Type of tax (collected by)	Raised	Potential	Progressiveness
Income tax – individual (federal)*	< 1 million people paying tax 3% of GDP	Up to 20 million people	Progressive if tax base is broad and if not heavily reliant on withholding taxes. At the moment tax base is narrow and there's a heavy reliance on withholding taxes: the impact is that income tax is regressive and inequitable.
Agricultural tax (provincial) **	< $9.5 million 0.0036 % of GDP	> $505 million 0.19% GDP	Progressive if income tax. At the moment operating as a land tax. Neither regressive nor progressive, but there is lost potential.
Urban immovable property tax (provincial) – Punjab ***	$ 75 million 0.04% of GDP	$ 238 million 0.13% of GDP	Progressive in principle at the individual level. However, regional disparities in potential: Punjab has highest potential followed by KP and Sindh (considering urbanization & development). Balochistan has least potential. Levied in all 4 provinces.
Urban immovable property tax – KP ****	1.8 % of provincial GDP	In Punjab 4.7% of provincial GDP	
Sales tax on services – Sindh*****	In 2009 $143 million 0.1 % of GDP	In 2012 $477 million 0.25% of GDP	It is regressive

Sources: *Rashid et al (2013), Shirani (2015, 2016), own calculations; **Mukhtar and Nasim (2016); ***Nabi and Sheikh (2011); ****CDPR (2013); *****Govt of Sindh.

Agricultural tax

Pakistan is an agri-based economy; the sector accounted for 21% of GDP in 2014. Tax from the agricultural sector is 0.4% of GDP (Government of Pakistan, 2014), or less than Rs. 1 billion ($9.5 million). Mukhtar and Nasim (2016) calculate the potential of agri-tax to be more than Rs. 53 billion ($509 million) in 2014-15. Punjab has the largest share of agricultural production (more than 65%), Sindh contributes about 25% and the rest is contributed by KP. Punjab alone could be generating Rs. 2 billion ($19.2 million) each year.

The agricultural tax structures are sub-optimal and the tax rates outdated. In Punjab and Sindh, tax rates on agricultural land and incomes have remained frozen at the levels set the early 2000s. Mukhtar and Nasim (2016) argue that "taxing agricultural incomes at rates comparable with non-agricultural incomes could have raised over Rs. 53 billion ($0.5billion) in FY2014" (p.3), stating that 'this could have financed the provincial government's entire development and recurrent expenditure on health services in that year which was about Rs. 51 billion ($ 0.48 billion) (p.3). The authors also develop projection models using different types of tax structures to estimate that Punjab alone could be generating an additional amount of between Rs. 2 billion ($0.01 billion) and Rs. 114 billion ($1.2 billion) per year (depending on the type of tax structure imposed).

Agricultural tax as it is currently set up is a tax on land or a wealth tax, and as such the amount of tax generated is linked to the value of land regardless of what the yield is (which might be higher than the value of the land for some). If agricultural income, rather than agricultural land, were to be taxed – tax revenues will be tied directly to the income generated each month, and can be more progressive.

Urban Immovable Property Tax (UIPT)

In FY2014 Punjab collected Rs. 7.9 billion ($75 million) in property tax. Nabi and Sheikh (2011) estimated the potential of UIPT in Punjab to be Rs. 25 billion ($238 million). This figure in 2010-11 would have been equivalent of 13% of Punjab's development budget for that year and 26% of the provincial health and education budget (Nabi and Sheikh, 2011: p.07).

The UIPT has been identified in Pakistan's context as one with considerable revenue-generation potential, if efficiently designed and effectively implemented, one that can enable governments, local ones in particular, to deliver local services more effectively. Provinces have the right to legislate on property tax but the tax is a local one. Urbanization rates have been high in Pakistan especially in the Punjab, Karachi and Hyderabad in Sindh and in some parts of the Khyber Pakhtunkhwa (KP) (**Table 6**). Balochistan has a large area but a very small population and there are very few cities/urban areas in the province. UIPT potential, in Balochistan, for the moment at least, is therefore very limited. In other provinces large urban settlements have arisen around existing cities and many smaller towns have grown into mid sized cities.

Efficient UIPT collection requires a) inclusion of new areas into the tax net, and b) periodic land/dwelling value assessments for calculating the tax liability. Provinces have been lax in dong both. The potential of UIPT rests in a) ensuring all urban areas are documented and in the tax net and b) assessments of properties are updated regularly. There have been some pilots conducted by the government of Punjab on adding new areas and updating assessments recently and these have yielded substantial tax revenue gains for the province (as much as 30-40 percent more tax revenue even in the first two years). These pilots now need to be taken to scale in the Punjab. There is no active conversation, yet, on UIPT in Sindh and KP currently.

Pakistan is among countries with the lowest share of property tax in tax revenue, despite experiencing substantial urbanization over the past few decades. Simple restructuring efforts led to improvements in tax collection in the Punjab to an unprecedented $ 31 million in 2009. This change was an outcome of reforms undertaken prior to the NFC restructuring in 2010. An economic advisor involved with the restructuring reform in his interview with us said that in the years leading up to that time there was a financial crunch and provinces needed more resources. With the revision of the NFC rules and provinces getting more resources from the centre, the incentive disappeared and the reform was abandoned.

General Sales Tax

Provinces have been assigned the GST (General Sales Tax) on services to collect and retain for the provincial consolidated fund. The federal government has retained the general sales tax on goods. All provinces, but particularly Sindh and Punjab have raised considerable revenue, and receipts from GST on services have increased substantially. Collection in Sindh has increased substantially from Rs. 15 billion ($0.14 billion) in 2009 (when GST on services was a federal tax) to more than Rs. 50 billion ($0.48 billion) in 2012.[7] Policy researchers and government representatives in Sindh and Punjab are all viewing this as a very positive outcome, and an indication that were the federal government to transfer more taxes to the provincial level, collection could improve considerably.

GST on services is a more difficult tax to collect, for provinces, than on goods. In many a jurisdiction it is GST on goods that is a provincial subject and federation retains the right to impose and collect GST on services. In Pakistan, it is the other way: provinces are mandated to collect the GST on services. Recent tax revenue gains for Sindh and Punjab are a result of this tax. The provinces, rightly, see this as their most buoyant tax. But the gains, so far, have been from services that were easy to tax. As provinces move to more complex services (banking, mobile telephony, other financial services), with higher potential for revenue generation, implementation and collection of taxes will present challenges. Eventually, a rearrangement of federal and provincial mandates regarding GST will be needed, and relevant constitutional amendments required to make the tax structures more rational.

Fiscal relations, needs, and equity concerns

By virtue of the nature of taxes, the sources of income for the federal government are responsible are relatively rich and buoyant. By contrast, taxes assigned to the provincial governments are less buoyant and a comparatively less lucrative source of income. Provinces therefore rely almost entirely on transfers from the federal government for their income (see Malik and Rose, 2015): more than 70% of total income of provinces is from federal transfers.

Increasing revenue collection from the provinces is potentially the most sustainable way of ensuring higher revenue generation domestically. Decentralizing revenue collection in parallel to service delivery will empower governments to be more flexible in decision-making, and allow public

[7] These figures were mentioned during an interview. Yet to be corroborated. Budget speeches being accessed currently to corroborate the numbers.

service delivery to be more demonstrably linked with tax collection. Having said that, there is a need to strike a careful balance between capacity and need in the redesign of fiscal relations to one where provinces are more independently raising resources to fund their expenditures. The equity implications have to be kept in mind: regions that have least capacity to raise resources through the standard menu of provincial taxes, are also the ones that need more support for development. The federal government will need to continue to play its role of equalizing resources through direct transfers and development grants.

A more localized tax structure would need to be broader and more diverse by design to allow provinces to tap into resources they have in order to generate resources for their needs in a sustainable way. For Balochistan this would mean greater control over management of its natural resources. Balochistan is very rich in natural gas, coal and gold. At the moment, control of mineral oil and natural gas (taxation and legislative powers) rests with the federation; other minerals – like coal, gold etc - are with the provinces (part 1, fourth schedule, constitution of Pakistan). If this structure was to change, as with agricultural income decentralized to provinces, Balochistan would be able to benefit more directly. Additionally, even in the current structure, taxing other minerals which are abundant in Balochistan, can be a source of revenue for the province. However the latter will require building capacity for mineral exploitation. Similarly, KP can capitalize on its capacity to produce hydal power.

At the same time, while its important for the balance of taxes to shift to provinces raising more, differences in baseline capacities to generate funds and development needs necessitate continuation of the redistributive role the federal government has been playing so far.

The political economy challenges of tax and administrative reform

Effective tax reforms in Pakistan are overdue. The government, despite reform efforts of the last two decades, has not been able to increase the number of income tax payers substantially. The federal government has offered numerous amnesty schemes for people to declare past income and get it regularized and to allow these people to become taxpayers in future but all of these amnesty schemes have failed. Administrative reform of the Federal Bureau of Revenue is also in need to improve the administrative capacity and efficiency of tax collection. One plan involves inducting 300,000 new tax payers into the fold by identifying potential tax payers using the National Identification Card database with the National Tax database; but this number is a drop in the ocean given the total potential taxpayers. Other aspirational steps the government has planned include simplifying tax filing processes, and strengthening the tax audit (Government of Pakistan, 2014). However, currently the government machinery does not have the capacity to effectively document individual incomes and this allows people to either stay out of the net completely (non-filers) or under-report their income significantly. Stunted capacity for documentation of economic activity and tax collection is in part an outcome of weak political will. A lot of the steps for broadening the tax base requires political will to take steps necessary for accurate and broad recording of incomes. Agriculturalists and traders not only represent an important constituency for political parties, often they are in government.

Pakistan is a case of contrasts: it has experienced periods of high growth (in the 60s) and more recently moderate levels of growth (4%), and yet it lags behind countries who are on a similar growth trajectory in terms of human development levels. Investments in human development (particularly education) have been always been very low. Easterly (2001) explores these contradictions and using political economy models offers some explanations. He states that Pakistan has an abundant labor force and in an agricultural economy with low returns to human capital, the political and economic elite has never had the incentive to tax themselves to provide resources for education. He goes further to say that the elite find it in their interests to have uneducated masses to rule over with ease.

We offer an alternative explanation of an aspirational but weak state. An explanation for why attempts at tax reform have been unsuccessful lies in the way the government and the state is organized. Democratically elected governments should be able to take on unpopular reforms - even a little at a time. In Pakistan, this has not happened. The democratic civilian governments have been weak, often under threat of military coups. The PPP coalition government of 2008 was the first one to complete its five year term since 1947. Additionally, over the years political parties have become more closely defined by regional and ethnic identities (the past two governments have been coalition governments, and next ones the same - a different political party in each province). The political contestation has become stronger and fiercer. The political calculus is almost entirely about survival, and playing into the hands of interests that can help win the next election. Even if an elected central government wanted to take the unpopular decision of bringing large agriculturalists and traders in the tax net, it is unlikely that other political parties will openly support them in making it happen.

In a context where political and civilian governments have been weak and disposed often, taking on any meaningful reform – particularly unpopular reforms such as agricultural and property tax – has never been a real possibility. Even military governments have had to create pockets of support to legitimize their rule and have not been able to reform structures or reduce of military spending. In other words, the legitimacy of governments has not extended to undertaking unpopular reform, for challenging strong lobbies (including, traders, small and medium enterprises, agriculturalists, and property elites). Reforms led by international donors such as the IMF have in many ways been more successful, as an external actor is leveraged to grant legitimacy to policy reforms being undertaken. Some examples of donor led programs include the privatization program in the energy and airline sector, which though unpopular are being pushed through.

There is an element of path dependency as well, heavy borrowing from the IMF has locked the country in a cycle of debt-servicing and surrendered at least some of its autonomy for economic and fiscal reforms. For example, heavy reliance on sales tax is in part driven by the debt servicing conditions as it is easiest to collect in the short run; even though there is recognition that it is regressive. The shortfall of revenue creates the need to rationalize the tax structure. Any rational tax system would have a healthy sales tax component. But the debt trap Pakistan finds itself in has compounded the need to rely on taxation that is easy to collect with a weak collection machinery and immediate in its returns.

Improving equity and efficiency of existing resources

Policy planning at the federal/national level has incorporated equity concerns. The biggest example of this is the changes to the resource redistribution calculus for the provinces. Until 2009, provinces had received funds based on the share of their population. The last census was held in Pakistan in 1998. The formula was regressive, as it did not account for levels of deprivation or underdevelopment in the provinces, or their ability to raise their own resources. The federal government had relied on a system of development grants for the more deprived provinces, but these were not determined in a systematic and predictable manner. In 2009, the 7th NFCA, changed the calculus of distribution to include three additional criteria for determining provincial revenue shares: poverty or 'backwardness,' revenue collection or generation, and inverse population density. Weighting is based on 82% associated with population size; 10% with poverty backwardness; 5% with provincial revenue collection 5%; and 2.7% with inverse population density (Malik and Rose, 2015).

Changes in redistribution have benefited the smaller, less developed provinces: Balochistan now receives 9% of the share of the NFCA funds compared with its population share of 5%, while the relatively wealthier Punjab province receives 52% compared with its larger population share of 56%. Given the differences in the population shares across the provinces, this results in the more sparsely-populated, poorer province of Balochistan receiving almost 2.5 times more per capita in 2014-15 compared with the wealthier, more densely populated Punjab provinces, suggesting that the formula has been effective (**Table 1**).

In addition to these changes, the federal government decreased the share of resources it retained for itself and increased that dedicated for the provinces. All provinces have since 2010 increased allocations to education. While increased resource allocations are a necessary first step towards achievement of policy targets, improved outcomes at the school level will materialize if: increased allocations translate into increased spending at the school level; resources are spent on capacity building and reform projects (and not merely absorbed into inflated administrative costs); reach districts and schools that are most challenged. These criteria for spending require high capacity for responsive planning and governance mechanisms. (Malik and Rose, 2015).

Aspects of planning and governance at the provincial and district level restrict the impact of increased resource allocations on school level outcomes. These include: leakages in funds-flow chains linking provinces, districts and schools; underdeveloped capacity at the district level to spend funds; a planning process which over-emphasizes infrastructure development; and importantly an imbalance between need and resources received. The capacity for effective public finance management – which involves estimation of fiscal need and linking spending to need – is weak.

Additionally, schools have very little autonomy over where they can spend funds. Head teachers do not feel empowered to address the challenges they face in schools: either they do not have the resources they need to hire teachers or build rooms etc in their schools; or when they have resources, the threat of audits keeps them from spending them. A small proportion of school councils have been successful in supporting the head teachers in bringing about school level changes.

Tracking public expenditure at the district level

A number of public expenditure tracking exercises undertaken in recent years reveal that resource allocations within provinces is inequitable. Punjab Social Sector Expenditure Review by the World Bank showed that the least developed districts were also receiving the least amount of funds

(World Bank, 2012). An independent think tank I-SAPS used budgetary data for 2014 for a similar exercise and revealed that 2 most developed districts in Punjab (Lahore and Faisalabad) received 9% of the total budget, while 8 of the poorest districts received 8% of total budget. In KPK, 3 districts receive 23% of the total budget and four of the least developed districts receive 4% of the total funds (I-SAPS, 2014).

Inequities in resource allocation manifest as inadequate infrastructure, missing facilities and insufficient human resources in the least developed areas. A number of reports rank districts in Punjab and other provinces using government data on missing facilities. Parts of South Punjab and interior Sindh rank as low as Balochistan in terms of missing facilities (missing or dysfunctional schools). Bari et al (2013) use the government's education management information system data to calculate imbalances in teacher deployment by district and find that low income areas within districts and poorly developed districts have far fewer teachers per student than stipulated in policies.

We use budget data from the World Bank and district level learning data from ASER (2015) to link outcomes with per child expenditure at the district level (**Figures 1, 2, and 3**). An important message is that, under current arrangements for the allocation of resources within provinces, the budget per child[8] by district and the data for learning outcomes and out of school children at the district level show no significant discernable patterns. Gujranwala, Bahawalpur and Khanewal have similar budget per child, but learning patterns across the three districts are very different. Khanewal reports higher learning outcomes than Bahawalpur, which in turn performs better than Gujranwala. It is apparent in some cases that districts with better outcomes are also receiving more resources. More importantly, the data seem to validate descriptions of planning processes at the provincial level by representatives of provincial education departments, that resource allocation is driven by political imperatives and not systematic planning and assessment of need. In Sindh, the Annual Development Plan - decided by the provinces - is announced as an overall package for different districts, with no justification for need or planning logic offered. Districts that are politically strong receive funds, while others lag.

An important point to make here is that it is not the case that the underdeveloped districts where outcomes are low are being ignored as a matter of policy, or that the more developed districts are preferred. Rather that factors such as low outcomes, or fiscal and developmental needs, are not part of the planning process at all. Instead, a political calculus dictates decisions taken. The planning and governance machinery has never undertaken decision-making processes that are based on evidenced based, output linked, medium to long term planning process. This is where the gaps in capacity to plan emerge from.

[8] Budget per child is calculated by dividing the total expenditure on education for that year with the total number of children 5-16 years (in and out of school). Number of children 5-16 years is calculated by dividing primary and secondary enrolment figures by the proportion of children (5-16) attending school. Sources: Enrollment data from Education Management Information Systems (EMIS); budget data from World Bank.

Figure 1: Resources and outcomes at the district level in Punjab

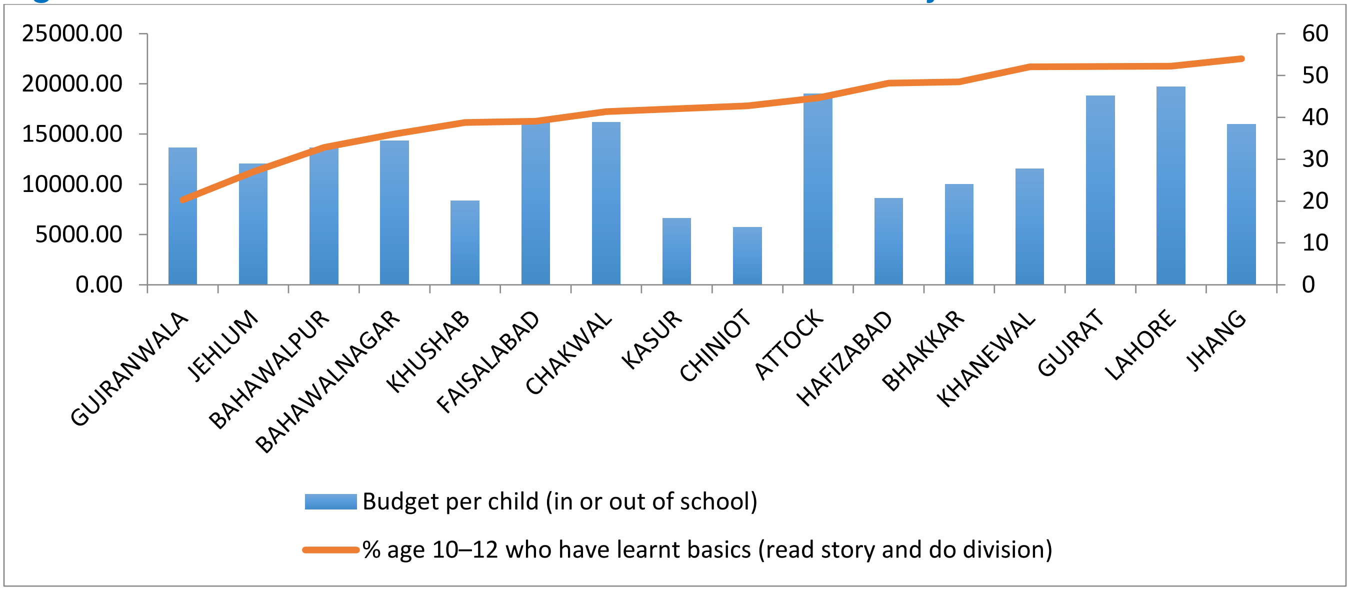


Figure 2: Resources and outcomes at the district level in KP

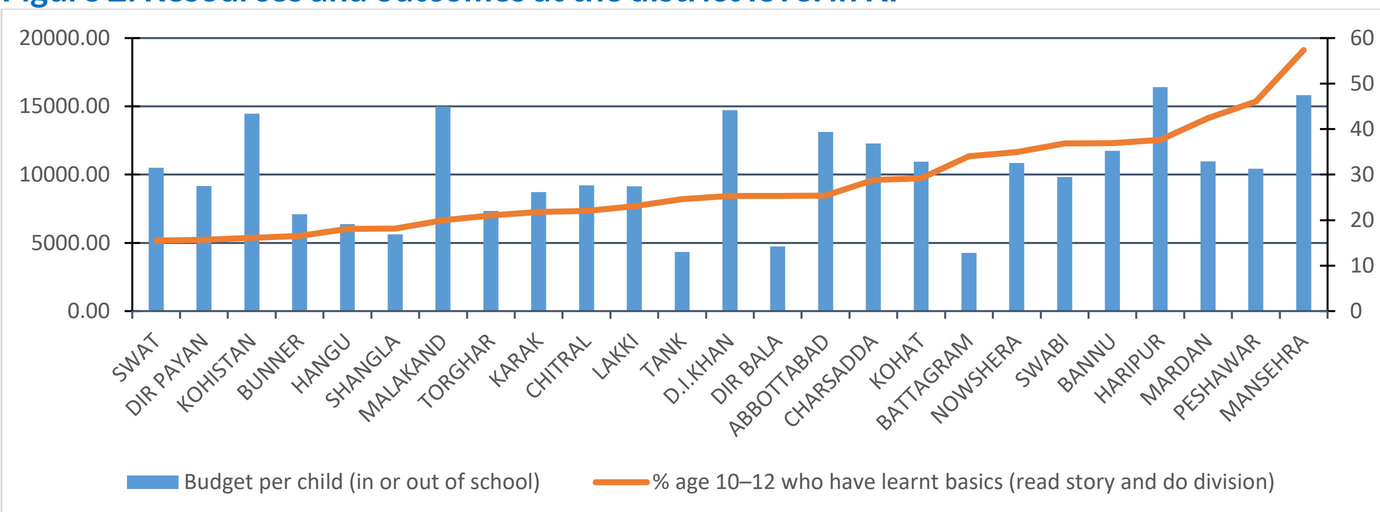
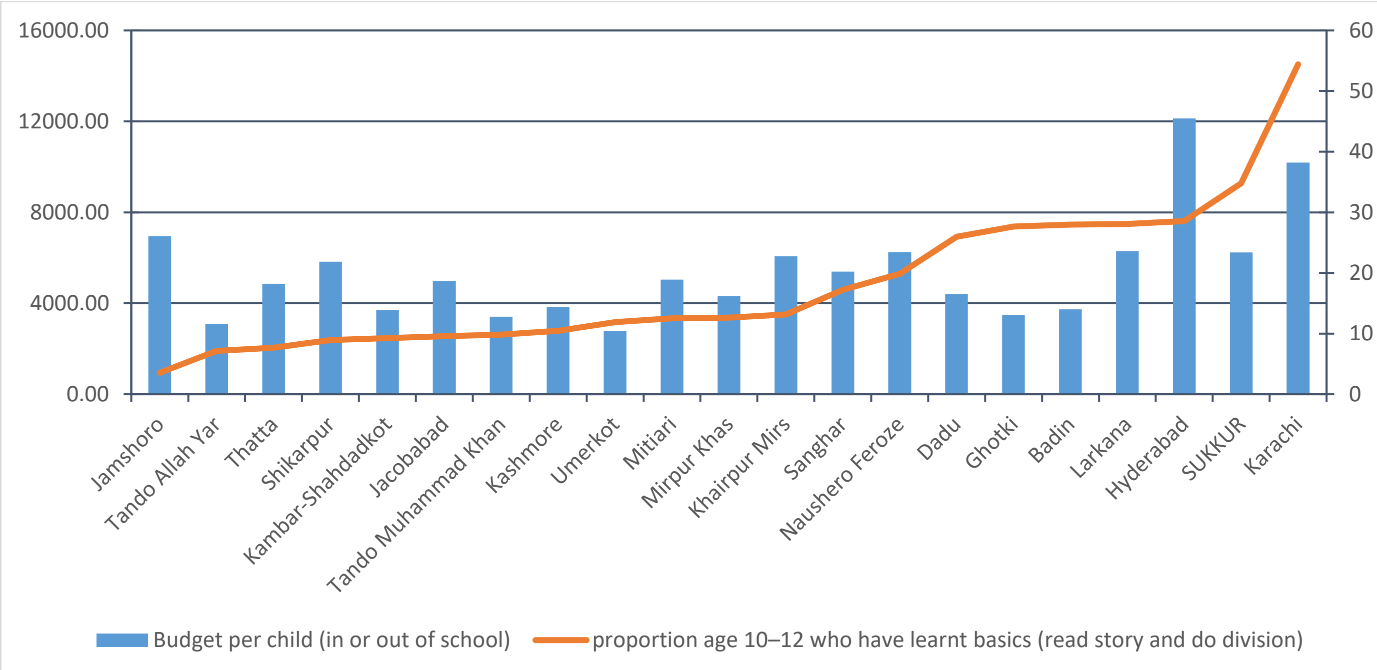


Figure 3: Resources and outcomes at the district level in Sindh



Transfers between districts, particularly development expenditures, are in principle meant to be guided by a formula. Interviews with fiscal experts in four provinces reveal that while theoretically a PFCA (Provincial Finance Commission Award) is to operate on the same principles as NFCA (National Finance Commission Award), in practice neither of the four provinces are using a formula for resource allocation – a combination of unavailability of data needed for future planning, low priority given to developing needs-based resource distribution mechanisms, and political economy factors. Outdated population figures (the last census was undertaken in 1998) means the population distribution between urban and rural areas is uncertain, and district populations are also projections. The provincial government has very little sense of the fiscal needs of the districts, the rural and urban municipalities. Moreover, elected officials find it convenient to exercise discretion over allocation development projects to areas and in ways that can further their political interests. This is true also for the development fund allocations in the education sector.

Using prior expenditure patterns as the main criterion for resource distribution reinforces prior resource shortages and imbalances. The system not only doesn't reflect current need, it remains incapable of self-correcting. Such a system also creates and perpetuates incentives for inefficiencies within local administrative and governance structures.[9] Formula-based rules for resource distribution are needed to instill transparency and predictability in the resource allocation process. These principles have greater importance when resources are scarce. Punjab has recently started work on piloting a formula that might become the basis for resource distribution at the provincial level. The formula will base determination of district shares on a variety of social indicators including health, education and social protection needs. For education, the formula will be focusing on projected numbers of out of school children to introduce

[9] Interview with representative of donor-funded INGO providing technical assistance to the Punjab government.

Punjab has also tried to link outcomes to planning through the Education Road Map – part of the Education Sector Reform Program and based on the framework of 'Deliverology'. A database reporting on key education indicators (infrastructure, enrollments, teacher absenteeism etc.) ranks districts on each of the key indicators. The underperforming districts are highlighted in red or orange, depending on distance from achieving goals. This system is used to hold District Coordinating Officers – representatives of the provincial government at the district level – to task, and to spur action in areas where the need is greatest. Recent stock takes have revealed a plateauing of enrollments in the data, and little impact having been had on reduction of out of school children. Interviews with advisors to the government and representatives of the education department reveal that the approach has been unable to make the system more responsive to challenges continually and in a sustainable manner. The system can be an effective tool if used at a more decentralized level (i.e. at the district by the DCOs themselves) but is largely ineffective in the way that it is being used as a centralized monitoring system. In its current mode of operation, the system gets gamed.

The Education Sector Reform Program for Sindh 2014-2017 mentions a Medium Term Budgetary Framework tool, envisioned as a planning tool for relieving the budgetary planning process from the constraints of yearly planning and linking it to outcomes that could be realized over a number of years. While this is the sort of reform required at provincial levels, this particular framework has been introduced as a result of lobbying by donor organizations, and has little or no traction within the education and other departments themselves. One ex-Cabinet member of Sindh and a current advisor to provincial governments called it an exercise in futility. His assessment is based on a lack of capacity at the provincial level and the disconnect between the proposals and current mode of operations which is likely to make the reform suggestions ineffective. Reforms have to be initiated and owned by the governments if they are to be successful.

Gaps in Allocations and Spending

Sindh and Balochistan in particular have reported significant underspending of allocated development funds in the education sector. Between 2010-11 and 2013-14 9% to 13% of Punjab's education budget remained unspent (I-SAPS, 2014). This money could have supported 1.1-1.5 million children out of school at the primary level. Underspending of $ 310 million in Sindh in 2013-14 could have supported 2.7 million out of school children through primary school. Underspending in development funds appears to be more severe, with proportions as high as 60% of development budgets remaining unspent in Sindh (Malik and Rose, 2015).

In 2015-16, the amount allocated for development funds for Sindh in the education budget has been reduced, and this is a direct outcome of historical underspending. In part this is because of the financial cycles being out of sync with the realities of procurement processes and the unavoidable time-lags involved in multi-department collaborations that any development or reform program in the education sector requires.

Budget data from Punjab support claims by representatives of the education departments that development funds lie unspent for the first three quarters of the year, and ad hoc spending decisions made in the final quarter in face of considerable pressure to get the money out the door, resulting in short-lived impact or in the worst money flowing to schools and districts that are most convenient not the most in need.

Leakage of Funds

There are four types of funds transferring between different tiers within education at the subnational level that are channeled to schools: Non-development expenses (salaries and administrative) financed through current budget by the district government; development budget (missing facilities) financed through the Annual Development Plan which is prepared using data from the Annual School Census (the Program Management Implementation Unit and School Education Department work together to for this) and is disbursed by the provincial government; the School Council funds are disbursed by the provincial government as are the free text books.

World Bank's expenditure tracking review reports cases where physical facilities to which money had been allocated on paper could not be located in schools. Another chronic issue in Pakistan's case is that of ghost schools – where schools exist on paper, and buildings may exist, but no teachers are teaching yet operational school funds are transferred with regularity. Policy makers have taken this issue on in many cases in Punjab and Sindh, however, it still remains an issue (World Bank, 2016).

A report by Pakistan Coalition of Education (PCE) reports findings from a school level expenditure tracking survey undertaken in 2300 schools across the country, and corroborate findings from the World Bank survey: a third of the schools reported not receiving funds designated for school councils, and half of the schools that received funds did so in the last school quarter. Half the funds that were received were utilized, mostly for infrastructural extensions and repair.

Alternative sources of funding and service delivery: scale, impact on equity, and sustainability

Donor Aid

Donors have the potential to support domestic resource moblisation. However, this constitutes an extremely small part of their activities in Pakistan – in recent years, donors have allocated less than 0.5% of their aid to Pakistan to core activities aimed at domestic resource mobilization, falling to 0 by 2013. One reason for this is the unsatisfactory rating received by the World Bank Tax Administration Reform Project, a review of which concluded: 'Stand-alone investment loans may not be the most appropriate instrument for supporting major tax reform. To increase likelihood of tax reform success, a thorough and systematic political economy analysis (PEA) should not only be seen as a desirable feature, but rather as a key component of project design and implementation' (World Bank, 2012).

Pakistan receives international aid for education, which supplements domestic funding. While aid money is a small proportion of domestic resources - aid is 8.1% of total government spending on education in 2013, and has historically hovered around 10% (OECD-DAC), aid makes an important contribution and donor programs and interventions influence the programs and reforms within the country, if not the direction of domestic resource allocations. While the proportions are small, the magnitude of aid money has increased from $168 million in 2002 to $267.8 million in 2014. In recent years, around one-quarter of aid to Pakistan has been spent on education (OECD DAC data).

A considerable amount of donor funding for education, and the policy/reform focus, has been on promoting the role of private actors through various initiatives, including access to finance for low-fee private schools across the country, developing entrepreneurship models of education service delivery, and funding voucher programs (Malik and Rose, 2015). Donors have helped establish and funded operations of semi-autonomous bodies called education foundations at the provincial level to support the development and expansion of public private partnerships in education.

This expansion of the role of private actors is happening without a parallel buildup of state's capacity to regulate and monitor. There are questions also regarding whether the programs can be sustained without donor funding.

The private sector

The fast expanding fee-charging private sector is viewed as a viable policy alternative to the inefficient state sector. Around 20% of children go to private schools in the country (with a similar proportion out of school, and the remaining children mainly in government schools (Alcott and Rose, 2015).

Contrary to the situation where parents exercise informed choice between two comparably well performing school systems, in Pakistan the shift to private schools is an outcome of dismal quality in state schools which in turn is related to under-investment in these schools. Reliance on the private sector as a policy prescription to inefficiency or quality challenges of the state schools has clear equity implications. Children in private schools are overwhelmingly from high income households (around 37%), compared with just 14% from the poorest quintiles. Those attending private schools, even low fee private schools, are systematically different from those excluded from the private sector in terms of their socio-economic status. And there are fewer private schools in rural areas and fewer schools in less developed areas of the country (rural Sindh and rural Balochistan). Moreover, for those from poorer families paying fees to attend private schools, this can have significant impact on the household budgets, which is greater proportionately than on budgets for wealthier households. Average expenditure of a family on a private school is Rs. 370/ month ($3.53) and Rs.4423 ($42.2) per annum (Ilm Ideas, 2014). The average monthly household income for the poorest quintile is reported to be Rs.16583 ($158.6) (Household Integrated Economic Survey 2013-14). Taking into account they might have 3 children or so in private schools, the burden is high. As such, reliance on private schooling is likely to be regressive – with the poor facing a significant burden of cost yet receiving lower quality schooling. While a breakdown of information for those in private and government schools by wealth is unavailable, the EFA Global Monitoring Report estimates that two-thirds of spending on education comes from households (UNESCO, 2015). These high costs to households are largely driven by low government spending, and is unlikely to promote equity in who gets access to better quality schools.

Additionally, even though better than government schools on average, the quality of private schools is far from ideal: more than a fifth of 10–12 year-olds in rural private schools are unable to read a paragraph, with rich children around three times more likely to be able to read a paragraph than poorer children in the same type of school (Alcott and Rose, 2015).

As a policy option, public finance of private choice can in principle address equity concerns, as service remains free at the point of delivery. However, a critical condition public funding needs to be targeted to low income households and communities. In practice, effective targeting mechanisms require vast amounts of information about the population to estimate financial need, and extensive monitoring mechanisms to ensure rules compliant administration.

The voucher program in Punjab, Pakistan is run by the Punjab Education Foundation – a semi-autonomous body (supported by World Bank and DfID) with a mandate to expand private sector provision through state funding. In 2014-15, PEF's reported budget was Rs. 11 billion (which comes to 3.8% of Punjab's total budget for education), of which Rs. 7 billion was reported as the budget for the Education Voucher Scheme (EVS). 208000 vouchers were distributed in 2014 (1.6% of Punjab's school age population). For its subsidized schools program, Foundation Assisted Schools, the foundation reported a budget of Rs. 61 billion for a little over 1.3 million students in 2300 schools (10.2% of Punjab's school age population). Both these schemes require considerable administrative overhead for identification and monitoring of the scheme, and even then only reach a modest part of the province's population. Needs-assessments for voucher schemes involve identification of low-income communities and households. The cost of administration and monitoring has contributed to the scale of the programs being limited.

The Education departments in other provinces have limited capacity to administer complex needs-assessments and administer voucher programs, nor to regulate private sector schools (many of which are unregistered). In recent times there have been demands, from parents, to impose certain regulations on private schools. The most vocal demand has been about the need for fee capping. Recent fee hikes from private providers led to protests from parents and provincial governments have, in haste, placed fee caps on schools.[10] But the debate on private schooling needs to be a lot broader and deeper than about fee-capping issue given the poor quality of education that the most disadvantaged are experiencing, the majority of whom are either out of school, or in poor quality government or private schools.

Private philanthropy

Private philanthropy is another source of funding for education in Pakistan. Large NGOs operating in the education sector – working with the government or running their own schools - fund-raise through national and expat networks. There is very little publically available, collated data on national philanthropic donations, and no data on funds raised in the expat community. According to one survey by the PCP, total donations by private limited companies amounted to $ 40 million in 2012 (PCP, 2013). This is a fraction of total government expenditure in the same year which amounted to $4.4 billion.[11] With caveats [a) philanthropic giving is underreported and actual figures might be higher; b) assuming entire amount going to education – actual proportion is unknown)], the magnitude of funding philanthropic funding is less than 0.9% of the total expenditure by the government.

[10] (2015, September 7) Crying foul: Protest against school fee increase enters second consecutive day. The Express Tribune. Retrieved from http://tribune.com.pk/story/958129/crying-foul-protest-against-school-fee-increase-enters-second-consecutive-day/

[11] A blog post written the same year reported total philanthropic giving to be in the area of $1.7 billion. $0.04 billion is reported philanthropic contributions from public listed companies (http://southasiainvestor.blogspot.co.uk/2012/01/pakistan-ranks-high-on-philanthropy.html)

Philanthropic funding of education allows NGOs to run schools in the country, and often engage with state schools as well. However, the scale of those operations remains very small as well. The largest NGO in education sector runs more than 1,000 schools in the country after 10-15 years of operation. The government has also given 600 plus of its own schools to NGOs to manage; this is through a partnership mechanism whereby NGOs adopt the role of school managers in state schools. Over 15 years the mechanism has expanded 600 schools.

While philanthropic funding and engagement through partnerships are playing important roles, the magnitude of philanthropic funding and the scale of operations supported through this funding may not be enough to tackle challenges. The structure of philanthropic funding in Pakistan is such that a very large number of individuals – that comprise the civil society in Pakistan and the expat community - are giving small amounts, rather than a few very rich individuals and foundations. The most prominent philanthropic names in education (CARE Foundation, The Citizen's Foundation) sustain their work on fundraising from the public rather than through endowments. The education debate and priorities are in a way being shaped by the civil society in that way. There would seem to be limited scope, therefore, to see philanthropic funding as a viable alternative to a better functioning tax system in Pakistan. Moreover, this is but a stop gap measure. Moreover, a constitutional right cannot be based on decisions for resource allocation based on charitable contributions by individuals.

Recommendations

Based on the analysis of primary data, existing policy and academic research work in the area, and on conversations with key public finance and fiscal policy experts, the following recommendations for short, medium and long term strategies that Pakistan can adopt to sustainably increase the amount of domestic resources for education to ensure every child has access to equal opportunities. Any discussion of the reforms needs to take into account the political economy context which resists tax reforms.

In **the short term**, it is important to ensure communities and schools that need resources the most are receiving them. Policy research in recent years has exploited improved information management systems to detect and describe district, constituency, and school level infrastructure and facility provision. Government departments in some provinces have made significant progress in utilizing school census information for planning purposes (notably Punjab). However, there is considerable variation in provincial capacities to use data for planning, and to link budgeting to desired outcomes. In the short term, donors can support capacity building for planning to improve public finance management, and domestic resource mobilization through aid for education.

The formula for resource distribution within provinces as across provinces could help to address regional equity needs. Punjab is actively working on developing a formula for resource distribution that can make help prioritize development needs, including education indicators (particularly out of school children), as triggers for resource allocation. Lessons from this could be used to inform approaches in the other provinces.

Improving the quality of public service delivery and making it visible for citizens will improve the state's moral authority to demand taxes, and improve voluntary tax compliance. If people are able to connect service provision to the taxes they pay, voluntary compliance may increase. Local governments are in a better position to take the lead in this than central or provincial governments too far removed from citizens. For example, a local government tax on schools can be charged.

Reforming the tax system requires **medium to long term** engagement and reform. In the medium term, tax reforms should focus on shifting the balance between taxes collected at the federal and provincial levels, and extend taxes that can be collected in the provinces (while leaving some at federal level for redistribution across provinces) – both with potential for progressive tax mobilization and equity of spending, particularly when combined with sub-provincial resource distribution reform. There is also a need to shift the balance of type of taxes collected towards more progressive income taxes.

Tax reforms in Pakistan so far have been driven by ease of collection rather than considerations of equity and sustainability. An outcome of a combination of factors, including policy myopia, over reliance on external borrowing, and political economy factors discussed above. Any meaningful tax reforms are long term. Many of the steps that need to be taken by the government are well known and documented – for example documentation of income and the informal economy, penalties for tax evasion, tax rationalization incentives for the corporate sector to pay, technical and structural reform of the tax collection machinery. However, these require tackling political economy issues.

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Haris Gazdar – Senior Economist at Collective of Social Science Research (Advisor, Govt. of Sindh; Member of Provincial Finance Commission)
Asad Sayeed – Senior Economist at Collective for Social Science Research
Ijaz Nabi - Country Director, International Growth Centre (Advisor, Prime Minister's Council of Economic Advisors; Chief Minister's Economic Advisory Council, Punjab).
Anjum Nasim – Senior Research Fellow, Institute of Development and Economic Alternatives
Dr. Hanid Mukhtar - former Senior Economist (World Bank)
Naveed Sheikh – Deputy Secretary (Education and Literacy Dept, Government of Sindh)
Afzal Latif - Elementary and Secondary Education Department, Govt. of KPK
Dr. Kaiser Bengali – Senior Economist (Advisor, Government of Sindh; Govt. of Balochistan)
Faisal Rasheed – Advisor, Sub-national Governance Program (DfID), Oxford Policy Management