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Fiscal Decentralization in Pakistan: 7th NFC Award as Case Study

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Abstract

The globalization and its associated challenges have transformed the concept of decentralization from mere business of local government to a broader concept of Governance. By transferring payments to lower tiers of government, the central government actually tries to involve all federating units in economic development of the country. After independence, the Government of Pakistan adopted the colonial fiscal structure for payments and grants between the Centre and provinces but this mechanism could not be put into practice due to undemocratic political culture. The resource distribution formulas were often condemned by the smaller provinces being unjust. After enactment of 18th amendment to the 1973 Constitution, provinces were given more financial and administrative autonomy through 7th NFC Award based on the criterion of population, backwardness and inverse population density (IPD). This study finds that the constitutional reforms and 7th NFC award has strengthen the perception about provincial autonomy but due to capacity issues, benefits of fiscal decentralization could not be achieved in Pakistan.

Keywords: Fiscal Federalism and Decentralization, Provincial Autonomy, NFC Award, Pakistan.

1. Introduction

Fiscal Federalism or fiscal decentralization has been remained an important area of debate for the experts since long, especially after World War II when worldwide initiatives for revamping the institutional structures for emerging world got pace. Etymologically speaking, word federation has been extracted from Latin word “Foedus”, meaning “covenant” or a written statute or agreement, it means the circulation of power in an organization between a vital authority and the constituent units, which provides constitutional guarantee of protection and safeguard. In nutshell, fiscal decentralization or federalism can be described as an important tool to achieve economic efficiency by giving financial autonomy to the lower level governments. Fiscal decentralization on one hand empowers the lower level governments financially as well as administratively and on the other hand it enables them to share the workload of the central government. By transferring payments or grants to lower tiers or through sharing its revenues with lower levels of the government, the central government actually tries to involve all federating units in economic development of the country.

2. Aim and Scope of the Study

Irrespective of the ideological or political differences, almost each and every state needs some sort of decentralization to conduct the daily business. Decentralization in large states enables the government to conduct the daily business of revenue collection, care of law and order and agreeing the problem of inaccessibility to the remote areas. Furthermore, States with uneven economic developments, ethnic diversities and cultural variations always demand some sort of decentralization to encounter centrifugal tendencies. The globalization and its associated challenges have transformed the subject of decentralization from mere business of local government to a broader concept of Governance. The study will help to evaluate the fiscal federalism of Pakistan, a country having a long history of confrontation between federation and its units. It will certainly help other developing countries facing the similar challenges to reform and redesign their respective political and financial institutions. By employing case study approach it has been tried to analyze the impact of 7th National Finance Commission Award (NFC Award) on the overall economic growth of the country whereby financial resources are placed at the disposal of provinces to achieve the benefits of the fiscal decentralization? In addition, it will also be tried to see as to whether the 18th Amendment was the best available remedy for the long standing problem of political, administrative and financial autonomies for the provinces?

3. Methodology

This paper is semi-qualitative based on document analysis coupled with strong empirical data gathered from intellectual discourse on the issue and divided into three parts. The first part is the overview of fiscal federation in the post-independence era while the second part is the critical analysis of the initiatives taken by various governments in Pakistan. The third and last part consists of conclusion and recommendations.

4. Fiscal Federation in the Post-independence Era

Pakistan being colonial state inherited governance structure from its British masters and after independence, the Government of Pakistan adopted the same structure of fiscal decentralization for the better arrangement of payments and grants between the Centre and its federating units but this mechanism could not be put into practice due to undemocratic political culture and frequent military interventions. After independence, the Government of India Act 1935 was adopted as interim constitution, which besides other also defined responsibilities between the federation and the provinces. Under the said Act, 96 items were enlisted in respect of which the federal government was empowered to legislate; however, these 96 items were reduced to 56 in 1956's Constitution but was retained in the Constitution of 1962. The constitution of 1973 provided two lists i.e. Federal Legislative List enumerating powers of the federal government and Concurrent List consisting upon the subjects on which federal and provincial governments can legislate.

It is quite interesting to note that before independence, the Muslim League (ML) the founding party of Pakistan was a flag bearer of provincial autonomy and it was specially highlighted in the 1940's Lahore Resolution. It was held that without a clear acknowledgement of provincial rights and autonomy it would not have been feasible for the ML to get the 1940 Resolution adopted. Unfortunately, after independence, the government became gradually more centralized. The shortage of resources and the absence of constitutional protections were considered main causes of that shift. To overcome shortage of resources, at first the centre demanded the right to charge some taxes that were to be levied by the provinces but later on, the change was made permanent under a new economic package. In the same way while tackling the problems of drafting new constitution, the leadership deliberately disregarded and ignored its traditional acknowledgement of rights and autonomy for the units making up the federation.

The constitution of 1956 strained the province-centre relations and the constitution of 1962 failed to mend the damages and eventually forced the Bengalis out of Pakistan. After separation of Bangladesh, the ruling caucus understood that a descent to address the anxieties of provincial units could jeopardize the country's honesty and even existence. That's why, in the 1973 Composition, some enterprises were considered to be the federating units. In his speech while giving the Constitution Bill, the Law Minister Abdul Hafiz Pirzada admired federalism to the degree of signifying that it was absurd to think of Pakistan without thinking about federalism. He said that for some years there had been demands for equilibrium between the authorities of the president and the prime minister, while the real problem was the lack of federalism. But once again, while hovering the edifice of the federation, the political rights that should have been conceded to the provinces were not understood and the provinces were politically as well as financially reliant on the Centre. During the next three decades, Pakistani nation has to bear the aftershocks of that unrealistic and irrational approach of addressing the national problems.

The federation has stanchly been facing criticism from its units for violating the constitutional compulsion to grant administrative and fiscal autonomy. After the restoration of democracy in 2008, all federating units along with Centre reached at a consensus to bring required changes in the Constitution to meet the demands of balance of powers between the federation and provinces. On April 19, 2010 the "Parliament of Pakistan" passed 18th Amendment to the Constitution which is a hallmark in the constitutional history of the country through which not only true parliamentary system was restored but the abnormality introduced in the Constitution of 1973 during Military regimes by dictators were also pulled out. The provinces were given more financial and administrative autonomy. By introducing 18th Amendment in the Constitution of Islamic Republic of Pakistan, the political leadership has initiated the process of reforms in the administrative, financial and political structure of the government. These initiatives also envisaged large scale fiscal decentralization enabling the provinces to manage and utilize its resources for socio economic development.

5. Initiatives Taken by various Governments to Enhance the Provincial Autonomy

Though the 18th amendment has enhanced the quantum of provincial autonomy but on the same time has raised new challenges for the federal and provincial governments. Since it has been almost four year after passage of 18th amendment; therefore it is the time to discuss the outcome of claims of provincial autonomy and evaluate the legal and administrative implications of devolution of financial powers to the provinces. The elimination of Concurrent List was a long-standing request of the provinces because it was considered colonial legacy designed to give the provinces impression of ownership in certain areas but retaining a safety valve for central government to demonstrate its authority as and when required. This concern of provinces was duly considered in the 18th amendment and Concurrent List containing subjects, on which both the Federal and Provincial Assemblies could make laws, were absent except Criminal Procedure, Criminal Laws and Evidence Law, on which both the Parliament and the Provincial Legislatures can brand laws.

After 18th amendment, the Constitution of 1973, being the federal in nature, has been significantly rehabilitated. Initially, 114 items of power were booked by the central government, out of which 34 have been transferred to provinces, which not only has allowed autonomy to the provinces politically but financially also. After delegation of 17 ministries to provinces, errands have been detached to provinces. The essential of this devolution was the transmission of the functions related to the decentralized federal ministries to provinces in letter and spirit but it could not be appeared because of sure political and administrative problems.

The chief attention of this regionalization was to allow and brace provincial governments to track their official business more self-reliantly, so, the allocation of errands was the first step to advance the efficacy of the anew congenital launches and wings under local departments. On the other hand, shifting of revenue creating departments was the second step to progress the financial resources of the provinces, aiding them to be more independent, self-relied and having more space for financial decision making. No disbelief, the experiment of increased regionalization is a new marvel and have created manifold paradoxical issues among federation and provinces but the Council of Common Interest (CCI) is the remedial platform for resolving these issues within the legal frame work but question arises that how much effective and efficient role could this platform of CCI play, so, the overall reform strategy can be judged in this scenario along with NFC awards.

A. Redefining the Role of the CCI

As per 18th constitutional amendment, CCI has been assumed as the constitutional guard and financial decisions made by CCI cannot be upturned. Vide 18th amendment; the bodies of CCI and the National Economic Council (NEC) are further supported. Beforehand, these institutions were quiescent and the smaller provinces had always demanded their instigation. By leaving down processes for their working, the 18th amendment furnished new spirit to the relations between the Federation and the Provinces. The change in the composition of CCI is an important tread towards provincial autonomy and settling disputes vis-à-vis provision of wherewithal through shared headship. The Council is instructed to frame and order policies in relation to Part II of the Federal Legislative List and exercise direction and control over related institutions. In settling its tasks, the Council is sure to meet at least once in three months. In addition to the condition of mandatory meeting of CCI after every three months, it has surefire the involvement of all provinces in the matters pertaining to their collective interest. Further, positive new accesses have also been added to the Federal Legislative List part II, which shall now be jointly painstaking by the CCI.

These entries are:

- Supervision and management of public debt
- Federal regulatory authorities
- Inter-provincial coordination matters

B. Efforts to Fortify Finances of the Provinces

Through 18th amendment, various significant variations are carried to augment the income resources of the provinces. Under new inserted Article 161 (a) the Federal Excise Duty calm on gas "shall not form part of the Federal Consolidated Fund and shall be remunerated to the province in which the well-head is located". Article 161 (b) also afford that the Federal Excise Duty placid on oil well-heads shall vim to the province in which the oil well-head is situated. Another momentous development is the readiness of international loans to provinces for their development projects which was previously routed through the Economic Affairs Division.

Since the actions were long and awkward which often occasioned in cost boom or waning the practicality of the projects. Besides, since these loans are running scared done the Federal Government; therefore, these loans were moved to provinces on the higher interest rate than it was established from the plagiarizing agency and in this way federation was receiving vast money on the loans used by the provinces. Now, after the 18th amendment, this practice has been altered. Too, the provinces have been specified the power to advance domestic or international loans or spring guarantees on the security of the Provincial Consolidated Fund (PCF) with the approval of the NEC. Other main changes which conveyed bonus resources under the province of provinces are that the lands, minerals and other things of value underlying the ocean in the territorial waters of Pakistan will be kept by the provinces in its place in spite of the Federal Government. Likewise, the mineral oil and natural gas within the Province or the territorial waters head-to-head thereto shall vest together and equally in that Province and the Federal Government.

6. Revenue Sharing Formula

In united India, Niemeyer Award founded under the Government of India Act 1935 was followed for supply of resources between federal and provincial governments. Later the independence, the mission of voicing workable formula for sharing income between federation and its units was assigned to Sir Jeremy Raisman, who presented a formula in December, 1947 under which the income tax, general sales tax, wealth tax, capital gains tax, and custom duties were comprised in the federal divisible pool. Since portrayal of 1973 Constitution, seven National Finance Commissions have been instituted out of which only four have crooked up with approved bounds of resource dissemination between federation and its units.

The first Award was vacant in 1974, whereby some taxes were comprised in the divisible pool, population was cast-off as criterion for redistribution of resources and ratio of 20:80 was fixed for plumb delivery of resources among federal and provincial governments. As population was the only criteria for supply of resources therefore Punjab's share increased from 56.50 percent to 60.25 percent causing drop off in the share of other provinces. The fourth NFC Award was one of the accord awards which were created in 1990 under the government of the Prime Minister Nawaz Sharif. That award noticeably amplified the volume of provincial shares in the federal revenue around 18 percent as matched to the first NFC Award. For the first time, the provinces' right on the net hydel profit, development surcharge on gas and excise duty on crude oil was approved and amounts were moved in the form of straight transfers to the provinces. Inopportunely, after that, none of the government could endow to grasp on consensus on delivery of financial resources till the approval of the 7th NFC Award.

7. Salient Features of 7th NFC Award

A less methodical approach was accepted to decentralize the financial matters in Pakistan since the 6th NFC award. Over time, dividable pool has been frenzied due to profound poise on indirect taxes as well as buttressing in the collection. Population was the sole spreading criteria in all NFC awards from the divisible pool. This has up stretched a lot of rasping among the provinces. The lack of technical expertise and perpetuity of the NFC is another disablement. The matter of resource sharing among federal and provincial governments is a prolific tricky question. In history, the problem of resource delivery was never taken acutely.

It is also very intricate for the reason that compromise of all the stakeholders is mandatory for developing any new NFC awarding formula. In the 7th NFC award resolution, Sindh, Balochistan and KPK sought various criteria, whereas, Punjab was anxious in the sole population criteria. Sindh also wanted substantial share for revenue (Sales Tax, Services collection) and Balochistan, being the prevalent and speckled populous province has prominences on the inverse population density. (Table 1) NFC Award is a constitutional must under Article 160 of the 1973 Constitution of Islamic Republic of Pakistan and it is requisite for the government to fuse NFC Award after every 5 years for the agreeable resource diffusion between the federation and its particular units. Provinces then also reorganize revenues between lower levels of the government, done revenue sharing formula i.e. Provincial Finance Commission (PFC) Awards. (Figure 1) NFC Award is a step forward for fiscal confederacy as it will upshot into accountability, equity, cost effectiveness and opportunities for sanctioning and serving the masses. This dispersal of resources has considerate impact on the escalation and expansion of any region, area or locality. Resultantly, it perturbs their income level, backwardness, poverty and its attenuation. One way of distribution of resources is formula based which includes:

i. NFC
ii. PFC
iii. Federal to Local
iv. Local to Local

The other scheme is random connections like change, different grants, executive, unrestricted and parliamentarian funds etc. Seven NFC Awards were instigated so far. The first Award which was portrayed by Mr. Zulfiqar Ali Bhutto government in 1974, under which infection taxes were comprised in the clip-on pool, which comprised of income tax, sales tax and export duty while the criterion used for resource relocation was optional to the population and resources were abruptly distributed at a fixed ratio of 20:80 among the federal and provincial governments. Punjab's share improved from 56.50% to 60.25% while the other three provinces anguished, with Sindh suffering the most because population being the sole criterion thinning out this situation and extended up to 16 years. (Figure 2) NFCs were unable to issue an award in 2000 and 2005, due to lack of consensus amongst provinces on the following issues:

- Which taxes are to contain in the detachable pool and what will be the size of respective share of federal and pooled provincial government in the pool?
- Dispersal amid the provinces → fiscal equalization Criterion for dispersal - Population agreed weight (flouting other dials such as tax effort, area, IPD, backwardness/poverty etc.)
- How to incentivize resource enlistment in the provinces as financial dependence of the provinces to evade soft budget restraints?

In Pakistan, the resource distribution formulas are often condemned by the smaller provinces being unjust and unrealistic. The provinces are given their share according to the National Finance Commission Award and the provinces distribute it through the PFC. NFC awards are based on different criterion i.e. population, area and backwardness etc. Decentralization, being an important growth accelerating measure helps the lower governments to act as an agent of the central government in more responsible and efficient manner to implement social policies because lower level of government is in better position to know the needs of the people and different regions falling under their domain. In other words, decentralization enables the journeying of efficient resource allocation and its proficient utilization.

Unfortunately, Pakistan's economy is under pressure due to energy shortages, law and order and governance issues. These critical issues are adversely affecting the economic growth and forcing the federal government to revise tax collection targets. In addition, due to none achievement of anticipated targets, agreed share from the federal divisible pool could not be transferred to the provinces which have limited the fiscal space to undertake development projects, forcing the provinces to look for federal grants. In the budget for the fiscal year 2013-14, revenue targets of Rs. 2475 billion has been set. Whereas, federal government's total revenues are estimated at Rs. 3420 billion, out of which Rs. 1502 billion is the share of provinces. Then again, the federal expenditure under debt servicing, defense affairs and services and other affairs are estimated as Rs. 2056 billion which shows that there is deficit of Rs. 138 billion, compelling the government for more borrowings. Similar state of affairs was witnessed during the year 2012-13; resultantly the provinces could not get the promised amounts from NFC.

This has goaded the fiscal deficit which is high-flying in the provincial budgets. After the historic 18th amendment, the provinces of Punjab and Sindh have taken few initiatives to generate financial resources to trounce the fiscal deficit but the ongoing war against terror in the province of Khyber Pakhtunkhawa and mutiny in Balochistan has not only thinned the investment opportunities rather overburdened the federal as well as provincial governments to expend extra resources on improving law and order situation. Therefore, it can be safely concluded that even with increase in the volume of transfers to provinces, no positive impact on the economic growth is witnessed.

8. Conclusion and Recommendations

Overall this study finds that the constitutional reforms introduced through 18th amendment followed by the accord 7th NFC award, have strengthen the perception about the provincial autonomy but due to non availability of proper implementing apparatus and incapacity to engender extra financial resources, the benefit of fiscal decentralization could not be achieved. To realize the objectives of decentralization following actions are recommended;

i. After 18th amendment, responsibility to maintain fiscal discipline has now been transferred to the provinces; therefore, efforts are required to be done for capacity building of province to manage financial resources prudently.
ii. Presently, right to levy tax vests in the federal government which is also an hurdle for provinces to spawn extra resources, therefore, the provinces should be given right to levy indirect taxes on goods and services within their respective jurisdiction to minimize their reliance on taxes collected by the federal government.
iii. With limited and unpredicted financial resources, it is not practically possible for the federal and provincial governments to undertake substantive projects for social uplift of marginalized and deprived segments of the society; therefore, measures should not only be taken to improve the tax collection but also for extending its sphere.
iv. Share of provinces promised in the 7th NFC award may immediately be transferred to the provinces to provide them fiscal space to undertake social economic development programmes for timely provision of social services to the masses.
v. Over the past so many years, deteriorating law and order situation has cost damaging effects on the Pakistan's economy. On the one hand billions of rupees are being spent on fighting against militants and maintaining law and order while on the other this internal strife is hindering internal and Foreign Direct Investment (FDI). Therefore, there is dire need to normalize law and order situation to attract investments. In this regard, the political leadership has to come forward and formulate a coherent policy by setting aside their political differences.

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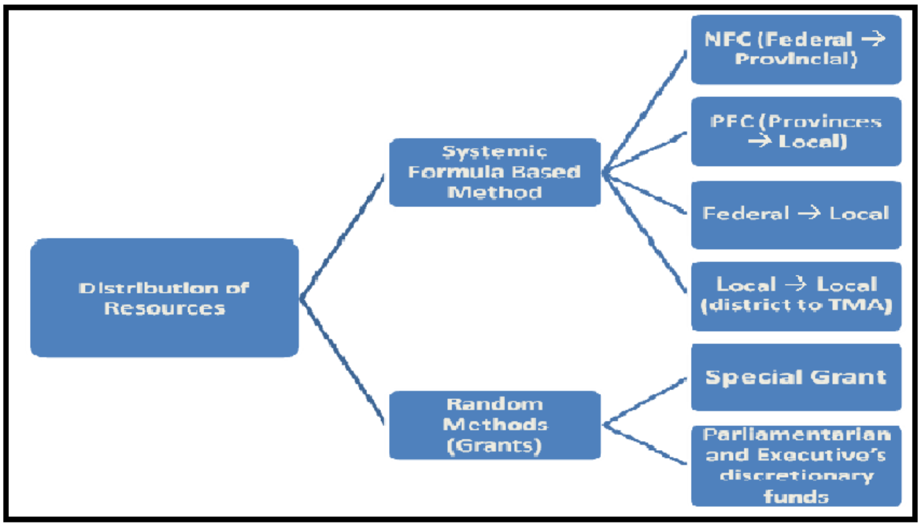

Figure 1: Distribution of Resources

Trend in share of total transfers in federal tax revenues			
	Total Transfers (in Rs billion)	Total Transfers as %age of federal taxes	Divisible pool transfers & special grants as %age of federal taxes
1990-91 pre 1990 NFC	33.8	30.2	28.7
1991-92 post 1990 NFC	65.8	46.4	34.9
1996-97 pre 1996 NFC	139.4	46.4	43.0
1997-98 Post 1996 NFC	131.7	44.9	37.9
2005-06 pre 2006 order	316.0	41.2	33.0
2007-08 post 2006 order	490.8	50.2	41.5
2008-09 post 2006 order	606.0	51.4	43.9

Figure 2: Increasing Reliance on Transfers

Share in total transfers by provinces					
	Total Federal Transfers in Rs billion	Punjab	Sindh	KP	Balochistan
1990-91 pre 1990 NF	33.8	55.3	24.0	12.7	7.9
1991-92 post 1990 NFC	65.8	45.1	23.9	19.0	12.0
1996-97 pre 1996 NFC	139.4	51.3	24.9	15.9	7.9
1997-98 Post 1996 NFC	131.7	47.0	23.8	17.8	11.4
2005-06 pre 2006 order	316.0	47.1	30.1	14.4	8.4
2007-08 post 2006 order	490.8	47.3	29.8	14.8	8.0
2008-09 post 2006 order	606.0	46.5	30.2	14.7	**8.6**

Source: Chapter 7: Fiscal Decentralization: Strengthening Provincial Finances (BNU Third Annual Report, 2010

Table 1: Revenue Sharing Formula for 7th NFC Award, 2009

Indicator	Pakistan	Punjab	Sindh	Balochistan	KPK
Population	82	57.36	23.71	5.11	13.82
Backwardness/poverty	10.3	23.16	23.41	25.61	27.82
Revenue Generation / Collection	5	44.0	50.0	1.0	5.0
IPD (Inverse Population Density)	2.7	4.34	7.21	81.92	6.54
Total Share	100	51.74	24.55	**9.09**	14.62

Source: http://www.pide.org.pk/pdf/seminar/seminar148.pdf