National Finance Commission Awards in Pakistan: A Historical Perspective

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ABSTRACT

This study explores the evolution of fiscal resource distribution in Pakistan. Pakistan is a federation comprising four provinces, federally-administered areas, and the Islamabad Capital Territory. Being a central type of government, most of the revenues are collected by the centre and then redistributed vertically between the federal and the provincial governments, and horizontally among the provinces. Provinces then also redistribute revenues among lower tiers of the government, through a revenue-sharing formula. A thorough look at the history indicates that this process has been complex and has a far-reaching impact. A less systematic approach has been adopted to decentralise the financial matters. Over time, the divisible pool has expanded due to heavy reliance on indirect taxes as well as improvement in the collection. Population is the sole distribution criteria, adopted in all NFC awards from the divisible pool. This has raised friction among the provinces, necessitating inclusion of other potential variables evolved from international best practices. In addition to that, absence of technical experts and permanency of the NFC is another impediment. The NFC is supposed to provide the framework for amicable distribution of resources between the federal and the provincial governments for the joint goal of development and prosperity.

JEL classification: H71, H72, H73, H77

Keywords: NFC, Pakistan, Fiscal Federalism, Rule and Discretion, Political Economy, Population, Subventions, Doing the Business of Government

1. INTRODUCTION

Pakistan is a federation comprising of four provinces, federally administered tribal areas, northern areas and Islamabad Capital Territory. Being a central type of government, most of the revenue are collected by centre and then redistributed vertically between federal and provincial governments and horizontally among the provinces. While the provinces further redistribute the revenue through a revenue sharing formula amongst the lower tiers of the government. The resource transfer paradigm had been a major bone of contention among the federation and the federating units. With the implementation of devolution plan, the government has devolved various functional assignments to the local tiers of the administration. Nevertheless, there are large fiscal deficits among these local tiers on the part of public service delivery as of their assignments, mainly due to concentration of revenue collection at centre through major tax heads. For proper service delivery there is a need for higher share for the provinces in the NFC awards. These resource transfers can be broadly categorised as systematic (formula based) method of resource transfer and the other being random method (grants etc.). Under the systematic basis there are four stages [Jaffery and Sadaqat (2006)]; firstly, revenue sharing occurs at federal and provincial government through National Finance Commission (NFC), secondly, from provincial government to local government through Provincial Finance Commission (PFC); thirdly, from federal to local government and lastly from local to local government (e.g. District Government to Tehsil Municipal Administration). On the other hand random transfers include: development/special grants, executive's discretionary funds and parliamentarian funds, etc. In this paper the focus is on the systematic resource transfers from Federal to Provinces only.

The resources transfer includes revenue shares, grants, straight transfers and loans. Among the revenues that are shared come from income tax, sales tax, custom duties, and excise duties [Jaffery and Sadaqat (2006)]. In addition there are other types of revenues, called straight transfers, are collected by federal government but paid to provinces, e.g. royalties etc. On the other hand from revenue consideration provinces are also assigned collection of minor tax assignments such as agricultural tax, stamp duties, motor vehicle tax etc and others which are levied and retained by provincial govt. Further all non-tax receipts are levied and retained by Federal government.

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National Finance Commission (NFC) has undergone many changes and has dynamically grown to its present shape. NFC is established by law for the smooth and judicious re-distribution of resources collected by centre according to the need and goals for development of federation and federating units. NFC is constituted under Article 160(1) of the 1973 constitution (Annex I) and proposed to be held at the intervals of five years. Its members are Federal Finance Minister (Chairman), Provincial Finance Ministers and other concerning experts which the President may appoint after consultation with provincial Governors [Constitution of Pakistan (1973)].

The main charter of NFC is to recommend on the following [Pakistan (2006b)]:

(1) The distribution of specified taxes, duties between federation and provinces.
(2) The disbursement of grants to provincial governments.
(3) The borrowing powers exercised by federal and provincial governments.
(4) Any other financial matter referred to commission.

As per law NFC is intended to have an amicable mechanism for resource sharing formula between the federation and provinces and amongst the provinces. On ground it faced difficulties from time to time which barred its development. There are only three awards (recommendations) as such, in the last 34 years by National Finance Commission. The most recent NFC award is of year 2006 which was announced by the President, after a deadlock between provinces and federal government on conforming to one distribution formula. During the delay period interim NFC award were used in order to make transfers.

The present study evaluates NFC award and its related issues in historical perspective of Pakistan. Further to provide some recommendations for an optimal distribution of resources between federal and provincial governments. The paper consists of four sections. After the introduction, next section is of historical perspective, with four sub headings i.e. Pre-independence resource distribution, post independence revenues sharing, during one unit period and lastly after 1973 constitution where all the seven NFC awards (following 1973 constitution) are briefly described. In the third section over time development of NFC awards is critically analysed. The final section comprises of conclusion and recommendation.

2. HISTORICAL PERSPECTIVE

This chapter analyses the historical aspects of resource sharing between the federation and the federating units. It has been further divided into four subparts as mentioned earlier i.e. pre-independence state, post-independence scenario, during One Unit period and awards following the 1973 constitution of Pakistan. These are discussed here one by one.

2.1. Pre-independence Revenue Sharing (Niemeyer Award)

Prior to independence, Niemeyer Award (under the 1935 Act) was followed to distribute the resources between federal and provincial governments of the British India. Under this award sales tax was a provincial subject while income tax collections to be redistributed were prescribed as 50 percent of the total collection. Even after the creation of Pakistan, till March 1952, same award was followed although with some adjustment in railway budget, sharing of income and sales tax [Pakistan (1991)]. In addition Sindh and NWFP were given annual grants of Rs 10 million and Rs 10.5 million, respectively. However when the financial position of Sindh improved, these grants were used to settle its federal debt thus it was virtually getting no grants at the time of independence.

2.2. Post-independence Revenue Sharing (Raisman Award)

After the independence, Sir Jeremy Raisman was assigned to formulate a feasible revenue sharing formula between federation and federating units of the country. Thus Raisman formula was presented in December, 1947 [Pakistan (1991) and Jaffery and Sadaqat (2006)] and subsequently adopted on April 1, 1952.

In that formula, to overcome the poor financial situation arising from partition federal government was given 50 percent ad hoc share of sales tax to cope with its financial crises under Raisman award. Out of the proceeds of 50 percent income tax East Pakistan government got 45 percent of the federal divisible pool while West Pakistan got the remaining share. This share was distributed as 27, 12, 8, 4, 0.6, 0.6, and 2.8 percent amongst provinces of Punjab, Sindh, NWFP and Bhawalpur, Khairpur, Balochistan states union and residual[1], respectively [Pakistan (1991)]. Under this award the subvention to NWFP was Rs 12.5 million.

2.3. Revenue Sharing under One Unit

Four provinces NWFP, Sindh, Punjab, and Balochistan of West Pakistan were declared as one unit during 1955. Earlier, these provinces were considered as separate identities as of East Pakistan. Therefore, after these arrangements there were only two units namely East and West Pakistan. Two awards for year 1961 and 1964 were announced during that period. At that time the resources were distributed only amongst East Pakistan and West Pakistan.

2.3.1. *The 1961 Award*

Under the award, out of the divisible pool (70 percent of sales tax plus other taxes), East Pakistan and West Pakistan got 54 and 46 percent share,

[1]The states that may join Pakistan after the independence.

respectively. 30 percent of sales tax was specified to the provinces on the bases of collection in their respective areas. While the remaining duties on agricultural land and capital value tax on immovable property were given to the units as per their collection [Pakistan (1991)].

2.3.2. *The 1964 Award*

The 1964 National Finance Commission was set up under article 144 of the 1962 constitution. The divisible pool consisted of collection from income tax, sales tax, excise duty and export duty. However 30 percent of sales tax was distributed in accordance with its collection in each province. The respective share out of divisible pool between centre and provinces were 35:65 percent. The share of East Pakistan and West Pakistan remained unchanged at 54 percent and 46 percent. However, on 1st July 1970 the West Pakistan was disband into Punjab, Sindh, NWFP and Balochistan, thus its share of 46 percent was distributed as 56.5, 23.5, 15.5 and 4.5 percent respectively among the new provinces [Pakistan (1991)].

2.3.3. *National Finance Committee 1970*

A committee[2] was set up to recommend for the inter-governmental resource sharing under the Federal Finance Minister on April 1970. The divisible pool remained unchanged, however the share of the federal and provincial governments in the divisible pool was considered to be 20:80 percent respectively. Out of the provincial share 54 percent was given to East Pakistan, while the remaining 46 percent was distributed among the rest of the provinces as is given in Table 1.

Table 1

Provincial Share in the 1970 Award

Punjab	Sindh	NWFP	Balochistan
56.50%	23.50%	15.50%	4.50%

Source: Pakistan (1991).

However after the separation of East Pakistan the provinces that constituted West Pakistan continued to receive their respective shares in the same proportion as stated above where as the size of revenue pie changed.

2.4. Financial Arrangements in the 1973 Constitution

Through the 1973 constitution, it was made obligatory for the government to compose NFC at an interval extending not more than 5 years for the amicable

[2]For the first time instead of a commission a committee was constituted which has lower capacity as of a commission.

resource distribution among the federation and their respective units. This was the period when the West Pakistan (existing Pakistan) started its journey after the separation of East Pakistan. The following sections briefly overview the developments after the 1973 constitution:

2.4.1. *The 1st NFC Award 1974*

In this award fewer taxes were included in the divisible pool which consisted of income tax, sales tax and export duty while the criterion used for resource redistribution was recommended to be population. Resources were vertically distributed among federal and provincial governments at a fixed ratio of 20:80 as before. As population being the sole criterion for distribution, Punjab's share had increased from 56.50 percent (1970 award) to 60.25 percent while the three other provinces suffered, with Sindh suffering the most. The horizontal resource sharing among the provinces, under 1974 NFC award is presented at Table 2.

Table 2

Provincial Share According to the 1974 NFC Award

Punjab	Sindh	NWFP	Balochistan
60.25%	22.50%	13.39%	3.86%

Source: Pakistan (1991).

Annual grants of Rs 50 and Rs 100 millions respectively were also allocated to Balochistan and NWFP government's to compensate their weak financial situation.

2.4.2. *The 2nd NFC Award 1979*

President General Zia-ul-Haq constituted the second NFC under the Chairmanship of Mr Ghulam Ishaq Khan, Federal Finance Minister in 1979. Unfortunately, it never held any meeting and resultantly made no proposals. Therefore, for resource distribution in the interim period, the 1974 award was followed. After the new census of 1981, population proportions changed and resource shares were adjusted, accordingly. This led to some what improved situation in Balochistan and Sindh while the share of NWFP remained unchanged. New resource distribution according to population share for the provinces is given in Table 3.

Table 3

Provincial Share, 1979 Award

Punjab	Sindh	NWFP	Balochistan
57.97%	23.34%	13.39%	5.30%

Source: Pakistan (2006b).

2.4.3. *The 3rd NFC Award 1985*

The third NFC was also composed during the President Zia-ul-Haq era in 1985. Although, the commission under the Chairmanship of Dr Mahbubul Haq, Federal Finance Minister, held nine meetings in three years, but could not finalise its recommendations. This was mainly contributed due to the internal as well as external political instability. Thus the third NFC award 1985 as of its previous 1979 award also failed to produce any fruits. The resource distribution from divisible pools remains same as of 1974 up to 1990.

2.4.4. *The 4th NFC Award 1990*

After almost 16 years of break in declaring a consensus NFC award, the 1990 NFC award came up with some positive recommendations in April 1991 under the democratic government of Prime Minister Nawaz Sharif. The commission was headed by Mr Sartaj Aziz, Federal Finance Minister. The most significant development under this award was the expansion of the divisible pool. The excise duties on sugar and tobacco which were part of non divisible pool earlier now become a part of divisible pool in this award. The divisible pool under fourth NFC award 1990 consists of number of taxes/duties which include income tax, sales tax, export duty and excise duty. However, custom duty still remained with Federal government. The commission failed to achieve consensus for the diversification in the resource sharing formula despite the demands from the provinces. Thus still population remained the sole element for revenue sharing criteria in the NFC award. Revenue deficits were adopted as the basis for determining the amount of subvention requirement. The sharing of the divisible pool between federal and provincial governments continued to remain at 20:80 percent, respectively [Ghaus and Pasha (1994)].

However, from the resource transfer side the 1990 award significantly increased the volume of provincial shares in the revenue collected (by federal government) by around 18 percent as compared to 1974 award. This increase was due to the inclusion of excise duty on two items (sugar and tobacco) in the divisible pool. This award was a move forward towards fiscal decentralisation by extending more financial autonomy to the provinces. In addition to this for the first time the provinces right on net hydel profit, development surcharge (on gas) and excise duty on crude oil was admitted and amounts relocated in the shape of straight transfers to the provinces. Resultantly, the transfers to provinces increased from 28 percent (Rs 39 billions) to 45 percent (Rs 64 billion) of federal tax revenue [Ghaus and Pasha (1994)]. The percentage shares which provinces got under this award are presented at Table 4.

Table 4

Provincial Share, 1990 Award

Punjab	Sindh	NWFP	Balochistan
57.88%	23.28%	13.54%	5.30%

Source: Pakistan (1991).

The proportion of horizontal distribution remained the same because population was still the sole criteria for resource distribution and there was no census since 1981. However, the volume of money transfer from federal and provincial government had increased due to inclusion of more items in the divisible pool. On the other hand to meet the developmental need of the provinces special grants to the provinces were also provided (Table 5).

Table 5

Special Annual Grant to Provinces in 4th NFC, 1990

(Rs Million)

Amount/Years	Punjab	Sindh	NWFP	Balochistan
Amount	1000	700	200	100
Next Years	3	5	3	3

Source: Pakistan (1991).

Although, there was an increase in the financial transaction from the divisible pool to the provinces and they were also advised to generate funds from their own revenues. But the required autonomy to motivate as well as capacity building for generating their own revenues was missing [Jaffery and Sadaqat (2006)].

2.4.5. *The 5th NFC Award 1996*

Malik Meraj Khalid, the caretaker Prime Minister, constituted NFC in December, 1996. Mr Shahid Javed Burki, Finance Minister was its Chairman. The commission announced the award in February 1997. All taxes/duties were included in the divisible pool. Which comprised: (a) income tax (b) wealth tax (c) capital value tax (d) sales tax (e) export duties (f) custom duties (g) excise duties (excluding excise duty on gas, charged at wellhead), and (h) any other tax collected by federal government. In addition to that, royalties on crude oil and net development surcharges on natural gas were also given to the provinces. Incentive of matching grant was introduced, although up to a certain limit, to the provincial governments that if they exceed their revenue growth target of 14.2 percent they would be provided matching grants [Pakistan (1996)]. The maximum limits of matching grants specified to different provinces are presented at Table 6.

Table 6

Matching Grants under the 1996 Award

(Rs Million)

Punjab	Sindh	NWFP	Balochistan
500	500	100	100

Source: Pakistan (1996).

An important aspect of 1996 NFC award was that it bifurcated the public expenditures into priority and non-priority expenditures. The priority expenditure were described as expenses on defense, debt servicing, social sector and development expenditures while those on general administration, community services and law and order were termed to be the non-priority expenditures [Sabir (2001)]. This was done to solve the emerging financial and other challenges, issues and accordingly prioritise the path of development.

However, due to the inclusion of all taxes in the divisible pool, the share of provincial government from the divisible pool changed drastically. The share to the federal government was assigned to be 62.5 percent (earlier it was 20 percent) while that of provinces to be 37.5 percent (earlier it was 80 percent). This ratio was actually suggested by the 1985 NFC but was adopted later on in this award. Then the shares in the divisible pool were further revised according to 1998 population census with effect from 1st July 2002.

The drastic shift in provincial shares was based on the optimistic projections of higher GDP growth and desired inflation rate. But during the period when the award was going to be exercised, the provinces were adversely affected due to certain internal and external shocks and the economy did not responded accordingly. So there is a perception that if the previous award of 1990 still continued to prevail at that time, the provinces would have been in a better financial position [Sabir (2001)]. With no change in resource sharing element, population still being the sole criteria, the percentage provincial share remained the same as with maximum 57.88 and minimum 5.3 percent of Punjab and Balochistan, respectively (Table 7).

Table 7

Percentage Provincial Share, 1996 Award

Punjab	Sindh	NWFP	Balochistan
57.88	23.28	13.54	5.30

Source: Pakistan (1996).

Keeping in view the meager financial situation in NWFP and Balochistan, special grants of 3.3 and 4 billions rupees were given to these provinces for the next five years (Table 8). These amounts were also subject to be adjusted in the line of inflation.

Table 8

Special Annual Grant to Provinces in the 5th NFC Award

(Rs Billion)

Amount/Years	Punjab	Sindh	NWFP	Balochistan
Amount	–	–	3.31*	4.08*
Next Years	–	–	5	5

Source: Pakistan (1996).
* To be adjusted for inflation.

2.4.6. *The 6th NFC Award 2000*

On 22nd July 2000 General Pervaiz Musharraf, President of Pakistan constituted NFC under the Chairmanship of Mr Shaukat Aziz, the Federal Finance Minister. It held 11 meetings since then but could not finalise its recommendations due to lack of consensus among its members. Provinces were demanding for higher share in the divisible pool (upto 50 percent) as well as the diversification of the distribution criteria.

2.4.7. *The 7th NFC Award 2006*

Similarly the new NFC was constituted on 21st July, 2005, but it met with the same result by having no consensus among the members to have a mutually acceptable mechanism for judicious resource distribution. This gave rise to a deadlock and finally all the provincial Chief Ministers vested the authority to the President to announce a just award. As a result the President under Article 160(6) of the Constitution of Islamic Republic of Pakistan, through Ordinance No. 1 of 2006, made amendment in the “Distribution of Revenues and Grants-in-Aid Order, 1997”. Consequently the new NFC was announced to take effect from 1st July 2006 [Pakistan (2006 a)].

Under the award, the provincial share was revised and decided to be 45 percent (share in total divisible pool + grants) for the 1st financial year and would reach 50 percent with subsequent increase of 1 percent per annum. The divisible pool consisted of the items i.e. (a) income tax (b) wealth tax (c) capital value tax (d) sales tax (e) export duties (f) custom duties (g) excise duties (excluding excise duty on gas, charged at wellhead), and (h) any other tax collected by federal government [Pakistan (2006a)]. With the robust economic growth during the period of award the Federal Government has enough resources to distribute among the provinces. In the financial year 2007-08, total amount of Rs 497 billion is projected to be given to the provinces, which was Rs 418 billion last year. This would be 46 percent of the divisible pool i.e. 1 percent higher than previous year’s allocation [Federal Budget Speech (2007-08)]. The size of the pie has considerably increased (Figure 1). Net proceeds equal to 1/6th of Sales tax are given to the provinces to transfer it further to the district government and cantonment boards. Its share for Punjab, Sindh, NWFP and Balochistan was 50.00, 34.85, 9.93 and 5.22 percent, respectively [Pakistan (2006a)]. While the provincial share out of the divisible pool is given as (Table 9).

Table 9

Percentage Provincial Share, 2006 Award

Punjab	Sindh	NWFP	Balochistan
57.36	23.71	13.82	5.11

Source: Pakistan (2006a).

Total subvention/grants for provinces were enhanced from Rs 8.7 billion to Rs 27.75 billion which will further increase annually in line with the growth of net proceeds. Punjab and Sindh which were not given any grants in the previous award, but in this award they were also entitled to receive 3.05 and 5.83 billion rupees (Table 10). So the total increase in the resource transfer from Federal to Provincial government in the form of share and subventions has an increase of almost 51 billion [Pakistan (2006b)].

Table 10

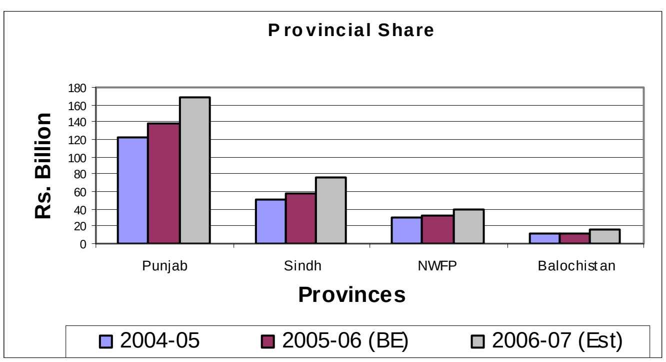
Special Grants to Provinces under the 2006 Award

(Rs Billion)

	2005-06 (BE**)	2006-07 (Estimates)
Punjab	–	3.05
Sindh	–	5.83
NWFP	3.9*	9.71
Balochistan	4.8*	9.16
Total	8.7	27.75

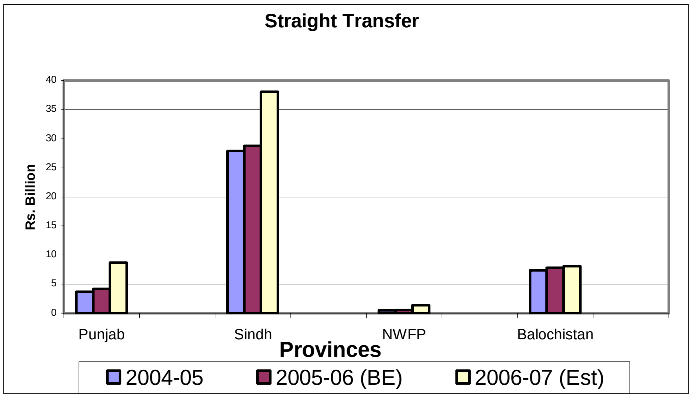
Source: Pakistan (2006b).
* Adjusted for inflation.
** Budget Estimates.

Fig. 1. Provincial Shares in Different Years



Source: Pakistan (2006b).

Fig. 2. Straight Transfers to Provinces



Source: Pakistan (2006b).

The other important development in this award was the increase in the straight transfers of royalties on Gas and Crude Oil, excise duty on Gas and Gas Development Surcharge. In addition, the NWFP Government is also receiving net hydel profit from WAPDA at a capped level of Rs 6 billion annually [Pakistan (2006b)]. There is substantial annual increase in these amounts over time (Figure 2). It is important to indicate that Sindh is the highest receiver of the amount through straight transfers. Current NFC award gives province a higher command on monetary resources and their revenue continue to grow over time as well.

In addition to straight transfers, Federal Government under Public Sector Development Programme (PSDP) also finances the province's different development projects either with full funds or with 50:50 shares. The non-developments funds transferred to provinces include compensation for victims of natural calamity and any uncontrolled situation.

3. DEVELOPMENT OF NFC AWARDS OVER TIME

Financial resources are playing imperative role for the development. Its judicial and equitable distribution is necessary to build up any under develop or under privilege area/location. The current state of resource distribution has evolved over time. Various improvements have been made in the resource sharing mechanism among the federal and provincial governments. In the following section we would describe the important aspects of different awards and their impact on the fiscal decentralisation in the country.

In Pakistan fiscal federalism remained a focal issue of confederation. Out of total of seven commissions (constituted after 1973 constitution), only four has come up with additional parameters to distribute the resources among the federating units. Over time the federal government had been more centralised rather than devolving the affairs both from the financing and expenditure side to lower tier. This has poorly affected the performance and created disincentives for the provincial governments to work efficiently. The main responsibilities of Central government are to determine the foreign policy, defense matters, communications, currency and debt servicing. In addition to that it has the responsibility of general administration, maintaining law and order, look after the industrial development and elements of public welfare including education and health. Thus in order to take care of all these matters the federal government requires resources.

With the passage of time, federal government has overstretched itself into several matters that are purely the provincial subject. This has increased both administrative and financial burden on federal government. These augmented activities include roads, irrigation, some aspects of agricultural sector (like quality control), culture and tourism, youth affairs, and rural development. These are the sectors which can be transferred to the provinces to save time and money. Specifically, when the government is eyeing towards devolution of power from centre to local government, it is necessary that these tiers of government should have proper finances. The federal government generates about 93 percent resources despite the fact that its share in total expenditure is only 72 percent. On the contrary, the provinces are left with only 7 percent resources although it account for around 28 percent aggregate expenditure [Khan (2006)]. The argument behind the higher collection by the federation is based on the achievement of equity, efficiency, economy, and the federal government's ability to levy and collect [Kardar (2006)]. But provincial and local governments are thus left with lesser opportunities to generate their own resources because the available resources are already exhausted. Therefore, it results in dependency of provinces on the federation for resource transfer.

NFC, although had less agreements of award, remained very consistent with the population as the only criterion for resource distribution between federal and provincial governments. It gives us an idea about the stagnancy and lack of coordination in our policy making. It is worth mentioning that population is not the sole criterion for resource distribution anywhere in the world otherwise. Throughout, the world various factors like revenue generation, poverty, population density, income distribution, backwardness, etc are used to disaggregate the federal tax revenues. Consequently, over the period of time there is no serious shift in resource distribution among the provinces despite vast differences in the economic conditions of the masses, future prospects and strategic objectives for different federating units of the country. Figure 3 and 4 depict the overall situation of NFC award and its percentage allocation over the period of time among different provinces. (See Annex II)

Fig. 3. NFC over Time

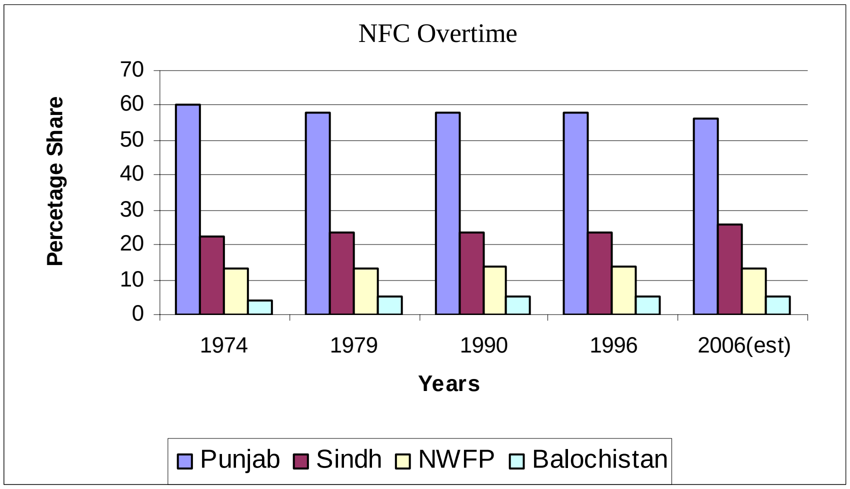
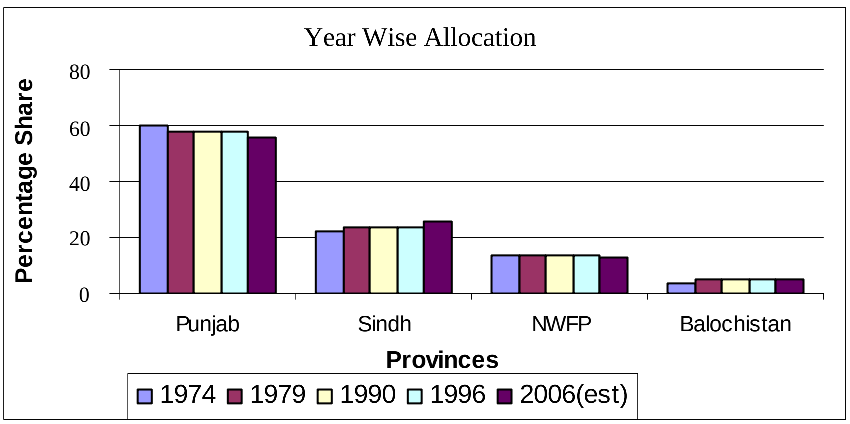
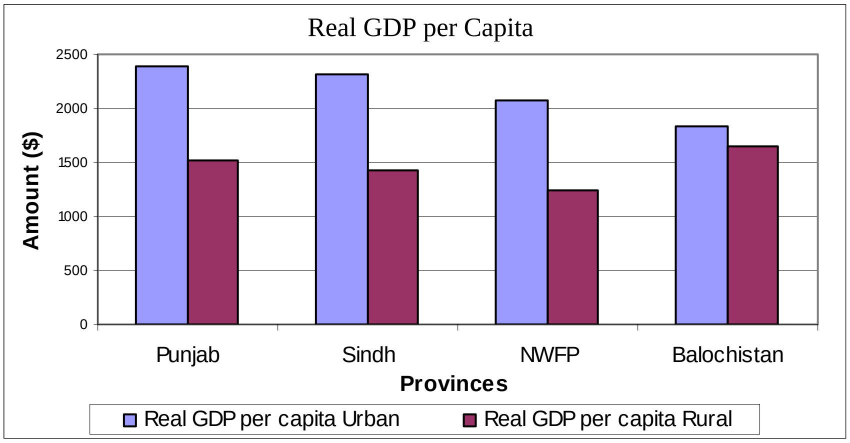


Fig. 4. Year-wise Allocation among Provinces



Rules are non-discretionary and transparent, and it leads to establishment of trust and expectations of the interacting economic agents to increase their developmental activities and therefore economic prosperity. There are significant differences in the standards of living across provinces and even within urban-rural areas. Although, rural-urban disparities come under the umbrella of Provincial Finance Commission (PFC) but the facts remains that provinces can remove these disparities only when they have sufficient funds transfer from central government. Varying gap between the real per capita GDP of rural and urban areas in different provinces is depicted at Figure 5. (See Annex III) What is needed to be done is that proper attention should be given to various elements to achieve equity as well as develop harmony among the provinces. NWFP has been facing maximum disparities in rural and urban income, followed by Sindh and Punjab. Although, in Balochistan there is a lesser gap but it is because of lack of urban development as well as lesser economic opportunities in cities.

Fig. 5. Real GDP per Capita, Provinces



Source: National Human Development Report UNDP (2003).

The major shift in government policy towards fiscal decentralisation can be seen in 1996 NFC award. Prior to this award fewer taxes were shared between federation and federating units so the provinces had to depend on grants. In this award all taxes/duties were included in the pool to increase transparency, simplicity and predictability. But this was one side of the picture, because there was an unprecedented and sudden change in resource sharing formula among federal and provincial governments. Hence, the actual flow of transfer might not be changed significantly at all. There was a drastic change in the share of Federal/Provincial governments from 20:80 to 62.5:37.5 percent. This dramatic change could not be absorbed by the provinces and they fell into acute shortage of revenue funds. Still the argument of efficient revenue generation and the prevalence of desired inflation rate were the culprits. But none of the above happened accordingly and provinces were trapped into serious resource shortage.

In May 1999 provinces were given 1/6th of Sales tax in order to deal with the financial shortages that aroused due to the abolition of Zila and Octroi tax.[3]

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[3]Initially, 12.5 percent sales tax was proposed but after abolition of Zila and Octroi it was increased to 15 percent.

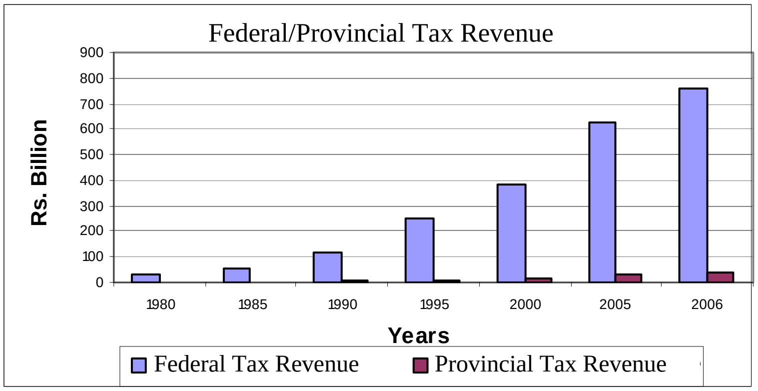
The increment 2.5 percent was directly transferred to province to compensate Zila and Octroi taxes.

Due to these problems the federal government decided to address the provincial grievances and adjusted the federal/provincial share as 55:45 taking province's demand to announce a just award. But still in 2006 award the only visible change was seen in the percentage of revenue sharing between federal and provincial governments whereas the criteria for horizontal resource distribution still lay its basis on the population.

The criteria adopted for proportion revenue sharing between Federal and Provincial governments has created friction between the two and this frustration has resulted in the non-agreement on NFC award. This friction was then removed when the federal government agreed to enhance the percentage share of provinces to 45 percent that to reach 50 percent (tax revenue + grants) in the following five years. This again underlines the justifiability of province's demand earlier. But on the other hand from federal government point of view it is argued that overtime whenever there is an increase in the share of provinces it has increased the non-developmental expenditures, this is definitely not always desired. Provinces on the other hand lack proper projects to improve the living standards of its people and pose a serious capacity problem e.g. poverty ratio in NWFP was 44 percent while ratio in Balochistan was 37 percent in 1997 [Jaffery and Sadaqat (2006)] but provincial governments failed to present any serious plan to reduce the prevailing difference.

This pertains to the issue of political economy and public choice. The electoral process could lead to such a situation where the federal government is hijacked by the larger federating unit, because of majority seats in the National Assembly. Although, in the upper house (Senate) all provinces have equal representation but they only have power to discuss, not to formulate any feasible resource distribution mechanism. Further, the centre does not want the federating units to grow independently which would reduce the rite of the central government on the affairs of doing the business of the government both from the representatives and bureaucracy perspective. This could be seen as since independence, 10 awards for formula based justified resource sharing have so far been constituted, out of which only two (1974, 1999) came from the elected governments. Among the other two, 1996 award was announced by a caretaker government, while the year 2006 award was announced by the uniform president after NFC failed to achieve consensus among the members on an amicable resource distribution mechanism. Although in Pakistan, the tax-to-GDP ratio is the lowest in region [Sherani (2006)]. Nonetheless there is an increase in resource allocation over time, because the total revenues collection has improved. Resultantly, the pie to be divided have increased, hence the resources transferred from federal to provincial government are improving (Figure 6 and Annex IV).

Fig. 6. Federal/Provincial Tax Revenues over Time



Source: Economic Survey (Various Issues).

Further the incentives for the provincial governments for matching grants (i.e. on exhibiting revenue increase growth of 14.2 percent) and thereby creating their credibility for their sustainability also failed due to absence of any concrete revenue assignment for resource generation on their own effort coupled with lack of capacity and closer voice and accountability of the people to the local tiers.

Major tax assignments are lying with the federal government thus under capacitating the provincial governments (Table 11). An important development in 1996 award was the distinction of priority such as defense expenditure, debt servicing etc. and non-priority expenditure which were ensured by the federal government accordingly. This helped in sustaining the trust of both the domestic (defense mainly) and the international community (debt) to avoid any economic and/or political crises due to perception of default.

Table 11

Revenue Assignments among the Federal and Provincial Government

Governments	Direct Taxes	Indirect Taxes
Federal Government	Income Tax Corporation Tax Wealth Tax Property Tax	Sales Tax Excise Duty Custom Duty Import Duty Export Duty Gas & Petroleum Surcharge Foreign Travel Tax
Provincial Government	Land Revenue Urban Immovable property tax Tax on transfer of property Agricultural income tax Tax on professions and trades	Stamp Duty Motor Vehicle Tax Entertainment Tax Electricity Duty

Source: "Rural Service Delivery in Pakistan", A study for World Bank (2006).

4. CONCLUSION AND RECOMMENDATIONS

The main objective of the study was to collate history of resource distribution which has taken place over the period of time in Pakistan through NFC mechanism. Several issues are identified in this context. There is a need for inclusion of other factors like infrastructure, poverty, backwardness, revenue generation, environment, etc. to be taken into account for justifiable of resource distribution. Even if we look at our neighbouring country India, various criteria are used for resource distribution from central to provincial governments. So, in order to achieve equity, such policies should be devised which take different aspects of development into its account while distributing the resources.

The issue of resource distribution among federal and provincial governments never proved to be simple and is a much complex issue. But when we go through the history of NFC, it becomes obvious that the problem of resource distribution is never taken seriously. Or it's a political economy issue, where in the game theoretic perspective the stakeholders bargain over the resource pie, and due to non-consensus, by will or forced, they retreat to a uni-variable criteria based formula which is not optimal. That's the reason that NFC by and large has been unsuccessful to evolve and to tackle the problem of fiscal decentralisation, amicably. As there had been little or no consensus achieved at times thus giving way to interim awards and grants benefiting the larger province.

There has been no systematic approach to decentralise, capacitate and to encourage the provinces by incentivising generation of their own revenues thus creating a long term administrative and financial dependence on the centre. The resource pie has been increasing at a systematic pace due to the large reliance on the indirect taxes. Rather then creating a rule based transparent mechanism of resource distribution and increasing the resource flow to downward governments. Federal government has been maintaining a status quo by reformulating inwardly. Hence trust and expectations development of the interacting economic agents to increase their developmental activities is lacking resulting to lower economic prosperity.

Population had remained the sole criteria for resource distribution the whole time, which is not the best practice around the world. Throughout the period, smaller provinces have asked for adoption of a judicious formula with the inclusion of factors such as revenue generation, poverty, backwardness, area etc. in the revenue distribution criterion but nothing concrete have taken place. Where as in the Provincial Finance Commissions (PFC) there are other criteria as well. The Ministry of Inter-Provincial Coordination on 3rd March, 2007 has also suggested for the inclusion of two additional factors (backwardness and poverty) as revenue sharing elements while announcing NFC award.

The federal government has been overstretching itself by accepting the matters which are purely provincial in nature like roads, rural development, gender issues and so on, for that they keep resources with them as well. So there is a need to empower the provincial governments by clearly defining the roles of each tier of the government and giving the required resources (both human and financial) to them for their planning and development autonomy. This would encourage the provinces to contribute towards the development of the country by streamlining their capabilities by having a better voice and accountability.

It is encouraging to note that there is an element of provincial autonomy and fiscal decentralisation in recent awards. In the 1990 award and onwards the divisible pool has been expanded with the inclusion of more taxes. Thus provinces are given more resources and development funds. Similarly an incentive of matching grants is another step forward to motivate the provinces for their own resource generation and financial autonomy.

Proper systematic approach to decentralise and to encourage the provinces for generating their own revenues should be made. This would help to reduce administrative and resource dependency towards the federation. There is need to incorporate provincial grants into their respective resource shares in such a way so that the provinces achieve autonomy and become able to devise their indigenous development plans.

Although, federally constituted, but with its ad hoc nature, NFC has failed to provide ideal resource distribution criteria. There are no penalties, as such and certain provinces have benefited by having no consensus for redistribution. Furthermore, the parameter choice is very narrow and sub-optimal, especially the population. This is based on census, which is carried out after every 10 years and has issues such as demographic dividend, migration, etc. in recent years. Therefore, international experiences must be incorporated in the resource distribution formula. While announcing NFC award the government should give proper importance to following factors which are exercised in the rest of the world. The factors that can be incorporated are:

(1) Backwardness and development gap.
(2) Inverse income distribution (rural urban income disparity).
(3) Natural resource endowment.
(4) Revenue generation/revenue collection.
(5) Population density.
(6) Poverty.
(7) Area.
(8) Non-formula transfers.
(9) Environmental consideration.

There should be a permanent body of NFC, with professionals of the subject as consultants to regularly monitor and evaluate the equitable utilisation of the award. Visits should be made to different areas and stakeholder consultation should be made to have a real look at the situation prevailing there so that the resource allocation can be made more appropriate. Like PFC it should have a dynamic interface with other stakeholders in improving the flow of funds. The federal assignments should be gradually reduced, both from the financing side as well as the service delivery side.

Finally, the key to successful public service delivery is adequacy, sufficiency, transparent and regular flow of funds to the stake holders in doing the business of government. There should be an integration of the other resource distributions tied to the development unit. Thus a bottom up approach, including all levels of formula, straight transfers and non-formula ad hoc transfers is required. This should be accompanied with clearly identified aims and objectives of the financing and service delivery assignments; this will lead to an optimal level of growth and equity. Government has already focused on the devolution of power, which if accompanied with an adequate financial devolution would bear maximum economic returns.

Annexures

ANNEX I

Article **160. National Finance Commission.**

(1) Within six months of the commencing day and thereafter at intervals not exceeding five years, the President shall constitute a National Finance Commission consisting of the Minister of Finance of the Federal Government, the Ministers of Finance of the Provincial Governments, and such other persons as may be appointed by the President after consultation with the Governors of the Provinces.

(2) It shall be the duty of the National Finance Commission to make recommendations to the President as to-

(a) the distribution between the Federation and the Provinces of the net proceeds of the taxes mentioned in clause (3);

(b) the making of grants-in-aid by the Federal Government to the Provincial Governments;

(c) the exercise by the Federal Government and the Provincial Government of the borrowing powers conferred by the Constitution; and

(d) any other matter relating to finance referred to the Commission by the President.

(3) The taxes referred to in paragraph (a) of clause (2) are the following taxes raised under the authority of [Majlis-e-Shoora (Parliament)], namely:

(i) taxes on income, including corporation tax, but not including taxes on income consisting of remuneration paid out of the Federal Consolidated Fund;

[(ii) taxes on the sales and purchases of goods imported, exported, produced, manufactured on consumed;]

(iii) export duties on cotton, and such other export duties as may be specified by the President;

(iv) such duties of exercise as may be specified by the President; and

(v) such other taxes as may be specified by the President.

(4) As soon as may be after receiving the recommendations of the National Finance Commission, the President shall, by Order, specify, in accordance with the recommendations of the Commission under paragraph (a) of clause (2), the share of the net proceeds of the taxes mentioned in clause (3) which is to be allocated to each Provinces, and that share shall be paid to the Government of the Province concerned, and, notwithstanding the provision of Article 78 shall not form part of the Federal Consolidated Fund.

(5) The recommendations of the National Finance Commission, together with an explanatory memorandum as to the action taken thereon, shall be laid before both Houses and the Provincial Assemblies.

(6) At any time before an Order under clause (4) is made, the President may, by Order, make such amendments or modifications in the law relating to the distribution of revenues between the Federal Government and the provincial Governments as he may deem necessary or expedient.

(7) The President may, by Order, make grants-in-aid of the revenues of the Provinces in need of assistance and such grants shall be charged upon the Federal Consolidated Fund.

ANNEX II

Table

Inter-Provincial Distribution under Various NFC Awards

(Percentage)

Year	Fed/Prov	Punjab	Sindh	NWFP	Balochistan	Total
1974	20:80	60.25	22.50	13.39	3.86	100
1979	20:80	57.97	23.34	13.39	5.30	100
1985	Interim award	Interim award	Interim award	Interim award	Interim award	Interim award
1990	20:80	57.87	23.29	13.54	5.30	100
1996	62.5:37.5	57.88	23.28	13.54	5.30	100
2000 (not awarded)	Interim award	Interim award	Interim award	Interim award	Interim award	Interim award
2006 (estimated)	45:55*	56.07	25.67	13.14	5.13	100

* Provincial share to be increased by one percent each year till it touch the 50 percent mark.

ANNEX III

Table

Provincial Real GDP per Capita

	Real GDP per Capita Urban ($)	Real GDP per Capita Rural($)
Punjab	2380	1523
Sindh	2308	1418
NWFP	2074	1241
Balochistan	1837	1653
Total	2319	1464

ANNEX IV

Table

Federal/Provincial Revenue Profile

Year	Federal Tax Revenue	Provincial Tax Revenue	Federal Non-tax Revenue	Provincial Non-tax Revenue
1980	31403	1809	4731	559
1985	57921	3297	15184	1001
1990	114004	5431	38182	1188
1995	248059	9833	51395	8645
2000	386800	18800	90800	16100
2005	624752	34611	218271	22404
2006	762800	42800	247200	42800

Source: Economic Survey (Various Issues).

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