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Fiscal Decentralization in Pakistan: Past, Present and Future

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Abstract: This paper offers a longitudinal appraisal of fiscal decentralization in Pakistan. The difference between federalism and decentralization is subtle, semantic, and hardly of any practical value but needs to be clarified nevertheless. The subject-matter is divided into five parts. The first part sets the contemporary context as rationale for pursuing this research. It explains how, since the expiry of the 7th NFC in 2015, the constitutional imperative has been eclipsed by purportedly graver considerations to the resentment of provinces. The second part gives an overview of the theory of fiscal federalism so as to acquaint the reader with the definition of the concept. This will help understand the logic of decentralization and evaluate practice in light of theory. The third part draws on the gestation of federalism from 1947 to 1970. It recounts the approaches adopted by governments in the past when it came to this critical question, including the arrangements adopted to this effect. Part four gives an account of three major developments viz. the 1973 constitution, the 7th NFC Award and the monumental 18th Amendment – all three being the arrangements that govern fiscal decentralization to this day – it also includes an overview of the revenue-sharing formula used in other countries. Finally, part five briefly reviews the performance of the fiscal decentralization arrangement adopted in Pakistan. It ends with a set of research and policy recommendations, identifying the way forward for fiscal decentralization in Pakistan.

Keywords: Fiscal administration, Pakistan, National Finance Commission, resources sharing

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1. Introduction

This paper offers a longitudinal appraisal of fiscal decentralization in Pakistan. The difference between federalism and decentralization is subtle, semantic, and hardly of any practical value but needs to be clarified nevertheless. The term fiscal federalism refers to the set of guiding principles that helps define fiscal relations between federal and local governments (local here means all subsequent levels of the government – primarily provincial or state governments – to whom power is being devolved). The term fiscal decentralization, on the other hand, refers to the practical application of those principles in the form of devolution of power from the higher to the lower tiers of government (Rabbani, 2011). Very briefly, federalism is the concept, decentralization is the operation.

The year 2009 marked a milestone for the institution of federalism in Pakistan. The report of the 7th National Finance Commission – constituted under Article 160 of the constitution to manage vertical and horizontal resource distribution – was hailed and celebrated as a *fait accompli*. The temporal order held significance: Pakistan had only recently found its way out of the fourth military rule in history and an optimism, albeit cautious, accompanied the Zardari-led Pakistan People's Party into office. The authors of the said report commended the “spirit of utmost cordiality and accommodation” that characterized the deliberations and inserted a clause expressly thanking the Punjab Government for showing “grace” in the acceptance of longstanding demands by Sindh, Khyber Pakhtunkhwa (then NWFP), and Balochistan to adopt a multiple-indicator formula for resource distribution (Report of the National Finance Commission, 2009).

Under the constitution, the NFC is to be constituted every five years. It follows that an award is due *every five years* to set out a distribution plan for the next term. The award of the 7th NFC expired in the year 2015, but instead of announcing a new award the incumbent government settled with extensions to the one announced in 2009 and the same continued well into the third quarter of 2017. This may be attributed, in part, to the ruling party's being embroiled in controversy. But that logic does not quite fit since all ruling parties everywhere face similar situations and it is for this reason precisely that opposition has come to be institutionalized in democratic polities. The real reason lies in the stakeholders' inability – or unwillingness – to overcome the political deadlocks that are bound to punctuate any such exercise.

One factor that has impeded the NFC's progress is the Federal Finance Minister's proposal to reduce the size of the divisible pool. The amount hence reserved, it is argued, would be used for the mainstreaming of the Federally Administered Tribal Areas – 2%, the uplift of Gilgit-Baltistan and Azad Jammu & Kashmir – 1% each, and the establishment of a National Security Fund for financing security of the China-Pakistan Economic Corridor – 3% (Kiani, 2016).

Though this is not a reduction in the provincial share per se, it is tantamount to the same: the actual amount transferred to the provinces would be reduced by the same amount with cuts in the size of the divisible pool as with cuts in the actual provincial share. A number of negotiations broke down in the year 2016 due to the provinces' resistance to this proposal. The process was scheduled to resume in January, earlier this year, but the government's priorities were soon overshadowed by the federal budget for FY 2017-2018. As it is, prospects for timely consensus on the next award are falling while apprehensions of another extension are on the rise.

Results of the 2017 Census figure as another factor. The relative success of Punjab's population programme has decreased its share as compared to Sindh and Balochistan – both of which have seen increases (Khawar, 2017). Though a victory of sorts, this development will call for a redistribution of resources from the former to the latter since population continues to be the major criterion in this regard. This may or may not affect the cordiality and accommodation Punjab vouchsafes in the next round of the NFC but will have to be taken into consideration nevertheless for its potential to discourage the province from concessions still due to smaller constituents.

As recently as September 20, 2017 a conference attended by representatives from KP, Sindh and Punjab issued a statement vowing to appeal directly to the Prime Minister and, if need be, to the Supreme Court if the centre continued to pursue dilatory tactics in respect of the long-due 8th NFC award (Yousafzai, 2017). The provinces are likely to up the ante in the coming months and keep it so at least as long as the onset of the next year does not replace this legitimate, long-term concern with short-term electoral concerns.

Notwithstanding their indispensability for the effective functioning of the federation, the NFC and its awards are only just instruments. In order for one to have an informed opinion and a voice in the contemporary discourse, it helps to develop academic insight on the subject by going beyond the instruments of fiscal decentralization to review the legal and institutional framework that employs them.

2. Literature Review

Fiscal federalism refers to the distribution of fiscal responsibilities between the centre and provinces in a federal state. A federation, by definition, is a polity combining one general and various constituent governments, each with its share of powers delegated by the people through a constitution (Ahmad R. , 2010). The logic of a federation is rooted in the logic of dividing political power to discourage overarching, monopolistic governments and to encourage greater citizen participation and accountability. Federalism is a contract between the centre and the units that ensures the coordinated implementation of mutually-agreed policies. It entails rights and duties for both tiers of the government.

Theories of fiscal federalism may be categorized into first- and second-generation fiscal federalism – FGFF and SGFF, respectively. At the heart of both is the decentralization theorem by Wallace E. Oates who is a pioneer in the field. Wallace approaches decentralization from the perspective of public service delivery and, as such, his primary concern revolves around identifying the fiscal instruments and functions that should be centralized and those that should be decentralized *in the interest of improved public service delivery*. His decentralization theorem states that the level of welfare will be high if Pareto-efficient levels of consumption are provided in each jurisdiction separately than if they were provided at a single, uniform level of consumption across all jurisdictions. (Oates, *An Essay on Fiscal Federalism*, 1999).

For Oates, this is largely due to imperfect information. A government at the centre cannot possibly be better informed about the needs, sensibilities, and cultural preferences of the people than governments at the grassroots. Therefore, devolving powers to the latter will help them serve the people accordingly. There is always the question of interjurisdictional externalities – both positive and negative – but that is simply the fallout of decentralization and something that the centre has to wherewithal to help internalize (Oates, *An Essay on Fiscal Federalism*, 1999).

Second-generation fiscal federalism, or SGFF, does not contradict the propositions of FGFF, rather, it enhances them. It is better aligned with the reality of the democratic polity where people seek more than just efficient service delivery: they seek accountability of the representatives they are voting into office. According to SGFF, imperfect information – and thereby allocative inefficiency – are not limitations that the central government does not have the wherewithal to overcome. What is left, therefore, is the problem of externalities, and – when it comes to the capacity for managing these – the centre clearly holds sway. This means that from an efficiency perspective, it is the centre that should have greater power in the fiscal-federal setting.

However, if the same were concentrated in the upper tiers of the government – that is, if the lower tiers had little to no substantial power – not only would they (the lower tiers) be exempt from greater service but also from greater accountability. The trade-off, then, is one facing the public itself and is between efficiency and accountability. They can choose a more efficient mechanism of service delivery (centralization), or they can choose one where they can hold the agency accountable decentralization (Oates, 2005).

2.1 The practice of fiscal decentralization: instruments for the devolution of power

Devolution of power takes place in tandem with a devolution of the resources necessary to execute that power. In other words, as responsibility is devolved so should be the means to discharge that responsibility. This is achieved in a federal system with the help of two kinds of transfers: divisible pool taxes and grants-in-aid.

Tax transfers fall under the head of revenue-sharing and are meant for purposes of equalization and policy alignment across jurisdictions (Khawaja & Din, 2013). However, devolving revenue-expenditure without devolving revenue-generation is likely to lead to fiscal indiscipline since local governments tend to develop profligate spending habits when it comes to the revenue they never put their energies to generating (Jin, Qian, & Weingast, 2005). It amounts to what may be called the perverse incentive to underperform (Oates, 2005).

Devolving revenue-generation also has the added benefit of establishing hard-budget constraints: if local governments are made to rely on self-generated revenues for their expenditures, and if they are assured against any help from the centre in the event of fiscal emergencies resulting from inefficiency, prodigality, or corruption, they will take their actions – and the consequences thereof – more seriously.

Grants-in-aid may be used by the centre to help local governments internalize positive inter-jurisdictional externalities or for purposes of centre and local policy alignment. One instrument to achieve this is the matching grant (Rodden, 2001). Matching grant is a kind of conditional grant that bounds the recipient to continue spending on a programme that is spilling benefits over into other jurisdictions or one that is in line with some national priority set by the government. Grants-in-aid may also help achieve fiscal equalization as in the case of special allocations to areas suffering from conflict and/or deprivation. Pakistan itself serves as a case-study in this regard (Report of the National Finance Commission, 2009).

It is argued that grants-in-aid can do the disservice of reversing gains from the decentralization of revenue-generation by converting hard-budget constraints into soft-budget constraints. There may be some truth to this assertion but it depends, ultimately, on the attitude and posture that the centre assumes to this effect. The centre has the capacity to discipline provincial governments. However, electoral and reputational concerns may limit this capacity too (Oates, 2005).

2.2 Federalism in a post-colonial state

In 1972, Hamza Alavi – Pakistani social scientist and historian renowned for his scholarship in left-leaning Western academic circles – published a paper titled *The State in Post-Colonial Societies: Pakistan and Bangladesh*. In this paper, Alavi contended that the nature of relationship between the state and social classes in post-colonial societies is different from those explained by classical Marxist theory which draws exclusively upon the Western experience. In the latter, the nation-state develops bottom-up, while in the former it is *imposed* top-down by the metropolitan bourgeoisie i.e. the bourgeoisie of the colonizers.

The structure so formed in the colony is subordinate to another so-called superstructure, “equipped with a powerful military-bureaucratic apparatus and mechanisms of government”, to enable the exercise of absolute authority over native classes (Alavi, 1972). This superstructure, though detached from its metropolitan origins at the time of independence, continues to exercise the power vested in it by imperial masters long after they are gone – hence the formation of an overarching or, in the words of Alavi, “overdeveloped” state to the peril of underdeveloped civilian and constituent units.

Alavi's thesis offers a reliable insight into the endemic crisis of federalism in Pakistan. It explains why it has been difficult and painstaking for the state to come to terms with a system premised on the distribution of powers and devolution of authority.

2.3 Federalism in Pakistan: 1947 to 1962

By virtue of its ethnic diversity and strong tribal culture, the land now Pakistan has always been governed by some variant of a federal structure. There has, historically, been no other way to win over the powerful landed classes except by granting their constituencies some degree of autonomy. The British started off with a highly centralized mode of governance but eventually came down to devolving powers starting 1919. Thenceforth, up until its culmination in the 1935 Government of India Act, the unilateral nature of the Raj started withering away under the influence of bilaterally-arrived understandings (Ahmad R. , 2010).

The state that emerged in 1947 was still in keeping with Alavi's thesis. It took nine years for Pakistan to come up with its first constitution. But the 1956 constitution had hardly been in operation for two years when the imposition of martial law by Field Marshal Ayub Khan led to its abrogation and deliberations on a new constitution. This was promulgated in 1962 and lasted till the fatal blow to the Pakistani federation and federalism led to the secession of Bengal in 1971.

The constitutions of 1956 and 1962 were both executive-oriented. The former provided for a parliamentary democracy but vested executive authority in the president. Three lists – federal, provincial and concurrent – outlined the distribution of powers. 33 items were retained by the centre while 94 were devolved to the provinces. The concurrent list's 19 items were to be jointly legislated on, though the centre was to have precedence. In case of a conflict, the matter was to be referred to the Supreme Court for mediation. In order to match Bengal's disproportionately large population share, provinces in West Pakistan were huddled into a single unit under the infamous One Unit formula, thus laying the foundations of discord in the nascent federation. At the national level, a unicameral legislature was formed with parity representation from East and West Pakistan. The 1962 constitution provided for an indirect presidential democracy. It abolished the provincial list of subjects, placing 49 subjects in the federal list and the rest under the concurrent list. The unicameral legislature, parity representation, and One Unit were retained (Ahmad R. , 2010).

The highly centralized nature of the first and second constitutions bade ill for essential principles of federalism such as ethnic inclusiveness, democratic participation, and accountability. In attempting to ensure greater cohesiveness, the framers of these constitutions paved the way for greater political schisms in the republic, perpetuating the conflict between the centre and provinces. Ultimately, as Paula R. Newberg notes in her book *Judging the State: courts and constitutional politics in Pakistan*, the policy became "self-defeating for heads of states, heads of governments, constitutions and citizens alike" (Newberg, 1995).

2.4 Fiscal-federal arrangements from 1947-1970

An historical account of the fiscal-federal mechanism in place from 1947 to 1952 is given in a 2007 paper by Ahmed, Mustafa and Khalid of the Pakistan Institute of Development Economics. The same is summarized below:

- Niemeyer Award: Since the Government of India Act was serving as the interim constitution at the time of independence, the mechanism for fiscal decentralization was also drawn from it, with minor adaptations, to form the Niemeyer Award of 1947. Under

this award, sales tax was an exclusively provincial subject while 50% of the revenues collected by the centre were to be transferred to the provinces. Grants for Sindh and then NWFP were earmarked at Rs.10 and 10.5 million, respectively, though Sindh's grant was withdrawn once its financial position improved.

- **Raisman Award:** In 1952, the Niemeyer Award was replaced by the Raisman Award. It put an end to the provinces' exclusive control over sales tax by providing for the retention of 50% of the proceeds by the centre. Between East and West Pakistan, 45% share was earmarked for the former and the remaining for the latter. NWFP was given a Rs.12.5 million grant-in-aid.
- **1961 Award:** Sales tax was to be collected by the provinces and transferred to the divisible pool whence they would be returned a 30% share based on their contribution. East Pakistan's share rose to 54% under this award, while that of West Pakistan fell to 46%.
- **1964 Award:** 30% of the sales tax was distributed to each province based on its collection, as in the previous award. Whereas the share of East Pakistan and West Pakistan remained unchanged at 54 and 46%, respectively, the overall share of the provinces rose to 65% while that of the centre fell to 35%.
- **1970 Award:** The characteristic feature of this award was the change in the centre-province ratio from 35:65 to 20:80. The shares of East and West Pakistan remained the same. (Ahmad, Mustafa, & Khalid, 2007).

3. Discussion

3.1 The 1973 constitution and fiscal-federal arrangements from 1973 to 1997

The enactment of the 1973 constitution brought no real prospects for federalism or fiscal-federalism for that part. It did away with the One Unit and a unicameral legislature, reinstating the provinces (this time four) and providing for a bicameral legislature with proportional representation in the lower house and parity representation in the upper house. But whereas it kept only a restrictive federal list of subjects primarily including defence, foreign affairs, currency and trade, it kept a good 39 subjects for the concurrent list, devolving the residual to the provinces. Both the centre and provinces were to legislate on subjects provided in the concurrent list however, as before, the centre was to prevail in case of conflict. The Council of Common Interests was formed but since authority was clearly vested with the centre, neither it nor the provinces had an interest in convening its sessions. As a result, the Council remained virtually dormant (PIDE, 2010). Article 160 of Constitution of Pakistan 1973, called for the constitution of a National Finance Commission. The Commission was to have representation from both the centre and provinces and was to meet at regular intervals not exceeding five years.

Between 1973 and 2009 – the year of the 7th NFC – the NFC issued three awards under the framework provided by the constitution. These are summarized below. The criterion for resource distribution was population for all three awards (Ahmad, Mustafa, & Khalid, 2007):

- **1st NFC Award, 1974:** The size of the divisible pool was shrunk. The centre-province ratio was retained at 20:80. Punjab stood to gain the most from this award.
- **The 2nd and 3rd NFC's** constituted under General Zia-ul-Haq in the year 1979 and 1985, respectively, did not issue any awards.
- **4th NFC Award, 1990:** The size of the divisible pool was expanded again, leading to an increase in the volume of money transferred from federal to provincial governments. Both the 20:80 centre-province ratio and single-indicator (population) criterion were retained.

- 5th NFC Award, 1997: All taxes/duties were included in the divisible pool. The centre-province ratio, by extension, underwent a drastic change and came down to 62.5:37.5. Provinces were given the incentive of matching grants if they could exceed their revenue generation targets by 14.2%.
- The 6th NFC was constituted under General Pervez Musharraf in 2000 but did not issue any award.

A comparison of the three awards given in this period can be summed up in the table below (Table 1).

Table 1: Comparison of NFC Awards

<i>NFC Awards</i>	<i>Share (federation: provinces)</i>	<i>Divisible Pool Taxes</i>	<i>Grants-in-Aid (in millions)</i>	<i>Distribution Criterion</i>
1974	20:80	Export duty on cotton, taxes on sales and income	NWFP: 100 Balochistan: 50	Population
1990	20:80	Expanded to include: excise duty on tobacco and tobacco manufacturers and on sugar	Punjab: 1000 for 3 years Sindh: 700 for 5 years NWFP: 200 for 3 years Balochistan: 100 for 3 years	Population
1996	62.5:37.5	All FBR* taxes except: excise duty on natural gas; income tax paid out of the federal consolidated fund	NWFP: 3,310 for 5 years Balochistan: 4,080 for 5 years	Population

Courtesy: Report of the National Finance Commission, 2009.

*Federal Board of Revenue

Provincial shares in this period evolved as follows (Table 2).

Table 2: Provincial Share in NFC Awards

<i>NFC Awards</i>	<i>Punjab %</i>	<i>Sindh %</i>	<i>NWFP %</i>	<i>Balochistan %</i>
1974	60.25	22.50	13.39	3.86
1991	57.87	23.29	13.54	5.30
1996	57.88	23.28	13.54	5.3

Source: (Jaffery & Sadaqat, 2006).

The award of the 7th NFC

Deliberations of the 7th National Finance Commission began in 2005. It consisted of the federal and provincial finance ministers, in addition to one technical member from each province. The 7th NFC continued with the concept of national resource picture introduced earlier. It had three major determinants, all projected:

- Real GDP for the next five years against the benchmark of FY 2009-10.
- Tax-to-GDP ratio. This was projected at 15% by FY 2014-15, inclusive of surcharges, non-tax revenue, and the provincial tax effort.
- Federal expenditures including development, security, arrears and liabilities.
- Federal and provincial borrowings from international lenders.

Following were the recommendations of the Award: The size of the divisible pool was expanded “in the interest of national solidarity and provincial harmony”, while revenue collection charges were reduced from 5% to 1%. The centre-province ratio was set at 42.5:57.5. Increase in the provinces’ share was based on the decentralization paradigm i.e. greater resources will have to be transferred to the provinces to ensure better public service delivery. Grants worth 1.83 and 9.09% of the provincial pool were earmarked for NWFP and Balochistan, respectively, while Sindh was to get a Rs.6 billion grant from the centre (equivalent to 0.66% of the provincial pool). The highlight of the 7th NFC was the adoption of the multiple-indicator criteria for horizontal resource distribution. It is unfortunate that population had been the sole criterion in this regard in all previous awards which effectively obstructed equitable distribution and, by extension, fiscal federalism. The 7th NFC’s report especially hailed this concession by the centre – basically Punjab – since the same had been a longstanding demand of the smaller provinces.

Population continued to be the major indicator with an 82% weightage but other factors were also adopted. Poverty or backwardness was adopted on the insistence of then NWFP; inverse population density (IPD) on that of Balochistan which has the greatest incidence of the same owing to its disproportionately large area; revenue collection on that of Sindh as most taxes are *collected* from Sindh – since they are *generated* in Punjab, revenue generation was held at par with the former.

The following table gives each province’s position on these indicators (Table 3).

Table 3: Position of Provinces according to 7th NFC Award

<i>Indicator</i>	<i>Punjab</i>	<i>Sindh</i>	<i>NWFP</i>	<i>Balochistan</i>
<i>Population</i>	59.36%	23.71%	13.82%	5.11%
<i>IPD</i>	4.32%	7.18%	6.51%	81.99%
<i>Poverty/backwardness</i>	23.1%	23.42%	27.83%	25.62%
<i>Revenue collection</i>	27%	70%	3%	1%
<i>Revenue generation</i>	63%	28%	7%	2%

Courtesy: Report of the National Finance Commission, 2009

Based on this, the horizontal distribution formula was devised. The weightage of indicators was set as follows:

Population:	82%
IPD:	2.7%
Poverty/backwardness:	10.3%
Revenue collection:	2.5%
Revenue generation:	2.5%

The share of the provinces as follows:

Punjab:	51.74%
Sindh:	24.55%
NWFP:	14.62%
Balochistan:	9.09%

In order to put revenue sharing in Pakistan into perspective, it helps to compare it with the mechanisms adopted by other countries. For this reason, the case of three South Asian countries – India, Sri Lanka, Nepal – and one West African country – Nigeria – since it shares many of the political and security dynamics prevalent in Pakistan. A comparison of the indicators used in these countries with Pakistan is given in Table 4.

3.2 The 18th constitutional amendment

In the year 2006, former prime ministers Benazir Bhutto and Nawaz Sharif, met in London to develop a strategy for democratizing the political setup in Pakistan – then under the military regime of General Pervez Musharraf – and, more immediately, to improve their electoral prospects in the general elections scheduled for 2008. The end result was the Charter of Democracy. This was meant to “oblige the process of decentralized system of federalism on the principles of balanced structure of governance”, inter alia (Bukhari & Faisal, 2013).

This was followed through once the Pakistan People’s Party rose to power on a wave of sympathy vote in the aftermath of Benazir Bhutto’s death. A Special Committee for Constitutional Reforms, having across-the-board representation from political parties at the centre, was set up to recommend reforms on a number of matters including strengthening parliament and provincial assemblies and provincial autonomy, in light of the Charter of Democracy. The goal was to restore the spirit of the 1973 constitution by fixing the “distortions” that General Musharraf had introduced to suit his ends. Limitations were imposed by the military to the extent that the committee could make its proposals, and it was presumed that – given the number and diversity of parties at the table – a consensus was unlikely. However, the same was arrived at in an unprecedented development: the 18th amendment bill was passed by a unanimous vote of both houses of parliament and signed into law by then president Asif Ali Zardari on April 19, 2010 (Adeney, 2012).

The 18th amendment was a quantum leap forward in Pakistan’s constitutional development. Its major contribution was the abolition of the concurrent list. There remains, since, only one list – the federal legislative list – divided into two parts. Part I of the federal legislative list includes subjects that are exclusively the centre’s domain, while part II contains subjects that are of interest to both the centre and the provinces and will therefore be subject to joint legislation.

A total of 17 ministries were abolished in this regard. These were: Food and Agriculture, Livestock and Dairy, Health, Labour and Manpower, Education, Minorities, Social Welfare and Special Education, Tourism, Population Welfare, Women Development, Youth Affairs, Special

Initiatives, Environment, Local Government and Rural Development, Sports, and Zakat and Usher.

Table 4: Country Comparison

<i>Country</i>	<i>Indicators</i>	<i>Weightage</i>
<i>India¹</i>	Income distance (difference between GDP of state in question with state with highest GDP)	50%
	Population, 1971	17.5%
	Area	15%
	Population, 2011 (in order to determine demographic change)	10%
	Forest cover	7.5%
<i>Sri Lanka²</i>	Economic (poverty head count ratio)	
	Health (no. of hospital beds per 1000 persons)	
	Education (computer literacy rate; %age of difficult schools)	-
	Infrastructure (%age of length of roads to be developed)	
	Agriculture (paddy cultivated extent/km ² ; avg paddy yield)	
<i>Nepal³</i>	Population	50%
	Poverty	25%
	Tax effort	15%
	Area	10%
<i>Nigeria⁴</i>	Equality	40%
	Population	30%
	Landmass/Terrain	10%
	Internally generated revenue	10%
	Social development factor	10%

Unlike previous arrangements, federal legislation would not prevail over the provincial in case of conflict. Instead differences would have to be resolved under the aegis of a reinvigorated Council of Common Interests. This council, as mentioned earlier, was instituted by the 1973 constitution but was largely dormant due to its irrelevance in view of the legislative dynamics under the concurrent list. Under the 18th amendment, however, it was entrusted with decision making,

¹ (Vasudevan, 2015)

² (Palihakkara, 2016)

³ (Ghimire, 2014)

⁴ (Lukpata, 2013)

monitoring, supervision and control responsibilities, was to meet at least once every ninety days, and had a permanent secretariat in Islamabad (Ahmad, 2010).

The 18th amendment also tilted the balance of power in the National Economic Council in favour of the provinces. The NEC is the highest constitutional body tasked with the oversight of national economic policies. Earlier, provinces had one representative each in the council. This number was later raised to two. It was mandated that the council would meet at least twice a year (Shah, 2012).

With the expansion of their domain, the 18th amendment has given provinces the potential to raise additional revenues from capital value taxes on property, estate and inheritance taxes, and environmental taxes and charges (Shah, 2012). They have, then, the wherewithal to raise revenues from own resources though the extent to which they succeed to this effect depends upon the incentives or disincentives provided by the centre. Also, the provinces now enjoy greater access to capital finance following the permit to borrow from national and international lenders subject to any constraints/conditions imposed by the NEC. A World Bank policy paper on the 18th amendment by encapsulates the changes in tax assignment in the Table 5 (Shah, 2012).

Table 5: 18th Amendment Tax Assignments

<i>Federal Taxing Powers</i>	
<i>Added</i>	<i>Deleted</i>
Taxes on sale and purchase of goods	Taxes on estate and inheritance (wealth tax including agricultural wealth)
Taxes on capital value of assets excluding immovable property	VAT on service
	Zakat and Usher
<i>Provincial Taxing and Financing Powers</i>	
<i>Added</i>	<i>Deleted</i>
VAT on service	
Taxes on immovable property	
Zakat and Usher	
Borrowing powers subject to conditions imposed by the National Economic Council	

Other takeaways from the reassignment of taxes are as follows:

- Sales tax on services, in the form of value-added tax, was devolved to the provinces. However, the federal was to help in its collection and administration.
- Provinces were tasked with determining the base and rate of Zakat and Usher, while the federal was to collect and administer it. Basically, the 18th amendment reversed the roles erstwhile assumed by the two tiers.
- Collection and administration of royalty on natural gas was assigned to the provinces while the federal continued to determine the base and rate.
- Earlier, revenues generated from the capital value tax on immovable assets were divided on a 50:50 ratio between the centre and provinces. After the amendment, this was changed to 100:0 supposedly to minimize locational inefficiencies (Oates, 1999).
- Personal and corporate income taxes were *retained* by the centre though there is some case for the sharing of these too.

A summary of federal-provincial-local revenue collection and expenditure share is given in the Table 6.

Table 6: Tax Collection/Expenditure

<i>Fiscal Year</i>	<i>Indicator</i>	<i>Federal</i>	<i>Provincial-Local</i>
2009-10	Collection	94%	6%
	Expenditure	66%	34%
2011-12	Collection	90%	10%
	Expenditure	64%	36%
2014-15	Collection	85%	15%
	Expenditure	45%	55%

Source: (Shah, 2012)

The enactment of the 18th amendment has implemented the 2009 NFC’s vision for economic decentralization. But though the centre-province dynamics have significantly improved and promise to do so in the future, the process would be incomplete unless it continues to devolve power and responsibilities from the provincial to local governments. Since the whole logic of decentralization lies in obliging progress from the lower strata (Bukhari & Faisal, 2013), this is an indispensable and longstanding prerequisite.

4. Conclusion

For some effects of the fiscal decentralization, one need not go very far. For example, Sindh and Punjab have engaged in “aggressive mobilization” of revenue ever since the aforementioned fiscal arrangements were put in place. Each established its own Board of Revenue, as did Khyber Pakhtunkhwa. But whereas revenue collected after the devolution of GST on services rose from Rs. 15 bn to Rs. 25 bn in Sindh, the same could not be replicated in Khyber Pakhtunkhwa or Balochistan since the tax bases in these provinces are fairly small (Bengali, 2015).

Dr Hafiz A. Pasha wrote an insightful piece on the impact of the 7th NFC for the Business Recorder earlier this year. Some of his findings can be summed up below (Pasha, 2017):

- Devolution of GST services has raised the provincial tax-to-GDP ratio from 0.4% of the GDP in FY 2009-10 to 0.7% in 2014-15. Unfortunately, similar effect did not ensue from the devolution of agriculture tax and property tax.
- With the increase in transfers, provincial expenditures have also increased – these have gone up from 6.2% of the GDP in FY 2009-10 to 7.2% in 2014-15. As a result of this, the provincial share in national expenditure has gone up from 28% to 35%. This may look like a positive development on paper but when compared with the projected level of 45% - or that in India, 55% - one realizes how greater the scope for improvement is. Secondly, a major contradiction in this regard is the imperative of generating surpluses (upon directions from the centre) in order to meet deficit targets set by international lenders, basically the IMF.

- The most important findings pertain to public service delivery since that was the whole object of the decentralization exercise. A five-indicator formula was adopted to gauge this viz. primary school enrolment, secondary school enrolment, literacy, immunization, and provision of tap water. Findings showed that provincial performance in this regard was better in the bracket from FY 2004-05 to FY 2008-09 than in the bracket from FY 2008-09 to FY 2014-15, and whereas absolute performance was better in Punjab, relative performance was better in Sindh and Khyber Pakhtunkhwa.

Ever since Pakistan achieved a semblance of political stability following the landmark 2013 democratic transition and the military's proverbial retreat to the barracks, policymakers and the intelligentsia have been afforded greater space to address matters of greater and more immediate concern to the people. This process was offset long before the said transition materialized and bore fruit in various phases, most notably the award of the 7th National Finance Commission and the 18th constitutional amendment. Both the amendment and the award were milestones in the substantiation of fiscal decentralization in Pakistan and seemed to have hit the nail on the head. A number of issues, both political and social, had stemmed from an overcentralized government in the past and these developments promised to fix the distortions so created. With hardly a decade into the decentralization and with the process still incomplete, it is still early to judge the extent to which this will prove effective. However, as it is, there are still some lessons to learn from the theoretical body of knowledge and whatever little on-ground experience we have had so far.

5. Recommendations

The multiple-indicator criterion needs to be revised further still. One reason Punjab conceded to the inclusion of other criteria for resource distribution was that there had been no substantial decrease in the population indicator weight per se. It continues to stand at 80%. Compare this with India where the same indicator has a weight of 10-20% and with other countries that do not include it at all (PIDE, 2010). There are two essential problems with this. One, the 80% weightage, or the indicator itself for that part, assumes that per capita needs are similar across jurisdictions. This is not the case. They may vary with the cost of service delivery and with minimum standards (different for each jurisdiction) set by provincial governments in different sectors. Secondly, it acts as a disincentive for population control. Punjab, for example, managed to reduce its population according to the 2017 census by a meagre amount. As a result, it stands to lose from the NFC Award based on the existing formula.

The structure of the NFC needs to align with best practices around the world to bring more rigour and impartiality to the resource distribution exercise. For this purpose, it would help to bifurcate the NFC into two tiers with the existing commission acting as the intergovernmental forum and independent advisory body introduced to make recommendations to the forum based on expert analysis and research (Khawaja & Din, 2013). This would inform the entire exercise and bring more transparency.

Reduction in the size of the divisible pool. Though an unattractive suggestion, a reduction in the size of the divisible pool will create incentives for both the centre and the provinces. With the exclusion of certain tax bases from the divisible pool and the guarantee that the money collected from these bases will not have to be redistributed to the provinces, the centre will be encouraged to undertake the revenue-collection exercise with greater dedication. On the other hand, with a bar set on unconditional block transfers from the centre, the provinces will *have to* focus on

generating revenue from own-sources. This will lead to a more rigorous tax effort, enhancing both provincial capacity and performance as a result.

Also, this will have to be paired with increased decentralization of tax bases. Whereas tax-revenues are shared under the existing arrangement in Pakistan, tax-bases are not so much. Devolution of tax bases will serve the dual purpose of solving the free rider problem and creating a demonstration effect (Khawaja & Din, 2013). Each province will get only that for which it will strive, to the extent that it will strive, and performance by one province will encourage others to perform and deliver too.

As stated in the previous chapter, the process of decentralization does not end with devolution from the centre to the provinces, devolution from the latter to local governments is just as important. The existing mechanism – more so, the political will to undertake province to local devolution – seems inadequate at best and non-existent at worst. Absent this, the whole devolution process will have been executed without having achieved the most important end of efficient and need-based public service delivery and decentralization will have gone from one to multiple centres of power, equally monopolistic and imperfectly informed.

Recommendations for future research

Future researchers can focus on the subject area of the paper. A future avenue of research could be the debate on reduction versus expansion of the size of the divisible pool. Each, as pointed out earlier, has its own benefits. Whereas reduction in the size of the pool can encourage efficiency on part of the centre and responsibility on part of the provinces, expansion can ensure greater provincial autonomy and, arguably, improve provincial performance. Perspectives on this debate would help weigh the pros against the cons and suggest the better option for Pakistan. Similarly, the debate on the trade-off between provincial autonomy and policy alignment or uniformity across jurisdictions is also equally important. It is for the centre to decide, while formulating its policy on fiscal decentralization, as to which of the two ought to be preferred over the other. Since each has its own implications, this decision will affect the very nature of fiscal decentralization. Another question is the criterion for resource distribution. Should it be based on needs or performance? Basing it on needs would ensure justice but could create perverse incentives. Basing it on performance, on the other hand, may encourage a greater focus on results but may conversely perpetuate the cycle of underperformance: how can a province be expected to perform better unless its needs are met?

Finally, an exploration of the causes and consequences of horizontal resource distribution is needed. Longitudinal studies of NFC awards from 1974 to 2009 tackle the subject from the tax assignment perspective which is described and analysed in detail. But when it comes to the share each province was accorded under a certain award, there is no commentary on the motivations that drove those decisions, nor any appraisal of their consequences – apart from very generic observations regarding the single- or multiple-indicator formula. This is also a limitation of this research. Since it is a vast and complex subject that requires exhaustive study, it was not deemed something that could be casually opined on.

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