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The Political Economy of Fiscal Decentralisation in Pakistan: A Historical Perspective

Economics

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Abstract

This paper examines the evolution of revenue and expenditures decentralisation in Pakistan. Major issues regarding the financial distributions and expenditures obligations of both federal and provincial governments are discussed in details. Fiscal decentralisation in Pakistan has been a contentious issue and hot topic of debate. The central government has always been criticized for over centralization of revenues. It collects the majority of tax and non-tax revenues and transfers a part of it to the provincial governments through the National Finance Commission (NFC) Award. A thorough look at the history of resource distribution suggests that the process of fiscal decentralisation has been less systematic and failed to pace with fiscal and administrative demands of the provincial governments. There have seven NFC Awards after independence, and with the exception of 1974 Award, the trend shows a consistent increase towards fiscal decentralisation. Albeit since 1990 NFC the process of decentralisation has got momentum, yet, a quantum jump towards true fiscal decentralisation is represented in 7th NFC, concluded in 2009. It rationales the intergovernmental fiscal relations, expands the divisible pool by bringing more taxes into its orbit and increases the provincial share and more importantly includes more criteria other than population for horizontal *distribution. As a result the financial position of the provinces improves and gives them a significant autonomy.*

Keywords: *fiscal decentralisation; NFC Award; political economy; rules and discretions; service delivery; Pakistan*

Introduction

As in other developed and developing countries, fiscal decentralisation in Pakistan is aimed to promote the efficiency of various tiers of government in social services delivery and governance. Alongside the empowerment of the sub-national governments in fiscal matters, the fiscal decentralisation is likely to enhance harmony and coordination amongst the provinces and strengthens the federal structure. The fiscal empowerment of sub-national governments involves the devolution of revenue-raising and spending obligations within the territorial jurisdictions of sub-national governments. The assignment of revenue and spending responsibilities to various tiers of government depends largely upon the comparative advantage in maintaining the efficiency and equity while embarking upon these obligations. Fiscal decentralisation also helps in enhancing the efficiency of social service provisions and quality of government through accountability of government(s) to the masses (Oates, 1993; Bahl, 1999; and WB, 2007).

Fiscal decentralization may also promote a governance structure which prevents the central government from indulging in unnecessary fiscal engagement. “For the services to be efficiently provided”, Bird and Smart (2002) argue that “those receiving transfers need a clear mandate, adequate resources and sufficient flexibility to make decisions”. Musgrave (1959) in his profound theory on public finance assigns ‘resource allocation’ function to government, along with macroeconomic stability and income distribution. He discusses that resource allocation function may be assigned to sub-national governments to allow the latter to reflect the preferences of their populaces. Oates (1972) in his “Decentralisation Theorem” believes that public goods provision under the fiscal decentralisation system of governance is welfare enhancing with the reflection of tastes and preferences of local population compare to its central counterpart with uniform level of provision, or in his words “one size fits for all” across all districts and jurisdictions. Faguet (2004) paper shows that decentralisation affects the pattern of investments on social sectors and human capital formations. He applied his simple model on a dataset from Bolivia during the period of 1992-96, and demonstrates that the poorest provinces would invest greater chunk of the devolved funds on high priority projects which meet the basic needs of local people[*]. However, Rodden et al (2003) and Von Hagen et al (2000 & 2001), among others, maintain that if decentralisation is weakly designed, the provinces/states may be encouraged to externalize their costs to their neighbours[†].

Pakistan is a centralist federation with a centralised system of taxation, in which the federal government collects the majority of tax and non-tax revenues and subsequently distributes the same vertically and horizontally. Decentralisation in Pakistan is very ambiguous where the provincial governments have high expenditure obligations with very limited and narrowed tax collecting authority: the central government expends 70% of total public expenditures (Pakistan, various issues). This indicates the imbalanced structure of public finance of Pakistan, where the central government dominates in revenue collection in comparison to undertaking the public sector expenditures. Having a paramount mismatch between the level of expenditure and revenue-raising responsibility, distributed among various tiers of government, the inter-governmental transfers have become an imperative tool in meeting the resource requirements of the lower tiers of government. The inter-governmental resource transfer, which is the significant feature of sub-national finances in Pakistan, takes place under the fiscal arrangement of National Finance Commission (NFC) Award. As mandated by the Constitution, after every five years the President of Pakistan constitutes the NFC Award that prescribes a formula-based fiscal resource distribution and sharing of taxes between the federation and the federating units (provinces) and among the latter itself. Fiscal decentralisation in Pakistan has been a contentious issue and hot topic of debate. However, despite the importance of the issue, no any serious academic and systematic attempt has been made to highlight the fiscal relations of federal and provincial governments and bring out the level and magnitude of fiscal decentralisation in Pakistan. This paper is aimed to bridge this academic gap by identifying the strengths and weaknesses of the fiscal resource distribution and expenditure obligations system in Pakistan. The study is expected to identify the degree and level of fiscal autonomy of the sub-national governments.

The structure of the paper is as follows. Section 2 discusses how intergovernmental fiscal system operates in Pakistan. Following section reports the types of the intergovernmental resource transfers. Section 4 analyses the rationality behind the intergovernmental resource transfer and

[*] For more reading see Shaw (2004); Zhang et al. (2004); Besley and Coate (2003); Lockwood (2002); Alesina et al. (1999); Huther and Shah (1999); Easterly and Levine (1997); Seabright (1996).

[†] For a rigorous discussion refer to Persson and Tabellini (1994) Hindriks and Lockwood (2009).

expenditure obligations of various tiers of governments. Section 5 sketches the evolution and critical dimensions of NFC Awards. Section 6 analyses the political economy dynamics of resource distribution in Pakistan. A final section brings out the overall conclusions of this study.

Intergovernmental Fiscal System in Pakistan

The intergovernmental fiscal system is a significant element for lower tiers of government in the majority of federal countries including Pakistan. In Pakistan, the resource flow takes place at four levels. First flow takes place from the federal to provincial governments through the NFC. While at second level it occurs from the provincial governments to the local governments through Provincial Finance Commission (PFC) Award. At third stage the federal government directly transfers funds to the local governments. Lastly, it is undertaken among local governments. The systematic resource transfers to the provinces from the federal government include revenue shares, development grants, grants-in-aid and loans. In addition to this, the federal government also collects and transfers 'straight transfers' like royalties on gas and petroleum surcharges to the provinces. Major tax revenues of the federal government that also make up the divisible pool are income taxes, sales tax, and excise and custom duties. Though the role of the provincial governments in revenue generation is considerably limited, they are however responsible for the collection and retention of motor vehicle tax, stamp duties, income tax on services, and agriculture tax among other small taxes and duties.

Tax Assignments to Various Levels of Government and Its Components

The assignment of taxes to various tiers of government is defined in the constitution of Pakistan, as has been observed in the majority of countries with federal structure. A thorough analysis reveals a stark difference in tax assignments between federal and federating units' governments, respectively. The provincial governments are not only constraint in having exclusive domain on few taxes and duties (property tax, stamp duties etc.), but are largely pre-empted by federal government in share them.

Taxes that exclusively fall under the federal government mandate are: custom duties, sales tax on goods, and income tax on goods, corporate tax and natural resource taxation. The provincial governments, on the other hand, have exclusive domain on property taxation, stamp duties and income tax on services. Many of the tax bases are shared between federal and provincial governments - yet due to the ambiguous nature of overlapping in these taxes - the problem of excessive taxation in certain tax bases takes place, coupled with increasing compliance costs (Bahl, 1999; and Ahmed and Wasti, 2002).

Expenditure Obligations of Federal and Provincial Governments, and its Components

In Pakistan the expenditure functions of federal and provincial governments is more balanced than the revenue mobilization. However, in Pakistan does not adhere to the general trends flowed in other federations. For example, education, health, agriculture etc. are largely the functional responsibilities of the provinces in majority of federal countries. However, in Pakistan these functions are jointly undertaken by federal and provincial governments, where the functional role of each tier of government is blurred to a great deal.

Nevertheless, in certain sectors like defence, foreign affairs, air services, railway, and currency and banking where the federal government exercises exclusive functions. The function of the federal government on these services is strictly in accordance with the standard principles of federations around the world. With few exceptions the provincial governments would not exercise exclusive authority in any functional responsibility. Albeit, the exclusive role of each tier of government is limited in federal form of government, yet in Pakistan certain functions which ought to be purely in provincial domain are either shared by both level of governments or come in the purview of federal government – agriculture, education, health and social functions are the classic examples. Thus, notwithstanding the extent and nature of decentralisation underlined in 1973 constitution, the real assumption and execution of power has been largely centralized in Pakistan.

Vertical imbalance in Revenue Mobilization and Expenditures in Pakistan

Vertical imbalance in tax and non non-tax resource mobilization is starkly higher in comparison to expenditure. These imbalances are such that the federal government has a budget surplus of 17% to 23%, whereas the budget deficit of provincial governments is with the same magnitude. Table 6 indicates that the provincial governments – this includes the local governments, which come under the jurisdiction of former governments – resource mobilization ranges over 5% to about 9% of total national revenue. On the contrary the federal government enjoys higher revenue share with relatively smaller expenditure, and hence has been able to maintain a budget surplus over the time. This revenue and expenditure imbalance between federal and provincial governments points to two crucial things: 1. revenue decentralisation in Pakistan is not only far lower than other federation, it also has shown a very slight movement over the course of 25 years; and, 2. it implies that the provincial governments with relatively larger expenditure obligations have very narrow base for resource mobilization, therefore, experienced a large budget deficit. This suggests that high centralization of revenue collection with relative decentralisation of expenditure responsibilities has enabled the provincial governments to indulge in unnecessary expenditures, knowing that the federal government finances their budget gaps through intergovernmental resource transfers. This, therefore, makes the provincial governments less accountable to the tax payers.

Table 1: Current expenditure and Revenue Mobilization of Federal and Provincial Governments (Share in percentage)

Year	Expenditure Share		Revenue Mobilization Share		Deficit/Surplus	
	Federal Government	Provincial Governments	Federal Government	Provincial Governments	Federal Governments	Provincial Governments
1980-81	75.3	24.7	93.4	6.6	18.1	-18.1
1985-86	74.1	25.9	92	8	17.9	-17.9
1990-91	73	27	93	7	20	-20
1995-96	72	28	95	5	23	-23
2000-01	74.2	25.8	92.9	7.1	18.7	-18.7
2005-06	76.3	23.7	92.7	7.8	16.4	-15.9
2010-11	73.9	26.1	91.2	8.8	17.3	-17.3

Source: Economic Survey of Pakistan (various years) and federal and provincial governments Documents (various year)

Types of Intergovernmental Resource Transfers

Lower tiers of governments receive several types of transfers from the higher level of government(s). These resource transfers comprise unconditional and conditional transfers respectively. The former include revenue sharing from the divisible pool taxes and straight transfers such as royalty on oil and electricity and development surcharges on gas. The conditional transfers, on the other hand, constitute a relatively low magnitude and largely include development grants, closed-ended matching grants as incentives to provinces for provincial resource mobilization, federal transfer to the universities, among others.

The four types of resource transfers that take place from the federal government to the provincial governments are distinguished below:

3.1. Revenue-Sharing Transfers

Under this head the taxes collected by federal government are shared with sub-national governments under the coverage (divisible pool) of revenue sharing arrangement and divisible pool includes numerous of taxes and duties. This arrangement also decides the share of revenue from each tax to be transferred to sub-national governments. In addition to this, the divisible pool determines specified revenues given to the provincial governments, which include royalty on the exploration of oil and gas, and surcharges on electricity.

3.2. Recurring Grants and Loans

The federal government transfers funds to sub-national governments in order to subsidise a particular social or economic service through grants-in-aids and another kind of grants. Additionally, in case of a severe budget deficit problem in provincial governments the federal government may take the responsibility of financing the deficit through grants, since the lower level of governments are constraint from borrowing to cover it. In case the federal government is reluctant to finance it through grants, then the provincial governments are encouraged to take soft loans from the former. Moreover, the provinces are also given loans to cushion their budget for financing the development expenditures.

3.3. Development Grants

The higher level of government transfers block or specific grants to provincial governments so as to finance the overall development expenditure of the latter or finance particular social service provisions, like education and healthcare, which are deemed necessary for the welfare of the people. Development grants from the federal government usually finance provincial governments through its Annual Development Programme (ADP).

3.4. Debt Servicing and Surcharges

Debt servicing of provincial governments to federal government is the manifestation of reverse flow of funds from lower to higher level of governments, wherein the former pay back to the latter. This reverse payment consists of interests and the principal amounts of loans that have been taken by the provincial governments on various occasions to finance the budget deficit. In addition to this, provinces pay revenues which occur to the higher level of government, specifically the surcharges levied on taxes of the sub-national governments.

4. Rationale Of Expenditure Obligations And Intergovernmental Resource Transfers

As with any federation, in Pakistan intergovernmental fiscal transfers may be justified on following grounds:

Firstly, given the better infrastructure of tax machinery and resources available to the federal government compare to the provincial governments in collecting larger tax revenues, the former government is more able and efficient to levy and collect such taxes, whereas, the provincial governments with the dearth of required or inefficient tax machinery and infrastructure are largely less efficient in undertaking larger tax collections. On the contrary, due to their proximity to taxpaying agents – individuals, corporations etc. – and nature of smaller taxes, such as stamp duties, motor vehicle tax et al, the latter governments are economically efficient to collect these taxes. In the expenditure front, since the central government operates throughout the country with an open economic space, it is therefore more efficient for the central government to embark upon major public expenditures. It is worth mentioning that one of the fundamental assertions in fiscal federalism literature (Oates, 1972) that supports the centralization of public expenditures is the matter of externalities and spillover effects. On the other hand, if externality does not exist, which is largely with small scale projects or public sector expenditures, arguably the sub-national governments are more efficient in undertaking such expenditures. It is, moreover, argued that the latter governments due to their proximity and representation to the people are better able to cater to the needs of the public by embarking on public sector expenditures, which are not economically efficient but socially desirable. Therefore, it is emphasized that expenditure and revenue obligations to various tiers of government may be placed based on the criteria of economic efficiency as well as social desirability, though with lesser magnitude.

Secondly, in Pakistan the expenditure and revenue generation obligations, respectively, are unequally distributed to various levels of government, albeit compare to revenue mobilization the allocation of expenditure functions are evidently more balanced. For example, on average the federal government collects 89% to 90% of total revenue but incurs only 72% of total public sector expenditure. The provincial and local governments, on the other hand, undertake 23 and 5 percent of total public expenditures with the revenue collection share of 5 and 6 percent, respectively (Pakistan, 2010). Yet given this mismatch between resource mobilization and expenditure obligations, an intergovernmental transfer from the national government to sub-national governments is felt to be essential.

Thirdly, an in-depth examination of public finance of Pakistan reveals that the sub-national governments have been incapable of financing the maintenance of running projects and other governmental services, let alone initiating new ones. This inadequacy of revenue in which the sub-national governments are not only incapable of raising adequate revenue to launch new public sector enterprises, but are largely unable to meet the running expenditures, warrants the flow of funds from the federal government to sub-national governments.

Finally, in the majority of countries, developed and developing alike, which have federal system of governance, the income tax and sales tax are sub-national government's subjects in character, that is, they are levied and collected largely by the provincial/state governments. However, in Pakistan both income tax and sales taxes are levied and collected by federal government, though the income tax in services has recently been assigned to the provincial governments for the first time in Pakistan's history after the 18th amendment to the constitution and 7th NFC award.

National Finance Commission Awards: A Historical Perspective

The resource distribution mechanism in Pakistan has undergone through remarkable changes over the year and culminated to its current shape. The NFC gives the legislative provisions of resource distribution between the central and provincial governments and among provincial governments. The NFC Award, established under the Article 160 (1) of the constitution of 1973, is to ensure an even and astute distribution of resources mobilized by the federal government and shared between the latter and the provincial governments. Legally the NFC Award is to be constituted after every five years, as discussed in section 2, by the president of Pakistan, appointing the federal finance minister as the chairman and provincial finance ministers as well as other legal and financial experts as members (Constitution of Pakistan, 1973).

Financial resource distribution in Pakistan traces its history back to the 1935 of Government of India Act, in which the fiscal relation between federal (centre) and provincial governments is delineated and prescribed. The 1935 Act governs the distribution of revenues alongside the legislative responsibilities of central government and its constituent units (Jaffery and Sadaqat, 2006).

Table 2.2 portraits the share of provincial governments in various resource sharing Awards. Though, there have been 12 Awards in total since the independence of Pakistan, only 7 could successfully conclude their final recommendations amicably. The resource transfers trend has been increasing since the first award – Raisman award -, from 12.8% in 1951 to 56-57.5% in 2009. With the exception of 1974 Award, and the following two inconclusive Awards (1979 and 1985) which replicated 1974 Award, the share of provincial government in divisible pool has consistently been increasing. This, therefore, testifies that the country has gradually, albeit very slowly, moved towards fiscal decentralisation.

4.1. Niemeyer Revenue Sharing Award

Niemeyer Award under the 1935 of Government of India Act formulated the resource distribution framework between the central government and its federating units. After the independence, the same financial distribution arrangement was continued, though with some readjustment with the sharing of sales and income taxes and railway budget (Pakistan, 1991).

Table 2: Revenue Sharing Arrangement Under Various Awards *(Provincial share in %age)*

Divisible Pool	Raisman Award 1951	NFC Award 1961	NFC Award 1964	NFC Award 1970	NFC Award 1974	NFC Award 1979	NFC Award 1985	NFC Award 1991	NFC Award 1997	NFC Award 2002	NFC Award 2006	NFC Award 2009
Income Tax and Corporation Tax	50	50	65	80	80	80	80	80	37.5	37.5	41.5 - 46.25	65 - 57.5
Other Direct Taxes									37.5	37.5	41.5 - 46.25	65 - 57.5
Sales Tax	50	60	65	80	80	80	80	80	37.5	37.5	41.5 - 46.25	65 - 57.5
Excise Duty				80								
Tea	50	60	65								41.5 - 46.25	65 - 57.5
Tobacco	50	60	65	80				80			41.5 - 46.25	65 - 57.5
Sugar											41.5 - 46.25	65 - 57.5
Betelent	50	60	65	80							41.5 - 46.25	65 - 57.5
Export Duties									37.5	37.5		
Cotton		100	65	80	80	80	80	80				
Jute	50	100	65	80							41.5 - 46.25	65 - 57.5
Import Duties									37.5	37.5	41.5 - 46.25	65 - 57.5
Succession Duties		100		100					37.7	37.7	41.5 - 46.25	65 - 57.5
Capital Value Tax on Immovable Properties		100		100					37.5	37.5	41.5 - 46.25	65 - 57.5
Petroleum Surcharges									100	100	41.5 - 46.25	65 - 57.5
Gas Development Surcharge									100	100	41.5 - 46.25	65 - 57.5
Divisible Pool Transfers as % of Federal Tax Revenue	**12.8**	**23.1**	**35**	**53.4**	**29.8**	**29.8**	**29.8**	**35.3**	**37.3**	**37.3**	**41.50 - 46.25**	**56 - 57.5**

Source: NFC Reports (various years)

4.2. Raisman Revenue Sharing Award 1951

In December, 1947 Sir Jeremy Raisman presented an Award which was assigned to him in order to formulate a revenue sharing between the federal and provincial governments that was adopted after a long delay on 1st April of 1952. After partition 50% ad hoc share of sales tax was given to the federation (Pakistan, 1991). In remaining 50% the then East Pakistan received 45%, while the rest 55% of half of total sales tax was distributed among the federating units of West Pakistan* based on population.

Table 3: Share of Provinces in West Pakistan in Divisible Pool *(In Percentage)*

Province	Punjab	Sindh	Khyber Pakhtoonkhwa	Balochistan	Total
Population Share	63.58	18.71	14.10	3.61	100
Share in Divisible Pool	59.39	24.14	15.32	1.15	100

Source: Pakistan (1990)

4.3. Revenue Sharing Formula under One Unit: between1961 and 1964

In 1961 a Finance Commission appointed by the then President of Pakistan tabled its recommendations in December. The commission proposed that grants-in-aids and other transfers may be given to the provinces, keeping in view the economic condition of the latter. 50% share of income tax, sales tax and excise duty on tea, tobacco and sugar respectively were given to the units with the share of 54% of West Pakistan and 46% to East Pakistan (table 7).

In 1964 a National Finance Commission was established under the 1962 Constitution's Article 144, in which the scope of the divisible pool was narrowed down to tax on income, export and excise duties, respectively. Under this Award, the share of federal government was 65% and provincial governments received the remaining 35% of the divisible pool.

4.4. National Finance Committee 1970

Under this commission the vertical distribution was recommended as 20: 80%, respectively, for the federal and provincial governments. Out of 20% of provincial share, the East Pakistan received 54 percent – a remarkable departure from the previous awards in which the east Wing's share had invariably remained lesser than its western counterpart. The remaining 46% was given to the West Pakistan and distributed among the provinces accordingly on the basis of Population.

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* Former West Pakistan included the States of Bahawalpur and Khairpur, which later was merged into the province of Punjab and Sindh, respectively.

Even after 1971 when East Pakistan was separated and One Unit was collapsed, the respective provinces continued to get transfers with the same proportion, yet with bigger size of the revenue pie (Ahmed et al., 2007).

4.5. First National Finance Commission Award 1974

The 1974 NFC Award was the first one concluded after the 1973 constitution whereby the scope of divisible pool remained limited to income taxes, sales tax and export duty. The Award recommended that the distribution of net proceeds of allocable federal taxes between the federal and provincial governments would be 20%:80%: the federal government received 20% proceeds, whereas, the remaining would go to the provincial governments' exchequer. For vertical distribution population being the sole criterion placed the Punjab as major beneficiary, as suggested in table 9.

Table 4: Share of Provinces in Divisible Pool In 1974 Award *(In Percentage)*

Province	Punjab	Sindh	Khyber Pakhtoonkhawa	Balochistan	Total
Population Share	60	22.50	13.5	4	100
Share in Divisible Pool	60.50	22.50	13.50	3.86	100

Source: Pakistan (1974)

4.6. The Fourth National Finance Commission Award 1991

After a gap of almost 16 years, in 1990 the first democratic government of Nawaz Sharif formed a Commission under the head of the then federal minister, Mr. Sartaz Aziz, which presented its final recommendations in April 1991. The Award was considered a historic achievement in the sense that it came after a long delay during which the provinces had experienced large and chronic deficits in their respective budgetary positions mainly due to the unbalanced intergovernmental resource transfer pattern. The remarkable accomplishment of this award was that for the first time in Pakistan's history the size and scope of the divisible pool was expanded with the inclusion of taxes and duties, such as duties on Sugar and Tobacco, which hitherto had remained out of divisible pool. Another significant development was the tremendous growth of horizontal share of the provinces: the latter registered a noticeable 60% growth; from 28% (Rs 39 billion) in previous award to 45% (Rs 64 billion) in current award (Ghaus and Pasha, 1994).

However, the Commission remained unsuccessful in including custom duties in divisible pool in spite of strong demand from the provinces in its favour. Another major failure of 1991 Award was to achieve an agreement on horizontal resource distribution; consequently, the existing formula of population was carried out as sole criteria despite serious doubts and reservations for the less populated provinces, particularly the province of Balochistan. Thus, under the recommendations of this award 80 percent of income tax, sales tax, excise duties on Tobacco and Sugar, export duty on Cotton, which formed the divisible pool, were transferred to the provinces from the federation. That was further distributed among the former on the basis of population, as presented in table 11.

Table 5: Share of Provinces in Divisible Pool In 1991 Award *(In Percentage)*

Province	Punjab	Sindh	Khyber Pakhtoonkhawa	Balochistan	Total
Population Share	60	22.50	13.5	4	100
Share in Divisible Pool	57.88	23.28	13.54	5.30	100

Source: Pakistan, 1991

The 1991 Award is considered as a way forward toward fiscal decentralisation that is because the provincial share in total revenues collected by the federal government registered a quantum jump of 18 percent compare to the previous awards. This increment has happened largely due to the inclusion of excise duties on Sugar and Tobacco into the divisible pool which thus far had remained indivisible (Ahmed et al, 2007). Additionally, in pursuance of Article 161 of the 1973 constitution of Pakistan, this award for the first time recognized the rights of the provinces, as surcharges and Royalty on natural gas and net hydel profit, respectively. Moreover, the provinces were also given excise duty on Crude Oil in the shape of straight transfers.

Though, the horizontal transfer did not change due to the population being the only distributional criteria, however, the size of the transfer increased because of the bigger volume of the divisible pool pie. Other drastic steps taken in this award which furthered the fiscal autonomy of the provinces were; first, the provision of special grants and straight transfers to finance the development needs of the latter governments. Hence, under the special grants to the provinces' financial heads, Punjab, Sindh, KP and Balochistan were granted Rs 1000 million, Rs 700 million, Rs 200 million and Rs 100 million respectively in 3rd, 5th, 3rd and 3rd years (Pakistan, 1991). And second, alongside the inclusion of federal excise duty and sugar and tobacco in divisible pool, the share of provinces in two pivotal federally collected taxes – sales tax and corporate income tax – has increased to 80 percent (Sabir, 2001).

However, it is maintained albeit the intergovernmental transaction from federal to provincial governments increased many folds, the provinces were not motivated to build their own infrastructure to generate revenues, which could guarantee the latter's fiscal autonomy (Jaffery and Sadaqat, 2006 &Ahmed et al, 2007).

4.7. The Fifth National Finance Commission Award 1997

The fifth NFC Award was formed under the federal caretaker finance minister, Mr. Shahid Javed Burki, in December 1996, which presented its recommendations in February, 1997. This Award was a departure from the previous ones in many respects; most notably it not only expanded the size of the divisible pool with the inclusion of all tax revenues into it but it also extended the royalties and development surcharges on crude oil and natural gas respectively to the provinces in the form of straight transfers. In other words, the Commission recommended that in every fiscal year each province would be given "a share in the net proceeds of the total royalties on crude oil, an amount which bears to the total net proceeds the same proportion as the production of crude oil in the province in that year bears to the total production of crude oil" (Jaffery and Sadaqat, 2006: p. 217). Likewise, each province would get net proceeds of development surcharges on natural gas equivalent to the well-head production of gas situated in that province.
However, the horizontal resource formula stuck to the population as the singular criterion, that resultantly provided the most populace province of Punjab with ample advantage at the cost of the least populated (though the biggest one in term of territory) but most poorest province of Balochistan – the former province took 57.88 percent of total proceeds and the latter received only 5.30 percent, as presented in table 12.

Table 6: Share of Provinces in Divisible Pool In 1997 Award *(In Percentage)*

Province	Punjab	Sindh	Khyber Pakhtoonkhawa	Balochistan	Total
Population Share	60	22.50	13.5	4	100
Share in Divisible Pool	57.88	23.28	13.54	5.30	100

Source: Pakistan (1997)

In addition to this, this award also recommended grants-in-aids for the two least developed provinces: KP and Balochistan received Rs. 3310 million and Rs. 4080 million respectively each year for five years subject to the 11 percent increment annually in order to adjust the inflation. Moreover, this award also included matching grants to the provinces. Provincial governments with the growth rate of minimum 14.2 percent in provincial receipts, including imposition of new local taxes, withdrawal of exemptions, increasing the levied taxes among others that enhance the local tax mobilization efforts, would receive matching grants of maximum amounts in the subsequent year. Maximum grants for each province is as follows (Jaffery and Sadaqat, 2006):

Punjab and Sindh:	Rs 500 million each,
Balochistan and KP:	Rs 100 million each

The economic downturn during this period constrained the federal government financial positions. Consequently the federal government redesigned and curtailed the federal transfers to the provincial governments. Table 7 highlights a short fall in all transfers during 1997-98 to 2000-01 financial years; however, short falls in divisible pool was more acute than straight transfers and subventions. For instance, the actual transfers to the provinces during 1997-98, 1998-99, 1999-00 and 2000-01 have been Rs.25.532 billion, Rs. 24.9922 billion, Rs. 27.494 billion and Rs.30.111 billion against the projected transfers of Rs. 38.941 billion, Rs.43.304 billion, Rs.49.498 billion and Rs. 58.92 billion, respectively. Looking at subventions and straight transfers, one may realise that the provincial actual receipts were slightly different compare to the projected one (Sabir, 2001; NFC Report, 1997).

4.8. The 6th National Finance Commission 2000

Despite having 11 meetings and intense deliberations, the 6th NFC award, constituted by the president of Pakistan under the chairmanship of federal finance minister, Mr. Shoukat Aziz in July 2000 failed to reach to a conclusion and final recommendations for resource distribution under the a new award. The fundamental reason for this failure was the lack of consensus on vertical and horizontal distribution, respectively. Provincial governments strived to get at least 50 percent share of divisible pool, but and federal government was reluctant to increase the former's share. Similarly, the horizontal distribution was also contentious wherein the smaller provinces, particularly Balochistan and KP were demanding the diversification of horizontal resource distribution criteria by including poverty, backward, inverse population etc. as indicators. However, the largest province, Punjab, resisted and insisted on continuing with the population as the sole criterion for horizontal distribution as it had been the case yet. Thus, this award completed its five years period without any achievement (Khatak et al, 2010).

4.9. The National Finance Commission Award in 2006

The NFC Award in 2006 encountered the similar fate as was the case with its predecessor, that is, it stumbled into a serious deadlock therefore failed to reach into a final agreement for an amicable and judicious resource distribution between federal and provincial governments and among the latter. This stalemate led the Commission into the final option in which the provincial chief ministers entrusted the authority to the president of Pakistan to declare a just and agreeable-to-all award. Consequently, the president under the Article 160(6) of the 1973 constitution amended the "Distribution of Resources and Grants-in-aids Order, 1997", and announced a new award on July, 2006. Hence, this Award raised the provincial share from 41.50 percent to 46.25 percent in both divisible pool and grants during first year, and 50 percent in last fiscal year of this award with addition to 1 percent annually in subsequent years. The divisible pool included taxes on income and wealth, sales tax, capital gain tax, and duties on custom and excise; besides other tax revenues mobilised by the federal government (Pakistan, 2006).

Three broad categories markedly distinguished this award from the previous ones. Firstly, instead of a static share of provinces in divisible pool, for the first time it set up varied share of the provincial governments – that started from 41.50 percent in first year and ended up with 46.25 percent in last year of this award. Secondly, it included Punjab and Sindh as recipients of subventions grants, which they had not been entitled before. And thirdly, it also incorporated 1/6 of the net proceeds that were to transfer further down to the district governments through provincial governments. Furthermore, even if the provincial governments' demand for at least 50 percent transaction from the divisible pool was not met, nevertheless, this award enhanced the share of provincial governments from the 37. 25 percent, that had been practiced in preceding two awards.

However, the demand of smaller provinces of diversifying the horizontal resource distribution has been grossly ignored, and population continued to be the sole horizontal distribution criterion despite the sheer discontent of smaller provinces, particularly of Balochistan.

Table 7: Share of Provinces in Divisible Pool In 2000 Award *(In Percentage)*

Province	Punjab	Sindh	Khyber Pakhtoonkhawa	Balochistan	Total
Population Share	60	22.50	13.5	4	100
Share in Divisible Pool	57.36	23.71	13.82	5.11	100

Source: Pakistan (2006)

As indicated in table 14, the province of Balochistan, despite having 43 percent of total territory of the country and with highest per capita cost in development and social services provision (Nabi and Sheikh, 2011), and highest poverty rate[*] received the lowest transfers from the divisible pool, while Punjab still remained the prime beneficiary – with 57.36 percent share -, thanks to its high population and dominance on country's political economy.

4.10. The 7th National Finance Commission Award 2009

Concluding the final recommendations for this award was not less formidable than the preceding ones, where the provinces of Balochistan and KP insisted on the inclusion of indicators like poverty, backwardness, inverse population density, poor infrastructure among other as criteria for horizontal distribution in one hand, and Sind was not less demanding in including the sales tax on services collection in distribution criteria, on the other hand. It is worthwhile to note that Sindh province contributes more than 60 percent of total tax revenues; that is because, Sindh not only hosts majority of industries, but virtually all custom duties emanates from the same province, thanks to the only functional port[†] of the country being situated in Sindh. The province of Punjab, the vital beneficiary of population being the sole criterion for horizontal distribution, insisted uni-variable criterion-based formula should continue.

Amidst this all pulls and pushes, on December 2009 the 7th NFC award under the chairmanship of federal finance minister, Mr. Shoukat Tareen, recommended a plausible award to the prime minister of Pakistan with the consensus of all stakeholders (Mustafa, 2011). The Award introduced some fundamental shifts in both horizontal and vertical distributions:

1. It took a drastic step towards fiscal decentralization by increasing the share of provincial governments in divisible pool to 56 percent in first year, effective from first July, 2010, and 57.5 percent in remaining 4 years of this Award. In addition to this, the collection charges, which hitherto had been 5 percent by the federal government, has reduced to 1 percent. The federal government also relinquished the sales tax on services under federal excise duties to the provinces (Nabi and Sheikh, 2011).
2. Alongside vertical distribution the horizontal distribution has also undergone into a major shift. Population as a sole resource distribution criterion among provinces very often caused impasse in

[*] In Balochistan 48 percent of population lives below the poverty line whereas in Punjab, Sindh and KP the poverty rate is 26.1 percent, 31 percent and 29 percent, respectively, Ahmed (2010).

[†] Though Pakistan constructed another port at Balochistani town of Gwader in 2008 with the help of China (Ferguson, 2011), but it is yet to be fully functional due to many internal and external factors unleashed in the region.

previous awards, therefore, resulted into an inclusive outcomes. This award, however, tool a positive step to mitigate the horizontal imbalance by diversifying the distribution criteria. Besides population, poverty, backwardness, resource mobilization and inverse population density determined the distribution of resources among the provinces.

As table 16 shows, the inclusion of indicators like poverty/backwardness and inverse population density benefited the smaller provinces - Balochistan and KP, the most. Albeit, population yet stayed as the major indicator compare to other three included indicators, with 82 percent weight, against the poverty/backwardness, revenue mobilization and inverse population density with 10.3 percent, 5 percent and 2.7 percent weight respectively, however, due to the enlargement of the provincial share in vertical distribution the smaller provinces particularly received a big financial relive to consolidate their deteriorating budgetary positions.

3. In order to compensate the provinces that faced extraordinary financial difficulties special considerations have been made in this award to deal with it. For example, it was pledged that the province of Balochistan would get not less Rs 83 billion under the divisible pool transfers. Therefore, its share in divisible pool has increased to 9.09 percent, as indicated in table 2.15, from the actual 7.17 percent based on four indicators criteria for horizontal distribution. In addition to this, conceding the role of KP province as the frontline state in war against terror, the federal government along with remaining provinces agreed upon embarking 1 percent additional of proceeds out of the divisible pool in each fiscal year of this Award is to be given to the KP.
4. In every fiscal year, it is agreed that, each province would receive 50 percent of net proceeds on total royalty on crude oil. Additionally, Balochistan was to receive Rs 120 billion under the head of Gas Development Surcharges, which were owed to federal government, of the installment of 12 years. Likewise, KP was to get Rs 110 billion on the head of hydel profit in 5 years time (Pakistan, 2010).

The bottom line of the 7th NFC award is that it recognized the federal spirit of Pakistan and conceded the fact that without greater fiscal decentralisation provinces would desperately fail in providing social services like education, healthcare basic infrastructure, drinking water and sanitation to their respective population, for which they are constitutionally responsible. Given this, the current award took a quantum jump in providing a much bigger fiscal space to the provincial governments in order to enable them in providing quality social services to the people and consequently be accountable for.

Table 8: Distribution Criteria for 7th NFC Award *(Share in Percentage)*

Population	Poverty/ Backwardness	Revenue Generation	Inverse Population Density	Grants for Compensation on account of OZ&T*	Grant for War on Grants for War on Terror**	Share on the basis of previous award	7th NFC Award
82	10.3	5	2.7			100	100
57.37	23.16	44	4.34			53.01	51.74
23.71	23.41	50	7.21		0.66	24.94	24.55
13.82	27.82	5	6.54	1.8		14.88	14.62
5.11	25.61	1	81.92			7.17	9.09

Source: NFC document (2010) and Nabi and Sheikh (2011)
*Grant-in-Aid to Sindh province is equivalent to 0.66% of the net Provincial Divisible Pool, is given as compensation for losses on account of abolition of OZ&T
**The grant for war on terror is 1% of the total divisible pool, which is equivalent to 1.8% of the provincial share in the net proceeds of Provincial divisible pool.

5. Political Economy Of Resource Distribution And Fiscal Decentralization

Fiscal decentralisation process has been very rocky patch to tread for the last six decades. The strong military and civil bureaucracy with centralist attitude has always remained stubborn in transferring the fiscal and political powers to the federating units. Over-centralization of power embedded in centralist forces impeded the fiscal decentralisation from taking place in a way as otherwise ought to be the case in an ethnically, politically and economically diverse federation as Pakistan. These and other such reasons with similar magnitude made the business of constituting and recommending a NFC for the vertical and horizontal resource distribution, incorporating fiscal needs of all stakeholders, a daunting task in Pakistan. The NFC seems to be a political economy issue, whereas in game theoretic perspective the stakeholders bargain over the resource distribution. In case of failure to reach into a consensus they retreat, willingly or otherwise, to previous Award which is not optimal. Similarly, a consensus-based and multi-factors NFC Award inherently promotes provincial autonomy and fiscal decentralisation, and sadly the latter have been the distasteful area for centrist forces. Political economy discourse in Pakistan shows that forces hostile to decentralisation missed no opportunity in sabotaging any attempt made toward fiscal decentralisation and provincial fiscal and political self rules. Therefore, out of total seven NFC Awards in total constituted after the promulgation of the 1973 constitution, which has made its formation mandatory after the interval of five years, only four succeeded in formulating new parameters in resource distribution. In other words, only four Commissions effectively concluded with their recommendations with consensus.

The criticality of resource distribution lies on the mere fact that since the resource mobilization mechanism is highly centralised in Pakistan, a just and equitable share of provinces in divisible pool makes the latter fiscally capable to finance their development and non-development expenditures. Hence, NFC Award is the only mechanism though which the provinces can fetch a due share of resources to ensure their fiscal autonomy. A less systematic approach adopted thus far in various NFC Awards with central government with heavy share in divisible pool, and the reliance on population as a sole criterion for horizontal distribution negated the resource distribution process that is the general practice similar federations around the world.

This not only hampered the provincial autonomy and fiscal decentralisation that has inflicted serious fraction upon central-provincial relations but also placed a rift among provinces itself. The country which had already lost her Eastern Wing due mainly to the “biased resource distribution” in the favour of West Wing among various other attributed reasons, felt a similar danger that might disbanded the fabric of federation – this time the danger is predominantly sensed from the disgruntled province of Balochistan. So it was felt that the country needed such a resource distribution mechanism that not only revamped the vertical distribution in order to have a lean toward fiscal decentralisation to mitigate the provincial discontent, but to incorporate other criteria for the horizontal distribution alongside population in order to accommodate the less developed and smaller provinces. The matter of resource distribution though has not never been a easy business in any federation let alone Pakistan, however, serious and collaborative deliberations, and honest approach to the issue across the board would help hammering out a consensus-based resource sharing formula, as has shown during the 7th NFC award in Pakistan

6. Concluding Remarks

The federation of Pakistan has gone through various challenges mostly financial, political and geographical in nature since its creation. Among them financial distribution has been pivotal in shaping the strength and direction of the federation. The federal structure of Pakistan demands cooperative and accommodative federalism wherein the federating units can enjoy maximum political, administrative and fiscal autonomy. Therefore, despite centralist tendency the overall mood of the country has always supported for greater decentralisation. One of the central issues of federalism in Pakistan is the vertical and horizontal resource distribution between federal and provincial governments that is mainly discussed in this paper. In addition to this the paper also briefly discussed the expenditure responsibilities of federal as well as provincial governments.

Since resource distribution between federal and provincial governments takes place largely under the NFC Award, therefore, this paper has analyzed fiscal decentralisation in the light of various NFC Awards. Several revenue sharing (NFC) Awards have been announced since independence, and latest one which was concluded in 2009 came after a 19 years with unanimity and accommodating approach to all stakeholders.

The issue of resource distribution between federal and provincial governments has been never simple. Nevertheless, despite complexity, this issue has not been taken seriously during both dictatorial and democratic regimes. The history of resource distribution discussed in this study reveals that the failure in reaching to a consensus-based distribution formula under various NFC Awards has been a political economy issues wherein with game theoretic perspective the stakeholders after being unsuccessful in formulating an acceptable-to-all resource sharing awards led to retreat to a single criterion distribution formula that is not optimal. Thus, it gave way to several interim awards based on uni-variable (population) criterion, which has been very costly for smaller provinces specially Balochistan but beneficial for larger province (Punjab). As a result the process of fiscal decentralisation has not been evolved amicably, and led to create a sense of deprivation and alienation among smaller provinces. However, perceiving the contentious issues the federation was confronted, the incumbent democratic regime made a significant progress towards fiscal decentralisation in the shape of 18th constitutional amendment and 7th NFC Award.

In expenditure front, the federal government overstretched itself into the provincial governments' domain by accepting the matters which were purely provincial in nature like rural development, education, health, road construction, rural development et al. Thus, it was desperately needed to define the provincial governments' fiscal and expenditure roles and provide them with the adequate financial resources so that they could contribute towards the socio-economic development of country as well as strengthen the federal structure.

Albeit, the horizontal resource distribution had been unbalanced till 7th NFC Award, there has been a trend towards fiscal decentralisation in the 1990 Award onwards, in which the divisible pool has expanded with the inclusion of more taxes that hitherto had remained out of the orbit of the divisible pool.

Fiscal decentralisation has been has been adopted by numerous countries around the world based on economic efficiency and equity by encouraging provinces for more competition. And competitive federalism through creating a competition amongst the provinces arguably would take the latter towards better service provisions and more revenue generation. Such competition as result would enhance the economic growth and increase the economic efficiency and improve the governance. For improved and adequate service social and economic service delivery, a sufficient and transparent flow of fund to the lower tier of governments is imperative. Such financial and administrative autonomy would provide more confidence to federating units and make them accountable to their constituents. A decentralised federation of Pakistan would reduce the financial, administrative and political dependency of the provinces on centre and allow the latter to concentrate on critical national issues. Similarly, the provincial governments need to enhance their administrative capacity to ensure the effective implementation of service delivery and revenue generation mandate that are devolved to them after 7th NFC Award and 18th constitutional amendment.

Before we conclude a caveat is in order: this paper has largely limited its discussion to the fiscal and administrative relations between federal and provincial governments. The devolution plan of the government of Pakistan announced in 2001 involved substantial decentralisation to the third tier (local) of governments that is unprecedented in the history of Pakistan. Considering the enormity of research requires analysing the length and breadth of devolution plan and its impact of various socio-economic variables, we leave it for the future researchers to conduct a systematic study.

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