POLITCAL ECONOMY OF FISCAL DECENTRALISATION IN PAKISTAN: AN ANALYTICAL STUDY

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ABSTRACT

This paper examines the evolution of revenue and expenditures decentralisation in Pakistan. The paper discuses major issues regarding the financial distributions and expenditures obligations of both federal and provincial governments. The federal government 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 the fiscal and administrative demands of the provincial governments. Total Seven Awards after the independence of Pakistan, and with the exception of 1974 Award, the trend shows a consistent increase towards the fiscal decentralisation. Although since 1990 Award, the process of decentralisation has got momentum but a quantum jump towards true decentralisation is represented in 7th Award that was concluded in 2009. The last Award the expanded the divisible pool by bringing more taxes into its orbit increased the provincial share and included other criteria besides population for horizontal distribution. As a result the financial position of the provinces improved that resulted into more autonomy.

Keywords**:** Fiscal Decentralisation; NFC Award; political economy; Social service Delivery; Pakistan

INTRODUCTION

As in other developed and developing countries, fiscal decentralisation in Pakistan is aiming to promote the efficiency of various tiers of government in social services delivery and governance. Besides the empowerment of the sub-national governments in terms of finance, the fiscal decentralisation is likely to enhance the harmony and coordination among the provinces hence 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. Oates (1993) and Bahl (1999) argue that 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 decentralization can promote a governance structure which prevents the central government from indulging unnecessary in fiscal arrangement of sub-national governments. Bird and Smart (2002) argue that for the sub-national governments to work effectively, clear mandate and adequate resources are to be made. Musgrave (1959) in his profound theory on public finance argues that the resource allocation function may be assigned to the sub-national governments to reflect the preferences of people. Oates (1972) in his "Decentralisation Theorem" believes that the public goods provision under decentralisation is welfare enhancing reflecting the local population compare to the central governments with uniform level of provision, and "one size fits for all" across all the board. Faguet (2004) shows that decentralisation affects the pattern of investments on social sectors and human capital formations in Bolivia[1]. However, Rodden *et al.* (2003), Von Hagen *et al.* (2000 & 2001) among others maintain that if decentralisation is weakly designed and the provinces/states may be encouraged to externalize their costs to their neighbors.

Pakistan is a centralist federation with a centralized system of taxation, in which the federal government collects the majority of tax and non-tax revenues and distributes them vertically and horizontally. This indicates the imbalanced structure of public finance of Pakistan, where the central government dominates in revenue collection in comparison to conducting the public sector expenditures. Having this mismatch between the level of expenditure and revenue, the inter-governmental transfers have become an imperative tool in meeting the resource requirements of sub-national governments. The inter-governmental resource transfer, which is the significant feature of provincial governments' finances in Pakistan, takes place under the fiscal arrangement of the 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 provinces and among the provinces. Fiscal decentralisation in Pakistan has been a contentious issue and the 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 attempts to fill the gap by indentifying the strengths and weaknesses of the fiscal resource distribution and expenditure obligations system. The paper identifies the degree and magnitude of fiscal autonomy of provincial governments.

The structure of the paper is as follows. Section 2 discusses how intergovernmental fiscal system operates in Pakistan. Section 3 reports the types of the intergovernmental resource transfers. Section 4 analyses the rationality behind the intergovernmental resource transfer and 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. Section 7 gives the conclusion.

Intergovernmental Fiscal System in Pakistan

In Pakistan, the resource flow takes place at four levels. Firstly, it goes from the federal to the provincial governments through the NFC Award. Secondly 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, the local governments share resources among themselves.

The systematic resource transfers to the provinces include revenue shares, development grants, grants-in-aid and loans. In addition, the federal government collects and transfers 'straight transfers' like royalties on gas and petroleum surcharges to the provinces. Major tax revenues of the federal government that constitute 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 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.

Taxes that exclusively fall under the federal government mandate are: custom duties, and income taxes on goods, corporate tax and natural resource taxation. The provincial governments have exclusive domain on property taxation, stamp duties and income tax on services. Many of the tax bases are shared between the federal and the provincial governments. - Because of the overlapping of such taxes, the problem of excessive taxation in certain tax bases occur coupled with increasing compliance costs (Bahl, 1999, and Ahmed and Wasti, 2002).

Expenditure Obligations of Federal and Provincial Governments, and its Components

The expenditure functions of the federal and provincial governments are more balanced than the revenue mobilization. In sectors like defense, foreign affairs, air services, railway, and currency and banking the federal government exercises exclusive functions, which is in accordance with the standard principles of federations around the world. On contrary, with few exceptions the provincial governments do not exercise exclusive authority in any functional responsibility. Although the exclusive role of each tier of government is limited in federal form of government, yet in Pakistan certain functions which should be purely in provincial domain are either shared by both level of governments or only done by the federal government –. 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 resource mobilization is starkly higher compare to the expenditure. Because of this imbalance the federal government has a budget surplus of 17% to 23% with provinces having the same magnitude of deficit. Table 1 indicates that for the provincial governments' resource mobilization constitutes around 5% to 9% of total national revenue. This revenue and expenditure imbalance between federal and provincial governments points to two crucial things. First revenue decentralisation is not only far lower historically compare to other federations with similar nature it has failed to evolve over the time. , Second it implies that the provincial governments with relatively larger expenditure obligations have very narrow base for resource mobilization thus 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. So, the provincial governments remain 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: Developed from various issues of Economic Survey of Pakistan and Federal and Provincial Governments Documents.

Types of Intergovernmental Resource Transfers

Provincial governments receive several types of transfers from the higher federal governments, which include unconditional and conditional transfers. The unconditional transfers 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 constitute development grants, closed-ended matching grants as incentives to the provinces for provincial resource mobilization, federal transfer to the universities etc.

The four types of resource transfers from the federal governments to the provincial governments are elaborated here.

Revenue-Sharing Transfers

Under this head the taxes collected by the federal government are shared with the provincial governments through NFC Award. This arrangement also decides the share of revenue from each tax to be transferred to the provincial governments. In addition, the NFC specified revenues given to the provincial governments, which include royalty on the exploration of oil and gas, and surcharges on electricity.

Recurring Grants and Loans

The federal government often transfers funds to the provincial governments in order to subsidise particular social or economic service through grants-in-aids and another kind of grants. Additionally, in case of severe budget deficits the federal government gives grants to the provinces. In case the federal government is reluctant to finance it through grants, the provinces are encouraged to take soft loans from the federation. The provinces are also given loans to cushion their budget for financing the development expenditures.

Development Grants

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

Debt Servicing and Surcharges

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

The 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 than the provinces in collecting larger tax revenues, the federal government is better and efficient levying and collecting the majority of taxes. Taxes such as stamp duties, motor vehicle tax etc. the provinces are more efficient in collecting them because of their proximity to taxpaying agents On expenditure front the central government is better in embarking upon the major public expenditures given an open economic space available to it.

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. However, if the externality does not exist, the sub-national governments are more efficient in undertaking such expenditures that are community or region specific Thus it may be argued that the provinces 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. The expenditure and the revenue obligations to various tiers of government may be given based on the criteria of economic efficiency and social desirability, though with lesser magnitude.

Secondly, the expenditure and revenue generation obligations are not equally distributed to various levels of government, albeit compare to revenue mobilization the allocation of expenditure functions are more balanced. Given this mismatch between resource mobilization and expenditure obligations between the federal government and the provinces, a vibrant intergovernmental resource transfer mechanism is essential.

Thirdly, an in-depth examination of public finance of Pakistan reveals that the provinces are not able to finance the maintenance of the running projects and other governmental services, not to mention initiating new ones. This inadequacy of revenue therefore pre-empted necessitated the flow of funds from the federal government to the provinces.

And finally, in the majority of countries that have federal form of governance, the income tax and sales tax are provincial/state subjects in character. That is, they are levied and collected largely by the provincial/state governments. However, in Pakistan both the taxes are levied and collected by the federal government, though the income tax in services has recently been assigned to the provinces after the 18th amendment to the Constitution and the 7th NFC award.

National Finance Commission Awards: A Historical Perspective

The NFC Award gives the legislative provisions of resource distribution between the federation and provinces and among the provinces itself. 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 federation and shared between the federation 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 the Government of India Act. The 1935 Act governed and delineated the distribution of revenues alongside the legislative responsibilities of central government and its constituent units (Jaffery and Sadaqat, 2006). Table 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 data presented in table 2 show that 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 provinces in divisible pool has consistently been increasing. This, therefore, testifies that the country has gradually, albeit very slowly, moved towards fiscal decentralisation.

Niemeyer Revenue Sharing Award

Niemeyer Award under the 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)

Raisman Revenue Sharing Award 1951

In December, 1947 Sir Jeremy Raisman presented an Award to formulate a revenue sharing between the federal and provincial governments that was adopted after a long delay on 1st April of 1952. After the 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 was distributed among the provinces of West Pakistan[2] based on population.

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

Province	Punjab	Sindh	KPK	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)

Revenue Sharing Formula under One Unit: between1961 and 1964

In 1961 a Finance Commission constituted in 1961 tabled its recommendations by the turn of the same year to the then president of Pakistan. The Commission proposed that grants-in-aids and other transfers may be given to the provinces, considering the economic situation of the provinces. Under this Commission 50% share of income tax, sales tax and excise duty on tea, tobacco and sugar respectively were given to the provinces with the share of 54% of West Pakistan and 46% to East Pakistan. However, 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. Under this Award, the share of federal government was 65% and the provinces got the remaining.

National Finance Committee 1970

The 1970 Commission recommended the vertical distribution as 20%: 80% for the federation and the provincial governments. Out of 20% of provincial share, the East Pakistan received 54% – a remarkable departure from the previous Awards in which east Pakistan share had invariably remained lesser than West Pakistan. The West Pakistan share (46%) was allocated based on population. Even after 1971 when East Pakistan was separated and One Unit was collapsed, the provinces continued to get transfers with the same proportion, though with bigger size of the revenue pie (Ahmed *et al.*, 2007).

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%.For vertical distribution population was the sole criterion that placed Punjab the major beneficiary, as suggested in table 4.

Table 4: Share of Provinces in Divisible Pool 1n 1974 Award *(In Percentage)*

Province	Punjab	Sindh	KPK	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)

The Fourth National Finance Commission Award 1991

After a gap of almost 16 years, in a Commission was formed., The Commission presented its final recommendations in April 1991. The Award was considered an 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 accomplishment of this Award was that 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 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 this Award (Ghaus and Pasha, 1994). However, the Commission was not successful in including custom duties in divisible pool despite strong demand from the provinces. Another major failure of the 1991 Award was not making a consensus on horizontal resource distribution. Consequently, the existing formula of population was carried out as sole criteria even with serious doubts and reservations for the less populated provinces, particularly the province of Balochistan. The share of provinces in the 1991 Award is shown in table 5.

Table 5: Share of Provinces in Divisible Pool 1n 1991 Award *(In Percentage)*

Province	Punjab	Sindh	KPK	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 because the provincial share in total revenues collected by the federal government registered a quantum jump of 18 % 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 was not divisible (Ahmed et al, 2007).

Though, the horizontal distribution criteria did not change, the size of the transfer increased because of the bigger volume of the divisible pool pie. Under this Award the fiscal autonomy of the provinces increased because of the provision of special grants and straight transfers to finance their development needs. Moreover, the share of provinces in two pivotal federally collected taxes – sales tax and corporate income tax – has increased to 80 % (Sabir, 2001).

The Fifth National Finance Commission Award 1997

The fifth NFC Award was formed in December 1996 that 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 to the provinces in the form of straight transfers. In other words, the Commission recommended that each year province will get “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). Furthermore, each province would get net proceeds of development surcharges on natural gas equivalent to the well-head production of gas situated in that province.

The horizontal resource formula still stuck to the population as the singular criterion, that gave Punjab 57.88% share of distributed pool, and only 5.30% for Balochistan (see table 6).

Table 6: Share of Provinces in Divisible Pool 1n 1997 Award *(In Percentage)*

Province	Punjab	Sindh	KPK	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, this Award 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 % increment annually in order to adjust the inflation. It also included the matching grants for the provinces. Provinces with the growth rate of minimum 14.2 % 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 (Jaffery and Sadaqat, 2006).

The 6th National Finance Commission 2000

The 6th NFC Award, constituted in July 2000 failed to reach to an amicable solution despite having 11 meetings and lots of deliberations. The fundamental reason for this failure was the lack of consensus on vertical and horizontal distribution criteria. Provinces strived to get at least 50 % share of divisible pool, but federal government was reluctant to increase the provincial share. Similarly, the horizontal distribution was also contentious wherein the smaller provinces, particularly Balochistan and KP demanded the diversification of horizontal resource distribution criteria by including poverty, backward, inverse population etc. as indicators. However, other two provinces resisted the diversification of horizontal resource distribution. Thus, this Award completed its five years period without any concrete outcomes (Khatak *et al.*, 2010).

The National Finance Commission Award in 2006

The NFC Award in 2006 encountered the similar fate as the Award of 2000. That is, it stumbled into a serious deadlock and failed to reach into a final agreement for an amicable and judicious resource distribution between the federal and provinces and among the provinces. This stalemate led the Commission into the final option where the 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 % to 46.25 % in both the divisible pool and the grants during first year, and 50 % in last fiscal year of same Award with addition to 1 % 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 mobilized 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 % in first year and ended up with 46.25 % in last year of the Award. Secondly, it included Punjab and Sindh as recipients of the subventions grants, which they had not been entitled before. And thirdly, it 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 % transaction from the divisible pool was not met, nonetheless, the Award enhanced the share of the provinces from the 37. 25 %, that was followed in preceding two Awards. However, the demand of smaller provinces of diversifying the horizontal resource distribution was not entertained thus population continued to be the sole horizontal distribution criterion.

Table 7: Share of Provinces in Divisible Pool 1n 2000 Award *(In Percentage)*

Province	Punjab	Sindh	KPK	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 7, Balochistan despite having 43 % 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[3] received the lowest transfers from the divisible pool, while Punjab still remained the prime beneficiary – with 57.36% share -, due to its high population and the dominance on country's political economy.

The 7th National Finance Commission Award 2009

Concluding the final recommendations for 2009 Award was equally difficult as the previous ones where Balochistan and KP insisted on the inclusion of indicators like poverty, backwardness, inverse population density, poor infrastructure among other as criteria for the horizontal distribution. Sind demanded in including the sales tax on services collection in distribution criteria. It is worthwhile to note that Sindh province contributes more than 60 % of total tax revenues because Sindh not only hosts majority of industries, but virtually all custom duties emanates from the same province, due to the port[4] of the country being situated in Sindh.

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

[4] Though Pakistan constructed another port at Gwader, Balochistan in 2008 with the help of China (Ferguson, 2011), but it is partially functional due to several internal and external factors.

The Punjab the vital beneficiary of population, insisted uni-variable criterion-based formula should continue.

Amidst this on December 2009 the 7th NFC recommended a plausible Award to the prime minister 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 the fiscal decentralisation by increasing the share of the provinces in divisible pool to 56 % in first year, effective from first July, 2010, and 57.5 % in remaining 4 years of this Award. In addition the collection charges, which hitherto had been 5 % by the federal government, has reduced to 1 %. 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 previous Awards. Therefore, they resulted into 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 8 shows, the inclusion of indicators like benefited the smaller provinces. Albeit, population yet stayed as the major indicator compare to other three included indicators, with 82 % weight, against the poverty/backwardness, revenue mobilization and inverse population density with 10.3 %, 5 % and 2.7 % 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 (see table 8 for more details) in every fiscal year, it is agreed that, each province would receive 50 % 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 provinces 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)*

Indicators	Population	Poverty/ Backwardness	Revenue Generation	Inverse Population Density	Grants for Compensation on account of OZ&T*	Grant for War on Grants for War on	Share on the basis of previou	7th NFC Award

						Terror**	s award	
Weight	82	10.3	5	2.7			100	100
Punjab	57.37	23.16	44	4.34			53.01	51.74
Sindh	23.71	23.41	50	7.21		0.66	24.94	24.55
KPk	13.82	27.82	5	6.54	1.8		14.88	14.62
Balochista n	5.11	25.61	1	81.92			7.17	9.09

Source: NFC document (2010) and Nabi 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.

Political Economy Of Resource Distribution and Fiscal Decentralisation

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 reluctant in transferring the fiscal and political powers to the provinces. Over-centralization of the 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, was a daunting task in Pakistan.

The NFC Award 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. However, the fact remained that the centrist forces seem n not to have much appetite for fiscal decentralisation. Political economy discourse in Pakistan shows that forces hostile to decentralisation missed no opportunity in sabotaging any attempt made towards fiscal decentralisation and provincial fiscal and political self rules. Therefore, out of total seven NFC Awards constituted after the promulgation of the 1973 Constitution only four succeeded in formulating new parameters in resource distribution.

Given the centralized resource distribution mechanism in a just and equitable share of provinces in divisible pool makes them fiscally incapable 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 the population as a sole criterion for horizontal

distribution negated the resource distribution process that is the general practice in 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. 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.

CONCLUSIONS

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 strengths and directions of the federation. The federal structure of Pakistan demands cooperative and accommodative federalism where the provinces 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 both the governments.
Since resource distribution between federal and provincial governments takes place largely under the NFC Award hence this paper has analyzed fiscal decentralisation in the light of various NFC Awards. Several revenue sharing (NFC) Awards have been announced since the 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. The history of resource distribution shows that the failure in reaching to a consensus-based distribution formula under various NFC Awards has been a political economy issues with game theoretic perspective, in which 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 population, which has been very costly for smaller provinces specially Balochistan but beneficial for Punjab. As a result the process of fiscal decentralisation has not been evolved amicably, but led to create a sense of deprivation and alienation among smaller provinces.
In expenditure front, the federation overstretched itself into the provinces 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 provinces 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. Although 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. Decentralization can reduce the financial, administrative and political dependency of the provinces on centre and allow the latter to concentrate on critical national issues. And, 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 the federation and the provinces. The Devolution Plan 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 is required analyzing the length and breadth of the Devolution Plan and its impact of various socio-economic variables, we leave it for the future researchers to conduct a systematic study on this issue.

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