

ASSESSING FISCAL RESOURCE DISTRIBUTION IN PAKISTAN- THE NFC AWARDS



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Fiscal resource distribution in Pakistan has never proved easy. Due to the associated political economy, Pakistan has experienced a stagnant state of affairs with regard to National Finance Commission awards (NFC), which is worrisome. Research at PIDE⁹ has shown the fault lines and has highlighted the line of action, as summarised below.

Functioning federal system needs a coherent, vibrant and effective interaction between the centre and the federating units. Resource generation, its apt availability and efficient utilization is what the representatives compete for in the federal and provincial governments, so to make their electorate satisfied. Hence, clarity in constitutional mandate as well as in fiscal responsibilities is important to mitigate negative competition. Efficient resource distribution mechanism is achieved through a dynamic resource distribution formula, which carries a balance between equity and efficiency aspects. As obvious, the dynamic resource distribution is required to contain incentives for each tier to perform and achieve their best.

⁹See Bibliography for details

Pakistan faces challenges not only in finding an efficient NFC formula (which could satisfy the conditions of need, equity and efficiency) but also has yet to adopt an efficient mechanism, which could help to arrive at an amicable resource distribution in Pakistan.

HURDLES FACED IN SMOOTH POLICY PROCESS FOR RESOURCE DISTRIBUTION

1) Stalemate in meeting and resultantly in the announcement of NFC awards

- a. Unanimity rule (decision revolves around political economy and consensus rather than economic rationale)
- b. Constitutional Bar after 7th NFC award has compromised the dynamic nature of resource distribution (no incentive for new formula unless greater funds are available for redistribution)

2) Mechanism adopted for resource apportioning

- a. NFC members are predominantly political stakeholders
- b. Absence of dedicated NFC secretariat
 - i. Lack of professionals and inability to engage research support
 - ii. Lack of institutional strength, hence, lack of continued analysis and monitoring

3) Missing emphasis on efficiency

- a. Efficiency is not adequately rewarded in NFC formula (given criterion in formula ('revenue collection/generation') is inappropriately represented with inadequate proxy)
- b. Weights for different criteria are arbitrarily assigned, needs in-depth impact assessment for different formula (needs experimentation with available criteria factors and weights for each criterion)

FAULT LINES AND THE PROPOSED POLICY RESPONSES

Issue

1. What is unique to Pakistan is that throughout its history the provinces always remained dependent on the financial assistance from the centre to provide basic services

Line of action

- The federal government shall have regular meetings of CCI to discuss the issues faced by the country and shall work to achieve consensus among the federating unit. Given the constitutional bar, there is no incentive for provinces to agree to a new NFC award because the federal government cannot spare more funds for the provinces. Thus, the only way out at the moment is that each unit shall work to enlarge the resource pie and also to efficiently utilize the given fiscal resources

Issue

2. Provinces' eroded fiscal capacity as well as the lacking political will to raise revenues from potential indigenous resources, despite having a clear mandate since 2010

Line of action

- In the last NFC award, provinces were required to generate budgetary surpluses to contain fiscal deficits, they should adhere to their promises; a consensus to be achieved through CCI. Moreover, provincial own source revenues shall be tapped to its full potential. The new NFC formula shall keep significant incentive (e.g. matching grant) for achieving local revenue growth. Similarly, NFC formula should reward the tax-broadening efforts by each subnational government tier including local governments (100% retention of newly generated resources for specific period)

Issue

3. A functioning Local government (LG) system is missing

Line of action

- Provinces draw constitutional mandate of autonomy from the 18th constitutional amendment but when the same Act asks for empowered LGs, provinces have somehow avoided it till date. A range of hurdles including: late legislation, delay and postponement of LG elections and subsequent oath taking, compromised fiscal mandate (coupled with lack of decision space) and alike, were imposed on LGs to not let go the influence of provincial governments/representatives on local administration and local funds allocation. This has hampered the service delivery process at lower level which subsequently now rest (unduly) on provincial bureaucracy and members of provincial assembly.
- This discrepancy in the form of compromised decision space at local government level needs to be sorted out for efficient resource utilization. CCI can be a forum where the provincial LG system and the ICT LG system needs to be reviewed, analysed and amended to ensure an efficient service delivery model in true spirit.
- Direct transfers to LGs (in NFC award) can be a good start to empower the LGs in all federating units. Such funds can be allocated on the basis of (i) development needs (population and area), (ii) basic rights (health and education – spending needs and rewards for high achiever LGs) and (iii) adherence to national strategic goals (e.g. working towards sustainable urban development, SDGs and environmental sustainability)
- In addition to direct transfers, LG shall be allowed to retain all the locally generated revenue resources which should be spent on improvement of local services in area of origin

Issue

4. The compromised federal budgetary situation post 7th NFC (2010) and the continued federal government's stubbornness not to let go the subjects and initiatives (and hence the concerned ministries, authorities and departments) which are purely provincial mandate post 18th constitutional amendment

Line of action

- The federal government has rightly embarked upon the right sizing policy. All the ministries, departments and initiatives (e.g. poverty (BISP), Education (HEC/Single National Curriculum), Environment (Ministry of Climate Change) and Health (Ministry of National Health & DRAP)) needs to devolved to appropriate subnational level.
- Moreover, the discretionary funds for the executives and member of parliaments shall be discontinued where all the public funds allocation be made through the concerned institutions. This will institutionalize the public funds allocation and empower the institutions while ensuring better transparency.

Issue

5. Specifically with respect to the resource distribution in Pakistan, three issues need special attention. Firstly, what mechanism of vertical inter-governmental transfers should Pakistan follows? Secondly, how the weights be assigned to different criteria and lastly, the functionality, consistency and above all the ability of the resource distribution forum to present amicable resource distribution formula.
6. Regarding the selection of criteria and assigning their weights is concerned, the situation in Pakistan is not ideal. While deciding the NFC award in 2009, the commission failed to share any analytical evidence (other than brainstorming) to support the rationale for selecting certain criterion or their respective weights. Similarly, allocating different weights to each of the four criteria also needs to be based on sufficient analysis to understand the individual impact of each and hence to develop different scenarios. This is even more important when the stated aim of 2010 NFC award was diversification but still population criterion is continued as a dominant indicator with 82% weightage.

Line of action

- As far as the resource distribution mechanism and the formation of NFC forum is concerned, political appointees (federal and provincial finance ministers) dominantly occupy the given mechanism (i.e. the national finance commission). Given their prime responsibilities and engagements, the forum lacks the ability to undertake rigorous analysis that is necessary for ensuring efficient resource distribution in Pakistan. This impression arises when one look at the composition of NFC, which is predominantly consisting of political representatives instead of experts in the field. Hence, the NFC forum should have a permanent secretariat, consisting of researchers and experts in the field. The said research secretariat for NFC and PFCs shall be responsible to provide essential support in the form of compiling international best practices, ensure regular stream of data and determine the future needs of the nation.
- Similarly, the existing national finance commission shall be replaced with a technical research team, having professionals and policy experts that can make extensive engagements with stakeholders, conduct field visits throughout the country and develop impact scenarios for different resource distribution formulae to assess the impact of any given resource distribution formula on the people and state.
- The said forum should prepare a report (within the stipulated time) and place it before the CCI (or any appropriate political forum), which shall be responsible to review, amend (if required) and award the apportioning formula.

Issue

7. The current fiscal resource distribution mechanism has left the centre handicapped to take any immediate policy initiative having financial implications (e.g. terrorism, natural calamity in the form of Covid-19/ floods, development needs of erstwhile FATA, agricultural catastrophe like locust attack etc.)

Line of action

- While deciding the NFC award, a given percentage may be allocated out of the total government proceeds to achieve strategic national goals. CCI can be utilized to develop consensus about the given strategic goal and the ratio of total proceeds.

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Annexure:

S.No.	Country	Shared taxes	Percentage	Criteria	Percentage
1.	Argentina	Value added tax	53.90	Population	65.00
		Income tax	48.70	Development gap	25.00
		Asset tax	49.00	Inverse population density	10.00
		Excise tax	49.00		
		Financial service tax	49.00		
		Fuel tax	53.00		
2.	Brazil	Income tax	21.50	Population	Equal
		Payroll tax	66.70	Area	
		Tax on industrial production	21.50	Per capita basis	
		Taxes on Hydroelectricity and Minerals	45.00		
3.	Colombia	All Federal Taxes	23.00	Population	70.00
		Beer Tax	40.00	Equal share	30.00
		VAT	50.00		
4.	Germany	Income tax	42.50	Origin	100.00
		Corporate tax	50.00	Origin	100.00
		VAT	50.00	75% on population & 25% to Lander having per capita tax revenue below national average	75:25
5.	India (15 th FC award, 2020-2025)	Income Tax	28.00	Population	15.00
		Excise Duties	28.00	Income distance	45.00
		Estate Duties	28.00	Area	15.00
				Demographic performance	12.50
				Forest and ecology	10.00
				Tax & Fiscal efforts	02.50
1.	Indonesia	Royalties on Oil & Gas	100.00	Origin	100.00
		Forestry Royalties	35.00	Origin	100.00
		Motor Vehicle Tax	100.00	Origin	100.00
		Tax on land and area	81.00	Origin	100.00
2.	Japan	Income tax	32.00	Collection	100.00
		Liquor tax	32.00		
3.	Malaysia	Import & Excise duties on oil	30.00	Collection	100.00
		Export duties on Tin	10.00		
4.	Mexico	Income tax	17.35	Population	50.00
				Collection	50.00
5.	Nepal	NA	NA	Population	50.00
				Poverty	25.00
				Tax effort	15.00
				Area	10.00
6.	Nigeria	All federal taxes	31.50	Minimum responsibility	40.00
				Population	40.00
				Social development factor	15.00
				Collection	05.00

S.No.	Country	Shared taxes	Percentage	Criteria	Percentage
1.	Pakistan	All federal taxes	57.50	Population	82.00
				Poverty or Backwardness	10.30
				Revenue Collection or Generation	05.00
				Inverse Population Density (Area)	02.70
2.	Philippines	All federal taxes	40.00	Population	25.00
		Tax on Petroleum and Natural Resources	77.00	Land area	25.00
				Equal share	50.00
				Origin	100.00

Source: Rana (2017); For Germany-UNDP, 2015; For India and Pakistan-Author's own contribution; For Nepal, Palihakkara (2016), NA= Not Available

Year	Fed/prov.	Distribution criteria	Punjab	Sindh	KPK	Baluchistan
1974	20:80	Population 100%	60.25	22.50	13.39	3.86
1979 (Interim award)	20:80	Population 100%	57.97	23.34	13.39	5.30
1985 (Interim award with adjustments)	Interim award	Population 100%	Interim award	Interim award	Interim award	Interim award
1991	20:80	Population 100%	57.87	23.29	13.54	5.30
1997	62.5:37.5	Population 100%	57.88	23.28	13.54	5.30
2000 (Interim award)	Interim award	Population 100%	Interim award	Interim award	Interim award	Interim award
2006 (via Presidential ordinance)	45*:55	Population 100%	53.20	24.96	14.78	7.05
2010	42.5:57.5	Population 82% Poverty/ Backwardness 10.3% Revenue Collection/Generation 5% Inverse Population Density 2.7%	51.74	24.55**	14.62***	9.09
2015 (Interim award)	Interim award	Interim award	Interim award	Interim award	Interim award	Interim award
2020 (Interim award)	Interim award	Interim award	Interim award	Interim award	Interim award	Interim award

* to rise by 1% per annum till its reaches 50% of the divisible pool
**plus 0.66% for losses in OZT
***plus 1% of total divisible pool for losses in war on terror.
Source: Author's contribution