

PIDE Working Papers

No. 2025:11



PIDE
PAKISTAN INSTITUTE
OF DEVELOPMENT
ECONOMICS

Resource Distribution Mechanism in Pakistan: A Critical Review

Iftikhar Ahmad

PIDE Working Papers
No. 2025:11

**Resource Distribution Mechanism in Pakistan:
A Critical Review**

Iftikhar Ahmad

Pakistan Institute of Development Economics, Islamabad.

PAKISTAN INSTITUTE OF DEVELOPMENT ECONOMICS
ISLAMABAD
2025

Editorial Committee:

Dr. Amena Urooj

Disclaimer: Copyrights to this PIDE Working Paper remain with the author(s). The author(s) may publish the paper, in part or whole, in any journal of their choice.

Pakistan Institute of Development Economics
Islamabad, Pakistan

E-mail: publications@pide.org.pk
Website: <http://www.pide.org.pk>
Fax: +92-51-9248065

Designed, composed, and finished at the Publications Division, PIDE.

CONTENTS

Abstract	v
1. Introduction	1
2. Resource Distribution Mechanism in Pakistan	2
2.1 Commentary on the NFC award-2010	3
3. Insights from the Literature	6
3.1 International Experience	6
3.2 Historic development and commentary on the 7th NFC award	11
3.3 Mechanism and Structure of Resource Distribution in Pakistan	17
3.4 Empirical studies	18
4. Summary and Conclusion	20
References	21

LIST OF TABLES

Table 1. International Experience w.r.t. Fiscal Resource Transfer Mechanism	7
Table 2. Revenue and Resource Distribution between Centre and Sub-National Governments	8
Table 3. Revenue and Resource Distribution between Centre and Sub-National Governments (cont.)	9
Table 4. Governance structure: 20th versus 21st Century	11
Table 5. History of Resource Distribution in Pakistan	13
Table 6. Composition of Transfers from Federal to Provincial Governments	14
Table 7. Revenue Sharing between Federation and the Provinces under Various NFC Awards (Percent)	14
Table 8. Straight Transfers to the Provinces	15
Table 9. Structure of Provincial Revenues (Percent)	15
Table 10. Provincial Shares under each Criterion of 2010 NFC Award	16

ABSTRACT

This study reports important literature on resource distribution in Pakistan. Resource distribution is a vast policy area having three different dimensions including federal to provinces transfers, provincial to local governments transfers and direct transfers from federal to local governments. This study specifically concentrate on the first proposition, hence, analyses literature on National Finance Commission awards (NFC) in Pakistan. There is handsome literature available on resource distribution in Pakistan but a major chunk seems to be repetitive given the stagnant state of affairs in Pakistan. For analysis, studies have mainly relied on three methodological spheres including thematic analysis, basic arithmetic estimates and the econometric techniques that frame the cause and effect dimensions of fiscal resource distribution. Papers, as obvious, adopted thematic analysis while discussing the resource distribution mechanisms overtime. The papers broadly structured the discussion around different NFC awards and explained the changes and disagreements among the stakeholders. These studies enable the reader to understand the historical overview of the resource distribution in Pakistan. The second strand of discussion on resource distribution consists of the studies that have presented arithmetic estimates to discuss the current or suggested resource distribution and their implications on provincial resource availability. Lastly, a number of studies have resorted to econometric techniques to report the impact of fiscal decentralisation on different economic and social indicators namely economic growth, public expenditure efficiency, health, education, poverty, infrastructure as well as governance and corruption. These studies have worked out the cause and effect analysis and commented on the effectiveness of fiscal resource distribution in Pakistan employing different dependent variables. To summarize, this study agrees that NFC award of 2010 is a step forward in the stagnant affairs of resource distribution in Pakistan, nevertheless, the current formula as well as the resource distribution mechanism is still far from optimal in true sense.

Keywords: Fiscal federalism, intergovernmental relations, resource distribution mechanism, Pakistan, NFC awards, formula transfers, grants

1. INTRODUCTION

Functioning federal system needs a coherent, vibrant and effective interaction between the centre and the federating units. Once the constitutional prerequisites are accomplished, the most important condition to make a federation work is the functioning financial arrangements. Resource generation, its apt availability and efficient utilisation is what the representatives compete for in the federal and provincial governments, so to make their electorate satisfied. Thus, representatives at both the tiers are competing against each other for resources, which represents a paradox. Hence, clarity in constitutional mandate as well as in fiscal responsibilities is important to mitigate negative competition. Efficient resource distribution mechanism calls for the ideal Pareto efficient point where no further improvement is possible without imposing a cost on the other party. This can only be achieved through a dynamic resource distribution formula, which carries a balance between equity and efficiency thus is required to contain incentives for each tier to perform.

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. The federal government continuously provided funds to provinces, having the excessive funds collected at the centre. The said practice, however, eroded provinces' capacity as well as their willingness to raise revenues from potential indigenous resources, which is now proving an important issue despite having a clear mandate since 2010 (Ahmad, et al. 2021). Thus, the provinces always look to the centre to cover their expenses, which made them vulnerable and dependent. The situation continued until the 7th NFC award, as previously the federal government distributed a manageable portion of additional resources among the federating units. However, the situation reversed in 2010, when it was decided that 57.5 Percent of the total federal tax proceeds be horizontally divided among the provinces while centre is left with 42.5 Percent of the total divisible pool. However, the compromised federal budgetary situation is also attributed to its stubbornness not to let go the subjects and initiatives (hence the concerned ministries, authorities and departments) which were now purely provincial in nature after the 18th constitutional amendment e.g. poverty (BISP), Education (HEC/Single National Curriculum), Environment (Ministry of Climate Change) and Health (Ministry of National Health & DRAP).

Bottlenecks do exist and will persist until detailed analysis is undertaken. With respect to resource distribution in Pakistan, three issues need attention. Firstly, what mechanism of vertical inter-governmental transfers does Pakistan follows? Secondly, how the weights are being assigned to different criteria and lastly, the functionality and consistency of the forum to present amicable resource distribution formula. Talking of the first point, if we observe the global practices, the vertical transfers' approaches are categorised in three: need based, equity based and efficiency based. Usually, the transition happens in the same order as mentioned and is tied to the country's stages of development. Countries have also experimented by having a combination of the given.

Pakistan follows formula transfers approach to address vertical fiscal imbalances. The mechanism though is not optimal. Studies have questioned the composition of National Finance Commission (NFC) and the subsequent consideration like inclusion of different indicators in the formula and their respective weightages. The given system is believed to be politically motivated and not based on rigorous analysis 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. As far as the second

point 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 Percent weightage. Therefore, there is need to investigate literature that how resource distribution formula can be made in a better way, based on international experience, local context and ground realities.

Lastly, in order to understand the underlying basis of failures for NFCs, we need to understand the political economy of NFC forum and compare it to the one in vogue internationally. Unanimity rule being adopted for approval of the NFC has led to recurrent deadlocks; hence, we need to investigate what literature offers on this. Is efficiency factor intentionally being ignored or just assigned an insignificant weightage? The available literature is likely to guide on the aforementioned issues. Thus, it is important to understand the political economy perspective of NFC, which is pivotal for the whole resource distribution mechanism and the dynamics attached to it.

Resource distribution in Pakistan has always remained a bone of contention (Ahmad, et al. 2007). Historically, Pakistan has excessively remained a centralised federation, with the federal government having vast powers to collect revenues, leaving provinces with exhausted avenues for revenue raising (unless new initiatives at provincial level are undertaken). The 7th NFC award (2010) was a bold step in our resource distribution history, however, the situation demands further analysis to search for an optimal resource distribution mechanism. This is important so that no one can externalise their inefficiencies on the other member of the federation. There is a need for new formula, which can induce the centre and provinces to put in their maximum effort for optimal resource generation and to ensure spending efficiency in order to achieve the highest possible shared prosperity (Ahmad, et al. 2021). The required mechanism need a deeper analysis to assess the needs of the population as well as the potential of the jurisdiction so that no one gets a free lunch. An updated NFC formula is required not only to fulfil the expenditure needs (in wake of population needs or cost disabilities) but also to have sufficient incentives to reward efficiency and efforts. Hence, this study aims to collect evidence for the upcoming NFC formula and compile evidence on the required institutional, political and financial preconditions. The aim is to learn from available literature about best possible solutions and indicate the criteria used to proxy needs, performance as well as to pen down set of right incentives to each federating unit to perform optimally for long term goals.

2. RESOURCE DISTRIBUTION MECHANISM IN PAKISTAN

Article 160 of the 1973 Constitution of Pakistan states that, “*Federal Government will set up a National Finance Commission (NFC) at an interval of no more than 5 years for distribution of resources among federation and its units*”. Provinces are also required to form Provincial Finance Commission (PFC) for further redistribution of provincial resource among the lower tiers. Thus, the resource distribution mechanism is clear in terms of Constitution but there still are issues in the adopted mechanism and its implementation in true spirit.

Since 1973 to date, at least ten NFCs awards were to be announced constitutionally. However, due to political instability and deadlocks, only five NFCs have been announced (Ahmad et al., 2007). These include, the NFC awards of 1974, 1991, 1996, the Presidential Order of 2006 while latest is the NFC award of 2010. Out of these, four had brought certain phenomenal changes (including the one for 1991, 1996, 2006 and 2010) with the last being unprecedented in terms of facilitating the provinces and diversifying the resource distribution criteria.

Historically, the horizontal share of the divisible pool was apportioned amongst the provinces on per capita basis until 2009. This was despite the fact that provinces were demanding for the inclusion of different indicators to their advantage. In addition, provinces were also demanding for greater share out the divisible pool. Their demands bore fruits in 2006 NFC award, which though was implemented through a presidential order. In 2008-09, major breakthroughs occurred like completion of tenure of elected government, first democratic transition of elected government and above all the 18th constitutional amendment. Same was the period when deadlock on national finance commission had also come to an end. In 2009, the formula for resource distribution was revised in 7th NFC and provincial share was increased to 57.5 Percent. Moreover, in the 7th NFC award, multiple indicators criteria was also introduced for horizontal resource distribution which was a mile stone.

7th NFC Award – Distribution Criteria	
<i>Indicator</i>	<i>Weightage</i>
Population	82.0 %
Poverty/Backwardness	10.3 %
Revenue Collection/Generation	5.0 %
Inverse Population Density	2.7 %

2.1 Commentary on the NFC award-2010

Higher transfers from the federal government to provinces (57.5 Percent of total federal taxes) under the NFC award-2010 was applauded from the provincial autonomy perspective. However, such arrangement is unique in the sense that no other country makes such high transfers to subnational tiers. As obvious, this tilted arrangement has given birth to financial problems at the federal level, which is by no mean sustainable in the long run (GoP, 2009). The NFC report by the government of Pakistan itself states that members were briefed that “*Under the options proposed, the overall fiscal deficit would neither be consistent with the one agreed with International Monetary Fund (IMF) nor desirable for a stable economy*”. Yet, the award with proposed apportioning was announced and Pakistan is facing hard fiscal conditions 15 years down the road.

The 18th Constitutional Amendment along with the 7th NFC award-2010 are viewed as a turning point in the constitutional and fiscal history of Pakistan. The amendment delegated 47 subjects including education, health, tourism, environment, culture, women development etc. to the provinces, accepting their mandate for service delivery. The 7th NFC not only carved out fiscal resources from the divisible pool but also boosted the provincial tax-base by recognising the provinces’ rights over services tax and capital value tax (CVT) on immovable property to back their novel responsibilities. It also acknowledged the provinces’ right to their natural resources by promising royalties. These steps helped the provinces increase their incomes, enabling them to spend more on

development and delivery of public service to their citizens. However, fifteen years down the road, it has proved only a step towards a very far laying destination. Miles have to be covered yet as NFC formula seems to be deficient of enough performance incentives.

The 7th NFC award, despite being promising, carries certain issues which need attention. The NFC report (GoP, 2009) elaborates that in addition to vertical distribution, the weights for horizontal distribution were also decided arbitrarily without sufficient evidence and analysis on the implications is missing. Following the announcement, the situation worsened as there are unfulfilled promises related to the 7th NFC award e.g. raising Tax to GDP ratio to 15 Percent by 2014/15, generating surpluses in provincial budgets and maintaining low inflation rate. The historic lethargy in generating own revenues at provincial level still continues and only the low hanging fruits like taxes on property, hotel industry or communication services are pursued. Whereas, taxes on professions (like professionals (doctors, engineers, lawyers) and retail etc.) along with tax on agriculture sector (and sector trades) are still to realize actual revenue potential.

Furthermore, the award turned a blind eye to the needs of the centre especially related to debt servicing and defence. The current fiscal resource distribution mechanism has left the centre handicapped to take any immediate policy initiative having financial implications (e.g. natural calamity in the form of Covid-19/ floods, development needs of erstwhile FATA, agricultural catastrophe like locust attack etc.). The 18th constitutional amendment has also played an important role in further complicating the situation as the federal government is in a compromised situation to get into or fulfil international agreements as a number of ministries (including the environment) have been devolved to the provinces. This by no means imply that resources be centralised again but in fact a workable solution is necessary which can take care of the urgent national responsibilities as well as reward fiscal effort and discipline. We have also seen federal government encroaching into provincial mandates (e.g. BISP, discretionary spending, PSDP addressing local issues and alike), which also needs to be checked. Hence, spending appropriations as per constitutional mandate and avoidance of duplication of effort needs to be checked through prudent fiscal discipline. These can only be achieved if we do away with discretionary spending and resort to evidence-based systematic transfers.

Certain provisions of the 18th amendment have also made the award inflexible in certain ways. The 18th constitutional amendment required that the provinces' share shall not be less than what is decided in 2009 NFC award. This non-flexibility clause added to the complexity of resource distribution and distorted the dynamism of the mechanism (Ahmad, et al. 2021). This is reflected in the deadlocks experienced in the following years with no NFC awards (third consecutive commission have failed so far to fulfil the constitutional requirement and present an award). The reasons are obvious that there are no incentives for the provinces to sit and revisit, as the federal government has nothing more to offer.

1. Objectives

The objective of the study is to analyse the resource distribution in Pakistan from three perspectives. These are:

- Extensive review of literature on the resource distribution mechanism in Pakistan and documenting international best practices
- To analyse criteria for resource distribution which can fulfil the need, equity as well as efficiency principles, thus putting the incentive right.

- To summarize empirical literature that have reported the impact of fiscal decentralisation on various economic and social indicators in Pakistan.

First objective deals with the assessment of the approach adopted for resource distribution in Pakistan. To fulfil this objective, the study undertakes extensive review of literature on fiscal resource distribution in Pakistan. As obvious, the resource distribution forum is a political body¹ in Pakistan, though with a presence of nominated experts from each province. Moreover, there is no permanent NFC secretariat, which could provide the expert analysis and analyse different scenarios. Above all the structure of the forum and the mechanism of deciding the resource apportioning is in itself questionable. Most importantly, NFC awards can only take effect if one is a consensus award. So, the question remains that having presence in the commission, how will a member facing a financial loss still sign a new (even if efficient) award, if it necessitates a consensus to take effect. Hence, there is a need to search for a workable solution where resource distribution can take place in an academic setting to assess the possible pros and cons of any change in criteria. Hence, international experience will help in arriving at the practice being followed for an efficient resource distribution mechanism around the world.

The second objective assesses the stage we are in at the moment. Every resource distribution mechanism has to graduate out of pure need-based to equity-based allocation while eyeing for opportunities to include criteria that can push the federating units towards greater efficiency. Hence, the second objective would enable us to understand the stage at which Pakistan is currently positioned and to find the focus for next move. Once obvious, it will help us to strive for the best possible attempt to achieve equity without hurting the efficiency matters via the new NFC formula.

The third objective deals with identifying the preconditions that are instrumental in having best results from a resource distribution formula. Here we explore ideas that serve as the preconditions for the successful implementation of an efficient resource distribution mechanism. Hence, covering the above objectives will give us a comprehensive review regarding an efficient resource distribution system.

2. Methodology

This is a review paper and aims to conduct an exhaustive review of literature on the topic. Literature on resource distribution in Pakistan has mainly relied on three methodological spheres including thematic analysis, basic arithmetic estimates and the econometric techniques that frame the cause and effect dimensions of fiscal resource distribution. As obvious, papers adopted thematic analysis when discussing the resource distribution mechanisms overtime. The said papers² broadly structured the discussion around different NFC awards and explained the changes as well as major disagreements among the provinces. These studies discussed a number of milestones as well the reasons for deadlocks, hence, enables the reader to comprehend the historical overview of the resource distribution in Pakistan since 1952 till date.

The second strand of discussion on resource distribution consists of the papers that have presented international experience and presented arithmetic calculations to explain the current or suggested resource distribution and its implications. Such studies have developed different scenarios and have substantiated their analysis by providing scenario

¹federal and provincial finance ministers are member of the NFC.

²Ahmad, (2007); Khattak, et al. (2010); Ghaus & Pasha (1994); Jaffery & Sadaqat (2006); Khawaja & Din (2013); Rana (2017).

analysis³. Lastly, a number of studies have resorted to econometric techniques to analyse the impact of fiscal decentralisation on different economic and social indicators namely economic growth, public expenditure efficiency, health, education, poverty, infrastructure as well as governance and corruption⁴. These studies have worked out the cause and effect analysis and commented on the effectiveness of fiscal resource distribution in Pakistan. Different data sets including time series, cross sectional as well as primary survey data, have been put to use to analyse the variables of interest. Econometric techniques namely Fixed effects model, ARDL, GMM, Spatial Durbin Model, Engle-Granger and OLS are used to undertake the analysis.

3. INSIGHTS FROM THE LITERATURE

Local governance allow policy experimentation that is normally risky at the central level due to various reasons including the scale, equity and diversity of needs considerations. A functional local governance system necessitates a plausible financial support mechanism that can enable subnational governments to undertake their obligations. Pakistan has constitutionally adopted the three-tier governance system comprising of central, provincial and local government tiers; the last tier though has remained suspended or paralysed most of the time despite having constitutional cover. Practically, Pakistan has been predominantly governed with two tiers of government i.e. the central and provincial level. The 18th constitutional amendment has made the governance model clear by empowering the second tier with adequate policymaking and spending mandate. However, there are still hurdles in the optimal functioning of the said system (e.g. a dysfunctional LG system), nevertheless, second tier is enjoying significant scope to devise, implement and fund social policies. Therefore, for practical reasons this paper would focus only on the resource distribution between the federal and provincial government and its implications in Pakistan, leaving the LGs discussion for future research.

The literature on the topic is divided into four streams i.e. (a) International Experience, (b) Overtime development and commentary on the 7th NFC award, (c) Mechanism and structure of resource distribution in Pakistan and (d) Empirical studies exploring the relationship between fiscal resource distribution and socio-economic factors including economic growth, expenditure efficiency, health, education, poverty, governance and corruption. Hence, this review consists of four sub-themes.

3.1 International Experience

Generally, the resource distribution takes place through formula transfers because it provides better predictability in the resource availability for the sub-national governments. Countries where resource generation is highly centralised, by default, necessitates vertical resource transfers from upper to the lower tiers. On the contrary, countries with decentralised resource generation systems, subnational tiers are relatively more empowered to generate own revenues, hence have less dependence on federal transfers. Nevertheless, such countries too disburses equalisation transfers to bring the lagging states at par with national standards. Equalisation transfers, however, are designed in a way that necessitates the beneficiary states to put in their best revenue generation

³Shah (2010); Tanzi (2010); Rana, (2017); Pasha, et al. (2010, a); Ahmad (2010); Pasha, et al. (2010, b)

⁴Ahmad, (2020); Khan, et al. (2019); Ahmad, et al. (2020); Ahmad, (2016); Ahmad, (2015); Sabir (2001); Khawaja & Din (2013); Iqbal (2013); Shahzad & Yasmin (2016); Raza & Hina (2016); Iqbal, et al. (2012); Ara & Sabir (2010).

efforts. Discussion below summarises international experience concerning the resource distribution mechanisms around the world.

The IMF's Government Finance Statistics shows that Canada was the most fiscally decentralised country in 2019 where the sub-national states collected about 55 Percent of the taxes. This was followed by Switzerland with 53 Percent and USA with 47 Percent of sub-national tax share, respectively. The sub-national tax share was 20 Percent among the OECD countries (during 2016-19), followed by only 13 Percent in non-OECD countries, which indicates that developing countries are fiscally centralised (Agrawal et al., 2024). In Pakistan, the subnational tiers collect only 7 Percent of the total tax revenues (Khan, 2006). Table 1 and 2 summarises the international experience on resource transfer mechanism, citing important countries.

Table 1

International Experience w.r.t. Fiscal Resource Transfer Mechanism

S.no.	Country	Resource Distribution by	Distribution mechanism	Resource generation
1	Canada	Central government	Transfer funds to only those states whose revenues are below the national average	Highly decentralised
2	India	Central government	Resource distribution formula, primarily based on estimated expenditure needs	Highly centralised
3	Pakistan	Central government	Resource distribution formula, primarily based on estimated expenditure needs	Highly centralised
4	Australia	Central government	States are transferred the equalisation funds to bring the lagging states at par with national standards	Highly decentralised
5	USA	Central government	No formal resource transfer mechanism but has more than 600 programs for states and local governments which are funded by the federal government	Highly decentralised
6	Germany	Rich states finance the poorer states	The transfer program ensures to bring the fiscal capacity of lagging states to 90 Percent of the national average, leaving incentive to improve to reach national average expenditure levels	Highly decentralised

Source: Khawaja & Din (2013); and Author's contribution.

Table 2

<i>Revenue and Resource Distribution between Centre and Sub-National Governments</i>					
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	10.00
		Excise tax	49.00	population density	
		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		
		All Federal Taxes	23.00	Population	70.00
3.	Colombia	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		

Table 3

Revenue and Resource Distribution between Centre and Sub-National Governments (cont.)

S.No.	Country	Shared taxes	Percentage	Criteria	Percentage
6.	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
7.	Japan	Income tax	32.00	Collection	100.00
8.	Malaysia	Liquor tax	32.00	Collection	100.00
		Import & Excise duties on oil	30.00		
9.	Mexico	Export duties on Tin	10.00	Population	50.00
		Income tax	17.35		
10.	Nepal	NA	NA	Collection	50.00
				Population	50.00
				Poverty	25.00
				Tax effort	15.00
11.	Nigeria	All federal taxes	31.50	Area	10.00
				Minimum responsibility	40.00
				Population	40.00
				Social development factor	15.00
12.	Pakistan	All federal taxes	57.50	Collection	05.00
				Population	82.00
				Poverty or Backwardness	10.30
				Revenue	05.00
				Collection or Generation	
				Inverse Population Density (Area)	02.70
13.	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).

Indian resource distribution mechanism is unique in the sense that it presented 15 consecutive Finance Commission (FC) awards without any break. Though criticised in the literature for having multiple indicators⁵, the mechanism adopted to achieve equity and efficiency simultaneously is what seems to drive the given formula setting. Moreover, the unending experimentation with formula and indicators suggest that search for an optimal formula is still underway. Hence, the Indian FC presents a good example of how dynamic a commission should be, owing to the fact that nationwide consultation takes place within the given time, accepting inputs from across the states governments, think tanks, researchers and experts. The FC reports makes it obvious that Indian FC award is not a closed-door marriage of convenience, instead, it is rather an extensive and exhaustive effort to bring equity and efficiency in to the system of national finance.

Another example of successful resource distribution is the case of Germany. Germany has 16 federal states, called Lander. Both the center and the Landers jointly collect different taxes that are later apportioned using different criteria. Each Länder has the responsibility to collect their own taxes, however, only the lagging⁶ Landers are allotted transfers. Thus, the lagging Landers are supported by rich Landers (to enable the lagging ones to achieve 90 Percent of national average) but not to make these dependent on pre-assigned transfers, preserving incentives for own source revenue collection efforts (UNDP, 2015). Similarly, the US constitution empowers the federal, state and LGs to tax individuals and enterprises, thus enables each tier of government to raise and adjust revenues. Income tax is levied by the federal government while the state government charges sales tax whereas the local government raise revenues from property taxes, thus all make efforts to finance their expenditures and facilitate citizens without externalising their expenditures to other jurisdictions (Khalid & Hussain, 2018).

Designing a resource distribution mechanism that avoids perverse incentives, has remained a hot topic in the literature. A number of researchers and policy practitioners have written about it and have presented unique ideas to provide better understanding for competing resource distribution approaches. Shah (2010) discusses the emerging governance model namely 'Glocalisation', where governance is designed by global trends and obligations, while the routine issues are solved at local level in contrast to the classic central & provincial governance model. Table 3 provides a comparison of two governance models. The paper presents interesting figures for 2006 stating that in India 254,119 local governments spend only 5 Percent of the total government spending, which too goes majorly into the salaries of elected representatives and support staff. In contrast, 43,965 LGs in China accounts for 51.4 Percent of total government expenditures owing to the fact that LGs are fiscally empowered (and provinces have a reduced role in China). Thus, LGs for the sake of it does not present a solution unless mandated with adequate spending responsibilities to reap its full potential for improved governance and administration.

International experience suggests a number of interesting insights. The set of criteria to distribute resources has largely remained the same (i.e. population, areas, inverse population density, tax effort and alike; as presented in Table 2). It is clear that developed countries pay special attention to efficiency factors when apportioning resources. This obviously is linked to their development stage (having covered basic needs of the citizens) and most importantly they are characterised by a devolved revenue generation systems. Thus, the resource distribution in developed countries focuses on incentivizing the subnational tiers to put in their optimum efforts and alongside looks after

⁵which is believed to distort incentives under different criterion.

⁶Whose tax revenues are below the national average.

them via the required transfers to bring them at par with national average. On the contrary, the developing countries, while deciding resource distribution, mainly resort to expenditure needs of the subnational governments. To summarise, an optimal resource distribution mechanism is of utmost importance and should allow lower tiers a greater independence in revenue streams without compromising their revenue generation capacity.

Table 4

Governance structure: 20th versus 21st Century

20th Century	21st Century
Centralised or provincialised	Globalised and localised
Centre that manages	Centre that leads
Citizens as agents, subjects, clients and consumers	Citizens as governors and principals
Bureaucratic	Participatory
Command and control	Responsive and accountable
Internally dependent	Competitive
Closed and slow	Open and quick
Intolerance of risk	Freedom to fail or succeed
Focus on government	Focus on governance with interactive direct democracy
Competitive edge for resource based economies	Competitive edge for human capital based economies
Federalism as a tool for coming together or holding together	Global collaborative federalism with a focus on network governance and reaching out
Residuality principle, ultra vires, “Dillon’s rule”	Community governance principle, subsidiarity principle, home- or self-rule and shared rule
Limited but expanding role of global regimes with democracy deficits	Wider role of global regimes and networks with improved governance and accountability
Emerging federal prominence in shared rule	Leaner but caring federal government with an enhanced role in education, training, and social protection
Strong state (province) role	Ever-diminishing economic relevance of states (provinces) and tugs-of-war to retain relevance
Diminishing role of local government	Pivotal role of local government as the engine of economic growth, primary agent of citizens, gatekeeper of shared rule, facilitator of network governance; wider role of “beyond government” entities
Tax and expenditure centralisation with revenue sharing and input based conditional grants to finance subnational expenditures	Tax and expenditure decentralisation with fiscal capacity equalisation and output-based national minimum standards grants

Source: Broadway & Shah (2009) as adopted from Shah (2010).

3.2 Historic development and commentary on the 7th NFC award

Analysing the literature on the resource distribution in Pakistan, the second stream that emerges is consisting of papers that summarised the historical developments. Ahmad, et al. (2007) summarises the history of resource distribution in Pakistan and presents its overtime development. Pakistan, had realized the importance of amicable resource distribution right after its independence in 1947, when Sir Jeremy Raisman was appointed to work on the first resource distribution award in 1948. The award was notified in 1952,

followed by three subsequent awards in 1962, 1964 and 1970. However, all these awards were put to work during extraordinary circumstances like post-independence era, wars and civil conflicts, thus could not prove instrumental in development. The process was reinitiated in 1974 following the promulgation of 1973 constitution, however, the following awards saw similar fate as earlier when the National Finance Commissions could not announce the consensus awards in 1979 and 1985. However, there were few adjustments in 1986-87 when the divisible pool was expanded.

After a long wait, the 1991 NFC award came up with a number of initiatives like expansion of the divisible pool and straight transfers to provinces. The provincial share increased from 28 Percent to 45 Percent of the federal tax revenues in the 1991 NFC award. The next NFC award of 1996 has always remained controversial in the literature due to various reasons. Firstly, it was announced by a caretaker setup, which was not mandated to take decisions having long-term implications. Secondly, the bifurcation of spending in priority and non-priority spending limited government's autonomy. Similarly, in anticipation of higher economic growth and expansion of the divisible pool (having included all the federal taxes), massive changes were made in federal and provincial shares out of the divisible pool, which however, proved counterproductive. The federal and provincial shares were revised from 20:80 to 62.50:37.50 simultaneously, leaving provinces worse-off. This was followed by two more failed NFCs when the commissions were unable to announce consensus awards for 2001 and 2005. Following this, resources were apportioned through a presidential order (in 2006), also revising the federal and provincial shares to 50:50 Percent. It is important to note that despite the fact that all the commissions were entrusted to look for an optimal resource distribution mechanism, all have resorted to a sub-optimal sole criterion of population for horizontal resource distribution among the provinces.

The latest 2010 NFC award, however, have busted the myth of a single resource distribution criterion and has somewhat included other indicators to apportion resources among provinces. Nevertheless, population, which is a crude indicator for expenditure needs only, still carries 82 Percent weight in resource distribution. The remaining three additional criteria collectively carries 18 Percent weight. Out of the total divisible pool, the federal and provincial shares were revised from 50:50 Percent to 42.5:57.5 Percent simultaneously. Table 4 and 5 summarizes the historical progress over time.

It is obvious that the 2010 NFC award is an important milestone, nevertheless, there are still gaps and unmet demands of both the provinces and the federal government which needs attention. Rana (2017) notes down that the provinces are demanding for increased vertical share (upto 70 Percent of the divisible pool) whereas the federal government is seeking to increase its share to 49.5 Percent (from 42.5 Percent) of the divisible pool to cater for a number of national needs. Federal government has repeatedly asked the provinces to spare 4 Percent for Ex-FATA and Gilgit-Baltistan whereas 3 Percent for national security, given the rising security risks. However, due to the constitutional cover to the 2010 NFC awards, the matter is still unresolved as the provinces sense no incentive in developing consensus for reduced shares.

Table 5

History of Resource Distribution in Pakistan

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 Percent per annum till its reaches 50 Percent of the divisible pool.

**plus 0.66 Percent for losses in OZT.

***plus 1 Percent of total divisible pool for losses in war on terror.

Source: Author's contribution.

Table 6

Composition of Transfers from Federal to Provincial Governments

	(Rs in Billion)			
	Divisible Pool Transfers	Straight Transfers	Special Grants	Total
1990-91	32.1 (95.0)	1.7 (5.0)	- (-)	33.8 (100.0)
1991-92	47.5 (72.2)	16.3 (24.8)	2.0 (3.0)	65.8 (100.0)
1996-97	119.2 (85.5)	18.2 (13.1)	2.0 (3.0)	139.4 (100.0)
1997-98	104.0 (79.0)	20.3 (15.4)	7.4 (5.6)	131.7 (100.0)
2005-06	244.6 (77.4)	62.8 (19.9)	8.7 (2.7)	316.0 (100.0)
2007-08	403.1 (79.6)	70.6 (13.9)	33.0 (6.5)	506.7 (100.0)
2009-10	574.1 (80.0)	87.2 (12.1)	57.8 (7.9)	689.0 (100.0)
2010-11	865.8 (81.0)	197.0* (18.4)	6.0 (0.6)	1068.7 (100.0)

Figures in parenthesis give share in total transfers.

*Inclusive of arrears and the sales tax on services like telecommunications.

Source; Pasha, et al (2010, b).

Table 7

*Revenue Sharing between Federation and the Provinces under
Various NFC Awards (Percent)*

Tax Heads	Niemey r Award 1937 ¹	Raisma n Award 1951 ²	NFC 1962	NFC 1964	NFC 1970	1st NFC 1974	4 th NF C 1990	5 th NFC 1996	Interim Award 2006	7 th NFC 2009
Shared Taxes										
Income & Corporation Tax	50	50	50	65	80	80	80	37.5	46.25 ³	57.5 ⁰
Wealth Tax ⁴	-	-	-	-	-	-	-	37.5	-	-
Sales Tax	-	50	60	65	80	80	80	37.5	46.25	57.5
Custom Duties	-	-	-	-	-	-	-	37.5	46.25	57.5
Capital Value Tax ⁴	-	-	-	-	-	-	-	37.5	46.25	57.5
Central Excise on tea/betel nut	-	50	60	65	80	-	-	-	-	-
Export Duty on Cotton/Jute	62.5	62.5	100	65	80	80	80	37.5	-	-
Excise Duty on tobacco	-	50	60	65	80	-	80	-	46.25	57.5
Excise Duty on Sugar	-	-	-	-	-	-	80	-	-	-
Federal Excise Duties	-	-	-	-	-	-	-	37.5	46.25	57.5
Taxes on Capital Value of Immoveable Property	-	-	100	100	100	-	-	-	-	-
Estate and Succession Duties for agriculture land	-	-	100	100	100	-	-	-	-	-
Straight Transfers										
Excise duty on Natural Gas	-	-	-	-	-	100	100	100	100	100
Royalty on Natural Gas	-	-	-	-	-	100	100	100	100	100
Surcharge on Natural Gas	-	-	-	-	-	-	100	100	100	100
Royalty on Crude Oil	-	-	-	-	-	-	100	100	100	100
Hydel Profits	-	-	-	-	-	-	6 bn	6 bn	6 bn	-
Subvention/Special Grant (Rs in Million)										
NWFP	10	12.5	-	-	-	100	200	3310	27.75 bn	-
Baluchistan	-	-	-	-	-	-	100	4080	-	-
Sindh	10.5 ⁵	-	-	-	-	-	700	-	-	-
Punjab	-	-	-	-	-	-	1000	-	-	-
Fiscal Transfers as % of Federal Tax Revenue	-	12.8	23.1	27.0	33.4	29.8	35.3	41.3	45- 50%	60.0%

Source: Statutory Orders issued from time to time

1. Governor General Order 3 of 1949

2. Governor General Order 23 of 1953

3. Subvention was later suspended as financial conditions improved

4. Wealth Tax and Capital Value Tax have since been abolished.

5. The provincial share during first year of Award was 41.5 percent and gradually increased to 46.25 percent

6. The Provincial share during the first of Award was 56 percent and increased to 57.5 percent in second year

Adopted from Rana (2017)

Table 8

Straight Transfers to the Provinces

Province	Straight Transfers
Punjab	Excise duty on Natural Gas Royalty on Natural Gas and Crude Oil Surcharge on Natural Gas (share of net proceeds assigned to provinces) Net Hydel Profit on Electricity administered by Federal Government in the province
Sindh	Royalty on Crude Oil Excise duty on Natural Gas Royalty on Natural Gas Surcharges on Natural Gas
KP	Net Hydel Profit on Electricity administered by Federal Government in the province Excise Duty and Royalty on Natural Gas Royalty on Crude Oil Excise Duty and Royalty on Natural Gas Transfers Surcharge on Natural Gas
Balochistan	Excise Duty and Royalty on Natural Gas Transfers Surcharge on Natural Gas

Source: Various Statutory and President's Orders

Adopted from Rana (2017)

Table 9

Structure of Provincial Revenues (Percent)

Assignment	Punjab	Sindh	Khyber Pakhtunkhwa	Balochistan	Total
			1984-85		
Federal tax Assignments	45.9	61.6	32.7	60.8	47.7
Provincial Own Receipts	14.0	23.7	06.2	02.8	13.3
Non-Tax (Including Grants)	40.1	14.7	61.1	36.4	39.1
o/w Grants	23.9	00.0	52.2	29.5	25.3
			1990-91		
Federal tax Assignments	65.0	75.6	44.4	59.4	62.9
Provincial Own Receipts	12.3	12.7	03.6	01.8	09.9
Non-Tax (Including Grants)	22.7	11.6	52.0	38.8	27.2
o/w Grants	09.9	00.0	43.0	34.9	16.0
			1998-99		
Federal tax Assignments	76.6	77.0	52.2	69.0	72.0
Provincial Own Receipts	14.6	14.5	05.2	01.7	11.7

Assignment	Punjab	Sindh	Khyber Pakhtunkhwa	Balochistan	Total
Non-Tax (Including Grants)	08.8	8.5	32.8	29.3	16.3
o/w Grants	00.0	00.0	13.2	27.1	04.9
2001-02					
Federal tax Assignments	77.4	66.2	63.2	58.4	79.1
Provincial Own Receipts	09.8	12.1	05.4	02.2	09.0
Non-Tax (Including Grants)	12.8	21.7	31.4	39.4	20.9
o/w Grants	03.5	06.6	13.0	18.6	07.4
2014-15					
Federal tax Assignments	84.6	77.0	87.0	95.4	83.3
Provincial Own Receipts	15.4	23.0	13.0	04.6	16.7

Adopted from Rana (2017)

Table 10

Provincial Shares under each Criterion of 2010 NFC Award

Indicators	Weight under 2010 NFC (%)	Punjab (%)	Sindh (%)	Khyber Pakhtunkhwa (%)	Balochistan (%)
Population	82.00	59.36	23.71	13.82	05.11
Poverty/ Backwardness	10.30	04.32	07.18	06.51	81.99
Inverse Pop. Density	02.70	23.17	23.42	27.83	25.62
Revenue collection*	2.50 (50% of the criterion weight)	27.00	70.00	03.00	01.00
Revenue generation*	2.50 (50% of the criterion weight)	63.00	28.00	07.00	02.00

* In the 2010 NFC, Fiscal effort is collectively assigned 5 Percent weight which is equally distributed within Revenue collection and Revenue generation criteria by assigning 50 Percent weight to each

Source: G.o.P (2009); Shahab (2018).

To summarise, the resource distribution mechanism in Pakistan is far from optimal. Provinces still lack sufficient incentives to go for optimal revenue generation level, hence, their revenue collection capacity needs to be improved. Local revenue collection will

make the provincial spendings reflective of the local aspirations and territorial needs; hence would bring efficiency. Moreover, such a setting will make them accountable to local electorate who can better scrutinise provincial spendings, their matching with subnational taxes and provincial governance.

3.3 Mechanism And Structure Of Resource Distribution In Pakistan

Building upon the historical developments, there is some literature that has discussed the resource distribution mechanism and have suggested changes to the National Finance Commission. Khawaja & Din (2013) commented on the mechanism and design of the 2010 NFC award, criticising the weights assigned to various criteria especially population. They have also questioned the way weights for each criterion is determined and asked for transparency. The absence of matching grants is also criticised. Lastly, the authors assess that with the new NFC award, provinces are endowed with large federal transfers, leaving little incentive to generate own source revenues⁷. In brief, the paper criticises the mechanism of resource distribution in the NFC award and asks for reevaluation keeping focus on the institutional structure of the commission. The paper further suggests a two tier system for resource distribution where the base work is undertaken by an expert forum (an independent agency consisting of experts on the topic exclusively) which may prepare recommendations based on research and data analysis. It is suggested that once the process completes, the upper tier (the intergovernmental forum comprising of federal and provincial finance ministers) shall review and decide on the recommendations, taking into account the practicality and political repercussions.

Similarly, Rana (2017) thoroughly discussed the resource distribution mechanism in Pakistan. The report presents a number of recommendations and offers a new resource distribution formula. As highlighted by a number of papers, this report also emphasises on establishing permanent secretariats for NFC and PFC, equipped with qualified professionals and regular flow of data. The points highlighted for deliberation by the report includes (a) creating knowledge-stock of international best practices, (b) definition of the divisible pool, (c) rationalising the balance between fiscal capacity and fiscal equalisation, (d) borrowing limits, (e) incentives for demographic changes and (f) fiscal performance and accountability. As obvious, these are all very relevant points for deliberation and moving forward. Rana (2017) also provides guidelines on the working of the NFC and PFC secretariat and advises to legislate on different issues to bring transparency and to develop mechanisms to handle stalemates. The points highlighted include (a) qualification of members, (b) nomination of members from private sector, (c) given timeframe to furnish recommendations, and (d) public hearings.

Rana (2017) have also made important contributions for new NFC formula. Given the constitutional protection, the vertical distribution is agreed to remain at the currently prevailing position (42.5:57.5), however, federal government shall make no extra transfers to provinces; the report suggests. The resulting savings is advised to be used for the development of Ex-FATA, GB and AJK. The report terms reliance on provincial budgetary savings as highly risky and asks for other non-tax revenues as remedies for federal budget balancing. Rana (2017) also suggests to expand the current NFC formula by including 'Inverse Demographic Change' and 'Income Distance' as two additional criteria for horizontal distribution. The study advises that new NFC formula should focus on achieving fiscal equalisation among provinces, increasing regional income and taking additional measures that can support revenue efforts to finance expenditures on national

⁷that are expected to bring efficiency gains.

priorities. The study calls for further in-depth analysis into the matter. Overall, Rana (2017) offers valuable insights, however, while targeting for fiscal discipline, greater focus of the study seems to be on the federal needs, which shall not be taken as advice for compromising provincial autonomy.

Another important study by Fatima and Naseem (2013) commented on the expenditures undertaken at federal level and suggests to incorporate the electricity tariff differential subsidy into the NFC award. The study undertakes in-depth investigation into the tariff subsidies enjoyed by different DISCOs and suggests that such may be incorporated into the NFC shares of the provinces to reflect the extent of total provincial shares in divisible pool. The paper however, does not take into account the legality issue of such subsidy where federal government is asked to subsidise for the distributional inefficiencies and electricity theft. Moreover, the cost of inefficient agreements imposed by the federal government policies are also not discussed.

3.4 Empirical studies

Lastly, a number of studies have analysed the impact of fiscal decentralisation on different economic and social indicators namely economic growth, public expenditure efficiency, health, education, poverty, infrastructure as well as governance and corruption. These studies have investigated the cause and effect analysis employing econometric techniques and commented on the effectiveness of fiscal resource distribution in Pakistan using different dependent variables. Data sets including time series, cross sectional as well as primary survey data have been put to use to analyse the variables of interest. Similarly, these studies have resorted to a number of econometric techniques namely Fixed effects model, ARDL, GMM, Spatial Durbin Model, Engle-Granger and OLS to undertake the analysis.

The first-generation theories of fiscal federalism (FGTFF) emphasised on exploring the direct effects of fiscal decentralisation on economic indicators (Vo, 2009). This section summarises a number of papers that have empirically tested the said theories of FGFF by analysing the impact of decentralisation on economic growth and public spending efficiencies. However, with the emergence of second-generation theories of fiscal federalism (SGTFF), literature started to explore the indirect effects and the prerequisites to analyse the enabling environment for a functioning federalism (Vo, 2009; Weingast, 2014). Researchers empirically analysed factors such as governance, institutions and decision space to test their role in the effectiveness of fiscal decentralisation. This section presents both types of the studies with a particular focus on Pakistan.

Decentralisation while promising spending efficiency, also bring along the risks of corruption, capacity deficits and inequality [Weingast (2014), Ivanyna and Shah (2014), Ivanyna and Shah (2011), Vo (2009)]. Therefore, researchers often find it hard to verify empirical relationship between decentralisation and economic indicators because of its mandatory prerequisites for effective implementation. This can also be attributed to the fact that decentralisation is often defined through the lens of fiscal capacity, which is a suboptimal proxy (Ahmad, 2015). Given below are few of the selected studies that have explored the direct as well as indirect effects of fiscal decentralisation on a number of socio-economic indicators.

Ahmad, et al. (2016) explored the complementarity between institutional quality and fiscal decentralisation for its effects on economic growth. The paper built upon the second generation theories of fiscal federalism and explored the role of institutional quality in terms of two indicators i.e. control over corruption and democratic

accountability. The study found positive relationship between FD and EG when complemented with better institutional quality in developing countries. Khan, et al. (2019) found similar results. In an earlier analysis, Ahmad, et al. (2010) analysed the direct impact of fiscal decentralisation on economic growth in Pakistan. The paper used the Davoodi & Zou (1998) model for estimation using time series data for Pakistan. Two important proxies (i.e. the provincial own source revenues and federal transfer to provinces) were used to gauge fiscal decentralisation. The empirical estimates however, indicated negative long run effects of fiscal decentralisation on economic growth in Pakistan, which highlights the sub-optimal state of fiscal decentralisation in Pakistan.

Iqbal, et al. (2012) undertook a similar empirical investigation, which analysed the impact of fiscal decentralisation on economic growth while incorporating the mediating role of democratic institutions. Using the endogenous growth model, the paper uses three different proxies for fiscal decentralisation to capture its impact on growth. The analysis exhibits that revenue decentralisation promotes economic growth while opposite results were found in case of expenditure decentralisation. The paper reports that democratic institutions significantly enhance the effectiveness of fiscal decentralisation. Subsequently, Iqbal (2013) further extended the discussion by analysing the impact of fiscal decentralisation on inflation, hence, on macroeconomic stability in Pakistan. This study use similar premise and employed the mediating role of democratic institution to judge the impact of fiscal decentralisation. The study found that expenditure decentralisation has a negative impact on inflation when complimented with democratic institutions, hence, help in achieving macroeconomic stability.

Raza & Hina (2016) have undertaken an innovative analysis by linking fiscal decentralisation to provincial economic growth and spillover effects. The study employs spatial econometric technique to empirically estimate the said relationship. The empirical results indicate that revenue decentralisation has positive while expenditure decentralisation has negative effect on provincial economic growth. Moreover, the spillover effects were found to be significant only in the case of revenue decentralisation. Weak institutions, lack of competition among provinces and the absence of political vision are cited from the literature as the possible causes for negative and insignificant spillover effects in case of expenditure decentralisation. The paper however did not tested the said dimensions in the empirical analysis.

Ahmad (2015) found statistically significant relationship between decentralisation and pro-poor social spending and reports that fiscal transfers to subnational governments results in higher social spending. The empirical results explain that decentralised spending on services like rural development and water management are more efficient. The paper, however, attribute this development prone to local elite capture and political patronage. In a bit earlier setting, Sabir (2001) found contrary results and reported that the bifurcation of public spending in priority and non-priority expenditures in the 1997 NFC award, had failed to protect the social sector spendings. Hence, both the papers are skeptical about the capacity of subnational governments to bring efficiency into local public spendings.

Ahmad, et al. (2020) investigated the impact of fiscal decentralisation on health sector in Pakistan. The health sector indicators included both the input as well as the outcome variables i.e. the total health expenditures and the infant mortality rate. Given the lack of focus on health sector, both by the federal as well as the provincial governments overtime, no favourable evidence could have been obtained. The results found no cointegrating relationship between provincial autonomy and both the health sector indicators. Similarly, the federal transfers have negative relationship with health

expenditures while it has statistically insignificant relationship with infant mortality rate. This specifies that the health sector in Pakistan has remained neglected for long.

Shahzad & Yasmin (2016) analysed the impact of fiscal decentralisation on poverty and income inequality. The variable of interest i.e. decentralisation has been captured with three indicators including revenue decentralisation, expenditure decentralisation and a composite indicator. The empirical analysis also incorporated the role of institutional quality into the analysis. However, despite presenting an interesting proposition, the paper lacks in reliability as the empirical results needs reassessment given the econometric issues especially in models estimating impact on poverty.

Ellahi (2020) presents a theoretical paper debating the corruption and development in a multi-tiered local government system. The paper theoretically presents that corruption takes place at two levels. The lower tier tax collector firstly play a facilitator's role for households to make tax evasion possible. Following that the tier two bureaucrat needs to be convinced by the first tier tax collector to hide the said corruption and let the corruption cycle complete. The paper discusses the incentive mechanism which enable such nexus to develop, which once developed, will result in high levels of corruption, leading to low development. The paper summarises that poor institutional decentralisation will always result in high corruption and low development, hence, advocates for better institutions.

To summarise, fiscal decentralisation is empirically well researched and researchers have analysed its impact on various social and economic dimensions. As obvious from above discussion, for the majority of times, three different proxies are used to gauge fiscal decentralisation including subnational tax revenue, subnational local revenues (sum of tax and non-tax revenues) and federal taxes to subnational tiers; where all are represented in ratio to total government revenues. This section has made it clear that institutional quality plays a pivotal role in ensuring the effectiveness of fiscal decentralisation. Hence, the key message that the policy makers can extract from the above discussion is that fiscal decentralisation can produce positive impact, however, it requires to be complimented with good institutions.

4. SUMMARY AND CONCLUSION

This paper presented a brief summary of literature on the fiscal resources distribution in Pakistan. This study covers the historical overview and important developments in the National Finance Commission awards in Pakistan. One important dimension of this study was to cover the international experience on the said subject, which was also covered, explaining the international trends. Given the international experience, the paper further commented on the structure and mechanism of resource distribution mechanism followed around the world and have highlighted frequently adopted criterion. Lastly, this paper covered important empirical evidence on the impact of resource distribution in Pakistan.

The write-up provides important insights, which will serve to make comparisons and learn from international best practices. Most importantly, it is clear that resource distribution in Pakistan is far from optimal and needs political will and dedicated efforts to improve the system. The NFC awards mechanism needs further refinement and a proper NFC secretariat needs to be commissioned to conduct in-depth research and analysis. NFC award formula and its composition also needs revisions to make it reflective of the ground realities. Although the diversification of NFC award formula is appreciated, but there is still need to further refine the definition of each criterion and to search for better proxies. The efficiency element also needs to be appreciated in the new NFC formula.

To conclude, given the vast scope of the topic, the paper could not cover the full extent of the literature but have tried to get a glimpse of important studies to cover vital dimensions. This study needs to be expanded further by covering each section in more detail. The resource distribution mechanism, the expert forum, criterion for efficiency, hunting for better proxies to reflect each criterion and political economy for amicable resource distribution are the aspects that needs detailed analysis in the future research. To conclude, this study agrees that NFC award of 2010 is a step forward in the stagnant affairs of resource distribution in Pakistan, nevertheless, the current formula, the weights assigned to each criteria and the resource distribution mechanism by itself are still far from optimal, thus need in-depth research and deliberations.

REFERENCES

- Ahmad, E. (2010). Improving Governance in Pakistan; Changing Perspectives on Decentralisation. *The Pakistan Development Review*, 49:4 Part I (Winter 2010) pp. 283–310.
- Ahmad, I. (2020). Fiscal Decentralisation and Economic Growth. *Pakistan Journal of Applied Economics*, AERC, 30(1), 95–121.
- Ahmad, I. (2016). Assessing the Effects of Fiscal Decentralisation on Education Sector; A Cross-Country Analysis. *The Lahore Journal of Economics*, 21:2. pp. 53–96.
- Ahmad, M. (2015). The Political Economy of Decentralisation and Access to pro-poor Social Services Delivery in Pakistan. *The Pakistan Development Review*, 54:4 Part II (Winter 2015) pp. 471–486
- Ahmad, I., M. Z. Arif & M. Khalid (2016). From Fiscal Decentralisation to Economic Growth: The Role of Complementary Institutions in Developed and Developing Countries. *The Pakistan Development Review*, 55:4 Part II (Winter 2016) pp. 761–780.
- Ahmad, I., M. Haq & J. Khan (2020). Investigating the Impact of Fiscal Decentralisation on Health Sector: A Case of Pakistan. *Kashmir Economic Review*, 29(2), 31-44
- Ahmad, I., N. Iqbal, & M. Khalid (2021), Fiscal Federalism in Pakistan: Need for a Revisit, *PIDE Policy Viewpoint*, No.33:2021.
- Ahmed, I., U. Mustafa, & M. Khalid (2007). National Finance Commission Awards in Pakistan, A Historical Perspective. *PIDE Working Paper Series* No. 33, PIDE, Islamabad.
- Agrawal, D. E., J. K. Brueckner & M. Brühlhart (2024), Fiscal Federalism in the 21st Century, *CESifo Working Paper No. 10951* DOI: <https://doi.org/10.1146/annurev-economics-081623-020713>.
- Ara, I. & M. Sabir (2010). Decentralisation of GST Services and Vertical imbalances in Pakistan. *The Pakistan Development Review*, 49:4 Part I (Winter 2010) pp. 479–495.
- Broadway, R. & A. Shah (2009). *Fiscal Federalism: Principles and Practice of Multi-Order Governance*. New York: Cambridge University Press.
- Davoodi, H. & H. F. Zou, (1998). Fiscal decentralisation and economic growth: A cross-country study. *Journal of Urban economics*, 43(2), 244-257.
- Ellahi, A. (2020), Corruption, Tax Evasion, and Economic Development in Economies with Decentralised Tax Administrative System. *The Pakistan Development Review*, 59:3 (2020) pp. 419–438

- Fatima, U. & A. Nasim (2013). Interprovincial Differences in Power Sector Subsidies and Implications for the NFC Award. *The Pakistan Development Review*, 52:1 Part I (Winter 2013) pp. 421–436.
- Ghaus, A. F. A. & H. A. Pasha (1994). Dynamic Budgetary Consequences of the 1991 NFC Award. *The Pakistan Development Review* 33:4, 627–645.
- GoP (2009), “Report of the National Finance Commission 2009”. Government of Pakistan, National Finance Commission Secretariat, Dec 30, 2009.
- Iqbal, N. (2013). Fiscal Decentralisation, Democratic Institutions and Inflation. *The Pakistan Development Review*, 52:3 (Autumn 2013) pp. 207–220.
- Iqbal, N., M. Din & E. Ghani (2012). Fiscal Decentralisation and Economic Growth: Role of Democratic Institutions. *The Pakistan Development Review*, 51:3 (Autumn 2012) pp. 173–195.
- Ivanyna, M., & A. Shah (2014), How close is your government to its people? Worldwide indicators on localisation and decentralisation, *Economics: The Open Access, Open-Assessment E-Journal*, 8. <http://dx.doi.org/10.5018/economicsejournal.ja.2014-3>.
- Ivanyna, M., & A. Shah (2011), Decentralisation and corruption: New cross-country evidence, *Environment and Planning C Government & Policy*, 29(5299).
- Jaffery, N. B. & M. Sadaqat (2006), NFC Awards Commentary and Agenda. *Pakistan Economic and Social Review* 44:2, 209–234.
- Khalid, I. & N. Hussain (2018), Financial Federalism in Pakistan: Implications for Centre-Province Relations, *Journal of Political Studies*, 25, Issue 1.
- Khan, M. J., I. Ahmad & M. Z. Arif (2019). Decentralisation, Institutions and Economic Growth: Further Investigation. *City University Research Journal*, Vol (9), No. (4), 788-798.
- Khan, M. Z. (2006) Intergovernmental Resource Transfers: Prospects and Issues. *The Lahore Journal of Economics* (Special Edition).
- Khattak, N. R., I. Ahmad, & J. Khan (2010), Fiscal Decentralisation in Pakistan. *The Pakistan Development Review* 49:4 Part II, pp. 419–436.
- Khawaja, I. and M. Din (2013). Intergovernmental Transfers: An Evaluation of Mechanism and Design of transfers in Pakistan. *The Pakistan Development Review*, 52:1 (Spring 2013) pp. 45–68.
- Palihakkara, U. H. (2016). *Recommendations – 2016 to H.E. The President in terms of Article 154R (4) of the Constitution of Sri Lanka*. Colombo: The Finance Commission, Sri Lanka.
- Pasha, H. A., A. G. Pasha & M. Imran (2010, a). Budgetary Consequences of the 7th NFC Award. *The Pakistan Development Review* 49:4 Part II (Winter 2010) pp. 375–385
- Pasha, A. G., H. A. Pasha & A. Zubair (2010, b). Fiscal Equalisation Among Provinces in the NFC Awards. *The Pakistan Development Review* 49:4 Part II (Winter 2010) pp. 563–576.
- Rana, A. W. (2017), National Finance Commission Award: Analysis of Inter-Governmental Transfers in Pakistan, *PRIME Policy Papers*.
- Raza, Q. & H. Hina (2016). Fiscal Decentralisation, Provincial Economic Growth and Spillover Effects; A Spatial Panel Data Analysis. *The Pakistan Development Review*, 55:4 Part II (Winter 2016) pp. 743–760.
- Sabir, M. (2001). Dynamic Consequences of the 1997 NFC Award: Provincial Social Sector Expenditures. *The Pakistan Development Review* 40:4, Part II (Winter 2001) pp. 967–984.

- Shah, A. (2010). Empowering States and Provinces or Unshackling Local Governments: Does it Matter for Peace, Order, Good Governance and Growth. *The Pakistan Development Review* 49:4 Part I (Winter 2010) pp. 333–362.
- Shahab, N. B. (2018). Fiscal Decentralisation in Pakistan: Past, Present and Future. *Pakistan Administrative Review*, 2(4), 357-372. <https://nbn-resolving.org/urn:nbn:de:0168-ssoar-61077-9>.
- Shahzad, S. & B. Yasmin (2016). Does Fiscal Decentralisation Matter for Poverty and Income Inequality in Pakistan? *The Pakistan Development Review*, 55:4 Part II (Winter 2016) pp. 781–802.
- Tanzi, V. (2010). Revenue Sharing Arrangements: Options and Relative Merits. *The Pakistan Development Review* 49:4 Part I (Winter 2010) pp. 311–332.
- UNDP (2015), Analysis: The NFC Awards: Past, Present and the Future, *Development Advocate Pakistan*, Vol 2, Issue 2.
- Vo (2009), The economics of fiscal decentralisation, *Journal of Economic Surveys*, 24(4): 657–679.
- Weingast, B. R., (2014), Second Generation Fiscal Federalism: Political Aspects of Decentralization and Economic Development, *World Development* 53: 14–25.

Pakistan Institute of Development Economics

Post Box No. 1091, Islamabad, Pakistan

www.pide.org.pk