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**A Critical Path to Fiscal Federalism:
Policy Imperatives for the
NFC Award Remake**

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EXECUTIVE SUMMARY

This study presents a comprehensive analysis of Pakistan's current fiscal federalism framework under the 7th National Finance Commission (NFC) Award and proposes a new, performance-based model to address its inherent shortcomings for the upcoming 11th NFC Award. The 7th NFC Award, despite its historic devolution of resources, has created a "structural trap" of provincial dependency on federal transfers¹, disincentivizing own-source revenue generation along with efficient public service delivery.¹ The study's core thesis, supported by empirical evidence, is that a robust and sustainable fiscal system is a function of public trust which in turn is based on demonstrated performance of federating units.² By critiquing the current formula, analyzing successful global models from Canada⁴ and India⁶, and leveraging academic research on tax morale⁹, this study proposes a new framework which would nudge the current system for not just better taxes but also improved service delivery. This framework introduces a multi-dimensional Provincial Performance Index (PPI) to a revised horizontal distribution formula.⁸ The PPI would reward provinces for tangible improvements in revenue mobilization, governance and trust-building, human development outcomes, and fiscal prudence. However, the transition has to be backed by political will and should be gradual. The recommendations also include institutional reforms, such as the creation of a permanent NFC Secretariat⁷ and the constitutional devolution of resources to local governments¹², to foster a more equitable, accountable, and ultimately, sustainable path for Pakistan's national development.

1. INTRODUCTION: THE IMPERATIVE FOR A NEW NFC AWARD

The National Finance Commission (NFC) Award stands as the central pillar of Pakistan's fiscal and political federalism, defining the mechanism for distributing financial resources between the federal government and its constituent provinces.¹³ As a constitutionally mandated, five-yearly programme, its purpose is to address both vertical and horizontal fiscal imbalances.¹³ The 7th NFC Award, enacted in 2010, marked a significant and historic shift by increasing the provincial share of the divisible pool to 57.5 percent from 47.5 percent¹⁴ and moving away from a single-criterion distribution to a multi-indicator model.¹⁵ This landmark reform was a monumental step toward greater provincial autonomy and fiscal decentralization.¹⁶

Despite these foundational improvements, the 7th NFC Award, which has continued far beyond its original tenure due to political disagreements, has created significant systemic issues.¹⁷ The existing framework has resulted in a "structural trap" of provincial resource needs saturation due to sufficient federal transfers¹, a condition that fundamentally distorts subnational fiscal behavior and undermines the incentive to generate own source revenues or to substantiate revenue collection efforts of center through improved public service delivery.¹ This dependency has led to budgetary volatility and weakening of the social contract between the state and its citizens.¹ The stalemate in having a new award since 2010 underscored the political and systemic dysfunction inherent in the current arrangement.¹⁸

This study hypothesizes that for fiscal federalism to be effective and sustainable, it must move beyond simple resource distribution to a system that explicitly incentivizes new initiatives and rewards provincial performance.¹⁴ The premise, that tax collection and compliance are directly correlated with public trust in government and the perceived fairness of the system, is not merely a theoretical construct but a well-supported conclusion from academic research.² Therefore, a new framework is needed which must acknowledge and integrate this causal relationship, making a province's efforts 'to build public trust and enhance governance', a key determinant of its resource allocation along with supporting FBR's efforts for increasing tax bases/compliance.⁸ This approach would transform the NFC Award from a passive resource-sharing mechanism into a dynamic instrument for national development and accountability.

2. THE 7TH NFC AWARD: A CRITICAL ANALYSIS OF STRUCTURAL FLAWS

The current NFC framework, in effect for over 15 years, has introduced several structural flaws that perpetuate fiscal imbalances and hinder effective governance. A detailed analysis of these issues is crucial to inform a comprehensive reform agenda.

2.1. Formulaic Distribution and its Consequences

The horizontal distribution formula of the 7th NFC Award is a multi-criteria model designed to address various provincial needs. It allocates resources based on four distinct factors: population, poverty, inverse population density, and revenue collection effort.¹⁴ The respective weights assigned to each of these criteria are 82 percent, 10.3 percent, 2.7 percent, and 5 percent.¹⁴

The overwhelming weight placed on population at 82 percent ensures that the most populous province, Punjab, receives a perpetual majority share of the divisible pool, amounting to 51.74 percent of total transfers.¹⁵ This heavy reliance on population, while

a simple and easy-to-measure metric, can be viewed as an oversimplification that fails to account for the complex needs of other provinces. For example, the 10.3 percent poverty component, although intended to compensate for socio-economic disadvantages, is insufficient to adequately address the spatial challenges and high costs of service delivery in geographically disadvantaged provinces such as Balochistan.¹ This creates a situation where some provinces are perpetually disadvantaged, regardless of their developmental needs. Seriously undermining the equalization component generally observed in fiscal transfers.

A particular point of contention is the 5 percent weight for "revenue collection efforts," which is intended to incentivize provinces to enhance their own tax base.¹⁴ This component is flawed by design. For example, Sindh, a province that generates significant own tax revenue (PKR 676.1 billion), receives a "negligible incremental benefit" from this component in the NFC formula.¹ This indicates that the metric's low weight and ambiguous calculation (some sources say it's the revenue collected through electricity bills i.e. federal tax) have failed to serve their purpose.¹ Revenue collected through electricity bills, are part of the broader federal tax administration and not the provincial efforts.¹⁹ Further the core dysfunction is the method itself which offers no incentive to enhance provincial efforts for exploiting new tax avenues and generate optimal own source revenues. Moreover, it is a fact that the entire revenue effort component is too small to meaningfully alter provincial behavior.¹ This structural imbalance ensures that provinces have little reason to invest in politically difficult tax reforms when the returns are so minimal.

Table 1.

The 7th NFC Award: Horizontal Distribution Formula

Criteria	Weight (percent)
Population	82.0
Poverty	10.3
Inverse Population Density	2.7
Revenue Collection Effort	5.0
Total	100.0

Table 2.

Provincial Shares

Province	Share (percent)
Punjab	51.74
Sindh	24.55
Khyber Pakhtunkhwa	14.62
Baluchistan	9.09

2.2. The 'Structural Trap' of Fiscal Dependency

The most significant consequence of the current formula is the creation of a "structural trap" of fiscal dependency.¹ Provincial government have become overwhelmingly reliant on federal transfers to finance their operations and development programmes. This reliance has diminished their incentive to develop autonomous fiscal capacity, a key requirement for efficient-governance and political scrutiny.

Data from the fiscal year 2024-25 illustrates this dependency in stark terms. Punjab, the country's economic powerhouse, generates only 16.8 percent of its total

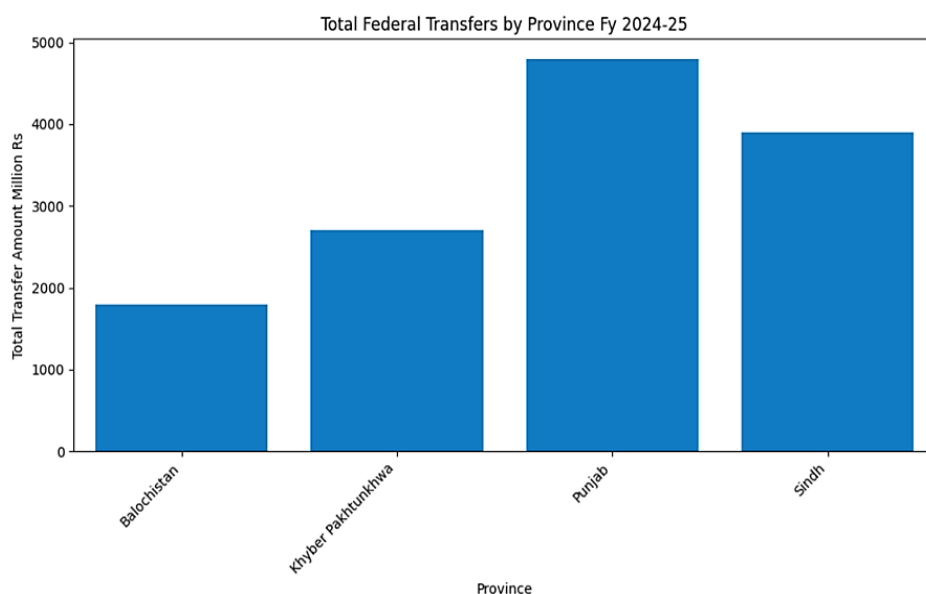
resources from its own tax and non-tax revenues.¹ The remaining 83.2 percent flows from federal transfers.¹ The situation is even more pronounced in other provinces. Federal transfers constitute 93.6 percent of the resource pool for Khyber Pakhtunkhwa, followed by 87 percent for Baluchistan and 75 percent for Sindh.²¹ This heavy reliance is a nationwide phenomenon; provincial governments, collectively, generate only about 8 percent of total national resources, while their share of total public spending is 28 percent¹³ and should have expanded after the 18th amendment.

This substantial reliance on transfers creates a classic problem of "moral hazard." When provinces are guaranteed a large, unconditional transfer regardless of their own fiscal performance, the incentive to undertake or even shoulder politically challenging but economically necessary tax reforms is virtually eliminated.¹ Tax collected at federal tier inherently brings lesser accountability for subnational governments as the people making sacrifice and those getting benefits are not necessarily being the same. Why would a provincial government risk public displeasure by imposing new or higher taxes on agriculture, services, or property when predictable federal transfers offer a much easier path to balancing the budget? Or even campaign and enforce such interventions made by the federal government. The existing system, therefore, rewards political negotiation and lobbying for federal funds over genuine fiscal effort by provinces. This lack of incentive is a primary reason why provincial tax revenues have remained stagnant, comprising a paltry 0.7-0.8 percent of the country's GDP.¹⁴

Table 3.

Provincial Fiscal Profiles: Comparison of Own-Source Revenue (FY 2024-25)

Punjab	16.8 percent
Sindh	25.0 percent
Khyber Pakhtunkhwa	6.7 percent
Baluchistan	13.0 percent



2.3. Volatility and the Erosion of Budgetary Integrity

Beyond dependency, the implementation of the NFC Award introduces significant volatility into provincial budgets.¹ This unpredictability undermines the credibility and stability of provincial fiscal planning, turning their budgets into little more than theoretical exercises.

The fiscal year 2024-25 provides clear examples of this dysfunction. Khyber Pakhtunkhwa experienced a massive 11.23 percent transfer shortfall, triggering widespread fiscal disruption.¹ Punjab faced a 4 percent cut in the same year, a sharp reversal from the 4.5 percent surplus it had enjoyed just two years prior in 2021-22.¹ This volatility is not random but stems from structural flaws, including the absence of statutory disbursement timelines and the federal government's routine practice of diverting divisible pool funds to meet its own fiscal crises.¹ Consequently, provincial budgets are forced to serve as "shock absorbers for federal mismanagement" rather than instruments of local development.¹

The real impact of this fiscal instability is most acutely felt at the grassroots level. This systemic failure has tangible human costs. When federal shortfalls occur, development budgets are often the first casualty. In Punjab, development spending, which already constitutes a small portion of total expenditure at 31.4 percent, is jeopardized, leading to the stalling of critical infrastructure projects.¹ In Baluchistan, a province already facing significant spatial disadvantages, these fluctuations directly result in "abandoned schools and understaffed hospitals," demonstrating how fiscal mismanagement at the center has a direct, devastating impact on the quality of life and public service delivery for citizens.¹ This breakdown of service provision further erodes public trust, creating a vicious cycle of poor governance and limited tax compliance.

2.4. Legal and Institutional Gaps

The NFC framework is also undermined by significant legal and institutional deficiencies. A major hurdle to reform is the 18th Constitutional Amendment. Its Article 160(3A) stipulates that "*The share of the Provinces in each Award of National Finance Commission shall not be less than the share given to the Provinces in the previous Award*". While this provision was intended to protect provincial autonomy and prevent the center from unilaterally reducing shares, it has made it politically difficult to reach a new consensus on a revised formula.¹⁸ Any proposed changes that might reduce provinces share—even if more equitable overall—are immediately blocked, leading to the current state of perpetual extension of the 7th Award.

Furthermore, the absence of a robust institutional or judicial mechanism to stabilize disbursements or enforce constitutional mandates is a major flaw. The system relies almost entirely on political will, which is often in short supply. The very existence of such a legal challenge highlights the system's reliance on political negotiation rather than legally binding and enforceable obligations.²⁵ The lack of judicial recourse for transfer shortfalls and other violations leaves provinces with little power to hold the federal government accountable, ensuring that the system's inherent volatility remains unaddressed.¹

3. THE THEORETICAL AND EMPIRICAL FOUNDATIONS OF REFORM

For any new NFC Award to be effective, it must be grounded in a sophisticated understanding of how taxation, governance, and public trust are interconnected. The

traditional view of tax compliance as a simple function of enforcement and penalties by the federal government is incomplete. A more nuanced perspective, rooted in behavioral economics and institutional theory, offers a more viable path forward.



3.1. The Nexus of Public Trust and Tax Compliance

The core premise of this study is that a robust and sustainable fiscal system is a direct function of public trust.³ This idea is strongly supported by academic research. A study on Pakistan's informal sector found that "Public Trust, Regulatory Quality, and Tax Policy have a significant and positive effect on Tax Compliance".² Another study confirmed that "government trust and tax justice perception are the major determinants of tax compliance behavior in Pakistan".³ These findings indicate that citizens are more likely to comply with tax laws when they perceive the system to be fair, transparent, and well-managed, and when they trust that their contributions will be used for public good.³

This body of work signals a crucial paradigm shift in the academic discourse on taxation, moving from a purely punitive approach to a behavioral or institutional one.² Simply increasing enforcement and penalties will not be enough to fundamentally alter a culture of tax evasion. A sustainable increase in tax compliance requires building a new social contract based on confidence and accountability. This is a principle that the Federal Board of Revenue (FBR) itself appears to recognize.²⁶ An FBR report notes that its recent success is "attributed to improved taxpayer engagement, the effective integration of new technologies, and enhancements to our digital infrastructure".²⁷ A separate FBR document explicitly states a key goal to "Build public trust and confidence in the tax administration system".²⁶ These statements provide a strong, internally consistent rationale for a framework that rewards provinces for their efforts in building this trust.

3.2. Provincial Government's Role in Fostering Trust

Provincial governments are the tier of governance closer to the citizen and are directly responsible for the delivery of critical public services, such as health and education.¹⁴ Because of this direct engagement, provinces are uniquely positioned to either build or erode public trust. When a provincial government efficiently provides quality services—clean water, accessible schools, functional hospitals—it reinforces the

social contract and demonstrates to citizens that their taxes are being used for their benefit.³ This tangible demonstration of good governance fosters a sense of legitimacy and fairness, which academic research has shown to be a major determinant of voluntary tax compliance.³

The proposed system in this report would create a cycle of accountability by tying fiscal transfers to measurable improvements in these services. By making a portion of the NFC Award conditional on key performance indicators (KPIs) in health, education, and other public services, the framework would force provinces to become more accountable to their citizens. This accountability would, in turn, foster the public trust necessary for voluntary tax compliance, creating a self-reinforcing mechanism for good governance and fiscal sustainability. The alternative—a system that provides unconditional transfers—removes this vital link between public service and public accountability, perpetuating the very issues the system was designed to solve.

3.3. The Concept of Performance-Based Fiscal Transfers

The concept of using performance-based fiscal transfers is not new; it has been successfully employed by international organizations and federations worldwide to improve institutional and service delivery performance.²⁸ The World Bank, for example, has utilized mechanisms known as "Urban Performance Grants" or "Subnational Competitiveness Grants".²⁸ These are fiscal transfers from a higher level of government conditioned on achieving performance in predetermined areas, such as urban infrastructure or local economic development.²⁸

These grants provide a clear theoretical and practical foundation for a new NFC framework. They prove that linking financial rewards to concrete, measurable outcomes can be an effective tool for incentivizing desired behaviors in subnational governments.²⁸ Instead of simply redistributing revenue based on static demographic factors, a performance-based system would create a dynamic incentive structure that encourages provinces to compete on the basis of good governance, fiscal prudence, and human development.

4. GLOBAL MODELS OF FISCAL FEDERALISM: LESSONS FOR PAKISTAN

An analysis of global fiscal federalism models provides critical lessons and practical precedents for designing a more effective NFC Award. By examining the systems in Canada, India, and Australia, a synthesis of best practices emerges, highlighting the need for technical sophistication, behavioral incentives, and institutional integrity.

4.1. The Canadian Equalization Programme

Canada's equalization programme is a sophisticated, formula-based system designed to ensure that all provinces have the fiscal capacity to provide "reasonably comparable levels of public services at reasonably comparable levels of taxation".²⁹ The system does not aim to equalize actual spending or tax rates but rather to equalize the ability of each province to raise its own revenue, a concept known as "fiscal capacity".²⁹

To achieve this, the Canadian model employs a "Representative Tax System" (RTS).⁴ This is a highly technical and data-driven approach that measures a province's capacity for over 30 revenue sources by applying national average tax rates to each province's tax base.⁴ This provides a more objective measure of a province's fiscal effort

and potential. This method contrasts sharply with Pakistan's current system, which relies on a very low-weighted and ambiguous "revenue collection effort" component¹⁴, and provides a clear path for Pakistan to create a more effective metric to incentivize provincial and province level revenue mobilization.

However, the Canadian system is not without its critics. It has been described as "broken" due to political compromises and complexities, particularly in its treatment of natural resource revenues.⁵ For example, the formula may not adequately penalize provinces that forgo certain taxes or revenues, such as those from electricity generation, while penalizing others for foregone taxes like a provincial sales tax.⁵ This serves as an important cautionary tale: a successful formula requires both technical rigor and continuous political consensus to maintain its integrity and effectiveness.

4.2. India's Finance Commission

India's Finance Commission (FC) provides a direct parallel for Pakistan's reform agenda, as its model combines a multi-criteria distribution formula with explicit performance-based incentives.⁶ The 15th FC's formula for horizontal distribution, while similar to Pakistan's in its use of population and area, includes a dedicated 2.5 percent weight for "Tax and fiscal efforts".⁶ This metric is measured as the ratio of a state's average per capita own tax revenue to its average per capita Gross State Domestic Product (GSDP), a more precise measure of revenue effort than Pakistan's current metric.⁶

Beyond the formula, India's model goes further by using performance-based grants tied to specific reforms.⁸ The 15th FC recommended grants for states that achieved developmental targets in areas such as power sector efficiency, health outcomes, and local body governance.⁷ This approach provides a clear precedent for Pakistan's proposal to introduce "performance-based guarantees" and KPIs.

An additional key feature of the Indian model is the role of NITI Aayog, National Institution for Transforming India- a policy think tank that complements the FC's work.⁷ NITI Aayog evaluates programme performance and promotes data-driven decision-making through tools like the Health Index and the SDG India Index, which are used to benchmark state performance and ensure accountability.⁷ This highlights the need for a complementary, data-driven body in Pakistan to monitor the proposed PPI, ensuring that performance metrics are transparently and objectively measured. Moreover, the Indian FC is an independent, non-partisan body, doing academic exercise based on research and consultation instead of political bargaining, as is the case in Pakistan.

4.3. Australia's Horizontal Fiscal Equalization

Australia's fiscal federalism is managed by the Commonwealth Grants Commission (CGC), an independent statutory body formed in 1933.¹⁰ The CGC's primary role is to provide impartial advice on how revenues, particularly from the Goods and Services Tax (GST), should be distributed to achieve "horizontal fiscal equalisation".¹⁰ This means ensuring that each state and territory has the fiscal capacity to provide a comparable level of services, regardless of its unique circumstances.¹⁰

The CGC's methodology is highly rigorous and involves a comprehensive, five-yearly review to determine the most appropriate methods and data for measuring the relative fiscal capacity of each state.¹⁰ The existence of this permanent, independent, and expert-led body for fiscal equalization is a critical lesson for Pakistan.¹⁰ The CGC's role in depoliticizing the process and providing continuous, data-driven research stands in

stark contrast to Pakistan's situation, where successive NFCs have failed to reach a new consensus due to political disputes.¹⁸

4.4. Synthesis of Lessons

The analysis of these global models provides three key lessons for Pakistan:

- **Technical Sophistication:** A new formula must adopt a more sophisticated, data-driven methodology to objectively measure provincial fiscal capacity and effort.⁴ A system similar to Canada's Representative Tax System could replace Pakistan's flawed 5 percent revenue effort component with a more precise metric.¹⁴
- **Incentivizing Behavior:** The formula must include explicit, performance-based components and grants, akin to India's "Tax and fiscal efforts" metric and its grants for sectoral reforms⁶, to incentivize desired behaviors such as revenue mobilization, good governance, and human development.
- **Institutional Reform:** The process of creating and implementing a new NFC Award must be supported by an independent, expert institution that can provide data-driven advice and ensure continuity.¹⁰ The roles of Australia's CGC¹⁰ and India's NITI Aayog⁷ demonstrate that such a body is essential to depoliticize the process and foster long-term stability.¹ PIDE is well positioned to deliver on such customization of the formula and regular basis of transfers.

Table 4.
Comparative Analysis of Global Fiscal Equalization Models

Feature	Canada	India	Australia
Purpose	To ensure provinces have sufficient revenue to provide comparable services at comparable tax rates.	To correct vertical and horizontal fiscal imbalances and promote equitable development.	To ensure states have the fiscal capacity to provide comparable services.
Formula Components	Relative fiscal capacity, measured through a Representative Tax System (RTS) across 30+ revenue sources. ⁴	Multi-criteria including Income Distance, Population, Area, and "Tax and fiscal efforts" (2.5 percent weight). ⁶	Assesses relative fiscal capacity based on an extensive methodology across revenue and expense categories. ³¹
Performance Metrics	Not explicit in the main equalization formula, but uses a data-driven measure of fiscal capacity.	Explicitly uses a "Tax and fiscal efforts" metric and provides performance-based grants for sectoral reforms. ⁶	Aims to equalize fiscal capacity, not dictate policy, but its data-driven process implicitly rewards efficiency.
Institutional Mechanism	A formula-based proramme managed by the federal government, often subject to political compromise.	Quinquennial Finance Commissions make recommendations. NITI Aayog acts as a complementary data and policy think tank. ⁶	A permanent, independent statutory body (Commonwealth Grants Commission) provides impartial, expert advice. ¹⁰

5. A PROPOSED FRAMEWORK FOR A PERFORMANCE-BASED NFC AWARD

Based on the analysis of the 7th NFC Award's shortcomings and lessons from global models, a new framework is proposed. This framework directly addresses the core idea of making provincial performance a central pillar of resource distribution hence acting like a catalyst for growth and development.

5.1. A New Horizontal Distribution Formula

A revised horizontal distribution formula should be adopted to rebalance the current over-reliance on population.¹ The current 5 percent weight for "revenue effort" is too insignificant to change behavior.¹ Therefore, a much larger weight, approximately 15-20 percent, should be assigned to a new, multi-dimensional component. The proposed formula would be:

- Population (fixed at figures of 1998 population census): 60 percent
- Poverty & Backwardness: 15 percent
- Inverse Population Density: 5 percent
- Provincial Performance Index (PPI): 15 percent
- Sustainable Future (dynamic in nature but having at least three dimensions i) forest cover, ii) Dams iii) Climate resilient infrastructure): 5 percent

This new structure maintains a primary focus on population for vertical equity but introduces a powerful incentive for provinces to compete on the basis of tangible performance. However for the success of such transition strong political will, similar to the case of 7th NFC Award and 18th Amendment is the necessary condition. Further any transition has to be smooth, especially in this case should not be reducing the absolute transfers from the previous years. This would be in compliance with the Article 160(3A) of the Constitution of Pakistan which mandates that the provincial share in each subsequent award cannot be less than the previous one.

5.2. Designing the Provincial Performance Index (PPI)

The Provincial Performance Index (PPI) would be the cornerstone of the new formula, with its components tied to measurable Key Performance Indicators (KPIs).⁷ The PPI would be composed of three main sub-components:

5.2.1. Revenue Mobilization Efforts (50 percent of PPI)

This component would replace the current, flawed metric. It would measure the growth and efficiency of a province's own-source revenue (OSR) relative to its potential. A methodology similar to Canada's Representative Tax System (RTS) could be adapted to objectively measure this effort.⁴ Data on Punjab's estimated revenue collection for FY25 (PKR 960 billion)²² and Baluchistan's projection (PKR 124 billion)²³ would serve as a baseline. The metric would measure a province's OSR-to-GSDP ratio, directly rewarding those that undertake difficult but necessary tax reforms.⁶

5.2.2. Governance and Trust-Building (25 percent of PPI)

This component directly addresses the core thesis of the link between trust and compliance.² KPIs would measure a province's tangible efforts to foster a transparent and accountable relationship with its citizens:

- Digitalization and Transparency: Measuring the progress of provinces in automating tax systems, implementing e-filing, and digitalizing public records.³³
- Citizen Feedback Mechanisms: Tracking the effective use of tools like the Pakistan Citizen’s Portal (have Punjab, Sindh, KP, Baluchistan Citizen Portals) to measure the rate of resolution for tax-expenditure related complaints.³⁴
- Public Trust Metrics: Incorporating data from periodic, independent surveys to measure public trust in provincial tax authorities and the government as a whole.²
- Functional Local Governments: Ensuring local service provision by local representatives and regular Provincial Finance Commission (PFC) awards every three years

5.2.3. Human Development Outcomes (25 percent of PPI)

Tying a portion of the award to improvements in key human development indicators aligns fiscal incentives with national development goals.⁸ These are responsibilities constitutionally devolved to the provinces.¹⁴

- Health: Measuring improvements in health outcomes, not only reflected by changes in health budget allocations (Punjab increased its health budget by 24 percent in FY24-25)²², and other metrics of service delivery but to include other tangible outcomes such as Maternal Mortality rate, Stunting and Wasting of children etc.⁷
- Education: Tying transfers to improvements in literacy rates and school enrollment, acknowledging the vast disparities in provincial spending priorities (e.g., Sindh allocating 18.4 percent of its budget to education versus Punjab’s 7.3 percent) does not reflect true outcomes until substantiated by metrics of out of school children and other learning and ability metrics.¹

Table 5.
Proposed Provincial Performance Index (PPI) Breakdown

PPI Component	Proposed Weight (percent)	Example KPIs
Revenue Mobilization Efforts	50 percent	Growth in Own-Source Revenue (OSR) / Provincial GDP ratio; Tax base expansion for FBR in respective provinces.
Governance & Trust-Building	25 percent	Digitalization of tax records; Citizen complaint resolution rates; Public trust survey scores. A PFC every three years and an empowered and functional local government system
Human Development Outcomes	25 percent	Change in literacy rates; School enrollment rates; out of school children; Key health indicators (e.g., vaccination rates, infant mortality, maternal mortality).

5.3. Institutional Recommendations

The success of a new performance-based framework depends on robust institutional and legal reforms. A new award cannot succeed without a new process.

- A Permanent NFC Secretariat: The current process, which relies on ad-hoc commissions that often fail to reach a consensus, must be replaced with a permanent, independent body.¹ A permanent NFC Secretariat, mirroring Australia's Commonwealth Grants Commission or India's Finance Commission, would provide continuous, data-driven research and policy advice.⁷ This would depoliticize the NFC process, ensure continuity, and provide the technical expertise necessary for a complex, performance-based formula.⁷
- Judicial Enforcement and Mediation: A clear legal framework must be established to ensure the timely and predictable disbursement of transfers.¹ The absence of judicial enforceability is a major weakness of the current system.¹ A formal mediation mechanism could be created to resolve disputes, thereby addressing the issues of transfer shortfalls and avoiding situations that necessitate judicial intervention, such as the recent Peshawar High Court petition.²⁵

5.4. Empowering Local Government

A truly transformative NFC Award must also address the long-standing issue of fiscal devolution to the third tier of government. The research material suggests that provinces have "miserably failed to enhance the provincial tax revenues" and have also "lagged in devolving fiscal powers" to local governments.¹⁴

A portion of the provincial share, for example, 10-15 percent, should be constitutionally mandated to be transferred directly to local governments.¹² This would provide a direct incentive for provinces to empower local bodies, as they would be rewarded for it.¹² These transfers could be tied to performance metrics at the district level, such as the efficiency of service delivery or improvement in local services. LGs shall also be allowed to retain local revenue generated⁸ to provide sufficient incentive to take new initiatives. This would address the spending efficiency issue at the provincial level and provide a new avenue for political credit and accountability at the grassroots level, empowering local leaders to deliver on public services.¹²

6. CONCLUSION: A ROADMAP FOR EQUITABLE AND SUSTAINABLE FISCAL FEDERALISM

The analysis in this study demonstrates that Pakistan's current fiscal federalism framework under the 7th NFC Award is fundamentally flawed.¹ Its reliance on a population-heavy formula and its chronic political stalemates have created a self-perpetuating cycle of provincial dependency, fiscal instability, and a weakening of the social contract.¹⁸ This system provides a minimal incentive for provinces to improve governance, mobilize their own revenue, or invest efficiently in human development.¹

A new NFC Award, complemented by robust institutional and legal reforms, can break this cycle.¹⁴ The proposed framework is not merely a technical adjustment; it is a fundamental re-imagining of the fiscal relationship between the federation and its provinces.¹⁴ By introducing a Provincial Performance Index and its key metrics, the new model would align fiscal incentives with national development goals, rewarding provinces for their tangible efforts in building public trust, enhancing governance, and

delivering on their constitutional responsibilities.² The study's recommendations for a permanent NFC Secretariat and the devolution of resources to local governments provide a comprehensive roadmap for transforming the system from one of passive resource distribution into a dynamic engine for national progress.¹² This new approach offers a path toward a more equitable, accountable, and sustainable federation for Pakistan. However, the transition has to be backed by political will and should be gradual to make it a success like the 7th NFC award and 18th Amendment.

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