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Financial Federalism in Pakistan: Implications for Centre-Province Relations

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Abstract

This paper explores the development in financial federalism of Pakistan through execution of NFC Awards. Improvement and mutual consensus in fiscal matters are not only vital for the overall economic wellbeing of a federation but also for its integration. An overview of federal governments in the world provided economically stronger center with comparatively less resourceful units.Pakistan like other federations of the world has gone through many ups and downs but still matters are to be settled. Wide economic differences in provinces have made collection and sharing of revenue complicated. Efforts in the NFC Awards are not revolutionary butA slow change to remove vertical and horizontal imbalances has been observed. Eighteenth amendment has helped provinces to obtain the revenue from local sources as well for devisable pool.Delay in next NFC Award points out that Fiscal federalism still needs interprovince coordination and more efforts for exploration of local resources. A national political debate along with economic realities are needed to regulate the process of NFC Awards. Pakistan can consider Canadian fiscal federalism to improve some issues highlighted in NFC debates. Execution of a just and acceptable Award will improve fiscal federalism as well as political federalism of Pakistan.

Keywords: Financial federalism, NFC Awards Pakistan, Federation Issues, Federalism, Eighteenth Amendment, Centre province relations, revenue distribution. Political economy

Introduction

When we look at the history of financial federalism in Pakistan there are two views; federal government generates more revenue on the expanse of provinces and it does not share its revenue with provinces on just grounds. Second the mechanism of vertical and horizontal revenue sharing through NFC is slow and need improvement. Financial federalism plays vital role in the economic development in Pakistan, because spending of both level of governments on public services is subject to the fiscal policy of federation. The present fiscal policies have their roots in the past political system. This article will observe the historical and political context of financial federalism of Pakistan

The system of fiscal federalism along with the financial federal working of USA, Canada and India are also discussed. The development of financial Commissions of Pakistan is examined with implications and conclusion. Although financial federalism in Pakistan is improving with the working of federal system under civilian

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governments fiscal but the progress is slow and need more political reforms to improve the fiscal federation.

Financial Federalism

In the twentieth century, federal system was preferred option for many states who have differences in their landscape or in people. There is no single model for federation or for its constitutional arrangements, some federations are made from territorial units adopted for federation like American states and some federations gave status of federal units to its territorial parts or already a collected territory decided to adopt the federal system like India and Pakistan. Federation could be defined as a system which divides political and economic powers between territorial units and the central government in such a way that non-is subordinate to other but in reality, federal government has an upper hand. Major characteristic of federal system is regional autonomy which entails and encourages diversity, greater response of government and adaptation for differences with freedom. Federal states have the constitution with explicit details of division of powers between central and unit governments and a supreme court to explain the powers of both tiers. These powers are divided into legislation powers and financial powers. In the twenty-first century, financial part of federal system has gain more consideration because of involvement of governments in the welfare works.

The term of financial federalism was introduced by Richard Musgrave in 1959. It is used to explain financial relations and division of revenues among the tiers of governments. This is not an easy task especially where economic disparities are acute in units. Musgrave says that central government should be responsible for the income redistribution and economic stabilization but the allocation of resources should be the duty of local governments therefore it has the capacity of combining the larger idea with solid representation of smaller interests (Ebenstein, 1944). The fiscal arrangements between federation and its units for taxing, grants, expenditures and borrowing are interlinked with the issues of state at different levels. This system demands a capacity of central government for economic management. The demands for revenue constrain the autonomy of units because taxes by federation is resulted into opposition from units. Fiscal arrangements, intergovernmental competition for more revenue and nature of grants have become equally important if not more for provincial and local governments to governance, corruption, political stability, ethnic conflict resolution, globalization or nation state.

All federations are not same in the distribution of political and financial powers between central and territorial governments. Federal states are broadly separated into two models; dual and cooperative federalism (Boadway& Shah, 2009). In dual federalism powers of central and territorial governments are clearly separate and equal to each other. This type of federalism worked in USA in its early years. In cooperative federalism, central government has more powers to state revenues and it makes policies which are carried by units. With time and growing demand for more public works has turned dual federations into cooperative federations. The economic role of state in federal governments has grown with time.

Central governments now spend on goods and services which government purchases to provide to its people e.g. defence, health and education facilities etc. Governments make transfers to individuals or families from government e.g. unemployment fund or old age pension etc. Subsidies; intergovernmental transfers mostly from Centre to units but in some rare cases, it can reverse. Revenue collections of governments, taxation, fees, borrowings, money creation and regulation of economics related activities e.g. rules for goods and services market, capital market, labour market and for licensing etc. Third type of economic activities by governments involve working public corporations e.g. utilities, aircrafts production, communication, transportation and industries setup etc.

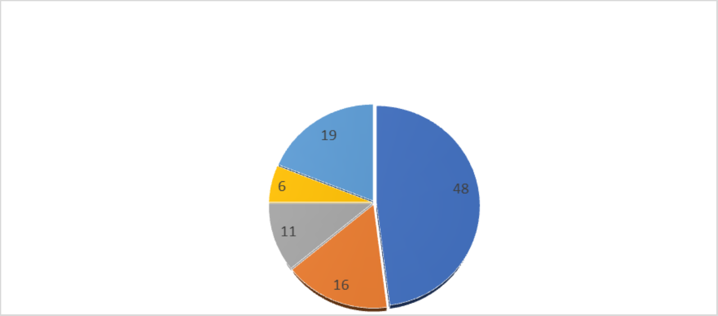
American Financial Federalism

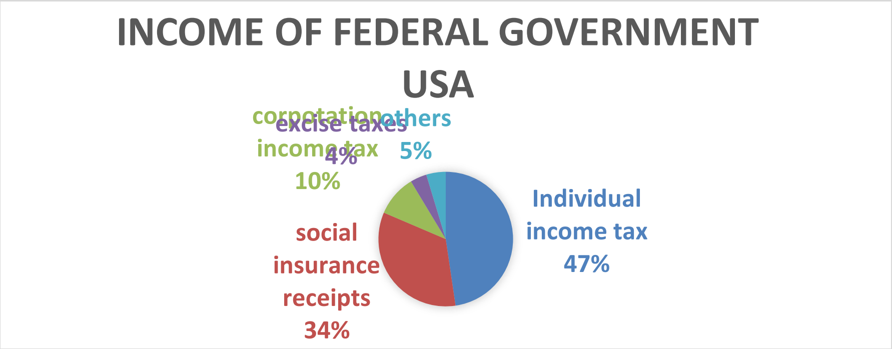
American federal system has adopted the cooperative nature with time. Federal government has gain more power in the form of grip on important revenues. Some restrictions are for both level of governments and the residuary powers are granted to the states.US government is neither a dual federalism nor a cooperative federalism, in fact constitution kept it away from each extreme. Tenth amendment provides the powers which are used by federal government are called enumerated powers, powers used by both level of governments are known as concurrent powers while rest of all is called reserved powers and are for states to retain. The current structure in the United States gives federal, state, and local governments the power to tax individual citizens. Commonly there are more than three levels of taxing authority if special districts are involved. Federal government levied income tax, states charged sales tax and local governments have the right to property tax.

Early federalism in America was clearly dual federalism in nature, especially till civil war 1861-65. After the rapid development of industries, commerce and transportation means, interstate relation developed and cooperation between states and federal government it became cooperative federalism in which federal government is more involve in the policy affairs which were previously part of states legislation for example no child left uneducated program etc. The first federal direct tax under the new U.S. Constitution was levied in July 1798 on population, house values, and land. As of 1801 only half of the total amount due has been collected.(Sobel, 1997). In 1890 Supreme Court explained the interstate commerce; manufacturing tax was given to federation and interstate transport of goods tax was given to states. The authority of Court kept active in the explanation of the financial powers for both levels but in 1937 this supremacy was over. During New Deal years President Franklin Roosevelt`s many orders were declared unconstitutional by Supreme Court but later were taken back. He planned to appoint new judges but in 1935 Court accepted that national character of manufacturing industry. And federation was responsible for public welfare. Second time in 1960 during the presidency of Lyndon B. Jonson federal government took part in the public works which were in the domain of sates before (Patterson, 2002).

As the Dollar is controlled by federal government therefore its borrowing is better than states. The federal government provides revenue to states via categorical grants-in-aid, block grants, and revenue sharing. Tax policy has favored state and local governments throughout United States history with the goal of reducing costs of providing local services (Watson & Vocino, 1990). Revenue for federal government is collected through levied taxes on incomes, land, occupations, deeds, contracts, postal receipts, customs and other subjects. Certain Manufacturers have been also taxed since civil war. Internal revenue of state was chiefly from income tax, manufacturers and consumption of tobacco, beer and whisky. States in their turn were free to tax properties and persons in their boundaries but problem is that more taxes in a state encourage citizens to migrate into less tax charging states. In 1930s federal cash payments to states in shape of grant in aids increased to 10 %.

Two major aids which are received by states and local governments are Categorical Aid and Block Grants. Categorical Aid is for specific programs e.g. School Lunch program etc., and the Block Grant is for federal programs but are spend by states. In1980`s President Reagan adopted the policy of shrinking the federal bureaucracy and spending and putting more responsibilities on states governments to deal with social problems along with more revenue powers (Lowe, 1984), Federal government said that states and local governments were more effective in relying on private sector to eradicate poverty. Levitan (1948) observed that federal government could not only coordinate with states and local governments for poverty but in other plans too. Us government tries to increase the state sources for revenues but his government failed to create employment through facilitating rich (Jenda, Berry and Goldman, 1992). 45% of federal revenue goes to states; more grants are derived by southern states in the shape of aids and grants to overcome poverty. 20 to 25% of states revenue is based on money





Source: (Jenda, Berry & Goldman, 1992)

Canadian Financial Federalism

Canada has ten provinces and three territories. Provinces are given the powers by constitution whereas territories although enjoy same powers but they are not given these powers by the constitution. When Canada was under the confederation the position of provinces was of subordinate position. In 1867 Canada was made a federation. Central powers control the trade & commerce, taxation, national defence, banking, Aboriginals, criminal law, interprovincial transportation and communications. Provincial powers include direct tax within the province, public lands, hospitals and health care, municipal institutions, education, property and civil rights, administration of justice. Concurrent powers consist on agriculture, immigration and old age pensions. The evolution of division of power between provincial governments and the federal government can be observed in two parts the amendments in the constitution and the decisions by apex courts that explains the sections of 91, 92 and 132 of the constitution 1867.Phases of Canadian federalism can be divided into three i.e.1867-1945, executive federalism, Canadian federalism 1984-2000, Canadian federalism in the 21st century. There are three subjects in concurrent list. Despite both levels of governments are working on almost every area intertwined. Now most actions are taking place not in the courts rather in political bureaucratic circles in terms of constitutional reforms (Russell, 1985).
As for as federal control is concerns in1867 three specific federal controls were reservation, declaratory powers and disallowance. Decline in the use of these powers has increased the stature of provinces and Canada has become a genuine and highly decentralized federation (Dyck, 2004, p. 427), (Chandler & Herman 1989). Provincial revenues were insufficient from the beginning and grants were given to them. In 1907 grant system was amended largely. Provinces at that time began to levy their own personal and corporate income tax. Provinces were given conditional grants most important grant was the old age pension which started in 1927. In this period both

governments were taxing same personal and corporate income. To solve the issue Aa commission called Rowell-Sirois Commission in 1937 was setup. Commission decided that income taxes and succession duties will be levied by federal government and in return provinces will be given annual unconditional grant based on need. It was also recommended that Unemployment insurance should be transferred to federal government.

There are three methods of federal payments to Provinces. Right to collectin come taxes were given to federal government, which provided the provinces a share of tax portion vary from each other. The Conditional and block Grants: The Rowell- Sirois commission report criticized independent programs by both level governments addressing the same field. Educational postsecondary education grant was block grant which covers 50% of such expenditures. For health care program, federal government wanted to pay individuals instead of provinces.

Equalization payments: it is the third aspect of federal province finance constitutes equalization payments. It was also recommended in the Rowell-Sirois Report unconditional grants so that provinces can. Any province whose per capita revenue is under an average fixed by the state receives a payment based on per capita shortfall multiplied by the province population. Ontario and Atlanta are out of this equalization formula for their per capita income is higher than standard.

Provinces for their revenue, obtain natural resources revenue, corporate income tax, some provinces get direct tax from federal government. The revenue from natural resources is from forests, tax on logging operations lease and rental of Crown lands, royalties, rental and stumpage fees from forest management and timber. Provinces also obtain revenues from mining operations, acreage taxes, license and permit fees, lease and rental payments, plus royalties on mineral productions. Petroleum and gas producing provinces also collect the revenue from gas and petroleum including proceeds from the sale of Crown oil and gas lease, taxes on oil and gas production, royalties, free hold tax, rental and lease permit and fees.

The combination of revenue from natural resources, unanticipated federal grants and direct taxes has contributed significantly to improve the status of provinces in Canadian federal system. It is interested to note that decentralization and more power of taxation to provinces came from provinces with substantial personal and corporate tax means. Manitoba and Atlantic provinces apposed decentralization of taxes because their extended power of taxation and shorten power of federal taxes provide them less. They prefer a strong federal government because it can redistribute revenues through means of equalization payments. With unconditional grants and taxing and spending in different areas have made governments of both level independent from each other. Both governments are intertwined in terms of taxation agreements and by conditional and block grants programs for expenditures.

In twenty-first century new Areas of federal provincial interactions like Aboriginal affairs, environment policy, regulation of financial institutions, external internal trade, securities industries are addressed by both levels. The new health care implementation of Kyoto Protocol on reducing pollution was critical issues agreed upon. Tax agreements in which provinces have withdrawn from integrated tax system with federal government to adopt a 'tax on income' instead of 'tax on tax'. All provinces except Quebec allow federal government to collect taxes for them.

Federal Transfers provinces: provinces have persuaded federal government to pay more in terms of Canada Health Transfer and Canada Social Transfer even it has taken the duty of healthcare in 2000. To check private health care system the Romanov report suggested including provinces in it. Large metropolitans and their needs are becoming the part of province federal government agenda (Dyck, 2004).

Indian Fiscal Federalism Model

India is a federal state before independence. It adopted amended 1935 Act as interim constitution till 1950, when new constitution was introduced in the country. New constitution called it the 'Union of States' this union has 28 states, 7 federally administrated territories. The distribution of powers is given in seventh schedule. Federal list which is called Union list contained 100 items states list has 61 items and concurrent list has 52 items on it. Residuary powers are not mentioned in the constitution, so they rest with the federal parliament. Article 256 states that states governments cannot act or go against the central laws related to administration. Article 356 explains that president can impose presidential rule in any state and can proclaim emergency. President has to appoint a commission every five year for grants and tax devolutions. Indian president can proclaim under article 360 of constitution the financial emergency in whole or in any part of union if there is threat to financial stability of the union important thing is that neither union nor financial commission has given the guideline for it.

Revenue distribution in India consisted on two tiers i.e. union and states. In 1993 two amendments (73rd& 74th) in the constitution turned the fiscal distribution in three tires and local governments were also involved. Sales tax which is the major tax is collected by federal government. Constitution accepted that the revenues for states are inadequate for their expenditures therefore; union government shares taxes on other than non-agriculture incomes and union excise duty with states. The tenth Finance Commission recommended changes. After amendment in constitution states were given share in all central taxes in the devisable pool. Commission also improves the system of grants in aid in favour of states. States can borrow from central government and from market as well but if a state is already in debt of central government then it has to take prior permission from it to borrow from the market. Indian financial system shows a clear vertical as well as horizontal (Rio, 2003) imbalance. States can meet only about 44% of their expenditures through their own sources. Centre provides about 55% of their expenditures. There is also a clear Horizontal fiscal imbalance among 28 states. Their natural sources, number of population, landscape divides the Minto high, middle low and very low-income categories.

Transfers by Indian Finance Commission

Finance commission makes overall budgetary requirements assessments for union and states governments to determine the volume of central transfers. It estimates planed and non-plan expenditures. It also determines the share of states in the tax revenues of Centre and the procedure of transfer. It also works on the gaps between grants in aid and nonplan expenditures. The criteria for tax devolution are based on following economic indicators;

Table 1: Indicators of Horizontal Distribution in India

Type of Economic Indicators	**Percentage**
Population	10.02 %
Income (Distance Method)	62.53 %
Area	7.5 %
Index of Infrastructure	7.55 %
Tax Efforts	5.06 %
Fiscal Discipline	7.5 %
Total	**100 %**

Source: (Rao, 2003)

Grants and aids are given to the states on the formula devised by National Development Council (NDC), thirty percent of funds are allocated for special category states (very poor) in shapes of grants and loans whereas seventy percent are distributed on the bases of 60 percent weight assigned to population, 25 percent to per capita SDP, 7.5 percent to fiscal management, and the remaining 7.5 percent to special problems of these states. Some transfers of funds are made through direct schemes by union government in the states.

Loans or borrowing of states are the significant part of Indian financing set-up. The liabilities of states consist of loans from the central government, market borrowings, a share of small savings collections, provident funds, deposit accounts, and others. The central loans constitute 60 percent of state borrowings. These loans are given mainly for financing the plans under the Gadgil formula. According to the formula states receive 70 percent of Plan assistance in the form of loans. Other central loans consist of ways and-means advances and a share of small savings collections. The states can also borrow from the market. However, if a state is indebted to the Center, it has to take central permission before borrowing. As all the states are indebted to the Center, the Ministry of Finance, the Planning Commission and the Reserve Bank of India determine market borrowings of the states. Repayment liability, investments planned for the year, and the overall debt burden of each state are also taken account in determining market borrowings. The whole process is complex and need a lot of homework. In 1998-1999, outstanding loans from the market constituted 22 percent of states' indebtedness (Rao, 2003).

Financial Federalism in Pakistan: Historical Background

Early British India could be seen in two administrative parts; British provinces and princely states. British had chosen federal form of government for India due to its vast terrain and diversity in its geography, people, cultures and languages etc. Although provinces were given legislation and administration powers but there were no clear judicial demarcations between the powers of central government and of provinces. Centralism was clearly prominent, there were no proper division of revenues, provinces were allotted money for their administrative expenditures (Nazir, 2008). In 1912 provincial governments were allowed to make their own budgets in 1919 Act of India Government, representative governments at provincial level were introduced but there was no change in the context of Centre province relations but the Act of 1919 provinces were allowed to make developmental plans and could have allotted money for them for example education, health, public works, justice, veterinary, irrigation, forests, stores and factories etc. Though financial matters were in the hands of governors through non-transferred departments. But the positive point was that provinces were allocated separate and independent sources of revenues. Separate financial departments were made in the provinces but Governor General was the custodian of the Public money and Secretary of State for India was in general control the spending of Indian revenues. The Niemeyer Award was being followed for resource distribution between the Centre and provinces. According to this award, an important tax i.e. sales tax was levied and collected by the provincial governments. In the case of income tax, 50 percent of the total collection was reallocated to the provinces (Zaidi, 2015).

The Government of India Act 1935 also provided for federal system. Provinces were categorized into the provinces with Governors and Chief Commissioners. With the making of Sindh now there were eleven provinces. It was not obligatory for the princely states to join the federation. There were three list of subjects which described the division of powers between Centre and provinces. Federal list confined 59 subjects whereas provincial 54 and concurrent list contained 36 subjects related to provinces but needed even handling throughout India. Diarchy which was practiced in provinces before was abolished at provincial level and was introduced at central level. However, the discretionary powers of Governor were there which he could use without permission of provincial legislature with the consultation of Governor General. Before the Act of 1935 the financial resources of provinces could be taken back by Centre at any time. Now some sources of revenues were allocated for provincial use.

The financial powers of provincial legislatures were increased and they can vote on annual provincial budget. Centre has decided to share a prescribed percentage of its taxes with provinces according to the suggestions of Niemeyer Award Under the 1935 Act of United India. Sales tax was collected and used by provinces. Income tax other than agriculture was levied and collected by federal government but it now reallocates the 50 % of total taxes to the provinces. Salt tax, federal excise and export duties were collected and spent by the Centre. Fixed sum grants from federal government were given to the provinces.

Federalism in Pakistan was the product of the British period and was eagerly adopted by Muslim League during freedom movement for it suited their demands, of provincial autonomy. They have the chance to make government in Muslim majority provinces, whereas Congress wanted the strong Centre because they have the chance to get the government at national level.

Interim Constitution of Pakistan; Act of 1935

When in 1947 India was divided into two independent states, the government of India Act 1935 was modified and made interim constitution of Pakistan and India till they made their own constitutions. The Pakistan federation came into being with two parts away from each other with a distance of about one thousand miles. Both parts were different in landscape, climate, nature of economic production, people, culture and language but one thing was common and that was the bondage of Muslim identity. Federal system was ideal choice for the situation and it was adopted too. The 1935 Act worked as interim constitution of Pakistan till 1956.

National Finance Conference November, 1947

The lack of resources for rehabilitation of immigrants and for needs of defence, encouraged new government to reshaped the already pro Centre revenue system of 1935 Act. In November 1947 (Ali, 1994, p,46) a conference was held of federal and provincial representatives of governments to discuss the issue of revenue collection among federal government and provincial governments. It was decided on the special appeal on Quaid-e- Azam to let the Centre take over sales tax which was before the part of provincial revenue and also to accept the reduction in income tax share of provinces. New percentage in tax from federal government would be decided for the provinces. The new share of East Pakistan in the export duty of jute was now 37.5%. It was provided in the Act of 1935 that Jute producing provinces would be returned the 50% of export duty on the jute will be returned to the related provinces according to Neymar Award. This provision was amended also by an order of Governor General and 37.5 % was now given instead East Pakistan had already acute economic poverty. This reduction created bitterness in the province against federal and Punjab governments. In 1950 the period of this policy was extended to March 1952. In 1952-53 federal government had 290 million rupees surplus, which caused protest in poorer East Bengal on federal behavior. The politicians wanted a different Award for the revenue distribution between central and provincial governments. Prime Minister Liaqat Ali Khan appointed Sir Jeremy Raisman to find the solution.

Sir Jeremy Raisman Award

In 1951 Sir Jeremy Raisman was consulted to recommend the proposals for allocation of revenues for federal and provincial governments. He was a competent ICS officer with high experience of Indian financial situation. Provinces especially East Bengal wanted federal government to decide a fair method of sharing the federal revenues. Provincial government wanted the share in jute duty. Sir Raisman recommended 50 % return of income tax from the relevant province and 62.5% of basic jute export duty to be given to the East Bengal. It was not implemented till April, 1952.This Award could not improve the fiscal position of provinces especially East Bengal where still poverty was acute. It has only one major source of income and that was jute export duty. NWFP (now KPK) had not any noticeable sources of its own. Punjab was better off due to its better collection of taxes, agriculture income tax. It has its source of tax on irrigation land and immovable property tax which were making the 36% of its total revenue. The sense of insecurity from a hostile India made it impossible for federal government to provide a better share of its revenue to the provinces. Constitution making process complicated the political and fiscal power distribution between central and provincial governments. West Pakistan was converted into one unit and was given equal status to East Bengal, which was still more populated. Public opinion of smaller provinces was also ignored while constitution making. Powers distribution was hardly different from 1935 Act.

Financial federalism in 1956 Constitution

1965 constitution has three lists for federal and provincial powers while provinces in the western Pakistan were converted in one unit and principle of parity was implemented for both wings of the state. Federal list contained 30 subjects in it, provincial list had 94 whereas concurrent list consisted on 19 subjects. Federal legislature was given the right to make laws for any provincial matter. Observers says that different taxes for federal government were grouped under one subject while provincial list was expanded through describing parts of one group onto single items. (Nazir, 2008, p. 131)

The 1956 constitution was not very different in its financial relations from 1947 interim Act. Federal government along with the subjects of federal list has the right to charge and collect customs, export and excise duties, corporation tax, income tax other than agriculture land and purchases, terminal taxes on passengers and goods carried by air or sea, tax on fare and merchandise tax on gas and oil.

The major sources of provincial revenue were taxes on land and buildings, mineral rights, drugs, alcohol, vehicles, advertisements, animals, boats, professional trades, luxuries. Both were authorized to impose fee on the subjects included in the concurrent list.

Article 118 required to appoint a National Finance Commission consisting finance ministers of federal and provincial governments and such other persons by the president with the consultation with governors of both provinces. This commission will make appropriate recommendations for the allocation of federally collected revenues for provinces. The commission will also devise principles for the distribution of grants in aid and other grants. But this commission was not setup during two years of constitution. Another provision provided for the establishment of an Inter Provincial Council to discuss the matters of common interest for both federation and provinces, this council was also not established.

1962 Constitution and Distribution of Financial Powers

According to senator Raza Rabbani the undemocratic and illegal constitution was not passed by Parliament instead it was given the shield of a 'fraudulent referendum' (Rabbani, n.a.). There were two lists of subjects, one for federal government with 49 entries and a concurrent list, all residuary powers were given to the provinces according to article 132. Borrowing by provinces and intra provincial trade were same as in 1956 constitution. Railways and industrial corporation were given to the provinces. Article 144 and 145 provided for National Finance Commission and National Economic Council but with no explicit representation from provinces (Ali, 1994, p.126). Two Awards were made during Ayub period first was implemented in 1961 and second in 1964. In the 1961 financial Award devisable federal revenues were divided into both East and West Pakistan on the ratio of 54 and 46. 30% of sales tax was given to provinces on the bases of collection efforts. Revenue sharing was slightly changed and 100% export duty on jute and cotton were given to the province in 1961-2 while in 1964 it was again turned to 65% (Jaffery & Sadaqar, 2006). In 1970 the constitution of 1962 was dissolved and one Unit was also disbanded, the 54% revenue for west Pakistan`s share was distributed(on the ratio of Punjab:56.55%, Sindh:32.55%, NWFP:15.55% and Balochistan: 4.55%) among the provinces. In 1970National Finance Committee was setup and new NFC Award was announced by Yahya government in which 80% of all export duties were shared with the provinces and 100 % of import duties. Critical political situation left no time to assess the effects of these too late changes.

Financial Provisions in 1973 Constitution

In 1971 East Pakistan was separated, one of many causes of this integration was called the unsatisfying financial federalism. East Pakistan had not accepted the ill-advised federal taxing arrangements in early years of Pakistan especially related to jute duty. Later measures though not quite revolutionary did not compensate the grievances of provinces. Zulfiqar Ali Bhutto tried to make the distribution of political and financial powers among federal and provincial governments fairer and more explicit in the constitution of 1973(Baxter, 1974). The constitution in its original form contained two lists; federal and concurrent lists. The federal list contains two parts; first part has 59 items while list B has 8 items. Concurrent list with 47 items was abolished in 18th amendment and 24 federal ministries were transferred to provinces. Article 160 provided to establish the National Finance Commission (NFC). The members of this commission will be the finance ministers of all provinces, Finance minister of federal government and same number of persons with consultation of Governors of the provinces. This commission will make recommendations to the President of Pakistan on the distribution of taxes, export duties, excise duties, grant in aids by federal government, provincial borrowing or any other matter related to finance mentioned by president.

These recommendations by NFC with the explanatory note will be placed onto both houses of parliament and provincial assemblies. The federal taxes which will be not the part of consolidated funds according to Article 161 are duty, royalty on natural gas and well head. Any profit earned from hydroelectric power or station will also paid to the province where it is situated. Professional tax will be provincial tax. Provincial borrowing could be made on the security of that province`s Consolidated funds and Centre will provide guarantee as is in Article 167.

National Financial Awards (NFC) in Pakistan under 1973 Constitution

The scarcity of sources and revenue to meet the growing needs of Pakistan has always been a serious issue. Federal government since independence has to meet the needs of defence and international constraints as well as to cover the horizontal imbalances in provinces.(Jaffery and Sadaqat, 2006).After the separation of East Bengal in 1974 Zulfiqar Ali Bhutto government announced the Award with population as it main indicator of federal revenue sharing with the provinces. Two National Financial Commissions during Zia regime were appointed in 1979 and 1985, but no award was announced due to lack of consensus among the members of the commission. Under the 1973 Constitution of the Islamic Republic of Pakistan, the federation and the provinces had, in addition to their exclusive sources of revenues, a divisible pool comprising the net proceeds of specified taxes which is shared by all the provinces. The federal government meets the additional requirement of the provinces through various special transfers such as grant-in-aid, subsidies subvention, assistance, emergency relief and federalization of functions. Giving the importance and complexity of revenue sharing the Constitution provides (under Article 160) for setting up the NFC periodically to recommend on the operation of divisible pool, borrowing powers, grants-in-aid and other such matters. NFC Award was based upon a mathematical formula devised by economists, financial specialists mathematicians and statisticians. Five type of taxes which were collected by and for federal government are given below;

Table 2: Federal Taxes

No.	**Types of Federal Taxes**
1	Income tax
2	Sales tax
3	Capital Value taxes
4	Federal Excise
5	Custom duties taxes

Source: (Sabir, 2010)

The provinces generate almost 8% of total national revenue and their share in spending is 28%. The National Finance Commission is responsible to devise an acceptable formula for the sharing of devisable revenue of federal government. The principle on which NFC is based that all provinces and federal government should agree upon the formula. Often NFC Award is not accepted by all parties therefore a deadlock occurred or provinces were forced to accept the formula. The revenue which is offered to share with and within the provinces is called devisable pool. There are two main decisions to be reached in NFC; first what would be share of the federal government in this devisable pool and second what criterion would be followed to divide revenue among provinces. (Khawaja and Din, 2013, p 24)

In 1974 first NFC Award with the collaboration of provinces was successfully enacted in the state. It does not essentially mean that there were not any financial contradictions among provinces. Bhutto belonged to Sind and Punjab was his strong hold with PPP government at provincial level. Indicator of population favoured Punjab now.

In 1979 and 1985 two NFC Awards were made during Zia government. Due to the new census in 1981 there were some adjustments only, grants for Blochistan were increased share of NWFP kept same. Many meetings could not crate any acceptance by the provinces.

In 1991 during Sharif government many suggestions were considered. More items i.e. excise duty on sugar and tobacco were included in the devisable pool. For the first time, provincial share in gas and oil net profit was accepted and straight transfers to provinces were made; the share of transfers to provinces therefore increased to 45% from 28% as vertical balance. But no change was made horizontal distribution of revenue. The 1995 NFC Award was presented by PPP government. The royalties on crude oil and net development surcharge on gas were given to provinces. Matching grants were given to the provinces for meeting the target of revenue growth. During the Award period, many changes were made because revenues were not collected according to estimated growth rate of GDP and high rate of inflation did not let the plan completed.

In 2000 Gen. Musharraf government constitute NFC under Shoukat Aziz; finance minister but could not obtain the consensus, provinces asked for a diversified distribution criterion and more share of provinces in the devisable pool. NFC in 2006 met the deadlock because provinces did not agree upon the resource distribution method and Chief ministers of four provinces gave the authority to President to announce the Award. President Musharraf announced Award through an Ordinance in 2006.The revenue for sharing were increased due to better economic performance and it was decided to share it to the level of Districts and cantonment governments. Sindh received largest amount of straight transfers. Some non-development funds were transferred to provinces under the compensation for victims of natural disaster or any uncontrolled situation.

Table 3: A Preview of Financial Awards in Pakistan & Results

Financial Award	Years	Government	Nature	Horizontal Distribution Base
Raisman Award	1951	Liaqat Ali Khan	inconclusive	GNP, Tax Performance
Raisman Program1961	1961	Gen. Ayub Khan	inconclusive	GNP, Tax Performance
Raisman Program1961	1964	Gen. Ayub K	inconclusive	GNP, Tax Performance
ReformCommittee Award	1970	Gen Yahya Khan	inconclusive	GNP, Tax Performance
First NFC Award	1974	Zulfiqar Ali Bhutto	Conclusive	population
Second NFC Award	1979	Gen M. Zia ul Haq	Inconclusive	population
Third NFC Award	1985	Gen M. Zia ul Haq	Inconclusive	population
Forth NFC Award	1990	Nawaz Sharif	Conclusive	Population,
Fifth NFC Award	1995	Benazir Bhutoo	Conclusive	Population
Sixth NFC Award	2000	Gen Pervaiz Musharraf	Conclusive	Population
Distribution Order	2006	Yousaf Raza Gillani	------------	Population
Seventh NFC Award	2009	Yousaf Raza Gillani	Conclusive	Population, poverty, Tax collection, inverse population
Eighth NFC Award	2015	Nawas Sharif	Not agreed	Yet to decide

Source: (Sabir, 2010)/ National Finance Commission

7th NFC Award 2010

The significance of seventh NFC Award was that it was coming after the introduction of eighteenth amendment in the constitution. It was developed in 2009 and was affected in July 2010. It was a major development in financial federalism of Pakistan due to two main steps i.e. federal government agreed to take 10% less in federal share and the distribution of revenue in provinces was based on multiple indicators criteria and not on the bases of population as was in practice in past years. Following sources were included in the divisible pool. Personal and cooperate income tax, wealth tax, capital value tax, sales & purchase taxes, custom duties and federal Excise duties (excluding gas).

The vertical distribution of revenue between federal government and provinces was 56 to 57% share kept for provinces. The horizontal distribution was made on the formula other than only population based. Now population was given the 82% weight, poverty 10% and revenue collection efforts and inverse population density were also the part of distribution formula. Although it was not a revolutionary act but a positive step toward making the horizontal balance among provinces. In this Award the share of Punjab fell slightly but it was not less than the previous shar because Award says that no party will receive less than its previous share. The share of Balochistan and KPK is increased in grants and aids too. This will help to lessen the poverty in both these provinces.

Table 4: Factors Formula Used for Horizontal Devisable Pool Distribution.

Indicators for Horizontal Distribution of Revenue	NFC (1974 to 2010)	NFC 2010
Population	100%	82.%
Poverty/ Backwardness	-	10.3 %
Revenue Collection/ Generation	-	5 %
Inverse population density	-	2.7 %

Source: (Sabir, 2010)

The Prospect of Eighth NFC Award 2016

On 30th June 2015 seventh NFC Award expired. Many meetings of the Financial commission were held from July 2015 to devise a fresh formula for the division of resources under the chairmanship of federal Finance Minister, but no formula was agreed by the parties. KPK and Sindh provinces have the ministries other than the Muslim League (N), they protested the delay in announcement of NFC. Federal and Provincial governments have decided to allocate revenue percentage among provinces under the Award after the census of 2017. But after the census Sindh and Karachi refused to accept its results, therefore Award is still not made and interim orders by president are in practice for the year. It was decided to monitor the NFC meetings quarterly, federal government also agreed to pay KPK and Blochistan for the damages made by war on terrorism. Pakistan also assured IMF that a Fiscal Coordination Committee comprising on Secretaries finance of all provinces will meet every four months to develop fiscal policy coordination at national level (Dawn,1-1- 2017). As there is civilian rule in Pakistan and all three political parties; PPP in Sindh, PML (N) in Punjab and PTI in KPK are running the provincial governments have their contradictions on the Award. It is a sign of maturation of political process in Pakistan.

On 20th September 2017, a statement by the representatives of Provinces declared that they are considering to go to Supreme Court to challenge the delay of NFC Award (Daily Jung).

Conclusion and Implications

The early years of Pakistan were dominated by Muslim League the creating political party of Pakistan, it tried to run the state in centralized unitary style. Federal provinces were assumed to sacrifice for the sake of strong Centre without considering the local needs and patterns. Authoritarian obedience from Punjab did not convince other provinces to follow the same line. As the provinces were also run by Muslim League Chief Ministers, therefore the financial issues were raised mostly at party level and were ignored by Centre.In1950 East Pakistan has explicit complaints due to lack of sources because sales tax was taken over by federal government. Sir Raisman Award 1951 was also not implemented. And in 1954 Muslim League was out of local government in East Bengal with the emergence of local political parties. The demands for the excise duty on Jute was on political agenda of East Bengal. As Punjab had Muslim League Ministry and did not demand the excise duty on Cotton with same earnest. Grants and devisable transfers were based on the formula of GDP performance and tax generation. Both indicators were in the favour of West Pakistan. Members of National Constituent Assembly and Provincial Assembly of East Bengal criticized federal surplus in revenue and smaller percentage of developmental grants, some of which were conditional (Ali, 1994). Korean War provided the opportunity to earn more export duty on jute but federal government could not satisfy the East Bengal with its portion of the earned revenue. Defence budget of federation absorbed most of federal revenues and small was left for provinces. The provincial government in Punjab was still of Muslim League and hardly contradict on financial matters with Centre.

During the one-unit years (1955-69) Smaller provinces of West Pakistan also show their doubts on the distribution of revenue within the one unit. The West Pakistan`s share was distributed among one unit constituting provinces and the states merged in it. No National Economic Commission was made under the constitution of 1956. 1960 and 1964 awards were announced by the Gen. Ayub Khan government but without any open and satisfactory public debate; which is as vital as the Award itself. Provinces were promised to provide more revenue because the income of federal government was increased due to rapid economic development. In 1970 National Finance Committee proposed 20:80 ratio between Centre and Provinces while East Pakistan and West Pakistan have the sharing ratio of revenue for provinces at 54: 46. And the distribution among West Pakistan provinces was also on population.

After the separation of East Pakistan many financial improvements were tried in 1973 constitution but population kept the indicator of revenue sharing. At this stage National Financial Commission was made under Article 118 of constitution to make recommendations to the President of Pakistan on the distribution of resources between provinces and federation. India and Canada have better sharing formulas for their units. Canada has a largest province of Ontario and many less developed provinces even with smallest population just as Pakistan has Punjab and Blochistan. Pakistan could have followed Canadian financial federal model. Peoples Party of Zulfiqar Ali Bhutto had the provincial ministries in Sindh and Punjab. Both governments hardly contradicted on logical bases with the Centre and accepted the Awards by Bhutto in 1971 and 74.

During Zia years two Awards were announced one follow the lines of 1974 and other was based on 1981 census; which gave a small benefit to Blochistan and NWFP (KPK). Military regimes tried to act more professionally and just in economic issues but failed even more than civilian because an open debate and political vision is needed to get mutual consent and satisfaction. Therefore, they have failed to implement any revolutionary or modern changes in the vertical and horizontal distribution of resources.

Interestingly in the decade of second civilian rule which started from 1985 to 1999; first time Punjab had the different Party government from federal government twice, but the situation did not change for the population was only criteria of horizontal revenue distribution. General Musharraf like his predecessors was quite active in preparing and announcing the Award in 2000 and 2006. District governments and boards were involved in revenue sharing but federal government failed to provide provinces their own sources for revenue generation. Special grants were given to the poorer provinces. Federal government could not make consensus among provinces on vertical and horizontal revenue distribution. 2006 Award was implemented by a presidential order because a deadlock occurred due to disagreement of provinces. The period of this NFC Award faces internal and external pressures of war against terrorism, economy of state was badly affected by the war in Afghanistan. Law and order in Pakistan was deteriorated by terrorist activities in Pakistan. Most revenues were spent on law and order. Economic growth rate also declined and consequently decrease the taxes and duties.

After the eighteenth amendment, it was obligatory for federal government to constitute NFC under article 160. NFC Award was given more space to work; because constitution provided the provinces some control on the natural resources within them. Federal government is bound to pay royalties on oil, gas and hydroelectric stations and these revenues will not be the part of consolidated funds of federal government. Eighteenth amendment has strengthened the National Finance Commission by activating the Council of Common Interest (CCI) and National Economic Council (NEC). The seventh NFC Award 2010 has a new horizontal distribution formula. It has included the indicators of poverty, inverse population and tax generation efforts along with population. This distribution has profited to Blochistan and KPK.

Ironically the more funds are made the part of devisable pool the more dependent become the provinces on federation and ask for more grants and shares. The borrowing by provinces is becoming an offensive farce. The deficit of provincial budgets and loan are increasing. Provinces also show less interest in tax collection and devolution of funds to districts local government. Lack of provincial sources is also an important problem. Public representatives in the Parliament other than Punjab find the Punjab exploiting and the Punjab itself has a south north issue within. In 2015 when the tenure of seventh NFC Award was over and meetings of NFC were held during 2015 and next years but parties could not have reached to a consensus. National census is not acceptable to the province of Sindh and a deadlock prevail in the working of NFC. In the provinces of Punjab, KPK and Sindh three different major political parties are in government. This change can lead to a positive decentralization in financial field.

These issues are common in federations; and situation can be made better with proper reforms. A fair distribution of resources should be discussed in the parliament and NFC forum. Only fiscal expertise or mathematicians cannot satisfy an old suspicion. Provinces will support their interests its natural but they should be reminded of the practical existence of other provinces. In Canada provinces had approached to Supreme court to get the revenue issues solved. In America till 1930, Supreme Court played significant role in preserving the economic rights and sources of the states. Provinces in Pakistan can have the option of supreme court. The distribution of revenue should be revised by observing the Canadian and Indian financial federation. Canadian equalization formula is helpful for less developed provinces. Some part of the devisable pool can be permanently given to the provinces as their sources it will increase their sense of responsibility and freedom. Role of Punjab in the financial federalism in Pakistan need more impartial study to determine the actual situation. The weightage of population can also decrease in the formula for devisable pool. Educational and modern economic development by federation in the least developed and resourceful areas of provinces can control the internal urban migration and development. Pakistan has a youthful population it can be trained with educational investment especially in KPK where natural resources lacked.

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