



## EMERGING ISSUES AND CHALLENGES TO FISCAL FEDERALISM IN PAKISTAN

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### ABSTRACT

#### Article History

Received: 21 February 2022

Revised: 4 April 2022

Accepted: 25 April 2022

Published: 6 May 2022

#### Keywords

Federalism

Act

Amendment

Constitution

Pakistan

Politics

Distribution of power.

#### JEL Classification:

A19; B59; D04; E00.

After the enactment of the 1973 constitution, the defined roles of federal and provincial governments hit snags when democracy got derailed by two martial laws between 1977 and 2008. The consequences were obvious, as the federation; inter-provincial harmony, and intergovernmental fiscal relations witnessed wide socio-economic development gaps in Human Development Index amongst provinces. The genuine pressing public demand was reflected through a consensus of 7<sup>th</sup> NFC award during the 18<sup>th</sup> constitutional amendment by then the democratic government to create harmony in society in general, raising the responsibilities, in particular. The analysis examined the issues like enforcement of fiscal discipline, strengthening the role of the Senate of Pakistan, local governments, barriers to internal trade, absence of fiscal responsibility laws, devolution of further taxes such as GST on retail sales and wholesales needs to be corrected to mitigate dividends of 7<sup>th</sup> NFC award making fiscal federalism principles a great success in Pakistan.

**Contribution/Originality:** This research helps in a new era of “Fiscal Federalism” in Pakistan, as the provinces are still learning to live in changed circumstances since their responsibilities have increased manifold for public welfare gains to get a new system of maturity.

## 1. INTRODUCTION

The country’s political history shows that strong centralizing policies with authoritarian leadership resulted in a weak Pakistani state as a result of the political ability to combine ethnic groups into one entity and build among them a strong sense of Pakistani nationalism. Almost all ethnic groupings in the political parties constantly came up with a demand for increased provincial rights, autonomy, decentralization of power, and devolution of authorization (Kennedy, McNeil, Ernst, & Gilmartin, 2003). During constitutional periods from Independent Act 1947 up to the 1973 constitution, the settlement of the question of allocation of powers which was most controversial remained central to the problem. Lastly, a solution in the shape of a federal democracy was attempted by the Constitution of 1973. The permanent Constitution came into force on 14<sup>th</sup> August 1973 and was adopted by the National Assembly on 10<sup>th</sup> April. Under this constitution, four federating units are itemized and the constitution also predicts the Federal republic with the legislative system at the national and provisional levels (Munir, 1967).

The consequences of which resulted in the dismemberment of Pakistan and Bangladesh was created in 1971, only after 24 years of independence from British India (Khaskhelly & Khaskhelly, 2004). Thereafter, the consensus 1973 constitution was enacted which restored historic four provinces namely, Punjab, Sindh, Khyber Pakhtunkhwa (KP), and Baluchistan. This constitution was based on true federalism principles, as it envisaged a federal

parliamentary system with bicameral legislature and council of common interest while recognizing rights of provinces to have their say in state affairs especially economic and fiscal matters. However, subsequent changes brought about through the 8<sup>th</sup> and 17<sup>th</sup> constitutional amendments by two military dictators disturbed the equilibrium of rights between center and provinces especially in fiscal matters. This deprivation resulted in absence of rule of law, the weakening of public sector institutions, bad governance, poor law and order, rise in ethnic conflicts, and terrorism both sectarian and ethnic. Above all rich-poor gap widened. Thus, a major portion of the population across Pakistan facing socioeconomic inequalities.

Although the 7<sup>th</sup> NFC award and devolution of sales tax on services to provinces have increased the revenue share of all the provinces, this responsibility of tax assignment has to prove the capacity of provincial governments for the provision of efficient public services delivery. Usually, the success of fiscal decentralization can be judged from the assumption that it increases economic efficiency, because SNGs being closer to people can offer better services, provided systems are transparent with no or least corruption. Also, they- may be more accountable, because of easy access of its people and being more informative on the issues concerning their development.

The Federal Governments have held on the revenue resources across the globe and because of the varied requirements such as socioeconomic diversities, political compulsions, etc., they are facing distribution issues. Further, “few issues excite the political pulse more than those associated with taxation and distribution of government revenues”. Hence, fiscal federalism principles guarantee fiscal autonomy to Sub-National Governments (the provinces and local councils) to broaden their revenue base, expand their spending assignment, guarantee relative transparency, accountability in their spending and expenditure assignments, to become closer to people to provide more efficient service delivery, socio-economic justice, higher growth and poverty reduction. Given the above, the subject has been analyzed under the hypothesis that “phenomenal fiscal decentralization improves the quality of governance, brings in economic development at par, serves to address rising corruption, introduces accountability by making systems more transparent, strengthens the democratic institution, mitigates fiscal conflicts, empowers public through active participation, augments autonomy of provinces, resulting in the integration of federation in Pakistan”.

Fiscal Federalism principles propel Fiscal Decentralization (FD) to strengthen institutional mechanisms. Recent trends reveal that efforts are being taken in Pakistan to strengthen the process of FD through the 7<sup>th</sup> NFC award and 18<sup>th</sup> constitutional amendment. The idea was to bring the fiscal powers of the Centre and the provinces in equilibrium so that conflicts are avoided. The prime objectives of this research therefore are:

- *To ascertain how much FD may be required to satisfy the needs of the public in the provision of goods and services.*
- *To bring equilibrium in devolving the fiscal powers between the center and the provinces.*

The research looks into a significant legislative process utilized by the country’s lawmakers to provide a solution to this issue that has plagued the country for a long time. Similarly, giving an overview and highlights the obstacles to Pakistan’s fiscal federalism. Moreover, this discussion would enable the study to find out gaps, issues, and implications of the 7<sup>th</sup> NFC award & 18<sup>th</sup> amendment about Fiscal Federalism.

## 2. REVIEW OF LITERATURE

Political theorists have long been chastised for basing their ideas on the taken-for-granted concept of the nation-state while disregarding the prevalence of conflict-like circumstances between state nationalism and minority nationalism (Kymlicka & Straehle, 1999). Further, the country as a political group in one’s mind in his celebrated work on nationalism. This imagination is restricted and sovereign both intrinsically. The imagination is founded on the idea “that even the members of the tiniest nation never know, will meet or hear of most of their colleagues, but that the picture of their communion lives in thought”. While the appearance of imagined entities is a sign of impending doom, to link the Iranian identity to its difficulties in the global environment and coined the term “psycho-nationalism”. Many authors (Connor, 1972; Kymlicka & Straehle, 1999; Pearson, 1986) argue that

confrontations between state nationalism and minority nationalism have been common highlights of the twentieth century. While language and education policies have gotten a lot of attention in terms of identity-related conflicts, researchers of federal country statehood have recently been interested in a more financial perspective. The study of several levels of government, with an emphasis on the split of tasks and policy tools between the central government federating entities, is called fiscal federalism (King, 2016; Oates, 1999). It entails examining various sources of government revenue, their allocation to administrative units, and their expenditure on delivering public goods, with a particular focus on how we might make this process more efficient.

FD prescribes a highly narrow tax base for SNGs. It certainly shifts resources from central government (having higher rates of capital spending) to SNGs (that spend relatively more on consumption goods and services). National growth gets setbacks when the overall spending on infrastructure (capital) is lowered. SNGs may not have the potential skills to collect devolved taxes efficiently as do the central government, increasing thereby chances of corruption and inefficiency, and maladministration (Bahl & Cyan, 2011). According to Kwon (2013) after conducting regression analysis on various indicators concerning fiscal decentralization on the data collected from 17 developed and developing countries, concluded that quality of regulation and rule of law were seen as the effective determinants for government effectiveness, while the responsibility of expenditure and revenue was effectively devolved. The devolved functions expanded the budget of the lower-tier which ultimately helped deter corruption, enhanced autonomy for the public good. Moreover, To ensure accountability and transparency in spending and generating financial resources fiscal decentralization can play an effective role (De Mello Jr, 2000).

Scholars and reactionaries also disagree on transferring revenue and spending responsibilities at a lower level. This rubicund depiction is full of drawbacks (Poterba, 1996). Literature also reveals that there is a great possibility that FD may generate undesirable results. Prud'Homme (2000) describes FD as an effective drug that contains enough toxins, hence may harm the patient (Systems/institutional mechanism of FD), if the correct dosage could not be prescribed at the right time for the right disease. The opinion of Davoodi and Zou (1998) is not different than (Shah, 2012) that effective review and monitoring must be in place when introducing new systems.

Moreover, by recent literature, Weingast (2014) distinguishes the two generations of fiscal federalism, i.e. First-Generation Fiscal Federalism (FGFF) and Second-Generation Fiscal Federalism (SGFF), and highlights that FGFF studies the performance of decentralized systems under the assumption of the benevolence of social planners, while SGFF studies, how behavior within real political institutions such as democracy interacts with federal institutions. He further argues that FGFF has a well-developed normative theory of assignment of revenue and expenditure. The SGFF complement the normative literature as "Decentralization Theorem" which states that goods should be assigned to different levels of government. Weingast (2014) supports democracy as the prime ingredient of political systems and accountability. The way forward according to him Weingast (2014) is perpetual institutions influencing public policy formulation for the public good and desirable efficiency can mitigate conflicts. The growing literature on decentralization suggests that it has an in-built capability to mitigate conflicts in divided and diversified societies such as States with ethnic, cultural, religious, and linguistic differences. It has a role to play in "holding together" the diversity within such States. Riker (1964) indicate that holding federal states together confront two kinds of problems, over-centralization due to the Federal Government's overwhelming control over states/provinces, and vice versa. They are of the considered opinion that federal stability by way of holding together comes under the ambit of Self-Enforcing Federalism when all the stakeholders at both national and provincial levels address and mitigate their respective conflicts through the institutional mechanism and respect each other's constitutional jurisdiction. In the backdrop of the 18<sup>th</sup> amendment to the 1973 constitution in Pakistan, Shah (2012) opines that the said amendment is a positive act though, but likely to weaken political harmony and federal structure. He argues in favor of the Chinese model, which has a unitary form of government with a strong local government tier. He finds that the 18<sup>th</sup> amendment has reinforced an outmoded "*pot-belly model*" (Federalism of provinces). He continues to argue that, major reforms such as, strengthening local governance (third tier of

government), enforcing fiscal discipline, strong public accountability for service delivery of all the tiers of government are a must. While, [Boetti, Piacenza, and Turati \(2012\)](#) appreciate the recent legislative reform agenda being pursued all over the world, aimed at reducing vertical fiscal imbalance (VFI) and enhancing the efficiency in the provision of public services through increased accountability of politicians and institutions. As for the horizontal imbalance among the federating units is concerned the prime responsibility of the center is to ensure fairness in fund transfer across the country ([Oates, 1999](#)). From the above discussion and literature review, it can be deduced that democracy, decentralization, federalism both fiscal and political or administrative, perpetual institutions hold a future in Pakistan.

### 3. METHODOLOGY

In the contemporary research methodology, a mix of both qualitative and quantitative studies is gaining popularity. Therefore, both qualitative and quantitative methodologies shall be applied to analyze the data collected through specific research. Why both methods are being taken up together because the mixed-method approach increases diversity and helps in comprehending the research problem. According to [Hashmi, Amirah, and Yusof \(2020\)](#); [Hashmi, Amirah, Yusof, and Zaliha \(2021\)](#) and [Rashid et al. \(2021\)](#), “the integrated approach maximizes the profits of strengthening of overall research design. Moreover, the mixing of both methods complements each other and offsets respective weaknesses. The result is thus comprehensive, and convincing when compared with mono method studies”. There is every likely hood that the mixed method approach may be a useful tool in interdisciplinary collaboration.

For the current paper, the secondary data (empirical) has taken from the Economic Survey of Pakistan, Planning Division, the Finance department of Sindh, KPK, Punjab and Baluchistan, SPDC (social policy and development center) Karachi, PILDAT, SDPI has been obtained to discuss and draw how the prevailing, as well as previous resource distribution mechanisms through NFC awards, have contributed in socio-economic development across Pakistan. The objective of the analysis was to know the extent to which these awards are unable to create equity as for as development is concerned in the country. For this research, we also consulted the qualitative data from different research scholars in the domain of financial institutions.

### 4. ANALYSIS: FISCAL FEDERALISM AND THE AMENDMENT – AN OVERVIEW

Today’s Pakistan comprises four provinces and has a broad-based consensus on a federal constitution which was adopted and enacted unanimously in 1973. There exist now a bicameral federal legislature and the four provincial assemblies. This constitution too could not survive long as martial law was clamped in July 1977 by a military dictator, since then again, the same breed of politicians coupled with civil-military bureaucratic alliance attacked severely and changed the constitution’s democratic face and the federation was again converted into the highly centric state. Several amendments to the constitution of 1973 were made to water down decentralization and devolution of administrative and fiscal powers to the federating units - the provinces and thus stunted their socio-economic development and administrative autonomy ([Waseem, 2015](#)).

In the first instance, the amendments to Articles 6 and 270 aim to eliminate the potential of future army takeover, which is one of the primary reasons for federalism disruption. Article 6 now expressly prohibits the judicial confirmation of illegal military actions ([Ahmad, 2010](#)). The next most notable element of the amendment is the transferal of the parliamentary system by replacing all competencies to the Prime Minister that the President had previously usurped in numerous amendments. Thirdly, with the inclusion of Article 25, education was recognized as a basic right. The other major change was that the present list of legislative issues considered a major advance towards provincial autonomy will be abolished ([Ahmad, 2010](#)).

Unfortunately, the leading spirit behind the revival of democracy was Benazir Bhutto who fell to the bullets of obscurantist terrorists on the 27<sup>th</sup> December 2007. Being the first woman Muslim Prime Minister, and twice elected

to the seat of the premiership, Benazir Bhutto's death was a major setback to the country's federal and democratic structure, yet the pavement that she helped to lay has helped usher in an era of a civilian democratic polity in the country. However, the recent constitutional reforms have come as a firm step towards strengthening federalism. But there is still a lot that needs to be done to make federalism work and benefit the public at large if not to complete the unfinished agenda—to make Pakistan a real democratic federation. This entails evolving accountability and good governance institutions and mechanisms to bring in fiscal discipline and efficient use of public finances so that real benefits may be passed on to the citizens, rather than the rent-seeking interests.

#### 4.1. 7<sup>th</sup> NFC Award

Article 160 of the Constitution of Pakistan obliges the President to establish, for the term of five years, the National Finance Commission (NFC) with the responsibility of establishing resources between the Centre and the federating units under a formulation that has previously been accepted. Since the adoption of the 7<sup>th</sup> NFC Award, however, no significant improvement has been accomplished. The Centre and the provinces have been reached a stalemate over its successor awards - the 8<sup>th</sup>, the 9<sup>th</sup>, and the 10<sup>th</sup> (Shah, 2012).

The NFC, consisting of the Federal Minister of Finance and acting as Chairman, is a constitutional entity comprised of four provincial finance ministers and one non-statutory member from each province. In general, a non-statutory member has certain technical expertise in matters of public finance and fiscal decentralization (Shah, 2012). Even though the President has notified the 10<sup>th</sup> National Finance Commission, disagreements have arisen regarding its membership and terms of reference. Almost all opposition parties, including the Sindh government, have spoken out against its composition and variations in terms of reference (Kundi, 2020). Significantly, the safety cushion in the form of Article 160 of the Constitution stipulates that the share of the provinces shall not decrease from that listed in the previous NFC Award in future NFC agreements. This functions as a bulwark against the future divergence from fiscal federalism in the form of constitutional protections (Shah, 2012).

The conclusion of the 7<sup>th</sup> NFC Award in 2010 showed a considerable increase of the proportion of the provinces in the federal divisible pool from 47.5% to 57.5%, which is a considerable increase of 10%. As a result, now the provinces have received such important social areas to evolve their policies on as education & curriculum, health services, rural and urban development, natural resources. The provinces are now free to broaden their resource allocation by their political and social agendas. Therefore, there have come new possibilities to strengthen fiscal federalism enhance, economic and social growth, and particularly foster the rating of low 'Human Development Index (HDI)' (as per the goals set by United Nation's "Millennium Development Goals (MDGs)". NFC awards announced after enactment of the 1973 constitution are given in following Table 1.

Table 1. NFC awards from 1974 to 2009.

Award	Date of Constitution	Date of Effect
1974 (1 <sup>st</sup> NFC)	9th Feb 1974	1st July 1975
1979 (2 <sup>nd</sup> NFC)	11th Feb 1979	Remained Inconclusive
1985 (3 <sup>rd</sup> NFC)	25th July 1985	Remained Inconclusive
1990 (4 <sup>th</sup> NFC)	23rd July 1990	1st July 1991
1995 (5 <sup>th</sup> NFC)	23rd July 1995 (Reconstituted, 1996)	1st July 1997
2000 (6 <sup>th</sup> NFC)	22nd July 2000 (Reconstituted, 2003)	Remained Inconclusive
2009 (7 <sup>th</sup> NFC)	10th May 2010	Consensus, Award Announced.

Overall, the shift has given the small provinces more advantages, in relative terms. Punjab 57.88%, Sindh 23.28%, NWFP (13.54%) and Baluchistan (5.30%) were formerly population-based province allocations. The 7<sup>th</sup> NFC Award used a four-point pattern with the subsequent weights: population (82%), poverty (10.3%), revenue (5%), and inverse population density (2.7%). Substantially, Punjab now has 51.74%, Sindh 24.55%, NWFP 14.62%, and Baluchistan 9.09% of the new inter-provincial shares (Bengali, 2020).



Table 2 shows the percentage allocated to multiple criteria in setting horizontal imbalances. As per weightage how much a particular province would fetch from the revenue pie called divisible pool.

**Table 2.** Revenue sharing formula under 7<sup>th</sup> NFC Award.

Indicator	Pakistan	Punjab	Sindh	Baluchistan	KPK
Population	82	57.36	23.71	5.11	13.82
Backwardness/poverty	10.3	23.16	23.41	25.61	27.82
Tax efforts	5	44.0	50.0	1.0	5.0
IPD	2.7	4.34	7.21	81.92	6.54

Source: NFC. Ministry of Finance, GOP (<http://www.finance.gov.pk>).

In the absence of formal communication of the findings of the National Population Census in 2017 due to concerns voiced by different stakeholders, especially in Karachi, the new NFC is expected to face a serious legal challenge. Due to changes in the government and replacement of non-statutory members, the 9<sup>th</sup> NFC was established on April 24, 2015, and re-created a couple of times in 2016, 2018, and 2019 but couldn't send a new Award because of meaningful and organized debate.

The 18<sup>th</sup> Amendment strengthened provincial fiscal autonomy by introducing clause 3A in Article 160, which states that 'the provinces' participation in each National Finance Commission Award shall not be less than the provinces' share in the preceding Award.' The amendment now precludes a regression of the 7<sup>th</sup> NFC Award's advances in provincial budgetary autonomy and safeguards smaller provinces in particular.

#### 4.2. Role of the Council of Common Interest

After the re-assigned role to all the layers of government, the Council of Common Interest's (CCI's) responsibility has increased altogether. Never before in the history of Pakistan, has such an important sharing of devolution powers taken place. The provinces have been shouldered to the provision of basic services that is socio-economic development of its citizens. CCI meetings are now required every 90 days. In Islamabad, a secretariat has been formed for this purpose. Steps have also been done to overcome its prior erratic operation. On the other hand, the Federation and Provinces have been jointly assigned responsibilities under the oversight of CCI, empowering provinces additionally on issues, such as electricity, natural resources, etc.

## 5. CHALLENGES TO FISCAL FEDERALISM

Fiscal Federalism principles accommodate diversity in local identities and preferences. They create incentives for all constitutional orders of government (central up to local), aiming to provide services competitively, efficiently, equitably, and responsibly to its citizenry. In doing so, the federations require their constitutions to be imbued with appropriate design under the guiding principle of setting assignment problems about revenue or tax expenditure or spending along with regulatory mechanisms in place to function with responsibility.

The foremost challenge to Fiscal Federalism in a multi-order government like Pakistan lies in its distribution mechanism is allocation of responsibility. This includes principles of expenditure or spending as well as tax or revenue assignments. As such, the fight for federalism and provincial rights has lasted a long time. And the adoption of the 18<sup>th</sup> Amendment was a watershed moment. However, there are significant factions in the country that feel that a strong centralized state is the only way to ensure national unity. There are numerous areas of worry for those who wish to safeguard what has been accomplished and expand the federal initiative.

Table 3 clearly shows that Federal Government collects more revenue than what it spends, although, provinces collect a small amount and have the jurisdiction of spending over their tax assignments.

**Table 3.** Comparison of revenue and expenditure share (Nabi & Shaikh, 2010).

<b>Government</b>	<b>Revenue Share</b>	<b>Expenditure Share</b>
Federal	92	72
Provincial (All)	8	28

The amendment and NFC award both came at a time when the world was witnessing an economic slump, oil price hike, food shortages due to floods, etc., all together affected economic stability which usually relied on capital inflows and neglected domestic resource mobilization. IMF asked Pakistan to fix the holes in its tax system, especially the Sales Tax. At this point, when the NFC award have been announced already, the provinces were looking forward to meeting the MDGs in the education and healthcare sectors, and now Sustainable Development Goals (SDGs). Their financial strength was deplorable, and in the backdrop of NFC, wanted to swell their purse to cater to the needs of the social sector. The 7<sup>th</sup> NFC Award came earlier than the 18<sup>th</sup> Amendment to the constitution was enacted, therefore, issues about appropriate tax and expenditure assignments could not be taken up, which the governments intend to take up in the deliberations of the 8<sup>th</sup> NFC award ahead. The above table depicts a clear mismatch of tax and expenditure assignment between both layers of government in Pakistan.

Broadly, four general economic principles such as economic efficiency, national equity, administrative feasibility, and revenue adequacy or fiscal need help in deciding as to which assignment of tax goes to the Federal Government and vice versa. Matching of expenditure and tax assignments prevent over-dependence of SNGs on intergovernmental transfers, which otherwise pose in-equilibrium. Thus, under the circumstances in Pakistan, the provinces need to create opportunities of “own-source revenue” instead of relying heavily on the Federal Government.

Moreover, for devolution under the 18<sup>th</sup> amendment to succeed, the tax reforms strategy was the need of the hour for the effective service delivery, but opposition from vested interests compelled weak coalition government at the center to postpone the restructuring or at least slow it down for a considerable time. Ahmad (2010) has rightly pointed out that, “without the tax reforms, the NFC award is just a mirage in the desert”.

Concurrent functions devolved to provinces under the 18<sup>th</sup> amendment that didn't have the mechanism to regulate in the areas of education and healthcare. The absence of such coordinated functions further deplored the conditions. Such as primary healthcare regulations, higher education regulations, climate change, and natural disasters that have been severely affected (Shah, 2012).

**Table 4.** Resource distribution criterion before & after 7<sup>th</sup> NFC (Khawaja & UdDin, 2013).

<b>Criteria for Distribution of National Revenue</b>	<b>Presidential Order 2006</b>	<b>7<sup>th</sup> NFC Award</b>
Provincial Share in Divisible Pool	46.25%	57.5%
Grants and Subventions	3.75%	-
<b>Indicators and Weights</b>		
Population	100%	82.0%
Poverty	-	10.3%
Revenue Generation	-	5.0%
Inverse Population Density	-	2.7%
Given the Weights indicated above, the provincial share in the Divisible Pool works out as follows:		
Punjab	53.01%	51.74%
Sindh	24.94%	24.55%
Khyber Pakhtunkhwa	14.88%	14.62%
Baluchistan	7.17%	9.01%

Particularly in the case of Article 160 (3A) of the 18<sup>th</sup> Amendment, which prohibits lowering provincial contributions, inventive methods to scale back some of the budgetary transfers to the provinces are being proposed. One option is to give the federation 7% of the Federal Divisible Pool before allocating the remainder to the federation and provinces on a 42.5:57.5 split. The other option is to devolve certain high-cost federal programs to

the provinces, including the main national social security program, the Benazir Income Support Program. The provinces, understandably, are opposed to any such ideas (Bengali, 2020). Table 4 completely demarcates the setting of both the imbalances.

The provinces are demanding attention and additional reforms in three areas: expanding the Senate's powers, decentralization at the local level and to the local level, and merger of local governments along improving the local and provincial government their administrative and financial management prophecies.

## 6. KEY FINDINGS

### 6.1. Reforming Tax Structure

In the backdrop of the foregoing discussion, the tax structure needs to be examined as to whether; devolved tax structure or integrated and harmonized system is the panacea of Pakistan's Resource Distribution mechanism. Literature reveals that devolution of taxes to SNGs becomes successful when they are provided with sufficient revenue for fiscal adequacy, and when fiscal responsibility is imposed at the margin. Hence centralization of all significant taxes is highly inappropriate (Bahl & Cyan, 2011).

Analysis of Pakistan's tax structure reveals Pakistan's tax system is full of flaws in collecting taxes for agriculture, immovable property, and capital gains because of preferential treatment across the different segments.

The taxes collected in Pakistan are insufficient to meet the needs of the society; therefore, government tends to rely on external as well internal borrowing. The inappropriate investments in health 0.7% and education 2% are resultant in service delivery and reduction in human development.

Since the 7<sup>th</sup> NFC Award grants provinces, the ability to receive GST on services, both Sindh and Punjab have created their separate revenue authorities to make the collection of sales taxes on their services more endogenous. To collect the GST on services at the province level in 2011, Sindh took the initiative in setting up the Sindh Revenue Board. Similarly, to collect the GST on services from July 2012, Punjab followed and established up the Punjab Revenue Authority, as well as, Khyber Pakhtunkhwa too established a revenue authority. Consequently, income from GST services is not an immediate transference and is included in the ongoing study as provincial income after 2011-2012. Apart from GST on services, the GDS distribution formula changes to reflect the viewpoint of Baluchistan and the 7<sup>th</sup> NFC Award increases the excise tax rate. These modifications also influenced the straight transfer quantity.

### 6.2. Increasing Globalization-Barrier

The increasing globalization in this age of information technology has put fiscal federalism principles in developing federal countries has put provincial autonomy at risk. Because of globalization, the local governments are more empowered and the new economic order requires more accountability, efficiency, a leaner structure that is more responsive. The historical provinces are not ready to accept this dictum rather they have expressly challenged this through their respective Local Government Acts.

### 6.3. Natural Resources

Pakistan already facing conflicts across the provinces on the matter of gas and water. Through the 18<sup>th</sup> amendment, the division of profits of oil and natural gas has been sorted out. Article 172 (3) is now abundantly clear, that dividends and profits are to be shared equally by the Federal Government and the source Provincial Government. It means that clear demarcation has been made for fiscal transfers between FG and PG. However, what is required is that this division of the fiscal pie is fair and transparency is maintained. There is no mechanism as such but the Council of Common Interests (CCI) is responsible to regulate and formulate policies on the subject.



## 7. CONCLUSION

Literature and international experience suggest that Fiscal federalism principles guarantee fiscal autonomy to Sub-National Governments (the provinces and local councils) to broaden their revenue base, expand their spending assignment, to guarantee relative transparency, accountability in their spending and expenditure assignments, to become closer to people to provide more efficient service delivery, socio-economic justice, higher growth and poverty reduction. This study has been analyzed under the hypothesis that “phenomenal fiscal decentralization improves the quality of governance, brings in economic development at par, serves to address rising corruption, introduces accountability by making systems more transparent, strengthens the democratic institution, mitigates fiscal conflicts, empowers public through active participation, augments autonomy of provinces, resulting in the integration of federation in Pakistan”.

Through the 18<sup>th</sup> amendment, provinces have been re-assigned with selective functions to the federation to be overseen by CCI and devolved others to provinces. All most 17 ministries have been abolished and the federal government has been completely stripped of powers in planning, industry, agriculture, rural development, including social services and welfare functions. The federal government does not have authority over provincial banks, financial institutions, and insurance companies created under provincial laws. It is pertinent to mention here that, the federal government continues to borrow to plug the holes and fill in the gaps in the balancing of trade and debt retirement or schedule re-payment, which is a huge burden on provinces. At the source, the deduction is a normal fashion of FG, at the time of fiscal transfers under the NFC award, without prior discussion or mechanism evolved.

## 8. POLICY RECOMMENDATIONS & WAY FORWARD

In a nutshell, for enforcing a just and fair fiscal transfer mechanism, a set of following wide spectrum steps must be considered:

- (i) Setting a national standard of development at a minimum level for provincial harmonized human development index and creating macro-economic stability in depressed regions.
- (ii) Off-setting vertical and horizontal imbalances in setting fiscal equalization programs.
- (iii) Considering local priorities of provinces and local governments while working on NFC awards.

If taken care of the above variety of steps in letter and spirit, Pakistan would yield better results for a strong federation—indeed a dividend of democracy and fiscal federalism.

**Funding:** This study received no specific financial support.

**Competing Interests:** The authors declare that they have no competing interests.

**Authors' Contributions:** Both authors contributed equally to the conception and design of the study.

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