



## 7th National Finance Commission Award 2009 Towards Fiscal Federalism

A new NFC Award will be announced.

**Article 5, Charter of Democracy**

Distribution criteria for NFC Award will take into account contribution to revenues, geographic size, backwardness and level of development as well as population.

**Pakistan Peoples Party Manifesto, 2008**

### NFC: Composition and Functions

The NFC is constituted by the President of Pakistan under Article 160 of the constitution, which recommends an appropriate mechanism of revenue sharing between the Federation and provinces to the President. Keeping in view the regional disparities in level of economic activities and revenue generation capacities, the constitution of Pakistan empowers the Federal Government to collect certain types of taxes from all over the country and to put them in a divisible pool. These resources are then distributed among four units of the Federation so that their financial needs can aptly be met. In order to maintain harmony and a sense of brotherly bond among provinces, a consensus over resource sharing formula is highly important. The distribution formula has essentially two components: one, vertical distribution between Federal Government and provinces; and the other, horizontal distribution within provinces.

In the spirit of Charter of Democracy and the PPP Manifesto, President Asif Ali Zardari re-constituted the Seventh National Finance Commission (NFC) on July 24, 2009. Authoritarian regimes had accentuated the horizontal and vertical imbalances over the years. However, President Asif Ali Zardari's policy resolve to address these imbalances was translated into reality when the 7th NFC Award was signed in Balochistan's port-city Gwadar on December 30, 2009. The signing ceremony was presided over by Prime Minister Syed Yousaf Raza Gilani, and attended by the Cabinet and Chief Ministers of all four provinces.

On March 16, 2010, The President of Pakistan Asif Ali Zardari signed and stamped the Award at a ceremony in the Presidency, which was attended, among others, by the Prime Minister, Federal and Provincial Ministers, three Provincial Governors, and the four Chief Ministers.<sup>1</sup>

The selection of Gwadar for the initial signing of the NFC Award was symbolic and meant to express solidarity with the struggle of the

<sup>1</sup>Dawn, March 17, 2010.



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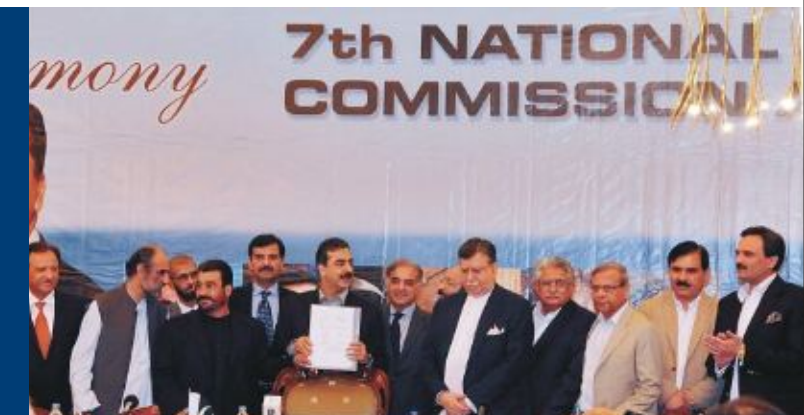
Baloch people who have suffered a lot under the last authoritarian regime. The presence of Pakistan's democratic leadership in Gwadar was historic in a way to assure the Baloch people that the State of Pakistan under the democratic leadership has been transformed from a callous alien to a caring mother. It has been widely recognized that the hammering out of a consensus among the Centre and the provinces on the 7th NFC Award is a major achievement and a positive event for those who believe that the future of a vibrant Pakistan lies in a democratic Federation.<sup>2</sup>

Under the new NFC, the Federation has sacrificed its chunk of share along with reduction in collection charges from 5% to 1%. The Federation has slashed its 52.5% stake to 44% in this award, and if we include 4% point reduction in collection charges, the sacrifice is even greater<sup>3</sup>. It is, indeed, the first NFC Award with a new national spirit to accommodate the demands of the smaller provinces<sup>4</sup>.

The NFC 2009 has been widely appreciated by cross-sections of society, both domestic and international. It has been interpreted as a

## Highlights of 7th NFC Award

- Federal and Provincial Governments developed a consensus.
- The new award would come into effect from FY2010-2011.
- Population to be given 82% weightage, poverty 10.3%; revenue collection 5% (2.5% revenue generation, 2.5% revenue collection); and area 2.7%.
- The provincial share of the divisible pool would increase from the present 47.5% to 56% in the first year of NFC, and 57.5% in the remaining years of the award.
- As for inter-provincial sharing of the divisible pool, it would be made on the basis of multiple criteria formula and their respective weight as agreed upon are population, poverty/backwardness, revenue (generation/collection), and poverty. Consequently, under the new formula, Punjab would get 51.74% from the divisible pool, Sindh 24.55%, Khyber-Pakhtunkhwa 14.62%, and Balochistan 9.09%.
- Punjab would give up 1.27%, Sindh 0.39%, and Khyber-Pakhtunkhwa 0.26%, while Balochistan has gained.
- In monetary terms, the award translates into Rs.471 billion for Punjab, Rs.223 billion for Sindh, Rs.133 billion for Khyber-Pakhtunkhwa, and Rs.83 billion for Balochistan. These are the projections for FY2010-2011 and based on 56% share.
- For the remaining years of the new award, based on provincial share of 57.5%, Punjab would receive Rs.938 billion, Sindh Rs.445 billion, Khyber-Pakhtunkhwa Rs.265 billion, and Balochistan Rs.165 billion. At present, Punjab is receiving Rs.419 billion, Sindh Rs.197 billion, Khyber-Pakhtunkhwa Rs.118 billion, and Balochistan Rs.53 billion.
- Sindh would receive an additional transfer of Rs.6 billion from the Federal Government, which is equivalent to 0.66% of the provincial pool. The Commission also decided to devolve sales tax on service to the provincial level.
- The Federal and Provincial Governments pledged commitment to bear all expenditures incurred by Khyber-Pakhtunkhwa Government on the war on terror.
- Thus, as a gesture of support by all provinces and the Federation, 1% of the total divisible pool has been earmarked for Khyber-Pakhtunkhwa as an additional resource for war on terror during the award period. This would be equivalent to 1.83% of the provincial pool.



The presence of Pakistan's democratic leadership in Gwadar to sign the Award was historic in a way to assure the Baloch people of the Federation's commitment.

'victory of democracy' and 'fruit of reconciliation'. Independent analysts and political parties have congratulated the People's Government on arriving at a consensus NFC Award after a long spell of 19 years. Economic experts have observed that the 7th NFC has laid down the firm foundations for 'fiscal federalism' in Pakistan. Former Chairman of NFC, Shaukat Tarin, termed it as "a giant leap towards financial autonomy of provinces".<sup>5</sup>

### Provincial Consent and Consensus

The 7th NFC 2009 award has introduced significant changes in Pakistan's resource distribution mechanism to the satisfaction of all units of the Federation. Under the award, the Federal Government has agreed to increase the share of provinces in the divisible pool to 56% in the first year of NFC, and to 57.5 percent in the remaining years of the award from the current level of 47.5%. The Federal Government has also agreed to reduce collection charges to just 1% from the existing level of 5%, which will increase the actual transfers to the provinces from the divisible pool.

<sup>2</sup>Dawn, December 13, 2009.

<sup>3</sup>Zafarul Hasan Almas, "NFC Award: some positive developments", *The News International*, December 21, 2009.

<sup>4</sup>*The Baloch Hal*, December 30, 2009, <http://thebalochhal.com/2009/12/editorial-the-landmark-nfc-breakthrough/>.

<sup>5</sup>Dawn, December 31, 2009.

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A number of measures have been taken to increase revenue of provinces, including enhancing federal revenue and curtailing government expenditure. This has given extra 5% fiscal space to the provinces, while the Federation has decreased its NFC charges from 5% to 1%. Thus, the extra savings from these factors have been transferred to the divisible pool.

To increase the share of Balochistan to 9.09%, the three provinces have agreed to slash their percentage shares. The Khyber-Pakhtunkhwa is entitled to get an additional 1% of the total divisible pool, regarding its role as a frontline province in the continued war against terror. This would be equivalent to 1.83% of the provincial pool. Similarly, the Center also gave the option to the provinces by allowing them to collect sales tax on services.

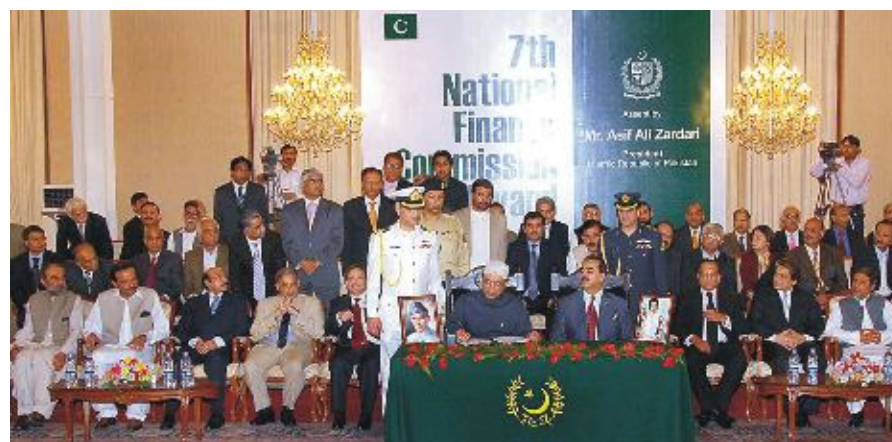
Another notable development was the consensus on using other parameters in addition to population for revenue sharing among the provinces (see *Table: Revenue Sharing Formula for 7th NFC 2009*). To assign weight to poverty and backwardness, the NFC used database from three studies, i.e., 1999-2000 Poverty Reduction Strategy Paper (PRSP), Human Development Index (HDI) 2003-2004, and HDI 2007-2008, developed by the Federal Bureau of Statistics. Again, to resolve the conflict among provinces regarding use of studies, NFC agreed to use an average of these three reports.

### Making History

Historically, the resource transfer paradigm has always been a major bone of contention in Pakistan between the Federation and the Provinces, as financial resources are a key for development. Its judicious and equitable

distribution is necessary to build up any underdeveloped or under-privileged area and to win confidence of the federating units. And this is what the 7th NFC Award has achieved.<sup>6</sup>

The 7th NFC has established a number of milestones.<sup>7</sup> For the division of resources among the provinces, the Federation has moved away from the unsatisfactory single



The 7th NFC Award has achieved the objectives lucidated by Shaheed Mohtarma Benazir Bhutto in her election manifesto of 2008.

criterion of population to a multi-criteria award that includes poverty/backwardness; revenue collection and generation; and inverse population density. Moreover, the Center and the provinces have shown a spirit of fair play when addressing Balochistan and the Khyber-Pakhtunkhwa.<sup>8</sup> Balochistan has been guaranteed a minimum award, with the Center pledging to make up for any shortfall, while in a nod towards the Khyber-Pakhtunkhwa's extraordinary burden in the war against militancy, the province has been

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promised a special 1% of the undivided federal pool.<sup>9</sup>

Inclusion of net hydel profits, and royalties and excise duties on oil and gas in the divisible pool, which caused Federal-Provincial tensions for years -- despite a clear constitutional stipulation that these should be dealt with outside of the NFC award -- is another example of the People's Government's efforts to strengthen the Federation by implementing a policy of national reconciliation.

Sales tax on services has been surrendered to the provinces, which means that Sindh and Punjab will benefit more from it.<sup>10</sup> Sindh

already stands to collect more from the criterion of contribution to the divisible pool.

By addressing the long-standing structural imbalances in resources distribution between the Center and the provinces, the 7th NFC Award has laid down firm foundations towards a sustainable 'fiscal federalism' in Pakistan. It is encouraging to note that the Award achieved the objectives elucidated by Shaheed Mohtarma Benazir Bhutto in her election manifesto of 2008.

### Revenue Sharing Formula for 7th NFC 2009

Indicators	Weight	Punjab	Sindh	Khyber-Pakhtunkhwa	Balochistan
Population share (SBP estimates) *	82.0	57.36	23.71	13.82	5.11
Poverty/backwardness **	10.3	23.16	23.41	27.82	25.61
Revenue generation/collection **	5.0	44.0	50.0	5.0	1.0
Inverse population density (SBP estimates) *	2.7	4.34	7.21	6.54	81.92
<b>Total share</b>	<b>100</b>	<b>51.74</b>	<b>24.55</b>	<b>14.62</b>	<b>9.09</b>

\*Province-wise distribution of population and inverse population density is estimated on the base of data obtained from *Pakistan Statistical Year Book 2008* published by Federal Bureau of Statistics, Islamabad.

\*\* Distribution of poverty/backwardness and revenue generation/collection are taken from *The News International*, December 14, 2009.

<sup>9</sup>Ibid.

<sup>10</sup>*Daily Times*, "NFC: The big breakthrough", October 15, 2009.

<sup>6</sup>Sania Nishtar, "Beyond NFC", *The News International*, March 4, 2010

<sup>7</sup>*Dawn*, Editorial: 'NFC Award' December 31, 2009.

<sup>8</sup>Ibid.