

## **Special Section 2: National Finance Commissions Awards – A Review**

A very important and welcome development was the approval of 7<sup>th</sup> National Finance Commission (NFC) Award 2009 by all four provincial and the federal governments, reflecting political will to resolve key issues.

The National Finance Commission 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 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 other horizontal distribution within provinces.

As per constitution, the NFC has to be constituted after every five years which consists of finance minister of the federal government, four provincial finance ministers and such other persons as may be appointed by the President after consultation with the governors of the provinces. Starting from 1974, seven NFC awards have been announced up till now with the most recent coming in December 2009 (**Table SS2.1**).

The first NFC was constituted in 1974 that recommended population as the criterion for resource distribution among the provinces. The second (1979) and third (1985) NFCs could not offer any recommendations; thus resources continued to be distributed according to the first award until 1990.

In 1990, fourth NFC award was announced through which the divisible pool was expanded and special grants were also provided to the provinces. The provinces' right on net hydel profit, development surcharge (on gas) and excise duty on crude oil was also admitted in that award. The next successful NFC award was announced in 1996. It brought more sophistication to the mechanism of intergovernmental fiscal transfers. All taxes, royalties and development surcharges were included in the divisible pool that drastically increased the pie.

**Table SS2.1: Resource Distribution under Various NFC Awards\***

No	Year	Federation: provinces distribution	Distribution within provinces			
			Punjab	Sindh	NWFP	Baluchistan
1 <sup>st</sup>	1974	20:80	60.25	22.5	13.39	3.86
2 <sup>nd</sup>	1979	20:80	57.97	23.34	13.39	5.30
3 <sup>rd</sup>	1985			Interim award		
4 <sup>th</sup>	1990	20:80	57.87	23.29	13.54	5.30
5 <sup>th</sup>	1996	62.5:37.5	57.88	23.38	13.54	5.30
6 <sup>th</sup>	2000			Interim award		
	2006**	55:45	57.36	23.71	13.82	5.11
7 <sup>th</sup>	2009	44:56	51.74	24.55	14.62	9.09

\* Adopted from Ahmad et al (2007)<sup>1</sup> & media reports for 7<sup>th</sup> award.

\*\* By Presidential order

The national finance commissions constituted in 2000 and 2006 could not come up with consensus formulae. The President of Pakistan, therefore, promulgated an ordinance for resource distribution in 2006. According to this ordinance, the provincial share was revised upward to 45 percent which would reach 50 percent with subsequent increase of 1 percent per annum. Net proceeds equal to 1/6th of sales tax were given to the provinces to transfer it further to the district government and cantonment boards with Punjab receiving 50 percent, Sindh 34.85 percent, NWFP 9.93 percent and Balochistan 5.2 percent share. It was decided to distribute the remaining balance amongst the provinces on the basis of their respective population.

### SS2.1 NFC Award 2009

The 7<sup>th</sup> NFC 2009 award introduced significant changes in resource distribution mechanism to the satisfaction of all units of the federation.

Under the award, the federal government agreed to increase the share of provinces in divisible pool to 56.0 percent in the first year of NFC and to 57.5 percent in the remaining years of the award from existing level of 47.5 percent. The federal government has also agreed to reduce collection charges to just one percent from the existing level of five percent, which will increase the actual transfers to the provinces from the divisible pool.

To increase the share of Baluchistan to 9.09 percent, the three provinces agreed to slash their percentage shares. The NWFP is entitled to get an additional one percent of the total divisible pool, regarding its role as a frontline province in the

<sup>1</sup> Ahmad, Iftikhar, Mustafa, Usman and Khalid, Mahmood (2007). National Finance Commission Awards in Pakistan: a Historical Perspective; Pakistan Institute of Development Economics Working Paper 2007:33.

continued war against terror. This would be equivalent to 1.83 percent of the provincial poll. 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 (**Table SS2.2**). To assign weight to poverty and backwardness, the NFC used database from three studies, i.e., 1999-2000 report of Poverty Reduction Strategy Paper (PRSP), Human Development Index (HDI) of 2003-04, and HDI 2007-08 developed by Federal Bureau of Statistics (FBS). Again to resolve the conflict among provinces regarding use of studies, NFC agreed to use average of the three reports.<sup>2</sup>

To resolve the issue regarding the use of indicator to assign weight to revenue generation or collection, NFC used the electricity consumption by collections of withholding tax. In order to avoid conflicts on the distribution of 2.5 percent GST, the federal government agreed to transfer Rs 6.0 billion to Sindh from its own kitty.<sup>3</sup>

**Table SS2.2: Revenue Sharing Formula for 7<sup>th</sup> NFC (2009)**

Indicators	Weight	Share of provinces in terms of indicators			
		Punjab	Sindh	NWFP	Baluchistan
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>100.0</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 Daily The News, December 14 2009.

<sup>2</sup> Daily *The News*, December 14, 2009.

<sup>3</sup> Ibid