Policy Paper No.25

Agenda for the 8th NFC

Lessons from the 7th NFC Award, Post-7th NFC Developments and Emerging Issues

December, 2014

SOCIAL POLICY AND DEVELOPMENT CENTRE

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Agenda for the 8th NFC:
Lessons from the 7th NFC Award, Post-7th NFC Developments and Emerging Issues

by

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December
2014

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Introduction

Intergovernmental fiscal transfers are an integral part of the federal system of government. In Pakistan, these transfers are routed through the National Finance Commission (NFC) Awards which are of great importance for both the federal and provincial governments. The NFC Award suggests the method for the allocation of transfers through a formula-based revenue sharing mechanism. According to Article 160 of the Constitution of Pakistan, the National Finance Commission has to be constituted every five years by the President of Pakistan. The 7th NFC Award will complete its tenure in June 2015; therefore, it is a constitutional obligation to initiate deliberation on the 8th NFC Award during this fiscal year and announce it before June 2015.

This report first analyses the financial implications of the 7th NFC Award on both provincial and federal governments. Then it discusses emerging issues related to the 8th NFC Award such as the impact of the 18th Constitutional Amendment, IMF programme and the like.

Salient Features of the 7th NFC Award

Before dealing with the financial implications, it is important to recall the milestone achieved by the 7th NFC Award. The 7th NFC Award has brought some profound changes in the resource distribution formula that can be classified under three broad groups: (1) divisible pool transfers, (2) straight transfers, and (3) grants/others.

Changes in the Divisible Pool

Divisible pool transfers are formula driven transfers based on sharing of five taxes collected by the federal government namely income tax, capital value tax, sales tax, federal excise and customs after deducting collection charges. Historically, 5 percent of the gross revenue was retained by federal government as collection charges to cover the expenditure of revenue collecting agency – the Federal Board of Revenue (FBR). The provinces felt that the collection charges were excessive in relation to the actual cost of collection. Therefore, they demanded a significant reduction in these charges. In addition, provincial governments also demanded a higher share in revenues to meet their growing expenditure requirements. Finally, concerns were raised from Sindh on the inclusion of GST on services in the divisible pool collected in the Central Excise (CE) mode on legal grounds.

Based on the deliberations of the 7th NFC Award the following changes were made in the divisible pool:

1. Collection charges of the federal government decreased from 5 percent to 1 percent thereby enlarging the overall size of the divisible pool;

2. The federal government and all the four provincial governments recognised the role of Khyber Pakhtunkhwa as a frontline province against the war on terror. One percent of net proceeds of the divisible pool was therefore earmarked for KPK for the entire Award period. In 2010-11 for example, Khyber Pakhtunkhwa received an additional Rs15 billion because of this provision;
3. The provincial share in the remaining divisible pool increased from 46.25 percent to 56 percent in 2010-11 and then to 57.5 percent for the rest of the Award period. This means that the share of the federal government in the net divisible pool was 44 percent in 2010-11 and 42.5 percent during the remaining period;
4. This Award ensures that Balochistan gets at least Rs83 billion under divisible pool transfers. In case the estimated share of Balochistan is less than Rs83 billion, the balance funds are to be contributed by the federal government;
5. GST on services collected in the Central Excise (CE) mode was accepted as a provincial tax and therefore its revenue proceeds are to be reverted to the provinces and not be part of the divisible pool.

Changes in Straight Transfers

While straight transfers do not explicitly fall under the domain of the NFC, they were an integral part of the 7th NFC Award deliberations. There were two reasons for this inclusion: (1) divisible and straight transfers are interlinked, and (2) some provinces made the settlement of issues related to straight transfers conditional upon a discussion on divisible pool transfers. Consequently, the following changes were made through the 7th NFC Award in straight transfers:

1. Along with provincial sales tax, GST on services collected on CE mode is accepted as a provincial tax. Provinces were given the choice to collect GST on services provincially or allow the FBR to collect it on their behalf with proceeds reverted back as a straight transfer.
2. On the demand of the Government of Balochistan, the formula for Gas Development Surcharge (GDS) computation was revised.
3. The rate of excise duty on gas was increased from Rs5.09 to Rs10 per MMBTU.

Changes in Grants/Others

Grants and constitutional subventions are another component of the NFC deliberation. Discretionary grants-in-aid is a concurrent part of NFC Awards. The 7th NFC Award leaped forward by making the following changes in this regard:

1. Discretionary grants-in-aid to all provinces were abolished.
2. Sindh was given a grant of 0.66 percent of the provincial divisible pool to partly offset losses due to the merger of one-sixth of GST in the divisible pool.

3. Arrears on the payment of hydel profits to KPK were ensured.
4. Arrears of Gas Development Surcharge (GDS) to be paid retroactively to Balochistan.

Vertical Distribution of the Divisible Pool

Table 1 presents the formula for vertical distribution or the provincial share in the divisible pool of NFC Awards. It indicates that until the NFC Award of 1991, provincial governments had been receiving 80 percent of two major and buoyant federal taxes: sales tax and income and corporation tax. The 1991 NFC also gave provinces a share in the federal excise duty on tobacco and sugar. The NFC Award of 1997 included all federal taxes in the divisible pool and decreased the provincial share from 80 percent to 37.5 percent, which was less than half of their previous share. Thereafter, the trend has been to increase the share of provinces in the divisible pool of taxes.

Table 1
Provincial Share in Divisible Pool Taxes

(%)

Divisible Pool Taxes	1st NFC 1974	4th NFC 1991	5th NFC 1997	DRGO 2006	7th NFC 2009
Income Tax and Corporation Tax*	80	80	37.5	41.50 - 46.25	56.0 - 57.5
- Other Direct Taxes	-	-	37.5	41.50 - 46.25	56.0 - 57.5
Sales Tax	80	80	37.5	41.50 - 46.25	56.0 - 57.5
Central Excise Duty**	-	-		41.50 - 46.25	56.0 - 57.5
- Tobacco	-	80	37.5		
- Sugar	-	80			
Import Duties	-	-	37.5	41.50 - 46.25	56.0 - 57.5
Export Duties					
- Cotton	80	80	-	-	-

*Excluding taxes on income consisting of remuneration paid out of federal consolidated fund. | **Excluding Central Excise Duty on Natural Gas.

Source: Source: Sabir, M (2010)

Horizontal Distribution of the Divisible Pool

Table 2 shows the formula for horizontal distribution of the divisible pool in NFC Awards. It points out that the entire distribution of the divisible pool among provinces in the first three NFC Awards and in the Distribution of Revenues and Grants-in-aid Order (DRGO) was based only on population. However, the 7th NFC Award expanded the distribution criteria for the divisible pool which now includes: population (82 percent), poverty and backwardness (10.3 percent), revenue collection/ generation (5 percent), and inverse population density (2.7 percent).

Table 2
Factors used in Horizontal Distribution of Divisible Pool Taxes

(%)

Factors	1st NFC 1974	4th NFC 1991	5th NFC 1997	DRGO 2006*	7th NFC 2009
Population	100.0	100.0	100.0	100.0	82.0
Poverty/Backwardness	-	-	-	-	10.3
Revenue Collection/ Generation	-	-	-	-	5.0
Inverse Population density	-	-	-	-	2.7

*Other than 1/6th of sales tax on goods collected and distributed in lieu of Octroi/Zila Tax.
Source: Sabir, M (2010)

Financial Implications of the 7th NFC Award

The changes made in the 7th NFC Award have significant implications for federal and provincial finances. This section provides quantitative estimates of these changes for both federal and provincial finances for the years 2010-11, 2011-12 and 2012-13. It also provides a comparison with DRGO 2006 and highlights the magnitude of the change in financial resources of both federal and provincial governments.

Federal and Provincial Revenues from Divisible Pool Taxes

Table 3 presents the vertical implications of the 7th NFC Award on FBR taxes since 2010-11. The FBR tax revenue for 2010-11 was Rs1,568 billion, which is projected to increase to Rs2,794 billion by 2014-15. Division pool is formed by excluding federal excise duty on natural gas, export duties, provincial GST, and collection charges from the total FBR tax revenue. As highlighted earlier, the 7th NFC Award made two changes in the divisible pool: reduction in collection charges and exclusion of GST CE mode from the divisible pool. While the first change increases the size of the divisible pool, the second change reduces it. The net impact is presented in the table, which indicates an increase of Rs3.7 billion during 2010-11.

Table 3
Vertical Implications of the 7th NFC Award on Divisible Pool Transfers

(%)

Factors	FBR Tax Revenue	Divisible Pool	Federal Share	Provincial Share
As per 7th NFC Award				
2010-11 RE	1,568	1,463	628	835
2011-12 RE	1,937	1,835	772	1,063
2012-13 RE	1,989	1,929	795	1,134
2013-14 RE	2,262	2,207	929	1,278
2014-15 BE	2,795	2,729	1,148	1,581
As per Distribution Order 2006				
2010-11 RE	1,568	1,459	784	675
2011-12 RE	1,937	1,821	979	842
2012-13 RE	1,989	1,917	1,030	887
2013-14 RE	2,262	2,189	1,177	1,013
2014-15 BE	2,795	2,697	1,450	1,248
Impact of change in Design				
2010-11 RE	0	4	-156	160
2011-12 RE	0	14	-207	221
2012-13 RE	0	12	-235	248
2013-14 RE	0	18	-248	266
2014-15 BE	0	32	-302	333
Impact of change in Design (%)				
2010-11 RE	0	0.3	-19.9	23.7
2011-12 RE	0	0.8	-21.1	26.2
2012-13 RE	0	0.6	-22.8	27.9
2013-14 RE	0	0.8	-21.1	26.3
2014-15 BE	0	1.2	-20.8	26.7

Source: Author's estimates based on Explanatory Memorandum on Federal Receipts (various issues)

The combined federal transfers to provinces increased by over Rs160 billion, Rs221 billion, Rs247 billion and Rs266 billion in 2010-11, 2011-12, 2012-13 and 2013-14 respectively. In percentage terms, the increase in transfers to the provincial government ranges from 23.7 percent to 27.9 percent as a result of changes made in the distribution formula in the 7th NFC Award. This increase in transfers reduces revenues of the federal government from the divisible pool by about one-fifth.

Table 4 presents the horizontal distribution of FBR taxes as per the 7th NFC Award and DRGO 2006. This estimation is based on the tax-wise estimates of FBR taxes and the assigned share to each province in the 7th NFC Award and the Distribution Order 2006, incorporating the four changes in horizontal distribution described in the earlier section. The Award has, expectantly, had a differential impact on the four provinces, benefiting dispropor-tionately the smaller provinces. For example in 2010-11, Balochistan was the largest gainer acquiring an additional Rs 48 billion, (equivalent to 140 percent increase,) followed by Khyber Pakhtunkhwa.

Table 4
Horizontal Implications of the 7th NFC Award on Divisible Pool Transfers
(Rs. in Billion)

	Punjab	Sindh	Khyber Pakhtunkhwa	Balochistan
Divisible Pool Transfers as per 7th NFC Award				
2010-11 RE	420	199	133	83
2011-12 RE	541	257	171	95
2012-13 RE	568	270	180	116
2013-14 RE	650	308	206	123
2014-15 BE	804	381	254	141
Divisible Pool Transfers as per Distribution Order 2006				
2010-11 RE	380	170	90	35
2011-12 RE	482	201	116	43
2012-13 RE	507	212	122	45
2013-14 RE	579	242	139	52
2014-15 BE	714	299	171	64
Impact of change in Design				
2010-11 RE	39	29	44	48
2011-12 RE	58	55	55	52
2012-13 RE	61	57	58	71
2013-14 RE	71	66	67	72
2014-15 BE	90	83	83	77
Impact of change in Design (%)				
2010-11 RE	10.3	16.9	48.6	139.9
2011-12 RE	12.1	27.4	47.6	120.5
2012-13 RE	12.0	27.1	47.6	156.8
2013-14 RE	12.2	27.2	47.9	138.2
2014-15 BE	12.6	27.6	48.5	121.4

Source: Author's estimates based on Explanatory Memorandum on Federal Receipts (various issues)

For a period of five years (during 2010-11 and 2014-15), average gains of Balochistan, Khyber Pakhtunkhwa, Sindh and Punjab have been 134 percent, 48 percent, 26 percent and 12 percent respectively.

Clearly, it can be concluded that the 7th NFC is fiscal equalizing and the objective to ensure horizontal equalization through non-discretionary, transparent mechanisms appears to have been successful.

Impact of the 7th NFC Award on Straight Transfers

An interesting implication of the 7th NFC Award on straight transfers is the acceptance of provincial rights over GST on services in any mode. As per the Constitution, GST on services is a provincial tax, however, previously the FBR collected it under two heads: (1) GST services (CE Mode) and (2) GST services (provincial). While the latter was directly transferred to provincial governments after deducting collection charges based on population share, GST on services (CE Mode) was treated similar to GST on goods which was distributed among the federal and provincial governments as any other divisible pool tax. The 7th NFC Award requires the reversion of all revenue proceeds from taxation of services to provincial governments after the deduction of collection charges. This had resolved the anomaly in vertical distribution of

GST on services. Consequently, straight transfers increased in the first two years after the 7th NFC Award. However, there was lack of consensus in horizontal distribution of GST services.

Since the 7th NFC Award gives the right to provinces to collect GST on services, both Sindh and Punjab have established their respective revenue authorities and are endogenizing the collection of sales tax on services. Sindh took the lead in setting up the Sindh Revenue Board (SRB) to collect GST on services at the provincial level in 2011. Punjab has followed and has set up the Punjab Revenue Authority to collect GST on services from July 2012. Khyber Pakhtunkhwa too established a revenue authority to collect GST services. Therefore, revenues from GST services are no longer a straight transfer and are treated as provincial revenue after 2011-12 in the ongoing analysis.

Other than GST on services, the 7th NFC Award changed GDS distribution formula to accommodate Balochistan's point of view and increased the rate of excise duty. These changes also affected the quantum of straight transfers.

Table 5 shows the comparison of province-wise revenues from straight transfers under the 7th NFC Award with DRGO 2006. It indicates that the revenues of the Government of Punjab increased massively due to the transfer of GST on services (CE mode) from the divisible pool to straight transfers. In absolute terms the increase is more than Rs30 billion in 2010-11 and 2011-12. Similar to Punjab, the transfer of GST services (CE mode) has also benefitted Khyber Pakhtunkhwa as the province received an additional Rs8 billion on average in 2010-11 and 2011-12.

Table 5
Province-wise Implications of the 7th NFC Award on Straight Transfers

(Rs. in Million)

	Punjab	Sindh	Khyber Pakhtunkhwa	Balochistan
Straight Transfers as per 7th NFC Award				
2010-11 RE	44,120	78,843	29,767	16,307
2011-12 RE	45,420	82,002	32,417	16,725
2012-13 RE	9,826	56,157	30,215	13,281
2013-14 RE	8,999	71,928	35,312	15,648
2014-15 BE	9,006	82,624	41,263	18,501
Straight Transfers as per Distribution Order 2006				
2010-11 RE	10,767	62,080	21,033	11,663
2011-12 RE	13,906	53,456	24,686	12,005
2012-13 RE	8,347	53,660	25,124	8,859
2013-14 RE	7,820	66,600	35,250	15,004
2014-15 BE	6,406	76,457	42,931	17,690
Impact of the 7th NFC Award				
2010-11 RE	33,352	16,763	8,734	4,644
2011-12 RE	31,514	28,546	7,730	4,720
2012-13 RE	1,479	2,497	5,091	4,423
2013-14 RE	1,179	5,328	62	644
2014-15 BE	2,600	6,166	-1,668	811
Impact of the 7th NFC Award (%)				
2010-11 RE	309.8	27.0	41.5	39.8
2011-12 RE	226.6	53.4	31.3	39.3
2012-13 RE	17.7	4.7	20.3	49.9
2013-14 RE	15.1	8.0	0.2	4.3
2014-15 BE	40.6	8.1	-3.9	4.6

Source: Author's estimates based on Explanatory Memorandum on Federal Receipts and Province-wise Annual Budget Statement (various issues)

In the case of Balochistan, changing GDS distribution formula provided an additional Rs2 billion increase per annum. Moreover, the inclusion of GST (CE mode) in straight transfers also helped increase Balochistan's revenues. Sindh has a negative impact of Rs2 billion due to the change in GDS distribution formula, however, the province benefited from upward revision of the excise duty from Rs5.09 to Rs10. Moreover, its efforts to collect GST services by setting a provincial revenue board also helped the province maximise gains from the 7th NFC Award. Consequently, the massive increase in 2011-12 is a result of SRB's efforts.

Impact of the 7th NFC Award on Grants and Arrears

Another important domain of the NFC is to allow or withdraw grants/constitutional subventions to provinces. The 7th NFC abolished the grants-in-aid to all provinces given under DRGO 2006. However, Sindh was given a grant of 0.66 percent of the provincial divisible pool to offset losses resulting from the abolition of a separate basis of distribution of 1/6th of GST revenues or OZT grants. Other than this, the 7th NFC Award has given grants to Khyber Pakhtunkhwa and Punjab for arrears of net hydel profit, and to Balochistan for arrears of GDS.

Table 6 presents the estimates of increased or decreased provincial revenues due to the four changes mentioned above. The 7th NFC Award's decision to abolish grants to provinces cost them heavily. However, this decline in grants was partly offset by arrears of net hydel profit to Khyber Pakhtunkhwa and Punjab, arrears of GDS to Balochistan and OZT grant to Sindh. Consequently, during the post-NFC period the decline in grants to provinces ranged from Rs6.5 billion to Rs37 billion from 2010-11 to 2013-14. On average, Sindh, Balochistan and Punjab have a decline of roughly 50 percent during the post-7th NFC Award period. Khyber Pakhtunkhwa was initially better off due to the decision taken in the 7th NFC Award, however, in 2014-15 it may experience a

Table 6
Province-wise Implications of the 7th NFC Award on Grants and Subventions

(Rs. in Million)

	Punjab	Sindh	Khyber Pakhtunkhwa	Balochistan
Grants as per 7th NFC Award				
2010-11 RE	5.17	6.00	25.00	12.00
2011-12 RE	5.17	7.00	25.00	12.00
2012-13 RE	5.12	9.00	25.00	12.00
2013-14 RE	0.00	8.50	25.00	11.52
2014-15 BE	0.00	10.80	0.00	10.00
Grants as per Distribution Order 2006				
2010-11 RE	6.02	11.49	19.15	18.06
2011-12 RE	7.51	14.34	23.91	22.54
2012-13 RE	7.91	15.10	25.16	23.72
2013-14 RE	9.03	17.24	28.73	27.09
2014-15 BE	11.13	21.24	35.40	33.38
Impact of the 7th NFC Award on Grants				
2010-11 RE	-0.85	-5.49	5.85	-6.06
2011-12 RE	-2.35	-7.34	1.09	-10.54
2012-13 RE	-2.79	-6.10	-0.16	-11.72
2013-14 RE	-9.03	-8.74	-3.73	-15.57
2014-15 BE	-11.13	-10.44	-35.40	-23.38
Impact of the 7th NFC Award on Grants (%)				
2010-11 RE	-14.2	-47.8	30.5	-33.6
2011-12 RE	-31.2	-51.2	4.6	-46.8
2012-13 RE	-35.3	-40.4	-0.6	-49.4
2013-14 RE	-100.0	-50.7	-13.0	-57.5
2014-15 BE	-100.0	-49.2	-100.0	-70.0

Source: Author's estimates based on Federal Details of Demands for Grants and Appropriations (various issues) massive decline in its revenues due to the decline in grants after transferring Rs100 billion arrears of hydroelectricity profit.

Aggregate Financial Implications of the 7th NFC Award on Provinces

Having estimated the financial implications of changes in the divisible pool, straight transfers and grants, we are now in a position to assess the overall impact of the 7th NFC Award. Table 7 presents province-wise financial implications of the 7th NFC Award in comparison with DRGO 2006. It indicates that as per the revised estimates from 2010-11 to 2013-14, in absolute terms Punjab has been the biggest beneficiary of the 7th NFC Award, followed by Khyber Pakhtukhwa, Sindh and Balochistan. However, in relative terms, Balochistan is the biggest beneficiary, with an increase of more than 60 percent throughout the tenure of the NFC Award, followed by KPK. The relative picture substantiates the point made earlier that the 7th NFC Award is fiscally equalizing as its provisions disproportionately benefit the relatively backward provinces more.

Table 7
Province-wise Implications of the 7th NFC Award

(Rs. in Billion)

	Punjab	Sindh	Khyber Pakhtunkhwa	Balochistan	Total
NFC Transfers and Grants as per the 7th NFC Award					
2010-11 RE	469	284	188	111	1,052
2011-12 RE	591	346	229	124	1,289
2012-13 RE	583	335	235	142	1,295
2013-14 RE	659	389	266	150	1,464
2014-15 BE	813	475	296	170	1,753
NFC Transfers and Grants as per Distribution Order 2006					
2010-11 RE	397	244	130	64	835
2011-12 RE	504	269	165	78	1015
2012-13 RE	524	281	172	78	1055
2013-14 RE	596	326	203	94	1219
2014-15 BE	731	397	250	115	1492
Impact of 7th NFC Award on Total Transfers and Grants					
2010-11 RE	72	40	58	47	217
2011-12 RE	88	76	64	46	274
2012-13 RE	60	54	63	64	240
2013-14 RE	63	63	63	57	245
2014-15 BE	82	78	46	55	261
Relative impact (%)					
2010-11 RE	18.1	16.4	44.8	73.1	26.0
2011-12 RE	17.4	28.4	38.9	59.4	27.0
2012-13 RE	11.4	19.2	36.6	81.9	22.8
2013-14 RE	10.6	19.2	31.0	60.3	20.1
2014-15 BE	11.2	19.8	18.4	47.8	17.5

Source: Author's estimates based on Federal Details of Demands for Grants and Appropriations (various issues)

Fiscal Health of Federal and Provincial Governments after the 7th NFC Award

It is generally believed that the NFC Award in Pakistan is a zero sum game where an increase in the share of one federating unit affects the fiscal health of others oppositely. Therefore, it is inferred that the increase in the share of provinces adversely affected the fiscal health of the federal government. In our view, the higher share of provinces in the 7th NFC Award is a win-win situation. On the one hand, it provides much-needed fiscal space to provinces to foster socio-economic development by providing quality services. On the other hand, it encourages the federal government to focus on generating additional resources and curtailing their expenditure to meet the budget deficit targets. Since Pakistan has one of the lowest tax-to-GDP ratios, the scope for resource mobilisation is substantial. Moreover, the 18th Amendment provided an opportunity to curtail the current expenditure of the federal government.

This section analyses the fiscal health of both the federal and provincial governments after the 7th NFC Award in comparison with projections made at the time of the Award which were published in the report of the National Finance Commission.

Projected and Actual Fiscal Health of the Federal Government

At the time of NFC negotiations, the federal government portrayed a rosy picture. FBR revenues were projected by an Average Compound Growth Rate (ACGR) of 20 percent during 2009-10 to 2013-14. It translated to more than 10 percent growth in net revenue receipts of the federal government. Current expenditure were projected moderately with 6 percent growth while development expenditure by more than 17 percent (Table 8). All these projections lead to an average budget deficit of 4.8 percent of GDP. In contrast, the actual average budget deficit turned out to be 7.1 percent of the GDP during this period.

Despite all the efforts the FBR missed all revenues projections. In fact the FBR's shortfall crossed Rs600 billion in 2013-14. During this period, FBR revenues grew by 14.3 percent instead of 20 percent as projected by the 7th NFC. In contrast, other tax revenues grew faster than anticipated by the NFC and showed more than 15 percent growth instead of the 5 percent projected growth (Table 8). Consequently, there was no shortfall in the net revenue receipts (total revenue minus transfer to provinces) of the federal government during 2013-14 as compared to NFC projections for the same year. In fact, the federal government received more than Rs118 billion in revenue compared to NFC projections in 2013-14 because its resource mobilisation efforts largely hinge on revenues other than those of the FBR.

Table 8
Federal Key Budgetary Magnitudes: Actual and Projected

(Rs. in Billions)

	2009-10	2010-11	2011-12	2012-13	2013-14	ACGR (%)
FBR Tax Collection						
Actual	1,327	1,550	1,882	1,936	2,266	14.3
7th NFC Projection	1,380	1,711	2,048	2,443	2,891	20.3
Difference	**-53**	**-160**	**-167**	**-507**	**-625**	**-6.0**
Other Tax and Non-tax Revenues						
Actual	647	594	543	839	1,146	15.4
7th NFC Projection	617	627	677	696	761	5.4
Difference	**30**	**-33**	**-134**	**143**	**385**	**10.0**
Federal Net Revenue Receipts						
Actual	1,341	1,145	1,334	1,560	2,006	10.6
7th NFC Projection	1,289	1,296	1,463	1,641	1,888	10.0
Difference	**52**	**-151**	**-128**	**-81**	**118**	**0.6**
Federal Current Expenditure						
Actual	1,841	2,142	2,209	2,625	2,885	11.9
7th NFC Projection	1,736	1,800	1,887	2,028	2,192	6.0
Difference	**104**	**342**	**323**	**597**	**693**	**5.9**
Federal Development Expenditure						
Actual	432	300	403	816	874	19.2
7th NFC Projection	358	405	477	552	685	17.6
Difference	**74**	**-104**	**-75**	**264**	**189**	**1.6**
Budget Deficit						
Actual	932	1,297	1,278	1,881	1,753	17.1
7th NFC Projection	805	908	902	939	989	5.3
Difference	**127**	**388**	**376**	**942**	**764**	**11.8**
Budget Deficit as a percentage of GDP						
Actual	6.4	7.2	6.2	8.2	6.9	
7th NFC Projection	5.4	5.5	4.9	4.6	4.3	
Difference	**0.9**	**1.7**	**1.3**	**3.6**	**2.6**	

Source: Author's estimates based on Report of the National Finance Commission 2009 and Pakistan Fiscal Operation (various issues)

On the expenditure side, the comparison of NFC projections with actual expenditure presented a gloomy picture. Current expenditure grew by 12 percent instead of the projected 6 percent growth anticipated at the time of the 7th NFC. There are various explanations for this deviation including higher electricity subsidies, half-hearted devolution after the 18th Amendment and the like. But whatever the reason, the growth in current expenditure dented the fiscal health of the federal government substantially.

Similarly, after the initial decline, the federal development expenditure also grew by 19.2 percent – more than the projected growth of 17.6 percent. During the first year after the 7th NFC Award, federal development expenditure sharply declined compared to the base year as well as the projected amount. This pattern continued in the next year as well. However, in 2012-13 federal development expenditure increased by more than 100 percent and crossed the projected amount by Rs264 billion. The trend continued in 2013-14 where federal development expenditure were more than the projected amount.

Consequently, the federal budget deficit exceeded the projected amount throughout the post-7th NFC period. Initially, the deviation between actual and projected federal budget deficit was less than Rs400 billion or 2 percent of the GDP. However, in 2012-13 it grew by more than Rs900 billion or 3.6 percent of the GDP.

Projected and Actual Fiscal Health of the Provincial Government

The 7th NFC projected federal transfers to provinces by an ACGR of 24 percent. Since the FBR missed it targets, the actual growth was around 22 percent. In contrast, the Commission projected a growth of 42.6 percent in provincial tax receipts (Table 9). While provincial tax receipts grew by a healthy 36.4 percent, they missed the target set by the Commission. Given that the base year collection was only Rs55 billion, it is commendable that provincial tax revenues increased to Rs190 billion. The GST on services is the main contributor in this growth.

Table 9
Provincial Government (Combined) Key Budgetary Magnitudes: Actual and Projected

(Rs. in Billions)

	2009-10	2010-11	2011-12	2012-13	2013-14	ACGR (%)
Federal Transfers						
Actual	634	999	1090	1215	1406	22.1
7th NFC Projection	708	1045	1260	1442	1686	24.2
Difference	**-75**	**-45**	**-171**	**-227**	**-279**	**-2.1**
Provincial Tax Receipts						
Actual	55	65	107	151	190	36.4
7th NFC Projection	74	107	161	239	307	42.6
Difference	**-19**	**-43**	**-54**	**-88**	**-117**	**-6.1**
Provincial Non-tax receipts						
Actual	68	62	48	71	49	-7.7
7th NFC Projection	89	99	110	122	137	11.3
Difference	**-21**	**-37**	**-62**	**-51**	**-87**	**-19.0**
Federal Loans and grants						
Actual	120	85	89	107	122	0.4
7th NFC Projection	43	107	116	126	137	33.7
Difference	**77**	**-21**	**-27**	**-18**	**-16**	**-33.3**
Provincial Current Expenditure						
Actual	646	831	981	1110	1187	16.4
7th NFC Projection	661	754	860	980	1117	14.0
Difference	**-15**	**77**	**121**	**130**	**70**	**2.4**
Provincial Development Expenditure						
Actual	258	246	375	372	431	13.6
7th NFC Projection	320	588	755	926	1122	36.9
Difference	**-61**	**-342**	**-380**	**-554**	**-691**	**-23.3**
Provincial Budget Surplus(+)/Deficit(-)						
Actual	-29	135	-22	63	150	
7th NFC Projection	-67	16	32	23	27	
Projection	**38**	**118**	**-55**	**40**	**122**	
Provincial Budget Surplus(+)/Deficit(-) as a percentage of GDP						
Actual	-0.20	0.74	-0.11	0.27	0.59	
7th NFC Projection	-0.45	0.10	0.18	0.11	0.12	
Difference	**0.25**	**0.65**	**-0.28**	**0.16**	**0.47**	

Source: Author's estimates based on Report of the National Finance Commission 2009 and Pakistan Fiscal Operation (various issues)

Being a provincial tax, it was practically devolved after the 7th NFC Award. Provincial non tax receipt did not show any dynamism during this period and declined by almost 8 percent. Moreover, federal loans and grants were also stagnant and showed a nominal growth of 0.4 percent. The overall provincial revenues were far below the projected revenues and shortfall was on average more than Rs300 billion per annum.

In contrast, provincial current expenditure grew by 28 percent during the first year after the Award due to the federal government's decision to increase salaries of government employees by 50 percent. Afterwards, the growth in current expenditure declined from 18 percent in 2011-12 to only 7 percent in 2013-14. Despite the slowdown in the growth of current expenditure, they were more than the projected amount throughout the post-7th NFC Award period. In contrast, provincial development expenditure is far below the projected development expenditure during the same period. In fact, the growth in provincial expenditure is less than the growth in federal development expenditures. This underspending resulted in a provincial surplus that reached Rs122 billion in 2013-14.

Projected and Actual Fiscal Health of the Government of the Punjab

Table 10 presents post-7th NFC Award key budgetary magnitudes of the Government of Punjab in comparison with projections made by the 7th NFC. It reveals that the 7th NFC projected federal transfers to Punjab by an ACGR of 25 percent, while actual transfers grew almost by 19 percent. One possible explanation is a shortfall in FBR revenues compared to projected tax revenues. The Commission projected an overly optimistic growth of 42 percent in provincial tax receipts. While provincial tax receipts grew by a healthy 34 percent, they missed the target set by the Commission. Given that the base year collection was only Rs30 billion, it is commendable that provincial tax revenues increased to Rs96 billion. The GST on services is the main contributor in this growth. The Government of Punjab started the collection of this tax in 2012-13 after setting a revenue authority, similar to Sindh. Provincial non tax receipt did not show any dynamism during this period and declined by almost 5 percent. Moreover, federal loans and grants grew by almost 20 percent in Punjab compared to a projected growth of 10 percent. The overall average revenue shortfall in Punjab was Rs200 billion per annum during the period.

In contrast, provincial current expenditure grew by 24 percent during the first year after the Award due to the federal government's decision to increase salaries of government employees by 50 percent. Afterwards, the growth in current expenditure declined from 18 percent in 2011-12 to only 3 percent in 2013-14. Despite, the slowdown in growth of current expenditure, they were more than the projected amount throughout the post-7th NFC Award period. In contrast, provincial development expenditure fell short of projected development expenditure during the same period. In fact, the growth in provincial development expenditure was much less than the growth in federal development expenditures. This underspending resulted in a provincial surplus that reached Rs56 billion in 2013-14.

Table 10
Key Budgetary Magnitudes of Government of Punjab : Actual and Projected

(**Rs. in Billions)**

	2009-10	2010-11	2011-12	2012-13	2013-14	ACGR (%)
Federal Transfers						
Actual	325	461	518	569	646	18.7
7th NFC Projection	332	496	603	683	807	24.9
Difference	**-7**	**-35**	**-84**	**-113**	**-161**	**-6.1**
Provincial Tax Receipts						
Actual	30	33	42	77	97	34.1
7th NFC Projection	45	64	88	148	182	42.1
Difference	**-15**	**-32**	**-46**	**-70**	**-85**	**-8.0**
Provincial Non-tax receipts						
Actual	28	24	26	28	23	-5.1
7th NFC Projection	53	60	66	73	82	11.3
Difference	**-25**	**-36**	**-40**	**-45**	**-59**	**-16.4**
Federal Loans and grants						
Actual	18	14	8	27	38	19.7
7th NFC Projection	15	17	18	20	22	10.0
Difference	**3**	**-3**	**-11**	**7**	**16**	**9.7**
Provincial Current Expenditure						
Actual	303	376	445	536	552	16.1
7th NFC Projection	315	359	409	467	532	14.0
Difference	**-12**	**17**	**36**	**70**	**20**	**2.1**
Provincial Development Expenditure						
Actual	132	107	158	155	196	10.4
7th NFC Projection	175	278	367	457	561	33.8
Difference	**-43**	**-170**	**-209**	**-302**	**-365**	**-23.4**
Provincial Budget Surplus(+)/Deficit(-)						
Actual	-34	48	-9	11	56	
7th NFC Projection	-45	0	-2	0	0	
Projection	**11**	**48**	**-7**	**11**	**56**	
Provincial Budget Surplus(+)/Deficit(-) as a percentage of GDP						
Actual	-0.23	0.27	-0.04	0.05	0.22	
7th NFC Projection	-0.30	0.00	-0.01	0.00	0.00	
Difference	**0.07**	**0.27**	**-0.03**	**0.05**	**0.22**	

Source: Author's estimates based on Report of the National Finance Commission 2009 and Pakistan Fiscal Operation (various issues)

Projected and Actual Fiscal Health of the Government of the Sindh

Table 11 presents post-7th NFC Award key budgetary magnitudes of the Government of Sindh in comparison with projections made by the 7th NFC. It reveals that the 7th NFC projected federal transfers to Sindh by an ACGR of 21 percent, while actual transfers grew by 19.5 percent. One possible explanation of the lower decline in transfers compared to Punjab despite the shortfall in FBR revenues is the moderate growth in straight transfers. While the divisible pool transfer declined with the same magnitude compared to Punjab, it was the growth in straight transfers that stabilised Sindh's revenues. Moreover, Sindh also performed well in own tax collection. Despite, an optimistic growth of 41.4 percent projected by the 7th NFC, the actual growth in Sindh's tax revenue was more than 38 percent. In fact, during 2011-12 Sindh's actual tax revenue collection reached the projected amount. Given that the base year collection was only Rs21.6 billion, it is commendable that provincial tax revenues increased to Rs79 billion. The GST on services is the main contributor in this growth. Government of Sindh started collection of this tax in 2011-12 after setting a revenue board. In contrast, provincial non tax receipt did not show any dynamism during this period and declined by almost 20 percent. Moreover, federal loans and grants grew only by 6 percent compared to a projected growth of 30.6 percent. The overall average revenue shortfall in Punjab was Rs66 billion per annum during the period.

Table 11
Key Budgetary Magnitudes of Government of Sindh: Actual and Projected

(Rs. in Billions)

	2009-10	2010-11	2011-12	2012-13	2013-14	ACGR (%)
Federal Transfers						
Actual	188	280	285	321	384	19.5
7th NFC Projection	207	281	337	379	444	21.1
Difference	**-18**	**-2**	**-52**	**-59**	**-60**	**-1.6**
Provincial Tax Receipts						
Actual	22	28	60	68	79	38.3
7th NFC Projection	23	33	60	75	92	41.4
Difference	**-1**	**-6**	**0**	**-7**	**-13**	**-3.1**
Provincial Non-tax receipts						
Actual	13	12	12	25	5	-20.1
7th NFC Projection	28	31	34	38	42	11.3
Difference	**-14**	**-19**	**-22**	**-13**	**-37**	**-31.4**
Federal Loans and grants						
Actual	18	12	26	32	22	5.9
7th NFC Projection	7	14	16	18	21	30.6
Difference	**11**	**-2**	**10**	**14**	**2**	**-24.7**
Provincial Current Expenditure						
Actual	185	248	298	302	328	15.5
7th NFC Projection	213	243	277	316	360	14.0
Difference	**-29**	**5**	**21**	**-14**	**-32**	**1.5**
Provincial Development Expenditure						
Actual	67	62	114	102	121	15.9
7th NFC Projection	75	116	155	194	238	33.5
Difference	**-8**	**-54**	**-41**	**-92**	**-118**	**-17.6**
Provincial Budget Surplus(+)/Deficit(-)						
Actual	-11	21	-29	41	41	-11
7th NFC Projection	-24	0	15	0	0	-24
Projection	**14**	**21**	**-44**	**41**	**41**	**14**
Provincial Budget Surplus(+)/Deficit(-) as a percentage of GDP						
Actual	-0.07	0.11	-0.14	0.18	0.16	-0.07
7th NFC Projection	-0.16	0.00	0.08	0.00	0.00	-0.16
Difference	**0.09**	**0.11**	**-0.22**	**0.18**	**0.16**	**0.09**

Source: Author's estimates based on Report of the National Finance Commission 2009 and Pakistan Fiscal Operation (various issues)

In contrast, provincial current expenditure grew by 34 percent during the first year after the Award due to the federal government's decision to increase salaries of government employees by 50 percent. Afterwards, the growth in current expenditure declined from 20 percent in 2011-12 to only 1.3 percent in 2012-13 and bounced back to almost 9 percent in 2013-14. This slowdown in growth of current expenditure resulted in savings of Rs14 billion and 32 billion in 2012-13 and 2013-14 respectively. Similar to Punjab, provincial development expenditure was not close to the projected development expenditure during the same period. In fact, the growth in provincial development expenditure was much less than the growth in federal development expenditures. This underspending resulted in a provincial surplus that reached Rs41.4 billion in 2013-14.

Projected and Actual Fiscal Health of the Government of the Khyber Pakhtunkhwa

Table 12 presents post-7th NFC Award key budgetary magnitudes of the Government of Khyber Pakhtunkhwa in comparison with projections made by the 7th NFC. It reveals that the 7th NFC projected federal transfers to Khyber Pakhtunkhwa by an ACGR of 27 percent including one percent of the divisible pool as earmarked for the war on terror, while actual transfers grew by more than 30 percent resulting in an extra revenue of Rs30 billion from transfers in 2013-14.

Table 12
Key Budgetary Magnitudes of Government of Khber Pakhtunkhwa: Actual and Projected

(Rs. in Billions)

	2009-10	2010-11	2011-12	2012-13	2013-14	ACGR (%)
Federal Transfers						
Actual	80	158	179	200	234	30.8
7th NFC Projection	101	163	198	235	265	27.1
Difference	**-21**	**-5**	**-19**	**-35**	**-30**	**3.7**
Provincial Tax Receipts						
Actual	2	4	4	4	12	49.4
7th NFC Projection	5	6	9	11	26	55.9
Difference	**-2**	**-3**	**-5**	**-7**	**-15**	**-6.5**
Provincial Non-tax receipts						
Actual	24	25	5	10	17	-8.6
7th NFC Projection	5	6	7	7	8	11.3
Difference	**19**	**19**	**-2**	**3**	**9**	**-19.9**
Federal Loans and grants						
Actual	46	37	35	30	40	-3.4
7th NFC Projection	14	57	61	67	73	50.6
Difference	**32**	**-20**	**-27**	**-37**	**-33**	**-54.0**
Provincial Current Expenditure						
Actual	102	122	151	174	187	16.3
7th NFC Projection	80	91	104	119	135	14.0
Difference	**22**	**31**	**47**	**55**	**52**	**2.3**
Provincial Development Expenditure						
Actual	40	52	75	74	73	16.3
7th NFC Projection	51	125	151	179	210	42.3
Difference	**-12**	**-74**	**-77**	**-104**	**-137**	**-26.0**
Provincial Budget Surplus(+)/Deficit(-)						
Actual	10	50	-4	-4	43	
7th NFC Projection	-6	16	19	23	27	
Projection	**16**	**34**	**-23**	**-27**	**16**	
Provincial Budget Surplus(+)/Deficit(-) as a percentage of GDP						
Actual	0.07	0.28	-0.02	-0.02	0.17	
7th NFC Projection	-0.04	0.10	0.11	0.11	0.12	
Difference	**0.11**	**0.18**	**-0.12**	**-0.13**	**0.05**	

Source: Author's estimates based on Report of the National Finance Commission 2009 and Pakistan Fiscal Operation (various issues)

The Commission projected an overly optimistic annual growth of 56 percent in tax receipts. While provincial tax receipts grew by a healthy 49 percent, it missed the target set by the Commission. Given that the base year collection was only Rs2.3 billion, it is commendable that provincial tax revenues increased to Rs11.7 billion. The GST on services is the main contributor in this growth. The Government of Khyber Pakhtunkhwa started collection of this tax in 2013-14 after setting a revenue authority, similar to Sindh and Punjab. Provincial non tax receipt did not show any dynamism during this period and declined by almost 9 percent. Moreover, federal loans and grants also declined by 3.4 percent. The overall average revenue shortfall was Rs51 billion per annum during the period compared to the 7th NFC Award projections.

Provincial current expenditure grew by 19 and 24 percent during the first two years after the Award mostly due to the increase in salaries of government employees. Afterwards, the growth in current expenditure declined to 7.6 percent in 2013-14. Despite, the slowdown in the growth of current expenditure, they were more than the projected amount throughout the post-7th NFC Award period. In contrast, provincial development expenditure was far below the projected development expenditure during the same period. In fact, the growth in provincial development expenditure was much less than the growth in federal development expenditures. This underspending resulted in a provincial surplus that reached Rs16 billion in 2013-14.

Projected and Actual Fiscal Health of the Government of the Balochistan

Table 13 presents post-7th NFC Award key budgetary magnitudes of the Government of Balochistan in comparison with projections made by the 7th NFC. It reveals that the 7th NFC projected federal transfers to Balochistan by an ACGR of 26 percent, while actual transfers grew by more than 37 percent due to the lower base year value. At the time of the NFC Award Balochistan expressed concerns over the projections made by the NFC related to FBR revenues. The Government of Balochistan requested that their divisible pool transfers should not be affected by any shortfall in FBR revenues. Therefore, the NFC ensured that Balochistan will receive Rs83 billion as per the projected share and any shortfall in revenues will be borne by the federal government. Consequently, Balochistan received Rs83 billion under divisible pool transfers. The shortfall of Rs3 billion during the 2010-11 is an outcome of low revenues from straight transfers. In the spirit of the 7th NFC Award, it was perceived that Balochistan will receive the same projected amount under divisible pool transfers. However, Balochistan received divisible pool transfers as per the budgeted amount and not as per NFC projections. Consequently, afterwards the gap between projected and actual transfers started widening and reached almost Rs28 billion in 2013-14. While the provincial tax revenues grew by 28 percent, they were still far less than the projected amount. So far Balochistan is the only province without a revenue board or authority to collect GST services. Therefore, its revenues did not show much dynamism as reflected in the growth of other provinces. Balochistan is the only province where provincial non tax receipt surpasses the NFC projection during most of the post-7th NFC Award period. Moreover, federal loans and grants were also in line with NFC projections. The overall average revenue shortfall was Rs18.5 billion per annum during the period compared to the 7th NFC Award projections.

Table 13
Key Budgetary Magnitudes of Government of Balochistan: Actual and Projected

(Rs. in Billions)

	2009-10	2010-11	2011-12	2012-13	2013-14	ACGR (%)
Federal Transfers						
Actual	40.0	100.7	107.4	125.3	141.9	37.3
7th NFC Projection	68.3	103.7	122.9	144.9	169.8	25.6
Difference	**-28.4**	**-3.0**	**-15.5**	**-19.6**	**-27.9**	**11.7**
Provincial Tax Receipts						
Actual	1.0	1.0	1.0	1.1	2.8	28.3
7th NFC Projection	2.2	3.2	4.4	5.5	6.8	32.3
Difference	**-1.2**	**-2.2**	**-3.4**	**-4.4**	**-4.1**	**-4.0**
Provincial Non-tax receipts						
Actual	2.3	1.7	5.0	8.4	4.2	16.3
7th NFC Projection	2.7	3.0	3.3	3.7	4.1	11.3
Difference	**-0.4**	**-1.3**	**1.7**	**4.7**	**0.1**	**5.0**
Federal Loans and grants						
Actual	37.8	22.5	20.8	18.3	21.7	-12.9
7th NFC Projection	6.7	19.4	20.2	21.0	21.9	34.2
Difference	**31.1**	**3.1**	**0.6**	**-2.7**	**-0.1**	**-47.1**
Provincial Current Expenditure						
Actual	56.1	85.9	86.3	98.0	120.4	21.0
7th NFC Projection	53.1	60.5	69.0	78.6	89.6	14.0
Difference	**3.1**	**25.4**	**17.3**	**19.4**	**30.8**	**7.0**
Provincial Development Expenditure						
Actual	19.5	24.3	28.8	40.3	40.7	20.1
7th NFC Projection	18.5	68.8	81.7	96.4	113.0	57.1
Difference	**1.0**	**-44.5**	**-52.9**	**-56.1**	**-72.3**	**-37.0**
Provincial Budget Surplus(+)/Deficit(-)						
Actual	5.4	15.6	19.1	14.8	9.5	
7th NFC Projection	8.4	0.0	0.0	0.0	0.0	
Projection	**-2.9**	**15.6**	**19.1**	**14.8**	**9.5**	
Provincial Budget Surplus(+)/Deficit(-) as a percentage of GDP						
Actual	0.04	0.09	0.09	0.06	0.04	
7th NFC Projection	0.06	0.00	0.00	0.00	0.00	
Difference	**-0.02**	**0.09**	**0.09**	**0.06**	**0.04**	

Source: Author's estimates based on Report of the National Finance Commission 2009 and Pakistan Fiscal Operation (various issues)

Despite high growth in provincial resources, provincial development expenditure did not grow in line with NFC projections. In contrast, the growth in current expenditure is much higher compared to NFC projections. The current expenditure grew by 53 percent during the first year after the Award. It was higher than the salary increase announced by the federal government. Similar to other provinces, provincial development expenditure was far below the projected development expenditure throughout the post-NFC period. This underspending resulted in a provincial surplus that ranged from Rs9.5 billion in 2013-14 to Rs19 billion in 2011-12.

Post-7th NFC Award Performance in Key Fiscal Indicators

This section presents an overview of the performance of the federal and provincial governments with reference to key fiscal indicators during the post-7th NFC Award period. The key fiscal indicators include level of fiscal efforts, development spending, budget deficit and expenditure on social services.

Level of Fiscal Effort

Pakistan has a low tax-to-GDP ratio, where most of the buoyant taxes are in the domain of the federal government. It was generally perceived that the higher share of the provincial government in FBR taxes will put pressure on the federal government for resource mobilisation to meet its expenditure. Consequently, tax-to-GDP will increase due to these efforts. However, a look at the growth rate of FBR tax collection reveals that growth in FBR taxes declined after the 7th NFC Award. During 2006-07 to 2009-10, growth in FBR taxes was more than 16 percent, which declined to 13.5 percent during 2010-11 to 2013-14. In contrast, tax revenues of provincial governments with an impressive 43 percent during 2010-11 to 2013-14 compared to a meagre growth of 14.2 percent during 2006-07 to 2009-10 (Table 14).

Table 14
Level of Fiscal Effort by Federal and Provincial Governments

(**Rs. in Billions)**

	2006-07	2007-08	2008-09	2009-10	ACGR (%)	2010-11	2011-12	2012-13	2013-14	ACGR (%)
Federal Government										
FBR Tax Revenues	846.5	1,007.2	1,157.0	1,327.4	16.2	1,550.2	1,881.5	1,936.1	2,266.3	13.5
Other Tax Revenues	6.4	2.7	1.6	1.8	-33.9	1.9	3.8	2.7	4.7	35.9
Petroleum Levy	29.7	14.5	112.0	88.7	44.1	82.7	60.4	109.7	103.5	7.8
Total Federal Taxes	**882.5**	**1,024.4**	**1,270.6**	**1,418.0**	**17.1**	**1,634.8**	**1,945.7**	**2,048.5**	**2,374.5**	**13.3**
Provincial Government										
Punjab	19.6	20.2	22.1	29.9	15.0	32.6	42.1	77.4	96.5	43.6
Sindh	14.0	17.1	21.0	21.6	15.5	27.5	60.4	68.1	79.1	42.1
Khyber Pahktunkhwa	2.4	2.6	2.2	2.3	-0.5	3.5	3.7	4.1	11.7	49.6
Balochistan	0.8	0.8	0.9	1.0	8.3	1.0	1.0	1.1	2.8	41.2
Total Provincial Taxes	**36.8**	**40.8**	**46.1**	**54.8**	**14.2**	**64.6**	**107.2**	**150.7**	**190.0**	**43.3**

Source: Author's estimates based on Pakistan Fiscal Operation, Finance Division, Government of Pakistan (various issues)

Table 15 shows the tax-to-GDP ratio of federal and provincial taxes. It indicates that on average federal tax-to-GDP ratio declined from 9.39 percent during the pre-7th NFC period to 9.19 percent during the post-7th NFC Award period. In contrast, on average provincial tax-to-GDP ratio increased from 0.37 percent to 0.57 percent during comparable period. Devolution of GST in services played an instrumental role in this growth. Despite, this growth more than 90 percent of the tax revenue is collected by the federal government.

Table 15
Level of Fiscal Effort by Federal and Provincial Governments
(**As Percentage of GDP)**

	2006-07	2007-08	2008-09	2009-10	Average	2010-11	2011-12	2012-13	2013-14	Average
Federal Government										
FBR Tax Revenues	8.08	9.61	8.84	9.05	8.89	8.58	9.11	8.45	8.92	8.77
Other Tax Revenues	0.06	0.03	0.01	0.01	0.03	0.01	0.02	0.01	0.02	0.01
Petroleum Levy	0.28	0.14	0.86	0.61	0.47	0.46	0.29	0.48	0.41	0.41
Total Federal Taxes	**8.42**	**9.78**	**9.70**	**9.67**	**9.39**	**9.05**	**9.42**	**8.94**	**9.35**	**9.19**
Provincial Government										
Punjab	0.19	0.19	0.17	0.20	0.19	0.18	0.20	0.34	0.38	0.28
Sindh	0.13	0.16	0.16	0.15	0.15	0.15	0.29	0.30	0.31	0.26
Khyber Pahktunkhwa	0.02	0.02	0.02	0.02	0.02	0.02	0.02	0.02	0.05	0.03
Balochistan	0.01	0.01	0.01	0.01	0.01	0.01	0.00	0.00	0.01	0.01
Total Provincial Taxes	**0.35**	**0.39**	**0.35**	**0.37**	**0.37**	**0.36**	**0.52**	**0.66**	**0.75**	**0.57**

Source: Author's estimates based on Pakistan Fiscal Operation, Finance Division, Government of Pakistan (various issues)

Level of Development Spending

Economists classify expenditures into two broad categories referred to as current (non-development) and development expenditures. Non-development expenditures refer to the recurring operational costs involved in provision and maintenance of a range of government services. Developmental expenditures represent outlays in new physical and social infrastructure, which are needed time to time to establish new physical and social infrastructure, new facilities or even new administrative functions. In a broader sense, this distinction of non-development and development expenditures can be referred to as consumption and investment. Consequently, if any government is indicating higher public investment, it generally implies higher development expenditures. Higher share of development expenditure may generate higher employment opportunities and provides greater scope for economic growth and poverty reduction.

Table 16 presents the trend on development in both the federal and provincial governments before and after the 7th NFC Award. It was generally perceived that a higher share in revenues will provide the fiscal space to provinces to enhance their development expenditure as per their development needs. However, the statistics in Table 16 present a different story. Prior to the 7th NFC Award the federal government had played a major role in development spending. Moreover, the growth rate in federal development expenditures was more than double compared to the growth in provincial development expenditure during 2006-07 to 2009-10. This trend still continued after the 7th NFC Award, whereas federal development expenditure grew by almost 43 percent compared to almost 21 percent growth in provincial development expenditure. It is surprising to note that growth rate in development spending of Khyber Pakhtunkhwa declined from 19 percent to 12 percent during the post-7th NFC Award period compared to the pre-NFC Award period. While there is an increase in the growth rate of development spending in other provinces after the 7th NFC Award, it is far lesser than the growth in federal development spending.

Table 16
Level of Development Spending by Federal and Provincial Governments

(Rs. in Billions)

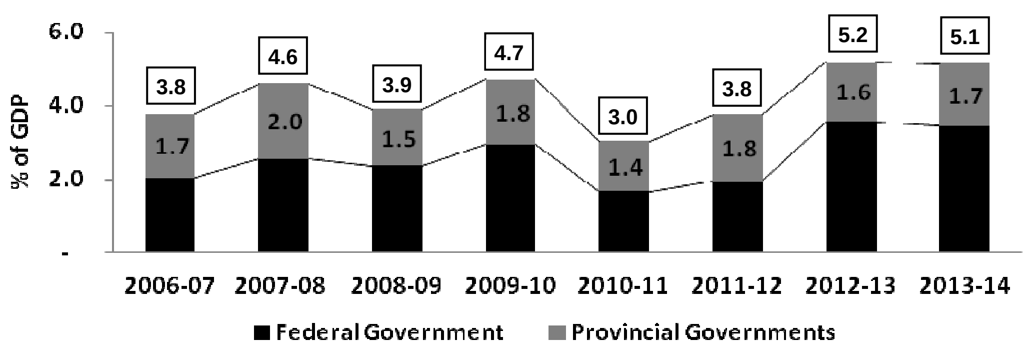
	2006-07	2007-08	2008-09	2009-10	ACGR (%)	2010-11	2011-12	2012-13	2013-14	ACGR (%)
Federal Government										
Dev. Expenditure	213.6	267.3	308.3	432.4	26.5	300.1	402.7	816.0	874.3	42.8
Provincial Government										
Punjab	109.6	118.8	106.8	132.3	6.5	107.4	157.8	154.6	196.3	22.3
Sindh	35.1	45.4	48.1	66.9	24.0	62.2	114.2	102.3	120.9	24.8
Khyber Pahktunkhwa	23.6	27.9	31.9	39.7	18.9	51.7	74.6	74.3	72.6	12.0
Balochistan	14.3	22.0	15.0	19.5	11.1	24.3	28.8	40.3	40.7	18.7
Total Provincial Taxes	**182.6**	**214.1**	**201.8**	**258.4**	**12.3**	**245.6**	**375.4**	**371.5**	**430.5**	**20.6**

Source: Author's estimates based on Pakistan Fiscal Operation, Finance Division, Government of Pakistan (various issues)

Chart 1 shows federal and provincial spending as a percentage of GDP. It indicates that development spending during the first year after the 7th NFC Award substantially declined due to the decline in federal development spending. Afterwards, federal development spending bounced back and consequently total development spending as a percentage of GDP reached above 5 percent. On average, development spending of provincial governments also increased during post-NFC period with the exception of Punjab where it declined from 1.0 percent to 0.7 percent of GDP.

Chart 1
Development Spending by Federal and Provincial Governments

(As Percentage of GDP)



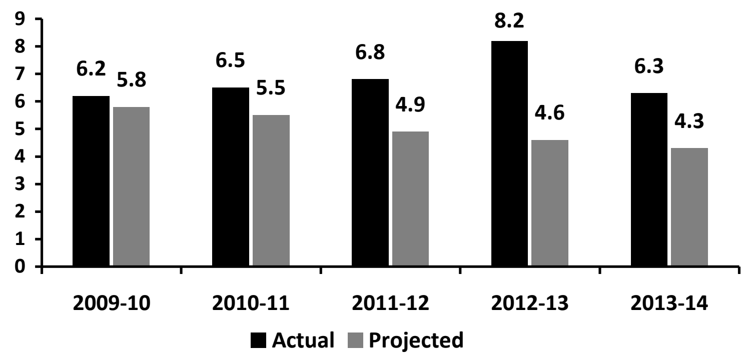
	2006-07	2007-08	2008-09	2009-10	Average Pre-NFC	2010-11	2011-12	2012-13	2013-14	Average Post-NFC
Federal Government	**2.0**	**2.6**	**2.4**	**2.9**	**2.5**	**1.7**	**1.9**	**3.6**	**3.4**	**2.6**
Provincial Governments	**1.7**	**2.0**	**1.5**	**1.8**	**1.8**	**1.4**	**1.8**	**1.6**	**1.7**	**1.6**
Punjab	1.0	1.1	0.8	0.9	1.0	0.6	0.8	0.7	0.8	0.7
Sindh	0.3	0.4	0.4	0.5	0.4	0.3	0.6	0.4	0.5	0.5
Khyber Pahktunkhwa	0.2	0.3	0.2	0.3	0.3	0.3	0.4	0.3	0.3	0.3
Balochistan	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.2	0.2	0.2
Total	**3.8**	**4.6**	**3.9**	**4.7**	**4.2**	**3.0**	**3.8**	**5.2**	**5.1**	**4.2**

Source: Author's estimates based on Pakistan Fiscal Operation, Government of Pakistan (various issues)

Level of Budget Deficit

Chart 2 presents the actual and projected budget deficit as a percentage of the GDP. It indicates that during the post-7th NFC period actual budget deficit surpasses the projected budget deficit with wild margins. For example, for 2012-13 the projected budget deficit was only 4.6 percent of the GDP while actual budget deficit was more than 8 percent of GDP. Since, this is a combined (federal and provincial) budget deficit, therefore in the next subsection we analysed which tier of the government is responsible for this deviation.

Chart 2
Actual and Projected Budget Deficit
(As Percentage of GDP)



Source: Author's estimates based on Report of the National Finance Commission 2009 and Pakistan Fiscal Operation (various issues)

What Explains Growth in the Federal Budget Deficit?

It is generally argued that the higher share of provinces in the 7th NFC Award is the biggest cause of fiscal problems for the federal government including massive growth in federal budget deficit. Table 17 shows the difference in actual and projected revenues and expenditures. It reveals that the FBR never achieved tax targets projected by the 7th NFC and deviation ranged from Rs160 billion in 2010-11 to Rs625 billion in 2013-14. The shortfall in FBR revenues largely affected transfer to provinces in 2011-12, 2012-13 and 2013-14. On the other hand, federal revenues other than FBR grew more than their projections in 2012-13 and 2013-14 by Rs143 billion and Rs384 billion respectively. As a result shortfall in net revenue receipts of federal government is Rs151 billion in 2010-11 and reduces with the passage of time. In 2013-14, net revenue receipts of federal government exceeded the 7th NFC projected amount by Rs118 billion.

Table 17
Deviations in Federal Budget Deficit
(Rs. in Billions)

	2009-10	2010-11	2011-12	2012-13	2013-14
Deviation in Revenues					
FBR Revenues (a)	-53	-160	-167	-507	-625
Other Revenues (b)	30	-33	-134	143	385
Transfer to Provinces (c)	-75	-42	-173	-283	-358
I. Total Revenue Impact (a + b + c)	**52**	**-151**	**-128**	**-81**	**118**
Deviation in Expenditure					
Current Expenditure (i)	104	342	323	597	693
Development Expenditure (ii)	74	-104	-75	264	189
II. Total Expenditure Impact (i + ii)	**179**	**237**	**248**	**862**	**882**
Increase in Budget Deficit (II – I)	**127**	**388**	**376**	**942**	**764**

Source: Author's estimates based on Report of the National Finance Commission 2009 and Pakistan Fiscal Operation (various issues)

In contrast, in all the fiscal years during 2010-2014, current expenditure of the federal government overshot by more than Rs300 billion compared to the projected amount. In 2013-14, the deviation was close to Rs700 billion. It indicates that the federal government failed to curtail its current expenditures despite the devolution of basic social services to provincial governments. In the case of the federal development expenditure, the comparison of actual outlays and 7th NFC projections portrays a mixed pattern. It was less than the projected amount in 2010-11 and 2011-12 and more than the projected amount in 2012-13 and 2013-14 (Table 9).

The above analysis clearly spells out that the biggest cause of the higher federal budget deficit is the tremendous growth in current expenditures. FBR revenue shortfall along with higher federal transfers to provinces caused a slight deviation in the budget deficit but it is the higher than projected current expenditure that caused the growth in budget deficit.

What Explains the Provincial Budget Surplus?

In contrast to the federal government, provincial governments (combined) had a budget surplus throughout the post-7th NFC Award period except in 2011-12. Table 18 presents the deviation in actual and projected key budgetary magnitude of provincial governments combined. It indicates that provincial governments have less than projected revenues throughout the post-7th NFC Award period. The quantum of shortfall in revenues reached almost Rs500 billion in 2013-14. Despite this massive shortfall, provincial governments were able to generate a budget surplus of Rs122 billion in 2013-14. While their actual current expenditures were more than the projected amount, there was huge underspending in actual development expenditure compared to projected development. The underspending in provincial development spending is the only reason for the unanticipated provincial budget surplus.

Table 18
Deviations in Key Budgetary Magnitudes of Provincial Governments (combined)

(Rs. in Billions)

	2009-10	2010-11	2011-12	2012-13	2013-14
Deviation in Revenues					
Federal Transfers (a)	-75	-45	-171	-227	-279
Provincial Own Revenues (b)	-41	-80	-116	-139	-204
Other Transfers (c)	77	-21	-27	-18	-16
I. Total Revenue Impact (a + b + c)	**-38**	**-146**	**-313**	**-384**	**-499**
Deviation in Expenditure					
Current Expenditure (a)	-15	77	121	130	70
Development Expenditure (b)	-61	-342	-380	-554	-691
II. Total Expenditure Impact (a + b)	**-76**	**-265**	**-259**	**-424**	**-621**
Increase in Budget Deficit (I – II)	**38**	**118**	**-55**	**40**	**122**

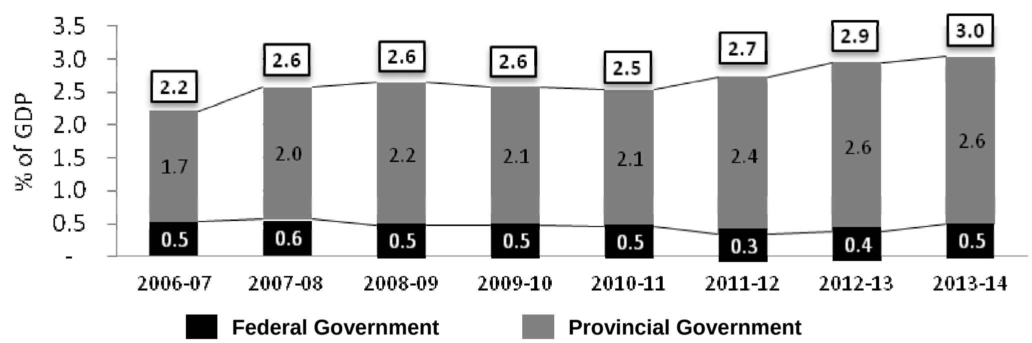
Source: Author's estimates based on Report of the National Finance Commission 2009 and Pakistan Fiscal Operation (various issues)

Level of Expenditure on Social Services

Public expenditure on social services such as education and health contributes to human capital formation and enhancing human capabilities and is therefore considered as poverty reducing in character. Moreover, higher public spending on social services is likely to contribute to the achievement of the Millennium Development Goals (MDGs) which the Government of Pakistan stands committed to. However, Pakistan historically spends a very low share of its GDP on the social sector. Since provincial governments are principally responsible for the provision of these services, one explanation generally presented for the low level of spending is the relatively low share of provinces in divisible pool taxes. This situation has been corrected by the 7th NFC Award. Therefore, it is imperative to look at trends in social sector spending as a percentage of GDP at both tiers of the governments.

Chart 3
Public Spending on Social Services

(As Percentage of GDP)



	2006-07	2007-08	2008-09	2009-10	Average Pre-NFC	2010-11	2011-12	2012-13	2013-14	Average Post-NFC
Federal Government	**0.53**	**0.56**	**0.47**	**0.48**	**0.51**	**0.46**	**0.33**	**0.37**	**0.48**	**0.41**
Provincial Governments	**1.69**	**2.01**	**2.18**	**2.10**	**1.99**	**2.07**	**2.40**	**2.58**	**2.56**	**2.40**
Punjab	0.96	1.04	1.15	1.07	1.06	1.11	1.22	1.24	1.24	1.21
Sindh	0.36	0.51	0.55	0.53	0.49	0.55	0.52	0.64	0.62	0.58
Khyber Pahktunkhwa	0.25	0.31	0.36	0.37	0.32	0.23	0.46	0.49	0.47	0.41
Balochistan	0.12	0.14	0.12	0.13	0.12	0.18	0.20	0.20	0.22	0.20
Total	**2.21**	**2.57**	**2.64**	**2.58**	**2.50**	**2.53**	**2.73**	**2.95**	**3.04**	**2.81**

Source: Author's estimates based on Pakistan Fiscal Operation, Government of Pakistan (various issues)

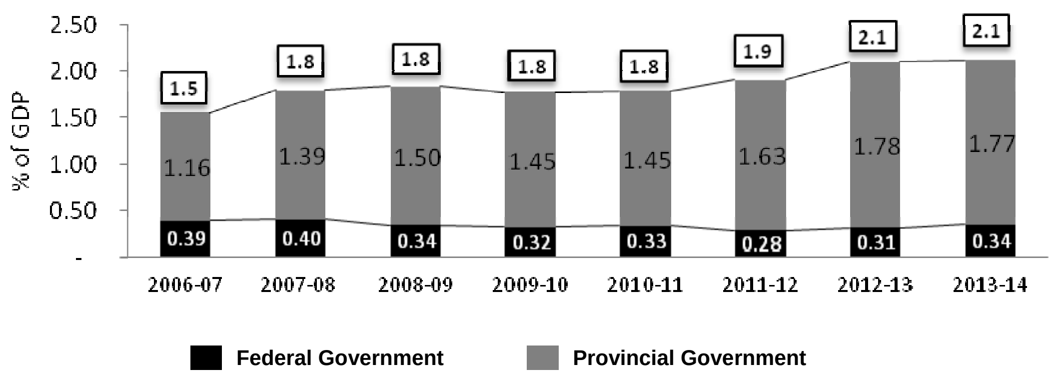
Chart 3 shows the public spending on basic social services i.e. education, health, and water supply and sanitation as a percentage of GDP. It shows that during the first year after the 7th NFC Award public spending on social services declined from 2.6 percent of the GDP to 2.5 percent of GDP. However, afterwards it gradually increased to 3 percent of the GDP. Provincial government played a pivotal role in this increase. While federal spending on social services declined from 0.51 percent to 0.41 percent of GDP, provincial spending increased from 2 percent to 2.4 percent of the GDP. All four provinces contributed to this growth.

Level of Expenditure on Education

Chart 4 shows federal and province-wise public spending on education as a percentage of GDP. It shows that after the 7th NFC Award public spending on education gradually increased to 2.1 percent of GDP. Provincial governments are the main contributor in this growth. Provincial spending on education increased from an average 1.4 percent of GDP during the pre-7th NFC Award period to 1.7 percent of GDP during the post-7th NFC Award period.

Chart 4
Public Spending on Education

(As Percentage of GDP)



	2006-07	2007-08	2008-09	2009-10	Average Pre-NFC	2010-11	2011-12	2012-13	2013-14	Average Post-NFC
Federal Government	**0.39**	**0.40**	**0.34**	**0.32**	**0.36**	**0.33**	**0.28**	**0.31**	**0.34**	**0.32**
Provincial Governments	**1.16**	**1.39**	**1.50**	**1.45**	**1.37**	**1.45**	**1.63**	**1.78**	**1.77**	**1.66**
Punjab	0.68	0.73	0.79	0.73	0.73	0.79	0.84	0.86	0.86	0.84
Sindh	0.22	0.36	0.37	0.36	0.33	0.40	0.33	0.43	0.42	0.39
Khyber Pahktunkhwa	0.19	0.23	0.26	0.28	0.24	0.15	0.33	0.37	0.35	0.30
Balochistan	0.07	0.07	0.07	0.08	0.07	0.11	0.12	0.13	0.15	0.13
Total	**1.55**	**1.79**	**1.84**	**1.77**	**1.74**	**1.78**	**1.91**	**2.09**	**2.12**	**1.98**

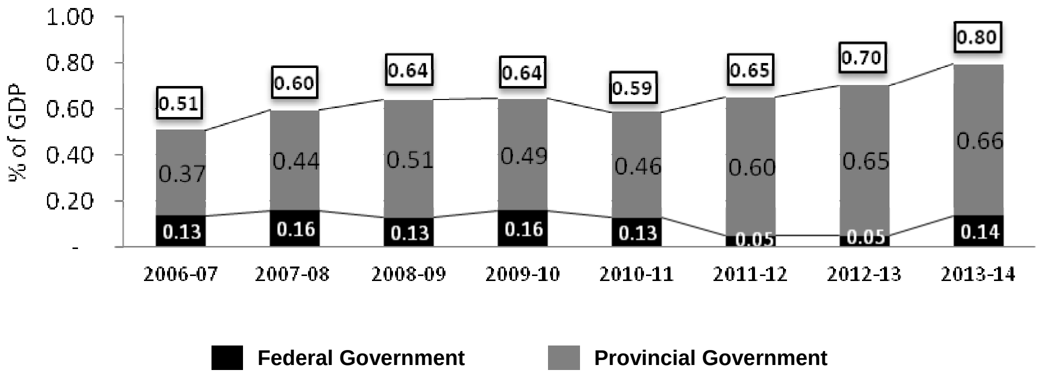
Source: Author's estimates based on Pakistan Fiscal Operation, Government of Pakistan (various issues)

Level of Expenditure on Health

Pakistan spends a very low share of its GDP on health. This situation slightly improved after the 7th NFC Award. In 2006-07, Pakistan spent only 0.51 percent of its GDP on health, which gradually increased to 0.8 percent of the GDP in 2013-14 (Chart 5). Initially, there was a decline in public spending on health after the 7th NFC Award. Afterwards, it started growing from 0.6 percent in 2010-11 to 0.8 percent in 2013-14. Provincial governments played an important role in this growth.

Chart 5
Public Spending on Health

(As Percentage of GDP)



	2006-07	2007-08	2008-09	2009-10	Average Pre-NFC	2010-11	2011-12	2012-13	2013-14	Average Post-NFC
Federal Government	**0.13**	**0.16**	**0.13**	**0.16**	**0.14**	**0.13**	**0.05**	**0.05**	**0.14**	**0.09**
Provincial Governments	**0.37**	**0.44**	**0.51**	**0.49**	**0.45**	**0.46**	**0.60**	**0.65**	**0.66**	**0.59**
Punjab	0.21	0.24	0.27	0.25	0.24	0.23	0.30	0.33	0.33	0.30
Sindh	0.08	0.12	0.14	0.13	0.12	0.13	0.15	0.19	0.18	0.16
Khyber Pahktunkhwa	0.06	0.06	0.08	0.07	0.07	0.06	0.10	0.09	0.10	0.09
Balochistan	0.02	0.02	0.03	0.03	0.02	0.04	0.05	0.05	0.05	0.05
Total	**0.51**	**0.60**	**0.64**	**0.64**	**0.60**	**0.59**	**0.65**	**0.70**	**0.80**	**0.68**

Source: Author's estimates based on Pakistan Fiscal Operation, Government of Pakistan (various issues)

New Constitutional Provisions following the 18th Amendment

The 18th Amendment made significant changes in the Constitution which have a significant impact on intergovernmental fiscal transfers. This section presents a review of the relevant clause of the amended constitution.

Fiscal Powers

According to the Constitution of Pakistan, the federal government was empowered under 4th schedule (Federal Legislative List Article 70(4) of the constitution) to levy Sales tax on the sales and purchase of goods. Since Article 142 (c) of the Constitution allows the Provincial Assembly to make laws with respect to any matter not enumerated in the Federal Legislative List the sales on services exclusively falls under the domain of provincial governments.

The 18th Amendment explicitly endorsed that sales tax on services is a provincial tax by amending the Federal Legislative List and adding "except sales tax on services." Therefore sales tax on services is a provincial tax. The other tax explicitly endorsed as provincial tax is tax on the capital value on immovable property. The 18th Amendment also deleted "Duties in respect of succession to property" and "Estate duty in respect of property" from the Federal Legislative List in the spirit to ensure that any tax on property is a provincial subject.

Devolution of Functions

The 18th Amendment deleted the Concurrent Legislative List (CLL) formerly a part of the constitution. The erstwhile Concurrent List contained 47 subjects that have now been transferred to the provinces. However, some subjects such as electricity; legal, medical and other professions; and standards in higher education have been added to Federal Legislative List Part II. The major subjects devolved under the 18th Amendment are education, health, population planning, labour and environmental pollution and ecology. Since, these functions were in the concurrent list therefore both federal and provincial government had their role in the delivery and financing of these services. After the 18th Amendment, the federal government is gradually stepping out putting greater responsibilities on provincial governments which have implications for the 8th NFC.

Floor to the Share of Provincial Governments

An important change has been brought about in Article 160, regarding constitutional provisions for the NFC, which states that "the share of the Provinces in each Award of National Finance Commission shall not be less than the share given to the Provinces in the previous Award." This amendment indicates that the 8th NFC Award cannot reduce the share of provinces from existing 57.5 percent of the divisible pool.

Borrowing Powers of Provincial Governments

International loans to provinces were formerly routed through the economic affairs division of the federal government. There have been concerns about cumbersome procedures involved in the sanctioning of these loans as well as higher interest rates charged by the federal government. Under the 18th Amendment, provinces have been given borrowing powers. Article 167 (4) states that "a Province may raise domestic or international loan, or give guarantees on the security of the Provincial Consolidated Fund within such limits and subject to such conditions as may be specified by the National Economic Council."

Emerging Issues for the 8th NFC

The 7th NFC Award was successful in resolving many pressing issues related to intergovernmental fiscal relations. However, it was constituted prior to the 18th constitutional amendment. Therefore, the 8th NFC Award has to resolve issues related to the costs of devolved functions. Another recent development which has implications for the 8th NFC is the federal government's commitment with the IMF regarding budget deficit of provinces. This section provides a summary of emerging issues related to the 8th NFC.

Inter-Governmental Fiscal Relations in the IMF Programme

The Government of Pakistan signed a Memorandum on Economic and Financial Policies for 2013/14 –2015/16 with the IMF on August 19, 2013. Table 2 of the memorandum contained a list of "Prior Actions and Structural Benchmarks Under Extended Fund Facility". One of the prior actions mentioned in the list is "Impose a balanced budget requirement on provinces and agree with provinces to save additional revenues generated by the program." In compliance with this action the memorandum contained an assurance from the federal government which states that "… an agreement has been reached at the level of the Council of Common Interest to assure that it is used for deficit reduction or saved. In addition, the government has tightened the balanced-budget requirement on provinces, and provided incentives for them to maintain surpluses (prior action)."

A search of the Council of Common Interest's (CCI) decision in this regard revealed that the federal government in consultation with provinces had decided that provinces would be allowed the rate of return on their minimum surpluses at latest T-bills rate, maintained for a minimum of three months. As per this decision, the federal government distributed Rs3.865 billion during 2013-14 as an incentive grant on marinating provincial surplus. The major beneficiaries of this decision were Balochistan and Khyber Pakhtunkhwa. This also explains the growing budget surpluses at provincial levels.

Table 19
Incentive Grant on Maintaining Provincial Surpluses

(Rs. in Million)

	Incentive Grant (2013-14)
Punjab	556.5
Sindh	2.3
Khyber Pakhtunkhwa	1,504.4
Balochistan	1,801.9
Total	**3,865.1**

Source: Federal Details of Demands for Grants and Appropriations (2014-15)

While this helps to reduce the overall budget deficit in the country, it is against the spirit of the 7th NFC Award that aimed to increase the level of development spending at the provincial level. Moreover, it is also strange that federal government is enhancing current and development spending instead of curtailing the federal budget deficit.

Costs of Devolved Functions

Financial implications of the 18th Amendment for the provinces include higher wage bills and pension liabilities due to the transfer of human resources; higher operations and maintenance costs since infrastructure is transferred in the devolved subjects; and provincial outlays for development for the new functions. Total current expenditure on the devolved divisions was Rs21.5 billion in 2010-11. However, due to various adjustments the increase in current expenditure liability of provincial governments after devolution is estimated to be Rs5.0 billion in 2011-12.

A number of federal PSDP projects/schemes relating to devolved subjects have also been transferred to the provincial governments. The basic issue that arose was the financing of these projects. The provincial governments were of the view that since the 7th NFC Award preceded the 18th Amendment, the additional liabilities transferred to the provinces were not coupled with the transfer of additional resources. Hence, the provinces cannot continue the execution of these projects without a meaningful transfer of additional resources at least till the currency of 7th NFC Award. However, the CCI in its meeting on April 28, 2011 made the following decisions:

1. The federal government will continue to fund higher education till the next National Finance Commission (NFC) Award due in 2014-15;
2. The federal government will provide financing for vertical programmes of the health and population sectors;
3. All projects located in the provinces except those being carried out under the president and prime minister's directives would be financed by the provinces.

Table 20 presents a summary of PSDP projects transferred to the provinces. These include projects located in the provinces, except those being carried out under the directives of the president and prime minister. The total cost of the projects transferred to the provinces was Rs 108 billion while expenditure incurred on these projects up to June 2011 was Rs 40 billion implying a throw forward of Rs 68 billion. The provinces had the option to continue or discard these projects according to their own development priorities. An analysis of provincial ADPs of 2011-12 and 2012-13 indicates that most of the projects have been continued in the provinces of Punjab, Khyber Pakhtunkhwa and Balochistan. These projects have been integrated into their respective ADPs. As shown in Table 3.4, the total cost of the projects, which have apparently been discontinued, amounts to Rs20 billion. Expenditure already incurred on these projects was Rs3 billion, which is naturally a sunk cost. In the case of Sindh, however, devolved projects do not appear to have been integrated into ADP as regular schemes.

Table 20
PSDP project transferred to provinces (excluding vertical programmes)
(Rs. in Million)

	Project Transferred		Project Discontinued	
	Cost	Expenditure upto 2011	Cost	Expenditure upto 2011
Punjab	34,991	13,455	14,347	1,257
Khyber Pakhtunkhwa	22,518	2,714	1,724	453
Balochistan	9,114	4,085	3,925	1,246
Sindh	40,917	19,371	n.a.	n.a.
Total	**107,540**	**39,625**	**19,996**	**2,957**

Source: Social Development in Pakistan 2011-12: Devolution and social Development, SPDC

In Sindh's ADP of 2011-12, a block allocation of Rs3.4 billion was made for devolved projects. Total cost mentioned for all projects was Rs41 billion with a throw forward of Rs21.5 billion. No details of individual schemes have been provided. However, in the next year's ADP (2012-13) the total cost given for all devolved projects is Rs754 million with the same amount of throw forward. It is not clear whether all the remaining projects have been discontinued.

Incentives for Fiscal Effort

One of the fiscal challenges in Pakistan is to encourage sub-national government to collect taxes as per their capacity and focus more on development spending compared to current expenditure to stimulate economic growth. One possible solution is to introduce an incentive for fiscal efforts in the design of the NFC Award. However, a measure of fiscal effort is not a straightforward exercise because fiscal effort must be related to some notion of fiscal capacity. In general tax revenue in relation to the state/provincial GDP is used as a proxy for fiscal effort. However, in Pakistan official estimates of provincial GDP are not available. Alternatively, an index of fiscal discipline similar to Indian NFC Award can be introduced in the 8th NFC Award. This index is computed using the following three steps:

1. ratio of own revenue receipts of provinces to its total revenue expenditure is computed for base year as well as for the reference period;
2. a relative ratio to all provinces is computed by dividing province-wise value with the aggregated value of all provinces; and
3. relative ratio of base year and reference year is used to compute performance of a provenance in fiscal discipline in relation to other provinces.

It may be noted that such an improvement in the first ratio requires either improvement in tax collection or reduction in current expenditure or a combination of both.

Level of Hydro-electricity Profits

Article 161 part 2 of the Constitution of Pakistan states that “the net profits earned by the Federal Government, or any undertaking established or administered by the Federal Government from the bulk generation of power at a hydro-electric station shall be paid to the Province in which the hydro-electric station is situated.” The article further explain it as follows “For the purposes of this clause "net profits" shall be computed by deducting from the revenues accruing from the bulk supply of power from the bus-bars of a hydro-electric station at a rate to be determined by the Council of Common Interests, the operating expenses of the station, which shall include any sums payable as taxes, duties, interest or return on investment, and depreciations and element of obsolescence, and over-heads, and provision for reserves.”

Under this constitutional provision federal government paid profit on hydroelectricity to Government of Khyber Pakhtunkhwa. However, the computation of profit from hydroelectricity is ad hoc and fixed at Rs6 billion on an annual basis. Government of Khyber Pakhtunkwa objected this ad hoc calculation and went for arbitration. The arbitrators report indicates Rs100 billion dues under the head of hydroelectricity. The 7th NFC Award accepted Khyber Pakhtunkhwa claims of Rs100 billion and decided to pay these dues in the form of four installments of Rs25 billion each. As per the directives of the 7th NFC Award federal government paid this amount annually. However, it continued the previous practice of allocating Rs6 billion as profit from hydroelectricity.

Given the quantum of hydroelectricity and the differential in production cost of electricity from water and other resources, it can be inferred that the issue of profit from hydroelectricity would be raised during the deliberations of the 8th NFC and a similar decision may be taken again.

Balochistan’s Divisible Pool Transfer Anomaly

At the time of the NFC Award Balochistan expressed concerns over the FBR revenues projections made by NFC and asked to isolate transfers to Balochistan with any shortfall in them. Therefore, the NFC ensured that Balochistan will receive divisible pool transfers as per NFC projections and any shortfall in revenues will be borne by the federal government. Consequently, Balochistan received Rs83 billion under divisible pool transfers in 2010-11 instead of the estimated share of Rs76.7 billion as per the budget estimate. In the spirit of the 7th NFC Award, it was perceived that Balochistan will receive the same projected amount under divisible pool transfers during the rest of the 7th NFC period. However, Balochistan received divisible pool transfers as per the budgeted or actual amount and not as per NFC

Table 21
Divisible Pool Transfers: Balochistan
(Rs in Billions)

Year	Projected	Actual	Difference
2010-11	83.0	83.0	0.0
2011-12	99.6	95.0	4.7
2012-13	118.8	116.4	2.4
2013-14	140.6	123.3	17.3
2014-15	164.8	141.2	23.5
Total	**606.8**	**558.8**	**48.0**

Source: Author’s estimates based on Report of the National Finance Commission 2009 and Annual Budget Statement, Government of Balochistan (Various issues) projections. It creates an anomaly that why Balochistan received divisible pool transfers as per budget estimates except 2011-12. Table 21 shows the projected and actual divisible pool transfers and loss in revenues to Balochistan due to this anomaly. Balochistan is likely to receive additional Rs48 billion if federal government transfer projected amount.

Revenues from Natural Gas

The revenue collected from supply of natural gas are treated as provincial revenues. Article 161 the Constitution of Pakistan mentioned three heads of revenues from natural gas i.e. Gas Development Surcharge (GDS), royalty and excise duty on natural gas as provincial revenues. Consequently, the revenues from these heads have been transferred to provinces after deduction of collection charges as straight transfers. However, after the 7th NFC award and the 18th Constitutional Amendment, the federal government introduced a cess on natural gas as Gas Infrastructure Development Cess (GIDC). The initial idea of this cess is to generate earmarked revenues for Pak-Iran gas pipeline. However, afterwards it was treated as a tax in federal government budget documents. The revenues from GIDC is growing and reached Rs88 billion in 2013-14 which are provincial revenues since it is collected from the sale of natural gas. Even if GIDC is a tax, it is not mentioned in the federal list of taxes and may be treated as a residuary subject and fall under the provincial domain. Moreover, revenues from natural resources like oil and gas are treated as provincial resources. Therefore, revenues from GIDC are provincial revenues and may be transferred to respective provinces.

Table 22
Gas Infrastructure Development Cess

(Rs. in Billion)

	Amount
Revised Estimates	
2011-12	8.0
2012-13	35.0
Budget Estimates	
2013-14	88.0
2014-15	145.0

Source: Federal Budget in Brief (various issues)

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