

### **Economic reforms: Part – XXXXII**

Continuing our discussion on the NFC Award of 1990, the provinces demanded a significantly larger share of the divisible pool, and more. They wanted that the federal government should continue to pick up their deficit besides handing over the sales tax as well as royalties on oil and the gas development surcharge. Although they didn't get everything they asked for, the provinces did succeed in getting a sufficiently high transfer of additional resources vis-a-vis the federal government.

Before we examine the details of the award, let's point out the concerns addressed by the commission. We have already noted the provincial arguments demanding a much larger share of resources.

From the federal government's side, there was no articulation, as was done in the 1960s, of what was happening to the overall credit of the federal government – the ultimate test of the sovereign standing of the country on the basis of which both foreign investment and much-needed resources could flow smoothly from investors and international lending agencies. Consequently, this important aspect of revenue-sharing was never discussed.

In fact, this aspect would also be consistently ignored in future awards as every commission would mean that more resources are needed to be transferred to the provinces. There is a very fine balance that has to be struck among federal resource mobilisation, the sovereign economic standing of the economy, fiscal and financial stability, and the need to expend centrally-mobilised resources at the doorsteps of the people. Reportedly, the 1985 commission had discussed some adjustments in vertical shares and had agreed to recommend a sharing ratio of 35:65, with some expansion of the divisible pool. But that report wasn't finalised.

The divisible pool was expanded by the president by adding excise duties on sugar, tobacco and tobacco manufactures. However, the commission didn't agree to reducing the provincial share in the divisible pool (vertical distribution) and maintained it at the ratio of 20:80, as was done in the 1970 and 1975 awards. The distribution among provinces (horizontal distribution) was based on population shares worked out on the basis of the 1981 census, with small adjustments based on the relative growth rates of provincial populations.

The commission did discuss the possibility of introducing other factors, such as relative collections for horizontal distribution. The provincial finance minister met separately to reach an agreement. The consensus emerged that population should remain as the exclusive basis for distribution.

The new award meant a significant boost to the provincial share in overall revenues. The 1975 award had assigned 29.8 percent of the total federal revenues to the provinces. With the new award, this ratio would jump to 35.3 percent. A marginal increase of 5.5 percent was indeed a major additionality made available to the provinces. There was more to come through the two new terms of reference assigned to the commission.

The most surprising inclusion in the terms of reference for the commission was the gas development surcharge (GDS) and royalties on oil. The GDS was imposed in 1967 through an ordinance and was an exclusive federal levy that wasn't included in the divisible pool. By sending a reference to the commission to this effect, a clear signal was given that the government wanted to share this tax.

Reportedly, Balochistan faced a significant decline in the net proceeds of royalties and excise duty on gas, which under Article 161(1)(a) was assigned to the provinces. Therefore, there was a need to strengthen its finances by assigning it a permanent and dependable source of the tax base. Although many proposals of sharing were considered, it turned out that the commission recommended the entire GDS revenues to be

given to the provinces in the form of straight transfers. Obviously, the horizontal sharing was relative to the gas production in each province.

Article 161(1)(b) deals with the excise duty on oil produced in a province and assigns it to the producing province. But it provides no directions on dealing with royalties on oil as it does for those on gas. Thus, this new reference to the commission provided an opportunity to deliberate on this subject. The commission decided to assign royalties to the province also.

While the royalty on oil wasn't a major revenue item, a constitutional issue was overlooked: what the constitution didn't give was given by seeking a recommendation from the commission. Meanwhile, the GDS was a significant source of revenues and remains so to this day. More importantly, the word 'surcharge' in the context of taxation was reserved, through a constitutional scheme introduced in 1935, for an additional charge/levy to be imposed, even if the tax proceeds were to go entirely to the provinces, exclusively for the federal government. A peculiar distortion was introduced by assigning the revenues of the surcharge to the provinces.

The provinces also demanded some concessions on their loan liability owed to the federal government. This demand was resisted on account of the fact that the expenditure estimates agreed by the commission had catered to debt-servicing and hence any further sharing of the burden wasn't justified. The provision of grants and subventions were also resisted by the federal government as it thought that sufficient revenues were made available relative to expenditure projections. After considerable debate, it was decided that grants and subventions would be made time-bound to three to five years only.

The commission didn't make any recommendations regarding the limits on the borrowing powers of the federal and provincial governments, which is included in the terms of reference. Yet, in a remarkable move, it made a recommendation that no previous commission had made previously: "In case of temporary imbalance, the federal government may permit the provinces to float market loans after due scrutiny or obtain ways and means advances from [the] SBP".

All previous commissions had underlined that the existing borrowing authorities were working fine and the borrowing needs of the provinces would be met through the federal government. Allowing provinces to borrow is tantamount to enlarging the overall fiscal deficit, which is unfeasible as the federal government itself faces a perennial deficit.

To be continued

The writer is a former finance secretary. Email: waqarmkn@gmail.com

Waqar Masood Khan