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Economic reforms: Part - XLVII

We now turn to the main features of the 7th NFC Award. After agreeing to a set of issues that the NFC were to consider, working groups were constituted to make recommendations for their resolution.

Some of these matters have already been covered in the last part of this series (March 20, 2019). The major issues that required resolution were: vertical distribution between federation and provinces, and horizontal distribution among provinces. Then there was the question of benchmarking revenue requirements based on expenditure projections.

Historically, the exercise of expenditure requirements has been controversial because every unit would attempt to overstate its requirements in the hope to secure a larger share. It is therefore not surprising that, despite carrying out this exercise, the distribution of resources was only tangentially concerned with expenditure projections. There were projections of revenues, expenditures and borrowing but those were not the basis of vertical transfers. How it was arrived at, we will see shortly.

The first meeting of the commission was held on August 27-28, 2009 in Islamabad and then it moved to all the provincial capitals and finally it held its sixth meeting in Lahore, for four long days on December 9-12, 2009. Provincial chief ministers also joined the negotiations. In a dramatic development, a record note was signed by the members, duly endorsed by CMs, announcing the agreement on the Award. It was only the 108th day since the first meeting. No previous democratic government since 1991 had reached an agreement on the Award. [The 1997 Award, which was reached in less than 100 days, was given by an interim government]. As we see, if the federal government is willing to concede provincial governments' demands, reaching an Award is not a challenge.

In a radical departure from the approaches of past awards, the 7th NFC set the following principles to determine the Award:

"The approach adopted by the seventh NFC is rooted on the premise that most of the development work needs to be initiated at the provincial level to ensure results at the grass roots level. Furthermore, the responsibility of providing social sectors services also rest with the provincial governments. As such the needs of the provinces must be addressed first.

"The commission was also of the unanimous opinion that the vertical programs of the federal government were not providing the desired results and should be thus reduced. Instead greater resources should be placed at the disposal of the provincial governments. The commission was also of the view that there is a duplication of functions ie the same functions were being performed by departments of the federal and provincial governments resulting in wastage of government resources.

"Thus, instead of determining the expenditures requirement of the federal and provincial governments simultaneously, in the first instance the requirements of the provincial governments would be assessed and worked out, and the share of the provinces in the divisible pool Taxes net [sic] would then be determined. After setting aside the provincial shares, the federal expenditures would be adjusted to maintain the borrowing level at an acceptable level".

Clearly, there was an abdication of federal responsibility in terms of its constitutional responsibilities. In fact, it was an indictment of the federal government's role in fiscal affairs. The primacy of provincial expenditures or abandonment of federal space of responsibility was unprecedented. An Award is reached when a unanimous recommendation is made by the commission, which is binding on the president to implement. Unless this happens, no Award is possible. Thus, there was no compulsion for the federal government to accept such vast amendment in fiscal responsibilities in favour of the provinces. However, the stage was set to transfer a major share of divisible pool, which was as broadly defined as in the case of the 1997 and 2006 awards.

Based on the above principles, the federal government voluntarily made an offer to increase the share of provinces to 55 percent in the divisible pool. However, on the insistence of the provinces, it was agreed that in the first year of NFC ie 2010-11, the provincial share would be 56 percent and for the remaining years the share would be increased to 57.5 percent. In another remarkable development, the federal government agreed to reduce the cost of collection from 5 percent to 1 percent, thereby enhancing the divisible pool by another 4 percent. Additionally, it was agreed that one percent of the divisible pool would be set-aside for (the then) NWFP as cost of war. Interestingly, this subject was not part of the terms of reference issued by the president for the commission.

There were many more deductions from the meagre share that the federal government was left with. First, as we had already noted in the last part of this series, a GDS liability of Rs10 billion was to be paid over a five year period. Second, there was an outstanding arbitral tribunal award of Rs110 billion against Wapda on account of net hydel profit, which was also agreed to be paid by the federal government, Rs10 billion immediately, and Rs100 billion to be paid over a next four years. [In the 1991 NFC, it was decided that this was the liability of the generating company].Third, the Sindh government was given an additional grant of 0.66 percent of its share in the divisible pool. Fourth, the Balochistan government was given an exceptional treatment by assuring a fixed amount of transfer irrespective of actual tax collections, the difference to be made up by the federal government.

It may be recalled that the Musharraf Award of 2006 had already pushed the share of provinces from 37.5 percent to 41.5 percent in 2006-07 and which was to gradually increase to 46.5 percent in 2010-11, the last year of the Award. In sharp contrast, the 7th Award gave a ten percentage point increase in provincial share in the first year and then added another one and half percentage to take it to 57.5 percent. Note that this is not the share out of the divisible pool of the past.

The pool was increased by 4 percent by reduced cost of collection besides additional deductions from the remaining share of the federal government. This Award would leave the federal government hugely handicapped to run its finances from its share in revenues.

To be continued

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

Waqar Masood Khan
Economic notes