INTERNATIONAL THE NEWS

30 October 2018

Economic reforms: Part-XXXII

In the next few parts in the series, we will narrate the evolution of fiscal federalism in Pakistan. This is a very sensitive subject as passions often mar rational discourse on the subject.

A momentous occasion in this regard was the 18th Amendment and the last National Finance Award announced just around the same time in 2010. There have been muted voices suggesting a revisit of the amendment, and rationalisation of the NFC Award which has led to significant fiscal imbalances. It is imperative that a dispassionate discussion is held on this subject, allowing lawmakers to assess the performance of these initiatives with respect to the goals originally set out for this purpose.

Fiscal federalism is a process through which the expenditure responsibilities, taxation authority and regulatory powers are distributed among different tiers of the government. A variety of considerations determine an efficient and equitable scheme of fiscal federalism. It needs to be emphasised that, whatever the constitutional provisions defining fiscal federalism, there is a single fiscal policy that emerges once the arrangements are executed. For a given fiscal constitution, policymakers at different tiers form their budgetary strategies which, taken together, is the overall fiscal policy of the country; it leads to certain fiscal outcomes, such as the overall fiscal deficit and path of public debt accumulation. An important aspect of this process is economic stability, particularly the mechanism for correcting economic imbalances.

An OECD study (2016), based on a comparison of 16 countries, has identified five building blocks of a system of fiscal federalism: (1) autonomy; (2) responsibility; (3) co-determination; (4) budget frameworks; and (5) stability.

Autonomy refers to the degree to which a given unit in federation is allowed fiscal freedom. This comprises powers of taxation, spending, borrowing and budgetary framework. Responsibility means the extent to which the unit is supposed to limit its fiscal affairs within certain constraints and the manner in which breaches would be addressed. Co-determination refers to the degree to which sub-national fiscal policies can be set by the federal government. Budget frameworks impose certain rules that constrain fiscal discretion. Stability refers to the ease with which constitutional rules affecting fiscal policy can be modified.

In Pakistan, constitutionally mandated fiscal federalism revolves around federal and provincial tiers of government. The constitution has not mandated a third tier of local government; fiscal federalism between provincial and local governments is regulated through arrangements designed by a province within its own legislative jurisdiction.

A significant amount of fiscal and regulatory autonomy is available to provinces with respect to subjects not enumerated in the Federal Legislative Lists Parts 1 and 2 (Article-70(4) and the Fourth Schedule). This division has evolved after a considerable degree of devolution of federal authority to provinces since Independence.

In 1947, under the Indian Independence Act, 1947, Pakistan adopted the Government of India Act, 1935 as its interim constitution. Under the act, distribution of powers followed a three-list method – federal, concurrent and provincial – with primacy to federal laws made on subjects in the concurrent list. The first constitution of 1956 enacted a unicameral legislature with only two provinces, East and West Pakistan. The division of powers followed the pattern of the 1935 Act, with the exception that residuary legislative powers were to vest in the provinces.

A major departure came under the 1962 constitution, which was a unicameral legislature with the presidential form but which simplified the distribution of powers by only specifying a much truncated federal list. All subjects outside the list were provincial. Notwithstanding this provision, the central government had overriding powers to legislate on any subject in the provincial list if the defence, maintenance of law and order and economic developments so warranted. The constitution of 1973 re-introduced the concurrent legislative list, whereas after the 18th Amendment, the concurrent list has been eliminated.

The 1973 constitution has made Pakistan a federal republic of autonomous provinces, barring some special areas. With the exception of a fairly narrow set of conditions, mostly relating to the defence and security of the country, the federal government doesn't enjoy any authority over matters falling under provincial jurisdiction. Therefore, the provincial governments are fully autonomous in incurring expenditures, setting budgetary priorities, raising revenues under their taxation authority, and spending federal transfers under the revenue-sharing arrangements, as they deem fit.

There has always been an issue over whether the responsibilities assigned to the provinces, entailing expenditure obligations, are commensurate with the resources from provincial resources and federal transfers. The main tax-bases – income and corporation taxes, excise and customs duties and now sales tax) have been assigned to the federal government. All constitutions stipulated revenue-sharing provisions for transfer of federal taxes among provinces (discussed in the next part).

Borrowing powers, on the security of their consolidated funds, have been allocated to both federal and provincial governments but the provincial governments would have to seek permission from the federal government if they were indebted to the federal government. This essentially means that the provincial governments are supposed to limit their budgetary frameworks within the resources they mobilise from their own sources and federal transfers. The latter remains the predominant source of provincial resources. There is an over-draft facility available to provinces from the central bank, which sets the deficit limit they can incur. Until the enactment of the Fiscal Responsibility and Debt Limitation Act (FRDLA), 2005, the federal government faced no limit on borrowing so long as expenditures were approved by the National Assembly.

In all constitutions the subjects of coinage, currency, central bank, banking, insurance, corporations and foreign exchange have been allocated to the federal government. In the next part, after discussing the evolution of revenue-sharing arrangements since inception, we will highlight the fiscal outcomes the above-mentioned fiscal federalism has produced.

To be continued

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