

Economic reforms: Part - XXXVIII

The 1962 constitution was promulgated in June 1962. In pursuance of Article 141, the first NFC was constituted on March 31, 1964, when the ad-hoc 1964 award was running in its second year. The commission was headed by Mr Mohammad Shoaib, the then finance minister.

With remarkable foresight, the commission laid out criteria for the consideration of revenue sharing, which comprised four elements: one, a strong and viable central budget is essential for sustaining and raising the credit worthiness of the country both at home and abroad. Two, a revenue surplus with the centre can be more easily conserved for development, and made available for financing the development expenditure of both the provinces and the centre. Three, there should be sufficient cushion left at the centre to enable it to render financial assistance to the provinces in times of unforeseen calamities and also to tide over the requirements of defence in any national emergency. And, four, customs revenue being susceptible to wide fluctuation for meeting a possible fall in revenue in bad days.

Evidently, the criteria reflected the concern that the level of transfer had been rising and could become a challenge for central finances. The elements of the criteria were all focused on underlining the importance of the centre's ability to preserve its financial strength and credit worthiness with the outside world. There was a presumption that resources in the hands of the centre were more reliable both for development and to meet unexpected contingencies. The susceptibility of customs revenues to international events, which was a source assigned to the centre, was also cited as a reason for the need to strengthen central finances.

The commission succeeded in formulating recommendations and presented it to the president for his approval. Without any modifications, which he could have made as per the constitution, the president accepted the recommendations.

The Distribution of Revenue Order, 1965 was issued by the president on July 1, 1965. The main provision of the order required: out of the net proceeds of the following taxes and duties, 65percent was assigned to the provinces and 35percent to the centre – (i) taxes on income, including corporation tax, but not including taxes on income consisting of remuneration paid out of the Central Consolidated Fund; (ii) sales tax; (iii) excise duties on tea, tobacco and betel nuts; and (iv) export duties on jute and cotton.

The share of the provinces in the divisible pool was increased from 60 percent to 65 percent for the taxes listed in (i) above. For the horizontal distribution between the provinces, however, the old formula of 54 percent and 46 percent for the country's eastern and western wings was retained. Additionally, it was agreed, as earlier, that 30 percent of sales tax receipts would be distributed on the basis of collections and 70 percent on the basis of the general formula.

An interesting development was the inclusion of export duties for division between centre and provinces on the 35:65 formula whereas in the 1962 Award 100 percent of it was given to the provinces. On the other hand, this was compensated by raising the division of income and corporation taxes at a 35:65 ratio as opposed to 50:50 in the previous award. The omission of estate and succession duties in respect of agriculture land and the taxes on capital value of immovable property meant these were fully devolved to the provinces for collection purposes also.

The overall provincial share in the divisible pool rose from 23.1 percent to 27 percent, which was a significantly improved level of transfer, allowing provinces to make their own choices for the purpose of development. [In the last article, the provincial share was erroneously stated as 27 percent] This shows the criteria laid out at the outset did not lead to reversal of an increasing trend in provincial transfers.

The 1965 award made several departures from previous awards. For example, it required provinces to deploy additional revenues only for the purpose of development. It exhorted provinces to redouble efforts towards the full potential of their own tax bases. Greater scrutiny of development spending was recommended with a focus on returns from investments and avoiding projects with low returns. Closer coordination between the development budget and foreign exchange budget was emphasised to ensure that only such projects were undertaken for which forex resources were available, so as to avoid a burden on the country's reserves.

In view of higher transfers, development grants were discontinued. And, in view of significant devolution under the new constitution, whereby many departments and institutions were transferred, it was decided to continue their financing – which, however, was frozen at the level of the 1964-65 budget. It was also decided that the grants-in-aid from the centre would not be tied to specific projects but for priority spending. The annual subventions of Rs29.9 million to the West Pakistan government was to continue. And, lastly, no change was recommended in the borrowing powers of the central and provincial governments were not set.

The limitation on the use of additional resources under the award for development purposes only was a remarkable condition. It could only be imposed under the 1962 constitution, which gave the president extraordinary powers. Future constitutions would not have such liberty. Continuance of financing for transferred functions, though fixed at the last budget level, was a sensible arrangement to enable provinces to build capacity and shift resources to the new areas of responsibility. Freeing up grant-in-aid from being tied to specific uses afforded provinces greater flexibility in setting their own priorities.

Perhaps the most significant decision of the award was about the borrowing powers of central and provincial governments, which were unchanged. It may be noted that, however deficient, this was the first political award since Independence and it was natural to deliberate on this important aspect of relative borrowing powers and limitations thereof.

The constitution allows borrowing within such limits as a law of the legislature would impose. In its absence, it is unlimited. This liberty is the source of the fiscal indiscipline that would eventually make our economy vulnerable once it was deregulated in response to pressures brought about by globalisation.

To be continued

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