

Beyond the NFC Award

Dr. Sania Nishtar

The National Finance Commission (NFC) will be announced by the Prime Minister in Gawadar today. Felicitations are due not only for the amicable coming to fruition of a process fraught with long-drawn disputes, but also for the innovations which have been introduced with regard to a set of new criteria. Indeed, the dispensation of vertical and horizontal distributions from the divisible pool have ensured a better deal for the smaller provinces, and can pave the way for better federal-provincial and inter-provincial relationships.

Before some of the constraints that stand in the way of achieving these objectives are reviewed, the issue of resource transfers should be examined more closely. Systemic resource transfers are not confined to the NFC, but occur at three other levels -- from the provincial to the local government; from the federal to the local government and from the local to another tier of the local government. There must be similar issues at these levels that are never brought to the fore, perhaps, since the local stakeholders do not wield the same influence as the provincial political hierarchy.

Additionally, there are random methods of resource transfers such as grants, which must be taken into account. This becomes important as the government is increasingly making use of debt swaps to free up resources, and in view of the envisaged inflow of aid under the new Kerry-Lugar arrangements. Although there will be no subventions and grants for provincial governments under the new NFC, given the 56 per cent provincial share from the divisible pool, a policy relating to random transfers will nevertheless bring greater clarity.

Now that the provinces are on their way to becoming more empowered, the question of other provincial taxes, which are to be levied and retained by the provinces such as the agriculture tax, should also be addressed squarely. There are political and capacity constraints in this regard. The extent to which the feudal dominated provincial assemblies will make headway in that direction remains to be seen.

An increase in financial resources for the provinces must bring to bear the poor correlation between total spending and intended outcomes, particularly development outcomes. Unless there are parallel efforts to improve returns on spending, not much will be achieved.

Several factors are known to impair the ability to expend; these include excessive centralisation of operational decision-making, onerous financial and administrative procedures, lack of accountability of decision-making delays, and limited capacity to plan and implement. An allied issue relates to quality of expenditures -- tracking of budgetary fund flows in the public sector shows a predominance of expenditures in May and June before the

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Governance

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In terms of returns on investments, the effect of corruption on compromising public investments in a highly-constrained environment must be taken into account. Leakage of funds from the system is an outcome of various forms of corruption. These occur because of poorly-managed expenditure systems and poor fiscal controls over flow of public resources.

Procurement graft is rampant and is fully institutionalised in many areas in provincial domains. It is, in fact, one of the 'easiest' ways of pilfering resources from the system. The recent attention to this systemic fault line should lend impetus to fully institutionalising procurement reforms.

In the same vein, it must be recognised that there is an additional responsibility that the provinces now have with regard to

generating surplus cash balance in order to meet budget deficit targets stipulated by the IMF in view of the limitations that the federal government now faces, due to a decrease in the size of its share in the divisible pool.

Coming back to the NFC, the importance of building capacity to deal with the matter on an on-going basis must be concomitantly underscored. Although the decision on the NFC award has been remarkably well handled this time round, it is not a guarantee that it will always be the case in the future, which is why institutional capacity is needed to track progress and inform policy in order to guard against any future deviations as has been the case with NFC awards in the past. Inclusion of net hydel profits and royalties and excise duties on oil and gas in the divisible pool, which caused federal provincial tensions for years, despite the clear constitutional stipulation that these should be dealt with outside of the NFC award, is another example, while reflecting back in history. Yet another is that of implementation of the GST on services by the federal government, revenue from which under the constitution should have accrued entirely to the provincial governments. Although these matters are now history given that they have been admirably resolved under NFC 2009, they have nevertheless set a precedent in the past.

Then there is the long-standing issue of tax devolution, towards which the provinces would like to move and policy issues with regard to pros and cons of tax devolution that need to be balanced. All these and other complex issues need policy guidance on an on-going basis. By creating a dedicated institutional resource for on-going policy guidance to strengthen fiscal federalism, NFC 2009 can have a sustainable impact on other awards in times to come.

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