

**FORUM OF FEDERATIONS: MAKING THE 18TH
AMENDMENT AND 7TH NFC AWARD WORK**

***ADEQUACY OF PROVINCIAL ASSIGNMENTS AND
TRANSFER DESIGN***

Islamabad October 30, 2010

BALUCHISTAN'S SOCIO-ECONOMIC PERSPECTIVE

- 1. Inadequate infrastructure of public utilities and services due to relative underdevelopment and historical differentials**
- 2. Lack of resourceful/entrepreneurial private sector for complementing public service delivery through private facilities in health, education, transport, housing sectors etc.**
- 3. Absence of public/private corporate head offices affecting revenue collection, employment opportunities and local commerce**
- 4. Inadequate development/exploitation of the provincial economic potential relating to functions in Federal List: regional communications, international trade, coastal resources etc.**
- 5. Near absent foreign investment in the Province**
- 6. Near absent commercial banks' loans/advances in the Province**

PRINCIPAL SOCIO-ECONOMIC DISPARITIES (RELATIVE)

Punjab: Population

KP: Poverty/Backwardness

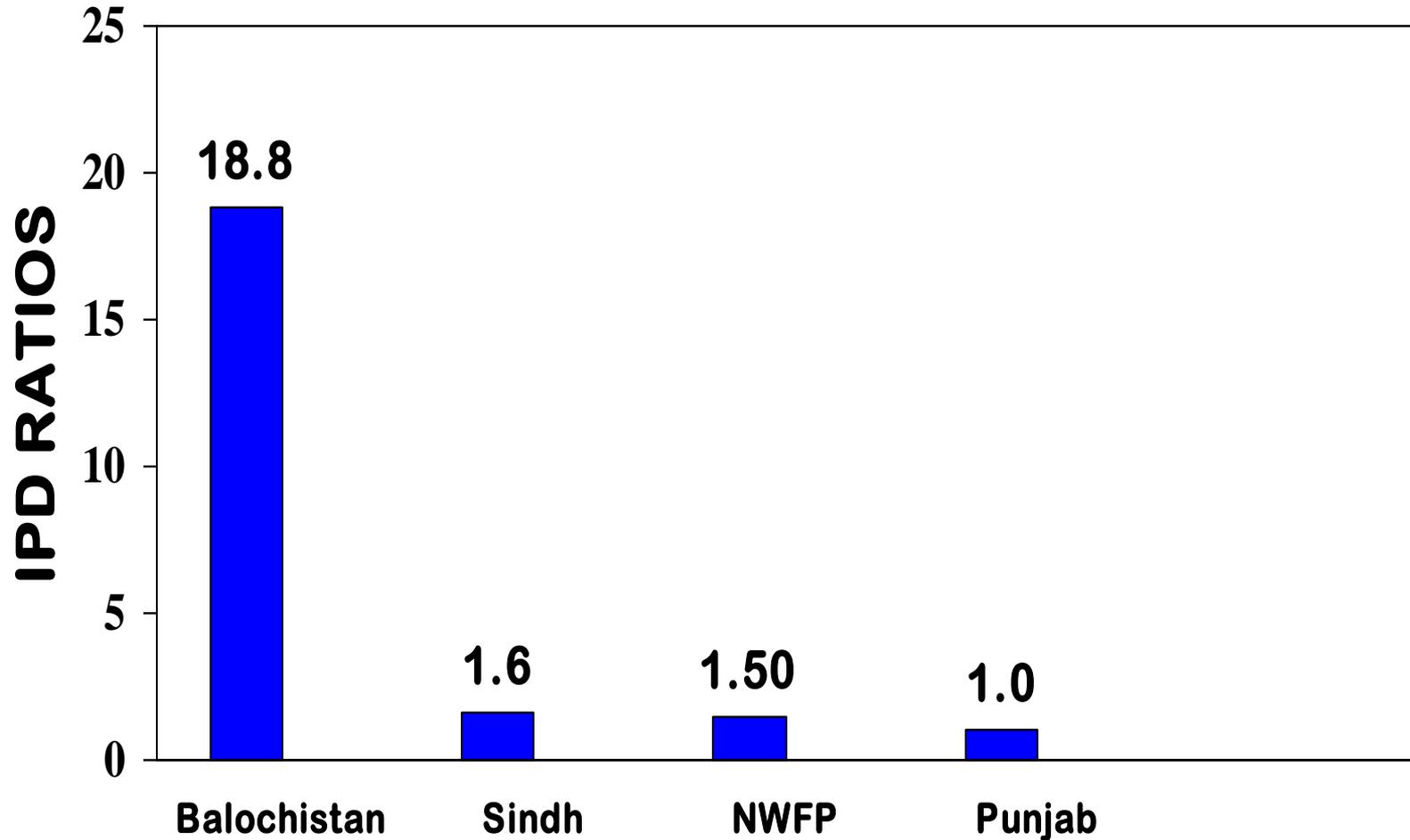
**Balochistan: Inverse Population Density &
Poverty/Backwardness**

Sindh: Revenue Generation/Collection

INVERSE POPULATION DENSITY

- **Relative per-capita cost of providing public services and development increases as area increases**
- **Relative per-capita cost of providing public services and development increases as population concentration decreases**
- **The ratio of **area**/**population** is called IPD.**
- **Relative per-capita cost of providing public services and development gets compounded and increases rapidly as IPD increases.**
- ➔ **IPD is an essential economic parameter for equalization of provision of public services and development in federating units.**

INVERSE POPULATION DENSITY RATIOS 2009-2010



BALUCHISTAN'S STRATEGIC CONSIDERATIONS FOR 7TH NFC AWARD

- 1. Increase in provincial share in the Divisible Pool: 60%**
- 2. Decrease in collection charge of 5% deducted by the Federal Government to actual (1 % approx)**
- 3. Broad-based horizontal distribution formula taking principal disparities of all provinces into account**
- 4. Revision in the formula for distribution of Gas Development Surcharge on equitable basis**
- 5. In view of growing resentment against perpetual grants/subventions Baluchistan expects a rightful share in the FDP that meets its budgetary needs sans subventions**
- 6. Settlement of publically perceived arrears of low rate of gas royalty and gas development surcharge from the time Sui Gas Field came on production in 1954**

BALUCHISTAN'S ANTICIPATED THRESHOLD

Population (Per capita equalization)	85%
Poverty/Backwardness (Horizontal equalization)	5%
Inverse population density (Cost of services and development equalization)	5%
Generation (Incentive for increased contribution to FDP)	5%
Total	100%

7TH NFC AWARD

VERTICAL DISTRIBUTION FORMULA

- **2009/2010 (Existing)** **47.5%**
- **2010/2011** **56.5%**
- **2011/2012 – 2014/2015** **57.5%**
- **Equivalent share**
 - **1% to KPK for war on terror** **0.5% (Approx)**
 - **Rs 6 billion/0.66% to Sindh** **0.5% (Approx)**
- **Net Equivalent Share of Provinces**
 - **2010/2011** **57.5%**
 - **2011-2015** **58.5%**
- **Additionally, collection charges reduction from 5% to 1% amounts to approximately 2.3% of the FDP to provinces**
- **Substantive increase (about 20% or Rs150 b above 2009/2010) in transfer of resources to provinces strengthening federalism especially provincial autonomy**

7TH NFC AWARD

HORIZONTAL FISCAL EQUALIZATION FORMULA

Indicators	weight	Punjab	Sindh	Khyber- Pakhtunkhwa	Balochistan
Population share (1998 Census)	82.0	57.36	23.71	13.82	5.11
Poverty/Backwardness	10.3	23.16	23.41	27.82	25.61
Revenue Generation/ Collection	5.0	44.0	50.0	5.0	1.0
Inverse Population Density (Area/Population Ratio)	2.7	4.34	7.21	6.54	81.92
Total share	100	51.74	24.55	14.62	9.09

Apart from the relative weights to be assigned to multiple parameters, the real challenge was faced in the provincial ratios especially for Poverty/Backwardness and Revenue Generation/Collection. Consensus was achieved through proxy indicators.

RESOLUTION OF OTHER ISSUES

- 1. Gas Development Surcharge distribution formula is changed: GDS and royalty equalized on per million BTU basis throughout the country resulting in about Rs 3 billion increase for Balochistan annually**
- 2. Publically perceived shortfall in payment of royalty and GDS from 1954 to-date including compound mark-up for Rs130 billions to be paid in annual installments to Balochistan**
- 3. Payment of arrears of the hydel profit was resolved to the satisfaction of Khyber Pakhtoonkhwa**
- 4. Rightful share of Balochistan is increased from 5.11% to 9.09% obviating the need for grants/subventions for running the budget**

WAR ON TERROR COSTS

FG has assumed the responsibility of bearing direct costs of the raging war on terror to the provinces and people but as a land mark show of solidarity all stakeholders have set aside 1.0 % off the top of undivided FDP for Khyber Pakhtoonkhwa for being the front line province bearing the brunt. This amounts to an equivalent to around 1.8% of the provincial divisible pool. This is a substantive message to the people suffering inexorably since the start of this war.

FEDERATING UNITS IN PAKISTAN

- 1. A federation with a predominant unit generally experiences a structural imbalance affecting federal harmony. In the 7th watershed NFC Award the predominant unit in our case played an harmonizing and unifying role of forging a consensus by offering a net reduction in its percentile share to shore up the share of Balochistan. Other provinces joined in an unprecedented show of federal solidarity and conceded their shares to give Balochistan 9.09% of the divisible pool. The structural weakness that arises from anomalous sizes of the federating units has thus been covered through cooperative approach which is a hallmark of strengthening federalism.**
- 2. Another extraordinary measure has been unanimously approved by FG and provinces in the Award to guarantee the transfer of projected revenues to Balochistan for the full term of five years to provide it the fiscal stability to catch up in development and improvement in service delivery.**
- 3. Both the smaller provinces of Balochistan and Khyber Pakhtoonkhwa did receive a boost in their share of revenue.**

TRANSFER DESIGN

1. **Nearly 90% of provincial expenses are met through federal transfers because of centralization of collection. It becomes very critical for the provinces to receive money regularly to run the governments smoothly.**
2. **Monthly transfers were introduced on express demand of the provinces to ensure regularity of receipts.**
3. **Revenue collection is seasonal and back loaded; most of the revenue is collected during the last quarter of the year (April-June)**
4. **Seasonal revenue collection and monthly transfer disconnect creates serious problems for the provinces in planning, development and current expenditures resulting in frequent overdrafts.**
5. **Due to circular debt in the energy supply chain E&P companies are also holding the payment of royalty on oil and gas to the provinces which aggravates their cash flow problems. The provinces in turn add to the circular debt by piling up unpaid energy bills.**

TRANSFER OF CONCURRENT LIST FUNCTIONS TO PROVINCES

- 1. 18th Amendment meets the long standing demand of transferring all Concurrent List functions to the Provinces. This restructuring is complex and time consuming. Theoretically the additional functions will also bring their share of budgets but practically it is likely to introduce additional budgetary pressure on the provinces because of the economies of scales. The distribution of the federal budget relating to the devolving functions should take the provincial economies of scales into consideration**
- 2. Provinces will need to go vigorously through capacity enhancement. The federal reform of transferring functions to sub-national governments would bear fruit only if the provinces are able to improve the service delivery in the devolved functions. This marks a priority undertaking as the government grapples with the implementation of this reform.**

WAY-OUT AVENUE

- 1. Some federal revolving/stabilization fund is needed to render the transfer design responsive and efficient. All stake-holders need to come together to create a revolving stabilization fund to cushion the seasonality in collection and ensure regularity in transfers.**
- 2. Borrowing by FG is creating fiscal strain and restricting credit facilities to private sector development activities.**
- 3. One-time initiative is needed to circumvent the circular debt and render the energy sector solvent.**
- 4. The mounting cost of war on terror and tens of billions of dollars lost in the unprecedented floods have compounded the financial challenges. Crucial development activities could suffer indefinite slippages for a number of years.**
- 5. An easy way-out is not in sight. The situation demands paramount commitment to financial discipline and improved governance. In this challenging scenario the advent of independent judiciary provides a solid silver lining around the dark clouds over the national horizon.**

Thank you!