**[Perspectives on NFC Award](https://www.dawn.com/news/1831377/perspectives-on-nfc-award)**

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EVER since the seventh NFC Award was finalised in 2010, it has been vilified in many quarters for ‘bankrupting’ the centre. Of recent, demands for revisiting the [award](https://www.dawn.com/news/1822745) have gained momentum after it was reported that it has been put on the table by the IMF for discussion.

On the face of it, blaming the seventh NFC Award is not without merit. Pakistan’s public finances are in a Ponzi game now, and have been so for several years. With the lion’s share of the federal divisible pool going to the provinces since 2011, the centre’s share of retained revenue has been progressively meeting a smaller, and declining, proportion of its growing expenditure. This has forced the centre to borrow heavily. With concessional sources of external financing drying up, the borrowing has come largely from high-cost, shorter tenor domestic borrowing. This has laid the basis for the unsustainable debt dynamic witnessed over the past several years, whereby debt servicing now accounts for well over 100 per cent of net federal revenue.

Given the above fiscal path since its implementation, it is not surprising that the seventh NFC Award is widely blamed. However, the criticism is usually not anchored in a proper context and is misleading in important aspects. As the principal economic adviser at the Ministry of Finance at the time, I can perhaps proffer a somewhat fuller, and more balanced, account of the underpinnings of the seventh NFC Award. (There has been some excellent commentary in the newspapers over the past few weeks, but these have taken either a centre-centric view or a provinces-centric one).

It will be useful to begin by stating the rationale for the NFC Award. The Award is not just a constitutional requirement, but is also an imperative for the kind of participatory federalism that Pakistan aspires to. Barring a few items, the main expenditure assignments relating to social spending and public service delivery, such as education and health, are in the domain of the provinces. Hence, the NFC Award is designed to serve an all-important fiscal equalisation objective by providing the necessary fiscal resources to provinces to meet their expenditure mandates.

A more cautious and nuanced approach needs to be taken with regards to the NFC Award.

In line with this imperative, the conceptualisation behind the seventh NFC Award was that the centre would transfer more fiscal resources to the provinces, while also transferring, under the soon-to-follow 18th Amendment, expenditures it was incurring on their behalf. In addition, the provinces had been told clearly that the seventh NFC Award was only sustainable if jointly, tax revenue worth an additional three per cent of GDP was not raised in three years. The targeted increase in the tax-GDP ratio over a five- to seven-year period was an ambitious 5pc of GDP. (The potential ‘unworkability’ of the Award without the additional tax revenue had been clearly discussed with the provincial finance ministers).

It was expected that the provinces would step up their till-then underwhelming tax effort, and start leveraging their substantial tax bases of urban immoveable property and agricultural income. It was hoped that services would be brought into the tax net via a modern, integrated (ie goods and services) value added tax — a route adopted by India years later. This efficient solution, however, was shot down by one of the larger provinces, even though it was, and remains, a sensible path to take for its ‘informational’ value, and to address the challenge of the split tax bases.

Finally, the expectation was that the NFC Award would lead to fiscal decentralisation, with provinces enacting local governments into existence and setting up provincial finance commissions to finance them.

Despite the ‘neat’ architecture drawn up by the then-finance minister to safeguard against several of the pitfalls the Ministry of Finance and its advisers had pointed out, numerous loose ends in both the conceptualisation as well as execution of the award remained. The most important one was that the commitment of the provinces to raise their tax effort was not made a binding part of the seventh NFC Award. In addition, while a weak implementation mechanism was agreed upon, no proper oversight mechanism was put in place to monitor how the additional fiscal resources were being put to use, or oversee the progress on fiscal decentralisation.

Among the biggest concerns expressed was regarding the perverse incentives the generous award would set up for the provinces in relation to own-source revenue mobilisation. This is borne out by the fact that while the provinces claim outstanding success in their revenue mobilisation since the seventh NFC Award, in ‘real’ terms their tax effort remains underwhelming. The provinces continue to collect less than 1pc of GDP in taxes, or around 8pc of total tax collected nationally. Tellingly, they finance only around 16pc of their expenditure with their own revenue.

However, this is only a partial explanation at best, since it does not explain the centre’s own poor performance at moving the needle on tax collection since 2010, despite the substantial positive incentive to do so.

There are a lot of ways the existing NFC Award can be improved. These include introducing needed safeguards, correcting the perverse incentives, linking the award to outcomes both on the revenue as well as expenditure side, and exploring how provinces can contribute to debt servicing as well as electricity circular debt. For starters, collection charges of at least 2pc of the divisible pool should be returned to FBR. In addition, strengthening the role of the Council of Common Interests as an oversight body is required. Each of these recommendations will be given fuller treatment in a subsequent article.

Revisiting the seventh NFC Award is an important element of the effort to restore a semblance of stability to Pakistan’s fiscal framework, but it cannot be the only component. Importantly, it should be approached with caution, and should not be an external- or unilateral centre-driven exercise. Rather it should be a collaborative exercise with the provinces fully on board.

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*Published in Dawn, May 4th, 2024*