

26th Annual General Meeting and Conference
Pakistan Society of Development Economists

Fiscal Decentralization: Empowering the Provinces, Strengthening the Federation

With the passage of the 18th Constitutional Amendment, Pakistan has taken a major step towards fiscal decentralization. While the Amendment has conferred substantial economic authority upon the provinces the 7th NFC Award has allowed transfer of more funds from the federation to the provinces. The provinces will now have the authority over a range of functions from the provision of health and educational facilities to the development of physical infrastructure and from electricity generation and distribution to the management of the environment. A fundamental shift in the division of powers between provinces and the center is thus clearly emerging, and this has far reaching implications for the country's long term development and growth prospects. Whereas fiscal decentralization is expected to provide effective mechanisms for achieving various development goals, its success will depend in large measure on striking a right balance of power between the provinces and the federation that empowers the provinces while at the same time strengthens the federation.

Against this backdrop "Fiscal Decentralization: Empowering the Provinces, Strengthening the Federation" has been chosen as the theme of this year's conference, to be held from December 28-30, 2010. It is hoped that the conference will be instrumental in encouraging research and dialogue on the key issue of fiscal decentralization and its implications for Pakistan's economic development. The sub-themes of the conference, within the broader context of fiscal decentralization, include:

1. Macroeconomic management and economic planning
2. Taxation in a decentralized setup
3. Financing megaprojects
4. Managing the social sectors
5. Learning from international experience
6. The 7th NFC award

A brief on some of the key issues and questions that may be addressed under each of the sub-themes follows:

1. Macroeconomic management and economic planning

With fiscal decentralization have emerged new issues of macroeconomic management and economic planning. After the transfer of more money and powers to the

provinces, the respective roles of provincial and federal governments in macroeconomic management and economic planning will have to be redefined. What would be a desirable arrangement for the division of powers between the provinces and the federation in terms of tapping new avenues for resource generation, management of fiscal deficits, and allocation of the development budget? How can macroeconomic policies at the two levels of government be aligned so as to achieve the objective of macroeconomic stability and robust economic growth? Research on these questions can provide insights into designing appropriate frameworks for macroeconomic management and economic planning at the two tiers of the government.

2. Taxation in the decentralized setup

Fiscal decentralization envisages a more active role of the provinces in taxation matters. How can the transfer of fiscal powers to the provinces be leveraged to tackle the stubbornly low tax-to-GDP ratio? Research on this question may shed light on ways in which the provincial governments can expand the tax base as well as on identification of new potential avenues for revenue generation. Additionally, the provinces, laced with more fiscal powers, are expected to compete with each other to attract businesses through tax incentives. Such competition may encourage the provinces to keep taxes low at the cost of fiscal stability. Research may inform how the provinces may coordinate their tax incentives for businesses so as to maintain fiscal discipline.

3. Financing megaprojects

The Amendment allows the provinces to develop physical infrastructure including such megaprojects as power generation and distribution. Research may inform how the provinces can generate adequate funds to finance these megaprojects? The Amendment also allows the provinces to negotiate foreign loans. What should be the desirable modalities for such loans? Funds in international bond market might be available only against securitization of assets. What kinds of assets the provinces may securitize? How the provinces may secure credit ratings is another area that requires attention.

4. Managing the social sectors

With the passage of the Amendment social sectors like health and education are now in the sole domain of provinces. How can the provinces build their capacities and generate resources for effective public service delivery in social sectors? Whereas the provinces seem to be better positioned to offer social safety nets, different levels of spending across the provinces may raise equity concerns as well as engender what the Public Finance literature refers to as the “Tie Bout process” ---- people ‘voting with their

feet', that is, migrating to areas with greater social security or lower taxation. How can the provinces coordinate their spending on social safety nets to maintain an equitable system of social protection across the provinces?

5. Learning from international experience

Fiscal decentralization has been in vogue in a number of countries since long and Pakistan can learn a lot from their experiences. What is required is an identification of international best practices and tailoring these to suit local conditions.

6. The 7th NFC award

For 63 years of Pakistan's existence, the population has remained the sole criterion for distribution of federal resources amongst the provinces. The 7th NFC award has broken with the past to introduce a multiple criteria of resource distribution. The new criteria as well as the weights assigned to the different components of the criteria needs a thorough analysis focusing in particular on implications for economic growth and welfare. It is noteworthy that Award was announced months before the 18th amendment was enacted. In all probability, the Award had not envisaged the transfer of numerous functions to the provinces. The Award distributes the funds between the federation and the provinces in the ratio of 43:57. Given the Amendment, should this ratio be reviewed? Should the divisible pool of funds be enlarged?