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# Fiscal Federalism in Pakistan: A Political-Economy Analysis of the National Finance Commission Award and the Limits of Provincial Autonomy

**Ayesha Aqeel**
Visiting Lecturer, University of Central Punjab, FAST University, Lahore, Punjab, Pakistan
ayeshaaqeel14@gmail.com
**Muhammad Asif**
Lecturer, FAST NUCES, Department of Sciences and Humanities, Lahore, Punjab, Pakistan
asif1797@gmail.com

**Abstract**
*The devolution of fiscal resources in Pakistan can be traced back to the successive National Finance Commission (NFC) Awards. Fiscal decentralization has further been reinforced with the passage of the 18th Constitutional Amendment Act 2010. With devolution it became evident that provinces were to receive greater fiscal and administrative responsibilities. However, problems with vertical and horizontal fiscal balances, lack of tax assignment and complaints of smaller provinces receiving unequal access to resources remain relevant. This study assesses whether decentralization of finances since the passing of the 18th Amendment has met its goals and identifies why institutions and politics, more specifically Pakistan's civil-military hybrid political structure, have prevented provinces from obtaining complete fiscal independence. Qualitative assessment of NFC Award formula, provincial revenues and expenditures, as well as stakeholder interviews served as a tool to understand why provinces are unable to fully capitalize on the fiscal guarantees provided for by the constitution. This research provides policy relevant recommendations for establishing sustainable, equitable and transparent fiscal federalism in Pakistan.*

***Key Words***
*Fiscal Federalism, 18th Constitutional Amendment, National Finance Commission, Provincial Revenue, Decentralization*

## Introduction

Federalism has manifested itself quite pervasively in recent discourse surrounding governance, particularly throughout the developing world. Fiscal federalism, developed off of a robust theoretical framework of decentralization of fiscal authority and functions amongst different levels of government, encompasses a wide array of institutional fiscal arrangements contingent upon varying governmental capacity and political environments. The ensuing allocation of functions, finances, and power among different levels of government culminate to have crucial consequences on social development.

The structure of Pakistan's federal system has been shaped throughout a highly dynamic historical and political development. Milestones in Pakistan's pursuit of fiscal federalism include the implementation of the 18th Constitutional Amendment, which devolved a significant amount of authority and spending responsibilities to the provinces from the federal government, particularly within social sectors. Moreover, the 7th National Finance Commission (NFC) Award was also a pioneering step towards ensuring a fair share of federal resources for provinces; specifically with regards to inter-governmental fiscal transfers, as it introduced several criteria on which the horizontal distribution of divisible pool revenues would be based. However, despite these significant reforms, there have been no improvements to the tax assignment structure within the country. Intergovernmental tax arrangements remain arbitrary and have been the cause of inefficiencies within the system, extreme vertical imbalances, and provincial reliance on the federal government. Discussions have been had surrounding many elements of fiscal federalism within Pakistan including; the current mechanics of revenue collection and sharing, how further autonomy for provinces would impact spending, and the structure of the NFC itself.

With many of these critical issues being discussed in current dialogue, this paper attempts to add to the conversation by revisiting the principles of fiscal federalism theory and applying them to Pakistan. This section includes calculations to demonstrate the fiscal impact of the 7th NFC Award as well as analysis of how increased provincial resources could affect economic growth. Recommendations provided in this report are context-specific and provide suggestions to help revisit resource distribution and limit reliance on fiscal transfers.

**Literature Review**

Dr. Manzoor Ahmed in his article titled "The Political Economy of Fiscal Decentralization in Pakistan: A Historical Perspective" researches upon the issues associated with the divisible pool of taxes revenues & non-tax revenues expenditures responsibilities of both federal and provincial government & its history. Federal Government has always come under criticism of over-centralization when it comes to revenues collected by it. Out of total taxes revenues & non-tax revenues collected by the federal government it transfers some to provincial governments through NFC Award. There have seven NFC Awards after the independence Pakistan and except 1974 NFC Award increasing trend towards fiscal decentralization is visible. Though since NFC of 1990 process towards decentralization started picking momentum, still a quantum leap towards real fiscal decentralization was witnessed in 7th NFC which was concluded in year 2009. In this award 7th NFC rationalized intergovernmental fiscal relations by expanding divisible pool (bringing more taxes under its umbrella) & increasing provincial share& most importantly added more criteria for horizontal distribution other than population. As results financial position of provinces became strengthen & gave them fair level of autonomy (Dr. Manzoor Ahmed, 2014).

Article "Issues in Fiscal Governance: A Case of Pakistan" writers Dr. Muhammad Abdul Mateen Khan states peoples have been denied their right to become part of decision-making process (as oppose to democratic dispensation) at grassroots level in state structure. Writer attempt to highlight main pillars of fiscal governance in Pakistan, evaluate fiscal institutions efficiency, scrutinize impact of fiscal policies on economic growth & stability & review issues in raising revenue. Writer use descriptive- analytical approach to analyze the main topic of discussion. Writer concludes by suggesting policy should develops in such a way that there must be held regular elections at grass root level and rules and regulations about duration and tenure of every elected representative should be made clear to them elected representatives will feel that their vote bank and their term depend upon local citizens (Dr. Muhammad Abdul Mateen Khan, 2023).

World Bank Country Director for Pakistan Bolormaa Amgaabazar in her Article titled “Fiscal Federalism” published in Dawn News website writes about new World Bank Report which focus on improving federalism in Pakistan. Author states that Pakistan must bring reforms in its Fiscal Federalism structure as it is about to start work on 11th National Finance Commission (NFC) Award. She mentioned that how legislature changes failed to bring federal spending in line with provincial responsibilities and led to a structural budget deficit and increasing country’s debt. In addition to that she also highlights how world bank point out fragmented tax system which failed to capture major sources of revenues like agriculture and property taxes which ultimately leads to a very low tax-GDP ratio. World bank also finds that most of Provincial funds are diverted to cover administrative cost rather than being invested in important sectors like health and education. To overcome from these Issues World bank proposed solution should be that taxes should be collect centrally and Government expenditures should be rationalized and Provincial funds must be linked with accountability. Along with NFC Award reforms would help Pakistan provide better services to its citizens, enhance fiscal sustainability and boost long-term economic growth (Amgaabazar, 2026).

In their Report titled “Federalism in a Hybrid Regime: The 18th Amendment in Pakistan” Authors Yasser Kureshi, Asad Sayeed, Zoha Waseem and Sidra Adil argue that due to hybrid political setup decentralization process in Pakistan had crippled. Federalization process in Pakistan had been started from the year 1947 has always been centralized. Authors also provide few examples from Pakistan history like in 1955 one-unit plan was devised & implemented, sense of insecurity and threat perception from Sheikh Mujeeb-ur- Rehman’s six points pushed civil and military leaders to kinetic solutions which finally led to separation of East Pakistan. Author goes on explain how historic mistrust of Muslim majority provinces towards the powerful Punjab continues to shape politics in Pakistan. Today, similar fears and apprehensions around provincial autonomy and decentralization continue to linger within Pakistan’s federal civil and military bureaucracies and even some political parties. When Pakistan’s elected legislature was able to find some common ground around decentralizing power in Pakistan through the 18th constitutional amendment in 2010, the military pushed back with similar alarm.

General Bajwa, the Chief of Army Staff, warned in explicit terms that the 18th Amendment was “more dangerous than Mujib’s six-point formula.” In fact, a centerpiece of what came to be known as the “Bajwa doctrine” was rolling back and reversing the effects of the 18th Amendment. Reflection of 18th constitutional Amendment is also mentioned in report. The amendment impacted every province of Pakistan but developed governance capacity of provinces didn’t improves which also led to recentralization of power. To conclude we can say that 18th Amendment is Pakistan’s most important constitutional reform since 1973. It had strong federalism and provincial autonomy notably in fiscal matters but decentralization of power was not equally seen in every sector. Full implementation of the amendment was stopped by hybrid political system of Pakistan as few powerful unelected institutions still hold the power to intervene in governance of Pakistan (Yasser Kureshi, 2024).

Mohammad Asif concludes in his paper “Fiscal Federalism in Pakistan: A Critical Analysis of the National Finance Commission Award and Resource Distribution among Provinces” based on his research analysis that still in the contemporary environment there are some shortcomings in distributing resources particularly when it comes to smaller provinces including KP, Sindh, and Baluchistan although there were constitutional guarantees and amendments made to previous policies. The article reviewed the NFC Award (National Finance Commission Award), as an instrument of fiscal federalism in Pakistan, and focuses particularly on resource distribution among provinces. The study draws conclusions about the history, evolution, constitutional basis, and socio-economic impact of NFC Awards (especially after the 18th Constitutional Amendment) to assess the subject through both qualitative and quantitative analysis. The 7th NFC Award in 2009 introduced a multi-variables formula but still various gaps in the implementation of the formula politically and through lobbying along with institutional inefficiencies that is affecting fiscal balance negatively. The article concludes with a policy recommendation that there should be a push toward more transparency, provincial empowerment, and constitutional compliance if we are to achieve a fairer and more sustainable fiscal federal structure (Asif, 2025).

Ayesha Aqeel in her article “Federalism and Ethnic Conflict Management in Pakistan” stated that economic inequity at the provincial level is pervasive nature. If we see the situation with a little retrospection then it could be noticed that how federal governments have handled provinces with an air of supremacy and contempt. Provincial disparity and resentment toward the federal government is mostly due to non- consociational environment. Conditions have been created by discriminatory economic policies adopted by successive governments at the federal level. Grievances over sharing of economic or financial resources have been the main source of discontent in the relations between the federal government and provinces. Unfortunately, provinces have never been well-disposed toward the method of distribution of these resources. Provincialists claims that the federal government has coerced federating units into accepting the formula of distribution of resources (Aqeel, 2024).

Muhammad Asif Iqbal and Muhammad Sabir state in their article “Strengthening Fiscal Federalism in Pakistan: The Way Forward” that Pakistan’s federal system of government has been shaped by a historical and political journey. The historic 18th Constitutional Amendment further strengthened fiscal federalism by devolving authority and responsibility for significant expenditures to the provinces, particularly for providing public social services. Likewise, the seventh National Finance Commission (NFC) Award was also commendable, particularly in terms of the fiscal transfers between governments and introduced multiple criteria for horizontal distribution of divisible pool transfers. However, reforms have not seen any major change in the tax assignment structure of Pakistan. The tax assignment in Pakistan is still arbitrary and it leads to creation of diseconomies, huge vertical imbalance, and provinces being reliant on the federal government (Muhammad Asif Iqbal, 2018).

The literature on fiscal federalism in Pakistan examines, for the most part, how federal fiscal arrangements developed historically and constitutionally; reviewing the history of various NFC Awards and exploring how the 18th Constitutional Amendment helped to decentralize fiscal authority and responsibility to the provinces. The literature provides a good analysis of what is structurally imbalanced about Pakistan’s fiscal federalism (vertical fiscal imbalance, tax assignment is too centralized and rigid, horizontal disparities between provinces remain contested despite various formulas introduced in NFC Awards, and more.) However, these works fail to explain why these gaps in fiscal federalism exist. Why have historical and constitutional guarantees failed to achieve a more equitable fiscal system, particularly for smaller provinces like KP and Baluchistan? Asif touches on the point that politics and institutional inefficiencies affect implementation of the NFC Award but this is presented as an observation and not grounded in any political economy argument about why these mechanisms continue to operate today.

**Theoretical Framework**

The theoretical framework of this paper is Second-Generation Fiscal Federalism (SGFF) Theory. SGFF conceptualizes fiscal federalism not as a technocratic exercise aimed at appropriately allocating revenue and expenditure assignments across various levels of government (as traditional fiscal federalism theory would suggest), but as a product of political-economy factors including elite negotiations, institutional behavior motivated by self-interest, and rent-seeking behavior of both federal and provincial stakeholders. SGFF Theory differs from First-Generation fiscal federalism by challenging the assumption that governments are unitary actors concerned primarily with maximizing social welfare; under SGFF, policymakers and political institutions respond to their own sets of incentives and may act in ways that circumvent or contradict an otherwise well-designed constitutional or legislative framework. By utilizing SGFF Theory, this paper examines how institutional motivations of vested interests in Pakistan can explain why policies on paper that aim to ensure a fair distribution of resources – including the distribution formula based on multiple criteria agreed to in the 7$^{th}$ NFC Award and the formal devolution of subjects in the 18th Amendment – have failed to yield fiscal justice: the centralization of tax assignment, reluctance of the federal government to devolve revenue raising capacity to the provinces, and provincial mismanagement of resources are all rational policy outcomes derived from self-interested provincial institutions acting within Pakistan’s current set of incentives (Muhammad Asif Iqbal, 2018).

**Research Methodology**

The design of the proposed study is qualitative exploratory case-study in nature. Secondary sources of data such as NFC Award documents (all seven awards), federal and provincial budget statements, Ministry of Finance reports and documentation from other international bodies such as World Bank would be used to map revenue and expenditure responsibilities across various tiers of government as they have been assigned over time as well as how provincial fiscal positions have changed overtime.

**Research Questions**

i. To what extent has the NFC Awards achieved genuine fiscal decentralization in practice, as opposed to on paper?
ii. What reforms could realign institutional incentives to improve transparency, provincial autonomy, and constitutional compliance in Pakistan's fiscal framework?

**Historical Background of Fiscal Federalism and NFC Awards in Pakistan**

Fiscal or Financial federalism was coined by an American Economist Richard Musgrave in his book named “The theory of Public Finance.’’ in year 1959. The term is used to define financial relations and distribution of revenues among different tiers of governments. It is always a difficult job if economic disparities are too high among provinces due to unbalanced growth. According to Musgrave, central government’s job should be income redistribution and stabilizing economy while provinces are responsible for efficient allocation of resources so it helps to combine bigger vision with effective voice of small interests (Hussain, 2018). In Pakistan, fiscal federalism operates mainly through the Constitution of Pakistan of 1973. Articles 160–165 deals with fiscal federal structure and NFC act as main instrument to share the revenues between center and provinces. Fiscal federalism of Pakistan has changed drastically from a highly centralized system at the time of independence to decentralized fiscal federalism system especially after 7$^{th}$ NFC Award (2009) and 18$^{th}$ constitutional amendment (Iftikhar Ahmed, 2007).

**Pre-independence Revenue Sharing Formula**

Proceeding with Niemeyer Award (under the 19 35 Act), distribution of resources was made between federal and provincial government of British India. As per this award tax on sales was made provincial subject while tax on income, whose proceeds were to be redistributed, was fixed at 50 percent of total collection. After independence, with the creation of Pakistan, same award was used till March 19 52 though there were some amendments made in the Railway Budget and sharing in income tax and sales tax was agreed upon (Iftikhar Ahmed, 2007).

**Early Evolution of Fiscal Federalism (1947–1973)**

Pakistan began with a centralized financial system in 1947 where almost all taxes and expenditures were controlled by the Federal Government while Provincial Governments were financially dependent on transfers from the federal government with no set formula. The degree of centralization reached its peak in 1955 through the introduction of the One-Unit Scheme that created resentment in smaller provinces leading to political instability that eventually culminated into East Pakistan seceding in 1971. Pre-1973 constitutional arrangements witnessed interim revenue allocation plans such as the 1951 Raisman Award followed by revenue sharing formula of 1961 and finally the 1970 revenue allocation formula which failed to provide a permanent and equitable fiscal system for cooperation between governments (Waseem, 2010).

**Fiscal Federalism under the 1973 Constitution**

The **1973 Constitution** established Pakistan as a federal parliamentary state and provided a constitutional framework for intergovernmental fiscal relations.

Key constitutional provisions include:

- **Article 160:** Establishes the National Finance Commission (NFC).
- **Article 161:** Distribution of net proceeds from natural resources.
- **Article 162:** Taxation on inter-provincial trade.
- **Article 163:** Grants-in-aid.
- **Article 164:** Borrowing by provinces.
- **Article 165:** Federal and provincial taxation powers. (Iftikhar Ahmed, 2007)

NFC stands for National Finance Commission; it is simply the formula or method through which the federal divisible pool distributes its resources amongst the federal and provincial governments. Federal divisible pool are those funds of taxes collected by the federal government which are income tax, sales tax, capital value tax, federal excise duties that are later distributed amongst the provinces and federal government. Taxes or resources in NFC are divided through vertical and horizontal formulas. Vertical is the division between the federal and provincial governments, whereas horizontal distribution takes place amongst the provinces only (Mustafa, 2009).

Every 5 years, as mentioned in the Constitution, the President is required to make up the National Finance Commission. The body will make recommendations to the President of Pakistan regarding; Taxes, export duties and excise duties, Grants, aids given by federal government to provinces, Provincial borrowing from the federal government, or any other matter put forward by the President about finance. If after 5years they are unable to agree on the new criteria of NFC award, the previous one will extend for five more years through the presidential order. For instance, there was a consensus made in 20-10 regarding 7th NFC award and now till date there is an issue about the 11th NFC award. Provincial finance ministers, Experts nominated by the provinces, Federal finance Minister (Chairperson) and Federal representatives are included in NFC (Hussain, 2018).

**i. First NFC Award (1974)**

Introduced by Prime Minister Zulfikar Ali Bhutto, the First NFC Award gave effect to Article 160 of the Constitution. Population was accepted as the sole criterion for allocation of shares to the provinces in the divisible pool. The Award continued the trend of marked federal fiscal dominance even though constitutional changes had been made because the provinces did not have substantial taxation powers of their own and relied heavily on federal transfers. Resources continued to be shared vertically between federal and provincial tiers at 20:80 ratio respectively. Punjab' share because of criterion of population jumped to 60.25 percent from 56.50 percent of (1970 award) while it reduced shares of the other provinces. Rs 50 million and Rs 100 million annual grants were also announced to Baluchistan and NWFP governments respectively to compensate them for their weak fiscal position (Iftikhar Ahmed, 2007).

| | | | |
|---|---|---|---|
| Punjab 60.25% | Sindh 22.50% | NWFP 13.39% | Baluchistan 3.86 |

**Source: Figure 1 (Governmet of Pakistan Finnace Diviosn , 1975)**

**ii. Second NFC Award (1979)**

Efforts were made to amend the fiscal setup during General Zia-ul- Haq's martial law government. The 2nd NFC award was formed under finance minister Ghulam Ishaq Khan. Population shares were changed after the completion of new census in 1981 which further led to adjustment in shares of resources. Baluchistan and Sindh saw somewhat better situation while NWFP's share remained static (Hussain, 2018).

| | | | |
|---|---|---|---|
| Punjab 57.95% | Sindh 23.34% | NWFP 13.39% | Baluchistan 5.30% |

**Source: Figure 2 (Governmet of Pakistan Finance division, 1983, )**

**iii. Third NFC Awards (1985)**

The third NFC constituted in 1985 during President Zia-ul-Haq regime under the leadership of Finance Minister Dr. Mahbubul Haq could not arrive at any consensus. In spite of nine meetings spread over three years, continuous political instability in the country as well as internationally prevented a final outcome and the formula of 1974 remained applicable up till 1990 (Hussain, 2018).

**iv. Fourth NFC Award (1991)**

Fourth NFC Award aimed at improving provincial finances by enhancing the provincial share in federal revenues. Commission was headed by Mr Sartaj Aziz, Federal Finance Minister during democratic rule of Nawaz Sharif. Expansion of divisible pool was major achievement of this Award. Excise duties on sugar and tobacco were earlier part of non-divisible pool but now they were included in divisible pool in Fourth NFC Award. However, allocation among provinces was still almost entirely based on population criterion which remained main criticism of less-developed provinces and horizontal division remained unchanged 20:80 (Iftikhar Ahmed, 2007).

| | | | |
|---|---|---|---|
| Punjab 57.88% | Sindh 23.28% | NWFP 13.54% | Baluchistan 5.30% |

**Source: Figure 3 (Governmet of Pakistan Finnce Division, 1991)**

**v. Fifth NFC Award (1996)**

National Finance Commission constituted in 1996 by the caretaker Prime Minister Malik Meraj Khalid was headed by Finance Minister Shahid Javed Burki and was awarded in Feb 1997.The 1996 NFC merged all federal taxes (Income tax, wealth tax, capital value tax, sales tax, export tax, custom duties and general excise duty (except wellhead gas excise) in federal divisible pool and further supplemented it with resource profits from oil and gas for provinces. Major highlight of 1996 NFC award was that it divided public expenditures into priority and non-priority expenditures where priority expenditure is defined as defense, debt servicing, social sector and development expenditures whereas expenditures on general administration, community services and law and order were considered non-priority. With the constant share of resources element and population being the only criteria provinces retained their share with maximum of 57.88 percent and minimum of 5.3 percent shares for Punjab and Baluchistan

| | | | |
|---|---|---|---|
| Punjab 57.88% | Sindh 23.28% | NWFP 13.54% | Baluchistan 5.30% |

respectively (Sabir, 2011).

**Source: Figure 4 (Governmet of Pakistan Finnace Division, 1997)**

**vi. The 6th NFC Award 2000**

President Pervez Musharraf established the National Finance Commission (NFC) on July 22, 2000 under the chairmanship of Finance Minister Shaukat Aziz. Although the Commission held 11 meetings, they couldn't reach a consensus. Provinces demanded as much as 50 percent share in the divisible pool of taxes besides new formulas for distribution of funds (Sabir M. , 2011).

**vii. The 7th NFC Award**

The December 2009 7th National Finance Commission (NFC) Award introduced new system of fiscal federalism replacing erstwhile population-based system with a multi-factor formula. It enhanced provincial share in taxes from 46.5% to 56% in 2010 and 57.5% subsequently while reducing that of the federal government up to 42.5%. The provinces and the federal government also agreed to move away from the single criterion (population) and fixed the provincial pool percentage at 56% and then 57.5%. Concurrently, the federal government retained a reduced percentage of all revenues collected (Iftikhar Ahmad, 2025).

**Salient Features of 7th NFC AWARD:**

During the negotiation of the 7th NFC award reconciliation, Sindh, Baluchistan and Khyber Pakhtunkhwa (KKP) favored multiple criteria whereas Punjab was keen only on population criteria. Moreover, Sindh also demanded considerable share on revenue (sale tax and services collection). Majority of tax receipts are collected from Punjab and Sindh. Nearly entire custom duties are realized on Port of Karachi. KPK also demand poverty whereas Baluchistan being largest and widely scattered province laid emphasis on inverse population density in the award. (Dr. Muhammad Ahmad, 2024).

At last, during the implementation of 7th NFC award Baluchistan, Sindh and KPK demands were accepted. Now NFC award is based on multifactor formula. Population is not only criterion poverty, underdevelopment and inverse population density was also considered for granting shares to provinces.

Federation had to sacrifice more than 10 percent of its share to provinces shares. From federal Federation about Rs 225 billion more were given to provinces in the budget of 20 10-11. Thus the 7th NFC award has added a new yardstick significant measurement for sharing resources amongst all units of a federation and has proved it to fulfilment.
In the new NFC award formula, both the Federation and the provinces of Punjab, Sindh and Khyber Pakhtunkhwa have recognized the special cases of Baluchistan and agreed to give Baluchistan Rs 83 billion (9.09 percent) of the provincial pool as its share in the first year of the Award. Overall 7th NFC Award has given weightage of 82 percent to population, poverty 10.3 percent, revenue collection 5 percent (2.5 percent revenue generation & 2.5 percent revenue collection); whereas area will get 2.7 percent share. It will be nice to share that after special cases of Baluchistan are considered and multiple indicators are applied, Punjab province will get 51.74 percent, Sindh 24.55 percent, Khyber Pakhtunkhwa 14.62 percent and Baluchistan 9.09 percent. Punjab has sacrificed 1.27 percent, Sindh 0.39 percent and Khyber Pakhtunkhwa 0.26 percent; whereas Baluchistan gained 1.82 percent in the new Award. Federal government had sacrificed more than 10 percent of its share to provinces (Mustafa, Fiscal Decentralization, 2009).

| Criterion | Weight |
|---|---|
| Population | **82.0%** |
| Poverty and Backwardness | **10.3%** |
| Revenue Collection/Generation | **5.0%** |
| Inverse Population Density | **2.7%** |

**Figure 5: Criteria of horizontal division**

**Implications in the 7th NFC Award**

Addition of items in the Federal Legislative List through the passage of 18th Amendment and the 7th NFC Award may be claimed as federalizing measures that encourage provincial autonomy. However, these changes have grave monetary and administrative implications which demand considerable realignment in terms of development and non-development expenditures, human resource setups and legal aspects.

**Fiscal Adjustments**

There is certainly more scope in provincial budgets for diversion towards flood relief, rehabilitation and reconstruction than in the Federal Budget that foresees development spending dipping as per IMF target. Federal government envisaged with reforms that provinces will generate significant revenue surplus and restrict their development spending to eventually create cash balance. A study of 20ll-ll provincial budgets shows that higher transfers have not resulted into noticeable extravagance in current expenditures by provinces, though there are indications of possibilities of lack of planning and wastage in utilization of resources.
Seventh NFC Award was announced at a time of low and stagnant tax to GDP ratio. Heavy reliance on fiscal transfers to meet sub-national expenditures was felt to be disincentive to exploit sub-national tax sources. One key question while designing new federal transfers mechanism was whether it will

encourage provinces to better their fiscal management. This assumption is questionable considering years of effort produced no fruitful results (Sabir M. , 2011).

**The Lack of Robust Mechanism for Tax Collection**

The 1935 Government of India Act assigned sales taxes on goods to the states (provinces) and services to the centre. This was reversed for Pakistan under the Pakistan General Sales Tax Act 1948, making services a provincial assignment. Accordingly levying of taxes on 'Goods' was done by the federation and 'Services' by the provinces. However more recently and from July 1, 2010 onwards Value Added Tax (VAT) has been made applicable on all business activity or all 'Supply of Goods' as well as 'Rendering of Services' subject to very few exceptions. Under the 18th amendment provincial right to levy and collect GST on services was reiterated which was also agreed upon in the principle of 7th NFC Award however it was clear cut visible that fissures had developed over who would administer GST on services (Dr. Manzoor Ahmed, 2014).

**Center's Concern Over Vertical Distribution of Divisible Pool**

Critics contend that provincial share of divisible pool of federal taxes at 57.5% has weakened federal revenues badly leaving very little money for federal expenditures like debt servicing thereby exacerbating federal budget deficits. However, provincial share cannot be reduced due to Article 160(3A) unless there is an amendment to the constitution of Pakistan. Furthermore, this larger share leaves very little money in the hands of federal government to meet its important expenditures like debt servicing adding fuel to the fire of federal budget deficits. Provinces are hooked to federal transfers so they haven't bothered developing their own revenue sources. Nonetheless provinces have the power to levy sales tax on services and agricultural income tax etc. but provincial tax contribution in terms of tax-to-GDP ratio is very poor and at the minute just 0.8% and even slipped from over 1% in 2017-18 (Dr. Muhammad Ahmad, 2024).

**Policy Constraints on Provincial Governments**

Provincial governments also have limited borrowing powers and require special permission even in emergencies. In comparison Indian states were able to borrow up to 3% of GDP in the fiscal year 2022-23. Provincial governments are also mandated to run cash surpluses; for 2023-24 a total of Rs.650 billion is needed (Iftikhar Ahmad, 2025).

**Decline in Federal Transfers and Social Expenditures**

Federal transfers to the provinces have fallen as a share of GDP from 5.7% in 2017-18 to 5% estimated for 2022-23 mainly due to compression in the federal tax-to-GDP ratio over the years. Lower federal transfers have affected provincial expenditure on development and crucial sectors like education and health. Provincial education and health spending has declined from 3.2% of GDP in 2017-18 to 2.9% of GDP in 2021-22. This contributed to slide in Pakistan' UNDP Human Development Index from medium to low categories of human development. Compression in social spending is reflective of fiscal constraints. Tackling these issues needs concerted effort at federal and provincial levels for revenue mobilization and fiscal austerity (Sabir M. , 2011).

**Provincial Concerns regarding 11$^{th}$ NFC Award**

Federal taking heavy amount from provinces has also raised eyebrows regarding the shares which they have to provide for defense and debt servicing of Pakistan. Issue of security, law and order is very grave in Baluchistan and KPK so they want others provinces (Punjab & Sindh) should contribute voluntarily.

Baluchistan’ share has been increased 3times since 1974 but according to them it is still not enough to overcome severe challenges it is facing. Punjab has also raised their concerns regarding what they give in defense and debt servicing. Before 2010 Punjab's share was around 60% which after 2010 it was decreased to 51%. Punjab have issues like environment & climate change, smog issue, floods, regional &economic imbalances and increasing population. According to Punjab these provinces should not be overburdened with money issues. Sindh strongly objected any decrease in the 57.5% provincial share from the divisible pool and declined the federal government's efforts to impose devolved financial obligations like social safety initiatives onto the provinces. The province asserted that revenue sharing and expenditure responsibilities must remain strictly separate, as outlined in the constitution. It also denied KPK's demand of more shares after merging of FATA (Express Tribune, 2026).

**Recommendations for Enhancing Fiscal Federalism in Pakistan**

Following recommendations will helpful in strengthening of Federalism and also will be making NFC award effective and efficient:

- It is high time that Provinces pay full attention to sales tax on services, agricultural income tax, and property taxes in order to improve their revenues generation capacity.
- The federal government must widen the tax net and spend on building effective collection machinery in order to increase tax revenue.
- PFCs should devise effective criteria like MPI to transfer resources to districts for poverty alleviation purposes and align their functions in order to focus more effectively on SDGs and reforms associated with good governance.
- The devolution of subjects under 18th Amendment in phased manner with appropriate transition mechanism for vertical health, population programs, and higher education.
- The provinces should spend on improving their absorptive capacity in order to utilize the transfers received & generation of additional revenue.
- Assignment of responsibility of natural resources whether it is Oil, Gas and hydroelectric resource in letter and spirit keeping in view provinces rights.
- Provinces need to focus fully on the potential of sales tax on services, agricultural income tax, and property taxes to enhance their revenue base.
- The federal government and provinces should cooperate on expenditures of Azad Kashmir, Gilgit Baltistan and FATA and share responsibilities of natural disasters and terrorism.
- Revive Provincial Finance Commissions for better service delivery at grass root level.
- The governments at all tiers should do their work within their sphere performing decentralized planning and development as per indigenous requirements.
- The deteriorating law and order situation has adversely affected Pakistan’ economy over the years. Not only billions of rupees are being spent in fighting militancy and maintaining law and order but internal conflict also discourage local and foreign direct investment (FDI). There is an immediate need to normalize law-and-order situation in the country to attract investment. All political stakeholders must unite and devise a proper policy ignoring political tendencies.

- Increase allocation specifically for Environmental issues and promotion of projects that focus on sustainable development to reduce the challenges caused by climate change.
- Set aside funds for environmental protection and allow provincial governments to spend on addressing environmental concerns within their provinces.
- Pay special attention to the socioeconomic development and economic integration of FATA.

**CONCLUSION**

The historic decision of the 7th NFC Award in December 2009 broke the long stalemate over the issue of design of distribution of resources. However, the current institutional setup of NFC can easily become hostage to future deadlocks. A two-tier institutional structure, as suggested in this paper, can provide an effective framework for smooth working of the NFC based on improved mechanisms for distribution design. Although the new distribution design is better than its predecessor yet falls far short of the international benchmarks. For instance, population share (which does not figure in the distribution design of the developed countries and has a small weight in some of the developing countries' distribution designs) has been assigned a weight of 82 percent in Pakistan's revenue distribution design. An effective design would incentivize provinces to increase own-source revenues as against potential disincentive created by the 7th NFC Award in this regard. Design of distribution can, by itself, only partially incentivize own source revenue generation, for example, by incorporating revenue effort and provision of matching grants in the distribution design. While the weight assigned to revenue effort is too small, matching grants have no place in the current distribution design. For providing greater incentives to provinces for own source revenue generation, the federal government will have to part with some of the broad-based tax sources like income tax and corporate tax in favor of provinces instead of distributing their revenues through the NFC.

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