

## FISCAL DECENTRALIZATION: IT'S IMPACT ON DEVELOPMENT- A CASE STUDY OF BALOCHISTAN

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### **Abstract:**

*Discovering and measuring the important effects of fiscal decentralization on the uplift of masses and economic development of Balochistan. For this purpose, Data will be taken from the years 2005 to 2012 and data of 29 districts out of 32 will be selected for concluding study. This papers mainly concentrates on expenditure decentralization and expenses which are being continued by the districts for the progress. As a matter of fact, there are some three main indicators of the economic development including the betterment of health sector, standardization of educational level and infrastructure. In this matter, children immunization, net primary enrolment in education, availability to tape water are taken as important indicators. . The study of research highlights how the distribution of financial powers to lower tiers and district affect the basic institutions of the area such as health, education and development of infrastructure, it also discusses the negative outcomes of centralized system in which the smaller provinces are deprived of their basic rights. Moreover, this thesis will thoroughly discuss the overall ramification of current criteria of distribution of resources.*

### **Introduction:**

#### **Historical Perspective /Background:**

It is pertinent to mention here that there are number of research papers and reports which are directly or indirectly related and helpful to conduct this

thesis in a very productive manner. Firstly, the World Bank published a report with the title of "fiscal decentralization and relationship between intergovernmental transitions" it has briefly described that since the industrial revolution and development of modern technology the world has witnessed a revolutionary and development in human life. In this process, it is realized that development and improvement in human life can be observed if financial powers are transferred to lower tier of the government. It is believed that 95% of democratic governments on greater extent have already established local bodies whereas the other governments are also in process of establishing elected local bodies. This is reported by World Bank in 1999.

Decentralization of governance and financial advancement, it is an article related to *Economic Perspective* Published in 2005 by Bardhan, P. in this regard Oates has thoroughly elaborated in 1993 that financial decentralization accelerates and paves the way for economic development and advancement in a country. but, there are a number of problems being faced by the nations such as institutional infrastructure development, quality education access to general masses and lacking basic health facilities, etc. moreover, in under developed countries that need to work out on addressing it before initiating the process of decentralization. Financial decentralization without introducing institutional change can pave the way for corruption and other evils. Bardhan says that for the efficient and productive local services delivery or conducting local business more effective then powers particularly concerned to the governance need be transferred to local authorities. In this way people will be having the exact information in relation to local preferences and incentives which are necessary for formulating policies.

Apart from this, national finance commission "a way forward". It is a *Research Report Published by Ali, a.* In 2010. in this research report the criteria for the distribution of resources and its implications on smaller provinces is discussed keeping in view the different dimensions of it .it is believed that only the 7<sup>th</sup> NFC has created platform to these backward and deprived regions and their shares have immensely increased in 7<sup>th</sup> NFC award. This policy great shift has paved the way for Balochistan to have more shares and this can be witnessed in the increase of shares till 9.09 and its annual budget requirements and needs increased by almost 200%

From the above-mentioned facts and discussion, it can easily be identified that generally Pakistan particularly Balochistan is in deep crisis and people are facing a number of problems to spend a comfortable life. similarly, from last award, it is observed that transfer of resources from federal to federating units have increased and almost every province is in a better position to handle the issues and eliminate social evils in order to ensure a better and prosperous life National Finance Commission it is a Research Report published by Ahmed Usman and Mahmoud, in 2007. Moreover, the 18<sup>th</sup> Amendment has brought revolutionary changes in the conducting the state

affairs it has played a significant role to transfer the powers to the provinces and it has eliminated the concurrent list which contain those subjects in which both the federal government as well as the provinces were having right to regulate its affairs. The fiscal decentralization after 18<sup>th</sup> amendment resulted to the unanimous and without any objection got approval of 7<sup>th</sup> national finance commission. the recent shifts in governing the administration and finance has increased transfers of funds from federal government to federating units vertically and main objective of FD is to promote economic development and prosperity specially of the under- developed and highly backward areas such as Balochistan. Furthermore, in Pakistan, since horizontally, state resources distributed and it's sharing formula was mainly based on population basis not including the 7<sup>th</sup> NFC. Thereby, the shares contained by the small provinces in divisible pool were made limited particularly for Balochistan 4.788 % on average since disintegration of East Pakistan.

**Prime objectives of the thesis:**

The prime purpose of this study is to know the implications of fiscal decentralization on the economic development and prosperity of the province.

- It contains three important indicators such as health, education and development of infrastructure in Balochistan.
- To study the effects of financial decentralization on economic development in this regard the variations in the spending and generating of revenue and there proper utilization is discussed in different prospects.
- To know the adequate utilization of funds.

**Significance and utility of the study:**

It is generally observed that throughout Pakistan it is a popular demand that there shall be maximum financial decentralization in the country and for this purpose the smaller provinces have been demanding this since the inception of the country.

Balochistan need to have a more access revenue generated by its resources which can be properly utilized in decentralized financial and political systems. Almost everyone from smaller province consider the existing highly centralized and control system as one the main factors responsible backwardness and fragile economy of the country. This thesis carries some important questions and there applicable solutions answers.

This study clearly highlights the effectiveness of financial distribution of powers and reforms needed to be introduced by the central government for giving more and more provincial autonomy to the provinces. Second, it gives due focus to backwardness of the province which ultimately place Balochistan on the top of the list. In short the problems being faced by the smaller provinces can be resolved through adopting multi-dimension measures to achieve the desired objectives.

**Methodology of study:**

It is to be noted that know about the exact implications of financial decentralization district level the data of 29 districts out of 32 is selected .it contains the period from 2005 to 2012.in this research thesis the data is collected through different sources such as newspapers ,journals ,books ,features and government notifications etc.

**Review of Literature:**

**Introduction:**

There is ongoing trend of fiscal decentralization and transfer of financial distribution of resources and powers at lower strata particularly in developing and progressing economies since last five decades. There are a number of studies that analyze the effects of financial decentralization on different social and economic factors like, poverty, employment, growth inequality, education, and health and the overall economic progress, etc. of the society. It is very important to mention here that to review the existing literature is of highly importance related to this topic. Therefore, this chapter deals with the review of necessary theoretical and empirical studies on this topic of financial decentralization impacts on development of society.

**Theoretical studies:**

According Oates (1993) Financial Decentralization accelerates economic development in country. However, there are many problems like institutional infrastructure, systematic planning, proper execution of policies etc. especially in developing countries that are necessary to be addressed while initiating decentralizing process. Decentralization without proper institutional change can pave the way for corruption and breed number of evils in society. Bardhan (2002) believes that for the efficient local services delivery and local business development more powers specially related to the governance should be transferred to the concern local authorities, because these people know the actual problems of people and having exact information regarding the local preferences and having more incentives from policies framed by them for the progress of the society. However, for better

results, along with decentralization, there need to be an adequate mechanism to make the local bodies more accountable because same times this change lead to safeguard only interest of local elite class of society.

**Empirical Studies:**

*Mulyono (2012)* mainly tried to assess the impact of FD on regional economic development using the data for period 2005/08. Four factors i.e. poverty, employment, economic growth and HDI are being used for knowing economic development. The results indicate on average regional economic development factors have improved but it has not clearly identified whether it is from high financial decentralization or regional economic sustainability. The results also indicate that in few provinces have not gained maximum benefits from already transfer of financial powers to them. This can be due to mismanagement that mostly observed during the process of decentralization

*Smith (2012)* examines the hypothesis that can endowing sub-national governments with more revenue collection powers could promote economic development? American Six Latin cities from Mexico, Argentina 3 from each and using qualitative and quantitative research analyses to know the hypothesis. The data of 1980 to 2010 regarding quantitative analysis was used and finding of the research indicates that cities generating more revenue are in suitable and better position to plan more productive development strategies that not only increase jobs opportunities but also improve or make better overall living standard of people.

**Fiscal Decentralization at Lower Tiers in Pakistan and NFC Awards from 1974 to 2010:**

The first national finance commission came into being under the article 160 in 1974 by referring population as chief cause of resource distribution among the provinces

However, under the fiscal relationship in new awards remained the same ratio of 20:80. In contrast to previous awards only few taxes including export duty sales tax, and income tax were studied for divisible pool GOP, (9191). Since population remained the only factor for distribution, thereby Punjab managed to get a maximum shares. However, the

Second and Third NFC Awards (1979 and 1984). However, in the Second and Third NFC Awards the government of Zulfikar Ali Bhutto was toppled by military coup on 5 July 1977. General Zia ul Haq, the then chief of army staff, took the charge of the country as Chief Martial Law

Administrator. Thereafter, he served as the president of Pakistan from 1978 till 1988. He constituted NFC two times during his era; first NFC meeting was headed by Ghulam Isaq Khan who was the finance minister in 1979 and second meeting was chaired by Mehbobul Haq, the then Finance Minister. During the meetings, federal ministers and representatives of four provinces many financial issues were discussed but the meetings were ended in smog without reaching on any meaningful conclusion. Later on, the formula of 1974 was extended. However, the 1981 census had altered the figures due to the growing population Sind and Balochistan.

Apart from this, the Fourth NFC Award (1990) General Zia ul Haq lost his life in 1988 and democracy again came into practice in Pakistan. A new NFC was established for resources distribution. Later on, during the first term of Prime Minister Nawaz Sharif's government, the suggestions for the next NFC were recommended by adding a few extra variations to the old formula of NFC. However, the committee headed by Sartaj Aziz, the Finance Minister finalized some recommendation. In fact, once again population was considered the main factor of horizontal distribution of fiscal resources. Resultantly, no consensus was developed between all federating units regarding division of revenue distribution formula (Sadaqat *et al*, 2006). In addition to, some changes were introduced in reference to extra excise duties namely Tobacco and Sugar. To some extent, magnitude of divisible pool was increased. The vertical distribution were not altered and shared remained the same one the old one 20:80. On the other hand, the shares of four provinces in central revenue and resource collections enhanced by 18 % due to adding of additional excise duties.

Whereas, in the Fifth NFC Award an acting Prime Minister in December, 1996, Meraj Khalid formulated the fifth NFC Award. The finance minister Mr. Shahid Javid Bukhari headed the commission and prepared the final draft of recommendations which was later on declared in February 1997. Thus, the divisible pool size was surged to all taxes i.e. export, customs, Excise duties comparatively and income tax, sales tax Wealth tax were made the part of it. Besides, oil royalties and gas surcharges were also announced by providing to the respective provinces (Khalid *et al*, 2007). The overall addition completely altered vertical relationship on the ratio of 62.5 %, and 37.5, compared to that of 20:80. In addition to, horizontal distribution was not changed and in special grants of amounting Rs4.08 billion while Rs3.3 billion committed to give other provinces in the next five year. (Sadaqat *et al*, 2006).

In the NFC Award of (2000), historically speaking, army has frequently overthrown the democratic set up in Pakistan. In 1999, General Musharraf dissolved assemblies by toppling down the democratic government of Muslim league led by Mr. Muhammad Nawaz Sharif. Initially, General Musharraf remained as chief executive but soon took oath

of president in 2003. Musharraf constituted a commission for suggesting recommendations on new NFC formula. Finance minister Shauket Aziz headed the committee and later on remained prime minister of Pakistan ended without giving proper formula even after passing of several meeting in which the provinces continuously demanding the high shares (Khalid *et al*, 2007). But in the Sixth NFC Award of 2006, 21 July, 2005, President Musharraf again constituted new commission for considering revenue sharing formula. In this regard, several meetings were held in order to create consensus among all provinces but ended in smoke. The provinces and central government failed to reach on mutual consensus for unanimous revenue sharing formula. In this regard, president Musharraf, on July 1/ 2006 under article 160(6) of constitution 1973 altered distribution as well as grants in aid by using his powers and issued president ordinance in 2006. A series of the new taxes were added to the divisible pool the shares of central government surged to 45 percent. It was also promised to increase 50 by 1 % increase per year (Khalid *et al*, 2007).

In addition to, on sales tax 1/6 fixed for all provinces to transfer its funds to local governments while shares of Punjab, Balochistan, KPK, and Sind and were 50 percent, 5.22 percent 9.93 percent, and 34.85 percent respectively. The following diagrams illustrates the shares of the federating units (Government of Pakistan, 2006a), the Seventh NFC Award (2010) as a matter of fact, the 7<sup>th</sup> NFC award brought a great change in revenue distributing sources which has supported the less populated and backward provinces. This formula was first time unanimously adopted by all provinces by which they framed this revenue sharing reward by taking all provinces on board. They considered it as remarkable step to reaching on agreed agenda in the history of Pakistan. This award minimized the grievances of the less developed provinces. All the provinces agreed to add poverty, revenue collection and backwardness in the distribution of revenue. The Pie Diagram illustrates the different weightage factors in revenue distribution sharing formula. Source: Sabir (2010).

Under this reward due importance was attached to KPK government due its confrontation with the terrorism. And, additional 1 percent was given in divisible pool, while the central government reduced collection charges from 1 percent to 5 percent (Dawn News, 31/02/ 2009). Moreover, vertical distribution regarding federal government and provinces has been largely altered from 51:49 up to 44:56 percent and it was also decided that 1 percent rise could be increased in the year 2010/2011, 2012 and on word. In reality, the government has really taken very good steps in order to strengthen

national integration by giving up to 8.5 percent shares (Khan, 2009). it is also referred here that horizontal revenue shares of all provinces in the divisible pool had received different figures by adding of multiple factors framed for resource sharing formula.

The main transfer of shares to provinces on the basis of backwardness and bring them at par with other provinces by ensuring economic development and prosperity. Besides, vertical inequality was also addressed for the first time in the history of Pakistan, all provinces got appropriate shares even as compare to the federal government. Horizontal and vertical relationship over the time among province and federal government are shown in the table as under.

#### **Data Analysis:**

In fact, Fiscal Decentralization is often referred to the provision of revenue to provincial governments. Fiscal decentralization is usually measured through revenue ratio and expenditures Ratio. Tax collection system is the shabby state in Pakistan. That is why most of the revenues are collected by the federal government then distributed among the provinces. Thus, measuring FD through revenue decentralization cannot be useful and the results might not be accurate. In contrast, in this study the expenditure decentralization technique has been used to measure FD. In general, expenditure decentralization, the ratio of minor to major tire has been selected. Factually speaking, this research is handling with district level progress. Development expenditures are taken from the 29 districts. Thus, we will discuss development expenditures by taking natural log on the basis of the assembled development index of various districts. However, the other control variables are used in this study in order to the preferred results, firstly the Instability, the poor law and order situation is deemed as instability. So target killing, ethnic and sectarian violence in Balochistan is a few to name in this regard. It had left worst effects on the economic activities of the province. In addition to this, the Literacy rate is referred to the number of literate persons. This research paper refers those people literate who are above ten years are referred as literate and finally the Political radicalization as achieving their desired Political scenario, politicians have created political instability. Undoubtedly, Balochistan has been prey of political radicalization. In 2004, former the army dictator waged military operation against those people who protested for their constitutional and political rights. Thus, finding accurate data of ethnic cleansing has been difficult because e of measuring bullet riddle bodies.

#### **Conclusion and policy recommendations:**

##### **Conclusion:**

It is generally considered that economic growth increased through FD efficient delivery of public services and greater access to the people preferences, enhance equity and economic stability. Besides, the overall life stander of the people is also raised. The relationship between FD economic has been explored in this paper. For this purpose, the data of twenty-nine districts of Balochistan since the period 2004 to2012 has been utilized for empirical analysis.

An index of development has been used to examine the impact of FD on economic development, "It has been constructed from the weighted average of three key indicators of development i.e. education, health and infrastructure)". The representative indicators for education have taken primary enrolment while for health, children inoculation and for infrastructure, access to tap water have been used.

It has been found by Using panel data estimation techniques (One-way fixed effect models), that FD is instrumental in improving the overall financial condition of the people. More specifically, after the 7<sup>th</sup> NFC, the significant impact of FD on economic development surges level has raised. In addition, the paper has explored and analyzed the relationship between FD and different development indicators such as education, health and infrastructure. The outcomes have vivid a positive and significant relationship between FD and educational results. Positive and statistically significant relationship between FD and infrastructure has also been explored .However, FD is inconsequential to health outcomes according to the results, but after 7<sup>th</sup> NFC award, FD turn out significant to health care services. Hence, after the enforcement of 7<sup>th</sup> NFC Award all the indicators have improved in great extend and pace that are used in this research work to construct economic development index. It has also been discovered during the analysis that the highly centralized and restricted flow of resources has the chief cause of backwardness of many areas of the country particularly that of Balochistan. In addition to, the centralization has become one of the major causes of violence and uprisings against the center in small provinces the country. So, decentralization of power is the dire need of the time. Under these types of circumstances, it is highly imperative for the state to allow people to decide their own fate. This will certainly eliminate the grievances of provinces and help to bridge the gap between the center and the highly unstable regions such as Balochistan. In addition, the regional leaders are more accustomed with social problems and inclinations of local people. They

could better promote economic growth and development in their respective regions through their development oriented policies.

**Policy recommendations:**

Here are some important policy recommendations for the policy makers that are based on empirical results of this research work.

- The FD has positive influence on economic development. It might not be stopped and should be used in Pakistan.
- FD should be declared entirely a provincial subject. It has increased the educational outcomes, therefore, all the educational funds that are used by center should be transferred to provinces.
- FD has succeeded to enhance the infrastructure facilities in provinces. Therefore, more powers and funds should be allocated for beginning new multifarious infrastructure promotion schemes.
- FD has been able to develop health care facilities After 7<sup>th</sup> NFC Award. The provincial government could provide all the necessary health care facilities to their masses provided that the center might empower the provinces in financial matters.

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