

## Devolution and Fiscal Governance in Pakistan: Uneven Developments and Uneven Capacities Need to be Addressed

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### Abstract

*The article evaluates income, expenditure, per capita income and per capita expenditure of local government authorities. The analysis reveals that there was rampant rural to urban, inter district, intra district, inter cities and intra cities inequalities in Pakistan. It is also a fact that the amounts of grant and government transfers were so small that it was not easy to apply vertical mechanism to address the issue of uneven development and uneven capacities of various authorities in 1979-1998. The article figurese out that in 1998 government transfers enhanced up to 90 percent of income in some cases. This increase provided opportunity to the government to apply vertical financial management decisions for equal and judicious distribution of resources. Finally, it also comprehends the steps taken by government under devolution plane to address the issue.*

### Introduction

In this era of modern technology and communication no one can deny the importance of equalization. It is a popular slogan of democratic as well as dictatorial regimes. Equal and equitable distribution of resources, at least up to assurance of basic needs and essential services in various regions and in various groups of people is prerequisite of good governance. Poverty which is breeding terrorism, violence, crimes and other negative activities in society can be alleviated by addressing this issue. No doubt that in present integrated world rich nations has to transfer some wealth to less developed and least developed countries. At the same time it is earnest responsibility of nation states to take measure to reduce inequalities at gross root level which can be done through local government system. So, the process of equality and equitable distribution should start from global level and come down to local level to save the world from some other negative revolution. In present era local government is an agent of economic as well as political development. This play vital role to improve the quality of life according to the priorities set by local people according to their requirements. This institution has potential to ensure more or less equal and equitable distribution of services to the smallest segment of society. Blair (1993:7) is of the opinion tha "*Financial*

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*Equalization*" is taken to mean the achievement of a more equitable distribution of financial resources between different authorities at the same level. Governments are faced with the problem of, on the one hand, the need to ensure a reasonable overall balance in the distribution and quality of public services and, on the other hand, major differences in the financial capacity of local or regional authorities and hence in their ability to provide such services. If it is not to resort to centralized provision of services, the higher level authority is therefore, obliged to take measure to enhance their financial potential of those local or regional authorities whose taxable capacity is weaker than average or which have higher than average expenditure needs. Purpose of this article is to evaluate this aspect of local government in Pakistan.

Pakistan represents different cultures and socio-political pattern as well as economic development in various regions. For example, disparity between urban and rural, inter urban and inter rural is quite visible. There are not only inter-city disparities but intra-city disparities could also be observed. For example, the biggest and the most resourceful urban council Lahore had localities like Allama Iqbal Town, G.O.Rs, (Government Officers Residences), Gulberg, Cant and etc., residents of which are enjoying more or less standard services. At the same time, dwellers of kachiabads and other areas are yet waiting for clean water to drink and natural gas to cook the food. The number of kachiabads in Lahore is 97 where about 170,000 people are living. People living in slums are still waiting even for conservancy services. Lahore, the city of gardens, has beautiful parks in its heart and surroundings of the city like Gulshane-i-Iqbal, Iqbal Park, Jallo Park, Shalamar Bagh, and etc. Lahore is called city of gardens and colleges. In contrast, there are many slums in this city where all inhabitants do not have access to proper sewerage. There are numerous complaints that over-flowing sewerage is converting the localities into dirty pounds (Muhammad, 2004). One can find out the same situation in Multan for example; Cantonment, officers colony, parts of Gulgasht Colony and etc represent different level of development, while, Qadeer abad, inner city, where majority of population is living with out basic necessities of life. Karachi, Queta, Peshawar and other big cities are suffering from this kind of intra-city disparities. Correspondingly, Islamabad, Karachi, Lahore, Peshawar, Queta, Faisalabad and to some extent Multan cities present a different level of development, while, Sargodha, Layya, Ghotki and Manshehra cities represent a low level development as compare to mentioned cities. Likewise, disparities and differences can be observed in most of the rural areas. The overall condition of the rural Pakistan is miserable. People still lacking sewerage and latrine system. In some cases there is not any arrangement to dump sewerage water. Old pounds have been captured by Qabza Groups and new system is not evolved by responsible authorities. Clean water is not available. In some areas the villagers store water in ponds and then drink from the same along with other animals. Now the government took initiative to provide clean water to every one. Education, health facilities are not as much of in rural Pakistan. This is a result of uneven distribution of avail able resources between rural and urban, between posh city areas and slums, between villages of influential people/ near city and far flung villages. Despite the fact that local government institution is very old in Sub-Continent but it could not contribute effectively to remove uneven development and uneven capacities of local units.

## Historical Review

The roots of local government institution in Sub-Continent could be found from Arian period. However, the foundation of modern local government system was laid down by British but the system in this region was not structured on western pattern. The basic aim was to create a class capable enough to mediate between rulers and ruled. To mobilize resources at local level to shoulder the local development activities and conservancy services, especially, in urban areas. They were least interested in mending the quality of life or in lessening the social disparities. With the emergence of Pakistan the leadership accepted the same system with minor readjustments as they were much busy in other big issues. Ayub Khan restructured the institution in line with his requirements and named it Basic Democracy System (BDS). This multi functional institution was designed, headed and operated by civil bureaucracy. The institution enjoyed special status during the regime and spent a big amount on development projects. However, the regime neither considered this institution a tool to ensure equal and equitable distribution of resources in different regions and authorities nor for decentralization. Over all state's economic, political and administrative system was highly centralized. In result of government policies more or less 80 percent industry was installed in Karachi while other areas of Pakistan were neglected. 22 families bagged maximum bank, insurance and industrial assets. Under the slogan of Green Revolution Land reforms, farm mechanization and chemical input schemes were launched. These schemes were operated through government officials. Deputy Commissioner was empowered to grant free Tube-Well engines by using his discretionary powers. Central and local policies of the government generated province-to-province, urban to rural and class-to-class disparities and conflicts, which played important role along with others to disintegrate country. Under the constitution of 1973 a democratic parliamentary type of government was established. People were expecting that people's party who elevated to the government with support of people will bring some revolutionary changes to improve the quality of life of general public. It was also expected that the government would restructure the local government system to ensure the participation of people at gross root level, to provide justice at the door step, to improve quality of life and to ensure equal and judicious distribution of resources in all segment of the society for effective social inclusion. But unfortunately, the party could not pay heed to the system because it was not suited to political elites of the party having feudalistic and dictatorial mind set. Moreover, Party leadership was suffering from ideological contradiction. Resultantly, the fragile institution of local government was run by government servants under the unofficial management of ruling party workers. The election of this institution was never held during the period.

## Local Self Government 1979

General Zia-ul-Haq infused the new life in the system in 1979. At this time slogan was local self government and decentralization. Consequently, the urban as well as rural, big or small all were comprised and headed by elected representatives. The role of bureaucracy was curtailed to some extent. However, the system could not address the issue of uneven development and uneven capacities of different areas. The parliamentary system from 1985

to 1998 accepted the local government institution halfheartedly. They considered it hurdle in their political mechanism. So, some time elected leaderships of these institutions were suspended and some time elections to elect representatives of these institutions were not held. Resultantly, the institutions were run by civil bureaucracy. Both the political leaders, Prime Minister Be-Nazir Bhutto and Prime Minister Nawaz Sharif used discretionary powers in development schemes. They were much more interested to spend more funds in their own and their cronies' constituencies. Obviously, this was against the spirit of good governance. Figures speak that government 1979-2000, ignored to use this institution to overcome the issue of intra province uneven development and uneven capacities. The table one indicates the disparities between urban and rural councils by taking into account population, income and expenditures factors.

**Table 1 Population, Income and Expenditure of Urban and Rural Councils Punjab**

| Council                   | Population<br>1981-82 (0000) | Income 1981-82<br>(Rs million) | Expenditure<br>1981-82 (Rs. million.) |
|---------------------------|------------------------------|--------------------------------|---------------------------------------|
| Urban Councils            | 12073                        | 1123.6                         | 1114.5                                |
| Rural councils            | 34264                        | 327.1                          | 327.6                                 |
| Intra Urban Council       |                              |                                |                                       |
| Metropolitan Corporations | 6208                         | 596.8                          | 562.3                                 |
| Municipal Corporations    | 3946                         | 403.6                          | 422.3                                 |
| Town Committees           | 1989                         | 123.2                          | 129.9                                 |

Source: Government of Pakistan (1989).

Population of urban councils was 12073 thousands when income was Rs.1123.6 million and expenditures were Rs.1114.5 million on the other hand population of rural councils was 34264 thousands and income and expenditure were Rs. 327.1 and Rs. 327.6 million respectively. The same table indicates intra urban disparity by taking in to account the same factors. The municipal corporations, municipal committees and town committees reflected difference in the stage of development. Especially the town committees (semi-urban areas) were not usually capable enough to provide bare minimum civic services. There were town committees such as Mustfaabad, whose per capita income was only Rs.2.62 per annum (Muhammad 2004).

District Council was the most important unit of rural councils. It enjoyed powers to impose, collect taxes and spend them according to their decisions. By considering the factor of per capita income and per capita expenditure one can observe the level of inter district council's disparity. For example, in 1981-82 the per capita income of the Multan district council was the highest in this cadre, i.e., Rs.32.3, whereas in those of the district councils of Sahiwal, Bahawalpur and Gujrat were Rs.22.19, Rs.6.18, Rs.7.43 respectively (Ttable 2).

**Table 2 Per Capita Income and Expenditure of Selected Urban & Rural Councils**

| Name       | Municipal Corporations (Urban Councils) |                                       | District Councils (Rural Councils) |                                       |
|------------|---|---------------------------------------|------------------------------------|---------------------------------------|
|            | Per Capita Income<br>Rs. 1981-82        | Per Capita Expenditure<br>Rs. 1981-82 | Per Capita Income<br>Rs. 1981-82   | Per Capita Expenditure<br>Rs. 1981-82 |
| Lahore     | 88.37                                   | 80.64                                 | 17.66                              | 28.60                                 |
| Gujranwala | 103.44                                  | 94.02                                 | 9.16                               | 8.15                                  |
| Saalkot    | 104.94                                  | 111.85                                | 10.16                              | 9.33                                  |
| Rawalpindi | 137.93                                  | 139.70                                | 9.77                               | 13.65                                 |
| Sargodha   | 114.17                                  | 107.38                                | 13.83                              | 13.59                                 |
| Faisalabad | 95.06                                   | 95.90                                 | 14.95                              | 16.42                                 |
| Multan     | 96.50                                   | 74.69                                 | 32.33                              | 33.28                                 |
| Bahawalpur | 79.31                                   | 78.59                                 | 6.18                               | 6.54                                  |

Source: Government of the Punjab (1994).

Moreover, the intra-district disparity in development was also wide spread. For instance, the villages that were close to the headquarters of the district council were more developed than those that were far flung. Similarly, villages situated in the constituency of chairman of district councils were used to get more funds than others. This was clear-cut injustice with other areas and misuse of funds to influence the future election result. Sargodha district council is the best case to understand this state of affairs. Mr. Anwar Ali Cheema the then chairman spent most of the funds in his constituency Tehsil Sargodha, while other three Tehsil of the District were neglected (Muhammad 2005).

The analysis and figures points out that institution was suffering from rural to urban, inter urban and intra urban, inter district and intra district disparities. There was not any mechanism to address the issue of uneven development and uneven capacities of different regions, authorities or units. Town Committees and villages were affected by shortage of funds. The percentage of grant was undersized. Some time rural councils and some time urban councils were main beneficiaries. Table 3 shows that the grant fluctuated from 1.71 percent to 8.98 percent in 1981-82 to 1990-91 the situation remained the same up-to 1998. In the case of urban councils the situation can be observed from the same table which shows that in 1981-82 to 1990- 91 the grant could not cross the magic line of seven percent of the total income.

**Table 3 Income Grant and percentage of Grant of Rural and Urban Councils**

| YEAR    | Rural Councils of Punjab |             |                   | Urban Councils of Punjab |             |                   |
|---------|--------------------------|-------------|-------------------|--------------------------|-------------|-------------------|
|         | Total Income             | Total Grant | % of total Income | Income                   | Total Grant | % of total income |
| 1981-82 | 1525.9                   | 50.2        | 3.29              | 1123.6                   | 18.5        | 1.6               |
| 182-83  | 1757.7                   | 47.5        | 2.70              | 1283.6                   | 15.9        | 1.2               |
| 1983-84 | 1959.3                   | 33.5        | 1.71              | 1444                     | 9.7         | 0.7               |
| 1984-85 | 2368.3                   | 64.4        | 2.72              | 1679.5                   | 23.3        | 1.4               |
| 1985-86 | 2544.3                   | 88.2        | 3.47              | 1791.1                   | 11.0        | 0.6               |
| 1986-87 | 2922.8                   | 112.5       | 3.85              | 2101.6                   | 44.6        | 2.1               |
| 1987-88 | 3325.1                   | 128.5       | 3.86              | 2338.7                   | 59.0        | 2.5               |
| 1988-89 | 3856.9                   | 265.1       | 6.87              | 2713.6                   | 150.3       | 5.5               |
| 1989-90 | 4326.1                   | 272.4       | 6.30              | 2949.1                   | 166.2       | 5.6               |
| 1990-91 | 5213.2                   | 468.1       | 8.98              | 3499.5                   | 241.7       | 6.9               |

Source: Government of the Punjab (1994).

This meager amount was never distributed according to scientific, fair and transparent formula. In many cases it was given on the basis of political affiliations, for example, in 1990-91 it was decided to provide amount of Rs. 1,00,000 to each union council. Practically the union councils, which were headed by the chairmen of the opposition parties, were excluded from the list. And this amount was spent through the committees comprised by the members of government party. In 1997-98 and 98-99 Lahore Municipal Corporation got maximum grant from the government.

The previous financial system was a centralized system and had a number of inherent flaws. The development funds were distributed to Provincial Departments according to their requirements. The main problem was the poor linkage between the Development and Non-Development budget. The Development schemes and projects were being undertaken with total disregard for the accompanying recurring costs. The funds earmarked for development could not be spent on Non-development activities. The identification, appraisal, and approval of development projects were centralized. This led to projects, which had no relationship with the local priorities. The element of Community participation was totally missing from the process. The design of projects did not include the viewpoint of the community. High technology projects were adopted where low cost technology should have been used. The issue of sustainability was overlooked in most cases. The process of allocating funds was totally non-transparent and inequitable. Politicians were provided development funds to be spent according to their wishes. All this led to a "Graveyard of Projects of 2006. In 2000 the government reevaluated the previous system and declared to fetch revolutionary changes Under Devolution Plan. In new system urban and rural councils

amalgamated and introduced three tier system "Union Council, Tehsil Government (Towns for big Cities) and District Government". All three governments are integrated by providing membership to directly elected Naib Nazim and Nazim of union council in Tehsil and District Government Assemblies respectively. It was opined that amalgamation of Rural and urban area will help to reduce rural and urban inequalities. Every council will be treated equally as they are lower tier of Tehsil and District Government respectively. Their representatives have equal vote and equal voice in upper tiers to fight the cases of their respective councils. Districts and Tehsil Councils will carry out inter Tehsil and inter Union schemes. Obviously these schemes will be beneficial for rural as well as urban areas equally.

A significant addition for equal and judicious distribution of resources is a provision for (Annex 2). Finance Commission (PFC). PFC is responsible to evolve distributive formula compatible to the requirement of respective province. The PFC took in account population, under-development, fiscal effort, revenue generation capacity, and expenditure requirement besides other. The objectives of fiscal transfers are to provide base-line levels for essential services, encourage own-source revenue efforts, encourage spending in priority areas and promote efficient spending.

### Distribution Criteria

All provinces have adopted a formula of sharing approach to the district level governments. None of the provinces has considered an objective-based fiscal transfer system. Population is the most important factor used in all provinces. Backwardness index is used in 3 of the 4 provinces, while the two largest provinces incorporated the tax effort provisions. Balochistan gives 50% weight to district areas and NWFP assigns 25% weight to infrastructure deficiency. In all cases, grant funds vary directly with fiscal need but fiscal capacity has no influence on grant entitlements (Annex 2 &3).

- From the above-mentioned decisive factor, following needs to be addressed:
- All local jurisdictions are treated likewise, which can result inter-jurisdictional fiscal inequalities. Large city districts with large services and entirely different needs are lumped to gathered with smaller and largely rural districts. Towns provide many services and facilities, especially in the social and cultural fields, which also benefit the surrounding areas. It therefore seems only reasonable that financial equalization should take into account the extent to which suburban or rural residents benefit from services financed by the central town.
- Tehsil council's municipal services should be recognized separately.
- With the devolution plan the dependency of local governments over provincial and federal transfers is overwhelming which results in strong incentives for local elected officials to more focus on influencing provincial distribution criterion and neglect local revenue raising efforts. This will give a trend to local units to collect fewer taxes from their respective areas. This is so because the incentive that the more they pay the more they get will nullify and the local units will yield less tax. This also

results in breaching an important aspect of bottom-up accountability.

- The PFCs should also focus on enhancing efficiency and equity, providing right incentives for responsive, responsible and accountable governance.
- Sales tax should be declared shared tax and share of its income should be considered own income of local government.
- Still a huge development grants are at the discretion of central and provincial governments. Discretion should be reduced.
- In 1998 Central government introduced sales tax and promised with the public to reduce the burden of other taxes if they will shoulder the burden of sales tax. Consequently, the Octroi tax and Zila tax were abolished and local governments are receiving the share of this tax in lieu of that. A huge amount is transferred in this category. This distribution formula favour already rich authorities and enhances inequalities. This amount also should be distributed according to PFC formula. However, PFC should readjust its formula by considering population, income, expenditure and needs of authorities.
- In 1998 Local Government share in Sales tax enhanced the percentage of government transfers to local government. In some cases these transfers went up to 91 percent of the total income of a local council (Annex 1).

This provided space to government to implement vertical equalization policies. It is suggested that the grants and shared taxes should be dispersed by taking in account the factor of equalization by institutionalized system. A fair, Transparent and realistic formula on the basis of population, area, income, expenditure and needs may be adopted for equalization and equity purpose.

The most obvious variable affecting the cost of the provision of local service is population. However, for identifying differences in some expenditure needs, this criterion is often found to be crude. For example, spending on schools depends largely on the number of school age children. Child care is influenced not only by the number of children but also those of the relevant age group, and so on. Moreover, the surface area of a local authority has an evident influence on the amount, which it has to spend on standard services and infrastructure. But for some purposes a more specific yardstick may be preferred, for example, the total mileage of roads to be maintained and repaired, Provision of Sewerage system and its maintenance, the proportion of built up areas, clean water, the total number of dwellings, the number of older dwellings, population density, population growth, and so on. To adopt such a basis for the equalization (spending requirements) is by no means free from problems, (i) availability of relevant statistical data (ii) it is difficult to fix the standard or level of the services to be provided (iii) Calculation of expenditure on needs. It varies from place to place.

It is necessary to mention that the equalization is not only the technical complexity, but also by a plurality of objectives and immediate relevance to material political interests, financial equalization can never be solely a matter of abstract models. It will always involve



elements of expediency, compromise and adaptation to the political context in which it is carried out but what is essential that is political will and transparent actions of political managers to minimize inequality and to promote equity must be there (Muhammad 2004).

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### Annex 1 District Councils: Total Income Percentage of Grant 1999-2000 (000')

| Name          | Total income | Total Grant Received | Grant% of total income of district |
|---------------|--------------|----------------------|------------------------------------|
| Kasur         | 122882       | 111956               | 91.11                              |
| Okara         | 79615        | 66127                | 83.06                              |
| Gujranwala    | 204928       | 33373                | 16.29                              |
| Hafizabad     | 36400        | 17585                | 48.31                              |
| Narowal       | 19708        | 8817                 | 44.74                              |
| Attok         | 127600       | 77734                | 60.92                              |
| Jehlum        | 54500        | 34160                | 62.68                              |
| Khushab       | 511704       | 41740                | 8.16                               |
| D.G. Khan     | 124076       | 101665               | 85.24                              |
| Muzafar Garh  | 136939       | 47934                | 74.24                              |
| Layyah        | 76388        | 50759                | 62.75                              |
| Bahawalpur    | 78159        | 46750                | 64.94                              |
| Bahawal Nagar | 65397        | 46750                | 71.49                              |

Source: Government of the Punjab (2001).

**Annex 2 Provincial Divisible Pool under Present System\***

| Province    | Divisible Pool Defined by the Province  |
|-------------|---|
| Punjab      | Provincial revenues from all sources  |
| Sindh       | Provincial receipts from federal revenue sharing, federal revenues returned by the province of collection, provincial tax revenues. Provincial non-tax revenues are excluded.   |
| NWFP        | Provincial revenues from all sources, minus provincial obligatory expenditures. The latter include: interest payments, debt repayments, pensions, subsidies, contributions to general provident and pension funds and charged expenditures on the governor's house, provincial assembly and high court. |
| Baluchistan | Provincial revenues from all sources except revenues from the 2.5% GST tax revenues   |

\* Each province defines the divisible pools slightly different.

**Annex 3 Weight Used in Provincial Finance Awards FY 2002-2003**

| Total Pool and Criteria                          | Punjab | Sindh | NWFP | Baluchistan |
|--|--------|-------|------|-------------|
| Local Share of Provincial Divisible Pool         | 39.8%  | 40%   | 40%  | 31%         |
| Formula Factors With Weights                     | 100%   | 100%  | 100% | 100%        |
| Population                                       | 75%    | 50%   | 50%  | 50%         |
| Backwardness                                     | 10%    | 17.5% | 25%  |             |
| Tax Efforts                                      | 5%     | 7.5%  |      |             |
| Fiscal Austerity                                 | 5%     |       |      |             |
| Area   |        |       |      | 50%         |
| Development Incentive/ Infrastructure Deficiency | 5%     |       | 25%  |             |
| Hold Harmless/ Transitional Assistance           |        | 25%   |      |             |

Source: Devolution in Pakistan Annex 2 Technical Considerations (2004).