

## **TAMING THE LEVIATHAN TOWARDS BETTER PUBLIC SECTOR RESOURCE EFFICIENCY: FISCAL FEDERALISM OR DECENTRALIZATION IN PAKISTAN**

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### **INTRODUCTION**

Fiscal decentralization, as a pivotal component of governance and economic policy, has gained substantial attention worldwide. The idea of redistributing fiscal powers and responsibilities between central and subnational governments has been implemented in diverse contexts to enhance local decision-making, improve public service delivery, and foster economic development. In the case of Pakistan, a country characterized by its intricate federal structure and multi-tiered governance system, fiscal decentralization has been a subject of significant policy experimentation and discourse.

With the advent of liberalized policies worldwide during the 1990's, many countries have shown strong advocacy toward fiscal aspects of decentralization. The major motivation behind fiscal decentralization is to achieve government resource efficiency and improvement in public sector service delivery. However, some mixed results are found in the case of developing countries such as Pakistan. In case of Pakistan, there is asymmetric decentralization of the fiscal and political institutions i.e., the political structure is completely decentralized as against the centralized fiscal system. In Pakistan, higher degree of fiscal centralization is observed due to greater share of the federal government in tax autonomy and spending as well as heavy reliance of the federating units on federal transfers.

Fiscal decentralization basically increase the competition between sub-national governments in provision of public goods leading to economic growth. In case of Pakistan, a recent research showed how fiscal decentralization can lead to economic growth by improving efficiency of sub-national governments. This shows how by simply giving more revenue generating responsibilities to sub-national government led to such a considerable impact on economic growth. Following such a positive impact on economy, it is important to explore how a growing economy can progress its public sector efficiency through the process of fiscal decentralization to escape the Leviathan. Proponents of leviathan hypothesis (Hobbs) view that national and sub-national government's act to maximize their expenditures when they have to draw resources and compete from a common divisible pool, resulting in rent seeking and inefficiencies. This research examines the effect of decentralization in this context. Major move towards decentralization in Pakistan was through 18th Amendment Act in 2010, which included significant changes like transfer of taxation powers to provinces, increased revenue sharing, increased provincial autonomy and provincial resource mobilization

Since 18th Amendment Pakistan has gradually decentralized more fiscal responsibilities to the provincial governments through the introduction of federal and concurrent list. The research paper also examines whether government service delivery has increased as result of fiscal decentralization in Pakistan. It is argued that Leviathan can be kept in check by effective decentralization i.e.

delegating spending and revenue generation to the local tiers of the government which are better informed on spending requirements. This research sees whether fiscal decentralization measures have been effective in achieving this by examining provincial expenditure.

## METHODOLOGY

This research provides a comprehensive analysis of the mixed results of fiscal decentralization in Pakistan by examining the dynamics of central and provincial government revenue and expenditure. By closely examining the shifts in revenue generation and allocation, as well as the patterns of public expenditure, this research aims to contribute to a more nuanced understanding of how fiscal decentralization has impacted Pakistan's governance and economic landscape.

Through an exploration of historical data it provides insights into the factors that have contributed to the mixed results observed in the wake of fiscal decentralization. The present research is a desk-study conducted by collecting data from secondary sources of various annual reports published by Ministry of Finance, Pakistan Bureau of Statistics and State Bank of Pakistan along with data from provincial ministries of finance for spending on sub-national level. The time-period covered is from 2010 till present depending on the availability of data in annual reports of SBP and statistical supplements. Also FY22 Federal and provincial government annual accounts are used to show current situation.

The research studied 10 variables classed into three objectives namely Fiscal Federalism and decentralization, fiscal discipline and public sector service delivery. The data sources for above were SBP Annual Reports (various issues), SBP Statistical Supplements (various issues), Economic Survey of Pakistan (various issues), Pakistan Bureau of Statistics, Ministry of Planning Development and Special Initiatives, PSDP reports (various issues), ADP reports (various issues). Outcome is in form of analytical analysis presented through descriptive statistics, graphical illustrations and comparison bar charts on the above variables.

## FINDINGS

Federal nature of Pakistan's fiscal operations is obvious as there is heavy reliance of provincial government on federal resource transfers specially tax transfers. The provincial tax collection as percentage of GDP is minimal which points to a constrained fiscal capacity at the subnational level. This phenomenon has implications for both fiscal autonomy and effective governance within the provinces. The central government's control over fiscal transfers leads to centralization of power and resources, aligning with the Leviathan model's predictions. This limits the effectiveness of fiscal decentralization in promoting local governance and development.

Fiscal transfers to provinces have increased as a direct result of new resource sharing formula under the 18th Amendment. Provinces expenditure has continued to increase as rate between 10-20% with ups and downs till FY22 as Leviathan went unchecked. Provincial own sources revenue generation has been low.

Provincial and federal government expenditure has continued to increase, provincial governments now account for a greater size of government as percentage of GDP. Budget deficit at the federal level are now lined with fiscal performance at the sub-national level with vertical imbalance increasing. Spending on public service delivery including health and education has continued to increase.

Revenue generation capacity at provincial level is limited and draw revenue from one or two major tax sources despite there being large number of tax heads and over five collection departments. The provincial governments have limited control over revenue sources, as the bulk of tax collection is conducted by the federal government. This dependency restricts their ability to generate sufficient revenue independently.

## CONCLUSIONS & KEY POLICY RECOMMENDATIONS

As a direct effect of increased revenue transfers after 18th amendment and updated NFC awards, provincial governments have turned into mini-leviathans of their own. The vertical imbalance has increased showing evidence of common pool hypothesis. This also leads us to the conclusion that the budget deficit at the federal level are now lined with fiscal performance at the sub-national level. Policy reforms should be such that they balance the need of the need for central oversight (federal) while empowering provinces to become more self-reliant financially

Transfer taxation power to the provinces with the initial plan of equating taxes collected by provinces to match those that need to be transferred through the NFC award. The federal government can begin with end in mind by calculating upcoming transfers and using that magnitude, devise tax policies with provincial governments that enable them to raise tax revenue equating to those that would have otherwise been transferred through NFC.

The government should enhance the capacity and autonomy of local government bodies, such as municipalities and district governments, to manage their own finances. This can be done by providing training, resources, and technical support to local officials.

Addressing challenges requires a multi-faceted approach involving policy reforms, capacity building, improved tax administration, and coordination between the federal and provincial governments. Enhancing the revenue generation capacity at the provincial level is crucial for effective fiscal decentralization, as it allows provinces to have greater fiscal autonomy, make informed policy decisions, and provide essential services to their citizenz. Some reforms that can be considered to mitigate these issues within the context of fiscal decentralization in Pakistan:

1. **Enhance Revenue Generation Capacities:** Encourage subnational governments to diversify their revenue sources and explore alternative avenues for generating income. This could include improving tax administration, expanding revenue streams such as property taxes, local user fees, and charges for services.
2. **Improve Fiscal Responsibility and Accountability:** Establish clear rules and guidelines for fiscal discipline at the subnational level. Encourage transparency in financial reporting and ensure that local governments adhere to fiscal targets and benchmarks. Strengthen auditing mechanisms to ensure effective utilization of resources.
3. **Incentivize Efficiency and Performance:** Link revenue transfers to performance indicators and outcomes, such as improved service delivery, infrastructure development, and public welfare. Implement incentive-based mechanisms that reward subnational governments for efficient resource allocation and effective governance.
4. **Capacity Building and Technical Assistance:** Provide training and capacity-building programs to enhance the fiscal management skills of subnational officials. Equip local governments with the tools and knowledge necessary to manage their budgets effectively and make informed financial decisions.

5. **Decentralize Service Delivery:** Devolve responsibility for service delivery to the level of government closest to citizens' needs. Empower local governments to take charge of essential public services, which can lead to more efficient and responsive resource allocation.
6. **Strengthen Intergovernmental Coordination:** Enhance communication and coordination mechanisms between the central and subnational governments. Develop frameworks for consultation and collaboration to ensure that both levels of government work together to optimize resource allocation and prevent duplication of efforts.
7. **Gradual Reduction of Transfers:** Gradually reduce the dependency on central government transfers over time as subnational governments build their revenue capacities. This can be achieved through a phased approach that includes a mix of revenue diversification, improved governance, and capacity development.
8. **Promote Local Economic Development:** Encourage local governments to foster economic growth within their jurisdictions by supporting entrepreneurship, attracting investment, and promoting industries that can contribute to revenue generation.
9. **Public Awareness and Participation:** Raise awareness among citizens about the importance of fiscal responsibility and efficient resource allocation. Encourage public participation in the budgeting process to ensure that local priorities are aligned with the allocation of resources.
10. **Regular Review and Adjustment:** Continuously monitor and evaluate the effectiveness of fiscal decentralization policies and their impact on dependency and efficiency. Adapt strategies based on lessons learned and changing circumstances.

By implementing a combination of these strategies, Pakistan can work towards reducing subnational government dependency on transfers and improving efficiency under the common pool hypothesis. It's important to recognize that these reforms may require a long-term perspective and commitment from both central and subnational governments, as well as active engagement from various stakeholders and civil society.