

Vertical Distribution of Divisible Pool of NFC Award for Azad Jammu Kashmir and Gilgit-Baltistan

By

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Abstract

Jammu and Kashmir, either administrated by Pakistan or India, is declared ‘disputed’ by the United Nation. The administrative responsibility of one part of Jammu & Kashmir (J&K) is entrusted to Pakistan through “trust obligation” of UN Security Council resolutions (UNSC) and UN Commission for India and Pakistan, UNCIP. The paper is about the fiscal decentralization for these ‘disputed’ territories i.e., Pakistan Administrated Jammu & Kashmir (PAJK) and Gilgit-Baltistan (GB).

The National Finance Commission (NFC) award is distribution of financial resources between the Centre and provinces – the vertical distribution – and among the four federating units – the horizontal distribution. The federal government has two sources of revenue i.e., tax income and non-tax income. The tax income is the divisible part under the NFC award. First, vertical distribution of divisible pool is decided between the federal government and four provinces i.e., Baluchistan, Khyber Pakhtunkhwa (KP), Sindh, and Punjab. Subsequently horizontal distribution among the provinces takes place. The current arrangement under the 7th NFC award is such that out of gross divisible income, the first 1% goes to KP as reconstruction relief due to ‘War on Terror’, and 0.66% goes to Sindh as compensation for abolishment of Octrio and Zila Tax in 1997; afterwards 57.5% goes to four provinces and the remaining income comes under the domain of federal government. The federal government pays for its obligations under its domain including debt servicing, defense, salaries and pension of federal employees and development and non-development funds to two ‘disputed’ territories of PAJK and GB. It is important to note that there is defined formula to distribute the 57.5% revenue only among four provinces, not for the territories of PAJK and GB. Moreover, Clause 3(A) of Article 160 of the Constitution says that the share of provinces in the new NFC award will not be less than prescribed share in the previous Award (i.e., 57.5%).

Currently, the distribution of resources to PAJK and GB is on *ad hoc* basis and at the discretion of federal government since these territories are not permanent members of NFC award. The findings of the research suggests two tiers solution to this issue based on the principle of ‘inclusiveness’ instead of ‘othering’. First, there should be constitutional amendments to provide permanent membership to PAJK and GB in the award while bringing them in ‘fiscal federalism’ without ‘political federalism’. Second, both territories should be accommodated in horizontal formula of distribution of NFC award while increasing the proportional ratio in vertical distribution of 57.5% followed by measures for fiscal equalization and adjustment.

Key Words: Fiscal Federalism, National Finance Commission (NFC), Jammu & Kashmir, Gilgit-Baltistan, Pakistan

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1. The History of NFC Award

The history of NFC award exists well before the partition of India when resources were distributed according to Niemeyer Award of 1936 under the Government of India Act 1935. The formula outlined a vertical 50:50 revenue sharing between center and provinces (Khan, 2015).² After creation of Pakistan, the same formula prevailed until the introduction of Raisman award in 1951. The award proposed 50:50 share of divisible pool whereas East and West Pakistan were getting 45:55 respectively in horizontal distribution. The next award came into effect by the Presidential Order No. 23 on 1st July 1962 by the President General Ayub Khan. That time, the country was governed on the principle of 'One Unit system'³ and the proportion of distribution between the East and West Pakistan was set at 54:46 respectively. The vertical distribution of resources between Federal government and two provinces (East and West Pakistan) was based on mixed criteria.⁴ The next NFC of 1964 gave more vertical share to provinces i.e., 65%. However, the horizontal distribution remained the same between East Pakistan (54%) and West Pakistan (46%). The NFC award of 1970 increased the vertical distribution to provinces to 80 percent (Ahmad, Mustafa, & Khalid, 2007; Khan, 2015).

After separation of East Pakistan (Bangladesh), the West Pakistan (Pakistan) is left with four provinces and three federating units (PAJK⁵, GB, and Federally Administrated Tribal area, FATA). The existing Constitution was approved by National Assembly of Pakistan on 19th February 1973. The Articles 160-165 of the Constitution deal with the NFC award. The Article 160(1) and Article 161(1) of 1973 Constitution of Pakistan mandates the President to constitute NFC award for a span of five years. Article 160 (2) clearly defines that the duty of the NFC is to make recommendations regarding distribution of the Divisible Pool between the federation and four provinces. It does not include the distribution of financial resources to PAJK and GB, instead it is placed under the domain of federal government to assign funds for both territories. Under the new Constitution, the NFC award of 1974 included few taxes in divisible pool such as corporation

² Under the award, agriculture tax and sales tax were provincial matter however, the former was not the part of divisible pool and later was under the domain of divisible income (Khan, 2015)

³ Under this arrangement, all provinces of West Pakistan was declared 'One Unit' in 1955. Hence, there were two Units of Pakistan i.e., West Pakistan and East Pakistan (Kalia, 2015).

⁴ For example, income tax was distributed 50:50 between federation and two units whereas sales and excise taxes were allocated 60 percent and remaining taxes were allocated 100 percent to the provinces.

⁵ In official document of Pakistan, PAJK is officially called Azad Jammu & Kashmir (AJK). Both PAJK and AJK are used interchangeably in this paper.

tax, sales tax, income tax and export duties. The award maintained the same old ratio of vertical distribution of 80:20 between provinces and federal government respectively and horizontal distribution among the provinces had a sole criteria of population. During the regime of President General Zia Ul Haq, both NFC awards of 1979 and 1985 were inconclusive and followed the formula of NFC award of 1974, where the later award was based on the census of 1981. The NFC award 1990 maintained same formula for vertical and horizontal distribution with the inclusion of excise duties on tobacco, tobacco manufacturing and sugar production. In addition, the award introduced a concept of ‘straight transfer’ where the income from indigenous resources of each province should be directly transferred to respective province after deduction of service charges on collection.⁶ The NFC award 1997 reduced the vertical distribution for provinces from 80% to 37.5% with the inclusion of all taxes (including custom duty) except excise duty on gas.⁷ (Ahmad et al., 2007; Khan, 2015).

The NFC award 2006, under the President General Pervez Musharraf, increased the vertical distribution to provinces from 37.7% to 41.5% (42.5%) for the first and second fiscal years 2007 (2008) respectively. For the remaining three years, the recommended increase was 1.25% for each year. The horizontal distribution among the provinces was still based on sole criteria of population. In addition, 1/6th of sales tax was transferred to provinces to compensate them for the losses due to abolition of Octroi and Zila tax (Ahmad et al., 2007; Khan, 2015).

A major breakthrough for provincial autonomy came with the announcement of 7th NFC award in 2009 assigning 56.5% for the year 2010-11 and 57.7% for the remaining four years of the award.⁸ After the separation of East Pakistan (Bangladesh) in 1971, population had been sole criterion for distribution of divisible profit among four provinces until 7th NFC award, which was based on four parameters. The 7th Award is operative since 1st July, 2009. It has the following salient features and give substantial financial autonomy to the provinces:

- It has enhanced the share of vertical distribution to 57.5% among four provinces.

⁶ Articles 172 (3), read with 161(1) and 154 (1) of the Constitution deal with ‘straight transfer’.

⁷ The taxes include income tax, custom duty, corporation tax, sales tax, capital value tax, wealth tax, and excise tax (excluding excise duty on gas). Some other features of this award were: an increase in the fixed amount of subvention for KP and Baluchistan, pursuing Structural Adjustment Program of the IMF, matching grants against the sub-national fiscal efforts and abolition of Octroi and Zila Tax.

⁸ http://www.finance.gov.pk/nfc/reportofthenfc_2009.pdf

- It set aside 1% of divisible pool for KP in connection with war on terror. Up till now, the KP government has received Rs. 1.894 trillion in this connection (The Ministry of Finance, 2019).
- The provision of extra 0.66% for Sindh to offset the losses due to abolition of Octrio and Zila Tax back in 1997.
- The use of multiple indicators for horizontal distribution which was previously based on sole criteria of population. The current criteria of horizontal distribution is based on four parameters: Population (82%); Poverty and Backwardness (10.3%); Revenue Collection and Generation (5%); and Inverse Population density (2.7%). Based on these four parameters, during 2009, the share of each province was: Punjab 51.74%, Sindh 24.55%, Khyber Pakhtunkhwa 14.62% and Baluchistan 9.09%.
- To safeguard share of Baluchistan on budgetary projection in comparison of actual receipts. The federal government paid about Rs. 90 billion till now to fill the protection granted to Baluchistan (The Ministry of Finance, 2019).
- The declaration of the GST on services as provincial matter. Though, the GST on goods is still a federal subject and included in divisible pool taxes.
- A reduction of collection charges of taxes by Federal Board of Revenue (FBR) from 5% to 1%.

The 18th Amendment provides further protection and autonomy to the provinces while including clauses 3(A) and 3(B) in Article 160. The clause 3(A) states that share of a province in each NFC award should not be less than the ratio of that province in preceding award. Similarly, the Clause 3(B) assures the proper implementation of the award by federal and provincial finance ministries. Based on the clause, the government published Biannual Monitoring of Implementation of NFC Award reports.

Various scholarships support the notion that 7th NFC award and 18th Amendment provide financial autonomy to the provinces (Waseem, 2010; Mustafa, 2011). However, it has created a serious deficit at federal level (Ismail, 2018). For example, the federal deficit in post-7th NFC award period (2010-2018), on average, is 6.8% of GDP in comparison to 5.5% in pre-7th NFC award period (2005-2010).⁹ According to Federal Ministry of Finance, the remaining amount after distribution

⁹ Official documents of Ministry of Finance.

among provinces are not enough to finance two important and obligatory expenditures i.e., debt servicing and defense.

Dr. Salman Shah, the member of NFC award from Punjab, addresses the challenges to federal government in financing deficit including low tax-to-GDP ratio, circular debts, high debt servicing, loss making public sector enterprises, increasing cost of pension fund, deficit in provision of key social services including health and education, providing jobs for youth, regional issue of poverty and human development.

Seven NFC awards were conclusive i.e., 1951, 1962, 1964, 1974, 1990, 1997, and 2009; however, some NFC awards were inconclusive such as 1970, 1979, 1985, 2006, and 2015. Most of the awards in the elected governments were based on consensus and proved conclusive, however, the awards in the military regimes have deadlocks (Waseem, 2010). In addition, the NFC ‘has recorded a history of *ad-hocism* and a lack of scientific approach’ (Khan, 2015, p. 363), and this is specifically true in case of PAJK and GB.

According to latest statistics of 2019 by the Ministry of Finance, the total spending is 22% of GDP, of which 9.9% is on general public services, 4% on economic affairs, 3% on defense, 2.3% on education, 1.4% on law and order, 1.2% on health, 0.3% on housing and community amenities, 0.1% on social protection and very minimal percentage for environment protection. On the other hand, the revenue including grants is 15.4% of GDP which results in a financing deficit of 6.6% of GDP. In this 15.4% receipts, 13% came from taxes including 11% tax from FBR.

After the 7th NFC, deliberations were started for holding the 8th NFC award from July 2010. However, the award was inconclusive and agreed to continue the formula of 7th NFC till the announcement of 9th NFC award in July 2015 which will complete its tenure in June 2020. Recently, the President reconstituted the 9th NFC award in January 12, 2019. The NFC meeting dated February 6, 2019 formed six working groups to focus on different aspects of the award.¹⁰ The working group – II addresses the perspective of federation about vertical distribution of the Award and has four themes: (1) Setting aside a percentage of divisible pool for PAJK and GB; (2)

¹⁰ Working group –I: Punjab will coordinate the group and do recommendation on “Macroeconomic Framework and Determinants of Benchmark for Receipts and Expenditures of Federal and Provincial Governments”. Federal government will coordinate Working group –II: “Vertical distribution of divisible pool resources including distribution of funds for GB/PAJK, establishment of fund for security and natural disasters”. Baluchistan will coordinate Working group –III: “Devising formula for horizontal distribution including selection of indicators”. Sindh will coordinate working group –IV: “Tax procedures and payment systems to facilitate businesses”. Khyber Pakhtunkhwa will look after working group – V: “NFC for the development of erstwhile FATA, following its integration/merger with KP.” Baluchistan will coordinate working group –VI: “Streamlining straight transfers”.

Establishment of fund for Security and Disaster Management; (3) Sharing of subsidies of Energy Sectors by the Provinces; and (4) Change the composition of divisible pool taxes. This paper focuses on the first theme of the working group i.e., vertical distribution for PAJK and GB.

2. The Political Economy of Pakistan Administrated Jammu & Kashmir (PAJK) and Gilgit Baltistan (GB)

The situation of Jammu and Kashmir (J&K) has been politically problematic since late 1830s when the troops of Gulab Singh invaded the area for the first time (Huttenback 1961). Both areas now known as PAJK and GB came under the control of princely state of Jammu and Kashmir (J&K) in 1846 through Treaty of Amritsar (Hayat, 2016)¹¹ under the control of Dogra Raj. During British Raj, GB was part of Frontier Territories of princely state of J&K (Dogra Raj), a part of that territory was declared as Gilgit agency by British in 1878 and then again in 1889 (Sökefeld, 2015a). Till 1935, it was jointly governed by both British and Dogra Raj, afterwards the territory was leased by British from Maharaj Hari Singh for sixty years (Sökefeld, 2017). The notably point is that at the time of partition of India, major part of current GB was under the control of *Maharaja* Hari Singh (Hayat, 2016).

The map (Figure 1) shows the total area of J&K. Currently, the PAJK is situated in Western part of Kashmir valley, GB is situated northwestern corner of Kashmir valley and Indian Administrated Kashmir (IAK) is situated in the eastern part of Kashmir valley (Snedden, 2013).

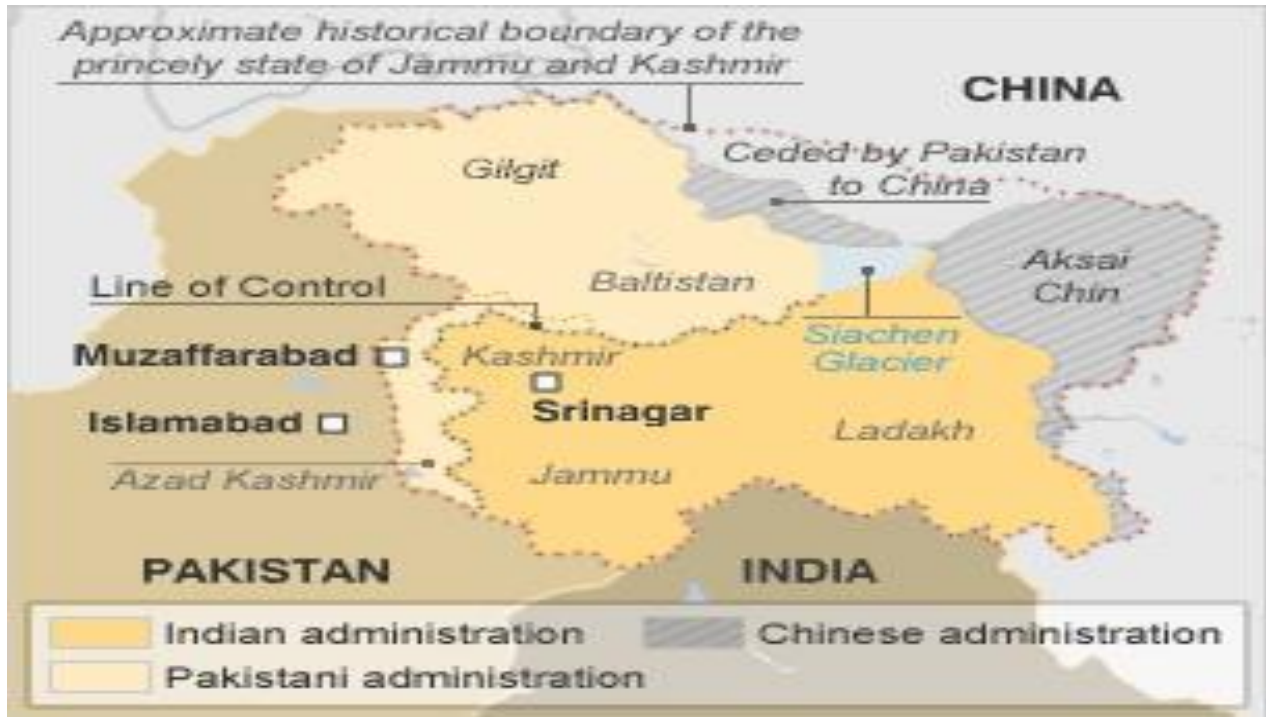
The total area of J&K is 222,236 Sq. Km (85,806 Sq. Miles). Out of which only two fifth is under the control of Pakistan (Gillani, 2011). The total area of PAJK is 13,297 Sq. KM (5,134 Sq. Miles) and GB is 72,496 Sq. Km (27,990 Sq. Miles). The area of GB is six times more than PAJK (Sökefeld, 2017). According to 2017 census, the PAJK population is 4,045,366 and GB has 1,900,000 (Baltistan has 922, 745 and Gilgit has 977,255).¹² The Multidimensional Poverty index of PAJK is 0.115 and GB is 0.209.¹³ The Inverse Population Density of PAJK is 0.003287 and GB is 0.038156 based on the census of 2017.

Figure 1: Map of Princely State of Jammu and Kashmir

¹¹ <http://www.kashmir-information.com/LegalDocs/TreatyofAmritsar.html>

¹² A significant number of population of GB and PAJK is settled in other parts of the Pakistan. For example, in 2011, the population of GB was 1.4 million and PAJK is 3.5 million. And the residents living outside the areas in other cities or abroad is 1.6 for GB and 1.5 for PAJK (Sökefeld, 2017).

¹³ The estimation is according to Pakistan Human Development Index Report by UNDP, 2018.



After the partition of united sub-continent, in October-November 1947, the residents¹⁴ and PAJK revolted against Maharaja and declared accession with Pakistan.¹⁵

Jammu and Kashmir, either administrated by Pakistan or India, is declared ‘disputed’ by the United Nation (Hayat, 2016). The administrative responsibility of PAJK and GB is entrusted to Pakistan through “trust obligation” of UN Security Council resolutions (UNSC) and UN Commission for India and Pakistan, UNCIP (Gillani, 2011). Formally, the PAJK and GB (formerly known as Northern Areas) administration came under the domain of Pakistan through Karachi Agreement of 1949 (Mahmud, 2006).¹⁶ In March 1949, the Ministry of Kashmir Affairs and Northern Areas (now known as Ministry of Kashmir Affairs and GB) was established.

The PAJK was governed through different acts such as Act 1960, 1964, 1968 and 1970. The first election of presidential and legislative assembly of PAJK took place in 1970. Later, Azad Jammu

¹⁴ The Gilgit Scout (paramilitary troop established by British) and Pashtun Tribals also participated in the revolt (Hayat, 2016). The people of GB celebrated November 1 as Independence Day (Lamb, 1991).

¹⁵ Though, the scholarships exist over the controversies of the ‘timing’ and ‘nature’ of accession with Pakistan. According to Hayat (2015), there is no consensus upon the timing of signing the instrument of accession with Pakistan. However, Bangash (2016) and Mir (2016) support the narrative that formal accession with Pakistan took place. Waseem (2010) documented that there was unilateral accession with Pakistan by local administrator Major Brown in 1947. Though, many people in PAJK still consider GB as their part (Sökefeld, 2015b). But the irony of the fate is that Pakistan looks GB as a part of disputed territory but not the part of Jammu and Kashmir (Sökefeld, 2017). Though, the people of GB demand full accession with the Pakistan (Ali and Akhunzada, 2015; Sökefeld, 2017).

¹⁶ Hayat (2016) commented that “Government of PAJK and Government of Pakistan has no *locus standi*” for this agreement. Indeed, it is just power sharing formula between PAJK, GB and Pakistan.

and Kashmir ‘Interim Constitution’ was adopted in 1974 for governance of this territory.¹⁷ The PAJK council was established under Section 21 of the Interim Constitution where majority of seats are owned by Pakistan and chaired by Prime Minister of Pakistan.¹⁸ It is the highest linking forum between federal government of Pakistan and PAJK (Shafiq, 2015). This way, Pakistan tightened its control on PAJK where many subjects are with federal government of Pakistan including foreign policy, defense, international trade, paper currency, and security (Gillani, 2011). The Ministry of Kashmir Affairs took care of the affairs of Kashmir before the establishment of the Council.

In initial years of Pakistan, the GB was governed under the colonial rule of Frontier Crime Regulations (FCR). In 1970, the first election for the Northern Areas Advisory Council was announced.¹⁹ In the time of Presidency of Zulfikar Ali Bhutto, the FCR and taxes of GB were abolished (Sökefeld, 1997b) and constituted Northern Areas Legislative Council. In the year 1979, the construction of Karakorum Highway (KKH), which links China and Pakistan is passing through GB, is a major step to bring the attention of Pakistan to GB (Hayat, 2015). In the latest reform of 30th August 2009, the Gilgit-Baltistan Empowerment and Self-Governance Order 2009²⁰ was promulgated. Resultantly, GB Council was established similar to the PAJK Council in May 2010 under Article 33 of the Order, 2009.²¹ The Order 2009 provided “province-like status” to the Northern Areas while renaming it as Gilgit-Baltistan (Waseem, 2010).

There are three tiers of constitutional structure for GB and PAJK (Gillani, 2011; Shafiq, 2015). Tier 1 is the Government of Pakistan which exercise all legislative and executive authorities in the subjects of defense, foreign policy, international trade, foreign aid and currency issuance. Tier 2 is

¹⁷ <https://law.PAJK.gov.pk/assets/lawlibrary/2019-02-13-5c645034ade141550078004.pdf>

¹⁸ The council comprises of 14-member of PAJK and 15-member of GB. The Prime Minister of Pakistan (Chair) appoints five individuals out of members of parliament of Pakistan.

¹⁹ According to Hayat (2015), the “Azad Jammu & Kashmir Government Act 1970” is the only Act in the history of PAJK which provided autonomy to the territory. The author suggested that the same Act should be used as a reference point to give more autonomy to PAJK and GB (Shafiq, 2015).

²⁰ The Interim Constitution of 1974 for PAJK is similar in many ways to that of Gilgit-Baltistan Empowerment and Self-Governance Order, 2009. However, a notable difference is that any amendments in PAJK is carried out by joint sitting of Legislative Assembly and Kashmir Council; however, any amendment in GB is purely done by Government of Pakistan (Gillani, 2011).

²¹ The Gilgit-Baltistan Council comprises of a Chairman (PM of Pakistan), Vice Chairman (Governor GB), Chief Minister Gilgit-Baltistan, Six members nominated by the Chairman, Six Members elected by GBLA, Federal Minister for Kashmir Affairs, and the Minister of State for Kashmir Affairs and Gilgit-Baltistan (Ex-officio). <http://www.gilgitbaltistan.gov.pk/images/stories/downloads/Governance-Order.pdf>

the Council²² for PAJK and GB which have the domain of federal legislative and behave like the role of federal government for the four provinces. The councils act like an anchor between PAJK & GB and federal government (Shafiq, 2015). Tier 3 is Legislative Assemblies and Governments for PAJK and GB for remaining subjects including day-to-day affairs of the territories. It is important to mention that the subjects under the domain of governments of PAJK and GB are mostly carried out by the bureaucrats appointed directly by Government of Pakistan commonly known as “lent officers” such as Chief Secretary, Accountant General, Inspector General of Police, Secretary Health, Auditor General etc. (Feyyaz, 2019; Shafiq, 2015; Mahmud, 2016).²³ In nutshell, both PAJK and GB are “not a de jure but a de facto part of Pakistan.” (Sökefeld, 2017, p. 13). It is also important to note that both PAJK and GB do not have permanent representation in Federation of Pakistan as they do not have seats in National Assembly, Senate and any federal institutions which coordinate relationship between federal government and provinces such as Council of Common Interests (CCI), National Economic Council (NEC), National Finance Commission (NFC) and Indus River System Authority (IRSA) of Pakistan. Even, they do not have claim on the resources of hydro-electric projects despite the fact that both GB and PAJK have economic resource of water (Gillani, 2011; Sökefeld, 2015b). This phenomenon is sometimes termed by the residents as ‘colonization’ by Pakistan (Sökefeld, 2017, p. 12). “Pakistan creates a ‘state of exception’ in which PAJK and GB enjoy neither constitutional rights nor actual autonomy.” (Sökefeld, 2015b, p. 185). According to Husain (2018) “GB is loosely defined as a centrally-administered, partially-empowered and economically-dependent part of Pakistan.”

The most recent development regarding the constitutional position of GB and PAJK is the abolishment of the Council in February 2018. There was demand by the residents of both territories to give more empowerment to respective assemblies (Shafiq, 2015; Hayat, 2016) and it can be done with the abolishment of the councils of both territories. After abatement of PAJK council, many subjects devolved to respective assembly including tax collection. Now the tax collection in PAJK is administered by Ministry of Finance PAJK which was previously collected by PAJK Council. Any tax collection from PAJK is not transferred to federal divisible pool.

²² The Chair (PM Pakistan) appoints five members of 14-member Council of PAJK and 15-member Council of GB out of members of parliament of Pakistan.

²³ The lent officers are more in GB compare to PAJK. The 2009 Order specifies explicit formula for operational distribution of administrative powers between federal and GB government. The formula specifies that federal government appoints officers of Basic Pay Scale (BPS) 17, 18, 19 and 20 in a proportion of 25%, 50%, 60% and 70% in GB’s administrative setup. This way, GB is more closely administrated by the federal government (Hussain, 2018).

However, the members of GB strongly opposed the decision and pressurized the federal government to re-instate the Council. Resultantly, in May 2018, the GB council is retained in the 23rd meeting of National Security Committee. In addition, GB is given tax exemption for five years which was levied in March 2012). GB is also given a status of an “observer” in the NEC, IRSA, CCI and NFC. Since 2014, the federal government has been demanding to increase the share about 6-7% to accommodate the expenditure of security and grants for PAJK and GB (Shah, 2019).

After the devolution of many subjects to the provinces (and hence after the territories), the direct funding from federal government for various projects had suffered a lot. For example, in year 2011, federal government was funding five different projects in the Ministry of Food, Agriculture and Livestock in PAJK with the total cost of Rs. 900.658 million. After the devolution, the PAJK government paid Rs. 386.105 Million till the end of 2011 (Feyyaz, 2019). Though, the planning commission of Pakistan provided aggregate compensation for the devolved ministries but not explicit provision for the three territories.

Table 1: Revenue of PAJK

		Rs. In Billion							
Revenue		2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20 target
Own Receipts of PAJK									
1	Tax Revenue	8.31	10.63	10.04	14.27	15.74	20.46	22.33	25.60
2	Non-Tax Revenue	8.60	10.12	12.31	11.58	11.20	12.90	16.68	16.10
3	Other Loan & Advances	-	-	-	-	-	-	0.29	0.45
Sub-Total (1)		16.91	20.75	22.35	25.84	26.95	33.36	39.30	42.15
Receipts from Federal Government									
1	Recurring	21.50	24.60	26.77	27.37	31.76	39.15	49.00	54.85
2	Development	9.55	10.50	10.50	11.50	12.00	22.00	22.00	24.50
3	PSDP	2.46	3.49	1.23	1.55	2.45	3.34	3.86	2.46
Sub-Total (2)		33.51	38.59	38.50	40.42	46.21	64.49	74.86	81.81
Total = Sub-Total(1) + Sub-Total (2)		50.42	59.34	60.85	66.27	73.16	97.85	114.16	123.96
Total Gross Divisible Pool		1,887.31	2,184.82	2,467.09	3,083.97	3,173.99	3,691.32	N.A	N.A
Net Divisible Pool excluding 1% Collection Charge of FBR		1,868.36	2,162.97	2,442.34	3,041.39	3,129.38	3,640.24	N.A	N.A
Receipts from federal Govt. as		1.79%	1.78%	1.58%	1.33%	1.48%	1.77%	N.A	N.A

percentage of Net Divisible Pool								
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Note: For 2011-12: Gross (Net) Divisible Pool is 1,800.30 (1,782.22) Billion; for 2010-11: Gross (Net) Divisible Pool is 1,470.53 (1,455.77) Billion. Till 2018, the tax is collected by PAJK Council and then transferred to the PAJK government. After 2018, now it is directly collected by PAJK finance department. The average of the last row is 1.62%.

3. Proposed Constitutional Amendments

The previous section of the paper presents that both PAJK and GB territories trace roots from previously Princely State of Jammu and Kashmir and lately declared ‘disputed’ by the UNSC and UNCIP, whether administrated by Pakistan or India. Pakistan is administrating both PAJK and GB under the “trust obligation” of the UN. Under these circumstances, it is constitutionally difficult for Pakistan to declare them as ‘provinces’ (Gillani, 2011; Hayat, 2015; 2016). Moreover, this move will also hurt the stance of Pakistan towards Kashmir which states that the issue should be resolved according to the wishes of the Kashmiris. That’s the reason that Pakistan is raising serious concern at the abolition of Article 370 and 35(A) by India.²⁴

One argument is that both PAJK and GB should be declared provinces like the other four as the same is happened in case of FATA merger with KP under 25th Amendment. Even the research of Ali and Akhuzada (2015, p. 9)’ survey said that about 82% of GB population “prefer to call themselves Pakistanis and disassociate themselves from the larger Kashmiri identity” and wish to join Pakistan either as permanent or provisional province. In May 29, 1999 judgement of Supreme Court of Pakistan says that residents of GB are “citizens of Pakistan in all intent and purposes”. The residents of GB and PAJK are “*de jure*” citizens as they possess the Computerized National Identity Card (CNIC) and passport of Pakistan (Sökefeld, 2015b, p. 176).²⁵ However, many residents still consider their connection with the Kashmir valley and wish to be an independent territory after permanent resolution of dispute as per the wishes of the residing people according to the UN resolutions (Hayat, 2015, 2016). There is claim on the territory by PAJK as well. The

²⁴ The Article 370 gave ‘special status’ to J&K where only few subjects were with federal government of India such as foreign affairs, defense, and communication. The rest of the subjects were under the domain of J&K assembly which was formed by Maharaja in form of interim government in March 1948 under the government of Sheikh Muhammad Abdullah. In order to assure the identity of local Kashmiris, Article 35(A) restricts Indians to buy land in Kashmir. Recently, Indian government abolished Article 370 and 35(A) on August 5, 2019 through Jammu and Kashmir Re-organisation Act. This Act fully brought the J&K under union government which is violation of resolutions of UNSC and UNCIP (Ahmar, 2019).

²⁵ A paradoxical position of Pakistan regarding the territories is the member of legislative assemblies of both PAJK and GB do not have representation in National Assembly and Senate and cannot become Prime Minister of Pakistan. However, the natives of same territories settled in other parts of Pakistan can vote and may be member of respective provincial assembly and national assembly of Pakistan (Gillani, 2011).

High Court PAJK judgement of 1993 by Chief Justice Malik Majeed is a reference point in this regard where GB was declared as a part of PAJK. Later on, the Supreme Court of PAJK reverted this decision on ‘technical grounds’ (Sökefeld, 2015b). So any unilateral decision by Pakistan to declare both territories as provinces may not be acceptable to the residents of respective areas (Hayat, 2015, 2016) and contrary to the historical connection of the territory. Hence, it is not only the discretion of Pakistan to declare it as a province or not; instead the historical references and wishes of the residents of GB and PAJK should be kept on priority in this regard.

It is suggested that there should be an ‘interim’ constitutional arrangements under the Article 257 of Pakistan constitution which says that “when the people of the State of Jammu and Kashmir decide to accede to Pakistan, the relationship between Pakistan and that State shall be determined in accordance with the wishes of the people of that State.” The ‘interim’ arrangements should be till the permanent solution of Kashmir dispute according to the UN’ resolutions (Gillani, 2011). For this purpose, some of the clauses of constitution of 1973 have to be amended such as Article 1(2), Article 40, Article 41, Article 51, Article 59, Article 257 and Second Schedule (Gillani, 2011; Hayat, 2016). In this regard, the ex-prime minister of PAJK, Raja Farooq Haider Khan commented that Article 31(3) should retain with the government of Pakistan and the rest of the subjects should be given to government of PAJK (Pildat, 2011). To bring both territories in ‘fiscal federalism’ without ‘political federalism’, there should be an Amendment in Article 160 (2a) of Pakistan Constitution which elaborates “the distribution between the Federation and the Provinces of net proceeds of the taxes”. It should be amended as “the distribution between the Federation and the provinces (including two territories of PAJK/GB) of net proceeds of the taxes”.

This paper pushes for a debate to include GB and PAJK in ‘fiscal federalism’ without ‘political federalism’. By fiscal federalism I mean to treat both PAJK and GB like other four provinces in financial matters. In addition, the arrangement should be ‘interim’ till the permanent solution of Kashmir dispute. This way the residents of the territories will have equitable rights and facilities like other provinces of Pakistan. This is also not new as different clauses of the Interim Constitution of 1974 for PAJK and the Order 2009 for GB show that both territories are similar to the four provinces in many ways such as issue of CNIC and Passport for the residents of both PAJK and GB; the oath of loyalty with the ideology of Pakistan and the cause of accession of Jammu and Kashmir with Pakistan; Quota in CSS exams for both territories like provinces; the natives of both areas can vote in provincial and national assembly of Pakistan if they are settled

there, even they can contest for these assemblies; major political parties have political stakes and contest elections in these areas (Gillani, 2011). All these points show that these territories are treated ‘like’ province, but not province (Sökefeld, 2017). So, it is not anything out of blue to do constitutional amendments to bring them in the domain of ‘fiscal federalism’.

4. Accounting for PAJK and GB in NFC Award

Table 2 & 3 are computed based on the data of fiscal year 2017-18. Table 2 shows the share of horizontal distribution for four provinces and Table 3 is a proposed horizontal distribution after inclusion of PAJK, GB and FATA in NFC award. Both the tables are based on certain assumptions.

- The population is based on 2017 census as the 9th NFC award would be calculated on the data of 2017.
- Inverse Population Density is equal to 1/population density where population density = population/area (Sq. KM). The population is based on 2017 census.
- The Poverty and Backwardness is Multidimensional Poverty Index calculated by UNDP Human Development Index report, 2018.²⁶
- The 7th NFC award gives half weight to Tax Collection and half weight to Tax Generation. The withholding tax on electricity consumption is used as a proxy of Tax Generation. One limitation of the computation is that it assigns whole weightage to tax collection as I did not find the values of Withholding Tax on electricity consumption of each province and territory. According to 7th NFC award, the Tax Collection and Generation Ratio was 44% (Punjab), 50% (Sindh), 5% (KP) and 1% (Baluchistan). The computation of Table 2 shows similar pattern based on Tax Collection only but the percentages are different. So it will not bring much difference in the overall computation of horizontal share of each province.
- The computation does not have the data of Islamabad.

Table 2: Tentative Horizontal Distribution of NFC Award (Based on Data of 2017-18)

Province	Population (%)	Inverse Population Density	Poverty and Backwardness (%)	Tax Collection (%)	Horizontal Distribution (%)	Horizontal Ratio (7 th award)
KP	15.20	0.0024	24.34	14.31	15.88	14.62

²⁶ The 7th NFC award calculated the Poverty and Backwardness Index while averaging the findings of three reports i.e., Poverty Reduction Strategy Paper-I (PRSP-I) report, Human Development Index by UNDP Report, 2003 and Human Development Index by Federal Bureau of Statistics Pakistan Report, 2008. However, this computation assumes a single estimate of Multidimensional Poverty Index calculated by UNDP Human Development Index report, 2018.

Punjab	54.80	0.0019	14.80	50.52	49.13	51.74
Sindh	23.85	0.0029	22.49	27.10	23.45	24.55
Baluchistan	6.15	0.0281	38.36	8.06	11.54	9.09
Total	100.00	0.0354	100.00	100.00	100.00	100.00

The Table 2 shows the horizontal distribution for only four provinces (excluding FATA as well). It is evident from the Table that the share of Punjab and Sindh have decreased while the ratio of KP and Baluchistan have increased according to new data. This computation is not surprising as same results are documented by Arqam (2019) in a report published by News Line magazine quoted “Under the provisional results of the 2017 population census, which is yet to be approved by the Council of Common Interests (CCI), the allocated share of Baluchistan and KP would increase, while that of Punjab would decrease by more than 5 per cent.”

Table 3: Tentative Horizontal Distribution of NFC Award (Based on Data of 2017-18)

Province	Population (%)	Inverse Population Density	Poverty and Backwardness	Tax Collection (%)	Horizontal Distribution
KP	14.42	0.002441	14.81	14.19	14.14
FATA	2.36	0.005442	19.96	0.00	4.17
Punjab	51.96	0.001867	9.00	50.08	46.10
Sindh	22.62	0.002943	13.68	26.87	21.40
Baluchistan	5.83	0.028125	23.34	7.99	8.51
PAJK	1.91	0.003287	6.81	0.77	2.41
GB	0.90	0.038156	12.38	0.11	3.27
Total	100.00	0.082261	100.00	100.00	100.00

Note: The Tax collection of GB is extracted from Financial Statements prepared by Accountant General of Pakistan where tax collection from GB government: 212 Million and GB council is 1894 Million, Total: 2,106 Million.

The Table 3 is a proposed horizontal distribution of resources after inclusion of PAJK, GB and FATA. After the merger of FATA with KP, the province would have claim on share of FATA as well after interim period of five year. For computation purpose, I assume no taxation from FATA as it was a tax-exempted zone before merger.

4.1 Extracts from Computation for PAJK

- According to the formula (Table 3), PAJK share is 2.41% in horizontal distribution and Receipts from Federal Government as a percentage of Net Divisible Pool is 1.62%, on average, for PAJK (Table 1).

- So the difference is in a form of deficit of $2.41 - 1.62 = -0.79$.
- A portion of the deficit (0.79%) can be covered with the help of transferring tax²⁷ of PAJK to federal divisible pool which is 0.56 of Net Divisible Pool for the year 2017-18. $(20.46/3640.240 * 100)$
- The remaining deficit can be offset after adjusting 1% of special allowance for ‘war on terror’ on need basis. This special allowance should be on pro-rata basis depends on the security situation. For example, if the situation on eastern border is tensed, it should be for PAJK and GB and similarly for KP and Baluchistan in case of tension on western border.
- Any other deficit should be compensated from non-tax revenue of federal government as there have been practices of special grants to different territories for fiscal equalization and adjustment. In addition, other provinces can accommodate a portion of deficiency.
- I also did separate computation while taking the values of budgeted Revenue and Capital Expenditures from Budget Reports of PAJK over the period from 2012-13 to 2017-18.²⁸ The total Revenue and Capital Expenditure as percentage of Net Divisible Pool is 2.5%, on average. It shows that federal receipts to PAJK is an excess of the proposed share of 2.41% (Table 3). In this case, the inclusion of PAJK will bring surplus for the federation especially when the tax revenue of PAJK is also transferred to the Divisible Pool.

Similar computation can be calculated for GB.²⁹ The table also shows that if population is the sole criterion of horizontal distribution, the inclusion of PAJK and GB may lead to have surplus revenue for federal. As federal grants, on average, to PAJK and GB is lesser than their combine share in Net Divisible Pool. Moreover, one can expect an increase in tax revenue from GB once the operation of CPEC route starts in future which will also boost commerce, trade and tourism.

²⁷ As the table is just an estimation, so I did not exclude the GST on services which is a provincial matter.

²⁸

Revenue and Capital Expenditure as percentage of Net Divisible Pool	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	Average
	2.65%	2.57%	2.54%	2.24%	2.35%	2.59%	2.49%

The data is available on demand.

²⁹ One of the biggest limitations of the paper is unavailability of complete ten years data, since the Order 2009, for GB in order to provide data similar to Table 1 for PAJK. <https://www.thenews.com.pk/tns/detail/566553-award-g-b-problem> says that GB government got Rs. 20 Billion in grants for the year 2017-18. If we assume this amount as total Revenue and Capital Expenditures for the year, then the percentage of the federal receipt for GB as percentage of Net Divisible Pool is $(20 * 100 / 3,640.24) = 0.56\%$.

4.2 Proposed Adjustment in NFC Vertical Distribution of Resources

It is proposed that both PAJK and GB should be included as permanent members in NFC award. The computation reveals that the *ad hoc* federal grants to both territories are not significantly different from their share in ‘proposed’ horizontal distribution (Table 3). This can be best accommodated while increasing the share of vertical distribution to the amount of each territory in ‘proposed’ horizontal distribution. For example, the vertical distribution of 57.5% should be increased by 2.41% for PAJK. Any discrepancy can be adjusted via:

- I. Transferring taxation of both PAJK and GB to Divisible Pool.
- II. Re-visit 1% special allowance of ‘war on terror’ on need basis.
- III. The provinces can accommodate some portion of deficiency like in case of Germany where rich provinces transfer to poor provinces; KP province is already doing it where a portion of revenue from settled districts is transferred to FATA.
- IV. Lastly, offset some deficiency from non-tax revenue of federal government, in extreme cases, the concept of subvention was present in most of the NFC awards.³⁰

One can argue that this arrangement will further intensify the already fiscally constrained federal government, as a result of 7th NFC, while increasing the vertical distribution above 57.5%. The answer to this argument is that federal government is already paying almost equal percentage to both territories in shape of grants on *ad hoc* basis. Moreover, the incremental adjustment in the share of 57.5% will safeguard the Clause 3(A) of Article 160 of the Constitution which says that the share of provinces will not be less than prescribed share in the previous Award.

The bigger picture of the computation is there is win-win situation for federal government, provinces and both territories (PAJK and GB). None of the partly will financially suffer significantly after permanent inclusion of PAJK and GB in NFC award. However, the inclusion will give a sense of ownership to residents of both territories and confidence to respective governments after abolition of *ad hocism* in federal transfer. They would be confident in planning future projects after have permanent share in NFC award.

³⁰ The subvention to financial deprived territories will not be new, even the British provided such facility to NWFP (now KP) and Sindh of Rs. 10 and Rs. 10.5 million respectively under the Niemeyer award and Act 1935 (Khan, 2015).

5. Policy Implications

The findings of the research suggests two tiers solution based on the principle of ‘inclusiveness’ instead of ‘othering’.

1. First, there should be constitutional amendments to have permanent membership of PAJK and GB in the award while bringing them in ‘fiscal federalism’ without ‘political federalism’.
2. Second, it is proposed that both PAJK and GB should be included as permanent members in NFC award. The computation shows that the *ad hoc* federal grants to both territories are not significantly different from their share in ‘proposed’ horizontal distribution (Table 3). This can be best accommodated while increasing the share of vertical distribution to the amount of each territory in ‘proposed’ horizontal distribution. For example, the vertical distribution of 57.5% should be increased by 2.41% to accommodate PAJK. Any discrepancy can be adjusted via: (I) transferring taxation of both PAJK and GB to Divisible Pool; (II) Re-visit 1% special allowance of ‘war on terror’ on need basis; (III) The provinces can accommodate any deficiency like in case of Germany where rich provinces transfer funds to poor provinces, the KP province is already doing it where a portion of revenue from settled districts is transferred to FATA; and (IV) lastly, offset some deficiency from non-tax revenue of federal government, in extreme cases.

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GB. It does not refer that these meeting do not have a value addition in the paper. I acknowledge that some of the computation in Section 5 is because of the input from a participant during consultation meeting at Quetta. In addition, I am thankful to a faculty member of University of PAJK who assisted me in getting the desired data for preparing the Table 1 for PAJK. I am obliged to the officials of NFC-1 and NFC-2 of Peshawar secretariat for their sincere cooperation and guidance. Lastly, I am thankful to all those individuals who guided me in an honest manner during the completion of the project.

The biggest limitation of the report is that I could not find the data for GB to prepare a table similar to PAJK (Table 1). I searched the official website of GB government, where only ADP data was available for few years, and website of Ministry of Finance Pakistan including reports of ‘Biannual Monitoring of Implementation of NFC Award’ which carries only data of horizontal distribution to the four provinces excluding PAJK and GB. I personally contacted few officials in the GB government and Council, but could not find the desired data. Similarly, the reports from federal Planning and Development do not fulfill the requirements.

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