FISCAL ARRANGEMENTS IN PAKISTAN (1947–48 to 1969–70)

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The article relates to the financial relationship between the centre and provinces in Pakistan covering the period from 1947-48 to 1969-70. An attempt has been made to critically analyse the various financial arrangements made during this period with a view to have a deep understanding of these relations, which affect the well-being of the people concerned.

The financial relations between the centre and provinces upto the creation of Pakistan were regulated according to the Niemeyer Award of 1937, given under the Act of 1935. The revenue distribution system, though complicated was a good attempt in solving the problem of revenue imbalance[1]. After Independence in August 1947, the financial structure was adopted with the following temporary adjustments[2].

1) The railway finances were included in the general budget. (However the railways were allowed to continue to accumulate depreciation funds at normal rates and to operate as much as possible on commercial lines.).

2) The sharing of income tax with the provinces was suspended in 1948-49

3) The sales tax, which was a provincial source of revenue was temporarily handed over to the centre (subject to the allocation of 50% of its proceeds to the provinces). The provinces were to receive their share on the basis of net collections within their own areas.

It was also decided that public borrowing would be the sole concern of the centre which would, in turn, provide loans to the provinces according to their needs.

Changes in the adjustments were thought necessary because of the disruption in the economy caused by partition of the subcontinent. Trade and industry were mostly controlled by the non-Muslims, who migrated to India. As such the migration of businessmen, financiers, chief middle-men, and a host of others, resulted in a loss of revenues from income tax and corporation tax. The problem was aggravated by the influx of refugees and the underdeveloped state of economy, dominated by a poverty stricken Agricultural population[3], which was not liable to direct taxation. Central excise duties presented even more difficult problems, since these were

collected at points of manufacture, many of which were in India, even though the goods were consumed in Pakistan. On the other hand, more funds were needed to finance the entirely new administration and to meet the defence requirements in the face of threat of war from India and Afghanistan.

The above mentioned revision of the policy of financial decentralization, deprived the provinces of their revenues from the 50% of income tax and 50% of sales tax. Furthermore the trade deadlock with India especially after September 1949, reduced East Bengal's income from export duty on jute. It may be mentioned that Bengal was allotted 62% of the export duty on jute by the Niemeyer Award[4]. The acquisition of Karachi (the capital of Sind, and the only seaport in the western wing) by the Centre, deprived Sind of its highly productive revenue yielding area, as it was the main industrial, trading and commercial centre of the country.

At first the provinces out of enthusiasm for the establishment of a central government of a newly born country, and in view of the defence needs, acquiesce in these changes. But later on, when the centre's financial position improved they demanded a share in the income tax and restoration of the full sales tax. Moreover, East Bengal (later East Pakistan) demanded a greater share of export duty on Jute, and Sind and Punjab wanted a share in the increased proceeds of the cotton export duty. The following table shows the financial position of the centre and the provinces in the period 1947-50.

Table I — Revenue receipts and expenditure of centre and provinces 1947–50

(Rupees in Million)

	1947-48	1948-49	1949-50
1. Centre			
Revenue	198.9	667.6	885.4
Expenditure	236.0	647.0	856.0
Surplus (+) or Deficit (-)	-37.1	30.6	29.4
2. East Pakistan			
Revenue	97.2	168.6	144.2
Expenditure	88.4	160.0	171.0
Surplus (+) or Deficit (-)	8.8	8.6	-26.8
3. West Pakistan[6]			
Revenue	181.8	280.3	300.0
Expenditure	240.6	310.9	301.6
Surplus (+) or Deficit (-)	(-) 58.8	(-) 30.6	(-) 1.6

The above table shows that the financial position of centre had improved. The increase in the central revenues was mainly due to increased export duties as a result of high rates possible due to rise in cotton and jute prices caused by the Korean War boom; and increased collections from import duties due to extreme use of import licensing policy.

The central government, therefore, in view of the provincial demands for more revenues, sought the help of Sir Jermey Raisman, an ex-Finance Member of the Government of undivided India, and on the basis of his recommendations, Raisman Award came into effect from 1st April, 1952.

The above temporary arrangements at the time of partition, were a step towards centralization. From the provincial point of view these were worse than those made under the Government of India Act 1935[7]. The Act, though it had given the major sources of revenues to the centre, but had provided provinces with a full sales tax and a share in the income tax. Further the centralization of the borrowing of loans, deprived the provinces of the right to borrow independently.

Another notable change was that the distribution of 50% of the share of sales tax was to be made on the basis of collection probably recognizing the fact that as it was originally a provincial source of revenue, hence the basis of distribution be collection, whereas under the Niemeyer Award 1937 the income tax was shared both on the basis of collection and population, giving neither factor a rigidly pandantic deference.

The arrangements under the Raisman Award are given below.

The Raisman Award 1952

The following financial arrangements were made according to the Raisman Award[8].

1. 50% of the net proceeds of income tax (other than Corporation Tax and those pertaining to Federal Capital and Federal emoluments) were to be distributed as follows:

East Pakistan (Bengal)	45%
Punjab	27%
Sind	12%
N.W.F.P.	8%
Bahawalpur State	4%
	96%

The remaining 4% was meant for Baluchistan and other states which might accede and in the meantime was allocated to the then existing units in the same proportion.

2. Sales tax was to remain centrally administered, but the provinces were to receive half of the net collections in their areas. In view of the importance of Karachi as the nerve centre of trade and commerce in the western wing, half of the collections in the Karachi area were allotted to the various units in West Pakistan as follows:–

Punjab	54%
Sind	16%
N.W.F.P	10%
Bahawalpur State	4%
Karachi	6%
Bluchistan	2%
Tribal Areas and other States	8%

3. 50% of the proceeds of the excise duties on tobacco, betel nuts and tea were to be divided among the various units in accordance with the percentage for distribution of income tax receipts.

4. East Pakistan was allocated 62½% of the basic jute duty and 10% of any additional duty.

5. The subvention for N.W.F.P. was raised from 10 million to 12.5 million rupees.

The Award was the result of the demands of the provinces for more revenues, and the Centre's desire to retain important sources of revenue thereby maintaining its financial domination. It was not based on any clearcut principle but was seemingly concerned with evolving a compromise formula which could provide the provinces with some sources keeping in view their budgetary requirements in the light of their demands including share in the income tax and restoration of full sales tax.

The arrangement shows that instead of giving independent sources of revenues to the provinces, it made them more dependent on divided revenues. The distribution of sales tax between the provinces, on the basis of collection, while that of income tax and other shared duties neither on collection, nor on population, again shows that it was mainly concerned with the balancing of budgets of provinces, rather than evolving a definite principle.

Integration of West Pakistan

In 1955, all the provinces, Punjab, Sind, North West Frontier (N.W.F.P.), Baluchistan and the princely states in the western wing of the country were integrated into one province called West Pakistan, thus reducing the number of provinces to two only in the 1956 Constitution. No change in the financial relations between the Centre and the provinces was made. These continued to be governed by the Raisman Award. The share of divisible taxes for provinces remained the same – that of East Pakistan at 45% and of West Pakistan 55% (the aggregate share of its composite units). The Award remained effective till 1962.

The Centre–Provincial Relations Under the Constitution of 1962

The Martial Law Government which took over in 1958, approved the new Constitution which came into force in March 1962. The Constitution remained federal in character.

Division of Functions:

The triple division of subjects into federal, provincial and concurrent was abandoned. Only federal powers were listed and the residue belonged to the provinces. The federal government was given exclusive powers over the functions in Third Schedule (49 items), including defence, external affairs, inter-provincial and international trade, national economic planning and co-ordination, foreign exchange, banking, navigation and shipping, aviation, posts and telecommunications etc., and the provinces had the competence over the rest of the activities not enumerated therein, which included police, education, medicine and health, agriculture, land tenure and labour and social services. The railways became a provincial responsibility. Provision was also made for delegation of powers to the provinces even in respect of functions within the executive authority of the centre[9].

Division of Revenues:

The Constitution gave the provinces powers of taxation in respect of all sources other than (a) customs duties (including export duties), (b) excise duties, including salt but not including alcoholic liquour, opium or other narcotics, (c) corporation taxes and taxes on income other than agricultural income (d) state and succession duties, (e) taxes on capital gains on immovable property, (f) taxes on sales and purchases, (g) terminal taxes on goods and passengers carried by sea or air and taxes on their fares and freights, and (h) taxes on mineral oil, natural gas and the minerals for use in generation of nuclear energy[10]. This left the provinces with limited sources such as land revenue, stamp duties, provincial excise and receipts from Motor

Vehicles Act, registration etc. Such a division left the major sources of revenue with the centre[11]. It, therefore, did not accord with the aspirations of the people of provinces in a heterogenous federation like Pakistan, as it made the provinces dependent on the centre. The financial weakness of the provinces enabled the centre to treat them not like autonomous units, but as local municipalities. Particularly in Pakistan's case where the provinces cherish political autonomy, and are weary of the centre's motives about domination, such a division of revenues did not seem to be in harmony with their quest for autonomy and less dependence.

The Constitution also provided for the periodical constitution of the National Finance Commission for the purpose of (a) sharing of the central taxes with the provinces, (b) making of grants-in-aid by the central government to the provincial governments, and (c) any other matter relating to finance referred to the commission by the President of the country[12]. The Constitution of Finance Commission was a good thing in harmonizing the financial relation between the centre and provinces. But its role in Pakistan was again restricted by its periodical nature; and of its dominance by the central government which was supposed to be a stumbling block in the way of provincial autonomy.

Furthermore, the provision of National Economic Council[13], by the Constitution, to review the overall economic position of Pakistan, formulate economic plans in respect of financial, commercial and economic policies and economic development of Pakistan, was another measure towards centralization. Though it may have been desirable to have a unified policy for the country as a whole, but such a policy may well be regarded as geographically inequitable, [14] and secondly it again impinged on the political autonomy of the provinces. It made the central government influence the expenditure pattern which hitherto was decentralized by the Constitution. Thus on the one hand the Constitution centralized the revenue sources, and on the other though it decentralized functions, it influenced them by the process of planning. The Constitution also limited the independent borrowing powers of the provinces[15].

It may be said that the Government of Inida Act 1935 served as a basis for the Constitution.[16] The objective pursued had been to make centre finacially strong. Though the functions of development had been transferred to provinces, but major revenue sources had been retained by the centre. The Constitution makers developed a system on the basis of an old system of an undivided India, whereby the centre had control over the main sources of revenue, the basis which was not in line with aspirations and political autonomy of the provinces after Independence, when the Provinces wanted to be partners with the central government rather than mere agents, i.e. they wanted to maintain their autonomous identity, which became a free without financial autonomy. The necessity for the provinces in a federation, is that

their governments should have sufficient independent revenue sources to permit them to carry out a full budgetary exercise without interference.[16] The Constitution even went a step further towards centralization, than the Government of India Act 1935, by making sales tax a source of central revenue, and created the National Economic Council, which directed the expenditure policies.

The Distribution of Revenues and Consolidation and Payments of Loans Order 1962

According to the provisions of the Constitution, a National Finance Commission was appointed, whose recommendations replaced the Raisman Award from 1962-63. The recommendations of the Commission as approved by the government were given in "The Distribution of Revenues and Consolidation and Payment of Loans Order 1962."[18] Under this Order, the following assignments were allowed to the provinces from the proceeds of the central taxes with effect from July 1, 1962, to enable them to meet the expenses to be incurred by them on the responsibilities assigned under the Constitution:

i)	Taxes on income (including corporation tax but excluding the tax on federal emoluments)	50%
ii)	Sales Tax	60%
iii)	Federal duties on tea, betel nuts and tobacco	60%
iv)	Export duties on jute and cotton	100%
v)	Estate and Succession duties in respect of agricultural land	100%
vi)	Taxes on capital value of immovable property	100%

The sums to be assigned to the provinces were to be apportioned between the two provinces on the following terms:

i) Sales Tax:
   (a) 30% of the sum assigned was to be distributed between the provinces on the basis of collections, and

   (b) the balance of 70% of the sum so assigned in each year, East Pakistan received 54% and West Pakistan 46% (population basis).

ii) Estate and Succession duties in respect of agricultural land taxes on capital value of immovable property:

Of the sum so assigned in each financial year, each province received an amount equal to the collection in that province in that year.

iii) Other taxes and duties:
Of the sum so assigned each year, East Pakistan received 54% and West Pakistan 46% (population basis).

In addition to these increased revenue assignments the provinces were given further relief in loan repayments. All loans made by the central government to the provinces after August 14, 1947 (other than foreign loans and preindependence loans) outstanding on June 30, 1961, were written down by fifty per cent and converted into one loan in each case, which were to bear interest at the rate of 3½ per cent and were repayable by the province concerned to the central government in 25 annual instalments commencing on the first day of July, 1961.

The province of West Pakistan continued to receive a sum of Rs. 7 million as a grant-in-aid.

The above Award, under the Order of 1962, instead of giving provinces separate sources of revenue, just kept them dependent on the shared revenues, only by making some changes in the percentages according to increased budgetary needs of the provinces.

It is significant that the basis of division between the provinces was kept on a population basis with the exception of sales tax, where 30% was to be distributed on collection. This was done to favour East Pakistan, whose population comprised 54%. The Award, on the whole, kept in principle the centralizing trend, by increasing the dependence of provinces on shared revenue.

Distribution of Revenue Order 1965

Pakistan's Third Five-Year Plan was to commence from July 1965. In order to assess the fiscal position of the centre and the provinces in the light of financial targets to be realized in the Third Plan, the National Finance Commission was set up to make recommendations about allocations of revenues between the central and the provincial governments.

In tackling this problem of central-provincial fiscal relations, the Commission kept in view the following basic criteria:

(a) A strong and viable Central Budget is essential for sustaining and raising the creditworthiness of the country both at home and abroad.

(b) A revenue surplus with the centre can be more easily conserved for development, and made available for financing the development expenditure of both the provinces and the centre.

(c) There should be sufficient cushion left at the centre to enable it to render financial assistance to the provinces in times of unforeseen calamities and also to tide over the requirements of defence in any natural emergency.

(d) Customs revenue being susceptible to wide fluctuations on account of changes in international trade conditions, there is need to provide a cushion for meeting a possible fall in revenue in bad years.[19]

The criteria more or less meant that the centre should be financially strong and maintain its financial superiority. It favoured the provinces' dependence for revenues.

The Commission made a number of recommendations which were accepted by the central government and given effect to under the Distribution of Revenue Order 1965, from 1st July, 1965. The main provisions of this Order were:—

Out of the net proceeds of the following taxes and duties, 65% were assigned to the provinces and 35% retained by the centre:

i) The taxes on income, including corporation, but not including taxes on the income consisting of remuneration paid out of the Central Consolidated Fund.

ii) Sales Tax.

iii) Excise duties on tea, tobacco and betel nuts.

iv) Export duties on jute and cotton.

For calculating the provincial share, the basis to be followed was the same as under the Order of 1962, i.e. in case of taxes on income, excise duties and export duties, East Pakistan received 54% and West Pakistan 46% (on population basis), while in the case of sales tax, 30% was distributed on the basis of collections in each province and the balance in the same ratio as other taxes.

This Award, too, maintained the old trend of making provinces dependent on shared revenues. No attempt was made to give the provinces financial autonomy by providing them as far as possible with their own major sources of revenues. There was no significant change under the Order of 1965, than under 1962 Order. The only change was that of variation in percentages, keeping in view the increasing budgetary requirements of the provinces.

Comparative View of the Different Revenue Distribution Arrangements

To take a comparative view, the arrangements made under different Awards are given in the following table.

Table 2 – Arrangements for Provinces Under Different Awards

Arrangements (1)	Taxes on Income (2)	Sales Tax (3)	Federal Excise duties on Tea, and Betel nuts (4)	Export duties on Jute and Cotton (5)
1) Transitional period (1947-48 to 1951-52)	No Share	50%	–	62.5% of basic duty on jute for East Pakistan.
2) Raisman Award (1952-53 to 1961-62)	50% excluding corporation tax and receipts pertaining to Federal capital and taxes payable in respect of Federal	50% of collection in Karachi being tributable among West Pakistan provinces.	50%	62.5% of basic duty on jute & 10% of any additional duty for East Pakistan.
3) The Distribution of Revenue etc. Order 1962 (1962-63 to 1964-65)	50% including corporation tax but excluding taxes on income consisting of remuneration paid out of the Central Consolidated Fund.	60%	60%	100% on jute and cotton.
4) Distribution of Revenue Order 1965 (1965-66 to 1969-70)	65%, subject to the above proviso.	65%	65%	65%

There has been a steady enlargement in the percentage allocations to the provinces, with the exception of export duty on jute and cotton. More spectacularly it has been in the case of income tax, where, after 1961-62 the corporation tax was also included.

Conclusion

All the arrangements made so far point towards one thing, i.e. centralization of revenues. Every attempt was being made to provide funds to the provinces by making changes in the percentage of shared revenues, rather than giving them, as far as possible, separate sources of revenues. The basic idea was to make tight central control by making provinces dependent on it for revenues: a policy which had its roots in the colonial past, and was not in line with the aspiration of provincial autonomy after Independence. The arrangements were even worse than those before Independence under the British Rule.

In spite of decentralization of functions by the Constition, the expenditure patterns were influenced by the process of centralized economic planning, which further reinforced centralization.

References & Notes.

1. Khaskhelly, Ghulam Hussain, "A critique of the Budgetary position of the Province of Sind". Sind University Research Journal, (Arts, series, Humanities and Social Science), Vol. XVII & XVIII, 1978-79, pp. 14—17.

2. 'Twenty Years of Pakistan 1947-67' Pakistan Publications, Karachi, p. 355.

3. Agricultural labour force (12 years and above) in Pakistan was 75.47%, in 1951, and 74.06% (10 years and above) of the total in 1961.

4. Khaskhelly, Ghulam Hussain, op. cit., p. 15.

5. Pakistan 1953-54, Pakistan Publications, Karachi; Twenty Years of Pakistan 1947-67, Pakistan Publications, Karachi; and Pakistan Budgets 1969-70, prepared by Economic Adviser to the Government of Pakistan, Ministry of Finance, Islamabad.

6. Worked out by consolidating the budgets of the province of Punjab, Sind and North West Frontier Province (N.W.F.P.).

7. Khashelly, Ghulam Hussain, op. cit., p. 13.

8. Economy of Pakistan 1948-68, perpared by Economic Adviser to the Government of Pakistan, Ministry of Finance, Islamabad, pp. 184—185.

9. The Constitution of the Islamic Republic of Pakistan (as modified up to the 28th February, 1965), Article 143.

10. Ibid., Third Schedule, item 43.

11. In Pakistan more than 80% of the central and provincial tax revenues come from the main sources, e.g. Customs, Central Excise, Income and Corporation tax and Sales tax. each contributing not less than about 10%.

12. Constitution of Pakistan, op. cit., Article 144.

13. Ibid., Article 145.

14. Musgrave, R.A., "Theory of Public Finance—A study in Public Economy", McGraw Hill Book Co., London, 1959, p. 121.

15. Constitution of Pakistan, op, cit., Article 140.

16. Articles 131, 134, 137, 138, 139, 140, 141, 143, 146 of the Constitution dealing with the Central-Provincial relations are the same as the Sections (99, 100, 107, 104, 107, 154, 142, 162, 163, 142A, 124, 174 of the Government of India Act 1935, correspondingly.

17. Hicks, U.K., "Development Finance – Planning and Control", Oxford, 1965. A chapter on Inter-governmental Fiscal and Financial Relations.

18. Economy of Pakistan., op. cit., pp. 185–186.

19. Report of the National Finance Commission 1964-65 (Under Article 144(4) of the Constitution), p. 5.