

## FISCAL DECENTRALIZATION AND ITS IMPACTS ON GOVERNANCE IN PAKISTAN

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### ABSTRACT

*Decentralization has been seen as a process, which normally transfer functions, authority power and responsibility from top government tier to lower government tier. Decentralization is a kind of system which has been implemented by many developed as well as developing countries for better governance at local or provincial level in order to improve the overall financial, administrative and political system of the country. After the 18th amendment the importance of decentralized system has significantly increased because of provincial autonomy provided by the constitution of Pakistan for enhancement of decision making process at provincial and local level. Decentralization has three dimensions including political, administrative and fiscal decentralization. This paper emphasizes on fiscal decentralization and its impacts on governance in Pakistan. The key objective of the paper is to analyze the impact of fiscal decentralization on governance. Schneider Model has been applied by making minor modification in it for measurement of fiscal decentralization on basis of data taken for governance indicators and fiscal decentralization. One of the conclusions of the paper reveal that fiscal decentralization may be the reason for better governance, but in case of Pakistan, fiscal decentralization is not improving governance at local and provincial level by having low revenue and expenditure share to the provinces. Findings of the paper also highlight the shifting of power as a problem for the funds to be transferred at large level with rationality. However, there are certain measures given in the way forward may be taken for enhancement and improvement of the system such as: Fiscal decentralization policy needs to be implemented by providing the two most important mechanisms by transferring revenue responsibilities to district governments and spending decisions.*

**Keywords:** Decentralization, Governance, Fiscal Decentralization, Governance Indicators

### INTRODUCTION

Fiscal decentralization is described as transferring the financial resources to the provincial and local government from federal or central government. Fiscal decentralization focuses on sub-national revenue and expenditures along with tax revenues. Sub national government is actually provincial government in fiscal decentralization. The core responsibilities of fiscal decentralization are (a) Transparency of allocation (b) Predictability of the amounts available to the local institutions. (c) Local autonomy of decision making on resource utilization. Schneider (2003) describes decentralization is a system having three basic dimensions which are: Fiscal, Administrative, and Political.<sup>1</sup> Fiscal decentralization refers to how much central government hand over non-central government bodies. Decentralization is the system in which central government used to play a little role in all financial, administrative and political dimensions. This system allows the central governments to give the power to provinces to carry on their administrative, fiscal and political functions at their own. The management of these all functions lie with the provincial government. The entire decision making is done at provincial or local level.

#### *Objectives of the Study*

The key objectives of the study are about analyzing the impact of Fiscal decentralization on Governance in Pakistan, to identify the dimensions and indicators for Decentralization and Governance and to develop the way forward for improvement of decentralization system.

### LITERATURE

There are some empirical evidences about fiscal decentralization in Brazil research conducted by Dillenger and Webb (1999) analysis showed that in Brazil high level of fiscal decentralization resulted into financial and budgetary crises.

Different literatures in Academia of Brazil define reasons for declaring Brazil's democratic political institutions consists of political parties system, electoral rules, federation and legislation system are best tools for ensuring policymaking effectiveness and capabilities of democratic representatives. (Inter-Development Bank, 1997; Bahl, 1999; and Oates, 1999) analyzed the importance of relationship between Decentralization and Governance. On the basis of Public Finance Principles which includes Revenue and Expenditures at Decentralization and Governance. On the basis of Public Finance Principles which includes Revenue and Expenditures at Government level reflect the fiscal decentralization. This close association between these two variables Expenditures and Revenue mobilization at the subnational level can lead to better accountability of government actions. (Humplich and Estache, 1995; Huther and Shah, 1998; Fishman and Gatti, 2000; and Triesman, 2000) Fiscal decentralization the assignment of expenditure

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functions and revenue sources to subnational levels of governments has a recognized bearing on Governance and on the quality of Government. (Hommes, 1995; Inter-American Development Bank, 1997; World Bank, 1999; and Fukasaku and de Mello, 1999) Fiscal Decentralization can lead to allocative inefficiencies, as well as poor accountability and Governance, if expenditures and revenue mobilization functions are not clearly assigned at different levels of government. (Inman and Rubinfeld, 1997; and de Mello, 2000b) Fiscal Decentralization also help in strengthening social capital and in encouragement of political participation. (World Bank 1999) Electoral reforms and rules are not enough to encourage voter participation and improve accountability through more general and continuous participation of civil society in the political process. (Mello and Barenstein, 2001) Fiscal decentralization having expenditures and revenue mobilization is directly associated with different worldwide governance indicators like corruption, rule of law, and government effectiveness. (Vazquez and Macnab, 1997) argued that there is an open connection between fiscal decentralization and democratic governance. Democratic Governance is having great value and contribution at various levels of society. This association can be best explained as symbiotic relationship. Fiscal decentralization play its important role in enabling democratic institutions by bringing government closer to the people of the community for making decisions directly related to their daily lives. (Putman, 1993) describes that decentralization promotes democracy and fiscal decentralization which requires democratic governance to deliver best in the form of effective service delivery. As there is a strong relationship between fiscal decentralization and Governance the latter has taken clear consideration in the economics literature other than at theoretical level.

## METHODOLOGY

### *Decentralization Dimensions and Indicators*

**Table 1:** Decentralization Dimensions & Indicators

Dimension	Indicator
Fiscal Decentralization	Subnational expenditures as percentage of total expenditure
Fiscal Decentralization	Subnational revenues as percentage of total revenues.
Administrative Decentralization	Taxation as a percentage of subnational grants and revenues.
Administrative Decentralization	Transfers as percentage of subnational grants and revenues.
Political Decentralization	Municipal Elections
Political Decentralization	State Elections

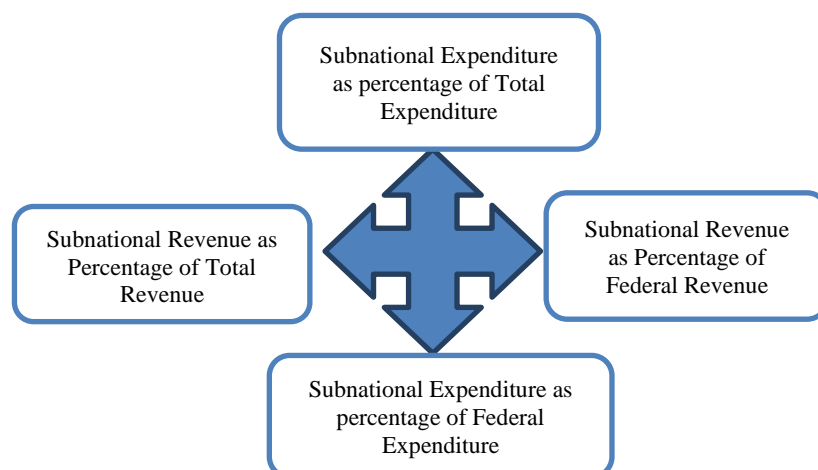
Source: Schneider, 2003

### *Governance Dimensions and Measurement Indicators*

There are six main governance dimensions which are given below: Voice and Accountability, Political Stability and Absence of Violence/Terrorism, Government Effectiveness, Regulatory Quality, Rule of Law, Control of corruption.

## THE MODEL

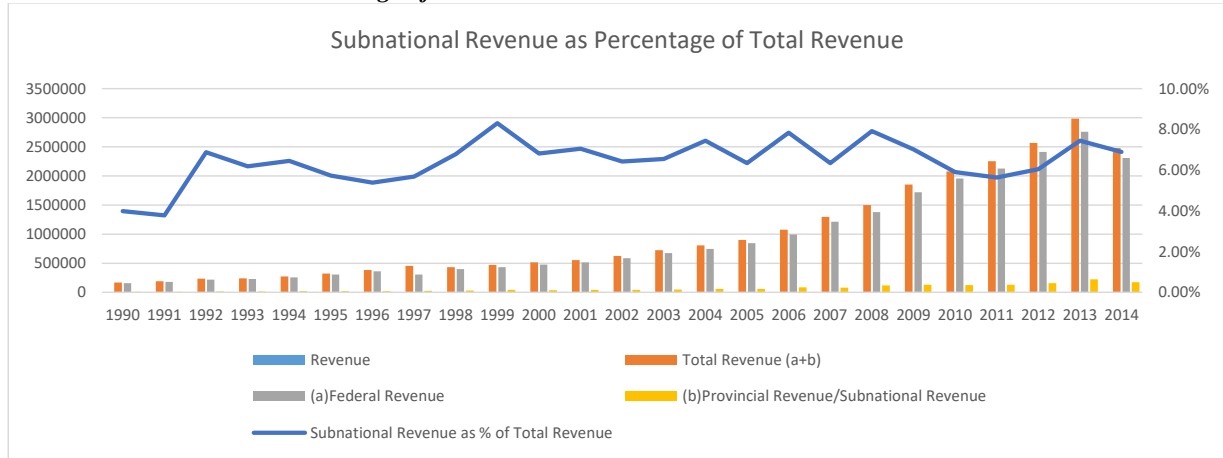
### *Fiscal Decentralization Measurement Model*



Source: Developed by Researcher

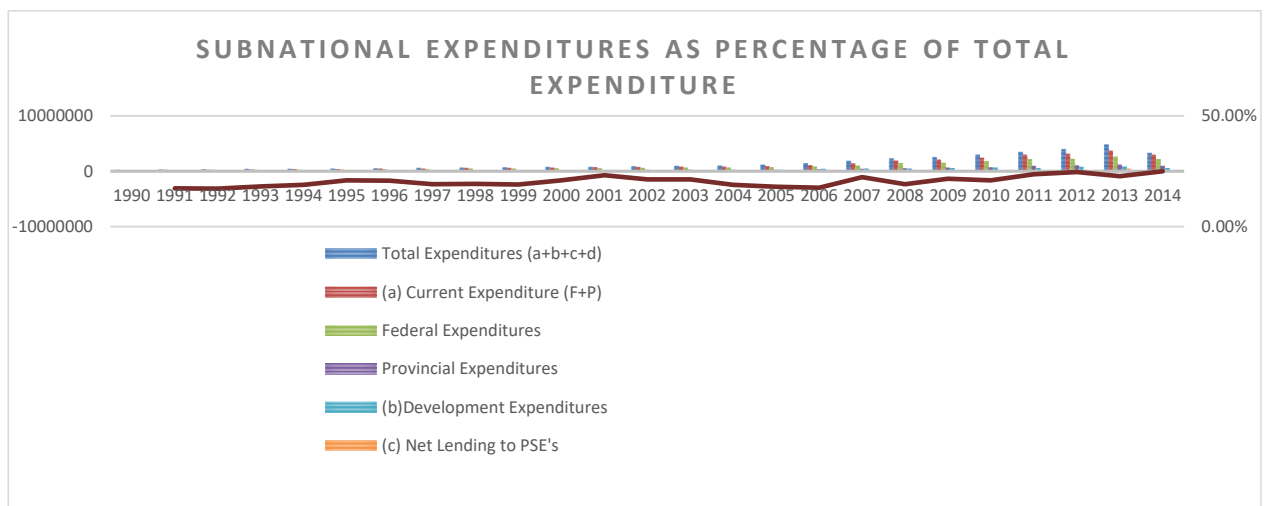
## AN ANALYSIS OF FISCAL DECENTRALIZATION AND GOVERNANCE IN PAKISTAN

### Subnational Revenue as Percentage of Total Revenue



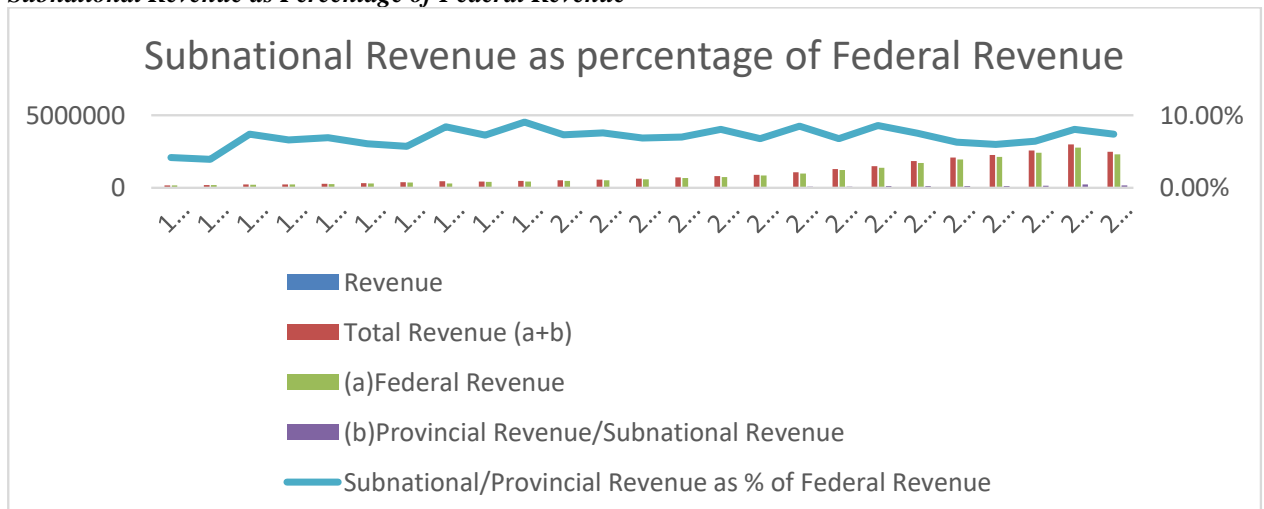
**Fig 1:** Subnational Revenue as Percentage of Total Revenue

### Subnational Expenditures As Percentage Of Total Expenditure



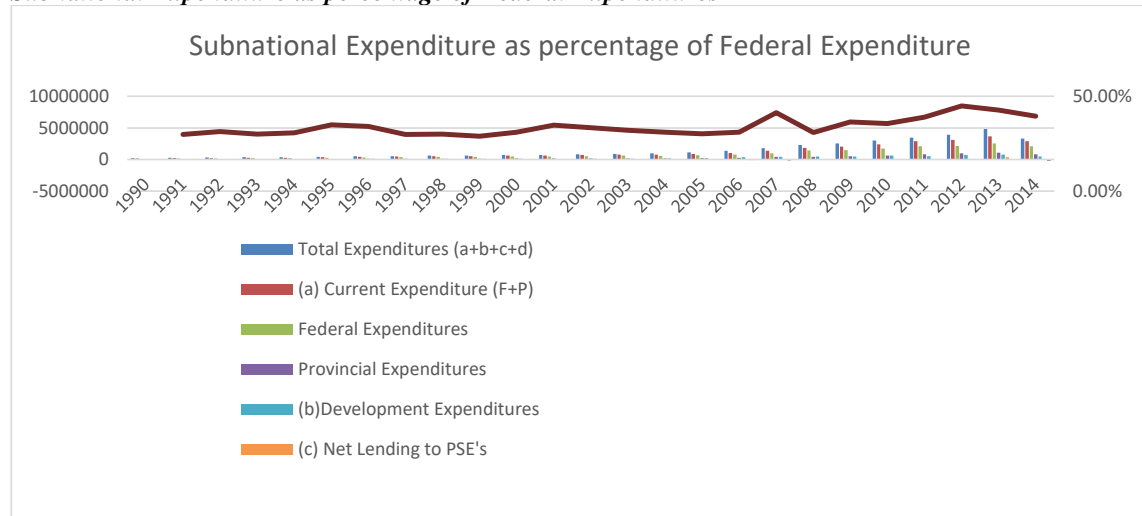
**Fig 2:** Subnational Expenditures as Percentage of Total Expenditure

### Subnational Revenue as Percentage of Federal Revenue



**Fig 3:** Subnational Revenue as Percentage of Federal Revenue

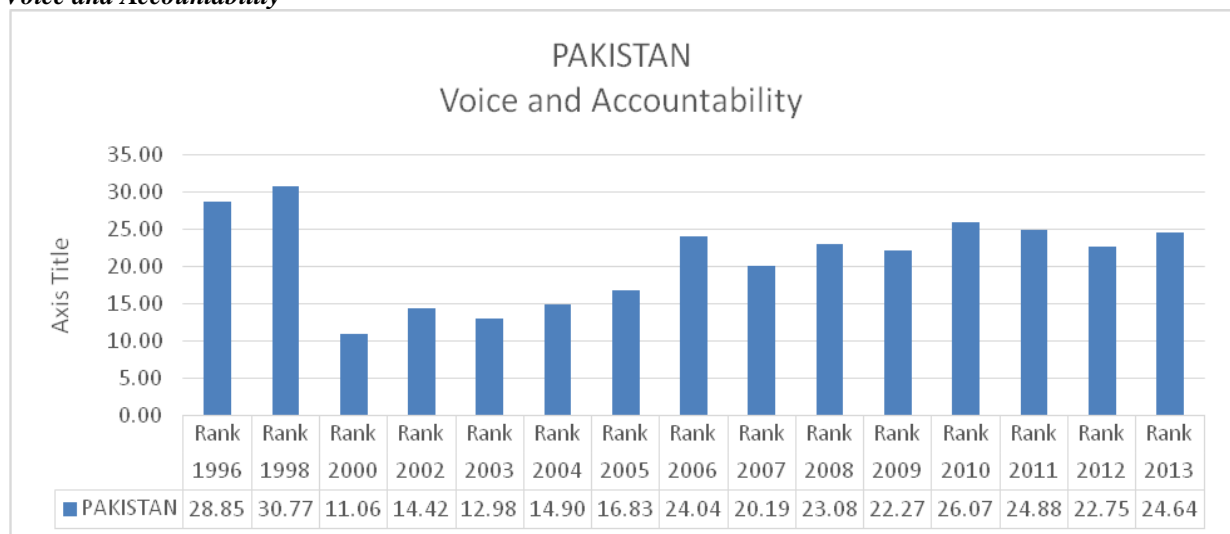
### Subnational Expenditure as percentage of Federal Expenditures



**Fig 4:** Subnational Expenditure as Percentage of Federal Expenditures

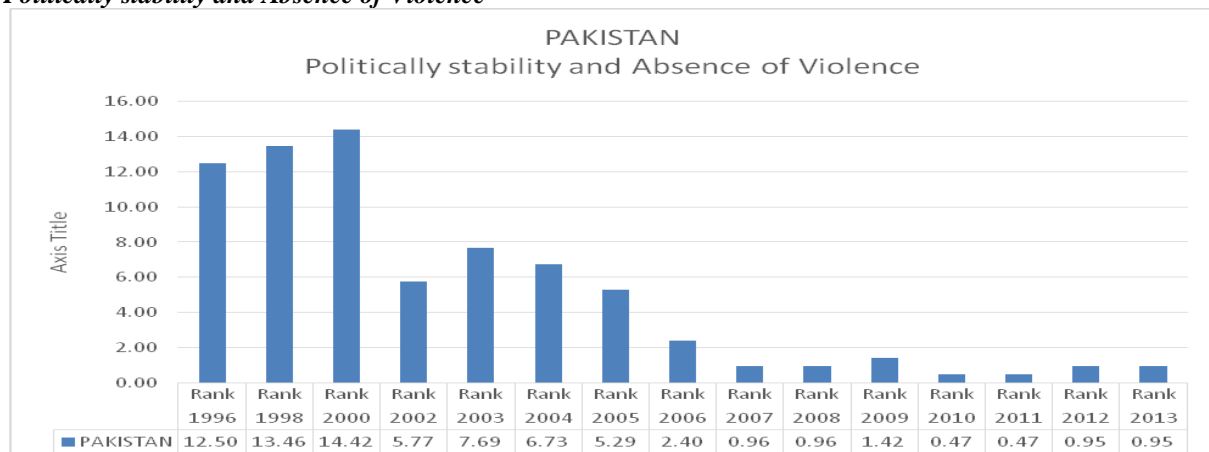
## GOVERNANCE IN PAKISTAN THROUGH WORLDWIDE GOVERNANCE INDICATORS

### Voice and Accountability



**Fig 5:** Voice and Accountability

### Politically stability and Absence of Violence



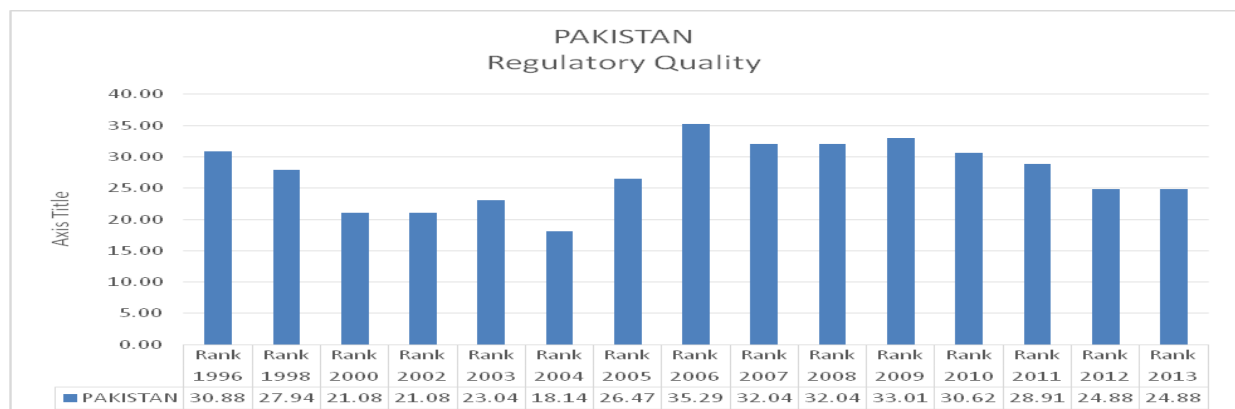
**Fig 6: Political Stability and Absence of Violence**

**Government Effectiveness**



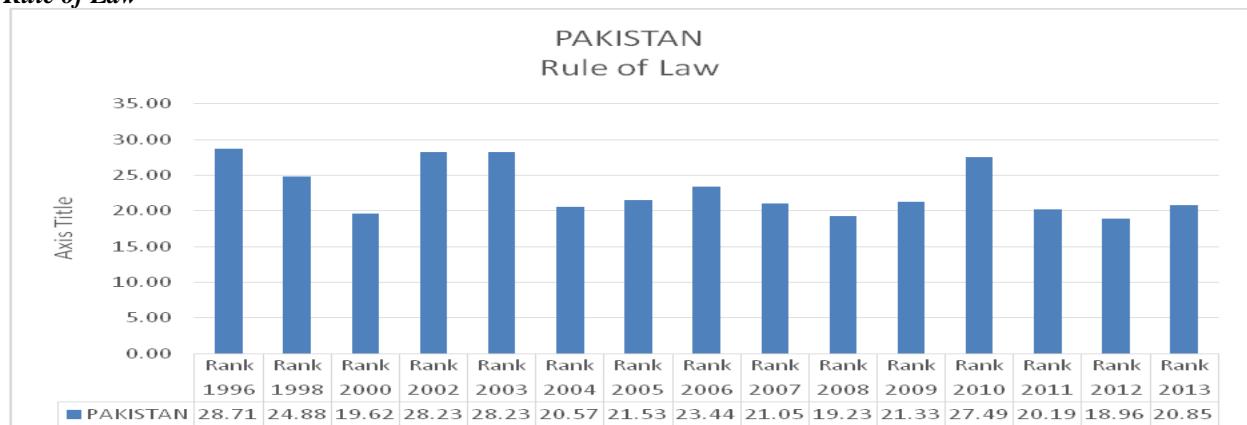
**Fig 7: Government Effectiveness**

**Regulatory Quality**



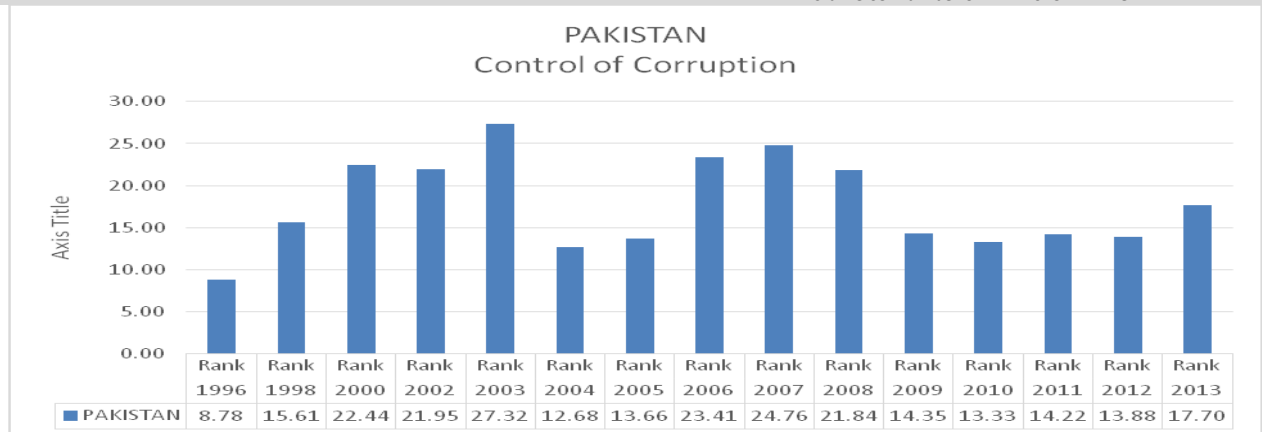
**Fig 8: Regulatory Quality**

**Rule of Law**



**Fig 9: Rule of Law**

**Controlling Corruption**



**Fig 10: Controlling Corruption**

### HOW VARIABLES EFFECT GOVERNANCE?

It is very important part of the paper that how the independent variables in the model developed by the Researcher effect Governance? Analysis of decentralization data and Governance data has been made separately. The relationship of decentralization and governance along with the impact of decentralization is very general in nature according to the qualitative study. The literature proved that Decentralization plays its part in enhancing governance to the some extent but along with positive and negative points and showed there is a relationship between these two variables. It is the general observation that when more funds or budget is allocated to the provincial governments or subnational governments then they used to spend more money on basic necessities along with enhancement of governance. Fiscal decentralization is done for improvement of governance in terms of availability of financial resources. Subnational Revenue as percentage of Total Revenue effect Governance because when there will be low share of Revenue to the Provincial Government they will not be able to spend much money for improvement of Governance. Subnational Expenditure as percentage of Total Expenditure will also have same impact as given by Revenue. When Revenue share will be less and Expenditures will be more then there will be less chance of enhancement in the indicators of Governance. Subnational Revenue as percentage of Federal Revenue will also have impact on Governance in terms of minimum share of revenue with comparison to Federal Government. Subnational Expenditure as percentage of Federal Expenditure will also effect governance in terms of more spending than revenue which creates gap of Budget deficit leads to limitation of financial resources in order to tackle the Governance. The graphs in the data analysis are just showing the Decentralization and Governance performance of Pakistan in last couple of decades. This Research Paper is making analysis on the basis of literature and performance of Pakistan in Decentralization and Governance. It results into the real impact of Decentralization on Governance is very positive overall but Pakistan is lacking behind in Fiscal Decentralization which is leading to poor performance in Governance instead of its enhancement or improvement.

### CONCLUSION

After detailed analysis of the data in the previous chapter the discussion of results shows that there is no proper Fiscal Decentralization in the country for last 24 years. Share of Provincial or subnational Governments in revenues along with expenditures are not enough to meet the challenges of Governance or to enhance the level of governance in Pakistan. Fiscal decentralization is not prevailing with rationality. Provinces are given much low share of Revenues with percentage of total revenue and even with percentage of Federal Revenue. The six worldwide governance indicators are also showing poor performance of Pakistan in the world. Governance is also showing that Pakistan is not improving the level of governance in last 17 years. Decentralization is the most valuable source for improving governance at subnational level but unfortunately financial resources are limited which are creating hurdles in the enhancement of the system. Local government system is not prevailing in the country right now which is the big reason for the failure of decentralization. The shifting of power is not happening which is not approving funds to be transferred at large level to the subnational, provincial or local level. Hence it is supporting null hypothesis that is Fiscal Decentralization does not improve Governance in Pakistan on the basis of findings from the fiscal decentralization and Governance Indicators data which show in ratio that there is no improvement in Fiscal decentralization ratio which is not enough to meet the requirements for improvement of Governance in Pakistan.

### SUGGESTIONS AND RECOMMENDATIONS

1. There is a need of balance in fiscal decentralization while sharing revenue or expenditure. The provincial and local Governments need higher ratio of revenue in accordance with their expenditures in order to implement their plans in effective manner.
2. Fiscal decentralization policy needs to be implemented by providing two most important mechanisms by transferring revenues to district governments by supporting development projects and equalizing income between rich and poor of the society.
3. Institutional development is needed for timely action by achieving policy domain for decentralization system.
4. As I have discussed the Worldwide Governance Indicators but the most basic indicators which are: Health and education need to be given attention. The Education and Health Emergency is the need of the hour for improving Governance. These two basic governance indicators will directly improve the other worldwide Governance Indicators.
5. Equal distribution of wealth, proper allocation of resources among provinces can be the real game changer step.
6. Financial autonomy is to be implemented in systematic way. After 18<sup>th</sup> amendment provincial autonomy has been introduced but still there is a need for improving the formula for distribution of financial resources. Backwardness should be given a high percentage while distributing share of the provinces in NFC Award.
7. Tax Administration should be enhanced to a level where tax collection may be done on the yardstick of uniformity. System of tax collection should be transparent so that burden of taxes may be divided between the upper class and the middle class.
8. Share of revenues should be increased for the provinces and subnational governments so that they may spend the money to improve the governance at the provincial and local level.
9. A rationale budget should be developed for implementation of basic indicators which make governance efficient and it should be started from Education, Health, Law and order. When the start will be from basic indicators it will automatically improve the worldwide Governance Indicators.

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