PROCEEDINGS OF 7TH NATIONAL FINANCE COMMISSION

Government of Pakistan
National Finance Commission Secretariat

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GOVERNMENT OF PAKISTAN
FINANCE DIVISION
(NFC SECRETARIAT)
*****

No.F.2(1)-NFC/2009-335 Islamabad, the 24th August,2009

SUBJECT: **FIRST MEETING OF RECONSTITUTED 7TH NATIONAL FINANCE COMMISSION**

Reference Finance Division's letter No.2(1)-NFC/2009-334 dated 13th August, 2009 on the above subject. The agenda items for the first meeting of reconstituted 7th NFC will be as under:-

(I) Finalizing the agenda for the 7th NFC and specifically to consider whether NFC may take up the following provisions given in the TOR of 7th NFC constituted on 21st July, 2005:-

a) Sales Tax on Services (CE Mode);

b) the question of rationalization of payment of royalties on crude oil and of surcharge on natural gas collected by the Federal Government; and

c) developing and enforcing a mechanism for setting of parameters to fiscal discipline at the Federal and Provincial levels.

(II) Open discussion on the methodology to be adopted for early finalization of NFC recommendations.

(III) Presentation by the provinces indicating their viewpoint on the sharing of Divisible Pool Vertically and Horizontally.

2. Working paper on agenda item No.1 is enclosed.

Sd/-
(Mian Muhammad Younis)
Senior Joint Secretary

(1) Chief Minister/Finance Minister,
Government of Sindh,
Karachi.

(2) Minister for Finance
Government of the Punjab
Lahore

(3) Minister for Finance
Government of NWFP
Peshawar.

(4) Minister for Finance
Government of Balochistan
Quetta

(5) Mr. Abdul Ghafoor Mirza,
House No.24, St.44,
F-8/1, Islamabad.

(6) Mr. Kaiser Bengali,
173/1/2, PECHS,
Karachi-75530

(7) Senator Haji Muhammad Adeel,
NWFP Gunner Lane, Ziarat Road,
The Mall, Peshawar Cantt,
Peshawar.

(8) Dr. Gulfaraz Ahmed,
H.No.1-A, Street-23, Sector F-8/2,
Islamabad.

Copy for information to:

1. Finance Secretary, Govt. of the Punjab, Lahore
2. Finance Secretary, Govt. of Sindh, Karachi
3. Finance Secretary, Govt. of NWFP, Peshawar
4. Finance Secretary, Govt. of Balochistan, Quetta

WORKING PAPER FOR THE 1ST MEETING OF RECONSTITUTED 7TH NFC TO BE HELD ON 27TH AND 28TH AUGUST, 2009

AGENDA ITEM-I

The 7th NFC was constituted vide notification SRO.739(1)/2005 dated 21st July, 2005 (Annex-I). After political set up in place, it was considered appropriate not only to reconstitute the 7th NFC but also deliberate upon certain items of TOR for which Government of Sindh has requested to exclude from TOR. Accordingly 7th NFC was re-notified on 24th July, 2009 (Annex-II) and the following provisions of TOR are required to be discussed in the context whether these provisions may remain as part of the TOR or may be excluded:-

1. Sales Tax on Services (CE Mode);

2. examine the question of rationalization of payment of royalties on crude oil and of surcharge on natural gas collected by the Federal Government; and

3. to develop and enforce a mechanism for setting of parameters to fiscal discipline at the Federal and Provincial levels.

2. A brief background of each of the above items is given as under:

(a) ***Sales Tax on Services (CE Mode):***

The background of Sales Tax on Services (CE Mode) is given in the letter of CBR (Annex-III) in which it has been stated that originally the schedule of sales tax was to be imposed on 14 categories of services from the 1st day of July, 2000. The relevant draft laws to be promulgated by the provinces were forwarded to M/o Law for legal opinion. The Ministry of Law opined that the provinces were constitutionally not competent to levy sales tax on the following three services, namely:

(i) Domestic travel by air and train;

(ii) Carriage of goods by air, and

(iii) Services provided or rendered by persons engaged in telecommunication work.

Consequently, the provinces promulgated Ordinances for only eleven services. As regards the above three services, the Government decided to collect GST in central excise mode because sales tax cannot be levied on services by the Federal Government. Hence the Central Excise (Amendment) Ordinance, 2000 was promulgated by the President as these are included in the 4th Schedule under the Federal Legislative List (Sr.7,22, 24 of Part-I & Sr.1 of Part-II) of the Constitution. The Ordinance was got cleared from the Ministry of Law and found in accordance with the Constitution. A notification SRO 617(1)/2000 dated 02-09-2000 was issued by Revenue Division (Annex-IV).

NFC may deliberate on the issue and give recommendations for its retention or exclusion from the TOR.

(b) ***<u>To examine the question of rationalization of payment of royalties on crude oil and of surcharge on natural gas collected by the Federal Government;</u>***

The development surcharge on natural gas is levied under the Natural Gas Development Surcharge Ordinance, 1967. In pursuance of the said Ordinance, the Federal Government has to fix the sale price for the consumers and prescribe a price for the gas companies. The difference between the two prices is the margin available to the government as development surcharge. The prescribed prices of the gas companies undergo changes from time to time to cover the well head cost and the cost of transmission and distribution of gas.

This item was referred to NFC by the President of Pakistan on 12th July, 1989 (Annex-V) and it was included in the TOR vide notification SRO.764(1)/90 dated 23rd July, 1990 in terms of Article 160(c) of the Constitution (Annex-VI). The same is reproduced below:

> *"To examine the question whether, and in what manner, the net proceeds, collected by the Federal Government.*
>
> i. Royalty on crude oil, and
>
> ii. Of surcharge on natural gas shall be paid to the province concerned."

The 4th NFC made the following recommendations on GDS and royalty on crude oil:

(i) From 1st July 1991 the net proceeds of development surcharge on natural gas would be transferred to the Provinces and shall be distributed on production basis at well heads after deducting the collection charges of 2%. The net proceeds would be determined by Ministry of Petroleum and Natural Resources, in accordance with the past practices and criteria after taking into account any international agreement entered into by the Government.

(ii) The net amount of royalty from crude oil be paid to the Provinces according to the production in each province.

The above recommendations of NFC were given effect by promulgation of President Order No.1 of 1991 "Distribution of Revenues and Grants-in-Aid Order, 1991" (Annex-VII). Similarly, this provision remained included in the TOR of 5th NFC vide notification SRO.1361(1)/96 dated 10th December, 1996 (Annex-VIII) and the formula/ recommendations given by 4th NFC were kept intact by the 5th NFC. Again this item remained included in the TOR of 6th NFC and 7th NFC. It can only be excluded by the referring authority, i.e. President of Pakistan.

NFC may deliberate on the issue and give recommendations for its retention or exclusion from the TOR.

(c) ***To develop and enforce a mechanism for setting of parameters to fiscal discipline at the Federal and Provincial levels***

This provision was made in the TOR of 6th NFC notified vide SRO. 529(1)/2000 dated 22nd July, 2000 (Annex-IX). The 6th NFC could not reach consensus for the Award and it completed its tenure on 20th July, 2005. However, this item remained included in the TOR of 7th NFC constituted on 21st July, 2005.

NFC may deliberate on the issue and give recommendations for its retention or exclusion from the TOR.

AGENDA ITEM-2

Presentation by the provinces indicating their viewpoint on the sharing of Divisible Pool vertically as well as horizontally.

3. All provincial Finance Minister would be requested to make presentation on their province turn by turn.

Annex-I

TO BE PUBLISHED IN THE GAZETTE OF PAKISTAN (EXTRAORDINARY)

FINANCE DIVISION

(NFC Secretariat)

Islamabad, the 21st July, 2005

S. R. O. 739(I)/2005.—In pursuance of Article 160 (1) of the Constitution of the Islamic Republic of Pakistan, the President is, pleased to constitute National Finance Commission consisting of the following namely:—

(1)	Minister for Finance Government of Pakistan	*Chairman*
(2)	Minister for Finance Government of the Punjab	*Member*
(3)	Minister for Finance Government of Sindh	*Member*
(4)	Minister for Finance Government of NWFP	*Member*
(5)	Minister for Finance Government of Balochistan	*Member*
(6)	Advisor to the Prime Minister on Finance	*Member*
(7 to 10)	One Member from each Province to be notified in consultation with the Governors of the Provinces.	
(11)	Finance Secretary Government of Pakistan	*Official Expert*

Terms of Reference

2. The terms of reference for the Commission are as under:—

(a) the distribution between the Federation and the Provinces of the net proceeds of the following taxes:

   (i) taxes on income, including corporation tax, but not including taxes on income consisting of remuneration paid out of the Federal Consolidated Fund;

   (ii) taxes on the sales and purchases of goods, imported, exported, produced, manufactured or consumed;

   (iii) Sales Tax on Services (CE Mode);

   (iv) Export duties on cotton;

   (v) Consider the inclusion of other.Federal. Taxes including Customs Duties and Federal Excises, but not including taxes on income paid out of Federal Consolidated Fund.

(b) the making of grants-in-aid by the Federal Government to the Provincial Governments;

(c) the exercise by the Federal Government and the Provincial Governments of the borrowing powers conferred by the Constitution;

(d) examine the question of rationalization of payment of royalties on crude oil and of surcharge on natural gas collected by the Federal Government to the Provincial Governments;

(e) to consider review of the distribution of share of taxes between the Federal Government and Provincial Governments;

(f) to develop and enforce a mechanism for setting parameters to achieve fiscal discipline at the Federal and Provincial levels and for ensuring consistency in maintaining an appropriate fiscal balance at the consolidated level; and

(g) any other matter relating to finance referred to the Commission by the President.

3. The National Finance Commission notified *vide* Gazette of Pakistan Extraordinary SRO 529(1)/2000, dated 22nd July, 2000, SRO 895(1)/ 2000 dated 18th December, 2000 and SRO 1043(0/2003, dated 13th November, 2003, shall stand dissolved with immediate effect.

[No. F. 2(1)-NFC/2005.]

Sd/-
MIAN MUHAMMAD YOUNIS:
Joint Secretary (PF)
Secretary
National Finance Commission.

Annex-II

TO BE PUBLISHED IN THE GAZETTE OF PAKISTAN (EXTRAORDINARY)

GOVERNMENT OF PAKISTAN

FINANCE DIVISION

(NFC SECRETARIAT)

*****

Islamabad, the July 24, 2009

NOTIFICATION

S.R.O. In partial modification of Notifications SRO.739(1)2005 dated 21st July, 2005, SRO.950(1)2005 dated 12th September, 2005 and SRO.900(1)2008 dated 26th August, 2008 and in pursuance of Article 160(1) of the Constitution of the Islamic Republic of Pakistan, the President is pleased to reconstitute National Finance Commission consisting of the following members, namely:

(1)	Minister for Finance Government of Pakistan	Chairman
(2)	Minister for Finance Government of the Punjab	Member
(3)	Minister for Finance Government of Sindh	Member
(4)	Minister for Finance Government of NWFP	Member
(5)	Minister for Finance Government of Balochistan	Member
(6)	Mr.Abdul Ghafoor Mirza (Punjab)	Member
(7)	Mr.Kaiser Bengali, (Sindh)	Member
(8)	Senator Haji Muhammad Adeel, (NWFP)	Member
(9)	Dr. Gulfaraz Ahmed, (Balochistan)	Member

2. The Commission shall, in addition to matters referred in para 2 of SRO.739(1)2005 dated 21st July, 2005, make recommendations on the following matters, namely:—

(i) Sales Tax on Services (CE Mode);

(ii) examine the question of rationalization of payment of royalties on crude oil and of surcharge on natural gas collected by the Federal Government; and

(iii) to develop and enforce a mechanism for setting of parameters to fiscal discipline at the Federal and Provincial levels.

3. The Finance Division shall, as per the Rules of Business, 1973, provide the Secretariat support to the Commission.

No.F.2(1)-NFC/ 2005-

Sd/-
(Mian Muhammad Younis)
Senior Joint Secretary/ Secretary
National Finance Commission

The Manager,
Printing Corporation of Pakistan Press,
Islamabad.

Annex-III

GOVERNMENT OF PAKISTAN

REVENUE DIVISION

CENTRAL BOARD OF REVENUE

(SALES TAX WING)

*****

SUBJECT:- **LEVY OF GST ON SERVICES BY THE PROVINCES**

I am directed to refer to letter No.PSG-I/2000-2438 dated 24.10.2000 of the Governor of Punjab addressed to the Finance Minister wherein the Governor has requested to withdraw the Central Excises (Amendment) Ordinance, 2000 and allow the Provinces to extend the net of sales tax to all categories of services. He has opined that the said Ordinance is not in line with the Constitution. He has also requested for compensation to the Provincial Government for its lost income by transferring the revenue received from GST on these three services.

2. The matter has been examined in CBR. It is not correct to say that the recent promulgation of the Central Excises (Amendment) Ordinance, 2000 brings all services into the net of Federal sales tax. The said Ordinance only empowers the Federal Government to specify those excisable services on which the duty shall be levied and collected as if it were a tax payable under section 3 of the Sales Tax Act, 11990. Sales tax cannot be levied on services by the Federal Government under the Constitution.

3. The decision for introducing legislation for levy of sales tax on services was made in the Inter-Provincial Coordination Committee (IPCC) on 22.12.1998. Subsequently a meeting was held on 12.05.2000 which was chaired by Federal Finance Minister and attended by the Finance Ministers for Punjab and NWFP, Finance Secretaries of all four provinces and Secretary Revenue Division. The schedule of services to be annexed to the Provincial Ordinances was finalized in consultation with the Law Division. Originally sale, tax was to be imposed on fourteen categories of services from the first day of July, 2000. The relevant: draft laws to be issued were forwarded to the Ministry of Law for legal opinion.

The Ministry of Law opined that the provinces were constitutionally not competent to levy sales tax on the following three services, namely:—

(i) domestic travel by air and train;

(ii) carriage of goods by air, and

(iii) services provided or rendered by persons engaged in telecommunication work.

4. Consequently, the provinces promulgated Ordinances for only eleven services. In respect of the said three services, the Government decided to collect central excise duty under GST, mode because sales tax cannot be levied on services by the Federal Government. Hence the Central Excises (Amendment) Ordinance, 2000 was promulgated by the President. The Ordinance was got cleared from the Ministry of Law and found in accordance with the Constitution. A notification SRO. 617(1)/2000 dated 02.09.2000 was issued in order to specify the services on which central excise duty would be levied and collected as if it were a tax payable under section 3 of the Sales Tax Act, 1990. As regards services of 'restaurants' it is mentioned that supplies of cooked/prepared food had already been brought under Sales Tax Act, 1990 on 16th August, 1999. Such supplies cannot be treated as services.

5. As regards the distribution of revenue in respect of the three services mentioned in para 3 above, it is stated that this is not a subject matter dealt by CBR. It relates to the Finance Division.

Sd/-
(DR ASHFAQ AHMED TUNIO)
Secretary (STR)

Mr. Sami Saeed, Joint Secretary (Provincial Finance), Ministry of Finance, Islamabad. CBR's U.O. Note No.4(80)STB/98(PL) dated 2" November, 2000.

Annex-IV

GOVCRNRNENT OF PAKISTAN

Revenue Division

***

Islamabad, the 2nd September, 2000

NOTIFICATION

(CENTRAL EXCISE)

S.RO. 617 (I)/2000.— In exercise of the powers conferred by the third proviso of subsection (1) of section 3 of the Central Excises Act, 1944 (I of 1944), the Federal Government is pleased to specify the following excisable services, on which central excise duty shall be levied and collected as if it were a tax payable under section 3 of the Sales Tax Act, 1990, and all the provisions of said Act and the rules made and notifications, orders and instructions issued thereunder shall, so far as may be with necessary modifications, apply, namely:—

(1) Domestic travel:—

(i) by air;
(ii) by train in Air conditioned sleeper class;
(iii) by train in Air conditioned Parlour Class (Sitter); and
(iv) by train in First Class sleeper;

(2) carriage of goods by air; and

(3) services provided or rendered by persons engaged in telecommunication work in respect of:—

(i) telephone;
(ii) telex;
(iii) telegraph;
(iv) telefax; and
(v) other services,

excluding-

(i) pager service;

(ii) such charges as are billed by persons providing internet services and are in excess of the sales tax paid charges of Pakistan Telecommunication Corporation Limited, included in the bill; and

(iii) such charges payable on the international leased lines of the Pakistan Telecommunication Corporation Limited used by—

(a) software exporting firms registered with the Pakistan Software Export Board; and

(b) data and internet service providers licensed by the Pakistan Telecommunication Authority.

2. <u>This notification shall be deemed to have taken effect on the 1st September, 2000.</u>

<u>[C.No.9(11)-CEB/99].</u>

Sd/-
(SYED MOHSIN ASAD)
Additional Secretary

Annex-V

PRESIDENT'S SECRETARIAT (PUBLIC)

NATIONAL FINANCE COMMISSION

Finance Secretary may kindly refer to the summary No. 1857/Secy of 4th February 1989 on the noted subject.

2. The Ministry of Finance made a proposal that a National Finance Commission be set up under Article 160(1) of the Constitution, and further proposed that "in accordance with the Constitution, the Governors of the four Provinces, who will act on the advice of their respective Chief-Ministers, may be consulted by the President, on the appointment of non statutory members." A draft letter from the President to the Governors of the four provinces was also submitted , by the Ministry of Finance for approval. The proposal of the Ministry was accepted by the P.M who advised the President also to approve it.

3. A letter was addressed by the President to the Governors for intimating names of persons to be appointed on the Commission and for making suggestions with regard to terms of reference of the Commission.

4. All the four Governors have sent their replies. Taking into account the outcome of the consultations held with the Governors, regarding both the constitution of the commission and its terms of reference, the President, in exercise of the powers ,conferred on him, by Article 160 of the Constitution, has been pleased to constitute the National Finance Commission, together with terms of reference as follows :—

I. **Constitution**

a. **Statutory Members**:

(1) Federal Minister for Finance (Chairman)

(2) Finance Minister, Government of Punjab, Member

(3) Minister for Finance, Government of Sind, Member

(4) Minister for Finance, Government of NWFP, Member

(5) Minister for Finance, Government of Baluchistan, Member

b. **Non-Statutory Members:**

(1) Advisor to the Prime Minister on Finance, Economic Affairs, Planning and Development.

(2) Minister of State for Finance, Economic Affairs, Planning and Development.

(3) Dr. Mahbubul Haq, Senator, Punjab, Member.

(4) Mr. Piyar Ali G. Allana, Sind, Member.

(5) Mir Afzal Khan, Senator, NWFP, Member

(6) Mr. Tariq Mehmood Khetran, MPA, Baluchistan, Member.

(7) Finance Secretary, Federal Government (Official Expert).

II. <u>Terms of Reference</u>

a. The distribution between the Federation and the Provinces of the net proceeds of the taxes given below :—

(1) Taxes on income including corporation tax, but not including taxes on income consisting of remuneration paid out of the Federal Consolidated Fund.

(2) Taxes on the sales and purchase of goods imported, exported, produced, manufactured of consumed.

(3) Export duties on cotton.

(4) Excise duty on tobacco and tobacco manufactures and sugar.

b. Examine the question whether, and in what manner, the net proceeds, collected by the Federal Government,

   (i) of royalties on crude oil, and

   (ii) of surcharge on natural gas,

   shall be paid to the Province concerned.

c. The making of grants-in-aid by the Federal Government to the Provincial Governments.

d. The exercise by the Federal Government and the Provincial Governments of the borrowing powers conferred by the Constitution.

e. Any other matter relating to finance referred to the Commission by the President.

5. Inclusion in terms of reference of excise duty on sugar, royalties on crude oil, and surcharge on gas has been recommended by Governors NWFP, Sind, and Baluchistan, respectively.

6. The President has been further pleased to direct that National Finance Commission notified vide Gazette of Pakistan extra ordinary SRO 717(1)/85 dated 25 July 1985 shall stand dissolved with immediate effect.

Sd/-
(Fazlur Rahman Khan)
Secretary to the President

Finance Secretary

No. F.57/100(3)/PS(Pub)/Dir-2 dated 12 July, 1989

Annex-VI

Statutory Notifications (S. R. O.)

GOVERNMENT OF PAKISTAN

FINANCE DIVISION

NOTIFICATION

Islamabad, the 23rd July, 1990

S. R. O. 764 (I)/90.—In pursuance of Article 160 (1) of the Constitution, the President is pleased to constitute National Finance Commission consisting of the following, namely :—

(i)	Minister for Finance, Government of Pakistan.	*Chairperson*
(ii)	Minister for Finance, Government of the Punjab.	*Member*
(iii)	Minister for Finance, Government of Sind.	*Member*
(iv)	Minister for Finance, Government of N.W.F.P.	*Member*
(v)	Minister for Finance, Government of Baluchistan.	*Member*
(vi)	Advisor to the Prime Minister on Finance, Economic Affairs, Planning & Development.	*Member*
(vii)	Minister of State for Finance, Economic, Affairs, Planning and Development.	*Member*
(viii)	Dr. Mahbubul Haq, Senator, (Punjab).	*Member*
(ix)	Mr. Piyar Ali G. Allana, (Sind).	*Member*
(x)	Mir Afzal Khan, Senator, (NWFP)	*Member*

(xi) Mr. Tariq Mehmood Khetran, MPA, (Baluchistan). — *Member*

(xii) Finance Secretary, Government of Pakistan. — *Official Expert*

Terms of Reference

2. The terms of reference for the Commission are as follows:—

(a) The distribution between the Federation and the Provinces of the net proceeds of the taxes given below :—

(1) Taxes on income including corporation tax, but not including taxes on income consisting of remuneration paid out of the Federal Consolidated Fund.

(2) Taxes on the sales and purchase of goods imported, exported, produced, manufactured or consumed.

(3) Excise duty on tobacco and tobacco manufactures and sugar.

(4) Export duties on cotton.

(b) Examine the question whether and in what manner, the net proceeds, collected by the Federal Government:

(i) of royalties on crude oil, and

(ii) of surcharge on natural gas, shall be paid to the Province concerned.

(c) The making of grants-in-aid by the Federal Government to the Provincial Governments,

(d) The exercise by the Federal Government and the Provincial Governments of the borrowing powers conferred by the Constitution.

(e) Any other matter relating to finance referred to the Commission by the President.

3. The National Finance Commission notified *vide* Gazette of Pakistan Extraordinary S. R. 0. 717 (I)185, dated 25th July, 1985, shall stand dissolved with immediate effect.

[No. F. 2 (I) NFC/90.]

JAVED TALAT,
Addl : Finance Secretary (B).

Annex-VII

PART I

Acts, Ordinances, President's Orders and Regulations

GOVERNMENT OF PAKISTAN

MINISTRY OF LAW, JUSTICE AND PARLIA1VIENTARY AFFAIRS

(Law and Justice Division)

Islamabad, the 22nd April, 1991

No. F. 2 (2)/91-Pub.—The following Order made by the President on 20th April, 1991 is hereby published for general information:—

PRESIDENT'S ORDER No. 1 OF 1991

WHEREAS, in pursuance of Clause (1) of Article 160 of the Constitution, the President, by the Finance Division Notification No. SRO 764 (I)190, dated the 23rd July, 1990, appointed a National Finance Commission to make recommendations, among other matters, as to the distribution between the Federation and the Provinces of the net proceeds of certain taxes ;

AND WHEREAS the said Commission has submitted its recommendations with regard to the said distribution;

NOW, THEREFORE, in pursuance of clause (4) and (7) of Article 160 of the Constitution, the President is pleased to make the following Order:—

1. **Short title and commencement.**—(1) This Order may be called the Distribution of Revenues and Grants-in-Aid Order, 1991.

2. It shall come into force on the first day of July, 1991.

2. **Definition.**—In this Order, unless there is anything repugnant in the subject or context :—

(a) "net proceeds" means, in relation to any tax, duty or levy, the proceeds thereof reduced by the cost of collection as ascertained and certified by the Auditor-General of Pakistan; and

(b) "taxes on income" includes corporation tax but does not include taxes on income consisting of remuneration paid out of the Federal Consolidated Fund.

(3) **Distribution of Revenues.**—The Provincial Governments shall be assigned in each financial year a share equal to eighty per cent of the net proceeds of the following taxes and duties levied and collected by the Federal Government in that year, namely :—

(a) Taxes on income.

(b) Taxes on sales and purchases.

(c) Export duties on cotton.

(d) Excise duty on tobacco and tobacco manufacturers.

(e) Excise duty on sugar.

4. **Allocation of shares to the Provincial Governments.**—The sum assigned to the Provincial Governments under Article 3 shall be distributed amongst the Provinces on the basis of their respective population in the percentage specified against each :—

The Punjab	57.88%
Sind	23.28%
The North-West Frontier province	13.54%
Baluchistan	5.30%
Total:	100.00%

5. **Payment of net proceeds of royalty on crude oil.**—Each of the Provinces shall be paid in each financial year as a share in the net proceeds of the total royalties on crude oil an amount which bears to the total net proceeds the same proportion as the production of crude oil in the Province in that year bears to the total production of crude oil.

6. **Payment of net proceeds of development surcharge on natural gas to the Provinces.**—Each of Provinces shall be paid in each financial year as a share in the net proceeds of the surcharge on natural gas an amount which bears to the total net proceeds the same proportion as the well-head production of natural gas in the Province in that year bears to the total. well-head production of natural gas.

7. **Grants-in-aid to the Provinces.**—There shall be charged upon the Federal Consolidated Fund each year, as grants-in-aid of the revenues of the Provinces, (for the period) specified against each, the amount so specified :—

Province	Period	Amount
The Punjab	For 3 years.	Rs. 1000 million.
Sind	For 5 years	Rs. 700 million.
The North-West Frontier Province	For 3 years	Rs. 200 million.
Baluchistan	For 3 years.	Rs. 100 million.

8. **Repeal.**—Articles 2, 3, 4 and 5 of The Distribution of Revenues and Grants-in-Aid Order, 1975 (P.O. No. 2 of 1975), and the Distribution of Revenues Order, 1983 (P.O. No. 8 of 1983), are' hereby repealed.

GHULAM ISHAQ KHAN,
President.

IHSAN-UL-HAQ CHAUDHRY,
Secretary.

ERRATA

[To the *Gazette of Pakistan, Extraordinary,* Part I, Publishing Date March 28, 1991, an Act No. 1 of 1991, dated 19th March, 1991, published by Senate Secretariat is Corrected to read as under] :

Page 65, Para 1 of Short title and commencement, Line 2 :
For : " ssion of Terrorist (Special Courts) (Amendment) Act, 1991.
read : " ssion of Terrorist Activities (Special Courts) (Amendment) Act, 1991. ".

Annex-VIII

FINANCE DIVISION

Islamabad, the 10th December, 1996

S. R. O. 1361 (I)/96.—In partial modification of Notification No. S. R.O 33 (I)/95, dated 23rd July, 1995 and in pursuance of Article 160 (I) of the Constitution, the President is pleased to reconstitute National Finance Commission, consisting of the following members:—

(1)	Minister for Finance Government of Pakistan	*Chairman*
(2)	Minister for Finance Government of the Punjab	*Member*
(3)	Minister for Finance Government of Sindh	*Member*
(4)	Minister for Finance Government of N.W.F.P.	*Member*
(5)	Minister for Finance Government of Balochistan	*Member*
(6)	Adviser to the Prime Minister for Finance, Economic Affairs and Planning and Development.	*Member*
(7)	Professor Dr. M. Rafique, Former V. C. Punjab University (Punjab).	*Member*
(8)	Mr. Nabi Bux Bhurgri Minister for Irrigation and Power (Sindh).	*Member*
(9)	Mr. Imtiaz Ahmad Sahibzada (NWFP)	*Member*
(10)	Mr. Khursheed Marker (Balochistan)	*Member*
(11)	Finance Secretary Government of Pakistan	*Official Expert*

2. The revised Terms of Reference for the Commission are as follows :—

(a) The distribution between the Federation and the Provinces of the net proceeds of the taxes given below:—

(i) Taxes on income including corporation tax, but not including taxes on income consisting of remuneration paid out of" the Federal Consolidated Fund.

(ii) Taxes on the sales and purchases of goods, imported, exported, produced, manufactured or consumed.

(iii) Export duties on cotton.

(iv) Consider the inclusion of other Federal Taxes including Customs Duties and Federal Excises, but not including tax on income paid out of Federal Consolidated Fund.

(b) The making" of grants-in-aid by the Federal Government to the Provincial Governments.

(c) The exercise by the Federal Government and the Provincial Governments of the borrowing powers conferred by the Constitution.

(d) Examine the question of rationalization of payment of royalties on crude oil and of surcharge on natural gas collected by the Federal Government to the Provincial Governments.

(e) To consider review of the distribution of share of taxes between the Federal Government and Provincial Governments.

(f) Any other matter relating to finance referred to the Commission by the President.

[No F. 2 (1)'NFC/96.].

FIDA HUSSAIN
Joint Secretary (PF)/
Secretary,
National Finance Commission.

Annex-IX

TO BE PUBLISHED IN THE GAZATTE OF PAKISTAN EXTRAORDINARY

GOVERNMENT OF PAKISTAN
FINANCE DIVISION
(NFC SECRETARIAT)

Islamabad, the 22nd July, 2000

NOTIFICATION

S. R. O. 529(I)2000.—In pursuance of Article 160 (1) of the Constitution of the Islamic Republic of _Pakistan, the President is pleased to constitute National Finance Commission consisting of the following namely:—

(1)	Minister for Finance Government of Pakistan	Chairman
(2)	Minister for Finance Government of the Punjab	Member
(3)	Minister for Finance Government of Sindh	Member
(4)	Minister for Finance Government of NWFP	Member
(5)	Minister for Finance Government of Balochistan	Member
(6 to 9)	One Member from each Province to be notified in consultation with the Governors of the Provinces.	
(10)	Secretary General Finance Government of Pakistan	Official Expert
(11)	Finance Secretary Government of Pakistan	Official Expert

TERMS OF REFERENCE

2. The terms of reference for the Commission are as under:-

(a) the distribution between the Federation and the Provinces of the net proceeds of the following taxes:

   (i) taxes on income, including corporation tax, but not including taxes on income consisting of remuneration paid out of the Federal Consolidated Fund;

   (ii) taxes on the sales and purchases of goods, imported, exported, produced, manufactured or consumed.

   (iii) GST on services

   (iv) Export duties on cotton

   (v) Consider the inclusion of other Federal Taxes including Customs Duties and Federal Excises, but not including taxes on income paid out of Federal Consolidated Fund.

(b) the, making of grants-in-aid by the Federal Government to the Provincial Governments;

(c) the exercise by the Federal Government and the Provincial Governments of the borrowing powers conferred by the Constitution;

(d) examine the question of rationalization of payment of royalties on crude oil and of surcharge on natural gas collected *by* the Federal Government to the Provincial Governments;

(e) to consider review of the distribution or share of taxes between the Federal Government and Provincial Governments; and

(f) to develop and enforce a mechanism for setting parameters to achieve fiscal discipline at the Federal and Provincial levels and for ensuring consistency in maintaining an appropriate fiscal balance at the consolidated level.

(g) any other matter relating to finance referred to the Commission by the President.

3. The National Finance Commission notified *vide* Gazette of Pakistan Extraordinary SRO 733(1)/95, dated 23rd July, 1995 and SRO 1361(1)/96, dated 10th December, 1996, shall stand dissolved with immediate effect.

No.F.2(2)-NFC/ 2000

(A. M. Zahid)
Joint Secretary (B)
Secretary
National Finance Commission

The Manager,
Printing Corporation of Pakistan Press,
Islamabad.

GOVERNMENT OF PAKISTAN
FINANCE DIVISION
(NFC SECRETARIAT)

SUBJECT: **<u>MINUTES OF THE 1ST MEETING OF RECONSTITUTED 7TH NATIONAL FINANCE COMMISSION</u>**

1. The 1st meeting of National Finance Commission (NFC) was held on 27th August, 2009 under the Chairmanship of Federal Finance Minister/ Chairman NFC in the Conference Room of Finance Division, Islamabad. The meeting started with the recitation from the Holy Quran by Federal Finance Secretary. A list of participants is at Annex-I.

2. The Chairman welcomed the participants noting that the meeting of 7th NFC was being held after a long time. The Chairman stated that the people of Pakistan had very high expectations from this meeting and assured that the grievances and viewpoints of all the provinces would be shared. The Finance Minister claimed he had come with an open mind and desired to conclude the meeting objectively resolving any difference amicably. He then highlighted the agenda of the meeting, which included discussions on GST on Services (CE Mode), Gas Development Surcharge (GDS), and to develop a mechanism for ensuring fiscal discipline and a methodology to be adopted by the NFC for giving an equitable and just award. Thereafter, provinces were to give presentations on their positions.

3. While throwing light on the methodology to be adopted by the NFC, the Chairman stated that the meetings of the Commission will be held at provincial headquarters on rotation basis. The next meeting would be held in Quetta, the third in Peshawar, the fourth in Karachi, the fifth in Lahore and the last meeting would be held in Islamabad. After briefing the participants about the agenda items, the Chairman requested Finance Minister Balochistan to give his introductory remarks.

4. In his opening statement Finance Minister Balochistan thanked the President, the Prime Minister and the Chairman for fulfilling the promise of arranging the NFC meeting within the given time period. He also thanked the other provinces and stated that the prevailing situation in Balochistan was very precarious and that it was running away from federation. He stressed that it was imperative that grievances of the province be reviewed. Finance Minister Balochistan described his

province as full of natural resources but explained that during the last 63 years the rightful share of the province had not been given. He stated that although the proportionate share of his province for the Gas Development Surcharge is high, it is decreasing. He pointed out that due share of Gas royalty and GDS may be provided to his province and stressed that the Gas development surcharge prior to 1991 may also be paid to them. Finance Minister Balochistan explained that his province comprised of 45% of the total area of Pakistan but had scattered population, and therefore, required more funding to meet its developmental activities since the present resource availability position is insufficient.

5. The Chairman then invited Finance Minister NWFP to give his point of view. The Finance Minister NWFP congratulated the Chairman for convening the NFC meeting since the forum provided the much needed opportunity to discuss resource distribution. He proposed that the issue of "Cost of conflict of War on Terror" may also be included in the TORs.

6. Finance Minister NWFP stated that his province was passing through a very critical phase as a result of the "War on Terror". The population of the affected area had to be displaced because of the operation. Suicidal bombing and attacks on public are persistent. The Finance Minister NWFP illustrated findings of a study carried out by Oxford Policy Management Group which showed that poverty ratio which currently stands at around 40% and is rising. Similarly commercial and industrial activities have been reduced to the minimum, which has resulted in falling household incomes. Rehabilitation cost is enormous with conservative estimates amounting to Rs.207 billion and the losses suffered by the economy have been colossal. The total cost of conflict can be estimated to be Rs.154 billion including loss of private property at around Rs.35 billion.

7. Finance Minister NWFP further stated that security expenditure had risen tremendously and security spending has increased from Rs 6 billion to 12 billion after the conflict and is expected to rise even further. Due to military operations, more than 50% of the Malakand population had to be shifted to secure places on short notice thus leaving their assets unsecured/unmonitored. The cost of provision of food and shelter in the IDPs camps had run into billions. Although the Government of NWFP made sincere efforts to look after them and reduce their agony yet the magnitude of the tragedy was beyond its capacity. The Minister

stated that he, along with his team had come to the NFC meeting with the hope that requirements for resources would be looked into sympathetically and that the Federal Government and fellow provinces would extend full support to NWFP due to it being the frontline province against the enemies of Pakistan. The Minister explained that the all parties conference held by the Chief Minister on 26th August, 2009 mandated him to place the above submissions for consideration.

8. Finance Minister NWFP explained that Net Hydel Profit being paid to the province at a unilaterally capped figure of Rs.6 billion was not in accordance with the Article 161 and that NWFP should be paid NHP amounting to Rs.110 billion as announced by Arbitration Tribunal. The total claim of NWFP till end of 2008-09 based on the Award amounts to Rs.251 billion. Net Hydel Profit for the financial year 2009-10 according to the Award is Rs.38 billion. He claimed that these are constitutional obligatory transfers as enshrined in Article 161(2) and its disbursement is ensured by the Federal Government being the guarantor. Finance Minister NWFP stressed that this must be paid to his province immediately. He further requested that the issue of royalties on Oil and Gas and the rate of surcharge on gas must be resolved.

9. The Chairman then invited Chief Minister/ Finance Minister Sindh to give his introductory remarks. Chief Minister Sindh expressed his gratitude to the President and the Prime Minister for realizing the sensitivity of the issue at hand and reconstituting the 7th NFC with its actual members. He paid his respect to the sentiments of other provinces noting that all are equal shareholders in the federation of Pakistan. He showed his reservations over the 1996 NFC Award on the plea that this award was announced by the Caretaker Government, which had no mandate over the people of Pakistan, while the present members of the Commission were the true representatives projecting the will of the people.

10. He stated that poverty is rampant in Sindh and this issue requires pint effort. He showed sympathy towards the NWFP Government in playing a frontline role in the "War on Terror" and expressed the need to help the province in this regard. He further stated that Karachi is a hugely populated city, where people from different areas/ segments of the society i.e. Punjabis, Path ins, Sindhis, Muhajirs and Balochis are residing. Hence, pressure to provide basic social sector facilities to its inhabitants remains a pressing issue, for which Sindh province will be in need of more funds.

11. While referring to Article 160, Chief Minister Sindh stated that the main function of the NFC was to give its recommendations on (i) divisible pool taxes; and (ii) grants-in-aid by the federal government to the provinces. He stated that other items such as Gas Development Surcharge, Royalty on Oil and Net Hydel Profit etc. must not be included in the TORs. He read out Clause-3 of Article 160 and highlighted that Sales Tax on Goods and not on Services was included in the Constitution. He added that since the GST on Services fall under the domain of provincial governments therefore, they must not form part of the Divisible Pool Taxes. He was of the view that the NFC is required to remain within the scope of Article 160 and therefore concentrate on the divisible pool only.

12. Chief Minister Sindh pointed out that the Federal Government is imposing GST on Services (CE mode), on telecommunication, air travel and transportation of goods by air and train hence ignoring the Constitutional provision. (since services are not mentioned in the Constitution being a provincial subject). He suggested that instead of the Federal Government imposing GST on CE Mode it should be handed over to provincial governments. He also suggested that the distribution of GST (Provincial) should be based on collection and not on population.

13. He further showed his reservations over abolishing the OZT and enhancing the sales tax by 2.5%. He stated that this enhancement in the sales tax rate is made to offset their losses of OZT and that the distribution of 2.5% must be made based on the audited ratios of OZT or else provinces may be allowed to revive the OZT regime.

14. Thereafter, the Finance Minister Punjab gave his introductory statement. He stated that in Punjab there is a coalition government of PML (N) and PPP and there must be a judicious and fair mechanism for transfer of resources. He showed his reservation over the Presidential Order, 2006 which is an action of undemocratic rule. He expressed full confidence in the present NFC, which had been constituted democratically. Finance Minister Punjab agreed that NFC should also discuss the issue of ' War on Terror" since Punjab has also suffered due to it. He emphasized inclusion of Petroleum Development Levy in the Divisible Pool and showed willingness to support a formula having multiple indicators provided that all the federal transfers including straight transfers are reviewed. He further stated that he come to the meeting with an open mind and will support a judicious, fair and equitable formula.

15. Senator Haji Adeel, member NWFP stated that in his province, there too is a coalition of ANP and PPP. He emphasized that the issue of "War on Terror" must be given priority as his province had suffered a lot on this account. He drew the attention of the Chair towards the commitment of the Friends of Pakistan and inquired about the amount received from these Friends. He doubted that the funds received in the name of "War on Terror" and IDPs had not been spent in the province. He stressed that:

(i) The distribution ratio between the federation and the provinces should be 80:20 in favour of the provinces as indicated in the charter on democracy;

(ii) The total financial receipts of the Government of Pakistan need to be disclosed. It is open to question why the Government of Pakistan takes a share from the provinces when it retains for itself a far larger pool of funds, which are not placed in the divisible pool.

(iii) 5% additional share over and above the existing population share may be given to NWFP to meet the challenge of the "War on Terror".

(iv) Net Hydel Profit - Award announced by the arbitral tribunal regarding payment of Rs.110 billion up to 2004-05 and now totaling Rs.251 billion up to 2008-09 should be honoured by the Federal Government as it is the awards guarantor.

(v) Services extended to FATA by NWFP may be taken into account and compensation be provided to NWFP.

(vi) The downstream provinces have been using about 3 MAF of NWFP share of water from the Indus River system for which we demand compensation since the user provinces are deriving abiana/malia for the use of such waters.

(vii) Serious concerns were shown regarding payment on account of development surcharge/royalties on gas/oil, as production in NWFP has gone up but the amount paid has fallen.

16. While referring to the demand of the Sindh Government regarding distribution of resources based on collection he stated that public sector investment has largely been made in the big cities/urban areas of the country. The Senator was of the view that there is very negligible investment in his province, as well as, in Balochistan and suggested that these two provinces may first be brought at par with other provinces and then the issue of distributing resources based on collection should be addressed. He was expressed that the credit facilities by the banks were also made to two provinces and he inquired about data with regards to province-wise public investment, as well as, credit facilities extended by the commercial banks.

17. The Chair assured the members that he would provide the requisite data after its collection from their relevant agencies and stressed that all issues must be discussed including GST on Services, GDS, NHP etc. He proposed constitution of sub-committees to discuss these issues in detail.

18. Dr. Gulfaraz Ahmed, member Balochistan stated that instead of assigning these issues to committees, the NFC itself should look into deliberate upon them in detail in order to save time and effort. He further stated that the royalty on gas and Net Hydel Profit comes under Article 161 of the Constitution as agreed by all provinces. The GDS on the other hand does not form part of Article 161 and the proceeds of GDS are being transferred to provinces in pursuance of the decision of the NFC in 1990. He noted that the formula for distribution was devised by the NFC and that the Government of Balochistan had agreed to it despite certain flaws. Now the Balochistan Government wants revision in the formula recognizing the NFC as the competent forum for this revision. As regards GST on Services (CE Mode), the Balochistan Government would support maintaining status-quo.

19. Mr. Abdul Ghafoor Mirza, member Punjab demanded inclusion of Petroleum Development Levy in the divisible pool. As regards GST on Services, he held the view that it should be dealt with according to the Constitution. He referred to one of the TOR of the NFC regarding borrowing powers of the federation and the provinces and stated that the Federal Government should restrain in accordance with the Fiscal Responsibility and Debt Limitation Act (2005). He supported inclusion of GDS as a TOR of NFC and that NFC should recommend a mechanism for maintaining fiscal discipline both at federal and provincial levels.

20. Mr. Kaiser Bengali, member Sindh stated that despite services falling exclusively under the domain of provincial governments, the Federal Government is collecting the same in the CE mode, thus going against the Constitution. He held the view that although Balochistan and NWFP had weak revenue collection capacity, some weightage was required to encourage revenue generation in Sindh Punjab. He demanded that 1/6th of sales tax must not be made part of the divisible pool and should be transferred to provinces separately since provinces were suffering heavy losses by this combination.

21. The Chairman summed up the issues and requested the provincial governments to give their presentations as per the agenda. Mr. Abdul Ghafoor Mirza, member Punjab suggested that it would be more appropriate if the Federal Government gave its presentation before the provincial presentations in order to know the size of the pie i.e. divisible pool. He further pointed out that the Federal Government FBR receipts shrunk from 15% of GDP to now below 9% of GDP. Mr. Kaiser Bengali noted that this trend was a result of the readjustment of the GDP. Federal Finance Secretary advised that provinces may give their presentations first and in the light of their requirements, the Federal Government would make necessary adjustments. The alternative argument was that the Federal Government may present first, highlighting the overall resource picture according to which the provinces would re-adjust.

22. Mr. Kaiser Bengali pointed out that the main responsibility of the NFC was to devise a formula irrespective of the size of the divisible pool.

23. The Chairman summed up the first session of the proceedings and stated that in the next session the Federal Finance Secretary would make a presentation on the overall fiscal resources followed by presentations by the provincial governments. <u>The session was closed till 11.30 a.m. the next day i.e. 28th August, 2009.</u>

24. The second session of the meeting started on 28th August, 2009 with recitation from the Holy Quran by Finance Secretary NWFP. The Chairman welcomed all the participants and then invited the Federal Finance Secretary to present the overall fiscal resource position of the Federal Government.

25. The Federal Finance Secretary started his presentation with an account of historical data on federal fiscal operations. He then illustrated details of federal transfers to provinces. Thereafter, macroeconomic framework projections up to 2013-14 were presented. He informed that these projections had been agreed with the International Monetary Fund (IMF) in which FBR receipts were 9.3% of GDP in 2009-10 (BE) which would gradually be increased to 11.9% of GDP in 2013-14.

26. The Chairman said that under the prevailing tax structure 60% of tax is being contributed from the Manufacturing sector, which is further divided in to 60% from domestic industries and 40% from imports. Total contribution of the Industrial sector to GDP is 40% while 60% to tax revenue is collected from the sector. The Services sector contributes 52% to GDP but its contribution to tax revenue is less than 20%. Similarly, the Agriculture sector is the major contributor to GDP cut tax from agriculture is very nominal. These facts underline the need to revise the tax structure. The Chairman explained that both the Agriculture and Services sectors must be taxed in proportion to their contribution to GDP. And that VAT system needs to be implemented in order to meet bare minimum requirements of the economy. Presently, Federal Government is facing revenue deficit with PSDP funding entirely from loans. The Chairman was of the view that minimum tax to GDP ratio must be 13% to 15%.

27. The Federal Finance Secretary, while continuing his presentation, said that these were merely projections and that the FBR targets could be upwardly revised provided the political forces have the will to implement the reforms in true spirit. He stated that he would welcome views/ comments/ suggestions from the members of NFC.

28. In the end, the Federal Finance Secretary highlighted the existing composition of transfers of resources, rates of cost of collection and the vertical, as well as, horizontal distribution mechanism. Hard copies of the presentation were circulated to all the participants.

29. The Chairman, while summing up the presentation, stated that there were four areas (sectors) which were not taxed properly but needed to be. These included:

a. Agriculture;
b. Real Estate;
c. Services; and
d. Stock Exchange.

30. Mr. Abdul Ghafoor Mirza, member Punjab, while giving his response, requested for a separate presentation on FBR receipts. He also noted that there were serious loopholes in the tax collecting systems, which resulted in heavy tax evasion. He drew attention of the Chairman towards smuggling, lack of auditing system, corruption in the tax collecting agencies, lack of control of the field formations, and lack of documentation etc. The Chairman assured efforts to control all such kinds of discrepancies amicably.

31. The Chairman observed that after the presentations by the provinces, sub committees would be formed to deliberate upon benchmarking, vertical and horizontal distribution and other issues cropped up during the initial deliberations. Dr. Kaiser Bengali pointed out it would be inappropriate to deliberate upon all issues. The main function of the NFC was to devise a formula for horizontal distribution of resources and therefore, the NFC should stick to its primary role. NFC is not competent to give recommendations on all other issues which are not part of the TORs of NFC. The Chairman was of the view that in order to have firsthand information of the future resource availability position, benchmarking would be necessary.

32. The Chairman then invited Mr. Abdul Ghafoor Mirza to give a presentation on Punjab's position. Hard copies of the presentation were circulated to all participants at the meeting.

33. Mr. Abdul Ghafoor Mirza referred to three myths/ misperceptions regarding transfers to Punjab resulting in a severe distortion of reality including:

a. Federal transfers are made on the basis of population favouring the largest province, Punjab.

b. Because of high share in federal transfers, provincial Government of Punjab is relatively well off and is spending more per capita compared to the other provinces.

c. The smaller provinces are unable to provide basic services to their residents because of diversion of revenues to Punjab.

34. He was of the view that these 'myths' were the consequence of lack of appreciation of the changing structure of Federal Transfers. Straight Transfers have emerged as a significant mechanism of revenue

transfers since 1990 NFC. According to him significance of special grants/ subventions has also increased since the 1996 NFC. Punjab continues to heavily depend on divisible pool transfers, which have declined in proportionate terms in Federal Transfers. He presented historical data to support his point of view. As regards myth 1, Mr. Abdul Ghafoor Mirza was of the view that almost as much as one third of the Federal Transfers is not on population basis but is distributed based on collection/ location basis. With regards to myth 2, he said that the per capita expenditure of the province is considerably low as compared to other provinces mainly due to lower share in Federal Transfers. This has resulted in having relatively limited network of schools, hospitals beds etc. in relation to its population size. As regards to myth 3, he stated that Punjab has a low level of basic public service provision per capita.

35. He expressed that all provinces have to expand social service delivery to meet Millennium Development Goals (MDGs), especially in areas of health and education. They also have to increase their security related expenditures substantially. They need higher infrastructure investments in order to increase growth in the long run. Due consideration is required to be given on expenditure implications of potential abolition of Concurrent List functions and the reduction of vertical programmes by the Federal Government.

36. While giving Punjab's position on Vertical Sharing, he informed that Pakistan is falling behind in achieving the MDGs. Provincial Governments play a key role in providing MDG related services. Performance is lagging especially in the following:

a. Eradication of poverty;
b. Achievement of universal primary education;
c. Promotion of gender equality; and
d. Reduction in child and maternal mortality

37. Punjab has the highest share of expenditure on public order and safety affairs, which is increasing rapidly. Increase in federal resources has warranted inclusion of Petroleum Development Levy (PDL) in the divisible pool. Sales tax on Services should be transferred to the provinces as per the Constitutional Provision after inclusion of three major services i.e. domestic travel by air and train, carriage of goods by air and services provided or rendered by persons engaged in telecommunication

work; all provinces should get net profits from hydroelectric power generation as per Article 161 of Constitution.

38. As regards Punjab's position on Horizontal Sharing, Mr. Abdul Ghafoor Mirza highlighted the following points:

a. Historically low level of per capita transfers

b. Low level of per capita expenditure

c. Large fiscal deficit despite relatively lower expenditure

d. Requirement for higher security related expenditure (already explained)

e. Relatively higher expenditure requirement for employment creation, skill development and social protection

f. The new growth strategy emphasizes agricultural development and SMEs, which will imply larger PSDPs in Punjab

39. The relatively low level of transfers has placed Punjab in a difficult position. The province had the largest fiscal deficit in 2008-09 while the same is projected for 2009-10. This strengthens the case for higher transfers in any future NFC Awards to remove the deficit. The war against militancy and slowing down of the economy has also increased funding needs of the provinces, especially Punjab. Expenditure on 'social protection' has increased, with Punjab making a special pro-poor effort (cash transfers, food subsidy, skill development and employment program). There is also a higher rate of unemployment in Punjab amongst male youth who are more vulnerable to militancy. In the new Inclusive Growth Strategy Punjab has a stronger case for larger development allocations because the Agriculture sector is receiving higher priority and Punjab is the agriculture 'heartland' and 'granary of Pakistan' (73% of national cereal production). Higher food production in Punjab will contribute to greater national food security.

40. Concluding his point of view, he said that Federal Transfers should be viewed in totality and the focus should not just be on divisible pool transfers stressing that the revenue sharing formula be on the basis of

population. However, he added that Punjab was ready to discuss a judicious resource sharing formula subject to revised structure of divisible pool and a higher provincial share.

41. Thereafter, the Chairman invited Dr. Gulfaraz to present Balochistan Government's point of view. Hard copies of the presentation were circulated to the members of the NFC.

42. In his presentation, Dr. Gulfaraz stated that Balochistan had a vast area (43.6%) but small population (5.11%) and low population density resulting in multiplying the per capita cost of development and provision of public services. As a result of using the equality of rupees per capita instead of provision of public services per capita for distribution of divisible pool among provinces, Balochistan province had remained backward. Resultantly the perception of deprivation was widespread. He claimed that Balochistan was not receiving the just share of Gas Development Surcharge in line with generation by each province adding that Balochistan seeks compensation through special grant for the past low royalty received from the gas produced from Sui field.

43. While describing the economic realities of Balochistan he stated its characteristics:

a. Inadequate infrastructure of public utilities and services due to underdevelopment and historical differentials

b. Lack of resourceful/entrepreneurial private sector for complementing public service delivery through private facilities in health, education, transport and housing sectors.

c. Absence of corporate head offices affecting revenue collection, employment opportunities and provincial commerce

d. Inadequate development/exploitation of the provincial economic potential in areas within the Federal List: regional communications, international trade and coastal resources.

e. Near absent foreign investment in the Province

f. Near absent commercial bank advances in the Province

g. Heavy financial burden on the Province caused by CDL.

44. While describing the fiscal federalism, he stated that the political autonomy provided to provinces in the Constitution in the form of autonomous functions necessitates matching fiscal federalism. Provinces need rightful access to adequate share of national resources/revenues to carry out their functions autonomously. The main characteristics of fiscal federalism include existence of vertical and horizontal fiscal imbalances. Vertical imbalance arises from centralization of revenue collection with the Federal Government and excessive dependence of Provincial Governments on Federal Transfers. Generally, vertical imbalance is purposely created by various federations for equalization of development and public service delivery among sub-national governments through a revenue sharing mechanism. Horizontal imbalance results from disparities in revenue capacities and revenue needs of provinces on the basis of relative costs of development and provision of public services. Most federations distribute the provincial share of resources through Horizontal Fiscal Equalization (HFE) mechanisms based on equalization of development and provision of public services taking into account the relative costs (relative efficiency of sub-national governments is normally taken into consideration in HFE).

45. Dr. Gulfaraz highlighted the use of certain indicators for resource sharing summarized as follows:

POPULATION

a. Basic parameter relating to fiscal needs for socioeconomic development.

b. Commonly used with varying weights for Horizontal Fiscal Equalization

c. Adopted as a sole criterion for horizontal distribution only in the federation of Pakistan

INVERSE POPULATION DENSITY (IPD)

d. Per capita cost of providing public services and development increases as area increases

e. Per capita cost of providing public services and development increases as population decreases

f. The ratio of area/ population is called IPD

g. Relative per capita cost of providing public services and development increases more rapidly as IPD increases

h. IPD is an essential economic parameter for equalization of provision of public services and development in federating units

HORIZONTAL FISCAL EQUALISATION RATIONALE

i. Governments raise public revenues for providing public services and carrying out development. The basis for distribution of divisible revenues should be cost per capita of providing public services and development and not equal money per capita.

j. On the basis of comparison of IPD disparity with Australia it is presumed that ratio of <u>cost of providing public services and development in Balochistan is about three-times that of the other provinces.</u>

46. Dr. Gulfaraz said that no federation in the world follows population as the sole basis for distribution of revenues among the federating units except that of Pakistan. In Australia, resource distribution is based on the relative cost of providing public services/development and relative revenue capacity.

47. While giving Balochistan's proposal he stressed that the provincial share in the divisible pool be increased to 60% and Petroleum Development Levy may also be included. Collection charge of 5% deducted by the Federal Government may be reduced to actual. He added that a broad-based horizontal distribution formula was required taking into account IPD, backwardness and generation. GDS was made distributable by NFC but should stay within its purview. The need for a change in the formula based on detailed working of generation by each province was necessary. He noted that there was widespread resentment in Balochistan against grants/subventions and this time a rightful share from the divisible pool was expected that can meet its needs without any grant in the NFC.

48. The Chairman invited members from the NWFP Government to present their point of view. Hard copies of the presentation were circulated to the members of the NFC.

49. The representative of NWFP Government gave a presentation pointing out that NWFP is facing a severe financial crunch mainly due to security operations in 11 districts of NWFP, constant displacement of population, suicide bombing, widespread poverty (40%), reduced commercial and industrial output, weakening governance and increased trust deficit on the issue of Net Hydel Profit. A brief account of NWFP's sources of revenue receipts was also provided claiming that they were completely insufficient to meet their expenditures. The province would require an estimated cost of Rs.154 billion on account of war indicative costs for the period 2006-07 to 2011-12. He also stated that NWFP province had low per capita income and scarce drinking water availability. He demanded that while considering the horizontal distribution resources, poverty, economic backwardness, Afghan refugees, services rendered to FATA and involvement in the "War on Terror" be given due weightage.

50. While referring to the issue of NHP he stated that the arbitration tribunal awarded Rs.110.0 billion up to 2004-05 together with interest, as well as, unpaid arrears with the total claim coming to Rs.251.5 billion. He stressed payment arrangement of the same before finalization of the NFC Award. Since the arbitration agreement had been endorsed by the Federal Government and as in the Presidential Order of 1990, the Federal Government was to act as guarantor, it was its responsibility to arrange early payment of the rightful share of the NHP.

51. He concluded his presentation showing the signed copy of the resolution of all parties conference and requesting revision of the TORs of NFC in order to accommodate due demands of the NWFP Government. With regards to vertical sharing, demand of 80% share for provinces was suggested.

52. Chairman invited Mr. Kaiser Bengali to present Sindh Government's point of view. Hard copies of the presentation were circulated to the members of the NFC.

53. Mr. Kaiser Bengali, while giving the history of the NFC stated that in the past 35 years, only three NFC Awards could be made in 1976, 1991 and 1996 — the first two under political governments and the

third under a caretaker government. The Distribution Order 2006 was not based on the recommendations of the NFC and largely a continuation of 1996 Award. The 1991 Award was significant being a Consensus Award and was achieved within a short period of 3 months. He claimed that the major feature of these three Awards had been that they used a single criterion for Horizontal Distribution of Resources. And that no other federation in the world used only population as a criterion for Resource Distribution. The 1996 Award given by an Interim setup gave greatest blow to the provinces by drastically reducing provincial share from 80% to 37.5% under the garb of "National Resource Picture".

54. He further stated that over the last few years many "Constitutional and legal violations" had crept into the NFC which needed to be corrected urgently. GST on Services despite being a provincial levy was being distributed on the basis of population. GST on Services (CE Mode) was another contradiction as the Federation cannot levy GST on a Service through any other mode including CE. Dr. Bengali stated that $1/6^{th}$ of GST was levied primarily to offset loss of Local Governments' on account of abolition of OZT and that its distribution through a population cum collection formula was contrary to the objectives of replacing OZT with Sales Tax since $1/6^{th}$ of GST was a Straight Transfer. However, as per Distribution Order 2006 it is included in the divisible pool and is being deducted from the Provincial Share. He claimed that this anomaly was incurring huge costs to "all provinces".

55. While giving the position of Sindh Government he stated that Sindh is the most strategically located province, having a population of 45 million with numerous natural and manpower resources - yet continuing to be largely underdeveloped. Sindh houses a huge migrant population from all over Pakistan imposing a burden on its resources. Despite a robust economic base, Sindh has suffered severe fiscal deficits and consequent deficits on account of human development especially health and Education. Sindh has suffered severely on account of law and order for over 25 years in terms of economic costs; law and order expenses and loss of precious human lives.

56. He added that the current Low Revenue Share in the divisible pool was not sufficient to provide the required level of services. Due to paucity of resources, the overall quality and coverage of services in Sindh had depleted over time with serious implications on the province's quality of life.

57. He further stated that the horizontal distribution formula needed a complete review as the population based distribution formula leads to further inequity and imbalanced growth. When the cost of provision of services is varied then per capita distribution is also economically unviable. Per capita distribution now needs to be supplemented with 'criteria such as: Revenue Generation; Backwardness and Area.

58. While listing some examples of international practices, he stated that India uses population, area, index of infrastructure, tax effort, fiscal discipline and income distance as indicators for resource distribution. Argentina, Brazil and Philippines include development gap, land area and equal shares, while Malaysia; Japan and China use collection as principal criteria.

59. He further elaborated the Rationale of Revenue Collection as a criterion and stated that the basic idea was to revert at least a part of the proceeds to the area that generates revenue and the population that bears the tax incidence. Businesses are located in Sindh due to economic factors especially the returns on investment due to agglomeration of different infrastructure and services. If minimum levels of infrastructure and services were not provided, investment environment would be adversely impacted with serious repercussions on the national economy. Dr. Bengali claimed that national growth targets were crucially dependant upon the vibrancy and dynamism of the economy of the largest metropolis of Pakistan. Its infrastructure is fast depleting and congestion and environmental condition deteriorating. Some taxes have a high degree of exporting. Sindh demands share only in taxes that have low degree of exporting. Personal Income Tax; Retail Sales Tax; Sales Tax on Utilities and Central Excise are borne by the residents/population from where taxes are being collected. Fiscal federalism principles suggest that these taxes can exclusively be transferred on the basis of origin of tax.

60. While giving Sindh Government's point of view he stated that the existing revenue distribution was particularly unfriendly to Sindh. Correction in the horizontal distribution was required by taking into account internationally accepted principles based on social and economic factors. Non NFC issues created through NFC decisions and mechanisms needed correction as per constitution and law.

61. He also presented some statistical data with regards to the distribution of 1/6th of Sales tax. Hard copies of the presentation were already circulated to the members of the Commission during the meeting.

62. While summing up the deliberations, the Chairman constituted two sub-committees. The first sub-committee will be headed by the Chairman himself. Provincial Finance Ministers and all four members of provinces will be members of this Committee. The second sub-committee headed by the Federal Finance Secretary and all provincial Finance Secretaries in addition to two female participants will be members of the Committee. The sub-committees will meet on 4th and 5th September, 2009 respectively.

Decisions:

63. The following decisions were taken in the meeting:

a. The upcoming meetings of the Commission will be held at provincial headquarters on rotation basis. The second meeting will be held in Quetta on 18th and 19th September, 2009.

b. Two sub-committees will be constituted. The composition and the TORs of the sub-committees would be as follows:

Sub-Committee-I

1. Federal Finance Minister	Chairman
2. Chief Minister/ Finance Minister (Sindh)	Member
3. Finance Minister (Punjab)	Member
4. Finance Minister (NWFP)	Member
5. Finance Minister (Balochistan)	Member
6. Mr. Abdul Ghafoor Mirza (Punjab)	Member
7. Mr. Kaiser Bengali (Sindh)	Member
8. Senator Haji Muhammad Adeel (NWFP)	Member
9. Dr. Gulfaraz Ahmed (Balochistan)	Member
10. Mr. Asif Bajwa, AFS(EF-P & ERU)	Member/ Secretary

Terms of Reference (TORs)

(i) Devising a formula for horizontal distribution of divisible taxes amongst the provinces.

(ii) Considering the formula for distribution of Gas Development Surcharge among the provinces and making recommendations in respect thereof.

(iii) Considering issues in relation to net profits from hydro electric stations and making recommendations in respect thereof.

(iv) Considering issues relative to GST on Services both levied by the provinces and by the Federal Government under Central Excise Mode and making recommendations in respect thereof.

(v) Considering the issues relative to expenditures/costs on "War on Terror" including Internally Displaced Persons (IDPs) and Afghan Refugees and making recommendations in respect thereof.

(vi) Considering the issues relative to distribution of $1/6^{th}$ of Sales Tax and making recommendations in respect thereof.

(vii) Considering the applicability of the concept of equalization grants.

Sub-Committee-II

1. Federal Finance Secretary	Chairman
2. Finance Secretary (Punjab)	Member
3. Finance Secretary (Sindh)	Member
4. Finance Secretary (NWFP)	Member
5. Finance Secretary (Balochistan)	Member
6. Mrs. Naheed Durrani, Spl. Secretary (Sindh)	Member
7. Dr. Aisha Ghous Pasha, consultant (Punjab)	Member
8. Secretary (NFC)/Sr. JS (PF)	Member/ Secretary

Terms of Reference (TORs)

(i) Determination of benchmarks of expenditures and receipts for federal and provincial governments.

(ii) Determination of growth rates for Federal Government and each of the Provincial Governments to be applied to receipts and expenditures for projections in the next five years.

(iii) Vertical distribution of the divisible pool taxes including consideration of the possibility of enlarging the divisible pool.

(c) The meeting of the sub-committee-I will be held on 4th September, 2009 at 11.30 a.m. in the Conference Room of Finance Division, Islamabad.

(d) The meeting of the sub-committee-II will be held on 5th September, 2009 at 11.30 a.m. in the Conference Room of Finance Division, Islamabad.

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Annex-I

LIST OF PARTICIPANTS OF 1st MEETING OF 7TH NFC

S.No.	Name	Designation
	Federal Representation	
1.	Mr. Shaukat Tarin	Federal Finance Minister
2.	Mr. Salman Siddique	Federal Finance Secretary
3.	Mr. Asif Bajwa	Special Secretary Finance (EF-P & ERU)
4.	Mian Muhammad Younis	Senior Joint Secretary (PF)
5.	Mr. Abdul Malik Balghari	Assistant Secretary (NFC)
	Provincial Representation	
Punjab		
6.	Mr. Tanvir Ashraf Kaira	Finance Minister, Punjab
7.	Mr. Abdul Ghafoor Mirza	Member (Punjab)
8.	Mr. Tariq Mahmood Pasha	Finance Secretary, Punjab
9.	Dr. Aisha Ghous Pasha	Consultant
Sindh		
10.	Syed Qaim Ali Shah	CM/Finance Minister, Sindh
11.	Mr.Kaiser Bengali	Member (Sindh)
12.	Mr.Fazalullah Pechuho	Finance Secretary, Sindh
13.	Mrs. Naheed Durrani	Special Secretary Finance
NWFP		
14.	Mr. Muhammad Humayun Khan	Finance Minister, NWFP
15.	Senator Haji Muhammad Adeel	Member (NWFP)
16.	Mr. Khalid Aziz	Adviser to Government of NWFP
17.	Mr.Abdus Samad Khan	Finance Secretary, NWFP
Balochistan		
18.	Mr. Muhammad Asim Kurd	Finance Minister, Balochistan
19.	Dr. Gulfaraz Ahmed	Member (Balochistan)
20.	Mr. Mahfooz Ali Khan	Finance Secretary, Balochistan
21.	Mr. Noor-ul-Amin Mengal	Additional Secretary (Budget)

FINANCE DIVISION
(NFC SECRETARIAT)
****

Working Paper for the 1st meeting of Sub-Committee-I

Item No.1

Devising a formula for horizontal distribution of divisible taxes amongst the provinces.

Federal transfers consists of the following:

- Divisible Pool transfers;
- Grants-in-Aid (Special grant);
- Straight Transfers;

The distribution mechanism of the above transfers as provided under Presidential Order No.1 of 2006 (Annex-I) is given as follows:

Divisible Pool Transfers:

Out of the provincial share in the divisible pool, the amount equivalent to 1/6th of sales tax are transferred to provinces based on formula giving 50% weightage to audited OZT collection for the year 1998-99 and 50% to population. The ratios are as follows:

Punjab	Sindh	NWFP	Balochistan	Total
50.00%	34.85%	9.93%	5.22%	100.00%

The balance amount of divisible pool is distributed based on population ratio of each province as given below:

Punjab	Sindh	NWFP	Balochistan	Total
57.36%	23.71%	13.82%	5.11%	100.00%

The Committee may deliberate upon as to what could be recommended for horizontal distribution of divisible pool. However, NWFP government vide their letter dated 1st September, 2009 (Annex-II) stated that the issue of horizontal distribution may be settled after finalization of vertical distribution.

A presentation will be made by Dr. Gulfaraz Ahmed on vertical as well as horizontal distribution of divisible pool.

Grants-in-Aid:

In the Presidential Order No.1 of 2006 (Annex-I) all the four provinces were made eligible to receive grants-in-aid and the ratio of distribution has been fixed as follows:

Punjab	Sindh	NWFP	Balochistan	Total
11.0%	21.0%	35.0%	33.0%	100.0%

The grants-in-aid is to be increased in line with increase in divisible pool taxes.

Straight Transfers:

The straight transfers include royalty on natural gas and excise duty on natural gas (under Article 161[1]) and gas development surcharge and royalty on crude oil. Except gas development surcharge, all other straight transfers are being made on location basis. The distribution of GDS is being made in the proportion of well-head production of natural gas in the provinces.

Item No.II

Considering the formula for distribution of Gas Development Surcharge among the provinces and making recommendations in respect thereof.

The GDS was included as straight transfers on the recommendations of the 4th NFC in 1990. The relevant provision in the Presidential Order both in 1991 and 1997 (Annex-III) are reproduced as follows:

> "Each of provinces shall be paid in each financial year as a share in the net proceeds of the surcharge on natural gas an amount which bears to the total net

> proceeds the same proportion as the well-head production of natural gas in the province in that year bears to the total well-head production of natural gas."

Balochistan government intends to make a presentation on this issue.

Item No. III

Considering issues in relation to net profits from hydro electric stations and making recommendations in respect thereof.

This issue does not fall under the purview of the NFC and also has not been included in the TOR of NFC. This falls under Article 161(2). However, NWFP government is pressing hard for early finalization of this issue and has taken up the issue at the forum of NFC. A high level committee has already been constituted and the meetings of this committee are being held. The second meeting was held on August 8, 2009 and third meeting has been scheduled on September 5, 2009. A paper received from NWFP government is at Annex-IV.

Item No. IV

Considering issues relative to GST on Services both levied by the provinces and by the Federal Government under Central Excise Mode and making recommendations in respect thereof.

There are two type of GST on Services.

(i) GST on Services (CE Mode); imposed through Federal legislation;

(ii) GST on Services (Provincial); imposed through Provincial legislation;

As regards (i) above, in 2000, when it was decided to levy Value Added Tax on Services, a total number of 14 services were selected for promulgation by the Provinces. However, the Law Division opined that the provinces were not authorized to levy any tax on three services *[i.e. domestic travel by air /train, carriage of goods by air and services* *rendered by persons engaged in telecommunications]* as these are included in the Federal legislative List of the Constitution. Keeping the constitutional limitation in view, federal government levied GST in CE Mode on these items through amendment in the Central Excise Act. GST on Services (CE Mode) is part of the divisible pool and the proceeds thereof is being distributed between federal and provincial governments and amongst the provinces as per revised Presidential Order, 2006.

As regards (ii), this is a provincial levy being collected by the FBR. In pursuance of the decision of the IPCC the proceeds are being transferred to provinces on the basis of population ratio.

Item No.V

Considering the issues relative to expenditures/costs on War on Terror including internally displaced persons (IPDs) and Afghan Refugees and making recommendations in respect thereof.

This issue was taken by the NWFP government. However, no working paper on this issue was received. The representative of NWFP government may be requested to provide a comprehensive proposal in this regard.

Item No.VI

Considering the issues relative to distribution of 1/6th of Sales Tax and making recommendations in respect thereof.

1/6th of sales tax is part of the divisible pool taxes and as such needs to be tackled alongwith the divisible pool. However, at present the amount equivalent to 1/6th of sales tax are transferred to provinces based on formula giving 50% weightage to audited OZT collection for the year 1998-99 and 50% to population.

Item No.VII

Considering the applicability of the concept of equalization grants

This concept of grants-in-aid on concept of equalization grants may be discussed by members of the NFC.

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Annex-I

PART I

Acts, Ordinances, President's Orders and Regulations

GOVERNMENT OF PAKISTAN

MINISTRY OF LAW, JUSTICE AND HUMAN RIGHTS

(Law, Justice and Human Rights Division)

Islamabad, the 19th January, 2006

F. No. 2(2)/2006-Pub.—The following Order promulgated by the President is hereby published for general information :—

ORDER NO. I OF 2006
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ORDER

further to amend the Distribution of Revenues and Grants-in-Aid Order, 1997

WHEREAS, in pursuance of clause (1) of Article 160 of the Constitution, the President, by the Finance Division's Notification No. SRO 529(1)/2000, dated 22nd July, 2000, as modified by SRO No. 895(1)/2000, dated 18th December, 2000, Notification No. F-2(2)NFC/2000-508 dated 7th November 2001, Notification No. F 2(2)NFC/2000-200 dated 6th April, 2002, SRO No.1043(1)/2003, dated 13th November, 2003, read with SRO No.739 (I)/2005, dated 21st July, 2005 and SRO No.950(1)/2005, dated 12th September, 2005, appointed National Finance Commission to make recommendations, among other matters, as to the distribution between the Federation and the Provinces of the net proceeds of certain taxes;

AND WHEREAS the Commission could not submit its recommendations with regard to the said distribution and the matter being of urgent and national importance can not be further delayed;

AND WHEREAS it is expedient further to amend the Distribution of Revenues and Grants-in-Aid Order, 1997 (P.O. No.1 of 1997) for the purposes hereinafter appearing;

NOW, THEREFORE, in pursuance of clauses (6) read with clause (7) of Article 160 of the Constitution of Islamic Republic of Pakistan, the President is pleased to make the following Order:—

1. **Short title and commencement.**—(1) This Order may be called the Distribution of Revenues and Grants-in-Aid (Amendment) Order, 2006.

(2) It shall come into force on the first day of July, 2006.

2. **Substitution of Articles 3, 4 and 7, P.O. No.1 of 1997.**—In the Distribution of Revenues and Grants-in-Aid, Order 1997 (P.O. No. 1 of 1997) for Articles 3, 4 and 7 the following shall be substituted, namely:—

"3. **Distribution of Revenues.**—(1) The Provincial Governments shall be assigned in each financial year a share equal to the percentage of the net proceeds of the following taxes and duties levied and collected by the Federal Government in that year as specified in clause (2):—

(a) taxes on income;
(b) wealth tax;
(c) capital value tax;
(d) taxes on sales and purchases;
(e) sales tax on services (CE mode);
(f) export duties on cotton;
(g) customs-duties;
(h) federal excise duties excluding the excise duty on gas charged at well-head; and
(i) any other tax which may be levied by the Federal Government.

(2) The percentage share of the provinces . from the net proceeds of taxes and duties in each year shall be as under:—

Financial year	Percentage share
2006-07	41.50%
2007-08	42.50%
2008-09	43.75%
2009-10	45.00%
2010-11 and onward	46.25%

4. **Allocation of shares to the Provincial Governments.**—(1) Out of the sum assigned to the Provincial Governments under Article 3 an amount equal to the net proceeds of 1/6th of Sales Tax shall be distributed amongst the provinces at the following ratio and the Provincial Governments shall further transfer the whole of such amounts to the District Governments and Cantonment Boards without retaining any part thereof :—

The Punjab	50.00%
Sindh	34.85%
The North-West Frontier Province	9.93%
Balochistan	5.22%
Total:	100.00%

(2) The balance shall be distributed amongst the provinces on the basis of their respective population in the percentage specified against each:—

The Punjab	57.36%
Sindh	23.71%
The North-West Frontier Province	13.82%
Balochistan	5.11%
Total:	100.00%

7. **Grants-in-Aid to the Provinces.**—There shall be charged upon the Federal Consolidated Fund each year a sum of Rupees twenty seven billion seven hundred and fifty million, as grants-in-aid of the revenues of the provinces to be distributed amongst the provinces as per ratio specified against each province, namely:—

Province	Amount
The Punjab	11.00%
Sindh	21.00%
The North-West Frontier Province	35.00%
Balochistan	33.00%
Total:	100.00%

Note.— The grants-in-aid will be increased annually in line with the growth of net proceeds of divisible taxes for each year."

Explanation.—With the arrangements contained in Articles 3 and 7 above, the overall provincial share in the net divisible pool would not be less than 45% in the first financial year and 50% in the last financial year.".

GENERAL
PERVEZ MUSHARRAF,
President.

JUSTICE (RETD.)
MANSOOR AHMED,
Secretary.

Annex-II

GOVERNMENT OF NWFP
FINANCE DEPARTMENT

No.PS/SSF/FD/2009
Dated Peshawar the 1st September, 2009

To

The Finance Secretary,
Government of Pakistan,
Finance Division, "Q" Block,
Islamabad

Subject:- **MEETING OF THE SUB-COMMITTEE**

Dear Sir,

I am directed to state that during NFC meeting, the issue of vertical and horizontal distribution was deliberated in detail. The majority of the Provinces were in favour of discussing the vertical distribution. Contrary to this the sub-committee No.1 dealing with horizontal distribution of divisible tax amongst the Provinces has been convened first.

2. We would appreciate if this distribution of resources in between the Provinces is discussed after the vertical distribution is settled. Furthermore, Mr. Khalid Aziz NWFP expert may also be included in the sub-committee No. II.

In the meanwhile assuring our fullest cooperation.

Yours sincerely,

Sd/-
(Nazir Ahmad Awan)
Deputy Secretary (NFC)

Annex-III

TO BE PUBLISHED IN THE OFFICIAL GAZETTE

PART 1

Acts, Ordinances, President's Orders and Regulations

GOWERNNIENT OF PAKISTAN

MINISTRY OF LAW, JUSTICE, HUMAN RIGHTS AND PARLIAMENTARY AFFAIRS

Islamabad, the 12th February, 1997

No. F. 2(2)/97-Pub.—The following Order made by the President is hereby published for general information.

PRESIDENT'S ORDER No. 1 OF 1997

WHEREAS, in pursuance of- clause (1) of Article 160 of the Constitution, the President, by the Finance Division Notification No. SRO 733(I)/95, dated 23rd July, 1995 as modified by the said Division's Notification No. SRO 1361 (1)/96, dated the 10th December, 1996, appointed a National Finance Commission to make recommendations, among other matters, as to the distribution between the Federation and the Provinces of the net proceeds of certain taxes;

AND WHEREAS the said Commission has submitted its recommendations with regard to the said distribution;

NOW, THEREFORE in pursuance of clause (4) of Article 100 of the Constitution, the President is pleased to make the following Order :—

1. **Short title and commencement.**—(1) This Order may be called the Distribution of Revenues and Grants-in-Aid Order, 1997.

(2) It shall come into force on the first day of July, 1997.

2. **Definition.**—In this Orders unless there is anything repugnant in the subject or context:—

(a) "net proceeds" means, in relation to any tax, duty or levy, the proceeds thereof reduced by the cost of collection, as ascertained and certified by the Auditor-General of Pakistan ; and

(b) "taxes on income" includes corporation tax but does not include taxes on income consisting of remuneration paid out of the Federal Consolidated Fund.

3. **Distribution of Revenues.**—The Provincial Governments shah he assigned in each financial year a share equal to thirty-seven point five percent of the net proceeds of the following taxes and duties levied and collected by the Federal Government in that year, namely:—

(a) taxes on income ;

(b) wealth tax ;

(c) capital value tax ;

(d) taxes on sales and purchases ;

(e) export duties on cotton ;

(f) customs-duties ;

(g) Federal excise duties excluding the excise duty on gas charged at well-head and

(h) any other tax which may be levied by the Federal Government;

4. **Allocation of shares to the Provincial Governments.**—The sum assigned to the Provincial Governments under Article 3 shall be distributed amongst the Provinces on the basis of their respective population in the percentage specified against each

The Punjab	57.88%
Sindh	23.28%
The North-West Frontier Province	13.54%
Baluchistan	5.30%
Total :	100.00%

5. **Payment of net proceeds of royalty on crude oil.**—Each or the Provinces shall be paid in each financial year as a share in the net proceeds of the total royalties on crude oil an amount which bears to the total net proceeds the same proportion as the production of crude oil in the Province in that year bears to the total production of crude oil.

6. **Payment of net Proceeds of development surcharge on natural gas to the Provinces.**—Each of Provinces shall be paid in each financial year as a share in the net proceeds of surcharge on natural gas an amount which bears to the total net proceeds the same proportion as the well-head production of natural gas in the province in that year bear: to the. total well-head production of natural gas.

7. **Grants-in-aid to the Provinces.**—There Shall be charged upon the Federal Consolidated Fund each year, as grants-in-aid of the revenues of the Provinces, (for the period): specified against each, the amount so specified :—

Province	Period	Amount
The North-West Frontier Province.	For 5 years	Rs. 3310 million
Baluchistan	For 5 years	Rs. 4080 million

Note.—The grants-in-aid will be increased annually by 11 % subject to subsequent adjustment in line with the actual rate of inflation for each year.

8. **Matching Grants to Provinces.**—Whereas the Provincial Governments achieve a minimum growth of 14.2% in provincial receipts with fiscal efforts which include increases in tax rates, withdrawal of exemptions, imposition of new taxes and revision in rates of user charges, as ascertained and certified by the Auditor-General of Pakistan, the Federal Government will pay to each province in the subsequent year, the matching grant subject to the maximum limits specified below:—

The Punjab	500 million
Sindh	500 million
The North-West Frontier Province	100 million
Baluchistan	100 million

9. **Repeal.**—Articles 2, 4, 5, 6 and 7 of The Distribution of Revenues and Grants-in-Aid Order, 1991 (P. O. No. 1 of 1991), are hereby repealed.

FAROOQ AHMA D KHAN LEGHARI,
President.

JUSTICE (RETD.) AKHTAR HASSAN,
Secretary.

Annex-IV

GOVERNMENT OF NWFP
FINANCE DEPARTMENT

SUBJECT: **CONSIDERING ISSUES IN RELATION TO Net HYDEL PROFITS FROM HYDRO ELECTRIC STATION AND MAKING RECOMMENDATIONS IN RESPECT THEREOF.**

Payment of Net Hydel Profits to Provinces is governed under Article 161 (2) of the Constitution of Islamic Republic of Pakistan , methodology of AGN Kazi's Committee as approved by the Council of Common Interests in its meeting held on 13th Jan 1991 and read with subsequent decisions of CCI dated 12th Sep 1993, 29th May 1997 and 22nd Dec 1998.

2. The payment of Net Hydel Profits to Provinces has been assigned to WAPDA by the National Finance Commission.

3. The payment mode as finalized by the Ministry of Finance, Ministry of Water and Power and Provincial Government of NWFP was on monthly basis vide Finance Division letter No. F.2(3) PF.1/91, dated 13.7.1991. However, it is not being made on monthly basis, rather payment is made even after the close of financial year.

4. With the corporatization/unbundling of WAPDA, the payment is coming from PEPCO and WAPDA has no role in it. NWFP Government is facing difficulties in receipt of Net Hydel Profits and infact there is no system like divisible pool / straight transfers.

5. NWFP Government suggests that Finance Division like other transfers to Provinces (Divisible Pool / straight transfer) may authorizes monthly payment to the Provinces, to overcome their difficulties.

6. It is also necessary to streamline the procedure of Net Hydel Profit's computation, annual budgeting and related matters, following recommendations are placed for consideration:—

(i) Ensure submission of Annual Audited account of WAPDA and its all subordinate entities to Government of NWFP with in three months of the close of the financial year.

(ii) Ensure submission of annual detailed calculations/ workings of Net Hydel Profits (Hydel station wise) according to approved methodology within three months of the close of the financial year.

(iii) Annual payment of Net Hydel Profits to the Province should not be less than the amount based on actual accounts for the preceeding financial year. However as soon as the workings based on audited accounts for the last financial year are available the same shall be adopted for payment.

Example: For the purpose of budget estimate FY 2009-10, the actual calculation of Net Hydel Profits for FY 2007-08 will be the basis for preparation of budget. Payment will also be made on these basis. However, after having actual figures for FY 2008-09, the same will be adopted for payment during the year.

(iv) The province wise calculation of Net Hydel Profits based on actual account should be worked out jointly (WAPDA and concerned Provincial Government) and signed by both the parties.

(v) Delay if any in monthly/yearly payment, the Federal Government / WAPDA shall pay markup at CDL rate.

7. Provincial Government also requests that implementation. of Arbitration Award of 9th Oct 2006 should be ensured.

Provincial Own Receipts

7. The data of provincial own receipts for the last five years have been given at Table-6. The ACGR has been witnessed as 20.8% which is reasonable. It is proposed that Rs.42.723 billion (Rs.27.373 billion tax receipts and Rs.15.350 billion non tax) may be adopted as

Decision: As the Federal Government is in the process of

GOVERNMENT OF PAKISTAN

FINANCE DIVISION

(NFC SECRETARIAT)

WORKING PAPER FOR THE SUB COMMITTEE-II

Agenda Item-I

	Tax Receipts	Non-tax Receipts	Current Expenditure	Development Expenditure
Federal Government	17.9%	20%	16.4%	25.8%
Punjab	20.1%	16.8%	18.7%	22.1%
Sindh	17.1%	29.2%	19.9%	19.7%
NWFP	23.7%	-2.5%	7.4%	30.4%
Balochistan	12.7%	0.8%	15.0%	8.2%
Provinces (Combined)	19.3%	16.3%	17.1%	21.5%

Own Receipts

17. The ACGR in respect of non-tax receipts of NWFP is negative whereas in case of Balochistan very negligible. However, in case of other provinces the ACGR is fairly reasonable. It is accordingly proposed that we may adopt 20% for tax receipts and 16% for non-tax receipts. In case of FBR tax receipts, this would be 9.3% of GDP in FY 2009-10 which would be gradually increased to 11.9% in 2013-14. This arrangement has already agreed with the IMF. As regards non-tax receipts, in future certain receipts of the government will not be available as explained below:

18. Defence Receipts of $1.5 billion (=Rs.122 billion) may not be available from the next financial year;

(i) Dividends will be shrinking as a result of privatization; and

(ii) SBP profits may also on the decreasing trend as a result of heavy overdraft.

(iii) As such there will be no growth in the non-tax receipts rather it will either on the decreasing or will be stagnant during the entire span of the NFC.

Current Expenditure

19. The ACGR for Current Expenditure of the Federal Government has been witnessed 16.4% whereas provinces combined is 17.1%. In order to maintain fiscal discipline, this growth needs to be adjusted downward considerably. Accordingly, the current expenditure of the Federal Government is proposed to increase at 8% whereas for that of the provinces it will be 10%.

Development Expenditure

20. The ACGR for Development Expenditure of the Federal Government has been witnessed 25.8% whereas provinces combined is 21.5%. In order to maintain fiscal discipline, this growth also needs to be adjusted downward considerably. Accordingly, the Development expenditure of the Federal Government is proposed to increase at 18% whereas for that of the provinces it will be 15%.

Agenda Item-III

Vertical distribution of the divisible pool taxes including consideration of the possibility of enlarging the divisible pool.

21. As Federal Government is already facing revenue deficits of around 2% of the GDP (Table-3), it may not be advisable to enlarge the divisible pool taxes. It may further be pointed out that all FBR taxes have already been included in the Divisible Pool taxes. Petroleum Development Levy is not a tax rather it is a non-tax receipts of the Federal Government. As such it is not advisable to include this in the Divisible Pool taxes.

Table-1

Fiscal Position (Federal + Provinces)

Rs. in Billion

	2009-10 (BE)
Total Receipts	**2,007.2**
FBR Receipts	1,380.0
Non-tax Receipts	627.2
Transfers to Provinces incl. GST(Prov)	655.2
Net Receipts	**1,352.0**
Current Expenditure (net of foreign loan repayment)	**1,566.7**
Revenue deficit/surplus	(214.7)
Net Capital Receipts	(17.1)
Development Expenditures	**563.1**
Deficits/Surplus	(794.9)
GDP (mp)	**14,837.0**
Rev. deficit as % of GDP	1.4%
Deficit as % of GDP	5.4%

Table-2

Federal Current Expenditure (Historical Trend)

Rs. in Billion

	2005-06	2006-07	2007-08	2008-09	2009-10 (B. E)	ACGR
Current Expenditures (net of foreign loan repayment)	**854**	**1,003**	**1,454**	**1,516**	**1,567**	**16.4%**
Yearly growth		*17.4%*	*45.0%*	*4.3%*	*3.4%*	
Debt Servicing	237	369	490	638	647	28.5%
Yearly growth		55.7%	32.8%	*30.2%*	*1.4%*	
Defence	242	250	285	330	343	9.1%
Yearly growth		*3.3%*	*14.0%*	*15.8%*	*3.9%*	
Others	375	384	679	548	577	11.4%
Yearly growth		*2.4%*	*76.8%*	*-19.3%*	*5.3%*	
Current Expenditure excl. debt servicing	617	634	964	878	920	10.5%
Yearly growth		*2.8%*	*52.1%*	*-8.9%*	*4.8%*	

Federal Receipts (Historical Trend)

FBR Receipts	713	844	1,007	1,155	1,380	17.9%
Non-tax Receipts	302	390	394	582	627	20.0%
Gross Receipts	1,015	1,234	1,401	1,737	2,007	18.6%

GDP (mp)

Table-3

Federal Fiscal Operation - Historical Trend

As % of GDP

	2005-06	2006-07	2007-08	2008-09	2009-10 (B.E)
FBR Receipts	9.4%	9.7%	9.8%	8.8%	9.3%
Non-tax Receipts	4.0%	4.5%	3.8%	4.4%	4.2%
Gross Receipts	13.4%	14.2%	13.6%	13.3%	13.5%
Transfers to Provinces	4.0%	4.6%	4.4%	4.0%	4.4%
Net Receipts	9.4%	9.6%	9.2%	9.2%	9.1%
Current Expenditures net of foreign loan repayment	11.2%	11.5%	14.1%	11.6%	10.6%
Debt Servicing	3.1%	4.2%	4.8%	4.9%	4.4%
Defence	3.2%	2.9%	2.8%	2.5%	2.3%
Others	4.9%	4.4%	6.6%	4.2%	3.9%
Revenue surplus/deficits	-1.8%	-1.9%	-5.0%	-2.3%	-1.4%

Table-4

Provincial Fiscal Position (BE 2009-10)

Rs. In Billion

	Punjab	Sindh	NWFP	Balochistan	Total
Total Revenue Receipts	413.253	242.045	113.691	58.475	827.464
Provincial Own Receipts	82.946	42.723	9.649	3.846	139.164
Tax Receipts	49.647	27.373	5.992	*1.913*	*84.925*
Non-Tax Receipts	*33.299*	*15.350*	*3.657*	*1.933*	*54.239*
Federal Transfers	330.307	199.322	104.042	54.629	688.300
Divisible Pool Transfers	*321.023*	*143.924*	75.670	*29.205*	*569.822*
Straight Transfers	*4.625*	*46.504*	*7.549*	*11.448*	*70.126*
Grants-in-Aid	*4.659*	*8.894*	*14.823*	13.976	*42.352*
Other Transfers (NHP	-	-	*6.000*		*6.000*
Current Revenue Expenditure	314.873	213.398	80.000	53.077	661.348
Revenue Surplus/Deficits	98.380	28.647	33.691	5.398	166.116
Net Capital Receipts	37.182	25.337	(42.594)	(2.548)	17.377
Federal Dev. Assistance	11.943	5.430	4.881	5.175	27.429
Development Expenditure	188.248	75.000	51.157	18.536	332.941
Surplus/Deficits	(40.743)	(15.586)	(55.179)	(10.511)	(122.019)

Table-5

PROVINCIAL OWN RECEIPTS AND EXPENDITURES

Punjab

Rs. In Billion

	2005-06 (F)	2006-07 (F)	2007-08 (F)	2008-09 (RE)	2009-10 (BE)	ACGR
General Public Service excl. debt servicing	83.079	123.618	137.071	131.954	145.973	15.1%
Yearly growth		*48.8%*	*10.9%*	*-3.7%*	*10.6%*	
Debt Servicing	26.042	1.546	7.858	13.366	13.800	-14.7%
Yearly growth		*-94.1%*	*408.3%*	*70.1%*	3.2%	
Public Order & Safety Affairs	23.145	31.260	36.518	48.349	54.524	23.9%
Yearly growth		*35.1%*	*16.8%*	*32.4%*	*12.8%*	
Economic Affairs	14.441	16.592	17.605	37.105	51.910	37.7%
Yearly growth		*14.9%*	*6.1%*	*110.8%*	*39.9%*	
Environment Protection	0.032	0.039	0.031	0.038	0.046	9.8%
Yearly growth		*23.9%*	*-21.0%*	*22.6%*	*21.1%*	
Housing & Community Amenities	0.780	1.666	1.358	1.281	2.272	30.6%
Yearly growth		*113.4%*	*-18.5%*	*-5.7%*	*77.4%*	
Health Affairs & Services	5.913	8.992	8.818	15.256	21.772	38.5%
Yearly growth		*52.1%*	-1.9%	*73.0%*	*42.7%*	
Recreation, Culture & Religion	0.723	1.076	2.798	1.136	0.740	0.6%
Yearly growth		*48.9%*	*160.0%*	*-59.4%*	*-34.9%*	
Education Affairs & Services	2.988	11.899	11.803	32.030	22.385	65.4%
Yearly growth		*298.3%*	*-0.8%*	*171.4%*	*-30.1%*	
Social Protection	1.306	1.351	2.399	1.766	1.451	2.7%
Yearly growth		*3.5%*	*77.6%*	*-26.4%*	*-17.8%*	
Total CRE	158.448	198.039	226.259	282.281	314.873	18.7%
Yearly growth		*25.0%*	*14.2%*	*24.8%*	*11.5%*	
Development Expenditure	84.790	170.046	137.956	173.550	188.248	22.1%
Yearly growth		*100.6%*	*-18.9%*	*25.8%*	*8.5%*	
Provincial Own Receipts	41.739	44.414	65.659	64.239	82.946	18.7%
Yearly growth		*6.4%*	*47.8%*	*-2.2%*	29.1%	
Tax Receipts	23.847	23.364	23.587	28.141	49.647	20.1%
Yearly growth		*-2.0%*	*1.0%*	19.3%	*76.4%*	
Non-tax Receipts	17.892	21.051	42.072	36.098	33.299	16.8%
Yearly growth		*17.7%*	99.9%	-14.2%	-7.8%	

Table-6

PROVINCIAL OWN RECEIPTS AND EXPENDITURES

Sindh

Rs. In Billion

	2005-06 (F)	2006-07 (F)	2007-08 (F)	2008-09 (RE)	2009-10 (BE)	ACGR
General Public Service excl. debt servicing	34.505	85.421	89.050	110.377	126.310	38.3%
Yearly growth		*147.6%*	*4.2%*	*23.9%*	*14.4%*	
Debt Servicing	9.060	8.644	7.541	9.318	8.981	-0.2%
Yearly growth		*-4.6%*	*-12.8%*	*23.6%*	*-3.6%*	
Public Order & Safety Affairs	12.592	14.737	18.547	24.405	29.223	23.4%
Yearly growth		*17.0%*	*25.9%*	*31.6%*	*19.7%*	
Economic Affairs	11.766	9.979	12.778	15.683	17.652	10.7%
Yearly growth		*-15.2%*	*28.0%*	*22.7%*	*12.6%*	
Environment Protection	0.044	0.118	0.102	0.317	0.816	107.0%
Yearly growth		*166.4%*	*-13.9%*	*210.6%*	*157.6%*	
Housing & Community Amenities	0.341	0.317	0.707	2.319	2.147	58.4%
Yearly growth		*-7.2%*	*123.3%*	*227.9%*	*-7.4%*	
Health Affairs & Services	6.074	4.106	5.211	8.731	10.568	14.8%
Yearly growth		*-32.4%*	*26.9%*	*67.6%*	*21.0%*	
Recreation, Culture & Religion	1.090	0.194	0.357	1.063	0.773	-8.2%
Yearly growth		*-82.2%*	*83.7%*	*197.9%*	*-27.3%*	
Education Affairs & Services	25.099	3.547	5.584	12.158	16.495	-10.0%
Yearly growth		*-85.9%*	*57.4%*	*117.7%*	*35.7%*	
Social Protection	2.551	0.602	0.677	0.581	0.434	-35.8%
Yearly growth		*-76.4%*	*12.4%*	*-14.1%*	*-25.3%*	
Total CRE	103.123	127.666	140.554	184.952	213.398	19.9%
Yearly growth		*23.8%*	*10.1%*	*31.6%*	*15.4%*	
Development Expenditure	36.546	35.342	47.375	69.632	75.000	19.7%
Yearly growth		*-3.3%*	*34.0%*	*47.0%*	*7.7%*	
Provincial Own Receipts	20.070	20.380	26.870	31.630	42.723	20.8%
Yearly growth		*1.5%*	*31.8%*	*17.7%*	*35.1%*	
Tax Receipts	14.560	14.936	17.082	25.557	27.373	17.1%
Yearly growth		*2.6%*	*14.4%*	*49.6%*	*7.1%*	
Non-tax Receipts	5.509	5.444	9.788	6.073	15.350	29.2%
Yearly growth		*-1.2%*	*79.8%*	*-38.0%*	*152.8%*	

Table-7

PROVINCIAL OWN RECEIPTS AND EXPENDITURES

NWFP

Rs. In Billion

	2005-06 (F)	2006-07 (F)	2007-08 (F)	2008-09 (RE)	2009-10 (BE)	ACGR
General Public Service excl. debt servicing	8.479	33.115	37.184	43.602	47.083	53.5%
Yearly growth		290.5%	12.3%	17.3%	*8.0%*	
Debt Servicing	7.754	6.903	0.331	6.182	7.170	-1.9%
Yearly growth		*-11.0%*	*-95.2%*	*1767.8%*	*16.0%*	
Public Order & Safety Affairs	5.391	5.938	8.161	11.145	11.487	20.8%
Yearly growth		*10.1%*	*37.4%*	*36.6%*	*3.1%*	
Economic Affairs	4.591	3.270	5.100	6.487	6.119	7.4%
Yearly growth		*-28.8%*	*56.0%*	*27.2%*	*-5.7%*	
Environment Protection	0.041	0.019	0.022	0.012	0.012	-25.8%
Yearly growth		*-54.8%*	*18.9%*	*-45.1%*	*2.7%*	
Housing & Community Amenities	0.568	0.157	0.025	0.103	0.028	-52.8%
Yearly growth		*-72.3%*	*-84.1%*	311.7%	-72.7%	
Health Affairs & Services	3.450	1.850	2.348	2.610	2.990	-3.5%
Yearly growth		*-46.4%*	*26.9%*	*11.2%*	*14.6%*	
Recreation, Culture & Religion	0.180	0.201	0.169	0.265	0.244	7.9%
Yearly growth		11.7%	-16.1%	*56.6%*	*-7.7%*	
Education Affairs & Services	17.167	1.003	2.487	3.070	3.943	-30.8%
Yearly growth		*-94.2%*	*147.9%*	*23.4%*	*28.4%*	
Social Protection	12.610	1.024	0.370	2.124	0.924	-48.0%
Yearly growth		*-91.9%*	*-63.9%*	*473.9%*	*-56.5%*	
Total CRE	60.232	53.480	56.197	75.600	80.000	7.4%
Yearly growth		*-11.2%*	*5.1%*	*34.5%*	*5.8%*	
Development Expenditure	17.670	23.158	28.618	39.001	51.157	30.4%
Yearly growth		*31.1%*	*23.6%*	*36.3%*	31.2%	
Provincial Own Receipts	6.612	5.600	6.230	7.175	9.649	9.9%
Yearly growth		*-15.3%*	*11.3%*	*15.2%*	*34.5%*	
Tax Receipts	2.559	3.004	3.001	3.785	5.992	23.7%
Yearly growth		*17.4%*	*-0.1%*	26.1%	*58.3%*	
Non-tax Receipts	4.054	2.596	3.229	3.390	3.657	-2.5%
Yearly growth		*-36.0%*	*24.4%*	*5.0%*	*7.9%*	

Table-8

PROVINCIAL OWN RECEIPTS AND EXPENDITURES

Balochistan

Rs. In Billion

	2005-06 (F)	2006-07 (F)	2007-08 (F)	2008-09 (RE)	2009-10 (BE)	ACGR
General Public Service excl. debt servicing	14.102	16.685	19.824	24.930	32.204	22.9%
Yearly growth		*18.3%*	*18.8%*	*25.8%*	*29.2%*	
Debt Servicing	3.152	3.936	3.636	2.675	1.743	-13.8%
Yearly growth		*24.9%*	*-7.6%*	*-26.4%*	*-34.9%*	
Public Order & Safety Affairs	4.146	4.531	5.604	5.548	5.558	7.6%
Yearly growth		*9.3%*	*23.7%*	*-1.0%*	*0.2%*	
Economic Affairs	5.961	5.102	6.325	7.580	7.887	7.3%
Yearly growth		*-14.4%*	*24.0%*	*19.8%*	*4.0%*	
Environment Protection	0.561	0.746	0.671	0.503	0.522	-1.8%
Yearly growth		*33.0%*	*-10.0%*	*-25.0%*	*3.8%*	
Housing & Community Amenities	0.116	0.104	0.578	0.806	0.539	46.7%
Yearly growth		*-10.4%*	*453.9%*	39.5%	-33.2%	
Health Affairs & Services	1.086	1.255	1.141	1.513	1.650	11.0%
Yearly growth		*15.6%*	*-9.1%*	*32.6%*	9.1%	
Recreation, Culture & Religion	0.213	0.257	0.191	0.091	0.135	-10.8%
Yearly growth		*20.7%*	*-25.8%*	*-52.5%*	*49.0%*	
Education Affairs & Services	0.900	1.239	1.794	2.277	2.814	33.0%
Yearly growth		*37.7%*	*44.8%*	*26.9%*	*23.6%*	
Social Protection	0.072	0.149	0.259	0.185	0.026	-23.0%
Yearly growth		*105.0%*	*74.4%*	*-28.7%*	*-86.2%*	
Total CRE	30.311	34.005	40.023	46.108	53.077	15.0%
Yearly growth		*12.2%*	*17.7%*	*15.2%*	*15.1%*	
Development Expenditure	13.545	19.041	22.951	26.367	18.536	8.2%
Yearly growth		*40.6%*	*20.5%*	*14.9%*	*-29.7%*	
Provincial Own Receipts	2.869	3.345	3.809	3.626	3.846	7.6%
Yearly growth		*16.6%*	*13.9%*	*-4.8%*	*6.1%*	
Tax Receipts	0.998	1.036	1.131	1.566	1.913	17.7%
Yearly growth		*3.8%*	*9.2%*	*38.5%*	*22.2%*	
Non-tax Receipts	1.872	2.309	2.679	2.060	1.933	0.8%
Yearly growth		*23.4%*	*16.0%*	*-23.1%*	*-6.2%*	

PROVINCIAL OWN RECEIPTS AND EXPENDITURES

Combined

Rs. In Billion

	2005-06 (F)	2006-07 (F)	2007-08 (F)	2008-09 (RE)	2009-10 (BE)	ACGR
General Public Service excl. debt servicing	140.16	258.84	283.13	310.86	351.57	25.8%
Yearly growth		*84.7%*	*9.4%*	*9.8%*	*13.1%*	
Debt Servicing	46.01	21.03	19.37	31.54	31.69	-8.9%
Yearly growth		*-54.3%*	*-7.9%*	*62.9%*	*0.5%*	
Public Order & Safety Affairs	45.27	56.47	68.83	89.45	100.79	22.2%
Yearly growth		*24.7%*	*21.9%*	*30.0%*	*12.7%*	
Economic Affairs	36.76	34.94	41.81	66.85	83.57	22.8%
Yearly growth		*-4.9%*	*19.6%*	*59.9%*	*25.0%*	
Environment Protection	0.68	0.92	0.83	0.87	1.40	19.8%
Yearly growth		*35.0%*	*-10.4%*	*5.3%*	*60.5%*	
Housing & Community Amenities	1.81	2.24	2.67	4.51	4.99	28.9%
Yearly growth		*24.2%*	*18.9%*	*69.0%*	*10.6%*	
Health Affairs & Services	16.52	16.20	17.52	28.11	36.98	22.3%
Yearly growth		*-1.9%*	*8.1%*	*60.5%*	*31.6%*	
Recreation, Culture & Religion	2.21	1.73	3.52	2.55	1.89	-3.8%
Yearly growth		*-21.6%*	*103.3%*	*-27.3%*	*-25.9%*	
Education Affairs & Services	46.15	17.69	21.67	49.54	45.64	-0.3%
Yearly growth		*-61.7%*	*22.5%*	*128.6%*	*-7.9%*	
Social Protection	16.54	3.13	3.71	4.66	2.83	-35.7%
Yearly growth		*-81.1%*	*18.5%*	*25.7%*	*-39.1%*	
Total CRE	352.113	413.189	463.033	588.941	661.348	17.1%
Yearly growth		*17.3%*	*12.1%*	*27.2%*	*12.3%*	
Development Expenditure	152.550	247.587	236.900	308.549	332.941	21.5%
Yearly growth		*62.3%*	*-4.3%*	*30.2%*	*7.9%*	
Provincial Own Receipts	71.290	73.739	102.568	106.670	139.164	18.2%
Yearly growth		*3.4%*	*39.1%*	*4.0%*	*30.5%*	
Tax Receipts	41.963	42.340	44.800	59.049	84.925	19.3%
Yearly growth		*0.9%*	*5.8%*	*31.8%*	*43.8%*	
Non-tax Receipts	29.327	31.399	57.768	47.621	54.239	16.6%
Yearly growth		*7.1%*	*84.0%*	*-17.6%*	*13.9%*	

REVENUE RECEIPTS OF PROVINCES

PUNJAB

(Rs in million

FUNCTION CODE	DESCRIPTION	2005-06 (F)	2006-07 (F)	2007-08 (F)	2008-09 (RE)	2009-10 (BE)
B	**TAX REVENUE**	23,847	23,364	23,587	28,141	[illegible]
B01	**Direct Taxes**	**7,672**	**7,545**	**7,2131**	**10,050**	**17,090**
B011	Tax on Income (Agri. Income Tax)	658	709	667	600	1,100
B013	Property Tax	2,787	1,670	2,068	5,000	10,450
B014	Land Revenue	3,389	3,552	4,212	4,100	5,060
B016	Tax on Profession, Trades and Callings	222	249	12	350	480
B018	Motor Vehicles Tax	616	1,365	254	-	-
	Indirect Taxes	**13,095**	**13,844**	**15,275**	**15,107**	**28,850**
B023	Sales Tax on Import-Share of Net	2,224	2,482	3,117	3,102	8,759
B026	Provincial Excise	847	798	942	1,300	1,450
B027	Stamps Duties	5,859	5,919	6,542	6,400	11,000
B028	Motor Vehicles	4,154	4,627	4,560	4,300	7,624
B029	Sale of Opium ..	11	19	113	5	17
B03	**Indirect Taxes - Others**	**3,079**	**1,975**	**1,099**	**2,984**	**3,707**
B030	Indirect Taxes - Others	3,079	1,975	1,099	2,984	3,707
C	**Non-Tax Revenue**	**17,892**	**21,051**	**42,072**	**36,098**	**33,299**
CO1	**Income from Property & Enterprise**	**158**	**1,143**	**9,410**	**7**	**2,500**
C012	Interest on Loans & Advance to Sindh & NWFP	85	(11)	1	-	-
0013	Interest on Loans & Advance to District Govt/TIVIA	1	1	0	-	279
C015	Interest on Loans to Non-Financial Institutions	-	7	0	2	2,216
C016	Interest on Loans & Advances to Govt. Servants	2	1	1	1	1
C018	Interest on Loans - Others	16	1,120	0	4	4
C019	Dividends	54	26	9,408	-	-
CO2	**Receipt from Civil Administration and other**	**3,357**	**3,776**	**4,467**	**4,999**	**7,702**
CO21	General Admin. Receipts-Organisations of State	50	46	66	71	75
CO22	General Admin. Receipts-Fiscal Administration	45	84	51	45	111
CO23	General Admin. Receipts - Economic Regulations	110	64	67	72	72
CO25	Defence Services Receipts	-	-	-	-	-
0026	Law and Order Receipts	1,244	1,418	1,614	2,700	3,191
CO27	Community Services Receipts	928	992	1,032	954	2,102
CO28	Social Services	978	1,173	1,638	1,157.	2,151
CO3	Miscellaneous Receipts	14,377	16,131	28,195	31,092	23,097
CO31	Economic Services Receipts - Food & Agri.	535	547	459	431	838
CO32	Eco.Serv. Receipts – Fisheries& Animal Husbandry)	397	454	535	463	750
CO33	Economic Services Receipts Forest	803	516	977	721	1,178
CO34	Cooperation, Irrigation & Embankment - Drainage Works	1,870	2,161	2,177	2,501	3,201
CO35	Economic Services Receipts - Others	298	389	429	398	719
CO37	Extraordinary Receipts	1,341	723	722	253	13,660
CO38	Others	9,132	11,341	22,895	26,325	2,751
	Total Provincial Receipts	**41,739**	**44,414**	**65,659**	**64,239**	**8.2,946**

Table-11

REVENUE RECEIPTS OF PROVINCES

Sindh

(Rs in million)

FUNCTION CODE	DESCRIPTION	2005-06 (F)	2006-07 (F)	2007-08 (F)	2008-09 (RE)	2009-10 (BE)
B	**TAX REVENUE**	**14,560**	**14,936**	**17,082**	**25,557**	**27,373**
B01	**Direct Taxes**	**1,305**	**894**	**1,250**	**1,370**	**1,610**
B011	Tax on Income (Agri. Income Tax)	198	33	189	190	200
B013	Property Tax	808	564	604	700	900
B014	Land Revenue	123	114	229	230	250
B015	Workers Welfare Tax	-		48	-	-
B016	Tax on Profession, Trades and Callings	176	184	180	250	260
B02	**Indirect Taxes**	**8,224**	**8,290**	**9,451**	**11,682**	**14,321**
B023	Sales Tax on Import-Share of Net	919	1,026	1,298	1,282	3,621
B026	Provincial Excise	1,312	1,443	1,777	2,100	2,300
B027	Stamps Duties	3,938	3,762	4,215	6,000	5,900
B028	Motor Vehicles	2,055	2,060	2,161	2,300	2,500
B029	Sale of Opium	-	-	-	-	-
B03	**Indirect Taxes - Others**	**5,031**	**5,752**	**6,381**	**12,505**	**11,442**
B030	Indirect Taxes - Others	5,031	5,752	6,381	12,505	11,442
C	Non-Tax Revenue	5,509	5,444	**9,788**	6,073	15,350
CO1	**Income from Property & Enterprise**	**12**	**337**	**10.**	**1,272**	**1,315**
C013	Interest on Loans & Advance to District Govt			2	1,258	1,298
C015	Interest on Loans to Non-Financial Institution	-	-	-	-	-
0016	Interest on Loans & Advances to Govt. Servants	2	328	1	2	2
C018	Interest on Loans - Others	0		-	-	-
C019	Dividends	9	9	7	12	15
CO2	**Receipt from Civil Administration and other**	**1,158**	**1,183**	**1,446**	**1,589**	**1,717**
CO21	General Admin. Receipts-Organisations of State	-	5	25	43	50
CO22	General Admin. Receipts-Fiscal Administration	37	37	65	64	75
CO23	General Admin. Receipts - Economic Regulation		38	38	50	66
CO26	Law and Order Receipts	567	681	768	814	839
CO27	Community Services Receipts	228	160	231	255	266
CO28	Social Services	326	261	319	363	421
CO3	**Miscellaneous Receipts**	**4,340**	**3,923**	**8,332**	**3,212**	**12,318**
CO31	Economic Services Receipts - Food & Agri.	123		31	50	65
CO32	Eco.Serv. Receipts - Fisheries & Animal Husbandry	27	18	14	20	20
CO33	Economic Services Receipts Forest	48	50	79	115	120
0034	Cooperation, Irrigation & Embankment - Drainage Works	337	273	267	561	771
CO35	Economic Services Receipts - Others	163	144	210	126	142
CO37	Extraordinary Receipts	2,852	2,128	6,151	1,200	8,500
CO38	Others	790	1,226	1,580	1,140	2,700
	Total Provincial Receipts	**20,070**	**20,380**	**26,870**	**31,630**	42,723

Table-12

REVENUE RECEIPTS OF PROVINCES

NWFP

(Rs in million)

FUNCTION CODE	DESCRIPTION	2005-06 (F)	2006-07 (F)	2007-08 (F)	2008-09 (RE)	2009-10 (BE)
B	**TAX REVENUE**	**2,559**	**3,004**	**3,001**	**3,785**	**5,992**
B01	**Direct Taxes**	**591**	**891**	**871**	**903**	**1,203**
B011	Tax on Income (Agri. Income Tax)	18	20	20	19	90
B013	Property Tax	77	235	163	180	242
B014	Land Revenue	430	565	604	621	758
B016	Tax on Profession, Trades and Callings	66	71	84	83	113
B02	Indirect Taxes	1,512	1,752	1,862	2,157	3,950
B023	Sales Tax on Import-Share of Net	536	598	751	747	2,110
B026	Provincial Excise	20	26	31	25	33
B027	Stamps Duties	352	441	412	534	702
B028	Motor Vehicles	604	687	668	851	1,105
B029	Sale of Opium	-	-	-	-	-
B03	indirect Taxes - Others	457	360	268	725	839
B030	Indirect Taxes - Others	457	360	268	725	839
C	**Non-Tax Revenue**	**4,054**	**2,596**	**3,229**	3 ?o^n	3,657
CO1	**Income from Property & Enterprise**	**28**	**119**	**170**		**160–**
C013	Interest on Loans & Advance to District Govt/TMA	8	0	16	(375)	(363)
C014	Interest on Loans to Financial Institutions	7	6	-	11	9
C015	Interest on Loans to Non-Financial Institutions	-	-	5	383	383
C016	Intereston Loans & Advances to Govt. Servant	6	6	5	5	5
C018	Interest on Loans - Otheres	3	80	136	111	106
C019	Dividends 4	4	27	8	15	20
CO2	**Receipt from Civil Administration and other Functions**	**573**	**662**	**771**	**1,372**	**1,515**
CO21	General Admin. Receipts-Organisations of State	10	39	15	16	18
CO22	General Admin. Receipts-Fiscal Administration	38	47	58	66	75
CO23	General Admin. Receipts - Economic Regulations		5	6	25	25
CO26	Law and Order Receipts	194	256	268	562	611
CO27	Community Services Receipts	176	216	282	344	388
CO28	Social Services	150	99	142	359	398
CO3	**Miscellaneous Receipts**	**3,452**	**1,814**	**2,288**	**1,8E**	**1,982**
CO31	Economic Services Receipts - Food & Agri	71	60	194	84	115
CO32	Eco.Serv. Receipts - Fisheries & Animal Husbandery	34	35	43	47	53
CO33	Economic Services Receipts Forest	350	567	548	593	594
0034	Economic Services Receipts, Cooperation, Irrigation & Embankment -Drainage Works	251	271	268	350	395
CO35	Economic Services Receipts - Others	48	278	161	74	83
CO37	Extraordinary Receipts	2,035	0	-	-	-
0038	Others	662	605	1,074	720	742
	Total Provincial Receipts	6,612	5,600	6,230	7,175	9,649

Table-13

8. Mr. Tariq Pasha pointed out that distortions will be created if we are taking budgeted figures at some places and actual figures at another. Things like this will not let us arrive at any conclusion.

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Annex-I

LIST OF PARTICIPANTS OF 2ND MEETING OF NFC SUB-COMMITTEE-II

S.No.	Name	Designation
	Federal Representation	
1.	Mr. Salman Siddique	Federal Finance Secretary
2.	Mr. Asif Bajwa	Special Secretary Finance
3.	Mian Muhammad Younis	Senior Joint Secretary (PF)
4.	Mr. Talib Hussain Baloch	Joint Secretary (Budget)
5.	Mr. Abdul Malik Balghari	Assistant Secretary (NFC)
	Provincial Representation	
Punjab		
6.	Mr. Tariq Mahmood Pasha	Finance Secretary, Punjab
7.	Dr. Aisha Ghous Pasha	Consultant
Sindh		
8.	Mrs. Naheed Durrani	Special Secretary, Finance Department
9.	Dr. Noor Alam	Additional Secretary (Resources)
NWFP		
10.	Mr. Khalid Aziz	Adviser to Government of NWFP
11.	Mr. Abdus Samad Khan	Finance Secretary, NWFP
Balochistan		
12.	Mr. Mahfooz Ali Khan	Finance Secretary, Balochistan
13.	Mr. Noor-ul-Amin Mengal	Additional Secretary (Budget)

REVISED

AGENDA FOR THE 2ND MEETING OF NFC

1. Presentation by Sindh Government on the GDS issue.

2. Presentation by Chairman, OGRA and Ministry of Petroleum & National Resources on "determination of Gas Development Surcharge, determination of well-head cost of gas and determination of its prescribed price and sale price".

3. Presentation by Chairman, FBR on "the legal position of GST on Services (CE Mode)".

i) Legal presentation by Government of Pakistan,
ii) Legal presentation by Government of Sindh,
iii) Legal presentation by independent counsel.

4. Presentation by Chairman, NEPRA on "Electricity price fixing mechanism".

5. General discussion on the outcomes of Sub-committee-I & II.

Government of Pakistan
Finance Division
(NFC Secretariat)
-:-

Subject: <u>Minutes of the 2nd Meeting of 7th National Finance Commission</u>

The 2nd meeting of the 7th National Finance Commission (NFC) was held on 18th September, 2009 at 1100 hours under the chairmanship of Federal Finance Minster/Chairman NFC in the Conference Room of Finance Division, Islamabad. The meeting started with recitation from the Holy Quran by the Finance Secretary, NWFP. List of participants is at Annex-I.

2. The Chairman welcomed the participants and briefed them about the agenda items. He informed them that the meeting would start with a presentation by the Government of Sindh on the issue of Gas Development Surcharge (GDS) in response to the presentation of the Balochistan Government made before the Sub Committee-I. Subsequently, OGRA and M/o P&NR would give presentations on the issues of determination of GDS, well head, prescribed and sale prices. Thereafter, NEPRA would give a presentation on electricity price fixing mechanism followed by general discussion on the recommendations of Sub-committees I&II. He further added that the issue of GST on Services (CE Mode) would not be discussed during the meeting on the Sindh Government's request. On that, the Chief Minister, Sindh clarified that although his province was fully prepared to give presentation on GST (CE Mode), but due to occurrence of 27th of Ramadan and *Jummat-ul-Wida*, lengthy proceedings would be inappropriate. Furthermore, an independent counsel was also required to be arranged on this issue.

3. Dr. Gulfaraz, Member (Balochistan) while referring to Para-6, page-3 of the minutes of Sub Committee-I stated that his viewpoint needed to be expressed properly. He pointed out that in the said meeting he emphasized that the NFC should meet regularly after every three months even after announcement of the Award and this was agreed to by the Chairman. Accordingly, minutes should be revised to include the phrase <u>"and the NFC should continue to meet after every three months even after announcement of the award in order to review the implementation of the Award".</u> Similarly, he noted that the last phrase of the first sentence i.e. "and raised the issue of implementation of the

Presidential Order/Award" was also vague and suggested that the phrase "in connection with collection charges" needs to be added at the end of the sentence. The Chief Minister Sindh pointed out that during the meeting of the Sub Committee-I, he had read entry 53 of Fourth Schedule of the Constitution and argued that GST on Services was not a federal subject, whereas this had not been included in the minutes.

4. The Chairman then asked the Government of Sindh to present the issue of GDS. Dr. Kaiser Bengali gave the presentation, hard copies of which were circulated among all members of the Commission. Dr. Bengali stated that his presentation was in response to the points raised in the presentation given by the Balochistan Government in the first meeting of Sub Committee-I, in which the Balochistan Government tried to single out Sindh by saying it had serious reservations on the existing formula and was trying to revise it. This stance had the support of Punjab and NWFP. He assured that his province was neither in favour of confrontation nor in favour of encroaching the territories of other provinces, but rather the vested interest of his province was that the rights and interests of every province should be safeguarded. The least developed provinces should be able to exploit their resources fully for development of their areas. Less development in other parts of the country would result in migration of people from those areas to Karachi, which could lead to distortion of the demography of the Sindh province. He claimed that the Balochistan Government accepted the existing formula in 1990 because it had suited it, but now that it did not the Balochistan province was agitating to revise the formula. He gave the example of cricket and stated that "it is not appropriate for the cricket team to demand bowler friendly rules when the team is bowling and batting friendly rules when the team is batting". He stated that the stance of the Balochistan province was that the formula becomes just when that province was getting 70 percent of the share while the same formula becomes unjust when the share of that province is decreased to 25 percent. Therefore, Dr. Bengali stated that the demand for amendments in the formula with the change of percentage share of the province might not be appropriate.

5. Dr. Bengali further stated that the presentation of Balochistan revealed that they tried to draw a formula based on notional and estimated figures, which according to him was conceptually wrong. He claimed that while such projections could be used to analyze future trends they could not be used for drawing a formula since that had to be based on actual figures. He further pointed out that in the presentation of the Balochistan

province, the utility cost being the common denominator had been passed through in the working, whereas that could only be done in the case of the constant denominator. He explained that the utility costs were not constant in case of Mari and Kondkot gas fields; the distribution costs were almost zero since the location of end users was next to the gas fields and therefore, while working for weighted average wellhead cost the utility costs could not be passed through.

6. Dr. Bengali further pointed out that the proposal of Balochistan Government had inbuilt characteristics of volatility. The formula needed to be buoyant and adoptable in changing scenarios. The weighted average cost would be radically changed on inclusion of newly discovered gas fields and exclusion of old gas fields on closure as wellhead prices of old gas fields were low whereas those of the newly discovered fields were relatively high. Similarly, with the change of the year, the result of weighted average cost would be changed. Dr. Bengali claimed that a formula which completely changes with the change in the composition of gas fields, as well as, change in the time period cannot be termed as a stable formula adding that a system must not be built on such an unstable formula. He also pointed out mathematical error in the formula proposed by Balochistan that if two provinces give -100 each to GDS and the other two fields give +100 each, then summation of two becomes zero. Since dividing or multiplying any figure with zero gives a mathematical error, Dr. Bengali claimed that this formula would not be termed as workable conceptually, mathematically and practically. He further showed his reservations over negative GDS. According to him, negative GDS is like negative price. He was of the view that, mathematically and from the business point of view, it would not be possible to sell a pen to someone and also give money to that buyer.

7. With the help of a pie chart, Dr. Bengali stated that while the Sindh Province produced 72 percent of gas it consumed only 41 percent. Punjab produced 5 percent but consumed 49 percent. NWFP produced 2 percent but consumed 3 percent. Balochistan produced 21 percent but consumed only 7 percent. He further stated that the relevant price for GDS calculation was prescribed price and not wellhead price. It would not be possible to have gas-field wise break-up of ex-gas field costs such as transmission costs, depreciation, returns to companies. He stated that the wellhead price is determined through Petroleum Concession Agreements, while the prescribed price is determined by OGRA keeping in view wellhead gas price, royalty and excise duty at wellhead, operating and

maintenance costs, depreciation and return on assets. Selling (consumer price) is the sum of prescribed price and Gas Development Surcharge. He presented a comparison of prescribed and sale prices of SSGC, SNGP, MGCL and PPL Kondkot. According to him, the bulk of GDS generated from MGCL and PPL were exclusively located in Sindh. The GDS generated from SNGPL and SSGCL was negligible. He also gave data of 2007-08 showing province-wise gas purchased, as well as, province-wise sale by SNGP and SSGC. He quoted a decision of OGRA dated September 19, 2008 and stated that the losses of SNGP and SSGC were adjusted against GDS. Resultantly, SNGP and SSGC produced zero GDS. The distribution amongst the provinces was made, based on the GDS produced by MARI and Kondkot (Sindh) fields. According to him, GDS was used as a shock absorber for producing company profits. If company costs exceeded the prescribed prices, GDS declined and if company costs exceeded consumer prices, GDS was adjusted in the future year.

8. Concluding his presentation, Dr. Bengali said that although he did not support the proposal put forward by the Balochistan Province, he supported the cause of Balochistan. He admitted that injustice had been done with that province, but in his view, these injustices had not been done by the Sindh province. He presented the proposal of the Sindh Government on this issue with the following main points:

(i) Dedicated Wells (independent systems) to be separated from the utility systems.

(ii) A dedicated company needs to be created that will purchase gas from Balochistan fields and generate GDS thereof. Through this company, the benefit of lower wellhead and prescribed prices of Balochistan province can be given to them.

(iii) GDS for Provinces should be guaranteed on the same pattern as that of the company profits.

(iv) Provinces must have a share in the company profits.

(v) Provinces must be given representation on OGRA Board to be part of policy decisions.

(vi) GDS is not part of Federal Consolidated Fund and should not be reflected in the Budget.

He was of the view that this was not a final proposal and could be debated and certain adjustments/changes could be made with the consensus of all stakeholders.

9. Senator Haji Adeel, Member (NWFP), was of the view that the wellhead price for the gas fields of Balochistan Province had been determined very low arbitrarily. Dr. Bengali admitted that although the wellhead price and subsequently the prescribed prices of the gas fields of Balochistan were very low as compared to other fields of the country, but the benefit of these low prescribed prices did not reach to that province. As a result of low wellhead price, the provinces also received less royalty and excise duty. He argued that provinces must be associated in formulating oil exploration policies and determination of wellhead prices so that they may be able to protect their rights. He also enquired about the constitutional status of GDS. Dr. Bengali clarified that the constitution was silent on this issue. Initially, GDS was imposed with a view to utilize the proceeds for further gas exploration. However, from 1990 it was decided to transfer the proceeds to the provinces. He further stated that the nomenclature "Gas Development Surcharge" had become anomalous and suggested that it should be renamed "Provincial Development Surcharge". Senator Haji Adeel asked for clarification regarding whether the GDS generated from Balochistan was utilized in the Balochistan Province or was spent in the entire country. Dr. Bengali replied that the Federal Government (M/o P&NR) would be in a better position to explain. Haji Adeel was of the view that GDS generated from Balochistan was spent in other provinces and Balochistan province must, therefore, be compensated accordingly. Finance Secretary, Balochistan stated that Rs.90 billion generated as GDS was invested in other provinces for exploration of gas.

10. The Chairman observed that the presentation was well considered and asked Dr. Gulfaraz, Member (Balochistan) to respond. Dr. Gulfaraz thanked the Chairman and stated that final comments would be given after due consideration of the presentation at a later stage. However, he commented on each of the slides instantly. He said that GDS Ordinance was implemented in the country as a whole. The sale price had always been fixed by the Federal Government keeping in view GDS to the tune of Rs.15-16 billion must be generated in order to fulfill the expectation of the provinces. He further stated that wellhead prices were

determined by the Federal Government. If the wellhead price of a province was historically low, the royalty and excise duty would also be at the lower side. As a result, Balochistan had not only been receiving less royalty and excise duty in gas but was also deprived of its due share of GDS. Dr. Gulfaraz pointed out that this was very unfortunate since the province was producing cheap gas and subsidizing it in the entire country. The province itself consumed only 4 percent of gas produced in the country. No reward was being given for subsidizing gas. He claimed that by justice he meant that the province must be compensated by providing it with its due share of GDS.

11. While responding on the plea of the Sindh Government, regarding summation of the weighted average price might equals to zero and in that case it would not be possible to make further calculation, He stated that it is illogical. When the weighted average prices of the four provinces were substantive figures, he doubted how the summation of these figures could equal to zero.

12. Regarding volatility of the formula claimed in Mr. Bengali's presentation, Dr. Gulfaraz said that presently GDS was distributed based on the proportion of production of each province, which varied on day to day basis meaning that volatility existed in the present formula. He claimed that the magnitude of volatility in the formula proposed by him may not be higher than the existing formula. The prescribed prices were fixed by the Federal Government on semi-annually basis. The only volatility that existed was in production and presently the distribution based on production. He was of the view that weighted average was a good technique through which each province could get their due share. He informed the participants that the wellhead price of one of the gas field situated in Sindh was very low and through the weighted average price, the impact of this low wellhead price would be reflected in the formula. He further pointed out the instances of negative GDS adding that these had been ignored while calculating the weighted average price. He claimed there was no question of negative GDS in the formula.

13. While referring to slide 12 of the Government of Sindh's presentation, wherein rate of GDS was shown for various categories of MARI and PPL, he stated that the sale price had not been fixed category-wise or gas field wise and had always been fixed on all Pakistan basis. The prescribed prices, however, covered all the expenses including prices of gas and O&M charges. Although the sale prices for different consumers

were different these were uniform throughout Pakistan. Therefore, the issue of GDS had always been linked with the system as a whole and not with the individual gas fields or companies. Regarding Sindh's claim for subsidizing fertilizers, he said that only 2 percent of the fertilizer production was consumed in the Balochistan Province. Furthermore, by producing cheap gas, the overall price index had been kept low. Resultantly, Balochistan province was subsidizing gas in the entire country, while only 4 percent of the gas was consumed in the province. He advocated the cause of justice with that province to avoid the longstanding and justifiable heartburning and sense of deprivation in the province.

14. The Chairman observed that there might be benchmarking for determination of prescribed and sales prices and asked for clarification in this regard. Dr. Gulfaraz stated that the representatives of OGRA might clarify it, however, in his view, this issue involved two dynamics. Since most of the payments were made in dollars, therefore, with the change in exchange rates, the wellhead and prescribed prices also changed. The other reason of changes in the prescribed prices might be the change in the operating cost. OGRA scrutinizes the operating costs and then prescribed prices are fixed. The Chairman was of the view that if the benchmarking was to be based on the cost of gas then no incentives were given to those provinces which were producing the gas for more exploration. He further stated that since the representatives of the OGRA were also attending that meeting, they might be asked to give their presentation.

15. Dr. Gulfaraz also [illegible]ted out that in order to give an incentive to producers the Government had enhanced the wellhead prices, which have been indexed with dollar. Wellhead prices and petroleum policy have always been interlinked. The petroleum policies were revised after every one or two years by upwardly revising the wellhead prices in order to provide incentives for new explorations. In the 2009 Petroleum Exploration Promotion Conferences, road shows were held in London, Hungary and Boston and the Federal Government offered worldwide producers to invest in Pakistan on the plea that the wellhead prices have substantially been increased.

16. The Chairman said that being a neutral person, he was of the view that wellhead and sales prices must be linked with international prices and the sales price minus wellhead price and distribution cost must go to the provinces. Dr. Gulfaraz stated that the wellhead price of Balochistan was Rs.181 whereas that of Sindh was Rs.251 while the sales

prices remained at the same level. The difference, if paid to the provinces, would be completely in accordance with the demand of Balochistan. He further pointed out that the formula presented by him was neither contrary to any principle of justice nor mathematically unstable. He apologized for the feelings of the Sindh Government being singled out. Their perception might be based on the support extended by other provinces to his viewpoint. Finance Secretary, Balochistan pointed out that the Sindh Government had prepared this presentation with great zeal. A similar presentation was prepared in 2003 wherein the Sindh Government admitted that Rs.14 billion had been generated from Balochistan, whereas now it had taken a u-turn stance. He was of the view that the GDS generated from Balochistan had been invested in Sindh. Now the Sindh Government claimed that the investment in Sindh had been made by the Federal Government. He stated that Sindh was producing 70 percent of gas and Balochistan 20 percent and therefore, making Sindh eligible for 70 percent of GDS while Balochistan for 20 percent was unjust. The Balochistan province requested the National Finance Commission to do justice with it.

17. The Chairman observed that the provinces producing gas must be given due incentives so that they may be encouraged to boost production and the dichotomy, if existed, must be removed. He further stated that in his view, a formula which was under implementation for the last 10 years must not be considered as everlasting but should be examined in depth and any shortcomings must be removed to make it workable and just. The ultimate results must be that maximum benefits must go to those provinces which produce gas. He directed OGRA authorities to look into the matter and try to rationalize the issue and asked them to give their presentation.

18. Mr. Tauqir Sadiq, Chairman OGRA and Mr. Jawad Naseem, Senior Executive Director (Finance) made a presentation, hard copies of which were circulated to all participants. The Chairman informed the meeting that OGRA determines Revenue Requirement (Prescribed Prices) of natural gas utilities pursuant to Section 8(1) and 8(2) of OGRA Ordinance, 2002. Thereafter, the matter was referred to the Federal Government, which under Section 8(3) of OGRA Ordinance, 2002, advised the sale prices for each category of consumers after making adjustments for subsidies/development surcharge within forty days. The prescribed and sale prices are accordingly notified by OGRA. He stated

that in determination of the Revenue Requirements of the gas companies, OGRA has to analyze and assess the following expenditures:

a. Cost of Gas (Producers' Prices)

b. Transmission & Distribution (T&D) Cost

c. Prescribed Rate of Return

d. Gas utilities are entitled to fixed rate of return (SNGPL 17.5 percent and SSGCL 17.0 percent) on operating assets (ROA) before tax and financial charges.

19. The Chairman NFC observed that the presentation should start with the issue of GDS i.e. determination of the wellhead prices. Mr. Jawad Naseem stated that the wellhead prices were determined on half yearly basis in accordance with the agreements signed by them with the Federal Government. Historically, following are the main features of wellhead price determination:

a. 1985 – 1991 : 66 percent of HSFO less negotiated discounts

b. 1991 – 1992 : 57 percent of HSFO less negotiated discounts

c. 1992 – 1993 : 100 percent of HSFO less negotiated discounts

d. 1994 onwards: Zone-wise gas prices indexed to the basket of crude oil prices with progressive capping:

Zone-I	High Risk/High Cost	77.5 percent of C&F imported crude oil price
Zone-II	Medium Risk/High Cost	72.5 percent of C&F imported crude oil price
Zone-III	Medium Risk/Low Cost	67.5 percent of C&F imported crude oil price

- Per 2001 Petroleum Policy, Floor price of US$ 10 per BBL, ceiling of US$ 36 per BBL has been applied to crude oil

- Per 2009 Petroleum Policy, Floor price of US$ 20 per BBL, ceiling of US$ 100 per BBL has been applied to crude oil

- Exception: Mari Gas 30 percent guaranteed return on shareholders' fund.

20. The Senior Executive Director further stated that the wellhead prices vary from gas field to gas field depending on the year of exploration and Gas Price Agreements (GPAs). He gave details of gas fields province-wise along with the wellhead prices effective from 01.07.2008 and 01.01.2009.

21. Senator Haji Adeel interrupted and asked to explain in detail how the wellhead prices were determined and what the policies of the Government in determination of the wellhead prices were. The Senior Executive Director (OGRA) stated that he could only explain the existing position and formula for determination of wellhead prices while the factors behind those policies could only be explained by M/o P&NR, which used to negotiate with the producers and signed the agreements. Mr. Abdul Ghafoor Mirza, Member (Punjab) stated that there might be some international standards based on which the Federal Government might have formulated policies. He requested the OGRA to explain those standards for better understanding of the issue. Dr. Gulfaraz pointed out that in Pakistan, mostly the gas explorations were carried out through international investments. In order to attract foreign investment, the Federal Government tried to make the gas prices internationally competitive and offered certain incentives through petroleum policies. He further stated that the Sui Gas Field was discovered in 1952 and for 30 years this was the lifeline of the Pakistan's Economy. The gas pipes were airlifted to the area and in three years, gas was supplied to Karachi through pipelines.

22. On a query, the Senior Executive Director stated that zoning was done by the M/o Petroleum keeping in view the cost effectiveness and risk involved; Zone-III was the cheaper area with low cost and risk, whereas Zone-I was the difficult zone where risk and costs were on the higher side.

23. While flashing the units of wellhead prices of each gas field, the Chairman observed that in some cases the units had been shown in rupees while in some it had been shown in dollars. He pointed out that a uniform unit needed to be used for a better comparison. The Senior Executive Director (OGRA) assured that next time they would show a uniform unit by converting dollars into rupees. He also gave various formulae applicable to various gas fields and said the policy applicable at the time of gas discovery and as given in gas price agreement would continue to be applicable even after change of the policy. Dr. Gulfaraz pointed out that this was the reason that the wellhead price of Sui Gas Field was very low. The Senior Executive Director (OGRA) stated that although the wellhead price of Sui Gas Field had been upwardly revised when its agreement was unbundled by the Government it was still very low compared to other fields.

24. The Senior Executive Director (OGRA) further stated that all the prescribed prices were included into one basket and a weighted average prescribed price was calculated. That had been done in order to provide gas on a unified price; otherwise sales prices would be different in different provinces. He, however, clarified that the gas price for different consumers were different. The Chairman (NFC) asked the OGRA to give concrete proposals for distribution of the difference between prescribed and the sale prices (Gas Development Surcharge) amongst provinces. He observed that if the wellhead price of a gas field in Balochistan was say Rs.101; that province would get royalty of Rs.12.5 at the rate of 12.5 percent; this gas would be sold at Rs.315; out of the difference of the average sale and prescribed prices (say Rs.200) how much would that province then get in the form of GDS? The Senior Executive Director explained that all GDS was put into one basket and that was distributed keeping in view the ratio of production of each province irrespective of which contributes more to the GDS. The Chairman (NFC) observed that this may not be justified and asked OGRA to give a concrete mechanism for distribution of GDS.

25. Dr. Gulfaraz pointed out that the prescribed price of a gas field having a wellhead price of Rs.101 worked out to be around Rs.130 after adding the royalty, excise duty and all the utility charges including maintenance and distribution charges. On the other hand, this gas was sold at the average of Rs.310 and therefore, that province must be given the benefit of this vast difference i.e. Rs.180. since the province of Balochistan had not received its due share for the last 62 years. On a query

from Dr. Bengali, the Senior Executive Director clarified that these were meant for SSGC and SNGP, which were on the net. PPL and MARI Gas were not included in the National Grid and were off the net. The Chairman observed that on the net and off the net is meaningless and rather, the question was which gas field contributes how much to GDS. He noted that OGRA being the expert must analyze the issue in detail and come up with workable and just solutions.

26. Dr. Bengali presented a proposal on behalf of the Sindh Government suggesting that province-wise companies must be established to transact gas from province to province and feasibility of establishing such companies could be ascertained by OGRA. The Chairman observed that a new committee would be constituted to look into the mechanism of properly pricing and distributing GDS. Senator Haji Adeel pointed out that for distribution of gas there must be a province-wise company and the same method must be applied to Net Hydel Profit. The Chairman observed that in the first instance the issue of gas needed to be resolved and was of the view that if sincere efforts were made the issue would be resolved.

27. The Finance Secretary, Punjab pointed out that the direction of the discussion was towards complexity of the case. A number of factors were involved including cross subsidies. It would not be feasible to constitute province-wise companies. The NFC should confine itself towards the proposals given by the Balochistan Government and or by the Sindh Government. The Chairman observed that opting for short-term solutions might not be correct and that permanent solutions of the case should be sought instead.

28. Mr. Abdul Ghafoor Mirza, Member (Punjab) observed that various projects were launched to explore gas and large funds were spent on them. He gave an example of well drilling in Rodho, D.G. Khan. The well after drilling was closed claiming it was not feasible whereas factually it was and the need of D.G. Khan could have been fulfilled from this field. An exercise, therefore, was essential to be undertaken regarding how many wells were closed after drilling and how much investment had been made on these projects.

29. The Chief Minister Sindh pointed out that the constitution of a committee would not resolve the issue until a specific timeframe be given.

30. The Chairman observed that since he would be out of the country till the second week of October the meeting in Quetta would be scheduled on October 12-13, 2009 where the Committee would submit its report. On Chairman NFC's request to nominate one member from each province, Punjab nominated Mr. Abdul Ghafoor Mirza, Sindh nominated Dr. Kaiser Bengali, NWFP nominated Senator Haji Adeel and Balochistan nominated Dr. Gulfaraz Ahmad, Secretary Petroleum. The Chairman NFC asked Chairman OGRA to act as coordinator.

31. The following decisions were accordingly taken in the meeting:-

i. A committee consisting of the following will be set up with the TOR of "Rationalization of the distribution formula for the Gas Development Surcharge, review of wellhead, prescribed and sale prices and royalty determination methods":

1.	Mr. Abdul Ghafoor Mirza (Punjab)	Member
2.	Mr.Kaiser Bengali (Sindh)	Member
3.	Senator Haji Muhammad Adeel (NWFP)	Member
4.	Dr. Gulfaraz Ahmed (Balochistan)	Member
5.	Secretary/Special Secretary, P& NR	Member
6.	Mr. Tauqir Sadiq, Chairman OGRA	Member

The Committee will opt one of its member as a Chairman. Mr. Tauqir Sadiq, Chairman OGRA will act as a Coordinator. The Committee will submit its report to the NFC in its next meeting scheduled in Quetta.

ii. The next meeting of the NFC will be held in Quetta on 12th and 13th October, 2009.

32. The meeting ended with a vote of thanks from and to the Chairman.

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(iv) The GDS due to Balochistan Government with effect from 01.07.2002 would be worked out and the amount subject to maximum of Rs.10 billion would be paid by the Federal Government to Balochistan province.

(v) A Committee consisting of the four non-statutory members of the NFC has been set up to deliberate upon the horizontal distribution mechanism including applicability of multiple indicators.

(vi) The 4th meeting of the NFC would be held at Peshawar on October 29-30, 2009.

29. The Chairman on his behalf and on behalf of all the members of NFC thanked the Government of Balochistan through the Finance Minister Balochistan for the hospitality extended by the province to the Commission. The meeting ended with a vote of thanks from and to the chair.

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Annex-I

LIST OF PARTICIPANTS OF 3RD MEETING OF 7TH NFC

S.No.	Name	Designation
	Federal Representation	
1.	Mr. Shaukat Tarin	Federal Finance Minister
2.	Mr. Salman Siddique	Federal Finance Secretary
3.	Mr. Mahmood Salim Mahmood	Secretary Petroleum
4.	Mian Muhammad Younis	Senior Joint Secretary (PF)
5.	Mr. Mahmood Alam	Member Indirect Taxes (FBR)
6.	Mr. Abrar Ahmad Khan	Chief Sales Tax (FBR)
7.	Mr. Saeedullah Shah	D.G.(Gas) M/o Petroleum
8.	Mr. Tauqir Sadiq	Chairman OGRA
9.	Syed Jawad Naseem	Sr. Executive Director (F) OGRA
10.	Mr. Mushtaq Ahmad	Deputy Secretary (PF)
11.	Mr. Hasan Mehmood	Financial Analyst
12.	Mr. Abdul Malik Balghari	Assistant Secretary (NFC)
	Provincial Representation	
Punjab		
13.	Mr. Tanvir Ashraf Kaira,	Finance Minister, Punjab
14.	Mr. Abdul Ghafoor Mirza	Member (Punjab)
15.	Mr. Tariq Mahmood Pasha,	Finance Secretary, Punjab
16.	Dr. Aisha Ghous Pasha	Consultant
Sindh		
17.	Syed Qaim Ali Shah	CM/Finance Minister, Sindh
18.	Mr. Kaiser Bengali,	Member (Sindh)
19.	Mr. Fazalullah Pechuho,	Finance Secretary, Sindh
20.	Mrs. Naheed Durrani	Special Secretary Finance
21.	Mr. Makhdoom Ali Khan	Advocate
NWFP		
22.	Mr. Muhammad Humayun Khan,	Finance Minister, NWFP
23.	Senator Haji Muhammad Adeel	Member (NWFP)

24.	Mr. Khalid Aziz	Adviser to Government of NWFP
25.	Mr. Abdus Samad Khan,	Finance Secretary, NWFP
Balochistan		
26.	Mr. Muhammad Asim Kurd	Finance Minister, Balochistan
27.	Dr. Gulfaraz Ahmed	Member (Balochistan)
28.	Mr. Mahfooz Ali Khan	Finance Secretary, Balochistan
29.	Mr. Noor-ul-Amin Mengal	Additional Secretary (Budget)

AGENDA FOR THE 4th MEETING OF NFC

Day -1 *(29th October,2009)*

11:00 hours	Opening Remarks by the Chairman
11:15	Confirmation of the Minutes of the 3rd Meeting of National Finance Commission
11:45	Presentation by Governor State Bank on: (i) Monetary policy of the Government; (ii) Province-wise investment by commercial banks and DFIs.
14:00-15:00	Break for lunch/ Zuhar prayer
15:00	Horizontal revenue sharing; *(Report of Sub-Committee-III);*

Day -2 (30th October,2009)

09:30	Presentation by Sub-committee-II on: (i) Overall economic situation of the Country; (ii) Macro-economic Framework; (iii) Benchmarking of the receipts and expenditures of the federal and provincial governments; (iv) Vertical revenue sharing.
11:30	1/6th of GST
13:00 - 14:30	Lunch Break /Jumma Prayer
14:30	Conclusion

Government of Pakistan

Finance Division

(NFC Secretariat)

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Subject: **Minutes of the Fourth Meeting of 7th National Finance Commission**

The 4th meeting of the 7th National Finance Commission (NFC) was held on October 29, 2009 at 1100 hours under the chairmanship of Federal Finance Minister/Chairman NFC at Governor's House, Peshawar. The meeting started with the recitation from the Holy Qur'an by the Finance Secretary NWFP. List of participants is at Annex-I.

2. The chairman welcomed all the participants at Peshawar. He showed his deepest grief and sorrow over the tragic bomb blast of 28th October, 2009 in Peshawar, where more than hundred people lost their lives and hundreds were injured. The Finance Secretary requested the participants to pray for the departed souls. The Finance Secretary NWFP offered prayers (Dua) for the departed souls and for restoration of health of the injured persons.

3. Federal Finance Minister/Chairman then invited Finance Minister NWFP to give opening remarks. Finance Minister NWFP welcomed all participants and apologized for the inconvenience faced by the participants due to the prevailing law & order situation. He briefly elaborated terror attacks and its aftereffects faced by his province. He thanked the Chairman for holding meeting at Peshawar despite law and order situation. He was of the view that by holding the meeting at Peshawar a message has been conveyed to the terrorists that despite of such kind of situation, the whole nation is united and States business would continue without disruption. Thereafter the agenda items were taken up.

4. The Chairman asked for observations, if any, on the draft minutes of the 3rd meeting held at Quetta. Chief Minister, Sindh expressed serious reservations on drafting of minutes and complained that their point of view had not been reflected properly. Mr. Kaiser Bengali, Member (Sindh) informed the meeting in detail about the changes for incorporation in the minutes. He intimated his reservations in writing to NFC Secretariat. Dr. Gulfaraz Ahmad, Member (Balochistan) also informed the

meeting that he had also proposed minor changes in the minutes through an e-mail sent to the NFC Secretariat. Finance Secretary, Balochistan also proposed certain addition in the minutes through a written statement handed over to NFC Secretariat. The representatives from NWFP also suggested minor changes. The Chairman observed that Mr. Bengali should visit NFC Secretariat and incorporate the changes in consultation with Special Finance Secretary and Sr. Joint Secretary (PF) and thereafter final minutes may be circulated to all concerned.

5. The Chairman then invited Governor, State Bank of Pakistan to brief the participants about the monetary policy and loans extended by the commercial banks and DFIs. The Governor thanked the Chairman for granting him the opportunity to address National Finance Commission. Governor State Bank briefed about the monetary & fiscal policy prevalent in Pakistan. He stated that monetary policy involved central banks' use of monetary instruments to influence interest rates and money supply in the country to keep inflation stable at low levels without prejudice to economic growth. On the other hand, fiscal policy was a key responsibility of the federal and provincial governments, which involve preparing the budget and financial strategy for the country or province. The main tools of fiscal policy are taxation and government expenditures. He further stated that through timely, consistent, and coordinated efforts implementation of monetary and fiscal policies would be prerequisite for a macroeconomic stability, productivity and long term growth.

6. He was of the view that monetary policy would succeed in reducing and stabilizing inflation at moderate or low levels. However, an expansionary monetary policy would stimulate output and employment only in the short run and that too if actual output is much below the capacity with low inflation. He further stated that monetary policy would also help in bringing stability in the foreign exchange market. Monetary policy would help long term growth by keeping inflation stable at low levels, by minimizing uncertainties. Monetary policy would also help in keeping a balance between consumption and savings and promoting long term investments. Stability in the foreign exchange market supports foreign investment and domestic business activities. He was of the view that monetary policy could not directly influence long term growth. Economic activities at national or regional levels can only be promoted directly through fiscal (or other related) policies at federal, provincial or local bodies level. He further stated that monetary policy might not address distributional aspects. Distribution of income at individual or

geographical levels could only be addressed through fiscal policy at federal or regional levels. Distribution and promotion of investment at regional levels can only be addressed through incentives at regional levels. Monetary policy would encourage savings but would not direct them to be used in specific activities. In his view market forces would determine allocation of resources. However, incentives could be used to change their direction. As such bottom line would be that monetary policy is a macro stabilization policy and can only partially impact long-term growth potential.

7. He informed the meeting that long term investments in the country could be increased by ensuring macroeconomic stability, increase in domestic savings, promotion of foreign investment, generating the exportable surplus and consistent & attractive incentives. Similarly infrastructure and human resources would require to be developed by channeling state resources for development expenditures, investing in healthcare and education of the masses, improving law and order situation, promoting political stability and ensuring that benefits of growth trickle down to the masses through effective and broad based taxation and provision of targeted subsidies.

8. He elaborated that monetary policy would affect the goal variables (i.e. inflation and growth) through adjustment in aggregate demand brought about by changes in interest rate and money supply. The changes in policy rate, in turn, would affect the interbank and other retail interest rates in the economy directly as well as through changing the 'expectations' for future. The resulting changes in retail interest rates would affect the consumption and investment behavior of the economic agents and thus, the level of aggregate demand in the economy. Finally, the adjustment in aggregate demand would affect the price level in the economy.

9. While giving brief account of the economy of the country, he stated that falling international commodity prices also helped in price stability. Fiscal accounts improved during FY09 and government borrowings from the central bank had remained within the quarterly limits. External position strengthened with contraction in current account deficit and improvement in SBP's foreign exchange reserves. Growth in domestic aggregate demand moderated significantly resulting in narrowed saving investment gap. All these factors helped SBP in easing monetary policy by reducing the policy rate by 200 bps to 13 percent since April 2009.

Despite falling interest rates, the demand for private sector credit was low because of global recession, which resulted in reducing external demand and exports. Domestic investment activities were dormant as businesses were waiting for improvement in law and order situation. Power outages had crippled production activities. Large scale manufacturing growth had seen a record run of twelve consecutive month declines up to June 2009. In addition, rising Non Performing Loans (NPLs) had resulted in restricting banks for lending. In September 2009 monetary policy review, SBP maintained the policy rate due to several emerging risks. Likely electricity and oil price increase, increase in public sector wages, and an expansionary fiscal stance led to renewed inflationary pressures. The fiscal position remained under pressure. Financing the proposed deficit was challenging. Shortfall in the projected foreign inflows would have negative implications for the fiscal and external sectors as well as market liquidity. Due to slow recovery in global economy, export demand would remain weak.

10. The Governor while discussing province-wise deposits and advances by the commercial banks and DFIs, informed the meeting that deposit generation, advances availed and utilization of advances would not necessarily be geographically synchronized because other than personal depositors, industrial entities and utility companies were the largest depositors and recipients of bank advances and most of the advances are availed through head offices, which may be located in a different province/region. He however presented certain available information in this regard. The relevant portion of the presentation are at Annex-I.

11. The Governor while concluding his presentation stated that SBP would suggest Regional Development Plan. The objectives of the plan would be:

a. To accelerate development & job growth via integrating SME (<Rs 75 mn) & PPP strategies.

b. 3-5 year development plan targeting key sectors for facilitated growth needs to be established (NWFP/Fed. Ministries).

12. He proposed that banks to delegate high level of authority to regional offices. Further targets may be fixed for banks to achieve loan growth levels of over 20% pa and bank lending rates to SME to be capped at KIBOR minus 1%. He further proposed that in return SBP/MoF would

arrange up to 3% refinance margin to banks, plus consider easing cash reserves and insurance mechanisms to be activated using "pooling" mechanism.

13. The Chairman thanked the Governor State Bank of Pakistan for sparing time and addressing the participants of National Finance Commission on monetary and lending policies of commercial banks and DFIs. He informed the meeting that for the first time, the Governor had presented facts and figures with regards to province-wise deposits and advances by the commercial banks. The Governor also presented some proposals in order to remove regional disparity with regards to lending by banking sector. He told that it would be appropriate to discuss the proposals put forward by the Governor instead of discussing the past injustices. Our target would be to explore how disparities would be removed. Governor SBP had given three proposals i.e. to empower regional banks, setting targets of achieving a growth of 20% per annum by these banks and subsidizing loans through capping the interest rate at KIBOR minus 1%. If the members had some other proposals, these would also be discussed.

14. Dr. Gulfraz Ahmad appreciated the briefing of the Governor and stated that useful information had been placed before the Commission. He stated that as evident from the information, the investment through lending by commercial banks in Balochistan was the lowest among all the four provinces. He requested for acceleration of corrective measures by the State Bank. He further stated that as informed by the Governor SBP macroeconomic stability was the core objective of the monetary policy. He raised the question whether there was any proposal to cope with temporary price shocks through the instrument of macroeconomic federal stabilization fund?

15. Senator Haji Muhammad Adeel, Member (NWFP) observed that routine proposals have been formulated by the Governor State Bank of Pakistan. Presently, NWFP is facing war like situation prevailing in his province. The business has been standstill as a result of war on terror. The infrastructure had already been damaged badly. He while referring Bank of Punjab, Bank of Khyber and other commercial banks, stated that these banks did nothing for the uplift of the province. For restoration of business, special package and incentives were required on war footing basis. Finance Secretary, Punjab stated that the mishap with the Bank of Punjab was as a result of financial mismanagement. Now, necessary

corrective measures had been taken with the help of SBP and the Bank was on the road to recovery. In order to remove disparity, he was of the view that banks need to be assigned certain limits and targets for investing in certain sectors and regions which other wise would be neglected by the banks. SBP has to monitor these limits and targets.

16. Mr. Abdul Ghafoor Mirza, Member (Punjab) supported creating employment opportunities for innumerable jobless in the country and enhancing productions. For the purpose, he asked for strengthening the SME and Public Private Partnership. He made a specific proposal of opening SME financing windows by the large banks and financial institutions, who should also facilitate the new investors/ entrepreneurs in preparation of feasibilities for such enterprises. The Governor SBP responded positively to the proposal and agreed to take appropriate action in the matter. It was also pointed out that a Wing has already been created in the Ministry of Finance. This Wing needs to be strengthened. Dr. Aisha Ghaus Pasha asked for the views of the Governor on the assumption that public borrowing would result crowding out of money from private sector and remaining within the macroeconomic framework agreed with IMF, debt sustainability would become a problem for its sustainability.

17. The Governor SBP while responding to Senator Haji Muhammad Adeel, stated that Bank would not lead development activities, as government and the private sector had to prepare development projects. Bank would facilitate projects by providing loans. In the absence of projects, SBP may not be in a position to strive development. Haji Adeel was of the view that SBP should issue strict instructions to Banks for facilitating less developed provinces. He was of the view that in Karachi loans are approved in hours but in NWFP people are waiting for months and year to get their loan approved. He was of the view that SBP should adopt concrete steps to minimize such disparities. Mr. Khalid Aziz was of the view that government should formulate policies and then approach the Federal Government to help his province. The role of SBP would be to stabilize the monetary policy. Finance Secretary NWFP also asked for providing loan facilities to the people of his province. The Governor SBP assured adopting all possible measures in this regard.

18. The Chairman concluding the discussions stated that federal government had already initiated necessary steps through public private partnerships. While deliberating upon the situation in NWFP and FATA,

he stated that a package in consultation with the NWFP Government as well as business communities would be prepared. Necessary steps have already been taken in this regard. This would redress most of the demands of the area. While referring the query of Dr. Gulfraz, he said that in Balochistan tremendous opportunities are available. He would try his level best to explore the opportunities. He thanked the Governor SBP for sparing time and giving the briefing to the NFC.

19. The Chairman then invited the Sub Committee-III to present their report on the horizontal distribution. Mr. Abdul Ghafoor Mirza pointed out that despite repeated requests the data of province-wise tax generation had not been provided yet. In the absence of this data, discussions on horizontal distribution would be useless. Senior Joint Secretary (PF) explained that acting Chairman FBR told the Sub Committee-III that FBR did not maintain data on province-wise tax generation. He was of the view that the tax payers while submitting tax returns did not mention geographical location of the income and as such it would be extremely difficult to bifurcate province-wise tax generation. Special Finance Secretary also informed the meeting that the companies submit their tax returns being a unit irrespective of the fact that its businesses spread all over the country. As such the data on tax generation would not be worked out. Finance Secretary Punjab pointed out that it would not be possible to collect this data readily. If available at least a year would be needed to collate this data. The representatives of FBR also showed their inability to provide such kind of data. The chairman directed that FBR should start collecting province-wise data of tax generation for use by the next NFC.

20. Dr. Bengali pointed out that in the first instance principles are to be decided. First principle would be to decide adopting of single criterion or criterion having multiple indicators. If the decision was to adopt multiple indicators, then which indicators are to be used and then how much weight would be given to those indicators. Discussing regarding tax generation would amount to jumping into the second phase without deciding the first principle.

21. The Chairman observed that first vertical distribution needed to be discussed. Having a first hand knowledge about the pie, provinces would be able to reach on a decision more easily on the horizontal distribution. Provinces of Punjab, NWFP and Balochistan supported the idea floated by the Chairman. However, Sindh showed reservations on this and stated that they want to discuss horizontal first. However, since the

three provinces supported discussion on vertical distribution first, the members from Sindh agreed discussion on the vertical distribution with the condition that the NFC would revisit the vertical distribution decision keeping in view the outcome of horizontal distributions.

22. Finance Secretary, Punjab was of the view that it was the spirit of fiscal federalism to discuss the vertical distribution first. The horizontal distribution should facilitate filling the gap of the provincial receipts and expenditures. He was of the view that provinces would not produce any surplus. The Chairman observed that the two main pillars on which the NFC had to make decision would be vertical and horizontal distribution of resources through consensus. In the absence of decision on any one of the pillar, the NFC would not be able to give the award.

23. Government of NWFP, with the permission of the chair showed a documentary based on "Swat Operation and the problems faced by the people of Swat". The Chairman observed that this was a moving documentary and requested that copies of this documentary may also be provided to federal government so that it can be shown to business community and other donor agencies. He assured that Federal Government fully aware of the problems faced by the province and would extend all possible support for the development and rehabilitation of the province. He then asked Special Secretary Finance to present the various options prepared by the federal government on vertical distribution of resources. Special Secretary Finance M/o Finance started his presentation with macroeconomic assumptions given as under:

- Real GDP growth would remain 3% in the benchmark year (2009-10) which would gradually increase to 6% in the terminal year i.e. 2014-15.

- Inflation rate would be assumed at 10% in the benchmark year and gradually decreased to 6% in the terminal year.

- The nominal GDP growth would be around 12% in this projection period.

Given the above assumption on which the entire macroeconomic framework had been constructed. Thereafter he presented a comparison of macroeconomic framework agreed with the IMF and the one proposed by Dr. Aisha. He explained that while working out framework, Dr. Aisha had not proposed changes in the initial two years, for the remaining three years higher deficit was proposed by her with more fiscal space for provinces. However, he stated that IMF would emphasize to remain within the stabilization mode for the next five years and as such higher deficit would not be supported by the IMF. Thereafter a brief about the FBR receipts was given indicating that 9.3% of GDP in the benchmark year would reach to 12.1% of GDP in the terminal year. On the expenditure side, he pointed out that the expenditure would be reducing in terms of percentage to GDP over the next five years

25. Then he gave various options for vertical distribution. As per existing scenario, which is 50% of divisible pool together with grants. Based on this scenario the federal deficits, 5.3% of GDP in the benchmark year and would be gradually decreased to 3.1% in the terminal year. The existing scenario assumed that provinces would generate surplus in order to maintain the OFD within the targets given in the macroeconomic framework. The second scenario was based on the provincial share 52.5% with no grants. Ms. Naheed Durrani, Special Finance Secretary Sindh pointed out that 1/6th of sales tax is not part of the divisible pool. On exclusion of this, the provincial share in the divisible pool would be 41%. The Special Secretary Finance informed the meeting that in these projections, Rs.120 billion had been included in the federal expenditures spreading over the 5 years in order to reflect the true picture of the fiscal position of the federal government. As a result of this scenario, federal deficit would range between 4.5% to 3.4%. Federal government would need fiscal efforts either through expenditures adjustments or enhancing revenues by 0.1% to 0.3%. The second scenario was based on 55% of provincial share in the divisible pool. This scenario had resulted federal deficit between 4.7% to 3.7%. The third scenario was based on provincial share 52.5% with no grants and collection charges at 2%. The fourth scenario was based on provincial share 55% with no grants and collection charges at 2%. In both these scenarios the federal deficits would be on higher side as compared to OFD agreed with IMF and extra efforts in the shape of cut in the federal PSDP would required to be made.

26. The Chairman informed the meeting that federal government had trillions of throw-forward liabilities of PSDP. As such there was little room left for the federal government to make adjustments in their both current and development expenditures. Provinces had to mobilize and made efforts to enhance their own revenue receipts as well. Dr. Aisha Ghaus stated that Federal Government should meet their expenditure

requirements through borrowing and provincial share in the divisible pool be increased. As the proposed vertical share will not meet the fiscal needs of the Provinces. She also pointed out that the debt sustainability in Punjab MEF is not an issue as incremental debt is very minimal compared to IMF Framework. While responding Dr. Aisha's proposal, Mr. Sakib Sherani pointed out that increasing fiscal deficit would also impact upon federal debt servicing. He was of the view that instead of looking debt servicing as percentage of GDP, the debt servicing as percentage of total expenditures and as percentage of total revenue would also require to be looked into. The chairman observed that excessive borrowing by the federal government would create inflation and this would not be desirable. He was of the view that fiscal space must be created by increasing the tax to GDP ratio. He supported increasing the tax to GDP ration by 15% in the terminal year. However, given the existing circumstance it would not be possible. He therefore asked for re-work out of the macroeconomic framework by enhancing the entire tax to GDP ratio (inclusive of provincial taxes) to 14% of GDP in the terminal year. He expressed that through automation and other efforts the target could be achieved.

27. The Finance Secretary Punjab proposed that the federal and provincial share in the divisible pool may be fixed at 40 : 60. The Chairman observed that this scenario can be developed and debated upon. However, he was of the view that this scenario would have adverse effects on the deficit of the federal government and as such may not be sustainable.

28. On a query by Dr. Gulfaraz regarding non-inclusion of Petroleum Development Levy, Dr. Bengali stated that constitutionally, this is not part of the divisible pool of taxes. The Chairman read out Clause-3 of Article 160 of the Constitution and concluded that PDL would not form part of the divisible pool taxes. The Special Secretary Finance pointed out that in the framework, the provincial own receipts had been projected pessimistically. Provinces would also need to take efforts to increase their own receipts instead of demanding extra ordinary increase in the provincial share from the divisible pool. Finance Secretary, NWFP stated that keeping in view the war like situation, his province would not be able to grow their own receipts. The Chairman observed that keeping in view the given situation, the NWFP may not be able to get their required results, but other provinces must take efforts to grow their own receipts.

29. The Chairman then took the horizontal distribution for discussion. Dr. Gulfraz asked for the Commission to identify certain parameters for horizontal distribution. This identification would be a great achievement in this NFC meeting held at Peshawar. The Chairman Sub Committee-III to present the proceedings of the meeting. Dr. Gulfraz informed that the Committee met twice one informally and the other formally in the Ministry of Finance. But in his view this issue needed to be decided by the full NFC. The Chairman then asked the four members of the Committee being experts to give their view point. On the instance of Mr. Abdul Ghafoor Mirza, the Senior JS(PF) gave brief account of the discussions of the Sub Committee-III. He informed that Dr. Bengali was of the view that in the first instance principles would require to be decided. Mr. Abdul Ghafoor Mirza was of the view that in the absence of the data on province-wise tax generation, no further discussion on horizontal distribution could be initiated and that vertical distribution would required to be decided first instead of horizontal distribution. Dr. Gulfraz Ahmad was of the view that any of the issue can be discussed. Haji Adeel was busy in some other important meeting. Mr. Khalid Aziz was also of the view that either of the issues i.e. vertical or horizontal distribution criteria can be discussed. However, that there was no consensus on the horizontal distribution. At this stage Dr. Bengali further clarified during the meeting held on 27th October, 2009 he pointed out that in order to discuss horizontal distribution, availability of province-wise data would not be necessary. This would be required while discussing a particular indicator. He further stated that Punjab had been claiming that their share from the Federal Transfers was not based on population rather it was far below from its share in the population and it might be around 46%. In his view although explicitly population was using as a sole criterion but implicitly other indicators were also operating. His submission would be to formalize these implicit factors into limelight and an explicit formula based on multiple indicators be adopted. However, the sharing arrangements must ensure no absolute loss for any province. Dr. Gulfraz also supported the suggestions of Dr. Bengali.

30. Finance Secretary Punjab pointed out that his province was not satisfied with the present sharing arrangements and in his view Punjab would need more resources in order to meet with their genuine requirements. Mr. Khalid Aziz stated that in the present scenario, there were five players. In his view each province had its own difficulties. In his view, it would not be possible to satisfy 100% of the requirement of all the provinces and stated that 70% weightage for population and 10% each to

security, poverty and HDI may be given. As regards revenue collection, he stated that the FBR data shows zero collection on account of GST from telecommunication from NWFP while there are million of subscribers who made payments on this accounts. As such his province would not support collection being used misleading as indicator.

31. Mr. Abdul Ghafoor Mirza pointed out that the ratio of 46% was worked out keeping in view the provincial share of 37.5% with special grants and other straight transfers. This needed to be looked into in that perspective. Now, Punjab would need to look into the total pie available to the provinces and keeping that in view further discussions could be undertaken. Regarding determination of poverty level in the country, he suggested use of the government approved data as contained in the PRSP-1 report and not HDI report mentioned by one of the participants of the meeting. Finance Secretary NWFP supported this argument.

32. After thorough discussion, the Chairman asked Balochistan Government to the indicators which they propose to be incorporated in the formula. Dr. Gulfraz presented population (75%), inverse population density (10%), revenue generation (5%) and HDI (poverty) (10%) as indicators for horizontal distribution. Senator Haji Muhammad Adeel supported multiple indicators with population (70% weightage), 10% weightage each to War on Terror, HDI and poverty. Dr. Bengali stated that population (70%) as major indicator, the second indicator would be area (10%), HDI (10%) and revenue collection (10%). Punjab supported use of population, area, HDI and revenue generation.

33. The Chairman, while summing up the proposals given by the provinces, stated that using population as major indicator supported by all the four provinces. Then poverty (HDI) which was the second indicator supported almost by all the four provinces. The third indicator which had the support of the three provinces was area. Revenue generation had the support of two provinces i.e. Punjab and Balochistan and the revenue collection by one province. As such revenue generation could be fourth possible indicators. The Chairman further observed that all the provinces have agreed to include cost of war as one of the indicators. The modalities will be worked out later on.

34. Mr. Abdul Ghafoor Mirza pointed out that these would be the possible indicators. Sufficient time needed to be given to provinces to formulate their viewpoint on each of the indicators.

35. Chairman observed that further deliberation on each of the indicators would be carried out in the next meeting to be held in Karachi. It was decided that the next meeting would be held on November 18-19, 2009.

36. At the end the Chairman on behalf of the participants and on behalf of the federation showed full solidarity to the people of NWFP on this tragic incident. Chief Minister Sindh also thanked the people of NWFP. He was of the view that holding of this meeting at Peshawar was necessary in order to show solidarity to the people of NWFP. He prayed to almighty Allah to give courage to government and people of NWFP to face the situation courageously. He assured full support to Government of NWFP. Finance Minister Punjab also thanked the government of NWFP and extended deep condolence to people of NWFP on such tragic incident and also requested Finance Minister NWFP to visit hospital. He also accepted the fact that NWFP is in great trouble and issues are needed to be addressed on urgent basis. Finance Minister Balochistan thanked the Chairman for the efforts made in resolving the issues of Balochistan and also mentioned that people of Balochistan have great expectations from the NFC award. The meeting ended with a vote of thanks from and to the chair.

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Annex-I

LIST OF PARTICIPANTS OF 4th MEETING OF 7TH NFC

S.No.	Name	Designation
	Federal Representation	
1.	Mr. Shaukat Tarin	Federal Finance Minister
2.	Mr. Asif Bajwa	Special Secretary Finance
3.	Mr. Salim Raza	Governor State Bank
4.	Mr. Sakib Sherani	Economic Advisor
5.	Mian Muhammad Younis	Senior Joint Secretary (PF)
6.	Mr. Talib Hussain Baloch	Joint Secretary (Budget)
7.	Mr. Iftikhar Kutab	Chief (Sales Tax) FBR
8.	Mr. Mushtaq Ahmad	Deputy Secretary (PF)
9.	Mr. Abdul Malik Balghari	Assistant Secretary (NFC)
	Provincial Representation	
Punjab		
10.	Mr. Tanvir Ashraf Kaira,	Finance Minister, Punjab
11.	Mr. Abdul Ghafoor Mirza	Member (Punjab)
12.	Mr. Tariq Mahmood Pasha,	Finance Secretary, Punjab
13.	Dr. Aisha Ghous Pasha	Consultant
Sindh		
14.	Syed Qaim Ali Shah	CM/Finance Minister, Sindh
15.	Mr. Kaiser Bengali,	Member (Sindh)
16.	Mr. Fazalullah Pechuho,	Finance Secretary, Sindh
17.	Mrs. Naheed Durrani	Special Secretary Finance
NWFP		
18.	Mr. Muhammad Humayun Khan,	Finance Minister, NWFP
19.	Senator Haji Muhammad Adeel	Member (NWFP)
20.	Mr. Khalid Aziz	Adviser to Government of NWFP
21.	Sahibzada Saeed Ahmad,	Finance Secretary, NWFP

Balochistan		
22.	Mr. Muhammad Asim Kurd	Finance Minister, Balochistan
23.	Dr. Gulfaraz Ahmed	Member (Balochistan)
24.	Mr. Mahfooz Ali Khan	Finance Secretary, Balochistan
25.	Mr. Noor-ul-Amin Mengal	Additional Secretary (Budget)

AGENDA FOR THE 5th MEETING OF NFC

Day -1 *(18th November, 2009)*

11:00 hours	Opening Remarks by the Chairman
11:15	Confirmation of the Minutes of the 4th Meeting of National Finance Commission
11:45	General discussion on vertical revenue sharing;
14:00-15:00	Lunch Break / Zuhar prayer
15:00	Discussion to be continued

Day -2 (19th November, 2009)

1000	General discussion horizontal revenue sharing; ➢ Divisible pool sharing inclusive of 1/6th GST. ➢ GST provincial.
13:00-14:30	Lunch Break / Zuhar Prayer
14:30	Conclusion

Government of Pakistan

Finance Division

(NFC Secretariat)

-:-

Subject: **Minutes of the Fifth Meeting of 7th National Finance Commission**

The 5th meeting of the 7th National Finance Commission (NFC) was held on November 18-19, 2009 at 1100 hours under the chairmanship of Federal Finance Minister/Chairman NFC at Sheraton Hotel, Karachi. The meeting started with the recitation from the Holy Qur'an by the Federal Finance Secretary. The meeting was attended by all members of NFC and other representatives of the four provincial governments. List of participants is at Annex-I.

2. The Federal Finance Minister, who is the Chairman NFC, welcomed all the participants at Karachi and requested the Chief Minister, Sindh for his introductory remarks.

3. The Chief Minister Sindh while recapturing the background from the previous meetings of the NFC mentioned that they had come long way and had discussed almost all minor issues in the previous meetings. In this meeting real big and thorny issues like distribution of divisible pool/resources and criteria thereof would be taken up. The current meeting of the NFC would therefore, deliberate upon firstly, the vertical distribution, and then horizontal distribution of resources amongst the provinces. He expressed his full confidence and optimism that Federal Government as well as all provincial governments would manage to resolve the issues with mutual accommodation and would come up to the expectations of the people of Pakistan. The Chief Minister thanked all the participants for giving the Government of Sindh an opportunity to host such an important meeting.

4. The Chairman NFC, thereafter opened the discussion by taking up the first agenda item of the meeting i.e. confirmation of the minutes of 4th meeting held at Peshawar, and invited comments, if any, of the members thereon.

5. The NFC Members from Balochistan and Sindh informed the meeting that the draft minutes had been finalized by the NFC Secretariat

in consultation with them and as such they were satisfied with the minutes. The NFC Member from Punjab also confirmed that he was consulted before circulating the draft minutes and the suggestions made by him had already been incorporated in the draft minutes.

6. Finance Secretary, NWFP also mentioned that he, after receiving the minutes, had circulated those to all concerned in his province.

7. Finance Secretary, Punjab desired that the audio recording of the discussion should have been provided to all the provinces along with the draft minutes so that they could have compared and made appropriate changes accordingly.

8. The Secretary NFC responding to the above point informed that copy of the draft minutes was forwarded to all the provinces. They were therefore, taken on board before finalization of the draft. He further informed that minutes were forwarded to NFC members only.

9. The Chairman NFC directed the NFC Secretariat that copy of the minutes should be forwarded to all NFC members and provincial Finance Secretaries so that changes, if any, could be made and confirmation of minutes could be done timely.

10. The Chief Minister Sindh, before proceeding further, drew attention of the Chairman and other participants towards inadequate control & secrecy of the proceedings/documents relating to the NFC meetings. He appreciated the role of the media; however, premature access of the media to the sensitive information of the NFC proceedings could put any of the governments in an awkward position. He, therefore, impressed upon all to consider it as their moral duty to protect the important data and discussion from leakages so that media might not get a chance to influence the proceedings indirectly. He desired that all participants as well as dealing personnel to be more vigilant and careful while handling the information relating to NFC proceedings.

11. Federal Finance Secretary suggested that present tax base should be expanded by imposing Value Added Tax (VAT). He briefed the participants on the conference held in Dubai and shared the positive outcome of that conference. He also offered to share a document with the participants relating to discussions on VAT in the conference. The

document would help in understanding the imposition and comprehending the usefulness of VAT.

12. With the permission of the Chairman NFC, Special Secretary Finance made presentation on projected resource availability and its vertical distribution. The presentation was based on the assumption that:

- The real GDP growth would be 3% in 2009-10 which would reach to 6% in the terminal year i.e. 2014-2015. The inflation projected at 10% in 2009-10 would reduce to 7% in the next year and then at 6% in the remaining years.
- The tax to GDP ratio (combined FBR + provinces) projected at 10.7% in the benchmark year would reach to 14% in the terminal year.
- The receipts on account of GST on Services and Excise duty on Natural Gas would be treated as Straight Transfers along with other Straight Transfers such as Royalty on Oil, Royalty on Natural Gas, Gas Development Surcharge (GDS).
- For the provincial current and development expenditures, budget estimates of the current financial year have been adopted as benchmark.
- Current Expenditures of the provinces have been projected at 14% annual growth.
- The provinces would remain neutral as far as their surpluses/ deficits was concerned.

13. Based on the above assumptions, when GDP growth would touch 6% in the terminal year, the GDP in absolute terms would be around Rs. 14.8 trillion in the benchmark year i.e. 2010-2011 and Rs. 25.6 trillion in the terminal year i.e. 2014-2015. FBR tax efforts would be needed at 0.9% in the first two years, 0.7% in the third year, 0.4% and 0.3% of GDP in the fourth year & fifth (final year). Similarly, tax efforts by provinces would be required at 0.1% of GDP in each year.

14. The Special Secretary Finance then presented various Scenarios/options for vertical sharing. The gist of the options was as under:

a. **Existing:** This scenario was based on the existing distribution arrangements. The federal deficits together with deficits/surplus of the provinces would be exactly in accordance with the OFD agreed with the IMF.

b. **Scenario 1: Provincial Share 52.5% with no grants & Collection Charges at 2% and tax to GDP ratio to reach at 14% of GDP.** Based on this scenario, the federal deficits were higher than the OFD and federal government had to make adjustment by cutting their PSDP by 0.5% to 1.6% in order to maintain the deficit at the acceptable level.

c. **Scenario 2: Provincial Share 55% with no grants & Collection Charges at 2% and tax to GDP ratio at 14% of GDP.** Based on this scenario, the federal deficits were much higher than the OFD and federal government had to make adjustment by cutting their PSDP by 0.7% to 1.9% in order to maintain the deficit at the acceptable level.

d. **Scenario 3: Progressive Provincial Share 52.5%-55% with no grants & Collection Charges at 2% and tax to GDP ratio at 14% of GDP.** Based on this scenario, the federal deficit was again much higher than the OFD and federal government had to make adjustment by cutting their PSDP by 0.5% to 1.9% in order to maintain the deficit at the acceptable level.

15. The Special Secretary, while summarizing his presentation highlighted that in all the above scenarios, provinces would get substantial increase in the resources to finance their current and development expenditures but the federal government would be in a difficult position as it would not be able to maintain the deficit at an acceptable levels.

16. The different scenarios presented by the Special Secretary were based on absolute numbers. He, complying with the direction of the Chairman NFC, however, offered to share with provincial governments background tables/workings relating to his presentation.

17. The Chairman NFC expressed his firm belief that Pakistan had great potentials to increase its tax receipts to secure a prudent fiscal

position. The major and only tool to convert the belief into reality was to raise the tax to GDP ratio to a reasonable level to make it comparable with the other developing countries in the region which had tax to GDP ratio between 15% - 20% of their GDP. Pakistan being no less than any of these countries should also require having tax to GDP ratio of 15% minimum. He therefore desired that options earlier presented be revised by increasing the tax to GDP ratio to 15%.

18. Finance Secretary Punjab suggested that ambitious revenue projections would increase the risks for federal as well as provincial economies. If, in case, projected percentages were not realized then the provinces would fall in a difficult situation where they might not be able to meet even their current expenditures.

19. The Finance Minister (Chairman NFC) highlighted that there was a need to increase the share of provinces which would result into improving the life of the people in the province. He observed that improvement in tax to GDP ratio would help in enhancing the pie (revenues). Resultantly the provinces would get greater share and bigger amounts. Federal Government would also be comfortable to allocate more resources to Defence without reducing the allocations in other sectors. More over federal government would have some space to look after its establishment (bureaucracy) too. He therefore desired that there was no need to be conservative in projecting higher targets and making efforts to ensure their realization/achievement.

20. The representatives of the government of NWFP expressed their apprehensions that in case of "no grants", the NWFP and other smaller provinces would be badly affected and might go into losses.

21. The Finance Minister (Chairman NFC) assured that Federal Government would not let any province suffer a loss and decisions would be taken in a way that every province shall be better off.

22. The NFC Member from NWFP pointed out that in the earlier meetings it was agreed to reduce the cost of collection to 1% but in the scenarios presented by the Federal Government, the collection charges had been reduced to 2% only.

23. The Finance Minister (Chairman NFC) directed that the presentation be revised with tax to GDP ratio at 15% with collection

charges at 1% and the revised presentation would be discussed a short while.

24. In compliance with the direction of the Chairman NFC, the Special Secretary Finance, after incorporating the new parameters/ assumptions, made another presentation to NFC. The presentation was based on the provincial share at 52.5%, 55% & 52.5%-55%, collection charges at 1 %, no grants and tax to GDP ratio at 15%. The scenarios entailed additional effort by FBR as well as by the provinces. Provincial share under divisible pool went up from Rs. 569 billion to Rs. 1689 billion at the annual compound growth rate of 24.3% under Scenario 1 and to Rs.1,770 billion under Scenarios 2 and 3 at the annual compound growth rate of 25.4%. Overall expenditure of the provinces increased from 6.4% to 10.4% of GDP and while their development expenditures were enhanced from 2.0% to 5.3% of GDP under scenario 1 and 2.0% to 5.6% of GDP under Scenarios 2 & 3.

25. As a result of new working, more fiscal space was available to provinces. But in the case of Federal Government no tangible improvement in its deficit was noticed as collection charges was reduced to 1%.

26. The Chairman NFC, while concluding the discussions, told that every thing had been placed on the table. He therefore invited suggestions from the participants as how to move forward to reach to a conclusion by developing an equitable formula for vertical distribution of the resources wherein the federal government versus provinces should be at a win-win situation.

27. The NFC Member from Sindh indicated that, prima facie, the increase in provincial share progressively from 52.5% to 55% would seem workable. However, he desired that the provinces as well as federal government be given some more time to further think over the vertical distribution formula on the basis of the presentation made by the Federal Government. He further suggested that, perhaps, developing a formula for vertical distribution of resources would be comparatively easy if horizontal distribution of resources amongst the provinces was taken up first. The representatives from Balochistan and NWFP supported the proposal.

28. The Chairman NFC accepted the above suggestions and decided that members of NFC might have to think over different options for an acceptable vertical distribution formula; therefore the Commission would take up the horizontal distribution issues first. Further discussion on the vertical distribution would be taken up at the conclusion of this meeting or in the next meeting scheduled at Lahore. Punjab representative suggested that Punjab's position on vertical distribution was 60% resources for province and 40% to Federal Government.

Day-2 (November 19, 2009)

29. The Chairman NFC, while recapturing the yesterday's discussions, mentioned that they had already deliberated upon the issue of vertical distribution of resources at length. He mentioned that despite projecting FBR receipts at 15% of GDP, the OFD of the federal government under certain scenarios were not workable. Both federal government and provinces, therefore, would require initiating some concrete measures/steps in the right direction to overcome the difficulty. He desired that a presentation on the imposition/application of VAT and its impact on the quantum of resources becoming available to governments be given in the next meeting scheduled at Lahore.

30. He further mentioned that the province of Punjab appeared as a major beneficiary as compared to the smaller provinces in the scenarios discussed yesterday. Rather the province of Balochistan was in negative in most of the cases. He was convinced that change in the formula of vertical distribution only would not be a solution to the problem. Therefore formula for horizontal distribution of resources had become more important and was needed to be discussed and reformulated first for equitable distribution of resources amongst the provinces.

31. The Chairman NFC while continuing the discussion, referred to the options on horizontal distribution developed and circulated by Mr. K. Bengali, NFC Member from Sindh. He appreciated the efforts of the Member and invited comments of the participants on the options put forward by the member. He observed that perhaps provision of Grants (grants-in-aid) by the federation to the provinces had been made regular part of the share of the province hence each option in the paper presented Punjab as major beneficiary. The incremental increase in the case of Punjab was on a very higher side whereas in case of Sindh, the increase was marginal and it was negative in the case of NWFP and Balochistan.

32. Mr. Abdul Ghafoor Mirza, NFC Member from Punjab stated that it would be difficult for him to comprehend the tables circulated by Member from Sindh. He requested that basis of each number appearing in the table should be shared in order to understand the workings.

33. The Chief Minister, Sindh indicated that the options in the working paper were open to correction/changes. It was mentioned by Mr. Bengali that options were built having indicative numbers, assuming no grants would be available from federation, GDP growth rate as used by the federal government in its presentations. In addition, distribution of 1/6th of sales tax on 50% population and 50% OZT Collection had also been used. The change in any of the parameters would change the results in the option.

34. One of the representatives from NWFP pointed out that their team had also prepared some working on the horizontal distribution which was being shared with all the participants. He further mentioned that in order to overcome the possible financial imbalances of the provinces, the concept of Grants-in-Aid might not be done away and would therefore be required to be in-built in the horizontal distribution mechanism.

35. Dr. Gulfaraz Ahmad, NFC Member from Balochistan stated that the population of Balochistan was about 5% of the country whereas its area was about 45% of the country. Relative cost of providing public services was therefore much higher in Balochistan (in excess of three times) than that of other provinces. Balochistan would not support any formula which did not take the relative cost of providing public services and development into account by giving a due weight to inverse population density. He emphasized the concept of fiscal equalization in the horizontal distribution in order to promote nearly equal level of public services and development in all the four provinces of Pakistan.

36. The Chairman NFC intervened and indicated that federal government would keep on playing its role to mitigate the financial imbalances amongst the provinces caused due to any horizontal distribution formula or due to some natural calamity. One of the reasons to pend final decision on vertical sharing was to assess the need of grants and subventions coming into notice during finalization of the horizontal distribution formula.

37. One of the representatives from Punjab stated that major assumptions of the options needed to be shared. Moreover, as per earlier understanding/decision the concept of horizontal fiscal equalization was to be incorporated in the horizontal distribution formula. It would therefore be appropriate to discuss first each and every indicator being considered to be incorporated in a formula. They were of the firm opinion that none of the province would be at disadvantageous position if the vertical share of the provinces was enhanced.

38. The Chairman NFC while agreeing to the demand mentioned that NFC would discuss all the issues as well as indicators. He however, desired that let Dr. Bengali who developed the options quickly run through his workings for the benefits of the participants.

39. Dr. Bengali explained that increase in divisible pool as suggested by Federal Government would surely increase the share of each province. But since the element of "grants" had been eliminated, therefore, NWFP and Balochistan which were the major beneficiaries of such grants would not witness any substantial increase in absolute terms. The options had been run on basis of availability of resources at 52.5% and 55% and 52.5% to 55% progressively share in the divisible pool. The growth rate adopted by the Federal Finance Secretary in his projections had been taken and inter-provincial share was the weighted average of 1/6th of sales tax and the population ratio.

40. The province of NWFP demanded using "war on terror" as one of the indicators.

41. The Chairman NFC, inferring from the above discussion mentioned that participants were narrowing down to the possible indicators to be used in developing the horizontal distribution formula. He further announced that there appeared to be consensus on using "population" and "poverty/backwardness/HDI" as indicators in the formula. In addition, two provinces were in favour of using "area" as one of the indicators. Balochistan demanded using IPD as indicator. Sindh, supported as "Inverse Population Density (IPD)" as indicator.

42. To use "revenue collection" or "revenue generation" as another indicator in the formula, Punjab and Balochistan were advocating for using "revenue generation" as one of the indicators. Sindh demanded

using of "revenue collection" as indicator. NWFP instead of any of two wanted "war on terror" as one of the indicator.

43. The Chairman NFC mentioned that "war on terror" was grave reality for the whole nation. The whole country was standing behind the armed forces and the province of NWFP in the fight against terror. He indicated that it was a temporary phenomenon and should be dealt with separately. He assured that expenses on the war as well as for restoring the development would be met either through federal PSDP or through some other sources by the federal government. He mentioned that federal government considered it as a catastrophe and any of the provinces could face such situation. He therefore suggested that let it remain the responsibility of federal government to provide funding to tackle the menace, rehabilitate the IDPs and redevelop the affected areas.

44. Senator Haji Muhammad Adeel, NFC Member from NWFP welcomed the offer of the federal government taking the responsibility and providing compensations for immediate losses. He however stated that as a result of war, the infrastructure had been damaged very badly. Businesses had gone to standstill. Business community sustained heavy losses. The rehabilitation of the infrastructure might take a decade covering two or more NFCs. As such the "war on terror" factor must be given due weightage while formulating horizontal distribution mechanism.

45. The Chairman appreciating the concern observed that the rehabilitation process would require at least two hundred billion rupees which might not be possible to provide through any NFC distribution formula. He further mentioned that even assigning maximum weight to war would approximately work out as Rs. 10 billion a year which would be far less than the amount required for restoring the infrastructure damages. He therefore indicated that it would be in favour of NWFP to let the federal government deal/meet the war expenses separately.

46. The Finance Minister, Punjab stated that the "war on terror" was a big issue and they were fully supportive of the Chairman's proposal. He was of the view that making war on terror as a parameter in horizontal distribution would marginalize the issue. He however demanded that any decision/ assurance of the federal government in that respect be recorded and properly minuted to provide comfort to the NWFP government.

47. The Chairman NFC observed that war on terror was on top of every thing and as such no province should have any worries in this regard. He referred to a comprehensive Damage Need Assessment (DNA) report which covered all damages/losses caused due to war on terror. Every demand of the NWFP government in this regard would be covered and met in very comprehensive manners. The report had already been shared with NWFP government.

48. Since as per UNO's reports US$ 2.00 billion would be required for rehabilitation work so it was suggested that amounts received from donors (locals as well as foreign) for IDPs should be placed in a separate Account/Fund. The funds provided by the other three provinces also be deposited in the same Account/Fund.

49. A short documentary portraying the development needs of Sindh province was shown to the participants.

50. Mr. Khalid Aziz NFC Member from NWFP stated they had also prepared some tables. The figures of the working of his province were not much different from the figures of Mr. Bengali. He however desired to reconcile few figures with Federal Government.

51. The Chairman directed the officials of the Federal Finance Ministry to extend full co-operate to the member to have his figures reconciled.

52. Federal Finance Secretary pointed out that the Constitution of Pakistan provided provision of grants to the provinces to redress their financial difficulties. He mentioned that an institutionalized mechanism had been in existence under which all four provinces had been made eligible for grants from the federal government at the notional rate of 11% for Punjab, 21% for Sindh, 35% for NWFP and 33% for Balochistan. The ratios/percentages apparently seemed as have been giving due weightage to IPD, backwardness and revenue collection/generation.

53. While discussing the indicators/factors for horizontal distribution, Dr. Gulfaraz advocated adopting IPD as one of the indicators/factors. It would redress the issue of relatively higher cost involved in providing services to the masses of the less densely populated areas of Balochistan. Dr. Bengali stated that Sindh would have no problem in adopting IPD as one of the indicators.

54. On the indicator/factor of poverty Dr. Bengali pointed out that studies carried out by different institutions to measure poverty and level of backwardness in the four provinces produced variant results. Due to non availability of uniform definition of poverty and non standardization of the components/parameters to gauge poverty there would be different data on poverty showing the level of backwardness of different provinces differently. Ranking assigned to each province was different in every study. However, data being used to determine Human Development Index (HDI) in each province of Pakistan was almost standardized. He therefore suggested using HDI to assess the level of poverty/backwardness in the provinces. He further informed that Government of Sindh has officially rejected poverty figures of the PRSP-I. The representative from Balochistan also stated that they too had rejected 1998-99 PRSP-I figures.

55. Punjab supported using PRSP-1 report as basis for poverty. However, Dr. Gulfaraz demanded data of PRSP-II report which were under process and yet to be finalized. He however, supported using HDI as indicator as given in the UNDP report or the report of Federal Bureau of Statistics circulated by the NFC Secretariat. No consensus could emerged on using the data on poverty or HDI.

56. Dr. Aisha Ghaus suggested that the Commission in the first instance should discuss and decide about the indicators with out referring to the weightage to be assigned to such indicators. She further suggested that before assigning weightage to the indicators, formula relating to vertical distribution should be finalized first so that provinces in general and Punjab in specific should know as to how much space available to them to accommodate each other.

57. Mr. Khalid Aziz once again highlighted NWFP Government's immediate and continuous needs to deal with menace of terrorism and its after effects. He stated that due to new security arrangements (including fresh recruitment of security personnel), the current expenditures of the province were increasing manifold. He therefore suggested that "war on terror" should be included in the horizontal distribution formula as one of the indicators.

58. The Chief Minister Sindh mentioned that they would respect the point of view of the NWFP and would have no objection of including "war on terror" as a 5th indicator in the horizontal distribution formula.

59. Finance Secretary Punjab pointed out that the impact of war on terror be given due consideration. He was of the view that the Punjab was also being effected by war on terror. He supported the idea of creating a separate FUND for rehabilitation of IDPs and development affected area of NWFP. If some other province faced a similar situation it would also be eligible to access that Fund. The Finance Minister Punjab however, indicated that weightage to be assigned to that indicator be kept pending till the next meeting.

60. The Chairman observed that conceptually the Commission had agreed to give weight to "war on terror". However, modalities would be worked out in the subsequent meetings/sessions.

61. The Chairman summing up the discussion on two indicators; "population" and "war on terror" expressed his satisfaction that there was no disagreement by any of the province for adopting those two indicators in the horizontal distribution formula. He then invited comments on adoption of "area" or "Inverse Population Density (IPD)" as another indicator in the formula.

62. Two of the provinces; Punjab and NWFP were in favour of using "area" while Balochistan and Sindh wanted to adopt "Inverse Population Density (IPD)" as another indicator/factors in the horizontal distribution formula. After detailed discussions the province of Punjab and NWFP to maintain the spirit of accommodation let the "IPD" instead of "area" be adopted as indicator in the formula.

63. After having agreed in principle to include "population", "poverty/HDI" and "IPD" as indicators in the horizontal distribution formula, the Chairman invited views of the participants on the proposal of including "revenue collection" and/or "revenue generation" in the formula.

64. NFC Members from Sindh pleaded that "revenue collection" be included as another indicator/factor for resource distribution amongst the provinces. It was argued that both the developed ports of the country were located in the province of Sindh. The whole sea imports and exports make use of the infrastructure of the province for transportation of goods to and from the ports. The government of Sindh spends huge amount on the maintenance of the roads and other infrastructures. Dr. Bengali therefore demanded that to offset the burden of maintaining the

infrastructure to facilitate smooth operation at the ports "revenue collection" be adopted as a basis for resource distribution. He mentioned that such an indicator/factor would help Balochistan and Punjab to efficiently maintain the required infrastructure on becoming Gawadar port operational and opening of Indian (Wagha) border for trade between India-Pakistan and/or India-Pakistan-Afghanistan respectively.

65. Member from Sindh mentioned that revenue collection by the province of Sindh for and on behalf of the rest of country was reality like population, area or a dam in other provinces. The ports in Karachi, a geographical reality which needed to be accepted. Internationally, it is factor of collection rather than generation which is taken as an indicator. The province of Sindh which was never compensated in the past should therefore be compensated now.

66. The Finance Secretary Punjab responded by indicating that KPT was already collecting port handling charges on imported as well exported goods. Similarly, for maintenance of the roads, Sindh government had levied a reasonable infrastructure development cess. As far as actual collection was concerned it was mentioned that Income Tax and Customs department of the federal government (not the provincial departments) were performing the duties of collectors of revenues. As regards the plea that it would benefit Balochistan in the long run, the prevalent position was that both NWFP and Balochistan would get less than 1% share under this scenario. Rather NWFP would get major set back by use of this indicator.

67. He further mentioned that most of the multinationals have their factories in Punjab or up country. They use either local inputs or do value addition on the imported inputs in these factories. The product is also either sold in the up country or is exported through sea port. In this way though their major business takes place in the up country but owing to their head offices in Karachi they deposit the revenue and file their return in Karachi. Would the income tax worked out on the factories located in Punjab but payment made at Karachi be considered as tax of that province? Would it be justified to consider that NWFP had no consumers of telephone and mobile phones because telecommunication services provider had deposited the tax on the services at any place other than NWFP. It was also mentioned that there were discrepancies in the percentages of the collection.

68. It was indicated by the Punjab that collection figures would be deceptive as compared to reality. It was therefore, suggested that generation would be more reasonable and logical for using as indicator instead of collection.

69. Punjab was providing food security to the entire country and as such Punjab could consider proposing that to be used as one of the indicators in the horizontal distribution formula.

70. Dr. Gulfaraz stated that though both collection and generation did not provide any benefit to his province but Balochistan supported revenue generation in the interest of arriving at a consensus because the principle disparities of all the four provinces needed to be addressed. In response to point made in paragraph-70, he was of the view that Karachi was a developed port city even prior to partition due to its advantageous location. He welcomed Punjab's readiness to consider/accept multiple indicators for horizontal distribution which was a paradigm shift and termed it as great achievement of the whole Commission.

71. Finance Secretary Balochistan stated that due to non availability of data even on booking of transactions relating to PPL and Sui gas and coal produced in Balochistan by PIDC it was difficult for Balochistan government to take stand in favour of revenue collection or in favour of revenue generation.

72. Mr. Bengali responding to the points raised by other provinces stated that the infrastructure cess levied by government of Sindh was very negligible and its collection was hardly sufficient to maintain the huge infrastructure in the port city. While appreciating the national security issues relating to trade on Wagha border, as highlighted by Punjab, he mentioned that such problems would be overcome with the passage of time. The increase in volume of trade would automatically enhance the collection therefrom. On the discrepancy of tax collection figures he mentioned that it was an accounting problem relating to treatment of the collection of Islamabad.

73. The Chairman while summing up discussion indicated that Punjab and Balochistan were tilted to accept generation as an indicator whereas Sindh argued for revenue collection to be taken as indicator.

74. The Chairman concluding the discussion on horizontal distribution of resources suggested that even before the vertical distribution, a notional amount (some percentage) would be set aside for war on terror as a seed fund. However, modalities would be decided in the subsequent meetings.

75. The Chairman further mentioned that all four provinces were agreeable to have "poverty" as one of the indicator/factor in the Horizontal distribution formula. However, the method/figures (PRSP-I or PRSP-II or HDI) depicting poverty level would be discussed and agreed upon in the next meetings.

76. As regards "area" or "IPD", two provinces supported area and two provinces supported IPD. However, after detailed discussions all provinces showed agreement on using IPD as an indicator instead of Area.

77. It was decided that the next meeting will be held at Lahore on December 9-10, 2009 to finalize the vertical as well as horizontal formula.

78. The meeting ended with a vote of thanks from and to the chair. The chairman on his behalf and on behalf of the participants acknowledged the warm hospitality extended by Sindh government to the delegates of NFC.

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Annex-I

LIST OF PARTICIPANTS OF 5th MEETING OF 7TH NFC

S.No.	Name	Designation
	Federal Representation	
1.	Mr. Shaukat Tarin	Federal Finance Minister
2.	Mr. Salman Siddique	Finance Secretary
3.	Mr. Asif Bajwa	Special Secretary Finance
4.	Mr. Sakib Sherani	Economic Advisor
5.	Mian Muhammad Younis	Senior Joint Secretary (PF)
6.	Mr. Shabbir Ahmad	Joint Secretary (PF/Exp.)
7.	Mr. Talib Hussain Baloch	Joint Secretary (Budget)
8.	Mr. Mushtaq Ahmad	Deputy Secretary (PF)
9.	Mr. Abdul Malik Balghari	Assistant Secretary (NFC)
	Provincial Representation	
Punjab		
10.	Mr. Tanvir Ashraf Kaira,	Finance Minister, Punjab
11.	Mr. Abdul Ghafoor Mirza	Member (Punjab)
12.	Mr. Tariq Mahmood Pasha,	Finance Secretary, Punjab
13.	Dr. Aisha Ghous Pasha	Consultant
Sindh		
14.	Syed Qaim Ali Shah	CM/Finance Minister, Sindh
15.	Mr. Kaiser Bengali,	Member (Sindh)
16.	Mr. Fazalullah Pechuho,	Finance Secretary, Sindh
17.	Mrs. Naheed Durrani	Special Secretary Finance
NWFP		
18.	Mr. Muhammad Humayun Khan,	Finance Minister, NWFP
19.	Senator Haji Muhammad Adeel	Member (NWFP)
20.	Mr. Khalid Aziz	Adviser to Government of NWFP
21.	Sahibzada Saeed Ahmad,	Finance Secretary, NWFP

Balochistan		
22.	Mr. Muhammad Asim Kurd	Finance Minister, Balochistan
23.	Dr. Gulfaraz Ahmed	Member (Balochistan)
24.	Mr. Mahfooz Ali Khan	Finance Secretary, Balochistan
25.	Mr. Noor-ul-Amin Mengal	Additional Secretary (Budget)

AGENDA FOR THE 6th MEETING OF NFC

Day -1 *(9th December, 2009)*

10:00 hours	Opening Remarks by the Chairman
10:15	Confirmation of the Minutes of the 5th Meeting of National Finance Commission
10:45	General discussion on horizontal revenue sharing;
14:00-15:00	Lunch Break / Zuhar prayer
15:00	Discussion to be continued

Day -2 *(10th December, 2009)*

10:00	General discussion on horizontal revenue sharing;
12:30 - 14:00	Lunch Break / Zuhar Prayer
14:00	General discussion on vertical revenue sharing;
16:00	Conclusion

Record Note of deliberations and decisions taken in the 6th Meeting of the 7th NFC held at Lahore December 9-11, 2009

The Federal Government recognized the need of the provinces for a larger share in the divisible pool since provinces are assigned the task of provision of basic services like health, education, water supply and sanitation.

- **Divisible pool:** The size of the divisible pool is proposed to be increased in the i'nterest of national solidarity and provincial harmony. Federal government shall make major efforts to boost tax revenue. In addition the divisible pool will be increased by reducing the collection charges from 5% to 1%.

- **Sales Tax on Services:** NFC recognized that sales tax on services is a provincial subject under the Constitution of Pakistan, and may be collected by respective provinces, if so desire.

- **War on terror:** The federal government and all the four provinces recognize the role of NWFP as a frontline state against war on terror. The federal government reiterates its commitment to bear all expenditures incurred on the war on terror. However, as a gesture of support by all provinces and the Federation 1% of the total divisible pool has been earmarked for NWFP as an additional resource for war on terror during the Award period. This would be equivalent to 1.83% of the provincial pool.

- **Vertical Distribution:** The provincial share of the divisible pool will increase from the present 47.5% to 56% in the first year of NFC and 57.5% in the remaining years of the Award.

- **Horizontal Distribution:** The discussions among provinces on horizontal distributions of the divisible pool were held in a spirit of utmost cordiality and accommodation. All four Provincial Chief Ministers actively participated in the discussions.

    - Long standing demand of Sindh, NWFP and Baluchistan to distribute the divisible pool according to multiple indicators has been accepted.

    - The NFC expressed its special thanks to the government of Punjab for showing grace in acceptance of this demand.