

The 18th Constitutional Amendment: Glue or Solvent for Nation Building and Citizenship in Pakistan?

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Abstract

The almost unanimous passage of a landmark consensus constitutional amendment—the 18th Constitutional Amendment—restored Pakistan’s constitution to its original intent of a decentralized federation of provinces as envisaged in the 1956 (two provinces) and 1973 (four provinces) constitutions. This article takes a closer look at the provisions of this amendment and highlights both the potentials and pitfalls of the new constitutional order for good governance in Pakistan. It argues that the amendment represents a step forward but encompasses several missteps in creating a harmonious political and economic union. The 18th Amendment has reinforced an outmoded “pot-belly” model (federalism of provinces) whereas an “hourglass” (federalism of local governments) model is more suited to Pakistan’s circumstances. Major fundamental reforms are needed that right-size the federal and provincial governments, strengthen local governance, enforce fiscal discipline and citizen-based accountability for service delivery performance on all orders of government, dismantle provincial barriers to factor mobility and internal trade, and restrain beggar-thy-neighbor policies and unaccountable governance by “empowered provinces” to mitigate the unintended adverse consequences of the 18th amendment for nation building and citizenship in Pakistan.

Keywords: Governance; fiscal federalism; decentralization; state and local governance; nation and province-building; constitutional division of powers; intergovernmental fiscal relations.

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1. Introduction

On April 20, 2010, Pakistan’s parliament passed a landmark consensus constitutional amendment to restore Pakistan’s constitution to its original intent of a decentralized federation of provinces as envisaged in

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the 1956 and 1973 constitutions. This development came after several decades of military and autocratic rule, which had dismembered Pakistan's constitution to serve the interests of the ruling elite and, in the process, centralized fiscal powers at the federal level.

Table 1 shows that the division of power in Pakistan has been in flux since the late 1950s. The pendulum has swung in favor of centralized power at the federal level since 1956, until the trend was recently reversed by the 18th Amendment in 2010. Taxing powers were centralized in 1956 at the federal level in the interest of tax harmonization and lower tax collection costs. That year, the provinces voluntarily ceded the power to collect sales taxes in favor of federal collection and a formula-based revenue sharing arrangement that were formalized by the 1956 constitution. The military regime of General Ayub Khan sought legitimacy by introducing the system of "basic democracy" with indirect elections at the local level and enhancing the powers of local councils while keeping them under the strict control of federal bureaucrats. The regime also amalgamated the four provinces of what then comprised West Pakistan into one unit to counterbalance the dominance of East Pakistan in the federal system. The system of basic democracies was dismantled with the fall of the regime in 1968.

During 1968–71, there was movement toward greater provincial autonomy. The 1971 elections returned Sheikh Mujibur Rahman of the Pakistan Awami League to power at the federal level, but the leader of the Pakistan People's Party, Zulfikar Ali Bhutto, in collusion with the Pakistan Army, prevented Mujibur Rahman from assuming the position of prime minister and instead ordered military action in East Pakistan. This culminated in the formation of East Pakistan as the independent state of Bangladesh in 1972, and was followed by the dismantling of one unit in the now truncated country of Pakistan. From 1973 to 1977, Pakistan remained under a pseudo-military-cum-democratic regime. A new constitution was enacted in 1973 but fundamental rights were suspended on the eve of promulgation of the new constitution. The Bhutto regime used emergency powers to wrest control of major industries, businesses, and schools from the private sector. These policies initiated Pakistan's economic decline, a situation that has not been reversed by subsequent regimes.

Table 1: The shifting sands of power in Pakistan: Expenditure and revenue collection shares by order of government

Government	1955	1965	1985	1995	2005	2010	2011
Expenditure shares							
Federal	60	60	65	67	70	66	67
Provincial	35	30	30	29	20	25	28
Local	5	10	5	4	10	9	5
All	100	100	100	100	100	100	100
Revenue shares							
Federal	70	85	90	90	93	94	93
Provincial	25	10	5	5	6	5	6
Local	5	5	5	5	1	1	1
All	100		100	100	100	100	100

Source: World Bank staff estimates.

In 1977, the Pakistani military used the pretext of economic decline and war in Afghanistan to stage a coup d'état. General Zia-ul-Haq ruled Pakistan with an iron fist from 1977 to 1987 and centralized powers at the federal level. Local governments were allowed to function under the strict control of federal bureaucrats who, as they assumed greater powers, ensured that most local governments remained dysfunctional and, therefore, under the direct supervision of federal civil servants. With the demise of General Zia, Pakistan returned briefly to democratic control but the system was destabilized by the military. In October 1999, General Pervez Musharraf staged a military coup on the pretext that the popularly elected prime minister did not follow due process in removing him from the position of chief of army staff. In 2001, Musharraf sought to strengthen local governments while keeping control through indirectly elected *nazims* as an antidote to the return to power of the country's two major national political parties. He was forced to resign in May 2008 and, with his departure, the local government system that had been established was set aside by the provinces.

Table 1 shows that there has been a consistent erosion of provincial taxing and spending powers over the period 1955–2010—this trend has been arrested by the 18th Amendment. However, local government spending powers have typically increased during military regimes and diminished under democratic regimes while their taxing powers were eroded in the late 1990s with the abolishment of the *octroi* tax in return for a

static federal revenue guarantee—a poor bargain that significantly weakened local self-governance in Pakistan. The contrasting attitudes of military and democratic regimes toward local governments can be explained by the argument that the former have tended to support a semblance of local autonomy to seek legitimacy and undercut political parties whereas the latter at the center and in the provinces have perceived local governments as competitive providers that might reduce their own relevance in people's lives. Both types of regimes, however, have perceived empowered and autonomous local governments as liable to undercut their own dominance and control of the political system. As a result, local governments have remained wards of the state in Pakistan.

This centralization of the fiscal system has been accompanied by a deterioration both in law and order and in the quality and quantity of public services. The dysfunction of public governance in Pakistan appears to have reached a tipping point in the first decade of the 21st century, which has prompted the popular western media to label Pakistan rightly or wrongly as a “failing” state. Some Pakistani scholars have already labeled it a “failed state” (Haque, 2010). Will the new constitutional dispensation help Pakistan reverse this course? This article examines the implications of the 18th Amendment for promoting peace, order, good government, and growth. Section 2 reflects on the state of fiscal federalism prior to the 18th Amendment. This is followed by a discussion of the amendment and its institutional, fiscal, and service delivery implications (Section 3). Section 4 debates its potential for improving public governance in Pakistan. This is followed by a discussion on several overlooked issues. Section 5 presents a conceptual perspective on multi-order governance in a globalized, interconnected world, and compares it with the governance system envisaged by the 18th Amendment. Section 6 provides a synthesis of the significant potential risks of the proposed political and economic union, inadvertently introduced by the 18th Amendment. Section 7 advocates an hourglass model of federalism for Pakistan. The final section draws some conclusions.

The article concludes that the 18th Amendment must be seen as a first step toward the broader agenda of reform in fundamentally restructuring the multi-order public governance system in Pakistan. This is because the amendment offers some potential for improving public governance but also introduces major risks for political and economic union. These risks can be averted by further reforms. The unfinished reform agenda should include reasserting home rule for local governments and treating them as the primary agents responsible for delivering public services, uplifting the local

economy, improving economic and social outcomes for its residents, and ensuring their liberty and right to life and property.

Additionally, this reform agenda would include a framework for fiscal responsibility binding on all orders of governments, creating a common economic union by dismantling all barriers to goods and factor mobility, including the provincial residency rules enshrined by the 18th Amendment. It would also include citizens' rights to information and to hold governments accountable for their performance, among other things. Another important element would be reforming intergovernmental finance to introduce results-based accountability while preserving provincial autonomy and flexibility. The article recognizes that this is an ambitious agenda and that the political and bureaucratic impediments may seem overwhelming at present, but an important first step would be for all orders of government to agree on the need for such reforms. Without such a consensus, the centrifugal tendencies unleashed by the 18th Amendment may pose significant risks for the future of political and economic union in Pakistan.

2. The State of Fiscal Federalism Prior to the 18th Amendment

The developers of the 1956 Constitution visualized Pakistan as a decentralized federation with significant public spending responsibilities being assumed by lower levels of government. They also gave these governments significant means of revenue to discharge their responsibilities. The federal government, on the other hand, was given greater access to its own revenue bases than that needed for federal direct expenditures alone, so that it could ensure a reasonably comparable level of services across the nation primarily by exercising its spending power (fiscal transfers to the provinces) to influence provincial-local priorities.

The vision of a decentralized federation was set aside in favor of a centralized quasi-federation under military rule from 1958 to 1968. The military regime also tried to introduce a new form of local governance—the so-called “basic democracy” system—that supported a system of indirect elections of local mayors. Most local functions were managed and delivered by elite civil and military bureaucrats with local councilors intended to provide limited popular participation in state affairs at the local level. With the brief departure of the military regime, the basic democracy system was dismantled, and elections under the 1956 constitutional system were held in 1969, which returned Sheikh Mujibur Rahman's Awami League to power. The Pakistan military leadership

refused to respect the electoral outcome and instituted Zulfikar Ali Bhutto as prime minister. This led to political strife and civil war, resulting in the breaking away of East Pakistan and its establishment as the independent state of Bangladesh in 1972. Bhutto convened a constituent assembly in 1973 that adopted a new constitution.

In the interest of administrative efficiency, the 1973 constitution chose to centralize revenue means by bringing sales taxation within the central government's domain. This measure accentuated the centralization tendencies in public spending responsibilities. The 1973 constitution also introduced as part of the Fourth Schedule a concurrent legislative list that enumerated the shared responsibilities of the federal and provincial governments. The intention of this list was to allow the provinces an interim period for preparation prior to their assuming their responsibilities. Instead, the federal government used this list to encroach on provincial and even local government responsibilities. The provinces, in turn, made local governments dysfunctional and took over their responsibilities (see Table 2).

The 1991 National Finance Commission (NFC) Award sought to rectify this by giving the provinces unconditional access to a large pool of federal resources. The award initiated a process of expenditure realignment, which, over time, was expected to give the provinces a greater say in areas of shared responsibilities, such as education and health. Nevertheless, it delinked spending and taxing decisions in a major way, and federal transfers to smaller provinces financed 99 percent of provincial operating expenditures. The military coup in 1999 reversed the trend toward greater provincial autonomy and centralized power, which was used to brutally crush political discontent in Balochistan, nourishing a separatist movement. The military regime also sought to debase the country's major political parties by devolving the responsibility for service delivery from the provinces to local governments. The military junta led by General Musharraf chose an indirect form of elections for local mayors as a vehicle for central control. The government also introduced complementary administrative and police reforms, which the civil service elite strongly resented. These reforms led to service delivery improvements at the local level but weakened provincial control over law and order. However, these reforms were incomplete as there was no attempt to rationalize federal and provincial powers. The federal government continued to encroach on provincial and local responsibilities in contravention of the division of powers laid down by the 1973 constitution (Shah, 1997). The major political parties refused to acknowledge even the

positive dimensions of these reforms and, on returning to power, sought to dismantle them in toto.

Democratic rule returned to Pakistan in 2008, and provincial empowerment and the dismantling of military-led reforms became a rallying cry for all political parties. These efforts led first to a consensus 7th NFC Award in 2009, effective from 1 July 2010 to 30 June 2015, which served as a major step toward building provincial harmony. The award placated Balochistan and Khyber-Pakhtunkhwa by including measures of poverty and inverse population density, and Sindh by including a tax effort indicator in the formula. It subsequently forged a momentous political consensus that culminated in the passing of the 18th Constitutional Amendment on 9 April 2010. The amendment sought to strengthen provincial powers and weaken the federal government's authority. The latter has, nevertheless, continued to take certain unilateral actions with adverse financial consequences for the provinces. One of the most egregious of these has been to grant federal civil servants a 50 percent salary increase in the face of a major fiscal crisis, in the process adversely impacting provincial finances as the provinces are forced by provincial unions to match such increases.

3. Implications of the 18th Amendment: Institutional, Fiscal, and Service Delivery

3.1. Institutional Implications

The 18th Constitutional Amendment is a landmark in legislation because it has introduced profound changes in the institutions of intergovernmental coordination. The most significant of these changes is the reassertion of two institutions of the federation—the Council of Common Interests (CCI) and the National Economic Council, which aims to strengthen provincial representation as discussed below.

3.1.1. The Council of Common Interests

The CCI was initially created by the 1956 constitution. It was chaired by the prime minister or by a federal minister on his/her behalf and comprised equal membership from the provinces and federal government. The CCI had jurisdiction over the federal legislative list and electricity, and was intended to serve as a forum to seek provincial input in the conduct of federal responsibilities. It was not, however, required to

meet periodically, and the federal government chose to make the institution dormant as it had little interest in provincial views.

The 18th Amendment attempts to reinvigorate this institution to deal with all matters relating to the federation. The CCI is to be chaired by the prime minister and include four provincial chief ministers and three federal government nominees as members. It will have a permanent secretariat and is required to meet at least once every quarter. The CCI has been entrusted with decision making, monitoring, supervision, and control responsibilities over the Federal Legislative List Part II, which includes the following: railways; minerals, oil, and natural gas; hazardous materials; industrial policy; electricity; major ports; federal regulatory authorities; national planning and economic coordination; supervision and management of public debt; censuses; provincial police powers beyond provincial boundaries; legal matters; regulation of the legal, medical, and other professions; standards in education and research; interprovincial coordination; and conflict resolution.

3.1.2. *National Economic Council*

The National Economic Council is also a constitutional body with oversight responsibility for national economic policies and has remained active in the past. Chaired by the prime minister, its membership previously had been left to the president's discretion, provided that at least one member from each province was represented. The 18th Amendment has tilted the balance of power on this council in favor of the provinces by mandating two members each, including the chief ministers of each province, and four federal members appointed by the prime minister. The Council must now meet at least once every six months.

In addition to strengthening these two institutions of the federation, the 18th Amendment has also introduced significant changes to the division of powers as discussed below.

3.1.3. *Constitutional Rearrangements in Pakistan*

The 18th Amendment has deleted the list of federal/provincial concurrent responsibilities and reassigned selective functions to the federation to be guided by the CCI and devolved others to the provinces. The former list consisted primarily of natural resources, electricity, and regulatory functions (see Table 2). The latter encompasses most economic and social services. Table 2 shows that the federal government has been

completely stripped of its responsibilities in planning, industry, agriculture and rural development, and social services and welfare (including social protection). This has resulted in the abolition of 17 ministries—with a combined budget of PKR 49 billion for the fiscal year (FY) 2011—including the ministries of food and agriculture, education, and health. Table 3 lists these ministries and their FY2011 budgets. These functions have been absorbed on a selective basis by the provinces in existing departments. With the abolition of the ministry of education, Pakistan joins Canada as the only two federal countries with no ministry of education at the federal level. With the abolition of the health ministry, Pakistan assumes a unique status among all federal countries.

The federal government has also been constrained in terms of its authority over banking, finance, and insurance as its regulatory authority no longer extends to provincially owned entities or private entities operating in a single province. The federal government has been mandated to consult the provinces prior to initiating any hydroelectric projects. The provinces, on the other hand, have been given a free hand in all public services delivered within their territory, and control over all local government institutions. All the residual functions not enumerated in the constitution also fall within the provinces' domain. Additionally, a new article has been inserted to provide the right to free education. Article 25A states that, "the state shall provide compulsory education to all children of the age of five to sixteen years in such manner as may be determined by law." Since education is a provincial responsibility, this article mandates the provinces to provide free secondary school education to all citizens seeking this service.

Table 2: Reassignment of spending and regulatory functions among different orders of government under the 18th Amendment

Federation/CCI (joint federal-provincial) tasks (Federal Legislative List Part II)	
Electricity	Provincial police operations beyond provincial boundaries
Minerals, oil, and natural gas	Industrial policy
Railways	National planning and national economic coordination
Major ports	Coordination of scientific and technological research
Censuses	All regulatory authorities under a federal law
Public debt	Standards in higher education and research, scientific and technical institutions
Federal corporate entities, including the Water and Power Development Authority and Pakistan Industrial Development Corporation	Interprovincial matters and coordination
Legal, medical, and other professions	
Federal functions (Federal Legislative List Part I)	
Defense	International and interprovincial trade
External affairs and international treaties	Nuclear energy
Immigration and citizenship	Airports, aircraft, air navigation, air and sea travel and shipment, lighthouses
Post and telecommunications	Patents, trademarks, copyrights
Central banking, currency, foreign exchange	Stock exchanges and futures markets
Corporate regulation, including banking and insurance	National highways and strategic roads
Fishing beyond territorial waters	Federal geological surveys and meteorological organizations
Standards of weights and measures	Local government in cantonment areas
Provincial responsibilities	
All residual functions	
Local government responsibilities	
Determined by provincial government	

Source: Constitution of Pakistan (2010). Fourth Schedule.

Table 3: Federal ministries/divisions abolished*

Rank order	Federal ministry	FY2011 budget (PKR mn)	Rank order	Federal ministry	FY2011 budget (PKR mn)
1	Food and agriculture	19,800	10	Livestock and dairy	486
2	Health	15,711	11	Labor and manpower	434
3	Education	3,093	12	Minorities	220
4	Social welfare and special education	2,130	13	Tourism	218
5	Population welfare	1,969	14	Women development	173
6	Youth affairs	1,569	15	Special initiatives	138
7	Environment	820	16	Local government and rural development	78
8	Sports	654	17	Zakat and usher	26
9	Culture	579		Total (17)	49,099

* Effective 1 July 2011.

Source: Pakistan, Ministry of Finance. Federal budget for FY2011.

There has also been a limited reassignment of taxing powers (see Table 4). The federal government has been empowered to levy taxes on the sale of goods and on the capital value of financial assets. In the past, it had exercised these powers because the provinces had voluntarily surrendered the right to sales taxation in the interest of improving the efficiency of tax administration. The federal government has also been asked to cede responsibility for taxes on immovable property, estate and inheritance taxes, value-added tax (VAT) on services, and zakat and usher (religious taxes) to the provinces. The resulting reassignment of taxes is detailed in Table 5. Provincial borrowing privileges have been expanded to include domestic and foreign loans, subject to limits and conditions imposed by the National Economic Council.

Table 4: Reassignment of taxing powers among different orders of government under the 18th Amendment

Federal taxing powers	
Added:	
Taxes on the sale and purchase of goods	
Taxes on the capital value of assets, excluding immovable property	
Deleted:	
Estate and inheritance taxes (wealth tax, including agricultural wealth)	
VAT on services	
Zakat and usher	
Provincial taxing and financing powers	
Added:	
VAT on services	
Taxes on immovable property	
Zakat and usher	
International and domestic borrowing, subject to limits and conditions imposed by National Economic Council	
Local government taxing powers	
No change	

Source: Constitution of Pakistan (2010) – Fourth Schedule

Table 5: Reassignment of taxes to various orders of government*

Tax/fee/surcharge	Determination of		Tax collection and admin.	Share in revenues (%)		
	Base	Rate		Federal	Provincial	Local
Federal						
Personal income and corporation taxes (excl. on agriculture income)	F	F	F	42.5**	57.5**	0
Customs duties, incl. export duties on cotton and jute	F	F	F	100	0	0
Excise duties (excl. opium, liquor, narcotics, sugar, tobacco, and gas)	F	F	F	42.5**	57.5**	0
Excise duties on sugar, tea, tobacco, and betel nut	F	F	F	42.5**	57.5**	0
Excise duty on natural gas	F	F	F	2	98	0
Sales tax on goods	F	F	F	42.5**	57.5**	0

Capital value tax on immovable assets	F	F	P	100	0	0
Royalty on crude oil	F	F	F	2	98	0
Royalty on natural gas	F	F	P	2	98	0
Air travel tax	F	F	F	100	0	0
Surcharge on natural gas	F	F	P	0	100	0
Surcharges on mineral oil and electricity	F	F	F	100	0	0
Provincial						
Tax on property transfers	P	P	P	0	15	85
Property tax ⁴	P	P, L	P, L	0	15	85
VAT on services	P	P	F, P	0	100	0
Zakat ¹	P	P	F	0	100	0
Usher ¹	P	P	F	0	100	0
Taxes on professions, callings, and trades ⁶	P, L	P, L	P, L	0	100***	100***
Agricultural income tax ²	P	P	P	0	100	0
Capital gains tax ³	P	P	P	0	100	0
Excise duties on opium, liquor, and narcotics	P	P	P	0	100	0
Stamp duties	P	P	P	0	100	0
Cotton fee	P	P	P	0	100	0
Betterment tax	P	P	P	0	100	0
Electricity duty	P	P	P	0	100	0
Court fee	P	P	P	0	100	0
Education cess	P	P	P	0	100	0
Motor vehicle taxes ⁵	P	P	P	0	100	0
Tolls on roads and bridges	P	P	P, N	0	0	100
Taxes on cinemas and hotels	P	P, L	P, L	0	100***	100***
Arms license fees	P	P	P	0	100	0
Entertainment taxes	P	P, L	P, L	0	100***	100***
Rates on services (water supply, drainage, lighting)	P, L	P, L	P, L	0	100***	100***
Local						
Export tax	P, L	L	L, N	0	0	100
Market fees	L	L	L	0	0	100
Fees at fairs, agricultural shows, etc.	L	L	L	0	0	100
Fees for specific services	L	L	L	0	0	100

Tax for construction and maintenance of public utilities	L	L	L	0	0	100
Taxes on other-than-motor vehicles	L	L	L	0	0	100
Tax on advertisements	L	L	L	0	0	100
School fees	L	L	L	0	0	100
Fees on sale of cattle at fairs	L	L	L	0	0	100
Tax on lands not subject to local rates	L	L	L	0	0	100
Tax on hearths	L	L	L	0	0	100
Tax on births, marriages, and feasts	L	L	L	0	0	100
Conservancy rate	L	L	L	0	0	100
Fees for erection of buildings	L	L	L	0	0	100
Fees for animal slaughter	L	L	L	0	0	100
Surcharge on any tax levied by the provincial government	L	L	L	0	0	100

* Effective 1 July 2010.

Notes: F = federal, P = provincial, L = local, N = private.

1 Islamic welfare tax that is not deposited into the Consolidated Fund and does not form part of the budget.

2 So far legislated by the governments of Punjab, Sindh, and NWFP (now Khyber Pakhtunkhwa).

3 Was abolished in 1986 by all provincial governments except Balochistan.

4 In the Lahore metropolitan area, the provincial government retains 57.5 percent of revenues as one half of the 85 percent share of MCL goes to WASA, a provincial agency. In Balochistan, it is shared on a 5:95 basis.

5 In Balochistan, 50 percent of the revenues are shared with local governments.

6 Each government (i.e., provincial and local) retains 100 percent of their portion of collected tax.

** 5 percent of tax revenues are retained by the federal government as administrative charges; the rest is divided up as specified.

** "100,100" sharing indicates that the tax base is co-occupied; each level of government retains its own full share of the tax.

3.1.4. Outlook for Provincial Finances

The 18th Amendment has expanded the provinces' tax domain to include a dynamic and buoyant tax base—sales tax on services. This base alone, if effectively taxed, could yield revenues equivalent to 0.5–1% of gross domestic product (GDP). The Institute of Public Policy (IPP) (2011) conservatively estimates it at 0.5 percent of GDP for FY2012. Since FY1997,

the provinces have also levied agricultural income taxes but these have extremely low yields. The IPP also notes that both the presumptive tax rate (PKR 150–250 per acre) and penalties for noncompliance (maximum PKR 1,000 in nominal terms) are extremely low. In fact, the penalty for failing to file a return of PKR 1,000 is absurdly low and creates incentives for noncompliance. It has recommended raising the presumptive tax rate to PKR 750–1,250 and the noncompliance penalty to PKR 10,000. The proposed increases are fairly modest and still may not be able to induce compliance. To raise significant revenues, the effective tax rate should be at least 20 percent of income for large farms (more than 25 acres), which would translate into a rate of PKR 3,000 per acre in real terms. The penalty for failure to file a return has to be punitive to ensure voluntary compliance and for large farms must be at least PKR 1,000,000 plus assessed back taxes marked up by the rate of inflation plus 10 percent. Note that, ideally, agricultural income should be taxed as ordinary income in addition to having a local land tax on agricultural lands. These options, however, have been ruled out by the relevant constitutional provisions.

Provinces also have the potential of raising additional revenues through capital value taxes on property and estate, and through inheritance taxes and environmental taxes and charges. All these fields are currently either underexploited or unexploited. Overall, the provinces have the resources needed to raise additional revenues from their own sources but perhaps not the incentive, as they have traditionally happily depended on manna-from-heaven transfers (NFC awards) and clamored for increased revenues from this source rather than raising revenues from their own sources.

The 18th Amendment has also opened the door for greater access to capital finance by permitting both internal and external borrowing, subject to limitations imposed by the National Economic Council. Previously, the provinces had been prevented from such access and required federal government approval for such actions so long as they owed it any debt, which they always did.

3.2. Fiscal Implications of the 18th Amendment

With the 18th Amendment, almost all direct public services become a provincial responsibility. As a consequence, 17 central government ministries have been devolved to the provinces. As mentioned earlier, some of the retained functions of the abolished ministries have been reassigned to the remaining ministries. For example, the People's Works

Program has been assigned to the Cabinet Division. The newly created Capital Administration and Development Division at the federal level has been entrusted to handle all those functions of the abolished ministries that have been retained by the federal government but not assigned to the remaining ministries.

Expenditure decentralization has also been accompanied by the much more limited decentralization of taxing powers, most notably for VAT on services. This is potentially a buoyant source of revenue. The revenue- and expenditure-related implications of these changes will be moderated by the federal government for the three-year transition period. The federal government has agreed to provide financing for vertical programs in health, such as the National Program for Family Planning and Primary Healthcare, the Expanded Program for Immunization, and the National TB Program for the next three years. It has also assured continued financing for the current and development expenditures of universities and the National Council for Human Development (NCHD).¹ The federal government will also continue to finance, during the transition period, the Planning Commission and the Higher Education Commission—two institutions with unclear mandates.

The federal government will also retain indefinitely about 65,000 employees whose positions have been made redundant as a consequence of the 18th Amendment and who the provinces appear reluctant to accept. So far, they have accepted only 15,000 federal employees who were posted to provincial field offices. With the transition arrangements in place, the federal deficit is expected to increase by about 3 percent, and collectively the provinces will be in surplus by the same amount (see Table 6). While Pakistan's federal finances are already in a precarious state, with an operating deficit at about 100 percent of operating revenues, this development will push the federal government further to the brink unless it takes corrective action through privatization and tax reform or by restructuring federal departments. Its past record in dealing with such issues is not admirable, but the situation can be overcome in a fully mature system by FY2015 provided the federal government is able to shed irrelevant structures and is either successful in transferring its redundant employees to the provinces or terminating their services. This is expected to be a difficult issue to resolve in the coming years since the redundant employees typically do not have the knowledge or skills to manage service

¹ The NCHD has about 16,000 employees but the provinces have refused to take over its functions and absorb its employees as they contend that the institution has mostly “ghost” employees.

delivery tasks but have significant political clout through their unions/associations.

Table 6: Fiscal consequences of the 18th Amendment

Fiscal year	Indicator	Federal share (%)	Provincial–local share (%)
FY2010 (2009/10)	Revenue collection	94	6
	Revenues retained	65	35
	Expenditure share	66	34
	Residual fiscal gap after transfers	-1	1
FY2011 (2011/12)	Revenue collection	90	10
	Revenues retained	61	39
	Expenditure share	64	36
	Residual vertical fiscal gap after transfers	-3	3
FY2015 (2014/2015)	Revenue collection	85	15
	Revenues retained	45	55
	Expenditure share	45	55
	Residual vertical fiscal gap after transfers	0	0

Source: World Bank staff estimates.

By the time the system matures in FY2015, the structure of government in Pakistan will have undergone a profound transformation from centralized federal power to centralization at the provincial level (see Table 7). For all economic and social services, the provinces will assume a dominant role in policymaking and service delivery. For the average citizen, the government that will then matter is the provincial government. The implications of such governance for responsive, responsible, fair, and accountable governance are taken up in the next section.

Table 7: Fiscal implications of the 18th Amendment for direct expenditure by function and order of government*

Expenditure function	Percentage							
	Federal FY2010	Provin. FY2010	Local FY2010	Total FY2010	Federal FY2015	Provin. FY2015	Local FY2015	Total FY2015
General administration	74	25	1	100	20	75	5	100
Defense	100	0	0	100	100	0	0	100
Debt servicing	85	15	0	100	85	15	0	100
Public order and safety	30	70	0	100	30	70	0	100
Economic services	26	50	24	100	10	66	24	100
Environmental protection	3	40	57	100	1	42	57	100
Housing and community services	0	84	16	100	0	84	16	100
Recreation, culture, and religion	53	32	15	100	5	80	15	100
Education	14	23	63	100	5	33	63	100
Health	9	51	40	100	5	55	40	100
Social protection	12	27	61	100	2	37	61	100
All	66	25	9	100	45	55	10	100

* Pre- and post (matured system in FY2015) 18th Amendment.

Source: World Bank staff estimates.

4. The 18th Amendment: Potential and Pitfalls

4.1. Potential Payoffs

The 18th Amendment has received plaudits from policymakers and scholars alike for its potential to improve the authorizing environment and allow the federal system to better function (see IPP, 2011). While such high expectations may need to be tempered, the amendment, nevertheless, offers a number of positive potential payoffs. These include the following.

- *Reduced threat of military intervention (?)*. Its foremost merit is that it might limit the threat of military adventurism. The Pakistani military has a long tradition of intervening in domestic politics on one pretext or another—the last being that the prime minister did not

follow due process in removing the military chief. Such temptation might be tempered in the event that critical responsibilities and decision-making rest with the provinces rather than the federal government. Thus, by shifting the power locus to the provinces, the 18th Amendment may have paved the way for reduced military political adventurism in the future. If this prediction materializes, then it would be considered the crowning achievement of this constitutional reform. It is doubtful, though, that the military will be restrained as they may choose to redefine the division of powers consistent with their own wishes.

- *Greater harmony in federal–provincial relations.* The 18th Amendment has reinforced provincial autonomy consistent with the original intent of the 1973 constitution and, in doing so, has removed an important irritant in federal–provincial relations. The amendment has narrowed the opportunity for arbitrary federal intervention in provincial affairs and, therefore, may have gone some distance in limiting provincial discontent with federal policies. The proper working of the CCI provides an opportunity to build trust and harmony in federal–provincial relations in Pakistan and thwart separatist movements spawned by federal unilateralism or by the high-handedness of military regimes.
- *Greater clarity in government accountability.* With the new constitutional order, both policy determination and service delivery responsibilities have been concentrated at the provincial level. This makes it clearer to citizens which order of government to hold to account for dysfunctional service delivery as the buck now clearly stops at the provincial chief minister’s doorstep.
- *Moving the government closer to the people (?).* The 18th Amendment has also moved the government a few small steps closer to the people. If this leads to greater citizen participation in public affairs, it has the potential to make governments more responsive and accountable to the people.

4.2. Pitfalls and Risks

While the discussion and debate leading up to the passage of 18th Amendment represented a unique opportunity—the only one after the enactment of the 1973 constitution—this opportunity has been largely lost as the amendment has failed to address some of the fundamental challenges of fiscal federalism in Pakistan. This is discussed below.

- ***Reforming multi-order governance in Pakistan.*** This would have required a comprehensive review of the roles and responsibilities of all orders of government—federal, provincial, local, and beyond government—in delivering public services (see Shah, Ahmad, Boadway, Chaudhry, Huther, Mukhtar, & Pasha, 1996; Shah, 1997 for pathways to such reform). Instead, the amendment simply focuses on devolving functions from the federal government to the provinces to the neglect of rationalizing the former's central functions or the latter's provincial functions. It also completely neglects the role of local governments and beyond-local-government entities in public services delivery.
- ***The federal functions of the federal government.*** Securing a common economic union; a harmonized tax system; protecting minorities and disadvantaged groups; and dealing with natural disasters, emergencies, and calamities such as floods and earthquakes are considered among the core functions of the federal government but have been left out of federal domain. At the other extreme, a purely local function, such as the People's Works Program, has been centralized to the Prime Minister's Office despite its already being overloaded with work.
- ***Natural resource ownership.*** For political and economic union, it is important that ownership of the country's natural resources be vested in the nation as a whole, and that the revenues from those resources be invested in a national heritage fund rather than being made available to any order of government for current use. All citizens of Pakistan would hold equal shares in this fund and receive annual dividends as done in Norway. Various orders of government would be eligible to receive a fraction of the fund's earnings for investment in long-lived assets. In Pakistan, ownership of natural resources is currently vested in the provinces, to which current revenues accrue. This creates both the potential for "Dutch disease" as well as interprovincial conflict. Pakistan has already experienced serious interprovincial conflict in water and gas distribution across the provinces.
- ***A roadblock to tax reform.*** In tax areas, by reasserting the powers of the provinces to tax agricultural income, capital gains, and services, the amendment may have blocked avenues for reform in creating a modern income and sales tax system in Pakistan. Instead, it has strengthened opportunities for tax evasion by enabling tax arbitrage by potential taxpayers who can now shift their income to agriculture and business expenses from higher taxed sectors or sources of income.

- ***Finance does not follow function.*** A decentralized fiscal system works best when expenditure decentralization is accompanied by tax decentralization so that spending decisions and any associated tax increases have to be presented to the public and defended. This helps control the leviathan tendencies associated with a reliance on higher-level fiscal transfers to finance subnational expenditures. The amendment has missed the opportunity to realign finance with function according to the order of government, which would have allowed greater accountability.
- ***Rightsizing the federal government.*** Even in the implementation of the amendment, the federal government has failed to seize the opportunity to realign its organizational structure with the new mandate. Instead, it has retained all redundant employees and continues to finance vertical programs as though it was financing its line agencies rather than instituting grant programs with specific objectives and accountability mechanisms. It has also allowed the Planning Commission, Higher Education Commission, and National Centre for Human Development to continue without rethinking their roles and appropriate new institutional structures to perform those roles.
- ***Federal government's lack of access to financing instruments to secure a common economic union.*** The amendment does not revisit the financing of the provincial governments through fiscal transfers. The NFC awards have the twin objectives of dealing with the vertical fiscal gap and horizontal equalization. With the devolution of social services and infrastructure responsibilities to the provinces, the federal role in providing financing for these services to set national minimum standards for merit services and to secure common economic union gains prominence. At present, however, there is no instrument available to further the federal government's spending power to advance national objectives.
- ***Increased risks to macro-stability with provincial government ownership of financial institutions.*** The 18th Amendment has also empowered provinces to borrow from domestic and international sources, subject to conditions imposed by the National Economic Council. However, the Council may not be able to discipline such borrowing as effectively as provinces' own banking and other financial and nonfinancial institutions. Non-arms-length borrowing from such institutions may go undetected as happened in Australia in the 1970s under the (old) Australian Loan Council, in Brazil in the 1990s, and more recently in China. In Brazil, such borrowing led to

state and local government bankruptcies, including in the largest and richest state of Sao Paulo. In China, local governments are prohibited from borrowing but they use their autonomous enterprises to borrow from the financial sector and then make transfers to the local government. Such borrowing is estimated to be worth about one trillion yuan and poses significant risks to China's macro-stability. The Chinese government has recently taken steps to "discover" these loans and reduce the debt burden of local governments.

- ***Potential for confusing and contradictory regulatory standards with high transaction costs for business and citizens.*** Even in the areas with which it is concerned, the amendment has created major anomalies. For example, national uniform standards are required for drug approval; pharmaceutical regulations; food and agricultural safety inspection; the control and disposal of hazardous materials and waste; water and air pollution; highway safety standards; consumer product safety standards; and social safety nets. These areas have now all been relegated to the provinces, creating potential for a jungle of confusing and contradictory standards with high compliance and administration costs. Imagine the consequences for businesses and consumers if each province were to decide to set up its own food and drug regulatory agency as stipulated by the amendment.
- ***Potential for greater barriers to goods and factor mobility.*** Finally and most importantly, the 18th Amendment has failed to institutionalize any constraints on barriers to factor and goods mobility across the country. Instead, it has opened up the potential for such barriers by recognizing provincial authority to discriminate against nonresidents. Article 27(2) of the amendment overrides the safeguard against discrimination in employment by empowering provinces and local governments to institute a three-year local residency requirement. This poses a serious risk to economic union in Pakistan.

5. Conceptual Perspectives and Lessons from International Practices on Multi-Order Governance in an Information Age

In this section, we take a step back from the governance model adopted by the 18th Amendment, and take a conceptual and international perspective instead. We review the pros and cons of the federalism model adopted by the amendment and its relevance in the information age, and reflect on the new governance structures required for economic success in a globalized, interconnected world. In doing so, we draw heavily on the analysis presented in Shah (2010a) and Boadway and Shah (2009).

The genesis of the 18th Amendment is the “holding together” view of federalism, also called the “new federalism.” It represents an attempt to decentralize responsibilities from the federal government to the states or provinces with a view to overcoming regional discontent with central policies and forestalling secessionist tendencies. This view is the driving force behind the current interest in principles of fiscal federalism in unitary countries, in relatively newer federations such as Brazil, India, and Pakistan, and in emerging federations such as Iraq, Nepal, Spain, Sri Lanka, and South Africa.

In Pakistan, this was the primary motivation for unanimous consent to the recently passed 18th Amendment to Pakistan’s constitution. The amendment has eliminated the concurrent functions list (overlapping functions), separating and making distinct from each other the responsibilities of the federal and provincial governments. In doing so, it has moved away from the earlier “layer-cake” model of dual federalism to a “coordinate authority” model. In the layer-cake model that had prevailed in Pakistan till 2010, there was a hierarchical relationship among the federal, provincial, and local governments with the federal government at the apex as the dominant player. Under the “coordinate authority” model of dual federalism adopted by the 18th Amendment, provincial governments will enjoy significant autonomy from the federal government while local governments will simply be creatures of the provincial government.

5.1. The Potential of Pakistan’s Dual Federalism Model

The “coordinate authority” model of dual federalism empowers provinces and states. This is considered sound as it moves decision making somewhat closer to the people. It also has the advantage of dealing with ethnic and linguistic conflicts if a country comprises numerous provinces that are small enough geographically and represent populations with relatively homogeneous characteristics for a menu of taxes and public services (as cantons in Switzerland). If provinces are properly delineated as economic regions, then they can enhance the efficiency of the internal common market by exploiting economies of scale and scope. They also have the potential to deal with inter-local spillovers and intra-regional inequities. Provincial governments can also be responsive to citizen preferences if not captured by feudal, industrial, and military elites. Additionally, the absence of a well-developed communication and transportation system and lack of urbanization also makes provinces a virtual necessity for countries that span a large geographic area.

The dimensions mentioned above, however, have limited relevance for Pakistan, which comprises only four large provinces with heterogeneous ethnic and linguistic populations and one dominant province in which the majority of the population lives. Historical records from other countries show that federal countries with less than eight constituent units have typically proven politically unstable. The provincial boundaries in Pakistan are not synonymous with economic regions but are historical accidents representing the best wisdom of the British colonial empire for control of the local population. There is also a significant degree of feudal, military, and elite capture of provincial governments. Moreover, Pakistan has a well-developed communications and road infrastructure network, which also diminishes the economic relevance of the provinces.

5.2. The Pitfalls of Dual Federalism in Pakistan

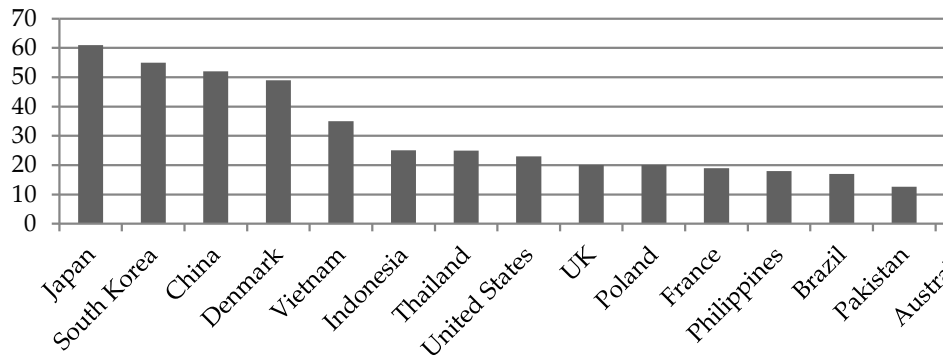
The dual federalism model empowering provinces, nevertheless, has significant conceptual shortcomings. These include the following.

- *Tragedy of the commons associated with common pool resources.* Under dual federalism, both the center and the provinces compete to claim a larger share of the fixed national pie. This accentuates universalism and pork-barrel politics, leading to a tragedy of the commons where all federating units out-compete each other in wasteful spending and giveaways in taxes and subsidies. This tug of war over resources leads to zero-sum games; the resulting swings in the balance of power within nations are a perpetual feature of dual federalism. Pakistan, too, manifests these tendencies, as is evidenced by past negotiations on the NFC awards.
- *A leviathan model of governance.* Empowering provinces can create potential for the greater duplication of government structures and processes at central and provincial levels, leading to increased costs for the exchequer and higher transaction costs for citizens. This can also lead to overgrazing by politicians and bureaucrats. As a result, the growth in the size of government becomes unrelated to the quality and quantity of service delivery. Opportunism and pork-barrel politics leads to governments acting as employment creation agencies, detracting them from their primary role in financing public services. While there is no recent rigorous study available to refute or document this consideration in Pakistan, Shah et al. (1996) and casual empiricism suggest that, during the last two decades, public sector employment and the associated expenditures on wages and benefits have grown at the expense of reductions in other operating and development expenditures.

- ***Agency problems with incomplete contracts.*** In most large countries, empowering provinces does not necessarily imply that decision-making moves closer to the people. Provinces and states are often larger in terms of size/population than small countries—the governments of New York, California, Ontario, Sao Paulo, Punjab, Sindh, Balochistan, Bihar, and Gujarat have jurisdictions exceeding the size of many countries. Having decision-making far removed from the people implies that provincial governments have incomplete contracts with their citizens and cannot be held to account by the latter. In countries such as Pakistan where politics is dominated by feudal, military, and industrial elites, this lack of accountability can completely alienate governments from their people. It is accentuated when voice and exit options are constrained by provincial empowerment.
- ***Weaker and fragmented local governance.*** Empowered provinces create incentives for weaker and numerous local governments. The exigencies of provincial politics dictate that local governments are given straitjacket mandates with few resources, and kept under tight provincial reign as in India and Pakistan. Empowered provincial governments typically encourage local fragmentation in the interest of a higher degree of intrusive controls. In India, there are 254,119 local governments responsible for a fraction (5 percent) of national expenditures. Most of these expenditures go toward financing the salaries and allowances of civil servants and three million elected officials, with little left to deliver public services (see Figure 1).

In contrast, in China where the provincial role is restricted and local governments are more empowered, there are only 43,965 local governments accounting for 51.4 percent of national expenditures (Qiao & Shah, 2006). Pakistan's situation is similar to that of India, with few resources and responsibilities at the local level. The modest increase in these resources and the local autonomy granted under the previous military regime has already been formally stripped in Punjab and Sindh, and more informally in the other two provinces. In both Punjab and Sindh, the provincial governments have acted to curb local autonomy and reintroduce provincial controls through the elite civil service. The deteriorating law and order situation has been the primary motivation for these reversals but such moves could also forestall the emergence of good local governance in Pakistan.

Figure 1: Provincial empowerment is associated with weaker local governments and vice versa (2010)



Source: Shah (2010a).

- Stifled local innovations.** Provinces and states are apt to impose one-size-fits-all mandates that constrain local choices and flexibility, and stifle any innovative approaches. In Pakistan, the provincial ordinances of 2000 required all local governments, small or large, to have 16 departments and a fixed number of positions. In the US, outdated state laws rooted in an unjustified distrust of local decision-making have stifled successful cities from developing and implementing any coherent vision of their future and from better serving their residents (see Frug & Barron, 2008).
- Constrained good governance and metropolitan growth.** Empowered provinces typically block the rationalization of local government functions, especially when empowering local governments implies chipping away at their own powers. A classic example is that of the powers assigned to metropolitan areas under dual federalism. The literature on fiscal federalism suggests that large metropolitan areas should have autonomous two-tier regional governments with powers equivalent to that of a province and direct interface with the center. For this reason, the local governments in Tokyo, Shanghai and Beijing, Bangkok, Seoul, and Helsinki are treated by Japan, China, Thailand, the Republic of Korea, and Finland, respectively, as provinces. In contrast, in India and Pakistan, where provinces are relatively more powerful, metropolitan areas with large populations and significant economic bases such as Mumbai (21 million people with a large and dynamic tax base), New Delhi, Karachi, and Lahore, among others, are treated as typical local governments with limited autonomy. Such treatment deprives residents of the benefits of home rule and constrains their efforts in local economic development.

- ***Adverse impact on public service provision.*** The concentration of administrative power at the provincial level can create significant inefficiencies in public service provision that may be exacerbated by the breadth of provincial control. These controls may also limit private and not-for-profit sector participation in improving access to public services. Shah et al. (1996) document these concerns in Pakistan's context.
- ***Fragmentation of internal common market.*** Empowered provinces also have the potential to create internal barriers to trade and factor mobility through domicile (residence) requirements, and by creating protective regulatory and trade barriers across provincial borders. Mature federations such as the US have circumvented these problems by including an interstate commerce clause in the constitution. These barriers are, however, formalized in the political and bureaucratic system of India and Pakistan, resulting in a fragmented common economic union. The 18th Amendment has expanded the powers of the provinces to create barriers to factor mobility by allowing them to enact three years' domicile requirements for access to provincial public employment.
- ***Increased threat of succession.*** Provincial empowerment can also pose a potential threat to political union, especially in countries with ethnic, linguistic, and religious divides and a small number of provincial jurisdictions with one or more dominant provinces, such as Pakistan. The literature shows that, as a rule of thumb, all dual federalism models with less than ten provincial jurisdictions are likely to face internal conflict and political instability.
- ***Dual federalism ("federalism of provinces") versus international competitiveness in a globalized, localized, and interconnected world.*** The new world economic order dictates that the economic relevance of intermediate orders of government (provinces and states) has diminished, while that of local governments has expanded. The dual federalism model was relevant when Pakistan adopted its 1956 and 1973 constitutions but, sadly, constitutional dictums were subsequently ignored and a centralized federal system prevailed. The new economic order requires a more responsive, leaner, efficient, and accountable government structure.

Globalization and the information revolution are working to make the economic role of provinces largely redundant. Globalization empowers supranational regimes and local governments at the expense of national and provincial governments (see Table 8). It also implies that a country's international competitiveness is decoupled

from its resource base but directly linked to its knowledge base. This suggests that the national government could play a greater role in financing education and training.

National government also assumes greater importance in social risk management due to the vagaries of the global system and social dumping by corporations to stay internationally competitive. It plays a greater role in securing a common economic union. The provincial economic role, on the other hand, is likely to wane given that the information revolution makes national coordination and oversight over local governments and horizontal coordination at the local level through inter-local partnerships feasible, as done in Finland.

States and provincial governments are, therefore, under growing pressure to reposition their roles to retain their economic relevance. The political role of states and provinces, however, remains strong in all countries and is even on the rise in some, as in Germany, Pakistan, and India. In Germany, the Lander has assumed a central role in implementing European Union directives and in policymaking for regional planning and development. In India, states have effectively blocked the implementation of the 73rd and 74th amendments to the constitution (passed in 1992), which empower local governments. In Pakistan, the provinces have recently moved to scale back local governments' fiscal and administrative autonomy.

Economic interests in an information age warrant that the modern role of a local government is to deal with market failures as well as government failures. This role requires local government to operate as a purchaser of local services, as a facilitator of networks of government providers and entities beyond governments, and as a gatekeeper and overseer of province/state and national governments in areas of shared rule. Local governments also need to play a mediatory role among various entities and networks to foster greater synergy and harness the untapped energies of the broader community to improve residents' quality of life. Globalization and the information revolution have reinforced these conceptual perspectives, superimposing them on a catalytic role for local governments. This view is especially grounded in the history of developing countries.

Table 8: The 18th Amendment and comparative models of governance

20th century	21st century
Centralized or provincialized	Globalized and localized
Center that manages	Center that leads
Citizens as agents, subjects, clients, and consumers	Citizens as governors and principals
Bureaucratic	Participatory
Command and control	Responsive and accountable
Internally dependent	Competitive
Closed and slow	Open and quick
Intolerance of risk	Freedom to fail or succeed
Focus on government	Focus on governance with interactive direct democracy
Competitive edge for resource-based economies	Competitive edge for human capital-based economies
Federalism as a tool for coming together or holding together	Global collaborative federalism with a focus on network governance and reaching out
Local governance based on residuality principle, <i>ultra vires</i> , "Dillon's rule"	Local governance based on community governance principle, subsidiarity principle, home-/self-rule and shared rule
Limited but expanding role of global regimes with democracy deficits	Wider role of global regimes and networks with improved governance and accountability
Emerging federal prominence in shared rule	Leaner but caring federal government with an enhanced role in education, training, and social protection
Strong provincial role	Ever-diminishing economic relevance of provinces; tugs-of-war to retain relevance
Diminishing role of local government	Pivotal role of local government as the engine of economic growth, primary agent of citizens, gatekeeper of shared rule, and facilitator of network governance. Wider role of "beyond-government" entities, mediator of conflicts, developer of social capital, and purchaser but not necessarily provider of local services
Tax and expenditure centralization with revenue sharing (NFC awards type) and input based conditional grants to finance subnational expenditures	Tax and expenditure decentralization with fiscal capacity equalization and output-based national minimum standards grants

Source: Adapted from Boadway and Shah (2009).

In the Nordic countries and in ancient civilizations in China, India, and Pakistan, local government was the primary form of government until wars and conquest led to the transfer of local government responsibilities

to central and provincial/regional governments. This trend continued unabated until globalization and the information revolution highlighted the weaknesses of centralized rule in improving quality of life and social outcomes. This view is also relevant for carving out and sustaining a competitive edge in international economic relations as demonstrated by China's recent experience. Empowering local governments and strengthening their role in local economic development ushered China into an era of sustained economic growth, and helped lift billions out of the poverty trap (see Box 1).

Box 1: China is shining on the world economic stage—thanks to its unshackling of its local governments

China is an economic powerhouse poised to assume world economic leadership in the coming decades. It has held a sustained record of economic growth—an average annual growth rate in real per capita GDP of 10 percent over the last three decades, which nearly tripled its per capita income from 1978 to 2010—and prosperity. Its record in alleviating poverty is unparalleled in the economic history of the world—the country has reduced its poverty headcount rate from 31 percent in 1978 to less than 2 percent in 2008. These facts are well known. But what is less well known is that this came about because Deng Shao Peng in 1979 unshackled local governments and unleashed their innovative spirit and energies in pursuit of economic growth and local economic development.

China has one of the most empowered local governments, which serve their residents from cradle to grave. Local governments command an 89 percent share of public sector employment and a 51 percent share of consolidated public expenditures. Other than defense, debt, and foreign affairs—which are the exclusive domain of the center—all other functions, including education, health, and social insurance, are the responsibility of local governments. There is no uniform model and all local governments pursue their own unique approach to service delivery and local economic development. Contracting out service delivery to autonomous service units is widely practiced. The provincial role is weak and largely limited to agriculture and providing coordination and oversight of local governments on behalf of the center.

Thus, China, while it has a unitary constitution, bears an affinity to the hourglass model of federalism. There is strict accountability to citizens at all orders of government through a directly elected people's

congress at each level. In addition, Communist Party oversight committees at every level monitor citizen satisfaction as well as dissatisfaction (number of protests). Higher-level oversight of local governments is based on objective results-based criteria that incorporate: (i) local economic development performance; (ii) local service delivery performance; and (iii) citizen satisfaction. Local government success is rewarded by greater local autonomy and sustained failure is punished by reduced autonomy and intrusive oversight and controls by higher-order governments.

Source: Qiao and Shah (2006).

6. Province Building and its Incompatibility with Nation Building

The 18th Amendment represents both opportunities and challenges. Here, we take stock of the major challenges that could arise from provincial empowerment.

6.1. Challenges to Peace and Order

Given that Pakistan has only a handful of unbalanced federating units, there is significant potential for federal–provincial and inter-provincial conflict, which could be accentuated by empowered provinces. The CCI may not be in a position to deal with such easily triggered issues. There is even greater potential for intra-province conflict, as is already happening in Sindh. The federal role in the international “war on terror” might also be circumscribed since law and order functions, especially police protection, now rest primarily with the provinces.

6.2. Challenges to Good Government

As outlined earlier, the 18th Amendment supports a model of multi-order governance that may not be in tune with Pakistan’s present needs. For this model to work well, Pakistan needs enlightened leadership and a professional and specialized bureaucracy at the provincial level that will work selflessly in the national interest rather than simply focusing on province building. These traits are not always found, even in developed countries. The risks, as discussed below, in the absence of appropriate checks and balances could be significant in such an environment, as demonstrated by the history of Pakistan and of other countries.

In the absence of fundamental reforms in political parties' governance, political finance, land reforms, and devolution to the local levels, provincial empowerment may not necessarily lead to greater participation and accountability, while corruption and abuse of power may continue unabated. The provincial political leadership, if operating on a short-term horizon, may choose to use provincial government agencies as employment creation agencies to entrench its support base and, in the process, create a leviathan model of governance. Tendencies to bow to the leadership under political pressure might allow legislators to encroach on executive functions, undermining the integrity, rationality, and accountability of public decision-making. (This role is already pervasive in Pakistan and further entrenched by special allocations for each provincial assembly member.) Pakistan has a civil service culture of rotating appointments, which accentuates this culture of mis-governance and lack of accountability. While several commissions have been mounted to undertake comprehensive civil service reforms, all such efforts have been to no avail. The 18th Amendment may have made the pursuit of such reforms even more difficult.

6.3. Challenges to Economic Development and Service Delivery

On economic and service delivery fronts, the prospects for improvements are even more uncertain. The provinces might pursue beggar-thy-neighbor policies and create barriers to trade and factor mobility, thereby fragmenting the internal common market. The 18th Amendment has made it easier to pursue such policies by recognizing provincial rights to discriminate against nonresidents based on residence requirements. Given the predominance of manna-from-heaven transfers in provincial financing, the provinces have no incentive to meet national minimum standards in public services, while the federal government has no levers to induce compliance. Standards other than respect for basic human rights are intended to facilitate the integration of slow-growing provinces in the broader national economy by creating a level playing field.

Under the new governance arrangements, land and tax reforms may also be more difficult to accomplish in view of the split of services from goods and of agricultural income from ordinary income. The reform of the revenue sharing system (the NFC awards) to introduce results-based accountability while respecting provincial autonomy might also not be feasible since the provinces are unlikely to have an interest in any arrangements that move them away from the status quo of "autonomy without accountability" that comes with unconditional formula-based

revenue-sharing federal transfers (the so-called manna from heaven transfers). In the absence of a legal framework for fiscal responsibility, the risks to macro-stability through provincial non-arms-length access to bank financing can be hardly overstated. Additionally, service delivery disruptions associated with political imperatives cannot be ruled out.

7. A New Vision of Federal Governance in Pakistan: An Hourglass Model of Federalism

After more than 60 years of existence, Pakistan still faces existential threats, mostly from within. The 18th Amendment may have unintentionally compounded these threats by reasserting a failed and outmoded model of federal governance. In Pakistan, both centralized federal governance and centralized provincial governance have failed to deal with deteriorating law and order and the delivery of basic services. Rather than assuring citizens their security of life, liberty, and property, government agencies are often seen as impediments to these and to citizens' economic advancement.

To overcome this trust deficit, Pakistan sorely needs to fundamentally restructure its political and economic governance. The guiding principles of this restructuring should be that (i) people are sovereign—the governors and masters of all orders of government; (ii) various orders of governments are agents and serve at the behest of the people; (iii) local governments are the primary agents of the people and responsible for securing their interests in ensuring security of life and property, and improving social and economic outcomes; and (iv) there must be a constitutional guarantee that no government can erect barriers to goods and factor mobility, including provincial–local residency requirements, or infringe on the freedom and liberty of its citizens.

This hourglass model of federalism is based on the following division of powers:

1. *Federal government*. Responsible for defense, police, currency, foreign affairs, protection of minorities, regulation of internal and international trade, communications, electricity, water, natural gas, equalization, and results-based financing to ensure national minimum standards in merit (education, health, social welfare, unemployment insurance, social security, and infrastructure) services.
2. *Provinces*. Inter-local functions (services) and inter-local and central–local coordination.

3. *Local governments.* All service delivery responsibilities except those noted above.
4. An independent tax authority that administers taxes for all orders of government.

This vision will require a newer and a leaner structure of provincial governance where the provincial legislature is not directly elected but simply comprises ex-officio directly elected heads of local government in the province, providing oversight to a provincial executive comprising a federally appointed governor and locally recruited civil servants. The provincial legislature would further act as an inter-local coordination body. The size of a provincial jurisdiction would also be capped at a maximum of 15 million people or 30,000 square kilometers to create a more balanced federal system.

8. Concluding Remarks

In over 60 years, Pakistan has moved from crisis to crisis. An important reason for its dysfunctional governance is the ruling elite's lack of adherence to constitutional principles. In the words of a Pakistani scholar, successive regimes have transformed the country from a "state" to an "estate" for the ruling elite (Niaz, 2010). While such criticism may be unjustifiably harsh, it nevertheless captures the growing negative perception of public sector performance in Pakistan.

The 18th Amendment is well intentioned in its aim to bring greater clarity to the roles and responsibilities of various orders of government, and to ensure greater provincial autonomy to reduce incentives for military interventions in the political system. However, the amendment must be seen as only the first and incomplete step—and in some respects a misstep—toward reforming public governance in Pakistan. To complete this process, further fundamental reforms are needed to ensure that the public sector serves the public interest and secures a common political and economic union. Important first steps in this direction would include the devolution of most provincial powers, except those dealing with inter-local coordination and oversight, to local governments; constitutional guarantees to overcome internal barriers to trade and factor mobility; and a framework for fiscal responsibility and fiscal discipline for all orders of government.

This is an enormous unfinished agenda for reform that needs to be undertaken over the coming years. A beginning must be made now by recognizing the need for reforms and developing a strategy to reach a

national consensus on the directions for reform. In the words of a Chinese philosopher, "All long journeys start with the first small steps." The 18th Amendment must be seen as that first step in the long journey to restore Pakistan to its original glory. Indeed, the reform process is eternal. We may never fully succeed but we must keep trying.

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