

# Devolution in Pakistan - preparing for service delivery improvements

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## Background

The World Bank, ADB and DfID have agreed with the Government of Pakistan that they will jointly undertake a Devolved Service Delivery (DSD) study, to review progress towards improving service delivery through decentralization. Government has emphasized that they are looking for feasible, practical recommendations that add value to a devolution process that is well advanced. Two products of the work have been identified:

Product 1: *Issues and Options Notes* - a series of short, published notes and associated workshops that look at emerging concerns and difficulties posed by devolution, with an emphasis on pragmatic, immediate steps that could be taken to alleviate difficulties faced by local governments. Government has emphasized that these should set out a range of options for action, rather than suggesting a single preferred policy direction.<sup>1</sup>

Product 2: *Overview of the service delivery implications of devolution* - a comprehensive but short and readable summary of the emerging lessons and implications for both policy and operational practices. Government has made the point strongly that this should not be an assessment of the larger legal or political arrangements. Government notes that the focus of the paper must be on pragmatic actions for service delivery improvements at district and tehsil level, based on reasonable assumptions about the likely preconditions for service delivery.

This working paper is a step towards the second product. The authors have drawn comprehensively on the extensive published outputs from the NRB and a range of informal outputs including presentations and conference notes.

The DSD will be informed by the following datasets:

Dataset 1: *District Studies* - new, largely qualitative, data gathered from six districts (and a selection of tehsils within them) on their experiences to date gathered through the use of a series of sector-specific templates systematically reviewing experience to date with sectoral concerns including public expenditure, civil service, politics, water and sanitation health, education, and access to justice issues. The districts identified by government for this study are:

Punjab: Faisalabad and Bhawalpur  
Sindh: Karachi and Khairpur  
NWFP: Bannu  
Balochistan: Killa Saifullah

The District Studies will get underway during the first week of July and will end the first week of September 2003.

Dataset 2: *Intergovernmental Flows of Funds* - a model of fiscal flows underpinned by a comprehensive database of revenue and expenditure for district governments and tehsils. The model will allow:

- Some analysis of the overall fiscal architecture and in particular the combined effect of the Provincial and National Finance Commission Awards under alternative scenarios - illustrating the impact of revenue reassignments or of any changes in funding assumptions;
- An assessment of the impact of any 'lumpiness' in revenue, assessing the cash flow problems that the provinces are flagging as the major reason for their slow movement towards the devolution of civil service pay; and
- A comparison to be drawn between the intended and the actual behavior of provinces in transferring funds, assessing how predictably districts received their anticipated funds.

It is hoped that this database will be updated and republished each year to support informed debate by local governments, finance agencies (e.g., Province Finance Commissions) and the general public.

## Acronyms

ACR	Annual Confidential Reports	MMA	Muttahida Majlis-i-Amal (political party)
ADB	Asian Development Bank	MNA	Member of National Assembly
ADPs	Annual Development Plans	MoWD	Ministry of Women’s Development, Social Welfare & Special Education
AG	Accountant General	MPA	Member of Provincial Assembly
AGP	Auditor General of Pakistan	MQM	Muttahida Quaumi Movement
AGPR	Accountant General Pakistan Revenues	MVT	Motor Vehicle Tax
AIT	Agriculture Income Tax	NAM	New Accounting Model
APT	Appointment, Promotion & Transfer	NFC	National Finance Commission
BHU	Basic Health Unit	NGO	Non-governmental Organization
BPS	Basic Pay Scale	NIH	National Institutes of Health
CBR	Central Board of Revenue	NPA	National Plan of Action
CCB	Citizen Community Board	NPSC	National Program Steering Committee
CDMD	City Development and Municipal Department	NRB	National Reconstruction Board
CED	Central Excise Duties	NWFP	North West Frontier Province
CEDAW	Convention on Elimination of All Forms of Discrimination Against Women	OZT	Octroi and Zila Tax
CFAA	Country Financial Accountability Assessment	P&D	Planning and Development
CGA	Controller General of Accounts	PCA	Police Complaints Authority
DAOs	District Account Officers	PCF	Provincial Consolidated Fund
DCO	District Coordination Officer	PCP	Pakistan Centre for Philanthropy
DfID	UK Department for International Development	PERI	Punjab Economic Research Institute
DMG	District Management Group	PFCs	Provincial Finance Commissions
DoF	Department of Finance	PHED	Public Health Engineering Department
DOs	District Officers	PIFRA	Pakistan Improvement to Financial Reporting and Auditing Project
DPO	District Police Officer	PO	Police Order
DPR	Development Policy Review	PPP	Pakistan People’s Party
DPSC	District Public Safety Commission	PRGF	IMF Poverty Reduction and Growth Facility
DRTAs	District Regional Transport Authorities	PRSP	Poverty Reduction Strategy Paper
DS	Deputy Secretary	PSC	Public Service Commission
DSD	Devolved Service Delivery Study	PSDP	Public Sector Development Program
DTCE	Devolution Trust for Community Empowerment	PTAs	Provincial Transport Authorities
EDO	Executive District Officer	PTAs	Parent Teacher Associations
EPI	Expanded Program for Immunization	RTA	Regional Transport Authorities
FCF	Federal Consolidated Fund	RWSSP	Rural Water Supply and Sanitation Program
GDP	Gross Domestic Product	SAP	Social Action Program
GFS	IMF Government Finance Statistics	SLGO	Sindh Local Government Ordinance
GRAPs	Gender Reform Action Plans	SMCs	School Management Committees
GST	Goods and Services Tax	TAOs	Tehsil Accounts Officers
HMIS	Health Monitoring Information System	TMAAs	Tehsil Municipal Administrations
IMF	International Monetary Fund	UC	Union Council
IT	Information Technology	UIPT	Urban Immovable Property Tax
KPP	Khushal Pakistan Program	W&S	Water and sanitation
KWSB	Karachi Water and Sewerage Board	WAPDA	Water and Power Development Authority
LGO	Local Government Ordinances	WASA	Water and Sewerage Authorities
LHC	Lahore High Court	WB	World Bank
MICS	Multi-Indicator Cluster Survey	WDD	Women’s Development Department

## Executive Summary

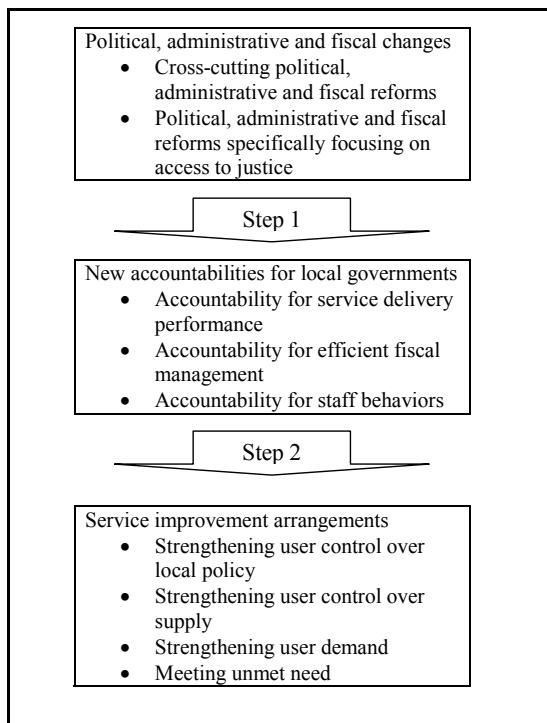
“Devolution is not opposed because of capacity constraints, shortage of technical manpower, the quality or awareness of local elected leaders or any such thing. Its opposed simply because it created such a huge disruption in the political economy of corruption”.

*Long serving DMG Officer*

Pakistan’s far-reaching devolution initiative has been designed with three broad and inter-related objectives in mind. Undoubtedly, service delivery improvements, particularly in the social sectors, are seen as crucial. However, the focus was broader and devolution also reflected a concern to improve the way laws about property, labor rights, and local economic management, were determined and enforced, and to increase ‘access to justice’ through local enforcement of the ‘separation of powers’, ending the executive magistracy, and improving local judicial administrations and oversight of the police. This paper presents a preliminary overview of the progress made to date in establishing the new structural arrangements, and provides an initial evaluation of the extent to which the new structure has succeeded in creating the necessary incentives for local governments to achieve at least some of these three objectives.

This paper addresses three notional readers. First, the 'nazims of good intention' - the recently elected local politicians who are keen to make improvements in service delivery in the imperfect but improved local autonomy that they find within the district government. It invites them to comment on a set of new incentives and challenges/opportunities that appear to have been opened up by devolution. Second, donors - who while often sympathetic to devolution and occasionally strongly supportive, can nevertheless by their actions occasionally undermine the process. Third, government - inviting senior officials who have worked long and hard in introducing these radical reforms to agree, or not, with the suggestions that it offers for the next key steps in the journey.

**Figure 1: The 2-step logic of decentralization**



The paper has three sections. Section 1 summarises the impressive range of structural changes that have been implemented to date. This is a summary of the accompanying technical annex that reviews, without evaluation, the administrative, political and fiscal changes that have been made as part of the devolution initiative. Section 1 then sets out a framework for assessing Pakistan’s devolution - noting that improved service delivery, while a key goal, is not the only target. The paper notes that there is a two-step logic to the linkage between the structural changes introduced and improvements in service delivery (Figure 1). First, decentralization attempts to influence the incentives within the public sector through a pragmatic combination of administrative, fiscal and political changes that will both empower local governments and hold them responsible for service delivery, for efficient fiscal management and for staff behaviors. Second, these changes in perceived accountabilities will then motivate government officials to improve service delivery. This paper takes the approach of evaluating the degree to which the political,

administrative, and fiscal reforms seem to be creating new accountabilities for local governments that are likely to lead to service delivery improvements over time.

Section 2 is the heart of the paper and asks whether the structural reforms have prepared the local governments for improved service delivery. It poses 8 questions (Table 1) concerning the degree to which these changes have established new local accountabilities for senior staff and politicians, changes that will empower and motivate local government leaders and senior staff to provide services that matter to the poor.

**Table 1: New local accountabilities: summary observations**

Areas where accountability might be improved as a result of devolution	Tentative observations
Accountability for service delivery performance	<p>1. Have the changes clarified jurisdictions?</p> <p>a. Between local governments</p> <p>b. Between provincial and local governments</p> <p>c. Within local governments</p> <p>2. Has electoral accountability and citizen oversight been strengthened?</p> <p>3. Has new political blood been introduced?</p>
Accountability for efficient fiscal management	<p>4. Have incentives to raise revenues, efficiently and appropriately, increased?</p> <p>5. Have incentives to use resources efficiently been strengthened?</p> <p>a. Administrative autonomy</p> <p>b. Autonomy in execution of the non-salary and development budgets</p> <p>6. Is funding more predictable?</p>
Accountability for staff behaviors	<p>7. Are staff transfers under control?</p> <p>8. Are staffing rigidities undermining management?</p>

Accountability for service delivery performance may be negatively effected by confusion among the public about which tier is responsible for service delivery, particularly between local and provincial governments; by poor intra-local government coordination; and the relatively large size of district, the system of indirect elections, and limited channels of direct citizen monitoring. While some previously marginalized groups have now entered the political system for the first time in large numbers, this has occurred primarily at the lowest level of local government.

With regards to accountability for efficient fiscal management, the paper notes that under the present system of fiscal transfers, local governments have limited incentives to raise additional taxes. With the notable exception of Punjab, administrative autonomy of districts remains severely curtailed, with the provinces still paying the salaries of district employees from their own account. There have also been problems in the execution of non-salary and development budgets, due to capacity problems and transitional teething problems, as well as due to a number of transfers of district finance officials. There have been significant complaints, especially at the level of TMAs,

about delays or inadequacy of fiscal transfers, and data from Punjab and Balochistan suggests that there are some discrepancies between budgeted funds and the releases to local governments.

Finally, local governments do not yet feel fully responsible for the behaviors of their staff. Local governments need autonomy over personnel decisions (hiring, posting, performance monitoring, and rewarding) of facility-level and other related staff, and the two key areas restricting this autonomy are staff transfers and staffing rigidities. In general, it appears that the problem of senior staff transfers, due mainly to the continued presence of federal and provincial cadres in senior positions in local government, has provided a significant obstacle to effective staff management, particularly in the provinces of Sindh and NWFP. Occupational groups also remain vertically separated, distinct career streams, which have led to problems at the district level in merging different groups of staff.

Section 3 of the paper then offers priorities for action in five areas - noting that these stem from two related sets of risks (Table 2). On the one hand, low expectations about how local governments will perform can lead higher-level governments, in concert with donors, to perpetuate pre-devolution systems and at times create special purpose arrangements to maintain direct controls over local authorities. These can result in "infantilization", preventing the new local governments from ever walking on their own; this will undermine local government. On the other, some of the basic foundations for devolution are not yet secure. Implementation of the Police Order, reform of accounting and auditing systems, and strengthening public demand for better services are all very pressing issues.

These priority actions all reinforce commitments made by government, but they also follow logically as the next critical steps beyond the significant gains already achieved by government in launching the devolution initiative.

The first suggested priority is to find an exit strategy from the many special purpose financing arrangements – often instituted with donor support – that run parallel or inconsistently with the intentions of the LGO. While acknowledging that in any system of inter-governmental financing there is a role for vertical programs, there is a risk that these can compete for fiscal and political space with local governments and undermine their autonomy in service planning, budgeting, and delivery decisions.

Second, to minimize federal and provincial government's micro-management of district staffing it is important that budgetary responsibility for salaries be transferred to the district governments, that government's proposal to create a District Service be implemented, and that the cutoff between provincial and district staff be raised to grade 18.

Third, it is important that the Police Order be implemented, both for improved police performance as well as to mitigate the problems that the abolition of the Executive Magistracy has created in the ability of local governments to perform their regulatory functions. To this end it is important that District Public Safety Commissions be quickly established, that ancillary institutions concerned with public safety, such as the Police Complaints Authority, and Insaaf Committees, be made functional, and that a public awareness campaign be launched about these new institutional arrangements. Equally, an essential adjunct to the Police Order is the need to enact and implement legislation for independent prosecution services.



**Table 2: Next steps in devolution: summary actions**

Avoid undermining local government	1. Move from vertical programs to conditional grants	a. Design and implement a transition strategy for vertical programs for local service delivery
		b. Institute a major program of support to PFCs to help graduate to the next generation of formula-based intergovernmental transfer grants
		c. Raise donor awareness of the dysfunctional consequences of vertical programs in the context of devolution and promote design of new project assistance modalities
	2. Find an exit strategy from provincial micro-management of district staffing	a. Where this has not yet happened, funds for salaries need to be transferred to the districts via Account # IV and on the basis of the budgeted amounts.
		b. Create a District Service.
		c. Raise the cut-off between district and provincial staff to grade 18
Complete the foundations	3. No backtracking in the implementation of the Police reforms	a. Complete process of establishing and building capacity of Public Safety Commissions.
		b. Support enactment of independent prosecution services
		c. Support establishment of auxiliary institutions concerned with public safety and policing.
		d. Invest in public awareness about the new arrangements, including public interest, legal literacy and litigation offered by civil society organizations.
	4. No backtracking in the reform of accounting and auditing systems	a. Resolve the issue of control of accounting cadre
		b. Reinforce local accountability for local performance.
		c. Ensure implementation of PIFRA compatible systems
	5. Help strengthen devolution's 'demands side'	a. Promote greater awareness amongst civil society / NGOs of the opportunity for citizen-state interaction through devolution and support demands for improved legislation.
		b. Help kick-start effective CCBs
		c. Improve community level monitoring and social audit arrangements.

Fourth, it is important that an integrated system of accounts be urgently established. This requires that the present disagreements between the federal Controller General of Accounts and provincial Finance Departments be resolved; that Auditor General's reports of the district government be only presented to the District Council, and not also to the Provincial Assembly, so as to avoid dual accountabilities; and that the automation of accounts under PIFRA be ensured.

Fifth, supplying 'good governance' – improved administration, transparency, greater accountability – is not enough; it is also important that citizen's demand it. Citizen engagement with government has to be nurtured, which requires efforts to educate NGOs about the role they can play in local government, and to aggressively promote the registration of Citizen Community Boards (CCBs), which have been mandated to play a crucial role in identifying and implementing local development projects. Equally important are efforts to improve community level monitoring and social audit arrangements such as have already been initiated by the NRB and in the context of PRSP monitoring.

## 1. Introduction: a framework for assessing Pakistan's devolution

### Context

The track record of social sector service delivery in Pakistan is so poor that it is tempting to assert that almost any reformed governance arrangements could only do better. Many reports point out that Pakistan lags behind countries with comparable per capita income on most of the social indicators.<sup>1</sup> However, the underlying governance challenges that have led to this poor track record make any productive changes difficult and, against this context, government's progress to date in initiating a massive program of devolution is truly remarkable.

Analyses of government performance on the delivery of basic services point repeatedly to problems of over-centralization, massive wastage and very poor productive efficiency, all of which point to the 'covert political economy' of rent-seeking and diversion of public resources intended for service delivery. Public office is widely regarded, by citizens and incumbents alike, to be an opportunity for pilferage and patronage. Well-established systems operate for the informal taxation of public resources, the marketing of positions in public office and the diversion of development funds. Across all major sectors – health, education, water supply, policing, and the judiciary – there is the expectation, perhaps resignation, that these practices may occur with near complete impunity.

Devolution is attempting to tackle these entrenched interests. The stakes are high as the poor are subject to the predatory and dysfunctional role of the local agencies of government (in particular, those responsible for education, health, land registration and taxation, policing and the courts). Their vulnerability is much increased by the rent-seeking behaviors of local officials responsible for licensing and regulating economic activities, particularly in the informal sector. Also well known, the vulnerability of the poor is continually reaffirmed by the corruption of local officials that hampers access to public goods and services – health, education, land management, etc. – or brazenly capture and divert these resources from their intended purpose. Finally, the failure of government institutions to provide adequate access to justice: redress for administrative grievance, access to basic information about entitlements and accountability, or inclusion in elementary public policy and decision making, greatly increases vulnerability to poverty. Local government performance is therefore intimately linked with vulnerability and poverty.

In the past two years, Pakistan's government has introduced far-reaching policy commitments in the context of a Poverty Reduction Strategy Paper process that highlights devolution, public resource management, access to justice, gender reform and social development. These commitments, combined with the dividends of recent improvements in macro-economic performance, could dramatically impact human development.<sup>2</sup>

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<sup>1</sup> ("Pakistan Development Policy Review: A New Dawn? (Report No. 23916-PAK)": 2002) notes that Pakistan has grown much more than many other low-income countries, but failed to achieve social progress commensurate with its economic growth. Measures as diverse as the mortality rate for children under 5, the percentage of childbirths with low birth-weight, gross primary school enrollment and the literacy rate all show a worse performance than should be anticipated for a country with this level of per capita income. The 1990s have seen a continued lag in human development indicators: indeed, gross primary enrollment has shown little improvement over the decade, especially in rural areas.

<sup>2</sup> The broad agenda was laid out in the iPRSP that was discussed in the Boards of the Bank and the IMF in December 2001 and that formed the basis for the IMF's PRGF loan. The breadth and progress of these reforms are analyzed in ("Pakistan Development Policy Review: A New Dawn? (Report No. 23916-PAK)": 2002). The full PRSP was presented at the 2003 Pakistan Development Forum

## The objectives

Though not set out in any single document the objectives of Pakistan's devolution program can be discerned from the various publications of the NRB, and the Local Government Ordinances and their amendments. The Devolution Plan highlighted at least three inter-related objectives each in various ways designed to deal with the three aspects of vulnerability experienced by the poor. Service delivery was given special prominence: it was argued that local governments, appropriately empowered, staffed and resourced, would deliver better on primary health, education and basic municipal services and agricultural extension. Policy held that mandating local governments with service obligations will improve both productive efficiency – that is, local governments will more efficiently turn resources into services – and allocative efficiency – that is, decentralization will create institutions that are more attuned, and capable of responding, to local needs and preferences.

### Box 1: PRSP and Devolution

Addressing the governance component of the poverty reduction strategy has required major transformation of governance structures and systems, as well as of political and organizational culture, especially at the local level. This was essential due to an accumulated governance deficit that has led to institutional decay and breakdown. Despite the enormity of such an undertaking and the level and continuity of political will required, Pakistan is now committed to overcome its governance crisis and lay the foundation for a successful poverty reduction strategy. This commitment consists of a series of fundamental transformations, including devolution of power to the grass roots level and decentralization of administrative and financing authority, access to justice at the local level and civil service reform.

Source: ("Draft Poverty Reduction Strategy Paper": 2003, p.30)

Government policy statements did not regard service delivery as an end in itself; and in some respects the architects of policy saw the pitfalls of a narrow focus on efficient service delivery.<sup>3</sup> Thus, a second purpose of devolution was to improve the way laws about property and labor rights, and economic activities, were determined and enforced - for which reason local governments were mandated with responsibilities to regulate and administer laws on land, labor, natural resources, NGOs and commercial enterprises. Third, and perhaps least well appreciated, devolution in Pakistan was about 'access to justice', that is, stemming from the decision to implement the 1973 Constitutional provision of 'separation of powers', it was believed that the performance of the local administrations, the courts, the police would all improve, that basic human rights would be better recognized and protected under devolution.

The technical and administrative agenda was most clearly articulated (see Box 2) although there was an undoubted parallel concern to reform the political structures, and to introduce a raft of new local politicians onto the scene.

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<sup>3</sup> Shifting political authority over services and over resources to sub-national governments *can* improve service delivery, positive results are contingent on a large number of other factors, not least: the ability of civil society to exercise discipline over government; electoral arrangements and access to information; preventing monopoly control of information being exercised by community leaders; locating functional responsibilities for public goods at the right levels; limiting the retention of hierarchical authority by national governments (even if this is rarely used); and improving the flow of information from governments to their constituents.(Azfar: 2002).

### **Box 2: A view from the National Reconstruction Bureau**

"The objectives of changing the system of governance...

- a) Restructure the bureaucratic set up and de-centralize the administrative authority to the district level and below.
- b) Re-orientate administrative systems to allow public participation in decision-making.
- c) Facilitate monitoring of government functionaries by the monitoring committees of the local councils.
- d) Rationalize administrative structures for improving efficiency.
- e) Introduce performance incentive systems to reward efficient officials.
- f) Ensure functioning of the related offices in an integrated manner to achieve synergistic effect and improve service delivery.
- g) Eliminate delays in decision-making and disposal of business through enhanced administrative and financial authority of district and tehsil level officers.
- h) Improve administrative and financial management practices in the district and management controls over operational units.
- i) Redress grievances of people against maladministration through the office of Zila Mohtasib. The government functionaries will also be eligible to lodge complaints against the unlawful and motivated orders of the elected officials.
- j) Enable the proactive elements of society to participate in community work and development related activities."

*Source:* (National Reconstruction Bureau: 2001)

### **Actions to Date: progress in creating new institutions**

Table 3 summarizes the achievements to date in structural reforms towards devolution.

The 26 divisions, 105 districts, and 354 tehsils of the four provinces, prior to 14 August 2001 were metamorphosed into 6,458 new local self-governments for the population of 141 million: 97 districts and 4 city districts; 306 tehsil municipal administrations and 29 city towns; and 6,022 union administrations.

**Table 3: Progress to date in political, administrative and fiscal reforms**

<p>Political changes</p>	<p>Pre August 2001</p> <ul style="list-style-type: none"> <li>• Constitution entrenches the federal and provincial governments only.</li> <li>• The four provinces were divided into three deconcentrated levels for administration and service delivery.</li> </ul> <p>Cross-cutting reforms</p> <ul style="list-style-type: none"> <li>• 6,458 new indirectly elected local governments.</li> <li>• Methods established for both the internal and external recall of the nazims in local government.</li> <li>• Citizen Community Boards (CCBs) conceived with a broad ‘governance’ mandate.</li> <li>• Responsibilities for regulation of civil society activities devolved to District governments.</li> </ul> <p>Particular emphasis on access to justice</p> <ul style="list-style-type: none"> <li>• New institutional framework for checking police conduct introduced.</li> </ul> <p>Emerging issues</p> <ul style="list-style-type: none"> <li>• Of the 126,462 new union councilors, 25% were women. Elected positions have, in the main been won by people with a pre-existing political background.</li> <li>• Slow progress in the new oversight bodies</li> <li>• Most progress has been achieved in establishing the District Public Safety Commissions (DPSCs), but this is patchy.</li> </ul>
<p>Administrative changes</p>	<p>Pre August 2001</p> <ul style="list-style-type: none"> <li>• Significant presence of federal civil servants in the provincial administrations.</li> <li>• Local administrations largely led by federal staff from the District Management Group.</li> <li>• Mismanagement of the police by the executive authority of the state at every level.</li> <li>• The District Deputy Commissioner role combined magisterial and administrative powers.</li> </ul> <p>Cross-cutting reforms</p> <ul style="list-style-type: none"> <li>• District governments divided into eleven departments.</li> <li>• District Coordination Officer (DCO) established as the highest-ranking civil servant in the district.</li> <li>• Some federal staff remain in the districts, but former rural district council employees now are district employees. However, some ambiguity about the reporting arrangements for the large numbers of staff from provincial employment groups.</li> </ul> <p>Particular emphasis on access to justice</p> <ul style="list-style-type: none"> <li>• Office of deputy commissioner abolished - powers divided between the district and sessions judge, district Nazim and the DCO.</li> </ul> <p>Emerging issues</p> <ul style="list-style-type: none"> <li>• Shifting the employer function to coincide with the new levels of functional responsibility is proceeding slowly, resulting in some competing lines of control.</li> <li>• Determination of the wage envelope takes place at the provincial level, as, with the exception of Punjab, salaries are still paid from the provincial Account I rather than the district-controlled Account IV.</li> <li>• Useful preparatory steps have been taken toward transferring employer functions to the school level, but this remains more an ambition than reality.</li> </ul>
<p>Fiscal changes</p>	<p>Pre August 2001</p> <ul style="list-style-type: none"> <li>• Constitution specifies the functions of the federal government, and the areas of shared responsibility. Shared responsibilities treated as primarily federal responsibilities. Centralization of taxes by agreement with the provinces.</li> <li>• Most buoyant taxes with significant revenue potential assigned to the federal government or ceded by the provinces on efficiency grounds.</li> <li>• Main source of provincial revenues is a transfer based on a share of federal tax collections determined by the National Finance Commission</li> <li>• The importance of federal transfers has significantly increased over time.</li> </ul> <p>Cross-cutting reforms</p> <ul style="list-style-type: none"> <li>• District governments given responsibility for delivering elementary and secondary education, primary and secondary health, agriculture, etc. Towns and tehsils have relatively unchanged responsibilities. Union administrations have not been assigned any significant major service delivery responsibilities.</li> <li>• Local governments given the rights to raise some additional revenues.</li> <li>• Provincial Finance Commissions established which have made awards for the distribution of provincial resources to local governments.</li> <li>• NB: No shifts of responsibility from the federal to the provincial governments.</li> </ul> <p>Particular emphasis on access to justice</p> <ul style="list-style-type: none"> <li>• Additional funding provided to subordinate courts and police services</li> </ul> <p>Emerging issues</p> <ul style="list-style-type: none"> <li>• Progress in creating the necessary secretariats and establishing the required analytic support for the PFCs has been slow.</li> <li>• For the majority of districts, the provincial finance departments de facto prepare the budgets.</li> <li>• Budget execution procedures made it difficult for the district governments to incur non-KPP expenditures</li> <li>• The cash flow position of the province has become a major factor obstructing the smooth flow of funds to the districts.</li> </ul>

Districts vary considerably in size – both population and area-wise. Many districts, particularly those centered on cities, are potentially resource rich and economically viable. In making assumptions therefore about local government and its potential in Pakistan, it is important to bear in mind that the units of local government are equal in size to many nation states. The population of Faisalabad is 6 million (2003 estimates) and Karachi has a population of over 12 million. To “devolve” government and service delivery to these units therefore offers both challenges as well as enormous opportunity.

Federal Government	No change Remains with largely the same structure
Provinces	The deconcentrated units of the major service delivery line departments (staff, assets and budgets) devolved to local government. Provincial government now has no local representation in the devolved service delivery sectors, except for provincial functions, but head offices and directorates remain unchanged
Divisional tier of province	Abolished, except for police. Functions, staff and budgets allocated to districts
District level province offices	Grouped in 11 ‘Groups of Offices’ with creation of new offices of F&P, Law and Literacy. The 11 Groups, an elected Nazim and a Zila Council created to form the new tier of District Government; 97 district governments and 4 city district governments created
Urban and rural local bodies established under LGO 1979	The earlier jurisdictions redrawn to merge rural and urban areas; in most cases the new precincts remain coterminous with the revenue tehsils, while in case of ‘city districts’ the municipal areas were divided to form ‘towns’; provincial departments of Public Health Engineering devolved to this level (although not in all provinces) 335 Tehsil/Taluka/Town Municipal Administrations created largely with the municipal service delivery mandates of the local bodies
Union administrations	In some cases larger Unions have been divided and in case of urban areas also Unions have been created 6022 Union Administrations have been created with minimal executive functions but, legally, a potential to gain more functions

## **A framework for viewing devolution**

### Political, administrative and fiscal changes

The point of entry for devolution is changing incentives within the public sector via a pragmatic combination of political, administrative, and fiscal reforms:

- *Political reforms* initiated to date include the creation of a new local government structure, with new electoral arrangements, and rules for government formation and dismissal. In parallel, a variety of new institutions have been created to foster greater citizen participation in local government. CCBs have been created to foster participation in local government policy-making and responsibilities for regulation of civil society activities devolved to District governments.
- *Administrative reforms* achieved include the new executive structure within local governments, the partial transfer of staff to local government.
- The major *fiscal reforms* include the new responsibilities assigned to the districts and tehsils, the new rights for local governments to raise additional revenues, and the new arrangements and guarantees for fiscal transfers to local governments.

Some of these political, administrative, and fiscal reforms have had a particular focus on improving access to justice. Notable achievements include the new institutional framework for checking police conduct, the abolition of the executive magistracy and the additional funding provided to subordinate courts.

#### New accountabilities for local governments

These fiscal reforms are *intended* to change how senior political and administrative officials of sub-national governments understand their tasks - changing their perceived accountabilities so that they feel responsible for achieving service delivery improvements. These new accountabilities at local level should include:

- Accountability for performance - with clear organizational jurisdictions, robust electoral accountability and citizen oversight, and new political blood - independent of the long-term patronage networks.
- Accountability for efficient fiscal management - with incentives to levy taxes and user charges efficiently and to use resources efficiently. This includes removing the defense for inefficiency and unresponsiveness that is provided by unpredictable financing, and ensuring a concern to finance capital investments, sustainably, for the long term.
- Accountability for staff - ensuring a reasonable tenure for senior district staff, and managing the problem of the occupational groups

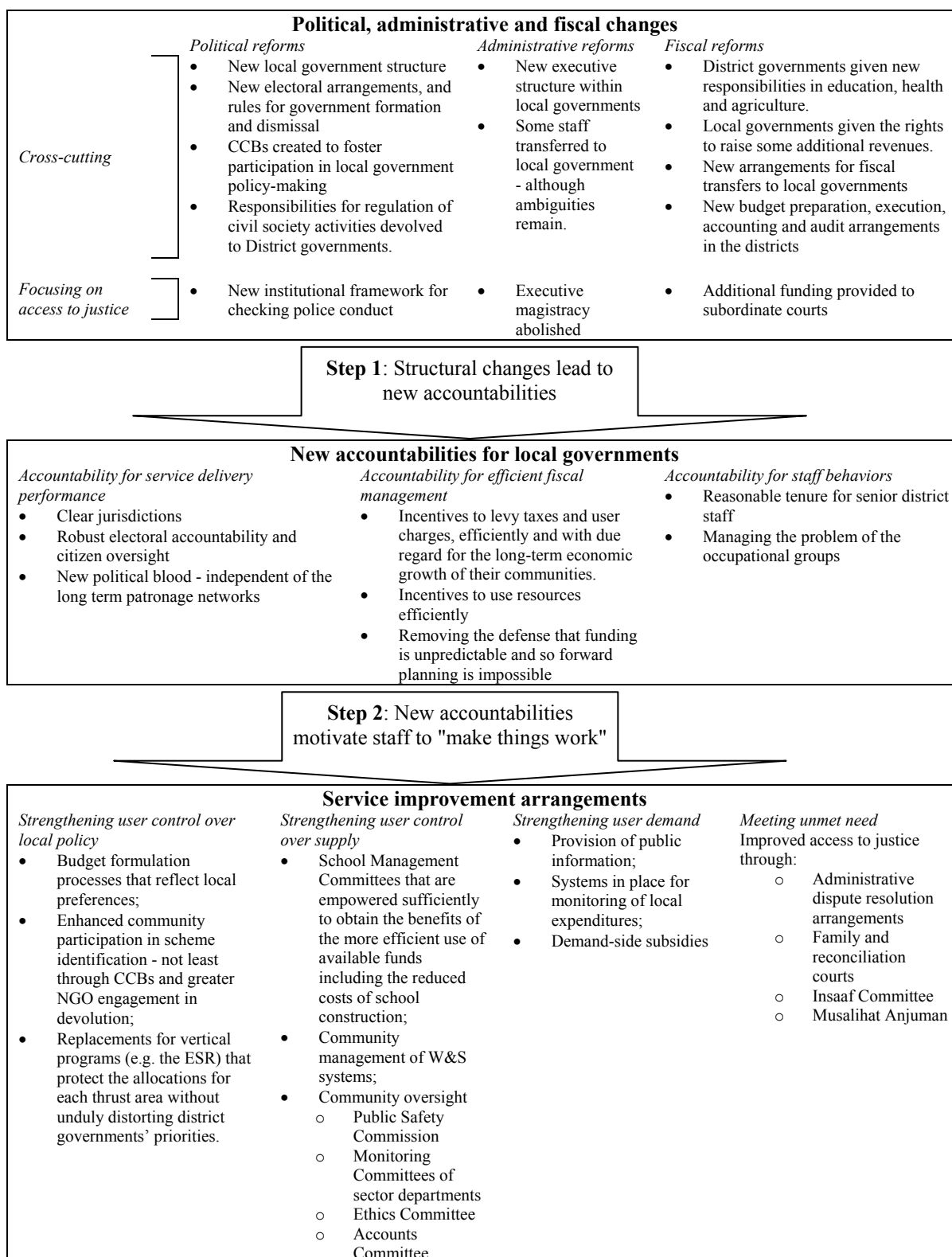
#### Service improvement arrangements

At the end of this chain, if these changes in perceived accountabilities were in place, the ultimate goal of devolution - a lasting set of arrangements for improving service delivery – would be achieved. The improvements would be of several sorts. User control over local policy about the type of services that are to be delivered would be strengthened through enhanced community participation in scheme identification (including through Citizen Community Boards). User control over the way in which services are supplied would be strengthened through School Management Committees and community management of W&S systems, and through the various community oversight bodies (Public Safety Commissions, Monitoring Committees of sector departments, Ethics Committees, Accounts Committees). User demand would be strengthened through improved provision of public information and monitoring of local expenditures.<sup>4</sup> Finally, new services would respond to previously unmet need - very particularly securing improved access to justice through new family and reconciliation courts, Insaaf Committees and Musalihat Anjuman (Alternative Dispute Resolution Committees). Intertwined with this strengthened citizen role in respect of services, would be the direct link between locally elected politicians serving Union councils with relatively small populations (approx. 25,000) and the ability of the citizen to unseat failed politicians at the next electoral opportunity.

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<sup>4</sup> Demand-side subsidies (school vouchers, etc.) could in principle be included but none have been identified to date.

**Figure 2: The anticipated chain of connections**





The key assumption in the devolution logic is not that these service improvement arrangements could not happen within a centralized system. The logic is that making any such arrangement work requires effort and ingenuity on the ground, and changing the accountabilities of senior officials in local government motivates them to install and sustain these arrangements. The Pakistan experience has illustrated that centralization has not achieved innovation in delivery or service improvement. The increasing capture of concurrent federal/provincial functions (particularly education and health) by the Federal level coupled with the disproportionate financial allocations to federal government has resulted in increasing distance between the delivery of the service and its planning and management. In political terms, the distance between MNAs at the Federal level and MPAs in the provincial assemblies has meant that the “representation” of the interests of constituents has been negligible. It is unsurprising that services have not met the needs of people and that planning, management and financing systems have been incapable of responding to the realities on the ground.

Primary education offers an example of this chain of connections. Passing authority over teacher recruitment and discipline to competent local School Management Committees can be a step towards better educational service delivery. However, establishing local governance arrangements for schools could in principle be undertaken by central government as well as by subnational government. The decentralization argument is that a judicious mix of political and fiscal changes, coupled with some decentralization of hire and fire authority over teachers to local government, will be the trigger that makes nazims and senior district officials more concerned to make these arrangements work. The same example illustrates why service delivery improvements require better local policy as well as improvements in service quality. Improvements in the quality and attendance of primary school teachers are rather marginal if patronage and elite capture significantly direct public spending towards secondary education for the middle classes, rather than primary education for the poor.

## **Reviewing progress**

There are three different ways to review the progress made towards devolution.

First, and ideally, the improvements in service delivery could be measured directly. However it is not feasible as it is too early as yet, and there are too many variables at play to reach any firm conclusions on the impact of the new arrangements on service delivery. In addition, new district data are needed, as many national indicators do not give an accurate picture of district performance.

Districts need to be able to both collect and analyze data as a prelude to improved planning and performance monitoring. Some good work is beginning to emerge although the experience of the Social Action Program demonstrates the intrinsic problems with data collection concerning service delivery and the incentives for misreporting (Statistics Division: 2002). UNICEF has completed a Multi-Indicator Cluster Survey (MICS) in all districts in NWFP and is currently working on the same for Punjab. The World Bank will shortly initiate a Core Welfare Indicator Questionnaire (CWIQ) exercise in all 101 districts that will equally begin to give a robust indicator of the development baseline of districts. CWIQ has the potential to be refined to meet the specific needs of districts – by the addition of specific modules – and also to be tuned to collect data at the level of the sub-district in the future. EMIS and HMIS data is already disaggregated by District. The Participative Poverty Assessment (PPA) work has much to offer in identifying the key issues that are important to ordinary people. The CIET survey on behalf of NRB is shortly to be published and will give district profiles which indicate the extent to which services are responsive to the needs of the poor.

Two examples serve to highlight the ambiguities involved in looking at service delivery improvements. The improvements in local government outputs shown in Table 5 could be taken as a hopeful sign. However, these must be interpreted in the rationalization of district health facilities in 17 of the 24 NWFP districts so that the same category of hospitals have the same facilities across all districts. So it is hard to tell if the data represent lasting service improvements, or the temporary result of restructuring.

**Table 5: Hopeful signs of health service delivery improvement in NWFP**

Indicator	2001	2002	2002	2002	2002
	(All 4 quarters)	(All 3 Qtrs)	(1st Qtr)	(2nd Qtr)	(3rd Qtr)
% of health facilities w/o essential drugs and medical supplies	42	43	44	42	40
% of BHUs providing immunization services	44	48	46	47	52
% of BHUs providing deliveries by trained staff	52	56	54	55	59
% of BHUs providing family planning services	48	48	47	43	55

Source: NWFP, HMIS reports 2001-2002

In NWFP apparent improvements in the routine immunization coverage of 12-23 month children (from 38% in 1998/99 to 45% in 2001/02 as reported by the NWFP HMIS) need to be contrasted with the recent deterioration reported by the federal EPI cell, NIH. In either case, since EPI is a Federal vertical program with the Federal Ministry managing the supply of drugs and consumables to the local levels, the proportions of blame and credit that should be given to the federal and district levels are unclear.

So, it is simply too early and the data are too weak to tell whether devolution is leading to its ultimate goal of service delivery improvements.

As an alternative, the second approach to evaluation could be to assess the political, administrative and fiscal changes that are driving the reforms against some notional best practices in devolution. This paper, and the technical annex, review these changes and place them in some comparative perspective, but there are risks in over-relying on this sort of "best practice in institutional design" approach, as there is no universal consensus concerning the best way to approach devolution.

This paper takes the third path - that of evaluating the degree to which the political, administrative, and fiscal reforms seem to be creating new accountabilities for local governments that from international experience could lead to service delivery improvements over time.

## **2. Creating new local accountabilities for improved service delivery**

It is difficult to overstate the dramatic scale and pace of structural and administrative changes in support of devolution in Pakistan. While the achievements noted in Section 1 are remarkable, they are not the final goal of devolution. Rather, establishing these basic structural and administrative arrangements is meant to improve the accountability of key government actors, and thereby stimulate improved public services for the poor. If the new arrangements are effective, they will result in senior officials at district and tehsil levels who feel themselves to be:

- *Accountable for service delivery performance* - with clear organizational jurisdictions and robust electoral accountability and citizen oversight.

- *Accountable for efficient fiscal management* - with incentives to levy taxes and user charges, and to use resources efficiently.
- *Accountable for staff behaviors* - ensuring a reasonable tenure for senior district staff, and managing the problem of occupational groups

This section is not a critique. It is too early for that and the empirical evidence is too patchy. Rather, this section presents a series of discussion points that address the following questions: "For a nazim of good intentions, how has their world changed? What will encourage and enable them to deliver services that make a difference in the lives of the poor within their local jurisdiction?"

## **Accountability for service delivery performance**

### Overview

To understand the link between devolution and improved service delivery, one first has to explore why failures of voice can occur under a democratic system. Why, in Pakistan, have elected politicians performed badly in delivering key public goods to the poor, *despite* needing the votes of the poor to get elected.<sup>5</sup>

In Pakistan, the orthodox answer to this puzzle is 'feudal politics'. The influence of large landlords and tribal elders in rural areas allegedly transforms free elections into a kind of theater, in which local voters merely pretend to exercise independent discretion. Unquestionably, local power relations are important in everywhere, particularly rural Sindh. However, recent studies of electoral behavior argue that politicians care a great deal about voter demands. Unfortunately, providing patronage rather than public goods is generally the key to electoral success (Wilder: 1999; World Bank: 2002). As a recent study of electoral politics in Pakistan notes:

Voting behavior is increasingly being influenced by voter concerns over local issues such as assistance in *thana-katcheri* (police station and courthouse) affairs; or the need for a road, school, or basic health unit in their village; or for an electricity, telephone, or natural gas connection for their house; or for jobs, promotions, or transfers in the workplace. A growing number of votes are therefore being cast for candidates with strong records of addressing these local concerns by delivering patronage to their constituencies and introducing development schemes in their constituencies (Wilder: 1999).

There are potentially four sets of reasons why politicians in Pakistan favor the provision of targeted, private goods to improvements in broad-based public services

First, electoral campaigns are expensive. It is estimated that campaign spending averaged \$120,000 per parliamentarian in the 1997 elections (World Bank: 2002).<sup>6</sup> Campaign funds are needed for posters, for vehicles, for fuel, for newspaper and television access, and for door-to-door campaigning, but also for dispersing private goods to the constituency. The money to finance these campaigns may be obtained from local elites, in exchange for providing private favors to campaign contributors once in office.

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<sup>5</sup> Clearly this question is relevant only for the periods of democratic government in Pakistan

<sup>6</sup> Often elections are more expensive in developing countries than in developed countries. For example, in Uganda an average campaign cost between \$40,000 to \$ 60,000. By contrast, though likely to be at the low end of the OECD range, spending per constituency in the UK elections of 1992 amounted to less than \$10,000. (Barkan and Thomas: 2003)

Second, when faced with demands from their constituents for both private and public goods, politicians often favor the former because it is easier to claim credit for providing private goods. For example, it is much easier for a politician to demonstrate to a voter that he/she was responsible for providing the voter with a job, or for resolving a police dispute, than to convey that he/she was responsible for reducing teacher absenteeism in the village school (World Bank: 2003).<sup>7</sup>

Third, because Pakistan is a federal state with formerly two, and now several, tiers of government, voters are unlikely to attribute the provision of public goods to a single tier of government. Again, the informational demands associated with evaluating who is responsible for improvements in service delivery will create incentives for politicians in each tier to focus on targeted benefits that they can more easily take credit for.

Finally, if terms of office are short, as they were in Pakistan during the democratic period in the 1990s, politicians have less incentive to promote policies that require years to show results. Unlike the provision of government jobs or construction of school buildings, improvements in service delivery, such as higher quality education, do not bear immediate fruit and are therefore unlikely to be prioritized by politicians with short time horizons.

Will the new accountabilities help to shift politics away from the provision of jobs and contracts, to the provision of improved services for the poor? Realistically, the underlying motives for the provision of private rather than public goods will not diminish in the short term. The question is whether the new structural arrangements will reduce the opportunities to pursue private-goods strategies over time.

Initial evidence suggests that district government officials have the same incentives as their provincial and national counterparts. Nazims are very conscious of the need to keep their "electoral college" (i.e. the Union councilors) on board. Thus, they have sometimes decided to use funds by parceling out small sums to councils in order to try to secure support. However, as a result, all Union administrations may have sums that are inadequate to carry out the sorts of schemes that their constituents are demanding, particularly for rural areas in water and sanitation. Conversely, where nazims have used other criteria to allocate development funds between union councils, those who have received no funds have accused the nazim of being partisan.<sup>8</sup>

The key devolution issues in this section concern:

- Clarity of jurisdictions - is it obvious to citizens which government is meant to be doing what?

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<sup>7</sup> As a corollary to this argument, individual contacting by voters is also more likely to be for private favors, which also tends to bias politicians towards these types of goods. For example, one study found that an influential politician in Punjab was inundated with an average of 150 – 200 requests from constituents per day, the vast majority of which were requests for private favors like jobs, for getting land disputes resolved, for help in police matters, and for getting admissions to colleges and universities (Wilder: 1999).

<sup>8</sup> Local people are not necessarily more informed about local than central governments. Nor are the incentives for local or national politicians any different. One study of the Philippines and Uganda, both among the more radical decentralizers, found that voting patterns and rationales were similar for local and national elections, and that there were important constraints on information flows that limited accountability. For example, an opinion survey in the Philippines revealed that only 1 percent of the people succeeded in naming their mayor or vice-mayor correctly, as compared to over 40% for important national politicians (Azfar: 2002). Moreover, people relied very heavily on local community leaders or local officials for information on local politics, raising the possibility of elite capture.

- Electoral accountability and citizen oversight - will the new arrangements provide leverage to those constituents that do want public goods?
- New political blood - will the new generation of local government politicians be independent of established patronage networks?

Have the changes clarified jurisdictions?

*Between local governments*

While the functions assigned to TMAs and Union administrations are well specified, the functions allotted to district governments are less clear. This is partly because the districts have been assigned many responsibilities that prior to devolution were performed by the provinces. However, the jurisdictional line between the provinces and district governments has remained somewhat unclear in the LGOs. For example, while district headquarter hospitals have been assigned to the district governments, teaching hospitals in larger cities have remained with the provincial governments. A similar situation exists for certain high-profile facilities in the education sector, which have been retained by the provincial government.

Problems exist at the tehsil level, as well, despite the relative clarity of functional assignments. WASAs have been transferred to the TMAs,<sup>9</sup> but not without creating some difficulties. In Punjab, the responsibility for the four WASAs of four non-City Districts have been transferred to just one of the city TMAs, although the service network spreads into neighboring TMAs. As for tehsil schools and their teachers, outside of Punjab they have yet to be transferred to the districts.

The devolution plan aims to establish a system of local governments without an overt hierarchical relationship between the three component parts. However, the government seemingly has yet to address the problems inherent in coordinating among a large number of dispersed governments. Some provinces argue that the devolution design makes it far more difficult to coordinate with local government, as the province now has to deal with each local government independently. If provincial government is subordinate to the national government in terms of the supervisory role, and the district government is subordinate to the provincial government, then there is no intrinsic reason why this logic can not be followed at the lower two levels.

The difficulties are most evident in the City District Governments. Almost every service of the lower tiers of local government must contribute to creating and managing the city transport infrastructure, but there is no effective coordination mechanism specified in the LGOs to ensure this. Anecdotally, union nazims and naib nazims report that voters are demanding services from them for which they are not responsible; and despite their presence ex officio on tehsil and district councils, they are not credited with any of the successes of higher tiers of government.

The weak management links between the district, tehsil, and union administrations do present challenges in collaboration. The only coordinating mechanism between district and tehsils is the Mushawarat Committee. The District Mushawarat Committee, with the membership of the district and town nazims and the DCO, was envisaged to be the forum for evolving the strategic plans for the district, and coordinating the development plans of local governments. However, it appears this is not happening in practice, as the Committees have no leverage over reluctant or recalcitrant parties. The City Districts have similar committees that should act as the fora for the approval of

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<sup>9</sup> Except in the City Districts where, in accordance with the LGO, WASAs fall under the district governments.

capital investments for municipal services. These are viewed, however, as hurdles to be cleared for scheme approval, and not as opportunities for rationalization.

The District Development Committees represent a more overt relationship between districts and union administrations.<sup>10</sup> The Committees are empowered to approve the schemes submitted by the union administrations. Interestingly, tehsil officers provide technical advice but cannot decide on these proposals, even though many of the UC schemes relate to tehsil activities such as drains, water, and sewerage.

### *Between provincial and local governments*

There are undoubtedly tensions between these levels of government. Given the importance of patronage, it is not surprising that the newly elected provincial governments have raised objections to the devolved structure.<sup>11</sup> Objections to the devolution plan have been most vociferous in NWFP and Sindh, provinces where the majority of the district nazims have political affiliations different from the ruling coalitions in the province. In Sindh, the nazims of Khairpur and Karachi, who belong to opposition parties, have complained about transfers of district staff made without their authorization by the provincial governments. In NWFP, the provincial MMA government (who counts only 2 districts nazims as political supporters) has been accused by nazims of interference in districts affairs. Nazims have tendered their resignations to the President and asked for the Federal Government to deal with provincial interference. Tehsil and Union Council Nazims have backed the district nazims position and offered to resign in sympathy

One of the first steps of the national elected government was to re-introduce the former practice of providing funds for development schemes identified by the members of National Assembly (MNA). As each MNA is allowed to identify schemes up to Rs 5 million (FY02-03 and 10m thereafter), the maximum expenditure on this program could be as high as Rs 1.7 billion. Following suit, all the provincial governments have given similar allotments of development funds to the individual MPAs.

#### **Box 3: MNA and Nazim each claim credit for gas**

A tussle developed between the nazim of Toba Taik Singh and the newly elected MNA over the provision of gas to two towns in the district. The district nazim announced before the October general election that gas had been approved for the two towns. However, in a big public meeting after his election, the MNA asserted that he had been responsible for the approval of the gas connection. The nazim responded by ordering an inquiry against the heads of government educational institutions who displayed banners praising the MNA for getting approval of gas for the two towns. The MNA in turn challenged the nazim to a public debate and announced that he would quit politics forever if his opponent succeeded in proving that the announcement was wrong. It is not known whether this challenge was taken up.

*Source:* Dawn, February 20 2003

Apart from the concerns this raises about the circumvention of standard project appraisal procedures, this allocation of funds to MNAs and MPAs has the potential for undermining clarity concerning the responsibility for service delivery.<sup>12</sup> Opportunistic politicians likely will exploit voters' relative lack of knowledge to avoid responsibility for their own lack of effort and/or to claim credit for others' actions in providing public goods (see Box 3). If voters are likely to be

<sup>10</sup> The Committee, made up of district officials, is chaired by the District Nazim in NWFP and by the DCO in all other provinces.

<sup>11</sup> The Education and Health departments, both of which have been devolved to the districts, have the most posts at their disposal, and are therefore a major focus for political influence.

<sup>12</sup> The NRB has declared that MNA funds can only be used for purely federal subjects.

grateful to all the tiers of government when public goods increase, regardless of their relative contributions, then the incentive to provide that public good is diminished.<sup>13</sup>

Some groups of staff have a vested interest in blurring the jurisdictional responsibilities between provinces and local governments, as Box 4 illustrates.

**Box 4: Turf issues in water and sanitation**

The devolution of the Public Health Engineering Department (PHED) has been undertaken differently in different provinces. In NWFP, some PHED staff remain at the provincial level, and some have been devolved to the Works and Services departments of the Districts. There is no Tehsil-level PHED presence, causing serious constraints for TMAs to deliver services in the absence of requisite technical staff. In Sindh, PHED has been completely devolved, with only a Technical Directorate in the Local Government Department (for schemes under implementation and donor-funded projects) remaining at provincial level. TMAs have been left to struggle to provide some key services, such as drinking water, which call at times for highly technical expertise that the TMAs are ill-equipped to provide. None of the provincial departments regard enhancing the coverage or quality of drinking water as part of their mandate.

Overall, it seems that PHED staff would prefer to remain at the provincial level and, at most, be devolved down to the district. The argument they make is that the provincial departments are technically more qualified to design and implement infrastructure and that the tehsil does not have the technical capacity. The suggestion is that they should design and implement the schemes and then transfer them to the TMAs. However, the TMAs are not prepared to assume responsibility for schemes that have been identified, designed, and implemented without their involvement.

Devolution of WASA in Faisalabad to TMA City is another example of emerging turf issues. WASA's service coverage extends into other TMAs, particularly TMA Saddar, creating coordination problems. Within TMA Saddar's boundaries, solid waste management is its own responsibility whereas sewerage is the responsibility of WASA. Quite often solid waste is dumped into open manholes, which chokes the sewerage system. Similarly, TMA Saddar has little leverage to influence WASA's decisions affecting its constituents. While the TMO Saddar is a member of the WASA Board, this arrangement does not provide the requisite level of coordination. There is a crucial need for effective management arrangements that allow for services like water and sanitation to be managed across tehsil boundaries.

*Within local governments*

The transport sector is representative of the inter-agency difficulties that have emerged during the transition to devolved structures. The sector is comprised of roads management (or "access infrastructure") and transport management (regulation). Separate departments have traditionally existed for the two sub-sectors; and although attempts were made to integrate both under one department in the initial devolution plans, the eventual design left these under separate management. Consequently, many rivalries have developed (see Box 5).

<sup>13</sup> There is some cross-national evidence to support this argument. A recent econometric study found that the number of tiers of government was positively associated with corruption, and negatively with the number of paved roads or infants inoculated (Triesman: 2002).

**Box 5: Local organizational rivalries in the transport sector***Road management*

Prior to devolution, a range of organizations were responsible for road management in any given district, including the provincial communications and works departments, district councils, municipal corporations/committees, and cantonment boards. Although the geographic jurisdictions of these entities largely overlapped, there were well-defined functional and technical distinctions between the infrastructure for which each was responsible. The post-devolution set-up has resulted in a fragmentation of institutional roles and responsibilities. For example, in Sindh there is some confusion at the district level over the ownership and management of the former district council road network. These have neither been taken over by the district W&S department, nor have these been devolved/transferred to the tehsil level (unlike the case of some NWFP districts). The province retains responsibility for a significant proportion of the district level access and secondary road network, apparently due to the fear of provincial work redundancy and loss of control over district affairs.

*Transport regulation*

In the pre-devolution framework, overall provincial transport management fell under the purview of provincial transport departments and their operational arms, the Provincial Transport Authorities (PTAs), in all four provinces. The PTAs, were entrusted with transport regulation functions, such as issuance of route permits, classification of routes, and overseeing and regulating the work of the Regional Transport Authorities (RTAs) working at the divisional level. The RTA functions included issuance of inter city and district route permits, and regulating and restricting the operations of transport services. Districts were not directly involved in such transport management, although they were consulted occasionally by the RTAs in formulating recommendations and other decision-making functions. At the time of devolution, the RTAs were abolished and " District Regional Transport Authorities" (DRTAs) established in all the districts. These are functioning to varying degrees in different provinces.

Some of the teething problems could be alleviated if the provincial governments disseminated the Rules of Business (RoBs) more actively. Delays in their dissemination appear to have prompted local bodies to evolve their own division of responsibilities and their own processes and procedures. Of greater concern, provincial departments have been able to effectively re-appropriate the responsibilities of local governments, as observed in the case of rural water and sanitation.

Has electoral accountability and citizen oversight been strengthened?

Electoral accountability for the nazim is dependent on the degree to which voters (a) understand the nazim's role, (b) have information about the nazim's performance, and (c) can use that information to affect the nazim's performance.

The role of the nazim can be rather hard to fathom given the independent, "hierarchy-free" levels of local government and the low levels of political literacy amongst the population. Combined with the indirect method of electing nazims, electoral accountability in such situations is likely to be modest at best. The district nazim/government is generally viewed as responsible for the delivery of all the services assigned to the local governments. As a result, the inability of the district nazim/government to make a non-performing tehsil government function adequately is considered an indicator of poor performance by the former more than the latter.

Table 6 compares the average population per local government and the mode of electing mayors and councilors in Pakistan and a few selected countries. The average size of district government in Pakistan is quite large, especially compared to the countries in Latin America. In addition, Pakistan's indirect electoral arrangements are unusual. The most common practice of electing mayors is by way of direct, separate elections – i.e. generally mayors are elected by a simple



plurality, with some countries, such as Brazil, holding a second-round runoff in the event that an absolute majority is not obtained in the first round.

**Table 6: Local electoral arrangements for Pakistan in comparative perspective**

Country	Number of Local Governments <sup>14</sup>	Average population per local government	Mode of election of mayor	Mode of election of councilors
Argentina	1,100	30,818	D	D
Bolivia	311	27,703	D	D
Brazil	4,974	31,222	D	D
Columbia	1,034	34,429	D	D
Indonesia	370	567,000	I	D
Philippines	1,538	490,000		D
<b>Pakistan</b>	101	1,443,000	I	D

D: direct, I: indirect

Sources: (Azfar: 2002; Hofman, Kaiser and Goga: 2002; Nickson: 1995)

The indirect election of the district nazim in Pakistan complicates the accountability linkage with voters because the re-election of an incumbent nazim is not decided directly by the voters, but rather by a few hundred union councilors. Indirect elections such as these raise the potential for abuse. In addition, the formal rules for recall of a nazim effectively protect the nazim from a no-confidence motion by the councilors. In proposing a no-confidence motion against a district nazim, the district councilor (who is also a union council nazim) has to be sure of securing a majority in both the district council and among all the union councilors in the district, because otherwise he/she will be forced to resign as union nazim.

More direct mechanisms for citizen monitoring can be just as important as elections, and have been formally incorporated in many local government structures across the world. These mechanisms include laws that require the regular holding of public meetings (India, Mali, South Africa, Uganda); laws and legally created entities for voice expression (Bolivia's Law of Popular Participation, Uruguay's Public Accountability Boards); participatory planning forums (Brazil, Nepal, South Africa); participatory budgeting mechanisms (Paraguay, Brazil, South Africa); and media-related voice mechanisms (Philippines, Uganda) (Shah and Andrews: 2002). In Pakistan, while the LGO provides for institutional arrangements - such as Village and Neighborhood councils, and CCBs -- for citizen participation in local government, their strength as citizen monitoring agencies has yet to be tested. CCBs are being formed primarily for the purpose of identifying and managing local, relatively small-scale service and infrastructure investments. CCBs are 'selected' rather than 'elected' and the risk is that some might be 'captured'. However, equally, they may prove themselves to be a powerful route for breaking apart existing patterns of local control. (see Box 6).

The rules for the establishment of CCBs are laid down by the NRB. CCBs must raise 20% of the costs of a development project and can then call down the balance of funding from district governments. CCBs were initially slow to form, but are now gaining pace as awareness is raised

<sup>14</sup> In cases where there are multiple tiers of local government – as in Philippines, Indonesia, and Pakistan – the tier that has the most jurisdiction over service delivery is chosen. In the case of Pakistan this is district government.

about the availability of resources. The government resources for CCBs may not be re-allocated to any other head of expenditure and they may be carried forward to subsequent financial years. Thus, there is a real incentive for local governments to ensure that CCBs are operational.

Are these proposals merely reproducing the strong incentives to create new infrastructure and facilities, with little improvement in actual service delivery? To what extent are CCBs already ‘captured’ and being shaped up as ‘constituency management groups’ for local elites? Will CCBs become more than impromptu project management groups? Will they begin, with appropriate support and guidance, to address the much wider range of issues highlighted by the ‘voices of the poor’ – violence against women, debt bondage and tenancy rights, corruption, land or labor rights? These larger ‘pro-poor’ possibilities are not likely to be championed by any of the citizen-state institutions provided for by the LGO and PO unless unprecedented commitments are made in the near term by higher-level governments, Pakistan’s donors, and concerned citizens.<sup>15</sup>

#### **Box 6: The potential role of Citizen Community Boards**

In the main, CCBs have been configured as community based project implementation and management bodies. There is no inherent reason why CCB’s could not form for the purpose of monitoring police conduct or the activities of the Patwari, to promote the interests of women before the subordinate courts, or for direct input into the management of any public facility (schools, irrigation facilities, etc.) or public process (such as the annual budget process).

It is perhaps not surprising that in their first generation CCBs almost exclusively promote investments in health, education or drinking water facilities. This has been the pattern of similar community institutions fostered by decentralization elsewhere, such as in Uganda (Porter and Onyach-Olaa: 1999). But there is no reason to suppose this will be the pattern in the medium term.

CCBs can provide an important site for learning political skills and processes and, where early engagement in providing facilities to meet general needs is successful, could empower communities to take on more ambitious responsibilities, including exposing corrupt practices and insisting on enforcement and interdiction where needed.

Distinctively, in Pakistan the ability of the CCBs to roll funds over from one year to the next will increase their profile. The provision for the carry-over of unspent monies means that development funds earmarked for CCB projects will accumulate and cannot be re-allocated to other heads of local government expenditure. In time it will create some competition between departments who will, it is hoped, see that gaining citizen support for CCB proposals is a key strategy for increasing the range and quality of development projects in their sector. Conversely, the Union Councils might come to resent CCBs, fearing that they will tie up development funds needlessly. This risk is greater in poorer communities.

#### Has new political blood been introduced?

It was hoped that the new system would enhance electoral accountability by introducing a new class of honest, hardworking, and competent politicians to represent constituency-wide interests.

Unsurprisingly, the number of new entrants to politics increases as one moves down the tiers of government. At the union council level, a majority of the councilors had never contested elections

<sup>15</sup> The ordinances also call for the creation of Monitoring Committees at all three levels of local government to act as a check against abuses. However, these do not provide for direct citizen participation. Each Monitoring Committee is to have a minimum of three members – one third of the members shall consist of reserved seats of women, peasants, workers, and minorities and the others will be elected from among the Council members. (NRB, Guidelines)

before (Pattan Development Organization and UK Department for International Development: 2001). The proportion of first time contestants was highest in the category of reserved seats for females, peasants and workers, and least for the union council nazims. The socio-economic profile of union councilors displays a similar trend – nazims and naib nazims are more educated and, in general, belong to rich and influential families, while councilors, particularly female councilors, come from more impoverished backgrounds (Table 7).

**Table 7: Literacy of Union Councilors**

	Nazim	Naib Nazim	General Muslim	Muslim Female	Peasant/ Worker	Peasant/ Worker Female	Minority
Illiterate %	0	0	11.4	45	18.3	57.9	42.7
Literate %	100	100	88.6	55	81.7	42.1	57.3

*Source:* (Charlton, Ebel, Mukhtar, Scott and Vaillancourt: 2002).

The majority of nazims are experienced politicians from established political families. According to one media survey, 30% of district nazims in Punjab were former MNAs or MPAs, and approximately 90% belonged to established political families.<sup>16</sup> Some of these nazims later resigned from local government in order to contest for provincial or federal assemblies.

Established families dominate a greater proportion of elected offices as one moves up the tiers of local government, as at the provincial and national level candidates who are not extremely wealthy stand little chance of electoral success (Wilder: 1999). In rural areas, for example, voters expect to be provided transport and to be fed on Election Day, and may even demand money in return for a vote. Even at the union council level, replacing the ward system with a multi-member constituency made it more costly for candidates to reach out to the entire constituency.<sup>17</sup> Officially the elections were non-party and therefore there was no recourse to party-financing.<sup>18</sup>

A significant achievement of the system is the large increase in women's participation in the political process. As a result of the reservation system, about 36,000 women are now members of local government institutions – approximately 32,000 in union councils, 1,800 in tehsil councils, and 2,000 in district councils (Table 8: Gender Profile of Union Councilors). The majority of these women are from poorer segments of society. Not only are these numbers orders of magnitude larger than the reserved quotas for women in the past, they have also, unlike in the past, been filled through direct elections. In general, the elections for these seats were competitive, although with significant inter-provincial variation. Overall, 70% of the general reserved seats were won through a contest, ranging from a high of 84% in Punjab and a low of 30% in Balochistan. Just two district council nazims, and one tehsil council nazim, are women (all in Sindh).

<sup>16</sup> *The Herald*, August 2001

<sup>17</sup> Union's are multi-member districts -- i.e. all the candidates for the union council seats contest from the Union as a whole and those receiving the most votes are elected. An alternate ward system, whereby each Union is divided into single-member districts and the highest vote-getter is returned from each ward, would obviously be cheaper from an electioneering standpoint as the areas to be covered during campaigning would be smaller.

<sup>18</sup> (Pattan Development Organization and UK Department for International Development: 2001)

**Table 8: Gender Profile of Union Councilors**

Province	Women Nazims	Women Union Councilors	Total Union Council Seats	Women Union councilors as a percentage of total seats
Punjab	9	20,007	72,513	27.6
Sindh	2	5,878	22,974	25.5
NWFP	-	3,963	20,097	19.7
Balochistan	-	2,374	10,878	21.8
TOTAL	11	32,222	126,462	25.4

Source: (Mirza: 2002)

New blood, of course, brings with it a capacity problem, given the relative inexperience and lower educational background of these councilors. The NRB has developed and delivered training programs for elected councilors on structures and functions of local government, planning and budgeting, skill development, and cross cutting themes such as community development, gender sensitivity, communication and environmental impact analysis. Local civil society groups also have provided training support, with some civil society organizations targeting the less-empowered councilor groups (women, peasants/workers). Training has focused on constituency and coalition building, social mobilization, strategic negotiation, legislative oversight processes and legal rights awareness for elected representatives. Further training could usefully include skills-building for new local government politicians to publicize local achievements.

The question of whether the new arrangements will bring in new leadership is not confined to elected offices. Some critics argue that Citizen Community Boards, as presently being developed in some districts, are likely to entrench the influence of local moneyed interests rather than to empower the poor. One issue concerns the limited time that citizen activists will have to contribute to a large and growing range of participative bodies – including Citizen Community Boards, Citizen Police Liaison Committees, village, union, district and tehsil councils, Rural Support Programs, and District Development Committees. Also, since the number of new elected members at various levels is very large, the allowances paid are very modest, which is a problem of special concern to many low-income councilors (especially those elected on reserved seats). The travel costs they must incur to attend a council session can be as much as a day's wages.

### **Accountability for efficient fiscal management**

#### Overview

Examining the incentives for efficient fiscal management requires that a series of questions be addressed.

- Does the "nazim of good intentions" have a reason now to levy taxes and user charges? Or is it a more sensible managerial and political strategy to rely just on the fiscal transfers from the province? If nazims do raise local revenues, what encourages them to do this efficiently?
- On the expenditure side, have incentives been increased for the efficient use of resources?
- Can nazims, justifiably or otherwise, hide behind the well-known defense that funding is so unpredictable that forward planning is impossible?
- Finally, what will encourage their long-term stewardship of local government capital assets? Why should they not simply build for the jobs and contracts that this brings today, leaving the next nazim to address the problem of under-maintained buildings and unfinished projects?

### Have incentives to raise revenues, efficiently and appropriately, increased?

The 1973 Constitution assigns almost all taxes with any worthwhile revenue potential to the federal government. The exceptions are the Agriculture Income Tax (AIT), Urban Immovable Property Tax (UIPT), Motor Vehicle Tax (MVT) and Stamp Duties. As the revenue heads assigned to local governments, particularly the districts, are unlikely to generate sufficient revenue to meet local government expenditure needs. Therefore, local governments will continue to rely heavily on revenue transfers from the provinces, and on direct, earmarked transfers from vertical programs.

While fiscal transfers from the provincial governments can help the district governments to discharge their responsibilities, such an arrangement compromises the accountability of the local governments. Revenues generated by a local government through taxing its own constituents are more likely to be spent efficiently than resources obtained from fiscal transfers, as the latter are collected from taxpayers outside of the local government area who may not be using the services produced by this government.<sup>19</sup>

Among the local governments, tehsils have been assigned bases for more buoyant and potent taxes. The Urban Immovable Property Tax (UIPT) is a tehsil tax, collected by the provinces for a 15% collection charge. The tehsils are also assigned the transfer of property tax and entertainment tax. The provincial professional and calling tax, though collected by the province, has been devolved to the union administration. The Octroi and zila tax-related transfers from the province (to be paid from revenue from the additional 2.5% of GST) go directly to the accounts of the tehsil and union administrations, respectively.

Some of the taxes that have been assigned to the districts would be very difficult to use in practice. Under the LGOs, district governments have been assigned the Education and Health taxes. Given that there is every reason to subsidize education (as is the case for elementary education, which is provided free of cost in every province) and health services, far less tax them, use of these tax opportunities would be hard to justify.<sup>20</sup> Tuition (and other) fees are already levied on secondary<sup>21</sup> and tertiary level education. Where modest user charges have been levied in education, these have been collected at the level of the school and then sent to the District who then reallocates. Thus revenue effort at the level of the school is not rewarded. Given the potential for high private returns from the latter, and that because that higher education services are generally availed by relative more affluent segments of the society, there is every reason to rationalize user-charges for tertiary education. However, this needs to be done in conjunction with establishing mechanisms to avoid the poorer households getting excluded from availing higher education due to higher costs

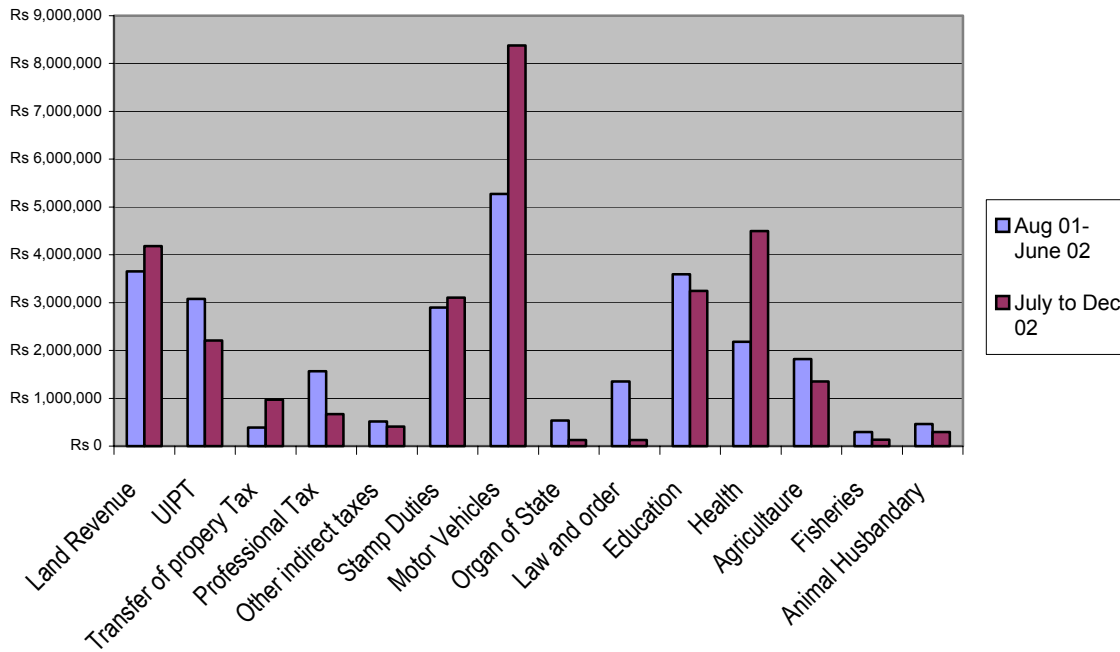
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<sup>19</sup> On the importance of local revenue for local performance see (Shah: 1996)

<sup>20</sup> There is some uncertainty here in the wording of the LGOs because these taxes are mentioned in the same clause as other heads of revenue. The NRB is of the opinion that “education tax” and “health tax” means earmarked taxes *for* education and health services, and does not mean tax *on* education and health services.

<sup>21</sup> From the 2002/03 budget, Sindh has opted for free secondary education, which Punjab government is seriously thinking of replicating from the 2003/04 budget.

**Figure 3: Average own revenues by source for each NWFP district government**



Source: Devolved Service Delivery study database

There are also many local tax administration issues to resolve. The PFCs have determined that from 2003-2004 collection of property tax will be decentralized to the districts, which will collect on behalf of the tehsils in the district. Currently, the tax is collected by the district revenue office (previously the district office of the Provincial Excise & Taxation Department) on behalf of the province. In the case of education and health, the estimated revenues have been counted in the district revenues but, although the district offices collect them, they are credited to the provincial consolidated fund. These taxes are not credited to the respective district funds. The mechanism for returning taxes for property, health and education to the point of collection or otherwise has not yet been specified.

If districts do raise additional revenues, then to date little attempt has been made to ensure horizontal (or vertical) harmonization of taxes among various governments. Imposition of a new tax by a local government, without any corresponding levy by other similar governments, can make mobile taxed resources move out of the taxed jurisdiction to other locations. This has clear implications for business and economic activity within the taxed jurisdiction. Inevitably, this discriminates against the more backward jurisdictions, where the revenue needs are the highest, but where, due lack of infrastructure and other amenities, economic activities are already limited. In distinction to tax equalization, which argues for equal tax rates across all jurisdictions, tax harmonization suggests that local tax structures should be consistent with the economic and social conditions of each jurisdiction. This also does not rule out the possibility of an efficient and productive tax competition among various local governments, whereby a local government can enhance taxes but prevent its impact on business and economic activity by providing better living and business environment through its expenditure decisions.

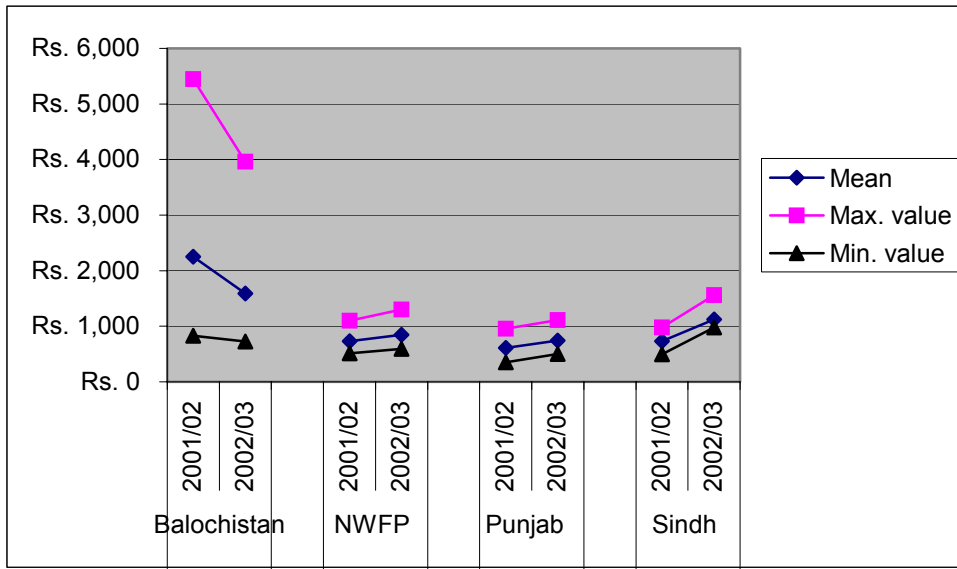
In their first year, local governments employed a variety of new revenue measures to meet their expenditure needs, with no consideration given to the viability, efficiency or sustainability of these

measures. For example, a tehsil in Khairpur district, decided to use its development funds to establish public real estate, which could yield a future stream of rental income for the TMA. Not only does this run counter to the government's stated objective of withdrawing from areas of private sector expertise, the experiences of other countries point to grave risks in such a mode of revenue generation. After some Union Administrations resorted to collection of tolls (and the defunct zila tax), the federal government intervened to require that local governments get any new taxes that the plan to levy vetted by the provincial finance department. While this is important for tax harmonization and coordination and for prohibiting the local governments from thwarting national and provincial policies and objectives through imprudent taxes and other fiscal measures, it potentially undermines the independence or discretion of local governments.

Overall, districts are left with little incentive to raise additional taxes, and even less incentive to raise them well. Indeed, there are overwhelming political disincentives for nazims to levy taxes. They are primarily dependent on fiscal transfers, and under these circumstances subnational governments have few incentives either for cost efficiency or to improve efforts to raise revenues. Such imbalances can be mitigated by a combination of formula-driven predictability in the intergovernmental fiscal transfers, and autonomy for provincial governments in relation to setting the tax rate and the tax base for those revenues that are assigned to them. However, thus far, the effect of the formula based transfers has been limited, as in order to provide for a smooth transition, financing of recurrent expenditures has been determined according to the principle of 'revenue adequacy', that is, to maintain service delivery at pre-devolution levels.

The 'revenue adequacy' principle worked well to prevent large-scale disruptions in service delivery at the outset of the new system, but it has also preserved the disparities within provinces that are evident in the per capita budgets before the introduction of the interim PFC awards. This probably means that, for the nazim of good intentions, "grantsmanship", the manipulation of expenditures in order to trigger greater transfers in the future, remains a better bet than tax effort for increasing district revenues. Still, it is intended that a reallocation will gradually reflect relative need and revenue potential. Figure 4 shows that there are some changes in the size of fiscal transfers, but the implication is not yet clear.

**Figure 4: Per capita provincial transfers to districts - FY 02 and FY03**



*Source:* FY02 - World Bank, Asian Development Bank, NRB. FY03- (Vaillancourt: 2002).

*Note:* These data include only the provincially transferred resources and therefore do not provide the full picture of district's public resources.

Overall, newly-appointed district and tehsil nazims will be wary of raising additional taxes. The interim PFC awards in Sindh and Punjab do seek to create some incentives for increased revenue generation. For instance, in Sindh, districts will be given an additional allocation matching their baseline collection of certain items. However, this may have the perverse effect of motivating districts to raise taxes regardless of how well they are spent. Districts with wider tax bases and lower efficiency may gain more than those with a narrow base and higher efficiency.

In addition, the incentives remain weak for encouraging user-fees for private goods. The community is willing to pay for improvements in the delivery of services that they value. In the case of water and sanitation, for example, devolving capital expenditures from the provincial level to the district or tehsil level, accompanied by good intentions to tie them to capacity for operations and maintenance, is unlikely to be sufficient to discipline investment. Without a relationship between quality and quantity of services delivered, on the one hand, with the cost of those services, on the other, infrastructure will suffer from under-investment and problems in operations and maintenance will continue.

There are examples of community management of W&S systems in Faisalabad, where in some places the citizens have constructed the sewerage system with their own funds and are also managing the system. Jurisdictional problems obstruct the replication of these initiatives in other areas as the Water and Sanitation Agency, which is responsible for all water and sanitation services within the defunct municipal corporation boundary, covers an area that extends into other city towns.



## Have incentives been strengthened to use resources efficiently?

### *Administrative autonomy*

Operational efficiency in local government was initially hampered by the rather one-size-fits-all approach of the LGOs. The initial approach of the provinces was to apply the provision of the LGO uniformly to each district in the province. This created some anomalies in terms of administrative devolution as all districts were assigned all the departments, irrespective of need. Providing staff and budgets for each of departments in each district created some redundancies. For example, urban Karachi was assigned the agriculture department (along with the other departments) whereas nazims of predominantly rural districts complained they had to budget for IT departments, despite limited utilization of IT. Similarly, literacy departments were assigned to all districts, with almost the same number of staff, although city districts and small rural districts had less demand for this service.

To remove this anomaly, the provinces were given the right to modify their respective organizations and thus provide for a more efficient allocation of resources. For example, in Balochistan, where the problem was most acute, a specific provision was included in the LGO to allow the assignment of functions on the basis of need. In NWFP the City Development and Municipal Department (CDMD) was created by the Peshawar City District Government for the provision of macro-municipal services, as well as to undertake special infrastructure projects (funded by the provincial government within the district boundaries). It is the successor of the previous PDA. The LGO provides City Districts with the authority to establish additional departments per their specific requirements. In other provinces, the problem has not yet been fully addressed.

The administrative autonomy of the districts remains severely curtailed. With the exception of Punjab, salaries are still paid from provincial Account I rather than the district-controlled Account IV. The districts must seek approval from the province (approval is via the provincial District Accounts Officer) for the release of the funds from Account 1 for their salary payments. Thus, the salaries effectively are still paid from the provincial budget.<sup>22</sup> There are similar ambiguities at the Tehsil/Taluka level, but the number of staff affected is much smaller.

There are several reasons why provinces may be reluctant to transfer district salaries via Account IV, in addition to basic concerns about district capacity. First, no objective needs-based formula has been devised to ensure distribution of salaries approximating the current expenditures. Second, in the absence of reliable employee databases, transfers based upon the number of sanctioned posts run the risk of over-funding those districts in which there are many unfilled positions. Third, the provinces argue that transferring salaries through Account IV presents a potential cash-flow problem. The current arrangement effectively allows the province to pool the district budgets until they are disbursed, providing the government with sufficient balances to cover the shortfalls arising from irregular receipts from Federal disbursements, thereby obviating the need for ways and means borrowing.

However, the present arrangement means that the largest part of the budget is outside of the control of the district government. The districts are unable to reallocate resources or change the composition of the workforce. Once salary budgets are paid through Account IV, the districts

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<sup>22</sup> This is in contrast to the previous employees of the rural district councils who are paid from the district budget through Account IV (or the Local Fund where this has not yet been merged with Account IV). It seems that even when salaries are transferred through account IV, there will not be any change in the responsibility for future pension liabilities.

would, according to the LGO, be able to select more of one type of staff or skill and less of another. In practice, the provinces may retain control over the creation of new sanctioned positions; but at the least the districts would be empowered to reallocate any staffing savings.<sup>23</sup>

#### *Autonomy in execution of the non-salary and development budgets<sup>24</sup>*

Spending on development budgets was initially slow because the new "financial circuits" were not always in place:

- Financial officials such as the EDO-Finance and their staff were not in place in all districts when devolution was implemented, not having been posted or, if posted, not having moved to the districts until September/October;
- Once posted, financial officials may not have had access to the necessary resources, such as offices or office equipment;
- Even when equipped, they did not always have adequate training in financial matters, did not always understand their new duties, and found it difficult to operate using both local funds and provincial funds.
- The accounts in the State Bank of Pakistan/National Bank of Pakistan into which provincial funds were transferred to districts and tehsils for non-salary expenditures (account IV) were opened only in October 2001 and January 2002. This did not affect salary payments since those were paid directly by the provinces out of account I, but it did affect non-salary funds. Mistakes also were made by these banks in drawing and depositing funds in one account rather than another, leading to further confusion.
- District budgets had to be approved by district councils. This slowed down spending in most districts since most budgets were approved only in October/November 2002, with political choices as to how to use the development budget through identification and selection of schemes made afterwards, followed by the preparation of technical documents, tenders etc.

The perennial staff transfer problem also impacted on performance. Once trained and informed through various directives as to how to carry out their work, district finance officials were often posted to other civil service jobs. There are also unconfirmed, anecdotal reports that some officials may have been less willing to spend because they were uncertain how much to extract as corruption in the new environment.

The 2002-2003 budgets were set by June 30, 2002, before the federal and provincial elections in October 2002, with the wage bills still determined at the provincial level, and with many detailed and occasionally counterproductive controls.<sup>25</sup> The budgets were prepared in collaboration between district officers (EDO Finance) and provincial civil servants. Generally, the degree of district government autonomy in preparing their 2002-2003 budgets was low, with city districts exercising greater autonomy. One of the difficulties faced by the districts was that the PFC awards were finalized late in the budget preparation cycle.

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<sup>23</sup> The Government of Punjab has begun working on this issue. The proposal has been made that where a district identifies a staff saving/redundant post, the employee will be sent to a provincial surplus pool for re-posting – possibly to another district. Districts will receive a proportion of the saving, although the province will retain a high proportion, as they will have to continue paying the salary.

<sup>24</sup> No data are yet available on implementation of the 2002/03 budgets. The following analysis therefore relies on 2001/02 budgets.

<sup>25</sup> In Sindh, for example, districts were told that they were being given an incentive to economize on salary and utility payments as any underspends would be available for development. The transfers provided however for only the actual expenditures - with the savings remaining with the province.

A larger problem emerged with the development budget, as each provincial government provided sizable funds for schemes to be identified by the elected members of the provincial assembly (MPAs) – in the Balochistan case, these allocations were financed by withholding district development budgets. This practice has undermined the sovereignty of local governments to plan the development of their districts according to their own priorities. Moreover, there are concerns about the coordination of the two (provincial and local) streams of development activities to avoid duplication and over provision of service facilities. Although MPAs have been directed to seek scheme approval through the District Development Committee, this accommodation has continued to confuse responsibilities and accountability for efficient use of resources.

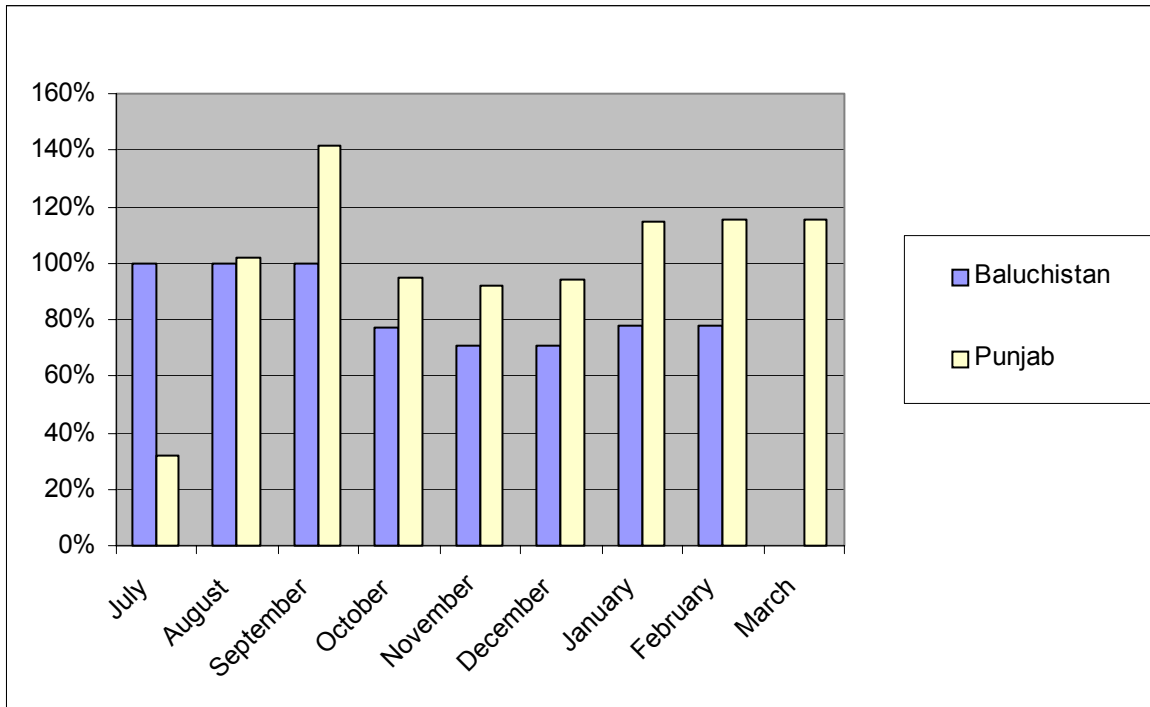
The large "throw forward" of uncompleted development schemes has a dual impact on the autonomy of district governments in executing the development budget. First, the provincial governments are (rightly) concerned that transfer of large development resources to the local governments runs the risk of some (or most) of the on-going schemes being abandoned to start new schemes, thus the provinces have some justification for their moves to limit the amount of development resources transferred to the local governments (at least through Account IV). Second, even if the funds for on-going schemes are transferred to the local governments, completing on-going schemes implies that the new local governments have become conduit for implementing the priorities of the previous set-up, and have little leverage to implement projects and programs based on their own priorities. The intentions are that from FY 2003-04, the districts can decide that schemes, if still incomplete, could be dropped. If this happened, they would not be responsible for paying for keeping them going and the Province would have to decide if it wished to fund them. Districts would not have their allocations cut to deal with this.

#### Is funding more predictable?

There have been significant complaints, especially at the level of TMAs, about delays or inadequacy in transfers. Although it is the responsibility of the PFCs to adjudicate and provide redress, they have not so far been able to assume this role. Mechanisms for dealing with these issues might emerge through the rules of business. Fully functional PFC secretariats would provide the capacity to review complaints, inquire into them and take action.

Figure 5 shows that in the 2 provinces where the data are comparable, there are some discrepancies between the budgeted funds and the releases to district governments. In case of Punjab and Balochistan the data allow a comparison for predictability since all transfers, including salary, were made through Account IV.

**Figure 5: Releases as percentage of district budgeted shares**



Note: Data for March for Balochistan is not yet available  
 Source: Devolved Service Delivery study

Amendments to the LGOs through insertion of a provision in the Fifth Schedule (except in Balochistan) provide for framing fiscal transfer rules which, inter alia, institute reporting formats, ascribe roles and responsibilities to various agencies, and institute a continual updating of databases of the Department of Finance and PFC. However, erratic transfers are enabled by the absence of any monitoring arrangements. For the districts, data are available through the State Bank accounts statements, but these are not compiled at present. In the TMA case, no reporting is taking place in any of the four provinces (although in Sindh, the Local Government Department is creating a database of TMA finances).

**Accountability for staff behaviors**

Overview

As noted above, efficient fiscal management is undermined by the constraints imposed on district governments in managing their own budgets – specifically the refusal, to date, of most of the provinces to transfer salaries through the mechanism of Account IV. Even if they had the budget, districts would still have to set up mechanisms to manage redundant staff – as per the Punjab proposal noted above. The transfer of functions and the physical relocation of staff have not been matched by the transfer of the employer role. Figure 6 shows the current state of play for Sindh and NWFP.

**Figure 6: Location of the employer function for district staff in Sindh and NWFP**

Employer function		Sindh	NWFP
Budget Control	Paying staff salaries from its own budget	Province	Province
	Determining the wage envelope	Province	Province
	Authority to dismiss surplus staff	Province	Province
Performance Management	Directing and supervising activities and tasks	Formally district, informally many provincial influences.	Formally district, informally many provincial influences.
	Conducting evaluations (Annual Confidential Reports - ACRs)	District	District.
	Undertaking discipline/dismissal	Not yet decided.	District for health and education staff. Not yet decided for others.
Recruitment	Legally recognized as the employer	Not yet decided	District.
	Authorized to hire	District	District.
Career Management	Offering promotion	District	District for health and education staff. Not yet decided for others.
	Making transfers within local government	Formally district, informally many provincial influences.	Formally district, informally many provincial influences.
Establishment Control	Controlling overall staffing numbers	District	District
	Controlling disposition of staff within local offices and facilities	Formally district, informally many provincial influences.	Formally district, informally many provincial influences.
Pay Policy	Setting overall wage rates	Province but effectively federal	Province but effectively federal
	Setting hardship/remoteness allowances	Province but effectively federal	Province but effectively federal

Local governments need autonomy over other personnel decisions (hiring, posting, performance monitoring, and rewarding) of facility-level and related staff. The two key questions posed in this section are:

- Does the perennial problem of staff transfers undermine the ability of the nazim and the respective EDOs to direct their own staff?
- What rigidities prevent rational human resource management and planning at the district level?

#### Are postings and transfers managed?

The problem of senior staff transfers (grade 17+) provides a significant obstacle to effective staff management. There is a formal and an informal aspect to this.

Formally, the disjuncture between the geographic location of senior staff and the location of their appointment, promotion, and transfer authorities creates competing lines of control. For instance, while the new District Coordinating Officer (DCO) replaces the former Deputy Commissioner and reports to the district nazim, he or she usually remains part of a federal cadre - although a few are from provincial cadres. In either case, his or her promotion and transfers are managed outside of the district, undermining the reporting relationship to the nazim. DCOs have been transferred from their original post during the first 2 years of devolution.<sup>26</sup> Nazims may request but cannot prevent

<sup>26</sup> This varies between provinces and it is likely, for example, that postings and transfers have been more frequent in Sindh than in Punjab.

such a transfer. Similarly, the 10 to 12 Executive District Officers (EDOs) – responsible for sectors such as education, health, and literacy – report (formally) to the DCO and not to the line ministries in the former divisional/provincial hierarchy. However, as their promotion and transfers are determined at the provincial level, they too are unlikely to regard the district managerial structures as paramount.

Informally, the authority retained by the Provinces to transfer senior staff in any of the provincial occupational groups (i.e., above grade 16 and thus not transferred to the districts in December 2002) leads to other deeply entrenched transfer problems. Although the competence of the province to transfer staff is formally limited to senior staff, in fact it extends to the lowest levels of the district structures. By the threat of an unpleasant transfer, or the promise of an attractive one, the senior staff member can be pressured to arrange the transfer of a junior employee, below grade 16. Enforced inter-district transfers for provincial cadres posted to the tehsils are also a major problem.

### **Box 7: The politics of staff transfers**

#### Sindh

Inter-district transfers of provincial cadre staff are an enormous problem, particularly in the period just prior to and just following elections. Many EDOs reportedly were pressured to accede to transfers in advance of the by-election in Sindh, with the threat that they themselves would be transferred out of the district if they did not comply. The newly-elected provincial governments have also precipitated a flurry of transfers as the new parliamentarians attempt to assert and expand their control. The authority of district and Tehsil/Taluka Nazims has suffered as a result.

Several reports have appeared in *Dawn* recounting the rivalry between the Muttahida Qaumi Movement (MQM), a key member of the provincial coalition government, and the Jamaat-e-Islami party, which controls City District of Karachi. While the Nazim has insisted that no officer should be transferred without his permission or at least consultation, the MQM has ignored this demand. In February 2003 senior police officers were transferred without consulting the Nazim, Naimatullah Khan, although law and order is a responsibility of the district government. In March, the EDOs for Revenue, Finance, Education, and Local Government were similarly transferred, with successors chosen by provincial officials.

Pakistan People's Party (PPP) dominates rural district administration in Sindh. However, even some PPP parliamentarians have come out in favor of curtailing the authority of local nazims, as these can represent a challenge to the authority of the party's provincial office holders. Rural district nazims have complained to the Chief Secretary that their DCOs have ordered transfers without consulting them, and approved transfers that countermand their direct instructions. The simple fact, however, is that nazims have little control over the DCO.

#### NWFP

On June 2, 2003 all 24 district Nazims in NWFP resigned in protest against the MMA government's 'interference'. The primary concern of the provincial government, the nazims alleged, is the transfer of government officials and the placement of politically sympathetic new recruits within the districts. "The officers were threatened of bad consequences if they didn't obey directives about transfers and postings." Source: (The News International, Pakistan, Monday June 2, 2003)

As long as provincial and federal cadres retain positions in local governments, then some minimum time must be placed on the tenure of these officers. Without this, the temptation to use transfers as a covert policy instrument is overwhelming.

### Are staffing rigidities undermining management?

Despite various reform efforts, the occupational groups remain vertically separated, distinct career streams. This creates a well-recognized problem at the federal and provincial levels as these groups have developed a claim to certain positions within government departments and divisions. In some cases set proportions of various groups have to be maintained. As a result, the structure of divisions and departments at both the federal and provincial levels is unnecessarily restricted by the need to ensure that the various occupational groups with a claim to positions within that division or department are satisfied. At times, positions are created to satisfy the needs of the various groups and cadres for promotion opportunities, rather than on the basis of policy priorities or operational needs.

The appointments made at senior levels reflect the need to accommodate generalists who tend to be promoted in large numbers because their cadres are larger, and thus promotion is faster. For some of the technical cadres the promotion path narrows with seniority and might end before reaching the highest levels. For this reason, senior positions tend to exclude staff with technical backgrounds. Lateral induction on fixed-term contracts has been introduced recently (MP grades system). However, it is unclear how many organizations are taking advantage of this flexibility. It appears that the proportion of these positions in senior management remains very low.

These systemic civil service problems are replicated at the district level. The parallel, vertically-oriented occupational groups have led to significant problems in merging different groups of staff. In some Sindh districts, for example, devolution has resulted in Communications and Works Department staff working alongside the Education Works Department staff at the district level. In some cities, the Development Authorities, which were responsible for structural planning, have now been wound up and their staff transferred to various tehsils, where they have joined the staff from provincial departments posted there. Thus, tehsils have had to absorb staff coming from a variety of different sources in the first months of devolution. These mergers have led to complex and in some cases seemingly insoluble problems of seniority. No acceptable formulae for merging seniority lists can be found in such situations.

The underlying problem is that without some increased flexibility then future reorganization at the district level will be more difficult, and – as with the provincial and federal cases – the structures of district offices will be distorted by the need to accommodate promoted staff.

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### **3. Priorities for Action**

This section highlights five key issues that should be addressed during the next phase of devolution.

There is a concern, most recently expressed by donors at the May 2003 Pakistan Development Forum, that because devolved institutions are still weak, resources intended for pro-poor service delivery will be ‘captured’ by elites unless special measures are put in place to bypass local government control. This concern is well justified - it has been widely acknowledged in Pakistan<sup>27</sup>

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<sup>27</sup> Ishrat Husain, Governor of the State Bank of Pakistan, for instance, researching why, given Pakistan's remarkable average GDP growth rate of 5 percent over fifty years (1947 to 1997), could poverty could be so widespread and apparently unyielding, concluded "Our main hypothesis is that failure of governance and the consistent domination of political power and state apparatus by a narrowly based

and has been found to be an issue elsewhere.<sup>28</sup> But the remedy can be rather worse than problem, as the effect of these measures can be to ‘infantilize’ local government and to undermine devolution. In essence, local governments will not ‘grow up’ unless they are enabled to assume effective responsibility for the mandates granted to them by the LGOs.

Local government is undermined by: (i) the creation of special purpose vertical programs to ring fence the bulk of resources destined for services, and (ii) the continued significant involvement of the federal and provincial governments in management of staff in the districts. These practices stem from concerns about weak capacity of local governments and about a history of weak governance. Neither of the measures can or should be simply stopped - and the concerns are not misplaced. However, unless an exit strategy is evolved then the weaknesses and malpractices that require this external hand-holding will become ever more deeply entrenched as this delays the emergence of capable and accountable local authorities and reinforces patrimonial linkages between local officials and their peers in higher offices (Craig and Porter: 2003).

There is a parallel risk – that some of the foundational arrangements in the devolution plan will not be fully implemented. Impatience for service delivery improvements, and the concern to avoid elite capture noted above, could overshadow the need to complete some of the foundations on which effective local government will rest in the long term.

Three examples of this risk are discussed in this section: (i) continuing lack of progress on implementation of the Police Order may see the re-introduction of the executive magistracy and, thus, undermine the basic precepts of devolved governance; (ii) failure to resolve long-standing disputes about jurisdictional responsibilities for local accounting and auditing will delay creation of a national, unified set of accounts, and threaten the entire apparatus necessary for creation and enforcement of new norms of accountability, and (iii) the risk that too much is left to supply-side reforms - including improved service delivery and accountability arrangements, coupled with local elections and other mechanisms of representative democracy - and that the demand-side will not be nurtured.

Addressing these issues is challenging, not only because they are technically complex, but also because it requires government to address long standing corrupt practices through which resources intended for service delivery are diverted.

The first two issues – about vertical service delivery programs, and human resource management - are clearly hot topics at the moment. There are active discussions between local governments, the provinces and federal government, and between government and the donor community concerning these issues. However, the need to complete the foundations is less actively discussed. Taking these forward will require an active strategy for completing devolution and this raises the issue of how implementation of devolution is to be managed in the new political dispensation. The role of

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elite seeking to advance their private and family interests to the exclusion of the majority of the population lies at the root of the problem... (this) has made (formal) institutionalized decision making irrelevant." (Husain: 1999).

<sup>28</sup> There is much evidence that devolving authority carries the risk of ‘elite capture’ and perpetuates existing inequalities (Blair: 2000; Crook and Sverrisson: 2001; Manor: 1999; Moore and Putzel: 1999). Where constituencies comprise large numbers of poorly literate people dependent on powerful elites there are few cases where decentralization has proven effective - unless special efforts have been made to redress inequalities in real rights and entitlements governing land and property or to deal with the covert markets for public office, the award of contracts for development investments or the unwarranted exercise of discretion in public regulatory functions (Wade: 1985). For details of this phenomenon in India see (Harriss: 2001).



the NRB to define policy, prepare the legal instruments and host of supporting regulations and guidelines has always been clear. However, responsibility to communicate and implement devolution, to prepare and disseminate subordinate regulations and rules of business, to monitor promising innovations and to clearly flag constraints and issues must involve a far wider range of actors if success is to be achieved.

## **Avoid undermining local government**

### 1. Move from vertical programs to conditional grants

#### *The problem*

Vertical programs are federal or province government programs that provide services within a local government's functional jurisdiction but for which executive authority is not exercised by the local government. Thus, for example, the NWFP Barani Area Development Project, the Punjab Barani Village Development Program, and the Tameere Sindh Program (MPA program), all promote service delivery in areas that fall within the jurisdiction of district and tehsil governments - but without the local government having any planning, budgeting or expenditure control.

At root, vertical programs allow federal and provincial governments to maintain executive control over planning, budgeting and expenditure decisions to ensure that resources are directed into their preferred services and outcomes. So, for example, in the Extended Program of Immunization (EPI), the Federal Ministry of Health prepares and executes budgets and procurement plans for delivery of drugs and consumables. Although they can be effective in ensuring the implementation of federal priorities, vertical programs undermine local government authority, as they bypass the local governments' own nascent planning and budgeting systems. Where a large share of the resources available for local service delivery are channeled through vertical programs, this also reduces the fiscal space available to local elected leaders to respond to the demands expressed by their constituents.

Vertical programs also undermine the utility of the PFC, as they deny it the opportunity to develop objective formula-based transfers for local governments that ensure approaches are consistent, that resources are equalized according to needs, and that systems of incentives and sanctions are introduced to encourage good performance. Vertical programs also provide the opportunity for federal or provincial governments to determine the size and distribution of funds on political criteria. This disrupts service delivery by creating an unfair, uncertain and unstable funding environment.

Expediency is leading federal and province governments, often with donor support, to maintain vertical programs for service delivery. While recognizing that the federal and provincial governments are justifiably concerned to ensure that some priority programs are implemented, they should move from vertical programs formula-based conditional grants to support local political actions and accountability.

Not all pre-devolution programs administered by federal and province governments should be redesigned to comply with the LGO – some are nearing completion. Beyond this, however, it is clear that an exit strategy must be found from the many special purpose arrangements that run in parallel to or inconsistently with the intentions of the LGO. In some cases this seems to reflect only the need to ‘reorient’ pre-devolution approaches, but despite some notable efforts<sup>29</sup>, in few cases do

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<sup>29</sup> In some cases, such as the Khushal Pakistan Program, the CBOs created by NGOs have been encouraged to seek registration as CCBs and access local government funds

donor assisted projects support the new kind of participatory planning, budgeting and expenditure relationships between communities and local governments envisaged in the LGO.

This is clearly a major task. In the water and sanitation sector alone there exist in various stages of design, implementation and completion some 35 water and sanitation projects supported by \$560 million in aid from fifteen multi/bilateral agencies. These programs are largely funded through grants or credits agreed by the donors with the federal or provincial governments - not the local governments - and transferred with no reference to the PFC.

The newly elected provincial governments are strong supporters of vertical programs. Instead of the expected sunset of Khushhal Pakistan Program, this was transformed into Tameere Pakistan, Tameere Punjab and like programs. The extension of pre-devolution programs has been used by provincial departments to recentralize control over investment decisions that are clearly mandated to local governments.<sup>30</sup>

The role of the provinces is a sensitive issue lying behind this. Some of the provincial concerns are that the new arrangements leave them with a residual role as little more than a mechanism for transmitting federal funds to local government. There is certainly a sense in which they have been squeezed between the continuing strong role of the federal government, and the new role of local government. Historically, the assignment of responsibilities has been significantly more centralized than that intended or provided by the Constitution. Behind the stated concern that provincial and local governments have weak financial and administrative capacity, the federal government has appropriated a large number of functions that were either shared or provincial domains. There remains great scope to devolve additional functions from the federal to the provincial governments. Government announced its intention at the Pakistan Development Forum in May 2003 to examine the roles of Federal Government in relation to those of the Provinces and, on the basis of subsidiarity, reallocate responsibilities more clearly to provinces. Education and Health would be particular targets for such reallocations. As they are concurrent responsibilities, no constitutional change would be necessary to achieve this.

Devolution of these functions would ease provincial governments' concern about becoming redundant in the wake of large devolution to the district governments, would lift the morale of the provincial civil service and enable the federal government to focus on its key strategic functions.

#### *Action needed*

##### *Design and implement a transition strategy for vertical programs for local service delivery:*

Higher-level governments seek from local governments a reasonable assurance that their policy priorities will be reflected in local spending decisions and service performance. However, these pronouncements of concern often merely mask an imperative to maintain control over the lucrative development and recurrent budgets that comes with retaining executive control over what are clearly the mandates of local governments. Further, international experience has been that until local authorities are given substantial responsibility – in other words, executive and accountable responsibility – for planning and delivering services they will not develop the required skills and capacities, despite assurances from higher authorities that they will be granted such responsibility ‘when capacity develops’.

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<sup>30</sup> The Punjab Community Water Supply and Sanitation Program, approved by ADB late in 2002, has been used by the Province Department of Public Health Engineering as pretense to recentralize control over technical and financial sanction power to the province level, away from the Tehsils.

Most productive would be to identify high profile, bell weather vertical programs, in health, education and basic infrastructure provision and design ways and means to progressively integrate and transfer these to local government authority. This can be done through PFC-sanctioned conditional grant programs - with grants promoting equalization, in particular priority areas. Where there is an argument that economies of scale can be achieved by provincial government rather than local government delivering a particular service (school construction, textbook printing might be examples) then local governments can be offered the opportunity to contract higher-level government for this service.

*Institute a major program of support for the PFCs to help graduate to the next generation of formula-based intergovernmental transfer grants*

It is imperative that PFCs are politically and technically supported, especially over the next twelve months. Before the next generation of formula-based grant systems are put in place, studies will be required to provide a rational estimation of fiscal need and local fiscal capacity and to create new incentives through which higher level policies can be transmitted to local governments. Alongside this, legal instruments through subordinate legislation will be needed, including framing of fiscal transfer rules, rules of business of the PFC and mechanisms for redress of grievance. Similarly, the mode of removal of members of PFC will need to be specified through a set of rules that does not weaken the independence of the body.

Politically, this will require that the PFC awards bind the Provincial Assemblies. Article 121 (e) of the constitution allows for this, providing a route by which PFC-mandated transfers can be treated as charged expenditures.

*Raise awareness amongst donors of the dysfunctional consequences of vertical programs in the context of devolution and promote design of new project assistance modalities:*

Many donors are aware of the perverse effects of pre-devolution project execution arrangements and are trying to redesign project assistance in ways consistent with devolution.<sup>31</sup> In tandem, given that many, if not most federal and provincial vertical programs are co-financed by donors, special efforts will be needed to ensure donor commitment to design ‘good practice’ benchmarks, first to ensure these arrangements do not usurp or undermine local planning, budgeting and service delivery mandates and, second, to promote progressive phasing out of pre-devolution mechanisms. For some donors, the shift from the ex ante controls on expenditure through project agreements to formula and performance based grant financing through PFC sanctioned arrangements will require adjustments to in-house arrangements and, possibly, new financing modalities.

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<sup>31</sup> The ADB, for instance has announced that all new lending for service delivery (such as the proposed multi-sector Devolved Social Services Program in Sindh, and subsequently other provinces) will be designed to simultaneously support devolution and that newly approved projects will be revisited. DFID has recently redesigned the Rural Water Supply and Sanitation Program (RWSSP) in NWFP along these lines, and is struggling to reconcile its support to the federal Health Ministry’s Lady Health Worker program with high profile commitments to devolution. The proposed World Bank Punjab Education Sector Adjustment Credit is seeking to ensure that it is supportive of the Punjab PFC.

## 2. Find an exit strategy from provincial micro-management of district staffing

### *The problem*

The difficulties created for district governments by the active presence of the province in management of the civil service were noted earlier.<sup>32</sup> The involvement of provincial and federal governments in personnel management decisions in the districts (and to a lesser extent in the tehsils) creates a pervasive sense of micro-management and is one of the key constraints on enhanced responsibility for civil service performance at the district level.

This problem arises partly because there are few transparent avenues available to the federal government and to provinces to influence local government policy priorities. PFCs, as noted above, have not yet developed the grant systems that will provide the primary mechanism of influence. Provinces fear that the formal leverage available to them on local government behavior is very weak. At present, the LGOs empower them only with 'moral suasion' operated through 'non-binding directives'.

Provinces are tempted to use other, less transparent, mechanisms to shape local government policy. The principal opportunity is the retained ability of the Provinces to transfer senior staff in any of the provincial occupational groups (i.e., above grade 16 and thus not transferred in December 2002 to the districts). Although this ability to transfer staff is, formally, limited to senior staff, in fact it extends deeply into the district structures. By the threat of an unpleasant transfer, or the promise of an attractive one, the senior staff member can be put under pressure to accede to a transfer of the junior staff, below grade 16 (or grade 18 in Punjab).

### *Action needed*

Three steps are needed. The first two have been under active consideration by government for some time. The third proposal may be introduced where feasible.

*Transfer budgetary responsibility for salaries to the district governments.* Funds for salaries need to be transferred to the districts via Account # IV and on the basis of the budgeted amounts. This is not a sufficient condition for local governments to value professionalism more than patronage, but it is undoubtedly a necessary one. Local governments at all levels will only start taking their responsibilities for workforce management seriously as and when they consider themselves to be fully the employer of their staff. In practice, even if salary funds are transferred through Account IV, the provinces may retain control over the creation of new sanctioned positions; but at the least the districts would be empowered to reallocate any staffing savings.<sup>33</sup>

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<sup>32</sup> See "Are postings and transfers managed?" on page 37.

<sup>33</sup> The Government of Punjab has begun working on this issue. The proposal has been made that where a district identifies a staff saving/redundant post, the employee will be sent to a provincial surplus pool for re-posting – possibly to another district. Districts will receive a proportion of the saving, although the province will retain a high proportion, as they will have to continue paying the salary.

*Create a District Service.* One justification for the involvement of the provinces in personnel management in the districts is that, realistically, career paths for staff would be unattractive unless they are part of provincial cadres. This argument has some force - but it could be mitigated by supporting the proposal made by federal government and under discussion in some provinces for the creation of a District Service.

The overwhelming majority of district government employees came from formerly provincial employment groups – particularly Public Health Engineering, Rural Development, Local Government, and Education. Most provincial groups had some staff in the districts. Most of these transferred groups are at grades 1-15 (90% of all such staff in NWFP and 83% in Sindh) - and it is these transferred staff who might constitute a future District Service. Most of the small numbers of employees who had earlier belonged to the rural district councils would join them in any newly created District Service. Some of these staff at lower grades were assigned as administrators to the Union administrations (maximum of 3 staff per UC at Grade 9).

The even smaller numbers of staff from federal employment groups (primarily District Management Group (DMG) and the Audits and Accounts Group) would remain outside of any district service. Their employer remains unambiguously the federal government. Senior staff (grades 16 and above) from the formerly provincial employment groups would also remain outside of any district service.

**Table 9: Possible future for the staff of district governments**

Staff groups		Possible future
Staff from federal employment groups (primarily District Management Group (DMG) and the Audits and Accounts Group)		Will remain in federal or provincial services
Formerly provincial employment groups – particularly Public Health Engineering, Rural Development, Local Government, and Education	Grades 16+	
	Grades 1-15	To form a District Service.
Employees who had earlier belonged to the rural district councils		

In the longer term, a District Service would open up the possibility that skilled staff, serving in difficult or remote locations, could be rewarded at significantly higher levels than the current common pay scale allows for. This is likely to be particularly important in the attraction of teachers to serve in remoter, less desirable areas.

*Raise the cut-off between district and provincial staff to grade 18.* There are many reasonable arguments for maintaining a federal presence at the provincial level, and similarly for maintaining a federal and a provincial presence in the districts. However, this provides a point of entry for manipulation and, particularly for the new district governments, leaves them subject to provincial pressures to transfer staff. As feasible, the appointment, promotion and transfer (APT) authorities for staff should be progressively passed to the districts. Currently, staff at grade 17 and above are appointed, promoted and transferred by the provincial governments (19 and above in Punjab). APT authorities for grades 17 and 18 can be transferred to the districts within a year, although this will require some clarification of the role of the Provincial Service Commissions.

In addition, minimum times in post for senior federal, provincial and district staff should be clearly specified with a requirement that public explanations be provided if staff are to be moved before they have completed the minimum. By themselves, however, such specified

minimum tenures are unlikely to be sufficient to withstand the considerable political pressures for inappropriately rapid transfers.<sup>34</sup>

## **Complete the foundations**

### 3. No backtracking in the implementation of the Police Order

Commitment to dismantling administrative structures more suited for rule by a colonial power rather than citizen oriented service delivery is a major departure from previous governments that have used these colonial structures to exert control and undermine the rule of law. In this respect the abolition of the powerful office of the district commissioner and the vesting of that office's judicial powers to the judiciary was a bold, essential step in devolution and underpins both the LGO and the Police Order 2002.

Implementation of the Police Order is essential for a successive impact of devolution on service delivery, in two respects. First, improved police performance is an essential public good in its own right for it underwrites public safety, observance of basic rights and, ultimately local respect for the rule of law and the credibility of local institutions without which local social and economic development is unlikely. This is especially important for the welfare of vulnerable and disadvantaged groups. In many cases, police are largely responsible for making informal sector survival strategies increasingly difficult, by harassing small traders and vendors, especially women. Even when markets and infrastructure to access markets is available, travel and trade is difficult because of numerous checkpoints and concomitant police harassment. While police actions can range from indifference and neglect to corrupt activities, the severest form of injustice affecting the poor usually takes the form of violent police harassment of individuals. Minority or socially excluded groups are particularly vulnerable to police extortion and harassment. Poor people who are able to solicit the patronage of the police fare substantially better than those who are unable to enlist this kind of support. However, soliciting this patronage often forces the poor to either sell their assets, thus pushing them further into poverty, humiliation and silence. As noted internationally, controls over police action a crucial. "When the institutional checks and balances on police action disintegrate the police force is capable of immense repression and exploitation" (Narayan, Patel, Schafft, Rademacher and Koch-Schulte: 2000).

Failure to progress with the police reforms will impact immediately on efforts to reform the judiciary and the various alternate dispute resolution institutions (e.g., Anjumani Musalihat, Insaaf committees, Criminal Justice Coordination Committees). But experience elsewhere suggests that when the police fail to respect and enforce the law, this reinforces a culture of cynicism and disrespect for the public and is mirrored by the behavior of other public officials.

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<sup>34</sup> A requirement that staff remain in post for at least 3 years is already included in the Government Rules of Business (Rule 35 (ii) Schedule 9). This is not implemented however.

**Box 8: The risks of municipal service**

Faisalabad, ‘Three employees of the Tehsil Municipal Administration sustained burn wounds when a vendor threw acid on them during an anti-encroachment campaign in Jhang Bazaar. ... (the accused) in the lock up told Dawn that he and other vendors had been paying handsome nazranas to TMA employees for the last many years and there was no justification to lift their goods and destroy their business ‘.

Source: (Dawn 3 May 2003).

Implementation of the Police Order has wider significance for devolution. Most commonly expressed by TMAs, the failure to bring about a more publicly responsive police service is said to be hampering efforts to deal with municipal law and order - leading to problems with respect to price checking, dealing with encroachments and land disputes, food sampling and enforcing standards with agricultural inputs and the like. Whereas in the past, the police, in tandem with the executive magistrates enabled the local administration to ‘enforce its writ’, the police are now less inclined to pay attention to these cases, to support local executives. With growing pendency lists and low conviction rates in the subordinate courts, some high profile cases of violence against TMA officials carrying out their municipal functions, and with equally poor levels of enforcement, local authorities are dissuaded from taking action, either through the imposition of fines or through the courts. This, it is said, is contributing to a general decline in ‘law and order’, and underpins calls for re-introduction of executive magisterial powers.

It is debatable whether, as during Moharrum in March/April 2003, law and order was more or less effectively maintained in those areas of Punjab where special judicial powers were temporarily granted to the executive, compared with areas where the new arrangements applied. It is clear, however, that unless the provisions of the Police Order are effectively implemented and, perhaps as a result of this experience, amendments made to fine-tune the respective powers of the Public Safety Commissions, the Nazim or the Police Complaints Authorities, that this will also contribute to pressure arise for reintroduction of the executive magistracy. This will in turn undermine the separation of powers, the essence of devolution and see reintroduction of discredited institutions of the colonial era. However, alongside these institutions, it will be critically important also to progress with enactment of legislation providing for establishment of independent prosecution services, and to bring the services fully into function.

*Action Needed**Complete process of establishing and building capacity of Public Safety Commissions.*

Implementation of new institutions created under the PO and the LGO most concerned with access to justice issues has been slow. Some progress has been achieved in establishing the District Public Safety Commissions but this is patchy. Partly, the slow pace of implementation can be fairly attributed to delays in forming government at federal and province levels. However, it may also be the case that there are few incentives for province officials to cede control over police to the Safety Commissions, or to ensure they have sufficient budgetary and secretariat facilities to support preparation of annual policing plans, create viable working relations with the District Police Officers (DPO), and monitor conduct against these agreements. Responsibility for budgeting, training and capacity building and representing the interests of safety commissions is currently diffused and unclear to most officials. The respective responsibilities of the Nazim, the police and the Province departments of law and home must be clarified.

*Support enactment of independent prosecution service.*

In the earlier system, prosecution was an arm of the police; the Police Order requires an independent prosecution service will start working as an institutional mechanism to

examine evidence for quality, veracity and transparency. This is critical to prevent the abuse of power by police, but to also improve the quality of investigation, deter insufficiently supported litigation and thereby reduce pendency in the lower courts.

*Support establishment of ancillary institutions concerned with public safety and policing.*

The Police Complaints Authorities, the Insaaf Committees, the District Justice Coordinating Committees, the District Ombudsman's office, the Anjumani Musalihat, and Citizen Police Liaison Committees are all crucial adjuncts to the effective functioning of Safety Commissions. At present, in no case can these institutions be said to be functioning, nor does it appear on the list of priority actions for governments or donors. The functioning of these institutions is critical for the overall public credibility of devolution.

*Invest in public awareness campaigns about the new arrangements, including public interest legal literacy and litigation efforts by civil society organizations*

While efforts have been made to publicize the new powers and responsibilities of local officials under the LGOs, these have not been accompanied by publicity for the more complex responsibilities for public safety and order – shared between the Nazim, the DPO, and the Safety Commissions/Complaints Authorities. Greater public awareness is a pre-condition for improved legal literacy amongst special interest groups and the longer term process of building through litigation a case load of legal precedents.

4. No backtracking in the reform of accounting and auditing systems

In tandem with the numerous mechanisms under the LGOs to support accountability of both administrative and political organs of local governments, major reforms have been occurring in Pakistan's accounting and auditing apparatus through the Controller General of Accounts and the Pakistan Auditor General. These are important as international experience has confirmed that mechanisms to support 'upwards accountability', that is oversight by higher levels of government, are important for improved governance.<sup>35</sup>

Accompanying these administrative changes has been a technological change under the World Bank supported Project for Improved Financial Reporting and Accounting (PIFRA) to move from the existing system of manual accounting and control (basically provincially installed systems) to install a core set of accounting (general ledger) cash management systems built around the SAP R3 software at the local level. PIFRA is supporting, amongst other things of a new Chart of Classification, the New Accounting Model (NAM). Deriving a legal mandate from the Constitution and Auditor General of Pakistan's (AGP's) prescription, the CGA is seeking to implement the NAM for the accounting systems of the federal government, provinces and ultimately local governments. The roll out of the technological change and associated staffing realignment is a major activity for the CGA and the AGs.

The Auditor General unquestionably *can* audit the accounts of the federation, provinces, and all entities created by or under them according to Article 169 of the Constitution. The question of whether Article 170 implies that the AGP's authority to prescribe the forms, principles and methods of preparation of accounts extends to the actual preparation and maintenance of accounts. The Controller General argues that the accounts are to be maintained by a federal cadre at the

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<sup>35</sup> Pakistan's recent experience is replete with examples to confirm this, from SAP ("Project Performance Audit Report on the Social Action Program (Sector) Project (Loan 1301-PAK(SF)) - PAK 26017": 2001) through to the recent CFAAs ("Country Financial Accountability Assessment, Draft Report": 2003). More generally, see for example (Tendler: 1997).



federal, provincial and district levels. The provinces have a very different view of the issue. Accounting is seen as a provincial function according to the Constitution - and this logic is supported by current international practice of vesting responsibility for accounting within the same level of the government that has responsibility for the expenditures. A policy decision was taken in July 2002 that accepted the need to devolve responsibility for accounts from 2006.

Failure to institute integrated accounting makes timely reconciliation impossible. Where spending practices by local governments are unreliably and non-transparently reported this plays to a ready audience of skeptics: local governments are not to be trusted, and special purpose parallel control and accountability arrangements must be instituted to 'protect' and accurately report the PRSP social service delivery commitments. Further, the absence of integrated public accounts, available for scrutiny by higher-level officials and the public without doubt reinforces an environment conducive to plunder with impunity.

#### *Action Needed*

##### *Resolve the issue of control of accounting cadre*

Required is confirmation and/or modification of the July 2002 interim agreement on the issue of responsibility for the maintenance of accounts. Given the intensity of service cadre rivalries and the sensitivities of federal – province interests, Pakistan's donor partners may help facilitate this process. It is not the role of donors to interpret the constitutional provisions regarding federal and provincial accounting mandates. But it is reasonable to promote an integrated system of accounts, urgently, according to international norms and domestic laws. This is an essential underpinning for the entire apparatus of upwards accountability and the all-important responsibility of governments at all three levels to make their fiscal performance available for public scrutiny. Given concerns with service delivery, the efficient use of public resources and with 'elite capture', the relative inattention given to these issues by donors is surprising. Resolution of this issue might best be achieved by agreeing to transfer responsibility for accounting back to the provinces when they can demonstrate capacity, rather than fixing a specific date.

##### *Reinforce local accountability for local performance*

The June 2002 Chapter XII made it a dual responsibility for the Auditor General to lay the reports before the Provincial Assembly as well as Zila Council thus creating a 'dual accountability' for the District Nazim, to the province in addition to the Zila Council. This has been rectified in the recent round of amendments to Chapter XII recently made by all four provinces. The Auditor General has recently again recommended to the President that the audit reports of the districts should be submitted to the Governor and therefore the issue may re-open.

##### *Ensure implementation of PIFRA compatible systems.*

While PIFRA is being readied for nation-wide implementation, technical studies are needed to fine-tune the SAP R3 systems to ensure appropriate arrangements for the transit from manual local systems to the new computerized system, to ensure human resources required to operate this software are available locally and to resolve on-going differences of opinion about the functionality of these systems. Provincial information technology departments have moved ahead with costly decisions to design other systems and networks that may or may not be consistent with PIFRA. A simple, user-friendly system (possibly a simplified version of the accounting technology) that district, tehsil, and union officials can utilize to feed in data to the larger SAP R3 system is needed.

## 5. Help strengthen devolution's 'demand side'

More direct forms of participation are certainly no guarantee of service delivery improvements (Crook and Manor: 1998). Supplying 'good governance' - improved administration, transparency, greater accountability - is necessary step, but is insufficient by itself. A justifiably cynical population must also demand improved service delivery (Crook and Sverrisson: 2001; Harriss: 2001; Tendler: 1997), but that demand has to be nurtured. Studies have repeatedly shown that strong and capable higher level government institutions are required to activate citizen-local government relationships (Harriss: 2001; Tendler: 1997).

The present situation is inconsistent. On the one hand, the LGO and Police Order provide a statutory basis for an unprecedented array of local institutions through which citizens can directly influence local governance. On the other hand, and in marked contrast with the attention given to implementing new procedures for planning, finance management and, more recently, auditing, by and large, these kinds of institutions have been neglected. The donor community has seemingly been preoccupied with supply-side issues and filling the 'financing gap' in social services. At the same time, the results of participatory poverty assessments and community social audits highlight the poor's concern to ensure their rights and entitlements are guaranteed whenever public services do finally reach them ("Participatory Poverty Assessment": 2003; CIET: 2002). In many cases it is clear to the poor that contact with health, engineering, revenue, land registration and public safety officials is the prime source of their vulnerability to poverty.

The many opportunities provided by devolution for citizen engagement in local governance will not receive adequate support without direct attention from higher level governments backed by firm commitments by Pakistan's donor partners. Without this there are few incentives to encourage local elites to ensure these opportunities are appropriately resourced and politically supported or, where this does occur, the political space they offer will not be occupied by people with interests quite contrary to 'local empowerment' and social justice. Three initiatives may help counter this eventuality: greater NGO involvement in devolution, efforts to kick-start the CCBs, and increased resourcing for community based monitoring and social audit initiatives.

### *Actions Needed*

*Promote greater awareness amongst civil society/NGOs of the opportunities for citizen-state interaction through devolution and support demands for improved legislation:*

While many NGOs give special prominence to participatory development, gender, empowerment and community action, few are acquainted with the provisions and possibilities of the LGO or the PO.<sup>36</sup> NGOs could have a prime role, but in most cases their mandate to 'deliver social services' under agreements with vertical programs simply overwhelms their ability to support the kinds of citizen-state institutions that might make lasting improvements in people's ability to access to services or justice.

Equally important is to make progress with updating legislation governing regulation of civil society organizations. Devolution assigned responsibilities for regulation of not-for-profit, labor and civil society organizations to districts. There is chronic lack of capacity and awareness of existing legislation amongst district social welfare department officials. Moreover, legislation is outdated and conflicting, open to malicious interpretation. The

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<sup>36</sup> There are obvious exceptions, e.g., Aurat Foundation, Pattan Development Organisation. But the general conclusion is evident in the results of country-wide consultations undertaken by the Pakistan Centre of Philanthropy in preparation of their *Enabling Environment Initiative* report 2002.

Pakistan Centre for Philanthropy's *Enabling Environment Initiative*<sup>37</sup> aimed to create a consensus-based enabling legal framework and involved wide-ranging consultations across the country for 10 months from November 2001. This provides one key opportunity to redress this situation and should be resuscitated with government and international support.

#### *Help kick-start effective CCBs*

Approximately 1,600 CCBs are now registered across the country, animated to register no doubt by the fact that 25% of local development funds must in the current fiscal year be allocated to projects identified by CCBs. However, to date there has been no special purpose efforts made at anything like the necessary scale to promote this crucial provision of the LGO.

One promising initiative by the National Reconstruction Bureau deserves mention for it is the only effort to re-focus on citizen empowerment in the context of Union administrations with a nation-wide ambit, namely the Devolution Trust for Community Empowerment. Although yet to commence operations, the DTCE is a special purpose institution designed to focus on citizen empowerment through CCBs.<sup>38</sup> These initiatives deserve support for at least in concept, they put up front all three of the objectives of devolution highlighted in the Devolution Plan 2000 – improved productive and allocative efficiency in service delivery, alongside empowerment within the provisions of laws relating to land, labor and civil society, and support for basic entitlements to security and justice.

#### *Improve community level monitoring and social audit arrangements*

The NRB and federal and province agencies responsible for the PRSP are attempting to establish and institutionalize improved arrangement to monitor devolution and service delivery at community level. Quantitative information from the kind of monitoring systems being developed by the NRB's 'National Reconstruction Information Management System' (NARIMS), and that proposed by the Government of Pakistan in the draft PRSP<sup>39</sup>, are essential to inform management at all levels. Equally important to ensuring demand-driven management is qualitative information of the sort becoming available through the Community Social Audit process, again sponsored by the NRB.

Monitoring and evaluation arrangements are everywhere costly to establish and maintain. It is however critically important that these initiatives are adequately resourced and integrated at appropriate levels to ensure they regularly and reliably inform decision-making.

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## **4. Conclusions and Next Steps for the Devolved Service Delivery Study**

### Risk of reversals

<sup>37</sup> Launched in association with the Aga Khan Foundation and the Karachi-based NGO Resource Centre, argued for a self regulation regime governed by ex post facto reporting enshrined in a new law, Nonprofit Public Benefit Organisations (Governance and Support) Act. Although the PCP proposals were discussed at high level government – NGO forums during mid-2002, they were not accepted in full. A modified draft "Nonprofit Organisations (Governance and Support) Ordinance 2002 was placed before Cabinet in September 2002 but was never promulgated.

<sup>38</sup> "to create a proactive citizenry to improve local conditions through self-development that promotes grass roots pluralism and democracy"

<sup>39</sup> The proposed PRSP monitoring framework emphasizes: expenditure tracking; EMIS; HMIS and Lady Health workers.

This paper begins from the fact that government has committed to devolution and made remarkable progress. The paper's purpose was not to make the case for devolution. Rather, the paper notes that there are many steps needed to support a devolution initiative that is already very well advanced. It has also sought to open up discussion on the big-ticket questions concerning the degree to which these structural changes are introducing new accountabilities for local government staff and elected officials- for the proverbial "nazim of good intentions".

The overall intention has been to show why five key actions might merit attention to assist in creating the right environment for improved service delivery by local governments:

1. Realign vertical programs
2. Find an exit strategy from provincial micro-management of district staffing
3. No backtracking in the implementation of the Police Order
4. No backtracking in the reform of accounting and auditing systems
5. Help promote NGO engagement in devolution and kick-start the CCBs

These 5 actions are illustrative and not comprehensive summary of what remains to be done. For example, at some point it will be appropriate to question, for instance, whether the new arrangements have led to fragmentation, with too many local governments and too few provinces.

Reversal of some of the key reforms is not out of the question. Some signs of retreat are evident in terms of what is not being adequately raised in public debate – such as the five key issues and actions mentioned above – or no longer being discussed - PSCs were envisaged at Union level, as were the institution of 'Union Guards', village councils have disappeared from the agenda, etc. How these issues are dealt with will largely determine whether historical patterns are repeated, that is, of centralization under civilian governments and decentralization under military ones.

### **Box 9: Historical re-centralization**

Pakistan's short national history has been characterized by a series of political crises and a persistent tension between divergent local and regional interests, and attempts to bind this together with a strong federal framework. Despite a tendency for military governments to espouse decentralization, there has been a general drift towards centralization since the secession of Bangladesh in January 1972.

Pressures to increase military expenditures arising from a series of military conflicts (with India, with the former East Pakistan, peripherally in the Soviet-Afghan conflict and the Gulf wars) have contributed to the politically centralizing forces. This centralist view has also been consistent with a philosophy of strongly state-led development, espoused most strongly by the 1973 Bhutto government. However, there has also been a repeated attempt to balance a strong federal center, with an activist and participative local government. The "Basic Democracies" system, proposed by General Ayub Khan when he assumed the presidency in 1958, created 80,000 "basic democrats", or union councilors. These local leaders constituted the Electoral College for presidential elections and for elections to the national and provincial legislatures created under the constitution promulgated by Ayub in 1962. The Basic Democratic System had four tiers of government from the national to the local level, and each tier had a clear assignment of responsibilities. The system was never fully introduced.

Fiscally, the drift towards increased centralization is most evident in the distance between the 1956 Constitution, which envisaged a decentralized federation with significant Provincial public spending responsibilities and revenue raising powers, and the current highly centralized revenue responsibilities of the federal government.

That 1956 Constitution gave the federal government the duty to exercise its tax and spending powers to ensure a base of comparable services across the nation through a system of fiscal transfers to provincial governments - and most crucially, gave the lower levels of government sufficient revenue to discharge their significant functional responsibilities (Shah: 1996). The 1973 Constitution took a significant step in centralizing revenue responsibilities by bringing sales tax within the domain of the federal government.<sup>40</sup> The 1973 Constitution was subsequently frequently amended, and was suspended in 1999. Most recently the 2002 amendments to the constitution are politically centralizing, in that they give the head of state power to dissolve the National Assembly and provincial governors the authority to dismiss provincial legislatures.

#### More resources transferred to local levels

Local governments must have adequate fiscal and human resources to fulfill their duties appropriately and efficiently. Considerable efforts need to go into developing the managerial and technical capacity of the local governments and providing them with adequate office technology. Nevertheless, without a significant increase in fiscal resources of local and provincial governments, there is little hope for any major improvement in public services through the devolved delivery system. At present, the subnational governments are facing a severe fiscal squeeze. Whereas the National Finance Commission (NFC) has been seriously considering an increase in the share of provinces in the federal divisible pool from 37.5 percent to 40 percent, a much greater flow of funds would be required to achieve the PRSP targets, regardless of the improved efficiencies that might come with decentralization. Mechanisms need to be developed to allow a large portion of the fiscal space created at the federal level to be passed down to the subnational levels. This shift will require the NFC and PFCs to not only assign much greater formula-based transfers to the

<sup>40</sup> Since partition, Pakistan has had four federal constitutions: the interim constitution of 1947 based on the Government of India Act of 1935, the Constitution of 1956 devised by the Constituent Assembly, the Constitution of 1962 imposed by the military, and the 1973 Constitution drafted after the secession of East Pakistan (Bangladesh).

lower-level governments, but in addition put in place a system of financial incentives for the local governments to internalize national priorities within their own policies and plans.

#### A new role for the provinces

Strategically, devolution will require continual adjustments in the political environment, the policies, laws, fiscal and institutional arrangements. An active role for the provinces must be found within the new arrangements, not least through more attention to federal to provincial devolution. One area that the provinces might well be encouraged to pursue is in actively choosing the form of devolution that they encourage. They could choose among several different paths. Early signs are that Sindh is likely to seek to maintain stronger guidance over policies at the local government level, whereas Punjab may feel more comfortable in delegating authority. If this is the case, then the key is clarity and honesty about what approach provinces are taking. Radical devolution might not be the approach chosen by each province, but ad hoc adjustments, often to accommodate short term political expediencies within province governments and with the federal government, cannot be good for devolution either.

#### Next steps for this study

There are three focus areas for the study. First, a series of *District Studies* will be undertaken in six districts (and a selection of tehsils within them) to review whether the new accountabilities flagged in this paper are being introduced in reality and whether they are leading to early signs of improved service delivery. As noted, the districts identified by government are:

Punjab: Faisalabad and Bhawalpur

Sindh: Karachi and Khairpur

NWFP: Bannu

Balochistan: Killa Saifullah.

In parallel, some pictures will be developed of the local economies in these 6 districts and the potential impact of devolution.

Second, the database on the *Intergovernmental Flows of Funds* will allow some analysis of the overall fiscal architecture and in particular the combined effect of the Provincial and National Finance Commission Awards under alternative scenarios - illustrating the impact of revenue reassignments or of any changes in funding assumptions. It will also facilitate an assessment of the impact of any 'lumpiness' in revenue, assessing the cash flow problems that the provinces are flagging as the major reason for their slow movement towards the devolution of civil service pay; and will allow a comparison to be drawn between the intended and the actual behavior of provinces in transferring funds, assessing how predictably districts received their anticipated funds. It is hoped that this database will be updated and republished each year to support informed debate by local governments, finance agencies (e.g., Province Finance Commissions) and the general public.

Third, to broaden the debate, proposals for "Issues and Options Notes" are being invited to deepen the debate on emerging concerns and challenges posed by devolution, with an emphasis on pragmatic, immediate steps that could be taken to alleviate difficulties faced by local governments. Government has emphasized that these should set out a range of options for action, rather than suggesting a single preferred policy direction.<sup>41</sup>

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<sup>41</sup> Invitations to prepare these Notes are posted on the ADB website at: [www.adb.org/PRM/io\\_notes.pdf](http://www.adb.org/PRM/io_notes.pdf), and on the World Bank website at: <http://www.worldbank.org.pk/>.

The intention is to provide federal, provincial and local governments with materials and suggestions for practical actions that can help sustain and deepen the devolution reforms that they have initiated, and in which they have already made so much progress.

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Local Government Plan 2000  
The SBNP Local Government Ordinance 2001  
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Guidelines For Monitoring Committees of Local Governments  
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Draft 9

# Technical Annex: A Stocktaking of Recent Structural Changes towards Devolution in Pakistan

Prepared for the Forum on Intergovernmental Relations and Service Delivery in Pakistan

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## **Background: The Devolved Service Delivery Study**

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The authors have drawn comprehensively on the extensive published outputs from the NRB and a range of informal outputs including presentations and conference notes. Much additional material is drawn from the findings of recent World Bank, ADB, and DFID missions to Pakistan.<sup>1</sup> A complete bibliography of sources used is attached.

### **Continuing work**

The World Bank, ADB and DfID have agreed with the Government of Pakistan that they will jointly undertake a Devolved Service Delivery (DSD) study, reviewing progress towards improving service delivery through decentralization. Government has emphasized that they are looking for feasible, practical recommendations that add value to a devolution process that is well advanced. The new data that are being developed to inform the Devolved Service Delivery (DSD) study are as follows:

Dataset 1: *District Assessments* - new, largely qualitative, data gathered from six districts (and a selection of tehsils within them) on their experiences to date gathered through the use of a series of sector-specific templates systematically reviewing experience to date with sectoral concerns such as health, education, municipal services, etc. The districts identified by government for this study are:

Punjab: Faisalabad and Bhawalpur  
Sindh: Karachi and Khairpur  
NWFP: Bannu  
Balochistan: Killa Saifullah

Dataset 2: *Intergovernmental Flows of Funds* - a model of fiscal flows underpinned by a comprehensive database of revenue and expenditure for district governments and tehsils. The model will allow:

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<sup>1</sup> This includes the first DSD mission, October 12-28 2002, which consisted of Shahnaz Arshad, Raja Rehan Arshad, Amer Durrani, Bob Ebel, Zahid Hasnain, Inaam ul Haq, Nick Manning, Hanid Mukhtar, Ayaz Parvez, Jeffrey Rinne, Francois Vaillancourt (World Bank), Jackie Charlton, Musharraf Cyan, Shahid Kardar (DfID), with support from Doug Porter (ADB). The paper also incorporates material from several other key sources: a note written in support of the World Bank's Development Policy Review (DPR) by Jackie Charlton, Robert Ebel, Hanid Mukhtar, Roxanne Scott and Francois Vaillancourt; Shah, Anwar. 1996. "Fiscal Federalism in Pakistan: Challenges and Opportunities". World Bank. Washington DC; Mukhtar, Hanid. 2003. "Draft Explanation of the Flow of Funds Model". World Bank. Washington DC; and Sharif, Hamid and Porter, Doug. 2003. "Template for reviewing Access to Justice Issues". ADB. Islamabad.

- Some analysis of the overall fiscal architecture and in particular the combined effect of the Provincial and National Finance Commission Awards under alternative scenarios - illustrating the impact of revenue reassignments or of any changes in funding assumptions;
- An assessment of the impact of any ‘lumpiness’ in revenue, assessing the cash flow problems that the provinces are flagging as the major reason for their slow movement towards the devolution of civil service pay; and
- A comparison to be drawn between the intended and the actual behavior of provinces in transferring funds, assessing how predictably districts received their anticipated funds.

It is hoped that this database will be updated and republished each year to support informed debate by local governments, finance agencies (e.g., Province Finance Commissions) and the general public.

Progress in compiling the first dataset has been constrained by the uncertain security situation in the country early in 2003, as a result of which it was necessary to postpone the 6 district assessments. However, a first mission was undertaken to Khairpur and Faisalabad in October 2002, a research team has been assembled (comprising both international and local researchers), and detailed research templates have been prepared on: political arrangements; access to justice issues; fiscal issues (revenues/expenditures); civil service; gender; education; health; water and sanitation; and transport.

On the second dataset, a model of fiscal flows has been developed and a database of revenue and expenditure for district governments and tehsils is being assembled comprising: provincial data (income receipts by major category, function-wise expenditures); district data (opening balance, income receipts, expenditure); and town /tehsil municipal administration data. The anticipated dates for availability for these data are set out in Appendix 1: Availability of intergovernmental flows of funds data.

## Acronyms

ACR	Annual Confidential Reports	MMA	Muttahida Majlis-i-Amal (political party)
ADB	Asian Development Bank	MNA	Member of National Assembly
ADPs	Annual Development Plans	MoWD	Ministry of Women’s Development, Social Welfare & Special Education
AG	Accountant General	MPA	Member of Provincial Assembly
AGP	Auditor General of Pakistan	MQM	Muttahida Quaumi Movement
AGPR	Accountant General Pakistan Revenues	MVT	Motor Vehicle Tax
AIT	Agriculture Income Tax	NAM	New Accounting Model
APT	Appointment, Promotion & Transfer	NFC	National Finance Commission
BHU	Basic Health Unit	NGO	Non-governmental Organization
BPS	Basic Pay Scale	NIH	National Institutes of Health
CBR	Central Board of Revenue	NPA	National Plan of Action
CCB	Citizen Community Board	NPSC	National Program Steering Committee
CDMD	City Development and Municipal Department	NRB	National Reconstruction Board
CED	Central Excise Duties	NWFP	North West Frontier Province
CEDAW	Convention on Elimination of All Forms of Discrimination Against Women	OZT	Octroi and Zila Tax
CFAA	Country Financial Accountability Assessment	P&D	Planning and Development
CGA	Controller General of Accounts	PCA	Police Complaints Authority
DAOs	District Account Officers	PCF	Provincial Consolidated Fund
DCO	District Coordination Officer	PCP	Pakistan Centre for Philanthropy
DfID	UK Department for International Development	PERI	Punjab Economic Research Institute
DMG	District Management Group	PFCs	Provincial Finance Commissions
DoF	Department of Finance	PHED	Public Health Engineering Department
DOs	District Officers	PIFRA	Pakistan Improvement to Financial Reporting and Auditing Project
DPO	District Police Officer	PO	Police Order
DPR	Development Policy Review	PPP	Pakistan People’s Party
DPSC	District Public Safety Commission	PRGF	IMF Poverty Reduction and Growth Facility
DRTAs	District Regional Transport Authorities	PRSP	Poverty Reduction Strategy Paper
DS	Deputy Secretary	PSC	Public Service Commission
DSD	Devolved Service Delivery Study	PSDP	Public Sector Development Program
DTCE	Devolution Trust for Community Empowerment	PTAs	Provincial Transport Authorities
EDO	Executive District Officer	PTAs	Parent Teacher Associations
EPI	Expanded Program for Immunization	RTA	Regional Transport Authorities
FCF	Federal Consolidated Fund	RWSSP	Rural Water Supply and Sanitation Program
GDP	Gross Domestic Product	SAP	Social Action Program
GFS	IMF Government Finance Statistics	SLGO	Sindh Local Government Ordinance
GRAPs	Gender Reform Action Plans	SMCs	School Management Committees
GST	Goods and Services Tax	TAOs	Tehsil Accounts Officers
HMIS	Health Management Information System	TMA	Tehsil Municipal Administrations
IMF	International Monetary Fund	UC	Union Council
IT	Information Technology	UIPT	Urban Immovable Property Tax
KPP	Khushal Pakistan Program	W&S	Water and sanitation
KWSB	Karachi Water and Sewerage Board	WAPDA	Water and Power Development Authority
LGO	Local Government Ordinances	WASA	Water and Sewerage Authorities
LHC	Lahore High Court	WB	World Bank
MICS	Multi-Indicator Cluster Survey	WDD	Women’s Development Department

## Summary

This working draft is intended as a basic primer to set the scene concerning the remarkable devolution that has taken place within the government of Pakistan prior to and following the creation of a new local government arrangements on August 14, 2001.

This is not an evaluative summary. It is intended to be a factual description of the changes that have occurred in key dimensions of state reconstruction.

The paper sets out the remarkable progress that has been achieved in creating new local institutions - with new structures for local government, electoral arrangements, new rules for government formation and dismissal. It also explores the complex issues concerning the executive structure of local governments and their staffing inheritance.

It also notes the radical changes that have taken place in reforming access to justice. The radical agenda entailed in the reforms of the police and the subordinate courts is one of the more complex and ambitious components of the devolution agenda.

This paper explores in depth the budgetary and fiscal reforms - reviewing the new expenditure and revenue assignments, and the mechanisms for intergovernmental fiscal transfers and the consequences for budget preparation, execution, accounting and audit.

The achievement in putting in place this remarkable array of new structures and accountability arrangements can hardly be overstated - particularly since this was far from the only radical reform in process. In parallel with the devolution initiative, government also oversaw a program of significant reforms in taxes, trade, deregulation and privatization, financial sector, fiscal transparency and human development and social protection.



## **Progress in creating new political and administrative institutions**

### **The historical legacy**

Prior to August 14, 2001 the four provinces were divided into three administrative levels, resulting in a national picture of 26 divisions, 105 districts, and 354 tehsils. Other local government bodies existed mainly in urbanized areas and, in decreasing order of size, there were two metropolitan municipal corporations (Lahore and Karachi), 12 municipal corporations, 144 municipal committees and 303 towns committees. There were also (and still are) 41 unelected cantonment boards. In rural areas, District (Zila) councils were responsible for local services. The districts and divisions were distinct legal entities (created by the Provinces as envisaged by the 1973 Constitution), but unlike the Provinces they lacked constitutional status.

On taking power the military government announced a far reaching reform agenda for "reconstructing the institutions of the state" by setting up of a democratically elected system of local government across all four provinces in order to deliver "people centered, rights and responsibilities based on service orientated" local government. The new system is designed to ensure citizen involvement in planning services and to provide mechanisms for citizen oversight of implementation.

The process started in March 2000 with a National Reconstruction Bureau (NRB) discussion paper that called for a series of bold structural changes to be implemented by August 2001 - a deadline that was met. The changes included the abolition of the existing three levels of provincial administration (divisions, districts and tehsils) and the creation of a new tier of local governments comprising districts (called city districts in the four provincial capitals), tehsils (city towns in the four city districts) and union administrations, and the replacement of the existing municipal bodies by these new local governments. These arrangements apply to all provinces, but not to the Cantonment (military) areas of towns and cities -- which remain under the control of non-elected boards headed by military commanders -- or the Federally Administered Tribal Areas.

### **The political changes**

#### New elected bodies

At the end of this process, Pakistan remains, constitutionally, a two-tier federal state. However, there are now 6,458 new local self-governments for the population of 141 million: 97 districts and 4 city districts; 306 tehsil municipal administrations and 29 city towns; and 6,022 union administrations.<sup>2</sup>

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<sup>2</sup> For simplicity, unless more precision is needed, this report uses the general term district to refer to districts and city districts, and tehsil to refer to Tehsil/Talukha Municipal Administrations and city towns.

**Table 1: Local government in Pakistan**

	District Governments	City District Governments	Tehsil Municipal Administrations	City Towns	Union Administrations
Punjab	33	1	115	7	3,453
Sindh	16	1	86	18	1,044
NWFP	23	1	34	2 /a	957
Balochistan	25 /b	1	71	2	568
<b>Total</b>	<b>97</b>	<b>4 /c</b>	<b>306</b>	<b>29</b>	<b>6,022</b>

Notes:

a/ In NWFP, single tehsil districts have been given the opportunity to sub-divide tehsils into what are termed 'towns'. However, these have neither the legal underpinning nor the roles and responsibilities of city district towns.

b/ 5 of these district governments have been newly created and while they have the district administration in place, the Election Commission has yet to hold the indirect elections for the nazim and naib nazim

c/ Islamabad became a City District in November 2002 with the passing of the Islamabad Capital Territory Local Government Ordinance. However this has yet to be implemented.

The strength of any constitutional guarantee for this structure is debatable. Although the 1973 Constitution makes local government a provincial subject and empowers provinces to create both administrative units through decree and local governments via local government ordinances, such bodies had no constitutional status or protection. It remains permissible under the 1973 Constitution for local governments to be disbanded by the parent province at any time. However, the Legal Framework Order amending Constitutional provisions issued in August 2002 *requires* provinces to establish local governments.<sup>3</sup>

Local government elections are held on a non-party basis. The electorate for the union councils is made up of all registered voters who are Pakistan citizens and who are over the age of 18. For the first time in these elections, the voting age was lowered from 21 to 18.

The foundation of the electoral structure for the three tiers of local government is the Union Council. The Union is a multi-member ward for the election of members of the union council (i.e. each constituency is on average 25,000, which is large), and each Union Council is composed of 21 directly elected members.<sup>4</sup> The nazim and naib nazim (mayor and deputy mayor) are elected on a joint ticket. The remaining 19 seats on the union council are allocated as follows:

- 12 Muslim seats, 4 of which are reserved for women
- 6 seats for peasants and workers of which 2 are reserved for women
- 1 seat for minority communities.<sup>5</sup>

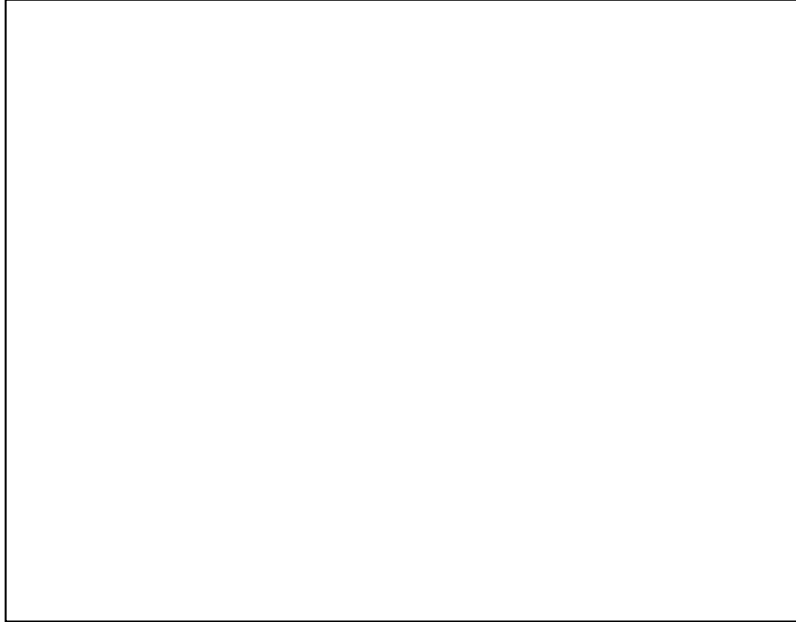
<sup>3</sup> Legal Framework Order (August 21, 2002), section 140A: Local government. "Each Province shall, by law, establish a local government system and devolve political, administrative and financial responsibility and authority to the elected representatives of the local governments."

<sup>4</sup> Councilors must be at least age 25, be a Pakistani citizen residing in the relevant ward, of good Muslim character (except for non-Muslims), and must not have been convicted of various crimes, nor be an employee of federal, provincial or local governments. Nazims and naib Nazims must have a matriculation or secondary school certificate

<sup>5</sup> In a district where the population of the minorities is in excess of 10% of the total population, some seats are reserved for minority communities. There are direct elections for these seats for which only the minorities will be eligible to vote, and the whole of the district will be the constituency.

The nazim of the union council then becomes ex-officio a member of the district council. The naib nazim of the union council becomes ex-officio a member of the tehsil council See Figure 1 for details.

**Figure 1: Indirect elections**



The union councilors constitute the Electoral College for the district/tehsil councilors at large and for the district and tehsil nazim and naib nazim (neither of which can be union councilors). District councils include all the union council nazims and tehsil councils include all the union council naib nazims. Elected union councilors are not permitted to stand for election as nazim or naib nazim of any tehsil or district. They stand as a joint ticket once all the union councilors in their district had been elected. If no joint tickets (nazims and naib nazims) secure at least fifty percent of the votes for any district or tehsil, then there will be a run-off election within a week for that district or tehsil between the two pairs that secured the highest number of votes. The joint candidates securing the highest number of votes in the fresh elections will be declared winners.

Each tier of local government has a term of office of four years<sup>6</sup>, with a two-term limit for nazims and naib nazims at all levels of government.

One third of seats are reserved seats for women – directly elected at UC level and elected by the electoral college of Union councilors at tehsil and district levels. This emphasis on women's participation in politics is a dramatic break from the past. In addition, 5% of district and tehsil seats have been reserved for peasants (in rural constituencies) or workers (in urban areas), and 5% for minorities. Thus, overall, district councils and tehsil councils are made up of about two thirds directly elected members and one third indirectly elected, including the nazim and naib nazim.

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<sup>6</sup> The term of office was changed from three years through an amendment in 2002.

### Box 1: The arithmetic of Local Government Elections

Assume a district with 60 union councils (UCs), grouped in three tehsils of the same size (20 UCs per tehsil)

	<i>Union Councils</i>	
Direct elections	<ul style="list-style-type: none"><li>• There are direct elections for all 21 UC councilors. 19 are elected individually, but the UC nazim and naib nazim are elected on a joint ticket. In this example, there are therefore 1,260 UC councilors overall.</li></ul>	
Indirect elections	<p><i>Tehsil Councils</i></p> <ul style="list-style-type: none"><li>• Each UC naib nazim is automatically a member of the tehsil council;</li><li>• In addition to the 20 UC naib nazim, each of the three tehsil councils has a tehsil nazim and naib nazim, plus 9 additional members: 7 women councilors, 1 peasant/worker councilor and 1 minority councilor;</li><li>• The tehsil nazim, the tehsil naib nazim and the additional 9 councilors are elected by the 420 UC councilors (20 UCs in the tehsil x 21 UC councilors per UC).</li></ul>	<p><i>District Council</i></p> <ul style="list-style-type: none"><li>• Each UC nazim is automatically a member of the district council;</li><li>• In addition to the 60 UC nazim, the district council has a district nazim and naib nazim, and 26 additional members: 20 women councilors<sup>7</sup>, 3 peasant/workers and 3 minority councilors;</li><li>• The district nazim, the district naib nazim and the additional 26 councilors are elected by the 1,260 UC councilors.</li></ul>

Source: Adapted from (Charlton, Ebel et al. 2002)

### The rules of government formation and dismissal

The LGOs specify the methods for both the internal and external recall of the nazims in the three tiers of local government. For the external recall of a district nazim, the Chief Executive of the province may move a motion in the Provincial Assembly against a nazim, and if the motion is passed by a simple majority then the nazim would cease to hold office with immediate effect. Similarly, the district nazim can move a motion in the district council for the recall of a tehsil or union nazim. If a majority in the council approves these motions, they are then subjected to a vote of all union councilors in the tehsil in the case of the motion against the tehsil nazim, and by union councilors in the union in the case of the motion against a union nazim. If a majority of the members support the motion then the respective nazim stands dismissed.

The procedure for the internal recall of the nazim is more elaborate. A member of the district council, seconded by another member, may move a motion against the district nazim in the Council; if the motion is passed by a simple majority then the Election Commission will seek a vote from the members of the union councils in the district. If the union councilors approve the motion by a simple majority then the district nazim stands dismissed. However, if the motion fails, then the proposer and the seconder of the motions in the district council shall lose their seats both as union nazims and members of the district council. Moreover, no such motion can be moved in the first six months of the assumption of office of the district nazim or for twelve months after the rejection of a previous motion. The procedures for the internal recall of the tehsil and union nazims are similar.

<sup>7</sup> The 33% special seats for women on the district council applies regardless of how many are already on the district council by virtue of their having been elected as UC nazims. So in theory if a large proportion of women were elected as UC nazims, an additional number of at-large seats would still be provided, giving women a majority on the council.

In recent allegations concerning mismanagement by District Nazims in NWFP, the Local Government Commissions has been the mechanism for investigating the nazims and bringing them before the provincial assembly.

#### Other formal arrangements for participation in local government affairs

The devolution plan intended that there should be new statutory opportunities for citizens to formally engage in local governance. Combined, the Police Order and the LGO, together with legal initiatives governing laws of defamation, administrative dispute resolution and the district ombudsman's office, freedom of information, contempt, as well as accounts and audit provide an unprecedented array of opportunities for citizens to access basic information, seek redress for grievance against the system, engage in planning, budget and service delivery processes.

In addition to the formal political elected structures, Citizen Community Boards (CCBs) were conceived with a broad 'governance' mandate, not just as alternate mechanisms to raise local funds for priority investments in basic infrastructures and services. At this stage, the broader potential for CCBs to impact on council politics or wider questions of power, corruption and social justice, land or other dispute resolution is not yet apparent. In practice, to date, more than 1600 CCBs have been registered, primarily for the purpose of mobilizing funds for investments in primary health, education, water and other municipal services. The rules for their constitution are laid down by the NRB. It was originally envisaged that 50% of total development funds of local governments would be reserved for CCBs; this proportion has now been reduced to 35%.<sup>8</sup> In order to receive development funds, CCBs must provide a cash contribution of at least 20% for the identified project. CCBs must raise 20% of the costs of a development project and can then call down the balance of funding from district governments. CCBs were initially slow to form although this is now gaining pace as awareness is raised about the availability of resources. The government resources for CCBs may not be re-allocated to any other head of expenditure and they may be carried forward to subsequent financial years. Thus, there is a real incentive for local governments to ensure that CCBs are operational.

In recognition of the significant role of NGOs in local governance, as policy advocates, as deliverers of key services and activists in the promotion and protection of human rights and gender concerns, efforts have been made to revisit the legal and regulatory arrangements for the registration and promotion of civil society organizations. Devolution reassigned the bulk of responsibilities for regulation of civil society activities to District governments, though responsibilities for labor regulation seems still diffused between province and local governments.

The Enabling Environment Initiative, launched by the Pakistan Centre for Philanthropy in association with the Aga Khan Foundation and the Karachi-based NGO Resource Centre, aimed to create a consensus-based enabling legal framework and involved wide-ranging consultations across the country for 10 months from November 2001. This applauded delegation of registration powers to districts but argued that government staffing, skills and financial capacity to fulfill this mandate are too limited, that decision making is excessively arbitrary, "even well intentioned legislation mutates into an ugly beast in the hands of a malicious regulator" ("Enabling Environment Initiative" 2003, p ix), and argued in favor of a self regulation regime governed by ex post facto reporting enshrined in a new law, Non-profit Public Benefit Organisations

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<sup>8</sup> See also National Reconstruction Bureau. October 14, 2002. "Guidelines for Citizen Community Boards". Islamabad.

(Governance and Support) Act.<sup>9</sup> Although the PCP proposals were discussed at high level government – NGO forums during mid-2002, they were not accepted in full. A modified draft “Nonprofit Organisations (Governance and Support) Ordinance 2002 was placed before Cabinet in September 2002 but was never promulgated.<sup>10</sup>

## The administrative changes

### Executive structure within local governments

The executive side of the district governments has been divided into eleven departments.<sup>11</sup>

<b>District Coordination</b>	Coordination, Human Resource Management and Civil Defense.
<b>Agriculture</b>	Agriculture (Extension), Livestock, Farm Water Management, Soil Conservation, Soil Fertility, Fisheries, Forests and Wildlife.
<b>Community Development</b>	Community Organization, Labor, Social Welfare, Sports and Culture, Cooperatives, and Registration office.
<b>Education</b>	Boys Schools, Girls Schools, Technical Education, Colleges, (other than professional) Sports (Education) and Special Education.
<b>Finance and Planning</b>	Finance & Budget, Planning & Development, Accounts, Enterprise and Investment Promotion.
<b>Health</b>	Public Health, Basic & Rural Health, Child & Woman Health, Population Welfare, District and Tehsil (Headquarters.) hospitals.
<b>Information Technology</b>	Information Technology Development, Information Technology Promotion, and Database.
<b>Law</b>	Litigation, Legal advice, Legislation, and Environment. <sup>12</sup>
<b>Literacy</b>	Literacy Campaigns, Continuing Education, and Vocational Education.
<b>Revenue</b>	Land Revenue & Estate and Excise and Taxation.
<b>Works and Services<sup>13</sup></b>	Housing, Urban & Rural Development, District Roads and Buildings, Energy and Transport.

The District Coordination department is headed by the District Coordination Officer (DCO), -- the highest-ranking civil servant in the district. An Executive District Officer (EDO) heads each of the remaining departments.

The Tehsil/Taluka/Town government (commonly called the Tehsils/Taluka/Town Municipal Administration (TMA), performs mainly municipal functions (see Appendix 2: Local government

<sup>9</sup> Similarly, the Voluntary Social Welfare Agencies (Registration and Control) Ordinance 1961 would be repealed, the Societies Registration Act 1860 would be amended to limit its applications to societies that do not pursue public benefit purposes, and that organizations registered under the new law would be excluded from the Charitable Funds (Regulation of Collection) Act 1953.

<sup>10</sup> ("Enabling Environment Initiative" 2003, p. 121 et seq.) provides a summary of feedback on the draft law.

<sup>11</sup> Originally environment was also listed as a separate department, but this was later merged with agriculture. The twelfth group of offices, the magistracy, appears in the First Schedule to the Ordinances but as a policy decision stands abolished.

<sup>12</sup> The provinces may relocate (deconcentrate) this office but it will not be a separate district department.

<sup>13</sup> The housing and Physical Planning/Town Planning Department is decentralized to the Tehsil Municipal Administration but an appropriate nucleus staff can be retained for intra-district coordination of tehsil level plans.

expenditure responsibilities). While the Tehsil/Taluka/Town Nazim is the political head of the TMA and formally head of the executive, the Tehsil/Taluka/Town Municipal Officer (TMO) performs similar coordination functions as the DCO at the district level. There are four Tehsil/Taluka/Town Officers (TOs) reporting to the TMO, one each for (i) Finance Budget and Accounts, (ii) Municipal Standards and Coordination, (iii) Land Use Control, and (iv) Rural-Urban Planning.

### Staffing reforms

With the establishment of districts in August 2001, responsibility for various government functions shifted from provincial governments to the districts. Three groups of staff subsequently were assigned to district governments to carry out these functions. They included:

1. A few staff from federal employment groups, primarily District Management Group (DMG) and the Audits and Accounts Group;
2. Former rural district council employees; and
3. Many staff from provincial employment groups, particularly Public Health Engineering, Rural Development, Local Government, Health and Education.

**Table 3: Education responsibilities transferred to the districts in Sindh**

Functional responsibilities <sup>14</sup>	Nos. of staff
Primary (yrs. 1-5) (staff grades 7-9)	101,049 a/
Middle school (yrs. 6-8) (staff grades 11-16)	8,947
Secondary (yrs. 9-10)	30,229
Higher secondary (yrs. 11-12)	5,224
Non-teaching staff (approx.)	55,000
College/university (13+)	5,239
Special education	437
Teacher training	1,595
Technical institutes	3,409
<b>TOTAL</b>	<b>211,129</b>

Source: Dept. of Education, Sindh Education Profile. Data for Dec. 2001.

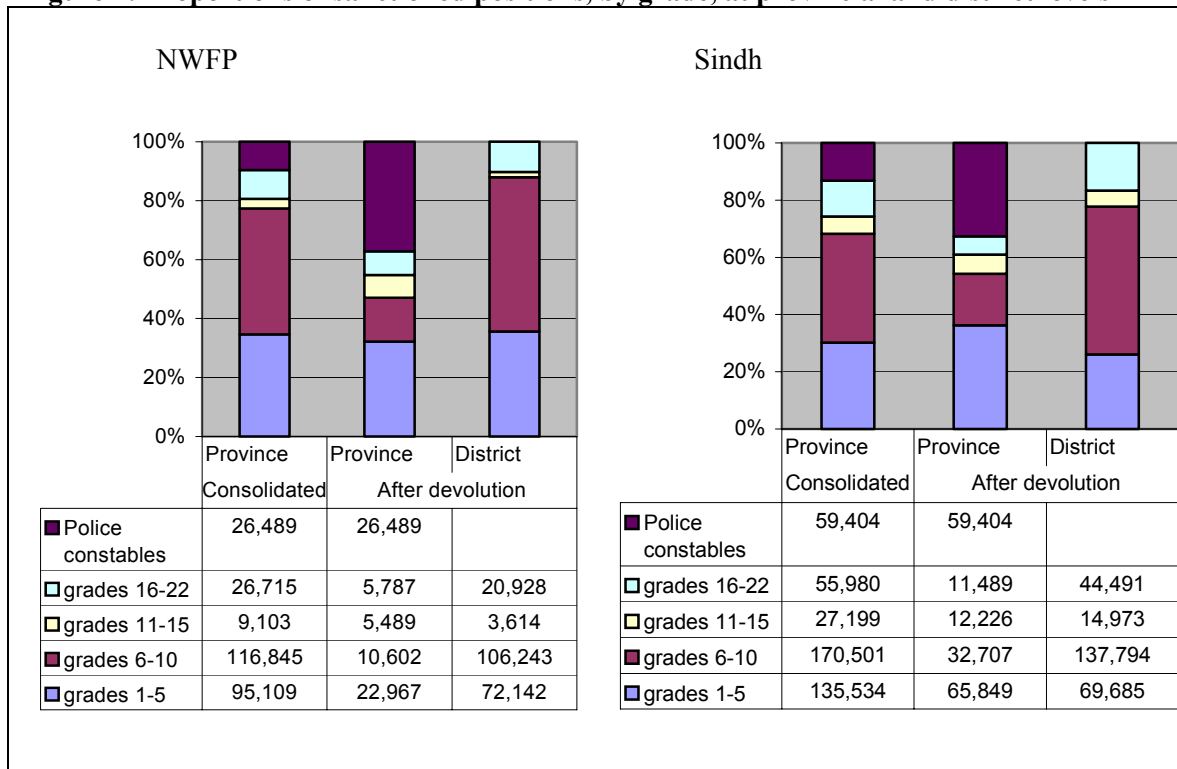
a/ This includes the 3,000 'facility-specific' fixed term contract staff that Sindh had hired on a one-off basis in August 2001.

There has been a recruitment freeze before and since that time.

There is a large number of staff now working in district governments: for example nearly 267,000 staff in Sindh and roughly 203,000 in NWFP. The overwhelming majority of these employees belonged to the provincial employment groups, particularly education. Most are in grades 1-15 (90% of district staff in NWFP and 83% in Sindh).

<sup>14</sup> In Sindh, as per "Guidelines For District / City Government On Education, November - 2001" (<http://www.sindhedu.gov.pk/download/District%20Guidline.doc>, Section 35 - Functions To Be Performed At District Level), functional responsibility for all institutions except for technical institutes were transferred to the districts (See also the undated Schedule-II Rule 3(2) <http://www.sindhedu.gov.pk/Links/devo.htm>)

**Figure 2: Proportions of sanctioned positions, by grade, at provincial and district levels**



Notes:

1. Police constables are at grade 5
2. In NWFP: fixed pay staff have been taken to be grade 1 - this is not quite accurate at the moment as they are paid at a lower rate - but they will shortly be placed on to grade 1; special grade staff (judges) and fixed grade staff (mainly rural doctors) are shown as if they were in grades 16-22 - in fact their payments are probably in excess, but the total nos. are quite small (special grade: 18; fixed grade: 171).
3. These figures only reflect the formerly provincial staff, below grade 16. Districts have a relatively small number of other staff - from federal employment groups (primarily District Management Group (DMG) and the Audits and Accounts Group), and employees who had earlier belonged to the rural district councils.

In Sindh, the increase after devolution in the proportion of lower grade staff in the province is because the majority of unfilled vacancies remain in the province. The Ministry of Finance in NWFP reports that fewer than 5,000 of the sanctioned posts are vacant.

## New issues arising

### Local elections

Non-party elections for Union Council seats were held sequentially, in 5 rounds, in the period from December 2000 to September 2001.<sup>15</sup>

<sup>15</sup> The election of nazims, naib nazims and reserved council seats at the district level took place after the election of union councilors



**Table 4: Phasing of local government elections 2000-2001**

Election dates	Dec. 2000	March 2001	May 2001	Aug. 2001	Sept. 2001	Totals
Number of districts	18	20	20	31	11	100 a/
Number of union councils	959	1,459	1577	1,677	353	6,022
Number of union council seats	20,076	30,639	33,117	35,217	7,413	126,462

Source: (Pattan Development Organization and UK Department for International Development 2001)

a/ The table reports elections to 100 district councils while the text states the numbered 96; this is a result of the merger of the five Karachi districts after the election. The table shows the potential total of union councilors. (6,022 x 21 =126,462). However not all seats were filled.

Overall the participation rate was 52.5%, ranging from 33.1% in Balochistan and 41.6% in Sindh, to 44.4% in NWFP and 58.6 % in Punjab.

Given the absence of any tradition of elected local politicians, accountable for the delivery of local services, the achievements in holding elections for union councilors in late 2000 and in 2001 was remarkable. With two exceptions (in Karachi the Muttahida Quaumi Movement (MQM) boycotted the non-party elections, and in many NWFP union councils women were prevented from casting their votes by religious political parties) they were held in a fair, impartial, and non-violent manner. The isolated NWFP experience notwithstanding, a key break from Pakistan's political past was accomplished with the election of a large number of women councilors (79% of whom had never before run for political office). Of the 126,462 new union councilors, 25% were women (although this indicates that about one third of the 33% of seats that were reserved for women remain empty).

Elected positions have, in the main been won by people with a pre-existing political background. There have been new entrants to politics, some from large business concerns. Some of the nazims had previously held political office, including ministers in the National and Provincial Assemblies, and some of these have now resigned from local government in order to return to provincial or federal politics.<sup>16</sup>

#### The staffing inheritance of the districts

The ongoing challenge of decentralization, so far as personnel issues are concerned, is to gradually shift the employer function to coincide with the new levels of functional responsibility – to create, in effect, the equivalent of a District Service whether a body is formally established by that name or not.

Progress, to date, is decidedly mixed. The NRB continues to discuss the possibility of creating a formal District Service; but no decision has been taken yet. If it were eventually agreed, a District Service would constitute a body of people clearly employed by the districts. Being fully the “employer” means that a government is responsible for:

1. Budget Control
2. Performance Management
3. Recruitment
4. Career Management

<sup>16</sup> The Local Government Ordinances require that Nazims and naib Nazims resign their seats prior to putting themselves forward as candidates for the assemblies.

5. Establishment Control
6. Pay Policy.

See Appendix 5: Theoretical considerations in administrative decentralization for further details.

Along these dimensions, the federal government clearly remains the ‘employer’ of the first group of staff mentioned above (the DMG and Audit & Accounts Group staff posted to the districts). Senior staff of the districts (Executive District Officers (EDOs) and other staff at or above BPS-16, or BPS-18 in the case of Punjab) remain subject to the province or the federal government for appointment, promotion and transfer decisions.<sup>17</sup> This has resulted in confused and competing lines of control. For instance, while the newly-created District Coordinating Officer (DCO) replaces the former Deputy Commissioner and reports to an elected politician (the Nazim) at the district level, he or she remains part of a federal cadre. Thus, his or her promotion and transfers are managed outside of the district, undermining the reporting relationship to the Nazim. DCOs are likely to be transferred frequently. And while Nazims may request the transfer of a DCO, they cannot prevent such a transfer.

The district undoubtedly became ‘employer’ of the second group, the former rural district council employees.<sup>18</sup>

The third group, former provincial cadres, account for the vast majority of district staff. At the current stage of devolution, many ‘employer’ roles for these staff remain with the province.

In detail, the current status of the transfer of the employer function is as follows:

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<sup>17</sup> In Sindh, responsibility for transfers of grades 16 and below were passed to the districts from October 2002. Notification no. SORI (S&GAD) 2-7/2001, dated October 26, 2002, distributes authority for transfers within Sindh as follows:

- grades 1-2 within the district: Deputy District Officer
- grades 3-5: District Officer
- grades 6-11: Executive District Officer
- grades 12-15: District Coordination Officer
- grades 16 and 17: District Coordination Officer in consultation with the Nazim.

It is anticipated that Nazims will have transfer authority for grades 17 and above, but this has not yet been notified. So, at present, Nazims do not have independent authority to transfer district staff. In practice, transfers of teachers and tapedars (revenue officers) have taken place by DCOs and EDOs on the orders of Provincial Ministers. Hence, the authority for transfers continues, de facto, to reside with the provinces.

Appointment authority also has been devolved, in principle, for staff at grades 16 and below. In Sindh the notification allocates the authorities as follows:

- grades 1-2: Deputy District Officer concerned
- grades 3-5: District Officer
- grades 6-8: Executive District Officer
- grades 9-11: District Coordination Officer
- grades 12-15: District/City Nazim
- grade 16: Secretary
- grade 17: Minister
- grade 18 and above: Chief Minister.

However, in practice, appointments continue to reside with the provincial government even for posts at 16 and below.

<sup>18</sup> Some of these former rural district council staff at lower grades were assigned as administrators to the Union Councils (maximum of 3 staff per UC at Grade 9).

On *budget control*, determination of the wage envelope takes place at the provincial level, as, with the exception of Punjab, salaries are still paid from the provincial Account I rather than the district-controlled Account IV.<sup>19</sup> Under this arrangement, the districts must seek approval from the province for the release of the funds for their salary payments. Thus, the salaries effectively are paid from the provincial budget.<sup>20</sup> There are similar ambiguities at the Tehsil/Taluka level, but the number of staff affected is much smaller.<sup>21</sup>

There are several reasons why provinces may be reluctant to transfer district salaries via Account IV, in addition to basic concerns about district capacity. First, there is no objective needs-based formula devised as yet which would result in a distribution of salaries approximating the current expenditures. Second, in the absence of reliable employee databases, transfers based upon the number of sanctioned posts run the risk of over-funding those districts in which there are many unfilled positions. Third, provinces argue that transferring salaries through Account IV presents a potential cash-flow problem. The current arrangement effectively allows the province to pool the district budgets until they are disbursed, providing the government with sufficient balances to cover the shortfalls arising from irregular receipts. In NWFP, in particular, the irregular hydroelectric transfers from WAPDA create potentially serious cash-flow problems for the province.<sup>22</sup>

*Performance management* responsibility was transferred to the districts at their creation, as Annual Confidential Reports (ACRs) are initiated at the same level of government as the administrative location of the staff. District officers (DOs) heading each of the functional service categories in district government are to have their ACRs initiated by their respective EDOs, and countersigned by the DCO. Below this level, ACRs are initiated by an employee's immediate superior. Unfortunately, given the weaknesses in the ACR system, this does not create strong incentives for improved performance.

In transferring *recruitment authorities*, the district clearly is recognized as the employer for health and education staff. In NWFP district cadres were formally created for these staff on January 15, 2002 and March 15, 2002, respectively.<sup>23</sup> Oversight of merit rests in part with the districts and in part with the PPSCs. For instance, in NWFP, district staff at BPS 1-10 will be recommended by the Departmental Selection Committees. For BPS 11-15, except

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<sup>19</sup> In Punjab, salaries, non-salary recurrent and development expenditures are all being transferred to the districts through the district-controlled Account IV. In fact, salaries are being transferred as budgeted rather than actuals, so the districts may retain any savings.

<sup>20</sup> This is in contrast to the previous employees of the rural district councils who are paid from the district budget through Account IV (or the Local Fund where this has not yet been merged with Account IV). It seems that even when salaries are transferred through account IV, there will not be any change in the responsibility for future pension liabilities.

<sup>21</sup> At the Taluka level in Sindh, a similar distinction applies between staff paid from the Taluka budget, and those paid from the provincial budget: previous employees of the urban local councils (including the Municipal Corporations) and the Development Authorities are paid from the Taluka budget through Account 4, whereas formerly provincial employees posted to the Talukas are paid through the mechanism of Account 1.

<sup>22</sup> Dawn, June 3, 2003, reported that in NWFP, the "Provincial assembly also demands that the federal government, being a guarantor, should make it binding on the Water and Power Development Authority to pay monthly installments of net hydel profit share to the NWFP in line with a decision of the Council of Common Interests so that financial crisis hampering the development and non-development activities of the provincial government could be put and end."

<sup>23</sup> Gazetted Notifications SOR.I(E&AD)1-218/2001 and SOR.II(E&AD)1(20)98.V.III.

for the staff of the devolved departments, the PPSC will make the recommendation to recruit. And for BPS 16 and above, the PPSC makes the contract appointment.<sup>24</sup>

*Career management* authority is divided between the provinces and districts in a complicated fashion. Legally, all former provincial staff below grade 16 now have their appointment, promotion and transfer (APT) decisions made through the districts. However, a number of ambiguities must be resolved. What happens, for instance, when district cadre staff at grade 15 is promoted to grade 16? Does she/he automatically revert to a provincial cadre?

The 10 to 12 Executive District Officers (EDOs) – responsible for sectors such as education, health, and literacy – report (formally) to the DCO and not to the line ministries in the former divisional/provincial hierarchy. However, as their promotion and transfers are determined at the provincial level, they too are unlikely to regard the district managerial structures as paramount.

In NWFP a province-wide transfer policy was notified in February 2003, and the District Rules of Business were amended accordingly in May. In principle, the policy requires that inter-district transfers for staff below grade BPS 1-16 are made by the EDO, in consultation with the DCO, with no involvement from provincial authorities unless the employee wishes to appeal against an unfair posting. Other district staff (District Police Officer, DCO, EDO, and BPS 17+, are transferred on the authority of the provincial government).

*Establishment control* – avoiding over-recruitment – is a district responsibility; and the districts, in theory, control the disposition of staff within local offices and facilities. However, in practice, there are many informal influences from the province. Once salary budgets are transferred through Account IV, the districts would, in theory, be able to select more of one type of staff or skill and less of another.<sup>25</sup> Even if the provinces retain control over the creation of new sanctioned positions - at the least the districts would be empowered to reallocate any staffing savings.

*Pay policy* (setting pay levels for various staff groups and employment grades, as well as determining allowances and ensuring gender pay equity) remains unambiguously with the provincial government. The provinces, in turn, follow the lead set by the federal government in setting levels of salaries and allowances. It is improbable that pay policy will be devolved to the districts in the short or medium term future.

In NWFP Parent Teacher Associations (PTAs) have no employer function and there are as yet no plans to devolve this authority to PTAs. In Sindh, meanwhile, useful steps have been taken

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<sup>24</sup> In Sindh province an Ordinance providing the Sindh Public Service Commission with additional autonomy was promulgated on December 8, 2001. Associated rules were issued, notified in the Official Gazette on January 3, 2002, that require the Commission to undertake all recruitment to grades BPS 11 and above. It seems that this rule also covers district appointments, as revisions to the Sindh Local Government Ordinance require that district governments send hiring requisitions to the PPSC for selection by the PPSC. The merit list subsequently is to be provided to the district governments for appointment by them.

<sup>25</sup> The SLGO establishes as a "function and power of the Zila council" to "approve the proposals of the District Government for changes in the number of posts of officials and employees of the decentralized offices of District Administration and Taluka Municipal Administration and Town Municipal Administration as part of the budget statement" (Art. 39).

toward transferring employer functions to the school level.<sup>26</sup> However, this remains more an ambition than reality. SMCs have received very limited funds from the transfer to the districts of some non-salary operating budgets in FY01 and 02. SMCs in a few comparatively rich areas have raised their own funds, as well. However, the additional, extra-budgetary funds required to hire one or more new teachers are well beyond the capacity of almost all SMCs.<sup>27</sup> Likewise, SMCs have not been granted the flexibility to decide to hire fewer staff and reallocate the funds to, say, textbooks or building maintenance. Teacher salaries soon may be routed through Account IV; but there is no immediate intention to route them through the SMCs. In most cases, SMCs also would need training in order to assume responsibility for human resource management decisions.

### Gender and institutional design

The legal rights of Pakistani women and their equality has been recognized and accepted by the constitutions of Pakistan, but they are still subject to injustice, discrimination and intimidation, both before the law and in practice. By international standards, despite some improvements over the last 30 years, the status of women in Pakistan is appalling.

The Government has exhibited a new concern for gender equity and this has been given special prominence in devolution policy. Soon after the Musharraf government came into power, the Ministry of Women's Development, Social Welfare and Special Education (MoWD) submitted to the Chief Executive a 10-point agenda to amend laws that discriminate against women. The Government created an independent Permanent Commission on the Status of Women in July 2000 to examine gender equity in policy and programs; review laws, rules, and regulations affecting women's rights; and suggest amendments or new legislation. Policy commitments include launching the National Plan of Action (NPA) in 1998; formulation of National Policy on Development and Empowerment of Women in 2002; and ratification of the Convention on Elimination of All Forms of Discrimination Against Women (CEDAW), and International Labor Organization Convention 100 on Equal Remuneration.

After extensive consultations a number of laws were redrafted to make them gender sensitive. These include the Family Law Ordinance and Rules, Nikahnama form (marriage license), Family Court Act, Dissolution of Muslim Marriages Act, and Child Marriage Restraint Act. So far, however, the conservative religious lobby has prevented the enactment of these reforms. The Government has also declared that all "honor killings" will be treated as murder. As noted above, it is seeking to improve women's voice and access to resources by increasing their political representation: a third of local council seats have been reserved for women (resulting in a total of 36,007 women elected across all four provinces, although not all reserved seats were filled). The number of seats reserved for women in the National Assembly has been increased. Combined, these provisions at federal, province and local government levels are the most strategic step taken towards women's political empowerment.

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<sup>26</sup> For example, in Sindh the "Rules for School/College Management Committees" were notified on August 13, 2001 ([http://www.sindhedu.gov.pk/download/GOS%20\(NOTIFICATION\).doc](http://www.sindhedu.gov.pk/download/GOS%20(NOTIFICATION).doc)). A subsequent Government of Sindh notification authorizes SMCs to spend money on both non-salary and salary items (<http://www.sindhedu.gov.pk/Links/notificationsmc2.htm>). However, further notifications stipulate that SMCs may only hire staff on contract appointments. (<http://www.sindhedu.gov.pk/Links/notificationsmc1.htm>).

<sup>27</sup> See "Funds released in FY2001-2002" (<http://www.sindhedu.gov.pk/Links/funds-released.htm>) and "Distribution of SMC Fund FY 2002-2003" ([http://www.sindhedu.gov.pk/download/ORDINANCES\(1974-01\)/Abstract.pdf](http://www.sindhedu.gov.pk/download/ORDINANCES(1974-01)/Abstract.pdf)). The latter indicates that the annual amount per student is Rs. 104.

It is well understood that male domination of politics and administration has historically excluded women from governance, resulting in the neglect of women's concerns and interests in public policies, the most fundamental political instrument that directly affects their lives. Women lack access to the means of political participation such as political experience, economic resources, education, training, and access to information due to structural and cultural barriers and the male domination of political parties and the bureaucracy. Local government is the most feasible tier of government for women to enter into formal politics. Local government can become a place for women to develop political skills and enable them to enter into higher tiers of government at the provincial and national levels.

Despite patriarchal resistance in strongholds of tribal and feudal politics, particularly, in North-West Frontier Province and Balochistan, where the local male elite along with religious groups and political parties signed agreements to stop women participating as voters and candidates in elections, only 9% of the seats reserved for women remained vacant. There is no doubt that a large number of women were nominated at the union council (UC) level as a result of local political factions dividing women's seats among themselves and that no contest was allowed to take place on women's reserved seats: a majority of women councilors, especially those who were elected at the UC level, are the nominees of local elites or male members of their families (Pattan Development Organization and UK Department for International Development 2001). This kind of nomination process undermined women's chances and opportunities to participate in the electoral process and learn political skills. They lack political and institutional skills and support systems, as the majority of them do not belong to political parties and are not well connected with civil society organizations. The profile of women councilors indicates that the majority at the UC level is illiterate.

Within government, political/technical support to women representatives or to mainstream women's concerns into public policy and planning across sectors is constrained by the lack of formal horizontal and vertical administrative linkages among the MoWD, Women's Development Departments (WDDs) at province level and other key ministries and departments such as Finance, Agriculture, Education, and Health. The Ministry and provincial WDDs have only marginal impact on development policies or programs. From 1997 to the present, the Ministry has established 26 focal points to implement the NPA in the line ministries to coordinate and ensure incorporation of gender concerns in their respective sectors. Most of these focal points lack essential academic qualifications and experience, and none of them are trained in gender analysis and planning skills. Gender and Development Cells have been created in some departments, in some provinces, but these have everywhere been under-resourced and ineffective.

At local level, the office of Community Development, an extension of the District Social Welfare Department, is responsible for women's affairs. Therefore, within the department, gender equity must compete with other responsibilities such as community organization, registration of voluntary organizations, social welfare, sports and culture, labor and cooperatives.

The National Reconstruction Bureau and MoWD have initiated training and networking programs for women representatives. To institutionalize these efforts, a comprehensive National Program for Women's Political Participation is underway by MoWD encompassing all political tiers of government, i.e., district assembly, provincial assembly, national assembly and the senate. MoWD will further develop this Program under Gender Reform Action Plans shortly to be approved by federal and provincial governments. GRAPs will commit governments to revision of laws and administrative systems, as well as long term efforts to increase women's representation

in the civil services and to introduce gender-responsive budget and expenditure management systems.

Representation of women is a necessary but not a sufficient condition to impact governance structures and processes. Women's empowerment, given representative opportunities, depends on training, political education, and enhancing their ability to negotiate and promote gender interests effectively in planning and budgetary processes of local government systems. The key challenges faced by women representatives in local government are (i) a generalized limitation in political and administrative capacity within local government, in particular in policy formulation, planning and budgetary processes, and monitoring and evaluation; (ii) a lack of political support for women representatives from public institutions and civil society organizations; and (iii) the prevalence of patriarchal rules, norms, and practices of institutions.

Women councilors have a strong sense of powerlessness due to the control exercised by male nazims over decision-making processes and financial resources. Males perceive that women councilors represent only women and that they should be assigned to traditional social welfare-type activities. At the UC level, women councilors are frequently not even invited to the council's meetings. They complain about not having access to district financial resources for development work like male councilors. They lack institutional support such as office space, separate toilets, and honoraria. Networks of women councilors are emerging in some districts (e.g. Faisalabad), but these are hampered by the acutely expressed need for information about their roles and responsibilities and the local government system.

## Fiscal reforms

### The historical legacy

#### Expenditure assignments

Areas of expenditure responsibility of the federal and provincial governments are set out in the Constitution of Pakistan. While the *Federal Legislative List*<sup>28</sup> of the Constitution specifies the functions of the federal government, the *Concurrent List*,<sup>29</sup> indicates the areas of shared responsibility, i.e. those which *can* be undertaken by the federal government or by the provincial governments (or jointly by both levels). The Constitution is silent on the remaining functions and (by default) assumes that these residual functions are to be performed by the sub-national (i.e. provincial or local) governments.

Thus, according to the Constitution, the federal government is responsible for foreign affairs, defense, banking and currency, postal service, transportation (ports, airports, railways), while the main provincial responsibilities are police services, justice, roads, education and health. The actual assignment of functions remained much more centralized than the Constitutional provisions required, as higher levels of government played a dominant role in areas of shared responsibility. Centralization of taxes, by agreement with the provinces, has emphasized this practice.

The Constitution accepts that the assignments (actual or implied) of expenditures (and revenues) will lead to vertical fiscal imbalances between the upper two levels of government, which are to be resolved through revenue sharing. Thus, the Constitution also sets up the National Finance Commission - an institution assigned with the task of determining appropriate revenue sharing arrangements among the federal and provincial governments.

#### Revenue Assignments

The 1973 Constitution also specifies the taxation responsibilities of the federal government. Most buoyant taxes with significant revenue potential had been either assigned to the federal government or have been ceded by the provinces to the federal government on grounds of collection efficiency. The Constitution provided just four taxes with any worthwhile revenue potential to the provincial governments. These were: the Agriculture Income Tax (AIT), Urban Immovable Property Tax (UIPT), Motor Vehicle Tax (MVT) and Stamp Duties.

#### Fiscal Transfers to the Provinces

In Pakistan, revenue sharing (as distinct from by making the size of federal-provincial transfers independent of the magnitude of federal revenues) is the dominant form of federal-provincial fiscal relations.<sup>30</sup> The main source of provincial revenues is a transfer based on a share of federal tax collections. The decision on the list of taxes to be shared (the "divisible pool"), the ratio of the provincial/federal share of the pool, and the formula for its distribution to the provinces is to be fixed at least once every five years by the National Finance Commission (NFC) established under Article 160 of the Constitution. The NFC last rendered a decision (called an Award) in 1997, allocating to the provinces 37.5% of the divisible pool, comprising all major federal taxes, with

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<sup>28</sup> Contained in the fourth schedule, article 70(4) of the Constitution.

<sup>29</sup> Also contained in the fourth schedule.

<sup>30</sup> See Appendix 4: Theoretical considerations in fiscal decentralization.



the distribution to the provinces on the single criteria of population (based on the 1981 Census of Population). Besides determining the taxes to be included in the Divisible Pool and the respective shares of the federal and provincial governments, the NFC also determines other tax and non-tax revenues that would be provided to the provincial government as “Straight Transfers”. These generally include revenues from those heads, which technically fall in the provincial domain (e.g. taxes and royalties on natural resources), but which, for collection convenience or other reason, are collected by the federal government.

Previous quinquennial awards stay in force in the event a consensus is not reached on the new award. As the 2002 NFC failed to come to a consensus on a revised Award, the 1997 NFC Award is still current.

### **Box 2: The 1997 NFC Award**

The 1997 NFC award (renewed in 2002 changing the basis of provincial shares from the 1981 population ratios to 1998 census) consisted of three components: (a) revenue sharing component – distribution of a pool of federal revenues to provinces by formula; (b) straight transfers - returning to the province of origin resource royalties, charges and excises after deducting a federal collection fee; and (c) special lump sum transfers to NWFP and Balochistan provinces for backwardness.

#### Revenue sharing component

Under the 1997 Award, the federal divisible pool comprises all major federally collected taxes (i.e. all CBR collected taxes). These include Income Taxes (both personal and corporate), Wealth Tax, Capital Value Tax, General Sales Tax (GST) on goods, Central Excise Duties (CED) (excluding gas) and Custom Duties.

These revenues are notionally placed in the divisible pool and then collection charges, set at 5% of the gross amount collected, are deducted to cover the presumed administrative overheads of the federal government. An additional 1% is deducted from income tax collected. This removes from the divisible pool an amount roughly equal to the income tax paid by federal civil servants.<sup>31</sup> 37.5% of the remaining funds are then distributed to the provinces on the single criterion of population (based on the 1981 Census of Population).

In addition, to these revenues, provinces currently receive an additional 2.5% of general sales tax (GST) revenues as pass-through funds for local governments in lieu of their elimination of octroi and zila taxes.<sup>32</sup> For FY2002-2003 total divisible pool comprised of 448.5 billion Pak Rupees and the provinces received 159 billion rupees as revenue sharing transfers (see Table 6 for details). The revenue from 2.5% of GST was transferred to the provinces in two separate forms: the NFC formula based normal transfers (which accounted for about Rs 14 billion of the total Rs 34 billion in FY03); and federal grants determined on the basis of OZT collection in the province at the time it was abolished (this accounted for the remaining Rs 20 billion). While revenue received under the first mode automatically became part of the divisible pool, each PFC also included revenues received under the second mode as items in the divisible pool.

#### Revenues returned by origin

<sup>31</sup> This resolves the problem that would otherwise arise because the income tax would amount to a direct contribution from the Federal Consolidated Fund (which pays civil servants salaries) to the provinces via the divisible pool, and it is illegal for the FCF to fund the provinces.

<sup>32</sup> While Octroi was an “import tax” on selected goods being transported into the urban local bodies, the zila tax was an “export tax” levied by District Councils. The revenue from 2.5% of GST is transferred to the provinces, from where it is transferred to tehsils (on the basis of share of Octroi collection when abolished) and UCs on the basis of share on zila tax. The transfers are being made either directly by the province or via the District Government. In some provinces a proportion is retained by the District Governments also.

Other taxes (royalty on crude oil, surcharge on natural gas, Central Excise Duties on natural gas, royalty on natural gas and GST on services are distributed as "straight transfers". These are taxes that are returned to the provinces on a derivation basis net of a 2% federal collection charge. In FY2003-2004, provinces received 34.3 billion rupees on account of these revenues.

It is important to note the distinction between GST on goods and GST on services, as constitutionally the former falls in the federal domain, and therefore forms part of the divisible pool, while collection of the latter (by default) is a provincial responsibility, which has been given to the federal government through provincial ordinances in exchange for an undertaking that all the (net) revenue from the tax will be transferred to the provinces (as straight transfers).

Similarly, the CED has to be distinguished between natural gas-related and other CEDs. The (net) revenue from the former is passed on to the provinces as straight transfer (on collection basis), while the latter are distributed through the divisible pool.

#### Special Grants to Fiscally Disadvantaged Provinces

The NFC mandated payments of special lump sum grants to NWFP and Balochistan provinces in recognition of their special needs. In FY2002-2003, Rs. 20 billion in federal revenues were transferred to these two provinces.

The importance of federal transfers has significantly increased over time. They were only 65% of provincial revenues in 1977-1978 and 76% in 1987-1988, but accounted for 80% of provincial revenues in 1998-1999, with those drawn from the divisible pool representing 80% of that total or 64% of all provincial revenue. In 2000-01, federal-to-provincial transfers accounted for 87% of total Provincial Revenues. Even the non-transfer provincial revenues were largely derived (57%) from centrally set tax bases and rates. NWFP and Balochistan are more dependent and Sindh and Punjab less dependent on federal transfers for their revenues.

Historically, local governments in Pakistan were fiscally self-sustaining, with little assistance from the provincial governments (about 5% of total expenditures). In 1998, local governments were directed by the federal government to abolish octroi taxes against a federal undertaking that they would receive equivalent revenues as grants (2.5% of GST).

### **Structural changes**

#### Expenditure assignments

As local governments are not a constitutional tier of government, they are established and assigned functional responsibilities through provincial legislatures, primarily via the Local Government Ordinances (LGOs).<sup>33</sup> Under the 2001 LGO, the district governments have been given responsibility for delivering some important social and economic services, including elementary and secondary education, primary and secondary health, agriculture, etc. Towns and tehsils have the responsibility for municipal services and local infrastructure although most of the important functions assigned to the Tehsil Municipal Administrations (TMAs) were already being performed by their predecessors in interest, the urban local bodies. The union administrations, the lowest tier of the government, have not been assigned any significant major service delivery responsibilities. However, they are responsible for small-scale development projects that initially have been funded from the District Government allocations under KPP. Limited funds for Union Councils have remained a problem for District Nazims who depend on Union Councilors as the Electoral College for the nazim's reelection. In addition, Union administrations are expected to

<sup>33</sup> Acts of the Provincial Assemblies or Provincial Ordinances.

play a major oversight role. See Appendix 2: Local government expenditure responsibilities. Unions have been created in urban as well where they did not exist earlier.

There were no shifts of responsibility from the federal to the provincial governments. The initial attempt was to bring about changes that would not require any Constitutional Amendment. Devolving any function to the local governments from the Federal Legislative List (or even the Concurrent List) would have required a Constitutional amendment.

### Revenue assignments

Under the 2001 LGOs, local governments have been given the rights to raise additional revenues.

**Table 5: Revenue-raising authorities for local government**

District Councils	Tehsil and Town Councils	Union administrations
<ul style="list-style-type: none"> <li>• Education tax.</li> <li>• Health tax.</li> <li>• Tax on vehicles other than motor vehicles.</li> <li>• Local rate on lands assessable to land revenue.</li> <li>• Fees in respect of schools, colleges, and health facilities established or maintained by the district government.</li> <li>• Fees for licenses granted by the district government.</li> <li>• Fees for specific services rendered by a district government.</li> <li>• Collection charges for recovery of tax on behalf of the government as prescribed.</li> <li>• Toll on new roads, bridges, within the limits of a district, other than national and provincial highways and roads.</li> </ul>	<ul style="list-style-type: none"> <li>• Local tax on services.</li> <li>• Tax on the transfer of immovable property.</li> <li>• Property tax on annual rental value of buildings and lands.</li> <li>• Fee on advertisement, other than on radio and television, and billboards.</li> <li>• Fee for fairs, agricultural shows, cattle fairs, industrial exhibitions, tournaments and other public events.</li> <li>• Fee for approval of building plans and erection and re-erection of buildings.</li> <li>• Fee for licenses or permits and penalties or fines for violation of the licensing rules.</li> <li>• Charges for execution and maintenance of works of public utility like lighting of public places, drainage, conservancy, and water supply.</li> <li>• Fee on cinemas, theatrical shows and tickets thereof, and other entertainment.</li> <li>• Collection charges for recovery of any tax on behalf of the Government, District Government, Union Administration or any statutory authority as prescribed.</li> </ul>	<ul style="list-style-type: none"> <li>• Fees for licensing of professions and vocations.</li> <li>• Fee on sale of animals in cattle markets.</li> <li>• Market fees.</li> <li>• Fees for certification of births, marriages and deaths.</li> <li>• Charges for specific services rendered by the union council.</li> <li>• Rate for the remuneration of Village and Neighborhood guards.</li> <li>• Rate for the execution or maintenance of any work of public utility like lighting of public places, drainage, conservancy and water supply.</li> </ul>

As tax bases are assigned to the local governments through the LGOs and not through the constitution, tax assignments between the provinces and local government can, in principle, be changed according to the requirements of the time. The Provincial Finance Commission, could, through mutual agreement, alter this tax assignment. The possibility of this happening in the short-run is extremely limited.

### Fiscal Transfers to the Provinces

Although no new NFC Award has been announced, the previous revenue-sharing arrangement has not been static since 1997. In 1999, 2.5% was added to the GST to raise revenue to finance Octroi and Zila Revenue Replacement Grants.<sup>34</sup> This buoyant tax was distributed directly to local

<sup>34</sup> Until devolution, districts were budgetary units of provincial governments and as result, did not have autonomous revenues. Now, as then, the Districts rely primarily on federal transfers to provinces. Urban local bodies collected Octroi (import taxes levied by municipal entities at their borders on goods imported for resale) while rural ones collected Zila Export taxes on agricultural goods exported out of rural (then called "Zila" councils). Together, the octroi (collected largely in urban

bodies as a "hold harmless" revenue replacement grant. The basis for the distribution was the claims made by the provinces concerning the amounts that had previously been raised from these local taxes.

However, for 2000-01, arguing that the 2.5% of the GST was generating an amount in excess of the initial amount raised (Rs 30 billions 2002-03 compared to Rs 19 billion in 1999-00), the federal government maintained that it was reasonable to cap the grant in nominal terms at Rs 19 billion as there was no reason to replace more than the original amounts lost with the abolition of OZT. Thus the replacement grant to the provinces fell to 62.5% of Rs 19 billion OZT (Rs 11.9 billions).<sup>35</sup>

**Table 6: Federal-Provincial Fiscal Transfers FY 2002-2003**

(Million Rupees)

<b>Program</b>	<b>Punjab</b>	<b>Sindh</b>	<b>NWFP</b>	<b>Balochistan</b>	<b>All Provinces</b>
Revenue sharing	92,155	37,080	21,554	8,442	159,231
Return of revenues by point of collection	5,277	19,387	573	9,044	34,281
<b>Total</b>	<b>97,432</b>	<b>56,467</b>	<b>22,127</b>	<b>17,486</b>	<b>193,512</b>

Source: Federal and Provincial Budgets, FY 2002-2003

In 2001/2, while the mechanism for transfer of revenue remained the same, the cap on amount of revenue to be transferred was removed and the entire Rs 30 billion collected from the tax was transferred (37.5% through the NFC mechanism and the remaining as federal grants) to the provinces for onward transfer to the local governments. This was undoubtedly a significant victory for the provinces and local governments.

These changes have had very little impact on the vertical fiscal imbalance, measured as the transfers to subnational government as a share of total subnational expenditures.

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areas) and zila (rural area) taxes accounted for 50% to 60% of autonomous local revenues. While productive of revenues, both taxes (which when combined are referred to as the OZT) were notorious for their inefficiency and as a source of corruption at the point of collection. Accordingly, they were abolished as of fiscal 1999-2000 with the agreement that the federal government would come up with a replacement grant to be paid to the local bodies.

<sup>35</sup> The distribution result is that Sindh which collected 45-50% of octroi and zila taxes but which receives only 24 % of the distributable pool, has seen its replacement revenues fall below what it would have collected under OZT. The other three provinces have experienced net gains. Provinces complain that the revenue elasticity of octroi was higher than that of the GST while the federal government argues that the 19 billions Rs are an un-audited excessive amount

### **Box 3: A new NFC Award**

The new NFC has been notified, and the provinces have been asked to nominate their representatives to the Commission. However, even if the Commission starts to function immediately it is too late to agree on an Award in time to influence budget-making for the next fiscal year. In other words, the new NFC Award, even if formulated, would probably be implemented from FY05.

Discussions on a revised Award within the reconstituted NFC became stuck on the question of the shares of hydroelectric profits between the NWFP government and WAPDA. As this issue could not be resolved in time, the announcement of NFC Award was delayed until the elections. There was also some concern about preempting the new government in the politically sensitive issue of revenue sharing. Discussions had led to some consensus, but it is not clear whether these will remain agreed when negotiations recommence:

- The share of provinces in the divisible pool was increased from 37.5% to 40%. Including the revenue from 2.5% of GST, the provincial share in divisible pool taxes could be as high as 44%. (Sindh had lobbied for an increase from 37.5% to 50 %)
- Balochistan and NWFP were to be given additional subventions for dropping their demands to have factors like tax collection, backwardness and area as factors determining revenue shares. Balochistan and NWFP often raise such equalization measures, with the former also frequently emphasizing land area. Balochistan, NWFP and Sindh all qualified for receiving subventions from the federal government. Agreement was reached to raise the amount of these subventions from about Rs 10 billion to over Rs 30 billion.

In the federal budget announced on June 7, 2003, the Federal Finance Minister announced that Rs 214 billion would be transferred to the four provinces under the National Finance Commission Award for 2002-2004 on the basis of population, applying the existing formula of 63.5:37.5 federal:provincial split.

When a new award is made, the 1999 Census will be the basis of its analytical work, not the 1981 Census.

### PFC Awards

Devolution brought a significant decentralization of expenditure responsibilities to district governments, particularly for social services. Mirroring the federal/provincial arrangements, this was to be accompanied by a system of unconditional fiscal transfers from the provinces determined by provincial finance commissions.

All provinces have now established Provincial Finance Commissions and these have made awards for the distribution of provincial resources to local governments. According to the legislation establishing each PFC (which were only slight variations of the model suggested by the NRB), the PFC is to evolve a formula for distribution of resources, including distribution of the proceeds of the Provincial Consolidated Fund between the provincial government and the local governments.

The PFC interim awards were made in 2002 (although never actually published for Balochistan) and were initially intended to cover just the first two quarters of FY03. A full award was to be determined by the end of the first quarter FY03 to cover the last two quarters of FY03 and the subsequent 3 years (FY04-06). However, the final awards have not been made and the interim awards were extended to cover the entire FY03 and FY04.

What constitutes a divisible pool for allocation of local share varies somewhat across provinces with Punjab including all provincial revenues in the pool but other provinces making some exceptions.

**Table 7: Provincial Finance Awards - FY 2002-2003**

<b>Total pool and distribution criteria</b>	<b>Punjab</b>	<b>Sindh</b>	<b>NWFP</b>	<b>Balochistan</b>
Local share of the Provincial Divisible Pool	39.8%	40%	40%	31%
Formula factors with weights:	100%	100%	100%	100%
Population	75%	50%	50%	50%
Backwardness	10% <sup>36</sup>	17.5% <sup>37</sup>	25% <sup>38</sup>	
Tax effort	5% <sup>39</sup>	7.5% <sup>40</sup>		
Fiscal austerity	5% <sup>41</sup>			
Area				50%
Development incentive/ infrastructure deficiency	5%		25% <sup>42</sup>	
Hold harmless/ transitional assistance		25%		

Population is the most important indicator used in all provincial awards. Backwardness index is used by three of the four provinces and the two largest provinces incorporate tax effort provisions. Balochistan gives 50% weight to district area and NWFP assigns 25% weight to infrastructure deficiency. In all cases grant funds vary directly with fiscal need but fiscal capacity has no influence on grant entitlements.<sup>43</sup>

<sup>36</sup> Both of these indices are created from the PERI "development score" index. Under-development is the inverse. The "development score" was taken from the Punjab Economic Research Institute (PERI) study of district-wise development scores in various economic sectors. The scores are based on the "eigen value" of the matrix of various sectoral indicators. See: (Punjab Economic Research Institute 2001).

<sup>37</sup> The "Backwardness Index" is the "Deprivation Index" developed by the Social Policy and Development Centre (SPDC) on the basis of their study on development ranking of districts in Sindh. The "Deprivation Index" is a geometric mean of "educational poverty", "housing quality", "residential services" and "employment" indices. The "educational poverty" index in turn is a weighted average of four educational indicators. Similarly, the "housing quality" index is a weighted average of nine housing indicators, and the "employment" index is a weighted sum of two indicators.

<sup>38</sup> The "backwardness" index is derived from the UN sponsored Multi-Indicator Cluster Survey (MICS), which includes the following elements: child survival and nutrition; immunization and EPI for children up to 5 years of age; education & literacy; availability of drinking water; and income.

<sup>39</sup> An index is calculated from actual income (revenue) generation as a proportion of the normalized revenue mobilization (tax and non-tax) across all districts. The index is calculated by taking total revenue generated by a particular district (from its own sources) as a percentage of total revenue generated by all districts in the province (from their own sources). Hence, the formula benefits the districts which are more "fiscally affluent".

<sup>40</sup> The "tax collection" index is derived from provincial tax revenues collected in different districts in the 1999/00. The index was calculated as percentage of provincial tax revenue collected in a given district (in FY01). It shows the governments attempt to plow back some of the tax revenue back into the district and indicates only the tax capacity and not the tax effort of the district.

<sup>41</sup> Inverse proportion of expenditure reduction. Rather than rewarding districts that are more cost efficient, it rewards the district that had spent more vis-à-vis their budget allocation. If the district managed to spend only a small fraction of its budget, it gets relatively small share on the basis of this index. For example, Rahim Yar Khan, which spent only 59% of its allocated budget, received only Rs 6 million for "expenditure reduction", whereas Bahawalpur spent 106% of its budget and got Rs 112million under "expenditure reduction".

<sup>42</sup> The "lag in infrastructure" index derives from three other indicators: urban development; rural sanitation, and transport and communication.

<sup>43</sup> Fiscal capacity of a province equals the revenues that could be raised by a province if it applied national average tax effort to all its tax bases.

**Box 4: Fiscal transfers to tehsil and union administrations**

Different provinces have taken different routes for funding tehsil and union administrations.

In Punjab, the PFC determined the shares of not only the district but also those of TMAs and Unions. The other PFCs decided to work out the sharing formula for province and districts only - presumably on the assumption that the local government will work out a sharing arrangement among themselves. However, the NWFP sharing arrangement does specify that development funds given to the district under the revenue sharing arrangement will be distributed in the ratio of 60: 30: 10 percent among the districts, tehsils and unions.

The Octroi and zila tax related transfers from the province (to be paid from revenue from the additional 2.5% of GST) go directly to the accounts of the tehsil and union administrations, respectively.

Tehsils also receive UIPT and any fees that are raised and charges for contracting out various levies and charges on roads etc.

*Punjab*

The Punjab PFC agreed to include all provincial revenues for determination of Provincial Retained Amount and Provincial Allocable Amount. These include federal tax transfers, and provincial tax and non-tax revenue. However through creation of a third entity, Provincial Obligatory Expenditure, outside of the operation of the vertical distribution formula, an undefined amount in the Provincial Consolidated Fund remains with the province.

The government of Punjab announced an Interim PFC Award in June 2002 (which specified that the Provincial Allocable or local government share of the Provincial Consolidated Fund was 38.72%) and this was revised in mid-October (to 39.80%). Both the interim and the revised Awards were calculated so as to minimize changes in the 2002/03 provincial budgets.

The amounts budgeted for meeting the salary expenditures, calculated as incremental increase on the baseline configuration, were to be transferred over and above the formula based shares of the local governments. As such therefore the grant for recurrent expenditures was only partly formula based.

*Sindh*

The Sindh PFC decided that the Provincial Divisible Pool (for current expenditures) should comprise:

- i) Federal divisible pool transfers;
- ii) Federal straight transfers; and
- iii) Provincial tax revenue (excluding district tax revenue)

As the provincial non-tax revenues are essentially user charges, it was decided that these should be outside of the Divisible Pool. The Divisible Pool will be divided into Provincial Retained (60%) and Provincial Allocable (40%). The proceeds of an important provincial loan, Sindh Structural Adjustment Credit, which according to the constitutional description formed part of the Provincial Consolidated Fund, remained outside of provincial revenues for the purposes of PFC. This was not in accordance with the provisions of Sindh Local Government Ordinance.

The Transitional Transfers weight is determined on the basis of the gap between district's expenditure and revenue transfers indicated by population, tax collection and backwardness indices. In order to make the total revenue transfers equal to the overall amount of the Provincial Allocable Fund a small equal share is given to each district. An incentive for expenditure saving was announced but due to transfers for recurrent expenditures on the basis of filled positions rather than the budgeted the savings remained in the provincial share without a clear mechanism for transfer to the local governments.

For development expenditures, the PFC formula seeks to provide incentives for scheme completion. Amounts equal to the remaining costs for completion were budgeted in the local government shares in accordance with the location of the ongoing schemes.

#### *NWFP*

The NWFP PFC provided the only Award that defines divisible pool in terms of net resources, i.e. after deducting the province's "obligatory" expenses (interest payments, debt repayments, pensions, subsidies, contributions to General Provident and Pension Funds and charged expenditures on the Governor's House, Provincial Assembly and High Court). This was not in accordance with the statutory provisions requiring a determination of the provincial and local shares out of the total Provincial Consolidated Fund. The NWFP statute provided for the baseline expenditures of the local governments to be protected as a 'charged expenditure' keeping it outside the Provincial Assembly voting on the Annual Budget Statement. This was an important mechanism according local government transfers a status similar to the treatment of the provincial shares under the NFC. However, this has been amended and now the baseline expenditures in all the four provinces sit within the voted component of the Finance Bill.

The (gross) provincial divisible pool is composed of all the revenue resources of the provincial governments, except federal development and extraordinary grants and revenue from additional 2.5% of GST. 90% of the latter is provided to local governments as a straight transfer proportionate to the collection rate of Octroi and Zila tax at the time it was abolished. The divisible pool includes:

- i) Revenue transfers from the federal government
- ii) GST on Services (although transferred by the federal government)
- iii) Royalty on Crude Oil Gas (a straight transfer from the federal government)
- iv) Net hydel profits from WAPDA
- v) Subventions received from the federal government
- vi) Provincial own receipts

The net divisible pool is divided into the Provincial Retained amount (40%) and the Provincial Allocable amount (60%). It is used only to determine the distribution of 90% of the development funds among the districts, and is not used for the recurrent budget. 10% of development funds are distributed on the basis of "equalization" needs, i.e. shortfall in formula based transfers in meeting the "throw-forward" of development schemes.

To determine the allocations for recurrent expenditures, the Award looks at the assessed demands for salary and non-salary recurrent budgets made by each district. The PFC then awards funds on the assumption that only 94% (based on historical data) of the assessed salary demand and only 90% of the total non-salary amounts are "genuine". The remaining 10% of the non-salary funds



are provided on the basis of "equalization", meeting the shortfall between the assessed demand and funds provided on the basis of formula.<sup>44</sup>

Finally, 90% of the revenue from 2.5% of GST is transferred on the basis of the district historical share in collection of Octroi and Zila taxes in 1999 (when these taxes were abolished).

### *Balochistan*

With the exception of federal development and extra-ordinary grants, the Balochistan PFC transfers all revenues, in whole or in part, to local governments. The OZT grants and revenue from 2.5% of GST are to be transferred fully (after deducting 10% as provincial share) to local governments. All remaining heads of revenue are included in the divisible pool. These include:

- (i) The federal tax assignment (except revenue from 2.5% of GST);
- (ii) Federal subventions; and
- (iii) Tax and non-tax revenues collected by the province.

The PFC determined that the divisible pool should be divided into the Provincial Retained amount and Provincial Allocable amount in the proportions, respectively, of 69%:31%. For 2002/03, the PFC considered that the revenue from the divisible pool should be divided among the 24 districts only on the basis of their historical share in revenue transfer during 2001/02.

For distributing straight transfers (i.e. 90% of the aggregate revenue from OZT grant and 2.5% of GST), the PFC felt that as Balochistan, in general, is a backward province, there is hardly any reason for distinguishing districts from each other on the basis of backwardness. Hence, in order to divide revenue among the 24 districts of the province, the PFC decided to use the district's share of population and in area as the only two indicators of fiscal need, with equal weight (i.e. 50%) given to each factor.

### Accounting and audit

Accounting and audit arrangements have also been reformed. Although this was not undertaken directly as part of the devolution process, it has significant implications. The context is that the promulgation of Auditor General's (Functions, Powers and Terms and Conditions of Service) Ordinance 2001 and Controller General of Accounts (Appointment, Functions and Powers) Ordinance 2001 separated audit from accounting. The latter Ordinance created the new office of the Controller General of Accounts (CGA) as the head of the accounting machinery in the country, taking accounting out of the administrative control of the Auditor General of Pakistan (AGP). This separation is rather partial as staff can and do move across the accounting and audit lines - either voluntarily or through transfers and repostings.

In parallel to these institutional reforms, some technical changes have been driven by PIFRA. This is introducing a new computerized accounting system entailing a new Chart of Classification and a new format for reporting, and a shift of the basis of accounts from cash to commitment.<sup>45</sup> Deriving a legal mandate from the AGP's constitutional prescription of accounting systems the CGA is seeking to implement the NAM for upgrading the accounting systems of the federal government, provinces and ultimately local governments. The roll out of the technological change and associated staffing realignment is a major activity for the CGA and the AGP, both at federal and provincial levels.

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<sup>44</sup> If the funds provided on the basis of the formula meet or exceed the assessed demand, they are taken as the final provision of funds for non-salary budget.

<sup>45</sup> This is referred to in aggregate as the New Accounting Model (NAM).

For local governments, adjusting accounting systems to correspond to the new administrative entities in the district governments is an immediate requirement for the preparation of district government accounts. The merger of the local funds with the operations under the Provincial Consolidated Fund in order to create District Funds and appropriation and finance accounts for Account IV is a major task. The Local Government Accounts Code, recommended for notification by the AGP to the President, will underpin this move.

Responsibility for the audit function is relatively uncontentious. Although generally the audit function for all levels of government is to be undertaken by the Auditor General, an amendment to the Local Government Ordinances, through insertion of a new Chapter XII in June 2002, assigned the audit responsibility for TMAs and union Administrations the Local Fund Audit of the provincial service. This was based on the argument that in the short term the capacity of the Local Council Accounts Service renders the introduction of NAM or the earlier Chart of Classification impossible. Therefore, whilst accounts will be maintained under the old system, audit will be carried out by the Local Fund Audit (Provincial Group) where capacity for auditing of the accounts made according to the old system is available.

Reforms of accounting and audit responsibilities are hostage to constitutional and statutory interpretations. The Auditor General unquestionably *can* audit the accounts of the federation, provinces, and all entities created by or under them according to Article 169 of the Constitution.<sup>46</sup> However, the argument turns on whether Article 170 implies that the AGP *must* undertake this audit.<sup>47</sup> This has led to a major argument over responsibility for the preparation and maintenance of accounts.

Accountants General (AGs) for the provincial accounts, and the Accountant General, Pakistan Revenues (AGPR), for the Federal accounts, report to the CGA. The Controller General of Accounts and the Auditor General both argue that quality assurance in their respective tasks requires direct, hands-on federal control at all levels of government. Thus the CGA maintains that the accounts are to be maintained by a federal cadre at the federal, provincial and district levels - with TMA accounts also to be maintained by the federal accounting cadre as soon as possible. This would require that managerial control of all District Accounts Officers be passed to the CGA from the provincial Finance Departments, and that staff members of provincial District Treasuries should be merged with the staff of the District Accounts Offices and brought under the Accountants General. Ultimately, it would also require that responsibility for the TMA accounts should be transferred from the Local Council Accounts Service to the CGA. Such transfers are very difficult to arrange because of intricate cadre issues. Provincial staff would want their seniority protected in a merged cadre - but the federal accounts staff are reluctant to concede this because of perceived differences in the levels of skills. If the CGA were to assume charge of the TMA accounts this would require some posting of federal cadre personnel as Tehsil Accounts Officers (TAOs). A staffing plan in Punjab was prepared on these lines last year but could not be implemented.

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<sup>46</sup> Article 169 of the Constitution notes that: "The Auditor-General shall, in relation to  
(a) the accounts of the Federation and of the Provinces; and  
(b) the accounts of any authority or body established by the Federation or a Province, perform such functions and exercise such powers as may be determined by or under Act of Majlis-e-Shoora (Parliament) and, until so determined, by Order of the President."

<sup>47</sup> Article 170: "The accounts of the Federation and of the Provinces shall be kept in such form and in accordance with such principles and methods as the Auditor-General may, with the approval of the President, prescribe."

The provinces have a very different view of the issue. Accounting is seen as a provincial function according to the Constitution - and this logic is supported by current international practice of vesting responsibility for accounting within the same level of the government that has responsibility for the expenditures. A policy decision taken in July 2002 has accepted the need to devolve responsibility for accounts from 2006. The Federal Cabinet again reiterated this on 6 November 2002.

### **New issues arising**

#### Developments in the Provincial Finance Commissions

The statutory basis for the PFCs was created through amendments in the Local Government Ordinances nearly a year after local governments were created as administrative entities. The legal provisions of the Ordinances aim at the creation of medium term formula based transfer systems. Progress in creating the necessary secretariats and establishing the required analytic support for the PFCs has been slow.

The initial round of amendments, promulgated in June 2002, varied between provinces in the assignment of functions to the Provincial Finance Commissions and in the nature of the institutional arrangements. The amendments provided for permanent, technical and independent Commissions. However the technical support considered necessary, and the nature of the independence, were interpreted in very different ways. Except for Sindh, where the PFC was constituted with the strong presence of private sector experts and where the recommendations of PFC were made binding on the provincial government, provincial PFCs largely comprise ministers and civil servants and have an advisory role in developing formulae for revenue distribution.

Subsequent to the June 2002 amendments in the LGOs, a second round of amendments to Chapter XII A of the Ordinances has increased the number of private members in the PFC in Punjab, NWFP and Balochistan (in Sindh their number was reduced), and has made the recommendations of PFC binding on the provincial governments.

The Seventh Schedule of the LGOs provides for considerable protection to the tenure of the private members, in order to guarantee independence to the PFC. The amendments have inserted a provision in Chapter XII A which leaves the procedures for the removal of private members open and subject to detailed rules to be framed by the provincial government. Arguably, the participation and role of private members in the PFC deliberations could become rather marginal.

Departments of Finance provide secretariat support. This has so far meant preparation of working papers and arrangement of meetings. In all the provinces, officers of deputy secretary rank, have been given the additional charge of looking after matters relating to the PFC. As such dedicated staff or office space have not been allotted. The PFCs therefore do not work as permanent bodies as envisaged by Chapter XII (a) of the LGOs, but function more on the pattern of the NFC.

Statutory provisions enunciate the principle that the budgets of the PFC will be a 'charged expenditure' on the Provincial Consolidated Fund. This places them in the category of budgetary allocations for the High Courts. It will be an important measure to secure the independence of the Commissions.

**Table 8: Provincial Finance Commissions: Status of Institutional Development<sup>48</sup>**

<b>Institutional Aspect</b>	<b>Balochistan</b>	<b>NWFP</b>	<b>Punjab</b>	<b>Sindh</b>
<b>Chapter XII A Amendments</b> <i>- which provide for Province Finance Commissions</i>	Promulgated in June 02. Provided for a majority of government members. A subsequent amendment to ensure independence and technical nature of PFC cleared by provincial government and promulgated in June 03	Promulgated in June 02. Provided for a majority of government members. A subsequent amendment in November 02 provided for independent and technical nature of the PFC	Promulgated in June 02. Provided for a majority of government members. A subsequent amendment in October 02 provided for independent and technical nature of the PFC	Promulgated in June 02. Provided for a majority of non-government technical members and permanent secretariat. A subsequent amendment in November 02 ensured the independence of the PFC but diluted to have uniformity amongst provinces
<b>Membership</b> <i>- all in accordance with model LGO, but with different membership</i>	2 private members, 3 local government members and four government members	2 private members and 2 Nazims; 3 government members	3 private members and 3 Nazims, 4 government members	3 private members and 3 Nazims, 4 government members, earlier 5 private members; reconstitution of PFC in accordance with amendments sought through a Summary.
<b>Secretariat</b>	Not yet established; an FD Additional Secretary designated but not appointed.	Senior Economist, DoF designated with additional charge.	DS Resources, DoF given additional charge	A DS in DoF designated to provide support as additional charge.
<b>Office Space for private members</b>	Not allotted	Not allotted	Not allotted	Not allotted; Summary approved for separate office space
<b>Budgets</b> <i>- to support PFC activities</i>	No separate allocation	No separate allocation	No separate allocation	No separate allocation
<b>Meetings</b> <i>- frequency, functioning</i>	Has not met since June 02	Has met twice since June 02	Has met 7 times since June 02	Has not met since June 02
<b>Work on Medium term formulae to replace interim award</b>	First meeting scheduled for April 30 postponed	Meeting scheduled for 7 May 03	First meeting held on 26 April	On reconstitution the PFC will meet to modify the interim award
<b>Analytic Work</b> <i>- To support preparation of award</i>	Not undertaken	Two workshops with Nazims and DCOs, EDO F&P and Departments	Not undertaken except in house work by DS Resources	Not undertaken

Source: Prepared by Musharraf Cyan, ADB.

The absence of a secretariat, offices for private members and budgetary allocations represent a serious constraint on the working of the PFCs. It especially militates against the role of the private members and the local government representatives who, for want of timely information, access to data and briefings on emerging financial scenarios, cannot adequately contribute to the work of the PFCs. Under these circumstances, the duties of the PFCs to monitor implementation

<sup>48</sup> As at 5 May 2003

of the distribution formulae, prepare and maintain data on local government and provincial finances, and ensure redressal of grievances will be hard to fulfill.

### Budget preparation in the districts

For the majority of districts, the provincial finance departments have de facto prepared the budgets. This was all but inevitable in the first year of devolution. Each provincial finance department prepared the budgets for each district government by “unbundling” the provincial budget on a district basis. However, the district governments were given the right to modify these budgets according to their own needs and priorities by re-appropriating funds from one head to another (or even one sector from the other), thereby preserving the fiscal autonomy of the district governments. All the staff (other than those few that had been with the local government prior to devolution) remained as provincial employees and their salaries were paid directly by the provincial governments. The non-salary budget, recurrent and development, was transferred to the district governments for disbursement according to their own priorities.

Each district budget was formalized by having it approved by the District Councils. This approval led to demands for more resources by some district councils - and these were met in some cases. Table 9 presents the overall size of the provincial and district budgets for 2001/02. The table shows that district shares of the total provincial budget ranged from 43% for Balochistan to 26% for Sindh. These allocations fall under three principal headings: salaries (establishment charges), current non-salaries expenditure (petrol, electricity, school supplies, medications, etc.) and development expenditures. Salaries, while appearing as district expenditures, are paid by the provinces in 2001-2002.<sup>49</sup>

**Table 9: Pakistan Provincial and District budgets, 2001-2002**

*Rs million*

Province	Provincial Total	District Total	District Transferables (i.e. non-salary and development)	Wage component	Total Provincial and District (4)
Balochistan	14,313	10,937	NA	NA	2,5250
NWFP	31,771	12,289	1,714	10,575	4,4060
Punjab	77,269	43,044	14,914	28,130	120,313
Sindh	51,464	17,959	2,788	15,171	69,413

Source: Local Government Fiscal Transfers, volume I ADB, Table II-V, and volume III, Summary Tables

Note: These data are taken from provincial budget books prepared in June 2001. Districts voted on these budgets in the autumn of 2001 and in a few cases, may have obtained larger transfers from their respective provincial governments. These budgets are for expenditures funded by the provinces; they do not include district, tehsil or UC spending funded by Local funds, which are revenues raised by their own taxes or obtained from the OZT replacement grant.

Table 10 shows the functional breakdown of the district budgets. Unsurprisingly, education is the major function of districts, with 50% of current spending in Punjab (70% in NWFP and Sindh). Health follows in the 10-15% range; other items are less than 5% of spending. This breakdown

<sup>49</sup> As a result, non-salary current and development expenditures are sometimes referred to as transferables.

reflects the priorities of the district governments in relation to their functional and expenditure responsibilities as outlined in Appendix 2: Local government expenditure responsibilities.

**Table 10: Budgetary Allocations by Function, Selected Provinces, 2001-2002**

	NWFP	Punjab	Sindh
Development-total	8.9%	8.8%	16.0%
Current-total	91.1%	91.2%	84.0%
Education-current	63.4%	43.8%	59.0%
Health-current	10.3%	9.4%	12.9%
Public works-current	1.6%	3.3%	1.1%
Other	15.8%	34.7%	10.0%
Total	100.0%	100.0%	100.0%

Source: District budget documents.

Note: Police expenditures have been removed from Sindh data for purposes of comparability.

For 2002/03, the federal government asked the provinces to provide a single line transfer to each district – practically forcing the districts to make their own budgets. While the provinces adhered to the federal government directive and each district was provided a single line transfer in the provincial budget, the provincial finance departments, especially in Sindh and NWFP, continued the practice of formulating the district budgets, although these were more indicative than binding on the districts governments. Nevertheless, most of the districts adopted the given budget as their own with minor, if any, changes. In 2003/04, only the NWFP government continued the practice of preparing (indicative) district budgets.

Even, as for most districts in Punjab, where a district government did prepare their own budget, these were done in collaboration with the provincial finance department. Overall, the degree of autonomy of districts in preparing their 2002/03 budgets was not high, although city districts showed more independence reflecting their capacity and political influence. One particular difficulty faced by the districts was that the PFC awards were finalized late in the budget preparation cycle. The second constraint was in the form of the high rigidity of the salary budgets, which by far are the major component of the district budgets. The districts cannot increase or decrease the number of positions in any office nor can the vacant positions be filled without provincial concurrence. In large measure therefore budget making becomes an exercise giving incremental increases in the salaries with autonomy remaining in areas where unconditional funds are received from the GST share or own source revenues.

#### Budget execution

To facilitate disbursement, a provincial account (Account # IV) was created in the State Bank of Pakistan for each district. Account #IV could be considered a sub-account of the Provincial Consolidated Fund (also called the provincial Account # I); but funds deposited in the account are cash transfers, and thus cannot be re-appropriated by the provincial government (i.e., they are non-lapsing). The District Account Officers (DAOs) were asked to keep separate accounts of Account # I and Account # IV, which are reported separately to the provincial Accountant General (AG), who then consolidates them into a single account of provincial financial flows. For reporting and monitoring purposes, the AG prepares three sets of monthly Civil Accounts, two on provincial basis (i.e. those pertaining to Account # I and the consolidated provincial accounts) and one for each district (i.e. those related to each Account # IV).

These elaborate and rather cumbersome budget execution procedures were intended to minimize the risk of financial indiscipline. However, as expected, they did lead to some difficult for the

district governments in incurring expenditures. As a result, district level expenditure fell short of the budget allocations. In case of the KPP funds, utilizations were good as the new districts had full autonomy to implement projects. In case of non-salary and general development funds, in the transition year the expenditures met problems. Lahore for instance ended up with a cash of nearly Rs.250 million.

Notwithstanding the provisions of the LGO and the directives of the federal government, the provincial governments have designed their own procedures for release of funds to the district (and other local) governments. With few exceptions, the overall cash flow position of the province has become a major factor obstructing the smooth flow of funds to the districts. While funds for recurrent budget are transferred on monthly basis, release of development funds is rather arbitrary.

In Sindh, where the entire development program (provincial or district) is unfunded, the bulk of development funds are still being transferred as “pro forma-based”, i.e. scheme-wise transfers, from the provincial Account # I, thereby distorting the expenditure profile of the districts.

The Punjab and Balochistan governments have transferred the salary budget to the district governments through account IV. However, Punjab is transferring funds on the basis of the budgeted amount, NWFP is transferring funds on the basis of actual expenditures. Sindh on the other hand is still disbursing salaries through account # I.

## **Reforming access to justice**

### **The historical legacy**

The Devolution Plan 2000 had as one of its objectives to bring “justice to the doorstep” so that citizens can enforce the rights granted to them by the law. Although reforms to the system of policing have received most attention in the public eye, various task forces established by the National Reconstruction Bureau have taken a much wider view of ‘access to justice’ – including its various political, administrative and judicial/policing aspects. The Local Government Plan was predicated on the urgent need to implement the 1973 Constitutional principle of separation of powers, a prerequisite for transition to local democracy. Central to this was a reconstitution of the law and order/justice system 'from the thana upwards'.

Historically, there have been somewhat sporadic efforts in the domain of ‘administrative justice’ to establish a system of redress for citizen’s complaints against public institutions and also grievances within government departments. These efforts have caused the ombudsman's office and the courts to be overburdened with petty, avoidable, and fruitless litigation. The tradition of withholding rather than disclosing information relating to public institutions lies at the root of some of the fundamental barriers to accessing justice. Even when policies are translated into law, the laws are published in English, thereby disenfranchising an additional segment of the population that has a basic literacy rate of about between 40 and 50% in English, but considerably greater in Urdu ("Literacy Trends in Pakistan" 2003; Population Census Organization 1998). A large proportion of the population, especially women and the poor, remain unaware of their legal rights (women’s literacy is between 32 and 38%). Laws have been enacted concerning freedom of information and defamation, the office of district ombudsman, and some, albeit slow, progress has been achieved in establishing administrative disputes redressal mechanisms and beginning the process of translating new laws into Urdu.

A Police Reforms Focal Group tasked under the seven-point reform agenda announced by the President in October 1999, comprising civil and police officers, lawyers, journalists and members of the public, concluded that "the state of order in society was at a very low ebb, and the Police are incapable of confronting the challenges posed by fundamental changes in the nature and extent of crime" due in large measure to "an outdated legal and institutional framework (and) arbitrary and whimsical mismanagement of the police by the executive authority of the state at every level." (Government of Pakistan 2001, pp.1-2).

The widely acknowledged culture of brutality and rent-seeking by the police has deep historical roots. The Police Act 1861 was patterned after the infamous law that established the Ulster Constabulary in Northern Ireland; the predominant function of the police was simply to control. From its inception, the police mandates were unfunded, i.e. the police force was expected to raise its expenses from the public. This bred a culture of rent-seeking and extortion that continues. Police mandates are still unfunded, with the average budget for a police station per year being a mere Rs. 8,000 (\$120). The forensic capacity of the police is limited to distinguishing between human and animal blood.

### **Structural changes**

#### Ending the executive magistracy

Under the pre-devolution system, the office of deputy commissioner used to be considered the face of the government, having all administrative powers to implement official policy. One of the



earliest reforms was the abolition of this office - dividing the powers of the deputy commissioner/district magistrate between the district and sessions judge, district Nazim and the DCO.

### Police reforms

The Police Order 2002 is a remarkable piece of legislation. It seeks to establish an institutional framework for creating adequate checks on police conduct, making the police answerable to citizens and the rule of law, and increasing its efficiency and competence. The Police Order (PO) seeks to insulate the police from political interference so that the District Police Officer (DPO) does not take direction from the political or civil service leadership at the district level on professional matters, including posting and transfer of officers, but instead from the Province Police Officer. The DPO is, however, answerable to the District Public Safety Commission (DPSC) in accordance with an annual plan with targets approved by the DPSC. The district police are also answerable through the Police Complaints Authority (PCA). In addition, the DPO is a member of the Criminal Justice Coordination Committee established to provide some judicial oversight over efficiency in the police force.

### The Subordinate Courts

Reforms to the court system were from the outset a key part of the commitment that accompanied devolution, that is, to 'bring justice to the doorstep' of the average citizen. "The interests of powerful investment houses and powerless Pakistani citizens in a functioning legal system are not mutually exclusive. Predictability and fairness are the hallmarks of a legal system that works." (Government of Pakistan 1998, p.41). In practical terms, the focus of debate around judicial reforms was on measures to provide for speedier, cheaper and fairer justice. The common refrain was "justice delayed is justice denied".

Reliable information about the functioning of the courts is scarce, although some problems are clear. A high percentage of cases are filed but not dismissed. Relatively few cases (10%) are settled before going to trial. There is a high level of unmet demand. Due to the unpredictability of results, many people with meritorious claims do not seek justice through the courts or even threaten to access the courts (because the threat provides no meaningful inducement for the injurer to settle). A very high percentage of court decisions are appealed, and judgments enjoy virtually no voluntary compliance. In fact, the key motivation to sue before the courts is to delay justice.

In most aspects of their lives, the poor rely on informal justice and dispute resolution systems, but nevertheless, it appears that the courts remain the most popular forums for dispute resolution for the majority of the population.<sup>50</sup> Local *panchayats* (traditional council of elders/ leaders) are popular, in the main for their ability to maintain peace and harmony, their low cost, and their link to local communities and families. *Panchayats* are not renowned for their commitment to the truth or ability to avoid vested interests. While the informal legal system offers cheaper resolution of disputes, it is more difficult to enforce decisions, and its deliberations are frequently manipulated by local elites. As a result the *panchayats* are unable to hear both parties on an equal basis. Improvements in the performance of the formal court system, and in particular the subordinate courts, have therefore been a key feature of the devolution reforms.

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<sup>50</sup> Research sponsored under ADB (2001) TA 3640-PAK: Supporting Access to Justice Under the Local Government Plan, preliminary results.

Together with police reform, progress on judicial reform was considered the most difficult of the governance reforms. At least eight law reform commissions have been constituted since 1958 to review the administration of justice in Pakistan.<sup>51</sup> Many commission reports contained unassailable recommendations. However, while overwhelmingly popular, the public has often been skeptical about the legitimacy of efforts by the executive to reform the judiciary, and this undoubtedly impacts citizen expectations and demands for change.<sup>52</sup>

## **New issues arising**

### Slow progress in the new oversight bodies

Implementation of new institutions created under the PO and the Local Government Ordinances concerned with access to justice issues has been slow. Most progress has been achieved in establishing the District Public Safety Commissions (DPSCs), but this is patchy:

- In Sindh, only eight have been established
- In Punjab, DPSCs have been established in 31 of 34 districts along with meager operating budgets
- In Balochistan, they exist in 21 of 22 districts, as yet without facilities or budget support.

The host of ancillary institutions concerned with public safety and policing – the Police Complaints Authorities, the Isaaf Committees, the District Justice Coordinating Committees, the Anjumani Musalihat, and Citizen Police Liaison Committees – and enactment by Provinces of the Ordinance of Independent Prosecution Services have been relatively neglected in contrast with devolved institutions for administration, planning and budgeting for social service provision. The courts at the tehsil and district level have now assumed many of the functions that previously resided with the executive magistracy, but with only a modest increase in capacity resulting from the transfer of about a half of the former executive magistrates.

### Early signs of improvement in court performance

There are three promising indications of progress: in public access to information about court performance; in early evidence on delay reduction and the decline in court pendency, and in budgets committed by the federal government to the judiciary, in particular, the lower courts.

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<sup>51</sup> The eight law reform commissions were the: (i) Law Reform Commission of 1958, (ii) Law Reform Commission of (1967-1970), (iii) "High-Powered" Law Reforms Committee of 1974 (otherwise known as the Hamood-ur-Rahman Commission), (iv) Law Reforms Committee for Recommending Measures for Speedy Disposal of Civil Litigation of 1978, (v) Secretaries' Committee of 1979, (vi) Salahuddin Ahmed Committee of 1980, (vii) The Committee on the Islamization of Laws and Establishment of Qazi Courts of 1980, and (viii) Commission on the Reform of Civil Law of 1993. Other committees on penal law and the law related to women have published reports since 1993.

<sup>52</sup> Much cited is the decision taken less than 12 hours before polling for the general elections, when President Musharraf invoked his powers as the Chief Executive to amend the Constitution to extend the retirement age for judges of the Supreme Court and the High Courts by three years. Critics described it as an attempt by the President to win over judges on constitutional matters. See (Pakistan Institute of Legislative Development and Transparency 2003), p. 18. But the courts have not been wholly compliant as a result. On February 10, 2003, the Supreme Court set aside the President's decree prohibiting defeated political leaders from contesting Senate elections. The Court held that this order was "discriminatory in nature and as such violative of Article 25 of the Constitution". This was the first judgment of the Supreme Court questioning the validity of the action of the President on constitutional grounds.

In 2002 the Lahore High Court made available to the public its first annual report. This documented disposal of 100,000 cases, against a total of 96,959 new cases instituted. It reported that the LHC has been able to reduce arrears by 4,000, although the pending cases remain at 65,000, a backlog that would take 17 years to clear. At the lower court level, while around 780,000 cases were disposed, over 800,000 were instituted, indicating the scale of the challenge to bring about 'inexpensive and speedy justice to the doorstep'. It is important, however, to note that this kind of public reporting required new kinds of data to be collected by the courts, and that the commitment to make this available for public comment is unprecedented.

Second, where measures have been systematically introduced to reduce delays, extraordinary results have been achieved. In ten subordinate courts (seven civil and three criminal) in three large urban centers (Karachi, Lahore and Peshawar) a pilot project<sup>53</sup> was introduced to test the efficacy of case flow management principles in addressing the long delays and long backlogs endemic to trial courts. From September 1, 2001, through July 31, 2002, these courts reported an overall increase of 53% of dispositions compared with their performance in the previous years. Four district courts in Karachi, with over 110 judges in their Districts, became directly involved in the backlog reduction. In this process, they increased the disposal by an average of 77% in the first half of 2002, compared with the first half of 2001. The most successful district was particularly effective in resolving the oldest civil and criminal cases. Not only is its overall inventory of pending cases down by 31% since the beginning of September 2001, but also the number of civil cases over five years old had declined by 85%. This pilot project is now being scaled up.

Third, there is some progress with the vexed issue of providing sufficient budgetary outlays to chronically under-resourced courts in Pakistan raising allocations for 'access to justice' sectors — the police and judiciary— during FY 2002-03 of 129.38% on development side and 12.1% on current side, including an increase in provincial non-salary budgets of 19%.<sup>54</sup> International standards indicate at least 15-20 percent of the judicial recurrent budget is necessary to cover essential non-salary inputs. Yet, at the civil court level, the non-salary percentage of the budget ranges from a mere 2 percent in Sindh to 4 percent in Balochistan, 7 percent in NWFP and 8 percent in Punjab. Non-salary inputs have declined as a percentage of the budget over the past 10 years to one of the lowest in the world ("Legal and Judicial Reform Project - Integrated Report (Ta 3015-PAK)": 1999).

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<sup>53</sup> As part of the ADB supported Access to Justice Program.

<sup>54</sup> Ministry of Finance reports that during the FY 2002-03, a total of six new projects in the justice sectors (Judiciary and Police) with estimated total cost of Rs.5,233.139 million have been funded in the PSDP with an allocation of Rs.1081.500 million. This increase constitutes 132.35% over the allocation of 2001-2002. Similarly in the provincial ADPs (2002-03), a total of 51 new schemes related to judiciary and police, with an estimated total cost of Rs. 1,054.152 million have been funded with an allocation of Rs. 421.722 million. This increase constitutes 122.36% over the allocation of 2001-2002. On the recurrent side, the increase is 12.6% at federal level and 12.1% at the provincial level (combined). Non-salary budget of the judiciary and police constitute 15.3% and 19.0% respectively of total expenditure at Federal and Provincial levels (average). It is not known whether these increases partly reflect some additional emphasis on anti-terrorism activities.

## Appendix 1: Availability of intergovernmental flows of funds data

	Year Ending June 30, 2001	Year ending June 30, 2002	First six months of year ending June 30, 2003
<b>1) Provincial Data</b>			
a) Income Receipts by Major Category	Data available. Status of data entry: NWFP- Done Sindh- Done Balochistan- Done Punjab- Done	Data available. Status of data entry: /a NWFP Done Sindh Done Bal. Done Punjab Done	Data not yet available. Status of data entry: Will be done by the end of Financial Year 2003 (During 2 <sup>nd</sup> Phase).
b) Function-Wise Expenditures	Data available. Status of data entry: NWFP Done Sindh Done Bal. Done Punjab Done	Data available. Status of data entry: /a NWFP Done Sindh Done Bal. Done Punjab Done	Data not yet available. Status of data entry: Will be done by the end of Financial Year 2003 (During 2 <sup>nd</sup> Phase)
<b>2) District Data</b>			
a) Opening Balance	<i>n/a - devolution plan was unfolded in Aug 2001</i>	Data not yet available. Status of data entry: Will be done during 2 <sup>nd</sup> Phase of the study.	Data not yet available. Status of data entry: Will be done during 2 <sup>nd</sup> Phase of the study.
b) Income Receipts			
i) Transfers		Data not available as transfers took place from July 02 onwards.	Data available for July 02 - March 03. Status of data entry: Done for all Provinces and Districts
ii) Taxes devolved		Data available. Status of data entry: NWFP Done Punjab June 20 Bal. June 7 Sindh /b	Data available for all provinces for July - December. Status of data entry: NWFP Done Punjab June 20 Bal. June 7 Sindh /b
iii) Non tax revenues - receipts of devolved departments like Education, Health, Works & Services etc		Data available. Status of data entry: NWFP Done Punjab June 20 Bal. June 7 Sindh /b	Data available for July - December. Status of data entry: NWFP Done Punjab June 20 Bal. June 7 Sindh /b
iv) Grants		/c	/c
<b>3) Expenditure</b>			
a) Eleven EDO Functions		Data available for all provinces Status of data entry: NWFP Done Punjab June 20 Bal. June 7 Sindh /b	Data available for all provinces for July – December (minus salaries) Status of data entry: NWFP Done Punjab June 20

	Year Ending June 30, 2001	Year ending June 30, 2002	First six months of year ending June 30, 2003
			Bal. June 7 Sindh /b
b) Breakdown of these expenditures into salary / non-salary functions		/d	/d
<b>4) Town / Tehsil Municipal Administration Data /e</b>			
a) Opening Balance	<i>n/a - devolution plan was unfolded in Aug 2001</i>	Data not yet available. Status of data entry: NWFP September 15 <sup>th</sup> Sindh September 15 <sup>th</sup> Bal. September 15 <sup>th</sup> Punjab September 15 <sup>th</sup>	Data not yet available. Status of data entry: NWFP September 15 <sup>th</sup> Sindh September 15 <sup>th</sup> Bal. September 15 <sup>th</sup> Punjab September 15 <sup>th</sup>
b) Income Receipts		Data not yet available. Status of data entry: NWFP September 15 <sup>th</sup> Sindh September 15 <sup>th</sup> Bal. September 15 <sup>th</sup> Punjab September 15 <sup>th</sup>	Data not yet available. Status of data entry: NWFP September 15 <sup>th</sup> Sindh September 15 <sup>th</sup> Bal. September 15 <sup>th</sup> Punjab September 15 <sup>th</sup>
c) Expenditure		Data not yet available. Status of data entry: NWFP September 15 <sup>th</sup> Sindh September 15 <sup>th</sup> Bal. September 15 <sup>th</sup> Punjab September 15 <sup>th</sup>	Data not yet available. Status of data entry: NWFP September 15 <sup>th</sup> Sindh September 15 <sup>th</sup> Bal. September 15 <sup>th</sup> Punjab September 15 <sup>th</sup>

Notes:

- /a The Finance Accounts of all the provinces for fiscal year 2002-03 have not been finalized as yet. The figures provided are the revised estimates, which have been used for preparing the budgets of the provinces for the year 2002-03
- /b The office of Accountant General Sindh has been requested to provide data pertaining to expenditures and revenues; due to problems with records and repeated authorizations requested by the AG it is being delayed.
- /c Grants to individual local governments are not reported. Mostly they are for capital expenditure and therefore will need to be tracked down for all such cases; reportedly grants have been given to selected TMAs in Punjab. In case of the NWFP the PFC award allocates funds for discretionary grants
- /d Break down of Expenditures will be available after finalization of Appropriation Accounts for the year ending June 30, 2002. Similarly for the current year, break down of Expenditures will become available by March 2004.
- /e Issues in TMA accounting relate to absence of systems for reporting to province level organizations. In case of Sindh, where an attempt is being made for collation, the data will become available early but case of others special requests are being made through the Ministry of Finance to provincial LFA organizations to collect these data at the end of the fiscal year. Therefore these items have been shifted to 2<sup>nd</sup> Phase of data collection.

## Appendix 2: Local government expenditure responsibilities

City District	District	Tehsil/Taluka/Town <sup>55</sup>	Union
<ul style="list-style-type: none"> <li>• Public transportation and mass transit</li> <li>• Passenger and freight transit terminals</li> <li>• Traffic planning, engineering and parking</li> <li>• Industrial estates and technological parks</li> <li>• Cottage, small and medium sized enterprise promotion</li> <li>• Investment promotion and protection</li> </ul>	<ul style="list-style-type: none"> <li>• District planning</li> <li>• Schools (boys &amp; girls)</li> <li>• Girls Schools</li> <li>• Technical Education</li> <li>• Colleges (other than professional)</li> <li>• Special Education.</li> <li>• Literacy Campaigns &amp; Continuing Education</li> <li>• Vocational Education</li> <li>• Public Health</li> <li>• Basic &amp; Rural Health</li> <li>• Child &amp; Woman Health</li> <li>• Population Welfare</li> <li>• District and Tehsil (HQ) hospitals</li> <li>• Agriculture (Extension)</li> <li>• Livestock</li> <li>• Farm Water Management</li> <li>• Soil Conservation</li> <li>• Soil Fertility</li> <li>• Fisheries</li> <li>• Forests (local)</li> <li>• Community Organization and registration</li> <li>• Labor safety regulation</li> <li>• Social Welfare</li> <li>• Sports and Culture</li> <li>• Cooperatives</li> <li>• Enterprise and Investment Promotion</li> <li>• Civil Defense</li> <li>• Information Technology</li> <li>• Development &amp; Promotion</li> <li>• Environmental regulation</li> <li>• Land Revenue &amp; Estate</li> <li>• Excise and Taxation.</li> <li>• Spatial Planning and Development</li> <li>• District Roads and Buildings</li> <li>• Energy and Transport</li> </ul>	<ul style="list-style-type: none"> <li>• Spatial plans</li> <li>• Control over land-use, land-subdivision, land development and zoning by public and private sectors for any purpose</li> <li>• Prevention of encroachments</li> <li>• Regulation of sign-boards and advertisements</li> <li>• Municipal infrastructure and services</li> <li>• Water supply and control</li> <li>• Development of water sources</li> <li>• Sewerage, treatment and disposal</li> <li>• Storm water drainage</li> <li>• Sanitation</li> <li>• Solid waste collection and disposal</li> <li>• Roads and streets, other than roads falling under the jurisdiction of, and maintained by, the District Government or Government and streets maintained by the Union Administration</li> <li>• Traffic planning, engineering and management (including traffic signaling systems, signs on roads, street markings, parking places, transport stations, stops, stands and terminals)</li> <li>• Street lighting</li> <li>• Fire fighting</li> <li>• Parks, playgrounds, open spaces and arboriculture</li> <li>• Slaughterhouses</li> <li>• Sports, cultural, recreational events, fairs and shows</li> <li>• Regulation of markets and services</li> </ul>	<ul style="list-style-type: none"> <li>• Statistical information for socio-economic surveys</li> <li>• Consolidation of village and neighborhood development needs</li> <li>• Union-wide development</li> <li>• Coordination for removing deficiencies in the delivery of TMA services</li> <li>• Registration of births, deaths and marriages</li> <li>• Libraries</li> <li>• Sports tournaments, fairs, shows and other cultural and recreational activities;</li> <li>• Cattle fairs and cattle markets</li> <li>• Public open spaces, public gardens and playgrounds</li> <li>• Public sources of drinking water, including wells, water pumps, tanks, ponds and other works for the supply of water</li> <li>• Street lighting, public ways and public places (through mutual agreement with the TMA)</li> <li>• Facilities for the handicapped, destitute and poor</li> <li>• Protection against stray animals and animal trespass</li> <li>• Cattle pounds</li> <li>• Regulation of grazing areas</li> <li>• Assistance in disasters and natural calamities, and relief activities (including de-silting of canals)</li> </ul>

In addition, City Districts may set up District Municipal Offices for the integrated development and management of the following responsibilities jointly with the Tehsils:

1. Water source development and management, storage, treatment plants, and macro-distribution
2. Sewage tertiary and secondary network, treatment plants, and disposal
3. Storm water drainage network and disposal.
4. Flood control protection and rapid response contingency plans.
5. Natural disaster and civil defense planning
6. Solid waste management, treatment and disposal, including land fill cities and recycling plants.
7. Industrial and hospital hazardous and toxic waste treatment and disposal
8. Environmental control, including control of air, water, and soil pollution in accordance with federal and provincial laws and standards

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In urban areas, these responsibilities are undertaken by city districts, not the city towns.

9. Master planning, land use, zoning and classification, reclassification
10. Urban design and urban renewal program; promulgation of building rules and planning standards.
11. Parks, forests, play grounds, sporting, and other recreational facilities.
12. Museums, art galleries, libraries, community and cultural centers
13. Conservation of historical and cultural assets
14. Landscape, monuments, and municipal ornamentation
15. Urban and housing development, including urban improvement and upgrading, and urban renewal and redevelopment, with care being taken to preserve historical and cultural monuments.
16. Regional markets and city wide commercial centers

Unions can receive functions from Districts and Tehsils, provided that they are also provided with the funds for managing those functions.

## Appendix 3: Theoretical considerations in political decentralization

### Overview

The political justification for decentralization rests primarily on the argument that by bringing the government ‘closer to the people’ devolution improves government performance by increasing the ability of citizens to hold government officials accountable. There are two steps to this argument. First, that citizens are better informed about the actions of local as opposed to national politicians and find it less costly to influence decision-making, both through better-informed voting and through more active direct contacting and pressuring of local officials. In other words, decentralization results in increased citizen *voice*, particularly for formerly marginalized groups, who now find it easier to participate in the policy-making process. Second, as a result of more active citizen involvement and voice, local politicians have greater incentives to deliver public goods than their provincial and national counterparts.<sup>56</sup>

There are both theoretical and empirical reasons to question this causal chain of devolution leading to greater citizen voice and in turn leading to enhanced accountability of policy-makers. Over two centuries ago, James Madison argued in the Federalist Papers that local governments were more susceptible to elite capture. The logic is that the greater heterogeneity of the population at the national level raises the costs to special interest groups of buying influence (Bardhan and Mookherjee 2000). Empirically, there is no clear evidence that decentralization has led to better governance and economic performance (Azfar, Kähkönen et al. 1999; Blair 2000). Other variables are at play.

First, voice is not just a function of the distance between citizens and government officials – it is also dependent on a host of other institutional and socioeconomic variables. The formal institutional factors include how ‘close’ is the local government to the people, the electoral arrangements, the relationship between the local and other tiers of government, and whether or not there exist other, non-electoral, mechanisms for citizens to exercise voice.

Second, politicians' incentives to deliver public goods are also dependent on other institutional variables, such as electoral arrangements and regime type, as well as by the nature of demands that voters present them with. Also, voice is a multi-dimensional variable and it is possible that politicians have a greater incentive to satisfy one set of demands over others.

### Why democratic governments may fail to provide public goods

To understand the linkage between decentralization and improved service delivery, one first has to explore why failures of voice can occur under a democratic system – that is, why governments can enact policies that hurt a majority of citizens generally, and why government’s may fail to provide public goods, like basic education and health, specifically. In the Pakistan context specifically, the question that needs to be asked is why have elected politicians failed to effectively deliver services to the poor *despite* needing the votes of the poor to get elected.

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<sup>56</sup> It is important to note that political devolution is not only pursued for improvements in accountability that will drive allocative efficiency and service delivery - it is also undertaken to strengthen legitimacy - very particularly to counter perceptions of poor governance (personalization of state structure, lawlessness, and inability to control communal violence).



There are at least four sets of arguments that shed light on this puzzle. These are examined in turn below. Three of these arguments hinge crucially on voter information levels, in particular the informational difficulties associated with public goods.

#### Informational asymmetries across different groups of citizens

An important conclusion of the literature on democratic accountability is that politicians are responsive to the more informed group of citizens, and that the demands of this informed citizenry is likely to be for private goods and for welfare-reducing policies. The Public Choice literature was one of the earliest attempts to explain why governments enact policies that are economically inefficient and hurt society on the whole. A starting assumption of this literature is that the most voters are 'rationally ignorant'. The logic for this ignorance is that given that acquiring information about policy-making is costly, and given that that an individual's vote is one amongst millions, the probability that one's efforts in acquiring information will lead to better policies is small. Only those groups that can extract a *private benefit* from the government have an incentive to be informed about government policies.

Since most voters are uninformed they can be manipulated and electoral success is contingent on candidates' advertising, which creates a natural alliance between politicians and the informed subset of citizens. Money becomes a crucial determinant of electoral success, and candidates trade specific favors to interest groups and elites in exchange for money with which they can run their campaigns. Thus these groups will not lobby for the provision of public goods because the benefits of public goods accrue to everyone; they have every incentive to lobby for private goods, and to meticulously monitor policy-makers to ensure that they are delivering on what they promised.

While the Public Choice literature's focus was to explain sub-optimal policies, like trade quotas and farm subsidies, in industrialized countries, the argument is of considerable relevance to less-developed countries as well. Voters in developing countries, due to the higher levels of illiteracy, are likely to be even less informed about policies. Also, evidence suggests that the costs of elections in developing countries is, as a proportion to GDP, higher in developing countries than in developed countries (World Bank 2002, Barkan and Thomas 2003 ).

The 'patronage-politics' model is the Public Choice equivalent for describing politics in less-developed countries. According to this model, politics in developing countries is not about policy but about delivering goods and services to the people. Political parties are largely devoid of any ideological underpinnings, and instead are large patronage structures. The logic however, is similar to that articulated above. Patrons, who are generally locally influential people, provide politicians with the resources to conduct their electoral campaigns; in return they expect private favors, such as government jobs and contracts; and the mass of citizens are uninformed and are easily influenced by what the politicians say and who the patrons tell them to vote for.

#### Informational asymmetries across different types of voter demands

The public choice and patron-client models argue that due to informational asymmetries *across* voters, politicians have an incentive to target the more informed and hence more influential voters. A related argument is that there are informational asymmetries *across the demands* made by individual voters, and politicians have incentives to focus on satisfying those demands which voters are more informed about. That is even if there is no elite capture, and that lobbying is done by all voters and not just a subset of voters as in the previous argument, politicians will still focus on satisfying some types of demands rather than others.

The logic of this argument is as follows: Voters, even poor voters, present a menu of demands to their elected representatives and these representatives have to decide on which of these demands to satisfy in order to maximize their political support. Voters are concerned with both provision of public goods as well as individual-specific demands, such as requests for public sector employment, complaints about harassment by the police, admission for their children in schools and colleges etc. Demands for public goods and for individual-specific favors differ in the relative ease with which preferences are transmitted to policy-makers. Individual contacting for particularized benefits places the least organizational demands on citizens, and presents the clearest relationship between action and result. Demands for public goods entail free-rider problems and are therefore much more difficult to organize. For example, the children of all parents in the community are likely to benefit from improved education in the village primary school, regardless of whether a parent lobbied for it or not. Therefore, a priori, one would expect that initiatives to contact politicians are much more likely to be for individual problems than for public goods.<sup>57</sup>

These differences in the way preferences are transmitted have implications for voters' information levels. Since individuals are much more likely to lobby for private goods, they are also likely to be much more informed about whether or not this demand was satisfied, and whether or not this fulfillment was due to the efforts of the representative. People will observe how helpful the local representative's office was, how much attention was paid to them, and what were the impressions of others waiting in line, and obviously whether they received the benefits. By contrast, improvements in service delivery will be much harder to measure. As the World Bank (World Bank 2003) points out, service delivery places very high informational demands on voters as these are transaction-intensive services with outcomes that are crucially dependent on the behavior of providers that are very difficult to monitor. What this informational asymmetry implies is that politicians will find it much more difficult to claim credit for improvements in service delivery than for providing targeted, individual-specific benefits. In other words, while the voter will observe that teaching has improved in the village school, he will have a hard time figuring out who in the government was responsible for this improvement. Politicians will therefore, have an incentive to provide targeted, private goods, as opposed to public goods.

#### The impact of institutional structure

Institutions, such as electoral arrangements and regime types, can also provide politicians with incentives to provide targeted goods. Recent papers have examined the impact of electoral district size on government policy (Persson and Tabellini 2000). Larger electoral districts are more heterogeneous and competing political parties require the support of broad coalitions to win. Both parties therefore have an incentive to enact broad policies, and provide public goods, that impact these broad coalitions. Smaller districts are likely to be more internally homogeneous, and typically a party is a sure winner in some districts and a sure loser in others. Competition therefore, boils down to a few key districts and both parties have strong incentives to target redistribution towards such districts. In other words, the smaller the district the greater the incentive to provide targeted benefits.

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<sup>57</sup> There is some evidence from Pakistan to corroborate this claim. One study found that the Political Secretary for the Chief Minister of Punjab dealt with an average of 150 – 200 requests per day, the vast majority of which were requests for jobs, for getting land disputes resolved, for help in police matters, and for getting admissions to colleges and universities (Wilder 1999).

Regime type, in particular the number of tiers of government, can also have an impact on politicians incentives to provide public goods. If several independent levels of government share responsibility for providing particular public goods, provision will be lower than if a single government is responsible (Triesman 2002). Even if responsibilities are separate, the public is unlikely to be aware of these distinctions, and voters are likely to share credit across the tiers even if one level of government contributed to the public good. Again, the informational demands associated with public goods, will create incentives for each tier to focus on targeted benefits that it can more easily take credit for.

### The impact of political instability

If terms of office are short, politicians have less of an incentive to implement policies that require a longer time to show results. Improvements in service delivery, such as ensuring better quality teaching, unlike the provision of government jobs or construction of school buildings, do not bear immediate fruit. There is some evidence of the distortionary impact of short terms of office. Mexico's three-year, non-renewable mayoral terms, for example, have been associated with a very short-term focus in local officials' governance strategies. Econometric studies have also shown that 'a higher propensity of change in executive power, either by constitutional or unconstitutional means' leads to lower investments in public goods and slower economic growth (Alesina, Ozler et al. 1996).

Terms of office for local political leaders are closely related to issues of authority and accountability. This issue is explored most comprehensively in the literature concerning local government mayors. There is clear evidence that they need incentives to focus on at least the medium-term, rather the solely the short-term. This requires a long enough term or potential terms to be able to be seen to be accomplishing meaningful objectives. Mexico's three-year, non-renewable mayoral terms, for example, have been associated with a very short-term focus in local officials' governance strategies. In practice, where multiple terms are allowed, three to four year terms are desirable. Where only single terms are permitted, then 5-6 years would be appropriate. The detailed design of authority, powers, accountability systems and procedures must be related to local circumstances, including issues which may range from cultural traditions to the state of accounting and auditing systems. Considerations also include the balance to be struck between preferences for room for aggressive leadership versus protecting the community from excesses.

### **Conclusion**

The key lesson that emerges from this theoretical discussion is that elections may not provide sufficient incentives for politicians to deliver on public goods. The crucial question then is whether or not decentralization changes these incentive structures.

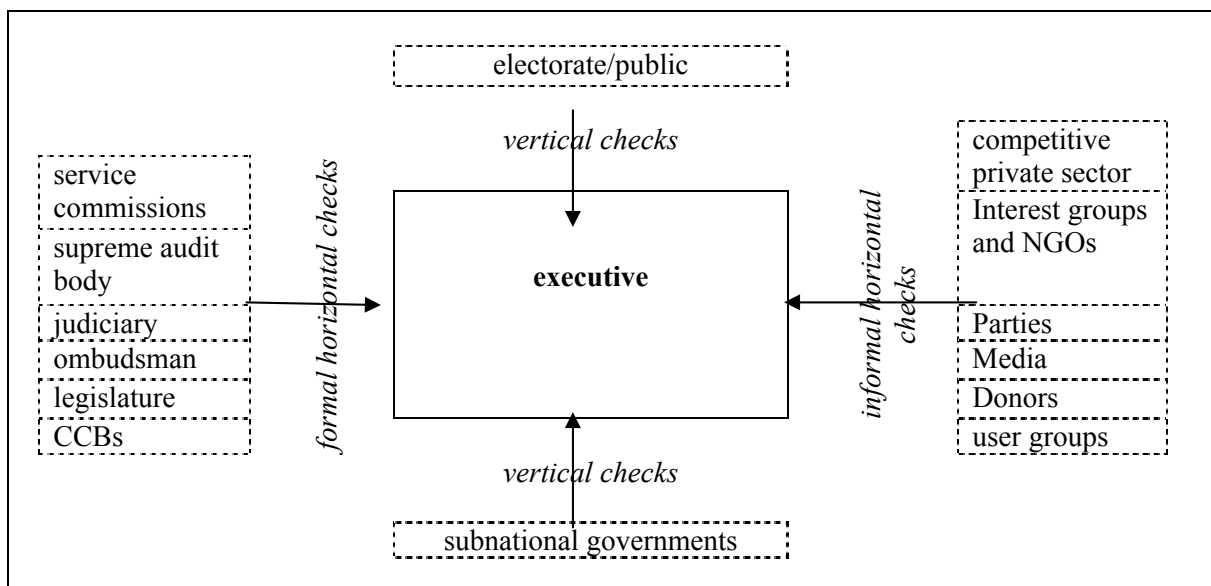
International evidence suggests that in countries where devolution has resulted in increased accountabilities and in turn to improvements in service delivery, the key has been a combination of small electoral district size, direct election of office holders, and mechanisms for direct citizen monitoring of, and participation in, local government policy-making. For example, in Bolivia, one study found that decentralization had significantly changed the pattern of public expenditure, with investments in infrastructure declining and those in education, health, and water & sanitation increasing significantly, particularly in the more deprived municipalities (Faguet 2001). Bolivia's devolved structure is unique in the extent to which efforts have been made to bring the government closer to the people. Bolivia has a system whereby mayors and councilors are directly elected from relatively small constituencies –the mean population per local government is 27,000, while the median population is only 8,000. In addition, Bolivia has a system of popularly

chosen Vigilance Committees charged with overseeing the elected councils. A Vigilance Committee member is chosen for each canton within a municipality, and represents on average 3000 citizens, and has a term of office of 2 years (as compared to the mayor's term of 5 years). These committees are empowered to oversee municipal spending, and can suspend all revenue transfers from the central government to the municipality if they believe that funds are being misused.

Similarly, in Columbia there is some evidence that democratic decentralization has increased the representation of non-elites and responsiveness of policy-makers to local preferences. Opinion surveys reveal that the overwhelming majority of citizens trust local governments more than the central government, and that sectoral allocations are in line with community preferences (Fiszbein 1997). Among the factors cited for this success is the reduction in clientelistic practices through the elimination of funds for individual elected officials for their own discretionary use, and the regular use of opinion surveys through which mayors can get a better match between their programs and community preferences. These surveys are conducted twice a year, and ask the community to evaluate the current administration's performance, and then to list and rank works and programs that the next administration should undertake.

In light of this theoretical and empirical literature, the analysis of devolution in Pakistan requires one to probe in depth the nature of the accountability relationships that are likely to be impacted by these structural changes, particularly with respect to both *horizontal* and *vertical* accountability relationships. Horizontal accountability concerns relationships between the executive and those players of more or less equal power, while vertical accountability refers to relationships where power is predominantly on one side. Both of these relationships can, of course, lie along a spectrum according to the frequency with which accountability is exercised. Figure 3 maps these relationships.

**Figure 3: Holding the executive accountable<sup>58</sup>**



<sup>58</sup> This mapping of accountability relationships owes significantly to (Schedler, Diamond et al. 1999)

For vertical accountability relationships, the relevant areas of examination include:

- The impact of the new structure on local patronage politics: Is devolution reducing or increasing the influence of 'special interests' in elections. There is considerable debate in the literature on this issue (Bardhan and Mookherjee 2000; Prud'homme 1995)
- Frequency of contact with local representatives and level of participation in community-level institutions: frequency of councilors' meetings with their constituents, extent to which representatives were known by their constituents.
- The types of demands being presented: are voters presenting different demands to local officials than to national and provincial ones; have demands for public goods and service delivery increased, and those for private goods decreased?
- Access to information: meaningful participation requires that citizens be informed and that their voices have impact where consequences are immediate. The legal/regulatory system needs to provide for, *at minimum*, full, timely and easily accessible public disclosure of resource allocation decisions - in budgets, in procurements, and in expenditure programs.

Improved citizen participation is unlikely to lead to better policy if political devolution leads to destabilizing competition between the different tiers of government. Relevant areas of investigation in these horizontal accountability relationships include:

- The relationships between the local governments and the provincial and national governments. How much interference is there in District government affairs by the provincial and national governments. Are there cases of external recall of the nazim. What impact does partisan affiliation have on these relationships
- Relationships among the local governments: Level of competition between councilors and nazims, functioning of coordination committees, impact of patronage politics on competition between locally elected officials, impact of party-based vs. non-party based elections.

## Appendix 4: Theoretical considerations in fiscal decentralization<sup>59</sup>

### Definitions

*Vertical fiscal imbalance* in a federation reflects the revenues raised by the federal government that are made available to provinces to finance their expenditures. There are two broad ways this transfer of funds can take place. One is by assigning a pre-determined share of federal revenues to the provinces (revenue-sharing), while the other is by making the size of federal-provincial transfers independent of the magnitude of federal revenues.

*Fiscal decentralization* is a measure of autonomy on both the expenditure and the revenue sides, however it is the latter that provides the more substantial measure of the degree of decentralization. A commonly accepted objective of fiscal decentralization is to enhance the effectiveness and accountability of the government in use of public resources, making possible for it to achieve its development and re-distributive objectives through efficient allocation of resources and equitable provision of public services to the people. This objective is to be achieved through a set of policies which complement, and not run counter to, the overall fiscal objectives of preserving/establishing macroeconomic stability and promoting economic growth.

### Expenditure assignments

There is no first best way for deciding which level of government should be responsible for particular public services. The adequacy of any assignment has to be judged in terms of how well it achieves the goals or objectives set up by the government in its decentralization strategy. Clearly, without a specific assignment of expenditure responsibilities it will not be possible to assess the adequacy of the revenue and tax assignment to different levels of government, or the need and effectiveness of a system of intergovernmental transfers. Expenditure assignment needs to be the first and fundamental step in the design of a decentralized system of intergovernmental finances.

On theoretical grounds, there is a considerable consensus among the fiscal experts that of the three broad functions of the government, namely allocation, redistribution and stabilization, the lower levels of government are best suited to perform the former function, while the latter two functions should appropriately be assigned to the national government. In other words, it is desirable that the national government should assume the responsibility for delivery of national public services, international affairs, monetary policy, regulation, transfers to persons and businesses, fiscal policy coordination, regional equity, re-distribution (in which all levels of government may play a role), and preservation of an internal common market. Some central functions, such as regulation of the financial sector or the environment, may be effectively shared with subnational governments. Sub-national governments may have significant responsibility for education, health, social insurance, inter-municipal issues, and oversight of local governments. (Particularly for the social sectors, however, the central government continues to play a critical role by ensuring a minimum level of some services for reasons of externalities or equity.) All local services should be assigned to local governments. In areas of shared responsibilities, the roles should be clarified. Generally, the central government should be involved with overall policy, setting standards, and auditing; state governments should have an oversight function; and local governments should be involved in the provision of infrastructure and services.

Assignment of public services to local or regional governments can be based on considerations such as economies of scale, economies of scope (appropriate bundling of public services to

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<sup>59</sup> This section draws extensively on (Shah 1996, 1998, 1999, 2002; Shah and Andrews 2002)

improve efficiency through information and coordination economies and enhanced accountability through voter participation and cost recovery), cost-benefit spillovers, proximity to beneficiaries, consumer preferences, and flexibility in budgetary choices on composition of public spending. Box 5 provides the conceptual framework for assigning functional responsibilities to various levels of government in a federal system.

Assigning responsibility for the provision of service to a specific level does not imply that the same level of government should be directly engaged in its production. Collection, transport, and treatment services in solid waste management, for example, can be assigned to different public and private entities depending on economies of scale, commercial viability, and externalities. Many other services can also be unbundled. Production decisions should result from an evaluation of alternatives using efficiency and equity criteria.

Experience has clearly shown that effective decentralization requires complementary adaptations in institutional arrangements for intergovernmental coordination, planning, budgeting, financial reporting, and implementation. Such arrangements may encompass both specific rules (for example, in the design of fiscal transfers) and provisions for regular intergovernmental meetings and periodic reviews of intergovernmental arrangements. Detailed central control over local use of funds is seldom appropriate. Instead, what is needed is transparency and accountability to local constituencies supported by strengthened higher level monitoring and reporting of local fiscal performance.

#### **Box 5: The Conceptual Framework for Assigning Functions in a Federal System**

The literature on fiscal federalism provides some basic principles for assigning functional responsibilities to various levels of government in a federal system. These include:

**Efficiency:** The assignment of functions should ensure that the economy is operating with economic efficiency, i.e. ensuring that all gains from trade are fully exploited given the resources, technology and constraints facing society.

**Cost effectiveness:** Functions need to be assigned to the level of government that can perform them at the least cost (economic and social) to the society. For example, local services should be assigned to sub-national governments, not only because they can better cater to local preferences but also because they can provide these services at a lower cost as they are likely to have lower overheads. Moreover, proximity to the service location can reduce the cost of monitoring and evaluation.

**Equity and Redistribution:** A major issue of fiscal federalism is the level of government that should be responsible for equity and redistribution. An argument can be made for centralization of functions on the grounds that society's social welfare function ought to include all persons in the federation, and how much to redistribute from more to less affluent segments should not depend on which locality these persons reside in. On the other hand, there may be distinctly local preferences for the extent of redistribution, and some localities may have a lower aversion to inequality than others. Decentralizing the redistribute functions of government could therefore allow for "local preferences" for intra-regional inequalities.

**Internal common market:** Efficiency requires that fiscal policies (i.e. regulation and tax, subsidy, procurement and public expenditure policies) should not impede the movement of goods, services, labor and capital across jurisdictional boundaries within the federation.

**Local public goods and externalities:** The federation should be decentralized enough to be able to provide the type, mix and quality of public services according to the preferences of its residents. However, in practice the benefits (positive and negative) of local public expenditures may spill over to the residents of neighboring jurisdictions. Since local governments will have no incentive to take account of these spillover benefits, a careful balance is needed in the roles of each level of government.

**Fiscal efficiency and equity:** While assigning functions and roles to various levels of government, inter-regional differences in fiscal capacity (the revenues that could be raised by a province if it applied national average tax effort to all its tax bases) need to be kept in mind and also addressed explicitly.

Notwithstanding, the theoretical reasoning for assigning public functions among various levels of government, a short-run practical bottleneck for appropriate assignment is the ability and capacity of the level of government to perform the assigned function. This argument alone has been the responsible for centralization of functions in a large number of developing countries, where lower level of governments usually lack capacity to appropriately perform the function, which theoretically should fall in their jurisdiction.

The Constitution of Pakistan defines both a *Federal Legislative List*, specifying the functions of the federal government, and a *Concurrent List*, indicating the areas of shared responsibility, i.e. those which *can* be undertaken by the federal government or by the provincial governments (or jointly by both levels). This arrangement is typical for many federal Commonwealth countries (Malaysia, Nigeria, India for example). In principal, such a concurrent list is the basis for the concept of "cooperative federalism" or "federal partnership", the idea being that it leads to a constructive dialogue between the federal government and the provinces.<sup>60</sup>

### **Expenditure autonomy**

Expenditure assignments are not the same as expenditure autonomy. Much spending that happens at the local level is centrally mandated by policy conditions imposed by federal government - and thus expenditure by provinces or districts is no sign that this was in any sense a policy choice.<sup>61</sup> The difficulty with measuring autonomy in expenditure is that it is highly variable between sectors. Pure cash flows, as measured by the GFS, convey little about autonomy (Ebel and Wilma 2002). The reality varies significantly between sectors with, for example, education likely subject to greater federal influence than health, but to understand autonomy in this regard one needs to look at the welter of federal directives and interpret the resulting room for maneuver that remains at the local level. Even if this can be undertaken, across all sectors, then any assessment of fiscal decentralization on the expenditure side must be weighed against the centralizing impact of administrative centralization. So, for example, even if there is significant apparent discretion in how districts assemble their health budgets, but hiring and firing of health staff is significantly a federal or provincial function, then since this represents a large proportion of district staffing one can conclude that expenditure autonomy is proportionately reduced.

### **Tax Assignment<sup>62</sup>**

Assignment of various tax bases among different levels of government depends on the mix of taxes used in the country overall. Public finance theory has not fully resolved the issue of the ideal tax mix, even in the unitary state. Governments almost universally employ balanced tax systems, meaning that different taxes apply to basically the same bases. For example, general sales taxes, payroll taxes, and income taxes have broadly overlapping bases. On efficiency and equity grounds, a single general tax base should suffice. In practices, however, no government relies exclusively on a single tax base, mainly to minimize tax evasion. The usual explanation is that administrative considerations play an important role. A mix of taxes keeps the rate on any

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<sup>60</sup> This is in clear distinction to the arrangement found in a few Commonwealth settings and many others in which there is a clear-cut distinction between the powers that are retained by the center in the form (the reserve list), and the powers that are devolved (the devolved list). The way in which residual powers are defined can flow in either direction, thus, for example, in Canada, the powers are enumerated to the provinces, and the residual powers are left for the federal government while the reverse is true for the USA.

<sup>61</sup> This is a well-recognized difficulty with GFS data. Local expenditures that are mandated by central government or are spent on behalf of central government appear as subnational expenditure.

<sup>62</sup> This section relies heavily on (Shah 1999)



individual tax low, thereby reducing the incentive to evade or avoid the tax. Furthermore, a mix of taxes means that taxpayers who would otherwise be able to avoid taxation of one type are caught in the net of another, increasing the fairness of the tax system. The importance of a given tax in the overall mix of taxes utilized, however, is a matter of judgment rather than something that can be deduced from principles.

These same general considerations apply to assigning taxes in a federal system of government. Efficiency and equity arguments have to be reevaluated in view of administrative considerations, and the exact assignment depends on informed judgment. Following are some important economic principles that come into play in deciding which taxes to assign to lower levels of government.

*Efficiency:* Economic efficiency requires an unrestricted movement of economic resources (labor, capital and goods and services) from one region to another. Therefore it is important that the tax system, and especially tax assignment among various levels of government, should not distort or impede the movement of economic resources within the country. An uncoordinated decentralized tax system is likely to lead to distortions in markets. Sub-national governments that recognize the mobility of economic resources, especially of capital and tradable goods, may attempt to attract resources into their area (province, district, etc.) by formulating *appropriate* tax policies. If all subnational governments engage in such socially wasteful beggar-thy-neighbor policies, the end result will simply be inefficiently low taxes (or high subsidies) on mobile factors.

*Equity:* The tax and transfer system is one of the main instruments of achieving redistribution of economic resources. The argument for making equity a federal objective is simply that all people in the country ought to enter into government's "social welfare function" as equals (i.e. with the same weight), and the federal government is presumably the only level that can ensure that residents in different regions are treated equitably. The redistribution objective may be hampered if sub-national governments do not hold the same view of redistribution as does the national government. Decentralized taxes can therefore interfere with the achievement of redistribution objective of the national government. For example, subnational governments may use both taxes and transfers payments to attract people with high incomes and to repel those with low incomes. This is obviously likely to be more of a problem for taxes that are redistributive in nature, as well as for transfers.

*Administrative Costs:* By forgoing economies of scale in tax collection, decentralized tax administration can also increase the cost of collection for both public and private sectors. There are fixed costs associated with collecting any tax that have to be borne for each type of tax used by the subnational governments. Taxpayers also incur compliance costs for all taxes levied. For some types of taxes, in particular where the tax base is mobile or runs across more than one jurisdiction, the possibilities for evasion and avoidance increase with decentralization. In the case of multi-district tax bases, rules are needed to allocate tax revenues among jurisdictions, for in their absence, some tax bases may face either double taxation or no taxation at all. Auditing procedures may also be more difficult for tax bases that involve transactions across state boundaries.

*Fiscal Need:* To ensure accountability, revenue means should be matched as closely as possible at the margin to revenue needs (that is, expenditure responsibility). Thus tax instruments intended to further specific policy objectives should be assigned to the level of government with responsibility for the related service. Progressive redistributive taxes, stabilization instruments, and resource rent taxes would be suitable for assignment to the national government, while tolls on inter-municipal roads are suitably assigned to subnational governments. In countries with a

federal value added tax (VAT), subnational sales taxes may be too cumbersome. In such circumstances, the fiscal need criterion would suggest allowing subnational governments access to taxes that are traditionally regarded as more suitable for national administration, such as personal income taxes. Excise duties on production of commodities that are harmful to health (e.g. tobacco and cigarettes) should ideally be assigned to the level of government that is responsible for delivering health services.

*Localization:* While assigning taxes to the local governments, it is important to devolve taxes that are local in nature, i.e. the bases of taxes are relatively immobile. Mobility of tax-bases across jurisdiction creates a possibility for the local government to impose relatively heavy taxes on goods and services which are consumed more outside the jurisdiction of their government, thereby “exporting” tax to the constituents of other local governments, which do not benefit from the services delivered by the taxing government. This creates issues related to efficiency and equity.

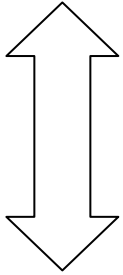
*Accountability:* The main problem with the tax assignment that emerges from the preceding prescriptions is that it generally does not provide sufficient revenues for lower-tiers of government. Partly for this reason, subnational governments levy a variety of specific taxes like sub-national excises or taxes on motor vehicles. However, such levies seldom produce the revenue needed to finance a significant part of subnational expenditures such as education and health.

There are two main options for resolving the problem. The first is to supplement subnational revenues with intergovernmental fiscal transfers, but policies must be designed to avoid creating incentives for local governments to reduce their own tax-collection efforts. The second option is to permit subnational governments to levy their own broad-based taxes for local goods, as long as they burden local beneficiaries only. In principle, a retail sales tax or a tax on personal income would be possible. Retail sales taxes are seldom feasible in developing countries, however. In practice, an efficient, broad-based subnational tax that seems feasible is a flat-rate surtax (often called “piggybacking”) on a national personal income tax. Whether with respect to such a surtax, a local property tax, or local taxes in general, the critical elements required to ensure local accountability without efficiency costs are restricting local governments as much as possible from exporting taxes and permitting them to set their own tax rates. For efficiency, it may be desirable to assess the base of a tax centrally and even to have it collected by the central government, but for accountability, it is critical that subnational authorities be responsible (within limits) for setting the tax rate.

### **Revenue autonomy**

Revenue autonomy is in many ways a more fundamental measure than expenditure autonomy. Maximum revenue autonomy would, in principle, be generated by subnational government being able to generate all its revenues from taxes over which it has full control. autonomy. Ebel and Yilmaz note that there is an implicit spectrum of tax autonomy: No subnational government in any country has all its revenues from taxes where it sets both the tax rate and the base (Ebel and Yilmaz 2002). The question is where the weight of taxes is distributed along the spectrum.

**Figure 4: The spectrum of autonomy in tax revenues**

<b>Own Tax Revenue</b>	Subnational government sets tax rate and base	
	Subnational government sets tax rate only	
	Subnational government sets tax base only	
	Revenue split may be changed with consent of Subnational government	
<b>Tax Revenue Sharing</b>	Revenue split fixed in legislation (may be changed unilaterally by the central government)	
	Revenue split determined by the central government	
	Central government sets rate and base of Subnational government tax	
		<i>centralized</i>

Source: Developed from (Ebel and Yilmaz 2002)

### **Fiscal transfers**

However, autonomy in tax revenues again is only part of the full story about revenue autonomy. Since subnational governments are always dependent to a very significant degree on transfers from central government, then the autonomy of tax revenue only has significance in the context of certainty and predictability in intergovernmental fiscal transfers. To the degree that subnational governments come to view transfers as up for negotiation, then generally speaking they will not use their tax autonomy to raise revenues as this has local political consequences - while greater transfers from federal government do not. Thus in looking at autonomy in tax revenues, it is important to also look at the degree to which such autonomy is undermined by arbitrariness or discretion in fiscal transfers, lack of autonomy, perverse incentives etc. The degree to which fiscal transfers matter at all is reflected by the vertical imbalance - measured as the transfers to subnational government as a share of total subnational expenditures.

Intergovernmental transfers are the dominant source of revenues for sub-national governments in most developing and transition economies. For enhancing accountability it is desirable to match revenue means (the ability to raise revenues from own sources) as closely as possible with expenditure needs at all levels of government. However, higher level governments must be allowed greater access to revenues than needed to fulfill own direct service responsibilities so that they are able to use their spending power through fiscal transfers to fulfill national and regional efficiency and equity objectives.

### **Box 6: Criteria for the design of intergovernmental fiscal transfers**

*Autonomy.* Subnational governments should have complete independence and flexibility in setting priorities, and should not be constrained by the categorical structure of programs and uncertainty associated with decision-making at the center. Tax base sharing – allowing subnational governments to introduce their own tax rates on central bases, formula-based revenue sharing, or block grants – is consistent with this objective.

*Revenue Adequacy.* Subnational governments should have adequate revenues to discharge designated responsibilities.

*Equity.* Allocated funds should vary directly with fiscal need factors and inversely with the taxable capacity of each jurisdiction.

*Predictability.* The grant mechanism should ensure predictability of subnational governments' shares by publishing five-year projections of funding availability.

*Efficiency.* The grant design should be neutral with respect to subnational government choices of resource allocation to different sectors or different types of activity.

*Simplicity.* Grant allocation should be based on objective factors over which individual units have little control. The formula should be easy to comprehend so that "grantsmanship" is not rewarded.

*Incentive.* The design should provide incentives for sound fiscal management and discourage inefficient practices. There should be no specific transfers to finance subnational government deficits.

*Safeguard of grantor's objectives.* This is best done by having grant conditions specify results to be achieved and giving the recipient flexibility in the use of funds.

*Singular focus.* Each grant should be focused on a single objective.

These criteria are often in conflict with each other and the nature of the compromise varies according to the type of subnational government concerned. Local governments vary in population, size, area served and the type of services offered, with urban/rural usually the most profound distinction. Generally, it is advisable to classify local governments by population size, municipality type, and urban/rural distinction and have a separate formula for each class of municipalities. Some common useful components in these formulae are: equal per municipality component, equal per capita component, service area component and fiscal capacity component.

Source: (Shah 1994).

Box 6 sets out the key principles to be kept in mind in designing fiscal transfers. The specific design arrangements for fiscal transfers depend on the objectives being addressed.<sup>63</sup>

#### To bridge a fiscal gap

A fiscal gap is defined as an imbalance between the revenue-raising ability of regional and local governments and their expenditure responsibilities. It is important to deal with the sources of this gap through reassignment of responsibilities, tax decentralization or tax abatement by the center and tax base sharing (by allowing sub-national governments to levy supplementary rates on a national tax base). Only as a last resort should unconditional formula-based transfers or revenue sharing based on the origin/derivation (point of collection) principle be considered as options to deal with this gap. This is because such transfers weaken accountability to local taxpayers. In many developing and transitional economies, general revenue sharing is typically used to deal with fiscal gap. A number of countries including China, India, Malaysia, Pakistan, South Africa have in the past tried deficit grants to fill fiscal gaps at sub-national levels with unwelcome results in terms of mushrooming of sub-national deficits. These grants are still in vogue in China, Hungary and South Africa.

#### To correct for differentials in regional fiscal capacities

Decentralized decision-making results in differential net fiscal benefits (imputed benefits from public spending minus tax burden) being realized by citizens depending upon the fiscal capacities of their place of residence. This leads both to fiscal inequity and fiscal inefficiency in resource allocation. Fiscal inequity arises as citizens with identical incomes are treated differently depending on their place of residence. Fiscal inefficiency in resource allocation results from people in their relocation decisions comparing gross income (private income plus net public sector benefits minus cost of moving) at new locations whereas economic efficiency considerations warrant comparing private income minus moving costs. Thus a nation which

<sup>63</sup> The following is based upon (Shah 2002)

values horizontal equity (i.e., the equal treatment of all citizens nationwide) and fiscal efficiency will need to correct the fiscal inequity and fiscal inefficiency which naturally arise in a decentralized government. Central-state grants can eliminate these differences in net fiscal benefits if the transfers to each region depend upon the tax capacity of the region relative to others and upon the relative need for and cost of providing regional public services. The more decentralized the tax system is, the greater the need for equalizing transfers.

Most transition economies have equalization components in their grant programs to sub-national governments. Latvia, Lithuania, Poland, Romania, Russia and Ukraine have adopted transfer formulae that explicitly incorporate either fiscal capacity and/or expenditure need equalization concerns. In developing countries, programs using an explicit standard of equalization are untried, although equalization objectives are implicitly attempted in the general revenue sharing mechanisms used in Argentina, Brazil, Colombia, India, Nigeria, Mexico, Pakistan and South Africa. These mechanisms typically combine diverse and conflicting objectives into the same formula and fall significantly short on individual objectives. Because the formulae lack explicit equalization standards, they fail to address regional equity objectives satisfactorily.

#### To compensate for benefit spillovers

This is the traditional argument for matching conditional grants. Regional and local governments will not have the proper incentive to provide the correct levels of services that yield spillover benefits to residents of other jurisdictions. A system of open-ended matching grants based on the expenditures giving rise to the spillovers will provide the incentive to increase expenditures. Typically, the extent of the spillover will be difficult to measure so the correct matching rate to use will be somewhat arbitrary.

Although benefit-cost spill-out is a serious factor in a number of countries such transfers have not been implemented in developing countries with the single exception of South Africa. South Africa provides a closed-ended matching grant to teaching hospitals based upon an estimate of benefit spillovers associated with enrollment of non-local students and use of hospital facilities by non-residents.

### To set national minimum standards

Setting national minimum standards in regional-local services may be important for two reasons. The first is that there is an advantage to the nation as a whole from such standards as these will contribute to the free flow of goods and services, labor and capital and reduce wasteful inter-jurisdictional expenditure competition, and will therefore improve the gains from trade from the internal common market. Second, these standards serve national equity objectives. Many public services provided at the sub-national level such as education, health and social welfare are redistributive in their intent, providing in-kind redistribution to residents. In a federal system, lower level provision of such services – while desirable for efficiency, preference matching, and accountability – create difficulty in fulfilling federal equity objectives. Factor mobility and tax competition create strong incentives for lower level governments to under-provide such services and to restrict access to those most in need, such as the poor and the old. This is justified by their greater susceptibility to disease and potentially greater risks for cost curtailment. Such perverse incentives can be alleviated by conditional non-matching grants where the conditions reflect national efficiency and equity concerns, and where there is a financial penalty associated with failure to comply with any of the conditions. Thus conditions will not be on the specific use of grant funds but attainment of standards in quality, access and level of services. Such grants do not affect local government incentives for cost efficiency but do encourage compliance with nationally specified standards for access and level of services. Properly designed conditional non-matching transfers can create incentives for innovative and competitive approaches to improved service delivery.

Conditional non-matching transfers to ensure national minimum standard are rarely used in developing and transitional economies. Central government transfers to provincial and local governments in Indonesia, central per capita transfers for education in Colombia and South Africa, and the capitation grant to Malaysian states come close to the concept of such a transfer.

### To influence local priorities in areas of high national but low local priority

In a federation, there is always some degree of conflict among priorities established by various levels of government. One way to induce lower level governments to follow priorities established by the higher-level government is for the higher-level government to use its powers of the purse, the so-called spending power, by using matching transfers. Open-ended matching transfers with matching rate (percent of expenditures financed from own sources by the recipient) to vary inversely with fiscal capacity would be consistent with this use. The use of ad hoc grants or open-ended matching transfers for local tax effort is inadvisable. The former is unlikely to have behavioral responses consistent with grantor's objectives and the open-ended nature of the latter may create budgetary difficulties for the grantor. India, Malaysia, and Pakistan use conditional closed ended matching programs. Pakistan in late 1990s got into serious difficulty by offering open-ended matching transfers for provincial tax effort. Central government had to abandon this program in midstream, as it could not meet its obligations under the program.

### To create macroeconomic stability in depressed regions

Fiscal transfers can be used to serve central government objectives in regional stabilization. For this purpose capital grants would be appropriate, provided funds for future upkeep of facilities are available. Experience with capital grants shows that such grants often create facilities that are later not maintained by sub-national governments as they either remain unconvinced of the utility of such facilities or do not have the means to provide a regular upkeep.

Capital grants are pervasive in developing and transitional economies and most countries have complex processes for initiation and approval of submissions for financing capital projects. These processes are greatly susceptible to lobbying, political pressures and "grantsmanship" and favor projects that give the central government greater visibility. The projects typically lack citizen and stakeholder participation and often fail due to proper local ownership, interest and oversight. In view of this difficulty, it may be best to limit the use of capital grants by requiring matching funds from recipients and by encouraging private sector participation in infrastructure by providing political and policy risk guarantees.

**Table 11: Principles and better practices in grant design**

<i>Grant Objective</i>	<i>Grant Design</i>	<i>Better Practices</i>	<i>Practices to avoid</i>
To bridge fiscal gap	<ul style="list-style-type: none"> <li>• Reassign responsibilities</li> <li>• Tax abatement</li> <li>• Tax base sharing</li> </ul>	Tax abatement and tax base sharing in Canada	Deficit grants Tax by tax sharing
To reduce regional fiscal disparities	General Non-matching Fiscal capacity equalization transfers	Fiscal equalization programs of Australia, Canada and Germany	General revenue sharing with multiple factors
To compensate for benefit spillovers	Open-ended matching transfers with matching rate consistent with spill-out of benefits	Republic of South Africa grant for teaching hospitals	
Setting national minimum standards	Conditional non-matching block transfers with conditions on standards of service and access	Indonesia pre-2000 roads and primary education grants Colombia and Chile education transfers	Conditional transfers with conditions on spending alone <i>Ad hoc</i> grants
Influencing local priorities in areas of high national but low local priority	Open-ended matching transfers (with preferably matching rate to vary inversely with fiscal capacity)	Matching transfers for social assistance as in Canada	<i>Ad hoc</i> grants
Stabilization	Capital grants provided maintenance possible	Limit use of capital grants and encourage private sector participation by providing political and policy risk guarantee	Stabilization grants with no future upkeep requirements

Source: (Shah 1994, 1998). Also in (World Bank 1997)

### **Borrowing**

The willingness to use the revenue opportunities provided by tax autonomy is also undermined by access to soft loans - loans that someone else will have to repay. The moral hazard problem—the

proposition that access to financial markets by subnational governments may create unplanned fiscal liabilities for central government—is the core of the argument.

The academic literature and country experiences, however, do not suggest an a priori adverse link between decentralizing borrowing powers and the central government's ability to maintain fiscal discipline and macroeconomic stability. The key is the design of the regulatory framework under which borrowing powers are decentralized.

In this regard, there are three primary reasons why access to financial markets is considered important for subnational governments:<sup>64</sup>

1. **Financing capital expenditure:** Subnational governments often have responsibility for public investments that are lumpy in nature. Financing such capital investment through increases in current taxes would be inefficient. In addition, because the benefits of such public investments often last several decades, equity considerations would suggest that future generations participate in the financing. Capital markets provide this intertemporal link.
2. **Matching expenditure and tax flows:** Within a particular fiscal year, expenditures incurred and tax intake may not be fully in synchrony. Access to financial markets offers an opportunity to smooth out such mismatches.
3. **Fostering political accountability:** The pricing of capital by markets may provide an independent mechanism for fostering political accountability. Markets may signal the poor performance of subnational governments through increases in interest rates or simply by blocking access.

## **Pakistan's fiscal system in context**

### Current federal-provincial fiscal relationships

At this level, the constitutionally mandated structure of the National Finance Commission represents an excellent model of a federal-provincial participatory decision making body with all the key stakeholders represented. The consensus decision rule further offers opportunity for political compromise and accommodation. However, on the other hand, this makes it almost impossible to change the formula that favors one government more than the others, irrespective of the fact that circumstances under which the original formula was approved may have changed drastically.

This model is superior to so-called independent and largely academic grants commissions in India and Australia as the decision makers are not represented on latter bodies. The practical merits of such an institutional arrangements are borne out by the simplicity and transparency of the commission awards.

The revenue sharing system practiced in Pakistan represents a simple, objective (formula-based) and transparent way of reasonably secure and growing amount of revenues to the provinces. It provides transfers in a lump sum, unconditional and - in theory - predictable way to the provinces. The provinces are left with full discretion and complete autonomy over how to spend these funds. This facilitates the decentralization of fiscal responsibility and contributes to the efficiency of the federal system. The provinces remain accountable to their own constituents via the legislative process for the manner in which they provide services.

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<sup>64</sup> See also: Should Borrowing by the Public Sector be Decentralized? (<http://www-wbweb.worldbank.org/prem/prmps/decentralization/borrow.htm>)



The NFC award also facilitates the preservation of a fully harmonized tax system in Pakistan. It has enabled the federal government to retain major revenue raising responsibilities to achieve greater efficiency in tax collection and administration and lower the compliance costs of the tax system. These arrangements have avoided tax jungles that continue to block the reform of sales taxes in India.

The NFC awards equalize to an uncertain standard the fiscal needs of the provinces as population represents a good proxy for fiscal needs. The special grant program for NWFP and Balochistan provides additional unconditional assistance to the two smaller provinces with lower than average fiscal capacities and higher than average expenditure needs especially in Balochistan due to dispersal of population over a large area to be serviced.

However, for all its simplicity and effectiveness in getting funds into the hands of the provinces with a minimum of intrusion, revenue sharing has some drawbacks especially if relied on excessively as is the case in Pakistan:

1. The main issue is that provinces receive these funds like manna from heaven with no accountability to tax payers. They do not experience the pains of justifying additional taxes to their constituents while enjoying the pleasures of spending on their pet projects. Thus they have few incentives to utilize these resources efficiently. At the same time, to the degree that the federal government is simply transferring the revenues, they have few incentives to maximize the efficiency with which the tax is collected (although at least they have fewer concerns about liberalization which might reduce the revenue in the short term<sup>65</sup>).
2. A related concern is that while provinces are left with considerable discretion in the use of revenue sharing funds, they have virtually no discretion over the amount of funds they receive.<sup>66</sup> If revenue sharing is seen as an alternative to other forms of federal-provincial transfers, this is no drawback. But revenue sharing in Pakistan leaves little revenue raising responsibilities with the provincial governments. In these circumstances tax decentralization options – such as tax base sharing might offer superior alternatives. Enhancing the ability of provinces to raise their own revenues can increase the accountability of provincial governments for their fiscal performance.
3. Another important drawback of revenue sharing system is that it does not permit fiscal capacity equalization to a national average standard. Such an equalization system fosters a sense of unity in the nation, as citizens benefit from having reasonably comparable levels of public services at reasonably comparable levels of taxation across the nation. The proposals currently under discussion in Pakistan to include backwardness and other indicators in the NFC formula would make the system complex without achieving fiscal equalization.
4. An additional important drawback of the revenue sharing system is that it removes from the federal government the lever for influencing provincial priorities in order to achieve

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<sup>65</sup> Prior to 1997 NFC Award, provinces had an 80% share in revenues from Sales and Income taxes. For this reason, the federal government was lukewarm to the idea of expanding the base of these two taxes. On the other hand, 100% of revenue from Custom Duties used to accrue to the federal government, making federal government reluctant to undertake tariff reduction and trade liberalization reforms on the fear of losing their main revenue source. Immediately after the 1997 NFC Award, which made provincial share uniform (37.5%) in all of these taxes, the federal government undertook sweeping tax and tariff reforms.

<sup>66</sup> Other than the theoretical and perverse incentive of allowing for rapid increase in population.

- national objectives of, for example, national minimum standards in education and health to foster internal economic union.
5. Another potential drawback of the existing system is that the formula determining a province's revenue allocation bears little relation to province's expenditure responsibilities. A province's revenues grow at the rate of growth of federal revenues. This may differ considerably from the rate of growth of province's expenditure responsibilities. Provincial expenditures on education, health, and infrastructure are likely to far outstrip growth in federal revenues.
  6. Finally, the existing revenue sharing program exposes the provinces to risks associated with changes in federal tax bases and collection performance.

The program of returning resource royalties by origin seems also difficult to justify as the federal government collects revenues at centrally determined rates and then returns them to provinces on the basis of collection (Shah 1996).<sup>67</sup> While it can be argued that resource royalties as opposed to resource profit or rent taxes could be reasonably assigned to the provinces, but then provinces should be able to decide on the rates and structure of such royalties while collection could be either provincial or federal.

The special grant program for NWFP and Balochistan is also flawed as the size of these grants are determined in an ad hoc manner and both the size and duration is unrelated to any provincial fiscal capacities. This program weakens accountability of provincial governments to their taxpayers without dealing with regional equity concerns in a satisfactory manner.

#### Restructuring federal-provincial fiscal transfers

If tax decentralization and tax base options were adopted, the need for a revenue sharing program to deal with vertical imbalances would be less urgent. Tax decentralization would, however, accentuate regional fiscal disparities. Therefore the case for a fiscal equalization program that enables all residents regardless of their place of provincial residence to have access to reasonably comparable levels of public services at reasonably comparable levels of taxation, would take prominence. In addition, there would be a need for the federal government to have the ability to influence provincial policies through the use of its spending power (fiscal transfers to provinces). Keeping these two objectives in mind, the following long term options for the reform of fiscal transfers are worthy of consideration:

- *Fiscal capacity equalization program.* This program will upgrade provincial fiscal capacities to a national average standard. A representative tax system approach to fiscal equalization is practiced in a small but growing number of countries. Under such an approach the fiscal capacity of a province equals the revenues that could be raised by a province if it applied national average tax effort to all its tax bases. A federal program attempts to bring all provinces to a national average per capita fiscal capacity. See (Shah 1994, 1996) for details on the application of this approach. Among developing and transition countries, Poland, Russia and Indonesia have adopted variants of this approach.
- *Transfers to set national minimum standards:* These transfers would be based upon simple demographic factors for distribution among provinces and there would not be any conditions on the use of funds but there would be expectations on the results (service delivery performance). Compliance failure would invite public censure but persistent failure to achieve agreed upon results could result in discontinuation of grant funds.

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<sup>67</sup> The main reason for assigning collection of these revenues to the federal government is that taxes and royalties are collected (from oil and gas companies) by the federal government corporations, who deal directly with these companies.

Both the options, however, require that the transfer mechanism be based on clear and transparent indicators to avoid their varying interpretation by different stakeholders, and to deter the higher-level government from using different interpretation on these indicators to “punish” a “non-conforming” provincial government or to retain a larger part of transferable revenue.

#### Current provincial-local fiscal relationships

The system of revenue sharing adopted by the provinces is commendable for several reasons. The new institutional arrangements for determining the divisible pool and the distribution criteria are transparent and a large pool of resources are being transferred to local governments using reasonably objective methods. The formula factors primarily emphasize various indicators of local expenditure needs. The emphasis on these factors had a positive impact on the provincial information base of local governments and their fiscal needs. Local governments, in principle, enjoy full autonomy in the use of available transfers.

However, the new revenue sharing system has important limitations.

1. The one size fits all approach used by the provincial finance commissions is flawed. Under this approach all local jurisdictions are treated alike creating significant interjurisdictional fiscal inequities. Large city districts with a larger menu of local services and very different needs are lumped together with smaller largely rural districts. There is also no separate recognition of tehsils with responsibility for municipal services.
2. The awards ignore the differential fiscal capacities of various local governments. This neglect makes the distribution of revenues solely based upon expenditure needs inequitable and indefensible.
3. The awards do not fully match the transferred expenditure responsibilities at the local level leaving relatively higher revenues with the provinces than required by their newer responsibilities. Thus vertical imbalances persist even after the transfer of significant resources to local levels. Such imbalances impede the realization of improvements in service delivery associated with decentralized management.
4. The awards have the potential to weaken local government accountability to resident taxpayers. Such bottom-up accountability is considered critical for the success of any decentralization program. With devolution, local government dependency on provincial and federal transfers has become overwhelming. This creates strong incentives for local elected officials (like their provincial counterparts in the case of NFC) to be much more focused on influencing provincial distribution criteria at the neglect of local revenue raising efforts.
5. Finally and most importantly, the provincial finance commissions have failed to recognize the role of fiscal transfers in enhancing efficiency and equity of the federal system by providing the right incentives for responsive, responsible and accountable governance. The finance commissions are focused primarily on dividing the pie.

The system of provincial-local fiscal relations requires a systemic examination, with a careful examination of tax decentralization options at the local levels. Provincial Local Governments Acts, 2001 have advanced this agenda but much more work remains to be done. Local fiscal equalization is necessary to achieve minimum standards of local services across various municipalities and to introduce competition and innovation in service delivery and accountability for results at the local levels,

## Appendix 5: Theoretical considerations in administrative decentralization<sup>68</sup>

### What is a Decentralized Staffing Model Attempting to Achieve?

More administrative decentralization is not necessarily better. In fact, extensive decentralization can have negative consequences for developing a strong, professional civil service at the local level if mobility, promotional and financial opportunities are curtailed as a result. The interaction of fiscal, political and administrative features needs to be taken into account if the intended degree of decentralization is to be realized.

A distinction needs to be made between the ‘ends’ or objectives of administrative decentralization and the means by which it is achieved. ‘Ends’ in this context refers to the ability of local governments to manage their staffing and financial resources, rather than the ultimate goals of improved service delivery or poverty reduction. These ‘ends’ or objectives of decentralization can be summarized as:

- *Local government must be able to hold its staff to account, in terms of its performance.* This means that local government must be able to supervise and direct the work that is done. It also means that local government should review performance, reward good performance through promotion, pay increases or other incentives, and discipline poor performance, including the authority to fire. It does not mean that local government must also hire staff, especially if more centralized mechanisms are in place to ensure that hiring decisions are based on merit, but it would be beneficial. And in principle, if these accountability mechanisms are in place, staff could still be formally employed by the center, although practically it will be very challenging to do so without some blurring of the lines of accountability.
- *Local government needs to have the ability to allocate staff where the need is greatest.* This means being able to determine and/or influence the numbers of staff employed at particular facilities (or performing certain functions) through establishment controls and perhaps the use of financial or other incentives.
- *Local government needs to be able to manage its financial resources.* Since the wage bill typically represents a significant portion of the overall budget, control over wage rates and/or numbers of staff is essential.
- *Local government should have the means to attract and retain skilled staff.* The most direct way to do this is through financial or other incentives. It may also be possible to retain qualified staff by such means as establishing a local government civil service cadre that serves a number of local governments, thus preserving mobility and career advancement opportunities.

### Ends and means

There are six key dimensions of personnel management that apply to all categories of public employees. However, the authority for these management functions can be different for disparate groups of staff at different levels of government. The means to achieve the ends of administrative decentralization is to shift some or all of these employer functions from higher levels of

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<sup>68</sup> This section draws extensively on (Evans 2003)

government to subnational government. Being fully the “employer” would mean that a government is responsible for all or most of these 6 major dimensions of the employer function.

Table 12 identifies shows how changes in each of these dimensions contribute towards achieving the objectives of administrative decentralization.

<b>Table 12: Devolving the Employer Function to Provide Administrative Autonomy</b>				
<b>Dimensions of the Employer Function</b>	<b>Impact on Administrative Autonomy</b>			
	<b>Ability to hold staff accountable</b>	<b>Ability to allocate staff</b>	<b>Ability to manage financial resources</b>	<b>Ability to attract and retain skilled staff</b>
<b>Budget Control</b> <ul style="list-style-type: none"> <li>• Paying staff from its own budget</li> <li>• Determine the wage envelope</li> <li>• Authority to dismiss surplus staff</li> </ul>		✓	✓ ✓ ✓	
<b>Establishment Control</b> <ul style="list-style-type: none"> <li>• Control overall staffing numbers</li> <li>• Control staffing numbers in local offices &amp; facilities</li> </ul>		✓	✓	
<b>Recruitment</b> <ul style="list-style-type: none"> <li>• Formal employer</li> <li>• Authority to hire</li> <li>• Independent merit-based recruitment mechanism (e.g., PSC)</li> </ul>	✓ ✓ ✓	✓		
<b>Career Management</b> <ul style="list-style-type: none"> <li>• Promotion</li> <li>• Transfers within local government</li> <li>• Horizontal mobility</li> </ul>		✓ ✓		✓ ✓
<b>Performance Management</b> <ul style="list-style-type: none"> <li>• Direct and supervise activities and tasks</li> <li>• Conduct evaluations</li> <li>• Financial rewards/promotion</li> <li>• Ability to discipline/fire</li> </ul>	✓ ✓ ✓ ✓			✓
<b>Pay Policy</b> <ul style="list-style-type: none"> <li>• Set overall wage rates</li> <li>• Set local hardship/remoteness allowances</li> </ul>		✓	✓	✓

### **Compromises are always necessary**

Under a system of "complete" administrative devolution, the authority for all six dimensions of personnel management would be found at the same level of government where staff are located. In practice, there are always very sensible reasons to deviate from this a simplistic model. Above all, history and tradition determine much of the present arrangements, and it is difficult to abandon them completely and start again. Moreover, there are quite defensible reasons for higher levels of government to retain some control over staffing at lower levels. Specifically, such an arrangement provides:

- an opportunity to exercise some top-down influence over policy (as a national integrating device) even where political and fiscal authority have been largely devolved;
- a broader set of career options for civil servants, so they are competing for positions both within and outside of their immediate administrative location; and
- some fiscal safeguards in settings where the political pressures might otherwise overwhelm constraints on hiring or remuneration.

There are also sector-specific reasons – particularly in education and health – for maintaining certain personnel management responsibilities outside of the administrative unit where staff are located. For example, there is a need to follow a common set of professional standards in curriculum design and public health. Arguably, this can be achieved most readily by creating overarching staff groupings that share common interests and provide a single career path.

## **The Path that the Decentralizers Have Followed**

### The Advanced Case: Strong Decentralizers

There is consistency in the characteristics of the countries that are relatively more decentralized administratively (for example Indonesia, the Philippines, and Poland). In other words, those countries that are the most decentralized tend to be decentralized in the same way. These ‘strong decentralizers’ all have strongly decentralized mechanisms for budget control (determining the wage envelope, authority to dismiss surplus staff), establishment control (controlling overall staffing numbers and disposition of staff within local offices and facilities) and performance management (directing and supervising activities and tasks, conducting performance evaluations and undertaking discipline). As for performance management, in most cases this authority is tempered or guided by centrally established guidelines or directives, and in practice performance evaluations and merit-based promotions are far from institutionalized, but the tools are in place. By contrast, in ‘weak decentralizers’ these same mechanisms generally continue to be controlled by the central government.

The more administratively decentralized countries also have some ability to undertake their own recruitment (they are legally recognized as the employer and authorized to hire), and career management (offering promotion, making transfers within local government).

But even for the strong decentralizers, the resultant arrangements give them only marginal ability to attract and retain staff – specifically in local control over promotion, horizontal mobility, ability to discipline/fire and to set local hardship/remoteness allowances. This is a widespread concern. From the employer’s point of view, the ability to attract skilled professionals directly affects local government’s ability to deliver its mandate - but from the perspective of the staff themselves, a transfer to local government can mean losing significant mobility that can in turn hinder career development. There are few cases where this disincentive for staff to transfer has been effectively addressed, although in some situations financial incentives have been used.

<b>Table 13: Stages of administrative decentralization</b>			
	<b>Early points of entry</b>	<b>Advanced decentralizers</b>	<b>Long term reforms</b>
<b>Budget Control</b>	Paying staff from its own budget ----->	Determine the wage envelope ----->	Authority to dismiss surplus staff ----->
<b>Establishment Control</b>	Control overall staffing numbers ----->	Control staffing numbers in local offices & facilities----->	
<b>Recruitment</b>	Formal employer ----->	Authority to hire ----->	Independent merit-based recruitment mechanism (e.g. PSC) ----->
<b>Career Management</b>	Transfers within local government ----->		Local government civil service cadre (horizontal mobility) --->
<b>Performance Management</b>	Direct and supervise activities and tasks ----->	Conduct evaluations ----->	Promotion ----->
<b>Pay Policy</b>		Ability to discipline/fire ----->	Set local hardship/remoteness allowances----->
			Set overall wage rates ----->

### Points of Entry

To the extent that the 'intermediate' are on a path towards becoming 'strong' decentralizers, it seems that some control over own recruitment (legally recognized as the employer), career management (control over transfers within local government) and performance management (directing and supervising activities and tasks, conducting performance evaluations and managing promotion) are the preferred (or perhaps the easiest) points of entry.

This is undoubtedly because in ensuring a basic level of local accountability for staff it is most important to be able to directly supervise activities of staff, reward and promote good performance. Being able to discipline or even fire poor performers is also critical to accountability, but is usually only tackled by the strong performers. Other mechanisms, such as establishing local government as the formal employer, and paying staff from its own budget, will strengthen the accountability relationship but they are not the most critical factors. Thus, from the potential early gains in local control, performance management stands out as the most significant.

It is also clear that local government needs at least one mechanism that allows it to move staff to where the need is greatest, in order to meet their service delivery priorities. This can be accomplished either directly, through local authority to transfer staff, or indirectly, through the use of hardship/remoteness allowances. Of the two, transferring would seem a better point of entry candidate.

There is also a tradeoff to be considered in relation to the ability of local government to control the overall financial resources devoted to wages. Since it is improbable that the authority to set wage rates will have been decentralized, it is important that local governments do have control over numbers of staff. Thus even where they are not authorized to hire, they should at least be able to effectively veto further recruitment.

## Long Term Reforms

Some issues cannot be addressed in the short or medium terms. Centrally established base wage rates are common if not universal. Although this is certainly constraining, in the more decentralized cases this is somewhat mitigated by the ability to increase or decrease numbers of staff. In addition, ‘strong’ decentralizers generally have some ability to supplement wages where necessary. Where the central government controls wage rates, staff numbers and the ability to dismiss surplus staff, management has virtually no flexibility.

Similarly, any independent oversight over recruitment (district service commissions etc.) is not generally available (although, interestingly, this is present in Uganda, an intermediate case). Mobility through the creation of a cross-cutting local government service or cadre is also hard to introduce although in a recent review, 11 of 34 OECD countries and select Central and Eastern European countries have a separate civil service for subnational government.<sup>69</sup>

An almost universally unsolved problem concerns the ability of local government to attract and retain skilled staff. Some positive results have been achieved with the use of salary incentives or hardship/remoteness allowances. However, it is clear that this area warrants further attention.

## **Lessons for Developing an Action Strategy**

Extrapolating from these case studies, we can deduce some stylized lessons for would-be decentralizers.

### Some Points of Entry Are More Feasible

- First think about devolving authority over:
  - performance management (directing and supervising activities and tasks, conducting performance evaluations, managing promotions and undertaking discipline)
  - career management (devolve control over transfers within local government)
  - recruitment (legally recognize local government as the employer)
- Ensure that their staff can be moved to where the need is greatest.
- Provide local governments with control over numbers of staff.

### Build on These in the Medium Term

- Where this has not already been achieved, decentralize mechanisms for:
  - budget control (determining the wage envelope, authority to dismiss surplus staff)
  - establishment control (controlling overall staffing numbers and disposition of staff within local offices and facilities)
  - own recruitment (legally recognizing local government as the employer authorized to hire)
  - career management (offering promotion, making transfers within local government)
  - performance management (directing and supervising activities and tasks, conducting performance evaluations and undertaking discipline)

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<sup>69</sup> The Scope of the Civil Service in OECD and Select CEE Countries  
([http://www1.worldbank.org/publicsector/civilservice/cs\\_law\\_oecd.htm](http://www1.worldbank.org/publicsector/civilservice/cs_law_oecd.htm))



- Recognize that performance management authority will be tempered by centrally established guidelines or directives
- Note the persistent problem for local government of attracting and retaining staff.

### Recognize Constraints

- Centrally established base wage rates are unlikely to be devolved in the short or medium terms.
- Independent oversight over recruitment (district service commissions etc.) is difficult to establish.
- Achieving inter-local government mobility through the creation of a crosscutting local government service or cadre is also institutionally challenging and expensive.

### **Devolving management to the facility level**

There is a further level of administrative decentralization - to the facility level. In education, the logic of school-based management is that parents and the local community have better information about the quality of teaching in the local schools, and of the needs of the local school, than central or even sub-national governments, and therefore should have the responsibility for managing the affairs of these schools. Following this logic, a number of countries have shifted responsibility and power to communities and parents.

Empirical investigations of school autonomy, while few, appear to support this proposition. Two countries that have been studied in some detail are El Salvador and Nicaragua. In El Salvador, community-managed rural schools, called EDUCO, were given significant decision-making authority and autonomy, including the ability to hire and fire teachers and principals, choosing textbooks and determining teaching methods, and responsibility for equipping and maintaining the schools. One study found that EDUCO schools had much higher parent involvement – measured by frequency of meetings with teachers and visits to classrooms – than traditional schools, and consequently that these schools had a lower incidence of student and teacher absenteeism than traditional schools (Jimenez and Sawada 1998). Moreover, this higher parent engagement occurred despite EDUCO parents being on average poorer than the parents in traditional schools, suggesting that institutional reform was a decisive factor in the improved outcomes.

In Nicaragua, from 1993 onwards school management functions have been transferred to a select number of primary and secondary schools. These autonomous schools were given *de jure* responsibility over teacher management, and over the school plan and budget. However, one empirical investigation found that *de facto* autonomy varied considerably across these autonomous schools, and that, after controlling for a variety of student and household characteristics, there was a positive and statistically significant relationship between the degree of decision-making actually exercised and student achievement as measured by test scores (King and Ozler 1998). Furthermore, the ability of schools to monitor teacher activities and teacher staffing had the greatest impact on student achievement.

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