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Strengthening Fiscal Federalism in Pakistan: A Roadmap for Reforming National Finance Commission Award

POLICY BRIEF



Strengthening Fiscal Federalism in Pakistan: A Roadmap for Reforming the National Finance Commission Award

Acknowledgements

This work is a product of the staff of SDPI (**Abdullah Khalid, Saad Ali Ahmed, Maheen Rehan**) with external contributions (**Abdullah Fateh**). The findings, interpretations, and conclusions expressed in this work do not necessarily reflect the views of SDPI.

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The findings, interpretations, and conclusions expressed here do not necessarily represent the views of SDPI or its partners. It is our hope that this study stimulates constructive debate and supports evidence-based reforms to make fiscal federalism in Pakistan more inclusive, equitable, and responsive to emerging national priorities.

Executive Summary

This study undertakes a critical and empirically grounded analysis of Pakistan's National Finance Commission (NFC) Award, with the objective of informing a rigorous, forward-looking reform agenda for intergovernmental fiscal transfers. Leveraging a multi-dimensional methodology incorporating quantitative simulations, legal and institutional diagnostics, and unstructured stakeholder engagement, the study identifies structural and operational limitations within the prevailing 7th NFC Award. The existing formula, with its disproportionate reliance on population as the principal determinant of horizontal transfers, has not only entrenched inter-provincial inequities but also undermined incentives for revenue mobilization, human development, gender parity, and climate-responsive governance. These limitations are compounded by demographic transitions, rising expenditure responsibilities post-18th Amendment, and intensifying socio-economic and climate-related vulnerabilities.

The study presents a robust and contextually relevant reform blueprint predicated on phased recalibration of formula weights and the systematic integration of dynamic, performance-based indicators. The recommended roadmap envisages a gradual reduction in the population weight from 60% to 50% across successive NFC cycles, concomitant with enhanced weightage for poverty alleviation (static and progress-based), provincial revenue generation (growth, diversification, and tax effort), environmental sustainability (forest cover and verified carbon offsets), and gender equity (female labor force participation, education, and leadership metrics). This reconfiguration is fully compliant with Pakistan's constitutional provisions, particularly the Article 160. The proposed approach further advocates for the institutionalization of a permanent technically competent NFC Secretariat, the adoption of transparent monitoring and evaluation mechanisms, and third-party validation of key indicators.

By situating fiscal transfer criteria within the broader imperatives of inclusive development, climate resilience, and SDG alignment, this study underscores the necessity of transforming the NFC from a static distributional mechanism to a dynamic instrument of national cohesion, innovation, and sustainable growth. The realization of these reforms will require high-level political consensus, strengthened intergovernmental coordination, and a sustained commitment to evidence-based policymaking. The recommendations presented herein seek to advance a resilient, equitable, and adaptive framework for fiscal federalism, capable of meeting Pakistan's complex development challenges in the future.

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1 Introduction

1.1 History & Background

The National Finance Commission (NFC), a product of Article 160 (1) of the 1973 Constitution of Pakistan, lays the foundation of equal distribution of revenues between the federal and four provincial governments. It replaced the “Raismen Award” as constituted by the India Act of 1935 [i]. Events post 1971 impressed upon the need for a more effective and fair distribution of resources among the newly formed provinces at that time. This structure used population as the sole metric for resource distribution, with 80% of the divisible pool allocated to the Centre [ii].

The 5th NFC Award (1996) expanded the divisible pool available for distribution, adding new resource heads such as Customs duties and Capital Gains Tax (CGT). The 7th NFC Award (2006), which is still active today, marked a significant milestone in advancing provincial demands through three key changes.

First, it has augmented the formula for resource distribution to benefit less populated provinces. Second, it has expanded the divisible pool through the addition of new revenue streams. Third, it has increased the overall provincial share of the pool, which in addition to the aforementioned modifications, has significantly enhanced provincial autonomy.

1.2 Composition of Divisible Pool under the 7th NFC Award

Component	Constituent Revenue Streams
Divisible Pool	<ul style="list-style-type: none"> Income Tax Wealth Tax Capital Value Tax Sales Tax on Goods Export Duties Customs Duties All Other Taxes Collected by the Federal Government Royalties on Crude Oil and Gas Surcharge

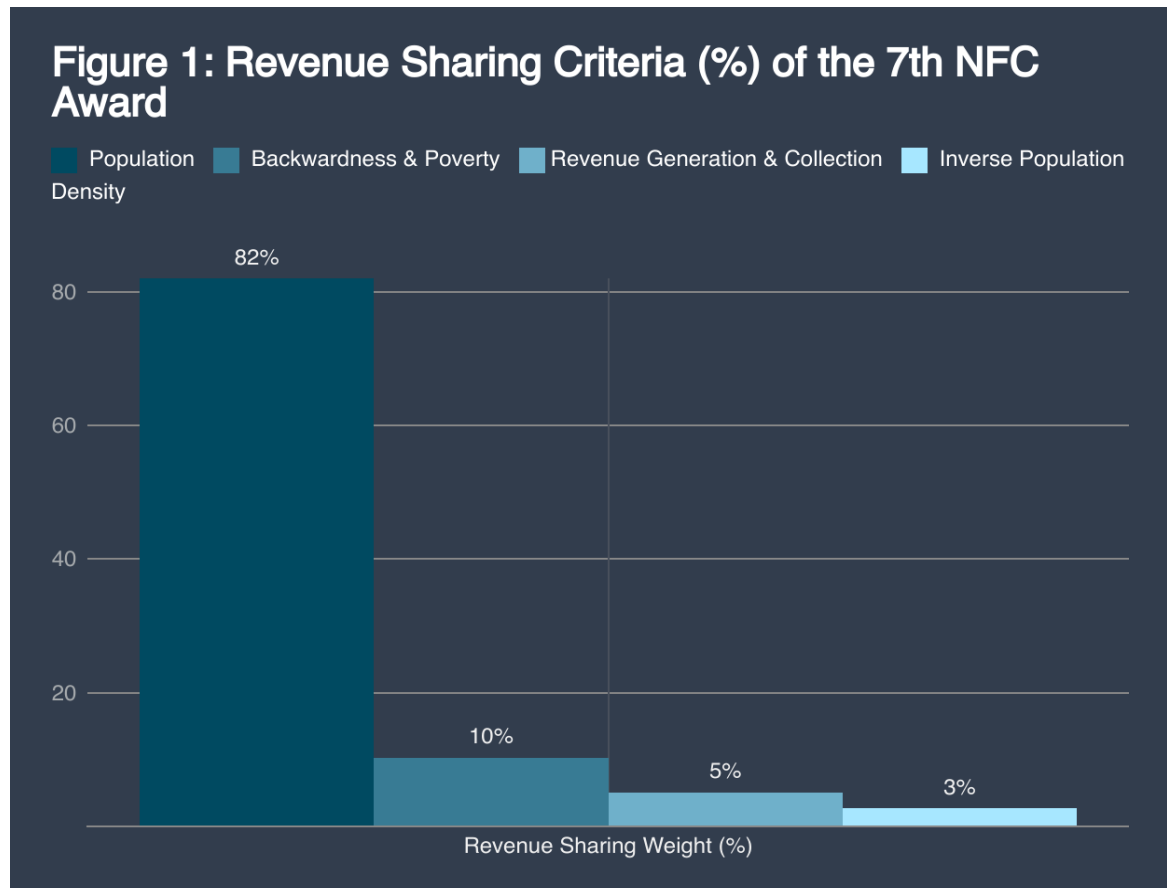
Source 1: Government of Pakistan

As presented in Table 1, the current composition of the divisible pool under the 7th National Finance Commission (NFC) Award reflects a comprehensive aggregation of federal tax revenues, encompassing key instruments such as income tax, wealth tax, capital value tax, sales tax on goods, export duties, customs duties, and royalties on natural resources. While the inclusion of these diverse streams was intended to strengthen fiscal decentralization and broaden the resource base available for intergovernmental transfers, the structure remains predominantly reliant on conventional federal tax sources. Notably, the framework has not evolved in tandem with the changing economic realities and emerging sectors that characterize Pakistan’s fiscal landscape in the 21st century.

With the changing economic scenario, there is a compelling policy rationale that the criteria that governs how divisible pool resources were allocated and distributed should be re-visited. With the diversification of economic activity beyond its conventional sectors to services, digital economy,

and environmental assets, the formula established by the National Finance Commission to promote innovation, sustainability, and mobilization by provinces will have to be re-balanced. The introduction of performance-based indices, as well as the orientation of fiscal transfers towards national development goals would also enhance the values of equity, resilience, and foresight as the determining factors in fiscal federalism in Pakistan. This is because such strategic reforms would increase efficiency and transparency in the distribution of resources besides strengthening compliances with the constitutional mandate and international commitments especially as regards inclusive growth and sustainable development.

1.3 Revenue Sharing Criteria of the 7th NFC Award

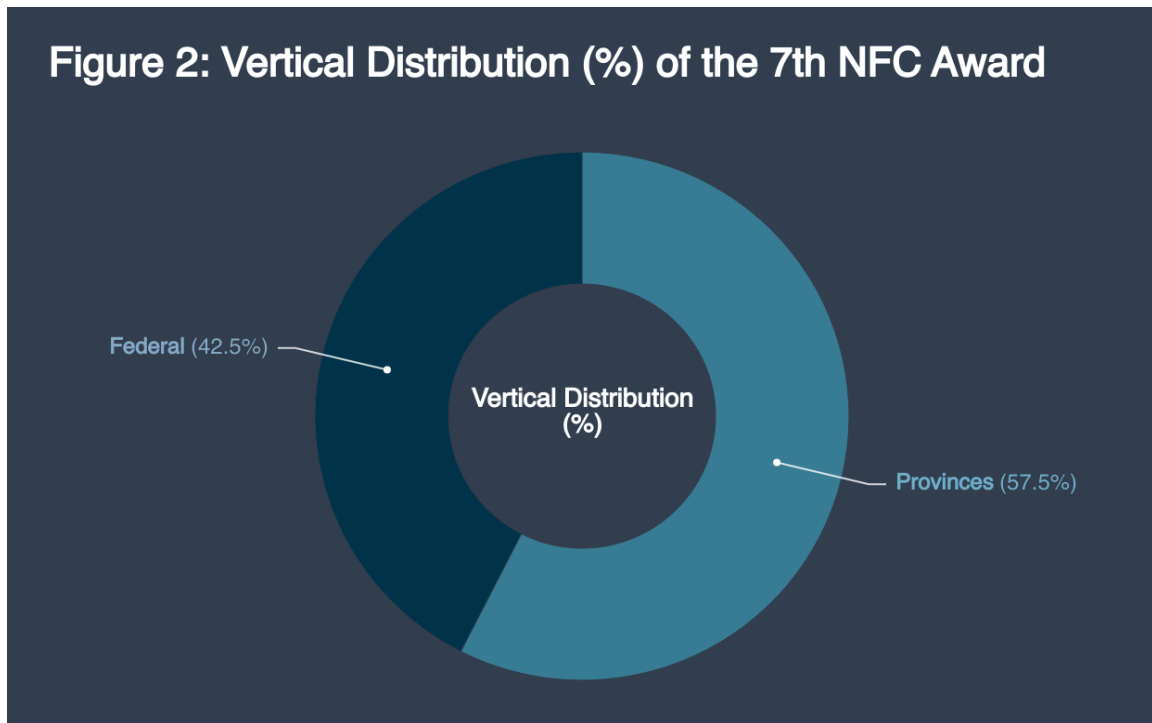


Source 2: Government of Pakistan

The revenue sharing structure provided under the 7th NFC Award places excessive emphasis on population which accounts for 82 per cent of the total NFC award criteria and thus the mechanism has become highly weighted at the cost of population as the chief determinant. Though the population privileging is theoretically supported by the principle of equal access to public resources and services, the overconcentration of influence brings about distortions in the inter-provincial fiscal transfers. The rest of variables, such as poverty, revenue generation and regional disparities, amount to less than 20 % of the formula. This leaves little room for those parameters, which are considered to be critical to development. The existing mechanism reduces incentives for the provinces to engage in bringing about substantive changes in revenue mobilization, poverty alleviation, and sustainable development planning because it strengthens a static needs-based approach.

Such an imbalanced distribution framework is increasingly misaligned with Pakistan's evolving socio-economic landscape and policy priorities. Overreliance on population as the primary criterion not only risks entrenching inequities between provinces but also politicizes census exercises, incentivizing population inflation and obscuring genuine developmental needs. The marginal allocation to backwardness, revenue generation, and inverse population density fails to reward provinces for effective governance, innovation, or progress in human development indicators.[iii] In light of these deficiencies, there is a compelling need to revise the NFC criteria by incorporating more dynamic and performance-based indicators such as poverty reduction, domestic resource mobilization, environmental sustainability, and gender equity. Doing so will promote a more balanced, resilient, and development-oriented fiscal federalism, in line with Pakistan's constitutional mandate and international commitments to the Sustainable Development Goals.[iv]

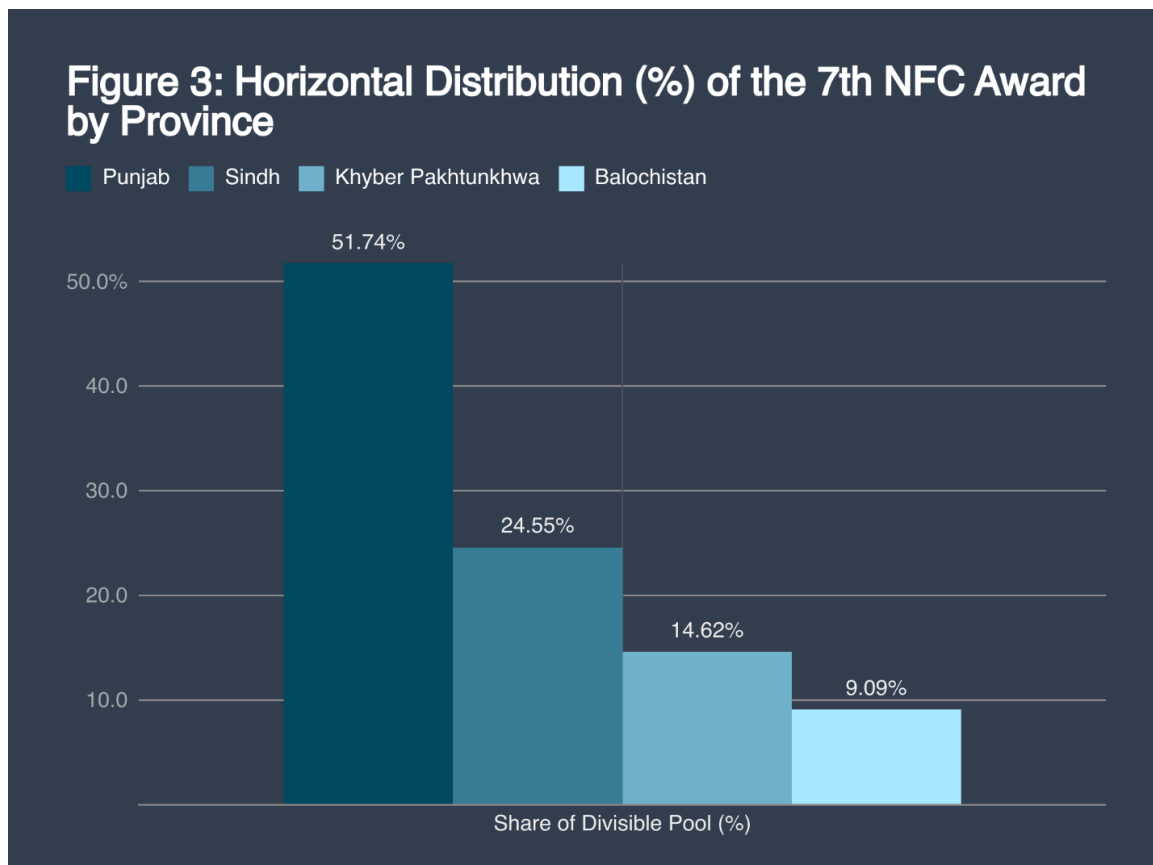
1.4 Vertical Distribution (%) of the 7th NFC Award



Source: Government of Pakistan

The vertical distribution of the divisible pool shown in figure 2 as given by the 7th NFC Award wherein 42.5 per cent of the divisible pool is allotted to the federal government and 57.5 per cent among the provinces marks the clean shift towards fiscal decentralization and increased provincial autonomy in the federal structure of Pakistan. This outlay relates to sector share that has been devolved to the provinces by virtue of the 18th Constitutional Amendment especially in social spheres such as health, education and social protection. Despite the mechanism has enhanced provincial ability within the provision of public services, it has at the same time, imposed a substantial fiscal tightness on the national government, specifically the capability to fulfil the national commitments as well as responding to the unexpected expenditures. The present vertical sharing arrangement should therefore be periodically reviewed to make resource allocation consistent with changing spending demands, developments in national priorities, and macroeconomic issues thus ensuring appropriate application of the principles of equity, efficiency and fiscal sustainability in the intergovernmental fiscal framework of Pakistan. [v]

1.5 Horizontal Distribution (%) of the 7th NFC Award by Province



Source: Government of Pakistan

Horizontal revenue allocation of the divisible pool by the 7th NFC Award has a sharp concentration of fiscal resources with the Punjab receiving the largest share (51.74%), Sindh (24.55%), Khyber Pakhtunkhwa (14.62%), and Balochistan (9.09%). The given framework is influenced largely by population as the key determinant, thus providing more fiscal freedom to more populous provinces. Whilst the current allocation meets the theoretical standard of per capita equity on resources allocation, it is argued that it does not adequately support intra-provincial differences associated with socioeconomic development, geographic disadvantages, and administrative capacity. The exclusion of the provinces which are less populated, especially Balochistan and Khyber Pakhtunkhwa, has created apprehension regarding equal access to a share of public goods and decentralized growth.

The 7th NFC Award resulted in an extra 1% allocation of the net divisible pool towards Khyber Pakhtunkhwa. This was due to the increased spending needs of the province on account of war on terror. This distribution structure has been in operation at federal level since the introduction of the 7th NFC formula during the financial year 2010. This increased fiscal autonomy of the provinces was later institutionalized by the provisions of the 18th Constitutional Amendment, especially under Article 160(3), which prohibits any amendment that will reduce the share of the province in the divisible pool. As a result, the Amendment enhanced the ideology of provincial autonomy and fiscal security. Moreover, the constitutional requirement of the meeting of NFC

meetings once in five years was also proposed so as to periodically review and adjust the distribution formula in a participatory and consensus-based approach to fiscal federalism.

Although progressive, the National Finance Commission Award has lacked ability to keep pace with changing fiscal realities, emerging development demands and structural differences among provinces due to its outdated distribution formula. The horizontal revenue allocation has no dynamic and performance-based thresholds, which means that provinces are not encouraged to optimize their own-source revenue collection, advance poverty alleviation, and sustainability projects. As such, the idea of profound renewal of NFC criteria, including multidimensional indicators like poverty incidence, human development performance, environmental guardianship, and gender equality in addition to population, would be strongly compelling in nationalizing a much more balanced, approval, and growth-centric system of intergovernmental fiscal transfers.

Subsequent NFC meetings have been unable to produce a consensus on new distribution mechanisms to adapt to changing circumstances and needs of the Federation. In 2014, the federal government expressed its desire to increase the Centre's share to fund vital expenditure, such as administrative expenditures of Federally Administered Tribal Area[vi]. Disagreements, however, prevented any change in the inconclusive 8th NFC meeting in 2015. The 9NFC meeting (2020) similarly could not garner consensus between all stakeholders and thus led to a continuation of the 7th NFC award to date. A change of note was the 25th Amendment in 2018, merging the FATA with Khyber Pakhtunkhwa (KP). This resulted in an additional 03% of the divisible pool of the NFC allocated to KP for a duration of 10 years to meet the region's developmental challenges.

2 Research Methodology

This policy brief employs a desk-based, mixed-evidence methodology combining descriptive analysis, gap assessment, and staged reform design. It begins by establishing a baseline of the 7th NFC Award using official data from the Ministry of Finance, NFC Secretariat, Pakistan Bureau of Statistics, and provincial budget documents, supplemented by international datasets from the World Bank, UNDP, and IMF for benchmarking. The existing formula is qualitatively assessed against Pakistan's evolving priorities such as revenue mobilization, poverty reduction, environmental sustainability, and gender equity drawing on secondary literature, legal provisions under Article 160, and credible media sources. Based on this gap analysis, the study develops a three-cycle reform model (8th–10th NFC Awards) that progressively reduces population weight and integrates performance- and sustainability-based indicators, presented as weighted allocation tables rather than computed provincial shares. The feasibility of these reforms is evaluated through political-economy analysis of stakeholder incentives, transitional mechanisms, and institutional requirements, culminating in recommendations for Article-160-compliant legal pathway and the establishment of a permanent NFC Secretariat to manage data, monitor indicators, and ensure periodic formula reviews.



3 Challenges of the 7th NFC Award

Currently, the NFC undoubtedly fulfils the purpose of resource allocation to the Centre and provinces. However, its effectiveness at engendering broader economic and social development has been questionable. Inherent challenges in the NFC can be divided into the division formula, the provincial and federal shares, alongside deeper questions of institutional deadlock stymying effective reforms. Moreover, the purpose of the NFC as simply a means of resource allocation is a significant perceptual roadblock to the NFC's overall effectiveness.

3.1 Limited Perceptual Purpose of the NFC

3.1.1 Defining the Purpose of the NFC

The currently structured National Finance Commission (NFC) is confronted with a fundamental issue in its purpose definition. If it is viewed solely as a mechanism to divide federal revenues among provinces, it fails to function as a tool for strengthening the federation. A more effective approach would be to frame the NFC to enhance efficiency, equity, and cohesion among provinces. [vii] In its present form, the NFC does not fulfil this broader federal purpose.

3.2 Formulaic Inefficiencies

3.2.1 Emphasis on Population Acts as a Moral Hazard

Another major problem lies in the overemphasis on population as a distribution criterion, which accounts for 82% of the division metric. A number of critics, including Federal Minister for Planning, Development and Special Initiatives Ahsan Iqbal, have termed the current NFC formula as "regressive" because it rewards provinces based on population growth, inadvertently creating incentives to inflate population figures. [viii] This not only undermines population control efforts but also politicizes the census and promotes a myopic view of national development. This further promotes the NFC as a performative exercise, which does not seek to engender socio-economic uplift and national development by discriminating against less populated provinces facing unique challenges.

3.2.2 Revenue Generation Given Low Importance

The low priority given to revenue generation is another concern, with a 5% provincial revenue component that discourages provinces from expanding revenue streams. [vi] The recent National Fiscal Pact, agreed between the Centre and Provinces, aims to rectify woefully low property and agriculture tax collection. However, without great impetus to provide greater incentives, provincial tax revenues are likely to underperform for fear of political blowback, thereby perpetuating dependencies on transfers.

3.2.3 Poverty Not Adequately Addressed

Poverty considerations in the current award are limited as well. Only 10.3% is allocated based on poverty, which does not reflect the severity or distribution of deprivation across provinces. Additionally, the absolute poverty metric neglects broader human development indicators that could arguably function as a better indicator of provincial necessity.

3.2.4 Sustainable Goals Not Reflected

There is little to no incentive in the NFC for provinces to prioritize sustainability, human development, or environmental protection. Pakistan's HDI ranking fell to 168th, falling into the Low Human Development category according to the UNDP. [viii] Similarly, Pakistan faces a disproportionate impact of climate change that warns of losses more than 10% of GDP by 2050,

according to the World Bank. [ix] Social indicators such as the Gender Global Gap also rank Pakistan 145th out of 146th in terms of gender parity.

Given these sizable human development and climate change challenges, the NFC's exclusion of relevant SDG metrics limits provincial growth in these domains. Efforts to advance sustainability are also a key pillar to tap the \$300 billion per annum pool created post COP 29. [x]

Additionally, the NFC award remains silent on incentivizing participation in global climate finance streams, such as voluntary carbon markets. With the rise of forest-based carbon offsets as a tool to meet both environmental and financial goals, provinces should be encouraged to establish and monetize forest carbon projects. Recognizing verified emissions' reductions through reforestation or conservation could enable provinces to tap international capital, while aligning with Article 6 of the Paris Agreement.

"Integrating Carbon Finance into NFC Planning"

The global voluntary carbon market surpassed \$2 billion in 2023, with forest-based offsets accounting for a major share.[xi] Provinces like KP and Gilgit-Baltistan, with vast forest reserves, can position themselves as leaders in nature-based solutions. Including a small incentive weight (e.g., 1–2%) for validated carbon credits can help integrate NFC fiscal planning with emerging environmental markets.

3.3 Division of resources and responsibility between Federal and Provincial Unit

3.3.1 Unsustainable Federal Pressure

Federal concerns regarding regions like Gilgit-Baltistan and Azad Jammu & Kashmir also require attention. Since these regions are not part of the NFC, the federal government bears the full cost of their development.[xii] If they continue to be excluded, a formal mechanism should be created where provinces contribute a specific share to support them with an idea already floated during the 9th NFC (2015).

Given persistent security concerns due to terrorism and heightened security risks posed by India, the Federation's fiscal space has been significantly squeezed by the 7th NFC Award. Furthermore, the interest expense of Rs7.3 trillion in FY23-24 amounts to about 95% of the total fiscal deficit. [xiii] These significant costs imposed on federal expenditures, for benefits accruing to the nation at large, necessitate a rethink of the federal share, which currently stands at 42.5%. Article 160 (6) prevents a reduction in the provincial share, thus acting as an impediment to reform.

3.3.2 Continued Federal expenditure on Devolved Responsibilities

Post 18th Amendment and abolition of the concurrent list, provincial autonomy was greatly enhanced in areas including but not limited to revenue generation, education, and health. Nevertheless, over Rs637 billion has been spent by the federal government on devolved areas in the fiscal year 2023-24. [xiv] A significant portion of these funds is allocated to social welfare

services such as Benazir Income Support Programme (BISP). The scale of expenditure for items that are provincial in nature adds greater strain to an already limited federal pool.

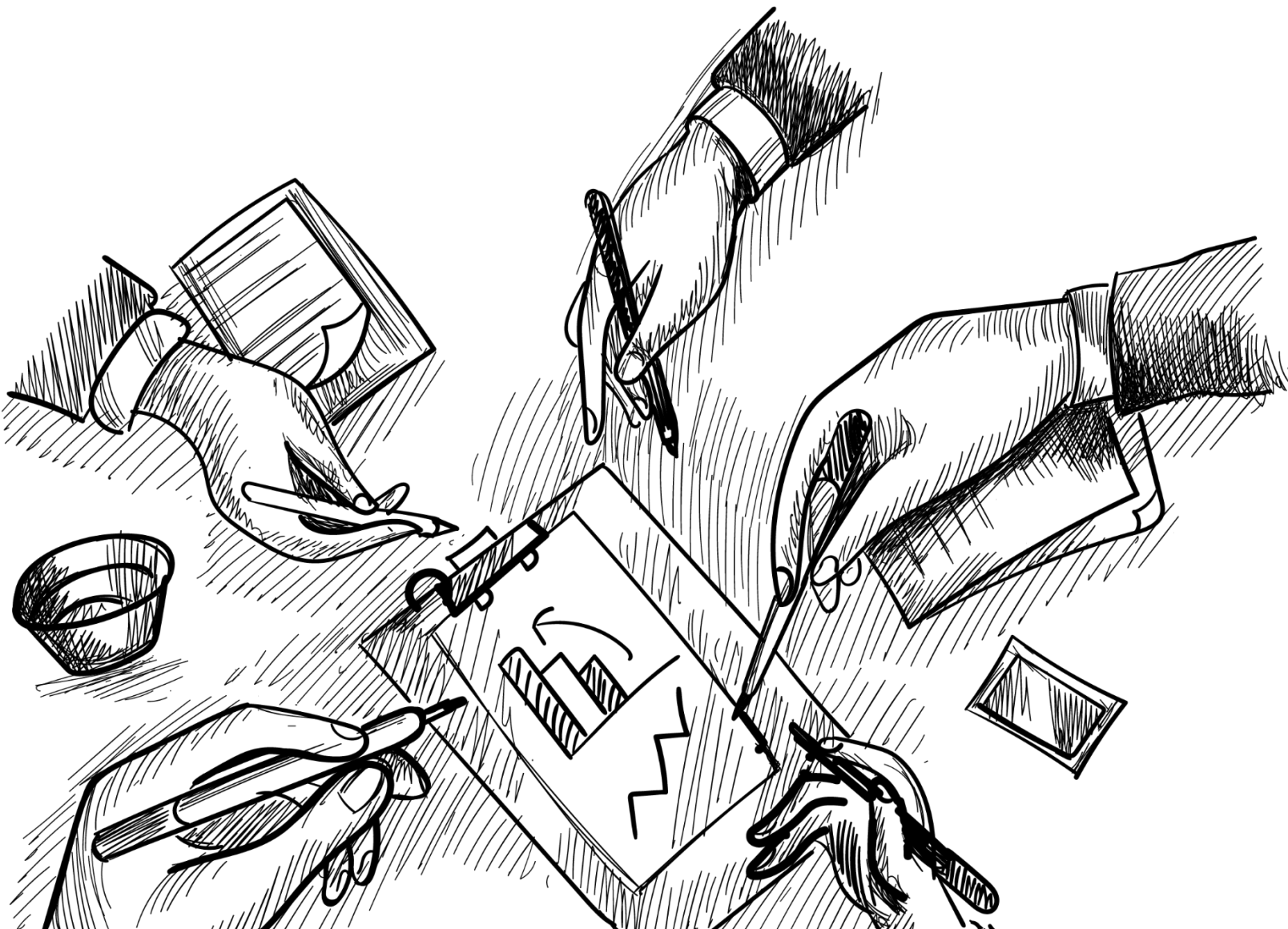
3.4 Institutional Deadlock Preventing New NFC Award

3.4.1 Consensus Difficulties in Council of Common Interests

While Article 160 necessitates a review at “intervals not exceeding five years,” the 7th NFC has continued relatively unaltered, given a lack of provincial consensus. Political disagreements between the provinces thus pose a significant challenge to ensure that regular NFC Awards are made in the national interest. [xv]

3.4.2 KP Dissatisfaction Post 25th Amendment

The 25th Amendment merged FATA with Khyber Pakhtunkhwa (KP) and also led to an agreement to increase KP's share of the divisible pool by 3% for a period of 10 years. KP claims that this ad-hoc measure has not been implemented, with a significantly reduced NFC than what KP should be entitled to. [xvi] In 2025, KP Chief Minister Ali Amin Gandapur rejected any attempts to extend the current NFC award as discriminatory. [xvii] FATA's poverty rate, the highest in Pakistan, alongside unique security challenges, only serve to exacerbate the issue. [xviii]



4 Political Economy and Feasibility

4.1 Stakeholder Incentives and Consensus-Building

The proposed reformulation of the NFC Award, particularly the phased reduction of population weightage and the introduction of performance-based and sustainability-linked criteria, is anticipated to face significant resistance from larger provinces, notably the Punjab, due to potential real or perceived fiscal losses. Recognizing this, the following strategies are recommended:

4.1.1 Data-Driven Impact Assessment:

Commission independent fiscal impact simulations for each province, quantifying the projected transfers under revised formulas. Transparent dissemination of these findings will mitigate misinformation and provide a shared evidence base for negotiations.

4.1.2 Multi-Tier Consultative Mechanism:

Institutionalize an inter-provincial working group under the Council of Common Interests (CCI), comprising representatives from provincial Finance Departments, the Federal Ministry of Finance, and the newly-proposed NFC Secretariat; (This working group should oversee model calibration and consensus-building besides initiating dialogue prior to political negotiations.)

4.1.3 Transitional Equalization Grants:

Introduce sunset-based equalization grants for provinces demonstrating net losses during the first two NFC cycles, to be phased out over a pre-defined period; (This ensures no province will experience sudden fiscal shocks during formula adjustment.)

4.1.4 Structured Communication and Public Engagement:

Develop a public information strategy, using policy briefs, experts' roundtables, and media engagement, to present the economic rationale and broader benefits of recalibrated fiscal federalism; (This will help counteract resistance rooted in status quo bias.)

4.2 Risk Analysis and Mitigation

4.2.1 Political and Institutional Risks

- **Political Contestation:**
Heightened inter-provincial competition and possible politicization of census or poverty statistics may impede consensus.
- **Implementation Delays:**
Weak administrative capacity and lack of reliable disaggregated data may hinder operationalization of new indicators.
- **Policy Reversals:**
Change in federal or provincial government leadership could lead to reversal or stalling of reform commitments.

4.2.2 Risk Mitigation Measures

- **Third-Party Oversight:**
Engage credible national and international institutions to provide technical review and arbitration of formula design, data integrity, and dispute resolution.
- **Staggered Implementation:**
Operationalize a phased transition in three distinct NFC cycles (see roadmap below), with pilot implementation of new indicators (e.g. gender, climate) in one or two provinces prior to national rollout. Pilot results should inform refinement.
- **Capacity Building Initiatives:**
Establish dedicated federal and provincial technical assistance units, financed via earmarked federal grants and international donor support, to improve provincial capacities in data management, revenue mobilization, gender budgeting, and climate governance.



4.3 Phased Implementation Roadmap

Table 2: Phased Implementation Roadmap for NFC Reform

Phase	Milestones & Activities	Timeline	Responsible Institutions	Review & Accountability
Phase 1	Establish NFC Secretariat; create inter-provincial working group; baseline data studies	6 months	MoF, NFC Secretariat, CCI	CCI bi-annual review
Phase 2	8th NFC: Implement revised formula (Population 60%, Poverty 20%, Revenue 20%); initiate equalization grants; provincial capacity building programmes	Years 1-2	NFC Secretariat, Provincial Fin. Depts	Annual progress reports, CCI oversight
Phase 3	9th NFC: Integrate climate/forest indicators (5%), population down to 55%; pilot climate and gender indicators	Years 3-5	NFC Secretariat, MoCC, third-party auditors	Annual and mid-term external evaluation
Phase 4	10th NFC: Full integration of gender (5%) and climate (5%) components; population at 50%	Years 6-8	NFC Secretariat, MoF, MoCC, CCI	Comprehensive performance audit, public reporting

4.3.1 Institutional Arrangements:

- Legally constitute a permanent, autonomous NFC Secretariat by executive order, with statutory reporting lines to both the Ministry of Finance and the CCI.
- Mandate that each province, within its Finance Department, designate an NFC focal person, who is responsible for indicator data collection and intergovernmental coordination.
- Embed technical support units for gender-responsive budgeting and climate finance readiness within the NFC Secretariat.

5 Methodological Approach for the Proposed NFC Formula

The model followed in the revision of the NFC formula is a microcosm of performance-based, sustainability-oriented, and need-based indicators, thus facilitating the ability of fiscal transfers to appeal to both the future developmental demands and preexisting interprovince inequalities.

The following tables form a disaggregate plan to reform the National Finance Commission Award, and under this plan NFC 08 will be the base year; NFC 09 will form the first stage of the plan; and NFC 10 will be the final stage of the plan. This transformation aims at reducing a focus on population as the central criterion of fiscal transfers and introducing performance and sustainability-oriented indicators at the same time that reflect Pakistan's socio-economic and climate-related priorities that are shifting.

Table 3: Proposed 8th NFC Award Criteria

Component	Weightage	Explanation
Population	60%	Retains population as the dominant factor to ensure baseline equity in service delivery, reflecting the number of people requiring public goods.
Revenue Generation	20%	Encourages provinces to enhance their own-source revenue by rewarding fiscal effort, revenue growth, and diversification of tax streams.
Poverty Reduction	20% (10% for poverty level, 10% for reduction)	The component is bifurcated: 10% weight is based on the absolute poverty level in a province (measured by indices such as MPI or headcount ratios); the remaining 10% rewards provinces for demonstrable year-on-year reductions in poverty. This dual structure incentivizes both immediate support for poor provinces and continuous progress in poverty alleviation.

The current NFC formula is organized in three staggered phases (NFC 8 to 10), which carries with it a strategic change of mechanism of population to that of a performance mechanism. The table presents component-based weightings, and it is necessary to discuss deeper the reasons, implications, and policy outcomes accompanying each specific variable. This discussion then examines the individual element in the larger picture of the dynamic demographics, budgetary scenario, Sustainable Development Goals, and constitutional imperative in the context of Pakistan.

5.1 Population (60%-50% over the course of 3 NFC awards)

The horizontal allocation of federal revenue among provinces given a weight to population under the 7th NFC Award is 82% part of the equation, which makes it the deciding factor in the equation. The means of achieving equity was voiced by the methodology which required that more populations would require proportional contributions on allocating available resources to offset the expenses of governing. Over time, this formula has brought with it an even greater number of distortions and has created inter-provincial hostility. The further demographic changes of Pakistan that have occurred since then, the increasing urbanization, the structural aging and the growing intra-provincial difference proves that the previous mechanism has become outdated. Provinces like the Punjab and Sindh deal with excessive urban densities, and places like Khyber Pakhtunkhwa and Balochistan are faced with underdeveloped infrastructure and dispersed population that is settled in the Punjab and Sindh. These shifts in patterns highlight the necessity

of a new formula for taking care not only of the size of population but also of the sophistication of development demand, regional capacities and demographic stresses. Based on this, the consideration of the fiscal and governance implications of population weight is essential.

5.1.1 Why is a change in population weightage necessary?

Population is strongly rewarded under the current NFC Award that it biases development and disadvantages provinces that controlled their population. This method discourages attempts to manage population and opposes the country's National Population Policy 2021 and its Sustainable Development Goals (SDGs). Furthermore, because of the high population weight, provinces may manipulate census results to generate more funding. During the debates on 2017 and 2023 census results, there were many controversies in Sindh and Balochistan. Owing to the way it works, the formula makes it harder for provinces such as Balochistan to develop because they spend more on basic services than other provinces, regardless of the number of people living there. Using a fixed demographic measure to distribute most federal transfers can only reward large populations and not those who improve governance and poverty.

5.1.2 Rationale for the proposed reform plan

The planned change is to progressively lower the population weight from 60% in the 8th NFC Award to 50% in the 10th NFC Award. This gradual adjustment maintains population as a fundamental driver of fiscal allocation, recognizing its importance in public service delivery while making room for other dynamic and policy-relevant factors. A weightage of 50-60% continues to reflect the real service burden that provinces bear as a result of their population size, ensuring that equitable access to resources is prioritized. Simultaneously, reducing population dominance frees up economic space for rising policy imperatives like gender equity, environmental sustainability, and poverty reduction performance. This adjustment brings the NFC framework in line with Pakistan's broader policy objectives such as family planning goals, decentralized governance under the 18th Amendment, and the emerging green federalism paradigm, which prioritizes climate-resilience and inclusive development.

5.2 Poverty 20% (10% for poverty level, 10% for reduction)

The 7th NFC Award allocates 10.3% for poverty and backwardness, making it a secondary factor in resource distribution. At that time, this allocation to poverty and backwardness might have reflected the lack of provincial capacity for targeted interventions and limited data availability. Now, the poverty demographics in Pakistan have changed. Though few provinces have made gains from the BISP, others continue to be deprived, especially rural Sindh and Balochistan. Moreover, the current existing formula fails to account for reduction in poverty and incentivize it.

5.2.1 Why is Change in Poverty Weightage necessary?

Change in the poverty component in the NFC Award has become a necessity in Pakistan, especially because the current weightage does not differentiate amongst the provinces that are working on poverty reduction and those that are operating without targeted improvements. The current NFC Award does direct resources to deprived provinces based on poverty-based allocation, but it does not reward provinces based on the introduction of effective poverty reduction strategies, expansion of social safety nets, or improvement in human development. The current system relies solely on static poverty data, neglecting the progress that has been made in multidimensional areas such as health care, education, clean water, and nutrition that are vital for sustainable development. Based on this, the NFC remains reactive rather than enabling. This stresses the need

to evolve the NFC Award into a tool that focuses on short-term and long-term relief from poverty alleviation.

5.2.2 Rationale for the proposed reform plan

The planned change assigns 20% to poverty reduction, equally splitting between the current poverty levels (10%) and year-on-year improvement (10%). This dual based structure helps in balancing the need-based support with performance. This revised formula would help in providing provinces with higher poverty rate with the fiscal space to meet their basic service's needs, while those provinces that have significantly reduced poverty would be awarded based on their effective policy implementation. This revised formula would not only help strengthen equity across the provinces but also encourage healthy competition amongst them besides helping in data driven policy making. This revised formula would help in tracking both deprivation and progress, transforming the NFC Award from a redistributive mechanism to a development focused fiscal instrument.

5.3 Revenue Generation (20%)

The 7th NFC award awarded only 5% to revenue generation, providing provinces with the room to not focus on increasing their tax base and revenue generation. This allocation was done because the provinces relied heavily on federal taxes and lacked the capacity to further broaden their fiscal space. However, after the 18th Constitutional Amendment and the rising expenditure costs such as education and health, provinces are required to fund a large share of their development budget, therefore in nexus with economic constraints and fiscal shocks, provincial revenue generation has become crucial and necessary. Strengthening this component in the NFC Award is vital for sustainable inter-governmental finance.

5.3.1 Why is Change in Revenue Generation Weightage necessary?

There is a need to change the current NFC formula because it allocates only a minor portion towards revenue generation, providing no incentive to provinces in enhancing their fiscal performance. Provinces such as Sindh that have introduced reforms to improve their tax collection systems receive no recognition, undermining the spirit of fiscal federalism and discouraging investment in public finance. With the increase in expenditure responsibilities, post 18th amendment, the federal fiscal space continues to shrink providing a reason for provinces to be encouraged to increase their revenue through their own resources. This would help in closing the fiscal gaps, supporting decentralized development planning, and fiscal equity.

5.3.2 Rationale for proposed reform plan

The planned change allocates 20% to revenue generation, which is split into revenue growth (10%), diversification (5%), and revenue-to- GSDP ratio (5%). This would create a fair, performance-based fiscal incentive for the provinces. In the revised formula, the provinces would be assessed relative to a fixed base year. This would ensure that large and small economies can compete based on their performance instead of their absolute size. The revised change promotes provinces broadening their tax base, encouraging provinces to reduce reliance on unpredictable federal transfers, and improve compliance. This new formula supports long-term reforms regarding tax administration and aligns with Pakistan's commitments for resource mobilization and IMF's fiscal benchmarks.

6 Phased Fiscal Reforms

6.1 8th NFC Award

The eighth National Finance Commission (NFC) Award proposes a much-amended formula of equitable distribution of federal financial resources among the provinces. Having cut the population component by 25 per cent (85 to 60 per cent), it reorganizes the fiscal architecture to a more incentive-based model. It is accompanied by an allocation of 20 per cent of the weight to provincial revenue generation and 20 per cent allocation to poverty reduction. The enhanced design, therefore, promotes fiscal decentralization as it involves a shift in the focus on demographic factors only to performance indicators. Furthermore, the 8th NFC Award institutionalizes the anticipation that the provinces play a more semi-autonomous financial role given the devolution of power under the Eighteenth Amendment for key responsibilities such as education, health care, and social welfare. The inclusion of such performance measures indicates a distinct shift in the direction of abandoning the homogeneous, need-based model and moving towards a more differentiated condition-controlled allocation of federal revenue in the following cycles.

6.2 9th NFC Award

The framework from the 8th NFC Award has been further strengthened in the proposed 9th NFC by giving environmental sustainability a lead role in intergovernmental finance. A special emphasis on forest areas by including 5% recognition reflects how Pakistan is moving to coordinate its national budget with its climate commitments in the Paris Agreement, its Nationally Determined Contributions (NDCs) and its target. Through this step, the NFC award grants Khyber Pakhtunkhwa its benefits for leading forestation and reforestation and motivates other provinces to pay greater attention to land use planning, protecting forests and responding to climate shifts. The parts of the reform now are population (55%), revenue generation (20%), and poverty reduction (20%), helping maintain its shape as the fiscal conversation moves toward supporting nature. The switch to the 9th NFC now includes considering what the nation's ecology and environment add to economic and population growth. Furthermore, as global interest in voluntary carbon markets continues to grow, NFC reforms should integrate carbon finance readiness by rewarding provinces that engage in climate obligations. Moreover, provinces that develop validated carbon offset projects under international voluntary standards, such as Verra or Gold Standard, thereby contributing to Pakistan's

Table 4: Proposed 9th NFC Award Criteria

Component	Weightage	Explanation
Population	55%	Begins the transition away from population dominance, reallocating resources to more strategic development priorities.
Revenue Generation	20%	Maintains emphasis on fiscal performance, aiming to promote provincial autonomy and reduce dependency on federal transfers.
Poverty Reduction	20% (10% for poverty level, 10% for reduction)	Continued dual focus: the static component addresses current deprivation while the dynamic component promotes year-on-year improvement in social indicators.
Forest Cover	5%	Introduces environmental stewardship into the NFC framework. Provinces with higher forest cover or afforestation gains are rewarded to align with Pakistan's climate commitments and SDG targets.

6.3 10th NFC Award

Moving on, the 10th NFC Award prioritizes gender equity with the focused attention of having a 5% weight gain. With this addition, Pakistan shows that promoting sustainable development requires addressing imbalances in education, health, work and leadership between men and women. Provinces would be assessed based on gender indicators like labour force literacy, female literacy, access to health care, and participation in leadership roles. The 10th NFC Award would help in institutionalizing fiscal rewards by focusing on gender equity which brings more women into government and leadership roles in provinces encouraging provinces to adopt gender approaches in their spending plans. At the same time, the forest cover part (5%) stays intact, helping to continue environmental efforts. When you reduce the share of population to 50% and keep revenue generation and poverty reduction at 20% each, the 10th NFC makes for a comprehensive and developed fiscal setup. It means moving from simple equity to stressing development, equality and the ability to handle climate change with resource division now leading to change in federalism.

Table 5: Proposed 10th NFC Award Criteria

Component	Weightage	Explanation
Population	50%	Achieves the final target for population share, thereby creating fiscal space for emerging policy imperatives like gender equity and climate resilience.
Revenue Generation	20%	Sustained priority for enhancing domestic resource mobilization at the provincial level.
Poverty Reduction	20% (10% for poverty level, 10% for reduction)	Upholds the twin-track poverty strategy. Provinces are encouraged not only to support their poorest populations but also to actively implement and scale up poverty reduction interventions.
Forest Cover	5%	Reinforces the role of green development in fiscal planning. Provinces that protect or expand natural forests will be recognized for their contribution to environmental stability.
Gender Equity	5%	A new criterion introduced to advance inclusive development. Provinces will be evaluated based on gender-sensitive indicators including female labor force participation, education, healthcare access, and political representation. This aligns with Pakistan's national commitments to SDG 5 and international frameworks such as CEDAW.

7 Legal and Constitutional Considerations: Navigating Constitutional Provisions

7.1 Article 160 Compliance:

Ensure that the reconfiguration of formula weights does not reduce the absolute provincial share, thus remaining within constitutional bounds. Emphasize that the reforms are a recalibration of horizontal distribution, and not a diminution of overall transfers.

7.2 Legislative and Executive Action:

- Amendments to the NFC Award formula are to be negotiated under CCI, formalized by Presidential Order under Article 160 (1).
- NFC Secretariat to be notified through a Federal Cabinet decision, subsequently ratified by the CCI.
- Executive rules to empower the NFC Secretariat with explicit mandates for data collection, performance review, and indicator updating.

7.3 Precedent and International Law:

Justify integration of gender and climate metrics with reference to Pakistan's SDG commitments and Paris Agreement obligations, which provide legal and normative legitimacy for reforms.

8 Policy Recommendations

- **Progressively Reduce Population Weightage**
Gradually reduce the population component from 82% to 50% across the three NFC cycles. This shift enables more development-focused metrics while discouraging census politicization and inflated population figures.
- **Split Poverty Component into Static and Dynamic Metrics**
Allocate 20% of resources to poverty, divided equally between current poverty levels and measurable year-on-year reductions. This promotes both immediate support and long-term poverty alleviation strategies.
- **Enhance Revenue Generation Incentives**
Assign 20% to revenue generation, distributed across revenue growth (10%), tax base diversification (5%), and revenue-to-GSDP ratio (5%). Use fixed base years to ensure fair inter-provincial comparisons.
- **Integrate Environmental Performance through Forest Cover**
Introduce a 5% weight for provinces with high forest cover or afforestation achievements from the 9th NFC onward. This reinforces Pakistan's NDCs under the Paris Agreement and rewards green provincial planning.
- **Institutionalize Gender Equity Indicators**
Allocate 5% weight to gender equity in the 10th NFC. Metrics should include female education, labour force participation, health care access, and political representation aligned with SDG 5 and CEDAW.
- **Promote Readiness for Voluntary Carbon Markets**
As voluntary carbon markets expand globally, NFC reforms should integrate carbon finance readiness by rewarding provinces that credibly engage in forest carbon offset initiatives. This would incentivize sustainable land use, strengthen climate governance, and unlock new revenue aligned with Pakistan's international climate obligations.
- **Establish a Permanent NFC Secretariat with Technical Expertise**
To address recurring institutional deadlock and ensure continuity in fiscal federalism, a permanent NFC Secretariat should be established. This body should be composed of independent technocrats, public finance experts, and economists tasked with developing, reviewing, and updating NFC formulas based on evidence and policy priorities rather than political expediency. By reducing political bias in NFC deliberations and embedding technical rigour, the Secretariat would facilitate transparent intergovernmental negotiations, produce regular fiscal performance reviews, and ensure timely compliance with Article 160 of the Constitution.

9 Conclusion

Pakistan's current National Finance Commission structure, based on the 7th NFC formula, favours the demographic weighting over nation-wide developmental goals. Though this system has paved the way for provincial fiscal autonomy through increased shares and widened divisible pool, the over central theme of population has produced distortions, inefficiencies, and increasing distemper especially among low-density, undeveloped provinces. The current NFC Award primarily addresses non-technical challenges, notably structural deficiencies in governmental and political institutions, manifested in systemic predictability, asymmetries in federal authority and powers, and inadequate alignment of fiscal transfers with poverty-reduction, revenue-mobilization, and the long-term sustainability of fiscal federalism. This study offers a potential structural overhaul of the National Finance Commission (NFC) under the 8th, 9th and 10th Award cycles in perspective. Against the existing constraints, it is proposed that the rebalancing should be achieved through the proposed adjustments of lowering the population distribution weight to 50 per cent against increasing revenue generation weightage, poverty reduction allocation, forest cover expansion and gender basis. This gradual transformation would be one of the defining turning points to induce a shift in poor governance performance, social equity, and in line with its pursuant requirements under the SDGs and the Paris Agreement.

By including measures such as year - on - year poverty reductions, domestic resource mobilization, forest cover and gender equality in the fiscal structure, the revised formula tries to strengthen the NFC as the true foundation of national harmony and progress. Instead of just a resource distribution mechanism, the new NFC focuses on strengthening provincial competition, promoting fairness and building resilience amongst the provinces.

The reform will succeed if it is supported by the right political moves, good communication among government institutions and ideas shared by government officials at both levels. If Pakistan wants to be a fair and dynamic country, it must remake its financial structure to match the needs of the 21st century and federal principles.

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