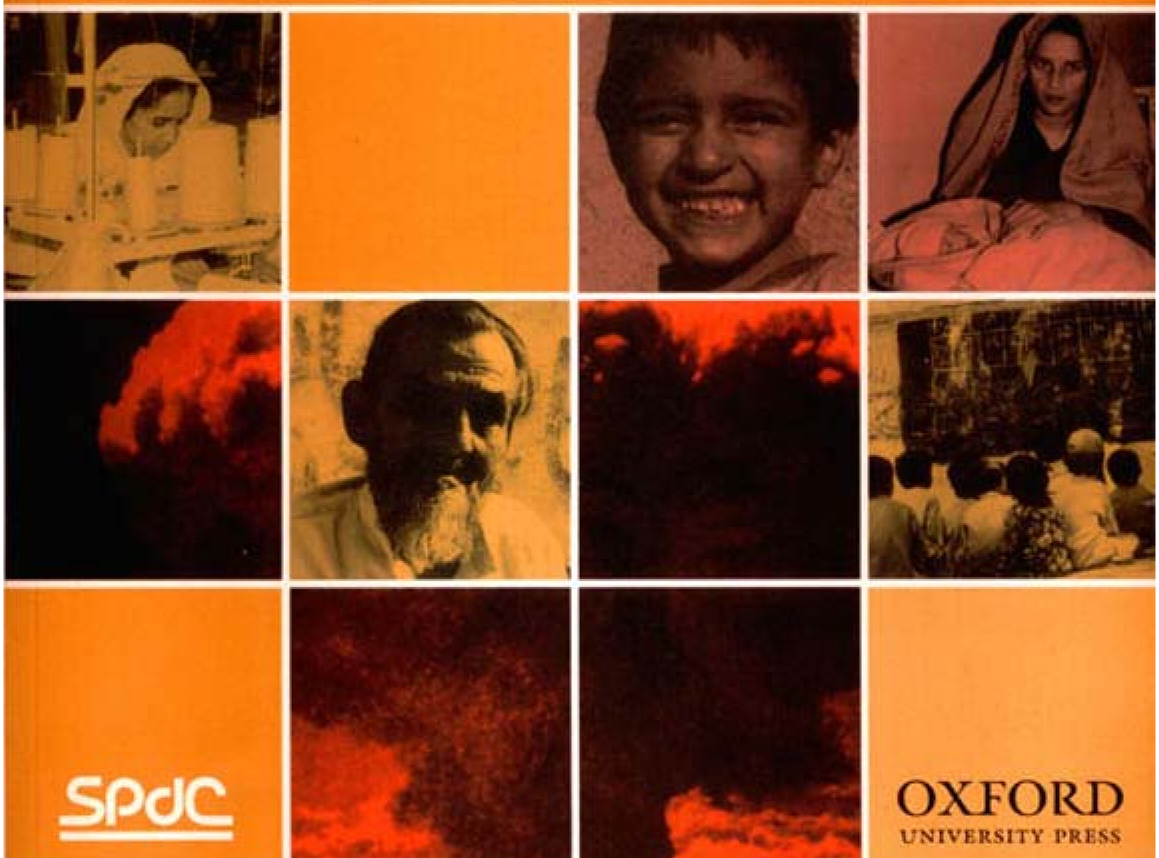
SOCIAL DEVELOPMENT IN PAKISTAN

ANNUAL REVIEW
1999

Social Development in Economic Crisis



SPDC

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SOCIAL POLICY AND DEVELOPMENT CENTRE

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FOREWORD

Crises are part of a nation's history. Periods of crisis provide the leadership an opportunity to rebuild a sound social and economic order which can steer the nation towards a process of recovery and revival; otherwise the country risks drifting even deeper into a quagmire. It is commonly perceived that Pakistan's economic crisis is more serious than at any other time in the past. Some argue that it is a direct consequence of the nuclear blasts and the resulting sanctions in May 1998. Others are of the view that there is a deep and festering economic malaise caused by problems of governance which had to eventually culminate in a crisis. Whatever the contributing causes, Pakistan today not only has severe macroeconomic imbalances but, at the micro level, widespread evidence of institutional decay, burgeoning law and order problems and ethnic or sectarian strife. As a result, there is serious erosion of the country's momentum for future progress.

Pakistan has chosen the path of going back to a IMF/World Bank program and has obtained debt rescheduling from the Paris Club. However, this is only a temporary respite. We must use the breathing space to resolve in a determined manner, the outstanding structural problems which impede growth and decide on a strategy to mitigate the impact of the crisis and improve the quality of life for the people.

Social Development in Pakistan, Annual Review 1999 deals with the subject of *Social Development in Economic Crisis*. Chapter 1 traces the long-term and short-term causes of the crisis. Chapter 2 analyzes the various strategic options available to the country, including a path of self-reliance, to achieve sustained development. Chapter 3 traces the impact of each option on some of the key social dimensions including poverty, unemployment and the status of women and children.

Given the prospect of rising poverty, the review examines the adequacy of different social safety nets in Pakistan. Chapter 4 looks at the Social Action Program and concludes that the program is in jeopardy due to growing fiscal constraints and needs to be revitalized through radical institutional reforms. Chapter 5 evaluates a number of other social safety nets, both of the government and NGOs. The analysis indicates that in most cases both coverage and targeting efficiency are low, primarily because of lack of financial and institutional support. The review concludes that at a time when poverty and unemployment are rising, our institutional framework is inadequate to handle the problem. Both government and civil society at large will need to launch a concerted program against poverty if we are to ensure that the majority of the people do not suffer inordinately during the structural adjustment process that we have embarked upon.

This review has been prepared as SPDC's humble contribution to promoting an understanding of the links between changes in the macro economy and the process of social development. Our hope is that this report will be of interest to government officials, government organizations, multilateral and bilateral donors and researchers, as well as members of non-government organizations, private sector and civil society at large — indeed to all those who share a concern about Pakistan's prospects for social development at this difficult time.

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SOCIAL POLICY AND DEVELOPMENT CENTRE

Established in 1995, the Social Policy and Development Centre (SPDC) is a private sector research organization that serves as a focal point for policy-relevant research on social sector development. Using a multidisciplinary approach, the centre assists both public and private sector institutions and non-governmental organizations to plan, design, finance, execute and manage social sector programs in a cost-effective manner. The results of its research are made available to policy makers, interested groups and the general public to promote informed discussion and action on vital social sector issues.

SPDC is independent and non-partisan and cooperates with a wide range of organizations working in related areas, within Pakistan and internationally. It determines its own pace-setting research agenda within the parameters of its mandate and objectives, and maintains autonomy, flexibility and balance between responsive and proactive social sector research. Key activities include research and policy analysis; social sector government database support; pilot project monitoring and evaluation; training of government, private sector and non-governmental organizations; and information dissemination through publications, conferences, seminars and workshops.

The SPDC evolved from a four-year process of research and training funded by the Canadian International Development Agency (CIDA). The Canadian Advisory Agency (CAA) provides advisory services and support to strengthen the SPDC and help it achieve its mandate. Led by Cowater International, the CAA is a consortium that includes the Institute on Governance and the University of Western Ontario.

The SPDC Board of Directors consists of eminent personalities selected for their commitment to social sector development and their belief that the use of analytical tools in developing public policy is necessary to ensure sustainable social sector development. It includes:

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C H A R T S

T A B L E S

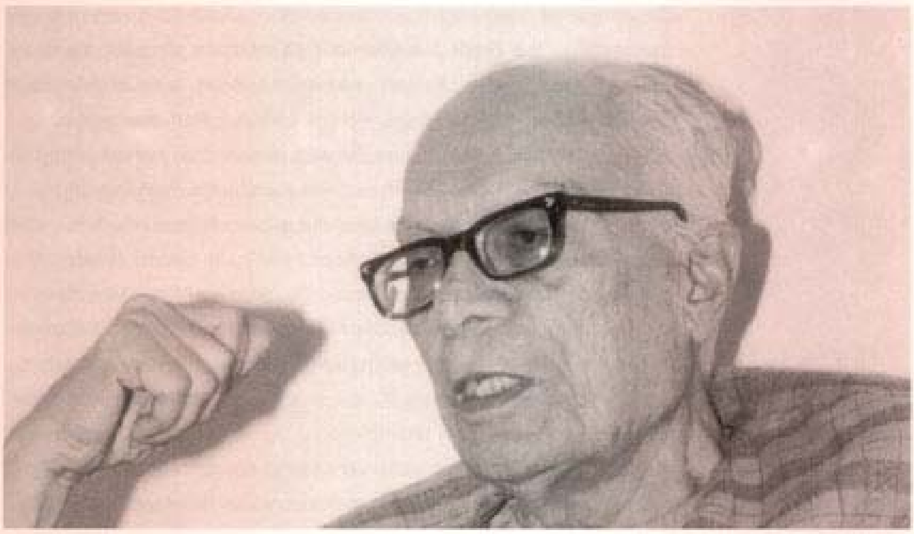
ACRONYMS

ADB	Asian Development Bank
AGP	Auditor General of Pakistan
AIE	Ali Institute of Education
AIT	Agricultural Income Tax
AJK	Azad Jammu and Kashmir
ASS	Atta Subsidy Scheme
AUS$	Australian Dollar
BHU	Basic Health Unit
BMN	Basic Minimum Needs
BOP	Balance of Payments
BOR	Board of Revenue
BRAC	Bangladesh Rural Advancement Committee
CACL	Coalition Against Child Labor
CAR	Commission on Administrative Restructuring
CBO	Community-based Organization
CHC	Community Health Committee
CIDA	Canadian International Development Agency
CO	Community Organization
CTBT	Comprehensive Test Ban Treaty
DFI	Development Financial Institution
EFF	Extended Fund Facility
EOB	Employees' Old-Age Benefits
EOBI	Employees' Old-Age Benefits Institution
ESAF	Enhanced Structural Adjustment Facility
ESCAP	Economic and Social Commission for Asia and Pacific
FANA	Federally Administered Northern Areas
FATA	Federally Administered Tribal Areas
FBS	Federal Bureau of Statistics
FCA	Foreign Currency Account
FDI	Foreign Direct Investment
G7	Group of Seven
GDP	Gross Domestic Product
GM	General Manager
GNP	Gross National Product
GOP	Government of Pakistan
GRP	Gross Regional Product
GST	General Sales Tax
HBFC	House Building Finance Corporation
HDI	Human Development Index
HIES	Household Income and Expenditure Survey
HUBCO	Hub Power Company
IEC	Information Education and Communications
IFA	Individual Financial Assistance
IFI	International Financial Institution
ILO	International Labour Organization
IMF	International Monetary Fund
IPP	Independent Power Producer
ISPM	Integrated Social Policy and Macroeconomic model

JRY	Jawahar Rojgar Yojuna
KAPCO	Kot Addu Power Company
KESC	Karachi Electric Supply Corporation
KWSB	Karachi Water and Sewerage Board
LGRDD	Local Government and Rural Development Department
LHW	Lady Health Worker
LHWP	Lady Health Worker Program
M&E	Monitoring and Evaluation
MDCP	Mansehra District Council Program
MEGS	Maharashtra Employment Guarantee Scheme
MICS	Multiple Indicators Cluster Survey
MNA	Member of the National Assembly
MPA	Member of the Provincial Assembly
MSU	Multi-Donor Support Unit
MYRADA	Mysore Resettlement and Development Agency
NAHP	Northern Areas Health Project
NFBE	Non-Formal Basic Education
NFC	National Finance Commission
NGO	Non-Government Organization
NGORC	NGO Resource Centre
NIH	National Institute of Health
NRSP	National Rural Support Program
NSS	National Savings Schemes
NWFP	North West Frontier Province
OGDC	Oil and Gas Development Corporation
O&M	Operations and Maintenance
OPP	Orangi Pilot Project
P&D	Planning and development
PBM	Pakistan Bait-ul-Mal
PCO	Population Census Organization
PDP	Participatory Development Program
PFP	Policy Framework Paper
PHED	Public Health Engineering Department
PIHS	Pakistan Integrated Household Survey
PMLC	Prime Minister's Literacy Commission
PML (N)	Pakistan Muslim League (Nawaz Group)
POL	Petroleum Oil and Lubricants
POPI	Poverty of Opportunity Index
PPAF	Pakistan Poverty Alleviation Fund
PSDP	Public Sector Development Program
R&M	Repairs and Maintenance
RHC	Rural Health Centre
RP	Regional Professional
RPO	Regional Professional Office
Rs.	Rupees
RWSS	Rural Water Supply and Sanitation
SAL	Structural Adjustment Loan
SAP	Social Action Program
SAPP	Social Action Program Project
SBFC	Small Business Finance Corporation
SBP	State Bank of Pakistan
SDC	Swiss Agency for Development and Cooperation

SKAA	Sindh Katchi Abadis Authority
SMC	School Management Committee
SNGPL	Sui Northern Gas Pipeline Limited
SO	Social Organizer
SOE	Statement of Expenses
SPDC	Social Policy and Development Centre
SPO	Strengthening Participatory Organization
SSGCL	Sui Southern Gas Company Limited
TOP	Terms of Partnership
TPV	Third Party Validation
UK	United Kingdom
UNDP	United Nations Development Program
UNFPA	United Nations Fund for Population Activities
UNHCR	United Nations High Commissioner for Refugees
UNICEF	United Nations Children's Fund
USA	United States of America
US$	United States Dollar
WAPDA	Water and Power Development Authority
WB	World Bank
WFP	World Food Program
WHO	World Health Organization
WTO	World Trade Organization

Views of a Leading Social Sector Personality



"Governments pay lip service to a welfare state but without supporting the system and administration needed to support a welfare state."

— Dr. Akhtar Hameed Khan

Dr. Akhtar Hameed Khan is a world authority on self-reliance for social development. A keen student of history, a scholar of Persian, Arabic and Pali, and a poet in the post-Indian Mutiny tradition of Hali and Azad, Dr. Khan began his career with the Indian Civil Service. After resigning from the Service about 50 years ago, he established the Rural Development Academy at Comilla. There he initiated the Comilla Project which has been a model of rural development in many countries. He was a Visiting Professor at Michigan State University in 1973 where he was awarded an honorary LLD. In 1980 Dr. Khan became the director of the Orangi Pilot Project (OPP) whose goal was to improve the lot of the migrant Biharis who had settled in Orangi. Dr. Khan has been the recipient of many awards in recognition of his work: the awards of the Sitara-e-Pakistan and the Hilal-e-Pakistan in this country, and the prestigious Magsaysay Award in the Philippines.

The low level of social development in Pakistan, Dr. Khan says, is the result of three major factors. The first is the lack of recognition within Pakistani society of the interconnections among the social sectors, and the lack of sympathy among the rulers for the poorer segments of society.

The total living environment is critical to social development. Dr. Khan says that his work with poor people tells him that the most important elements of social development are housing, sanitation, health, hygiene, population welfare, education and skill development. Unfortunately, he says, this view is neither understood nor practised by some of the leading social development policy makers in Pakistan.

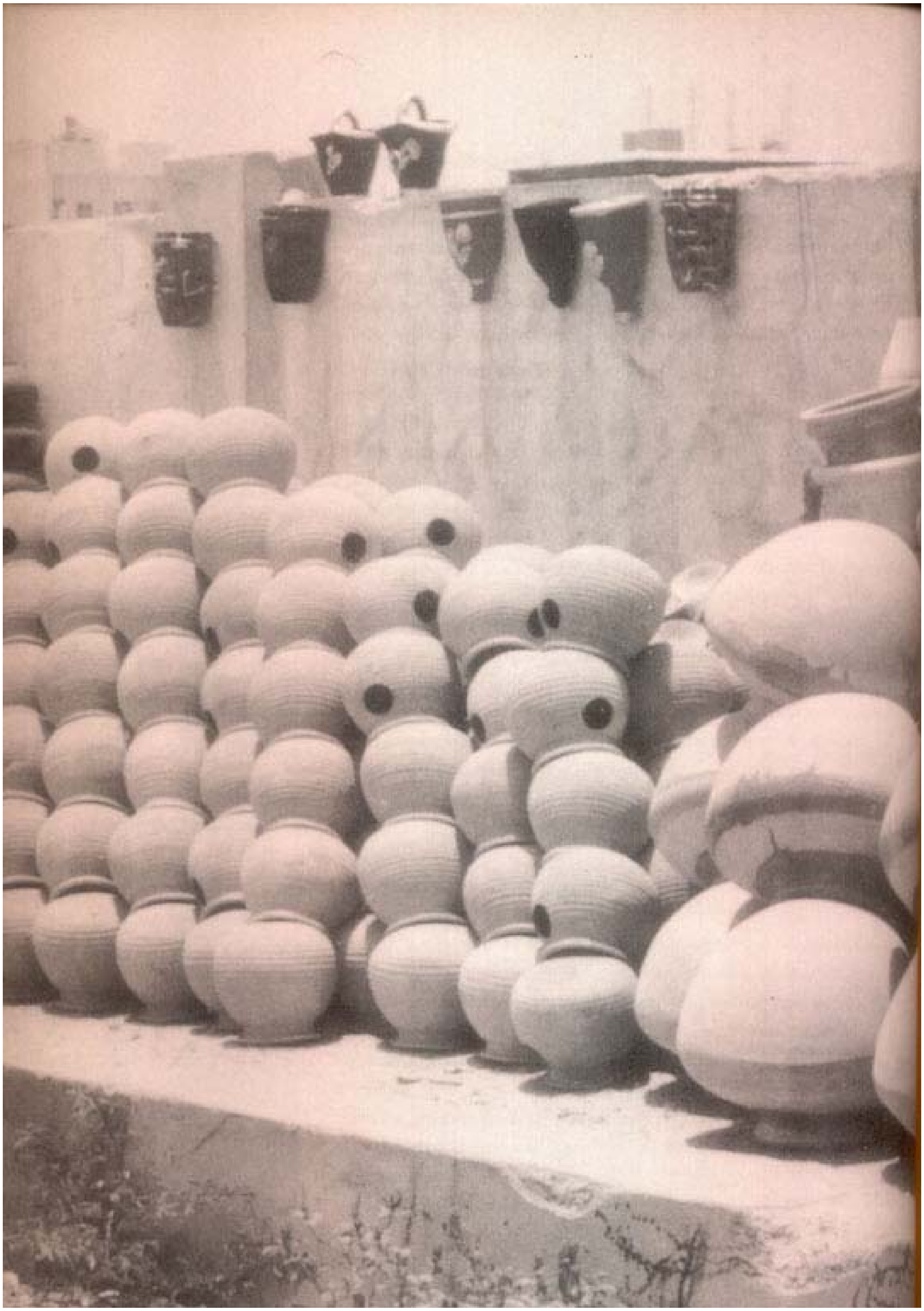
The second major factor that hinders social development, Dr. Khan believes, is that learning is not connected to the development of skills needed for jobs. This situation is exacerbated by the lack of new employment opportunities coupled with the ever-expanding labour force resulting from the high population growth rate. Dr. Khan points out that this has created a disenchanted segment in the population which has turned to crime.

The third factor contributing to low social development is the deteriorating quality of governments in Pakistan. Effective and accountable local government units have been replaced by a weak central government. Governments pay lip service to a welfare state but without supporting the system and administration needed to support a welfare state. Moreover, governments have institutionalized corruption, through the MNA/MPA programs, and created a culture of tax evasion through weak tax administration, a laissez faire attitude towards the growth of the informal economy and excessive reliance on foreign aid. Pakistan is faced with a "double default" situation, a government that can't deliver, and a civil society in anarchy. Dr. Khan warns that "even a revolution, such as that by Mao and Khomeini, I fear, will not be able to rectify this situation. We will continue to see a state in anarchy."

History gives us insight into the reasons for the rise and fall of great empires and nations. Successful nations recognize the importance of good governance, which implies transparency and accountability in the process of development and active participation by the people. Dr. Khan says that the Orangi Pilot Project and the Comilla Project have benefited from those lessons from history, as have some NGOs. Multi- and bi-lateral donors have also learned from these experiments and are trying to replicate the models in their own jurisdictions. Dr. Khan regrets that successive governments in Pakistan have not learned from these experiments in their backyard.

The OPP from the outset advocated the philosophy of self-reliance rather than dependence on the hollow promises of politicians and bureaucrats, Dr. Khan says. This approach was backed by research into developing alternative technologies which communities could afford. For example, OPP's sanitation program offered a pit latrine at a substantial savings to households. It also reduced the incidence of such diseases as typhoid which would cost a family as much as a month's salary with each incidence. The OPP also showed that using small bore sewers to remove stagnant water would both increase property values and reduce expenditure on curative health care. The OPP took six months to build the first lane sewer, and in about four years the process of self-reliance became sustainable: today there are enough OPP-trained artisans and skilled workers to install the lane sewers themselves, without OPP's involvement.

After five years' effort, the OPP's credit program achieved similar success in inculcating the values of honesty and hard work. Dr. Khan says that the OPP initially faced considerable opposition because governments would promise "free lunches" while the OPP insisted on beneficiary contribution. The OPP has, however, been able to overcome this barrier. In its first five years, there was a loan default ratio of about has been done in Bangladesh, by officials of the Sindh Katchi Abadis Authority and by some NGOs in Pakistan. What is needed is the commitment of a small group of officials backed by political will. Planning officials should visit the grass root levels to understand and respond to the hopes and needs of the people. They should adopt affordable technologies that work in real life. They should move away from dependency and take on the mantle of self reliance.



THE ECONOMY IN CRISIS

CHAPTER 1

"The nation is facing a multifaceted dilemma following the nuclear blasts in May 1998 and subsequent imposition of sanctions."

THE ECONOMY IN CRISIS

BACKGROUND

Crises are a common and integral component of progression in a nation's history. It is how that nation deals with its crises that is the issue. Its leaders can seize the chance to modify and rebuild a sound social and economic order which steers the nation onto a more lasting path of progress. Or they can fritter away the opportunity and allow the country to sink into a quagmire.

Nationalists and optimists label the current situation in Pakistan not a crisis but an indicator of resilience and a demonstration of the ability to surmount difficulties. Pakistan's currency did not collapse, nor were there riots in the streets after the imposition of sanctions in May 1998. These are seen as sufficient proof of the country's resilience. It is argued that the leaders need to exploit this resilience for the benefit of the populace at large.

At the other extreme, the conservatives highlight the current situation as the worst crisis since the dismemberment of the country in 1971. There is agreement that it is, indeed, of economic nature, but there is less agreement on whether it is a short-term problem of balance of payments liquidity or a longer-term problem of structure. Some see its roots in the poor governance, politicization of the economy and institutional decay since the 1970s.

Political instability is one of the fundamental causes of poor governance and weak political consensus in the country. Nascent democracy, dependent on coalition governments and attendant political manoeuvering, has encouraged rent-seeking and has bred inefficiencies in the system. The short-term perspective is manifest in the loss of sovereignty in economic decision making since 1988.

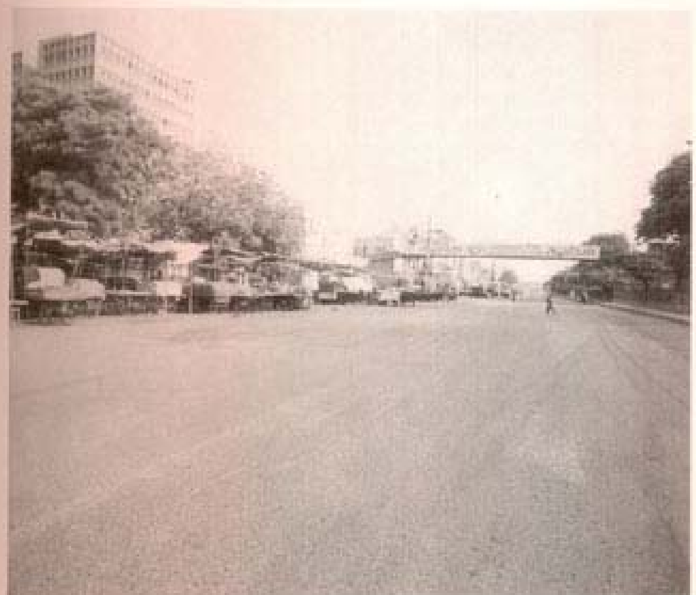
However, recent official announcements imply that the crisis was precipitated by the international sanctions in May 1998. These have disappeared now with the revival of the Enhanced Structural Adjustment Facility/Extended Fund Facility (ESAF/EFF) by the IMF and the rescheduling of debts by the Paris Club. Given the return to normal external transactions, it is argued that the economy can resume the path to recovery and growth which was interrupted temporarily by the sanctions.

In this introductory chapter, we outline the major structural problems which affect the social and economic fabric of the country. Our objective is not to identify scapegoats but to present an impartial perspective of the multidimensional nature of the dilemma that confronts Pakistan on the eve of the 21st century.

Political instability is one of the fundamental causes of poor governance and weak political consensus in the country.

Politics and Governance

The quality, nature and implementation of policy decisions (economic, social and political) in any country are an outcome of the political system



With burgeoning law and order problems, strikes are taken as part of life.

in place. Since its inception and specifically after 1971, Pakistan has experienced periods of both democratically elected governments and military dictatorship.

Politicization of the economy: 1971-1977

The economic agenda between 1971 and 1977 was guided by the politico-economic ideology of the Pakistan Peoples' Party of Mr. Z. A. Bhutto. Reducing inequalities in distribution of income and wealth was the dominant theme. This led to large-scale nationalization of private assets in industry, trade and finance, planting the seeds for future economic crises. Loss of confidence resulting from this policy, as well as expansion of the role of the public sector in economic activity, drastically affected private investment. Political 'lending' and/or political 'appointments' in nationalized banking, in large cement, fertilizer, sugar and steel manufacturing establishments and in export trading corporations led to loss of profitability and efficiency in these sectors.

Law and order and constitutional crises: 1977-1988

The macroeconomic policies during the period of military rule from 1977 to 1988 were primarily aimed at reversing the policy of nationalization and reducing public sector involvement in the economy. The Afghan crisis proved to be a mixed blessing. In the short to medium term, it ensured Western support — political, military and financial — for the military regime's foreign and economic policies. However, in the long run, institutionalized connivance with leakages in the cross-border arms supply route to the *Mujahideen* permanently sowed the seeds of a breakdown in law and order within the country.

During elections, normally house-bound women line up eagerly to cast their votes.

In an effort at acquiring legitimacy, the military regime promoted a veritable consumption boom. This was facilitated by the rapid growth of remittances from the Middle East and soft fiscal and monetary policies. Numerous tax breaks were given to buy the loyalty of different groups. On top of this, the regime increased defence spending to such an extent that fiscal deficits topped 10% of the GDP. Public debt ballooned, rising from less than 40% of the GDP to over 80% during the 1980s. The debt trap that the country finds itself in today owes its origin to that decade.

The recurrent eruption of constitutional crises in the 1990s is partly attributable to the constitutional amendments introduced by the military regime of General Zia-ul-Haq. Specifically the infamous Eighth Amendment in the revived parliamentary system under the 1973 Constitution gave the President greater powers, including the power to remove the Prime Minister and dissolve the National Assembly.

The decade of musical chairs: 1988 onwards

Military rule ended in 1988. The elections were won by the PPP, led by Ms. Benazir Bhutto. Since 1988, Pakistan's decade of democracy has been marked by four popularly elected governments (two each of PPP and PML(N)) and three interim governments. How has the decade of democracy contributed to the present crisis? Did the 'class' background of elected representatives impede the reform agenda of each elected government? Or, on a more positive note, has democracy helped to strengthen the institutions of the judiciary and a free press?

The recurrent eruption of constitutional crises in the 1990s is partly attributable to the constitutional amendments introduced by the military regime of General Zia-ul-Haq.

Many consider that the shortened survival of each of the popularly elected governments has contributed to the current crisis in Pakistan. In the last decade, each remained in office on average between two and a half to three and a half years, far short of their constitutionally allotted life of five years. These abbreviated periods of office affected political commitment to long-term (institutional, social and economic) reform. The result was an ill-defined and faltering agenda throughout those years. A key indicator of this is the process of institutional decay in Pakistan **(see box 1A)**. Capacity for good governance has been further limited by bouts of breakdown in law and order, ethnic clashes and sectarian violence.

Economic management and institutions

The instability of popularly elected governments and state captured by special interest groups are, however, not the only factors responsible for the crisis of confidence in each successive government. The current

BOX 1A

INDICATORS OF INSTITUTIONAL DECAY IN PAKISTAN

- The cash deficit of the seven major public utilities/enterprizes (WAPDA, KESC, Pakistan Railways, OGDC, SNGPL, SSGCL and Pakistan Steel Mills) is expected to increase from Rs. 64 billion in 1997-98 to almost Rs. 100 billion in 1998-99. This is a reflection of growing inefficiency and corruption, overemployment, high costs (for example, power supplied by IPPs to WAPDA), high receivables, etc. The biggest increase is in the case of WAPDA from Rs. 36 billion to Rs. 57 billion and in KESC from Rs. 12 billion to Rs. 35 billion.
- The circular debt among public enterprizes/utilities stood at Rs. 84 billion in the beginning of September 1998. The primary sources of debt are WAPDA and KESC with payables in excess of Rs. 53 billion to other public utilities. In turn, WAPDA has over Rs. 30 billion of receivables from government and private sector entities, especially the provincial governments. The high level of circular debt has created severe liquidity problems. It threatens interruption of vital supplies such as oil and gas and has led to the sickness of a large number of industrial units which are suppliers to the public enterprizes/utilities.
- The banking system is in deep financial stress, with the nationalized commercial banks suffering from low levels of profitability and capitalization ratios. The primary cause of this is the high proportion (almost 29%) of non-performing debt in the loan portfolio. Many of these loans were originally granted to parties because of political pressures and without proper appraisal. The consequence of the bad debts of Rs. 146 billion (as of the end of 1997-98) is that interest rates are exceptionally high in Pakistan. Unless the commercial banks and DFIs recover the bulk of the outstanding amounts, these institutions remain vulnerable to failure.
- The Central Board of Revenue, the premier tax collection agency of Pakistan, has over 33,000 employees. Its officials are generally considered prone to corruption and inefficiency. Coupled with large-scale tax evasion, it is not surprising that there is only one tax payer per 100 persons in Pakistan, and it is estimated that almost 40% of taxable income in the country is not declared for taxation purposes. Recently, legislation has been tabled with the National Assembly for the establishment of a Pakistan Revenue Service.
- Other public institutions, such as the police, judiciary, civic agencies, social service outlets, etc., are commonly perceived as having suffered major declines in the quality of service, increased corruption and inefficiency.

Capacity for good governance has been further limited by bouts of breakdown in law and order, ethnic clashes and sectarian violence.

predicament is also a reflection of the quality of economic management that has prevailed in the country in the last decade. In the medium run, any economic analysis of factors leading to the present situation cannot be divorced from the design, implementation and impact of various World Bank/International Monetary Fund (WB/IMF) structural and stabilization programs entered into by the government since 1988.

A section of the intelligentsia would argue that after signing the first ESAF in 1988, we effectively gave away to donors and multilateral agencies whatever little sovereignty we had in economic decision making. Therefore, the question of quality of economic decision making is of little relevance, while that of implementing the WB/IMF agenda becomes paramount. As our subsequent analysis indicates, the government policy makers thrice attempted to steer the economy away from the diktat of the multilateral agencies. The fact is that the last decade's economic performance and management are the result both of sovereign economic decision making and the implementation of the WB/IMF agenda.

In assessing the economic performance of the last decade, a convenient starting point is 1988, the year of the first formal Structural Adjustment Lending (SAL) from the World Bank and the IMF. During this time, most WB/IMF structural lending programs to various countries, including Pakistan, had two sets of economic targets. Stabilization, or demand management targets, was the goal for short to medium term. Structural adjustments were the targets for the medium to long run. **Tables 1.1** and **1.2** illustrate the decade-long performance of indicators post- and pre-1988.

In Pakistan, the primary focus of the IMF-sponsored stabilization programs has been to lower the budget and current account deficits. In contrast, in Latin American countries the goal of these programs in the

In Pakistan, the primary focus of the IMF-sponsored stabilization programs has been to lower the budget and current account deficits.

TABLE 1.1

PERFORMANCE OF STABILIZATION INDICATORS

Stabilization Indicators	Pre (1977-78 to 1987-88) %	Post (1988-89 to 1997-98) %
Rate of Inflation	7.6	10.7
Budget Deficit (% of GDP)	7.1	6.7
Current Account Deficit (% of GDP)	4.5	5.5
Total Revenue as % of GDP	16.8	17.4
Public Expenditure as % of GDP	24.5	24.4
Export of Goods as % of GDP	16.7	19.2
Import of Goods as % of GDP	18.7	17.9
Growth Rate in Export of Goods (US$)	10.5	7.5
Growth Rate in Import of Goods (US$)	6.8	6.7
Depreciation of Nominal Exchange Rate	6.8	9.4
Growth Rate in Money Supply (M2)	13.6	15.8
Nominal Interest Rate on Deposits	8.0	6.2*

* 1988-89 to 1996-97.
Sources: Economic Surveys, Finance Division, Government of Pakistan.

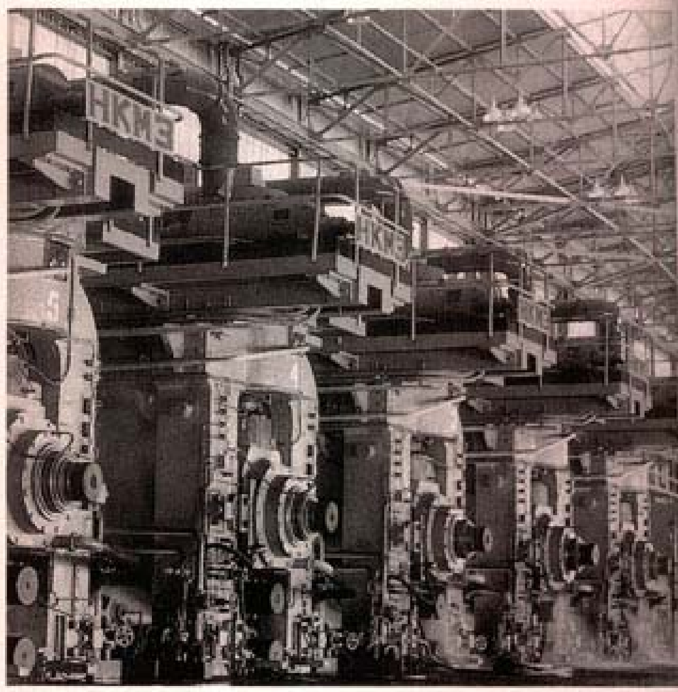
Because of the bullock-drawn plough and other outdated practices, agricultural productivity in Pakistan is low.

TABLE 1.2

PERFORMANCE OF STRUCTURAL INDICATORS

Structural Indicators	Pre (1977-78 to 1987-88) %	Post (1988-89 to 1997-98) %
GDP Growth Rate	6.4	4.5
• Agriculture	4.0	3.6
• Manufacturing	8.9	5.0
• Other Sectors	7.3	4.8
Growth in Index of Agricultural Production	4.5[a]	2.0
Growth in Total Cropped Area	1.2	0.5
GROWTH RATE OF YIELDS PER HECTARE		
• Wheat	2.3	2.0
• Rice	-0.3	2.0
• Sugarcane	1.5	2.0
• Cotton	8.1	-0.3
Domestic Saving (% of GDP)	8.2	13.4
Private Investment (% of GDP)	7.3	9.1
Growth in Foreign Direct Investment (US$ million)	19.1	12.5
Growth in Total Debt Servicing	21.9	19.4
Total Debt Servicing as % of GDP	4.1	7.1
Concentration Ratio of Exports to Group A Countries	33.8	43.3
Concentration Ratio of Exports to Group B Countries	8.6	14.0
Share of Cotton + Cotton-based Products in Total Exports	40.3	56.9
Share of Other Exports[b] in Total Exports	30.3	27.6

[a] 1978-79 to 1985-86
[b] Excluding Cotton + Cotton based products, Rice, Fish, Carpets and Leather.
GROUP A: USA, Japan, UK, Germany, Italy and France.
GROUP B: Malaysia, Indonesia, the Philippines, Thailand, S. Korea, Singapore and Hong Kong.
Sources: Economic Survey, Finance Division, Government of Pakistan.



Idle industries: the result of stagnation.

1970s and 1980s was to fight hyperinflation **(see box 1B)**. The twin deficits in Pakistan were to be lowered by the removal of price distortions and by making structural changes in almost all the sectors of the economy. For example, the budget deficit was to be reduced by reducing and switching public expenditures and broadening the tax base. Table 1.1 compares the post-1988 decade average performance with the pre-1988 decade. After 1988, Pakistan's economy performed poorly in all the stabilization indicators except for a nominal reduction of the budget deficit and a slight increase in total revenues and share of exports in the GDP. In contrast, many other indicators showed deterioration. Average inflation in the 1990s stood at close to 11% against 8% in the 1980s. The current account deficit, on average, rose by a full percentage point in the current decade from the 1980s.

Table 1.2 compares the economy's structural performance during the post- and pre-1988 decades. One observes significant improvement in the share of domestic savings in the GDP, a nominal rise in the share of private investment in the GDP and slower growth of total debt servicing. In agriculture, the growth rates of rice and sugarcane yields per hectare are higher in the post-1988 decade. The rest of the indicators show either a nominal or significant decline. On average, GDP growth fell by approximately two percentage points, due primarily to a fall in manufacturing growth from 9% in the 1980s to 5% in the 1990s. From an economic perspective, the explanation of the present crisis lies in the poor performance of these indicators during the 1990s. Critics argue that the performance of each individual indicator (see tables 1.1 and 1.2) carries an explicit verdict on the economic management and faulty design of the WB/IMF programs. Proponents of sound economic management and meaningful implementation would argue that in the absence of a counterfactual scenario (i.e., how the indicators would have appeared in the absence of structural adjustment) the causality remains at best conjectural.

BOX 1B

INTERNATIONAL EXPERIENCE: LESSONS FOR PAKISTAN

- The main message that comes through from the experience of such countries as Argentina, Brazil, Chile, Mexico and Uruguay is that a liberalized economy is more vulnerable to shocks (internal and/or external) than an insulated economy. All the above countries were on some form of WB/IMF stabilization program before a crisis. A series of bank failures (an internal shock) in these countries, except Uruguay, led to a dramatic increase in the domestic credit over the pre-crisis period, consequently undermining the confidence in the exchange rate regime of Tablitas, i.e., a pre-announced path of exchange rate changes. A collapse of the exchange rate was followed by hefty devaluation or the adoption of a dual exchange rate regime.
- Once a fundamental decision is taken to adopt liberalization according to the neo-classical path of market-based exchange rates, interest rates and domestic prices, the cost to the economy of half-hearted, incomplete or selective, wrong and delayed implementation of WB/IMF structural programs is much greater in an open than in a closed economy. In addition, lack of adequate and timely monitoring of economic indicators combined with delayed policy actions can inflict heavier costs than in an insulated economy. The remaining lessons are a corollary to this central point.
- In respect of the BOP liquidity crisis, and specifically the prevention of speculative attacks on the currency or reduction in the volatility of exchange rate movements, the credibility of announcements by the policy makers and central bank authority is of utmost significance. Rational agents in the economy form their expectations on the fundamental inconsistency between monetary and exchange rate policies. Agenor and Montiel [1996] have observed, "Measures such as foreign borrowing and capital controls may temporarily enhance the viability of a fixed exchange rate, but will not prevent the ultimate collapse of the system if a consistent — and sustainable, in light of the inter-temporal budget constraint faced by the government — macroeconomic policy mix is not adopted. The more delayed fundamental policy adjustments are, the higher will be the potential costs of a regime collapse."
- Fiscal adjustment is necessary. In the case of Pakistan, absence of permanent fiscal adjustment translated into higher debt obligations, undermining the efficacy of monetary policy and thereby the exchange rate management.
- The recent East Asian crisis carries the lesson that external short-term commercial borrowing (either by the public or private sector) and/or capital inflows (in the case of Pakistan's foreign currency accounts) are no substitutes for structural changes in the external trade sector that bring about sustained improvement in the current account deficits. Moreover, capital inflows into portfolio investments are no panacea for slow domestic growth and productive investment activity.

Implementing SAL/ESAF/EFF programs: an objective assessment

Considerable literature tells us why the WB/IMF programs of the outgoing decade fell short of their targets. These shortfalls can be broadly classified into "six sins":

- *Lack of political consensus:* strong government with a political commitment to reform is a basic precondition for successful policy reform. It must have the credibility and ability to withstand opposition both from government functionaries and vested interest groups. This precondition generally did not exist in Pakistan, except for the present PML government which has a sweeping mandate. Apparently in this country, a strong government is a necessary condition but not a sufficient one to ensure meaningful reforms. This is demonstrated by the reluctance of the present government to undertake wide-ranging and deep structural reforms in its first two years of existence. It has not extended the tax net (especially the general sales tax and the agricultural income tax) and has not downsized government.
- *Incomplete and selective implementation:* Piecemeal and slow implementation of reform can inflict heavy costs on the economy. For example, in early 1997, tax rates were cut to promote a supply-side response but the tax base was not broadened nor was the tax administration strengthened. This has led to a haemorrhaging of revenues.
- *Backsliding of reforms process:* Reform in the last decade in Pakistan has moved one step forward and two steps back. Slippages abound in the promised economic measures and institutional reforms over the last decade. This sends confusing signals to domestic and foreign investors and IFIs, seriously undermining the credibility of the process.
- *Defective design and sequencing of reforms:* Can the IMF/WB be absolved from hurtling Pakistan into the present crisis? The critics point to weak design and faulty sequencing of their programs, which are mostly insensitive to the social and political realities of a country and the capacity for implementing reforms. For example, nearly 40% of the economy is undocumented due to corruption and poor governance, and the financial sector is saddled with excessive bad loans and poor lending practices. So where is the wisdom in opening up foreign capital accounts before the budget deficits are reduced, trade is liberalized and healthy foreign exchange reserves are achieved? This unfortunate sequencing took a heavy toll on government's credibility in May 1998 when FCAs were frozen and capital controls had to be re-imposed. Similarly, the ballooning of debt servicing is partly a consequence of switching to market-based interest rates and financial sector reforms in the absence of prior fiscal deficit reduction.
- *Emphasis on numerical targets versus institutional reforms:* IMF/WB's preoccupation with quantitative targets for macroeconomic stabilization at the cost of real policy and organizational reforms is often criticized. It encourages governments to indulge in creative accounting and diverts its attention from tackling real institutional reform.
- *Politicized lending:* In spite of a favourable assessment by the IMF mission in April 1998, lending under the ESAF agreement was discontinued following the nuclear blasts. This vindicates the critics' longtime claim that loans by the multilaterals serve the geopolitical aims of the G-7 countries which can override the economic agenda.

Reform in the last decade in Pakistan has moved one step forward and two steps back.

CRISIS IN THE MAKING

Through its economic managers, government has failed to make tough decisions either on its own or in credible implementation of the various WB/IMF/SAL programs over the last decade. The costs to the economy in terms of worsening indicators have been highlighted in tables 1.1 and 1.2. The basic question is, why is Pakistan's economy so crisis prone?

Debt Trap or 'Death' Trap

In the last 20 years, Pakistan has been quietly building up its debt (internal and external) liabilities to a point that now they are essentially unserviceable and unsustainable. Such a rapid buildup has seriously undermined the effectiveness of monetary, fiscal and exchange rate policy **(see box 1C)**. Debt servicing has pre-empted a large part of slow-growing revenues, thereby arresting the increase of development

BOX 1C

WHY HAS THE PUBLIC DEBT-TO-GDP RATIO INCREASED IN PAKISTAN?

Public debt ratio has risen substantially in Pakistan since the 1980s. The ratio was 47% in 1979-80, rose to 83% by 1989-90, somewhat stabilized in the early 1990s and is currently about 91%. In the context of Pakistan, the increase in the public debt-to-GDP ratio is caused by the following factors:

- the size of the primary budget deficit (overall budget deficit net of interest payments): the larger this deficit, the greater the quantum of borrowing and, therefore, the bigger the increase in public debt;
- the extent to which the real interest rate on public debt exceeds the real GDP growth rate; and
- the extent of capital loss due to real exchange rate depreciation.

There was a big increase in the public debt-to-GDP ratio of about 36% points in the 1980s (see table below):

FACTORS CONTRIBUTING TO THE RISE IN PUBLIC DEBT-TO-GDP RATIO IN PAKISTAN (%)

	Primary Budget Deficit-to-GDP Ratio	Other Factors	Change in Debt-to-GDP Ratio
1979-80 to 1989-90	46.2	-10.6	35.6
1989-90 to 1997-98	15.0	-6.8	8.2
Cumulative			
1979-80 to 1997-98	61.2	-17.4	43.8

The major factor contributing to this rise was the cumulative effect of successive large primary deficits. The impact was partially alleviated by the large differential between the real external and domestic interest rate and the real growth rate of the economy. Capital losses on external debt due to the real exchange rate depreciation also made a significant contribution.

During the 1990s, accumulation of public debt moderated substantially, public debt-to-GDP ratio showing an 8% increase. Notice again that it is largely driven by the primary budget deficit-to-GDP ratio, with other factors having a mitigating impact on the growth of the ratio. It, therefore, appears that if Pakistan is to curtail the increase in its debt burden, it has to manage the budget deficit. In particular, the primary budget deficit has to be curtailed. In fact, a key objective of budget makers in the country should be to attain primary budget surpluses so that the debt burden can be reduced. This was achieved for the first time in 1997-98.

Through its economic managers, government has failed to make tough decisions either on its own or in credible implementation of the various WB/IMF/SAL programs over the last decade.

expenditure needed for long-term growth. In the last three years, constrained by budget deficit targets of SAL programs on one hand and rising debt servicing expenditure on the other, policy makers had little fiscal space even to increase development expenditures commensurate with inflation.

Market-based interest rates under the financial sector reforms did not deter the government from financing its debt servicing obligations through bank and non-bank borrowing, thus accumulating debt stock and fuelling high interest rates. Servicing of foreign debt continues to eat a greater portion of export earnings and reduce the net inflow of foreign assistance. The managed floating exchange rate policy and capital account liberalization finally fell victim to ever-rising foreign debt servicing in May 1998 when capital controls had to be reintroduced and a dual exchange rate regime was put in place.

Table 1.3 presents various dimensions of the debt profile during pre-1988, post-1988 periods and the last four years. Growth rate in domestic debt and its servicing obligations slowed down after 1988 compared to the previous decade. In contrast, the growth in external debt (public long-term debt) and commercial debt in rupees (short-term debt borrowed in the international capital markets on commercial terms) accelerated in the 1990s compared to the pre-1988 level. As a ratio to GDP, the two external indicators show a visible worsening while the domestic debt shows a dramatic deterioration. In spite of slower growth during the SAL period, the poor ratios are more a reflection of smaller growth in GDP during the post-1988 period.

To achieve long-run sustainability, a basic rule of thumb is that the growth in debt servicing must be equal to, or lower than, the growth in GDP. In the case of Pakistan, wide divergence between the two rates in the last two decades has eventually thrown the economy into a debt trap. Our capacity to service foreign debts is swiftly eroding. We are having to rely on short-term borrowing to close the current account gap and service

To achieve long-run sustainability, a basic rule of thumb is that the growth in debt servicing must be equal to, or lower than, the growth in GDP.

TABLE 1.3

PROFILE OF DEBT INDICATORS (%)

Indicators	Pre-1988	Post-1988	1994-1998
Growth Rate in Domestic Debt	21.0	14.8	12.8
Growth Rate in External Debt (US$)	6.2	6.3	4.8
Growth Rate in External Debt (Rs.)	14.5	16.9	16.2
Growth Rate in Commercial Debt	21.3	28.3	27.2+
Growth Rate in Domestic Debt Servicing	30.3	24.2	20.8
Growth Rate in Foreign Debt Servicing (US$)	8.7	8.7	8.2+
Domestic Debt as % of GDP	30.1	44.0	42.8
Foreign Debt as % of GDP	39.4	43.4	44.5
Commercial Debt as % of GDP	2.3	3.1	3.7+
Foreign Debt Servicing as % of Exports	24.2*	47.9**	56.2

Sources: Annual Reports State Bank of Pakistan.
+1994-97
*Does not include servicing of external short-term loans
**1989-90 to 1996-97

The garment industry which relies on low-paid women is ill prepared for competition from other developing countries.

our long-term obligations. All these factors indicate that the crisis is not just a short-term liquidity crisis but one of a more structural nature arising from an unsustainably large current account deficit due primarily to a lack of growth in exports. Foreign borrowing, capital controls and rescheduling can only provide temporary respite. For permanent enhancement in external debt repayment capacity, export growth is of fundamental importance.

Side-Stepping Globalization: Limping Manufacturing Sector and Export Growth

Globalization will continue to present a serious challenge to the private as well as the public sector in Pakistan. Unfortunately both entities are ill-prepared to meet that challenge. In dollar terms, growth in exports of goods fell to 7% in the 1990s against 10% in the 1980s. Similarly, the growth in manufacturing tumbled from an average of nearly 9% to 5%. This performance is in spite of a nominal increase of two percentage points in the average share of overall private investment in GDP in the last decade. Why are the policies and magic of liberalization not working to revive the economy?

Many studies, including the ones on Pakistan, forewarned as early as 1993 that manufacturing, specifically large-scale activity, nurtured behind high tariffs will suffer with liberalization and reduction in tariffs. The slowdown of the last four years (with the exception of 1997-98) should, therefore, not come as a surprise. The private sector, particularly manufacturing, is still not prepared to adjust to the new market-based input and output price structure. The agrarian (cotton, sugar, tobacco,

fertilizer), import-substituting (consumer goods), and inward-looking structure (cement, electrical equipment) of the manufacturing sector magnifies the adverse effects of globalization.

Is the public sector also equally responsible for the current slowdown in the real economy? With globalization did it provide a pro-active base or act as catalyst to facilitate the transition of the manufacturing sector from domestic to international suppliers? Fiscal policy once again failed. On the one hand, it did not synchronize with the 'spirit' of intended reforms to provide cost advantages to our industry early in the reform process. On the other hand, it did not sustain a level of demand for domestically manufactured investment goods through larger allocations to development programs.

Table 1.2 shows that our attempts at commodity diversification of exports did not succeed, although geographic diversification of exports met with partial success. Growth in exports is mired in a fluctuating external macro environment, non-tariff barriers (i.e., child labour, environment and safety standards by the developed world and growing hegemony of WTO). Added to this are our own supply constraints and apathy to genuine quality control systems. Is the management of the exchange rate policy to be blamed also for slow growth in exports and consequently the short-run BOP liquidity crisis? On the one hand, exporters and believers in the efficacy of price mechanism regard the exchange rate adjustment in the last decade as untimely and inadequate. On the other hand, institutionalists would argue that exchange rate adjustment was too frequent, unwarranted and dictated by multilateral agencies. Our supply of exports is basically inelastic to the exchange rate movements. The impact was to raise the cost of inputs and thus render our exports even less competitive.

Empirically, the evidence during the post-1988 era is in favour of the institutionalist hypothesis. The average growth rate in exports was 7% in comparison to an average depreciation of 9% in the exchange rate (see table 1.1). However, rupee depreciation in line with the average inflation rate of 11% strengthens the observation that the exchange rate policy of 'crawling,' per se, maintained a fairly stable real exchange rate through the greater part of this decade, although with lags. Since 1997, expectations of impending devaluations and the inability to service accumulated short-term external liabilities became a challenge for orderly exchange rate management. This led to the springing of the debt trap in May 1998.

Leaking Banking Sector: Is it the Cause or the Effect of the Crisis in the Making?

Can one implicate the financial sector, like the industrial sector and exports, in this crisis? Since the release of the figure of Rs.90 billion as the loan default of the private sector by the interim government of Mr. Moeen Qureshi in 1993, many regard it as one of the elements in moving the country toward crisis. Nationalized banks since the 1970s were used to promote 'crony capitalism' by each successive government in power, resulting in near insolvency of the banking sector by the 1990s. This raised the intermediation costs of the banking sector

BOX 1D

"NO ILLITERATE SOCIETY HAS EVER BECOME AN INDUSTRIAL TIGER" Mahbub ul Haq (1998)

The 'miracle' of South East Asian economic development owes much to high levels of primary education. And without primary education there cannot be adequate levels of literacy and numeracy to support the technical education needed for economic growth. When, as in Pakistan, the average worker has less than three years of schooling, and half of the entrants in technical schools drop out for lack of adequate basics, the potential for long-term economic development is in jeopardy. A modern workforce needs technical skills, not muscle power.

Education is not only a major engine of economic development, it also confers important benefits on society as a whole, including improvements in sanitation, hygiene, nutrition, the status of women and life expectancy. Education is therefore a sine qua non for personal development, for social development and for long term economic development.

by imposing high interest rates on advances and negative real interest rates on deposits.

However, the causality is not that straightforward. In spite of financial sector reforms and the introduction of prudential regulations, the rise of defaulted loans (Rs. 1 million and above) to Rs.146 billion by June 1998 may be the result of genuine borrowers falling victim to the market-based interest rate policy, foreign currency loans ballooning because of depreciation and overall depressed demand conditions. Thus the poor performance of the banking sector is partly a fallout rather than a cause of the crisis.

The Costs of Poor Social Development

Consensus is emerging between development thinkers and practitioners that social progress is a necessary precondition for sustained economic growth. Social development leads to higher levels of literacy, better health standards and overall improvement in the society's living conditions. In fact, there is a two-way relationship between economic growth and social development **(see box 1D)**. Economic growth translates into higher revenues for government and higher per capita income for households, motivating both to spend more on social/human development. Improvements in social indicators feed into ever higher economic growth through the enhanced productivity of labour and capital. In other words, well-developed human capital makes a significant contribution to economic growth which, in turn, offers improved welfare and better living conditions.

Given this, if there is a breakdown in the chain, and economic development is not translated into social development, then the pace of economic development is eventually bound to be adversely affected. Pakistan is a clear example of a country where the chain indeed has been broken. Currently, the female literacy rate is 33%, being somewhat higher for males at 56%; primary school enrollment for females is 55%, for males 78%; infant mortality rate is 105 out of 1000; and only 48% of the population has access to sanitation. In the most recent ranking of countries

Consensus is emerging between development thinkers and practitioners that social progress is a necessary precondition for sustained economic growth.

BOX 1E

PAKISTAN'S RANKING IN SOCIAL DEVELOPMENT: HAVE WE ALWAYS BEEN BACKWARD?

The long-term evolution of social development from 1960 to 1995 has been studied by applying the technique of principal components analysis on international cross-sectional data on a number of indicators for a sample of developing countries (with per capita income below US$ 500 and population above 10 million in 1960).

In the context of Pakistan, the basic question is whether its poor performance in the HDI (with the most recent country ranking according to UNDP of 132) is because over time Pakistan has slipped behind other countries or because Pakistan to start off was relatively backward, and its current low ranking is largely a reflection of poorer initial conditions.

According to the above-mentioned criteria for country selection, there are 25 countries in the sample, five from South Asia, seven from other parts of Asia, four from Latin America and nine from Africa. Development rankings have been generated for 1960, 1970, 1980, 1990 and 1995. The indicators included in the analysis are as follows: infant mortality rate, life expectancy, literacy rate, primary school enrollment rate, secondary school enrollment rate and GNP per capita (in US $).

Ranking of Pakistan in the group of 25 countries is given below:

Year	Ranking of Pakistan
1960	16
1970	18
1980	23
1990	21
1995	18

Pakistan was relatively backward in 1960 with a ranking of 16. This ranking deteriorated further to 18 in 1970 and to 23 in 1980. Since then there has been some improvement, with the ranking rising to 21 in 1990 and to 18 in 1995. It appears that the Pakistani case is one of poorer initial conditions (in 1960) which has been exacerbated by a relatively low rate of improvement in the indicators since then.

in terms of HDI, Pakistan came a dismal 132nd. **Box 1E** provides the international context. Pakistan not only started with poorer initial conditions of social development, but conditions have been exacerbated due to a relatively low rate of improvement since then.

The poor state of social development partially explains why even the moderate growth of the economy has begun to lose momentum in the 1990s. The under investment in social sectors is now beginning to exert severe limits to growth. For example, exports have been constrained by the poor human capital endowment of the labour force (average years of schooling per worker of only 2.3 years).

The poor state of social development partially explains why even the moderate growth of the economy has begun to lose momentum in the 1990s.

FACING UP TO SANCTIONS

The above analysis highlights the various political and economic elements which have historically contributed to the present vulnerable state of the economy. The susceptibility to crisis of the economy was, however, unique in one specific dimension. The rest of the economy largely remained insulated from the recurring BOP crisis facing the nation since the early 1990s. With the imposition of sanctions in May 1998, the dormant, widespread, structural weaknesses crystallized into a full-blown overall economic emergency epitomized by a balance of payments liquidity crisis. Foreign exchange reserves just prior to the nuclear blasts were adequate to finance only six weeks of imports.

After the revival of the IMF/WB program, controversy exists as to whether the economy is still in a state of crisis as in the sanctions period or has it slipped once again into an incubation state with the prospect of recurrence of a crisis down the road. One view is that before the sanctions, Pakistan was well on the path to recovery after the downturn of earlier years. The brewing crisis prior to the sanctions is tacitly ignored. According to this view, the recent short-term BOP liquidity crisis in the country was engineered by the sanctions. Now that this liquidity problem has been resolved by additional program assistance by IMF and other multilateral agencies and the debt rescheduled by the Paris/London clubs, Pakistan will get back to the path of recovery and growth once again. Note that after the revival of the IFIs' program, this view sidelines the dormant nature of the crisis and resultant vulnerability of the economy to any future shocks.

This view is reinforced by the observed response of the economy to the short-lived sanctions. Unlike the other Asian countries, Pakistan's currency did not tumble and the inflation rate remained single-digit. The economy did not witness a phenomenal upsurge in prices, unemployment and poverty, as observed, for example, in Indonesia. The question is, what contributed to Pakistan's resilience towards sanctions? Sanctions were of limited duration. Beginning at the end of May 1998, they remained in effect till the end of November 1998. Timely policy actions, a favourable external environment and dynamics of the informal economy appear to have been the major factors responsible for the resilience.

Crisis Management at Work

Although capital controls and freezing of FCAs shattered the long-term confidence of resident and non-resident Pakistanis, they prevented a haemorrhaging of the foreign exchange reserves. Moreover, the short-term and commercial debt servicing obligations were primarily due to public sector borrowing in contrast to the private sector cum banking sector default scenario in the East Asian crisis. This allowed the government to stagger external payments and build up arrears of debt to official (government) creditors with minimal impact on the exchange market.

The credit for resilience at the time of sanctions and the ability to avoid speculative attacks on the currency are also shared by the prudent monetary policy in force for the last two years although at a cost of higher interest rates. Banking sector reforms in terms of prudential regulations were more or less in place at the time of sanctions which prevented unnecessary expansion in domestic credit to fuel capital flight (a key element in the exchange crisis of Latin American countries). Increased taxation (i.e., a 25% hike in petrol prices) and a large cut in Public Sector Development Program (PSDP) prevented unchecked growth in government borrowing. The fiscal measures reinforced the tight monetary policy. The dual exchange rate regime cushioned the impact of significant nominal devaluation on everyday prices of edibles, POL products and pharmaceuticals, as the imports of these items were allowed on the lower official exchange rate.

Timely policy actions, a favourable external environment and dynamics of the informal economy appear to have been the major factors responsible for resilience to the sanctions.

Favourable External Environment

The above discussion relates to the contribution of the monetary, fiscal and exchange rate policy to the apparent short-run resilience of Pakistan's economy. Real factors in terms of food availability further added to the resilience. By historical standards, the year 1997-98 ended with a relatively good performance in the agriculture sector with sufficient carry-over stocks of wheat and sugar. Thus, short-term foreign exchange shortages were not manifest in food shortages immediately after the sanctions.

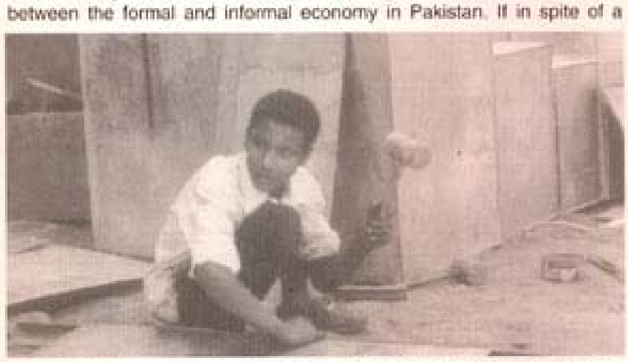
Understandings with neighbouring oil producing countries helped to sustain petroleum imports, although the reserve stocks of petroleum products were depleted to less than a week of consumption in the later period of the sanctions. General deflation in import prices due to East Asian contagion prevented any inflationary tendencies in the economy and limited the size of the trade deficit.

Resilience of the Informal Sector

The temporary new-found resilience has also opened a debate whether in times of shocks, the informal or 'invisible' economy and its internal dynamics of employment and income generation can be a blessing in disguise? Why was there no visible plunge in employment and incomes? Partly the answer lies in the composition of external indebtedness. The private sector in Pakistan is still not directly leveraged by external loans as in the case of Thailand and South Korea. Within the private sector, the employment-intensive sectors, i.e., construction and transport, are even less interlinked with foreign capital markets than formal large-scale manufacturing. Labour-intensive, small-scale manufacturing and the informal sector as a whole thus remained largely insulated and continued under their own dynamics of production, consumption and income generation.

Can the above policy measures and external environment before sanctions be mistakenly interpreted as strengths of the informal sector, and its role in the economy be elevated to that of engine of growth? This raises the questions of intertemporal linkages and interdependencies between the formal and informal economy in Pakistan. If in spite of a

Concrete policy steps aimed at sustained revival of the formal economy are needed if momentum in the informal economy is also to be sustained.



While the Pakistan economy performed poorly in the 1990s, the informal sector remained active.

limping large-scale manufacturing sector in the 1990s, the informal economy carried the common man through the shock of sanctions, is there some inherent strength in the informal economy? Can this momentum be consolidated for reviving growth in the formal economy?

Empirical evidence supports a contrary view. Growth in the formal economy has always been an engine of growth for the informal economy and this role is irreversible (**see box 1F** on the Indian experience).

BOX 1F

GROWTH OF THE INFORMAL ECONOMY: THE INDIAN EXPERIENCE

Estimation of the size and growth of the informal economy (characterized essentially by small-scale and undocumented activities) is difficult because of the very nature of such activities. In Pakistan, the national income accounts inadequately capture the informal economy. They do not reflect the size of sectors characterized by informal activities such as wholesale and retail trade, services, construction, etc., and they assume an unchanged growth rate every year in some cases, (such as small-scale manufacturing).

ANNUAL GROWTH RATE OF INDIAN ECONOMY (%)

Decade	Agriculture	Formal Economy	Informal Economy	Overall Growth
60s	2.3	6.5	4.2	3.7
70s	1.5	4.7	3.9	3.1
80s	3.5	8.6	5.7	5.7
90s	2.8	7.8	6.1	5.7

Source: Indian Economic Survey, 1997-98

In India, however, proper estimation of national income accounts has higher priority. Consequently, annual surveys are taken to determine the quantum of income generated in different informal activities, and figures reveal year-to-year variation in growth rates in all informal sectors.

Analysis of the growth trends of the Indian economy since the 1960s reveals the following empirical regularities in the growth patterns:

- The growth rate of the informal economy* is always lower on a long-term basis (in each decade) than the formal economy.**
- There is a strong correlation between the growth rate of the formal economy and that of the informal economy. When the buoyancy in the formal economy is greater (as in the 1980s and 1990s) it provides a fillip to the informal economy. When the formal economy is relatively stagnant (as in the 1970s), the informal economy also exhibits a low growth rate.
- The growth rate of the informal economy generally exceeds that of the economy as a whole.
- A key finding is that on a long-term basis the growth rate of the informal economy lies between the growth rate of the overall economy and the formal economy.

The above experience of long-term growth patterns in India highlights the fact that in Pakistan also it is unlikely that on a sustained basis the growth rate of the informal economy can exceed that of the formal economy, although for a particular year this is possible. Therefore, as the growth rate of the formal economy of Pakistan has declined in the 1990s to 5.5% from 7% in the 1980s, it is more or less inevitable that the growth momentum in the informal economy will come down eventually, even if it has not fallen already.

* The informal economy consists of: manufacturing (unregistered); construction; wholesale and retail trade; transport by other means, storage; real estate and ownership of dwellings and other services.

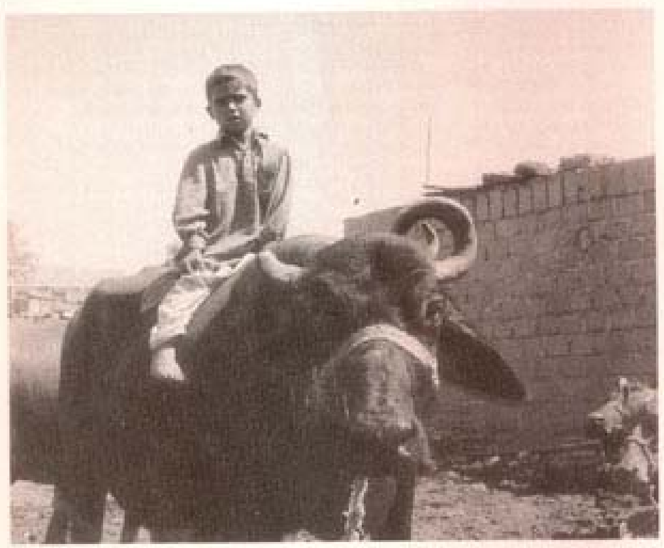
** The formal economy consists of: manufacturing (registered); mining and quarrying; electricity, gas and water supply; hotels and restaurants; railways; communications; banking and insurance; public administration and defence.

Consequently, the observed momentum of the informal economy in Pakistan is a lagged or a carry-forward effect of momentum of the formal economy in the 1980s. During the last few years, this carry-forward effect may be converging to the low growth rates of the formal economy. This is indicated, for example, by the large decline in growth rates of the construction and retail and wholesale trade sectors in recent years.

Therefore, concrete policy steps aimed at sustained revival of the formal economy are needed if momentum in the informal economy is also to be sustained. Supporting this argument is the reasoning that the informal economy will shrink in the years to come as increased documentation and effective regulatory framework are instituted during the process of structural fiscal adjustment. However, the counter view that half-hearted and incomplete implementation as in the past will push the formal into informal mode also should be considered.

IMPACT OF SANCTIONS

As a consequence of crisis management, specifically on the balance of payments front, the impact of the sanctions on private capital inflows was transmitted immediately. The second-round impacts of the sanctions on other macro variables (e.g., growth, inflation and unemployment), were beginning to be felt. If the sanctions had continued longer what would have been the loss in growth momentum? Would the prices have eventually skyrocketed? How serious would be the unemployment in the country? Would Pakistan have gone beyond a technical to an actual default on its external obligations?



Development expenditure has been scaled to a minimum leaving little hope for village kids.

We use the Integrated Social Policy and Macroeconomic (ISPM) model developed by the Social Policy and Development Centre to seek answers to some of these important empirical questions (**see box 1G** for a

BOX 1G

FEATURES OF THE SPDC ISPM MODEL

The SPDC Integrated Social Policy and Macroeconomic (ISPM) model has three major components: the macro economy, public finances and social development (see Appendix A-1). It has 22 blocks relating to the following:

macro economy: production, index of economic infrastructure, input demand and unemployment, macro economic expenditure, international trade, monetary and price blocks.

public finances: federal revenue, federal expenditure, federal deficit, provincial revenue, provincial expenditure, provincial and total budget deficit, local revenue, local expenditure and index of fiscal effort blocks.

social development: human capital index, public health index, poverty, educated unemployment, gender inequality and malnutrition.

The model has 265 endogenous variables (variables determined by the model) and 64 exogenous variables (variables determined outside of the model). Many of the exogenous variables which drive the model are policy related and thereby impart to the model the ability to analyse the consequences on the macro economy and social development of key policy changes. Some of the key policy variables are:

- real effective exchange rate
- interest rates
- intergovernmental fiscal relations
- new taxation
- level of petroleum development surcharge
- defence expenditure
- extent of cost recovery in different services
- level of subsidies
- grants by federal and provincial governments

The model is behaviourally rich and is able to capture first-round and subsequent effects of changes in policy or transformations in the international environment. Some of the key relationships, which have been empirically estimated for Pakistan from 1972-73 onwards are as follows:

production: production in each sector of the economy is derived on the basis of inputs of labour and capital while 'factor productivity' is proxied by the indices of human capital and public health and the stock of public infrastructure.

private investment: depends upon interest rates, price of imported capital goods, index of capacity utilization, remittances, exports, stock of public infrastructure, etc.

public investment: depends upon net inflow of foreign aid, net revenue receipts and throw-forward of last year's development expenditure.

exports: depend upon world income, international prices, exchange rate and domestic output.

imports: depend upon GDP, private investment, international prices and exchange rate.

money supply: depends upon budget deficit, current account deficit and buildup of reserves, change in domestic output and price level.

price level: depends upon index of aggregate demand, ratio of money supply to real GDP, import price level and incidence of indirect taxes.

tax revenues: depend upon the relevant tax bases and the level of discretionary fiscal effort.

interest payments: depend upon interest rates and stock of outstanding debt.

expenditure on services: depend upon resource availability and previous year's expenditures.

human capital index: depends sequentially upon expenditures on education, stock of facilities and inputs, enrollments, output and stock of workers with different levels of education.

public health index: depends sequentially upon expenditures on health, stock of facilities and inputs, output in terms of patients treated.

Determinants of poverty, educated unemployment, gender inequality and incidence of malnutrition are discussed in Chapter 3.

description of the features of the model). The model is capable of tracing and quantifying the impact of various internal and external shocks on economic and social indicators, as well as linking the changes in these indicators to the short- and long-run growth potential of the economy. We compare the costs of sanctions on the economy in relation to a counterfactual situation or scenario of no sanctions, i.e., performance of the economy if Pakistan had not undertaken nuclear tests and the economy had continued on the pre-blasts/sanctions path of recovery **(see box 1H).**

The numbers in **table 1.4** highlight the percentage differences between the performance of macro indicators in the pre-blasts and post-blasts/sanctions situation in the first year.

It is apparent from the performance of these indicators that the acquisition of nuclear capability and the resulting sanctions inflicted substantial costs on the economy in the short run. All the indicators, except inflation and budget deficit in the post-blasts/sanctions era, are lower or worse than in the counterfactual pre-blasts position. Tight fiscal policy, specifically expenditure curtailment, artificially closed the budgetary gap. Predictions of lower inflation in the post-blasts/sanctions scenario reflect the onslaught of deep recessionary conditions in the economy. The growth in real GDP and manufacturing is lower by 3% and 7% in the post-blasts/sanctions scenario respectively. Manufacturing suffers notably due to a drop in capacity utilization as a consequence of

BOX 1H

MACROECONOMIC PROJECTIONS IN THE PRE-BLASTS SCENARIO

Government, in its Annual Plan, prior to the blasts and the imposition of international sanctions, projected key macroeconomic parameters for 1998-99 as follows: GDP growth rate, 6%; inflation rate, 8%; budget deficit, 4.5%, and current account deficit, 1.5%. IMF also made some projections both for 1998-99 and up to 2002-03 as part of the original ESAF/EFF program. For 1998-99, it projected an inflation rate and current account deficit at three percentage points higher than the government's projections, that is, 9.5% and 4.5% respectively. The five-year outlook envisaged a slightly higher economic growth rate, at 6.5%, moderation of inflation, at 7%, decrease in budget deficit to GDP ratio to about 4% and some stablization in the current account deficit to about 3.5%.

Since then, two key developments have taken place. International prices have tumbled, reducing the pressure on domestic prices and improving the current account deficit but impacting adversely on tax revenues. Therefore, the projections of tax revenues have not materialized and tax collection performance has been below expectation in 1998-99. On the expenditure side, there exists little margin for further curtailment (development expenditure is at the bare minimum of 3% of GDP, the scope for economy in non-development spending is limited). As such, the target of reducing the budget deficit to 4% is unrealistic in the pre-blasts scenario.

SPDC's projections of the macroeconomy incorporate the impact of international developments which were not foreseen in May - June last year. However, additional foreign assistance due to the revival of the IMF package and rescheduling were not factored into the pre-blasts simulations. They are similar to the IMF projections, except we forecast a slightly lower rate of inflation, at 6.5%, and a higher budget deficit at 6% of the GDP in the pre-blasts scenario.

TABLE 1.4

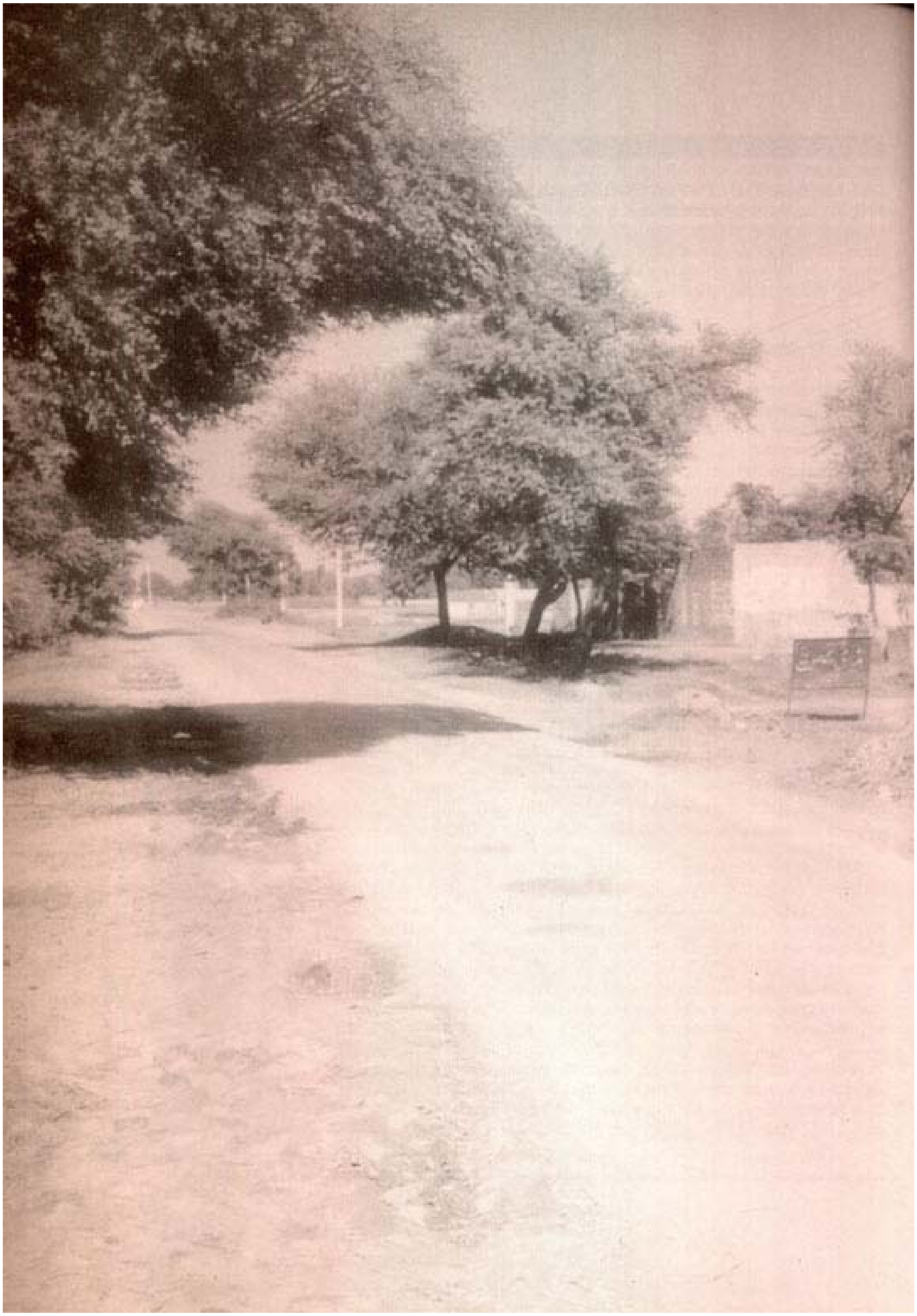
DIFFERENCES* BETWEEN POST-BLASTS/SANCTIONS AND PRE-BLASTS SCENARIOS

Indicators	Base Year 1997-98 Values	Short Run (1 year)
Growth Rate of GDP	5.4	-3.0
• Agriculture	5.9	-1.5
• Manufacturing	6.7	-7.0
• Other Sectors	4.8	-2.5
Inflation Rate	7.8	-1.0
Unemployment Rate	5.4	0.5
Private Investment (% of GDP)	8.8	-0.5
Public Investment (% of GDP)	5.2	-1.5
Exports as % of GDP	13.2	0.0
Imports as % of GDP	16.1	-0.5
Export Growth of Goods (Real)	4.0	-4.0
Import Growth of Goods (Real)	-8.2	-5.0
Exchange Rate (Nominal) Depreciation (Rs. per US$)	10.8	-1.0
Current Account Deficit (% of GDP)	3.3	2.0
Budget Deficit (% of GDP)	5.4	0.0
Domestic Debt (% of GDP)	42.1	2.5
External Debt (% of GDP)	49.5	1.0
Total Debt (% of GDP)	91.6	3.5
Total Public Expenditure (% of GDP)	21.8	-1.0

*Differences are rounded off to the nearest one half percentage point.
Source: SPDC ISPM model.

import compression and recessionary conditions. The current account deficit is higher by 2% of GDP. This gap mainly reflects the lower level of remittances and the absence of FCAs as a financing source of current account deficits. In the medium run this deterioration in external accounts is clearly unsustainable.

Although the short-term resilience of the economy surprised even the pundits of doom, the sustainability of the newly found resilience in the case of prolonged sanctions is seriously challenged by the above counterfactual evidence. The analysis clearly puts into question the existence of built-in long-term resilience. It indicates an underlying malaise that is not short lived and one that requires strong governance and a single-minded reform agenda. The conservatives maintain that in a 'do nothing' scenario, the country would have eventually defaulted on its payments, and the economy would have collapsed within a year of sanctions. It was clearly faced with the option of declaring a unilateral moratorium on its external payments or entering into a negotiated settlement with its international creditors in an attempt to rescue the bruised economy as quickly as possible. In the next chapter we look at the economic consequences of choosing the second option.



TOWARDS A SUSTAINABLE PATH OF DEVELOPMENT

CHAPTER

2

"If the country had chosen the path of self-reliance, instead of the conventional strategy, what would the key elements be?"

TOWARDS A SUSTAINABLE PATH OF DEVELOPMENT

STRATEGIC ECONOMIC OPTIONS BEFORE THE NATION

The previous chapter highlighted the economic costs of the blasts and the sanctions in the short run. The economic outlook for 1998-99 **(see box 2A)** further approximates the numerical first-year predictions of the Integrated Social Policy and Macroeconomic (ISPM) model for Pakistan developed by SPDC. The nation is facing a number of dilemmas following the nuclear blasts in May 1998, and the subsequent imposition of sanctions. The post-blasts/sanctions scenario demonstrated that political considerations weigh heavily in lending decisions, not only of individual donor countries but also of multilateral lending agencies. Even now, the priority attached by the IMF to reactivating the Enhanced Structural Adjustment Facility (ESAF) and ensuring debt rescheduling is a reflection of Pakistan's willingness to proceed on the political road map (signing of the Comprehensive Test Ban Treaty (CTBT), etc.) agreed with the United States.

Pakistan risks loss of sovereignty if it relies solely on international financial institutions (IFIs) and Western donors to close the foreign exchange gap. Such a risk suggests that the nation choose the path to self-reliance by reducing its dependence on external assistance as quickly as possible. Advocates of this choice are optimistic for the longer term, citing the economy's recent successful short-term demonstration of

BOX 2A

PAKISTAN'S ECONOMIC OUTLOOK FOR 1998-99

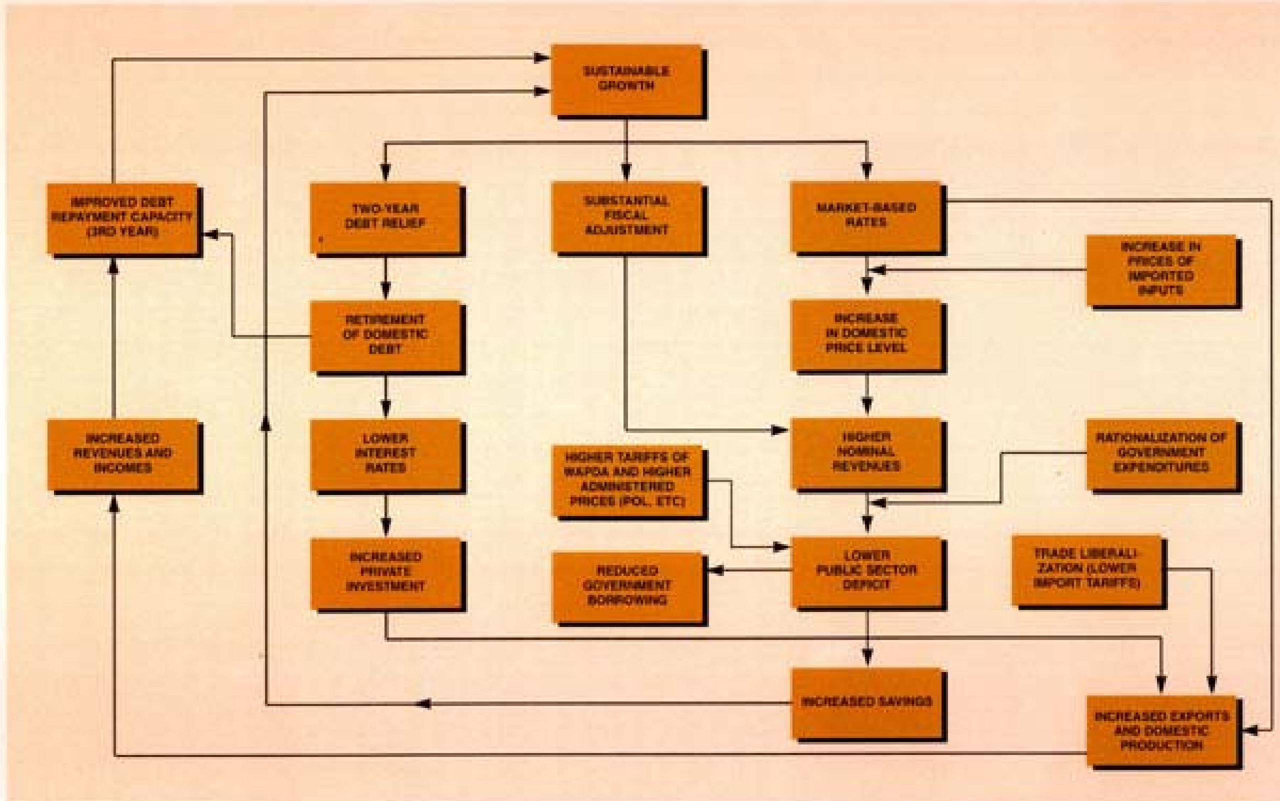
All indicators point to a general slowdown of the economy in 1998-99:

- GDP growth rate of less than 4% as compared to almost 5.5%. Agricultural growth is expected to be 2.5%, with both wheat and cotton crops below target. This will override the increase in rice, 7%, and sugarcane, 3%. Large-scale manufacturing will grow by about 3%, although the final outcome will depend upon the sugar industry's performance.
- Home remittances are likely to fall to US$950 million from US$1400 million last year. In the first seven months of this period, foreign private investment has fallen 57%, and portfolio investment 92%. Private domestic investment is also expected to show a big drop.
- Last year's inflation was recorded at close to 8%. This year it is likely to be closer to 7.5%.
- Tax revenues have shown a 2% growth over last year in the first seven months of 1998-99. A shortfall of Rs. 8 billion has already been recorded in the first six months in relation to a lower target for the year than in the original budget.
- Exports and imports have both plummeted, by about 12% and 19% respectively. Consequently, the trade gap has already narrowed by 46% in relation to that in 1997-98.

Pakistan risks loss of sovereignty if it relies solely on international financial institutions (IFIs) and Western donors to close the foreign exchange gap.

CHART 2.1

RESUMING GROWTH VIA IMF/WORLD BANK STABILIZATION IN THE ESAF/EFF PROGRAM



Faced with rising prices, women try to add to the family income by learning to cut and sew.

resilience while facing sanctions. From this experience, they contend that economic managers can and must create a viable and enforceable economic program that leads to economic and political sovereignty.

However, given the high short-run political and economic costs of the unilateral moratorium on its external debt payments, and the consequent tough policy actions, the Government of Pakistan has opted instead for a conventional strategy to restore the viability of its external transactions and revive the economy. It concluded a debt rescheduling agreement in January 1999 with the Paris Club and has agreed to the revival of the October 1997 ESAF/EFF program of the IMF and the World Bank.

If the country had chosen the path of self-reliance instead of the conventional strategy, what would the key economic elements be? What are the short- and long-term costs of a self-reliance path in comparison to the conventional demand-management program designed by the IFIs for Pakistan? To answer these questions, we first look at the implications of reviving the ESAF/EFF program and debt rescheduling. We then discuss the structuralist approach to self-reliance.

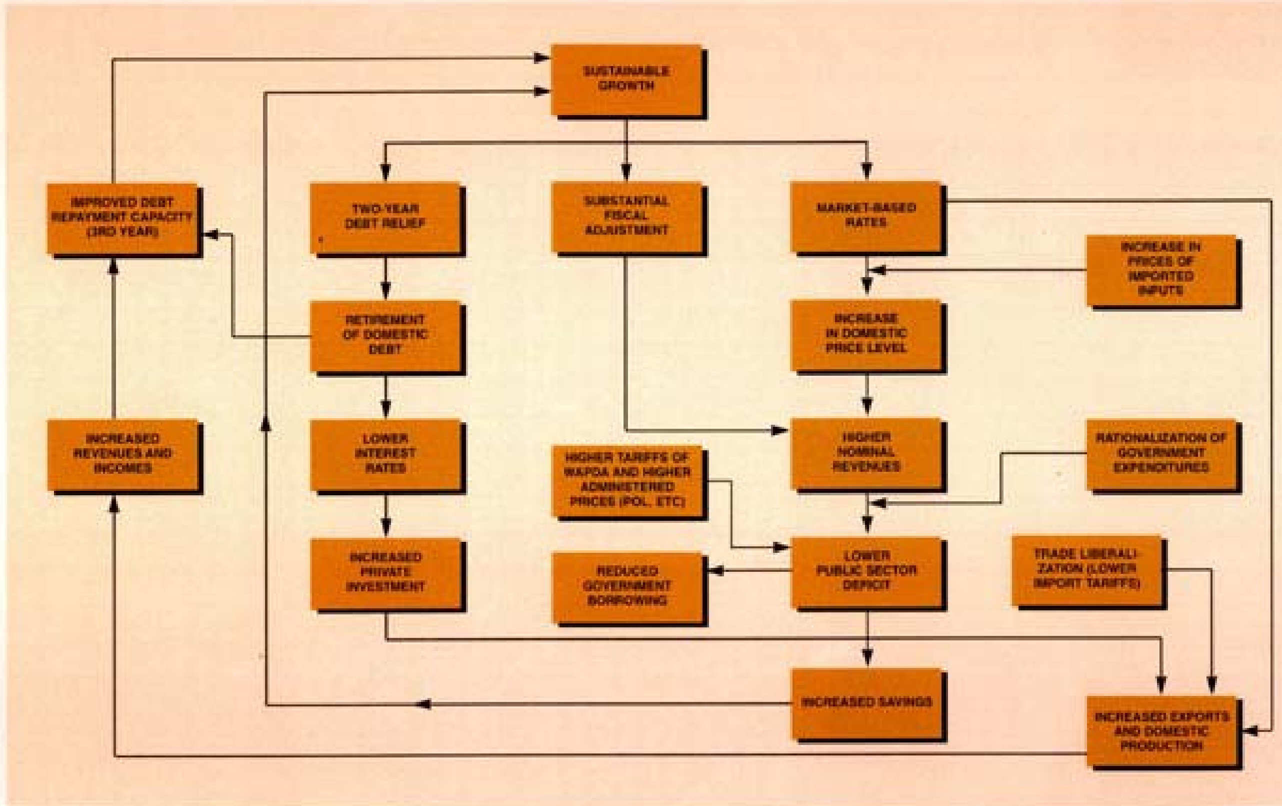
REVIVAL OF ESAF/EFF PROGRAM AND DEBT RESCHEDULING

Will the conventional strategy as prepared by the IFIs put Pakistan on a track of sustainable growth? **Chart 2.1** illustrates the working of the package including debt rescheduling. The success of the strategy depends on three anchors: a market-determined exchange rate with trade liberalization (through import tariff reductions), substantial fiscal adjustment and a two-year debt relief.

Market-determined exchange rate: at the macro level, a tight fiscal and prudent monetary policy complemented by an appropriate exchange rate

CHART 2.1

RESUMING GROWTH VIA IMF/WORLD BANK STABILIZATION IN THE ESAF/EFF PROGRAM



adjustment is called for in the Policy Framework Paper (PFP). The PFP states that "exchange rate policy will need to play an important role in safeguarding external competitiveness and supporting the achievement of the official reserve targets." This policy will be reinforced by lowering tariff rates to a maximum of 35% to reduce anti-export bias.

Fiscal adjustment: the main thrust of fiscal policy measures **(see box 2B)** in the ESAF/EFF package is no different from the earlier ones that failed. The measures for fiscal adjustment — broadening the tax base (including the general sales tax and agricultural income tax), improving tax administration, rationalizing public expenditures (for example, by elimination of subsidies) and reforming the civil service — are very similar to the ones recommended repeatedly since 1988. In addition, there is an effort at

BOX 2B

KEY CONDITIONALITIES IN THE ESAF/EFF PROGRAM

REVENUES

General Sales Tax
- Increase in GST rate from 12.5% to 15%.*
- Extension of GST to services, petroleum products, electricity and agricultural inputs in 1999-2000.

Customs Duty
- Reduction in the maximum tariff rate (from 45% to 30-35%).

Agricultural Income Tax (AIT)
- Strengthening of collection mechanisms of the AIT in all four provinces to ensure achievement of a target of Rs. 2.5 billion in 1998-99.
- Development of an action plan for improvement of the AIT by March 1999 to achieve a revenue target of 0.3% of GDP (equivalent to Rs. 9 billion currently) in the medium term.

Petroleum Development Surcharge
- Enhancement in the tax incidence on petroleum products.

Tax Administration
- Legislation for establishment of a Pakistan Revenue Service to be presented to parliament.

PUBLIC EXPENDITURE

General
- Existing hiring freezes at the federal level to be maintained (with some exceptions, such as SAP and tax departments).
- Implementation of restructuring of federal divisions to start in 1999-2000.
- An action plan for civil service reform to be prepared by June 1999 and implementation to begin in 1999-2000.

Subsidies
- Reduction and elimination (in two steps) of the wheat subsidy.
- Phasing out in two stages of the electricity subsidy to domestic consumers by September 1999.

Development Expenditure
- Cut in the PSDP for 1998-99 from Rs. 110 billion to Rs. 98 billion.
- Agreement with the World Bank to scrutinize any new project carefully.

Social Action Program
- Total rupee expenditure on SAP (excluding foreign project assistance) to be Rs. 56.5 billion in 1998-99, with at least Rs. 5.5 billion in non-salary expenditures.

OTHERS

Financial Sector
- Divestiture of the government's remaining ownership interests in the Muslim Commercial Bank and Allied Bank.
- Privatization of Habib Bank Ltd., United Bank Ltd., National Bank of Pakistan, National Development Finance Corporation and the Industrial Development Bank of Pakistan.

Foreign Exchange Market
- The exchange rate regime to be fully unified at an appropriate time to improve economic efficiency.

* to be implemented prior to program resumption

reducing the 'quasi-fiscal deficit' by bringing down the deficits of public enterprizes, especially that of the Water and Power Development Authority (WAPDA), largely through enhancements in tariffs. However, in view of the current recession and political difficulties, many of the tough policy measures are being pushed back to 1999-2000 to allow time for the economy to recover from the post-blasts shock of the sanctions.

Debt relief: the rescheduling of debt liabilities to the official creditors and multilateral agencies for 1998-99, 1999-2000 and the first half of 2000-01 is predicated on meaningful adherence to the first two anchors. The relief amounts to US$ 3.3 billion from the Paris Club. It is a component of the overall external financing package of US$19 billion put together by the IMF as part of the ESAF/EFF program for 1998-99 to 2000-01 **(see box 2C)**.

The theory is: sustainable growth will be achieved by this strategy because it is expected that a realistic exchange rate policy combined with trade liberalization will improve exports and reduce pressure on the balance of payments. The inflationary costs of the exchange rate adjustment can be cashed in as an increase in nominal revenues. Increased revenues and lower expenditures combined with improved performance of public enterprizes will increase public savings and thus ease pressure on interest rates and the current account of the balance of payments. The two-year debt relief will permit the retirement of domestic

In view of the current recession and political difficulties, many of the tough policy measures are being pushed back to 1999-2000 to allow time for the economy to recover from the post-blasts shock of the sanctions.

BOX 2C

EXTERNAL FINANCING IN THE ESAF/EFF PROGRAM

- The total external financing requirements for 1998-99 to 2000-01 are estimated as follows:

	(US$ billion)
External financing requirements for balance of payments	19.0
Buildup of gross official foreign exchange reserves	1.3
TOTAL	**20.3**

- The gap would initially be covered partially by:

	(US$ billion)
Medium-term private flows (FDI, etc.)	1.3
Official project loans	4.1
Grants	0.4
Trade credits for food imports	0.7
New medium-term commercial loans	0.4
New short-term commercial loans	1.3
TOTAL	**8.2**

- The residual financing gap of US$12.1 billion (= 20.3-8.2) would be covered by:

	(US$ billion)
IMF	1.6
World Bank	1.4
Asian Development Bank	1.0
Potential bilateral creditors	0.4
Exceptional financing	7.7
TOTAL	**12.1**

- The external financing arrangements appear to have a number of downside risks. First, a reserve buildup of only US$1.3 billion is projected. Second, it is assumed that even after debt rescheduling and downgrading of credit ratings, Pakistan will be able to mobilize new short- and medium-term commercial loans of US$1.7 billion. Third, that despite the major loss of confidence, medium-term private flows (FDI, etc.) of US$1.3 billion will be forthcoming.
Given the low reserve buildup and tenuous nature of some of the financing assumptions, Pakistan could find itself confronted with a foreign exchange crisis even during the period that the debt rescheduling is operative.

debt and further dampen interest rates. The latter will boost private investment and lead to increased production, incomes and government revenues. In the medium term, along with the debt retirement, it will improve the debt repayment capacity of the economy by lowering the overall public debt-to-GDP ratio.

In practice, it is far more complex. Some of the impacts in the case of Pakistan cannot be quantified, some may be weak, some ambiguous. For example, the threat of unilateral default and speculative attacks on currency is postponed; with the revival of structural adjustment lending, confidence in the economy is restored; domestic and foreign direct investment is encouraged; unification and adjustment of the exchange rate can gradually increase remittances and portfolio investments back to pre-blasts levels; and in the medium run, a competitive exchange rate policy can stabilize and even lower the current account deficit.

Coupled with a policy of rapidly lowering the fiscal deficit **(see box 2D)**, relief on external debt servicing will enable domestic debt retirement. Net retirement of domestic debt will have important secondary effects on interest rates at three levels. Reduced demand for bank borrowing will lower treasury bill yields in the primary bond market. Lower yields and thereby commercial banks' profitability can depress the rates offered to depositors as lending rates will have to be lowered. This will widen the gap between the commercial banks' deposit rates and those offered by the government National Saving Schemes (NSS). To prevent widespread disintermediation, government may opt to lower NSS rates.

If inflation remains subdued, supply of savings in response to lower nominal interest rates will continue to be unaffected while *a priori* demand for savings (investment) will rise. In essence, debt rescheduling will dilute the interest costs of a tight monetary policy in favour of the private sector, and will bring down the debt-to-GDP ratios. The success of debt rescheduling to improve the debt repayment capacity of the economy in the future will depend on increases in production capacity via private sector investment. The latter, of course, is mildly sensitive to interest

The success of debt rescheduling in improving the debt repayment capacity of the economy in the future will depend on increases in production capacity via private sector investment.

BOX 2D

MACROECONOMIC OBJECTIVES IN THE ESAF/EFF PROGRAM

The macroeconomic objectives for 1998-99 to 2000-01 are:

- recovery of real GDP growth rate from 3% to 4% during 1998-99 and to a medium-term range of 5% to 6%;
- reduction in annual inflation from about 10% to 11% in 1998-99 and 1999-2000 to about 6% in 2001-02;
- contraction of the current account deficit (excluding official transfers) from about 3% of the GDP in 1998-99 to less than 1.5% of the GDP in 2001-02. For this, the trade account will need to register small surpluses starting from 1999-2000;
- decline in the consolidated budget deficit from 5.5% of GDP in 1997-98 to 4.3% of the GDP in 1998-99 and to 3.3% of the GDP in 1999-2000;
- gross capital formation to increase from less than 15% of the GDP in 1998-99 to about 17% in 2001-02, largely reflecting a recovery in private investment;
- gross national savings to rise from about 12% to about 16% from 1998-99 to 2001-02, largely on account of increased public sector savings; and
- target of official foreign exchange reserves of three months of imports by 2001.

Boys hope to beat widespread unemployment by acquiring a skill.

rates, but the role of non-economic factors is by no means insignificant, especially when investor confidence is so low.

In the long run, the initial pricing shock will lead to more efficient allocation of resources and distribution of consumption expenditure and investment. However, increasing reliance on foreign capital could worsen the external debt-to-GDP ratio, especially in view of the deferment of debt repayment. It could create prolonged inflationary pressures through devaluations and expectations and render the economy vulnerable to frequent political and economic pressures of donors. As highlighted in box 2C, the external financing package up to 2000-01 is fragile. The economy could find itself confronted with a foreign exchange crisis even while the debt rescheduling is taking place.

We used the ISPM model to simulate the consequences of the ESAF/EFF program. The objective was to document the direction and magnitude of its impact on selected key macro indicators. **Table 2.1** gives the differential impact (in percentages) between the pre-blasts scenario and the scenario following implementation of the ESAF/EFF program package (including debt rescheduling). Before the decision to explode the nuclear device, the economy's performance was monitored under the ESAF/EFF agreement of October 1997. The program was soft in terms of conditions and speed required for policy reforms. The revived program has tougher policy actions (see box 2D) and Pakistan is being watched closely by international agencies to ensure their timely implementation.

What are the short- and long-term costs and benefits to the economy of the revived package? How will these impacts on the economy compare with those of the original ESAF/EFF program? In essence, the difference between the two scenarios represents the permanent costs to the economy of acquiring nuclear capability and facing up to the sanctions.These costs can be traded off against the perceived non-quantifiable gains in the nation's security through development of military deterrence.

TABLE 2.1

DIFFERENCES* BETWEEN THE IMF + DEBT RESCHEDULING SCENARIO AND THE PRE-BLASTS SCENARIO (%)

Areas of Impact	Actual 1997-98	Short Run (1 year)	Long Run (5 years)**
Growth Rate of GDP	5.4	-2.0	-1.0
Agriculture	5.9	0.0	0.0
Manufacturing	6.7	-5.5	-2.0
Other Sectors	4.8	-2.0	-1.5
Inflation Rate	7.8	3.0	0.0
Unemployment Rate	5.4	0.5	1.0
Private Investment (% of GDP)	8.8	-1.0	-1.0
Public Investment (% of GDP)	5.8	-0.5	-0.5
Exports as % of GDP	13.2	1.5	1.5
Imports as % of GDP	16.1	0.0	0.0
Export Growth of Goods (Real)	4.0	1.5	-1.0
Import Growth of Goods (Real)	-8.2	-5.5	-1.5
Exchange Rate (Nominal) Depreciation (Rs. per US$)	10.8	9.0	0.5
Current Account Deficit (% of GDP)	3.3	0.0	0.0
Budget Deficit (% of GDP)	5.4	-2.0	-3.0
Domestic Debt (% of GDP)	42.1	-3.5	-17.5
External Debt (% of GDP)	49.5	6.0	10.0
Total Debt (% of GDP)	91.6	2.5	-7.5
Total Public Expenditure (% of GDP)	21.8	- 4.5	-2.5

Source: SPDC ISPM model
* rounded off to the nearest one half percentage point
** average for the five years

The economy suffers an immediate loss of growth momentum equivalent to 2% of GDP. Over five years (or on a permanent basis) an average of 1% annually of GDP growth is lost. As a result of the tougher new program, the manufacturing sector sheds 5.5 percentage points initially but recovers to an average annual loss of 2 percentage points over the five-year horizon. Growth in the agriculture sector in the short-run remains insensitive to price stimulus from steeper devaluation in the current package. Private investment fails to recover fully with the new package, as the average difference between the two scenarios remains 1% of the GDP over the long run. Increase in unemployment of half a percentage point in the first year of the program is a spillover from the considerable drop in the performance of the manufacturing sector.

The impact of the new package on the inflation rate, external trade and indebtedness largely hinges on the conduct of the exchange rate policy. To compensate for the loss of inflows into foreign currency accounts and lower direct foreign investment in the short run, the revived program underscores the need for substantial realignment of the exchange rate in real terms. The model indicates an additional 9%

The cost of food items is likely to go up when the proposed unification and market determination of the exchange rate takes place in mid-1999.

nominal devaluation in the first year to steer the economy out of the BOP crisis. In the model, the larger impact on inflation is primarily transmitted through the substantial realignment of the exchange rate. In practice, nominal devaluation of 12% (Rs.50 from Rs.44 against the US dollar) since the imposition of sanctions has not visibly helped exports, primarily because of the depressed external environment. Similarly, the currently observed pass-through effects of nominal devaluation on inflation are small in comparison to the predictions of our model. The dual exchange rate, deflationary trends in international prices, favourable domestic food stocks, a stringent monetary policy and the economic recession appear to have suppressed the inflation costs of nominal devaluation.

The inflationary outlook for 1999-2000 may be closer to the predictions of our analysis for the following reasons. First, after the imposition of the sanctions and introduction of the dual exchange rate in May 1998, wheat and POL products are still imported at the lower official exchange rate of Rs.46. Unification of the exchange rate in mid-1999 in line with the current composite rate will raise the imported cost of these products. The increase in POL prices will ripple through the economy to exert upward pressure on the general price level.

Second, in view of the anticipated shortfall in this year's wheat production, its import requirements are projected in the range of two to three million tons for the coming year. The pressure on the fragile foreign exchange reserves and open market exchange rate will further fuel inflationary expectations. However, the government's decision to absorb the increase in price of imported wheat (due to unification) through a higher subsidy may hold inflation under check. But it will be at the cost of a higher fiscal deficit and backsliding on the commitment to IMF to reduce subsidies. Correspondingly, if the increase in the landed cost of POL imports is absorbed through reduction in surcharges, non-tax revenues, currently a substantial contributor to overall revenues, will decline.

In the long run, the effects of initial adjustment in the exchange rate fade away, although the average annual adjustment over the five-year period is marginally higher (an extra half percent per annum) for the revived package. *The initial upsurge in inflation rate subsides and almost disappears between the two situations in the long run.* Initial benefits to external trade do not expand but are merely sustained. In the long run open unemployment rate in the economy remains on an average one percentage point higher with the revived program. Except for debt indicators, projected five-year averages show that the losses and gains in initial differences converge between the two approaches as the economy adjusts gradually to the initial shock.

A permanent improvement in domestic indebtedness is substituted for worsening external indebtedness. This arises from a reduction in the budget deficit by 2% to 3% of the GDP. Contrary to claims by the government that the IMF package will lead to greater self-reliance in the long run, our analysis suggests a higher level of external indebtedness. The average difference over the five-year period in the external debt-to-GDP ratio between the old and revived IMF package widens to almost 10 percentage points. Clearly, Pakistan will emerge from the grace period of external debt repayment more vulnerable to foreign exchange crises unless exports, in particular, improve dramatically in the intervening period.

A STRATEGY OF SELF-RELIANCE

Given the risks associated with the ESAF/EFF program, we offer an alternative strategy of self-reliance and explore its implications. Self-reliance simply connotes living within one's means, without borrowing. The underlying concept is the same for a person or a country. Mittleman (1980) states, "The guiding principle of self-reliance is that third world countries seeking to stamp out underdevelopment must redress the imbalance between production and consumption. The objective is to produce what is consumed and to consume what is produced, subject to the possibilities and limitations of a country."

However, self-reliance does not mean isolation or complete autarky. Mittleman argues, "It requires neither complete rejection of nor total acquiescence in the world system." Until the 1970s in Pakistan, the principle of self-reliance was applied to wheat production. In response to growing foreign exchange expenditures on the import of edible oil, the concept of self-sufficiency was extended to the production of edible oils in the 1980s.

The sanctions following the nuclear blasts in May 1998 have clearly exposed the nation's excessive dependence on foreign assistance and private flows. On pure economic grounds, the justification for self-reliance rests on many empirical studies assessing the impact of foreign aid. These studies have found no evidence of foreign assistance helping to close the investment-savings or trade gap in Pakistan. In contrast, it appears that efforts to mobilize domestic resources slacken off in periods of easy flow of foreign aid, and there is an artificially high inflow of imports.

A permanent improvement in domestic indebtedness is substituted for worsening external indebtedness.

A Shift in Economic Paradigm

Embarking on a self-reliance strategy means a basic paradigm shift in our economic policies. It means an alternate macroeconomic framework for sustaining economic growth in the medium to long run. However, its implementation entails strong political will and commitment, along with sacrifice from all sections of the society. The crucial elements of the self-reliance strategy as they relate to economic policies are as follows:

- minimal dependence on foreign savings; in other words no foreign borrowing for balance of payments support, commodity aid or project aid for development purposes. However, foreign direct investment, grants and aid for humanitarian needs (social sectors) are allowed to flow into the country;
- unilateral moratorium (i.e., one to five years) on external debt servicing, and repayment of principal to creditors including commercial creditors. However, budgetary provisions continue to be made for debt servicing and repayment of principal on external debt accumulated in the past;
- administrative and legal controls on free outflow of capital; and
- under current account transactions, export of goods and services to be completely offset by import of goods and services.

The first three elements above suggest minimal activity in the capital account of balance of payments.

A relevant question is that to achieve self-reliance, should one rely on neo-classical price mechanisms (i.e., exchange and interest rate adjustments) or structuralist 'quantity' adjustments? The latter, though administratively more difficult and time consuming, may inflict less severe costs to the economy in the short run in terms of inflation, unemployment and poverty. Structuralist adjustments may also prove superior to neo-classical mechanisms in the long run if inflation is held in check.

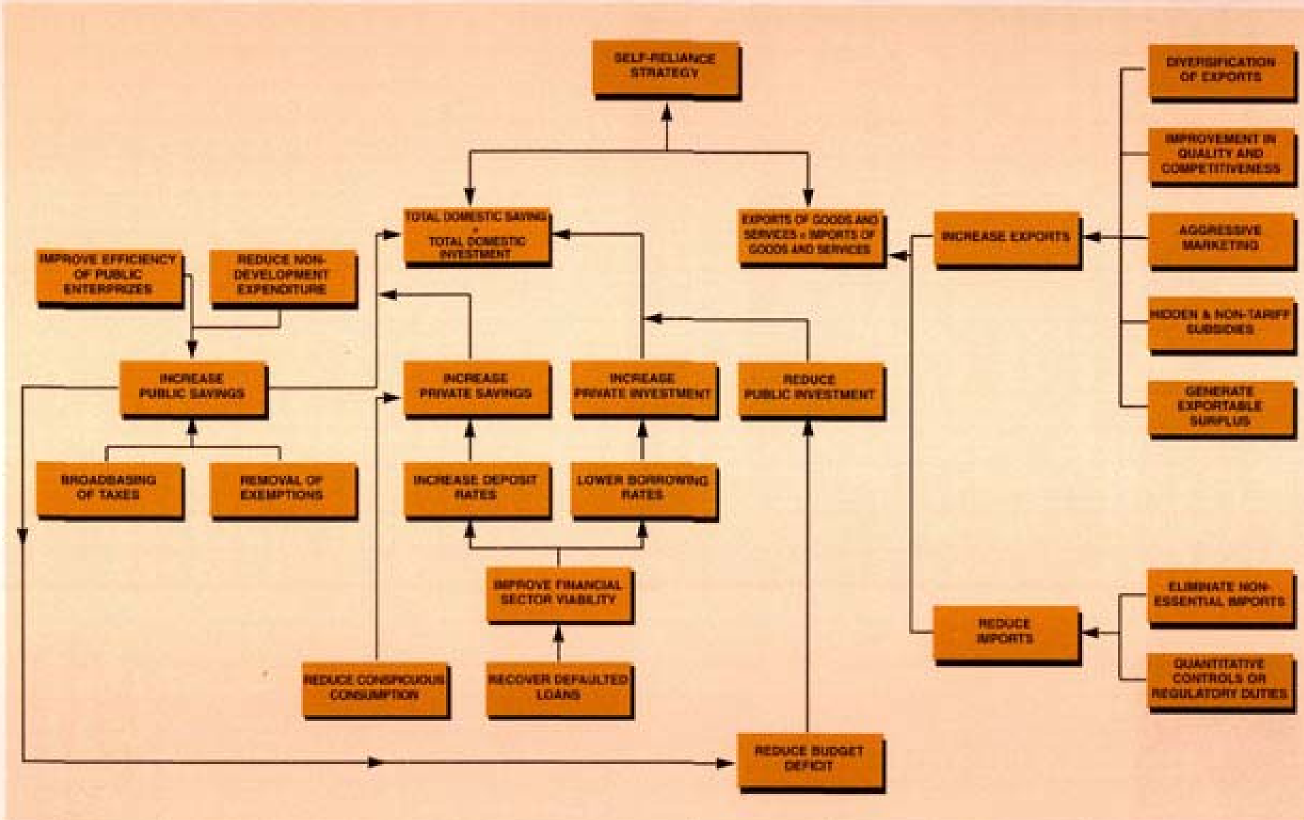
Chart 2.2 outlines the transmission mechanism of the structuralist strategy. In Pakistan, the quantity adjustments would restrict non-essential imports (both consumer goods and raw materials for non-essential consumer goods). And they would promote higher exports through institutional improvements and export subsidies. This approach would close the current account gap in the short run. Initially, there is some nominal devaluation which pushes the economy to a new equilibrium, but subsequently the exchange rate 'crawls' to maintain a constant or even a somewhat over-valued rate. In the real economy, capacity utilization in manufacturing is the main casualty of import compression.

Efforts to recover defaulted loans improve the viability of the banking sector and bring down disintermediation costs. The results are favourable borrowing rates which, in turn, attract private investment. Elimination of exemptions and concessions, and improved tax administration generate more revenues. Increased public savings backed by prudent government spending (including the abandonment of all mega projects) reinforce private savings to increase the supply of investment funds in the economy.

The sanctions following the nuclear blasts in May 1998 have clearly exposed the nation's excessive dependence on foreign assistance and private flows.

CHART 2.2

SELF-RELIANCE STRATEGY: THE STRUCTURALIST ROUTE



Simulating the Structuralist Route

We compare the economic gains and costs to the economy of the two approaches, the quantity route and the stabilization package or pricing route. **Table 2.2** gives the first-year impact in percentage differences between the structuralist strategy and the revived IMF package. The rate of inflation, depreciation of the exchange rate and external debt-to-GDP ratio are significantly lower in the structuralist scenario. However, there is a major sacrifice in terms of the growth of the economy, which is lower by 1 to 2 percentage points. Except for the debt indicators, the respective gains of the IMF package are sustained but with diminishing margins over the five-year horizon. The structuralist approach consolidates its edge over the IMF program scenario with an average reduction of 21 percentage points in external debt-to-GDP ratio. However, these gains are tempered with an increase of 30.5 percentage points in domestic debt-to-GDP ratio.

A somewhat lower level equilibrium path for the economy may be one of the costs that the nation should be prepared to pay for its political and economic sovereignty.

The self-reliance strategy requires strong political will to eliminate tax

TABLE 2.2

DIFFERENCES* BETWEEN THE STRUCTURALIST AND THE IMF + DEBT RESCHEDULING SCENARIO

Areas of Impact	Short Run (1 year)	Long Run (5 years)**
Growth Rate of GDP	-2.0	-1.0
Agriculture	-2.0	-1.0
Manufacturing	-4.5	-3.0
Other Sectors	-1.0	-0.5
Inflation Rate	-6.0	-1.5
Unemployment Rate	0.0	0.0
Private Investment (% of GDP)	0.0	0.0
Public Investment (% of GDP)	-1.5	-1.5
Exports as % of GDP	-1.5	-3.0
Imports as % of GDP	-1.5	-2.0
Export Growth of Goods (Real)	-10.0	-4.5
Import Growth of Goods (Real)	-3.0	-1.0
Exchange Rate (Nominal) Depreciation (Rs. per US$)	-12.5	-3.0
Current Account Deficit (% of GDP)	0.5	0.5
Budget Deficit (% of GDP)	1.5	1.5
Domestic Debt (% of GDP)	9.0	30.5
External Debt (% of GDP)	-11.0	-21.0
Total Debt (% of GDP)	-2.0	-9.5
Total Public Expenditure (% of GDP)	3.5	2.5

Source: SPDC ISPM model
*rounded off to the nearest one half percentage point
** average over the five years

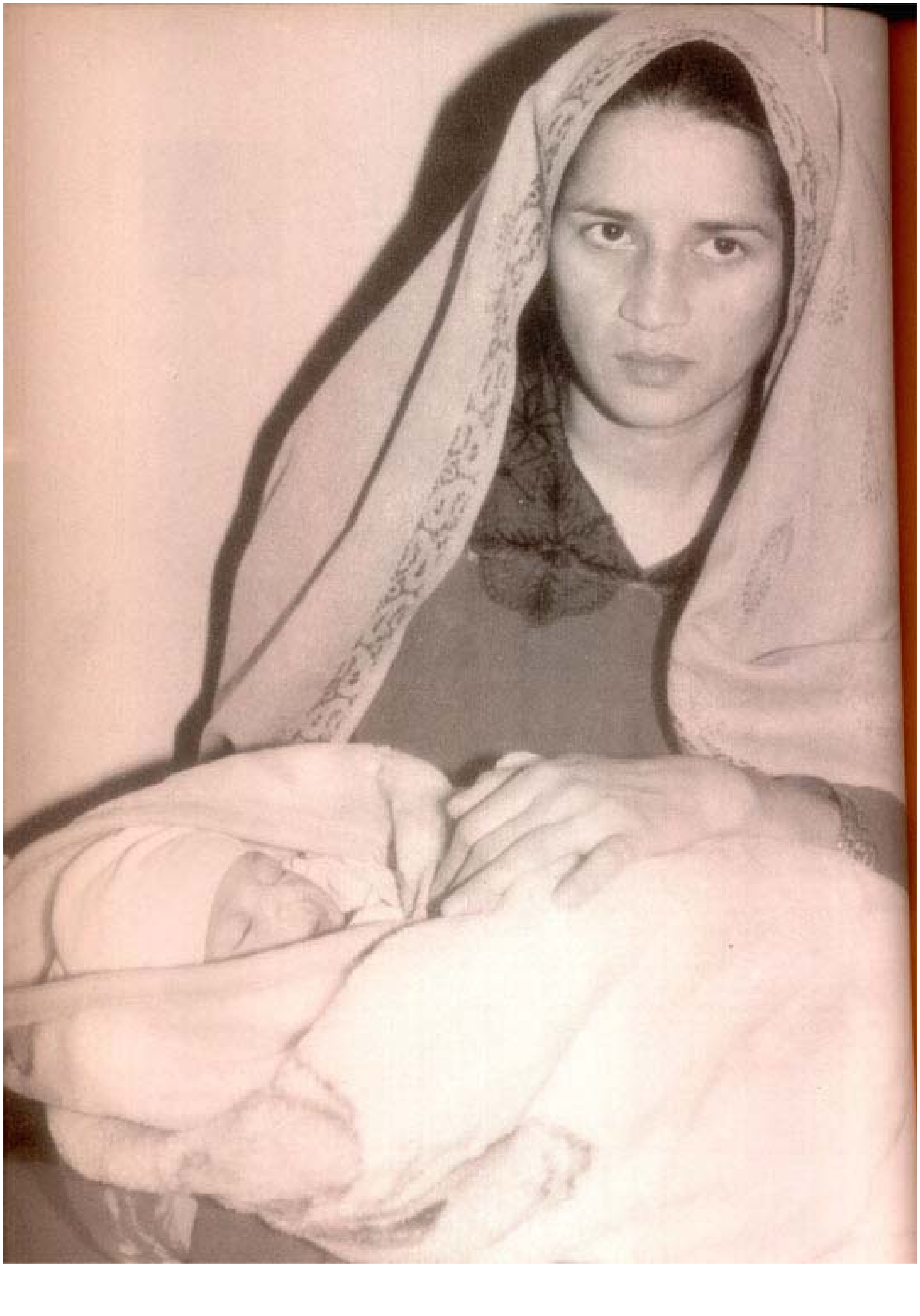
The self-reliance strategy requires strong political will.

A sewage treatment plant under construction in Karachi. With both growth and investment rates going down, development activity has stalled.

exemptions/concessions, check tax evasion, cut public expenditure, introduce import quotas, enforce bank debt recovery and improve efficiency of public enterprizes. Clearly, the political costs of such a strategy are high in the short run and explain why the government has opted instead for increased dependence on donor agencies and a path of staggered reforms.

The permanent economic costs and benefits of announcing nuclear capability and facing upto the sanctions are clear. These trade-offs emerge as a consequence of abandoning the October 1997 package and negotiating the revived package. In spite of rescheduling, the growth rates are lower, and investment rates remain depressed. External indebtedness increases in relation to the pre-blasts scenario. In the long run, the effectiveness of the IMF program will hinge on its credible implementation and consequential response of investors. In contrast, the structuralist self-reliance route implies a trade-off with respect to the growth rate of the economy in relation to the route adopted under the IMF program. It is definitely a better strategy, however, if the primary objective is to achieve independence from foreign aid.

In the long run, the effectiveness of the IMF program will hinge on its credible implementation and consequential response of investors.



DIMENSIONS OF SOCIAL DEVELOPMENT: THE FUTURE OUTLOOK

CHAPTER 3

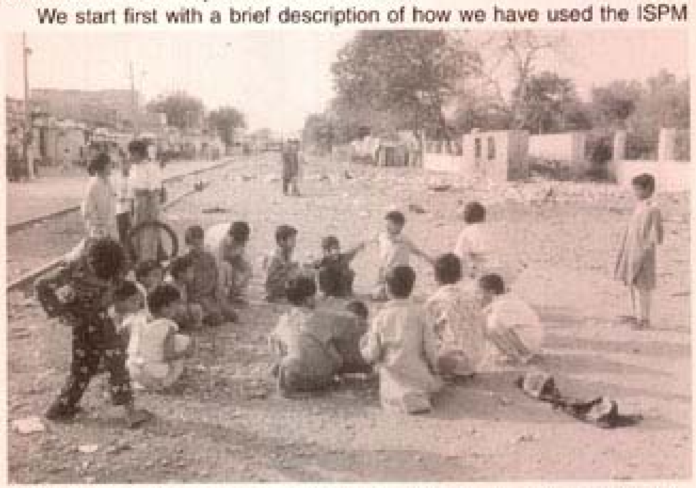
"Has the burden of sanctions fallen on the poor people of Pakistan?"

DIMENSIONS OF SOCIAL DEVELOPMENT: THE FUTURE OUTLOOK

It has been demonstrated in the previous chapters that recent events, including the imposition of sanctions following the nuclear tests by Pakistan have had a big impact of a more or less permanent nature on the Pakistan economy. It is, therefore, important to know how future changes in the course of the economy will affect the social development of the nation. Questions of special interest are: Has the burden of international sanctions fallen on the poorer people of Pakistan? And will the IMF program help to alleviate the growing poverty?

For projecting the outlook for the social development of Pakistan, we have adopted a two-fold approach: the first is to use the SPDC Integrated Social Policy and Macroeconomic (ISPM) model. As elaborated in Appendix A-I, the ISPM model is capable of tracing the chain of major linkages between the macroeconomy, public finances and social development. It highlights the likely changes in such key social dimensions as poverty, employment, real wages, status of women and children, etc., caused by macroeconomic shocks or policy changes used to restore balance of payments or fiscal imbalances. The model potentially indicates not only the direction of the impacts but also the magnitude. This quantitative analysis in the Pakistan setting is supplemented, wherever possible, with international experience of structural adjustment. We have studied a large number of countries which have experienced economic crises in recent years and which have adopted similar strategies to learn how social development has been affected and if some parallels can be drawn.

We start first with a brief description of how we have used the ISPM



Blissfully unaware of macroeconomic models and the growing incidence of poverty, the future generation plays on garbage-littered land.

It is important to know how future changes in the course of the economy will affect the social development of the nation.

Construction workers, earlier much in demand, now sit around waiting for a builder to hire them.

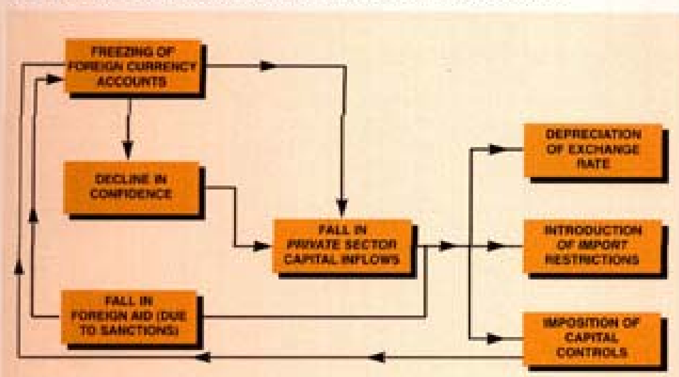
model to present the future outlook of key social sectors. This is followed by an analysis of the key impacts.

THE KEY SOCIAL IMPACTS

Before the nuclear tests, the economy was on the path of recovery. The blasts which led to the imposition of international sanctions disrupted this process. Sanctions terminated all new non-humanitarian lending by the donor agencies, leading to a balance of payments crisis. The government had to freeze foreign currency accounts, adopt a dual exchange rate policy and institute exchange controls to artificially compress the demand for foreign exchange **(see chart 3.1)**. These measures led to a severe loss of

CHART 3.1

THE INITIAL SHOCK AND THE POLICY RESPONSE



private sector confidence, whereby the flows of direct foreign investment and remittances collapsed, further exacerbating the balance of payments crisis. Economic activity in almost all its facets slowed down, directly affecting the government's income (particularly tax) stream. Public expenditures, particularly development outlays, consequently had to be curtailed to keep the fiscal imbalance manageable and to contain aggregate demand so as to reduce pressures on the balance of payments.

What are the social impacts of the emerging economic scenario and how do they filter through? The ISPM model, with its rich specification, can derive the consequences of various shocks. For example, research on poverty in Pakistan indicates **(see box 3A)** that the incidence of poverty depends upon the level of per capita income, extent of unemployment, level of food prices and level of home remittances. The model captures the impact on poverty, via changes in these variables, caused by the shock.

For example, **chart 3.2** traces the impact mechanisms of an exchange rate depreciation on the incidence of poverty (proportion of population below poverty line). Exchange rate depreciation has a number of negative impacts on poverty. The first is a rise in the domestic price level which erodes purchasing power, particularly of the lower-income population. As food prices rise, the severest hit are the poorer households. The second is a more indirect link operating via the investment-production process. Exchange rate depreciation increases the relative price of capital goods (which are imported) and thereby discourages private investment in the country. Lack of new investment affects the capital stock and reduces the production level. The demand for labour accordingly recedes, leading to less employment and/or a decline in wage rates. Also, lower economic activity, with a given population, means a contraction in the per capita income. On the fiscal side, the cost of external debt servicing rises, which implies a larger fiscal deficit. To the extent that this deficit is monetized, there is higher inflation generally and in food prices particularly.

As opposed to this, exchange rate depreciation can have a number of favourable impacts on poverty. If exports increase, there is better use of existing industrial capacity, and private investment is also stimulated. Similarly, as domestic prices of agricultural commodities rise, there are

What are the social impacts of the emerging economic scenario and how do they filter through? The ISPM model, with its rich specification, can derive the consequences of various shocks.

BOX 3A

DETERMINANTS OF POVERTY IN PAKISTAN

The incidence of poverty (measured as percentage of population below the poverty line) is estimated as follows:

Year	Incidence of Poverty %
1979	30.7
1982	26.4
1985	24.5
1988	17.3
1991	22.1
1993	22.4

In the Pakistani context, the following factors appear to be the principal determinants of the extent of poverty:

- average household income (y)
- overall human capital endowment of labour force (hce)
- price index for food (pif)
- real per capita home remittances (pcrm)
- open unemployment rate (u)

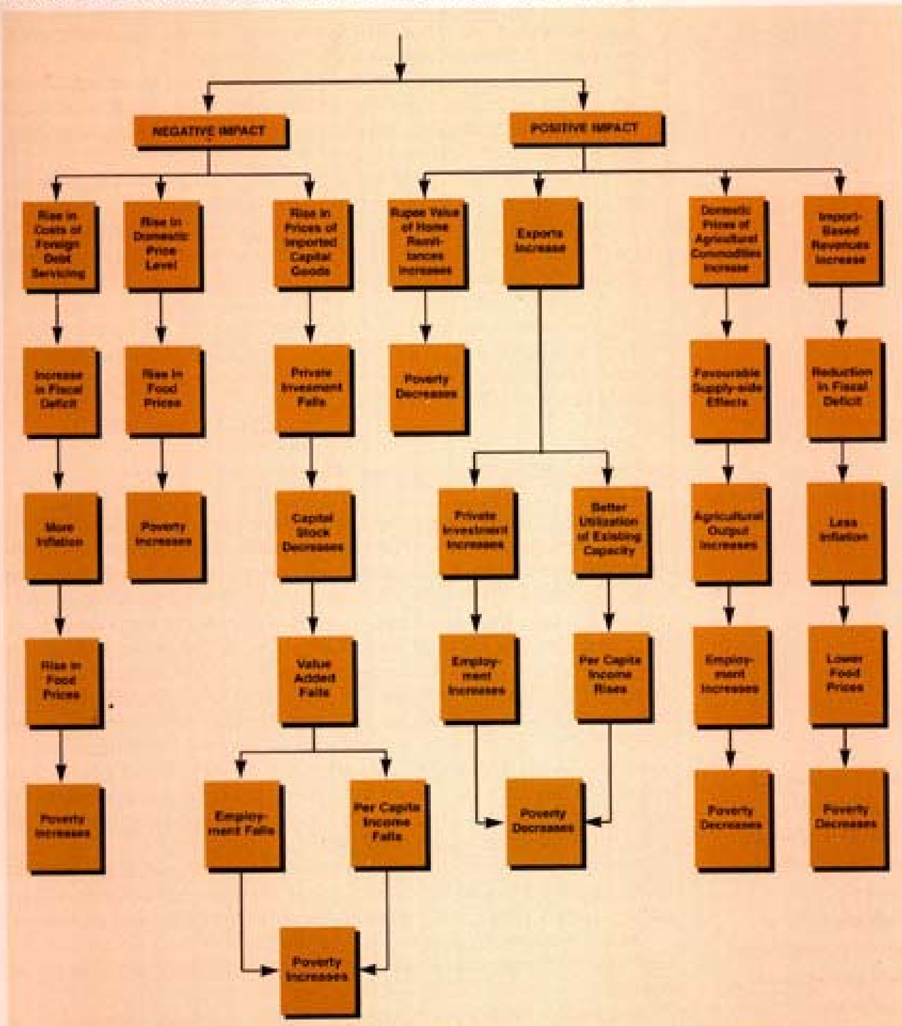
The quantitative impact of each variable on the incidence of poverty is as follows:

Variable	Unit	Increase	Impact on % of population below poverty line
y	Rs	100	-0.10
hce	Units	10	-1.53
pif	Units	10	0.38
pcrm	Rs	100	-1.05
u	%	1	0.48

favourable supply-side effects and agricultural output increases. All these impacts lead to higher employment and incomes. In addition, the rupee value of home remittances increases. Also, there are higher import-based revenues which counteract the adverse impact on the budget of the higher costs of debt servicing. Altogether, the overall impact of exchange rate

CHART 3.2

IMPACT OF EXCHANGE RATE DEPRECIATION ON POVERTY



depreciation on poverty is ambiguous.

This example demonstrates how the ISPM model can be used to simulate the impact on key variables such as poverty, unemployment, status of women and children, etc.

Tracing various key linkages, the ISPM model addresses the following questions:

- What are the key social consequences of the nuclear tests and the subsequent sanctions imposed by the international community?
- Now that the IMF program has been negotiated along with debt rescheduling, how will social development in the country improve compared to the post-blasts/sanctions scenario?
- If the government had followed a different course of adjustment adopting a structuralist strategy, as described in chapter 2, what would have been the state of social sector development? Would it be better, compared to the route now taken?
- Has there been a permanent change in the course of social development in the country due to the sanctions? Or does the IMF program, plus debt rescheduling, fully bring the country back to the level of social development it would have achieved if there had been no sanctions to begin with?

We examine the impact on income and poverty, the labour market, women and children under the various scenarios. Simultaneously, wherever possible we also highlight the international experience on the impacts of economic crises.

IMPACT ON POVERTY

The policy framework agreed to by the Government of Pakistan with the IMF contains a number of conditionalities, implementation of which could have important consequences on poverty.

The policy framework agreed to by the Government of Pakistan with the IMF contains a number of conditionalities, the implementation of which could have important consequences on poverty. **Chart 3.3** analyzes the potential contribution of each policy measure on either poverty reduction or poverty enhancement. The consequences on poverty of some actions are clear, such as the negative impact of a rise in the power tariff or the favourable effects on the economy of removal of import restrictions, higher foreign aid (and program assistance) plus debt rescheduling, development of the agricultural income tax (AIT) and general improvements in tax administration. Other policy moves, such as exchange rate depreciation, have ambiguous consequences on poverty, as highlighted earlier. This includes broadening the base of the general sales tax, trade liberalization (through tariff reforms) and a likely cut in development expenditure (to get to the program target for the fiscal deficit).

Because the impact of the IMF program is so ambiguous, we used the ISPM model to simulate the consequences of the various policy measures on key factors determining poverty. These include the level of real per capita (or household) income, rate of inflation in food prices and the unemployment rate. This enables quantification of the resulting impact on poverty.

The real per capita (or household) income is initially projected to be about 1.5% lower in the IMF program scenario in comparison to the pre-

CHART 3.3

POTENTIAL IMPACT* OF POLICY CONDITIONALITIES IN IMF PROGRAM ON POVERTY IN PAKISTAN

Policy Measure	Contribution to Poverty Alleviation	Contribution to Poverty Enhancement	Net Impact on Poverty
MOVE TO MARKET-BASED EXCHANGE SYSTEM AND EXCHANGE RATE DEPRECIATION	● Higher domestic prices, supply-side response and higher employment in agriculture ● Higher demand for exports stimulating employment ● Higher rupee remittances ● Higher import-based revenues, lower fiscal deficit and enhanced social sector expenditure	● Higher prices of basic food and other items (with pass-through in administered prices) ● Lower private investment, less employment and incomes ● Higher cost of debt servicing	Ambiguous
REMOVAL OF IMPORT RESTRICTIONS	● Higher capacity utilization stimulating employment ● Lower prices of basic imports ● Higher import-based revenues, lower fiscal deficit and enhanced social sector expenditure		Positive
HIGHER FOREIGN AID AND PROGRAM ASSISTANCE PLUS DEBT RESCHEDULING	● Improved BOP, lower exchange rate depreciation ● Less resort to domestic government borrowing, less inflation ● Higher PSDP, higher employment and incomes ● Lower interest rates, stimulating investment and employment		Positive
BROADENING OF GST AND INCREASED RATE	● Lower fiscal deficit, less monetary expansion, less inflation	● Higher prices of basic goods and services	Ambiguous
TARIFF REFORMS	● Lower consumer prices of basic imports	● Labour displacement in domestic industry due to loss of protection ● Higher fiscal deficit, more monetary expansion, more inflation	Ambiguous
RISE IN POWER TARIFFS		● Increased tariffs for low-income domestic consumers	Negative
CUT IN DEVELOPMENT EXPENDITURE	● Lower fiscal deficit, less monetary expansion, less inflation	● Lower employment and incomes	Ambiguous
WITHDRAWAL OF CONSUMER SUBSIDIES	● Lower fiscal deficit, less monetary expansion, less inflation	● Higher prices of basic goods and services	Ambiguous
IMPROVEMENT IN TAX ADMINISTRATION	● Higher revenue; lower fiscal deficit, less monetary expansion, less inflation		Positive
AGRICULTURAL INCOME TAX DEVELOPMENT	● Higher provincial revenues, higher social sector expenditure		Positive

*Only the first round or primary impacts

Even her festive clothes cannot veil the worries reflected in her face.

blasts scenario. The income loss is limited by the relief on interest payments to external creditors, which raises net factor income from abroad. However, beyond the period of debt rescheduling, real per capita income is expected to be lower by about 6%, due partly to lower growth and partly to lower

Mahmooda and her jailbird husband

My name is Mahmooda and I am 25 years old. I live in a one-room place in a *Katchi Abadi* near Ayesha Manzil. It has water and electricity but no gas for cooking. My husband doesn't work even though we have three sons and four daughters. He sells fruit occasionally and brings Rs. 100 in a month.

When I was three, my father brought us to Karachi from Bangladesh as he had no job there and we were starving. Now I work as a *maasi* (cleaning woman), sweeping, mopping and washing clothes in the big houses of the rich. I earn Rs. 2500 a month, which is barely enough for us to eat two meals a day. If a child is sick and has to go to the doctor, that night it's plain roti (bread) for us. My husband who spends all his time in the house wants me to do all the work. He fights with me often over money and beats the children. He was earlier caught and jailed for trying to travel to India on a fake passport .To get him released I had to spend Rs 45,000, which I borrowed from various people. The problems I faced during this difficult time and, later, when I had to return the loans are impossible to put into words.

My husband came out of jail a changed man. He now gambles and often beats me and takes money from me by force. With my husband in jail, I couldn't send my daughters to school for lack of school fees and also because the children were so ashamed. Now they go to read the Quran for which I pay Rs. 200. Even though I work around 12 hours every day, I still cannot earn enough to buy anything for the children except basic rice and lentils, and tea and a bit of sugar and milk. Actually, our condition is going from bad to worse.My daughters are now teenagers and I worry about getting them married. I don't allow my girls to work as I am afraid men will exploit them. I don't trust anybody so I feel they should stay at home.

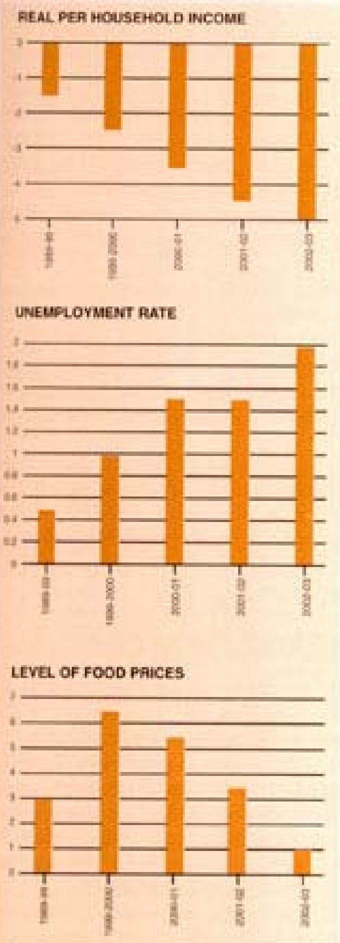
It's not just the men who misbehave with the poor, many rich women do too. In some houses the begums (ladies) give me such a hard time that I am forced to look for another job. Sometimes I wonder if my daughters' lives will be a bit better than mine. Or will they too struggle and suffer all their lives.

home remittances **(see chart 3.4)**. Short-run impact of the shocks and the IMF program on unemployment is small. However, in a more medium-run setting, the unemployment rate may be higher by one to two percentage points. Food prices are likely to be significantly higher (up to 6.5%) in 1998-99 and 1999-2000, primarily because of faster devaluation of the currency. This effect will, however, diminish later.

An additional 1.5% of the population is likely to fall below the poverty line in the IMF program scenario.

CHART 3.4

DIFFERENCES BETWEEN SCENARIOS* IN DETERMINANTS OF POVERTY

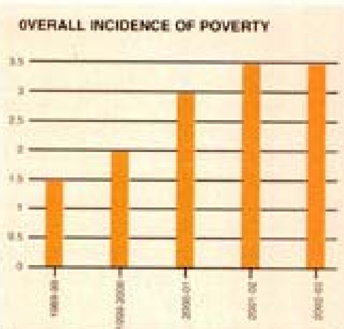


* between the IMF program scenario and the pre-blasts scenario.
Source: SPDC ISPM model.

Altogether, the shocks registered on the economy in 1998 and the IMF program imply higher food prices, higher unemployment, lower per capita income and home remittances. Consequently, the incidence of poverty is likely to be higher. In 1998-99, an additional 1.5% of the population is likely to fall below the poverty line in the IMF program scenario, as compared to the pre-blasts scenario **(see chart 3.5)**. This implies that almost 2 million people will slip below the poverty line. Over the next five years, the IMF program may imply a higher incidence of poverty of about 3.5% of the population, or almost 5 million people.

CHART 3.5

DIFFERENCES BETWEEN SCENARIOS* IN INCIDENCE OF POVERTY



* between the IMF program scenario and the pre-blasts scenario.
Source: SPDC ISPM model.

Over the next five years, the IMF program may imply a higher incidence of poverty of almost 5 million people.

TABLE 3.1

WHY IS THE INCIDENCE OF POVERTY HIGHER?*

FACTOR	% CONTRIBUTION TO HIGHER POVERTY	
	SHORT RUN (first year)	LONG RUN (fifth year)
Lower Real Per Household Income	30	45
Lower Human Capital Endowment	11	18
Higher Food Prices	23	3
Lower Real Per Capita Remittances	23	8
Higher Unemployment Rate	13	26
TOTAL	**100**	**100**
Increase in Population below Poverty Line	2.0 million	5.0 million

*Comparison of IMF + Debt Rescheduling Scenario with Pre-Blasts Scenario.
Source: SPDC estimates.

It may be pointed out that the IMF program initially contributes to higher poverty, even compared to the post-blasts/sanctions scenario. This is primarily because of high food prices and lower growth in human capital endowment. Subsequently, however, poverty would have risen sharply in the absence of the IMF program.

To be able to design the appropriate strategy for social safety nets, we need to estimate the quantitative contribution of different factors to the additional poverty in Pakistan. This is given in **table 3.1.**

The role of lower real per household income is clearly highlighted. In the short run, food prices could play a significant role in contributing to poverty while in the medium to long run, rising unemployment emerges as a major factor.

It is of importance to note that the incidence of poverty could have been lower, by about 1 million people, in the medium run if the structuralist route to adjustment had instead been adopted by the government. This would largely have been the consequence of relatively low food prices.

IMPACT ON LABOUR MARKET

Economic crisis and structural adjustments have had major impacts on the labour markets internationally **(see box 3B)**. In summary, there are instances of an increase in the unemployment rate, particularly in urban areas and among those with higher levels of education. There is also higher underemployment, especially if informalization of labour takes place. A shift from the formal to the informal sector increases employment in the latter. There are sectoral shifts away from the public sector because of public sector employment cuts or freezes and a decline in real wages, especially where the trade union movement is underdeveloped.

Economic crisis and structural adjustments have had major impacts on the labour markets internationally.

According to the results from the ISPM model, the unemployment rate in Pakistan will be up to two percentage points higher than it would have been in the pre-blasts scenario (see chart 3.4). This implies that in a five-year framework an additional 0.8 million people will be unemployed in the country. This is largely a consequence of the relative slowdown of the

BOX 3B

IMPACT OF THE ECONOMIC CRISIS AND STRUCTURAL ADJUSTMENT ON THE LABOUR MARKET: INTERNATIONAL EXPERIENCE

Employment:

- One consequence of economic crisis and of the early structural adjustment period is that unemployment rises.

Official figures for **India** show that when it entered the reform program in 1991, there was an initial backlog of open unemployment in 1990 of about 13 million. Estimates suggest that in the initial years of stabilization unemployment almost doubled.

Chile has exhibited one of the most dramatic unemployment rates for countries undergoing adjustments. In 1983, the unemployment rate stood at one third of the labour force. This was especially significant for the population aged 25 or older, which suggests that a large number of the unemployed were heads of households.

- Under structural adjustment unemployment tends to be higher in urban areas and lower in rural areas. Groups that are hit by unemployment tend to include women and those with higher levels of education.

In **Morocco** 1991 the unemployment rate in urban areas stood at more than 20% as opposed to 5% in rural areas. Urban unemployment seemed to have worsened due to adjustment. The groups that were the most badly hit by urban unemployment were women, youths (15-24 years) and those with primary and secondary education.

In **Chile**, between 1976 and 1987, unemployment was at its most dramatic with unemployment levels of over 10% in all the years.

- One of the effects of economic crisis is that underemployment increases especially where informalization of labour takes place.

Underemployment was observed in **Costa Rica, Bolivia** and **Argentina**. In these countries underemployment moved with unemployment rates. Participation rates also changed and informalization increased.

In **Morocco**, the adjustment period also seems to have been characterized by underemployment.

Employment shifts:

- One of the effects of economic crisis is that there is a shift from formal to informal sector employment. Sectors linked to export activities in particular grow during structural adjustment.

In the decades 1960 to 1990, there was a shift from formal to informal sector employment in **Argentina**. Non-wage employment grew faster than wage employment in non-tradeables, and in both manufacturing and agriculture, non-wage employment grew faster than wage employment. In **Brazil** there was a shift into the unprotected employee sector rather than self-employment.

In the 1980s there was an expansion in the unorganized/informal sector in **South Asia** due to the slow growth or stagnation of employment in the organized private and public sector. Sectors like garments, tailoring, leather units, gems, etc. linked to export activities, were successful in raising employment.

economy. However, there does not appear to be any immediate impact on the employment level in the country. Sectoral shifts are also likely to occur, as results suggest a more rapid decline in the growth of employment in the manufacturing and services sectors as compared to the agricultural sector.

Analysis also suggests that the incidence of unemployment is likely to be higher among educated workers. Research undertaken by SPDC in the context of Pakistan shows that if the unemployment rate in the country increases by one percentage point, unemployment of the educated (Matriculation and above) increases by 1.1%. The highest increase in unemployment is in the case of postgraduates, of about 1.4%.

Nominal wages in the economy depend on the price levels and the

In Pakistan, the evidence is that there is incomplete adjustment of wages to rising prices and, therefore, in periods of high inflation, real wages tend to fall.

unemployment rate. In Pakistan, the evidence is that there is incomplete adjustment of wages to rising prices and, therefore, in periods of high inflation, real wages tend to fall. Our results indicate that the inflation rate is likely to be higher initially in the program scenario, in relation to the pre-blasts scenario, and then lower. The unemployment rate is not affected as much in the short run as in the long run. Therefore, the factor operating on the growth of real wages in the short run will be the rate of inflation while, in the long run, the key determining factor is likely to be the rate of unemployment. The ISPM model estimates that real wages in the economy will initially be 1% lower and, eventually, about 2% lower in comparison to the projected level in the pre-blasts scenario.

IMPACT ON WOMEN

An important factor contributing to the social development of a country is the elimination of any differentiation between genders in access to social or economic opportunity. An index of gender inequality has been constructed to monitor the trend in the relative position of females with respect to males in Pakistan. Four indicators have been used: (i) life expectancy, (ii) literacy rate, (iii) school participation rate and (iv) labour force participation rate (see Appendix A-2). The magnitude of the inequality index is given in **table 3.2.** Results suggest that gender

TABLE 3.2

MAGNITUDE OF GENDER INEQUALITY INDEX FOR PAKISTAN

Year	Life Expectancy	Literacy Rate	School Participation Rate	Labour Force Participation Rate	Composite Index of Gender Inequality
1972-73	100.47	143.60	140.58	184.80	142.62
1973-74	100.23	142.79	140.67	186.00	142.76
1974-75	99.96	141.93	139.77	187.08	142.75
1975-76	99.72	141.12	139.50	184.95	141.75
1976-77	99.72	140.27	140.13	182.96	140.81
1977-78	99.72	139.46	134.82	179.58	139.07
1978-79	99.72	138.60	134.46	176.19	137.72
1979-80	99.63	137.74	134.46	177.09	137.78
1980-81	99.51	137.34	133.65	177.54	137.72
1981-82	99.39	138.47	133.02	178.41	138.15
1982-83	99.27	139.59	133.92	179.28	138.75
1983-84	99.15	140.72	136.53	180.90	139.80
1984-85	99.15	141.26	134.19	182.46	140.17
1985-86	99.15	140.31	132.57	181.59	139.51
1986-87	99.15	139.32	132.57	176.01	137.42
1987-88	99.06	138.38	131.67	179.34	138.18
1988-89	98.94	137.39	132.12	177.75	137.44
1989-90	98.85	136.40	133.47	176.28	136.86
1990-91	98.73	135.90	131.22	174.30	135.50
1991-92	98.73	135.90	130.95	171.87	134.96
1992-93	98.73	135.90	126.18	173.52	134.98
1993-94	98.73	135.90	122.94	173.19	134.32
1994-95	98.73	134.23	120.15	177.03	135.57

Source: SPDC estimates., refer to Technical Appendix A-2.

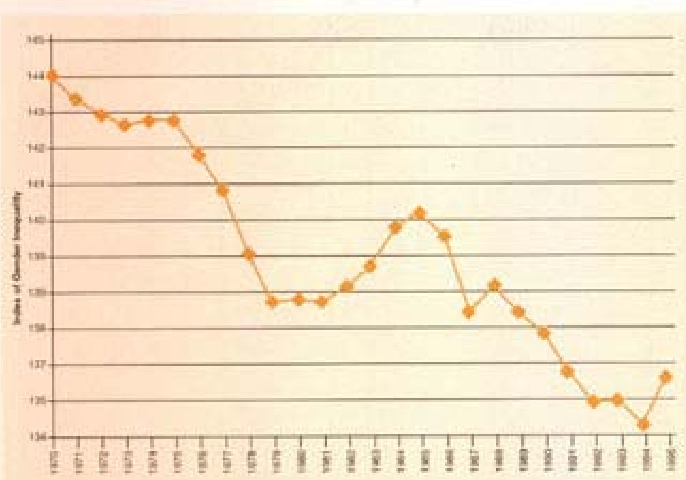
Squatting by the roadside, she shares some rice with her children.

inequality is most pronounced in the labour force participation rate, followed by literacy rate and school participation rate. Life expectancy is actually slightly higher for females than for males.

Gender inequality appears to have declined during the decade of the 1970s, **(see chart 3.6)** with improvement, especially, in female school participation rate in relation to males. The period of Islamization during General Zia-ul-Haq's military regime, however, reversed this trend. Gender inequality increased once again in the first half of the 1980s, such that the gains achieved during the 1970s were largely lost. Since

CHART 3.6

GENDER INEQUALITY IN PAKISTAN (1970-1995)



then there has been some recovery in the relative position of women.

However, an international comparison of gender inequality ranks Pakistan second in a group of developing countries **(see box 3C)**. Afghanistan ranks first. The conclusion is that there still exists substantial gender inequality in Pakistan, especially in terms of participation rates in the labour force. A dramatic improvement will have to await big increases in income levels and fundamental changes in socio-cultural norms.

Analysis of the determinants of the level of gender inequality in Pakistan reveals the importance of three types of variables (see Technical Appendix A-2). The first relates to the macroeconomy. A rise in real per capita income

BOX 3C

GENDER INEQUALITY IN OTHER COUNTRIES

Data on a sample of developing countries (see table below) reveal that substantial gender inequality still exists in most parts of the world, especially in labour force participation and literacy rates. On average, for every two literate females there are three literate males, while for every female worker there are almost five male workers.

There is also a large variation in gender inequality among countries. At one extreme are countries such as Nepal, Afghanistan, Algeria and Pakistan, while at the other extreme are countries such as the Philippines, Thailand, South Korea and Kenya which have made substantial inroads into the elimination of inequality between the genders.

Differences between Pakistan and the sample countries are most pronounced in the ratio of labour force participation rate, literacy rate and secondary enrollment rate of males versus females.

GENDER INEQUALITIES IN VARIOUS INDICATORS IN A SAMPLE OF COUNTRIES
Male as % of Female [1989-94]

Country	Life Expectancy	Literacy Rate	Primary Enrollment Rate	Secondary Enrollment Rate	Labour Force Participation Rate
Afghanistan	97.6	313.3	287.5	275.0	483.3
Algeria	95.7	182.9	115.6	121.8	757.1
Bangladesh	97.6	192.3	121.9	216.6	376.1
Brazil	93.3	100.0	103.7	75.7	500.0
Colombia	92.1	100.0	98.3	82.4	433.3
Egypt	96.3	161.5	118.0	120.2	609.0
Ethiopia	93.0	180.0	142.1	100.0	377.8
India	97.9	168.4	124.2	157.9	514.2
Indonesia	94.7	115.4	103.6	120.5	422.2
Iran	98.4	118.2	107.9	127.6	785.7
Kenya	94.4	102.9	101.1	117.4	334.7
South Korea	89.5	108.8	98.0	102.2	405.2
Mexico	91.5	106.9	103.6	100.0	566.7
Morocco	94.9	216.0	141.7	141.3	500.0
Nepal	101.7	315.4	151.8	366.6	405.3
Nigeria	93.9	117.0	128.0	114.8	471.4
Pakistan	**100.0**	**216.7**	**163.2**	**223.1**	**660.0**
The Philippines	94.2	102.1	101.8	97.5	433.3
Sri Lanka	94.2	106.9	101.0	89.7	460.0
Sudan	94.8	162.0	143.9	135.2	640.0
Thailand	92.9	104.3	101.0	100.0	329.6
Turkey	94.2	127.8	109.2	154.2	462.5
Average for Sample Countries	**95.1**	**155.4**	**125.8**	**142.7**	**496.7**

Source: World Bank, Social Indicators.

is associated with reduction in inequality, possibly because of a narrowing of the nutrition and education gap between males and females at the household level and an improvement in economic opportunities for women. The second group of determinants is socio-cultural in character. In the Pakistani setting, age at marriage and changes in religious norms, especially as they relate to the role of women outside the household, have an important bearing on the time path of gender inequality. The third category relates to the provision of services which affect the pattern of time allocation of women and enable labour savings. In particular, an improvement in the ratio of girls' to boys' schools can contribute to greater equality in school participation. This highlights the role of access to educational facilities as opposed to demand factors which influence female enrollment rates.

Turning now to the future outlook, does the economic crisis have a bearing on gender inequality in Pakistan? If so, will the coming years witness an increase or a decrease in the extent of inequality? **(see box 3D)** In the long run, the gender inequality index would have been higher by two percentage points in the post-blasts/sanctions scenario. However, with the

BOX 3D

WOMEN AND CHILDREN AT RISK: DOWN THE STAIRCASE OF POOR REPRODUCTIVE HEALTH

This year women in Pakistan will give birth to about 2,500,000 girls. At least 600,000 will be undernourished at birth, implying increased risk of poor mental development and poor immunity to infection. When an undernourished girl survives and marries she could become one of the 30,000 women who die each year as a result of pregnancy or childbirth.

For a typical malnourished girl in Pakistan the journey through life can be painful and short. Her life is like walking down a staircase in the dark, where each step leads to a new and unknown danger. Compared with her brothers she will receive less affection, food, health care and education. Her teenage marriage will lead to several pregnancies before her own development is complete. She will give birth to an undernourished baby, then without contraceptive protection she will soon be pregnant again, to face depletion through successive steps of pregnancy, childbirth and breastfeeding. She will have no help from a trained midwife. Before her 25th birthday she might bleed to death after giving birth. Her death would be unremarkable, but it will immediately lead to a much higher risk of sickness and death for her surviving young children.

One in every 40 women in Pakistan will die as a result of pregnancy or childbirth; this risk is one of the highest in the world; it is 50 times higher than for a woman living in an industrialized country. Many who do not die will have serious reproductive health problems. This large burden of death and disease could be greatly reduced if undernourished women had just a little more food during pregnancy, some basic obstetric care, plus contraceptives after the birth to space the next pregnancy. But even these simple measures may not be available soon because of the economic crisis.

The current crisis has led to increases in prices of food and household cooking fuels. These price increases will hit poor people hardest, resulting in less nutrition for girls and pregnant women, not more. And public health budgets are decreasing; this will mean less health care for pregnant women, not more.

The probable result? During the next few years Pakistan will experience increased numbers of undernourished babies, school children, brides and mothers. This increased burden of disease will be reflected in higher rates of sickness and death, especially among impoverished girls and women.

Najma and her drug-addict husband

I am Najma, 25, with two daughters and a son, and I live in a one-room mud hovel in Muslim Pak *Katchi Abadi*. Sharing the room with the five of us are another five relatives including my aunt and mother-in-law. Our room has gas and electricity but no water, and that has to be fetched from far and near. I work as a cleaning woman, sweeping, mopping, dish washing and washing clothes. My aunt used to work with me but is now too old and sick to do so any more. My maternal uncle is a labourer and brings in Rs. 2,500 a month. My husband no longer works having become a drug addict.

Even though my uncle's and my earnings total Rs. 4,500, my husband snatches most of my money from me to buy drugs. He often fights with me, demanding money even when I have none. He wants our daughters to go out to work also, but I am afraid to send them out as they are innocent and immature. There was a time when my husband earned a fair amount of money and life was good. But that was in the early years of our marriage. As our family grew, he began to run away from work and turned to drugs. Due to his addiction, and the money he grabs from me, there is never enough for our daily needs. These in any case are the barest. The soaring inflation has just about cut my throat. I give my children two meals a day, instead of the three we used to have in better days. There are times when we go hungry the whole day. Once I used to dream of sending my young ones to school but there is no question of that now. I am lucky if I can give them *roti* (bread) every day.

I am coping somehow with the difficulties at home, but what to do about the misery I face every time I step outside? Men, and boys too, think they can misbehave with me, as if I am not respectable, as if I am up for sale. I ask myself, could they bear to have their women treated the way they treat me? I work in people's houses, having no other choice and because I'm not educated. Men are supposed to provide protection for their families but what am I to do when my man doesn't? Some of the women I work for also treat me harshly. Some refuse to pay me at the end of the month. Then I must leave their house and look for another job. That can take days, even weeks, and brings hunger to the family. When I get a new job I thank God since He alone can help us.

IMF package, equality has been partially restored, and the index is one percentage point higher than the pre-blasts scenario, but one percentage point lower than the post-blasts/sanctions scenario. It thus appears that the emerging developments will have a differentially higher impact on women in the country. This conclusion is in line with international experience. As indicated in box 3B, economic crises have had more of an impact on women in the workforce, both in terms of contraction in employment opportunities and/or wage rates. Also, since women are prime beneficiaries of social services such as education, health care, water supply and sanitation, population welfare and nutrition programs, contraction in their public provision (discussed in the next chapter) is likely to have more of an adverse bearing on women.

IMPACT ON CHILDREN

International experience reveals that any increase in poverty and/or decline in public social sector provision is bound to adversely affect children, particularly from the poorer segments of the population. The previous sections indicate how economic crises, either by increasing unemployment, reducing wage rates or increasing prices, particularly of food items, can accentuate poverty. These are likely to lead to higher school dropout rates, a decline in the quality of health care (both preventive and curative) and increased malnutrition among children. On top of this, if affordable public sector provision of basic services shrinks, the problem is compounded and the impacts multiply.

Striving hard to earn enough to feed the family.

Our results indicate significant differences among the scenarios in enrollments of boys and girls at the primary level. In the short run, 80,000 more children will not be able to attend primary schools, 50,000 of which will be boys. The decline in enrollment in the long run is projected to be in the order of 0.5 million out of which half will be boys. This is primarily due to lower per capita income which reduces the demand for schooling. It may be mentioned here that a reduction in enrollment implies more child labour, especially in the case of boys.

Allah Ditta: a Child's Plight

I am called Allah Ditta and I am 11 years old. My parents, my eight sisters and I live in a small hut near the railway station. We have light but have to fetch water and wood for fuel from distant places. My mother collects sticks and bits of wood for the stove and fetches water. She cooks and cleans and does the family washing. My father sells clay pots, and being the only son I also work, even though at times I wish I could go to school. We are originally from Multan but my father had no work there and sometimes there was nothing to eat. So my parents brought us to Karachi.

Every morning I wander along the streets and go to the crowded markets looking for people who want their shoes polished. Whatever money I make during the day, I hand it to my mother. Between us my father and I make enough to feed us all, even if it's only lentils and bread. We usually wear old clothes given to us as charity by people.

My mission now is to repair our hut's roof and do something about its broken walls. When it rains, the leaking roof forces us to take shelter under a roadside tree. The winter cold and summer heat are difficult to bear and are especially painful for those of my sisters who happen to be sick.

Life is tough on the streets as people whose shoes I polish can be very difficult. Some refuse to pay me, saying my polish is inferior. Others give me only a fraction of the money they had agreed to pay and fight if I protest. Still others beat me after getting their shoes polished, calling me a pickpocket. Older boys often bully me, shopkeepers order me to move away, taking me for a thief, some scold me, mistaking me for a beggar. The policemen are the worst as they often catch me and snatch my money from me, threatening to lock me up. Those are the times I want to cry and feel myself broken in spirit.

I worry that if I don't bring any money home, how will my sisters manage? They'd have to sleep without food. Daily I think that when I grow up I will do some other kind of work, make a lot of money and get my sisters married. If I had a bicycle I could put my things on the carrier and ride to the big office buildings downtown and make big money.

The impact of malnutrition on children is likely to be sizeable, caused primarily by the lower per capita income and higher food prices. Research undertaken by SPDC on variation in the incidence of malnutrition (as measured by the weight-to-age ratio) in a sample of 45 countries reveals the presence of three important determinants, per capita income, extent of female literacy and the coverage of the immunization programs. Based on the projected values of these determinants in the different scenarios, we estimate that the number of malnourished children could increase by almost 400,000 in the short run and by almost 500,000 in the next few years. This is a first-order impact and needs to be factored into the design of appropriate social safety nets.

WHAT HAVE THE NUCLEAR BLASTS/SANCTIONS COST US?

We are now in a position to make a summary assessment of what the nuclear blasts and sanctions have cost the people of Pakistan, even after the apparent bail-out by the IMF and other multilateral agencies through enhanced external assistance and debt rescheduling. **Table 3.3** gives the estimates of the magnitudes of different costs. First, the average household will lose Rs.400 annually (at 1980-81 prices) in the short run which will rise to about Rs.1600 in the next five years. Almost Rs.13 billion will be lost from the GDP in the short run and over Rs. 40 billion by 2002-03.

Employment opportunities are expected to be reduced by over half a million annually in the next five years. Almost 2 million more people could fall below the poverty line in the short run, with the number rising rapidly to over 5 million by 2002-03. Rising food prices and lower incomes, along with contraction in preventive health services such as immunization programs, will exacerbate the problem of the high proportion (over 40%)

TABLE 3.3

WHAT HAVE THE NUCLEAR BLASTS/SANCTIONS COST US?

SHORT RUN (First Year)	LONG RUN (Fifth Year)
• Lower Gross Domestic Product by Rs.12 billion*	• Lower Gross Domestic Product by Rs. 41 billion*
• Lower real per household income annually by Rs.400*	• Lower real per household income annually by Rs.1600*
• Lower consumption expenditure by Rs.17 billion*	• Lower consumption expenditure by Rs. 43 billion*
• Lower employment by 80,000	• Lower employment by 740,000
• 16,000 more educated unemployed	• 200,000 more educated unemployed
• 2,000,000 more persons below the poverty line	• 5,000,000 more people below the poverty line
• 400,000 additional malnourished children	• 480,000 additional malnourished children

*valued at constant prices of 1980-81
Source: SPDC estimates.

of malnourished children in Pakistan. Almost 400,000 additional children could be adversely affected in terms of their nutritional status. Lower income growth and a tight labour market will diminish the prospects for a rapid improvement in the status of women.

Altogether, Pakistan will pay a significant price for the acquisition of nuclear capability in the face of international sanctions. It will take time for confidence and growth momentum to be restored, even with the IMF program. Of course, it can legitimately be argued that this is the minimum price a nation is willing to pay for its national security and that Pakistan is today a stronger nation with greater international recognition. It is essential, however, to recognize that, irrespective of the magnitude of costs, these must be distributed equitably. The standard of living of poor people must decline the least, through resort to appropriate macroeconomic policies and the development of social safety nets.

THE SOCIAL ACTION PROGRAM

CHAPTER 4

"SAP-II must be radically reformed if it is to have a significant impact on the social indicators of Pakistan."

THE SOCIAL ACTION PROGRAM

The Social Action Program was conceived in 1991 by the Government of Pakistan in response to the realization that Pakistan's performance and ranking in social development compared unfavorably with developing countries in general, and with the other countries of South Asia in particular. The Program was initiated with substantial donor assistance in 1992-93 and has since been able to achieve some success in terms of increased allocations, improved access especially to primary health care and greater awareness among government functionaries and civil society at large regarding the importance of the Program. It has, however, simultaneously faced a number of impediments during its implementation which have limited its effectiveness. On the whole, proponents of the Program argue that in the absence of the Social Action Program, access to basic social services would be more limited and, therefore, the Program must be pursued with vigor and commitment. This chapter attempts to review the performance of the Program since its inception and suggests possible mechanisms and actions for improvement.

SAP-II PROGRESS AND PROGNOSIS

Progress

After more than five years of experience and Rs. 145 billion of expenditure on SAP-I,[1] the World Bank, in its appraisal of SAP-II,[2] has concluded that while:

- the sectors received enhanced funding;
- allocations were largely protected;
- policy dialogue was encouraged; and
- some preliminary steps to initiate institutional reform had been taken, nevertheless,
- vested political interests at various levels remain strong enough to frustrate reform;
- bureaucratic delays and political interference plague the system from the top down through several layers to the local level;
- the management of services is too centralized with too little community involvement;
- implementation capacity remains weak; and
- users who ought to have a stake in reforming the system remain largely uninvolved.

1. SAP is the larger framework or program of the Government of Pakistan out of which the donors have extracted a part and are funding a project referred to as the Social Action Program Project (SAPP).
2. SAP-II extends for 51/2 years, from January 1997 to June 2002.

The Pakistan Integrated Household Survey (PIHS), the basic monitoring instrument, indicates that SAP has had only a very small impact on the basic social indicators. **Table 4.1** shows that, for example, in the education sector, the gross enrollment rate for primary education has actually declined, except in the case of girls; and enrollment in government schools has declined even though there has been a major increase in the number of schools. In health, however, there has been some reduction of incidence of diarrhoea, perhaps owing to the Lady Health Workers Program (LHWP), and the Expanded Program for Immunization has been successful.

The lessons learned in SAP-I were expensive not only in monetary terms, but more important in terms of lost opportunities for the rural people who were meant to benefit but did not.

In SAP-II there is more at stake, as the budget has more than trebled to almost Rs. 500 billion. The two important questions are:

- Have we learned anything from SAP-I and consequently safeguarded SAP-II against the pitfalls of SAP-I?
- Will substantial improvements now be made in the quality of services provided?

SAP-I experiences have led to attempts to reinforce SAP-II by including the following elements.

A focus on quality and not on construction: Improved quality, however, will not happen until fundamental changes are made in delivery and institutions. Unfortunately, government continues to prioritize salaries and construction.

Quality enhancing improvements are the most important expenditures in terms of service, but these remain poorly funded and have been prone to cutbacks whenever a resource crunch is felt. Institutional strengthening is also poorly funded. For example, funds allocated to technical assistance, a crucial component of institutional strengthening, represent only 0.17% of the

TABLE 4.1

SAP ACHIEVEMENTS 1991 TO 1997 (%)

Indicator	Baseline in 1991	Change from 1991
Primary Gross Enrollment Rate	**73**	**-1**
Male	86	-6
Female	59	5
Government Enrollment (% of Total)	**86**	**-8**
Male	87	-9
Female	85	-7
Full Immunization	**25**	**26**
Male	29	23
Female	22	29
Incidence of Diarrhoea	**26**	**-11**
Male	27	-11
Female	25	-11

Source: Government of Pakistan, Federal Bureau of Statistics, Pakistan Integrated Household Survey, Round 2: 1996-97, Islamabad, 1998

SAP-II budget **(see table 4.2)**. The total allocation for improving quality through these and other measures to ensure community involvement is less than 1% of the SAP-II budget. This will not even begin to address the issues. If change is to be brought about, donors and government must face this reality.

Decentralization and a shift to community control: Despite the importance of this objective, to date there has been no real decentralization and no change in power structures within line departments. Some attempts have been made to hand over responsibilities to communities in such areas as managing water supply schemes and schools, but there has been little or no real devolution of authority.

Encouragement of service provision by Non-Government Organizations (NGOs) and the private sector: This initiative depends largely on the Participatory Development Program (PDP) by which government can develop partnerships with NGOs and support their delivery of basic social services. Unfortunately, the PDP has been allocated less than half of one percent of the total SAP-II budget. If administered properly, NGOs have the ability to manage a much larger program. The bottleneck here is government's inability to manage the PDP.

Measurement of outcomes and impact: SAP-II calls for much greater emphasis on monitoring and evaluation. This is essential as line departments have, for many years, relied on the information gap between the village and provincial headquarters to hide their poor performance. The obvious flaw here is that it is the government itself that will be collecting and analyzing the critical information. Strengthening government capability in this area is an obvious need, but the severity of the problem, the magnitude of SAP and what's at stake, all call for stronger measures. Independent institutions of unquestioned international repute and professional calibre must be contracted to conduct the required monitoring and evaluation and ensure proper accountability.

The above objectives are all worthy but unattainable without wholesale changes in methods, organizational structure, incentives and attitudes. Vested interests in the status quo are too strong and will continue to block attempts at reform.

TABLE 4.2

SAP-II EXPENDITURE SHARES

	Rs. Billion	Share (%)
Elementary Education	329.2	66.0
Primary Health	96.9	19.4
Rural Water Supply and Sanitation	49.0	9.8
Population Welfare	19.0	3.8
Sub-Total Programs	**494.1**	**99.1**
Participatory Development Program	2.4	0.5
Monitoring and Evaluation	1.4	0.3
Technical Assistance	0.9	0.2
Total	**498.8**	**100.0**

Source: Federal SAP Secretariat, Government of Pakistan, Special Tabulations

The Macroeconomic Perspective

SAP-I was launched during 1992-93 in a period of growing fiscal transfers to provincial governments following the 1991 National Finance Commission (NFC) Award. Consequently, the government was prepared to protect expenditures on the basic social services. Total expenditures during the first phase of SAP increased from 1.8% of the GDP in 1992-93 to nearly 2.1% in 1996-97 at an annual growth rate of 22%. By 1997-98, however, the fiscal position had worsened substantially and the 1997 NFC Award reduced transfers. Expenditures on SAP were pruned, even though Pakistan had committed to raising them to 2.4% of GDP in the Extended Structural Adjustment Facility (ESAF) program. It is estimated that in 1997-98, the first full year of SAP-II, expenditures on the program fell almost 0.6% to about 1.8% of GDP **(see table 4.3)**, a shortfall of Rs. 17 billion.

Based on the Integrated Social Policy and Macroeconomic (ISPM) model of SPDC, we project the likely SAP expenditures from 1998-99 to 2002-03. These projections take into consideration the reactivation of the ESAF and Extended Fund Facility (EFF) program with the IMF and debt rescheduling by the Paris Club. The growth in expenditures is linked to the growth in fiscal transfers to the provinces. Accordingly, we expect SAP expenditures to aggregate to Rs. 53 billion in 1998-99, compared to the program's expectation of expenditures of Rs. 56.5 billion (not including foreign project assistance). Due to fiscal constraints, SAP expenditures are expected to rise by about 0.05% of the GDP annually to reach 1.85% in 2002-03 **(see table 4.4)**. It is clear that not only will the original ESAF program

TABLE 4.3

SAP EXPENDITURES, 1992-93 TO 1997-98

Years	Recurring Expenditure	Development Expenditure (Rs in Billion)	Total Expenditure	Expenditure as % of GDP
1992-93	15.5	7.2	22.7	1.69
1993-94	19.9	7.1	27.0	1.72
1994-95	23.5	12.0	35.5	1.89
1995-96	29.5	14.5	44.0	2.03
1996-97*	38.9	12.2	51.1	2.13
1997-98 (RE)	31.1	18.1	49.2	1.78

* The expenditure appears to be high when compared to the estimates for total social sector expenditure. This may be due to the differences in accounting methods and also the vintage of estimates.

Sources: Government of Pakistan, Statistical Supplement, Economic Survey, 1997-98; Social Policy and Development Centre, Determinants of Social Sector Expenditures; forthcoming Federal SAP Secretariat, Planning Commission, Government of Pakistan, Special Tabulations

TABLE 4.4

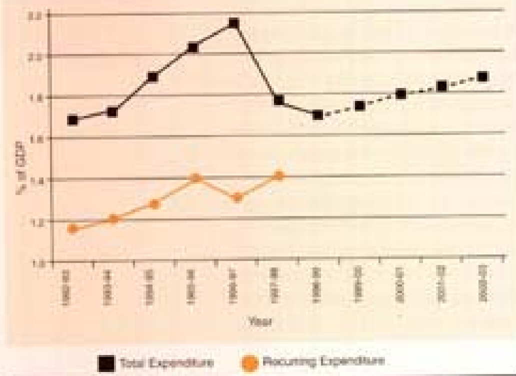
PROJECTED SAP EXPENDITURES 1998-99 TO 2002-03

Years	Total Expenditure (Rs. in Billion)	Expenditure as % of GDP
1998-99	52.7	1.69
1999-2000	62.3	1.73
2000-01	68.0	1.79
2001-02	76.1	1.82
2002-03	84.0	1.85

Source: Projections by SPDC's ISPM model

CHART 4.1

SAP expenditure as % of GDP



commitment of 2.4% of the GDP not be met, but that over the next five years, expenditures will fall far short of the peak of 2.13% attained in SAP-I.

This bleak outlook for the remainder of SAP-II underscores the need for rationalizing the whole program and for rethinking the government's role in the social sectors. The events of May 1998 — the nuclear tests and subsequent sanctions — caused the expenditures to dip even lower **(see chart 4.1).**

One of the principal changes in the focus of SAP-II from SAP-I was on improving quality. However, quality improvements remain unattainable without fundamental changes in delivery and institutions. And, unfortunately, monitoring missions are focusing on issues of disbursement rather than institutional reform. Indeed, government is making construction its first priority. Already, a year and a half into SAP-II, the familiar complaints about salary expenditures are being heard, that they are getting higher priority than non-salary expenditures **(see table 4.5)** even though the allocations to non-salary items are about 40% higher than actual spending during SAP-I. A closer examination of the breakdown of expenditures shows the infinitely small proportion of expenditure on "quality enhancing inputs" — a specific

TABLE 4.5

PATTERN OF SAP EXPENDITURES 1995-96, 1996-97 AND 1997-98 (%)

Elements of Expenditure	Elementary Education	Health Population &Nutrition	Water Supply & Sanitation	Total
	Share in Total Expenditure			
Recurring Expenditure	90.9	85.0	32.9	81.5
Direct Costs	78.3	59.4	31.2	68.6
Salaries	77.4	46.4	12.5	63.3
Quality Enhancing Inputs	0.8	11.3	8.3	3.4
R & M of Facilities	0.1	1.8	10.4	1.9
Overheads	12.6	25.5	1.7	13.0
Salaries	4.6	14.4	0.0	5.4
Goods & Services	3.8	9.7	0.9	4.3
R & M	0.8	1.1	0.8	0.9
Miscellaneous	3.3	0.4	0.0	2.4
Development Expenditure	9.1	15.0	67.1	18.5

Source: Government of Punjab, Sindh, NWFP and Balochistan, Demand for Grants and Appropriations (Current Expenditure) and Demand for Grants and Appropriations (Development Expenditure), 1996-97, 1997-98, 1998-99; Lahore, Karachi, Peshawar, Quetta, June 1996, June 1997, June 1998.

One of the principal changes in the focus of SAP-II from SAP-I was on improving quality. However, quality improvements remain unattainable without fundamental changes in delivery and institutions.

To reduce infant mortality, more health care funding is needed.

condition of the PFP requiring at least 10% being allocated to this area. Over the last three years, the allocations have averaged only 3.4%, ranging from 0.8% for primary/elementary education to 11.3% for primary health care.

Prognosis

It is already apparent that the social sectors are failing to meet SAP-II agreements and objectives. The most recent assessments of progress are the Auditor General's Third Party Validation (TPV) of March 1998 and the Multi-Donor Review Mission of December 1998. Briefly, their principal conclusions are as follows:

- Lack of adherence to criteria for site selection, staff recruitment and procurement is seriously constraining the program.
- There is a lack of understanding of SAP at all levels, probably caused by the rapid turnover of key staff. The Multi-Donor Review Mission was "profoundly concerned that the progress of SAP is being severely jeopardized by the weakness in institutional capacity, the rapid, indiscriminate and disruptive transfer of key managers in all SAP departments."
- Donor funds for essential activities such as monitoring, technical assistance and the PDP are not being used. Imprest accounts set up for the purpose remain unavailable due to bureaucratic delays and lack of understanding.

For several years, government has given high priority to SAP but is becoming disillusioned with the lack of progress in social sectors and the lack of improvement in social indicators. In a period of severe fiscal constraints, continued commitment of resources to SAP is becoming

SAP's target of getting every girl into the classroom has met only partial success.

increasingly difficult, especially when the key productive sectors such as irrigation and roads are drained of resources. Emphasis on reviving the economy by investment in economic infrastructure is beginning to acquire higher priority.

In conclusion, SAP-II is in jeopardy. The improvements already made in its design are inadequate and will not overcome the basic flaws in implementation capacity of the line departments. Unless substantial changes are made in both how social services are delivered and who delivers them, SAP-II may share the same fate as SAP-I.

Future Strategy: Preparing for the Long Term

A radically different strategy is needed to improve the performance of SAP and maximize the impact on social indicators with the resources available. Such a strategy would include the following elements:

- identification of the core public services targeted to the poor and vulnerable groups such as children and women, which would remain the responsibility of government irrespective of the resource position; those services would then be identified which can effectively be handed over to the private sector or NGOs or scaled down in view of lack of resources;
- institutional reforms of the way social services are delivered which would be more cost effective and have a greater impact on the social indicators; these reforms would be based on experience gained from the success of innovative programs which are ongoing in Pakistan;
- strengthening of the process of involvement of NGOs and of mechanisms for independent monitoring and evaluation; and
- a redefinition of the role of donors and changes in financing mechanisms to provide incentives for implementing reform.

ESSENTIAL CORE PUBLIC SOCIAL SERVICES

Core public services are those which:

- are basic and essential;
- provide greatest benefit at low cost;
- have an impact on the key social indicators (literacy rate, infant mortality, etc.);
- target poor people and vulnerable groups including children and women;
- can be provided by government in a cost-effective manner; and
- cannot be provided by the private sector, NGOs or the public at large.

Based on these criteria, the core public services in each sector are identified below. The fundamental responsibility for providing free primary education to all children rests with the government, as a basic right of all children. While the government cannot abdicate this responsibility it can, under specific circumstances, encourage the private sector and NGOs to provide such services.

Elementary Education

Promoting the private sector: NGOs and the private sector have made commendable progress in the provision of primary and secondary education throughout the country **(see box 4A)**. Since public schools cost more to set up and operate than do non-government schools, it would be more cost effective for government to provide financial assistance to the NGOs and the private sector and retreat from direct provision.

BOX 4A

THE PRIVATE SECTOR IS A MAJOR PRESENCE IN DELIVERING SOCIAL SERVICES

The private sector is making considerable headway in providing basic social services. The PIHS 1996/97 shows that it is providing schooling to 44% of urban children and 10% of rural children. In health care, 81% of diarrhoeal consultations are by private health practitioners; 56% of pre-natal consultations are at private facilities and 92% of child deliveries are by private health care providers.

Studies based on the 1995/96 PIHS, in particular the FBS publication, Access and Usage of Basic Health Services in Pakistan, state that 80% of the health care is provided by the private sector. If handpumps are considered to provide safe water, then the private sector provides potable water to nearly 52% of the people. On-site sanitation is also the domain of the private sector.

PRIVATE SECTOR IN SOCIAL SERVICE DELIVERY, 1996/97

	Total (%)	Urban (%)	Rural (%)
EDUCATION			
Primary Enrollment	22	44	10
Male	23	46	11
Female	21	41	9
HEALTH			
Diarrhoeal Consultations	81	81	82
Male	82	81	82
Female	80	80	81
Pre-Natal Consultations	56	59	54
Child Delivery	92	83	96

Focusing on entry-level age groups, girls and backward areas: The gross enrollment ratio for boys is substantially higher than that for girls. Results from the PIHS, 1996-97, indicate that the gross primary enrollment rate for boys in the rural areas is 74% compared to 53% for girls. As a policy, government intervention should be restricted to girls' education in the rural areas and the backward regions, generally focusing on enrolling children aged 5-7 years and keeping them in school. In other words, government should retreat from expansion of boys' elementary education in developed areas.

Promoting non-formal education: The experiment of promoting non-formal basic education (NFBE) through the Prime Minister's Literacy Commission (PMLC) offers potential for greater access to universal primary education at low cost. However, the policy of involving NGOs and Community-based Organizations (CBOs) should be strictly adhered to. No NFBE schools should be established and operated by the government itself.

Raising the quality of education: It is widely recognized that the quality of education provided by both the public and private sector is poor. It can be improved through teaching techniques which are activity-based and child-centred rather than based on rote learning. Government must provide and promote more and better teacher training and a curriculum suited to today's needs. Government should open its teachers' training centres to private and NGO schools while encouraging the private sector to operate its own teachers' training centres. The government should also set standards and protect beneficiary interests.

Health, Population and Nutrition

Expanding preventive health services: The PIHS has established that public health care services have been successful in providing preventive health care. This includes the immunization of children and hygiene education which has reduced infant mortality and incidence of diarrhoea. Under the pressure of shrinking budgets, SAP should give top priority to those programs that benefit people in addition to the immediate consumer. The programs that merit continuing public sector subsidies include women's reproductive health programs, immunization, health communications for behaviour change, and programs for the control of communicable infections of the respiratory tract, such as tuberculosis, and communicable infections of the intestinal tract such as diarrhoea. In addition, SAP should provide emergency health services for treatment of burns, injuries and obstetric complications.

Government must provide and promote more and better teachers' training and a curriculum suited to today's needs.

Integrating public sector health, family planning and nutrition services: There is little co-ordination of health, family planning and nutrition services. The Ministry of Health and the Ministry of Population Welfare each have focused on its own services, to the virtual exclusion of the other's. The consolidation of health, family planning and nutrition activities in one federal ministry and in one department in each province, will reduce public sector costs and increase efficiency. This is particularly true of reproductive health which touches all three areas — health, birth spacing

More and more poor people are turning to the private sector for health care.

and nutrition. It also focuses the three services on the people who need them most: pregnant women, breastfeeding mothers and children.

Increasing sustainability of the Lady Health Workers(LHWs) Program: The government should continue to support salaries (at least in the medium term) of the 40,000 Lady Health Workers (LHWs) employed by the Prime Minister's Program for Health and Family Welfare. These trained local community women provide reproductive health services to the most needy of Pakistan's people. SAP should commission field research that compares the costs of the system with its outputs and impacts. If justified, then SAP should also set up a pilot project to explore the ramifications of transferring the costs of LHWs to communities.

Limiting the public sector role in curative care: More than 80% of curative health services are provided by the private sector today (see box 4A). The public sector should focus on secondary curative care in *tehsil* hospitals and transfer management of such curative services as the underutilized Basic Health Units (BHUs) and Rural Health Centres (RHCs) to the private sector. Because most BHUs and RHCs are poorly operated, drug-starved and notoriously inefficient, opening up management to entrepreneurs such as private doctors, community health committees or NGOs could only lead to better services. Because management would be localized, it would come under the watchful eye of the community that benefits from its operation. The question arises: With private sector management, would poor people be excluded from access to curative health services? The answer is, probably, not. Numerous examples of cross-subsidization exist in most private hospitals, clinics and doctors' consulting rooms. In the larger hospitals and clinics, committees have been set up to determine hardship cases and establish eligibility for subsidy which is available through cross-subsidies or philanthropic

endowments and contributions. In the case of owner-operated clinics and consulting rooms, needy persons receive subsidized treatment. However, the level of service provided may vary.

Rationalizing drugs and medical supplies: Drugs and medical supplies are a major input but in scarce supply at public facilities. This is primarily because of malfeasance in the purchasing and distribution system. In a resource-constrained environment, the government may be forced to abandon the centralized purchasing of drugs and medical supplies; this would mean that all supplies needed in public hospitals would be purchased by patients from retail chemists, which will place additional hardships on poor people. A less draconian measure may be to slash the drug supply budget to a level that would still be adequate for *tehsil* hospitals and above, to ensure that poor people would still have access to emergency and other curative care. Drug supply for primary care facilities may be delegated to local bodies such as community health committees, NGOs and private entrepreneurs who could be trained by SAP to set up Revolving Drug Funds.

Water Supply and Sanitation

Drinking water is a highly sought after commodity. On the one hand, the government's selection of communities to receive water supply schemes has become highly politicized and often has little to do with need or affordability. On the other hand, government is faced with mounting operations and maintenance costs that are not being recovered from the users. By not demanding that the community pay for and manage its own water supply system, the government has introduced a lack of accountability resulting in expensive designs, poor quality construction and major leakage of funds. The typical Public Health Engineering Department (PHED) scheme is at least twice as expensive as it needs to be.

The situation today is almost at a stalemate. PHEDs and politicians maintain their monopoly over the water sector which forces communities to remain dependent on the provincial governments. But governments can no longer afford to provide free services. Existing systems are falling into disrepair and rural water coverage through public schemes has fallen behind population growth. The water supply sector is, in fact, regressing.

The status of the water supply sector is measured by coverage. In its appraisal of SAP, the World Bank estimated that rural water supply coverage was 55% in 1997-98. However, this did not take into account the private sector's provision of potable water. The PIHS and the UNICEF/Ministry of Health surveys paint a different picture. In particular, the 1995 UNICEF Multiple Indicators Cluster Survey of Pakistan found that 17% of rural households had piped water and 52% had family handpumps inside the dwelling. This represents a minimum of 69% coverage. (A note of caution, however, is advised in interpreting these discrepancies since there are variations from region to region, particularly in terms of accessibility.) Overall, one could surmise that water supply coverage in rural Pakistan is presently in the range of 70%; considerably more than the 55% coverage used as the basis for planning SAP-II.

The typical Public Health Engineering Department (PHED) scheme is at least twice as expensive as it needs to be.

Rural women are forced to fetch water from great distances in the absence of a public water supply system.

In establishing essential key services in public water supply, the priorities are clear:

A focus on the hardship areas: Provision should be concentrated on communities where collection of water takes more than one hour. Local Government and Rural Development Departments (LGRDDs) should provide community handpumps where feasible, that is, where the water table is less than 150 feet below ground.

The completion of ongoing schemes: Larger allocations should be made for schemes presently under construction and for rehabilitation of those in disrepair. These allocations should be made with the express purpose of transferring all schemes over to the community through properly designed and executed community management programs.

The end of new water supply schemes: No new public water supply schemes should be provided to communities able to acquire water supply themselves through the private sector such as by the family and community handpumps.

The promotion of private sector and NGO participation: NGOs and the private sector should be encouraged to deliver water, latrines and drainage through grants-in-aid, support in technology development, training and facilitation.

INSTITUTIONAL REFORMS IN SOCIAL SERVICE DELIVERY

Learning from Alternative Delivery Mechanisms

The earlier sections have clearly identified the need to rethink the role of government in the social sectors. With governments unable to generate

Schools run by NGOs/CBOs are reaching out to a growing number of children.

sufficient resources to provide even basic service levels, we must identify and develop alternatives. Pakistan has, over the years, used several innovative approaches to deliver basic social services through the private/NGO sector or in partnership between government and NGOs. Some have been successful, others not. Each has, however, provided lessons for the future. A study of these approaches tells us what can be done, what cannot, what pitfalls to avoid and what successes to replicate.

We must use the fiscal space provided to Pakistan to regroup and, building on these experiences, develop alternative mechanisms for delivery of basic social services. Some of these are discussed below.

Elementary education

Private sector schools: Few have been in operation for very long, but following rapid expansion since denationalization in 1979, private sector schools now number in the tens of thousands. They offer a quality of service which ranges from a level marginally higher than government schools to that comparable to the best available abroad.

A significant initiative in this area is the *Ali Institute of Education* (AIE). The AIE was established in 1993 with two main goals: to meet the demand for primary teachers, and to produce teachers who recognize that activity-based teaching and child-centred learning will produce the best results. Graduates of AIE readily find jobs with the private sector schools catering to middle to upper-middle-income groups. Recently, AIE has opened its doors to in-service training for both private and government school teachers, including an outreach program in Punjab.

Non-Formal Basic Education schools (NFBEs): There are some 300 NGOs and CBOs which are either operating NFBEs or are interested in establishing them. The NFBE schools follow the curriculum specified for the formal schools, with some flexibility in school hours. The basic

Education is a priority need as almost 25% of boys and 45% of girls are still denied this basic right.

methodology adopted by such schools is child-centred learning with a focus on developing skills and creativity.

Basic community schools: These schools are operated under the Prime Minister's Literacy Commission by local NGOs, CBOs and the private sector promoting literacy through mechanisms ranging from adult literacy programs to NFBE schools. The latest experiment in literacy started in December 1995 with the intent of establishing 10,000 NFBE schools. A proposal has been made by PMLC to expand this to a network of 82,000 NFBE schools. However, this is being held back pending a formal appraisal of the existing NFBE schools established by the PMLC.

School Management Committees (SMCs): These committees are being introduced into government schools under SAP. Their role is becoming more meaningful through a more representative membership intended to reduce the influence of politicians and village influentials. This effort to decentralize school management is a step in the right direction, but the GOP still has a long way to go.

Home schools: This approach to educating children is the most successful component of the Balochistan Primary Education Program. More than 300 such rural schools have been established with full support of the villages. Parents pay fees covering the full costs of school operation. Similar approaches have been successfully demonstrated in the Karachi townships of Orangi and Baldia where the schools are often in single rooms in the homes of the teachers themselves.

Health, population welfare and nutrition

Community health management: Health Department officials work with Community Health Committees (CHCs) which provide volunteers and small amounts of money collected locally. The government provides

The shortage of water all over the country affects children also.

matching grants plus human resources to develop capacity of the CHCs to manage primary health facilities. Committees use the funds to repair government health facilities and to purchase medical equipment and supplies. The concept is promising because it places responsibility and authority in the hands of intended beneficiaries.

Social marketing: Social marketing organizations in Pakistan provide more than 20% of contraceptives, most of the iodized salt and most of the in-service training of private health providers.

NGO umbrellas for Community-based Organizations (CBOs): Health NGOs in Pakistan generally have good reputations, but their outreach is limited. Outreach can be multiplied by the umbrella concept: a donor contracts with a well-managed umbrella NGO which subcontracts with several smaller NGOs. In a successful family planning umbrella project in Pakistan, the United Nations Fund for Population Activities (UNFPA) contracted with Pathfinder International to be the umbrella over six NGOs. The result was a rapid and substantial increase in contraceptive use in poor communities.

Water supply and sanitation

The LGRDD/UNICEF Community Handpump Program: Over the last decade, UNICEF has been providing advice and funding to the provincial LGRDDs in a low-profile but sizeable program providing water supply through community-based handpumps. With the installation of more than 25,000 handpumps, the program is providing low-cost, reliable, clean water to over 2.5 million rural people 24 hours a day. In addition, it uses locally produced, energy-efficient technology. The program is sustainable, without long-term dependence on government.

Household sanitation by the private sector: UNICEF has been an important proponent of sanitation in Pakistan. From its many and varied

In the absence of a drainage system stagnant pools of polluted water collect in the vicinity of urban and village communities.

project-based experiences, two conclusions have emerged. The first is that although the provision of subsidies for latrines helps gain entry into the community, in the long term it is detrimental as it creates dependency and is not sustainable. The second conclusion is that private sector *mistris* (skilled workers) trained in latrine installation function well as promoters. The profit motive is an effective incentive.

Mansehra District Council Program (MDCP): This program focused on village water supply when surveys revealed that more than three quarters of the rural population still relied on streams and springs for water. It originally envisaged 1552 schemes, but ended up building more than 3639, over 2000 more than planned! The water supply schemes are owned by the communities through water committees. On average, communities contributed 50% to 60% of capital costs in equipment, supplies and labour.

Community management of schemes: The most successful program began in Azad Jammu and Kashmir (AJK) a decade before SAP began. Nearly all piped LGRDD water schemes now come under community management. Besides O&M costs, the community also pays for 15% to 25% of the capital cost. A second example of a successful community management project took place in 1995 when the United Nations High Commissioner for Refugees (UNHCR) transferred responsibility for its tube well schemes to the Afghan refugee communities in the camps in Balochistan and NWFP. Working through the private sector, it was able to introduce community management to over 70 schemes.

The family handpump: This pump is a source of drinking water where there is shallow groundwater, especially in rural Punjab and Sindh. The Multiple Indicators Cluster Survey (MICS) indicated that 52% of the rural

population get their water from the family handpump (this is corroborated by the PIHS-97). This implies that there are some six million family handpumps in use in Pakistan today. This highly successful, private sector handpump provides reliable water supply 24 hours a day at a very low cost. It is completely in the control of the householder with no burden on government. Unfortunately, the importance of the family handpump has not yet been recognized by government. No attempt has been made to strengthen or draw on the family handpump providers, who form an enormous resource in the water supply sector.

Several common themes weave through the examples cited:

- the use of technology or mechanisms adapted to local needs;
- the identification of needs in consultation with beneficiaries;
- the flexibility in implementation;
- cost effectiveness;
- effective beneficiary involvement throughout;
- accountability and transparency;
- consistency in staff/beneficiary interface;
- effective devolution; and
- cost recovery.

To introduce these elements into government operations, institutional reform is needed. Staff selection and appointment must be on merit only. Staff once appointed must be retained without transfer for several years. Staff must be trained in identifying and adopting the appropriate technology and mechanisms suited to the needs of the beneficiary. Rules must allow for innovation and flexibility. Beneficiary participation must be effective and start with identification of the need and continue through implementation and subsequent operations, maintenance and management, including the management of financial, human and material resources. There must be effective devolution. All of these will allow for transparency, accountability and cost effectiveness. A system to ensure cost recovery — at the minimum, the cost of operations and maintenance — must be introduced.

Elements of Reform

In line with key reforms incorporated in the design of SAP-II and based on the lessons learned from successful innovations in social service delivery, the major elements of institutional reform are described below.

Decentralization: This is an important key to improving the quality of social services. Rigid control of power at the central levels has been SAP's most crippling constraint. Over-centralization has encouraged politicization, poor information management, inefficiency, low transparency, corruption and lack of accountability. SAP services are nearly all under central control of the line departments in the four provincial capitals. Yet, even under the very best of conditions, provincial line departments cannot be expected to deliver quality local services to such large rural populations, which number in the tens of millions, living in a widely dispersed network of settlements.

Most of SAP's objectives can only be achieved if authority and responsibility are devolved to lower tiers of administration. This means eventually shifting control to local governments. But such devolution will require many years to complete **(see box 4B)**. In the meantime, SAP can take the first steps toward devolution by delegation direct to the community and district level.

Empowering the community: Limited community management of water supply, education and health has already begun but with varying degrees of success. In Punjab, education committees have been given direct funding for maintenance of their classrooms. In AJK, the community is directly involved in planning and implementation of its water supply scheme as well as contributing some 20% of its capital cost. In Mansehra, the district council was entirely responsible for a program in which communities helped install more than 3,000 piped water supply schemes.

BOX 4B

INVOLVING THE PEOPLE

In Pakistan, autonomous local government does not exist. What does exist is a host of "local bodies" operating under the provincial LGRDD, line departments and the District Administration as the field representative of the provincial governments.

Under SAP, "decentralization" to the community, NGOs and CBOs goes only part way in devolving decision making. Real authority, in fact, stays with the provincial government in what remains a centrally controlled agenda. Provincial government notifications create the village committees, determine their composition, powers and mode of operation. These committees can be restructured or even dissolved by notification, and their powers and functions altered at will.

Community participation is, indeed, of crucial importance both for governance and accountability. However, it has to be built into the framework of local government to be effective. Thus, integrated local governments must be created with exclusive jurisdiction over specified local functions, such as education, health, water, roads and housing, and must have direct accountability to the electorate. Local governments need to be empowered to undertake overall planning of the package of services, to raise resources and to make expeditious decisions on their implementation. In addition, this process has to be promoted through fiscal decentralization.

The institutional reforms required are substantial. Constitutional provisions will have to be made to ensure that local governments derive their authority from the Constitution and not suffer at the mercy of bureaucratic manipulation of the LGRDD or of political expediency of the provincial or federal governments. The framework of local government (its executive and legislative arms, and its powers and functions) will need to be specified. The parallel levels of local administration (the district administration and field offices of the line departments) will have to be merged into the local government structure. Most important of all, local government will need to be protected against arbitrary dismissal or dissolution. And finally, local governments will need to have adequate fiscal powers to ensure that their political and administrative autonomy is not compromised. They will also need substantially larger fiscal transfers from higher levels of government.

The above measures will require an important basic change. District councils will have to be elected by rural and urban voters of the district. The operational agency for rural areas will have to be union councils and for urban areas the metropolitan/municipal town committees. In total, these steps will constitute a significant move toward the goal of devolution of authority and responsibility for social services delivery.

Most of SAP's objectives can only be achieved if authority and responsibility are devolved to lower tiers of administration. This means eventually shifting control to local governments.

Transferring authority to the community and district is feasible within SAP-II, but it will take government's commitment and full backing to see it through. Ultimately, the transfer of authority will affect the line departments' roles which will naturally shift from control to facilitation. This will take the form of sector monitoring, research, training, maintenance of standards, information management and macro-level planning.

Social communications for behaviour change: Public awareness campaigns have been in the forefront of social development in countries as varied as Bangladesh, China and Great Britain, but not yet in Pakistan. To be effective in Pakistan, communications campaigns should aim at behaviour change, target specific audience segments, be adequately researched and tested before use, and be carried via channels appropriate for each target audience, including mass media for the general public and interpersonal media for school children. Public awareness campaigns are essential to changing behaviour in health, hygiene and education. They will also be needed for better understanding of SAP and its opportunities both inside and outside government. The latter is the subject of a new SAP communications project supported by the Canadian International Development Agency (CIDA).

Strengthening the private sector: Government tends to look on the private sector as competition whereas, in fact, it is a partner. The private sector is responding to public demand in precisely those areas where government is not. Since it is actually relieving government of its burden in many areas of service delivery, government should strengthen the private sector and harness its considerable resources for the benefit of the social sectors. Government could lease its under-used physical facilities, provide grant funding and support the private sector in enhancing its methods, technology and standards. Budgetary requirements would be small, the benefits would be enormous. **Chart 4.2** provides an overview of a few of the opportunities which are immediately available. There are many more.

Government and NGO partnerships: There are thousands of NGOs in Pakistan varying in size, scope and operations. Most lack capacity, outreach and experience to have any significant widespread impact in the social sectors. A handful that do have relevant experience and sufficient capacity have their own agenda and are reluctant to take on government programs or assume government's responsibilities. They will not embrace government programs unless they feel that they benefit directly and that their work with government meshes well with their objectives and programs. On its part, government has always viewed NGOs with scepticism and even suspicion. This would not seem to be a climate conducive to a successful partnership or working relationship.

Yet, opportunities abound for working with NGOs (some are listed in chart 4.2). But first the government must improve its attitudes and procedures when working with NGOs even though there might be good reasons for scepticism. Although numerous NGOs are not suitable, many more are, and it is not difficult to identify the better ones. Training and awareness programs are needed within government to upgrade NGO credibility and value in the eyes of the bureaucracy. This should provide for better understanding of NGOs, their principles and programs.

Government tends to look on the private sector as competition whereas, in fact, it is a partner.

CHART 4.2

SUPPORTING THE PRIVATE SECTOR AND NGOS

Program	Description	Recipients	Support	Support Agencies
Strengthening private sector primary and elementary schools	Expansion in the number and quality of private sector schools serving low- and middle-income households	Private sector and NGO rural, peri-urban and Katchi Abadi schools	Teacher training and curriculum design using activity-based teaching and child-centred learning Technical assistance Tax breaks and credit, Leasing of unused schools	Ali Institute of Education, Lahore, Institute of Educational Development, Aga Khan University, Teachers Resource Centre, Karachi Montessori Association
Expansion of Non-Formal Basic Education	Expansion in number and quality of non-formal schools contributing to literacy and universal primary education.	Umbrella NGOs working with partner CBOs and private sector with proven experience in NFBE	Curriculum and methods development drawing on expertise in Bangladesh and Punjab Teacher training Leasing of schools	NFBE umbrella NGOs such as Bunyad Literacy Community Council, Private sector
Daycare, nursery and prep classes in home schools	Establishing chains and improving quality and management of home schools Providing pre-school classes	NGOs, CBOs teachers and home school managers	Training in home-school management Grants for home school start-ups Educational aids	NGOs with experience in home schools development (such as in Orangi and Baldia, Karachi)
Local management of Rural Health Centres and Basic Health Units	Transfer of responsibility for RHCs and BHUs to private sector doctors and community management	Private sector doctors, umbrella NGOs, NGOs and CBOs	Training in clinic management Monitoring Lease of under-used RHCs and BHUs Start-up credit	District Health Offices, consultant doctors and NGOs working in the health sector
Revolving Drug Funds for Essential Drugs	Generic drug procurement and retailing by private clinics, RHCs and BHUs	Privatized and public RHCs and BHUs, clinics, hospitals, NGOs and CBOs	Technical assistance Training in marketing and management Start-up grants	Health departments, NGOs in health sector, consultant pharmacists
Food Fortification Nutritional Campaigns Nutritional Surveillance	Distribution and retailing of fortified nutritional products at affordable prices IEC campaigns on optimal feeding	Social marketing firms, commercial distributors, retailers Basic Health Facilities, LHWs NGOs	Technical assistance on nutritional products Training in marketing and start-up grants Equipment and supplies for fortification	UNICEF, WFP, UNDP, WHO, NIH, NGOs, and private firms with marketing experience
Community management of existing water supply schemes	Rehabilitation and transfer of schemes to communities for operation, repair, maintenance and ownership	CBOs supported by NGOs, and private sector firms	Rehabilitation grants and technical support Training and certification in community development and scheme management Monitoring	Training Centres for Community Management established as centres of excellence for training and certification
Private sector household sanitation	Creation of private sector capability in marketing and installing sanitation	NGOs and private sector mistris	Training in business development and technology in latrines, septic tanks Start-up credit	LGRDDs and UNICEF
Family handpump upgrading and marketing	Upgrading of technology and installation techniques of family handpumps	Families and handpump fabricators and installers	Improving the quality of the family handpump and its installation to lower repair costs and improve water quality Credit for new fabrication Training in technology, marketing and installation	UNICEF to upgrade technology, train private sector and NGO master trainers to train handpump fabricators and installers

By the end of 1998-99, SAP-II will have completed two and a half years with little to show in the way of institutional reform. Much can be done in the immediate future to offset the impact of these delays. The piecemeal approach to institutional reform, adopted so far, provides avenues to the bureaucracy for stifling reform.[3] Reform must start with the basics, namely, the need to make bureaucrats realize that they are public servants and their function is to serve not govern. Reform must be systemic, coordinated and implemented in a logical sequence. Therefore, the Efficiency and Disciplinary Rules must be changed to ensure that future increments and promotion will depend on an annual review of performance by the people bureaucrats serve and not by their superior officers — who are anyway cut from the same cloth.

Another immediate action would be to remove the power now enjoyed by elected officials of making a gift of appointment or interfering with a posting. This would introduce merit and longevity in a position, thereby making bureaucrats accountable for their actions. The powers of the Deputy Commissioner should be truncated only to that of law and order and revenue collection, the raison d'etre for the position. The coordination function should be the responsibility of the chairman of the district council. All district officials should be employees of the district council and not of provincial governments.

The Participatory Development Program (PDP)

The PDP has been set up as part of SAP to foster stronger linkages among communities, NGOs and government. It is an important and much publicized initiative. NGOs have found that during SAP-I, PDP was, and during SAP-II continues to be:

- centralized and lacking in transparency;
- extremely slow in project selection and payment to the point of nearly collapsing some of the projects; and
- unfriendly, in that government is unable to work effectively with NGOs. Its approach was found to be regulatory and controlling, not supportive.

SAP-II has attempted to address some of these issues. An important first step is the decentralizing of project selection and administration to the provinces. The government has increased resources for monitoring by the private sector and plans to include training. Transparency has been improved by including NGOs on the PDP committees. However, many issues remain unresolved.

- The SAP PDP committees are heavily dominated by government, in particular the line departments.

3. Punjab's step to hold elections for membership of SMCs has been challenged in the courts by vested interests (teachers and district officials). Their argument is that the change has no legal precedent, that SMCs will provide an opportunity for political interference and that quality will suffer. However, what is at stake is that SMCs would be responsible for overall management of schools, performance of teachers, sanctioning wages by linking them to absenteeism, ensuring the availability of teaching materials and essential routine maintenance of assets. This change would ensure performance by employees, reduce the chance of moonlighting and ghost employment, and "invisible" purchase of goods and services will now be accounted for.

- The NGOs have found the attitudes and methods of government to be condescending and inflexible. There remains an element of distrust and disrespect on the part of government which counters any attempt to form working partnerships between government and the NGOs.
- Although SAP has had the experience of administering two rounds of NGO selection and funding, a full 12 months after announcing PDP and receiving over 300 proposals, SAP has been unable to select/fund any NGOs **(see box 4C)**. This has resulted in frustration, to the point that many NGOs have decided never again to attempt preparing PDP proposals but to seek funding elsewhere.

BOX 4C

SELECTING THE RIGHT NGOs FOR PDP

Evaluation Criteria For Organizations proposed by SPDC are:

1. Legal Status: Highest rank for those registered under the Companies Ordinance and lowest for NGOs/CBOs not registered through available legislation.
2. Accounting standards adopted: Highest rank for those maintaining accounts as required by a public limited listed company under the Companies Ordinance and lowest for those maintaining only rudimentary accounts. Evidenced by copy of last accounts.
3. Auditing: Highest rank for audit by reputable Chartered Accountants, followed by reputable Cost & Management Accountants and lowest for no external audit. In the context of small accounting firms (proprietorships or two-member partnerships) "reputable firm" shall be only those who have been certified by the relevant institute as being of "good professional repute."
4. Organization and Experience
   - Age of organization: Over three years; over one and up to three years; not less than one year
   - Length of service of key managers with the applicant
   - Quantum of finances handled over each of the last several years
   - Profile of funding - quantum of community contributions actually realized
   - Tasks and activities undertaken previously
   - Relevance of staff/volunteers employed
   - Identification of target group.
5. Completeness of questionnaire:
   - Highest marks for all questions being answered
   - Second order marks for critical and second tier questions answered
   - Lowest marks for only critical questions responded to.

Evaluation Criteria For Projects/Activity

1. Relevance of project or activity to SAP sectors.
2. Project/activity proposed relevant with experience of organization and of the staff being proposed.
3. Human resource availability at the level of:
   - Leadership
   - Management
   - Field Staff
4. Scale-up factor
   - Proposed size of project compared to historical average over last three years
   - Proposed area of operations compared to historical profile.
5. Target group: comparison to objectives of SAP.
6. Composition of funding: Proportion of funds contributed through community participation, own contributions/other sources and reliance on PDP. Also to be compared with historical profile of achievements / performance.
7. Extent of internal capacity building for delivery of services or completion of activities.
8. Extent of competition with existing facilities.
9. Measures for sustainability after completion of PDP funding.
10. Output/Results
11. Impact : Quality, equity, access.
12. Project cost:
    - Ratio of capital: recurring cost
    - Ratio of human resource cost: recurring cost
    - Ratio of delivery capacity-building cost: recurring cost

NGOs are becoming more active. A home school in progress.

As explicitly stated in its objective, the purpose of PDP is to supplement SAP by involving CBOs, NGOs, the private sector and civil society. However, the interpretation by the line departments is that the PDP should be used to overcome deficiencies in government's service delivery or "gap filling." Almost by definition, NGOs are not interested in undertaking government work or gap filling. Indeed, the intent of PDP is not to hire NGOs to undertake service delivery on behalf of government.

There is no appreciation of the magnitude or complexity of establishing and maintaining an effective NGO/CBO support mechanism worth US$47 million and with more than 500 projects. Not having had any experience in such programs, government has assumed that it is merely a matter of selection, funding and monitoring. This is a recipe for disaster. If indeed the objective is to draw on the NGO sector for support in SAP services delivery, the NGOs will need strengthening and support specifically tailored to their needs. Experience in Pakistan and elsewhere in South Asia has amply demonstrated that strengthening NGOs/CBOs is a complex and demanding task requiring considerable resources and specialized expertise, neither of which are available in government.

After over one year of implementation, the PDP process is to be evaluated and the program redesigned. This will provide an opportunity to make the following changes.

- The PDP should be implemented by non-government and/or private sector organizations having the ability to understand, foster and strengthen government/NGO relationships.
- The PDP Steering Committees should be reconstituted so that the majority of its members are selected from civil society (excluding retired bureaucrats). Procedural changes should be made to ensure that meetings are compulsory for the members themselves and not their alternates. Sufficient notice (say 15 days) should be given of

A mother and child waiting patiently symbolizes the conditions in the rural areas.

impending meetings. By using this mechanism to channel PDP funds, equity and transparency will be assured.

- The program should include a major component of NGO/CBO capacity building.
- Only after the NGOs have shown their ability to use funds properly and can demonstrate capacity, the overall budgetary allocation should be increased to reflect the capacity of NGOs to undertake social services delivery.

Independent Monitoring and Evaluation

SAP-II calls for the strengthening of monitoring and evaluation (M&E) capabilities of the SAP secretariat, provincial SAP cells and line departments. Indeed they need it. SAP-I demonstrated their weakness and partiality in reporting. So-called third party validation has begun to measure process indicators such as site selection, staff recruitment, staff absenteeism, transparency and efficiency. In addition, external monitoring has been planned to cover community participation and NGO/CBO/private sector involvement. While these are necessary measures, they are limited to monitoring process variables, not outcomes and impacts.

Distances between the villages and provincial headquarters present a major block in accessing reliable information on SAP developments at the village level. Centralized line departments rely on their district offices for such information. Usually it is inaccurate and incomplete. It is further culled before being passed on to planning and development (P&D) departments and central agencies such as the Multi-Donor Support Unit (MSU). Seldom do independent monitors venture out to the villages to get first-hand, accurate information. Donors have provided funds for hiring independent monitors but they are not being used. SAP must speed up

Child immunization is one of the few big success stories in the health field.

the process of establishing comprehensive data sets and regular monitoring (including value-for-money audits) by third party monitors contracted outside of government. Only then will the required accuracy and completeness in reporting be available to donors and SAP planners.

Monitoring within SAP-II is off to a poor start. It is currently based on official statistics, the Auditor General's Third Party Validation (TPV) surveys and the PIHS. Each suffers in quality and scope. The TPV surveys are limited to process parameters such as procurement and recruitment but in a way which is strictly administrative and narrow in focus. Line departments are being encouraged to set up management information systems, but nearly all are unreliable. Paper projects, absenteeism and poor performance are common and go unreported. The situation is so serious that the Punjab Government called in the army last year to conduct field surveys of schools to find out what the real situation was. Other governments have either followed suit or are in the process of requesting similar assistance.

The PIHS is upgrading its sampling and survey methods but falls short of measuring service quality or impact in full. It is not attempting to measure value-for-money or cost effectiveness. Strengthening government capability in this area is an obvious need, but the severity of the problem, as well as the magnitude of SAP and what is at stake, calls for stronger measures. It calls for contracting a firm of unquestioned international repute and professional calibre. Such firms are available in the private sector, even in Pakistan.

Even at this late stage there is still a window of opportunity for donors to establish a truly independent M&E mechanism which will go that one essential step further — to determine the quality of services and their impact on the rural population. Relatively speaking, this initiative will not cost a great deal but would have a tremendous effect on SAP. It would not only provide reliable feedback to improve service delivery, it would also act as a check on government's M&E efforts, which would undoubtedly improve as a consequence.

A donor-funded monitoring and evaluation program would not be difficult or time consuming to set up. It would be a matter of establishing proper criteria, indicators and survey methodology and then hiring in the private sector to undertake the work. Many reputable local and international firms have the expertise and experience necessary. The principal reason why truly independent M&E mechanisms are not in place is that the donors are reluctant to insist on them. Subconsciously, they may be hesitant to reveal the true situation. It will take real commitment on the part of the donors to push the concept through. But push they must. It is essential; there is too much at stake.

ROLE OF DONORS

Financing Mechanisms

Total donor funding for SAP-II exceeds US$2 billion. The donors hoped that this would be sufficient to leverage the institutional and delivery reforms needed to attain the objectives of SAP. However, during SAP-I, even though the funding mechanisms were the same, the planned institutional reforms were not implemented. A major cause for the lapse has been the continual back-pedaling by each successive donor Review Mission. The underlying reason is perhaps due to the systems and procedures used to fund projects as opposed to programs.

Project funding is based on contracted amounts paid for completion of civil works; the performance of services or salaries and agreed expenditures. As in SAP-I, disbursement of SAP-II funds routed through the World Bank are treated as reimbursable expenses. These reimbursements are made on the submission of verified eligible expenditures in the form of quarterly Statement of Expenses (SOEs). A major defect of such funding is that it is disbursement oriented and not based on quantifiable output measures. This provides an opportunity for both donors and government to stall on the implementation of reforms or adherence to stipulated conditions.

Program funding mechanisms, such as those under IMF's ESAF/EFF, and the World Bank's Structural Adjustment Loans or Program Loans are structured such that it is nearly impossible to circumvent any of the conditions. These mechanisms provide initial bridge financing to start the process of change. They specify quantifiable benchmarks, verifiable by third parties, which must be achieved before any subsequent tranche is released. Disbursement is either withheld or delayed pending compliance, thereby providing both the carrot and the stick to encourage the implementation of change.

If donors are really committed to seeing better governance and improved performance in social sector delivery in Pakistan, they should adopt this strategy. For instance, each step identified in the policy action matrix[4] should be linked to the release of a specified amount. Each agency and level of government should be treated as an independent

Total donor funding for SAP-II exceeds US$2 billion.

4 For instance, those attached as annexes to the project appraisal documents of both the Asian Development Bank and the World Bank. An example of the link between the action and the release of a tranche could be the devolution of control over staff hiring, posting and transfer to the beneficiary management committee or the district council. Another could be the transfer of employment of line department district functionaries to the district council.

For deprived children an improved SAP-II can holdout a little hope.

entity. There should be no upper limit to the amount which any agency or government could claim; as a performance-based funding mechanism, only the active agency/government implementing the reform would gain. Such an approach would also act as an incentive to the laggards to catch up fearing that they would lose their share.

The added advantage is that the agency/government would implement reform as a result of its demonstrated political willingness even though the driving force may actually be a need to gain access to additional funds to augment scarce public resources. The temptation to divert these funds to other uses can be overcome by placing these amounts in an escrow amount to be released only for approved SAP expenditures by the agency/department concerned.

Donor Support of NGOs

The entire NGO movement needs strengthening, not only in terms of building capacity, but also in making NGOs more accountable and credible.

Grant funding of non-government organizations has traditionally been the purview of the bilateral donors. In contrast to other South Asian countries, the NGO sector in Pakistan is underdeveloped. Literally thousands of small NGOs and CBOs have good potential but are inexperienced, lack credibility and are oriented toward welfare, not development. As such they are not able to contribute significantly to social sector development. Government is attempting to strengthen NGOs, such as through the PDP, but due to its inexperience and distrust of NGOs, these attempts have failed to have any significant impact.

The entire NGO movement needs strengthening, not only in terms of building capacity, but also in making NGOs more accountable and credible. This strengthening can only be accomplished by the NGOs themselves, and on a voluntary basis. NGO resource centres (such as the NGO Resource Centre (NGORC) in Karachi and the Frontier Resource Centre in Peshawar) are already established credible institutions with the mandate and experience in strengthening NGOs. Others which focus on capacity building of CBOs, such as the South Asia Partnership and Strengthening Participatory Organizations (SPO), are working in all provinces. The capacity-building programs of such entities in turn need to be strengthened and broadened to include management (personnel, project, financial and information management), administration, reporting, promotions, marketing, M&E and participatory methods to name but a few.

NGO credibility is another important issue. Government often gives dishonesty and lack of transparency as the reasons why NGOs should not be supported. NGOs need to establish a self-regulatory system to enhance their transparency and credibility. The recommended resource centre NGO strengthening program described above should also offer courses in accountability. As a requirement of certification, each participant NGO should undertake its own financial audit through a recognized accredited auditor. NGOs would want certification in that donors and governments would naturally favour those NGOs which had successfully completed the strengthening and audit process.

Donors need to step back and review the development of Pakistan's NGO movement; determine which resource centres to support; identify key capacity building programs; build the necessary training capabilities within the NGORCs themselves, and fund and implement the program. A well-designed, coordinated and executed program would be tremendously beneficial, not only within the NGO community but for the entire social sector.

Altogether, the overriding conclusion is that SAP-II must be radically reformed if it is to have a significant impact on the social indicators of Pakistan. Otherwise, this program, potentially the most important in the history of Pakistan, is destined for failure.

SOCIAL SAFETY NETS

5

CHAPTER

"Direct approaches through special programs for poverty alleviation become even more important when a country is in an economic crisis, as is the case in Pakistan."

SOCIAL SAFETY NETS

Social safety nets are necessary components in efforts to alleviate poverty because macroeconomic policies, through their 'trickle-down' effect, are unlikely to be effective, even in periods of high growth. This is primarily because of the difficulty in micro targeting and reaching poor and disadvantaged people directly.

Direct approaches through special programs for poverty alleviation become even more important when a country is in an economic crisis, as is the case in Pakistan. Attempts to stabilize its economy through steep reductions in fiscal and current account deficits are hurting the populace, especially those at the bottom of the economic ladder. The process of structural adjustment in this country has caused tax hikes (especially on consumption), cut-backs in public expenditure (particularly on social services) and the phasing out of food subsidies (for example, on wheat). It has depreciated exchange rates and enhanced tariffs on public utilities (such as power and gas). All these "adjustments" will reduce economic opportunities and further lower the living standards of poor people.

The spectre of growing unemployment and rising incidence of poverty (as highlighted in previous chapters) brings with it major social implications. To mitigate the situation, existing safety nets must be improved rather than dismantled, and new ones must be developed. Such actions are a natural complement of a structural adjustment program.

TYPES OF SOCIAL SAFETY NETS

To be effective, social safety nets must be designed on the basis of an understanding of the extent and nature of poverty. And they must respond to the needs of those groups most likely to be affected by the process of structural adjustment.

We need at least three types of programs. The first is long-term financial assistance to those who are unable, more or less, permanently, to provide for themselves through work. This group would include handicapped and disabled people, orphans, widows, etc. The second type of program is designed for those who are able to work but whose incomes are low and irregular. The goal here is to smooth income and consumption in slack seasons.

Of great importance in the present context is the third type of programs. These are for people normally capable of earning adequate incomes but who are temporarily unable to earn a living because of shocks or downturns in the economy such as, in Pakistan, the economic sanctions and the ongoing recession. Such programs provide short-term assistance (such as unemployment benefits), promote employment through public works programs and offer micro credit for income generation.

Existing safety nets must be improved rather than dismantled, and new ones must be developed.

Transfers to people living in poverty can take various forms:

Cash transfers are the traditional form of support. They include private charitable contributions and are considered to be a fairly efficient transfer method because they do not distort consumption or production choices. However, the need for a means test, targeting problems and the scope for leakage (benefits being pre-empted by higher-income groups) make them difficult to administer. They also tend to create a state of permanent dependence on the part of beneficiaries.

In-kind transfers are designed primarily to provide basic food security to poor households. The transfer mechanisms include quantity rationing (along with a price subsidy), food stamps and food for work. If well designed, in-kind transfers can be an effective equivalent to cash transfers but are also complex to administer.

Related to these are *generalized price subsidies* for food items or for other basic commodities and services. Their disadvantage is that they can distort consumption choices and do not specifically target poor people. They are, however, easy to administer.

SOCIAL SAFETY NETS IN PAKISTAN

In Pakistan, the principal form of cash transfers to the poor is through the publicly administered *Zakat* system (along with private charitable contributions). The *Ushr* is also designed to subsidize poor people in rural areas but it has floundered on grounds of inadequate collections. Cash transfers have acquired importance more recently by the launching of the cash *Atta* Subsidy Scheme (ASS) through the *Bait-ul-Maal*.

A traditional social safety net has been the generalized wheat subsidy, a primary source of expenditure by both federal and provincial governments. However, it has been so severely criticized for problems of targeting and leakages, it is expected to be phased out under the Enhanced Structural Adjustment Facility (ESAF) program. Late last year, the government announced a sizeable 30% power tariff subsidy for domestic consumers with a substantial budgetary outlay.

In the area of social security, the federal government operates an employees old-age benefits insurance scheme through a semi-autonomous institution, the EOBI. The coverage of workers under this scheme remains limited. Plans are afoot for development of more elaborate private pensions schemes with matching employer contributions and tax breaks by government.

An ambitious micro-credit scheme for self-employment has been launched recently by commercial banks and other financial institutions such as the Small Business Finance Corporation. It is considered pivotal in the creation of opportunities for educated youth at a time when employment prospects have significantly worsened. However, experience with such schemes (such as the Yellow Cab scheme) has not been encouraging because of poor targeting and high default rates in repayment of loans.

The House Building Finance Corporation (HBFC) continues to operate a subsidized housing finance scheme but it has problems too. It has been accused of having an urban and middle class bias, loans are not being paid back, and in recent years, access to funding has become a serious problem.

NGOs and international agencies have a number of innovative and possibly more effective schemes underway. The World Food Program (WFP) operates the food for work and food for lactating mothers and school girls' programs; the National Rural Support Program (NRSP) runs the micro-credit scheme; and a Pakistan Poverty Alleviation Fund is being proposed. However, these programs are limited in financing, scope and coverage and unless replicated nationally are unlikely to make a major contribution to poverty alleviation.

The total income value of the government transfer schemes is estimated at Rs.24 billion, equivalent to about 0.8% of GDP **(see table 5.1**). The generalized consumer subsidies make up more than Rs.13 billion of this amount. Also included in this tally are the wheat and power subsidies, both probably on their way out. What this illustrates is that, not only are public transfers to poor people relatively small in Pakistan, they are likely to get much smaller.

To alleviate poverty in Pakistan, public transfers should constitute about 3.5% of the GDP, more than four times the present level **(see box 5A)**.

Private transfers are substantially larger, currently at about Rs. 59 billion **(see box 5B)**. They go mostly to religious organizations, with a large share used for mosque construction. Direct cash or in-kind transfers to households are relatively limited.

To alleviate poverty in Pakistan, public transfers should constitute about 3.5% of the GDP, more than four times the present level.

TABLE 5.1

TOTAL VALUE* OF TRANSFERS UNDER DIFFERENT SCHEMES

	Rs. Million
Cash Transfers	**4500**
Zakat	4000
Ushr	n
Bait-ul-Maal	500
In-kind Transfers	**400**
Food Program of WFP	400
Consumer Subsidies	**13200**
Wheat Subsidy	5000
Power Subsidy	8200
Micro-credit Programs	**5000**
NRSP Program	1000
New Self-Employment Scheme	4000
Social Security	**1000**
EOBI	1000
Housing Finance	**300**
HBFC	300
Total Value Of Transfers	**24400** 0.8% of GDP

n = negligible
* Income equivalence in approximate terms
a Estimated
b Assumed Income Multiplier of 1
c Assumed Income Multiplier of 0.5
d Assumed Income Multiplier of 0.2

Source: SPDC estimates.

BOX 5A

TRANSFER PAYMENTS NEEDED TO ALLEVIATE POVERTY

The following formula illustrates the minimum transfer payment (T) needed, as a proportion of the GDP, for more or less full poverty alleviation:

$$\frac{T}{GDP} = \left(\frac{\overline{p}}{y}\right) \quad \frac{i\,g}{t\,(1-a)}$$

where $\overline{P}$ = poverty line (Rs. per month), i = proportion of households below poverty line, g = average poverty gap as proportion of poverty line, t = targeting efficiency, a = administration cost as proportion of transfer, GDP = gross domestic product.

We determine below the required transfer for different parameter values:

CASE	PARAMETER VALUES	T/GDP
I	$\frac{\overline{P}}{Y} = \frac{1}{4}, i = \frac{1}{4}, g = \frac{1}{5}, t = \frac{2}{5}, a = \frac{1}{20}$	3.3%
II	$\frac{\overline{P}}{Y} = \frac{1}{5}, i = \frac{1}{4}, g = \frac{1}{5}, t = \frac{2}{5}, a = \frac{1}{20}$	2.6%
III	$\frac{\overline{P}}{Y} = \frac{1}{4}, i = \frac{1}{3}, g = \frac{1}{5}, t = \frac{2}{5}, a = \frac{1}{20}$	2.5%
IV	$\frac{\overline{P}}{Y} = \frac{1}{4}, i = \frac{1}{4}, g = \frac{1}{4}, t = \frac{2}{5}, a = \frac{1}{20}$	2.6%
V	$\frac{\overline{P}}{Y} = \frac{1}{4}, i = \frac{1}{4}, g = \frac{1}{5}, t = \frac{1}{3}, a = \frac{1}{20}$	4.0%
VI	$\frac{\overline{P}}{Y} = \frac{1}{4}, i = \frac{1}{4}, g = \frac{1}{5}, t = \frac{2}{5}, a = \frac{1}{10}$	3.5%

Parameter values in Case VI are closest to those in Pakistan. The minimum level of transfer payments to alleviate poverty is about 3.5% of the GDP, or approximately Rs. 100 billion. The total income value of transfers currently is about Rs. 25 billion, only about 25% of what is required.

BOX 5B

PHILANTHROPY IS ACTIVE IN PAKISTAN

- In 1998 it is estimated that the people of Pakistan contributed Rs. 59 billion (about 2% of the GDP) and volunteered 1.3 billion hours of time to philanthropic activities.
- Almost 90% of the money and 85% of the time went to religious organizations. The remainder went to social welfare groups such as Edhi and Ansar Burney. Very little went to the education and health sectors.
- Almost 45% of volunteer time went for construction of mosques.
- More than 90% of donations are given directly rather than through a charitable institution.
- As a share of income, relatively low-income households contribute more than upper-income households.
- Contributions to religious organizations are motivated by trust, sense of obligation and spiritual satisfaction.
- In comparison to other countries, Pakistan performs fairly well in charitable involvement and spirit of volunteerism.

Source: Arshad Zaman (1999).

BOX 5C

SOCIAL SAFETY NETS IN THE ESAF PROGRAM

[Quotes from the Section on Social Safety Nets in the Policy Framework Paper]

A multifaceted strategy will be adopted to minimize potential social costs of macroeconomic adjustment and strengthen the social safety net. This strategy includes the following:

- By protecting the Social Action Program and high-priority public investments (agreed with the World Bank) from expenditure cutbacks, the government expects to maintain the level of basic social services provided to the poor.
- Based on a review of existing public sector safety nets (i.e., *Zakat*, *Ushr* and *Bait-ul-Maal*) the government will ensure better targeting of the most vulnerable groups among the poor.
- The Pakistan Poverty Alleviation Fund (PPAF) has been set up to mobilize and assist poor communities in developing income-generating activities through human resource development and micro-credit programs. The government has started funding the PPAF and intends to provide its full endowment amounting to Rs. 500 million by December 2000.
- The government is seeking technical and financial assistance from the donor community to compensate and retrain workers affected by the implementation of various restructuring programs.

[Quotes from other sections of PFP]

- A new electricity subsidy for household consumers introduced in October 1998 is estimated to have a budgetary cost of Rs. 8.2 billion in 1998-99. The electricity subsidy will be phased out in two stages by September 1999.
- The wheat subsidy will be phased out in two stages.

Source: Policy Framework Paper, ESAF/EFF program, IMF.

Altogether, social safety nets have remained underdeveloped and largely ineffective in alleviating poverty in Pakistan. The total quantum of transfers is small, and fiscal constraints are eroding them even further. They are inefficient in reaching the right people, and their coverage is limited. On top of this, some recent initiatives, such as the power tariff subsidy and self-employment scheme, appear to be motivated more by political considerations than by the desire to alleviate poverty.

The ESAF program emphasizes the need for social safety nets. Even so, the Social Action Program will probably be scaled down and subsidies involving major budgetary outlays phased out. Nor is there a likelihood of any new major initiatives **(see box 5C)**. Given such passivity in the face of growing poverty, there is a real danger that social conditions will go into a free fall, deteriorating quickly and soon.

The following description of the strengths and weaknesses of existing social safety nets forms the basis for recommendations for the improvement of these programs and the creation of new ones. Given emerging economic developments in Pakistan, social safety nets are crucial to the survival of those people currently undercovered and those who soon will be.

Altogether, social safety nets have remained underdeveloped and largely ineffective in alleviating poverty in Pakistan. The total quantum of transfers is small, and fiscal constraints are eroding them even further.

DESCRIPTION OF SOCIAL SAFETY NETS

Zakat: The *Zakat and Ushr Ordinance* was passed in 1980. *Zakat* is a form of religiously mandated charity under Islam and officially collected

A *Zakat* and *Ushr* committee office where the indigent are given small subsistence grants.

only from *Sunni* Muslims. An autonomous *Zakat* council administers the Central *Zakat* Fund, maintained by the State Bank of Pakistan (SBP), which does not form part of the federal consolidated fund. This council is supported by the *Zakat* and *Ushr* wing of the Ministry of Religious Affairs. Disbursement in the provinces is regulated by the provincial *Zakat* councils. The most important tier is the local *Zakat* committee, which identifies the *Mustahqin* (the needy and the indigent). It is estimated that there are about 1.5 million *Mustahqin* at present. These committees, of which there are about 39,000, have seven elected, non-official, unpaid members, including two women. Each committee can spend up to 10% of its allocated funds on administration.

Zakat is deducted compulsorily once a year from *Sunni* Muslims at the rate of 2.5% on specified financial assets. Collections in 1997-98 are estimated at Rs. 4.1 billion, a drop from the peak of Rs. 4.7 billion collected in 1993-94. More than 50% of the revenue comes from a tax on savings bank accounts and about 16% from fixed deposits. (A recent judgement by the Supreme Court has allowed all sects *(Fiqh)* to file a declaration seeking exemption from payment of *Zakat* on financial assets. This puts in serious jeopardy the mechanism of compulsory deductions and the level of contributions.)

The Central *Zakat* Fund retains a portion of the proceeds which it invests on a non-interest basis. The outstanding cash balance in January 1996 was almost Rs. 11 billion. Provincial disbursements are based on population, although this criterion is not strictly followed. Distribution of funds by the provincial *Zakat* council is formula driven, with 60% going to local *Zakat* committees and 40% to institutions (*deeni madaris*, public hospitals, vocational training institutions, etc.).

Those eligible to receive *Zakat*, either directly or indirectly, include needy, indigent and poor people (especially widows and orphans), and people with handicaps or disabilities. Local *Zakat* committees give two main types of support: a monthly subsistence allowance of Rs. 250 to each

The vast potential of *Ushr*, a religious tax on agricultural produce has not been realized, leaving the handicapped to live by begging.

Mustahqin, with an additional Rs. 50 per child, and a rehabilitation grant of up to Rs. 3000. These two grants constitute about 70% of the support, with grants for *jahez* (marriage dowry), educational and medical expenses making up the other 30%. All payments are made through banks.

Ushr: a religious tax, *Ushr* is levied under the *Zakat and Ushr Ordinance* on agricultural produce exceeding 948 kg of wheat, or the equivalent value of other crops. Like *Zakat*, it is paid by *Sunni* Muslims. According to religious statutes, the rate of *Ushr* is 5% of the value of crops at a farm site for irrigated land and 10% in the case of non-irrigated (*barani)* land. Even though in practice, a uniform rate of 5% is being applied, the revenue potential of the tax is sizeable.

Unlike *Zakat*, the collection and distribution of *Ushr* are completely decentralized down to the local *Zakat* committee. Collection began in 1983, and revenues peaked at Rs. 0.3 billion in 1984-85. Since then, the local committees have largely failed in the task of assessment and collection and, at present, are collecting less than Rs. 10 million across the whole of Pakistan.

An attempt was made in the *Finance Act* of 1990 to transfer the collection responsibility to the provincial Board of Revenue, but this proposal has not been effectively implemented. The *Ushr*, which has the potential to become a major source of help to poverty-stricken rural households, is essentially moribund.

Bait-ul-Maal: Pakistan *Bait-ul-Maal* (PBM) was established in February 1992 under the provisions of the Pakistan *Bait-ul-Maal Act* of 1991 mainly to provide assistance to those in need (such as the minorities) who are not covered by *Zakat*. PBM is administered by an autonomous board of management consisting of the chairman *(Ameen)*, five non-official members (appointed by the federal government) and three official members. Administrative costs are low, at about 2% of total funds.

Funds for the *Bait-ul-Maal* essentially come in the form of non-lapsable grants from the federal government. Originally, the grant came from the proceeds of the excise duty on bank advances, but since this duty was abolished in the 1997-98 Budget, funding has dropped sharply from Rs. 1 billion in 1996-97 to Rs 0.2 billion in 1998-99. The PBM also receives small grants from the Central *Zakat* Fund, and provincial and local governments.

The *Bait-ul-Maal* provides two main benefits: the Individual Financial Assistance (IFA) scheme which in 1997-98, disbursed Rs. 14 million to about 5,000 beneficiaries, and the Food Subsidy Scheme (FSS), renamed the *Atta* Subsidy Scheme (ASS). In 1997-98, ASS provided about 240,000 families with a monthly cash stipend of Rs. 200. Of the beneficiaries, 29% were widows, 19% were disabled people or invalids and the remaining 52% were families living below the poverty line. The total disbursement was Rs. 0.6 billion.

Until 1994, the PBM ran a food stamp scheme, now abandoned, which benefited 4.2 million people.

Applying for assistance from the *Bait-ul-Maal* is a time-consuming procedure. Three local people (including a local *Zakat* committee member) must attest the application form, which is then processed both at the district and provincial levels. However, the Prime Minister and other high-level functionaries can sanction amounts in open *kutcheries* (public gatherings) or elsewhere for individual financial assistance.

Employees Old-Age Benefits Institution (EOBI): The Employees Old Age Benefits Institution started functioning as an autonomous body at the federal level under the EOB Act of 1976. Applicable to all enterprises with 10 or more employees, it aims to provide pensions to workers who earn less than Rs. 3000 a month. EOBI takes care of all the functions including collection of employer contributions, investment of funds and payment of pensions through banks. It has a network of offices from which employers can get the necessary forms.

Policy making and overall supervision of the institution rests with a 19-member board of trustees, with representation from federal ministries, provincial labour departments, employers and employees. The Secretary of the Federal Ministry of Labour acts as chairman. The institution's accounts are subject to audit both by the government and an external auditor.

Employers pay periodic contributions (at 5% of wages) for their registered workers: by June 1997, more than 37,000 employers were making contributions for 1.2 million registered workers. The annual growth rates in the 1990s were 6% and 7% up to 1997. The annual income from contributions is currently estimated at about Rs. 1 billion. As of the end of June 1997, the cumulative income of the institution since its inception stands at Rs. 9 billion. The federal government traditionally gives a grant of up to Rs. 1 billion from the budget each year, although it was slashed for the first time in 1997-98 because of fiscal constraints. Even so, EOBI has built up a fund of over Rs. 27 billion.

Anyone who has worked for at least 15 years and is 60 years of age (55 years for females) is eligible for a monthly pension provided the employer makes the EOBI contributions. The amount of pension is

determined by a formula based on the number of years worked. The minimum an individual can receive is Rs. 675.

There is provision for a reduced pension (claimed by workers who retire before the age of 60), a pension for invalids (for the duration of the illness), a survivor's pension and old age grants.

Currently 128,000 workers are receiving pensions, and the annual amount paid out by EOBI in pensions or other benefits is about Rs. 1 billion.

Power Subsidy: The Water and Power Development Authority (WAPDA) and Karachi Electric Supply Corporation (KESC) supply electricity to more than seven million domestic consumers in Pakistan. This accounts for about 42% of total power consumption in the country. Tariffs (inclusive of surcharges) are relatively low for most domestic consumers, ranging from Rs. 1.34 per kwh for the first 50 units to Rs. 6.57 per kwh for consumption in excess of 4000 kwh per month. In early March 1998, these tariffs were raised on average by about 21%, with the largest proportion of increase affecting medium-sized consumers. The increase was to improve the financial position of WAPDA and gradually eliminate cross-subsidies to a range of users, including small and medium-sized domestic consumers.

In a dramatic and somewhat unexpected reversal of this policy, the Prime Minister announced, in October 1998, a 30% reduction in tariffs for all domestic consumers; in effect, a subsidy. The move was based on the expectations of savings in payments to private power producers, especially Hub Power Company (HUBCO) and Kot Adu Power Company (KAPCO). This measure not only ran the risk of jeopardizing WAPDA and KESC's already precarious financial situation, it led to the immediate breakdown of the negotiations with IMF on the resumption of the ESAF program.

The magnitude of this subsidy to domestic power consumers is estimated at Rs. 8.2 billion in 1998-99, with much of the benefit going to upper-income consumers.

The government has now reached an understanding with the World Bank and IMF that it will transfer the amount of the subsidy to WAPDA and KESC from the budget, and that the subsidy will be explicitly shown on the bills of consumers.

House Building Finance Corporation (HBFC): Established in 1952 under an act of parliament, the HBFC now has 11 zonal offices and 58 district offices throughout the country. It provides financial assistance for house construction and purchase to homeless people and lower- and middle-income groups. The original subsidized credit provided by the SBP has been discontinued, and the sole source of funding for the program is the amount recovered from past loans. This amounts to about Rs. 2 billion annually.

To be eligible for a HBFC loan, an applicant should have clear land title and be able to pay off the loan in regular installments. (The average interest rate is 13%.)

Since January 1999, the maximum limit for a HBFC loan has been raised to Rs. 2 million. During 1997, HBFC disbursed Rs. 1.3 billion to more than 9000 borrowers. Fifty-five percent of the loans during the last five years were below Rs. 100,000, 40% were between Rs. 100,000 and Rs. 200,000 and the remaining 5% were above Rs. 200,000. Default rates are as high as 30%.

Currently 128,000 workers are receiving pensions.

Will the family elders bring home enough to feed this expectant brood?

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Food for mothers: Initiated in 1992 by the Federal Ministry of Health through the Lady Health Workers (LHW) program, Food for mothers now covers 85 districts through government health facilities. It promotes primary health care in rural areas and urban slums by encouraging expectant mothers to use specific health care services. The inducement is the provision of free edible oil for attendance at health centres.

Each woman receives up to four tins of oil (four to five kgs each) during the course of one pregnancy/delivery and postnatal care period. At each stage of the process, she receives relevant health care and health education on a number of issues including family planning. The regularly monitored scheme has served about 225,000 women to date.

The government covers administration costs (10% of total project costs), and WFP covers the rest. The cumulative cost of the project is about US$26 million. Fairly strong statistical evidence indicates that the use of primary health care has gone up significantly since 1994.

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The project currently covers 10 districts in Balochistan and aims to start in Sindh soon. The selection of the districts is based on the participation rate of girls, and priority is given to those government girls' primary schools in rural areas where the student/teacher ratio is low and where it is logistically feasible to delivery oil in a cost-effective manner.

Enrollment levels have increased since the launching of the program, especially in the *Katchi* (kindergarten) classes. It is possible though, that parents are enrolling under-age girls to benefit from the scheme, thus taxing the capacities of these schools. The dropout rates are high, but the project is still not at a stage where it can have a tangible impact on keeping girls in school. It does seem to have increased enrollments though and, with greater community awareness, the WFP feels that enrollments can eventually be sustained without the oil incentive.

Food for work: This program is a residual of a much larger program run for Afghan refugees, providing food in exchange for work. In the present system, food stamps are issued equivalent to one workday wage (now Rs. 45) which can then be exchanged for wheat in utility stores. The work is mostly in forest management in which the government supervises the planting, growing and guarding of trees. The provincial Forest Department identifies the land, selects the nursery plants and invites villagers to participate.

There are also schemes in watershed management and the prevention of soil degradation. In AJK, a village road-building project is underway, and there is also an attempt to form village development committees. Usually off-peak seasons are chosen for work and the schemes are all self selecting.

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NRSP's partnership with Habib Bank is a breakthrough in the rural micro-credit financing history in this country. Between July 1997 and November 1998, credit disbursement has increased from Rs. 0.1 billion to almost Rs. 1 billion, and the number of borrowers has gone from 23,000 to 52,000 in almost 4000 community organizations.

One fourth of the expected loan is initially pledged by the borrower as collateral. Peer pressure and social reputation of the individual and community organization are effectively used as a collateral tool. Even though the annual rate of interest is 18% to 20%, the recovery rate is high. This has been achieved by developing an effective credit disbursement procedure **(see box 5D)**.

Enrollment levels have increased since the launching of the food for girls program.

BOX 5D

CREDIT PROCEDURE OF NRSP

S. No.	Activity	Responsibility	Evidence
1	Introduction of credit program to rural communities and community organizations (COs)	• All field staff • Regional Professional (RP) • Management, including the GM	• Field visit reports • Minutes
2	Identification need	• Requesting members of COs with other members	• Proceedings register of COs
3	Social appraisal	• CO members • Manager and President in the general body meeting of the CO	• Resolution signed by at least 80% of the CO members
4	Technical appraisal	• Social Organizer (SO), • Regional Professional (RP)	• Appraisal form and designs for PPIs by engineer
5	Determining terms and conditions	• Social Organizer • RPO/CO members • Manager • President from CO	• Terms of partnership (TOP) • List of intended borrowers with specimen signatures • Any proof by the borrower showing amount saved equal to 25% of the credit requested (not mandatory) • Affidavit on simple paper of properly utilized credit and prompt recovery
6	Office work: checking of previous performance of the borrower, scrutinizing supporting documents, preparing cheque in the name of CO and maintaining records	• Regional Professional Credit and Accounts	• Sanction form along with above supporting loans from 3-9
7	Signing of cheques	• RPO and RP	• Cheque book • Bank Statement
8	Delivery of cheque in the name of CO with a repayment schedule for each loan	• By SO in the General Body meeting of CO	• Proceedings Register of COs
9	Recovery	• Generally through CO's Activist	• Official Receipt by NRSP
10	Monitoring	• Community Organization • Social Organizer • Regional Offices • Headquarters Office	• Proceedings register • Recovery rate • Reports

In the absence of effective social safety nets destitute children turn to begging.

Pakistan Poverty Alleviation Fund (PPAF): established in February 1997 as a non-profit and autonomous private company under the *Companies Ordinance*, 1984, the PPAF provides micro credit and sustainable development programs with community participation. Its main authority rests with its General Body and Board of Directors. The Government of Pakistan has provided the fund with a Rs. 100 million grant which is expected to be raised to Rs. 500 million by the year 2000. The World Bank will also be providing a major credit line shortly. The aims and objectives of PPAF are to improve the economic welfare and income of poor people; to strengthen partner organizations and local communities; and to provide credit to eligible partner organizations to assist them expand their poverty-targeted micro-credit programs.

The fund has three components. A micro-credit/micro-enterprizes scheme provides loans to partner organizations. A second component finances small-scale community infrastructure through grants and loans provided on a cost-sharing basis to partner organizations. The third component is aimed at improving capacity of stakeholders and partner organizations. A partner organization must be a registered NGO with a good track record, have the institutional capacity for implementation, be gender sensitive and have a transparent management system.

CRITERIA FOR EVALUATION OF SAFETY NETS

The following criteria for evaluation of these safety nets are based on international experience in this area **(see box 5E):**

- *targeting efficiency:* measured by the extent to which a program's expenditures actually reach poor people rather than relatively well-off segments of the population;

BOX 5E

LEARNING FROM THE EXPERIENCE OF OTHER COUNTRIES

- In countries with poor populations, direct poverty-targeted programs alone may not reduce the severity of poverty.
- Improvements and innovations in delivery of programs can be of significant help to poor people.
- Maintaining low program costs (as a percentage of the total budget) ensures sustainability. Critical transfers should not be diluted because of fiscal deficits.
- Universal food subsidies are fiscally unsustainable and distortionary. Targeting, therefore, is necessary for sustainable and cost-effective programs.
- All social assistance transfers generate incentive costs. The best way to minimize incentive costs is to keep the amount of transfers modest.
- For political reasons, the poorer segments of the population may actually lose out from too much fine tuning in targeting because of lack of broad-based political support.

- *program coverage:* the proportion of poor households which receive benefits from the program;
- *ease of access:* the level of transactions costs imposed on eligible households in accessing the program, as indicated by the simplicity and transparency of procedures, documentation requirements and level of discretion with program officials in the disbursement of benefits;
- *percentage of program expenditure dedicated to benefits:* measured by how much of the program budget is spent on administration costs rather than benefits;
- *adequacy of support:* the extent to which the benefit reduces the poverty of a recipient;
- *income equivalence of transfer:* the extent to which the transfer distorts consumption choices of the beneficiaries. For example, an open-ended power subsidy may lead to over-consumption and waste;
- *incentive effects:* positive or negative. Anti-poverty interventions can change behaviour. For example, an unemployment benefit may reduce the motivation for job search. On the other hand, school food programs can raise school participation and reduce dropout rates;
- *extent of self financing/progressive financing:* programs which raise funding through well-defined and earmarked sources are likely to be more sustainable fiscally. A program is more secure if it is supported by wealthier households rather than general budgetary sources which are vulnerable to inflation and cut-backs when the fiscal position worsens;
- *displacement of private transfers:* a transfer should not either partially or wholly displace corresponding transfers by households or private sector entities. An example is the *Zakat* whereby compulsory deductions may lead to a more or less matching reduction in private charitable contributions;
- *impact on development:* programs can contribute either directly or indirectly to development. A public works program, for example, could lead to the creation of improved irrigation or farm-to-market roads and thereby contribute to higher agricultural productivity.

TABLE 5.2

EVALUATION* OF SOCIAL SAFETY NETS IN PAKISTAN
Government Programs

Criteria	*Zakat*	*Bait-ul-Mal*	*Ushr*	Wheat Subsidy	Power Subsidy	Employees Old Age Benefits Scheme	Self Employment Credit	Housing Finance (HBFC)
Targeting efficiency	M	M	M	L	L	H	L	M
Program coverage	M	L	L	H	M	L	L	L
Ease of access	M	M	M	H	H	L	L	L
Adequacy of support	H	H	L	H	H	M	H	M
Income equivalence of transfer	H	H	H	M	L	H	H	M
Share of benefits in program expenditure	H	H	H	L	H	H	L	L
Incentive effects	M	M	L	M	M	L	M	M
Extent of self-financing/ progressive financing	H	L	M	L	L	M	L	H
Displacement of private transfers (or expenditure)	L	M	M	M	M	M	H	H
Impact on development	L	L	L	L	L	L	M	M
SUMMARY								
High Scores	4	3	2	3	3	3	3	2
Medium Scores	4	4	4	3	3	3	2	5
Low Scores	2	3	4	4	4	4	5	3

*A rating of H (high) has a score of 4, rating of M (medium) has a score of 2 and L (low) has a zero score.

Tables 5.2 and **5.3** illustrate the application of these criteria to different social safety nets in Pakistan. Some key findings are discussed below.

EVALUATION OF SOCIAL SAFETY NETS

Zakat performs well on a number of criteria. The support provided in the form of subsistence allowance appears to be adequate. According to the World Bank (1995) this allowance is about three times the average income gap of people living in poverty, but a proper conclusion requires knowledge of the number of dependents. Since the allowance is in cash, there is full income equivalence of the transfer. Administration costs as a whole are low, primarily because of voluntary inputs provided by members of the local committees. One of the strongest points in favour of *Zakat* is its access to an earmarked source of revenue. (However, contributions are likely to be adversely affected by the recent Supreme Court judgement on compulsory deductions). Its reliance on a specific source not only ensures sustainability, but the nature of the tax (on financial assets) is such that the burden falls mostly on upper-income households. Therefore, the *Zakat* has the potential of playing a strong re-distributive role.

Problems with the *Zakat* include its degree of targeting efficiency. There is conflicting evidence on this. According to the World Bank

TABLE 5.3

EVALUATION OF SOCIAL SAFETY NETS IN PAKISTAN

NGO Programs

Criteria	Food for lactating mothers and school girls (WFP)	Food for Work (WFP)	Micro-credit Scheme of NRSP	Pakistan Poverty Alleviation Fund
Targeting efficiency	H	H	H	M
Program coverage	L	L	L	L
Ease of access	H	H	M	M
Adequacy of Support	M	M	H	H
Income equivalence of transfer	H	H	H	H
Share of benefits in program expenditure	L	H	H	M
Incentive effects	H	M	H	M
Extent of self-financing/ progressive financing	L	L	L	L
Displacement of private transfers (or expenditure)	M	H	H	H
Impact on development	M	H	H	H
SUMMARY				
High Scores	4	6	7	4
Medium Scores	3	2	1	4
Low Scores	3	2	2	2

* A rating of H (high) has a score of 4, rating of M (medium) has a score of 2 and L (low) has a zero score.

(1995) and Jehle (1995), about half the benefits went to the lowest quintile of households in 1991. Therefore, the other half went to households which cannot be considered poor. However, Naseem Shah Shirazi (1996) uses the 1991 Household Income and Expenditure Survey (HIES) data to show that 94% of *Zakat* (official and private) was received by families in the lowest quintile of the income distribution.

Access to the benefit is another problem. A number of stages are involved in defining a *Mustahqin*, and there is inevitably some patronage involved at the local level. The number of *Mustahqin* has grown slowly despite the significant increase in the number of people below the poverty line. With only 1.5 million *Mustahqin*, it is clear that the program does not cover the majority of poor households. This obviously demonstrates problems of access and inadequate program coverage.

Also at issue is the interaction with private transfers. To the extent that *Zakat* is deducted at source, there is the possibility that private transfers may be correspondingly reduced. This has been the basis for the argument that *Zakat* payments should be largely voluntary. We need more research to determine if the overall payment of *Zakat* is enhanced or left largely unchanged by deductions at source.

Bait-ul-Maal: Its limited coverage is one of its biggest problems. With only 240,000 people receiving the *atta* subsidy, it is clear that subventions from the *Bait-ul-Maal* make only a minor dent on poverty in Pakistan. Unlike the

Zakat, the *Bait-ul-Maal* no longer has any identifiable source of income. Its exclusive reliance now on budgetary support makes it particularly vulnerable to changing fiscal conditions, as has been demonstrated by the steep fall in government contributions in 1998-99.

Transparency also appears to be a serious problem in terms of the level of discretion which exists with high-level functionaries in allocating funds from the *Bait-ul-Maal*. The recent arrest of a former Chief Minister of Punjab on allegations of embezzlement of funds from the *Bait-ul-Maal* certainly raises the question of the effective use of taxpayers' money made available to this scheme.

Ushr: As highlighted above, this tax is essentially moribund, and collections have dropped to a negligible level. The issue is whether it should be revived and its collection improved through a stronger tax administration (by involvement of provincial BORs) or should the focus be on development instead of the agricultural income tax (AIT), as emphasized by the IMF.

If the objective is to develop social safety nets in rural areas, where poverty is high and likely to increase, then development of *Ushr* is clearly a better strategy. The design of this tax is good and, like *Zakat*, it has the potential to be a significant redistributive mechanism. The problem with the AIT is that its revenues accrue to the provincial consolidated fund and may be used for purposes other than for alleviating poverty.

Wheat subsidy: The wheat subsidy has the merit of being a generalized intervention, with no problem of program coverage (except perhaps for rural households living in inaccessible areas). However, there is potentially a high degree of wastage because of target inefficiency. The first issue is how much of the subsidy actually gets through to consumers in the form of lower prices and how much is pre-empted by mill owners, middlemen and corrupt officials. Research in Pakistan demonstrates that the wheat subsidy contributes very little to bringing down prices. Wheat prices vary at different locations and are determined primarily by availability, which is regulated and can be manipulated.

The second issue is that the subsidized wheat prices could affect the domestic producers by lowering farm incomes, particular those of small farmers.

The third issue is that even if some of the benefits of the subsidy trickle through to consumers then, since it is a general, population-wide subsidy (in the absence of rationing), a major share of the benefit may be pre-empted by upper-income households. Based on the consumption patterns of *atta* in the country, it is estimated that almost 85% of the consumption is by households in the upper four quintiles. This is a measure of the potential extent of program leakage.

Therefore, the overall question of withdrawal or retention of the wheat subsidy is a complex one. However, it seems to have been resolved by the recent agreement with the IMF whereby it is proposed that the subsidy be withdrawn in two phases. Governments, both federal and provincial, could take this opportunity to maintain their financial commitment to social safety nets. They could ensure that the Rs. 5 billion resulting from the phasing out of the wheat subsidy be targeted specifically to improve the lot of poor people in this country.

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EOBI: The only form of social security available to low paid workers is the EOBI. Targeting efficiency has been enhanced by limiting the coverage to workers with wages below Rs. 3000 per month, but program coverage is low. The 1.2 million registered workers make up only 20% of the number of employees in urban areas. This is due partly to the preponderance of small establishments (employing fewer than ten people) in the country. It is also probably the result of large-scale evasion by employers (although, theoretically a worker can prevent this by registering directly). This scheme could be extended without its financial viability being affected because of the rapidly expanding labour force and large proportion of young workers. It is not surprising that EOBI has built up a fund of Rs. 27 billion, although part of this build-up has been financed by annual government contributions from the budget.

The pension scheme also has some negative impacts. First, all contributions are by employers (although it is not clear if this is reflected in a lower wage rate). These contributions are ad valorem in character and add to the cost of hiring labour (to the extent that they do not lower wages) and have an anti-employment bias. In this sense, they go against the interests of the very group that they are designed to protect. Second, informal social security at the joint household level is widely prevalent in Pakistan. Pension payments from EOBI may, therefore, at least partially substitute for private transfers among members of a household (for example, a working son supporting a retired father).

The EOBI scheme has the scope for being developed as a major social safety net for low-income, retired or invalid workers. This will necessitate changes in the system of contributions, expansion of coverage and the introduction of positive incentive effects (in the form of higher private savings). Employee contributions could be encouraged with the guarantee of a matching amount by government.

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As the HBFC extends house building loans to city residents only, villagers' mud houses don't have any utilities.

Self-employment credit scheme: Although this scheme has a high degree of political patronage, in its present form it does not score high on a number of criteria. The present collateral and documentation requirements tend to exclude people living below the poverty line who do not have access directly to the commercial banks or other financial institutions such as SBFC. Therefore, there is the danger that the scheme will acquire a middle class, urban bias and be subject to political influence in the granting of loans. Also, banks already staggering under substantially non-performing loan portfolios and low profitability may be reluctant to expand credit in an area where overhead costs and likelihood of default are high. However, bank credit in Pakistan has been largely pre-empted by large borrowers, and there is a strong case on both efficiency and equity grounds for diverting more credit to small and medium-sized enterprizes.

The key test will be whether the interest rate on such loans remains market-based or is driven down to concessional levels under political pressures since the scheme is being seen as, more or less, central to economic revival in the country. It is being considered as a way of solving the growing unemployment problem (especially of educated youth) with its concomitant implications on law and order.

Credit must be channeled under this scheme to areas with high-income and employment multipliers. It would probably benefit from replicating the Habib Bank-NRSP venture in the area of micro credit which is promising to be an important anti-poverty intervention.

To become effective in improving shelter conditions for poor people in this country, HBFC needs substantial revamping

Housing finance (HBFC): This scheme fails to meet most of the evaluation criteria. All the symptoms of bad financial intermediation are present in HBFC. These include a distorted pattern of lending (bias towards large cities and for medium-sized loans), high overhead costs, low rates of recovery and the resulting inability to compete in the capital market for funds. To become effective in improving shelter conditions for

Will the family elders bring home enough to feed this expectant brood?

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- *incentive effects:* positive or negative. Anti-poverty interventions can change behaviour. For example, an unemployment benefit may reduce the motivation for job search. On the other hand, school food programs can raise school participation and reduce dropout rates;
- *extent of self financing/progressive financing:* programs which raise funding through well-defined and earmarked sources are likely to be more sustainable fiscally. A program is more secure if it is supported by wealthier households rather than general budgetary sources which are vulnerable to inflation and cut-backs when the fiscal position worsens;
- *displacement of private transfers:* a transfer should not either partially or wholly displace corresponding transfers by households or private sector entities. An example is the *Zakat* whereby compulsory deductions may lead to a more or less matching reduction in private charitable contributions;
- *impact on development:* programs can contribute either directly or indirectly to development. A public works program, for example, could lead to the creation of improved irrigation or farm-to-market roads and thereby contribute to higher agricultural productivity.

TABLE 5.2

EVALUATION* OF SOCIAL SAFETY NETS IN PAKISTAN
Government Programs

Criteria	*Zakat*	*Bait-ul-Mal*	*Ushr*	Wheat Subsidy	Power Subsidy	Employees Old Age Benefits Scheme	Self Employment Credit	Housing Finance (HBFC)
Targeting efficiency	M	M	M	L	L	H	L	M
Program coverage	M	L	L	H	M	L	L	L
Ease of access	M	M	M	H	H	L	L	L
Adequacy of support	H	H	L	H	H	M	H	M
Income equivalence of transfer	H	H	H	M	L	H	H	M
Share of benefits in program expenditure	H	H	H	L	H	H	L	L
Incentive effects	M	M	L	M	M	L	M	M
Extent of self-financing/ progressive financing	H	L	M	L	L	M	L	H
Displacement of private transfers (or expenditure)	L	M	M	M	M	M	H	H
Impact on development	L	L	L	L	L	L	M	M
SUMMARY								
High Scores	4	3	2	3	3	3	3	2
Medium Scores	4	4	4	3	3	3	2	5
Low Scores	2	3	4	4	4	4	5	3

*A rating of H (high) has a score of 4, rating of M (medium) has a score of 2 and L (low) has a zero score.

Tables 5.2 and **5.3** illustrate the application of these criteria to different social safety nets in Pakistan. Some key findings are discussed below.

EVALUATION OF SOCIAL SAFETY NETS

Zakat performs well on a number of criteria. The support provided in the form of subsistence allowance appears to be adequate. According to the World Bank (1995) this allowance is about three times the average income gap of people living in poverty, but a proper conclusion requires knowledge of the number of dependents. Since the allowance is in cash, there is full income equivalence of the transfer. Administration costs as a whole are low, primarily because of voluntary inputs provided by members of the local committees. One of the strongest points in favour of *Zakat* is its access to an earmarked source of revenue. (However, contributions are likely to be adversely affected by the recent Supreme Court judgement on compulsory deductions). Its reliance on a specific source not only ensures sustainability, but the nature of the tax (on financial assets) is such that the burden falls mostly on upper-income households. Therefore, the *Zakat* has the potential of playing a strong re-distributive role.

Problems with the *Zakat* include its degree of targeting efficiency. There is conflicting evidence on this. According to the World Bank

TABLE 5.3

EVALUATION OF SOCIAL SAFETY NETS IN PAKISTAN

NGO Programs

Criteria	Food for lactating mothers and school girls (WFP)	Food for Work (WFP)	Micro-credit Scheme of NRSP	Pakistan Poverty Alleviation Fund
Targeting efficiency	H	H	H	M
Program coverage	L	L	L	L
Ease of access	H	H	M	M
Adequacy of Support	M	M	H	H
Income equivalence of transfer	H	H	H	H
Share of benefits in program expenditure	L	H	H	M
Incentive effects	H	M	H	M
Extent of self-financing/ progressive financing	L	L	L	L
Displacement of private transfers (or expenditure)	M	H	H	H
Impact on development	M	H	H	H
SUMMARY				
High Scores	4	6	7	4
Medium Scores	3	2	1	4
Low Scores	3	2	2	2

* A rating of H (high) has a score of 4, rating of M (medium) has a score of 2 and L (low) has a zero score.

(1995) and Jehle (1995), about half the benefits went to the lowest quintile of households in 1991. Therefore, the other half went to households which cannot be considered poor. However, Naseem Shah Shirazi (1996) uses the 1991 Household Income and Expenditure Survey (HIES) data to show that 94% of *Zakat* (official and private) was received by families in the lowest quintile of the income distribution.

Access to the benefit is another problem. A number of stages are involved in defining a *Mustahqin*, and there is inevitably some patronage involved at the local level. The number of *Mustahqin* has grown slowly despite the significant increase in the number of people below the poverty line. With only 1.5 million *Mustahqin*, it is clear that the program does not cover the majority of poor households. This obviously demonstrates problems of access and inadequate program coverage.

Also at issue is the interaction with private transfers. To the extent that *Zakat* is deducted at source, there is the possibility that private transfers may be correspondingly reduced. This has been the basis for the argument that *Zakat* payments should be largely voluntary. We need more research to determine if the overall payment of *Zakat* is enhanced or left largely unchanged by deductions at source.

Bait-ul-Maal: Its limited coverage is one of its biggest problems. With only 240,000 people receiving the *atta* subsidy, it is clear that subventions from the *Bait-ul-Maal* make only a minor dent on poverty in Pakistan. Unlike the

Zakat, the *Bait-ul-Maal* no longer has any identifiable source of income. Its exclusive reliance now on budgetary support makes it particularly vulnerable to changing fiscal conditions, as has been demonstrated by the steep fall in government contributions in 1998-99.

Transparency also appears to be a serious problem in terms of the level of discretion which exists with high-level functionaries in allocating funds from the *Bait-ul-Maal*. The recent arrest of a former Chief Minister of Punjab on allegations of embezzlement of funds from the *Bait-ul-Maal* certainly raises the question of the effective use of taxpayers' money made available to this scheme.

Ushr: As highlighted above, this tax is essentially moribund, and collections have dropped to a negligible level. The issue is whether it should be revived and its collection improved through a stronger tax administration (by involvement of provincial BORs) or should the focus be on development instead of the agricultural income tax (AIT), as emphasized by the IMF.

If the objective is to develop social safety nets in rural areas, where poverty is high and likely to increase, then development of *Ushr* is clearly a better strategy. The design of this tax is good and, like *Zakat*, it has the potential to be a significant redistributive mechanism. The problem with the AIT is that its revenues accrue to the provincial consolidated fund and may be used for purposes other than for alleviating poverty.

Wheat subsidy: The wheat subsidy has the merit of being a generalized intervention, with no problem of program coverage (except perhaps for rural households living in inaccessible areas). However, there is potentially a high degree of wastage because of target inefficiency. The first issue is how much of the subsidy actually gets through to consumers in the form of lower prices and how much is pre-empted by mill owners, middlemen and corrupt officials. Research in Pakistan demonstrates that the wheat subsidy contributes very little to bringing down prices. Wheat prices vary at different locations and are determined primarily by availability, which is regulated and can be manipulated.

The second issue is that the subsidized wheat prices could affect the domestic producers by lowering farm incomes, particular those of small farmers.

The third issue is that even if some of the benefits of the subsidy trickle through to consumers then, since it is a general, population-wide subsidy (in the absence of rationing), a major share of the benefit may be pre-empted by upper-income households. Based on the consumption patterns of *atta* in the country, it is estimated that almost 85% of the consumption is by households in the upper four quintiles. This is a measure of the potential extent of program leakage.

Therefore, the overall question of withdrawal or retention of the wheat subsidy is a complex one. However, it seems to have been resolved by the recent agreement with the IMF whereby it is proposed that the subsidy be withdrawn in two phases. Governments, both federal and provincial, could take this opportunity to maintain their financial commitment to social safety nets. They could ensure that the Rs. 5 billion resulting from the phasing out of the wheat subsidy be targeted specifically to improve the lot of poor people in this country.

Research in Pakistan demonstrates that the wheat subsidy contributes very little to bringing down prices.

Kiln workers who toil long hours and earn barely subsistence wages are not covered by EOBI.

The only form of social security available to low paid workers is the EOBI.

EOBI: The only form of social security available to low paid workers is the EOBI. Targeting efficiency has been enhanced by limiting the coverage to workers with wages below Rs. 3000 per month, but program coverage is low. The 1.2 million registered workers make up only 20% of the number of employees in urban areas. This is due partly to the preponderance of small establishments (employing fewer than ten people) in the country. It is also probably the result of large-scale evasion by employers (although, theoretically a worker can prevent this by registering directly). This scheme could be extended without its financial viability being affected because of the rapidly expanding labour force and large proportion of young workers. It is not surprising that EOBI has built up a fund of Rs. 27 billion, although part of this build-up has been financed by annual government contributions from the budget.

The pension scheme also has some negative impacts. First, all contributions are by employers (although it is not clear if this is reflected in a lower wage rate). These contributions are ad valorem in character and add to the cost of hiring labour (to the extent that they do not lower wages) and have an anti-employment bias. In this sense, they go against the interests of the very group that they are designed to protect. Second, informal social security at the joint household level is widely prevalent in Pakistan. Pension payments from EOBI may, therefore, at least partially substitute for private transfers among members of a household (for example, a working son supporting a retired father).

The EOBI scheme has the scope for being developed as a major social safety net for low-income, retired or invalid workers. This will necessitate changes in the system of contributions, expansion of coverage and the introduction of positive incentive effects (in the form of higher private savings). Employee contributions could be encouraged with the guarantee of a matching amount by government.

The EOBI scheme has the scope for being developed as a major social safety net for low-income, retired or invalid workers.

As the HBFC extends house building loans to city residents only, villagers' mud houses don't have any utilities.

Self-employment credit scheme: Although this scheme has a high degree of political patronage, in its present form it does not score high on a number of criteria. The present collateral and documentation requirements tend to exclude people living below the poverty line who do not have access directly to the commercial banks or other financial institutions such as SBFC. Therefore, there is the danger that the scheme will acquire a middle class, urban bias and be subject to political influence in the granting of loans. Also, banks already staggering under substantially non-performing loan portfolios and low profitability may be reluctant to expand credit in an area where overhead costs and likelihood of default are high. However, bank credit in Pakistan has been largely pre-empted by large borrowers, and there is a strong case on both efficiency and equity grounds for diverting more credit to small and medium-sized enterprizes.

The key test will be whether the interest rate on such loans remains market-based or is driven down to concessional levels under political pressures since the scheme is being seen as, more or less, central to economic revival in the country. It is being considered as a way of solving the growing unemployment problem (especially of educated youth) with its concomitant implications on law and order.

Credit must be channeled under this scheme to areas with high-income and employment multipliers. It would probably benefit from replicating the Habib Bank-NRSP venture in the area of micro credit which is promising to be an important anti-poverty intervention.

To become effective in improving shelter conditions for poor people in this country, HBFC needs substantial revamping

Housing finance (HBFC): This scheme fails to meet most of the evaluation criteria. All the symptoms of bad financial intermediation are present in HBFC. These include a distorted pattern of lending (bias towards large cities and for medium-sized loans), high overhead costs, low rates of recovery and the resulting inability to compete in the capital market for funds. To become effective in improving shelter conditions for

Carrying food for her father working in the fields.

poor people in this country, HBFC needs substantial revamping.

World Food Program: The various innovative food programs for mothers, school girls and for work combine some of the best features of social safety nets. They are likely to contribute not only in the alleviation of poverty but also in achieving important social development objectives. The food for work program scores high in as many as six out of the 10 criteria. Targeting has been ensured by keeping the wage rate sufficiently low so that only poor people in rural areas go into the program. Benefits are enhanced since payment is made in the form of food stamps rather than food items themselves, thus avoiding high transportation costs, especially in remote areas. Not only does the program have an impact on development, its focus on environmental projects promotes the sustainability of economic activity in the project areas. The food for work program is, however, small in coverage and restricted essentially to the northern part of the country.

The program for lactating mothers and school girls is also well designed and has demonstrated some success already. In this case also, the process of self-selection has ensured targeting. It is not clear, however, if the provision of edible oil is the best form of intervention because of serious problems arising from interruptions in supplies. An alternative is food stamps which would reduce program costs (through reduction in transportation costs) and provide greater flexibility in household budgeting.

NRSP: The NRSP has developed an effective procedure for disbursement of credit, which has enabled high recovery of loans from low-income communities at market interest rates. It has also promoted the overall process of community mobilization and higher savings. The issue here is whether the field staff, especially the social organizers, have the capacity to expand the program. With Habib Bank funding available, NRSP's operations can be widened if staff capacity is increased and

The various innovative food programs for mothers, school girls and for work combine some of the best features of social safety nets.

communities mobilized. Given the success of this scheme, other banks may want to replicate it.

RECOMMENDATIONS

An appraisal of social safety nets in Pakistan demonstrates the low priority which government has afforded to direct interventions for poverty alleviation. Most schemes have weak institutional structures. Their funding is uncertain, their targeting inefficient, and their coverage very limited (about 5 million out of the 32 million population below the poverty line). This at least partly explains the growing poverty in the country.

The income value of transfers is less than 1% of the GDP, a percentage that is likely to shrink further as budgetary contributions for subsidies wither in the face of fiscal constraints and in view of the recent Supreme Court judgement on *Zakat*. This is happening at a time when the country faces big increases in unemployment and poverty due to the prevailing economic conditions and the likely consequences of the process of structural adjustment (see chapter 3).

The following recommendations are based on these considerations as well as a study of innovative social safety programs in other countries **(see box 5F)**.

BOX 5F

WHAT OTHER COUNTRIES ARE DOING

- Tunisia greatly improved the targeting efficiency of a universal price subsidy by subsidizing only those foods largely consumed by poor people.
- In Bangladesh, the ration program was effectively restricted to those in need by tying distribution to attendance in government primary school. This also raised the primary school enrollment rates.
- Food stamp targeting was improved in Honduras and Jamaica by linking stamp delivery to attendance at health clinics.
- India operates a massive nationwide *Jawahar Rojgar Yojuna* (JRY) public works program which reached 1 billion workdays by 1995. The program is geographically targeted to the backward districts. It operates mainly in the agricultural off-season, and the wage rate corresponds to the minimum wage. The program has primarily sought to create minor irrigation infrastructure on small farms.
- The Grameen Bank, the Bangladesh Rural Advancement Committee (BRAC) and the Mysore Resettlement and Development Agency (MYRADA) in India have been able to extend credit to poor people because these programs eliminated the requirement of collateral, advanced small loans and avoided delays. Grameen Bank relies on group lending and peer monitoring to ensure repayment.
- The Mahrashtra Employment Guarantee Scheme (MEGS) in India provides, on request, employment at a stipulated wage, within 15 days, and no more than five kilometres away from the participants' home villages. An unemployment allowance is paid when this is not possible. The scheme, which guarantees employment year-round, has significantly reduced the rural unemployment rate.

With rising rural poverty, a rural works program during off-peak seasons is needed.

- The government must make a clear-cut commitment to the alleviation of poverty by announcing that henceforth it will allocate from budgetary sources at least 0.5% of the GDP (currently Rs. 15 billion) in the form of transfers in cash or in kind. Another transfer of 0.5% of the GDP should be made annually from the banking system as micro credit for poor people.
- Institutional arrangements must be strengthened for identification of eligible persons in schemes such as *Zakat* and *Bait-ul-Maal* while attempting at the same time to make the procedures transparent and simple. The *Bait-ul-Maal*, in particular, needs a strong financial management and auditing system before it can develop as a major social safety net.
- With rising rural poverty, social safety nets must be increasingly oriented towards the rural areas. It will be necessary, in particular, to provide employment opportunities to the rural work force. A major, nationwide rural works program should be set up to provide employment during the off-peak seasons in schemes relating to construction of farm-to-market roads, desilting and lining of irrigation canals, etc. Sustained funding can be ensured by earmarking the revenues from the AIT for this purpose. The program could be run through the provincial LGRDDs with active involvement of district and union councils. With AIT revenues of about Rs. 2 billion, supplemented by government development allocation of Rs. 8 billion or so, and a wage rate of Rs. 40 per day (paid in cash or food stamps), the program could generate employment of almost 150 million days. (About 40% of costs would cover materials and the rest would cover labour.) The linkage between payment of AIT and matching allocations by government, with benefits through local development of infrastructure, should improve the prospects for collecting higher revenues from the tax.
- With the prospect of higher *atta* prices due to the impending unification of the exchange rate (as wheat imports are currently on the lower

What happens when food prices rise further? Even now, the poor scrounge for food in the garbage heap.

official exchange rate), and the likelihood of a bigger wheat deficit next year, it is absolutely essential that proper arrangements be put in place. These could include the development of a strategic wheat reserve (of up to two million tons), and the involvement of the private sector in wheat importing. The withdrawal of the wheat subsidy, especially the federal part, must be deferred. In addition, direct targeting mechanisms must be strengthened, possibly replicating the innovative World Food Program of food stamps for lactating mothers and school girls in the rural areas and urban *Katchi Abadis*.

Receipt of benefits could be linked to regular attendance, and food stamps of about Rs. 100 per month on average be given to each beneficiary. A mechanism would, of course, be needed to ensure that there is no overlap with receipt of *Zakat* payments. The relevant provincial line departments (education and health) could run the scheme and the operations could be independently monitored. If developed properly, this scheme has the potential of matching the *Zakat* scheme in terms of coverage.

- The banks may prefer to replicate the Habib Bank–NRSP experiment in the area of micro credit rather than enhance the allocations for the Self-Employment Scheme. The former has already demonstrated success in keeping overhead costs and default rates low. The PPAF should be activated quickly and concentrate, in particular, on enhancing the capacity of partner organizations to channel micro credit through group-based lending. With support from commercial banks and PPAF, NRSP could take the lead in expanding the micro-credit program nationally and emerge as the equivalent of the Grameen Bank in Pakistan.
- The EOBI is a potentially useful mechanism for providing social security to low-income workers. But, like other programs in the country, its coverage remains very limited and access is difficult. The scheme could

Deprivation and the absence of opportunity can drive people to launch strikes, rioting and mayhem.

be simplified by introducing a flat rate contribution per worker by employers and by ensuring that there is a matching contribution by government. In addition, the scheme should be opened up to the self-employed and employers in establishments with fewer than 10 workers. Receipts from the Worker's Welfare Fund, which currently accrue to the federal consolidated fund, could be earmarked as part of government's matching contribution to EOBI.

At this time there is a desperate need for social safety nets in Pakistan. The present arrangements are inadequate. Both NGOs and governments can be jointly mobilized to work towards poverty alleviation if there is a general recognition at all levels that this task must get the highest priority for preserving political and social stability in the country. But there are many challenges for institutional development in this area in creating effective instruments focused on the poor people of this country.