BRIEF ON ANNUAL REVIEW OF SOCIAL POLICY AND DEVELOPMENT CENTRE (SPDC) FOR 2000 ON *TOWARDS POVERTY REDUCTION*[?]

By
Hafiz A. Pasha

Today, 46 million people of Pakistan are poor and one in every three families is unable to meet its basic requirements of nutrition and other needs. During the decade of the 90s the number of poor has increased by as much as 25 million. If present trends continue then we expect that within the next three years the number of poor will increase by another 14 million and approach 60 million, almost 40 per cent of the population. Clearly poverty has emerged as the principal problem requiring urgent attention if a large-scale social breakdown is to be averted, with its concomitant implications for law and order.

The seriousness of the problem is highlighted by, first, the presence of pockets of extreme poverty, with over half the population being poor, in rural Sindh and Balochistan, and, second, by the fact that much of the poverty is chronic, with almost 70 per cent of the country's poor households headed by someone who is either illiterate, elderly or female.

The people of Pakistan have made valiant efforts to fight against poverty, through an informal household or community-based welfare and support system of transfers to the poor. Such transfers are indeed sizeable at over Rs 100 billion annually, of which almost two thirds reach poor families. They are over five times the magnitude of public transfers to the poor. Almost one and a half million households are able to rise out of poverty because of support from other households.

The informal sector of the economy has also played a major poverty-mitigating role. It has acted as a residual employer especially of unskilled and illiterate workers displaced primarily from

[?] *Presented at the Launch of the Annual Review for 2000 at the Marriott Hotel, Karachi, on the 22nd of December, 2000.*

agriculture. Today, the informal economy is almost half the national economy. But as the growth momentum of the formal economy has faltered, the process of income generation in the informal economy has also slowed down. This explains the rapid increase in urban poverty in recent years. Therefore, despite people's attempts and changes in the economic structure, poverty is spreading fast in Pakistan. At the macro level this has been caused by the stagnation in real incomes, rise in unemployment, higher food prices, fall in home remittances and underinvestment in human capital.

Social safety nets have been unable to cope with rising poverty due to the unfavourable macro economic trends. Most of the existing schemes for poverty alleviation have weak institutional structures, funding is uncertain, their targeting inefficient and their coverage very limited. The government has announced a poverty alleviation program with primarily four components - a public works program, a food support program, improvements in *Zakat* and microfinance. The report highlights that this is not enough and much more needs to be done if the problem of growing poverty is to be tackled effectively and on a timely basis.

The Report presents a comprehensive poverty reduction strategy. SPDC fundamentally believes that a *three-pronged* poverty reduction strategy will have to be adopted, consisting of (1) increased *economic opportunities* for the poor (2) their *empowerment* and (3) access to *welfare* and support through development of appropriate social safety nets.

It is clear that if the increase in poverty is to be contained, economic opportunities for the poor will have to be improved dramatically. A strategy for economic revival will, therefore, have to be central to any national program for poverty alleviation. The key elements of the macro revival strategy will include enhancing rapidly the level of development expenditure (especially to remove the physical constraints to growth), cutting back on current expenditure, improving tax administration and broad-basing the tax system, preserving real exchange rate stability and low real interest rates.

The government seems to have moved away from its prime objective of achieving economic revival. While the recently approved IMF stand-by facility will alleviate the balance of payments problem in the short run, there is a real danger that in view of its heavy emphasis on macroeconomic stabilization it will stifle the process of economic revival and exacerbate the problem of poverty. Specifically, there are a number of conditionalities in the IMF program which could negatively impact on poverty, first, the program relies heavily on real exchange rate depreciation, which coupled with the withdrawal of subsidies and the automatic petroleum price adjustment mechanism, will lead to rapid increases in fuel and food prices, second, the proposed taxation (by GST) of agricultural inputs like fertilizer and pesticides could adversely impact on agricultural production and raise food prices, third, further trade liberalization, through reduction in maximum tariffs to 25 per cent in the next two years, will erode effective protection to a large number of industries and create labor displacement, fourth, sharp reduction in fiscal deficit required as a key target of the program will mean that in the event of significant revenue shortfalls, both development and social expenditures will be severely cut, and, fifth, rationalization of public enterprises and privatization could lead to more unemployment.

The fact that Pakistan was denied access to the IMF Poverty Reduction and Growth Facility means that we have been forced to defer the tackling of the problem of poverty and concentrate instead on reducing the fiscal and current account deficits in order to enhance our debt repayment capacity in the medium run.

The second key element of the poverty reduction strategy described in the report is *empowerment* of the poor. The report sees the process of empowerment as consisting of (1) increasing the poors' ownership of physical assets (land, property, livestock) in order to improve their prospects of being able to generate secure, sustainable and adequate livelihoods, (2) augmenting human capital endowments through improved access to education and health services, in order to give people the ability to get out of the poverty trap by better exploiting whatever economic opportunities are available, and (3) moving towards pro-poor governance through changes in the political system, state institutions and laws that promote decentralization and participation of the people, thereby enabling the voices of the poor to be heard in the forums of policy making.

Specifically, the report advocates land reform as a prime instrument for reducing rural inequality, reforms in the subordinate judiciary, enactment of pro-poor laws and equitable application of existing laws, civil service reform, strong anti-corruption measures, implementation of the process of devolution subject to adequate strengthening of local institutional capacity, safeguards against elite capture and adequate arrangements for fiscal decentralization.

The report observes that in an environment of resource limitations and changing priorities, expansion in the coverage of social services must increasingly come through higher efficiency and greater cost effectiveness. In addition, the federal government must target direct spending and transfers to the provinces to ensure that at least 20 percent (in relation to the present 12 percent) of public expenditure goes to social services. The report also highlights that the Social Action Program is in jeopardy and identifies badly needed institutional and policy reforms to save this program.

The third element of SPDC's poverty reduction strategy relates to welfare measures that primarily target the poor. These include economic reforms in the areas of public expenditure, taxation, and pricing policy, as well as the development of social safety nets. The latter should reach out primarily to the poorest of the poor, who are unable to avail of economic opportunities.

Public expenditure reform will require fundamental changes in expenditure priorities, away from military and administrative expenditures towards development and social expenditure. Today, defence expenditure in Pakistan is more than twice the total public expenditure on education. Similarly, subsidies on various services add up to Rs 145 billion, almost 5 per cent of the GDP. Only about one third of these subsidies are for merit goods (i.e. primary education and health), the rest go primarily to economic services (e.g. irrigation) and higher education, which largely benefit upper income households. The policy must be to enhance charges for services that benefit such households and use the revenue generated for transfer payments to the poor.

Tax reforms must attempt to shift the burden from the poor to the rich while simultaneously raising more resources primarily to finance the poverty alleviation program. Two areas which will need to be focused on are tax evasion and elimination of tax exemptions and concessions. The report estimates the size of the black economy as 25 per cent of the GDP, implying a revenue loss of Rs 105 billion, while the revenues forgone due to exemptions / concessions, which primarily benefit the rich, aggregate to Rs 120 billion. Elimination of tax evasion will require measures for documentation of the economy, which go beyond the tax survey, alongwith complete restructuring of the CBR and enforcement of tax laws. Simultaneously, the tax code will have to be simplified and most of the SROs eliminated.

Commenting on the government's poverty alleviation program, the report says that the Integrated Small Public Works Program (ISPWP) has a number of problems including the lack of ability of provincial governments to finance this program and inadequate institutional arrangements to ensure local involvement, proper targeting, minimisation of leakages and resort to labor-intensive techniques. The Food Support Program also appears to beset with potential problems including the danger of serious mistargeting, limited coverage and lack of an earmarked source of revenue to finance the costs of the program. As far as microfinance is concerned, the *Khushali* Bank has had an auspicious start with the government providing extraordinary support and incentives. This augers well for the future of microcredit to the poor in the country.

Overall, despite the greater emphasis now on anti-poverty interventions, the existing social safety nets are likely to have only a small impact on the incidence of poverty in the short run. The total value of public transfers is estimated at Rs 20 billion, representing a paltry 0.6 per cent of the GDP. A maximum of three million households could be reached with the level of support being inadequate to lift a large proportion of these households out of poverty.

The government will not only have to strengthen the existing interventions but other mechanisms will also have to be put in place. Two sections of the population, in particular, will need additional support - the elderly and retired low income workers and households that suffer loss of assets and income earning opportunities due to natural calamities (like the draught). Following institutional improvements, the public works program will have to be extended to more effectively cover urban slums and *katchi abadis.*

The report concludes by saying that Pakistan is perilously placed. There is a likelihood of rapid increase in poverty in coming years, which could lead to a systemic breakdown and shake the foundations of the state. Government, donors civil society and people at large will all have to work together with great determination and commitment to avert this outcome. We hope that this report will heighten general public awareness, promote debate and improve policy effectiveness in the area of poverty reduction.

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